

Recent Labour Market Developments in Canada

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- *In 2002 and early 2003, both employment and labour force participation increased at an unusually rapid pace compared to domestic economic activity.*
- *Around mid-2003, employment growth came to an abrupt halt in concert with a substantially slower pace of economic activity. This pause is expected to be transitory, since an anticipated pickup in output growth should stimulate employment. However, given the strength in employment relative to economic activity in the past year and a half, employment growth may initially be moderate relative to output gains.*
- *Employment has adjusted to significant monetary stimulus and fiscal expansion, as well as to an uneven economic recovery in the United States. Facing a rapidly increasing supply of workers interested in part-time jobs and possibly reacting to uncertainty about short-term growth prospects, firms relied on part-time work to an unusual degree. This shift in the composition of employment contributed to a reduction in the length of the average workweek in 2002. As a result, labour input progressed at a rate that was markedly slower than for employment and more in line with its historical relationship to output growth.*
- *Much of the rise in labour force participation since late 2001 reflects a faster rate of increase in the participation rate of the 55 and older age group. The increased supply of labour helped to moderate overall wage growth.*

Canada's labour market recorded a very different performance between the first and second halves of the 1990s. Slow employment growth and declining labour force participation rates prevailed in the first half of the decade, along with weak output growth and industrial restructuring. It was only well into the second half of the 1990s that robust employment growth was sustained in a context of vigorous output gains and a resumption of public sector hiring. By the late 1990s, strong employment growth was accompanied by a marked rebound in labour force participation, and, by 2000, the unemployment rate had declined to its lowest level in over 20 years. Then, the economy slowed markedly, owing mainly to the recession in the United States. As a result, employment growth stalled, and the unemployment rate began to increase.

The slowdown was brief, however, as 2002 saw a return to more vigorous output growth and a resumption of the exceptional rates of increase in both employment and in labour force participation. In fact, while employment growth decelerated markedly during the first half of 2003, owing to a substantially slower pace of economic activity, the cumulative increases in employment and participation since the end of 2001 have been unusually large compared with the output gains.

In this article, we focus on developments in the Canadian labour market over the past year and a half.¹ We begin by highlighting the role of Canadian monetary and fiscal policies, U.S. economic growth, and sectoral shocks in the evolution of output and employment. We go on to explain why gains in employment have been unusually large, relative to output growth,

1. The article is based on data up to August 2003. The end of the reference period for all quarterly calculations is June 2003, unless stated otherwise.

compared to gains in total hours worked. We then discuss what drove up the participation rate over the period. Finally, we examine how the unemployment rate has adjusted as a result of these developments in demand and supply. We conclude with some comments on potential implications for the short term.

Main Sources of Employment Growth

In the 18 months leading up to mid-2003, the Canadian economy generated over 600,000 new jobs. The ratio of employment to the working-age population rose to a peak of 62.4 per cent in the first quarter of 2003. These employment gains resulted from a strong expansion in domestic demand, which was supported by monetary and fiscal stimulus. As well, an uneven U.S. recovery first stimulated and then depressed employment in export-related industries.

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Low interest rates in 2002 stimulated demand for housing and consumer durables, creating demand for labour in construction, real estate, and segments of retail and wholesale trade, as well as manufacturing of building materials and home furnishings. Employment in ancillary services such as architectural and engineering services also increased at a robust pace, given new housing developments and the need to provide supporting infrastructure.

Canadian fiscal policy was more expansionary in 2001 and 2002, as indicated by the Organisation for Economic Co-operation and Development (OECD) measure of the general government primary surplus.² Increases in the fiscal stimulus stemmed from various initiatives, including a reduction in personal income taxes and increased spending on health care, education, and

2. OECD (2003) estimates of the cyclically-adjusted primary surplus for Canada fell from 5.5 per cent of potential output in 2000 to 4.6 per cent in 2001 and 3.2 per cent in 2002.

security. Income tax reductions supported household spending, and hence employment gains in consumer-related industries, while the higher expenditures on health and education translated into substantial increases in employment in those areas of the public sector. Moreover, employment in public administration advanced at a more rapid pace than in earlier periods, likely reflecting in part increased hiring to enhance security. All in all, the direct effects of increased government spending may have accounted for more than one-third of the rise in total employment over the period 1Q02 to 2Q03.³

Following a relatively mild recession in 2001, the U.S. economy began a rather uneven recovery that was buffeted by a series of shocks, including the 11 September attacks, corporate accounting scandals, sharp movements in stock prices, higher oil prices, and increased geopolitical uncertainty related to the war in Iraq. Not surprisingly, Canadian export volumes also experienced a choppy recovery in 2002 before dropping again around year-end. As a result, employment in the manufacturing and transportation industries started falling in 4Q02 following substantial gains over the previous three quarters. In the manufacturing sector, employment in the transportation equipment, computers and electronic equipment, chemicals, and textiles industries experienced significant declines. In contrast, employment in the wood industry grew at a very strong pace, supported by buoyant residential construction in both the United States and Canada.

Employment growth came to an abrupt halt around mid-2003 as sectoral shocks and the slow U.S. recovery depressed economic activity. For example, concerns over severe acute respiratory syndrome (SARS) have reduced travel spending and led to cuts in employment in the accommodation and food services industry. As well, reduced activity in the animal-slaughtering sector as a result of the single case of bovine spongiform encephalopathy (BSE) in Canada caused layoffs in this industry. More generally, the decline in economic activity in the second quarter of 2003, which was concentrated in the goods-producing sector and was affected by a fall in U.S. industrial production, gave rise to marked declines in employment in manufacturing and transportation services. Total employment edged down in both July and August as a result of job losses in the services sector. Growth should nevertheless

3. Employment in the education, health and social assistance, and public administration sectors rose by 226,000.

resume as the external environment improves and the domestic economy strengthens.

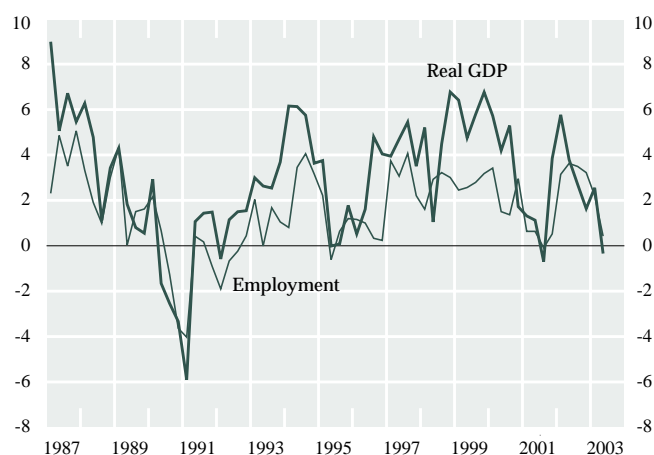
Why Employment Has Been Strong Relative to Output

Employment progressed at an annualized average quarterly rate of 2.7 per cent, the same pace as GDP, in the year and a half leading up to mid-2003. This development is unusual by historical standards, since output typically outpaces employment (Chart 1).⁴ A key factor explaining the strength of employment relative to output is the composition of the employment gains. While employment in both the full-time and part-time categories experienced a vigorous expansion, a salient feature of the recent period is the unusually large contribution from part-time work.⁵ In fact, part-time employment accounted for 33 per cent of the total increase in employment from 1Q02 to 2Q03, which was nearly twice the share of part-time jobs in total employment at the end of 2001 (Table 1). The increased proportion of part-time employment resulted in more workers than usual being required to accommodate output growth, since on average each worker worked less hours per week. Indeed, there was a significant decrease in the length of the average

Chart 1

Growth in Real GDP and Employment

Quarterly at annual rates



Source: Labour Force Survey and National Income and Expenditure Accounts, Statistics Canada

4. From 2Q76 to 4Q01, employment and output grew an annualized average quarterly rate of 1.7 and 2.9 per cent, respectively.

5. Part-time employment is defined as less than 30 hours at main job.

Table 1

Proportion of Employment Growth by Age and Type of Work

Per cent

Category	Annualized average quarterly growth 1Q02 to 2Q03	Share of employment change 1Q02 to 2Q03	Share of total employment 4Q01
Total employment	2.7		
Full-time	2.0	67.0	82.0
Part-time	5.0	33.0	18.0
Total young workers (ages 15-24)	3.0	17.0	15.0
Full-time*	2.0	7.0	8.0
Part-time*	4.0	11.0	7.0
Total prime age workers (ages 25-54)	1.0	33.0	74.0
Full-time*	1.0	27.0	65.0
Part-time*	2.0	7.0	9.0
Total older workers (ages 55+)	12.0	50.0	11.0
Full-time*	11.0	35.0	9.0
Part-time*	16.0	14.0	2.0

* May not sum exactly because of independent seasonal adjustment

Source: Labour Force Survey, Statistics Canada

workweek during 2002. As a result of this decrease, total hours worked (labour input) progressed at a markedly slower rate than employment and more in line with its historical relationship to output growth.

The increased proportion of part-time employment resulted in more workers than usual being required to accommodate output growth, since on average each worker worked less hours per week.

The substitution towards part-time employment occurred not only in the service industries, such as accommodation and food services, where this form of work usually predominates, but also in industries in which part-time employment is traditionally small, such as manufacturing; transportation; and finance, insurance, real estate, and leasing (FIREL). Moreover, the increase in part-time employment was concentrated in permanent, rather than seasonal, term, or casual jobs.

To a large extent, the strong gains in part-time employment reflected voluntary choices by workers. Indeed, an unusually high percentage of the increase in part-time employment came from workers aged 55 and over, and more than 80 per cent of these workers prefer part-time work to full-time work (Table 1).⁶

At the same time, firms may have been motivated to hire part-time employees because of increased uncertainty over the short-term prospects for aggregate demand conditions caused by the series of shocks that hit the U.S. economy. The possible impact of uncertainty on firms' hiring decisions is underscored by the much faster rise in part-time employment than full-time in the United States from 1Q02 to 2Q03, based on *Current Population Survey* data. Firms can increase their labour input by increasing full-time or part-time employment or by increasing hours of existing workers. Uncertainty may have motivated firms to use part-time work because of the possibly lower fixed costs of doing so compared to full-time work. As the economic recovery takes hold and uncertainty is reduced, the proportion of full-time employment should increase, which could result in slower employment growth than in the recent period.

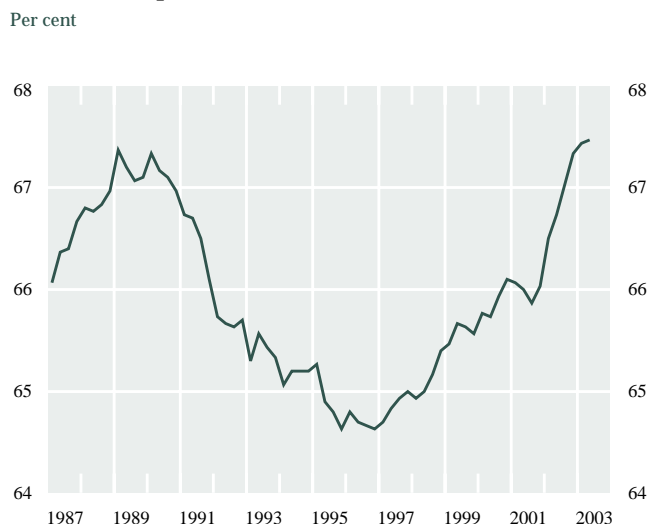
Another factor favourable to the strong growth of employment was the moderate pace of wage increases, which provided an incentive for firms to use labour to accommodate output growth. In the 18 months before mid-2003, compensation per hour in the business sector increased at an annualized average quarterly rate of 2.1 per cent. This subdued progression partly stemmed from a sharp rise in the labour force participation rate that had the effect of boosting labour supply, thereby stemming potential pressures on wages arising from continuing demand for labour.

Labour Supply

After falling more or less continuously over the early 1990s, the labour force participation rate began a recovery in 1996 that accelerated markedly after 2001, propelling the participation rate to a new all-time high in 2Q03 (Chart 2). To a large extent, this profile reflects that of the 55 and older age group (Table 2), which accounted for over 80 per cent of the 1.4 percentage point increase in the aggregate participation rate over the 1Q02 to 2Q03 period. Increases in the participation

6. Reasons for the increase in labour supply from the 55 and over age group are discussed later in the article.

Chart 2
Total Participation Rate



rates and employment ratios of the young age group (15–24) have also been noteworthy since the late 1990s, but on balance did not get much stronger in the past 18 months.⁷ As for the prime age groups (25–54), their participation rates have been on a steady course since the mid-1990s: rather flat in the case of men and rising in the case of women (Chart 3).

Table 2
Contribution to Aggregate Participation Rates

Age group	Participation rate (per cent)			Contribution to participation rate change (percentage points)	
	4Q96	4Q01	2Q03	1Q97 to 4Q01	1Q02 to 2Q03
Males					
15–19	48.1	52.7	54.4	0.12	0.04
20–24	79.1	79.1	81.3	(0.05)	0.09
25–54	90.7	91.2	91.7	(0.25)	(0.18)
55+	32.2	34.3	38.0	0.49	0.61
Females					
15–19	46.8	52.5	54.8	0.17	0.06
20–24	73.1	74.5	77.0	0.01	0.11
25–54	76.3	79.1	80.6	0.36	0.15
55+	16.5	19.8	23.0	0.59	0.56
Total participation rate	64.6	66.0	67.5	1.4	1.4

Source: Labour Force Survey, Statistics Canada

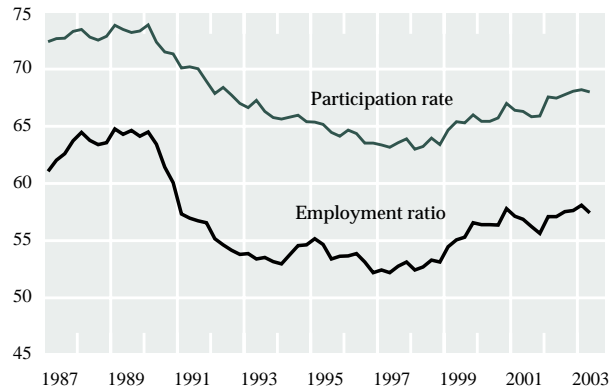
7. Employment ratio is defined as employment divided by working-age population.

Chart 3

Participation Rates and Employment Ratios

Per cent

Males 15 to 24



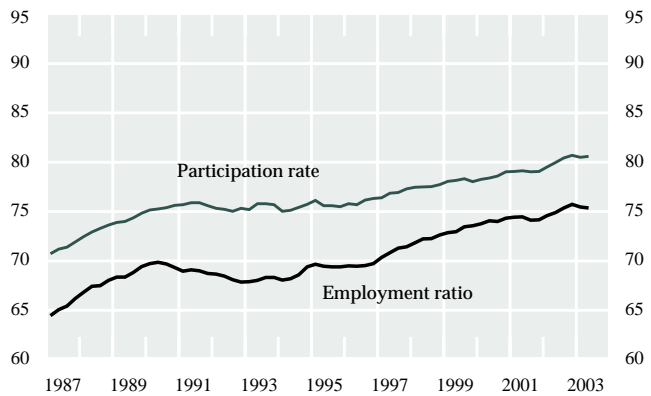
Females 15 to 24



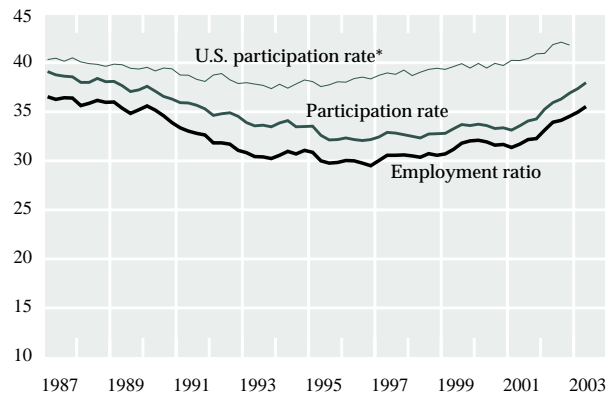
Males 25 to 54



Females 25 to 54



Males 55+



Females 55+



* This seasonally adjusted series ends in 4Q02.
 Source: Labour Force Survey, Statistics Canada and Current Population Survey, U.S. Bureau of Labor Statistics

The 55 and older age group accounted for over 80 per cent of the 1.4 percentage point increase in the aggregate participation rate.

Participation rates differ considerably by age and gender and are influenced by a wide range of factors. Among them are employment conditions as related to cyclical movements in labour demand, which have the greatest impact on the young population, and two structural factors: changes in personal wealth and cohort effects, or the tendency of newer cohorts to have higher participation rates than earlier cohorts as a result of better education, the cumulative effects of socio-economic changes, and other factors.⁸ Cohort effects have influenced the participation rates of women most.

Since 1996, the rise in the participation rate of the 55 and over group appears to have largely reflected a strong cohort effect likely arising from higher education levels and greater skill diversity. In addition, improved employment conditions probably played some role in the recovery of this group's participation rate, as evidenced by a marked decline in the number of discouraged workers and those awaiting recall among the 55 and over group. As well, industrial restructuring and the associated skill mismatch, which likely contributed to depressing the participation rate of the men 55 and over in the early 1990s, was in all likelihood no longer a significant factor in the late 1990s.⁹ Changes in personal wealth may also have influenced the participation of the 55 and over age group, but not in the same direction all the time.¹⁰ For example, this group increased their wealth over the 1990s, owing mainly to increases in the value of their holdings of equity and RRSPs, and this may have slowed the rise of their participation rate over the period 1996–2001. In contrast, the fall in personal

8. For a discussion on participation rate trends and shifts, see Ip (1998).

9. For a detailed discussion of survey results on firm restructuring, see Kwan (2000).

10. Paquet, Sargent, and James (2000) show that wealth is one determinant of employment rates. We assume that the wealth effect is relevant to participation rates as well.

wealth relative to GDP in 2001 and 2002, owing mainly to the sharp correction in equity prices and a large decline in real personal interest and dividend income may have prompted more re-entry into the labour market.¹¹ Thus, a wealth/income effect may have first mitigated, and more recently, accentuated the combined influence of a significant cohort effect and a cyclical strengthening in labour demand.

Although it is difficult to determine precisely the respective contributions of cyclical and structural factors to the increased participation of the 55 and over age group, there is a strong presumption that its rise is largely structural. The experience of the United States is instructive in this regard. It shows a similar upturn in the participation rate of the 55 and over age group since around the mid-1990s, even as employment growth has been much poorer than in Canada (Chart 3). This suggests that common structural factors have played a predominant role in both countries.

The substantial recovery of the participation rate in the 15–24 age group since the late 1990s largely reflects a response to a marked improvement in labour market conditions. This was signalled by a strong pickup in the ratio of employment to population for youth, from a trough of 52 per cent in 1997 to 58 per cent in the first half of 2003 (Chart 3). The increase in participation was sharpest for the 15–19 group, which reacts more to cyclical changes in labour demand than the 20–24 age group. As well, the school attendance rate of the 15–24 age group, which had increased by 3.5 points between 1991 and 1996, declined from 65 per cent to 63 per cent between 1996 and 2001, modestly contributing to the rebound in the participation rate.

Taking into account that the increases in the participation rates of both the 55 and over age groups and the female 25–54 age group appear to have been mostly structural since 1996, the rise in the aggregate participation rate would be mostly structural as well.

The Unemployment Rate

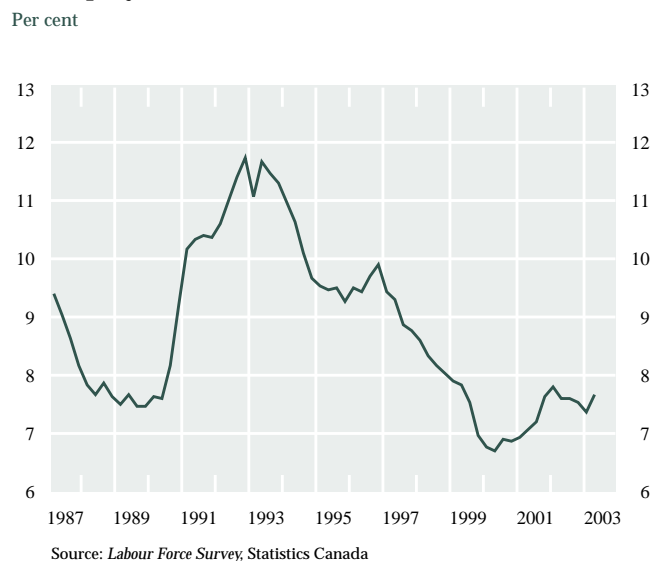
The balance between labour demand and labour supply is reflected in the unemployment rate, which fell throughout the latter half of the 1990s almost until the

11. One would expect that the trend towards increasing reliance on defined contribution pension plans relative to defined benefit plans is likely to result in the future in more sensitivity of the participation rates of the older cohorts to movements in financial asset prices. As at 1 January 2000, defined contribution plans accounted for 14 per cent of the total members of pension plans in Canada compared to about 10 per cent four years earlier. See Canada (2000).

onset of the U.S. recession early in 2001. The unemployment rate then rose temporarily before falling again in 2002. Despite big gains in employment in that year there was only a moderate decline in the unemployment rate, owing to the substantial increase in labour force participation. As labour demand softened into the first half of 2003, unemployment moved to a level close to the trough recorded in the late 1980s (Chart 4). This evolution was fairly uniform across age and gender groups.

The trend decline in the unemployment rate since the early 1990s has been associated with a rapid reduction in the rate of long-term unemployment and a related shortening in the average duration of unemployment spells, to about 16 weeks in 2002 from nearly 26 weeks in 1994 (Chart 5). This trend decline in unemployment may be related in part to some structural factors. The first would be the cumulative effects of earlier tightening of the Employment Insurance (EI) provisions.¹² The ratio of the regular beneficiaries of EI to the unemployed has hovered around 45 per cent since 1997 after a sharp fall earlier in the decade.¹³ The second

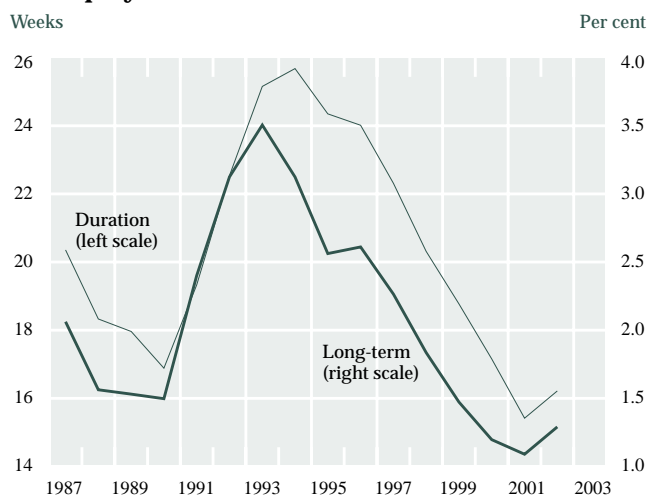
Chart 4
Unemployment Rate



12. For instance, amendments were introduced in November 1990, April 1993, July 1994, and July 1996.

13. Regular benefits exclude those resulting from maternity or parental leave and other special programs.

Chart 5
Average Unemployment Duration and Long-Term Unemployment Rate*



* Long-term unemployment rate = persons unemployed 27 weeks or more divided by the labour force
Source: Labour Force Survey, Statistics Canada

factor would be the diminishing effect of industrial restructuring. The rate of long-term unemployment in Canada has a pronounced cyclical component, but its very high level in the first half of the 1990s may have also reflected an unusually large degree of skill mismatch arising from extensive industrial restructuring. Finally, increased access to the Internet may have improved the matching of jobs to workers, as was suggested for the United States by Katz and Krueger (1999). While probably still of minor importance, this factor is likely to play a greater role in the future.

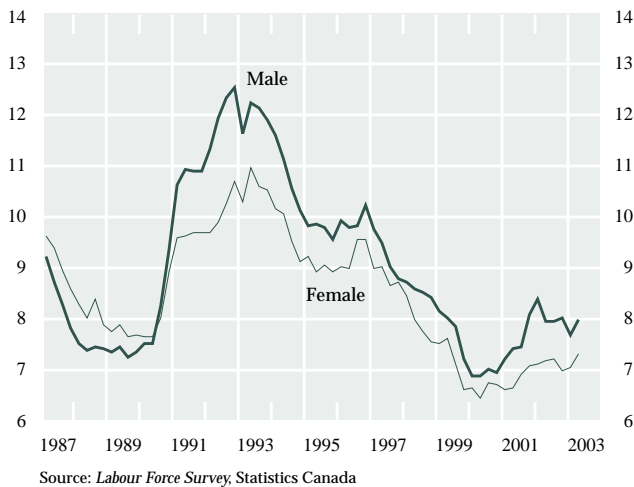
The trend decline in the unemployment rate since the early 1990s has been associated with a rapid reduction in the rate of long-term unemployment and a related shortening in the average duration of unemployment spells.

The movements in the unemployment rate during 2001 and 2002 have been more pronounced for men

Chart 6

Male and Female Unemployment Rates

Per cent



Source: Labour Force Survey, Statistics Canada

than for women (Chart 6). The recession and uneven recovery in the United States more directly affected jobs in the manufacturing, primary, and transportation industries, which are very largely held by men, than jobs in the services industries, where female employment tends to be concentrated. In fact, the greater pro-cyclical behaviour of output in the goods-producing industries largely explains why the unemployment rate for men shows larger variations than the rate for women over a business cycle. Over the past two and a half years, the unemployment rate rose less for women than for men on balance, even as the female labour force increased relatively more rapidly. Contributing to this is the fact that women benefitted

more than men from the strong pace of job creation in the health care, social services, and education sectors.¹⁴

Conclusion

Canada's labour market has experienced strong increases in labour force participation and employment since the end of 2001. The increase in labour force participation came largely from the 55 and over age group, reflecting cohort effects, improved labour market conditions, and wealth effects, although more evidence is needed for a definitive judgment on the latter. An unusually high proportion—one-third—of the recent employment growth came from part-time work, reflecting both the preference of the 55 and over group for this form of work and the readiness of firms to use it in a climate of heightened uncertainty about aggregate demand prospects. The substantial rise in part-time employment in turn meant that more workers than usual were required to accommodate output growth. Thus, the increased participation of the 55 and over age group and their preference for part-time work help to explain the relatively vigorous growth in total employment relative to total hours worked and output.

Going forward, cohort effects will support further increases in the participation of both the 55 and over age group and prime-age women. In the near term, as the economy rebounds and uncertainty is reduced, the cyclical component of the growth in part-time employment should diminish and that of full-time employment increase. This should result in more moderate employment growth in relation to output than has been observed in recent years. In addition, there may well be a cyclical rebound in labour productivity, inasmuch as total hours worked may increase slowly during the initial recovery in output growth.

14. In 2002, women held 82 per cent of the positions in the health and social assistance sector and 65 per cent of the jobs in the education sector. During 2002, 21,000 adult women were hired as nurses, and another 21,000 as teachers. See Bowlby (2003).

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