We are pleased to present the inaugural issue of “Highlights,” HCEO’s new quarterly publication. Our aim is to share the important research of our 500 members with a wider audience.

In the past year, HCEO has started several exciting initiatives: our 3 Questions series; in–depth video interviews with members on their research, and our Research Spotlight, which highlights HCEO working papers.

We continue to foster academic collaboration on issues of inequality by partnering with institutions across the globe to expand our programs. In 2016, HCEO hosted 8 events in 3 different countries, including 3 sessions of our Summer School on Socioeconomic Inequality. These events had 273 participants from 118 institutions. In this issue, we will provide a closer look at these events, along with a snapshot of what we are looking forward to in 2017.

Thank you for your interest in learning more about HCEO’s mission to connect cross-disciplinary experts in the study of inequality.

First Time Reader? Flip to page 22 to learn about who we are and what we do.
RESEARCH SPOTLIGHT

The Capabilities Approach

The capability approach is a theoretical framework that studies all aspects of human flourishing. It holds forth two claims, as explained by the Stanford Encyclopedia of Philosophy: that the freedom to achieve well-being is of primary moral importance and that the freedom to achieve well-being should be understood in terms of people’s real opportunities to do that which they value. The approach, largely developed by Amartya Sen, is used to help evaluate the development of countries, as with the United Nation’s Human Development Index. Despite the popularity of the capability approach, some limitations remain. In a recent HCEO working paper, Co–director James Heckman and CEHD Research Professional Chase Corbin review the capability approach and compare it with the skill–based human capital approach.

As the authors note in “Capabilities and Skills,” the capability approach goes beyond standard economic approaches of policy evaluation to offer a more comprehensive look. The approach looks not only at a person’s internal capabilities, but also at their external capabilities, that is whether social and political institutions “inhibit or promote” the expression of skills. Yet the theory–heavy approach lacks the sort of empiricism favored by economists.

“Research on capability theory strongly reflects personal beliefs about ideal ethical structures for society,” the authors write. “While this gives it a more comprehensive, philosophical perspective, it limits its empirical application and policy relevance.” On a more basic level, the authors argue, the capability approach lacks a theory of internal capability formation. Recent research in the economics of human development can enhance the capability theory by showing how skills are formed and how they can be measured. It also accounts for how capabilities and skills evolve over the life cycle, whereas the capability approach is “intrinsically static.”

“Skills empower. They enable action in a wide array of life domains.”

Both approaches seek to better understand poverty and look for ways to reduce inequality. Studying skill formation is central to understanding the development of human capital. “Skills empower,” the paper notes. “They enlarge opportunity sets.” They are major sources of well-being and “enable action in a wide array of life domains.” As the authors note, while skills are only part of the story for explaining the action of individuals, they are “an important part and one that can be shaped by policy.”
The role of preferences is central to both approaches. The economics of human development considers “the role of preferences in shaping how skills are measured, which skills are expressed, and which skills are acquired.” Similarly, as the authors note, “all evaluations in the capability literature rely on preferences.” The difference between preferences and skills can be dubious, as “preferences are often valued as skills.” Furthermore, in the capability approach, only observed choices can be evaluated, although “the choices that were possible but not taken constitute the full capability set.” Conversely, the economics literature can account for alternative options “by measuring the responses to incentives which encourage or discourage agent choices.”

Measuring capabilities can be particularly challenging; skills are just one area in need of measurement. Social factors, one’s agency, and freedom of choice must also be considered. Corbin and Heckman make two criticisms of the capability literature’s attempts to measure capability sets. Self-reported survey measures “have consistently been found to be poor predictors of future outcomes.” Furthermore, a subject’s answers depend largely on “individual and socially imposed preferences;” one’s society plays a great role in what one considers an important concept.

Still the two approaches have much in common: both analyze inequality and social mobility, both use inclusive measures of inequality, both evaluate policies using an array of measurements, and both examine the core sets of skills that make up capabilities. Yet the policy relevance of the capability approach is limited by its lack of a theory of internal capability formation. While the economics of human development has a theory of skill and preference formation, it lacks any moral or ethical criteria, and has a less-comprehensive agenda.

According to Corbin, the paper also makes clear “the importance of holistic investment in the skills and abilities of children and young people through education, training, and interventions.” He says investments that enhance those made by parents and communities, “rather than fragmented policies that target specific outcomes, like the reduction of crime” are shown to be more effective. “While such specific policies, like increasing the number of police or provision of public nutrition programs, are often effective at meeting their target goals, holistic policies that aim at improving the skills and abilities of the disadvantaged meet those same targets and do so more efficiently,” Corbin says.

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These findings are significant as governments and agencies around the world rely “extensively on the capabilities approach” in assessing the development of countries, as Corbin notes. “Although the capabilities approach has been very critical of standard economic approaches to the questions of human welfare and well-being, he says, “how these alternatives are in any way an improvement over traditional methods remains very unclear.” For example, the UN’s Human Development Index “partitions citizens’ well-being into categories of life expectancy, educational attainment, and standard of living,” Corbin says. “While it is meant to capture the capabilities that individuals might possibly attain, it is constructed using only measures based on observed outcomes, a practice explicitly criticized by the capabilities approach.” The modern economics of human development, the authors write, “addresses many of the criticisms raised by capability theorists against standard economic approaches, and does so in an empirically oriented fashion.”

Thanks to Chase Corbin and James J. Heckman for their assistance in completing this article.

For more Research Spotlights, visit: hceconomics.uchicago.edu/research
2017-019 Facing Yourself: A Note on Self-Image
Armin Falk

Numerous signaling models in economics assume image concerns. These take two forms, as relating either to social image or self-image. While empirical work has identified the behavioral importance of the former, little is known about the role of self-image concerns. We exogenously vary self-image concerns in manipulating self-directed attention and study the impact on moral behavior. The choice context in the experiment is whether subjects inflict a painful electric shock on another subject to receive a monetary payment. Three between-subjects conditions are studied. In the main treatment, subjects see their own face on the decision screen in a real-time video feed. In the two control conditions, subjects see either no video at all or a neutral video. We find that the exogenous increase in self-image concerns significantly reduces the fraction of subjects inflicting pain.

2015-014 How Risky Is College Investment?
Lutz Hendricks and Oksana Leukhina

This paper is motivated by the fact that nearly half of U.S. college students drop out without earning a bachelor’s degree. Its objective is to quantify how much uncertainty college entrants face about their graduation outcomes. To do so, we develop a quantitative model of college choice. The innovation is to model in detail how students progress towards a college degree. The model is calibrated using transcript and financial data. We find that more than half of college entrants can predict whether they will graduate with at least 80% probability. As a result, stylized policies that insure students against the financial risks associated with uncertain graduation have little value for the majority of college entrants.

2017-039 On the Joint Evolution of Culture and Institutions
Alberto Bisin and Thierry Verdier

Explanations of economic growth and prosperity commonly identify a unique causal effect, e.g., institutions, culture, human capital, geography. In this paper we provide instead a theoretical modeling of the interaction between culture and institutions and their effects on economic activity. We characterize conditions on the socio-economic environment such that culture and institutions complement (resp. substitute) each other, giving rise to a multiplier effect which amplifies (resp. dampens) their combined ability to spur economic activity. We show how the joint dynamics of culture and institutions may display interesting non-ergodic behavior, hysteresis, oscillations, and comparative dynamics. Finally, in specific example societies, we study how culture and institutions interact to determine the sustainability of extractive societies as well as the formation of civic capital and of legal systems protecting property rights.

2017-029 Personality Traits, Intra-household Allocation and the Gender Wage Gap
Christopher Flinn, Petra Todd, and Weilong Zhang

A model of how personality traits affect household time and resource allocation decisions and wages is developed and estimated. In the model, households choose between two modes of behavior: cooperative or noncooperative. Spouses receive wage offers and allocate time to supplying labor market hours and to producing a public good. Personality traits, measured by the so-called Big Five traits, can affect household bargaining weights and wage offers. Model parameters are estimated by Simulated Method of Moments using the Household Income and Labor Dynamics in Australia (HILDA) data. Personality traits are found to be important determinants of household bargaining weights and of wage offers and to have substantial implications for understanding the sources of gender wage disparities.
Human capital, including health and nutrition, has played a key role in the literature on poverty traps. Economic shocks that affect human capital during early life are thought to translate into permanently reduced levels of human capital and, thereby, push individuals into poverty. Three potential concerns in this literature are explored with empirical evidence drawn from primary longitudinal survey data collected before and after two major shocks in Indonesia: the 1998 financial crisis and the 2004 Indian Ocean tsunami. First, it is very hard to identify shocks that are unanticipated and uncorrelated with other factors that affect human capital outcomes. Second, and related, there is abundant evidence that individuals, families and communities invest in strategies that are designed to mitigate the impact of such shocks. The nature and effectiveness of the myriad array of these behaviors vary with the context in ways that are not straightforward to measure or model. Third, the impacts of shocks on human capital outcomes in the short and longer-term may differ precisely because of the behavioral changes of individuals and their families so that drawing inferences about the longer-term impacts based on negative impacts in the short term can be very misleading. The picture of remarkable resilience that emerges from investigating the impacts of major shocks on child health and human capital in Indonesia is nothing short of stunning.

We present a theory of the relation between health and retirement that generates testable predictions regarding the interaction of health, wealth and financial incentives in retirement decisions. The theory predicts (i) that wealthier individuals (compared to poorer individuals) are more likely to retire for health reasons (affordability proposition), and (ii) that health problems make older workers more responsive to financial incentives encouraging retirement (reinforcement proposition). We test these predictions using administrative data on older employees in the Dutch healthcare sector for whom we link adverse health events, proxied by unanticipated hospitalizations, to information on retirement decisions and actual incentives from administrative records of the pension funds. Exploiting unexpected health shocks and quasi-exogenous variation in financial incentives for retirement due to reforms, we account for the endogeneity of health and financial incentives. Making use of the actual individual pension rights diminishes downward bias in estimates of the effect of pension incentives. We find support for our affordability and reinforcement propositions. Both propositions require the benefits function to be convex, as in our data. Our theory and empirical findings highlight the importance of assessing financial incentives for their potential reinforcement of health shocks and point to the possibility that differences in responses to financial incentives and health shocks across countries may relate to whether the benefit function is concave or convex.
Please describe your area of study and how it relates to current policy discussions surrounding inequality.

My area of study focuses on a couple different aspects of inequality. The first is really thinking about the costs and the consequences of government policies that try to mitigate or deal with inequality, and thinking about how the government should think about the costs and benefits of those policies. The second aspect of my work does a deeper dive looking at the role of place, and thinking about the impact of where you grew up on generating inequality and, in particular, intergenerational inequality.

What areas in the study of inequality are most in need of new research?

I think there are so many different areas. We think the baseline models that existed for 30–40 years in economics and we lived in this representative agent world and that was very nice. There were theoretical motivations for doing that. But as we’ve kind of opened up that box and realized, there’s now a lot of different people with different skills, backgrounds, endowments, and that leads to tremendous differences in the effectiveness, the desirability, and the goals of different social policies. So I think the study of inequality should become so important because we went down a road of not putting it into our thinking enough in economics. So I think what areas then become most important for future work, I mean, there’s so many, right? We just started to uncover the role of places in inequality and mobility. I think we still are working through thinking about the fundamental constraints of what generates inequality. To what extent is it differences in skills, differences in the impact of things like trade policies, immigration, and these things that are ripe on the national news at night, are things that we have some evidence on but are still, there’s so much more to do to really understand the causes and consequences of inequality. So I would say, it’s hard to say there’s one area. I mean, if you’re interested in immigration, go study it. If you’re interested in trade policy, go study it. If you’re interested in the costs of redistribution, go study it. If you’re interested in market imperfections and how that generates maybe some more inequality, go study it. The areas have become so ripe I wouldn’t pin everything down on, “Oh, you have to go study this area.” Get excited about something and go study it.

What advice do you have for emerging scholars in your field?

The number one piece of advice I would give is find a topic that you’re interested in. There are a lot of topics out there, there are many topics that you could hear that other people are interested in. But at the end of the day, the best work, I think, is a topic that maybe somebody else, or maybe the majority of the field, wasn’t really focused on, but you’re passionate about it. And start to understand why you’re passionate about it and then go convince other people that it’s important and learn why. That kind of attitude towards research is something that I think will help with the general motivation that you need to have to execute on a project, of getting up every morning for a year working on a project that you hope will see the light of a day. And if you’re not the one that’s excited about it, that’s the end of that project. For me, I like to think of topics that show up maybe when I’m reading a book or watching TV, something that I’m just curious about and let that curiosity drive your interest. That would be my best advice.
FEATURED EVENT
Market Design Perspectives on Inequality

The rise in inequality has become a common topic in the public discourse, for good reason. Following the recession, the top 1 percent of Americans took home 85 percent of income growth, while the bottom 20 percent did the worst financially since World War II, with about a 30 percent drop in their earnings. But inequality does not apply solely to wealth or income, markets such as healthcare and education are also affected. The HCEO Market Design Perspectives on Inequality Conference, held August 6 and 7, 2016, brought together multidisciplinary experts to study these issues through the lens of market design. Conference organizers, Scott Duke Kominers, an MIP network leader, and Alex Teytelboym, an MIP network member, convened both market designers and experts in the economics of inequality to share their research on a variety of subjects from housing to refugee resettlement to youth employment.

The first session of the conference focused on international cooperation. Al Roth presented broadly on situations where people are motivated to cross international borders in order to improve their welfare, health, or safety. He discussed the challenges of market design in three areas: the global kidney exchange, surrogacy, and refugee qualification. While all three endeavors seek to improve lives, there are a myriad of challenges. For global kidney exchange and surrogacy, differences in international laws, for one, prevent efficient functioning despite a clear need for these services. For resettling refugees, a major issue is “qualifying” for refugee status, an investigative procedure that alienates those seeking refuge.

Similarly, Will Jones shared his research on the refugee crisis, suggesting that refugees be resettled by a centralized matching system, similar to what is used in many places for school choice. Jones argued that a matching algorithm can efficiently place refugees by factoring in a variety of priorities and preferences for both sides.

Ashok Rai began the session on poverty and vulnerability with a lecture on coffee contracts, and how best to improve outcomes for producers. Rai noted that the coffee trade is full of frictions, including quality concerns and lack of credit and insurance. He drew on fieldwork from Nicaragua, Costa Rica, and Ethiopia, and shared some ideas to improve contract outcomes for coffee producers.

Canice Prendergast discussed a project he has been involved with for several years through Feeding America, a national nonprofit working on hunger relief. Prendergast helped put in place a market system for the group that better allocates food. The system, which lets food banks auction for the items they are most in need of, has greatly increased efficiency and has reduced inequality in access to food for different areas of the country.

For a session on the digital economy, Avi Goldfarb focused on how digital markets raise privacy and inequality concerns. As more economic interactions take place online, Goldfarb said, more information is collected and stored, which not only affects privacy but also offers different benefits to consumers based on their socioeconomic class. For example, instances of price discrimination have been documented online. Future work is needed to examine how information markets may be designed with inequality issues in mind.

“Market design has turned economics into a tool for engineering”

- Scott Duke Kominers
Rob Metcalfe used big data from Uber to estimate consumer surplus using the company’s “surge” pricing algorithm. He found that in 2015, each dollar spent by consumers generated about $1.60 of consumer surplus.

Zvika Neeman and Ed Glaeser both presented on urban issues. Neeman discussed inequality in access to justice use the procedural mechanism “res judicata, which addresses inconsistency in the law. He found that cases must be stochastically correlated and the social welfare of two cases not separable in order for res judicata to apply. Glaeser lectured on the challenges of growing mega-cities in the developing world face, such as having low capital and inadequate public resources. He then discussed how market design can be used when a standard cash market is inappropriate.

For a session on schools, Jonathan Davis shared research on how mechanism design can be used to improve teach labor markets. He looked at how different candidate mechanisms might be used to improve teacher quality and reduce school inequality. Parag Pathak reviewed case studies on market design and school assignment.

On the topic of healthcare, Stacy Lindau discussed her work with CommunityRx, an information technology system that aims to connect people with unmet needs to local resources. She used the system, which operates in Chicago, to explore areas where market design might be used to reduce inequality and suffering. Similarly, Kate Ho shared her research on the consequences of narrow health provider networks.

Judd Kessler and Vincent Slaugh both shared research on lifetime opportunities. Kessler studied a summer youth employment program. One finding showed that participants had decreased incarceration and mortality probability. Slaugh examined the Pennsylvania Adoption Exchange, which pairs foster children with prospective families. A match spreadsheet tool helped caseworkers better utilize the information they collected.

Rob Collinson and Neil Thakral discussed public housing. Collinson identified three problems in the allocation of low-income housing, and offers some existing approaches to improve the system. Thakral also considered housing-assistance policies and how market design can improve allocation.

For the last session, on college admissions, Brent Hickman explored how affirmative action policies can be used to narrow the human capital gap. Alan Caniglia presented a case study on college under-matching. He found that promoting enrollment of high-talent low-to-moderate income students at value-added colleges increases economic efficiency.

Learn more about this event, watch videos of lectures, and download slides at: bit.ly/2lh4x47
The 2017 Human Capital and Economic Opportunity Global Working Group Summer School on Socioeconomic Inequality will teach the tools needed to study inequality and will communicate a sense of the frontier research. SSSI Chicago 2017 will break down barriers between theoretical, econometric, and empirical work in economics, and introduce insights from psychology and sociology.

**UPCOMING EVENTS**

**Understanding Human Capital Formation and its Determinants**

*November 3, 2017*

*Chicago, IL*

Markets network leaders Aloisio Araujo, Dean Corbae, Mariacristina De Nardi, and Lance Lochner will host a one-day conference on human capital formation at the University of Chicago.

**The Gut Microbiome in Human Biology and Health**

*November 9–10, 2017*

*Chicago, IL*

The goal of this workshop is to survey the rich body of literature describing the gut microbiota and its interactions with human environments in an effort to explore its potential integration into health disparities research.

**Workshop on Social Interactions and Crime**

*October 20–21, 2017*

*Chicago, IL*

HCEO Co-director Steven Durlauf and MIP network member Daniel Nagin will bring together a cohort of interdisciplinary scholars to discuss the causes and consequences of crime and inequality. The two-day conference will be held at the University of Chicago.

**NES-HCEO School on Socioeconomic Inequality**

*August 28 – September 2, 2017*

*Moscow, Russia*

The 2017 NES–HCEO Summer School on Socioeconomic Inequality will provide a state-of-the-art overview on the study of inequality and human flourishing. Participants will learn about the integration between psychological and sociological insights into the foundations of human behavior and conventional economic models.

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## RECENT EVENTS

### Online Resources

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<td>Summer School on Socioeconomic Inequality, Guangzhou, China</td>
<td>Jun. 25–29, 2017</td>
<td>bit.ly/2tO1Xmf</td>
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<td>Conference on Human Capital and Financial Frictions</td>
<td>Apr. 20–21, 2017</td>
<td>bit.ly/2gPplOx</td>
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<td>Conference on Genetics and Social Science</td>
<td>Dec. 8–9 2016</td>
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<td>Workshop on the Maternal Environment</td>
<td>Nov. 17–18 2016</td>
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<td>Asian Family in Transition Conference on Migration</td>
<td>Oct. 9–10 2016</td>
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<td>Market Design Perspectives on Inequality</td>
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<td>Summer School on Socioeconomic Inequality, Chicago</td>
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<td>Microeconomics of Life Course Inequality</td>
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<td>Human Capital and Inequality Conference</td>
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PERSPECTIVES ON INEQUALITY

We spoke with ECI network member Adele Diamond during CEHD’s recent Conference on Measuring and Assessing Skills about her research on executive functions and the prefrontal cortex. Executive functions are things like self control, selective attention, working memory, cognitive flexibility, problem solving, planning, and reasoning.

“I look at what biological things affect them, like hormones or neurochemistry, and what environmental things affect them, like poverty or interventions,” Diamond says. “What I’m concerned about is how to help kids thrive. One of the ways is to help them have healthy executive functions.”

She also discussed her more recent work exploring the benefits that music and dance can have on executive functions, which combines her interest in dance and cognitive neuroscience. Diamond and her team are also looking closer at some things that have long been assumed to be beneficial, but that have little evidence behind them.

“People have focused too much on just narrowly training cognition or improving aerobics to improve cognition,” she says. “Instead of thinking about the incredible power that the emotions have, whether you’re emotionally invested, whether you’re motivated, whether you’re enjoying the activity. And we think that’s key to their benefits.”

Her lab is also exploring ways to make education benefits last longer. “Nobody has looked at what would help them last longer,” she says.

Diamond is the Canada Research Chair Tier 1 Professor of Developmental Cognitive Neuroscience at the University of British Columbia.

Watch Diamond’s Interview: Link: bit.ly/2sPW1ZO

Watch Recent Interviews:

- William Revelle Link: bit.ly/2rAC9N1
- Turhan Canli Link: bit.ly/2qKWu2P
- Daniel Silverman Link: bit.ly/2rkpkFM
- Rebecca Myerson Link: bit.ly/2qlaHIt

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ABOUT HCEO

Founded in 2010, the Human Capital and Economic Opportunity Global Working Group (HCEO) is a collaboration of over 500 researchers, educators, and policy makers focused on human capital development and its impact on opportunity inequality. HCEO’s unique approach enables collaboration among scholars with varying disciplines, approaches, perspectives, and fields, and integrates biological, sociological, and psychological perspectives into traditionally economic questions. The result is innovative thinking and approaches to inequality and human capital development research.

HCEO is led by Nobel laureate James J. Heckman, the Henry Schultz Distinguished Service Professor of Economics at the University of Chicago; Steven N. Durlauf, Professor at the University of Chicago Harris School of Public Policy; and Robert H. Dugger, the co-founder of ReadyNation and Hanover Provident Capital.

HCEO focuses its efforts through six research networks that study the most pressing issues within human capital development and inequality: Early Childhood Interventions; Family Inequality; Health Inequality; Identity and Personality; Inequality: Measurement, Interpretation and Policy; and Markets. These networks produce one-of-a-kind conferences, research programs, and publications that highlight findings from the best science and the application of best practices. Through its networks and their resulting research, HCEO plays a vital role in understanding and addressing opportunity inequality around the world.

Impact

- Multidisciplinary networks result in new approaches to research and its application
- Relationships with governments and policy makers put best practices into action
- We have influenced numerous research studies and governmental policies
- Findings are being applied in one of the largest populations in the world—China

We Play a Vital Role

- Income and opportunity inequality is a global and growing problem
- Governments, private think tanks, and others each look at only a portion of the total problem in hopes of finding a lasting solution
- Only HCEO integrates biological, sociological, and psychological perspectives into traditionally economic questions addressed by multidisciplinary teams of experts

- Our research approach treats social science research as an empirical endeavor, resulting in rigorously tested public policy directions and solutions
- Our research provides insights and directions on how to best foster human flourishing and improve economic productivity

Learn more at:
hceconomics.uchicago.edu/about
HCEO is run by the Center for the Economics of Human Development, and funded by the Institute for New Economic Thinking.

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