TOUCH
STONE
PAMPHLET#9

The Red Tape Delusion

Why deregulation won't solve the jobs crisis

The Red Tape Delusion: Why Deregulation Won't Solve the Jobs Crisis **challenges the neo-liberal assumption that economic success is contingent upon weakly regulated labour markets. Based on an extensive evidence review of the economic literature, it demonstrates that the case for unfettered free markets has been badly discredited and that fairer rights for workers are compatible with economic success – as well as bringing far better social outcomes.** ***The Red Tape Delusion*** **proves that despite the siren voices from the business lobby, fair regulation is an essential part of modern labour markets. If economic policy was based on evidence, the UK would be making immediate moves towards a new model – promoting both growth and fairness.**

About the authors

Stewart Lansley is an economic and social policy consultant specialising in inequality, wealth, poverty and the labour market. He is the author of *Do The Super-Rich Matter?* TUC Touchstone Pamphlet, 2008 and joint author of *Londongrad: From Russia With Cash*, Fourth Estate, 2009.

Howard Reed was the chief economist at the Institute for Public Policy Research and is now director of Landman Economics, an economic consultancy specialising in policy analysis and quantitative research. His research interests include labour market policy, macroeconomic policy, business finance, the tax and benefit system, and the methodology of economics.

Acknowledgements

We would like to thank members of the Economic and Social Affairs Department at the TUC for helpful input throughout.

TUC

TOUCH
STONE

The Red Tape Delusion

Why deregulation won't solve the jobs crisis

Contents

Foreword

by Brendan Barber, TUC General Secretary

Over the last few decades the business lobby has never been slow to tell us that red tape destroys jobs. And by red tape they normally mean decent rights for people at work.

Before the introduction of the minimum wage and other rights, we were warned of rising unemployment and a reduction in job creation. But doomsday never came to pass – instead the UK experienced its longest period of growth for decades.

What brought that growth to an end was the biggest downturn in the world economy since the 1920s. Businesses have gone bust. Working people throughout the world have lost their jobs. Public services face deep cuts as countries struggle with the holes in their finances caused by the recession.

None of this was caused by excess regulation, but rather by its lack. Decades of business campaigns to set markets free, lift burdens on employers and cut red tape came back to bite their advocates. As unregulated financial markets ran riot, countries across the world felt the full force of the economic storm.

Now should be a time for reflection and rethinking. The economic model of the last decades has failed. The search should be on for a new approach – one where markets serve society, rather than one where society is subordinated to market imperatives.

But the siren voices have returned. Already we are being told that we need to take more of the medicine that nearly killed us – business has resumed its anti-red tape crusade.

These arguments no longer stand up. Howard Reed and Stewart Lansley's comprehensive examination of domestic and international literature in this pamphlet, and its accompanying literature review, exposes the red tape delusion.

Regulation can be an essential means to achieve both economic success and greater equality. Of course that doesn't mean that every regulation is good. Making someone with a red flag walk in front of every car did not help the motor industry develop. But it does mean that the mirror image argument, that all regulation is bad, belongs in that old cliché, the dustbin of history. Regulation can boost the economy, make society fairer and contribute to a better life for all.

Executive summary

For most of the last three decades, the conventional wisdom among economists and policy makers has been that free and flexible labour markets deliver greatly superior economic outcomes than regulated ones. So influential was this view that from the late 1970s the UK embarked on a sustained path of deregulation and privatisation aimed at reducing the role of government and shifting the balance of power from the state and organised labour in favour of business.

Although Labour governments from 1997 signed up to the principle of flexible labour markets, they also introduced a number of measures – such as the minimum wage, statutory recognition rights for trade unions and improved maternity and paternity leave – which have brought greater workforce protection. Despite these additional measures, however, Britain still has one of the least regulated labour markets among the developed economies.

According to their advocates, allowing labour markets to self-correct without state interference brings higher levels of employment and growth, encourages entrepreneurialism and wealth creation and prevents boom and bust. Indeed, a number of powerful business voices from the Confederation of British Industry to the British Chamber of Commerce are now calling for existing regulations to be cut back still further.

Such calls have come despite the fact that the orthodox free labour market case has been badly discredited in recent years. This is in part because after more than 20 years of experimentation with labour market flexibility, especially in the UK and the US, there is now a substantial body of empirical evidence that demonstrates that flexible markets have not been nearly as successful as their adherents have claimed. In many ways, the policies implemented in the name of neo-liberalism have had seriously detrimental economic outcomes.

Such is the importance of these findings that in 2006 the Organisation for Economic Co-operation and Development (OECD) – formerly one of the most influential advocates of freer labour markets – moved to distance itself from the deregulation school. In its 2006 *Jobs Study*, the organisation acknowledged that countries with very different levels of regulation had experienced equal levels of success in generating employment. The orthodox account was, for example, unable to explain why a number of European nations, such as Denmark, the Netherlands and Norway, displayed economic success despite their relatively highly regulated labour markets.

The prescriptions of the neo-liberal school have also been seriously undermined by the economic crisis of the last two years. Indeed the neo-liberal advocates of free markets – a group which still dominates the international economics profession – have long argued that the recession of 2008-09 was an event that could not happen in countries like the United States and the UK which have religiously pursued a deregulated path. As the American economist Robert Lucas, Nobel Laureate and one of the high priests of the new philosophy, declared in 2003, 'the central problem of depression-prevention has been solved, for all practical purposes.'

For the most part the prescriptions of the neo-liberal school do not stand up to detailed scrutiny. In the UK, the introduction of the national minimum wage in 1999 failed to deliver the dire consequences predicted by its critics while the modest re-regulation of the British labour market in the last decade has been achieved without detriment to employment creation. Indeed, the impact of the 2008-9 recession on UK unemployment – which has risen by much less than in the early 1980s and 1990s recessions – suggests that the slightly more regulated labour market of the last decade has been working well.

The domestic and international evidence is also that:

- Trade unions have no significant negative consequences for labour market outcomes, and have positive effects in promoting workplace cohesion and social justice.
- Co-ordinated and responsible bargaining systems are associated with lower unemployment while under the right conditions social corporatism works.
- Active labour market policies, if well designed, can make a substantial difference to the employment prospects of the long-term unemployed.
- In-work benefits boost labour supply while redistributing income to low-paid workers.
- Generous unemployment benefits of limited duration (with ongoing social assistance provided for those in need) combined with job search requirements are effective in reducing long term unemployment.

The 'one size fits all' model simply doesn't work. A number of European countries have both highly interventionist policies and a strong record on employment generation and unemployment. The evidence is that two quite distinctive models work particularly well. First, the Anglo-Saxon model (including the UK) with its lower unemployment benefits, light touch employment protection, weaker trade unions and more limited collective bargaining. Secondly, the Scandinavian/flexicurity model (including Denmark, the Netherlands, Norway, Finland and Sweden) which is characterised by strong collective bargaining, high levels of employment protection and generous unemployment benefits accompanied by stringent job-search requirements and available for limited durations.

Yet while both models achieve similar results in terms of employment and unemployment rates, some Anglo-Saxon countries have experienced considerable economic turbulence in the last two decades and an especially deep recession in 2008–09. Moreover, the flexicurity model is much more successful when it comes to social outcomes and the Anglo-Saxon model is characterised by high earnings inequality and higher levels of in-work poverty. In both the US and the UK, for example, both poverty and inequality have risen sharply from the late 1970s following the adoption of more market-orientated policies. The flexicurity countries have achieved, in contrast, high employment and good growth rates with much lower levels of wage inequality and in-work poverty.

Given the strength of the evidence, and the persistence of economic volatility, Britain should start planning moves towards the flexicurity model. Measures should include:

- Development of a new understanding of the positive contribution that unions can make to workplaces and to workplace prosperity, allowing the trade union movement to play a more central role in the major issues of political economy.
- Fairer employment protection legislation to reduce job insecurity and inequality.
- A significant increase in the level of Jobseeker's Allowance to bring it closer to the European average, with the maintenance of job search requirements.
- Strengthened active labour market policies, with large increases in programme investment.

These measures should be carefully implemented and their impact evaluated so that they satisfy the test that they work in the real world. Achieving a fair and successful labour market is dependent upon their implementation.

This pamphlet draws heavily on the TUC Report *Flexible with the Truth? Exploring the relationship between labour market flexibility and labour market performance* written by Howard Reed. This provides a more detailed summary and analysis of the extensive body of domestic and international evidence on the economic impact of labour market regulations, drawing on both macro- and micro-economic studies. It is available to download at **www.tuc.org.uk/flexiblewiththetruth**

The TUC Touchstone pamphlet *The Road to Recovery: How effective unions can help to rebuild the economy* further discusses the value that effective unions can bring to long-term employment relations, and to both employees and employers. It demonstrates that unions have a key role to play in driving Britain out of recession. The report also provides a range of case studies highlighting the real economic and social benefits that unions can bring. It is available to download at: **www.tuc.org.uk/touchstonepamphlets**

1. Introduction*

From the early 1980s it became increasingly accepted in academic, policy and business circles that relatively free and flexible labour markets offer better economic performance than heavily regulated ones. This view reflected the growing belief in an economic model that favoured the freeing up of markets across all areas of economic activity, a reduction in the role of the state and the dismantling of much of the economic apparatus that had emerged in the post-war decades.

This new 'neo-liberal' orthodoxy came to dominate economic thinking among those who count – governments, corporations and powerful global institutions – as part of a general shift in favour of market-oriented solutions to economic problems. It was an approach to policy that was adopted most stridently in the United States and in the UK under the governments of Ronald Reagan and Margaret Thatcher. The ideas were mostly much slower to catch on in continental Europe where there has been much less of a commitment to deregulation over the last 25 years.

What became a clear Anglo-Saxon orthodoxy emerged out of the growing economic problems of the early 1970s, when the return of turbulence combined with low growth gave rise to what became known as 'stagflation' – a combination of high unemployment and high inflation. For thinkers on the Right, the solution to these emerging problems was seen to lie in the freeing up of markets.

High levels of public spending were viewed as 'crowding out' private enterprise. Too much state intervention in the economy was said to stifle free enterprise and the creation of wealth. State industries and government departments were seen as inefficient and inflexible. Embracing these views with enthusiasm, Mrs Thatcher embarked, from 1979, on a radical restructuring of economic policy. The goals of macro-economic management were refocused to give top priority to squeezing inflationary pressure out of the system. State industries were privatised. Government regulations were swept away. A succession of policies were introduced to reduce what were seen as damaging restrictions on the way labour markets worked and to tackle what was viewed as Britain's poor record on industrial relations.

There was of course nothing new about such views. They had long been held by theorists on the right, but they had been out of fashion in the post-war era when the political and economic consensus, born out of the depression and rising

---

* For more detail see Howard Reed, *Flexible with the Truth?* London: TUC, 2010, Introduction.
Available to download at **www.tuc.org.uk/flexiblewiththetruth**

unemployment of the early 1930s, favoured enhanced state intervention to mitigate what were seen as the negative effects of untrammelled markets. The success of the long post-war boom meant that these radical voices on the right stayed on the fringes of economic and political thinking. By the early 1980s, however, their views had displaced the old consensus and become the mainstream view in the US and the UK, leading to sweeping economic and social change.

Central to the argument of the new neo-liberal orthodoxy was that the problem of unemployment was not the result of the failure of centrally determined demand management and a deficiency of demand but a supply-side problem characterised by the failure of labour markets to work properly. The solution to high unemployment – which in 1986 stood at 3.3 million compared with 750,000 in 1971 – was seen to lie in the deregulation of labour markets.[1] There were, it was claimed, too many restrictions on the freedom of employers while unions were too powerful and wages too rigid and too high. If restrictions on employers were swept away, and the balance of power tilted in their favour, the unemployment problem would solve itself. Wages would adjust to the level which brought the demand and supply of labour into equilibrium. Productivity would rise as employers were able to have more flexibility over their labour forces. Entrepreneurialism would be given a new lease of life.

This became the rallying cry of much of the academic economics profession and of the new right-of-centre governments in the UK and the US. Influential international bodies also began to promote the virtues of 'flexible labour markets'. Perhaps the most coherent expression of this view came in a massive report – *The Jobs Study* – published by the OECD in 1994.[2] Some of the recommendations of the report were uncontentious such as setting macroeconomic policies to encourage sustainable growth and improving labour force skills. But while the report failed to endorse some aspects of 'new right' economic thinking, including a commitment to the kind of pure monetarism practised in the 1980s, its overall thrust was to stress the role of labour market flexibility as an essential precondition of economic success.

The OECD advocated making labour costs more flexible by removing restrictions on wage levels and rates; the reform of employment security provisions that were seen as inhibiting the expansion of private sector employment; the reform of unemployment and related benefits systems and the widening of wage differentials. Detailed policy recommendations included limiting minimum wage legislation by indexing it to prices rather than average earnings, weakening restrictions on dismissals to allow faster economic restructuring, restricting the length of entitlement to unemployment benefits and reducing benefit levels.[3]

Individual countries were given specific recommendations on issues including wage formation, conditions of benefit eligibility and employment protection. The OECD also published charts detailing how far individual countries already complied with these recommendations. The UK and New Zealand topped the list with 80 per cent compliance while France stood near the bottom.

In 2003, the IMF restated the view (adopted nine years earlier by the OECD) that the causes of unemployment could be found in labour market institutions. "Accordingly, countries with high unemployment have been repeatedly urged to undertake comprehensive structural reforms to reduce 'labour market rigidities'".[4] The IMF went on to argue that lower unemployment benefits, labour taxation and employment protection measures would reduce unemployment by nearly 3 per cent.

These arguments have had a big influence on policy, though they have only ever been fully embraced in the Anglo-Saxon world. For the most part, continental Europe has only travelled a short way down the 'orthodoxy' road. Although there have been some moves to flexibility in more recent years with, for example, the German government ending the right to indefinite unemployment benefit in 2003, these moves have been much less radical than the changes introduced in the UK and the US. Most European nations have retained policy packages that are closer to regulated labour markets than flexible ones.

Although from 1997 Labour introduced a number of regulatory measures, from the introduction of the national minimum wage and improved rights on dismissal to more generous maternity leave, Tony Blair and Gordon Brown continued to express support for a flexible labour market as the best way of building a modern successful economy. By 2008, Britain had the third weakest system of employment protection (behind the US and Canada) of all developed economies.

Despite the UK being one of the least regulated of OECD nations on most measures of labour market flexibility, considerable pressure persists for additional deregulation. Adherents of flexibility have been using the recession to argue that freeing up labour markets still further would help to stimulate and sustain recovery and have variously called for the scaling back or delay of regulations such as equal treatment rights for agency workers, new paternity rights and entitlements to request time off for training.

In January 2010, the Conservative Party suggested that it was considering handing over the power to set some benefit rates, including Jobseeker's Allowance, to local councils. Under the proposals councils could reduce benefit rates if they considered it was easy to find work in the area,[5] despite the fact that the JSA is already one of the lowest in the developed world.

In November 2009, the British Chamber of Commerce – which has repeatedly dismissed new regulations as adding to 'red tape' – called for a "three-year moratorium" on proposed new labour legislation aimed at, for example, strengthening the rights of agency workers and increasing paternity leave entitlements.[6] In the same month the Confederation of British Industry argued that "employers remain especially worried about the excessive burden of employment regulation." CBI Deputy Director-General John Cridland said: "employers remain deeply frustrated by the amount of paperwork and regulation they have to deal with."[7]

Business also favours a weakening of Britain's minimum wage system, even though in 2009, the rate was raised by only 1.2 per cent. In 2009, a group of Tory MPs signed up to Christopher Chope's 'Employment Opportunities Bill' – a Ten Minute Rule Bill – which would have allowed companies to opt out of the minimum wage. A senior Tory has been reported as saying: "It would be foolish to continue hiking up the minimum hourly rate by the rate of inflation every year. We need to find ways of helping British business to remain competitive. The minimum wage won't be scrapped but it will be allowed to wither on the vine."[8] In October 2009, Mark Littlewood, General Secretary of right-of-centre thinktank the Institute for Economic Affairs, went one further by calling for the minimum wage to be lowered or scrapped. "The full, and substantial, cost of Britain's minimum wage legislation is becoming increasingly plain to see. In times of plenty, the impact it had on pricing employees out of the labour market was less dramatic. But in the depths of a recession, it acts as a real barrier in getting people back to work."[9]

This pamphlet demonstrates that there is no case for the argument that UK labour market regulation needs to be pared back still further. The evidence in fact mostly favours the strengthening of the regulatory framework. Indeed the orthodox view and its belief in self-correcting markets that bring full employment and an end to boom and bust has been largely discredited. The first reason for this is that, after more than 20 years of experimentation with flexible labour markets, there is now a substantial body of empirical evidence on their effectiveness. For the most part, this evidence demonstrates that flexible markets have not been nearly as successful as adherents have claimed. In many ways, the policies implemented in the name of neo-liberalism have had seriously detrimental economic outcomes. In a major study for the Work Foundation in 2006, *Who's Afraid of Labour Market Flexibility*, for example, David Coats concluded that "recent research suggests that the standard account of why 'Anglo-Saxon' [i.e. deregulated] labour markets perform well is shot through with myths, half-truths and a cynical manipulation of the evidence."[10]

Because of the impact of the evidence, the once entrenched orthodox position has faced ebbing support. The most significant sign of this erosion came in a second report published by the OECD in 2006. This update on the influential 1994 *Jobs Study* took a much more balanced view of the role of intervention, with conclusions that distanced the organisation from those of the 1994 study and added up to a clear retreat from the pure neo-liberal position.

Thus the 2006 report no longer backed deregulation as a labour market cure-all and acknowledged that countries with very different amounts of 'flexibility' had experienced equal levels of success in generating employment. The orthodox account was, for example, unable to explain why a number of European nations, such as Denmark, the Netherlands and Norway, were economically successful despite their relatively highly regulated labour markets. Furthermore, it pointed out that there are strong drawbacks to flexibility. The US, for example, has the most deregulated labour market of all OECD nations, and has performed relatively well on some key labour market indicators such as unemployment and employment. But it also has some of the highest levels of inequality and poverty in the developed world.

The prescriptions of the orthodox school have also been seriously undermined by the implosion of global credit markets and the ensuing economic crisis of the last two years. Neo-liberal economists, a group which still dominates the international economics profession, completely failed to anticipate the build-up to the meltdown and the resulting severe recession of 2008-09. Indeed, the onset of the worst downturn since the 1930s was an event which most proponents of the neo-liberal view had assured us could not happen in countries like the United States and the UK, which have keenly pursued a deregulated path. Their view was that a key economic issue had been resolved – if markets were allowed to function freely, self-correction would tame the economic cycle. As the American economist Robert Lucas – Nobel Laureate, one of the high priests of the new philosophy and a strong critic of Keynesianism – declared in 2003, "the central problem of depression-prevention has been solved, for all practical purposes." This was an audacious claim, and one that has proved entirely bogus.

The only economists to have foreseen the impending crisis were critics of the free-market school, a group from the radical wing of the profession such as the Australian Steve Keen and the late Hyman Minsky, both of whom had long predicted the 'credit crunch' and the resulting near-collapse of the global financial system.[11]

The seriousness of the 2008–09 recession adds to what was already a growing critique of the prescriptions of the orthodox school. The last two decades have seen a series of global financial crises – the recession of the early 1990s, the Latin American and Asian crises of the 1990s and the new economy bubble at the turn of the millennium. These successive crises have exposed the reality of the self-stabilising predictions of the adherents of free markets.

A key implication of this failure is that as the neo-liberal advocates have been wrong about the desirability of 'light regulation' in financial markets, then they are also likely to have been wrong about the desirability of deregulation in labour markets. As the American columnist John Cassidy has written in his new book, *How Markets Fail*, the long-held belief among modern economists that the free market is inherently stable – that it will self-correct – has been proved badly wrong. Alan Greenspan, former chairman of the Federal Reserve, and a key adherent of the self-regulating school, admitted as much when he told a Congressional Committee in October 2008 that he was shocked to find that the system of markets that "had been going for 40 years or more with very considerable evidence that it was working" wasn't.

Cassidy concludes that we need a new framework of 'reality-based economics' based on empirical analysis of what policies actually work best in practice, rather than the dogmatic application of abstract theoretical models. This framework would take sentiments like greed and fear into account and recognise that the state still has an important role to play if we are to minimise the destabilising and damaging tendencies of markets.

This pamphlet takes a reality-based view of the relative merits of flexible and regulated labour markets. It examines the link between labour market flexibility and economic performance and asks whether the UK is over- or under-regulated, or has it about right. It looks at the arguments of those who are still calling for Britain to rein back its already limited system of regulation.

Section 2 looks at what is meant by flexibility, at the history of regulation since the late 1970s and at where the UK stands in comparison with other countries. Sections 3 and 4 review the extensive empirical evidence on the effectiveness of different forms of intervention based on both macro and micro studies, not just in the UK but in other developed economies. Section 5 looks at whether labour market policies help account for the lower rise in UK unemployment than would have been expected from the depth of the recent recession.

The empirical evidence explored is as up-to-date as possible although selected older studies are also reviewed and summarised when they are relevant. The aim in every case is to provide a balanced assessment of the evidence base while taking into consideration the quality and wider applicability of the empirical work that has been done at both macro and micro levels.

2. What is meant by a flexible labour market?*

The theory

There are broadly two schools of thought among academic economists about the virtues of free or flexible labour markets (FLM) versus regulated labour markets (RLM).

The orthodox 'free market', anti-regulation view

The first school of thought – the orthodox or neo-liberal school – is broadly, though not exclusively, associated with the right of the political spectrum, with those who favour a free market approach to running the economy. Adherents of this view argue that just as government intervention to manage demand or effect production is bad or counter-productive, labour market flexibility is 'a good thing' for the economy while policies which reduce employers' flexibility are bad.

Orthodox thinkers argue that if left to themselves, markets will work through what Adam Smith described as an 'invisible hand' to deliver maximum efficiency, or the best possible outcome for the economy including a state of full employment: any interference in the market will produce an inferior result. This view has the convenience of delivering straightforward, unambiguous answers to economic problems. How much regulation should there be in the labour market? According to the orthodox framework, 'as little as possible'. What level should wages be set at? The orthodoxy tells us: 'Whatever level the market decides.'

But this efficient outcome only follows if the world conforms to a particular set of very abstract and unrealistic assumptions about the way the economy functions. These include rational and perfectly informed producers, workers and consumers and perfect competition in labour and product markets. In this perfectly competitive world, wages reflect skills and effort and the value of what workers produce. Competition among employers will mean that workers paid less than their worth will be offered a higher wage to prevent them leaving. Any two workers with the same productivity earn the same wage; firms can hire as many workers as they want at the prevailing wage rate; there are no frictions stopping workers from leaving their jobs; workers can move from one job to another costlessly; and pay differentials merely reflect variations in ability.

---

* For more detail see Howard Reed, *Flexible with the Truth?* London: TUC, 2010, Chapter 3.
Available to download at **www.tuc.org.uk/flexiblewiththetruth**

In this world, welfare and production are maximised, the production process achieves optimum efficiency; and measures which reduce this flexibility by strengthening the bargaining power of labour and/or restricting the decisions of employers will be either ineffectual or counterproductive. Thus interventions that take wages above a worker's value to the firm – such as minimum wages or industry-wide bargaining – simply lead to increased unemployment because firms will not employ workers when it is not economically viable to do so. Regulations on working time will reduce efficiency because all workers are already working at their optimal number of hours. Employment protection legislation will introduce artificial frictions by making it more difficult for workers to move from one job to another. Active labour market policy is unnecessary because workers can move into work costlessly if they so wish. Unemployment benefits reduce the incentive to work and hence make workers less likely to enter work, leading to increased unemployment.

Although this perfectly competitive scenario is an extreme case, and perhaps something of a crude characterisation of the orthodox position, the arguments and the 'worldview' associated with it are still widely used by neo-liberal protagonists to challenge incursions in labour markets and to defend labour market flexibility. This view is promoted regardless of the empirical evidence on the impact of regulations.

The pro-regulation school

There are several different theoretical approaches among the pro-regulation school, all of which offer a challenge to orthodoxy. One comes from a group which modifies the orthodox model by assuming *imperfect* rather than *perfect* competition. This school opposes the neo-liberal characterisation of the labour market while remaining within a broadly neo-classical (mainstream) framework which still assumes that individual behaviour is rational, forward-looking, and utility-maximising.[12]

This approach takes a more realistic view of the world – that market behaviour fails to correspond to the predictions of economic textbooks. It accepts that wages may not reflect a worker's full contribution and that employees with the same productivity working for different firms, or even the same firm, may earn quite different wages; that there are recruitment and advertising costs involved with hiring workers; that the costs associated with moving from job to job restrict labour mobility; and that workers' and firms' information about each other is considerably less than perfect.

The assumption of imperfect competition in labour markets has a huge impact on the theory of the rule of labour market regulation. Indeed, a labour market characterised by imperfect competition introduces a number of inefficiencies that require correction by intervention. Economic theorists have shown that under such conditions, regulation can therefore *improve* the working of the labour market.

For example, when imperfect competition leads workers to be paid less than their true value to the firm, unnecessary unemployment will occur because some workers will not find it worthwhile to work at the going wage, while the incentive to improve skills is too low because of the inadequate return. In this situation, minimum wages and wage bargaining can raise wages for workers who are being paid less than their value without increasing unemployment (indeed, in some cases they may actually *increase* employment over a certain range). This is because in the absence of minimum wage legislation firms can pay workers less than the value of what they produce *without* the worker finding it economically viable to leave for another job elsewhere

Other forms of intervention which can overcome inefficiencies include:

- Regulations on working time to prevent workers who face costs of leaving a job being forced to work more hours than they would like.
- Active labour market policies to help reduce unemployment through reducing the cost to the unemployed of finding work.
- The provision of unemployment benefits which can improve the efficiency of the labour market by subsidising costly job-search activity.
- Active trade unions, formal consultation procedures and effective workplace representation to help deal with grievances and issues relating to workplace environments where workers who are 'tied into' jobs because moving is costly would rather exercise 'voice' than 'exit' mechanisms.[13]

The imperfectly competitive framework does *not* imply that labour market regulation is *always* beneficial; for example, it is still possible for minimum wage laws to adversely affect employment if they are set too high and excessive protection can stifle labour mobility. However, the key message is that each piece of labour market regulation has to be assessed on its own merits.

The imperfectly competitive model of labour markets retains the key features of mainstream economics such as rational employees and profit-maximising employers. Because it is a relatively small departure from the neo-liberal model, a number of non-mainstream economists have developed more radical critiques, which recognise that the real world is much more complex than is implied in both perfect and imperfect competitive models.

The Australian economist Steve Keen has identified a list of objections to these models of the labour market.[14] For example, under the theory of 'bilateral monopoly', in situations of both perfect and imperfect competition, powerful employers can prevent workers being paid the value of what they produce unless they also organise – for example, into trade unions.[15] Again, the way workers and employers respond to changes in wages (in economists' jargon, the supply of and demand for labour) are not as 'well-behaved' as neoclassical economists assume. There can be multiple equilibria of supply and demand and reducing wages will not necessarily increase employment (as mainstream economists would argue). In addition, demand and supply in the labour market are not independent because changes in labour supply will affect the distribution of income, which itself affects the demand for goods and services, which in turn affects the demand for labour.[16]

If these criticisms of the neoclassical model are correct, then economic theory gives essentially *no* prediction as to what the impact of labour market regulation on economic performance might be. While this doesn't automatically mean that any specific labour market regulation is always and everywhere a good idea, it does mean that the question of whether a particular labour market regulation is good or bad for labour market performance can only be settled by empirical study.

The practice

Because the theoretical construct of the orthodox school is such a poor reflection of the way labour markets actually behave, even the advocates of flexible labour markets accept that to overcome these imperfections there have to be some constraints on the way labour markets are allowed to operate. Indeed, it is partly because of these critiques that organisations that once supported the axing of regulations, such as the OECD, have since modified their views.

Moreover, even those advocates who stick to the pure orthodox position accept that there may be occasions when intervention is necessary – even if the effect is to worsen efficiency. This has been called the efficiency/equity trade-off, an acceptance that it is sometimes necessary to accept a loss of efficiency to pay for a fairer society.

The pro-regulation school argue that the case for intervention is not just a matter of equity. They argue that some regulations actually improve economic performance, and that individual acts of intervention need to be assessed on their merits. Those favouring regulated labour markets tend to be pragmatists who have responded to a growing body of evidence (reviewed in detail in this pamphlet) showing that different economies, with very different approaches to labour market flexibility, have produced equally good results. They claim that, while it has certainly been possible for badly thought-out regulation to have harmful effects, the idea that there is some simple positive relationship between the flexibility of the labour market and good economic performance is not supported by the empirical evidence.

Once it is accepted that untrammelled markets have severe limitations, the policy question becomes one of degree and type. How far should labour markets be free to operate and how far should they be constrained? What economic, social and political principles should determine how much intervention is appropriate? What types of intervention are most effective?

Today no developed country in the world operates a fully flexible labour market in which employers are free to set the terms and conditions of employment and workers are treated as just another input to production, like machinery or raw materials. The nearest we find to such a system was that operating in the early phases of the industrial revolution in the late 18th and early 19th centuries (and which still characterises production in many ‘sweatshop factories’ in developing countries today) when child labour was commonplace and work was mostly characterised by long hours, unsafe and dangerous conditions and a lack of holidays and rights.

Since that time governments throughout the world have intervened to limit the freedom of employers. The twentieth century brought new employment rights with strengthened levels of protection against dismissal and poor working conditions, new rights for trade unions and more generous unemployment benefits financed by higher rates of national insurance contributions. Some countries introduced minimum wage legislation and in most countries there were rising levels of union membership.

These measures were introduced in part for social reasons, to prevent what was accepted to be unreasonable exploitation of workers, to protect against powerful interests and to prevent poverty. Nobel Laureate Robert Solow described this view in a speech to the British academy in 1998: “Every one of these regulations or restrictions [on the operation of the labour market] was intended to promote a desirable social purpose. Some may do so ineffectively or inefficiently. That is worth knowing; but the fact remains that wholesale elimination of these "rigidities" is neither desirable nor feasible."[17]

Such interventions have also been aimed at improving economic performance. Thus while the most 'flexible' labour market from an employers' point of view would be one where the terms and conditions of employment were set unilaterally by employers to maximise production efficiency, many employers have not chosen to operate in this manner but have opted for policies aimed at promoting good employment practices. As the Department for Business, Industry and Skills has pointed out, involving a workforce in decisions about the organisation and content of work is often an essential precondition for high-productivity, well-performing workplaces. It is unlikely that a workforce which is treated like an inanimate object and not engaged with or consulted in any way will perform effectively.[18]

Today governments intervene to influence the functioning of labour markets in a number of different ways:

- To influence (or limit) the degree of wage flexibility through the wage bargaining system (e.g. by encouraging collective bargaining in the workplace, across industries or sectors or the economy as a whole) or through legislation on minimum wages.
- To improve trade union rights such as the right to join a union or have a union recognised for bargaining purposes.
- To protect labour through employment protection legislation which restrict employers' abilities to 'hire and fire' employees.
- To impose limits on working time such as through the EU Working Time Directive and regulations on the extent of part-time and flexible working.
- To affect maternity and paternity leave rights, the number of paid holidays, the extent of flexible working, health and safety arrangements and aspects of non-wage remuneration such as pension arrangements.
- To address unemployment through education and training and through active labour market policies – government-funded programmes designed to get more unemployed (and inactive) people into work.
- To provide income support during periods of unemployment, financed through payroll taxation.

What level of intervention in each of these areas is appropriate is a matter of considerable controversy, and degrees of intervention vary widely between countries. In the UK, the extent and nature of regulation has changed sharply over time. For much of the UK's industrial relations history, collective bargaining – rather than social protection legislation – provided the principal source of protection for working people. The UK's system of industrial relations, known colloquially as 'collective laissez-faire', started to develop from the 1870s. At the beginning of the twentieth century the Trades Disputes Act made it lawful for trade unions to take industrial action and Wage Councils, which included both union and employer representatives, were established to set and agree wages in a number of low paid and 'sweated trade' industries. A national system of a national collective bargaining gradually evolved in the public and private sectors[19] and from 1940, the Fair Wages Resolution (which required suppliers to government departments to respect prevailing wages and conditions) was extended to cover minimum terms and conditions for employees working in non-unionised workplaces.

Since the early nineteenth century, there have also been a number of legislative measures designed to strengthen the rights of employees – rights which were more or less non-existent until then. A series of Factory Acts from 1819 banned the employment of children under 10, restricted the hours of children over 10, and enforced new health and safety regulations, and in 1911 Unemployment Benefit was first introduced. But it was not until the mid-1960s/70s that legislation began to play a more significant role in regulating the relationship between employers and workers, with the introduction of rights over issues such as redundancy pay, maternity pay, and sex and race discrimination law and equal pay. During the 1970s, Europe became a key source of employment rights.

Over the same period, national bargaining arrangements started to decline and a significant number of Wage Councils were gradually wound up. There were also several attempts from the late 1960s to reform the law on industrial relations – from Barbara Castle's controversial White Paper *In Place of Strife* to Edward Heath's Industrial Relations Act – all of which foundered. Legislation introduced by the Labour governments in 1974–76 reverted to the traditional immunities-based approach to labour law as well as introducing statutory protections from discrimination for trade union members and activists and time off rights for union officials. The 1960s and 70s also witnessed moves towards social corporatism, with the adoption of incomes policies and the establishment of the Social Contract.

By the late 1970s the industrial relations landscape involved a mix of formal centralised and localised bargaining. Sections of the economy lacked any kind of collective bargaining machinery. Nevertheless in 1980, 71 per cent of the UK workforce's terms and conditions were determined through collective agreements and 11 per cent by Wage Council orders.[20] Although lacking the formalism of corporate structures built around social partnership in European countries such as Germany, the UK's industrial relations system offered comparable protection for the working population.

Industrial relations in the UK were however subject to criticism. Low pay remained commonplace and access to rights including maternity leave, holiday entitlement, sick and redundancy pay and hours of work were limited. With a wave of high profile strikes throughout the 1970s, along with the return of rising unemployment, the neo-liberal school – which favoured the abolition of Wage Councils, the weakening of employment rights, lower payroll taxes and weaker rights for unions – began to gain more influence within the political arena. The previous political consensus in support of plural industrial relations systems based on free collective bargaining was unsettled. Successive Conservative governments from 1979 embarked on a series of radical measures designed to encourage the greater flexibility favoured by business and pro-market economists (see Box 1).

Box 1: Conservative measures to de-regulate the labour market, 1979 – 97

- There were major changes in Britain's system of industrial relations, including the abandonment of support for 'collective laissez-faire' and the attempt to manage the economy through state corporatism.[21]
- Support was removed for collective bargaining including the rescinding of the Fair Wages Resolution in the early 1980s, the repeal of the statutory system for extension of minimum conditions (agreed in sectoral level agreements) and the repeal of the statutory procedure for trade union recognition. ACAS' duty to promote collective bargaining was also removed.
- There was also an extensive reform of trade union law through a series of six separate Acts of Parliament, from the Employment Acts of the early 1980s to the Trade Union Reform and Employment Rights Act of 1993. These set out to restrict the ability of unions to take industrial action, including a prohibition on political strikes, secondary industrial action and new restrictions on secondary picketing. As a result trade unions became liable for damages for unlawful industrial action. Postal ballots and notices to employers were made compulsory before strikes could be called. The closed shop was effectively banned. Legislation was introduced regulating the internal governance of trade unions, including the requirement for five yearly elections for senior trade union officials and restrictions on the ability of unions to discipline members. The defeat of the miners in the prolonged and bitter strike of 1984–88 fuelled the shift in power away from the union movement that had been encouraged by trade union legislation, making it more difficult for unions to resist later attempts at industrial restructuring (including the controversial privatisation of the utilities).
- There were a number of revisions to the laws relating to employee rights, including changes to unfair dismissal protection which had the effect of removing rights for part-time and fixed term workers. The minimum qualifying period for unfair dismissal was raised from six months' continuous service to two years and to five years for employees working fewer than 16 hours a week. These were aimed at reducing the "administrative burden of these schemes especially on small firms, and at permitting a greater degree of flexibility in determining pay levels and conditions of employment."[22]
- The Wage Councils' role was first watered down (with, for example, the pay of young people under 21 excluded from Wage Council jurisdiction) and then abolished in 1993. Only the Agricultural Wage Council, which set wages for farm workers, continued to operate.

- The process of privatising the nationalised utilities, together with the outsourcing of public sector jobs in areas such as cleaning and refuse collection, reinforced the trend towards a more flexible labour market. Many workers were re-employed by private contractors on lower wages and poorer conditions of service including reduced holiday and sick pay entitlements and loss of entitlement to the local government pension scheme.
- During this period some new employment regulations were introduced as a result of European law including the principle of 'equal pay for equal value work'.
- State support for the unemployed was steadily scaled back. From 1980 all the main social security benefits (along with the state pension) were upgraded in line with prices rather than average earnings. Earnings-related supplements to unemployment (and sickness) benefits were abolished in 1982 and child additions in 1984. In 1996, Unemployment Benefit (which had been paid indefinitely) was replaced by Jobseeker's Allowance which was time-limited to six months with strengthened job-search requirements. However, in 1988 Family Credit replaced Family Income Supplement and its generosity was increased.

The impact of these policy changes, along with the changing economic climate, had a profound impact upon the labour market environment and the nature of industrial relations. By the time the Tories lost the election of 1997, the relationship between employers and employees had been transformed. The trade union movement, perhaps at the height of its influence in 1979, had found its powers, membership and finance ebbing away. The number of days lost to strikes fell from 29.5 million in 1979 – the year of the winter of discontent – to 278,000 days in 1994. Trade union membership in Great Britain stood at 13.5 million in 1979, 57 per cent of potential union membership. By 1997 that figure had fallen to 7.8 million.

Workers had been forced to lower their expectations of both work and welfare while bargaining power had shifted sharply away from labour and in favour of capital. These changes contributed to the fall in the share of wages in GDP and the rise in the inequality of earnings that occurred between 1979 and 1997 – indeed this was one of the intended goals of the policy changes.[23] In 1997, the unemployed faced much greater insecurity than was the case at the end of the 1970s.

While most of this transformation was the direct product of legislation, some of it was also the result of wider economic and social shifts, notably the recessions of the early 1980s and early 1990s, the acceleration in the shift in employment away from manufacturing, and shifting cultural, political and social attitudes and lifestyles.

When Labour came to power in 1997, it was not one of their priorities to turn back the tide of the previous 18 years. Tony Blair made it only too clear that the commitment to flexible labour markets would be maintained. As Labour's leader told the TUC Congress in September 1995: "There is not going to be a repeal of the trade tnion laws. Ballots before strikes are here to stay. No mass or flying pickets. All those ghosts of the past."

Blair shared much of the Thatcherite position on industrial relations. He supported most Conservative reforms of the labour market and bought into the 'supply-side' agenda to improve industrial efficiency and productivity. Gordon Brown was equally emphatic that Labour believed in labour market flexibility and 'light regulation'. As he put it in Labour's business manifesto published in March 1997, Labour "would not turn the clock back to the 1970s in industrial relations because we know that flexibility is vital for business to prosper." Indeed flexibility became as much the watchword of successive Labour governments as of the previous Conservative administrations.

Despite this declared commitment to the market, Labour was more interventionist in practice than they were in rhetoric. Thirteen years of Labour rule brought a number of workplace reforms, though these measures were always presented as part of Labour's commitment to economic modernisation, prudent finance, fiscal stability and low inflation. As Tony Blair put it, he wanted partnership in the workplace combined with the "pursuit of strong markets, modern companies and the creation of an enterprise economy."[24] Blair and Brown rarely missed an opportunity to argue that their economic priorities lay in improving productivity, enterprise and job creation.

Since 1997, there have been a number of measures aimed at the operation of the labour market, most of which have involved a modest increase in regulation (see Box 2):

Box 2: Labour measures to re-regulate the labour market, 1997 – current

- Perhaps the most significant of these measures was the introduction of the statutory minimum wage in 1999, with the rate initially set at £3.30 per hour for those aged 22 or older.
- The 1999 Employment Relations Act introduced an array of new rights for workers. Alongside the reduction in the qualifying period for a claim for unfair dismissal from two years to one, the maximum limit for unfair dismissal compensation was raised to £50,000 and provision made for annual index-linked increases. A right to statutory recognition, where a majority of workers supported it and 40 per cent of those entitled to vote did so, was introduced. Workers were given protection from victimisation when campaigning for union recognition. The 1999 Act also created a right to be accompanied by a trade union official or colleague at grievance and disciplinary hearings and made limited changes to industrial action notice and balloting rules. It also provided powers for the Government to introduce rules prohibiting blacklisting of trade unionists, which have recently been put into effect. Further changes were made by the Employment Relations Act 2004, in particular rules were introduced prohibiting unfair practices by employers during statutory recognition ballots and limiting improvements to dismissal protections for striking workers.

In some senses these measures were, as one commentator has put it, ' the minimum required to close the substantial gap in legal rights and obligations that existed between the UK and mainland Europe employment practice.'[25]

- In 2003, parents with children under the age of six and parents of disabled children under the age of 18 were given new rights to request flexible working. More recently, the right has been extended to carers and to parents of children under the age of 17.
- There were several extensions to maternity, paternity and adoptive leave and pay arrangements. Women employees are now entitled to 52 weeks' maternity leave, with 39 weeks' pay – increased from 18 weeks' pay in 1997. There is now a right to statutory paternity leave – for two weeks – while employed parents are also entitled to a total of 13 weeks' unpaid parental leave until the child's fifth birthday. The Government has also published plans to give families greater flexibility over child care arrangements including proposing a new right for the last six months of maternity leave to be transferred to the father.
- In 1998, Labour implemented the European Working Time Directive giving workers the right not to work more than 48 hours per week; the first statutory right to four weeks' paid annual paid leave; and restrictions on night work.
- Labour also ended the previous opt-out from the European Union's Social Chapter that had been negotiated under the Tories. However, the commitment was highly conditional, with Tony Blair reassuring business of his commitment to flexible labour markets. By 2004, the ending of the opt-out had led to equal treatment rights being introduced for part-time workers and fixed term employees and to the extension of unfair dismissal rights to fixed term staff. New rights to information and consultation about structural change were also introduced nationally and in European Works Councils.

Despite these measures Blair and Brown remained, at least until the onset of the recession, much more receptive to the business than the trade union lobby. Most of the limits on trade union rights, introduced during the 1980s and 1990s, still exist with the effect that industrial action remains vulnerable to legal challenge by employers. The effect of these rules was again highlighted in 2009 when courts imposed injunctions preventing industrial action from taking place, including in the recent British Airways cabin crew dispute. The Labour Government has also taken little positive action to extend the coverage of collective bargaining, with trade union recognition contingent upon workplace membership of above 50 per cent, a measure that particularly restricts collective representation in sectors with the most transient and low-paid workforces (such as hospitality).

Wedded to low replacement rates (the share of earnings in work met by benefits when unemployed), Labour continued the policy of raising unemployment benefits in line with prices rather than earnings. In 2009, the value of Jobseeker's Allowance – £64.30 per week – stood at 13 per cent of median earnings.

Considerable pressure was exerted on Blair by the trade union movement to move Britain in the direction of the European model of social consensus and corporatism. Many European nations are still characterised by institutionalised tripartism that brings together government, business and trade unions in formal discussions on the management of the political economy. In these models, centralised negotiations often take macro-economic factors into account in the determination of wages. Despite this, Blair – who held that the principal role of unions was to help add value to companies – refused to introduce the type of social consensus model widely adopted on the continent. The one exception was the Low Pay Commission, established as an advisory body in determining the level of the national minimum wage. Despite strong pressure from the TUC, Blair also repeatedly blocked attempts by the European Commission to introduce legally binding workplace representative bodies in companies with over 50 workers, even though such practices were commonplace abroad.

Although Labour implemented a clear, if modest, increase in labour market regulation from 1997 – including the minimum wage, enhanced maternity and paternity rights, and the right to request flexible working – today the UK's labour market remains one of the most lightly regulated of any developed economy, closer to a flexible than a regulated labour market. Table 1 ranks OECD countries by a simple summary measure of employment protection (EP) embracing a number of dimensions of protection from regulations governing the dismissal process, notice periods, severance pay and appeal procedures to regulations governing fixed-term and temporary contracts and agency workers. The index, devised by the OECD, ranges from zero (no protection) to 6 (extremely high protection). The UK was the third least protected of the 26 OECD countries in 2008 (after the US and Canada), compared with the second lowest in 1990.

Table 1 shows a modest convergence towards the average level of employment protection (EP) across these nations over the 1990s and 2000s, with most of the countries with the lowest EP (such as the US and the UK) seeing small increases and most of the countries with the highest level of EP (such as Portugal and Spain) decreasing levels of protection.

Table 1: Employment protection in selected OECD countries, 1990 – 2008

	OECD employment protection index (EP)				Change
Country	1990	rank	2008	rank	1990–2008
United States	0.21	1	0.85	1	+0.64
United Kingdom	0.60	2	1.09	3	+0.49
Canada	0.75	3	1.02	2	+0.27
New Zealand	0.86	4	1.16	4	+0.30
Ireland	0.93	5	1.39	6	+0.46
Australia	0.94	6	1.38	5	+0.44
Switzerland	1.14	7	1.77	8	+0.63
Hungary	1.27	8	2.11	11	+0.84
Poland	1.40	9	2.41	15=	+1.01
Japan	1.84	10	1.73	7	-0.11
Austria	2.21	11	2.41	15=	+0.20
Finland	2.33	12	2.29	14	-0.03
Denmark	2.40	13	1.91	9	-0.49
Netherlands	2.73	14	2.23	13	-0.50
Korea	2.74	15	2.13	12	-0.61
Norway	2.90	16	2.65	20	-0.25
France	2.98	17	3.00	22	+0.02
Mexico	3.13	18	3.23	24	+0.10
Belgium	3.15	19	2.61	18	-0.54
Germany	3.17	20	2.63	19	-0.54
Sweden	3.49	20	2.06	10	-0.53
Greece	3.5	21	2.97	21	-0.53
Italy	3.57	22	2.58	17	-1.01
Turkey	3.76	23	3.46	25	-0.30
Spain	3.82	24	3.11	24	-0.71
Portugal	4.10	25	3.05	23	-1.05
Average	2.30		2.20		-0.10

Source: OECD Main Economic Indicators

Another measure of labour market flexibility is trade union density (the percentage of employees who are members of a trade union). This is much easier to measure than EP, being a simple index. Table 2 shows the OECD countries ranked on this measure, from highest to lowest union density.

Table 2: union density, OECD, 1990–2007

	Trade union density (%)				Change (% pts)
Country	1990	rank	2007	rank	1990–2007
Iceland	92.1	1	88.6	1	-2.5
Sweden	80.0	2	70.8	2	-1.8
Denmark	75.3	3	69.1	3	-6.2
Finland	72.5	4	70.3	4	-2.2
Norway	58.5	5	53.7	5	-4.8
Ireland	56.7	6	31.7	9=	-25.0
Poland	54.8	7	14.4	22	-40.4
Belgium	53.9	8	52.9	6	-1.0
New Zealand	48.8	9	22.0	14	-22.8
Luxembourg	47.0	10	41.8	7	-5.2
Austria	46.9	11	31.7	9=	-15.2
Australia	40.0	12	18.5	19	-21.5
United Kingdom	39.3	13	28	12	-11.3
Italy	38.8	14	33.3	8	-5.5
Greece	37.5	15	23	13	-14.5
Canada	32.9	16	29.4	11	-3.5
Germany	31.2	17	19.9	15	-11.3
Portugal	27.5	18	18.7	18	-8.8
Japan	25.4	19	18.3	20	-7.1
Netherlands	24.3	20	19.8	16	-4.5
Switzerland	22.7	21	19	17	-3.7
Turkey	19.2	22	8.3	25	-10.9
Korea	17.2	23	10	24	-7.2
United States	15.5	24	11.6	23	-3.9
Spain	12.5	25	14.6	21	+2.1
France	10.3	26	7.8	26	-2.5
Average	41.6		31.8		-9.8

Source: OECD Main Economic Indicators

Table 2 shows that union density across the OECD decreased by an average of ten percentage points over the period 1990 to 2007. The UK's fall in union density, from 39 per cent to 28 per cent, is about average. On this measure, the UK came 12th in 2008 – about mid-way in the rankings.

Another study – published in 2008 – attempted a more comprehensive approach to measuring labour market flexibility, placing countries into four different groups according to the strength of (a) employment protection legislation, (b) union and collective bargaining strength and (c) 'social protection' – the generosity and coverage of their unemployment insurance.[26] Although developed nations are a very long way from having uniform or harmonised labour market policies (unlike, for example, macroeconomic policy, where in Europe, membership of the Euro dictates a common monetary policy for most of the EU), the study was able to find four distinct groups, as follows:

- The 'Anglo-Saxon flexible labour market', a cluster of countries which includes the UK, US, New Zealand and Canada. These countries feature relatively low levels of EP and union strength and a low-to-moderate degree of social protection.
- Belgium, Switzerland and Ireland fall into the 'European flexible labour market category' – rather like the Anglo-Saxon cluster but with slightly more protection and regulation on all three dimensions.
- Finland, the Czech Republic and Denmark fall into what has been described as the 'flexicurity' category, with moderate levels of employment and social protection, moderate union power and strong job search requirements for the unemployed.
- The remaining European countries – Spain, Germany, Italy, Portugal, Poland, Norway, Sweden, France and the Netherlands – are in the 'corporate continental triple secure' category, with high scores on all three indices.

The study shows that of the countries in the study, the 'flexicurity' countries seem to perform best according to a range of indicators of economic performance. They demonstrate high growth and relatively low unemployment, inequality and poverty.

3. How regulation affects wider economic performance*

So has the UK been right to link itself to the flexible labour market model? Has the adoption of a comparatively low level of employment and social protection contributed to improved economic performance? This section looks at the macro level impact of regulation on employment and unemployment. The next section looks at micro-studies, which consider the impact of individual dimensions of labour market flexibility.

The orthodox position has been that employment protection measures, high levels of unionisation and generous unemployment benefit systems will increase the overall level of unemployment. Under this model regulation is associated with weak economic performance and light regulation with strong economic performance. Advocates of 'light touch' regulation – a mix of orthodox economists, business leaders, leading politicians from all main parties and international organisations such as the OECD and the IMF (though both have recently softened their views) – have long argued that the continental European 'social model', with its higher taxes, stronger welfare systems and more powerful unions, has led to higher rates of unemployment and lower rates of employment than the more lightly regulated UK and US.

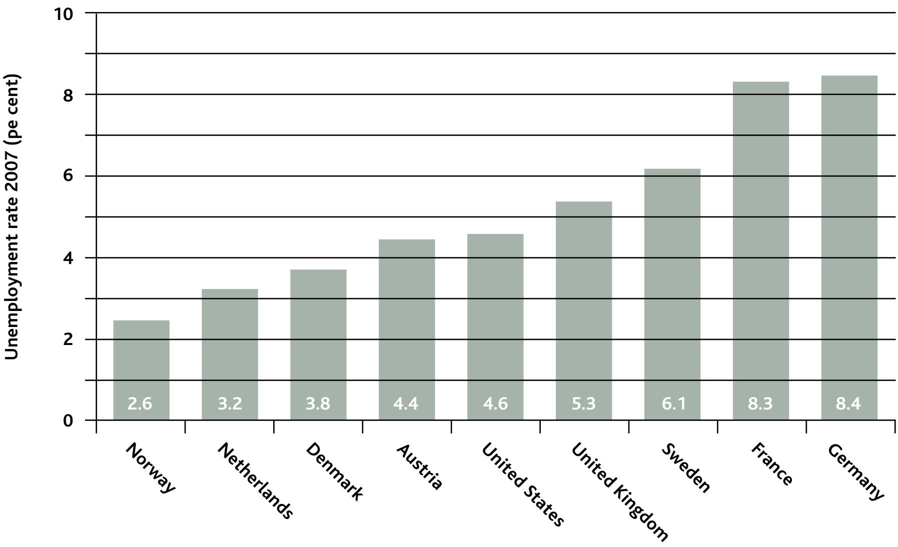
The reality is much more complicated. Figure 1 shows the level of unemployment in 2007 (that is, before the onset of recession) for a range of countries. While France and Germany have high unemployment rates, several European states with relatively highly regulated labour markets – for example Norway, the Netherlands, Denmark and Austria – have unemployment rates that are lower than those of the UK and US, despite their lower levels of regulation. A comparison of labour force participation rates – the proportion of the labour force employed – would show a similar pattern. Again, very different labour markets achieved comparable levels of employment performance.[27]

The main countries where the orthodox view finds some support are Germany and France, both of which have had higher levels of unemployment and lower levels of employment participation along with higher levels of regulation. Some of France's and Germany's problems may lie, at least in part, in their more rigid and controlled labour markets. In recent years, Germany has attempted to make its labour market more flexible through, for example, a reform of its once indefinite

---

* For more detail see Howard Reed, *Flexible with the Truth?* London: TUC, 2010, Chapters 3 and 4.
Available to download at **www.tuc.org.uk/flexiblewiththetruth**

Figure 1: Unemployment rates, 2007



Source: OECD, Eurostats

and relatively unconditional unemployment benefit system and a change in its wage bargaining rules to allow for greater scope for flexibility at enterprise level. Table 1 shows a sharp fall in the degree of employment protection in Germany over the 18 years to 2008.

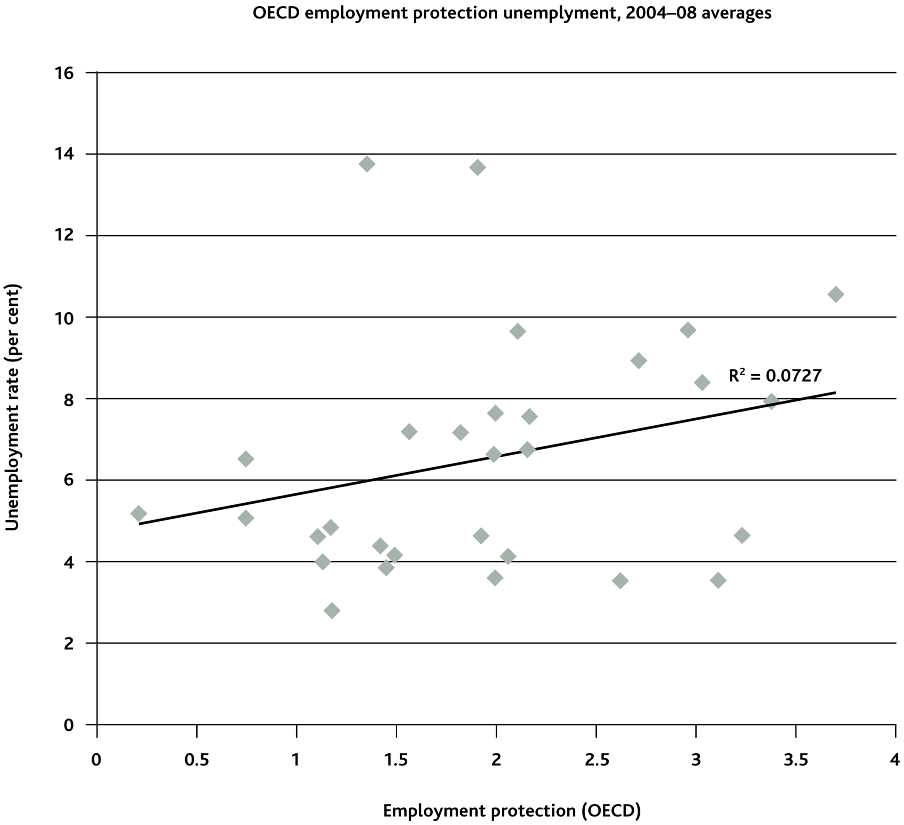
Nevertheless it would be wrong to conclude that the solution to above average German unemployment lies in further heavy doses of de-regulation. Economic dislocation caused by unification, along with the speed with which East German wages were brought into line with West Germany's, contributed to the nation's sustained unemployment. Its employment problems are, according to Adair Turner, also related to the wider macro-economic strategy of the Eurozone, which follows tight monetary policy and emphasises price stability, and the level of the deutschmark exchange rate at the time the single currency was created.[28]

France has also engaged in a major internal debate about how to tackle high unemployment, which is at least in part structural, but has not yet taken serious moves to make its market more flexible. The nation has, for example, a relatively high level of youth unemployment yet its adult minimum wage applies from the age of 18 while the UK has a lower rate for 18–22 year-olds and 16–17 year-olds.

Despite the outlying position of Germany and France, there remains a lack of an obvious pattern between regulation and unemployment. Figure 2 shows the relationship between the OECD's employment protection index (EP) and the unemployment rate (the average over the five years 2004–08) for the 26 member countries.

The figure includes a linear regression trend line (the best statistical estimate of the relationship between EP and unemployment). While this appears to show a slight positive relationship, and would be interpreted by orthodox commentators as evidence that high employment protection is associated

Figure 2: The relationship between employment protection and unemployment

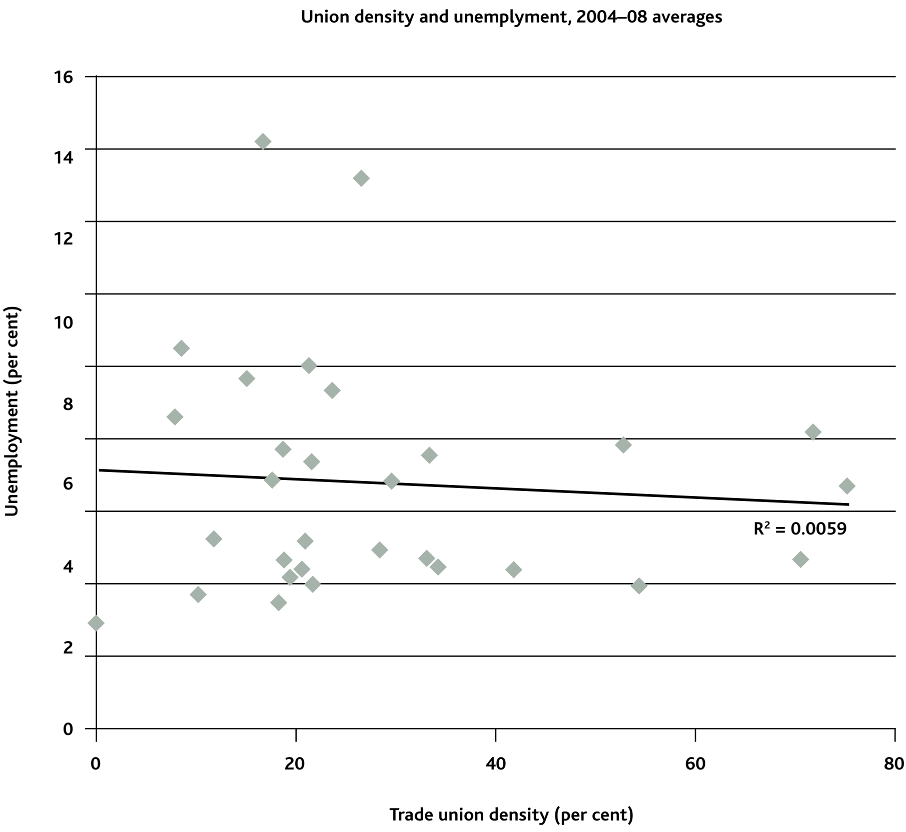


with higher unemployment, such a conclusion does *not* follow. This is because the line explains very little of the variation in the points on the graph and the relationship is not statistically significant. The extent of the variation measured by the graph is given by the 'R-squared' statistic, which is around 0.07. This shows that only 7 per cent of the variation in the figure is accounted for by the regression line.

Moreover, even if there had been a statistically significant positive relationship, such two-way correlations are subject to the limitation that no other control variables are included in the analysis. To the extent that other variables are correlated with either unemployment or EP, we could be picking up the effects of these variables rather than a true causal effect of EP on unemployment. This is known as 'omitted variable bias'. Thirdly, there is no way of establishing the direction of causality. It could be that increases in unemployment lead to increases in employment protection rather than the other way round.

A similarly ambiguous conclusion emerges when unemployment (averaged over 2003–07) is correlated with union density (Figure 3). This shows that despite orthodox claims about the adverse impact of unions on the labour market, there is in fact no statistically significant relationship between trade union density

Figure 3: The relationship between union density and unemployment



and unemployment, and thus no support for the orthodox view of unions as an impediment to efficient labour market functioning. Similar findings emerge from a study of the impact of changes in employment protection levels on productivity. Simple comparisons reveal no evidence in support of economic orthodoxy.

Because of the limitations of these simple correlations to say anything conclusive about the impact of different degrees of regulation, there have been a number of more sophisticated studies of the relationship between regulation and unemployment. These studies use techniques which overcome the problem of omitted variable bias because they can handle more than one variable at once (though they do not overcome the problem of determining the direction of causation).

These studies have examined the impact of a number of different aspects of regulation – including the extent of employment protection, the unemployment benefit replacement ratio, the duration of unemployment benefit, union density, the degree of centralisation of wage bargaining and the 'tax wedge' (the amount of direct tax workers pay on their gross earnings, i.e. a measure of the tax burden on employees) – on the level of unemployment across different countries.

One study published in 2005 surveyed all the main earlier studies supplemented by the authors' own analysis to bring the studies up to date.[29] These were the key conclusions:

- The only variables found to have a consistent correlation with unemployment rates were the presence of a co-ordinated bargaining system where unions and employers negotiate wages at national or sectoral levels (which is associated with reduced unemployment) and the tax 'wedge' (which is associated with increased levels of unemployment).
- The impact of bargaining co-ordination (if causality does run from co-ordination to unemployment rather than the other way round, which is impossible to say for sure) varies sharply – from around a one to a 10 percentage point *decrease* in unemployment.
- The tax wedge variable has a minor impact on employment. A 10 percentage point increase in the tax wedge – a huge increase – is associated with a one percentage point increase in unemployment (however these studies do not take into account the ways in which the expenditure of tax receipts can improve economic performance).[30]
- The employment protection (EP) and unemployment benefit duration variables are significant and positively correlated with unemployment in most of the listed papers though the effects are small. In one case, 1-unit increase in EP (a large increase, given that the OECD use a 6-point scale and most countries are between 1 and 3) is associated with less than a 0.3 percentage point increase in unemployment. In the most recent data, increased EP is actually associated with a small *reduction* in unemployment.

Thus the collated evidence in this study does not support the straightforward conclusions of the orthodox school. At most it offers limited support for the notion that employment protection and the tax wedge have a small positive correlation with the unemployment rate, controlling for other factors. However, the strongest result is that more co-ordinated wage bargaining systems are associated with *lower* levels of unemployment – an argument which runs counter to orthodox labour market prescriptions.

As the authors of the survey conclude: "Our results suggest a yawning gap between the confidence with which the case for labour market deregulation has been asserted and the evidence that the regulating institutions are the culprits. It is even less evident that further weakening of social and collective protections for workers will have significant positive impacts on employment prospects. The effects of various kinds of deregulation on unemployment are very hard to determine and may be quite negligible."[31]

These results were published in 2005 and few of the studies included data from the twenty-first century. There have been two more recent major studies – a 2006 OECD study which uses data up to 2002 and an academic study published in 2007.[32] Both confirm the picture of ambiguity. Sometimes the orthodox predictions are upheld but mostly they are not. For the most part the findings are inconclusive or where there is a clear pattern, the impact is weak. The main findings of the OECD Report – which examines the impact on *employment* as well as unemployment rates – are summarised below:

Those that are supportive of the orthodox position:

- The tax wedge is significantly related to unemployment, with the impact of a 10 percentage point increase in the aggregate tax rate associated with a 2.5 percentage point rise in unemployment (this compares with only a one percentage point rise in the 2005 survey). However these studies do not take into account the ways in which the expenditure of tax receipts can improve economic performance.

- 'High and lasting' unemployment benefits are positively correlated with unemployment and there is some evidence that macroeconomic shocks such as recessions may be amplified by very high benefits.

Those that are supportive of the pro-regulation position:

- Highly centralised and/or co-ordinated wage bargaining systems are associated with reduced unemployment and act to dampen recessions.
- Publicly funded training programmes have a significant association with lower unemployment.
- Union density is positively correlated with employment rates.

Again, several interventionist measures were found to have no consistent correlation with the level of employment or unemployment. The 2007 study found that the replacement rate and union density were positively related to joblessness while strong employment protection reduces it.

Overall, the macro evidence finds little conclusive support for the orthodox proposition that labour market regulation has a negative impact on economic performance. The strongest result – that co-ordinated bargaining is associated with reduced unemployment – runs directly counter to the orthodox prospectus. Despite this evidence, neither the OECD nor the IMF have recommended that countries where collective bargaining is weak – like the US, Britain and Australia – should reform their labour market to establish co-ordinated bargaining institutions.

The only two robust findings from the macro evidence that provide limited evidence for the orthodox model are that the size of the tax wedge and the generosity of the unemployment benefit system are correlated with higher unemployment. However, in both cases, the effects found are mostly small.[33] As the authors of the 2007 study conclude: "The influence of institutional arrangements is actually far more complex than implied in most theoretical models and policy agendas. Notably, the results appear more complex than what is stressed by the 'new orthodoxy view'. We do not generally confirm the superiority in terms of employment performance of systems founded on deregulation (or even flexicurity)."[34]

The empirical evidence shows that there is no single route to achieving low unemployment, no 'one size fits all' set of policies that are appropriate for all economies, irrespective of their cultural and social background and institutional structures. Countries with very diverse approaches to the labour market have ended up with very similar outcomes when it comes to employment and unemployment. For example, the 'Scandinavian' and the 'flexicurity' nations, despite being highly regulated, have enjoyed relatively successful employment and unemployment outcomes over the last decade. As the eminent American labour economist, Richard Freeman, put it in 2005: "The evidence for the *Jobs Study* orthodoxy was and remains at best mixed. Many economists have known that the time-series and cross-country data on which some proponents of the view relied was of dubious value. Indeed, in various Employment Outlook analyses post-1994, OECD economists themselves made clearer the fragility of the empirical support for some of the orthodox claims. Other analysts, usually country specialists, have known that the simple flexibility story does not explain the good or poor performance of their national economies. How else to account for the success in employment of Scandinavian countries… [or] the success of the United States compared to economic near-clone, Canada?"[35]

4. Micro-level evidence*

Because of the ambiguity, and the well know weaknesses associated with measurement and methodology in macro-studies, the micro-level evidence is in many ways more useful. Micro-studies have several advantages over macro-studies. Whereas macro-studies are limited by problems of aggregation and simplification of variables into indices, and the difficulty of establishing causal links, micro-studies are able to control for other factors which might affect labour market outcomes in a much more systematic fashion.

The flip-side of this increased accuracy in isolating (as far as is possible) the causal impact of individual dimensions of labour market flexibility is that the results from micro-studies are not individually generalisable. Each relates to a specific time, place and policy, and multiple studies are required to reach systematic conclusions about 'what works' in policy terms.

Minimum wages

The orthodox prediction is that a minimum wage will either have no effect on the labour market whatsoever (if set at a level below what the lowest-paid worker in the labour market is paid) or will reduce employment (if set above this level). In this view, the higher the minimum wage is, the higher unemployment will be.

Alternative views based on imperfect competition in the labour market suggest that it is possible that many workers are being paid less than the value of what they produce and in this situation, it is possible for a minimum wage to raise wages without adverse effects on employment.[36] In certain models there may also be a *positive* impact on employment.[37] There is a certain critical level above which adverse employment effects may occur, but it is an empirical question as to where that level is. However, the actual rate may need to vary in this model, by, for example, setting lower rates for workers with lower than average productivity (such as young workers) to avoid adverse employment effects.

The debate on the impact of a minimum wage has swung wildly ever since a 1995 study by two eminent American labour economists produced results which showed

---

* For more detail see Howard Reed, *Flexible with the Truth?* London: TUC, 2010, Chapter 5.
Available to download at **www.tuc.org.uk/flexiblewiththetruth**

that the best estimate of the effects of the minimum wage on US employment was zero.[38] This conclusion – which overturned the standard orthodoxy – was challenged in a 2007 study which concluded that there *is* a significant negative impact from increases in the minimum wage on employment, averaging across a range of US and other country studies.[39]

However, a more recent large-scale analysis based on 64 studies in the US argues that the results of the 2007 study (at least for the US) were driven by 'publication bias'.[40] This is the tendency, well-documented in academic publications in a wide range of subjects, for empirical research which produces an intervention outcome significantly different from zero to be deemed more 'interesting', and hence more likely to be published than research which shows no effects.[41] Once publication bias was controlled for using standard statistical techniques, the estimated average effect of minimum wages on employment was found to be almost exactly zero.

In the UK, the Low Pay Commission commissions regular empirical work on the impact of the UK's national minimum wage (NMW) which currently stands at £5.80 for an adult. Prior to its introduction there was concern that it would prompt knock-on wage increases for slightly higher paid workers in a bid to maintain differentials. The Commission's latest report suggests that this does not seem to have happened.[42] There is some evidence of reductions in hours for adult men resulting from increases to the NMW in 2001 and 2003, but these are small in magnitude. In general, there is no statistically significant evidence of reductions in employment or increases in unemployment arising from the uprating of the minimum wage in the UK, even though it has increased in real terms and relative to median earnings since 1999.

This finding is consistent with earlier evidence on the initial introduction of NMW which found no employment or unemployment effects, though one study found some evidence that the minimum wage increased wages at the expense of profitability for firms based in industries which employed particularly high shares of low-paid workers.[43] There is also some evidence supporting the argument that, in the absence of a minimum wage, workers are paid less than the value of what they produce, and that the minimum wage stops this happening (at least for workers at the bottom of the wage distribution) by placing a floor under wages.[44]

In summary, once correction for publication bias is made there is no evidence of adverse effects of minimum wages on the labour market in the United States. Nor is there evidence of adverse effects in the UK. Given that studies have shown that the minimum wage does seem to set an actual wage floor, rather than being set below levels at which it would actually bite, the absence of a measurable employment effect presents a real challenge to the orthodox view of labour markets and is considerable *prima facie* evidence in favour of an alternative understanding – whether it be a conventional imperfect competition model of the firm's wage-setting decisions or based on more complex arguments around inequality of bargaining power.

That said, policymakers need to be careful not to be reckless with increases in the minimum wage. Even in alternative models, there remains *some* level above which minimum wages are likely to cause unemployment.

Employment protection legislation

'Employment protection' (EP) involves policies which reduce the ease with which firms can get rid of workers and soften the impact of redundancy when it happens – for example through unfair dismissal legislation and statutory redundancy pay provisions. As shown in section 2, EP provisions in the UK were loosened during the 1980s and 1990s. Though there was some modest re-regulation under Labour, the UK still has the third weakest level of protection among OECD nations.

Most theoretical work predicts that EP legislation will reduce the flow of jobs. This is because it reduces the rate of job loss (by making it more difficult for firms to get rid of workers) but also reduces the rate of job creation. However, the theoretical literature is split on whether EP is good for the wider economy in terms of employment, productivity and innovation.

While orthodox models predict that EP, like most other regulations, reduces efficiency by impeding the 'ideal' operation of the market, in more realistic models the effect is more mixed. On the negative side, some models predict that EP may create a barrier between a core workforce of employed, well-protected 'insiders' and a casual or unemployed periphery of 'outsiders'.[45] There may also be reductions in productivity growth and/or innovation if EP impedes employment shifts from less productive to more productive firms.[46]

On the positive side, many 'job-search' models of the labour market suggest that the optimal level of EP for economic efficiency is greater than zero because a reduction in the risk of being fired acts as an insurance mechanism for workers.[47] Similarly, severance pay is a (partial) insurance against the risk of being made unemployed, particularly in countries where unemployment benefits are low.[48] EP can also *increase* productivity and/or innovation in an economy where skill enhancement is important, but firms are vulnerable to economic shocks.[49]

While the empirical evidence is mixed, there are plenty of studies which suggest that moderate levels of protection can be economically effective. As shown in section 2, while some countries with strong protection, such as Germany and France, have high unemployment most, such as Denmark, Sweden and the Netherlands, have low unemployment.

One cross-European study found that while job mobility rates are negatively related to stricter EP, EP has more positive effects on youth labour markets and on skills acquisition.[50] A study of the impact of the 1999 British reform which reduced the qualifying period for unfair dismissal provisions from two years to one year found that it reduced the probability of *leaving* employment for workers with tenure of between one and two years, probably because the reform induced employers to find workers who were better matched to their jobs (and thus, less likely to be candidates for firing).[51]

Very low levels of employment protection actually *reduce* growth because they reduce the incentive for workers to improve their skill levels.[52] Thus, up to moderate levels, EP is productivity-enhancing. However, very high levels of EP can raise wages and thus lower profitability (and hence investment), which reduces productivity growth.

In summary, while strong EP can reduce the extent of job flows and job re-allocation between different sectors of the economy, a certain degree of EP helps preserve jobs where acquiring skills is an important determinant of productivity. In addition, whatever the economic effects, EP plays an important social role, offering a degree of workplace security that would not occur in a free market and protection against the process of industrial change that can be highly destructive.

Given that the UK has the third lowest EP level of any developed country, the ambiguity of the empirical evidence suggests that it is unlikely that a reduction in EP from this low level would deliver enhanced labour market performance or that modest increases would be detrimental. Indeed given the theoretical literature which suggests that EP has positive effects on productivity at low levels, which turn negative at high levels, reducing EP from where we are now could actually reduce productivity.

'Family-friendly' policies: childcare, maternity and paternity leave and flexible working

This section looks at policies aimed at making work more compatible with having and looking after children, and measures which increase flexibility for workers with children while reducing it for employers.

Childcare

The promotion of access to childcare for working families has been an important element in Labour's aim of increasing the overall working-age employment rate by moving more lone parents and couples with children into work. The Working Families Tax Credit (introduced in 1999) and the Child Tax Credit (introduced in 2003) both included support for childcare expenditure for low-income working families, while the ambitious 2004 Ten Year Childcare Strategy planned for a number of extensions to current state support for childcare provision.[53]

The evidence is that, by reducing the net cost of entry to work, childcare subsidies have a positive impact on the labour supply decisions of mothers – whether lone parents or in couples. Although the subsidy has to be paid for out of increased taxation (so that the resulting increase in the tax burden may have some adverse and offsetting impact on economic efficiency[54]), the UK evidence is that childcare subsidies boost female employment, assist women's re-entry into the labour market after having children, and contribute to a reduction in the pay gap between men and women.[55] Such subsidies are an important part of the 'welfare-to-work' strategy.

Family-related leave

Although Labour has made several extensions to mothers' rights to statutory maternity leave and pay since 1997 and introduced statutory paternity leave (for two weeks) these provisions remain less generous than many other European countries. In general, employer organisations have been more opposed to extensions of parental leave rights than to childcare, because of perceptions that parental leave imposes an additional cost burden on employers – either due to the cost of having to cover for the person on leave or the temporary disruption for the business.

While the orthodox view suggests that in the short run, parental leave costs are shifted on to employees via lower net wages, in more complex models – where there is imperfect competition and potential scope for bargaining – the effects of parental leave are less clear. On the negative side, long periods of family-related leave might be disruptive to the business if they cause working patterns to have to be rearranged and reduce productivity. On the other hand, if family-related leave allows a mother or father to return to the same job – rather than having to leave the labour market and return to another job – it could raise productivity compared with a situation where no parental leave scheme is available.

Although there is limited evidence on the wider economic impact, the empirical evidence suggests that paid maternity leave has strong social benefits. It increases the time that women spend out of the labour market immediately after giving birth; it increases the likelihood of women returning to employment after the leave period runs out; it increases the likelihood of women returning to the same job (i.e. it improves worker retention; it has much bigger effects than unpaid maternity leave) largely because women are much less likely to take unpaid maternity leave; it has positive effects on child health (measured by birthweight), a negative correlation with infant mortality, and a positive impact on mothers' health outcomes.[56] The more limited evidence for fathers is that when fathers take longer parental leave, they are more involved in the care of their infants nine or 10 months after the birth.[57]

Paid maternity leave has a much more powerful impact on encouraging female employment than unpaid leave. Maternity leave improves job retention for women and, since reductions in pay for women moving jobs after childbirth are a large part of the explanation for the gender pay gap, it contributes to greater gender equality by enabling women to return to their pre-childbirth jobs (and pay levels). Research over the period 1998 – 2004 has also found that workplaces in which the incidence of family-friendly working practices increased were more likely to be identified by managers as having improved in financial performance relative to others. However, it is not clear what the causal interpretation of this relationship is – whether high-performing workplaces had more spare funds to introduce family-friendly working, or whether family-friendly working actually improved workplace performance.

The right to request flexible working

The right to request flexible working, introduced for parents with children under six in 2003 and extended to parents of children under 16 in 2009, is a classic piece of 'soft' labour market regulation – it gives employees the right to make a formal request for flexible working arrangements though employers are under no obligation to agree to the request.

One 2006 study found that 91 per cent of employers accepted all requests for flexible working in the 12 months prior to the survey, and 92 per cent said they would consider a request for flexible working from any employee – even those without children.[58] Forty per cent of employers said they had received at least one request for flexible working in the 12 months prior to the survey. This suggests considerable previously unmet demand for flexible working and that employers are (in the majority of cases) prepared to be flexible about accommodating demands. This is further evidence that real-world labour markets operate differently from the idealised economic textbook versions.

While there is no direct empirical evidence on the impact of the right to request flexible working on the wider economy, the extensive willingness of employers to respond to such requests suggests that effects on productivity or profitability are unlikely to be negative.

Trade unions

Orthodox economists have portrayed trade unions, like minimum wages, as little more than mechanisms for creating unemployment by raising wages above their market-clearing levels in the unionised sector.[59] It was the alleged adverse effects of trade unions on equilibrium unemployment levels in the economy – together with concerns about the number of working days lost to industrial action in the 1970s – that were the justifications used by the Conservatives for their new legal restrictions on the freedom of unions.

However, by the 1980s the orthodox economic view was being challenged in a way which demonstrated a potentially *positive* role for unions under theoretical assumptions that deviated from strict orthodoxy. Analysis of their role in an *imperfectly competitive* environment shows that, as with the analysis of the impact of a minimum wage under imperfect competition, there is scope for unions to increase wages (at the expense of reductions in profits) *without* adverse effects on employment. This is known as the efficient bargaining model.[60]

Based on groundbreaking research on the economics of imperfect competition by academics such as the Nobel Laureate economists Joseph Stiglitz and James Mirrlees, a number of studies have shown how unions could play a positive role in liaising with management to make workplaces fairer and more effective by providing a trusted channel to articulate workforce suggestions and grievances.[61]

The role of trade unions is thus another example of an area of economic theory where relaxation of the basic assumptions yields predictions that are completely different from the orthodox view. However, the new theories tell us nothing about the magnitude of trade unions' positive impact on wages and/or productivity or workplace functioning – or even if such effects can be detected in the real world.

Despite these new theories, trade unions are still viewed as a negative force by the anti-regulation school. Changes in union law have weakened the opportunities once available to unions while employers have often displayed a reduced willingness to recognise unions for bargaining purposes.[62]

This weakening in trade union rights has failed to recognise the economic benefits that unions bring. In the UK, unions have been shown to be worthwhile institutions for their members and to be associated with 'good practice' in the workplace. For example, research for the Department of Business, Enterprise and Regulatory Reform has shown that union density is significantly related to reductions in more serious disciplinary actions such as suspensions and dismissals.[63] A union presence has also been found to have what one writer has called a 'sword of justice' effect in the workplace – an important role in promoting social justice at work – with, for example, a better record on gender equality, better treatment for disabled people and fewer workplace accidents.[64] The presence of trade unions in the workplace is also positively correlated with the availability of parental leave (above the statutory minimum), special paid leave and job-sharing options.[65]

There is also evidence that union density is associated with a range of positive wider economic outcomes. A World Bank analysis across developed and developing countries found that the extent of collective bargaining by trade unions was negatively associated with unemployment, inequality and the incidence of strikes.[66] Another study found that trade union recognition in manufacturing firms is positively related to several different types of innovative practice.[67] The existence of trade unions is also correlated with several aspects of good workplace performance, although it is admittedly hard to show a definite causal link. As shown in the macro-economic literature above, countries where unions are involved in setting co-ordinated bargaining agreements across the economy tend to have lower unemployment. The TUC Touchstone pamphlet *The Road to Recovery*[68] provides further discussion of the workplace benefits that collective bargaining can bring, including workplace innovation, employee engagement, improved retention and reduced absence, increased income equality and improved access to education.

There is also evidence that in some countries, including Denmark and the Netherlands, the tripartite approach has accelerated the pace of structural reform, encouraging unions to agree to wage restraint in return for tax reform, improvements in welfare provision, greater diversity in working time or accepting changes that are employment-enhancing.[69] Because of these positive associations, the OECD has more recently come to accept that under certain conditions, trade unions can contribute to jobs growth and that high levels of collective bargaining through centralised negotiating and corporatist models have produced successful labour market outcomes in a number of countries.[70]

Unemployment insurance, in-work benefits and active labour market policy

While orthodox commentators have argued that generous unemployment insurance systems simply lead to unemployment, the OECD has recommended both in-work financial support for low-income earners and an active labour market policy as key planks of the strategy for reducing unemployment.[71] So what does the micro-evidence say about the impact of all these policies in the UK and other comparable countries?

Unemployment and other out-of-work benefits

In the UK, the system of unemployment insurance has gradually been pared back. Today, Jobseeker's Allowance (JSA) pays £64.30 per week for adults aged 25 and over, requires an adequate record of national insurance contributions and is only paid for six months with claimants required to demonstrate that they are actively seeking work (although income-related JSA can be claimed for longer for those passing a strict income test). The UK benefits system also provides varied support for non-working people who are unable to work because they are sick or care for others.

The orthodox view is that the more generous out-of-work benefits are, the less likely people are to be in work. This is because unemployment insurance raises the 'reservation wage' – the net income from work above which people find it worthwhile to enter work. The orthodox view is that anything which reduces the reservation wage is good, whereas anything that increases it is bad. For example, the OECD's 1994 *Jobs Study* advocated reducing the generosity of unemployment insurance, imposing short time limits on claim periods, tightening the criteria for eligibility and reducing the tax burden on low earners.

Most orthodox economists do not argue that out-of-work benefits for jobseekers should be abolished entirely, as they accept the rationale for a safety net to alleviate extreme poverty on equity or social justice grounds. However, they mostly argue that the existence of safety nets is part of the 'efficiency/equity' trade-off – the acceptance of a loss of efficiency in return for a gain in equity.

Other economists have challenged this view, particularly its assumption of 'perfect information', whereby workers move costlessly into their most-preferred jobs. Indeed, recent theoretical research into labour market dynamics – the process by which workers move between jobs and from unemployment to work – is dominated by 'search-matching' models. These accept that job-searching takes time and effort and demonstrate that it is quite possible that unemployment benefit at a level greater than zero can enhance efficiency by providing workers with the means to make a more effective (and often more time-consuming) search for jobs, which also means they are likely to get a higher wage than if they took a job quickly.[72]

The empirical evidence on the effects of unemployment insurance is mixed. The macro-evidence (discussed in section 3) indicates a negative correlation between the generosity and duration of unemployment benefits and levels of unemployment. The micro-evidence is usually based on examining labour market performance before and after specific reforms.

Research on the replacement of Unemployment Benefit with JSA in the UK in 1996 shows that it is important to consider what happens to *inactivity* as well as unemployment when evaluating the success of reforms of this type. The official government evaluation claimed that the reform was successful because *flows off* the 'claimant pool' of people receiving the allowance increased when the reform was introduced.[73] However, other studies suggest that while the tightening of the work search requirements and reduction in the qualifying period did result in large reductions in the claimant count, these were overwhelmingly into *inactivity*, not employment.[74]

There is also recent evidence on Germany's 'Hartz reforms' introduced from 2003. These implemented most of the OECD 'medicine' by reducing the duration of unemployment benefit eligibility from an indefinite period to 12 months and by greater enforcement of the job-search criteria. Although this evidence shows that the reforms had some effect in decreasing unemployment, this was also in part the result of a better macroeconomic environment leading to substantial job growth in the years following 2004.[75]

A US study has shown that while more generous unemployment benefits do increase unemployment durations, about 60 per cent of this increase is due to unemployed people choosing to smooth their consumption patterns over time. This reduces workers' risks of immediate and severe poverty, as well as maintaining demand in the wider economy. Higher benefits also help unemployed workers to secure better matches, which better utilise their skills. Using cost-benefit analysis, the study argues that the optimal unemployment benefit level would be just over 50 per cent of the average US weekly wage.[76] By comparison, the current JSA level in the UK is £64.30 – just 13 per cent of gross average earnings, much lower than the relative value in other countries such as the Netherlands and Denmark.[77]

The evidence on the effect of reforms to unemployment insurance is therefore mixed. Even pro-regulation economists accept that over-generous unemployment benefits with indefinite eligibility and limited job-search conditions are likely to act as a disincentive to work. On the other hand, evidence from the much less generous UK and US systems suggest that benefit reforms which start from a relatively ungenerous base, and tighten eligibility conditions still further, can have adverse effects on the efficiency of job searching.

A 'third way' on unemployment insurance between the extremes is exemplified by the Danish 'flexicurity' system, which combines generous benefits with stringent job-search conditions and time limits. Research suggests that this hybrid approach can achieve low levels of unemployment while avoiding the negative social and economic aspects of the UK and US models.[78]

In-work benefits

One way of overcoming the problem of out-of-work benefits raising the reservation wage is to raise the level of *in-work* incomes using in-work benefits. The UK has a long history of in-work financial support, going back as far as 1971, when Family Income Supplement was introduced. This was replaced by Family Credit in 1988, the Working Families Tax Credit (WFTC) in 1999 and finally the Working Tax Credit (WTC) in 2003.[79]

In general, orthodox economists are less opposed to in-work financial support because it helps to restore financial incentives to enter work to something like the level that they would be in the absence of an out-of-work benefit system. Also, in-work benefits offer a way of redistributing income without adverse effects on the incentive to work (indeed, while encouraging work); this makes them desirable to many commentators on equity, as well as efficiency grounds. The UK has also been influenced by the political and economic debate on in-work benefits in the US, where the Earned Income Tax Credit (EITC) system has been shown to have significant positive effects on the employment rates of lone parents and low income families with children. Early New Labour thinking on in-work benefits was heavily influenced by the US experience, and the WFTC was in some ways meant to mirror the EITC.

The empirical evidence on the effectiveness of in-work benefits in promoting employment shows clear positive results for lone parents – who face unambiguous financial incentives to enter employment as a result of the policy. Studies have shown that the increase in generosity of the WFTC compared with its predecessor benefit, Family Credit, boosted lone parent employment by between 65,000 and 80,000 (between 3.8 and 5.2 percentage points) between 1999 and 2003.[80]

In contrast, the impact of the WFTC on the labour supply of *married* mothers has been found to have insignificant effects overall.[81] This is largely because by raising household income, increasing in-work benefits for a couple where just the man is working can make the woman *less* likely to seek work. In the case of two-earner couples, increasing in-work benefits might make the second earner more likely to move *out* of employment. For couples where *neither* earner works, in-work benefits make it more likely that one earner will enter work.

Active labour market policy

An increased emphasis on active labour market policy (ALMP) has been the main 'interventionist' recommendation that the OECD has been making for the last fifteen years, first in its 1994 *Jobs Study* and most recently in its 2009 *Employment Outlook*, where it argues that countries need to be spending a lot more on ALMP to reduce the unemployment impact of the current recession.

In practice, ALMP can comprise a host of different policies including assistance with job-search activity (for example, using personal advisers or training courses to assist unemployed people); employer subsidies to take on long-term unemployed people; direct job creation when the government/public sector agencies assign long-term unemployed people to jobs directly; and assigning unemployed people to training schemes to improve their skills. In most countries these policies are targeted specifically at long-term unemployed people and/or marginalised groups.

There is substantial empirical evidence on the effectiveness of different types of ALMP – particularly from the US and Canada, where these types of programmes have a long history. One summary study of US and Canadian active labour market initiatives from the 1980s and 1990s found that such programmes mostly have positive effecs on employment.[82] The OECD has reached similar conclusions about job-search, finding that subsidised job or earnings supplement programmes are particularly effective.[83]

In the UK, there have been a number of active labour market policies over the last decade starting with the New Deal programmes from 1998. These first targeted long-term unemployed people aged under 25 and were then extended to the over-25s. They offered assisted job-search support (the 'Gateway') followed by assignment to work or training options – a subsidised job with an employer, full-time education and training, a voluntary sector job or a placement with the Environmental Taskforce – if the client had not secured a job after six months. This was followed by the voluntary New Deals from the early 2000s available for some of the groups not covered by the compulsory New Deals – including lone parents and disabled people. These voluntary programmes offered people intensive job-search assistance, training and jobs through public, private and voluntary sector 'job brokers'. The Pathways to Work programme – mandatory work-focused interviews coupled with job-search assistance – from 2004 was aimed at claimants of Incapacity Benefit (since replaced by Employment and Support Allowance).

On the whole, the evaluations of UK ALMP schemes (though less thorough than the US evidence) show positive effects from each programme, although there is some evidence that the long-run effects are smaller than the short-run effects. As with the

US evidence, 'work-first' options (programmes that offer assistance with job-search, or which place participants into work directly through subsidised jobs) seem to be more effective than full-time education and training-based options.

From October 2009 the Government began to replace the existing New Deal schemes with a 'Flexible New Deal' programme, which integrates the schemes and expands the role of private and voluntary-sector contractors in delivering work placements. They also set aside £1 billion (the Future Jobs Fund) to create jobs for young people unemployed for more than six months. Economists including Paul Gregg and Richard Layard have proposed a 'Job Guarantee' scheme, which would extend the FJF scheme to all unemployed adults who have been out of work for over 12 months. It would take the 'work first' approach to its logical conclusion by creating jobs for people facing long-term unemployment using direct funding from the public purse. They propose creating low-skilled jobs in sectors such as maintenance (e.g. of public housing, schools, hospitals and roads) and social care (e.g. home helps). Workers would be paid the national minimum wage rate or just above rather than only receiving their benefits.[84]

There is evidence from Denmark and the Netherlands, where these types of schemes have been tried already, that they reduce unemployment – which is as expected given that the government is essentially creating additional jobs.[85] Previous evidence on whether such schemes can help long-term unemployed workers into unsubsidised jobs is mixed – it depends very much on whether the Job Guarantees can help clients acquire the skills they need to forge a long-term relationship with the labour market and on whether continued support with job-searching is provided throughout the programme.[86] The final point to note is that schemes like this do involve additional initial expense relative to New Deal programmes; for example, Gregg and Layard have estimated that a programme of Job Guarantees for all Flexible New Deal claimants for six months (after already going through the Flexible New Deal) would cost around £2.5 billion more than existing policies. This gross cost could however be reduced in the long run as people entering the Job Guarantee scheme make the transition into sustainable long-run employment – an outcome that would also bring considerable social benefits.

While some commentators have dismissed such schemes – Labour MP Frank Field (a vocal opponent of recent welfare-to-work schemes) has called the New Deal schemes "a £60 billion waste of money"[87] – their views are not supported by the balance of evidence. Indeed, the main recommendation from the most recent OECD *Employment Outlook* in the context of the current recession is that spending on active labour market policies with a proven success record should rise to limit the increase in unemployment.[88] The OECD also argues that the 'safety net' feature of unemployment benefits in a time of substantial increases in unemployment is vital. Many people who become unemployed may be out of the labour market for a considerable time, and it is important that out-of-work benefits are generous enough to avoid families falling into dangerous levels of poverty and hardship. The OECD's call for increased spending on ALMPs is particularly resonant in the UK, where overall spending on ALMPs as a proportion of GDP – at 0.3 per cent – is only around half the OECD average.[89]

5. Labour market regulation and the 2008–09 recession*

Although the 2008–09 recession has brought the most severe contraction of economic activity for the UK since the 1930s – a 6 per cent fall in GDP on the latest data surpassing the early 1980s recession (which saw an output fall of around 4.5 per cent) and the early 1990s recession (with a fall of around 2.5 per cent) – the UK labour market seems to be performing significantly better than it did in either 1980–84 or 1990–93. While the recessions of the 1980s and 90s saw a rise in unemployment of between 1 and 1.5 percentage points for every percentage point decrease in GDP, unemployment has only risen by 2 percentage points so far in the current recession, despite GDP falling some 6 per cent. The fall in employment over the last two years has also been a lot shallower than in the previous two recessions.

Table 3: Changes in unemployment and employment in the last three recessions

	Early 1980s		Early 1990s		Late 2000s	
	Rate (%)	Quarter	Rate (%)	Quarter	Rate (%)	Quarter
Unemployment						
Before	5.9	1980 q1	7.2	1990 q3	5.8	2008 q2
After	12.0	1984 q2	10.8	1993 q1	7.8	2009 q3
Change	+6.1		+3.6		+2.0	
Employment						
Before	74.0		75.0		74.6	
After	68.0		70.0		72.5	
Change	-6.0		-5.0		-2.1	

Source: ONS, *Economic and Labour Market Review*, January 2010

Notes: figures used are for men aged 16–64 and women 16–59; as the impact of the 2008–09 recession on the labour market may not have run its course, the 'after' row for this recession should be taken as indicative only.

* For more detail see Howard Reed, *Flexible with the Truth?* London: TUC, 2010, Chapter 7.
Available to download at **www.tuc.org.uk/flexiblewiththetruth**

Part of the explanation for the improved employment position is that public sector employment showed a small increase between the first quarter of 2008 and the third quarter of 2009, offsetting falls in the private sector.[90] But the key reasons are that average hours worked have decreased while average earnings have been squeezed. Between the second quarter of 2008 and the second quarter of 2009, average hours worked by employees fell by 0.4 hours, while the proportion of employees working part-time increased by 0.8 percentage points.[91] This fall in hours has been a product of a rise in the proportions of part-time and temporary workers in the UK labour force, along with an increase in the number of 'involuntary' part-timers – i.e. part-time workers who would like to work full-time but cannot find a full-time job.[92] There is also some evidence that unions and firms have negotiated temporary short-time working arrangements as a response to the fall in demand.[93]

In addition, the annual rate of increase in earnings (including bonuses) fell from 3.3 per cent in the autumn of 2008 to 1.2 per cent by the autumn of 2009. Because public sector earnings grew by some 2.8 per cent in the year to the end of the third quarter of 2009, the bulk of the wage restraint took place in the private sector.[94] These reductions in hours and modest wage increases have helped enable employment to stay relatively high despite the severity of the recession.

Some pro-orthodox commentators have claimed that the relatively good recent performance of the UK labour market demonstrates the benefits of a 'flexible labour market' and the rewards which the UK has reaped from the Conservative reforms of the 1980s and early 90s. In essence, it is argued, the UK labour market is now so flexible that companies can cut production, hours and wages while keeping more of their employees in work. It is also argued that more onerous redundancy procedures have also played their part, making it more difficult to fire than in the early 90s slump. However, while these factors may have played a role, there are several reasons why they do not appear to be the sole or main explanation.

First, as table 3 shows, relative to the size of the recession (in terms of lost output), the rise in unemployment during the early 90s recession was not that different from the early 80s recession, despite the weakening of regulation over the decade.[95] The main difference in labour market behaviour seems to be between the current recession and both earlier recessions, rather than between the early 80s and the early 90s. This does not fit the orthodox view because the labour market was more regulated in most respects in the late 2000s than in the early 90s.

Second, it is entirely possible that some of the additional labour market regulations introduced since 1997 – such as the right to request flexible working – have improved the operation of the labour market and made it more able to withstand recession. It is not possible to be sure of this at the moment as it is too early for rigorous empirical research and the full impact of the recession is not yet known.

Third, it is possible that as the economy is more reliant than in the past on human capital, it has been in the interests of business to retain workers and their skills. If this is true both employers and workers (also anxious to stay put) will have been more willing to support wage freezes, pay cuts and sabbaticals. As one expert has put it: "In its co-operation between management and workers, Britain is looking ever more like continental Europe from 1945–1973."[96]

Fourth, there is some tentative evidence that the greater emphasis on active labour market policies – such as the Future Jobs Fund guarantee scheme for young people and the extra spending on helping unemployed people find work – have helped restrain the rise in unemployment. The beefing up of Jobcentre services appears to have made a positive impact on claimant unemployment levels – the number of claimants coming off JSA in January 2010 was 13 per cent. This compares favourably with December 1991 (two months after the economy returned to growth) when only seven per cent of claimants moved off unemployment benefit.[97]

Fifth, although the UK has enjoyed a relatively mild rise in unemployment, the opposite is the case in the US, despite heading the flexibility league. As BBC economics editor Stephanie Flanders has pointed out, the unemployment rate has risen much faster in the US than in either the UK or Germany. In the latter the rise in unemployment has been lower than in the UK despite its greater regulation. US employers seem to have (on average) adopted a strategy of laying off staff as quickly as possible, to reduce short-term costs. By contrast, companies in Germany (and to an extent in the UK) have been much more likely to hold onto their skilled workers and reduce average hours of work rather than instigate mass redundancies. According to Flanders: "Far from becoming more American in this recession, the argument would have to be that British employers have become more German, holding on to their skilled workforces much more tightly than they ever have before, but cutting hours to reduce the impact on the bottom line."[98]

Finally, it is quite possible that factors completely separate from labour market regulation have affected the labour market response to recession differently this time round. Recent research from the Bank of England[99] suggests that other economic factors – for example the depreciation of the sterling exchange rate by 25 per cent between 2007 and 2009 (compared with a stable exchange rate in the early 1990s recession until the pound's exit from the Exchange Rate Mechanism in 1992) and a more lenient approach by business creditors (resulting in fewer business failures in this recession than in the last recession, at least in the short run) may be just as important as anything to do with the labour market itself.

The UK's better than expected performance on employment does not provide support for the supremacy of the neo-liberal model. Instead it appears that change in the composition of the workforce, the modest post-1997 re-regulation and the UK's more active labour market programmes have all played a role in limiting the recession's labour market effects. While the full picture is still far from clear, there is no evidence that reduced regulation is responsible for the UK's improved performance.

6. Summary and conclusions

Today there remains considerable support for the idea that labour market flexibility is the key to economic success. The Treasury continues to argue that Britain's flexible labour market, the third least regulated of all OECD countries, is the key to strong economic and employment performance. The Confederation of British Industry and the British Chamber of Commerce along with several right-of-centre thinktanks have called for the reining back of some current and planned regulations.

Yet, as shown in this pamphlet, the fundamental arguments of the anti-regulationist school and its belief in self-regulating markets simply don't stand up to the economic experience of the last two decades. The free market experiment has been plagued by instability, not the stability it predicted.

The empirical evidence provides no backing for those calling for the weakening or abolition of the minimum wage and cutbacks in current and planned labour market interventions. While badly thought-out regulation can be harmful, the evidence is that it is possible to achieve successful economic outcomes (low unemployment, high employment participation and growth) with strong social and workplace protection. More regulation does not necessarily mean poorer economic performance while increased regulation of the appropriate kind can actually improve performance in the right circumstances. Indeed, the OECD, once the champion of the orthodox view, has accepted the case for intervention in recent years.

This is because the empirical evidence shows that properly designed and monitored interventions can have positive economic and social outcomes. The only two findings which support the orthodox position are, firstly, that employment protection legislation reduces the flow of workers between jobs (and thus, perhaps, slows down re-allocation of labour from less to more productive uses); and secondly, that generous unemployment benefits paid for an indefinite length of time *without* job-search conditions can reduce the incentive to work and lead to persistent unemployment.

Even in these cases the overall picture from the micro-research is more complex. Econometric studies are split fairly evenly on whether the impact of EP on *overall productivity* in the economy – as opposed to job flows – is positive or negative. Positive impacts include improvements in skills and reduced vulnerability to economic shocks. Some individual employment protection measures, such as maternity leave and policies to limit and mitigate dismissal, have significant social benefits without serious detriment to job creation and economic innovation. Employment protection measures at the levels applying in the UK have minimal if any negative impact on employment. Parental leave policies are important for encouraging female employment and reducing the gender pay gap. Moreover, if generous unemployment benefits are combined with limited duration and strong job search incentives as in the Scandinavian countries, they are not associated with higher unemployment.

In the UK, the introduction of the national minimum wage in 1999 failed to deliver the dire consequences predicted by its critics. Trade unions have no significant negative consequences for labour market outcomes, and may have positive effects in promoting workplace cohesion and social justice. While wage flexibility is important for economic dynamism and to withstand economic shocks such as recessions, the macro-evidence is that coordinated and responsible bargaining systems are associated with lower unemployment. Under the right conditions, social corporatism works.

Active labour market policies, if well designed, can make a substantial difference to the employment prospects of long-term unemployed people. And in-work benefits boost labour supply while redistributing income to low-paid workers. Both these policies have been endorsed by the OECD (as have childcare subsidies) and have the additional advantage of enhancing labour market performance *and* contributing to social justice.

In the last decade Britain has allowed a modest re-regulation of its labour market – through for example, the introduction of the national minimum wage, statutory rights to trade union recognition, the right to fair representation at work and to (paid and unpaid) maternity, paternity and adoptive leave – without detriment to employment creation or any evidence of serious additional rigidities. Indeed, the impact of the 2008–09 recession on unemployment in the UK suggests that the labour market has been working well. Even though the full picture is still far from clear, the available data does not support the orthodox position that the UK labour market is performing better than in the early 1990s because it is less regulated.

If there is a relationship between regulation and unemployment, it lies not in the level but the nature of regulation. Most importantly, the 'one size fits all' model simply doesn't work. A number of smaller European countries have both highly interventionist policies and a strong record on employment generation, labour force participation, unemployment and growth. These policies have included high levels of unionisation along with relatively generous unemployment benefits and welfare provisions. Although some European nations – notably Germany and France – have experienced problems, the widespread claim of 'euro-sclerosis' is greatly overdone.

The evidence is that two quite distinctive models work particularly well in terms of supporting low unemployment and relatively high employment rates:

- First, the Anglo-Saxon model (including the UK) with its lower unemployment benefits, lower taxation and light touch employment protection, weaker trade unions and more limited collective bargaining.

- Second, the Scandinavian/flexicurity model (including Denmark, the Netherlands, Norway, Finland and Sweden), which is characterised by strong collective bargaining, high levels of employment protection, generous welfare benefits and stringent job-search requirements and time limits on the durations of contributory benefits (with ongoing social assistance available for those in need).

The flexicurity model also demonstrates that flexible labour markets don't have to be de-regulated. These countries have managed to combine a high degree of protection with an ability to respond quickly, flexibly and effectively to changing economic circumstances and shocks.

What is also significant about these two models is that while both achieve similar results in terms of employment and unemployment, some Anglo-Saxon countries have experienced considerable economic turbulence in the last two decades and an especially deep recession in 2008–09. Moreover, the flexicurity model is much more successful when it comes to social outcomes. Thus the Anglo-Saxon model is characterised by high earnings inequality and higher levels of in-work poverty. In both the US and the UK, for example, both poverty and inequality have risen sharply from the late 1970s with the adoption of more market-orientated policies.

The flexicurity countries, by contrast, have achieved high employment and good growth rates with a more generous welfare state (and higher taxes), much lower levels of wage inequality and in-work poverty and higher levels of employment security. It is a model that has been identified by the OECD as an effective alternative to the orthodox model. As Coates has argued: "Policy makers need to be much clearer about emphasizing the twin objectives of economic dynamism and social justice, flexible labour markets *and* security for workers."[100]

The 'reality-based' experience shows that Britain could take a bolder approach to labour market intervention as a means to improve social outcomes and enhance economic performance. Although Labour has implemented stronger measures in some areas such as parental leave, childcare support and flexible working, Britain's labour market remains closer to the US than the European model. Its levels of social protection, employment rights and collective bargaining fall well short of those in place in most European countries with the result that Britain remains towards the lower end of the international regulatory league table. Yet the continental experience is clear – it is possible to achieve both social and workplace justice and economic dynamism.

Stronger regulation is also needed to help deal with the fall-out from the greater economic volatility of recent times. The freeing up of markets since the early 1980s has coincided with a substantial increase in domestic and international economic turbulence. Indeed Britain has seen three deep recessions since the late 1970s, each leading to a significant surge in unemployment. For the most part our relatively weak safety nets have proved inadequate in the face of the successive ratcheting up of unemployment in each of these downturns.

Given the strength of the evidence and the persistence of economic volatility, far from paring back on regulation Britain should instead start planning moves towards the flexicurity model by adopting the following findings and recommendations:

- **To allow the trade union movement to play a more central role in the major issues of political economy, Britain needs to develop a new understanding of the positive contribution that unions can make to workplaces and to economic prosperity.** Union membership in the UK is low, especially in the private sector, while collective bargaining covers only 35 per cent of the workforce compared with over 80 per cent in countries such as Austria, Denmark, Belgium, Finland and Sweden. Unions are mostly frozen out of decisions that can have major implications for the national workforce. Yet the empirical evidence is clear – and acknowledged by the OECD – that strong, co-operative and responsible unions can play a very positive role not only in creating greater workplace fairness but in wider economic performance. Indeed countries with co-ordinated bargaining systems and good tripartite relationships tend to have a strong employment record. As set out in the TUC's Touchstone pamphlet *The Road to Recovery*, the Government should consider measures including restoring ACAS's duty to promote collective bargaining and supporting the revision of the Posting of Workers Directive. The Government also needs to incentivise employers to support collective bargaining, rewarding employers that develop fairer pay systems, and to further support and extend collective agreements in the public sector. The Government should also recognise the impact that Conservative de-regulation in the 1980s has had on unions' capacity to organise, and consider reinstating important trade union rights.
- **There is a need for fairer employment protection legislation to reduce job insecurity and inequality and to enable all workers to benefit from flexible working patterns.** There is evidence that enhanced rights would contribute to increased labour market participation and productivity levels. Such protection forms a key part of successful flexicurity systems. Enhanced redundancy payments can contribute to labour market restructuring by enabling individuals to retrain for new employment. Enhanced family-friendly leave arrangements and the extension of flexible working patterns from individuals with caring responsibilities to the wider workforce is likely to improve worker motivation and employers' ability to recruit and retain staff.
- **Job-search requirements.** The evidence is clear that the flexicurity model – which combines generous out-of-work benefits with job-search conditions and time-limits for contributory benefits (with ongoing social assistance available for those in need) – is an effective way of reducing long term unemployment.
- **The level of Jobseeker's Allowance (JSA) should be increased to nearer the European average.** In the UK, the unemployment benefit replacement rate has fallen sharply over the last 30 years. It is now well below the OECD average and is among the lowest of any country in the developed world. Thus for a married couple with two children with average earnings, benefit rates meet 53 per cent of former net earnings compared with an OECD average of

76 per cent.[101] Yet, as the OECD has acknowledged, unemployment benefit plays a vital 'safety-net' role in times of high unemployment. As long as a higher benefit rate is buttressed by tough job-search requirements, raising the JSA rate would offer greater financial protection to those who are most vulnerable to economic instability, giving more time to find the right job without increasing unemployment.

- **To tackle rising levels of long term unemployment and greater economic volatility, Britain needs to strengthen its active labour market policies (ALMP), recognising that conditionality in the benefits system must be accompanied by improved support for unemployed people.** Britain has developed a more responsive active labour market strategy in recent years. Nevertheless, despite the call from the OECD to increase spending on ALMP measures with a proven record of success, Britain's proportionate spending in this area is only half the OECD's average. To prevent the further growth of long-term unemployment, Britain should accept the widely-backed proposal for a new universal job guarantee scheme available to all adults who have been unemployed for more than 12 months. As unemployment has risen in the UK, increased JSA and Tax Credit payments have acted as important automatic stabilisers – but it is also vital that spending on active labour market responses increases during recessions, promoting a quick re-integration of job losers into employment and preventing the risk of them sliding into long term unemployment and inactivity. This is a vital issue: even employers with a positive view of unemployed people are more cautious about recruiting those who have been unemployed for a long time. The evidence is also clear that long term unemployment is highly damaging to future prospects and has contributed to Britain's intractable 'low-pay, no-pay' cycle, a problem that affects more than 15 per cent of the population.[102]

All these measures should be carefully implemented and their impact evaluated so that they satisfy the test that they work in the real world. Implementation should follow the approach adopted with the introduction of the national minimum wage, in which the Low Pay Commission has closely monitored its impact to prevent damaging side-effects on employment. The Commission's remit ensures that decisions on raising the minimum wage are taken on the basis of the empirical evidence. Successive extensions of intervention should be monitored, assessed and adjusted accordingly to ensure that they have positive benefits. This evaluation could be carried out by developing a model along similar lines to that of the Low Pay Commission, which could be named the Labour Market Commission. One of the strengths of the Commission model is that as well as being independent of government, it is a successful example of a tripartite organisation with representatives from business, government and the unions.

Now that the prescriptions of the orthodox school have been discredited, it is time to re-assess the nature of the UK's labour market provisions. There is a strong case, based on successful practice in other counties and backed by firm international empirical evidence, for moving the UK away from its weakly regulated model to the higher levels of social protection available in many European countries. The evidence is clear that, contrary to the neo-liberal claims, this would bring improved economic and social outcomes.

References

1 Claimant count figures, www.statistics.gov.uk/StatBase/expodata/files/8547093331.csv

2 OECD, *Jobs Study: Facts, analysis, strategies*, Paris, 1994

3 OECD, *Jobs Study: Evidence and explanations*, 1994, pp43-8

4 IMF, *World Economic Outlook*, 2003, p 129

5 www.guardian.co.uk/politics/2010/jan/27/conservatives-local-councils-benefits-jobs

6 www.ft.com/cms/s/0/bc788742-d573-11de-81ee-00144feabdc0.html

7 CBI, 'Tough Pay Restraint Ahead', *Press Release*, November, 2009

8 www.mirror.co.uk/news/top-stories/2008/10/05/david-cameron-would-allow-minimum-wages-to-die-out-115875-20775693/

9 www.iea.org.uk/record.jsp?type=pressArticle&ID=413

10 D Coates, *Who's Afraid of Labour Market Flexibility?*, Work Foundation, 2006, p 10

11 S Keen, *Debunking Economics*, Zed Books, 2001; H Minsky, *Stabilising an Unstable Economy*, Yale University Press, 1986

12 It is a position most closely associated in the UK with Professor Alan Manning of the London School of Economics who uses the term 'monopsony theory' to describe the approach. See A Manning, 'A Generalised Theory of Monopsony', *Economic Journal*, Vol 116, pp 84-100, 2006

13 A Hirschman, *Exit, Voice and Loyalty*, Harvard University Press, 1970

14 S Keen, *Debunking Economics*, Zed Books, 2001

15 W Fellner, 'Prices and Wages Under Bilateral Monopoly', *Quarterly Journal of Economics*, Vol 61, No 4, 1947, pp 503-532

16 P Sraffa, *Production of Commodities by Means of Commodities, Prelude to a Critique of Political Economy*, Cambridge University Press, 1960

17 R Solow, 'What Is Labour Marker Flexibility?', *Proceedings of the British Academy*, 1998

18 BIS, *New Industries, New Jobs*, Dept for Business, Inovation and Skills, 2009

19 S Deakin and G S Morris, *Labour Law*, Fifth Edition, Hart Publishing, Oxford and Portland, Oregan 2009, p 689

20 S Milner, 'The Coverage of Collective Pay—Setting Institutions in Britain 1895-1990', (1995) 33 BJIR 69

21 S Deakin and G S Morris, *Labour Law*, Fifth Edition, Hart Publishing, Oxford and Portland, Oregan 2009, p 27

22 D Kavanagh and A Seldon (eds), *The Thatcher Effect*, OUP, 1989, p 69

23 S Lansley, *Unfair to Middling*, TUC Touchstone Report, 2009

24 R Taylor, 'Employment Relations Policy' in A Seldon (Ed), *The Blair Effect*, Little Brown, 2001, p 252

25 Taylor, op cit p 253

26 M Sharkh, 'Are There Optimal Global Configurations of Labour Market Flexibility and Security? Tackling the "Flexicurity" Oxymoron', *ILO Employment Sector Employment Working Paper No 15*, Geneva: International Labour Office, 2008.

27 Coates op cit, p 10

28 A Turner, 'What's Wrong With Europe's Economy', CEP Queen's Prize lecture, mimeo, 2003; see also R Schettkat, 'Is Labour Market Regulation At the Root of European Unemployment? The case of Germany and the Netherlands' in D Howell (ed) *Fighting Unemployment*, OUP, 2005

29 D Baker et al, 'Labor Market Institutions and Unemployment: A critical assessment of the cross country evidence' in D Howell (ed), *Fighting Unemployment*, OUP, 2005

30 Also these results do not take account of what tax receipts are spent on: there is a lot evidence, for example, that tax-financed spending on transport infrastructure can improve economic performance

31 Baker et al , op cit p 108

32 A Basselini and R Duval, 'Employment Patterns in OECD Countries: Reassessing the role of policies and institutions', *OECD Social, Employment and Migration Working Paper No 3*5, Paris: OECD, 2006; B Amable, D Demmou and D Gatti, 'Employment Performance and Institutions: New answers to an old question', *IZA Discussion Paper No 2731*. Bonn: IZA, 2007

33 Also, both the tax wedge and unemployment generosity are measured very simplistically in these regressions. It would be hard to take these results as a precise guide to exactly how the UK tax system should be reformed to reduce unemployment, for example

34 Amable, Demmou and Gatti, op cit

35 R Freeman, 'Foreword' in D. Howell (ed), *Fighting Unemployment: The limits of free market orthodoxy*, Oxford: Oxford University Press, 2005

36 For example, A Manning, *Monopsony In Motion: Imperfect competition in labor markets*, Princeton University Press, 2003

37 D Card and A Krueger, *Myth and Measurement: The new economics of the minimum wage*, Princeton University Press 1995

38 Ibid. In the US there is a national (federal) minimum wage but each individual state can choose to set a state-level minimum wage in excess of the national minimum. Most of the US studies are based on "difference-in-differences" estimates which look at the change in employment levels in a state or states where the minimum wage was increased and compare this with the change in employment levels in a state or state where the minimum wage was held constant. Often, the studies look at matched workplaces in each state (for example, fast food outlets)

39 D Neumark and W Wascher, 'Minimum Wages and Employment', *IZA Discussion Paper No 2570*, IZA, 2007

40 H Doucouliagos and T Stanley, 'Publication Selection Bias In Minimum Wage Research? A meta-regression analysis', *British Journal of Industrial Relations*, Vol 47 No 2, pp 406-429, 2009

41 J Sackett, 'Bias in Analytic Research', *Journal of Chronic Diseases* Vol 31 No 1, pp 51-63, 2009. In a minimum wage context, publication bias has two implications: that studies which find a negative impact of minimum wages on employment are more likely to be published that studies which find no effects; and that where researchers conduct an empirical study which produces several different results, there is a tendency to focus on the results which are statistically significant and different from zero, as this will make the paper more likely to be published (publication being the immediate objective of most researchers)

42 R Dickens, R Riley and D Wilkinson, *The Employment and Hours of Work Effects of the Changing Minimum Wage*, Report prepared for the UK Low Pay Commission, 2009

43 M Draca, S Machin and J Van Reenen, 'Minimum Wages and Firm Profitability', *CEP Discussion Paper No 716*, Centre for Economic Performance, London School of Economics 2006

44 Ibid

45 J Galdón-Sánchez and M Güell, 'Dismissal Conflicts and Unemployment', *European Economic Review*, Vol 47 No 2, pp 323-335, 2003; A Lindbeck and D Snower, 'Insiders versus Outsiders', *Journal of Economic Perspectives*, Vol 15, pp 165-188, 2001

46 R Caballero and M Hammour, 'Jobless Growth: Appropriability, factor substitution and unemployment', *Carnegie-Rochester Conference Series on Public Policy*, Vol 48, pp 51-94, 1998; W MacLeod, 'Regulation or Markets? The Case of Employment Contracts', *CESifo Economic Studies No 51*, pp 1-46, CESifo, 2005

47 e.g. G Fella, 'Optimal Severance Pay in a Matching Model', *Working Paper No 598*, Queen Mary, University of London, Department of Economics, 2007

48 C Pissarides, 'Consumption and Savings with Unemployment Risk: Implications for optimal employment contracts', *IZA Discussion Paper No 1183*, IZA, 2004

49 M Estevez-Abe, D Soskice and I Torben, 'Social Protection and the Formation of Skills: A reinterpretation of the welfare state', *Varieties of Capitalism*, Vol 40, pp 145-184, 2001

50 M Gangl, 'The Only Way is Up? Employment protection and job mobility among recent entrants to European labour markets', *European Sociological Review*, Vol 19, pp 429-449, 2003

51 I Marinescu, 'Job Security Legislation and Job Duration: Evidence from the United Kingdom', *Journal of Labor Economics*, Vol 27 No 3, pp 465-486, 2009

52 M Belot, J Boone and J van Ours, 'Welfare-Improving Employment Protection', *Economica*, Vol 74 No 295, pp 381-396, 2007

53 HM Treasury/Department for Education and Skills/Department for Work and Pensions/Department for Trade and Industry, *Choice for Parents, The Best Start for Children: A Ten Year Strategy for Childcare*, HMSO, 2004

54 Although the evidence for substantial impacts of the tax burden on economic growth is minimal. See for instance www.leftfootforward.org/2009/09/uk-economy-can-aborb-higher-taxes/

55 G Paull, J Taylor and A Duncan, 'Mothers' Employment and Use of Childcare in the United Kingdom', *IFS Working Paper No WP01/2*, Institute for Fiscal Studies, 2001; T Viitanen, 'Cost of Childcare and Female Employment in the UK', Labour, Vol 19 No 1, pp 149-170, 2005. There is similar supportive evidence from Canada

56 See for example http://jec.senate.gov/archive/Hearings/03.06.08%20Paid%20Leave/Waldfogel%20statement%203-6-08.pdf and www.enfant-encyclopedie.com/pages/PDF/KamermanANGxp_rev-Parental.pdf

57 S Tanaka and J Waldfogel, 'Effects of Parental Leave and Work Hours on Fathers' Involvement with their Babies: Evidence from the Millennium Cohort Study', *Community, Work and Family*, Vol 10 No 4, pp 409-426, 2007

58 B Hayward et al, 'The Third Work-Life Balance Employer Survey: Executive summary', *BERR Employment Relations Research Series No 86*, Department for Business, Enterprise and regulatory Reform, 2007

59 Milton Friedman, *Capitalism and Freedom*, University of Chicago Press, 1962

60 This was formalised in the 'efficient bargaining' model of A Oswald, 'Happiness and Economic Performance', *Economic Journal*, Vol 107 No 445, pp 1815-1831, 1997

61 R Freeman and J Medoff, *What Do Unions Do?*, Basic Books, 1984; Hirschman op cit

62 N Millward et al, *All Change at Work?* Routledge, 2001

63 S Moore et al, 'The Impact of Employee Representation upon Workplace Industrial Relations Outcomes', *Employment Relations Research Series No 87*, Department for Business, Enterprise and Regulatory Reform, 2008

64 D Metcalfe et al, 'Unions and the Sword of Justice', *National Institute Economic Review*, 2001

65 J Budd and K Mumford, 'Trade Unions and Family-Friendly Polices in Britain', *Industrial and Labor Relations Review*, Vol 57 No 2, pp 204-222, 2004

66 T Aidt and Z Tzanattos Aidt, 'Trade Unions, Collective Bargaining and Macroeconomic Performance: A review', *Industrial Relations Journal*, Vol 39 No 4, pp 509-533, 2003

67 J Michie and M Sheehan, 'Labour Market Deregulation, "Flexibility" and Innovation', *Cambridge Journal of Economics*, Vol 27 No 3, pp 123-143, 2003

68 TUC *The Road to Recovery: How effective unions can help rebuild the economy*, London: TUC, 2010

69 Coates op cit, p 30

70 OECD, *Employment Outlook*, 2006

71 OECD *Employment Outlook*, 2004; OECD, *Employment Outlook*, 2006; OECD, *Employment Outlook*, 2009

72 See, for example, Manning, 2006, op cit

73 E Rayner et al, 'Evaluating Jobseeker's Allowance: A Summary of the Research Findings', *Department of Social Security, Research Report No. 116*, 2000

74 Manning, 2006, op cit

75 L Jacobi and J Kluve, 'Before and After the Hartz Reforms: The performance of active labour market policy in Germany', *RWLI Discussion Papers No 41*, Rheinisch-Westfälisches Institut für Wirtschaftsforschung, 2008; W Eichhorst and K Zimmermann, 'And Then There Were Four... How Many (and Which) Measures of Active Labour Market Policy Do We Still Need? Finding a balance after the evaluation of the Hartz reforms in Germany', *DIW Discussion Paper No 635*, Berlin: DIW, 2007; http://www.gpn.org/media/other/germany_20080128/posen.pdf

76 R Chetty, 'Moral Hazard versus Liquidity and Optimal Unemployment Insurance', *Journal of Political Economy*, Vol 116 No 2, pp 173-234, 2008

77 www.oecd.org/dataoecd/52/8/42625548.xls

78 P Auer, 'In Search of Optimal Labour Market Institutions' in H Joergenson and P Madsen, *Flexicurity and Beyond: Finding a new agenda for the European social model*, Copenhagen: DJOF Publishing, 2007

79 The UK system focuses very much on families with children, and disabled people

80 P Gregg et al, 'Welfare Reform and Lone Parents in the UK', *Economic Journal*, Vol 119, pp F15-F37, 2009

81 M Francesconi et al, 'The Effects of In-Work Benefit Reform in Britain on Couples: Theory and evidence', *Economic Journal*, Vol 119 (February), pp F66-F100, 2009

82 D Greenberg and A Cebulla, 'The Cost-Effectiveness of Welfare-to-Work Programs: A meta-analysis', *Public Budgeting and Finance*, Vol 28 No 2, pp 112-145, 2008

83 OECD, *Employment Outlook*, 2004, 2006

84 http://cep.lse.ac.uk/textonly/_new/staff/layard/pdf/001JGProposal-16-03-09.pdf

85 See for instance OECD, *Employment Outlook*, 2007

86 See OECD, *Employment Outlook*, 2006

87 www.timesonline.co.uk/tol/comment/columnists/guest_contributors/article4374701.ece

88 OECD, *Employment Outlook*, 2009

89 www.oecd.org/dataoecd/52/8/42625548.xls; http://www.oecd.org/employment/keystatistics

90 www.statistics.gov.uk/pdfdir/pse1209.pdf

91 Eurostat, 'Fewer Hours Worked and More Part Time Work in the EU27', news release, 5 November 2009

92 TUC, *Recession Report Number 13*, November 2009, Trades Union Congress

93 www.incomesdata.co.uk/news/press-releases/focus_on_recession.pdf

94 However, price inflation (as measured by the Consumer Price Index) also fell over this period (from over 5% to below 2%), so real wage increases were actually higher in autumn 2009 than in autumn 2008

95 The economy did recover more quickly from the early 1990s recession than the early 1980s recession. However, it is not clear to what extent this was due to the labour market being more flexible, or whether it was due to the recession being not as bad in the first place

96 T Leunig, 'Fewer Jobless', *Prospect*, September 2009

97 TUC, Budget Submission, March 2010

98 www.bbc.co.uk/blogs/thereporters/stephanieflanders/2009/12/lagging_no_more.html

99 Bank of England (2010) *Quarterly Bulletin*, Volume 50, No. 1, 2010 Q1, Bank of England.

100 Coates op cit , p 15

101 http://www.oecd.org/dataoecd/52/8/42625548.xls

102 HM Treasury, *The Modernisation of Britain's Tax-Benefit System*, 1999

The TOUCHSTONE Blog

Go to **www.touchstoneblog.org.uk** for informed and lively progressive comment on the big policy issues of the day. Blog posts are written by TUC experts with a passion for social justice.

£10

For more copies of this title contact our ordering point on 020 7467 1294 or smills@tuc.org.uk

All TUC publications may be made available for dyslexic or visually impaired readers, on request, in an agreed electronic format or in accessible formats such as Braille, audiotape and large print, at no extra cost.

Design: Eureka! Design Consultants
Print: Precision Printing
Cover illustration: Lo Cole / Eastwing

Are weaker rights at work really an economic imperative? What does the evidence actually say? *The Red Tape Delusion* takes a forensic look at the reality of the relationship between regulation and growth – showing how fairer treatment at work could ensure both rising prosperity and reduced inequality.

Trades Union Congress
Congress House
Great Russell Street
London WC1B 3LS

www.tuc.org.uk

ISBN 978 1 85006 886 0