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3 Americans Awarded Nobel for Economics

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Three American economists were awarded the 2001 Nobel Memorial Prize in Economic Science yesterday for their pioneering research in the shortcomings and imperfections of market systems.

The winners were Joseph E. Stiglitz, a professor at Columbia University; George A. Akerlof of the University of California at Berkeley; and A. Michael Spence from Stanford University.

Their findings explain, among other things, why consumers view warranties as signals of product quality; why insurance companies vary premiums and offer deductibles; why a used car sells even though it is a lemon. Their theories incorporated "imperfect information" into economics -- a concept at odds with the mainstream view that markets are all-knowing and self-correcting. That is still the emphasis in many Econ 101 textbooks.

"The three of them really pioneered the view that markets, when confronted with imperfections, may not be the best way to allocate resources," said Alan Krueger, a Princeton University economist. "That changed economics."

Long before they won, Mr. Stiglitz, 58, and Mr. Akerlof, 61, were often mentioned as likely Nobel winners, for work that germinated when they were graduate students together, obtaining their Ph.D.'s in economics at the Massachusetts Institute of Technology in the late 1960's.

When the call came yesterday morning from the Nobel committee in Stockholm, Mr. Stiglitz said he was getting a cup of coffee in his Morningside Heights apartment. "We switched from coffee to Champagne," he said.

Mr. Akerlof was asleep in Berkeley. "My first thought was that Joe had won," he said, "and someone was calling to get my reaction."

Mr. Spence, 58, an emeritus professor at Stanford who retired two years ago to become a partner in a venture capital firm, was asleep at his vacation condominium in Hawaii. "I was stunned," he said.

The Nobel committee, in an award citation calling Mr. Stiglitz's work the broadest of the three, said: "Joseph Stiglitz's many contributions have transformed the way economists think about the working of markets. Together with the fundamental contributions by George Akerlof and Michael Spence, they make up the core of the modern economics of information."

The economists' research, done mostly in the 1960's and 1970's, persuaded all three that government must play a strong role in a market system, to prevent damage from imperfect information. At a news conference at Columbia yesterday, Mr. Stiglitz, the best known of the three, reiterated that view.

Financial markets, he said in offering one example, run on information, and without the Securities and Exchange Commission to enforce full disclosure, people would find themselves purchasing corporate stock without sufficient knowledge to determine a proper value. Management -- and perhaps others selling the stock -- might know of serious shortcomings that were hidden from buyers. If that "asymmetry" happened often enough, stock trading could break down.

"One part of the market knows more than another," Mr. Stiglitz said, "and in a sense imperfect or asymmetric information is at the heart of our work."

Just as imperfect information justifies government intervention, so does it explain various corporate strategies.

Insurance companies, for example, have a hard time distinguishing between the homeowner whose dwelling is a fire hazard and the homeowner less likely to have fire damage. Charging the same high rate to both for substantial coverage would draw more high-risk customers, while low-risk households would be more likely to risk going without insurance. With too many high-risk customers, claims would mount and the insurance company could go broke -- a market failure.

So the companies "intervene." They ration coverage, giving no customer as much as he would like, which encourages homeowners to install fire-safety devices. And they charge high premiums for the most complete coverage, while costumers who consider themselves low risk can choose a high deductible in exchange for a lower premium.

Mr. Stiglitz joined the Columbia faculty in July from Stanford, where he had been a professor since 1988, with time out in the 1990's for service in Washington as chairman of President Bill Clinton's Council of Economic Advisers and chief economist at the World Bank.

Mr. Akerlof was honored mainly for a 1970 essay, "The Market for Lemons," which the Nobel committee described as "the single most important study in the literature on economics of information."

Mr. Akerlof's insight came out of his observation that nearly every used-car buyer worries whether he or she is overpaying for a defective vehicle. The used-car dealer knows its status but the buyer lacks this information, and too many bad experiences can disrupt the used-car market. The advent of lemon laws helped to prevent this.

Critics argue that Mr. Akerlof's paper, and the findings of information economics in general, lack support in empirical research. "There is no evidence that the cars that are sold are lemons," said Orley Ashenfelter, a Princeton economist. Mr. Akerlof replies that his used-car work "is empirical in the sense that we took the behavior that everyone knows and put it into theory that explains what is involved in markets more generally."

Mr. Spence holds a doctorate in economics from Harvard University, but has not practiced his profession since 1984, when he became dean of the School of Arts and Sciences at Harvard, and in 1990, dean of Stanford's business school. The Nobel award came mainly on the strength of a single paper that Mr. Spence published in 1973 describing "market signals."

In the pure model of a free market, consumers are presumed to have perfect knowledge, able to accurately tell the differences in quality among, say, various models of refrigerators. Prices would automatically reflect that understanding. But most consumers lack this information, so sellers intervene, offering comprehensive warranties, for example, to signal high quality. "If a seller gave a fancy warranty on a product that broke down a lot," Mr. Spence said, "he could go broke."

Mr. Stiglitz also relied on his research to challenge traditional International Monetary Fund practices that led, he concluded, to unnecessary economic trauma during the Asian financial collapse of the late 1990's.

Because of his repeated criticism of the I.M.F., Mr. Stiglitz found himself forced from his World Bank job last year. But he has not let up. "There were terrible results in Asia," Mr. Stiglitz said at his news conference yesterday. "The I.M.F. is only now changing its view."

Photos: The Nobel committee called the work of Joseph E. Stiglitz, right, the broadest of the three. (pg. C1); A. Michael Spence, 58, left, from Stanford University, and George A. Akerlof, 61, of the University of California at Berkeley, won the Nobel. (Associated Press); (Agence France-Presse)(pg. C10)