# ECONOMIC BRIEFING – UK LABOUR MARKET

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## A literal sick man: a global perspective on the UK's labour market since the pandemic

### Introduction

Many developed economies saw rapid recoveries in economic growth from the spring of 2020 reflecting the roll-out of vaccines, the easing of pandemic restrictions and extensive policy support to protect incomes through the pandemic. The result was that recessions, while deeper than during the global financial crisis, were shorter, with consumer demand bouncing back faster than many initially expected.

The performance of labour markets too has been surprisingly strong. The UK and comparable countries—such as France, Germany, Italy, Spain and the US—saw a rapid tightening in labour market conditions, with high numbers of job openings and historically low levels of unemployment. Reports of labour shortages remain common across these countries as evidence suggests that the pandemic has caused workers to turn away from lower quality, contact-intensive jobs characterised by low pay and anti-social hours.

Unlike the rest of the pack, however, the UK's historically low unemployment and near-record high vacancies have been driven in part by the shrinking of its labour force. Even before Covid hit, population ageing was weighing on labour supply, and the pandemic and Brexit have added to the pressures. Over half a million more people have become economically inactive since the beginning of 2020, contributing to a decline in the labour force of nearly 300,000. A combination of long term sickness, early retirement and lower levels of economic migration have resulted in fewer workers and skills shortages.

This note will explore what's happened to the labour markets of these countries since the beginning of the pandemic, why the UK has seen a decline in labour force participation, and why this matters for the UK's economic prospects in the years ahead.

### Labour market trends since the start of the pandemic

The UK is not alone in seeing a high number of vacancies and too few workers to fill these jobs. Prior to the pandemic (February 2020) in the US there were 0.8 unemployed workers per vacancy, but this had fallen to 0.6 by November 2022.[1] Similarly, the ratio of unemployed workers per vacancy in Germany fell from 3.2 to a low of 2.6 in May 2022, edging back up to 3.0 as of November.[2] In the UK, this ratio has remained close to a historic low of 1.0. [3]

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[1] 'Number of unemployed persons per job opening, seasonally adjusted', US Bureau of Labor Statistics

[2] OECDStat.

[3] Vacancies and jobs in the UK: January 2023, ONS, 17th January 2023, at https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/jobsandvacanciesintheuk/january2023

Across developed economies businesses have reported significant labour shortages. There is some evidence that these shortages are concentrated in lower paying, contact-intensive sectors with non-standard working hours, like accommodation and food services, and health and social care. For example, the leisure and hospitality industry in the US has seen the highest quit rates since July 2021, above 5.2%, with the retail industry following closely behind, while higher paying industries like finance have seen lower quit rates.[4] A majority of US workers quitting their roles in 2021 said it was because pay was too low (63%).[5]

But shortages have emerged beyond contact-intensive industries, especially in manufacturing and resource extraction roles in the USA, the information and communication sector in Italy and France, and in waste, water and energy-related industries in the UK.[6] For instance, 38% of manufacturing and 40% of services firms in Germany in August 2022 reported production constraints due to labour shortages.[7] The CBI's Industrial Trends Survey found that 49% of UK manufacturing firms cited a lack of skilled labour as a likely constraint to output in the three months from October 2022, the highest since 1973.[8]

## We're seeing worker shortages across the comparator countries

The explanation for the emergence of labour shortages is part cyclical, part structural. As economies bounced back following pandemic, employment recovered and unemployment fell. However, there's also evidence that the pandemic has changed workers' preferences. As noted above, there are signs that people have become less accepting of low quality, contact-intensive, jobs characterised by low-pay and anti-social hours, such as retail trade, food and hospitality sectors. A recent IMF paper also noted the possibility that health concerns may be discouraging workers from choosing contact-intensive and customer service roles. At the same time, the expansion of remote and hybrid working opportunities offers the prospect of an improved work-life balance, which may have led workers to prioritise these jobs and discard others. For example, while Google search intensity for "jobs" has declined to pre-COVID levels (January 2020), the intensity for "telework" and "remote" remains high.[9]

This shift is borne out in UK data. Sectors characterised by contact-intensive roles have seen large increases in the numbers of vacancies between the December to February 2020 pre-pandemic quarter and October to December 2022. Accommodation and food services vacancies were up 64%, and human health and social work activities were up 50%.[10] Firms in the accommodation and food sector were also the most likely to report labour shortages in December 2022.[11]

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[4] Understanding America's Labor Shortage: The Most Impacted Industries, US Chamber of Commerce, 19th January 2023, at https://www.uschamber.com/workforce/understanding-americas-labor-shortage-the-most-impacted-industries

[5] Majority of workers who quit job in 2021 cite low-pay, no opportunities for advancement, feeling disrespected, Pew Research Centre, 9th March 2022, at https://www.pewresearch.org/fact-tank/2022/03/09/majority-of-workers-who-quit-a-job-in-2021-cite-low-pay-no-opportunities-for-advancement-feeling-disrespected/

[6] The post-COVID-19 rise in labour shortages, OECD, 15th July 2022, at https://www.oecd.org/publications/the-post-covid-19-rise-in-labour-shortages-e60c2d1c-en.htm

[7] OECD Employment Outlook 2022: Building Back More Inclusive Labour Markets, OECD, at https://www.oecd-ilibrary.org/employment/oecd-employment-outlook-2022_1bb305a6-en

[8] Manufacturing output falls as skills worries hit highest levels since 1973, CBI, 25th October 2022, at https://www.cbi.org.uk/media-centre/articles/manufacturing-output-falls-as-skills-worries-hit-highest-levels-since-1973/

[9] Duval, R., et al., Labour Market Tightness in Advanced Economies, Staff Discussion Notes, No. 2022/001, March 31st 2022, at https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2022/03/30/Labor-Market-Tightness-in-Advanced-Economies-515270

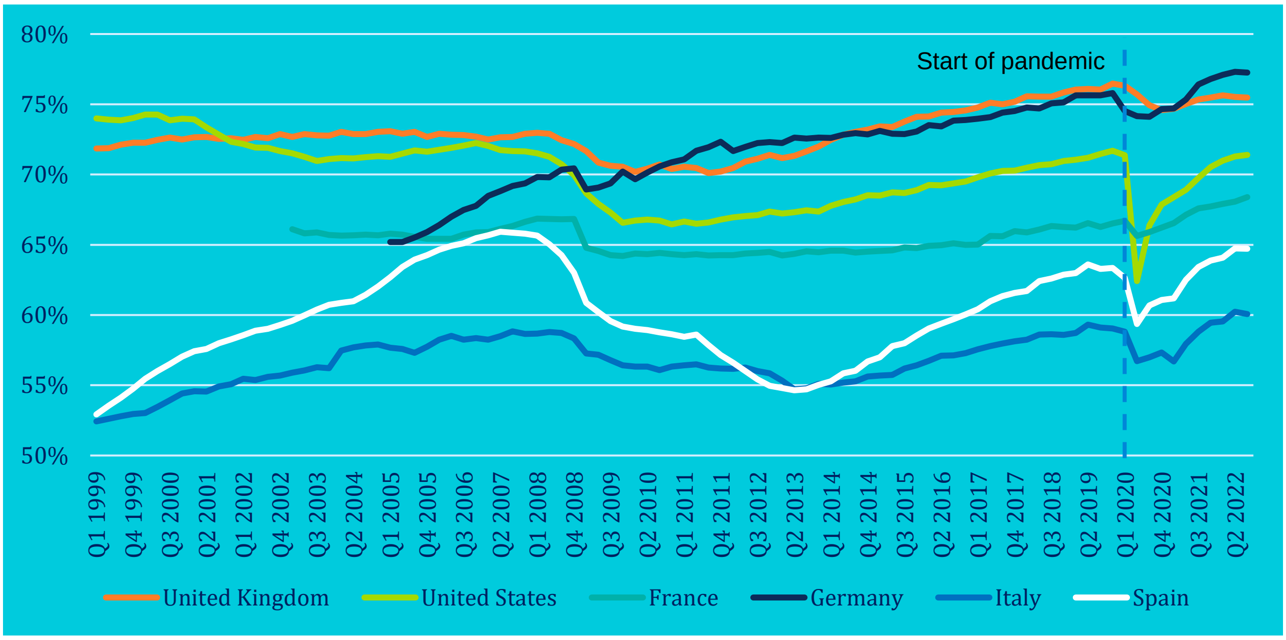
[10] VACS02: Vacancies by industry, ONS, 17th January 2023, at https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment/datasets/vacanciesbyindustryvacs02

[11] BICS Wave 74, Business insights and impact on the UK economy, ONS, 26th January 2023, at https://www.ons.gov.uk/economy/economicoutputandproductivity/output/datasets/businessinsightsandimpactontheukeconomy

## Developed countries see rising employment and falling unemployment post-pandemic

Many developed countries saw rising employment and falling unemployment in the aftermath of the global financial crisis, until the onset of the COVID-19 pandemic. Since the easing of restrictions, a rapid rebound in economic growth has led to a shortage of workers and tight labour markets. Data from the OECD[12] shows that employment rates (
*Figure* 1) – as measured by the share of employed people in the working age population – were rising in all our comparator countries in the years leading up to the pandemic, led by the UK and Germany. After a sharp drop in Q2 2020, reflecting pandemic related restrictions, employment rates have recovered and are continuing their steady upward movement in all countries other than the UK, where the employment rate remains below the pre-pandemic peak.

*Figure 1: Employment Rate (1999 to present)*




Likewise, unemployment rates in the comparator countries had been falling in the years running up to the pandemic (*Figure 2*) but rose to varying degrees following the outbreak of COVID-19. European countries tended to introduce state financed schemes modelled on "short-time working" schemes, whereby governments assumed a portion of wage bills to protect jobs and avoid mass unemployment. The US took a different approach, however, with the Federal government seeking to sustain demand, rather than employment, via several rounds of direct payments to individuals between April 2020 and December 2021, amounting to more than $900 billion. This resulted in much greater job losses initially, followed by a rapid fall in unemployment as the economy re-opened.

Unemployment remains at or below levels seen prior to the pandemic (Q4 2019) in all our comparator countries, led by Spain which has seen unemployment fall 1.4pp to 12.6%, and Italy which saw a 1.3pp fall to 8.3% in Q3 2022. Unemployment in both the UK and US remained broadly similar to Q4 2019.

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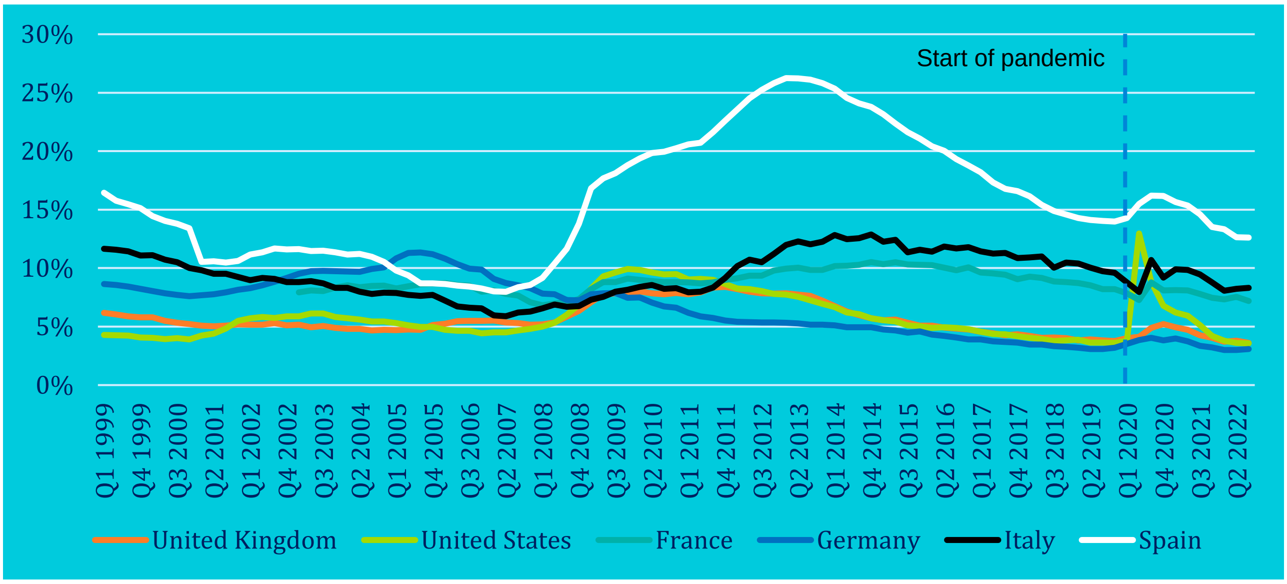
[12] International comparisons of employment and unemployment rates, ONS, 17th January 2023, at https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/datasets/internationalcomparisonsofemploymentandunemploymentratesa10

*Figure 2: Unemployment Rate (1999 to present)*

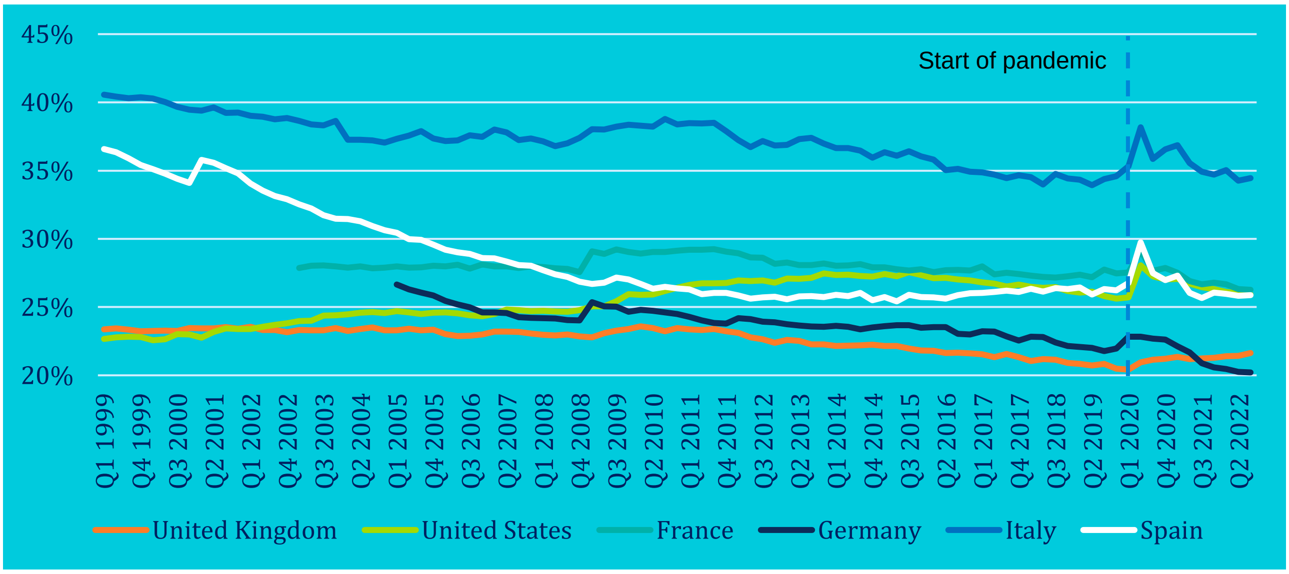



## The UK is the only comparator country to see economic inactivity rise

In contrast to our comparator countries, the post-pandemic fall in unemployment in the UK is explained to a much greater degree by higher inactivity rather than higher employment. This stands in stark contrast to the past two decades (*Figure 3*), when the UK, like many other developed countries, has been largely successful at reducing rates of economic inactivity—defined as the share of the working population that is neither employed nor unemployed and looking for work.

After jumps in inactivity in response to the pandemic, inactivity rates have been falling in our comparator countries, but not in the UK, where inactivity has ticked up from a low of 20.2% before the pandemic (Dec 19-Feb 20) to 21.5% in the three months ending November 2022. This amounts to an additional 575,000 people neither in employment nor seeking work. At the same time, 292,000 fewer people aged 16 and over are employed compared to before the pandemic, and total weekly hours worked are 16.3 million fewer than in the last pre-COVID quarter.[13]

*Figure 3: Economic Inactivity Rate (1999 to present)*

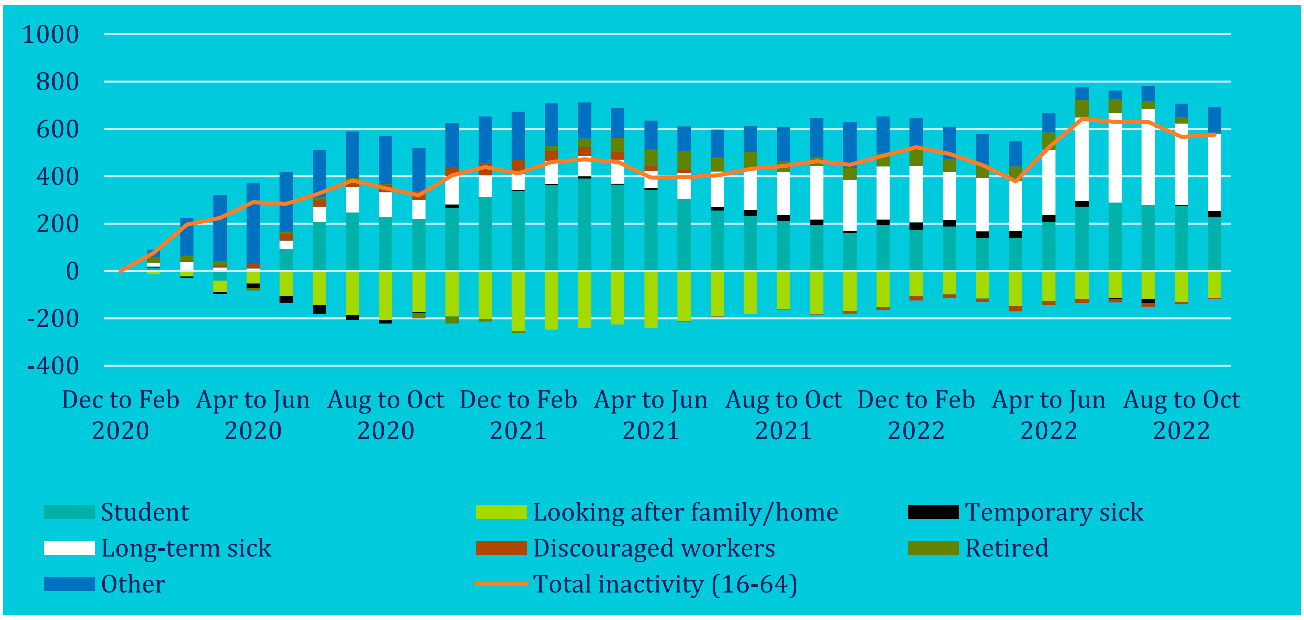



[13] Employment in the UK: January 2023, ONS, 17th January 2023, at https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/employmentintheuk/latest

## How and why is the UK different?

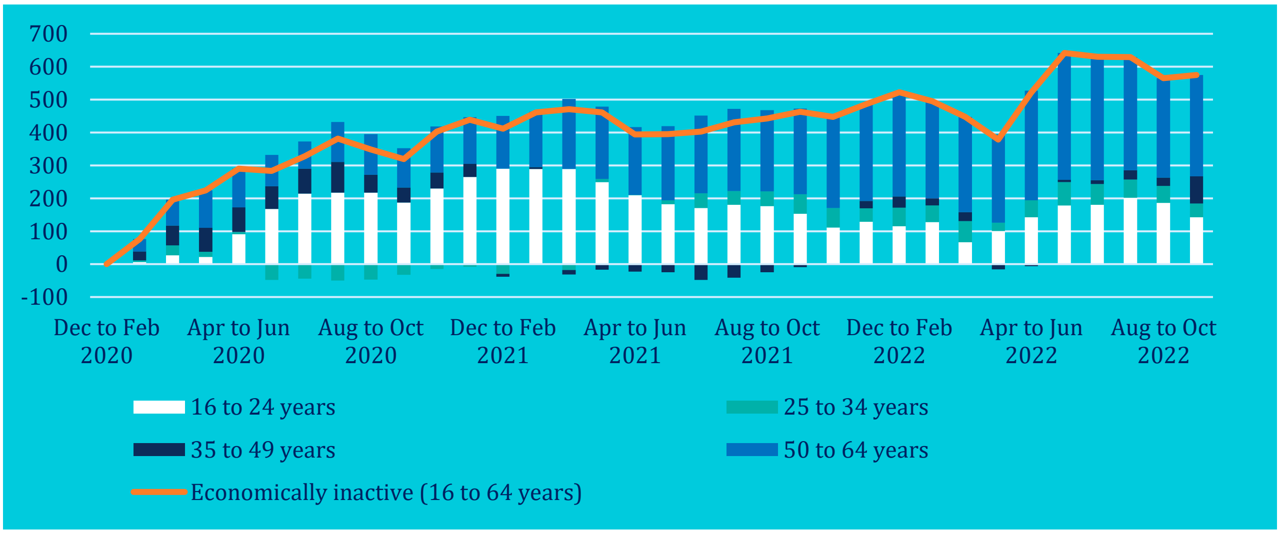
Rising inactivity rates have compounded the tightness of the UK's labour market. Understanding the reasons for this increase—and by extension the likelihood that these people will ever return to work—has therefore become a key focus for policymakers. As *Figure 4* shows, during the earlier stages of the pandemic, the rise in economic activity was primarily fuelled by workers leaving the labour market to become students. More recently, this pattern has changed and long-term sickness dominates as a reason for those remaining outside of the labour force, making up 28% of inactive people in June to August 2022, compared with 25% at the start of the pandemic.[14]

*Figure 4: Cumulative change in economic inactivity by reason since Dec-Feb 2020 (Seasonally adjusted, thousands)*




A pattern can also be identified by the age groups fuelling the move from activity to inactivity (*Figure 5*). Mirroring the trend seen in the earlier stages of the pandemic with rising numbers of students, younger people in the 16 to 24 cohort were the primary group driving higher inactivity. Since the beginning of 2021, however, larger numbers of people aged 50 to 64 have been leaving the workforce and have contributed over half of the increase in economic inactivity.

*Figure 5: Cumulative change in economic inactivity by age since Dec-Feb 2020 (Seasonally adjusted, thousands)*




[14] Half a million more people are out of the labour force because of long-term sickness, ONS, 10th November 2022, at https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/economicinactivity/articles/halfamillionmorepeopl

## Sickness and early retirement are keeping older workers at home

The rise in the number of inactive people because of long-term sickness has variously been attributed to “long-COVID”, increased waiting times and backlogs in the NHS, and growing mental health issues (among other causes). One indication that the increase can’t be entirely attributed to long COVID is that the biggest year-on-year increase in long-term sickness was seen between 2019 and 2020, covering only the earlier stages of the pandemic. But, the pandemic may have led to non-COVID related long-term sickness in two ways. First, between Q2 2019 and Q2 2022 the number of economically inactive people who also reported problems or disabilities connected with the back or neck rose by 31% (62,000), possibly due to increased home working since the beginning of the pandemic. Second, those citing depression, bad nerves and anxiety rose rapidly in 2020 and 2021 – matching a period of recurring national lockdowns – and has only recently returned to pre-pandemic levels. At the same time, the number reported mental illness and nervous disorders rose 22% over the same three-year period, with the sharpest increases seen after 2020.[15]

This creates a challenge for policymakers, as sickness related inactivity has risen as median wait times from referral to treatment have almost doubled in England, from 7 weeks in April 2019 to almost 14 in August 2022. Similarly, the number of people on Referral to Treatment waiting lists has risen sharply since the first lockdown, from 4.4 million in February 2020 to 7 million in August 2022.[16]

The picture is further complicated by recent research from the Institute for Fiscal Studies (IFS), which found that most people who reported long-term sickness as a reason for being economically inactive were already outside of the labour force before the pandemic and had previously reported another reason for inactivity. Thus, between Q1 2021 and Q2 2022, 69% of those who became inactive because of long-term sickness were already out of the labour market for another reason in the three months prior, with just 19% in employment before becoming long-term sick. [17] Instead, as the IFS have noted, workers are leaving the labour market for other reasons – like retirement – while there have been increasing levels of ill-health amongst those who have been out of the labour market for more than five years. This means that worsening health cannot be the core explanation for the increase in movements between employment and inactivity the UK has seen since the pandemic.

This poses a dual challenge for the UK. First, policymakers must find ways to bring those who have left the labour market to become inactive at a time when the economy is contracting and inflation is high and, at the same time, tackle rising levels of sickness among those who have been inactive for long periods of time.

## Net migration of workers may also be a factor

While changes in workers' job preferences, a trend towards early retirement and rising sickness may go a long way to explaining UK businesses’ current recruitment difficulties, a final trend to consider is changing patterns of migration. While net migration has remained positive, and even rose to a record high of 504,000 in the year to June 2022,[18] the number of migrants coming to the UK to work *may* be lower compared with rates seen prior to the pandemic.

For example, the increase in total immigration compared to a year earlier was primarily caused by non-EU nationals, driven by increasing numbers of international students and people travelling from Ukraine, Afghanistan and Hong Kong under visa support schemes, coupled with the fact that only 21% of those non-EU arrivals came to the UK to work, migration may be failing to offset the number of workers leaving the labour market. Similarly, just 38% of EU and British nationals migrated to the UK for work, behind ‘other’ reasons at 41%.[19]

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[15] Half a million more people are out of the labour force because of long-term sickness, ONS
[16] Half a million more people are out of the labour force because of long-term sickness, ONS
[17] Boileau, B. & Cribb, J., ‘Is worsening health leading to more older workers quitting work, driving up rates of economic inactivity?’, IIFS, 26th October 2022, at https://ifs.org.uk/articles/worsening-health-leading-more-older-workers-quitting-work-driving-rates-economic
[18] Long-term international migration, provisional: year ending June 2022, ONS, 24th November 2022, at https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/bulletins/longterminternationalmigrationprovisional/yearendingjune2022
[19] Long-term international migration, provisional: year ending June 2022, ONS

The pandemic may have accelerated a process set in motion by EU withdrawal, and sped up the decline in the employment of foreign workers which has contributed to labour shortages in low-skilled professions like construction, truck drivers, and in the contact-intensive hospitality and care sectors.[20]

## Looking ahead

The tight labour market has meant that firms are facing considerable labour shortages, with evidence that this is pushing up pay. But, in line with a recent decline in vacancies (since May) measures of labour shortages appear to have peaked.

Determining what happens next will depend on how many of those that have previously dropped out of the labour market will return. A recovery in the UK's labour force participation rate is expected, but likely to a level below that seen just before the onset of the pandemic.

Weakening economic activity will weigh on hiring, resulting in higher levels of unemployment. Looking ahead, we expect the rise in unemployment to be similar to that seen over the pandemic, but much lower than during the 2008/09 financial crisis, peaking at 5% at the end of 2023.

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[20] Duval, R., et al., Labour Market Tightness in Advanced Economies