

Box 7

RECENT LABOUR FORCE DEVELOPMENTS IN THE EURO AREA

The labour force, which comprises all individuals actively participating in the labour market (i.e. both unemployed and employed persons), is an important guide to labour supply. Its development is influenced both by the demographic trends of the euro area population and by participation decisions. In the long run, labour force growth is one of the determinants of potential output. This box describes recent changes in the euro area labour force and the main factors underlying these developments.

Labour force growth remained robust in the latest economic slowdown

The table shows the development of the euro area labour force and its main driving forces, i.e. population developments and changes in the participation rate. The computations are presented in terms of five-year averages. The periods 1981-85, 1991-95 and 2001-05 are periods of low economic growth – with real GDP growing by around 1.5% on average – while the periods 1986-90 and 1996-2000, when real GDP was growing at or above 2.5%, correspond to periods of higher growth.¹

The labour force grew at an average annual rate of 1.1% between 2001 and 2005. This is the highest growth rate observed for any of the five periods considered since the early 1980s, including periods of both low and high economic growth. The distinction between population growth and participation rate effects sheds some light on the reasons behind the unusually high

¹ These periods do not correspond to the standard business cycle dating of expansions and recessions, but enable the lags with which labour market variables tend to react to the cycle to be better captured.

Working age population, labour force and participation rate in the euro area

(annual percentage changes; percentages; percentage points)

	1981-85	1986-90	1991-95	1996-2000	2001-05
GDP growth	1.5	3.4	1.3	2.7	1.3
Working age population growth	0.9	0.5	0.4	0.3	0.4
Participation rate	64.1	65.5	65.3	67.5	69.8
Change in participation rate	0.0	0.3	-0.1	0.4	0.5
Labour force growth	0.9	1.0	0.3	1.0	1.1
Population growth effect	0.9	0.6	0.2	0.3	0.4
Participation rate effect	0.0	0.3	0.1	0.7	0.7

Sources: Eurostat and ECB calculations.

Notes: The labour force participation rate is defined as the number of people in the labour force expressed as a percentage of the total working age population (i.e. those aged between 15 and 64). The population growth effect and participation rate effect are expressed as percentage point contributions to labour force growth.

recent labour force growth. First, the participation rate, which in the past has shown a pro-cyclical pattern, appears to have made a very significant positive contribution to labour force growth (0.7 percentage point) in spite of slow economic growth in the period between 2001 and 2005. Second, working age population growth, which has been characterised by a downward trend since the early 1980s, has also contributed significantly to labour force growth in the recent period. The following sheds more light on these two factors.

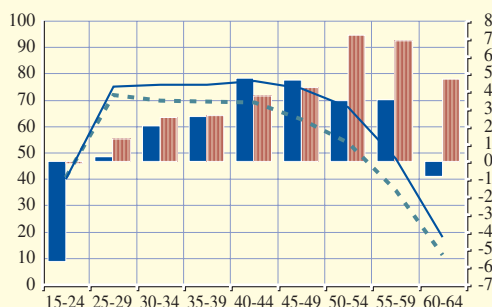
Labour market reforms have fostered participation rates

The participation rate increased by an average of 0.5 percentage point each year over the period 2001-05, in contrast with the developments observed in earlier periods of similarly weak economic growth. The main difference between the latest developments and those recorded in the early 1990s is the behaviour of the younger and older age cohorts for both genders (see Charts A and B). While the participation rate of those aged 15-24 declined markedly in 1991-95, it remained broadly unchanged in 2001-05. In addition, the participation rate of males

Chart A Labour force participation between 1991-95 and 2001-05, females

(percentages and percentage points)

- change in participation between 1995 and 1991 (right-hand scale)
- change in participation between 2005 and 2001 (right-hand scale)
- - - 1995 participation rate (left-hand scale)
- 2005 participation rate (left-hand scale)

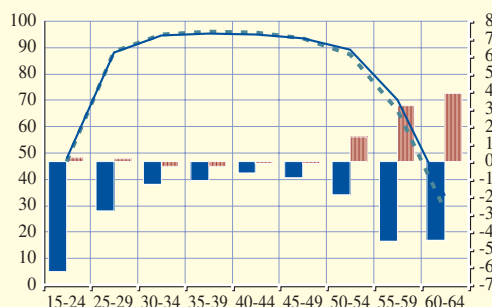


Sources: Eurostat and ECB calculations.

Chart B Labour force participation between 1991-95 and 2001-05, males

(percentages and percentage points)

- change in participation between 1995 and 1991 (right-hand scale)
- change in participation between 2005 and 2001 (right-hand scale)
- - - 1995 participation rate (left-hand scale)
- 2005 participation rate (left-hand scale)



Sources: Eurostat and ECB calculations.

above 50 years old, especially those aged 55 and above, also declined markedly in 1991-95, but increased in 2001-05. As regards the participation of females above 50 years old, a higher increase was recorded over the last five years compared with 1991-95.

The change in behaviour among younger and older workers is partly associated with changes in the institutional framework, owing to labour market reforms in some euro area countries. For instance, the increased flexibility brought about by a more extensive use of part-time contracts is likely to have had a positive impact on the participation of both males and females aged 15 to 24. As regards older workers, the decline in the use of early retirement schemes may be one of the reasons for an increase in participation, as it implies a delay in retirement. Lastly, other changes, including those to unemployment benefit systems, labour taxes and employment protection, have also favoured the participation of both younger and older workers.²

Developments in the working age population have also supported recent labour force growth

The annual growth rate of the working age population slowed from an average of 0.9% in 1981-85 to 0.3% in 1996-2000. Since then it has increased slightly to 0.4%. This latest increase seems to be explained by developments in Spain, in particular related to the regularisation of immigrant workers. Excluding Spain, the working age population growth would have been 0.2% on average in 2001-05.

In addition to these developments, the composition of the working age population has also changed somewhat since the early 1980s. In particular, the share of prime-age individuals (25-54 years old) has increased slightly. These compositional changes have had a positive effect on labour force growth by way of a higher overall participation rate. Indeed, they explain around 14% of the 4.5 percentage point increase in the participation rate between 1995 and 2005.

Overall, labour force growth appears to have been relatively strong between 2001 and 2005. This is partly due to immigration, but also reflects an underlying increase in participation, especially among the younger and older age groups, that is likely to be related to labour market reforms. The information available indicates that the labour force continued to expand at a robust pace in the first half of 2006, owing to both a trend increase in participation and strong working age population growth. Looking ahead, however, labour force growth is expected to decline owing to the projected slowdown in working age population growth. In that respect, economic policy must play an important role in supporting the developments of the labour force, for example by giving incentives to older males to delay retirement and by supporting flexible contracts that allow the youth and prime-age women to reconcile study and family life, respectively, and work.

² See "European women: why do(n't) they work?" by V. Genre, R. Gómez-Salvador and A. Lamo, ECB Working Paper No 454, March 2005.