

CLASSIFICATION AND AGGREGATION:
AN APPLICATION TO ESTIMATING WAGE EQUATIONS
FROM CPS DATA

by

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August 1989
Revised June 1990

Abstract

In this paper we offer a method for deciding how to aggregate a set of elementary industries. The method is then applied to the problem of estimating a wage equation that allows for industry-specific effects. Our method explicitly formalizes the trade-off between goodness-of-fit and parsimony implicit in an aggregation problem. By varying the parameter of the assumed loss function, one obtains a whole sequence of aggregation levels. Further, the resulting sequence is consistent; that is, groupings formed at one level of aggregation will never be undone when one aggregates further.

* We thank Finis Welch and two anonymous referees for their helpful comments. This research is supported by the U.S. Department of Health and Human Services, National Institute on Aging (Grant Number R01 AG07112). The second author also thanks the C.V. Starr Center for Applied Economics for financial support.