BREXIT Lunchtime Lectures

Labour markets, welfare and the portability of rights

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#LSEBrexit
Labour markets, welfare and the portability of rights

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http://econ.lse.ac.uk/staff/nb

Brexit Lunchtime Lecture
LSE, 1 March 2017
Labour markets, welfare and the portability of rights

1. The backdrop
2. Get the analysis right
3. The welfare state matters
4. Human capital matters
5. Mobility matters
6. Portability matters
7. Concluding thoughts
1 The backdrop
More international trade

World trade 1960-2015, % GDP


Nicholas Barr  March 2017
The EU is the UK’s largest trading partner

Exports to other countries, 2014

Nicholas Barr  March 2017
More international mobility (10,000s)


Nicholas Barr  March 2017
2 Get the analysis right

- Logical fallacy: Inappropriate comparison of steady states
- Empirical fallacy 1: Turning back the tide of history
- Empirical fallacy 2: Free trade is compatible with ‘Take back control’
- Misdiagnosis 1: Globalisation is not the problem
- Misdiagnosis 2: Immigration is not the problem
3 The welfare state matters

• In a civilised society – access to adequate nutrition, access to adequate health care

• Prompts the question: why do we have a welfare state?
  • Well-known: to relieve poverty
  • Less well-known: to do things that private markets would either not do at all, or would do inefficiently
3.1 Second-best economics

• The simple economic model (well-informed consumer, rational behaviour, etc.) is a useful benchmark but a bad basis for policy design

• What is needed is second-best analysis
Analysis should be framed in a second-best context

• Imperfect information (the economics of information, Nobel Prize 2001)
• Non-rational behaviour (behavioural economics, Nobel Prize 2002)
• Incomplete markets, incomplete contracts (Nobel Prize 2016; also cited in 2010 Nobel Prize)
• Distortionary taxation (which is necessary to finance redistribution; addressed in the literature on optimal taxation, Nobel Prize 1996)
How does this apply to the welfare state?

• Unemployment insurance

• Medical insurance (experiment called USA; ‘The problems of US medical finance are entirely explicable in terms of economic theory. Discuss’)

• Pensions: imperfect information; non-rational behaviour (how many of you are voluntarily saving for your old age?)
3.2 The welfare state as a device for optimal risk sharking

- Too little risk is sub-optimal (Communism)
- But so is too much risk; if there is no safety net people will be less prepared to start a new business
The world faces major uncertainties

• Important distinction: risk or uncertainty
• Pre-existing
  • Economic (another economic crisis?)
  • Political (instability in the Middle East)
  • Environmental (climate change)
  • Social (population ageing)
  • Technical (nuclear safety)
• Then add
  • Uncertainties connected with Brexit
  • Uncertainties regarding the new US administration
• These uncertainties reinforce the importance of the welfare state
4 Human capital matters

• Demographic change: if there are fewer workers, a rational response is to make each worker more productive. Doing so involves increased investment in physical and human capital, i.e. a more highly-educated and highly-trained workforce

• Skill-biased technical change is driving up the demand for skills
The future is bleak for those with medium skills

Source: OECD


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The two drivers point in the same direction

- More education and training, i.e. more people with higher skills
- More frequent education and training, since skills go out of date more quickly than in the past
- More diverse education and training (when I did my MSc at LSE, there were 19 MSc degrees; today there are over 100)
5 Mobility matters

- **Occupational mobility**
  - Expand tertiary education and training, perhaps in part by extending the student loan system
  - Quality assurance at a national level
  - Bologna-type process for vocational training to facilitate international mobility
  - Important motivation: give relevant skills to people left behind by technical change, i.e. not just economic

- **Geographical mobility within and across countries**
  - An element in human rights
  - For efficiency in modern labour market
  - To foster human capital
Mobility matters (2)

Labour mobility

- Promotes competitiveness by better matching the diverse skills and interests of workers with the diverse requirements of jobs
- Helps to bring real income in poorer countries closer to that in the richer ones, with benefits for both

Student mobility

- Contributes to labour mobility: study outside a person’s home country increases cultural and language skills, assisting later job mobility and improving the fit between mobile workers and jobs
- Improves the quality of higher education by increasing competition between universities
Portability matters

• The structure of benefits can harm mobility
• Particularly true of pensions
• National systems differ, inter alia, in terms of
  • Contributory (UK, USA) or not (Netherlands, New Zealand)
  • Number of years of contributions
  • Pensions formula
  • Vesting period
  • The role of private pensions

• Thus workers who move across countries may end up with little pension
A useful distinction

• Portability or preservation?
• Current rules: by May 2018
  • Full preservation of rights in state pension schemes
  • Maximum vesting period 3 years in private schemes
• But difficult problems remain
  • How ensure that a worker’s dormant pension rights are treated in line with rights of active members
  • Differences in earliest pension age
  • Different life expectancies in different countries (relevant to annuity pricing)
7 Concluding thoughts
Britain’s economic prospects

• Lord (John) Kerr (author of Article 50) House of Lords debate 21 February 2017, said that leaving the EU will mean that:
  • Britain’s economic relationship with Europe will be less advantageous than it is now;
  • Its relationships with the rest of the world will be more difficult economically;
  • That trade halves as distance doubles; and
  • That customs controls cause delays that damage modern global supply chains.
Factors exerting adverse pressures

- Lower trade
  - Economic: partly because of the initial reduction in free-trade, partly because of increased uncertainty
  - Political: risky to assume that the main driver for the EU27 is economic gain
  - Result: lower growth

- Exchange rate depreciation. Result: lower living standards

- Early evidence: third consecutive month drop in retail sales; rising inflation
Strategic policy response: policies that assist resilience

- Strengthen capacity of welfare state to share risk
  - Economic advantages
  - Political advantages
- More, better and more widespread human capital to help occupational and geographical mobility
- Pursue multilateral and bilateral agreements, with particular emphasis on good rules for preservation (which is often easier than portability)
Portability and preservation: How much differences does Brexit make?

• Can argue that much of the problem remains unsolved within the EU, hence the problem is not much greater when outside the EU

• Bilateral arrangements cover many countries

• A countervailing argument is that UK pensioners are more vulnerable to changes in UK government policy. However, that is already the case
The political economy of reform

• Enough people feeling that they are being left out economically (structural change plus austerity) or politically opens up space for populism

• The most important way to address populist pressures is to address the underlying problem
References

Nicholas Barr (2012), *The Economics of the Welfare State*, 5th edition, OUP

Nicholas Barr, ‘Letter to friends: this is why I will vote Remain in the referendum’, LSE BrexitVote, May 2016,
http://blogs.lse.ac.uk/brexitvote/2016/05/27/dear-friends-this-is-why-i-will-vote-remain-in-the-referendum/

Nicholas Barr, ‘Letter to friends (2): why Britain voted to leave, and what to do about it’, LSE BrexitVote, 22 July 2016,
Migration, mobility and the portability of skills

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Three key points

- Migration versus mobility
  - Freedom of movement, migration and ‘stickiness’
  - Needs-driven versus opportunity-led migrations
  - Mobility, allocation and market integration

- The costs and gains of mobility
  - Traditional costs and gains – in the labour market and beyond
  - The issue of skills: matching, skills acquisition and skills (re)deployment

- Portability of skills / portability of qualifications
  - Policy harmonisation, race to bottom and post-Brexit divergence
1. Migration versus mobility
# Migration vs mobility

## Migration as life-choice decision

<table>
<thead>
<tr>
<th>Factor</th>
<th>Push factors</th>
<th>Pull factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic and demographic</td>
<td>Poverty, Unemployment, Low wages, High fertility rates, Lack of basic health and education</td>
<td>Prospects of higher wages, Potential for improved standard of living, Personal or professional development</td>
</tr>
<tr>
<td>Political</td>
<td>Conflict, Insecurity, violence, Poor governance, Corruption, Human rights abuses</td>
<td>Safety and security, Political freedom</td>
</tr>
<tr>
<td>Social and cultural</td>
<td>Discrimination based on ethnicity, gender, religion, and the like</td>
<td>Family reunification, Ethnic (diaspora migration) homeland, Freedom from discrimination</td>
</tr>
</tbody>
</table>

Source: World Bank staff.

## Migration as a labour market / utility maximisation decision

\[
U_t = \ln(w_d)_t + \gamma \ln(e_d)_t - \ln(w_h)_t - \eta \ln(e_h)_t - z_t
\]

Labour market integration (equalisation, adjustment)

Within the EU: ‘freedom’, ‘demos’, convergence of models (‘yardstick’)
### Migration vs mobility

Factors Influencing the Decision to Move (2007 Data):
Striking Differences Between EU-15 and New Member States

<table>
<thead>
<tr>
<th>Reasons for Past Move</th>
<th>EU15</th>
<th>NMS12</th>
<th>EU27</th>
</tr>
</thead>
<tbody>
<tr>
<td>Job-Related</td>
<td>40.5</td>
<td>58.6</td>
<td>42.3</td>
</tr>
<tr>
<td>Education-Related</td>
<td>14.7</td>
<td>12.2</td>
<td>14.5</td>
</tr>
<tr>
<td>Family-Related</td>
<td>32.2</td>
<td>16.6</td>
<td>30.6</td>
</tr>
<tr>
<td>Other</td>
<td>12.6</td>
<td>12.6</td>
<td>12.6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Factors Encouraging Future Move</th>
<th>EU15</th>
<th>NMS12</th>
<th>EU27</th>
</tr>
</thead>
<tbody>
<tr>
<td>Work and Income</td>
<td>47.9</td>
<td>84.7</td>
<td>58.7</td>
</tr>
<tr>
<td>Social Network</td>
<td>52.8</td>
<td>37.3</td>
<td>48.3</td>
</tr>
<tr>
<td>Housing and Local Environment</td>
<td>71.2</td>
<td>57.0</td>
<td>67.1</td>
</tr>
<tr>
<td>Public Facilities</td>
<td>17.2</td>
<td>18.2</td>
<td>17.5</td>
</tr>
</tbody>
</table>

Percentage of respondents mentioning a certain factor. Regarding the reasons of the last move, job-related reasons comprise "found a new job", "did not have a job but looked for a new one", "were transferred by employer"; education-related reasons comprise "went to study, train, or learn a new language abroad"; family-related reasons comprise "accompanying partner or family", "went to be with family already living in new country" and "change in relationship/marital status." Regarding factors encouraging future mobility, work and income related factors comprise "to have a higher household income", "to have better working conditions", "to have shorter commuting time"; social network related factors comprise "to be closer to family and friends", "to meet new people" and "receive better support from family and friends"; environment related factors comprise "better local environment and amenities", "better housing conditions", "discover a new environment" and "better weather"; public facilities related factors comprise "better health care", "access to better schools", "better public transport". Respondents are allowed more than one answer.

Migration flows in the UK - as an example -

Chart provided by www.migrationobservatory.ox.ac.uk

Source: ONS for LTIM and OECD for GPD growth and unemployment
Short-term migration, EU nationals (non-UK), all reasons

![Graph showing short-term migration trends for EU nationals (non-UK), all reasons](image-url)
Short-term migration, EU nationals (non-UK), for employment

Corr = -65%

Corr = 34%
Long-term work-related EU migration to the UK has more than doubled between 2012 and 2016.
Increase almost entirely attributable to EU15 nationals (the ‘Greeks’ and the ‘Spaniards’) ➔ Labour mobility (cyclical differences)
In fact, inflows of EU10 nationals (the ‘Polish plumbers’) remained constant → Labour migration (secular differences)
2. Costs and gains of mobility
# Costs & gains of mobility

<table>
<thead>
<tr>
<th>Sending</th>
<th>Emigrants</th>
<th>Costs</th>
<th>Gains</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Lost family ties/help</td>
<td>Remittances</td>
<td></td>
</tr>
<tr>
<td>Locals</td>
<td>Depopulation, fall in demand; weaker local services</td>
<td>Less job competition, less ‘bumping-down’</td>
<td></td>
</tr>
<tr>
<td>Economy</td>
<td>Brain-drain, productivity loss, less investment; Dutch disease via remittances</td>
<td>Repatriation of entrepreneurship, lower unemployment pressures (SR)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Receiving</th>
<th>Immigrants</th>
<th>Costs</th>
<th>Gains</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Poor empl and living standards? Illegality?</td>
<td>Higher wages and employment rates</td>
<td></td>
</tr>
<tr>
<td>Locals</td>
<td>Substitutability: lower wages, less employment</td>
<td>Complementarity: higher demand and supply</td>
<td></td>
</tr>
<tr>
<td>Economy</td>
<td>Local unemployment (?), direct/SR pressures on services, ‘social costs’, more ‘leakages’, Rybczynski specialisations</td>
<td>Cheaper labour / less inflationary pressures, demand expansion, higher tax revenues</td>
<td></td>
</tr>
</tbody>
</table>
Costs & gains of mobility

Labour migration (secular differences)

Labour mobility (cyclical differences)

Demand shifts (complementarity, profits) can (over)mitigate effects

L^S_1 \rightarrow L^S_2:
- Wage compression (w_0 \rightarrow w_1)
- Less employment for locals (A \rightarrow D)
- Unemployment (if CB drawn from 0D)
  (NOTE: if w adjusts more, less U but more L-loss; if L^S less elastic, then L-loss lower but w-loss larger)

L^D_1 \rightarrow L^D_2:
- With partial w-adjustment, employment expands (A \rightarrow B) but with excess demand equal to BD (‘skill shortages’/‘underpay’)
- External supply can expand employment (up to D) without cost to wages / locals

More wage & empl stability for locals over the cycle!
Relative performance of migrants - a UK example -
Hourly wage (gross) differentials by occupation

- Elementary
- Processing
- Customer services
- Other services
- Skilled trades
- Administrative
- Associates
- Professionals
- Managers

Legend:
- English
- Poles
Skills matching, skills acquisition and skills (re-)deployment
Skills (re-)deployment

- **Matching**
  - Skill shortages, supply-side bottlenecks and the time-lag of education decisions / training provision
  - Cyclical/seasonal fluctuations, economics of adjustment

- **Acquisition**
  - Learning by doing, escalator / elevator regions and ‘buzz cities’
  - Alfred Marshall’s economies of ‘agglomeration & information’: learning from interaction (proximity, density and technology)

- **Redeployment**
  - Return ‘migration’ and ‘migrant’ entrepreneurship (brain-gain)
  - Resolving skills shortages, transferring technologies / know-how
3. Portability of skills
Portability of skills

➤ The EC on the new EQF (COM(2016) 383/2)
  Lack of transparency, understanding and valuing of skills and qualifications is a hindrance to geographical and occupational mobility of workers and learners that affects the EU as a whole. It is a major cause for the underuse of available skills [...] and as such is an important cause of skills mismatches.

➤ Portability of skills in the EU
  ➤ Bologna Process (higher education, comparability of standards)
  ➤ Copenhagen / Turin Process (VET, mutual ‘trust’/recognition)
  ➤ Common Frameworks: EQF, EQARF, Credit systems, Europass
  ➤ Common Agendas: Europe2020, Skills Agenda, Agenda for Innovation and Digital Technologies

➤ Questions for the UK
  ➤ Divergence in frameworks? (esp. EQF, but also Europe2020)
  ➤ Policy downloading/diffusion? (e.g., ‘German apprenticeships’)
Thank you

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1 March 2016, LSE
Populism, mobility and portability

- Tito Boeri
- Brexit Lunchtime Lecture
- LSE, 1 March 2017
Brexit from what?

• What is at stake is much more than Brexit

• **Four** elections to come that may walk us out of the Euro and of the European Union, at least as we know it …

• …and one dominating issue: unprecedented immigration of
Votes for populist parties and immigration

Halla et al. (2014)
Multivariate analysis (Flanders)

<table>
<thead>
<tr>
<th>OLS estimation of Vlaams Blok’s vote share in federal elections 1999</th>
<th>Vlaams Blok vote share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>$-2.630^{***}$ ($-6.43$)</td>
</tr>
<tr>
<td>Per capita income</td>
<td>$0.052^*$ ($1.84$)</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>$2.344$ ($1.35$)</td>
</tr>
<tr>
<td>Foreign population</td>
<td></td>
</tr>
<tr>
<td>Population from Maghreb and Turkey</td>
<td>$7.096^{***}$ ($2.99$)</td>
</tr>
<tr>
<td>Population from other countries</td>
<td>$-1.542^*$ ($-1.73$)</td>
</tr>
<tr>
<td>Crime</td>
<td>$0.804$ ($0.77$)</td>
</tr>
<tr>
<td>Associational life</td>
<td>$-111.149^{**}$ ($-2.22$)</td>
</tr>
<tr>
<td>Population density</td>
<td>$277.534^{**}$ ($2.47$)</td>
</tr>
<tr>
<td>District magnitude</td>
<td>$0.006$ ($0.79$)</td>
</tr>
<tr>
<td>Number of observations</td>
<td>103</td>
</tr>
<tr>
<td>Adjusted $R$ squared</td>
<td>$0.518$</td>
</tr>
</tbody>
</table>

Notes: $t$-values are in parentheses. The dependent variable is the transformed vote share: $\ln(V/(1-V))$. 

Coffè et al.
Multiplier effects: Distance from populist platforms (Guiso et al., 2017)
Populism: short-term protection driving us away from long-term solutions

Ideological space of populism in Australia (Dean et al. 2016)
3 key challenges

1. Preserving long-term protection requires decoupling migration and the welfare state: otherwise standard tools of social inclusion may become weapons on mass exclusion.

2. We should transform refugee into economic migration, integrating them by voluntary matching (rather than by «forced marriage»)

3. This is possible only in large labour markets. A single market for labour in Europe requires an infrastructure for mobile workers, ensuring portability of social security rights and preventing abuse. A modest proposal.
What drives negative perceptions of migrants
(OLS regression)

Overall Economy
Dependent variable: Migrants are bad/good (0-5) for the economy

<table>
<thead>
<tr>
<th></th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal drain</td>
<td>0.318***</td>
</tr>
<tr>
<td></td>
<td>(47.888)</td>
</tr>
<tr>
<td>Poverty/unemployment</td>
<td>0.182***</td>
</tr>
<tr>
<td></td>
<td>(30.525)</td>
</tr>
<tr>
<td>Crime rates</td>
<td>0.162***</td>
</tr>
<tr>
<td></td>
<td>(23.700)</td>
</tr>
<tr>
<td>Wage effects</td>
<td>0.083***</td>
</tr>
<tr>
<td></td>
<td>(14.342)</td>
</tr>
<tr>
<td>Country Dummies</td>
<td>Yes</td>
</tr>
<tr>
<td>Observations</td>
<td>20492</td>
</tr>
<tr>
<td>R squared</td>
<td>0.39</td>
</tr>
</tbody>
</table>

Fiscal drain is by and large the main driver of negative perceptions. Poverty, crime rates and wage effects also important but lower explanatory power.

Notes: It statistics in brackets, * significant at 10 per cent, ** significant at 5 per cent, *** significant at 1 per cent. Individual controls are: age, sex, income level, living in a city, presence of migrants among relatives or friends, left wing ideology, labour market status relative to immigrants, immigrant. Source: ESS 2002.

Tito Boeri - London, March 1 2017
Populism and “welfare shopping”

• **Claus Hjort Frederiksen** (Danish Minister for Employment): “If immigration from Third World Countries were blocked, 75 per cents of the cuts necessary to maintain the welfare state would be unnecessary”

• **Thilo Sarazzin** (former Berlin central banker): “Germany is digging its own grave by admitting waves of immigrants who are spongers, welfare cheats, and...”
Problems more serious with refugee migration

• Key differences between economic migrants and refugees:

1. Role of push (as opposed to pull) factors. Limited choice of «where to go». Matching to jobs more difficult.

2. Refugee migration comes in larger waves than economic migration. Perceived as temporary while it is not.

3. Regulations are substantially different (application should be made in the country of destination; while it is processed, the applicant cannot work, draws on welfare without paying, Refugees 50% less likely to work than economic migrants in the first 3 years since arrival. Convergence in 15 yrs (Cream 2016))
Recent evolution of refugee migration (UNHCR)
Decoupling migration and welfare

• The problem is in the non-contributory part of social transfers
• More Bismarck and less Beveridge (better targeting of social assistance)
• «Short-term» here is against populists: in the short-run working migrants pay our pensions!
• In order to allow them to integrate into our labour markets we need i) large markets, ii) mobility-friendly institutions for contributors, and iii) contracts offering to migrants «graded residence security» (longer permits the longer they stay).
Big Cities are different (Naticchioni et al., 2016)

Table 4. The role of big cities. IV estimates. Population as weight.

<table>
<thead>
<tr>
<th></th>
<th>All municipalities</th>
<th>Up to 99th perc.</th>
<th>Big cities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td></td>
<td>FE</td>
<td>FE-IV</td>
<td>FE</td>
</tr>
<tr>
<td>Immigrant share</td>
<td>0.188***</td>
<td>-0.272</td>
<td>0.302***</td>
</tr>
<tr>
<td></td>
<td>(0.052)</td>
<td>(0.548)</td>
<td>(0.049)</td>
</tr>
<tr>
<td>Density</td>
<td>0.018</td>
<td>0.048</td>
<td>0.047***</td>
</tr>
<tr>
<td></td>
<td>(0.013)</td>
<td>(0.036)</td>
<td>(0.012)</td>
</tr>
<tr>
<td>GDP growth NUTS-2</td>
<td>0.321***</td>
<td>0.392***</td>
<td>0.427***</td>
</tr>
<tr>
<td></td>
<td>(0.084)</td>
<td>(0.095)</td>
<td>(0.046)</td>
</tr>
<tr>
<td>Population/1000</td>
<td>-0.000***</td>
<td>-0.000***</td>
<td>-0.002***</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.000)</td>
<td>(0.001)</td>
</tr>
<tr>
<td>Constant</td>
<td>0.490***</td>
<td>0.492***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.017)</td>
<td>(0.012)</td>
<td></td>
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<tr>
<td>Observations</td>
<td>23,780</td>
<td>23,780</td>
<td>23,535</td>
</tr>
<tr>
<td>Municipality FE</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>F-stat Excl.instruments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>23.17</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R-squared</td>
<td>0.655</td>
<td>0.646</td>
<td>0.626</td>
</tr>
</tbody>
</table>
Why do we need large markets?

• Large markets are better to absorb large migration waves. Less «amenity» effects. Quicker job finding due to network and other scale effects.

• More room for self-selection even when people cannot relocate.

• Better matching also in the market for personal services: short-term advantages of migrants more visible in cities.

• This increases the costs of «gambling for resurrection» by voting for anti-immigration outsiders.
We never implemented the Rome Treaty

• A single market for labour in Europe is the best response to the refugee crisis

• It also offers the best unemployment insurance for young natives

• However intra-EU mobility constrained by increasing barriers to mobility (also for EU citizens) and persistent limitations to the portability of social security rights across countries.
An EU social security number?

- Free movement of labour in the EU cannot be protected without ensuring full portability of contributory social transfers
- We need coordination between different social security systems and institutes in order to prevent and contrast abuses (work in one country, obtain UB from another) and to regulate mobile workers implementing social insurance across countries
- A single **European social security identification number** would make this coordination easier
- Would also strengthen EU identity (example of the US Social Security Number)