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The Recent Decline in United Kingdom Labor Force Participation: Causes and Potential Remedies

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SIP/2023/051

IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries. It is based on the information available at the time it was completed on June 20, 2023. This paper is also published separately as IMF Country Report No 23/253.

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SELECTED ISSUES PAPER

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ABSTRACT: This paper studies the puzzling decline in labor force participation observed in the UK following the pandemic. Retirement and long-term sickness appear to be the main drivers, with chronic illness remaining a lingering distinctive factor vis-a-vis peer countries. While the government has recently adopted a battery of measures to increase labor force participation, more could be done to improve health outcomes and increase the participation of the long-term sick and the disabled, keep older workers in the labor force, increase female labor force participation, and improve the skills and productivity of both domestic and foreign workers that join the workforce.

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SELECTED ISSUES PAPERS

**The Recent Decline in United
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THE RECENT DECLINE IN UNITED KINGDOM LABOR FORCE PARTICIPATION: CAUSES AND POTENTIAL REMEDIES¹

The post-pandemic decline in labor force participation in the UK has puzzled analysts and concerned observers and policy makers alike. While a recent decline in inactivity among students has partially alleviated the problem, the UK is still underperforming other advanced economies, with potentially adverse consequences for potential growth. Retirement and long-term sickness seem to have been the main drivers of this post-pandemic inactivity spike, with chronic illness remaining a lingering distinctive factor vis-a-vis peer countries. While the government has recently adopted a battery of measures to increase labor force participation, more could be done to improve health outcomes and increase the participation of the long-term sick and the disabled, keep older workers in the labor force, increase female labor force participation, and improve the skills and productivity of both domestic and foreign workers that join the workforce.

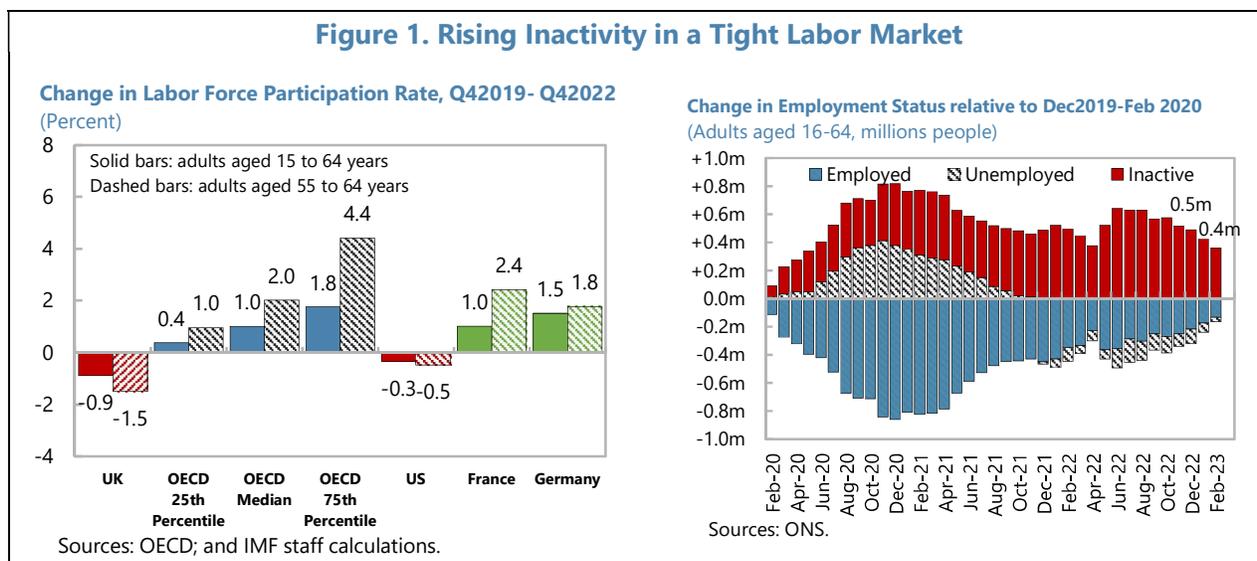
A. What is the Issue and Why Does it Matter?

1. The UK saw a distinctive rise in inactivity, notably among elderly and male workers, during the pandemic. Between end-2019 and end-2022 about half a million people (0.8 percent of the working age population) became inactive, while labor force participation increased in other advanced economies (Figure 1, left chart). Breaking down by age, older workers (50–64) experienced the highest growth in inactivity (mostly due to illness and retirement), followed by the youngest cohort of workers (16–24), many of whom became university students during the pandemic. Inactivity amongst the middle-aged group (25–49) increased only slightly, partly thanks to the success of the furlough scheme in maintaining workers tied to their companies during restrictions. This overall spike in inactivity in the UK coexisted with a historically tight labor market (Figure 1, right chart) that has complicated the authorities' efforts to bring down high inflation. While the number of economically inactive people has decreased since the start of 2023 (mainly due to more graduate students rejoining the labor force) the UK still has weaker labor force participation today than before the pandemic (by about 250 thousand workers). This spike in inactivity has been more acute among men than women.²

¹ Prepared by Gloria Li and Carlos Mulas Granados (both EUR).

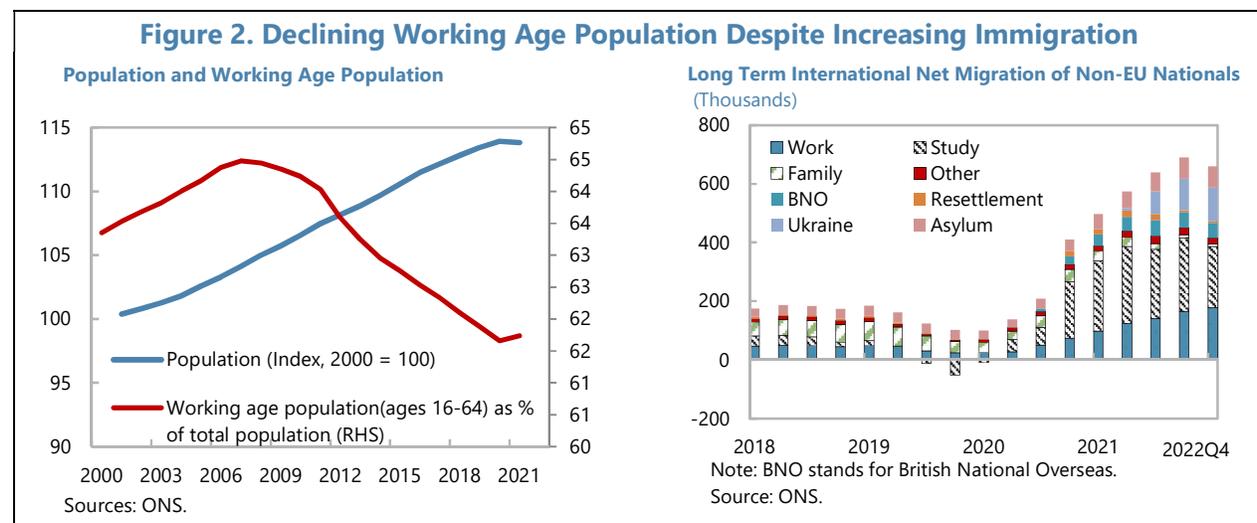
² This is representative of a long-term trend in the UK and other advanced economies of decreasing inactivity among women and increasing inactivity among men. Specifically, the UK's average pre-COVID (i.e., 2019) inactivity rates for men and women aged 25–34-year-olds were 6.8 percent and 18.3 percent, respectively. Within this age group, the inactivity rate for women had fallen to 15.4 percent by 2023Q1, but that for men had increased to 8 percent. In the age group 35–49, trends were similar, but the magnitude of the difference was smaller.

Figure 1. Rising Inactivity in a Tight Labor Market



2. This spike in inactivity has occurred against the backdrop of a declining working population. During the last two decades, the UK’s working age population has declined, even as the population continued to increase (Figure 2, left chart). The trend has begun to reverse in the last three years, coinciding with the increase in immigrants from outside the EU and notwithstanding the fact that many of these were arrivals motivated by humanitarian or political reasons (Ukraine) and students and via BNO channel (Hong Kong SAR) (Figure 2, right chart).³

Figure 2. Declining Working Age Population Despite Increasing Immigration



3. The UK’s post-pandemic inactivity spike contrasts with developments in other major advanced economies. Between end-2019 and end-2022, inactivity grew twice as much in the UK

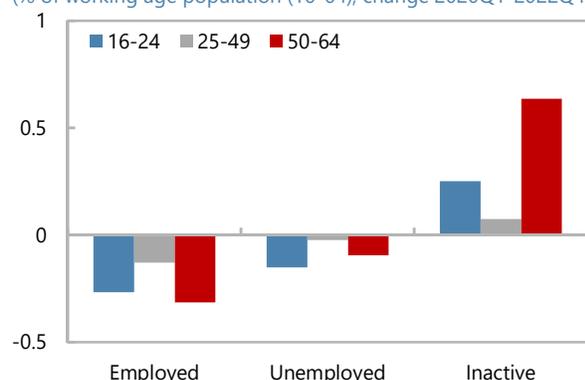
³ By end-2022, students from non-EU countries account for approximately 34 percent of the net migration from these countries into the UK. The proportion of those arriving for humanitarian reasons rose to a combined 28 percent by end-2022.

than in the US, especially among older workers (50–64), while in the US inactivity was more concentrated in middle-aged workers (25–49). Developments in Germany and France during the same period were markedly different. Inactivity in Germany remained unchanged during the same period and only among younger workers (15–24) there was a mild decline. Instead, in France inactivity decreased significantly across all age groups (Figure 3). It is worth noting that historically, the inactivity rate in the UK has been lower than in peer countries, and remains relatively low.

Figure 3. Post-Pandemic Inactivity Spike in Comparative Perspective

UK: Change in Employment Status by Age

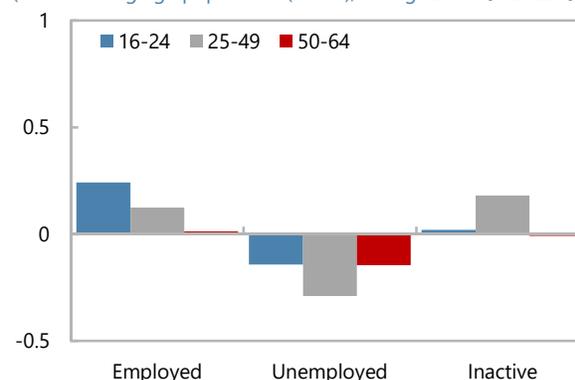
(% of working age population (16-64), change 2020Q1-2022Q4)



Sources: ONS; Haver Analytics.

US: Change in Employment Status by Age

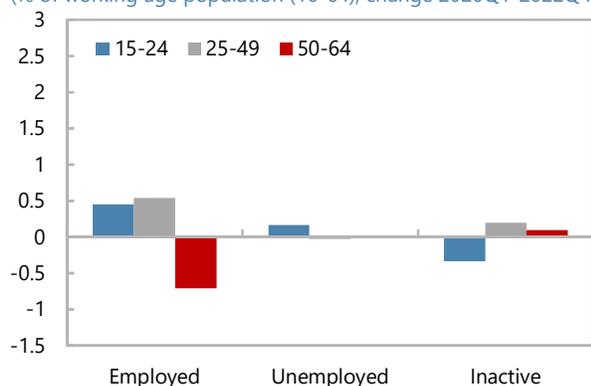
(% of working age population (16-64), change 2019Q4-2022Q4)



Sources: BLS; and Haver Analytics.

Germany: Change in Employment Status by Age

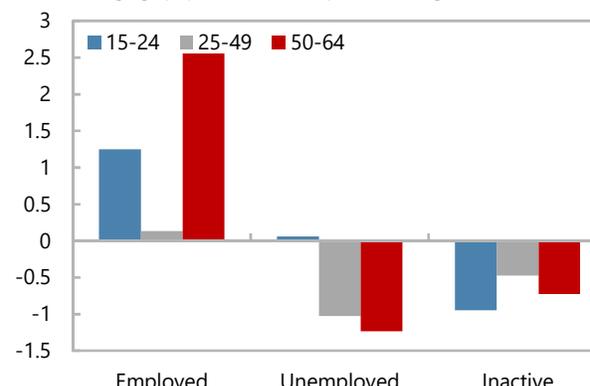
(% of working age population (16-64), change 2020Q1-2022Q4)



Sources: Eurostat; Haver Analytics.

France: Change in Employment Status by Age

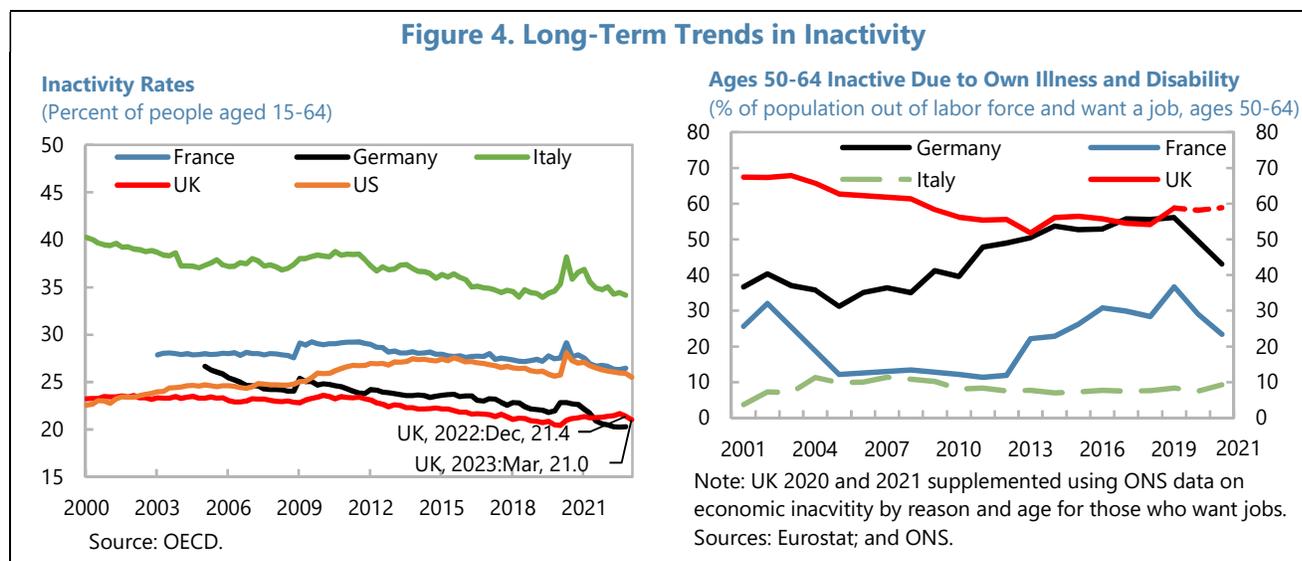
(% of working age population (15-64), percent change 2020Q1-2022Q4)



Sources: Eurostat; and Haver Analytics.

4. High inactivity due to illness has been a distinctive feature of the UK, despite a relatively low inactivity rate in level terms. Survey data shows that UK has had one of the lowest inactivity rates among peers since 2000, and it was on a further declining trend between the GFC and the start of the pandemic. Despite the recent pandemic-induced rise, the UK's inactivity rate (at 21 percent) is much lower than in the US or France, and only slightly above Germany's (Figure 4, left). However, when looking at long-term drivers of inactivity, the link with long-term sickness seems a distinctive problem for the UK (Figure 4, right).

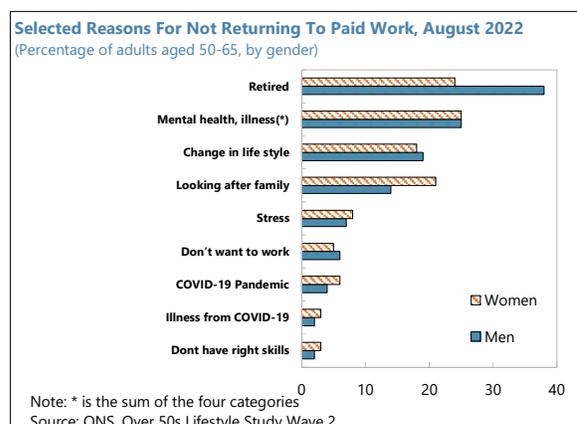
Figure 4. Long-Term Trends in Inactivity



5. If inactivity became structural, it could reduce labor supply and affect medium-term growth. A sustained increase in inactivity could weaken the potential growth of labor supply. In such a scenario, even if productivity grew twice as fast as in the pre-pandemic decade, medium-term potential output would mechanically be lower than otherwise.⁴ Additional consequences of inactivity and weak labor supply are: (i) it exacerbates labor market tightness, pushing up wages and inflation; (ii) complicates the fiscal challenges associated with aging (e.g., pensions, health and social care spending); and (iii) prevents significant parts of the population from reaching their potential, thus exacerbating income disparities.

B. What Explains the Recent Increase in Inactivity?

6. Retirement, health issues and caring for family were the most cited reasons for not returning to work after the pandemic. For those surveyed when the economy reopened fully in the summer of 2022, retirement was the main reason for not having returned to work (especially among men).⁵ Illness and worsening health conditions, not only Covid-related, was the second most important factor mentioned by both men and women. Importantly, looking after family members was the third main driver of inactivity for women.⁶ Income



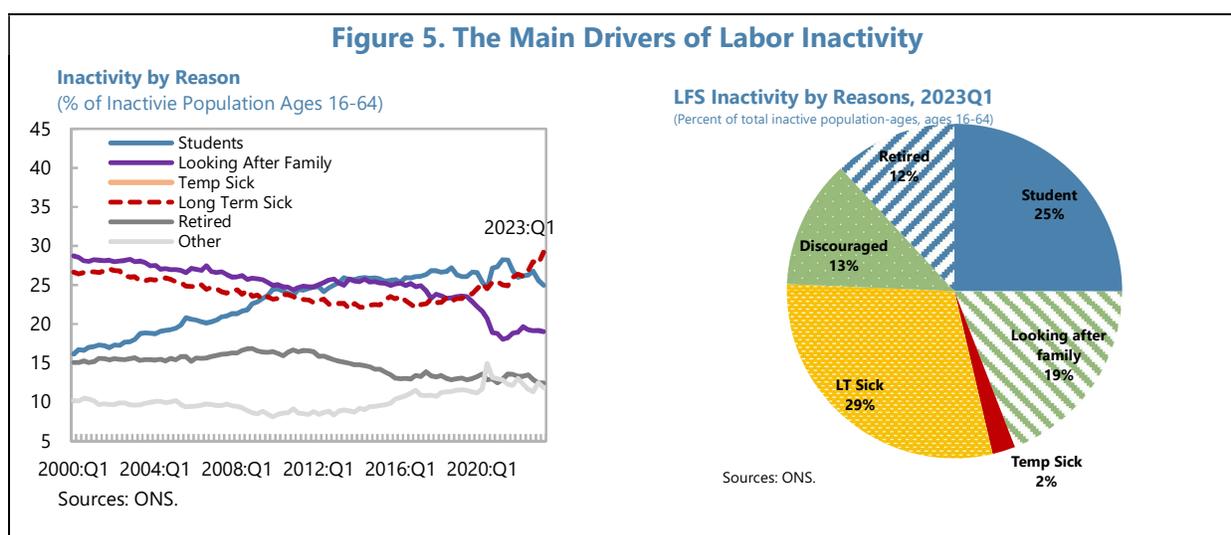
⁴ See: <https://www.bankofengland.co.uk/monetary-policy-report/2023/february-2023>, Table 3A.

⁵ <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/articles/reasonsforworkersagedover50yearsleavingemploymentsinthetstartofthecoronaviruspandemic/wave2>

⁶ <https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/economicinactivity/articles/halfamillionmorepeopleareoutofthelabourforcebecauseoflongtermsickness/2022-11-10>

status may have been partly associated with these different reasons for abandoning the labor market during the pandemic.⁷

7. Long-term sickness has become the leading reported factor of inactivity at the start of 2023. More recent data from the 2023Q1 labor survey shows that long-term sickness and disability has surpassed other traditional leading factors of inactivity such as studying or caring for family, and is now the single main driver of lingering inactivity in the UK for 1 in 3 inactive workers (Figure 5).⁸ Survey data also shows that the younger and middle-aged cohorts are increasingly reporting sickness. Among these age groups, the largest overall increase in people with long-term sickness was due to mental illness (a 24 percent increase since before the pandemic), and the second was for progressive illnesses (a 69 percent increase) such as cancer.



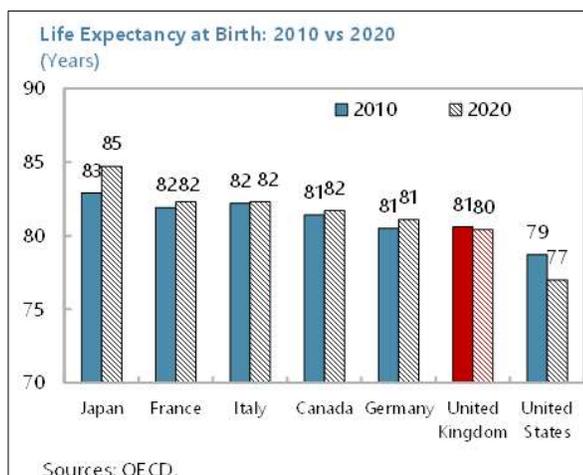
⁷ For example, over 50 percent of economically inactive 50–65-year-olds lived in poor-income households (and most of them were inactive due to sickness), while inactivity was three times lower in higher-income households (and mainly driven by retirement). Relatedly, 2/3 of those who left the labor market since the start of the pandemic owned their homes outright and half funded their retirement through a private pension. See Resolution Foundation (2023) “Post-Pandemic Participation: Exploring Labour Force Participation in the UK: from the Covid-19 Pandemic to the Decade Ahead” <https://www.resolutionfoundation.org/publications/post-pandemic-participation/>

⁸ In Q4 2022, 28 percent of inactive people were full time students. But since January 2023, inactivity due to study has gone back to previous trend, and the employment rate of people aged 18-24 has largely recovered to its pre-pandemic level at 63 percent.

8. The UK's distinctive long-term illness-induced inactivity could potentially reflect increasing pressures on the NHS and social care system, amid declining health indicators.

Rising inactivity might be just one manifestation of stresses in the healthcare system. Health experts point to organizational challenges (including the lack of interoperable IT infrastructure)⁹, funding levels for the NHS¹⁰, labor shortages¹¹ and the relatively low number of hospital beds¹² as some of the main factors that have led to recent backlogs and much longer-waiting times.¹³ They also point to life expectancy as a key health

outcome indicator in which the UK stagnated between 2010 and 2020, while most advanced economies improved.¹⁴ As possible reasons, experts mention that the UK has a high rate of premature mortality due to preventable conditions (e.g. pulmonary disease, diabetes, asthma and obesity) linked to smoking, poor diet, physical inactivity, and alcohol abuse.¹⁵



⁹ See, for instance, <https://blogs.deloitte.co.uk/health/2023/01/the-facts-and-figures-about-the-challenges-facing-the-nhs-in-2023.html>. For organizational challenges more broadly, see https://journals.lww.com/healthcaremanagerjournal/Abstract/2015/10000/Organizational_Failure_in_an_NHS_Hospital_Trust_A.13.aspx.

¹⁰ According to the Institute for Fiscal Studies: the NHS “would require around £4 billion of additional funding in 2024–25 to undo the remainder of the real-terms hit to NHS spending plans”. See: <https://ifs.org.uk/publications/nhs-funding-resources-and-treatment-volumes>

¹¹ Also, ONS data shows that since 2019, General Practitioners’ workloads have increased by 18 per cent and the full-time-equivalent (FTE) workforce has fallen by nearly 700 with each FTE GP now caring on average for an extra 120 patients. See: <https://www.rcgp.org.uk/News/Workforce-ONS-GP-Patient-Ratio>

¹² For example, in the latest edition of the OECD (2022) *Health at a Glance* report, the reported number of hospital beds per 1000 people in Germany was 7.8, in France was 5.7 and in the UK was 2.8. For more details, see: <https://www.oecd-ilibrary.org/docserver/507433b0-en.pdf?expires=1686760108&id=id&accname=guest&checksum=9600AEC13E032816489D3833CBCCDC1>.

¹³ Latest data reported by the British Medical Association in April 2023 shows a median waiting time for treatment of 13.8 weeks, which is almost double the pre-COVID median of 7.2 weeks (in April 2019). See: <https://www.bma.org.uk/advice-and-support/nhs-delivery-and-workforce/pressures/nhs-backlog-data-analysis#:~:text=Waiting%20times%20have%20rocketed,stood%20at%2031%2C494%20in%20May>

¹⁴ <https://www.kingsfund.org.uk/publications/whats-happening-life-expectancy-england>.

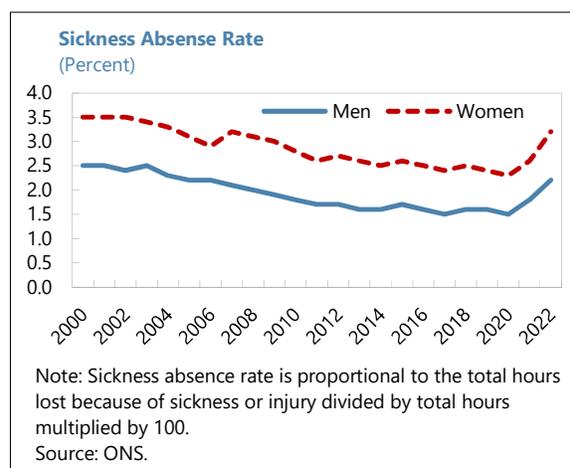
¹⁵ Around 40 percent of premature mortality in the UK is caused by preventable cardiovascular disease, diabetes, cancer, and chronic obstructive pulmonary disease. See: <https://publications.parliament.uk/pa/ld201617/ldselect/ldnhssus/151/15109.htm#:~:text=Around%2040%25%20of%20premature%20mortality,determinants%20of%20avoidable%20chronic%20conditions>

C. What Are the Potential Remedies?

9. A combination of policies could help reduce inactivity and strengthen other areas of the labor market. Below, staff discuss several policy options that could help alleviate the recent increase in inactivity, but also consider measures that could strengthen the labor supply, enhance labor market flexibility, and increase productivity, more generally.

Improving Healthcare

10. Poor health can also affect those who remain employed, causing absenteeism and low productivity. Long waiting times for referrals and diagnosis have coincided with an uptick in the number of employees calling off sick from work, reversing 3 decades of downward trend (though there are other potential factors, including post-pandemic behavioral shifts). In 2022, the sickness absence rate (the percentage of working hours lost because of sickness or injury) increased to 2.6 percent, up 0.7 percentage points from its pre-pandemic 2019 level, reaching its highest point since 2004. Sickness absence was more prevalent among women, public sector workers and part-time employees. About a third of large employers perceived sickness absence as a barrier to productivity in their organizations, especially in sectors such as manufacturing and construction.¹⁶



11. The government has made reducing waiting times one of his five priorities, and the government has approved new measures to address inactivity, including due to long-term sickness and disability. The 2022 Autumn Statement included additional budgetary allocations (about 0.3 percent of GDP per year) until 2025 for the health and social care systems. In the Spring budget, the government added a battery of initiatives to help remove barriers for those who are inactive due to long-term sickness. It introduced a Universal Support program to match people with disabilities and long-term sickness with jobs and provide support and training. A suite of measures to address the leading causes of ill health related inactivity included tailored employment support in mental health and musculoskeletal health services and expanding access to digital resources and health checks.

12. But more funding and structural reforms to the health and social systems may be needed soon. Last Fall, the NHS signaled the need for additional funding to meet expenditure pressures through up to 2025.¹⁷ Structurally, health already absorbs 38 percent of government

¹⁶https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1003911/sickness-absence-and-health-in-the-workplace-report.pdf

¹⁷ <https://www.england.nhs.uk/wp-content/uploads/2022/10/item-4.2-public-board-meeting-financial-position-and-the-future-financial-outlook-.pdf>

spending, but the UK still spends less on health care than countries like France and Germany as a share of GDP. The gap is especially large in capital spending, with the UK at the bottom of the OECD in terms of health investment per person. Experts emphasize that a different composition of spending is needed, especially if Integrated Care Systems are to succeed as envisioned by the 2022 Health and Care Act, since today most resources are tilted in favor of hospitals at the expense of primary care, prevention and public health policies.¹⁸ Addressing shortages of doctors and nurses, including through better working conditions and higher pay to make up the decade-long decline in real pay¹⁹ could help reduce waiting times and backlogs. Going forward, funding to hospitals should be focused on health-outcomes and innovation instead of top-down metrics based on activity. Short-term funding pressures in the social care system also remain intense despite the extra money in the 2022 Autumn Statement. Wider system reform of social care is also needed to address the other fundamental problems, including high levels of unmet need, chronic workforce shortages and a fragile provider market.²⁰

13. New incentives for occupational health could have a positive impact on workers' health. Improved employee health and wellbeing can benefit employees, employers, and the wider economy by reducing ill-health related job loss, sickness absence, presenteeism, and improving productivity. However, previous research shows that whilst most employers recognize their role, many face multiple barriers to investing in health and wellbeing support, such as lack of expertise, time constraints and cost. There is also wide variation in the support provided by employer size, with small and medium-sized employers significantly less likely to invest in formal health and wellbeing initiatives than large employers. Joint work by the departments of Health and Social Care and Work and Pensions shows that a new scheme of financial support and supplementary advice could increase the take up of occupational health initiatives by SMEs and potentially reduce sick absences and/or inactivity due to long-term sickness.²¹ The 2023 Spring Budget already announced an expansion of the SME occupational health subsidy pilot scheme. Going forward, staff recommends that the government builds on this and other evidence-based initiatives that help firms invest in the health of their workforce.

Keeping Older Workers Employed

14. While a significant part of the post-pandemic inactivity spike was due to retirement, bringing back retirees into the labor market is particularly challenging. Independent research shows that people who are economically inactive due to long-term sickness or disability are consistently more likely to return to employment than early retirees. For example, among those who have been out of work for less than three months, about 22 percent of those with long-term

¹⁸ <https://www.kingsfund.org.uk/publications/integrated-care-systems-explained>

¹⁹ <https://www.nuffieldtrust.org.uk/resource/chart-of-the-week-what-has-happened-to-nhs-staff-pay-since-2010>

²⁰ <https://www.kingsfund.org.uk/publications/health-and-social-care-england-myths>

²¹ <https://www.gov.uk/government/publications/incentivising-sme-uptake-of-health-and-wellbeing-support-schemes/incentivising-sme-uptake-of-health-and-wellbeing-support-schemes-summary>

sickness flow back to employment each quarter, compared to just 6 percent of retirees aged 50–64. The chance of re-entering work gets even lower over time: the chances of a retiree aged 50–64 returning to work are three times lower for those who left their last job between two and three years ago (i.e., during the summer of 2020) than those who left work less than three months ago.²²

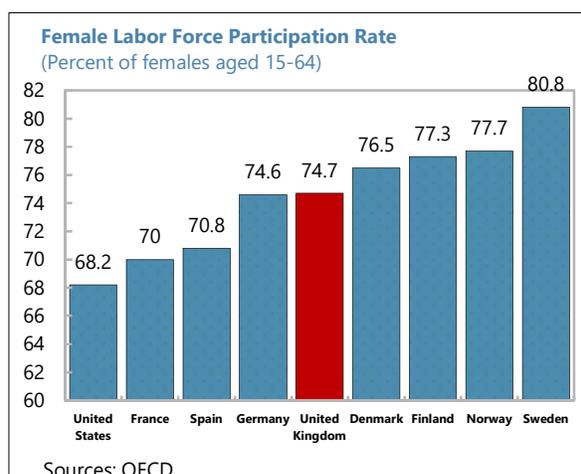
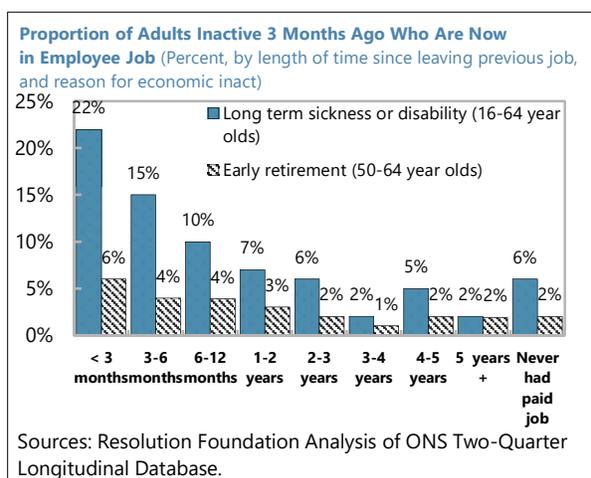
15. Policy should therefore focus on keeping older workers in the labor market.

Matching the older workers’ participation rate of Sweden, would add about 1 million of workers to the UK’s labor market, enough to compensate by itself the loss incurred due to the post-pandemic inactivity spike. To attract older workers into work, the Spring budget included a targeted pension tax reform aimed at removing disincentives to work more hours; and a new program of ‘returnships’ for elder workers. Other options that could be considered include: (i) increasing the State Pension retirement age from 66 to 68 earlier than planned to retain older and experienced workers in the labor force; (ii) deepening employment support tailored towards the needs of older people and in the sectors more likely to hire older workers; and (iii) expanding the network of work advisers specifically trained to deal with the full range of older jobseekers, including those from managerial or professional backgrounds.

Strengthening Female Labor Participation

16. Despite significant improvements in female labor force participation in the last decades, there is still room for improvement.

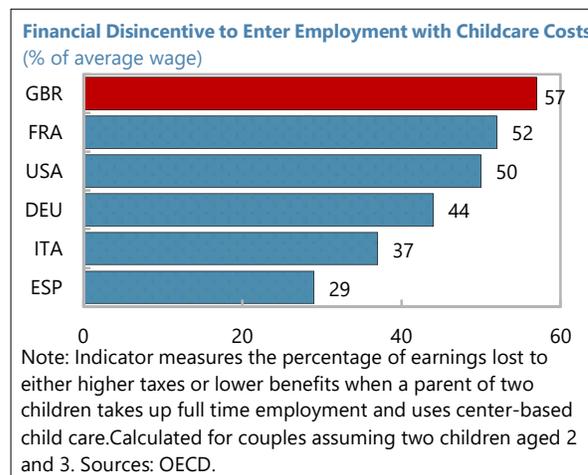
The female labor force participation rate in the UK has increased in the past two decades by 6 percentage points and is higher than G7 peers, but it is still below the Nordic countries. For example, increasing female labor participation rates to the levels of Denmark could add about another million female workers to the UK’s labor force. Despite recent increases in overall female participation, the participation gap between men and women in ages 25–34 is still significant



²² See Resolution Foundation (2023) “Post-Pandemic Participation: Exploring Labour Force Participation in the UK: from the Covid-Pandemic to the Decade Ahead” <https://www.resolutionfoundation.org/publications/post-pandemic-participation/>

(93 percent for men vs 81 percent for women) and there are sizable differences in labor force participation rates between prime-aged women with and without children.

17. Recent policy decisions to expand free childcare go in the right direction. The financial disincentives faced by mothers to enter employment with rising childcare costs are significantly higher in the UK than in other advanced economies, given that the cost of childcare rose by 60 per cent in cash terms between 2010 and 2021—twice as fast as average earnings.²³ Recent government initiatives aim at directly addressing this problem. The Spring budget included a significant expansion of childcare policies, by providing 30 hours a week of free childcare for 38 weeks a year, for eligible working parents of children aged 9 months to 3 years. This is expected to be rolled out gradually over the next three years and comes in addition to the 30 hours a week already provided for eligible working parents of 3 to 4-year-olds. To encourage the supply of childcare, the government announced that it would uplift the hourly funding rate paid to providers and launch a new scheme to support the expansion of school-based childcare provision. Additionally, support for childcare costs in Universal Credit would be made available upfront and the maximum potential benefit for parents is expected to increase. This battery of policy measures, once fully implemented, is likely to have a positive effect on female labor participation.



18. Other complementary policy initiatives could be considered. For example, increasing the hours per day when childcare is available and adding free part-time childcare options could help parents with longer schedules. The expansion of the social care infrastructure could also help support people who care for the elderly and the disabled. Investing in tailored retraining programs for caregivers, who are mostly women, could also help them return to work after long periods of inactivity.

Addressing Skills Shortages

19. Businesses have been experiencing a shortage of workers. The percentage of businesses experiencing a shortage of workers since end-2021 until now has ranged between 13 and 17 percent. Shortages seem especially acute among small businesses, with 80 percent declaring last year that they had difficulties in recruiting applicants with suitable skills.²⁴ The industries with the highest

²³ HMRC (2021) Tax-Free Childcare: barriers to sign up:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1062615/HMRC_research_report_630_Tax_Free_Childcre_barriers_to_sign_up.pdf

²⁴ See: <https://commonslibrary.parliament.uk/research-briefings/cdp-2023-0001/>; <https://www.fsb.org.uk/resource-report/scaling-up-skills.html>

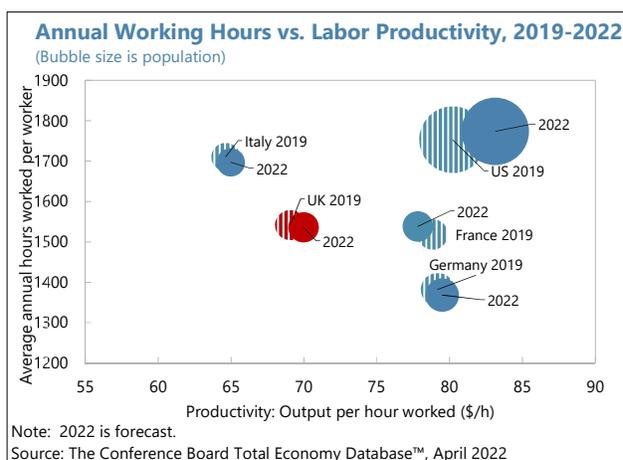
percentage of businesses experiencing worker shortages are accommodation, food services and construction. Experts point to different factors explaining these labor shortages, including a faster-than-expected post-pandemic growth in the demand for labor that has also affected other countries, “recruitment difficulties in low-wage industries resulting in part from longer-term problems such as unattractive pay or working conditions”, and the end of free movement linked to Brexit which according to the latest independent research, appears “to have exacerbated these existing problems employers have faced”.²⁵

20. Enhancing retraining programs and encouraging more open immigration arrangements could help address labor and skills shortages.

While the level of immigration a country chooses to allow is ultimately a political matter, a well-designed immigration system can bring important benefits. For instance, in ageing economies, immigration can increase labor supply in those specific sectors and skills where businesses are experiencing shortages. The UK system already tries to link immigration flows with labor market needs, but it could further refine its responsiveness to specific sectoral requests by increasing the frequency by which it revisits its lists of shortage occupations. Domestic workers adequately retrained through some of the reskilling programs introduced during the pandemic, could also alleviate those shortages.²⁶ These measures would unlock economic growth and tax revenues that could then be used for public services and needed infrastructure investments. Moreover, a well-designed immigration system can also enhance labor market flexibility, which can help alleviate inflationary pressures.

Enhancing Labor Productivity

21. In the long run, productivity is essential. When capital and labor are at their maximum potential, long-term GDP growth relies on productivity growth. Whether measured as total factor productivity or labor productivity (product-per-hour worked), the UK has been performing weakly in the decade before the pandemic. The UK’s average annual productivity growth between 2009 and 2019 growing was 0.7 percent, between 0.2 and 0.4 weaker than in the US, France, or Germany. During the pandemic the UK reduced slightly the annual average of hours worked and increased productivity slightly, but not enough to catch up with those three peers.



²⁵ See: <https://migrationobservatory.ox.ac.uk/resources/reports/how-is-the-end-of-free-movement-affecting-the-low-wage-labour-force-in-the-uk/>

²⁶ See: <https://commonslibrary.parliament.uk/research-briefings/cbp-8965/>

22. The last few years have seen numerous policy initiatives to improve education and reskill the workforce. The 2021 Spending Review announced the use of the UK Shared Prosperity Fund to improve public services in education and skills in struggling regions, including a strong focus on improving adult numeracy. It also introduced a Lifetime Skills Guarantee to give access to education and training throughout lives, including free courses at upper secondary level in economically valuable areas and skills bootcamps linked to job vacancies in growth sectors. The 2022 Autumn Statement and the 2023 Spring budget confirmed existing funding for traineeships and apprenticeships programs, expanded Youth Offer and work coach support, and introduced the ‘Supported Internships Pilot’.

23. Going forward, some additional measures could be considered by the authorities to further enhance skills and labor productivity. Introducing a national work-study apprenticeship system (similar to Germany’s approach) to connect students with private firms could reduce young inactive population and facilitate the first transition into the labor market; additional funding for on-the-job training could help in this regard. A crucial aspect of policies to increase productivity is consistency over time, so it will be important to identify the most successful programs and concentrate resources to grow them faster over the medium-term.