OBSERVATION

TD Economics

December 4, 2013

DON'T JUDGE A LABOR MARKET BY ITS UNEMPLOYMENT RATE

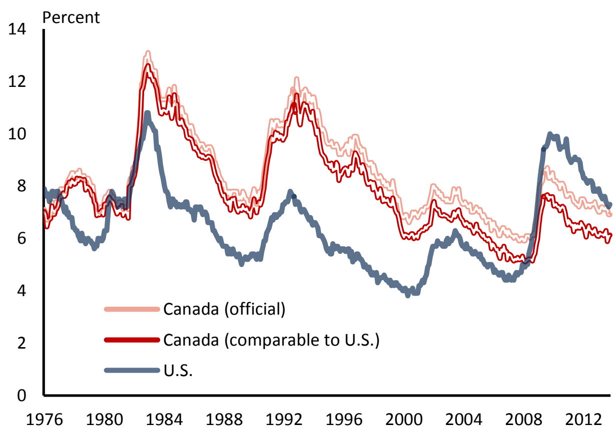
Highlights

- Over the last year, the Canadian unemployment rate has remained relatively static, while the U.S. rate has continued to fall. This has led to speculation that the recent outperformance of the Canadian labor market is coming to an end.
- Methodological differences in the calculation of the unemployed bias up the Canadian rate number relative to the U.S. A good rule of thumb is to knock at least a percentage point off the official Canadian number when comparing it to the U.S.
- Even more important is a growing divergence in labor force participation between the two countries, particularly among females. While Canada has seen an increasing share of its core working-age population (25-54) participating in the labor force, in America it has been in decline.
- If America had the same share of 25-54-year-olds working or looking for work as in Canada, the U.S. unemployment rate would be north of 11% (instead of 7.2%). Or from the north-of-the-49th perspective, if the Canadian participation rate tracked the U.S., the measured unemployment rate would be just 2.5% (instead of 6.9%).
- Canada may not be quite back to normal with an employment-to-population ratio that is still 2 percentage points below its pre-recession peak, but it is a lot closer than the United States with a deficit of 6.5 percentage points.

Recently, stories have been popping up in the press about the convergence of unemployment rates between Canada and the United States. It's an easy story to tell. At the start of 2013, the Canadian unemployment rate was 7.0% and ten months later it was little changed at 6.9%. By contrast, in the U.S., it has fallen from 7.9% to 7.3% in October. The steady improvement in the American unemployment rate relative to Canada has fueled talk about the eventual convergence between the two. Indeed, our forecast is for the U.S. rate to fall below that of Canada by mid-2014.

We'd like to put some speculation to rest. Irrespective of whether the unemployment rates converge on the surface, make no mistake; Canada's labor market is in much better shape than America's. Differences in methodology mean that Canada's comparable unemployment rate is still over a percentage point below the American rate. In addition, a growing divergence in labor force participation of core working age people (25-54), especially females, results in a much different job market in the two countries. If America had the same share of 25-54-year-olds working or looking for work as Canada, the U.S. unemployment rate would be over 11%.

UNEMPLOYMENT RATE
UNITED STATES & CANADA



Source: Bureau of Labor Statistics, Statistics Canada

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Canada is still not all the way back to normal with an employment-to-population ratio that is 2.0 percentage points below its peak. However, this compares to a deficit of 6.5 percentage points in the United States. While Canada is likely to return to full employment over the next two years, the slog will be noticeably longer in America.

Methodological differences result in apples to oranges comparisons

It's not just the spelling of labor that is different between the U.S. and Canada. Differences in who is counted in the labor market and unemployed mean that unemployment rates in the two countries are not directly comparable. Perhaps the most noticeable difference is that in Canada the labor force (spelled labour) begins at 15 years old, whereas in the U.S., it starts at 16. This causes Canadian labor market conditions to be biased weaker, since 15 year olds have a higher degree of unemployment and lower labor force participation.

There are other differences as well. Canada counts as unemployed people who are passively looking for a job (by looking at job ads), people who expect to start a job in the next four weeks, and people who are unavailable for work due to personal or family responsibilities. In the U.S. all of these people are considered to be outside of the labor force. On the other hand, Canada does not include as unemployed full-time students that are currently looking for full-time work.[1]

Fortunately, Statistics Canada corrects for these methodological differences and produces an unemployment rate comparable to the U.S. rate. In October, that rate was 6.1%, 1.2 percentage points lower than the U.S. rate.[2] This differential can change over time, but has been fairly stable over the last decade. As such, a good rule of thumb is to knock down the measured Canadian unemployment rate by a percentage point when comparing it to the U.S. rate.

Still, using the comparable rates, the differential between the two countries' unemployment rates has fallen over the last several years. At its peak in November 2011, the unemployment rate in the U.S. was 3.1 percentage points above the comparable rate in Canada (9.8% versus 6.7%). However, even the comparable rates miss a big *part* of the story – that is differences in labor force participation, especially of core working-age people between 25 and 54 years of age.

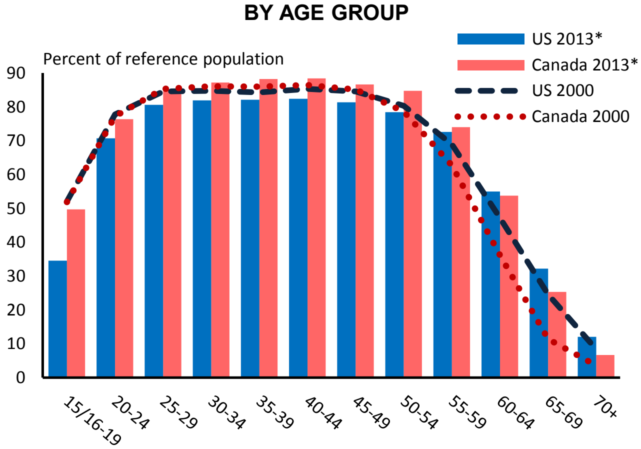
America's core participation rate peaked in 2000, Canada's in December 2012

Given the generally more stringent requirements for inclusion in the U.S. labor market, participation rates should also be expected to somewhat lower (roughly a percentage point) relative to Canada. However, differences in the age structure of the population also matter. Canada has a slightly older population and lower rates of labor force participation among older cohorts. As a result, population aging is exerting greater downward pressure on Canada's aggregate participation rate relative to the U.S.

A better apples-to-apples comparison is with people aged 25-54. This is often referred to as the core participation rate since most people between these ages are in the labor force and there is not much change in participation as a person moves through the age cohort.

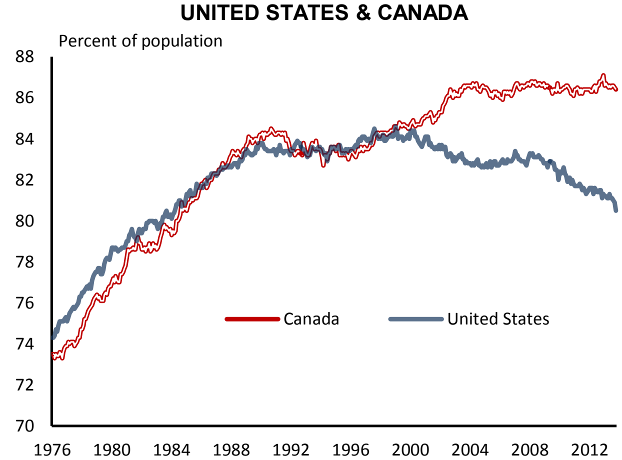
The participation rates of 25-54-year-olds in Canada and the United States moved closely together for much of their

LABOR FORCE PARTICIPATION RATES BY AGE GROUP



*Average of first 10 months.
Source: Bureau of Labor Statistics, Statistics Canada

PARTICIPATION RATE OF 25-54 YEAR OLDS UNITED STATES & CANADA



Source: Bureau of Labor Statistics, Statistics Canada history. In the late 1970s, the core U.S. participation rate was slightly above Canada's. Canada caught up in the 1980s and the two moved closely together up until the 2000s. However, since then, the participation rates have begun diverging in a meaningful way. Currently, 86.4% of Canadian adults between 25 and 54 are participating in the workforce, just shy of the peak of 87.1% reached in December of 2012. This compares to 80.5% in the United States. This is the largest divergence in the core participation on record with data going back to 1976.

Female participation explains much of the divergence

Splitting the data on participation between males and females, the source of the divergence is more apparent. In Canada, core female participation in the labor force has continued to rise through the last decade. Between 2000 and 2012, the participation rate of females between 25 and 54 rose 3.9 percentage points. In fact, gains in female participation were responsible for all of the increase in the core participation rate in Canada over this period. Male participation rates fell slightly, by 0.2 percentage points.

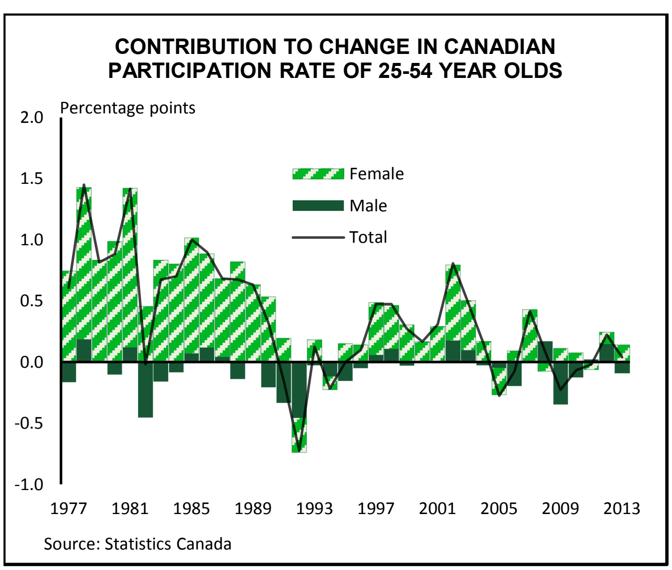
In the United States, both core male and female participation rates fell since 2000. For male participation rates, which have been in decline for much of their history, the fall accelerated, losing 3.0 percentage points. But, female participation rates also fell 2.2 percentage points, erasing all of the gains of the previous decade. Declining female participation made up 44% of the 2.6 percentage point fall in the core participation rate in the United States between 2000 and 2012. Over 2012 and the first 10 months of 2013, female participation has fallen more than male participation.

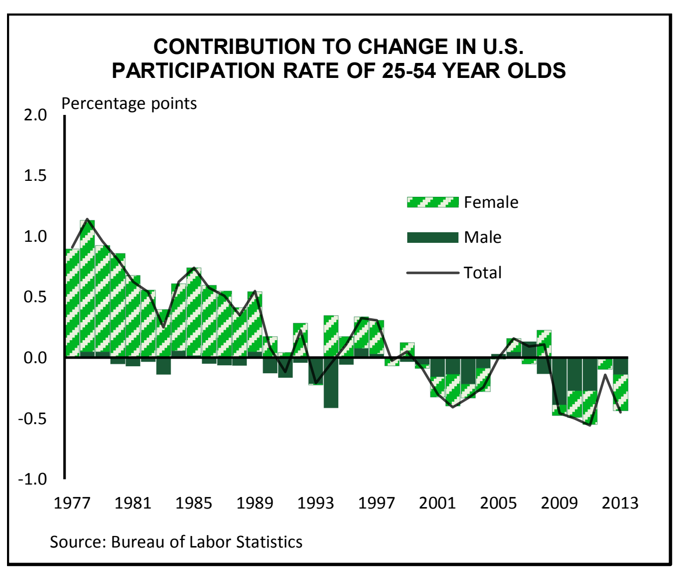
As a result, the gap between male and female participation, which has been declining for the most of the last 40 years, widened in America over the last two years.

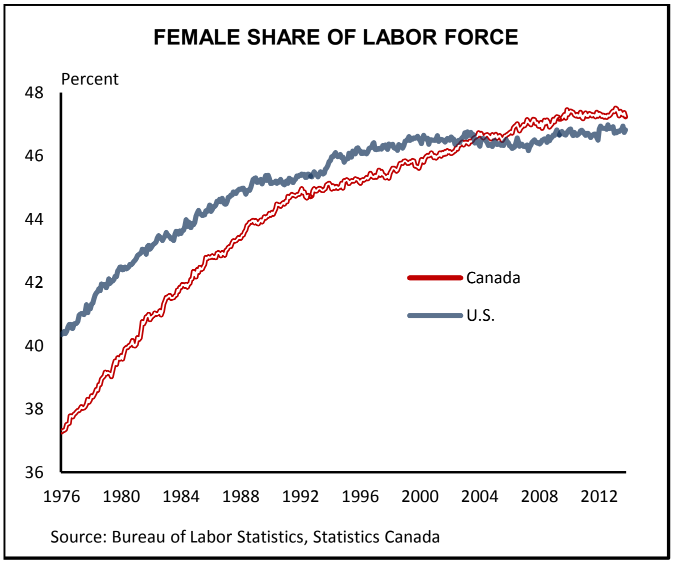
The divergence in participation rates between Canada and the U.S. is in large part due to the relative strength of the Canadian labor market. Canada lost fewer jobs during the recession and has created them at a faster rate since it ended. Since reaching their respective troughs in mid and late 2009, job growth has averaged 1.4% on an annual average basis in Canada and 1.0% in the United States (based on the household survey). As a result, the number of jobs is at an all-time high in Canada, but is still 2% below its peak in the United States.

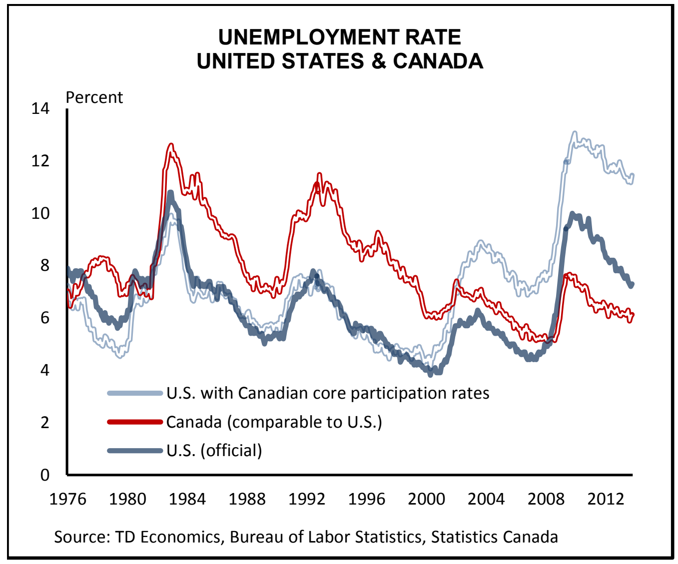
The relative outperformance of female participation rates in Canada is also due in large part to economic outperformance, especially in sectors where female employment is more prevalent such as services and government. From 2000 through 2012, employment in services industries grew by 1.8% annually in Canada compared to just 0.6% annually in the U.S. The 2008 recession also hastened the decline in female labor force participation in America. While the initial economic shock disproportionately hit men in both countries, male employment rebounded faster in the early stages of the recovery. As a result, the unemployment rate for males and females in the U.S. were neck and neck through 2012. The female unemployment rate only recently fell noticeably below the male rate and this is due in large part to declining participation.

While economic factors played a central role, other factors may also be at play. In addition to a growing services









sector, Canada has a relatively lower fertility rate, a higher incidence of part-time employment, higher tertiary education levels among females, and greater supports for leave around childbirth. All of these are shown to have positive effects on female labor force participation.[3]

What if participation rates in Canada & the U.S. had continued to follow each other?

The considerable divergence in labor force participation – much more than is explained by methodological differences – results in unemployment rates that are even more incomparable between the two countries. As an illustration of the importance of this divergence, if the core working age participation rate in the U.S. had maintained its historical relationship with Canada, the unemployment rate in the United States would currently be 11.3% instead of the reported 7.2%. Even more surprising, if you do the opposite thought experiment and impose core American participation rates on Canada, the Canadian unemployment rate would currently be an astonishing 2.5%.

Of course, one has to be careful in taking this analogy too far. It is unlikely Canada would have generated the level of job creation it has with the level of labor force growth seen in the United States. In other words, the growth in Canada's labor force has been a factor in Canada's labor market success.

Bottom Line

There are a few takeaways from this analysis. For one, even as the U.S. continues to make headway on bringing down its unemployment rate, unless this is accompanied by a greater share of adults participating in the labor market, it will be a pyrrhic victory. Canada's experience shows that even with an aging population, further gains in labor force participation are possible. In fact, taking a slightly longer view, the Canadian participation rate dipped in the early to mid-1990s due in large part to a poor labor market. At the time, several economists predicted that the decline was structural and that it would not rebound.[4] However, as the economy gained strength in the latter half of the decade and into the new millennium, the participation rate recovered. A higher participation rate is an important driver of economic potential – the greater the share of the population that is participating in the workforce, the greater potential labor supply. The Canadian experience should offer hope for the potential growth rate of the American economy, but also points to a long road ahead.

At the same time, for Canada, it shows just how strong the economic performance has been to date – especially its job creation record. Although the employment-to-population ratio in Canada is still 2.0 percentage points below its peak, as long as the economy continues to grow at its current pace, returning to full employment – characterized by low levels of unemployment and high labor force participation – is likely feasible within the next two years. Given the experience in the United States, where accomplishing this may not occur until the next decade (if at all), this is a notable achievement.

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Endnotes

1 Ferrao, Vincent. 2009. "The recent labour market in Canada and the United States." Perspectives on Labour and Income. Catalogue no. 75-001-X, 14-17. http://www.statcan.gc.ca/pub/75-001-x/2009103/pdf/10822-eng.pdf

2 Statistics Canada only reports the comparable unemployment rate on a non-seasonally-adjusted basis. The number quoted here is seasonally adjusted using Census X12.

3 Thevenon, Olivier (2013). "Drivers of Female Labour Force Participation in the OECD." OECD Social, Employment and Migration Working Papers No. 145. http://search.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DELSA/ELSA/WD/SEM(2013)1&docLanguage=En

4 Steven James, Tim Sargent, Russell Barnett and Claude Lavoie. 2007. "The Canadian Labour Force Participation Rate Revisited: Cohort and Wealth Effects Take Hold." Department of Finance Working Paper 2007-01. http://publications.gc.ca/collections/collection_2008/fin/F21-8-2007-1E.pdf