

text
Milian Bachem

Milian Bachem is a
Bachelor student in
Economics.

INSPIRED PEOPLE

It is sometimes difficult for a student of economics to understand how to become a real economist and what that path actually looks like. Today we have asked one of our own professors, Maarten Pieter Schinkel, to tell us about his inspiration, career, research and opinions on issues in the field of economics.

Could you tell me a little bit about your career and how you started out?

I studied at Maastricht University. The way of teaching there appealed to me, because the university adopted problem-based learning in small groups. They also taught in English from the start and that resulted in a diverse student population. I originate from the west of Holland but moved south especially to study at Maastricht. I started of studying International Management – to go into business – but what did I know? After the very first class I attended in Microeconomics, I found out that the study of Economics suited me much better. So I progressed my studies with a strong emphasis toward the Micro side of Economics and a specialization toward general equilibrium theory.

What fascinated you about the micro side instead of, for example the macro side?

Initially, a teacher inspired me but going on, I found out that I was more interested in how things work in detail and I can't live with just scratching the surface. Macroeconomics was too abstract for me.

A book that influenced me a great deal was "Zen and the art of motorcycle maintenance" (Robert M. Pirsig, 1974) – I first read it at 17, and still do so regularly. If you want to



really understand something, you need to become one with it and know all the little details. In the story the main character rides an old boxer motorcycle across the US from Minneapolis to San Francisco. He has learned all the mechanics of the machine over time, and even builds his own spare parts. His companion rides a brand new BMW motorcycle. This guy has no idea of how his motorcycle works. The book is, amongst many things, about the choice between deep experience and superficiality. And that is the more fundamental question for me. I was certainly more attracted to the detailed side.

The question whether macroeconomics or microeconomics is more scientific, is not an interesting one for me. I've studied both fields and I felt that I couldn't get comfortable with the fundamentals of macro.

A book that you often recommend for your second-year Microeconomics students is "The Worldly Philosophers" (Robert L. Heilbroner, 1953), how has this book affected you and why do you recommend it?

I recommend this book at what is one of the hardest parts of the course, as a relief. This book was instrumental in the time that I was making my switch to becoming an

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economist. It's a book that I recommend to my students because it adds a more colorful representation to the curriculum's mathematical and dry backbone. The book describes how great economists came to their ideas and what effect their ideas had on economics. What is often forgotten is that these scholars weren't just stuffy scientists sitting in their dusty rooms all day playing around with formulas. They were inspired people walking the streets that were sick of the poverty and wanted to do something about it.

How would you say that the book *Disequilibrium foundations of equilibrium economics* (Franklin M. Fisher, 1983) has influenced you in your work?

When I was in my last year of Master studies, I was madly in love with general equilibrium theory. I started to ►

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become more and more interested in what happens when economies are not in equilibrium – how do they get there? In equilibrium the supply and demand for all products and services are simultaneously equal. In principle, they are all interrelated. So what happens if in one market there is a disruption? How will things adjust back to an equilibrium again – or will they at all? Always? When I was struggling with this, I discovered this book, and it really transformed my way of thinking. For a week the only thing I did was read this book, and I think I read it cover to cover around 10 times. What was so interesting for me was that this book posed just that question, “what if economies are in disequilibrium?” and started to answer that question. I soon had a lot of comments and questions. This sparked me to write the author a letter, telling him how I loved his book but also disagreed on several things – in particular the competitive ending. He soon sent me back a letter inviting me to visit him and come study with him for a while at MIT.

What came out of these studies with professor Fisher?

First and foremost a time in intellectual heaven – I took classes at MIT and Harvard, met with (some later) Nobel Prize winners, and ended up presenting my main paper to giants. In a nutshell, there were two things that I managed to contribute. Starting from the observation that active intervention has to be taken by some companies in the model to shift an economy from disequilibrium into equilibrium, firstly I extended a little on Fisher's main global stability result (published in the *Journal of Mathematical Economics*, 2002). Companies make estimations of the supply and demand in their shop and subsequently change their prices to match these. So it's these companies that gradually move the economy from disequilibrium to equilibrium – and they can do so as long as nothing happens that was unexpected. Consequently, the adjustment process determines the characteristics of the new equilibrium. That means that institutions like the CPB

have to take great care calculating equilibria with fancy, but neutral algorithms. Secondly, I traced in the history of thought where theorists went wrong in neglecting disequilibria (*History of Political Economy*, 2006).

What happens if you introduce the government into these models?

That adds another thick layer of complexity. In principle, government distorts welfare efficient equilibria by introducing taxes and subsidies. But the taxes and subsidies can also disrupt the adjustments that the companies make to converge to equilibrium, which run over price signals in monopolistic competition. For example if you give one tomato farmer a subsidy (and/or taxing another) that tomato farmer may be able to sell his tomatoes at a much lower price, driving the others out of the market and transforming it into a monopoly.

So would you say that taxes are one of the most annoying things for Micro economists?

In general they are very disruptive, yes.

How would you as a micro economist change the way we tax?

The challenge is to design government finances that are least disturbing to the goal. There is a large microeconomic literature that can advise in this. It is not my specialty, but one of the first lessons in *Micro 101* is that you have to tax in lump sum to eradicate things like deadweight loss. A lump-sum tax takes a fixed amount of money instead of levying in relation to commodity prices. It is a question whether it is at all possible to tax lump-sum. A head tax, for example, creates incentives to move to another country and evade it. But where possible, we should try it. In addition, keep in mind that ad valorem taxes create enormous administrative burdens. Think of VAT (BTW in the Netherlands red.). On every transaction, however little, some has to be kept to pay the government its share.

Offices of people do this – accounting taxes. What a waste: these people could be doing more useful things. Just like those that think up avoidance strategies. There is a constant arms race between the corporate fiscal economists on one hand and the political fiscal economists on the other, trying to outsmart each other. This is truly a billion dollar business, and I think that's a shame, because these people could be using their intellect for much nobler endeavors. Tax systems should be designed from the perspective of minimizing the social costs of all of this.

Do consider taxing with lump-sum politically viable?

Well, there are always people that are profiting from the current way of taxation. Even if a change in taxation creates more economic welfare there will always be a certain amount of opposition. This opposition often has a lot of political power and would thus be able to stop any new, possibly better, policies. What I think we need to focus more on is how to use some of the new welfare that is created, to compensate the opposition. There is a large literature on the specifics of how to tax. This is another rich field of economics that isn't really being used enough.

Could you talk a little bit more about how these two books affected your work and elaborate on what you are currently working on?

Yes, so Heilbroner's book mainly moved me when I was making the transition from managerial economics to general economics. Fisher's book was most influential when I was writing my thesis. During that time I realized that the issues in disequilibrium economics were extremely complex, and I wasn't able to contribute much more than I had done then. At the conclusion of my thesis I realized that I wasn't going to be able to bridge the gap between Micro and Macroeconomics with high theory, as I had set out to do ambitiously. I concluded I needed to look at how individual markets work. I was very interested in the ►

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(disequilibrium) stories of these markets, and that's the way I arrived at Industrial Organization. It's mainly concerned with the way we keep markets an oiled machine, so we try to keep cartels out, eradicate abuse of power and try to keep markets competitive. The last 10 years or so, I have been working on the combination of law and economics, and specifically how to stop cartels.

How would you say that law and economics are combined, where law is the more subjective science and economics is more mathematical?

I would say that there are two different kinds of progress in this field. Firstly, it is very productive to incorporate relevant laws, or jurisprudence, into microeconomic models and analyze how they influence choices. This is the kind that lawyers can mostly agree with. Secondly, we can use economics to evaluate the process of law making from the point of view of efficiency and welfare. This is the more economic kind, which can, but does not need to, clash with objectives in law such as proportionality and fairness. The second builds in part on the first, but goes beyond.

With which kind of approach have you done more research?

Well I'd say that my research applies both approaches. Let me give you an example. I look at how competition authorities and cartels play a cat and mouse game. The competition authority tries to catch the cartel, and the companies within the cartel try to avoid being caught and profit. In that context, we can for example, consider if it is a good idea to give one company, which is the first to provide evidence of price fixing, a fine reduction in return for notifying the cartel to the authority. Such a leniency program changes the incentives of the cartel members, but they also invent new ways around it, which the competition authority should take on board in redesigning the program and the conditions under which it offers fine reductions. Yet other objectives in the agency – such as having a peaceful

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life, in which they are not threatened by big business, may interfere with the socially optimal thing to do.

Finally, what do you try to teach your students, what isn't specifically taught in the curriculum?

My task with the Micro course is to teach students rigorous mathematical microeconomics. Without mastering these mathematical fundamentals you will just not become a good economist – both because it is an insightful tool, and because other economists will use math to argue their case. You just should do this – like Daniel in The Karate Kid (1984) has to wash cars endlessly to finally see it is how to master the Crane stance. To not drown in the mathematics however, I offer the students extra reading advice to also get the why-are-we-doing-this side of the story. That is of course to create the highest possible welfare. In the final class, when we cover general equilibrium theory, the pieces of the puzzle should come together. I believe for many it does. It is great to see how students of today are motivated by new and wide opportunities to get really enthusiastic about economics. The credit crisis has contributed to this, I think, to show students how our models can and can't be used in real life. ■



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