

EDITORIAL
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The Euro has arrived! Almost 30 years after the European Summit in The Hague, when Europe's leaders for the first time decided to create a common European currency, almost 20 years after the start of the European Monetary System, and little more than 10 years after the Genscher memorandum, the common currency is a reality. Its smooth introduction in the international financial markets on 1 January was a plain success. Trading in the new currency has started smoothly, too, with only a few minor glitches in the new European payment system.

Now, the European governments will have to learn how to conduct economic policies with a common currency. A first point is to accept the fact that the new European Central Bank is independent and committed to price stability – ironically, it was the new German government that led the attack on the central banks pushing for lower interest rates last Fall. A second point is to coordinate fiscal policies in the EMU to achieve a combination of national policies and the common monetary policy conducive to full employment and external balance in addition to price stability. A third point is to create a framework for competition among the national authorities and their different approaches to structural improvement that leads to the discovery of the most adequate policies for reducing Europe's high rates of structural unemployment.

The common currency creates opportunities though no panacea for revitalizing the European economy. The challenge now is to complement economic with political integration to use these opportunities fruitfully. ZEI hopes to contribute to mastering that challenge by bringing together policy makers and researchers to develop new policy strategies and perspectives for making EMU work.


Prof. Jürgen von Hagen

What condition is Europe in? What constitution for Europe?

ZEI Conference sheds light beyond the German presidency

by Ludger Kühnhardt

In the first half of 1999, it is the turn of the German federal government to take over the presidency of the European Union. Heading the list of tasks to be tackled during this period is the decision on AGENDA 2000, the broad-based program of reforms being put forward by the European Commission. The intensity of current demands being placed both on the German presidency and the European Union as a whole must not, however, cause us to turn our attention away from the development of processes – now only slowly moving into the public eye – which will be of fundamental long-term significance for the EU.

Apart from the successful establishment of the euro, the key issue is that of pushing forward the process of creating a constitution for the EU, which will involve a long-sighted, sound reallocation of roles and responsibilities between regions or federal states, nations and the EU institutions. In the coalition agreement of October 1998, the parties of Germany's new red-green federal government put the case for a European charter of civil rights which could indeed become an important stepping stone towards a European constitution.

MEDITERRANEAN POLICY

Along with eastern enlargement, intended as an expression of European security and prosperity, requirements for the coming years also include the development of a unified EU Mediterranean policy. This would mean that the Mediterranean region would come to be seen as the starting place in the search for shared security and prosperity for Europe, and would turn the southern countries bordering the Mediterranean into an object of strategic interest for the whole of the EU.

For this to succeed, the EU will have to reopen the Turkey dossier and attempt to remove the obstacle caused by Cyprus – still divided and ever further from a resolution of the ensuing problems – embarking on EU accession negotiations. Making headway on this is a vital prerequisite to establishing a strategic, long-term community of interests with Turkey as the most important partner of the western world on the doorstep of the Middle East, the Caucasus and Central Asia. It is in Germany's own interests that Turkey be accepted as a “candidate country” and that its “European credentials” be measured strictly, but fairly, against the “Copenhagen criteria”.

TRANSATLANTIC ALLIANCE

1999 will see the completion of an advanced NATO strategy concept. The processes of reform in the EU and within the transatlantic alliance are not coordinated with each other, but they must produce complementary results and structures. In this context, the key requirement is that the EU and the USA as a learning community develop a common view of those challenges which must lead to consistency of objectives and complementary allocation of funds. This applies primarily to western policy vis-à-vis Russia, the Ukraine and Turkey. While there has been marked progress in developing a sustainable Euro-Atlantic partnership on global issues such as environmental protection and world trade, there has not yet been any real attempt to forge a strategic partnership to look at the consequences of the new geopolitical and geo-economic developments beyond the eastern and southern boundaries of the Euro-Atlantic structures.

NEW PUBLICATIONS

ZEI-POLICY/WORKING PAPER-SERIES:

B 16 1999

Labour Market & Tax Policy in the EMU (Deutsch-Französisches Wirtschaftspolitisches Forum)

ZEI-Discussion Paper-Series:

C 29 1999

Murat T. Laumulin: Die EU als Modell für die zentralasiatische Integration?

C 30 1999

Valdas Adamkus: Europe as Unfinished Business: The Role of Lithuania in the 21st Century's Continent

C 31 1999

Ivo Samson: Der widerspruchsvolle Weg der Slowakei in die EU. Die Slowakei vor der Marginalisierung in Zentraleuropa?

C 32 1999

Rudolf Hrbek / Jean-Paul Picaper / Arto Mansala: Deutschland und Europa. Positionen, Perzeptionen, Perspektiven

C 33 1999

Dietrich von Kyaw: Prioritäten der deutschen EU-Präsidentschaft unter Berücksichtigung des Europäischen Rates in Wien

C 34 1999

Hagen Schulze: Die Identität Europas und die Wiederkehr der Antike

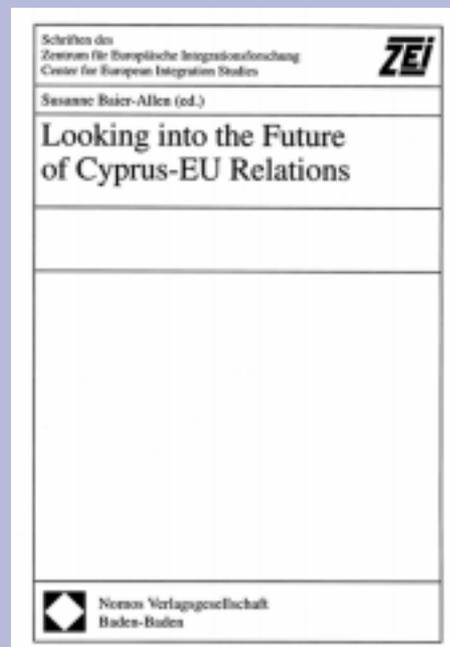
A list of all ZEI-Publications which have been published so far is available on the Internet under <http://www.zei.de>.

The Publications can be ordered free of charge. Please call +49-228-73-9218 (Series B) or +49-228-73-1880 (Series C) or contact us by E-Mail: zei@uni-bonn.de.

SERIES OF PUBLICATIONS (SCHRIFTENREIHE DES ZEI IM NOMOS-VERLAG)

In what way will the EU accession process impact on the Cyprus conflict? Will the prospect for EU membership be a catalyst towards finding a solution in one of the most long-standing and protracted conflicts in Europe? The authors in this book, both Greek, Cypriot, and Turkish Cypriot researchers as well as experts from Europe and the US, are addressing these questions taking into consideration the implications Cyprus's potential EU membership has on the security concerns and economic prosperity of the Cypriot people. The EU's decision to include Cyprus in the next enlargement has given fresh impetus for international mediation, yet the analyses of the options and perspectives for a settlement serve to highlight the diverging interests and the deep-seated mistrust of the parties to the conflict, which have so far stood in the way of successfully reuniting the island.

Volume 5: Susanne Baier-Allen (Ed.): Looking into the Future of Cyprus-EU Relations. NOMOS-Verlag, Baden-Baden, 1998, ISBN 3-7890-5620-0.



Further Publications recently published:

Volume 3: Ludger Kühnhardt: Zukunftsdenkler. Bewährte Entwürfe politischer Ordnung für das dritte Jahrtausend. NOMOS-Verlag, Baden-Baden, 1998, ISBN 3-7890-5618-9.

Volume 8: Peter Wittschorek (Hrsg.): AGENDA 2000 - Herausforderungen an die Europäische Union und an Deutschland. NOMOS-Verlag, Baden-Baden, 1999, ISBN 3-7890-5623-5.

Volume 9: Susanne Baier-Allen (Ed.): Synergie in Conflict Management. What can be learnt from recent experiences? NOMOS-Verlag, Baden-Baden, 1998, ISBN 3-7890-5623-3

The publications can be ordered from Nomos-Verlagsgesellschaft, Vertrieb, 76520 Baden-Baden, Fax: 07221/2104-27, E-Mail: NOMOS@nomos.de or from the book trade.

INSTITUTIONAL REFORMS

As well as these far-reaching plans for ongoing development of a common foreign and security policy - which has been on the agenda for many years, but will certainly not be able to be driven forward sufficiently during a single presidency -, the German presidency will provide the opportunity to discuss what improvements to the institutional structures of the European Union are necessary in order to create a more efficient, dynamic Union in the first years of the new century. The six-month rotating presidency gives all EU states a chance to present their European views within a federal partnership. At the same time, this puts a lot of organizational pressure on national government bu-

reaucracies, and not just in the case of the smaller member states, whose resources are often insufficient to cope with the impact of a presidency. That is why we need to consider a new system of presidency for the EU that is as efficient and workable as it is federal.

The Amsterdam Treaty of 1997 left the matter of the majority principle as the guiding principle of decision-making in the EU essentially unresolved. Decisions on this have been put back until the next Intergovernmental Conference (in about 2002?). Since the admission of new member states will then have moved closer, the question of the mechanisms and objectives of the rotating EU presidency will have to be looked at by then at the latest. It would be wise for Ger-

many, even at this early stage, to initiate discussions aimed at finding a balance between federal involvement by all member states and effective and successful continuance of EU general policy against the background of the forthcoming expansion of the circle of members.

RESULTS OF THE ZEI CONFERENCE

Germany's European policymakers will also be required, during and beyond Germany's six-month presidency, to balance their own, firmly held views with an appreciation of the priority tasks to be addressed, and will be called on to reconcile the conditions for safeguarding the operability of the EU with the requirements of a larger, strategic overall coherence. Maintaining continuity

in the established principles that have hitherto drawn cross-party support while continuing to expand Europe's horizons is therefore an essential part of Germany's European policy.

Against this background, the Center for European Integration Studies sees its contributions as a boost to the European debate in Germany and as a means of drawing together the different threads of European discussion. This became apparent at a ZEI specialist conference in January 1999 on the subject of "What condition is Europe in? What constitution for Europe?". Leading academics and political experts took up the invitation of the Center for European Integration Studies to discuss the intellectual, legal and political implications of the issue and reflect on the long-term outlook.

In the run-up to Germany's presidency of the EU, the ZEI provided an opportunity to look beyond the issues of the day and the laborious search for compromises on the issues currently under debate within the EU. The still distant goal of political union was brought back onto the centre stage again. Leo Tindemans, one of the great veterans of European politics and the former Christian Democrat President of Belgium, referred to the report from 1975 that bears his name to give a new impetus to his vision of political union. Franjo Komarica, the Roman Catholic Bishop of Banja Luka in Bosnia, outlined the moral and spiritual role that Europe will have to fulfil, even following the latest Balkan war, if it wants to adhere to the values and objectives it has set itself.

Leading German political representatives at regional, national and European level (Minister of State Günter Verheugen, SPD/Member of Parliament, Foreign Office; Jo Leinen, SPD/Member of the Europe Committee of the regional parliament of Saarland; Prof. Dr. Hans-Gert Pöttering, CDU/Member of the European Parliament, President of the Europa-Union Germany; Siegbert Alber, Solicitor General at the European Court of Justice) engaged in a lively debate, expertly chaired by Professor Matthias Herdogen of the University of Bonn, on the possibilities and limitations of a European constitution and the future demands on Germany's European policy. France's socialist Minister for Europe Pierre Moscovici rounded off the session with a call for a Europe-wide vision and restated the need for a European political Union.

Prof. Dr. Ludger Kühnhardt is Director at the Center for European Integration Studies and since October 1997 head of the Department „European Value Systems, Cultures and Languages“

The EMU Monitor

On ZEI's initiative a group of internationally renowned macro- and financial market economists from four different European countries have launched the EMU Monitor. Its purpose is to comment on the European Central Bank's (ECB) monetary policy.

by Bernd Hayo

On 1 January 1999, the European Central Bank (ECB) has assumed responsibility for monetary policy in the eleven member countries of the European Monetary Union (EMU). The ECB will face an extremely difficult task. It will have to establish its reputation as a central bank firmly committed to price stability without being irresponsibly fixated on an overly narrow interpretation of its mandate. Moreover, unlike national central banks, it will not have a natural political counterpart, since there is no European government, and it will find it harder to communicate with the general European public than a national central bank, as a European public opinion hardly exists today.

OBJECTIVES

In view of this situation a group of internationally renowned macro- and financial market economists have launched the EMU Monitor with the purpose of contributing to the quality of the European Central Bank's (ECB) monetary policy. Its purpose is to facilitate public accountability of the ECB by reviewing and commenting on its monetary policy, to contribute to an educated debate over monetary policy, and to guide monetary policy in the EMU by offering academic input. The EMU Monitor delivers its recommendations regularly in July and December at a press conference to the interested public.

MEMBERS

Currently, the group consists of Professors Patrick Artus (University of Paris I, France), Edward Bomhoff (Nijenrode University, Netherlands), Manfred J.M. Neumann (University of Bonn), Alessandro Penati (University of Milano, Italy) and Jürgen von Hagen (ZEI and University of Bonn). Since the creation of the EMU Monitor two other groups have been founded with similar aims,

one at the Centre for Economic Policy Research (CEPR) in London and the other at the Centre for European Policy Studies (CEPS) in Brussels.

RECOMMENDATIONS

The EMU Monitor has given its first press conference on 9 July 1998 at the Center for Financial Studies in Frankfurt. It recommends, for instance, a medium-term monetary strategy based on monetary targeting, which aims to keep inflation on average at a rate between 1% and 2%. Thus the group does not support the use of a direct inflation target. Important reasons for this choice are the problems connected with inflation forecasts and the lower informational input of monetary targets. Further, monetary targets are considered to be more transparent and more suited to build up reputation by the ECB during the early phase of EMU.

Since then, the ECB has decided upon a monetary strategy. The ECB strategy will primarily involve a monetary reference value, but it will also look at other economic and financial indicators when forming views about monetary policy actions. Clearly, the ECB has not taken up a strategy involving inflation targeting. The EMU Monitor considers the ECB strategy as very similar to monetary targeting, especially since the derivation of the reference value involves assumptions about trend growth rates of real GDP and the velocity of broad money, which are typically used to compute monetary targets.

At its second press conference on 17 December 1998 at the Frankfurter Presse-Club, the EMU Monitor has presented views on the economic outlook for the EMU area, monetary strategy, ECB accountability and the lender of last resort problem. In general, the EMU Monitor agrees with the ECB projections for the economic outlook of Euroland. Commenting on the co-ordinated cut in interest rates by the European central banks on December 3, the EMU Monitor thinks that this move was not based on economic grounds. It is rather seen as being motivated by the desire to reduce political pressure by the European governments on the ECB.

With respect to monetary strategy, the EMU Monitor believes that the reference value of 4.5% growth rate for harmonised broad money (M3H) is adequate. There is a risk that the trend rate of velocity becomes positive rather than negative, which would result in an expansion rate of M3H below 4.5% at given interest rates. In this case,

Prof. Dr. Jean Pisani-Ferry

Prof. Dr. Jean Pisani-Ferry is direct advisor of the French Minister of the Economy, Finance and Industry.



ZEI: What role does the Euro play in your opinion in the process of the European integration? Which further efforts have to be taken to make the Euro a successful project?

Pisani-Ferry: The Euro is both a powerful symbol of European integration and a very significant instrument for achieving price stability and growth in Europe. It will also enhance European integration, thereby fostering efficiency in the private sector, and, to an increasing extent, in the public sector also.

While the monetary constitution of the Euro zone has been laid down in great detail in the Maastricht treaty, more remains to do as regards economic and especially fiscal policy. The need for co-ordinating national economic policies is still a matter for debate among academics, but it is increasingly accepted among policymakers. No one really considers anymore that co-ordination would threaten the independence of the ECB. However, an efficient co-ordination requires appropriate procedures and institutions. Some rules are in place, and a new institution, the Euro-11, has recently been created, but my impression is that we are still in a learning process. In this context, there is a role for policy research in evaluating possible practical arrangements for organising co-ordination.

and as a general rule, the ECB should explain why tolerating this deviation is justified to avoid a misinterpretation of its policy course by the financial markets and the general public.

The institutional basis for accountability of the ECB is very weak and this cannot be resolved easily. To compensate that deficiency, the EMU Monitor suggests that the transparency of ECB monetary policy should be increased. Two practical proposals are that the Monetary Subcommittee of the European Parliament could invite the ECB President for regular, quarterly hearings, and that ECB Board members should talk to the public frequently.

Finally, regarding the function of lender of last resort in EMU, the EMU Monitor

points out that as long as financial institutions have collateral available, they can borrow funds at the penalty rate at their national central banks. If institutions do not have adequate collateral available, a workout should be arranged in the country where the respective bank is incorporated. However, during the time which is needed to arrange a workout, the central bank should keep credit lines to the troubled institution open, as a forced liquidation of a large bank might endanger the stability of the whole financial sector. ■

Dr. Bernd Hayo is Senior Fellow at the Center for European Integration Studies, Department "Economic and Social Issues"

ZEI: Unemployment is a major problem in Europe. Which actions should be taken in the individual member states to improve the situation on the labour market? What do you think of the idea of an 'employment pact' on the European level?

Pisani-Ferry: Unemployment in Europe is both cyclical and structural. To the extent that it contributes to a better policy mix, co-ordination can help reducing cyclical unemployment. Structural unemployment is more of the responsibility of national governments, private firms and unions, but there is a role for European initiatives: first, a common commitment towards reducing unemployment can help focussing energies on that goal; second, structural policies to reduce unemployment have a trial-and-error nature. Some measures are successful, and some other are not. Furthermore, the delay between the decision and the actual results is frequently very long, which leads to blur the assessment of the effectiveness of a particular measure. Confronting national experiences can help selecting the most efficient policies. This is after all a common practice in the private sector, under the name of benchmarking.

ZEI: The French-German Forum on Economic Policy was created to improve the understanding of French and German academics and senior policymakers about each other's thoughts about economic policy. Do you see any important differences between the French and German understanding of economic policy which could lead to problems between the two partners of the European Monetary Union?

Pisani-Ferry: I could speak at length on this topic, but let me give you three short answers instead:

- (i) there are obviously different economic policy cultures in Germany and France, but there is also increasing convergence. Just compare the situation today and ten or twenty years ago;
- (ii) we should not aim at eliminating differences, but rather at clarifying what are the reasons behind our disagreements. This was the intention Jürgen von Hagen and I had when we created the Forum;
- (iii) whatever differences we have, they are not such that they could represent a threat to EMU.

5th Political Dialogue in Maria Laach

In his introductory lecture at a ZEI colloquium in Maria Laach on the theme of "Germany and Europe - Positions, perceptions, prospects", the Tübingen-based political scientist and spokesman for the European Centre for Federalism Research, Professor Rudolf Hrbek, outlined the problems and challenges for the German presidency of the EU in the first half of 1999. Le Figaro's Germany correspondent, Jean-Paul Picaper, talked about the new phase in Franco-German relations following the change of government

in Bonn, and the role of this partnership in the process of European integration. Developments within Europe made the question of a European constitution ever more pressing, the journalist explained.

The Finnish ambassador, Arto Mansala, whose country will be taking over the presidency in the second half of 1999, described the launch of the euro as the single European currency as a "victory of optimism". It was now, he said, Germany's responsibility to ensure the continued success of the single currency, and to push through the vital decisions on "Agenda 2000". ■

A Spanish and German Outlook on Europe - Agenda 2010

The distinguished speakers at this top-calibre academic political symposium in Madrid in late autumn 1998 cast their minds beyond the issues of the day to take a long-term

look at the future of European development. The Instituto de Cuestiones Internacionales y Política Exterior (INCIPE), the editorial team of the prominent Spanish foreign af-



Josef Janning, Deputy Director of the Center for Applied Policy Research (CAP), Dr. Joachim Krause, Deputy Director of the German Society for Foreign Affairs (DGAP), the Spanish crown prince Felipe, Prof. Dr. Ludger Kühnhardt, Director at ZEI (from the left)
Foto: ZEI

fairs journal *Política Exterior*, the German Embassy in Madrid and the Center for European Integration Studies had jointly invited the speakers to Madrid for the symposium entitled "Agenda 2010: A Spanish and German Outlook on Europe". The discussions by leading academics, journalists and politicians from both countries focused on the conclusions and implications for both countries - and for future progress in the European Union as a whole - of moving beyond the issue of immediate interest, AGENDA 2000. There were lively contributions by the Spanish crown prince Felipe and input from EU commissioner Marcelino Oreja, the Prime Minister of Catalonia, Jordi Pujol, the Mayor of Berlin, Eberhard Diepgen (Madrid and Berlin are twinned), the Chairman of the Committee of the Regions of the European Union, Professor Manfred Dammeyer and others. The discussions made clear how essential it is to develop a common, coherent Mediterranean policy and to harmonise the strategic objective of eastern enlargement of the EU with the duty of solidarity within the European Union as it exists today. The findings of the workshop and essays by authors from both countries will be published in the ZEI's own series of papers. ■

Seminar on International Trade, Labor Markets, and Integration

ZEI, in cooperation with Tartu University, Esthonia, the University of Latvia, Vilnius University, and EuroFaculty, will host a week-long "Seminar on International Trade, Labor Markets, and Integration". The seminar is funded by an EU PHARE grant and will take place at Tartu University.

SEMINAR STRUCTURE

The five days of the seminar are split into two sessions. The morning sessions consist of two presentations from senior staff of top Western European academic institutions in the three principle seminar areas. Each afternoon session consists of four presentations by young economists - eight from Western Europe and 12 from the Baltic States. Senior Western European participants are, Jürgen von Hagen (ZEI, University of Bonn), Torben Andersen (Aarhus University), Seppo Honkapohja (University of Helsinki), and Guiseppe Bertola (European University, Florence, to be confirmed).

SEMINAR TIMETABLE

The seminar dates are 22-26 February 1999 (with travel scheduled on the 21st and 27th). Further information: http://www.zei.de/zei_english/f_veranstalt.html. ■

Lithuanian President Valdas Adamkus at ZEI

Lithuanian President Valdas Adamkus is calling for Lithuania to be included at the earliest opportunity in the group of countries which the European Union has invited to embark on direct, focused accession negotiations. The head of state, speaking at ZEI in Bonn, explained that Lithuania had made considerable progress in bringing about reforms and was on the right path. He reminded his audience that the EU had recognised the stability of Lithuania's democracy, the country's commitment to protect civil rights and minorities, the strengthening of the legal system and the economic reforms of the last three years in its "Progress Re-



Valdas Adamkus on 20 November 1998 at ZEI

port" published at the beginning of November 1998, which dealt with all 11 of the membership candidates. According to President Adamkus, the Commission's criticism that progress in Lithuania was not yet sufficiently firmly grounded was based on out-of-date figures. His country wanted to join the EU, with all the rights and obligations that would entail, as soon as possible, he said. To ensure the necessary preparations are successfully completed, the momentum of reform has to be maintained by granting the country the clear prospect of accession within a specified timeframe. The Lithuanian president praised the healthy state of relations between his country and Poland and the normality of relations with Russia, whose internal crises also give cause for concern in Lithuania. ■

Junior Fellows Programme at ZEI

A "Junior Fellows Programme" for graduates, designed with young academics in mind and leading to a doctorate in political science, has been in place at the ZEI since the end of 1997. There are currently 14 Junior Fellows on this programme who are ex-

ploring a range of European topics as part of their doctorate projects. Research work centres on issues surrounding accession to the EU, Europe's role in the world, the European institutions and their development, and the question of a European identity. The Junior Fellows usually meet every two weeks for a colloquium, in which they present their research projects and critically discuss the intermediate results of their studies. ■

Prof. Christian Koenig is to take charge of the department of "Political, legal and institutional issues" at the Center for European Integration Studies (ZEI) at the University of Bonn from 1 April 1999. The legal specialist has until now held the Chair in European, National and Administrative Law at the Philipps University in Marburg. His research and teaching centres on European and telecommunications law. In addition, he has argued the case for linking community law with national commercial law in numerous publications, research papers and seminars. Koenig's appointment means the last of the three head of department posts at the ZEI has now been filled. Koenig will bring a legal dimension to the work of the department, complementing the work of macroeconomist Jürgen von Hagen and political scientist Ludger Kühnhardt on the economic, political and cultural issues of European integration.

Dr. Aschot Manutscharjan joined ZEI's Senior Fellow Program at the start of the year to begin his research project which will involve an up-to-date, in-depth analysis of the conflict between Georgia and Abkhazia.

A study entitled "Frankreich und das vereinte Deutschland. Interessen und Perzeptionen im Spannungsfeld" by Dr. Valérie Guérin-Sendelbach is to be published shortly by Leske+Budrich of Opladen. Dr. Guérin-Sendelbach, who previously headed "Workplace France" at the German Society for Foreign Affairs, joined the ZEI on 1 January 1999 as a new member of the research group "Institutions and development of institutions in Europe".

Prof. Dr. Uwe Holtz will be based at the ZEI as a Senior Fellow from 1 April to 30 August 1999 while researching the subject of "50 years of European unity: the Council of Europe".

Dr. Stefan Comes, a member of the "EU accession strategies" research group at the ZEI since 1 January 1999, gave a paper on "EU Enlargement and the Reform of the Common Agricultural Policy" on 21 January at the conference entitled "German and Polish Interests in the Eastern Enlargement of the EU" in Warsaw. The paper will be published shortly.

Book presentation at ZEI

Creating a joint European identity remains a central problem of European policy, according to the chairman of the CDU/CSU parliamentary group, Dr. Wolfgang Schäuble, speaking at the presentation of the book "Kontinent Europa. Kern, Übergänge, Grenzen" by Ludger Kühnhardt and Hans-Gert Pöttering at the ZEI. The CDU chairman admitted that the problems discussed in the book do indeed still pose an obstacle on the path to a wider, and simultaneously more integrated union. The issues in question are connected with "Agenda 2000" and European enlargement, as well as implementation of the principle of



Dr. Wolfgang Schäuble on 2 December 1998 at ZEI

subsidiarity and democracy in the EU.

Ludger Kühnhardt und Hans-Gert Pöttering: *Kontinent Europa: Kern, Übergänge, Grenzen; Edition Interfrom (Texte + Thesen; 276), Osnabrück: Fromm, 1998, ISBN 3-7201-5276-6.*

Prof. Kenneth Kletzer (University of California, Santa Cruz) will stay at our center in May and June 1999. He will work on EU-related issues of international macroeconomics and will play an active role in ZEI's teaching activities on the post-graduate level.

Prof. Dr. Helmut Seitz (European-University Viadrina, Frankfurt/Oder and ZEW, Mannheim) will visit Prof. von Hagen's department (ZEI-b) from May through July 1999. His current research investigates the fiscal policy of subnational governments using the case of the German Laender.

ZEF - WINDOW

NEWS FROM THE CENTER FOR DEVELOPMENT RESEARCH (ZEF)

ZEF has launched a new research program on Information and Communications Technology (ICT) and the Poor. The research is focused on the scope for lowering barriers and costs of access through appropriate institutional and organizational arrangements to facilitate participation of the poor in ICT. The project includes planned field work with colleagues from India, China, Peru, Bangladesh and Southern Africa.

ZEF organizes a ZEF Research Seminar and the Bonn Dialogue on Development Policy. The weekly ZEF Research Seminar is meant to promote the interdisciplinary discussion with external experts. The Bonn Dialogue on Development Policy is a series of panel discussions which take place a few times a year. Representatives from national and international institutions and politicians present their thoughts and future visions on topics related to development policy. The presentations are open to public, and the programs can be found on the ZEF homepage <<http://www.ZEF.de>>.

Household water insecurity is a pressing problem in developing countries. Unsustainable water withdrawal is increasing due to population growth, industrialization, urbanization, and increasing agricultural production which leads to various problems like water scarcity and insufficient water supply, especially in developing countries. In the framework of a multidisciplinary approach to the analysis of water problems, Prof. Patrick Webb and Maria Iskandarani elaborate

in the ZEF discussion paper No.2 on water availability, access and usage, defining sectoral and cross-sectoral knowledge gaps. (P. Webb, M. Iskandarani: *Water Insecurity and the Poor: Issues and Research Needs*, ZEF Bonn, October 1998, pp. 66, ISSN: 1436-9931)

New research at ZEF emphasizes the importance of biotechnology for development. Martin Qaim and Prof. Joachim von Braun argue in the newly published ZEF discussion paper No. 3 that biotechnology can efficiently contribute to the achievement of development objectives. Policy-makers in developing countries and development organizations are challenged to select appropriate strategies for optimally harnessing the potentials of biotechnology for the poor. The paper presents a conceptual framework for ex-ante economic studies in developing countries. (M. Qaim, J. von Braun: *Crop Biotechnology in Developing Countries: A Conceptual Framework for Ex Ante Economic Analyses*, ZEF Bonn, November 1998, pp. 24, ISSN: 1436-9931)

The Center for Development Research closely cooperates with the Center for European Integration Studies (ZEI). The two centers together constitute the International Academic Forum (IWF) at the University of Bonn. ZEF is an international, interdisciplinary research institute that contributes to resolving global development problems. Further information: <http://www.zef.de>

The Consequences of Labour Market Flexibility

Can more flexible labour markets in Europe lead to less unemployment? A new ZEI study contributes to this debate

by Robert MacCulloch

When European leaders met in Copenhagen in June 1993 they were given a special presentation on the problem of unemployment in Europe by Jacques Delors, President of the EC. Delors explained that a lack of competitiveness with the United States and Japan was the basic cause of the rise in unemployment, and that a program of investment in infrastructure and high technology would be the cure.

His speech disappointed Paul Krugman, Professor of Economics at the Massachusetts Institute of Technology. Krugman's understanding was that economists who studied the European situation mostly shared "*more or less the same diagnosis of the European problem: the taxes and regulations imposed by Europe's elaborate welfare states have made employers reluctant to create new jobs, while the relatively generous level of unemployment benefits has made workers unwilling to accept the kinds of low-wage jobs that help keep unemployment relatively low in the United States.*"

Economists advising countries on these issues have been concerned, in particular, about the adverse effects of regulations relating to hiring and firing restrictions faced by firms. A number of countries have taken their view seriously. Great Britain and France are just two examples of countries that followed the economists' advice and reduced hiring and firing restrictions in the mid-1980's to combat high unemployment. This view of the labour market has also inspired large reform programs in the less developed world, where unemployment has recently increased. In fact, deregulation of the labor market is part of what the Washington Consensus often calls "second generation reforms". Labor flexibility is one of the main features of the IMF's recent agreement with Argentina, where unemployment reached an alarming 18.6% after the first 5 years of pro-market reforms.

Since unemployment brings real misery to people's lives, and job security provisions often involve delicate redistribution issues between richer firm owners and poorer work-

ers, the economists' advice is potentially politically explosive. One would think that economists giving such advice know what they are doing. More precisely, one would think that there are hundreds of papers studying whether more flexibility in fact does reduce a country's unemployment rate in practice. Sadly, this is not the case. To our knowledge, there is one panel study on the effects of labor market flexibility, and only a couple of cross-country studies, like that in the OECD Jobs Study (1994) based on 21 observations. Two leading U.K. economists, Gregg and Manning, review some of the available evidence on the effects of labor market flexibility and argue that it is "*much less persuasive than is commonly believed*", and that the profession's "*faith in the merits of labor market de-regulation is misplaced*".

RECENT RESEARCH ON FLEXIBILITY AT ZEI

In the paper, "The Consequences of Labour Market Flexibility: Panel Evidence Based on Survey Data", joint with Rafael Di Tella of Harvard University, we make an empirical contribution to this debate. We introduce a new panel data set on labor market flexibility from the *World Competitiveness Report*, which is based on surveys of business people in 21 OECD countries during 1984-90, so the indices we use are subjective in nature. One of the virtues of the data are that it originates from people who have to make their living out of roughly understanding how stringent job security provisions actually are in their countries.

The use of a subjective index allows respondents to capture movements in very different kinds of regulations that affect the flexibility of labor markets. These may include regulations on an employer's freedom to dismiss workers (which depends on severance payments, requirements of advance notice and authorisation by third parties - such as a trade union - as well as provisions for appeal against unfair dismissal), the enforcement of these rules, interpretation of what constitutes legal cause for termination, limits on the use (or the legal validity) of fixed-term contracts, limits on the use of temporary work agencies, limits on employer's use of part-time work, and so on. These regulations imply very different costs to normal business operations and would be extremely difficult to document with hard data.

There are, of course, limitations to the subjective data that we use. The index is

ZEI-CALENDAR

FEBRUARY 1999

23. ZEI European Dialogue (12:30 h): Joshua Holmes, Oxford University: „The Law and Politics of Media and Telecommunications Regulation in the European Union“.

MARCH 1999

2. ZEI European Dialogue (12:30 h): Dr. Burkhard Auffermann, University Tampere, Finland: „Finnland in der EU. Vom Rande Europas zur EU-Präsidentschaft.“
4. International Conference „The Future of Euro-Atlantic Relations.“
12. Workshop „Constituting the European Union.“
15. ZEI European Forum (17:00 h): Dr. Ioannis Kasoulides, Minister for Foreign Affairs, Cyprus: „Cyprus on the Way to the EU Accession“.
23. ZEI European Dialogue (12.30 Uhr): Lecture by John E. Reilly, President of The Chicago Council on Foreign Relations (in cooperation with the German Society for Foreign Affairs (DGAP))
30. ZEI European Dialogue (12:30 h): Arne Clemens Seifert, Ambassador (retired): „Innengesellschaftliche Konflikte und Systemtransformation - Das Beispiel Tadschikistan.“

APRIL 1999

- 8./9. Study Group „Weimarer Dreieck“ (in Paris)
29. ZEI European Forum (17:00 h): Lecture by Wolfgang Clement, Leader of North Rhine-Westphalia

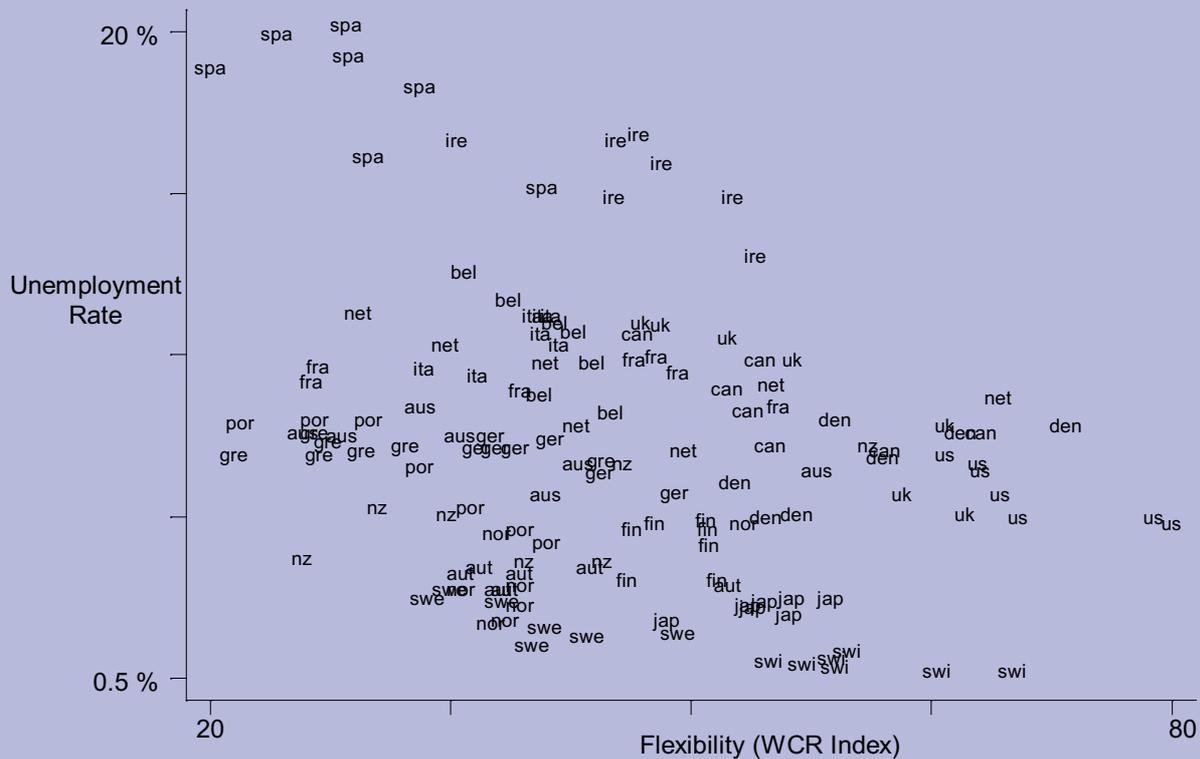
MAY 1999

10. ZEI European Forum (17:00 h): Lecture by Daniel Tarschys, Secretary - General of the Council of Europe

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more vague than what an economist would ideally like to use. By its nature, our flexibility index does not allow us to distinguish between the effect of the different regulations that are active. However, we believe the relevance of the subject matter and the

The Pooled Relationship Between Unemployment and Flexibility



Country codes: Australia (aus), Austria (aut), Belgium (bel), Canada (can), Denmark (den), Finland (fin), France (fra), Germany (ger), Greece (gre), Ireland (ire), Italy (ita), Japan (jap), Netherlands (net), New Zealand (nz), Norway (nor), Portugal (por), Spain (spa), Sweden (swe), United Kingdom (uk), United States (us).

evidence available to the profession to be so out of balance that a willingness to experiment with survey data is justified. We then present an empirical analysis of the effect of flexibility on a number of labor market variables.

WHAT DOES THE EVIDENCE TELL US?

We find that countries with more flexible labor markets have higher employment rates and higher rates of participation in the labor force. We also find some evidence of a positive effect of flexibility on the number of hours worked per week. The estimated employment effects seem to be large. A conservative estimate is as follows: if Germany were to increase the flexibility of its labor markets to US levels, the employment rate would increase by 1.7 percentage points, almost 24% of the actual difference in employment rates between the two countries. In terms of income, this employment gain could bring about a 2.7% increase in German GDP per capita. Of course, this says nothing about the convenience of such a reform. For that we would need information on the benefits (in terms of employment security, wages and so on) of flexibility, a fact sometimes forgotten in policy debates.

The paper only finds some evidence that countries with more flexible labor markets have lower unemployment rates and a lower proportion of long term unemployed. The Figure above shows the relationship in the

pooled data set between unemployment (on the vertical axis) and flexibility (on the horizontal axis), in which there appears to be some indication of a negative relationship.

We also find evidence suggesting that recessions are associated with higher inflow rates into unemployment in more flexible labor markets (this is as close as we can get with the data available to testing the hypothesis that regulation interferes with job destruction). Lastly, we explore some alternative hypotheses related to flexibility that have been suggested in the literature. First, we examine the jobless recovery hypothesis and find evidence which suggests that GDP growth is associated with smaller reductions in unemployment in countries with very inflexible labor markets. We also find that unemployment is more persistent in countries with more inflexible labor markets.

FUTURE WORK

To further our understanding of the issues surrounding labour market flexibility, ZEI is about to embark on a Workshop program jointly with the new Institute "Zukunft der Arbeit", to bring together a group of prominent researchers in this field who will present and debate their latest findings. There are many unresolved issues in theory, evidence and policy which need to be addressed. Theory problems include better definitions of the word "flexibility", which has been used not only to refer to the size

of hiring and firing costs, but also to regulations on qualification, regulations concerning the work place, quotas for women and handicapped persons, and so forth. Significantly more econometric evidence is needed on the labour market effects of flexibility. Policy questions include the appropriateness of increased flexibility as a means of reducing European unemployment. Should European labour markets be subject to greater deregulation?

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IMPRESSUM

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