

Newsletter issue 14 – June 2008

The 14th issue of 'Economics Research' contains articles on the effect of tax policies on labour market participation, the effects from the introduction of the Euro on productivity of European economies, the possible impact of the introduction of the Euro on the cost of living in Cyprus, and the relationship between tourism development and economic growth.

The effect of two alternative tax policies on labour market participation rates was investigated. In particular, the extent to which a generous tax-free labour income can be more effective for raising employment than in-work benefits was studied. For this, Cyprus data were used to estimate the labour market participation decisions of individuals and a tax-benefit model to simulate two revenue equivalent tax regimes: a system with in-work tax credits and low tax-free income; and a system without in-work tax credits but a high tax-free income. Results show that a high tax-free income from employment performs better at encouraging labour market participation.

The ERC investigates the effects from the introduction of the Euro on productivity of various economic sectors, both for countries that have adopted the Euro and for European countries that have chosen to keep their own currency. Using advanced econometric techniques, the analysis looks at the difference between the average costs of each country member of the Euro zone with the weighted average cost of the countries that do not belong to the Euro zone. The results obtained so far show that the levels of the average cost of Euro zone countries are larger than that of non- Euro zone countries. Nevertheless, the introduction of the Euro reduced this difference and also increased the productivity of Euro zone countries.

The introduction of the Euro in Cyprus in 2008 prompted a heated debate concerning the possible effects of the new currency on the cost of living. The first results of an econometric investigation suggest that inflation was not affected by the currency change. However, this concerns only the general price index and it is possible that there were distributional effects of the Euro through changes in prices on subgroups of goods and services (e.g. food and other necessities); The latter issue is still under investigation.

An analysis of tourism development and economic growth in 167 countries over the period 1980-2005 shows that specialization in tourism can produce substantial benefits to countries endowed with tourist attractions and few other resources. The contribution of tourism, however, diminishes as the economy grows and becomes negligible once a critical level of economic development is reached. Countries that specialise in tourism need to diversify into other areas in order to maintain reasonable rates of economic growth.