1 Introduction

With a referendum on continued UK membership of the European Union (EU) imminent, this paper attempts to cast light on a number of issues relating to the UK and European labour markets which have played an important role in the Brexit debate. First, the free movement of labour within the EU, which when coupled with a buoyant UK labour market, has led to a substantial increase in the UK population. This in turn has led to pressure on the housing market, on public services and on existing social structures. Dissatisfaction with these changes form an important part of the case put forward by the “leave” campaign. A second source of dissatisfaction stems from the real or presumed role of the EU in increasing the level of regulation of the UK labour market. Many businesses and entrepreneurs feel that such regulation inhibits their freedom to act, and entangles them in unnecessary bureaucracy resulting in unnecessary administrative costs. This paper seeks to assemble evidence relating to these issues. Initially it focuses on labour market regulation, trying to explain the EU’s role and rationale for involvement with the UK labour market. It then extends this discussion to consider labour market policy, part of the overall EU policy framework that has received relatively little attention in the Brexit debate. Next we look at migration between the UK and the rest of the EU, before closing with a discussion of the role of benefit payments to migrants, their use of public services and their net contribution to the UK’s fiscal balance. Each of these issues provide further scope for disagreement between the supporters and opponents of Brexit.

2 Labour Market Regulation

Labour market regulation provides safeguards for employees who might be exploited in a completely unregulated market. Regulation can prevent the exploitation of those with very little labour market power and it can provide reassurance to those belonging to disadvantaged groups who are uncertain about seeking employment. Providing access to work for such groups may have beneficial effects for the economy as a whole. From the human rights perspective, there is an unambiguous case for some level of labour market regulation, while there may also be an economic case for its existence.

However, markets may be overregulated in the sense that interest groups and “insiders” are able to lobby effectively for regulations that favour themselves at the expense of others or “outsiders”. For example, regulations that provide for redundancy payments based on length of time with the firm reduce the incentive for firms to retain workers, resulting in higher turnover and unemployment and/or only temporary jobs being offered. Regulations that impose costs on businesses with no countervailing benefit unambiguously reduce economic welfare. These arguments imply that while regulation has a role to play in the labour market, a balance should be struck which encourages a high level of employment on non-discriminatory terms and conditions and which does not impose unnecessary costs on businesses.

These arguments are relevant to the EU because the Single Market is one of its defining institutions. And the labour market is one of the four components of the Single Market, the others being the markets for goods, capital, and services. The creation of these markets by removing unnecessary restrictions on the free movement of goods, capital and labour and the regulation of these markets to prevent unfair trade has been a key priority for the EU since it was established. Thus in relation to the labour market, the free movement of labour requires that all member states should allow unimpeded migration of workers between member states while non-discriminatory regulations require that migrants from other member states must be employed under the same conditions as their nationals of that state. The free movement of labour should foster economic growth and economic prosperity by encouraging labour to locate to where it is most productive across the EU. However, this has been a particularly contentious issue in the UK due to the very substantial in-migration of workers from the EU8 accession states after 2004.

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1 The EU8 comprise the set of “Accession States” which joined the EU in 2004 – the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia. The EU2 comprise the states which joined in 2007 – Bulgaria and Romania. The EU10, not surprisingly, comprises the combination of the EU8 and the EU2.
The EU has also encouraged or required member states to adopt similar labour market regulations and thus prevent a “race to the bottom” in relation to workers’ terms and conditions. On occasion, EU regulation added to existing national regulations; on others, it has introduced entirely new sets of rules for employers and employees.

Employers frequently complain that such regulation interferes with their ability to compete. Yet states have agreed to limit competition in certain ways where they believe such competition would infringe workers’ rights or lead to unfair competition. “Unfair” competition between employers may take many forms, but selling at less than the cost of production – dumping – is an acknowledged example from goods markets. Paying wages that are insufficient to cover the costs of supplying labour on a sustainable basis is its counterpart in labour markets.

Labour market regulation affects firms in different ways. It can reasonably be argued that compliance costs are higher for small businesses given that there will almost certainly be economies of scale in meeting regulatory requirements. Hence it would not be surprising if such businesses provided the strongest opposition to EU regulation. In addition, given that small companies are less likely to export than large companies, the benefits of EU trade are likely to be less obvious to small businesses, even if they form part of the supply chain to firms that export extensively.

Regulation can also mitigate undesirable social and public costs of employers’ actions. Firms do not necessarily have to meet the full costs of their actions. For example, imposing a regime of long hours might help employers maximise short run profits, but is not necessarily in the social interest if it has an adverse effect on workers’ health, the costs of which are generally borne by the public sector.

A specific example of these issues arose during the long and convoluted history of the Working Time Directive (WTD). The purpose of the WTD was to protect workers’ health and safety by setting regulations governing working hours, rest periods and entitlement to paid annual leave. Its clear intention was the prevention of a race to the bottom among member states in relation to workers’ terms and conditions. The UK had no general regulations governing working time and entitlement to paid leave before the introduction of the WTD. Although weekly hours had been in long-term decline throughout almost all of the post-war period, the WTD came as an unwelcome shock to many UK employers. Its most well-known provision was a stipulation that weekly working time should not exceed 48 hours on average, but it also provided for rest breaks where the working day exceeds six hours, free health assessments for night workers and four weeks (twenty days) paid annual leave.

The 48-hour working week component of the WTD has been treated with suspicion by UK governments, even though the UK has the longest working hours in Europe. The WTD is a directive that was intended to be implemented by all member states. The UK was given an “opt-out” which allows it to exempt workers who give a written agreement that they do not wish to be limited to an average of 48 working hours per week. Thus, the UK Government has been able to negotiate an exemption which allows it to undercut its foreign competitors since, other things being equal, its hourly employment costs will be lower than those countries which adhere to the WTD.

On the other hand, in 2009, using domestic legislation, the UK extended the minimum annual leave requirements to 28 days. This means that UK legislation forces UK firms to provide more annual leave than is strictly required by the WTD. These examples show that labour market regulation derives both from EU and domestic law, but also that it can be difficult to determine whether dissatisfaction with such regulation should be directed at the UK Government or at the EU.

Econometric analysis of data on employment and working time suggests that one of the effects of the 48-hour maximum working week has been to slightly increase employment as average weekly hours have fallen (Department of Business, Innovation and Skills, 2014). However, the long-term sustainability of the 48-hour working week is perhaps questionable, given the blurring of the distinction between working time and leisure as the nature of work changes. One of the arguments against EU legislation has been that it is slow to adapt to changing circumstances due to the complexity of establishing new directives in a 28 member organisation.

For those wishing to leave the EU, such longer run considerations are of second-order importance: their principal focus tends to be on the additional costs of meeting existing EU regulations. On the other hand, those who benefit from the better working conditions which were initially contingent on directives such as the WTD might wish to question the extent to which their employment terms and conditions might deteriorate in the case of Brexit.

3 Labour market policy

Labour market regulation and labour market policy are not entirely distinct, but they are different. Regulation may have a greater focus on workers’ rights and labour market policy need not have a legislative underpinning, but both in principle may be used to improve the operation of the labour market.
EU labour market policy has gone through a number of phases. When unemployment rates were low during the 1990s and the early part of this century, labour market policy was seen as an aspect of social policy and focused very much on workers’ rights and protections. The treaty of the functioning of the European Union (2012) lays down the competencies of the EU in relation to social policy. These are based on the 1989 Community Charter of the Fundamental Social Rights of Workers and include supporting and complementing the activities of the member states relating to: health and safety, working conditions, social security and social protection of workers, protection of workers where their employment contract is terminated, representation and collective defence of the interests of workers and employers, conditions of employment for third country nationals, integration of persons excluded from the labour market, equality between men and women, combating social exclusion, and modernisation of social protection systems. The focus is clearly on workers’ rights.

This contrasts with the approach taken by the Organisation for Economic Cooperation and Development (OECD) since the publication of its “Jobs Strategy” in 1996. It recommended active labour market policies (ALMPs) to enhance labour market performance and efficiency. There was less emphasis on workers’ rights and protections and more on removing obstacles to hiring and firing workers and to make work pay relative to alternatives outside the labour market.

EU labour market policy is now tending to move away from a focus on workers’ rights and more towards promoting labour market efficiency along the lines proposed by the OECD. Members’ economic policies are now subject to annual review by the EU. These reviews frequently include proposals for labour market reform. For example, countries such as Portugal and Italy have been encouraged to repeal regulations that protect existing workers at the expense of those seeking employment. Although this policy direction is also in line with the approach taken by successive UK governments and may therefore seem a less obvious target for Brexit criticism, some would argue that the EU should not have a role in economic policymaking – particularly those outside the Eurozone, where the benefits of economic policy co-ordination are less clear.

In comparison with many other large trading zones, the recent performance of the EU labour market has been relatively poor. Persistently high unemployment rates, particularly among young workers and sluggish productivity growth have characterised EU labour market performance during the early part of this century and particularly since the financial crisis of 2008-09. Initially there was little focus on the labour market during the extended, and often convoluted, attempts to co-ordinate economic policy across member states. Discussion tended to focus on fiscal co-ordination as some of the member states inched their way towards monetary union. Aside from its brief flirtation with the European Monetary Union process, the UK has fairly consistently insulated itself from this process. However, the labour market now has a clear role within the EU growth strategy, which was initiated in 2010. The “Europe 2020” growth strategy comprises four elements covering both the labour market and more general economic policy. These are:

1. Employment guidelines that are intended to enhance the demand for labour, increase the supply of skills, improve the functioning of the labour market, whilst also promoting fairness, equal opportunities and combating poverty.
2. A joint employment report which assesses the employment situation in Europe.
4. Country reports analysing member states’ economic policies which issue country specific recommendations.

For those wishing to leave the EU, this process may appear an infringement of sovereignty. However, the recommendations contained in these reports have no legal force. The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), which was signed in 2012 by all member states, excluding the UK and Czech Republic, imposes legal constraints on budgetary policy and therefore forces policy co-ordination on its signatories.

However, the Europe 2020 report, as far as the UK is concerned, is not substantively different from those produced by the OECD for many years now on a regular basis for its member countries. These also contain recommendations for policy actions including some that relate to the labour market. Nevertheless, Brexit supporters might be concerned that the UK will not be able to maintain its isolation from the co-ordination process set in train by the TSCG.

Interestingly, while some of the country reports encourage member states to introduce measures that will improve the efficiency of the labour market, other parts emphasise the need to reduce debt levels, an implicit acknowledgement of the need to meet the requirements of the TSCG. Debt reduction measures may weaken labour demand and therefore work to offset increases in employment and reductions in unemployment stemming from improved labour market policy.
This somewhat confusing policy stance is no better exemplified than in Greece, where measures to reform the labour market (such as pension provision) are accompanied by drastic debt reduction policies which reduce the demand for labour. It is therefore perhaps no surprise that there has been limited success in reducing unemployment levels to those enjoyed outside the EU since the financial crisis of 2009–2010. Figure 1 shows unemployment rates in the 28 EU member states, the EU as a whole, the Eurozone, Japan, Norway and the USA for 2010 and for 2015. First, it demonstrates that there are very substantial variations in unemployment rates among the member states. In theory, worker freedom of movement within the Single Market should reduce, if not eliminate, such differences. These differences are consistent with, and provide prima facie evidence of, substantial differences in national labour market policies among EU member states. Second, while unemployment rates fell in most countries between 2010, when the financial recession was at its height, and 2015, when most countries had experienced some recovery, the change in unemployment rates varied hugely across EU member states, suggesting that labour market policy coordination had, at best, limited effect. Thirdly, it is clear that major countries such as the USA and Japan typically enjoy much lower rates of unemployment than most member states of the EU, a fact that has not gone unnoticed by supporters of Brexit.

The OECD constructs indices of labour market flexibility, which track the relative difficulty that employers face in changing the size of their workforce. The lower the level of the index, the lower the protections that workers have against dismissal, and the more “flexible” that country’s labour market is. The most recent (2013) values of these indices are shown in Figure 2. Two important points emerge. First, there is wide variation across EU members of the OECD in the “flexibility” of their labour markets. This implies that national, rather than EU, regulation dominates working conditions among these countries. Second, the UK has one of the most flexible labour markets in the OECD. This may give it an advantage, for example, in the competition for foreign direct investment where companies seeking to establish presence in the EU may wish to do so in a location which offers maximum flexibility in adjusting their labour force. Clearly this advantage could be lost if the UK did not manage to negotiate beneficial trading agreements following Brexit. In addition, if one of the motivations for leaving the EU is the burden of regulation, it is worth noting that the OECD labour market flexibility indices place the UK as the least regulated labour market amongst its EU members.

Figure 1: International Unemployment Rates 2010 and 2015
Source: Eurostat

![Figure 1: International Unemployment Rates 2010 and 2015](source: Eurostat)

![Figure 2: OECD Labour Market Flexibility Indices](source: OECD)

- Protection of permanent workers against individual and collective dismissals
- Protection of permanent workers against (individual) dismissal
- Specific requirements for collective dismissal
Thus, the UK appears to have moved further than its EU partners in terms of labour market deregulation. In contrast, many of its EU partners are being pressured by the EU Commission to further deregulate their labour markets. Meanwhile the process of forming a monetary union among some of the members (the Eurozone) has led to the creation of legal mechanisms to ensure policy co-ordination and, in particular, debt reduction. While the current UK government is also targeting debt reduction as a major policy objective, it is not willing to do so within the TSCG, at least in part because that would imply a substantial transfer of economic sovereignty from the UK to the EU.

4 Labour mobility

Another major area of dispute between supporters and opponents of Brexit concerns the free movement of labour, which, as indicated above, is one of the key principles underpinning the Single Market. The aspect of this principle that has produced most debate is migration to the UK. Concerns have focused on EU10 migrants. The UK was one of the few EU members which permitted migrants from the EU8 from 2004. This led to a very substantial increase in migrants to the UK, particularly from Poland and the Baltic states. A number of concerns have been expressed by Brexit supporters in relation to this inflow. These include the pressures that migrants place on public services and their effect on the labour market for UK citizens. We address these subsequently, but to put levels of net migration from the EU10 to the UK in perspective, Figure 3 shows the scale of migration from these countries to selected EU countries between 2011 and 2014.

The UK hosted around 1.3 million EU10 migrants over this period, the largest group in a single member state. However, migrant numbers in Germany, Italy and Spain were not substantially lower than in the UK. And while EU10 migrants comprised around 2.1% of the UK population, Austria and Ireland had substantially higher levels of migrants, when expressed as a share of the population. Population share is a better guide to pressure on public services than is the absolute numbers of migrants.

Figure 4 gives a more detailed breakdown of the citizenship of migrants to the UK for the year ended September 2015. The net migration flow for that year was 323,000 and demonstrated that the UK Government was far from achieving its objective of reducing net migration to the UK to “tens of thousands”. British citizens make up a substantial component of migrant flows, both leaving the UK and returning to it. The next most numerous, and with the largest net inflow, are migrants from the EU15 other than British citizens. The EU15 comprise the members of the EU, excluding the UK, before the accession of the EU10 countries, Malta and Cyprus. A large proportion of this group comprise individuals from Mediterranean countries whose labour markets have been performing poorly and are seeking opportunities in more buoyant employment conditions. Migrants from the EU8 and EU2 are less numerous but also contributed significantly to the total. The sharpest increase in the number of immigrants from these countries came in the years immediately following their membership of the EU.

Figure 3: Numbers and Shares of EU10 Citizens Resident in Selected EU Countries 2011-2014
Source: European Foundation for the Improvement of Living and Working Conditions
Why is the UK an attractive destination for migrants? Its flexible labour market and relatively high wages mean that migrants have a good chance of finding work that they consider rewarding. But work is not the only reason why migrants might be attracted to Britain. Figure 5 below shows the main reasons why people came to the UK between 2005 and 2015. It covers migrants to the UK from all destinations, including those outside the EU. Work is the dominant reason, accounting for almost 300,000 of UK migrants in 2015. The second most important reason for migration to the UK is to study. This has declined in recent years from a peak of 250,000 to fewer than 200,000 in 2015. Universities complain that the increasing cost and complexity of obtaining student visas, as result of UK policies, has deterred many students from coming to the UK and had a serious impact on their incomes. However, visas are not necessary for students from the rest of the EU which are anyway significantly outnumbered by their non-EU counterparts. Higher university fees in England may account for a fall in their number.

Migrants accompanying or joining other family members comprise the next most numerous group, while those migrating for other reasons or for unstated reasons make up the remainder. Nevertheless, given that most students will only be temporary migrants, the dominant reason for long-term migration to the UK is for work.

If work is the main motivation for migrating to the UK, then the effect of migrants on economic activity might be expected to be positive. Increasing the supply of labour should increase the productive capacity of the economy and GDP should increase. However it does not follow that per capita GDP will necessarily increase.

Whether per capita incomes increase depends on whether migrants are substitutes for, or complements to, native workers. If migrants simply substitute for natives, the net effect of migration on per capita incomes will be close to zero; migrants would then expand the size of the economy, without necessarily improving living standards. However if migrants, as Jonathan Portes (2016) has argued, also bring dynamic benefits, such as new skills which can either be transferred to native workers and thus enhance native workers’ productivity or which complement native workers’ skills they will increase per capita incomes. They might also do this through the construction of their own networks which expand trade, and expand economic activity.

What have been the effects of EU migration on the UK labour market? A number of studies have addressed this issue. These are summarised in Ruhs and Vargas-Silva (2015). The main conclusion is that the overall impact of immigration on the wages of native UK workers is relatively small. However, this conceals differences along the wage distribution with low-wage native workers tending to lose while medium and high paid native workers gain from immigration. The negative effects for the low skilled suggest that immigrants generally substitute for low skilled rather than high skilled natives. However, the effects of EU immigration on employment and unemployment among UK natives do not seem to be significant. Even though the UK has experienced high levels of net immigration from the EU in recent years, its unemployment rate is still well below the EU average.
These analyses primarily focus on short run effects. Longer run impacts on the labour market will depend on how well or how poorly immigrants and their children integrate over time. How well immigrant children adopt to the education system will clearly be of considerable importance in this regard. Opponents of immigration argue that future labour market prospects may be damaged because immigrant children have a negative effect on the education of natives, though there appears to be little evidence that this is the case.

5 Benefits, Public Services and Fiscal Balance

An aspect of the debate over migration has been the extent to which migrants are attracted to the UK by the relative generosity of its benefits system. Advocates of Brexit have argued that much of the migration to the UK is motivated by the attractiveness of Britain’s benefit system. As ever, the truth is a little complicated. What we do know is that EU migrants are less likely to claim out-of-work benefits but more likely to claim in-work benefits, especially tax credits, compared to the UK born. This outcome is partly the result of the design of the British tax system and partly the result of the types of jobs taken by EU migrants. EU10 migrants are also more likely to claim child benefits. This is because they are, on average, younger than the native population and have higher fertility rates.

Eligibility to receive welfare benefits in the UK is mainly based on means testing, rather than on contributions to the system. This may be more effective at focusing benefits on the poor and disadvantaged (since the better-off do not then qualify for benefits) but it means that individuals cannot be prevented from claiming benefits because they have no record of contributions. And since Single Market regulations require EU citizens be treated equally, wherever they are located within the EU, this implies that EU citizens cannot be denied access to such benefits.

However, recent changes to benefit regulations have sought to limit these rights. Thus, for example, Jobseeker’s Allowance (JSA), Child Benefit and Child Tax Credits are not now available during the first three months of residency. In addition, income related JSA will be stopped after six months for EU migrants, unless they can prove that they have a genuine chance of finding work. Also starting in 2014, work benefits to help determine whether an EEA national is, or was in, ‘genuine and effective work’ and so has a right to reside as a worker or self-employed person. EU migrants have also been denied access to housing benefit unless they are in work.

Higher take-up of tax credits is largely explained by relatively lower rates of pay among EU (particularly EU10) workers in the UK. Moreover, there has been a substantial increase in the number of low paying jobs in the UK in recent years, which is likely explained in large part by the flexibility of the UK labour market. More than half of EU born adults who reported receiving tax credits in 2015 were working full-time and around 90% had dependent children.
Many of these workers are employed in jobs for which they are overqualified, but which are better paid than the jobs for which their qualifications are appropriate in their native country. It might be expected that the introduction of the National Living Wage in April 2016 at £7.25 per hour will result in a reduction in tax credit take-up by both UK and non-UK EU citizens. However, with a minimum wage that is among the highest in the EU, the UK will continue to be an attractive destination for migrants from the poorer parts of the EU.

The main public services that migrants may consume directly are health, education and housing. There is no primary data source from which utilisation of National Health Service (NHS) services by migrants can be assessed. If their use is as frequent as that of UK citizens in their age group, nationals from all other EU states would have cost around 3.3 per cent of health care expenditure, while accounting for 4.1 per cent of the population in 2012-13 (Foti, 2014). As with health, data on the utilisation of education services by migrants in the UK is limited. Foti (op. cit.) suggests that spending is in line with population share and household structure. Finally, and contrary to widely-held perceptions, take-up of social housing by EU10 citizens is low. It is low, even after taking individual characteristics into account. This may be explained by the long waiting lists for social housing that exist in many local authorities. These waiting lists are based on need. Because most EU10 migrants are in work, they tend to be given low priority on these lists.

Several studies have attempted to take an overview of the net contribution that immigrants make to the U.K.’s public finances – the balance between the costs of public services consumed and tax revenue provided. Vargas-Silva (2015) provides a summary. The main conclusion is that the differences between taxes and other revenues contributed and the costs of public benefits and services consumed by migrants are relatively small (less than 1% of GDP). Some studies find a positive contribution, while others suggest that migrants have a negative effect on the U.K.’s fiscal balance. Net contributions vary by age and by country of origin. Migrants from the EU are generally considered to make a larger contribution than non-EU migrants. However, such static analysis leaves out the dynamic economic effects of migration as described by Portes (op. cit.).

**Summary**

Our paper has attempted to lay out some of the key evidence on labour markets, competitiveness and benefits which is relevant to the debate over Brexit. It is clear that the direction of labour market policy and the absence of regulation that characterises the UK labour market originates in the UK and that the UK has exercised considerable autonomy in this area. How else can we explain the high degree of flexibility relative to other EU countries?

Nevertheless, the UK is in a somewhat anomalous position in that it has negotiated opt-outs from part of the WTD, yet added to its provisions in other areas. It is also involved in the co-ordination of economic and labour market policies, but in a more detached way than other member states. This partly stems from its unwillingness to join the monetary union, preservation of which now plays a key role in EU policy setting.

The UK has little control over EU migrant flows, but these are the outcome of a highly interrelated set of incentives and disincentives to migrate and the UK has recently acted to reduce a number of these incentives. In terms of benefits, a number of restrictions have been introduced. In general, migrants come to the UK to work and therefore are more likely to claim in work, rather than out of work benefits. The two main benefits for which their claim rate exceeds that of natives are tax credits and child benefit. These can largely be explained by their age structure and by the relatively low wages. Their net contribution in terms of the revenues contributed to the UK government, set against the costs of providing public services is relatively small in the short run, but migrants may provide long run benefits to the economy, improving productivity and competitiveness via a number of mechanisms.

**References**


