LEARNING AND WORK INSTITUTE

The participation gap

The UK's labour market through the pandemic in international context

Stephen Evans

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Executive summary

After an initially successful labour market response, the UK has seen the largest employment rate drop in the G7 since the pandemic started. This is despite a recruitment crunch for many employers and is driven by rising numbers of people over 50 and with long-term sickness leaving the jobs market. There is an underspend of up to £2 billion in the Plan for Jobs, which the Government should reinvest to increase employment and ease recruitment issues.

The UK saw one of the smaller falls in employment of G7 countries in the first six months of the pandemic. Unemployment could have been 2.5 million higher if it followed the falls in economic output. Furlough and other economic and employment support prevented this.

However, since then the UK has experienced the biggest fall in employment rates in the G7 since the pandemic started. Employment rates are above pre-pandemic levels in many countries, but 0.8 percentage points lower in the UK. An extra one million people would be in work if the UK matched the best performance in the G7. Yet employers are struggling to fill vacancies despite record recruitment and unemployment is lower than pre-pandemic.

The explanation is an increase in people leaving the labour market, with our economically active population now one million smaller than if pre-pandemic trends had continued. The biggest rises in economic inactivity are among those aged 50-64, up 9% to 3.5 million, and people citing long-term sickness, up 11% to 2.3 million. The number of people economically inactive due to sickness is now double the number of unemployed people.

None of the other countries studied for this report had similar rises. There are likely to be some UK-specific factors. But one reason is that the Government's 2020 Plan for Jobs was planned for a sharp rise in unemployment which successful earlier action like furlough helped mitigate. As a result, Government schemes are likely to be underspent by up to £2 billion, including Kickstart (£665 million so far), Restart (potentially £400-1,100 million if current referral numbers continue), and Traineeships (£65 million in 2020-21 alone).

There is far less policy focus on how we might support economically inactive groups back into the labour market, even though 1.7 million economically inactive people say they want to work. This includes 63% of those in their 50s who've left work in the pandemic who also say they would like to work again if they could find a job that matches their skillsets and offers flexible working opportunities.

We currently have crunches in recruitment and labour market participation. Employers and the Government need to find ways to support people back into the labour market – growing supply rather than putting the brakes of a smaller, overheated economy.

We need a renewed plan for jobs, skills and growth that works with employers to find new ways to engage and support people into the labour market.

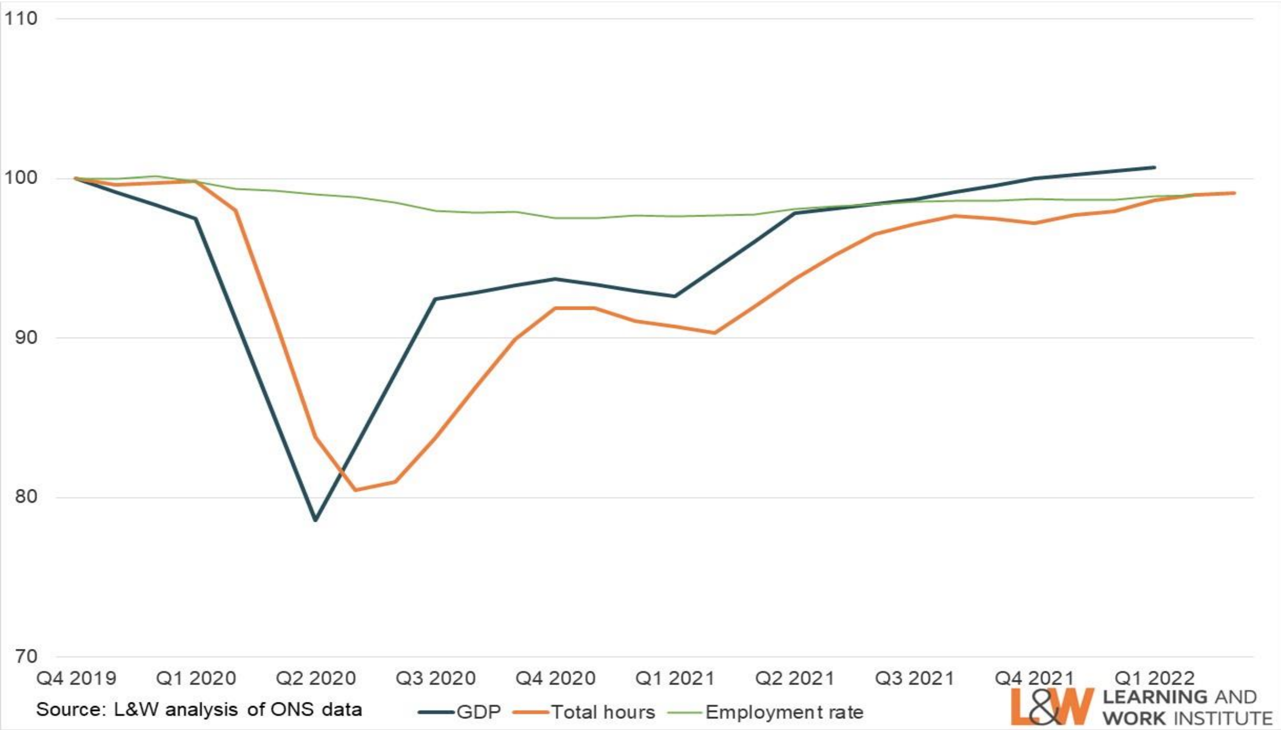
The headline picture

The UK has a relatively high employment rate, but has seen the largest drop in the G7 since the start of the pandemic. The immediate policy response, particularly furlough, helped save millions of jobs. But employment rates have stagnated since while they are fully recovered in many other countries.

Across the world, the pandemic has had significant effects on labour markets. These have varied according to the differing impact of the pandemic, public health measures, demographic and geographic factors, and labour market institutions and policies. This report considers how the UK compares to a number of other countries in the G7 and EU. But first we describe the UK experience.

The UK saw a sharp fall in employment and sharp rises in Universal Credit claims at the start of the first nationwide lockdowns in spring 2020, associated with a 20% drop in GDP. However, the furlough scheme, which paid 80% of people's wages if employers kept them in work but not working, helped protect millions of jobs. At its peak, around nine million employments were furloughed. We previously estimated that unemployment may have been 2.5 million higher without furlough if it had followed the path of economic output.[1]

Figure 1: UK employment, hours worked and GDP, Q4 2019 = 100

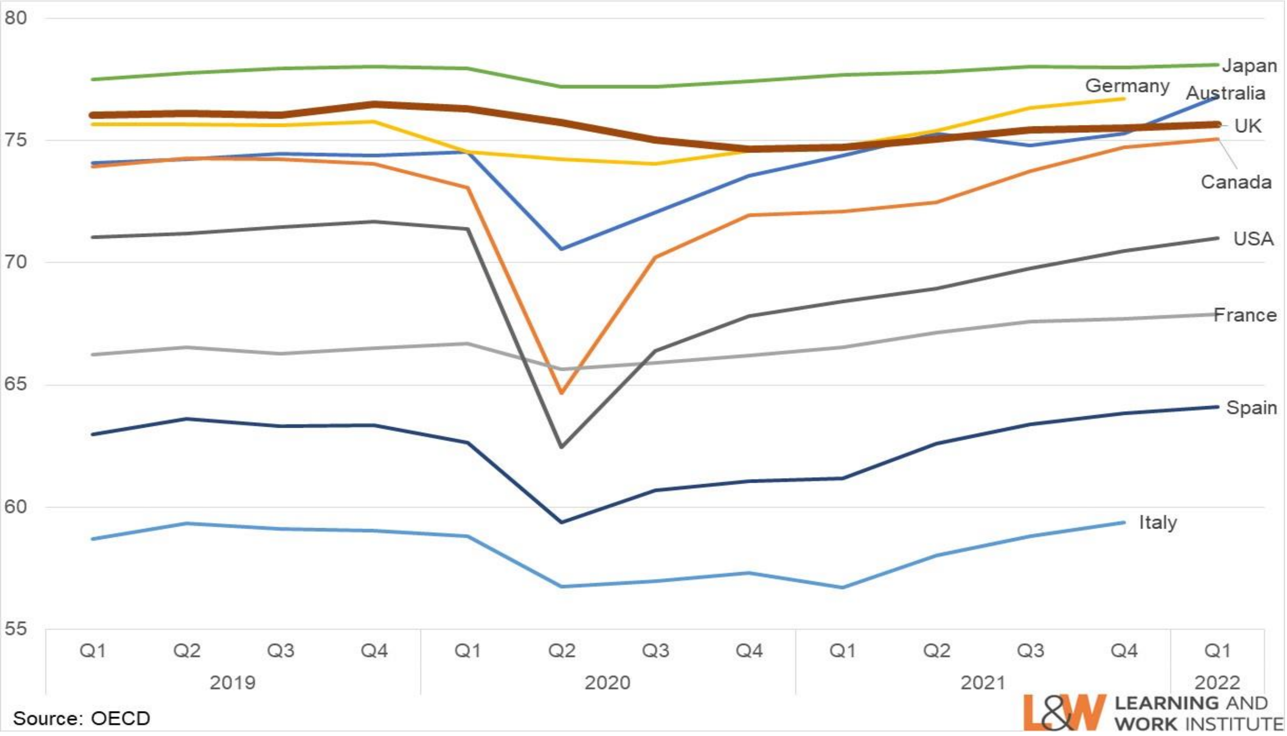


[1] One year on: the labour market impacts of coronavirus and priorities for the years ahead, Evans and Clayton, L&W, 2021.

This meant the UK, which started with a relatively high employment rate, saw a relatively shallow drop in employment during the first six months of the pandemic. Instead, the drop in economic output was felt more in falls in hours worked.

In the UK, the employment rate fell just 0.5 percentage points (pp) in the first half of 2020, compared to 2.4pp in the US and 3.5pp in Canada. The UK's early experience was closer to countries such as Germany which have longer traditions of such short-time working schemes. Germany's employment rate actually rose during the first half of 2020, and the Netherlands saw a small 0.3pp fall.

Figure 2: Employment rates by country, per cent of 15-64 year olds

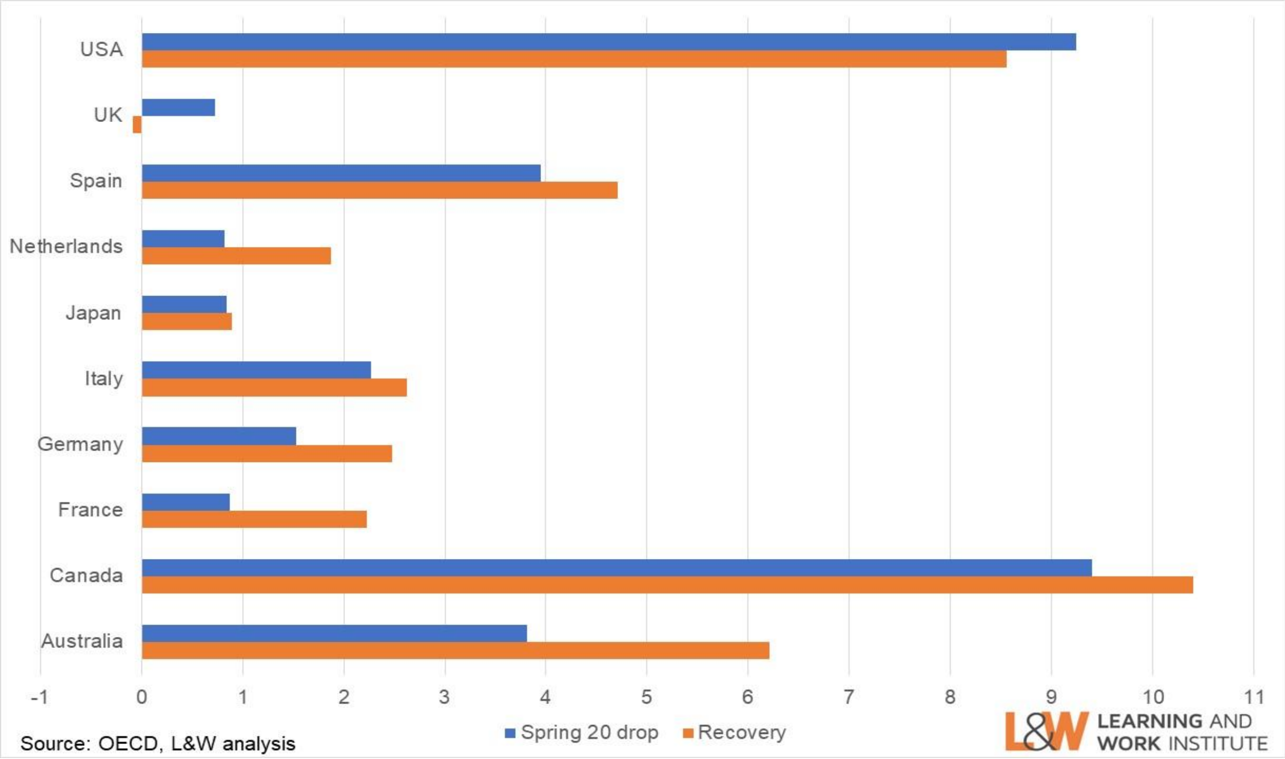


There were of course challenges introducing furlough, gaps in support for some, and unhelpful uncertainty as end dates for the scheme approached and were subsequently extended multiple times (though in part this reflected the uncertainty of the path of the pandemic). However, there is no doubt that the furlough scheme was rapidly introduced and helped to prevent a mass unemployment crisis.

The second phase of the pandemic

From 2021 onwards, however, the UK's employment rate performance has been less impressive compared to other countries. In general, countries with the largest employment falls in spring 2020 have seen the biggest rises since. For example, the US saw a rise since spring of almost 8 percentage points (pp) after a drop of more than 9pp, while Canada has seen a rise of more than 10pp after a drop of more than 9pp. This reflects the nature of their labour markets and benefit systems, in comparison with the short-term working schemes that helped limit employment falls in many European countries (including the UK).

Figure 3: Employment rate changes by country, 15-64 year olds, percentage points



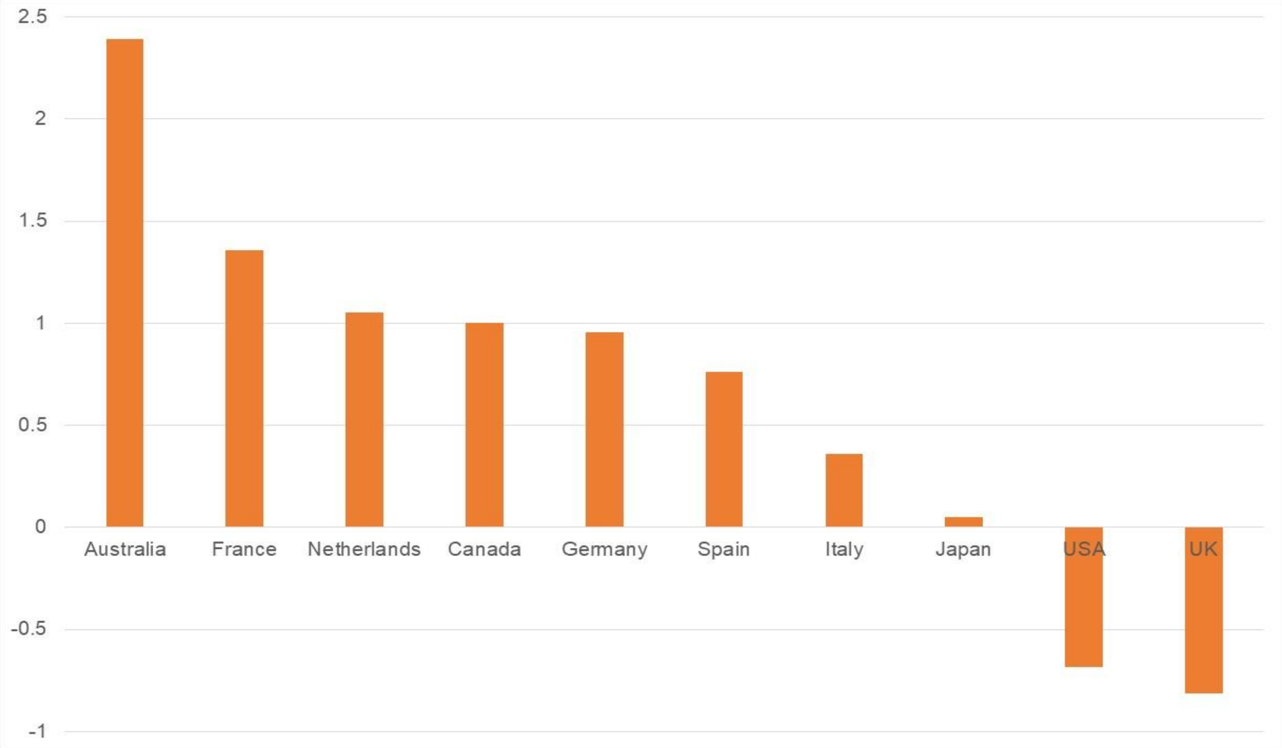
However, what is also noticeable is that most of the countries analysed have employment rates now that are higher than pre-pandemic. The UK and US are the only G7 countries where employment rates remain below pre-pandemic levels, with the UK seeing the biggest falls.

If the UK matched either the highest employment rate in the G7 (currently Japan) or the biggest growth in employment rates since the pandemic started (Australia, who started with a similar but slightly lower employment rate than the UK), then an extra one million people would be in work.

Explaining the big picture

The picture this suggests is of a UK labour market and economic response that was highly successful in the first part of the pandemic, with furlough and other support helping to protect millions of jobs, maintaining the UK's relatively high employment rate. But of a downward drift compared to other countries from 2021 onwards. The result is the UK now has the poorest employment rate performance since the start of the pandemic in the G7.

Figure 4: Employment rates changes since 2019 Q4, percentage points



What might explain this? Macroeconomic conditions have an impact. Economic output in the UK has now surpassed its pre-pandemic levels, but growth and forecasts don't compare strongly to other countries. However, the recovery in economic output is certainly stronger than the recovery in employment rates.

It may be that the structure of the UK economy means recovery here is less likely to translate into employment growth than in other countries. But our economy is, if anything, more reliant on employment-rich services than other countries. And our post-pandemic employment performance to date contrasts to the 'jobs miracle' post 2008. So this seems unlikely to be a major part of the explanation.

It may be that uncertainty is holding back investment and making employers cautious about taking on new staff. For example, the UK left the EU single market and customs union on December 31st 2020 and this represents a significant shift in trading conditions. However, while this change will undoubtedly have significant long-term effects, vacancies have been at a record level – around 1.2 million – over the last year or so. Clearly many employers are trying to hire (see next chapter for more analysis).

All of these explanations and more may be contributory factors to the UK's relatively weak employment rate recovery since 2021. However, we argue that a mismatch between supply and demand in the labour market and shortfalls in labour market policy are a contributor. The next chapter sets out our analysis.

Understanding changes in employment

Unemployment rose less in the UK than might be expected given the pandemic and is now below pre-pandemic levels, largely thanks to the furlough scheme and employment support. However, there has been a larger fall in economic activity in the UK as more people leave the labour market altogether, while economic activity has recovered in many other countries after an initial drop in spring 2020.

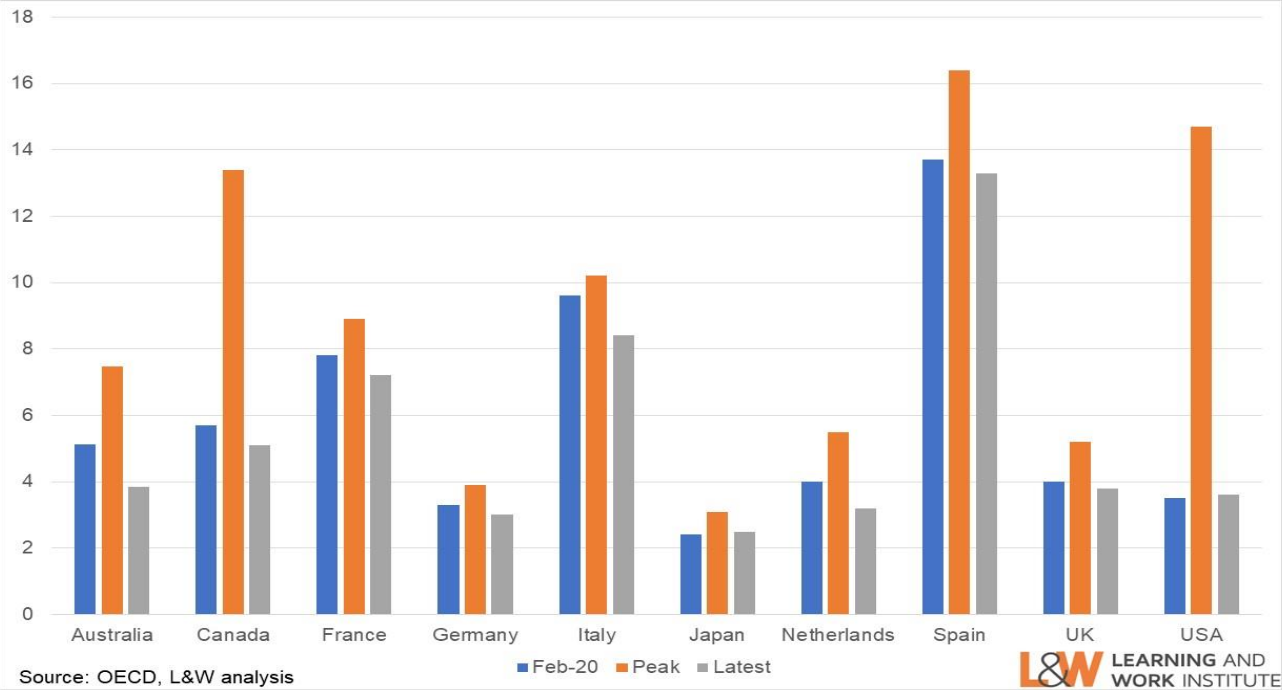
People can have three statuses in the labour market: employed, meaning they are in paid work; unemployed, meaning they are out of work, looking for work and available to start work in the next month; or economically inactive, meaning they are out of work and either not looking for work or not available to start in the next month.

Falls in the employment rate therefore either mean a rise in unemployment or a rise in economic inactivity. Of the two, a rise in unemployment is often seen as preferable (relatively speaking) depending on the reasons and circumstances as at least people are still attached to the labour market and looking for work. Indeed, many economically inactive people are not in contact with the employment and benefits system at all.This chapter looks at how the fall in employment manifested in the UK and other countries.

Unemployment

The UK saw a relatively small rise in unemployment rates in spring 2020 compared to the US and Canada. This reflects the overall employment picture discussed in the previous chapter and the nature of labour markets, for example whether there were furlough-type measures. Countries like Italy, Germany, Japan and France had smaller rises than the UK.

Figure 5: Unemployment rates by country



Source: OECD, L&W analysis

In all countries analysed unemployment rates are basically now at or below pre-pandemic levels (still up 0.1pp in Japan and US). There are now just 1.3 million unemployed people in the UK. This reflects both the recovery in employment rates (see previous chapter) and, to an extent, flows from unemployment into economic inactivity (discussed below).

It is not, therefore, differences in unemployment performance that explain the UK's weaker employment recovery compared to a number of other countries. Like most of the other countries analysed, the UK now has an unemployment rate below pre-pandemic levels.

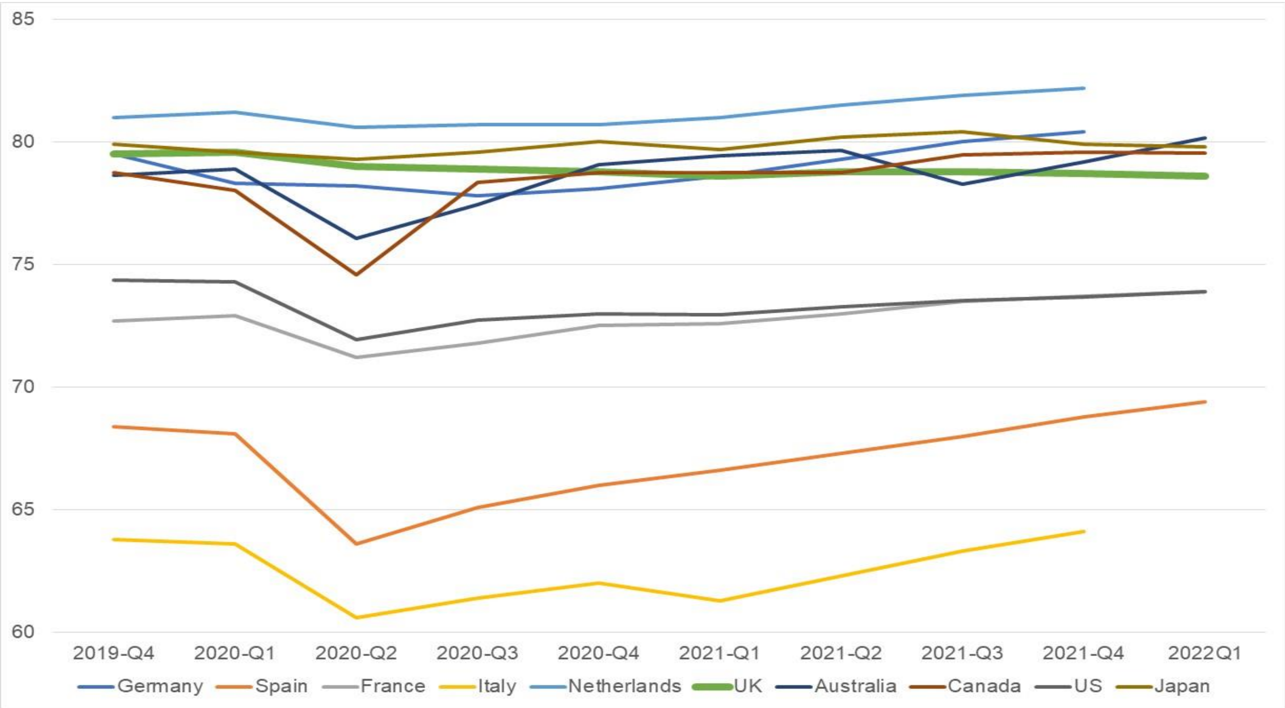
Economic activity

Most countries have seen rises in economic activity rates over recent decades. This is the product of labour market reforms, societal changes (such as greater participation of women in the labour market), and policy shifts (such as rising state pension ages).

Many countries, however, saw falls in economic activity rates early in the pandemic. This reflected a combination of lockdowns as sectors of the economy were shut down, requirements to stay at home, and health concerns. All of these limited employment opportunities and people's ability and willingness to look for work.

The size of these falls depended on labour market institutions and policies, as well as the relative scale and impact of the pandemic at that time. The UK had a relatively high economic activity rate and saw only a small fall, largely reflecting the success of the furlough scheme in keeping people in work.

Figure 6: Economic activity rates, per cent of 15-64 year olds[2]



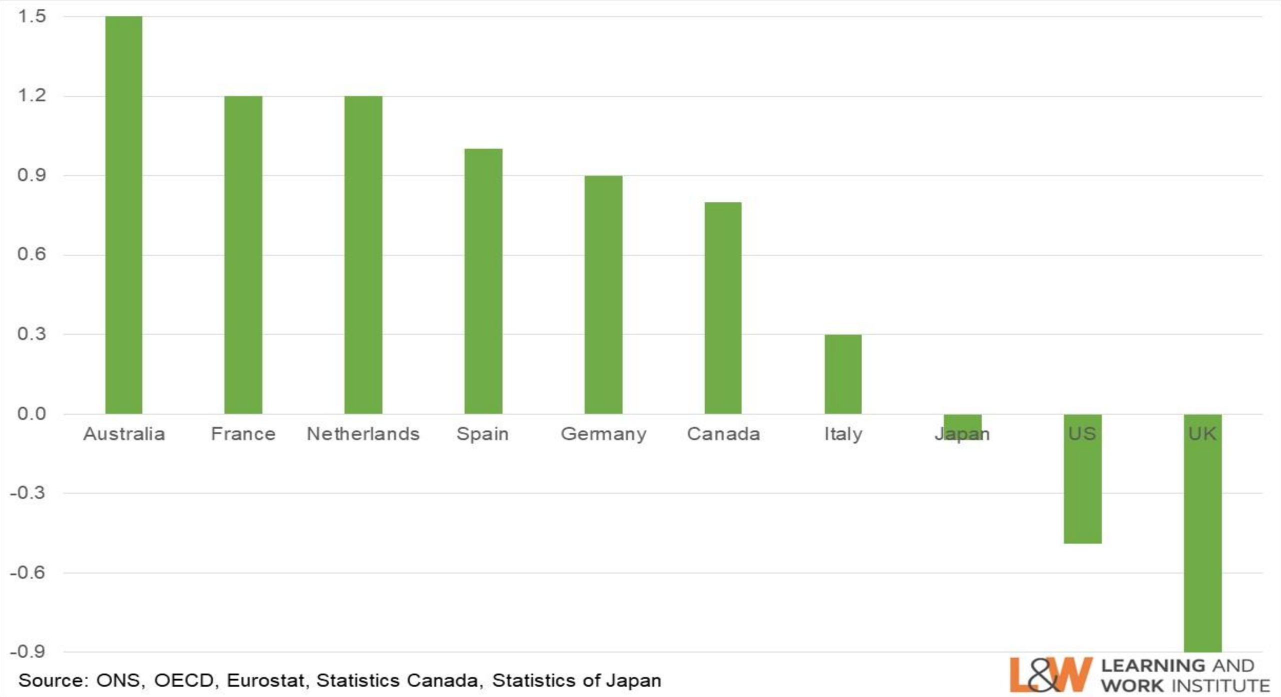
[2] UK data is for 16-64 year olds. This makes little difference to the overall picture.

Since spring-summer 2020, most countries have seen a full or partial recovery in economic activity rates, as economies have reopened. The result is that economic activity rates are now *higher* in Germany, Canada, Australia, France and the Netherlands compared to pre-pandemic.

Of the countries analysed, only Japan, US and UK have lower economic activity rates than before the pandemic. In fact, the UK has seen the sharpest drop in economic activity rates since the start of the pandemic of the ten countries considered.

If the UK had matched the economic activity rate growth of Australia, France or Netherlands, there would be an additional one million people in our workforce.

Figure 7: Changes in economic activity rates since 2019 Q4, percentage points



Source: ONS, OECD, Eurostat, Statistics Canada, Statistics of Japan

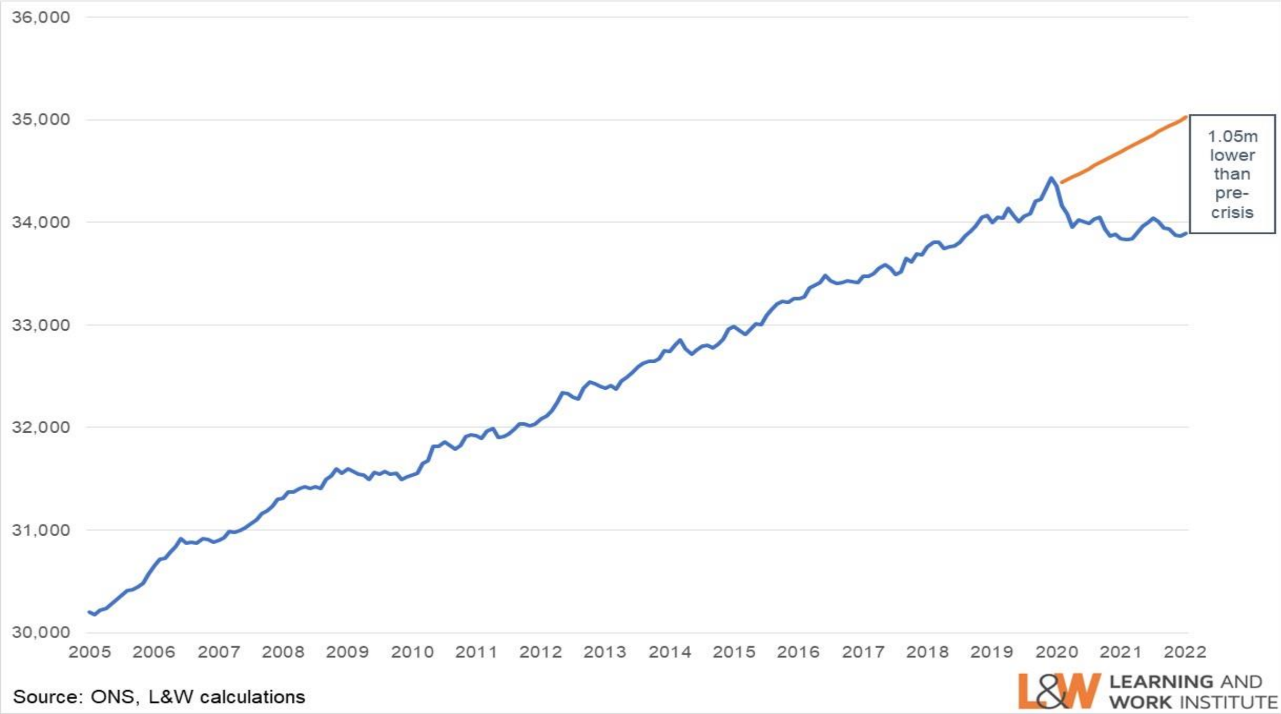
Population growth: the 'missing million'

As well as rates of employment and economic activity, the overall size of the population helps determine the labour force available to employers (as well as influencing demand in the economy).

It is challenging to estimate population size at the best of times, and clearly the pandemic increased these challenges. However, our analysis suggests that the number of people economically active in the UK is around one million lower than if pre-pandemic trends had continued.[3] We estimate that around two thirds of this is due to the fall in economic activity rates discussed above. The remaining one third would be due to slower population growth.

[3] We have not considered changes in population growth rates in other countries for this report.

Figure 8: Growth in the UK's economically active population, thousands



It is important to note the caveats about estimating population levels in the pandemic. In addition, slower population growth reduces both supply and demand in the labour market (put simply, there are fewer people demanding goods and services, as well as fewer people to supply them), though the effects may vary by geography and sector.

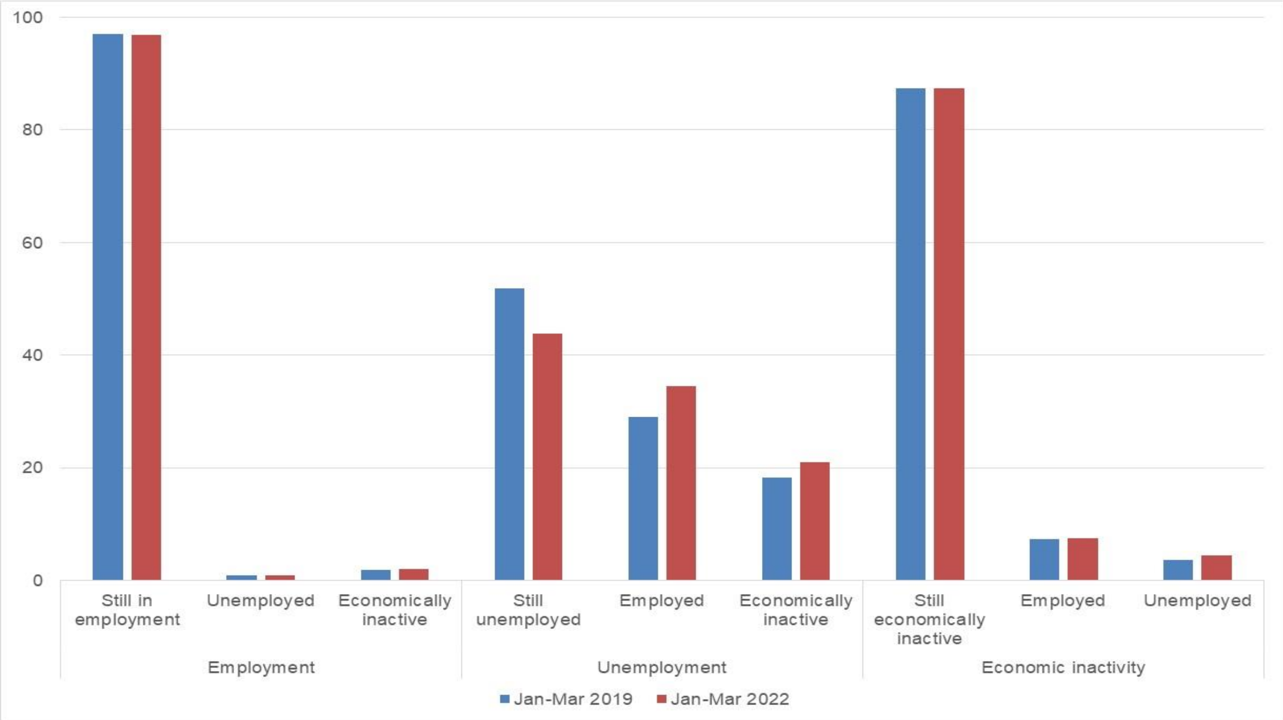
It is this combination of factors in the UK – rises in economic inactivity and slower growth in the workforce – that help explain the current crunch whereby vacancies are at record levels and unemployment is low, yet employment remains below pre-pandemic levels.

Record hiring is driven by higher job-to-job moves

The current recruitment crunch comes despite hiring being at record levels. In January-March 2022, a record 2.1 million people either moved into work or changed jobs compared to the previous quarter, up 11% on pre-pandemic levels and the highest on records dating back to 2001.

However, this was largely driven by rising numbers of job-to-job moves, rather than higher rates of people moving from unemployment and economic inactivity into work. The proportion of economically inactive people who move into work each quarter remains relatively low, at 7.4% in January-March 2022 this is little changed since January-March 2019 (though the number of economically inactive people is higher). Almost nine in ten economically inactive people are still economically inactive three months later.

Figure 9: Proportion of people in employment, unemployment and economic inactivity compared to status in previous quarter



This data helps to square the circle of the current unusual set of labour market data. Vacancies are at record levels and retention is a challenge for many employers, with job-to-job moves up. But a growth in economic inactivity and little change in the proportion of economically inactive people moving into work each quarter, is holding back employment and making life tougher for employers.

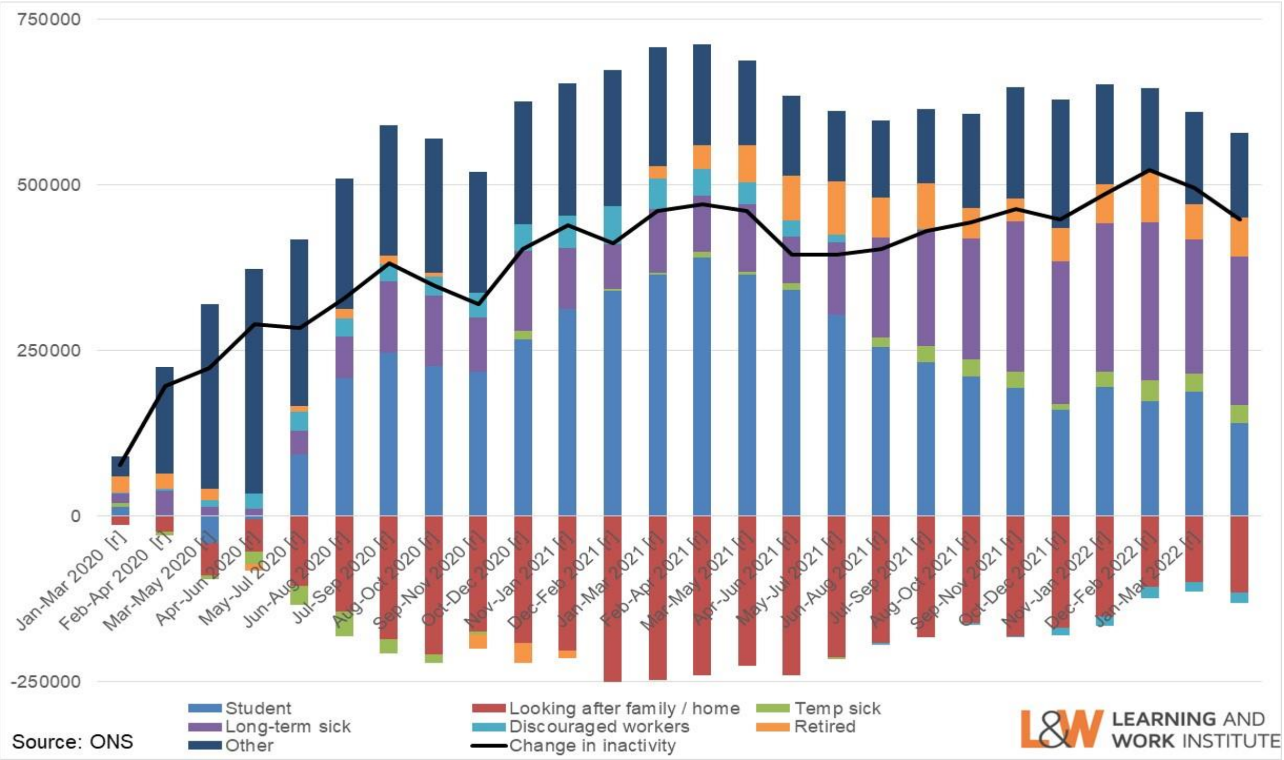
Understanding rises in economic inactivity

This chapter looks at changes in economic activity by age group across countries, to see how the UK's experience compares.

Two phases of growth in economic inactivity in the UK

The rise in economic inactivity (the other way to describe the fall in economic activity) in the UK through the pandemic breaks down into broadly two phases.

Figure 10: Reasons given for economic inactivity, change compared to December-February 2020



In the first phase, largely during 2020, economic inactivity rose primarily for two reasons. The first reason is 'other'. This is likely to be predominantly people stopping looking for work due to the pandemic, reduced work opportunities due to lockdowns, health reasons, and requirements to stay at home and limit social contacts.

The second reason, particularly from summer 2020, is growth in the number of students. This is up by 140,000 since the start of the pandemic. It is likely to be more young people staying in education, something that often happens during economic downturns – the opportunity cost of being in education, in terms of lost potential earnings, has decreased. The UK has lower education staying on rates and attainment of level 3 qualifications than many comparator countries. So this rise in education participation can be beneficial, if the education is of high quality and meets the needs of each individual. Of course routes such as apprenticeships can help to combine earning and learning, but their numbers fell during the pandemic as hiring froze and lockdowns limited opportunities.

In the second phase, from early-mid 2021, there has been a substantial rise in the number of people who are long-term sick and a smaller rise in the number of people of working-age who say they have retired. 225,000 more 16-64 year olds say they are economically inactive due to long-term sickness than at the start of the pandemic, and 58,000 more say they have retired early. This has helped to at least offset recent declines in the number of economically inactive students.

Taken together, this means there has been an 11% increase in the number of people economically inactive due to long-term sickness or early retirement since December-February 2020. The number of people economically inactive due to sickness (2.6 million) is now double the number of unemployed people (1.3 million).

A range of factors may contribute to this, including rising prevalence or awareness of mental health conditions, NHS waiting lists and potentially long Covid. For example, the ONS finds that 1.4 million people report long Covid symptoms at least 12 weeks after their infection, with 325,000 people of working age saying this affects their day-to-day activity a lot.[4] Overall, 2-4% of working-age people and 1.76% of people with no other health conditions (which would be around 500,000 people of working age) report long Covid symptoms.

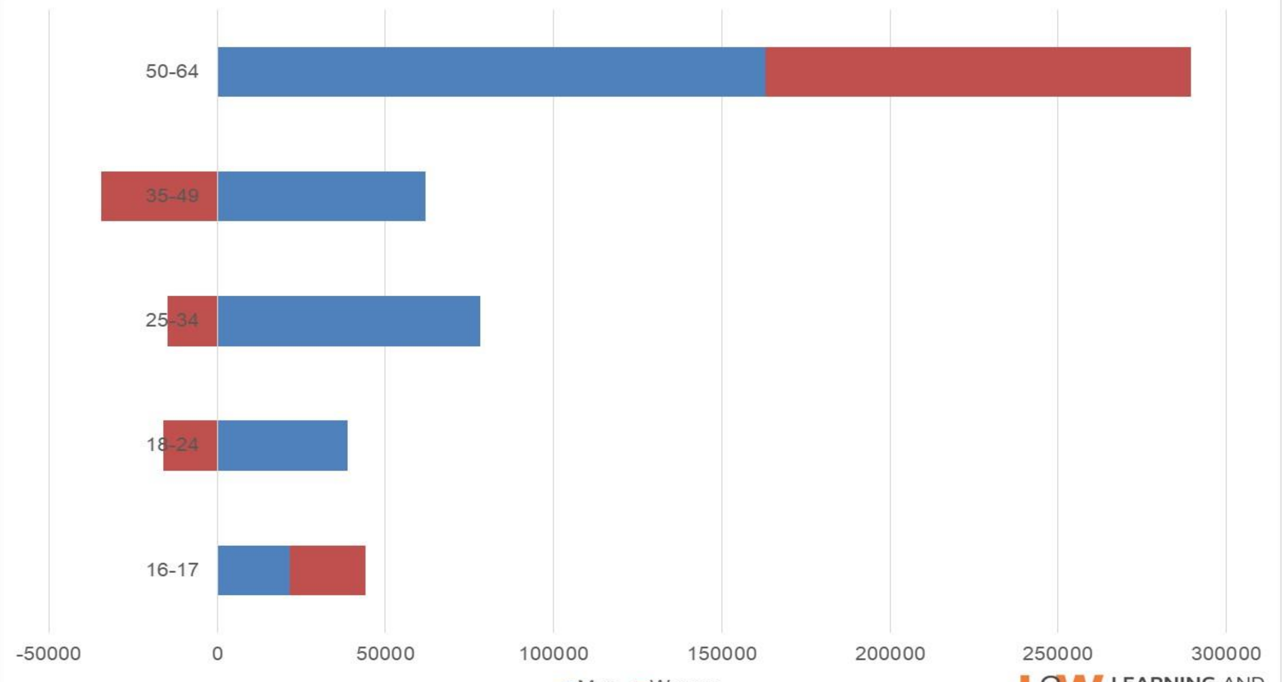
If we assume that 76% of these are in work (380,000) and that the daily activities of 20% of these are affected a lot (this is likely an overestimate as it matches the proportion in the population as a whole) then that would equate to 76,000 – one third of the total rise in the numbers economically inactive due to long-term sickness. There is lots we don’t yet know about long Covid and these survey figures are self-reported, but it may well be a contributor to rising economic inactivity alongside other factors.

Interestingly, the number of people economically inactive due to looking after family or home has fallen compared to pre-pandemic levels. This may be in part for people remaining employed on furlough when previously they may have left employment, or related to a growth in the availability of flexible working options through the pandemic. There have been some recent rises in this number, a trend worth monitoring.

Similar patterns can be seen by age. The chart below shows by far the largest rises in economic inactivity have come among men and women aged 50-64, up 289,000 (9%) to 3.5 million. This is likely to overlap to an extent with those citing long-term sickness and early retirement as their reasons for economic inactivity.

[4] Prevalance of ongoing symptoms following coronavirus (Covid-19) infection in the UK, ONS, 2022.

Figure 11: Changes in the number of people economic inactive by age since December 2019 - February 2020



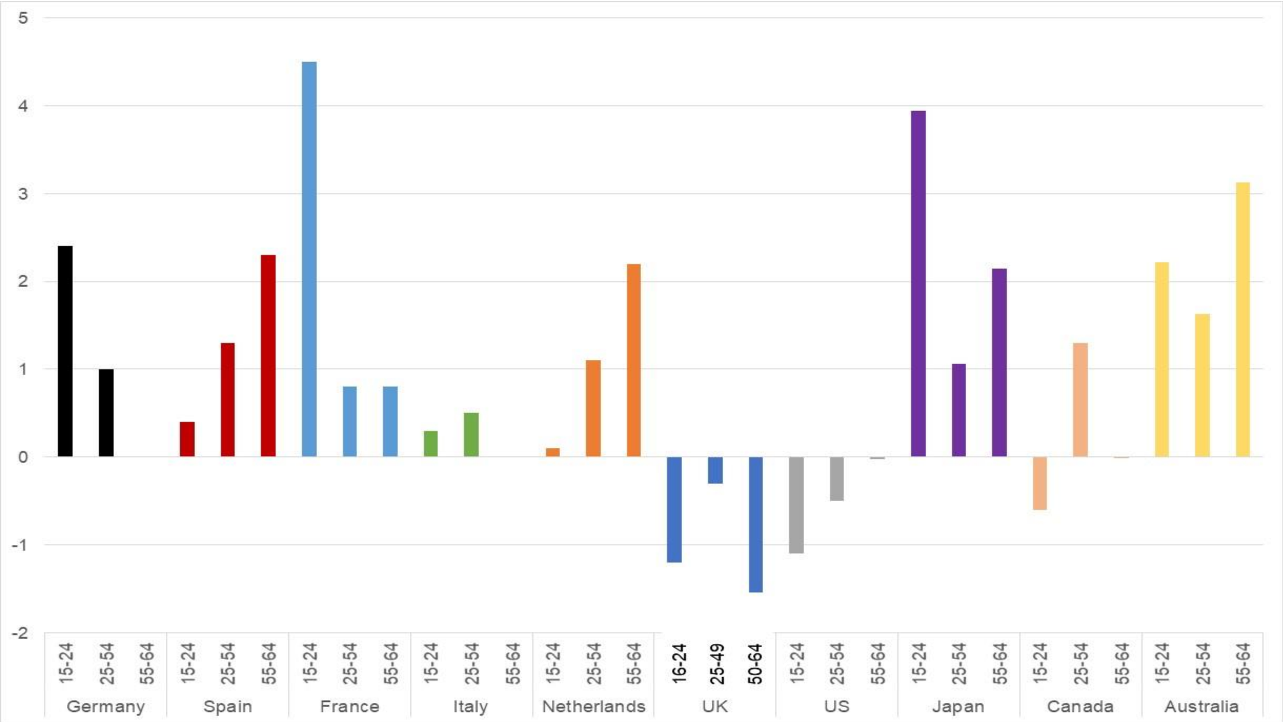
Source: ONS, L&W calculations

Of those who are economically inactive, some 1.7 million 16-64 year olds say they would like to work. This is clearly a substantial number – larger than the 1.4 million people who are unemployed. However, it is down by 125,000 since the start of the pandemic. The rise in economic inactivity has been driven by those who say they do not want a job. Of course it is possible this might change if people were offered employment support or if economic circumstances (e.g. the rising cost of living) altered people's needs.

The UK in international context

How does this pattern of changes in economic inactivity in the UK by age compare to other countries?

Figure 12: Changes in economic activity rates since Q4 2019, percentage points



Other countries, like the US and Canada, have also seen reductions in economic activity rates among young people. It is beyond the scope of this report to analyse the drivers of these changes by country. **The UK is the only country analysed to see significant falls in economic activity rates for people aged 55-64: rates are virtually back to pre-pandemic levels in Germany, Italy, the US and Canada, and have risen in Spain, Netherlands, Japan and Australia.**

What explains the UK's relatively poor performance?

There has been some analysis to try and shed more light on rising economic inactivity in the UK, and particularly among the over 50s.

For example, the ONS found that many in their 50s who had left work would consider a new job.[5] The main reasons cited for leaving work included mental health of stress (19%) and change of lifestyle (14%). Those in their 60s were more likely to say they had retired early. 58% of those in their 50s and 30% of those aged 60+ said they'd be interested in returning work. They wanted flexible working options, ability to fit work around caring responsibilities, and a job that suited their skills and experiences.

[5] Reasons for workers aged over 50 years leaving employment since the start of the coronavirus pandemic, ONS, 2022.

Another study found that the largest increases in economic inactivity for the over 50s came among those previously earning £18-25,000 per year.[6] They were more likely to work in sectors like wholesale and retail, transport and storage, and manufacturing, and occupations like process plant and machine operatives and sales and customer services.

In other words, while there are clearly a sizable minority, particularly those in their 60s, who have retired early and are financially able to do so, the majority are interested in work and may have financial reasons to do so.

Is the UK policy response missing the target?

The UK's policy response is likely to have contributed to its relatively high growth in over 50s economic inactivity. After the initial employment response to the pandemic, support has been focused largely on people who are unemployed. For example, the Government's Way to Work initiative focuses largely on increasing work search requirements for people who are unemployed, even though those requirements were already very tight and most unemployed people find work relatively quickly.[7] Similarly, the Government's Restart programme is focused on benefit claimants who are long-term unemployed. The increase in the number of Work Coaches again only supports people within the benefits system.

In short, the Government planned for an unemployment crisis that, thanks in part to the success of its initial policy response, didn't materialise. However, rather than refocus efforts on the challenge that did materialise – rising economic inactivity among the over 50s and for people with long-term sickness – instead programmes are underspending, with these underspends returning to the Treasury.

Table 1: Potential underspends in key employment and skills programmes

Kickstart	Restart	Traineeships
£700 million	£400-1,100 million	£65-130 million

For example, the DWP returned a £665 million underspend on **Kickstart** (providing wage support for employers who took on young people at risk of long-term unemployment) to the Treasury so far.[8] The Government originally said Kickstart would be a £2 billion scheme supporting up to 250,000 jobs.[9] In practice there have been 162,000.[10] This suggests the total amount of money returned to the Treasury may ultimately exceed £700 million.

The **Restart** scheme to support long-term unemployed benefit claimants into work has been scaled back (it's not clear by how much) and eligibility widened as long-term unemployment has risen less than expected. When Restart was announced (November 2020), the OBR was projecting unemployment would rise to 2.6 million (7.5%) before

[6] Policy briefing note: rising inactivity in the over 50s post Covid, Carillo-Tudelo, Clymo, Comunello, Visschers and Zentler-Munro, University of Essex, 2022.
[7] New jobs mission to get 500,000 into work - GOV.UK (www.gov.uk)
[8] Kickstart scheme: finance, Parliamentary Question 4563.
[9] Plan for Jobs, HM Treasury, 2020.
[10] Kickstart scheme: finance, Parliamentary Question 4563.

starting to fall.[11] In reality, unemployment has fallen to 1.3 million (3.7%). Long-term unemployment is now lower for young people than pre-pandemic and only 50,000 higher for those aged 25 and over.

The 2020 Spending Review announced Restart would be £2.9 billion over three years while a recent answer to a Parliamentary Question suggested the value of the contracts was £2.5 billion. This is suggestive of an underspend of perhaps £400 million (noting that the contracts are based on referral numbers and performance so providers may not be paid the full contract value).[12] An answer to a Parliamentary Question showed that 225,000 people had been referred to Restart, 40% lower than reported expectations of 375,000 (the scheme was planned to help 1 million people over three years).[13] A 40% underspend, if this trend continued, would equate to about £1.1 billion.

The Department for Education returned £65 million of unspent funding for **Traineeships** in 2020-21 as it only achieved 50% of the Traineeship starts for which it was funded.[14] Between August 2021 and January 2022 there were 8,900 Traineeship starts, just 100 more than in the same period the previous year. There is a clear risk of a further underspend on the £126 million allocated for Traineeships in 2021-22 and for following years too. **Apprenticeship** numbers have yet to recover to pre-pandemic levels (which were already down on pre-apprenticeship levy levels), increasing the likelihood of apprenticeship levy funding expiring and being returned to the Treasury.

By contrast, many of the over 50s who have left work and are now economically inactive and are not claiming benefits. The ONS study showed many are drawing down pensions or investments or relying on a partner for financial support: only 23% of 50-59 year olds were claiming state benefits (and this included benefits like Carer's Allowance) falling to 6% of over 60s.[15] Most UK employment support is targeted on people who are unemployed and claiming benefits, not those who are economically inactive or not claiming benefits. So there is a big group of people likely to miss out on support.

In the round, the Government pledged a significant sum of money through its Plan for Jobs. But the schemes introduced were designed to tackle a potential unemployment crisis rather than to reach the groups that actually needed most help as the pandemic progressed and new challenges emerged. Rather than reinvest, the Government has chosen to make savings on these schemes, likely in excess of £1 billion and perhaps up to £2 billion.

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[11] Economic and fiscal outlook: November 2020, OBR, 2020.

[12] Spending Review 2020, HM Treasury, 2020; Restart Scheme: Costs, Parliamentary Question 4559. Part of this apparent discrepancy might be that the Spending Review figure include consequential payments for Scotland and Northern Ireland (Wales is part of Restart). It is unlikely these would exceed £290 million.

[13] Restart Scheme, Parliamentary Question 231, 2022; UK government's £2.9bn job search scheme has put only 7% of participants in work to date | Unemployment | The Guardian

[14] DfE hands £65m for traineeships back to Treasury (feweek.co.uk)

[15] Reasons for workers aged over 50 years leaving employment since the start of the coronavirus pandemic, ONS, 2022.

This is a short-term saving but a long-term cost as it increases the likelihood that the current recruitment crisis for employers will continue and that people could become permanently locked out of labour market opportunity.

Of course, on top of recent rises in economic inactivity, there have always been concentrations of economic inactivity in particular groups and areas. It is not realistic to try and get economic inactivity down to zero – many people are too ill to work, or studying, or have caring responsibilities. Nonetheless, there is a case for saying policy still had further to go even before the impact of the pandemic.

What’s next? There remains further research needed to understand the differences in demographics and policy responses between the UK and other countries, as well as to understand changing patterns of economic inactivity across the UK. This should underpin a renewed Plan for Jobs to tackle the interlinked recruitment and labour market participation crises.

Conclusion

The UK's employment rate is relatively high and the performance of its labour market compared well internationally in the early phase of the pandemic, largely due to the success of furlough and other economic and employment support. However, since that early phase economic activity has continued to fall in the UK where it has recovered in many other countries.

It is this fall in the number of people economically active that squares the circle of this being a tight labour market with employers struggling to fill vacancies, despite employment remaining below pre-pandemic levels. Record hiring rates have predominantly come through a growth in job-to-job moves.

The UK's performance is relatively weak by international standards, with many other countries having seen a recovery in employment and economic activity rates. In particular, the UK has seen a significant rise in the number of over 50s leaving the labour market and increased numbers saying they are economically inactive due to long-term sickness.

These are groups that current employment policy and the Plan for Jobs are far less focused on. That plan is likely to be £1-2 billion underspent. In part that reflects initial success with the groups policy is focused on – unemployment has fallen. But not reinvesting this resource to tackle the challenge we have – higher economic inactivity – would be a missed opportunity, holding back growth and business success. The Government could also bring forward investment in people and skills through the UK Shared Prosperity Fund, currently not due to start until 2024-25 despite similar European Social Fund investment ending in December 2022.

The consequences of not doing this will be lower economic growth, with the Bank of England and Government needing to press the brakes on demand in the economy to prevent overheating. Instead, we should seek to expand our labour supply, creating the capacity for growth.

The Government should introduce a renewed plan for jobs, skills and growth, reinvesting current underspends on supporting economically inactive people who want to work into employment.