

# THEORIES AND MECHANISMS OF PRODUCTIVE EMPLOYMENT IN THE CONTEXT OF CZECH PENSION REFORM

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## 1. Introduction

The realization of pension reform leading to the creation of a “zero” pillar (a uniform means-tested pension) and the strengthening of the first pillar’s motivational role aimed at extending the period of an individual’s productive engagement in the professional markets is now on the agenda in the Czech Republic. This approach is getting significant support in the ongoing reforms in Austria.

The discussions on the given topic have been very dramatic. Four opinion groups have arisen from them:

- The conservative part of the public supported by some left-wing oriented politicians who have endeavoured to cast doubt on the necessity of any reforms in the area of the pension system. They concede only the need for some parametric modifications oriented towards greater egalitarianism and the more distinctive adjustment of pensions even at the cost of them being partially funded from taxes. However, in no way do they concede the need to extend the retirement age. They argue, amongst other things, that the existing demographic development is favourable and that the pension system is sustainable until at least 2030,
- The group of experts who proceed from the principle of preliminary caution and the fact that to the pension system is distinguished by a significant amount of inertia. They propose an across-the-board extension of the retirement age (to more than 67 years) in association with the change in the predicted life expectancy of the citizenry. This is a relatively unpopular proposal, but it is also supported by part of the state administration which has so far used any excesses in the pension system to finance other government expenditure. The pension account is now separate, but any excesses can still be used as resources in the budgetary system,
- Another group of experts which proposes reforms to motivate the individual extension of the retirement age according to the specific physical and mental state of each individual and the available job opportunities, just as this reform was briefly characterised in the opening sentence.
- At present, they have got the support of the Minister of Labour and Social Affairs and the Committee for Fair Pensions at the Ministry of Labour and Social Affairs. The main theoretical representative of this group, which has the

best elaborated concept for the gradual realisation of the reforms, but whose approaches and proposals are of course only partially acceptable for the ministerial Committee for Fair Pensions, is Vostatek (2020). Not all the representatives of this opinion group understand the wider context of resolving the problem of pension security and pension insurance in this way,

- The group of representatives from the financial sphere which would like to revisit the idea of introducing the second pillar. This existed in the Czech Republic for only a very short time. The option of arranging pension savings was established in the Czech pension system as of 1st January 2013 and it ended as of 31st December 2015. Given the negative experiences of our neighbouring countries, this group finds itself in a certain defensive position and its activities are associated more with a form of criticising the other approaches to the question of the future form of the pension system with the intention of laying the groundwork for reviving the variant of moving funds from the pay-as-you-go system into private funds.

This situation offers great opportunities for any theory which can extract itself from the interest-group and ideological background of the clashes of opinions which are taking place very intensively in the expert and media environment and thus contribute to finding the most effective and socially just solution, while pointing to the risks of some of the approaches, quantifying some alternatives and indicating the wider context of the reform of the pension system which is not possible without a dispassionate theoretical view of the understanding of pension system reform.

## **2. Subject, methods, literature review**

In this article, we have focused on showing the most significant benefits of the approach which motivates individuals to extend the period of their productive lives in the job markets, especially:

- its comparison with the approach which endeavours to introduce an across-the-board extension of the retirement age and which has been met with negative reactions across the world (the Russian Federation, France) which are also a response to biological limits. Here, we have made use of an original graphic expression of the given issue. The across-the-board extension of the retirement age is recommended, amongst others, by the National Budgetary Council (NRR), which is an independent expert body whose main mission is to evaluate whether the state and other public institutions have adhered to the rules of budgetary responsibility set out in Act no. 23/2017 Coll. At the same time, the activities of the National Budgetary Council contribute to the sustainability of the public finances of the Czech Republic and reduce the risk of the state becoming excessively indebted; see the Report on the Long-term Sustainability of the Public Finances (NRR 2019, p. 50). Those in favour of increasing the motivational role of the pension system leading to the voluntary individual extension of the period of gainful engagement are against this and have pointed out that the across-the-board extension of the retirement age would weaken this motivational role (see Barr 2002; Montizaan et al. 2013; Šatava 2015; Vermeer 2015; Mertl et al. 2018; Nakazava 2019),

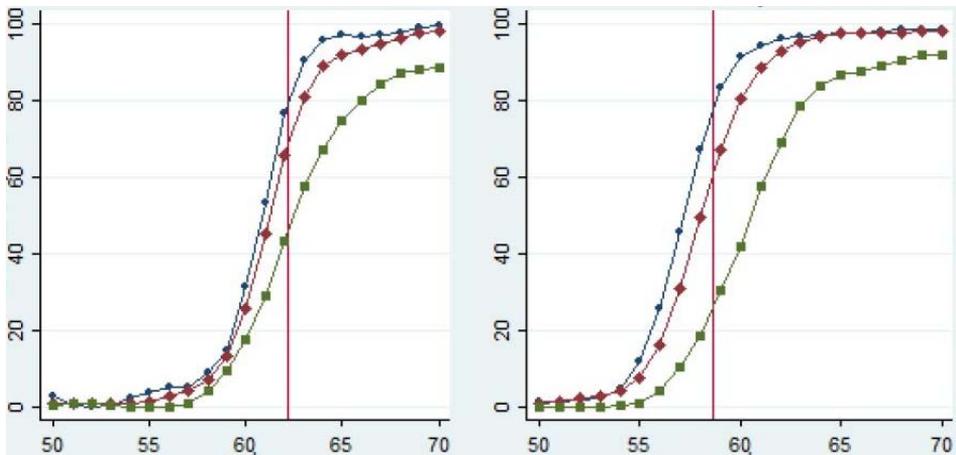
- the use of some options associated with the realisation of the “Austrian type” of reforms proposed by Vostatek (2019), which provides the implementation of a postgraduate extension of the pension system (also presented at PenCon 2018). Here we shall use the method of graphical expression of both alternatives followed by the previously published numerical model presented at PenCon 2018 and their interpretation by conceptual representation of relevant phenomena and comparison of alternatives,
- the resolution of the issue of the “crowding effect” in the area of the pension system, i.e. so that the extension of the retirement age does not reduce the employment options for younger individuals. In this area, we have used the results of the Analysis of Industry 4.0 project and the significance of creative teams with an emphasis on interdisciplinary and intergenerational cooperation (Říhová et al. 2019). The method used is to interpret the results of empirical research carried out in the field of identifying the possibilities of extending the productive time of persons of retirement age,
- the presentation of the wider context of the reform in the narrower sense (the connection with the reform of health insurance) and in the wider sense, the connection with the change in the character of economic growth (Valenčík et al. 2015; 2017; 2019). The method used is the interpretation of previously developed theoretical starting points in the area of possibilities and the importance of extending the period of productive employment of persons of retirement age.

The aim of the paper is to demonstrate that the focus on voluntary extension of productive employment by means of incentives incorporated into the pay-as-you-go pension scheme can bring significantly greater effects than a general extension of retirement age, in particular when doing the comprehensive solution of this issue and in the long term creating conditions in the form of comprehensive reforms in the areas of social investment and social insurance.

### **3. The across-the-board or individual extension of the retirement age?**

The dispute on whether to secure the sustainability of the pay-as-you-go pension system by enforcing an across-the-board extension of the retirement age or by strengthening the motivational function of the pension system so as to achieve the voluntary extension of the period of gainful employment is currently one of the most intense disputes in the Czech Republic.

A very valuable contribution to this discussion can be found in the study by Šatava (2015), who made following graph:



**Fig. 1.** Share of economic inactivity by age

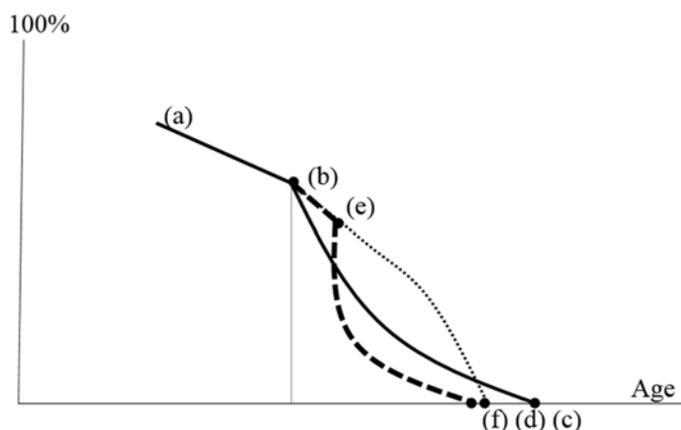
Source: Šatava 2015, p. 16.

Age is on the horizontal axis, while the degree of inactivity as a percentage is on the vertical axis. The left-hand graph shows men and women are on the right. The blue curve pertains to citizens with a primary education, the red curve shows citizens with a secondary education and the green curve depicts citizens with a tertiary education.

We will subsequently show several original graphs in which we clearly express what lies at the heart of the dispute about whether to compulsorily extend the retirement age for all by administrative means or whether to strengthen the motivational role of the pension system so that individuals are motivated to extend the period of their productive (gainful) engagement in line with their individual possibilities.

The second case – the orientation towards the voluntary extension of the period of productive engagement – presupposes the strengthening of the solidarity between those who can and want to be productively active at a higher age and those who are unable to be productively active for various reasons.

All the other published graphs are purely illustrative, which does not reduce their informative ability in any way.



**Fig. 2.** A comparison of the existing state of affairs with the proposal for an across-the-board extension of the period of productive employment

*Source: Own creation.*

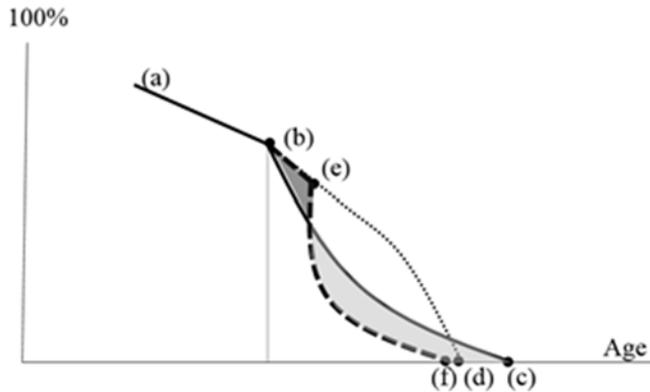
Curve (a)(b) describes the drop in the employment of people from a certain age as a consequence of aging.

Point (b) is the administrative boundary of the existing retirement age (currently over 63 and with a ceiling of 65).

Curve (b)(c) describes the status quo. The number of the gainfully employed individuals falls relatively quickly after reaching retirement age. This is more so in the Czech Republic than elsewhere. This means, amongst other things, that the motivation to remain gainfully active after reaching retirement age has been poorly set. At the same time, a certain percentage, albeit a small one, remains gainfully active until a high age.

Curve (b)(d) describes the hypothetical status, if the retirement age was unlimited.

Broken curve (b)(e)(f) describes what would happen, if the retirement age was extended across-the-board (for example, by two years). Initially, the number of gainfully active individuals would fall along curve (b)(d), i.e. less steeply than under the existing situation, up to the new retirement age, which is depicted by part (b)(e) of the curve, but then it would begin to rapidly fall as depicted in part (e)(f) of the curve. At the same time, this would be steeper than given the current retirement age. The across-the-board, enforced, administrative extension of the retirement age would reduce the individual motivation to prolong the period of productive engagement. The following figure describes the destructive influence on the loss of social efficiency.



**Fig. 3.** The status quo in comparison with the across-the-board, enforced, administrative extension of the retirement age

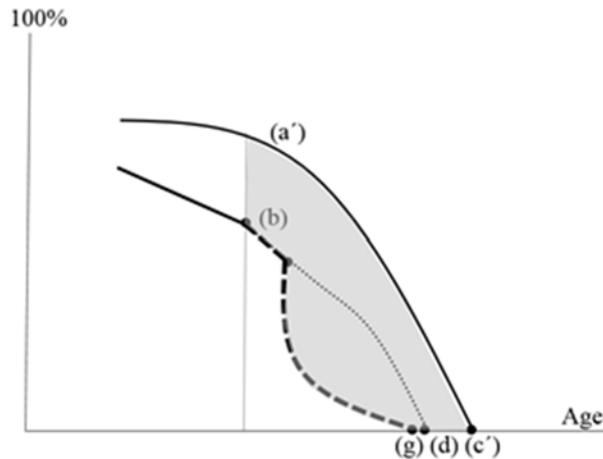
*Source: Own creation.*

The hypothesis that the area (b)(e)(g) is significantly smaller than the area (f)(c)(g) would surely be useful to test on expertly estimated data. It seems that the darker area (b)(e)(g) estimating the scope for a short-term effect from the increase in the number of persons due to the extension of the retirement period could take the following form: In a short period (for example, after an extension of two years – from today's 65 to a potential 67 years after 2035) this 'extended period' could bring about 24 contributions to the account of the pension account's income. Their number is estimated by the National Budget Council at up to 5% (NRR 2019, p. 45). This estimate is probably exaggerated, because the expected life expectancy of people aged 65 (those concerned by the extension of retirement period) is different in the different regions of the Czech Republic by up to two years, which would undoubtedly be significantly reflected in the overall extension of the statutory retirement age (ČSÚ 2019).

The overall effect of the extension of the retirement age would also probably be (but this needs to be further verified using indirect indicators) negative from a purely economic point of view. This would occur for a number of reasons.

The across-the-board extension would only lead to the short-term possibility of taking part of the funds from the pension insurance system and transferring them to the budgetary system and as a result this would lead to the substantial weakening of the pay-as-you-go pension insurance system, which would have a highly negative impact on the stability of the social system and especially on the standing of individuals who are currently aged 15 to 30.

It is possible to contrast this with the variant involving the voluntary extension of the period of productive engagement.



**Fig. 4.** The status quo compared with the extension of the retirement age based on increasing the motivational function of the pension system

*Source: Own creation.*

Curve (a')(c') shows the effect of increasing the motivational role of the pension system aimed at extending the period of productive engagement. The motivation to extend the period of productive engagement also works retroactively so that the number of productively (gainfully) active individuals is higher upon reaching retirement age.

If we consider the earnings of individuals instead of their numbers, the effect would be even more distinctive, because the effects of the motivated extension of the period of productive engagement would especially apply to individuals with higher earnings. This therefore leads to the extension of both the horizon and the zenith of productive engagement.

The difference between the across-the-board, enforced extension of the retirement age and the voluntary extension under the influence of motivation which has been built into the system is clearly expressed by the grey area in Fig. 4.

The economic effect of increasing the motivational role of the pension system (which would be “smothered” by the across-the-board extension of the retirement age) not only enables the permanent sustainability of the pension system to be secured (on a voluntary basis), but also (especially) the creation of the economic base for financing those branches which enable the extension of the zenith and horizon of a person’s productive employment in the professional markets and as such enable the transition to a new type of economic growth based on the development of human abilities culminating in a substantial increase in the country’s innovative potential. This is precisely the type of innovative potential focused on radically saving natural resources (including those which result in

a “carbon footprint”) which is essential for establishing a permanent balance between man and the natural environment. Amongst other things, the commencement of the growth of the role of those branches which contribute to the acquisition, preservation and application of human abilities would shift curve (a')(c') on the Fig. 4 to the north-east and further raise the influence of the motivational role of the pension system.

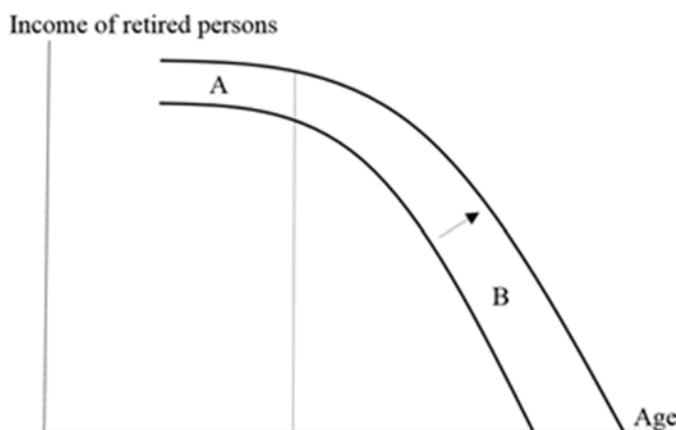
### 3. The role of the incentive extension of pay-as-you-go pension system in connection with the Austrian reform

The motivational role of the pay-as-you-go pension insurance system can be achieved in several ways. The Austrian system of monetary accounts, into which a pension entitlement calculated according to a monetary formula is paid every year with the adjustment of the pension entitlements in the pension accounts according to wage growth and with the indexation of the paid out pensions according to a legal scheme, would appear to be the most advantageous for the Czech Republic (Vostatek 2020).

The new system is being implemented in waves in Austria – starting with new insured individuals and continuing with the ten subsequent years (of birth) and it will not be until the next wave that the system will be expanded to include the remaining clients, including individuals of pre-retirement age (Vostatek 2020).

The postgraduate extension to the pension system (Mertl et al. 2018), which is fully compatible with the Austrian type of system with accounts, enables the strengthening of the motivational role of the pension insurance system in relation to individuals of the pre-retirement age or to involve them in the system at the time of their retirement or even afterwards.

This would bring significant economic effects and enable the faster start of growth in the role of those branches which contribute to the acquisition, preservation and application of human capital, as shown in Fig. 5.



**Fig. 5.** The effects of the service branches which contribute to the acquisition, preservation and application of human capital

*Source: Own creation.*

The growth in income of gainfully active individuals of retirement age:

A – the area of tax effects,

B – the area of tax effects and the effects in the area of the income for the pay-as-you-go pension system.

The service branches contributing to the acquisition, preservation and application of human capital extend the zenith and horizon of productive engagement and increase the earnings of individuals of a post-productive age and therefore also the taxes and contributions to the pension system. This means, for example that the basic uniform pension in the zero pillar could be financed in the future from pension taxation without this in any way weakening the motivational role of the pension system to extend the retirement age.

#### **4. The role of creative intergenerational teams from the point of view of the substitutional and complimentary effect of the extension of the period of productive engagement**

One of the most frequent objections used to cast doubt on the size of the effects brought about by increasing the motivational role of the pension insurance system to voluntarily extend the period of productive engagement the involves pointing to the “crowding effect” which this extension will have. In other words, that individuals of a higher age will remain in their jobs and in doing so limit the job access for younger individuals. This objection is relevant, but it leads to the fact that we must differentiate between the substitutional and complimentary effect of extending the period of productive engagement.

More employment among older individuals not only has a “crowding effect”, but also the exact opposite effect. This applies in cases where a complimentary relationship is created between older and younger employees. One of the most important cases involves creative intergenerational teams which are especially active in areas of technical innovation in association with Industry 4.0. Creative intergenerational teams:

- constitute the basis for the country’s innovative potential and their systematic support is of fundamental significance for the stability and competitiveness of the country,
- offer the key to resolving the problem of the permanent sustainability of the pension system, because they are able to absorb an essentially unlimited number of individuals of post-productive age, not on the basis of any substitutional relationship (where older people remaining in the job market limit the access of younger people to professional positions), but on the basis of a complimentary relationship (where the employment of older individuals create the prerequisites for the better employment of younger individuals and their faster professional advancement), and provide the option of complimentary employment to individuals who are oriented towards the strategy of extending the period of their productive engagement,

- they are effectively able to absorb the production of the branches of productive services (i.e. services oriented towards acquiring, preserving and applying human capital) and at the same time create the economic basis for the advancement of these branches (by enabling their financing according to their achieved economic effects on the basis of HCC contracts, i.e. contracts in the areas of acquiring, preserving and applying human capital),
- they play a key role during a fundamental change in the character of economic growth where the focal point of the economic growth shifts to the area of productive services, which enables an increase in the dynamic and the unlimited sustainability of the economic growth. This takes on a new quality which manifests itself, amongst other things, in the radical reduction of the amount of natural inputs (material and energy) into the economy which leads to its fundamental “easing”,
- the intergenerational dimension is significant for keeping stability, for development and for expanding creative intergenerational teams.

The aforementioned also points to the fact that, if the reform of the pension system is to be successful, it must be based on the identification and analysis of the conditioning context both from the point of view of the use of the opportunities which it opens up and from the point of view of the creation of the essential conditions for achieving the expected effects. The issue of the systematic and conceptual creation of conditions for the maintenance, expansion and healthy development of creative intergenerational teams is one of the areas which is directly associated with the reform of the pension system.

## **5. The wider context of pension reform**

As we have already mentioned several times, the strengthening of the motivational role of the pension insurance system is about much more than merely the sustainability of the pension system. It also creates the economic basis for financing branches which contribute to the acquisition, preservation and application of human capital (for example, education, including lifelong learning, healthcare, but also upbringing in the family, the requalification system, the spa industry and so on) on the basis of HCC (human capital contracts). As such, it is suitable to not only understand the present period as a certain stage in the Industrial Revolution (for example, the commencement of Industry 4.0), but also as a change which is fully comparable with the Industrial Revolution where a new economic sector is becoming dominant, in this case the sector of productive services enabling the acquisition, preservation and application of human capital.

This opens the path to investment opportunities associated with the acquisition, preservation and application of human capital being used (in the case of all members of society) according to their yield rate. From this point of view, it is suitable to go ahead to an analysis of investment chains, i.e. a sequence of consecutive investment acts where the full investment effect only manifests itself after the realisation of the entire investment chain. The most important links in investment chains in the area of investments in human capital under the current conditions include:

- the quality of tertiary education (the role of tertiary education in a chain based on social advancement enabled by education,
- the creation of networks of graduates as the prerequisite for the full application of the production of universities – both with regard to graduates and research results,
- the expansion and development of creative intergenerational teams,
- the focus of healthcare on the long-term engagement of individuals of retirement age,
- the motivational role of the pension system with regard to extending the period of productive engagement.

A very significant part of the chains which make use of investment opportunities associated with the acquisition, preservation and application of human abilities applies to the area of the extension of the zenith and horizon of an individual's productive (educational) engagement. The kind of idea which a person creates about his or her future fundamentally influences his or her motivation in the education process, the choice of a career, taking care of his or her health and so on. Therefore, the way the pension system works, the way it “increases the value” of investment chains, substantially influences the condition of the entire society. This especially involves the investments [in:]

- lifelong learning,
- care for one's health,
- the creation of social contacts, including university graduate networks,
- inclusion in creative intergenerational teams.

One of the areas where the gradual introduction of a pay-as-you-go pension system which motivates individuals to voluntarily extend the period of their productive (gainful) engagement opens the path towards increased efficiency is healthcare. Here, the model of the Chinese Emperor's physician is considered to be one of the difficult to achieve patterns. He was paid during the period when the Emperor was healthy, but his pay was suspended whenever the Emperor fell ill. The expansion of this example and its application under contemporary conditions comes up against a number of difficulties.

If a system which effectively motivates an individual to extend the period of his or her productive engagement is introduced, it is possible to consider a certain extension of the aforementioned model. We can show this using the example of healthcare financing in the Czech Republic. This is financed by seven health insurance companies in the health insurance scheme. The health insurance funds are fully allocated according to the parameters of the insurance portfolios of the individual insurance companies. Unlike the original ideas about the possibility of competition in the given area, it has been shown that no other solution is possible under the current conditions. The reform of the pension system offers the option of competition which increases the efficiency and quality of the healthcare in certain areas, provided we exclude that part of the contributions paid by individuals who are older than retirement age, but have remained gainfully active, from the allocation of funds (for example, the current insurance contribution paid by an employee – 4.5%). The contributions to the healthcare

system from their earnings are significantly higher than the payments made by the state for non-working pensioners. The insurance companies would then be (in a similar way to the Chinese Emperor's physician) interested in ensuring that part of their insurance portfolio consisted of individuals who could remain gainfully active at retirement age and for as long as possible thereafter. By contrast, however, individuals who would be interested (supported by the motivating role of the pension system) in extending the period of their productive engagement would look for insurance companies which would keep them in the best possible condition for as long as possible. It is of course necessary to resolve the question of how to set up the health insurance system for these cases, including the connection with prepaid healthcare programs, very sensitively.

It is also similarly possible to motivate the providers of healthcare, for example in the spa and wellness industries, but also in other areas of expertise or directly in individual spas, to provide efficient and comprehensive care for productively active citizens of a higher age within the framework of prepaid healthcare programs, whose significance has been emphasised by Mertl (2018). This can also involve various forms of lifelong learning aimed at acquiring a general overview, upgrading and supplementing one's education, refreshing one's spirit and so on within the framework of the cultural programs offered by these spas, which a number of spas already offer at present.

## **6. Summary and discussion**

The reform of the pay-as-you-go pension system leading to people being motivated to extend the period of their productive engagement is realistic and it can be implemented gradually and without any risks or social pain. It is part of a comprehensive system of reforms which will potentially increase the role of those branches of productive services focused on the acquisition, preservation and application of human capital. From a long-term point of view, this involves a change which is comparable with the Industrial Revolution and which opens space for a new type of economic growth. The role of the pension system is significant precisely because most of the investment chains involved in the acquisition, preservation and application of human capital culminate in this area.

The problems associated with pushing through the paradigm presented above are methodological on the one hand (new things always come up against stereotypes) and involve special interests on the other hand (they are at odds with the interests of certain lobby groups which see attractive spoils in the enormous amounts of funds which pass through the pension system). The elimination of the various barriers is an independent question and it is associated with the specific conditions of the individual countries, whereby these conditions tend to change drastically.

From the point of view of the practical application, it is important to pay attention to the specific possible engagements for individuals of an advanced (retirement) age and the role of creative intergenerational teams which constitute the most valuable part of the economic potential of each country, whose significance will grow and will decide on which places or countries will face difficult development in the future. The

exchange of experience between individual countries in this area will also be highly significant.

## 7. Conclusion

The current period is associated with several risks which the public is sensitively aware of and which it responds to, amongst other things, through its preferences in public choice and the political cycle. In this regard, one of the primary obligations of the social sciences is to come up with a comprehensible, promising and realistic vision which corresponds to the life experiences of people and their ability to contribute to its realisation. For a number of reasons, the pension system is one of the important components of any such vision-based idea on how to secure permanent sustainability (from the point of view of demographic development) and stability (from the point of view of possible turbulence in the financial markets and dynamic changes in professional markets).

The experience gained from the preparation of the pension system reform, the clashes of opinions which have taken place in this area, the individual prepared steps in the reform and, we hope, also their realisation are of significance not only for the lives of the citizens of the Czech Republic, but, provided they are continuously evaluated with the use of the theory and practical participation in these changes, also for the further development of the theory and the options for its use in other countries. The traditional series of PenCon international conferences, the significance of which may one day be shown to be greater than it would seem from the position of our absorption with the present, offers a significant opportunity in this regard.

## Acknowledgements

The result was supported by the students' project *Wealth and poverty as a problem in terms of economics of productive consumption* with support for specific university research grant at the University of Finance and Administration 2020.

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