



Perspectives by Ruth Lea

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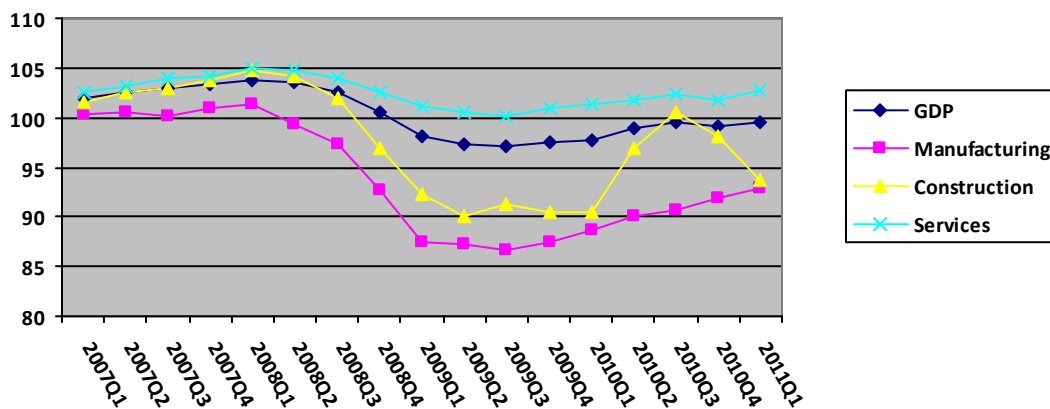


Disappointing GDP growth: all the more need for radical growth policies

Introduction: the economy is marking time

The preliminary estimate for GDP for 2011Q1 showed a modest 0.5% increase after 2010Q4's fall of 0.5%, suggesting that the economy has not grown at all since the third quarter of last year. Even though services industries (76% of GDP) bounced back rising 0.9% in the quarter and manufacturing (13% of GDP) was up 1.1%, the construction industry (6% of GDP) fell back by 4.7%. Of course the data may be revised, but the overall picture suggests a weak recovery. GDP has still 4% below its recent peak in 2008Q1, as shown in chart 1.

Chart 1: GDP, components, 2006=100, volume data



Sources: ONS, "GDP, preliminary estimate", 2011Q1, 27 April 2011

Moreover, the 0.5% increase for 2011Q1 is significantly lower than the OBR's March forecast, which suggested a 0.8% rebound in the quarter.¹ Unless the economy starts picking up momentum, the OBR's forecast for 2011's annual growth, just 1.7%, could be substantially undershot.

Monetary Policy Committee: 5 May 2011

As we have written on previous occasions,² the Bank is caught between Scylla and Charybdis. It is caught between a weak real economy, on the one hand, and above-target inflation and the possibility of losing its anti-inflationary credibility, on the other. Our central view remains that the Bank should start ticking-up interest rates fairly soon, providing the economic recovery looks secure. But on recent GDP data this is uncertain and we would not raise rates yet. Moreover, we do not expect the MPC will increase rates this week. April's MPC minutes were quite dovish.³ The first rise could now come in the third quarter (August, when the second quarter GDP figure is due?) with another before the end of the year. Thus our revised overall forecast for the Bank Rate is:

- 2011Q2: no change
- 2011Q3: increase from 0.5% to 0.75%.
- 2011Q4: increase from 0.75% to 1.0%.
- 2012Q2: increase from 1.0% to 1.5%.
- 2012Q4: increase from 1.5% to 2.0%.

“The Plan for Growth”: the regulatory burden.

The disappointing GDP figures really do underline the need for radical growth policies, as we have discussed in earlier Perspectives.^{4,5} More specifically there is a need for tough supply-side reforms in order to reverse the competitiveness lost since 1997. Of course, supply-side reforms do not act as an immediate “magic bullet”, they take time to “work” as was clearly the case in the 1980s. But they still need to be implemented if they are to ever work at all.

The Government certainly acknowledges the problem of lost competitiveness and, in particular, the horrendous regulatory burden on businesses, especially for small businesses.⁶ In their *Plan for Growth*⁷ they write:

- “Internationally the UK is facing an increasingly poor perception of its regulatory environment, with possible impacts on inward investment. The WEF ranks the UK as 89th out of 139 countries in terms of business perceptions of the burden of regulation.”⁸
- “In recent years, on average, more than 6 new regulations were introduced every working day. There are currently over 21,000 regulations and statutory instruments on the statute books. Estimates put the cumulative cost to business of regulations introduced since 1998 at nearly £90bn a year (sic).⁹ There is a £1bn burden for business from complying with employment law alone”.

Interestingly the WEF report showed that the UK’s perceived performance vis-à-vis the burden of regulation was quite one of the worst perceived aspects of the UK economy. The WEF survey showed that Britain’s “black spots” were (out of 139 countries ranked):

- Soundness of banks (133rd)
- Government budget balance (117th)
- Government debt (108th)
- National savings rate (107th)
- Business costs of terrorism (99th)
- Extent and effect of taxation (95th)
- Burden of government regulation (89th)
- Wastefulness of government spending (77th)
- Ease of access to loans (74th)

The Government have already acted to help businesses with the regulatory burden and will enact further measures. (See table 1, in the annex.) And they have said their “plan for growth” will be operative throughout the lifetime of this Parliament. In other words, more will be done. But the challenge they face if they are to seriously tackle the increased regulatory burden since 1998 is daunting, not least of all in the field of employment law. There are 2 main reasons for this:

- Many of the regulations are EU-sourced, so short of leaving the EU little can be done about them. This does not just apply to the regulations already implemented, such as the hugely costly Working Time Directive, but also to regulations in the pipeline including the almost-as-costly Agency Workers Regulations which come into effect in October 2011. The Government has estimated that the Agency Workers Regulations will cost British business £1.9bn a year, which makes the £350m of savings from policy reversals announced in the March Budget look rather inadequate. Note too that there are proposed amendments to the Pregnant Workers Directive that would cost employers an extra £2bn a year. (See table 1, in the annex.) The EU-sourced regulations are discussed further below.
- UK-sourced changes are still being introduced. (See table 2, in the annex for changes to employment regulations.) For example, the default retirement age (DRA) is being phased

out, despite the fact that it complies with EU law.¹⁰ In addition, Deputy Prime Minister Nick Clegg announced in January 2011 an overhaul of parental rights from 2015, that would almost certainly impose additional administrative costs on employers.¹¹

The Government will therefore find it very difficult (if not impossible) to take the radical decisions required to restore Britain's regulatory competitiveness, which it concedes is a major problem, unless there is a change in the mind-set towards the EU and/or employee rights, for example. And the boost to economic growth that could be triggered by restoring regulatory competitiveness is therefore highly unlikely to happen.

The economic significance of EU-sourced regulations

The numbers of British regulations that are EU-sourced is a contentious issue. Indeed, as we show below, it is not so much the numbers of British regulations in themselves that are EU-sourced that is important, as their economic significance. In this Perspective we will discuss just two heavily researched and credible reports which tackle the issue.

The first is by the House of Commons Library, which used statistics from the UK law and the EU's *EUR-Lex* databases to estimate the proportion of UK laws based on EU laws.¹² The main conclusions of the report included:

- Over the 12-year period (1997-2009) they estimated that 6.8% of primary legislation (Statutes) and 14.1% of secondary legislation (Statutory Instruments) had a role in implementing EU obligations.
- The degree of involvement varied from passing reference to explicit implementation.
- Sectoral studies suggested that agriculture formed the highest area of EU influence and defence the lowest.
- The researchers pointed out that the raw figures didn't, however, give an insight into relative importance or salience of EU or national legislative acts. The UK's *European Communities (Finance) Act 2001* to adopt the Council Decision on the EU's system of "own resources" was more significant in terms of its impact than, for example, the *Olympic Symbol etc (Protection) Act 1995*.
- Crucially, they also pointed out that the raw figures didn't give information on how EU laws affected the daily lives of citizens or businesses. The Working Time Directive was "arguably" (their word) of far greater significance to the working population of the Member States than, for example, the Commission Regulation on "the classification of padded waistcoats in the Combined Nomenclature".

In order to give an idea of the importance of EU-sourced legislation on the economy and business the House of Commons report quoted 2 statements by Lord Triesman (made in 2006), when an FCO Minister:

- In a reply to Lord Stevens (June 2006), who had asked how much UK legislation had its origins in EU legislation, Lord Triesman estimated "that around half of all UK legislation with an impact on business, charities and the voluntary sector stems from legislation agreed by Ministers in Brussels".
- In January 2006, in the light of a claim by the German Federal Department of Justice that an estimated 80% (sic) of German laws or regulations from 1998 to 2006 originated in the EU, Lord Triesman, replied "many EU regulations have a purely technical or temporary effect. We estimate that around 50% of UK legislation with a significant economic impact has its origins in EU legislation. OECD analysis of regulation in Europe yields similar results. In 2002, they estimated that 40% of all new UK regulations with a significant impact on business were derived from Community legislation. Despite reports that 80% of German regulation emanates from the EU, the German Government estimates that the proportion is about 50%".

And, as the final conclusion, the House of Commons Library stated that "the British Government estimates that around 50% of UK legislation with a significant economic impact originates from EU legislation" – to repeat one of the Lord Triesman's points.

Open Europe's research

The second report is by the think tank Open Europe. Its latest publication on the costs of EU legislation was released in June 2010.^{13,14,15}

Based on over 2,300 of the Government's own impact assessments,^{16,17} Open Europe found that regulation introduced between 1998 and 2009 had cost the UK economy a cumulative £176bn by 2009. Of this amount, £124bn (71%) had its origin in EU legislation. Open Europe made 2 other general points:

- Whilst the UK Government and the EU had taken positive steps to make the laws they pass less burdensome, the cost of regulation to the private and public sector went up every year.
- Since the UK Government launched its "Better Regulation Agenda" (2005), the annual cost of regulation had doubled. This was in no small part due to a failure to stem the flow of new, costly EU regulations.

Charts 2a and 2b show the breakdown of the costs by policy area and department. Chart 2a clearly shows that EU employment regulations were the most expensive, accounting for 22% of total costs (nearly £39bn), followed by environmental regulations and then legislation in the area of Justice and Home Affairs. Incidentally, in a separate release Open Europe estimated that just two pieces of EU employment legislation will cost £32.8bn (the Working Time Regulations) and £15.6bn (the Agency Workers Regulations) between 2010 and 2020.¹⁸ Chart 2b shows that the most affected departments were BIS (unsurprisingly), DfT, MOJ, DCLG, DEFRA and HMT.

Chart 2a Cost of regulation introduced 1998-2009 by policy area, % of total costs

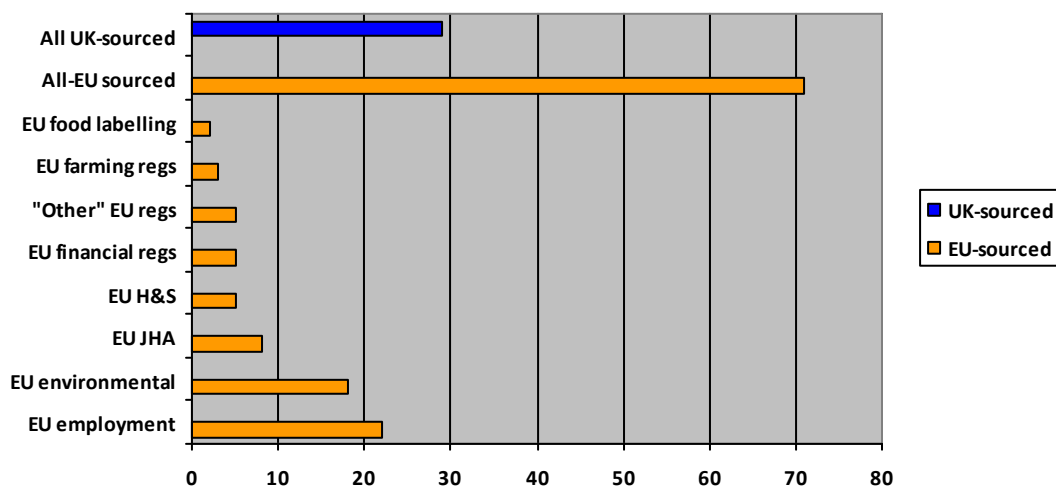
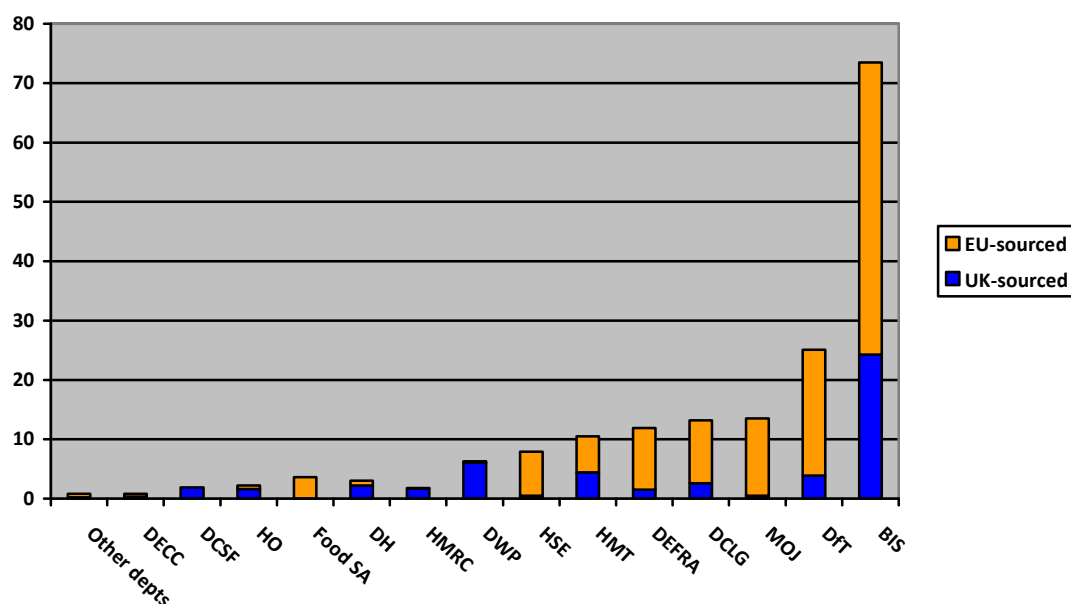


Chart 2b Departmental break-down, cumulative cost of regulation introduced 1998-2009, £bn (2009 prices)



Source: Open Europe, “Still out of control? Measuring eleven years of EU regulation”, June 2010. H&S=Health and Safety; JHA=Justice & Home Affairs; DCSF= Department of Children, Schools & Families (now Department of Education); Food SA=Food Standards Agency; HSE=Health & Safety Executive; MOJ=Ministry of Justice.

Open Europe made 2 other observations:

- They acknowledged, of course, that regulations have benefits as well as costs. (The costs are of course borne by business and the public sector whilst the benefits are enjoyed by the wider “society”.) They compared the benefit/cost ratios of EU-sourced regulations with UK-sourced ones concluding that there were “more bangs for your buck” (the author’s words not Open Europe’s) from the UK-sourced than the EU-sourced regulations. The benefit/cost ratios were 1.02 for EU-sourced and 2.35 for UK-sourced regulations. So for every £1 of costs the EU regulations delivered £1.02 of benefits, coming dangerously close to failing the overall cost-benefit test, whilst the UK-source regulations delivered £2.35. This suggests that it is far more cost effective to regulate at national level.
- They claimed that there was a lack of evidence for the widespread application of “gold-plating” of EU Directives. Indeed, they commented, “the ECJ and the Commission continue to take measures against the UK for under-implementing EU laws”.

Comparing Lord Triesman’s figures with Open Europe’s

Lord Triesman’s figures and Open Europe’s figures do not measure quite the same things:

- Lord Triesman said that 50% of laws (presumably referring to the number rather than the costs) impacting on “business, charities and the voluntary sector” (or had a “significant economic impact”) were attributable to the EU.
- Open Europe’s calculated that 71% of all the costs of regulations (introduced 1998-2009) were attributable to the EU. But these costs also include those borne by the public sector.

In conclusion, as a rough-and-ready “rule of thumb” Lord Triesman’s 50% seems quite reasonable, if arguably on the low side. And it has the benefit of coming from an FCO Minister. By any standards this is extraordinarily important. It means that the British Government can effectively do nothing about half the legislation affecting business and the economy, even on its own estimates, whilst the UK remains a member of the EU.

References

1. OBR, *Economic and fiscal outlook*, March 2011, Cm8036.
2. Ruth Lea, "The MPC and the Budget: marking time", Arbuthnot Banking Group, 4 April 2011.
3. Bank of England, "Minutes of the Monetary Policy Committee meeting, 6-7 April 2001", 20 April 2011.
4. Ruth Lea, "Britain needs a radical pro-growth strategy", Arbuthnot Banking Group, 7 February 2011.
5. Ruth Lea, "The Coalition Government's approach to reducing the regulatory burden", Arbuthnot Banking Group, 21 February 2011.
6. We will not deal with sector specific regulations, for example the financial sector, in this Perspective.
7. HM Treasury & BIS, *The Plan for Growth*, March 2011
8. WEF, *The Global Competitiveness Report 2010-2011*, 2010, is discussed in Ruth Lea, "Britain needs a radical pro-growth strategy", Arbuthnot Banking Group, 7 February 2011.
9. BCC, "The Burdens Barometer, 2010", May 2010.
10. National Council for Voluntary Organisations, "Default retirement age over 65 deemed lawful", 6 October 2009.
11. KEA Human Resources, "Flexible maternity and paternity to be introduced by 2015", 22 January 2011, www.kea-hr.co.uk
12. House of Commons Library, "How much legislation comes from Europe?", Research Paper 10/62, October 2010.
13. Open Europe, "EU regulation has cost the UK £124 billion since 1998, 71% of the total cost", press release, 30 March 2010, www.openeurope.org.uk
14. Mats Persson, Stephen Booth and Sarah Gaskell, "Still out of control? Measuring eleven years of EU regulation", 2nd edition, June 2010, Open Europe.
15. Mats Persson, Stephen Booth and Sarah Gaskell, "Out of Control? Measuring a decade of EU regulation", February 2009, Open Europe, was the previous year's version.
16. An Impact Assessment (IA) assesses the various costs and benefits of a regulation. They are designed to provide ministers and policymakers with evidence on the economic, social and environmental impact of a regulatory proposal, and assist them in selecting the most cost-effective policy option. IAs often, but not always, quantify the costs and benefits in monetary terms.
17. There are different types of regulatory costs: (a) administrative costs, incurred by companies from providing information to a third party, such as the Government or shareholders, or complying with administrative tasks such as record-keeping or invoicing; (b) policy costs, those incurred through meeting the aims of the regulations, such as installing new computer software to facilitate information sharing; (c) financial costs, arising from a direct transfer of money to the Government or other relevant authority, because of a tax or levy, for example regulations increasing NICs; (d) wider effects, costs not directly imposed by a regulation, but caused by its knock-on effects in the wider economy, for example regulations making it more difficult to sell real estate could lead to stagnation in the housing market (these costs are rarely quantified in IAs).
18. Open Europe, "Top 100 EU regulations to cost UK economy £184bn by 2020", press release, 21 December 2009.

Annex

Table 1 *The Plan for Growth*: selected regulatory measures

<p>What the Government has already done</p>	<ul style="list-style-type: none"> • Stemmed the flow of new regulation by introducing the “One-in-One-out” system & guidance on sun-setting clauses to ensure that regulation is kept up to date. And taking steps to avoid “gold-plating” of EU regulations. • Launched an Employer’s Charter • Scrapped Home Information Packs
	<p>Consulted on revised employment tribunal procedures, the introduction of fees and increasing the qualification period for unfair dismissal for 2 years (January 2011, “Resolving workplace disputes - public consultation”, closed April 2011). The Government sought views on measures to:</p> <ul style="list-style-type: none"> • Achieve more early resolution of workplace disputes so that parties can resolve their own problems, in a way that is fair and equitable for both sides, without having to go to an employment tribunal. • Ensure that, where parties do need to come to an employment tribunal, the process is as swift, user-friendly and effective as possible. • Help businesses and social enterprises feel more confident about hiring people.
<p>What the Government will do now</p>	<p>Introduce a moratorium exempting micro-businesses & start-ups from new domestic regulation for 3 years from 1 April 2011</p>
	<p>Drop existing proposals for specific regulations which would have cost business over £350m a year to implement. This includes:</p> <ul style="list-style-type: none"> • Not extending the right to request time to train to businesses with less than 250 employees, planned for April 2011. • Not bringing forward the dual discrimination rules (Equalities Act 2010). • Repealing the right to request flexible working to parents of 17-year olds, planned for April 2011. • Consulting to remove the unworkable requirement in the Equality Act for businesses to take reasonable steps to prevent persistent harassment of their staff by 3rd parties.
	<p>Launch a public thematic review to reduce the stock of regulation.</p>
	<p>Make further changes to employment legislation to reduce the costs to businesses of compliance</p>
	<p>Implement the proposals from Lord Young’s review of Health & Safety (HM Government, “Common sense, common safety”, Young report, October 2010), which followed a Whitehall-wide review of the operation of health and safety laws and the growth of the compensation culture.</p>
	<p>Plans to move registration of the main business taxes online</p>
	<p>Launch a major drive to revise burdensome EU regulations & directives:</p> <ul style="list-style-type: none"> • EU-sourced trade regulation, the Commission should launch a targeted simplification programme. • Proposed amendments to the Pregnant Workers Directive (1992), which would give 20 weeks maternity leave & 2 weeks paternity leave (in principle on full pay), would cost UK business in excess of an extra £2bn a year, with most of

	<p>the benefits going to the highest paid women.</p> <ul style="list-style-type: none"> • Clinical Trials Directive, the Government will seek to minimise the regulatory burdens. • Information & Consultation of Employees Directive, the Government will negotiate to avoid any costly revisions.
	Work with major companies to improve European growth opportunities for UK businesses
	Push the EU Commission to deliver a culture change that bears down on the overall impact of EU legislation.
	Improve online Business Link guidance on regulation
	Publish Enforcement White Paper (May 2011), to improve enforcement of regulations.

Sources: HM Treasury, *Budget 2011*, March 2011, HC836; HM Treasury & BIS, *The Plan for Growth*, March 2011, and additional (author's) notes.

Table 2 Changes in employment legislation: April-October 2011

Date	Policy
April 2011	<p>Fathers can claim up to 26 weeks additional paternity leave under new Additional Paternity Leave and Pay (APL&P) arrangements. Additional Paternity Leave is for a maximum of 26 weeks. If your partner has returned to work, the leave can be taken between 20 weeks and one year after your child is born or placed for adoption. You may be entitled to receive Additional Statutory Paternity Pay during your partner's Statutory Maternity Pay, Maternity Allowance or Adoption Pay period.</p> <p>The new right is granted to fathers of children due on or after 3 April 2011. The extra leave is in addition to the current two weeks' paternity leave entitlement. Policy changes are under the Work and Families Act 2006.</p>
April 2011	<p>Single Equality Duty for public bodies came into force, replacing the current separate duties for race, disability and gender, and including other grounds such as sexual orientation and religious belief. Policy changes are under the Equality Act 2010.</p>
April-October 2011	<p>The Default Retirement Age (DRA) is being phased out:</p> <ul style="list-style-type: none"> • From 6 April 2011, employers will not be able to issue any notifications for compulsory retirement using the DRA procedure. • Between 6 April and 1 October 2011, only people who were notified before 6 April, and whose retirement date is before 1 October can be compulsorily retired using the DRA. • After 1 October 2011, employers will not be able to use the DRA to compulsorily retire employees. • Although the Government is removing the DRA, it will still be possible for individual employers to operate a compulsory retirement age, provided that they can objectively justify it. Examples could include air traffic controllers and police officers.
October 2011	<p>The NMW rates are reviewed each year by the Low Pay Commission and from 1 October 2011:</p> <ul style="list-style-type: none"> • The main hourly rate for workers aged 21 and over will increase to £6.08 (from £5.93). • The 18-20 rate will increase to £4.98 (from £4.92). • The 16-17 rate for workers above school leaving age but under 18 will increase to £3.68 (from £3.64). • The apprentice rate, for apprentices under 19 or 19 or over and in

	the first year of their apprenticeship will increase to £2.60 (from £2.50).
October 2011	The Agency Workers Regulations 2010 will give agency workers the same basic employment conditions as permanent employees after just 12 weeks on an assignment. This will relate to pay, holidays and other conditions of employment. The Government estimates that it will cost employers £1.9bn each year.

Sources: websites including BIS's website, www.bis.gov.uk

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