

Institution: London School of Economics and Political Science
Unit of Assessment: 18: Economics and Econometrics
Title of case study: Improving job creation in Europe
<p>1. Summary of the impact (indicative maximum 100 words)</p> <p>Research by Christopher Pissarides and his LSE colleague Rachel Ngai has led to official acceptance by European Union (EU) policy-makers that a major source of new jobs will be sectors that provide services to the general public, notably healthcare and low-skill domestic services. The European Commission was initially hostile to this view, preferring the emphasis of the EU's so-called 'Lisbon strategy' on job creation in advanced technology industries. But the Commission's Growth Survey 2012 indicates that it has now adopted Pissarides' approach, and at the 'Jobs for Europe' summit in September 2012 he was invited to deliver a keynote speech on the same platform as the 'three Presidents' (of the Commission, the European Council and the European Parliament). His policy recommendations – including the need for better incentives for the 'marketisation' of activity in the care and unskilled services sectors – are now part of the official EU agenda on job creation. He has also advised national governments, including in his native Cyprus, where he was appointed president of the government's Economic Policy Council in 2013.</p>
<p>2. Underpinning research (indicative maximum 500 words)</p> <p><i>RESEARCH INSIGHTS AND OUTPUTS:</i> Pissarides' early work, summarised in his lecture on receiving the 2010 Nobel Memorial Prize for Economic Sciences (1), was on unemployment. But from the late 1990s, he shifted his attention to employment. The observation that prompted the research with Ngai is that during periods of economic growth, the structure of employment is changing all the time. The initial big changes are the decline of agricultural employment, the rise and subsequent decline of industrial employment and the rise of service employment. But structural change continues even in post-industrial economies: some sectors decline or disappear while others continue to flourish; and some service sectors increase rapidly while others decline.</p> <p>Ngai and Pissarides developed a model of a growing economy that undergoes structural change (2). The key result is that structural change co-exists with aggregate balanced growth, thus confirming the facts of the Solow growth model in an economy experiencing large employment shifts. The model has become the most highly cited model of the co-existence of balanced growth and structural change (around 600 citations in Google Scholar as of October 2013).</p> <p>The approach emphasises the importance of technological progress in the reallocation of labour across sectors. It shows that eventually labour will leave the fast-growing sectors and be drawn to sectors with low productivity growth, in particular the caring services (childcare and healthcare services), retailing and personal services. Previous empirical studies had described the facts of structural change, but the Ngai and Pissarides formalisation was new; other researchers have since built on their work to show that it is an important explanation of structural change in mature economies (3).</p> <p>Building on this framework, Ngai and Pissarides studied long-term trends in aggregate hours of work (4). The long swings in hours are explained by substitutions between home and market production, when the latter has productivity growth at least as fast as the former. Sectors with slow productivity growth attract labour from faster-growing sectors that produce distant substitutes, because distant substitutes are consumed in more or less fixed proportions.</p> <p>This research opened up two further fruitful avenues with policy relevance. First, employment rates vary widely across sectors of economic activity and the countries that fail to achieve high employment are failing in a particular set of sectors. Second, taxation and other forms of regulation have a different impact on different sectors, with an especially strong influence in sectors that have home substitutes.</p>

Building on these findings, Ngai and Pissarides examined the distribution of employment across the OECD and found that countries that fail to satisfy the EU's 'Europe 2020' targets fail mainly in the sectors that have home substitutes – the best examples being healthcare, childcare and unskilled services, including retail trade, such as shop assistants (5). There are also some failures in the provision of business services, but it is not yet clear if this is because of differences in the organisation of firms and the extent to which they franchise services.

To increase employment, especially of women and older people, European countries have to provide better incentives for the 'marketisation' of activity in the care and unskilled services sectors. The Scandinavian countries do so by heavily subsidising social services but this requires high tax rates elsewhere, hurting economic activity in the other sectors. The United States and (to a lesser extent) the UK achieve it by deregulating the lower skilled occupations and tolerating more income inequality. Neither solution is perfect, but the two strategies need to be brought into the open and discussed at national and EU levels.

KEY RESEARCHERS: Professor Pissarides has been at LSE since 1976; Dr Ngai since 2001.

3. References to the research (indicative maximum of six references)

1. Pissarides, Christopher (2011) 'Equilibrium in the Labor Market with Search Frictions', *American Economic Review* 101: 1092-1105 (the Nobel lecture). DOI: 10.1257/aer.101.4.1092
2. Ngai, Rachel and Christopher Pissarides (2007) 'Structural Change in a Multi-Sector Model of Growth', *American Economic Review* 97: 429-43. DOI: 10.1257/000282807780323460
3. Herrendorf, Berthold, Richard Rogerson and Akos Valentinyi, (2013) 'Two Perspectives on Preferences and Structural Transformation', *American Economic Review* [in press] <https://sites.google.com/site/bertholdherrendorf/Home/research-1/selected-publications>
4. Ngai, Rachel and Christopher Pissarides (2008) 'Trends in Hours and Economic Growth', *Review of Economic Dynamics* 11: 239-56. DOI: 10.1016/j.red.2007.07.002
5. Ngai, Rachel and Christopher Pissarides (2011) 'Taxes, Social Subsidies and the Allocation of Work Time', *American Economic Journal: Macroeconomics* 4: 1-26. DOI: 10.1257/mac.3.4.1

EVIDENCE OF QUALITY: Peer-reviewed papers in top journals, and key research awards:

1. ESRC award RES-000-22-0917 to Rachel Ngai and Christopher Pissarides (2005) 'Structural Change with Mobility Barriers: Implications for Employment and Growth', £40,783
2. IZA Prize in Labor Economics, 2005
3. The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel, 2010
4. The ESRC-funded Centre for Macroeconomics at LSE, launched in 2013, of which Pissarides is Chairman (based <http://www.centreformacroeconomics.ac.uk>)

4. Details of the impact (indicative maximum 750 words)

THE IMPACT: Official EU policy for increasing employment now includes healthcare and low-skill domestic services. There is more emphasis on labour-intensive sectors than on technologically advanced sectors. This was not previously the case: the 'Lisbon strategy' of 2000 established overall targets without reference to sectors of employment. The overall target for the rate of employment across the EU was 70% of the 15-64 age group, to be achieved by 2010. Despite the failure to reach this target, the Europe 2020 Strategy (currently in force) raised the target to 75% for the age group 20-64. Initially, the guidelines for increasing employment rates to these levels were based on recommendations about the acquisition of skills, increasing labour mobility, computerisation, technological innovation and 'good jobs' (a phrase that lacked precise definition). Now more emphasis is given to sectors such as 'green' employment and healthcare.

LINKS BETWEEN RESEARCH AND IMPACT: Pissarides has been active in the policy debate on employment and unemployment for several decades. Beginning with his keynote at the

Employment Conference of the Austrian Presidency in Vienna in 2006 [A], he became a key contributor to European debates about the sources of job creation. In March 2011, at an event to celebrate his recent Nobel Prize attended by the Commission President and all the Commissioners connected with economic policy, Pissarides made his argument about the importance of labour-intensive services more forcefully, urging the Commission to shift its emphasis in that direction. In the Commission's Growth Strategy 2012, published in September 2011 (and follow-up documents published in April 2012), there is a new emphasis on healthcare and unskilled services.

At the 'Jobs for Europe' summit in September 2012, the emphasis was on job creation in ICT, the green economy and healthcare, respectively addressing new technology and productivity growth, environmental concerns and employment at lower skill levels [B]. Pissarides was given the most prestigious platform to explain his analysis of employment creation and several members of the Commission staff connected with employment, including the Commissioner, credited him in their presentations at least partly with the shift in emphasis.

The way in which the 2012 Employment Package put the concept of dynamic labour markets into the heart of EU employment policy, had a direct connection with Pissarides's scholarly work. The March 2011 event was the first intellectual milestone in its preparation and his continued presence in the policy debate strengthens the implementation [C].

Following the summit, work currently at the Commission is examining the potential of healthcare and unskilled household services for employment generation. When the work is completed, there will be another summit to discuss the next phase in the role that could be played by these sectors in the pursuit of the Europe 2020 employment objectives. Pissarides has been invited to participate in the next phase of this work.

Pissarides has repeatedly emphasised in his involvement in EU policy debates that raising employment opportunities is the best social policy, in terms of both income growth and social inclusion. But apart from the benefits to society overall, the emphasis on the healthcare sector is also important in light of the ageing population. The sector will be both provider of services to an ageing population and a source of employment for many older people, especially women, who have a comparative advantage in healthcare.

This shift of emphasis in the type of jobs that are created is important for Europe, as the eurozone emerges from the financial crisis. Unemployment is high, especially for young people, mainly because of the austerity associated with the debt reduction programme. The key question debated at both national and EU levels is how to create new jobs that will absorb the unemployed, and how to encourage more women and older people to enter the labour force and stay on at work.

National governments look to the Commission for guidance, in addition to their own research. In that respect, the Commission's new emphasis on employment expansion sectors could prove very influential in the design of national policies for employment. Pissarides has been active in this dissemination process. Over the past 12 months, he has been involved in at least five high-level events focused on these issues. In October 2012, in connection with the Cyprus Presidency of the European Union, he was the invited speaker at the Informal Meeting of Education Ministers, where he outlined his views on youth unemployment and education. In January 2013, he was invited as an academic expert on austerity and rebuilding Europe's labour markets at the Informal Meeting of World Leaders during the World Economic Forum's annual meetings in Davos. In July 2013, he participated at the European Leaders Summit on youth unemployment in Berlin, with the participation of the majority of EU heads of government and employment ministers. And in October 2013 he was invited back in Brussels to be the guest of honour at the tenth annual high-level "State of Europe" summit that *Friends of Europe* co-organised with the Lithuanian EU Presidency and the *Financial Times*, where he spoke again about the need to shift the emphasis to job creation in Europe from the current austerity agenda.

Better understanding of the sources of job creation enables better educational and infrastructure planning. It also enables better national policies with respect to wages and social transfers. In

countries like the UK, this research is of particular interest because of the involvement of the state with healthcare. With healthcare spending expected to increase rapidly as the demand for healthcare services increases, the UK government needs to formulate a policy for the future of the NHS and the extent to which it wishes to see an expansion of employment under the public sector umbrella.

A commitment to continue meeting healthcare demands within the NHS would necessitate higher taxes, which is likely to be incompatible with other government objectives, such as encouraging a low-tax corporate culture. Other countries in Europe face similar problems as they plan their healthcare systems for the future. A recent plea to the Chancellor to think of the bigger questions about future job creation and the fiscal balance is in Pissarides' comment on the Autumn Statement 2012, published by the British Academy [D]. More recently, in October 2013, he was invited to a discussion between a small group of experts and the deputy Prime Minister where he again emphasised the role of NHS in job creation and the dilemma of public sector funding, a topic that attracted a lot of attention in the subsequent discussion.

WHY THE IMPACT MATTERS: Higher employment drives a rise in living standards and the reduction of poverty, as more people share in Europe's prosperity. Enhancing it at the top end of the skills distribution improves EU competitiveness and becomes a driver for growth. But unless it can also be improved at the bottom end, the benefits from growth are not equally shared and poorer sections of society must rely on social transfers to maintain their living standards. This is not a satisfactory situation.

5. Sources to corroborate the impact (indicative maximum of 10 references)

All sources listed below can also be seen at: <https://apps.lse.ac.uk/impact/case-study/view/18>

[A] Pissarides, Christopher (2006). 'Lisbon Five Years Later: What Future for European Employment and growth?' In Innovations in Labour Market Policies: Challenges in Times of Globalisation, International Conference February 16-17, 2006, Vienna, published by Federal Ministry of Economics and Labour, Studenring 1, 1011 Vienna, Austria, 2006
http://s3.amazonaws.com/zanran_storage/www.wisdom.at/ContentPages/751617028.pdf

[B] Jobs for Europe Conference papers are at
<http://ec.europa.eu/social/main.jsp?langId=en&catId=88&eventsId=641&furtherEvents=yes&previous=cHJldmld0VtcGxQb3J0YWwhMjAxMjAyMTU>

[C] Testimonial from Commissioner for Employment, Social Affairs and Inclusion in the Barroso II administration of the European Commission. This source is confidential.

[D] British Academy comment on the Autumn Statement is at:
http://www.britac.ac.uk/policyperspectives/Osborne_Autumn_Statement.cfm