The evolving modern world is characterized by two opposing trends: integration and segregation. On the one hand, we witness strong forces for segregation on the basis of nationality, ethnicity, religion, and culture in the former Soviet Union, the former Czechoslovakia, the former Yugoslavia, as well as in Northern Ireland, Spain, and Canada. These forces are quite strong and, in some cases, violent. On the other hand, the European Union and NAFTA represent the tendency for integration motivated primarily by economic considerations (such as gains from trade and scale economies). In fact, these opposing trends can be explained by the concepts developed in modern club theory, local public finance, and international trade. For example, club theory explains the advantages of the forming of homogeneous consumption groups, while international trade theory emphasizes the gains from trade among heterologous economies. The outcome of such forces may be a system of overlapping “functional clubs,” one in which an individual can belong simultaneously to several clubs, each fulfilling a different purpose.

This volume presents recent developments in urban geography, club theory and local public finance, and international trade which contribute to the explanation of these recent opposing trends. Part I is concerned with the role of transportation costs, crowding, and preferences for a large variety of goods in shaping the main features of urban geography. Positive and normative aspects of agglomerative economic forces are examined in the two contributions. Part II contains four contributions on fundamental issues associated with the provision of collective goods (club goods and local public goods) by use of a game-theoretic approach. Part III is devoted to issues associated with the production, pricing, and the consumption of congested public goods. The articles discuss the financing of transportation infrastructure (which is a special case of a congested public facility) in an intertemporal framework, the efficiency of monopolistic provision of congested public goods, the positive and normative aspects of the “musical-suburbs” problem, and the influence of secession forces on federations. Part IV deals with several interesting tax issues that have arisen in a world where economic borders are gradually being removed.
Topics in public economics
Topics in public economics
Theoretical and applied analysis

EDITED BY

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Dedication

Haim Ben-Shahar

More than two years have elapsed since the passing of our dear friend, Prof. Eitan Berglas.

Many scholars were acquainted with him, either personally or through his scientific work. I had the privilege of knowing Eitan for a long time, and our collaboration as colleagues and personal friends goes back a long way. Eitan was an outstanding human being. Probably the best way to pay tribute to him is simply by briefly telling his life story.

I first met Eitan in 1957 when, at the age of twenty-two, he was a first-year student. He had come to Jerusalem with his wife, Hadassah, to work full-time at the Ministry of Finance and to study nights at the Hebrew University, which he did, intensively. He already had a career behind him — that of treasurer of a kibbutz — a role that required him to carry the heavy financial burden of the kibbutz on his young shoulders.

Eitan’s academic talents became apparent immediately, and three years later he was accepted into the Ph.D. program in economics at the University of Chicago. By 1963, Eitan had received his Ph.D. degree and returned to Israel. He was the only young economist I ever knew to turn down Prof. Don Patinkin’s proposal to join the Faculty of the Department of Economics at the Hebrew University. Eitan believed that he could serve the country better by accepting another offer, to establish the Economics Department at the Ministry of Defense. He hoped to introduce new modes of rational choice economic analysis to the Ministry and, by so doing, to influence decision making on major defense policy issues.

Eitan spent over three years in the Ministry of Defense and, concurrently, taught part-time at the Hebrew University. He was thoroughly devoted to his major assignment at the Ministry of Defense. Unfortunately, he gradually became frustrated at the lack of impact despite his efforts. In 1967, he decided to resign. His decision was made exactly at the time that Tel Aviv University was establishing its Department of Economics and searching for faculty members. We both joined the new Department, with the understanding that Eitan would be its first Chairman.

With this decision, Eitan began what he considered to be the most important activity of his life – the inauguration, nurture, and upgrading of the Department of Economics at Tel Aviv University, a department that has since earned worldwide recognition and one that was recently elevated to a school, rightfully
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bearing his name. Eitan embarked on this mission head-on, knowing that some of the best young talents of the time, such as Yoram Ben-Porath, David Levhari, and Eytan Sheshinsky, among others, were committed to the Hebrew University. He initiated a search for younger promising talents and in the process discovered Jacob Frenkel, Elhanan Helpman, Efraim Sadka, and Assaf Razin, who were then at the very early stages of their academic careers.

Eitan knew that he had lost precious years by not conducting scientific research and therefore, three years later, he decided to nominate one of the young faculty members as Chairman in his place and devote more of his time to academic research. However, from that time on, he remained the unofficial chairman, guide, teacher, and mentor of every young faculty member and of the Department of Economics as a whole. No major decision was made without consulting him. He never willfully intervened; on the contrary, he was always approached for guidance, which he readily gave. The affairs of the department continued to receive the highest priority among his many other activities.

In 1974, when he took his sabbatical leave at the University of Rochester, he had already made a breakthrough in the theory of clubs. He found such pleasure and gratification in his research. During every meeting we had, he would talk like an enthusiastic youngster about his new ideas and accomplishments. It was apparent that academic work gave him immense satisfaction.

Upon returning to Israel, Eitan and I found ourselves immersed once more in close collaboration; this time at Tel Aviv University, where I was President and he was Deputy Rector. That period was especially difficult for the university due to the drastic government budget cuts following the 1973 Yom Kippur War. Eitan’s wise advice and assistance, given in a friendly manner and with a great deal of care, were tremendously helpful.

In 1978, Eitan was asked to head the Budget Division at the Ministry of Finance, a challenge he had to face, seeing it as an opportunity to exert a major impact on national economic policy. However, this turned out to be one of the most frustrating experiences of his career. Two years later he resigned and returned to the university to pursue his academic interests. By then, the Department of Economics had begun to take off. Eitan derived a great deal of pleasure from watching his “home base” flourish. Unfortunately, however, he could not enjoy it for long because Hadassah became ill. For two years Eitan and Hadassah struggled with the illness, initially with great hope. That hope soon faded, and in 1984 Hadassah passed away. From that time on, Eitan increased the ever-devoted attention he gave to his children.

In 1985, Eitan started his new career as Chairman of Bank Hapoalim, a career that made him a national figure. In this position, he was responsible for the largest bank in Israel at a time when it and the entire banking system were suffering from a deep crisis. Eitan had to confront many difficulties and deal with all of them simultaneously. He soon became the principal adviser of the
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bank's new CEO, Amiram Sivan. Eitan's wisdom, poise, and effectiveness helped bring Bank Hapoalim out of its crisis and, together with Sivan, he led the bank into a new era of prosperity. Eitan's unique qualities and skills were eminently realized in this position.

Eitan's contributions did not stop there. He was closely involved in advising the government on the stabilization plan of 1985. He handled macroeconomic issues as well as the bank's business responsibly and in a nonpartisan manner. All this made him a highly respected figure among government and political circles as well as in the business sector. Eitan's voice on national matters and banking issues was always respected, and his views were often accepted due to his sound reasoning and persuasiveness.

All the while, and in spite of his heavy involvement with the bank, the Department of Economics retained its place among Eitan's priorities. He always found time to deal with departmental affairs and handled them as devotedly as if they were his most important responsibility. He consistently participated in faculty seminars and committee meetings and found time to sit in his university office in order to meet with young faculty members. And he never gave up teaching, if only on a part-time basis.

When I reflect about Eitan's personality and rare qualities, a stream of adjectives and descriptive phrases come to my mind. Eitan was modest but conscious of his capabilities. He was a natural leader who never forced himself on others. He was loved and admired for his integrity, discretion, and wisdom, a man of his word who would not compromise on principles or values. Highly talented and capable of learning any complex subject quickly and in depth, Eitan expressed views that were thoroughly based on common sense coupled with incisive thinking. Although he did not possess rhetorical capabilities, he always expressed himself clearly and logically. He never attempted to accept a position solely to satisfy other people. Eitan was a man of substance, not of images or of public relations. He projected credibility, solidity, and, most of all, reliability. Despite his varied interests and career, his main love was academia, centered on the Department of Economics.

Eitan's malignant disease was discovered shortly after the death of his wife. He faced his illness with his usual poise and bravely fought it for many years. Eitan often underwent difficult medical treatments while he was the Chairman of Bank Hapoalim; however, this did not affect his performance. He functioned in that demanding position as any healthy person would. His illness remained a discreet and well-guarded private affair. Most of those who came in contact with Eitan as he fulfilled his duties at the bank or participated in university affairs and other public forums, knew nothing of his illness. Even when hospitalized for treatment, he would function over the telephone as if he were operating out of his own office. No one suspected that he was working from a hospital bed. Eitan maintained his usual workload up until his last week, when he was
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hospitalized with a very high fever. Who would have thought at the time that Eitan would leave us in just a matter of days?

It has been very difficult without Eitan; the passage of time has not made it any easier.
In memory of Eitan Berglas*

Elhanan Helpman

Eitan Berglas affected the lives of many. He had an engaging personality, a striking intelligence, and unprecedented humility in a profession that worships competition, and a rare kindness. Most of my professional life he was beside me, initially as a teacher, later on as a mentor, a colleague, a friend. He taught me economics in the classroom (my first courses in Public Economics and International Trade), during my tenure as his research assistant (working on income distribution and on an econometric model of the Israeli economy), during policy discussions and the heated debates over research topics. But most of all I learned from him how to be an economist, by which I mean how to view economic problems, how to mix theory with fact, how to evaluate solutions in a broad context, how to breath life into economic reasoning. This is the type of economist he was, and I have tried to follow in his footsteps.

In Israel, Eitan was widely known for his contributions to the formation of public policy. Initially as economic advisor to the ministry of defence, later on as director of the budget in the Treasury, and finally as the Chairman of the board of directors of Bank Hapoalim. Each of these jobs he performed with skill, honesty, wisdom, and great devotion. In each role, his influence greatly exceeded the confines of his authority. He quickly became a public figure, sought after by cabinet ministers, parliament members, business men, journalists, TV reporters, and numerous others. All this fame notwithstanding, he maintained a modest life style, friendly composure, and constant devotion to his family and friends. Despite his many duties in the public and business sectors, he always remained active at the university, showing up at the economists’ lunch table, at faculty meetings, and in the classroom. For no matter what he did at the moment, Eitan always remained a scholar at heart.

Eitan’s research spanned many topics. He wrote about monetary issues, exchange rates, the balance of payments, investment and productivity, taxes, the government budget, international trade, and economic integration. Despite the fact that much of the time he was deeply immersed in very practical problems, his research was mostly theoretical, although generally with practical implications. Much of his thinking was rooted in public economics. When he worked

* Translated from remarks, made in Hebrew, at the memorial service held in Tel Aviv, June 6, 1995.
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on exchange rates, he emphasized the relationship between the real exchange rate and the government budget; when he wrote about economic integration, he made a point of emphasizing taxation issues. Broad as his interests were, however, one subject was by far his favorite: the theory of clubs. He returned to this subject he returned time and again, until the very end.

One may wonder how a person with such broad interests in economics focused on a subject that appears so narrow. The answer is that Eitan viewed it as very broad indeed. In his perception, the canonical example of a country club with limited membership was only a metaphor. He saw clubs everywhere. Every company or public department that provides an assortment of services by means of a common facility is a club. As a result, clubs include schools, fire departments, health maintenance organizations, power companies, and telephone companies. Even cities can be viewed as clubs. Assortments of goods and services whose joint supply is cost effective, and which are subject to congestion, are natural candidates for economic clubs. Such goods and services can be supplied by private companies or by the public sector. Indeed, the study of the efficient organization of their supply, including the division of labor between the private and public sectors, comprised the core of his research program.

In 1965, James Buchanan published the first important paper on club theory. He described the conditions for an optimal structure of a club, and suggested a role for the public sector in the supply of club goods. Importantly, Buchanan also mentioned the possibility that the private sector may play a constructive role in the supply of club goods, but he did not explore this option. This is the point from which Eitan began his explorations. Eleven years after Buchanan, he published a paper that turned him into the leading exponent of club theory. The central argument of the paper was that the private sector can efficiently supply club goods in a competitive environment. However, in the domain of such goods, competition does not take the form of price taking for each good and service; rather, competition implies taking as given the utility level that a club needs to provide to prospective members because individuals choose their club association by seeking the highest reward in terms of their overall utility level. Eitan also extended the concept of club goods by distinguishing between their public and private dimensions. This ingenious distinction helped greatly in clarifying the role of market institutions in the supply of such goods; it has become part and parcel of the literature. This paper laid the foundations of modern club theory and has been widely cited over the years.

Eitan’s main arguments can be summarized as follows. Competitive firms choose to supply their products at minimum cost, and firms that supply club goods are no exception. For the same reason, they have an incentive to price their products efficiently. To be sure, competition in club goods involves non-linear pricing. He particularly emphasized the point that clubs compete in the structure of their pricing scheme, not just in the pricing of each service
In memory of Eitan Berglas

separately. It is then in the interest of each supplier to price her products efficiently. Moreover, clubs compete in a number of other dimensions as well, a particularly important one being the quality of services, which depends on the size of the available facility and on the number of visits made by members. Taking into account this multidimensional view of competition, he argued that the market can provide an efficient mix of clubs.

From this point, Eitan began a long and detailed exploration of the generalizability of his main insight. He sought to identify broad circumstances in which competition leads the private sector to supply club goods efficiently, and the necessary modifications that are called for in order to secure this outcome. In this vein, he showed that flat membership fees do not constitute an efficient pricing scheme when club members can alter the number of visits, and that in a population with heterogeneous preferences, separate clubs will be formed for each group having similar preferences. The latter result caused him great concern, because despite the tendencies for separation, it appears that in practice, economic clubs have substantially mixed populations. This seems to be particularly so in local communities, such as urban neighborhoods and small townships. Taking local communities as the relevant unit, he decided to investigate possible reasons for mixing populations. For this purpose, he constructed a model in which people differ in tastes on the one hand and in innate abilities on the other. The latter was designed to proxy differences in the ability to contribute to the local community, especially through the labor supply. Building on these features he showed that with sufficient complementarity of different skills, mixed communities are called for in an efficient allocation. These insights attracted much attention, and recent research is still occupied with their implications.

The next question that arose in this context was how to decentralize an efficient allocation with mixed communities when individuals migrate between them to better themselves and when local authorities compete for residents. He showed that as long as local authorities do not seek to redistribute income, they adopt similar tax structures and support an efficient allocation with mixed communities. But if local authorities aim to redistribute income among different types of people, and if they employ local taxation for this purpose, then the resulting tax competition prevents the attainment of an efficient allocation and, moreover, it produces severe instability in the structure of the communities.

These results have far-reaching implications. First, they explain why income distribution policies are best pursued by national governments rather than by local governments. Authorizing local governments to engage in income redistribution produces migration flows in response to tax policies, which generate budgetary difficulties, economic instability, and harmful consequences for the overall efficiency of the economic system. Examples of two-tier governments to which this tension applies include the central government and the municipalities in Israel, the federal and state governments in the United States, as well as
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the federal and provincial governments in Canada. A similar point arose in the 1992 program of the European Community which, among its many aims, also sought to enhance labor mobility across member countries. Its architects were urged to include tax harmonization as part of the program in order to avoid such instability.

Much of the work that I have described so far was done prior to Eitan’s service as Director of the Budget in the Ministry of Finance. Upon his return to the university, he also returned to his beloved research topic: the theory of clubs. This time, he joined forces with David Pines. Together they produced a fascinating synthesis of club theory, the theory of local public goods, urban economics, and transportation economics. Their 1981 joint paper has become a classic; and both of them have become the leading experts on this important subject.

Academic economists tend to be judged by their publications and Eitan achieved renown on this front. In addition, he contributed to the creation of a major department of economics, at Tel Aviv University, he significantly influenced the making of public policy in Israel – including the design of the very successful stabilization program of 1985 – and he was instrumental in leading a major bank from crisis to striking success during his chairmanship of the board of directors. Very few people can claim this much. In fact, his influence reached far beyond these achievements. His wise advice was sought by many; he thereby played a central role in major aspects of Israeli public life. He was a true public servant, with a strong commitment to doing good. He will be greatly missed.
Acknowledgments

David Pines
Efraim Sadka
Itzhak Zilcha

This volume, dedicated to the memory of Prof. Eitan Berglas, is the product of the efforts of three Tel Aviv University institutions: the Pinhas Sapir Center for Development, the Eitan Berglas School of Economics, and the Faculty of Social Sciences. The project began with the decision to dedicate the 10th Annual Sapir Conference in memory of Prof. Berglas and to invite papers closely related to the late Prof. Berglas' interests. We sincerely thank these institutions for their active support and cooperation.

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