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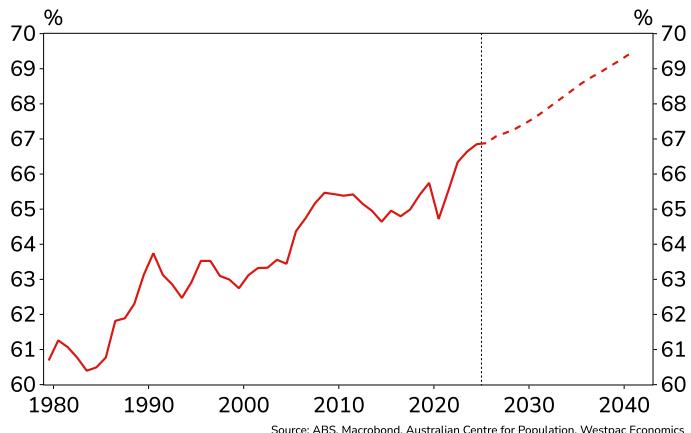
# AUSTRALIAN LABOUR SUPPLY BULLETIN

Rising trend, even without beating New Zealand

## Key points

- Trends in the participation rate matter for labour supply and thus potential output growth. Policymakers have repeatedly underestimated the scope for participation to rise despite population ageing.
- This note shows that plausible – even conservative – assumptions about participation rates for different age/sex groupings support ongoing increases in the overall participation rate.
- Our main scenario would see the participation rate increase to 67½% by 2030 and over 69% by 2040.
- Ignoring this trend would result in growth forecasts being too low, and knock-on issues for other policy areas.

### Participation Rate Projection: Main Scenario



# Further trend rise in participation is highly plausible

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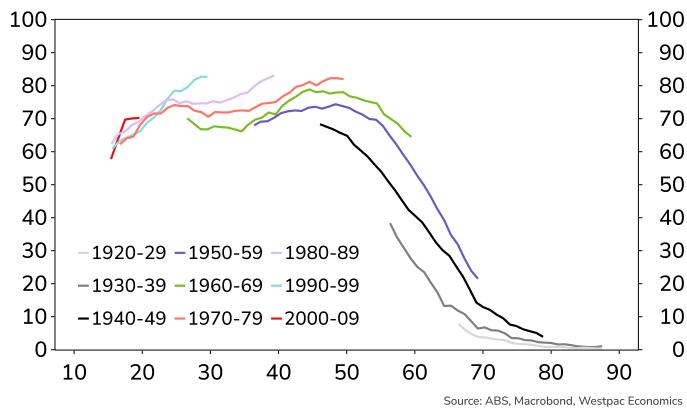
The participation rate – the share of working-age people who either have a job or are actively looking for one – is a key driver of labour market and broader economic outcomes. Too often, though, it is treated as an afterthought, something that pops out from a view on employment and unemployment. The participation rate has been on a multi-decade upward trend in Australia and many other economies, but this trend is often overlooked. Government forecasts have often assumed that population ageing means that a sharp downtrend is right around the corner. The [RBA](#) is meanwhile forecasting a flat trend for participation (over a shorter horizon of just two years), with positive structural forces expected to be offset by a cyclical downswing.

There are two main forces underpinning the structural trend. The 'cohort effect' describes how participation rates have evolved for different birth cohorts. Two important examples of cohort effects that have been widely observed are rising female participation and rising older-age participation, both of which have boosted overall participation. Charts 1 and 2, which plot the evolution of the participation rate by age for each birth cohort, showcases these effects. We can see that in each successive birth cohort, female participation has continued to lift across both the prime working age years (25–54) and in older years (55+) too. For males, the lift in participation at older ages is also clearly on display.

The 'demographic effect' describes changes in the overall participation due to shifts in the population's age and sex composition. The main dynamic here is the drag associated with an ageing population – as a large portion of population (i.e. baby boomers) moves into older age groups, which tend to have lower participation rates, the overall participation rate will fall.

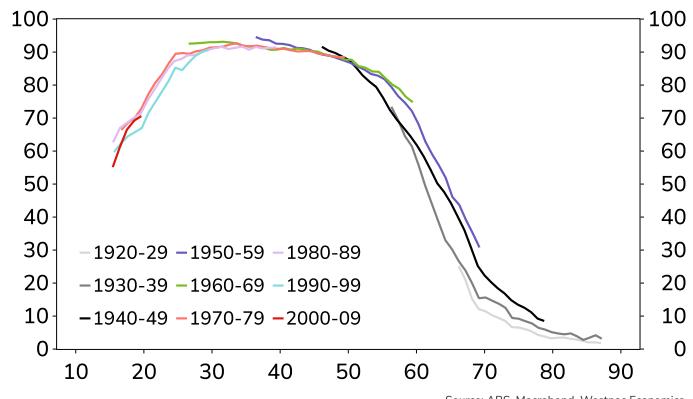
## 1. Participation Rate by Cohort: Females

Participation Rate (y-axis) by Average Age (x-axis)



## 2. Participation Rate by Cohort: Males

Participation Rate (y-axis) by Average Age (x-axis)



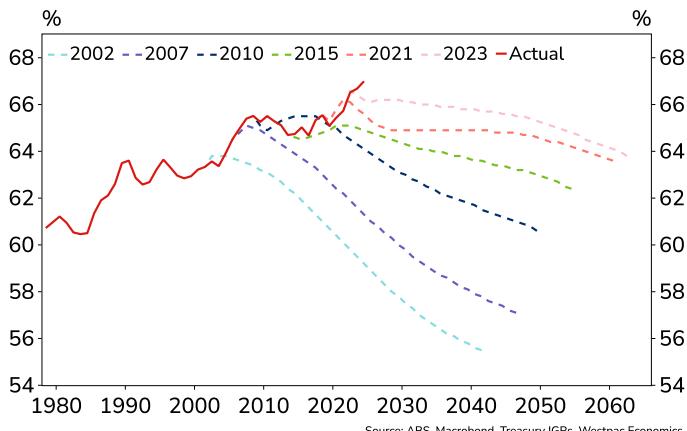
In the absence of an output gap model/projections, the cohort effect also captures cyclical factors throughout history. Previous [RBA research](#) shows that cyclical factors play a meaningful role in the short-run, but for the purposes of inspecting long-run trends in participation, structural forces (cohort and demographic effects) are the main drivers.

Whichever of these structural forces dominates plays a large role in determining the trend for the participation rate. As we discussed [last year](#), in many countries (including Australia), the positive impact from cohort effects have more than offset the drag from population ageing. The US stands as an outlier: cohort effects have been far less positive and, in some instances, even negative (prime-age males), resulting in a trend decline in labour force participation.

In Australia, the consensus view has often downplayed the idea of rising trend participation. Many commentators have consistently underappreciated the positive cohort effects. It has often been assumed the fruit of rising female and older participation had already been fully squeezed, and the drag from population ageing will quickly take over.

However, that is clearly not been the case. Chart 3 showcases Treasury's long-run forecasts for the participation rate in its Intergenerational Reports (IGRs). In the latest edition, it noted the increase in female and older participation, alongside a younger migrant intake (a 'positive' demographic effect while those migrants remain young) have resulted in actual participation outcomes consistently outperforming projections since the early 2000s.

### 3. Participation Rate Forecasts from Treasury IGRs



Our note [last year](#) discusses the role of improved health outcomes for older-age participation more in depth, but there are also a number of other interrelated drivers, including:

- Rising educational attainment and a stronger attachment to the labour market.
- The shift away from more manually intensive work towards knowledge-intensive work.
- Later career peaks and delayed retirement norms.
- Greater flexibility with a growing share of part-time work (e.g. work from home and Uber).

These underlying trends have not suddenly stopped, so the positive contribution from rising female participation and older-age participation should still have further to run. Whether this rising within-group participation continues to outweigh the drag from population ageing is an empirical matter – for example, it does not in Canada. For Australia, though, it would be unsafe to assume a near-term end to the multi-decade upward trend in overall participation. We therefore consider some possible scenarios to illustrate how much further this trend could run.

### What could such a situation look like in Australia?

One way to approach this question is by looking at our peer economies. New Zealand is an ideal candidate given our similarities. New Zealand has also consistently led Australia when it comes to the rise in participation rates across older age groups of both sexes, generally between 10–15 years. (This is partly because its pension system is organised differently and is not means tested.) New Zealand also represents a reasonable proxy for a theoretical maximum, noting that for some age/sex groups, participation rates are close to those in Japan, the leader among major advanced [economies](#).

In line with earlier research from the [RBA](#) and the [RBNZ](#), we can use a comparison economy's (or a group of economies) current participation rates as hypothetical endpoints for certain demographic groups in Australia. Then, taking projections of the age-sex composition from the Australian Government's Centre for Population, we can add in the population ageing effect.

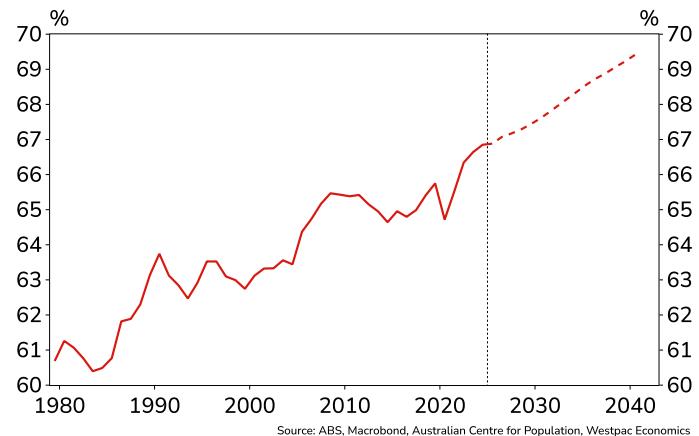
In our **Main Scenario\***, we project Australia's participation rates split into five-year age groups by sex, out to 2040, as per the following assumptions:

Group	Assumption
Males 15–24	Converge to post-2000 average.
Females 15–24	Converge to endpoint of post-2000 linear trend.
Males 25–54	Converge to post-2000 average.
Females 25–44	Converge to endpoint of post-2000 linear trend.
Males 55+	Converge to the current NZ participation rate.
Females 45+	Converge to the current NZ participation rate.

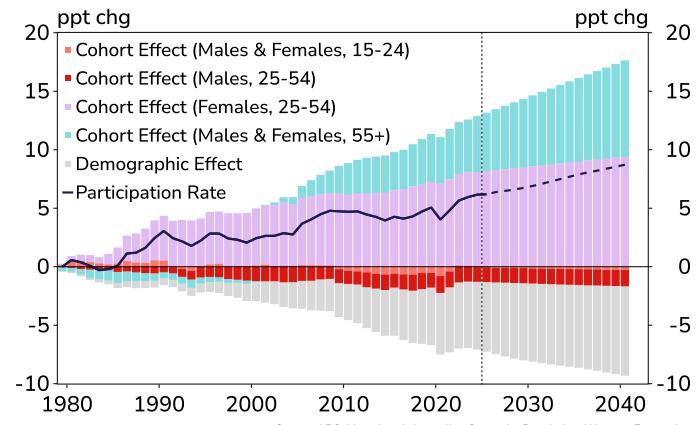
\* See Appendix for rationale

Under such a scenario, as seen in Chart 4, Australia's participation rate would lift by 2½ ppts through to 2040, from 66.9% to 69.4%. Chart 5 provides a breakdown of the contributions from the main cohorts and effects. The drag from population ageing clearly acts as a major drag on the participation rate, subtracting –1.8ppts over the horizon. There is also a small drag from the cohort effects associated with prime working age (25–54) male participation and youth (15–24) participation, both around –0.2ppts. But these drags are more than offset by rising participation among older age groups (55+) and prime working-age females, up 3.4ppts and 1.3ppts respectively.

### 4. Participation Rate Projection: Main Scenario



### 5. Main Scenario Decomposition



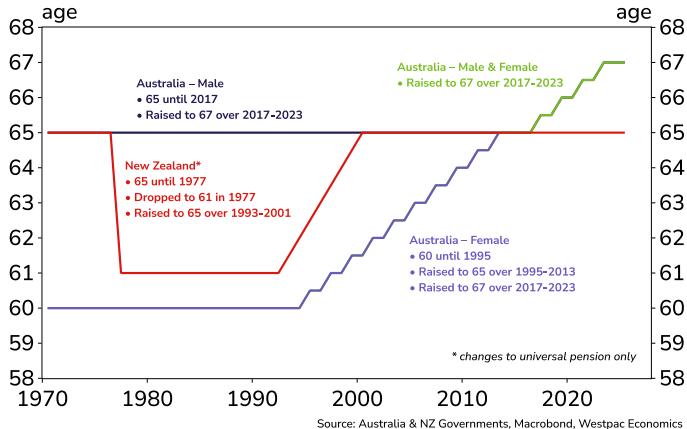
## How realistic is this scenario?

The Main Scenario highlights what a possible uptrend could look like for Australia, but a key question is: *how likely is such a scenario?*

Regarding older-age participation, there are some meaningful differences in pension and superannuation systems between Australia and New Zealand. Australia's pension system is means-tested, which discourages some older people from remaining in the workforce, as earning an income would reduce their pension. New Zealand's universal pension system tends to be viewed as more neutral for participation. Some also [claim](#) that Australia's Superannuation Guarantee imposes a large 'tax' on employment compared to New Zealand's KiwiSaver, given its mandatory nature and higher minimum employer contribution rate. While it is [generally thought](#) that these cross-country variations can explain some of the difference in older-age participation rates, precisely how much remains unclear.

On the other hand, Australia has recently increased its pension eligibility age to 67, while it is still at 65 in New Zealand. [Treasury analysis](#) suggests this can be expected to have a positive impact on older age participation rates in Australia, in line with analyses of previous increases in the pension age through history – although again, estimates of how much such increases in pension eligibility ages could add to participation vary widely.

## 6. Australia & New Zealand: Pension Eligibility Age



Stepping back, though, it is telling that for older age groups, there is little difference between assuming a convergence to New Zealand or a continuation of the post-2000 trend with respect to the trajectory of the overall participation rate. For decades, it has been commonly assumed that Australia's participation rate would enter a sustained downtrend. If we are instead going to see these recent cohort trends persist for longer, then something like the Main Scenario may well be a reasonable proxy.

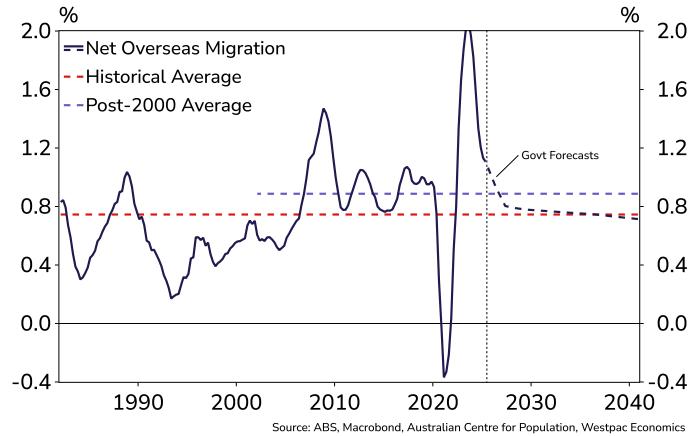
If anything, the Main Scenario could be seen as already incorporating conservative assumptions for prime-age male participation in Australia, which is assumed to remain broadly flat. While this has indeed been the case for most peer

economies since 2000, including Canada, the United Kingdom and New Zealand (once accounting for differences in data treatment), is it reasonable to assume this flatness will persist?

This flatness is a result of a [tug-of-war](#) between both positive and negative cohort effects. On the one hand, delayed workforce entry from younger males due to education/upskilling, a shrinking share of jobs in male-dominated manually intensive work due to automation, and a cyclical drag associated with the GFC have all suppressed prime-age male participation. But on the upside, those who pursue further education are likely to have a higher degree of labour market attachment in the future, complementing the rising share of more knowledge-intensive roles. This, together with continued improvements in health outcomes, favours a more constructive trend for this cohort.

A final point is that the demographic projections sourced from the Australian Government could be viewed as somewhat conservative. These projections assume net migration will quickly return to a long-run assumption of 235,000 per year by 2036. Note this is a fixed nominal amount that implies net migration's share of population growth will shrink rapidly to 0.80% in 2027 and trend down to 0.71% by 2040. This is below than the long-run average of 0.75% and much lower than the post-2000 average of 0.89%. Instead, net overseas migration could remain at a higher fixed share of the population, closer to recent trends, over the forward horizon. Given migration policy over the past two decades have generally targeted younger skilled migrants, this positive demographic effect has been noted to [offset the impact](#) from population ageing

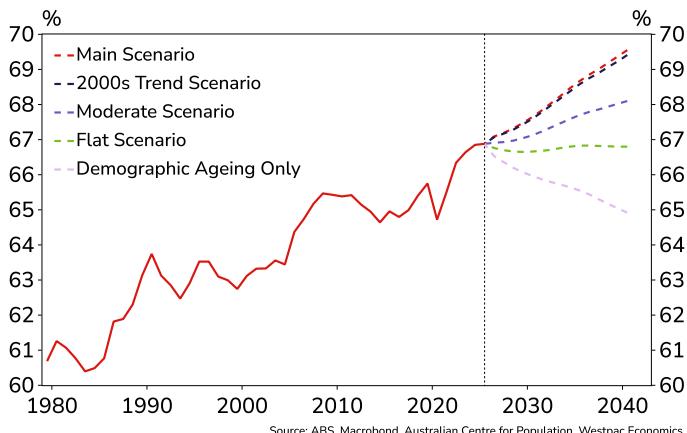
## 7. Net Migration Share of Population



## Other scenarios to consider

In any case, it is helpful to compare this to other scenarios to get a sense of sensitivity. One such example is a [2000s Trend Scenario](#), where it is simply assumed that each age-sex cohort in Australia will converge to an extrapolated endpoint of its linear trend since 2000. As noted earlier, this produces a very similar result to the Main Scenario, suggesting if recent cohort effects have further to run, it will result in a sustained uptrend in overall participation.

## 8. Labour Force Participation: Other Scenarios



We can also tweak the original assumptions in a more conservative direction to emphasise a bit more of the downside arguments noted prior. Instead of assuming a full convergence to New Zealand's participation rate, we can assume that the older cohorts (55+ males, 45+ females) converge only two-thirds of the way. This **Moderate Scenario** results in about half the increase of the participation rate compared to the Main Scenario, up around 1¼ ppts to 68.1% by 2040.

In order to achieve something closer to a **Flat Scenario**, where the overall participation rate holds broadly steady around current levels through to 2040, we have to make the original assumptions even more conservative – participation rates for those older cohorts must converge only one-third of the way to New Zealand's current participation rates. In this scenario, participation rates are still trending up for the relevant cohorts, but only modestly so.

To illustrate what would happen in the absence of any change in any cohorts' participation rate from here (i.e. zero cohort effect), the **Population Ageing Scenario** demonstrates the cumulative effect from population ageing, resulting in a downtrend that subtracts 2ppts off the overall participation to 64.9% by 2040. This is in the ballpark of previous forecasts from Treasury IGRs.

These scenarios are also sensitive to the chosen horizon that the trends are assumed to take place over. The drag from population ageing grows larger the further out we project, as the 'baby boomer' cohort moves progressively further into older-age groups with lower participation rates – a shorter horizon (i.e. quicker convergence) could result in a sharper uptrend, and vice versa.

## Conclusion

There is a demonstrated history of forecast misses when it comes to Australia's participation rate, including in official sector forecasts. This is a result of underappreciating the persistence of positive cohort effects, principally rising older age participation and female participation. If these structural drivers of participation continued, that would continue to overwhelm the drag associated with population ageing and see the uptrend in overall participation persist for longer.

If the upward trend in participation does continue, this will have clear implications for policy. As in the years leading up to the pandemic, if policymakers erroneously assume that trend participation is flat or falling, they might incorrectly conclude that labour supply will be tighter, and aggregate supply and potential output growth lower, than they actually turn out to be. This will in turn induce their wages growth and inflation forecasts to be biased up. Assumptions about fiscal revenues could also be underdone, depending on the balance between too-low employment and too-high wages growth forecasts. Overblown concerns about diminishing labour supply could have knock-on effects for other policies as well, including the strategy around the immigration intake, education and training, and demand planning around health and aged care.

Of course, the example of Canada shows that cohort effects need not outstrip population ageing effects indefinitely. Policymakers and other forecasts need to be alert to the potential for the balance to shift. For the rest of the decade, though, it would seem more prudent to work on the basis that the upward trend in participation continues. The past two decades in Australia and New Zealand shows that this would be both feasible and entirely plausible.

## Appendix: Main Scenario Assumptions

In the **Main Scenario**, participation rates split into five-year age groups by sex are projected out to 2040 as per the following assumptions:

Group	Assumption
Males 15–24	Converge to post-2000 average.
Females 15–24	

Prior to 2000, youth participation tracked a slight trend decline, widely attributed to the pursuit of further education, delaying workforce entry. Since then, youth participation has been flatter – stable around a relatively higher level pre-GFC, and a lower level post-GFC.

Assuming a convergence to a trend endpoint over this period imposes a sharp downtrend that relies heavily on the drop in participation around the GFC, given the higher cyclical sensitivity of youth participation. Outside of this, youth participation rates have been stable. Hence, we assume participation rates will instead converge to the average over this period. Despite large cyclical swings post-pandemic, the inclusion of this period has little impact on the aggregate result.

Group	Assumption
Males 25–54	Converge to endpoint of post-2000 linear trend.
Females 25–44	

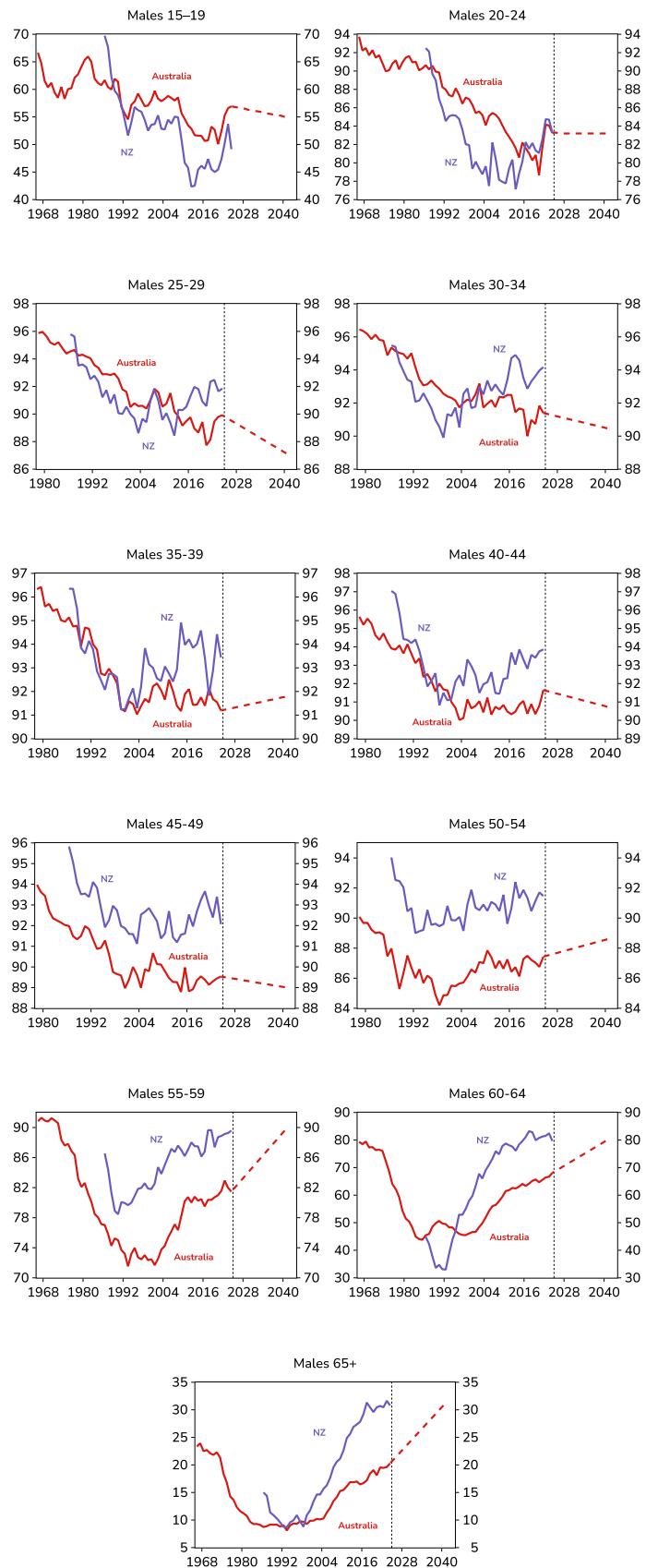
For 25–54-year-old males, participation rates for each five-year age groups are assumed to converge to the endpoint of the post-2000 linear trend, extrapolated out to 2040. This aims to be consistent with recent trends which differ across the age groups: 25–29 and 30–34 has a trend decline; 35–39, 40–44 and 45–49 are broadly flat, while 50–54 has a slight uptrend.

The same is assumed for females aged 25–44. Note that participation rates in this cohort overlap between Australia and NZ, so assuming a convergence to NZ would reflect a clear break in the uptrend. We do not apply this assumption for the 45–54 female bracket to preserve some conservatism, as it would result in a stronger uptrend above and beyond that of NZ for these cohorts.

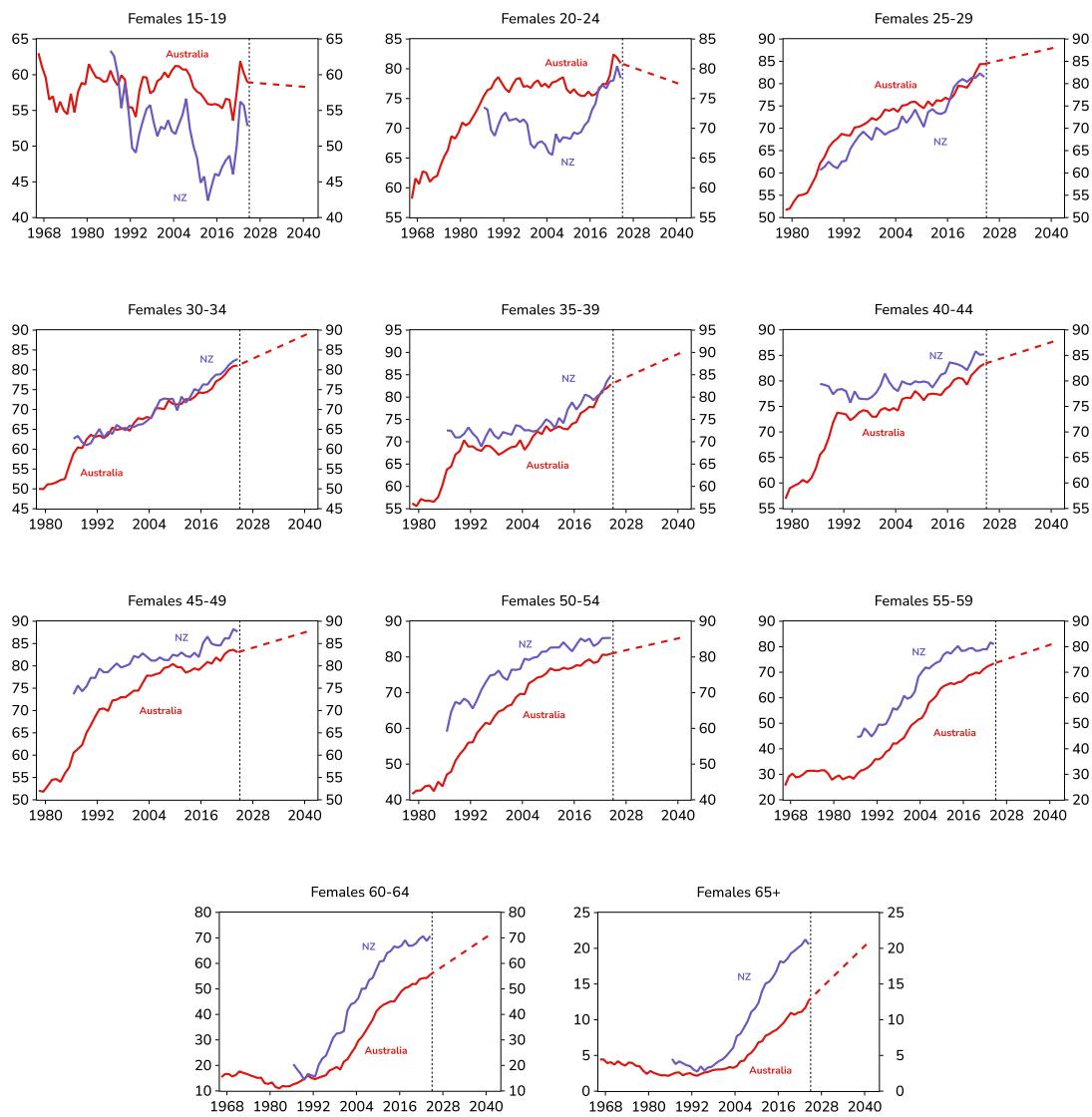
Group	Assumption
Males 55+	Converge to the current NZ participation rate.
Females 45+	

These groups are where positive cohort effects from rising older participation are captured. Given the similarities between our economies, the current participation rates for these cohorts in NZ are used as the endpoint to which the Australian cohorts will converge. Note, assuming a convergence to NZ is slightly more conservative compared to post-2000 trend endpoint convergence.

## Main Scenario Participation Rates: Males (%)



## Main Scenario Participation Rates: Females (%)



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