

Does it make sense to regionalize labour market institutions ? If so, how?

A comment.

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The fact that unemployment benefits are paid and personal income taxes and social security contributions are raised at the federal level while a number of policies such as labour market integration and education are a regional competence raises a conflict of interest between the federal government and the Regions. Regional policies affect the level of expenditures on unemployment benefits and tax revenues but the Regions do not collect the full proceeds of their actions. Hence they tend to under-invest, for instance in labour market integration and education.

The authors of the E-book argue that incentive contracts are required to resolve these problems of conflicting interests. This is a refreshing and more promising approach in the debate on regionalization of labour market institutions compared with the approach that argues that Regions need more coherent packages of instruments to fight the regional-specific unemployment and the ageing problems.

In a multilevel state some level of overlap of expenditure competences between national and subnational governments is somehow unavoidable. Therefore, the coherence of competence packages should not be such a big issue in the proposals for another state reform in our country. On the contrary, the debate should focus on coordination mechanisms and the lack of overlap between the revenue resources of the different governments. The lack of overlapping revenue resources particularly entails a number of negative externalities.

The dominance of grant financing induces negative externalities for the federal budget. Grants are rather consumed than invested. There is also the so-called raiding of the fiscal commons. The successive state reforms in our country are tantamount to a bailout by the federal government of the regions and communities.

In the case of overlapping tax bases, there are both horizontal and vertical externalities but these are counterbalancing. If different levels of government share the same tax base, then the tax levied by one government reduces the tax base available to the other levels of government. When each level of government neglects this negative effect of its taxing policy on the other levels of government, taxes will be set too high. With tax competition among lower levels of government, an increase in the tax rate by one region raises the tax base of others. When neglecting this positive horizontal fiscal externality, regions will tend to set tax rates that are inefficiently low.

In our country regions are mainly financed on the basis of federal grants and exclusive regional taxes. Not surprisingly we observe (excessive) tax competition between the regions (think for example of the abolition of the radio and television fee, first in Flanders, followed by Brussels, and probably also by Wallonia).

While economists care about budget constraints that are too soft (as is probably the case when grant financing is dominant), some political scientists also argue in favour of more fiscal responsibility in the name of democratic accountability. Fiscal responsibility would enhance the legitimacy of a government's policies, since it could argue that it spends its own

money. The current financing system creates an 'accountability gap'. Fiscal devolution or autonomy would increase transparency and democratic accountability because it would create a clear link between policy and public spending. The electorate would therefore be more able to hold government accountable for its policies and their cost.

For the sake of the budget of Entity I (federal government + social security) more financial responsibility for both regions and communities is needed. For the communities we even have 'representation without taxation'.

The sources of financing of the regions too need to overlap with these of the federal government, presenting a 'continuum from own taxation to grants from the federal level' (see Bordignon). The incentive schemes proposed in the E-book are examples of such a fiscal responsibility for the regions. The precise formula should however give more weight to the interests of Entity I. As we argue below, the proposed incentive schemes reflect too much particular (regional) interests.

1.

The communities are not made financially responsible although they are also responsible for the (under-)performance of the labour market. The mobility of labour or the probability of finding a job depends on the quality of initial schooling. Making the regions partially responsible for the funding of education could solve this asymmetry.

2.

Some proposals want to give a bonus, not a malus, to the Regions. This asymmetric experience rating however could be too expensive for the federal government.

Two comparisons can be made. First, with regard to the preretirement decision in the private sector, the current policy is to delay preretirement on the sole basis of a bonus. A person who works after the age of 60 gets a higher pension. There is no explicit penalty for retiring before the age of 65. With such a policy the present discounted value of retirement benefits at the age of 60 does not change. Hence higher boni are needed to restore the increase the incentive to stay in activity after 60, but this is of course more costly for the budget. Second, pollution reduction incentive schemes can be based on either taxes or subsidies, and both have the same effects. They matter of course for the income distribution, as the distributional consequences of the tax and subsidy scheme differ (a tax guards better the budget).

Since some proposals grant only benefits to the regions ('regionalization of the profits, (current) federalization of the losses'), a more symmetric incentive scheme should be developed. An example of such a scheme has been proposed by Frans Spinnewyn ea. in the research project 'Vlaamse Sociale Zekerheid 2002' in the mid-1990s. Their proposal can be presented as follows: the regions become partially (for example 10 %) responsible for the expenditures on unemployment benefit. As compensation, they receive a grant from the federal government. This grant is based upon the expenditures on unemployment in the base year (year 0). This is a symmetric (win-win or loss-loss) scheme. This can formally be shown as follows: Define X_t^g = unemployment benefits in region g in period t. In year t, the expenditures for the federal government are then equal to $X_t^f = \sum_g (0,10 \cdot X_0^g + 0,90 \cdot X_t^g)$

whereas the budget constraint for region g in time t equals revenues minus expenditures or $0,9 \cdot X_t^g + 0,1 \cdot X_0^g - X_t^g = 0,10 \cdot (X_0^g - X_t^g)$

The scheme involves a co-insurance of gains and losses. For example, there is a win-win when $X_0^g \geq X_t^g$.

3.

For the incentive schemes of the E-book only the initial position should matter ('let bygones be bygones'). It is however more costly to increase the employment rate by 1% point when the initial employment rate is 65% compared with 55%. Moreover, the use of the non-employment rate as a performance indicator instead of the employment rate may be a more neutral indicator *vis-à-vis* the regions.

4.

The incentive scheme should not be tailored to solve the so-called budgetary problems of the Brussels region. As Brussels has a major net inflow of commuters, a proposal in the E-book is that a worker living in one region and working in the other would contribute for 50% to the employment rate where she lives and for the other 50% to the employment rate of the Region where she works.

However, the chosen 50-50 rule seems arbitrary. Commuters also have positive externalities on the Brussels' labour market as they increase the supply of labour. The Brussels' government free-rides here on the investment in human capital made by the other regions and communities. The negative externalities of commuters however depend on the chosen mode of transportation. Since the underpricing of public and private transport is a generic problem, not restricted to Brussels, we should introduce congestion pricing in all regions. This is a better solution to the negative externalities of commuters than applying (partially) the principle of working place for determining the allocation of the bonus in the case of successful labour market policies.

Only a cost-benefit analysis can determine whether Brussels is underfunded or not. At first glance, Brussels is underfunded because the French community and the component cities of Brussels shift important expenditures to the regional level. The region is responsible for active labour market policies but not for the allocation of education and schooling expenditures. Hence Brussels definitely needs an internal institutional reform. The institutions of Brussels and the malfunctioning education system are at the heart of the current problems in Brussels, not the commuters.