

The Agency Workers (Amendment) Regulations 2019 – revocation of the Swedish derogation

Department for Business, Energy and Industrial Strategy

RPC rating: fit for purpose

Description of proposal

The Agency Worker Regulations 2010 (AWR) established a protective framework for temporary agency workers. Regulation 10 of the AWR, commonly known as the “Swedish Derogation”, allows agency workers to opt out of equal pay entitlements after twelve weeks of employment in exchange for compensatory payment between assignments.

The Taylor Review of Modern Working Practices¹ reported significant abuse of the Swedish derogation. Agency workers are not given the choice of their type of contract, either being forced to accept a derogation contract or receiving no work. The review states that, under the derogation, it is too easy for companies to avoid paying workers between assignments, by keeping them on longer assignments at reduced pay or by offering them unacceptable assignments when they are out of work. In light of these findings, this proposal aims to prevent businesses from abusing the Swedish derogation to avoid the requirement to offer agency workers equal pay.

The impact assessment (IA) considers two policy options in addition to the do nothing (option 1): state regulation of the Swedish derogation (option 2); and revocation of the Swedish derogation (option 3). Option 2 includes an extension of the remit of the Employment Agencies Standards (EAS) Inspectorate to cover all aspects of the AWR. Option 2 is ruled out on the basis that it is considered to place an excessive burden on business whilst being less effective than revoking the derogation. The Government’s preferred option is option 3, which is in line with the recommendation of the Taylor Review.

¹ The Taylor Review of Modern Working Practices, July 2017
[https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf]

Impacts of proposal

Number of businesses and individuals affected

The Department has used various data sources and consultation responses to inform its assessment.² The IA estimates that there are approximately 1,300,000 agency workers and 25,970 employment agencies in the UK. Labour Force Survey (LFS) estimates that the retail industry employs approximately 14.2 per cent of all agency workers, and manufacturing employs approximately 14.7 per cent of all agency workers. The Department estimates that between 8 to 10 per cent of UK agency workers are on Swedish derogation contracts, which corresponds to between 104,000 to 130,000 agency workers.

The lower estimate was derived from a research paper by *Forde and Slater* and the upper estimate is derived from the *Resolution Foundation's* analysis into the overall pay penalty for agency workers.³ The Department acknowledges the inherent uncertainty around the number of individuals likely to be on derogation contracts; this is partly due to individuals and businesses being unwilling to speak out from fear of repercussions. The Department has consulted key stakeholders, including the EASI, the Confederation of British Industry, the British Retail Consortium, and the Trades Union Congress in attempts to increase the accuracy of its estimates.

Ongoing costs (to business) and benefits (to workers) of increased wages

The IA compares the impacts of option 3 against the *status quo*. If the Swedish derogation is revoked, hirers will be required to pay agency workers the same rate as comparable permanent employees after twelve weeks. As this is a direct transfer from employers to workers, there will be a cost to business and an equivalent financial benefit to workers, as well as the wider benefit of reduced discriminatory treatment among workers.

The IA estimates the cost of increased wages by using Recruitment and Employment Confederation (REC) data to estimate the number of workers on derogation contracts and LFS data to estimate the median hourly wage differential between agency and non-agency workers, the average number of hours worked in a week, and the estimated number of weeks in a year, for which employers would incur extra costs. The detail of the methodology is explained in the IA's Annex A.1. The cost of increased wages is estimated to be between £227.5 million and £381.1

² Recruitment and Employment Confederation (REC); Labour Force Survey (LFS); BIS HOST report; Official National Statistics (ONS); "The effect of Agency Workers Regulations on agency and employer practice" Forde and Slater (2014); The Resolution Foundation; Trades Union Congress (TUC); Confederation of British Industry (CBI)

³ <https://www.resolutionfoundation.org/media/blog/unwrapping-the-agency-worker-pay-penalty/>

million each year. The wide range reflects the 104,000 to 130,000 workers that are estimated to be on derogation contracts. The overall cost estimates are consistent with the findings of similar research conducted by the Resolution Foundation, which found that there is a £300 million pay penalty gap between agency and non-agency workers.

While this option presents high annual costs, the majority of the costs is a transfer from business to workers, with some benefits to the Exchequer through additional tax revenue. The Department considers it likely that costs will decrease over time because, from anecdotal evidence, use of Swedish derogation is currently declining, partly due to the negative publicity attached to this type of contract. This is supported by a recent announcement by BT that they are phasing out all agency workers on derogation contracts by March 2019.⁴

Transition costs (to business)

The IA identifies that there would be three types of transition costs to employment businesses relating to the proposal, which includes: familiarisation; the cost of altering contracts; and the cost of reviewing pricing structures to account for the increased cost of those agency workers currently on derogation contracts. The Department estimates these transition costs using REC and ASHE data.⁵ The total transition costs of the preferred option are estimated to be between £3.2 million and £3.6 million.

The Department estimates that the revocation of the Swedish derogation will generate an equivalent annual net direct cost to business (EANDCB) of £265.3 million with a total net present value (NPV) of - £3.0 million and a business NPV of - £2283.7 million.

Wider impacts and risks

The IA highlights the loss of payment between assignments for agency workers as a potential risk from the revocation of the derogation. However, the Department explains that such payments are rare in practice, and so it does not expect this to be a significant loss to agency workers. Other risks identified by the Department include: businesses opting to use fewer agency workers; and hiring companies may continue to use eleven-week, or even, shorter contracts to avoid the equal pay

⁴ <https://www.cwu.org/news/cwu-victory-on-bt-pba-agency-contracts/>

⁵ ASHE Table 14.5a, Gross Hourly Pay for all Employees; REC Recruitment Industry Trends, 2015/16; Page 30

entitlement. The Department also notes that businesses should benefit from an increase in morale and higher productivity from their agency workers.

Small and micro business assessment

Consultation with the Employment Agency Standards Inspectorate suggests that the majority of hirers of agency workers are medium-sized and large businesses. The revocation of the Swedish derogation is expected, therefore, to have a disproportionately smaller impact on small and micro businesses that hire agency workers. Department also notes that the wage differential between agency and non-agency workers is likely to be smaller in small businesses. The IA estimates, using REC data, that there are 20,866 small and micro recruitment businesses that will face familiarisation costs and costs associated with altering contracts. The Department explains that from the Agency Worker Regulations IA, it was assumed that 85-100 per cent of the costs of offering equal pay would be passed on to the hirer by the employment agency business.

The IA states that there will be some small and micro-sized employment agencies that may face disproportionate familiarisation costs and costs associated with re-writing contracts. However, the Department anticipates that the overall impact on small and micro businesses would be minimal and, therefore, argues that an exemption would not be reasonable. Further, the IA explains that the exemption of small and micro businesses may cause confusion by exempting some businesses from using derogation contracts, but not others which could prevent policy objectives from being met.

Quality of submission

The IA presents a detailed assessment of the Government's preferred policy option. The Department has assessed the strengths and weakness of the evidence base and has consulted key stakeholders to improve the robustness of its estimates. The underlying assumptions used in the IA have been compared to the available research. The RPC is pleased to see that most of the impacts of the preferred option have been monetised; this is a proportionate approach for this high-impact measure. The IA has provided a sufficient small and micro business assessment.

The Department considers that the equivalent annual net direct cost to business (EANDCB) estimate is likely to be overstated due to a likely decrease in the use of derogation contracts over time, but does not present clear evidence to support this position. However, the Department explains why it is not possible to produce an estimate of this decline that is sufficiently robust to support the EANDCB figure and

has undertaken a sensitivity analysis to indicate how different assumptions would affect the total costs to business. On this basis, the RPC accepts the Department's approach as being reasonable.

The IA could be improved from addressing the following points:

Justification of choosing option 3 over option 2

The IA would benefit from clearer justification for the preference for option 3. The monetised net present value for option 2 is slightly higher than for option 3, although the Department has stated that the impact of increased regulation and inspection in option 2 is "...not costed fully" (page 3). The relative costs and benefits of options 2 and 3 could be explored further. In particular, the IA could explain the reference to non-fully monetised costs of option 2 and to assess further any non-monetised benefits, such as allowing employers who are using the derogation correctly to continue to do so, and the potential lower risk of reduced employment. The IA would benefit from providing stronger evidence to support its conclusion that option 2 would be more burdensome than option 3.

Impacts on level and type of employment

The IA discusses the risk that businesses will not offer agency workers on derogation contracts an alternative form of employment or a permanent contract, instead opting to reduce the size of their workforce. The Department does not anticipate a significant reduction in overall employment levels from this measure, partly because businesses will be able to utilise other forms of flexible working patterns. A survey by the Confederation of British Industry and Accenture 2014 found that "...41% businesses would reduce use of agency workers if the Swedish derogation were abolished, with 5% of businesses saying that they would stop their use of agency workers entirely." (page 30) It should be noted, however, that the survey information could, potentially, be outdated and may not be representative of the current labour market. The IA would benefit from further consideration of these risks and from discussing the costs, benefits, and desirability of outcomes from a wider labour market policy perspective associated with how businesses might respond. For example, the Department should have explored the impacts of a tendency to replace agency workers with workers on zero-hours contracts. The IA could also benefit from a discussion on the sectoral distribution of agency workers to identify the sectors that would be most affected by the proposal.

Monitoring and evaluation plan

The IA should state how the measure will be monitored and evaluated; this could facilitate a proportionate post-implementation review. Given the significant policy risks identified in the IA and the scale of the measure, a well-executed monitoring and evaluation plan would help the Department to assess whether policy objectives are being met, assess any impacts on labour force participation and to identify unintended consequences.

Small and micro business assessment

The Department explains that the majority of hirers of agency workers are generally medium-sized to large businesses. However, a higher proportion of employment agencies, are small and micro businesses. The IA notes that these small employment agency businesses would face higher familiarisation costs. The IA would benefit from a discussion of how these costs might be mitigated - for example, by providing specifically targeted guidance and communications on the regulatory change.

International comparison

The IA could be improved by including a discussion of international use of the Swedish derogation and, in particular, an explanation as to why some countries (notably Sweden) might have been able to use derogation contracts successfully and perhaps without unintended consequences. This discussion could include an analysis of relevant labour market and regulatory structures, as compared to the UK.

Presentation of figures

The BIT impacts have been calculated correctly and are consistent with the methodology presented in the IA. There are places where the presentations of the figures do not seem to correspond exactly - for example, the figures for “re-writing contracts” in the table on page 31 are slightly different from those in the table on page 29. The IA would benefit from explaining such instances, for example, where it is due to rounding.

Departmental assessment

Classification	Qualifying provision
Equivalent annual net direct cost to business (EANDCB)	£265.3 million
Business net present value	- £2,283.6 million
Societal net present value	- £3.0 million

RPC assessment

Classification	Qualifying provision (IN)
Equivalent annual net direct cost to business (EANDCB) – RPC validated	£265.3 million
Business impact target score	£1,326.5 million
Small and micro business assessment	Sufficient

Regulatory Policy Committee