

CELMR Research Digest



What is CELMR?

CELMR is the Centre for European Labour Market Research and is made up of 12 faculty from the Economics Department at the University of Aberdeen plus associate members from across the world. The Centre prides itself on high quality, policy relevant research examining a whole range of labour market issues based primarily around four themes:

- Education, Skills and Labour Mobility
- Inequality in the Labour Market
- Health and Work
- Wage Determination

More information about CELMR can be found on our website:
<http://www.abdn.ac.uk/business/research/celmr/index.php>

CELMR News Quick Hits

Hot off the Press – forthcoming publications in 2017:

- **Ramses Abul Naga**, 'Measurement of Inequality with a Finite Number of Pay States: The Majorization Set and Its Applications', *Economic Theory*.
- **Keith A. Bender**, J. S. Heywood & M. P. Kidd, 'Claims of Employment Discrimination and Worker Voice', *Industrial Relations Journal*.
- D. Leahy & **Catia Montagna**, 'Economising, Strategising and the Vertical Boundaries of the Firm', *B.E. Journal of Theoretical Economics*.
- F. Summerfield & **Ioannis Theodossiou**, 'The Effects of Macroeconomic Conditions at Graduation on Overeducation', *Economic Inquiry*.
- S. Heidenreich, V. Watson, M. Ryan, & **Euan Phimister**, 'Decision Heuristic or Preference? Attribute Non-attendance in Discrete Choice Problems', *Health Economics*.

Editors' Corner

Welcome to the seventh CELMR Research Digest! In this issue, as well as summaries of three research projects we have an tribute to the late Sir Tony Atkinson by CELMR member, Dr Ramses Abul Naga and an announcement of an upcoming research conference. We hope that you find it of interest and continue to welcome any feedback that you might have about this publication or the summaries contained here.

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and

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'Reforming the Liberal Welfare State: International Shocks, Unemployment and Household Income Shares'

H. Molana, Catia Montagna and G.E. Onwordi

CELMR Discussion Paper 17-06

(http://laura.abdn.ac.uk/bitstream/handle/2164/8789/DP_2017_6.pdf)



Prof Catia Montagna

In their new CLMR Discussion Paper 17-06, Hassan Molana, Catia Montagna and George E. Onwordi from project GlobLabWS examine how labour market and welfare state reforms in the direction of *flexicurity* affect long-run unemployment and the dynamic response to international shocks of an economy characterised by a liberal welfare state regime.

The working paper makes a relevant contribution to contemporary debates around the impact of international economic shocks on labour markets. It also complements existing work on distributional impacts of international trade and tax-and-benefit policies by tracing changes in shares of household income.

Flexicurity denotes a combination of relatively low degrees of employment protection with generous unemployment support accompanied by the adoption of active labour market policies (ALMPs) aimed at increasing workers' employability. The notion of flexicurity has been widely embraced as a guideline for welfare state reforms capable of reconciling concerns about 'competitiveness' (that underpin the rationale for labour market deregulation and welfare state retrenchments) and greater demands for social safety nets arising from a growing sense of economic insecurity.

The team considers a flexible 'liberal welfare system', such as the UK's, and examines the effects of implementing reforms packages in the direction of the flexicurity system of Denmark – which would entail reducing the flexibility of the labour market as well as increasing unemployment insurance and expenditure on active labour market policies.

Contrary to conventional wisdom, and consistent with some existing empirical stylised facts, the paper finds that higher employment protection and unemployment insurance do not provide a greater buffer against adverse shocks. Instead, reforms towards flexicurity result in a higher volatility in unemployment and GDP in response to exogenous foreign shocks. However, the analysis shows that when greater income support for the unemployed and stronger firing restrictions are combined with active labour market policies that enhance job creation and employability (such as the training of the unemployed), reforms can reduce unemployment and increase the level of economic activity in the long-run. An implication of the analysis is that productivity enhancing policies can complement social protection in countering the effects of negative shocks, pointing to the importance of the interdependencies between labour market, education, and industrial policies.

(For further information please contact Professor Montagna: c.montagna@abdn.ac.uk)

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Dr John Skåtun

'Taxation, Risk Aversion and the Wage Gaps in Tournaments'

John Douglas Skåtun

Oxford Economic Papers, Vol. 69, No. 3, 2017, pp. 834-45.

Over the last half century or so, most OECD countries have seen a fall in marginal income taxes coupled with an increase in the top income earners' share of GDP. However, whilst the empirical literature has found significant effects of the recent decades' trend to reduce taxes on the increase in the shares of the top 1% income groups, there is fierce academic debate over why this is so.

The theoretical framework in this paper suggests an explanation may come through tournament theory. In this theory, managerial jobs are arrived at through competition amongst co-workers, where winners are rewarded with higher salaries. It is well known that such internal structures are used by firms to incentivise workforces, and that it results in a wage profile with increasing wage returns of promotion at the top of the organisational hierarchy. How such a wage structure is affected by the tax regime is then the key focus of the paper.

Promotion tournaments are gambles where workers are only rewarded with the prize of winning with some probability that depends critically upon own and the competitor's effort. Thus, the participants' attitude to risk is likely to play an important role. This paper shows that workers with low levels of risk aversion will increase their effort in response to tax reductions. On the other hand, with sufficiently high risk aversion, effort falls with lower taxes. In the low risk aversion case, firms respond to lower income taxes

by increasing the wage spread, whereas they narrow the wage spread in the high risk aversion case.

There is a well-established finding that managers and CEOs of firms are more prone to risk taking than the population in general. This with the behavioural response by firms to taxes generates a link between lower taxes and higher pre-tax income of high earners. Thus it may explain the rise in CEO pay in response to reductions in taxes.

The unexpected result of the paper is that increasing taxes can be doubly effective in reducing inequality since firms that use tournaments to set pay will narrow their pre-tax wage distribution in response to the increased taxes.

Furthermore, with females being more risk averse, in general, it suggests tax reductions may adversely affect the CEO gender pay gap.

This paper argues that increases in taxes can be used to combat income inequality. That the post-tax income inequality falls with increases in income taxes is hardly surprising. The paper's main conclusion, however, is more unexpected as it argues the distribution of the pre-tax wages which firms offer narrows with higher taxes. However, whilst increased taxes lower CEO pay and reduces the male-female CEO gender pay gap, it also comes at the cost of lowering male CEO effort.

(For further information about this paper, please contact Dr Skåtun: jskatun@abdn.ac.uk.)



'The Unintended Consequences of Flexicurity: The Health Consequences of Flexible Employment'

Keith Bender and Ioannis Theodossiou

Review of Income and Wealth, forthcoming



Prof Keith Bender

Recent data from the ONS shows that nearly one million UK workers are on zero-hour contracts. While the number of workers on these kinds of contracts has been growing dramatically in recent years, it is only one form of a more widespread phenomenon – the rise of flexible contracts.

Proponents of flexible contracts point exactly to the descriptor – 'flexibility'. Since such contracts do not guarantee a long-term employment relationship or even hours, employers have increased flexibility in terms of responding to labour demand. Some workers who desire flexibility may also like such contracts as they have more control over their hours of work than in a 'standard' employment relationship.

However, it is unlikely that the vast majority of prime age workers would want the uncertainty that comes from such employment relationships. Recent data from the ONS suggest that a third of zero-hour contract workers want more hours – compared to only 10% of standard contract workers. Most workers desire stability in the employment relationship and in pay and would find flexible contracts stressful.

This is the premise of our paper. If flexible contracts cause stress, there may be an unintended

consequence of flexible contracts driving stress-related health problems. To examine this, we analyse data from the British Household Panel Survey. We start with a group of healthy workers and measure how often they are in flexible contracts vs traditional contracts. Then we look to see if there is any correlation between a subsequent event of ill health and the proportion of time spent in flexible contracts.

The results are striking and consistent – across a range of health measures (e.g. overall health, heart, stomach, mental, breathing, migraine and skin/allergy conditions), we find a strong correlation between these health conditions and flexible contracts. This is robust to a number of different factors, including endogeneity.

Clearly more research needs to be done in this area, but these results suggest an important unintended consequence of flexible contracts – one that workers, firms and public health officials should consider when implementing or supporting policies to encourage such contracts.

A summary of this research can be found at *The Conversation*: <https://theconversation.com/how-zero-hours-contracts-could-be-making-you-ill-77998>

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(For further information, please contact Prof Bender: kabender@abdn.ac.uk).



CELMR Policy Page

CELMR Member Ramses Abul Naga writes about the life and work of Sir Tony Atkinson

On the first day of 2017, Britain lost one of its most influential scholars and distinguished citizens. Sir Tony Atkinson was born on September 4, 1944 in Caerleon Wales and attended Cranbrook School in Kent. He later studied at Cambridge where he met Judith Mandeville, his wife and mother to their three children Richard, Sarah and Charles.

Tony Atkinson was to have a very profound influence on the landscape of today's teaching and research in economics. He resurrected in the late 1960s research on the measurement of income inequality, an area where prior contributions dated to the work of Arthur Pigou and Hugh Dalton in the first 20 years of the 20th century. Atkinson's Theorem provides the formal relation between non-intersecting Lorenz curves and the quantification of inequality using index numbers that exhibit a property known as social inequality aversion. The family of inequality indices he introduced came to be known as the Atkinson Family and are discussed in many disciplines other than economics. Tony's work in this area resonates in the mathematical theory of majorization and is discussed in Marshall, Olkin and Arnold's famous text: *Inequalities: Theory of Majorization and its Applications*.

Tony was a Member of the Royal Commission on the Distribution of Income and Wealth in the late 1970s and was also a member of the Conseil d'Analyse Economique, advising French Prime Minister Lionel Jospin's government in the years 1997-2002.

Among other important publications, every economics graduate student in the last 35 years studying the economics of the government sector will have been assigned readings from *Lectures on Public Economics*, co-written with Joseph Stiglitz in 1980. The second edition, dated 2015, testifies to the value of this seminal text, which remains unrivalled in its scope and clarity. The famous Atkinson-Stiglitz

Theorem regarding taxation shows that indirect commodity taxation is of no use at all when the income tax schedule is chosen in an optimal manner.

In their 1983 text *Parents and Children* authored by Tony, Alan Maynard and Chris Trinder, the authors examined the association between the incomes of a sample of workers in the city of York and their children. This monograph was to have a lasting influence in the field of labour economics, where it has now become routine work to estimate the correlation between parents' incomes with those of their children.

The field of Micro-Simulation, where researchers try to simulate the effect of various tax or subsidy reforms on the distribution of income or earnings, has largely resulted from Tony's pioneering efforts together with Holly Sutherland. Their joint work can be traced back to the development of the Taxmod software.

Tony contributed significantly in many other areas of economics, including health economics, macroeconomics, unemployment and the welfare state. Less known perhaps is his work with Joseph Stiglitz on the economics of technical change, where he revisited the Infant Industry argument.

A final contribution of fundamental importance was Tony's research on the distribution of top incomes across time, space and genders, which he pursued together with various colleagues including Thomas Piketty, Emmanuel Saez, Alessandra Casarico and Sarah Voitchovsky.

Tony was a very kind, quiet and compassionate person—in short a true gentleman. For those of us who were fortunate enough to have met and known him, he has undoubtedly changed our lives—for the better. For me, Tony will always symbolize the best side of Britain

Call for Papers

New Research in Pay Determination

The University of Aberdeen Business School and Centre for European Labour Market Research are inviting papers for a one-day conference on pay determination to be held at the University of Aberdeen on *8 November 2017*.

This conference is dedicated to our long-serving colleague Professor Robert Elliott who has retired this year. Professor Elliott has spent his entire career at the University of Aberdeen and has been President of the Scottish Economic Society and a member of the UK Low Pay Commission as well as a consultant for the UK Treasury, the European Commission and the OECD.

The Conference is open to both traditional and heterodox analyses of wage determination, as well as research on private-public sector wage differentials, the effects of minimum wage on employment and wage levels and compensating wage differentials – all areas of labour market research to which Professor Elliott contributed. Since recent evidence reveals that real average pay of the British labour force has declined by at least 10% since 2008, the expectation is that this conference will contribute not only to understanding more fully the determinants of pay but also offer important information for practitioners and policy makers on the reasons for this decline.

The conference will be organised around our invited keynote speakers (*Professor David Bell*, University of Stirling, *Tim Butcher*, Chief Economist and Deputy Secretary, Low Pay Commission, *Professor Philip Murphy*, Swansea University and *Professor Robert Sandy*, Indiana University-Purdue University Indianapolis).

If you are interested in presenting your work in this conference, please send an extended abstract (preferably a full draft paper) to Professor *Ioannis Theodossiou* (theod@abdn.ac.uk) or Professor *David McCausland* (d.mccausland@abdn.ac.uk) the conference organisers. **The deadline for submissions is 30 September, 2017.** Further details about the conference will be distributed in the autumn. Please contact Professor Theodossiou with any questions in the meantime.

Conference and dinner fees will be covered for the invited speakers, but all are welcome to the conference. The fee for conference attendance is £40, and for the conference plus dinner, the fee is £110.