

LIBERATING THE LABOUR MARKET

How reforming employment regulation can
boost British growth

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J R Shackleton

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Summary

- A free competitive market offers wide opportunities for individuals and businesses and is compatible with the framework of classical liberalism. It is also the best environment for boosting productivity and economic growth.
- There are uncompetitive elements within the UK's private sector which may distort market outcomes, but the growth of employment regulation in the last fifty years is a major contributor to our slow economic growth and stagnant real wages.
- Government interventions in the labour market are ostensibly intended to redress market failures and promote social justice, but they may not always serve these purposes.
- The Employment Rights Bill going through Parliament is likely to exacerbate the problems of the UK economy and will do little to promote growth.
- Serious deregulation of the labour market is not currently on the political agenda but may eventually become a necessity. There are, however, considerable barriers to reform.
- Some key areas for practical reform are discussed, such as discrimination and equal pay, education and training, unfair dismissal, and occupational regulation.
- A more radical, 'minimalist' approach to regulation is also possible, though this would require a major shift of opinion among both policymakers and the general public.

Foreword

Over the past thirty years or so, the UK's labour market performance has been reasonably strong. The unemployment rate has been, on average, less than 6%, and never much more than 8%. The long-term unemployment rate has been less than 2%. The overall employment rate, meanwhile, has been above 70% throughout. These figures are considerably better than the OECD average or the EU average.

This is remarkable if we bear the challenging context of much of the period in mind: sluggish economic growth, high net migration, Brexit-related uncertainty, a housing market that impedes mobility, and an education system that leaves many people poorly prepared for the job market. Britain's labour market has been able to create large numbers of jobs, and absorb large numbers of people, under difficult conditions.

Yet we have rarely treated Britain's labour market as an asset to be appreciated, and improved upon. Most of the media coverage relentlessly focuses on the negatives: gender pay gaps, ethnic pay gaps, low-paid jobs, insecure jobs, etc. We have simply taken it for granted that Britain's labour market will always create thousands of jobs, whatever burdens politicians impose on them.

Britain's labour market has never, within living memory, been a laissez-faire market based solely on freedom of contract. Governments have always interfered with the contractual relations between employers and employees in numerous ways. But they have still left enough flexibility to avoid the mass unemployment, or the insider-outsider dual labour market structure, that we see elsewhere. From a liberal perspective, though, the current

direction of travel is the wrong one. It has been for quite some time, albeit at a slow pace.

The Fraser Institute's Economic Freedom Index, which measures economic freedom on a scale from 0 to 10, contains a subcategory on labour market freedom, measured on the same scale. In 2005, the UK still scored 8.82 out of 10 on that sub-index. By 2010, that score had dropped to 8.39, and to 8.23 by 2022. The effect of the most recent policy changes has not yet been modelled, but given that there have been no liberalising measures, and major steps in the opposite direction, the UK can only have dropped further since.

There was no specific moment when Britain's political class decided to abandon the liberal-leaning labour settlement. They never consciously decided to move towards the French, the Spanish or the Greek model of labour relations instead. (And, to be fair, we are still some distance away from any of those.) Nor is there any one specific piece of legislation that marks a turning point. It is just that this abovementioned lack of appreciation for the relative strengths of the British labour market, the complacency about its job creation capacity, and the excessive focus on its downsides, lead to a political temptation to successively overburden it. Why not another obligation here, another regulation there, and another mandate over there? What harm could it do? The labour market is doing fine, and in any case – it only hurts the bosses, right?

But as Professor Shackleton shows in this paper, there is no free lunch in labour market policy. Measures that supposedly benefit workers are ultimately paid for by those workers themselves, and/or by a different group of workers.

Shackleton also shows that the temptation to mess around with labour relations is a difficult one to resist for politicians. As with

so many bad policies, the benefits are immediate and visible, while the costs arrive later, and are not directly observable. They require some abstraction, and thinking in counterfactuals. In several eurozone countries, we have seen protests against reform packages that contained, among other things, some modest labour market liberalisation measures: it is usually easy to identify the people who would (at least in the short term) lose out from those. But we never see demonstrations by the unemployed or the underemployed demanding labour market liberalisations.

Liberalisers cannot promise a specific improvement to a specific, identifiable group of people. But as Shackleton shows, a functioning, efficient labour market is a key ingredient to a country's prosperity. It enables people to develop their skills and talents, and to make the best use of them, to pursue their own interest, and benefit others around them.

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KRISTIAN NIEMIETZ

Editorial Director, Institute of Economic Affairs

London, June 2025

Introduction

Most of us will spend a large chunk of our lives selling our precious time to employers in the labour market. A labour market which works efficiently is key to our future prosperity. It must facilitate the productivity and employment growth which can offer us a wide choice of opportunities for decent and regularly improving living standards, while helping to support those not currently working as a result of age or unfitness – and funding a range of public projects considered important in a modern society.

Over the last half-century there has been an almost continuous expansion of government intervention in the UK labour market. Critics argue that excessive regulation has damaged employment opportunities and has slowed growth. Over the next few years we need to ensure that our employment regulation is appropriate and effective as businesses and workers face new challenges as the global economy mutates and artificial intelligence changes all our worlds.

Some regulation is relatively uncontroversial – such as restricting the employment of those convicted of child abuse, or mandating adherence to basic health and safety rules. Some, however, has been in hasty response to particular issues that may now be less relevant, or could be dealt with in other ways. Some is the residue of irrelevant EU Directives which have never been repealed, or is the result of lobbying by pressure groups pushing a sectional interest. Sometimes interventions have been badly designed, have proved ineffective in relation to their stated aim, and may have generated unintended negative consequences. The sheer scale of interventions and the accompanying costs of compliance

may have deterred investment and inhibited smaller firms from growing into larger businesses.

Thinking about this should, though, begin with some positives: our jobs market has in some ways performed surprisingly well in recent years. Millions of new jobs have been created by innovative enterprise, and the UK has enjoyed lower levels of unemployment than many other European countries. The recovery of payroll employment after the Covid lockdowns surprised many commentators, who had gloomily forecast a sharp and persistent rise in joblessness. Instead, unemployment quickly fell back, and vacancies soared for a time to record levels. This flexibility is an asset which we can build on.

Nevertheless, there are real problems. Despite low levels of joblessness nationwide, there remain significant pockets of high unemployment in parts of the UK, and for some young people and some ethnic groups. Simultaneously, though, there are serious shortages of workers in many areas. Often these are shortages of people with important skills, and this raises questions about the adequacy and quality of training opportunities and our education system. And although labour force participation is still relatively high in international terms, there has been a marked rise in inactivity since Covid (see Figure 1).

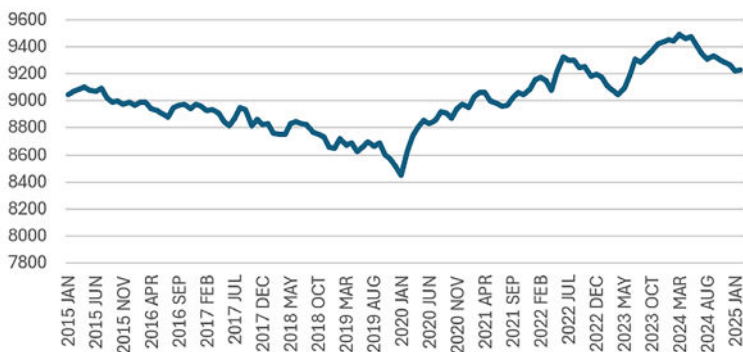


Figure 1: Economic inactivity (thousands) Jan 2015 – Jan 2025

Source: ONS

The increase in numbers of those neither in work nor looking for work is in part the result of more young people entering higher education and the predictable consequences of some of the ‘second baby boom’ taking early retirement with reasonable savings pots and occupational pensions¹. But the largest proportion of the recent rise in working-age inactivity has been people giving long-term sickness or disability as the reason for being out of the workforce. At the beginning of 2024 those inactive because of long-term sickness reached a record high of 7% of the working-age population, about 2.8 million individuals. This may be in part the effects of ‘Long Covid’ and treatment delays in the NHS. But there has also been a worrying rise in the numbers reporting mental health problems, particularly among the young.

Unlike in other European countries, UK inactivity rates have not fallen back to pre-Covid levels. One aspect of this is self-employment, which fell sharply with lockdown as many older

1 Note that public sector workers, usually with defined benefit pensions, typically retire two to three years earlier than private sector workers.

workers retired and, although it has risen again, remains well below the level of 2019.

Perhaps more fundamentally, labour productivity – the value we produce per hour worked – remains well below that in many comparable economies². Never growing very rapidly, productivity became even more sluggish after the financial crash (ONS 2022a), as Figure 2 shows. Not unexpectedly, therefore, median real pay stagnated for years, and the upsurge in inflation stimulated by monetary expansion and the effects of the Ukraine war meant significant falls in real income for many groups of workers. This in turn triggered an unforeseen resurgence of union militancy, particularly in the public sector where pay growth had lagged behind the private sector and where union membership remains relatively high³.

2 In 2021 labour productivity was 18.3% higher in France, 19.0% higher in Germany, and 25.5% higher in the US than in the UK (ONS 2023).

3 Across the economy as a whole, the proportion of employees in unions has fallen to its lowest level since records were kept in the current format. In large swathes of the private sector, unionisation is nugatory (Shackleton 2024).



Figure 2: Labour productivity: % change in output per hour worked, whole economy (seasonally adjusted) 1972–2024

Source: ONS

The incoming Labour government is proving hyperactive in its approach to the jobs market: higher minimum wages, a sharp rise in employers' national insurance contributions, plus an Employment Rights Bill which includes first-day employment rights, measures to boost union power, and restrictions on zero-hours contracts. While the government expects these measures to have a positive impact for workers, many economists have expressed concern about their wider impact.

In this paper I go back to first principles and look at the conditions for a successful labour market. I then examine the factors that may currently prevent them being achieved, and go on to suggest possible consequences of the proposals in the Employment Rights Bill.

Individual pieces of employment law, taken in isolation, may bring positive benefits to some workers, but it is argued that the cumulative result of well-intentioned government interventions

has been harmful to productivity and economic growth. Substantial deregulation of the labour market is difficult, partly because of the vested interests created by earlier interventions, and it is not currently on the political agenda. But it is not impossible that increasing economic difficulties will cause a gradual rethink, even among those on the political left.

I conclude by suggesting some priorities for deregulation of employment law, and a core body of regulation which could be compatible with both economic efficiency and classical liberal principles. But to move in that direction will require a change in the mindset that politicians, the media and the wider public bring to these difficult issues.

What an idealised labour market might look like

To begin the analysis, we need to think about the standard against which we might assess the current UK labour market.

Mainstream economics textbooks envisage the optimal level of employment – that which maximises well-being – as one where the wage rate paid is equal to the revenue produced by the marginal hour of work provided. What exactly does this mean? If it costs £20 to employ an extra bar worker or fruit-picker for an hour and that hour brings in £40 of additional revenue, it's worth employing them. If it brings in only £15, it's not. At £20, the Goldilocks spot, it's just right.

As for the employee, the £20 received is just sufficient to compensate for giving up an extra hour of 'leisure' (or work in the home, such as child or elder care, or digging up the garden). In a free competitive market, these two aspects of the wage are equalised, and all who want to supply work at the going rate are able to do so, while employers can obtain all the labour they want at this wage. Both parties are 'price takers' in the labour market. Profitable output is maximised and no individual or firm can be made better off without making someone, somewhere, worse off⁴.

This is a static, over-simplified picture. Labour markets never settle in one state: they are a constantly shifting kaleidoscope.

4 This is what economists dub a 'Pareto-optimal' equilibrium, named for the Italian sociologist who first explored the concept.

Patterns of demand change all the time as fads and fancies mutate; so do production possibilities as technologies change. Entrepreneurs dream up new goods and services to offer, or puzzle out cheaper ways to produce existing commodities. Meanwhile the labour force constantly reconfigures as people enter or leave paid work, acquire new skills, partner up and have children, or change their preferences between types of job and between work and leisure (or between commuting and working from home⁵).

In this dynamic context, an optimal labour market would be one that adapts instantaneously to change and moves seamlessly and costlessly from one quasi-equilibrium to another. Of course, no labour market there has ever been or ever will be can precisely match the static and dynamic conditions for optimality.

More practically, a well-functioning real-world labour market adjusts rapidly to change, reallocating people as quickly as possible if their previous employment dries up or new opportunities are presented. It may not always be painless, but a labour market that does this is going to be associated over time with increasing labour productivity, rising wages, and greater employee and consumer satisfaction.

It will also, from another angle, be consistent with classical liberal principles, being based on voluntary exchange between economic agents who can weigh up the costs and benefits of forming a contract.

5 There seems to have been a big shift in workers' attitude to homeworking since Covid, a shift that in some fields may be matched by employers' willingness to facilitate it (Aksoy et al. 2023).

Uncompetitive labour markets?

Such a well-functioning labour market depends, among other things, on a high degree of competition across the economy. But if there is insufficient competition in some product markets, dominant firms can raise prices above the cost of production and so grab higher-than-normal profits. The higher prices imply that quantity demanded, and therefore output, will be lower than under competition; this in turn can mean lower employment. The existence of 'supernormal' profits in these sectors may also mean that in some circumstances (particularly when unions are powerful) they can be shared with employees in the form of higher-than-normal wages. This produces further distortions in the jobs market. Some workers get pay which is artificially high – higher than they could obtain elsewhere – while other workers cannot obtain work in the favoured sectors and may have to accept jobs in lower-paid sectors where their skills are underemployed and undervalued.

So, a robust competition policy, subjecting mergers and takeovers to appropriate scrutiny, may be necessary – although we need to be careful that such a policy does not unintentionally protect UK businesses or retard the efficient reallocation of resources by excluding disruptors.

Another way labour markets may be distorted by powerful businesses is if these businesses possess some 'monopsonistic' power in the labour market – that is, they are the sole or dominant employers in a particular area or sector. In these circumstances, a

profit-maximising employer can hold both wages and employment below the level that would prevail under competition.

Such power may once have been exercised by companies in isolated areas where they were the only significant employer. In modern conditions such power seems unlikely – although some analysts have claimed that private-sector monopsonists are more common in the UK than you might think (Abel, Tenreyro and Thwaites 2018).

It is important to remember, though, that the public sector may have some nationwide monopsony power in fields where government is the dominant employer or funder. Doctors, for example, are primarily employed by the NHS; they are paid relatively less in the UK than in countries such as the US, where there is greater competition from the private sector⁶. The same applies to nurses, teachers, university lecturers and some research scientists.

Where there are parts of the country or sectors where there are few employment options, one response for some workers has always been to move to areas where job options are more plentiful. However, there is evidence of a fall in regional mobility over time (Lomax and Stillwell 2017; Duke-Williams, Stuckbury and Stockton 2021). There may be many reasons for this, but one is that much of the housing market is dysfunctional. If you want to move to London from, say, the North East, housing in the capital is very expensive⁷ and difficult to obtain. In some cases, you would be giving up low-cost social housing with no prospect of obtaining equivalent accommodation in London.

6 ‘The NHS as a monopsony’, *BMJ Opinion*, 20 September 2019 (<https://blogs.bmj.com/bmj/2019/09/20/jacob-wilson-the-nhs-as-a-monopsony>).

7 Median monthly private rent between September 2022 and October 2023 was £550 in the North East; in London it was £1,625 (Private rental market summary statistics in England - Office for National Statistics).

As a result, people may remain in an area where their skills are undervalued and productivity lower (Clarke 2017). Good graduates from degree courses in Sunderland or Middlesbrough may be reluctantly obliged to accept lower-skilled work or face unemployment in their home region.

Other problems of insufficient competition arise if workers themselves are organised in a way that prevents others from obtaining employment. Trade unions, by forcing up wages, may restrict employment opportunities. But high levels of unionisation in some industries and occupations enhance bargaining power and may also allow unions to control or have a veto over recruitment procedures and work allocation and delay the introduction of new equipment or technologies. Although it has fallen, there is still a 'union premium', higher pay (and/or better working conditions and contractual terms) for union members which can't be explained by relevant skills or compensating differentials⁸.

Unions use their bargaining power and the strike threat to resist organisational change, often a necessary element in boosting labour productivity⁹. Recent strikes on the railways illustrate this very clearly. Apart from pursuing a wage claim, the unions have successfully resisted changes to the long-established system of rostering, which makes weekend work dependent on volunteering; to the introduction on some services of driver-only

8 Some union members may be paid more because they are more highly skilled than non-union members, or because the job they are doing is more dangerous or involves unsocial hours. These factors would be compensated for by higher pay, even in the absence of unions, in a properly functioning labour market. But a problem arises if unions can use their bargaining power to enforce pay levels that go beyond market-determined compensation.

9 Another element in increasing productivity is investment in new equipment and related software. Disruptive industrial relations will also tend to deter such investment, or drive it away to more favourable locations.

operation; to the closure of ticket offices now so many people buy tickets online; and to track maintenance innovations that make the process less labour-intensive (and also less dangerous). Unions also typically try to maintain 'relativities' in a world where demand and supply shift frequently. The junior doctors' current demand to restore their position in the pay hierarchy to what it was fifteen or more years ago is an example.

Another way in which competition can be restricted is through occupational regulation, where, in order to enter an occupation, workers require certification and approval. In accountancy for example, this involves a privately organised system of required entry qualifications, examinations, training and regular updating. Those who acquire and maintain qualifications have an advantage over those whose book-keeping abilities are uncertificated. Organised occupational groupings thus have an incentive to raise entrance standards unnecessarily high in order to limit competition.

Government intervention in the labour market

More often than not, this occupational exclusivity is backed up by the state. In the UK today around 20% of all jobs require some form of government certification or licence: the proportion has risen sharply this century (Shackleton 2017). Some of this regulation may be necessary if consumers are less well-informed than producers and liable to exploitation or other unfortunate consequences (such as neglecting health conditions)¹⁰. However, the rapid growth of government-mandated occupational restrictions in the last twenty years (in areas as diverse as social work, private detective agencies and driving trains) may reflect pressures from unions and other interest groups that stand to gain from such regulation. One recent example is the introduction of licensing for estate agents, backed up by a system of examinations¹¹. The UK seems to be unique in Europe in requiring such licensing, which protects a group of workers at a time when artificial intelligence has the potential to simplify house sales, benefit the consumer and promote faster growth.

Occupational licensing is only one of very many ways in which government intervention can distort labour markets.

10 Although, nowadays, internet searches may enable alert consumers to judge for themselves the quality and terms of service offered by businesses and professionals.

11 'Occupational licensing of estate agents will restrict competition, and protect incumbents', *Institute for Economic Affairs*, 17 April 2018 (<https://iea.org.uk/the-extension-of-occupational-licensing-to-estate-agents-is-a-political-play/>).

Taxation

Take taxation, always at the very heart of the government's involvement in the economy. For most people, the taxes of which they are particularly conscious are income tax and national insurance. Income tax takes a slice of people's pay and opens up a gap between what employers pay and what workers receive. This gap or 'wedge' makes work at the margin less attractive and may, for some groups of workers, mean that they work fewer hours, or even stop work completely. This reduces output; in a dynamic context, gradual increases in the share of income taken in tax may be one explanation for slower growth.

Employee national insurance contributions (NICs) have the same effect. They are best considered as a variant form of income tax, but one that is not closely matched to it. Thus, we get peculiar 'steps' in the effective marginal tax rate, as national insurance bands don't match up with income tax bands.

But there is also *employer* national insurance, a payroll tax. Its effects are poorly understood by the general public, who perceive it as falling on the employer. The government, in its October 2024 budget, took advantage of this misperception to claim that, as it raised employer NICs¹², it wasn't raising taxes for employees. At one level, this is true, as employer contributions don't show up as a deduction on the employee's payslip. However, the incidence of this form of tax – who *really* pays it – is rather different.

In a competitive market, employers will aim to pay workers the value of their marginal contribution to the business, as outlined earlier. But if the employer national insurance contribution rises,

12 The budget raised the employer NIC rate from 13.8% to 15% and lowered the threshold at which employers pay contributions from £9,100 pa to £5,000 pa.

employers can't afford to pay workers as much if they are to maintain profitability. Given a competitive environment, much of the cost will therefore be passed on to the worker over time in terms of lower pay increases¹³. The Office for Budget Responsibility (2024) estimated that 76% of the cost of the increased employer NICs in Rachel Reeves' budget would be passed on to employees in the medium term in the form of lower pay than they would otherwise have received. This means that employment will be less attractive than it might have been, and some employees may choose to work fewer hours and thus output will be lower. Furthermore, to the extent that employers have to absorb some of the cost it may lead them to look for ways of reducing labour and substituting capital equipment¹⁴.

Nor is this all. Very importantly, but even less widely understood, similar analysis applies to much employment regulation which increases employer costs in just the same way as a hike in employer national insurance.

Employment mandates

There has been a steady expansion of mandated benefits in recent years, and this is one of the reasons for the slow overall rate of

13 Or perhaps through changes in other aspects of the job, such as greater pressure through increased monitoring, or removal of job 'perks' such as discounts on the firm's products. Such changes also make the job less attractive and may reduce hours of work supplied by some workers.

14 Incidentally, other taxes may similarly impact on employee pay. Corporation tax – which is formally levied on business profits – is only partly paid by shareholders. It is passed on to consumers in the form of higher prices, and to workers in terms of lower pay. Empirical studies (Felix 2007; Fuest, Peichl and Siegloch 2018) suggest that at least half of corporate taxation is effectively paid for by employees in the form of reduced wages.

growth of UK real wages – something that is rarely mentioned by politicians when they introduce their latest boondoggle.

Government employment mandates – auto-enrolment in and compulsory employer contribution to pension schemes, holiday entitlements, parental leave – act on the employer as a ‘stealth’ or disguised payroll tax. Instead of paying a tax to the Exchequer, the employer is required to provide a benefit, which has a monetary cost and therefore reduces the amount the employer can afford to pay workers. From the public’s point of view, employers appear to pay for such mandates, just as they are assumed to pay employer NICs, and the government avoids the odium that it might get if it raised taxes overtly. But this is misleading: what we need to consider is the ultimate incidence of the cost of the mandate. This cost will gradually be passed on, partly in price increases but mainly (Summers 1989; Gruber 1994) to the employee, who will again receive smaller wage increases over time than might otherwise have been the case.

It can be argued that they get a benefit in return, but mandates typically favour particular groups of workers (for instance, those with dependent children), while the reduced wages hit all workers. There is a more general point that employment ‘rights’ are unlike property rights, which can be freely traded. Nobody can sell or exchange the right to parental leave, for example, though this right is valueless to non-parents and even some families who might prefer higher pay to time off work, given their particular financial or family arrangements. Mandates can close off options to workers while benefiting some relative to others. To this extent, compulsion can weaken that ‘match’ of employment conditions to individual preferences, which is a sign of a properly working jobs market.

Think about the new government’s tightening of the reasons which employers can give for refusing a request for flexible

working. This is likely to mean that more people will be able to work from home at least part of the time – a benefit which has been estimated as the equivalent of a 4–5% increase in pay as a result of lower commuting costs and improvement in the quality of life (Aksoy et al. 2023). Yet some other workers may not be able to take advantage of this opportunity, because of the nature of their job or because their home accommodation is unsuitable for work – young people in crowded flats, for instance.

Because the mandates benefit some more than others, this ought to be reflected in changing relative wages. For example, those who cannot benefit from the option of working at home, such as bus drivers, ought to see their pay rise to compensate. But this does not happen quickly enough – particularly in public sector jobs where pay structures are rigid, largely as a result of union pressure. So, we get shortages of bus drivers and an excess supply of administrators.

Mandates can also have other unintended consequences. Take parental leave; one of the reasons why this was introduced was to maintain new mothers' links to the labour market, by giving them the security of a job to which they could return. This would, it was argued, tend to reduce the gender pay gap. Research (Thévenon & Solaz 2013; Kunze 2022) suggests, however, that prolonged leave leads to detachment from the workforce, human capital depreciation, and an *increase* in the gender pay gap.

Pay

Bear in mind that the government directly controls the pay of 6.12 million workers (January 2025) in public sector jobs. These are often organised in large blocks of disparate workers for annual pay reviews. For instance, the Agenda for Change group covers over

a million NHS workers, including nurses, midwives, paramedics, and thousands of support and administrative workers, operating in different organisations in different parts of the country – but they are effectively given the same, or very similar, pay increases. This inevitably creates imbalances as supply and demand shifts occur over time. Shortages of some types of staff, in some parts of the country, cannot easily be addressed. Discontent and poor morale may lead to high turnover or feed into industrial action. The public bears the cost in terms of delays and inconvenience.

Another block of people whose pay is set by the government are those who are on low wages in the private and voluntary sectors. At the last count¹⁵ 1.9 million were covered by the national living wage or the lower minimum rates for young people and apprentices. A substantial number of others – first-line supervisors in fast-food restaurants, for example – also have their pay effectively linked to minimum wages. Again, the system is essentially one-size-fits-all despite the variation in labour market conditions for different types of workers and in different parts of the country.

As a result, pay may become less effective as a means of allocating labour in a complex economy, of matching people to jobs which suit their interests and aptitudes. While a minimum wage provides a direct benefit to those employees covered, there can as a consequence be reductions in employment opportunities for other groups as businesses cut back on employees – particularly young workers who lack experience. This, in turn, may lead to looser engagement with the labour market over the rest of their lives¹⁶, with loss of output to the economy and slower growth. The rapid increase (16% in one year) in the minimum wage for

15 Low Pay Commission (2025) p. 40.

16 ‘Youth unemployment produces multiple scarring effects’, *LSE*, 28 July 2014 (<https://blogs.lse.ac.uk/politicsandpolicy/multiple-scarring-effects-of-youth-unemployment>).

18–20-year-old workers which the government has mandated from April is bound to have some effect on employers' willingness to hire inexperienced labour market entrants.

Looked at from a different angle, minimum wage laws limit the options for workers, who might be prepared to work for less in order to acquire valuable work or other experience. Recent interpretations of the law have, for example, restricted the availability of internships and au pair arrangements.

Another pay issue has been created by public policy focus on the gender pay gap. From 2017, large organisations (currently those employing at least 250 people) have to publish their gender pay gap each year. They also have to provide some further statistical breakdowns and their explanation of why any gap exists. They are expected to offer a narrative explaining what they are doing to reduce it. This involves a significant commitment of time and effort as organisations try to present the best possible face to government and the public¹⁷.

This exercise, based on each organisation's payroll data, is distinct from the ONS's annual publication of the cross-economy gender pay gap, which is based on the Annual Survey of Hours and Earnings. The Office for National Statistics is careful to emphasise that its indicator covers all jobs in the UK, in organisations large and small, and does *not* show the difference in pay between men and women for doing the same job. Unequal pay for the same work has been illegal since the 1970s, and employment tribunals impose compensation (which has in some cases run into seven figures) where any breach of the law is proven. As the ONS (2016) has pointed out, reflecting the consensus of academic studies, the main factors explaining why women tend to earn less than

17 The impact assessment at the time grossly underestimated the time and cost which businesses would put into this exercise.

men are the types of occupation women are in, their greater likelihood of working part-time (which is typically paid less than full-time work), and having and caring for children.

Yet there is real confusion among the public (and the media) about this, particularly when the pay gaps for each company are published. Such-and-such a company will be castigated if it has a large pay gap – usually because men and women do different jobs – and accused of paying its women employees less than men, even if no woman doing the same job as a man is being paid less.

The problem is that this may lead businesses to make decisions with an eye to their gender pay gap – and this can conceivably have unintended consequences that may be counterproductive. For example, an engineering business with few female employees may make an effort to recruit more female apprentices. But if it does so, it means initially having more poorly paid female employees and worsening its pay gap. More worryingly, a business having a large number of relatively poorly paid women in support functions may decide to outsource these functions and thus ‘improve’ its in-house pay gap.

If businesses start making employment decisions with a view to presenting better optics rather than focusing on productivity and profitability, the labour market will not work very well. Nor will it work well if potential female employees are put off applying to a particular organisation because they believe, erroneously, that the odds are stacked against them because of a large published pay gap.

A further problem arises from the expansive interpretation of equal pay legislation. The UK’s original Equal Pay Act 1970 focused on the pay of men and women doing the same work. But our entry into the European Community (later Union) led to the UK being subject to European law, which after 1975 enforced

the more ambiguous concept of ‘work to which equal value can be attributed’. Following a European Court of Justice ruling, the UK’s 1983 Equal Pay (Amendment) Regulations built this principle into English law, where it remains despite our exit from the EU. At first there were few cases brought, but in recent years there have been major legal decisions which have, or will, cost employers huge sums of money¹⁸. Most famous is the case of Birmingham City Council, where the courts ruled that thousands of female carers, cleaners and cooks should have been paid the same as male council roadworkers and bin men. Similar cases at ASDA and Next have found that largely female retail staff should be paid the same as largely male warehouse workers. The basis for these judgments is that pay differentials must in law be based on skill, effort and responsibility, ideally spelt out in an employer’s comprehensive job evaluation scheme.

This resembles the way in which pay differentials were structured in the Soviet Union and its dependencies – a system derived from Marx’s use of the Labour Theory of Value. It led predictably to shortages of workers in some areas, partially resolved by direction of labour. Thus, for example, graduates in the German Democratic Republic had no choice of their first job, to which they were allocated by the government. And workers in all jobs usually had to have permission to change their employment.

While skill, effort and responsibility will normally be taken into account by rational employers and be endorsed by most employees, economic realism suggests that other factors also play a role. Non-pay factors such as subjective assessments of the working environment, social contact, time and hours of work, job satisfaction and sense of purpose associated with particular jobs will influence potential employees. If pay cannot be allowed to vary to reflect this, there are likely to be shortages of applicants

18 As winning litigants can claim back pay for up to six years.

for some jobs and excess supplies of applicants for others which are rated the same by evaluators. The job market will not work well, and productivity will suffer. Organisations may be led into wasteful devices to get round these constraints such as the creation of unnecessary employment requirements and artificial responsibilities¹⁹ or outsourcing of difficult-to-fill jobs – devices which may lead to further legal challenges or trade union action.

Contracts and employment protection

The increasing restrictions on the way in which workers can be used and contracts formed (for example, recent restrictions on the self-employment status of gig workers such as Uber drivers, or limitations on the use of zero-hours contracts, or agency workers) also slow productivity increases. This restricts working opportunities for people, while also raising costs to the consumer.

Other restrictions on freedom of contract may also narrow choices of employment and pay opportunities. For example, the EU's Working Time Directive, which the UK was forced to adopt despite our government's vociferous opposition (and has naturally never been repealed), restricted the hours that people are allowed to work. This restriction may prevent people who are willing and able to work for long periods in unusual conditions to do so²⁰. The statutory right to paid holidays similarly prevents firms from offering, and individuals from choosing, shorter holidays and higher pay.

19 Such as the Waste Recycling and Collection Officer role which has been the central concern in the current Birmingham binsdispute.

20 However, they may take a second job, as well over a million workers currently do, thus to some extent defeating the point of the legislation.

Another issue is employment protection laws, which are intended to give workers security of employment by restricting the ability to dismiss an established worker whose post is redundant, or is perhaps not performing up to scratch. This has the effect of slowing down the exit of employees to unemployment or economic inactivity, but it also inhibits businesses from employing new workers on permanent contracts, as they are taking on a major financial (and human) commitment. Employment protection legislation is particularly strong in a number of continental European countries such as France, Spain and Italy; by contrast, the US is closer to the classical liberal concept of the 'contract at will'. Such a contract (Epstein 1984) can be ended by either party for any reason and with only the notice and compensation agreed in an individual contract: there is no legal backstop. Nowadays federal and state obligations under anti-discrimination law restrict the contract at will in some respects. But in Texas, for example, an employer can still fire an employee at any time without giving a reason, and an employee can quit without notice.

This difference between the US and many European countries has the consequence that American businesses are much quicker to shed labour in recessions. They are, though, correspondingly quicker to take workers on in upturns. The average length of periods of unemployment is thus higher in most of Europe than in the US (Young 2003; Cahuc, Malherbert and Prat 2019). In countries such as Spain this has led to a proliferation of temporary contracts²¹, which tend to be the lot of younger and less experienced workers and those from disadvantaged minorities.

21 Recent labour reforms in Spain have, however, begun to reduce the proportion of temporary contracts (<https://www.bbvaresearch.com/en/publicaciones/spain-more-permanent-contracts-in-may-and-fewer-indefinite-duration-temporary-contracts/>).

The UK's own version of employment protection – unfair dismissal legislation – has had a similar though less marked effect. In recent times, this legislation kicked in only after someone had been employed for two years. What it means is that you can be dismissed fairly for only a limited range of reasons – gross misconduct, capability issues, legal bars (such as immigration status or convictions for child abuse), clearly demonstrated redundancy (which normally involves significant compensation) or 'some other substantial reason'. In addition, there are requirements that the process of dismissal be conducted formally, with proper notice, consultation (accompanied by union officials or colleagues) and with a right of appeal. Failure to carry out this process correctly would lead to an automatic tribunal finding of unfair dismissal.

Detailed figures are not currently available since a new case management system was introduced by the Tribunals Service, but indications are that around 25,000 unfair dismissal claims are begun annually. While in only a few hundred (650 in the year April 2023–March 2024) cases do final tribunal judgments impose compensation, in many other cases businesses and other organisations will settle financially with claimants out of court. And even where claims are dropped without payment at an early stage, significant management and administrative time, and almost certainly legal costs, will be incurred.

This is compounded, however, by some employment rights now being effective immediately on employment. It may be that the growth of the gig economy, some other forms of self-employment and the use of employment agencies have been in part a reaction against this. The government is significantly increasing employment protection by making unfair dismissal rights come in from day one of employment.

Benefits

In thinking about government-induced impediments to greater employment, we cannot ignore the benefit system and the perverse incentives it can create. The UK's benefit dispensation is not particularly generous by comparison with some European countries, but it does provide a basic living standard for people who could work (and a slightly better standard for those who are unable to work because of illness or disability).

The UK's out-of-work benefits are not time-limited, unlike those in the US, which means that people can stay on them indefinitely. There is always a significant number of fraudulent claimants, including people who misrepresent their health status, work cash-in-hand while claiming benefits, or invent false identities. For the 2021–22 financial year, the Department of Work and Pensions estimated fraud overpayments at £6.5 billion²². While this may have been a particularly bad year given the government's Covid generosity, fraud has been a problem for decades.

An important feature of the welfare system is the provision of in-work benefits via Universal Credit, which means that people in employment can have their low pay topped up by the taxpayer. The problem here is that benefits have to be reduced as pay rises, and the 'taper' means that people can face a withdrawal rate that is equivalent to a steep effective marginal 'tax' rate. Rishi Sunak reduced the taper from 66% to 55% in his 2021 budget, but it is still uncomfortably high. This has been claimed to deter people working just a few hours a week from increasing their hours.

22 'Fraud and error in the benefit system financial year ending (FYE) 2022', *Department for Work & Pensions*, 26 May 2022 (<https://www.gov.uk/government/statistics/fraud-and-error-in-the-benefit-system-financial-year-2021-to-2022-estimates/fraud-and-error-in-the-benefit-system-financial-year-ending-fye-2022>).

Another problem which government may have inadvertently created is that childcare in the UK has become highly regulated (for instance in relation to staffing ratios and adherence to a tightly determined pre-school curriculum monitored by Ofsted) and thus limited in supply and very expensive in international terms²³. This means that for many mothers considering a return to work, the cost and/or availability of childcare is a deterrent (Statham, Parkes and Nanda 2022), leading significant numbers to work fewer hours than they wish, or perhaps not work at all, till their children are older²⁴.

Delay in women returning to work after childbirth, or switching to part-time work, will have lasting effects (Harkness, Borkowska and Pelikh 2019) on their labour force participation and pay, and thus on output and productivity in the economy as a whole.

Immigration

Yet another form of government involvement involves laying down immigration restrictions, an important (and controversial) issue. Previous administrations claimed that ending free mobility of labour from the EU would not restrict immigration for workers who could make a useful contribution to the economy. But setting out detailed rules about government-perceived shortage occupations and about the minimum earnings allowed to

23 Another factor is the government's 'free' childcare for 3–4-year-olds (and some 2-year-olds). This is, however, funded at rates that are insufficient to cover the costs of some providers. This leads to parents not entitled to support, and parents needing extra hours, having to subsidise government-funded provision. Where this is not possible, provision may be cut back and parents find it hard to obtain.

24 'Women in the labour market', *Centre for Progressive Policy*, 14 October 2021 (<https://www.progressive-policy.net/publications/women-in-the-labour-market-2>).

justify entry into the UK is not something governments have obvious expertise in. It restricts competition, and in practice can worsen shortages of some important groups of workers and slow economic growth.

For example, the House of Commons Environment, Food and Rural Affairs Committee reported in 2022 that the difficulties of the farming and food processing industries in recruiting staff had been exacerbated by the complicated and expensive bureaucratic procedures involved in bringing in workers from outside the UK.

This led to unharvested crops, the pointless killing of healthy pigs because of insufficient workers in meat processing, unavailability of some foodstuffs, and rising prices. The new post-Brexit immigration system allowed temporary short-term (three-year) visas for poultry workers, pork butchers and HGV drivers²⁵, but the costs and difficulties of using these routes meant that they did not have the desired effect. Whatever we think about appropriate levels of immigration, where this is allowed, employers should have a straightforward path to recruitment.

The previous government at times suggested that we should move to a high-wage economy, which would attract more British workers into difficult-to-fill jobs previously taken by EU migrants. There seems little sign of this as yet, however.

25 The shortage of HGV drivers has a number of causes, of which immigration restrictions are only one. For instance, changes to IR35 tax rules led many self-employed drivers to leave the industry.

Skills and education

One of the reasons why employers want to recruit workers from other countries is that our education system and skills training are seen as insufficiently aligned with the economy, and that the choices of individuals are distorted by government policy.

For example, the student loan system subsidises university study – by around £20 billion a year in England – which often has no necessary relevance to the jobs market. Even in areas where degrees have relevance – in law for example – it appears that there is a considerable oversupply of graduates in relation to available training places. The Office for Statistics Regulation has recently had to admit that Department for Education figures for the rate of return on higher education considerably exaggerate the benefits from degree study²⁶. Graduate unemployment in the UK is higher than average unemployment, while at any time around a third of graduates are working in jobs which do not require a degree (CIPD 2022). The HE system still prioritises full-time degree programmes, largely based away from home, while providing little help for students wishing to undertake qualifications through private study at the same time as holding down a job.

As for other forms of preparation for work, successive governments have arguably over-emphasised apprenticeships, which are not necessarily the best preparation for a rapidly changing labour market in which familiar types of job disappear and previously undreamt-of new jobs are created every day.

26 ‘Public misled on value of university, says government watchdog’, *Daily Telegraph*, 31 May 2025 (<https://www.telegraph.co.uk/news/2025/05/31/public-misled-value-university-degree-statistics-debt-loans/>).

Since 2017 an ‘apprenticeship levy’ is charged on all employers with an annual wage bill of £3 million. This is in the first instance a simple payroll tax, raising £3.84 billion in 2023–4, which like other taxes tends to be passed on in various ways. Employers paying the levy can claim funds back if they provide approved apprenticeships, but not all are able to do so, because of the nature of their businesses. Some critics claim that the process for accessing funds is too complex and inflexible: following the introduction of the levy the number of apprenticeships, rather than rising, fell sharply. It is further alleged that ‘low skill job roles that require minimal training’ have been ‘rebadged as apprenticeships’ (Powell 2024: 32), rather than new high-skill opportunities being created. Some business representatives argue that the money would be better spent on allowing businesses to reclaim for other forms of training. Others argue it should be scrapped in its entirety.

The Employment Rights Bill

Although the current government has realised that in some areas – land use planning, for example – intervention may have gone too far, this insight is not reflected in its attitude to employment regulation. They have announced several policies which will further complicate the operation of the UK labour market and could act as a brake on the economic growth which it wishes to encourage.

These policies include a large uplift in minimum wages, a substantial rise in Employers' National Insurance, and a plan (currently out for consultation) to require companies to monitor and publish their ethnic pay gap²⁷. But most of the planned new interventions are covered in the mammoth (currently 299 pages and counting) Employment Rights Bill²⁸ which is going through Parliament.

Prior to the general election, the Labour Party had made it clear that it wanted to radically alter employment law, to reverse some of the policies of successive Conservative administrations and introduce several new employee rights as part of its plan to 'make work pay'. It was not surprising, therefore, that an Employment Rights Bill was introduced to Parliament in October 2024. Some

27 A proposal which will require further resources, produce statistics which are even more problematic than organisations' gender pay gaps, and will again likely lead to businesses trying to 'game' the indicator by changing recruitment patterns for non-economic reasons. 'Mandatory ethnic pay gap reporting would be a terrible idea', *Daily Telegraph*, 28 June 2021 (<https://www.telegraph.co.uk/news/2021/06/28/mandatory-ethnic-pay-gap-reporting-would-terrible-idea/>).

28 UK Parliament (2025) *Employment Rights Bill*. Accessed: 15 June 2025 (<https://bills.parliament.uk/bills/3737>)

important components of this wide-ranging legislation are shown in Table 1, accompanied by some brief comments on their likely implications for the functioning of the UK labour market.

Table 1: Some features of the Employment Rights Bill

PROPOSAL	COMMENT
<i>Workers will have the right to take companies to court for unfair dismissal from the first day of their employment, compared with the current system where staff must be employed for at least two years before they qualify.</i>	There will probably be a short probation period to mitigate the effects of the new dispensation, but this change will still make it possible for more dismissed staff (the government’s official Impact Assessment does not attempt to estimate how many) to seek compensation through the tribunal system. This will as a minimum create extra work and expense for employers. It is also likely to make them more cautious in taking on new employees, possibly reducing opportunities for labour market entrants and encouraging the use of temporary and agency staff rather than permanent employees.
<i>Unpaid parental leave will be available from day one of starting a new job, instead of a year, while new protections will come in for pregnant women and new mothers returning to work.</i>	This will increase costs to employers, who will have to arrange cover and possibly retrain other staff. These costs are likely to fall more heavily on small and medium enterprises than on large businesses and government bureaucracies.

PROPOSAL	COMMENT
<i>'Exploitative' zero-hour contracts will be banned, meaning that those who want a fixed contract will be offered one but can remain on zero-hour contracts if they wish.</i>	Most zero-hours contract workers are part-timers, many moonlighting from full-time jobs. Some cannot commit to a fixed-hours contract, because of domestic or other commitments. Repeated offers of fixed-hours contracts, as envisaged in the bill, will be irksome to employers, who are likely to consolidate on a smaller number of contracted workers to save administrative costs. Job opportunities for others may be reduced.
<i>Statutory sick pay will be available immediately, without a waiting period, and extended to all workers regardless of income.</i>	Wider eligibility is predicted to raise annual business costs and will probably lead to higher levels of reported sickness. Costs are likely to fall more heavily on smaller businesses. Organisations may react by letting staff go if they fall ill repeatedly.

PROPOSAL	COMMENT
<i>Increased protection from sexual harassment at work.</i>	The employer is to be required to take 'all reasonable steps' to protect employees from third-party harassment, for example from customers in a bar or restaurant. Employers fear that they may be vulnerable to tribunal claims, as 'all reasonable steps' is an unclear requirement; this may lead to them having to turn away or police customers and clients to minimise risks. If extra costs are incurred, they will ultimately be passed on in terms of lower wages and/or fewer employment opportunities.
<i>'Flexible work' to be the default.</i>	The ability of employers to reject requests for flexible work (eg compressed hours, working from home, termtime only) to be reduced. This may lead to employers having to agree to arrangements which are costly and inconvenient to the business. Again, extra costs will be passed on.
<i>A new Fair Work Agency (FWA) will be established to police the changes.</i>	The FWA will be proactive in seeking out infringements of employment regulations without waiting for complaints and will encourage individual tribunal applications.

PROPOSAL	COMMENT
<p><i>New powers will be handed to unions. They will be able to enter employer premises and use a company's electronic communications to recruit members. It will be easier for unions to achieve formal recognition through the Central Arbitration Committee. Strike ballots, which will now be permitted to be held electronically, will have fewer hurdles (percentage of vote) to secure a vote for a strike. Strike mandates will be extended; no revote will be needed for a year. Union members will have to opt out of political levies rather than opt in.</i></p>	<p>This may lead to some increase in unionisation in the private sector, which has fallen to very low levels. The greater impact is likely to be in the public sector, making it easier to obtain majority votes in favour of strike action. This may lead to greater strike incidence and longer strikes, though it is possible that the increased union threat may instead lead to higher pay settlements without more strike activity.</p>
<p><i>'Fire and rehire' will be banned unless it affects the employer's ability to stay afloat.</i></p>	<p>The ability of firms in difficult financial situations to dismiss staff and rehire them on worsened terms has rarely been used, but the bill's changes may conceivably lead to some businesses closing when they could have been saved.</p>

Business groups such as the Confederation of British Industries, British Chambers of Commerce, the Institute of Directors, and the Federation of Small Businesses have all expressed concern about the effects of aspects of the bill.

As is required with new legislation, the government has produced impact assessments which are intended to spell out the costs and benefits of the proposals in the bill. These suggest that the costs to employers of these measures could be up to £5 billion in total. These are offset by measurable benefits to workers (such as an extra payment of £400 million in sickness pay), but also by much more nebulous assertions about the effects of the bill. For example, ‘Measures to improve worker wellbeing will result in happier, healthier and more productive workers, which could be worth billions of pounds a year’ and the union reforms are expected to have ‘significant benefits’ in reducing workplace conflict²⁹.

This may be wishful thinking. The various impact assessments have been widely criticised. For example, that on default flexible working: the Department for Business and Trade ignores the actual costs of changed working methods and concentrates solely on the administrative processes involved.

The high (91%) current acceptance rate of requests for flexible working is often assumed to reflect low or non-existent costs to the employer. However, this may be misleading, as it fails to account for the business costs of accommodating flexibility. Employers may often acquiesce where they feel that a rejected application could lead to an appeal followed by an employment tribunal claim – particularly where an applicant has a protected characteristic and might plausibly claim that a rejection is

29 Department for Business and Trade (2025) *Factsheet: Employment Rights Bill – Evidence and analysis*. Accessed: 15 June 2025 (<https://assets.publishing.service.gov.uk/media/67f67154b7e44efc70acc404/employment-rights-bill-analysis.pdf>)

discriminatory. In the heavily unionised public sector, employers may be particularly wary of rejecting applications. However, even if such a threat is unlikely, managers may agree simply because they don't want to damage relations with an employee, even if this creates difficulties such as extra costs involved with agreeing to a four-day week for one employee when five days need to be covered.

The Office for Budget Responsibility, though it has yet to produce its own costings, because there is insufficient detail in the government's plans, has said that it believes the new regulations are likely to have "material and probably net negative economic impacts on employment, prices and productivity"³⁰.

Meanwhile the independent Regulatory Policy Committee produced a review of the government's impact assessments in November, concluding that 8 of the 23 assessments the government produced were 'not fit for purpose'. More work was needed on the rationale for intervention, the identification of options and the 'pass-through' of employer costs to employees³¹.

30 Quoted in 'Business groups urge changes to workers' rights bill', *BBC News website*, 17 April 2025 (<https://www.bbc.co.uk/news/articles/c62xlnv1647o>).

31 See RPC Opinion (2024) *Employment Rights Bill*. Accessed 13 June 2025 (<https://assets.publishing.service.gov.uk/media/6740b7e829c74988c561aelb/>)

How does employment regulation inhibit growth?

As we have seen, there are dozens of different areas where employment law constrains businesses and employees in a bid to address perceived 'market failures' such as imperfect competition in the labour and product markets and, more generally, to pursue 'social justice', understood in redistributive terms. This is very different from a situation in the 1950s where a leading authority could write:

There is no major country in the world in which the law has played a less significant role...and in which today the law and the legal profession have less to do with labour relations. (Kahn-Freund 1954: 44).

Nobody could claim this any longer. The reach of UK employment law is all-embracing. Back in the 1950s and 1960s the consensus was that the government should stay out of the labour market, relying simply on basic contract law and allowing strong unions to negotiate with employers.

The switch to a heavily regulated labour market was at first gradual, but the last thirty-five years have seen regular extensions of government involvement. This was prompted partly by the requirements of the European Union after Tony Blair signed the UK up to the Treaty of Amsterdam, which incorporated the earlier Social Charter, but there has been much domestic innovation as well. The decline of trade union membership led to weakened unions pressing the Labour Party to pursue regulation as an alternative to using strike pressure. The Conservatives have

also often added to regulation, which became more popular as a substitute for direct social spending as fiscal difficulties grew. The belief that ‘employers pay’ for mandates, for example, is a convenient fiction which obscures from the public that we all pay for increased costs and slower growth.

One indication of the rise of employment regulation is the Heritage Foundation’s Economic Freedom Index. The labour component of this index, which includes measures of minimum wages, contract restrictions, mandated benefits and employment protection, has fallen from a high of 81% in 2006 to just 63% in 2024 – a trend that is also echoed by other indicators such as that of the Fraser Institute’s Economic Freedom of the World. We are moving further and further away from the free market ideal sketched earlier in this paper.

Critics of employment regulation have pointed to a number of ways in which it may have been implicated in the country’s poor performance in both productivity and growth.

Regulation reduces competition. By laying down rules about who is permitted to enter markets, occupational regulation – in finance, social work, teaching – reduces opportunity and innovation. Complicated legislation slows down change, as unions must be consulted on a range of issues and any alterations to working conditions or the introduction of new equipment have to be painstakingly negotiated. Regulation distorts choices, as businesses spend time and resources to get around barriers erected by government or ‘gold plate’ activities to minimise the risk that they will face a tribunal.

It involves excessive amounts of compliance and is one of the reasons for the proliferation of people with jobs which solely consist of ensuring that employees stick within rules which the government has imposed. Trainers, consultants and, above all,

the human resource profession, whose numbers rose by 42% between 2011 and 2021³², add little to output but raise costs of production.

Smaller businesses which might potentially grow to make a larger contribution to the economy are deterred from expanding by the difficulty of managing people in a rules-based environment. Large companies are deterred from investing by a regulatory framework where tribunals can interpret rules in a sense which Parliament may never have intended and employers may never have foreseen, imposing huge penalties.

32 According to the CIPD, more than 450,000 people are employed in HR professional or administrative roles. This is approximately equal to the total number of people employed as police officers, members of the armed forces, prison officers and general practitioners put together.

Reform is never easy

We can, therefore, see many factors which distort pay levels and employment patterns, reducing productivity and growth.

Many politicians also see this, but are unable or unwilling to do anything about it. Each new government adds to the pile of regulations: there have been few genuine attempts to unpick rules which add nothing useful. Reform is never going to be easy. Interest groups have grown up making it very difficult for governments to implement change. One area where this has become increasingly obvious is in planning rules. Economists have long understood that the Town and Country Planning Act, which zoned land use and led to the famous ‘green belts’ around our urban areas, has greatly restricted the development of land for housing use – and thus added to the shortage of affordable housing, which restricts labour mobility (Evans 2025).

Even where new housing has been permitted, it is only after long, complicated and expensive legal processes involving multiple opportunities for appeals by NIMBYs – local residents who object. Attempts by the last government to loosen planning rules came to an abrupt end as a result of the Conservative Party losing a by-election to the Liberal Democrats in Chesham and Amersham, a reverse thought to be attributable to opposition to these attempts. The new administration has pledged to return to the task of reform, but it faces considerable difficulties.

Local residents who stand to lose from planning reform are an archetypal concentrated interest group that finds it easier to organise than the hundreds of as-yet-unknown people who might gain from new housing and jobs in an area, and those whose

businesses might benefit. This asymmetry between gainers and losers from reform was a phenomenon documented by the American economist Mancur Olson (1965, 1982). His analysis shed light on the way in which organised interest groups such as trade unions and industrial producers had stymied Britain's development in the early post-war years. An updated analysis might focus on the 'anti-growth coalition', including public sector unions, NIMBYs, and – an important recent development – environmental protest groups.

Thinking about the labour market more particularly, incumbent businesses also form a very powerful interest group to resist reform. Given frequent business complaints about regulation, this may seem counterintuitive. But that is to confuse the difference between adding new rules and scrapping old ones: the process is asymmetrical.

Suppose that in the past employers have been obliged to provide a mandatory benefit. Firms will have adapted, incurring the cost involved and gradually passing much of it on to employees – who remain largely oblivious to this, as they will never know what they would have been paid absent the mandate. If a deregulating government now plans to scrap the obligation, incumbents face a problem.

If they stop offering the benefit, their workers will object, as they are facing a worsening of their employment conditions. There will be horrified compliance officers – part of that ever-growing human resource function – whose posts may become redundant. Meanwhile new market entrants, who have never had to internalise the costs of the mandate, will be a threat. They will have a cost advantage – and be able to pay their workers more than incumbent firms can profitably offer.

In these circumstances, incumbent firms will often oppose deregulation, inventing all manner of stories about how necessary the mandate is, how workers will lose out from scrapping it, how new entrants are 'cowboys' who will undermine standards. They will make common cause with unions, civil society groups and excitable media people. It will only be a very determined government that will be able to resist the pressure to drop the reform.

In principle there may be ways round some of these problems, by, for instance, offering groups who may lose from change a share of the gains from liberalisation. Local residents having the value of their houses threatened by new development can have their council tax reduced; employees who may lose their jobs as a result of deregulation can be given generous pay-offs. But it would be difficult and, at least in the short run, could be expensive.

Less amenable to compensation are those defenders of the status quo with a strong ideological commitment. On particular issues, there may even be a majority of the population who object to deregulation – even though it has no effect on them personally.

Perceptions of fairness are important in labour market policy generally. Those advocating reform need to persuade policymakers and the public that the optics are often misleading (eg the impression that employers pay for mandated benefits, or that a pay gap between groups of workers is necessarily evidence of discrimination) and that there are often unintended and unobserved negative consequences of policies which on the surface seem to be beneficial. This educational mission can be a difficult and thankless task.

Reform and deregulation are therefore often very difficult to achieve politically, even where we can point to clear benefits

which are likely to result – and, of course, benefits from deregulation are inevitably often speculative rather than nailed-on certainties, as they depend on how people and businesses will react to new opportunities. It is always easy for nervous governments to default to the status quo.

In what follows, I make brief suggestions about some possible reforms that might be expected to improve the performance of the labour market. Some might be acceptable even to the new government, which has so far been more interested in further regulation than deregulation. Some could be introduced quickly, although their benefits may take time to accrue. Others might take longer, and need the ground to be prepared before implementation. These examples do not, of course, exhaust the possibilities for reform.

Priorities for reform?

Economic costs spread across the economy can never be known accurately by governments³³, which makes impact assessments inevitably very sketchy. I have argued elsewhere (Shackleton 2017: 58–65) that the costs which employment regulation imposes on the economy are particularly difficult to pin down. Even the costs directly associated with legal obligations and mandated benefits – such as employing cover for staff on parental leave – will depend on the particular circumstances of businesses and will be heavier for some than for others. And the fact that costs are passed on, perhaps more than once, makes it even more difficult to assess costs. And then the impact of costs will fall differently. A business which is highly profitable will absorb an immediate rise in costs, while one which is operating at a heavy loss may just be pushed over into closure. One firm contemplating opening a new business or taking on more workers may be put off by new regulation-based costs, while another is more bullish.

If estimating the negative impact of regulation on economic activity is difficult, forming a view about the impact of deregulating is probably even more so. We may believe that lightening the regulatory burden will stimulate growth, but we can't say 'change X and Y will happen'. This may be why few politicians want to take the risk of deregulation.

33 The theoretical issue of the essentially subjective nature of costs was explored at the London School of Economics by Austrian-influenced economists many years ago. Some of the key sources are in the volume edited by Buchanan and Thirlby (1981).

We may not know what will result, but there follow some suggestions about changes which would seem likely to have a positive impact on stimulating the economy. They may not be politically feasible at the moment, but should be kept in mind. At the least, they flag up a warning not to go further down the road of government regulation in these areas.

Discrimination and equal pay

There is a classical liberal argument, again expressed by Richard Epstein (1992), that the government should not impose any restrictions on discrimination. Epstein argues for a return to common-law principles of individual autonomy and freedom of contract. He argues that the American Civil Rights Act of 1964 fundamentally changed the emphasis on the individual to an emphasis on group ‘justice’ which had perverse effects on economic efficiency, generated bureaucratic excess and ultimately failed to make people happy as it led on to claims of reverse discrimination and hostility between groups – between races and ethnic groups, between sexes, between age groups and so forth. He also, like other Chicago thinkers such as Gary Becker (1957) and Milton Friedman, tended to believe that the unpleasant effects of discrimination might be mitigated by competitive markets which offered greater opportunity to minority groups.

Despite Epstein’s logical tour de force, few economists have chosen to follow his radical approach. A more recent analysis is offered by Freeman and Morton (2025), who argue for a paring-back of discrimination law to the original ideas exemplified in the UK’s 1965 Race Relations Act which focused on direct discrimination, and a rejection of later developments, culminating in the 2010 Equality Act, which attempt social engineering to equalise pay

and other conditions for an expanding range of apparently disadvantaged people on the basis of ‘protected characteristics’.

If we took this latter line, we would see the end of pay gap monitoring by organisations, while equal pay comparisons would again be narrowed to people doing identical or very similar jobs, and would not embrace comparisons between people doing completely different jobs even though they might have been ranked as equivalent by a consultant.

It might make sense in this context to limit compensation through the tribunal system for discrimination. Currently there is no limit to what the tribunals can award, unlike compensation for unfair dismissal, where there is a cap.

Unfair dismissal

There would clearly be some advantage to employers in freeing up contracts so that it is easier to make staffing changes as needs alter, or indeed to dismiss problematic employees without the procedures which are currently required.

At the top end – with Premier League footballers or CEOs – it is possible to build into contracts ways for relationships to be severed, with appropriate compensation. But this is not so with most employees.

In principle, all employees and employers could negotiate appropriate levels of compensation themselves in a free market, with those workers seeking greater job security accepting a lower wage rate to offset the extra risk falling on the employer. However, there would be credibility issues, particularly for new employers. Moreover, the existence of a state benefit system

supporting those who lose jobs distorts choices and could lead to suboptimal levels of privately negotiated compensation.

This suggests that a complete Texas-style contract at will might be difficult to justify. Recognising that dismissal without any cause or notice at all can be very damaging to employees, we may need some form of no-fault dismissal with a guaranteed minimum level of compensation, as suggested some time ago in a report for the Cameron government (Beecroft 2011). This would give greater certainty to employers and avoid long-drawn-out and lawyer-heavy tribunal claims without seriously penalising employees.

Occupational regulation

It would be very useful to conduct a systematic review of the UK's attitude to professional qualifications and occupational exclusivity, with a view to enhanced value for money, competitiveness and the widest possible access to occupations for those with different qualifications and backgrounds. Such a review should naturally not be conducted by the regulators themselves.

UK governments in effect determine who can be everything from a social worker to a racehorse trainer, a gas engineer to a security guard, a private detective to a train driver, an estate agent to an art therapist. A galaxy of government departments, local authorities, quangos and professional associations lays down rules about such matters as academic and vocational qualifications, on-the-job training, tests of competence, continuing professional development and codes of practice.

The fundamental economic justification offered for government occupational licensing is the issue of 'asymmetric information'; an

uninformed public is said to need protection from incompetent or unscrupulous producers of goods and services.

In the past there was much greater reliance on standard cross-economy legislation covering, for example, fraud, misrepresentation and offences against the person. Otherwise, there was reliance on the principle of *caveat emptor*: the responsibility of consumers themselves to assess the reliability of suppliers, using cues such as brand names and membership of independent professional bodies. In recent decades, however, there has been much greater recourse to government mandates.

Occupational licensing continues to increase at a time when information asymmetries are being mitigated by online access to previously inaccessible knowledge, when new consumer ratings systems can quickly highlight poor or incompetent service and, importantly, when new technology is undermining the unique insights of professionals.

Even in medicine, our oldest regulated group of professions, new expert systems and artificial intelligence can diagnose many health issues faster and more reliably than humans can. This reduces the need for much of the routine work of general practitioners, radiographers and others – and offers opportunities for less qualified staff to help with patient care.

By setting very specific occupational requirements, government licensing discourages innovation and competition. It is often arbitrary – similar occupations are not regulated in the same way or at all (Shackleton 2017: 31–3). Government licensing may often reflect successful lobbying from members of an occupation or a knee-jerk response to a particular incident.

One problem with trying to keep tabs on what is happening is that licensing of different occupations comes under many

different government departments, each with their own concerns and their own lobbyists. The government could usefully take an across-the-board look at the process of creeping occupational regulation.

Occupational regulation does not seem to guarantee improvement in the quality of services (Koumenta, Pagliero and Rostam-Afschar 2019). Quality is anyway always an ambiguous concept, particularly where high costs associated with occupational exclusivity make it impossible for many people to use the service. Perhaps the services of a top KC are of a high quality, but those unable to pay for them will never know.

Licensing makes it more difficult and expensive to enter many occupations. This means that some groups which have problems financing long periods of training tend to be excluded, and thus the diversity of the occupational workforce is reduced. Older workers and labour market returners find it too difficult to retrain. Social mobility may be reduced.

For example, would-be barristers must be prepared to endure considerable financial hardship and years of dogsbody work as junior lawyers. They will already have faced an extremely competitive environment even to get a foot in the door. They will have needed a degree plus a vocational qualification, but only a third of those successful to this point get a pupillage, and there are fewer tenancies – in small and inefficient ‘chambers’ – than the numbers taken on as pupils.

This archaic training system naturally deters large numbers of potential applicants who lack the resources to finance their training or the self-confidence to handle archaic recruitment procedures. No wonder people complain about the lack of diversity in the legal profession. Just as importantly, the resulting exclusivity boosts the earnings of those who ultimately succeed

by creating an artificial scarcity – what economists call ‘rent creation’. This raises costs to consumers and taxpayers, and it can deny access to justice for many people.

It is often the case that these licensing requirements have been lobbied for by unions and professional associations as a means of reducing competition and enhancing the prestige of their members rather than the ostensible reason of protecting the public. A major study by OECD economists (Bambalaite, Nicoletti and von Rueden 2020) cites sources from many countries that occupational regulation raises prices, reduces the number of market entrants and lowers employment – while showing no clear evidence of improving perceived quality of services.

Their own empirical work using a composite measure of occupational entry regulations also suggests that productivity could be significantly enhanced in the UK and elsewhere by liberalising occupational rules. They also argue that relaxation of entry requirements would open occupations to a range of disadvantaged groups, including migrants who lack formal qualifications but possess other skills.

We could make it possible again for graduates to teach in state schools without undergoing teacher training (as is common in private schools) or for nurses to enter the profession without having to enrol for a degree, or for people to become social workers without a degree in social work or become estate agents without formal qualifications. Or we could revisit childcare rules that prevent migrants or those with poor language skills or formal qualifications from being involved.

Such changes would open up individual opportunities and make new business models possible. If the public really needs to be protected, concern could be directed towards the output of businesses and services rather than the input of particularly

qualified employees. Employers and the self-employed need to be able to determine the best way to serve the public rather than having to follow a government-dictated blueprint.

In considering post-Brexit policy towards migrants, the government could sensibly take a broadly positive and permissive attitude towards qualifications obtained abroad and resist pressure from UK professional associations and others to erect artificially high entry standards.

A minimum emphasis in a review of occupational licensing could be on those regulated professions that are not subject to licensing in most other European countries, as indicated in the European Commission's Regulated Professions database. Where continued intervention is thought to be justified, there could be a reassessment of the most appropriate form of regulation. In many cases it should be possible without safety or quality concerns to substitute registration for licensing or certification for registration. Public certification could be replaced by private accreditation.

The government should resist further attempts to regulate. Where a new problem is perceived, it could look to place more emphasis on the responsibility of the employer rather than setting up a new government regulatory body to vet individuals.

More generally, it should be recognised that free choice by consumers and experimentation by providers offer the best hope for productivity and real income gains as well as opening up opportunities for a workforce that needs access to the widest possible range of new jobs.

Education and training

We have seen that critics argue that our higher education system is turning out too many graduates, and in the wrong subjects. It is often argued that we need to direct many school leavers away from university and into more vocational courses. The assumption that we can ‘direct’ the career choices of young people – particularly in the absence of an effective pricing mechanism to encourage them – is simplistic, however.

One reason for the apparent overprovision of some university subjects is the incentives facing institutions. The system has evolved in such a way that there is no competition over the fees charged by subject. A university offering a degree in physics will have to charge the same as it charges for a sociology degree. But as the former costs much more to run than the latter, the incentive is to take in large numbers of sociology students to subsidise the physics department. This distorts the returns to degree subjects: if students were charged fees reflecting the real costs of course delivery, the returns to sociology might be higher and to physics lower.

Moreover, the pressure to recruit students to ‘cheap’ courses – the numbers of which are not capped by the government (unlike medicine, the most expensive courses to run) – leads some institutions to take on weak applicants³⁴. Such applicants are more likely to drop out or fail or do badly in degrees, and to avoid this, universities may be tempted to drop standards and create grade inflation. This can be done by such devices as substituting coursework for formal exams, altering course

34 A related problem arises from another means by which universities bolster their finances – by recruiting large numbers of overseas students, whose fees are not capped.

structures to allow students to drop difficult topics, or have only their best marks count for degree classification. This will generate apparently respectable grades, but does little to prepare students for employment. However, if graduates do badly in the labour market, this has little direct cost to the institution.

Arguably, we would get better outcomes if we could find some way of linking university funding to the success of their graduates (Ainsworth, McKenzie and Bayramoglu 2016). At the moment, universities are paid for recruiting students rather than on the outcome of their studies. Although they want their students to do well in the jobs market, they are not significantly penalised if they fail. The Office for Students (OfS) may raise the issue of an institution's poor graduate outcomes, but this is only one of a range of other factors, from widening participation to student satisfaction to curriculum content, with which the OfS is concerned and is not necessarily the priority.

Instead of the taxpayer running the risk that the student loan will not be repaid, part of that risk could be borne by the university. This might make universities think more carefully about the courses they offer, and the quality of students they admit. Once they admit students, they would be incentivised to prepare them properly for careers – and perhaps to have a continuing relationship with them, offering regular updating.

One clever suggestion is for universities to enter into income-sharing contracts with students, where, in lieu of fees, students agree to pay a proportion of their future income to their university. A more modest proposal (Ainsworth and McKenzie 2022) would allow universities to launch their own income contingent loan schemes to top up the frozen maximum tuition fees, either directly or via financial intermediaries.

Certainly, something on these lines could help to improve the responsiveness of our higher education system to market forces and better prepare students for the work environment.

Universities could improve employability by partnering with employers to generate vocational programmes, some of which might be badged as apprenticeships. However, the existing apprenticeship levy system could be scrapped. It has not achieved its aim of expanding high-level apprenticeships, and it involves a largely pointless bureaucracy to recycle money back to employers. While other areas of regulation have some keen defenders, the levy has few champions and would not be missed.

Trade unions

As I have argued elsewhere (Shackleton 2024), classical liberals do not have a fundamental problem with the existence of trade unions, though they may look askance at the privileges which the law has given to them since the Trade Disputes Act of 1906. Until recently, the Thatcher/Major reforms of the 1980s and 1990s seemed to have largely defanged the trade union movement, which has declined in numbers and relevance over many years. Recent strike outbreaks since Covid have suggested that union militancy is reviving, and this trend could be accentuated by the changes which the government is making in the Employment Rights Bill.

It is in the public sector where the problem, if it is one, lies. Most people have few alternatives to the service provided by the state in education or healthcare³⁵; they have none at all in the case of passport provision, driving licences or street cleaning – nor do

35 They should have more, but that is a question for another paper.

businesses in relation to the very many rules and permissions which allow them to function. This gives strong unions the ability to put the public through the wringer in an attempt to extort more pay from the government – which means, of course, the taxpayer. It is difficult to construct a plausible case for this type of monopoly power in a modern democratic society.

If we are going to see increased strikes and other industrial action in key parts of the public sector, perhaps at times comparable to the levels of disruption achieved in the 1970s, bans on strikes in some areas may be appropriate. Britain would not be an outlier if it moved in that direction. Strikes in health and social care, for instance, are banned in some countries. In Germany, civil servants, university staff and many teachers cannot strike. In the US no federal employee is allowed to strike. Failing this, perhaps compulsory arbitration, as practised at various times in New Zealand and Australia, could be considered. It may be thought that this type of intervention goes against the principle of deregulation, but it should be borne in mind that the ‘right to strike’ in the UK arises, as Hayek pointed out many years ago, from an interference by government. Without the immunity granted by the 1906 Act, a strike would be a breach of contract laying unions open to civil action.

A minimum level of regulation?

These suggestions cover only a limited range of issues, and still envisage a significant regulatory role for the state. But some would go further, and seek a minimalist involvement. If, by some overnight miracle or by a long process of attritional reform, we could shed most of the accretion of decades of employment regulation, what might we be left with? Is there a small core of regulation which free-market economists would regard as acceptable?

I suggest five areas where regulation of some sort is probably uncontroversial.

First, it seems acceptable to place some restrictions on the hours worked and types of job which children and young people can sign up to – though I would argue that there should be a reassessment of how much protection the law should impose. Regulation has substantially decreased the proportion of young people doing part-time jobs while still in education, because of the hoops through which employers have to jump. This is a pity, as access to ‘Saturday jobs’ has been shown to improve future employment prospects (Conlon, Patrignani and Mantovani 2015).

Second, there may need to be some limits on hours worked in areas such as transport and healthcare, where excessive hours may impose risks to the public. This may be a particular problem where, as in the UK, there may be little choice between providers. In principle, tort law could provide some protection to the public by making healthcare providers and transport operators liable

to being sued for damages, though legal processes are costly and subject to long delays.

Third, employment contracts of whatever form need to be enforceable cheaply and effectively. Where employees face substantial costs in, for example, recovering unpaid wages, there arguably needs to be an affordable and rapid mechanism to resolve disputes.

Fourth, recognising that dismissal without any cause or notice at all can be very damaging to employees, we may need some form of no-fault dismissal with a minimum level of compensation, as suggested above.

Fifth, and most controversially, it is difficult in today's climate, to argue that there should not be some form of anti-discrimination legislation, despite its often perverse effects. But this should be much more tightly drawn, minimise the subjectivity of discrimination offences, and have limits on compensation which can be claimed.

Even these requirements may be too much for the most austere of classical liberals. However, compared with the current level of employment regulation, they would imply a very much more extensive degree of economic freedom than we have experienced in this country for many years. An economy with only limited constraints on employment contracts would almost certainly be one where productivity, output and living standards would grow more rapidly. But, as pointed out earlier, this would require a fundamental change in the mindset of politicians and the electorate. That will take some time.

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