Tradeoffs

Department of Economics
University of Toronto

Fall 2001

In this Issue

Message From the Chair

by Mel Fuss

My year as Acting Chair was an eventful one. This was my second tour of duty, having previously been Chair during 1985-1990. I am struck by the ways in which technological change has impacted on the position in the past decade. The coming of age of fax machines, e-mail, and cell phones has increased the expectation that information will be communicated to other administrative units without delay, and that decisions will be made rapidly. There is no doubt that the time pressures have increased considerably.

I am gratified by the outstanding achievements of our recent hires; our success this year in recruiting; and our renewed sense of commitment to the Commerce and Finance Program. For the fourth year in succession, this department has won the Polanyi Prize in Economic Science, given to the most promising young economist teaching at an Ontario university. This year's recipient is Joanne Roberts. Congratulations, Joanne! Joining the previous year's hires of assistant professors (featured in this newsletter) are Eugene Choo, from Yale University; John Maheu, from the University of Alberta; Stephane Mechoulan from Northwestern University; and Johannes Van Biesebroeck from Stanford University. During the past year we also made a very significant senior appointment. Christian Gourieroux, an internationally acclaimed econometrician, will be spending half of each year in Toronto. The remainder of the year will be spent at his current position at the University of Paris.

The Commerce and Finance (B.Comm) program is in the process of expanding its yearly enrolment from 300 students to 450 students. Hence, the Department will be devoting more of its resources to this important and popular program.

At the graduate level, our new Master of Financial Economics (MFE) program has been approved by the University and is in the final stages of receiving Ontario government approval. This unique, innovative program combines both analytical and practical aspects of the study of financial markets. More details are provided later in this newsletter.

One of the most exciting developments during the past year has been the progress made in moving our dream for a new building closer to reality. Our detailed plans are in the process of being approved by the University and we will begin fundraising later this Fall.

An Acting Chair is particularly dependent upon colleagues and staff for help and guidance. I want to thank Francois Casas, who served as Acting Associate Chair of Undergraduate Studies. He met the challenge of our enrolment bulge with energy and commitment. Angelo Melino, Associate Chair for Graduate Studies, had the arduous tasks of preparing a brief for the Ontario Council of Graduate Studies review of our graduate programs and dealing with the impacts of a major change in the funding of doctoral students that was initiated by the University. He did an excellent job of coping with these tasks. Our successful recruiting activities would not have been possible without the contributions of Michael Denny as Chair of the Recruiting Committee. Margaret AbouHaidar, our financial officer, and Helen Cosic, my administrative assistant, made many contributions to the running of the Department, and, most importantly, kept me from making any major administrative blunders. Finally, I wish to thank the Faculty and Staff of the Department for their collegiality and support. This Department is completely free of the infighting which exists elsewhere; the importance of this is readily apparent to departmental administrators.

Michael Berkowitz, the incoming Chair, officially began his duties at the beginning of July. However, he has been involved in administration for a number of months, shepherding the MFE program through the approval process, and spearheading the progress on our new building. In addition, Michael has been providing me with valuable advice throughout the past year. I wish Michael good fortune in his future endeavours. I know that the Department is in most capable hands for the next five years.

Return to the Index

Undergraduate News: Past Numbers and Future Challenges

by Francois R. Casas, Associate Chair

When I took over from Greg Jump last summer, I had expected that after two successive "bulges" in our first year intake, life would return to normal. But even though overall enrolment in Arts and Science was slightly down we ended up with a high of 1,900 students in ECO 100Y and another 350 students in ECO 105Y. Enrolment in second and third year courses continued to expand as the 1998-1999 and 1999-2000 bulges moved through our various programs. This trend will continue in the foreseeable future, with admissions in September 2001 going up yet again, and more of the same in subsequent years as the St. George campus accommodates some of the growing high school population and, for a while at least, the much-talked-about double cohort.

For the just completed 2000-2001 session, the Faculty of Arts and Science had approximately 6,000 full-time and 2,900 part-time first-year undergraduates. Of these, almost 25% enrolled in either ECO 100Y or ECO 105Y. Of the 12,700 full-time and 5,400 part- time students in the College in upper years, just over 6,000 had completed one of those two courses. We currently have 2,300 students in our specialist, major and minor programs. Accommodating all these students is proving to be quite a challenge in the face of many faculty retirements in the recent past. However, we have successfully recruited a number of outstanding young academics and the Department continues to be very active on the recruitment front.

The biggest challenge faced by our Department in many years will start next year (September 2002) when the Commerce program will go its separate way in terms of student recruitment and move toward virtually 100 percent guaranteed admissions. Gone will be the many students admitted into the Economics and Commerce stream who major or specialize in Economics after failing to gain admission into the Commerce program in their second year. We anticipate, however, that they will be replaced by students admitted in the general Social Sciences stream with the goal of majoring in Economics. As noted above, with a bulging population of high school graduates it is unlikely that we will suffer declining enrolments anytime soon. But we will have to work harder at recruiting strong students instead of relying on the attractiveness of the Commerce program. Among the initiatives currently under consideration is the addition of programs in Financial Economics and in Strategic Economics.

On behalf of all my colleagues, I would like to extend my thanks to our Acting Chair, Mel Fuss and to our Graduate Associate Chair for the past few years, Angelo Melino. We are all indebted to them for their efforts and selfless devotion to our Department. I look forward to working with our incoming Chair, Michael Berkowitz, in the next few years (after a six-month break during which Greg Jump will be back at the undergraduate helm).

Return to the Index

Graduate Program News

by Angelo Melino, Associate Chair

It's been a busy year.

Every seven years, the Ontario Council of Graduate Studies (OCGS) reviews each of our graduate programs. An OCGS review presents the Department with an opportunity and an incentive to assess a program based on feedback from students, faculty, and alumni. When warranted, requirements are updated to reflect lessons learned or to address new needs and opportunities.

The Combined JD/MA program in Law and Economics is a demanding program that allows students to earn both their law degree (formerly the LLB) and an MA in economics in only three years. This will never be a large program, but it serves a useful niche and attracts a very interesting group of students to our department. Naturally, these aspiring lawyers were not shy in making their suggestions for improvement; perhaps surprisingly, they were just as vocal in their praise for the program and the role that it fills. In anticipation of the OCGS review, and in response to suggestions from students in the program, a few modest changes to the academic requirements were introduced. More importantly, a long list of bureaucratic issues was identified and (I hope) addressed that will reduce slightly the shadow value of time management skills. My thanks to Ed Iacobucci from Law and especially to our students for their efforts to improve the JD/MA program.

A good deal of my time this year has been spent preparing a brief for the OCGS review of our MA and PhD programs. I cannot pretend that preparing this three-volume tome was a rewarding experience. I had to follow instructions similar to "Please submit fourteen copies; Spirilex (surlox) binding is recommended for Volumes I and II." But now that it's done, I think it presents an interesting snapshot of our graduate programs along with recent trends. Some of these trends are disturbing, such as the decline in the faculty complement. Others, such as the reduction in time to completion for the Ph.D., are encouraging. To make the OCGS appraisal brief widely available, a version minus some confidential information was placed on the web and made available to faculty and students. If you are interested in seeing the nuts and bolts of our graduate program, and perhaps providing some feedback or suggestions, I urge you to visit our graduate website and follow the link provided to the OCGS appraisal brief. Of the various tasks required to prepare the brief, I most enjoyed tracking down the publications of our recent Ph.D. graduates. Research is the sine qua non of a Ph.D. program. The transition from student to researcher is a difficult one and more than once over the years I have wondered which of our students would ever make that transition. I confess that looking at the achievements of our recent graduates made me feel very good about the job that we are doing as a Department. Some exceptional young researchers have blossomed in recent years and almost all our Ph.D. graduates are building credible and constructive careers.

Beginning September 2001, the Department will participate in a new Collaborative Program in Asia-Pacific Studies. This program is designed to allow students to combine a traditional discipline base, such as economics, with a policy interest in the Asia-Pacific region countries. It also features a strong emphasis on acquiring language skills. My colleague Loren Brandt, well known for his work on economic development in China, is one of the principals in this new program. My thanks to him for representing the Department during its development and for serving as unofficial liaison.

The trial Master in Financial Economics (MFE) program, a collaboration between the Department of Economics and the Rotman School, has attracted over 100 applicants in each of the last two years. These applicants have competed for only five slots. Both academically and professionally, the trial program has been a resounding success. A proposal to make the MFE an official and separate degree program has been approved by the University and has been forwarded to OCGS for a final decision. If it receives OCGS approval, this new program will begin admitting students for September 2002, and will grow to a planned steady state of almost twenty-five students. On behalf of the Department, I would like to congratulate Michael Berkowitz and to thank him for his herculean efforts in creating and nurturing the MFE.

One of the most important developments for our graduate program this year relates to fellowships. Adel Sedra, our Provost, committed the University of Toronto to guaranteed multi-year funding for graduate students. For the most part, this is an exciting and encouraging development. The downside is that the extra fellowship money comes with strings. As a first approximation, MA students who are not identifiably in a PhD stream will be excluded from fellowships funded by the university. This raises an important challenge to the viability of our various combined and collaborative MA programs and will make life more difficult for the majority of MA students, however talented, for whom the degree looks like it will be their last. Departments will also be required to raise fellowships from donors or risk a reduction in the number of students that they can admit. In the short run, however, it is hard not to be excited about this new commitment from the University; it will increase the Department's fellowship budget by about 50% and will make the Department a much more attractive place to study.

In addition to two bursaries based on need, the Department administers a few fellowships and awards based on merit, all of which friends and alumni have funded. I am pleased to announce that Jiaping Qiu, a third-year student in our Management and Economics Ph.D. program, was awarded the Edward B. Kernaghan Fellowship based on his course work and an excellent second-year paper that looked at the link between ownership structure and mutual fund performance. Jia-Jeung Fan, a second-year Ph.D student, was named the first Helleiner Graduate Fellow for his work in development economics. Congratulations to them both. Next year, in addition to these two fellowships, the Department will also name the inaugural recipients of the Hollander Graduate Award and the Hartle Fellowship. Thanks again to those who contributed to make these awards possible.

Our graduates this year did particularly well on the job market. Most in the MA class that decided not to continue their studies have been placed and the feedback from those who have found jobs has been encouraging. For anyone still looking for work or looking to change jobs, I remind you that job announcements are regularly posted on our alumni discussion page; a link to it is provided on our graduate website. I want to extend my warmest congratulations to our departing PhD students and to wish them the best of luck in their new jobs: Gregory Gagnon (Ryerson), Sonia Laszlo (Ryerson), Daniel Lee (Hong Kong University of Science and Technology), Kevin Milligan (UBC), Eric Santor (Bank of Canada), Andrew Tepperman (Charles River Associates), Ilias Tsiakas (Warwick Business School), and Susan Zhu (Michigan State).

My three-year tour of duty as Graduate Director, or more formally, as "Associate Chair, Director of Graduate Studies, MA and PhD Supervisor, and Defender of the Neoclassical Faith" is coming to an end. (OK, I added the last little bit to the job title in a futile attempt to impress my wife). The job has given me the opportunity to learn a great deal about our Department and the people in it. In particular, it introduced me to our MA program and its students. I've also had the chance to meet many interesting people from all walks of life who wanted to pursue graduate study in economics. I like to think that I've done my best to maintain the good work of those who preceded me and to build the best graduate programs possible. The tradeoff has been that I've found it hard to keep up my research and I've had to make a number of difficult decisions. Some of those decisions have brought me unsolicited expressions of gratitude but many times I also faced outpourings of deep disappointment and anger. On the whole, I'm glad to be moving on. Before doing so, I want to thank a few of the people who have helped me over the years. I would like to commend all the students who have served as officers of the Graduate Economics Union for their efforts to make our graduate programs stronger and our graduate students happier. The Department's chairs during my term, Nancy Gallini and Mel Fuss, and the incoming chair, Michael Berkowitz have been very supportive. I've also had the pleasure to work with both Greg Jump and Francois Casas during their terms as Undergraduate Chair. But my biggest debt goes to our Graduate Administrator, Sophia Knapik. I don't know how this place could function without her. Fortunately, for my successor and for future graduate students, Sophia intends to soldier on. I'm looking forward to an honourable discharge and a quiet civilian life.

Return to the Index

Erindale News

by Arthur Hosios

The economics program at Erindale College has traditionally offered undergraduates first-rate training in economic theory, applications and quantitative methods. Nevertheless, there's always room for improvement. In response to the anticipated doubling of the student body at Erindale, the economists have proposed a number of innovative changes in their program. The 2001-2005 Strategic Plan for Economics involves a reorganization of the course offerings into three core areas, two proposed research centers that build on the strengths of our current faculty, and collaborative undertakings with the Departments of Political Science and Management at UTM. These new programs are all career oriented and not widely available elsewhere in Canada. Versions of them are already successful at the graduate level at U of T and comparable institutions.

Students in the major and specialist programs will be allowed to tailor their training to specific markets (the menu students choose from is being enlarged with the current program offerings remaining available). In addition to the basic course sequences in economic theory and quantitative methods that are currently required, intermediate- and advanced-level students will be able to enter a program of study in one of three core areas: Economic Policy (education, health, technology, growth), Economic Strategy (organizations, markets and strategy) and Financial Economics (corporate finance, risk management, information systems). Excellent appointments have recently been made in each of these areas: **Mark Stabile** (Health Economics), **Robert McMillan** (Public Economics), **Jo Van Biesebroeck** (Industrial Organization) and **John Maheu** (Financial Economics). The Department expects to build on this group in the near future in terms of both subsequent appointments and research activity at UTM, including the establishment of a Center for Economic Policy Research and a Center for Research in Financial Economics. Public and private sector support is being sought to fund these centers which, in addition to supporting faculty research, will allow undergraduates to get invaluable "hands on" experience.

Return to the Index

News from the Institute for Policy Analysis

by Frank Mathewson, Director

Our web page defines the Institute's goals as (i) to further scholarly research in applied economics and related disciplines toward strengthening and enhancing social policy formulation, and (ii) to disseminate these findings to academics, policy-makers and practitioners.

The scholarly activities of the Institute Associates serve the first objective. The associated research findings are published in major refereed journals, monographs, and books. The second objective is realized through several routes. To expedite the early dissemination of research findings, the Institute cosponsors a working paper series with the Department of Economics and the Rotman School. As well, the Institute sponsors five workshops at the University of Toronto, where local and visiting academics present their research papers. Each workshop meets regularly during the academic year. These workshops are:

- econometrics,
- industrial organization/business economics,
- labour economics,
- monetary and macroeconomics,
- public economics.

As part of the usual 5-year cycle for centres and institutes at the University of Toronto, external academics recently reviewed the Institute for Policy Analysis. The reviewers were Randall Krozner from the University of Chicago and Pierre Fortin from the University of Quebec at

Montreal. Their comments were supportive of the Institute's activities and they recommended that it's mandate be continued for a further term of five years.

We welcome the following recently appointed Research Associates to the Institute:

- Michelle Alexopoulos (University of Toronto)
- Li Hao (University of Toronto)
- Diego Restuccia (University of Toronto)
- Gregor Smith (Queen's University)
- Mark Stabile (University of Toronto)

A complete list of IPA Research Associates can be found in our Annual Report.

Return to the Index

A Common North American Currency?

by Jack Carr

Introduction

If there is to be a common currency in North America, there are only two possibilities: either Canada and the United States (and possibly Mexico) create a new North American Currency (like the Europeans created the Euro) or Canada (and Mexico) adopt the US dollar as the national currency. I believe that the only option that has any chance of being adopted is the second option. The US dollar is a strong international currency with a well established "brand name"'. The US government will never allow it to be replaced by some new North American currency.

Political Considerations

A monetary union is as much a political statement as an economic statement. Many supporters of the Euro believe that the European Monetary Union is a necessary first step on the road to a political union. Many of the Euro supporters want a United States of Europe. In the Canadian case, there appears to be no desire for closer political integration with the US. For many, this political aspect of a common currency is a major disadvantage to this proposal.

The main political push for adoption of the US dollar comes from the separatist government of Quebec. Bernard Landry has stated that serious consideration should be given to a common currency with the US. Adopting the US dollar now will impose the adjustment costs of moving to a new currency to the whole of Canada. Once the US dollar is adopted in Canada, Quebec if it secedes can continue to use the US dollar without obtaining the permission of the rest of Canada and without incurring any new adjustment costs. The use of the US dollar both before and after Quebec separation may persuade some Quebec voters that economic life after separation will not be that different from life before separation. This may increase the salability of the idea of a separate state for Quebec.

Economic Considerations

Monetary Policy

Adoption of the US dollar by Canada essentially means replacing the monetary policies of the Bank of Canada with the monetary polices of the Federal Reserve System. Because the Fed has had a very sensible policy of late and because the US economy is one of the strongest economies in the world, adoption of US policies seem more popular today than they may have been in the recent past. It should be noted that although US monetary policy is sensible now, this has not always been the case. From the mid-1960's to the mid-1980's, US monetary policy caused a high and variable inflation rate (which resulted in high and variable interest rates). Over the long-run, US monetary policy has not been superior to Canadian monetary policy. During the period from 1914 to the present, the Consumer Price Index in Canada grew at a rate very similar to the growth rate of the US Consumer Price Index.

Examination of monetary policy in Canada and the US supports the proposition that we in Canada would have little to gain from having the US conduct our monetary policy. For countries that can not trust their central banks, adoption of the US dollar may be a very desirable policy. Panama and Liberia use the US dollar and in doing so they gain a stable currency. Some Latin American countries with high and variable inflation rates may also gain with the adoption of the US dollar.

Even if adoption of the US dollar does not result in a superior monetary policy for Canada, it can be argued that Canadians will save on the transactions cost of exchanging Canadian dollars for US dollars. European advocates of a common currency emphasized these savings. Estimates of the savings are generally based on the cost that an individual will pay for changing money. However most exchanges are made by businesses which buy large amounts of currency and pay much smaller transactions fees than paid by retail customers of banks. In addition, for many multi-national firms, exchange rate transactions are only bookkeeping transactions and may not involve any money-changing costs. Although adoption of a common currency will lead to transactions cost savings, these savings will be modest.

The Optimum Currency Area Argument

The theory of Optimum Currency Areas was first advanced by Robert Mundell (*American Economic Review*,1961). For one currency to be optimal in a particular geographical area, there must be substantial labour mobility within the area and real shocks must be symmetric within the area (i.e. real shocks must affect all regions of the area in a similar fashion). Therefore the question of whether Canada and the US form a currency area where it is optimal to have just one currency is an empirical question. Recent empirical work does not support the proposition that Canada and the US form an optimum currency area. Tamim Bayoumi and Barry Eichengreen ("One Money or Many? Analyzing the Prospects for Monetary Union in Various Parts of the World" *Princeton Studies in International Finance*, No. 76, 1994) conclude that real shocks between Canada and the US are negatively correlated. Also labour mobility between the two countries is restricted by immigration laws.

Since 1975 the Canadian dollar has fallen by over 30%. Most of this fall represents a fall in the real exchange rate. Asymmetric real shocks have hit the Canadian economy. There is no doubt that these real shocks have reduced the standard of living in Canada as compared to the US. There are some commentators who seem to believe that if Canada had adopted the US dollar back in 1975, there would not have been the relative fall in Canadian standards of living. This is a fallacious argument. Real shocks will effect the Canadian economy regardless of the particular monetary arrangement Canada adopts. However, the path to equilibrium (and the consequent adjustment costs) will be different under different monetary systems.

Productivity Arguments

Tom Courchene and Richard Harris (*From Fixing to Monetary Union: Options for North American Currency Integration*, C.D. Howe Institute, 1999) consider the proposition that the falling Canadian dollar induces "laziness" on the part of Canadian manufacturers and thus reduces productivity in Canada vis-a-vis the US. David Laidler ("The Exchange Rate Regime and Canada's Monetary Order", *Working Paper 99-7*, Bank of Canada, 1999) rightly points out that the hypothesis that the floating exchange rate has provided a shelter behind which "lazy" manufacturers have been able to hide rather than take measures to improve productivity is based on non-profit maximizing behaviour of manufacturers. Both competitors and monopolists will engage in productivity improving investments provided the benefits exceed the costs. Any action that increases profit will be undertaken by both monopolists and competitors. A falling dollar, which reduces competition, does not provide a good theoretical argument to be lazy in introducing productivity enhancing investments. Productivity is lower in Canada than the US. There are a large number of real factors that account for this difference. The floating dollar is not one of them. The floating dollar is not responsible for lower productivity in Canada, nor is it responsible for higher productivity in the US.

Summary

Our current monetary system is serving Canada well. This system has provided Canada with stable and low inflation rates. This system has allowed Canada to have smoother adjustments to a number of real shocks. There is no reason for Canada to change its monetary system. Nevertheless, it should be noted that Canada has a number of real problems. Canada has lower productivity than the US. Canada has a lower standard of living than the US. Canada is beginning to experience a brain drain of highly skilled Canadians. All these problems are real problems which have to be addressed. Where government policies have caused these problems, these policies have to be changed. The floating Canadian dollar is not responsible for any of these real problems facing the Canadian economy. In fact, focusing on the Canadian dollar takes attention away from the real causes of these problems.

Return to the Index

Understanding the Role of Faculty Unions in Canada

by Arthur Hosios and Aloysius Siow

Faculties in four-year universities and colleges in Canada and the U.S. were not unionized prior to the 1960s. In the U.S., faculty unionization began in the sixties, and Canadian institutions soon followed. In 1973, two percent of the Canadian faculties were unionized. The unionization rate grew rapidly in the seventies and plateaued at around 66% by the mid eighties (actually 77% once Alberta and B.C., the provinces where faculty unions are prohibited by legislation, are excluded). Most recently, the faculties at Queen's University and the University of Western Ontario formed unions in 1996 and 1998, respectively. The unionization rate in Canada stands in sharp contrast with that in the U.S. where it is stuck at about a quarter and applies primarily to junior colleges and a few centralized state university systems.

The economic theory of union formation is well known. Unions generally form in non-competitive industries where firms earn monopoly or oligopoly profits. Without a union, shareholders receive these excess profits. Workers agree to form a union in hopes of extracting some portion of these profits for themselves. In competitive industries, workers do not usually form unions since there is no extra profit to share. The evidence supports this theory. The unionization rate is higher in industries in which firms had few competitors at the time of unionization (e.g., the airline, auto, and steel industries) and is lower in industries that have always had many firms, such as the service industries.

Faculty unions are difficult to understand in this context. There are no shareholders, and the compensation packages of administrators are not large enough to significantly increase faculty income should they be reduced. Thus, it is hard to argue that administrators are expropriating the extra profits that would otherwise be redistributed to faculty for the university to maintain its non-profit status. In most universities, the faculty essentially runs the university. In other words, the faculty is the owner of any excess profit that is generated and retained by a university.

In support of the faculty-owner model, we undertake an empirical analysis of 45 Canadian universities, over a 22-year interval (1973-1995). We show that the average faculty member enjoyed a 1.5% income gain from unionization (union dues of, say, 1% reduce the estimated net gain to 0.5%). This estimate is consistent with previous analyses of Canadian and U.S. faculty wage data. It does not rule out the possibility that there was no gain at all. By contrast, the average wage gain attributed to unions in the manufacturing sector as a whole is in the order of 10 to 20 percent.

A second piece of evidence is also revealing. The unionization rate among private universities in the U.S. is very low in general, and is zero at the most prestigious universities. Since the top private universities charge high tuition and receive large donations, there will be a substantial gain to unionization if the faculty does not already expropriate all the profits. The fact that they are not unionized suggests that these faculties are already expropriating the available profits.

There are three other explanations for faculty unionization: First, faculties are said to unionize when relations with their administrations deteriorate. While some claim that this was the case at the University of Western Ontario, "frustration" is not an economic variable that is amenable to testing or is likely to be insightful across many different universities over long periods of time. On the other hand, for any given set of benefits from unionization, enhanced dissatisfaction with the administration lowers the cost of organizing a faculty into a union, and hence increases the likelihood of union formation. Thus, for any given level of frustration, an explanation of union formation must identify its benefits for faculty.

Second, faculties in public universities arguably expect a unionized faculty to be able to obtain more revenues from the provincial or state governments that subsidize them. Whether unionized faculties can obtain more subsidies from the government is an empirical issue. Our analysis shows that Canadian universities that were unionized did not increase their revenues. We estimate that faculty unionization does not have a statistically significant effect on a number of different measures, including total university revenue, revenue per faculty member, and total expenditure. This evidence is consistent with the small, if any, income gains for faculty members after unionization. The bitter strike at York University in 1997 settled with no income gain for its faculty members. Perhaps the union was expecting that the administration would run a large deficit to pay for a substantial settlement.

The third explanation is that only a subset of the faculty, but still a majority of the voting members, may choose to unionize to redistribute income within the faculty. The goal here is not to raise average wages. Instead, the goal is to raise the wages of the lower-paid professors in a university by reducing the wages of their higher-paid colleagues. We find evidence of this redistribution in Canada. After a university's faculty forms a union, the ratio of its full professors' salaries to its assistant professors' salaries increases by 2-7%. Moreover, once a union is in place, the incomes of professors in disciplines with higher salaries fall relative to the incomes of professors in disciplines with lower salaries by 6-9%.

Redistribution is effected by the adoption of compensation rules that place greater weight on across-the-board increases in faculty base salaries and less weight on performance pay. Redistribution thus implies that the pecuniary return to academic research is attenuated after unionization. We also find that the rate of publication of academic papers by a faculty falls by about 4% after unionization.

The private gains from redistribution are limited. It is clear that some senior, tenured faculty members who are negatively affected by redistribution may find it too costly to leave. Nevertheless, potential new hires can choose where they want to work. As a result, a university, whether unionized or not, has to "meet the market"--i.e., make wage offers that are sufficient to entice new faculty members to join. When the market for professors is international, or even national, a university cannot practice long-run redistribution of income among professors without adversely affecting the quality of the scholars it can attract.

Based on Canadian data, we conclude that a faculty union will have a negative effect on a university's quality. This is because faculty unions tend to negotiate compensation that discourages research effort, encourages consumption of leisure, and makes it especially difficult to hire productive young scholars.

At present, the University of Toronto does not have a faculty union. Since its faculty members are among the most mobile academics in Canada, the potential impact of a faculty union on the quality of its professors is likely to be negative and significant. This quality reduction represents a significant cost of union formation that as yet appears to outweigh the associated redistributional benefits at U of T.

Return to the Index

New Colleagues

Ettore Damiano

Ettore joins us from Yale University where he recently completed his Ph.D. Originally from Italy, he is a specialist in Microeconomic Theory and Industrial Organization. Ettore's recent research has focussed on the theory of choice under limited uncertainty.
Photo of Ettore Damiano

Li Hao

Li is a Ph.D. from the University of Chicago who has previously taught at the University of Chicago, the University of Hong Kong and the State University of New York at Buffalo. His research program, which has already resulted in numerous papers, focuses on mathematical economics, game and decision theory, and monetary theory.

Alex Maynard

Alex joins us after a brief stint at the Board of Governors of the U.S. Federal Reserve System. He received his Ph.D from Yale University where he studied under Peter Phillips. His research is in the areas of econometrics and international finance.

Rob McMillan

Rob obtained his Ph.D. at Stanford University and comes to us after a year as Visiting Fellow at the Public Policy Institute of California. He comes from England, and his research focuses on issues associated with the provision of public goods and the economics of education.

Retirees

Noah Meltz

Noah was an undergraduate in Commerce here and joined the faculty in economics in 1964 after completing his Ph.D at Princeton. In addition to his distinguished career in the economics of human resources, Noah has served the University in a number of administrative capacities. He was Associate Chair of the Department in 1974-75, Director of the Center for Industrial Relations for a ten year period between 1975 and 1985, Assistant and then Acting Dean of the School of Graduate Studies between 1985 and 1988, and Principal of Woodsworth College from 1991 to 1998. Noah has eighteen books to his credit, either as author or editor, along with over one-hundred shorter publications and professional contributions. His counsel has been sought by innumerable committees, boards and study groups both inside and outside the University, including the governments of Ontario, Canada and Israel, throughout his long career. Noah continues to maintain an active research program.

Photo of Noah Meltz

Sam Rea

Sam is leaving us through early retirement to pursue highly successful business interests. He came to the Department in 1971 from Harvard University and became Professor in the Faculty of Law as well as the Department of Economics in 1981. He also taught at Erindale College for many years and was a key member of the Erindale group. During his long career, Sam published four books and numerous articles. Much of his work represents the application of economic analysis to legal questions, an area in which he has achieved wide distinction. Sam is also visible, in both the academic and policy-oriented communities, for his work on the retirement incentives and distributional effects of Canada's public retirement income system--the Canada Pension Plan, Old Age Security and the Guaranteed Income Supplement.

Return to the Index

Visitors

Jean-Marie Dufour

During the fall of 2001, Professor Jean-Marie Dufour of the University of Montreal visited the economics department for several weeks. Jean-Marie is one of Canada's leading econometricians. His current area of research is on finite sample and simulation-based inference methods in econometrics. During his stay, Professor Dufour gave a series of lectures as part of a graduate course in econometrics.

Wolfgang Haerdle

Professor Wolfgang Haerdle of Humboldt University in Berlin visited the Economics Department for three weeks in March, 2001. He is best known for his research on nonparametric techniques and the bootstrap. During his visit, Wolfgang gave a short course on nonparametric regression which included applications to microeconomics and financial econometrics. The course was attended by graduate students in Economics, Statistics and the Business School. Professor Haerdle is a pioneer in web-based statistical learning tools and his statistical package *Xplore* is now used in Europe, North America and Asia.

Wendy Morrison

Wendy Morrison from the University of Nottingham visited both the Department of Economics and the Department of Health Administration during the fall term. She presented some of her work in the micro theory workshop and participated in many discussions with members of our health economics group.

Clara Ponsati

This year Professor Clara Ponsati from Universitat Autonoma de Barcelona joined us for a sabbatical visit. She was a welcome addition to our theory group and a very active participant in our theory seminar series where she presented two interesting papers. In the first she modeled price formation in dynamic markets with decentralized trading under different bargaining procedures. In the second she showed that when a bargaining environment has an interested third party (for example, a government who can make transfers to the bargainers in order to facilitate agreement) strikes appear in equilibrium when the bargainers have asymmetric relationships with this stakeholder. Clara also taught an undergraduate course for us.

Martin Richardson

Martin Richardson spent the year with us, on leave from the University of Otago in New Zealand. Professor Richardson's research interests are in international trade theory and public policy. While here, he was an active member of our trade group, and gave two seminars: "Trade Policy and Access to Retail Distribution" in the international economics workshop, and "Cultural Quotas in Broadcasting" in the microeconomics workshop. The latter presentation was especially memorable, not only for its relevance to evaluating Canadian-content (and similar) regulations in television and radio, but for being the Department's first truly multi-media seminar presentation, including sound-clips from Canadian (and not-so Canadian) recording artists.

Gary Sawchuk

Gary Sawchuk, a senior economist at Industry Canada, visited us during the fall term. He is the first participant in the University of Toronto/Industry Canada "Visiting Scholar Program". His research focused on the areas of trade, specialization and regional growth in the context of Canada's growing economic linkages with the U.S.

Gregor Smith

The Department was very fortunate to have Professor Gregor Smith from Queen's University spend the year with us. Gregor is a distinguished macroeconomist who focusses on open-economy issues from both a theoretical and empirical perspective. His work has ranged across a wide area with major emphasis on stochastic process switching, exchange rate target zones and foreign exchange market speculation. Not only an excellent theorist and econometrician, Gregor has also contributed several papers in economic history. Also, he is the author, along with Andrew Abel and Ben Bernanke, of a current successful textbook in macroeconomics.

Return to the Index

The Joint Masters Program in Financial Economics

The Department is in the final stages of gaining Ontario government approval for its new Master of Financial Economics Program (MFE) which is scheduled to begin in September 2002. The program will cover three academic terms with students taking 12 one-term courses and a 4-month summer internship between terms 2 and 3. The strong theoretical component combined with the applied course work within the Rotman School, and the practical summer internship experience, ensures that graduates will compete favorably in the marketplace.

The areas of finance and economics have a strong programmatic tradition at the University of Toronto. At the undergraduate level, the Bachelor of Commerce Program (B.Com) has flourished as a joint offering in economics and management since 1920. Over the years, University of Toronto Bachelor of Commerce graduates have taken their place as leaders in the business, academic and public service sectors both within Canada and internationally. At the other end of the academic spectrum is the highly successful collaborative Ph.D. Program in Management and Economics.

The MFE Program is unique in North America in that it is the first such program to provide students with both a broad understanding of financial theory and the economic framework upon which that theory is based, together with applied experience working within a financial institution. The rapidly developing financial market system requires individuals who have the training to understand the implications of international market integration and the fundamentals associated with the valuation of securities in a market increasingly dominated by technology-based firms. This program will provide students with the necessary analytical and quantitative skills to meet these challenges in a rapidly changing marketplace.

Return to the Index

The Research Interests of Some of Our Faculty

Michelle Alexopoulos is currently working on projects that incorporate labor market frictions in general equilibrium models of output, employment and growth. A number of other papers focus on examining efficiency wage models that are based on the notion that an individual's productivity is affected by his wages. In particular, she is investigating whether incorporating efficiency wage considerations into general equilibrium business cycle models improve those models' ability to account for the behaviour of wages and unemployment over the business cycle. In related work, she is examining the behaviour of inter-industry wage differentials over the business cycle to determine if efficiency wage considerations are an important determinant of observed differentials. Her other current research interests include the causes of European unemployment, bankruptcies and technological development in financial markets.

Gordon Anderson is studying aspects of how we statistically measure and distinguish between economic inequality and polarization (the rich getting richer and the poor getting poorer) with a view to developing indexes for the latter concept. The results will be relevant to understanding the progress of poverty when it is viewed as a relative rather than an absolute concept. The concepts thus far developed are being employed to study the distribution of per capita GNP across nations, the distribution of education levels among married couples, the distribution of wage rates by gender among unionised and non-unionised workers and the distribution of incomes by family types.

Nancy Gallini focuses her research on the economics of intellectual property. A paper with **Suzanne Scotchmer** (University of California at Berkeley) forthcoming in *Innovation Policy and the Economy*, MIT Press, reviews the economic reasoning that supports patents and other forms of intellectual property over alternative mechanisms, such as contracts and prizes, for rewarding research. For those economic environments where intellectual property is justified, they review reasons why the institutions are designed as they are and the anti-competitive implications of licensing and other contractual arrangements for transferring technologies. Nancy is also collaborating with **Andrew Tepperman** (former PhD student in the Department) and **Jon Putnam** (Faculty of Law) on an empirical project that estimates the impact of intellectual property rights on the propensity to patent. They are interested particularly in identifying whether the increase in the propensity for foreign firms to patent in Canada can be attributed, at least in part, to recent changes in Canadian patent policy.

Rob McMillan is currently carrying out empirical research in two separate areas of public economics. The first uses some unique student-level data to examine the mechanisms by which a student's peers affect student behaviour and outcomes, particularly whether a given student gains from having good students around or suffers from having disruptive students as `peers.' Then in joint work with **Patrick Bayer** (Yale University) and **Kim Rueben** (Public Policy Institute of California) using restricted US Census data, he is estimating a model of household residential location choice in a large urban area. The estimates from this model are then used to carry out general equilibrium policy simulations that shed light on the likely effects of policies to increase choice in the education system.

John Munro specializes in the economic history of the later-medieval and early-modern Low Countries and England, with a focus on industrial organization (textiles), labour, wages, prices and (therefore) money. His current research project involves an analysis of changing trends in real wages before and after the so-called Golden Age of the Labourer in the later 14th and 15th centuries. For this he has constructed a weighted consumer price index for late-medieval Flanders and is reconstructing the well known Phelps Brown and Hopkins "basket of consumables" index using their working papers in the London School of Economics archives.

Diego Restuccia is currently working in the areas of family economics and economic growth and development. In joint work with **Carlos Urrutia** (Universidad Carlos III de Madrid), he is studying intergenerational mobility of economic status in a quantitative dynamic general equilibrium model of educational investments with credit constraints for investment by young people in future earning ability. They find that a large portion of the observed intergenerational persistence in earnings in the U.S. is accounted for by human capital investments that happen early in life. In work with **Luisa Fuster** (Universitat Pompeu Fabra) and **Andrés Erosa** (Universitat Autónoma de Barcelona), he is studying the aggregate and redistributive impact of mandatory parental leave policies in order to learn about issues related to the gender and family gaps in both pay and employment. In work with colleague **Xiaodong Zhu**, he is studying the role of endogenous population growth in accounting for cross-country income differences.

Mark Stabile is focussing his research efforts on health economics. He is examining the effects of private insurance and public provision with and without private co-payments on the use of health services in Canada. He is also researching the effects of health status and access to health care on labour supply both in Canada, in a joint project with **Michael Baker**, and China, in a joint project with **Loren Brandt** and **Dwayne Benjamin**.

Matthew Turner is working in the areas of environmental economics and microeconomics. One of his projects, with colleague **Diego Puga** and **Henry Overman**, uses satellite images of the US from 1970 and 1990 along with census data to describe and understand patterns of urbanization. They are investigating the extent to which urbanization is determined by regulation and the extent to which it is driven by economic factors such as the wealth or education of nearby populations. A second project, joint with **Loren Brandt**, looks at the relationship between the political institutions of rural Chinese villages and the functioning of the village economy. They use data collected specifically for the project in an effort to learn whether democracy is associated with a variety of different economic outcomes, such as faster income growth or better soil conservation.

Adonis Yatchew is working principally in the area of theoretical and applied econometrics. Recent papers include estimation of equivalence scales in South Africa, (with **Yiguo Sun** and **Catherine Deri**) and estimation of gasoline demand in Canada (with **Angela No**). In addition, he edits the *Energy Journal*. His forthcoming book entitled *Semiparametric Regression for the Applied Econometrician* will be published by Cambridge University Press.

Xiaodong Zhu is currently working on a variety of projects. With **Dennis Yang** at Virginia Polytechnical Institute, he is developing a theory of long-term economic growth that emphasizes the interactions between cities and agriculture. This theory can potentially provide a consistent framework for understanding the rise and fall of many great cities in history and the structural transformation associated with the industrial revolution. With **Diego Restuccia**, he is investigating the role of agricultural distortions in accounting for international income differences. And he is continuing his joint work with colleague **Loren Brandt** on the impact of institutions on macroeconomic dynamics in China. Together with **Wai-Ming Ho** from York University, he is also analyzing the impact of the Asian financial crisis on China's monetary policy, structural reform, and output growth. With **Yingyi Qian** from Berkeley, Xiaodong is developing a theory of political transition with applications to China and Russia. Finally, with former colleague **Huw Lloyd-Ellis** from Queen's University, he is working on the impact of institutions on fiscal response to shocks in OECD countries.

Return to the Index

We're Getting a New Building!

Over the years, the space problems at the Department's 150 St. George Street location have been tuned and tweaked, but the basic problem remains---lack of quality space within the departmental complex. Time after time, the space problem has been brought up in reviews of the Department, and it remains the proverbial thorn in our side. Not only is there a critical shortage of faculty office space, but students at both the undergraduate and graduate levels are currently deprived of the opportunity to regularly interact with each other and with faculty due to the space limitations of our present facilities.

Last January, a Users Committee was struck by the University to determine a space program for the Department of Economics that will accommodate the activities currently at 150 St. George Street and at other places where members of the Department are currently housed. The plan is to provide additional space for faculty and students and for alumnae activities so as to allow us to reach our goal of becoming one of the top five publicly funded economics departments worldwide. The Committee has completed its work and fund raising efforts will begin in earnest shortly.

Artist’s Conception of the New Building

Return to the Index

What's Happening in the Department of Economics

The Annual Graduate Economics Union Dinner

by Christine Neill

On Friday April 27, more than 80 people comprising a well-mixed group from the faculty and MA and PhD classes, and their guests, massed in the Movenpick restaurant in Yorkville. The occasion was the Third Annual End-of-Year Dinner. In the tradition of past years, it was a final chance for all members of the graduate class and faculty of 2000-01 to get together and enjoy the night and each others' company before the MAs (in particular, though not exclusively) headed off to their various corners of the globe. Reports suggest that a good time was had by all.

Huge thanks go to Leslie Preston of this year's MA class who, in the midst of what was a very busy time for her, almost singlehandedly organized the whole evening. Thanks also to the Department and to the Graduate Economics Union for their financial support.

Some photos from the dinner:

The Annual Alumni Gathering

The Department held its second Economics Alumni Gathering as part of Spring Reunion 2001 on June 1 at the Faculty Club. Honoured alumni from graduating years 1996 and each preceding 5-year interval (1996, 1991, 1986, 1981, ..., etc.) were invited to attend. It was wonderful to see some familiar faces and catch up on each others' lives. We look forward to next year when alumni from 1997 and each preceding 5-year interval will join us.

Other News

Special congratulations to ten of our colleagues who earned SSHRC grants this year: **Dwayne Bengamin**, **Miguel Faig**, **Nancy Gallini**, **Li Hao**, **Alex Maynard**, **Martin Osborne**, **Mike Peters**, **Diego Restuccia**, **Matthew Turner** and **Adonis Yatchew**.

Joanne Roberts has won the Polanyi Prize in Economics for this year and has been invited to be a member of the Canadian Institute of Advance Research.

[Return to the Index](#)

[Department of Economics Welcome Page](#)

From the Editor

Communications, suggestions, and information about alumni and other matters should be addressed to:

Prof. J. E. Floyd
Department of Economics
University of Toronto
150 St. George Street
Toronto, Ontario, M5S 3G7

The graphics on this page are the work of Professor Ken Rea and Kevin Milligan.

Return to the Index

Email the Editor