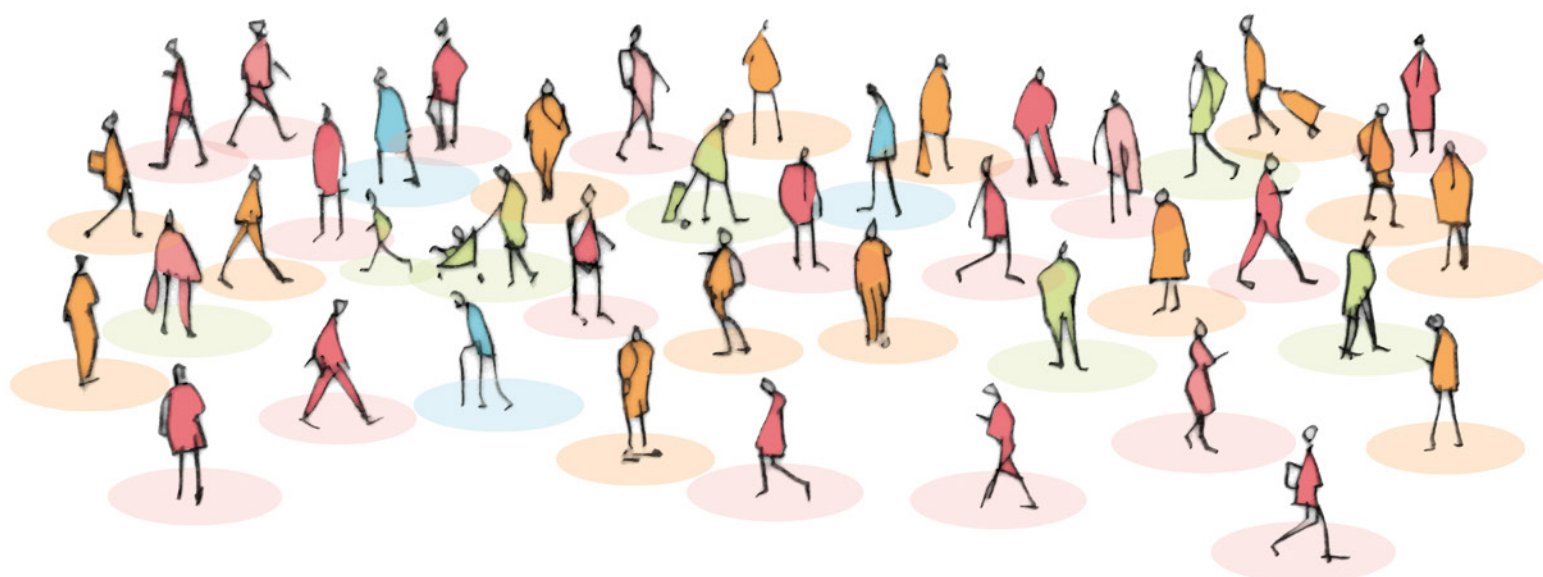




Concerns about a recent rise in economic inactivity have prompted new policies aimed at discouraging early retirement and encouraging the labour force participation of women with young children. **Stephen Machin** and **Jonathan Wadsworth** argue that such interventions would be more cost-effective if targeted at groups for whom inactivity is a longstanding issue.

The trouble with inactivity



A government seeking to raise the size of its labour force has four main options. It can encourage people to have more babies to increase future labour supply. It can bring in more immigrants. It can encourage people to work more hours. Or it could work to raise participation in the labour force, or, the same thing, try to reduce economic inactivity. It is the last of these options that is currently exercising policymakers.

The extent to which such worries are founded all depends on how persistent the rise in inactivity is likely to be. Some people have claimed that this is part of the “great resignation”, as people have voluntarily left the labour force. If so, it may be harder for them to want to come back.

In contrast, if withdrawal from the labour force is more demand-driven, related to the availability of jobs in the local area, then we might expect inactivity to start falling as and when appropriate demand conditions kick in. Governments seeking to help rectify the situation need to fashion policy accordingly.

Most students of economic policy are taught about “deadweight loss”. This means trying to avoid spending on issues that would be likely to resolve themselves without the need for extra spending and instead focusing spending on targeted “marginal” groups.

Inactivity rates show little change

The first point to make is that context is everything. The current inactivity rate isn’t much different from that in the 1970s. It was 25% of the working-age population in 1971 and 22% in 2022. Since the 1980s, each recession has been associated with a rise in the aggregate inactivity rate.

The most recent rise, which has garnered much attention, started during the Covid-19 crisis. Despite the recent concern, the current inactivity rate is still below the level seen at the tail end of the Great Recession of 2008-11.

If rising inactivity were associated with local labour shortages that drive up wages, we would expect to see a positive relationship between wage growth and inactivity growth. Instead, we find a negative association between wage growth and inactivity growth. Areas where more people have become economically inactive have experienced smaller wage growth, while areas with greater falls in inactivity have experienced larger wage growth.

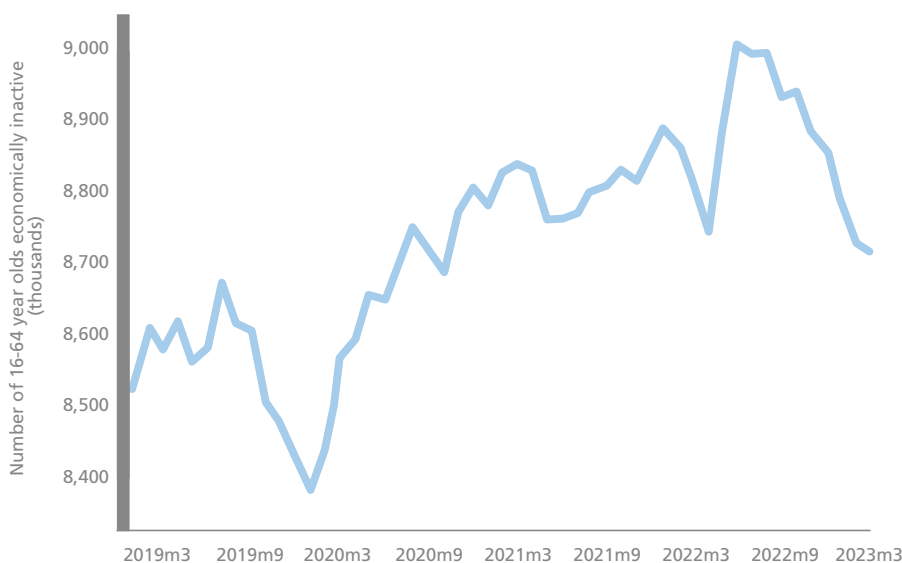
Learning but not earning

To see why inactivity may not be entirely driven by voluntary labour supply changes, it is helpful to break down the main drivers of inactivity over time.

Between the start of the pandemic in early 2020 and the end of 2022, the number of people who were economically inactive – meaning they were neither in work nor looking for work – rose by around 600,000.

Although this number has since fallen back by around 300,000 (see Figure 1), the reduction in labour supply is a potential problem for two reasons: first, fewer people offering their labour restricts the capacity of the economy to grow, in the absence of offsetting movements in productivity and/or immigration; and second, fewer people available for work could exacerbate skill shortages, which could drive up wages and in turn contribute to further “cost-push” inflation at a time of recent double-digit inflation.

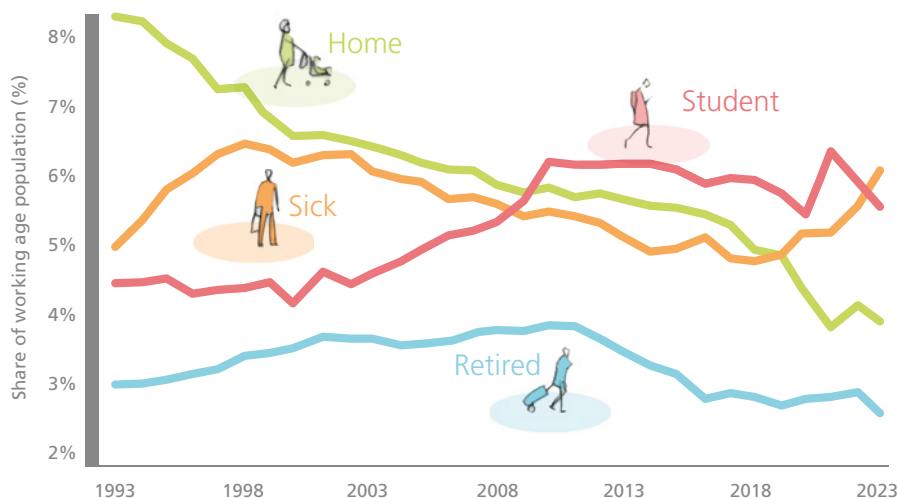
Figure 1:
UK economic inactivity, 2019-2023



Source: Labour Force Survey (LFS) raw data, Office for National Statistics (ONS).

Policymakers should avoid devoting resources to issues that may resolve themselves as the economy recovers

Figure 2:
Reasons for inactivity, 1993-2023



Source: ONS, authors' calculations.

Figure 2 shows that there are three main drivers of the recent rise in inactivity: more students, more sick people and more people looking after the home. Sickness and students each now account for around a third of all inactivity.

Looking after the home accounts for around 25% of all inactivity, but it is clearly a vanishing occupation. Just 4% of the working-age population now profess to do this as their main activity, down from 8% in the 1990s. So, the recent upturn in looking after the home still looks more like a blip in a long-term downward trend, rather than an economy-wide reversal of activity.

The share of early retirements in the working-age population has not risen much at all in recent years. Indeed, it is lower now than it was in the 1990s.

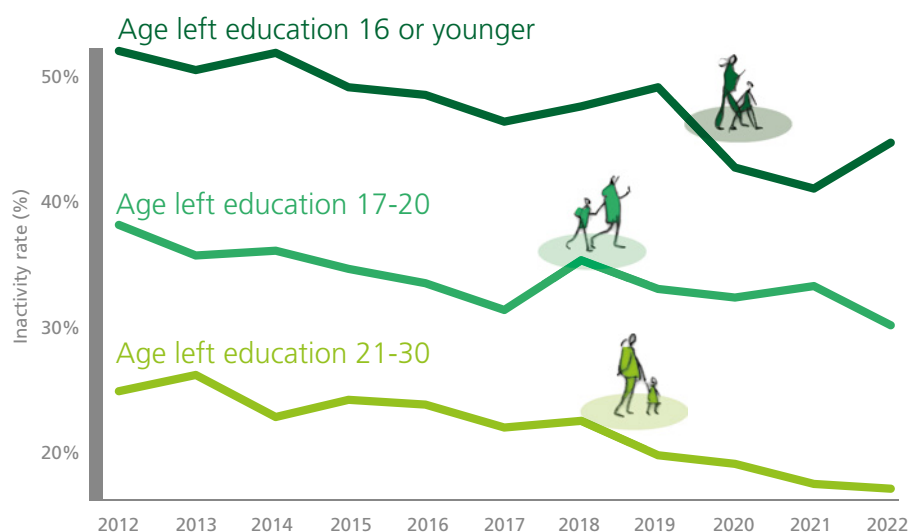
A rise in inactivity caused by more people in education should be regarded as a good thing. More people staying on to get more skills should raise the productive potential of the economy and help the

The share of early retirements in the working-age population is lower now than it was in the 1990s

labour market prospects of those who do stay on.

But Figure 2 only measures the proportion of students who are not in work or seeking work, and not the total number of students (international guidelines record any full-time student with a part-time job as being employed and not a student). So, some of this rise after 2019 is because a larger share of students is not in work or seeking work.

Figure 3:
Inactivity rates among women with a child aged 1-2, by mothers' educational attainment



Source: ONS, authors' calculations.

Focusing support

In the March 2023 budget, one of the government's responses to rising inactivity was a £1bn subsidy to occupational pension savings, the idea being presumably to reduce any incentives to retire early to avoid paying tax on an accrued pension pot above £1mn.

But Figure 2 shows clearly that early retirement does not underlie recent rises in economic inactivity. Some deadweight loss from this policy is therefore highly likely. A more targeted, marginal policy, aimed at a subset of occupations where early retirement is affecting labour supply is likely to have been a more cost-effective option.

The largest amount of cash announced in the budget was the package to increase free nursery places for working families with children aged nine months up to three years, for which the government pledged to provide over £4bn a year by 2027/28.

Inactivity rates among women aged 16-45 with a youngest child aged 1-2 are higher than for women whose youngest child is aged 3-4, although the gap is narrowing over time. But what's more, inactivity rates among those with young children under 3 have been *falling* for most of the past 20 years. So, a policy subsidising childcare for young children may well incur substantial deadweight loss.

But as Figure 3 shows, there is a large difference in inactivity rates by educational attainment among women

with a youngest child the same age. Inactivity is much higher among women who left school at age 16 than among other women with children the same age. Only among those with less formal education has inactivity risen recently. This suggests that a more targeted (marginal) scheme could again be a more cost-effective use of public funds.

How do wider economic conditions affect inactivity levels?

It seems that rising inactivity, or at least the bit that we should probably worry about most, is driven by a renewed rise in the share of older workers, men and women, who do not participate because of long-term sickness. Coming off the back of the pandemic this may not be too surprising, but rising sickness rates can be observed in earlier periods – such as following the recession of the early 1990s. This again suggests that sickness rates may be correlated with the extent of economic opportunities.

Sickness rates are, and have been for a long time, much higher among older, less skilled workers than others. Sickness rates for each older group, both higher and lower skilled, broadly follow the aggregate pattern of sickness rates over time, rising after a recession and moderating during economic recoveries. But sickness rates for the under 50s appear to be much less

The big longer-standing challenge around inactivity is low labour force participation among older, less skilled workers with illness in disadvantaged areas

responsive to the economic cycle. Recently sickness rates among younger less skilled workers have overtaken sickness rates for higher skilled older workers.

When thinking about solutions to the problem of rising inactivity, it is necessary to understand whether changes in labour demand or labour supply behaviour (or both) underlie the observed changes in economic inactivity. One way to address this is to look at changes in economic inactivity in a region or sector following changes in the economic performance of an area. If inactivity falls when the local economy improves, that suggests that demand may have some role to play in making things better.

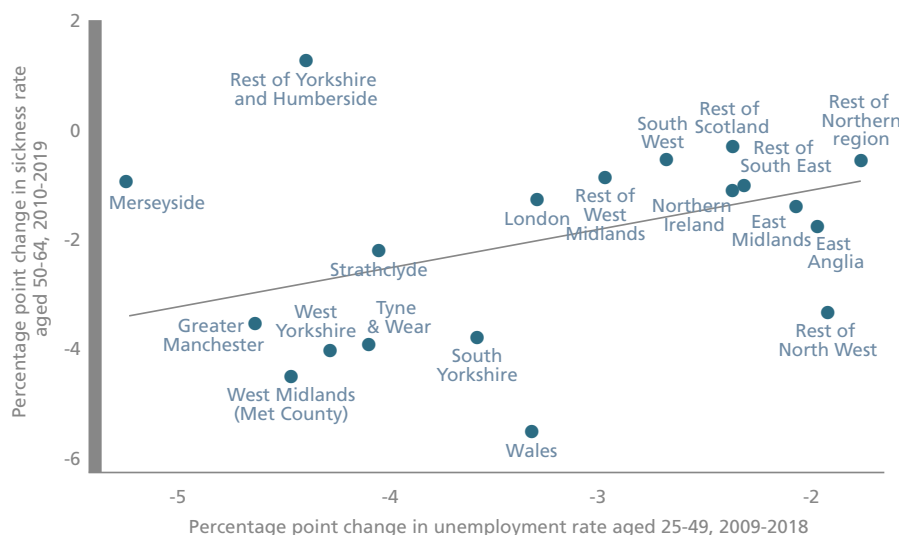
To do this, we compare changes in sickness rates among those aged 50-64 across 19 areas of the UK with changes in the area unemployment rate for those aged 25-49 (Figure 4). By using different age groups, we avoid the issue that a change in inactivity for a given age group will affect the unemployment rate for that same age group.

We find a positive association between changes in local area unemployment rates and changes in area sickness rates. Areas where unemployment of people aged 25-49 fell most had larger falls in sickness rates among those aged 50-64 than areas where unemployment fell less. While far from being definitive, this pattern – in which areas with a shrinking number of unemployed people under 50 also tend to have a fall in the number of over 50s who are too sick to work – does at least suggest that local area demand may matter.

Concerns about the recent rise in inactivity look to be somewhat misplaced. Policymakers should probably avoid devoting resources to issues that may resolve themselves as the economy recovers. It would be better instead to focus them on a longer-standing challenge – namely, a stubborn persistence of low labour force participation among older, less skilled workers with illness in disadvantaged areas. Stimulating demand in these areas is likely to complement targeted interventions aimed at the long-term sick.

Figure 4:

Changes in area sickness rates for those aged 50-64 and changes in area unemployment rates for those aged 25-49



Source: ONS, authors' calculations.

This article summarises 'The Trouble with Inactivity' by Stephen Machin and Jonathan Wadsworth, CEP Occasional Paper No. 59 (<https://cep.lse.ac.uk/pubs/download/occasional/op059.pdf>).

A version of the piece first appeared as 'Should the UK Government Get Active About Economic Inactivity?' on the *Economics Observatory* (<https://www.economicsobservatory.com/should-the-uk-government-get-active-about-economic-inactivity>).

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