# The Labour Market and Employment Relations Beyond the Recession

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## Editors Foreword

The Warwick Papers in Industrial Relations series publishes the work of members of the Industrial Relations Research Unit (IRRU) and people associated with it. Papers may be of topical interest or require presentation outside of the normal conventions of a journal article. A formal editorial process ensures that standards of quality and objectivity are maintained.

This paper publishes the text of the ninth Warwick-Acas Lowry Lecture, given to an invited audience in March 2010 by Richard Lambert, Director-General of the Confederation of British Industry and Chancellor of the University of Warwick.

The annual lecture is organised in honour of Sir Pat Lowry. A former chair of Acas, Sir Pat was for many years an Honorary Professor at the University of Warwick, a long-standing member of the Business School's Advisory Board, and a source of valued counsel to IRRU in its work. His outstanding contribution to the practice of industrial relations commenced when he joined the EEF in 1938. He went on to become the Federation's Director of Industrial Relations. He left in 1970 to join British Leyland as Director of Industrial Relations. In 1981, Sir Pat was appointed as Chair of Acas. He stepped down six years later with Acas' reputation for impartial and constructive advice enhanced, in the face of an often turbulent industrial relations landscape.

2010 marks the 40th anniversary of the establishment of IRRU. We were delighted that the University's Chancellor agreed to deliver the Lowry Lecture in this milestone year. The public policy agenda has changed considerably since 1970, but the need for independent, critically informed research on developments in employment relations remains vital. These include the crisis-induced innovations in employment practice highlighted by Richard Lambert in his lecture, which are the subject of current IRRU research.

The 2010 lecture addressed an appropriately recurrent theme; the impact of economic recession on employment relations across the economy. Several features distinguish this most recent recession from others that preceded it, notably the specific origins in financial crisis and the speed with which their ramifications ranged across the globe. But, the lecture argued, these features alone cannot explain the distinctively cautious response of most British employers, which have contributed to better employment retention than might have been expected. The lecture explored deep underlying changes in the labour market, in the regulatory environment, and in relations within companies to further understand these features, but warned of significant challenges ahead.

Trevor Colling and Paul Marginson

Good afternoon, today I am going to talk about the labour market beyond the recession and I want to start by addressing the question of why employment in the past two years has not fallen in the way so many people expected, given the steep drop in output that we have experienced. I will also talk about the development of what I consider to be a new employment relationship in the private sector over the past twenty years.

My central argument will be that two things can explain the employment resilience we have seen: first, structural changes in the labour market since the 1990s recession and, second, the development of a new kind of relationship between employer and employee. I will argue that these changes have been happening gradually over the past twenty years. This recession has been the first test of the new model – and although there are some big challenges to come, the results, at least so far, seem rather good.

But first let me thank Acas and the Warwick Business School's Industrial Relations Research Unit for inviting me to be here today. It is a great honour to speaking at the unit on its 40th anniversary. And it's a particular pleasure to be honouring the memory of Sir Pat Lowry, a great figure in the post-war history of industrial relations in the UK.

I was a boy reporter on the Financial Times (FT) in the 1970s when his work at British Leyland and later at Acas made him a household name. I was much too junior to meet him, but his reputation for decency and integrity was very well known in a world where there were not a lot of those qualities to spare.

One sign of how far things have changed since then, in part no doubt thanks to his influence, is that back in those early days the FT had – if my memory is right - six full time labour reporters and a whole labour page each day, dedicated to covering strikes and union politics.

And again if my reading of the bye-lines is right, the FT's last full time labour reporter has just recently retired. There's a whiff of cordite in the labour market air today, so let us hope the editor has got his timing right.

**Features of Current Recession**

We seem today to be emerging at last from what has been the steepest recession since the war. It has been a time of unprecedented disaster in the banking industry and of a steep collapse in business and consumer confidence. In response, businesses have been cutting back their investment in stock and working capital at the fastest rate in recorded history and investment in plant and equipment has also nose-dived.

It seemed a fair bet that the labour market was also going to take a savage blow. The Confederation of British Industry's (CBI) own forecast was for unemployment to peak this year at above three million and then to decline only slowly. Others, like former Monetary Policy Committee member Danny Blanchflower, were much, much more gloomy even than that. Indeed it has been a tough and worrying time for many people both in and out of work. But with unemployment today at 2.45m, the numbers are nothing like as bad as we had feared.

Output has fallen by 6.2 per cent since the start of the recession, but employment is down by just under 2 per cent. Compare that to past experience. In the early 1990s, a fall of 2.5 per cent in gross domestic product led to a fall of 3.4 per cent in employment. In the early 1980s, Gross Domestic Product (GDP) declined by 4.7 per cent, leaving employment 2.4 per cent lower.

Of course it may not be over yet but conditions in the labour market have been fairly stable since the Autumn. Employment has continued to decline but firms are not laying off full-time employees at the rate they were last year and our CBI surveys suggest that moderate rates of employment growth are possible later this year.

Most people who have become unemployed have moved back into work fairly quickly. More than 4.6 million people have moved off Jobseekers Allowance since November 2008, and the number of people claiming Incapacity and Lone Parent Benefits has remained broadly constant despite the recession. By contrast, between 1990 and 1995, the number of people claiming these benefits rose by around 1 million.

For what it is worth, the Treasury in last week's Budget assumed that the claimant count would peak at just under 1.75 million around the middle of this year, and fall back to around 1.25m by the end of 2012.

So what's going on here? It is true that the figures have been flattered somewhat by the continuing rise in public sector employment. Excluding the nationalised banks, the numbers now stand at around 5.9 million, compared with fewer than 5.2 million when the Labour Government took office. The numbers have also been helped by a rise in part time workers, including a good few who would be in a full time job if they could find one.

Other favourable influences include the fact that business insolvency rates have been running at a much lower level than in the early 1990s. And the Government itself has played an important part, with a stream of initiatives like the Young Person's Guarantee and the work being done at Jobcentre Plus.

But there is much more to the story than that. The big picture explanation is that aspects of 'employment' other than the headline numbers have been taking much of the strain of the fall in output. And this has helped to preserve jobs. Put simply, firms have reduced labour costs this time round in very different ways from those they used in previous recessions.

I think there are three main differences. First, employers have been much more reluctant to lay-off people than was the case in the past. Although they have been cutting costs wherever they can, many have decided to retain more people than they currently have a need for, even though that has temporarily pushed productivity down and unit costs up.

In our surveys on responses to the recession, businesses told us they were trying to minimise the loss of permanent staff by implementing freezes in recruitment. In the spring of 2009, nearly two thirds had recruitment standstills in operation. By last autumn, over a third of businesses were still not taking on new recruits.

Combined with other initiatives such as giving volunteers unpaid leave and short time working, this allowed firms to preserve the available work for their employees, reducing the flows into unemployment.

**Changes in the Labour Market**

What are the possible explanations for this greater reluctance to reach for the axe? One answer is that since the early 1990s, the proportion of UK working age employees who have been through higher education has risen from around a fifth to a third. The change is particularly marked in the manufacturing sector, where most of the million or more jobs that have disappeared over the past decade or so have been among the less skilled process workers.

Skilled staff are harder and more expensive to hire and to lay off than others, and plenty of companies were complaining of skills shortages before the recession hit. Certainly this is a reason quite a few firms have given me for their efforts to preserve the headcount over the past 18 months.

A second big change is that wages have been much more flexible than in past downturns. In the recession of the early 1980s, real hourly wages rose by 2.7 per cent. In the 1990s, the figure was 7.3 per cent. With labour costs rising at this kind of pace at a time when companies had no pricing power, large waves of redundancies were just about inevitable.

In this recession, by contrast, real hourly wages rose by just 0.1 per cent. Our latest survey found that almost half of employers were planning to freeze pay at their next review. In many cases, this followed on from a pay freeze in the previous year too. Companies surveyed by the Bank of England Agents recently forecast that wage growth in 2010 would be at least as low as was the case in 2009.

This restraint has also helped firms to preserve jobs. I can think of two possible explanations. One is the sheer scale and pace of the shock that hit the global economy in the final quarter of 2008, following the collapse of Lehman Brothers. This was not a long, slow attrition in which it took people a long time to realise that their world had changed. Rather, it was an express lift going rapidly down, with demand for just about everything suddenly falling by as much as a third. It was clear in a matter of weeks that labour costs would have to be curtailed, either by shorter hours or wage sacrifice, or by job losses. With conditions now stabilising, it may become harder for firms to persuade employees that times are still very tough and that restraint is still the order of the day.

The other explanation for pay restraint is that inflation expectations and inflation itself are both dramatically lower than they were during the previous two recessions. So there is much less pressure for compensating wage increases. And it was the sharp fall in the pace of inflation during the early 1990s that explained the big rise in real wages during that recession, since wages took longer to adjust to the new environment than prices.

So what else has changed in the labour market over the past 20 years? Let me just say a few words about the way the legal and regulatory framework for employment has developed since the watershed election of 1997. It is clear that employers were deeply apprehensive about New Labour’s plans. And we have certainly not welcomed every initiative.

But through a process of consultation it has proved possible to shape a workable regulatory system that has enabled us to retain the key elements of a flexible labour market. For example, the concept of a right to request flexible working has both ensured employees have a clear legal right to make their needs known, but also recognised that businesses have their own needs. Solutions have emerged in workplaces that simply could not be laid down by government diktat. And so far, at least, the Low Pay Commission has arrived at conclusions about the minimum wage that have been broadly acceptable to employer and employee. That is because it has been trusted as an independent arbiter, and it is vitally important for that independence to be retained.

Other structural changes in the labour market have also contributed to today's relative stability. Research shows that since the mid 1990s, the broad relationship GDP and employment levels, average hours and real wages appears to have changed. From 1975-1993 changes in GDP were closely correlated to changes in employment but since then, things have been different. When the economy grows, businesses are now more likely to change hours and wages than employment numbers. This suggests that the trends that we have seen throughout this recession are in fact a continuation of a bigger, structural change in the way our labour market works.

Could this be in part a result of globalization? The global labour market has roughly quadrupled in size over the past 20 years, and communications technology has made it possible to locate production wherever in the world it can be done most effectively. It would be surprising if this had not had some impact on the way firms manage their headcount through the economic cycle.

But other structural changes are also in play: hiring and firing costs have increased relative to the costs of adjusting hours and pay. This has provided incentives for employers to seek flexibility through other routes than changing headcount.

Contrary to the notion that the UK's flexibility is built on the low cost of firing people, CBI has argued that labour market flexibility is a much wider concept. It describes how well the labour market overall responds to changing economic conditions. It means having a workforce with skills that are relevant and transferable from job to job, and flexibility within employment through flexible working patterns.

But of course, the ease with which companies can adjust the size of their workforce is also important. Redundancy is not a cheap or easy option. Our research at the CBI shows that the cost of the average redundancy payment is around £12,000. To put this into perspective, this is more than six months' pay on the median wage – six months in which a company receives no output for the money it spends. That is a significant cost in any circumstances, let alone in a credit-constrained recession when conserving cash is business priority number one. And redundancies always bring with them costs in terms of public reputation, no matter how sensitively they are handled.

The other side of the coin is that it is now more expensive to hire new workers. As I have said, the UK workforce is now more skilled and more specialist, and it costs more to find the individual with the specific skills you're looking for than one with more generic competencies.

In effect we are left with a fairly simple equation. An increase in the costs of hiring and firing equates to a natural reluctance to lose employees unless you have no other choice. We saw this quite dramatically at the start of 2009 in the automotive sector. The major manufacturers in the UK engaged in short-time working schemes to push down labour costs as demand and financing collapsed. However, in my travels around the country I have seen for myself that the sacrifices made by both employers and employees at the time have allowed the skilled workforces in the sector to go back to work.

By using the downtime to engage in extra training, for instance, Nissan has developed the skills of their workforce even further. We've now had the excellent news that the company plan to build a new generation of electric cars in the North East, securing jobs in the area for years to come. If more of the skills in the sector had been lost to redundancy, it is hard to imagine this would have been the case.

**A New Employment Relationship**

So, at the macro-level, the labour market today and the behaviour of the actors in it look a lot different from the 1980s and 1990s. But labour market changes are only part of the story. I will now touch on what I consider the second reason for employment resilience – the development of a new employment relationship.

This new relationship has not emerged purely because of the recession. It has been developing gradually over the last 20 years. This recession is simply the first real test of the new model and it is making the changes more obvious to us.

I want to focus on two features of this change: changes in business profiles and changes in the nature of employee engagement.

*Changes in Business Profiles*

The profiles of businesses in terms of their workforces are perpetually changing. A century ago, manual jobs made up three quarters of the workforce, while managerial and professional posts accounted for just 7.5%. Even in 1971, over half of all jobs were manual ones.

Since then, the movement towards more highly skilled work has greatly accelerated. Research by the UK Commission for Employment and Skills shows that – in the 20-year period 1987 to 2007 – the number of managers and number of professionals increased by 1.6 million in each group. In the same time period the number of people in administrative and secretarial roles has fallen by nearly 300,000, there are two thirds of a million fewer machine and transport operatives, and there has been a similar fall in skilled tradesmen.

The current state of play was summed up by Sandy Leitch in his 2006 review of skills when he said:

> "Most occupations already require greater levels of skills than in the past. Skills that were once seen as specialist and technical, such as in ICT, have increasingly become core requirements for most jobs."

Given these trends, it should be no surprise that businesses in this recession are more willing to accept temporary periods of lower productivity to retain skills.

The profiles of businesses have also changed markedly in terms of how people work. I am sure there are many here today who will recall those debates in the 1980s about whether firms were moving to core and periphery models of workforce structure, with all the flexibility happening outside the firm's own permanent employees.

It does not seem to me to have turned out that way. The really rapid growth in flexibility in employment over the last 20 years has been among permanent employees. This is perhaps the most fundamental change we have seen in business profiles. There hasn't been the surge in temporary workers and self-employment that some commentators expected.

When the CBI conducted its first employment trends survey in 1998, only around half of employers operated flexible working practices of any type. In our latest survey, this figure stands at 93%. The single biggest area of growth has been in teleworking or working from home. Back in 2004 just 11% of employers said they made use of this flexibility. It is now 66%.

Take BT, where about 9,000 workers regularly work from home. That's about 10% of its workforce. At BT the option to work at home is part of wider flexible working policy, with compressed hours, job-sharing and annual hours also on offer to employees. Some 70,000 currently make use of at least one of these options. Even the opportunity to work from home brings flexibility. Employees have two homeworking options: first, *occasional*, whereby staff spend some time working from home and the rest in a company building or that of the customer or second, *home-based working*, where people primarily work from home.

The origin of BT's homeworking policy chimes with the experience of many other businesses I talk to. It lies in the rapid advances in recent years in information and communication technology, which have made new ways of working possible. Importantly, it was also driven by the customer. As BT's customers demanded a 24-hour service, the standard nine to five working day very quickly became outdated. Flexibility was therefore not a nice-to-have but a business necessity. Nevertheless, the real take-off had to wait until the 1990s. In 1986 BT had only 400 home workers, compared with the current 9,000.

I think this is really important in helping us understand the current employment numbers. In 1990 flexibility in the employment relationship just wasn't a feature on anything like the scale it is today.

*Changes in the Nature of Employee Engagement*

This brings me to the second feature of the new employment relationship: the role of employee engagement. When the MacLeod report was published last year, the single most striking feature to my mind was the scale of the consensus on the importance of employee engagement for businesses.

I know that there are some people, perhaps some in this audience, who question how engaged employees have been in decisions that have been taken in businesses through the recession. I know that there are also those who think that the decline of trade unions and collective bargaining in the private sector means that employee voice is fading away.

So let me be clear, in the private sector today, union membership stands at just 15.5%. For most employees in the private sector, having a say in what happens at work does not mean turning to a trade union representative. Instead, we have seen a huge expansion in direct methods of employee voice. Through non-union employee councils, focus groups, the widespread use of employee opinion surveys and other mechanisms, that voice is coming through loud and clear. And it matters to employers.

There is a growing body of academic material on non-union employee voice. Some of it may well have been written by some of you here today. For me, one of the few good news stories to emerge from this grim recession is this. Over the past decade or so, most managers have become a great deal better at explaining in detail the business conditions that are shaping the workplace. Employees have a much better understanding than they did in the past about the opportunities and challenges that are facing their business. There is a greater degree of trust, and of willingness to accept short-term sacrifices in return for longer-term prosperity. And trade unions have played a constructive part in making all this possible.

Of course there are exceptions. The current British Airways dispute is an obvious example, and of course it is a serious one. But if, like me, you can recall the FT's labour page in Pat Lowry's day, you would have a very different perspective of where we are today.

**Concluding Remarks**

Let me sum up what I think this all means. I have tried to explain why employment has been more resilient in this recession than has previously been the case. There are good reasons for this. In particular, the combination of structural labour market change and the development of a new model of employment and engagement has been important in increasing workplace flexibility in the UK. This benefits businesses and employees.

I think this new model is here to stay and it is certainly key to the economic outlook over the near term. Lower than expected unemployment costs have already helped the Government to manage its dire fiscal position. And a greater sense of stability in the jobs market will support consumer and business confidence, and thus the pace of economic recovery.

But there are challenges to come. Challenge number one is that companies have been hoarding labour over the past year, in order to be able to take advantage of the upturn when it comes. But if demand in the economy does not start to pick up soon, we could see another wave of redundancies.

Challenge number two: I have argued that the UK has been successful in stemming flows into unemployment. But there is more to do to increase flows back into employment. Two groups are of particular concern: the young unemployed and the long-term unemployed.

For young people, unemployment is particularly damaging. Research by the Organisation for Economic Co-Operation and Development (OECD) shows that young people's labour market outcomes are far more sensitive to the economic climate than older workers. This reflects their relative lack of skills and workplace experience. A period of unemployment in youth predicts poorer returns later in life.

Recent research for the Department for Children, Schools and Families shows that each young person who is a so-called NEET[1] costs the public an estimated £97,000 on average over a lifetime. We cannot afford a lost generation of young people to be the legacy of this recession.

The consequences of prolonged unemployment are also well-known. The resulting hardship, adverse impact on family and social life, and effects on physical and mental health have been well documented down the years. Critically, long-term unemployment erodes skills, particularly the employability skills that are essential for gaining a job and performing well in it. The longer someone remains unemployed, the greater the risk they will lose any effective contact with the job market.

The issue here is not just about employment policy: it reaches much more broadly into the workings of our social and education system. Put briefly, there is a high correlation in this country between skills and employment prospects. Individuals in the lowest education category face a three times higher unemployment and inactivity rate and half the job finding rate of those with the highest education levels.

And at the same time, there is also a high correlation between deprivation and the level of skills in our country. Nine out of 10 school students with two or more A levels can get to university, irrespective of their social and economic background. But way over half the children taking GCSEs in England and Wales every year fail to do well enough to move on to higher education. And that cohort is heavily skewed to the poorest parts of the country. That is why it seems to me that improvements in education opportunities for the poorer communities are an essential step to a more prosperous and fairer society, where job prospects are not so heavily determined by where your parents came from.

This brings me on to my third and final challenge: the need for restructuring in the public sector. It is clear that after the election, whoever wins, there is going to have to be a major rebalancing of public finances – and that has huge implications for all sections of the public sector workforce. If the essential reductions in public spending are not to mean big cuts in public services, we will need to re-engineer how we deliver those services on an unprecedented scale. And the challenge will be all the greater as – on the employee relations side – practices in the public sector have not changed at the pace they have in the market

[1] Not in education, employment or training

sector. Whether we are looking at collective bargaining practices, trade union membership or communication arrangements, our public services tend to look much more like the past than the future.

Let me give just one example illustrating the scale of the challenge. Figures from the CIPD seem to show public sector managers still shy away from tough action to improve employee performance. The public sector averages just 1 formal disciplinary case per 364 employees each year compared with 1 per 119 employees among private sector service employers. And when they do take action, it takes nearly twice as long to bring the matter to a conclusion. It simply defies belief that standards of conduct and performance are so much better in the public sector.

The simple fact is we're going to have to see a transformation of employment relations in the public sector in short order and it is unlikely to be a comfortable or trouble-free process. In the decade leading up to the recession, growth in our economy was driven by government and household consumption, both fuelled by debt, and by unsustainable expansion in the financial services sector. That game is over. There is a high probability that employment numbers in the public sector, which represent nearly a quarter of the workforce, will start to decline in the years ahead. Business investment and trade must expand to take up the slack. It happened after the recession in the early 1990s, when private sector job creation more than offset job losses in the public sector. The challenge is bigger this time, because we have a bigger mountain to climb. But wherever we come from, we all have an enormous interest in straining every sinew to make this adjustment possible, and to support the kind of economic and social stability that our country requires.

Thank you.