DELIVERING A LABOUR MARKET THAT SUPPORTS GROWTH

RESPONSE TO THE BUSINESS, ENERGY, AND INDUSTRIAL STRATEGY COMMITTEE'S INQUIRY INTO THE UK LABOUR MARKET

Economy wide labour shortages are holding back growth

The CBI welcomes the opportunity to contribute to the committee's inquiry into the UK labour market. The CBI is the UK's leading business organisation, speaking for some 190,000 businesses that together employ around a third of private sector employees. The UK economy has faced a challenging few years – from a global pandemic and war in Ukraine, to supply chain disruption and record high inflation. While employment increasing and unemployment near record lows are signs of labour market recovery, vacancies across the economy have reached yet another record high. The CBI is responding to this inquiry because more than three quarters of businesses say access to labour is threatening UK labour market competitiveness[1]. Recovering from the pandemic was never going to be easy – labour market activation, targeted immigration and skills reform and technology adoption are areas for business and government action to address recruitment and retention challenges and support growth.

Summary:

- Recruitment and retention challenges are affecting a range of sectors across the economy – with more than three quarters of businesses saying access to labour is threatening UK labour market competitiveness[1].
- Businesses are changing their practices to attract and retain talent in a tight labour market, but targeted immigration and skills reform – including a new Shortage Occupation List – is needed to boost business confidence.
- Labour market inactivity rates increased during the pandemic and failed to fall back. Business and government both have a role to play to support labour market activation, including measures to support older workers.
- Investing in technology drives productivity and is helping firms address labour shortages. Despite its benefits, there is a disparity in technology adoption when it comes to business size and sector.

Recruitment and retention challenges are affecting a range of sectors across the economy

This inquiry comes at a time of economic concern, with the CBI's latest Economic Forecast showing GDP growth slowing markedly in the coming 18 months as household spending turns downwards amid dented business and consumer confidence. For the labour market, skills and labour shortages and record high vacancies are putting a break on growth. The CBI expects a small rise in the unemployment rate as weaker economic growth weighs on hiring – ending 2023 at 4.1%. This suggests a tight labour market is likely to persist for the coming few years[2]. Labour shortages have been affecting businesses across all sectors since the economy reopened following the Covid-19 lockdowns, from hospitality and manufacturing to logistics and retail, with shortages being particularly apparent in sectors such as aviation that have experienced a more recent rapid return in consumer demand. As UK vacancies reach record highs month on month, labour shortages are ranked as businesses' primary concern for the next quarter[3].

Labour shortages are affecting firms' cost base and profits, holding back business investment in some sectors

Labour shortages are presenting a range of challenges for firms. For many, the reduction in staff has had a knock-on effect on production and supply of services, leading to failed deliveries and increasingly long customer lead times. For others, high vacancies have meant businesses haven't been able to operate at full capacity, leaving firms having to limit operating hours and available services. CBI members have also told us that shortages have significantly affected their cost base and profits, holding them back from investing in other measures to support business growth.

The CBI's latest quarterly manufacturing survey highlighted that labour shortages continue to be seen as a key constraint on output and investment growth – with two in five manufacturers (39%) citing shortages of skilled labour as a factor likely to limit output in the following three months. This was little changed from the near 50-year high reached in the previous quarter (42% versus a long-run average of 16%)[4]. For the services sector, the CBI's latest quarterly survey showed that one third of consumer services firms cited labour shortages as a constraint on investment (35% vs a long run average of 11%), while 40% cited availability of professional staff as a constraint on total business (long-run average of 14%)[5].

While labour shortages aren't unique to the UK, a combination of factors have meant domestic firms being hit particularly hard. On top of long-standing skills gaps, businesses have been navigating the impact of higher proportions of people leaving the labour market since COVID and changes to immigration rules post-Brexit, with an estimated 600,000 people of working age leaving the labour market since 2020[6]. CBI members have reflected that a far higher than expected proportion of their EU workers decided to leave the UK during the pandemic, while a lot of older workers have opted for early retirement.

Businesses are seeing shortages in lower and semi-skilled roles and exacerbated long-standing skills gaps

Labour shortages are being felt across a variety of different sectors in lower and semi-skilled roles, including those which are not eligible for visas under the UK's new point-based immigration system. The aviation industry is facing difficulty finding security staff and baggage handlers, for example. In hospitality – which currently has one of the highest vacancy rates – firms are competing for chefs, kitchen and catering assistants as well as housekeepers and waiters. In logistics, many firms are warning of severe shortages of forklift drivers and warehouse workers.

The rise in labour shortages has exacerbated the problem of long-standing UK skills gaps, from engineering to roles requiring digital skills. Across all sectors, there is increasing demand for and a concern that digital skills gaps are growing, risking firm's ability to compete. These range from basic to advanced digital skills such as software engineers and data analytics. The availability of people with these skills is low so firms face particular challenges losing digitally trained staff in today's tight labour market. Many sectors also face changing skills demands, with the transition to net zero and a limited pool of workers with these skills, which presents an urgent need to upskill existing staff. Sectors where green skills are missing include construction, which faces gaps in specialist building installers, and in the automotive industry which faces a shortage of people with the skills to build electric vehicles.

Businesses are changing their practices to attract and retain talent in a tight labour market, but targeted immigration and skills reform is needed to boost business confidence

With labour shortages expected to persist, businesses are prioritising investing in measures to be employers of choice and enhance productivity. Most CBI members have invested in pay to help them attract candidates, and many have invested in their employee value proposition too. Common strategies include redesigning jobs to make them more attractive, embracing more hybrid and flexible working and investing in brand image to ensure they stand out, and embracing diversity and inclusion strategies to help widen their talent pool and attract people from across society. On top of this, businesses have been looking to upskill their current workers to fill shortage roles and adopt new technology to improve productivity in the long-term.

But business action will only have effect if it's backed up by skills and immigration policies that respond to economic need. Not being able to hire the people they need is a major drag on business confidence. The government should help businesses hire when domestic workers are not available by commissioning the Migration Advisory Committee (MAC) to recommend a new Shortage Occupation List and granting temporary visas for roles in obvious shortage until their review is finalised. Roles at all skills levels are important to the economy, so CBI members think there should be flexibility in the immigration system such that where there's evidence of persistent domestic labour shortages, as advised by the MAC, people in roles below RQF level 3 can enter the UK if the salary threshold is met.

CBI members also want the government to add immediate flexibility to the apprenticeship levy for one year, allowing all UK employers to use their levy funds to tackle labour shortages by upskilling employees to fill in-demand roles. While apprenticeships themselves are part of the solution, and the UK should continue to increase the number on offer, fulfilling the UK's skills needs requires a broader mix of training solutions. For example, through short intensive courses that enable staff to be upskilled quickly to meet business needs. Updating the list of eligible qualifications for the Lifetime Skills Guarantee would also help businesses respond to the changing needs of the economy and help to solve labour shortages. Upskilling is of mutual social and economic benefit, with employees able to learn new skills that will benefit them throughout their working lives.

Business and government both have a role to play to support labour market activation

While employment rates increasing are signs of a strong recovery, the inactivity rate – the number of people who are neither working nor actively looking for work – increased during the pandemic and failed to fall back. Inactivity rates currently stand at 21.3% (8.8m people)[7] compared to 20.2% (8.3m people) in December-February 2020[8]. Of those people, 1.7 million are currently inactive but would like to work – marking 20% of the total inactivity pool. When breaking down the causes for inactivity, long-term sickness (30.6%), caring responsibilities (22.4%) and studies (20.6%) are the main reasons cited for being out of work. Economic inactivity due to long-term ill health is at its highest for 20 years, likely due to a combination of factors including delays to treatment, pre-existing conditions worsening during the pandemic, and the impact of long-covid[9]. People who are economically inactive and looking for work are a new potential labour pool that require proactive measures from employers and government to support into work.

Firms are introducing phased retirement and mid-life reviews to support retention of older workers…

Breaking down inactivity rates by age shows that the rate is highest amongst 50–64-year-olds; by the mid-2030s half the adult population will be over 50[10]. This has significant implications for employers and the labour market. If current workforce exit-rates continue for the over-50s, the labour shortages businesses are already facing may grow[11].

The ability of employers to retain older workers will be vital for productivity – with the potential for £88.4bn to be added to the UK economy if the employment rate of older workers matched those aged 30-40[12]. With five generations in the workforce – the most age-diverse workforce in history – firms are focused on retaining and developing older, more experienced workers, and finding ways to transfer knowledge and skills to younger staff before they retire. Strategies deployed by CBI members to retain older workers includes phased retirements, mid-life reviews that prepare employees for the next phase of their career by looking at work goals and retirement funding, and returnship or apprenticeship programmes. Offering flexible working is another common strategy deployed by firms.

…but government action is needed to help tackle long-term sickness that results in older workers leaving the labour market

The government also has a role to play to support older workers to participate in the labour market. One of the primary reasons older workers leave is due to sickness and ill-health. Employers know that their actions are key in supporting staff with health conditions to return from sickness absence and remain in work – this is why many businesses are changing practices from engaging earlier with staff on sick leave about return and investing in occupational health services, through to offering workplace modifications and paying occupational sick pay.

Throughout the pandemic, firms continued to place an increased emphasis on the health and wellbeing of their employees – with 46% of businesses reporting an increased effort to improve workplace health[13]. But cost remains a significant barrier, and reforms to Statutory Sick Pay are long overdue. CBI members believe the government should update rules to allow payment of part wage and part SSP (pro-rate) to encourage phased work returns, widen eligibility to employees who earn less than the Lower Earnings Limit, and introduce a rebate so more employers can afford investment in managing sickness absence and supporting early returns to work. The government can also support businesses to invest in their employees' wellbeing by revising existing policies to make them representative of current workforce health risks. For example, the current *expenses and benefits: medical or dental treatment and insurance policy* should remove the incentive as a benefit in kind and expand the tax-exempt provisions to reflect the current and increasing health offer provided by businesses across the economy which focus on the three highest workforce health risks: musculoskeletal conditions, ergonomics, and mental health.

Reducing the financial burden of childcare would help to promote greater levels of female participation in the labour market…

Women are currently overrepresented in the inactivity statistics, widely seen as due to women bearing the majority of caring responsibilities. Survey data suggests that many women are not leaving the labour market out of choice, but as a result of a financial decision based on the cost of childcare – with 43% of working mothers considering leaving their jobs, and 40% working fewer hours than they wanted to because childcare fees were unaffordable[14]. The UK has the highest childcare costs (as a share of household income) in the OECD and childcare accounts for half or more of women's median earnings in a two-earned household in the UK, compared to the net OECD average cost of 17%[15]. Many businesses are helping working parents with the cost of childcare, such as providing on-site creche facilities, childcare vouchers, or implementing flexible working policies to help working parents work in a way that supports their childcare responsibilities. But to help businesses tap into this pool of talent, and promote greater female participation in the labour market, the government should prioritise reducing the financial burden of childcare.

…and employment regulation can support people to best manage home and work

Caring responsibilities are one of the main reasons people are economically inactive. CBI members have always been clear that they are willing to incur financial and administrative cost where they think it will improve fairness in the labour market, such as helping people manage their home and work life. That's why they support government playing a role to support older workers, working families and carers access flexible working by removing the 26-week qualifying period so employees are eligible to request flexible working from day one of employment, and enabling employees to make two requests for flexible working per year to allow for changing circumstances.

The government's proposals to end one-sided flexibility by ensuring employers provide workers with notice of their shift schedules and compensation for last-minute shift cancellations are also welcomed by business. This will provide greater certainty to help people plan their home and work commitments and offset fixed costs like travel and childcare. With women and older workers often leaving the labour market prematurely to care for relatives, businesses were also supportive of the government's proposals to introduce new family friendly policies, such as a right to neonatal leave and pay and carers leave.

Investing in technology drives productivity and is helping firms address labour shortages

Technology adoption is one of the greatest productivity drivers – with the CBI's Seize the Moment report finding that AI diffusion could add £38bn to UK GVA in 2030 and a potential 1.4% uplift in productivity across sectors, through task automation of tasks[16]. In a recent survey, one in four companies said that labour and skill shortages were the main driver for AI adoption, and 59% said that AI is helping them address shortages by automating repetitive and manual tasks[17]. This can allow businesses to increase productivity and redeploy staff to shortages roles, and is associated with higher job satisfaction as staff can spend more time on interpersonal engagement, high-level decision making and creative assignments.

Expanding existing government programmes could help to accelerate technology adoption and bridge disparities in uptake between sector and size

The use of AI in UK firms lags other major European nations, with around a third of UK CTO's accelerating their AI rollout in the past two years, compared with a European average of 49%[18]. UK companies in the finance and TMT (Media and Telecom) sectors report the highest level of AI adoption at a released or advanced stage (52% and 38% respectively). This compares to the infrastructure and industrial products industries, where only 40% of organisations are at the piloting or released stage[19]. Across size, the CBI's Tech Tracker report found that over two-fifths (42%) of large business respondents said they had applied AI to their business operations, compared to just 15% of SMEs[20].

To accelerate technology adoption across all sectors, the CBI thinks the government should expand the Made Smarter Programme, currently for manufacturing businesses, and fund a pilot to support AI adoption in other high-value sectors to drive productivity. The CBI thinks this should start with transport, construction, and hospitality sectors, and consider others which would benefit from similar support. Members also want the government to expand the scope of technologies covered under the Help to Grow Digital scheme to enhance SME technology adoption, expanding its scope to cover technology such as cloud computing platforms, cloud storage, and project management tools.

Businesses support the government's approach to AI governance and see their role in reskilling for labour market transition

AI brings unprecedented opportunities for increased growth and productivity, but also new challenges for businesses and governments – from building trust and crafting regulation fit for the future, to meeting digital skills needs. Ahead of the AI governance white paper, the UK has a real opportunity to establish a cutting-edge governance framework that drives AI adoption and sets the global standard for AI governance. Businesses recognise the importance of AI governance and standards in driving the safe and trustworthy adoption of AI and have responded favourably to the UK's industry-led approach focused on standards and assurance, compared to the EU's regulation driven-approach.

Businesses see the adoption of automation as going hand in hand with reskilling. For some firms, this involves supplementary training courses to help employees become more proficient with readily available technologies, while for others this is a longer-term commitment while roles are transformed. To support businesses to reskill, the government should prioritise making the UK's skill system flexible enough to address different upskilling needs. This would help businesses prepare employees for a changing world of work through lifelong learning and best leverage their investments in automation.

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[1] Investing in People: CBI/Pertemps Employment Trends Survey 2021, CBI, 2021

[2] CBI Economic Forecast, CBI, June 2022

[3] This is the result of a CBI pulse check survey put to CBI council members. They survey received 189 responses from a variety of sectors across the UK and in was in field from 9 May to 7 June 2022.

[4] CBI Industrial Trends Survey, CBI, April 2022

[5] CBI Service Sector Survey, CBI, May 2022

[6] Monetary Policy Report, Bank of England, May 2022

[7] Labour Market Overview, Office for National Statistics, June 2022

[8] Labour Market Overview, Office for National Statistics, February 2020

[9] Labour Market Statistics, Office for National Statistics, March-May 2022

[10] Future of an Ageing Population, Government Office for Science, 2016

[11] A new vision for older workers, retain, retrain, recruit, Altman, R. 2015
[12] The Missing Million: Recommendations for Action, Business in the Community, 2015
[13] Seize the Moment, CBI/McKinsey, 2021
[14] '1 in 4 parents have had to cut down on heat, food & clothing to pay for childcare', Pregnant then Screwed, March 2022
[15] 'Is Childcare affordable?' OECD, June 2020
[16] Seize the Moment: How Can Business Transform the UK Economy? CBI, 2021
[17] IBM Global AI Adoption Index, IBM, 2022
[18] IBM Global AI Adoption Index, IBM, 2022
[19] Data Foundations and AI adoption in the UK private and third sectors, EY, 2021
[20] Tech Tracker 2020: The Innovation Imperative, CBI, 2020