Westpac

Institutional Bank

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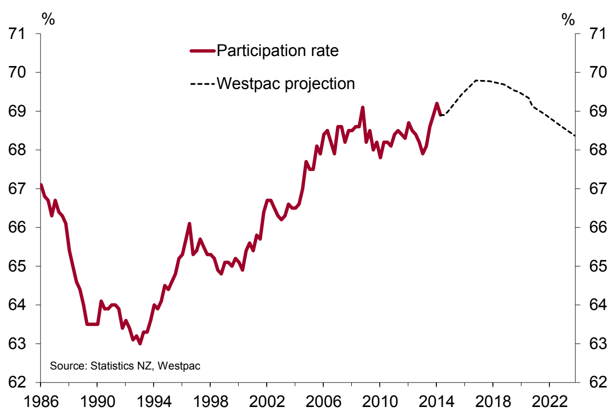
In or out

Labour force participation in New Zealand

- Over the past 20 years, New Zealand's labour force participation rate has risen to one of the highest in the OECD.
- We argue that New Zealand's rising participation rate is due to retirement policies that minimise the disincentive to working later in life.
- The encouraged worker effect stemming from the strong economy and recent welfare reforms have also contributed to the recent highs in participation.
- Rising demand for workers and a continued trend towards later retirement could see participation continue to rise over the next two years.
- But population aging is becoming an increasingly powerful force in the opposite direction. We expect labour force participation to peak in late 2016, and to start trending down later this decade.

Labour force participation rate



One of the biggest economic puzzles of recent years has been to understand the degree of 'slack' in the labour market in the wake of the global recession. Nowhere is this truer than in the US where, even as hiring has picked up, the rate of participation in the labour force has continued to fall to its lowest in decades. Falling participation has been a feature of many other developed countries since the recession, and even more recently in Australia, as the jobs market has cooled in the wake of the mining investment boom.

However, in New Zealand the puzzle has been just the opposite: the labour force participation rate is not only one of the highest among developed nations, but it has actually set new record highs since the recession. What's even more remarkable is that up until a year or so ago our participation rate looked to be joining the overseas trend, with weak jobs growth and an ageing population leading more and more people to exit the workforce. But since early 2013 participation has surged higher again.

There's a strong cyclical element to labour force participation – rising demand for workers tends to attract more people into the workforce – and it's true that New Zealand has been one of the better performers in the OECD over the last year. But in terms of the general level of economic activity compared to pre-recession levels we haven't been a standout, which suggests there are structural factors behind our high participation rate as well.

This article updates and expands on our previous study of participation rates.[1] We begin by looking at the long-term trends behind New Zealand's relatively high participation rate, and assess how much further they can run. Next, we take a closer look at the behaviour of the participation rate in the last few years – to what extent does it reflect the economic cycle, demographics, policy effects, or something else? Finally, we use this analysis to update our projection of the participation rate over the next decade, which forms part of our long-term economic forecasts.

1 Dominick Stephens, "Labour force participation in New Zealand – past, present, and future", Occasional Paper, January 2007, available at www.westpac.co.nz/assets/Business/Economic-Updates/2011/Labour-force-participation-in-NZ.pdf

Understanding the figures

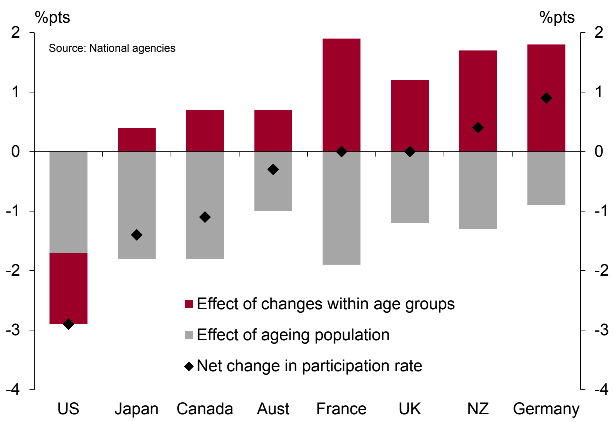
The participation rate is derived from the quarterly Household Labour Force Survey (HLFS). It is calculated as the share of the working-age population (age 15 and over) that is actively engaged in the workforce: either currently working, or actively looking for work (which is the official definition of unemployed). There are many of reasons why people may declare themselves to be out of the workforce, including study, retirement, disability/injury, caring for children, or being discouraged from looking during a weak jobs market.

As the chart on the first page shows, New Zealand's participation rate has generally been trending higher over the last two decades, reaching a record high of 69.2% in the March 2014 quarter. It subsequently edged back to 68.9% in the June quarter – still the third-highest on record, and at the least a reminder that there's a degree of sampling error in these figures.

Focusing on the overall participation rate hides the fact that the composition of the labour force is always evolving. To understand changes over time, we can separate out two effects: changes in the age structure of the population, and changes in participation within age groups. Participation rates are high among prime-age workers (25-54 years, though for women the peak occurs in the 45-54yrs range), somewhat lower for youth (who are often still studying) and sharply lower for those nearing or past the retirement age.[2] So an ageing population – that is, a rising share of the population over the retirement age – will drag down the total participation rate, all else equal.

Demographic effects are fairly easy to identify and forecast, as birth and death rates tend to evolve slowly. The chart below provides a breakdown of changes in participation rates across some of the major economies since 2007, just before the global recession. The effect of population ageing has been common to all developed countries to varying degrees. For instance, all else equal, population ageing since 2007 would have lowered New Zealand's participation rate by 1.3 percentage points.[3]

Changes in participation rates, 2007-2013



However, there has also been a widespread trend towards higher participation rates within age groups, especially among the older workers themselves. In some countries this has provided a partial offset to the effects of population ageing; in a few, such as New Zealand, it has actually been the dominant factor. (The US has been a glaring exception, with falling participation across most age groups. This trend pre-dates the recession.)

Why is New Zealand's participation rate so high?

New Zealanders' labour force participation hasn't always been high by international standards. Back in the early 1990s, we stood out compared to some European economies, but not against other English-speaking countries or even Japan.

The major change since then has been participation by older people. While New Zealanders used to retire relatively early, they are now retiring relatively late. We can trace the shift to a number of retirement policy changes in the 1990s:

- Between 1992 and 2001, the age of eligibility for national superannuation was raised from 60 to 65.
- In 1998, national superannuation stopped being means tested (except for couples with one partner under 65).
- In 1999, compulsory retirement was abolished as part of the Human Rights Act.

As a result of these policy changes, New Zealanders now face fewer incentives to retire early than people in other countries. Unlike in Australia, for example, the public pension isn't income-tested, so there is no penalty to working past age 65. Also in contrast to other countries, both national superannuation and Kiwisaver accounts can't be accessed before age 65, which discourages early retirement. It's also worth noting that while New Zealand's basic pension is generous by international standards, our low level of private savings translates into a relatively low overall level of retirement income – the OECD estimates it at 55% of the average male wage, versus an OECD average of 68%.[4]

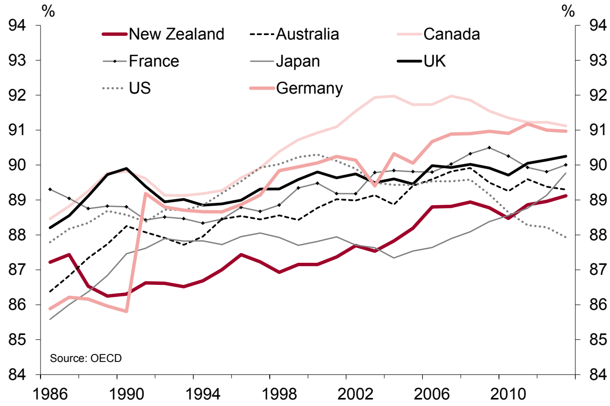
While New Zealand's retirement policy changes were largely complete by the early 2000s, workforce participation among older people has continued to rise since then. In part, this simply reflects a 'cohort effect', as generations with a greater propensity to stay in the workforce have moved into higher age brackets. The most notable example is women of the baby boomer generation – with all the associated shifts in education patterns, birth rates and attitudes towards women in work. But the cohort effect also probably caused the 1990s rise in the age of eligibility for national superannuation to reverberate into the 2000s – after all, more people working past age 60 means there are more people around five years later deciding whether to retire at 65.

2 Where there is no compulsory retirement age, as in New Zealand, the age of eligibility for superannuation serves a similar role.

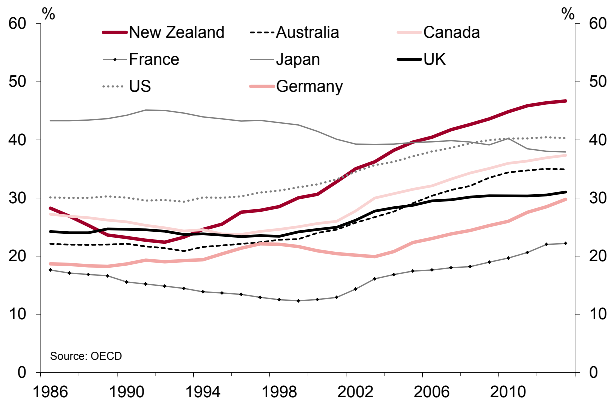
3 This is right in line with our 2007 article, which projected a 1ppt drag by 2012, accelerating to a 2.5ppt drag by 2017 as the 'baby boom' generation started to reach retirement age.

4 For a comparison of pension systems internationally, see OECD, 'Pensions at a glance' (2013), available at http://www.oecd-ilibrary.org/finance-and-investment/pensions-at-a-glance-2013_pension_glance-2013-en

Labour force participation rates, ages 20-54



Labour force participation rates, ages 55+



We estimate that these cohort effects would account for a rise of almost 3 percentage points in older-age participation since the early 2000s (see the appendix for details). However, since actual participation has risen by almost 11 percentage points in that time, it's clear that there has been a change in behaviour as well, with older people working longer now than they did a decade ago.

New Zealand isn't alone in this, and we suspect it reflects a range of factors that, in combination, have encouraged later retirement: the continued rise in life expectancy, meaning that retirement savings have to go further; the phasing out of defined-benefit pension schemes; and volatile investment returns since the Global Financial Crisis.[5] As such, we can't be sure that the process is complete, though for older men at least, it looks as if labour force exit rates may be stabilising.

Over the past decade, there has also been a rise in the proportion of women of child-bearing age in the workforce as public childcare support has become more generous (though still much less so than in the Nordic countries or Canada). The changes introduced include paid parental leave from 2003 and flexible working arrangements from 2008. We suspect the impact of the Working for Families income tax credit has been more ambiguous – while it will have encouraged some single parents into work, steep abatement rates make it less attractive for both parents to work.

Participation rates and the economic cycle

As we mentioned earlier, participation rates also move with the economic cycle to some degree: better economic conditions and increased demand for workers tends to draw more people into the active workforce, and vice versa. The previous peak in New Zealand's participation rate was in late 2008 – a typically lagged labour market reaction to the boom that was under way unit 2007. The downturn in participation lasted until 2010, whereas the economic recession ended in 2009.

However, cyclical forces don't seem to explain why New Zealand is in the relatively unusual position of having a higher participation rate than before the GFC (Germany is the only other major economy in the same position). Even though New Zealand has had the unique stimulus of the Christchurch rebuild in recent years, our economic upturn doesn't stand out as being particularly well advanced compared to our peers – for example, per capita GDP today is only 3% higher than the pre-crisis peak reached seven years ago.

In the past few years, participation rates have also continued to trend up for men and women of prime working age. Indeed, among those aged 25-49, the participation rate over the past year was about 1 percentage point higher than in 2008 (equivalent to about 14,000 people, mostly women). We find it hard to attribute all of this to an improving economy: the jobs market has only recently emerged from a long period of weakness, and people in this age bracket don't tend to drop out of the workforce when times are tough in the first place.

Nor does there seem to be an obvious cyclical story behind the behaviour of the participation rate in the last two years, as it fell then rebounded even more rapidly. While the various labour market surveys agree that jobs growth cooled a little in 2012 and strengthened in 2013, it's not clear why the household-based was affected much more than employer-based surveys.

Differing measures of employment growth

5 Even in the US, similar factors have substantially raised older-age participation rates since the late 1990s – see IMF, 'United States: Selected Issues' (2014), available at www.imf.org/external/pubs/cat/longres.aspx?sk=41778.0

Two things may help to explain what's going on: recent welfare reforms and the Canterbury rebuild. Changes to welfare eligibility in October 2012 and July 2013 imposed new work obligations on some groups, particularly single parents. Since then there has been a sharp drop in the number receiving the Sole Parent Support benefit, and a corresponding rise in full-time employment within sole parent households. There has also been a drop in the number of people on the Jobseeker Support benefit, but that began before the changes in eligibility and is harder to disentangle from an improving jobs market.

Meanwhile, the participation rate among men in the Canterbury region has surged by 3 percentage points – nearly 6,000 people – since the first earthquake in September 2010, and is now at levels last seen in the mid-1980s. It's hard to gauge to what extent that simply reflects workers moving from other parts of New Zealand (where participation mostly fell over that time) but it's certainly possible that the unusual opportunities generated by the rebuild have pulled people into the workforce.

How high can the participation rate go?

With the baby-boomers now entering retirement age, New Zealand's population will take on a noticeably greyer hue over the coming decade. We estimate that the share of the working-age population aged over 55 will rise from under 32% in 2013 to over 35% in 2023. The current migration boom, which is dominated by younger people, will temporarily slow this process, but it won't stop it.

That means that the participation rate will start to fall unless we see further rises in participation within different age groups, particularly among older workers. How much scope is there for this? In our view, not that much – at least, in the absence of significant changes to the retirement age, childcare provision, or social welfare policies.

Participation rates among middle-aged men and women tend not to be that responsive to economic conditions. While we suspect that the Canterbury rebuild has boosted male participation rates, they are already historically extremely high in Canterbury and may not be able to rise much further.

Among older workers, participation rates will continue to rise as a result of cohort effects. But on our calculations, this will do little more than offset the demographic impact of an aging population. The participation rate would rise further if recent trends towards later retirement continued – perhaps by another 0.3 percentage points. In our forecasts, we assume that older-age participation rates will continue to rise, but at a slower rate than over the last five years.

A stronger labour market does tend to draw younger and older people back into the workforce, and is likely to keep doing so. In our 2007 paper, we estimated these sensitivities, measuring labour market conditions by the unemployment rate. Updating that work for post-GFC data suggests that the further 1 percentage point drop in the unemployment rate we expect over the next two years could lift overall labour force participation by about another 0.5 percentage points.

All up, we think growing labour demand, cohort effects, and a further uptrend in old-age participation could see the participation rate peak at just under 70%. But by the end of 2016, we expect the ageing population to become the dominant factor at last, leading to a gradual downward drift in the participation rate in the following years.

Appendix: Workforce exit rates and cohort effects

A simple way to assess the importance of 'cohort effects' – the impact of particular generations or cohorts moving into higher age brackets – is by calculating workforce 'exit rates' for each age cohort. Essentially, these compare the participation rate for each five-year age group today to the participation rate for the next-youngest age group, five years ago. For example, for those aged 55 to 59:

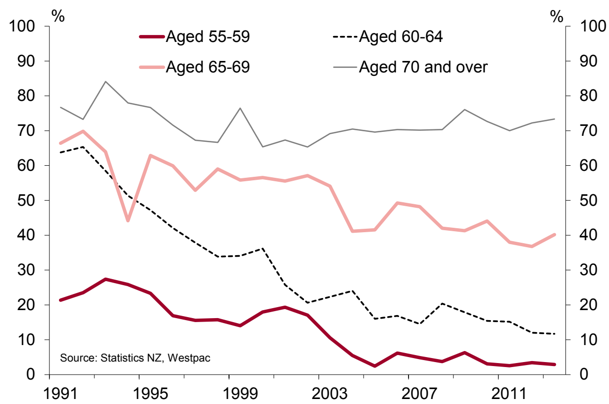
$$exit\_rate_t^{55\text{-}59} = 1 - \frac{part\_rate_t^{55\text{-}59}}{part\_rate_{t-5}^{50\text{-}54}}$$

If cohort effects were the only thing going on, these 'exit rates' should be fairly stable – we should be able to predict the participation rate of those aged 55 to 59 today, based on the participation rate of those aged 50 to 54, five years ago.

If exit rates hadn't changed since 2001, the participation rate among people aged 50+ would have risen by about 2.7 percentage points. In actual fact, it's risen by nearly 11 percentage points – so even allowing for cohort effects, older people are now working longer than they did a decade ago.

In our forecasts for the participation rate, we assume that work-force exit rates for those aged 55 and over continue to trend down, but at a slower pace than over the past five years.

Labour force exit rates, men aged 55+



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