

CHAPTER FOUR

All working together

How to draw more people into the
UK labour market

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The state we're in

Employment is at a record high of 75 per cent

Yet there is a 46 percentage point gap in participation rates between the best and worst performing groups in the labour market

Progress is possible: employment rates for single parents, the low qualified and older workers have risen significantly in the past two decades

What should we do?

Increase work allowances in Universal Credit for single parents and second earners to £2,000 and £1,500 respectively; restore work allowances for disabled recipients to value originally intended

Create a statutory 'right to return' period of one year for those absent from work due to sickness, coupled with a rebate on sick pay costs for firms

The government should explore allowing for the partial drawdown of the state pension, reinstating the option to take a lump sum, and supporting the expansion of partial drawdown options in private pensions

The last chapter focused on how firms might react to the changes in the labour market and how this would vary by sector. Firms may deal with the relative change in the price of low-wage labour by substituting labour for machines or taking on fewer – though perhaps more well-trained – staff. However this may not be an option for all firms and the reduction in migrant labour will mean that they will have to deal with a general supply shock. But we should remember that in the medium term the domestic labour supply is far from fixed. Government has a key role in helping more people engage with the labour market to ease the transition firms – particularly at the lower-paying end of the labour market – face in a world of lower migration.

Whatever challenges the UK's economy continues to face a decade on from the

financial crisis, there can be no doubt that its headline performance on employment has been remarkable. From a 2011 trough, the number of people in work has jumped by more than two million, with the 16-64 employment rate seeming to reach new highs on an almost monthly basis.

Even before the Brexit vote there was a strong case for focusing on further increasing labour market participation in the UK, both as a key component of economic growth, a driver of highly progressive income rises and part of the answer to how we adjust to an ageing society. With the labour market tightening, and the prospect of lower net migration (and therefore labour supply) from the EU, doing so is now more of an imperative. This increasingly means bringing in workers from those groups that have traditionally been further away from the labour market, such as older people and those with health problems. That's not a straightforward task and one that is unlikely to be achieved without serious and sustained focus from government, but it is one at which the country has enjoyed some success before.

In this chapter we consider the lessons we can learn from past policy interventions and highlight those areas worth focusing on as we endeavour to push the country further towards full employment as part of an approach to successfully adjust to big shifts in our labour market.

Labour supply is tight, and getting tighter

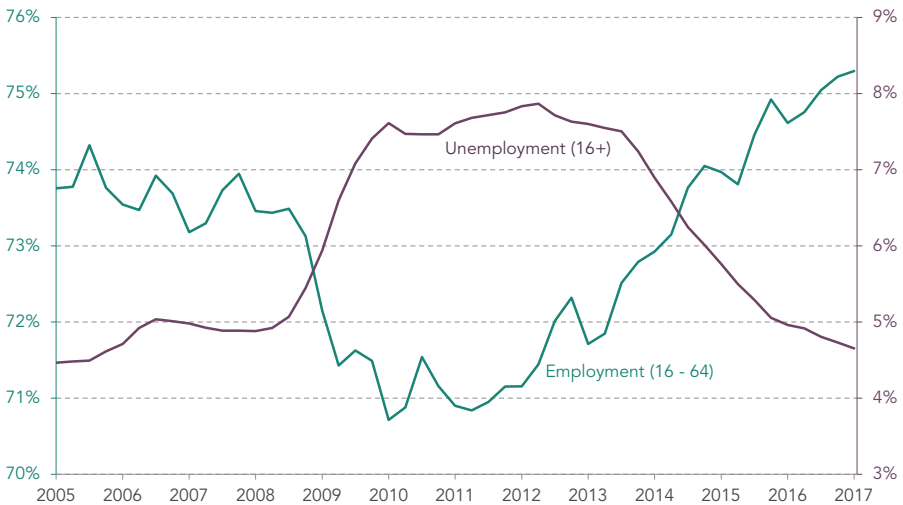
Responding to our migration survey (discussed in Chapter 2), four in ten (38 per cent) firms that employ significant numbers of migrant workers said that they would hire more UK nationals if the supply of migrant labour fell after Brexit. Yet the employment rate among the UK-born population aged 16-64 is already 75.3 per cent. The unemployment rate for this group – which captures just those out-of-work individuals who are actively looking for a job – has returned to pre-crisis levels (Figure 1). Add in the fact that the working-age population is about to start shrinking as large numbers of the 'baby boomer' generation retire and the ease with which firms might draw in replacement staff without wider changes is clearly open to question.

Not all firms and sectors have obvious opportunities for technology-linked productivity gains

As we touched on in Chapter 2, one response to any reduction in the size of the workforce is to simply accept that we

will produce less as a country. GDP would be lower but, to the extent that the population would also shrink, GDP per person might be sustained. However, this approach would have implications for our public finances (all else equal, the UK's stock of debt as a percentage of GDP would be higher if overall GDP was lower) and doesn't much help individual firms looking to maintain or increase output while wrestling with the challenges of a reduced availability of labour.

Figure 1: Employment and unemployment for those born in the UK



Source: RF analysis of ONS, *Labour Market Statistics*

However, the extent to which capital investment and greater automation is a feasible response will vary hugely across firms. Simply put, not all firms and sectors have obvious opportunities for technology-linked productivity gains.

Recognising the potential constraints on labour supply, 37 per cent of those firms saying they would recruit more UK nationals said that they would do so by expanding their pool of applicants. At the lower paying end of the labour market this in practice means looking to recruit workers from outside the current labour force. These firms will be helped by one of the big drivers of changes to this part of our labour market – the series of above-inflation increases in the wage floor associated with the development of the National Living Wage (NLW). Higher pay, particularly in this part of the wage distribution, should act as a pull factor by raising returns to work for many new entrants.

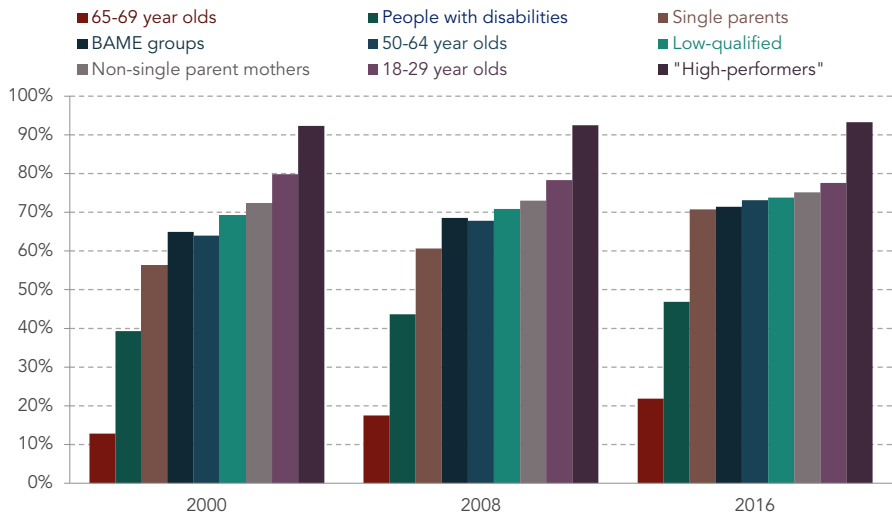
But experience tells us that market forces and wage incentives alone will prove insufficient to drive big structural increases in labour market participation. That is reinforced by evidence that employment levels vary significantly across the UK, but only a third of the gap between the best and worst performing areas can be attributed to differences in the functioning of the local economies.¹ A much larger part of the variation can instead be explained by differing levels of engagement across groups that we might label as ‘low activity’, such as older people, single parents, people with disabilities and ethnic minorities.

Boosting employment will increasingly rest on raising participation among 'low activity' groups

Figure 2 compares participation rates (that is, the proportion offering themselves up for work, irrespective of whether they are currently employed or not) within these 'low activity' groups with the 'high performer' group. This group – comprising white, non-single parent, highly qualified, non-disabled people – records a participation rate that is always and everywhere above 90 per cent. It appears relatively untouched by variation in either location or the economic cycle.

Three things are obvious from the chart. First, participation among most 'low activity' groups has improved substantially over the course of the 21st century so far, demonstrating that progress is possible. Secondly, all of these groups continue to lag well behind the 'high performer' group, highlighting the scope for improvement. Thirdly, recent experience has differed somewhat across the 'low activity' groups. The most dramatic improvements can be seen for single parents and older people whereas for other groups, in particular non-single parents, there has been less change over time.

Figure 2: 'Low-activity' groups have become more engaged with the labour market over time



Notes: 2000 bars for mothers, low qualified, and single parents represent trends based on slightly different group definitions, indexed backwards from the more recent trends. See Annex 1 of P Gregg & L Gardiner, *The road to full employment: what the journey looks like and how to make progress*, Resolution Foundation, March 2016 for full details.

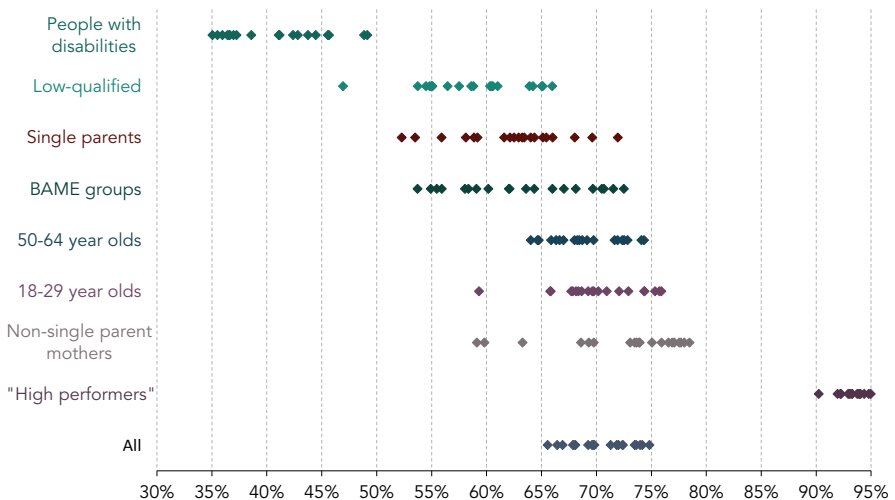
Source: RF analysis of ONS, LFS

Scratching beneath the surface of these numbers, Figure 3 suggests that there is nothing inevitable about the relatively poor performance of some groups. Each diamond represents the employment rate for a specific group recorded across 20 sub-regions of the UK, with wide dispersions highlighting the very different labour market outcomes that exist across the country. Variation is particularly marked for people with disabilities, single parents, mothers and ethnic minorities.

Boosting employment rests therefore with both closing inter- and intra-regional gaps in engagement within these ‘low activity’ groups and narrowing the distance between these populations and the ‘high performer’ group. Previous Resolution Foundation modelling

Figure 3: Labour market outcomes for ‘low-activity’ groups vary significantly across the country

Employment rates for different groups in 20 UK sub-regions (18-69 year olds, 2016)



Source: RF analysis of ONS, LFS

(summarised in Box 1) has concluded that the biggest gains in headline employment numbers are likely to be made by raising participation and employment for the low-qualified, older people and those with disabilities. From a policy perspective, pursuing such goals means identifying both the common improvements that can be made across groups and acknowledging the specific challenges faced by different parts of the population.

In the last chapter we looked at what could be done to increase human capital and in earlier work we have outlined specific proposals to improve labour market outcomes for younger workers and mothers.³ Future research will look at the labour market prospects

i Box 1: The employment gains from geographical convergence on 'low activity' performance

In order to assess where the biggest gains in terms of increased labour market participation and employment might be derived from, Gregg and Gardiner² undertook a modelling exercise in which they simulated geographical convergence in labour market outcomes across each 'low-activity' group. They focused on outcomes by 2020-21 against an assumed backdrop of trend population growth, trend participation increases and further falls in unemployment.

The convergence they modelled reflected the increase in participation and employment associated with people in each sub-region having labour market outcomes that were equivalent to similar people in the best two performing parts of the country: the East and South East. Clearly employment is boosted by convergence in each of the 'low activity' groups but, as the table below shows, the biggest gains associated with reaching full employment come from improving labour market outcomes for the low-qualified, people with disabilities and older people.

Table 1: Reaching full employment

	Actual (2014-15)	Full employment (2020-21)	Gain
All	30,440	33,030	+2,590
Low-qualified	7,810	9,140	+1,330
18-29 year olds	7,030	7,630	+600
50-64 year olds	8,180	9,100	+920
65-69 year olds	750	990	+240
Single parents	1,430	1,590	+160
Non-single parent mothers	4,350	4,530	+180
People with disabilities	3,380	4,270	+890
BAME groups	3,310	3,800	+490

Notes: For full details of modelling see P Gregg & L Gardiner, *The road to full employment: what the journey looks like and how to make progress*, Resolution Foundation, March 2016

Source: RF analysis of ONS, LFS

for BAME groups. Below we focus in more detail on how we can increase labour market participation of two of the groups where much might still be done: people with disabilities and older people. But first we consider two groups where policy has already had a marked impact in recent years – namely single parents and second earners.

Policy success and policy threats: the UK's experience on maternal employment

The rise in maternal employment over the last two decades is one of the key success stories of the British labour market, setting it apart from some other advanced economies such as the US. Between 1996 and 2016 the employment rate for (non-single parent) mothers rose by 7 percentage points, while the single-parent rate increased by a remarkable 23 percentage points.

Previous research suggests that these gains were the product of three different policy approaches all pushing in the same direction: improved financial incentives; greater regulation of the employment relationship; and conditionality combined with greater engagement with employment advisors.⁴ Going forward, there is much that we can learn from this experience in relation to other 'low activity' groups. But it is important too that we don't row back on these existing successes. In this regard, the fact that one element of this package – financial incentives – is being weakened is a cause for significant concern at a time when changes to our labour market make further increases in labour market participation even more crucial.

The difficulty lies with the roll-out of Universal Credit (UC). This new welfare benefit is gradually replacing the existing tax credits system for lower income working people. The move to a simpler benefit system is to be welcomed, but the current regime of UC being rolled out risks shifting incentives for some groups – particularly single parents and second earners in couples – in a way that puts past gains and future progress at risk.

Currently, single parents respond strongly to tax credits, with large numbers working precisely the 16 hours a week that constitutes the 'sweet spot' under the system. Here they receive the maximum boost in their tax credit receipt. But the structure of UC – particularly following a succession of budget cuts – means that this 'sweet spot' looks like it will drop to 10 hours (or five depending on housing costs). Once childcare costs are added into the mix, some single parents might conclude that it is no longer worthwhile to work at all.

The structure of UC also threatens work incentives for second earners in couples – often mothers

The structure of UC also threatens work incentives for second earners in couples – often mothers – another group where the evidence is very clear that financial incentives matter. The work allowance available to UC recipients – that is, the amount they can earn before their UC award starts to be removed – applies at the household rather than individual level. It is therefore typically entirely used up by the first earner in a couple, meaning that the family sees reductions in UC support as soon as the second earner starts to earn anything. As a result, around three in ten part-time second earners will lose 70p to 80p of every pound earned.

In order to avoid turning the clock back and instead build on the employment successes associated with tax credits, it's imperative that UC is reformed. We've written in detail on the subject before,⁵ about the need for higher work allowances alongside a number of other technical but important adjustments. The success of UC and of ongoing efforts to raise labour market participation depends on getting these details right.

Job retention as well as job entry: rising to the specific challenges of disability and long-term health problems

If the main goal in relation to mothers and single parents is to avoid undermining past gains, the aim for other 'low activity' groups is to replicate these successes. That ambition is certainly reflected in the Conservative party's commitment to getting 1 million more people with disabilities into work over the next ten years. This would be a similar number to the increase in employment we have seen over the past two-and-a-half years and would take us nearly half way to reaching full employment, based on our estimates in Table 1. But as things stand, government policy in this area is too narrowly focused on the necessary but not sufficient (or indeed always well implemented) task of getting people who are judged to be able to work off benefits and into a job. Figure 4 presents an alternative perspective, showing that more people leave work for health reasons than move into work from health-related inactivity. Moreover, exits from employment have been rising since 2011 and disabled people are more disadvantaged the longer they remain out of work. Non-disabled people are three times less likely to re-enter work if they have been out of a job for a year, whereas someone with a disability is 6.5 times less likely to re-enter work. With this in mind, the government should increase the emphasis it places on *job retention* for those suffering from health problems, alongside

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a continued focus on access to *job entry*.

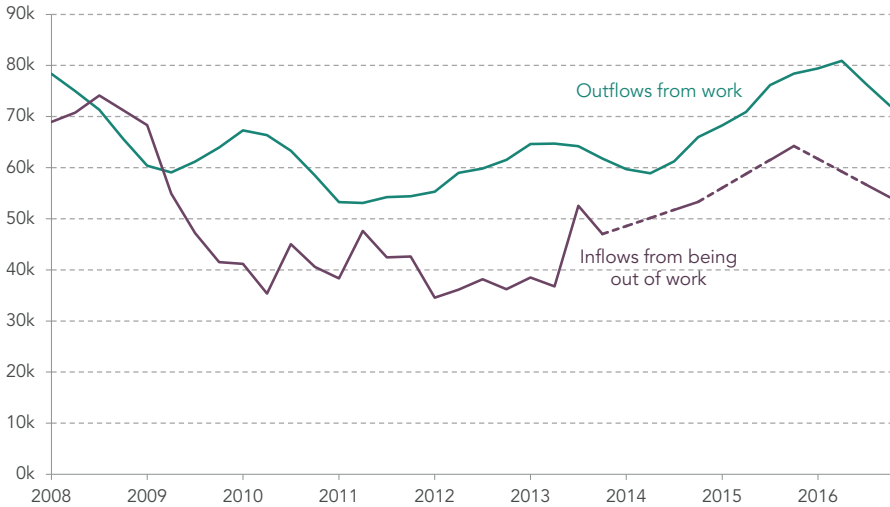
For example, building on the success of statutory maternity leave and the crucial lesson that retaining attachment to the labour force through

an existing employer is key, workers with health problems should have a new right to return to work following a period of ill-health of up to 12 months, mirroring the right to return for mothers after childbirth. To encourage employers to actively support people back into work, the government should also offer a rebate on Statutory Sick Pay (SSP) where that happens. Keeping workers in touch with the labour market could go a long way to boosting participation among those with disabilities and long-term illnesses.

Of course, while a focus on retention is important, people should not be tied to jobs at all cost. For those leaving employment, support, in the form of the Work and Health programme or other initiatives, needs to kick-in sooner and be more tailored. We provide a fuller outline of these and other proposals in the summary of recommendations.

Figure 4: Exits from work because of health problems have been rising

Number giving health reasons as main reason for leaving employment in last six months (18 & over) & number in work giving health reasons as main reason for not being in work a year ago



Notes: Dashed lines show linear extrapolation where quarterly data is not available.

Source: RF analysis of ONS, LFS

Financial and non-financial incentives: keeping older people in the labour market for longer

Finally in this chapter, we consider the particular challenges and opportunities associated with raising employment among older people. It should be acknowledged that this is a group for which labour market participation has been rising steadily over time, powered by improvements in health but also the end of the default retirement age and the raising of the state pension age.⁶ Despite this, further progress is both desirable and achievable. The labour force participation rate for workers 65 and over is lower than the G7 average. The UK performs better for workers aged 55 to 64 although performance is still below that of many Nordic countries, New Zealand, Switzerland, Japan and Germany. Given that around half the workforce exits employment before reaching state pension age, there is plenty of scope for catch up.⁷

There are of course crossovers with the approach that might be considered for those with disabilities: around a fifth of those aged between 51 and 65 who leave work do so because of health problems. But other factors are at play too.

For example, around 15 per cent of older people are unable to work because of caring responsibilities (compared to around 30 per cent who do not work because of health problems). And, while health problems have been falling over time in this age group, the impact of caring responsibilities has remained constant. The Conservatives have promised to help those with caring responsibilities move into, or return to work. In terms of the former the government could consider allowing those with caring responsibilities make a statutory request for flexible working immediately, without having to have been employed for 26 weeks. In terms of the latter we would welcome a similar right to return to that which currently exists for those on maternity leave. The Labour party are considering allowing all employees the right to request flexible working, having promised to give all workers equal rights from the beginning of their employment.

In other cases, older people may be discouraged from continuing in work once they reach state pension age. To encourage people to continue working it should be easier for those who have reached state pension age to partially draw down pension pots while continuing to work. Auto-enrolment provides an opportunity for the government to encourage firms to select, and pension providers to provide, schemes that allow for partial drawdown. Leading by example the government should make it easy to partially

Older people may be discouraged from continuing in work once they reach state pension age

draw down the state pension and the government should reinstate the option to defer the state pension and take a lump sum (which at present cannot be taken) plus uplift at a later point, both

of which were proposed by the Cridland Review.⁸ Such a move would be progressive as at present the current deferral arrangements are not very attractive for people with low earnings. Non-financial factors are also important: of those choosing to become self-employed after reaching state pension age the most common reason cited for doing so is job satisfaction.⁹

Addressing this, more can be done to ensure that older staff have the same opportunities for training and professional development as those younger than them. There should be wider use of mid-life and later-career reviews which the evidence suggests benefits workers as retirement age approaches.¹⁰ Firms are increasingly aware of the need to rethink their approach to staffing and retention to attract and keep older workers. Some large firms – including Barclays, Boots, Aviva and the Co-op – have set themselves targets to employ greater numbers of older workers and are promoting flexible working.¹¹ Government has a role to play in ensuring that good practice is spread.¹²

Pushing towards full employment requires active government involvement

The UK has made big strides on employment in recent years, but with the labour market at something of a tipping point it is now more vital than ever that we increase participation to reduce the pressures of labour supply constraints. A tight labour market, coupled with an ageing population and lower migration means that firms will need to look beyond their usual pools of talent.

But big gains in employment will not arrive automatically: the government needs to take deliberate action to help people move into, and perhaps more importantly stay in, work. Experience teaches us that policy action in these areas can deliver significant changes in labour market participation – benefitting both the individuals involved and the wider economy.

Getting people into work is only the first step. Wage rises at the bottom of the labour market will help, but for many work is still too insecure and low-quality. What was once seen as a *steadily increasing* feature of the UK labour market – atypical, insecure work – may now be plateauing, but the evidence is that a large chunk of insecurity is here to stay. The next chapter deals with how we tackle this.

Summary of recommendations

— Improving incentives

Recommendation 1 Increasing work allowances for single parents (to **£2,000**) and introducing a work allowance for second earners (of **£1,500**).

Recommendation 2 Work allowances for disabled recipients should be restored to the value originally intended, and increased in the future.

Recommendation 3 Allow for partial drawdown of the state pension and support expansion of partial drawdown options in private pensions.

— Keeping people in work

Recommendation 4 The government should establish a disability employment outflow reduction target.

Recommendation 5 The government should explore how it can support those with caring responsibilities, including with promised help for carers moving back into work following a period of caring leave.

Recommendation 6 The government should create a unified occupation health architecture including the Fit for Work Service and Access to Work.

Recommendation 7 The government should introduce a statutory 'right to return' period of one year from the start of sickness absence.

Recommendation 8 The government should offer a rebate on Statutory Sick Pay costs to firms whose employees make a successful return to work from long-term sickness absence within one year.

— Helping people return to work

Recommendation 9 Employment support programmes should be available for all those with disabilities, regardless of benefit receipt.

Recommendation 10 The Fit for Work Service should have the power to offer early referral to the Work and Health Programme for people unlikely to return to current employment.

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 - 5 D Finch, *Making the most of UC: Final report of the Resolution Foundation review of Universal Credit*, Resolution Foundation, June 2015
 - 6 J Cribb, C Emmerson & G Tetlow, *Signals matter? Large retirement responses to limited financial incentives*, Labour Economics, Volume 42, October 2016, Pages 203–212
 - 7 DWP, *Fuller Working Lives – Background Evidence*, June 2014
 - 8 J Cridland, *Independent Review of the State Pension Age Smoothing the Transition Final Report*, March 2017
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 - 11 O Ralph, *Businesses set targets for recruiting older workers*, Financial Times, 23 May 2017
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