UK COMMISSION FOR
EMPLOYMENT AND SKILLS

The Labour Market Story: An Overview

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The Labour Market Story provides an up to date assessment of the state of the UK labour market and how it is performing relative to our international competitors. It is intended to inform future skills investment and policy to deliver a more effective skills system and alignment of public and private investment in skills.

The skills and employment system

Skills are a derived demand, shaped by the interplay of factors such as the structure of the economy and types of businesses, product markets, business strategies and government economic and industrial policies. The public infrastructure and operating environment is shaped by public policy, and sets the context for firm-level decisions about strategy and investment in skills.

As much evidence has shown, raising skill levels through increased investment in education and training improves a country's economic potential, and workforce training also generates substantial benefits for the wider economy through increased productivity (Garrett *et al.*, 2010). However the skills available in the labour market need to be the 'right' skills; if the supply of skills is not well matched to employer need there will be inefficiencies and lost opportunities for growth. Skills also need to be used effectively in the workplace in order to turn potential into actual performance, and enable firms to pursue higher value added activities that will ultimately contribute to improved economic performance.

The UK Commission for Employment and Skills has developed an analytical model for assessing the skills and employment system to inform and guide labour market analysis and policy thinking (see Figure 1). This model guides the analysis on which the Labour Market Story is based.

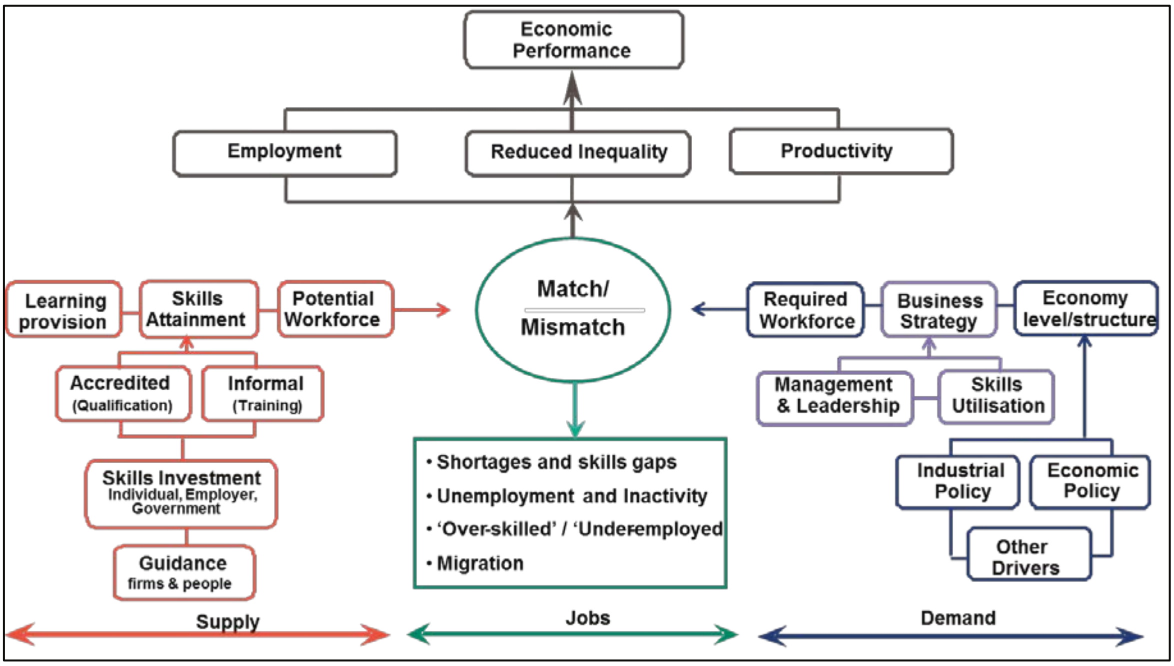


Figure 1: Skills and employment system model

Source: UKCES (2009)

The Labour Market Story examines both the demand for and supply of skills in the UK economy, the types of skills mismatch faced, use of skills in the workplace, and future skills challenges. It comprises this summary paper which sets out key messages, and a series of thematic briefing papers:

1. The UK following recession

The first paper provides an analysis of the current and recent performance of the UK economy and its competitive position internationally, key drivers of growth, and the contribution of skills investment to growth. It explores recent changes in the labour market and identifies challenges and opportunities for the UK.

2. The state of UK skills

The second paper covers the supply of skills as well as skills matches and mismatches. It provides an analysis of the stock of skills in the labour market and identifies skills gaps, shortages, under-use and mismatches in an increasingly polarised labour market. It explores the nature and extent of skills mismatches, considers how employers, individuals and the state are investing to overcome these, and argues that employers need to be more involved in education and training design.

3. Skills use at work

The third paper focuses on skills use at work. It assesses how skills are used in the workplace, and considers whether levels of employer demand are of sufficient quality and quantity to effectively utilise the skills available and move businesses up the value chain. It considers approaches to management and skills use at work, and suggests ways of raising employer demand for skills.

4. Skills for the future

The fourth paper draws on recent quantitative and qualitative research to provide an analysis of future employment trends and associated skills requirements. It considers potential drivers of skills demand in the future, including globalisation, economic trends, science and technology, environmental change, and changing societal values.

As a whole, the Labour Market Story provides an up to date assessment of the UK labour market and how it performs relative to international competitors.

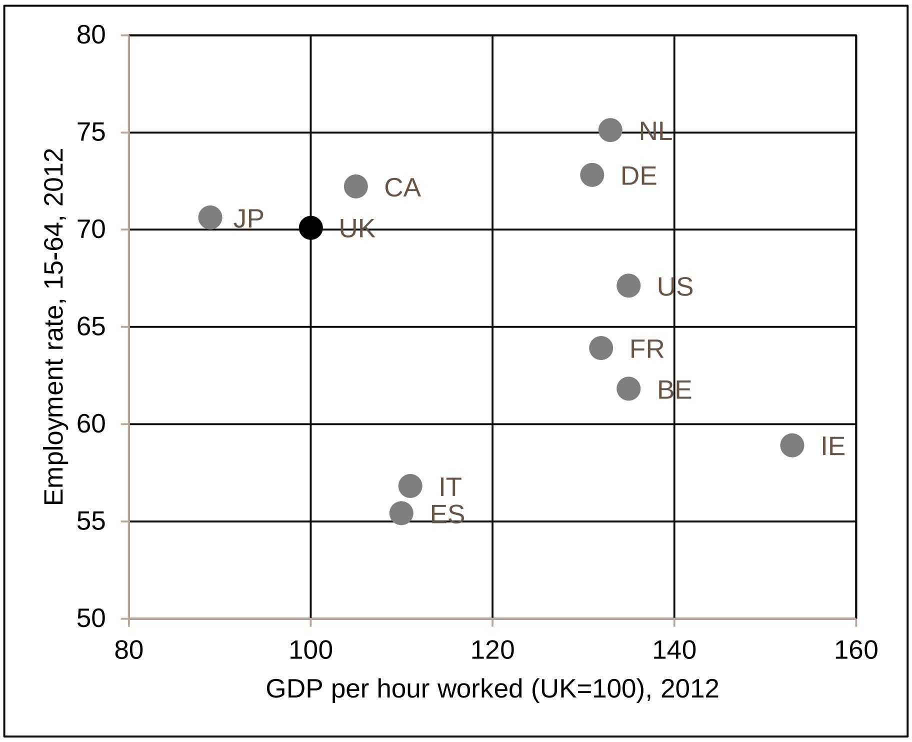
Key Findings

The UK following recession

The UK economy is now returning to sustained recovery but there is some distance to make up after such a sharp recession and delayed return to growth. **Recovery has taken longer than before,** not helped by severe problems in the Eurozone, one of the UK's largest export markets. The Office of Budget Responsibility's (OBR) latest (March 2014) forecasts suggest GDP growth of 2.7 per cent in 2014 and 2.3 per cent in 2015. However, there **remain substantial risks** in the global economy, and significant domestic challenges, including the need to consolidate the public budget deficit**.**

The most troubling aspect of the period since the onset of the recession is the **fall in labour productivity**. Years of continued progress in closing the longstanding gap in productivity with leading advanced economies such as the US and Germany saw significant reverses following the recession and there remains a substantial gap between the UK's productivity performance and those of the leading advanced economies (see Figure 2). Continued growth may restore UK competitiveness to its previous performance, but **UK businesses need to shift to higher value segments of the global market** to keep pace with international competitors.

Figure 2: Employment and productivity rates



Sources: ONS (2014) and OECD (2014)

The UK labour market, however, is performing much better than that in many EU countries, and has been relatively **efficient in keeping people in work**. Nonetheless, while the rise in unemployment was smaller than expected, it was still substantial, and hit hardest upon those at the margins, including those with low skills and young people. **Youth unemployment,** at almost 22 per cent, is four times that for people aged 24-64, although the decline in youth employment predates the recession.

In addition, there have been changes in the nature of employment. The UK has seen a sustained growth in **self-employment**, accounting for 83 per cent of the net gains in employment since 2007 (Ashworth *et al.*, 2014). However, the increase seems to have taken place alongside a fall in the relative earnings from self-employment, with a substantial real terms reduction in income. There has also been an **increase in** '**precarious' forms of employment**, including casual, very short-term arrangements or those with 'zero hours' guaranteed.

The economic conditions of recent years have created some profound changes and challenges for the UK labour market. There are now over 30 million people in employment in the UK (LFS, 2014). Administrative and secretarial employment (traditional middle-level jobs) is facing a long-term decline across many industries as certain functions become automated or off-shored, resulting in an **increasingly polarised labour market**.

In some sectors of the economy, the UK has succeeded in moving up the value chain and offering high skilled, high wage work where our competitive position is strong, including the pharmaceuticals, advanced manufacturing, and digital and creative sectors (HM Treasury, 2011). However, since 2010 **real wages have fallen** by around two per cent each year, the longest sustained period of falling real wages in the UK on record. The marked decline in real pay since the onset of recession, and its prior stagnation on some measures, is linked to the drop in productivity, increasing non-wage costs of employment, and a rise in inequality within wages.

Evidence through the recession continues to show that **those with higher skills and qualifications are more likely to stay employed** and have substantially **higher earnings** prospects, reinforcing the critical role that skills play in individuals' labour market outcomes.

There are major **variations in the way recession and recovery are being played out across different parts of the UK,** typically strengthening existing differences and raising the risk of further entrenching social inequalities. The overall dominance in the UK economy of London and the South East means that even if lower performing regions begin to improve, they will need to achieve much faster than average growth sustained over a long period of time in order to catch up. Looking at economic performance at the local level within England suggests that traditional ‘north-south’ narratives are far from the whole story.

Three main problems threaten the pace of economic recovery: weak demand in the global economy; low levels of business confidence in the domestic economy making firms reluctant to invest; and limited access to finance. Securing macroeconomic stability, boosting productivity and avoiding short-term unsustainable growth fuelled by consumer lending is essential.

UK employers have a major role to play by setting themselves more ambitious goals and taking advantage of policy support available to grow and move up the value chain, especially if they are to expand into potentially valuable overseas markets. The challenge is to make sure that skills and industrial policies push all sectors, regions and local areas with potential **towards a relatively high skill path to growth**.

Skills in the UK

Skills are a key driver of labour productivity (output per worker or per hour worked) and have a strong link with national economic performance. For an advanced economy like the UK, skills make a critical contribution to the ability of firms to take advantage of new market opportunities and new technologies.

The skills base of the UK (as proxied by qualifications held) has steadily improved in recent years. In 2011, of 33 OECD countries, the UK was ranked 19th for low skills, 24th for intermediate skills, and 11th for high skills – behind the US, Canada, Japan, South Korea, Finland and Norway. Future projections suggest that in 2020 the UK will rank 22nd on low skills, 28th on intermediate skills and 7th on high skills (UKCES, forthcoming). This picture is positive for high skills, but suggests that our progress on low and intermediate skills is **not keeping pace with international competitors**. Other countries seem to be investing more effectively in intermediate level skills. The projected occupational polarisation of the UK labour market and the relatively low proportion of people with intermediate level skills have implications for the progression of individuals, with a large gap to ‘jump’ between entry-level and higher skilled roles.

Overall, **state and individual investment** in education and skills (below HE level) is high relative to competitor countries. There are shifts in patterns of state investment in education and training, from Higher Education (HE) to vocational training, and in England individuals are now required to invest more in HE. In contrast, **overall levels of investment by employers in training, while substantial, have been falling over time** with a drop of £2.4 billion from 2011 to 2013 (UKCES, 2013); as has the average duration of training. While this could mean that employers are training 'smarter', the evidence is mixed, and small businesses still pay more per head to develop the skills of their staff.

The UK economy is characterised by **persistent pockets of skills deficiency**. Employers report direct and damaging impacts of skills gaps and hard-to-fill vacancies caused by skills shortages. This suggests that the demand and supply of skills is not fully aligned. While some degree of mismatch is to be expected, the persistent pockets of skills deficiency suggest problems could be **structural.**

Skills shortage vacancies make up 2.5 per cent of the total volume of jobs in the UK. Worryingly, skills shortages are accounting for a greater share of hard to fill vacancies across the UK, having risen from 16 per cent in 2009 to 22 per cent in 2011 (UKCES, 2013). The consequences for productivity and UK business performance are profound: over a quarter of firms face additional costs, delayed business expansion and lost business as a result.

The most common types of skills shortages across all occupations are **technical, practical or job specific skills**. These skills are best gained, and can sometimes only be gained, in a workplace setting, illustrating the critical role that employers have to play in overcoming skills shortages and building the pipeline of skilled labour.

Skills gaps among those already in work are reported by 15 per cent of employers, and are relatively common in lower skilled occupations across a range of sectors. Skills gaps are most commonly reported where employees are new in role, so may reflect **high levels of labour turnover**. They can also reflect misalignment between the skills the workforce has and those that employers need, suggesting that the content of qualifications and training may not be fully meeting employer needs.

Adequate skills supply for some jobs is currently reliant on **migration**, which indicates another form of labour market mismatch. Migrants occupy both high skilled and low skilled jobs in the UK and also tend to be more highly-qualified than the UK-born population.

Skills mismatches do not solely take the form of gaps or shortages: **under use of skills** occurs where workers have higher levels of skills and qualifications than those required for their job, and can reflect **demand deficiencies**. Almost half of employers in the UK have staff with skills and qualifications beyond those required, equating to **4.3 million workers.** As well as raising questions about the relevance of training supply, this suggests that there could be significant demand deficiency in UK workplaces. In addition, there has been a slower growth rate in the volume of high skilled jobs in the UK compared to other leading OECD economies, another indication of weakness in demand. Raising employer demand for skills and **ensuring skills are used effectively** is a significant challenge for the UK.

Effective skills use in the workplace

Our future economic performance depends upon employers both **investing in and using skills** effectively in the workplace in order to turn potential into improved performance and productivity. Employers invest where they recognise opportunities for their business to reach new customers, improve the quality and value of their offerings, or increase their efficiency.

High performance working practices (HPWPs), such as employee consultation, training and work shadowing, can support increasing investment in skills and more effective use of skills in the workplace, and when implemented in a balanced way help maintain job quality and satisfaction. However, **adoption of HPWPs in the UK is relatively low**. In 2013, just 12 per cent of establishments were regarded as being HPW establishments (adopting at least 14 of the 21 identified HPW practices). This raises the question of why businesses are not adopting tools and practices which could support them to compete more effectively and be more productive.

Part of the answer is **management skills.** Managers set the level of ambition for firms' product market strategies, determining the levels of innovation, and therefore level of skills required. While the UK has some very well managed firms, it also has a 'long tail' of poor performing (often small) firms with relatively weak management capability (Bloom and Van Reenen, 2010). Just one fifth of managers in the UK hold a management-related qualification and only 50 per cent of managers receive training – the lowest proportion of any occupational group. Comparing managers' ratings of their own performance with evidence from workers suggests many managers over-rate their skills.

Well-managed firms tend to have better performance on a wide range of measures: they are larger, more productive, grow faster, and have a higher survival rate. Skilled managers are more likely to innovate and launch new products and services and adopt higher, quality-based product market strategies. **Raising management ambition** is fundamental to helping the UK develop high value added innovative products and services, and achieve its global economic potential.

Job quality and employee satisfaction are both important contributors to productivity and are fundamentally influenced by management capability. Engaged employees take fewer sick days and are linked to better firm-level financial performance. Employee representation, including through trade unions, is an important mechanism in ensuring that employees feel their voice is heard. However, there has been a **decline in employee representative structures** in the period 2004-2011.

Employees in workplaces which have been sharply affected by recession are reporting adverse effects on training, job security and **well-being** including falling autonomy, contentment in and enthusiasm for work, and decreasing overall job satisfaction. The decline in well-being suggests that increased insecurity in employment results in adverse effects for staff and negative impacts on organisational performance.

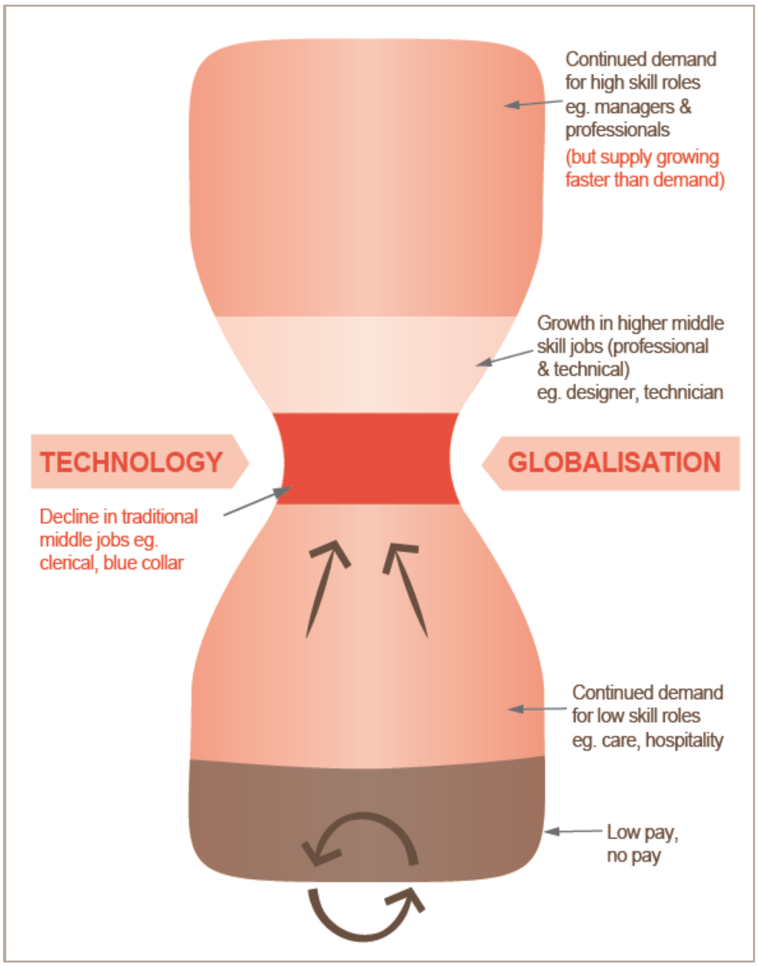
There are a number of proven tools which can be used to improve management and to improve employee engagement. These include High Performance Working practices; **Investors in People**; human capital reporting; and supporting employer collective action. Bringing employers together to share and learn from each other is critical in improving management practice and raising demand for skills. Employers are stepping up to collective leadership, including through 'industrial partnerships' of employers taking responsibility for skills needs in their sectors.

Future skills to drive growth

The recession and its immediate aftermath saw a shift from relatively highly paid employment in manufacturing and the financial sector towards lower paid service jobs. There has been some recovery, but it has been focused on the top and bottom of the labour market. To 2020, the largest share of job openings are projected to be in high skilled and low skilled jobs, further contributing to an **‘hour glass’ economy**. Projections suggest that while replacement demand (to fill jobs after existing workers leave the labour market) will mean continued job openings and career opportunities across all broad occupational areas, intermediate level jobs will continue to decline as a proportion of all jobs.

The projected changes are likely to result in significant differences in the labour market profile, occupational structures and career routes available, as while some intermediate roles would emerge, their overall volume would be reduced. This could result in a labour market with great prospects for those able to demonstrate talent early, but with fewer pathways for those who need to progress to higher skilled occupations through career development in work (see Figure 3).

Figure 3: The future shape of the labour market



The share of **employment in services** is projected to increase to 2020, and the share of employment in manufacturing and utilities to decrease. Projections also suggest **polarisation by location**, with higher skilled jobs increasingly concentrated in London and the South East. Employers and policy makers will need to devise ways to help workers who need to retrain to jump big gaps across sectors and up job ladders, develop creative approaches to improving the quality of work for large volumes of service sector jobs, and offer opportunities for progression.

Future skills demand will be shaped by technical change, trade liberalisation and demographic change. Information and communication technologies will make it increasingly easy for employers to engage in **complex supply chains** which cross national boundaries. The UK's skills base will need to form a substantial part of its competitive advantage. However, given declining employer investment in skills and falling performance relative to international competitors, the UK may become relatively less attractive to firms requiring employees with high and intermediate level skills. Failure to address persistent pockets of skills shortages could hinder the UK's future economic competitiveness.

Future projections suggest that technology alone will not drive growth, but will need to be accompanied by **organisational change to optimise the gains from technology**. High performance working will need to play an important role in bringing about future economic growth in the UK. People with **hybrid skillsets,** such as technology and project management skills, are likely to be in demand and workers will need to continue training to develop new skills throughout their careers. Some employers may need considerable encouragement and support to embark on a high road strategy to people management.

Demographic change as well as changes to the state pension age will increase labour supply. This suggests that individuals will be increasingly competing on the basis of their skills, and older workers will need to continue learning and updating their skills in order to adapt to multiple career shifts across a longer working life. Employers will need to consider succession planning as people leave the labour force.

Meeting future challenges will require a more **flexible and responsive skills system** which meets current and future economic needs. People will need to engage much more in seeking and interpreting **labour market information** (LMI) to make choices about education and employment. Policy makers and education providers have an important role in providing high quality LMI on job opportunities and returns to investment in learning.

In order to meet changing demands for skills and qualifications, organisations providing education and training will need to be adaptable. **Higher and Further Education institutions and private training providers** will need to adapt their services to meet emerging needs and find ways to deliver learning that crosses disciplines, focuses on what employers need and employers/individuals will pay for through customisation, and optimises technology use.

Achieving our economic potential: implications and conclusions

Skills need to sit at the heart of economic policy. Wider economic policy plays a fundamental role in shaping employer behaviour and the operation of the labour market. Since the recession, the Government has implemented a range of structural reforms to support increased business investment, improved productivity and wider economic recovery (HM Treasury, 2011). Ultimately, to improve productivity and maintain competiveness, the UK needs to shift the economy further along a high skill, high value path to growth. An internationally competitive skills base will enable the UK to capture high value segments of the global market. At the macro level, this requires creating and retaining high skill jobs in key industrial sectors. Industrial strategies for key sectors are being developed to support effective long-term partnerships between government and industry. At the micro level, it requires the more effective use of skills in the workplace to raise productivity at firm level.

We need to encourage greater and deeper employer collaboration to raise ambition and support economic growth. Rebalancing the economy will require a trade surplus in goods and services exchanged between the UK and the rest of the world. To achieve that we cannot rely on individual companies alone; bringing employers together to share learning will be crucial. **Collective approaches** (such as professional standards, employer networks and training levies) help to break through the barriers that prevent employers from pursuing more ambitious plans for workforce development. Employer networks at sector or local level can help smaller businesses access the training provision and support they need.

Approaches to economic growth also need to take account of **local and sectoral variations** in the economy and labour market. The recession has had a disproportionate impact on young people and those with low skills, and has tended to reinforce existing spatial disparities. Local action, including that led by Local Enterprise Partnerships (LEPs), needs to be aligned with national-level industrial strategies. At the sector level, there are promising signs of employers stepping up to collective leadership of skills, including through 'industrial partnerships'. These partnerships will identify the skills needed for their sector to grow over the long term, and commit to delivering and deploying those effectively.

Skills mismatches between the skills employees have and the skills employers are seeking result in lower productivity and missed opportunities for growth. One of the UK's biggest skills challenges is underutilisation of highly skilled and qualified people who are working in low quality jobs. Excellent management and the deployment of high performance working practices are needed to raise productivity at firm level and encourage a **shift towards higher value products and services**. This will require a more sophisticated approach to human capital measurement and recognition of the importance of people management and management education. Unions can play a key role here.

There also needs to be greater **connectivity between education and work**, so that the skills that the education system provides are the skills that employers need. This requires a better alignment of the skills system and labour market. We need to increase young people's exposure to the world of work, through work experience placements, part time jobs, and sandwich courses. Individuals will also need to take more responsibility for investing in and developing their skills. We also need to expand post-secondary education and build vocational pathways that lead all the way up from school to professional and degree level qualifications, so that employees can retrain and develop new skills throughout their working lives.

Policy makers therefore need to: ensure that **public investment supports skills provision that meets employer needs**; encourage employers to take ownership of skills and develop training solutions; support those with lower-level skills to reskill and take opportunities in a changing labour market; and mitigate local, regional and demographic disparities in access to jobs and skills. Redesign of the skills system, relying on much greater employer involvement, will take time to realise full benefits and achieve financial sustainability (UKCES/Beaver *et al.*, 2013).

The Labour Market Story 2013 portrays a UK economy and labour market that has suffered substantial shocks over the past five years, but has significant potential to emerge as a strong player in the global economy if it can meet the challenges ahead. **Adaptability, readiness for change and being prepared to meet future labour market needs** are the most important characteristics required of all the actors in the UK's skills system: employers, individuals, learning providers and policymakers. These will ensure the UK is sufficiently resilient to grasp future opportunities, while robust enough to adapt to foreseen and unforeseen disruptions and challenges.

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The Labour Market Story is based on research undertaken by the Institute for Employment Studies, the Warwick Institute for Employment Research, Cambridge Econometrics and the UK Commission for Employment and Skills. We would also like to acknowledge the assistance of expert reviewers who provided comments on early drafts.

The UK Commission for Employment and Skills is a social partnership, led by Commissioners from large and small employers, trade unions and the voluntary sector. Our mission is to raise skill levels to help drive enterprise, create more and better jobs and economic growth.

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