

CURRENT ANALYSIS

May 2014

What explains the decline in Canada’s labour force participation rate?

The Canadian participation rate, the percentage of the population 15 and over that is either working or actively looking for work, continued to decline in April, falling to 66.1% from 66.2% in March and further below the 66.5% rate a year earlier. This is a trend that has prevailed since hitting a pre-recession peak of 67.8% in February 2008 (Chart 1). Given the relatively modest pace of job growth in recent years, most recently averaging just 12K per month over the past year, this has caused speculation that weak labour markets are causing workers to become discouraged and give up their job search. When a discouraged worker stops actively looking for work, they are no longer counted as “in the labour force” which causes the participation rate to fall. Since they are no longer in the labour force, these workers also no longer meet the definition of “unemployed” and thus would not be included in the unemployment rate either. As a result, there has been speculation that the decline in the unemployment rate during the recession recovery (to currently sit slightly below its 10-year average at 6.9% in April) has also resulted from worker discouragement rather than fundamental improvement in labour markets.

Although an intuitively appealing argument, there is little data to support the claim that unusual levels of worker discouragement are major factors in the declines in labour force participation or the unemployment rate. Detailed data from the Labour Force Survey, from which the Canadian participation and unemployment rates are calculated, contains a count of the number of individuals age 15 and over who are not working, want a job, but have given up looking because of discouragement about job prospects. Chart 2 shows that while there was an increase in the number of these discouraged workers during the recession, the increase was never really large enough to have a significant impact on the participation rate and has fallen back below pre-recession levels. The economic cycle could also have an impact on the participation rate by encouraging some, particularly younger, workers to stay in school longer-than-normal to avoid a potentially difficult job search or through an increased number of workers waiting for recall. Chart 2 also shows, however, that the number of students who report they would really rather be working than in school, relative to the size of the labour force, is not notably out of line with what was observed prior to the 2008/09 recession and has, if anything, been trending somewhat lower in recent months. The number of workers waiting for recall, similarly, is in line with pre-recession levels and well-below higher rates earlier in the 1990s.

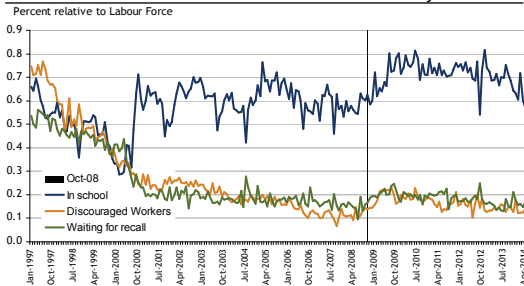
The more likely explanation is that longer-term demographic, rather than short-term cyclical, factors lie behind the recent downward trend in the participation rate. The most important factor appears to have been the aging of the baby boom generation and the resulting increase in the number of worker retirements. One way to illustrate this is to look at the change in the growth and composition of the population that is classified as “not in the labour force” and, thus, not included in the numerator of the labour force participation rate. Most of the increase in the population “not in the labour force” since October 2008 has been concentrated those aged 65 years of age and over. This likely entails a sizeable number of individuals retiring from the workforce. The total number of people aged 15 and up classified as “not in the labour force” has

Chart 1: Canada Participation Rate



Source: Statistics Canada, RBC Economics Research

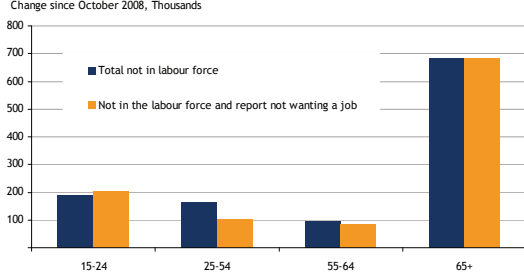
Chart 2: Canada Want a Job but Not in Labour Force by Reason



Source: Statistics Canada, RBC Economics Research

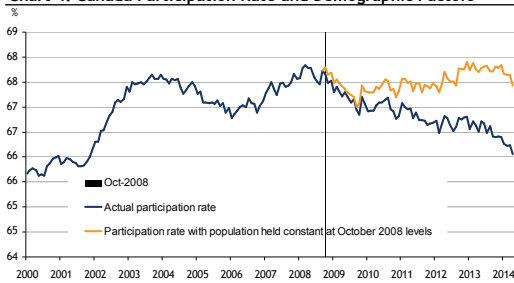
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**Chart 3: Canada Not in the Labour Force by Age**



Source: Statistics Canada, RBC Economics Research

**Chart 4: Canada Participation Rate and Demographic Factors**



Source: Statistics Canada, RBC Economics Research

risen by more than 1 million from October 2008 to April 2014. As shown in Chart 3, most of that increase (about 682K) was in the population 65 years of age and over. Including all age cohorts, about 95% of the increase in the population not in the labour force reflected an increase in the population who report not wanting a job.

Chart 4 shows the Canadian participation rate along with a modified rate calculated by holding the age composition of the population steady from October 2008. In effect, this modified rate controls for the impact of the shifting age composition of the population on the participation rate. Although it did dip lower during the recession, the rate has since been on an upward trend and, notwithstanding some recent declines, still sits right in line with its pre-recession level. This suggests that all of the decline in the Canadian participation rate since the 2008/09 recession can be explained by the aging of the population and a resulting increase in retirements. Interestingly, the idea that demographics could have a significant downward impact on the participation rate is not new. A [Statistics Canada study](#) from June 2007 (ie. pre-recession), for example, found that the Canadian participation rate would fall sharply over the next couple of decades under a variety of different scenarios, caused largely by population aging. The decline was expected to be exacerbated beginning in 2011 when the first of the baby boom generation began to reach retirement age.

The distinction between a decline in the participation rate driven by the exit of discouraged workers from the labour force compared to a decline due to longer-term non-cyclical factors, like retirements, has important implications for the assessment of the current state of the Canadian labour force. The exit of unemployed discouraged workers from the labour force lowers both the participation rate and the unemployment rate; however, a voluntary exit from the labour force resulting from a worker retirement lowers just the participation rate. The impact on the unemployment rate is typically negligible since both the labour force and employment are usually reduced by the same amount. The fact that the decline in the labour force participation rate in Canada appears to have been driven largely by worker retirements suggests that the decline in the unemployment rate does reflect cyclical improvement in labour markets rather than the exit of discouraged workers from the labour force.

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