



# Research active

The opening of LSE's new Research Lab in July marked a new era for four of the School's main research centres: the Centre for Analysis of Social Exclusion (CASE), the Centre for Economic Performance (CEP), the Financial Markets Group (FMG) and the Suntory and Toyota International Centres for Economics and Related Disciplines (STICERD).

**Richard Layard** talks to **Judith Higin** about the Lab, its work and its ambitions.

**JH:** So what is the aim of this new Research Lab?

**RL:** To put it simply, you have a situation where LSE is the leading European centre of thought on economic and social questions but the world centre is Boston. In the next phase, LSE has to challenge Boston and having this Lab, with this extraordinary conglomeration of talent, provides us with a wonderful chance to do that.

We have here a critical mass of extremely able people, working on inter-related questions and therefore stimulating each other and, of course, challenging any nonsense that any one of us individually might produce. We have here a wonderful framework for maintaining a data library, and a framework for interacting with the outside world in a way which is quite difficult for an individual scholar to do – with proper support and encouragement, not to mention prodding. With the Lab, we have a situation where people will contribute to the public debate in the media and, as a result of that, to government policy in a way which typically doesn't happen unless you have this kind of structure. Finally, we have here an excellent framework for training PhD students in an apprenticeship system with leading figures in their field, and the result of this is that we can draw in to LSE some of the most talented young people from all over the world.

**JH:** Is the Lab idea effective in practice, is it an environment which can challenge Boston?

**RL:** The basic way the Lab works is through seminars. Nobody publishes research which hasn't been argued out with their colleagues and really challenged. In the Lab there are probably two seminars a day in various research areas. This is also the way it is done in Boston. But Boston has the National Bureau of Economic Research, sitting between Harvard and MIT. The power of that congregation of people and their

interaction has led to a sort of intellectual dominance, which has not been altogether healthy in respect of Europe, in that much of our public debate gets based on evidence relating to American society, which is not the same as European society. That is why it is very important that we have our own research and that also, in the role of ideas and methods, we at LSE are leading the pack.

**JH:** What ground-breaking work have the centres achieved so far?

**RL:** In many areas people in the Lab have changed the way people think – and that, of course, is what social science is about. For example, in the early 1980s, a lot of people thought that high unemployment had come to stay, that we were moving towards 'the end of work', due to the increase in productivity, and that there was a limit to the amount of work to be done. To settle this there

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had to be a coherent model of how unemployment was determined. Partly at the request of the Treasury, Stephen Nickell and I produced a model which has now become the standard in Britain

and most of Europe for thinking about how unemployment is determined. Whatever the supply of labour, you can have high or low unemployment according to whether our social institutions are effective or not. We found that the two most important factors were how unemployed people are treated and how wages are determined. The main factor explaining why European unemployment is higher than American unemployment is how unemployed people were treated.

We then developed policies for getting unemployed people back to work by using the money spent on benefits on helping them find work, helping them to be more employable and ensuring they were active rather than passive after some period of time. These ideas were partly derived from the Swedish example and were taken up by a number of European governments, including the British government, and in these countries unemployment has been halved without an increase in inflation.

One part of this policy in Britain has been the New Deal, something devised before the 1997 election by the New Labour team and ourselves in the CEP, which I helped to implement as a part-time consultant after the election. CEP was also heavily involved in other aspects of Welfare to Work which centred around making work pay. Paul Gregg had discovered that Britain had more workless families than almost any other European country because of the workings of the benefit system. His work helped stimulate the introduction of the Working Families Tax Credit, with Paul a part-time member of the Treasury team that helped devise it. At the same time David Metcalf was a member of the Low Pay Commission which recommended on the level of the minimum wage.

Another big policy area where centres in the Lab have contributed is in producing six members of the UK's Monetary Policy Committee, namely Mervyn King, founder of the FMG, Charles Goodhart, Willem Buiter, Sushil Wadhwani and most recently Stephen ▶



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Nickell and Charles Bean [now chief economist of the Bank of England]. In addition, a former director of STICERD, Nick Stern, became chief economist at first the European Bank of Reconstruction and Development, and now the World Bank.

There are also very important social areas where the Lab has made a significant contribution to public policy, for example Anne Power in CASE has contributed to a fundamental rethink about the role of the public sector in housing, the development of alternative forms of social housing and the day to day practice of managing housing in poor areas. John Hills has played a central role in marshalling evidence on income distribution for the influential Rowntree Commission and in rethinking pensions policy and housing finance. In health and other areas, Julian Le Grand and Howard Glennerster have led the theoretical and evaluative work on using market incentives to transform public sector provision.

Having talked about the role of Research Lab members in contributing to policymaking near the coal face, I must add though that the fundamental role of staff here is to stand back, to try and see the currents that are determining what is happening, which other people have failed to notice. The Lab involves key researchers in economic theory and econometrics with the study of applied problems in macroeconomics, finance and public policy.

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**JH:** *What do you think are the big economic problems facing us today?*

**RL:** I believe there are three big economic questions for modern society. The first is social exclusion, where perhaps the two biggest problems relate to people without skill and people in old age. Modern technology is constantly reducing the demand for low skill labour and the huge challenge is how to raise people with lower levels of intellectual ability to a skill level for which there is a demand in a modern economy. If we can't do this, we shall have an underclass, which will be horrible for the people in it but also very unpleasant for the rest of society. Similarly the problems of old age are going to become much more severe. The number of elderly has risen relative to the population of normal working age and though of course the working age can be extended, there are huge challenges to the financial viability of existing pension arrangements which this Research Lab plans to address.

The second huge change is globalisation and, closely related to that, the Information Communication Technology (ICT) revolution. Obviously the integration of the world economy has brought huge gains, in terms of trade and foreign investment but not for everyone. The issue is to understand how the process is affecting different groups and then to think about policies which secure the huge benefits while

protecting against the losses. The work which STICERD's director Tim Besley is doing on evidence-based policy in developing countries is highly relevant, while the work of Tony Venables on the whole process of integration enables us to interpret the context in which these gains and losses occur. Now we also have the internet superimposed on what has already happened, and Richard Freeman is studying how that is transforming the working of markets and looking in particular at whether it supports further 'winner take all' forces in society or whether it acts in favour of the little man.

The third big issue facing the world is the integration of the financial markets and, again based on the ICT revolution, the extraordinary liquidity of these markets and the possibility of capital flight at the drop of a hat. The world has been through three major financial crises in the last seven years – and may be on the edge of another one. It is the role of intellectuals to step back from the day-to-day operation of the market to understand the forces at work and what kind of solutions are sustainable in the long term, and Hyun Shin and Charles Goodhart are doing that.

**JH:** *What is your view on the anti-capitalist protests in Seattle and other world cities?*

**RL:** One worries tremendously about ill-informed opposition to what is, after all, one of the prime forces behind poverty relief in the world. But one also worries that academics have not put out well-argued analyses, which the public can understand, of what the benefits are of the process and also what the costs are and how these can be assuaged. This is the kind of role the Lab is well-equipped to play. There are a limited number of economists that work in this area, and two of the leading ones, Paul Krugman and Tony Venables, have been working here together on the question of what determines which areas benefit from the process of integration and which don't. So we are very well-placed to participate in this debate – indeed it is our job to do so.

**JH:** *Are younger economists coming through and contributing to this debate?*

**RL:** I think there is a crisis in economics in Britain and this arises because of the extraordinary opportunities offered by the



## LSE Research Lab

- Officially opened in July 2001 with a two-day series of seminars, and guest speeches by Gus O'Donnell, head of the Government Economic Service and Nick Stern, chief economist and senior vice president of the World Bank

- More than 260 staff – one of the largest concentrations of economic, financial and social researchers anywhere in the world

- Premises largely financed by a £6.6 million grant through the Economic and Social Research Council with money from the government and Wellcome Trust's Joint Infrastructure Fund

- Comprises four centres, CASE, CEP, FMG and STICERD, which between them attract current funding of £4 million a year

- The Lab plans to hold around 18 conferences and 15 seminar series a year, publishing material in a variety of papers and special reports

For more information, see <http://rlab.lse.ac.uk>, or email: [rlab@lse.ac.uk](mailto:rlab@lse.ac.uk) or tel: +44 (0)20 7955 7596

City to people who might otherwise become academics. People completing their PhDs typically start on a higher income than the highest paid LSE professor so the incentive to be an academic is not strong. We have a profession that is not reproducing itself and the government has to do something to change this system of rewards. In fact, one colleague Steve Machin was co-author of a report for the Bank of England and the Royal Economic Society on the shortage of British PhDs and the reasons for it.

However, where the Lab is extraordinarily successful is in training European PhDs. In the last 20 years the School's Department of Economics has recruited only two British lecturers: most have been from other European countries. As a totally international university, this is fine for LSE, but again, from the point of view of the country, it is a disaster not to be producing its own stock of economics PhD graduates.

Another problem is that the government put up a large capital sum for the construction of the Research Lab, but there is no guarantee of recurrent funding for what goes on inside it. We have to try and attract money from private individuals and companies who can see the importance of what we are doing for the lives of ordinary people and the prosperity of the corporate sector. But, given adequate financial support, I do really believe that we can reach a higher level of work and contribution to public debate than LSE has ever achieved before.

**JH:** *What next for the Research Lab and for you?*

**RL:** Well, colleagues are working towards major conferences and research papers in 2002 on dollarisation and euroisation, on technology and skills, on spatial inequality and development, and neighbourhood regional policy. FMG and

STICERD have received funding from UBS Asset Management to launch a programme on social and financial aspects of pension provision, which should become the focus of UK work in the area. STICERD are developing a programme on policy reform, building on their work studying the interaction of political and economic forces which shape policy.

My next project is a book on happiness, which does involve rather a large range of subjects. The puzzle is that, as Westerners have become richer, they haven't on average become happier. It is the greatest challenge to economists and to social scientists as a whole. If we think the aim of social science is to produce social progress, and social progress consists of greater average happiness and less inequality, then we should be extremely worried if we don't see social progress.

**JH:** *And can the Research Lab social scientists successfully challenge Boston?*

**RL:** When Richard Freeman of Harvard became co-director of CEP last year he set us the objective to become the best in the world. There is no reason why that should not be achieved by the Lab as a whole. We have a lot going for us. We are already the leaders in Europe. The position of London and the English language gives us an even greater opportunity to draw on the world's talent, and especially on the talent of 900 million Europeans. Given that we are probably more international in outlook and interests than most US institutions, then yes, I think we have the capability to be not just as good as America but better. ■

### Richard Layard

is co-director of CEP, Emeritus Professor of Economics at LSE and a Labour peer. He is also a part-time consultant to the Department for Education and Skills.



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