At the helm of Tinbergen Institute
An interview with Maarten Janssen

On commuting

Finance and inequality: Theory and evidence

New column: Letters from Alumni
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Tinbergen Institute’s new General Director, Professor Maarten Janssen, has an excellent scientific record, is a highly praised pedagogue and has already demonstrated his management skills as Director of the Economics Group at Erasmus Universiteit Rotterdam. The electoral committee strongly believed that his tact and ability will be crucial in guiding the Institute through the challenges on the horizon: expanding the educational programme and obtaining the extension of the accreditation granted by the Royal Netherlands Academy of Sciences in 2000.

I would like to start by congratulating you on your appointment as the General Director of the Tinbergen Institute. I hope you will enjoy your new responsibilities, which brings me immediately to my first question: What exactly are the responsibilities of the General Director of Tinbergen Institute? How do they differ from the tasks of the Director of Graduate Studies, Jaap Abbring?

Thank you very much. Well... The General Director is ultimately responsible for everything going on at the Institute. Having said that, I share with Jaap the responsibility for the MPhil and PhD programmes, the philosophy behind them, and their financing. Jaap deals with the daily affairs, admissions and supervision. I attend to the research institute and fellow appointments, relations...
with the three founding faculties and other external relations.

What is your own vision of your new responsibilities?

There are two things that I would particularly like to accomplish: to satisfy the wish of the Board of TI on the point of extending our activities beyond the fields we presently cover, and to increase the international visibility of the Institute, which I think is related to the fellows’ attitude towards TI.

You will understand how much of a challenge the first issue is, once you have looked back into the history of Tinbergen Institute. Actually, business economics was part of the Institute in the early days. Then, in the ’90s, TI restricted its scope to a core programme in economics, econometrics and finance. There are several good reasons for TI to broaden its scope now, as there are more and more researchers in finance, marketing and organisation that use the same tools as in microeconomics and econometrics. Nevertheless, we must be rigorous in safeguarding excellence in teaching and research, and in exploiting synergies with the existing programme. Personally, I would also like to see a more extensive introduction of other fields of economic science that are currently only partially covered by the Tinbergen Institute (such as law and economics or health economics). I think it would benefit the Institute to offer courses on these topics and to have top researchers in these fields co-operate with us.

As I mentioned earlier, there is also a second issue... What I find very important is that fellows feel as strong an association with the Tinbergen Institute as with their home faculties. TI would make an excellent focal point for economics in Europe. Look at the Institute’s research rankings, for example: the Institute itself is not ranked at the moment, while the three departments are separately. They come out as 10th, 15th and 30th in Europe. If the publications of the departments were added up, Tinbergen Institute would rank first in Europe and 15th worldwide! By lending an ear to fellows’ wishes, I hope that I can make them feel at home here and appreciate TI as their Institute.

Looking at your CV, one has to wonder whether your day has only 24 hours. You are currently involved in teaching regularly, managing the Tinbergen Institute, running the Economics Group at EUR, working as a consultant through the Erasmus Competition and Regulation Institute ECRi, organizing seminar series at the TI, supervising four PhD students, conducting your own research, etc. On top of that, you have a family with two young children. What is your secret?

First, management must be done efficiently: delegate, be clear what you want, and trust the people you work with, that they can do a good job in working out the details. I have an excellent team here at the Institute, and that helps... The same is true for PhD students: I have developed a certain scheme for our cooperation. In the beginning, we work together on a paper, and then gradually the students work more independently. In the last two years of their programme, we actually discuss only the ideas for papers, and they work it out themselves... With teaching, it’s all up to experience. I have now been teaching for fifteen years or so; I know students, and I understand what they may find difficult.

You also mentioned consultancy... Actually, until three or four years ago I was a pure academic—not very keen to work on applied issues. At some point in 2001 the Dutch Parliament wanted to evaluate the UMTS auction (the auction of the 3G mobile telephony frequencies), which took place in the summer of 2000. Similar auctions have also taken place in other European countries, such as England and Germany. In comparison, the Dutch auction generated disappointingly low revenue. The Parliament wanted to find out whether or not the auction was badly designed. This was the first time that I applied economics to a serious real-world issue. It compelled me to find out what economic theory in fact has to say about real life, and it was a real eye-opener. My academic research has changed as a result: I’m now much keener to start off with an important real-life question, rather than with a modification of a theoretical model. The combination of research and consultancy work has been both inspiring and fruitful: my recent research still revolves around auctions. This time, we analysed the allocation of commercial radio frequencies in the Netherlands. My latest book is also about auctioning public assets.

I have to ask, then: how should we auction public assets?

What makes the kind of auctions I study particularly interesting is the fact that there is a market after the auction. There are two important issues that have to be considered. First, you have to consider the following: how much entry can support an efficient after-market? How do you organise the auction to stimulate enough entry? How do you deal with asymmetries between bidders? Usually you have a few (privileged) incumbents in the market and some newcomers. How do you give entrants a fair chance of obtaining the license? Another important issue is the specification of the goals that the government wants to achieve. Revenue is one possible goal; another might be efficiency in the after-
market. It is important to stress that these goals usually cannot go together: if you have an efficient (that is, highly competitive) after-market, then profits are low and you cannot get much revenue. In the case of auctioning Princes Diana’s dress, maximum revenue would be a good objective, but in the case of mobile telephony, an efficient after-market might be much more important.

We have been discussing your most recent work. I have looked at your professional interests, trying to see a broader pattern, and here it is: you started your career as a macroeconomist, then you became interested in the microfoundations, and finally you chose to devote yourself completely to microeconomics. Why is that? What is your story behind microfoundations?

My academic research has changed: I’m now much keener to start off with an important real-life question, rather than with a modification of a theoretical model.

My interest in microfoundations came with my interest in the philosophy of science. As you probably know, I obtained a Master’s degree in the Philosophy of Economics just after I graduated with a MSc in Econometrics. In the philosophy of science there is some literature on the relation between theories at the micro-level and theories at the macro-level. Just to give an example: in physics you have the ideal gas law, which describes properties of the gaseous state, and you also have theories on how individual molecules move and interact... You can ask a question: how is the ideal gas law related to the theories we have about the behaviour of molecules? I thought a similar problem might be of interest in economics. It seems that in economics this issue is much more complicated. First of all, the micro theories we have are sometimes not very accurate in describing the actual behaviour of individuals, contrary to physics. Then, there are many exogenous variables at the level of the economic system that affect interactions among individuals... I am somewhat pessimistic about whether we will ever be able to make the transition from micro to macro in a fully satisfactory way. I think that for the moment we should simply accept the fact that at the macro level certain regularities (which are hopefully quite stable) exist that we cannot fully track down to the behaviour of individuals— and that, on the other hand, we have theories on how people behave individually.

I am acquainted with both you and Jaap, and sense that you will make an excellent team, comparable to the Coen Teulings-Maarten Lindeboom duo. Jaap has slightly more diversified international teaching experience, while you have substantial management experience. You are both brilliant scientists. It looks like a recipe for success...

I couldn’t agree with you more; I think it’s a very nice team. We complement each other. You see, in a team it’s important for each member to have different areas of expertise; on the other hand, it’s important to have some overlap, so that you can communicate with each other. Jaap and I actually share interest in models with incomplete information: I am more of a theorist, while Jaap has done some applied research in that field. And as you said, I probably have more management experience, and some experience in consultancy. Jaap has an excellent international network. I think that while we can really benefit from each other’s expertise, we share enough common ground to assure smooth cooperation.

Thank you.
Introduction
As the activity that physically connects the residence and workplace of employees, commuting spatially links housing and labour markets. The ubiquity of commuting in our society is a relatively new phenomenon: it is a characteristic of industrialised economies in which firms employ most of the workers. Average commuting time has been quite constant over the last decades, whereas average commuting distance has been on the rise for at least a century. Although commuting is relatively unimportant (measured in kilometres) as a travel phenomenon (only 25% of km. travelled are due to commuting), it attracts a great deal of attention (and not only by economists) because it is the main contributor to road congestion: employees tend to commute at the same time, and workplaces tend to be spatially concentrated. Road congestion is a negative externality: car drivers thus impose time costs on each other.

Are commuting costs minimised?
The traditional (neo)classical way of thinking about commuting is that the length of the commute is the result of an employee’s choices regarding workplace and residence locations (White, 1986). Employees thus optimally choose the commute. Now, suppose that all jobs are identical, and all residences are identical (apart from their locations). Employees with a long commute must then be compensated either in the housing market (through lower house prices) or in the labour market (through higher wages), and the total commuting costs in the entire economy are minimised. One theoretical result suggests that the government should address the negative externalities due to road congestion, but allow the market to determine the location of workplaces and residences. Yet, is it realistic to assume that employees optimally choose workplace and residence locations? For example, one requirement would be that employees have full information about job opportunities and can change jobs at no cost. The main difficulty here is that the dominant way of thinking nowadays about the functioning of the labour market is that search frictions are relevant: unemployed and employed job seekers have limited information about job opportunities and must search for jobs. This indicates that workers may not be in their optimal job location.
A straightforward method to evaluate whether employees are situated in the optimal workplace location is to examine the relationship between the length of the commute and whether the employees search for another job (van Ommeren, 1998, 2000). It can be easily shown that a long commute induces on-the-job search (see Figure 1). Apparently, employees with a long commute are worse-off (they are not compensated by higher wages), and attempt to reduce the length of the commute by changing job (or moving house). The main lesson to be learnt here is that search frictions increase the commute.

In the housing market, search frictions are probably less important. Residences are more like a standard commodity. However, the presence of residential moving costs prevents employees from relocating their residence to the optimal location (van Ommeren and Leuvensteijn, 2003). In particular, when employees have a temporary contract, or anticipate moving to another job within several years, they will not reduce their commute by relocating their residence closer to the workplace after accepting a new job. This explains why most studies conclude that commuting is both inefficient and ‘wasteful’ (Manning, 2003; Hamilton, 1982).

**Personnel policy of firms**

Empirical research on commuting tends to focus on employee behaviour. Theoretical studies pay somewhat more attention to firms, as they determine wages and workplace locations. Nevertheless, the personnel policy of firms tends to be ignored in both theoretical and empirical studies—which is strange, since many examples illustrate the relevance of firm personnel behaviour for commuting.

Job applicants who receive a job offer are frequently offered a commuting-cost reimbursement, or a reimbursement in the form of a company car, but other successful applicants are offered relocation-cost reimbursements to move closer to the workplace. Although firms may be financially indifferent between one-time (partial) reimbursements of relocation costs, or continuous reimbursements of commuting costs, the effect on the commute is distinct. Relocation-cost reimbursements increase the likelihood that employees move residence closer to the workplace, whereas commuting-cost reimbursements decrease the odds (van Ommeren, van der Vlist and Nijkamp, 2002).

In Europe, many firms offer company cars as a (fiscally attractive) fringe benefit within the compensation package. Firms are more likely to offer company cars to those employees who must travel during work hours for job-related reasons. These cars may be owned by the company or leased from a lease company. In the Netherlands, 42% of new automobiles, 12% of all automobiles, and about 20% of all automobiles on the road at any given time are company cars. During rush hours, the proportion of company cars may be even higher. Although employees driving a company car may receive a lower wage and pay additional income tax, the marginal monetary costs for the use of the car are zero. Whether this exacerbates the use of the company car for private or commuting purposes is the important research question here.3

Although the answer to this question is unknown, the Dutch tax system seems to offer the wrong incentives regarding fringe benefits: whereas the use of the company car is not taxed at its full value, relocation-cost reimbursements are taxed as income in the Netherlands (apart from a certain threshold, which is only, on average, 25% of the average moving costs for owners).

**Government policy**

Government policies influence commuting behaviour– not only by taxing commute-related fringe benefits differently from labour income, but also in many other ways. This article focuses on two types of government policies that should receive more attention: road pricing (with its negative consequences) and zoning (assigning land to specific purposes).

Although transport economists have offered several ‘solutions’ to the negative externalities of road congestion, they tend to focus on road pricing. To what extent, however, will car drivers switch to public transport as a result of road pricing?4 The commuter selects the mode that will minimise commuting costs, which consist of a monetary component and a travel-time component (other relevant items may be convenience, flexibility, etc.). Road pricing
increases the variable monetary costs, but only slightly reduces time costs. Commuters seem to regard travel-time costs as relevant, whereas monetary costs seem to be relatively unimportant (van Ommeren and Dargay, 2004). Road pricing will thus have hardly any influence on the choice of the mode of travel. Improvements in public transport, however, may have an influence. This may explain why in Hasselt (a small town in Belgium), free use of the bus hardly stimulated car users to switch to the bus. However, an increase in the frequency of the bus trips (which determines the expected waiting-time costs), and in the number of routes, seemed to persuade more car drivers to switch to the bus.

In many European countries, government policies in zoning land for housing, workplaces, leisure etc. influence the spatial structure of the economy and therefore commuting behaviour. Thus, the government and the market both determine the potential workplace and residence locations available to employees.

An example in the Netherlands is Almere, a government-created town not too far from Amsterdam (and Utrecht). With 160,000 inhabitants (expected to grow to 300,000 within 20 years), Almere is a large town by Dutch standards. Many of the town’s inhabitants want to work and therefore supply labour. By creating this residential area, the government has formed a local labour supply, which is only partially met by local labour demand. The typical employee who lives in Almere therefore tends to work in neighbouring cities, such as Amsterdam. Not surprisingly, the average commute of workers living in Almere is relatively long, creating many negative externalities. Yet, the creation of Almere may prove to be optimal in the long run, because over time more jobs will be created in Almere, reducing the average commute (thus, jobs follow people).
This adaptation process is extremely slow, however, and in all likelihood it will take several decades at least before local labour supply and demand are in equilibrium (Vermeulen and van Ommeren, 2004). This raises also the question to what extent people follow jobs. Empirical research shows that the population is not responsive to shifts in jobs to other regions. This result is extremely important: it demonstrates that zoning land for housing, and in particular for workplaces, is not without cost to society. One major consequence would be that the Dutch government should allow the market to decide where to locate residences and workplaces.

Commuting is a phenomenon of our society with particularly important ramifications, due to its contribution to road congestion (with its negative externalities). Commuting behaviour may be influenced by government policies directly via road pricing but also indirectly by influencing firms and employees in the labour and housing markets.

References

Notes
1 The main reason is that employees have become richer, and their value of time has increased. Workers have switched from slow but cheap modes of transport (walking) to faster, but more expensive alternatives—particularly the car. In the Netherlands, the average commuting distance (one-way) is currently about 18 kilometres, which exceeds the distance of any other European country.
2 How much additional wage would the average commuter wish to receive as compensation for one additional hour of commuting? A general conclusion is that the wage compensation for one hour commuting is much less than the hourly wage rate. Van Ommeren, van den Berg and Gorter (2000) find that the compensation for one hour of commuting is about half of the hourly wage rate. This information can be used to calculate the costs of congestion for the average commuter.
3 The average commuting distance driven with a company car is about 50% longer than with the personal car. Any causal relationship between the use of company cars and commuting distance is not clear. Company cars are offered particularly to those job applicants with long commutes (van Ommeren, van der Vlist and Nijkamp, 2002).
4 The travel mode literature has a long history. Since the pioneering work of McFadden (1974), a number of studies have explored the choice of travel mode.
5 Nevertheless, the creation of Almere may have been a good idea from an economic point of view. Employees rationally choose to live in Almere, as they are compensated by lower house prices (as well as by larger gardens, etc.) for their long commute.
Introduction
A key controversy with regard to globalisation is whether free trade increases opportunities mainly for more productive individuals. Diffused entrepreneurial activity is an important determinant of economic renewal. Johnson et al. (2003) show that the success of new entrepreneurs determined the relative success of transition countries. Yet, while market reform proponents believe that liberalisation removes barriers for everyone to participate in broader exchange possibilities, opponents claim that reforms usually benefit a minority, and that economic inequality often increases after such reforms. If inequity further reduces access to productive opportunities, then the value of liberalisation may be brought into question.

Background
In theory, an effective financial system plays a vital role in economic growth. Improved access to funding may enhance the equality of opportunities, and reduce inequity. A more developed financial sector promotes subsequent economic growth.

Most financial reforms, however, do not target financial broadening (which expands access), but instead focus on financial deepening. Financial deepening emphasises formal, complex, large-scale institutions typical of developed economies, such as stock and bond markets, or policies maximising capital inflows—with scant attention paid to their distribution or to the promotion of greater domestic competition.

These deepening reforms favour the more established producers. Particularly in inequitable societies, they offer limited access to funding, and at times produce crises that narrow access to funding still further.

Gains and losses from liberalisation
What is the underlying mechanism for this effect of liberalisation? A classic view is that liberalisation initially favours firms with established comparative advantages. This appears not to be the case, however. Concentration of funding has not produced better returns. For instance, in many reforming countries losses on larger loans were much larger than for smaller loans, which suggests connected lending to powerful groups (on Mexico, see La Porta et al., 2002; on Russia, see Laeven, 2001, Gelfer and Perotti, 2000, and Perotti, 2002).

While gains tend to be concentrated, losses from liberalisation are often socialised. Crises in many developing...
countries have imposed heavy fiscal costs and have led to the economic disruption of society (such as in East Asia, Russia, Mexico or Argentina). Extensive misuse of bank lending often favoured well-connected individuals, while losses were shifted onto the public safety net (Halac and Schmuckler; de Silanes et al., 2002; Haber, 2004). Default costs were often funded via inflationary spending or fiscal cuts, hurting weaker social groups. The worst impact has not been on the poorest, however, who hardly participate in the formal economy and have little to lose; rather, the middle- and lower middle-income fractions of the population have been the hardest hit.

Why does liberalisation favour established interests?
Claessens and Perotti (2004) interpret this top-down approach to financial deregulation as a distortion introduced by established interests in countries with poor democratic scrutiny. A clue to this interpretation comes from recent evidence that initial inequality in such a country hinders the proper design and implementation of reforms. Established economic interests may block financial reform, if such a reform challenges their privileged access to capital (Rajan and Zingales, 2003; Perotti and Volpin, 2004). New theoretical work shows that even when broadening liberalisation is imposed from outside (e.g. by the IMF), established lobbies may manipulate its design and/or implementation in order to capture most of its benefits and to socialise its costs (Perotti and Feijen, 2004). The mechanism is simple: lobbying efforts for weak enforcement of investor rights lead to most poor entrepreneurs being either unable to raise enough funding, or, because they are more leveraged, more susceptible to being denied essential refinancing in a crisis. In fact, Keefer (2001) shows that liberalisation is more often followed by banking crises in countries with poor political institutions.

Recent evidence has also shown shockingly high barriers to starting new businesses in poor countries. Barriers include an exorbitant number of licenses and regulatory agencies, onerous formalistic rules, high fees and taxes. Such rules appear to be designed to create opportunities for bribery (Shleifer and Vishny, 1993). Acemoglu (2003) and Perotti and Volpin (2004) show that political accountability weakens the strength of elites in blocking entry. Moreover, Klapper et al. (2004) and Djankov et al. (2003) show that entry barriers are in fact higher in more corrupt and in less democratic countries. Barriers to economic participation thus ultimately favour established interests, limit growth and increase inequality.

Recent attention has also focused on measuring informal barriers (such as poor contractual enforcement) that obstruct financing, create predatory behaviour by regulators, and bias contractual enforcement
in favour of established producers. Small entrepreneurs often escape such requirements by remaining in the informal sector, which undermines their access to finance, limits their trade opportunities, keeps them dependent on established firms and generally hinders the growth.

A key question is whether poor enforcement is simply the result of an historically poor legal structure (as in La Porta et al., 1998), or whether laws are opportunistically enforced. Perotti and Volpin (2004) prove that lobbies of established interests have a natural advantage over competing lobbies of potential competitors, since restricting new entry produces larger pure rents, and thus generates more resources for political contributions and bribes. The article goes on to prove that poor political accountability (which fails to constrain political abuse) and high inequality will produce lower entry rates in sectors that require more external finance. Strong evidence obtained to support the model reveals, in particular, a negative correlation between entry and poor legal enforcement.

The final test shows that the quality of legal enforcement is best explained by political accountability and inequality, even after controlling for legal origin. This proves that it is neither the legal tradition nor the text of legislation that matter, but rather whether enforcement is subject to political opportunism. Graphs 1 and 2 illustrate the impact of inequality and political accountability on the quality of enforcement. These results are robust to controlling for per capita income, assuaging the concerns raised by Glaeser et al. (2004) that institutional quality increases with economic development.

Political accountability, a measure of the concentration of political access, thus has a direct effect on economic development because it affects access to resources. By undermining the reliability of laws, low political accountability distorts access to finance, and can thus destroy any private contractual solution. These results echo the empirical conclusions in Acemoglu and Johnson (2003): constraints on political power have a major impact on growth, while measures of legal efficiency affect financial development, but do not directly raise growth. Thus, while the quality of financial development is critical for growth, it is endogenous; beyond proper legislation and policies, growth also requires proper enforcement, which can be undermined in corrupt, inequitable, and undemocratic regimes.

**Conclusions**

Recent evidence suggests that financial crises in developing countries often arise because of deliberately poor design and implementation of reforms— itself the consequence of a highly skewed distribution of wealth and power. In highly inequitable circumstances, top-down, deepening reforms are simply too vulnerable to abuse. The consequences create a political backlash that undermines the sustainability of valuable reforms— as is happening in Latin America. This situation does not arise because liberalisation is inappropriate, but because it is too easily captured and distorted in inequitable societies with poor governance.
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Regression on the quality of legal enforcement (48 countries)

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When I was asked to write a letter for TI Magazine about my working experience after finishing my PhD, my mind went back to my first two years at the International Monetary Fund. During those years, I was in the Economist Program working first in the African and later in the Research Department. I started in a group of eighteen young economists, most of them with fresh PhDs. Every Thursday evening at 6:30 we would meet a few blocks from the Fund to share a beer and some pizza. We would talk about our new employer and the idiosyncrasies of living in Washington DC. Sometimes you could find us lamenting about how much time we spent doing such mundane things as fiddling with Excel spreadsheets and writing minutes, and about the many papers we had to review while being under continuous time pressure. By 8 o’clock, after a few too many beers, we would be betting who would be the first of our group to leave the Fund. Now, several years later, I can safely say that those bets were widely off the mark—perhaps no wonder, given the reputation of economists in this area.

I don’t think our misgivings were specific to our group or the institution we worked for. Rather, I believe it was part of a natural process we went through. After many years in university, where you can let your mind roam and are encouraged to question everything, it requires some adjustment to be suddenly transposed to an environment with short deadlines, where questioning everything all the time is simply not practical.

Seven years ago, I came to the Fund expecting to be exposed to the realities of economic policymaking in countries across the world, and to have some time to write an occasional research paper. Looking back, I think my assignments have largely lived up to that expectation. I have worked on about eight different countries, each with a unique set of economic problems, and I have dealt with a broad range of topics from fiscal policy to bank restructuring, and from monetary policy to issues in foreign trade. I must say, however, that I have had less time for research than I expected, and most of the papers I have written are more applied than academic. That is a pity, because operational work often yields interesting ideas for research, and the Fund has a very active seminar and workshop program that allows you to exchange ideas with leading economists from all over the world. Nevertheless, I consider myself fortunate to work with very bright people from many different countries in an organization that brings together virtually all economies in the world.

Our ‘group of eighteen’ has not been disbanded, but we no longer meet on Thursday evenings. We’ve all become busier and, perhaps more importantly, over time most of us have adjusted to our new environment. Several members, often not the ones we predicted, have left the Fund. Most have returned to academia or have joined think-tanks. Where will I be seven years from now? The best prediction is probably that I will still be at the Fund, but don’t bet your money on it.

The Board of TI
Magazine has decided to introduce a new feature: Letters from Alumni.
Beginning with this issue, the Board will ask one Alumnus to describe “life after the PhD thesis and defense”.
In this first letter, Harm Zebregs sketches a picture of his life at the IMF in Washington D.C. Harm graduated in 1998 from TI with a thesis on International Capital Movements and Technology in Economic Development.

Letters from Alumni

Harm Zebregs, IMF


in short

papers in journals

Behind international differences in male skill wage differentials

Wage inequality differs substantially across countries, and is larger in the US than in continental European countries. This is especially the case at the bottom of the wage distribution. Economists often debate the causes of these differences. Some argue that differences in institutions (such as minimum wages, unions and employment protection) explain most of these differences, whereas others make a case for differences in demand and supply forces. Previous research has attempted to test the demand and supply explanation by constructing a skill index based on years of schooling and years of work experience. This index is used to construct skill groups and to compare the relative wages between countries. These relative wages are then contrasted with relative net supply. Following this procedure, researchers have found no relation between the relative wage position of a skill group and its relative supply.

The current paper argues that this procedure, which ignores differences in educational systems and post-school training systems across countries, will result in faulty rankings if these differences matter. Instead of using education and training outcomes, the current paper relies on information from literacy and numeracy tests that were developed with the explicit aim of being comparable across countries. Performing the analysis using this direct measurement of skill completely reverses the findings of previous research. A larger relative net supply of a skill group is associated with lower relative wages of that same skill group. More specifically, low-skilled employees are relatively worse-off in the US than their counterparts in continental Europe, not because they lack the protective labour market institutions, but because there are so many of them. Reducing the supply of low-skilled employees may therefore—after all—be an effective means to improve their relative wages.


To unite or to separate?

When two regions—one large and one small—are faced by a decision to unite or to separate, their incentives may be considered in terms of a basic trade-off: separation allows each region greater influence over the nature of political decision making, while unification allows the unified region to exploit economies of scale in the provision of government. The findings in this paper suggest that if regions have dispersed preferences, then a small region is relatively more eager to form a union, compared to a large region. The incentives of a large region to form a union increase with the level of homogeneity of its preferences, however, while the reverse holds true in the small region.

The paper goes on to explore the social welfare of decisions made on the basis of majority voting in regions. The main finding: majority voting leads to excessive separation. A discussion of alternative voting systems reveals that a majority voting system supplemented with unification as a default option mitigates this social inefficiency to some extent, but still allows excessive separation as a possibility.

When the small region is very small, the tax burden of a government is excessive; this region may then be tempted to accept unequal or unconditional union. Under this arrangement, voters of the large region alone may decide on public policy, but inhabitants of both regions pay for the public good. This arrangement—clearly of interest to the large region—will be supported by the small region only if the region is very small. Unequal union is thus possible only if the regions are of very different sizes.

The paper relates these findings to empirical evidence on secession movements and outcomes of referenda (on union and separation) in different parts of the world in recent years.


discussion papers

Information overload in monopsony markets

In the economic literature, market inefficiency is often blamed on lack of information, implying that the more information, the better. However, some empirical evidence suggests that excessive information reduces the quality of decision-making, as economic agents are unable to deal efficiently with too much information. This paper argues that modern-day economies may experience problems of information overload, at which point the cost of information transmission decreases sharply, and the human ability to process the growing quantity of information becomes a scarce resource. The author addresses the information overload problem in the specific situation in which many applicants compete for a job position, and employers screen applications in order to select the best applicant.

The model developed here borrows standard concepts from the economics of information. A central assumption is that when infinitely many applications are processed, then each application provides no information about the ability of the corresponding applicant. Within this framework, information overload can arise as an equilibrium outcome.
The results show that information overload indeed occurs when the cost of application is low, relative to the information-processing technology level. In this case, it is optimal behaviour for fully rational employers to neglect some applications.

By Stefano Ficco (EUR), Information overload in monopsony markets TI 04-082/1

Dynamics of Chinese comparative advantage

The rapid development of the Chinese economy is almost daily headline news. Chinese economic growth (after correcting for international price differences) was about 7.25 percent per year in real terms in the period 1980-2001, implying a doubling of output every ten years. In the past two decades, China’s GDP moved from a fifth place in the world ranking of 1980 (behind the US, the Soviet Union, Japan, and Germany) to second place (behind the US) in 2004. Relative to American GDP, Chinese GDP rose from about 25 percent in 1980 to about 62 percent in 2004.

What caused this rapid development? A broad consensus argues that tremendous structural changes within the Chinese economy are the primary economic forces enabling China’s rapid economic development. These include, in particular, the way China is interacting with the outside world in terms of international trade and foreign direct investment flows. Exports and imports, for example, have increased dramatically, from about 2 percent of GDP in the early 1970s to about 24 percent today. Unfortunately, traditional statistical trade tools do not accurately identify particular periods of structural change.

Such periods of structural change may be identified using another method, however: calculating the recently introduced Harmonic Mass index to trace over time the distribution of comparative advantage for a country’s industries. Application of this technique to China (and to two other Chinese economies, Taiwan and Hong Kong) reveals two important years regarding structural change: 1980, when China started to open up to international trade flows, and 1985, when the start of foreign direct investments initiated the rise in technology-intensive exports. During this period the composition of Chinese exports changed structurally towards more unskilled-labour-intensive and technology-intensive exports, while there was a drastic decline in the export of primary products.

By Jeroen Hinloopen (UvA) and Charles van Marrewijk (EUR), Dynamics of Chinese comparative advantage TI04-034/2

Survey non-response and unemployment duration

Social surveys are the starting point of a great deal of empirical research in social sciences. However, the datasets compiled from the surveys are generally infected by the problem of non-response. This paper analyses how problematic non-response can be in the analysis of unemployment duration. Using a unique dataset that combines survey information of workers with administrative records of the same workers, the paper examines the bias caused by non-response. The findings provide evidence for bias in results that are based on survey data alone. In this case, failing to account for survey non-response leads to a downward bias of the exit rate out of unemployment and an overly optimistic estimation of duration dependence.

What is behind this downward bias? The paper explores the data variation in the timing of the moment of exit out of unemployment relative to the survey date in order to distinguish between two explanations: selectivity and causal effect. Selectivity occurs if unobserved determinants of unemployment duration are related to non-response behaviour. The causal effect arises when the fact that workers move to employment before the survey date increases the probability that they become non-respondent. The findings suggest that both selectivity and causal effects play a role in such a bias. This result has devastating implications for the efficacy of standard methods to handle non-response bias (imputation, weighting, instrumental variables).

By Gerard J. van den Berg and Maarten Lindeboom (VU), and Peter J. Dolton (University-upon-Tyne, and Centre for Economic Policy, LSE), Survey non-response and unemployment duration TI 04-094/3
Two approaches to vehicle and crew scheduling

Due to heightened competition in the public transport market and the pressure on governments to cut expenses, cost reductions in public transportation have been receiving increased attention. Since the main resources used in public transportation are vehicles and crews, the production of efficient vehicle and crew schedules is an important issue. This thesis considers two variants of the vehicle and crew scheduling problem: the integrated approach and the dynamic approach. In the integrated variant, vehicle and crew scheduling problems have been solved simultaneously, while in the dynamic variant a sequence of optimization problems has been solved. The stochastic nature of the travel times has also been taken into account in the dynamic vehicle and crew scheduling problem.

Finally, the thesis considers the executions of the planned schedules at the day of operation. If predetermined schedules are executed on a certain day, many things can go wrong. A delay at a particular moment can cause hold-ups in other trips assigned to the same vehicle, which leads to a ‘snowball’ effect. To prevent this possibility, a dynamic approach has been suggested; this has resulted in the development of several approaches to improve service to the passengers and reduce the number of delays, while the costs remain equal.

Thesis: ‘Integrated and dynamic vehicle and crew scheduling’, by Dennis Huisman
Published in the Tinbergen Institute Research Series #325

Retirement, expectations and realizations. Essays of the Netherlands and Italy

Most economically developed countries face the challenge of aging populations. The two countries analysed in this study, the Netherlands and Italy, are no exceptions. If the demographic picture is worrying, the economic outlook is even worse. In both Italy and the Netherlands, the labour market participation of older workers has diminished drastically. This thesis presents summary statistics for Italy that show that, at the end of the 1990s, approximately only 30% of the over-60 patern familias were still active. In the Netherlands, this figure is even lower: about 15%. Only 30 years ago, however, the participation of the elderly was comparable to the participation of the other age groups: in the 1970s, 80% of the males over 55 years of age were employed.

The literature has paid a great deal of attention to household retirement. This thesis specifies and estimates retirement models for singles and married couples. These models, which are estimated on data from the Dutch Social Economic Panel and the Italian Survey on Household Income and Wealth, postulate that financial incentives are a determinant of retirement. For the Netherlands, the recent policy developments for the old-age pension regulations (AOW) were found to have the unintended effect of lowering female labour market participation, when women cohabit with an older partner. Many Dutch people also fear an unexpected shock in their financial situation around retirement. The study’s findings suggest that their fears may be unjustified. In Italy, where data concerning retirement expectations are also available, pension reforms seem not only to have moderately prolonged working life, but also to have increased uncertainty about the future.

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