



Nicholas Boys Smith

**Mounting Costs:
Regulation,
Employment and the
British Labour Market**

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I

Introduction

The last six years have seen a significant re-regulation of the UK economy. Commentators differ as to whether this development is good or bad, too fast or too slow. What the British Chambers of Commerce regards as ‘excessive red tape stifling the very enterprise the Government is seeking to promote’ may be to the TUC General Secretary ‘not an unnecessary burden, or red-tape’.¹ The overall trend, however, is not in question. International commentators, trade unionists, businessmen, economists and lobbyists are agreed. As the OECD report for the UK in 2002 put it: ‘flexibility has been steadily eroded by ever-increasing regulation.’²

The aim of this study is to analyse the effect of these costs and how regulation affects behaviour. Do managers’ decisions differ as a result? What is the impact on small business? Do larger enterprises or the public sector fare better or worse? What, finally, is the result of this changing behaviour and what are the implications for Britain and the British economy? From wide economic and business research, illustrated by interviews with business owners, managers and human resources (HR) professionals, a disturbing picture of growing paperwork, constrained productivity and quietly altering attitudes to investment, growth, employment and legality emerges.³

These changes matter. Chapter III explores how they are hindering public sector productivity. New regulations alone are now costing Government at least £1 billion a year and probably much more. Chapter IV examines how small companies are being affected. They are now creating less employment as a result of regulation. In the longest-running business survey of small business behaviour by National Westminster, 50 per cent of those firms surveyed now estimate that they have cut jobs as a result of Government regulation and paperwork. This loss of British job-generating capacity is serious. Small British companies’ growth patterns are already less impressive than those of many other nations. And, although the figures are cyclically affected, British private sector employment growth has more than halved since 1997. For the long-term success of the British economy, the outlook is worrying.

Chapter V examines the impact of regulation on larger firms. At the moment this is less dramatic, but the personnel and compliance departments of businesses are growing and employee relations are being impaired. In particular, official estimates of the cost of changes to the tribunal system are likely to underestimate the full costs significantly since firms are now buying off employees before cases are even brought to tribunal.

A productive public sector and a prosperous private sector do not just appear of their own accord. They require certain skills, values, expectations and habits of behaviour to sustain them. These include fairness and hard work, the culture of the entrepreneur as opposed to the culture of the businessman-bureaucrat and the virtues of the honest businessman who pays his taxes and meets his obligations as opposed to the instinctive tax-dodger or black-marketeer. We are (just about) able to take these values for granted. However, it took a generation after the tax and supply-side reforms of the early 1980s for Britain to relearn fully the culture of the entrepreneur.⁴ And as Russia has discovered over the last decade, it takes more than a democratic framework and free-market reforms to create a culture of honest public governance and law-abiding business. The evidence currently available suggests that the recent re-regulation of the British economy has promoted unwelcome changes (particularly a more cavalier attitude to the law on the part of some employers and an increased 'have a go' attitude on the part of disgruntled employees). These could undermine the culture required for wealth and job creation. This is explored in Chapter VI.

It is important to keep matters in perspective. The legacy from the 1980s reforms and the recent boost in public sector spending have managed (just) to keep the British economy growing through the recent global near-recession. The UK still has more lightly regulated labour markets than most of its European competitors.⁵ However, as Chapter VII indicates, despite the burdens imposed by the EU the international framework is getting more, not less, competitive. Individual European nations are, finally, beginning to loosen up their regulatory superstructures. And the growth of competing manufacturers and service providers in the Far East and in India means that large firms, particularly, are increasingly intolerant of poor productivity or management. Outsourcing to India or China is already just a phone call away.

The Prime Minister has frequently expressed his desire for British 'wealth creation and enterprise to flourish.'⁶ If he wishes to achieve this aim, his Government cannot keep giving with one hand and taking with the other. Starting with the UK's accession to the social chapter, the Government's actions and policy decisions since 1997 have already undermined British international competitiveness. Separate surveys by the Institute of Management and Development, the World Economic Forum and the Heritage Foundation are all agreed on this.⁷ The hard-won resurgence of British confidence and economic competence is under threat. If Britain is to continue to reap the benefits of the 1980s' reforms as the 'healthy man of Europe', then the mania for new regulation has to stop.

II

The Re-regulation of the UK Economy

How has the British economy been re-regulated? Since August 1998, a Regulatory Impact Assessment (RIA) has accompanied each new regulation. According to research conducted for the British Chambers of Commerce (BCC), 709 RIAs had been published by June 2002. Depending on the efficiency with which the Regulatory Impact Unit (RIU) has collated the latest RIAs, this total had increased to between 820 and 860 by March 2003.⁸ The split of most of these RIAs by type and date is shown below.

Figure 1: Regulations by type, 1998-2003
(100% = 629 RIAs from Aug 1998 to March 2003)⁹

Type of new regulation	Percentage
Transport	14
Employment	12
Farming and Fishing	12
Environment and Energy	11
Tax and Benefit System	10
Competition and Consumer Law	8
Food	7
Health and Safety	6
Courts, Justice, Police and Immigration	5
Medicines and Medical Equipment	4
Broadcasting and Telecommunications	4
Regulation of Financial Markets	3
Care Homes and Care Provision	2
Planning	2

Figure 2: Regulations by complete year, 1999-2002
(100% =547 RIAs)¹⁰

Year	1999	2000	2001	2002
Percentage	27	20	25	27

An analysis of the regulatory burden by estimated cost as opposed to volume emphasises employment and data protection regulation. Although no completely comprehensive or up-to-date costing of all Government regulation is available, the BCC 'Burdens Barometer' contains most recent Government regulation. It is summarised by type in Figure 3.

Figure 3: Estimated cost of regulations by type, 1997-2003

Type of new regulation	Percentage of total cost in RIAs
Employment	49
Environment and Transport	21
Data Protection	19
Tax and Benefit System	7
Broadcasting and Telecommunications	1
Courts, Justice, Police and Immigration	1
Planning	1
Other	1

Three clear points emerge from this analysis. First, despite the Government's claims to be 'listening to business', there has been no let-up in the regulatory momentum in the last eighteen months. Second, the main areas of cross-sector regulation are employment regulation, environmental regulation and health and safety regulation. Finally, the sectors of the economy currently being most actively regulated are: transport, energy, farming, food and catering, medical supplies, radio and telecommunications, provision of medical care, financial services and fishing.

However, even the figures above do not convey the full extent of the Government's propensity to regulate. Not all statutory instruments require RIAs. Even the Government, which is keen to present statutory instruments as little more than 'business as usual,' admits that each year around 200 statutory instruments are issued which *do* have a significant impact on business.¹¹ The total number of statutory instruments has increased by 20 per cent over the last ten years and the Government is making increasing use of them as almost extra-parliamentary devices. In addition, under the terms of the Financial Services and Market Act 2000 which created the Financial Services Authority (FSA), not all FSA actions require RIAs. Since 1997 the FSA has issued over 200 consultation papers on proposed changes to the business regimes of financial regulation.

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Estimates differ as to the proportion of this total regulatory load that has been initiated by European legislation. The BCC and the Government's own Better Regulation Taskforce estimate that, respectively, 40 per cent and 42 per cent of regulation comes from the EU. The Confederation of British Industry (CBI) estimates are rather lower at 26 per cent. An estimate made in 2001 of the actual cost of regulations coming from the EU (as opposed to the total number of regulations) calculated that as much as 52 per cent of regulatory cost was EU-derived.¹² This suggests that between 40 per cent and 50 per cent of British regulatory cost is imposed by the EU and the remainder by domestic legislation.

Employment Regulation

The largest area of re-regulation is the labour market. This is thanks to two major pieces of legislation – the Employment Relations Act 1999 and the Employment Act 2002. The main arenas in which change was introduced were: employment tribunals, equal opportunities, unions and employee representation, minimum wage, working time, 'work-life' balance, employment agencies and transfer of undertakings (TUPE).¹³

Employment Tribunals

The Employment Relations Act 1999 raised the limit for compensation for unfair dismissal from £12,000 to £50,000, removed it completely from discrimination cases and extended the right of appeal to an employment tribunal to employees who had been with their employer for less than one year. The number of applications consequently went up by 50,000, or just over 60 per cent, between 1997/98 and 2000/01 although it has since fallen by 30,000. The total costs of the tribunals have therefore reached around £1 billion *per annum*.¹⁴ The growth of appeals to tribunals has been one of the main causes of concern to employers in the last six years, and a primary cause of soaring mandatory employers' liability insurance cover (with rises of over 50 per cent in 2002 alone).

The Employment Act 2002 responded to the explosion in the number, and cost, of tribunal applications by establishing set dismissal, disciplinary and grievance procedures to reduce pressure on the tribunal system. Complaints cannot now be presented to tribunals until all, or part, of the relevant statutory procedure has been completed. (Nevertheless, many legal experts are far from convinced that this will have the desired effect. Based on their knowledge of detailed case law, two distinguished legal academics believe that 'the Act is likely to increase the number and length of disputes rather than reduce them'.)¹⁵

Equal Opportunities

The EU Anti-Discrimination Directive prohibited discrimination on the grounds of disability, sexual orientation, age and religion or belief. These have been partially

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implemented in the UK by changes to the Disability Discrimination Act 1995 and the Race Relations Act 1976. Further changes will be required to fulfil EU requirements on preventing sex, and age and sex, discrimination by 2005 and 2006 respectively.

Unions and Work Councils

The Employment Relations Act 1999 created a statutory procedure for trade union recognition for organisations with more than 20 employees and gave trade unions extra legal protection if they launch, or threaten to launch, industrial action. It also gave employees the right to claim in a tribunal that they were dismissed because of union membership.

The Government is currently proposing to use the powers available under the 1999 Act to provide earlier access rights to unions in recognition cases and to establish a new legal right for members to access their union's services.

In addition, under the new National Works Council Directive, UK large-and medium-sized employers are soon to have a statutory duty to inform and consult employee representatives about important decisions via a formally appointed works council. From March 2005 until March 2007 it will be extended to businesses in the UK with 150 or more employees. From March 2007 the threshold will be reduced to businesses with more than 100 employees. Finally, from March 2008 all employers with more than 50 employees will be obliged to create and consult a formally-structured works council.

Minimum Wage

The minimum wage was introduced in 1998 at £3.60 for adults and £3.00 for those aged 18-21. Since then the two minimum levels have risen by 25 per cent and 27 per cent respectively to £4.50 and £3.80 – increases that are nearly double the rate of inflation over the same period. Recent changes made by the National Minimum Wage (Enforcement Notices) Act 2003 will oblige employers to compensate former, as well as current, employees for any minimum wage infringement. This year the Government is expected to extend the minimum wage to sixteen-year olds.

EU WorkingTime

The working time regulations came into force in October 1998. They implemented the European Working Time Directive and limited the time a worker can be required to work per week to 48 hours (with a voluntary opt-out) as well as stipulating certain minimum standards of paid leave, night worker minimum standards and daily rest breaks. The main source of business complaint about the standards was not the rights themselves but

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the cost of the associated bureaucratic record-keeping. The Working Time Directive is seen by HR professionals as their most onerous record-keeping challenge over the last six years.

The working time regulations are currently becoming more wide-ranging and stringent. Certain sectors were exempted from the initial regulations in 1998. These were road, rail, sea and freshwater transport as well as fishing, offshore oil and gas and the NHS (in respect of junior doctors). In 2003 the regulations were extended to these sectors.

The European Commission is also currently reviewing whether the UK regulations on employers' obligations to enforce holidays and workers' rights are actually in breach of the Working Time Directive. It is likely that they will need to be tightened up. Even more significantly, the European Commission has indicated that it wishes to remove from the Working Time Directive the provision which permits an opt-out from the 48-hour week. If the scope for individual opt-outs is removed, all employers whose employees work more than 48 hours per week would be committing an offence.

'Work-Life' Balance

The Employment Relations Act 1999 introduced a range of 'family friendly laws.' Some of its main provisions extended maternity leave, reduced the qualifying length of service for maternity leave, and introduced the right to further unpaid parental leave and leave for family reasons. Again, the main complaint from most businesses was not the nature of the rights themselves, but the bureaucratic and inflexible way in which employers were forced into a national statutory framework.

The Employment Act 2002 extended these rights further by giving parents of children under six the legal right to apply for a flexible working arrangement and by obliging their employer to consider the request seriously. It also introduced the right to paternity leave, and paid adoption leave along with a more generous framework for maternity leave and pay. The Government is currently considering extending these rights further through, for instance, a lengthening of paid paternity leave. One survey of the initial impact of these further rights has not so far revealed as many problems as some commentators had expected.¹⁶

EU Employment Agencies and Contract Workers

Since October 2002, the EU Fixed Term Work Directive has prohibited discrimination between fixed-term contract staff and permanent staff.

A draft directive published by the European Commission in 2002 also proposed to establish the principle of 'non-discrimination' between temporary agency workers and

full-time workers. It would require, for example, the same general terms and conditions to be given to both groups from day one and the same salary after six weeks. This proposal has not yet been agreed by the Council of Ministers. It is not certain whether it will be promulgated.

Transfer of Undertakings (TUPE)

This is the final area where regulation is limiting employer flexibility – specifically the ability to restructure companies in order to adjust to changing circumstances. The Government is currently proposing to protect service conditions and all occupational pension rights when TUPE applies (often a matter of complicated legal dispute) – particularly in relation to outsourcing and service provision changes. This will restrict the ability of many companies to adjust the size of their labour force in the UK.

EU Transport and Environmental Regulation

Over thirteen EU Directives and draft directives together with the Environment Protection Act 1990 provide the framework for current and future environmental regulation. Some important new directives are noted below.

The Landfill Directive bans the dumping of hazardous and non-hazardous waste in the same sites from June 2004. In the short term this is expected to reduce the number of sites from 200 to about 10, and increase illegal waste disposal or fly-tipping. In the longer term it is hoped that companies will alter processes to produce less hazardous materials.

The End-of-Life Vehicles Directorate obliges owners of vehicles acquired before July 2002 to take responsibility for their disposal. Manufacturers are responsible for disposing of cars sold after July 2002 and will be responsible for all disposals after 2007. Again an increase in fly-tipping is predicted. The British Metals Recycling Association has warned of 'environmental disaster and a blight on local communities.'¹⁷ Compliance costs are estimated at £126 million to £163 million a year.

The Waste Electrical and Electronic Equipment Directive will oblige manufacturers of electrical equipment to take it back and pay for the cost of disposing of it. This came into force in UK law in mid-2004. A companion directive will ban hazardous material in electrical and electronic equipment. Price rises for larger appliances are expected to be in the range of £14. Costs to industry in the UK are expected to be in the range of £217 million to £455 million a year. This includes investment in new technology and the cost of dealing with 'historic' waste.

The Tax and Benefits System

As is well known, the tax and benefits system has become more complicated since 1997. The Government has sub-contracted the payment of part of the benefits system (the Child Tax Credit and the Working Tax Credit) and the collection of student loans to employers. Simultaneously, the Chancellor has introduced a range of tax incentives which has increased the complexity of tax calculations.

Health and Safety Regulation

The Management of Health and Safety at Work Regulations 1999 made a fundamental change to the underlying principle of British health and safety regulations. Under the previous 1974 Health and Safety at Work Act, employers had been expected to maintain reasonable standards 'so far as is reasonably practical.' The new regulations go much further. They not only oblige employers with more than five employees to conduct, record and keep updated a risk assessment of the health and safety, but they are also far more prescriptive and explicit about what employers must do to manage health and safety at work.¹⁸ At the same time the Government is encouraging the Health and Safety Executive to take a far more interventionist approach – setting targets to increase the number of health and safety investigations by over 30 per cent, from 34,000 in 2000-01 to 45,000 in 2003-04.¹⁹

Financial Services Regulation

The Financial Services and Market Act 2000 replaced the range of previous regulatory bodies with the new 'super-regulator,' the Financial Services Authority (FSA). As noted above, since 1997 the FSA has issued over 200 consultation papers. These represent considerable changes to the regulatory requirements of the British financial services regime – in particular to the retail investment, life insurance, general insurance and mortgage markets. Some sense of the growing extent and depth of FSA regulation can be gauged from the growth in costs recovered from the industry. They are up by nearly 260 per cent, from £58m. in 1998/99 to £209m. in 2002/03.²⁰

Data Protection Regulation

The 1995 Data Protection Directive placed substantial obligations on employers to grant individuals rights to access personal data stored electronically. Many businesses have considered this a particularly tricky obligation (23 per cent of HR managers consider it the most difficult legislative change to implement).²¹

Just as most businesses had got on top of the bureaucratic (if not the financial) implications of the Directive, the Information Commissioner is now publishing a more detailed and wide-ranging code of practice for the use of personal data in employment relationships. The full cost and implications of this code are not yet clear.

The Total Cost of Increased Regulation

Since 1999, a range of different organisations and studies have attempted to cost the overall impact of the increased regulatory burden.

Initially this was done by costing the total number of the Government's own RIAs. But this method seriously underestimates the total cost. Not all RIAs are readily available.²² Of those that are, only 69 per cent of RIAs actually bother to quantify the regulatory cost (despite their mandatory requirement to do so).²³ And even those RIAs that do calculate the cost sometimes underestimate them seriously.²⁴ Nevertheless recent costings remain very helpful. The BCC compile the 'Burdens Barometer' (cited above) in this manner. It estimates that the total cost of new regulations since 1997/98 has been £20.6 billion with the minimum wage adding a further £10.2 billion. This cost is increasing and was running at £5.8 billion a year by 2003.²⁵

A second approach to costing the total impact of new Government regulation is now being developed empirically from surveys of actual costs and of time spent on regulatory activity in different firms. Using this method the law firm, Peninsular, has estimated that the total extra regulatory cost since 1997 amounts to £22 billion.²⁶

In short, totally different methods of estimating the cumulative cost of recent regulatory initiatives would imply that by June 2005 the total cost of new regulation will be between £26 and £36 billion.

III

Undermining Public Sector Productivity

The main critics of the re-regulation of the British economy have been the trade bodies of British enterprise – notably, the Confederation of British Industry (CBI), the Institute of Directors (IOD) and the British Chambers of Commerce (BCC).²⁷ Not surprisingly, these organisations have focused on the dangers which new regulations pose for their members in the private sector.

However, regulation does not just affect private sector employers. Many of the same employment and health and safety requirements impinge on their public sector counterparts. What are the benefits and costs?

The Dilemma of Product Sector Productivity

This issue is particularly politically sensitive. The Government is very publicly committed to raising public sector productivity. Gordon Brown asserted in November 2000 that: ‘We are determined that public sector productivity is improved . . . [we] will now rigorously tackle all barriers to productivity growth ranging from incentives to absenteeism, new technology to industrial relations’.²⁸

The Government’s problem is that public sector productivity is stubbornly failing to rise.²⁹ In 2003, for instance, the number of public sector employees went up (by 181,000), and public sector wages went up (by 5.1 per cent as opposed to 3 per cent in the private sector), but output per job steadfastly failed to keep pace. The unit cost of public service provision, measured by a wide range of outputs from patients served to claims processed, rose by 7.6 per cent.³⁰ Public sector employees work notably fewer hours while taking much longer off sick.³¹ According to the Director of the CBI, Digby Jones, improvements in public sector productivity have failed to match the increase in investment. He has urged the Government to improve the efficiency of public spending or ‘face the painful choice between scaling back investment or increasing taxes further’.³²

The Cost of Regulation to the Public Sector

The irony is that the Government’s regulatory innovations are helping to prevent the public sector from meeting its own aspirations. UK public expenditure now represents 41 per cent of British gross domestic product (GDP) and public sector jobs constitute approximately 20 per cent of the workforce. Despite economic growth, they have

increased from under 39 per cent and around 18 per cent respectively since 1997.³³

Estimated total private sector regulatory costs were £5.8 billion per year in 2003. Of this an estimated £4 billion was derived from regulations which are borne by the public sector as well as the private sector.

Some 20 per cent of British employees work in the public sector. A straight *pro rata* cost comparison implies that the cost of new regulation to the public sector is around £950 million per year – with a total increased cost since 1997/8 of around £6 billion. In fact these figures are probably an underestimate for three associated reasons.

First, the public sector workforce has a far higher proportion of female and part-time workers. For instance, local authorities employ some two million people, of whom 70 per cent are female and 40 per cent are part-time. As the Government's own Better Regulation Task Force has conceded, 'This means that regulations designed to help women or part-time staff in the workplace impact greatly on local authorities.'³⁴

Second, public sector employees seem to be more inclined to challenge their employers. One analysis of discrimination applications to employment tribunals discovered that more were made by public sector employees.³⁵ Public sector employees have also been more successful in using the Working Time Directive to win improved holiday and rest rights.³⁶

This greater propensity to seek redress in the public sector may be due to higher trade union membership and a more highly developed grievance and litigation culture. Around 59 per cent of public sector employees are union members as opposed to only 19 per cent in the private sector. This certainly results in a consistently greater proportion of industrial stoppages in the public sector than in the private sector. In 2001, public administration lost 153 days to stoppages per 1,000 workers as opposed to an average across all sectors of only 20. In 2002 and 2003, public administration lost 338 and 94 days to stoppages per 1,000 workers as opposed to an average across all sectors of only 51 and 19 respectively.³⁷ (This excludes those who, though employed in the private sector, are engaged in publically funded work or contracts.) In 2003 the top 25 public sector industrial disputes alone accounted for over half of all days lost to industrial action.³⁸

Third, perhaps partly as a result of higher trade union membership and their employees' relative militancy, many public sector managers also appear to be far more inclined to interpret minimum required standards generously.³⁹ Public sector HR managers also pay more attention to discrimination issues than their colleagues in the private sector (32 per cent have invested in IT to 'manage diversity' as opposed to only 18 per cent in the private sector – although the private sector systems work better!⁴⁰).

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Of course, this approach may represent the most appropriate HR policy in a given situation. Nevertheless, it does not appear to be working. A survey carried out two years ago showed that perception of an equal pay 'problem' was higher in the NHS, local councils and public administration (40-48 per cent) than in the average organisation (36 per cent).⁴¹

It is hard not to draw the conclusion that some sections, at least, of the public sector are indulging in management policies which do not represent good value for money for the taxpayer. One HR manager interviewed for this study with experience of working for a range of London councils felt that on average local authorities had about double the statutory minimum benefits. Another said:

'To be honest I would tell anyone who is likely to become pregnant to take a job in the public sector. You get a very very good deal there. Discrimination policy is also just getting out of hand [in the public sector]. We have two staff counselling young people and helping on outward bounds. One is blind and one is deaf. The deaf person needs to take someone with them to their counselling sessions. The blind person can't help on the outward bounds. It is costing us a fortune. We are scrimping and saving on other things and then we go and spend £10,000 on nothing. It is crazy.'

The unpleasant conclusion for the Government and the taxpayer is that the biggest single victim of the Government's mania for regulation is the Government itself. Additional regulation is costing the public sector at least £950m. per year in lost productivity or increased costs.

IV

Hindering Growth in Small and Medium-Sized Enterprises

It is broadly accepted that recent re-regulation has had a disproportionate impact on small and medium-sized enterprises (SMEs). Many regulations impose a minimum fixed cost on all companies regardless of size. Academic studies have estimated that compliance costs for firms with 20 employees or less are about 35 per cent higher than for firms with more than 500 staff.⁴² The Government's own Better Regulation Task Force has conceded these key points unambiguously:

'We found evidence that entrepreneurs are being distracted from running and growing their businesses by the cumulative burden of taxation, employment, public protection and environmental regulation.'⁴³

The Government recognises 'that small firms are often disadvantaged by the cumulative burden of legislation' and requires RIAs to 'consider the impacts of each option on small firms', (although in fact only 4 per cent of RIAs bother to quantify regulatory cost to SMEs – a standard of analysis which would not be acceptable outside Whitehall).⁴⁴

Which regulations cause SMEs most difficulty? Why? Which difficulties do business owners and managers overcome? What is the cost of doing so? Which regulations are not overcome? How does this affect their management, innovation and investment decisions? Are some sectors more affected than others? Finally, are there any implications for the future of the British economy?

Overall Impact

No survey conducted in the last five years has been able to avoid the conclusion that many SME owners are concerned about the re-regulation of the workplace. One survey showed that 93 per cent felt that employment regulation, and 84 per cent that payroll red tape, had got heavier since 1997. Consequently, only one in five small employers feel that they understand their employment obligations properly and 49 per cent now feel that regulation is a serious obstacle to the success of their business (second only to taxation). Their concerns have risen significantly in the last few years. In 1990 only 3.1 per cent of small firms felt that Government paperwork was the 'most important problem' facing their business. By 2003 that view was held by 15 per cent of small firms.⁴⁵

Hindering Growth

There is good evidence that the burden of regulation in the UK on the very smallest businesses (sole traders or micro-businesses with less than 5 employees) is comparably light. An OECD survey found that the administrative burdens on start-ups were less in the UK than in all countries save Denmark and the US.⁴⁶ Again, this is not surprising. Many UK regulations (including some health and safety rules, stakeholder pensions and re-employment after maternity leave) have exemptions below a certain threshold of employees or turnover. Value Added Tax (VAT) is also not payable below a turnover of £52,000. Consequently owners of larger SMEs are more worried than those with less than 10 employees about the extra workload that regulation creates. Sole traders are also less concerned about regulation generally. Only 11 per cent of sole traders consider regulation as the primary concern facing their business (as opposed to 16 per cent of larger SME owners polled in the same survey).⁴⁷

Very small firms are less likely to invest for growth if their owners are aware that a whole range of new regulations and requirements face them at various points. Research commissioned for the DTI shows that the very smallest firms are nearly twice as likely to react to Government regulation by reducing the number of people they employ as those with 10 to 19 employees. Overall the longest established survey of small business attitudes shows that *50 per cent of small businesses have reduced the number employed or else have employed fewer people because of the burden of paperwork and regulation.*⁴⁸ The potential impact of this trend on long-term British growth and job creation is enormous.

The Government's own Better Regulation Unit also conducted qualitative research which corroborates these findings. It has found that 'fears about regulation inhibit entrepreneurs from taking on employees' and that the implications of employing staff is 'more daunting in the UK than in Germany or Italy.'⁴⁹ Analysis of company turnovers also demonstrates that firms keep their turn-over below £52,000 so as to avoid VAT administration.⁵⁰

As well as exposing employers to more regulations, growth also increases their chances of being taken to an industrial tribunal. Over 20 per cent of employers with 10-19 employees have been involved in legal disputes on employment matters compared to only 10 per cent of employers with less than 10 employees. One Chief Executive Officer of a micro-business who had previously run larger firms explained why: 'at a very small business everyone is loyal to the others and to me in particular. You lose a bit of that personal trust as you get bigger.'⁵¹ In one survey 75 per cent of employers said that they had become more cautious about offering jobs as a result of the specific danger of tribunals.⁵²

Small firms are critical to economic growth and productivity. They account for 44 per cent of non-governmental employment and 37 per cent of turn-over. They create a

disproportionate number of new jobs. They foster innovation and reshape markets. Regulation discourages their growth and job creation, as comparative surveys of the UK, European and US economies have shown. British businessmen are actually more successful than most at setting up firms but less successful at expanding them.⁵³ Although the figures are cyclically affected, British private sector employment growth has more than halved since 1997.

In short, the Government is penalising the growth of a sector whose ability to expand and create jobs is crucial. This is the first melancholy implication of the re-regulation of the British economy on small and medium-sized enterprises.

Wasting Time and Reducing Employment Opportunities

Regulations waste time. An IoD survey in 2001 estimated that dealing with regulation took six hours a week for the average small businessmen. A survey by the law firm, Peninsular, found that the time required increased from 3 hours per week in 1997 to 9 hours a week by 2002.

A London media company employing thirty people provided a graphic illustration of the extra burden: 'Filing on each employee has gone up from 6 inches 4 years ago to about 12 inches now. Contracts used to be 2 pages long. Now they are 10 pages long . . . We do more paperwork than we probably need to cover ourselves just in case. For instance we monitor equal opportunities and race even though we currently make no use of this' (December 2003).

Small firms use several ploys to reduce this overload. One is to move away from the use of part-time workers to full-time staff. 20 per cent of firms affected by regulation have reacted in this manner.

Another ploy is to employ fewer women of child-bearing age as they enjoy the greatest protection under the 'family-friendly' rules. The proportion of small businesses admitting to finding those in this group less attractive as employees has risen from 45 per cent in 1997 to 67 per cent under the current rules.⁵⁴ Seven per cent of firms affected by regulation already admit to altering the balance between male and female employees as a result of new regulation.⁵⁵ This is not something to which firms admit readily. The true figure is probably much higher.

So recent re-regulation has hindered the employment of the very groups it was supposed to succour and reduced the range and flexibility of employment opportunities in the private sector.

Increasing Costs

Analysis of employers' least favourite regulations over the last five years yield an important conclusion. They evolve over time. Research conducted in 2000 showed that the Working Time Directive, the stakeholder pension and the family tax credit caused the most problems for record-keeping. By early 2004 the evidence suggests that the stakeholder pension and tax credits were causing less concern and that disability rights (due to the 2001 Adjustment of Premises Regulations) and 'family-friendly' regulation had become more prominent among business concerns.

The reason for this evolution is that small businessmen adapt to new regulations by contracting out the problem. They learn to turn it from a waste of time into an additional and predictable cost. The most obvious function that is now almost entirely outsourced as a result of regulation and complexity is payroll administration. The market for this service is now estimated at over £500 million a year and it is growing fast. Senior business executives are clear that it is legislation and increasing complexity which is driving this industry.

Another regulatory requirement which businesses are very inclined to turn from an administrative nightmare into a reduced margin is the 1994 Packaging Waste Directive which was brought into British law in 1997 and 1998. This requires firms to monitor and account for their waste products. The process is complex and demanding, and specialist firms now provide it for a price.

Finally, SMEs are having to outsource the very business of keeping up to date with their regulatory requirements. 40 per cent of small firms affected by regulation have increased their use of legal advice as a result. 45 per cent now use their accountants and 35 per cent their solicitors to keep abreast of regulatory changes.⁵⁶

Nor can businesses escape increased insurance premiums. Even if they themselves are slow in carrying out their legal requirements, their providers of mandatory employers' liability insurance are very aware of their increased risks. Driven particularly by more tribunals, average liability premiums rose by around 50 per cent in 2002 – far more than the rise in most insurance prices. Where some smaller firms or more hazardous businesses are concerned, trade federations have been complaining of rises of up to 2000 per cent or the removal of liability insurance – effectively forcing firms out of business.⁵⁷

In short, small companies are able to reduce the administrative burden of new regulation over time. They cannot escape the cost. Indeed more effective action to reduce the bureaucratic hassle only tends to increase the cost. This is why larger SMEs which are better able to outsource regulatory costs actually find that regulation is more likely to

have an impact on their overall business performance. (40 per cent of SMEs with 20–49 employees affected by regulation see an impact on overall business performance as opposed to only 33 per cent of firms with fewer than 10 employees).⁵⁸

Conclusion

It would be wrong to suggest that all SMEs are being crushed under a burden of new regulations. This is not the case. However, the vast majority think that regulation has got heavier and many think it is now a serious obstacle to their operations. Whether they realise it or not, millions of them are making different decisions about investing to grow, employment and recruitment styles. Regulation has perverse effects: it hinders growth, decreases profit margins and reduces overall employment opportunities – particularly, it seems, for women. For the moment this is the Government's curious and unattractive achievement.

V

Large Firms' Compliance and Investment Decisions

The regulatory challenge faced by larger firms is different from that confronting smaller employers. Unlike small firms they normally have specialist compliance and personnel departments. They normally *do* know what regulations need to concern them. The cost of the required bureaucracy is also more readily borne due to their economies of scale. At worst, the immediately obvious impact of regulation amounts to no more than the recruitment of a few dozen additional employees. Larger firms normally talk of an administrative burden rather than the challenge of meeting costs.

Nevertheless, it is possible to track the more subtle changes which re-regulation is making to the personnel functions and employee relations of larger firms.

The Changing Role of British Personnel Management

Since 1997, legal issues have been responsible for an increasing share of HR management costs. In a 2002 survey of personnel managers (whose respondents were predominantly drawn from larger private sector firms) participants reported a substantial increase in the resources needed to deal with employment law matters. 63 per cent of HR professionals now spend over 20 per cent of their time on them, 24 per cent spend over 40 per cent and 8 per cent spend over 60 per cent. Critically, 83 per cent of HR professionals reported that the amount of their time allocated to employment law issues had risen in the last few years. 40 per cent of HR managers dealt with this requirement by employing more staff. Another 40 per cent used an equal mixture of internal staff and external experts. The rest relied mainly upon external experts.⁵⁹ British HR departments have, in effect, become a part-time compliance arm of the DTI.

But regulation is not just taking up the time of British personnel management. It affects the actual decisions made. In the same 2002 survey, new legislation was listed as the most influential factor on the 'development of people management and development policies and practices.' 34 per cent listed 'new legislation' as the most significant influence in this field. By contrast, only 20 per cent listed business strategy. A further 36 per cent listed 'new legislation' as the second or third most influential factor on the development of their policies.⁶⁰

As a result, the growing compliance role of British personnel departments has increased the influence of HR managers with senior management. 73 per cent of HR professionals

report that they now have increased influence with senior managers.⁶¹ There are some signs of tension between personnel requirements and business strategy. 39 per cent report this tension.⁶²

The Breakdown of Employee Trust

The history of regulation is often the history of perverse consequences as organisations and individuals alter their behaviour to meet new circumstances. There are some signs that the re-regulation of the British labour market is actually impairing British labour relations.

Some employees are certainly becoming more demanding and militant. They know their rights and they intend to get them. Trade Union membership has ceased to fall. In 1999 and 2000 it actually grew. New regulations, particularly the Working Time Directive, increased the number of old-style collective agreements being made. Only 7 per cent of firms in one survey found the unions' attitude over the Working Time Directive to be 'co-operative' or 'pragmatic.'⁶³ 'Old style' disputes are also on the rise. The number of private sector stoppages increased by around 200 per cent from 200,000 days lost in 2001 to 600,000 days lost in 2002.⁶⁴

Even more marked is the growth of the 'compensation culture' and the stark rise in the range, number and cost of compensation claims.⁶⁵ This is due to more readily available financing (following the removal of the rules restricting the 'no win - no fee' arrangements for lawyers in 1995), the increase in average court awards for health and safety claims and the Government's removal of caps on employment tribunal awards in 1999.

Although there has been a slight reduction since 2000, 172,322 applications were still registered by employment tribunals in 2002-03. HR managers interviewed for this study agreed: 'there is a definite propensity for people to have a go.'⁶⁶ The figures support this view. 38 per cent of cases started in 2002-03 were withdrawn by applicants presumably because they had no reasonable chance of success. For large firms even this figure significantly underestimates the range of speculative compensation attempts launched. Often, even when they judge the case is unreasonable, firms will pay compensation to claimants. This is because the management time saved by not contesting the case is greater than the cost of the claim. In short, most of the 'cost' to larger employers which the expansion of the tribunal system has produced is unlikely ever to be included in the official estimates derived from the Employment Tribunal Service.

The new procedures introduced under the 2002 Employment Act are also making personnel policy far more bureaucratic and legalistic than ever before. This might have

the benign effect of reducing tribunal applications. However, by automatically escalating every minor dispute into a formal process, it also risks eroding further the sense of bond between employee and their individual manager. HR managers are concerned that even petty disputes are increasingly becoming formal processes with set procedures and HR intervention.

Trust is not just being eroded between employer and employee. It is also being eroded between different groups of employees. Although many HR managers remain very relaxed about the impact of new 'family-friendly' rights, nearly half (47 per cent) are concerned that staff without children resent their colleagues benefiting from these additional rights. Other academic research has highlighted the same concern.⁶⁷

Impact on Different Sectors

What sectors and types of company are most influenced by these trends? 16 per cent of firms with more than 2,000 employees report problems with the cost of compliance.⁶⁸ No convincing analysis has so far appeared of how this cost varies by sector. Nevertheless, several hypotheses are worth advancing.

First, sectors exposed to international competition are particularly likely to be damaged. The most obvious instance is manufacturing, which has been in recession and where the rate of return fell by more between 1999 and 2001 than between 1997 and 1999 (when a strong currency was supposedly squeezing margins). The Engineering Employers Federation (EEF) has warned 'of the damage done to industry by the increasing burden of regulation . . . US firms could gain advantage over UK firms simply because they were less constrained by red tape and employment legislation.'⁶⁹ The most high-profile recent loss to the British manufacturing sector was the decision of Dyson's vacuum cleaner manufacturing to relocate its business offshore.

Second, sectors which are highly fluid and need to evolve their employment arrangements rapidly are particularly at risk from reductions in labour market flexibility. The former HR director of a high growth telecommunications company stressed that 'a constantly evolving business, like ours, as it reorganises from a strategic to an operational focus is constantly exposed to the risk of tribunals.' Companies in sectors where many competitors operate outside the formal economy (such as construction or, increasingly, catering) represent a third area where large firms are particularly exposed to regulation. A fourth comprises large firms which are likely to reduce activity where heavy sector-specific regulation is under way. Several international players (such as AMP) have recently pulled out of British retail financial services which are being fundamentally re-regulated by the FSA. Meanwhile UK-based players (such as Prudential) have placed much of their investment for growth abroad. Finally, the employees in non UK-based companies with UK subsidiaries will be more exposed to closure than UK-domiciled firms.

VI

The Growth of the Informal Economy

So far this study has examined the cost and implications to managers of complying with regulations. There is another possible response – regulatory avoidance. This may reduce the burden of new regulation, but only at the cost of starting to undermine the values prosperous and law-abiding private sectors require – respect for the law, honesty, fair tax-paying.

Not all businessmen interviewed in the preparation of this study regarded regulation as a problem. Several felt very confident of their ability to escape compliance costs to some extent on the grounds that it is not very difficult to avoid red tape, much of which is not properly enforced.⁷¹

Is this attitude to compliance and the law on the increase? Is a growing proportion of the British economy composed of what economists term ‘the informal economy’ – where business is done without reference to the taxman or the regulator? And, if so, is this trend, at least in part, due to the growth of unduly bureaucratic regulation in the last six years?

The Nature of the Informal Economy

Experts on the informal economy define it as activity that would be legal if it were it reported - unlike straightforward criminal activity which is defined as activity that would be illegal whatever the circumstances. Drug-dealing and theft are illegal. Running a sandwich shop is only illegal if it is kept out of the purview of the Inland Revenue, Health and Safety Inspectorate, Food Standards Agency and Local Authority.

It is difficult to draw firm conclusions about the size and nature of the informal economy. Those who evade their legal obligations tend not to boast about their behaviour. In his official report to The Treasury on *The Informal Economy* in 2000, Lord Grabiner said that it was ‘impractical to arrive at a precise and meaningful figure as to the scale of the problem without a considerable investment of time and resources.’ Such reticence may have been due to the fact that the Government’s official estimate of the size of the informal economy (about 1.5 per cent of GDP) is markedly lower than that of most independent economists (about 8–13 per cent of GDP).⁷²

In fact, by comparing different markets over different periods, economists have found significant empirical evidence that more labour regulations increase the size of the

informal economy.⁷³ These findings are not intuitively surprising. Since the extra labour costs imposed by regulations can be shifted on to employees, they provide an incentive to employers (or the self-employed) to work in the shadow economy.

Are there any early indications that the recent re-regulation of the British economy is increasing the size of the informal economy ?

Unconscious Regulatory Avoidance

First, there is growing evidence that large numbers of business owners are simply not aware of all the regulations with which they are meant to comply. This might be termed 'unconscious regulatory avoidance.' Unconscious, or not, however, these business owners are breaking the law.

The Government's own survey of nearly 2,000 smaller firms concluded that only 20 per cent were confident of their own understanding of the increased range of employer obligations. Only 20 per cent of the smallest employers were aware of the right to additional maternity pay. Less than half were aware of the right to parental leave. Knowledge of employee rights under the Working Time Directive was greater but 20 per cent were still ignorant of the basic right to a maximum number of hours worked per week.⁷⁴

Interviews conducted during the preparation of this study amply bore out this conclusion. One London-based business adviser working with SMEs estimated that 10 per cent or less of the companies he visited were complying properly with the 1994 Packaging Waste Directive or with their obligations under the Management of Health and Safety at Work Regulations 1999. Employment lawyers also commented on the increasing complexity of the law in this area with primary legislation being supplemented by 'hundreds and hundreds of regulations and pages of statutory instruments' and with 'similar rights' having subtly different standard tests.

Conscious Regulatory Avoidance

There is growing evidence that some businessmen are actually failing to take action which they know they are obliged to take. This might be termed 'conscious regulatory avoidance.' A London-based business adviser interviewed by the author reported that many companies ignore his advice that 'they are non-compliant [with the Packaging Waste Directive] and ought to comply'. The Chief Executive Officer of a medium-sized firm was even more blunt:

‘A year and a half ago I realised that I had to offer part-time workers the same benefits as everyone else. How was I meant to know? We’ll try and get round to that soon.’

All but the most ignorant of small businessmen are aware that their employers’ liability cover is mandatory. However, with premiums rising sharply because of the Government’s changes to the law, Axa insurance now calculates that 13 per cent of small businesses do not have the required cover.⁷⁵

Changing Attitudes to Honesty

The bleakest conclusion to emerge from the interviews conducted for this study is an increasingly cavalier attitude to the importance of observing the law. The owner of a small media firm employing about 30 people said:

‘I just don’t have time to think about this. There are more important things to think about – like my cash flow and trying to stay afloat. The law is just getting absurd . . . We’ve got a discrimination policy. I wrote it myself off the internet about three years ago. No one has ever looked at it. . . . We’ve got an environmental policy. I just made it up.’

For some business owners and managers the combination of a welter of new regulations and inadequate enforcement is making the law an object of ridicule. Hundreds of thousands of companies appear not to be complying with the Packaging Waste Directive. The fines levied in the unlikely event of being caught (typically about £9,000 to £10,000) are not sufficient to deter companies from seeking to avoid the compliance cost (normally a charge of around £1,000 with ongoing annual costs of £1,000 to £2,000 for a small firm).

These changes in behaviour and attitudes matter. Capitalism needs honesty as well as thrift, industry and hard work. However, a recent survey of middle class attitudes found that richer members of British society are ‘turning to crime.’ Over 30 per cent of middle class respondents had either paid cash to avoid tax or knowingly held money back. Professor Karstedt, who conducted the survey, concluded bluntly that the British are ‘becoming a more dishonest society.’⁷⁶

It would be absurd to put the blame for this development entirely, or even predominantly, on recent Government policy. However, the result of its over-bureaucratic regulation of employment does seem to be a reduction in compliance and a growth in the range and scope of the informal economy. It would be wrong to assert this point with utter confidence. Yet all the available evidence does point in this direction.

VII

The International Dimension

Does this onset of new regulation matter? The British economy appears buoyant and, for the most part, it still has more flexible labour markets than most of continental Europe. Nevertheless, the prospects are not encouraging. All international economists and bodies agree that UK competitiveness has been reduced in the last six years. Nor are other nations standing still. Many European states are beginning to take steps to increase their own flexibility while the onset of a new age of real global competition for services as well as goods is exposing more of the British economy to foreign competition.

UK International Competitiveness

Different organisations monitor international competitiveness. Their backgrounds, standpoints and approaches vary. Their conclusions, however, are identical. The British economy is a less attractive place in which to invest and do business than it was in 1997. All rankings have dropped by between four and eleven places. Only the Heritage Foundation still thinks that Britain is one of the ten most competitive nations. The World Economic Forum and the Institute of Management and Development place the UK, respectively, 15th and 22nd.

Figure 4: UK Competitiveness Rankings since 1998⁷⁷

Index	1998	2000	2002	2004
Heritage Foundation	3rd	8th	9th	7th
World Economic Forum	4th	8th	11th	5th
Institute of Management and Development	13th	15th	16th	22nd

These annual surveys are backed up by other international bodies and polling organisations. As the most recent OECD report on the UK in 2003 stated bluntly: 'flexibility has been steadily eroded by ever-increasing regulation.' In 2001, a Gallup survey of several thousand businesses across the EU on the complexity of other member states' regulatory environment when trading, reached the same conclusion. The UK came bottom. It was judged to have the most complex regulatory environment of all 15 member states.⁷⁸

The reason why Britain's international competitiveness is dropping so rapidly and quickly is an important but often overlooked one. Our relative competitive advantage is a result of overall labour market flexibility. Land, property and product markets are regulated more tightly than by many competitors.⁷⁹ Workforce productivity and skills flexibility (the ability of the workforce to meet the changing needs of business) are also low in Britain due mainly to lower standards of education over several generations. In short, the British economy cannot afford to throw away the labour market flexibility which is its trump card. But it is currently doing so.

This is not all. The Government is re-regulating the British economy at precisely the moment when other European states are waking up to the damage that over-regulation does to an economy and taking steps to deregulate. The Government itself has conceded this point which also emerges forcefully in a recent CBI report on European labour markets.⁸⁰

Other EU countries are taking steps to make their labour markets more flexible. Germany has liberalised its policies on the use of fixed-term workers and Spain on agency workers. Italy has amended its legislation to increase flexibility in job placement. Even France is allowing an increasing number of exceptions to its 35-hour working week. Individual EU member states have also taken steps to make it easier for companies to restructure economically to meet changed circumstances. Spain has reduced severance pay when workers are dismissed. France suspended restrictive dismissal legislation in December 2002. And the Netherlands has reduced both statutory redundancy pay and the notice period before redundancies can be made.

Finally, individual EU states are also beginning to permit greater wage flexibility in order to combat long-term unemployment. Spain has liberalised its rules governing the ability of companies to opt out of regional wage agreements. Germany now permits increased flexibility at local level and allows companies to deviate from industry-wide agreements by up to 15 per cent. France, too, has introduced greater flexibility in its minimum wage.

Even so, most of Europe still remains more tightly regulated and less successful in creating jobs and growth than the British economy. But, as the CBI has concluded, 'at a time when France and Germany are removing layers of regulation to free up their labour markets, the UK is moving in the wrong direction.'⁸¹

The New Age of Global Competition

The challenge is not just European. The British Government has embarked on re-regulation at precisely the time when international competition has become noticeably greater. For most of the post-war period only a handful of economies ran a predominantly

free market: the US, Western Europe, Australasia, Japan and a few other outposts in Asia and Latin America. Since the 1980s the situation has been transformed. With very varying degrees of success all of Asia (bar Burma and North Korea), India, Eastern Europe and the Russian Confederation are all liberating, or have liberated, their markets for investment and trade. For many, such as Russia, this liberalisation has been achieved more in principle than in practice. (China is a curious exception – having accepted the market in practice but not in principle.) Nevertheless, the trend is clear. A new age of global competition has arrived. And this global competition will be for the supply, not just of goods. but of many services as well.

Due to the fall in telecom costs and the transformation of paper-based activities into digital ones, a wide range of service jobs and back-office functions can now be performed remotely - and at around 50 per cent of the cost.⁸² As the Chief Executive Officer of Intel Corp, Andrew Grove, recently put it: 'From a technical and productivity standpoint, the engineer sitting 9,700km. away might as well be in the next cubicle and on the local area network.'⁸³ Indeed from a productivity standpoint Mr Grove may be underestimating the potential. Many jobs sent offshore are considered undesirable and lacking in prestige in developed countries. This is not the case in developing economies. Offshore workers therefore not only cost less but are also more motivated. One British bank recently found that its call centre agents in India process 20 per cent more transactions with 3 per cent greater accuracy than their UK counterparts.⁸⁴ That is why IT-conscious firms are outsourcing tens of thousands of jobs to, above all, India which is English-speaking and has a surfeit of graduates and engineers. By 2008, Indian IT and back office services are predicted to be a \$57 billion annual export accounting for 7 per cent of the country's GDP.

The UK is particularly exposed to this development. It is very reliant on the business service and financial sectors (which require lots of processing). It is also exposed to more convincing English language competition due to the globalisation of English. What are the likely economic effects?

Recent analysis by international experts on outsourcing and its likely impact on the American economy has convincingly shown that, as long as new jobs are created, outsourcing's overall impact is benign. For every \$1 of US spending sent offshore to lower costs, higher profits by US-based providers offshore remitted back to the US and value from US labour re-employed are estimated to generate a potential benefit of \$1.12 to \$1.14 for the US economy. In short, the US should get richer the more it outsources offshore – if companies are able to find higher margin goods and services to provide.

The enriching experience of globalisation has already been seen during the globalisation of manufacturing. Since the 1950s a high proportion of the world's production has shifted from Europe and the US to Japan, Taiwan, South Korea and (latterly) China and Vietnam.

Despite this, the developed world became more, not less, prosperous. Most investment and labour shifted to higher margin services or higher value (i.e. more difficult and complex) manufacturing.

The UK will only be able to match this expected development in America and its own experience in the past if British companies are still able to find higher margin goods and services to provide nationally and internationally. The question for the UK (at a time when regulation has been shown to be hindering job creation) is: will British firms be able to create sufficiently attractive goods and services to more than compensate for the middle margin servicing jobs which are being lost? British firms certainly have the capacity to meet this challenge. The continuing growth of (currently) high margin sectors such as telecomms and media are good auguries for the future. Nevertheless, it must be worth asking: is a time of such international competition and uncertainty, an uncertainty to which Britain is peculiarly exposed, a good time to be undermining the nation's key competitive advantage – its flexible labour market?

VIII

Conclusion: A Fact-Based Response

This study has sought to demonstrate that ending the re-regulation of Britain is an economic necessity in an age of increasing global competition. Unfortunately, an economic necessity does not necessarily become a political reality.

As governments have discovered, it is harder to take away rules than to create them. It is going to be doubly hard for this Government to alter its current course. This is partly because it is under pressure from its supporters in the trade union movement to go further and faster. It is also because many of the rights which they have granted are politically popular. This is understandable. As long as the economy is not in free fall (and it is not), the legal rights to more leave and shorter working days are hardly likely to be vote-losers with the majority of the population. Finally, criticising any 'family-friendly' policy is politically risky. It is too easily parodied as an attack on families or women's equality - even though it is anything but.

Given this political difficulty in facing an economic problem, the programme set out below is designed to help the Government face down and avoid critics by understanding the impact of its own actions thoroughly. By having an overwhelming fact base and by altering the terms of regulatory creation wherever possible rather than by picking fights over existing rights, the Government would, in principle at least, be able to prevent the situation from getting much worse - with the significant exception of qualified majority voting (QMV) adjustments from Europe.

The Government also needs to take steps to reverse the regulation of the labour market, limit the scope of its own executive agencies and face up to the long-term trends within the EU. This would keep our sights not just upon Germany and France, but on the high growth markets of the next twenty years - the United States and the Peoples' Republic of China.

1. Understanding the impact of its own policies

Analysis conducted for the British Chambers of Commerce has established convincingly that the Government has not had a full picture of its own regulatory requirements and that its regulatory-creation process is still woefully inadequate.⁸⁵ The Government should take four key steps to assist its comprehension of its own activities.

- (i) It should publish in one place an up-to-date summary of all regulations (including statutory instruments and new EU rulings) as they occur. This would permit a fully informed debate on the regulatory burden and allow the Government itself to see more clearly the sheer range and scope of its own actions.
- (ii) The auditing of the costs (and benefits) of proposed regulation needs to be improved and removed from policy-making pressure (one senior official described the RIA process as ‘a formality that has no meaningful impact on policy’⁸⁶). It should be genuinely separated from the influence of Government Ministers and conducted in an independent Regulatory Audit Unit able to exert public pressure on the Government. (A less radical alternative might be to charge a Cabinet Minister ‘big hitter’ directly with responsibility for deregulation as opposed to pitting Cabinet Office junior ministers impotently against the ‘big beasts’ of the Cabinet.)
- (iii) The Regulatory Audit Unit should calculate and publish annually the total cost of regulations administered or promulgated by each government department. Departments could then be set appropriate annual reduction targets.
- (iv) A Regulatory Impact Select Committee in both Houses of Parliament should be created to review the cost, necessity, simplicity and equality of new and renewed regulation, and to provide a formal mechanism to investigate the accuracy of Government assessments of the regulatory burden.

2. Encouraging good regulation and controlling the executive agencies

The recent move to simplify the introduction of employment regulation by limiting it to two days each year is welcome. However, it is still too easy for the Government to preach good regulation in one breath and commend worst practice in the next. Legislation should be promulgated to force the Government to put pressure on itself and its executive agencies.

- (i) All regulation should carry ‘sunset clauses’ – the presupposition that it will lapse within a set period of time unless reviewed and renewed by Parliament.
- (ii) There should be a statutory minimum period for consultation with employers which would be longer if significant changes (such as adjustment to IT systems) are required. Legislation should also prescribe a minimum period of time by which guidance notes should precede regulations coming into effect.
- (iii) The budgets of the main regulatory quangos and executive agencies should be capped to prevent their continued regulatory hyper-activity and ‘gold-plating.’ The

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reduction of regulatory costs (as calculated by the independent Regulatory Audit Unit) should be set year on year as crucial annual targets for such organisations and for senior managers.

- (iv) The test of 'reasonable practicality' should be reintroduced into health and safety legislation so that good judgement rather than detailed prescription becomes the foundation of health and safety policy.

3. Ending the re-regulation of the labour market

Britain cannot afford to lose its traditional advantage of relatively free labour markets.

- (i) The Government should review the impact of regulatory and fiscal thresholds on the growth of small firms in order to minimise their (necessarily distorting) impact on British economic performance. There may be a case for increasing some thresholds while abolishing others altogether
- (ii) If the recent Employment Act does not result in a further 40 per cent fall in the total number of tribunal applications and costs (which seems highly likely), then radical steps need to be taken to undermine the compensation culture which has taken hold of parts of the British workplace. The steps that need to be taken are the introduction of new (reduced) limits on potential awards and an increase in the costs borne by opportunistic claimants or by claimants who withdraw after initiating a case but before it comes to tribunal or judgement is passed. The Government should also consider replacing the rules restricting 'no win-no fee' arrangements for lawyers which were removed in 1995.
- (iii) The Government should reintroduce flexibility into 'family-friendly' legislation to prevent regulation harming further the employment options available to women. Steps might include increases in the threshold before employers become subject to some regulations, permitting employers to designate certain jobs as 'critical' to give them immunity from the obligation to hold jobs open and giving employees the right to 'sell back' certain 'family-friendly' rights to the employer for increased wages (this last step would need to be piloted and implemented carefully or it could become counter-productive).

4. Minimising the impact of the EU

- (i) The Government should take steps to reduce the paperwork required by the minimum wage and Working Time Directive. (The Swedes passed the Directive into Swedish law in two pages of A4. UK regulations were published in a booklet of more

than 60 pages.) A series of carefully targeted analyses of what record-keeping requirements take the most time in a range of different firms would quickly identify what data requirements could be dispensed with. The Government may just have to accept less precise information about the progress of its policies in order to reduce private sector record-keeping costs.

- (ii) The Government needs to take urgent action to end 'gold-plating' of EU, or its own, regulations. Shortening guidance notes, ensuring that the Government takes up all possible derogations and placing a duty on all ministers and executive agencies not to create additional requirements are all needed.
- (iii) Short of Treaty renegotiation there is no escape from sweeping European rights over working time and parental leave. However, the Government has negotiating power and must publicly identify a reduction of existing regulatory bureaucracy and inflexibility as the primary aim of all its European negotiations. The Government must cease supporting EU-led regulation (as it did over parental leave) wherever it has the option to do so.

The Challenge

My previous Politeia study, *Interfering Government and its Cost to Business* (2001), concluded that if the Government did 'not curtail its current programme and control its future capacity to regulate then the combination of increased taxes, increased public spending and a changing regulatory environment will, over time, begin to hinder UK growth rates and to alarm international investors.'

The Government has not curtailed its regulatory programme. If anything the programme has been accelerated. We are now beginning to see the consequences. Public sector productivity is being set back. Small firm growth is being discouraged. Employment opportunities are being reduced. Even the very culture of honest business is being slowly and subtly undermined.

It would be wrong to suggest that any of these developments has yet reached a crisis point. None has. But growth is declining. Productivity is not improving. The economy is increasingly relying upon government debt, personal credit exposure and public spending.

Mr Blair is supposed to be anxious of his place in British history. If he does not act swiftly, his place may be secured as the premier who ended the revival of Britain. It would be a melancholy epitaph for the rest of us.

References

- 1 Chris Humphries cited in British Chambers of Commerce Press Release, January 2000. Trade Union Congress Press Release, 30 August 2003.
- 2 OECD, Country Report for the UK, 2002. For an academic discussion of the relative 'europanization' of UK labour policy, see P. Edwards, *The Employment Relationship and the Field of Industrial Relations*, 2003, pp 24-29.
- 3 Over forty separate interviews were conducted in small and medium-sized firms primarily in the media, professional services, manufacturing and retail sectors.
- 4 As late as 1994 an array of left-wing economists was able to postulate that the reduction in the power of the unions had not increased the sustainable level of sustainable employment – hardly a position that could be credibly held today (R. Barrell ed. *The UK Labour Market*, Cambridge, 1994, p. 8).
- 5 See R. Porter, *UK Competitiveness: Moving to the Next Stage*, DTI, 2003.
- 6 Speech to the CBI on 17 November 2003.
- 7 See Chapter VII below.
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