Tradeoffs

Department of Economics
University of Toronto

Fall 2002

In this Issue

Message From the Chair

by Michael Berkowitz

My first year as Chair was more memorable than I could ever have imagined. I began the job fresh with ideas and enthusiasm, looking forward to continuing the Department's remarkable ascent begun by my predecessors, only to be struck, like all of you, by the events of September 11. Although the memory of that day will continue with each of us forever, the year was also memorable for the remarkable accomplishments of our faculty. It was a year in which we saw our international ranking among economics departments soar to 10th among all publicly funded institutions and 1st in Canada. Our challenge over the next five years is to continue that climb into the elite group of the top five publicly funded economics departments in the world. I have confidence that, given the quality of our recent hires and the outstanding achievements of our faculty overall, we can achieve this goal.

I am gratified by our success this year in hiring **Shouyong Shi** as our first Canada Research Chair, together with three outstanding new junior hires, **Philip Oreopoulos** from Berkeley, **Andrés Erosa** from Universitat Autonoma de Barcelona, and **Luisa Fuster** from Pompeu Fabra. Congratulations to our faculty for their tireless effort, and a special debt of gratitude to **Martin Osborne**, Chair of the Recruiting Committee. During the past year, many colleagues were recognized for their outstanding achievements. **Mike Peters** won the coveted Rae Prize which is awarded by the Canadian Economics Association every two years to the Canadian economist with the best research record during the previous five years. **Mark Stabile** won the Harry Johnson Prize which is awarded annually by the Canadian Economics Association for the best article in the *Canadian Journal of Economics*. **Morley Gunderson** won the Industrial Relations Research Association Excellence in Education Award for outstanding teaching in labor economics while **Christian Gourieroux** was awarded the Silver Medal of the Conseil National de Recherche Scientifique by the French Ministry of Research. Finally, **Li Hao** was awarded a Hoover Institute Fellowship to spend the year at Stanford University.

I'd also like to thank **François Casas** who served this past year as Associate Chair for Undergraduate Studies during a hectic time of increasing enrollments as we approach the double cohort. While François was on sabbatical leave during the Fall term, **Greg Jump** stepped in to replace him and did a terrific job. This year, **Jon Cohen** took on the job of Associate Chair of Graduate Studies after having been Dean of the Graduate School. Jon's experience and dedication led the Department through a difficult period of transition in which we are now offering a minimum guaranteed funding package to all our Ph.D. students.

We also said goodbye to a number of colleagues this year through retirement and alternative opportunities. **John Floyd**, who serves as editor of this Newsletter, **Alan Hynes** and **Al Berry** retired, but I'm sure each will continue to be productive emerti professors. This year, long time librarian and tireless friend of everyone in the Department, **Ursula Guttenburg**, also retired. In addition, **Ralph Winter** left to join the University of British Columbia Business School while his spouse, **Nancy Gallini**, became the Dean of Arts at the University of British Columbia. After serving this Department as Chair for five years, Nancy will undoubtedly make a lasting mark in her new position and we wish both Ralph and Nancy well in their West Coast venture.

In March of this year we hosted the 2002 Malim Harding Visitorship Lecture in which **David Card** from University of California at Berkeley presented the paper, "New Technology and Rising Inequality: Are Computers to Blame?" Everyone thoroughly enjoyed both the lecture and interacting with David over the three-day event. We are grateful this year to have also obtained funding from the Bank of Nova Scotia for the Bank of Nova Scotia Visitors Program in Macroeconomics.

The achievement this year that personally rings closest to home is the launching of the new Master in Financial Economics program as a joint initiative with the Rotman School of Management. Having received final government approval and beginning with a class of 12 students, this will be the first group of students to receive the new M.F.E. degree upon graduation. This unique and highly innovative program combines both analytical and practical aspects of the study of financial markets. We are confident that the program will be successful and look forward to increasing our intake of students under the careful joint directorship of **Greg Jump** and **Varouj Aivazian**. Finally, the Commerce and Finance program is expanding to 450 students and the Department will be devoting more of its resources to this important and popular joint program sponsored in conjunction with the Rotman School. We look forward to continuing our long-term commitment to the B.Com. program.

Each Spring, we are fortunate to host an alumnae event and this past year was no exception. It was a great success and I would strongly encourage anyone who is interested in being involved with planning and organizing future alumnae events to contact me at `berk@chass.utoronto.ca' or Robbie Innes at `rinnes@chass.utoronto.ca'. With all the plans for our future, including the new M.F.E. program, expanding the Commerce program, increasing our faculty, and developing a strong alumnae base, it is not surprising that our space constraints severely limit our potential to achieve our goals. In the last issue of the Newsletter, then Acting Chair, **Mel Fuss**, reported on the exciting developments made in moving our dream for a new building closer to reality. The plans have now been approved and we are aggressively fund raising. We recognize that we are competing both within the University community and outside the University with many worthwhile philanthropic causes. At the same time, we welcome all our alumnae to work with us to organize fund raising events and to discuss possible sources of funding so that we can achieve our goals together.

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Undergraduate Report: More Challenges Ahead

by François R. Casas, Associate Chair

When I reported in the Fall 2001 issue of this Newsletter, I indicated that it was unclear what would happen to our first-year enrollment when the Commerce Program moved to full guaranteed admission for all high school students accepted into that program. We now have the answer: the demand for our two introductory courses, ECO100Y and ECO105Y, is up (again). As classes started in September, ECO100Y reached its cap of 1,900 students (compared to 1,850 a year earlier) while ECO105Y was full at 425 (versus 375 last year).

This is the result of a number of factors, chief amongst them the fact that Commerce ended up with 50% more students than planned (and therefore potentially many more Commerce students in second year in September 2003 than we have had in the past). Many students also continue taking our introductory course in the hope of being accepted into the Commerce Program in their second year, even though the odds of succeeding are highly unfavorable. Finally, the overall intake into Arts and Science has increased significantly (acceptances were up 8%) and our introductory courses remain favorites among many newly admitted non-Commerce students (35% chose those courses in their first year).

In second year, our enrollments are only slightly higher than in 2001-02, mainly because we have reached our capacity in most courses. The picture is quite different in third year courses where we have nearly 30 percent more students than just a year ago (and 60 percent more than four years ago). This has resulted in most courses being full to room capacity with virtually every 300-level course exceeding 100 students. No relief is in sight as the successive large first-year intakes move through the system. Whether the double cohort will make a bad situation worse will depend on whether the St. George campus will admit more students in the next year or two.

On the more positive side, **Greg Jump** has begun teaching a half course in financial economics which has proven wildly popular (with 128 students---and probably more if we had space). This is the beginning of what we hope will become a separate major within Economics, with the addition of several new courses (such as the Economics of Risk Management and Financial Econometrics). We are also considering the addition of fields of specialization in Urban Economics, Health Economics and Economic Strategy. However, the severe resource constraints under which we operate will make such developments difficult, especially if we need to allocate increased resources (instructional and teaching assistants) to deal with growing enrollments in our mainstream programs.

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Graduate Report

by Jon Cohen, Associate Chair

My predecessor in this job, **Angelo Melino**, observed in the fall 2001 Newsletter that we had to be doing something right because applications to our graduate program that year jumped by 25 percent. By this criterion, we are now approaching perfection. Applications to the M.A. program this year jumped by 60 percent and while the numbers applying to the Ph.D. program rose by a more modest 10 percent the acceptance rate by those Ph.D. applicants who received offers increased by one-third, from 60 to 80 percent. I should add that these figures do not include applicants to the M.F.E. program, which received Ontario Council of Graduate Schools (OCGS) approval to commence this fall as a stand-alone degree program and thus admitted its own students for the first time. The upshot of this dramatic rise in our popularity, aside from the unenviable task of having to review all the applications, is that we have one of our finest M.A. classes ever and, it would appear, an equally outstanding and very large incoming Ph.D. class.

To give you some idea of the nature and quality of the incoming classes, about 40 percent of the 34 students in the M.A. program are visa students, 6 are pursuing a combined J.D./M.A., five are in one of our three collaborative programs (International Relations, Environmental Studies, and

Asia-Pacific Studies), and about 40 percent are women. We have students from every Canadian province and every major university in the country. Roughly 45 percent of 20 students in our first year Ph.D. class are our own M.A. graduates, 65 percent are visa students, two are in the combined J.D./Ph.D. program, and four are in the collaborative Management-Economics program. To be accepted this year into the M.A. program, students needed an A average in their economics and mathematics courses and, for the Ph.D., an A average in their masters program. For those students who submitted GRE scores, the rough average on each of the math and analytical parts was about 700, placing our students in the top 10 percent of those who took the tests.

I should add that the University of Toronto participates in a number of international exchange programs that facilitate study abroad for our students and study in Canada for international students. Although graduate students from our economics programs have not participated in these exchanges, a large and growing number of international students express an interest in joining us for a year as non-degree visitors. This year we have five students from Germany, one from Sweden, and one from Hong Kong. The experience to date has been positive for our students and, I would guess, for the visitors as well.

Two years ago the University of Toronto introduced a guaranteed funding package for all students in funded programs. Most departments in Arts and Science jumped on the new bandwagon in 2001 but economics, fully aware that there is no free lunch, delayed participating for a year to clarify our priorities. We were able this year to secure the funding guarantee for all of our M.A. students---roughly $17,000 for a domestic student and $22,000 for an international student consisting of a teaching assistantship and a University of Toronto fellowship. All Ph.D. students receive the same funding guarantee for four years. Beginning next year, we will admit students into one of two streams in the M.A. program. The first will be made up of a small number of doctoral stream M.A.students who must take at least one of the Ph.D. sequence of first year courses and who will receive the funding guarantee. The second, larger group will be composed of regular M.A. students who will be eligible for teaching assistantships but not U of T fellowships. All of our Ph.D. students will continue to receive the four-year funding guarantee. The new funding scheme has created a much larger pool of funds for graduate students but it has reduced somewhat the Department's flexibility in allocating funds. As economics teaches us, there really is no free lunch!

In the last issue of this Newsletter, Angelo reviewed in some detail the time and effort that went into preparing the Departmental brief for the periodic appraisal of the Department by the Ontario Council on Graduate Studies (OCGS). The brief was submitted in the summer of 2001 and reviewed by a committee of OCGS that fall. The committee decided to send in two consultants, both economists, one from Queens, the other from Harvard, to carry out a site visit and to write a report. The consultants visited the Department for two days in March, met with faculty, students, and University and Department administrators. The good news is that the report was extremely positive---the Department, according to the consultants, has good students, an excellent and enthusiastic group of young faculty, and a well-designed graduate program. The OCGS committee's evaluation of the Department coincided with that of the external consultants and gave us a `plus' in all areas.

In 2001-02, **Richard Rogerson** from Arizona State University and **Randall Wright** from the University of Pennsylvania offered a mini-course on advanced topics in money and macroeconomics for graduate students and faculty. The success of the course encouraged us to expand the number of distinguished presenters to include **Victor Rios-Rull** from the University of Pennsylvania and **Lawrence Christiano** from Northwestern University. Moreover, the course now has a private sector champion---it is called, in recognition its financial support, the Bank of Nova Scotia Visitorship Program in Macroeconomics.

In a previous issue of the Newsletter, it was reported that the collaborative Ph.D. program in management and economics was revised in response to comments from external reviewers. In particular, course and other requirements were reduced to speed progress towards the degree. Although no student has graduated from the program since it came into existence ten years ago, the drought is likely to come to an end this year, thanks largely to these revisions. Students in the program are now making excellent progress which bodes well for future completion rates.

The job market in 2002 was excellent for our M.A. and M.F.E. students but less buoyant for our Ph.D. students. **Maria Rekkas** has joined the faculty in economics at Simon Fraser University and **Mingli Zheng** accepted a position at the University of Macao. We have a relatively large number of talented Ph.D. students on the job market this year across a range of fields including health economics, microeconomic and macroeconomic theory, trade, and finance. Although it is too early to assess the market, there is every reason to be sanguine about our ability to place them.

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News from Erindale College, UTM

by Varouj Aivazian

The University of Toronto at Mississauga (UTM) is in the process of a major expansion with significant student enrollment increases. At the same time UTM is undergoing an administrative restructuring as part of the new University of Toronto Tri-Campus Plan. Needless to say, these changes will affect the Department's program on the Erindale campus.

Enrollment in courses sponsored by Economics at UTM is up by close to 30% from last year, to 950 students. This is partially due to the increased enrollment in the Commerce Program. There are nearly 100 more students in our first-year Principles of Economics course this year compared to last year. At the second-year level, we have added fourth sections in Intermediate Microeconomics, Intermediate Macroeconomics and Quantitative Methods, which now raises enrollment in each of these courses to approximately 400 students. At the third- and fourth-year level, we have experienced extreme enrollment pressures and have increased the number of courses offered. We are offering two completely new upper-level courses this year, Econometrics for Public Policy Analysis and Topics in Economic Growth: Theory and Evidence.

Also, Urban Economics, has returned to the UTM timetable after being removed from our Calendar in 1996. We plan to add more upper-level courses next year.

We are moving forward with the initiatives outlined in the UTM 2001-2005 Strategic Plan for Economics that were described in the last issue of this Newsletter. They involve the introduction of three new interdisciplinary programs (with Management and Political Science): Economic Policy, Economic Strategy, and Financial Economics.

Two of the Department's excellent new hires this year, **Phil Oreopoulos** (Applied Microeconomics) and **Andrés Erosa** (Macroeconomics) are teaching in our program at UTM and we will be in the market next year for two additional colleagues in the areas of industrial organization and international macroeconomics. **Hala Ali** joined us in the Spring of 2002 as a full-time counselor, and has contributed greatly to the administration of our program.

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News from the Institute for Policy Analysis

by Frank Mathewson, Director

Beginning on July 1, 2001, **Ignatius Horstmann** was appointed to the faculty of the Rotman School of Management; at the same time, he agreed to serve as the Institute's Associate Director. Ig's presence at IPA reinforces the university-wide scope of the Institute. Ig has initiated an ad hoc seminar at IPA, known locally as the `NERDS' Seminar, where faculty and students are encouraged to present research early in the life cycle of a paper. The purpose is to expose ideas early to scholarly debate and to inform residents of IPA of the research of their colleagues.

As of July 1 of this year **Peter Dungan** becomes Director of the Policy and Economic Analysis Program (PEAP) at IPA. **Tom Wilson**, former Director and Emeritus Professor of Economics, has been appointed as a Senior Advisor to IPA.

Grant Reuber has been appointed to the Advisory Board of the Institute. Grant has served as President and Chief Operating Officer as well as Deputy Chairman of the Bank of Montreal, as Deputy Minister of Finance and, most recently, as Chairman of the Canada Deposit Insurance Corporation. In his earlier academic career, he was a distinguished Professor of Economics at the University of Western Ontario, where he later served as Provost and Chancellor. Grant is an Officer of the Order of Canada and a Fellow of the Royal Society of Canada.

The Institute has been especially pleased to host **Mara Berman**, a graduate student in economics from M.I.T., who is working on the economics of frequent flyer loyalty programs.

The IPA also made a significant monetary contribution in 2001 towards the visits of **Randy Wright** (University of Pennsylvania) and **Richard Rogerson** (University of Arizona) who offered a special topics mini-course to graduate students in economics within the Department.

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The New Professional Masters Program in Financial Economics

by Greg Jump

This September, twelve students began studies in the new Masters Program in Financial Economics. When these students complete their studies in December 2003, they will be the first recipients of a new professional degree designated Master of Financial Economics (M.F.E.). The program is a joint offering of the Department of Economics and the Rotman School of Management.

M.F.E. students are required to complete a three-semester program of study that combines courses in economic theory and econometrics with applied courses in finance. A mandatory summer internship between the second and third semesters provides students with practical work experience in the financial industry.

From 1999 to 2001 a total of 4 or 5 students were admitted each year to a pilot program with the same curriculum as the current M.F.E. program but which awarded graduates the degree of Master of Arts. The pilot program was designed to determine the extent to which prospective students and employers might be interested in a combination of training in economics and finance. Each year more than 100 highly-qualified students applied for admission to this pilot program, demonstrating a very high level of interest among potential applicants. Graduates of the pilot program were eagerly hired by employers ranging from banks to private consulting firms at starting salaries significantly above those offered to new M.A. graduates in Economics. Based on these results, both the University's administration and the Ontario Council of Graduate Studies (OCGS) enthusiastically supported the creation of a permanent program offering the new professional M.F.E. degree.

Final OCGS approval was granted last Spring and more than 200 persons applied to be part of the first group of students admitted to the new professional program. The number of applicants for admission in 2003 is expected to be even higher. Ultimately, the number of students admitted will grow from the current 12 to a steady state number between 22 and 25.

Administration of the program is the responsibility of the Department of Economics. The full-time Program Co-ordinator is **Lisa Cernivivo**, who began her duties in September. Professors **Varouj Aivazian** and **Gregory Jump** are currently serving as co-directors.

For further information on the new M.F.E. program, visit the program's website, http://www.economics.utoronto.ca/mfe/.

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Noah Moshe Meltz -- 1934-2002

We are saddened at the death on January 29th of our recently retired colleague Noah Meltz. Noah was born and raised in Toronto. He earned a B.Com. degree from the University of Toronto in 1957 and his A.M. and Ph.D. degrees from Princeton University in 1960 and 1964 respectively. In 1964 he returned to the University of Toronto as an Assistant Professor. He was promoted to the rank of Associate Professor in 1965 and Full Professor in 1971.

Noah was a prodigious scholar, publishing some 18 books in the field of industrial relations. He contributed chapters in 40 books in addition to numerous articles and papers in a variety of refereed journals. While maintaining this exhausting scholarly pace, he also took on a variety of administrative roles. He served as Acting Chair of the Division of Social Sciences at Scarborough College and also as Associate Chair of the Department of Political Economy before being appointed as Director of the Center for Industrial Relations from 1975 to 1985. From 1985 to 1987 he was Assistant Dean of the School of Graduate Studies, followed by a brief term as Acting Dean. He completed his administrative service as a popular and very successful Principal of Woodsworth College from 1991 to 1998.

Noah Meltz was also a beloved teacher and mentor for a generation of industrial relations students who have since gone on to become distinguished in their own right. His honors and professional activities are many and a brief sample includes Visiting Scholar at Sloan School of Management at M.I.T., and at the London School of Economics. He served as President of the Canadian Industrial Relations Association and was a founding member of the Society for the Promotion of Human Rights in Employment. Other service included Advisor to the Office of the Auditor General of Canada, Advisor, Central Bureau of Statistics, Israel, and Member, National Statistics Council, Canada. In 1988 he was appointed as Chair of the Advisory Committee on Labour Statistics to the Chief Statistician of Canada.

Noah Meltz was an avid squash player and firmly believed in exercise, which he called `human capital development'. He was a man of rare integrity, enormous intelligence and wisdom, and had a joyous sense of humor.

He will be remembered by his many colleagues in many countries and many divisions of the University as a wise and profoundly caring man. Professor Meltz was, above all, dedicated to his family. He is survived by his wife Rochelle, his four children: David, Jonathan, Toba and Hillel, and his seven grandchildren.

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David Card's 2002 Malim Harding Visitorship Lecture

L-R: Victor Harding, David Card

On Thursday, March 21, 2002 we had the opportunity to enjoy, along with our colleagues in Political Science, the annual Malim Harding Visiting Lecture, generously sponsored by the Harding family. Again, we were fortunate to have **Victor Harding** present in our midst. This year's lecture was given by **David Card**, Class of 1950 Professor of Economics at the University of California, Berkeley. By way of coincidence, David Card had a previous indirect connection with the Harding family, having worked in a Harding Carpet factory for a summer while growing up on a farm outside of Guelph.

The title of Professor Card's talk was "New Technology and Rising Inequality: Are Computers Really to Blame?" The United States in the 1980s and early 1990s experienced sharp increases in earnings inequality, especially between university graduates and those without degrees. Economists have explored a number of hypotheses, but the most popular remaining explanation is `skill biased technical change' (SBTC). The main idea behind this story is that technological change associated with the development of personal computers and related information technologies has a skill bias whereby the relative demand for skilled (educated) workers has increased, causing an increase in the wages of skilled relative to to unskilled workers and thereby increasing wage inequality. One important intellectual problem with this hypothesis, however, is that technological change is very difficult to measure, and there is no hard evidence that technological change is really behind the growth in wage inequality. The popularity of the SBTC hypothesis rests on its intuitive appeal, combined with the failure of more easily refutable hypotheses (such as increased trade) to explain the patterns of wage growth in the labour market.

The main purpose of Card's talk was to offer a variety of evidence that could be used to explore the validity of the SBTC hypothesis.

Card began by noting that the relative proportion of highly-educated workers has been rising throughout the past several decades. By itself, this supply effect would lead to a decline in relative wages of high-wage individuals, so the only way that the increase in wage inequality could be explained is through an offsetting demand effect for higher skills associated with the growth of technology. Drawing on joint work with **John DiNardo*** he then proceeded to show that the SBTC hypothesis falls substantially short as an explanation of changes in U.S. income inequality.

The biggest problem he noted is the fact that, by most reasonable measures, information technology has grown steadily in importance since 1948 with sustained growth since at least 1970 and a pronounced upsurge in the late 1990s while most of the rise in wage inequality over the past two decades was concentrated in the period from 1980 to 1986. Rises in wage inequality have not persisted in the 1990s, despite continuing advances in computer technology. Simply put, the timing of the spread of computers to the workplace and the rise in skilled wages do not line up.

Another problem is that the rate of growth in the supply of college-educated relative to high-school educated labour declined after 1982 and remained at the same lower level thereafter. While this supply effect can explain the rise in relative wages of more highly educated individuals in the early to mid-1980s, it cannot explain the flattening of wage inequality after 1990. The SBTC hypothesis would imply increased rather than unchanged wage inequality in the 1990s. Recent developments in the labour market thus contradict the predictions of the hypothesis.

Third, the average wage gap between college and high-school educated workers increased much more for younger workers than older workers. And younger workers have higher computer use than older workers, which raises the possibility that computer technology might have accounted for the greater increase in younger workers' earnings. Between 1984 and 1997, however, relative computer use by young vs. old flattened out while the average wage gap between younger and older men widened. Moreover, there was little difference in relative computer use among young and old women while the wage gap between young and old women behaved similarly to that of men. Patterns of computer use across groups in the population do not line up with changes in their relative wages in ways we would expect if the SBTC hypothesis were true.

Fourth, while it might be expected that the computer revolution would lead to an increase in the wage premium for college graduates in more technical fields such as computer science and electrical engineering, the mean starting salaries in these fields tended to rise in the 1970s and fall in the 1980s---the introduction of microcomputers was associated with a fall in the relative salaries of college graduates with the strongest computer skills. The wage premium for engineering and computer science graduates fell between 1980 and 1986, when the major increases in wage inequality were occurring.

A fifth problem relates to the male-female wage gap, which remained stable during the 1970s, fell significantly in the 1980s and early 1990s, and then remained stable thereafter. Because women use computers on the job more than men, it might be argued that the decline in the gender wage gap could have been the result of SBTC. The gap behaved similarly through time for both college and high-school graduates, however, and college educated women are less likely to use a computer than college educated men.

Finally, Card noted that the SBTC also runs into some difficulties in explaining changes in the wage premia enjoyed by white workers as compared to black counterparts. This race differential, which has been much greater for men than women, fell sharply during the 1970s and remained rather stable since the beginning of the 1980s. The SBTC hypothesis would suggest a widening of the racial gap should have occurred in the 1980s, since whites are more likely to use computers than blacks.

Professor Card concluded that, while many difficulties in interpreting the data remain and many specific attempts to interpret these data as favorable to the SBTC hypothesis might be constructed by an imaginative researcher, the hypothesis clearly fails as a unicausal explanation of the growth of wage inequality, and provides very weak evidence that the growth of wage inequality was other than a episodic event unrelated to the growth of computer technology. He went on to suggest one plausible alternative hypothesis---that the decline in the real value of the minimum wage in the 1980s (i.e., the growth of the price level by more than legislated minimum-wage increases) increased the number of workers receiving wages at the low end of the scale, thereby widening observed wage inequality.

As the subsequent questions and discussion from the audience made clear, it was an excellent lecture! In addition to helping us understand the specific problem of wage inequality, Professor Card demonstrated how the analysis of a rich array of data sets can shed light on the factual plausibility of economic hypotheses, making it clear why he is regarded as the top labour economist of his generation.

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* David Card and John E. DiNardo, "Skill Biased Technological Change and Rising Wage Inequality: Some Problems and Puzzles", National Bureau of Economic Research Working Paper 8769, February 2002.

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Electrical Restructuring: What and Why?

by Don Dewees

California had blackouts and its major utilities teetered on bankruptcy. Alberta had high prices and angry consumers. Ontario was told by a court that it could not sell the transmission company, Hydro One, and consumers have been asked to turn down their air conditioners. If this is what happens, why would any government contemplate restructuring the electricity sector? This article will answer four questions: What is restructuring? Why have governments done it? Why do economists like it? What can we reasonably expect from it?

What is Electricity Restructuring?

Electricity restructuring means, at a minimum, introducing competition in electricity generation. The traditional monopoly that a utility enjoys over electricity generation is replaced with a competitive market in which anyone who meets technical and prudential requirements may generate electricity and sell it to customers. In some cases, restructuring will require the existing monopolist to sell or lease some generation plants to create a competitive pricing structure, and competitive behavior will then set the wholesale price of electricity. In other cases the big utilities could remain the dominant generators, with regulated prices, but customers are free to purchase power from a competitive generator. In both cases, separate prices are determined for every hour of every day, adjusting continuously as market conditions change.

A transmission grid is required to transmit electricity from all generators to consumers. Although electricity itself becomes competitively priced, the long distance transmission and local distribution of that electricity remain natural monopolies subject to rate regulation. Independent retailers may emerge to purchase power from generators and sell it to customers, competing with what is usually a regulated `default supply' price for customers who do not choose a retailer. These retailers may offer fixed prices in contrast to the `default price' which often varies with the spot market price. The retailers may offer special services, such as load management, or special meters, including time-of-use metering and interval metering that records consumption separately for every hour of every day. If generation is initially owned by public enterprises, some must be privatized to create a competitive structure. If the transmission and distribution networks are initially owned by public enterprises, they may or may not be privatized.

Why Have Governments Restructured?

During much of the 20th century, the minimum efficient scale for electricity generating stations increased, so that most cities became served by a small number of large stations. In the 1980's, however, the combined cycle gas turbine (CCGT) emerged as an efficient power source that was economical at a much smaller scale than coal-fired plants. While gas is much more expensive, per unit of energy, than coal, CCGT plants use less than 2/3 as much energy to produce a megawatt-hour of electricity as do coal-fired plants and, unlike the latter, they produce no sulphur dioxide or particulate pollution. CCGT plants can be built in as little as two years as compared to five or more years for coal-fired plants, and produce little of the environmental objections that could add another five years to the approval process for coal plants. As CCGT became the preferred new source of power its small scale offered the promise of competitive generation using many plants rather than one single monopoly source of power.

In addition, many electric utilities in the 1980's were saddled with high costs from bad investments, usually expensive nuclear plants. Large industrial customers who chafed at paying high regulated average total cost (ATC) prices to utilities learned that the ATC of new CCGT plants was less than the price they were currently paying. They pressed for competition to get access to cheaper CCGT power.

Ideas and experience were also major factors. Economists had been preaching the virtues of competition for decades and there was a substantial literature about the capture of regulatory bodies by the regulated firms and the inefficient operation of regulated monopolies. Surely competition would produce lower costs and prices. These arguments had led to the deregulation of railroad and trucking rates, long distance telephone charges, natural gas prices in the US, and airline prices, in most cases yielding significant reductions. Why not bring the same benefits to electricity?

In Ontario, there were two additional factors. Some executives in Ontario Hydro felt that the limitations of a regulated crown monopoly offered insufficient challenges for the talents of the firm. With restructuring, Ontario Power Generation, the successor to the generation portion of Ontario Hydro, could buy generation units across North America and become successful on a much larger scale; Hydro One, the successor to the transmission and distribution portion of Ontario Hydro, could extend its expertise in transmission to grids across the continent. For other people, the crown ownership of Ontario Hydro had offered too many opportunities for government meddling in the utility's affairs, using it to create jobs or to subsidize certain consumers. Competition, and perhaps privatization, would limit the government's ability to meddle, improving efficiency and reducing costs.

Why Do Economists Like Restructuring?

Economists generally see four economic benefits from electricity restructuring. First, competition should lead to prices that reflect marginal costs at all times. Electricity cannot be stored. Demand varies considerably between day and night, weekdays and weekends, and summer (air conditioning) and winter (heating) versus spring and fall. Since supply and demand are inelastic, equilibrium hourly prices are likely to be highly variable. Regulated monopoly prices are generally fixed for a year or more in advance and do not vary with time except for the largest customers. These prices fail to reflect hourly marginal costs. They fail to induce conservation when demand and price are high and they fail to encourage consumption when demand and price are low. Competitive pricing should cause prices to reflect marginal costs for more customers, more of the time, thus reducing welfare losses inherent in fixed pricing.

Second, if wholesale prices are set by market forces, investors rather than consumers bear the risks of investment mistakes. If a generator invests in a plant that is uncompetitively costly, no regulatory body is available to force consumers to pay for it. Investment decisions should be better with market discipline.

Third, both theory and empirical evidence suggest that competitive markets should induce more efficient production than does regulated monopoly. Regulated monopolists do not work as hard to constrain costs since they can pass costs (if not obviously excessive) on to consumers. Unions extract higher wages and more costly working conditions from monopolists than competitors. Operational inefficiencies are more of a problem with regulated monopoly than with competition. In some other jurisdictions generation costs dropped substantially with restructuring.

Fourth, we expect more innovation and technological progress under competition than under regulated monopoly. The technology for generation should improve more rapidly when innovators can reap the profits resulting from cost savings. There is a great incentive for distributors and retailers to develop metering technology that accommodates prices varying by the hour, and demand management technology and strategies to help consumers efficiently manage their consumption to minimize their exposure to the highest prices.

What Can We Expect from Restructuring?

Many jurisdictions, including England and Wales, Australia, New Zealand, and Argentina have experienced lower costs and greater availability of generation units from restructuring. In England, the performance of the nuclear reactors improved considerably when one company was given sole responsibility for those plants with its survival depending on their performance. The experience with generation costs supports the economic predictions of the benefits of competition.

After restructuring, investment in new generation under competition has been predominantly, but not exclusively, in CCGT plants. Some coal plants have been built where environmental opposition is not too high. It seems unlikely that new nuclear plants will be built, given their economic risks and very long lead times, but this would have been unlikely under regulation as well.

Hourly spot wholesale prices in restructured jurisdictions have exhibited the predicted diurnal, weekly, and seasonal variations one would expect from time-varying demand, with occasional short-term power shortages immediately reflected in high prices. In general the prices are thought to reflect marginal costs, although in several jurisdictions there is evidence of price manipulation when prices are high and in some others price manipulation is suspected.

It is not easy to generalize about the observed effects of restructuring on the average level of prices to consumers. In England and Wales prices fell, but not nearly as much as generation costs because of a lack of retail competition and some price manipulation by the two main generating companies. Prices fell in both Australia and New Zealand. Consumer prices in Pennsylvania-New Jersey-Maryland dropped by 10% as required by regulations, but that does not indicate what will happen when the price regulation terminates. In Alberta, prices fell initially, then rose dramatically when a supply shortage caused a near-crisis. The supply shortage arose in part from investors staying on the sidelines while the government failed to resolve uncertainties over the market rules. In California, consumer prices fell at first, because of a government-mandated price cut, and were kept low when wholesale prices surged in the summer of 2000, leading to the near-bankruptcy of the distribution utilities that were buying high and selling low. By 2001, the government had instituted a 30% retail price increase and demand had fallen. The California government has now interfered so extensively that it is no longer possible to regard California prices as competitive prices. In the long run it is still reasonable to expect prices to be lower under competition than under monopoly, but this does not ensure any short-run drop in prices when competition starts, nor does it prevent prices from being higher for a few months or even years.

Price structures, as opposed to price levels, seem to change slowly. A year after restructuring, most customers still face fixed prices set a year in advance, either because that is the default provision or because that is the preferred plan offered by retailers. It is becoming clear that the process of moving customers to real-time hourly varying prices will move slowly after restructuring has taken place.

Finally, experience shows that if competition produces prices that are too high for too long, governments often respond to consumer complaints and lower the prices. While this is reassuring to consumers, it has two major downsides. First, it damages the market for electricity retailers who offer price security at a price somewhat above the expected average price. Why should customers hedge if the government will protect them? Second, it seriously damages the incentive to invest in new generation. Why invest in costly new plant if your price forecast has major uncertainty created by the risk of government intervention? Such intervention undercuts the economic rationale for restructuring.

Conclusion

Electricity restructuring is a bold experiment in applying market forces to a complex commodity that is unlike other commodities where competition has taken root. So far, we have had some successes, a spectacular failure, and the jury is still out in a number of jurisdictions. It is still not clear whether we can find a process for creating market rules that keeps the public interest paramount and resists the special interests of industry participants lobbying for their own gain. And only experience will tell whether a government that has set down sound rules can then keep its hands off those rules and let the market function when consumers demand protection from high prices or generators demand protection from low ones.

To learn more you can read:

- Severin Borenstein, "The Trouble with Electricity Markets: Understanding California's Restructuring Disaster", *Journal of Economic Perspectives* 16:1, Winter, 2002, pp. 191-211.
- Donald N. Dewees, "Price and Environment in Electricity Restructuring", Working Paper, University of Toronto, 2001.
- Paul L. Joskow, "Restructuring, Competition and Regulatory Reform in the U.S. Electricity Sector", *Journal of Economic Perspectives*, 11:3, Summer, 1997, pp. 119-138.

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Does Globalization and Trade Liberalization Lead to Downward Convergence of Countries' Social Policies?

by Morley Gunderson

The economic analysis of globalization and trade liberalization tends to focus on the flows of goods, capital, ideas (e.g., intellectual property rights) and human capital (e.g., labour mobility and the brain drain). These are obviously important. But what is equally important, but more often neglected, are the effects on social policy. As economists, we tend to regard social policies as exogenous constraints that affect market outcomes such as income, poverty, wages and employment. Considerable mileage can be had, however, by regarding them as endogenous responses to market forces that are affected by globalization and in turn affect the demand for social polices and the ability of governments to supply them.

Pressures for a Race to the Bottom

The general perspective of most industrial relations analysts is that trade liberalization reduces the ability of a country like Canada to develop and follow its own independent labour and social policies. The negative aspects of this are highlighted by phrases like: `social dumping', `harmonization to the lowest common denominator', `race to the bottom', `regulatory meltdown', and the `rule of law giving way to the rule of the market'.

The precise mechanisms whereby this can occur are often not clearly spelled out. The general notion is that with trade liberalization, mobile or `footloose' capital will be able to locate in countries (and jurisdictions within countries) where regulatory costs are low, and export back into countries with high regulatory costs. Similarly, mobile human capital will be able to locate in low-tax jurisdictions---hence, the concern over the brain drain. In such circumstances, governments will be pressured to compete with each other for business investment and the jobs associated with that investment. One way to compete is to appear `open for business' by reducing regulations, expensive social and labour policies, and taxes.

Necessary Conditions for a Race to the Bottom

For inter-jurisdictional competition amongst governments to lead to the harmonization of regulatory and social policy initiatives, and for that harmonization to be downwards to the lowest common denominator, five conditions must prevail. The absence of any one of these conditions can break the link whereby downward harmonization occurs. First, policies must be enforced and fully applied. This may not be the case if they impose extreme costs or regulatory burdens. The administratively cumbersome permit system for exceeding maximum weekly hours of work in Ontario, for example, has been largely ignored as evidenced by the fact that for every `legal' hour that was worked with a permit, 24 `illegal' hours were also worked.

Second, regulations and social policy initiatives must not yield benefits to employers that offset their costs. The phrase `efficient regulation' is not always an oxymoron. Workers' compensation, for example, imposes a payroll tax on employers, but that system was historically accepted by both employees and employers since employees gave up the right to sue their employer in return for `no-fault' indemnity benefits if injured. This saves employers the cost of expensive litigation (as occurs now, for example, in non-work related personal injury cases). Abandoning workers' compensation would also mean that employers would have to pay higher compensating wage premiums in return for workplace risks that are not insured. More generally, social safety nets may reduce worker resistance to technological and other efficient changes, and `costly' social programs may be less costly than prisons, crime or health expenditures that may arise if social programs are not in place. Put simply, an ounce of prevention may be worth a pound of cure.

Third, firms must not be able to shift the costs of social policy initiatives `backward' onto workers in the form of lower compensating wages in return for benefits of the policy. Empirical evidence indicates, for example, that about 75 percent of the costs of payroll taxes that initially fall on employers (e.g., for public pensions, workers' compensation, employment insurance and health benefits) is shifted to workers in the form of lower compensating wages. Under trade liberalization such tax shifting is increasingly likely to occur since labour is one of the few immobile factors of production that cannot easily move (or threaten to move) to escape such tax shifting.

Fourth, for social policies to deter business investment and capital flows, employers must respond to any net cost of the policies by altering their investment and plant location decisions. While this can certainly occur if the costs are substantial, the evidence appears mixed on the importance of social policy costs for such decisions. It is certainly not the case that investments flood into countries that impose few regulatory and social policy costs. This is in part because such countries are not perceived as providing the legal and social environment that is conducive to doing business. Social policies often `buy' social stability, and such stability is conducive to doing business.

Fifth, for downward harmonization to occur, governments must respond to any threat of capital flight and plant relocation by reducing their social policy initiatives. This need not occur in a democratic country, as governments---reflecting the wishes of their constituencies---may not want to compete on that basis.

While it is not likely to be the case that all of these conditions will prevail, it is the case that they prevail to a degree, and increasingly under globalization. In such circumstances, there likely will be a tendency towards harmonization and that tendency will be towards the lowest common denominator.

Pressures Against Downward Harmonization

While government competition for investment and the associated jobs will foster harmonization towards the lowest common denominator, there are pressures that may offset much of this, and in fact lead to sustained divergence or even upward harmonization. Consumer groups, activists and non-government organizations (NGOs) have applied considerable pressure on firms to improve their labour standards and practices, especially for multinationals that produce global brand-name products. The fact that they `live by their image' also means that they may `die by their image' and this sensitivity makes them vulnerable to public pressure including `internet outing'.

Multinationals may also foster upward harmonization by `exporting' their practices to their host country and following `voluntary' corporate codes of conduct often promulgated by international organizations.

Upward convergence of social policies may also be fostered by social clauses or side-accords in trade agreements requiring the countries with lower standards to raise those standards. Such requirements are often regarded by the less developed countries as `thinly disguised protectionism' that reduces the source of the comparative advantage that enables them to compete and ultimately to grow. It is amazing how our social conscience with respect to sweatshop working conditions and child labour just happens to develop when our domestic production is threatened by external competition.

Convergence in economic growth fostered by trade liberalization can also lead to a convergence in social policies. To the extent that there is a positive income elasticity of demand for social policies, the demand for social policies will grow more rapidly in lower income countries than in the higher income countries as their incomes converge. Tiebout-type multiple-equilibria are also possible with some jurisdictions providing a package that provides extensive public infrastructure and social policies paid for by high tax rates, and others providing the opposite. Path dependence may also sustain social policies based on the initial conditions that were present when the policies were established. This is enhanced if bureaucracies and particular stakeholders develop a vested interest around such policies.

Divergent social policies can also be sustained by `border effects' of the sort estimated in gravity models, whereby internal trade seems to be vastly preferred to external trade because of familiarity and social capital networks as well as similarities of culture, laws and institutions.

Evidence on the Race to the Bottom

Clearly, as is so often the case, basic theoretical considerations do not yield unambiguous predictions as to whether globalization and trade liberalization will lead to harmonization of labour and social policies, and if so, whether that harmonization will be towards the lowest common denominator. Hence, we must appeal to the empirical evidence. Unfortunately, the only consensus is that there is a need for more evidence.

My reading of the evidence is that there is a tendency towards convergence of policies, including labour and social policies, and that convergence tends to be towards the lower common denominator. This is the case with respect to collective bargaining laws, minimum wages, unemployment insurance, pay equity, welfare, labour standards in general, and taxes. The evidence is more mixed with respect to workers' compensation, health and safety, and anti-discrimination laws. Such downward harmonization is not always undesirable, however, as would be implied by phrases like `social dumping'. Much of it may be desirable since it should dissipate inefficient and rent seeking policies, with policies that have positive feedback effects on efficiency (and many do) not only surviving but thriving in the more internationally competitive environment. In essence, governments are now more compelled to pay attention to the cost consequences of their policies, but this is generally a desirable and not undesirable pressure. Competition can be as beneficial amongst governments as it is amongst firms. The state faces a `harder' rather than `softer' budget constraint in deciding its policies, but this simply compels it to confront the reality that we cannot simply solve social problems by `throwing money' at them.

An area of concern which applies to many social policies is that the components of social policies that have pure equity oriented purposes to assist vulnerable disadvantaged groups, and that do not have positive feedback effects on efficiency and competitiveness, will be most difficult to sustain. Yet they are likely to be the most important policies given the number of vulnerable groups who are being bypassed by the benefits of globalization. There are, as the title of this Newsletter implies, tradeoffs.

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New Colleagues

Eugene Choo

A native of Malaysia, Eugene comes to us from Yale University where he completed his Ph.D. following undergraduate work at the University of Melbourne. His fields of interest are mathematical statistics and econometrics, with applications to microeconomic topics.

Andrés Erosa

Andrés has his Ph.D. from the University of Minnesota and comes to us via the University of Western Ontario and Universitat Autònoma de Barcelona. Originally from Uruguay, he has published in the areas of monetary economics, public finance and economic development.

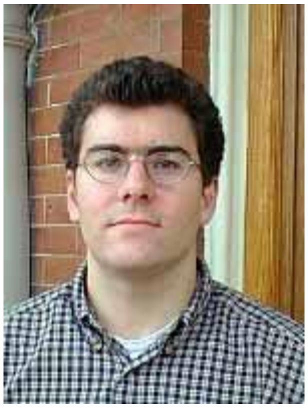
Luisa Fuster

Luisa joins us from Universitat Pompeu Fabra where she has taught for seven years following completion of her Ph.D. at Universitat Autònoma de Barcelona. Her publications are in macroeconomics, public finance and the economics of the family.

Christian Gourieroux

We are fortunate in having Christian, a world-class econometrician, join us for half of every year, spending the other half-year as Professor at the National School in Statistics and Economics, University of Paris IX. Up to this point in his career he has published, either by himself or jointly with others, seventeen books and over one hundred and sixty articles.

John Maheu

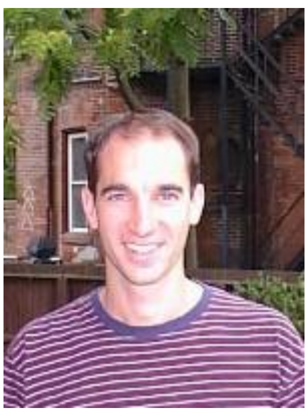


John, a Ph.D. from Queen's University, joins the Department after three years at the University of Alberta. A specialist in time-series econometrics and empirical finance, he already has several publications in major journals and has given a number of invited lectures.

Stéphane Mechoulan

A native of France, Stéphane obtained his Ph.D. from Northwestern University with specialization in health economics and economics of the family. He also works on issues regarding intellectual property rights and the economics of ethnic discrimination.

Philip Oreopoulos



Philip specializes in labour economics, public finance and applied econometrics. He is a native of Toronto and has just completed his Ph.D. at the University of California at Berkeley. His current research focuses on the economics of education.

Shouyong Shi

Shouyong obtained his Ph.D. from this Department in 1991 and now returns to occupy the Department's first Canada Research Chair, having published many articles and developed an international reputation while on the faculties of Queen's University and Indiana University. Shouyong specializes in macroeconomics and monetary economics with emphasis on search, matching and coordination models.

Johannes Van Biesebroeck

Jo, originally from Belgium, joins us from graduate work at Stanford University where he recently received his Ph.D. His specialties are industrial organization, productivity and technical change, applied econometrics and development economics.

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Retirees

Al Berry

Al Berry has his Ph.D. from Princeton University and spent a number of years on the faculty of Yale University before joining the Department in 1974. He has had a long, distinguished career in the field of economic growth and development, having written many books and articles on income distribution, labour markets, education, health, trade policy and agricultural reform in Latin America. He has been elected a Fellow of the Royal Society of Canada, and has served as an advisor on World Bank missions to Pakistan as well as various Latin American countries where he has played an important role in the development of policies to improve economic growth and development. In his retirement, Al remains deeply involved in economic research and policy advising.

Scott Eddie

Scott Eddie joined the Department in 1971 after three years at Williams College and visiting appointments at the University of Wisconsin and Yale. His PhD is from the Massachusetts Institute of Technology. Author of several books and many articles, Scott has been for many years a distinguished scholar on the history and development of the Eastern European economies with a focus on land tenure, land reform and agricultural development, international trade and economic policy, and the economics of transition and reform of planned economies. He has won numerous fellowships and has held visiting positions at several institutions including All Souls College, Oxford, and the University of Vienna. Scott will be using the early years of his retirement to produce two more books.

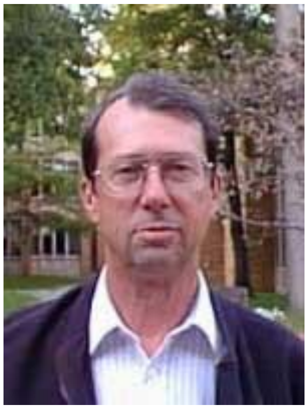
John Floyd

John has been in the Department thirty-two years, having joined in 1970 after eight years at the University of Washington. He did his undergraduate work at the University of Saskatchewan and his graduate work in agricultural economics at the University of Chicago. After one major paper on the effects of farm price supports on land rents his attention turned to international macroeconomics with a focus on the role of international capital mobility. He has written numerous articles and three books in this field, the most important being an analysis with Trevor Dick of the operation of the international gold standard in Canada prior to World War I. John has been editor of this Newsletter for the past seven years. He will spend his retirement working on another book.

Allan Hynes

Allan joined the Department in 1971 following nine years on the faculty of the University of Washington after his graduate work at the University of Chicago. His specialties are macroeconomics and monetary economics and, more recently, the history of economic thought. Al has published numerous papers, the most well-known of which have been a contribution to the theory of price dynamics and inflation, joint with Don Gordon, and an analysis of time preference and economic dynamics with Larry Epstein. Despite retirement, he remains active in the Department in teaching and research.

Tom Wilson



Tom Wilson received his PhD from Harvard University and spent five years on the Harvard faculty before joining us in 1967. He has over one-hundred publications, many in major economics journals, in the fields of macroeconomics, industrial organization, and economic policy, and has been a consultant to numerous Canadian Government agencies as well as Director of Investigation and Research for the Royal Commission on the Economic Union and Development Prospects for Canada. Tom was instrumental in the creation of the Department of Economics when the Department of Political Economy was devolved into its constituent parts, and was the Department's first chairman. He also served as Director of the Institute of Policy Analysis for six years and as a member of the Academic Board of the University. In retirement, he remains Senior Advisor to the Institute for Policy Analysis. In addition he is a past president of the Canadian Economics Association and a Fellow of the Royal Society of Canada.

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The Research Interests of Some of Our Faculty

Jon Cohen is working on a major project with **Michelle Alexopoulos** focusing on centralized economy-wide wage bargaining in Sweden during the period extending from the mid-1950s to the mid-1980s. This institutional arrangement is viewed by many as responsible for Sweden's apparent rapid growth of output and productivity and low inflation and unemployment during the period. Jon and Michelle's work thus far suggests that Sweden's macroeconomic record is less impressive than was widely believed and that centralized wage bargaining ultimately resulted, by the end of the period, in reduced worker effort and morale and lower productivity and output growth.

Ettore Damiano is studying decentralized matching markets and their ability to efficiently pair economic agents when those agents' productivity is private information, known only to themselves. In a paper with colleague **Li Hao**, he looks at the efficiency properties of the screening achieved via sequential markets, and their robustness. It is found that while sequential markets sort the participants efficiently they are `fragile', breaking down when participation costs are introduced. A second paper, part of the same research program, contrasts this result to the amount of sorting that can be achieved through parallel search markets.

David Foot is currently extending his work in demographic economics to the global arena. He presented a paper on population aging and future leisure trends at a conference sponsored by the University of Innsbruck, Austria in April and taught in a summer course on marketing in the Interdisciplinary School of Management at the London School of Economics. He has future presentations scheduled in the U.S.A. and Australia. In addition, he has been relating his global demographics work to sustainability issues and is drawing his experience in teaching this topic into papers for chapters in a forthcoming book.

Mel Fuss focuses his research on the interpretation and measurement of productivity and on issues in empirical industrial organization. A paper forthcoming in a North-Holland Publishing Company volume (joint with **Leonard Waverman**) surveys the literature on cost and productivity measurement in the telecommunications industry, and considers the implications of this literature for incentive-based government regulation. Mel continues his productivity research concerning Israeli industry (joint with Israeli economists **Arie Bregman** and **Haim Regev**). Two relatively new research projects are in early stages of investigation: An examination of scale and scope economies in mutual fund management (joint with **Larry Schwartz**), and an investigation of the concepts underlying the measurement of productivity in e-commerce enterprises (joint with **Leonard Waverman**).

Arthur Hosios is currently working on a range of different contracting problems. His research with **Loren Brandt** develops and tests theories of credit contracts between households in remote villages of less-developed economies. In one paper, they provide and test an explanation for why some households negotiate credit agreements with fixed durations while others choose open-ended agreements with no-fixed termination date. In another, they develop and test an explanation for why some households negotiate positive-interest-rate loans while others opt for zero-interest-rate loans. Hosios is also studying contracting problems between professors and universities. His research with **Aloysius Siow** develops and tests a model of faculty union formation in universities---they develop a model to explain why wages (and research output) tend to fall following union formation, and then test that model with Canadian data. In another more theoretical paper, Hosios argues that subjective performance evaluation and potential favoritism in academia can explain why pay compression, modest promotion standards and bureaucratic rules are preferred by faculty at lower-ranked institutions, while performance pay, informal evaluation criteria and irrevocable tenured appointments are preferred at higher-ranked institutions.

Alex Maynard has recently been developing robust estimation techniques to analyze relationships between variables when there is a possible regression imbalance, in the sense that a short-memory stationary dependent variable is regressed on a long-memory or nonstationary regressor, and vice-versa. Together with **Katsumi Shimotsu**, he is currently working to develop the theoretical properties of the estimators. In other work Alex also employs this methodology to revisit some of the stylized facts underlying the forward premium puzzle---the the historical tendency of forward exchange rates to mis-predict the direction of future movements in the spot exchange rate. This follows his previous work on this subject, some of it joint with **Peter C. B. Phillips**, emphasizing that the negative slope coefficients, which form the central stylized fact behind this puzzle, come from an arguably imbalanced regression.

Rob McMillan is currently working in three areas. In joint research with **Patrick Bayer** and **Kim Rueben**, he has been using restricted US Census data housed at the University of California at Berkeley to estimate a structural model of an urban housing market and carry out general equilibrium simulations using the estimates. The authors are currently using the estimation framework to obtain better estimates of the valuation of public school quality, and to understand better the likely effects of competition in the public education system. On a similar theme, he is just starting some research that uses cross-province variation in competition to see whether public schools in Canada respond to competition from private schools. And with **Ethan Kaplan**, he has been examining the effects of September 11 on the labour market experiences of Arab versus non-Arab workers in the United States.

Martin Osborne is engaged in two projects in the burgeoning field of political economy. One project, joint with **Rabee Tourky** of the University of Melbourne, shows that when legislative decisions are made by majority voting and there is a single issue, economies of party size lead to the emergence of exactly two parties. The other project, joint with **Ariel Rubinstein** of Tel Aviv University, studies the implications of voters' bounded rationality for the election of a centrist candidate.

Michael Peters is working on decentralized models of multilateral trade with **Sergei Severinov** of Duke University. Their most recent results provide perfect Bayesian equilibria for decentralized trading mechanisms that converge to rational expectations equilibria as the number of traders gets large. In addition, he is working with **Seungjin Han** attempting to provide a full characterization of equilibrium in multiple agency models with both many principals and many agents.

Jo Van Beisebroeck is studying technology adoption in the automobile industry, looking at the effects of new techniques on the production processes within plants and tracing impact of new technologies on the organization of activities in the industry, both nationally and internationally. Two aspects of particular interest are the factors that lead to outsourcing by assembly plants and the location decisions of component suppliers. In joint work with **Eugene Choo** he is also investigating whether inventories of unsold vehicles have an effect on firms' pricing decisions. In another project, Jo is using data on African manufacturing firms and their employees to investigate the efficiency of markets in several sub-Saharan African countries. Following up on previous work comparing the success of labor and capital markets in the U.S. and Africa in reallocating resources to more productive firms, he is comparing private returns to education with the effects of schooling on plant-level productivity. He is also investigating the link between a plant's decision to start exporting and domestic market failures such as credit constraints and problems of contract enforcement.

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What's Happening in the Department of Economics

The Department Receives Two Ontario Graduate Scholarships

We are pleased to announce the **Eva Klein and Leonard Waverman Ontario Graduate Scholarship** and the **Leon Lee On Wong and Susan Foon Chim Wong Ontario Graduate Scholarship** which will each provide an annual scholarship of $15,000 to a graduate student in the Department. We are extremely grateful for the generosity of these respective donors. Please refer to the last page of this Newsletter for information on the OGS program and how you might participate.

News from The Undergraduate Economics Course Organization

by Jae Hyun Park

The immense size of the University of Toronto can be daunting to our undergraduate students, particularly those in their first year. The mandate of the Economics Course Organization (EC0) is to help students and faculty overcome the impersonal nature of a large University so that individual students' opinions and suggestions are heard and their needs met.

This year ECO's executives are striving to achieve more than just bringing economics students together at social events, and helping students in career management and exam preparation. Through the use of online tools and a team of class representatives we are listening closely to the suggestions and opinions of economics students. The Economics Department's faculty and administration have asked ECO's executives to communicate with them more often than in previous years so that the Department can be further improved to meet students' needs.

Any advice and suggestions by economics faculty and/or graduate students will be greatly appreciated. We can be reached at `eco_council@hotmail.com'.

The Annual Graduate Economics Union Dinner

by Tracy Rong Li

Since 1999, the Department has been hosting an end-of-year dinner at a downtown restaurant. What initially started as a farewell dinner for the graduating masters students has become an annual occasion for faculty members and graduate students to come together and socialize outside of the department setting. This year's dinner was held on the 26th of April at Grano, a family style Italian restaurant near Davisville and Yonge. With an arduous effort on the part of the Graduate Economics Union, an estimated 80 tickets were sold, over 20 to faculty members including the chair, Professor Berkowitz, and the graduate program director, Professor Cohen.

The restaurant had a cozy touch to it and the ample space in the dining area allowed attendees to mingle before dinner. In fact, people were having such a good time chatting that a considerable amount of effort had to be exerted to get everyone to sit down so that dinner could be served. The menu was picked by the GEU members, Emily Hanna and Rhys Mendes. Thanks to them, the portions were generous and the taste fabulous. The Department is also to be thanked for a generous subsidy that made the event possible.

After dinner, a number of graduate students went on to the Madison pub to relieve the stress that had built up over the year and to continue savoring the festive mood of the evening.

Some photos from the dinner:


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The Annual Alumni Reception

On June 7, 2002, as part of the U of T Spring Reunion, the Department held a reception at Massey College honoring the graduating classes from years 1997, 1992, 1987, etc. About 40 faculty and graduates attended with classmates reminiscing about old times and reacquainting themselves with faculty and activities within the Economics Department. We were especially happy to have the opportunity to celebrate the 50th year graduation of Dagmar Stafl, Joan Milling, Donald Paterson, and Douglas Boozer. We encourage alumnae to participate in these events as well as ongoing departmental activities. For further information as to how you might become more involved with the Department, please contact the Chair of the Department, Michael Berkowitz, at (416) 978-8635, or by email at `berk@chass.utoronto.ca'.

The Canadian Economic Theory Conference

by Joanne Roberts

On the weekend of May 24-26 the Department hosted the annual Canadian Economic Theory Conference. We had thirty-four talks over the course of three days, given by a variety of participants from Canada and beyond. The highlights of the weekend were the talks given by our two invited speakers: Stephen Morris from Yale, and Eric Maskin, from Institute for Advanced Studies, Princeton. The theory group is grateful to the Department and the Institute for Policy Analysis who, through their generous support, made such a large scale and successful conference possible.

A Conference in Honor of Al Berry

by Sue Horton

A conference entitled "Social and Economic Impacts of Liberalization and Globalization: Effects on Labour Markets and Income Distribution" was held in Honor of Professor Albert Berry on April 19-20, 2002 in the Munk Centre for International Studies. 16 papers were presented by well-known economists from 10 different countries, representing the range of Al's work, in sessions on growth and income distribution in Latin America, Latin American labour markets, education, health and small enterprise in Latin America, trade policy and reform in Latin America, and finally, on the impacts of Al's work on these themes in other developing regions.

In addition to the academic discussions, highlights were a slide-lecture on Al's life and work, and a delightful banquet for 100 in Massey College, which went until midnight, with many funny speeches. In addition to Al's colleagues, his family and friends were well-represented at the banquet. Among the little known highlights of Al's career are the fact that he holds the record for sprinting across the bridge at St. Clair (to catch the courier deadline), his expertise in soccer (he played for UWO as an undergraduate), and his inability to say no to a new project (hence the extremely large number of piles of material on the floors of his various offices).

The papers from the conference are being published in various development journals. We are grateful to the Ford Foundation, the International Development Research Centre, the Department of Economics and the Office of the Vice-President, Research and International Relations, for financial support.

Other News

Special congratulations to colleagues

- **Morley Gunderson** who has won the Industrial Relations Research Association Teaching Award for outstanding teaching in the field of labour economics.
- **Mike Peters** for winning the Rae Prize for 2002 awarded to the Canadian economist with the best research record during the previous five years.
- **Mark Stabile** who has won the Harry Johnson Prize for the best article in the *Canadian Journal of Economics* in the past year.
- **Christian Gourieroux** who was awarded the Silver Medal of the Conseil National de Recherche Scientifique by the French Ministry of Research.
- **Li Hao** for being awarded a Hoover Institute Fellowship to spend the year at Stanford University.

- **Kevin Milligan**, who received his Ph.D. from this Department last year and is now on the faculty of the University of British Columbia, for winning the National Tax Association Award for the best doctoral dissertation in 2001.

This past year, seven of our graduate students received Ontario Graduate Scholarships. Congratulations to **Tasso Adamopoulis**, **Catherine Deri**, **Jia-Zhueng Fan**, **Seung Jin Han**, **Dianna Juricevic**, **Hankook Kim**, and **Mathiew Lerner**. All are Ph.D. students except Dianna Juricevic, who is in the combined J.D.-M.A. program, and Mathiew Lerner, who is in the M.F.E. program.

Special Congratulations to our students who have obtained their Ph.D. degrees. Together with their place of employment and thesis topic, they are:

- **Sonia Laszlo**, Ryerson University, "Household Education and Earnings: Evidence from Peru".
- **Yiu Fai Lee**, HUST, Hong Kong, "Labour Supply and Family Planning in Rural China".
- **Zhixin Li**, Bank of Montreal, "Mean Reversion, Tax Arbitrage and Hidden Markov Modeling of Risk Premia".
- **Kevin Milligan**, University of British Columbia, "Empirical Essays on Behavioral Responses to Taxation".
- **Franziska Ohnsorge**, International Monetary Fund, "Self-Selection, Labour Markets and Capital Markets".
- **Marie Rekkas**, Simon Fraser University, "Essays in Empirical Economics".
- **Eric Santor**, Bank of Canada, "Essays in Development Economics: Evaluating Solutions to Asymmetric Credit Markets".
- **Yiguo Sun**, University of Guelph, "Essays on Semiparametric Efficient Adaptive Estimation and an Empirical Analysis of Catastrophe-lined Security Markets".
- **Andrew Tepperman**, Charles River Associates, "The Implications of Intellectual Property for Firm Strategy and Organizational Choice".
- **Ilias Tsiakas**, University of Warwick, U.K., "Bayesian Empirical Applications of Generalized Stochastic Volatility Models".
- **Alan Xian Yang**, Algorithmics Inc., "An Investigation of Asset Pricing Puzzles with Cyclical Risk Aversion and Intertemporal Substitution".
- **Ming Li Zheng**, University of Macau, "Essays on Applied Economics".

We wish them all the best.

Congratulations also go to some of our graduates from previous years:

- **David A. Galloway** (BA 1966) has been appointed to the Board of Directors of Corel Corp.
- **Charles F. Scott** (BA 1969) has been appointed to Partner at Lax O'Sullivan Scott.
- **Peter Sprukulis** (BA 1983) has been appointed to Vice-President, Marketing at Ontario Power Generation.

We hope that our alumnae will let us know of their accomplishments so that we can share this information in subsequent issues of this Newsletter.

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Department of Economics Welcome Page

From the Editor

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

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Email the Editor