CAGE

Competitive Advantage in the Global Economy

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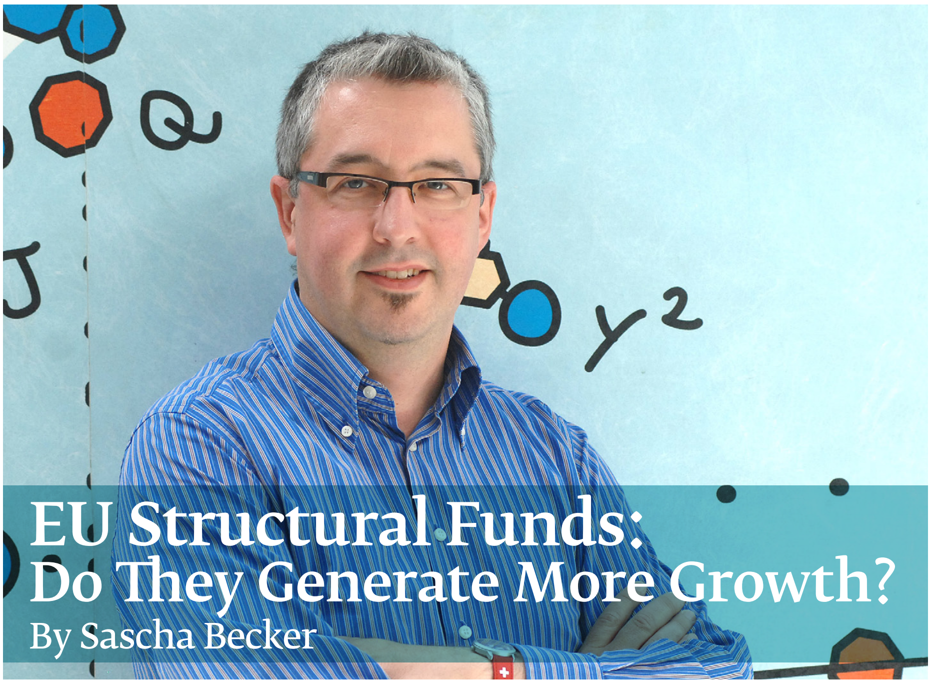

EU Structural Funds: Do They Generate More Growth?

By Sascha Becker

INSIDE

European Union budget negotiations have always been subject to rows between member states, and today's wrangling over funding is no different. Indeed, in the ongoing negotiations about the EU's long-term budget for 2014–20, the British Prime Minister, David Cameron, has threatened to veto any deal that would allow Brussels to push through an above-EU inflation increase of 5%.

In times of shrinking national budgets, a number of governments firmly believe that further swelling the EU budget must be resisted. In this context, it is fair to ask to what extent expenditures actually achieve their goal, considering that the EU spends €130 billion per year, equivalent to roughly 1% of the gross national income (GNI) of its 27 member states. And there are also calls by many, especially in the United Kingdom, to repatriate powers from Brussels, which would bring back budgetary decisions to member states.

One of the EU's primary expenditure items is on Regional (or Cohesion) Policy. The starting point for this regional focus is the fact that there are considerable differences in GDP per capita not only across countries but also across regions within countries. Expenditures on Structural Funds and the Cohesion Fund, accounting for more than one-third of the EU budget, aim to reduce regional disparities in terms of income, wealth and opportunities. But is this massive expenditure successful at increasing growth rates in the poorer regions of the EU?

Are all recipient regions equally adept in turning transfers into additional economic expansion or does the impact on growth depend on regional conditions, often referred to as a region's absorptive capacity? If they are beneficial in principle, do larger transfers lead to more growth or are there diminishing returns?

Answers to these questions are important in determining whether the EU Regional Policy is successful in its current form or whether it might be beneficial to make a few key adjustments.

It is generally very difficult to find the "causal effect" of EU transfers on regional growth because poor regions (the main recipients) might have different growth rates than rich regions also in the absence of EU structural funds.

Funding under Objective 1 (now called Convergence Objective) is particularly "interesting" because Objective 1 is by far the largest part of EU Structural Funds and because they are assigned by a clearly defined rule: NUTS2 regions, whose GDP

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CAGE and the ESRC Festival of Social Science

Now in its tenth year, the ESRC Festival of Social Science celebrates the importance of the social sciences with a wide variety of events across the UK designed to appeal to all sections of our community.

CAGE was delighted to participate in this year's Festival and organised two events at the University of Warwick:

Economics and the Real World

6th November 2012 • Warwick Arts Centre Cinema

This event, aimed at Sixth Form students, showcased research produced by academics from CAGE. Researchers demonstrated how their work addresses real world issues and can have an impact on government policy. The aim of this event was to help pupils appreciate the importance of economics, and to stimulate an interest in studying social science at University.

Religion, Gender, Education and Economics 9th November 2012 • *The Chaplaincy, University of Warwick*

This event, based on current research by Professor Sascha Becker, gave the audience the opportunity to discover some interesting facts about how religion still makes a difference in educational attainment and earnings, even though its role in public life has diminished. The talk was followed by a lively discussion on how religion, education and economics interact.

2012 Royal Economic Society Policy Lecture

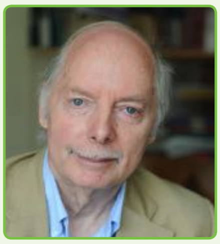
This year's RES Policy Lecture was given by Professor Nick Crafts on 17 October at the Bloomsbury Theatre, UCL. The topic was 'Returning to Growth: Policy Lessons from History' and was focused on what can be learned from the strong recoveries from recession in the 1930s and 1980s which might help the design of economic policy today.

To see a video of the lecture please visit the CAGE website.

Congratulations to:

Jennifer Smith

CAGE Research Associate, Dr Jennifer Smith, has been appointed part-time Consultant at the Bank of England from November 2012. Jennifer, Associate Professor of Economics at the University of Warwick, will be working on the project "Assessing Wage Rigidity in the United Kingdom" alongside members of the Costs and Prices Team of the Structural Economic Analysis Division of Monetary Analysis.



Marcus Miller

CAGE Research Associate and Warwick Economics Professor, Marcus Miller, has had two papers accepted by OEP.

'When bigger isn't better: bailouts and bank reform' (with Lei Zhang), OEP, forthcoming, April 2013, available online from December 2012.

'Liquidity When it Matters: QE and Tobin's Q' (with John Driffill), OEP, forthcoming, April 2013, available online from December 2012.

Both of these papers were previously CAGE working papers.

Victor Lavy

Victor Lavy, Professor of Economics at the University of Warwick and CAGE Research Associate, has recently won the prestigious advanced ERC (European Research Council) award. The ERC Advanced Grant allows established research leaders to pursue ground-breaking, high-risk projects that open new directions in their respective research fields or other domains. Professor Lavy's research is focused on the impact of schooling interventions – teacher quality, school quality, school choice etc. – on long-run life outcomes including educational attainment, employment, income, marriage and fertility, crime, and welfare dependency.

Nick Crafts

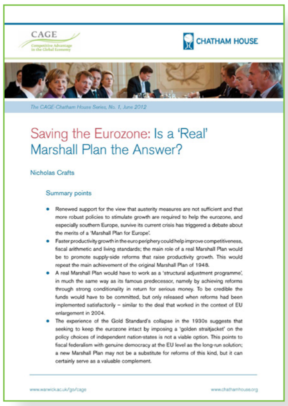
Professor Nick Crafts was announced as the 2012 winner of the Tjalling C. Koopmans Asset Award at the Asset International Conference, Tilburg University, Netherlands on Tuesday November 13th. This award is made in recognition of "extraordinary contributions to the economic sciences and for having reached the highest standards of quality in research". Previous winners include William Baumol, Jagdish Bhagwati, Robert Engle, Daniel Kahneman and Jean Tirole.

Wiji Arulampalam

Professor Wiji Arulampalam has been appointed as a member of the Technical Advisory Group for the Department of Education. This group will inform the development and conduct of the evaluation of the 16-19 Bursary Fund research project.

New CAGE/Chatham House Policy Briefing

'International Migration, Politics and Culture: The Case for Greater Labour Mobility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CHATHAM HOUSE

The CAGE-Chatham House Series, No. 1, June 2012

Saving the Eurozone: Is a 'Real' Marshall Plan the Answer?

Nicholas Crafts

Summary points

- Renewed support for the view that austerity measures are not sufficient and that more robust policies to stimulate growth are required to help the eurozone, and especially southern Europe, survive its current crisis has triggered a debate about the merits of a 'Marshall Plan for Europe'.
- Faster productivity growth in the euro periphery could help improve competitiveness, fiscal arithmetic and living standards; the main role of a real Marshall Plan would be to promote supply-side reforms that raise productivity growth. This would repeat the main achievement of the original Marshall Plan of 1948.
- A real Marshall Plan would have to work as a 'structural adjustment programme', in much the same way as its famous predecessor, namely by achieving reforms through strong conditionality in return for serious money. To be credible the funds would have to be committed, but only released when reforms had been implemented satisfactorily – similar to the deal that worked in the context of EU enlargement in 2004.
- The experience of the Gold Standard's collapse in the 1930s suggests that seeking to keep the eurozone intact by imposing a 'golden straitjacket' on the policy choices of independent nation-states is not a viable option. This points to fiscal federalism with genuine democracy at the EU level as the long-run solution; a new Marshall Plan may not be a substitute for reforms of this kind, but it can certainly serve as a valuable complement.

www.warwick.ac.uk/go/cage www.chathamhouse.org

In this policy briefing paper Professor Sharun Mukand argues that a policy shift to liberalise global labour markets could be a key tool for development and poverty reduction. Currently, neither development policy circles nor multilateral forums appear to view this as a viable option. Professor Mukand discusses why a policy that encourages international labour migration of a temporary nature, targeted to specific sectors and more modest in scope, could be the answer.

This is the second in a series of policy papers published by Chatham House in partnership with CAGE. Forming an important part of CAGE's five year programme of research and Chatham House's International Economics agenda, this series aims to advance key policy debate issues of global significance

This report was launched at Chatham House on 8 October to an audience that included policy makers and members of the business community and academics. To see a pdf of the paper please visit the CAGE website.

Forthcoming papers in the CAGE-Chatham House Series:

8 Dec 2012, Chatham House

'EU Structural Funds: Do They Lead to More Growth'
Professor Sascha Becker

Measuring National Well-being

20 November 2012

Professor Andrew Oswald was asked to speak at the Measuring National Well-being Conference organised by the Office of National Statistics (ONS).

The Conference marked the 2 year anniversary of the ONS 'Measuring National Wellbeing' programme and was designed to report back on the programme's main achievements to date to a diverse audience including academia, central and local government, think tanks and third sector.

Andrew's talk, 'Where well-being research currently stands in the world', covered relationships, health, education, environment, economy and governance – from a UK and international perspective.

Other speakers included Martine Durand, Chief Statistician from the Organisation for Economic Co-operation and Development and Roger Halliday, Chief Statistician, Scottish Government.

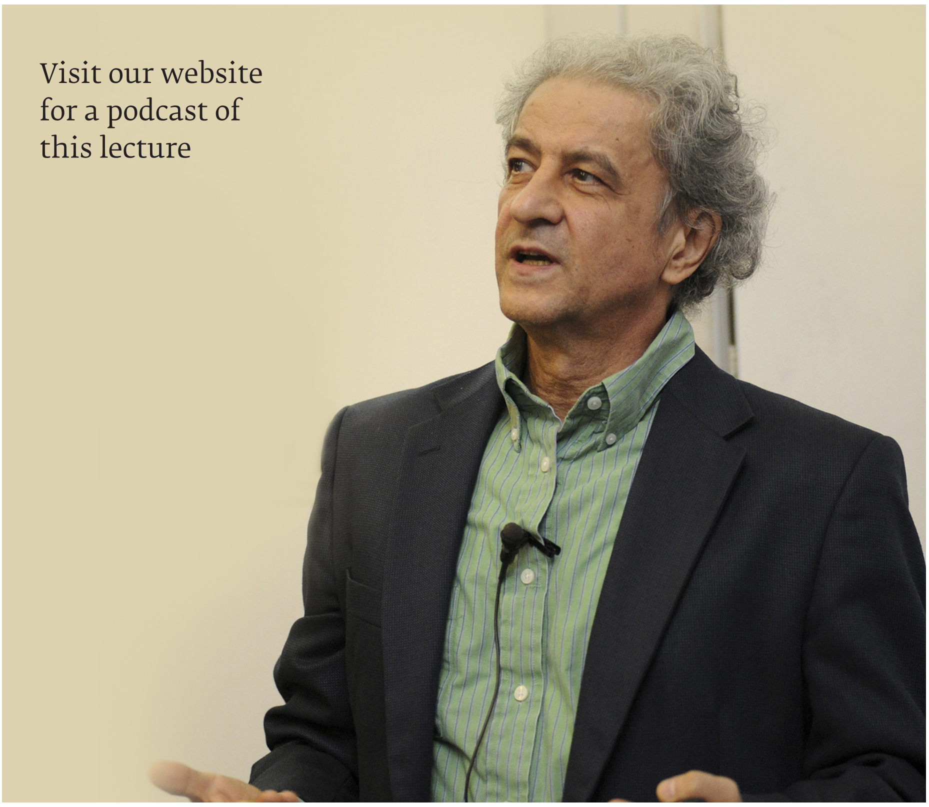
Merit and Social Justice

31st October 2012, University of Warwick

CAGE was pleased to welcome leading neuroeconomist Aldo Rustichini who gave a special public lecture on the concepts of merit and social justice.

The lecture, chaired by Professor Andrew Oswald, saw Professor Rustichini consider the concepts of social justice and merit, conflicting ideas which translate into a passionate political debate. In the analytical tradition of contract theory we are asked to perform a thought experiment: if we could create a society, and we wanted it to be fair, which society would we choose? In this talk Aldo Rustichini reviewed research that puts this same thought experiment on the firmer grounds of a controlled laboratory experiment.

Aldo Rustichini is Professor of Economics at the University of Minnesota. He has an undergraduate degree in Philosophy (University of Florence, Italy) a Masters in Economics (University of Manchester, UK) and a Ph.D in Mathematics (University of Minnesota). He is Fellow of the Econometric Society, and member of the Game Theory Council. His research interests are in Game Theory, Decision Theory, Experimental Economics and Neuroeconomics.



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per capita is less than 75% of EU average, are eligible. Assignment of funds to regions to the left and right of the 75% threshold is, from a statistical perspective, in the vicinity of the 75% threshold, like "flipping a coin" and can be exploited in statistical analysis.

In Becker, Egger, von Ehrlich (2010), our results are that Objective 1 funds are, on average, helping recipient regions to grow faster, but the "multiplier" is around 1, i.e. on average "you get out what you put in", but not more than that.

Going beyond average effects of Objective 1 funds, the question is whether there are differences in the growth effects of Objective 1 funds, depending on region characteristics? In other words: is there heterogeneity across regions?

The answer is yes: a region's endowment with human capital and a high quality of government matter.

Only regions with a more educated work force and regions with high quality of governance are able to turn transfers under the Union's Objective 1 Structural Funds programme into faster growth.

Those regions are the ones who are responsible for a positive average effect of the programme (see Becker, Egger, von Ehrlich (2012a)).

As for EU Structural Funds as a whole, do more funds mean more growth? In Becker, Egger, von Ehrlich (2012b), we analyze the effect of transfer "intensity" on regional growth and find that there are decreasing returns, i.e. after a certain point, additional funds do not lead to additional growth.

In summary: our research shows that (a) the EU's Objective 1 program works, on average, but (b) not all regions are equally good at turning EU transfers into additional growth, depending on their human capital endowment and quality of government and (c) the EU's Regional Policy as a whole is too much of a good thing for those regions that get "too much" money.

This article draws on the following three research papers:

Becker, S. O., Egger, P. and von Ehrlich, M. (2010), 'Going NUTS: The Effect of EU Structural Funds on Regional Performance', Journal of Public Economics 94 (9–10): 578–90.

Becker, S. O., Egger, P. and von Ehrlich, M. (2012a), 'Absorptive Capacity and the Growth Effects of Regional Transfers: a Regression Discontinuity Design with Heterogeneous Treatment Effects', University of Warwick CAGE Working Paper No. 89, forthcoming in American Economic Journal: Economic Policy.

Becker, S. O., Egger, P. and von Ehrlich, M. (2012b), 'Too Much of a Good Thing? On the Growth Effects of the EU's Regional Policy', European Economic Review 56 (4): 648–68.

Working Papers

CAGE publishes a series of working papers which are available online at **go.warwick.ac.uk/cage** Recent papers include:

Monetary Policy Flexibility in Floating Exchange Rate Regimes: Currency Denomination and Import Shares

Author: Vera E. Troeger No. 69/2012

This paper argues that the degree of monetary flexibility a government enjoys does not only depend on the implemented monetary institutions such as exchange rate arrangements and central bank independence but also on the economic and financial relationships with key currency areas. The author develops a formal theoretical framework explaining the degree of monetary independence in open economies under flexible exchange rate regimes by trading relations and financial integration. The model suggests that a) higher import shares from the key currency area increase the imported inflation when monetary authorities try to offset an exogenous shock by cutting back the interest rate while the base country does not encounter a similar shock, and b) the more cross border assets of a country are denominated in the base currency the higher the exchange rate effects of interest rate differences to the interest rate of the key currency area. The presented empirical evidence largely supports the theoretical predictions.

India and the Great Divergence: An Anglo-Indian Comparison of GDP per capita, 1600-1871

Authors: Stephen Broadberry and Bishnupriya Gupta No. 81/2012

This paper provides estimates of Indian GDP constructed from the output side for the pre-1871 period, and combines them with population estimates to track changes in living standards. Indian per capita GDP declined steadily during the seventeenth and eighteenth centuries before stabilising during the nineteenth century. As British living standards increased from the mid-seventeenth century, India fell increasingly behind. Whereas in 1600, Indian per capita GDP was over 60 per cent of the British level, by 1871 it had fallen to less than 15 per cent. As well as placing the origins of the Great Divergence firmly in the early modern period, the estimates suggest a relatively prosperous India at the height of the Mughal Empire, with living standards well above bare bones subsistence.

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