SUBMISSION TO TAYLOR REVIEW

Institute of Economic Affairs

Introduction

The Taylor Review was set up to consider *'how employment practices need to change in order to keep pace with modern business models'*. This form of words is ambiguous: is the objective to provide objective and disinterested advice to firms on how they might best use different types of contract to improve service to their customers, productivity and profitability - or to determine what further forms of government regulation should be imposed? Experience strongly suggests the latter, particularly since Chancellor Philip Hammond has spoken of the need to increase the tax take from newer forms of employment.

The 'business models' most frequently discussed are **agency work**, **self-employment**, the **zero-hours contract** and **'gig' employment**. None of these are entirely new, but there appears to have been a significant growth in these types of arrangement recently. Agency employment seems to have risen from less than 600,000 in 2010 to approaching 900,000 today; self-employment from 4 million to 4.7 million and zero-hours contracts from 170,000 to 900,000 over the same period ('Gig' work overlaps with these categories, and there is no official definition or measure). However some of these increases may be more apparent than real, with for instance zero-hours contracts being better reported now than a few years ago as a result of increased publicity. Moreover these increases should be seen against an overall increase of employment in the UK from 29 million in 2010 to 32 million today.

Changes in the labour market, as in other types of market, inevitably produce winners and (particularly in the short run) losers. Concern has grown about workers who may face low pay, insecure jobs and limited protection against unscrupulous employers. Such concern is understandable, but policymakers need to examine the causes of these trends and the possible consequences of intervening to prevent or mitigate them.

Why have non-standard forms of employment become more common? There are various reasons. Employment protection legislation and employment tribunal decisions which have made it difficult

and costly to dismiss employees, together with the increasing range of rights and benefits acquired by employees in the last few years, mean that taking on permanent workers is expensive and risky for businesses. Critics claim that the expansion of non-standard forms of employment is an attempt by businesses to evade their obligations, while others counter that this flexibility is a sensible and pragmatic response which has kept UK unemployment much lower than in most other European countries.

But there are other factors at work. The widespread use of information and communications technology has made working remotely much easier, which has encouraged many people to freelance and become self-employed. The type of work being undertaken in our changing economy, with the expansion of new forms of services, has made older types of employment less appropriate. The workforce is increasingly diverse, with attitudes towards self-employment, for example, varying considerably between ethnic groups, while immigrants seeking employment are more likely to get work through agencies than are UK-born workers.

Attitudes are changing as people pursue different lifestyles and greater independence in their lives. While paid work of some sort is a necessity for most people, more workers than ever do not have employment as of central importance in their lives, at least for a time. Some are part of the ever-growing numbers of students, who do not want fixed-hours contracts, while others are part of the rising generation of healthy retirement pensioners who seek to supplement incomes by paid work, rather than need a full-time job. There are far more women with children who want to return to the labour market soon after childbirth without being tied to permanent employment and fixed hours. Others with elder care responsibilities need to work around these commitments. All of this means that we should be cautious in applying common 'solutions' to perceived problems which some groups of workers experience.

Agency Workers

Employment agencies have for many years provided a range of services for UK employees and employers, including the provision of genuine temporary employment (for example, providing people to fill in for permanent staff who are ill or on leave, or extra assistance at times when demand for an organisation's services is abnormally high). Workers are screened by agencies and thus save employers time in the short run, and in the slightly longer term avoid employers having to take workers on permanently when they might be unsatisfactory or when the demand for services is so variable that permanent posts cannot be justified. The agency worker gets the benefit of

employment more quickly than he or she could find it otherwise, and the temporary nature of the work avoids long-term commitment which he or she would otherwise perhaps find difficult to offer because of personal circumstances. Agencies have long had an important role in areas of the UK labour market such as hotels and catering, nursing, acting and modelling, reception and secretarial work and security services.

In many other European countries, though, agencies have been looked on with suspicion as a means by which employers could evade employment protection legislation and exploit workers. In some countries, notably Italy and Greece, they were banned outright until relatively recently. The EU's Agency Workers Directive was a response to this suspicion. The ensuing UK Regulations give agency workers the same basic employment conditions after twelve weeks working for an organisation in the 'same role' as those that would apply if they had been recruited directly by the hirer. These are such conditions as access to training, holiday pay, automatic pension enrolment and notice periods. Even from day one of a temporary agency assignment the worker is now entitled to the same access to job vacancies as permanent members of the hiring organisation's staff, and to collective facilities such as staff canteens, childcare and transport services.

Despite the considerable concern expressed by employers about these Regulations, they do not seem to have made a great deal of difference. Undoubtedly some users of agency workers have experienced an increase in their costs, but overall the impact has been muted. After an initial dip in employment of agency workers, probably associated with the recession, their employment has risen again. A particular issue has been the belief that increasing numbers of people are on semi-permanent agency contracts which offer worse pay than direct employment.

The TUC[1] has accused the UK government of failing to implement the EU's Agency Workers Directive properly and called for a ban on the controversial 'Swedish derogation' clause. This clause exempts an agency from having to pay workers the same rate of pay as those employed by the hiring organisation if the agency directly employs the workers and guarantees to pay them for at least four weeks during the times when work is unavailable. Agency workers are then considered to be employed by the agency and can be hired out to other employers without triggering the 12-week rule.

[1] http://www2.cipd.co.uk/pm/peoplemanagement/b/weblog/archive/2013/09/02/ban-swedish-derogation-to-end-pay-abuses-says-tuc.aspx

In Sweden, where the clause originates, workers still receive equal pay once in post and 90 per cent of normal pay between assignments. But the TUC claims that in some UK workplaces agency staff are being paid much less than permanent staff, despite doing the same job: in the UK the payment between jobs need only be at the minimum wage. It also found that Swedish derogation contracts are used regularly in UK call centres, food production and logistics firms.

However, an interesting finding from a recent study by the Resolution Foundation[2] is that different types of agency worker seem to fare differently. Those who regard themselves as 'permanent' agency workers in response to Labour Force Survey questions appear to bear a 'pay penalty' amounting to around 45p per hour. That is, controlling for relevant variables, they earn less than those directly employed. 'Temporary' agency workers, however, seem to obtain a pay 'premium', earning 22p per hour *more* than the directly employed. This should make us wary of making generalisations about the use of agency work, and how it should be regulated across the board.

It might, however, tempt policymakers to try to restrict the use of Swedish derogation contracts by increasing the wage rate which must be paid during periods when jobs are not available. But this needs thinking through. The 'pay penalty' which those who are permanently employed by an agency appear to pay is subject to a number of interpretations. Economists point to the way in which positive or negative *compensating differentials* may influence pay. Those who work permanently on agency contracts earn less, but may have more secure employment and do not have to search for work, the agency doing this for them. If, as seems to be the case, this group of workers includes many who would find it difficult to obtain conventional employment (for instance immigrants from Eastern Europe and the EU accession countries, and younger workers), the 'pay penalty' may reflect the value agency workers get from avoiding the costs and difficulties of job search. Should agencies be forced to pay them more, this cost would be passed on to the users of agency labour. As demand curves for labour usually slope downwards, this would result in reduced employment opportunities for agency workers. It might make firms use other forms of non-standard employment: some commentators have argued that restrictions on agencies is one factor behind a growing use of zero-hours contracts.

Self-employment

[2] Available at http://www.resolutionfoundation.org/app/uploads/2016/12/Secret-Agents.pdf

Another deviation from the standard employment model is self-employment. Self-employment jobs have grown faster than employee jobs since the recession. This has led some commentators to argue that many of the self-employed are not in 'real' jobs, but are forced to scrabble around for freelance work. On this view, the apparent post-2010 jobs 'miracle' is phoney. Employers are cynically outsourcing work which should be done by those in regular employment. They get the work done more cheaply because they can avoid many of the costs of employing people directly, ranging from office space to auto-enrolment in pension schemes, but workers suffer in terms of lower wages and benefits and growing insecurity.

There will always be some working for themselves who are not doing well, but a look at the detail of the figures suggests a much more optimistic picture.

For one thing, a basic premise of the critics – that the numbers *entering* self-employment were rising faster than overall employment – is probably mistaken. Much of the increase in numbers seems rather to have been because there was a sharp fall in those *leaving* self-employment[3]. This means that more were persisting in self-employed status (a result partly attributable to more of the older self-employed working on after state pension age), and less were exiting to employment, unemployment or inactivity.

For another, there is little evidence of correlation at the industry level between employee jobs lost and increasing numbers of self-employed. This suggests that the belief that outsourcing is driving self-employment needs considerable qualification.

The position of UK governments has usually been that self-employment is in principle a 'good thing'. People striking out in business for themselves show enterprise, reduce the benefit bill, and may boost growth. On average the self-employed report themselves as happier than the employed. A considerable majority are not seeking employee status, and those self-employed who are working part-time are less likely to want to work more hours than the part-timers with employee status.

There has always been government concern, however, that self-employed people may be avoiding tax by non-declaration of income, the use of personal service companies, or by misleading HMRC about their independent status. Recently this concern has been exacerbated by the growing numbers of self-employed legitimately avoiding paying the full rate of employee national insurance

[3]https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/articles/trendsinselfemploymentintheuk/2001to2015

(and of course no employer contribution)[4]. In a time of financial stringency, it is not surprising that in the last budget Mr Hammond attempted to raise the national insurance contribution rate paid by the self-employed. In response to opposition citing the Conservatives' 2015 pledge not to raise taxes on incomes, this proposal was withdrawn. However there seems to be a drive to revive this plan after the election, but offset it by giving self-employed people access to some of the benefits enjoyed in standard employment, for example sickness pay, holiday pay and maternity/paternity pay.

This sounds at first to be a reasonable *quid pro quo*, but it would be very difficult to do this in the existing structure of self-employment. The benefits could not be paid by the employer except in quite limited circumstances where the self-employed worker has only one major client – and even here it would be difficult to implement. A self-employed shopkeeper or carpenter or cleaner with many clients or customers could not be paid in the same way: the state would have to pay, rather negating the point of raising NICs. Nor could they be forced to take holidays or maternity leave in the same way as an employed person, at least without considerable restriction of personal freedom.

There is reason to believe that the numbers of self-employed will continue to increase in the longer term. There is a rising trend in higher-skilled workers such as managers and professionals becoming self-employed, often as consultants[5]. The numbers of self-employed women – historically under-represented amongst the self-employed – are growing faster than those of men, and in a wider range of occupations than in the past when hairdressing, cleaning and childcare accounted for most women with this status. And as the greying of the population gathers pace, the tendency of older workers to have higher levels of self-employment will continue to boost numbers. Although younger workers are far less likely than older workers to be self-employed, their numbers are growing too – and are already much higher than in most continental European countries.

Changes in technology have facilitated changes in work patterns. Over half the self-employed regularly work from home, as opposed to about 6% of full-time employees, and obtain business online. It is much easier to contact suppliers and customers, and business registration is easier.

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[4] Both employer and employee NICs are ultimately paid by the employee. They are an unacknowledged form of income tax and should be merged with the latter. Successive Chancellors have recognised this but have lacked the will to do anything about it.

[5] There has been some discussion of alleged pressure by the BBC on employees and highly-paid 'talent' to turn themselves into personal service companies to reduce tax. Others (for example https://www.publications.parliament.uk/pa/ld201314/ldselect/ldpersonal/160/160.pdf) have suggested that the same has happened with some types of less-well-paid. While this may be a legitimate concern, it is the responsibility of HMRC to have a serious look again at the cumbersome IR35 regulations and does not need further employment regulation.

What should the role of government be? Freely-chosen self-employment – which is what seems to be the case for most - may be good for the economy, but does it require any help from the state? There have been dozens of schemes to boost self-employment over the years: they have not had much impact. Offering grants, cheap premises or finance to target groups usually has a significant 'deadweight' effect as these schemes encourage those who would have succeeded anyway. Training schemes, though no doubt worthy, similarly have little long-term impact.

It is probably better to concentrate on dismantling barriers to self-employment such as excessive occupational regulation, over- complex tax requirements and the difficulties faced when the self-employed begin to take on employees, rather than short-lived and ineffective subsidies.

Zero-hours contracts

Another controversial area has been the use of 'zero-hours' contracts (ZHC). These are a type of contract where employees have no guaranteed hours but agree to be potentially available for work. ZHC have been around for many years in the retail and hospitality industries, where demand fluctuates from month to month and even day to day. Their use has spread more recently to other sectors including healthcare, education and public services. Nor are they confined to profit-making employers trying to squeeze their wage bill. A 2013 survey of employers by the Chartered Institute of Personnel and Development[6] found that a third of voluntary sector organisations used zero-hours contracts, along with a quarter of public sector employers and 17% of private sector firms.

Not all such jobs are low paid, as many assume. In a TV question session before the 2015 election, Jeremy Paxman put David Cameron on the back foot by demanding 'could you live on a zero-hours contract?'. Cameron was poorly briefed and waffled: he should have replied 'It all depends. If I were a hospital consultant, a lawyer or a university lecturer working on such a contract, as many do, I certainly could'.

It is easy to see ZHC as exploitative. Unions have probably been too quick to generalise from hard cases where individuals are unhappy with their arrangements[7], but even some better-off ZHC employees point to difficulties in securing mortgages or consumer loans without a regular fixed

[6] https://www.cipd.co.uk/knowledge/fundamentals/emp-law/terms-conditions/zero-hours-reality-report

[7] For example Unite 'believes that in general zero-hours contracts are unfair, creating insecurity and exploitation for many ordinary people struggling to get by' http://web.archive.org/web/20130811185613/http:/www.unitetheunion.org/news/governmentmustacttohaltriseinzerohours/ accessed 9 March 2016.

income (a problem they share with many self-employed people). Despite this, research suggests that the large majority of people working on zero-hours contracts are happy to do so; indeed they are on average happier with their jobs than people on more conventional contracts.

For this type of contract has the advantage of offering opportunities to many people who would find it difficult to take regular work at fixed times[8].These include full-time students (with class timetables which change from term to term, limiting their ability to take fixed-hours jobs) who constitute about a quarter of all ZHC employees, and people with children and other care responsibilities. They are free to take shifts, or refuse them, on a day-to-day basis as their availability alters.

Other people on zero-hour contracts include people available for occasional extra work in addition to their main job (at the top end this includes hospital consultants and university lecturers), and semi-retired individuals who want to work occasionally but not on a fixed weekly basis. The availability of ZHC may be partly responsible for the recent increase in the numbers working past state pension age, something which is not as marked elsewhere in Europe. In some ways these contracts thus resemble other forms of work such as freelancing and self-employment.

Zero-hours arrangements are not ideal for all workers, though, and politicians have duly threatened action. The coalition banned 'exclusive' ZHC arrangements, where employers who cannot guarantee work nevertheless impose restrictions on employees working for other firms. The Labour Party suggested in the run-up to the 2015 election that people who work regularly on a ZHC for more than eight hours a week should be able to request a permanent contract, and that workers should be paid for cancelled shifts. Others go further: Jeremy Corbyn and his team have now pledged to ban zero-hours contracts outright 'so that every worker gets a guaranteed number of hours each week'[9].

This would be a serious mistake. Zero-hours contracts helped to keep levels of joblessness down during the recession, at a time when many other European countries with less flexible labour markets saw staggering levels of unemployment. Banning ZHC would be detrimental to both employers and employees. There are always going to be short-term fluctuations in demand[10] which affect staffing requirements. With a ban on ZHC, some work (for example, opening restaurants on

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[8] Only just over a third of ZHC employees want to work more hours than they currently do.

[9] http://labourlist.org/2017/04/the-20-point-plan-with-which-corbyn-and-mcdonnell-aim-to-end-the-rigged-econom/

[10] Labour Force Survey data show that there is a strong seasonal pattern in the use of zero-hours contracts, something which critics appear not to have noticed.

quiet evenings) would become uneconomic, or would be done cash-in-hand in the shadow economy. Zero-hours contracts would have to be consolidated into a smaller number of part-time permanent contracts for people who could commit to fixed hours. Opportunities would then disappear for some groups who are unable to work regular hours, including single parents, carers and students. No government can in reality enforce a situation where all existing ZHC workers would get a guaranteed weekly contract.

The 'gig' economy

One contributor to the future growth of self-employment and zero-hours contracts is likely to be the growth of the 'gig' economy. There have always been business projects which have brought people together for a specific event ('gig') or series of events, but which could not constitute a permanent employment relationship. Historically one-off construction projects were an example. Others include exhibitions, arts events and entertainment performances, and pop-up shops.

Recently there has been much attention to the emergence of computer applications (apps) which widen the scope of the gig economy, now understood as an environment where workers are paid for discrete (and each slightly different) tasks such as delivering food or a car journey. Apps such as Uber, which enables individuals to act as on-demand taxi-drivers either in their spare time or as a full-time job, or TaskRabbit, which enables households occasionally to outsource various chores, are challenging traditional forms of employment based on the firm.

The existence of firms, as Ronald Coase pointed out many years ago, is predicated on the need to reduce transactions costs, such as those involved in sourcing, negotiating and monitoring work arrangements. The new apps set out standard contractual arrangements such as price, and can ensure the quality of work through prior checking of workers and consumer rating systems. For a modest fee, rather than the overheads necessarily associated with a regular business firm, the app owners enable workers to operate flexibly and consumers to get rapid and inexpensive access to many services without extensive search.

Some observers have seen the gig economy as the future of work, with traditional employment collapsing - in service sectors in particular. This is possible, but others are more downbeat. It has been pointed out that many app-provided services do not display significant economies of scale, which may limit their scope. In many fields where traditional firms are tempted to outsource further via apps, there may be issues about how necessary training and updating could be managed.

There is also little evidence that, so far at least, large numbers of workers have chosen to work full-time in the gig economy. Rather, apps enable those with constraints on their time (such as students or parents of small children) to work more effectively on a part-time basis.

Another factor which may inhibit the spread of the gig economy is the increasing interest which regulators are taking in this type of employment. This may be intended to protect the consumer – although easy reporting and rating mechanisms via apps make company response to consumer complaints far faster than in the past. Uber drivers who perform badly can be instantly fined and taken out of the system for a period. Customers who report problems can be reimbursed more or less immediately. It may be driven by fear that taxes will be lost, particularly where apps operate across national frontiers. It is very likely to be pushed by pressure from interested parties, such as those operating London black cabs, who are bitterly opposed to Uber[11]. As with other developments discussed above, it may be driven by concern that existing labour standards – in areas such as minimum wages, working time, paid holidays, parental leave – will be undermined.

Recent employment tribunal and court decisions in relation to Pimlico Plumbers, Deliveroo and Uber have suggested that we may be moving towards a situation where some gig workers are to be treated as workers – entitled to some basic employment rights – rather than as independent self-employed contractors, though possibly not as full employees. The legal position is hazy.

There may be some legitimate grounds for concern if apps like Uber come to dominate the market, as this may enable them to act simultaneously as a monopsonist, demanding excessive payments from workers, or a monopolist, overcharging the consumer. However such issues are probably the concern of the Competition and Markets Authority, not employment law.

We should be very wary of heavy-handed intervention here. Uber and similar organisations have shaken up competition in existing markets and provided new services which clearly benefit the consumer in terms of both price and quality. If they are forced to become employers in a conventional sense – something for which they are totally unfit at present – their whole business model is likely to collapse, with the loss of tens of thousands of jobs. Even if it survives, it will inevitably be the case that the extra costs of conventional employment will be passed on to the consumer in higher prices and to the new 'employees' in terms of a larger slice of pay being taken by the 'employer' to compensate.

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[11] It is interesting to speculate what would have happened if the app had been the invention of a driver collective which made no direct profit from the innovation. Much of the political opposition to Uber would have been reduced to its essentials - special pleading by incumbent licensed taxi drivers.

Conclusion

The Review team will have received a large amount of advice from interested parties, particularly those advocating new regulation. It is hoped that the team will at least bear in mind some of the problems raised in this submission. Regulation is always tempting, as it seems to offer benefits without major cost to the government. But in competitive markets the cost is not borne by businesses in the long run, but is passed on in various ways to consumers and employees. Regulation restricts employment creation, and benefits some groups of workers at the expense of others. Moreover the inevitable attempts to find ways round regulations diverts the energies of businesses from more important tasks.

The desire to improve the quality of working life is something which members of the Taylor Review team have repeatedly and understandably stressed. But historically improvements in living standards and working conditions have largely been the result of rising productivity and the development of new goods, services and technologies rather than by legislative fiat. Any interventions which the Review proposes should not deter these beneficial market-led processes.