



# NEWSLETTER OF THE EUROPEAN NETWORK OF ECONOMIC POLICY RESEARCH INSTITUTES\*

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\* Members: Centre d'Etudes Prospectives et d'Informations Internationales (CEPII), Paris ▪ Centre for European Policy Studies (CEPS), Brussels ▪ Netherlands Bureau for Economic Policy Analysis (CPB), The Hague ▪ Deutsches Institut für Wirtschaftsforschung (DIW), Berlin ▪ Research Institute of the Finnish Economy (ETLA), Helsinki ▪ Fundacion de Estudios de Economia Aplicada (FEDEA), Madrid ▪ Belgian Federal Planning Bureau (FPB), Brussels ▪ Instituto di Studi e Analisi Economica (ISAE), Rome ▪ National Institute for Economic and Social Research (NIESR), London ▪ Niezalezny Osrodek Bana Economicznych (NOBE), Lodz.

## About ENEPRI

The European Network of Economic Policy Research Institutes (ENEPRI) was created late in 1999 at the initiative of the Centre for European Policy Studies (CEPS). ENEPRI brings together leading national institutes from a number of EU member states and accession countries. The network fosters the international diffusion of existing research, helps to co-ordinate research plans, conducts joint research and increases public awareness of the European dimension of national economic policy issues. The activities of the network are co-ordinated and managed by CEPS. See the front page of this newsletter for a listing of the current ten member institutes.

The activities of ENEPRI include the organisation of workshops and conferences, the publication of Working Papers and Occasional Papers and the formulation of joint research programmes. The network, in particular, prepares common research proposals to be presented to European bodies and national sources of funding for economic research. A contract providing financial support to ENEPRI during its first three years of operation (2000-02) under the 5th Framework Programme of the European Union was signed in February 2000 and the first operations were launched in September in Paris. The European Science Foundation funded an exploratory workshop that took place in November 2000.

A number of workshops and conferences have already been organised which are profiled in Newsletter Nos. 1, 2 and 3. Five workshops or conferences were held in 2002 and are reported on in this Newsletter. Future ENEPRI activities include:

- Conference on Policy Options for Welfare Systems in an Integrating EU (CEPS), January 2003

A selection of the contributions to these events and, additionally, from the output of ENEPRI member institutes are published as ENEPRI Working Papers, a series focusing on European policy issues. A selection of the titles of already published and forthcoming ENEPRI Working Papers are listed on the back page of this newsletter. They are available for free

downloading in a PDF file from the ENEPRI web site (<http://www.enepri.org>). Printed copies are also available on request from member institutes.

## Workshop on Mutual Recognition of Labour Market Regulations and Welfare Regimes (ISAE), 14 June 2002, Rome

The differences between States and social-economic systems within the European Union depend on disparities that are not only unavoidable, but which must be exploited to create those opportunities for exchange and competition necessary to reduce production costs, eliminate artificial obstacles to the free movement of workers, improve quality and prices for consumers, make the society less unequal and guarantee a safer environment for businesses and citizens.

However, evident difficulties emerged while trying to implement the principle of harmonisation. Meanwhile, the introduction of the principle of mutual recognition in the European Union's policies has led to significant results in the area of the free circulation of goods, persons, capitals and services. This has triggered real competition between countries/ruling systems and has favoured the prevailing of allocation systems drawing inspiration from those systems/countries that obtained higher efficiency and smaller managing costs.

In the long run, the final result of the mutual recognition implementation would be an *a posteriori* harmonisation of the economic, social and regulatory systems, with an increase of well-being and employment for the society.

The aim of this workshop was to examine the prospects and applications of the principle of mutual recognition, by analysing its effects in terms of the labour market, the welfare state (pensions, health care, etc.), political systems, financial settings and legal and judicial

structures, according to the following guidelines:

- mutual recognition versus harmonisation in the European Union and the effects on economic and social cohesion and on political systems;
- mutual recognition and rules and regulations in the production factors' markets;
- mutual recognition and unemployment;
- mutual recognition and welfare states;
- mutual recognition and education and qualifications;
- mutual recognition and legal and judicial frameworks; and
- mutual recognition and financial systems.

The following presentations were made:

*Mutual Recognition versus Harmonisation in the European Union and the Effects on Economic and Political Systems.* The debate was opened by Paolo Reboani (Ministry of Labour and Social Policy, Rome) with the participation of (Alfonso Mattera (European Commission). Angelo Maria Petroni (Scuola Superiore della Pubblica Amministrazione, Rome) served as discussant.

*Mutual Recognition in the Product and Service Markets (Inclusive of Education and Qualifications).* Jacques Pelkmans (Netherlands Scientific Council for Government Policy) made the initial presentation, Daniele Checchi (University of Milan) acted as discussant and the debate was opened by Grazia Sgarra (Confindustria, Rome).

*Mutual Recognition, Unemployment and Welfare States.* Chaired by Fiorella Kostoris Padoa Schioppa (ISAE), the workshop heard first from the discussant Daniel Gros (CEPS), and Giuliana Bongiorno (Collège d'Europe, Bruges) began the debate.

*Mutual Recognition and Legal and Judicial Frameworks.* Alberto Perduca (Office of the Prosecutor, Turin) was the principal author and the debate was opened by Sascia Lubicz (ISAE).

*Mutual Recognition and Financial Systems.* Piergaetano Marchetti (Bocconi University, Milan) offered an initial contribution, followed

by discussant Marcello De Cecco (Rome University *La Sapienza*) and the debate was opened by Sergio De Nardis (ISAE).

An Occasional Paper with policy recommendations based on the papers presented at the workshop will be published at a later date.

## Workshop on The Impact of Alternative Policy Rules (CEPII), July 2002

*This workshop took place in the Royaumont Abbey on 1-2 July, 2002, and was organised by CEPII on behalf of the European Network of Economic Policy Research Institutes (ENEPRI). The purpose of the workshop was to analyse the effects of alternative policy rules and their efficiency to stabilise the economy faced with adverse shocks. To do this, several macro-econometric models were simulated in a deterministic way as well as in a stochastic way.*

In his opening address, **Francis Ailhaud** (*Member of CEPII*) stressed the importance of multi-country models to evaluate the effectiveness of monetary and fiscal policies to stabilise an economy faced with adverse shocks. Evaluating the efficiency of economic policies in the eurozone is also interesting for the UK government, which has to make a decision on membership of EMU in the next two years.

**Alberto Locarno** (*Bank of Italy*) presented a paper that analyses the monetary transmission mechanism in the euro area through the use of the National Central Banks' models of the Eurosystem. Using a common hypothesis concerning euro exchange rates and the long-term interest rates, a 100 basis point increase in the interest rate results in a maximum aggregate fall in output and prices of 0.4%. The dominant transmission channel is the exchange rate in the first two years and the user cost of capital thereafter.

**Jean-Pierre Laffargue, Bronka Rzepkowski, Stéphane Capet and Paolo Zanghieri** (*CEPII*) presented a paper that evaluates the efficiency of several discretionary fiscal policies using the MARMOTTE model. An increase in government consumption has positive effects

on effective production, but they are not very big and prove to be ephemeral. Investment and private consumption and employment drop. A reduction in profit taxes has beneficial effects on investment, consumption and employment. Lower wage taxes have similar, but less relevant effects.

**Vanessa Rossi** (*Oxford Economic Forecasting*) presented a paper that compares the UK economy's response to interest rates inside and outside EMU. She found that the UK response is generally likely to be more pronounced inside EMU than outside because of the relatively rapid wage-price response.

**Ray Fair** (*Yale University*) presented two papers. The first examined the ability of various interest rate rules to dampen economic fluctuations caused by random shocks using his MC model. His main result was that rules with a coefficient on inflation less than one are efficient in reducing the output and price variability. This conclusion is contrary to what would be obtained using the "modern-view" model in which the economy is not stable if the inflation coefficient is less than one. The second paper showed that the Central Bank does not have to increase the nominal interest rate when it faces an inflation shock. One reason is that the data support the use of nominal interest rates rather than real interest rates in aggregate demand equations. Another reason is that nominal wealth increases less than inflation. A third reason is that wages react to inflation with a lag.

**Jean-Louis Brillet** (*INSEE*) gave an assessment of whether the introduction of the Taylor rule in the MACSIM model reduces the uncertainty of both real elements and prices. One conclusion of his study is that the Taylor rule is efficient in reducing variability of both GDP and inflation if uncertainty comes from real side elements.

**Ray Barrell** (*Niesr*) analysed the monetary policy implications for the ECB of diversity in consumption behaviour using the NIGEM model. The main conclusion of his study was that, whatever the structure of the world, for the euro area, a combined rule of nominal and inflation targeting should always be chosen by the ECB if it is concerned about price level stability.

**Pascal Jacquinot** and **Ferhat Mihoubi** (*Banque of France*) examined the optimality of the Taylor rule in the case of a two-area model MARCOS. The optimality of this rule was examined with respect to both the value of its parameters or to its horizon.

**Stefano Siviero** (*Bank of Italy*) presented a paper which assessed the role of national information for the monetary policy rule in the euro area. Using a simple multi-country econometric model, he finds that the performance of a central bank that chooses the nominal interest rate to minimise a standard quadratic loss function of area-wide inflation and output gap significantly improves if the reaction function includes national variables – as opposed to the case in which the interest rate reacts to area-wide variables.

**Jan Int'Veld** (*European Commission*) presented a paper that looked at the effectiveness of monetary and fiscal policy rules for stabilising output and inflation. Using the QUEST model, he analysed the performance of different sets of monetary rules in the presence of misconceptions about the nature of the output shocks by the central bank. If the central bank fails to recognise a permanent supply shock, a higher degree of inflation targeting is more efficient in stabilising the shock. Concerning fiscal rules, he found that expenditures-based rules are more efficient than revenue-based rules in stabilising country-specific demand shock.

**Marga Peeters** (*Dutch Central Bank*) presented the theoretical properties and several simulations of EUROMON, the Nederlandsche Bank's multi-country model. It is an aggregate neo-keynesian model where output is driven by demand factors in the short run and by supply in the long run.

**Matthieu Darracq-Pariès** (*Direction de la Prévision*) analysed the implications of different price-setting rules for optimal monetary cooperation using a two-country dynamic general equilibrium model with imperfect competition and nominal price rigidities. His main result was that the optimal cooperative policy depends on the price-setting rule: producer-currency-pricing or local-currency-pricing.

The workshop concluded with a synthesis offered by **Kenneth Wallis** (*University of Warwick*), who stressed that all the models are not designed to analyse the same economic question. In the closing address, **Florence Legros**, CEPII's Deputy Director, thanked all the participants for their interesting and very useful presentations and discussions.

## CEPS Workshop and Lunchtime Meeting on Enlargement and EU Cohesion Policy, 17 October 2002

*Joeri Gorter (CPB), José Antonio Herce (FEDEA), and Christian Weise (DIW)*

*Chairman: Paul de Grauwe, University at Leuven and Member of the Belgian Senate*

The following three studies by institutes belonging to ENEPRI (European Network of Economic Policy Research Institutes) were presented:

- Funds and games: The economics of European cohesion policy, by CPB (*Netherlands Bureau for Economic Policy Analysis*)
- European Union Enlargement: Effects on the Spanish Economy, by FEDEA (*Foundation for Applied Economics Studies, Spain*)
- How to finance Eastern Enlargement of the EU, by DIW (*German Institute for Economic Research*)

These three studies are available for free downloading at the ENEPRI website: [www.enepri.org](http://www.enepri.org)

The debate about the consequences of the forthcoming enlargement has mainly concentrated on the implications for the EU's budget of the application of the Common Agricultural Policy and the Structural Funds (the cohesion fund and the regional and social funds). However, as it became clear from the three speakers invited to our lunchtime meeting, the fiscal implications of enlargement are only a part of a wider complex of economic

and financial consequences of the adhesion of ten, and later more, countries of Central and Eastern Europe, the Mediterranean and the Balkans.

The CPB study, presented by Joeri Gorter, shows that there is considerable scope for improving the effectiveness of the EU's Structural Funds. Although not clearly defined in official documents, the goal of the EU Cohesion policy is to foster convergence of regional GDP per capita. The distribution of EU structural support seems to be consistent with this objective, as poorer regions get more funds than richer regions. This study also reveals that during recent decades, the GDP of poor regions has converged towards that of richer EU regions. However, evidence about the positive contribution to this convergence of EU structural support, including the CPB's own estimates, is not conclusive. Cohesion policy has a high potential to contribute to regional economic growth, but its real impact to economic growth in the last decades has been very low. This might have been due to several factors: although poor regions receive a high share in the total, an important part of cohesion support still flows to relatively rich regions. Furthermore, EU support may have crowded out national regional aid and have replaced natural convergence mechanisms (for example reducing labour mobility). Finally, national authorities may choose to use EU support to finance low effectiveness projects. There is therefore room for improving the effectiveness of EU cohesion policy. This could allow more to be done at a lower cost, thereby easing the pressure from enlargement. The CPB study suggests three alternative options for reform of the EU cohesion policy: 1) to strengthen the monitoring and control over the use of cohesion support by the European Commission, 2) to move to a system in which funds are allocated to projects (instead of being allocated to regions), 3) to replace the cohesion policy by a system of fiscal transfers from rich to poor countries.

Spain is one of the main recipients of EU structural support and, according to the study presented by José A. Herce, enlargement is expected to have, at least temporarily, a negative impact on the Spanish economy. In

fact, in relative terms, Spain may become less attractive for foreign direct investment and trade which may shift in favour of new member states. Furthermore there is likely to be a reduction of the Spanish share of EU structural and agricultural support. Moreover, the Spanish economy is not expected to benefit so much from the expansion of the single market, due to the fact that it has relatively little direct trade and investment flows with accession countries. Nevertheless, if Spanish economic agents reacted and decided to increase their exchanges with future member states, the impact of enlargement in the Spanish economy could be improved. Unfortunately, public opinion has preferred to focus on the potential loss of structural funds instead. But, as pointed out by José A. Herce, in this debate we tend to forget that cohesion funds were introduced to compensate those economies that, at that time, were not prepared to fully benefit from the internal market and the European Monetary Union. According to José A. Herce, the essence of structural support is that it should be lost once an economy grows, and indeed, many regions are expected to lose their classification of objective 1, independently of enlargement, due to their economic growth.

As Christian Weise explained, the enlargement of the EU could be financed without overshooting the EU budget limits. However, the enlargement should be taken as an opportunity to carry out the long-needed reform of both the EU structural policy and the Common Agricultural Policy (CAP). Not only will an EU of 25 member states be more costly than the current EU-15, but enlargement will also make it more important to have comprehensible and transparent rules for the financing of the budget. In the DIW estimations, a moderate reform would consist of national co-financing of direct income support payments to farmers and concentration of structural funds on objective 1 regions.

The DIW paper proposes a more substantial reform involving a reduction of the income support of the CAP and a concentration of EU structural support on the poorer member states (which is more coherent with the subsidiarity principle of the EU). These substantial reforms would distribute the cost of enlargement more

evenly among member states. In fact only two countries, Spain and Greece, would suffer more from a substantial reform than from a moderate one, (which, according to Christian Weise, would happen anyway). It should then, following Weise, be feasible to find an arrangement compensating Spain and Greece for the particular loss implied by a substantial reform.

## **Workshop on Labour Markets & Welfare Systems (CEPII/FEDEA/DIW), Marseilles, 25-26 October 2002**

As is well known, the dramatic change in European demographics and some considerable shifts in fiscal policy have called into question the viability of the current welfare scheme in almost all the EU members. The debate about how to reform them has come to the forefront of the economic and political debate.

Central to any proposal of reform must be the consideration that the effects of the welfare system are crucial for the economic development in several respects, and therefore, any change in policy has to consider its broader implications.

The conference's contributions were centred on three main issues, namely the rationale of any welfare system, how to design it, considering the economic and demographic environment, and finally the impact that welfare schemes have on the economy, with a special focus on the labour market.

The conference was divided into seven specialised sessions, in which technical papers were presented and discussed, and five non-technical lectures given by specialists.

The first session, chaired by Xavier Joutard of the University of Marseilles, dealt with the dynamics of the labour market over the life cycle. Jean Chateau, Jean Louis Guérin and Florence Legros (CEPII, Paris) presented a labour market model featuring segmented matching, calibrated on French data, and used it to study the effect of demographic change on

unemployment. In another empirical analysis, Robert Fenge, Silke Uebelmesser and Martin Werging (CESifo, Munich) provided an investigation of the intertemporal structure of implicit taxes, based on German micro-data, showing that they tend to decline over the life cycle. Finally Peter Eso (Northwestern University) and Andras Simonovits (Hungarian Academy of Sciences), in their theoretical contribution, presented an application of a mechanism design aimed at finding an optimal pension benefit rule for flexible retirement

In the second session, chaired by Bernard Casey (London School of Economics) some stylised facts about labour force developments in the euro area during the 1980s were presented by Véronique Genre and Ramon Gomez-Salvador of the European Central Bank. The second contribution, by José Ignacio Conde-Ruiz (FEDEA, Madrid) and Vincenzo Galasso (Bocconi University, Milan) offered a political economy analysis of the choice of the type of protection against labour market risk, providing a detailed explanation of the motivations underlying voters' choice between employment protection and unemployment benefits.

The third session, chaired by Bernard Seidel (DIW, Berlin) was devoted to policy design and provided an overview of some of the quantitative tools available to analyse the effects of retirement policies. Jukka Lassila and Tarno Valkonen (ETLA, Helsinki) showed the effect of demographic uncertainty on retirement age policies, using a calibrated dynamic computational General Equilibrium model for Lithuania. Pedro Cardoso and Bernard Van Praag (University of Amsterdam) presented a theoretical calibrated model to assess the sustainability of old age pensions when population is shrinking and labour supply is endogenous. Finally Werner Roeger (European Commission) showed some simulations made with the Commission's multi-country econometric model, to measure the impact of some possible reform of European pension schemes.

The effects of migration and labour force mobility were the subjects of the fourth session (chaired by Henri Sterdyniak, OFCE, Paris). Jorgen Hansen (Concordia University, Canada)

and Magnus Holfstrom (University of California at Irvine) provided a quantitative analysis of the effects of migration on welfare systems, using Swedish micro-data. Konstantinos Tatsiramos (European University Institute, Florence) developed and tested a partial equilibrium search model, to study the consequences of unemployment benefits on European inter-regional mobility.

When discussing welfare system reforms, an assessment of their consequences on labour supply is crucial. The fifth session (chaired by Lionel Fontagné of CEPII, Paris) presented three contributions on this topic. Holger Bonin, Wolfram Kempe and Hilmar Scheider (IZA, Bonn) used German household data to show the potential effect of some proposals of low-wage subsidies on labour supply. José Maria Arranz and Juan Muro (University of Alcalá) presented their detailed econometric study on the relationship between unemployment benefits and unemployment duration in Spain. Hannu Piekola (ETLA, Helsinki) studied the impact of the new pay schemes introduced after the fast technological development in Finland's industry.

The sixth session (chaired by Karl Gustav Scherman) was devoted to the effects of welfare schemes on income distribution, and presented an empirical and a theoretical paper. Ed Weterhout and Egbert Jongen (Dutch Planning Bureau) showed the role of minimum wages and unemployment benefits in tax shifting, using a general equilibrium model of the Dutch labour market. Pundarik Mukhopadaya (Singapore National University) illustrated some modification of the traditional Social Welfare Function able to disaggregate it by income classes.

The last session (chaired by Florence Legros CEPII) illustrated some results obtained with a micro-simulation model of the Belgian welfare system.

Along with the presentation of these technical papers, five lectures were given by leading scholars in this field, providing a broad overview of the main issues related to welfare system reforms.

Marc Fleurbaey (University of Pau) offered some insights on how to derive an optimal

income tax, given the differences in skills and preferences among individuals. The lecture of Eithan Sheshinski (Hebrew University of Jerusalem) was theoretical as well and centred on the following question: Is it optimal to give citizens complete freedom of choice (as implied by some reforms of the retirement system put forward recently)? The answer is negative as long as individual bounded rationality prevents them from choosing optimally.

Vincenzo Galasso (Bocconi University, Milan) dealt with retirement. He first proposed a positive theory of early retirement, using political economy analysis and then some observation about the consequences of early retirement on the distribution of income between young and old agents.

Bernard Casey (LSE) presented a thorough comparison of the OECD Jobs Strategy and the European Employment Strategy and the two views (to some extent opposite) of the labour market and of the welfare state they imply.

Finally Michael Orszag (Watson Wyatt, London) made a *tour d'horizon* of the possible scenarios for pension reform in the EU.

Overall the conference tried to provide a wide range of approaches to the analysis of the functioning of welfare system and an assessment of some reform options.

## **Workshop on Welfare Systems and Policy Competition (CPB), The Hague, November 2002**

With the ongoing economic integration in Europe, questions on the desirability and the consequences of systems competition become more and more important. European borders are vanishing rapidly, thereby increasing factor and product mobility. Does this call for more intense policy co-ordination? Does it automatically lead to policy competition? What are the consequences of these developments for the European welfare states? And how do institutions have an impact on these developments? In the framework of ENEPRI,

the CPB Netherlands Bureau for Economic Policy Analysis organised a workshop on these topics, focusing on such areas as social security, pensions, immigration and labour market policies. Below, we discuss a selection of papers and discussions of the conference.

On 29 and 30 November 2002, researchers gathered in The Hague to discuss the issues from various perspectives. Oosterwijk (Secretary General of the Dutch Ministry of Economic Affairs and Chairman of the Economic Policy Committee of the European Union) opened the conference by discussing why welfare state policies have remained within the national domain for such a long time, and why and how this has changed over the last few years. He concluded with some observations as to how welfare state policies could be dealt with in Europe in the years to come. In his speech, Oosterwijk highlighted both the European perspective as well as the Dutch view, reflecting his double expertise, being both secretary general of the Dutch Ministry of Economic Affairs.

Ruud de Mooij and Paul Tang (CPB) proceeded to discuss the future of the European welfare states by sketching several trends and their implications for the welfare state. Various trends put pressure on the welfare state, such as ageing and globalisation. The rising dependency ratio due to ageing may lead to intergenerational conflicts as rising pension costs requiring higher taxes and/or lower other benefits. Furthermore, ageing reinforces the effects of Baumol's law, which describes the rising demand for (public) services, notably the health care sector. Globalisation can be a threat to the position of trade unions in their traditional form. Do these and other threats call for a scaled-down welfare state? De Mooij and Tang propose several directions for reform, doing justice to the trade-off between equity and participation inherently present in every welfare state.

Although Tito Boeri could not present his paper due to illness, José Herce did an excellent job in discussing the main results of the paper. Boeri took a clear stance in favour of social policy co-ordination as a way to promote a more effective competition across systems. While it may sound as a contradiction, it is not.

Insofar as the proposed notion of co-ordination allows for more mobility of the European workforce, it implies that EU citizens can “vote with their feet” enhancing competition among systems. Coordination and competition can thus co-exist. Coordination provides rules for competition among systems and is a way to make sure that competition among systems enhances welfare of European citizens.

After a lively discussion, Krieger and Sauer (University of Gottingen) proceeded to ask whether Eastern European migrants will happily enter the German pension system. With diminishing wage differentials between Eastern Europe and the EU, the migration decision will be based more and more on factors other than wages. Besides cultural and social motives, also the welfare system may play a role. An important factor might be the pension system. They showed that the ideal migrant has little reason to migrate to Germany on the basis of the different pension systems. The Eastern European pension systems not only have a relatively large funded pillar; they also have a higher rate of return in both the pay-as-you-go and the funded system. The ideal migrant will migrate to Germany not owing to the pension system, but in spite of it.

Jensen, Lau and Putvaara (CEBR) assessed the welfare effects of different European pension systems using an overlapping generations life-cycle model on time allocation. They compare the Beveridgian and the Bismarckian pension systems, both with and without actuarial adjustment. They show that the pension system has a large impact on the retirement age: non-actuarial-adjusted systems encourage retirement at the official age, whereas actuarially adjusted systems promote more gradual retirement. Furthermore, the Bismarckian system is generally preferred over the Beveridgian system with its strong redistributive effects, even by the low-skilled, as they can be compensated owing to increased efficiency.

In the presentation of Haupt and Janeba (University of Frankfurt Oder), attention was drawn to the impact of globalisation on education and redistribution in developing countries. Whether individuals will attend school and whether they will migrate both

depend on the tax rates. On the one hand, globalisation thus limits the possibilities for governments to raise revenues to support education, due to reduced migration costs. On the other hand, globalisation presents a positive incentive for individuals to attain education as the returns are raised. Using a two-period model of a small developing country with internationally mobile skilled labour, they show that in the case of a redistributive government, declining migration costs first improve the available income of both the poor and the rich, then worsen the consumption opportunities for all workers and finally raise the welfare of the mobile workers at the expense of the unskilled labour force.

Dur and Teulings (Erasmus University, Rotterdam) also discussed the relationship between education and schooling. In contrast with Haupt and Janeba, they also considered the impact of skill supply on income. With rising average years of schooling, the returns to schooling drop, reducing the incentive to attain education (“wage function twisting”). This wage compression effect of education provides a motivation for left-wing governments to subsidise education to be able to redistribute income.

Goebel and Otto (DIW Berlin) compared the real world to a world without social transfers. Via a micro-simulation with data from the European Community Household Panel (1998), they show that the social democratic welfare states experience the largest reduction in poverty owing to social transfers. Their simulations also show that the decomposition of the effect on poverty (through a change in intensity, impact on income equality and incidence) is different for the various European countries.

Paul O’Brien (OECD) discussed the economic impacts of migration in the OECD. Theory tells us that migration increases unemployment or leads to falling wages in the destination country, depending on the rigidity of the labour market. Empirical findings are less univocal, however, showing e.g. the effects of education and institutions. Furthermore, he argues that a broad approach is needed to assess the fiscal impacts of migration, as the impact strongly depends on the time horizon considered. On

the one hand, negative fiscal impacts could lead to a race for the bottom in social security systems. On the other hand, these effects could also stimulate the implementation of more cost-efficient systems. That open borders need not lead to a race to the bottom in social security is supported by the finding that most migrants are better informed about the labour market situation in the destination country than about the social security system.

Lans Bovenberg (Tilburg University) discussed financing retirement in the European Union in the face of ageing. Ageing challenges the European Union to reduce risk (as the risk-return trade-off is worsened by falling returns and a narrowing contribution base) and to invest in (the maintenance of) human capital. This requires policy-makers to consider ageing and pension systems in a comprehensive framework. Risk is absorbed by raising the effective retirement age by indexing the retirement age to life expectancy. Moreover, this strengthens the incentive to invest in human capital. Furthermore, on the other end of the age spectrum, there is a conflict between the need to slow down the decline in fertility and the wish to raise (female) participation. Solving this conflict calls for a system that stimulates a more equal distribution of labour over the lifetime, thus internalising external effects of breeding.

Fugaro and Daianu (University of Bucharest) discussed institutional and policy variety and their implications for economic development. They sketched the historical developments and in particular the transition process of Eastern European socialist countries. They showed that over the past decades the consecutive paradigms and panaceas were not fully successful in solving the present dilemmas and were even overturned by newly arising challenges.

Delsen (University of Nijmegen) argued that a distinction should be made between positive and negative policy competition. European integration could lead to policy competition between the several types of welfare systems. Negative policy competition includes phenomena such as social dumping, race-to-the-bottom policies and social tourism. Positive policy competition, by contrast, implies that the

welfare state can be seen as an investment that can improve competitiveness. Both types of policy competition call for co-ordination, preventing a race to the bottom and implementing best practices.

Fiorella Kostoris Padoa Schioppa (ISAE, Rome) discussed the idea of mutual recognition in European labour markets. She provided a law-and-economics analysis on the impact of accepting the home country rules in welfare state provisions, instead of the current host country rules which imply equal treatment instead of mutual recognition. According to the author, mutual recognition will have a number of advantages for European labour market performance.

Axel Börsch-Supan (MEA, Mannheim) elaborated on the German public pay-as-you-go pension system. This mandatory "retirement insurance" has come under severe pressure, mainly from population ageing and from incentive effects that have reduced labour supply. He argued that Germany needs a pension reform with three main elements. First, a reformed pay-as-you-go pillar that is actuarially fair, features a transparent notional account set-up and freezes contribution rates at the current level. Second, a second funded pillar which is based on US 401(k)-style grouped accounts that finance the impending ageing burden. Finally, it should be augmented by redistributive features that guarantee a minimum pension and strengthen human capital formation.

Michael Burda (Humboldt University, Berlin) discussed the difference between small and large countries in reforming institutions. His conjecture was that small countries, which are less heterogeneous than large countries, find it easier to agree upon institutional changes than large countries and, therefore, perform better in terms of economic development.

## ENEPRI Working Papers

No. 15 *Estimating the Effects of Fiscal Policy in OECD Countries*, Roberto Perotti, October 2002

No. 14 *How to Finance Eastern Enlargement of the EU: The Need to Reform EU Policies and the Consequences for the Net Contributor Balance*, Christian Weise, October 2002

No. 13 *Mutual Recognition, Unemployment and the Welfare State*, Fiorella Kostoris Padoa Schioppa, September 2002

No. 12 *Internal Migration in Regions of Germany: A Panel Data Analysis*, Ashok Parikh and Michiel Van Leuvensteijn, September 2002

No. 11 *Interdependent Growth in the EU: The Role of Trade*, María García-Vega and José A. Herce, September 2002

No. 10 *Equilibrium Rates and Wage Flexibility in Europe*, R.C.M.H. Douven, August 2002

No. 9 *Midlife Caregiving and Employment: An Analysis of Adjustments in Work Hours and Informal Care for Female Employees in Europe*, C. Katharina Spiess and Ulrike Schneider, February 2002

No. 8 *Turkey's Performance in Attracting Foreign Direct Investment: Implications of Enlargement*, Henry Loewendahl and Ebru Ertugal-Loewendahl, November 2001

No. 7 *Is the ECB sufficiently accountable and transparent?* Lorenzo Bini-Smaghi and Daniel Gros, September 2001

No. 6 *Maastricht and the Choice of Exchange Rate Regime in Transition Countries during the Run-Up to EMU*, György Szapáry, September 2001

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