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STRATEGIC INTER-REGIONAL TRANSFERS

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Abstract

In this paper we derive the equilibrium level of redistribution from one mobile factor (say, the rich or capital) to another possibly mobile factor (say, the poor or labour) when regions choose both their inter-regional transfers and redistributive policies non-cooperatively. We find that inter-regional transfers are always desirable (to mitigate the fiscal competition), but cannot be sustained (as a Nash equilibrium) when chosen simultaneously with the redistributive policy. On the other hand if regions can precommit to inter-regional transfers before setting their redistributive policy, the strategic effect of inter-regional transfers makes them sustainable. However there are also equilibria with partial or no inter-regional transfers at all. The effects of regional asymmetries are analyzed. Interestingly enough, evidence suggests that predictions of our model accord very closely with the pattern of transfers in the EU across member states.

Keywords: inter-regional transfers, mobility externality, redistribution.

JEL Classification: C72, D62, H77, R50.

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