

# Resolution Foundation

## REPORT

### The road to full employment

*What the journey looks like and how to make progress*

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## Acknowledgements

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# The Resolution Foundation full employment project

This report marks the conclusion of a nine-month investigation into full employment conducted by the Resolution Foundation in partnership with Professor Paul Gregg, Director of the Centre for Analysis of Social Policy at the University of Bath.

Previous publications from this project are as follows:

- » P Gregg & A Corlett, *An ocean apart: The US-UK switch in employment and benefit receipt*, Resolution Foundation, June 2015
- » P Gregg & M Whittaker, *Completing the job: The pursuit of full employment*, Resolution Foundation, July 2015
- » P Gregg & L Gardiner, *A steady job? The UK's record on labour market security and stability since the millennium*, Resolution Foundation, July 2015
- » P Gregg & D Finch, *Employing new tactics: The changing distribution of work across British households*, Resolution Foundation, January 2016.

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## Executive Summary

‘Full employment’, for so long considered an unreachable relic of a bygone age, is back on the agenda. That it is once again part of economic and political debates is testament to the UK’s remarkably strong employment performance in recent years. A record-high employment rate – topping 74 per cent – is something few people would have thought possible this soon after the most sustained economic downturn in living memory. With every month of further good news in the employment statistics, expectations of what may be possible are shifting, and the question of how much further we might expect to go increases in relevance.

It is in this context that the Chancellor has committed to full employment as an ambition for the government, targeting the highest employment rate of G7 economies and a 2 million employment increase within this parliament under this banner.

Welcome though such ambition is, with no universally-agreed definition of full employment and no further detail on the government’s approach at present, it is not clear just what these targets represent, who they benefit, or how they should be achieved. This report addresses these questions. It sets out a vision for jobs growth that doesn’t just move us along the road to full employment, but delivers the strongest social and economic benefits as well.

### **Full employment is the surest route to delivering progressive living standards gains**

With wage growth having disappointed for more than a decade and reductions in working-age state support associated with fiscal consolidation, **rising employment in recent years has been key to supporting household living standards. Importantly, its effect has been inequality-reducing:** employment gains have been wholly concentrated among households on lower incomes. The result is that incomes for those in the bottom half of the distribution fell less sharply post-crisis, and then picked up more quickly than the incomes of those at the top.

This fits into **the longer-term story for low and middle income households over the past half-century: to a greater or lesser extent rising employment, particularly for women, has been a key factor in boosting incomes,** alongside the role of the working-age benefit system.

With working-age benefits and tax credits already declining in value and the outlook for wages currently uncertain, the expectation is that income inequality will begin increasing in coming years, reversing the recent pattern. Further improvements in employment for workless adults in the UK – who are unsurprisingly strongly concentrated in the bottom half of the income distribution – can form a key line of defence against such an outcome. **A concept of full employment that goes beyond a statistical reckoning of labour market potential or a fiscal reckoning of the tax boost it can deliver sits at the heart of meeting the country's living standards challenge and achieving inclusive prosperity.**

### **A definition of full employment rooted in the UK labour market experience**

On this basis, our concept of full employment moves away from the international benchmarks or arbitrarily-determined figures that are common. Rather, it is deeply rooted in the characteristics of those out of work in the UK and the labour market experience in different parts of the country. We do not claim to be presenting the definitive final word on full employment. Indeed, we recognise that expectations of what's possible can shift, and set a full employment benchmark that is time-specific as a result, taking us to the end of the parliament in 2020-21. We believe that **this 'bottom up' approach has the benefit of being stretching but achievable, with a clear connection to policy possibilities.**

A key feature of worklessness in the UK that underpins our concept of full employment is that the unemployed – the common focus of efforts to drive employment higher – are dwarfed in number by the economically inactive. This implies **that sizeable further employment increases that benefit households in the UK will require expanding the labour force via increased economic activity, or participation.** A narrow focus on just the unemployed – and particularly an even narrower focus on benefit claimants – will quickly run out of road.

With this participation focus we find that, perhaps unsurprisingly, **groups displaying traditional labour market disadvantages – young people, older people, the low-qualified, mothers and single parents, disabled people, and black, Asian and minority ethnic (BAME) people – tend to experience lower participation rates than the average.** We refer to these as ‘low activity’ groups. We note that while these groups generally experience lower participation, rates have often improved more rapidly than the average, with the progress for single parents and older people particularly marked. This implies that economic- or policy-driven changes in participation are possible.

As well as their overall participation ‘penalty’, we find **substantial variation in participation rates for low activity groups across different sub-regions of the country.** For example, in 2014-15:

- » The participation rate for **disabled people** was 35 per cent in Northern Ireland, compared to a rate of 53 per cent in the South East of England.
- » The participation rate for **low-qualified** people was 57 per cent in Merseyside, compared to a rate of 69 per cent in the East of England.
- » The participation rate for **50-64 year olds** was 61 per cent in Merseyside, compared to a rate of 76 per cent in both the East and South East of England.

On the basis of these observations, our definition of full employment models geographical convergence in participation (and unemployment) outcomes for low activity groups towards the tightest sub-regional labour markets in the East and South East of England. Beyond this – because even the best areas may not be at full employment for certain groups at present, and because environmental and policy changes can move the dial for particular groups – we seek further improvements over time, based on a continuation of recent trends for these groups. We also factor in population growth so that our full employment measure can be expressed in terms of numbers in work.

**Our definition of full employment therefore has as its goal a country in which the area you live in doesn’t bear down on your labour market outcomes relative to others with similar characteristics, and where the usual markers of disadvantage play a declining role.** Certainly this is a stretching prospect, but we think it is one worth striving towards.

## Full employment by the end of the parliament

Taking this approach, our benchmark for full employment is an increase in the 16-64 year old employment rate to 78 per cent by 2020-21, 3.9 percentage points higher than the current rate. **This would represent an additional 2 million people in work** relative to today, pushing the total number of people in work to 33.9 million. **Compared to the end of the previous parliament – the point from which the Chancellor’s set his ambition for a 2 million jobs boost – our full employment measure entails an increase in the number of people in work of 2.4 million. Our measure is therefore slightly more stretching than the Chancellor’s**, and provides a picture of what his commitment could constitute and how it could be achieved.

Beneath this headline total, some important features of our full employment measure are worth highlighting:

- » **The majority of the employment increase (75 per cent) is a result of rising participation**, that is, new entrants to the labour force. This underscores the limitations of a full employment agenda solely focused on driving unemployment downwards.
- » **Those in low activity groups experience large increases in their employment rates**, in particular disabled people, the low-qualified and BAME groups. For example, our measure entails an increase of almost 1 million in the number of disabled people in work.
- » **The lowest-performing parts of the country experience the greatest employment gains**, with an increase in the employment rate of more than 10 percentage points in Merseyside and the rural North East.

It should be clear that the individuals and areas that experience the largest employment gains on our measure of full employment are strongly aligned to its potential role in driving inequality-reducing improvements in UK living standards.

## Changing economic conditions mean further rapid employment increases are not a given

Our ‘bottom up’ approach to defining full employment means our measure is rooted in what is possible. Indeed if the pace of recent rapid employment growth were maintained, our full employment benchmark would be surpassed



before the end of the parliament. However, it would be wrong to conclude that full employment is likely to occur automatically.

In fact, approaching policy headwinds suggest the prospects for further employment increases look less rosy than they did a year or two ago. Employer labour costs are set to rise as a result of the ongoing roll-out of pensions auto-enrolment, and the introduction of the National Living Wage and Apprenticeship Levy. Each of these measures provides important new protections and boosts to those in work. But – all else equal – they are also likely to push back against the recent trend towards ever-higher employment levels.

Of course, all else doesn't have to be equal. Efforts to boost demand can drive up job quantity alongside job quality. However, our modelling suggests that, while rising demand can encourage those in low activity groups to join the workforce, it can only get us so far along the road to full employment. And we need to consider *where* the demand is located. For it to drive up employment for out-of-work people in the UK, rather than boosting employment for migrant workers, it must occur in the lowest-performing parts of the country.

**Full employment, then, requires an active policy focus. This is both in terms of ensuring that the demand that can prompt some low activity groups to participate is concentrated in the areas it is most needed, and in terms of pushing employment for all groups further still.**

### A 'post-crisis' policy agenda for achieving full employment

On this basis, we advocate a new policy approach driving towards full employment, dealing both with the specific challenges facing individual low activity groups, and with the overarching conditions conducive to progress. Drawing on our analysis of the UK labour market in recent decades, this approach has the following features:

- » It reaches beyond unemployment and benefit receipt to focus more broadly on **raising participation in the workforce**, crucial for groups such as young people, for whom the major challenge is ineffective school-to-work transitions, meaning too many disengage altogether.
- » It moves away from the conventional focus on entry into work and places a **new emphasis on reducing (or delaying) employment exits**, crucial for older workers and those becoming disabled.

- » It considers not just formal policy levers but also how these are normalised and interact with **cultural factors, including discrimination**.
- » It recognises that **location is of central importance**, both in terms of shaping policy interventions to the needs of local populations, and in the need to deliver a more equitable distribution of employment demand across the country.

On this basis, we offer 12 high-level policy directions as the starting point for a response equal to the full employment challenge, with more specific recommendations and suggestions beneath each of these. Our policy directions are summarised in Table 1.

Full employment is a high-value goal, and the record employment performance of recent years gives grounds for hope, but not complacency. Now, eight years on from the crisis-driven fall in employment, it's time for a post-crisis approach. The task is by no means easy, but we believe that a policy agenda such as the one we have put forward can set us on the road to full employment and genuinely inclusive growth: a destination well worth targeting.

Table 1: A policy agenda for achieving full employment: summary of our approach

A policy agenda aligned to the challenges faced by different 'low activity' groups	
By minimising employment exit	And by maximising entry to employment
<p><b>For mothers and single parents:</b></p> <p><b>1.</b> The government must defend the UK's impressive record on maternal employment by protecting financial incentives to stay in work and ensuring that rights and regulation around childbirth are normalised and embedded.</p> <p>&gt;&gt; Reverse plans to weaken work incentives in Universal Credit.</p> <p>&gt;&gt; Enhance initial Shared Parental Pay award to encourage take-up.</p>	<p><b>For the low-qualified:</b></p> <p><b>4.</b> The government must use the opportunity provided by the Apprenticeship Levy to ensure that apprenticeships and traineeships are more appropriately targeted towards those transitioning from study, unemployment and inactivity into work.</p> <p>&gt;&gt; Target of half of all new apprenticeships and traineeships allocated to those coming from study or who have been out of work.</p> <p>&gt;&gt; An apprenticeship access fund.</p>
<p><b>For disabled people:</b></p> <p><b>2.</b> The government must use its forthcoming disability employment White Paper to establish a comprehensive strategy not just for boosting employment entry but for minimising employment exit connected to disability and ill-health.</p> <p>&gt;&gt; A disability employment outflow reduction target.</p> <p>&gt;&gt; A statutory 'right to return' of a year.</p>	<p><b>For young people:</b></p> <p><b>5.</b> The government must put in place a system for identifying and engaging those young people struggling in the transition from education to employment.</p> <p>&gt;&gt; A new tracking system with accountability attached.</p>
<p><b>For older people:</b></p> <p><b>3.</b> The government and other organisations must work together to support manageable and sustainable employment flexibility for those approaching retirement.</p> <p>&gt;&gt; Widespread options for part-payment of pensions when reducing working hours.</p>	<p><b>For BAME groups:</b></p> <p><b>6.</b> The government must work with employers to end discrimination on the basis of race and ethnicity, and ensure that employment and skills services effectively engage with BAME groups.</p> <p>&gt;&gt; A new push on 'name blind' recruitment.</p> <p>&gt;&gt; Engage BAME groups in proportion to their prevalence in local workless populations.</p>
Policies to boost employment across 'low activity' groups	
<p><b>7.</b> The government must extend employment support services beyond those engaged with the benefit system to provide assistance to wider workless populations.</p> <p>&gt;&gt; Local 'public employment services' incorporating Jobcentre Plus and other advice and support.</p>	
<p><b>8.</b> Local and national employment and skills funding and resources must be targeted in a way that appropriately accounts for multiple disadvantage.</p> <p>&gt;&gt; The payment model for the new Work and Health Programme.</p>	
<p><b>9.</b> The government must support employers to create good-quality part-time and flexible job opportunities, and do so itself in its role as an employer.</p> <p>&gt;&gt; Prompt employers to offer jobs flexibly when posting on Universal Jobmatch.</p>	
An overarching framework for boosting employment across the country	
<p><b>10.</b> The government must ensure that its infrastructure investment, devolution and full employment agendas are fully aligned.</p> <p>&gt;&gt; National Infrastructure Commission to address transport bottlenecks to further employment growth in forthcoming report.</p>	
<p><b>11.</b> The government must set out a detailed plan for the implementation of the National Living Wage, with a focus on those sectors and parts of the country in which it is likely to bite hardest.</p> <p>&gt;&gt; A broader role for the Low Pay Commission to support areas to overcome blockages.</p>	
<p><b>12.</b> National, devolved and local governments must work together to evaluate and share learning from efforts to raise participation and employment outcomes in their areas.</p> <p>&gt;&gt; The first 'demonstration' projects of the government-backed What Works Centre for Local Economic Growth.</p>	

## Section 1

# Introduction: The importance of full employment

*The fact that full employment is once again a feature of economic and political debates is a testament to the UK's remarkably strong employment and unemployment performance in recent years. Attention is now turning to how much further we can go. However, the importance of full employment extends beyond a statistical reckoning of labour market potential; it is fundamental to prospects for UK living standards.*

*In this first section we summarise recent experiences in the UK in terms of employment, pay and productivity, showing that the strength of the former has been a key driver of inequality-reducing changes in living standards. We then assess the prospects for further employment growth delivering higher living standards, particularly for households on lower incomes – a central goal in our concept of full employment. Finally, we evaluate other economic benefits that full employment, as we define it, can deliver, in terms of wages, the public finances, and the UK's growth potential.*

## Recent strong employment growth has put full employment back on the agenda

The UK's employment and unemployment performance over the past four years has been remarkable. As Figure 1 shows, the 16-64 year old employment rate now stands at a four-decade high of 74.1 per cent, and as far as we can tell also beats the performance during the 1960s.<sup>[1]</sup> Unemployment has not quite returned to its lowest level, but – at 5.1 per cent – it is broadly in line with the pre-crisis average and below the medium-term equilibrium rate the Bank of England assumed was in place just six months ago.<sup>[2]</sup>

This strong labour market performance is all the more remarkable given the depth of the 2008-09 financial crisis. Despite a very sharp reduction in output, employment following the crisis fell by much less and then recovered at least three years earlier than it did in the downturns of the 1980s and 1990s.<sup>[3]</sup>

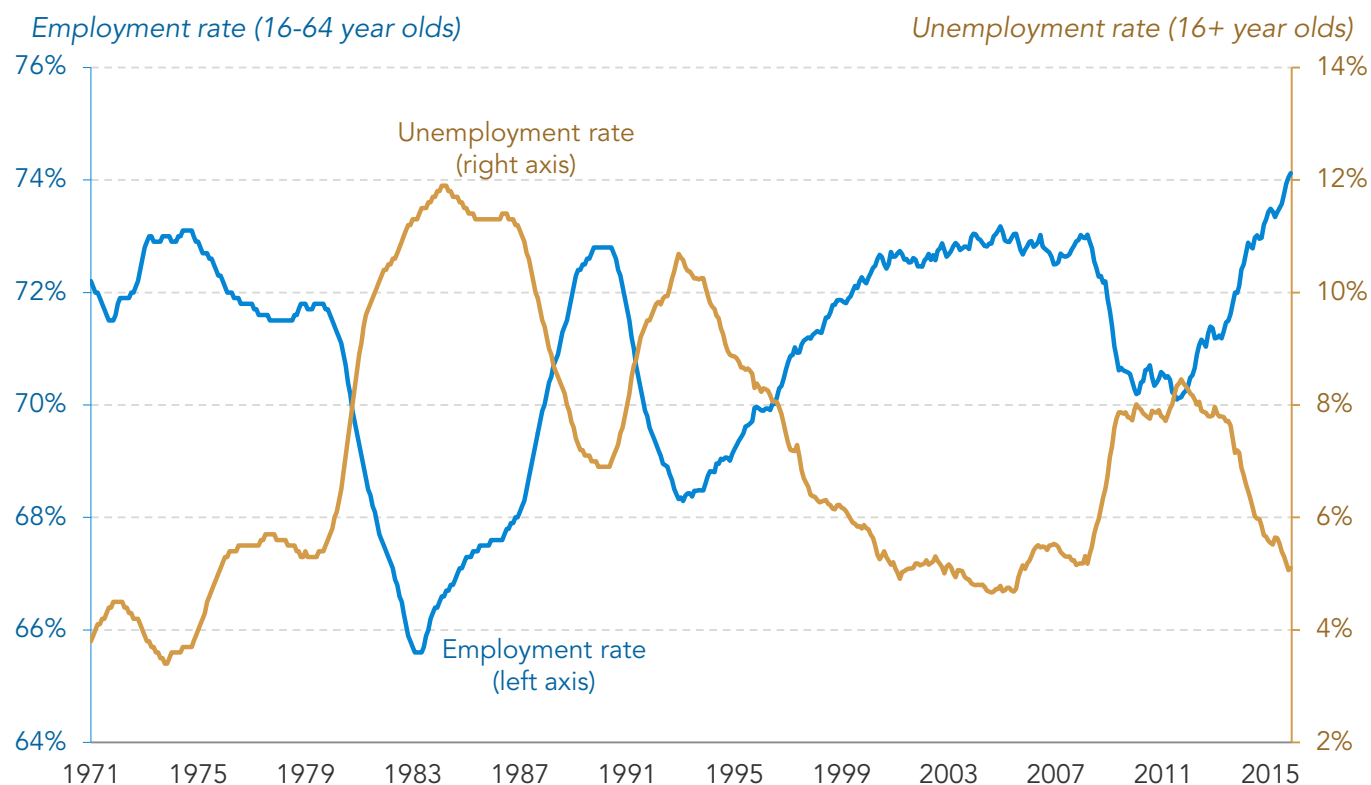
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[1] The data for this period covers a different age range to that now used.

[2] Because much of the employment increase has been a result of more people joining or staying longer in the workforce, especially aged 55+, the unemployment rate (which is measured as a share of the workforce not the total population) has not yet dipped below its past record. Nonetheless, Figure 1 makes clear that the recent progress has been dramatic here too.

[3] UK Commission for Employment and Skills, *The Labour Market Story: The UK Following Recession*, July 2014

Figure 1: UK employment and unemployment: 1971–2015



Source: RF analysis of ONS, Labour Market Statistics

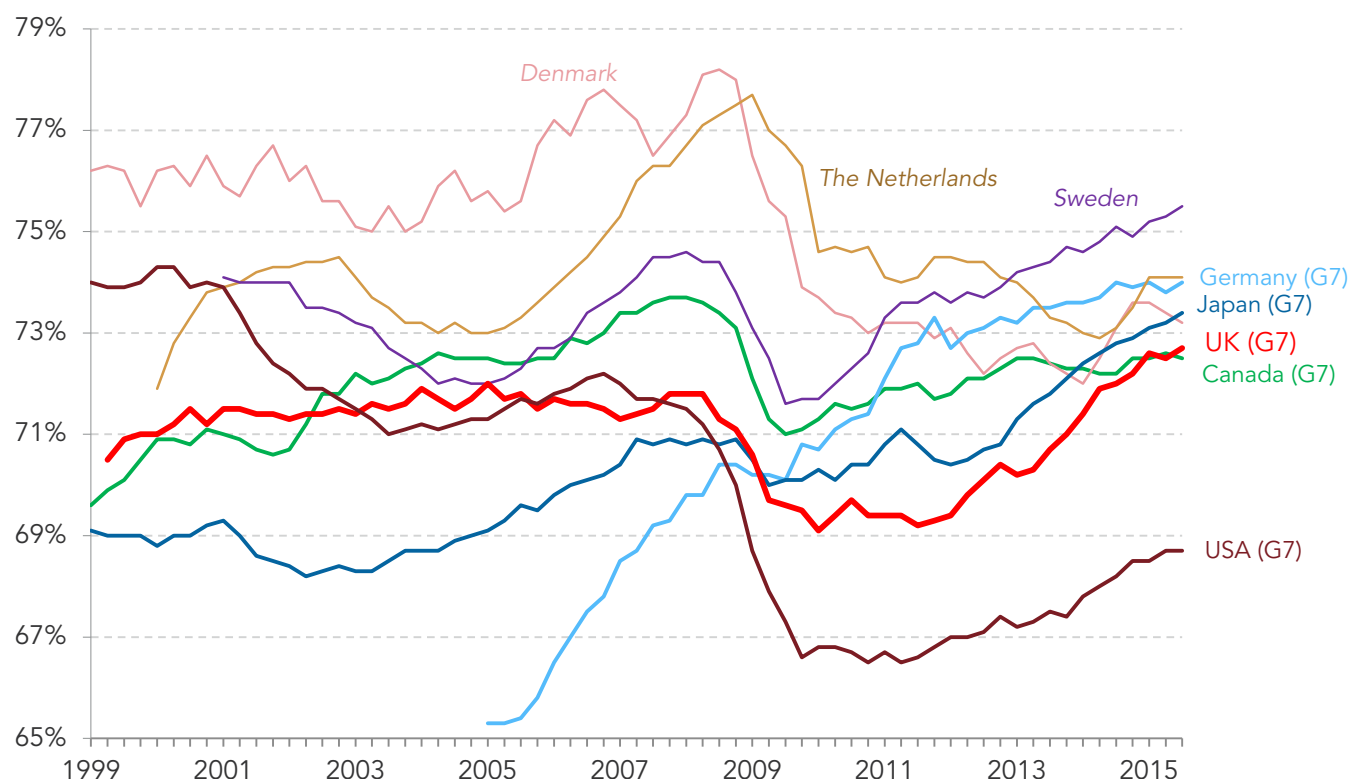
This employment record also compares favourably internationally. The UK currently ranks seventh of 24 developed economies in terms of its employment rate; has recently overtaken Canada to become the third-best performer in the G7; and is making up ground on Germany, Denmark and the Netherlands, as Figure 2 shows. And as previous Resolution Foundation analysis within our full employment project has explored, the UK has left the world's largest economy far behind since the late 1990s, reflecting divergent trends in labour market participation in the US and UK, particularly for prime-age women.<sup>[4]</sup>

[4] For further discussion of recent trends in US employment and participation, see: P Gregg & A Corlett, *An ocean apart: The US-UK switch in employment and benefit receipt*, Resolution Foundation, June 2015



**Figure 2: Employment trends in selected OECD countries: 1999–2015**

Employment rate (15-64 year olds; 16-64 year olds in the USA)



Source: RF analysis of ONS, Labour Market Statistics

In this context, it is perhaps unsurprising that attention is turning to how much further the UK can go, and the concept of full employment has returned to economic and political debates. Despite not being new, there is no universally-agreed definition of this concept and it has been adapted to different aims and agendas at different times, as we discuss in the following section.

Most prominently, the Chancellor has committed to full employment as an ambition for the government (with soon-to-be statutory obligations to report progress<sup>[5]</sup>), targeting the highest employment rate of G7 economies and a 2 million employment increase within this parliament under this banner.

Welcome though these targets are, the lack of further detail means it is not clear that they necessarily represent 'full employment', who they benefit, or how they should be achieved. The primary purpose of this report is to address these three questions, setting out a vision of further employment growth on the road to full employment that delivers the strongest social and economic benefits, and directions for how we might get there.

## Employment has driven living standards for lower-income households before and since the crisis

Set against the good news on employment has been the extremely poor performance of wages in recent years. From 2009 earnings fell for more than five years across the pay distribution, declining

[5] These conditions are set out in the Welfare Reform and Work Bill currently passing through parliament.

nearly 10 per cent in real terms and only beginning to recover in late 2014.<sup>[6]</sup> Such a sustained fall in wages has not been seen in the UK since Victorian times. Now, only a year after the earnings recovery began, real wage growth has already dipped back below its pre-crisis average. And in the short rebound of real wages in 2015, historically low inflation did much of the work.

The twin stories of poor pay performance and employment strength are, of course, linked. This is because the positive employment record has had adverse effects on productivity, the principal driver of pay growth in the long term. It's not always clear which way the causality between productivity and pay runs, but one reading is that the advent of wage restraint driven in part by increases in unemployment up to 2012 meant that hiring extra workers was relatively cheap compared to alternative ways of meeting demand for goods and services within firms, such as investment in capital and operational reorganisation to improve efficiency. This pushed employment upwards, which, coupled with subdued demand, meant that productivity (output per hour worked) stagnated. This productivity stagnation then had a self-reinforcing effect by holding wages back further still.

With wages declining in value and other major sources of income such as working-age benefits broadly flat in real terms, it is the strong performance of employment that prevented a deeper fall in living standards for working age households, and then drove forward the early living standards recovery in the past couple of years (with low inflation providing an additional boost in the recent past).<sup>[7]</sup>

Importantly, as well as driving the recovery in the living standards of working age households, increasing employment has also been strongly progressive in the distribution of these gains. As the right-hand panel in Figure 3 shows (taking adults up to 69 as a broad definition of working age used throughout this report – see Box 1 in Section 2 for details), while employment was lost mainly from the top half of the income distribution during the crisis, the improvements since then have been wholly focused in the bottom four deciles.

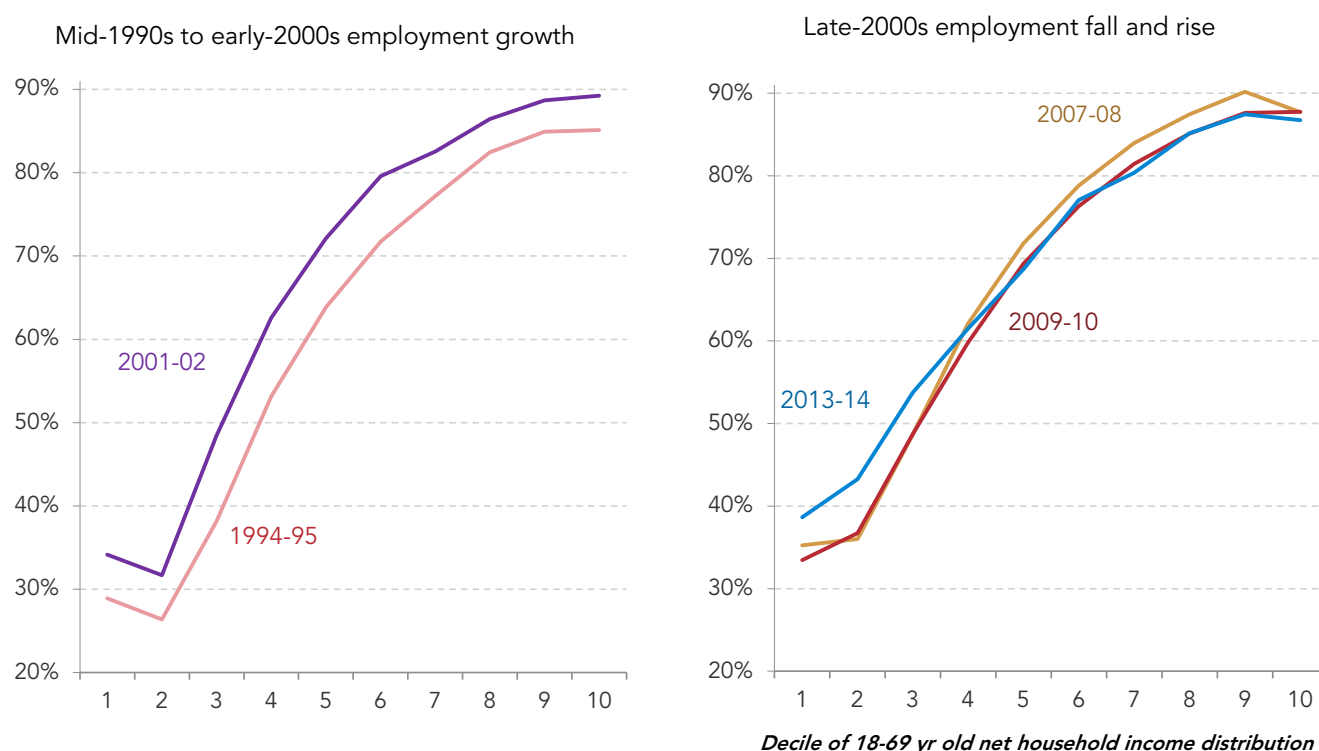
Of course, the patterns shown in the right-hand panel in Figure 3 will likely reflect the fact that some individuals lost jobs or had their pay or hours reduced, and therefore moved down the distribution during the early downturn. But the fact remains that – all else equal – recent employment growth has been inequality-reducing. More recent analysis ‘nowcasting’ changes in the income distribution from 2013-14 to 2015-16 suggests that this pattern has been maintained, with strong employment growth for first earners in particular boosting incomes towards the bottom of the distribution by more than twice as much as incomes at the top.<sup>[8]</sup>

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[6] A Corlett & L Gardiner, *Low Pay Britain 2015*, Resolution Foundation, October 2015

[7] A Corlett, D Finch & M Whittaker, *Living Standards 2016: The experiences of low to middle income households in downturn and recovery*, Resolution Foundation, February 2016

[8] J Browne & A Hood, *Living Standards, Poverty and Inequality in the UK: 2015-16 to 2020-21*, Institute for Fiscal Studies, March 2016

**Figure 3: Employment rates across the income distribution: UK, 1994-95–2013-14***Employment rates by decile of the 16-69 year old equivalised net household income distribution*

**Notes:** Households are included in this analysis if they contain at least one adult aged 16-69. This age range is used to be consistent with the broad working age definition we use to assess full employment in subsequent sections of this report – 18-69 year olds – however banding of age variables in the Family Resources Survey means we reduce the lower age limit to 16. See Box 1 in Section 2 for details of the population in scope for analysis throughout this report.

**Source:** RF analysis of DWP, Family Resources Survey

The left-hand panel in Figure 3 highlights that while employment growth has had inequality-reducing effects in recent years, this is not always the case. During the last period of sustained employment recovery (from the mid-1990s to the early-2000s) employment rose roughly evenly across the distribution. In other words, employment growth benefiting the bottom significantly more than the top is not a given.

Nonetheless, the recent experience is part of a longer-term trend where, for low and middle income households in particular, income growth since the 1960s was driven by rising employment, particularly among women, in conjunction with the increasing role of working-age benefits via, for example, the introduction of the tax credit system. Wage growth also played its part, but was less of a driver of income growth for low and middle income households than for others.<sup>[9]</sup> To varying extents, employment growth has been a key component of rising living standards for lower-income households over the past half-century.

## Sustaining the employment boom is key to further living standards improvements

With working age benefits and tax credits already declining in value and set to be reduced further over this parliament, and the outlook for wages currently uncertain although likely to be helped by the introduction of the National Living Wage, additional improvements in employment

<sup>[9]</sup> M Brewer & L Wren-Lewis, *Why did Britain's households get richer? Decomposing UK household income growth between 1968 and 2008–09*, Institute for Fiscal Studies, December 2011

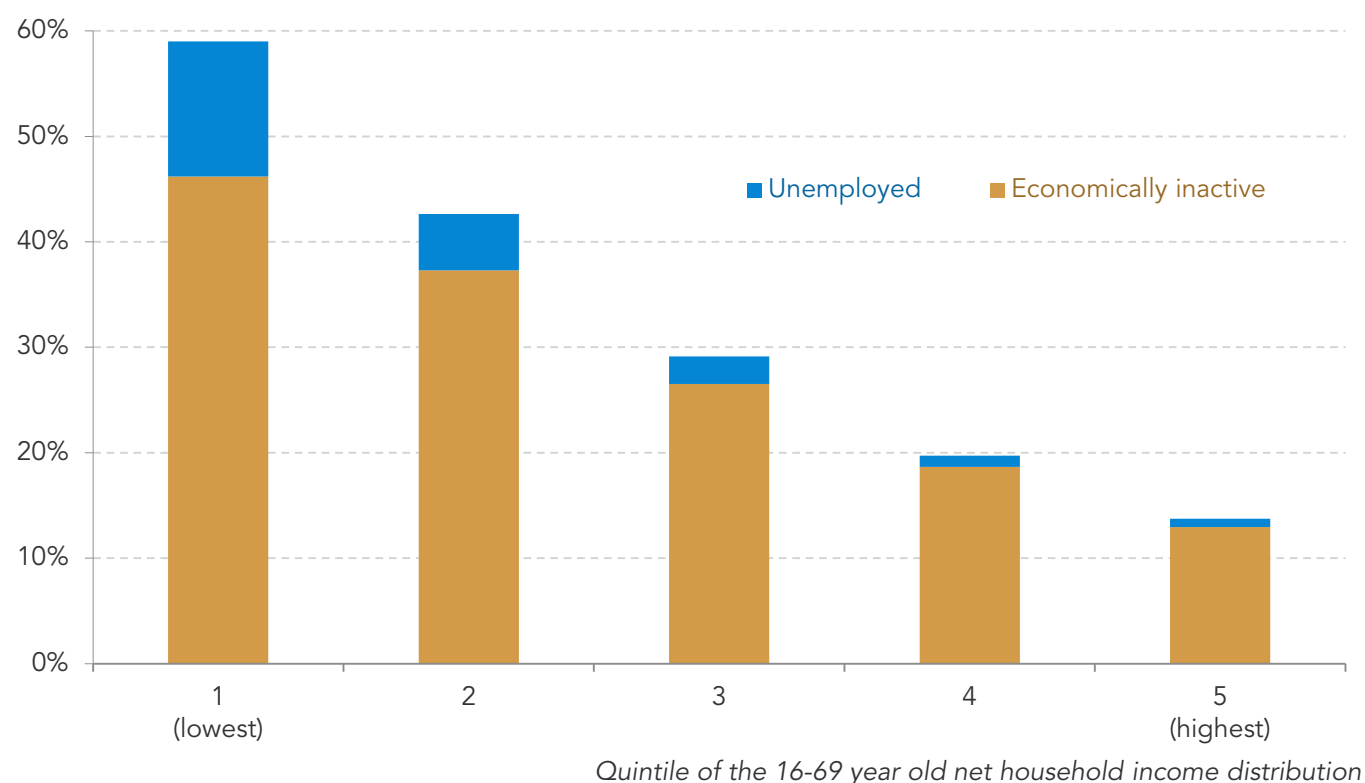
for groups ‘missing’ from the workforce look like the surest place to put our hopes for creating inclusive prosperity.

This is principally because, perhaps unsurprisingly, the remaining adults who aren’t in employment are strongly concentrated at the bottom of the income distribution, as shown in Figure 4. This shows that 60 per cent of workless adults are in the bottom 40 per cent of the distribution, and looking within quintiles, we see that nearly 60 per cent of adults in the poorest fifth of the 16-69 year old household population are not in work. Therefore, further employment increases are very likely to contribute to progressive improvements in living standards.<sup>[10]</sup>

Within this picture, Figure 4 highlights a key feature of today’s working age, workless adult population: the majority of out-of-work adults are economically inactive rather than unemployed. This implies that sizeable further employment increases that benefit households in the UK will require expanding the labour force via increased economic activity, or participation, and a narrow focus on just the unemployed (and particularly an even narrower focus on benefit claimants) will quickly run out of road. This participation-centric approach is at the heart of our concept of full employment, discussed in the following section of this report.

**Figure 4: The distribution of out-of-work adults: 2013-14**

*Workless adults as a share of all adults in each quintile of the 16-69 year old equivalised net household income distribution*



**Notes:** Households are included in this analysis if they contain at least one adult aged 16-69. This age range is used to be consistent with the broad working age definition we use to assess full employment in subsequent sections of this report – 18-69 year olds – however banding of age variables in the Family Resources Survey means we reduce the lower age limit to 16. See Box 1 in Section 2 for details of the population in scope for analysis throughout this report.

**Source:** RF analysis of DWP, Family Resources Survey

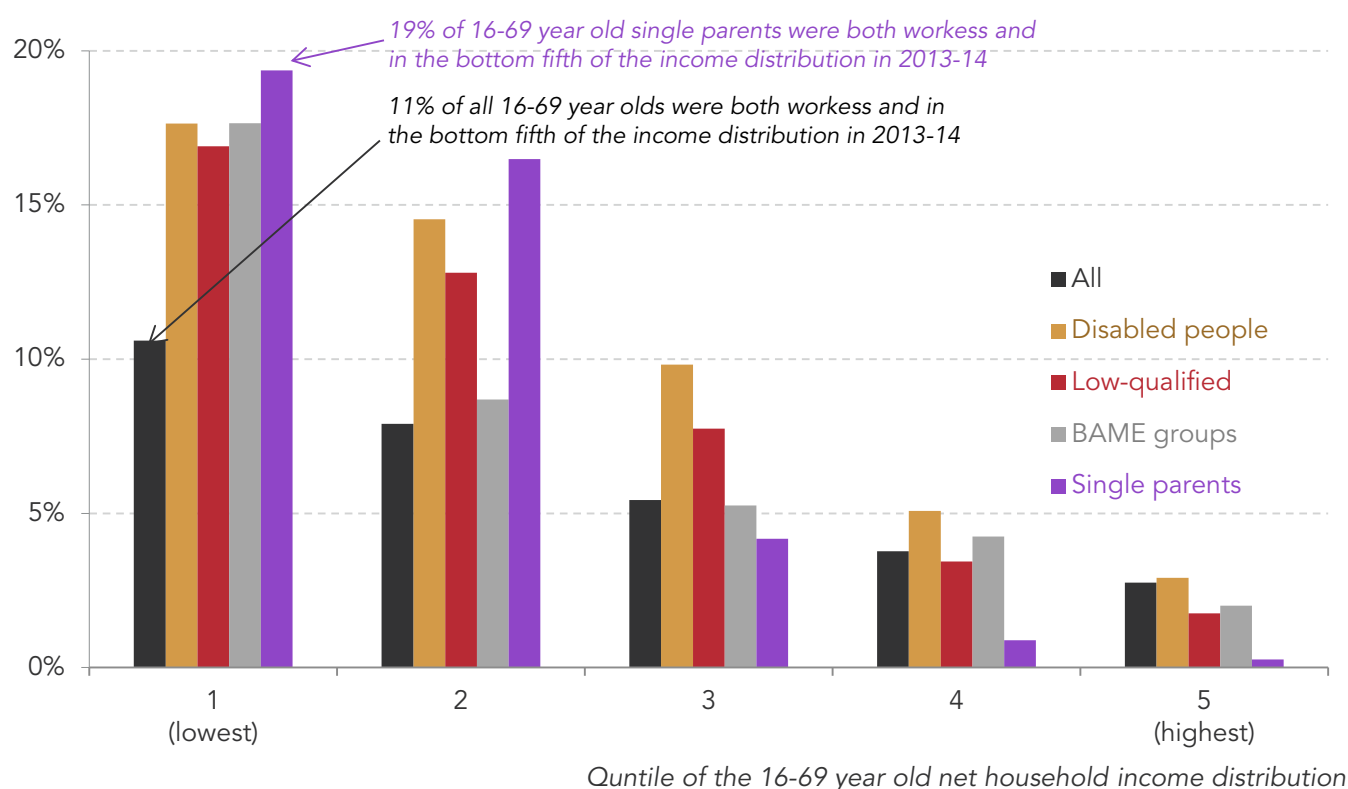
<sup>[10]</sup> That is, if they draw in these people, rather than principally attracting workers outside the UK, for example.

Figure 5 provides more detail on the distribution of out-of-work adults. It reinforces the finding that those out of work are most heavily concentrated within lower-income households, and also highlights the even greater concentration at the bottom of the distribution among those with a disability; low levels of qualifications; from a black, Asian or minority ethnic (BAME) group; or with single parent status. It shows, for example, that around 30 per cent of all adults are out of work, with 11 per cent falling in the bottom fifth of households. Among single parents, the overall proportion is higher at 40 per cent, and relatively more (19 per cent) fall in the bottom quintile.

This means that the more strongly tilted towards these groups future employment gains are, the richer the rewards in terms of raising the living standards of the poorest. As with our focus on participation, these groups lie at the heart of our assessment of full employment discussed in subsequent sections of this report.

**Figure 5: The distribution of out-of-work adults by individual characteristics: 2013-14**

*Workless adults as a share of adults in each quintile of the of the 16-69 year old equivalised net household income distribution*



**Notes:** Households are included in this analysis if they contain at least one adult aged 16-69. This age range is used to be consistent with the broad working age definition we use to assess full employment in subsequent sections of this report – 18-69 year olds – however banding of age variables in the Family Resources Survey means we reduce the lower age limit to 16. See Box 1 in Section 2 for details of the population in scope for analysis throughout this report. In contrast to definitions used elsewhere in this report, here disability is defined according to the Equality Act 2010 definition, and the low-qualified are those with qualifications at GCSE level or below.

**Source:** RF analysis of DWP, Family Resources Survey

In addition to the groups identified in Figure 5, we give particular consideration to younger and older people at the beginning and end of careers in this analysis. This is because this is when the major transitions into and out of the workforce are made, and increasing (or speeding up) ‘inflows’ and reducing (or delaying) ‘outflows’ are the two practical avenues to achieving a higher employment total. A balanced focus on both employment entry and exit therefore also lies at the heart of our concept of full employment and how it can be achieved.



In sum, if future employment growth focuses only on lowering unemployment, reducing the welfare bill or employing migrant workers, for example, it stops short of being a high-value goal. Employment growth must be strongly drawn from the wider workless population in the UK, focus on the major workforce transitions and target the characteristics disproportionately represented among lower-income workless adults if it is to deliver sizeable numbers and achieve its living standards potential. For employment gains to result in full employment, in our view, they have to work for these groups.

## The road to full employment is relevant to other central economic concerns

As well as its central role in driving living standards for working age households, our concept of full employment offers other rewards. First, as unemployment falls further and available workers grow more scarce (while we have said that unemployment is an insufficient focus for a full employment agenda, it necessarily remains the first port of call), wage increases should materialise for lower-paid workers in particular.<sup>[11]</sup> Although such pressures haven't been evident very recently, our view is that they will arrive, albeit with unemployment potentially having to fall further than it did in the past.<sup>[12]</sup>

But this relationship of course cannot deliver endlessly – there is a saturation point to falling unemployment driving rising wages. This is because higher labour costs prompt firms to be more efficient in their use of labour, boosting productivity but all-else-equal reducing the demand for workers. In addition, monetary policy will respond to wage-driven inflationary pressures by reducing the pace of growth in the economy. It is worth being aware of this theoretical underpinning, even though this feels like a distant problem at present.

This is where a broader concept of full employment than one that is only linked to unemployment can deliver. Boosting labour force participation – itself likely to be partly driven by the tightening labour market and improved wage offer, as we show in Section 3 – can delay this crunch point, allowing the economy to grow more rapidly for longer. Of course, by bringing more and often lower-skilled people into labour supply, it will also slow the pace of falling unemployment and have a moderating impact on wages. But rising participation is highly unlikely to be sufficiently fast to stop unemployment falling. Our view is that any effects on unemployment and wages are temporary as the extra labour force is absorbed, and the sustainable rate of unemployment in the economy isn't permanently altered.

In this way, boosting the size of the labour force pushes out the point at which employment is moderated by accelerating wages or by the central bank, offering the potential to achieve higher growth without inflationary pressures.

Of course, more people in work also has a beneficial impact on the working-age welfare bill and can boost tax receipts. And it helps the UK cope with an ageing population and the demands it places on society, the economy and public expenditure.

## Securing full employment

Full employment, then, has the potential to make the UK a world leader on employment, can play a very significant role in living standards improvements that are especially concentrated at the bottom, and should benefit us all via indirect effects on wages and the public finances.

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[11] For evidence of this lower-paid bias in unemployment-driven wage gains, see: D Baker & J Bernstein, *Getting back to full employment: A better bargain for working people*, Centre for Economic and Policy Research, 2013

[12] For a discussion of how the relationship between unemployment and real wages has changed, see: P Gregg & S Machin, *What a drag: The chilling impact of unemployment on real wages*, Resolution Foundation, September 2012

That's why we've made full employment the focus of a major investigation over the past nine months, with this report as its conclusion. In previous publications within our full employment project we've considered how the concept can be defined; looked at trends in UK employment, worklessness and job quality; and compared the UK experience to that in other countries.

In this final report, we update and extend our analysis to arrive at a definition of full employment and set out a policy agenda for achieving this ambition.

The remainder of this report is laid out over four sections:

- » In the following section, **Section 2**, we set out **our definition of full employment** and quantify the employment increases it entails over the course of this parliament.
- » In **Section 3** we discuss **the broad economic conditions needed on the road to full employment**; the potential role of labour market improvements in terms of driving progress down this road; and the interaction with recent labour market policy developments including the imminent introduction of the National Living Wage.
- » In **Section 4** we set out **a new policy agenda for delivering our concept of full employment**.
- » In the final section, **Section 5**, we provide **concluding remarks**.

The **Annexes** at the end of this report provide more detail on labour market trends and a full description of our analytical and modelling approach.

## Section 2

# Defining and quantifying full employment

*Having established why full employment is such an important ambition for the UK, in this section we set about defining it. We review past definitions and set out the parameters of our own approach, which is 'bottom up' and rooted in the UK labour market experience over the past two decades in different geographies and for individuals with different characteristics. After summarising this labour market experience across groups and areas, we summarise our full employment benchmark, which rests on closing sub-regional gaps in unemployment and participation for groups we term 'low activity', and further trend improvements from this point. Finally, we assess which individuals and areas experience the greatest employment gains under our measure, and how it compares to other forecasts and ambitions for employment growth.*

## Rethinking full employment

The concept of full employment – although it had not been a prominent feature of labour market discussions for a number of years until its recent resurfacing – is not new. However there is no universally-agreed definition, and views of what it constitutes have shifted over time and in relation to the labour market and policy context. Here we briefly summarise the history of full employment to date, before setting out the broad principles of our own approach to defining it.

### Past approaches to defining full employment

Full employment is generally thought of as a situation in which everyone who wants a job can get one, and has most often been articulated in relation to the unemployed – those looking for and available for work. The theory goes that at full employment there would be no 'cyclical' unemployment, nor a 'structural' element reflecting a mismatch between potential workers' skills or location and job requirements, but only 'frictional' unemployment as workers move between jobs.

The concept first gained prominence in the post-war era, having been defined by William Beveridge as parity between the number of unemployed people and the number of open vacancies.<sup>[13]</sup> Beveridge recommended targeting a three per cent unemployment rate under this banner, and the only ever formal definition of full employment by a British government similarly put it at three per cent unemployment (although this figure related to the claimant rate rather than the International Labour Organisation definition of unemployment that is now more common).<sup>[14]</sup> In an era of Beveridge-inspired Keynesian economic policies leading to the emergence of the modern welfare state, this idea of full employment was adopted as a policy priority in many advanced economies from the end of the Second World War until the 1970s.<sup>[15]</sup>

More recently, the full employment focus was superseded by a new emphasis on the non-inflation accelerating rate of unemployment, or NAIRU: the level judged to be consistent with stable

[13] W Beveridge, *Full Employment in a Free Society*, 1944

[14] P Gregg & M Whittaker, *Completing the job: The pursuit of full employment*, Resolution Foundation, July 2015

[15] T Dolphin & K Lawton, *A job for everyone: What should full employment mean in 21<sup>st</sup> century Britain?*, IPPR, July 2013

inflation. The emphasis on NAIRU is in line with a general focus on cyclical unemployment, but reflects a shift in economic policy-making since the 1970s towards controlling inflation (and a recognition that the sustainable level of unemployment is not just a function of vacancies). While it is important to acknowledge the relationship between low unemployment and price pressures, some have questioned whether it ought to have the primacy it has sometimes been given. As evidence for this, research has highlighted that the UK's unemployment-inflation relationship has frequently not behaved as theory would suggest (as is the case right now); the substantial challenges in estimating NAIRU; the fact that both the US and UK have experienced sustained periods of unemployment below the estimated NAIRU during which prices remained stable; and the fact that NAIRU can be shifted down via structural changes.<sup>[16]</sup>

Crucially, beyond specific critique of a NAIRU-driven policy agenda, more recent assessments have highlighted that a focus on unemployment per se may be too narrow in the context of full employment. This is because it misses the economically inactive – those either not looking or unavailable for work for a variety of reasons including retirement, health, family responsibilities and study. Given that some within this group express an interest in working (and others might under a different set of policy conditions or if the demand was there), excluding them from our view of labour supply appears limited.

Bringing them in implies shifting the focus away from unemployment and towards the employment rate instead. Such an approach underpinned the 80 per cent employment rate ambition of the Labour government in the mid-2000s, a measure that was similarly used in a recent definition of full employment by the IPPR (although excluding students).<sup>[17]</sup> Most recently, the Chancellor has retained the employment focus, setting his full employment ambition as the UK having the highest employment rate in the G7.

### Our starting point: A 'bottom up' approach capturing a broad population

For the purposes of this project, we wish to establish a full employment measure that has a clear connection to policy possibilities. We do not claim to be presenting the definitive final word on full employment, but we believe our 'bottom up' approach has the benefit of being stretching but achievable. We start with the following parameters and principles:

- » In line with the more recent approaches defined above, **we move away from a narrow focus on unemployment, and express full employment in relation to the employment rate.** This means we think that both lowering unemployment and reducing economic inactivity are important.
- » Rather than benchmarks based on the performance of other countries (which may not be at full employment themselves) or arbitrarily determined, **we use observed variation within the UK across geography, across time and for individuals with different characteristics to form a judgement on what full employment looks like.** Our approach is therefore 'bottom up' and rooted in the resident UK population, rather than 'top down'.
- » Reflecting the evolution described above, we recognise that full employment definitions can shift over time. As such, **we set out a full employment measure that is time-specific, taking us to the end of the current parliament in 2020-21.** This matches both the period within which the government intends to hit its own target, and the standard forecast horizon available from the Office for Budget Responsibility (OBR) and HM Treasury.
- » Going with the grain of our broad focus on employment rather than just unemployment, **we take a broader (but older) working age population into account. Our 'bottom up' approach is based on analysis of the 18-69 year old population including students,**

[16] D Baker & J Bernstein, *Getting Back to Full Employment: A Better Bargain for Working People*, 2013; T Dolphin & Kayte Lawton, *A job for everyone: What should full employment mean in 21<sup>st</sup> century Britain?*, IPPR, July 2013

[17] T Dolphin & Kayte Lawton, *A job for everyone: What should full employment mean in 21<sup>st</sup> century Britain?*, IPPR, July 2013

although for ease of comparison and monitoring we also express our measures in terms of total employment and the more conventional 16-64 year old employment rate. More detail on why we have selected this population is provided in Box 1.

### **i** Box 1: The population in scope for employment gains on the road to full employment

While the common 16-64 and 16+ employment and unemployment rates are useful metrics for many purposes,<sup>[1]</sup> different parameters might be more suitable for underpinning a full employment definition that is intended to both reflect the UK context today and drive a policy agenda.

In terms of the lower age cut-off, we take the view that the raising of the participation age to 18 from 2014-15 onwards, coupled with the recent history of changing patterns of work and study among 16 and 17 year olds, have shifted and will further shift the 'default' start of working age to **18**. While a minority of 16 and 17 year olds work (15 and 30 per cent respectively in 2014-15) and there are many good reasons for some continuing to do so, we don't think a full employment agenda should be concerned with reversing the downward trends in labour market participation for this group.

In terms of the upper age cut-off, we think a combination of factors merit a look beyond the common limit of 64. These include the removal of the default retirement age in 2011 (which had allowed employers to force employees to retire at 65); planned gradual increases in the State Pension Age beyond 65 once the male and female ages have been aligned; steady increases in employment in recent

years among the over 65s; and demographic patterns set to drive the dependency ratio up. There is no obvious cut-off above 65, but 69 appears appropriate as an age at which a significant minority currently work (one-in-seven in 2014-15) and where the upward trend since the early 2000s is in line with others in their late 60s (the trends get shallower for those in their early 70s). In addition, an upper limit of **69** is high enough to allow isolation of the over 65s as an independent group within our analysis.

Finally, we **include full-time students** in our assessment of where gains might come from. Although some argue that full-time students are effectively outside of the labour market, evidence suggests that (part-time) work while studying can smooth education-to-employment transitions and improves longer-term labour market outcomes.<sup>[2]</sup> In an era of mass rather than elite higher education, with broad industrial shifts placing increasing emphasis on 'soft' workplace skills and experience, and having removed 16 and 17 year olds for whom full-time study is now the default position from our analysis, it seems reasonable to suggest that full-time students remain in scope for a full employment measure. However, this is not necessarily the case if moving from a measure to a target, where care ought to be taken to avoid perverse incentives to prematurely drive students out of education and into work.

[1] For a discussion of the different employment rate measures that might be appropriate in different circumstances, see: A Corlett, 'The importance of digging beneath the headline measure on employment', *Resolution Foundation blog*, 11 August 2015

[2] D Conlon, P Patrignani & I Mantovani, *The death of the Saturday job: The decline of earning and learning among young people in the UK*, UKCES, June 2015

## Insights underpinning our full employment measure

We have said that our approach to defining full employment emanates from the observed experience in the UK across time, geography and individual characteristics. We build our definition on three key insights.

### **Insight 1: In normal times raising participation in the labour market is the main driver of employment growth**

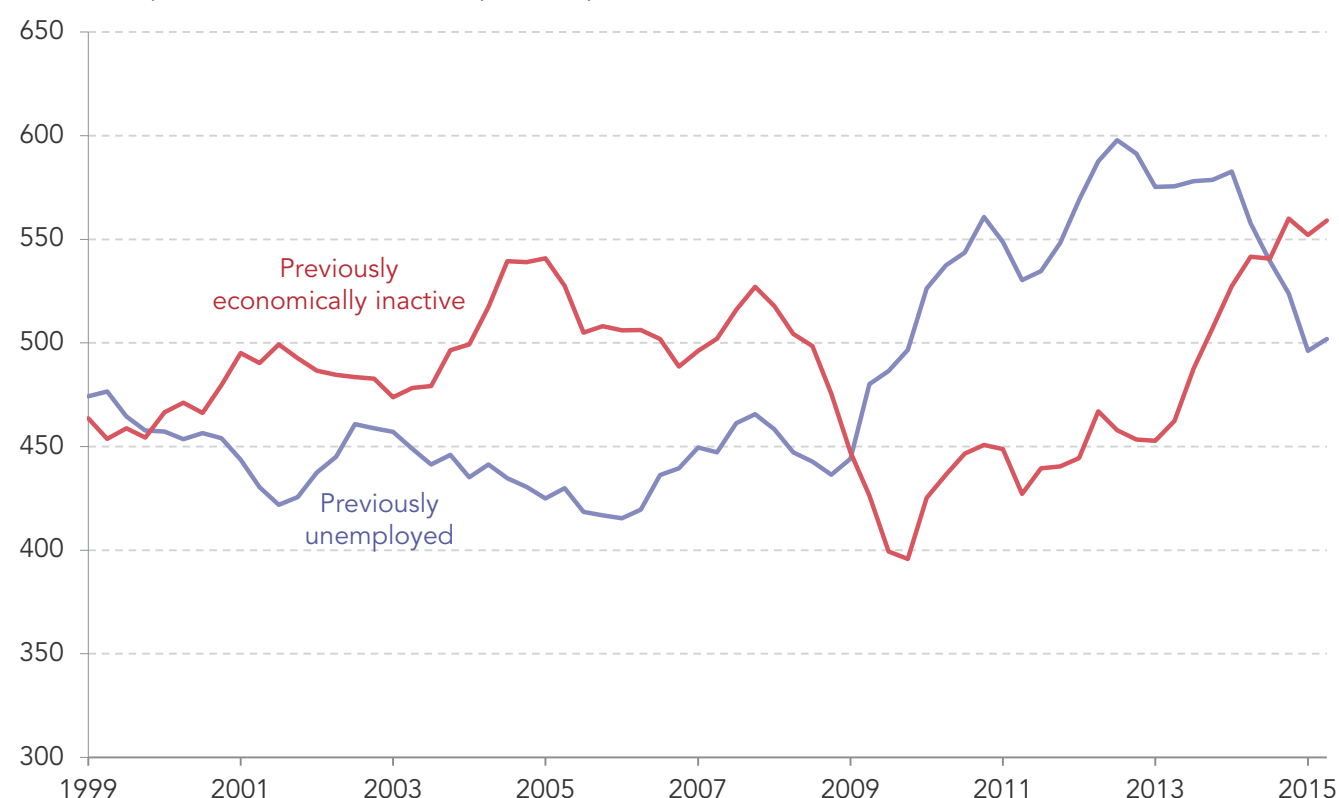
The unemployed are very often the focus when it comes to growing employment or filling vacancies. However, outside of recession and recovery phases, more people move into employment



from outside the labour force than they do from unemployment.<sup>[18]</sup> As Figure 6 shows, the UK has recently returned to this position, with a greater share of the newly employed having been economically inactive in the previous quarter (see Box 2 for details of what this entails), than unemployed.

**Figure 6: Entry to employment from unemployment and economic inactivity: UK, 1999–2015**

Quarterly employment entrants by status in previous quarter (16+ year olds, thousands)



Notes: Annual rolling average to date shown.

Source: RF analysis of ONS, Labour Force Survey two-quarter longitudinal datasets

While entering work from economic inactivity is less likely (an average of 4 per cent of economically inactive 18-69 year olds moved into a work over a quarter in 2005-2015, compared to 25 per cent of unemployed people) the far greater stock of inactive people means small shifts in behaviour on either inflows to, or outflows from, the workforce can make a big difference. As Box 2 details, there is much variation in the propensity to enter work across the inactive group. However, even some of those whose situation and stated preferences make them unlikely candidates for work do transition back into the labour market.

<sup>[18]</sup> While this is the case when measuring change over a quarter, in a technical sense, people would have had to become unemployed (looking for – or at least open to – and available for work) during the intervening quarter (even if only for a day) in order to find themselves in work the following quarter.

## i Box 2: Who are the economically inactive?

The unemployed (the group that responds to surveys saying that they are both looking for and available for work) are dwarfed in number by the economically inactive, those either not looking or unavailable for a variety of reasons. In 2014-15, 1.8 million 18-69 year olds were unemployed (4.1 per cent of this population<sup>[1]</sup>), compared to 10.8 million who were economically inactive (25.3 per cent of the group). Of these, one third (34 per cent) gave their main reason for inactivity as retirement; around one fifth (22 per cent) were sick or disabled; a further fifth (22 per cent) were looking after their family or home; just over one-in-ten (13 per cent) were students; and the remainder were discouraged workers, were awaiting the results of a job application or gave other reasons or no reason at all.

As well as their main reason for inactivity, the economically inactive are asked whether they would like a job, and three quarters say they would not. This has led some to conclude that the majority of economically inactive people are out of scope even in broader considerations of labour supply beyond just unemployment.<sup>[2]</sup> However, Figure 7 shows that this distinction matters little in terms of the chances of moving into work; for example, 2 per cent of those who say they are retired and do not want to work still find themselves in employment three months later, which

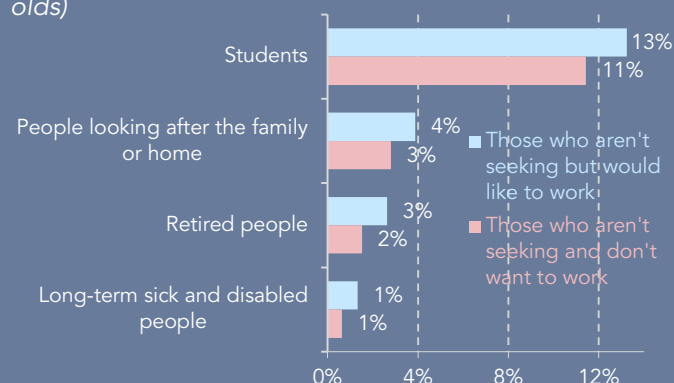
[1] This percentage is lower than the unemployment rate, because the unemployment rate excludes the economically inactive from the base of the calculation.

[2] For example, see J Robertson & E Terry, 'The ZPOP Ratio: A Simple Take on a Complicated Labor Market', *Federal Reserve Bank of Atlanta microblog*, 22 September 2015

is only a little below the 3 per cent figure recorded among those saying they do want to work.

**Figure 7: The propensity of the economically inactive to enter employment: UK, 2005–2015 average**

*Proportion entering employment from economic activity in previous quarter, by reasons for inactivity (18-69 year olds)*



Notes: Only those reasons for inactivity that account for more than 10 per cent of the economically inactive population are shown.

Source: RF analysis of ONS, *Labour Force Survey two-quarter longitudinal datasets*

With unemployment approaching its lowest rate in four decades, it follows that for employment to significantly and sustainably grow further these patterns would need to continue. In other words, and as we highlighted in the previous section, any substantial employment increase will require bringing new participants into the labour market (or, importantly, keeping participants in for longer).

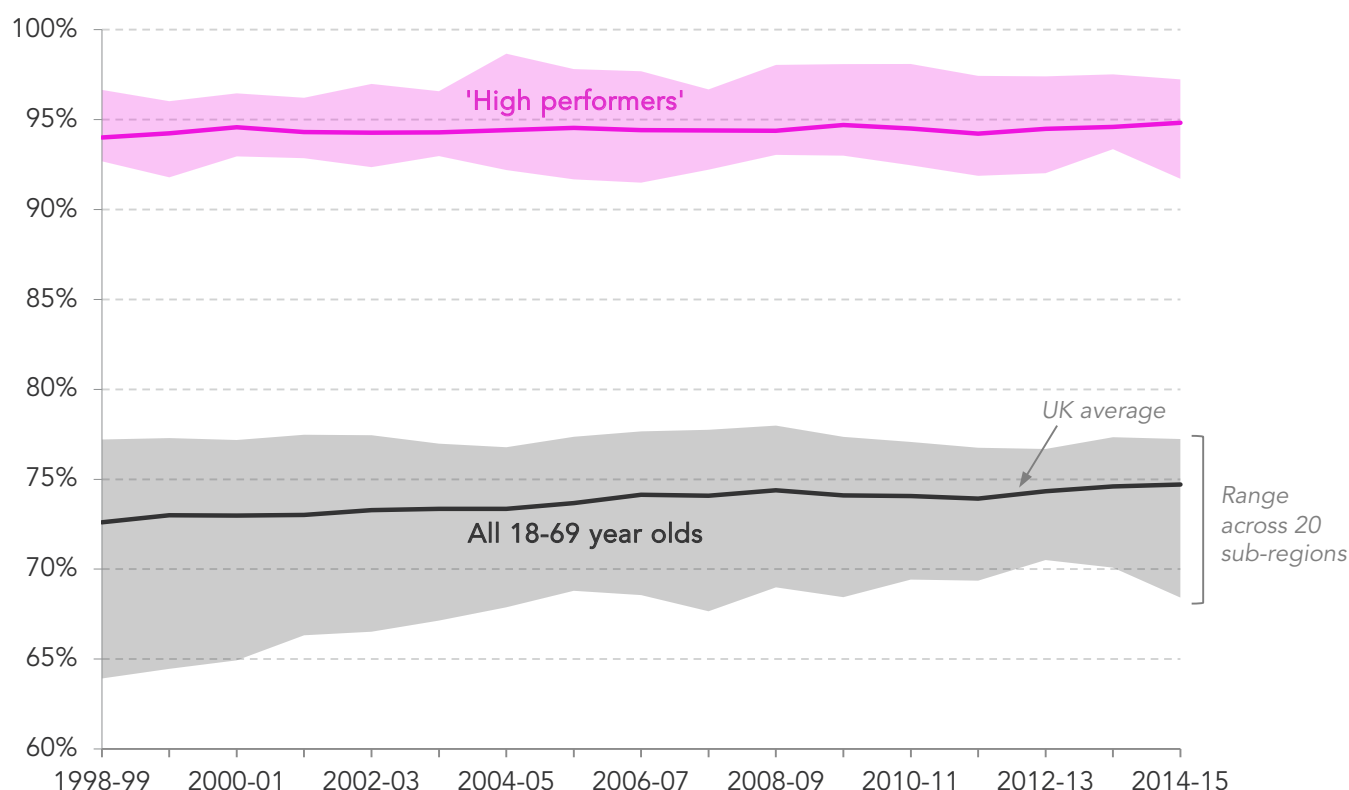
## Insight 2: Participation is very high for adults without prominent barriers or disadvantages

If participation is to provide a large part of any further employment gains, then which participants should we be looking to? Across geography and time, people with certain characteristics are consistently in the labour force at very high rates. Figure 8 shows this for a group of adults who we term 'high performers' – 30-49 year old, highly-qualified, white, non-single parent, non-disabled people (see Annex 1 for an explanation of how we have specified these characteristics) – who make up around 15 per cent of the 18-69 year old population in any given year.<sup>[19]</sup> The participation of 'high performers' is consistent at just below 95 per cent.

[19] Similarly, this group displays little variation across time and place in relation to employment rates.

**Figure 8: Labour market participation of 'high performers' across the UK: 1998-99–2014-15**

Participation rates across 20 UK sub-regions (18-69 year olds)



**Notes:** The 'high performer' group is composed of 30-49 year old, highly-qualified, white, non-single parent, non-disabled adults. See Annex 1 for details on our segmentation of qualifications and our definition of disability.

**Source:** RF analysis of ONS, Labour Force Survey

While the spread of outcomes across these areas is significantly wider for the 'all 18-69 year-olds' group, it has narrowed noticeably over the period. This implies that some of the improvement in overall participation seems to have been driven by a narrowing of the gap between the top- and bottom-performing geographies, an important outcome to which we shall return.

In terms of further participation and employment gains, then, there is reasonably very little we can expect from the minority of adults in the 'high performer' group. We might say that this group is more-or-less already at full employment.

### Insight 3: Almost all the variation in participation occurs within 'low activity' groups

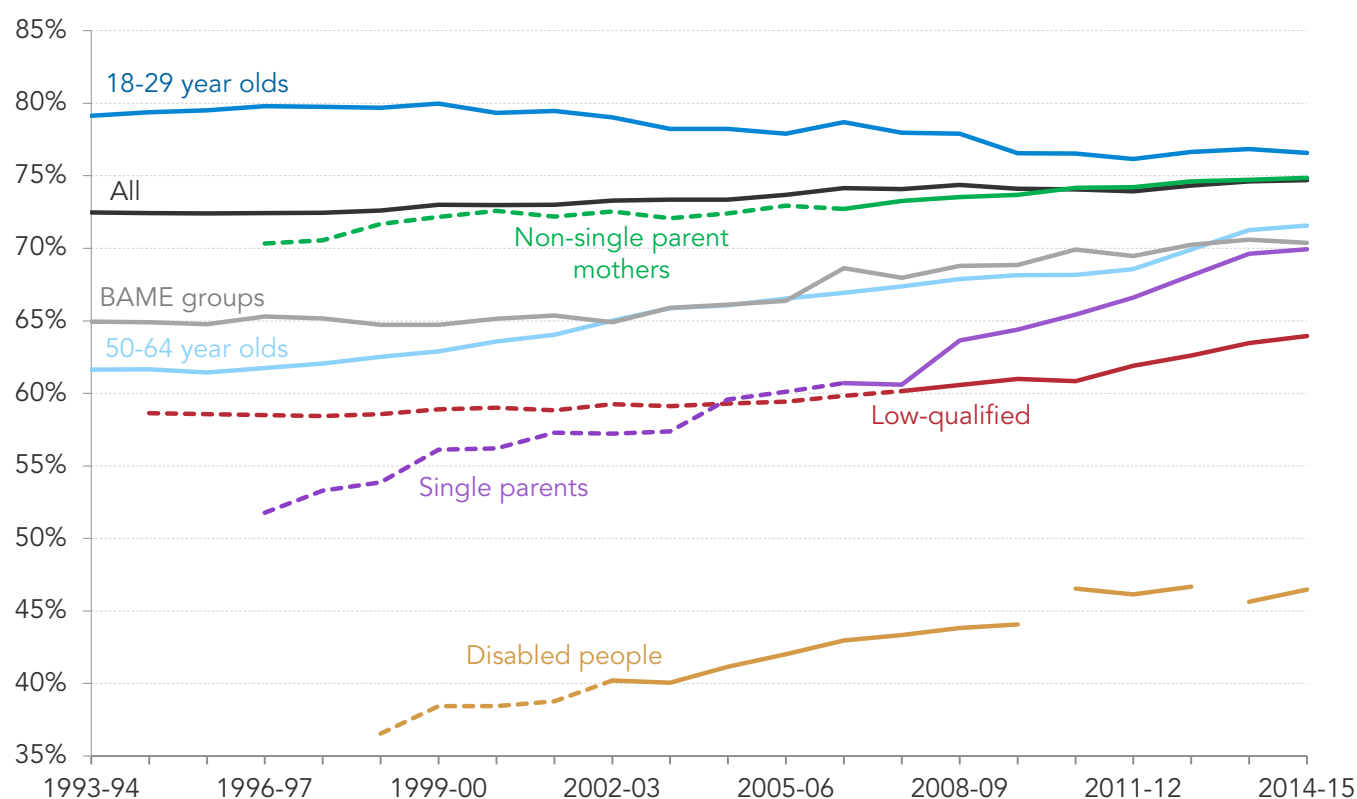
If 'high performers' offer very little room for improvement, then it follows that those not in this group should be our focus.

Figure 9 shows trends in participation rates over time for all those characteristics that place a person outside the 'high performer' group, which are those that have traditionally been considered to reflect barriers or disadvantages in the labour market. We find that these groups usually have much lower participation rates than the average and therefore, as shorthand, refer to them as 'low activity'. However, their participation has generally been rising more quickly than the overall measure, with the upward trend for single parents particularly marked and likely to reflect a confluence of cultural and policy changes over the past two decades (and showing that

marked change in low activity group performance is possible).<sup>[20]</sup> The observed improvement for single parents and other groups is another feature we will return to. Similar patterns are evident when focusing instead on employment or unemployment (although with greater cyclicity) – see Annex 2 for details of these.

**Figure 9: Labour market participation of 'low activity' groups: UK, 1993-94–2014-15**

Participation rates for groups with different characteristics (18-69 year olds)



**Notes:** Dashed lines represent trends based on slightly different group definitions, indexed backwards from the more recent trends. See Annex 1 for further details, and information on our segmentation of qualifications, definition of disability, and breaks in the disability series.

**Source:** RF analysis of ONS, Labour Force Survey

There are two exceptions to the general pattern of lower participation: non-single parent mothers, who were previously less likely to participate than the average but have now caught up; and young people, who have a consistently higher participation rate than overall, but for whom the downward trend represents a cause for concern. Although some of the latter is about more young people spending longer studying (participation is flat – though still not rising – for 18-29 year olds excluding full-time students) other developments that took hold before the downturn suggest this group merits attention despite fairly healthy participation. Employment was falling for 18-29 year olds in the mid-2000s while rising for the overall non-student population (see Annex 2), and this remains the case when we exclude full-time students. And this was coupled with marked stagnation in youth wages even before the downturn hit.<sup>[21]</sup>

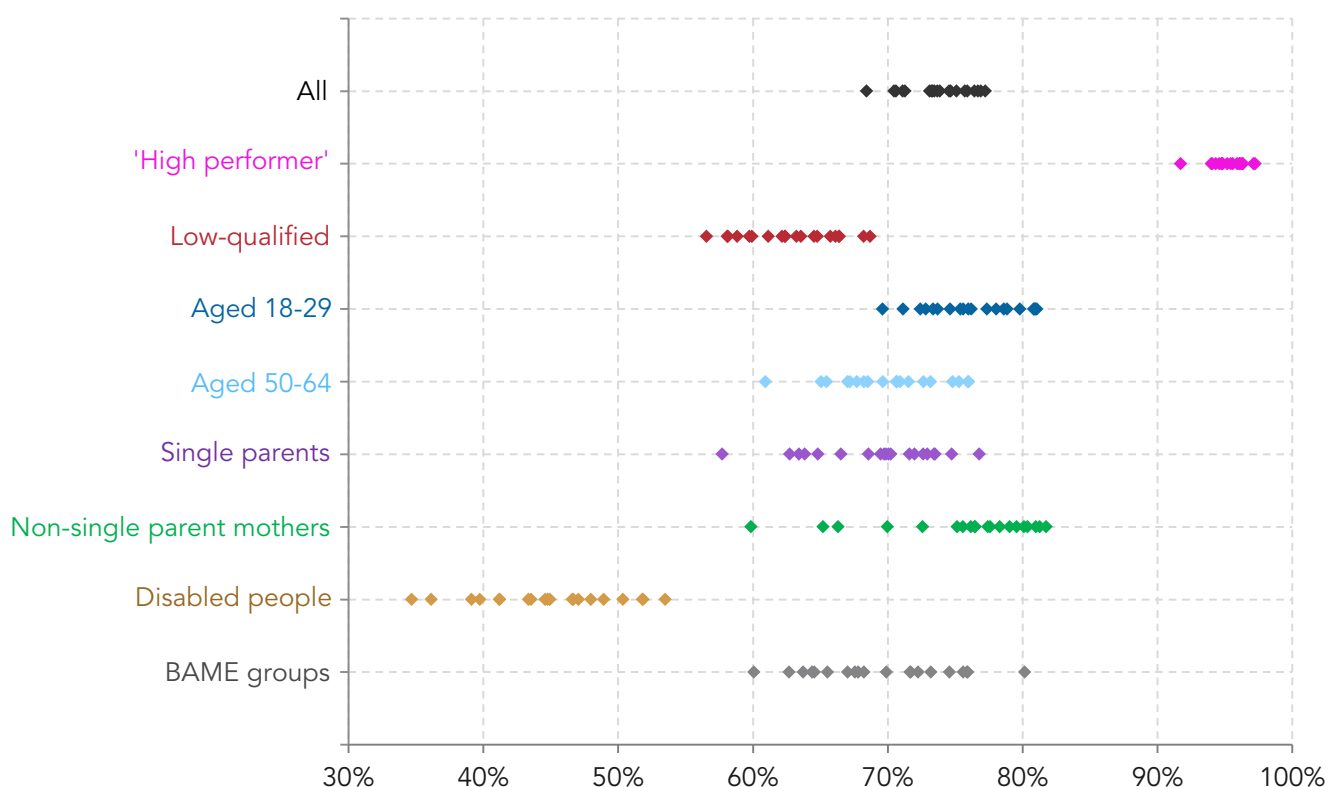
<sup>[20]</sup> For a summary of these see P Gregg & D Finch, *Employing new tactics: The changing distribution of work across British households*, Resolution Foundation, January 2016

<sup>[21]</sup> A Corlett & L Gardiner, *Low Pay Britain 2015*, Resolution Foundation, October 2015

As well as variation over time, these low activity groups display much more geographic variation in participation chances, as shown in Figure 10. The standard deviation – a common measure of the dispersion in a range of data – is 2.4 percentage points overall, and 1.3 percentage points for the ‘high performer’ group. For each low activity group it is at least 3.5 percentage points, rising to 5.9 percentage points for non-single parent mothers (for whom the UK average appears to mask some poor performing sub-regions, hence their continued inclusion in this analysis), 5.3 percentage points for BAME groups, and 5.2 percentage points for disabled people.

**Figure 10: Labour market participation of low activity groups across the UK: 2014-15**

Participation rates for groups with different characteristics in 20 UK sub-regions (18-69 year olds)



Notes: See Annex 1 for information on our segmentation of qualifications and definition of disability.

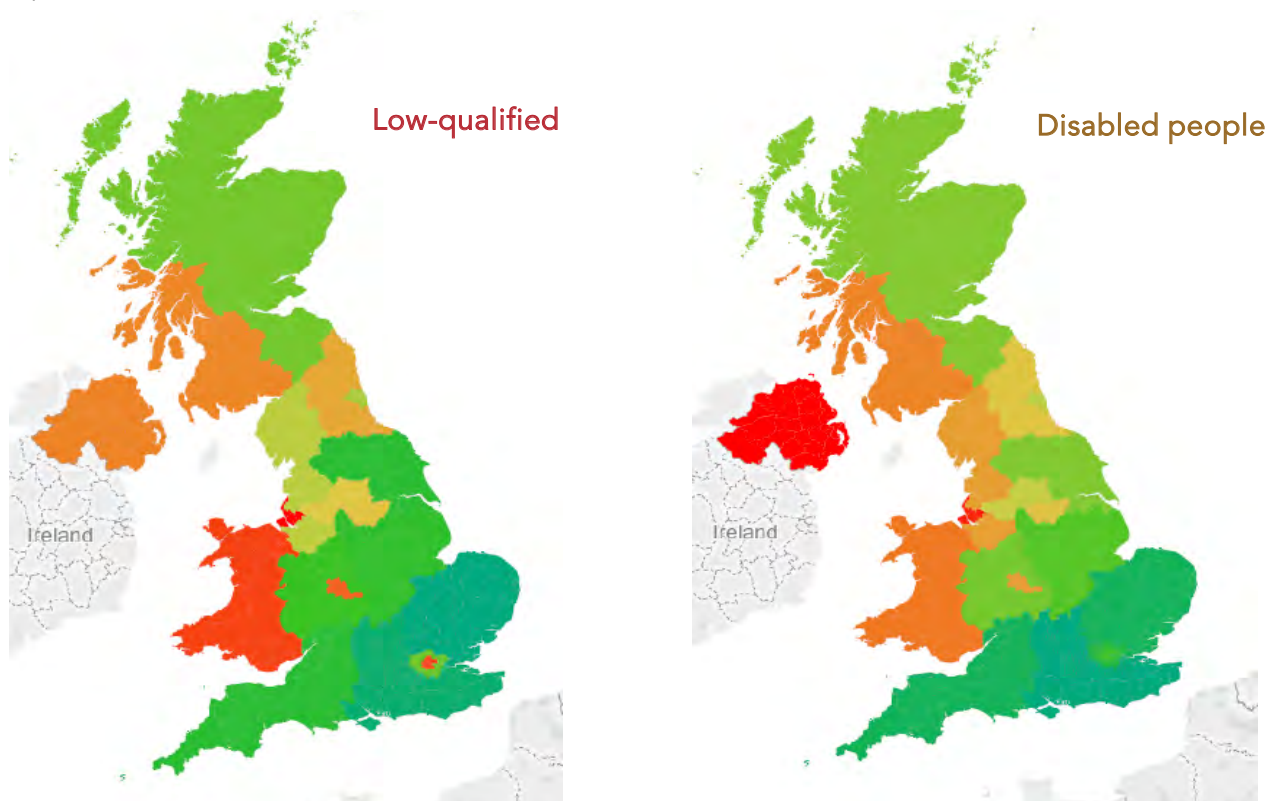
Source: RF analysis of ONS, Labour Force Survey

To give an indication of which sub-regions record the best and worst participation outcomes, Figure 11 shows maps that visualise participation rates for two selected low activity groups: the low-qualified and disabled people (with the full picture for all low activity groups provided in Figure 22-Figure 23 in Annex 2). These show a fairly high degree of consistency across sub-regions in terms of participation outcomes for different groups, with areas such as Wales, Northern Ireland, Strathclyde and Merseyside tending to perform worst.



**Figure 11: Labour market participation of the low-qualified and disabled people across the UK: 2014-15**

*Participation rates across 20 UK sub-regions (18-69 year olds)*



**Notes:** Sub-regions are colour-coded from red (lowest participation rate) to green (highest participation rate) separately for each low activity group. See Annex 1 for details on our segmentation of qualifications, our definition of disability, and breaks in the disability series.

**Source:** RF analysis of ONS, Labour Force Survey

This variation is further explored in Annex 2, both over time and using a smaller geographical area (local authorities) as the unit of analysis. This greater detail further underscores patterns we have discussed. In particular, we find that the narrowing of the gap between the best- and worst-performing sub-regions that was evident for the overall participation rate in Figure 8 is most pronounced for the low-qualified, 50-64 year olds, non-single parent mothers and BAME groups. We also find that young people, disabled people and BAME groups show particularly pronounced variation in participation across local authorities.

In sum, low activity groups display substantially different labour market outcomes across both time and geography. Convergence for these groups appears to be the most likely source of participation and employment gains.

## Quantifying full employment

Taking the above insights and discussion together brings us to the building blocks of our full employment measure. We set out a full methodology in Annex 3, describing a five-step process:

1. Closing sub-regional unemployment gaps;
2. Further unemployment tightening;
3. Closing sub-regional participation gaps;

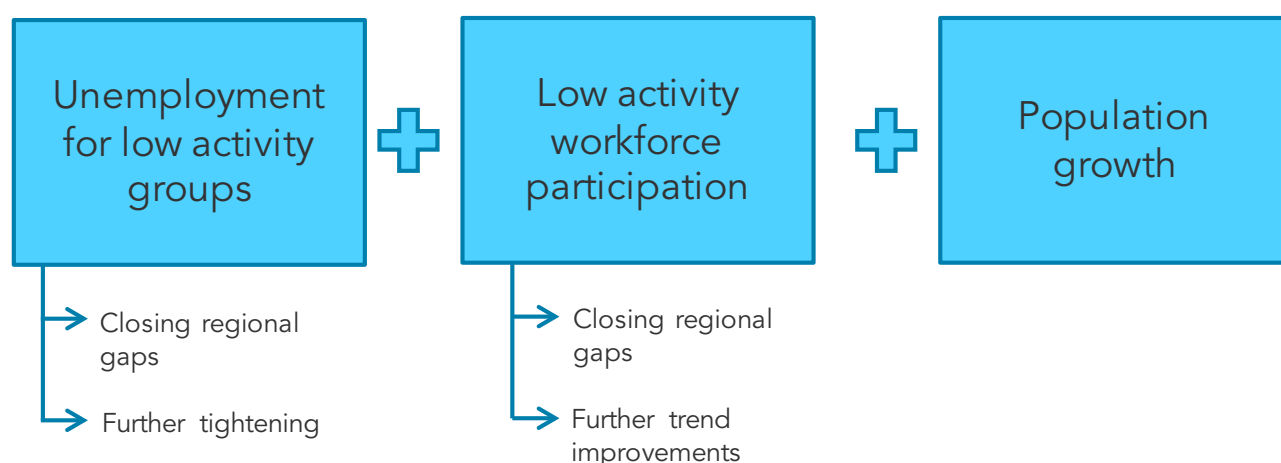
4. Further trend participation growth to 2020-21; and
5. Forecast population growth to 2020-21.

This process is underpinned by a view that a reasonable benchmark for full employment consists of geographical convergence in labour market outcomes dependent upon individual characteristics. Beyond this – because even the best areas may not be at full employment for certain groups at present, and because environmental and policy changes can move the dial for particular groups – we seek further improvements over time on the basis of certain recent trends continuing, setting our benchmark for the end of the parliament in 2020-21.

While we have said that our main focus is participation – or economic activity – there is still progress to be made on unemployment particularly for certain groups, as Figure 20 in Annex 2 shows. Therefore, our full employment measure turns to geographical and time-based reductions in unemployment first (Steps 1 & 2), before considering the same for participation (Steps 3 & 4). In addition, we account for expected population growth through to 2020-21 (both within and outside our core 18-69 year old population) in order to come to a measure of gains in employment numbers as well as the employment rate (Step 5).

This approach is summarised in Figure 12.

Figure 12: Our approach to quantifying full employment within this parliament



### Setting a benchmark for full employment

When ‘closing regional gaps’ (in Stages 1 & 3), we model convergence towards the two of the UK’s 20 sub-regions that consistently record the strongest labour market performance – the East and the South East of England. ‘Further tightening’ and ‘trend improvements’ (Stages 2 & 4) among low activity groups are then applied to all areas of the country.

Crucially, our analysis is based on regressions applied to the population in these two best sub-regions controlling for characteristics, which are then extrapolated to the population across UK sub-regions. This means that our results account for both the different characteristics of the population in different sub-regions (for example, people in Merseyside are more likely to be low-qualified than those in the South East, meaning our modelling assumes that Merseyside doesn’t ever fully catch up with the South East’s aggregate employment rate) and the impact on an individual’s participation and employment chances of multiple low activity characteristics (for example, a low-qualified disabled person has a much lower participation chance than a highly-qualified disabled person).

Population growth (Step 5 of our process) is based on the Office for National Statistics's (ONS's) latest population projections, which account for natural change (births and deaths) and expectations for migration.

Table 2 summarises the shift from existing labour market outcomes to those associated with full employment at each step in our process.

**Table 2: Progressing to full employment within this parliament: UK**

	Employment rate (16-64)	Unemployment rate (16+)	Employed thousands (16+)	Unemployed thousands (16+)
<b>Actual (2014-15)</b>	<b>73.1%</b>	<b>5.9%</b>	<b>31,210</b>	<b>1,950</b>
Step 1: Closing sub-regional unemployment gaps	73.8%	5.0%	31,520	1,650
Change	+0.7 pts	-0.9 pts	+300	-300
Step 2: Further unemployment tightening	74.7%	3.8%	31,890	1,280
Change from step above	+0.9 pts	-1.1 pts	+370	-370
Step 3: Closing sub-regional participation gaps	76.1%	4.0%	32,600	1,360
Change from step above	+1.4 pts	+0.1 pts	+710	+80
Step 4: Further trend participation growth to 2020-21	77.9%	4.1%	33,400	1,420
Change from step above	+1.7 pts	+0.1 pts	+800	+60
Step 5: Forecast population growth to 2020-21	78.0%	4.1%	33,930	1,430
Change from step above	+0.1 pts	-0.0 pts	+530	+10
<b>Full employment (2020-21)</b>	<b>78.0%</b>	<b>4.1%</b>	<b>33,930</b>	<b>1,430</b>
Change from actual 2014-15 position	+4.9 pts	-1.8 pts	+2,710	-520

**Notes:** See Annex 3 for more details of our full employment estimate and a fuller breakdown of the measure including participation and population estimates. Estimates are rounded to the nearest 10,000.

**Source:** RF modelling based on ONS, *Labour Force Survey*; and ONS, *2014-based National Population Projections*

So what is full employment? In our view, a very stretching but not unreasonable benchmark would be to raise the 16-64 employment rate by almost 5 percentage points between 2014-15 and 2020-21, which would entail a total employment increase of 2.7 million on the basis of current population forecasts.

We take 2014-15 as our baseline for data reasons, but we know that employment has continued to rise quite swiftly since then. As context, therefore, this full employment definition measures up to more recent time periods as follows (see Table 5 in Annex 3 for full details):

- » **Compared to the last full quarter of the previous parliament (Feb-Apr 2015), our measure of full employment in 2020-21 requires a 2.4 million employment increase.** This was the known labour market position when the Chancellor made his 2 million jobs commitment in the 2015 Summer Budget. **So our measure is similar to, but slightly more challenging than, the government's,** and shows how the figure the government has targeted might be arrived at.<sup>[22]</sup>
- » **Compared to the latest data (covering Oct-Dec 2015), our measure of full employment in 2020-21 requires a 2 million employment increase.** If the pace of change recorded over the first eight months of this parliament were maintained (a very big 'if'), full employment on our definition would be achieved before the end of the parliament.<sup>[23]</sup>

In addition, we can consider how our concept of full employment measures up against the OBR's forecast for the economy over this parliament. In its November 2015 Economic and Fiscal

[22] An increase of 2 million from this point would be broadly consistent with narrowing regional unemployment and participation gaps by around two-thirds (alongside maintaining trend improvements).

[23] In absolute terms at least. Such an increase could of course be consistent with faster than projected population growth (due to migration for instance) meaning the employment rate did not reach the level we believe to be consistent with full employment.

Outlook, this comprised a 1.1 million employment increase between 2014-15 and 2020-21.<sup>[24]</sup> **So hitting our full employment benchmark would involve going at more than double the pace the OBR currently expects** (see Annex 3 for a discussion of how the OBR's forecasting approach and our methods compare).

Clearly then, our definition of full employment is a stretching one. In particular, the closing of sub-regional unemployment and participation gaps, even conditional on individual characteristics, is an incredibly challenging task. Maintaining past improvements for certain low activity groups and reversing negative trends represents a clear additional challenge.

We think it is right to set the bar this high. A country in which the area you live in doesn't bear down on your labour market outcomes and where the usual markers of disadvantage play a declining role should be our goal, rather than a metric based only on what is readily achievable over the next five years.

### Who benefits?

Given our approach to quantifying full employment, it should come as no surprise that the groups we identify as 'low activity' are the major beneficiaries of progress down this road. This is summarised in Table 3 (with a more detailed breakdown in Table 6 in Annex 3).

**Table 3: Change in employment for low activity groups associated with moving to full employment: UK, 18-69 year olds**

	Actual (2014-15)		Change to full employment (2020-21)		Share of population in 2014-15	Share of full employment gains by 2020- 21
	Employment rate	Employed thousands	Employment rate	Employed thousands		
All	70.6%	30,440	+4.9 pts	+2,590	100%	100%
Low-qualified	58.3%	7,810	+9.0 pts	+1,340	31%	52%
18-29 year olds	68.4%	7,030	+4.8 pts	+600	24%	23%
50-64 year olds	68.9%	8,180	+6.7 pts	+920	28%	36%
65-69 year olds	20.9%	750	+6.4 pts	+240	8%	9%
Single parents	62.2%	1,430	+6.1 pts	+160	5%	6%
Non-single parent mothers	71.8%	4,350	+1.8 pts	+170	14%	7%
Disabled people	41.5%	3,380	+10.3 pts	+900	19%	35%
BAME groups	63.3%	3,310	+8.3 pts	+490	12%	19%

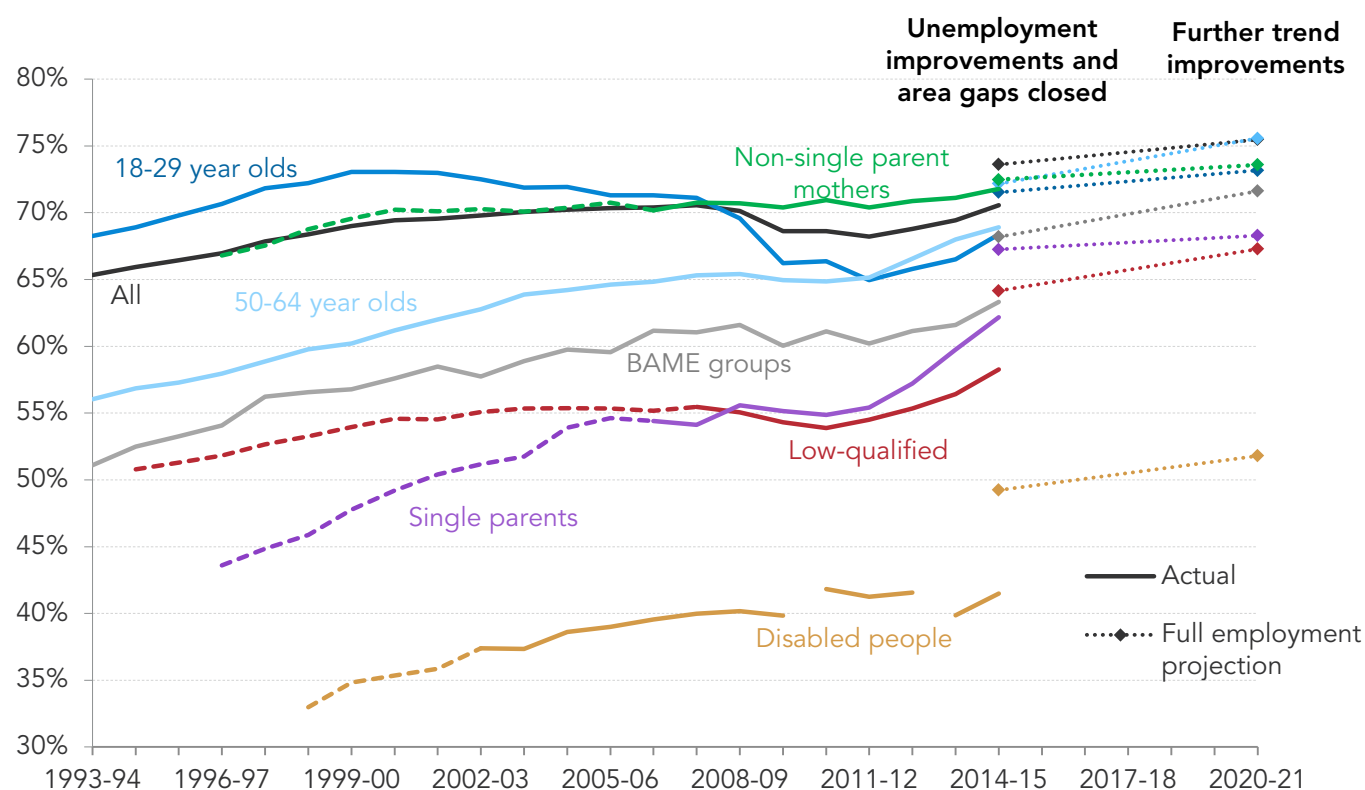
**Notes:** See Annex 3 for more details of our full employment estimate and a fuller breakdown of the measure including the employment increase for each low activity group at each step of the calculation. Estimates are rounded to the nearest 10,000.

**Source:** RF modelling based on ONS, Labour Force Survey; and ONS, 2014-based National Population Projections

We find that, compared to their prevalence in the population as a whole, older people, disabled people and the low-qualified disproportionately gain from full employment. At the extreme, disabled people would secure an employment gain of almost 1 million from 2014-15 (and this excludes disabled 16-17 and 70+ year olds who would also record a small amount of growth purely from population changes), corresponding to an increase in their employment rate of more than 10 percentage points (reflecting huge regional variation for this group).

Figure 13 visualises our measure of full employment, separating out unemployment improvements and area participation gap improvements (Steps 1 to 3 of our process) which present themselves as step-changes in 2014-15 (although in reality, of course, we expect these to be achieved over time), and further participation trends (Step 4), which are described by the dotted lines out to 2020-21.

[24] Office for Budget Responsibility, *Economic and Fiscal Outlook*, November 2015

**Figure 13: Employment of low activity groups, actual and full employment projection: UK, 1993-94–2020-21***Employment rates for groups with different characteristics (18-69 year olds)*

**Notes:** Historical dashed lines represent trends based on slightly different group definitions, indexed backwards from the more recent trends. See Annex 1 for further details, and information on our segmentation of qualifications, definition of disability, and breaks in the disability series.

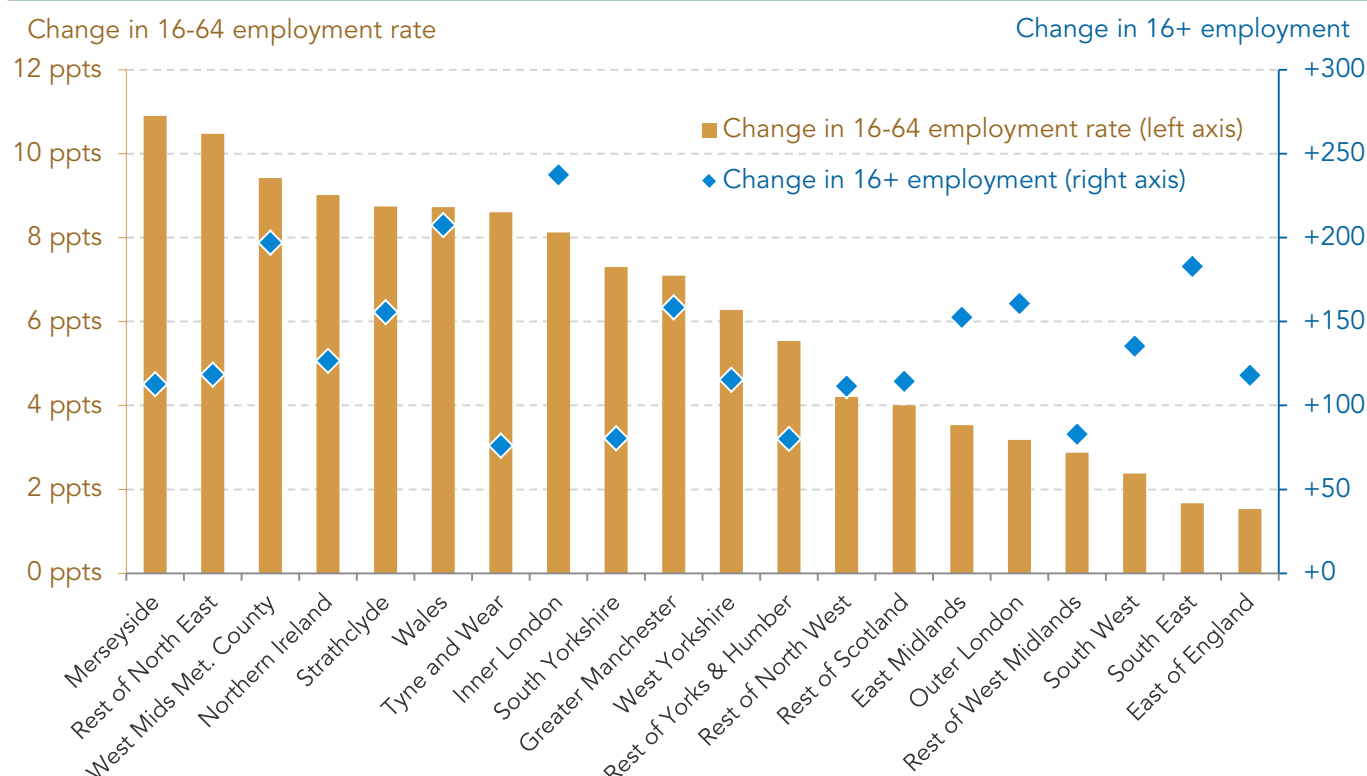
**Source:** RF modelling based on ONS, *Labour Force Survey*

It's worth noting that even the stretching improvement in disability employment described above only reduces the disability employment gap by around one-fifth. This would represent solid progress against the government's ambition to halve this gap,<sup>[25]</sup> but would leave much to do.

Turning to different areas of the UK, Figure 14 (see Table 7 in Annex 3 for more detail) summarises the impact of our measure on employment in UK sub-regions. Unsurprisingly given our approach, the smallest employment rate increases are recorded in the two sub-regions we single out as having consistently the tightest labour markets and use as benchmarks for improvements in the rest (the East and South East of England) while the largest employment rate gains go to the sub-regions that currently have the lowest rates (Merseyside and the more rural parts of the North East of England). Because of this, the geographic convergence underpinning our full employment measure more than halves the range in employment rates across UK sub-regions (from 11 percentage points to 5.2 percentage points).

[25] Conservative Party Manifesto 2015

Figure 14: Change in employment across UK sub-regions under full employment projection, compared to 2014-15 position: 2020-21



Notes: Population growth is estimated using the national projection, rather than projections for individual sub-regions. 16-17 and 70+ year old employment gains on the basis of forecast population growth and unemployment reductions are apportioned from the national figure based on each sub-region's population share.

Source: RF modelling based on ONS, *Labour Force Survey*; and ONS, *2014-based National Population Projections*

A glance at the order of sub-regions in Figure 14 suggests a strong bias in employment rate gains towards the parts of the UK with the lowest working-age household incomes.<sup>[26]</sup> We have previously said that one of the principal potential benefits of full employment is its role in driving strong and inequality-reducing improvements in living standards. Casting back to the analysis of worklessness across the income distribution in the previous section, it is clear that the individuals and areas that feel the strongest employment effects under our definition of full employment are strongly aligned to such living standards goals.

Finally, it's worth considering how full employment might affect the wider workforce and particularly those already in work. Our definition is based purely on counts of individuals – we do not formally quantify what full employment might mean for *underemployment* (which is still elevated compared to the unemployment rate) or average working hours. However we see reductions in underemployment as an essential and natural part of labour market tightening on the road to full employment, particularly as this would free up shorter-hours and flexible roles that are the preference of many in low activity groups. This is discussed in Box 3, and explored further in the following section.

[26] A Corlett, D Finch & M Whittaker, *Living Standards 2016: The experiences of low to middle income households in downturn and recovery*, Resolution Foundation, February 2016



### *i* Box 3: The implications of full employment for underemployment and average hours

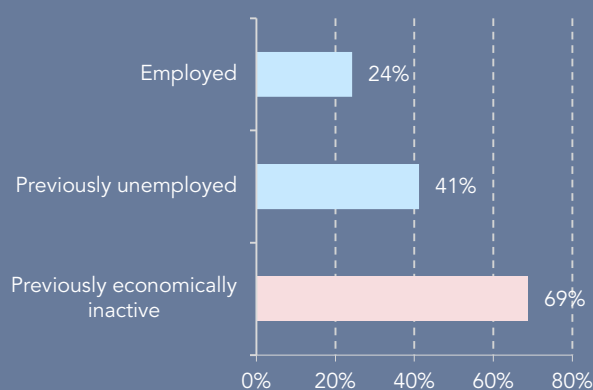
As well as reductions in unemployment and increases in participation, the road to full employment ought to involve reducing the labour market slack that manifests as underemployment. In 2014-15, this would imply a 5.2 million increase in weekly working hours (based on reducing net desired hours – the hours required by the underemployed minus hours the overemployed want to get rid of – to zero). This sounds like a lot but reaching this point is not an unreasonable expectation – net underemployment was at or below zero during 2001-2008.

On the other hand, on the road to full employment we might expect new people entering work (or staying in work longer) to have a preference for fewer hours than the existing employed workforce. Indeed, Figure 15 demonstrates that people entering employment from economic inactivity are much more likely to work part time (at least initially) than either those entering from unemployment or existing workers. A preference for part-time working is particularly likely for those with health problems or caring responsibilities – groups making up a large part of the participation increase our full employment measure is contingent upon.

We do not explicitly account for either reductions in underemployment or the hours preferences of new participants in our full employment measure. However, there is an intuitive sense in which these two factors can to some extent balance each other out: reductions in underemployment that involve workers moving out of involuntary part-time roles into full-time ones can free up these part-time jobs for new participants who want this flexibility. Such a process would also boost incomes for currently underemployed workers.

**Figure 15: Part-time working by status in previous quarter: UK, 2005-2015**

*Proportion of those in employment working part time (18-69 year olds)*



Source: RF analysis of ONS, Labour Force Survey two-quarter longitudinal datasets

There are two important implications of this argument. The first is that jobs created on the road to full employment do not necessarily need to match the skills and preferences of the new entrants we see full employment as depending upon – reallocation of labour can and should create spaces for them as the labour market tightens. Following on from this, the second implication is that good job mobility is strongly aligned with full employment objectives. The fact that job-to-job moves were declining before the crisis hit and currently sit one-third below their early-2000s peak is therefore a cause for concern.<sup>[1]</sup> These are issues to which we return in the following section.

[1] L Gardiner, *The RF Earnings Outlook: Q3 2015*, Resolution Foundation, December 2015

In this section we have established a stretching but achievable definition of full employment that centres on boosting participation and employment for 'low activity' groups. Policy changes that can drive us towards this ambition are the focus of Section 4. Before turning to the policy agenda, however, it's worth considering the broad economic and labour market conditions that will underpin any attempt to achieve full employment, and how changes in these conditions themselves affect the participation and employment of low activity groups. This is the focus of the following section.



## Section 3

# The conditions for full employment

*Having set out our definition of full employment and the groups and areas it benefits most, in this section we consider the broader economic backdrop that efforts to reach full employment in this parliament will be set against, and how this backdrop itself affects the prospects for maintaining current employment progress. In doing so, we address four potential misconceptions:*

- » *That recent employment strength means we can expect employment growth of this scale to continue in coming years;*
- » *That where in the UK employment demand is located is unimportant in the context of full employment;*
- » *That boosting employment is all about helping out-of-work adults to enter jobs; and*
- » *That any new jobs that emerge will need to match the characteristics of the individuals in low activity groups that our full employment measure focuses on.*

*This discussion reinforces the belief that economic conditions are of central importance to the achievement of full employment ambitions. In the final part of this section, we attempt to quantify the importance of employment availability and wages in particular, by assessing the ‘sensitivity’ of labour force participation within low activity groups to changes in these factors.*

## The importance of the economic backdrop: job availability and quality

Broadly speaking, there are three factors which drive participation (and therefore, in the main, employment) among the low activity groups our definition of full employment focuses on:

- » *First, individual characteristics.* That is, the nature and severity of some of the specific circumstances and barriers faced by these groups – including health problems, caring responsibilities, time spent studying and a lack of appropriate skills – help determine the likelihood of participation.
- » *Secondly, the policy environment.* This follows from the first point, because policy can help address barriers for those in low activity groups, by expanding the number of employment opportunities and the range of jobs, by changing their characteristics or by altering the financial incentives associated with entry into the workforce.
- » *Thirdly, economic conditions.* This is the corollary of our analysis of sub-regional participation gaps in the previous section. The best-performing labour markets in the UK overall (the East and South East of England) also record among the best participation outcomes across low activity groups, which is why our modelling of raising participation chances up to these two areas delivers sizeable gains.

We have already identified the importance of different individual characteristics on participation, and will turn to policy options aligned to these in Section 4. In this section, we instead focus on economic conditions – both considering what environment best supports participation and employment among different groups and exploring how the UK’s economic and labour market backdrop might alter in the coming years.

In doing so, we distinguish between ‘voluntary’ and ‘involuntary’ economic drivers of participation. ‘Voluntary’ non-participation is a situation in which wages are too low (or other markers of job quality too unfavourable) to make working worthwhile for some. In this situation, people at the margin choose not to participate even if work is available, but might be prompted to enter if wages improve (or if incomes when not in work fall). In contrast, ‘involuntary’ non-participation is a situation in which no employment is perceived to be available. In this case, an increase in job availability would encourage people to enter the workforce even if wages did not rise.

In other words, both employment availability and job quality (principally in relation to the available wage but also concerning wider job attributes) make a difference to participation. Both factors are likely to depend on underlying levels of demand and economic activity within a given area, and may often be related. That is, during good economic times, a region might generate an increasing number of jobs of ever-higher quality; during downturns the opposite is likely to be true.

But it is also important to consider how these factors can constrain one another. In steady-state (that is, absent any exogenous changes in demand) attempts to manufacture change in one of employment and wages might be considered to have an opposite effect on the other. Most obviously perhaps, raising wages (or other employee benefits) and therefore labour costs may constrain job availability. Crucially, this relationship is one that will be tested in the UK labour market in coming years.

## Job quality: the end of the ever-cheaper labour era?

As discussed in Section 1, the recent past has been highly unusual in terms of the performance of wages. Real median hourly pay fell for more than 5 years, declining by nearly 10 per cent. This pattern is unfamiliar in the UK: in the 1980s and 1990s recessions, real wages stalled temporarily rather than falling for a sustained period.<sup>[27]</sup> Coupled with slow real wage growth for typical employees prior to the downturn, this means that median hourly earnings are now at the level they were at in 2003.<sup>[28]</sup>

While it has been slow to arrive, it is clear that some form of pay recovery is now underway. Too much of the real wage growth observed since late-2014 has been driven by ultra-low inflation and there has been a disappointing lack of pay ‘rebound’, but wages are rising broadly in line with the pre-crisis trend rate. This recovery is likely to reflect rising demand within the economy, but there are at least three other factors that are liable to put upward pressure on labour costs in the coming years which suggest that the era of ever-cheaper labour is coming to an end.

» First, labour may not have been as ‘cheap’ as a narrow focus on wages would imply. Both the pre-crisis stagnation in pay and the post-crisis squeeze were compounded by employer pension costs, which have risen rapidly. This has been driven by increased longevity, historic under-funding of defined benefit pension schemes and the recent poor performance of pension fund investments. Thus, while median wages have ‘decoupled’ from productivity growth since the early-2000s, overall labour compensation hasn’t.<sup>[29]</sup> This ‘wedge’ between pay and compensation shows no signs of declining and may even be set to widen. The phased roll-out of pensions auto-enrolment means increasing numbers of firms now have to offer most workers a pension scheme and make minimum contributions (unless workers actively opt out). This will drive up labour costs, particularly for firms not currently offering pensions,

[27] J Jenkins, ‘The labour market in the 1980s, 1990s and 2008/09 recessions’, *Office for National Statistics Economic & Labour Market Review* 4:8, August 2010

[28] RF analysis of ONS, *Annual Survey of Hours and Earnings*

[29] For a fuller discussion of the divergent paths of wages and other labour costs, see: M Whittaker, *A recovery for all? The evolution of the relationship between economic growth and pay before, during and since the financial crisis*, Resolution Foundation, September 2015

which tend to be smaller and operating in lower-paying sectors.<sup>[30]</sup>

- » Secondly, from April 2017 firms with pay bills of over £3 million will be charged a 0.5 per cent levy to fund apprenticeships. As a payroll tax this is likely to further contribute to higher labour costs for businesses that cannot offset the costs of the levy against existing training activities.
- » Thirdly, from April this year the new higher minimum wage for workers aged 25 and over – the National Living Wage – comes into force. This initially increases the minimum wage for these workers by over 7 per cent, but it is then set to rise sharply over the course of the parliament to be equal to 60 per cent of the 25-and-over median wage by 2020 (around 12 per cent higher than expectations for where the National Minimum Wage will be by then). This welcome but dramatic move is expected to boost the wages of up to six million workers, who are particularly concentrated in the private sector; the hospitality, retail and care industries; and the lowest-paying regions of the UK.<sup>[31]</sup>

Taken together, these factors point to a period of rising labour costs. In turn, this could help to drive renewed productivity growth. That's because, faced with higher wage costs, we should expect firms to be more conservative in their use of labour and more highly incentivised to invest in capital and new technology.<sup>[32]</sup> Indeed, our recent survey of businesses suggested that boosting productivity is the preferred approach to absorbing the costs of the higher wage floor.<sup>[33]</sup> Welcome though this is, rising productivity and efficiency makes the maintenance of employment growth a more challenging prospect that it might have previously seemed. Given that cost pressures are going to be focused on less-qualified workers, low wage sectors and more deprived regions, the ability of the labour market to automatically generate employment for the groups and areas we target is far from assured.

## Employment availability: which jobs where?

Of course, such labour cost pressures can be reduced if aggregate demand continues to grow. The central importance of demand to the full employment agenda is reflected in the American literature, where policies to spur domestic demand by reducing the US trade deficit feature prominently.<sup>[34]</sup> We do not directly address how sufficient demand can be maintained in this study – we treat it as exogenous – however it's worth highlighting that macroeconomic stability and sustained economic growth throughout the parliament will be necessary pre-conditions to full employment.

As with the ability of the labour market to continue 'automatically' generating employment growth, these conditions are not automatic.<sup>[35]</sup> They are also likely to vary across the country.

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[30] Office for National Statistics, *2014 Annual Survey of Hours and Earnings: Summary of Pensions Results*, February 2015

[31] For a full discussion of the various expected effects of the National Living Wage, see: C D'Arcy, A Corlett & L Gardiner, *Higher ground: Who gains from the National Living Wage*, Resolution Foundation, September 2015; C D'Arcy & A Corlett, *Taking up the floor: Exploring the impact of the National Living Wage on employers*, Resolution Foundation, September 2015

[32] In a world in which we simultaneously move towards full employment, productivity and wage growth will be partially muted by the downward shift in workforce composition, as well as the increase in labour supply. As we said in Section 1, this participation boost can push out the point at which employment and wage growth moderate one another or are moderated by monetary policy. However, rising participation can only stall and not endlessly offset cost pressures.

[33] C D'Arcy & G Davies, *Weighing up the wage floor: Employer responses to the National Living Wage*, Resolution Foundation / CIPD, February 2016

[34] D Baker & J Bernstein, *Getting back to full employment: A better bargain for working people*, Centre for Economic and Policy Research, 2013

[35] Based on historical probabilities, we estimate a two-thirds chance of another recession before 2021. See: M Whittaker, *Renewed Interest: The role of monetary policy in crisis and beyond*, Resolution Foundation, January 2016

### The location of job demand

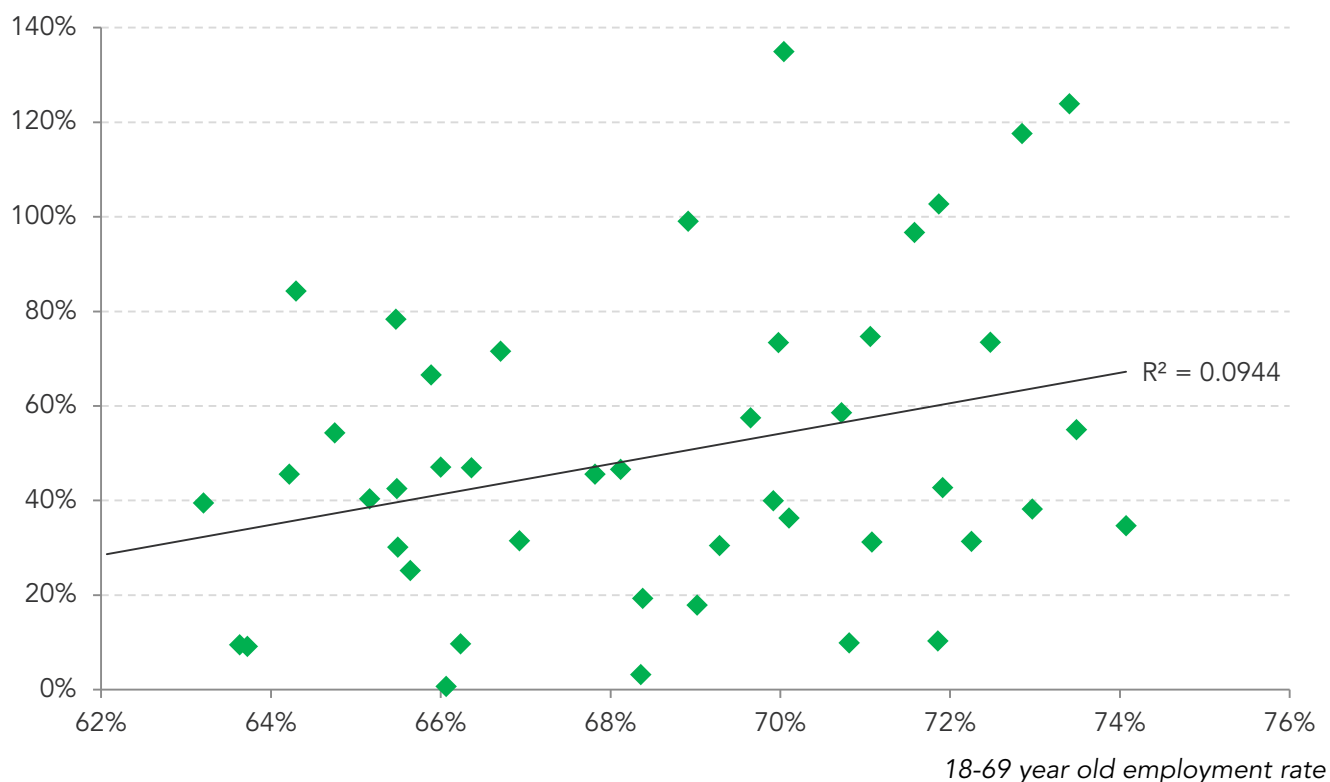
Beyond the overall demand conditions and the constraints created by rising labour costs, it's worth considering the types of employment availability that align with our concept of full employment. First, we consider location. We saw in the previous section that employment rate gains in our measure of full employment are strongly skewed towards the more disadvantaged areas of the UK, where low activity groups have worse participation outcomes. But does this imply that it matters where the job demand originates?

It might not if we believed that as the highest-performing labour markets neared full employment, the saturation of local labour supply would naturally shift demand to other areas where more potential workers are available. However this is not, in general, what happens in the UK. In part, that's because inwards migration tends to play a bigger role in filling the labour supply gap.

Figure 16 shows that in the lowest-employment sub-regions, foreign-born employment growth (our proxy for new migration) has accounted for around 30 per cent of total employment growth since 2010, whereas in the highest-employment sub regions the figure is around 60 per cent. This implies that areas can and do continue growing as the labour market tightens for resident populations, meaning that job demand does not automatically shift elsewhere in the UK.

**Figure 16: The relationship between sub-regional employment strength and the foreign-born composition of employment growth: UK, 2010–2015**

*Net annual change in non-UK born employment as a share of net annual change in total employment in sub-region*



**Notes:** Sub-regions where either employment growth, or non-UK born employment growth, are negative are excluded from the analysis, as are those in which non-UK born employment growth accounts for more than 150 per cent of total employment growth.

**Source:** RF analysis of ONS, Labour Force Survey

If job demand does not shift elsewhere, then might potential UK workers move to those areas of the country where their prospects appear best? Again evidence suggests not: internal migration rates are low in general, and lower-skilled workers (of which our low activity groups are strongly composed) are particularly unlikely to migrate internally for economic reasons.<sup>[36]</sup> There need to be very large discrepancies in employment across regions for less well-educated Britons to move in any numbers.

Taken together then, these two observations imply that the road to full employment must involve rapid job creation *outside* of the highest employment areas of the affluent wider South and East of England. That is, we need to generate growth in demand that is both strong and geographically spread – where employment demand occurs determines whether it helps us reach full employment or just boosts migration. While employment gains driven by migrants have beneficial effects in terms of output, these should not be the policy priority. To fulfil its potential in raising living standards for lower-income UK households, a primary feature of our full employment objective has to be to improve employment prospects *within* the lowest-performing local labour markets.

### New labour market entrants?

A further question on the nature of employment availability concerns whether we must exclusively rely on people moving *into* work. The need for new jobs to drive employment growth is in fact a common misconception, with most of the employment increases since the mid-1990s being driven by reduced *exits* from work. We explored these patterns in detail in previous analysis within our full employment project, finding that (outside of recession and recovery) employment entry from worklessness has been flat, while employment outflows have declined steadily over the past two decades.<sup>[37]</sup>

Figure 17 presents the latest picture on employment exits, showing that declining employment outflows have been concentrated among the over-30s and in particular the over-50s. For the over-50s, this reflects factors such as the postponing of retirement due to the rising State Pension Age for women, and the outlawing of compulsory retirement.

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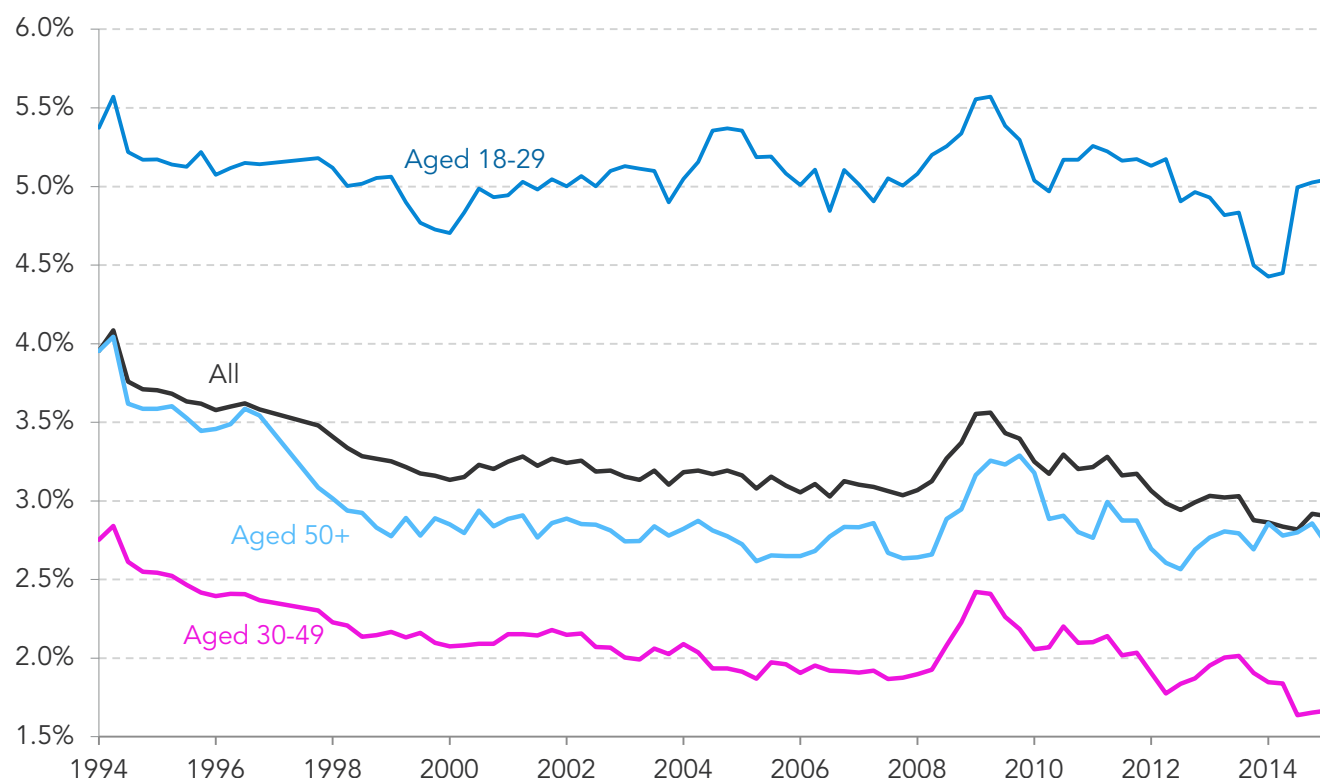
[36] P Gregg, S Machin & A Manning 'Mobility and Joblessness', in D Card, R Blundell & R Freeman, *Seeking a Premier Economy: The Economic Effects of British Economic Reforms, 1980-2000*, National Bureau of Economic Research, 2004

[37] P Gregg & L Gardiner, *A steady job? The UK's record on labour market security and stability since the millennium*, Resolution Foundation, July 2015

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**Figure 17: Employment outflows by age: UK, 1994–2015**

Proportion of those in employment moving to unemployment or inactivity each quarter (16-59(women)/64(men) year olds)



Notes: This analysis covers a more limited age range than that used elsewhere in this report due to data availability. Annual rolling average, year to date shown.

Source: RF analysis of ONS, Labour Force Survey two-quarter longitudinal datasets

For prime-age workers, declining employment exit primarily reflects mothers leaving the workforce around childbirth to a markedly lesser degree than used to be the case. This is likely to reflect changes in maternity leave policies and the availability of financial support towards childcare costs, while the trends towards later childbirth may also mean that women have more 'established' careers to return to post-birth than was previously the case.

Employment increases for older workers and prime age mothers have been almost entirely due to delaying retirement and maintaining contact with employment around childbirth, rather than entering new jobs after first leaving employment. And given the importance of these two groups to overall employment improvements over the past two decades, the key role of reducing outflows in driving aggregate employment increases is clear.

This is not to say that a focus on job creation or entry into employment from worklessness is *unnecessary* (indeed, just keeping employment entry rates constant becomes a bigger challenge as the pool of out-of-work adults becomes smaller), simply that it must not be the only focus of a full employment agenda.

### Jobs targeted at the skills and preferences of low activity groups?

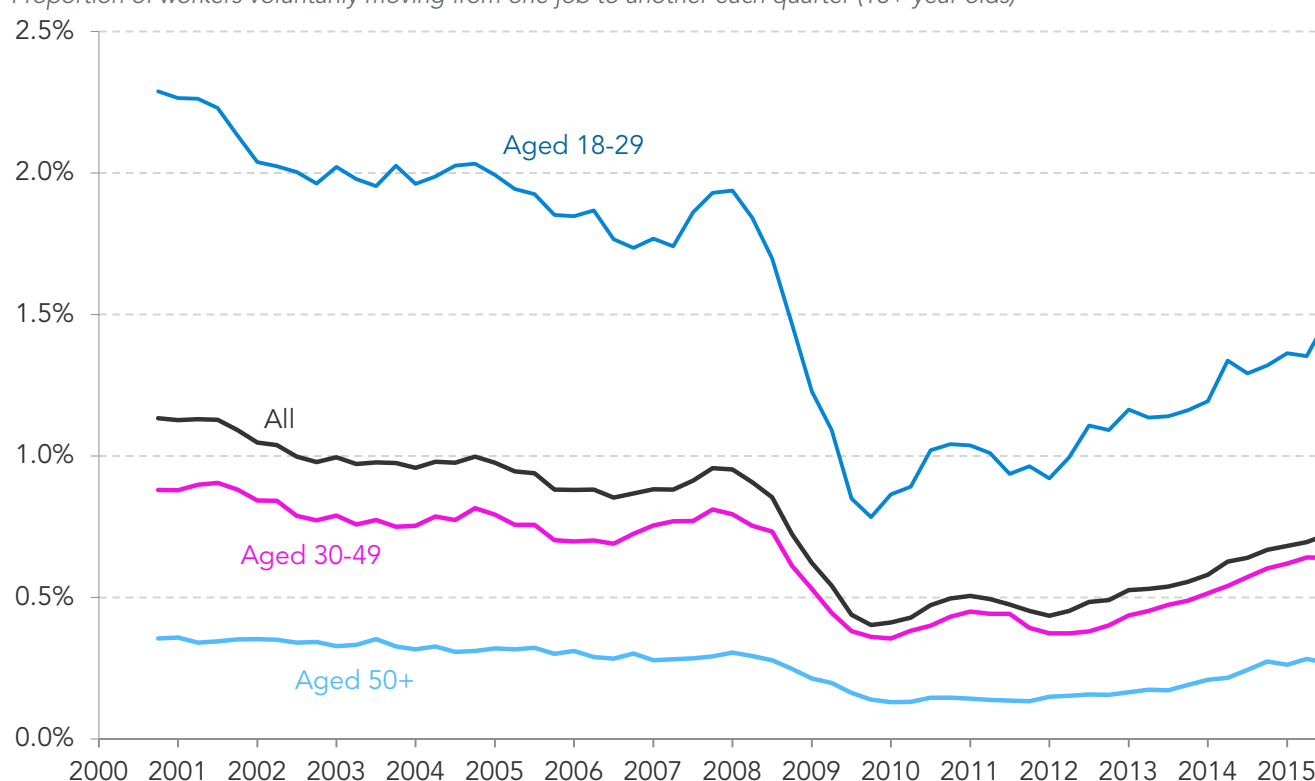
As well as the idea that entries into employment are the only way to achieve employment growth, a second misconception is that the jobs that do emerge need to match the characteristics of our low activity groups. In particular, because a large part of the potential additional workforce will be less qualified, the theory goes that new jobs will need to have low skills needs.

In fact, as we discussed in Box 3 in the previous section, job creation tends to spark chains of vacancies: those currently in work move to better-paid opportunities, gaining promotions and increased seniority, and creating a new vacancy lower in the jobs hierarchy. This is akin to house moving chains. Given the elevated levels of underemployment among the current workforce, this process can also help to re-balance working hours towards people's preferences, given that new participants show a tendency to move into short-hours jobs.

Also as touched on in Box 3, it is therefore a cause for concern that job mobility appears to be in long-term decline. Figure 18 shows that this is particularly the case for young people, for whom job-to-job moves are essential to promotion and wage gains at the beginning of careers. To some extent this will reflect the lower employment outflows discussed above, but it may also be due a lack of confidence after the experience of recent years, or a result of promotion blockages.<sup>[38]</sup> For young people in particular and for the efficient reallocation of productive capacity in general, job-to-job moves are an important feature of a well-functioning labour market that go very much with the grain of full employment ambitions.

**Figure 18: Job-to-job moves by age: UK, 2000–2015**

Proportion of workers voluntarily moving from one job to another each quarter (16+ year olds)



**Notes:** The measure captures the proportion of workers who report having resigned three months ago and who have been in their current job for fewer than three months. Annual rolling average, year to date shown.

**Source:** RF analysis of ONS, Labour Force Survey

Of course even with healthy job mobility there are limits to the role it can play in opening up appropriate vacancies for new participants, particularly given the geographic stickiness of lower-skilled labour discussed above. For vacancy chains to work they need to extend to places accessible by low activity groups.

[38] P Gregg & L Gardiner, *A steady job? The UK's record on labour market security and stability since the millennium*, Resolution Foundation, July 2015



And jobs suiting the hours preferences of new participants may not occur automatically even given current levels of underemployment, especially as we know that part-time and flexible opportunities tend not to send out the signals of quality and pay that are important to attracting people into the workforce.<sup>[39]</sup> The challenge of ensuring sufficient flexible and part-time roles that suit the needs and preferences of the individuals our concept of full employment targets is one to which we return in the following section.

## The absorption of low activity groups: what can economic conditions deliver?

Having discussed the prospects for employment availability and wages, here we try to assess evidence of how sensitive the participation of different low activity groups is to these factors. This allows us to give a rough indication of the extent to which labour market improvements across UK sub-regions might draw in new participants from the groups we target.

For this purpose, we compare labour force participation among low activity group members across location (the UK's 20 sub-regions) and time (between 1998-99 and 2014-15). Our regression analyses first combine all the low activity groups and then consider outcomes for each group separately, allowing us to test the sensitivity of participation to local labour market conditions in general and specific terms.<sup>[40]</sup>

In establishing the strength of local labour market conditions we use two proxy measures designed to capture employment availability and wage levels:

- » We capture **local availability of employment** by focusing on the employment rate recorded among all non-low activity adults (i.e. the 'high performer' group discussed previously, but including the mid-qualified to capture some additional variation). Rates are recorded in each sub-region in each year. To correct for national-level cyclical movements, these rates are expressed as ratios to the equivalent (combined) rates in the East and South East of England (our 'tightest' labour markets). We use this proxy for employment availability rather than data on vacancies, for example, because vacancies data is not available consistently covering the time-period we use, or for the geographies we focus on.
- » We capture **available wage levels** in two different ways. The first compares the median wage recorded within a region across low activity groups with the (combined) low activity median recorded in the South East and East. The second compares the same local median among low activity groups with the overall sub-regional median wage across all employees. That is, the former presents the relative wage offer for low activity groups in different parts of the country; while the latter presents the relative wage offer available within sub-regions for different groups of individuals. In this way, they both control for overall wage trends over time.

A full description of the specification of our models and a summary of our results is provided in Annex 4. We do not go into much detail here, rather summarising the key findings from this analysis.

First and foremost, our overall models (all low activity groups combined) produce positive and significant coefficients on both our employment availability and available wage proxies. We interpret this as showing that **an improvement in local labour market conditions (measured in terms of either job demand or wages) raises low activity workforce participation in general.**

[39] For example, only 6.2 per cent of quality job vacancies are advertised with the option to work flexibly. See: E Stewart & P Bivand, *How flexible hiring could improve business performance and living standards*, Joseph Rowntree Foundation, January 2016

[40] It's worth highlighting that we are modelling effects on *participation*, not the sensitivity of *employment* to local labour demand. The latter would likely be far more responsive to demand-side changes, but much of this would be met by changes in unemployment. In keeping with our focus throughout this project, we instead concentrate on how people are encouraged to join the labour force.

Our group-by-group models show that this is not the case for BAME groups or single parents. Participation within these two groups appears to be comparatively insensitive to local labour market conditions. Instead, **sensitivity to local labour market conditions appears to be concentrated within the four remaining low activity groups – the low-qualified, young people, older people and disabled people.** Here the coefficients remain positive, significant and relatively consistent across groups.

Interpreting the magnitude of our results is difficult. We create some simple scenarios, based on what we consider to be reasonable expectations for how much employment availability and available wage levels might change. In each instance, we consider what such changes would mean in terms of low activity workforce participation. Again, full details of these thought experiments are provided in Annex 4, with the headlines summarised here.

Turning first to employment availability, we consider the effect on low activity participation of eradicating sub-regional differences for non-low activity groups (a not unreasonable metric in the context of the road to full employment, which should give more advantaged workers more-or-less the same employment chance no matter where they live). In 2014-15 this would have equated to a low activity participation increase of up to roughly 2 percentage points in the most-affected sub-regions. Totalling these gains across sub-regions implies a participation increase of 200,000-240,000 additional people in the workforce belonging to one or more of the low-qualified, young, old, and disabled groupings.

In terms of the available wage, we use alternative approaches to cover both of our proxies. First, we consider the impact of raising the pay of low activity groups across sub-regions to at least its level in the East and South East of England in 2014-15. Secondly, we consider reducing the low-activity-median-to-overall-median wage gap across sub-regions to its smallest in any sub-region in 2014-15. Both of these simulations are stretching – implying a wage increase for low activity workers of up to 15 per cent in some sub-regions – but not outlandish given the likely impacts of the National Living Wage in coming years and where these impacts are likely to be focused. Totalling the gains across sub-regions from these simulations implies 330,000-420,000 additional participants in one or more of the low-qualified, young, old and disabled groupings.

In sum, these stretching – but tenable – simulations suggest a **total participation boost from relative improvements in local labour market conditions of around 600,000**, with slightly more of an effect from wage rises as we have modelled them than from increased job demand. In other words, both improvements in the availability of work and increased wages will act to substantially draw people into the workforce. This is not the same as saying that *employment* would be boosted by 600,000: not all of these new participants would be in employment – but most would.

Comparing these estimates to our full employment benchmark suggests that the ‘pull’ factors of employment availability and wages, even on very stretching assumptions, might get us some but not all of the way there. And this appears to be the case for some but not all low activity groups, with single parents and BAME groups seemingly less responsive to local labour market conditions.

On this basis then, the need for a policy agenda to support full employment should be clear. This is both in terms of ensuring that the demand that can prompt some low activity groups to participate is concentrated in the areas it is most needed, and pushing employment for all groups further still. We turn to what this policy agenda might look like in the following section.

## Section 4

# A policy agenda for achieving full employment

*Having established what full employment looks like and the economic conditions that are conducive to its achievement, in this section we turn to the essential role of policy. We first address policies that aim at boosting participation and employment for each of our 'low activity' groups. Our contention is that for some groups a conventional focus on out-of-work adults entering employment is appropriate; but for other groups, policies to reduce the rate at which people exit employment play the dominant role. We discuss recent policy developments affecting each low activity group and offer directions for improvement in each case. After reviewing the policy agenda for each group, we turn to policy directions that cut across groups, and directions to ensure that demand-side conditions and overarching frameworks are as aligned to full employment ambitions as possible.*

## The importance of policy innovation

The discussion in the sections above has set out where and for whom the employment gains on the road to full employment will need to come from, and how this journey might interact with and be shaped by the broader economic environment within this parliament. This has underscored a need for fresh policy thinking if full employment is to be more than a casual aspiration, principally for three reasons:

- » First, as discussed in the previous section, we can't just assume that current employment progress will continue, because this has been rooted in historically unprecedented flat earnings. Maintaining strong progress on employment growth is by no means a given.
- » Second, although tightening labour markets – if they materialise – will provide a 'natural' participation boost among low activity groups, our estimates suggest that this will get us some but not all of the way towards our full employment measure. This makes clear that we cannot just rely on economic demand-driven improvements – fresh policy thinking will be a must.
- » Third, to the extent that demand can drive improvements, our analysis suggests that it must be strongly tilted towards lower-employment parts of the country, which is by no means a given. Here, too, there is a need for a policy focus.

Full employment therefore requires a policy agenda of its own. Clearly the challenges this agenda needs to address are large and wide-ranging, and we do not attempt to cover all aspects of it here.

Over the course of this project we have engaged with a wide range of experts across different policy areas, via public events, private roundtables and one-to-one meetings. Building on their expertise, and the recent and past experience in the UK and elsewhere, here we set out directions for local and national government policies emanating from our analysis. We offer specific policy ideas where we see opportunities for action, and we highlight interesting examples of approaches worth learning from that have been shared with us over the course of this project.

## Reframing the policy agenda for low activity groups: focusing on inflows *and* outflows

Employment policy for the six main low activity groups that we focus on – young people, older workers, the low-qualified, mothers and single parents, disabled people, and BAME groups – is vast and complex. We do not attempt to describe it all in detail here, and nor do we make recommendations for how all aspects could be improved. Rather, we set out where we think the most significant gains for each group must come from.

For this purpose, a helpful starting point is the observation made throughout our analysis that overall employment growth is the product of two distinct factors: *entry* into employment from worklessness, and employment *exit*. Important though it is, too much of the current policy discussion focuses only on the former of these. This is a product of the central role played by the Department for Work and Pensions (DWP) in the employment agenda, and the frequent conflation of employment aspirations with reducing the welfare bill. For us, as has been made clear, full employment is much broader than this.

For some groups, entry into the workforce *should* be the key focus. We suggest that it is on this side of the equation that the biggest challenges lie for three of our low activity groups: the low-qualified, young people, and BAME groups. This is not to say that there are not issues for these groups when in work. However, the greater challenge appears to be engagement with the labour market and entry into secure work in the first place.

For other groups, we suggest that a focus on reducing exit from the workforce can reap higher rewards. This is the case for disabled people, mothers and single parents, and older workers. Again, this is not to say that there is not progress to be made on the other side of the equation. For example, with so many disabled people out of work, a need to focus on employment entry for this cohort is undeniable. And to take a specific example, improving the poor job entry rates recorded for disabled and older participants on the Work Programme (the government's flagship welfare-to-work initiative for long-term benefit claimants in the last parliament) in its successor is a must.<sup>[41]</sup>

However, even successful employment programmes achieve comparatively low job entry rates for disabled and older people,<sup>[42]</sup> with many older people who lose jobs in their 50s and 60s moving from unemployment into early retirement as a result.<sup>[43]</sup> And mothers who return to work after a period of detachment are often consigned to more unstable and lower-paid opportunities than the employment they left.<sup>[44]</sup> This highlights the damaging effect that losing touch with the labour market can have. Of course we must support those who do suffer these adverse outcomes, but a more proactive approach involves avoiding them in the first place by stemming flows out of work.

Finally, across low activity groups, it is important to acknowledge the role played by financial incentives to enter or stay in work. While we discuss these in some places, financial incentives are not a major focus of our policy directions, for reasons set out in Box 4.

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[41] Centre for Economic & Social Inclusion, *Work Programme statistics: Inclusion analysis*, September 2015

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[42] A Corden & B Thornton, *Employment Programmes for Disabled People: Lessons from research evaluations*, Department for Work and Pensions, 2002

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[43] TUC, *Older workers and the recession: Taking account of the long-term consequences*, October 2009

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[44] 'The career challenge of taking a break to raise a family', *Workingmums*, 19 October 2015

*i* Box 4: The role of financial incentives

Financial incentives – the difference between the amounts of money a person has when in and out of work – are an extremely important part of the policy landscape, and have been an essential feature of changes over the past two decades. This is the case both in terms of increasing employment entry – for example, the introduction of the tax credit system in the early 2000s raising in-work incomes for parents (see Box 5 for more details) – and delaying employment exit – for example, the raising of the State Pension Age for women reducing out-of-work incomes for those in their 60s. These and other changes to incentives to enter or remain in work have had a measurable effect on employment rates for particular groups.

Despite their importance, changing financial incentives is not a central feature of many of the policy directions offered in this report. This is because, as stated, this is an area where much progress has already been made in

recent decades, and where transformation is underway in the transition to Universal Credit (UC) over this parliament.

Of course, this is not to say that we can be complacent on this issue. Indeed, our previous in-depth analysis of the impact of UC has highlighted that while it improves financial incentives to enter employment at a low number of hours for some of the groups we focus on (e.g. disabled people), it creates incentives for others to reduce working hours.<sup>[1]</sup> In addition, cuts in generosity that have been maintained in UC while being scrapped in tax credits reduce the value of the benefit overall and weaken incentives to enter work for many groups. We will further explore the incentive effects of UC as currently conceived in a forthcoming publication.

[1] D Finch, *Making the most of UC: Final report of the Resolution Foundation review of Universal Credit*, Resolution Foundation, June 2015

## Policy directions for achieving full employment

Within this framework of a balanced focus on *inflows* for some groups and *outflows* for others, we consider possible policy solutions for each low activity group in turn. Building on this, we then discuss essential elements of the policy environment that apply across all groups, before finally turning to the demand-side conditions and overarching frameworks that can support a full employment agenda. Our policy directions are summarised in Table 4, with a discussion of each and more detailed recommendations and suggestions in the sections below.

**Table 4: A policy agenda for achieving full employment: summary of our approach**

A policy agenda aligned to the challenges faced by different 'low activity' groups	
By minimising employment exit	And by maximising entry to employment
<p><b>For mothers and single parents:</b></p> <p><b>1.</b> The government must defend the UK's impressive record on maternal employment by protecting financial incentives to stay in work and ensuring that rights and regulation around childbirth are normalised and embedded.          &gt;&gt; Reverse plans to weaken work incentives in Universal Credit.          &gt;&gt; Enhance initial Shared Parental Pay award to encourage take-up.</p>	<p><b>For the low-qualified:</b></p> <p><b>4.</b> The government must use the opportunity provided by the Apprenticeship Levy to ensure that apprenticeships and traineeships are more appropriately targeted towards those transitioning from study, unemployment and inactivity into work.          &gt;&gt; Target of half of all new apprenticeships and traineeships allocated to those coming from study or who have been out of work.          &gt;&gt; An apprenticeship access fund.</p>
<p><b>For disabled people:</b></p> <p><b>2.</b> The government must use its forthcoming disability employment White Paper to establish a comprehensive strategy not just for boosting employment entry but for minimising employment exit connected to disability and ill-health.          &gt;&gt; A disability employment outflow reduction target.          &gt;&gt; A statutory 'right to return' of a year.</p>	<p><b>For young people:</b></p> <p><b>5.</b> The government must put in place a system for identifying and engaging those young people struggling in the transition from education to employment.          &gt;&gt; A new tracking system with accountability attached.</p>
<p><b>For older people:</b></p> <p><b>3.</b> The government and other organisations must work together to support manageable and sustainable employment flexibility for those approaching retirement.          &gt;&gt; Widespread options for part-payment of pensions when reducing working hours.</p>	<p><b>For BAME groups:</b></p> <p><b>6.</b> The government must work with employers to end discrimination on the basis of race and ethnicity, and ensure that employment and skills services effectively engage with BAME groups.          &gt;&gt; A new push on 'name blind' recruitment.          &gt;&gt; Engage BAME groups in proportion to their prevalence in local workless populations.</p>
Policies to boost employment across 'low activity' groups	
<p><b>7.</b> The government must extend employment support services beyond those engaged with the benefit system to provide assistance to wider workless populations.          &gt;&gt; Local 'public employment services' incorporating Jobcentre Plus and other advice and support.</p>	
<p><b>8.</b> Local and national employment and skills funding and resources must be targeted in a way that appropriately accounts for multiple disadvantage.          &gt;&gt; The payment model for the new Work and Health Programme.</p>	
<p><b>9.</b> The government must support employers to create good-quality part-time and flexible job opportunities, and do so itself in its role as an employer.          &gt;&gt; Prompt employers to offer jobs flexibly when posting on Universal Jobmatch.</p>	
An overarching framework for boosting employment across the country	
<p><b>10.</b> The government must ensure that its infrastructure investment, devolution and full employment agendas are fully aligned.          &gt;&gt; National Infrastructure Commission to address transport bottlenecks to further employment growth in forthcoming report.</p>	
<p><b>11.</b> The government must set out a detailed plan for the implementation of the National Living Wage, with a focus on those sectors and parts of the country in which it is likely to bite hardest.          &gt;&gt; A broader role for the Low Pay Commission to support areas to overcome blockages.</p>	
<p><b>12.</b> National, devolved and local governments must work together to evaluate and share learning from efforts to raise participation and employment outcomes in their areas.          &gt;&gt; The first 'demonstration' projects of the government-backed What Works Centre for Local Economic Growth.</p>	



## Minimising employment exit – mothers and single parents, disabled people and older workers

### Mothers and single parents

As has been highlighted throughout this report and in previous publications from our full employment project,<sup>[45]</sup> progress on employment for mothers in general and for single parents in particular has been a major success story over the past two decades, contributing to improving living standards for lower-income households. This story is summarised in Box 5, in particular our view that success has been down to the combined effects of three elements: regulation of the employment relationship to reduce employment ‘outflows’ around childbirth; reasonable welfare conditionality aligned with services to support employment entry for single parents in particular; and financial incentives. A balance between inflow and outflow – and between ‘stick’ and ‘carrot’ – is evident here.

#### i Box 5: The policy agenda to date supporting maternal employment

Progress on maternal employment over the past two decades has been rapid. The non-single parent mother employment rate was 5 percentage points higher in 2014-15 than it was in 1996-97, and the single parent employment rate a remarkable 19 percentage points higher (see Figure 20 in Annex 2 for details). Our view is that gradual shifts in the policy environment have played a big role here, which an examination of the timing of improvements particularly for specific subsets of mothers attests to.<sup>[1]</sup> This has involved a mix of three broad elements:

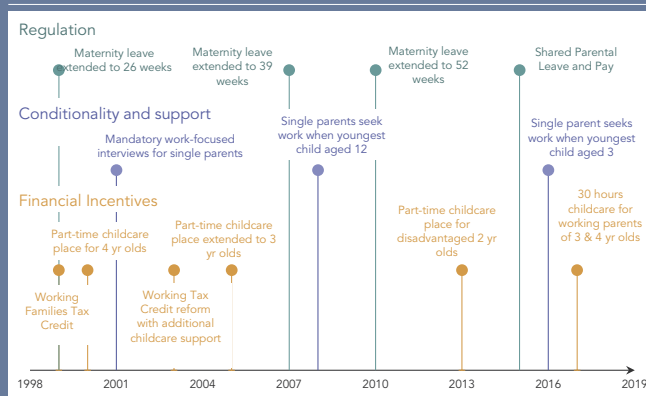
- » *Regulation of the employment relationship*: particularly in extensions to the period in which a mother has the right to return to her previous employer after childbirth, and more recently the right to request flexible working patterns. Increased generosity of Statutory Maternity Pay, particularly in the mid-2000s, will also have played a role in encouraging mothers to retain contact with employers.
- » *Conditionality and support*: principally in the form of increasing job search conditions attached to the receipt of Income Support for single parents and the migration of those with children above specified minimum ages onto Jobseeker's Allowance. This increased conditionality entails more regular contact with employment advisers,

thereby extending new forms of employment support.

- » *Financial incentives*: particularly the introduction of the tax credit system and increasing support towards childcare costs.

Some of the main changes under each of these categories are summarised in Figure 19.

Figure 19: Key policy interventions to support maternal employment



[1] For a detailed discussion of such trends, see: P Gregg & D Finch, *Employing new tactics: The changing distribution of work across British households*, Resolution Foundation, January 2016

Impressive though performance on maternal employment has been, there remain opportunities for further gains, or areas where past success needs protecting or sustaining.

[45] P Gregg & D Finch, *Employing new tactics: The changing distribution of work across British households*, Resolution Foundation, January 2016



One area where further changes are on the horizon is the next extension of conditionality for single parent benefit claimants, with those with a youngest child aged three or four moved into the Jobseeker's Allowance-equivalent group in Universal Credit (UC) from 2016 (currently the cut off is those with children aged five). It appears unlikely that this age limit will be pushed any lower in the medium term. This may drive further participation gains, and is being supported (albeit a year later) by the extension of free childcare for three- and four-year-olds with working parents to 30 hours per week from 2017.

However, as discussed in Box 4, financial incentives are undergoing much wider upheaval in the transition to UC, leading to an uncertain net effect on maternal employment. In particular, incentives to enter (or remain in) work are being weakened for single parents and second earners, with the risk that some reduce working hours or exit employment altogether.

In terms of regulation of the employment relationship, the policy framework was bolstered further in 2015 by the introduction of Shared Parental Leave and Shared Parental Pay. This represents another step forward by allowing couples to more equally share time out of the labour market, therefore providing greater opportunities for mothers to maintain contact with employers. However, the fact that men often earn more, and their statutory allowance is comparatively less generous, may be a barrier to take-up. That is, the initial drop in income associated with a father taking leave is significantly greater than for mothers. In addition, despite a strengthened regulatory framework, for too many women maternity leave is an avenue to economic inactivity rather than a short break in employment. Evidence suggests that as many as 50,000 mothers per year are unfairly dismissed in connection to pregnancy and maternity, or treated so poorly they feel unable to return to work.<sup>[46]</sup>

**In sum, the impressive policy record that has helped drive rising maternal employment has been based on a triangulation of conditionality and support, financial incentives, and regulation. But with financial incentives to enter or remain in work set to be weakened in coming years, and with the regulatory framework not always delivering to its potential, there are risks that progress may stall or reverse.**

**i** Policy direction 1: The government must defend the UK's impressive record on maternal employment by protecting financial incentives to stay in work and ensuring that rights and regulation around childbirth are normalised and embedded.

We recommend:

- » The government should reverse plans to weaken incentives to remain in work for single parents and second earners in Universal Credit.
- » The government should explore options for reducing unfair dismissals connected to pregnancy and childbirth, beyond the regulatory framework that is in place. For example, as a further deterrent against employer malpractice, the costs of making someone redundant while on maternity leave could be increased.
- » To encourage take-up and normalise a more balanced division of parental leave between partners, the government should consider introducing a more generous rate of Shared Parental Pay in the initial weeks for couples making use of Shared Parental Leave. This could involve the initial award for the father being equal to a proportion of his usual earnings, rather than the statutory flat rate (similar to the allowance available during the first six weeks of Statutory Maternity Pay). This would only be available to couples sharing leave – not a standard feature of Statutory Paternity Pay.

[46] D Pyper, *Maternity Discrimination: Westminster Hall debate*, House of Commons Library, October 2015

## Disabled people

Policies to boost employment for disabled people are essential to achieving full employment. The government recognises this, and is due to publish a White Paper that will set out reforms to improve support for people with health conditions and disabilities, including exploring the role of employers.<sup>[47]</sup>

For this group, given their much lower chances of participation and their disproportionate share in full employment gains on our measure, it's clear that a substantial and multi-faceted approach will be necessary, including a focus on both employment entry and employment exit.

Most of the policy focus in recent years has been on boosting employment entry, an ambition that has often been conflated with efforts to reduce the out-of-work welfare bill. Notable changes include the introduction from 2008 of Employment and Support Allowance (ESA), a new out-of-work benefit for people with health conditions. This was intended to be a more 'active' benefit than its predecessor, but has been plagued by implementation problems.<sup>[48]</sup> More recently, ESA for those expected to return to work at some point has been time-limited for contributory claimants. And there are plans progressing through parliament for it to become less generous. The argument for this change was to ensure that the system sufficiently incentivises entry into employment.<sup>[49]</sup>

In terms of employment support for those claiming health-related benefits, the Work Programme has been roundly criticised as achieving very poor outcomes for ESA claimants and disabled participants in general (many of whom claim Jobseeker's Allowance).<sup>[50]</sup> In the 2015 Spending Review, the government announced that that Work Programme and its more health-focused and generously-funded counterpart – Work Choice – were to be replaced by a new Work and Health Programme, which would be smaller and more explicitly targeted at claimants with health conditions and the very long-term unemployed.<sup>[51]</sup>

Disability employment policy has gone through and is continuing to experience substantial reforms, with a particular focus on the management of (or reduction in) claimant numbers. As has been made clear throughout this report, we view the achievement of full employment as a much broader agenda than a narrow focus on benefit off-flows allows.

We will shortly publish a paper that will address the changes described above in more detail. For now, we note that even beyond the benefits-rather-than-jobs focus, the emphasis on employment entry is itself too narrow. As we have said, disability employment policy needs far more of an 'exit' focus. We consider the high-level direction this should take here, again with further detail to come in our forthcoming publication on disability employment policy.

At each bout of reforms to disability benefits that are designed to reduce spend, it is surprising how little attention is paid to how people arrive at these benefits in the first place. The evidence is there, however: a recent review into sickness absence highlighted that too many people – 330,000 each year – move from work (including self-employment) onto out-of-work, health-related benefits.<sup>[52]</sup> More up-to-date evidence suggests that just under one-third of the subset of this

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[47] HM Treasury, *Spending Review and Autumn Statement 2015*, November 2015

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[48] For example, see: P Litchfield, *An Independent Review of the Work Capability Assessment – year five*, Department for Work and Pensions, November 2014; C Pickles, E Holmes, H Titley & B Dobson, *Working welfare: a radically new approach to sickness and disability benefits*, Reform, February 2016

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[49] HM Treasury, *Summer Budget 2015*, July 2015

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[50] Centre for Economic & Social Inclusion, *Work Programme statistics: Inclusion analysis*, September 2015

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[51] HM Treasury, *Spending Review and Autumn Statement 2015*, November 2015

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[52] C Black & D Frost, *Health at work – an independent review of sickness absence*, Department for Work and Pensions, November 2011

group coming from employee jobs have not had a period of paid sick leave with their employer beforehand, with agency workers particularly overrepresented in this group.<sup>[53]</sup> Flows onto ESA from self-employment – a group for whom there is no sick pay equivalent – are also elevated.<sup>[54]</sup>

These outflows from work are likely to partly reflect the fact that the relationship with employers around the onset or escalation of health problems and disabilities is quite limited when compared internationally.<sup>[55]</sup> Statutory Sick Pay (SSP) is paid at a flat rate for up to six months, with few requirements in terms of what employers must do during this period, and no obligation to maintain the relationship with the employee once SSP is exhausted.

While statutory obligations are limited, nearly half of employers offer voluntary Occupational Sick Pay policies to all employees. These are more generous than SSP and often come with occupational health and rehabilitation support attached. Occupational Sick Pay is more common in larger firms in higher-paying sectors.<sup>[56]</sup> And evidence suggests that early intervention and vocational rehabilitation services that are often associated with these policies reduce sickness absence and speed up the return to work.<sup>[57]</sup> In these instances, continued attachment to and a supportive relationship with the firm are key ingredients of success.

The main other policies relevant to the onset or escalation of health problems at work are disability discrimination legislation, Access to Work, and the new Fit for Work service:

- » Access to Work provides funds to support both employment entrants and those already in jobs with travel costs, adaptations (beyond reasonable adjustments required by employers), and for managing mental health conditions. While proving a boon for some, take-up remains limited, with a recent review of disability employment support describing the programme as the “government’s best kept secret.”<sup>[58]</sup> And over the course of this project some have raised concerns that Access to Work is becoming too exclusively focused on employment entry rather than job retention.
- » The Fit for Work service, introduced in 2015 on the recommendation of the Black / Frost sickness absence review, is an independent assessment service that works with employees on sickness absence of four weeks or more and their employers, conducting an occupational health assessment and supporting the return to work.<sup>[59]</sup> It is too early to judge the performance of this service, but anecdotal evidence suggests low referral numbers have been a feature of its first months.

Finally, it’s worth noting that high levels of employment outflows connected to health should not be considered intractable. For example, 30 per cent of people aged 50+ who leave employment for reasons of sickness or disability say that they would not have left had adjustments been made to their duties or work environment.<sup>[60]</sup>

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[53] L Adams et al., *Understanding the journeys from work to Employment and Support Allowance (ESA)*, Department for Work and Pensions, June 2015

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[54] C Black & D Frost, *Health at work – an independent review of sickness absence*, Department for Work and Pensions, November 2011

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[55] Ibid

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[56] Ibid

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[57] ‘Long-term sickness absence costs UK businesses £4.17bn a year’, *Centre for Economics and Business Research press releases*, 30 October 2015

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[58] L Sayce, *Getting in, staying in and getting on: Disability employment support fit for the future*, Department for Work and Pensions, June 2011

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[59] C Black & D Frost, *Health at work – an independent review of sickness absence*, Department for Work and Pensions, November 2011

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[60] T MacInnes et al., *Disability, long-term conditions and poverty*, New Policy Institute, July 2014

**In sum, the disability employment policy agenda is overly focused on benefit off-flows rather than employment outcomes, and too focused on employment entry rather than employment exit. The significant challenges associated with supporting disabled people who have lost touch with the labour market into employment indicate that much more can be gained from a focus on preventing this situation from occurring in the first place, with maintaining attachment to the firm the key ingredient. While some policy initiatives are in place to support this attachment, there is far more to be done to enhance their impact and effectiveness, and to strengthen the relationship with employers in periods of sickness.**

## *i* Policy direction 2: The government must use its forthcoming disability employment White Paper to establish a comprehensive strategy not just for boosting employment entry but for minimising employment exit connected to disability and ill-health

We recommend:

- » The White Paper should set a health and disability employment outflow reduction target, with requirements for national, devolved and local governments to take steps to support this and reduce the rate at which people become detached from the labour market due to ill-health.
- » The government should introduce a statutory 'right to return' period of a year from the start of sickness absence. This would mirror its successful counterpart in maternity policy. It would introduce a clearly demarcated period of time, extending beyond the current Statutory Sick Pay period, during which an employee cannot be dismissed and has a job to return to, with minimum requirements on employers to support this return.
- » Renewed efforts to enforce Statutory Sick Pay rules for agency workers and an information campaign around new sick pay entitlements should be introduced to ensure compliance.
- » The government should explore options for extending Statutory Sick Pay beyond its current six-month period in some circumstances, conditional on employees demonstrating progress against return-to-work plans. This additional cost for businesses could be reimbursed by government, also conditional on employers meeting certain expectations such as evidence of progress against plans. The potential to offset the public costs of this Statutory Sick Pay extension against the resulting reduction in Employment and Support Allowance claims should be explored.
- » The government should do more to raise awareness of Access to Work funding and the new Fit for Work service among employers and employees, in particular to ensure that Fit for Work achieves its potential as an impartial and effective third-party support service within this new environment of increased requirements on both parties.
- » The government should ensure that parallel systems are in place for the self-employed. Eligibility criteria should be changed so that self-employed people can self-refer to the Fit for Work service. And insurance income from 'individual' Income Protection policies should be treated as 'earned' rather than 'unearned' under Universal Credit so that self-employed people, who are not eligible for Statutory Sick Pay, are not disincentivised from protecting themselves from the financial risks of ill-health. This would also increase access to the early intervention and rehabilitation services that are a part of such policies.<sup>[1]</sup>

[1] Under current UC plans, payments from 'individual' Income Protection insurance policies – which people can take out to protect themselves against the risk that they are unable to work for health reasons – are treated as 'unearned' income. This means that UC is withdrawn pound-for-pound against this amount. 'Earned' income, by contrast, is withdrawn at the UC taper rate of 65p for any amount above the work allowance. Given that Income Protection insurance is a specific product to replace earnings when out of work, and that payments from 'group' (employer-provided) policies that the self-employed can't access are treated as 'earned' income, such a change appears appropriate. For more information on Income Protection insurance, see: Association of British Insurers, *Welfare reform for the 21<sup>st</sup> Century: The role of income protection insurance*, September 2014

Case study 1 provides an example of an insurance-based approach to minimising the risks of sickness absence, and keeping workers in contact with the labour market when it occurs.

### *i* Case study 1: Unum Income Protection early intervention and rehabilitation services

Income Protection insurance provides workers with a financial safety net by paying a monthly income to people who are absent from work due to long-term sickness or injury.

As well as maintaining income at the onset of health problems, Income Protection policies place a strong emphasis on early intervention and rehabilitation services, to reduce the risk of sickness absence in the first place

and minimise its length. Research commissioned by insurance provider Unum from the Centre for Economics and Business Research suggests that early intervention and vocational rehabilitation services offered by providers can reduce the length of sickness absence by 17 per cent, and minimise flows onto state sickness benefits.<sup>[1]</sup>

[1] 'Long-term sickness absence costs UK businesses £4.17bn a year', Centre for Economics and Business Research press releases, 30 October 2015

## Older people

Given that the development or escalation of health conditions is strongly associated with age, much of the discussion of the disability employment policy agenda above is also relevant to older people.

As well as health conditions, at least two other common traits among older workers merit attention. The first is the increased likelihood of caring responsibilities for those of older working age. Statistics from the 2011 Census show that care responsibilities peak at age 50-64, where one-in-five are carers. And polling suggests that up to 2 million people have had to give up work at some point to care for loved ones, mostly in their 40s-60s and often because jobs proved insufficiently flexible to accommodate the new caring role.<sup>[61]</sup> As with health conditions and disability, caring responsibilities threaten attachment to the labour market for many older workers.

A second theme is the important role that self-employment has played in overall upward trends in older people's employment in recent years. Approaching half of self-employed people are over 50 (compared to just over a quarter of employees). In addition, sharp increases in self-employment in recent years can be partly explained by people becoming self-employed as a more flexible option towards the end of working lives, and in this way staying in the workforce for longer.<sup>[62]</sup>

It follows from the above that the employment challenge for older workers sits firmly within our discussion of the importance of reducing (or delaying) employment exits. Major policy changes aligned to this agenda in recent years have been the rising State Pension Age for women (with plans for further increases for both sexes once aligned); the removal of the default retirement age in 2011; and recent extensions of the right to request flexible working to all employees, not just parents. All these changes have increased incentives or opportunities for older people to remain attached to the labour market for longer.

Of course, as with the discussion of disability above, employment exit is certainly not the sole focus for older people. Many do find themselves out of work in their 50s and 60s, and as we have discussed this group finds it hard to move back in, with a comparative lack of evidence around what works in supporting older workless people back into employment.<sup>[63]</sup> However the fact

[61] Carers UK, *Facts about carers 2015*, October 2015

[62] C D'Arcy & L Gardiner, *Just the job – or a working compromise?: The changing nature of self-employment in the UK*, Resolution Foundation, May 2014

[63] With this identified as a knowledge gap, researchers at the University of Glasgow have partnered with a Work Programme provider, Ingeus, in order to identify the interventions that work in supporting those aged over 50 into employment.

remains that, as for disabled people, the most effective way to boost employment for older people is likely to involve building on the current policy agenda for delaying exit from the workforce.

**In sum, boosting employment for older workers further will rest on a continued focus on increasing incentives and opportunities to stay in employment for longer. Older workers display a preference for more flexible ways of working as they approach retirement, and lose contact with the labour market when flexibility is not available or not suited to their needs.**

### *i* Policy direction 3: The government and other organisations must work together to support manageable and sustainable employment flexibility for those approaching retirement

We recommend:

- » The government and pensions industry should work together to explore ways in which older workers can benefit from part-payment of pensions to maintain current income levels while reducing working hours. This should build on the (welcome) increasing flexibility in drawdown options that has been offered by the industry in recent years. Within 'defined benefit' schemes, this could include the flexibility to 'top up' lower part-time earnings with partial receipt of the pension (without losing entitlements or reducing future entitlements) – a 'half and half' approach allowing firms to retain experienced workers for longer. Within 'defined contribution' schemes, this could include more widespread provision of drawdown products specifically targeted at the needs of those wishing to combine flexible employment with some pension income.
- » The government should work with employers to encourage them to offer – on a voluntary basis – a 'right to return' following a period of unpaid leave connected to caring responsibilities, and other flexibilities to support older working carers.
- » Recognising the important role of self-employment in boosting employment among older people, the government should explore opportunities to simplify the environment for the self-employed and remove unnecessary barriers to this way of working.

Case study 2 gives an example of efforts by employers to provide flexible opportunities to older working carers.

### *i* Case study 2: Employers for Carers

Employers for Carers is a membership group for businesses committed to ensuring that employees with caring responsibilities can be retained. The organisation's purpose is to provide practical advice and support for employers seeking to develop carer-friendly policy and practice and retain skilled workers; and to identify and promote the

business benefits of supporting carers in the workplace. The practices recommended by Employers for Carers include paid emergency leave, planned unpaid caring leave, flexible working practices and in-house networking groups.<sup>[1]</sup>

[1] <http://www.employersforcarers.org/>



## Maximising employment entry – the low-qualified, young people and BAME groups

### The low-qualified

Of all the groups discussed in this analysis,<sup>[64]</sup> the low-qualified are the only one where an evident answer is to take people out of this status (or prevent them from being so in the first place) by raising qualification levels, or at least improving skills within the low-qualified grouping. Because we are talking about those who are above the new education participation age of 18 and, by definition, in the half of the population not going straight to university from school, the policy areas of most relevance are adult further education and skills design, provision, funding and take-up.

There has been significant upheaval in this area, in the context of an overall budget reduction of around a quarter in the last parliament and further reductions in coming years.<sup>[65]</sup>

- » Adult education grant funding for Level 3 and above qualifications has been replaced with Advanced Learning Loans (paid back as earnings rise in the same way as higher education student loans). This applied first to adults aged 24 and over, with the age limit then lowered to 19 in the 2015 Spending Review. Early evidence suggests that this has led to a decline in take-up, with only 62 per cent of the allocated budget spent in 2014-15.<sup>[66]</sup>
- » Funding has been withdrawn for a number of qualifications deemed to be poor quality or subject to low take-up.<sup>[67]</sup>
- » Remaining 19+ adult skills grant funding is to be brought under local control by 2018-19 as part of devolution deals with cities and Local Enterprise Partnerships (LEPs).
- » There has been a major focus on apprenticeships, with a commitment to delivering 3 million by 2020 and funding expanded. In addition, because apprenticeships are generally not open to those with few or no qualifications, traineeships have been introduced as a pre-apprenticeship route for 16-24 year olds. And from April 2017 the Apprenticeship Levy announced in the 2015 Summer Budget will help fund apprenticeship training.

There will be multiple ways to ensure this new adult skills environment is as aligned as possible to full employment objectives, for example in better marketing of the availability of loans to ensure that budgets are used, and in the allocation of devolved skills budgets by local leaders. However, given the current emphasis on apprenticeships and traineeships, this is the most obvious area for action and therefore the one that we focus on.

While there is much to be optimistic about from a full employment perspective in an agenda that links learning to work and provides a very effective route in other European countries, the current approach to apprenticeships and traineeships raises some concerns.

Despite efforts to respond to the Richard Review of apprenticeships which was critical of the quality of provision,<sup>[68]</sup> recent evidence suggests that quality frequently remains lacking.<sup>[69]</sup> Strikingly, only one-third of apprentices are new recruits (the rest are established in the business

<sup>[64]</sup> With the exception of disabled people for whom support to ameliorate certain types of health problems is important.

<sup>[65]</sup> R Lupton, L Unwin & S Thomson, *The Coalition's record on Further and Higher Education and Skills: Policy, Spending and Outcomes 2010-2015*, London School of Economics, January 2015

<sup>[66]</sup> P Offord, 'Further education and skills sector misses out on £250m in FE loans cash', *FE Week*, 30 October 2015

<sup>[67]</sup> R Lupton, L Unwin & S Thomson, *The Coalition's record on Further and Higher Education and Skills: Policy, Spending and Outcomes 2010-2015*, London School of Economics, January 2015

<sup>[68]</sup> D Richard, *The Richard Review of Apprenticeships*, Department for Business, Innovation and Skills, November 2012

<sup>[69]</sup> P Kirby, *Levels of Success: The Potential of UK Apprenticeships*, The Sutton Trust, October 2015



before starting), with indications that a much smaller subset had been out of work for any extended period before becoming an apprentice.<sup>[70]</sup> And groups including ethnic minorities are significantly underrepresented in the apprentice population.<sup>[71]</sup> Given our focus on employment entry for the low-qualified (and other low activity groups), this appears an inadequate targeting of public training subsidy.

**In sum, the existing approach to further education provision is strongly motivated by hitting a stretching apprenticeship target, without due consideration given to who benefits from these opportunities or the quality of the training provided. Apprenticeships are too-often being used not as a route out of low qualifications but as an in-work training solution for businesses.**<sup>[72]</sup>

**i** Policy direction 4: The government must use the opportunity provided by the Apprenticeship Levy to ensure that apprenticeships and traineeships are more appropriately targeted towards those transitioning from study, unemployment and inactivity into work

We recommend:

- » The government should set a formal sub-target that half of new apprenticeships and traineeships delivered by 2020 are allocated to new employees coming from full-time education, or who have recently been out of work.<sup>[1]</sup> As further and higher education are devolved policy areas, governments in the devolved nations should make similar commitments.
- » The government should top-slice a small proportion of the money raised via the Apprenticeship Levy to create an 'access fund' that targets and supports (financially

[1] We suggest that employees should not have to have been out of work immediately prior to starting an apprenticeship or traineeship, as it sometimes takes time to settle into the organisation before starting on formal training routes. A limit of six months seems appropriate.

and otherwise) disadvantaged workless people to move into apprenticeships and traineeships.<sup>[2]</sup> This should build on the successful model of access programmes within higher education.

- » To further increase access to apprenticeships and traineeships, the rules around these opportunities should be relaxed to allow flexible hours for certain groups, such as parents and those with caring responsibilities.
- » If the traineeship brand proves an effective entry point, eligibility should be extended to some older low-qualified people, for example, those who have been out of work for an extended period.

[2] More detail on how this fund might operate can be found in: National Institute for Adult Continuing Education, *NIACE/Inclusion 2015 Spending Review Submission*, September 2015

## Young people

Much of the recent political discussion around youth employment has centred on the challenge of getting young people off benefits and into work. For example, the government has announced plans to move young claimants from Jobseeker's Allowance onto a Youth Allowance with tougher conditionality, and to restrict access to Housing Benefit for those aged under 22.<sup>[73]</sup>

[70] J Higon, R Emmett & R Halliday, *Apprenticeship Evaluation: Learners*, Department for Business, Innovation & Skills, December 2014

[71] B Newton & J Williams, *Under-representation by gender and race in Apprenticeships: Research summary*, Unionlearn, December 2013

[72] This is an important outcome, but not one that addresses the primary challenge of boosting employment outcomes for the low-qualified.

[73] HM Treasury, *Summer Budget 2015*, July 2015

In reality, this focus on the welfare bill misses the greater challenge. In August 2015 there were 100,000 Jobseeker's Allowance claimants in England aged under 25, the group on which much of the policy attention has been focused. To this we might add a further 260,000 under-25s receiving benefits connected to sickness and single parenthood.<sup>[74]</sup> However, these figures are dwarfed by the number of 16-24 year olds not in education, employment or training (NEET) in England, which stood at 830,000 in the same period.<sup>[75]</sup>

The wider challenge is that many young people struggle to make effective transitions from education to work, and too many fall through the cracks along the way.

Policy initiatives to address this challenge in recent years include the raising of the participation age to 18 from 2014, meaning that young people are required to be in either full-time education or employment with training attached. However, this has not been backed up with responsibilities or resources for engaging with those dropping out. In addition, face-to-face careers advice for school-age young people is now the responsibility of schools (with no ring-fenced budget or monitoring of outcomes), with a much-reduced and predominantly online service for older age groups.

The attempts to boost the apprenticeship system described above are also an important part of this landscape (although access is not limited to this group – around two-fifths of apprenticeship starts are by those aged 25 and over<sup>[76]</sup>). The provision of a clear and visible route for vocational training offers a serious chance to radically improve school-to-work transitions in the UK. Looking across countries, those with strong apprenticeship systems tend to have comparatively lower youth unemployment when compared to 25+ unemployment.<sup>[77]</sup>

Finally, focusing briefly on those young people who *are* on benefits, Work Programme outcomes for young longer-term claimants are at least respectable, with around one-third of young claimants gaining sustained employment within two years.<sup>[78]</sup> However, the announcement that the much smaller successor to the Work Programme will only support those with health problems and the very-long-term unemployed means young people are largely absent from current welfare-to-work provision plans.

We see four key failings within the current, rather chaotic system:

- » Despite the national policy agenda and a large number of charities trying to support those young people not engaged in positive activities, in most of the country no agency consistently keeps track of young people from school age up into their 20s, monitors their education and employment status and reaches out to engage them. Local authority risk of NEET indicators (RONIs), do serve this purpose for those below the new education participation age, but evidence suggests they often do not address post-16 challenges, or drive mechanisms by which targeted support can be deployed.<sup>[79]</sup>
- » Schools have strong incentives to perform in terms of pupil exam results, but no similar incentive system exists for employment outcomes (though it increasingly does for universities).

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[74] RF analysis of DWP, *Work and Pensions Longitudinal Study*

[75] Department for Education, *NEET Statistics Quarterly Brief: July to September 2015, England*, November 2015

[76] J Delebarre, *Apprenticeship Statistics: England (1996-2015)*, House of Commons Library, January 2015

[77] C Biavaschi et al., *Youth Unemployment and Vocational Training*, World Bank, 2013

[78] Centre for Economic & Social Inclusion, *Work Programme statistics: Inclusion analysis*, September 2015

[79] S Day, *The evaluation of the raising the participation age locally-led delivery projects (RPA) 2011 to 2012: case study findings*, Department for Education, September 2012

- » The UCAS admissions system for universities has no coherent parallel in non-graduate opportunities, and information, guidance and a clear application process for the university route remains streets ahead of anything similar for non-graduate routes.
- » For those aged 18+ who fail to make a successful transition or who falter at a later date, the only national government funding for support and help is restricted to out-of-work benefit claimants of sufficient duration to be eligible, but two-fifths of young NEETs do not claim.<sup>[80]</sup> Even this provision looks set to be more limited in coming years.

**In sum, the current focus on getting young people off benefits misses the far wider challenge that far too many young people struggle to make effective transitions from education into work. Here the priority should be to strengthen vocational routes from school into employment, for example via the apprenticeship and traineeship system (discussed above), and ensure that all young people are progressing successfully down this (or other) routes rather than falling through the cracks.**

### *i* Policy direction 5: The government must put in place a system for identifying and engaging those young people struggling in the transition from education to employment

We recommend:

- » The government should introduce a tracking system, taking local risk of NEET indicators as its starting point, but extending coverage to older ages. This system should build on current efforts to work more effectively with administrative data across government departments, bringing together information from schools, further education colleges, apprenticeship funding (and access efforts), Jobcentre Plus, and local authorities. The option to incorporate real-time information on earnings from HMRC should also be explored. While the information would primarily be used at a local level, national government could support areas by developing a unified national information architecture.
- » Accountability for supporting those young people who are identified by the tracking system as not making swift transitions should be established, with one option being to hand it to cities and other areas within devolution deals.
- » Cities, local authorities and Local Enterprise Partnerships should be supported to provide more integrated services for young people, incorporating Jobcentre Plus and welfare-to-work provision, careers advice provided by schools and the National Careers Service, apprenticeship access activities, and services currently provided or commissioned by local authorities. Importantly, eligibility for support should not be limited to benefit receipt. In a similar vein, services should not target achieving benefit off-flows, and should place equal weight on work and learning outcomes, particularly at younger ages.

Case study 3 describes an approach to an integrated local employment service for young people, combining Jobcentre Plus services with other activities.

[80] G Cooke, *No more NEETs: A plan for all young people to be learning or earning*, IPPR, November 2013

### *i* Case study 3: MyGo – Ipswich City Deal

MyGo was created as part of the Greater Ipswich City Deal signed in 2013. It operates as an integrated youth jobcentre tasked with delivering the City Deal commitment that every 16-24 year old in Ipswich will be either in education, offered an apprenticeship, in work-related training or in work within three months of leaving education or becoming unemployed.<sup>[1]</sup>

MyGo is delivered by a partnership between a national welfare-to-work provider and the employment charity, Tomorrow's People. It incorporates Jobcentre Plus services for all young claimants prior to their entry onto

the Work Programme; provides a walk-in service to any young person regardless of benefit receipt; and conducts outreach work to engage target groups such as social housing residents and young people engaging with health services. It integrates careers advice and is the vehicle via which the local authority delivers its responsibility to prevent school-age young people becoming NEET.

While MyGo is structured around varying levels of intervention based on risks of disengagement, its ethos is based on an open-door, integrated, technology-driven approach designed to appeal to young people.<sup>[2]</sup>

[1] Greater Ipswich City Deal, October 2013

[2] <http://www.its-mygo.co.uk/>

## BAME groups

Ethnic minority people are clearly present (indeed, often overrepresented) in the other low activity groups we discuss. And in contrast to these other groups where we can pinpoint things like school-to-work transitions, caring responsibilities, and the onset of health problems, the 'barriers' or crunch points for BAME people are perhaps less evident. The result is that this group is not a prominent feature of policy debates.

However, the 'sensitivity analysis' summarised in the previous section and in Annex 4 suggests that this group if anything has a greater need for policy focus, their participation appearing the least responsive to improving labour market conditions. To understand why this is the case, we firstly point to the potential for conscious or unconscious discrimination on the part of employers or other services and agencies, which is not frequently discussed. For example, a randomised trial commissioned by the DWP found that candidates with 'non-white'-sounding names are nearly half as likely to be offered an interview.<sup>[81]</sup>

Other reasons why BAME groups appear the least responsive to labour market conditions may reflect some or all of:

- » The tight geographic clustering of some BAME groups in small subsets of the larger areas our analysis covers, where labour market improvements may be felt less.
- » Following on from the above, the more close-knit communities and cultures of some BAME groups in the UK may mean exposure to a more limited array of labour market opportunities, and less contact with policy systems designed to support employment entry.
- » Non-economic factors specific to certain minority ethnic groups, including cultural or religious expectations around labour market activity. Again these would mitigate in particular against entry into employment, rather than employment exit, hence our 'inflows' focus for BAME groups.

In support of the idea that services may not be reaching certain BAME groups, we note that those belonging to most Asian ethnicities are much less likely to be in receipt of benefits which are usually the passport to job search support. In 2014-15, the ratio of Jobseeker's allowance claimants to unemployed people (those looking for work and available to start as measured by surveys) was 45 per cent for white people, but only 32 per cent for Pakistanis, 28 per cent for Indian people and

[81] M Wood, J Hales, S Purdon, T Sejersen & O Hallyar, *A test for racial discrimination in recruitment practice in British cities*, Department for Work and Pensions, 2009

19 per cent for Chinese groups (a pattern that endures when controlling for gender).<sup>[82]</sup>

As further support for the suggestions above, we note that employment varies substantially across specific minority ethnic groups, and by gender within these. For example in 2011, Indian people in the UK had an employment rate of 70 per cent, while for Pakistanis it was 49 per cent. And within this headline Pakistani employment rate, women's employment chances were 52 per cent lower than men's, compared to a deficit of only 10 per cent for Chinese women.<sup>[83]</sup> This suggests that cultural factors are playing a role, and that geographic concentrations of certain groups may have a reinforcing effect on poor employment outcomes.

**In sum, while the specific challenge of supporting BAME groups into employment is not a prominent policy consideration, evidence of ongoing discrimination and difficulties engaging BAME groups in mainstream employment services suggest that it should be.**

## *i* Policy direction 6: The government must work with employers to end discrimination on the basis of race and ethnicity, and ensure that employment and skills services effectively engage with BAME groups

We recommend:

- » The UK government, governments in the devolved nations, cities and local authorities should maintain and build on recent efforts to tackle discrimination by employers, such as the Prime Minister's commitment to 'name blind' recruitment practices.<sup>[1]</sup>
- » Employment and skills services should be shaped with greater involvement by a diverse range of community

organisations in their design and delivery. This should include the commissioning of the Work and Health Programme (the Work Programme's successor), and the delivery of 19+ further education provision being devolved to cities (where ethnic minority groups tend to be more concentrated).

- » Employment services provided by Jobcentre Plus and others, and apprenticeship access activities, should place a greater emphasis on outreach, with a commitment to engaging and supporting BAME groups in proportion to their prevalence within local workless populations, regardless of benefit receipt.

[1] 'PM: Time to end discrimination and finish the fight for real equality', 10 Downing Street press office, 26 October 2015

Case study 4 describes an employment programme with outreach to BAME non-claimants as its driving purpose.

[82] RF analysis of DWP, *Claimant Count*; ONS, *Labour Force Survey*

[83] Office for National Statistics, *2011 Census analysis: Ethnicity and the Labour Market, England and Wales*, November 2014

**i** Case study 4: Partners Outreach to Ethnic Minorities programme, 2007-2009

The Partners Outreach to Ethnic Minorities (POEM) programme operated in areas of Birmingham, Bradford, Leeds, Leicester, London and Manchester between 2007 and 2009. POEM was designed to support people from Pakistani, Bangladeshi and Somali communities who were not in contact with Jobcentre Plus services, and were neither working nor claiming benefits. It was commissioned by the Department for Work and Pensions and delivered by providers who usually had experience working with these communities.

POEM providers engaged in community networks, partnered with cultural and religious organisations and included a strong multilingual element in order to access and recruit clients in the target groups. Evaluation evidence suggests that outreach work at a local community level, with outreach workers reflecting the ethnic and

linguistic make-up of target populations, were essential elements of success.

POEM provided flexible, one-to-one job search support to clients at a range of distances from the labour market, but with many further from work than had been anticipated when the programme was designed. It achieved an overall job entry rate of 29 per cent which improved over the course of the programme, with job entries of 21 per cent in the first year and 39 per cent in the second year. Improving performance was put down to staff developing an understanding of the client group over time and gradually strengthening community and employer networks.<sup>[1]</sup>

[1] J Aston et al., *Evaluation of Partners Outreach for Ethnic Minorities (POEM): Final report*, Department for Work and Pensions, 2009

## Raising participation across low activity groups

From this discussion of the specific challenges facing each low activity group, we draw three lessons for the direction that policies working across *all* these groups ought to take.

The first is that our broad focus on raising participation means that many of the people we identify as in scope for employment gains on the road to full employment won't be engaging with the out-of-work benefit system, generally the gateway to employment support initiatives. The ratio of Jobseeker's Allowance claimants to unemployed people had been falling since the introduction of the new sanctions regime in October 2012 (although it has risen again slightly in the past few months),<sup>[84]</sup> implying that a rising proportion of the unemployed are excluded from welfare-to-work support services. Beyond the unemployed, many working age economically inactive people don't claim out-of-work benefits. Those who do claim tend to receive disability and sickness benefits, but the limited eligibility for employment programmes within this group means that as few as one-in-ten workless disabled people are accessing DWP employment support services.<sup>[85]</sup>

With the combined Jobseeker's Allowance and equivalent UC claimant counts at an all-time low,<sup>[86]</sup> now is an appropriate time to consider the reorganisation of these employment support services and resources. The provision of services to new workless claimants (mainly second earners) in UC, plus in-work conditionality for low-paid UC claimants, and the exclusion of most long-term unemployed adults from the much smaller Work Programme replacement, provide further grounds for a rethink of eligibility for employment support services and how they are delivered.

Full employment requires easing the link between benefit receipt and employment support, and providing a more holistic employment support service offer.

[84] Learning and Work Institute, *Our Labour Market Analysis*, January 2016

[85] A Purvis, S Foster, L Lanceley & T Wilson, *Fit for Purpose: Transforming employment support for disabled people and those with health conditions*, Centre for Economic & Social Inclusion, July 2014

[86] RF analysis of ONS, *Labour Market Statistics*



## *i* Policy direction 7: The government must extend employment support services beyond those engaged with the benefit system to provide assistance to wider workless populations

We recommend:

- » The government should support the development of local 'public employment services' that incorporate the current remit of Jobcentre Plus, but also careers advice and access to employment and skills services organised by local authorities, Local Enterprise Partnerships and cities, with an emphasis on coherence rather than duplication at the local level. Services should remain mandatory for claimants subject to benefit conditionality, but would be voluntary for others, with a crucial role for outreach and engagement. Services could also incorporate or co-locate with others including housing options and broader advice provision.
- » As a first step to the creation of public employment services, pilots and projects should be developed, for example within devolution deals to cities currently being negotiated, with a view to scaling the best approaches over the course of the parliament.
- » National, devolved and local governments should pool resources to provide or fund provision to fill the gap left by the Work Programme once it is replaced by a much smaller health-focused initiative. Public employment services provide an obvious locus for this resource-sharing. In many cases this should involve commissioning on the basis of outcomes, backed by funding arrangements that invest future fiscal savings in programme funding (the so-called 'DEL-AME' switch). Crucially, investment must be sufficient for adequate engagement of and support for the low activity groups discussed throughout this report, including those not in receipt of benefits.

Case study 5 describes an example of a local employment service providing support to both those who receive out-of-work benefits and those who don't.

## *i* Case study 5: Newham Workplace

Newham Workplace provides a 'one-stop-shop' service to Newham residents who want advice about their employment options, help finding a job, or support to progress in work. It also helps local businesses to fill their vacancies, and is integrated with wider council services including housing and debt advice, and the dedicated young persons team.

Workplace is open to all residents including those not in receipt of out-of-work benefits. The service works

closely with Jobcentre Plus and other nationally-organised employment and skills provision, for example taking client referrals from local Jobcentre Plus offices.

Newham Workplace has helped over 25,000 residents into jobs between 2007 and 2015.<sup>[1]</sup>

[1] <https://www.newham.gov.uk/Pages/Category/Newham-Workplace.aspx?11=100008>

In the sections above we explored the policy environment for maximising employment within each of the low activity groups discussed throughout this analysis, in turn. However, it should be clear that these characteristics don't exist in isolation. For example, we have identified the strong associations between disability and old age, and the alignment of the policy environment for young people and skills provision to the low-qualified more generally. We have also identified specific subsets of the broad low activity groupings we use that merit particular attention, such as older people with caring responsibilities.



It follows from the analysis presented throughout this report that there is a compounding effect of multiple low activity characteristics. For example, of the four low activity characteristics that drive the lowest participation rates (single parenthood, disability, low qualifications and membership of a BAME group) the average participation rate for 18-69 year olds displaying just one of these characteristics was 73 per cent in 2014-15. For those displaying more than one characteristic, however, the figure falls to 47 per cent.

A policy agenda to support full employment as we have defined it must pay particular attention to the challenge of multiple disadvantage.

### **i** Policy direction 8: Local and national employment and skills funding and resources must be targeted in a way that appropriately accounts for multiple disadvantage

We recommend:

- » The particular needs of groups experiencing multiple disadvantage should be reflected in the payment

model for the new Work and Health Programme, the outreach activities of local public employment services, and apprenticeship access activities.

The final lesson to be drawn from the discussion above concerns the types of jobs our economy creates, and job design. We have seen that many groups, in particular mothers, disabled people and older workers, are likely to benefit (and have benefited in recent years) from opportunities to work part time and flexibly. More generally, analysis earlier in this report has highlighted the tendency and preference of new participants to work part-time when they first enter employment.

As discussed in the previous section, this does not mean that job creation on the road to full employment need be solely or even predominantly concentrated in part-time opportunities. A labour market with well-functioning job mobility can provide opportunities for currently-employed workers to increase their hours and pay, vacating lower-skilled and often part-time roles that are often most suited to the needs of the workless populations we discuss.

Nonetheless, a focus on expanding access to flexibility and part-time work is still likely to be necessary if employment growth is going to reach the heights consistent with our full employment measure. This is particularly important, as we know that part-time and flexible opportunities tend not to send out the signals of quality and pay that are important to encouraging people to participate. For example, recent research found that only 6.2 per cent of at least relatively well-paid job vacancies are advertised with the option to work flexibly.<sup>[87]</sup> The challenge is to ensure sufficient flexible and part-time roles that suit the needs and preferences of the individuals our concept of full employment targets.

[87] E Stewart & P Bivand, *How flexible hiring could improve business performance and living standards*, Joseph Rowntree Foundation, January 2016

## **i** Policy direction 9: The government must support employers to create good-quality part-time and flexible job opportunities, and do so itself in its role as an employer

We recommend:

- » When liaising with employers posting vacancies on Universal Jobmatch, Jobcentre Plus offices should prompt them to consider options to offer the job flexibly as standard. Similar processes should be in place for vacancies registered with local public employment services, if they don't operate the Universal Jobmatch system.
- » National and devolved governments, cities, local authorities and Local Enterprise Partnerships should

explore options for supporting employers to engage with flexible job design, piloting approaches and sharing best practice.

- » National, devolved and local governments should be the leader in offering flexible working options to existing staff and in the vacancies they advertise. For example, government jobs should be routinely advertised as 'open to flexibility'.<sup>[1]</sup>

[1] These recommendations draw on those of the Timewise Foundation. See: E Stewart & P Bivand, *How flexible hiring could improve business performance and living standards*, Joseph Rowntree Foundation, January 2016

## **An overarching framework for boosting employment across the country**

Having discussed policy options for each low activity group in turn and across groups, we end by considering overarching policy directions to support a full employment agenda.

In our vision of full employment, the gains are substantially skewed towards lower-employment parts of the country: most of the North, Wales, Northern Ireland, Inner London, and the Birmingham and Glasgow city regions need to see the largest employment rate improvements to reach full employment, as Table 7 in Annex 3 shows: they contain 40 per cent of the 18-69 year old population, but we expect them to deliver 62 per cent of the employment gains.

Evenly-shared local economic growth has been a perennial focus of UK governments, and a prominent one for the current government and the previous Coalition. In particular, much emphasis has been placed on the devolution agenda shifting funds and decision-making power to LEPs, City Deals, metropolitan mayors, the Northern Powerhouse, and the Local Growth Deals recommended by the Heseltine Review.<sup>[88]</sup> Most recently the emphasis has been on devolution deals, the main vehicle via which powers and funding will be handed down to cities and other local areas within this parliament. Strong and effective local leadership will be a crucial element in the success of these deals and the extent to which they increase opportunities for residents. For example, such leadership is evident in the recent experience of Greater Manchester (initially connected to the tram project).

Shifting the dial within local economies is not easy, with an ongoing challenge around scale and joining up powers and funding across different policy areas and departmental budgets. However, working within the current policy framework and the welcome steps that have been taken on devolution and empowering local economies, many current initiatives offer opportunities to ensure that employment growth is biased towards the areas and groups we have singled out.

[88] M Heseltine, *No stone unturned: In pursuit of growth*, October 2012

## *i* Policy direction 10: The government must ensure that its infrastructure investment, devolution and full employment agendas are fully aligned

We recommend:

- » Full employment should be a prominent objective within subsequent devolution deals, with cities and other areas encouraged to demonstrate how their plans boost employment demand and are aligned to the need of their workless populations in low activity groups.
- » In its forthcoming report, the National Infrastructure Commission should address the transport bottlenecks to further employment growth in its assessment of infrastructure needs.
- » Greater use should be made of the Social Value Act in the procurement of infrastructure projects and other public services. This should be with the goal of ensuring that the resulting employment opportunities are connected to local people and aligned with other policy directions presented in this report, such as the commitment to target apprenticeships at those progressing from study or who are now out of work.
- » National government should support areas to build leadership capacity, and encourage the adoption of full employment ambitions by new metropolitan mayors.

As discussed, the introduction of the National Living Wage – while providing a welcome pay rise for millions of workers and potentially making work more attractive for new ones – may create challenges for some businesses, particularly in more disadvantaged parts of the country and for more disadvantaged workers. With the legal wage floor rising into unknown territory, areas and businesses should be supported to manage these risks.

## *i* Policy direction 11: The government must set out a detailed plan for the implementation of the National Living Wage, with a focus on those sectors and parts of the country in which it is likely to bite hardest

We recommend:

- » The government should assign a broader role to the Low Pay Commission in exploring the scope to boost productivity and overcome blockages to higher wage floors in particular sectors and locations.
- » Cities, Local Enterprise Partnerships and devolved nations should monitor the impacts of the rising wage floor in their areas, and seek ways to support local businesses to adapt.

Finally, one of the principal benefits of greater devolution of funding and powers to local areas is more opportunity to experiment with approaches to boosting employment. Indeed, many of the most interesting approaches we have come across in the course of this project have emerged from the City Deal devolution process and its successors. The flipside of this local innovation will be a need to share learning and experience in order to build on past achievements and replicate successful approaches, as well as addressing country-wide evidence gaps. An emphasis on rigorous evaluation is particularly important as funding for new initiatives is increasingly linked to social investment or awarded based on evidence of invest-to-save benefits.

**i** Policy direction 12: National, devolved and local governments must work together to evaluate and share learning from efforts to raise participation and employment outcomes in their areas

We recommend:

- » The government-backed What Works Centre for Local Economic Growth should expand its current evidence base to cover raising the economic activity of low activity groups, and full employment should be a

focus of its first 'demonstration' projects due to launch this year. These projects should target groups where existing national employment initiatives appear to be having less impact, or where evidence of what works is lacking.

These 12 high-level policy directions, and the more specific recommendations and suggestions that sit beneath them, are by no means exhaustive. Not all of the recommendations will be straightforward to introduce and some will meet with resistance and criticism. However, they are offered as a package which provides the starting point for a policy response appropriate to the challenge of boosting employment among low activity groups and in lower-employment parts of the country.

While all have merit in isolation, we favour a wholesale approach such as this, which has the potential to push us from our very strong employment position to becoming a full employment country and a genuine world leader on employment.

## Section 5

# Conclusion: The prize for reaching full employment

Entering the post-financial crisis recession in 2008, very few people would have predicted that the UK's headline employment rate would top 74 per cent within seven years. Yet the proportion of 16-64 year-olds in work continues to break records each month, raising the prospect that what previously appeared unattainable – leading the way in the G7 for example – might now be possible.

Faced both with wage growth that has disappointed for more than a decade – with a significant slowdown from 2002 that evolved into a wage squeeze after 2009 – and cuts in state support associated with fiscal consolidation, the impressive employment performance of recent years has been key to supporting household living standards. And not just at the aggregate level: the pattern of employment growth has been clearly progressive over this period, much more so than during previous economic recoveries.

With income inequality projected to rise in the coming years – driven by a growing divide between those in work and those out of work and by further cuts to benefits and in-work support – the need for further employment improvements shows no sign of abating. The Chancellor's target for full employment matters not just from a fiscal perspective; it is at the heart of meeting the country's ongoing living standards challenge.

But the road to full employment is far from a clear one. With the level of slack in the labour market declining, further progress rests increasingly on raising economic participation. Yet by its very nature, bringing in workers from groups that are traditionally further away from the labour market – such as the low-qualified, older workers and those with ill-health and disabilities – represents more of a challenge than simply driving down unemployment.

And there are potential new headwinds that need navigating. Employer labour costs are set to rise as a result of the ongoing roll out of auto-enrolment, the introduction of the National Living Wage and the application of a new Apprenticeship Levy. Each of these measures provides important new protections and boosts to those in work. And they can play a role in attracting more people into the labour market. But – all else equal – they are also likely to push back against the recent trend towards ever-higher employment levels.

Against this backdrop, it becomes clear that securing full employment requires new forms of active intervention. The aim should be to raise participation across the country and among traditionally 'low activity' groups in particular. Jobs growth that rests on increases in already high-employment areas is more likely to be migrant-led, raising the number of people in work, but not the employment *rate*. Properly utilising the full productive potential of our population and driving forward living standards across the country means targeting inclusive employment growth.

We have set out a package of potential reforms that aims to create the conditions required for progress along the road to full employment. Not all of our recommendations will be straightforward to introduce and some will meet with resistance. But we believe that they can help us achieve genuinely inclusive growth. It's time to set about progress towards this ambition.

# Annex 1: Data and definitions used in this analysis

*In this annex we provide details of the various datasets used throughout this report, along with further information on the definitions used in relation to geographies and different group characteristics. In addition to our standard approaches, we set out any inconsistencies, breaks in series and required work-arounds.*

## Datasets

Most of the analysis in this report – the descriptions of historical and current labour market patterns, the modelling of full employment improvements and the econometric assessment of labour market sensitivities – is based on the Labour Force Survey (LFS). In general we make use of the cross-sectional (quarterly) datasets, also exploring the two-quarter longitudinal datasets to understand transitions between unemployment, economic inactivity and employment.

We create a long time-series beginning in 1993 and running up to the first quarter of 2015, generally presenting our results for pooled financial years. We do not make use of the latest quarters of LFS datasets (the third quarter of 2015 was the most up-to-date available at the time of analysis) because the geographical variable we use (which splits the UK into 20 sub-regions) is not available on public-access datasets after the first quarter of 2015.

We also make use of the Family Resources Survey provided by the DWP, the ONS's 2014-based population estimates, the ONS Annual Population Survey, and the latest labour market statistics published by ONS for elements of our analysis.

## Definitions

### Geography

For our analysis comparing different areas of the UK, we split the country into 20 sub-regions, which cover the more commonly-used 12 regions and nations of the UK but further divide some of these. This is the smallest geographical unit available on publicly-accessible LFS data. The sub-regions are as follows:

- |                                     |                         |
|-------------------------------------|-------------------------|
| » Tyne and Wear                     | » Rest of West Midlands |
| » Rest of North East                | » East of England       |
| » Greater Manchester                | » Inner London          |
| » Merseyside                        | » Outer London          |
| » Rest of North West                | » South East            |
| » South Yorkshire                   | » South West            |
| » West Yorkshire                    | » Wales                 |
| » Rest of Yorkshire & Humberside    | » Strathclyde           |
| » East Midlands                     | » Rest of Scotland      |
| » West Midlands Metropolitan County | » Northern Ireland      |



### Low activity groups

The 'low activity' groups discussed in this analysis are defined as follows:

- » **Low-qualified:** We use successive versions of the 'hiqua' variable in the LFS, which contains details of an individual's highest qualification, with the variable ranked in descending order. We then split the 18-69 year old UK population into three equally-sized groups (randomly distributing those individuals with qualification levels that straddle the boundaries). We define the bottom third as 'low-qualified' and the top third as 'high-qualified'. By repeating this process in each quarter, we capture 'relative' qualification levels and so control for the general improvement in the qualifications profile of the working age population over time.

Prior to 2008, qualifications information was only collected for the workless population if they were below the State Pension Age. To show a longer time-period, we use the 18-59(women)/64(men) population to cast backwards.

- » **Disabled people:** We use the old Disability Discrimination Act (DDA) definition of disability, which was the most commonly-used prior to that established by the Equality Act 2010 (the Equality Act definition excludes some specific groups from its 'core' measure that are included in the DDA definition). We do this because the DDA measure provides the longest consistent definition over time (and captures a population that tends to experience more acute labour market disadvantage than, for example, the 'work-limiting disabled only' group also captured in the data over this time-period).

Changes to question wording and questionnaire design mean that measures of disability in the LFS have discontinuities in 2010 and 2013. We show these as breaks in the series in our analysis (and create dummies to measure change at the discontinuity points in the modelling described in Annexes 3 and 4).

Prior to 2002, disability information was only collected for the workless population if they were below the State Pension Age. To show a longer time-period, we use the 18-59(women)/64(men) population to cast backwards.

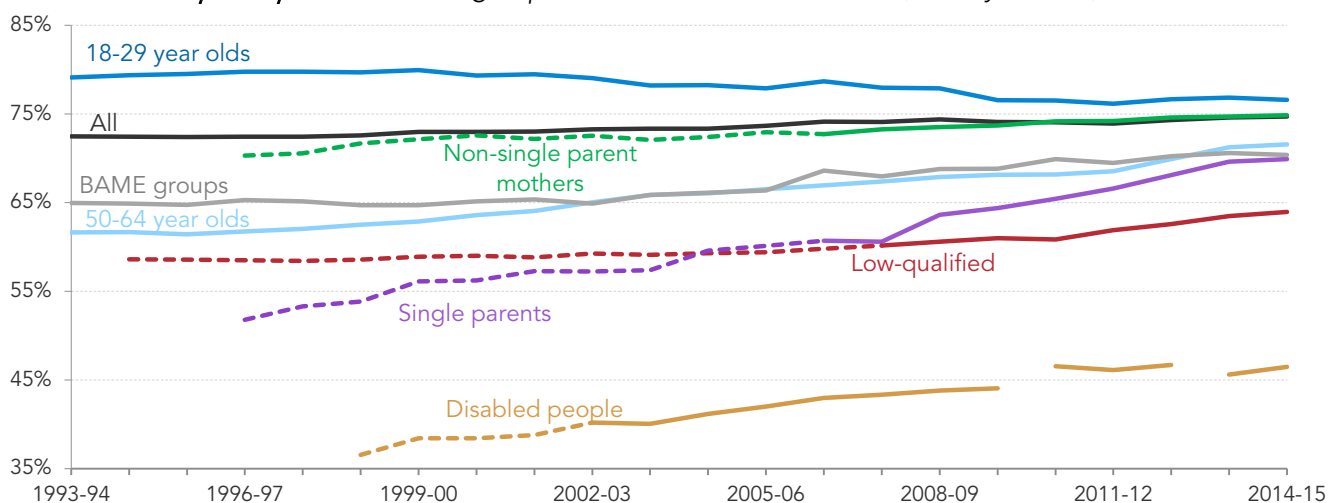
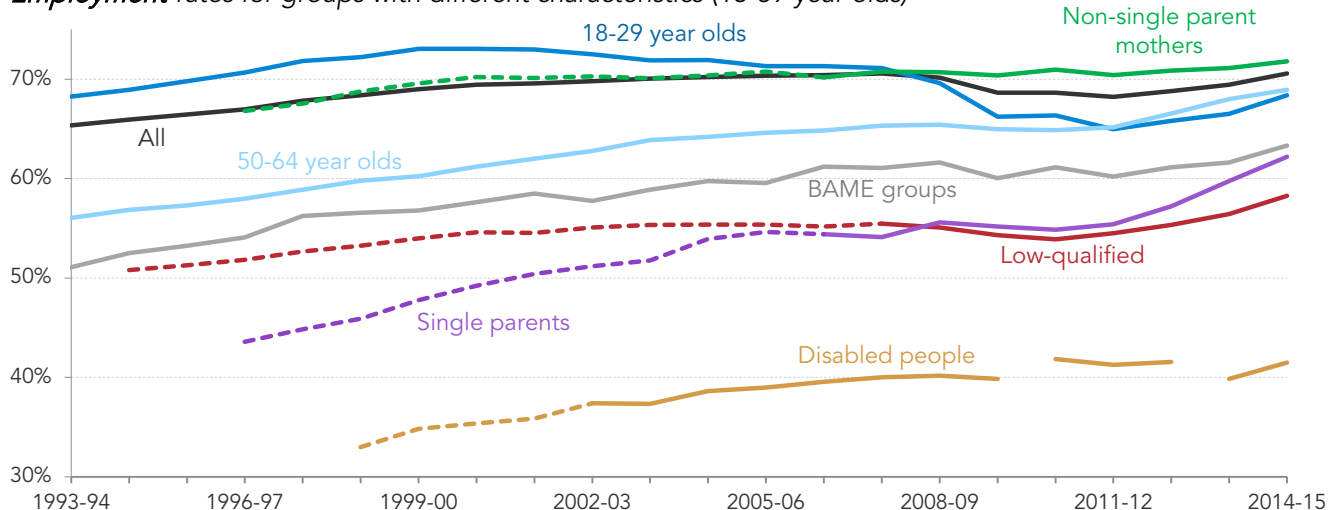
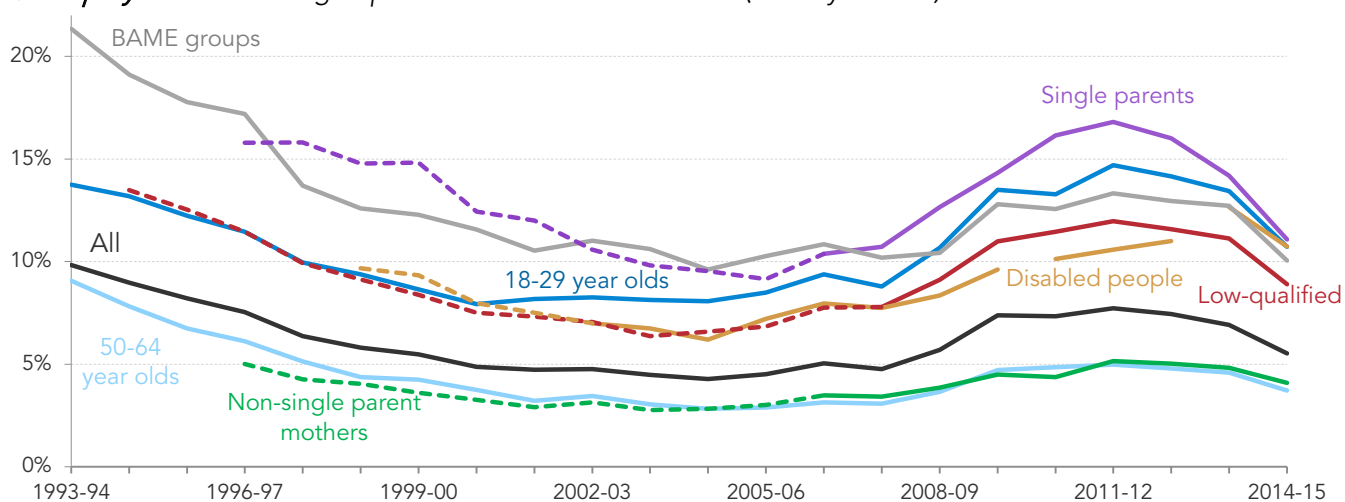
- » **Single parents:** Single parents are adults of either gender with dependent children and not living with partners. From 2006 onwards, this is defined using the 'type of family unit' variable – the same way as the ONS defines single-parenthood. This variable is not present on the public-access datasets prior to 2006, so we define single parents as those who are the heads of their family unit, have dependent children and are not living with a partner or spouse. The results are very similar to the ONS definition used from 2006-onwards, and we use these to cast backwards when showing longer time-periods.
- » **Non-single parent mothers:** Non-single parent mothers are women with dependent children living in couples. In the same way as for single parents (described above), we use slightly different variables to derive this group pre- and post-2006.
- » **BAME groups and younger and older age groups** are defined using the standard ethnicity and age variables available in the LFS.

## Annex 2: The variation in labour market experiences for low activity groups

*In Section 2 of the report, we presented summary information on the labour market experiences of low activity groups, but our underlying analysis is built on much more detailed exploration. In this annex we present some of that additional information in the form of a statistical appendix.*

- » Figure 20 shows participation, employment and unemployment rates, overall and for each low activity group. Each chart covers the period from 1993-94 to 2014-15 and highlights the steady narrowing of the gaps between low activity groups and the overall average – though sizeable differences remain at the end of the period.
- » Figure 21 presents eight charts that highlight the variation in participation for each low activity groups across 20 UK sub-regions and over time. In each instance, the low activity group's performance is compared to the participation of 'high performers' (30-49 year old, highly-qualified, white, non-disabled, non-single parents).
- » Figure 22 and Figure 23 present maps that visualise the variation in participation for each low activity group across 20 UK sub-regions in 2014-15. The maps are colour-coded separately for each low activity group – red representing the lowest participation rates and green the highest.
- » Figure 24 presents 'violin plots', which summarise the variation in the participation of some low activity groups across UK local authorities (a much more detailed geographical breakdown than we present elsewhere in the report – drawn from a different dataset and meaning that we don't capture all groups, and define some groups differently). These violin plots display the range of local authority participation rates, as well as providing information on where local authorities fall within that range. The height of each plot represents the gap between the lowest and highest local authority participation rates. The width of the plot – the area within the outer line – shows the number of local authorities at each point, so the wider the plot, the greater the number of local authorities with that participation rate. A longer, thinner plot indicates greater variation in participation between local authorities.

Figure 20: Participation, employment and unemployment across low activity groups: UK, 1993-94–2014-15

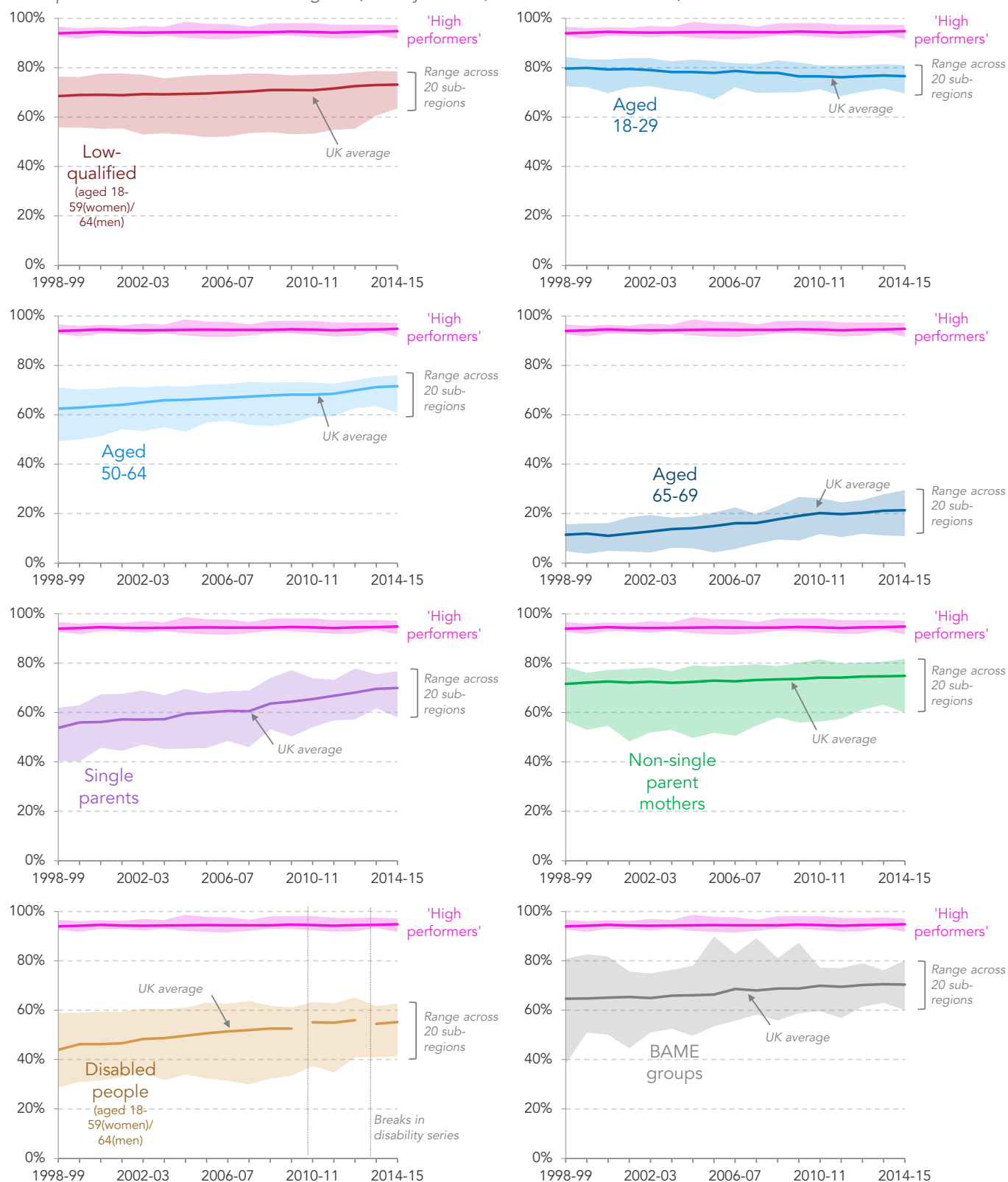
**Labour market participation** rates for groups with different characteristics (18-69 year olds)**Employment** rates for groups with different characteristics (18-69 year olds)**Unemployment** rates for groups with different characteristics (18-69 year olds)

Notes: Dashed lines represent trends based on slightly different group definitions, indexed backwards from the more recent trends. See Annex 1 for further details, and information on our segmentation of qualifications, definition of disability, and breaks in the disability series.

Source: RF analysis of ONS, Labour Force Survey

**Figure 21: Labour market participation of low activity groups across the UK: 1998-99–2014-15**

Participation rates across 20 UK sub-regions (18-69 year olds, unless otherwise stated)

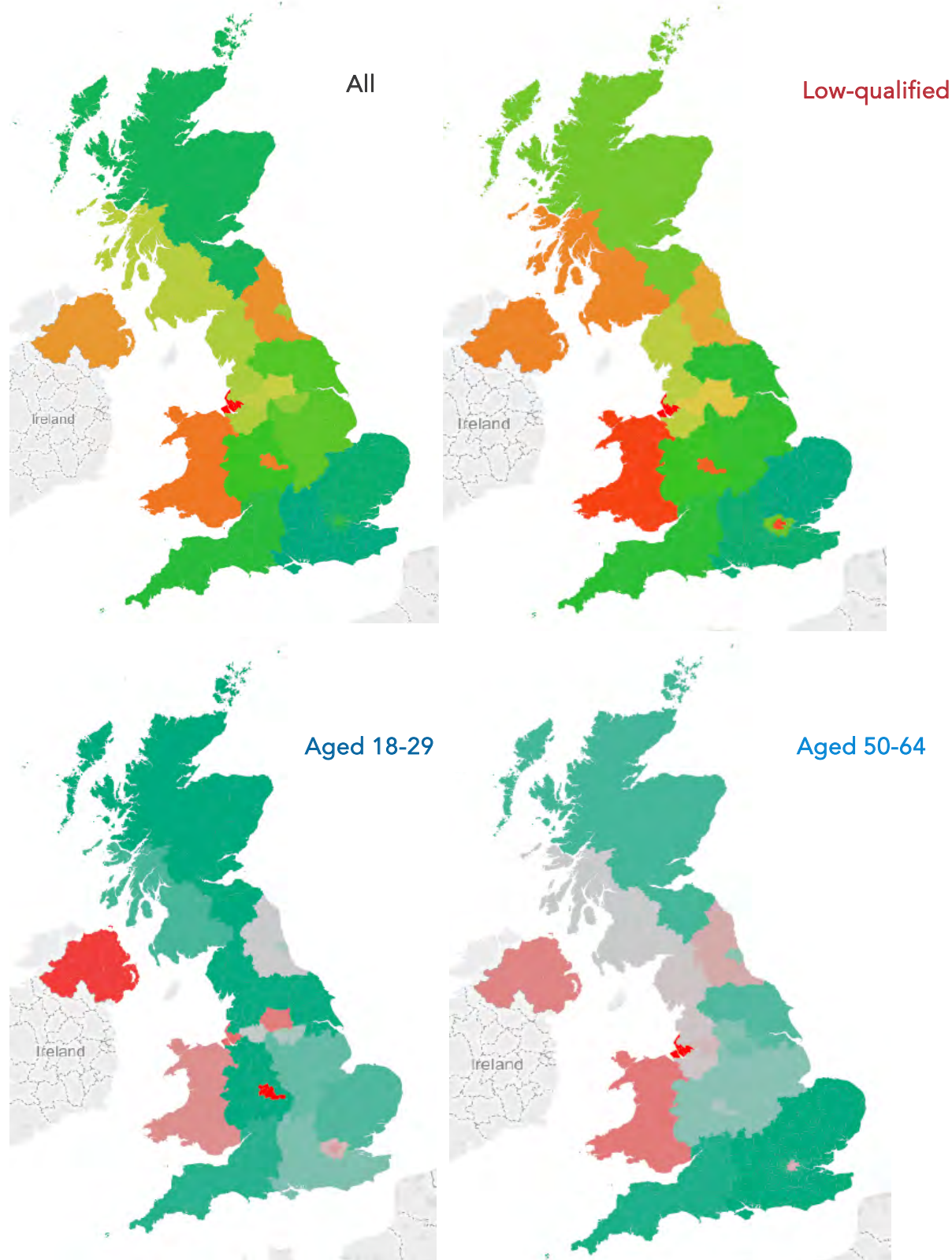


Notes: See Annex 1 for details on our segmentation of qualifications, our definition of disability, and breaks in the disability series.

Source: RF analysis of ONS, Labour Force Survey

Figure 22: Labour market participation of low activity groups across the UK (1): 2014-15

Participation rates across 20 UK sub-regions (18-69 year olds, unless otherwise stated)



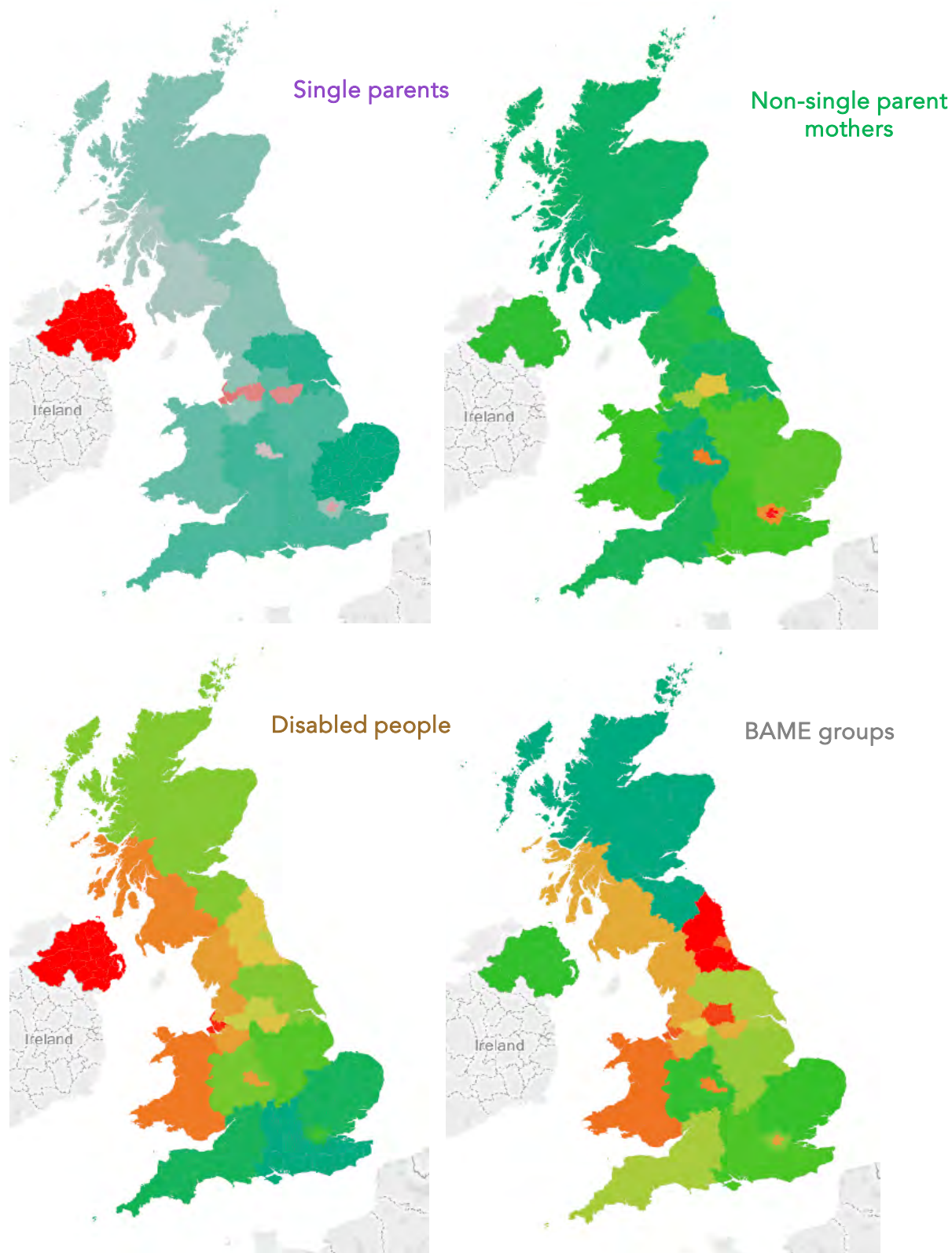
**Notes:** Sub-regions are colour-coded from red (lowest participation rate) to green (highest participation rate) separately for each low activity group. See Annex 1 for details on our segmentation of qualifications, our definition of disability, and breaks in the disability series.

**Source:** RF analysis of ONS, Labour Force Survey



Figure 23: Labour market participation of low activity groups across the UK (2): 2014-15

Participation rates across 20 UK sub-regions (18-69 year olds)



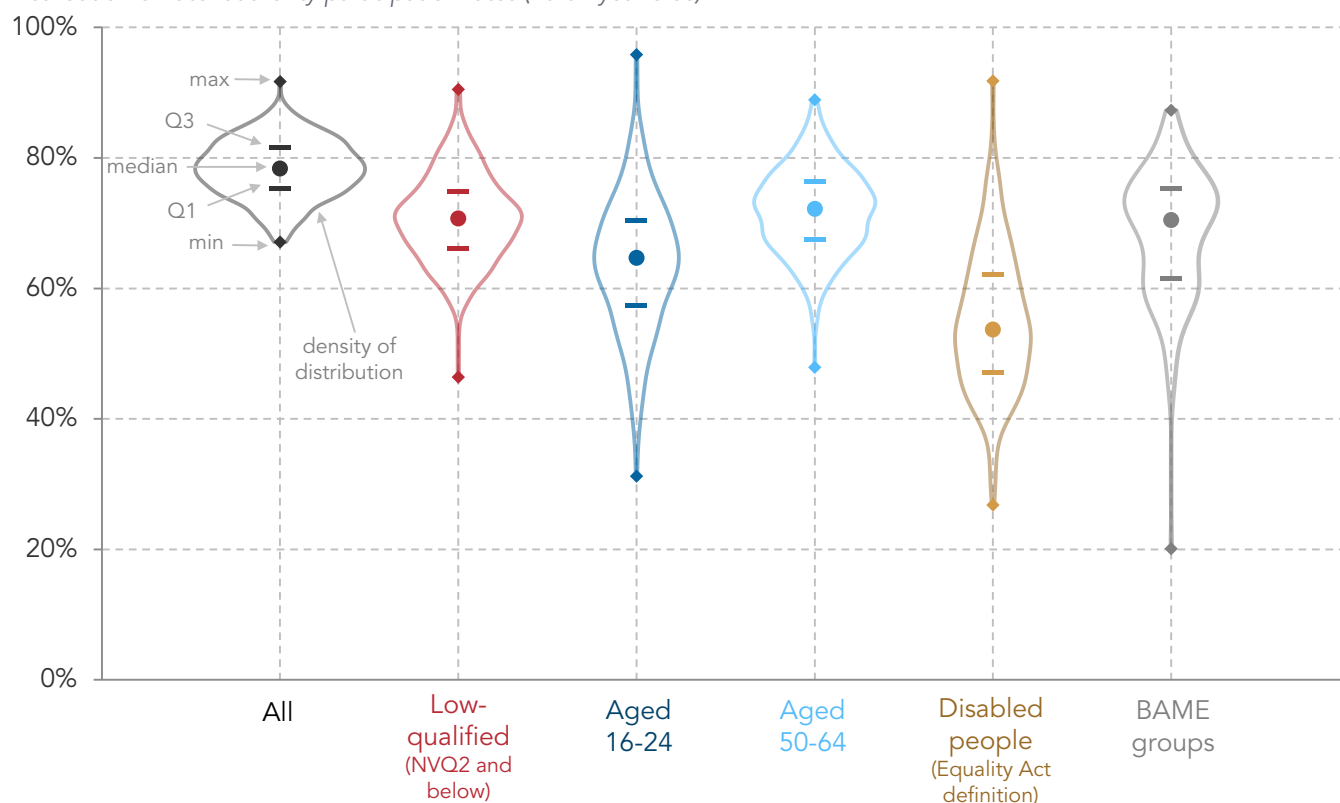
Notes: Sub-regions are colour-coded from red (lowest participation rate) to green (highest participation rate) separately for each low activity group. See Annex 1 for details on our segmentation of qualifications, our definition of disability, and breaks in the disability series.

Source: RF analysis of ONS, Labour Force Survey



**Figure 24: Labour market participation of selected low activity groups across UK local authorities: 2014**

*Distribution of local authority participation rates (16-64 year olds)*



**Notes:** Density distributions are plotted using kernel density estimation techniques. Only those low activity groups that can be identified in Annual Population Survey data are shown, and in some cases the definitions are different to those used elsewhere in this report.

**Source:** RF analysis of ONS, Annual Population Survey

## Annex 3: Quantifying full employment: details of our estimate

*We spent some time in Section 2 explaining how we quantified full employment, setting out a five-step process. In this annex we provide much more detail, alongside a comparison with Office for Budget Responsibility projections. We also provide more detailed versions of the results set out in Section 2, explaining how we move from outturn labour market figures to those associated with our definition of full employment.*

Our approach to quantifying full employment is based on geographical convergence in unemployment and participation rates dependent on individual characteristics; further time-based improvements, again conditional on these characteristics; and population growth. Our analysis is based on the 18-69 year old population, however we factor in lower unemployment, and population growth, for 16-17 and 70+ year olds to arrive at whole population totals and conventional 16-64 year old employment rates.

### Step 1: Closing sub-regional unemployment gaps

To quantify regional convergence in unemployment, we single out two of the UK's 20 sub-regions, the East and the South East, which have consistently the highest employment and lowest unemployment rates, both overall and for the most part also across each of our 'low activity' groups (see Annex 1 for details of these groups). These areas accounted for 23 per cent of the 18-69 year old UK population in 2014-15.

Using LFS records for the *economically active* individuals in these two sub-regions during 2014-15, we run an ordinary least squares regression with the following parameters:

$$\text{Unemployment chance} = i.\text{qualifications}(\text{low; mid; high}) + i.\text{age group}(18-29; 30-49; 50-64; 65-69) + i.\text{single-parenthood} + i.\text{motherhood} + i.\text{disability} + i.\text{ethnicity}(\text{white; BAME})$$

We use the resulting model to predict the unemployment chance of the economically active population *across all areas of the UK*, as if they lived in the best two sub-regions (the East and South East) in 2014-15. In this way, our analysis controls for the different characteristics of the population in different parts of the country, and the overlap between different low activity characteristics within these (for example, the increased likelihood of unemployment if someone is both disabled and a single parent).

### Step 2: Further unemployment tightening

Even the best two sub-regions on which we have based the regional unemployment convergence described in Step 1 were not at their tightest levels in 2014-15, when they had a combined 4.3 per cent 18-69 year old unemployment rate, compared to a 20-year low of 3.1 per cent in 2000-01. Our view is that full employment involves nearing this best performance.

Of course the characteristics of the population in these areas may have changed since then, so similar performance to 2000-01 dependent on characteristics might entail a higher or lower headline unemployment rate. However, we cannot model this in the same way as the regional convergence described above, due to changes and discontinuities in the variables used over the period since 2000-01. Therefore we assume that sub-regional population characteristics haven't shifted substantially over this time-frame, and approximate what further unemployment tightening towards the best results in the best areas would constitute by reapplying the

unemployment reductions calculated in Step 1 a second time (in this way continuing to control for different individual characteristics in different sub-regions in 2014-15). This is based on the observation that the unemployment rate in the best two sub-regions in 2014-15 is roughly half way between the national rate in 2014-15 (4.5 per cent for 18-69 year olds) and the 2000-01 low for the best two sub-regions.

In other words, we judge that the excess unemployment in 2014-15 above what we would expect at full employment is down to both regional disparity in unemployment performance conditional on characteristics (Step 1), and a general need for further tightening across the country (Step 2), in roughly equal measure. Clearly, our estimates are in part driven by judgements and approximations, but we view the resulting headline unemployment rates as not unreasonable in the context of the UK labour market.

At this stage, we also adjust the unemployment chance (by single year of age) for the 16-17 and 70+ year old populations down to its lowest national level since 2000. This is a rough approximation, which makes only a very small difference as there is very little unemployment within these groups.

### Step 3: Closing sub-regional participation gaps

Our approach in this step is very similar to our approach in Step 1 – a regression using the 18-69 year old population *in the best two sub-regions* in 2014-15 – the main difference being that because we are now assessing participation we use the whole 18-69 year old population rather than just the economically active:

$$\text{Participation chance} = i.\text{qualifications}(\text{low}; \text{mid}; \text{high}) + i.\text{age group}(18-29; 30-49; 50-64; 65-69) + i.\text{single-parenthood} + i.\text{motherhood} + i.\text{disability} + i.\text{ethnicity}(\text{white}; \text{BAME})$$

Again, we use the resulting models to predict the participation chance of the population *across all areas of the UK*, as if they lived in the best two sub-regions (the East and South East) in 2014-15. In addition, to calculate the resulting employment increases from this participation boost, we apply the predicted unemployment chances calculated in Steps 1 and 2 to our results. This means that we hold constant the improved unemployment chances of individuals conditional on their characteristics, but adjust our aggregate figure for the fact that the participation increase calculated in this step is strongly composed of low activity groups that are more likely to be unemployed when in the workforce.

As a test, in this step we also assess an alternative version of the regression model including additional variables that might further explain geographical variation in labour market outcomes: we interact age of youngest child on single-parenthood and motherhood; type of health condition on disability; and specific ethnic group and gender on ethnicity. This more detailed version does reduce the participation improvements predicted by our model for some groups. In particular, participation improvements are up to 40 per cent lower for single parents and non-single parent mothers in certain areas. However, the majority of the participation increase for these groups across the UK remains, and the overall participation increase across the UK population implied by this more detailed model is very similar to our central prediction. Via this process, we view the results of our analysis as realistic based on additional observed characteristics within the populations we analyse.

### Step 4: Further trend participation growth to 2020-21

As well as regional convergence in participation, we might expect some further improvements from the current rates in the best two sub-regions, reflecting a combination of broad economic and demographic shifts, and the impact of targeted policies including those discussed in this report. To approximate what a reasonable benchmark for trend improvement through to the end of this parliament might look like, we run another ordinary least squares regression assessing

the participation chance in the best two sub-regions<sup>[89]</sup> (the East and South East), but this time covering a longer time period (the longest period over which we have a consistent set of variables,<sup>[90]</sup> beginning in 2008), and interacting a time trend with each of our characteristic controls (and with an additional year dummy to capture overall cyclical effects):

$$\text{Participation chance} = i.\text{qualifications}(\text{low; mid; high}) * \text{time trend} + i.\text{age group}(18-29; 30-49; 50-64; 65-69) * \text{time trend} + i.\text{single-parenthood} * \text{time trend} + i.\text{motherhood} * \text{time trend} + i.\text{disability} * \text{time trend} + i.\text{ethnicity}(\text{white; BAME}) * \text{time trend} + i.\text{financial year}$$

We use the resulting model to predict the participation chance of the 18-69 year old population across all areas of the UK in 2014-15 as if it were 2020-21 (because this marks the end of the current parliament and the edge of the forecast horizon) and certain historic trends for low activity groups had continued (which we model by adjusting some of the interacted time trends):

- » We roll the time trend for the low-qualified, 50-64 year olds, 65-69 year olds and disabled people forward six years (to 2020-21).
- » The time trend on BAME groups is negative (their participation has been falling very slightly in the best two sub-regions recently, although rising across the country), an effect we reverse by 2020-21 by manipulating the associated time trend. In other words, we judge that overall participation improvements can return and continue for this group beyond regional convergence.
- » We do not manipulate time trends for young people. Here the trend is negative as it is for BAME groups, but it does not appear reasonable to reverse this given their overall high performance and trends in study. Halting the recent decline is judged to be a sufficient benchmark.
- » Nor do we manipulate time trends for single parents or non-single parent mothers. This is because they have already equalled or exceeded the current overall participation rate via the regional convergence in Step 3. Given these groups have evident barriers – particularly as much of the remaining economically inactive population has very young children<sup>[91]</sup> – pushing further beyond this point appears an unreasonable expectation.

Again, to calculate the resulting employment boost, we apply the unemployment chances calculated in Steps 1 and 2 to our results.

### Step 5: Forecast population growth to 2020-21

By applying the above steps, in succession, we arrive at new participation, employment and unemployment rates for the overall 18-69 year old population in each sub-region of the country, and for each of our low activity groups within this. Our final step is to apply these rates to the 2020-21 population, using the ONS 2014-based population forecasts, which account for both natural change (births and deaths) and migration expectations, disaggregated by age and gender. To arrive at 16+ and 16-64 year old totals, we also account for population growth within the 16-17 and 70+ year old populations, holding constant both their 2014-15 single-year-of-age participation rates and the unemployment rates for these age groups calculated in Step 2.

[89] We continue to restrict our analysis to these two sub-regions because some of the overall participation improvement across the country as a whole in recent years appears to have been driven by convergence between the best- and worst-performing sub-regions (see Annex 2). This means that assessing trends across all regions in our regression in Step 4 would essentially 'double count' some of the improvement calculated in Step 3.

[90] There are breaks in the disability series during this period, which we use dummies to overcome.

[91] P Gregg & D Finch, *Employing new tactics: The changing distribution of work across British households*, Resolution Foundation, January 2016

## Results

The results of this process are summarised in Table 5–Table 7.

### Comparison to Office for Budget Responsibility population and employment forecasts

In its November 2015 Economic and Fiscal Output, the OBR forecasts employment to be 32.2 million in 2020-21, 1.1 million above the 2014-15 level. This is based on ONS population forecasts (the same as those we use), and forecast trends in employment and participation rates which take into account expectations for some further reductions in unemployment; trend improvements in the participation of different age groups over time; and the effects of some policy-driven changes (the rising State Pension Age over this period and the fact that young people are staying in education for longer).<sup>[92]</sup>

In this way, the OBR employment forecasts capture the population growth we account for in Step 5 of our method, and also improvements in unemployment and participation rates equivalent to some of the things we consider in Steps 1 to 4 (but not as stretching, particularly given our focus on closing sub-regional gaps, which doesn't feature in the OBR assessment). This is why the OBR's employment forecast gives a higher employment increase between 2014-15 and 2020-21 than the element we attribute to population growth in Step 5, but a lower increase than our total full employment estimate entails.

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[92] For more information on the OBR's approach, see Annex A of: Office for Budget Responsibility, *Fiscal sustainability report*, July 2014

**Table 5: Progressing to full employment within this parliament: UK**

	Participation rate		Unemployment rate	Economically active	Of which: Total population	
	(18-69)	(16-64)			Employed thousands (16+)	Unemployed thousands (16+)
<b>Actual (2014-15)</b>	<b>74.7%</b>	<b>73.1%</b>	<b>5.9%</b>	<b>33,160</b>	<b>31,210</b>	<b>1,950</b>
Step 1: Closing sub-regional unemployment gaps <i>Change</i>	74.7%	73.8%	5.0%	33,160	31,520	1,650
	0.0 ppts	+0.7 ppts	-0.9 ppts	0	+300	-300
Step 2: Further unemployment tightening <i>Change from step above</i>	74.7%	74.7%	3.8%	33,160	31,890	1,280
	0.0 ppts	+0.9 ppts	-1.1 ppts	+0	+370	-370
Step 3: Closing sub-regional participation gaps <i>Change from step above</i>	76.5%	76.1%	4.0%	33,950	32,600	1,360
	+1.8 ppts	+1.4 ppts	+0.1 ppts	+790	+710	+80
Step 4: Further trend participation growth to 2020-21 <i>Change from step above</i>	78.5%	77.9%	4.1%	34,820	33,400	1,420
	+2.0 ppts	+1.7 ppts	+0.1 ppts	+860	+800	+60
Step 5: Forecast population growth to 2020-21 <i>Change from step above</i>	78.5%	78.0%	4.1%	35,360	33,930	1,430
	+0.0 ppts	+0.1 ppts	-0.0 ppts	+540	+530	+10
<b>Full employment (2020-21)</b>	<b>78.5%</b>	<b>78.0%</b>	<b>4.1%</b>	<b>35,360</b>	<b>33,930</b>	<b>1,430</b>
<i>Change from actual 2014-15 position</i>	+3.8 ppts	+4.9 ppts	-1.8 ppts	+2,200	+2,710	-520
<i>Change from end of previous parliament (Feb-Apr 2015)</i>	+0.0 ppts	+4.5 ppts	-1.5 ppts	+1,970	+2,380	-410
<i>Change from current position (Oct-Dec 2015)</i>	+0.0 ppts	+3.9 ppts	-1.1 ppts	+1,750	+2,030	-280

Notes: Estimates are rounded to the nearest 10,000.

Source: RF modelling based on ONS, Labour Force Survey, ONS, 2014-based National Population Projections; and ONS, Labour Market Statistics



Table 6: Progressing to full employment, change in employment for low activity groups: UK, 18-69 year olds (thousands)

	Actual (2014-15)	Step 1 change: Closing sub-regional unemployment gaps	Step 2 change: Further unemployment tightening	Step 3 change: Closing sub-regional participation gaps	Step 4 change: Further trend participation growth to 2020-21	Step 5 change: Forecast population growth to 2020-21	Full employment (2020- 21)
All	30,440	+300	+300	+710	+800	+470	33,030
Low-qualified	7,810	+180	+180	+440	+420	+130	9,140
18-29 year olds	7,030	+140	+140	+50	+170	+110	7,630
50-64 year olds	8,180	+40	+40	+320	+400	+130	9,100
65-69 year olds	750	+0	+0	+130	+100	+10	990
Single parents	1,430	+20	+20	+80	+20	+20	1,590
Non-single parent mothers	4,350	+20	+20	+0	+70	+60	4,530
Disabled people	3,380	+80	+80	+470	+210	+60	4,270
BAME groups	3,310	+70	+70	+110	+180	+50	3,800

Notes: Estimates are rounded to the nearest 10,000.

Source: RF modelling based on ONS, Labour Force Survey, and ONS, 2014-based National Population Projections

**Table 7: Progressing to full employment, change in employment across 20 sub-regions of the UK**

	Actual (2014-15)		Full employment (2020-21)		Change	
	Employment rate (16-64)	Employed thousands (16+)	Employment rate (16-64)	Employed thousands (16+)	Employment rate (16-64)	Employed thousands (16+)
All	73.1%	31,210	78.0%	33,930	+4.9 ppts	+2,710
Tyne and Wear						
Rest of North East	70.3%	530	78.9%	600	+8.6 ppts	+80
Greater Manchester	67.8%	670	78.3%	790	+10.5 ppts	+120
Merseyside	70.6%	1,300	77.7%	1,460	+7.1 ppts	+160
Rest of North West	65.7%	600	76.6%	710	+10.9 ppts	+110
South Yorkshire	72.6%	1,430	76.8%	1,540	+4.2 ppts	+110
West Yorkshire	70.8%	650	78.1%	730	+7.3 ppts	+80
Rest of Yorkshire & Humberside	71.0%	1,050	77.3%	1,170	+6.3 ppts	+120
East Midlands	72.8%	830	78.4%	910	+5.5 ppts	+80
West Midlands Metropolitan County	73.4%	2,240	76.9%	2,390	+3.5 ppts	+150
Rest of West Midlands	66.8%	1,210	76.2%	1,410	+9.4 ppts	+200
East of England	74.4%	1,420	77.2%	1,500	+2.9 ppts	+80
Inner London	76.0%	2,980	77.6%	3,100	+1.5 ppts	+120
Outer London	73.3%	1,800	81.4%	2,030	+8.1 ppts	+240
South East	74.8%	2,580	78.0%	2,740	+3.2 ppts	+160
South West	76.7%	4,430	78.4%	4,620	+1.7 ppts	+180
Wales	75.1%	2,640	77.5%	2,770	+2.4 ppts	+140
Strathclyde	68.4%	1,390	77.2%	1,600	+8.7 ppts	+210
Rest of Scotland	70.8%	1,070	79.6%	1,230	+8.7 ppts	+160
Northern Ireland	75.6%	1,570	79.6%	1,680	+4.0 ppts	+110
	69.3%	830	78.4%	960	+9.0 ppts	+130
Range across sub-regions	11.0 ppts		5.2 ppts			
Standard deviation across sub-regions	3.2 ppts		1.2 ppts			

**Notes:** Population growth is estimated using the national projection, rather than projections for individual sub-regions. 16-17 and 70+ year old employment gains on the basis of forecast population growth and unemployment reductions are apportioned from the national figure based on each sub-region's population share. Estimates are rounded to the nearest 10,000.

**Source:** RF modelling based on ONS, Labour Force Survey, and ONS, 2014-based National Population Projections

## Annex 4: Testing the sensitivity of low activity group participation to labour market conditions

*We presented a labour market ‘sensitivity analysis’ towards the end of Section 3, designed to highlight how responsive low activity groups are (overall, and in turn) to differing labour market conditions. We provided a brief overview of our approach alongside the findings, but set out a much more detailed methodology in this annex, along with the full results from our regression modelling.*

### Details of our models

We construct regression models to assess evidence of how sensitive participation rates for six of our low activity groups are to available employment and available wages. In other words, the impact that job availability and prevailing wage levels have on these groups’ economic activity. It is worth noting that the sensitivity of employment to these factors will be far greater, but much of this will be met by reductions in unemployment. Because the majority of the employment increase implied by our definition of full employment comes from raising participation rather than reducing unemployment, it is the decision of whether or not to enter the workforce among those in low activity groups that we are principally concerned with here.

These models are based on the 18-59(women)/64(men) population between 1998-99 and 2014-15. We use a narrower age range than that used elsewhere in our analysis so that variables are consistent over the time period. We are not able to include 65-69 year olds for this reason, and we don’t include non-single parent mothers as their participation rate had caught up with the average by 2014-15, and they experience by far the smallest employment rate increase within our full employment definition (see Table 3 in Section 2).

Our data is aggregated, with one record for each low activity group in each sub-region in each financial year, giving a total sample of 2,040 group-region-year cases. Within this:

- » Our **dependent variable is each low activity group’s participation rate**, which we express in relation to that group’s participation rate in the areas with consistently the tightest labour market outcomes (the South East and East of England) to control for cyclical effects and overall improvement across time.
- » Our **first independent variable – local availability of employment** – is captured via the employment rate of those who are not in any of our low activity groups in each sub-region and in each year (i.e. the ‘high performer’ group discussed elsewhere in this report, but including the mid-qualified to capture more variation and boost the sample size). Again we express this in relation to the same group’s employment rate in the South East and East, to control for the overall cycle.

This is an imperfect measure of employment availability, but we judge it to be the most appropriate we can derive within the data we use. In particular, because it focuses on the employment of everyone not in the low activity groups we focus on, it avoids capturing the same people on both sides of our regression equation.

- » We capture our **second independent variable – the available wage** – via two alternative measures. The first is the median wage across low activity groups in each sub-region and year in relation to that in the two employment-rich areas, the South East and East. The

second is the median wage across low activity groups in relation to the overall sub-regional median wage across all employees. We use the median wage across all low activity groups rather than for each group separately due to small sample sizes for some groups in some sub-regions in some years, and concerns about the accuracy of LFS wage data within these.

These approaches both capture a relative measure of the wage offer to low activity groups, in comparison either to the wages that the same groups can get elsewhere, or the wages that others in the same location can get. In this way, they both control for overall wage trends over time.

Our models also include time trends to capture underlying developments for our low activity groups not related to local labour market conditions. We use random effects regression techniques which weight the cross-sub-region variation, and the time variation within sub-regions, appropriately.

We assess one model covering all six low activity groups, and also one for each group separately. Table 8 summarises our results.

**Table 8: The sensitivity of low activity groups' participation rate to available employment and wages, regression results: UK, 1998-99–2014-15**

		Overall model (six low activity groups)	Individual group-by-group models					BAME groups
			Low-qualified	Aged 18-29	Aged 50-59 (women)/ 64(men)	Single parent	Disabled people	
<b>Version 1: 'Low activity wage ratio' as 2nd independent variable</b> (low activity median wage in relation to low activity wage in highest employment sub-region (East and South East))	Coefficient on 1st independent variable: employment availability	0.208***	0.272***	0.273***	0.313**	0.143	0.292**	-0.0838
	Coefficient on 2nd independent variable: available wage	0.0626***	0.107***	0.0299	0.207***	-0.0840	0.0937*	0.0563
<b>Version 2: 'Sub-regional wage ratio' as 2nd independent variable</b> (low activity median wage in relation to overall median wage in each sub-region)	Coefficient on 1st independent variable: employment availability	0.179**	0.240**	0.250**	0.262**	0.135	0.255*	-0.0866
	Coefficient on 2nd independent variable: available wage	0.195***	0.285***	0.163***	0.378***	0.0928	0.289***	-0.0660

**Notes:** The dependent variable is the low activity participation gap to the 'best two' sub-regions; the independent variables are the non-low activity employment gap to the 'best two' sub-regions and the log difference between the low activity wage and that in the 'best two' sub regions (Version 1), or the log difference to the overall sub-regional median (Version 2). Asterisks denote significance of coefficients (\*\*\* p<0.01, \*\* p<0.05, \* p<0.1). Data based on the 18-59(women)/64(men) low activity populations in each of 20 UK sub-regions in each financial year between 1998-99 and 2014-15. Models also include time trends, and are estimated using random effects techniques which weight the cross-sub-region variation, and the time variation within sub-regions, appropriately.

**Source:** RF modelling based on ONS, *Labour Force Survey*

These models show that when looking across these six low activity groups combined, there are positive and significant coefficients on both employment availability (proxied on the non-low activity employment gap to the 'best two' sub-regions) and the available wage for low activity groups (whether specified as a ratio to low activity groups in the 'best two' sub-regions or to the overall sub-regional median). We interpret this as showing that an improvement in local labour market conditions via either of job demand or wages raises low activity workforce participation in general.

Looking at our group-by-group models suggests that this is not the case for BAME groups or single parents – participation within these two groups appears to be comparatively insensitive to local labour market conditions. For the other low activity groups the coefficients remain positive, significant and relatively consistent (particularly on the employment availability variable),

suggesting sensitivity to local labour market conditions is concentrated within these four groups.

### Interpreting these results: Thought experiments

In terms of interpreting the magnitude of these coefficients, we consider some simple scenarios for how much one could reasonably expect our independent variables to change.

Turning first to employment availability, the range of this independent variable was 0.065 in 2014-15 (meaning a 6.5 percentage point difference in non-low activity employment rates across sub-regions). As a rough thought experiment, we can consider what the effect on low activity participation of eradicating these differences would be – a not unreasonable metric in the context of the road to full employment (which should give more advantaged workers more-or-less the same employment chance no matter where they live).

Eradicating a gap of up to 6.5 percentage points, with a coefficient of 0.25-0.3 across model versions when single parents and BAME groups are not considered, suggests a low activity participation increase of up to roughly 2 percentage points in the most-affected sub-regions in 2014-15. Totalling these gains across sub-regions implies a participation increase of 200,000-240,000 people in the workforce belonging to one or more of the low-qualified, young, old, and disabled groupings.

Now turning to the available wage in model Version 1, the low activity wage in more deprived sub-regions was up to 20 per cent below that in the sub-regions with the tightest labour markets (the South East and East) in 2014-15. As a rough thought experiment, we could consider the impact of closing this gap, i.e. raising the low activity wage to its level in the East and South East. (Note that London low activity wages were even higher than in these two sub-regions but, given the large gap between London wages and those elsewhere in the country, we don't consider stretching to these heights.)

Applying these gains in each sub-region outside London to the wage coefficient in model Version 1 implies a participation boost of up to around 2 percentage points in the most-affected sub-regions, totalling to around 330,000 additional participants in one or more of the low-qualified, young, old, and disabled groupings.

Finally, turning to the available wage in model Version 2, the gap of the low activity wage in each sub-region to the overall median regional wage varied by nearly 10 percentage points in 2014-15 (between a 5 per cent and 14 per cent wage gap). Our thought experiment considers moving all sub-regions up to the smallest gap. Applying these gains in each sub-region again implies a participation boost of up to around 2 percentage points in the most-affected sub-regions, totalling to around 420,000 additional participants in one or more of the low-qualified, young, old, and disabled groupings.<sup>[93]</sup>

In sum, these stretching, but tenable and indicative simulations suggest a total participation boost from relative improvements in local labour market conditions of around 600,000, with slightly more of an effect from wage rises than from increased job demand across both specifications of the model. While a small part of this participation increase would be felt in the unemployment numbers, most would feed through to employment.

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[93] Across these three thought experiments we get somewhat different boosts to total participant numbers, despite a similar boost of around 2 percentage points in the most-affected sub-regions. This is a function of the different low activity population sizes in each sub-region, and the fact that different sub-regions are most-affected in each of the three experiments.



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