UK Labour Supply: Investigating Economic Inactivity

A report submitted to The House of Lords Economic Affairs Committee

Professor Carlos Carrillo-Tudela, Dr Alex Clymo, Camila Comunello, and Dr David Zentler-Munro

Our team, reason for submitting evidence, and document outline

We are a team of academics from the Economics department at the University of Essex. We have been studying the rise in inactivity and labour shortage problems in the UK as part of our UKRI grant-funded research on the labour-market impacts of the pandemic (Grant reference ES/V016970/1). This document builds on academic papers and policy reports we produced as part of this project. We are submitting evidence to this committee to disseminate our research to policymakers and the public.

In this document, we use data from the national Labour Force Survey (LFS) and elsewhere to investigate the rise in economic inactivity. In summary, we argue that:

- The rise in inactivity in the UK is severe, at over 500,000 workers, and worse than comparable OECD countries.
- The rise is driven mostly by older workers. Relative to trend, inactivity has risen for both men and women, and is larger for less educated workers.
- Among older workers, the rise is due to inactivity due to retirement and inactivity due to health issues. The rise in over-50s inactivity appears to be highest for lower-middle income workers, and workers from lower income industries and occupations.
- The rise is due to more workers transitioning from employment to inactivity. But workers are also transitioning back from inactivity to employment more than before the pandemic, offering hope that inactivity might yet decline.

More details can be found at our project website, www.covidjobsresearch.co.uk.

Contact: Please direct enquiries to Professor Carlos Carrillo-Tudela at cocarr@essex.ac.uk.

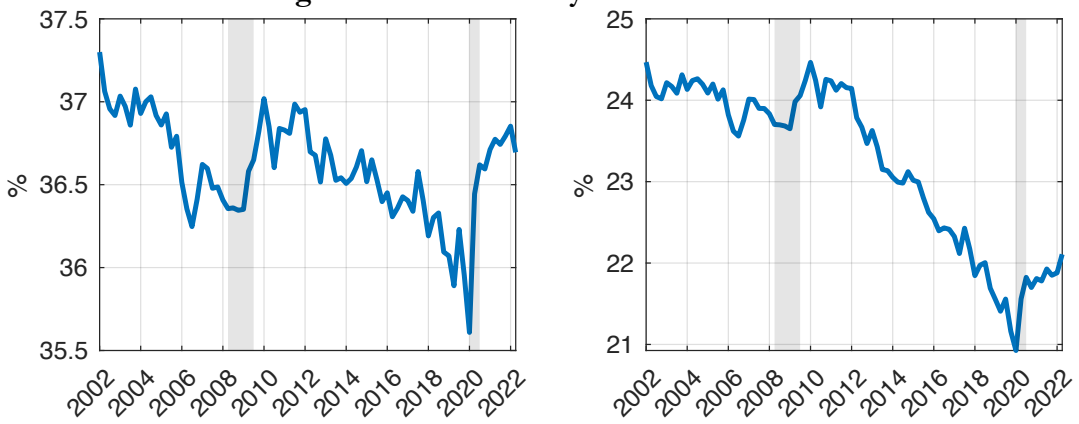
Introduction and comparison to other developed countries

This report explores how the total size of the UK labour force behaved during and after the COVID-19 pandemic. We focus on the **inactivity** level which tells us how many adults are neither employed nor actively searching for a job. In aggregate labour market statistics, individuals are classified as either employed, unemployed – meaning out-of-work, actively searching for a job and available for work – or inactive, meaning out-of-work and not searching for a job or not available to start work. A rise in inactivity therefore represents a decrease in the labour force available to the economy.

The pandemic saw a significant rise in the inactivity rate, which has remained persistently high. Using LFS data for the whole population, we find that inactivity has risen by 544,000 workers from

before the pandemic (2019Q4) to the latest data in 2022Q2. Focusing just on "working aged" population, those between the ages of 16 and 65, the increase is 427,000 workers. Hence, there has been a massive increase in the number of people choosing not to participate in the labour market, exacerbating labour shortages for firms. This remains true when adjusting for population growth: the inactivity rate, defined as the number of inactive people divided by the total population, rose by 0.95% for the working aged and 0.74% for the whole population.

Figure 1: The Inactivity Rate Over Time

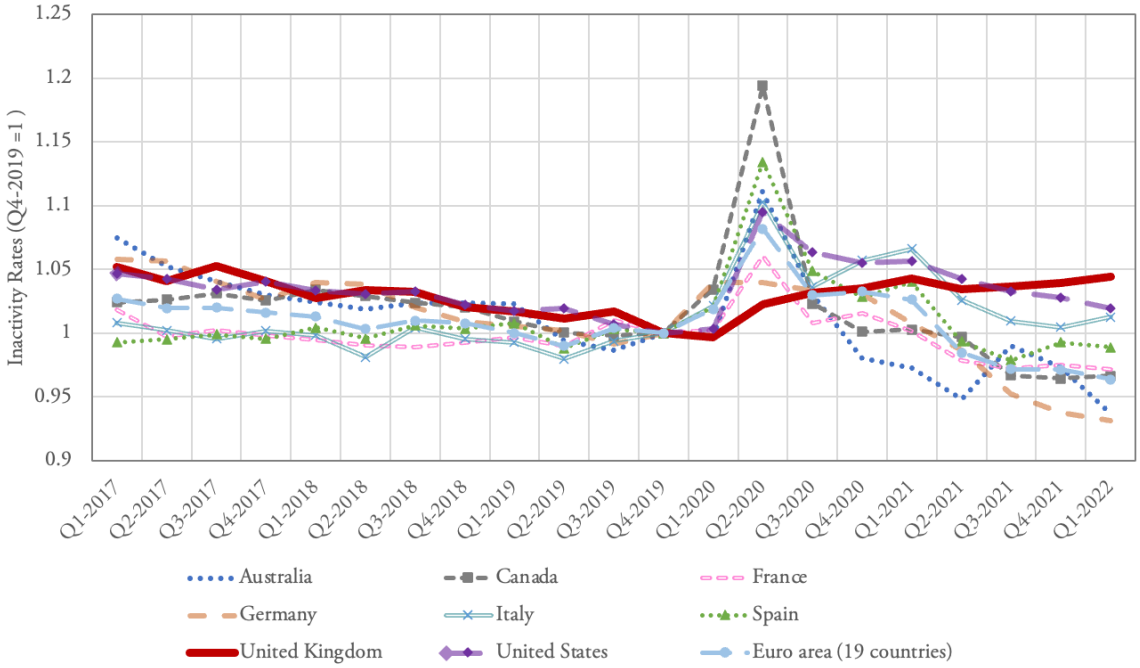


(a) Whole Population **(b) Working Age**

Source: LFS and authors' calculations. Shaded areas show UK recession dates.

In Figure 1 we plot the inactivity rate over time, which shows just how large the increase is. This is not simply a typical economic response to recessions, as the rise in inactivity appears to be greater and more persistent than the rise seen in the 2008 Great Recession.

Figure 2: Rising Inactivity: an International Comparison



Source: OECD and authors' calculations. Working age population. Inactivity rates normalised so Q4-2019=1

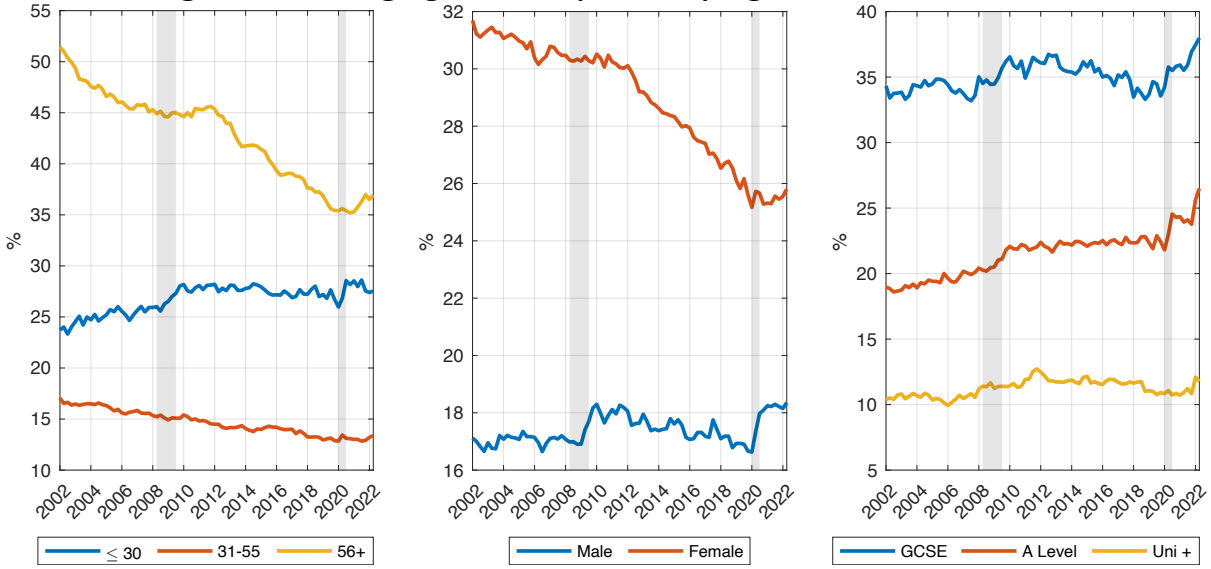
How does the UK's rise in inactivity compare with other countries?[1] In Figure 2 we plot the working-age inactivity rate in the UK and a sample of similar countries, using data from the OECD. The figure reveals that many countries saw a rise in the inactivity rate during the worst of the pandemic, often more severe than in the UK. However, the persistence of the rise in the inactivity rate in UK is unique. In fact, in all other countries the inactivity rate has been trending down since its peak, while in the UK it continues to rise.

As for why the UK is faring worse, the raw data cannot say alone, but there are two additional things to consider. Firstly, inactivity in the UK was already the lowest amongst this group of countries before the pandemic: 20.5% in 2019Q4 vs. 25.6% in the US and 26.6% in the Euro area. So it is possible that inactivity would have risen more in other countries, but this is being masked by other downwards trends. However, inactivity in Germany was also low at only 22% in 2019Q4, and it has now fallen while inactivity rose in the UK. Secondly, there was a policy change in the UK at the same time as the pandemic: the retirement age for women finished its planned gradual increase from age 60 to 65 around 2020. This UK-specific policy change, which stopped putting downwards pressure on the inactivity rate, rather than the pandemic itself, might explain why the UK has fared differently from these other countries.

Who became Inactive? Socio-economic and demographic breakdown

We now present a basic demographic breakdown of the rise in inactivity in the UK in Figure 3. The left panel plots the inactivity rate by age, the centre panel by sex, and the right by education level. Inactivity rates have risen more for older workers. The extent of this fact is partly masked by the previous downwards trend in inactivity in the 56+ age group, caused by people retiring increasingly later in life. Relative to trends, the increase in inactivity in the 56+ age group explains almost all of the persistent rise in inactivity in the UK.

Figure 3: Working-age Inactivity Rates by Age, Sex, and Education



Source: LFS and authors' calculations. GCSE refers to those maximum qualification is a GCSE or less, A Level to those whose maximum is an A Level, and Uni + to those whose maximum is a University degree or greater.

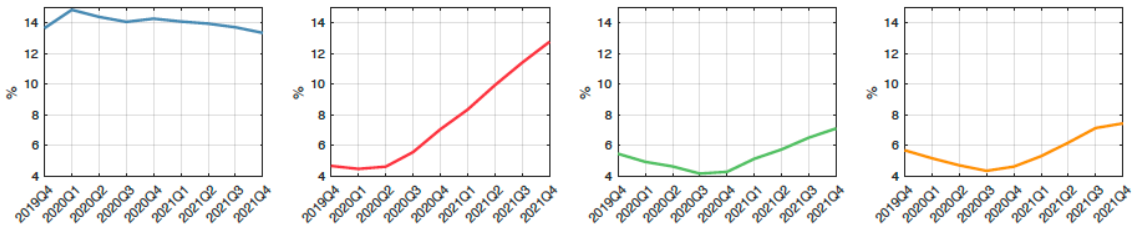
[1] For the latest UK data on labour markets stocks, flows, shortages, and mobility, see our snapshot here.

Care with trends must also be taken when interpreting the data by sex. In the raw data the increase in inactivity is larger for men than women. But inactivity had been trending downwards for women before the pandemic, caused by the increasing retirement age and increase female labour-force participation. Relative to trend, there are large increases for both men and women. Finally, the increase in inactivity is larger for less educated workers: those without a university degree. However, combined with the finding that the increase is larger for older workers this could simply be because older workers are less likely to hold university degrees.

Why? What factors are contributing to rising inactivity among older workers?

Since the increase in inactivity was largest for older workers, we focus on understanding the causes of reduced labour supply for this age group. In this section we present results from our study of inactivity in UK the over 50s.[2] One prominent hypothesis for why older workers have left the labour market is that they are relatively high income workers who accumulated extra savings during the pandemic, and hence could afford to exit the labour market. However, contrary to this hypothesis, we find it is workers in the lower to middle range of the weekly earnings distribution that have become inactive the most following the pandemic. Figure 4 shows that the fraction of employed workers who become inactive one year later has increase for most earnings levels, but has increased the most for workers in the 25-50% weekly earnings percentile range. This is consistent with our finding that it is over-50s workers with medium levels of education, and in lower paying industries and occupations that have seen the largest increases in inactivity. Looking instead at hourly wages, the rise in inactivity is largest for both the lower-middle and upper-middle hourly wage workers.

Figure 4: Rising Over 50s Inactivity at the Middle of the Income Distribution



(a) Lowest wages (b) Lower-middle wages (c) Upper-middle wages (d) Highest wages

Source: LFS and authors' calculations. Figures plot the fraction of employed workers at each weekly earnings level who are economically inactive one year later.

Another hypothesis, contrary to the wealthy early-retiree explanation, is that increased inactivity is a by-product of the welfare system becoming more lenient during the Covid pandemic. This hypothesis is also not supported by the available data: we find that older workers on non-sickness benefits have no increase in inactivity. However, there has been a rise in older workers inactive and claiming sickness benefits, which is to be expected given the health effects of Covid. Relative to trend, the largest effect is an increase inactivity from those claiming the state pension, due to the policy change discussed in the introduction.

Then what is the most likely cause of the rise in inactivity of the over 50s? Based on their stated reason for inactivity, sickness and a desire to retire stand out as the main culprits. Older inactive

[2] The work in this section builds on our earlier work on inactivity in the over 50s, and the analysis only runs up to the end of 2021. For more details, see our non-technical write up here, and a longer policy briefing here.

workers also state that they do not want a job, and do not expect to work again. Whether they continue to feel that way, and can afford not to work, remains a key question.

Which industries and occupations are most affected?

Given the rise in inactivity is driven by older workers leaving employment, it is instructive to consider what type of jobs they are leaving. Up to the end of 2021, we found that just four industries can explain 51% of the aggregate rise in inactivity in the over 50s: Wholesale and Retail, Transport and Storage, Manufacturing, and Health. Similarly, four occupations can explain 49% of the aggregate rise in inactivity: Professional, Administrative and Secretarial, Sales and Customer Services, and Process, Plant and Machine Operatives.

The top 4 industries and occupations with particularly high rises in inactivity have two things in common. Firstly, they are all in long run decline, with employment declining over the last 20 years. Secondly, they also were hit during COVID, with further employment declines, sometimes very severe. This suggests that older workers from these sectors might have chosen to become inactive because their industry/occupation was in long run decline, and then they lost their job during the pandemic. The pandemic might have represented a final straw for them, where they chose to become inactive rather than look for a job again in a sector they know is in decline. Given that these workers are older, they might not find it worthwhile to reallocate to a new sector, as the costs of transitioning or retraining might not be worth it as they approach retirement

Conclusion and Policy Challenges

The rise in the inactivity rate in the UK during the pandemic and its aftermath stands out for its persistence. Much of this persistence is driven by the older workers leaving the labour market and staying out. We have shown that some of the popular explanations for this appear to be at odds with the data – it doesn't seem to be higher wage or wealthier pensioners driving this phenomenon, nor is it those dependent on the welfare system. Rather there has been a rise in older workers becoming inactive due to ill health, part of a long term trend possibly exacerbated by Covid-induced health issues, while the number of inactive workers in retirement has stopped its downward trend seen before COVID and started to increase. This may partly be explained by workers who lost their job in the pandemic in sectors that were in long term decline, who may therefore be discouraged from further job search. Persuading these workers to rejoin the labour market will not be an easy task since the rise in inactivity was largest among older workers declaring they definitely did not intend to return to work.

By analysing the flows into and out of inactivity, we do find a glimmer of hope: while workers have been flowing from employment into inactivity at a higher rate, they have also been flowing *back* from inactivity to employment at a higher rate.[3] So far, the inflow into inactivity has been larger, which is why inactivity has been increasing. But if higher outflow back to employment can be further increased through policy, this could ease the labour supply shortages.

In summary, our analysis suggests two pressing challenges for policy; first, to persuade workers from declining sectors that there is merit in returning to the labour market, and second, to tackle the long-term and COVID-amplified trend of rising inactivity due to ill health.

[3] For data on labour market flows during COVID, see our online UK data snapshot page here.