A bonfire of the regulations, or business as usual? The UK labour market and the political economy of Brexit

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A Bonfire of the Regulations, or Business as Usual?

The UK labour market

and the political economy of Brexit

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Abstract

Employment and labour market regulation initially appeared as one of the solid red lines in the UK's renegotiation of the country's place in the EU. The basic argument is that the UK's more deregulated labour market would sit uneasily in the more organized models, based on statutory instruments or collective bargaining, found on the continent. While there is a legitimate problem here, EU employment regulations appear manageable from the point of view of business, while unions see them as important tools for socially responsible economic restructuring. Most of UK employment case law is now deeply entangled with EU law; labour market regulations have, on the whole, become part of the way of doing business in the Single Market; and a simple cost-benefit analysis appears impossible because some costs are not quantifiable and the costs of others are reduced when taken as a bundle. Labour unions agree that transposition of European law needs to be done taking into account local sensitivities, while internationally oriented companies do not see EU regulations on the whole as detrimental to business. Importantly, though, the costs and benefits of EU employment regulations are not symmetrically distributed across different companies: large companies are better able to reap the rewards and accommodate the costs of operating in the Single Market than smaller companies.

One of the key arguments deployed by Eurosceptics against UK membership of the EU has for a long time rested on the charge that the regulatory burden imposed on businesses by Brussels has sapped competitiveness and costs jobs. Many employers – even those who, on balance, believe EU membership is beneficial – complain in particular about the impact of EU employment regulations. The Working Time Directive, Temporary Agency Workers Directive and Acquired Rights Directive are singled out by firms as being particularly unwelcome. One estimate, by the think tank Open Europe, put the cost of employment regulations, the bulk of which originate in Brussels, at £39bn since 1998[1].

Before David Cameron presented his renegotiation demands in his letter to Donald Tusk on 10 November 2015, the signs were that rolling back EU employment regulations would therefore be a key objective of his government, ensuring the support of employers. The Conservatives' 2010 election manifesto had pledged to repatriate key powers over employment and social legislation, and the Coalition Agreement signed with its Liberal Democrat allies after the election committed the government to limit the application of the WTD to the UK. However, these pledges have been toned down somewhat, with the letter calling instead merely for a cut in the total regulatory burden on business alongside a clear commitment to boosting competitiveness. The softer approach is more in line with public opinion and also maintains the support of the trade unions, whom the government needs on board for a pro-EU campaign. The vague line being taken on employment regulation, which is not even explicitly mentioned in the letter, means that the only prospect of significantly reforming labour market policy in the immediate future now probably rests with a Brexit.

Yet most UK businesses don't want a Brexit, even if this theoretically allowed the UK a free hand to scrap or modify EU employment legislation, or at least to shift the regulatory regime in a direction arguably more compatible with the UK's flexible, service-oriented economy and labour market. The halfway-house that is being touted as a possible alternative to the current status quo, which involves leaving the EU while negotiating a deal to maintain access to the Single European Market (SEM), would make little practical difference to the regulatory burden as remaining EU countries would insist the UK adhered to the current regime to avoid UK firms gaining unfair advantage.

Accordingly, surveys of member firms by the Confederation of British Industry (CBI) reflect the uncertainty and/or unattractiveness of these options and show consistently strong, albeit qualified, support for EU membership. Even the more Eurosceptic Institute of Directors (IoD) remains broadly in favour of membership.

This is not to say that EU involvement in the employment policies of member states is uncontroversial or that there is no remaining pressure for reform. While most businesses accept that some regulation enforcing common standards is necessary to make the single market work and prevent 'social dumping', they take issue with both the process by which policy is devised and the manner in which it is enacted. Moreover, the impact of the EU on the operation of British businesses is distributionally complex. The burden of employment regulation falls roughly equally on all firms, depending on headcounts and the sector of operation. Yet not all of these benefit uniformly from access to the SEM or are powerful enough to represent their views in Brussels or to the UK government when it is negotiating employment policy. While large firms and digital entrepreneurs are overwhelmingly in favour of remaining in the EU, the majority shrinks dramatically to 47%/42% among Small and Medium-sized Enterprises (SMEs), according to recent YouGov polling[2].

The schism in business opinion is echoed, albeit to a lesser degree, among trade unions. The enthusiastic backing of the TUC for the UK to join the Single Currency in the late 1990s notwithstanding, unions have always been more ambivalent about the EU project than often assumed. Unions are obviously less concerned about business costs than employers are and focus instead on what the EU can deliver in terms of regulations granting UK workers new rights they might not otherwise receive if left to bargain on their own with their government. They cleave instead to a view of the EU as a possible vehicle with which to introduce elements of the collectivist 'European Social Model' (ESM) into the UK, and have become progressively more dismayed at what they see as its increasing obeisance towards market deregulation.

Discussion at the evidence session on employment regulations held in December 2015 as part of the LSE's Commission on the Future of Britain in Europe reflected these differing views on the purpose of the EU and Single Market and the place of the UK within it. Both unions and employers accepted that there are fundamental differences between the UK and continental European economic and social models. But where employers see these differences as working in favour of the UK's comparative advantage in the manufacturing and service industries of the future, and therefore something worth preserving, unions regard them as hurdles to be overcome in the quest for a fairer, more collectivist UK. Not surprisingly, these views condition whether groups view regulatory compliance as an irritating burden or the price to be paid for social solidarity. For businesses, therefore, the Brexit issue is ultimately a cost-benefit calculation: is it worth putting up with the regulatory burden in order to gain access to the SEM? For trade unions, the conundrum is more to do with what 'Europe' represents to them in terms of social regulation and whether it is moving in the right direction to deliver this.

This article examines the contours of this debate and assesses whether anything in them reinforced or undermines the arguments over whether to leave or stay in the EU. It is organised as follows. The first section considers whether regulation is required for the operation of the Single Market. The second section tackles the question of the 'cost' of EU membership to business and the economy. The third deals with legal and institutional differences between the EU and UK of relevance to labour markets, and the fourth with the putative 'distinctiveness' of the UK's economic model. The final section concludes.

1. Rival views on regulation of the Single Market

For students of European integration the distinction between negative and positive integration[3] is one of the analytical workhorses of the field. The first mode of integration refers to tearing down barriers to trade and competition so that markets can operate without obstruction. Precisely because this view sees markets as a 'natural' economic institutional arrangement, regulation is often counterproductive. It will, other things being equal, increase costs for business and thus distort competition – even when the regulations are the same everywhere, since not all companies can accommodate onerous regulations equally easily. The second mode of integration is built on the notion that markets do not exist without regulations and governance structures aimed at producing desired (economic, political and social) goals are necessary for social protection against the vagaries of the market. This view takes its inspiration from a perspective in which markets are embedded in broader social and institutional frameworks, and much of the history of capitalism over the last two centuries is that of a struggle to build these institutional frameworks.

Not surprisingly, these two views on markets also inform the disagreements between and among employers' representatives and labour unions in the UK over whether the SEM necessarily implies a corresponding social Europe, as the architects of the SEM believed, or whether market and social regulation should be kept separate. The CBI, which primarily represents large and small firms, and the SME-oriented Institute of Directors IoD cite results from member surveys that they conducted over the last few years in support of the latter position. The IoD reports that a majority of its members finds EU legislation in employment, including such areas as health and safety unhelpful. It costs money and it decreases the willingness to hire as employers are often brought to tribunal, which then influences hiring decisions.

Trade unions argue that such an approach not only overrides basic notions of fairness, but also hinders economic adjustment and rules out proactive labour market innovation to raise

and adapt skill levels. Going back to the origins of 'Social Europe' is instructive here. The inspiration for a social dimension was the understanding that successful economic integration would, as a process of creative destruction, create significant social tensions, for example in the case of firm closures and widespread redundancies. A well-developed social dimension to the SEM thus offers a way of facilitating change rather than preventing it – not to stop job losses, but to enable workers, regions and countries to cope with job loss when that occurs as a result of increased competition and economic restructuring. Similarly, in order for the free movement of labour to work, a common floor needs to be created so workers can be confident that they are treated similarly everywhere.

The debate is considerably more complex than this, however. Beneath the classic divide between labour and capital runs an important cleavage within business itself. Large firms see benefits in regulation – or at the very least consider regulation as a cost of doing business in Europe – while smaller companies see regulations only or primarily as costs. Put differently, regulation of the labour market yields a much more positive cost-benefit analysis for large firms than for small firms. The next section explores that point.

2. The 'cost' of EU regulation of employment

The obvious first step in examining divisions over the costs of SEM-related labour market regulation is to try to establish how these stack up. However, while it seems reasonable to assume that the overall cost of compliance is quite high, given the Commission's active interest in labour market issues as well as myriad differences in institutions across states which regulation is intended to ameliorate, it is quite hard in practice to put a figure on it.

Open Europe's 2011 report on this, 'Repatriating EU Social Policy' put the annual cost of EU social regulations to business and the public sector at a daunting £8.6bn a year[4]. Yet there are serious difficulties with this kind of analysis. The government estimates that two thirds of compliance costs for firms are to do with the Working Time and Agency Workers Directives alone[5]. Yet a report on agency workers regulations by Eversheds[6] argued that most firms were managing to avoid most direct costs from implementing this. With the Working Time Directive also being replete with opt-outs for most workers, bar medical staff and transport workers on health and safety grounds, it is hard to see where these gigantic costs are supposed to be falling. Such estimates tend also to include things UK employers would do anyway. For example, the WTD mandates 20 days annual paid leave, which could therefore be treated as a 'cost' of complying with it. But this is surely misleading when many UK employers choose to offer up to 28 days leave as a staff benefit and would continue to do this even after Brexit. The

British Chambers of Commerce stopped calculating its Burden Barometer in 2009, in fact, because the number of existing legislations became extremely high, which made any aggregate number somewhat meaningless.

Part of the problem with attributing costs to EU regulation obviously lies in the absence of a counterfactual. How much EU regulation would stay in the event of Brexit, and how much would go? Clearly, this depends on what a putative Brexit looks like. As already mentioned, the price of continued access to the SEM would probably be continued adherence to EU regulation. Yet, if arguments about the singularity of the UK's model of capitalism within Europe are taken seriously, then the onus would clearly be on a post-Brexit government to use the new freedom to try to deregulate the UK labour market as much as possible, or at least to heavily modify the existing policy regime to work more with the grain of its more flexible, service-oriented economy. This could imply a future outside the SEM accompanied by a 'bonfire' of regulations. In practice, however, legal professionals and academics warn of the great difficulty of disentangling EU and UK employment law owing to the decades-long accumulation of case law embodying principles grounded in EU judgments but applied to UK cases. It is hard to see how tearing up most of this, a process that would probably also require fresh primary legislation, can be squared with a simple cost-cutting narrative, at least in the short to medium term.

For employers, therefore, the issue of employment regulation should be seen primarily in terms of the marginal effects of new regulation rather than as a quarrel with the so-called stock of existing regulations. To a large extent, the regulations that make up social Europe have become 'part of the furniture' and therefore very difficult to remove. Nevertheless, while employers agree with the principle that a vast integrated single market on the continent requires a certain degree of regulation, there are three concerns of a practical nature, especially in light of the increased diversity of socio-economic models in the EU since the accession of new member states in the early 2000s. The first is that Brussels has become a self-centered bureaucracy with little knowledge of how business in Europe is conducted. Potential problems regarding implementation may therefore be lost during the long process of designing, adopting and adapting EU legislation. Secondly, there is a larger issue with implementation of EU Directives into UK legislation: 'gold-plating' – dressing up domestic legislation as emanating from Brussels not Westminster to avoid blame – often happens when ministers feel very constrained in how they design legislation, if only because of fear of the ECJ.

And, thirdly, since any legislation and regulations will fall on sometimes very different soil in different countries, the impact of legislation, especially measured in terms of costs for business, may be highly unequal across the EU (ignoring for a moment the pernicious problem

of enforcement). In addition, costs (and benefits) of regulation are not symmetrically distributed across the economy. Large companies are much more easily able to adjust to new legislation and absorb the associated costs.

Trade unions in the UK do not necessarily disagree but point out that many of the costs and benefits are very difficult to measure. How, for example, does one account for lives saved as a result of stringent health and safety legislation? And what are the hidden, almost shadow costs of not pursuing a developed form of social dialogue, which would include trade unions and their expertise in workplace matters? Fundamentally, the unions point out, categorising the effects of policies as costs or benefits is not as straightforward as it sounds: it also involves important prior decisions regarding the kind of society we want. Extended maternity and paternity rights, for example, can be considered as a large cost for employers, but it can also be considered as an important societal achievement. This underlines the fact that any analysis ultimately involves multiple goals: one could envisage analyzing the costs and benefits for each individual goal, but the decision regarding the probable trade-off between these goals is a political rather than an economic decision.

In summary, there seems to be some agreement among the UK social partners that reaching a measured view of costs and benefits of EU legislation is very difficult. Quantification is perhaps most useful when looking at individual measures and their potential impact – but that then leads to a situation where the overall architecture of the legislation might get lost. And, even if it were possible to calculate costs and benefits of broad policies relatively easily, it may not be very meaningful to capture such a cost-benefit analysis regarding a Brexit in a single number, in large measure because it all depends on the alternative scenario that is used as comparison. That said, many EU labour market policies could undoubtedly benefit from a more systematic and sustained impact assessment of their effects on business and workers.

3. Legal and institutional issues

Most detached observers of the UK's relationship with Europe note a double movement in terms of its effects on each side. The conduct of UK industrial relations has been significantly Europeanised since the 1990s through the introduction of employment legislation discussed in this article, while the Social Europe has increasingly been superseded by market liberalisation at the behest of Britain and its allies. Nevertheless, few in either the trade union movement or employer's associations identify, or predict, total convergence. Path dependency is strongly in evidence in the maintenance of distinctive UK and European legal and workplace bargaining arrangements. Continuing divergence between the European and the arguably more liberal and

individualistic UK traditions can therefore create friction when it comes to implementing EU employment policies in the UK. As might be expected, employers regard this friction as imposing a further cost on them, while unions see this as regrettable evidence of the UK's distance from the European mainstream which will only widen in the event of Brexit.

This institutional divergence takes several forms. The most obvious lies in the contrasting industrial relations systems and attitudes towards 'social dialogue' between trade unions and employers. The UK's liberal model of capitalism emphasises individual rights and a narrow conception of the employment relationship as a mainly economic exchange. The 'voluntarist' industrial relations system springing from this fosters a company or plant based bargaining environment free from overt interference by regulators. Continental European systems, on the other hand, are intentionally more 'decommodifying', embedding the employee-employer relationship in its social context and producing collective arrangements that imply a stronger role for public policy[7].

If the EU could be said to have an industrial relations system then it clearly mirrors the Continental tradition. Social dialogue between unions and employers was institutionalised in the 1992 Maastricht Treaty which obliges the Commission to consult them on social policy. Both sides are represented on the European Economic and Social Committee and through the Open Method of Coordination, the predominant policy-making vehicle of the previous decade. The Lisbon and Europe 2020 competitiveness Agendas also mandate social partner involvement, although European unions complain of being sidelined.

Interestingly, business groups at the Brexit hearing contended that they do not necessarily oppose social dialogue at the EU level, even though this is largely absent from the UK labour market and gives an advantage to large firms with the resources to secure representation in Brussels. The CBI views the process as useful in building an early consensus with unions on policies and ironing out potential difficulties prior to practical enforcement. In some cases, a *lack* of social dialogue may actually have contributed to bad policy. The blame for this can be laid at the door of what many businesses feel is a remote and unaccountable policymaking structure with little interest in ensuring that regulations mesh with the requirements of domestic markets in diverse members states, for example over the regulation of part-time work.

Further problems may arise, furthermore, in the transposition of EU regulations into UK employment law. Differences between the UK's common law tradition, emphasising contractual freedom, and Continental civil law which gives more recognition to collective associations and is the basis for EU legislation, are a further reflection of different economic and political traditions.

Moreover, these legal differences have been implicated in accusations that the UK government 'gold plates' regulations to remove any ambiguity in their interpretation. This tendency, which is designed to provide legal clarity, leads to over-complicated regulations which add to business costs. The UK also enforces employment law in different ways to other EU members. Many of these have a dedicated labour inspectorate whereas employment matters in the UK are dealt with by a plethora of government institutions and quangos prone to taking an over-zealous approach.

A further set of complaints relates to the 'judicial activism' of the Court of Justice of the European Union (informally known as the European Court of Justice or ECJ). Pooling sovereignty, through the creation of the SEM for example, obviously requires judicial oversight to make sure participants abide by common rules. But critics argue that the ECJ often oversteps the mark by reinterpreting Directives in ways that go beyond the original intention of those who drafted them. In some cases this may be because the wording of legislation was kept deliberately ambiguous to allow countries some discretion in adapting them to national conditions. In others, it may simply be down to poor drafting. Either way, UK employers complain that a number of ECJ judgments have gone against EU principles of subsidiarity and proportionality that ensure that regulation is the minimum necessary. In the fields of employment and welfare the ECJ is now increasingly regarded as a policy actor in its own right, violating the important principle of the separation of powers. Removing the ECJ's ability to act in this way, perhaps through Brexit, could therefore theoretically restore judicial supremacy over employment law to UK courts.

4. The British Variety of Capitalism in the European economy

The debates about market governance, costs of regulation, and the interaction between the EU and the British legal system all point to a wider issue. To what extent can the UK’s market-oriented, service-based economy and labour market coexist with the EU, which is dominated by economies that have a very different underlying economic logic? After all, if the competitive advantage of UK firms lies in lowering costs and maximising flexibility then this will likely be undermined, not enhanced, by extra regulation of whatever purpose. This conundrum underlies much of the debate about the cost of regulation and institutional incompatibility because it suggests that the question is about more than enticing UK businesses and organized labour to learn to live with the SEM, warts and all, as opposed to something potentially deeper and more intractable.

Since the collapse of the Berlin wall now over 25 years ago, it has become increasingly clear to observers that capitalism is a multi-faceted economic system, in which different elements of economic governance of capital, product and labour markets can be combined in a wide variety of ways. Whereas northern Europe has adopted a market economy that relies on coordination and negotiation among large, strong business groups, financial actors and labour, southern Europe looks at the state to fill gaps in economic governance, Central European member states are hovering between some form of organized capitalism and neo-liberalism (with the latter slowly winning the battle of regimes), while the UK has resolutely turned towards the market as the key, driving, economic institution (as Ireland has done, albeit in a less deregulated manner)[8].

These differences in organization and philosophy of economic governance are more substantial than they may appear at first, since a majority of the EU member states, and practically all the founding member states have a socio-economic model that is based on considerably more regulation of the labour market – through private associations or the state – than was present in the UK, even before the Thatcher revolution. In part this has been a political response to the unpredictability of capitalism and its effects on life chances of the working population; but in part such a densely regulated labour market also safeguards long-term investments in human capital in NW-Europe, which is one of the key factors in its comparative advantage, especially in manufacturing and related industries. Tight employment regulations assure workers that investment in deep industry-specific skills is rewarded in the long run and invite employers to invest in the long-term development of their workforce. Thus, skills of engineers and of shop floor workers, the key building blocks of northwest-European export prowess, are tailored to the needs of sophisticated manufacturing.

The UK's comparative advantages lie elsewhere. The slight revival of the UK car industry over the past decade should not blind us to the relative low unit value of products in this sector (highly sophisticated, expensive cars are, on the whole, made elsewhere in Europe). And the quasi-permanent trade deficit between the UK and the rest of the EU leaves little doubt where manufacturing exports are important. That does not mean, though, that the UK is not an active part of the integrated European economy – but in other sectors, such as international finance, consulting, and law; architecture and advertising; and higher education and science. In short, the UK excels in service sectors for which the key human capital inputs are based on general (rather than deep industry-specific) skills, and where the deregulated nature of the labour market is often a crucial advantage, both for employers and for employees.

The question then is how an economic model that thrives on a very lightly regulated, highly flexible labour market can be integrated into (or at least actively coexist with) more coordinated models of labour market regulation that appear to set, at least from the UK's perspective, the mould for any EU intervention. One set of arguments suggests that the considerably more liberal model of the labour market in the UK compared to most other EU member states should not be understood as imposing only a narrow path along which the UK can evolve. The UK may be a liberal market economy, but even within that framework problems such as inequalities in the labour market can be addressed – either through domestic legislation or via adopting common labour standards across the EU. A slightly different, more dynamic view is more cautious: in a world of unpredictable technologies and rapidly changing product and capital markets, adopting a single model of labour market – and by extension economic – governance would be unnecessarily risky[9].

The effects of the EU's few incursions into employment and labour market policy are considerably more flexible than pro-Brexit critics suggest. Rules enforcing non-discrimination and minimum host country standards for posted workers allow adaptation to local labour market standards. What the EU needs, clearly, is a multitude of more or less complementary but different labour market regimes with different strengths in terms of comparative advantage, against a background of broadly agreed common social standards in sensitive areas such as for example discrimination or protection for posted workers (both areas in which the EU sets rather than follows the agenda). If the discussion about the relation between the UK's mode of employment regulation and the EU highlights the need to keep such flexibility, then it will have achieved something concrete, regardless of the outcome of the referendum.

5. Conclusion

The UK labour market is very different from those of other EU member states who have provided the broad mold for EU-level labour market regulation. After the upheaval of the 1980s, it is easily the most deregulated labour market in the EU, ranking near the bottom of the OECD in terms of regulation. While that does indeed imply that complaints by employers about suffocating regulation are probably overstated, it also means that there is a legitimate issue regarding the forced introduction of more stringent (albeit very limited) EU legislation into the UK. Yet business in the UK seems to have managed those pressures reasonably well. Despite some regular ritual howls about the cost of such regulation, most of the large firms in the UK, which are international players, have adapted quite well. For them, access to the SEM means that they simply have to accept those rules – similar to British drivers on the continent having to

accept driving on the right-hand side of the road. It is, as it were, simply part of the cost of doing business in Europe.

The problem in the UK is that regulation *does* impose costs on firms, but that these are not evenly distributed in accordance with the benefits they receive from access to the single market. Large firms can more easily absorb those costs AND also benefit much more from European integration than smaller companies that are subjected to EU legislation (with its associated costs) but for whom domestic markets remain more important. The effect is predictably a schism within British business. Business *as a whole* benefits greatly from access to the Single Market, a requirement of which is some harmonization of labour law to prevent social dumping, but sections of UK business are out of self-interest strongly opposed to EU membership and lobby accordingly.

A more cogent criticism of EU activism in labour markets may be that the comparative advantage of UK industry rests on institutional foundations that are undermined by labour laws drawn up preponderantly with the interests of more coordinated economies in mind. If Britain excels in industries where deregulation is part of the comparative institutional advantage, then a set of more stringent labour market regulations is likely to undermine that. And, at least as importantly, perhaps, putting all the eggs in the basked of one regulatory model may, in today's rapidly changing, volatile economy not be the wisest thing the EU and its member states can do.

That may ultimately be the key insight about the relation between the economic model of the UK, including its labour market, and that of the rest of the EU. It pays for all parties in the set-up to tread lightly, and encourage domestic reforms instead of relying on Brussels as the reform lever. Domestic institutions are both historically grown and politically embedded, while EU institutions lack the legitimacy associated with those domestic institutions. The EU's democratic deficit is, on the whole, probably not as dramatic as some of its proponents have made it out to be. It exists, however, particularly in sensitive areas such as employment, and business regulation, and pro-Europeans should not be surprised that the interests and preferences of actors affected by these differ. There is a broad consensus among large businesses and trade unions behind remaining in the EU. The Brexit alternative entails numerous potential costs and uncertainties for very little gain. But it is not a complete or unambiguous consensus and campaigners for the status quo should be wary of assuming so.

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