During the course of our junior job market season—a process involving whittling down roughly 500 applications, to about 20 on campus interviews, to actually hiring 2-3 faculty—the Dean of Faculty and I had a conversation about the very stiff competition we were facing from business schools this year. In the end, out of the 10 offers we made 7 were turned down by people who had decided to join business schools instead. And many of these were not students in traditional business areas like finance and industrial organization but in fields like economic history, development, and macroeconomics.

A key factor in these decisions was compensation—with the large revenues produced by tuition paying MBAs, business schools can afford to offer substantially better financial packages and more time for research than can most economics departments. While the opportunity to teach Brown’s terrific undergraduate students and to teach PhD students works in our favor, these factors are more salient for senior faculty than they are for rookies. Of course some of the concerns the dean and I discussed were parochial—entry salaries in economics have continued to grow at 5% per year throughout the recession and this competition from business schools puts additional pressure on the dean’s budget during a difficult financial period for the University. But we also had concerns for the discipline more broadly: if many of the best young faculty are teaching business students and thus not directly involved in training and supervising PhDs in economics, will this somehow diminish the quality of the next generation of graduate students?

It might surprise many of our alumni to see how much time we invest in our graduate program. After all, Brown is probably best known for the high quality of our undergraduate program, and with undergraduate enrollments in economics hovering at around 4100*—up from 3271 in 2000—there is surely enough for us to do in keeping the undergraduate program afloat. And graduate education, by comparison, looks very resource intensive. Graduate classes, which tend to be quite specialized, average about 7 students per class while our average upper level undergraduate class has almost 10 times that number. And of course we spend countless hours with our graduate students outside of classroom—listening to their presentations, evaluating them, and trying to steer them in the right direction. But in the end, the quality of our graduate program is one of the key metrics by which we are evaluated by our peers and, as noted, it is one of the key

*Each enrollment represents one student taking one semester-long course in economics. Thus, individual students can account for one, two, or several enrollments in a given year.
Itay Fainmesser joins our department as an assistant professor having received his PhD from Harvard University. Itay’s research is in the field of microeconomic theory, focusing on the study of social networks and market design.

In his graduate research at Harvard, Itay studied the phenomenon of early hiring in entry-level labor markets (e.g. the market for medical interns or the market for judicial clerks) in the presence of social networks that connect firms and the mentors of the workers when the workers are still in school. The timing of hiring raised interest in the economic literature after several labor markets have unraveled to very early dates of hiring. For example, law clerks were hired as early as their first semester in law school, and NBA players have been drafted right out of high school.

Many of these markets have some features in common. While in school, information on workers’ quality is revealed over time. Early in their training, workers’ quality is known to their mentors, who observe them daily. However, workers have not yet proven themselves in a way that can be observed by firms. If firms want to sign early contracts with workers, mentors face a dilemma: they want their mentees to get a good job, but also want to maintain their reputation for providing accurate recommendations. Itay considers a model in which firms and mentors that never mislead them are connected. After graduation, workers have already proven themselves enough for firms to know if they are good or not. Itay characterizes the effects of changes to the network structure on the unraveling of the market towards early hiring. Moreover, he shows that an efficient design of the matching procedure between firms and workers after graduation can prevent this process of unraveling.

This project highlights one aspect of the importance of social networks, but also opens some new questions. For example, when can firms trust the recommendations of mentors? This question requires a careful analysis of the ability to sustain cooperation and trust in networked markets. More broadly, understanding the ability of buyers and sellers to maintain relationships of trust and cooperation through repeated interactions is crucial for the understanding of patterns of trade in markets that are missing the appropriate institutions. Such markets are especially common in developing countries in which it is often difficult to enforce formal contracts. Itay studies this theoretical question further in his dissertation.

Continuing with the labor market example, consider a mentor that has a low quality mentee and must decide whether to recommend her as a high quality worker to a firm. If there was only one mentor (with one mentee), one could apply standard game theoretic models and it is well known that if a given firm hires based on the mentor’s recommendations often, and if the mentor knows no other firm that can hire his mentees, it is sustainable that the mentor reveals the quality of the worker truthfully to the firm. This is true because the future placement record of the mentor depends on the firm continuing to hire his mentees. However, in a world with many firms and workers, truth-telling is hard to sustain.

Itay develops a game theoretic model of repeated games in which truth-telling and trust relationships are links that connect firms and mentors in a network, and characterizes networks that better incentivize mentors to truthfully reveal their mentees qualities. Network attributes that provide high incentives include: (1) moderate competition – a fine balance between the number of links that firms and workers have; (2) sparseness – each firm or mentor has only a few links; and (3) segregation – the network is a collection of smaller sub-networks such that in each sub-network all of the firms are connected to all of the mentors. Such networks are not efficient because they allow for situations in which several positions are not filled while some high quality workers are unemployed.

In his current work at Brown, Itay continues to study the broad question of trust and cooperation in networked markets, and explores what social institutions restore efficiency. One social institution that restores efficiency in large markets is a reputation network of credible Word-Of-Mouth via which clients share information on the quality of service (or accuracy of information) provided by different suppliers.
Justine Hastings joins Brown's Department of Economics beginning in the Fall 2010 semester as a tenured Associate Professor of Economics. Hastings comes to Brown from Yale University where she taught from 2003 to the present. She earned her PhD at the University of California, Berkeley in 2001, and before moving to Yale, she taught at Dartmouth College. Hastings' research lies at the boundary between industrial and public economics. In past work, she has examined consumer behavior and how it interacts with firm strategy and regulation to shape market outcomes in private and publicly funded markets. Her research topics have included: how parents choose schools and the ramifications for public school choice, how workers make retirement investments and the implications for social security privatization, the impact of income shocks on consumption, and the importance of information and decision making costs among low-income households. Her research employs diverse empirical techniques from field experiments to structural estimation. She has received grants from the National Institutes of Health, the Social Security Administration, the Department of Education, and the National Science Foundation. At Brown, she will teach industrial organization and public economics at both the graduate and undergraduate levels.

Noted economist Eytan Sheshinski will teach at Brown during the three fall semesters beginning in the 2010-11 academic year. During his first semester at Brown, he will teach an undergraduate course on social security reform and a graduate course on public finance. Sheshinski comes to Brown with a reputation for terrific teaching.

Sheshinski is the Sir Isaac Wolfson Professor of Public Finance at the Hebrew University in Jerusalem, Israel. He received his Ph.D. from MIT in 1967, and has taught at Harvard, Stanford, and MIT, among other schools. Since 1997, he has taught one semester each year at Princeton where he directed the Workshop on Privatization and Regulatory Reform. Sheshinski's research includes contributions to the theory of technical progress and economic growth, the theory of income taxation and public goods, and the theory of firms’ behaviors in the presence of inflation and adjustment costs. In recent years his research has focused on social insurance and markets for annuities and on behavioral public economics.

Unusual among economics scholars, Sheshinski has also been active in the business world, serving as Chairman of the Board of Koor Industries, Koor Capital Markets, and Tadiran Ltd., in Israel, and as a board member of a Discount Bank Israel and Psagot-Ofek Investment House.
Anja Sautmann will join the Brown Economics department as an assistant professor this fall. She holds an undergraduate degree from the University of Munich, Germany, and will complete her PhD in Economics at New York University in Summer 2010. Anja works on a range of topics in applied microeconomic theory, with a focus on development economics and experimental economics. Her experimental work, funded by an NSF grant, explores how employers vary wages and incentives depending on the level of “self-confidence” of each worker – that is, the extent to which the employee over- or underestimates his or her own productivity. An example for a wage scheme that takes advantage of worker overconfidence is a high performance bonus combined with a low base wage. Overconfident employees will not only work harder, but also be content with a lower average salary than more levelheaded workers, because they believe the chance of a bonus to be higher than it actually is. The results of this work suggest an explanation for some of the gender differences in labor market outcomes, because men tend to be more overconfident than women. For instance, overconfidence may explain why men are more strongly drawn to high-powered incentive schemes that rely on large performance bonuses.

Anja’s most recent research is concerned with the marriage “market” in India. In particular, it studies the question why dowries - marriage payments from the wife’s to the husband’s family – increased so much between the 1920s and 1970s. Anja uses a search theoretic model of marriage to show that the dowry increase can be explained as a consequence of the surge in population growth that occurred in the same period. Anja’s future research will focus on the application of microeconomic theory, in particular in the areas of matching, search and incentives, to topics in development economics and related areas. She is for example interested in age patterns at marriage, and the forces behind the asymmetry of the dowry marriage market (in which women leave the parents’ household, while men stay and inherit the family wealth) and its transition into a modern, more symmetric, system of marriage and bequest. Anja will be an affiliate of the Population Studies and Training Center at Brown.

Marriage age patterns in India. Most women are younger than their husbands, with an average age difference of 4.9 years. Even if the first marriage ceremony is performed at a very young age, cohabitation usually begins only after puberty (source: National Family Health Survey 2005-06).
Influencing Voters: Some Recent Work in Political Economy

By Brian Knight

In the past few years, my research has focused on the issue of voter uncertainty and the acquisition of information during elections. It is well known that voters are uncertain as to which candidate to support when going to the polling booth and may thus attempt to gather information regarding candidates from better informed sources. But exactly how do voters gather this information? And from which sources? Are voters rational in the sense of not placing undue weight on biased or overtly partisan sources of information? Does this learning on the part of uninformed voters increase the political power of these better informed sources? While this research topic has traditionally been in the domain of political science, economists have recently been using tools developed in economic theory and econometrics in order to investigate these questions, and this field of inquiry has become an active area within the broader field of “political economy.”

My first paper in this research agenda is titled “Momentum and Social Learning in Presidential Primaries” and is co-authored with Nathan Schiff, a former graduate student at Brown. This paper investigates the role of other voters in the acquisition of information. That is, do voters learn about the desirability of different candidates from one another? We investigate this issue in the context of the Presidential primary, where, given its sequential nature, late voters may naturally learn from the choices of early voters. To test for learning from other voters, we examine reactions of respondents in daily polling data to the revelation of voting returns in early states, such as Iowa and New Hampshire, during the 2004 Democratic primaries. Using these data, we find that late voters shift their support to candidates who outperform expectations and also increase their ratings of candidate favorability accordingly. Thus, our estimates demonstrate substantial learning from early voters. Due to this learning, our estimates suggest that early voters have up to 20 times more influence than do late voters in terms of the selection of candidates. We also predict that a hypothetical national primary, in which every state votes on the same day, would have been more competitive due to the lack of learning and the associated influence of early voters. Finally, we predict that outcomes may have differed under alternative primary calendars, resulting from the sensitivity of the nomination process to early election outcomes.

The second two papers examine the role of the media as a source of information for voters. In “Media Bias and Influence: Evidence from Newspaper Endorsements,” which is co-authored with Chun-Fang Chiang, also a former graduate student, we examine the relationship between media bias and the influence of the media in the context of endorsements. According to economic theory, rational voters should account for the bias of the newspaper and thus place less weight on unsurprising endorsements and more weight on surprising endorsements. Using daily polling data, our primary finding is that endorsements are influential in the sense that voters are more likely to support the recommended candidate after publication of the endorsement. The degree of this influence, however, depends upon the surprise of the endorsement. In this way, endorsements for the Democratic candidate from left-leaning newspapers, such as the New York Times, are less influential than are endorsements from right-leaning newspapers, such as the Washington Times. These findings suggest that voters do learn from endorsements but are rational and are not fooled on average by a biased media.

Finally, in “Partisan Control, Media Bias, and Viewer Responses: Evidence from Berlusconi’s Italy,” which is co-authored with Ruben Durante, who received his Ph.D. from Brown in 2010, we examine another potential response on the part of voters to media bias. In particular, this research examines whether and how viewers adjust their consumption of news from different outlets in response to media bias. We use data from Italy, where the main private television network is owned by Silvio Berlusconi, the leader of the center-right coalition, and the public
television corporation is largely controlled by the ruling coalition. We first document that after the 2001 national elections, when the control of the government moved from the center-left to the center-right, news content on public television shifted to the right. Using individual survey data, we also find that viewers responded to these changes by modifying their choice of favorite news programs. On the one hand, right-leaning viewers increased their propensity to watch public channels which, even after the change, remained to the left of private channels. On the other hand, left-wing viewers reacted by switching from the main public channel to another public channel that was controlled by the left during both periods. We show that this behavioral response, which tended to shift ideological exposure to the left, significantly, though only partially, offset the movement of public news content to the right.

Taken together, these studies suggest that voters use information from a variety of sources, including other voters, newspapers and television, when choosing between candidates in elections. We also find that, as a result of this learning, better informed sources are advantaged in the political process in the sense of having more control over the selection of candidates. Any advantage afforded better informed sources, however, is mitigated by the fact that voters are rational and thus do not place undue weight on biased sources of information.

Brian Knight joined Brown’s Department of Economics in 2003 and became Associate Professor of Economics and Public Policy in 2007. Since early 2010, he has been Director of Graduate Studies, overseeing the department’s Ph.D. program.

The Intergenerational Transmission of Economic Status

By Anna Aizer

Intergenerational correlations in economic status in the U.S. are high. Boys born to families with income in the bottom quintile of the income distribution have a 42 percent chance of remaining there as adults and only a five percent chance of reaching the top quintile. Sociologists have long sought to document such patterns, with more recent work by economists focused on understanding why and how parents transmit their economic status to their children. As a health economist, I have focused on the role of health as a mechanism behind the intergenerational transmission of economic status. Health is considered an important component of one’s human capital and a significant determinant of earnings. Moreover, it is now well-documented that parental economic status is strongly related to offspring health and, by extension, their future (adult) health and economic status.

But exactly how is it that parental economic status influences their offspring’s health? I focus on the role of parental education (which is significantly lower among the poor.) Grossman’s 1972 economic model of the demand for health stipulates that education improves the efficiency with which individuals produce health by reducing the costs of obtaining medical information and/or using it. If true, the model would predict that as new medical technology or scientific knowledge about health risks becomes available, it will be the most educated/highest income who learn about them and alter their behavior to avert such risks first because of their lower associated costs of doing so.

But how should we test this empirically? And how do we link this to offspring health? In work joint with Laura Stroud of Brown Medical School, we focus on how the first major advance in medical knowledge regarding the effects of smoking on health (the First Surgeon General Report on Smoking and Health published in 1964) affected the smoking decisions of pregnant women and, in particular, whether the response varied with maternal education. Moreover, because existing medical evidence supports a negative impact of prenatal smoking on fetal/newborn health, by focusing on pregnant women, we can link parental education and smoking decisions with their offspring’s health as a newborn which has, in turn, been linked with significant reductions in future cognitive ability, education and earnings.

We find that prior to the report, more and less educated women smoked in roughly equal numbers. After the report, the more educated reduced their smoking immediately in contrast to the less educated who did not. Interestingly, we see the same pattern in public opinion about the negative effect of smoking on health. Gallup poll data from before and after the 1964 Report show that before the report, there was little difference in people’s opinion about the relationship between smoking and, say, heart disease by either education or income. But after the report was published, the more educated were more likely to respond that they believed that smoking was a cause of heart disease.

This disparity in the response to advances in medical knowledge about the negative effect of smoking on health continued to increase until 1990 when the smoking of the less educated finally began to converge to that of the
more educated. Consistent with this, education disparities in newborn health as measured by birth weight and fetal death followed the same pattern: increasing immediately and eventually declining. These results illustrate not only how the economic status of a generation can affect the economic status of the next, but also how advances in medical knowledge can actually increase inequality, at least in the short run.

Anna Aizer earned her Ph.D. in Economics at U.C.L.A. in 2002. She joined the Department of Economics at Brown in 2003 and became Associate Professor of Economics in 2010. She maintains affiliations with the Center for Public Policy and the Population Studies and Training Program at Brown and is a Faculty Research Fellow of the National Bureau of Economic Research.

Glenn Loury Asks, “Is America Becoming a Nation of Jailers?”

By Scott Lowenstein

Since the 1970’s, the US has been incarcerating people at an unprecedented level, both compared to the rest of the world and to all of American history. On any given day, about 2 million people are confined in American prisons or jails.1 This mass-incarceration apparatus costs about $200 billion per year,2 outstripping the cost of the much talked about financial industry bailout and health care reform combined over the next decade. This growth has continued throughout the 1990’s and 2000’s, despite a precipitous drop in most kinds of crime activity, especially the violent crime that often makes the news. Among these prisoners, most are African American or Latino, less educated, and poor.

The sheer size, cost and misrepresentation of the system should give pause. What does it say about a country that locks up such a large share of its population? Professor Glenn Loury is seeking to describe just that – the historical and social conditions that have led to a racial and class-biased system of punishment that is fed by inequality and then reproduces it.

A quick statistical look at the U.S. penal system is staggering. Since the early 1970’s, the imprisonment rate has increased more than five-fold. In 2009, the average white man had a 3.3% risk of being imprisoned by the time he reached the age of 34 – about the upper age bound of most criminal activity. For black men, that number reached 20.7%. For high school dropouts, these numbers jump to 15.3% for white men and an overwhelming 69% for black men.3 This differential has only increased since the beginning of the prison-wave in the 1970’s, largely fueled by the War on Drugs in the 1980’s and tough sentencing laws like mandatory minimum sentences and three strike laws. When an entire group of people has a more than two-thirds chance of ending up in prison or jail, this begs the question of how such a differential is maintained and tolerated within our political system and culture that puts so much emphasis on freedom and equality of opportunity?

Moreover, this practice - what Loury and others call concentrated mass incarceration - has real consequences not only for the life prospects of the people in jail, but also for their families and social network affiliates. The massive incarceration rate among poor, mostly urban black communities breaks up families, sullies the job opportunities of ex-prisoners and can normalize the experience of prison for those most likely to be imprisoned. In a community where almost every family has someone in prison, incarceration

2. Ibid., pp. 2.
becomes less of an aberration and more a part of a normal life course. By isolating and systematically hurting the life chances of a whole segment of the population, the U.S. criminal justice system is perpetuating these inequities and continuing a cycle of increased punitiveness.

Loury’s work focuses largely on how such a system has maintained large public support and acceptability. The popular conception of a just criminal system (both culturally and electorally) requires that if someone commits a crime, he is punished for it. This idea of equality under the law is inherently appealing. But in the U.S., where a history of slavery, Jim Crow laws and overt discrimination cast a long shadow on issues of racial inequality, the appealing idea of legal parity is lost. Consider the African American high school dropout whose father and many friends have served time in prison. He cannot find a job—recent study found that employers were more likely to interview a white man with a felony record rather than a black man without one. He turns to selling drugs on a street corner where the police know people sell drugs, and he is arrested and sent to prison for three years. This man does not have equality under the law in the way it is intended. He will leave prison less likely to find and hold a job, get married, join a trade union and in some states, be eligible to vote. That is not to say that people who commit crimes are entirely victims of circumstance, or that overt discrimination is to be blamed for the system’s inequality. There will always be a place for a criminal justice system, one that punishes people based on deviations from the rules set out in law. It is too easy to blame this man’s actions on his situation—the so called “root causes” argument—just as it’s too easy to point to the impossible idea of “blind justice.”

What Loury looks for is a more subtle understanding of how race, crime and punishment operates that explains the striking inequalities of the system without resorting to root causes or loaded responses based on overt racism by the police or the justice system itself. Instead, Loury looks at stigma—the often subtle undercurrents behind dominant groups’ attitudes about what is normal or to be expected. [Chapter 3 of Loury’s book The Anatomy of Racial Inequality (Harvard University Press 2002) develops an analysis of what he calls “racial stigma” which in subsequent work he has applied to the incarceration issue.] Ultimately, the increasing punitiveness of the criminal justice system is a response to electoral pressure. “Tough on crime” is an almost essential campaign promise, and a shift in focus to a victim-centered portrayal of crime gives more political capital to groups campaigning for stricter and more punitive practices. Racial stigma operates not by acting to explicitly promote practices that lead to inequality, but rather by the dominant groups in power in essence, being unsurprised by the current system’s racial and class makeup. When there is no shock, no outrage at the way things are, there is no political and electoral pressure to change things.

So what does a new and more equal system look like? Loury does not provide easy solutions because there are no easy answers for something as ingrained and subtle as stigma and cyclical inequality. For one, the prisons system is too big. Prisons work in some ways—namely, by incarcerating potential criminals and deterring new criminals from committing crimes. But these effects don’t work in a linear way. In many situations, such as for low-level drug dealers that have constituted a large part of the growth of inmates, there will always be enough unemployment and interest in positions to immediately replace the imprisoned. The increases in sentence length mean that many of the incarcerated leave well after they are the age of most criminals. And the increasing ratio of crime rate to incarceration rate ensures that prisons are filled with less of the much-feared “dangerous” repeat criminals. Deterrence only operates so far as people know they will get caught, which has very little to do with how likely they believe they are to be caught. Also, if prison is a normal part of life, then maybe deterrence isn’t so strong. It only seems logical that the law of diminishing returns applies—the more people you imprison, the less effective each new prisoner becomes in reducing crime. Eventually, the cost—to society as a whole as well as to the communities affected disproportionately

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by incarceration – will be more than the crime-reducing benefits. That time may have already come and gone.

It is important to note recent changes in crime policies. In the face of the Great Recession, there is increasing movement towards decreased punitiveness in the prison system. For example, California, which adopted one of the earliest and toughest “three-strikes” laws, has recently moved towards increased early release programs. Though encouraging, relying on tight budgets to change prison practices is theoretically faulty. Budgets and economies recover, and without some sort of shift in attitude towards the purpose and importance of incarceration, it seems unlikely that any long-term change and shift away from a spiraling system of inequality can be achieved.

Scott Lowenstein earned his AB in the Applied Mathematics - Economics concentration at Brown with honors in 2010. In the spring semester, 2010, he assisted Glenn Loury in teaching his course EC 0180 (“Punishment and Inequality in America”) where he was exposed to some of the ideas in this article. In addition to this first-year seminar, Glenn Loury also teaches the upper level undergraduate course EC1370 (“Race and Inequality in the US”), a Masters-level course cross-listed with the Public Policy program, EC 2220 (“The Political Economy of Punishment”), and a more technical Ph.D.-level course, EC 2370 (“Theories of Economic Inequality”). Loury has also introduced the graduate and faculty workshop on economics and inequality. In addition to his publications in the leading scholarly journals in economics, Loury has been a frequent contributor over the years to the New York Times and The New Republic magazine, and an interviewee on programs such as the Charlie Rose Show and Bill Moyers’ Journal. His most recent book is Race, Incarceration and American Values, M.I.T. Press, 2008.

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Can the government crowd out child saving? Evidence from the U.K. Child Trust Fund program

By Molly Jacobson

Since 1970, there has been a shift in thinking about welfare policy in western nations. Researchers concerned with the well-being of the poor now wonder whether effective social policy should develop the savings, investments, and assets of individuals and families, rather than fixate on short-term income and consumption. Simultaneously, proponents of asset-based egalitarianism argue that assets can be used as a vehicle for economic equality. This is because financial assets and human social capital investments may promote intergenerational mobility and stabilize families in times of need. In addition, wealth inequality is currently far more skewed than income inequality in western nations, and research suggests that disparities in wealth are growing.

In my senior thesis, I study perhaps the best modern example of asset-based egalitarianism for evidence that it increases the total savings of children and families. The United Kingdom’s Child Trust Fund program is the first universal, automatic, government-sponsored savings program for children in the world. Initiated in 2005, the program provides every resident child of Britain born on or after September 1, 2002 with a long-term, tax-free savings and investment account, called a Child Trust Fund (CTF). I exploit the quasi-natural experiment arising from the introduction of the CTF program to combat the saver heterogeneity problem that usually confounds empirical work on saving. Put plainly, some people prefer to save, and others do not—this simple fact makes it difficult to compare the assets of saver and non-saver groups (Poterba et al. 1995). But since the underlying characteristics of the population receiving CTF funds are similar before and after the program’s introduction, the allocation of children’s savings accounts involves a form of randomization that solves the potential selection problem.

My research finds cohesive and consistent evidence that the CTF program crowds out other forms of saving for recipient children and their families. Using data from the Family Resources Survey of the U.K., I find that CTF eligibility is correlated with a 20% decrease in the probability that the child has other, non-CTF saving. Compared to ineligible children, eligible children are 2.6 times more likely to fall into the highest savings band determined by the FRS (savings greater than £3000) versus all lower bands combined (from £0 to £3000). This implies that, despite displacement of non-CTF saving, there is a net savings gain for eligible children. However, I run a linear probability model that qualifies this result. When a child becomes eligible for a CTF, the probability that he/she

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2 Importantly, savings totals for CTF-eligible children include any money they received as a result of the CTF program, such as the government’s seed deposit of at least £250.
will have savings greater than £0 and £500 increases significantly. But at higher savings thresholds, the effect of eligibility is practically zero. Thus, the overall positive effect of the Child Trust Fund program seems mostly to operate at the lowest levels of saving. Savings increase for children who would otherwise have no or very little saving, but the assets of those with account balances over £1000 remain unaffected by eligibility.

I also investigate the relationship between CTF eligibility and total family savings, finding that there is virtually no net difference in the assets of families of CTF-eligible children. Even across different savings thresholds, the coefficients on eligibility are all insignificant, and nearly zero. In sum, it appears that the Child Trust Fund program does not generate net gains in the savings of families with children, and actually crowds out assets that would otherwise have accrued for eligible children. However, the distribution of savings within the household shifts toward children.

My conclusion contrasts with prior findings of no crowd-out or even “crowd-in” in the literature on retirement savings and pensions. This begs the question: Why would households treat children’s saving differently from other assets? Richard Thaler’s theoretical work on mental accounting shows how parents might have a higher marginal propensity to consume the windfall gain from the Child Trust Fund than other types of wealth—say, a sudden increase in the market value of their home. It is also possible that children are not a savings priority. In a 2009 study using the British Household Panel Survey, Rossi shows that most people who saved did so for “no specific reason” (41%) followed by “holidays” (21%), while a much smaller fraction (4%) saved explicitly for their children. Notably, total child savings do not appear to be completely crowded out by the CTF program. If people are “impure” altruists who derive some utility from the act of giving, as Andreoni (1990) suggests, then parents’ optimal saving for their children should almost always exceed zero. Thus, the government will not completely crowd out parental saving for a child.

Whether the Child Trust Fund program is economically worthwhile is a particularly important question as the United Kingdom, facing serious budget shortfalls, debates cutting back major social programs. It is also a critical issue in the United States, where lawmakers in partnership with organizations such as the Aspen Institute have advocated similar legislation. Interestingly, despite the seemingly unfavorable outcomes apparent in my research, the Child Trust Fund program may yet accomplish many of its egalitarian aims. CTF eligibility appears to enhance savings most effectively for children who would otherwise have no or very few assets, and the program will ensure that every British child owns positive assets by age 18. Furthermore, account holders are still quite young—all children sampled in my study were under the age of five—and researchers might yet see marked differences in their savings behavior and expectations as a result of the CTF program. Finally, an investigation of the ultimate macroeconomic effects for the United Kingdom of the Child Trust Fund program is critical. In 2020, the very first recipients of CTFs will access their full account balances. This event will create an unprecedented phenomenon in Great Britain: an entire generation of citizens with positive saving to spend or invest. For policymakers and researchers, then, the next decade represents a fascinating period for evaluation. Does the Child Trust Fund program beget worthwhile social and economic benefits on net? Or could the program’s £500 million price tag be better spent elsewhere? Only time will tell.

Molly Jacobson earned her B.A. from Brown in May, 2010, graduating with honors in Economics. For her senior thesis, on which this article is based, she was awarded the 2010 Samuel C. Lamport Prize in International Understanding.

Cops in the Boardroom, or Co-opted? Using Savings and Loan Legislation to Examine the Effect of Independent Directors on Bank Boards

By Lindsay Mollineaux

A well-functioning financial system serves as a conduit for society’s savings, pooling together small deposits and directing them toward profitable projects. It plays a vital – and irreplaceable – role in translating the dreams of a populace into reality.

Yet despite nearly a century of concerted research and periodic financial crises, the connections between the governance structure of banks, their short-range performance, and the long-run stability of the financial system remain ambiguous. Economic theory predicts that problems arise when the owner and the user of capital are two different people, as they are in the case of banks. Executives and shareholders may disagree on how to use the capital to best achieve their own goals. CEOs may direct capital toward reputation-building projects, lavish money on personal offices and employee perks, or engage in downright embezzlement and fraud. If corporate boards function as internal watchdogs over the actions of bank CEOs and managers, these principal-agent problems may be mitigated. However, anecdotal evidence suggests that the incentives individual directors face may make them imperfect monitors of management. Economists have suggested a range of strategies for aligning the incentives of bank management with the interests of shareholders and society at large through executive compensation packages, the structure of debt, and the composition of boards of directors, but the empirical evidence for these proposals is mixed.

My thesis, undertaken with the supervision of Professor Ross Levine, examines the effect of one potential, random shock to bank governance – the passing of the FDIC Improvement Act of 1991. Once the law fully came into effect in 1993, all depository institutions above an asset threshold of $500 million were required to have an audit committee composed entirely of outside directors. The boards of all banks and thrifts below the threshold faced no increased mandate for director independence. I examine three effects – the effect of the legislation on the governance of affected banks, the effect of the legislation on bank performance and outcomes, and the implied effect of those randomizing changes in governance on outcomes of banks. The discrete threshold in the law allows me to isolate the specific audit independence effect from all other differences across banks. By comparing banks on either side of the eligibility threshold in ever-smaller groups, this paper can approach a real world test of current governance theories in almost experimental circumstances.

My results are ultimately inconclusive. I cannot reject that the law had no effect on the internal balance of power and governance within banks, and I see no change in any of the measures of performance I have available. These findings, however, do suggest a healthy skepticism of any financial legislation based on the premise that changes in the composition of corporate boards will markedly affect the behavior of internal management. If we as a country truly are interested in reining in the widespread risky behavior seen in the financial system in the past few years, it may be more effective to stop relying on boards of directors as monitors and concentrate instead on more direct mandates for executives.

Lindsay Mollineaux earned her B.A. in Economics from Brown in May, 2010. She was one of 18 students in a class containing 232 concentrators in economics and other concentrations sponsored by the Department to graduate with honors. For her thesis, she was also awarded the Gordon Lindsay Memorial Prize which goes to a student completing an outstanding piece of research in the area of finance.
Lending a Hand – Birth of “A Day at Brown”

By Ivo Welch

I live and work about five blocks away from Hope High School. For the most part, I only knew that it was a chronically underachieving school. Wikipedia states that it serves about 1500 students in four years, eighty percent of whom are Hispanic and Black. Few of the students are from the East Side, with many bussed in from other parts of Providence. Their socioeconomic background is often quite low. Not surprisingly, the academic performance of Hope High has been much poorer than that of its neighbors. The average combined SAT score was about 1050, compared to about 1950 at Moses Brown, the nearby Friends college preparatory school. A few years ago, the state had even threatened to take over Hope High.

In the Fall of 2009, on a whim, I decided to see if I could do something to help. My first idea was to teach a finance course for High School students (an experiment incidentally which we later conducted, but which did not fare too well). An acquaintance, Paul Williams, now a senior official at the Rhode Island Department of Elementary and Secondary Education, offered to introduce me to Arthur Petrosinelli, the Principal of Hope High School. I took him up on this and found myself one morning in Arthur’s office. I also met Sean Geoghegan, a young, smart and very engaged math teacher at Hope High, who has become my regular contact at Hope High. My first impression of their facilities, students, and most importantly both Arthur and Sean, was far more positive than I had imagined. (There was more order and less graffiti at Hope High than in my high school in Germany!)

Brainstorming with Paul, Arthur, Sean, and some other Hope High teachers and administrators, I learned that most of the students at Hope High do not know anyone who has ever gone to college. College for many of them seems abstract, unachievable—a different world. It’s not just Brown, an institution that many of them walk by and wonder about every day, but any college. At that point, Paul mentioned that the only reason why he himself had gone to college was that, one day, his basketball coach had dragged him and his team-mates from the court for just one day to Rhode Island College, where he got to sit in a classroom and listen to the lectures. It was only then that he realized that he had enough smarts to do this, too.

That day, Sean, Arthur, and I decided to try this. It was my role to recruit Brown undergraduate students from various classes, who would volunteer to take one Hope High student with them for a day. In exchange, I would pay for the lunch. (My own view was that the personal attention and one-on-one contact with one Brown student, who could answer questions and discuss all sort of issues, formal and informal, would make more of an impact than would direct involvement on my part.) On the Hope High side, Sean encouraged and chose students to participate in the program. We focused on 10th-graders, because this would be early enough still to make a difference for the kids that are on the margin—those who had not yet decided whether to invest effort into academics in order to shoot for college.

Our first trial in the Fall of 2009 matched up about a dozen students. The volunteering Brown students were from my Corporate Finance course. The program went without a hitch. Debriefing my own students, I learned that it was not a major burden for them—in fact many of them enjoyed it. It gave them an opportunity to open doors, a new world, for the kid that they were assigned to. A number of our Brown students even took the students to classes that they themselves were not enrolled in, just to better match the interest of the student that they were chaperoning.

On the other side, Sean later on talked to the Hope High students. He reported to me that he came away with the
impression that most of them were deeply affected—and that he thought that for some of them, it may well be a life-changing experience, too.

Buoyed by this success, in Spring 2010, we expanded our first trial to about 30 students. The Brown students were now drawn from a wide cross-section of classes. The program sponsorship has now moved to COE, which has also graciously agreed to pay for lunch! More seriously, institutional support and coordination is vital if we want the program to last. Although not costly in financial terms, the administrative effort is not low. There is a lot of scheduling coordination required. The Hope students are minors, and we are accepting the responsibility for shepherding them for this one day. Fortunately, no major problems developed in our first year. With one exception, dropoff and pickup was on time. Our plan right now is to continue this program for many years to come.

Not all the publicity for the program has been positive. The program has been criticized by some of our own Brown students in the Brown Daily Herald for potentially being condescending, and for offering too little to students in need of much more support. Fortunately, with regard to the first critique I can report that the Hope High students did not feel the program was condescending. In fact, I would think that high school students from anywhere else (and potential future applicants to Brown) would enjoy spending a day at Brown with one of our Brown students. It’s just that Hope High is getting a benefit from being so close to Brown. My own view about the second critique is that it is as correct as it is inappropriate. Our program is not intended to be a cure-all. It is a relatively modest attempt to help. If it makes a difference for some students, it will be a great success.

As readers of our newsletter, you may wonder what this all has to do with economics. Maybe very little right now. Still, even self-interested economists can do good! Academically, there are also future possibilities. We could potentially study what we are doing, too. We could do some random assignment tests—choose the Hope High students randomly, and then see whether it makes a difference in how they perform later, and in particular, how many will end up going to college. We could also study peer effects—do students who did not participate themselves, but who now know other students more motivated to study to go to college, also end up more often in college? And does it matter whether we do this repeatedly with the same student, or is one time enough? Only time will tell. The “Day at Brown” program has just begun.

Ivo Welch joined the Brown faculty in 2004 as Professor of Economics and Finance. He was the first Director of COE, the Commerce, Organizations and Entrepreneurship program, and remains a faculty affiliate and member of its Faculty Committee.
The 2009-10 academic year was a year of milestones for the William R. Rhodes Center for International Economics and Finance. Established in 2007 with the generous support of William R. Rhodes ’57, a Senior Vice Chairman of Citigroup with a long and distinguished career in international banking, the Center established its physical presence during this year in 70 Waterman Street, a building formerly occupied by the Center for Old World Archaeology and Art and re-allocated to the Department of Economics in 2010. The building includes offices for faculty and graduate students, and a large first floor common room which now displays the Rhodes Center logo.

Directed by James and Merryl Tisch Professor of Economics Ross Levine, The Rhodes Center seeks to advance the study of cross-border movements of capital, goods, services, and people, while also improving the understanding of cross-country differences in growth, development, and income distribution. During 2009-10, the Center received new pledges of financial support from Karen Ho Smith and David T.C. Ho and from the Garonzik family which, together with the leading support of Mr. Rhodes, contribute to an endowment expected to generate annual revenues sufficient to help underwrite the hiring of a William R. Rhodes Professor of International Economics and to provide support for major and minor research programs by faculty and graduate students, as well as visiting lectures and conferences.

In the wake of the global financial crisis that began in 2007-08, the year saw Levine giving numerous presentations on financial regulation in locations around the world, as well as engaging in a well-publicized debate on financial innovation organized by The Economist magazine. In the debate, Levine argued in favor and Nobel Laureate Joseph Stiglitz argued against the proposition that “financial innovation boosts economic growth.” In his annual report on the Rhodes Center’s activities, Levine remarked that his own activities relied heavily on inputs from graduate and undergraduate students and would not have been possible without the Center’s support.

But Levine was far from the only member of Brown’s Economics Department whose work benefited from the Center’s support. During the year, the Center provided financial support for the research of more than a dozen of the Economics Department’s Ph.D. candidates working on international research topics, and for projects of a number of Economics Department faculty including Oded Galor, Kaivan Munshi, and Yona Rubinstein. Center-supported projects also facilitated the work of outstanding Brown undergraduates, including senior honors recipients now headed for employment at the Federal Reserve Bank in New York and into top Ph.D. programs, among other destinations.
things that we can offer our prospective faculty. I therefore thought it might be worth saying a few things in this column about why a first-rate graduate program is so important.

The short answer, in the language of intermediate microeconomics, is that graduate students are complements in the production function of almost everything we are supposed to do as faculty. Part of our job as faculty is to try to influence the trajectory of our disciplines. We can do this in part through presenting and publishing our research—if we have found a new way to look at an economic problem and that approach is picked up and used by others, we have done our job. But working with graduate students is another way to have this kind of influence. By helping to mold them and giving them our best ideas about what problems are interesting and how these problems should be addressed, we create, if you will, disciples to carry our ideas to other departments and thus expand our influence.

Second, graduate students help bring new ideas and energy to the table that help push forward our research. It is striking that virtually all of the graduate students that we sent out on the "job market" this year had at least one paper that is coauthored with a faculty member. And it is clear in each case that the graduate student brought something new to the table. Often this involves regional expertise—an Italian student, for example, coauthored an article on media bias in reporting that looked particularly at Berlusconi's control of the media; a Brazilian student has a coauthored paper on how under-provision of utilities in the slums of Brazil's cities may reflect a deliberate policy designed to protect the interests of better off households; and a student from the Cameroon who has written a joint theoretical paper that provides a novel perspective on the spread of AIDS in sub-Saharan Africa. In other cases the student brings empirical or theoretical skills (perhaps learned from other faculty in the department) to a given faculty member's research. In still others, students bring the time and energy to explore an idea that the faculty member is intrigued about but not able to pursue on his or her own given other interests.

Third, graduate students are critical to the teaching process. Given the large sizes of our undergraduate classes, faculty are unfortunately not able to give all the students all the individual attention they need to grasp the underlying material. Our graduate student teaching assistants help to fill these gaps as well as to organize and help train the undergraduate teaching assistants that do such a great job for us in the Economic Principles course. And occasionally when a faculty absence or departure means we might otherwise have to cancel a course we rely on our best graduate student TAs to teach a whole course. Many of these graduate students are terrific in the classroom and rival the faculty in terms of evaluations.

We have made real strides in the graduate program in the last few years. Frank Kleibergen, who has served as the chair of the Admissions Committee for a number of years, has worked hard to identify and recruit progressively better students in each class. The graduate chair, Roberto Serrano (who will be taking over as departmental chair in July), instituted and implemented a series of guideposts so that the students have a better idea of where things stand, including orals in the second year and a paper in the third year. Additions to our faculty have increased the quality and depth of the training our students get, particularly in terms of empirical methods but also by bringing new topics and subfields to the classroom. Those of us working with students find them to be more capable than in past years, and the large number of joint papers in our most recent batch of job-seekers is reflective of the fact that they are now providing real synergy with the faculty. Most importantly, graduate student placements are improving despite the overall weak economy. Like the Brown economics faculty as a whole, our students are often distinguished by the extent to which their work extends across different subfields of economics.

We nonetheless have concerns. One of the biggest is that our graduate program is about a third smaller than it was 10 years ago. We are now at essentially 10 graduate students per class, which is far too few if one has 25-30 research-active faculty, as we do. This change is an unintended consequence of the otherwise laudable graduate schools decision to fully fund all PhD students—we used to get a significant number of students who were willing to self-pay for at least a couple of years and sometime these students proved to be among our best. Interestingly the possibility of growing our graduate program was mentioned in our last formal departmental review in 2000 when it was significantly larger. We hope, as we prepare for an external review next year, that this issue will receive further discussion.

Finally, let me take this opportunity to sign off as chair of the department. By the time you read this newsletter Roberto Serrano, as noted, will have taken over after eight years with me at the helm. This is a long time to be chair by the standards of economics departments, but it has certainly been an interesting time given the Program for Academic Enrichment, the growth in interest in economics among undergraduates, and the financial crisis and recession. It has not always been easy, but I am most grateful for the support I have received both from the faculty and the administration. I am grateful as well to Roberto for being willing to step into this role so that I can take over as the director of Brown's Population Studies and Training Center.
Notes from the Editor

This is our last “paper” version of the Newsletter. In an attempt to reduce the expense of publication we are switching to the electronic form.

If you wish to receive the Newsletter electronically, please, contact Natalia Ignatyeva at Natalia_Ignatyeva@brown.edu. A limited number of printed copies of the Newsletter will be available. Please contact Natalia Ignatyeva if you prefer to receive a printed copy.

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