

# just deserts?

poverty and income inequality:  
can workplace democracy  
make a difference?

By David Coats



Webb Memorial Trust

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## Foreword

Paul Hackett, Director of the Smith Institute, and Richard Rawes, Chair of the Webb Memorial Trust

This most timely report provides an important analysis of deep-rooted problems in the UK's labour market. It presents an insightful critique of how workplace democracy, in its different forms, can help tackle the rising levels of in-work poverty and income inequality. Having reviewed the case for workforce involvement, the report offers a compelling argument for change and makes a number of practical recommendations to government, employers, employees and their representatives.

Workplace democracy is not a panacea for the problems of low pay and poverty, but – as the evidence gathered in this report demonstrates – it can make a significant contribution to solving the problem. Indeed, as the report shows, the institutions and policies to support workplace democracy and tackle low pay that are commonplace in western Europe (and were once present in the UK) are now notable for their absence. The report does not argue for a return to the corporatist policies of the past or pretend that remedying the power imbalance in the workplace will be easy or free of conflict. Rather, it calls for more “inclusive” labour market policies, with stronger measures to promote workplace democracy (such as corporate governance reform), fair wages in the public-sector supply chain and skill-building programmes for the unemployed. Furthermore, the policies for tackling low pay and in-work poverty are presented as an integrated package and considered as part of the agenda for a more efficient and responsible form of capitalism.

Much of the narrative in this report is influenced by the work of Beatrice and Sydney Webb, who were pioneers in exploring the links between the activities of trade unions and the incidence of poverty. Although the world has changed dramatically since their time, the arguments for social partnership and fairness at work remain just as valid today.

We would like to thank David Coats, the report's author, for his sterling work, as well as John Monks and the other members of the advisory committee for all their patience and advice. We also offer a special thanks to all the interviewees and experts who contributed to the project.

Finally, we hope that the report will appeal to a wide audience and begin the process of persuading those not yet persuaded that promoting workplace democracy and social partnership are essential if the UK is to become a fairer and more prosperous society.



# Executive summary

## Executive summary

### Workplace democracy and the structure of the UK's labour market

- Profound structural weaknesses in the UK labour market have led to rising income inequality, the growth of in-work poverty and stagnant wages.
- Living standards for those with incomes below the median have been squeezed since 2004. A major reason for this is low wage growth. Rising in-work poverty is responsible for increases in the payment of tax credits and in-work benefits to low-paid workers.
- The UK also has low levels of employee participation and low rates of unionisation in the private sector. Forms of workplace democracy (from worker representation at board level to trade unions, collective bargaining, and "fair-wages" policies) either have never existed in the UK or have diminished in importance.
- The evidence presented in this report demonstrates the relationship between workplace democracy and incomes. It shows how the erosion of institutions in the labour market that seek to achieve a fairer initial distribution of incomes (instruments of "pre-distribution") have contributed to the rising tide of low pay, in-work poverty and income inequality.

### What do we mean by workplace democracy?

This report explores the following institutions of workplace democracy:

- worker representation at board level;
- works councils on the continental European model;
- trade unions and collective bargaining;
- co-operatives and mutuals;
- employee share ownership and "shared capitalism";
- individual employee involvement; and
- other policies that influence the initial distribution of incomes (like minimum wages, labour clauses in public contracts and "auxiliary" legislation to promote collective bargaining).

### Policy recommendations

After discussing the different models of workplace democracy and their effects

on in-work poverty and income inequality, the report makes the following recommendations:

### **Workers on the board**

- A Corporate Governance Commission must be established as a matter of urgency after the 2015 general election to make recommendations for the reform of company law, with the specific aim of establishing a stakeholder model of governance in the UK, either using the existing unitary board structure or the two-tier structure that is well established in Germany. The commission should be required to complete its work within 18 months so that legislation can reach the statute book before the 2020 general election.
- Swifter action should be taken in the field of executive pay and remuneration in listed companies, with new requirements imposed on corporations to achieve a higher level of transparency by publishing the following in their annual reports:
  - the ratio of the pay of the highest earner to that of the lowest earners in the organisation;
  - the number and percentage of employees paid at the national minimum wage;
  - the number and percentage of employees paid less than the living wage; and
  - the distribution of pay across the whole workforce, broken down by grade, gender and pay level.
- Board-level representation can be effective only if there is a robust structure for employee participation at all levels of the organisation. Works councils, collective bargaining and workers on the board are mutually reinforcing processes. Extending worker participation in strategic decision making must go hand in hand with an effort to rebuild institutions for participation in the workplace (see chapter 6).

### **Reform of the Information and Consultation of Employees Regulations**

- Major reform of the Information and Consultation of Employees Regulations 2004 (ICE) (which allow employees to establish structures through which they must be informed and consulted by their employer) could help promote workplace democracy and potentially begin to reduce the incidence of low pay. There



is some evidence from Germany to show that works councils act as a limited sword-of-justice.

- Significant reforms will be needed if the ICE Regulations are to be an effective vehicle for the extension of workplace democracy. Among the changes that should be considered are:
  - Trade unions should have rights to initiate the process of information and consultation (I&C), leading to the election of workers' representatives by the whole workforce, whether they are trade union members or not.
  - The trigger requirement that 10% of the workforce must support the request for information and consultation should be repealed and replaced by a requirement that there be some organised expression of the desire for representation. The German works council system offers an instructive example; the request for a works council can be activated with the support of five employees.
  - The "default" provisions of the 2004 regulations should become the minimum standard for all I&C arrangements. Consideration should be given to implementing a more extensive range of rights to information and consultation, learning from good practice elsewhere in the EU.
  - The provisions on pre-existing agreements should be amended so that only an agreement consistent with the default provisions can be sufficient to deflect a further request for I&C.
  - It should not be possible for direct participation to be a substitute for the representative participation envisaged by the EU directive on information and consultation.

### **Trade unions and collective bargaining**

- Of all the institutions of workplace democracy, the evidence for a positive impact on reducing in-work poverty and income inequality is most robustly established in relation to trade unions and collective bargaining.
- There is strong evidence to show that trade unions have an egalitarian effect and worker voice institutions can be good for business too. The unions' sword-of-justice effect in the UK has been blunted as a result of falling trade union membership. There is evidence that the union wage premium (the pay advantage for organised over unorganised workers) is decreasing too.

- Trade union membership has been under pressure throughout the developed world no matter what the dispensation of public policy. The report argues that repealing the anti-union laws would make little difference to the prospects for union growth.
- On the other hand, there is a compelling argument to suggest that action by government to extend the coverage of collective agreements can sustain the legitimacy of collective bargaining in otherwise adverse conditions. The statutory extension of collective agreements and the application of "fair wages" policies (particularly the implementation of a new fair-wages resolution) would be more beneficial to trade unions in the UK than a straightforward repeal of the industrial action and balloting legislation from the 1979-97 period.

### **Fair-wages policies**

- Government should commit to the reintroduction of fair-wages policies in public procurement. The fair-wages model, establishing either negotiated or going rates as the benchmark pay rates in the public-sector supply chain, was effective both in fixing a wage floor in public procurement and in extending the coverage of collective bargaining.
- ILO Convention No 94, which provides for employment/pay clauses in public contracts, should be re-ratified, with a view to establishing a wage floor either on the basis of collective agreements (where they exist) or with reference to the "going rate" in that industry. This will prevent undercutting and limit the scope for a race to the bottom in terms of pay and conditions in the public-sector supply chain.

### **The living wage**

- The "living wage" has a positive impact on the earnings of low-paid workers, although its coverage remains limited (especially in the private sector). There is potential to extend the living wage through fair-wages policies – it could, for example, be used as the reference wage in public procurement if there is either no relevant collective agreement in operation or if "going rates" are lower.
- Making the national minimum wage (NMW) the living wage has been suggested by some commentators. This would be a mistake; it would require the dismantling of the Low Pay Commission (leaving employers and trade unions

without a voice in the process) and could lead to job losses in some low-wage industries.

### **The Low Pay Commission**

- The remit of the Low Pay Commission (LPC) should be revised so that it has direct responsibility for the development of an overall strategy to tackle low pay – it needs to investigate the causes, consequences and cures.
- The LPC should be responsible for formulating some general principles of "affordability", which can be applied to identify appropriate pay rates in low-wage sectors where employers can potentially pay more than the national minimum wage.
- Government should sponsor a dialogue between unions and employers in low-wage industries at sectoral level, initially focused on skills and productivity, but eventually making recommendations about minimum rates of pay once the system has matured, using the LPC's affordability model.

# Terms of reference

## Terms of reference

The Smith Institute, supported by the Webb Memorial Trust, initiated this project in early 2012. It forms part of the institute's on-going research into wage inequality and the Webb Memorial Trust's overarching work on the legacy of the Webbs, how to obtain the good society without poverty, and what needs to be done to achieve it. The project also follows on from the two bodies' previous joint successful 2012 publication, *From the Poor Law to Welfare to Work*,<sup>1</sup> which among other things highlighted the growth of in-work poverty.

This project set out to examine the relationships between workplace democracy, in-work poverty and low pay. It also explores the way in which the so-called "institutions of pre-distribution" can reduce the incidence of in-work poverty and help narrow the wage divide. Regard has also been paid to the debate about the relationship between workplace democracy, higher pay and productivity.

Workplace democracy is broadly defined in the report as the policies and institutions that seek to give real meaning to the notion of industrial citizenship – that people at work are able to shape the conditions of their employment both individually and collectively, and to influence (but not determine) the critical decisions taken by employers affecting the nature and quality of working life – as well as the rewards available to people at work. It includes trade unions and collective bargaining, worker representation at board level, employee information and consultation models founded on statutory rights, contract compliance requirements on fair pay in the public-sector supply chain, co-operatives and mutuals, employee share ownership or "shared capitalism", and individual employee involvement and employee engagement.

The inquiry has considered the implications of a continuing shift in the balance of power towards employers; explored the role the state and public agencies can play in tackling in-work poverty; examined the links between wage bargaining, productivity and in-work poverty; assessed whether the revival of trade unions is a feasible proposition; and looked at alternative options for strengthening workplace democracy.

The work has been informed by:

- an extensive desk review of relevant data and research;

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<sup>1</sup> Coats, D et al *From the Poor Law to Welfare to Work: What Have We Learned from a Century of Anti-poverty Policies?* (Smith Institute, 2012)

- a call for evidence based around a consultation document setting out a wide range of questions relevant to the subject of the inquiry;
- two high-level roundtable discussions focused on the role and effectiveness of workplace institutions in reducing in-work poverty;
- a series of interviews with relevant stakeholders to assess the validity of the core argument and consider the development of a practical policy agenda; and
- an advisory (peer review) committee.

The research is largely UK based, but particular reference has been made to the emerging discussion about pre-distribution in the USA;<sup>2</sup> works councils and co-determination in continental Europe, and the "inclusive labour markets" of the Nordic countries; the "varieties of capitalism" literature; and the role of mutuals, co-ops and employee ownership – drawing on the experience at Mondragon and elsewhere.

The work was informed by an expert advisory panel led by Lord John Monks. Other members were: Baroness Ruth Lister, Nita Clarke (director of the Involvement & Participation Association), Alex Bryson (research director of the National Institute of Economic & Social Research), Nicola Smith (head of the Economic & Social Affairs Department at the TUC), Mike Emmott (advisor on employee relations at the Chartered Institute of Personnel & Development), and Ed Sweeney (chair of ACAS).

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2 Hacker, JS *The Institutional Foundations of Middle-class Democracy* (Policy Network, 2011)



# Introduction



## Introduction

### Summary

- The UK labour market has three profound structural weaknesses: stagnant earnings growth, rising levels of in-work poverty, and severe income inequality.
- Considerably better social outcomes were achieved in the post-war period as a result of:
  - full employment;
  - the development of a redistributive welfare state; and
  - institutions in the labour market that achieved a reasonably fair initial distribution of incomes (what is now known as pre-distribution).
- The period 1997-2010 witnessed the rebuilding of the first two pillars but little was done, beyond the introduction of the national minimum wage, to rebuild the third. This helps to explain why the Labour government's child-poverty reduction targets were not met; the state had to work too hard to compensate for original market inequalities and the tax credits policy was reaching the limits of its effectiveness.
- The purpose of this discussion is to examine the role of the institutions of workplace democracy as instruments of pre-distribution that might reduce in-work poverty and income inequality. The institutions under discussion include: worker representation on the boards of listed companies; collective bargaining as conventionally conceived; workplace information and consultation bodies, generally described as works councils in continental Europe; and alternative ownership models like co-operatives and mutuals.
- The enterprise is not entirely unproblematic, and proving direct causal links is difficult. There is strong evidence to show that trade unions have a generally egalitarian effect and that the worker voice institutions can be good for business too. This view is generally resisted, however, by the representative organisations of British business.
- The case for workplace democracy is supported by robust arguments of principle. Human beings are ends in themselves and not simply instruments to be deployed to achieve an employer's objectives. The values that we uphold as

a society are not sacrificed when we cross our employer's threshold. In other words, critical decisions affecting working life should be subject to the tests of justification (they have been explained) and legitimation (they have been made following due process, with an opportunity for employees to express their views).

- These principles are reflected in the Universal Declaration of Human Rights, which protects the rights to organise and bargain collectively, as well as the core conventions of the International Labour Organisation and the European Convention on Human Rights. They all reflect the fact that work is a fully human activity and that workers cannot simply be treated as "human resources".
- The employment relationship is characterised by an imbalance of power between employee and employer unless compensatory action is taken. Moreover, complex societies are characterised by a high level of pluralism (people have different aspirations and beliefs), and conflict can be managed effectively only through processes of dialogue and negotiation. These principles apply at work too. As Joseph Stiglitz has observed, "economic democracy is... an essential part of a democratic society".

There are three problems deeply embedded in the structure of the British labour market to which public policy must respond: first, the continued growth of income inequality, a phenomenon that first emerged in the 1980s; second, the growth of in-work poverty, which began in the late 1990s; third, stagnant wage growth (since 2004) for all those below median earnings level.

This has not always been the case, with lower rates of poverty and inequality recorded in the past. Elsewhere, many western European countries continue to achieve lower poverty rates and a more egalitarian distribution of incomes despite the supposed pressures of "globalisation" and "skill-biased technical change".

In Britain, the social achievement of the post-war period (1945-79) rested on three pillars. First, the commitment to full employment. Second, the development and maintenance of a generally redistributive welfare state. Third, the presence of institutions in the labour market that delivered a fairer distribution of incomes *before* the intervention of the tax and benefits system – what we now call pre-distribution. Relatively high levels of union membership, the widespread observance of collective agreements, action by the state to extend these agreements to non-signatory

employers,<sup>3</sup> the application of "fair wages" policies in public procurement and the fixing of sectoral minimum wage rates by the wages councils all helped to sustain this third pillar.

The Thatcher and Major governments adopted a very different approach and saw each of the three pillars as in some way flawed or responsible for the UK's economic problems. This change in policy was most obviously manifested in the government's willingness to tolerate a high level of unemployment. Moreover, the welfare state became less generous, with reductions in the real value of the basic state pension and benefits for the unemployed. Yet despite these policy shifts, the real revolution was the erosion of the institutions of pre-distribution.

From 1997 to 2010 Labour was largely successful in restoring full employment and did much to refurbish the welfare state, but beyond the introduction of the national minimum wage, little was done to reshape the initial distribution of incomes in the labour market.

This helps to explain, for example, why the tax credits policy was reaching the limits of its effectiveness as an instrument for the reduction of child poverty. According to the most recent statistics, more than 60% of poor children live in families where at least one adult is in work. Most of the present increase in the housing benefit bill is accounted for by the rising number of claims from working people with low incomes. And the imbalance of power in the labour market explains why workers (with little voice or influence over employer decisions) have seen wages stagnate at the same time as productivity is rising.

There is much that the UK can learn from countries with more "inclusive" employment regimes, most notably the Nordics and to a lesser extent the Netherlands. In each of these cases a coherent set of policies and institutions all pull in the same direction. The initial skills formation system gives young people a strong sense of occupational identity before they enter the world of work – and the education-to-work transition is seen as a critical event affecting sustained labour market participation. An emerging system of genuine lifelong learning equips workers with the capabilities they need to respond to structural and technological change, also creating opportunities for progression and development. A serious effort is made *inside* the workplace to eliminate inequality and occupational segregation. And active labour market programmes are focused on building the skills of the unemployed instead of just encouraging (or compelling)

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<sup>3</sup> Those employers in the industry who were not involved in the negotiation of the original agreement but who are made subject to its terms using some statutory or unilateral arbitration mechanism

people to look for work. All these measures are reinforced by strong and responsible trade unions, a balance of power between workers and their employers, and real possibilities for workplace participation. This notion of the "employment regime" is a very useful analytical tool in understanding the differences between countries, and it is used throughout this volume to shape an ambitious policy agenda for the future.

To be fully persuasive, a new labour market model must make a link between the politics of production and the politics of distribution. The case for responsible capitalism and the argument for active industrial policy must run in harness with the argument for inclusive labour markets.

Translating this analysis into practical policies will prove controversial because it raises questions about power and authority in the workplace. Some employers (although by no means all) may prove resistant to persuasion. What makes the current situation different is the unavoidable reality of the economic and financial crisis. The legitimacy of British capitalism is being challenged, and most of the business community seem stuck defending a discredited status quo.

Given the "crisis of capitalism", falling real wages, rising in-work poverty and widening income inequality, the focus of this report is on the third pillar of the post-war settlement: pre-distribution. We want to explore what has happened to the labour market institutions that used to achieve a more egalitarian distribution of incomes and develop proposals for the construction of new arrangements that can achieve similar results in the future. More specifically, our attention is directed towards workplace democracy, which for these purposes is defined as the policies and institutions that seek to give real meaning to the notion of industrial citizenship. In other words, people at work should be able to shape the conditions of their employment both individually and collectively and influence (but not determine) the critical decisions taken by employers affecting the nature and quality of working life. Moreover, workers must, through collective bargaining or some other machinery, help to determine their own remuneration.

### **What is pre-distribution?**

*When we think of government's effects on inequality, we think of redistribution – government taxes and transfers that take from some and give to others. Yet many of the most important changes have been in what might be called "pre-distribution" – the way in which the market distributes its rewards in the first place. Policies governing financial markets, the rights of unions and the pay of top executives have all shifted in favour of those at the top, especially the financial and non-financial executives*

*who make up about six in ten of the richest 0.1 % of Americans. The moral of this story is that progressive reformers need to focus on market reforms that encourage a more equal distribution of economic power and rewards even before government collects taxes or pays out benefits. This is not just because pre-distribution is where the action is. It is also because excessive reliance on redistribution fosters backlash, making taxes more salient and feeding into the conservative critique that government simply meddles with "natural" market rewards. Further, it is because societies in which market inequality is high are, ironically, ones where creating common support for government action is often most difficult. The regulation of markets to limit extremes and give the middle class more voice is hardly easy – witness the fight over financial reform in the United States. But it is both more popular and more effective than after-the-fact mopping up.*

– Jacob Hacker<sup>4</sup>

For the purposes of this inquiry we propose to consider a continuum of possibilities, from German-style co-determination (with workers on the board, works councils and sectoral collective bargaining), through various forms of employee ownership, to collective bargaining as conventionally understood in the British context, to the range of initiatives associated with "employee engagement" and individual employee involvement. For convenience the possibilities might be described as follows:

- worker representation at board level;
- a "strong" information and consultation model, with effective legal rights for workers' representatives elected on a universal franchise;
- national collective bargaining at the level of the sector and widespread coverage of collective agreements – often through processes of statutory extension;<sup>5</sup>
- a framework of national collective bargaining supplemented by variations at the firm level and strong workplace union organisation (in other words, a strong shop stewards structure);
- a "weak" information and consultation model on a voluntary basis with modest legal guarantees for workers' representatives;
- co-operative and mutual forms of employee ownership;
- employee share-ownership schemes and "shared capitalism";

<sup>4</sup> Hacker, op cit

<sup>5</sup> As we shall see, many continental European countries use the power of the state to extend collective agreements to non-signatory employers operating in the same industry or sector. Analogous arrangements existed in the UK, most recently in schedule 11 of the Employment Protection Act 1975. These provisions were repealed in the Employment Act 1980 as part of the programme of labour market deregulation. Along with the rescission of the Fair Wages Resolution (of which more later), this demonstrated the Conservative government's abandonment of the principle that collective bargaining was a collective good for both employers and employees.

- individual employee involvement and initiatives to promote "employee engagement".

These various options are not mutually exclusive. For example, national bargaining can co-exist with workers on the board and a strong information and consultation model – all of these elements are present in the German system and the institutions have the effect of reinforcing each other. Equally, national collective bargaining can co-exist with either strong or weak workplace organisation. Moreover, works councils can sometimes be a more effective guarantee of *workplace* democracy than the existence of a collective agreement – as is probably the case in France, where trade union membership is very low. The UK's experience points in the same direction: when national bargaining was terminated in the engineering industry, many small and medium-sized firms fell out of collective bargaining coverage; there was little resistance from the workforce largely because union workplace organisation was relatively weak. We might also observe that high union membership in some parts of the economy can quite happily sit alongside low membership and weak organisation elsewhere, as is the case in the UK's public and private sectors. One can see therefore that the description of the various options as points on a continuum may be a necessary device for the development of the discussion but carries the risk of some distortion or the oversimplification of a complex reality.

It should be clear that we have adopted a broad definition of workplace democracy, not least because the opportunities for immediate and direct participation in workplace decisions will be influenced (if not determined) by the wider institutional context. Representation at board level is about the company rather than the workplace; works councils may have company-wide responsibilities, with a hierarchy of structures for participation at lower level; and collective bargaining can take place at the level of the workplace, the region, the industry and sometimes internationally. It would be a mistake to focus attention on a narrow definition of "the workplace", not least because that would distort our understanding of how workers can exercise most influence over pay, conditions of employment and the critical employer decisions that affect working life.

All of these possibilities can be summarised quite simply: we are seeking to investigate those arrangements that purport to offer workers some influence over the conditions that prevail in their workplace. And we want to understand whether any or all of these arrangements have an impact (whether positive or negative) on the incidence of in-work poverty and income inequality. Each of these are explained and examined in more detail in the report.

An essential element of the argument presented here is that power in the workplace matters. Indeed, an IMF staff paper has made clear that many of the conditions that led to the global economic crisis were a consequence of the declining bargaining power of organised labour. Workers whose incomes were under pressure had no alternative but to borrow money to maintain their living standards.<sup>6</sup> The crisis crystallised when this tower of debt and the financial derivatives associated with it came tumbling down. Building a sustainable model of economic growth requires a rebalancing of bargaining power and policy measures to ensure that wages grow in line with productivity.

This is a substantial undertaking, not least because the trends in the UK over the past 30 years have been in the opposite direction. As one commentator observed in the early 1990s:

*Britain is approaching the position where few employees have any mechanisms through which they can contribute to the operation of their workplace in a broader context than that of their own job. There is no sign that the shrinkage of trade union representation is being offset by the growth in other methods of representing non-managerial employees' interests and views.*<sup>7</sup>

Beyond this practical difficulty, any effort to revive the argument for workplace democracy in the UK faces formidable ideological obstacles. Most seriously, the case for effective worker participation in strategic decision making has been dormant (or more accurately dead) since the publication of the Bullock report in 1977.<sup>8</sup> Furthermore, some employers are atavistically hostile to the notion that giving workers any influence over management decisions is compatible with the effective and efficient management of firms. As the Institute of Directors opined in 2003:

*Businesses are not democracies. Directors and managers are appointed to run companies for and are accountable to the shareholders; and they have all the responsibilities this entails. If they have the responsibility for running the company, they should have control. And they should not be burdened, distracted and delayed by any manifestations of compulsory "industrial democracy"*<sup>9</sup>

The IoD went further in arguing against the information and consultation (I&C) obligations envisaged by what was then the draft EU directive on I&C, the provisions of

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6 Kumhof, M and Ranciere, R *Leverage, Inequality and Crisis*, IMF working paper 10/268 (2010)

7 Millward, N *The New Industrial Relations?* (Policy Studies Institute, 1994)

8 Bullock, A at al *Report of the Committee on Industrial Democracy*, Cmnd 6706 (HMSO, 1977)

9 Lea, R *Red Tape in the Workplace* (Institute of Directors, 2003)

which were described as “quite alien to British workplaces”. As an historical statement this is demonstrably false, since one of the key functions of trade unions during 1945–79 was jointly to manage workplace change in some form of partnership with the employer, despite the fact that trade unions always placed more emphasis on collective bargaining than on joint regulation.<sup>10</sup> Nonetheless, the IoD's position explains with great clarity one current of employer opinion – although it is important to understand that other, more moderate views have been expressed.

An example of a slightly less hostile reaction can be found in the CBI's response to the Labour government's consultation on the implementation of the I&C directive. Nonetheless, this revealed a deep suspicion about the value of any form of collective voice, workplace democracy or what the CBI described as “indirect participation”. It was individual employee involvement (“direct participation”) that made the difference:

*There is significant evidence – both empirical and from member companies – that it is direct involvement which plays the key role in bringing about high performance and a committed workforce, with indirect involvement at most playing a supporting role.<sup>11</sup>*

Whether this was an accurate account of the state of the research findings at the time may be a moot point, but later (and more extensive) research points conclusively in the opposite direction; it is collective voice and effective workplace democracy that make the difference, not the extensiveness of individual employee involvement initiatives alone.<sup>12</sup>

Both the CBI and IoD positions are focused on instrumental arguments either for or against different forms of worker participation. But the case for workplace democracy depends on arguments of principle rather than the purely instrumental reasoning associated with the supposed economic effects of these institutions. Central to the case made here is the notion that people do not surrender their rights as citizens at the moment they cross their employer's threshold.

We have already seen that some employers' organisations reject the notion of worker voice and suggest that it is incompatible with a dynamic and competitive economy.

10 Fox, A *Industrial Sociology and Industrial Relations*, research paper 3 of the Royal Commission on Trade Unions and Employers Associations (HMSO, 1966)

11 Confederation of British Industry *High Performance Workplaces: The Role of Employee Involvement in a Modern Economy – CBI Response* (2003)

12 See, for example: Sisson, K et al *New Forms of Work Organisation: Can Europe Realise Its Potential?* (European Foundation for the Improvement of Living & Working Conditions, 1997); Kruse, DL et al (eds) *Shared Capitalism at Work* (National Bureau of Economic Research/University of Chicago Press, 2010)



Others, like the CBI in its response to the Labour government's l&tC consultation document, favour a limited measure of employee involvement but on the employer's terms only.

That may sound better than the pure "rejectionist" position adopted by the IoD in 2003, but it is still rooted in the belief that managers should manage and workers should do as they are told – except to the extent that the employer wishes to seek their views. The argument advanced here, however, is that there are good reasons of principle why we should care about workplace voice and why extensive and effective institutions of workplace democracy are central characteristics of a democratic society.

The arguments of principle can be briefly summarised as follows. First, work is a fully human activity, engaging all our capabilities and emotions. It is quite wrong to believe that we surrender our rights as citizens when we cross our employer's threshold. The values that we cherish outside work are just as important in the workplace. One might say that this position owes a great deal to Kantian ethics, to the notion that human beings are ends in themselves and can never be treated simply as means to an end. In other words, employers are treating people as less than fully human if they view their workforce as nothing more than a somewhat intractable factor of production.

Second, one could follow John Rawls<sup>13</sup> and argue that democracies around the world are characterised by "reasonable pluralism".<sup>14</sup> In other words, people will disagree, express different preferences and adopt different religious or philosophical systems. The challenge is to maintain social order when human ends appear to be conflict. An obvious response is that people should be free to join with others of like mind, to express their views collectively and to seek some kind of understanding with those who are inclined to disagree. Rights to free speech and freedom of association give practical expression to these values and are adumbrated in major international conventions and treaties like the UN Declaration of Human Rights (1948), the European Convention on Human Rights (1950) and the Council of Europe Social Charter (1961).

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13 Rawls, *J Justice as Fairness – A Restatement* (Harvard, 2001)

14 This notion can also be found in the thought of Isaiah Berlin, the great 20th-century liberal philosopher, who observed that the complexity of human societies and the diversity of preferences and viewpoints rendered it unlikely that complete agreement on ends could be possible (Berlin, *I The Crooked Timber of Humanity* (Polity Press, 2003). Moreover, while it was reasonable to believe that liberty, equality and justice were legitimate social objectives, the demands of each were sometimes in tension with the others. In other words, the pursuit of freedom is sometimes inconsistent with the pursuit of fairness. Political discourse represents a perpetual process of negotiation between these competing ends. This may sound a little dull, but as Berlin said, there is no requirement for the truth to be interesting.

Third, one might point to the inequality of bargaining power between the individual employee and the employer and argue that freedom of association (the right to join a trade union) and the right to establish collective bargaining, as guaranteed by the conventions of the International Labour Organization (ILO), are designed to redress the balance. Otto Kahn-Freund, the eminent Anglo-German labour lawyer, expressed the argument well:

*[T]he relation between an employer and an isolated employee is typically a relation between a bearer of power and one who is not a bearer of power. In its inception it is an act of submission, in its operation it is a condition of subordination, however much that subordination may be concealed by that indispensable figment of the legal mind known as the "contract of employment".<sup>15</sup>*

The American scholar John Budd has suggested that these arguments of principle, no matter what their provenance, all point in the same direction: work must be understood as a fully human activity: human beings cannot be considered simply as factors of production; power imbalances must be recognised; workers have a legitimate expectation that they will be heard (both individually and collectively) and that major decisions taken by their employers will be justified and legitimised.<sup>16</sup> But, and this is a critical element in the argument, Budd goes further and suggests that no one will be employed at all unless employers are able to run efficient and successful organisations. In other words, the employment relationship demands balance between three apparently competing values: *efficiency*, *equity* and *voice*. The notion of *efficiency* may be contested, but Budd's case amounts to little more than the statement that organisations must be successful if they are to survive and offer decent jobs at decent wages. *Equity* means fair treatment for workers – including fair pay. And *voice* means respect for the principles of freedom of association and workplace democracy.

It is worth spending a moment considering further the international human rights conventions, not least because they tell us a little more about why we should place a high value on workplace democracy. Perhaps the best starting point is to recognise that the rights for workers under consideration here were seen at the point of drafting as unequivocally human rights, linked inextricably to democracy and citizenship. For example, the 1948 UN Universal Declaration of Human Rights refers explicitly to freedom of association (article 20(1)), the right to work and protections against unemployment (article 23(1)), along with "the right to form and join trade unions for the protection of [workers'] interests" (article 23(4)).

<sup>15</sup> Kahn-Freund, *O Labour and the Law* (3rd edition, edited by P Davies and M Freedland; Stevens, 1983), p18

<sup>16</sup> Budd, *J Employment with a Human Face: Balancing Efficiency, Equity and Voice* (Cornell University Press, 2004)

Similar provisions can be found in the European Convention on Human Rights, adopted in 1950 and ratified in the UK by Winston Churchill's Conservative government. The Council of Europe's Social Charter (1961) supplements the convention by setting out the "social rights" that give the individual human rights practical effect. Part 1 of the Social Charter is explicit:

*All workers and employers have the right to freedom of association in national or international organisations for the protection of their economic and social interests.*<sup>17</sup>

At the heart of the human rights conventions is the belief that if people possess these rights then democratic societies with legitimate governments will be established and sustained. Nonetheless, one might also question whether observance of the conventions themselves can *create* the conditions under which the rights become meaningful. It may be more helpful, therefore, to identify the rights people possess and describe precisely *what they are able to do as a result of those rights*. By adopting this approach we are drawing explicitly on the work of Amartya Sen, who suggests that we should devote our efforts not to the creation of ideal philosophical systems that give a comprehensive account of what we mean by justice but turn our minds to enlarging the practical sphere of human freedom for as many people as possible.<sup>18</sup>

We have already made brief reference to the employer standpoints that seem to owe more to the old notion of master and servant than to any conception that work is a fully human activity or that workers do not surrender their citizenship rights at their employer's door. And we might legitimately question whether this position is consistent with the ideas of either "reasonable pluralism" or the conflict between human ends. As the Nobel prize-winning economist Joseph Stiglitz has argued, we need to give practical expression to the belief that democracy and human rights matter to us:

*We care about the kind of society we live in. We believe in democracy, regardless of whether it increases economic efficiency or not.... Democratic processes must entail open dialogue and broadly active civic engagement, and require that individuals have a voice in the decisions that affect them, including economic decisions.... Economic democracy is thus an essential part of a democratic society.*<sup>19</sup>

These arguments of principle help to explain why we should value industrial democracy.

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17 Paragraph 5

18 Sen, A *The Idea of Justice* (Allen Lane, 2009)

19 Speech by Joseph Stiglitz quoted in Chang, HJ (ed) *Joseph Stiglitz and the World Bank: The Rebel Within* (Anthem, 2002), p304

But the reality in the UK is that all of these institutions have been under pressure for 30 years. It is to the practical consequences of the erosion of the institutions of pre-distribution that we now turn.



## Chapter 1

# Poverty and inequality – the case for workplace democracy

## Poverty and inequality – the case for workplace democracy

### Summary

- Living standards for those with incomes below the median in the UK have been squeezed since 2004. Wages have been stagnant and have become more sensitive to unemployment. Joblessness is set to remain above its pre-recession level until 2017, which suggests that it would be unwise to expect a return to rapid wage growth unless policies change.
- Levels of income inequality are highly differentiated across the developed world. The Netherlands, Denmark and Sweden have some of the lowest levels of income inequality among the working-age population, while the UK, the USA and Italy have the highest levels of income inequality.
- The international evidence suggests that bundles of institutions (see annex 1) do have an effect on the initial distribution of incomes. But institutions alone are not enough – there must be actors who can make the institutions function effectively. The balance of power between capital and labour is an essential ingredient in the policy mix.
- Countries that seem to have similar institutions (like Germany and the Nordics) achieve rather different outcomes. This is best explained not through the popular “varieties of capitalism” lens (which distinguishes liberal market economies like the USA and the UK from co-ordinated market economies like Germany, the Netherlands and the Nordics) but with reference to the “employment regime” which enables us to understand differences between countries that appear to have embraced a “stakeholder” model of capitalism.
- The critical elements of the employment regime are:
  - the initial skills-formation system;
  - continuing vocational training;
  - the position of organised labour;
  - work integration policies – to what extent is policy oriented to reducing the differences between different groups in the workforce, creating more variety in work and offering decent protection to those in work?
  - employment integration policies – to what extent is getting the unemployed back to work and giving them real labour market

### opportunities a central focus for policy?

This approach will be used in the remainder of the discussion to shed light on the differences between countries and explain how the UK can move towards a more inclusive labour market model, with decent and rewarding jobs for all people at work.

### Growth of income inequality in the UK

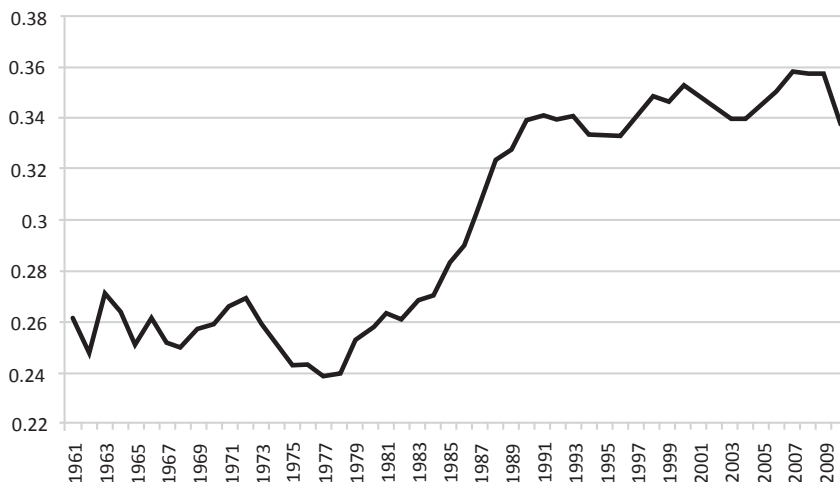
It is now a commonplace in social policy that income inequality rose dramatically under Conservative governments in the 1980s, stabilised in the early 1990s, continued to rise under Labour's first term, stabilised in the second term and rose again in the third (figure 1). The most recent data, from 2010/11, identifies a *fall* in income inequality in the period after 2009. It would be premature to suggest that there has been a break in the trend, and one year's data must be handled with care. Moreover, income inequality has returned to the level that it had reached at the time of Labour's election in 1997 – when many commentators were already concerned about the sense of social distance between the rich and the poor and the likely social disruption that might result. It is also reasonable to conclude that the Coalition's approach to "welfare reform" will make the situation worse rather than better: reductions in tax credits, the child benefit freeze, the real-terms cuts to other benefits, the cap on benefits received by a household, and the "spare room" tax will all exert downward pressure on the incomes of the most disadvantaged.

Income inequality characterised the labour market even before the financial crisis. According to the High Pay Centre, "some 26,000 people earning £500,000 or more take home more in a month (£21,500) than those on average salaries earn in a year (£20,5000 after tax). Yet our figures show that there are 6.75 million workers earning less than £800 a month."<sup>20</sup>

It is important to recall *why* income inequality has damaging social consequences. Professor Michael Marmot, among others, has documented the direct causal linkage between growing income inequality and widening health inequality. The evidence shows that people in poverty in societies like the UK and the USA have significantly lower life expectancy and worse health than the more affluent. Furthermore, the social gradient in health (the extent of the difference between the rich and the poor) is much steeper in unequal societies. Marmot also reports that reducing the extent of income inequality could lead to an improvement in the health and life expectancy of *all* groups in the population.

20 High Pay Centre *Top to Bottom: Understanding Fair Pay* (2013)



**Figure 1: Gini coefficient UK, 1961-2010/11<sup>22</sup>**

Source: IFS

### The squeeze on living standards

An analysis of the data on households below average income show that there were reductions in both average (mean) and median incomes between 2009/10 and 2010/11. This is attributed to the effects of the recession and what appear to be larger reductions for those on higher incomes – which may in part be a reaction to the public discontent with the large rewards available to those at the top of the distribution.<sup>23</sup> Moreover, incomes generally were rising more slowly than inflation. From one standpoint, this could be interpreted as a cyclical phenomenon; once growth returns, one would expect incomes to rise. A more disturbing account, however, is offered by the recent work of the Resolution Foundation, which points to a systemic, structural problem in the UK.<sup>24</sup> There is compelling evidence confirming that the incomes of those below the median have been subjected to downward pressure since 2004, leading to a stagnation of living standards. The following factors are said to be responsible for this phenomenon:

21 Marmot, M *Status Syndrome* (Bloomsbury, 2004); Marmot, M *Fair Society, Healthy Lives: The Marmot Review* (TSO, 2010)

22 The Gini coefficient measures inequality on a scale from one to zero. If zero then everyone has exactly equal incomes, if one then a single individual has all the income and everyone else has nothing.

23 Department for Work & Pensions *Households below Average Income: An Analysis of the Income Distribution 1994/95-2010/11* (2012)

24 Commission on Living Standards *Gaining from Growth* (Resolution Foundation, 2012)

- The share of national income going to labour fell as profits rose.
- Rising national insurance contributions and pensions costs reduced the share of compensation that reached workers' pay packets.
- Inflation hit the poorest families hardest.
- The UK has an economic model that creates a large number of low-skill, low-paid jobs. Despite the national minimum wage, the UK has a bigger low-pay problem than many other developed-nation economies.
- Labour market restructuring has led to more job growth at the top (among managers, professionals and associate professionals) and more job growth at the bottom (mostly in private services), with fewer jobs in the middle and fewer opportunities for progression – the so-called “hourglass labour market”.<sup>25</sup>
- Much of the increase in living standards to 2004 was a result of the rising labour market participation of women (more than a quarter of income growth for low-income families during 1968–2008). When women's participation stopped rising, household incomes at the bottom began to stagnate.
- Declining state support (cuts to tax credits) will apply further downward pressure to the incomes of those below the median.
- Wages have become much more sensitive to rises in unemployment. In other words, for wages to recover at the end of this recession, unemployment will need to fall further than was the case in previous recessions.<sup>26</sup>

The Commission on Living Standards also refers explicitly to the decline of collective bargaining and the abolition of sectoral wage floors as significant factors contributing to wage stagnation.

### **The rise of in-work poverty**

*From the Poor Law to Welfare to Work*, our previous report for the Webb Memorial

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25 Goos, M and Manning, A “McJobs and MacJobs: The Growing Polarisation of Jobs in the UK” in Dickens, R et al (eds) *Labour Market under New Labour* (Palgrave Macmillan, 2003); but for a contrary view see: Coats, D and Lekhi, R *Good Work: Job Quality in a Changing Economy* (Work Foundation, 2007)

26 Gregg, P and Machin, S *What a Drag: The Chilling Impact of Unemployment on Real Wages* (Resolution Foundation, 2012)

Trust,<sup>27</sup> documented the rise of in-work poverty in the UK. This was a problem before the advent of the global economic crisis and demonstrated both Labour's conditional success and relative failure in rebuilding the third, pre-distribution pillar of the post-war settlement. A buoyant labour market combined with the minimum wage and tax credits made work more attractive to the previously unemployed. But the net effect of this expansion in employment was to move people from workless to working poverty (see table 1, which records the extent of working poverty after housing costs have been taken into account). For the remainder of this discussion we measure poverty as a household income of less than 60% of the median.

**Table 1: The growth of in-work poverty during the boom, 1996/97 to 2005/06**

	Poor		Not poor	
	1996/7	2005/6	1996/7	2005/6
<b>Working</b>	2.0m	2.5m	12.1m	13.8m
<b>Workless</b>	2.2m	1.8m	0.9m	0.9m
<b>Total</b>	4.3m	4.3m	13.0m	14.7m

Source: Cooke, G and Lawton, K *Working Out of Poverty* (IPPR, 2008)

The growth of in-work poverty is a consequence of three phenomena. First, the propensity of the British economy to create large numbers of low-paid and low-quality jobs – especially in non-traded services like hospitality, cleaning and other business services. Second, the inability of workers in these industries to take action to secure better outcomes, whether through trade unions or some other form of collective representation. Third, the presence of a large number of low-income consumers who can afford only cheap goods and services, which enables some employers to operate low-pay/low-productivity business models and still make healthy profits.<sup>28</sup>

The most recent child poverty statistics confirm that low incomes from work are a continuing problem. Around three-fifths (60%) of children in poverty live in households where at least one adult is in work.<sup>29</sup> The greatest risk of living in poverty is experienced by children in workless, lone-parent households – although the risk of living in such a household reduced significantly between 1998 and 2011.

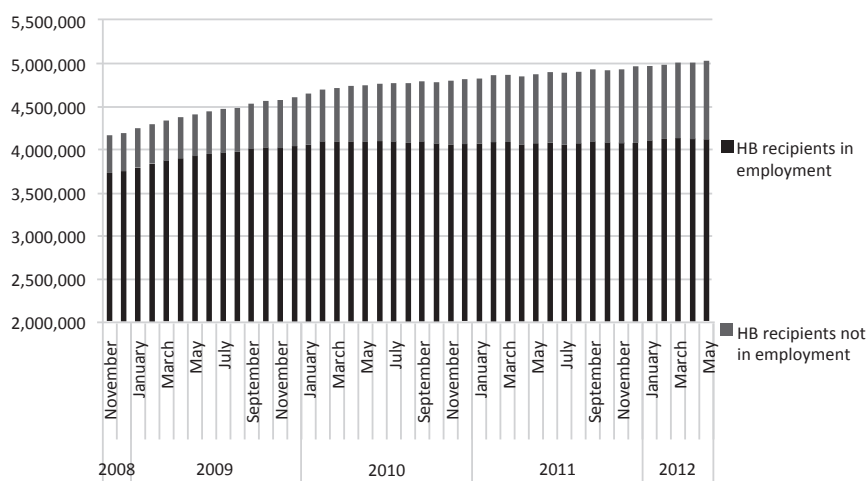
<sup>27</sup> Coats et al, op cit (2012)

<sup>28</sup> Keep, E and Mayhew, K *Was Ratner Right?* (Employment Policy Institute, 1998)

<sup>29</sup> DWP, op cit (2012)

There is one final piece of evidence supporting the argument that the growth of in-work poverty demands specific attention. The official figure for the number of housing benefit claimants in work more than doubled from 400,000 in November 2008 to 900,000 in May 2012 (see figure 2). Most seriously perhaps, since mid 2009 the net increase in housing benefit claimants has come almost exclusively from claimants who are in work. This increase, combined with rising rents, is costing the Treasury an extra £2.5 billion a year (even holding rents at 2008 levels shows an extra cost of £1.8 billion per annum).

**Figure 2: Housing benefit recipients by employment status**



Source: Calculated from DWP statistics – Housing Benefit Recipients by Passport Status: November 2008 to May 2012

### Gender and low pay

It is also important to recognise that low pay is principally a gender issue. As the reports of the Low Pay Commission have documented over the last decade, the principal beneficiaries of the national minimum wage have been women, often working part-time in industries like hospitality, retail and residential care. The Women and Work Commission noted that occupational segregation influences the distribution of earnings, with female employment concentrated in “caring, cashiering, catering, cleaning and clerical jobs”, all of which are generally undervalued for their economic and social contribution.<sup>30</sup> A natural response therefore might be to

<sup>30</sup> Women & Work Commission *Shaping a Fairer Future* (Department for Trade & Industry, 2006)

argue that a more aggressive approach to equal pay could begin to reduce income inequality quite significantly. There is no doubt, of course, that the gender pay gap remains a problem. But as the LPC has pointed out, the NMW has almost completely eliminated the gap at the bottom of the distribution. Low-paid women now earn almost as much as "comparable" low-paid men. Indeed, the gender pay gap is widest at the *top* of the distribution, because male investment bankers and City lawyers earn rather more than their female colleagues. Most seriously perhaps, the equal pay legislation (through the equal value regulations) became much tougher at precisely the time when income inequality began to rise. This is not entirely surprising, since the equal pay regime *cannot* counteract the powerful effects described elsewhere in this chapter. It is not designed to ensure fairness *across* the income distribution, but to guarantee equal treatment for women doing work of "equal value" to their male colleagues. Nor can it be a substitute for effective instruments of pre-distribution that maintain the link between rising wages and rising productivity for all people at work.

### **Pre-distribution and inequality: the international evidence**

It has become popular in the last decade to talk about globalisation (by which we mean the opening up and integration of markets and supply chains) as some force of nature that is experienced in an undifferentiated way across countries. The policy conclusion is often a counsel of despair: there is very little that can be done except to equip people with the skills they need to find their way in a more demanding and competitive world of work. Unfortunately for these pessimists (and fortunately for the rest of us) the evidence suggests that there is ample scope for domestic policy choice and that institutions do make a difference. There are two devices that we might use to assess these effects: first, an analysis of the Gini coefficient across a selection of developed world economies, measured both before and after the intervention of the state through the tax and benefits system; second, an assessment of poverty rates before and after taxes and transfers.<sup>31</sup> It is important to enter a caveat here, not least that what happens to income inequality can be as much influenced by general economic conditions as by the effectiveness of either pre-distribution or redistribution – witness, for example, the fall in the Gini coefficient in the UK in 2010/11.

Equally, institutions designed to achieve distributive justice can struggle to cope with external shocks – especially if public policies are pulling in the opposite direction.

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<sup>31</sup> All data is taken from OECDStat to allow for comparability, which is why the Gini coefficient chart for the UK in figure 4 looks somewhat different from the data presented in figure 3 – the general trajectory of inequality is the same in both figures.

Germany is wrestling with the consequences of a two-tier labour market, and wage growth there has been stagnant for almost a decade even though that country has an impressive array of institutions. All one can say, therefore, is that the results in each country have to be set in context. It would be quite wrong to reach irresistible conclusions about the importance and effectiveness of institutions by reference to the Gini coefficient and poverty statistics alone. Nonetheless, there does seem to be an association between social outcomes (poverty and inequality) and the presence of institutions like trade unions, works councils and worker participation at board level (see annex 1). Perhaps our best initial assessment is to say that power matters – it is *how* institutions are being used that makes the difference.

Institutions of workplace democracy will (if they have any effect at all) influence the level of incomes available to those in work, and that is the focus of our analysis here. A review of a selection of OECD countries in the late 2000s confirms the finding of widely differentiated national experiences and considerable room for domestic policy manoeuvre (see figure 4).<sup>32</sup>

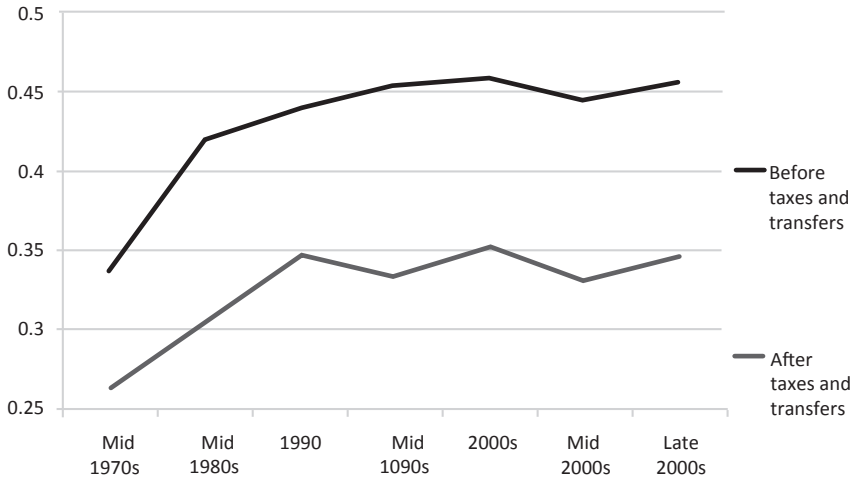
The UK, the USA and Italy have the most unequal distribution *before* the intervention of the state through taxes and transfers, while Denmark, Sweden and the Netherlands have the most egalitarian distribution. These findings are important in confirming that institutions matter, and while we would not claim to have demonstrated causation there is at least a persuasive story confirming that the UK is characterised by an institutional gap and an inequality of bargaining power (most institutions of pre-distribution are conspicuous by their absence: see annex 1). The data also reveal that those countries with the least egalitarian *initial* distributions also have the weakest commitments to *redistribution*.

What we can also see is that the effectiveness of pre-distribution in the UK has diminished significantly over time (figure 5). The UK in the mid 1970s looks, from the standpoint of an observer in 2013, like a relatively egalitarian country, not quite at the Nordic level but more egalitarian than either the USA or the Netherlands. By the mid 1980s the situation has been transformed, and by the late 2000s the institutions of pre-distribution have been eroded to such an extent that only Italy among this group of countries has a *less* egalitarian initial distribution.

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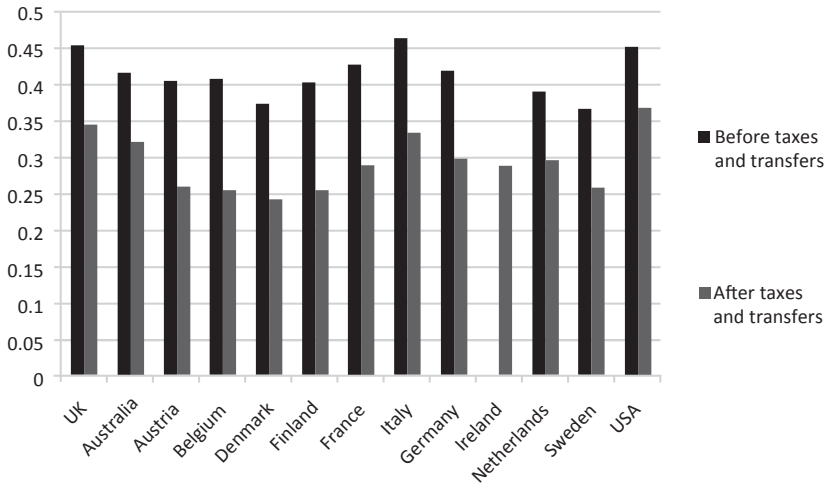
32 An index of both workplace democracy and pre-distribution institutions can be found at annex 1, which should be read in conjunction with this section

**Figure 3: The effectiveness of pre-distribution in the UK, mid 1970s to late 2000s**  
*Gini coefficient – working-age population only*



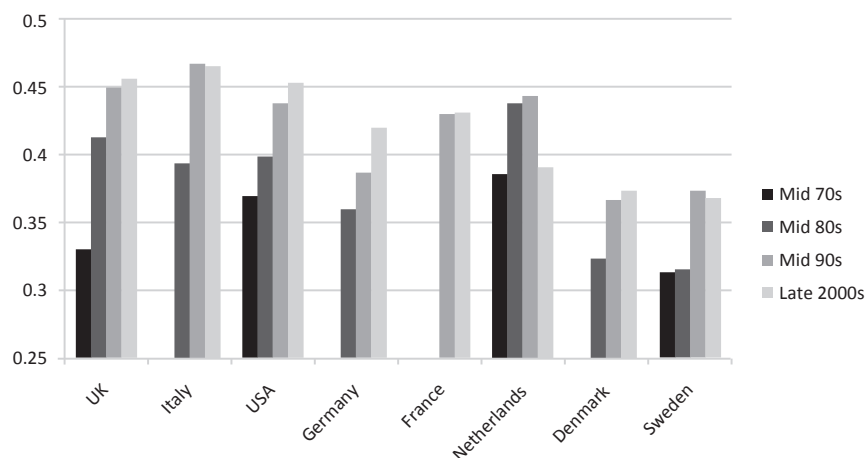
Source: OECDStat

**Figure 4: The effectiveness of pre-distribution, late 2000s**  
*Gini coefficient before/after taxes and transfers, working-age population 18-65*



Source: OECDStat

**Figure 5: Income inequality in selected OECD countries, early 1970s to late 2000s**  
*Gini coefficient, working-age population*



Source: OECDStat

The OECD has attempted to evaluate the impact that changes in policies and institutions may have had on the distribution of incomes across the developed world.<sup>33</sup> This is not a straightforward exercise because OECD member countries are so different and have historically experienced very different patterns of poverty and inequality. Despite these difficulties, the analysis is still worth the effort because the identification of average effects across countries sheds light on both the norm and the exceptions.

For these purposes, the OECD goes beyond the institutions of workplace democracy and examines product market regulation as well as union membership, collective bargaining coverage, the strength of employment protection legislation, the “tax wedge”<sup>34</sup> and the level of benefits available to the unemployed. It is worth noting that the UK is one of the most “liberal” economies in the OECD on all these measures – a permissive approach to product market regulation sits alongside weak trade unions, low collective bargaining coverage, a relatively low level of employment protection, low taxes and low income-replacement rates for the unemployed. After very careful analysis the OECD reaches the following conclusions in relation to wage inequality:

<sup>33</sup> OECD *Divided We Stand: Why Inequality Keeps Rising* (2011)

<sup>34</sup> The “tax wedge” is a measure of the percentage of income (for both individuals and businesses) taken by the state through taxation.



- Trade unions have the effect of reducing wage inequality and this effect is strongest where union membership and coverage are high and where bargaining is "centralised", with national agreements at a sectoral level and a co-ordinated bargaining process across sectors.<sup>35</sup>
- Declining union coverage rates have the effect of increasing income inequality.
- Countries with weaker employment protection legislation generally experience higher levels of inequality. This is especially true if temporary employment is subject to a different regulatory regime.
- Lower taxation of earnings has the effect of increasing wage inequality. This is because higher taxes imply higher labour costs for employers. Low-tax countries have a higher share of low-skilled, low-paid employees.
- Higher benefits for the unemployed are associated with lower inequality. This is because the unemployed then have a higher reservation wage (the level of pay that is needed to encourage them to return to work), which has the consequential effect of reducing the wage dispersion. In other words, the unemployed are likely to wait for the right job to come along rather than accept the first job that materialises.
- Countries with more liberal product market regulation tend to experience higher levels of wage inequality.
- Higher minimum wages, by setting a robust labour market floor, reduce wage inequality.

It is important to understand that these are *average* effects, and that analysis at the national level produces a more sophisticated story. For example, the Nordics are open economies with strong competition policies and relatively liberal product markets, but they have the most egalitarian distributions of income in the developed world. Denmark has a relatively low level of employment protection legislation but very strong collective bargaining institutions and wide bargaining coverage. Even so, the OECD's analysis of the impact of institutions and policies can explain some of the growth of income inequality in the UK. Weak unions, low bargaining coverage, low taxes and low benefits are all characteristics of the British system.

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35 See also chapter 3 ("Wage Setting Institutions and Outcomes") in OECD *Employment Outlook* (2004)

### Pre-distribution and poverty: the international evidence

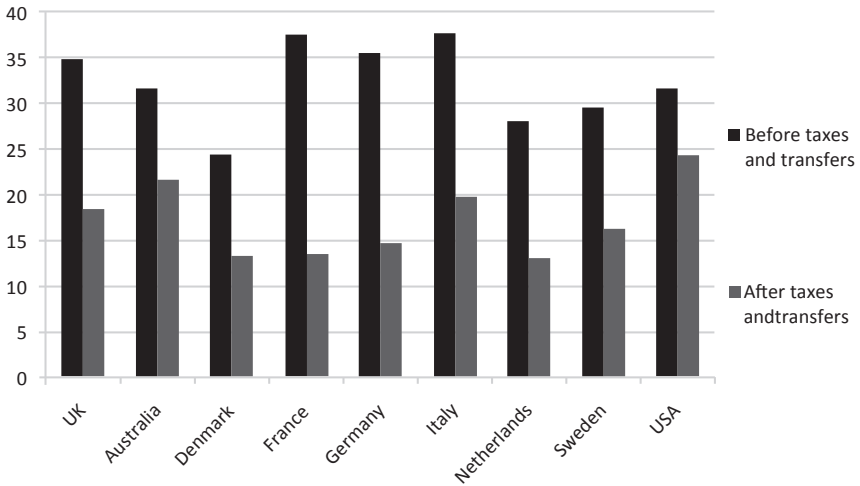
So far our analysis has dealt with the relationship between pre-distribution and income inequality. Whether the institutions of workplace democracy and pre-distribution have any impact on *poverty* (measured for these purposes as the percentage of individuals living in households with less than 60% of median income) is a rather different and somewhat narrower question. Once again, proving causation is problematic, but there are at least some persuasive associations (figure 6). Of course, not all the poor are in work; in fact most people in poverty are either children or pensioners or the unemployed – although we have already seen that child poverty is increasingly a labour market problem because parents have low incomes from work. Nonetheless, we are able, using this data, to make a crude assessment of the fairness of the initial distribution. Most striking perhaps, as with the data on inequality, is that Denmark, the Netherlands and Sweden have the smallest percentages of people living in households below the poverty threshold. But – and this is a critical element in the argument – what the data really reveals is the strength of the commitment to solidarity through the medium of redistribution.

Some of the results are rather surprising: for example, the French welfare state is significantly more redistributive than the Swedish welfare state, because it is addressing a much higher level of initial poverty before redistribution through taxes and transfers. Moreover, the percentage of households in poverty *before* taxes and transfers is higher in the UK, Australia, France, Germany and Italy than it is in the USA. Once taxes and transfers are taken into account, however, the USA has the highest percentage of people living in poor households: perhaps the most obvious manifestation of a weak social safety net.

We have also looked at the trajectory of poverty across these countries from the mid 1970s to the late 2000s using the same OECD dataset (annex 3). In several countries the incidence of poverty before the intervention of the tax and benefits system *fell* during the period in question – Australia, France and Denmark. In other countries the percentage of people living in poor households *increased* – Germany, Italy and the USA. Poverty levels were broadly stable in the Netherlands and Sweden before taxes and transfer payments. Whether we can attribute all of this to the effectiveness of institutions of workplace democracy is an open question, and other factors may be important. For example, if pensioner incomes are rising rapidly because of private saving then the percentage of people in poor households will fall, no matter what trade unions may be doing – although one might note that the negotiation of good occupational pensions was formerly a collective bargaining objective of many British trade unions. A similar experience can be found in Australia, where the trade unions successfully negotiated a new superannuation system in the 1990s as part of their social pact with the Labour government (the Accord).

**Figure 6: Poverty rates across the OECD, late 2000s**

*Percentage of people living in households with less than 60% median income*



Source: OECDStat

So far as the UK is concerned, the relatively high incidence of poverty before taxes and transfers says a good deal about the ineffectiveness of pre-distribution. Of course, the state undertakes some redistribution, but despite the extensive use of tax credits, the UK is still left in the middle of this group of countries. Denmark, France, Germany, the Netherlands and Sweden are all more effective in their efforts to reduce the percentage of people living in poor households. The poverty gap measure also places the UK in the same position: firmly in the middle of this group of countries.

### **Varieties of capitalism and employment regimes**

A well-known attempt to understand cross-country differences in social and economic outcomes is the literature associated with the "varieties of capitalism" story.<sup>36</sup> This draws a distinction between co-ordinated market economies, like the Nordics, Germany or France, and liberal market economies like the UK or the USA. In the former, much of the work of economic co-ordination (research and development, the skills system, regulation of standards) is undertaken by a partnership between the state, employers and other stakeholders. It is focused on co-ordination through institutions. In liberal market economies, on the other hand, markets rather than institutions undertake the

<sup>36</sup> Hall, P and Soskice, D *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (OUP, 2001)

functions needed to keep the economy moving. This distinction may be moderately helpful for our purposes, but it still fails to explain why there are differences between France, Germany, the Netherlands, the Nordics and Italy, all of which are co-ordinated market economies in the varieties of capitalism analysis.

For the purposes of this discussion, perhaps the best conceptual framework to explore the differences between countries can be found in the notion of the *employment regime*, developed by Duncan Gallie and his colleagues.<sup>37</sup> Even though the initial focus of the research was on the *quality* of work, there is enough substance in the employment regimes story for it to offer a valuable analytical lens as we evaluate the importance of workplace democracy in influencing the income distribution. Put simply, the employment regime approach seeks to make an assessment of the following features of national labour markets:

- the initial skills formation system;
- continuing vocational training;
- the position of organised labour;
- work integration policies (to what extent is policy oriented to reducing the differences between different groups in the workforce, creating more variety in work and offering decent protection to those in work?); and
- employment integration policies (to what extent is getting the unemployed back to work and giving them real labour market opportunities a central focus for policy?).

Mapping these factors onto a range of national labour markets produces a fourfold typology of employment regimes: the Nordic, continental, southern European and liberal models. Job quality is measured on the following dimensions: the opportunities for skill use and skill development; the degree of freedom an employee has in making decisions about the way work is done; work-life balance; satisfaction with pay; the pressure of work; and the opportunities available to influence critical employer decisions. These job quality outcomes map moderately well onto the inequality and poverty indicators that we explored above. The Nordics are most egalitarian, the continental countries follow, then the southern European group and the liberal economies.<sup>38</sup> Gallie and his colleagues describe the Nordic model as an "inclusive" employment regime since it is concerned to promote both equality and participation. This is a more accurate description in any event, since for these purposes the Netherlands has many "Nordic" characteristics.

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37 Gallie, D (ed) *Employment Regimes and the Quality of Work* (OUP, 2007)

38 The Nordics also achieved levels of employment that were either the same as or better than the UK's in the pre-crash period. And of course, they have fewer low-paid workers.

What the employment regimes lens also enables us to do is view the institutions of workplace democracy and pre-distribution as part of a system. In other words, we can see (and evaluate) the way in which each element of the system relates to all the others. We can explain, for example, whether the *initial* vocational training system creates a group of young people with a sense of confidence and a belief in their occupational identity at the point they enter the labour market. It is possible to assess whether the *continuing* vocational training system allows people to acquire the skills they need to remain active in the labour market. Moreover, the generosity (or otherwise) and design of the unemployment insurance system is part of this story too. Inclusive labour markets are characterised not just by higher benefits for the unemployed but by much higher levels of investment in active labour market programmes that build the human capital (and therefore the capabilities) of those without work. The balance of power between capital and labour could be seen as the linchpin of the analysis, not least because trade unions (or works councils) can make demands on employers and government for better training, more inclusive employment policies and more help for the unemployed to get back into work and stay there.

This report is not designed to explore all those issues – we are focused on workplace democracy and the distributional consequences of various institutional arrangements. Nonetheless, the employment regimes approach does help us to avoid some of the pitfalls of a crude story that tells us “institutions make a difference” but cannot really explain why. Perhaps the two critical concepts here are agency and capability. In other words, does the employment regime allow for a measure of workplace democracy creating *opportunities* to influence the distribution of incomes, conditions of employment or job quality? And more importantly, do the actors within these institutions (trade union officials or works councillors) have the *capability* to make a difference? In other words, do they have the bargaining power to get a hearing and, if necessary persuade the employer (or government) to alter course?

Subsequent chapters explore the following approaches to industrial democracy in more detail:

- worker representation at board level;
- works councils on the continental European model;
- trade unions and collective bargaining;
- co-operatives and mutuals;
- employee share ownership and “shared capitalism”;
- individual employee involvement; and
- other policies that influence the initial distribution of incomes (like minimum wages, labour clauses in public contracts and “auxiliary” legislation to promote collective bargaining).

## Chapter 2

# Workers on the board – corporate governance

## Workers on the board – corporate governance

### Summary

- The case for worker representation on the boards of listed companies remains controversial in the UK, following the unrewarding debates of the 1970s. Other countries made progress with this model of industrial democracy at a time when opinions in the UK were polarised. Today, the UK is unusual in the EU 15 in making no provision whatsoever for worker participation in strategic decision making.
- The case for a stakeholder model of corporate governance is clear. Workers are taking a risk by placing their economic lives in the hands of the firm. They deserve a voice in the critical decisions that will determine future performance.
- Other countries separate the executive from supervisory functions at board level by having a two-tier board structure. The aim is to resolve the “principal agent” problem: executive managers know a good deal more about the organisation than an atomised body of shareholders, which creates the danger that the business will be run in the interests of the senior management and not the shareholders. This explains much of what has happened in the financial services sector in recent times.
- The UK also has a distinctive problem of short-termism, ably diagnosed by the 2012 Kay review.<sup>39</sup> This leads senior managers to treat corporations as portfolios of assets to be managed rather than as organisations with histories, personalities and distinct capabilities. Changing the nature of the boardroom conversation through the development of a stakeholder governance model could have a catalytic effect, generating longer-term commitments to employees.
- The growth of excessive executive pay in the UK is at least in part a governance failure. Expanding shareholder oversight has done little to change the culture among senior executives.
- Appointing workers' representatives to the boards of listed companies demands a consensus. Some attempt should be made to forge strategic alliances with those on the political right to establish a framework for the conduct of responsible capitalism.

<sup>39</sup> Kay, J et al *The Kay Review of UK Equity Markets and Long-term Decision Making* (DBIS, 2012)

## Policy recommendations

- A Corporate Governance Commission must be established as a matter of urgency after the 2015 general election to make recommendations for the reform of company law, with the specific aim of establishing a stakeholder model of governance in the UK, using either the existing unitary board structure or the two-tier structure that is well established in Germany. The commission should be required to complete its work within 18 months so that legislation can reach the statute book before the 2020 general election.
- Swifter action can be taken in the field of executive pay and remuneration in listed companies, with new requirements imposed on corporations to achieve a higher level of transparency by publishing:
  - the ratio of the pay of the highest earner to the pay of the lowest earners in the organisation;
  - the number and percentage of employees paid at the national minimum wage;
  - the number and percentage of employees paid less than the living wage; and
  - the distribution of pay across the whole workforce, broken down by grade and pay level.
- Board-level representation can be effective only if there is a robust structure for employee participation at all levels of the organisation. Works councils, collective bargaining and workers on the board are mutually reinforcing processes. Extending worker participation in strategic decision making must go hand in hand with an effort to rebuild institutions for participation in the workplace (see chapter 6).

## Introduction

The debate about worker participation at board level has been dormant in the UK since the late 1970s. At the same time Germany, the Netherlands, Denmark and Sweden all implemented new arrangements for worker representation at board level and France followed suit in the 1980s.<sup>40</sup> These arrangements differ from country to country, reflecting their particular history and institutions. Nonetheless, what looks like common sense in much of northern Europe still looks alien or exotic to many observers here in the UK.

<sup>40</sup> Conchon, *A Board Level Employee Representation Rights in Europe: Facts and Trends* (European Trade Union Institute, 2011)



Some commentators, such as the economist Will Hutton, suggest that it is right for stakeholders (including workers) to have a voice in strategic decision making because a company is more than just its shareholders. Workers are bearing the risk of corporate success or failure just as much as shareholders and ought therefore to be able to influence the course of events.<sup>41</sup> Instrumental arguments are often used too: that industrial relations will improve if workers' concerns are properly taken into account or that there will be a positive effect on productivity or performance. Most interesting for our purposes, perhaps, is that little attention has been given to the impact on distribution. Indeed, where research has been conducted into the impact of workers on the board (mostly in Germany) the focus has been on a variety of measures of corporate performance – and the results are, to say the least, ambiguous, making it difficult to reach any conclusion about the relationship between worker representation at board level and economic outcomes.<sup>42</sup>

The level of diversity in national systems for board-level representation should not be underestimated. In some countries workers have a third or more seats on the board, and in others only one seat. Germany has a system of two-tier boards, with the executive board making the management decisions and the supervisory board (on which the workers' representatives sit) exercising oversight. This has the advantage of limiting conflicts of interest by ensuring that workers' representatives on the board have no direct influence over day-to-day management decisions. Moreover, the precise form of worker involvement (known as co-determination in the German system) depends on the size of the firm and the sector in which it operates – in effect Germany has three separate corporate governance systems under the 1976 Co-determination Act, the 1952 Works Constitution Act and the Coal, Iron and Steel Co-determination Act 1951 (amended in 1956).

Some national systems reserve seats for trade union representatives, while others require the election of worker directors by the whole workforce, some allow for the appointment of directors by the works council and others prevent anyone employed by the firm from sitting on the board.<sup>43</sup> Yet despite these differences, the UK and the USA are exceptional in having *no* opportunities for workers to influence strategic decision making except to the extent that this occurs through the process of collective bargaining – even the Republic of Ireland, which is often seen as another example of a "liberal" economy, has arrangements in place for worker participation at board level

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41 Hutton, W *The State We're In* (Jonathan Cape, 1995); Hutton, W *The World We're In* (Little, Brown, 2002)

42 Conchon, op cit

43 Conchon, op cit

in publicly owned enterprises.<sup>44</sup>

We have already observed the distinct lack of enthusiasm among the representative organisations of British employers for any policy initiative designed to create and sustain independent institutions of workplace democracy. This is not a new phenomenon. The CBI was just as opposed to the recommendations of the Bullock committee in the 1970s as it was to the implementation of new information and consultation obligations in the early 2000s. In part this may be a consequence of the distinctively Anglo-Saxon approach to property ownership described by Will Hutton.<sup>45</sup> But it also betrays a certain lack of confidence about the extent to which the British labour market was genuinely transformed in the 1980s – some employers appear to believe that any concession, no matter how small, to the case for worker voice will enable the barbarians to breach the walls and sack the city. Nevertheless, it is much more difficult for employers today either to sustain the argument that corporate governance arrangements work well in the UK or contend successfully that British capitalism is well regulated. The failure of the banks was a governance failure – at least in part.<sup>46</sup> And the continued public anger about the level of bankers' bonuses as well as more general movements in executive pay suggests that the agenda for reform is by no means exhausted.

The economic devastation caused by the global crisis has reopened conversations that had been firmly locked in a box labelled "do not open" for more than 30 years. In large measure the arguments now being used are more instrumental than principled. Advocates of corporate governance reform phrase their recommendations almost entirely in terms of efficiency and effectiveness rather than fairness. The purpose of this part of the discussion is to understand the arguments about different board structures, governance institutions and the impact on the long-term decisions made by investors. This is principally because there is a well-canvassed argument that short-termism in British capital markets is a cause of the nation's relatively poor economic performance.<sup>47</sup> The quest for immediate returns leads to a focus on financial

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44 Conchon, op cit; Bryson, A, Forth, J and George, A *Workplace Employee Representation in Europe* (European Foundation for the Improvement of Living & Working Conditions, 2012)

45 Hutton, op cit (2002). Hutton argues that in Anglo-Saxon systems property holders have extensive rights and few responsibilities to those who may be affected by the way in which property is used. In continental Europe he suggests that property owners have a balance of rights and responsibilities owed to those who may be affected by the property owner's actions.

46 The same might be said about the recently revealed activities of some traders at major banks to rig the LIBOR rate or the mis-selling of payment protection insurance. Both cases can be seen as failures of management, regulation *and* governance.

47 Kay, op cit (2012)

engineering rather than real engineering and, in the context of the crisis, inspired the speculation in complex derivatives that caused the economy to crash.

Other commentators suggest that short-termism in capital markets feeds into short-termism in employment relationships. This is especially the case in relation to those so-called "high performance" practices that are supposed to boost productivity. These practices depend on trust and commitment between employer and employee, but pressure from the capital markets drives the quest for cost reduction and the permanent revolution of business reorganisation. Both phenomena undermine the trust on which high performance depends, leading employees to become disaffected and demotivated.<sup>48</sup> From this standpoint, rebuilding the productive base of the economy depends on a transformation of corporate governance to allow for the long-term committed employment relationships found in other European countries with a better economic record than the UK (most obviously Germany, with particular reference to manufacturing).

But even if one accepts this diagnosis of the crisis, it is not necessarily self-evident that corporate governance reform and putting workers' representatives around the boardroom table is an *adequate* answer. We need to say a little more about how decisions are taken – and who takes them – before we can be certain that more pluralism in the boardroom will lead to better economic performance, less inequality and lower levels of in-work poverty. Moreover, we should be mindful of the very important observation that it is the bundling of institutions and the notion of the employment regime (including the balance of power between capital and labour) that really matters.

### **Governance – the principal-agent problem: unitary and supervisory boards**

In the British system, public limited companies have unitary boards. In other words, the same institution is responsible for the day-to-day management of the company and for oversight of the effectiveness of management and strategic decisions. Both executive directors (who are full-time employees) and non-executives (who are supposed to bring a critical eye and external expertise to the proceedings) deliberate around the same boardroom table. This should be contrasted with the practice in much of continental Europe, where the executive/management and supervisory functions are separated in law and in practice. Moreover, members of the supervisory board are generally drawn from a wider pool than non-executives in the UK and often have the direct responsibility of representing stakeholders, including workers.

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48 Godard, J "A Critical Assessment of the High Performance Paradigm" in *British Journal of Industrial Relations* (2004); Konzelman, S et al "Work Systems, Corporate Strategy and Global Markets: Creative Shop Floors or a Barge Mentality?" in *Industrial Relations Journal* no 216 (2004)

In principle, of course, in Anglo-Saxon or unitary board systems, the company is the property of its owners, the shareholders. Yet in practice the shareholders apply little direct control to the activities of management, even though they retain formal rights to appoint directors (both executives and non-executives) and remove members of the board. In their classic work *The Modern Corporation and Private Property*, Adolf Berle and Gardiner Means identified that the modern corporation was characterised absolutely by this divorce of ownership from control.<sup>49</sup> Managers will always know more than the shareholders about the realities of the business and can, other things being equal, run the business in their interests rather than the interests of shareholders.

This “principal-agent” problem may have taken a new form in the 20th century, but it was by no means new. In the 17th century, investors in the Dutch East India Company became increasingly concerned that the directors of the business were making large fortunes when dividends seemed scarce.<sup>50</sup> The solution was to set up an investors’ committee to supervise the activities of those running the company and ensure that those who had placed their funds at risk could be reasonably confident of an adequate return on capital. In other words, the solution to the principal-agent problem was to set up a two-tier board structure.

No similar corporate governance innovation was forthcoming in common law jurisdictions, and the solution in the UK in recent years has been to align the interests of executives with the interests of the corporation around the notion of the maximisation of shareholder value. Often this has involved share option schemes or bonus payments dependent on the performance of the share price. Moreover, apparent pressure from investors for rapid returns has exacerbated the incentives created by the executive remuneration strategy – many chief executives have begun to measure their success by the execution of mergers or acquisitions rather than a medium-term focus on building a business around products or services that consumers might find useful.

### **Short-termism, investors and governance**

The problem of short-termism has a number of dimensions, which can be summarised as follows:

- Investors in UK equity markets are too focused on monthly or, at best, quarterly results. Their obligations may be to ensure that (for example) the returns on investment enable pension funds to offer decent retirement

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49 Berle, A and Means, G *The Modern Corporation and Private Property* (Harcourt, Brace & World, 1932)

50 Mount, F *The New Few or a Very British Oligarchy* (Simon & Schuster, 2012)

incomes in the long term. But this is not always reflected in day-to-day investment practice.

- Short-termism can lead senior executives to focus on the execution of mergers and acquisitions as the most effective route to the maximisation of shareholder value.
- Short-termism also leads to "internal hyperactivity": frequent internal reorganisations that may be hugely destabilising but do little to build the underlying capabilities of a business.
- This hyperactivity can, in turn, make it difficult if not impossible for businesses to make a long-term commitment to their employees, with a consequent negative effect on employee commitment, motivation and performance.

John Kay, in his extensive review of short-termism for the Coalition government, argues that the root of the problem is located in the decline of trust and the misalignment of incentives throughout the equity investment chain.<sup>51</sup> Asset managers have dispersed portfolios, are too unwilling to engage with the businesses in which they are invested, hold their investments for too short a time, and are excessively influenced by relatively short-term information. The solution therefore is to shift regulatory philosophy and practice "towards support for market structures which create appropriate incentives, rather than seeking to counter inappropriate incentives through the elaboration of detailed rules of conduct".<sup>52</sup> In other words, most reform activity should flow through the voluntary decisions of market actors (under the tutelage of government) rather than heavy-handed regulatory intervention.

Most remarkable about these recommendations, perhaps, is that they offer no account of the realities of power in markets. It is a matter of shifting incentives, modifying market structures and then allowing the actors to go about their business. The diagnosis of the UK's problem – underinvestment, too much mergers and acquisitions activity, lower productivity, less innovation – may be exemplary, but the prescription, as with the proposals from the High Pay Commission (discussed below), looks less than adequate to meet the scale of the challenge. As John Kay has recognised himself, markets are embedded in an array of social institutions that reflect the power dynamics in the economy and in society.<sup>53</sup>

### **The growth of executive pay and unfairness in the workplace**

Most seriously, perhaps, the attempt to use incentive structures to align executive and

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<sup>51</sup> Kay, op cit (2012)

<sup>52</sup> Ibid

<sup>53</sup> Kay, J *The Truth About Markets* (Penguin-Allen Lane, 2003)

shareholder interests has also been associated with the explosive growth of executive pay. As the High Pay Commission documented, those at the top of some organisations saw their pay rise by over 3,000% in the period from 1979/80 to 2010/11.<sup>54</sup> In 2010/11 executive pay rose by 49%, at a time when the pay of average workers was rising by just 2.7%. In the year to June 2012 the increase was, by previous standards, a relatively modest 27%.<sup>55</sup> Of course, for most people wages are stagnant – and for those at the bottom of the distribution, real wages are falling.

### Box 1: The High Pay Commission's recommendations

#### Transparency

- Top executives should be paid a basic salary which is the largest element of remuneration.
- The top 10 executive pay packages should be published outside the boardroom.
- Remuneration reports should be standardised so that executive pay packages can be compared across companies.
- Fund managers and investors should be required to disclose how they vote on remuneration.

#### Accountability

- Workers' representatives should be included on remuneration committees.
- Plcs should publish a statement of the distribution of pay across the organisation.
- Shareholders should cast "forward-looking" votes on remuneration, covering executive pay packages for three years from the date of the vote.
- Investment should be made in the development of talent within the organisation, to limit the need to search for new executives on the open labour market.
- Non-executive director posts should be advertised widely and recruitment made from a wider pool.
- It should be ensured that the role of remuneration consultants is reported transparently so that conflicts of interest can be avoided – consultants advising companies in competition with each other could have an inflationary effect on executive pay.

54 High Pay Commission *Cheques With Balances: Why Tackling High Pay Is in the National Interest*, final report (2011)

55 Incomes Data Services *IDS Executive Compensation Review 2012* (2012)

## Fairness

- All plc's should be required to publish a "fair pay report", documenting the gap between the top and the median and how this has changed in the previous three years. These reports should include a statement of principles that informs pay determination in the organisation.
- A permanent body should be established to keep executive pay developments under review and make recommendations to government for reform.

Source: High Pay Commission *Cheques With Balances: Why Tackling High Pay Is in the National Interest*, final report (2011)

What is also interesting is that the High Pay Commission makes an explicit business case for fairness: if workers believe that they are fairly treated they will be more engaged, motivated and likely to offer productivity-enhancing innovations to the employer. Moreover, the extent of the perceived unfairness in pay is damaging employee engagement – which many senior executives believe to be central to business success. This argument has considerable political appeal, but it would be a mistake to undervalue the ethical dimension of the case for equality. An excessively large gap between rich and poor is socially damaging because it makes it much less likely that those at the bottom of the income distribution will be able to acquire the capabilities they need to choose lives that they value.

Whatever rationale is offered, there is a strong case for saying that unless there is some rebalancing of power in the boardroom, the conditions that led to rising income inequality, and ultimately to the financial crisis, will continue to exist. More radical thinking may be needed. For these purposes it is instructive to return to the proposals made by the Bullock committee in 1977 – not to suggest that these might be revived and applied without amendment or consideration, but rather to demonstrate the limits of the possible and draw some useful comparisons with the German system in particular. Yet even here we should proceed with some circumspection: the presence of worker representatives on the supervisory boards of German companies has not held back the rise of income inequality, prevented the erosion of the collective bargaining system or ensured that those working in "mini-jobs" enjoy decent pay and working conditions. Other elements are needed in the mix to make these institutions work effectively – not least the strong trade unions and widespread collective bargaining coverage found in Denmark and Sweden, where social outcomes are superior. In other words, it must be considered how multiple policy initiatives can reinforce each other – the policy question is about the redesign of British capitalism in totality, not a piecemeal programme of corporate governance reform.

### **Power, authority and workers on the board: the Bullock report**

The situation today of course looks very different from the world of the mid 1970s, when trade unions were a power in the land, corporatism was a principle of governance rather than a historical curiosity, and even Conservative politicians were willing to countenance an important (albeit restricted) role for organised labour. The Bullock committee was appointed by the 1974–79 Labour government in 1975 with the following terms of reference:

*Accepting the need for a radical extension of industrial democracy in the control of companies by means of representation on boards of directors, and accepting the essential role of trade union organisations in this process, to consider how such an extension can best be achieved, taking into account in particular the proposals of the Trades Union Congress report on industrial democracy as well as experience in Britain, the EEC and other countries. Having regard to the interests of the national economy, employees, investors and consumers, to analyse the implications of such representation for the efficient management of companies and for company law.<sup>56</sup>*

The assumptions implicit in the terms of reference look rather astonishing from the standpoint of any observer in 2013. A "radical extension" of industrial democracy was believed to be an unqualified good thing, with trade union participation as the linchpin of the new system.<sup>57</sup> In 1975 much of this was, if not commonplace across the political spectrum, then at least part of the common sense of British social democrats, linking industrial democracy to improved organisational performance. The Fabian Society, for example, submitted a positive memorandum to Bullock, suggesting that the purpose of the policy was "restoring the industrial base of the United Kingdom".<sup>58</sup> Going beyond the explicit terms of reference of Bullock, the Fabians argued (very much as this report argues) that industrial democracy requires participation at *all* levels of decision making. The TUC had suggested a two-tier board system, with representation of workers on the supervisory board, and a single-channel trade union route for the appointment of worker directors.

Bullock's terms of reference may be a little misleading, however, in suggesting a policy consensus when no such thing existed. To the left of the Labour Party, the Communists – then a significant force in some trade unions – opposed any extension of industrial democracy on the grounds that it would create potential conflicts of interests or, more pertinently, might blunt the unions' ability to prosecute the wages struggle; trade

<sup>56</sup> Bullock, *op cit*

<sup>57</sup> The Bullock recommendations are summarised in Annex 5

<sup>58</sup> Fabian Society *Workers in the Boardroom*, Fabian tract 441 (1976)



union officials could not be both directors and negotiators or capitalists and agents of the proletariat.<sup>59</sup> From the right of the trade union movement the electricians' union, the EETPU, took a rather similar view for apparently similar reasons – although without the revolutionary rhetorical flourishes. It was simply assumed that collective bargaining would give trade unions sufficient influence over strategic decisions without the risk of being sullied by management choices through participation at board level.

Employers certainly did not accept the case for a radical extension of industrial democracy, condemning the TUC's proposals (as summarised in Bullock's terms of reference) as:

*[d]etrimental to Britain's already weak economy because... they would interfere with the achievement of the basic task of all employers and managers, namely the optimum use of resources in the interest of employees, investors and consumers.*<sup>60</sup>

As an alternative, the CBI supported what it described as "participation agreements". These arrangements had nothing whatsoever to do with board-level representation and would best be described today as the development of an approach to individual employee involvement or consultation, agreed with the trade unions, to supplement the normal machinery of collective bargaining.<sup>61</sup> The principal purpose of these agreements was entirely instrumental, being designed to improve the "level of efficiency, profitability and prosperity of the enterprise". At best this might be characterised as a rather weak information and consultation model with a voluntarist foundation – albeit one that would have been subject to negotiation with more powerful trade unions than most employers confront today.

Five important features of the Bullock debates emerge from this brief review. First, while the Fabian Society devoted considerable attention to the question of industrial citizenship, this was not the predominant narrative at the time. Most striking perhaps is that the notion of workers as stakeholders was treated as a subsidiary theme – particularly in the submissions made by employers. Second, many of the positive arguments used on all sides were focused on instrumental goals, whether the grand objective of industrial regeneration specified by the Fabians or the workplace efficiency favoured by the CBI. Third, and reflecting the debates on information and consultation almost three decades later, British businesses were happy to countenance

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59 See, for example: Gill in Hobsbawm, E et al *The Forward March of Labour Halted* (Verso, 1981)

60 Confederation of British Industry *The Full Text of the CBI's Evidence to the Bullock Committee of Enquiry into Industrial Democracy* (1976)

61 Ibid

"participation" (generally on terms determined by the employer) but were much less well disposed to any notion of worker representative involvement beyond the (at the time) normal machinery of collective bargaining. Fourth, distributional or equity concerns were conspicuous by their absence, principally because the collective bargaining system as conventionally conceived was believed to deal with questions of distribution. The notion of industrial democracy as an instrument of industrial citizenship was about achieving either higher-quality employment (explicit in the Fabian position), higher productivity or industrial peace. Fifth, while the discussion in the UK was partisan, divisive and ultimately unrewarding, other European countries were either entrenching or developing their systems for worker representation at board level. An observer from continental Europe at the time would have been surprised by the intensity of the British debate and baffled by the inability of the parties to make progress with an agenda that had a powerful logic.

The Bullock committee offered an account of the pressures for change in chapter 3 of the report, which one might also assume were important in the European discussions too. Among the more important factors identified were:

- the growing concentration of ownership in industry, leading to an increasing disconnection between the workplace and the arena where critical business decisions were made;
- the disconnection of ownership and control – endorsing the diagnosis of Berle and Means;
- an accelerating pace of technological change and an uncertain economic environment leading to a higher level of organisational instability, which in turn demanded that change was legitimised and justified to affected employees – preferably through some process of participation;
- rising levels of educational attainment and the decline of deference – it was asserted that employees would be both more demanding of their employers and more aspirational;
- changes in trade union practice and culture – at national level this embraced the TUC's willingness to take some share of responsibility for the management of the economy, at local level it meant the development of an extended bargaining agenda by shop stewards to embrace issues that would have been the province of works councils in continental Europe (legislative changes, like the introduction of union backed health and safety representatives under the Health and Safety at Work Act 1974, confirmed the trend); and
- the development of industrial democracy at board level in continental Europe.

This last point was by no means unimportant. Germany had established a limited form of co-determination in 1951 and both Sweden and Germany had radically extended their arrangements for industrial democracy at board level in the early to mid 1970s. As the Bullock committee somewhat enviously observed:

*The fact that the West German and Swedish economies have been among the most successful in the world – not least in avoiding the industrial conflict which has cost Britain so dear – has not escaped notice.<sup>62</sup>*

Given what we know about subsequent events, Bullock represents a path not taken at a decisive fork in the road. The UK had a choice in the late 1970s. Either government, unions and employers could have sought to forge a better corporatism, with Bullock as the foundation stone for a new settlement, or the whole of the post-war system could be abandoned and the logic of free markets asserted as the only available alternative. That the Bullock proposals should have failed is not entirely surprising when one considers the range and depth of the opposition. Of course, the committee was itself divided, which did not help, with the employers' representatives producing a minority report and one member of the majority entering a significant note of dissent on the case for equal shareholder/trade union representation. Employers, with a few exceptions, were viscerally hostile. Trade unions were divided in their opinions beyond the usual ideological differences between right and left. And the Callaghan government, with its majority evaporating, had no political capital to invest in a major legislative initiative.

### **Workers on the board: the German case**

An observer from almost anywhere in northern Europe would find the discussion so far somewhat bewildering. As we have already seen (annex 1) many continental European countries make provision for workers to be represented at board level, continue to observe collective agreements and treat trade unions with respect despite their diminished status. Furthermore, while unions and employers in the UK were having the unrewarding exchanges in the 1970s that eventually caused the industrial democracy project to be abandoned, other countries were pressing ahead to expand the scope of worker influence on strategic business decisions (see annex 1).

The German case is perhaps the best known, with extensive arrangements for co-determination (on a basis of parity of representation) in the coal, iron and steel industries from the 1950s onwards. Weaker co-determination rights were established

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62 Bullock, op cit, chapter 3, para 13

in companies employing more than 500 workers by the Works Constitution Act 1952, with workers having a third of the seats in the supervisory board. There was a major new initiative in 1976, which extended parity of supervisory board-level representation in all companies with more than 2,000 employees – very much the corporate population at which Bullock was aiming. While some German employers have criticised the system since that time, there is no political consensus for a radical dismantling of board-level representation. Indeed, German policy makers believe that their economy has proved resilient in the crisis because of co-determination at all levels. The Free Democratic Party (FDP) – Germany's most "market-friendly" political party – did fight an election on a programme of eroding (or in their view reforming) the architecture of co-determination, but once in coalition with Chancellor Merkel's CDU/CSU these ideas were quietly dropped.<sup>63</sup>

It would be quite wrong, of course, to believe that it is possible to transplant an institution from one country and expect it to work without modification elsewhere. But the German case is instructive because the institutions are both prescribed in detail by law and deeply embedded in the system. That is not to say of course that the possibilities for worker participation are not under pressure in some parts of Europe – both Hungary and Slovenia have introduced the possibility of unitary boards with weaker rights for worker participation. But while recent political currents across Europe may appear to flow in both directions, the general direction of travel in Germany is either to maintain the status quo or to enhance the rights available for the appointment of worker directors. The provisions in Germany are detailed and complex. In this chapter we have summarised the system that applies under the Co-determination Act 1976, principally because it dates from the same period as Bullock and remains the most recent innovation in board-level representation (box 2).

## **Box 2: Co-determination at board level in Germany – the Co-determination Act 1976**

- The act covers joint stock companies, partnerships limited by shares, private limited companies and profit-making co-operatives, where these entities employ

63 Both the Social Democrats (SPD) and the Left Party (Die Linke) in Germany are calling for a strengthening of worker participation rights. The SPD has suggested that the supervisory board should have the explicit responsibility of ratifying plant closures, relocations and corporate restructuring. Moreover, the thresholds for worker participation should be lowered, with employer-worker parity on the boards of all companies employing 1,000 or more workers and one-third worker representation on the boards of all companies employing more than 250 employees. One of the most controversial topics in that country today is whether workers outside Germany employed by German companies should have the right to vote in the election of worker members of the supervisory board (Conchon, op cit).

at least 2,000 employees and have their legal headquarters in the Federal Republic of Germany.

- Companies covered by the act must establish supervisory boards with an equal number of employees' and shareholders' representatives on the board.
- The size of the board depends on the number of employees, with the act specifying the numbers in relation to a ratio of board members to employees.
- Either two or three seats on the supervisory board are reserved for the trade unions recognised for collective bargaining by the company, depending on the size of the company.
- A company with more than 20,000 employees will have a supervisory board with the following composition:
  - ten employees' representatives, three of whom will represent the trade unions, one of whom must be a salaried employee, one a wage earner and one an employee from the "executive" level;
  - ten shareholders' representatives.
- All employees' representatives are elected either by a ballot of employees or by "delegates" elected for the purpose (in companies employing more than 8,000 employees).
- Different groups of workers elect their representatives in different ballots. In other words there are separate elections for the wage earners, salaried employees and managers. The trade union representatives are elected in a ballot of all employees, whether trade union members or not.
- The chair and vice-chair of the supervisory board must be elected by a two-thirds majority of board members.
- Members of the managing board of the company are elected by a two-thirds majority vote of the supervisory board.

The differences between these arrangements and the Bullock proposals should be clear. To begin with, the German system draws a sharp distinction between the day-to-day management of the company and strategic oversight. These two functions were apparently confused in the British proposals – although Bullock rejected the supervisory board model on the grounds that there was no contradiction or conflict of interest. This assumption should to be contested (and should have been challenged at the time) simply because employee representatives on a unitary board would have found it difficult to maintain a sense of distance from difficult operational decisions. Given that most workers' representatives under Bullock's proposals would have been shop stewards (all of whom would have been new to the boardroom), the scope for

"collective bargaining" behaviour to leak into board-level discussions could have posed serious risks to the success of the scheme.

Furthermore, the German model is much more prescriptive about board size, composition and methods of election/selection. More importantly, perhaps, the supervisory board has the right to appoint (and dismiss) executive managers. That is a substantial power.

Perhaps the biggest difference between Bullock's proposals and the Co-determination Act is the lower priority given to the role of trade unions in the German scheme – and the fact that *all* workers have the right to vote for the union representatives on the board. A universal rights model was as deep-rooted in the German system in the 1970s as the single-channel trade union model was in the UK. After all, German works councils are elected on a universal franchise and it would look very odd for the board-level participation arrangements to adopt a different model.

We will explore the role of works councils in more detail in the next chapter, but it should be noted that their development has much to offer the UK given the current weakness of the trade unions in the private sector. This is a controversial proposition and is likely to prove unpopular with some trade unions and employers. If we believe, on the other hand, that "voice" is a necessary condition for a humane workplace then it is difficult to find an adequate alternative that can make industrial citizenship a reality.

### **Corporate governance, distribution and in-work poverty**

There is very little evidence recording the impact of board-level representation on the distribution of income. Most of the studies in Germany have focused on productivity and performance and have produced mixed or contradictory results.<sup>64</sup> It is also difficult to be precise about the trajectory of executive pay in those countries with a "stakeholder" model of corporate governance, in part because there may (surprisingly) be more transparency in Anglo-Saxon systems. In other words, public concern about the upward spiral of executive pay in both the UK and the USA has led to corporate governance reforms, which means that we know a great deal more about executive pay developments in those countries than we do about continental Europe.

Nevertheless, there have been controversies about executive pay elsewhere in the EU (Vodafone and Mannesmann in Germany, ABB in Sweden) all of which have led to more

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64 Conchon, *op cit*

transparency and more accessible data.<sup>65</sup> In a very careful piece of analysis, Martin Conyon and others<sup>66</sup> suggest that the differences between executive compensation in "stakeholder" and Anglo-Saxon governance models are not as stark as one might have thought. On the other hand, they also find that *average* chief-executive compensation is significantly higher in the USA and the UK and that there is a much greater reliance on stock options as a supplement to base salaries. That the corporate governance architecture has some impact on these arrangements seems self-evident. If the company is conceptualised as a vehicle for the maximisation of shareholder value, with a principal-agent problem between the investors and managers, then tying compensation to an equity stake in the firm looks like a rational choice – even if, as we have argued, this leads to short-termism and an excessive appetite for risk.

A very different approach to executive pay is required, however, if the corporation is conceptualised as a community of interests, investing for the long term and focused on building market share through the provision of innovative products and services. Hall and Soskice, in their work on "varieties of capitalism", identify incremental improvement and process innovation as one of the great strengths of the German system, particularly in manufacturing.<sup>67</sup> This requires committed and motivated employees – or "engaged" workers, to use the contemporary formulation. Allowing executive pay to spiral upwards is unlikely to be conducive to the sustainability of that culture. Moreover, it seems reasonable to suggest that if workers had half the seats on a supervisory board in the UK then the exponential growth of executive pay would at least have been more subdued if not eliminated.

What we cannot say, however, is that the extent of in-work poverty and inequality is reduced *simply* by having a corporate governance system with workers on the board. The German experience directly contradicts any such conclusion. In that case an extensive programme of labour market reform has pulled the income distribution in a much less egalitarian direction. The weakening of the collective bargaining system is another important factor in explaining the trajectory of income inequality in Germany. Once again it is power and capability that matter. Policy has to be consistent and in Germany it was not – institutions designed to achieve an egalitarian purpose found

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65 In the Mannesmann case, the supervisory board endorsed the payments of enormous bonuses to senior executives shortly before the completion of the takeover by Vodafone, despite the presence of workers on the board. One could see this as an isolated case but it proves that even the most effective institutions can be corrupted. In the ABB case, a huge pension payment ruined the reputation of the retiring chief executive and led to lawsuits from shareholders.

66 Conyon, M et al *The Executive Compensation Controversy: A Transatlantic Analysis* (Fondazione Rodolfo de Benedetti, 2011)

67 Hall & Soskice, op cit

it hard to resist government policies that were pursuing diametrically opposed objectives.<sup>68</sup>

### Lessons for the UK?

This brief historical account shows that the question of workers on the board generated much heat and little light in the 1970s. The Bullock proposals, which look modest in comparison with the arrangements in place across much of northern Europe today, could never muster the political support needed to bring the policy intention to fruition. British employers were opposed to participation at board level in the 1970s and are likely (given their declared attitude to information and consultation rights) to be equally opposed now.

Yet many of the forces that provided the impulse for policy innovation almost 40 years ago look just as relevant today. As the Fabian Society argued so persuasively at the time:

*Work can and should be a major source of fulfilment and growth for the individual and not merely a means of meeting his [sic] basic needs. Yet for most employees, the design, organisation and control of their work allows little room for development. A comprehensive democratic strategy which gave a much wider degree of participation and joint determination in formulation of policy at boardroom as well as workplace level would go far to give industry a human face.*<sup>69</sup>

Simply expressed, the Fabians were making the case for a systematic approach to worker participation, with institutions of workplace democracy at different levels reinforcing each other. This is highly pertinent to contemporary debates and suggests that corporate governance reform must sit alongside the construction of new institutions for worker representation.

Most interesting for these purposes is the increasing attraction of the political right to the case for corporate governance reform – and the merits of the two-tier board model in particular. Ferdinand Mount (formerly head of Margaret Thatcher's policy unit in Downing Street) has argued that halting and reversing the trend towards rising income inequality demands a different conversation and a wider range of voices in the UK's boardrooms.<sup>70</sup> His view is quite explicit: the unitary board structure has exacerbated

68 Particularly the creation of so-called "mini-jobs" outside the scope of the social security and collective bargaining systems.

69 Fabian Society, op cit

70 Mount, op cit



the upward spiral of executive pay. More dispassionate scrutiny by well-informed shareholders and their representatives on a supervisory board would have imposed some restraints on executive excess. Whether this is right or wrong is somewhat beside the point, not least because it creates the possibility for a revived discussion about the nature of the firm, the regulation of responsible capitalism and corporate purpose. Of course, Mount has said nothing about the possibility of workers' representatives on the supervisory board, but by attacking the *pensée unique* of corporate Britain he has, at least, allowed others to make the case for reform.

Perhaps the best way to take the argument forward is to begin to build a broad and deep constituency for change. There are multitudinous arguments for reform being advanced from the right (Ferdinand Mount) and the left (the High Pay Commission). But no participant in the British debate has yet suggested that the dynamics of power in the workplace need to shift decisively back towards the interests of workers for reasons of fairness and economic stability.<sup>71</sup>

If we return to our earlier argument about the *employment regime* we can see that Germany, Sweden and Denmark all make provision for board-level representation but achieve very different distributional outcomes. Obviously the relationship between the different elements of the system is important (workers on the board, collective bargaining and arrangements for workplace participation), but the critical element seems to be the way in which power is expressed through these institutions. The differences between Sweden, Denmark and Germany are best explained in terms of the relative power of the actors and the consistency of public policy in seeking egalitarian outcomes rather than the formal rights established in law. Again, there is a relationship between power and institutions: responsible participation by workers' representatives confers legitimacy, which in turn gives them more opportunities to shape the agenda. But more than this, following Duncan Gallie's argument enables us to understand the extent to which seemingly disparate institutions (the training system, the welfare system and the corporate governance architecture) both confer and reinforce power. One might say that the Nordic unions (despite their current challenges) have achieved a virtuous circle; industrial citizenship is seen as part of a wider politics of the quality of life, influencing politicians, employers and public opinion.

The argument for workers on the board as an important institution of pre-distribution rests principally on the case that a responsible capitalism investing for the long term is

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71 However, the IMF has made this case in a discussion paper (Kumhof & Ranciere, op cit) and it is implicit in the Resolution Foundation's recent work (Commission on Living Standards, op cit).

also a sustainable capitalism. Corporations that are confident enough to share management dilemmas with workers, treat people at work as citizens and recognise that managers do not have a monopoly of wisdom are much more likely to unleash the skills and talents of their employees. Board-level representation can be an important reinforcement to a culture of trust and openness. At the very least the case for industrial democracy, abandoned after Bullock was consigned to the dustbin of history, deserves a fair hearing.

### **Policy recommendations**

Developing a practical policy agenda for corporate governance reform is fraught with political difficulty, not least because some businesses appear to be atavistically hostile to anything that might challenge the status quo. But – and this is a critical issue – there have been numerous reports since the early 1990s, largely business sponsored, focused on improving the quality of corporate governance. The Cadbury report was published in 1992 in the wake of the Maxwell and BCCI scandals to prevent a recurrence of those events. It set out a range of recommendations, all of which were accepted, concerning the role of the chair of the board and the chief executive (drawing a clear distinction between those functions), the role of non-executive directors, and audit and financial reporting requirements. Somewhat later (in 1995), the Greenbury report made a series of recommendations about executive remuneration in response to rising public concern about excessive salaries for senior executives. Once again all the recommendations were implemented. In 1998 Sir Ronald Hampel and his colleagues reviewed the operation of the Cadbury and Greenbury measures and made a further series of proposals, all of which found their way into the Corporate Governance Code (sometimes known as the Combined Code), the application of which is supervised by the Financial Reporting Council.

Simply expressed, there was a widespread understanding throughout the 1990s that the legitimacy of business would be threatened unless there was change in Britain's boardrooms. Yet in each of these cases there was no challenge to the existing paradigm and no attempt to address any of the issues that had been raised in the deliberations of the Bullock committee. The focus was on improving the performance of the unitary board in an environment where maximising shareholder value remained the dominant consideration. After 1997 the Labour government instituted a wide-ranging review of company law, but the development of a "stakeholder" model was ruled out at a very early stage, with further policy development rooted in the principle of "enlightened shareholder value". Very little of substance emerged beyond some minor changes to directors' duties, including a requirement that directors have regard to the interest of employees.

John Kay's review of short-termism for the Coalition government is in a similar vein to these earlier initiatives. Yet while Kay's diagnosis of the UK's problem is exemplary, the proposals depend more on voluntary initiative than legislative action and will do little to change the nature of the boardroom discussion. Once again the focus is on enlightened investors, engaging with the companies in which they hold shares, to ensure that decisions are taken for the long term. This is of course a welcome step in the right direction, but – as Kay recognises in the report – an increasing percentage of UK equities are held by overseas investors (hedge funds and sovereign wealth funds), as domestic institutional investors look for less risky options to reflect the nature of their liabilities.<sup>72</sup> It is not entirely clear that a sovereign wealth fund based in the Gulf or Asia will have the best interests of the UK economy in mind when making investment decisions. Moreover, despite the hyperactivity in voluntary corporate governance reform in the 1990s, none of these changes has imposed any restraint on the growth of executive pay and failed to prevent the excessive risk taking in the banking sector that precipitated the global crisis. The pernicious culture that was allowed to develop among financial institutions that were "too big to fail" was, in large measure, as much a failure of governance as a failure of regulation.

It is possible today, just as it was *impossible* during the boom period, to ask profound questions about corporate purpose (what are limited liability companies for?) and the measures needed to create a more responsible capitalism. To outline a fully developed programme of corporate governance reform or to call for the wholesale importation of the German model to the UK is not entirely helpful. As with labour market policy more generally, what the UK needs is reform based on consensus. The risk of course is that a search for consensus will result in policy being reduced to the "lowest common denominator" ("Just what will the CBI accept?") or that a process of triangulation, splitting the difference between the radicals and enthusiasts for the status quo, will promise a spectacular display and deliver a damp squib. Simply put, there needs to be a dispassionate consideration of the issues rather than a partisan debate, and a process that encourages the recalcitrant to change their stance.

It would be sensible, therefore, for political parties to consider the limits within which this conversation should take place and make a commitment to establish a Corporate Governance Commission immediately after the 2015 general election. The objective is clear: to change the composition of Britain's boardrooms and create the conditions for

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<sup>72</sup> Final salary pension schemes are holding more gilts and fewer equities because they have liabilities to pay current pensioners and fewer people in work actively contributing to the scheme. This requires a lower-risk investment profile. The same can be said for UK-based insurance companies, which need to hold less risky assets to meet EU solvency requirements.

a more responsible capitalism. The commission should report within 18 months so that legislation can reach the statute book before the end of the 2015 parliament.

More rapid progress could be made through modest changes to company law giving effect to the recommendations of the High Pay Commission. Businesses will find it difficult to object to the case for more transparency in pay determination, and all listed companies should be required by law to publish the following in their annual reports:

- the ratio of the pay of the highest earner to the pay of the lowest earners in the organisation;
- the number and percentage of employees paid at the national minimum wage;
- the number and percentage of employees paid less than the living wage; and
- the distribution of pay across the whole workforce, broken down by grade, gender and pay level.<sup>73</sup>

The High Pay Commission's central recommendation is that a workers' representative should be appointed to the remuneration committee of all listed companies. This has some superficial attractions but may not achieve the desired results. Most importantly, perhaps, an under-resourced worker member will face genuine difficulties in challenging either the recommendations of highly paid, expert remuneration consultants or the opinions of more "conventional" members of the remuneration committee. At the very least there would need to be time off work for training, and workers' representatives would require rights to seek their own expert advice. Yet even with these safeguards, it is not entirely clear how the proposal could be effective in the absence of some representative structure in the organisation – either a works council or a recognised trade union.

All workers' representatives, in whatever context, must be seen as legitimate by the workforce. That implies a process of election and potentially competition between candidates. In other systems either union representatives or works councillors have

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73 At the time of writing it was proposed that a bonus cap should apply across the EU 27 to ensure that no bonus exceeded 100% of salary. This looks like a sensible measure, but it could have the perverse effect of encouraging businesses to offer significantly higher salaries in return for lower bonuses. The impact of any such change would need to be kept under review and action taken to counteract any unintended consequences. The British government has not opposed the measure (there are no votes to be found in a defence of the bonus culture) but the CBI has suggested that the bonus cap would prevent shareholders from making informed judgments about levels of executive pay and bonuses. This argument is rather weak, not least because shareholders rarely take a public position on remuneration unless the offence is especially egregious. Moreover, supposed shareholder oversight did nothing to stop the growth of the bonus culture in the first place and has imposed no restraints on levels of executive pay. Recent experience rather confirms the principal-agent problem and suggests that other reforms (like a stakeholder model of governance) may prove more effective than enhanced shareholder activism.

the right to put themselves forward for election to the board. There is a hierarchy of representativeness from the highest to the lowest level, with those who had been members of the information and consultation body providing the majority of worker candidates for board membership.

So far as the UK is concerned, there are no such structures for information and consultation in the vast majority of private-sector workplaces – 90% of manufacturing workplaces and 80% of workplaces in private services have no arrangements for joint consultation; only 10% of private-sector workplaces are covered by a collective agreement.<sup>74</sup> The representative infrastructure needed to make remuneration-committee representation effective is conspicuously absent.

One might conclude, therefore, that enthusiasts for remuneration-committee representation are looking at the problem through the wrong end of the telescope. Action needs to be taken to build the infrastructure of workplace participation at the same time as measures are implemented to ensure that workers' voices are heard in the boardroom. Making capitalism responsible depends on there being a body of workplace representatives who are ready, willing and able to solve problems in partnership with the employer and, at board level, take responsibility for critical decisions affecting the future of the business. No doubt some unions will argue that an extension of collective bargaining and the preservation of the single channel for the selection of workers' representatives is the best route forward. But this argument lacks real force given union membership weakness in the private sector – which is where the real problems of growing income inequality are located. Simply expressed, unions' best route to resurgence is by making use of the universal representative systems that are commonplace in most other EU 15 countries. This is a controversial proposition in the UK and it is to these issues that we now turn.

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74 van Wanrooy, B et al *The 2011 Workplace Employment Relations Study: First Findings* (Department for Business, Innovation & Skills/Economic & Social Research Council/ACAS/National Institute of Economic & Social Research, 2013)

## Chapter 3

# Works councils

## Works councils

### Summary

- Trade unions in the UK have always been somewhat suspicious of the universal rights models of representation widespread across the EU 15. Yet the decline in trade union membership and collective bargaining coverage have led some commentators to suggest that the reinforcement of the information and consultation (I&C) obligations derived from the 1998 EU directive is the "last chance for collectivism".
- Works councils are often prohibited from negotiating wages – a function that is reserved exclusively to trade unions and collective bargaining. Yet there is evidence in Germany to show that works councils can have a sword-of-justice effect, limiting the extent of low pay and inequality in the organisation. The argument advanced here, however, is that trade unions in Britain will need to alter their strategy so that they focus on organising works councils as a route to organising workers instead of taking a hitherto union-free workplace and attempting to establish collective bargaining in one leap. Over time one would expect this approach to achieve a fairer initial distribution of incomes.
- There is strong evidence to show that the status quo has left the UK with a severe representation gap. The UK has among the lowest level of employee participation in the EU 27, and the 2011 Workplace Employee Relations Survey shows a decline in consultative mechanisms. It is hardly surprising therefore that so many British employees should be disaffected, dissatisfied and disengaged.

### Policy recommendations

- The Information and Consultation of Employees Regulations 2004 require extensive amendments if they are to offer a useful vehicle for the establishment of industrial citizenship.
- Trade unions should have rights to initiate the information and consultation (I&C) process, leading to the election of workers' representatives by the whole workforce, whether union members or not.
- The trigger requirement that 10% of the workforce must support the request for I&C should be repealed and replaced by a requirement that there be some

organised expression of the desire for representation. The German works council system offers a starting point for discussion: the request for a works council can be activated with the support of five employees.

- The “default” provisions of the 2004 regulations should become the minimum standard for all I&C arrangements. Consideration should be given to implementing a more extensive range of rights, learning from good practice elsewhere in the EU.
- The provisions on pre-existing agreements should be amended so that only an agreement consistent with the default provisions would be sufficient to deflect a further request for I&C.
- It should not be possible for direct participation to be a substitute for the representative participation envisaged by the EU directive on information and consultation.
- Members of the works council should be entitled to time off for training and the conduct of their works council duties and should have the right to seek expert advice, for which the employer must pay.

## Introduction

Works councils have been part of the industrial relations landscape in Europe for some time (see box 3 for a description of the scope and purposes in Germany). However, neither trade unions nor policy makers in the UK have shown much interest in works council models. In the 1970s, it was generally assumed that the growth of the shop-stewards system of workplace representation played essentially the same role as works councils in continental Europe. On this view, there was no case for institutional innovation, and any change in the architecture of industrial relations would either be seen as damaging to relationships that were believed to work well or would be resisted by the unions as an attack on the edifice of collective bargaining. For an observer in 2013, this view looks more than a little complacent given the subsequent events and the erosion of union membership and influence in the workplace. In other words, a source of trade union resilience in continental Europe has been the legal rights guaranteed to works councils, despite the pressures of industrial restructuring and technological change that have had a negative impact on union membership in most countries (with the partial exception of the Nordics).

Moreover, it is plausible to argue that Bullock, confirming the common sense of the



trade union movement of the time, failed to draw an adequate distinction between the practices of collective bargaining and of information and consultation. Collective bargaining is essentially about questions of distribution, whereas information and consultation processes are about the management of workplace change and reorganisation. The simplest way to draw the distinction is to say that collective bargaining is a negotiation *across* the table whereas information and consultation is a process that takes place *around* the table. British trade unions have often taken the view that only collective bargaining constitutes "real" trade unionism.<sup>75</sup> That is where the action is. But an emphasis on distribution leaves many important decisions about the organisation of the workplace out of the account. One might even go so far as to say that neither trade unions nor employers in Britain in the 1960s and 1970s fully understood the importance of the *non-bargaining* elements of their relationship. The sociologist Alan Fox, writing in 1966, captured the importance of non-distributional questions in the employer-trade union relationship. In his view, by focusing on trade union pay bargaining:

*... an even more important role [emphasis added] has been neglected and insufficiently understood. This is the role of union organisation in the workplace itself in regulating managerial relations, i.e. the exercise of management authority in deploying, organising and disciplining the labour force after it has been hired.*<sup>76</sup>

The scepticism about anything outside the "single channel" (where trade unions have the exclusive right to represent workers) continues to influence British debates today. Much of the apparent trade union hostility or apathy towards the information and consultation rights derived from the I&C Regulations 2004<sup>77</sup> stems from the belief that this is an alternative to "proper" trade unionism.<sup>78</sup> In principle, one might say that trade unions do have more to fear today, since their relative weakness in the private sector makes it easier for employers to use information and consultation arrangements as a "union avoidance" strategy. But there is no significant evidence to support this conclusion, and those employers wishing to marginalise trade unions have almost certainly done so already.<sup>79</sup>

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75 Hall, M and Purcell, J *Consultation at Work: Regulation and Practice* (OUP, 2012); Terry, M *Partnership Uncovered: The Implications of Partnership for Trade Unions in the UK* (Unions 21, 2002)

76 Fox, op cit

77 The Information and Consultation of Employees Regulations were introduced on 6 April 2005 and apply to businesses with 50 or more employees. The regulations give employees the right, subject to certain conditions, to request that their employer sets up or changes arrangements to inform and consult them about issues in the organisation.

78 Hall & Purcell, op cit

79 Ibid

### **Works councils, trade unions and distributional outcomes**

Works councils are generally elected on a universal franchise by all employees – everyone has the right to vote, whether they happen to be a trade union member or not. But what makes works councils effective in every country where they are present is the enthusiastic participation of the trade unions. Candidates for election are often willing to identify themselves as union members, are supported by their unions with resources and access to training, and see their role as works councillors as another aspect of their trade union duties. Moreover, trade unions in some countries are divided along ideological lines and will measure their support according to the number of seats they win in works council elections (this is particularly true in France, for example). The most obvious conclusion here is that works councils cannot be effective *without* trade union support. Works councillors would be under-trained, under-briefed and under-resourced. Our main conclusion is confirmed: power and organisational capability matter more than anything else. Moreover, collective bargaining and information and consultation processes are complementary in most of the EU 15. French and German unions do not see works councils as either a threat or an alternative to collective bargaining.

It is important to confirm that there is little or no evidence showing a relationship between works councils, inequality and in-work poverty. This is because works councils are generally prohibited from negotiating wages, a function reserved to the collective bargaining system – although in some countries, including Germany, this general principle is being applied more flexibly at workplace and company level (see the discussion later in this chapter). On the other hand, returning to the notion of the *employment regime*, even if there is no immediate impact on pay, works councils can play a reinforcing role, establishing the legitimacy of worker participation at all levels (from the board to the workplace) and legitimising in turn the importance of collective bargaining, even in countries where union membership is low (see annex 1).

Another important feature of works councils is that they are concerned with achieving both a framework for participation and a balance between competing interests in the workplace. To take the German Works Constitution Act 1952 as an example, the objectives are said to be providing the workforce as a whole *and* individual employees with the opportunity to assert their legitimate interests at the same time as the employer's fundamental freedom to make business decisions is respected. The key features here are *consultation, consent and legitimation*. Put simply, workers are supposed to be participants, not simply the victims of change, while employers retain their authority to run their businesses efficiently and effectively. The statutory

framework is a practical expression of John Budd's three principles of *efficiency, equity and voice* (see introductory chapter).

### **Fundamental characteristics of works councils**

It would be wrong to conclude, however, that just because institutions across the EU are described as "works councils" they are all necessarily the same. Most countries have a trigger requirement before a works council can be established – in other words, workers must make a request to proceed with the election of a works council – but the powers and constitutions of these bodies vary enormously from one country to another. At the risk of some distortion we might summarise the common characteristics of these arrangements as follows:

- Either the establishment of the works council must be initiated by employees or else it is subject to a size threshold, although the level of support/size of establishment required to move to an election varies widely across countries, ranging from a trigger of five employees in Germany, to a threshold of 100 in Belgium, and 150 in Luxembourg. The average size threshold is between 30 and 50 employees.
- All employees have the right to vote in the election of works councillors.
- The powers, rights and duties of works councils are generally established in law.
- The constitution and composition of the works council will be specified by statute.
- The range of issues on which the employer must consult with the works council – and on which agreement might be sought – will be specified in law.
- Rights to time off and training for the conduct of duties are guaranteed.
- A clear distinction is drawn between the role of collective bargaining and the role of the works council.
- Works councils cannot generally organise strikes or other forms of industrial action.
- The works council can call on expert advice when necessary.

## The German experience

Works councils are most commonly associated with Germany, where the rights are both extensive and highly prescribed (see box 3). Unqualified enthusiasm for the success of the German model has to be tempered by a sober assessment of the realities. Not every establishment that qualifies has a works council. Indeed, there is evidence to show that the coverage of works councils in Germany is falling as a percentage of total employment. In the early 2000s less than half the workforce was covered by a works council and the percentage will be much lower today.<sup>80</sup> The number of seats held by trade-union-backed candidates has diminished too, with slightly over half of all seats now held by those who self-identify as union members. And despite the supposed exclusion of works councils from any collective bargaining activity, there is increasing evidence that works councils do have an impact on wages, which may be exacerbating rather than solving some of Germany's problems.<sup>81</sup>

Recent studies have suggested that there is significant wage drift, particularly in German manufacturing, with firms that are performing well offering wages above the level specified in the relevant sectoral collective agreement. What the analysis also reveals is that establishments with works councils offer a wage premium of around 11% in a like-for-like comparison with non works-council establishments.<sup>82</sup> Moreover, works councils seem to have a bigger impact on pay at the lower levels of the earnings distribution and also reduce the gender pay gap – German works councils appear to have a sword-of-justice effect.<sup>83</sup> It should be emphasised, however, that these findings are relatively recent and that the relationship between works councils and wages remains a fruitful area for research. One might conclude that that this is precisely the effect that would reinforce the case we are attempting to make in this report: that the institutions of workplace democracy, as a subset of the institutions of pre-distribution, produce egalitarian outcomes.

Yet income inequality in Germany is rising not falling, and the labour market increasingly looks like a two-tier system with well-protected "insiders" enjoying benefits that are unavailable to the "outsiders" employed in low-wage mini-jobs. Without a determined effort to address the low-pay problem, there is a risk that the "works council" wage premium could be having an anti-egalitarian effect. Put simply, a small number of

80 Carley, M et al *Works Councils, Workplace Representation and Participation Structures* (European Foundation for the Improvement of Living & Working Conditions/European Industrial Relations Observatory, 2004)

81 Gerlach, K and Meyer, W *Wage Effects of Works Councils and Collective Agreements in Germany*, mimeo (2007); Addison, JT et al *German Works Councils and the Anatomy of Wages*, mimeo (2007)

82 Gerlach & Meyer, op cit

83 Addison et al, op cit

high-performing large firms in manufacturing with effective co-determination have a proven ability to pay more than the going rate. This is not fatal to the pre-distribution argument, of course, but it does emphasise another of our core findings – that context is everything. It also confirms the validity of the employment regimes story and the advantages of implementing bundled policies to create an inclusive labour market. The issue for German policy makers is much less about eroding the co-determination system to achieve more “flexibility” and much more about developing the work integration and employment integration policies that we discussed in chapter 2. From a macroeconomic perspective this makes sense too: the German economy will always experience a deficiency of domestic demand if it is carrying a very large number of low-waged employees whose incomes are only sustained by cash transfers from the state.<sup>84</sup> Viewed in this light, the German and British problems look more similar than one might initially have anticipated.

### **Box 3: Works councils in Germany**

#### **Structure**

- Works councils can be established in all enterprises with more than five employees.
- Three employees with voting rights or a trade union recognised for collective bargaining can initiate the process of establishing a works council.
- The works councils legislation applies to all employees except executive staff.
- All (non-executive) employees have the right to vote in the election of the works council. Elections are supervised by an electoral board (consisting of three employees of the establishment with voting rights), and trade unions are entitled to appoint a non-voting member to the electoral board.
- The number of members of the works council is determined according to a formula prescribed by law related to the number of employees in the establishment.
- In multi-site organisations there will be a works council on each site and a central works council for the company as a whole. Each works council will appoint two of its members to the central works council.
- Works councils are elected for a term of four years.
- Meetings with the employer must take place at least monthly.

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84 Which is the case of course for those employed in mini-jobs

## Rights and responsibilities

- The employer and the works council are subject to a legal obligation to co-operate in a spirit of mutual trust.
- The works council has an obligation to maintain industrial peace in the establishment. It cannot organise industrial action (this is without prejudice to the freedom of trade unions to organise industrial action in pursuit of a legitimate collective bargaining objective).
- In law, the autonomy of the collective bargaining process is protected. The works council cannot deal with matters that are normally determined through collective agreements.
- Where matters are specified in law as subject to co-determination, the employer cannot proceed to implement a decision without the works council's consent.
- The scope of the works council's activities can be *extended by a collective agreement* to create wider possibilities for worker participation.
- If necessary the works council can call upon the assistance of outside experts for which the employer must pay.

## The scope of co-determination

The issues on which the employer must seek the works council's consent are carefully prescribed and include:

- Matters relating to the proper running of the establishment – for example, clocking in and out, the use of security passes, smoking policies, dress codes, use of company telephones etc.
- The times at which the working day will begin and end and the distribution of working hours among the days of the week.
- Temporary reduction of working hours in the establishment and the introduction of short-time working.
- The time, place and form of remuneration – weekly or monthly wages, whether paid in cash or by bank transfer.
- The operation of leave policies.
- The introduction of technologies that monitor employees' performance.
- The management of health and safety in the establishment.
- Remuneration policies – bonuses, piece rates, other forms of performance pay.

## Participation and co-determination in staff matters

In addition to these co-determination rights, the works council has a mix of participation and co-determination rights in relation to the following:

- Workforce planning – the employer must *inform* the works councils about future and present staffing needs. Moreover, the works councils must be *consulted* about any action that results, including dismissals.
- Co-determination rights in relation to the formulation of guidelines for recruitment and selection – this includes hiring rules, regrading and dismissals.
- Vocational training – the works council has the right to be consulted on all matters related to vocational training and has co-determination rights in relation to the implementation of vocational training policies in the establishment.
- In relation to individual employees, the works council must consent to new hirings. Rights to participate but not co-determine are established in relation to gradings and regradings. Essentially, the works council is verifying that the correct procedures have been followed.
- Provision is made for resolving disputes between the works council and the employer regarding grading, regrading and redeployment.

### **Participation and co-determination in economic matters**

- The works council has the right to be *informed* about the company's economic situation.
- In organisations employing more than 100 employees, an economic committee must be established, through which the employer must provide information to the works council.
- In relation to restructurings and redundancies the works council has rights of participation and limited rights to co-determination on measures to preserve employment or provide compensation to affected employees.
- The works council must be informed about the employer's plans in good time for consultation on any proposed measures to take place.
- In such circumstances the works council and the employer can also negotiate a "social compensation plan" for workers affected. This might include redundancy payments, compensation for those assigned to different jobs, or paid retraining.

### **Participation and co-determination in work organisation, job design and the working environment**

- Where changes are planned due to technological developments, the employer must inform the works council in good time to allow consultation to take place.
- Specific rights to consultation are created in relation to the ergonomic implications of technological change.

- A right of co-determination exists where any “special burden” is to be imposed on employees as a result of these technological/organisational changes.

### Does the UK really have a representation gap?

The decline of institutions (most notably the trade unions) that used to provide both voice and a sword-of-justice in the British labour market has been a central feature of the analysis presented here. Fewer than one in six workers in the private sector is now a trade union member, and the shop stewards movement, which supposedly offered great opportunities for enhanced participation in the 1970s, is a pale shadow of its former self. The Workplace Employee Relations Survey series has also recorded the decline of joint consultative committees (JCCs): in 2004 only 14% of workplaces with 10 or more employees were covered by a JCC, falling from 20% in 1998.<sup>85</sup> And, as Mark Hall and John Purcell have documented, the impact of the I&C Regulations 2004 has been muted, with only a minority of employers making constructive use of the provisions.<sup>86</sup>

These results may look a little surprising given the high-volume employer rhetoric about the need for engaged employees willing to “go the extra mile”. But there is equally strong evidence revealing a high level of perceived unfairness and disengagement in the British workplace.<sup>87</sup> Moreover, there is also evidence to show that British workers want to be represented by organisations capable of developing a high-trust or “partnership” relationship with their employer.<sup>88</sup> This is entirely consistent, of course, with the approach to co-operation specified in the Works Constitution Act, which suggests that British workers have a commonsense understanding of the case for collectivism – a finding confirmed by earlier research.<sup>89</sup> No doubt HR professionals would point to the wide variety of activities that they undertake, all of which have some notional relationship with individual voice. Nonetheless, as Hall and Purcell observe:

*While direct forms of involvement through workplace meetings, team briefings, problem solving groups and, to a much lesser extent, employee attitude surveys can provide some avenues for worker voice, and are very widespread, they do not constitute an institutional basis for dialogue with senior managers on strategic matters and HR policy initiatives.*<sup>90</sup>

85 Cully, M et al *Britain at Work* (Routledge, 1999); Kersley, B et al *Inside the Workplace: Findings from the 2004 Workplace Employment Relations Survey* (Routledge, 2006)

86 Hall & Purcell, op cit

87 Fevre, R et al *Fair Treatment at Work Report: Findings from the 2008 Survey* (Department for Business, Innovation & Skills, 2009); Fevre, R et al *Trouble at Work* (Bloomsbury, 2012)

88 Freeman, RB et al *What Workers Say: Employee Voice in the Anglo-American Workplace* (ILR Press, 2007)

89 Trades Union Congress *A Perfect Union?* (2003)

90 Hall & Purcell, op cit, p162



Brian Towers, writing more than a decade earlier, suggested that the UK and the USA were unusual among the advanced economies in having such weak institutions of worker representation.<sup>91</sup> Nothing that has happened since that time suggests that the representation gap has got narrower or that there has been an upsurge of "involvement" to compensate for institutional weakness.

We are then left with the question whether a revival of consultation would have a positive effect in reducing either income inequality or in-work poverty. As we observed earlier, the evidence here is weak but the German case offers some (not always positive) indications of a limited sword-of-justice effect. It is possible, however, to argue the case from a different standpoint, as a long-term exercise in institutional reconstruction. In other words, a revival of consultation in the UK could, as Hall and Purcell suggest, be the last chance for collectivism. Trade unions might, with some imagination and creativity, begin to use universal rights institutions to rebuild their organisational capacity. The reforms to the I&C Regulations outlined below would allow workplace structures to be established at much lower thresholds of support than those required by the legislation dealing with trade union recognition, for example.<sup>92</sup> Even if the I&C architecture does not cover questions of pay, the German experience suggests that the boundaries between bargaining and co-determination can sometimes be blurred. Rebuilding the capacity of workplace institutions to achieve fairer outcomes may not deliver immediate results, and a high degree of patience may be required. What this means in practice for trade unions, employers and others is considered in the concluding chapter of this report.

### **Benchmarking participation across the EU: workplace democracy, pre-distribution and desirable social outcomes**

There is one further useful piece of evidence that helps to reinforce our story about the bundling of policies and the importance of the employment regime. The European Trade Union Institute (ETUI) has produced a European Participation Index, which assesses the effectiveness of participation both in the workplace and beyond. Initially the index simply looked at the formal rights guaranteed in law (works councils, workers on the board), levels of trade union membership and collective bargaining coverage. Now, however, this rough institutional assessment has been supplemented by data from a large survey of European employers which records what happens in practice in

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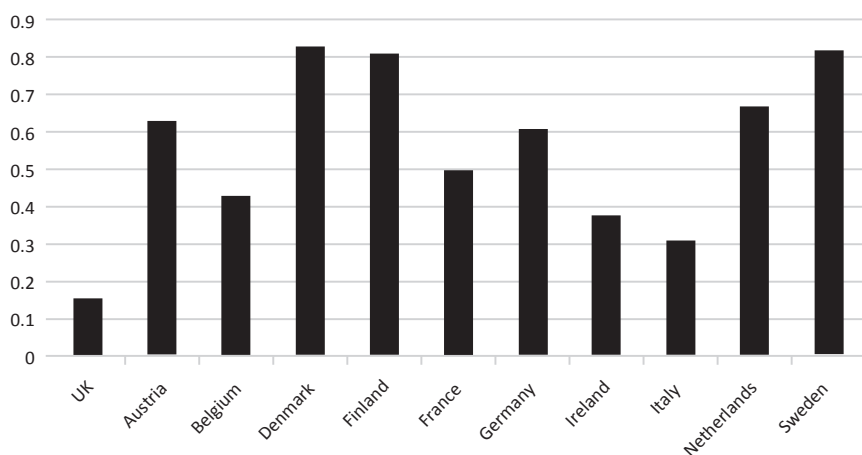
91 Towers, B *The Representation Gap: Change and Reform in the British and American Workplace* (OUP, 1997)

92 More than half of all those voting in a recognition ballot must express a clear preference for collective bargaining and at least 40% of all those entitled to vote must do so too.

the workplace, *beyond* the limits of formal legal obligations.<sup>93</sup> These results confirm that there can sometimes be profound differences between countries that have an apparently similar array of institutions. What the index is capturing therefore is not just institutional differences but differences in the *capabilities* of trade unions and others to make the institutions work effectively. The index gives a measure of whether there is an appropriate balance of power between capital and labour. Results for our selected group of EU member states are recorded below (figure 7).

**Figure 7: European Participation Index 2010**

*On a scale of 0 to 1.0*



Source: European Trade Union Institute, 2010

The UK is almost at the bottom of the index. Only Lithuania has a lower ranking (0.11). Of course this may in part be a reflection of the UK's lack of formal institutions – but the Republic of Ireland, which is almost as weak on most institutional measures, performs significantly better. Moreover, the index is based on employer self-reports of what they actually do to create opportunities for worker participation. If there was a great deal of “informal” activity in the UK then that would be captured by the index too – there is a specific category to record ad hoc participation practices. If further confirmation of the representation gap in the UK were needed, then the European Participation Index clinches the argument and confirms the first findings from the

<sup>93</sup> Vitols, S *The European Participation Index – A Tool for Cross-national Quantitative Comparison: Background Paper* (European Trade Union Institute, 2010)

2011 Workplace Employee Relations Survey that joint consultation in the UK is very much a minority pursuit.<sup>94</sup>

### **Policy recommendations: a British works council system?**

It is not terribly difficult to devise a programme of reform for the UK, since the analysis of the implementation of the I&C Regulations highlights a number of flaws in the statutory scheme, including:<sup>95</sup>

- the requirement that the support of 10% of workers is needed before a valid request can be made to activate the I&C Regulations;
- the high level of flexibility designed into the legal architecture, which means that *any* agreement with workers' representatives, no matter how flimsy, will be adequate to satisfy the test of compliance with the regulations;
- the possibility that an employer can pray in aid a pre-existing agreement to defeat a valid request under the regulations – if this agreement has been negotiated, approved and applies to the whole of the workforce then more than 40% of employees must express their dissatisfaction before any progress can be made towards a new agreement;
- the failure to prescribe some minimum conditions for an acceptable level of information and consultation;
- the possibility that "direct" methods of participation can be used as a suitable alternative to the representative participation envisaged by the EU directive on information and consultation;
- the failure to provide adequate resources to support the activities of workers' representatives;
- the absence of any rights to time off for training so that workers' representatives have the capabilities they need to offer employers a constructive challenge – at the very least a more modest version of the huge training programme envisaged by Bullock for worker directors may be required;
- the absence of any rights for representatives to call upon external expertise when technical questions are under discussion; and
- the failure to provide for either adequate or effective sanctions in the event of non-compliance by the employer.

The two most important changes would be to reduce the threshold for triggering the regulations and fixing some minimum standards for the scope of information and consultation. Of course, it is commonplace in other European countries to have both a

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94 van Wanrooy, op cit

95 Hall & Purcell, op cit

threshold and sometimes a trigger for the establishment of a works council, but none of them sets the bar quite as high as the UK. We have already noted that five workers in Germany can initiate the election of a works council. A similarly low hurdle would be appropriate in the UK.

Some commentators have suggested that there should be no trigger at all and that employers should be compelled to establish information and consultation committees. While superficially attractive, this approach has significant disadvantages. First, it puts employers rather than workers in control of the exercise. Second, it could lead to the creation of "empty shell" consultation bodies with unenthusiastic employee members and an agenda focused on routine or irrelevant matters. Effective information and consultation depends on workers taking responsibility and developing the capacities they need to be serious participants in the process. It would not be helpful if these compulsory institutions became rapidly discredited because they were seen to be ineffective. Third, employers would resist these compulsory measures using conventional arguments about "burdens on business"; and there is a good deal more to be said for this normally unconvincing argument in circumstances where employers are being required to establish structures without any employee demand for such an initiative. An organised presence of some kind in the workplace must be a prerequisite for the application of the new I&C provisions. This is essential for the legitimacy and effectiveness of the arrangements.

A further policy measure worthy of consideration would be to give trade unions a right to activate the operation of the regulations on their own initiative. In other words, unions would be able to approach an employer to establish an information and consultation committee without needing to secure the support of 10% of the workforce as is required today. This model applies in some other EU 15 countries, and a similar arrangement in the UK would therefore be consistent with practice elsewhere. Of course, unions would be activating a procedure that led to the election of a works council rather than the establishment of collective bargaining. Moreover, the union channel would be used to activate a universal rights institution because all workers (whether trade union members or not) would have the right to elect members of the works council.

The EU directive contains so-called default provisions that apply when the workers' representatives and the employer cannot agree on the scope of information and consultation. Presumably these are meant to set the *minimum* conditions for the discharge of the employer's obligations, but the UK regulations are drafted in such a way as to let a much weaker agreement replace the formula set out in the default arrangements.

A study of participation in 12 countries conducted in the 1990s produced a finding that is unsurprising in the light of the UK's recent experience: "the intensity of prescribed participation proved the strongest predictor of *de facto* participation".<sup>96</sup> Put another way, tough regulations deliver better results. This may be an unpalatable finding for some employers, but the evidence is clear and compelling. In the absence of an effective legal framework it is unlikely that anything will change. The current ICE regulations are just too feeble to make a difference. In future the difficult provisions must set the *minimum* conditions for a valid I&C agreement.

Even so, it would be a mistake to believe that simply changing the legislation is a sufficient condition for change. Someone has to make use of the new machinery and ensure that it is delivering the results desired by policy makers. Elsewhere in the EU much of this burden is shouldered by organised labour, which poses some difficult questions for British unions, many of which have been at best sceptical and at worst hostile towards any universal rights model of workplace representation. The argument presented here is that union opposition to universal rights bodies is based on a fundamental misconception; collective bargaining and robust information and consultation processes *can* be mutually reinforcing, assuming that both unions and works councillors have the power and capacity to achieve this objective. One might also say that it is difficult to envisage an alternative trade union strategy for membership growth. The trade union recognition procedure has been relatively unsuccessful in spreading the coverage of collective bargaining, and repealing all the so-called "anti-union" laws would be unlikely to make union membership more attractive.<sup>97</sup> As Mark Hall and John Purcell have observed, information and consultation may be the last chance for collectivism in the British workplace.<sup>98</sup> The precipitous decline in union membership and collective bargaining coverage in the UK is the issue to which we now turn.

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96 Heller et al, *op cit*, pp49-50

97 Coats, *D Time to Cut the Gordian Knot* (Smith Institute, 2010)

98 Hall & Purcell, *op cit*

## Chapter 4

# Trade unions and collective bargaining

## Trade unions and collective bargaining

### Summary

- Of all the institutions of workplace democracy, the evidence for a positive impact on reducing in-work poverty and income inequality is most robustly established in relation to trade unions and collective bargaining. Unions have a sword-of-justice effect.
- The sword has been blunted in the UK as a result of falling trade union membership, and there is evidence that the union wage premium (the pay advantage for organised over unorganised workers) is falling.
- Trade union membership has been under pressure throughout the developed world no matter what the dispensation of public policy. Repealing the anti-union laws would make little difference to the prospects for union growth.
- On the other hand, there is a compelling argument to suggest that action by government to extend the coverage of collective agreements can sustain the legitimacy of collective bargaining in otherwise adverse conditions (although it seems to have little impact on union *membership*). The statutory extension of collective agreements and the application of fair-wages policies would be more beneficial to trade unions in the UK than a straightforward repeal of the industrial action and balloting legislation from the 1979-97 period.

### Policy recommendations

- Government should commit to the reintroduction of fair-wages policies in public procurement (see also chapter 7).
- Consideration might be given at some time in the future to measures providing for the extension of collective agreements to non-signatory employers. This is controversial, however and, given the weakness of trade unions in the private sector, should perhaps not be an immediate priority.
- Trade unions should consider how they can make best use of the opportunities presented by a revised and considerably stronger approach to information and consultation. This should sit alongside a review of current recruitment strategies to ensure that organised labour can appeal effectively to a workforce who

struggle to see the relevance of trade unions as effective vehicles for collective action in the workplace.

Contrary to the experience elsewhere in the EU 15, for a century or more trade unions and collective bargaining were the *only* forms of workplace democracy well established in the UK. In the last 30 years that position has changed dramatically, with both union membership and collective bargaining coverage falling from a high point in 1979, leaving the UK with a much weaker set of institutions than comparable countries in northern Europe (figure 8). Of course, the problem of declining union membership is not unique to the UK. Outside the Nordic countries, where very special factors are at work (trade union membership was, until recently, the only way to access the unemployment insurance system), union membership has been either stagnant or falling in most advanced countries, and this phenomenon continued throughout the period when the global economy was experiencing boom conditions and employment was expanding (figure 9). Indeed, unions found it hard to recruit whether public policy was hostile to collective bargaining (the USA under George Bush), neutral (the UK under the 1997-2010 Labour governments) or generally supportive (Germany under governments of all political hues). One must look therefore to other factors, most obviously the rapid restructuring of developed economies, the shift in employment from manufacturing to services, and the growth of a new class of managers, professionals and associate professionals alongside the decline of skilled manual work. Inevitably public policy plays some role and appears to either accelerate or slow the pace of union membership decline. But even the most favourable public policy seems unable to stem the flow of workers away from direct union membership.

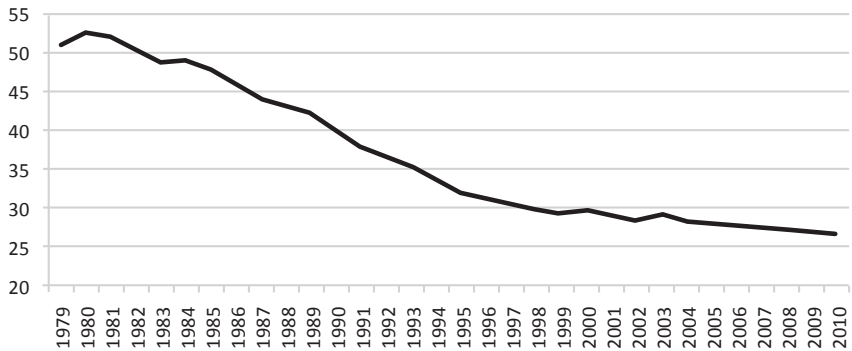
Nonetheless, trade unions in many of the EU 15 countries have managed to sustain the *coverage* of collective bargaining while membership is *falling* partly because employers have continued with the habit of observing collective agreements and partly because governments have intervened by extending collective agreements to non-signatory employers<sup>99</sup> (see annex 1 for details). These so-called extension mechanisms are particularly important in establishing a solid floor under wages. Sometimes they co-exist with minimum wages (as in France), and sometimes they are the only instrument used to limit the extent of low pay – as in the Nordics on a voluntary basis and now, less effectively, in Germany where there is a lively political discussion about the need for a statutory minimum wage to compensate for relative union weakness in low-wage sectors of the economy. What wide collective bargaining coverage cannot disguise,

<sup>99</sup> Employers who are not initially parties to the agreement but who operate in the sector/industry to which the agreement applies



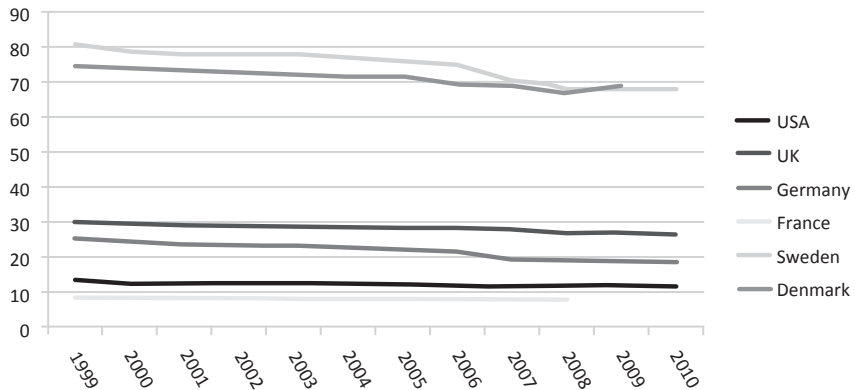
however, is the threat to trade union legitimacy if membership keeps falling. Unions across the OECD must find a strategy that leads to a revival of organised labour or run the risk of increasing marginalisation and irrelevance – and ultimately a much weaker impact on the distribution of wages.

**Figure 8: Trade union density in the UK, 1979-2010**  
*Percentage of employees*



Source: Labour Force Survey

**Figure 9: Union density selected OECD countries 1999-2010**  
*Percentage of employees*



Source: OECD

*Do unions have a sword-of-justice effect?* Despite the decline in union membership in the UK, there can be little doubt that trade unions continue to have a sword-of-justice effect in those workplaces where they are recognised.<sup>100</sup> The sword-of-justice effect can be measured on two dimensions: first, the union wage premium, or the extent to which workers covered by a collective agreement receive higher wages than comparable workers in a similar firm not covered by such an agreement; second, the extent of wage dispersion across the business – do unions have the effect of reducing differentials? Fortunately for our purposes, both findings are robustly established for the UK and for the USA in each of the last three decades.<sup>101</sup> In other words, pay differentials are narrower; there is less gender pay inequality and less inequality on the grounds of race, gender and disability.

A study from the early 2000s found that on a like-for-like comparison there was no *significant* trade union wage premium in the UK private sector.<sup>102</sup> In other words, when comparing workers of a similar type from similar firms the trade union members appeared to have pay rates similar to their non-union counterparts. Some commentators have sought to explain this by reference to intensifying international competition and changing market conditions that make it difficult for trade unions to disrupt product markets through strike action – if a dispute disrupts domestic supply then customers can look beyond the shores of the UK for their wants to be fulfilled.<sup>103</sup> More recent work has suggested that British unions continue to secure an average wage premium of 5% on a like-for-like comparison with non-union employees – but that this has fallen by 50% in the last decade (figure 10).<sup>104</sup>

It has been argued that this means trade unions should look beyond collective bargaining on pay if they are to have a secure role in the future. Put simply, a strong information and consultation or partnership model offers more possibilities than a focus on more conventional concerns.<sup>105</sup> The difficulty with this position is that it assumes trade unions are sharing economic rents<sup>106</sup> with employers, rather than

100 Metcalf, D et al "Unions and the Sword of Justice" in *National Institute Economic Review* vol 176, no 1 (2001)

101 Freeman, RB and Medoff, JL *What Do Unions Do?* (Basic Books, 1984); Metcalf et al, op cit; Bryson, A and Forth, J *Trade Union Membership and Influence 1999-2009*, CEP discussion paper no 1003 (CEP/LSE, 2010)

102 Forth, J and Millward, N "Union Effects on Pay Levels in Britain" in *Labour Economics*, vol 9, no 4 (2002)

103 Brown, W and Oxenbridge, S "Trade Unions and Collective Bargaining: Law and the Future of Collectivism" in Barnard, C et al (eds) *The Future of Labour Law: Liber Amicorum Bob Hepple QC* (Hart Publishing, 2004)

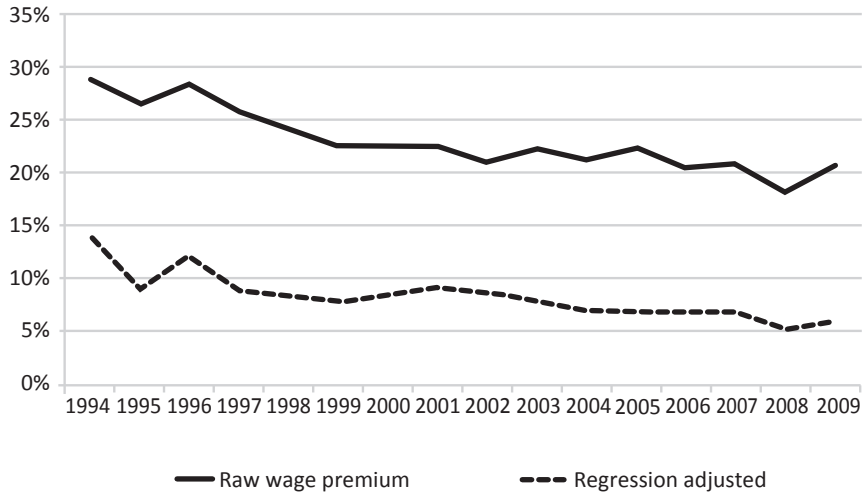
104 Bryson & Forth, op cit

105 Brown & Oxenbridge, op cit

106 In this context an "economic rent" means that prices are set to generate a surplus which is shared between the employer and employees. Prices are set above the level needed to generate either reasonable funds for investment or the level of pay that would generally be necessary for the employer to recruit and retain workers with the right skills. A common sense way of expressing this notion is that workers are being paid "over the odds" because employers can charge customers relatively high prices and trade unions can persuade employers to share a bigger piece of the pie with workers.

helping to guarantee that wages (through collective bargaining) increase in line with productivity.

**Figure 10: The union wage premium, 1994–2009**



Source: Labour Force Survey

There can be little doubt that this connection between wages and productivity has been broken in the USA.<sup>107</sup> Studies by the US Economic Policy Institute show that between 1979 and 2009 productivity in the US increased by 80%, while the hourly wage of the median worker rose by only 10.1%. Recent research by the Resolution Foundation draws a similar (although more nuanced) conclusion for the UK.<sup>108</sup>

One might conclude, therefore, that a revival of collective bargaining could, if developed in the context of a high-trust relationship between trade unions and employers, provide a solution to some of the most intractable problems in the UK's labour market. On the other hand, trade union membership has been on a general downward trajectory in the UK for around 30 years (figure 8). In part this can be explained by hostile public policy and the removal of the auxiliary legislation (like the Fair Wages Resolution) that

<sup>107</sup> Dew-Becker, I and Gordon, R *Where Did the Productivity Growth Go? Inflation Dynamics and the Distribution of Income*, paper presented to the Brookings Panel on Economic Activity (2005); Parker, S (ed) *The Squeezed Middle: The Pressure on Ordinary Workers in America and Britain* (Policy Press, 2013)

<sup>108</sup> Pessoa, JP and van Reenen, J *Decoupling of Wage Growth and Productivity Growth: Myth and Reality* (Resolution Foundation, 2012)

sustained collective bargaining. But structural change has had a bigger impact: deindustrialisation, the growth of employment in private services, the outsourcing of support functions, and employer hostility to trade unionism and collective bargaining.

According to the Labour Force Survey, trade unions still have some kind of presence in workplaces employing 45% of employees. What the data does not tell us is just what form this presence takes, whether it is overt or covert, or whether the employer has even noticed the existence of the trade union. If correct, however, this finding supports the case that union revival is a real possibility. A much bleaker outlook for organised labour is described by the first findings from the 2011 Workplace Employee Relations Survey, which reveals that union members are present in only 11% of private-sector workplaces.<sup>109</sup> This might be contrasted with the position in the public sector, where 90% of workplaces have union members present and 91% are covered by some kind of collective agreement. The results from the Labour Force Survey and the Workplace Employee Relations Survey appear to be pointing in opposite directions so far as the presence of union members in workplaces is concerned. They are consistent, however, in that they both highlight the decline of membership and bargaining coverage over a prolonged period.

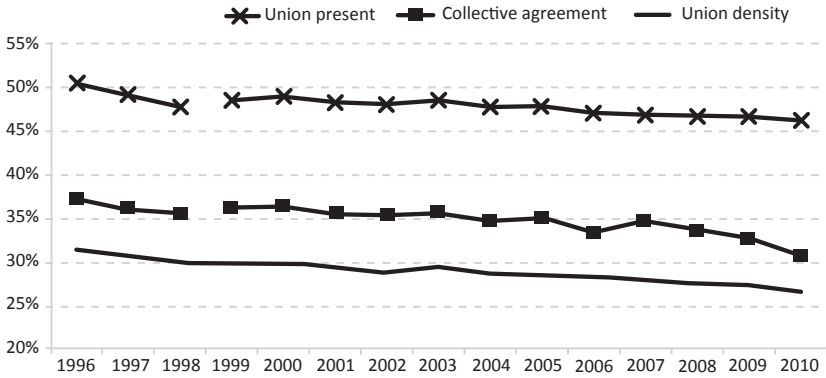
The consequences of this trend are equally clear, no matter whether the Workplace Employee Relations Survey or the Labour Force Survey proves to be more accurate. In most workplaces in the UK today, employers are free to determine terms and conditions of employment without any negotiation or consultation with representatives of their employees. One can only conclude that the possibilities for democratic participation in the workplace have therefore diminished. This situation should be contrasted with the position in some other OECD countries, where collective bargaining coverage remains at very high levels (annex 1). This can be the case even in a country like France, where trade union membership is exceptionally low. Moreover, Denmark, which is generally seen to have a flexible labour market, combines this flexibility with both high levels of union membership and collective bargaining coverage.<sup>110</sup> A logical conclusion of these findings is that institutions of pre-distribution can continue to be robust even if trade union membership is in apparent decline. So long as employers sustain the general habit of abiding by collective agreements, the presence of negotiated arrangements in the labour market can act as a breakwater against a potentially advancing tide of low pay and low-quality employment.

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109 van Wanrooy, *op cit*

110 Coats, D *The National Minimum Wage: Retrospect and Prospect* (Work Foundation, 2007)

**Figure 11: Collective bargaining coverage in the UK 1996-2010 (% employees)**



Source: Labour Force Survey, Office for National Statistics

This is not the place to consider in detail the desirability or otherwise of particular bargaining institutions, except to say that the level of centralisation and co-ordination of the bargaining process can have a significant impact on labour market outcomes.<sup>111</sup> The important question here is whether the bargaining process is co-ordinated or not, with all negotiations taking place at the same time based on a shared understanding of what employers can afford.

*Can the sword-of-justice effect be demonstrated beyond the liberal market economies?* Paradoxically, it may be more difficult directly to demonstrate the sword-of-justice effects in those countries with less income inequality (a lower Gini coefficient) than the UK. In part, this is because all employers in an industry or sector observe collective agreements, whether there are any union members in the workplace or not. This is true for the Nordic countries where union membership is very high (70% or more) and for France where membership is very low (less than 10%). Neither the Nordics nor France, however, has witnessed the huge growth in income inequality experienced in the UK. In the Nordics pre-tax inequality has risen significantly (from a very low base) but post-tax inequality has changed little. In France there has been no significant change at all.

*Do unions have the effect of entrenching general norms of fairness?* One of the arguments explored in this report is that trade unions have the effect of entrenching

<sup>111</sup> Ibid

norms of fairness in the workplace. Unions are able to identify the point at which executive remuneration gets out of step with wage developments for the majority of workers and to demand a change in behaviour. Whether this is effective or not depends crucially on trade unions' bargaining power. One might say that without a credible threat that can be deployed against the employer there is no reason for executives to concede the unions' argument. Put more straightforwardly, strong unions can make a difference in restraining executive pay but weak unions might raise and then disappoint expectations of fairness.

It would be wrong to create the impression that the argument for pre-distribution and the link to workplace democracy is simple or that a wide variety of national experiences (with highly differentiated institutions) can be easily characterised. What can be said with confidence, however, is that bargaining power matters: it affects both the initial distribution of incomes and the day-to-day experience of people at work. Those countries with better-developed institutions of workplace democracy understand this fundamental principle and recognise that the deployment of employer power has a number of dimensions. There is a difference, for example, between the process of distributing rewards (generally conducted through collective bargaining in continental European systems) and measures designed to ensure that the workplace operates efficiently and effectively, respecting the interests of workers and their desire for high-quality employment (generally dealt with through works councils). Both sets of institutions are important in establishing the balance of power. A reinforcing relationship is established when collective bargaining co-exists alongside effective information and consultation arrangements.

A final objection that may be raised is that representative institutions need to be populated by workers who want representation. If workers are mostly satisfied with their situation, then the consultation process becomes little more than a ritual enacted by a small number of disgruntled and unrepresentative enthusiasts. It is worth noting the difference between a commitment to collective action (which enjoys wide support) and a commitment to trade unionism, which is supported, according to the TUC's research, by around one in three workers.<sup>112</sup> One of the central questions to be answered in the case for a fairer wage settlement is whether a representation gap exists in the UK. Much of the social science here is based on data collected in the early part of the last decade (2001 and 2004), which means that it misses the prolonged squeeze on incomes. Even these analyses suggest, however, that workers with more problems have a higher demand for representation.<sup>113</sup> It would not be surprising, therefore, to find that the demand for representation has risen since the early 2000s.

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112 TUC, *op cit* (2003)

113 Bryson, A and Freeman, RB *What Voice Do British Workers Want?*, Centre for Economic Performance discussion paper no 731 (CEP/LSE, 2006)

### Policy recommendations

The establishment of strong information and consultation bodies in British workplaces is the most likely (perhaps the only) policy instrument available for the revival of collectivism. Trade unions are simply too weak in the private sector to make rapid expansion of collective bargaining a practical possibility, and waiting for a resurgence of conventional trade unionism (assuming that it is possible) is inevitably a long-term process. A natural conclusion of the argument made throughout this volume is that workers need representation *now*; the problems we have identified are immediate and pressing (in-work poverty, income inequality, the absence of meaningful industrial citizenship), and action needs to be taken both to secure an exit from the crisis and to lay the foundations for sustainable economic growth in the future.

Some trade unions have consistently argued that the repeal of the anti-union laws is a necessary condition for a rebalancing of bargaining power. But the public policy dispensation on this dimension (rules regulating ballots, strikes and picketing) seems much less important in determining levels of union membership than the realities of technological change and industrial restructuring. If unions everywhere have seen membership under pressure (which is generally the case) then the repeal of the anti-union laws may make little difference to the prospects for union growth.<sup>114</sup>

On the other hand, a source of resilience for unions in other countries is to be found in what might be called the "auxiliary" legislation supporting collective bargaining. Measures to extend the coverage of collective agreements to non-signatory employers, and fair-wages policies in public procurement (where the union-negotiated rate becomes the wage floor), have been much more important in sustaining union influence in adverse economic conditions. These measures are discussed in more detail in chapter 7. What is surprising, in the British context, is how little importance the unions attached to these auxiliary measures at the time they were repealed. The focus of the TUC policy effort in the 1980s was on industrial action legislation and intervention in unions' internal affairs, not opposition to the repeal of the 1974–79 Labour government's measures to extend collective bargaining through unilateral arbitration (under schedule 11 of the Employment Protection Act 1975) or the rescission of the Fair Wages Resolution. Unions might find a more sympathetic hearing for the introduction of new (suitably adapted) auxiliary measures to promote collective bargaining than for a straightforward demand for the repeal of the anti-union laws.

The Labour government's flagship measure in this field, the union recognition legislation, has rather fallen short of expectations. In part this may be because the

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114 Coats, *op cit* (2010)

statutory procedure sets a high level of support before collective bargaining can be established, but it is also because organising for collective bargaining in a largely union-free private sector is extremely challenging, no matter what the legislative framework. Most employers have no experience at all of unions, and the same is true of private-sector employees, the majority of whom will never have encountered a trade union at any point in their working lives. Indeed, the unions' language, heroic myths and general recruitment strategy militate against the effective communication of organised labour's compelling message to an increasingly distant workforce.<sup>115</sup> This volume is not intended to be a manual for union growth, an issue of immense complexity that demands separate treatment elsewhere. But it is at least arguable that trade unions need a *transitional* strategy, which takes them from a generally union-free private sector to a situation where collective bargaining again appears to be a practical possibility that enjoys the support of good employers.

The link to the creation of an information and consultation infrastructure lies here too. Trade unions may need to think less about making the leap from an unorganised workforce to full collective bargaining, and much more about organising works councils as the most effective route to the eventual organisation of workers. This process will be made considerably easier if trade unions are able to trigger the I&C process as was proposed in chapter 6. A union will then be able to secure the election of its members to at least some of the seats on the works council, provide support to those elected, and demonstrate the valuable role the union can play both to other workers and to the employer. Re-establishing credibility and legitimacy are the principal ends in view. No doubt some (among both employers and unions) will suggest that this approach is inconsistent with the UK's voluntarist tradition of industrial relations. Unfortunately, the reality is that there is very little of the voluntarist tradition left. In most private-sector workplaces the employer determines the extent of employee participation and exercises a veto over the establishment of voice institutions. If policy makers want seriously to give effect to Budd's three goals of the employment relationship, *efficiency*, *equity* and *voice*, then a more interventionist approach is needed.

Another important advantage of this approach is that it leaves the system of collective bargaining untouched. Where trade unions have recognition in the private sector there is no reason why the status quo should not prevail. If safeguards need to be sought, then the legislation on information and consultation could be framed to protect the realm of collective bargaining by giving unions the exclusive opportunity to make use of the I&C rights where a recognition agreement is in place. Similar arrangements already

115 Coats, D *Raising Lazarus: The Future of Organised Labour* (Fabian Society, 2005)



exist in relation to health and safety at work (the union channel is the only channel in organised workplaces), redundancy consultation and business transfers.

Moving beyond the potential ideological objections from both unions and employers, the more extensive use of works councils raises some practical and operational challenges for organised labour. According to the Workplace Employee Relations Survey series, the majority of workplace union representatives today spend most of their time on grievances, discipline and health and safety issues. A more radical approach to information and consultation will require unions to equip representatives with a different set of skills so that they can work with employers to solve shared problems of workplace reorganisation, productivity, skills development and utilisation. That is not to underplay the importance of negotiating and representational skills, both of which will still be required; but there is a real difference between bargaining across the table and problem solving around the table. Union educational programmes will need considerable development and expansion if these new challenges are to be met.

All of these measures can be moderately helpful to trade unions, but the real strategic decisions affecting the prospects for union growth lie with the unions themselves. Certainly some ideological revisionism is needed before the I&C model outlined here can be embraced with enthusiasm. But unions need to understand their distance from workers in the private sector and in particular need to accept that they face a cultural challenge. The world inhabited by many union activists bears only a distant relationship to the experiences of most people at work, who are certainly not union members and have no affinity with the procedures and practices of most trade unions. There is a sense in which some unions today behave almost as faith communities under pressure, looking inwards rather than outwards, polishing the finer points of doctrine and ignoring the unconverted mass of employees. This may sound like a harsh assessment, but the Workplace Employee Relations Survey 2011 findings are clear. Outside the public sector, trade union members are an endangered species.<sup>116</sup> This must change if the objectives of progressive public policy are to be achieved.

So far we have examined a range of labour market institutions designed to give workers a voice in decision-making processes. The approach in each of these cases is best described as interest representation: labour and capital have different interests and a dialogue is needed to achieve balance and reconciliation. Of course other solutions are available, including the possibility of ownership models like co-operatives and mutuals. It is to these supposed alternatives that we now turn.

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116 A notable exception is the shop workers' union USDAW, which is continuing to grow in the retail sector.

## Chapter 5

# Co-operatives, employee ownership and mutuals

## Co-operatives, employee ownership and mutuals

### Summary

- There is a rising tide of interest across the political spectrum in the role that might be played by co-operatives, mutuals and other corporate forms beyond the conventional limited liability company.
- There is limited evidence to suggest that the co-op/mutuals sector is growing, but it remains tiny in the context of the overall economy. In financial services (where mutualism used to be well-established in the building societies) there is no evidence of remutualisation.
- The evidence on the economic and distribution effects of co-operatives suggests that they may be positive for employment but negative for wage growth. These practical results are in line with the theoretical models of how co-ops and conventional firms behave when confronted with adverse conditions.
- Large claims are made about the differences between capital and labour disappearing in co-operative enterprises. The evidence available (in relation to the Mondragon co-operatives in Spain, for example) is much more equivocal, identifying a range of "conventional" employment relations problems and genuine reasons for workplace conflict.
- While co-operatives and mutuals can have a demonstration effect, showing that alternative models of ownership can be successful, it would be unwise to expect either a significant growth of this sector or an immediate impact on either in-work poverty or income inequality.
- Pluralism of corporate forms in markets remains an important policy objective, but it cannot be a substitute for worker participation in strategic decision making; effective information and consultation institutions; or stronger trade unions.

### Policy recommendations

- The Ownership Commission has made wide-ranging recommendations to encourage the expansion of co-operatives, mutuals and employee-owned businesses. These recommendations are welcome and helpful.

- A degree of scepticism is needed as to the likely impact that co-operatives and the like can make, not least because the conventional limited liability company is expected to be the predominant form of business organisation for the foreseeable future. Making capitalism responsible depends on making conventional businesses behave responsibly, not waiting for the existing model of corporate organisation to be replaced through a gradual process by supposedly progressive alternatives.

### **The case for co-operatives and mutuals**

The case for mutuals and co-operatives is often presented as a self-evident good that no rational person can resist. Who could be against co-operation, for example, a fundamental impulse that makes civilised life possible? Equally, who could oppose the idea that the users or employees of an enterprise should also be the owners of that enterprise? There is an apparently rising tide of political interest in the case for alternative ownership models, and the Coalition government has explicitly endorsed the development of mutuals as a model for public service delivery in the future. According to the Mutuals Taskforce, public service mutuals can:

- raise the quality of public services;
- improve efficiency and value for money;
- lead to better working conditions for employees.<sup>117</sup>

It is not the purpose of this volume to offer a critique of that analysis or of the proposals that the taskforce has made. But it is worth recalling that most advanced capitalist economies are principally populated by limited liability companies, whether public or private. Most developed economies have a co-operative or mutuals sector too, and this can vary quite widely in size. In the UK for example, the mutuals sector has shrunk significantly over the last 30 years – notably because many building societies demutualised and converted themselves into banks. While there has been a revival of interest in re-mutualising some financial institutions, very little progress has been made so far. For example, Northern Rock, which was taken into public ownership following the credit crunch and the collapse of depositors' confidence, has been privatised and sold to Virgin Money. Other opportunities for mutualisation may present themselves in the future, but the direction of policy seems to be flowing decisively towards conventional ownership models.

This is despite the efforts of the Ownership Commission to advance the case for more pluralism in corporate structures, with a specific focus on the role of employee-owned

<sup>117</sup> Mutuals Taskforce, 2012

businesses and mutuals.<sup>118</sup> While the Ownership Commission recognised that there were some practical, legal obstacles to the development of alternative ownership models, they identified lack of access to capital for employee-owned firms and a general lack of awareness of the opportunities by expert advisers as real impediments to the growth of employee ownership.

So far as mutuals were concerned, the pressure to demutualise in the 1980s and 1990s was intense in both the UK and the USA. The promise of an immediate cash windfall often looked more attractive to the individual member than the social benefit of a plurality of corporate forms. In this case the public interest and the individual interest appeared to be in direct conflict. On the other hand, one could argue that the members of these mutuals were placing a higher value on short-term gains than long-term losses, not least because the demutualisation windfalls were eventually offset by higher charges. Moreover, the demutualisation process led to less choice and competition in the financial services sector and contributed to the growth of institutions that were "too big to fail".

### **Advantages of employee ownership**

There is some evidence to suggest that employee-owned firms have distinct advantages over conventional ownership models. For example, in a report published in 2010 commissioned by John Lewis, the Cass Business School reported the following results:

- Employee-owned small firms (those with fewer than 75 employees) are more profitable than conventional businesses.
- Employee-owned firms create jobs faster.
- The profitability of employee-owned firms is related to the extent of employee involvement in decision making.
- Growing employee-owned firms must innovate to ensure that their employee involvement strategies can cope with the increase in firm size.
- Employee-owned businesses are more resilient. They see less variation in sales over the course of the cycle and managed to maintain sales growth during the recession.

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<sup>118</sup> Hutton, W et al *Plurality, Stewardship and Engagement: The Report of the Ownership Commission* (Mutuo, 2012)

- There are no significant differences in profitability between employee-owned and conventional businesses, although profits in the employee-owned sector were more resilient during the recession.
- Employee-owned businesses have higher levels of profitability in skill and knowledge intensive sectors.
- Employee-owned businesses add more value and invest more in human capital than conventional businesses.
- Employee-owned businesses recruit employees more rapidly and offer higher wages than conventional businesses.
- Access to capital is a real problem for employee-owned businesses – banks are more used to dealing with conventional ownership models.
- Lack of specialist support from business advisers during the transfer to employee ownership is a problem.
- Employee-owned businesses focused on international markets do better than those exclusively serving domestic markets.<sup>119</sup>

These results appear to confirm the superiority of employee ownership models. Yet if the argument is so compelling, one wonders why, despite the barriers, more firms have not made the transition to this model? In part the answer must be that converting a large listed company into an employee-owned organisation would not necessarily meet with the approval of existing shareholders. Nor is it clear how the employees would raise the capital needed to acquire the company. It would be unwise to place all our reform eggs in the employee-ownership or mutuals basket, and much better to recognise that corporate governance changes are needed, along with the introduction of much stronger rights to information and consultation, if British businesses are to behave as responsible capitalists.

### **The scale of co-operatives, mutuals and employee-owned businesses in the British economy**

Employee-owned businesses constitute a very small percentage of total employment in the British economy, with the majority of these employees working for the John Lewis

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<sup>119</sup> Lampel, J et al *Model Growth: Do Employee Owned Businesses Deliver Sustainable Performance?* (John Lewis Partnership/Employee Ownership Association, 2010)

Partnership. If we take the whole of the co-operative and mutuals sector the numbers are significantly larger, but are still dwarfed by the scale of conventional businesses (table 2).

**Table 2: Ownership models, jobs and revenue**

Sector	Number	Members	Jobs	Revenue
Building societies	47	25,000,000	42,000	3,700,000,000
Co-operatives	3,339	10,290,000	159,000	24,230,000,000
Co-operative trust schools	159	-	-	0
Credit unions	424	808,700	980	39,000,000
Clubs and societies	11,600	7,000,000	20,000	463,000,000
Employee-owned businesses	250	-	130,000	30,000,000,000
Football/rugby supporter trusts	170	270,000	214	11,000,000
GP co-ops and mutuals	34	-	7,500	120,000,000
Housing associations	1,694	6,727,000	170,410	14,039,000,000
Leisure trusts	101	-	21,400	739,000,000
Mutual insurers and friendly societies	56	8,500,000	17,200	7,800,000,000
NHS foundation trusts	136	1,900,000	481,060	30,700,000,000
<b>Total</b>	<b>18,010</b>	<b>60,495,700</b>	<b>1,049,764</b>	<b>£111,841,000,000</b>

Source: *The Mutuals Yearbook 2011* (Mutuo)

Indeed, these numbers slightly overstate the extent of pluralism in the economy because they include the employees and turnover of NHS foundation trusts, which most observers would continue to place firmly in the public sector. In other words, all the non-conventional forms of ownership constitute just over 2% of total employment in the UK economy. Even if we take the findings from the Cass Business School study as irrefutable, it would be heroic to argue that these models of ownership are having a significant impact on either income inequality or in-work poverty. The scale of the sector is too small and the rate of growth too modest for policy makers to be confident that offering more encouragement to a plurality of ownership models will have either

large or rapid distributional effects. That is not to say, however, that there is no effect on distribution at all. Policy makers might focus their attention on some of the other institutional instruments (and on the balance of power between capital and labour) if they want to reduce in-work poverty or halt and reverse the trend of rising income inequality. We review what limited evidence there is on distributional questions (generally from outside the UK) in the next section.

### **Case study: The John Lewis Partnership**

John Lewis is a "partnership" in the sense that the business is held in trust for the benefit of its members, employees of the organisation who become "partners" at the moment they join the business.

The trustee is the John Lewis Partnership Trust Ltd, whose members are the chair and vice-chair of the partnership (essentially the two most senior managers in the business) and three partners elected by the partnership council.

The governing principles of the partnership are set out in a written constitution and the principle purpose is described as "the happiness of all its members through their worthwhile and satisfying employment in a successful business". The organisation aims to make a profit but does so with this principal purpose in mind.

Power in the organisation is shared between the partnership council, the partnership board and the chair. The partnership council represents members of the partnership, and entrusts management business to the partnership board, which in turn delegates management authority to the chair. In essence, the partnership board is the board of directors of John Lewis and operates very much as a conventional board, albeit with three members elected by the partnership council.

Members of the partnership council are elected through a ballot of all partners, with the number of members and constituencies specified in the partnership's constitution. Members of the partnership board are automatically members of the council.

The partnership council exercises direct power through its influence on the chair. It can ask the chair and the partnership board anything it wishes. It has the right to call for a report from the chair every six months and can dismiss that chair on the grounds of having failed to fulfil the chair's responsibilities to the partnership. The council discusses, influences and makes recommendations on the development of policy and shares in decisions about the governance of the partnership.



The work of the partnership council is supported by divisional councils (for each operational division of the partnership) and local forums. These institutions undertake the same functions as the partnership council but at lower levels of the organisation.

No specific provisions are made for the negotiation of pay increases. Pay rates are informed by the market rate. The constitution specifies that the highest-paid employee cannot earn more than 75 times the average pay of a non-managerial employee.

All partners are entitled to an annual partnership bonus.

A partners' counsellor is responsible for the operation of the partnership machinery. Grievances and disciplinary matters are dealt with by the partners' counsellor's office.

John Lewis does not recognise trade unions for collective bargaining, although partners are free to join an appropriate trade union.

### **Assessment**

John Lewis makes extensive provision for the involvement of partners in business policy and strategy. The ownership structure means that institutional arrangements are difficult to fit into the taxonomy of workplace democracy used here. The partnership council could be seen to exercise some of the functions of a supervisory board (it can remove the chair) but also includes all the members of the partnership board, which is analogous to the executive board in two-tier systems. Alternatively, one could view the partnership council as a central works council on the German model, with the local forums analogous to establishment-level works councils. But the rights and responsibilities are much less clearly delineated than in the co-determination system.

The directors of the company (members of the partnership board) are selected in the usual way – they are not elected and cannot be removed by the partnership board. One might view this as an interesting hybrid, wherein an unusual ownership model featuring limited democratic accountability is grafted on to a conventional management structure with extensive opportunities for dialogue between partners and their employer.

It should be emphasised too that the possibility of conflict is recognised in the constitution – the partners' counsellor's office would have no responsibility for dealing with disputes if it were otherwise. Nonetheless, John Lewis does not recognise trade unions, and the determination of pay is more subject to management control than one might perhaps have expected in an employee-owned business. The ratio of 75:1

between the highest-paid partner and the average pay of non-managerial employees may look disproportionate, but it is significantly lower than the average for FTSE 100 companies.<sup>120</sup>

### **What do we know about the impact on productivity, wages and inequality?**

The performance effects of co-operatives and mutuals ought to be consistent with the thesis that productivity and wage growth are influenced by the extent of employee involvement. In other words, co-ops should be more productive than their conventional counterparts. It is surprising, perhaps, that beyond the ranks of a small number of academic enthusiasts this is a somewhat under-researched area, even though the level of interest in Mondragon (the largest co-operative enterprise in Spain), for example, has risen in the wake of the global financial and economic crisis.

There is very little evidence for the UK beyond the reports produced by organisations with an interest in promoting alternative ownership models. In part this may reflect the relatively minor role played by co-operatives, mutuals and employee-owned firms in the British economy, and it may also reflect the difficulty in collecting good data that allows valid comparisons to be made with conventional firms. The findings reported here do not necessarily tell a clear story, but that in itself is interesting given the generally positive account offered by proponents of alternative ownership models.

Despite the negative observations we have made about social outcomes in Italy, this is the market economy with the greatest incidence of worker-owned and worker-managed firms. One study, dating from 1992, found that co-operatives had higher productivity, more labour-intensive production, lower income differentials and better industrial relations outcomes than conventional firms.<sup>121</sup> Other researchers have suggested that the position is not quite so clear-cut. For example, an analysis of Italian data from 1992-94 comparing co-ops to more orthodox capitalist firms produced the following findings:

- Co-ops had wages that were 14% *lower* on average than in conventional capitalist firms.
- Wages in co-ops were *more* volatile than in conventional firms. In other words, they tended to fall faster when the business was under pressure and rise faster during periods of growth.

<sup>120</sup> High Pay Commission, op cit

<sup>121</sup> Bartlett, W et al "Labour-managed Co-operatives and Private Firms in North-Central Italy: An Empirical Comparison" in *Industrial and Labor Relations Review*, vol 46, no 1 (1992)

- Employment levels were *less* volatile in the co-operative enterprises. Workers were willing to accept wage cuts rather than job cuts in a downturn.<sup>122</sup>

These findings are consistent with some of the standard economic modelling assumptions made about co-ops and conventional capitalist firms. For example, during a downturn the conventional firm will want to cut costs by shedding labour rather than by cutting wages. The goal in these circumstances is to ensure that those who remain are motivated and productive. A co-op or employee-owned business, to the contrary, will have goals beyond profit maximisation and will pay closer attention to the social consequences of decisions – including any potential reduction in employment.

A study of co-ops in the plywood industry in the Pacific North West of the USA produced findings on wages and employment confirming the accuracy of the model. Co-ops seemed to be bad for wages but good for employment. Moreover, the same study suggested that workers' co-ops did have a small productivity advantage, but the authors concluded, "there is not much to distinguish these types of firms [from conventional businesses] in terms of overall production efficiency".<sup>123</sup>

Our final piece of evidence is drawn from one of the retail businesses that shelters under Mondragon's capacious umbrella.<sup>124</sup> This study is useful for two principal reasons. First, it confirms that not all Mondragon's businesses meet the co-operative ideal. The Eroski retail chain (which is one of Spain's largest) has some stores that are supposedly fully co-operative (although temporary workers, constituting some 24% of the workforce, are excluded from participation), some with partial employee ownership and involvement (so-called GESPA stores) and some with no employee participation at all. A clear finding from the co-operative stores is that wages are higher, workers have a larger financial stake in the business and productivity is higher too. On the other hand, levels of reported job satisfaction are lower than in the GESPA stores. This can be partially explained by the hypothesis that higher levels of participation lead to higher worker expectations that may not be met no matter how well the organisation is being managed. It is also suggested that work in the co-operative stores may be more stressful, principally because workers with a financial stake in the business may be expected to "go the extra mile". From this perspective the co-ops look a great deal more like conventional firms applying so-called "high-performance work practices", which

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122 Pencavel, J et al "Wages, Employment and Capital in Capitalist and Worker Owned Firms" in *Industrial and Labor Relations Review* vol 60, no 1 (2006)

123 Pencavel, J and Craig, B *Participation and Productivity: A Comparison of Worker Co-operatives and Conventional Firms in the Plywood Industry*, Brookings papers on microeconomics (1995)

124 Arando, S et al *Efficiency in Employee-owned Enterprises: An Econometric Case Study of Mondragon*, IZA discussion paper (2011)

are associated with employee dissatisfaction and perceived work intensification.<sup>125</sup>

There are also some nuanced findings on the question of performance and productivity effects. So, for example, productivity is higher in the co-operatively owned hypermarkets. In the supermarkets studied, small, co-operatively owned city supermarkets (the equivalent in size terms in the UK would be Tesco Local) are more productive than conventionally owned stores. But for larger supermarkets (those in the middle of the size range), those with a conventional ownership structure are more productive.<sup>126</sup> Perhaps all one can conclude from this brief review is that it would be wrong to believe that co-operatives are always superior performers to more conventional ownership models. It is also important to look beyond the formal presentation of the ownership story – Mondragon is a more complex organisation than most accounts would suggest, and it is important to understand these subtleties before embracing the model with unqualified enthusiasm.

### **Case study: The Mondragon co-operatives in Spain**

The first of the Mondragon co-operatives was founded in the Basque country of Spain in 1956, initially with only 25 workers. To begin with, the focus of activity was in industrial enterprises, but the Mondragon Corporation is now a conglomerate with businesses in manufacturing, financial services and retailing among others. Only half of Mondragon's businesses are co-operatives, and only a third of the corporation's employees are members. In the co-operative businesses, around 85% of industrial workers are members. The number of worker members should rise over the next three years because the Eroski supermarket business is gradually moving towards the co-operative model.

Mondragon claims to be the seventh-largest enterprise in Spain. Each element of the group is treated as a separate business with its own machinery for participation, the broad outlines of which are as follows.

Those employed on permanent contracts by a Mondragon co-op have to wait for a probationary period of six months before being invited to become a member of the co-op. To do so, they must pay a joining fee of around €6,000. The member's stake receives an interest rate that is set at above the market rate of interest. In addition, the amount of money in the member's account grows as members receive a portion of operating surpluses.

125 Godard, op cit; McGovern, P et al *Market, Class and Employment* (2007)

126 Arando et al, op cit

So far as governance is concerned, a member of a co-op has the right to vote and stand for election in the ballot for the governing council (the board of directors) and for the social council, the body responsible for determining working conditions.

Each co-operative contributes to the governance of the Mondragon Corporation, which has three key institutions for decision making:

- the co-operative congress – a body of 650 members representing all the co-ops under the Mondragon umbrella that sets broad policy and strategy for the corporation;
- the general council – essentially Mondragon's executive board of directors on which the vice-presidents of all the operational divisions sit; and
- the standing committee – a committee drawn from members of the co-operative congress whose purpose is to ensure that congress decisions are acted upon by the general council. One might view the standing committee as playing the same role as a supervisory board in a conventional company.

The pay ratio between the highest-paid and the lowest-paid in each co-operative is fixed at 6.5:1.

Mondragon's businesses do not recognise trade unions for collective bargaining.

It has been reported that Mondragon has weathered the storms of recession better than many Spanish corporations. While some areas of the business have witnessed job cuts, those affected have found employment elsewhere in the group.<sup>127</sup>

### **Assessment**

Mondragon's reported performance is impressive and the group has demonstrated genuine resilience since the first co-operatives were established in 1956. It would perhaps be wrong, however, to view Mondragon as a "pure" co-operative, as so many of its businesses are run on conventional lines and the level of membership among the workforce is relatively low. This may in part be a consequence of rapid growth in recent years (sometimes through acquisition, especially in the retail sector), and it will be interesting to observe whether the level of worker participation rises again as Mondragon's public commitments suggest.

Despite all the interest in the uniqueness of the Mondragon model, there is very

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<sup>127</sup> <http://www.bbc.co.uk/news/world-europe-19213425>

little research that offers a dispassionate account of the group's performance on the dimensions of productivity or worker satisfaction (beyond the study to which we have referred). There can be no doubt that the formal commitment to narrow pay differentials is important and it exemplifies the strong ethical commitment reflecting the influence of worker members in the co-operative businesses. It is this element of genuinely democratic participation (and the ability to elect managers) that draws the sharpest distinction with John Lewis. But both businesses have management hierarchies, and in the end it is the members of the general council at Mondragon and the partnership board at John Lewis that make the critical decisions.

### **What role for mutuals and co-operatives in the future?**

There remains a high level of enthusiasm for alternative ownership models and it would be churlish to deny that this brief review has identified that co-operatives and mutuals have some distinct advantages over conventional business models. While there is a strong case for saying that unnecessary barriers should be dismantled, as the Ownership Commission suggests, it is also important to be realistic about the prospects for change. Mondragon and John Lewis are presented as both exemplary on the one hand and unique on the other. It is not entirely clear how other businesses are supposed to make the transition to a co-operative or employee-owned model or why they should wish to do so. Indeed, most examples of a successful transition to employee ownership fall squarely into the John Lewis category – a charismatic owner-manager has no successor to whom the business can be passed and leaves the business in trust for the employees. Recent experience in financial services offers few grounds for optimism that there will be a rapid remutualisation in that sector.

Both the John Lewis and Mondragon examples are an implicit rejection of the core argument of this volume: that the interests of capital and labour converge and diverge and that institutions are needed to ensure balance in the employment relationship. Both John Lewis and Mondragon would no doubt argue that they offer efficiency, equity and voice, but it is not entirely clear that the possibility of a serious distributional conflict is admitted in either model. At the core of the *equity, efficiency, voice* argument (see introductory chapter) is the belief that interest representation is vital, conflict unavoidable and co-operation essential. The co-operative and employee-ownership models could be more compelling if these distributional conflicts were recognised and addressed with openness and honesty. The example of Mondragon's Eroski supermarkets highlights a number of pressure points: the differences between those who are and those who are not members of a co-op, the position of temporary workers (who can never qualify for membership) and the perceived problems among co-op members of job stress and work intensification. The case for more pluralism in

corporate forms does not depend on co-ops and mutuals being superior in all respects to conventional companies. It is not necessarily a weakness to admit weakness or accept that trade-offs may be necessary between fairness and efficiency.

### **Case study: The Nationwide building society**

Nationwide is the largest building society in the world, with around 15 million members. Its origins lie with the Provident Union Building Society founded in 1846.

It is a mutual and is therefore owned by its members, all of whom will be either depositors or lenders who have either deposited or borrowed at least £100. Members have the right to participate in the election of directors, to vote on resolutions and to attend the annual general meeting.

Members can run for election to the board – although they need to be qualified to do so, can table resolutions and can be represented by a proxy if they so wish at the AGM.

There are 12 directors, four of whom are members of the senior management team and therefore employees of the organisation. Of the non-executive directors, all have a background in financial services or management consultancy.

So far as management structures are concerned, Nationwide is hard to distinguish from other financial services organisations.

Nationwide's objectives are set out in a memorandum, which describes a conventional financial services business that receives deposits and makes loans. There is nothing that matches the John Lewis constitution here in explaining that the goal is to promote the happiness of the partners.

The building society recognises the Nationwide Group Staff Union for all bargaining relating to pay and conditions of employment.

In 2011/12 the chief executive's pay package (totalling £1.9 million, including benefits, with a basic salary of £800,000) rose by 4.1% at a time when employees' pay rose by 4.4%. No ratio is disclosed of the chief executive's pay either to the lowest-paid employees in the organisation or to the average. Otherwise, the report of the remuneration committee offers a transparent account of the composition of total pay including pensions, long-term incentive plans and bonuses.

## Assessment

Nationwide is one of the few remaining financial services mutuals and identifies its membership structure as a distinctive source of comparative advantage. There can be little doubt that this structure and the commitment to mutualism has helped to insulate the organisation from some of the catastrophic decisions made by societies that had demutualised – most notoriously Northern Rock. There is nothing in Nationwide's governance arrangements that offers any particular opportunities for workplace democracy – to that extent it looks like a conventional employer. But by avoiding the pressure of capital markets, Nationwide can avoid many of the perils identified by John Kay as associated with short-termism, most notably the hyperactivity of management reorganisation or mergers and acquisitions activity. Unlike each of the other cases reviewed in this section, Nationwide specifies no maximum ratio of high pay to low or median pay.

Each of the three examples given in this chapter is designed to shed light on organisations that find themselves at different points on the mutual/co-operatives/employee-ownership continuum. Nationwide is in many ways the most conventional: owned by its members but treating its employees in much the same way as any other employer. Mondragon and John Lewis are different again, with the former remaining a unique example of industrial democracy in practice (albeit that the pure co-operative nature of the business has been compromised in recent years) and the latter standing as a monument to the ethics of John Spedan Lewis. It would be a mistake, perhaps, to believe that the profound structural problems we have identified in this report can be resolved through ownership solutions. There can be no doubt that co-operatives and mutuals will continue to play a constructive role in setting an example for more conventional businesses. But it would be a false hope to believe that the publicly listed company is going to disappear from the scene in the immediate future. The task remains as it was described earlier: to create a responsible capitalism that operates with an inclusive labour market to generate the high-quality, secure employment that is necessary for the sustainable generation of demand.

## Policy recommendations

The Ownership Commission has made an extensive set of recommendations to promote the more effective stewardship of conventional companies and promote greater diversity in corporate forms.<sup>128</sup> It would be a relatively simple matter for government to legislate in these terms, removing supposed barriers to the development of co-ops and mutuals, providing information about alternative models, and where appropriate

128 Hutton et al, op cit (2012)



using fiscal incentives to encourage non-conventional forms of business organisation. All these measures would be welcome and could help to ensure a higher level of pluralism in the business environment. Nevertheless, the argument presented here is clear: it would be unwise to anticipate any such initiatives having a significant or rapid impact on either income inequality, in-work poverty or the effectiveness of industrial citizenship. A degree of scepticism is needed to offset the undoubted enthusiasm of those who believe that a revival of co-operation and mutualism can begin to halt and reverse some of the negative trends of the past 30 years.

It is important to be realistic too about the extent to which co-operatives or mutuals can be adequate substitutes for either collective bargaining or information and consultation institutions. As one of the case studies shows, Italy has a larger number of co-operatives and mutuals than most other comparable economies, and worse social outcomes in terms of poverty and income inequality. Progress towards a fairer labour market would be glacially slow unless complementary policies were to be implemented in the UK, essentially the wholesale reconstruction of the employment regime. Moreover, as we have already observed, co-ops may be good for employment but bad for wage growth, and many of the conflicts between capital and labour in conventional businesses are replicated here in a slightly different form. Diversity and pluralism are admirable objectives but cannot be seen as an alternative to policies for worker participation in board-level decisions, the creation of effective works councils or a stronger trade union movement.

## Chapter 6

# Employee share ownership, 'shared capitalism' and individual employee involvement

## Employee share ownership, 'shared capitalism' and individual employee involvement

### Summary

- The evidence that employee share ownership improves productivity and commitment is ambiguous. The most significant benefits are a consequence of giving workers real voice together with an equity stake in the business.
- It would be mistaken to conclude that enabling employees to hold a few shares constitutes a robust model of workplace democracy or leads to less in-work poverty.
- Individual employee involvement is most likely to be effective when combined with arrangements for collective worker voice.
- Employee engagement surveys show that many employees in the UK are actively "disengaged".
- The quest for employee engagement, while obviously better than poor, top-down management, is unlikely to lead to better distributional outcomes.

### Employee share ownership

Employee share ownership has been popular as an instrument of employee financial participation for some considerable time. In the USA, John D Rockefeller of Standard Oil was an enthusiast for employee share ownership and profit sharing as a response to communism and as a hedge against unionisation. Economists from Alfred Marshall in the 19th century to James Meade in the 20th have supported the notion that workers should have a financial stake in the businesses that employ them. Leaving aside the political motivations of some employers, the economic arguments for employee financial participation have focused principally on productivity. In other words, by aligning the employees' interests with those of the employer, theory suggests an improvement in motivation and commitment, leading to greater effort and therefore higher productivity.<sup>129</sup> Unfortunately, the evidence on this question is ambiguous – there is a problem with demonstrating causation; one reason that some studies find a positive relationship between employee share ownership and improved productivity is because it is well-managed firms or "good" employers that are most likely to implement these arrangements.

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129 Freeman, Blasi & Kruse in Kruse, DL et al (eds) *Shared Capitalism at Work* (National Bureau of Economic Research/University of Chicago Press, 2010)

What does emerge from the very careful studies in the USA is that the most significant effects in terms of both productivity and employee commitment are a consequence of giving workers real voice along with an equity stake in the business:

*The labour practice that has a big effect on behaviour is an employee involvement committee, which increases employee participation in decision making... [H]aving an employee involvement committee by itself increases productivity by 0.12 percentage points, whereas combined with profit sharing and employee ownership, the productivity effect nearly doubles to a 0.23 percentage point gain.<sup>130</sup>*

Bryson and Freeman find similar results for the UK using data from the 2004 Workplace Employee Relations Survey.<sup>131</sup> There also appears to be a positive relationship between employee share ownership, worker participation and the perceived effectiveness of human resource management. In other words, HR policies are seen to be more effective where workers have voice *and* an ownership stake – apparently disconnected initiatives have the effect of reinforcing each other; our earlier assessment is reinforced, it is bundles of complementary policies that make the difference.

This still leaves us with the questions about distribution largely unresolved. While the USA may “lead the world in shared capitalist modes of compensation”, as Richard Freeman and his colleagues suggest, it also has the highest income inequality of any major OECD economy. If this is “shared capitalism” then other countries seem to do significantly better without the need to give workers a financial stake in the business employing them. One might even say that the arrangements in the USA may give the appearance of sharing, but in reality very little sharing is taking place. All the productivity gains that accrued to labour in the boom period were received by workers at the very top of the income distribution.<sup>132</sup> “Shared capitalism” has done little to improve the incomes of American workers with earnings below the median.

Moreover, there is further evidence from the USA to suggest that access to employee share schemes is not equally distributed across the workforce. Women, black workers and workers with disabilities are all less likely to own shares in the company for which they work.<sup>133</sup> In part this is a consequence of labour market segmentation and the simple fact that women working part-time, those from ethnic-minority communities and the disabled are more likely to experience low pay and other forms of labour

130 Ibid

131 Bryson & Freeman in Kruse et al, op cit

132 Dew-Becker & Gordon, op cit

133 Carberry in Kruse et al, op cit

market disadvantage. Moreover, the US research shows a high level of ignorance about shared capitalism, even among employees who are supposed to be its beneficiaries.<sup>134</sup> If these findings are right (and the research is of the highest quality) then one should not be surprised to find no impact on employee motivation and commitment; after all, employees cannot respond positively to an incentive if they are unaware that it exists.

Finally, we should note that the extent of employee share ownership ranges from holding a small number of shares in a large multinational through to the full employee-ownership models that we discussed in the previous chapter under the heading of mutuals and co-operatives. In a conventional plc with a number of large investors, employees will be generally unable to use their shares to influence management decision making. That is why employers who want to get the most out of their share scheme understand the importance of creating other vehicles for employee participation in workplace governance. It would be mistaken to conclude that enabling employees to hold a small number of shares constitutes a robust model of workplace democracy or that it will, in itself, lead to a fairer distribution of rewards, lower inequality or less in-work poverty. The researchers from the National Bureau of Economic Research in the USA summarise the argument with elegance and skill:

*[W]hile shared capitalism provides the incentive to improve performance, increased involvement in decision making can provide the means to do so. Providing shared capitalism without at least some involvement in decision making may have little or no effect on performance, and may in fact have bad effects if employees see the shared capitalism [sic] simply as a device to shift income risk onto them.*<sup>135</sup>

#### *Individual employee involvement*

Throughout this discussion, workplace democracy has been defined as a continuum from participation in board-level decision making through to "individual employee involvement" in the workplace. It is not entirely clear that one should consider the latter a true form of workplace "democracy", since it is the employer rather than the workers themselves who define the nature and the scope of the participation. Often "employee involvement" is described as "direct participation", drawing a distinction from "indirect" or "representative participation" through the medium of a works council or a trade union.

Individual employee involvement is often broadly defined and can embrace all or any of the following:

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<sup>134</sup> Budd in Kruse et al, op cit

<sup>135</sup> Freeman, Blasi & Kruse in Kruse et al, op cit

- face-to-face meetings with line managers;
- "town hall" style meetings with senior management;
- team briefings;
- "quality circles" – where employees jointly consider how to deal with quality and performance issues in their work group;
- direct communication through company newsletters, intranets and suchlike;
- employee suggestion schemes;
- joint problem-solving groups;
- various forms of "team working"; and
- joint setting of objectives through the performance management system.

A comprehensive study of these practices in the EU found that they were most likely to be effective when combined with arrangements for indirect participation. In other words, it was the bundling of policies that seemed to make the difference on the dimensions of both performance and productivity.<sup>136</sup> Perhaps this should not surprise us too much, because the effectiveness of individual employee involvement will depend on the confidence employees have that they can speak up individually without recriminations and make proposals for workplace change that will not lead to job cuts or damaging changes to working conditions. Simply expressed, collective worker voice or some measure of workplace democracy is the indispensable lubricant that makes the individual employee involvement initiatives work effectively.

*Far from being a barrier to progress, it seems, employee representatives are the agents of change. The greater their involvement, in terms of both form and extent (and this applies particularly to negotiation and joint decision making) the more the indicators of the effects were positive.*<sup>137</sup>

Some commentators have taken issue with these findings, not to condemn them outright but to explain why the most appropriate "bundle" of individual and collective employee involvement practices is to be found so rarely in practice. Much of this research has been focused on the "liberal" economies of the English-speaking world rather than the EU<sup>138</sup> and is rooted in the belief that the nature of Anglo-Saxon capital markets renders it more difficult for employers to make long-term commitments to their employees (see chapter 2) – and in the absence of these commitments the level of trust in the workplace is too low for the "progressive" employment practices

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136 Sisson, K et al *New Forms of Work Organisation: Can Europe Realise Its Potential?* (European Foundation for the Improvement of Living and Working Conditions, 1997)

137 Ibid

138 See, for example: Godard, op cit

to work effectively.<sup>139</sup>

More recently, attention in the UK has shifted to the quest for “employee engagement”. This is another term lacking a precise definition but is encapsulated in the idea that employees are committed to their employer’s business and are therefore willing to “go the extra mile” or, in more formal terms, to offer a high level of discretionary effort.

The MacLeod review, established by the Labour government to consider the engagement-performance link, offers at least five definitions (including “you sort of smell it, don’t you”), the most convincing of which is:

*A set of positive attitudes and behaviours enabling high job performance of a kind which are in tune with the organisation’s mission.*<sup>140</sup>

In other words, engagement is the *outcome* that is supposed to be delivered through the application of the individual-employee involvement practices discussed in this section. Professor David Guest, in his evidence to MacLeod, noted that many definitions confuse attitudes, behaviours and outcomes to such an extent that “the concept of employee engagement needs to be more clearly defined or it needs to be abandoned”.

Given the attention devoted to engagement it still remains somewhat surprising that so many employees in the UK are actively “disengaged”. According to the most recent employee engagement survey<sup>141</sup> published by the Chartered Institute of Personnel & Development (CIPD):<sup>142</sup>

- a third of employees never receive feedback from their managers;
- only half of all employees believe that they will be dealt with fairly if they have a problem at work;
- two in five say that they are not informed about what is happening in their organisation, and just a third believe that their views will be taken seriously;

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139 Konzelman, op cit; Godard, op cit

140 MacLeod, D and Clarke, N *Engaging for Success: Enhancing Performance through Employee Engagement* (Department for Business, Innovation & Skills, 2010)

141 Chartered Institute of Personnel & Development Working Life: Employee Attitudes and Engagement 2006 (2007)

142 The last CIPD survey to deal exclusively with employee engagement was in 2007; the results were generally negative. An employee outlook is now conducted annually, surveying a much wider range of employee attitudes to work but with rather less detail on engagement. All results reported here are from the 2007 survey unless otherwise stated.

- only a third of employees trust senior managers;
- fewer than two in five employees are engaged in the sense that they display the attitudes and behaviours needed to deliver the organisation's mission;<sup>143</sup>
- employees offer a negative assessment of senior management's willingness to consult on strategic decisions (-26 on the CIPD's favourability scale in 2012);<sup>144</sup> and
- almost half (47%) of all employees do not feel well informed about what is happening in their organisation.<sup>145</sup>

For the representative body of HR professionals to open a report with the finding that most British employees are "generally unhappy with how they are managed" is genuinely astonishing.<sup>146</sup> We are left with the depressing conclusion that neither individual employee involvement initiatives nor the search for employee engagement have delivered the promised results. In part this must be because there is now no discussion at all of the distribution of power in British workplaces. But even the IMF and the OECD recognise that bargaining power does matter and that an improvement in the bargaining power of those on modest to low incomes is essential if the conditions that caused the global economic and financial crisis are to be avoided in the future. The quest for employee engagement, while obviously better than poor, top-down management, is unlikely to lead to better distributional outcomes.

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143 Chartered Institute of Personnel & Development *Employee Outlook* (2012)

144 Ibid

145 Ibid

146 CIPD, op cit (2007)





## Chapter 7

# Other institutions of pre-distribution

## Other institutions of pre-distribution

### Summary

- Government can affect the initial distribution of market incomes through statutory minimum wages, "fair wages" policies in procurement and the statutory extension of collective agreements. These are not institutions of workplace democracy strictly so called, but they have the effect of supporting the other institutions of pre-distribution.
- The national minimum wage has established a floor under wages, but it has done no more than that. It is not a strategy for the elimination of low pay.
- Some campaigners have suggested that the "living wage" (fixed by academic researchers as a level that can secure full social participation, assuming full take-up of tax credits) should become the national minimum wage. This would be a mistake. It would probably lead to job losses in low-wage industries, would give employers no stake in the process, and could therefore damage the political consensus supporting the national-minimum-wage regime. Community-based campaigners for the living wage are also opposed to this approach.
- The "fair wages" model, establishing either negotiated or going rates as the benchmark pay rates in the public-sector supply chain, was effective in both fixing a wage floor in public procurement and in extending the coverage of collective bargaining. ILO Convention No 94 on labour clauses in public contracts is based on the UK's Fair Wages Resolution, rescinded in 1983.
- Government needs a strategy for the elimination of low pay, drawing on the success of the Low Pay Commission and establishing new structures for dialogue at sectoral level focused on skills, productivity, job quality and wages.

### Policy recommendations

- The remit of the Low Pay Commission should be revised so that it has direct responsibility for the development of a strategy to tackle low pay – it needs to investigate the causes, consequences and cures.
- The Low Pay Commission should be responsible for formulating some general principles of "affordability" in low-wage sectors where employers could

potentially pay more than the national minimum wage (NMW).

- Government should sponsor a dialogue between unions and employers in low-wage industries at sectoral level, initially focused on skills and productivity, but eventually making recommendations about minimum rates of pay once the system has matured.
- ILO Convention No 94 on labour clauses in public contracts should be re-ratified, with a view to establishing a wage floor either on the basis of collective agreements (where they exist) or with reference to the "going rate" in that industry. This will prevent undercutting and limit the scope for a race to the bottom in terms of pay and conditions in the public-sector supply chain.
- The living wage could be used as the lowest reference wage in public procurement if there is either no relevant collective agreement in operation or if "going rates" are lower.

## Introduction

So far the discussion has been focused on either labour market institutions of various kinds that give workers voice or ownership models that apparently create similar opportunities. There are other instruments that can be used by governments to shape the initial distribution of incomes which are also important in achieving more egalitarian outcomes and a lower incidence of in-work poverty. The two most obvious are statutory minimum wages and the use of the government's purchasing power to impose conditions on those wishing to supply the state with goods or services. In the past the latter outcome was achieved through the Fair Wages Resolution (FWR) although in recent times "living wages" have become more popular, in part because there is now no legal basis for fair-wages policies in the UK since the rescission of the FWR in 1983.

While neither the NMW nor fair-wages policies are necessarily about workplace democracy, they are both important elements of the employment regime and help to create inclusive labour markets. Moreover, fair-wages policies, which have historically been based on the extension of collective agreements, often have the effect of encouraging employers to recognise trade unions for collective bargaining – since it makes more sense for a business to be a participant in these processes than to have the results of someone else's negotiation imposed by the government. In this chapter we explore the effectiveness of these instruments and consider how policy might be developed in the future.

### **The national minimum wage**

The UK has had a national minimum wage since 1999, but the history of minimum-wage fixing began almost a century earlier with the establishment of the wages boards in 1909. The intention at that time was to set minimum wages and other conditions of employment in the "sweated trades" (what we would now describe as low-wage employment) where collective bargaining was weak. It was assumed in the legislative design that collective bargaining was the best way to fix wage rates and the expectation was that, as the relationships between the parties strengthened, trade unions and employers would develop the capacity to manage without the support of the law. Wages boards brought together the relevant trade unions and employers with a number of independents to break any deadlock. Over time, the boards were reconstituted as wages councils and continued to set sectoral minimum wages until their abolition in 1993. Wages councils' orders had the force of law, and action could be taken by the Wages Inspectorate against employers failing to comply.

Lord Wedderburn, the eminent labour lawyer, once observed that the principal task of every wages council was to commit suicide – because collective bargaining was supposed to be a natural outcome of the process over time.<sup>147</sup> But wages councils continued to play an important role in fixing a labour market floor, principally because trade unions never developed the organisational capacity to sustain collective bargaining in those industries. A further impulse to the development of collective bargaining was created in the Employment Protection Act 1975, which allowed for the conversion of wages councils into statutory joint industrial councils – essentially a wages council without the independent members, whose decisions would continue to have legal effect and would be enforced in the same way as a wages council order. These provisions were never activated and were repealed in the Employment Act 1980. Nonetheless, they confirmed the public policy preference for collective bargaining inherent in the wages councils scheme, which we have also seen demonstrated in the approach of the Bullock committee, with its emphasis on the trade union role in the appointment of worker directors.

The national minimum wage is now recognised as a permanent feature of the labour market, and the Low Pay Commission makes recommendations to the government on the level of the NMW after reviewing the impact of previous recommendations and general labour market conditions. This has been important in cementing employer support for the NMW, with those affected by the outcome having a voice in the process. As with the wages councils, the LPC has three trade union members, three

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147 Wedderburn, KW *The Worker and the Law* (Sweet & Maxwell, 1986)

employer members, two academic experts and an independent chair. This is not the place to review the impact of the NMW in detail, although we might note that it has gradually risen in relation to average earnings over time, with the bite of the NMW being toughest in the mid 2000s. According to the LPC, around a million workers have their pay fixed by the NMW.

What the NMW is not and cannot be is a comprehensive strategy for the elimination of low pay. As we have already seen, the great achievement of Labour in government – getting more people into work – was also associated with a rise in in-work poverty. Some commentators have suggested that this means the NMW must retain its real value in relation to median earnings at the same time as government works with employers, trade unions and others on voluntary initiatives to eliminate low pay.<sup>148</sup> Practical proposals have included the establishment of sector forums, which would bring employers and trade unions together in low-wage industries to develop strategies for raising skill levels, improving the design of jobs, enhancing the quality of management and boosting productivity. The operational assumption here is that if productivity is rising then wages will rise too, although as the Resolution Foundation has documented, this will happen only if low-wage workers have adequate bargaining power to ensure that the wage-productivity nexus is maintained. The Labour Party included a commitment to the establishment of sector forums in its 2005 general election manifesto, although the policy was never implemented.

Another proposal, which appeared in Labour's 2010 manifesto, is that the remit of the Low Pay Commission should be widened so that it has the explicit responsibility to examine the causes, consequences and cures for low pay. In other words, the LPC would be the institution at the heart of the government's strategy for the elimination of low pay. One can see how this process might be linked to the previous sector-forums policy, with the LPC mapping the terrain and making recommendations, which the sector forums would then be required to implement.

The Resolution Foundation's Commission on Living Standards has adopted a very similar approach in suggesting that the LPC might identify those sectors that can afford to pay more than the NMW and identify an "affordable wage" for these industries.<sup>149</sup> This is an interesting proposal, but it may be placing too heavy a burden on the LPC, which has been successful precisely because there has always been unanimity on the appropriate level of the NMW. Simplicity has been the key to success.

148 Coats, *op cit* (2007)

149 Commission on Living Standards, *op cit*

As soon as one begins to talk about sectoral rates fixed by the LPC, the position gets much more complicated and the scope for disagreement widens.<sup>150</sup> It might be better, following the Labour Party's earlier policy prescription, for the LPC to set some general principles about the *measurement* of affordability and for more developed discussions to take place at sectoral level. Perhaps the simplest way to understand how this might work is to see the sector forums as wages councils that make non-binding recommendations – this raises questions, of course, about the composition of a sector forum and suggests that there will need to be some independent members to break any deadlock between the immediate stakeholders. Moreover, it may be sensible to adopt a step-by-step approach. The LPC could develop some general principles of affordability, and some sectoral discussions could begin on skills and productivity, with a wider discussion about pay taking place once the system has matured.

Overall, this approach has the advantage of setting wages in the wider context of productivity and organisational performance. It is a useful device to demonstrate that there are potential gains for employers (higher productivity) and workers (higher wages). Moreover, by facilitating a sectoral dialogue about pay in the medium term, the government could lay the foundations for a more robust process of negotiation. This approach could be reinforced by an energised system of information and consultation.

The Commission on Living Standards has also proposed greater pay transparency, with listed companies being required to publish the number and percentage of workers in receipt of the NMW and potentially those paid below a benchmark like the living wage (of which more is said below). These are sensible measures that seek to use the power of public embarrassment to supplement a rather sophisticated approach to improving performance, skills and pay.

In addition to all these welcome measures, rather less desirable policy initiatives have begun to surface, suggesting that those employers paying more than the NMW should be given a tax break for so doing. This might take the form of a reduced rate of national insurance contributions or a lower rate of corporation tax. We would not favour this approach, simply because the tax system is complicated enough as it stands and this would be another distortion or layer of complexity. So far no indication has been given as to when the tax break would apply, whether it would be limited by sector and how the level of wages that would activate the tax break would be determined.

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<sup>150</sup> It is difficult enough for the LPC to reach agreement on the rate of the NMW. To require the LPC to fix sectoral rates too on the basis of "affordability" could be a recipe for policy paralysis – and it runs the risk of breaking the LPC.

These tax proposals are also rooted in the assumption that a fiscal incentive of this kind would generate the desired changes in employer behaviour. Whether this assumption is correct or not is obviously untested, but the strongest objection to the policy is that government should not be offering employers a tax break for something that they should be doing anyway. Moreover, the tax system is a rather blunt instrument and the institutional innovations we have described may be more effective in producing the desired results. One might also say that wages are not the only or the most important problem here – the organisation of work, the design of jobs, the effectiveness of skills utilisation, the quality of management and the quality of work are all relevant considerations. Politicians are always attracted to simple, apparently effortless solutions, but believing that some small tax changes can help crack the low-pay conundrum is to buy a very misleading prospectus.

A successful anti-low-pay strategy would recognise two things that constitute the core argument in this paper: both institutions and bargaining power matter. The task is therefore to build institutions (of which the sector forums and the extended remit of the LPC are an example) at the same time as an effort is made to rebalance bargaining power between employers and employees. So far, the discussion about low pay has not properly taken account of these two factors. Much interest recently has focused on the question of the so-called "living wage" and it is to this issue that we now turn.

### **The living wage**

The "living wage" movement began in the USA in the 1990s and was driven by the decisions of municipal authorities to fix minimum wage rates that would have to be met by all suppliers with which they did business. We have already seen that the USA has a very severe inequality and poverty problem, and living wages are designed to improve the incomes of the working poor by compensating for weak bargaining power and the relative fragility of the federal minimum wage regime. While this may look like a significant policy innovation, the idea that there should be some measure of labour standard setting in public procurement was first established in the 19th century – in 1868 the US Congress required government contractors to observe an eight-hour day without any reduction in pay. At federal level the arrangements for the payment of "prevailing wages" are most developed in construction contracts, where the Davis-Bacon Act 1931 requires that either the rates specified in relevant collective agreements should be observed or, where there is no collective agreement, the "prevailing wage" in the area where the work is to be done should be applied. These provisions are analogous to the UK's Fair Wages Resolution, discussed in more detail in the next section.



Community-based campaigns, with the enthusiastic participation of faith groups and some support from the trade unions, have characterised the living-wage movement in the UK. Unlike in the USA, where the living wage is determined locally, the living wage in the UK is defined as £8.55 an hour in London and £7.45 an hour outside London. These rates are significantly higher than the current NMW rates, which are £6.19 for those aged 21 and over; £4.98 for those aged 18-20; and £3.68 for 16- and 17-year-olds. The living wage outside London is based on a calculation undertaken annually by the Centre for Research in Social Policy at Loughborough University, whereas the Greater London Authority calculates the London living wage. The figures are supposed to have the effect of giving families the wherewithal to secure full social participation *but also assume that households are claiming all the tax credits to which they are entitled*. Compliance with the living wage is subject to accreditation by the Living Wage Foundation.<sup>151</sup>

There is nothing mandatory about the living wage. Employers are encouraged to pay it on the grounds that they can afford it. Some local authorities have adopted the living wage as the reference wage that must be complied with before an organisation can be added to the approved supplier list. This rather contradicts the campaigning objectives of Citizens UK, the umbrella organisation co-ordinating living-wage activities, which places a high value on community organising and the construction of social capital. In other words, citizens are taking responsibility for and being equipped with the capabilities to influence their conditions of work – or at least their wages. These valuable features disappear if the living wage is simply imposed as a contractual requirement by a dispassionate bureaucracy.

In the private sector, compliance with the living wage is genuinely voluntary; and some major businesses – Barclays and PWC for example – have happily identified themselves as living-wage employers. This is not because they employ any low-paid workers directly, but because they have demonstrated a willingness to pay higher prices for contract cleaning and catering services so that the contractors can pay their staff a higher wage. That businesses are willing to take responsibility for their supply chain is a welcome development and the same might be said for those local authorities adopting the living wage. Nonetheless, it would be wrong not to recognise the relatively limited impact of the living wage so far, and the need for a broader strategy to tackle low pay.

According to research by the IPPR and the Resolution Foundation, relatively few workers have secured a higher wage as a result of a living-wage campaign:

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151 For more details on the foundation's work, see: [www.livingwage.org.uk](http://www.livingwage.org.uk)

*In London in 2010, an estimated 652,000 workers were earning less than the London living wage; yet only around 10,000 workers won a living wage in the six years between 2005 and 2011. Aside from a handful of notable exceptions (such as the cosmetics retailer Lush) relatively few companies in retail, food service or the travel and tourism sectors, which account for the bulk of low-wage jobs, have become living wage employers.*<sup>152</sup>

These figures, as the IPPR/Resolution Foundation report points out, do not of course include employers who pay the living wage but are not accredited.

It has been suggested that the living-wage rates should be used to fix the NMW because this would be a simple and straightforward device to reduce the level of low pay in the UK. But while the argument has some superficial attractions, it is probably not the best policy solution. To begin with, living-wage campaigners are themselves opposed to this proposition. In their minds the living wage is voluntary, should be based on the ability to pay, and should follow from an effort to mobilise the community. There is also a real risk that a NMW fixed at these rates would place jobs at risk. The Low Pay Commission has been very careful in fixing the NMW, and if it believed that it could recommend higher minimum-wage figures then it would have done so. An obvious response is to say that the NMW *could* be slightly higher than the LPC has recommended, because the presence of employers on the commission has the effect of depressing the level. But the purely "rational" or "technocratic" rate would not be very much higher than the rates currently in force. Moreover, the involvement of employers has entrenched the NMW as a permanent feature of the labour market, and anything that undermines the effectiveness of the LPC would also damage the political and economic legitimacy of the NMW.

Were the living wage to become the NMW, some employers might find it difficult to accept that their lowest rates should be determined by academic researchers. Once again, the contrast with the LPC is instructive. Employers have no influence over the level of the living wage but have a third of the seats on the Low Pay Commission. Those with no stake in the process are unlikely to take responsibility for the outcome in the way that both the CBI and the TUC do in relation to the NMW.

Another area of concern is that the living wage is not really a living wage at all. What constitutes a "living wage" will vary enormously by household type: the number of children in a family, whether both parents are working, and whether any members of

<sup>152</sup> Pennycook, M, *What Price a Living Wage? Understanding the Impact of the Living Wage on Firm Level Wage Bills* (IPPR/Resolution Foundation, 2012)

the household have any special needs. Even if the "living wage" rates were used to fix the NMW, that alone would be insufficient to eliminate in-work poverty or the need for extensive redistribution through the tax credits system (which is assumed in the calculation of the living wage in any event). Other measures, like a significant rise in child benefit, paid to the mother, could have a bigger impact on child poverty.<sup>153</sup>

Finally, the living wage may be an exceptionally useful campaigning tool, with positive impacts on the earnings of low-paid workers, but it is not intended to do anything to address other problems in the workplace. This in part is because the living wage is a voluntary initiative and its implementation relies heavily on self-policing (especially of subcontractors), although there is some monitoring by the Living Wage Foundation and in London by the GLA. Moreover, the campaign for a living wage does not seek to establish a workplace structure for future negotiations on wage rates or to address other workplace problems. In other words, it cannot replace effective workplace unions or a works council.

This may be an inevitable consequence of the community organising style, which looks very different from the union organising/bargaining model.<sup>154</sup> But what workers (especially low-paid workers) need alongside a campaign to improve low rates of pay is some embedded institution that allows them to express themselves to their employer through a well-developed dialogue about conditions of employment, which can also lead to the resolution of workplace problems.

Citizens UK understands these limitations of the policy but is reluctant to take a further step towards trying to represent workers who will have other difficulties in the workplace besides low pay. This is understandable, not least because Citizens UK has a proven capability to drive the living-wage campaigns to a successful conclusion but limited expertise in either solving employment-relations problems or negotiating pay and conditions of employment in a conventional setting. One possibility, of course, would be for a union to step into the gap immediately after a successful living-wage campaign. But that depends in turn on the union establishing credibility with the group of workers affected and managing a successful transition from community

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153 Bennett & Lister, *op cit*

154 For a fascinating account of the differences, see: Sennett, R *Together: The Rituals, Pleasures and Politics of Co-operation* (Yale University Press, 2012). Living-wage campaigners have a simple demand: "pay the living wage". This is a zero-sum game; either the campaign succeeds or it does not. Union organisation for collective bargaining is a very different enterprise. Trade unions may present a claim for a significant wage increase but negotiate in the expectation that they will settle for less. This can be cynically presented as the striking of shabby compromises in smoke-free rooms, but it is the unavoidable reality of industrial relations, even if it is less heroic than the ethically driven community organising approach.

organising to collective bargaining.

The situation would be a good deal simpler if the UK had an information and consultation system of the kind proposed in chapter 6. Community organisers would then have a structure to use to resolve other workplace problems; if workers are confident enough to speak up on pay then they should, other things being equal, have the capacity to develop a wider dialogue with the employer through I&C activities. The other advantage here, of course, is that the representatives will have time off for training and the conduct of their duties as well as the right to seek expert advice. It is not too fanciful to believe that community organisers could continue to play a role through these processes. Moreover, we have also proposed that trade unions should have the right to initiate these I&C activities. One can begin to see how, learning from international experience, the UK could rebuild a set of workplace institutions populated by citizens with the capabilities to exercise real influence over employers' decisions.

### **Fair wages**

Throughout this report, we have noted that the state can use the power of public procurement to ensure a more egalitarian initial distribution of income and achieve an appropriate balance of power between labour and capital. From 1891 to 1983 these objectives were achieved, at least in part, by the various Fair Wages Resolutions (FWR) of the House of Commons (the classic account of the FWR can be found in Bercusson's 1978 work *Fair Wages Resolutions*.<sup>155</sup> The FWR was not a law strictly so called, but more a form of soft regulation that acted as an instruction to every government department. The last FWR was adopted in 1946 and proved so influential that it provided the model for the ILO Convention No 94 on labour clauses in public contracts.

### **ILO Labour Clauses (Public Contracts) Convention, 1949 (No 94)**

#### **Article 2**

1. Contracts to which this Convention applies shall include clauses ensuring to the workers concerned wages (including allowances), hours of work and other conditions of labour which are not less favourable than those established for work of the same character in the trade or industry concerned in the district where the work is carried on –

(a) by collective agreement or other recognised machinery of negotiation between

<sup>155</sup> Bercusson, B *Fair Wages Resolutions* (Mansell, 1978)

organisations of employers and workers representative respectively of substantial proportions of the employers and workers in the trade or industry concerned; or

(b) by arbitration award; or

(c) by national laws or regulations.

2. Where the conditions of labour referred to in the preceding paragraph are not regulated in a manner referred to therein in the district where the work is carried on, the clauses to be included in contracts shall ensure to the workers concerned wages (including allowances), hours of work and other conditions of labour which are not less favourable than –

(a) those established by collective agreement or other recognised machinery of negotiation, by arbitration, or by national laws or regulations, for work of the same character in the trade or industry concerned in the nearest appropriate district; or

(b) the general level observed in the trade or industry in which the contractor is engaged by employers whose general circumstances are similar.

3. The terms of the clauses to be included in contracts and any variations thereof shall be determined by the competent authority, in the manner considered most appropriate to the national conditions, after consultation with the organisations of employers and workers concerned, where such exist.

4. Appropriate measures shall be taken by the competent authority, by advertising specifications or otherwise, to ensure that persons tendering for contracts are aware of the terms of the clauses.

As one might have anticipated, given all that we have seen of the UK's industrial relations culture before 1979, collective agreements were to provide the reference wage against which compliance with the FWR was to be judged. If no relevant collective agreement could be found then the public authority would need to determine the "general level" of wages for that trade or industry in that locality. In large measure these provisions are reflected in the Davis-Bacon Act, described above, which regulates labour standards in federal construction contracts in the USA.

The FWR may sound so arcane or distant from today's realities that it is easy to underestimate the importance of the instrument. Otto Kahn-Freund, one of the wisest

commentators on these matters, observed:

*The fact is that by what seemed to be general consent no governmental measure had over the last three quarters of a century done more to spread the habit of observing collective agreements than these fair wages resolutions, covering as they did a very wide sector of the economy, especially through the inclusion of sub-contractors.*<sup>156</sup>

In other words, not only did the FWR have the effect of establishing a sectoral wage floor, but it also encouraged the spread of what at that time was the *central* (in reality the only) institution of workplace democracy in the UK – a recognised independent trade union with a sophisticated structure of workplace representation. When trade unions talk in negative terms about the labour market reforms of the 1980s, they rarely mention the FWR even though there can be little doubt that the rescission of the instrument in 1983 was just as serious for organised labour as some of the higher-profile measures to restrict the scope of lawful industrial action and make unions liable in tort for the activities of their officials.

If we return to the Index of Pre-distribution (annex 1) we can see that most of the countries with a more egalitarian distribution than the UK have ratified ILO Convention No 94 – Sweden is the notable exception, but has very high levels of union membership and collective bargaining coverage, which almost renders ratification otiose. It would appear therefore to be a simple matter for the UK to re-ratify Convention No 94, establish a floor under wages in public procurement *and* encourage a revival of workplace democracy. But while the machinery of ratification may be simple, making Convention No 94 and a new FWR work in the UK would not be without difficulties.

HM Treasury would probably object to ratification (no matter who is in government) on the grounds that a revived FWR would push up the costs of public procurement. No doubt that is true, but there could also be a significant saving to the exchequer in the reduced payment of tax credits, given that most of the employees affected will be low paid. Precisely what the savings might be are hard to quantify, since the data is not available (beyond some crude estimates) of the extent of low pay in the public-sector supply chain. Equally, we cannot be certain about the scale of any cost increases. In macroeconomic terms, however, there appears to be little or no connection between the state of the public finances and application of Convention No 94. Italy has ratified the convention, but so has the Netherlands; the first is experiencing a fiscal crisis and the second most assuredly is not.

<sup>156</sup> Kahn-Freund, O *Labour and the Law* (3rd edition, edited by P Davies and M Freedland; Stevens, 1983)

A more serious objection is that the UK no longer has the labour market institutions needed to sustain the successful implementation of the FWR. We have seen that trade union membership is exceptionally weak in the private sector and that determining the appropriate "fair wage" by reference to a collective agreement will be difficult if not impossible. Were the FWR to be revived in the UK, public authorities would need, initially at least, to rely upon the "general level" provisions, which would require a survey of local wage rates to determine the "prevailing wage". No doubt some organisations might find this a little burdensome, but there is a strong element of learning by doing here, and once data has been collected initially the process of review and updating should prove much easier. Moreover, the whole point of an instrument like the FWR is to change behaviour – the goal is to reshape the world, not just to tinker with the status quo. This was the clear implication of the first FWR when it was first adopted in 1891; the objective was to encourage the development of collective bargaining and prevent a race to the bottom in terms of pay and conditions of employment.

It is also important to view the reintroduction of the FWR as part of a comprehensive strategy for the elimination of low pay. Policy must move forward on a number of fronts simultaneously. For present purposes the strengthening of the I&C regulations, the development of an anti-low-pay strategy through sector forums and the readoption of the FWR are essential elements in a project of institution building. For these initiatives to be effective, however, unions and others must play a constructive role. We return to these challenges in our conclusions and recommendations.

### **Wage floors and the employment regime**

A swift glance at the Index of Pre-distribution (annex 1) confirms that not all countries with statutory wage floors of various kinds enjoy good social outcomes. The USA, for example, has federal and state minimum wages, contract compliance in public procurement and living-wage ordinances at local level – but these institutions still deliver one of the most unequal societies in the OECD and a much higher incidence of poverty than one finds in the EU 15. Returning to the employment regimes lens once again, we are driven to the conclusion that what matters more than anything else is the relationship between these labour market institutions and the balance of power between capital and labour. It is possible to create a virtuous circle where strong organisations like trade unions (or other civil society organisations) make the institutions effective and institutional effectiveness enhances the role of the unions and similar institutions. This sets the boundaries of what the government can do, as the designer of the legally mandated institutional architecture (workers on the board, works councils, fair wages and minimum wages) and what others must do independently of government.

If this assessment is right, then it places very high demands on trade unions to ensure that they are both representative and relevant. It also requires employers too to recognise unions as legitimate institutions rather than quasi-revolutionary conspiracies against capitalism, operating at the margins of legality. Given the current state of affairs in the UK, confirmed by the country's woeful score on the EU Participation Index, there are no guarantees that either employers or trade unions are fully seized of the need for change or understand the scale of the challenge. Nor is it clear that policy makers are fully aware of the diagnosis presented in this paper either – although the Labour Party's interest in pre-distribution promises well for the future. But progress depends on some shared understanding of the problems so that a new settlement can be established in the British workplace. Once that consensus has been achieved, then the parties can begin the slow and painstaking work of institutional reconstruction that should enable the UK to achieve the social and economic outcomes that have proved elusive for more than 30 years.

### **Policy recommendations**

The Labour governments from 1997 to 2010 made limited progress, through the national minimum wage, in establishing the notion that pre-distribution matters. But we have already seen that the NMW is a floor under wages and is by no means a strategy for the reduction and elimination of low-pay, low-productivity, low-quality business models. There are also concerns about the policing of the NMW.

The living wage, which is attracting considerable interest, is essentially an effort to create a substitute for the wage floors that used to be established through collective bargaining and in public procurement through the Fair Wages Resolution.

More ambition is needed if progress is to be made in the future and if the squeeze on wages so admirably chronicled by the Commission on Living Standards is to be halted and reversed. Among the measures that should therefore be considered are:

- expanding the remit of the Low Pay Commission so that it has direct responsibility for the development of an overall strategy to tackle low pay – it needs to investigate the causes, consequences and cures;
- requiring the LPC to formulate some general principles of “affordability” in low-wage sectors where employers could potentially pay more than the NMW;
- strengthening the enforcement arrangements for compliance with the NMW;
- developing a dialogue between unions and employers in low-wage industries at sectoral level, initially focused on skills and productivity, but eventually making recommendations about minimum rates of pay once the system has matured;



- re-ratifying ILO Convention No 94 on labour clauses in public contracts, with a view to establishing a wage floor either on the basis of collective agreements (where they exist) or with reference to the "going rate" in that industry – this will prevent undercutting and limit the scope for a race to the bottom in terms of pay and conditions in the public-sector supply chain;
- using the living wage as the lowest reference wage in public procurement – if higher wages are established either through collective bargaining or "going rates", then they should be taken as the appropriate reference wage.

The final piece in the pre-distribution jigsaw used to be the unilateral arbitration arrangements that allowed for the extension of collective agreements to non-signatory employers. Trade unions were able to make an application to the Central Arbitration Committee that a particular employer was not observing the recognised level for the industry and should be compelled to do so. These procedures achieved the same effect as the widespread arrangements in other EU 15 countries that provide for the statutory extension of collective agreements. Given the weakness of collective bargaining across the private sector today, it seems unlikely that any government would wish to take immediate action. Nonetheless, the intention of the previous legislation is clear: to inculcate the habit among employers of observing collective agreements and to encourage wider coverage of collective bargaining. As a matter of principle this has significant advantages over living-wage approaches, not least that employers have a stake in the process of fixing the relevant rates. Perhaps the best that can be done for the time being is to monitor the implementation of those policies designed to give meaning to industrial citizenship and, as the system matures, consider whether further steps must be taken. The UK is an outlier in the EU 15 in having no instruments available to bring straying employers back into the fold. If the IMF's goal of a rebalancing of bargaining power is to be achieved and sustained, then these measures are an important ingredient in the potential policy mix.

## Chapter 8

# Conclusion and recommendations

## Conclusions and recommendations

### Introduction

The core argument presented in this paper is that labour market institutions matter and affect the initial distribution of incomes. We have presented a picture of countries that do better on this measure than the UK, and they all have an array of systems that allow workers real opportunities to influence the critical decisions affecting their working lives. These can range from direct representation on the board of directors, through collective bargaining as conventionally understood, to the guaranteed rights to information and consultation available to works councils in much of continental Europe. It would be mistaken to believe, however, that it is only institutions that make the difference. The state may create the architecture of workplace democracy, but this has to be populated by civil society organisations (and therefore citizens) who make the institutions work effectively. In most cases this function is performed by the trade unions, without whose enthusiastic support the structures of workplace participation would be little more than empty shells. Just as political parties (in principle) sustain our democratic system, so industrial citizenship requires a similar level of organisation.

We have sought to evaluate the effectiveness of the institutions of workplace democracy (as a subset of the institutions of pre-distribution) through the lens of the employment regime. The value of this approach is that it allows us to understand the complex relationship between institutions and outcomes at the same time as it writes power back into the workplace script. We can see how the state and civil society (including employers, trade unions and NGOs) all work together to create an inclusive labour market. The politics of the quality of work becomes part of a wider politics of the quality of life. Levels of social trust are higher in those countries with more egalitarian distributions of income,<sup>157</sup> which suggests that this phenomenon could be transferred to the workplace, leading to the high level of employee engagement referred to so extensively in the MacLeod report.<sup>158</sup>

Another important part of the story is that the value of industrial democracy does not simply lie in its instrumental effects on productivity and performance – or for that matter on inequality and in-work poverty. The rights to freedom of association and collective bargaining are seen as foundational precisely because they are associated with individual autonomy and because they help to equip people at work with the capabilities that they need to be active citizens with the power to influence critical

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157 Wilkinson, R and Pickett, K *The Spirit Level* (Allen Lane, 2009)

158 MacLeod & Clarke, op cit

social and economic decisions. Businesses may not be pure democracies where workers elect managers, but they cannot be pure autocracies either. The human rights conventions guarantee rights to organise, to be heard and to receive a reasoned response from the employer. Business decisions, as with political decisions, must pass the tests of due process and legitimacy if workers are to be anything more than the victims of diktats handed down by the management hierarchy.

To many observers in the UK, including many businesses, this will sound impossibly radical, or utopian, or at worst nostalgic for an era of failed corporatism. But the consistent argument made in this volume is that other countries handle their affairs with a much more ambitious set of institutions than the UK and have not experienced notably worse economic performance. As the European Employee Participation Index confirms, the UK is almost unique in the EU 27 in making such limited provision for the exercise of industrial citizenship. It is hardly surprising that the Chartered Institute of Personnel & Development has observed that most people are unhappy with the way that they are managed.

The low level of participation in the UK remains surprising, however, not least because the forces that provided the impulse for industrial democracy in the UK in the 1970s are in many ways just as strong today:

- Large organisations find it difficult to communicate effectively with workers to maintain motivation and commitment.
- A more highly skilled workforce means that expectations of high-quality work are rising and, as the Skills Survey shows, are often disappointed.<sup>159</sup>
- The decline of deference means that employers are held to a higher test of legitimacy – decisions that make little sense to employees will be subject to challenge, either formally or through informal measure of resistance like shirking on the job or high levels of sickness absence.

Other factors referred to in the Bullock report are also important as policy makers begin to think about an agenda for the future, including the relentless pace of technological change and continuing weaknesses in corporate governance. The disconnection between ownership and control identified by Berle and Means in the 1930s (and identified at the dawn of the modern age by the Dutch East India Company) remains

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<sup>159</sup> Felstead, A et al *Skills at Work 1986 to 2006* (ESRC Centre for Skills, Knowledge & Organisational Performance, 2007)

a problem today. Much of the financial crisis can be blamed on a corporate governance failure in the financial services sector. If shareholders had really been exercising oversight effectively, then the tower of exotic derivatives would never have been built and would never have collapsed, tipping the world into the worst economic crisis since the Great Depression. One of the consequences of short-termism in equity markets – the problem ably analysed for the Coalition government by John Kay – is that employers find it difficult to make credible long-term commitments to their employees. Mergers and acquisitions and the hyperactivity of reorganisations create a situation of permanent revolution in many businesses. This is bad for industrial citizenship, employment security, organisational performance and productivity. Employees who have to reapply for their jobs every 12 to 18 months are hardly likely to be motivated, committed or, in today's jargon, "engaged".

Reference has also been made to the literature on "varieties of capitalism", drawing a distinction between liberal market economies like the UK or the USA and "co-ordinated market economies" like Germany or the Nordics.<sup>160</sup> One possible interpretation of this story is that the trajectory of policy is path-dependent; if you happen to have a liberal market economy then it is impossible to decide to take a different path. In other words, all that policy makers can do in the UK is to make the best of the hand they have been dealt – they cannot alter the rules or fundamentally change the game. Three responses can be given to this objection. First, the "co-ordinated market economies" are as different from each other as they are similar. The German labour market today, with a high incidence of low-pay and low-quality employment, looks a great deal more like the UK than it does like a Nordic social democracy. Second, liberal market economies have managed to make institutional choices that have put them on a very different path. Before the crisis hit, the Republic of Ireland had experienced a successful corporatism for two decades (national agreements on pay, public spending and the social wage having been concluded by government, unions, employers and others). According to the Employee Participation Index, Ireland continues to do better than the UK in making a reality of industrial citizenship. Australia had a similar experience in 1983-96 under the Hawke and Keating Labour governments, when economic policy was managed in partnership with the trade unions through a series of "Accords" (essentially a successful version of the UK's social contract, where wage restraint was conceded by the unions in return for improvements in the social wage and the introduction of a compulsory superannuation system). It would be quite wrong to limit the choices available to policy makers in the UK simply on the grounds that innovative approaches fall outside the "liberal market" paradigm.

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160 Hall & Soskice, *op cit* (2001)

Third, it is important to understand that the construction of inclusive labour markets was a deliberate political choice made by the Nordic countries as a consequence of the economic upheavals of the Great Depression. A period of intense social conflict in Denmark, Sweden and Norway resulted in a new settlement between the government, trade unions and employers. Full employment and a strong welfare state remain the fundamental pillars of the Nordic model (even under governments of the centre-right). But there was a painstaking effort to build effective institutions and policies that became mutually reinforcing. Trade unions in Sweden in particular made a strategic choice to use the collective bargaining system to limit income inequality at the same time as they pursued the objective of a high-wage economy. All the social actors were broadly aligned behind similar goals to the extent that the centre-right parties in these countries still look like nothing of the kind to mainstream British Conservatives. In other words, choosing to take a different path is possible for the UK, even though the difficulties should not be underestimated. A robust political consensus is needed for progress to be made, especially in relation to labour market policy. Given the deep partisan divisions on these questions today, the idea of progress may look like wishful thinking, but there are reasons for optimism even if this must be tempered by a willingness to be patient.

### **Building an economy fit for the post-crisis era**

The crisis provides a useful point of reference as marking a break with the economic policy paradigm that had been predominant in the English-speaking world for more than 30 years. The beliefs that deregulated markets were always best, that a small state was the best state, that wealth would "trickle down" from the rich to the poor and that inequality was not really an issue for policy makers were all undermined by the crisis. The recent work of the IMF and the OECD on income inequality can only be understood as a partial rejection of the previous conventional wisdom. Their view is clear: fair societies deliver sustainable economic growth; unfair societies are characterised by booms and busts. An IMF staff paper is very clear: the situation before the global crisis most closely resembled the world before the Great Crash in 1929, and for largely similar reasons.<sup>161</sup>

The concern here, therefore, is that inequality creates both social injustice *and* economic instability, as low-income households increase their borrowing to maintain their living standards. The pre-crisis model failed that test, largely because it relied upon a form of "privatised Keynesianism" fuelled by personal debt rather than public spending.<sup>162</sup> The challenge for policy makers therefore is to consider how rising living

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<sup>161</sup> Kumhof & Ranciere, *op cit*

<sup>162</sup> Crouch, C *The Strange Non-death of Neo-liberalism* (Polity Press, 2011)

standards can be secured through increases in wages rather than increases in household borrowing. An orthodox response is that wages will rise in line with productivity, so productivity must be rising for pay to go up. As a general principle this may be true, but the connection between pay and productivity is not automatic and it can be broken. This is certainly true in the USA, where almost all of the productivity gains of the pre-crash era went to those who were already affluent,<sup>163</sup> and the Resolution Foundation's research in the UK has generated similar findings. In other words, it is less a matter of pay and productivity becoming disconnected at the aggregate level and more that those from the middle to the bottom of the distribution lack the bargaining power to ensure that they receive their fair share.

A natural conclusion of this line of reasoning is that the global economy cannot revert to the pre-crisis status quo. For countries like the UK and the USA, the best route to sustainable growth is to learn from the labour market models that have delivered high-quality employment at decent wages elsewhere. Another way of approaching the challenge is to say that new economic thinking is needed at a deeper and more profound level than either policy makers or professional economists managed before the crisis. Amartya Sen's work is instructive here, not least because he reminds us that the creation of wealth is not an end in itself:

*[I]t is simply not adequate to take as our basic objective just the maximization of income or wealth, which is, as Aristotle noted "merely useful and for the sake of something else". For the same reason, economic growth cannot sensibly be treated as an end in itself. Development has to be more concerned with enhancing the lives we lead and the freedoms we enjoy. Expanding the freedoms we have reason to value not only makes our lives richer and more unfettered, but also allows us to be fuller social persons, exercising our own volitions and interacting with – and influencing – the world in which we live.*<sup>164</sup>

Politicians across the political spectrum claim to be concerned about these issues. Ed Miliband has made the argument for a responsible capitalism the centrepiece of his leadership. David Cameron, before the 2010 election, was on record as saying that Labour had let the income inequality gap grow too wide. And Conservative commentators like Ferdinand Mount now make proposals for corporate governance reforms that British businesses will find more than a little challenging.<sup>165</sup>

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163 Dew-Becker & Gordon, op cit; Parker, op cit

164 Sen, *A Development as Freedom* (OUP, 1999), p14

165 Mount, op cit

Policy makers in the UK have two principal tasks: to fill the institutional gap identified in the analysis presented in this discussion and to facilitate the creation of civil society organisations that can make these institutions effective. The first is relatively straightforward; all government needs to do is develop a legislative programme that learns from the best experience elsewhere. The second is rather more problematic; government cannot legislate that unions become relevant, popular and effective. An act of parliament cannot bring about high-trust relationships in a high-quality workplace, even though it is the successful completion of this second task that will make a real difference to distributional outcomes. Of course government can devise a new set of institutions that appear to be well designed, but the exercise will be largely futile unless there has been a rebalancing of power in the labour market in the direction of employees on modest to low incomes.

### **Industrial democracy and corporate governance**

Anyone seeking to reopen the agenda of industrial democracy and corporate governance needs to proceed with caution. The Bullock proposals failed in the 1970s largely due to employer hostility and union indifference or opposition. Experience in the early 2000s confirms that British employers have not fundamentally changed their stance in opposing *any* measures that might affect their prerogatives – even very modest obligations of the kind found in the I&C Regulations. Labour in government instituted an extensive company law review that produced little more than some limited changes to directors' duties and slightly more transparency in reporting requirements. The history of the last three decades confirms that corporate power can be effectively deployed to defeat even the most limited prospectus for change.

Those with an apparently more ambitious policy agenda often produce a compelling analysis but rather weak prescriptions. The Kay review of short-termism is an excellent diagnosis of the UK's problems but the remedy can apparently be achieved through mostly voluntary market reform. The High Pay Commission, which has explained with passion and clarity why the UK's top-pay culture is unsustainable, produces little more than pleas for more transparency and for having one worker on a remuneration committee.

To present a fully fledged agenda for corporate governance reform would almost certainly be a mistake. But, given the consequences of the crisis and the concern about responsible business across the political spectrum, there is an irresistible case that the UK needs a sophisticated public conversation about what "good business" means. In grander terms, there is a case for a major national debate about the fundamental purposes that British capitalism seeks to serve. This is more than



just a philosophical question, because the state can either incentivise or penalise different kinds of corporate behaviour. If it is possible to reach some broad agreement on business purpose, one can then proceed to a narrower discussion about the regulatory architecture needed to sustain that model of responsible capitalism. At this point in the discussion, a wholehearted defence of the status quo would look unpersuasive, not least because the status quo produced the conditions that led to the crisis. It will be essential to incorporate some consideration of how corporate power is to be deployed, held to account and legitimised in the post-crisis era. But this approach to the question is more likely to bear fruit than a straightforward effort to update Bullock's recommendations and make them relevant to the world as it is today.

Corporate governance reform has to be an exercise in deliberative governance; enduring change cannot be secured through a divisive partisan debate. This means that depoliticising the process of policy development is essential. A Corporate Governance Commission should be appointed after the 2015 election with a clear mandate to change the composition of Britain's boardrooms, paying particular attention to the interests of stakeholders, including employees. The commission's work should be completed in 18 months so that legislation can reach the statute book before the 2020 election.

### **Workplace information and consultation: towards British works councils**

This leaves much of the corporate governance detail to a deliberative process, but there is a strong case for being considerably more prescriptive when it comes to information and consultation in the workplace. The ETUI's European Participation Index proves that a purely voluntary approach in the UK has led to woeful results, a finding confirmed by the initial results of the 2011 Workplace Employee Relations Survey. That representative participation has a positive impact on organisational performance is well established in the literature, suggesting that an expansion of the opportunities for participation would be in employers' interests too.<sup>166</sup> It is also clear that the intensity of prescribed participation is the strongest indicator of de facto participation.<sup>167</sup> Moreover, the capability to influence the working environment is important, following Amartya Sen again, in being able to choose a life that one has reason to value. There is a representation gap in the UK and it needs to be filled.

Mark Hall and John Purcell have proposed a series of changes to the I&C regulations that could, over time, begin to see an effective works-council model developing in the

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166 Sisson et al, op cit; Kruse et al, op cit

167 Hall & Purcell, op cit, p165

UK.<sup>168</sup> Among the amendments they suggest are:

- reducing the threshold needed (the number of workers who must express support for I&C) before a valid request can be made to activate the I&C Regulations;
- ensuring that all I&C agreements meet the requirements of the "default" procedure specified in the regulations – information about business policy and strategy, information and consultation about medium-term workforce planning (including any threats to employment), information and consultation with a view to reaching an agreement on significant changes to work organisation or contractual relations;
- limiting the scope for employers to pray in aid "pre-existing agreements" (PEAS) to defeat the activation of the I&C obligations – PEAs must at least meet the requirements of the default provisions specified in the directive if they are to be considered as valid;
- removing the possibility that "direct" methods of participation can be used as a suitable alternative to the representative participation – the current I&C Regulations are almost certainly not in compliance with the requirements of the EU directive;
- ensuring that workers' representatives have access to the resources they need to undertake their duties and activities;
- giving workers' representatives proper rights to time off for training and ensuring that these programmes are properly funded;
- imposing sanctions with a genuine deterrent effect on employers who prove to be recalcitrant.

These measures are welcome and could have a positive impact on the extent of workplace democracy in the UK. Nevertheless, the Hall and Purcell proposals still leave the law at some distance from the constitution of a continental European works council. The range of issues on which the employer *has* to inform and consult is expressed in very general terms in the default provisions when read alongside the topics specified as subject to co-determination in Germany. If it really is right to say that the level of prescription influences the level of participation, then a case can be made for much tougher regulations in the UK. German employers cannot act on some aspects of workplace organisation unless they have reached agreement with the works council (workforce planning, recruitment and selection or vocational training policies, for example). Leaving too much flexibility in the regulations could mean that

168 Ibid

the information and consultation process becomes mired in discussions of trivia or marginalia; specifying a substantive agenda in law would have more than a persuasive effect. Once again, it is not intended to offer a fully developed proposal for a British works council model (that deserves separate, detailed treatment in another report). What can be said with confidence, however, is that the general outlines of the reform programme are clear and that policy makers already have enough detailed material to make rapid progress.

It is also important to ensure that workers can make use of the I&C architecture without having to secure the support of 10% of employees to initiate the process. No other country in the EU 15 imposes such a burdensome requirement on the vindication of what should be seen as a fundamental right. The regulations should therefore be amended so that any organised group of workers in an organisation (taking the German trigger of five workers as a starting point for discussion) will be able to call for the election of workers' representatives. Moreover, trade unions should have the right independently to begin the process if they wish to do so.

Drawing a direct line of causation between effective institutions for workplace information and consultation and fairer distributional outcomes is not straightforward, although German works councils do seem to have a sword-of-justice effect even though they are legally prevented from engaging in collective bargaining. The argument in the UK is a little more complex and depends on the use of these institutions to rebuild collectivism in the workplace. The deep-rooted understanding of the case for collective action remains,<sup>169</sup> but this is rarely reflected in support for trade unions. People at work know that they need to act collectively to influence their employers but simply cannot see what trade unions might contribute to that process. Mark Hall and John Purcell argue that a re-energised information and consultation model is the last chance for collectivism and that if this fails the British workplace will be characterised by a profound, immovable imbalance of power; workers will have no alternative but to do as they are told.

Expressed slightly differently, if trade unions make use of the new I&C framework they might begin to build their credibility, relevance and legitimacy with both employers and employees. This might, over time (say, a 15-year period), lead to a revival of collective bargaining, which could eventually lead to a much fairer initial distribution of incomes and less work for the state to do through the tax and benefits system. The most important condition here is that the unions understand both the opportunity

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169 TUC, *op cit* (2003); Freeman et al, *op cit* (2007)

of the I&C architecture and the responsibility for making the system work. This raises both ideological and practical challenges, but there is a strong case for saying that, at this stage, unions have no other option but to call for a significant strengthening of the I&C obligations.

### **Minimum wages, living wages and fair wages**

In addition to the formal institutions of workplace democracy, the state can also intervene before the tax and benefits system does its work by using a number of different instruments to fix wage floors. We have seen that the first efforts at statutory wage fixing, through the wages boards, assumed that collective bargaining would develop in these industries as the process developed, rendering the wages boards redundant. For whatever reason, these hopes were disappointed and wages councils (as the wages boards were renamed) became a permanent feature of the labour market until they were abolished by John Major's government in 1993. Of course, the wages councils were criticised for their lack of effectiveness, weak enforcement and the unavoidable fact that some low-wage sectors (like retail, for example) were never covered. Nonetheless, the downward pressure on the wages of the lowest paid in the period between 1993 and 1999 – at which point the NMW was introduced – proved that the wages councils were moderately effective in protecting the low paid.

The NMW has boosted the wages of over a million workers with each uprating and principally benefits those in the bottom two deciles of the income distribution.<sup>170</sup> What it has not done, however, is either eliminate low pay or in-work poverty, principally because it is a wage floor and nothing more. The consequences of *not* having a comprehensive strategy to reduce reliance on low pay can be seen in the growth of in-work poverty, which rose by over half a million employees during the boom, and the brute fact that 60% of children living in poor households have at least one parent in work. In the medium term it is unlikely that any government will have the resources available to undertake more extensive redistribution through the tax credit system. The only route to less in-work poverty and lower income inequality is through an improvement in market wages.

Pushing the NMW to a much higher level, or to the level of the living wage, is almost certainly undesirable because it would have a negative impact on employment – particularly youth employment. Yet, as the Resolution Foundation has argued, employers in some sectors could afford to pay significantly more than they do today. It is possible, therefore, to go beyond the NMW as a wage floor.

<sup>170</sup> Low Pay Commission, 2010

In addition, there are two specific changes that might be made to the role of the Low Pay Commission. First, the LPC's remit should be widened so that it becomes more than a minimum wage commission. The LPC must have an explicit responsibility to investigate the causes, consequences and cures for low pay. Second, the LPC should be tasked with the responsibility of identifying those sectors that can pay more. Subsidiary institutions (sector forums) should be used to set voluntary rates through a further process of dialogue involving employers, unions and independent experts.

It is often asserted, sometimes with justification, that low pay is linked to low productivity – although some jobs are low paid because they are given a low social value, with childcare and care for the elderly being two obvious examples. To the extent that skills and productivity are real problems, sectoral strategies should be developed to implement a programme that will modify employers' business models and put the economy on a different path. These are not new ideas and first appeared in Labour's 2005 general election manifesto, albeit that they were never implemented. It would be new, however, for these sector forums to make recommendations about the "affordable wage" in a particular sector. One might see this as a pragmatic approach, taking the success of the LPC and trying to develop a similarly constructive dialogue between the parties in an industry. Or one might say that this is a modified wages-council model, where skills, productivity and organisational performance take their rightful place alongside pay as issues to be discussed by the parties. No doubt some employers will contend that the model cannot work because trade unions are not properly representative of workers in low-wage industries; to a degree that is true, but there are no more representative organisations, although the new arrangements might create some opportunities for participation by living-wage campaigners.

The living wage is enormously useful as a campaigning tool but also carries all the weaknesses that we identified in chapter 7. If local authorities wish to adopt the living wage as the benchmark standard for pay in public procurement, then that can only be a positive step. But employers may be rather uncomfortable having their wage rates determined by academic researchers. Moreover, there is a tension between community organising to persuade employers voluntarily to implement the living wage and the adoption of the living wage as a generally applicable labour standard. Finally, the implementation of the living wage does not eliminate the need for redistribution, since the level is calculated on the assumption that households will claim all the tax credits to which they are entitled.

It would not be unreasonable to conclude that the living wage is an attempt to set a floor under wages, substituting for the decline of collective bargaining coverage and

the rescission of the Fair Wages Resolution. Were the FWR still in operation there would be no question of an effective labour market floor in public procurement, because either collective agreements would set the floor or public authorities would need to determine the "general level" for the activities in question. If we refer to the index of pre-distribution (annex 1) we will see that not all the countries with better outcomes than the UK have ratified ILO Convention No 94 (Denmark has but Sweden has not, for example). What they all have in common, however, is effective trade unions and the general observance of collective agreements. Once again our conclusion holds: the balance of power matters.

For policy makers the principal question must be whether the ILO convention should be re-ratified. No doubt HM Treasury will argue that this could push up the costs of public procurement at a time of austerity, but given what we know about the extent of in-work poverty, any increase in wage costs could be offset by a reduction in tax credits. Moreover, the experience of the living-wage employers in the private sector shows that an increase in wages both reduces labour turnover and boosts productivity. One would need to collect extensive additional data before a comprehensive assessment could be made of the costs and benefits of re-ratifying Convention No 94. Nonetheless, given the UK's previous experience and the application of the convention elsewhere, the case is compelling for reintroducing a fair-wages regime.

### **Trade unions and the balance of power in the labour market**

Much of the argument presented in this report has focused on the relationship between institutions and the capacity of actors within those institutions to get things done. Unless the workers' representatives populating the institutions of workplace democracy have the wherewithal to make a difference, then the results will be disappointing. It is enormously unpopular to talk about power in the workplace today. Employers are much more comfortable with the idea of engagement than with Kahn-Freund's notion that the world of work is characterised by (unbalanced) power relationships (see introductory chapter). Equally, some employers may be perfectly happy to accept the case for a living wage but may be much less willing to accept the case for collective bargaining or information and consultation rights. They will almost certainly oppose any radical initiatives in the field of corporate governance.

It is equally unpopular to argue that the success of the programme of institutional reconstruction adumbrated in this report depends on a revival of trade unionism, albeit in a modernised form. Nonetheless, it is strongly arguable that just as democracies require political parties as well as ballots and parliaments, so industrial democracy requires trade unions alongside worker participation at board level and through

works councils. Of course, some employers would simply reject this analogy – witness for example the Institute of Directors' approach to the I&C obligations to which we referred in our introductory chapter – but the argument presented in this volume is that both workplace democracy and effective institutions of pre-distribution are essential ingredients of a responsible capitalism. It is much harder to sustain the Institute of Directors' arguments in the post-crisis environment.

Political citizenship demands participation, justification and legitimation, and industrial citizenship requires the same. Unfortunately, as the level of participation in British workplaces proves, as a practical matter workers do surrender most of their rights as citizens when they cross their employer's threshold. In large measure we might attribute the current state of affairs to the labour market revolution of the 1980s. Trade unions have been swept from the scene in the private sector. Most employers have no intelligent interlocutors with whom they can engage in a collective conversation about the workplace.

Yet even if trade unions are seen as indispensable institutions, that still leaves a practical conundrum to be solved. British trade unions have shown no capacity for growth even during periods when employment has been expanding. The best social science research shows strong support for collective representation at work but much weaker support for trade unionism.<sup>171</sup> People who have never been members of a trade union now outnumber those in the labour market who are current or former members of unions. Simply expressed, British unions in the private sector are now at a point of historic weakness and are more distant (because of where they are organised) from the experience of the majority of people at work today.<sup>172</sup>

The capacity for union resurgence depends not just on demonstrating relevance to workers but on making a compelling offer to employers too. This might focus, for example, on solving workplace problems at an early stage – before a worker makes an application to an employment tribunal – or in demonstrating the unions' strong record in the field of health and safety at work. Moreover, the effort could be as much on solving shared problems as on arguing about questions of distribution. Both employers and trade unions have a shared interest in raising skill levels, improving the quality of management, ensuring that skills are fully utilised, raising the general quality of employment, and looking to compete in open markets on quality as well as price. If unions and employers can work together in areas of shared interest – with the union

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171 TUC, *op cit* (2003)

172 van Wanrooy et al, *op cit*

making a clear commitment to the success of the organisation – then it becomes somewhat easier to manage distributional conflicts when they arise. In other words, British unions need to begin to think about the employment relations system as a system, must articulate a clear vision of the relationship they want with good employers (or responsible capitalists) and then deliver this aspiration in practice.

So far as workers are concerned, the messages are just as clear and just as difficult for trade unions to absorb. According to the TUC's own research, workers want an organisation that works with the employer to improve the workplace, rather than an organisation that fights exclusively for higher wages.<sup>173</sup> Workers have higher expectations of work, are increasingly well qualified and are much less likely to be employed in large enterprises with lots of male manual workers than was once the case. Unions that have grown successfully in recent years (like USDAW, the shop workers' union) have forged constructive relationships with employers, developed an agenda driven by their members (rather than their activists) and are as much concerned with progression at work as they are with workplace justice; they worry as much about "getting on" as they do about "getting even".

The general outlines of a strategy for union growth are reasonably clear, but a great deal more work is required on the detail. Most importantly for the purposes of this discussion, British trade unions have yet to abandon their suspicion of universal rights or works council models. If works councils, the core institutions at the heart of the argument presented here, are to be effective instruments of workplace justice then a degree of ideological flexibility is needed. Trade union strategy should be refocused on the organisation of works councils, leading to the organisation of workers, eventually establishing a secure foundation for a revival of collective bargaining. Works councils could be viewed both as a transitional stage on the route to a modernised approach to employment relations and a potential support for collective bargaining as the system matures.

### **What next for public policy?**

From one standpoint the next steps for policy makers ought to be clear: a fairer initial distribution of incomes depends on the construction of effective institutions of pre-distribution. Opening up a conversation about the practical realities of corporate governance under responsible capitalism, addressing the weaknesses in the architecture and establishing an effective floor in public procurement are all within the government's gift. Yet other elements of the agenda are, if not more speculative,

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173 TUC, *op cit* (2003), confirmed in Freeman *et al*, *op cit* (2007)



then at least beyond the direct control of the state. The government cannot legislate for relevant trade unions, trusted by employers and valued by their members. Nor is it possible to pass an act of parliament that guarantees high-quality work, decent management or wages that rise in line with productivity. The state can obviously design the institutions and shape the background conditions, but much of what happens in the world of work is beyond the direct reach of government.

Duncan Gallie's notion of the employment regime, which has been deployed throughout this discussion, is helpful in understanding the articulation between action by government and action by civil society. As has been argued elsewhere, it is not that one crowds out the other but that each complements the other.<sup>174</sup> Sustaining an inclusive labour market certainly requires the right institutions but it requires actors with the right capabilities too (whether citizens, works councillors, trade unions or corporations). The successful implementation of policy depends on a partnership between the state and civil society. Rebuilding that partnership is a necessary condition for the creation of more effective mechanisms of pre-distribution in the UK. Maintaining the redistributive functions of the state and securing a rapid return to full employment are both essential too. Only then will we begin to see some of the more damaging social trends of the last 30 years halted and reversed. This is a major political project on the same scale as the transformation wrought by the Conservative governments in the 1980s and 1990s. Capturing the public mood in this post-crisis moment could shape the agenda for a generation, leading to a more equitable society, a fairer distribution of incomes and more widespread opportunities for all citizens.

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174 Coats et al, *op cit* (2012)

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## Annex 1

# An index of pre-distribution institutions across the OECD region

## An index of pre-distribution institutions across the OECD region

Country and ranking	Employee representatives on the board?	Collective bargaining coverage (% of all employees)	Trade union membership (% of all employees)	Statutory extension of collective agreements to non-signatory employers	Works councils	Ratification of ILO Convention No 94 (Labour clauses in public contracts)	Statutory national minimum wage	Gini coefficient (before taxes and transfers) late 2000s (working age population) (Source: OECD Stat 2013)	Gini coefficient (after taxes and transfers) late 2000s (working age population) (source: OECD-Stat 2013)
<b>1 Sweden</b>	Yes	90	71	No (but agreements generally observed by all)	No (all employee participation takes place through trade union structures)	No	No	<b>0.385</b>	0.270
<b>2 Denmark</b>	Yes	80	67	No (agreements generally observed)	Yes (non-statutory)	Yes	No	<b>0.388</b>	0.248
<b>3 Norway</b>	Yes	70	54	No	Yes	Yes	No	<b>0.391</b>	0.257
<b>3 Netherlands</b>	Yes	85	22	Yes	Yes	Yes	Yes	<b>0.391</b>	0.293
<b>5 New Zealand</b>	No	30	20	No	No	No	Yes	<b>0.396</b>	0.306
<b>6 Germany</b>	Yes	62	19	Yes – but rarely used. Relevant collective agreements are generally observed	Yes	No	No	<b>0.403</b>	0.285
<b>7 Japan</b>	No	19	20	No	No	No	No (regional minimum wages by prefecture)	<b>0.409</b>	0.332

Country and ranking	Employee representatives on the board?	Collective bargaining coverage (% of all employees)	Trade union membership (% of all employees)	Statutory extension of collective agreements to non-signatory employers	Works councils	Ratification of ILO Convention No 94 (Labour clauses in public contracts)	Statutory national minimum wage	Gini coefficient (before taxes and transfers) (working age population) late 2000s (Source: OECD Stat 2013)	Gini coefficient (after taxes and transfers) late 2000s (source: OECDStat 2013) (working age population)
8 Belgium	No	96	52	Yes	Yes	Yes	Yes	0.413	0.258
9 Austria	Yes	98	28	Yes	Yes	Yes	No	0.414	0.266
10 Australia	No	43	18	No	No	No	Yes (through the Award system)	0.414	0.318
11 Finland	Yes	91	74	Yes	Yes	Yes	No	0.415	0.263
12 Canada	No	32	28	No (except in Quebec)	No	No	Yes (federal and provincial)	0.420	0.324
12 Luxembourg	Yes	60	37	Yes	Yes	No	Yes	0.420	0.272
14 Italy	No	80	35	No	Yes	Yes	No	0.437	0.321
15 France	Yes	98	8	Yes	Yes	Yes	Yes	0.449	0.301
16 Spain	No	71	16	Yes	Yes	Yes	Yes	0.452	0.337
17 Portugal	No	62	20	Yes	Yes	No	Yes	0.462	0.339
18 Greece	No	65	23	Yes	Yes (non-statutory)	No	Yes	0.471	0.338
19 UK	No	33	27	No	No	No	Yes	0.477	0.347

Sources: Gini coefficient – OECDStat; collective bargaining coverage, union membership, worker participation at board level, extension of collective agreements, works councils – European Trade Union Institute; ratification of Convention 94 – International Labour Organisation.

This index has been compiled from authoritative data sources and reports the result for the EU 15, the USA, Canada, Australia, New Zealand and Japan.

The Index of Pre-distribution seeks to measure the effectiveness of institutions in influencing distributional outcomes by benchmarking the number and extensiveness of the practices adopted by the selected countries against the level of income inequality found in the working-age population. This is because those of working age are most likely to have their incomes influenced or determined by collective agreements, statutory minimum wages or contract compliance arrangements in public procurement. The results are interesting because they show that the UK has the most unequal initial distribution. A purely institutional story would find it hard to explain why some liberal market economies appear to be doing better than some of the co-ordinated market economies – Australia, New Zealand and Canada all do better than one might expect. But this might be accounted for by the differential effects of the recession across the Eurozone and that the data is drawn not from one single year but from three – for some countries the data is only available for 2009, for others 2010 and for others 2011. This is an inevitable weakness of using a dataset of this kind, and one would be mistaken in believing that absolutely hard and fast conclusions are possible. What we can see, however, is that countries with “inclusive” employment regimes generally do best in the index, followed by some continental countries, the southern Europe and with the paradigmatic liberal market economies (the UK and the USA) bringing up the rear. In broad terms our story is confirmed by this analysis: institutions matter.

Moreover, our observations about the *capacity* and *capability* of the actors to make the institutions work still hold good. Achieving an appropriate balance between capital and labour is essential if the institutions of pre-distribution are to be effective.

It could be argued that the index ought to include the other elements of the employment regimes story, including the training system, the effort made to eliminate workplace inequalities, and the level of investment in integrating the previously unemployed back into the labour market. No doubt this is true, but some of these measures are qualitative and are hard to capture in the relatively rudimentary index presented here. This is an area for further research in the future.

A ranking of countries by their Gini coefficient *after* taxes and transfers has been included for comparative purposes.

### Gini coefficient (after taxes and transfers) and country ranking (working-age population)

1 Denmark	0.248
2 Norway	0.257
3 Belgium	0.258
4 Finland	0.263
5 Austria	0.266
6 Sweden	0.270
7 Luxembourg	0.272
7 Germany	0.285
8 Netherlands	0.293
9 France	0.301
9 New Zealand	0.306
10 Australia	0.318
11 Italy	0.321
11 Canada	0.324
12 Japan	0.332
13 Spain	0.337
14 Greece	0.338
15 Portugal	0.339
16 UK	0.347
17 USA	0.375

Source: OECDStat, 2013



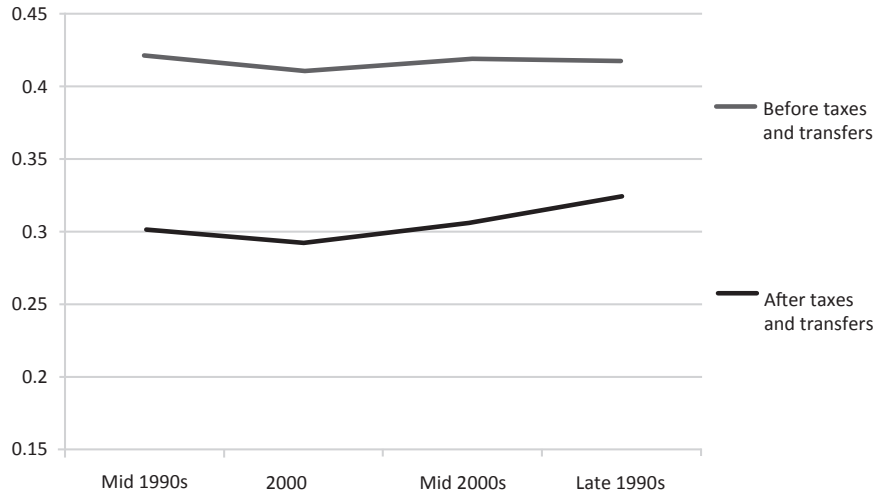


## Annex 2

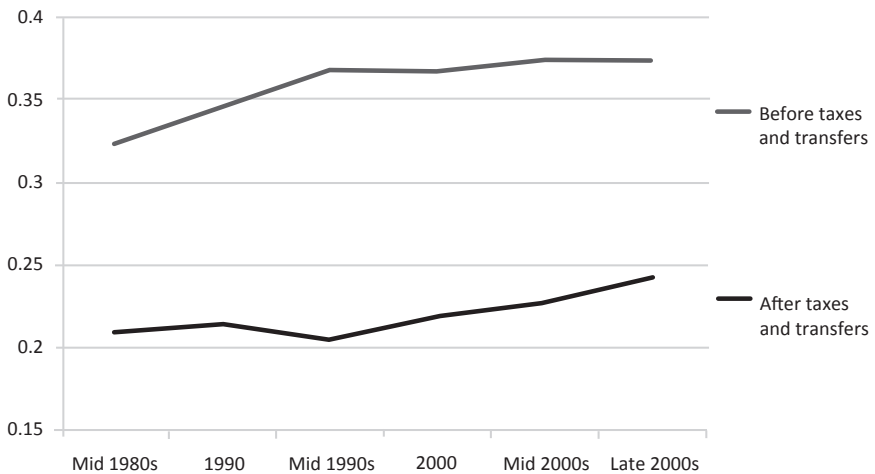
# Inequality across the OECD region, 1970s to late 2000s

**Inequality across the OECD region, 1970s to late 2000s**  
*Gini coefficient by country (working-age population only) (Source: OECDStat)*

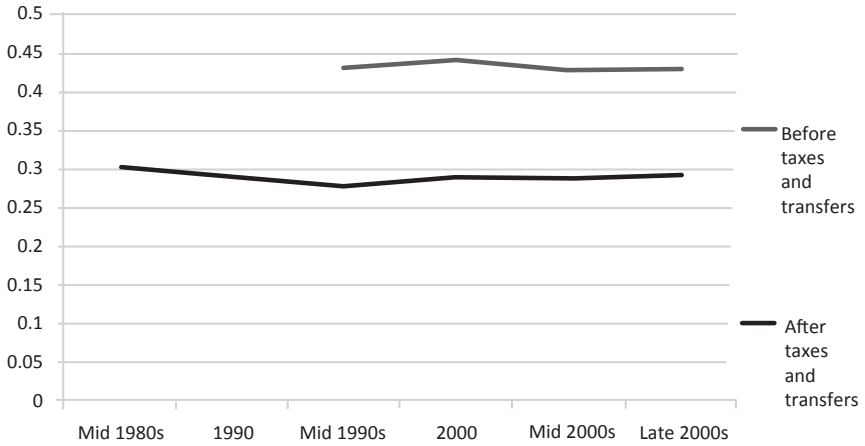
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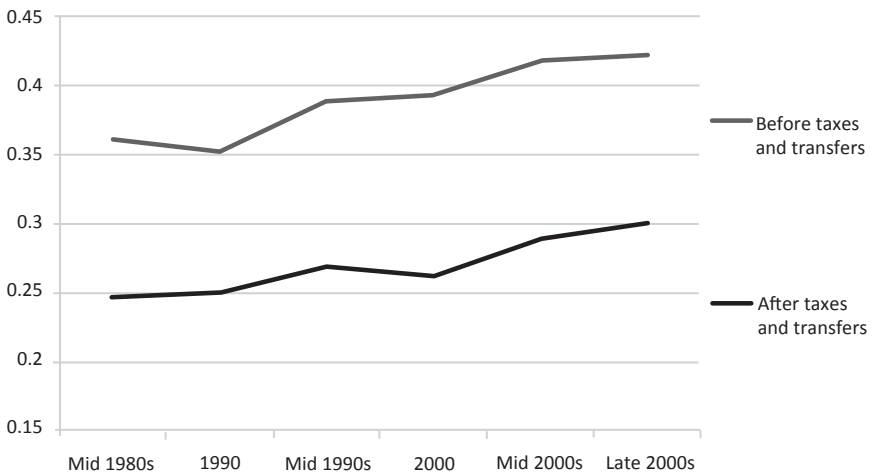
**Denmark**



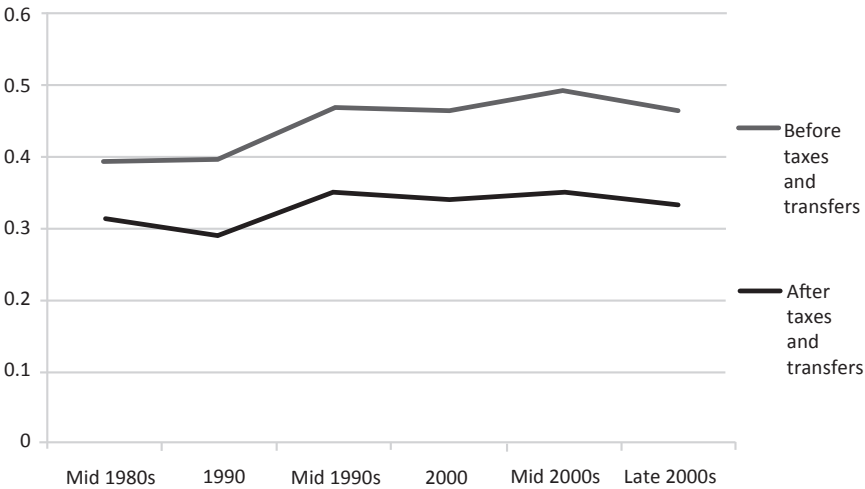
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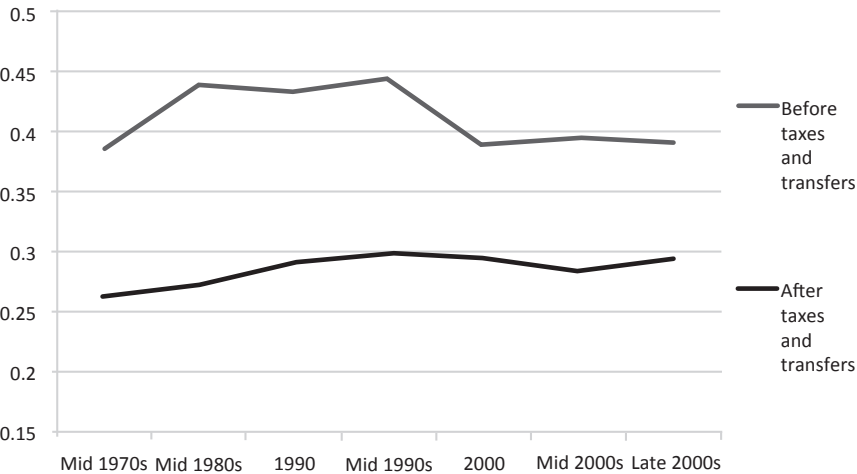
## Germany



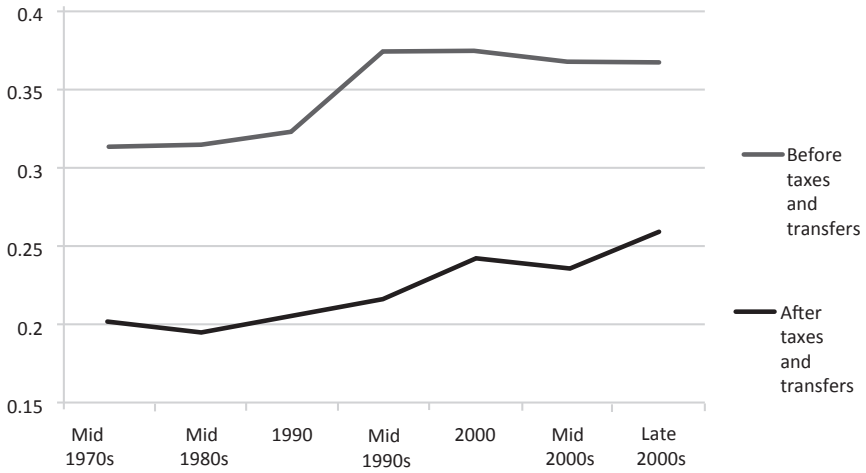
Italy



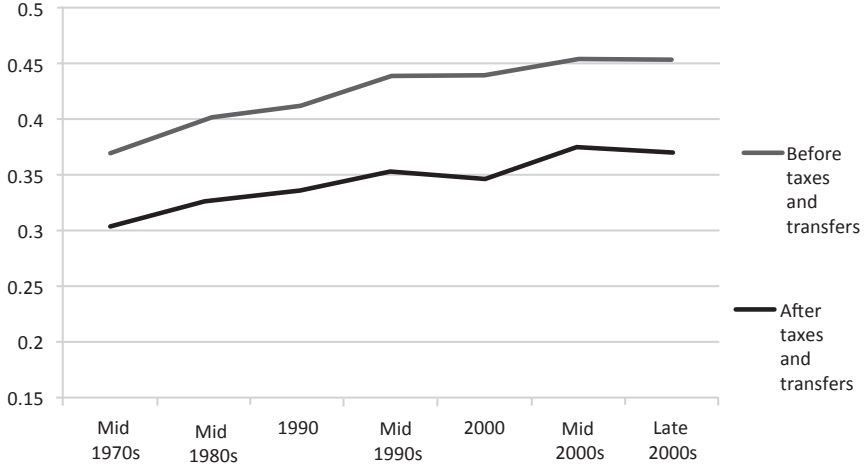
Netherlands



## Sweden



## USA





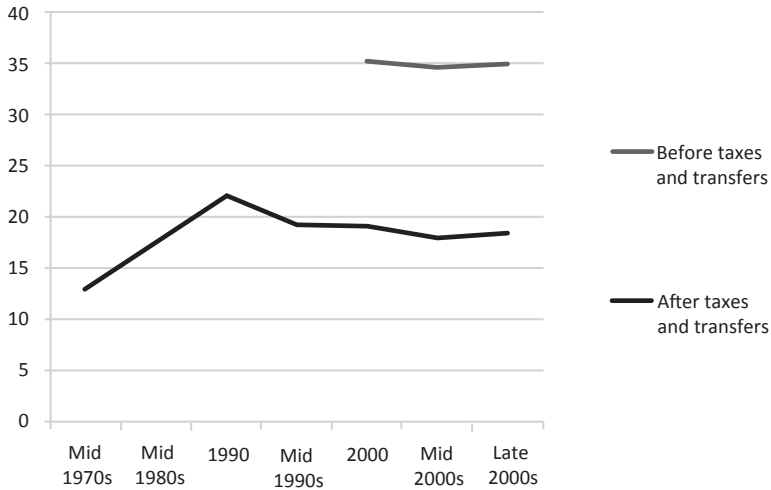
## Annex 3

# Poverty across the OECD region, 1970s to late 2000s

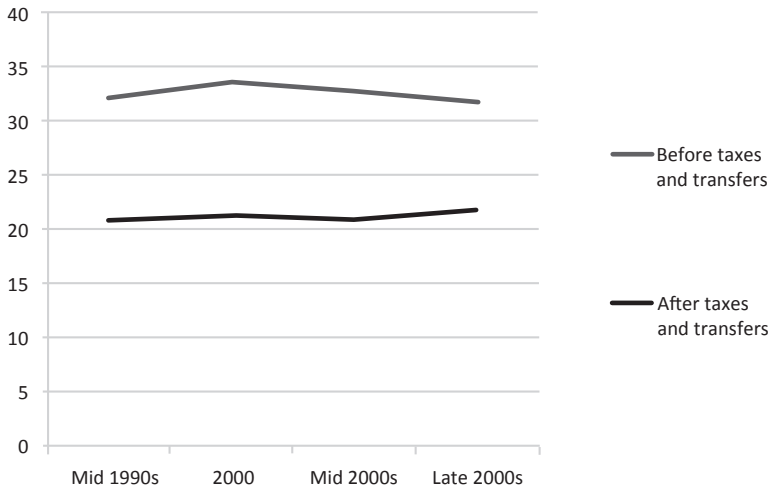


**Poverty across the OECD region, 1970s to late 2000s**  
*Percentage of people living in households with less than 60% median income (Source: OECDStat)*

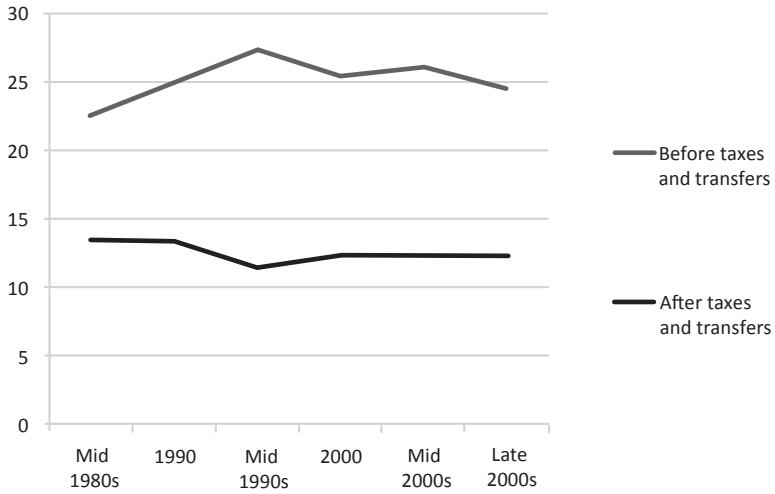
**UK**



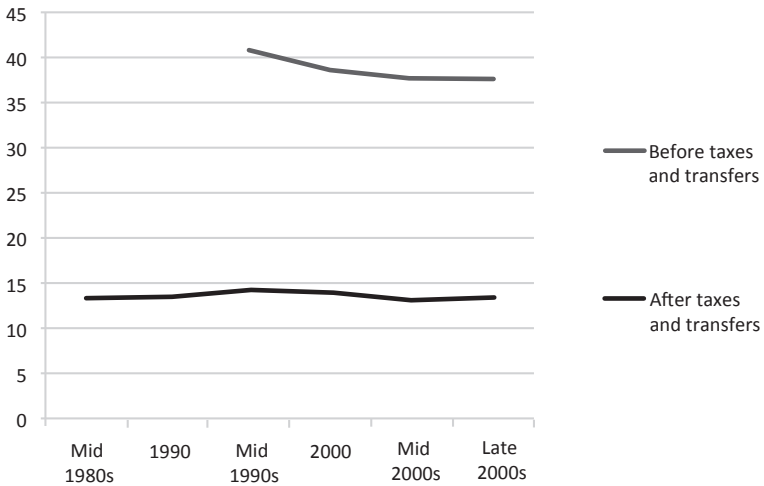
**Australia**



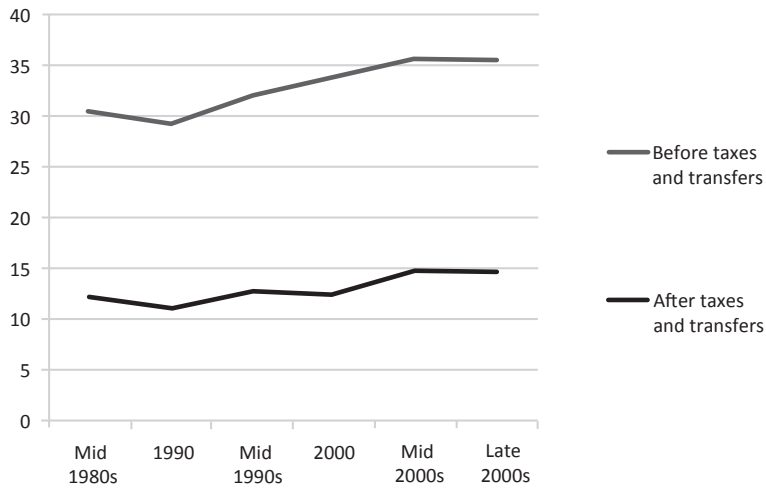
## Denmark



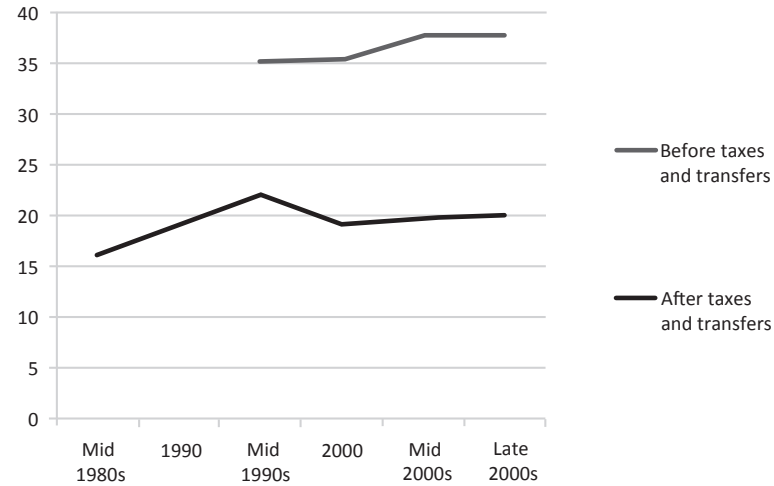
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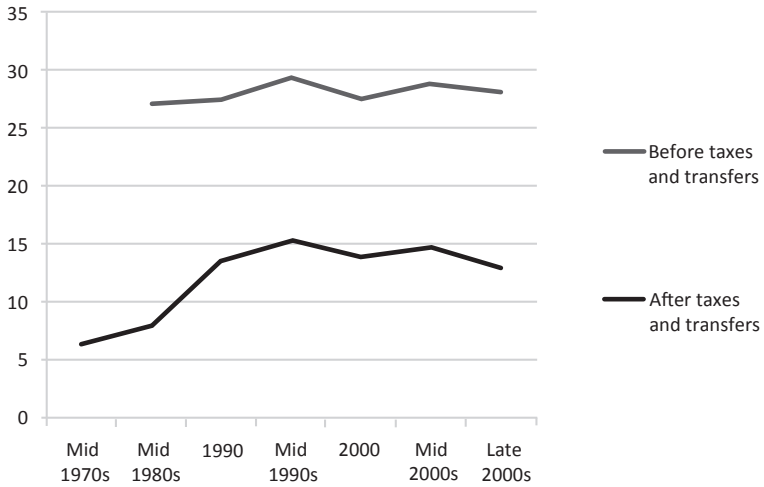
Germany



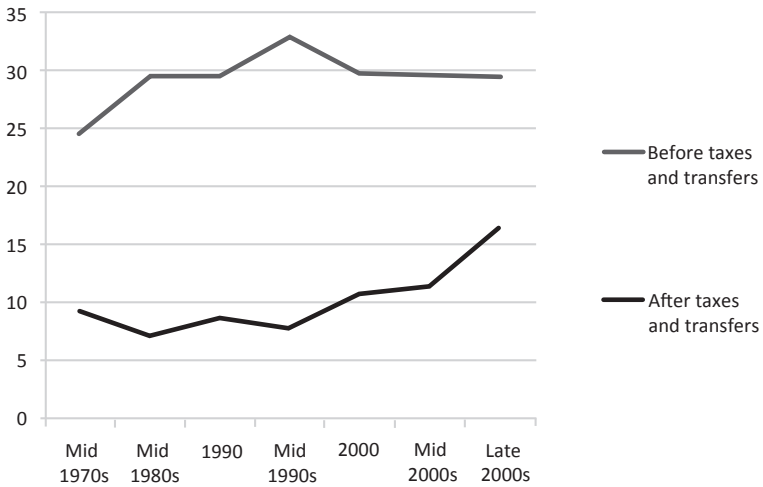
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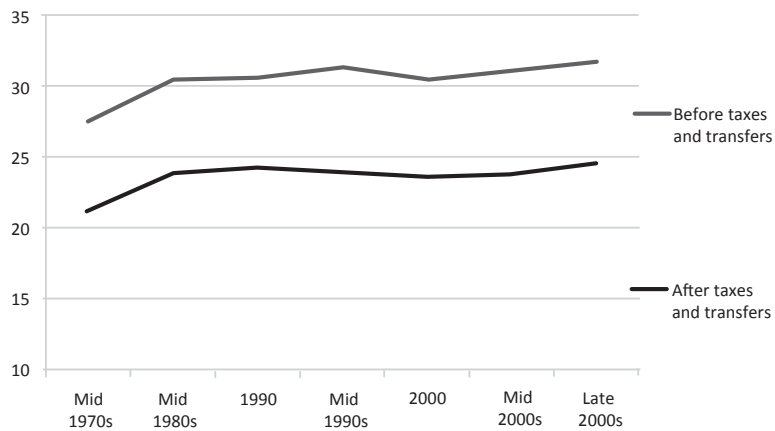
## Netherlands



## Sweden



USA



## Annex 4

# Recommendations of the Ownership Commission

## Recommendations of the Ownership Commission

There is no single magic bullet that will deliver better ownership. What we propose is an interconnected matrix of nudges, new protocols, better processes, the scaling up and deepening of some existing institutions together with the creation of some new ones, new capabilities and strengthened and clarified legal obligations that cumulatively will deliver more plural, engaged and stewardship-oriented ownership. The organising common theme in our proposals is that we want better to link the preferences and interests of the ultimate owner – whether investor, worker or consumer – with the organisation they own.

We believe there are three dimensions to good ownership – plurality, stewardship and engagement. If these can be sufficiently strengthened then a different, self-reinforcing dynamic will be created that will drive better ownership and corporate behaviours. It is because good ownership matters that Britain needs its current and future governments to start thinking in terms of ownership policy. What follows brings together our proposals made over the report. It is by no means the last word, but we hope it stirs a long overdue debate.

### Plurality

Plurality of forms of ownership provides more opportunity to align the form of ownership with the appropriate business model, promotes more resilience to shocks within particular sectors and the wider economy, allows investors and savers more avenues in which to save and invest, and gives consumers more choice. It can be promoted in the following ways:

- Britain's medium-sized family firms are a fraction of their comparable scale in Germany, denying the country a crucial source of innovation and investment and constraining the numbers of future big companies. Their share of output needs to increase substantially over the next 25 years. We propose that Britain develops new mechanisms and tax concessions to support the build-up of equity capital in the medium-sized family business sector, from corporate venturing to new tax reliefs on rates of corporate return as proposed by the Mirrlees report. In addition, we believe that Britain should build up a supportive network of institutions to support SMEs with more generous flows of credit and equity, innovative new technology and skilled workers.
- A 21st-century new mutualism should trigger the foundation of a new wave of co-operatives, whose combined output is now only around 2% of national output.

We recommend that mutuals become permanent through emulating in Britain the European principle of disinterested distribution, so that when mutuals are wound up their assets have to be placed with another mutual. We also propose radical measures to allow co-operative mutuals to raise external capital, which is the major constraint on their growth.

- Employee-owned companies, which now constitute less than 2% of GDP, should receive greater support, including via the tax system. Employee benefit trusts, which hold shares on behalf of all employees in a company, lost their tax advantages in 2003, due to their being abused. However, this has significantly disadvantaged founders and owners of companies, who view employee ownership as a long-term ownership model (for instance, as a route for business succession), as they now pay tax twice – once when profits are put into the trust, and again when profits are distributed. In the absence of tax relief, every £100 of employee trust shares cost £139 in company cash, which is a punitive premium. As a result, fewer employee buyouts can be financed and, of those that do get started, a higher proportion will unravel prematurely. A number of further steps can be taken to overcome the disadvantages faced by employee-owned firms at critical times in their business lifecycle, including creating taxation and regulatory equivalence with other types of companies, especially at the time of ownership succession.
- The government should play an active role in providing simple templates for employee ownership.
- For founders seeking to establish new companies or exit existing ones, there is currently inadequate professional advice on employee ownership options. A single off-the-peg model of employee ownership should be available.
- The government should extend the provisions of the Enterprise Act to better define the strategic public interest powers of the secretary of state. Currently, the Enterprise Act identifies defence, financial stability and aspects of media and news provision as specific areas where a public interest intervention may be considered. The Ownership Commission believes that the government should be pro-active in considering additional sectors to be of strategic public interest, allowing the government the latitude to make interventions that reflect the public interest.
- Public-sector mutuals should be protected from demutualisation by a clear “asset lock”.



## Stewardship

Shareholders, trustees, investment management companies and directors should have the definition of their fiduciary obligations widened to include better stewardship, and for this to be better enforced by closer links between the ultimate owners and managers. In particular, the commission proposes:

- All businesses should be required to make a statement of their business purpose in their annual report.
- Corporate directors should be required to declare what they consider is in the best long-term interest of a business to achieve such a declared business purpose. This should attract new "safe harbour protections" insulating their judgments from legal challenge. This would be part of the listing rules on the London stock exchange. At least 50% of equity should be freely traded.
- The government should consult with interested parties about the extent to which fiduciary duties are too narrowly defined and offer a redefinition to include a "duty of stewardship". As a starting point all institutional investors should be required to sign, comply with and implement the stewardship code. In particular investment institutions should provide a guide to what returns they are seeking and how they exercise their stewardship responsibilities.
- Pension funds and other long-term end assets owners should be encouraged to take more long-term control over the terms for the management of their beneficiaries' money. Excessive competition for investment mandates, promising immediate improvements in investment performance, exacerbate the already strong tendencies for short-termism.
- There should be maximum transparency for all aspects of ownership and change of ownership including advisers' fees and stock lending policy.

## Engagement

Engagement of employees, shareholders and other business stakeholders with management is proven to increase the performance and accountability of business. This can be promoted in the following ways:

- All companies should set out their approach to employee and investor engagement in their annual reports. In particular, employee ownership should be actively encouraged from employee share-ownership schemes to fully fledged

- employee-owned companies [see proposals on employee benefit trusts in chapter 3].
- Strategies and new technologies should be explored to allow disparate, individual and institutional shareholders to act collectively in engaging with the management of PLCs.
- In particular the commission recommends that serious consideration is given to the creation of share-voting pools or so-called "aggregation platforms" to whom individual or institutional shareholders can cede their voting rights. We are attracted to the idea that they could be not-for profit-mutuals, established to aggregate the voting rights of institutional investors to give more muscle to the shareholder voice – and developing a business model in which they charge for the service. This will address the emergence of "ownerless corporations".
- Stewardship requires an integrated and skilled approach. We believe that individuals with the right skills and credibility employed by the new aggregation platforms should carry out intervention on behalf of corporate owners at senior management and board director level. Making realistic and realisable demands of companies, informed by significant hands-on experience of business management and strategy setting, is critical to the good ownership of our public companies.
- It is becoming technologically possible to canvass the opinions of the pension fund beneficiaries and the other ultimate owners directly. We recommend that pilot schemes are developed and, subject to their success, that such consultation becomes the norm.
- The annual general meeting of PLCs needs revitalising to promote the greater involvement of shareholders.
- The participation of the whole range of stakeholders is essential in public service providers that are spun out of the public sector. Government should encourage foundation-trust style models of multi-stakeholder ownership to be extended across the public sector where independent organisations are being considered.



## Annex 5

# The Bullock recommendations

## **Annex 5: The Bullock recommendations**

### **Board structure and responsibilities**

- There should be a modified unitary board with a wider membership for all public companies with more than 2,000 employees.
- The composition of the board should be determined according to the formula  $2X + Y$ , with equal numbers of workers' and shareholders representatives supplemented by a group of co-optees (essentially playing the same role as non-executive directors today).
- There must be an odd number of co-optees and more than one co-opted director.
- The precise number of directors should be determined by agreement between the company and independent trade unions recognised for collective bargaining. In the event of a failure to agree, default provisions specified in statute would apply.
- Directors' duties should be modified (through a change in company law) to ensure that they take account of more than just shareholder interests in strategic decision making.

### **Appointment of employee representatives**

- The appointment of worker directors could only be triggered by a request for a ballot on the issue by independent trade unions recognised by the employer for collective bargaining.
- All workers, whether union or non-union, would have the right to vote in the ballot.
- For the trigger to be successful the union would need to win the support of more than half of those voting and more than a third of the total electorate.
- If the ballot result passed the required thresholds, only recognised independent trade unions could nominate workers' representatives to serve on the board. The rationale here was that shop stewards with workplace experience were better placed to serve on boards than full-time officials of the trade unions.

- In multi-union situations (the majority of workplaces in the 1970s) the unions would/should create a joint representation committee both to agree the board structure with the employer and to nominate the workers' representatives.
- Workers' representatives would initially serve three-year terms and could be reappointed at the end of their term. They would not receive fees but would be compensated for expenses and loss of earnings.
- Workers' representatives would be entitled to paid time off for the conduct of their duties and for training.
- A substantial training programme should be developed to ensure that worker directors had the capabilities required for the discharge of their duties. It was anticipated that trade union education departments would play an important role in this process.

### **Reversing the appointment of worker directors**

- After five years a recognised independent trade union could seek to reverse the decision to appoint workers to the board. The ballot thresholds would be the same as for the triggering of the process – more than half voting yes and more than a third of those entitled to vote choosing to abandon the appointment of worker directors.

### **The Industrial Democracy Commission**

An Industrial Democracy Commission should be appointed as a permanent body to oversee the new arrangements. Among its responsibilities would be:

- to deal with disputes about whether unions were recognised for the purposes of triggering a ballot;
- to supervise ballots;
- to resolve disputes between unions and employers about the size of the board;
- to deal with inter-union disputes around the composition of the joint negotiating committee;
- to resolve disputes concerning the appointment of co-opted directors; and
- to monitor and review the operation of the legislation with a view to making recommendations to government for reform.

The conciliation activities of the commission would, in practice, be handled by ACAS.

**About the author**

David Coats is the director of WorkMatters Consulting, which offers support to organisations wishing to improve employment relations, undertakes research on labour market issues and offers advice on how best to influence public policy. He is also a research fellow at the Smith Institute and a member of the Central Arbitration Committee (the industrial court for Great Britain). Previously he was Associate Director – Policy at The Work Foundation (2004–2010) and Head of Economic and Social Affairs at the TUC (1999–2004). David is recognised as an expert commentator on employment relations, labour markets and the quality of work. He was a member of the Low Pay Commission from 2000–04.

### **The Smith Institute**

The Smith Institute is an independent think tank which provides a high-level forum for thought leadership and debate on public policy and politics. It seeks to engage politicians, senior decision makers, practitioners, academia, opinion formers and commentators on promoting policies for a fairer society.

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### **The Webb Memorial Trust**

The Webb Memorial Trust has pursued the intellectual legacy of Beatrice Webb (1858–1943), who, together with her husband Sydney (1859–1947), embarked on a vigorous programme of social reform. The trust was formed in 1947 with the purpose of 'the advancement of education and learning with respect to the history and problems of government and social policy'. Founding trustees included R H Tawney and Harold Laski.

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