

Québec economy: The adverse effects of demographic shock are looming It is important to act now to soften the impact on the labour market

Québec is about to be impacted by two simultaneous demographic shock waves: a population that is both aging, and decreasing. This problem may seem far off and abstract, but the province will soon have to deal with the serious consequences of these upheavals, particularly on economic growth and on the labour market. The labour pool, i.e. the population between the ages of 15 and 64, will diminish just five years from now, which will put downward pressure on the unemployment rate. This will constitute a major challenge for businesses that will find it increasingly difficult to recruit workers. Should we expect a general labour shortage, or a shortage in certain industries? Will we see upward pressure on wages? These issues have serious consequences and deserve a thorough analysis.

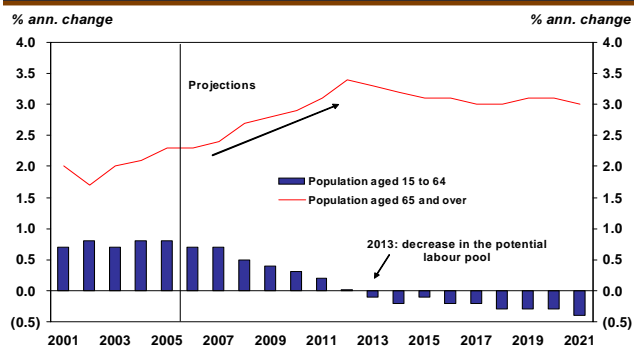
Since the upheavals will be more far-reaching in Québec than for our main trading partners, the economic stakes for the province are crucial. Moreover, the current demographic trends are impossible to reverse in the short and medium terms, even with higher levels of immigration and a higher birth rate. It is therefore important to find avenues of solution to soften the shock, which appears to be unavoidable.

THE LABOUR FORCE WILL AGE FASTER IN QUÉBEC

At present, Québec's population is still relatively young compared with major industrialized countries. In fact, the proportion of people aged 65 and over is currently in the neighbourhood of 15%, which is one of the lowest rates among the OECD countries. However, a major shift is on the horizon for Québec, which will soon experience an accelerated aging of its population. Starting in 2011, the first baby-boomers, born between 1946 and 1966¹, will reach their 65th birthdays. Since the wave of births that occurred over that period was relatively stronger here than in other parts of North America, the imminent effect on the aging of the population will be far more intense. Around 15 years from now, one quarter of Québec's population will be 65 years of age or older.

The consequences for the labour market will therefore be more acute in Québec than anywhere else in Canada. The anticipated departure of masses of retiring workers will shrink the labour pool (graph 1). The numbers of young people joining the labour force will not be enough to replace the older

Graph 1 – Growth in the population aged 65 and over will accelerate, while the 15-to-64 segment will soon decrease



Sources: Statistics Canada and Desjardins, Economic Studies

generation. According to projections from Statistics Canada, the population aged 15 to 64 will begin decreasing as early as 2013, whereas it will still be growing in Canada and in Ontario (graph 2).

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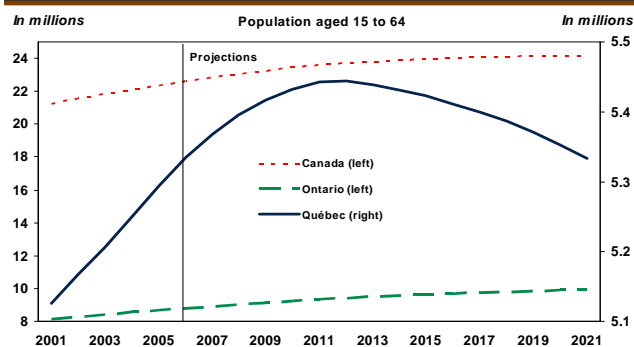
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Given the speed and the scope of the coming aging of the workforce, it is important to determine whether policies such as higher immigration targets or measures designed to stimulate the birth rate might prevent a contraction of Québec's labour pool. In light of the calculations performed by the demographers at Statistics Canada, we have no choice but to face the facts: for the short and medium terms, the die has been cast.

Graph 2 – The reduction in the labour pool will be problematic in Québec



Sources: Statistics Canada and Desjardins, Economic Studies

IS IMMIGRATION A SOLUTION?

At first glance, bringing in foreign workers to swell the ranks of the labour force seems like an attractive concept. In the second half of the 1990s, fewer than 30,000 immigrants settled in Québec each year, whereas in recent years their numbers have exceeded 40,000. Indeed, the Québec government will gradually raise its foreign immigration target to 55,000 people by 2010, compared with a maximum of 49,000 people this year. Of course, setting targets is not enough. We must not only reach them, but, more importantly, ensure that the newcomers stay for a long time. If they decamp after a few years, as many of them currently do, the effect on the labour pool will be practically nil. Over the years, many have moved to other provinces, in particular Ontario, which has contributed to keeping the interprovincial migration balance in the red. Although immigration is part of the solution, it can only fill in the gaps.

How many immigrants would we have to bring to Québec each year to stabilize the labour pool and prevent it from shrinking in the next few years? According to Statistics Canada, it would take an annual influx of 300,000 individuals from abroad to make a difference between a decrease and a stagnation of the population aged 15 to 64 (forecasts based on 2006 data). That is the equivalent of the number of foreigners who settle across Canada each year! Since that target is out of reach, labour will become a scarcer commodity in the years to come despite greater numbers of immigrants and better integration of those people into Québec society. In short, immigration alone cannot reverse the trend.

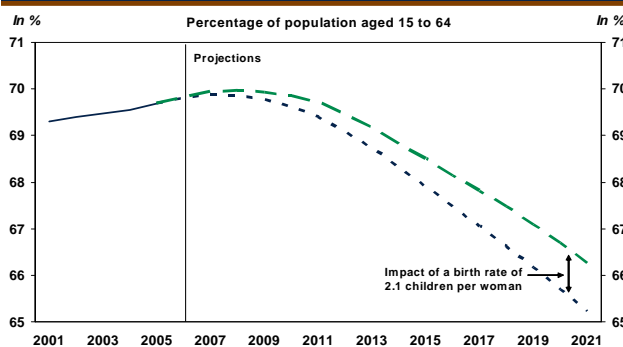
On the other hand, even though a decline in the population of working age is inevitable, raising immigration targets, assuming that they are actually reached, might at least mitigate the decrease. It is therefore worth adopting measures designed to promote the integration of newcomers into the labour market. Furthermore, recognizing their educational credentials and their work experience would encourage the newcomers to remain here for more than a few years.

WHAT ABOUT THE BIRTH RATE?

Another possible solution would be to increase the birth rate to 2.1 children per woman, which is the threshold required to replace the population. Since the birth rate, rather than immigration, has the greatest influence on the demographic curve, this approach seems more promising. Indeed, recent trends in the birth rate gave some hope on this front. In 2006, a significant increase of 8% brought the number of births to 84,200. Although some people talked about a baby boom, this was nothing compared to the peak of 140,000 births that occurred in the 1950s and 1960s. At any rate, the balloon was already burst in 2007 with a mere 3% increase in the number of births. The data for the first quarter of 2008 point towards an increase similar to that of last year.

Despite this rebound in the number of births in Québec, the number of children per woman has edged up only slightly since 2005, from 1.5 to 1.7 in 2007. The birth rate is still far below the rate of 2.1 that would replace the older generations. Even if that threshold were reached, it would take several years before any impact would be felt on the labour pool aged 15 to 64. According to estimates by Statistics Canada, even a return to a birth rate of 2.1 children per woman would not prevent a slump in the population aged 15 to 64 (graph 3).

Graph 3 – The population aged 15 to 64 would decline even if the birth rate went back up to 2.1 children per woman

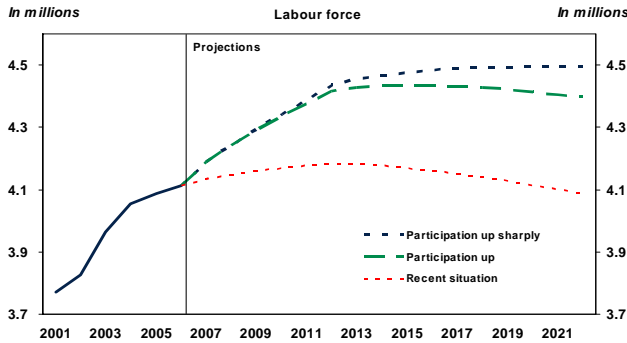


Sources: Statistics Canada and Desjardins, Economic Studies

In short, neither massive immigration nor an increase in the birth rate can turn the current trends around. In fact, since demographic factors can only attenuate the decrease of the labour pool, the challenge will instead be to induce a greater proportion of the population to participate in the labour market. According to analyses by Statistics Canada, demographic factors (birth rate and immigration) will have less impact on

the future labour supply, in the short and medium term, than trends in the rate of active participation. Although demographics cannot prevent the labour force from shrinking, increased participation in the labour market might delay it (graph 4).

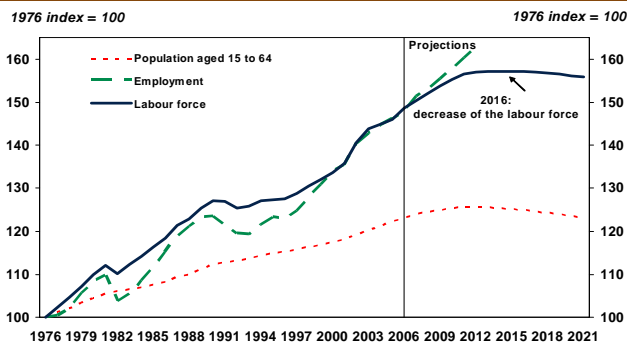
Graph 4 – Only a strong increase in participation rates would prevent the labour force from declining by 2016



Sources: Statistics Canada and Desjardins, Economic Studies

In this situation, what mechanisms will govern the trends in the labour market? First of all, the shrinking workforce is likely to lead to anaemic growth or even stagnation in employment over the next decade (graph 5). Over the long term, job growth is determined by the growth of the population that is participating in the labour market which, in turn, depends on demographics. Historically, job growth has matched the growth in the population of working age, but some variations in the past have been triggered by an increase in the labour force participation rate. Structural changes that occurred in certain periods fostered job growth that was higher than the growth in the population of working age. An increase in the participation rate can make a real difference.

Graph 5 – Will job growth hit a wall in the next decade?



Sources: Statistics Canada and Desjardins, Economic Studies

In the early 1970s, the continued massive entry of women into the labour market increased the labour force, thus expanding the pool of workers. In the current decade, we have so far seen a widespread return to work by people aged 55 or more after an early retirement. Thus, demographic trends can be mitigated by higher rates of participation in the labour force. In the final analysis, it is changes in the labour force, i.e. the

LABOUR MARKET LEXICON

Potential labour pool:

Population aged 15 to 64.

Labour force:

Number of people aged 15 or more who are employed or seeking employment (workers and unemployed people).

Labour force participation rate:

Percentage of people aged 15 and over who are participating in the labour market (labour force).

Unemployment rate:

Percentage of people in the labour force who are unemployed.

Employment rate:

Percentage of the population aged 15 or more who have a job.

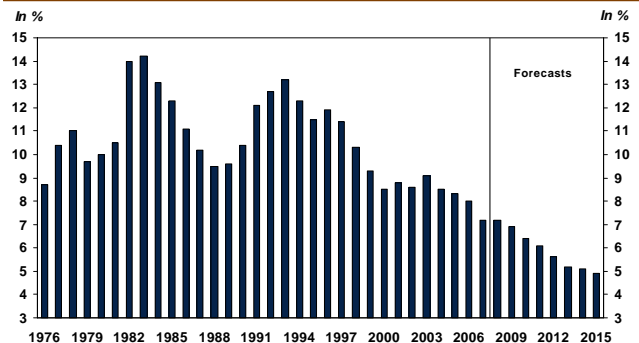
numbers of people aged 15 and over who are participating in the workforce, that will dictate future employment trends. Hope is slim on this point as well.

According to the scenario adopted by Statistics Canada, i.e. a rising labour force participation rate, growth in the labour force will crumble under the weight of demographic factors in the years to come and it will even decline in Québec starting in 2016. Between now and then, employment growth will gradually weaken even though economic conditions may trigger some deviations, both upward and downward, from time to time. In Ontario and other parts of Canada, demographic trends are far more favourable because growth in the labour force will continue, although at a slower pace. Incidentally, growth in employment will be lower in Québec.

WHAT WILL HAPPEN TO THE UNEMPLOYMENT RATE?

All of these upheavals will result in a sharp drop in Québec's unemployment rate in the years to come (graph 6). This indicator which, for many years, was the most closely watched

Graph 6 – The unemployment rate will decline sharply in Québec



Sources: Statistics Canada and Desjardins, Economic Studies

barometer of the state of the economy, will become completely obsolete. The drop in the unemployment rate will be like a mirage, since it will be attributable to demographic effects rather than to any real improvement in the labour market. The unemployment rate could even approach 5% within the next five years despite weak growth in employment. The shrinking pool of workers will make all the difference in this respect. Therefore, in order to compare Québec's economic performance with those of its main trading partners, we should avoid using the unemployment rate. In any event, that indicator is already deficient now. The employment rate, that is, the proportion of the population aged 15 and over that holds a job, provides a more exact picture of the labour market. We need only adopt that barometer in order to obtain a reliable reading of the economy.

WILL WAGES CLIMB?

In tandem with the falling unemployment rate, due to the scarcity of labour, many analysts believe that wages will be driven sharply upwards. In fact, wage adjustments are likely to differ from one industry to another. For example, manufacturers focused on foreign markets will be hard put to increase wages to attract workers in the current context of global competition. With labour in short supply, manufacturers may well shift production abroad even more, in order to stay profitable. Thus, demographic trends are likely to accentuate the decline of the manufacturing sector, whose economic weight is diminishing to an increasing extent. The only way out for businesses that want to produce locally will be to raise wages to attract workers, while at the same time increasing their productivity in order to remain competitive on international markets.

In the services sector, which is less affected by foreign competition, the dwindling supply of workers will put upward pressure on wages. Wage increases will be greater than those we see now, but the gains will be limited by the weaker growth of the domestic economy, linked to unfavourable demographics.

Wage increases will, in turn, trigger major structural adjustments, in particular moves by workers from outside the province. (This phenomenon might be mitigated in the case of Québec, however, due to linguistic factors.) Over the long term, people always tend to migrate to those areas that offer the best job opportunities. The recent case of Alberta speaks volumes on this point. The drop in the unemployment rate to around 3.5% since 2005 has pushed wages up by approximately 5% annually, thus attracting many workers from other parts of the country. In the first half of the 2000 decade, wages climbed by 2.5% to 3.0% each year, as has been the case in Québec over the past five years. However, the reasons behind such a low unemployment rate in Alberta are quite different. There, the oil boom has given a strong stimulus to economic growth,

driving up demand for workers. In Québec, it is the labour supply that will shrink due to demographic changes. Despite that divergence, the anticipated drop in the unemployment rate will exert pressure on wages. The annual increases of 5% observed in Alberta give us an idea of what may lie ahead for Québec in the next decade.

SHOULD WE WORRY ABOUT A LABOUR SHORTAGE?

Many analysts are forecasting a general labour shortage in the near term due to a shrinking labour pool. In fact, some industries are already finding it difficult to meet their staffing needs, a situation that is compromising their expansion. Demographic trends are thus stoking fears of a worst-case scenario. Yes, workers will become even harder to find in the years to come. A widespread shortage would occur only if no structural adjustments were made in light of the demographic upheavals, which is far from likely. Besides attracting workers from other provinces, higher wages could induce a larger share of the population to participate actively in the labour market, in particular those who are fit to work in Québec but who are unemployed. Before we sound the alarm, we must also take into account the consequences of a less dynamic domestic market on demand for workers. Demographic trends will generate a slowdown in economic growth which will inevitably limit the increase in demand for employees on the part of many businesses. Certain industries will, of course, experience difficulty in recruiting and retaining employees, as is currently the case. However, an acute labour shortage across the entire economy is far from being a certainty. In these circumstances, we are likely to see labour challenges, rather than a drastic shortage, in the years to come.

WAYS TO MITIGATE THE SHOCK

In short, neither massive immigration nor a higher birth rate alone will be able to prevent a future decline in the labour pool. However, both of these solutions can alleviate that decrease and warrant attention in the form of government policies. The real challenge will be to bring a larger proportion of the population into the labour market. Government policies should therefore focus on that approach. Many initiatives may be put forward, and the Québec government's Employment Pact is a step in that direction. At present there are 400,000 people in Québec who are available to work, but unemployed. Actions aimed at promoting the integration of those potential workers, as outlined in the Charest government's plan, are therefore welcome.

Another way to expand the labour supply would be to facilitate access to the job market for certain atypical workers, such as women with young children or people with irregular schedules. For example, the government could set up day care services that would be open in the evenings and on weekends.

Finally, the rigid constraints that currently govern the job market should be relaxed. Labour laws are overly restrictive and hinder flexibility in workforce management. Many industries are also subject to interprovincial barriers, in particular those imposed by professional associations, which reduce worker mobility. Actually, a new agreement on this subject has just been reached by the provinces. Effective April 1, 2009, a diploma or work permit issued by one province will be recognized by all the others.

Actions aimed at upgrading training and developing skills must also be put forward. Government assistance is necessary to ensure that Québec workers will be able to meet businesses' new requirements. It is imperative to help employees in low-value-added industries, which are being overwhelmed by global competition and the high value of the Canadian dollar, to turn towards more promising sectors. New qualifications may be acquired either in educational institutions or through internships and on-job training.

Furthermore, the labour force could be expanded by encouraging workers to remain active longer. To accomplish this, the government has just introduced some incentives designed to delay the start of retirement. The Supplemental Pension Plans Act and the Act respecting the Québec Pension Plan were amended to that end last June. The provincial government will allow workers aged 55 and over to continue participating in the labour market while receiving their pension benefits, and they will even be able to increase those benefits. In the past, workers were usually better off financially if they took early retirement, rather than continuing to work. Québec is the first province to pass legislation promoting gradual retirement. This will help overcome the demographic challenge and alleviate its repercussions on the labour market.

It is to be hoped that these measures will help span the gap between the labour force participation rate among those aged 55 and over in Québec (29.3%) and in Canada as a whole (33.3%). Québec would benefit, not only from an expanded labour pool, but also from the experience of these older individuals who are often more productive than other workers. This would also create a situation that would be conducive to the sharing of expertise from one generation of workers to another, to the benefit of businesses.

Finally, the government could even delay the normal retirement age, which would be consistent with the longer life expectancy observed in recent years. Average life expectancy was 75 years of age at the beginning of the 1980s, whereas it is now 81. Indeed, many OECD member countries are raising their normal retirement age, and the transition is being implemented over a long period of time. The United States and Germany

will gradually raise the retirement age from 65 to 67 over the next 20-odd years. Incidentally, if the average retirement age were delayed by two years, this would have a considerable impact on the pool of available workers.

Furthermore, the tax regime could be changed to induce more people to join the labour force. Workers would benefit from lower income taxes, which could be compensated by a general increase in consumption taxes. The effect on tax revenues would be neutral, and this approach would encourage more people to work.

In conclusion, many initiatives could help expand the labour pool in Québec. Better integration in the labour market, increased training of employees, and incentives to delay retirement and, ultimately, raise the official retirement age by a few years would increase labour force participation. This would help offset demographic trends to some extent. What is certain is that the demographic shock will require businesses to make major efforts to adapt. Fewer available workers and a slow-growth domestic market will make the challenge of remaining competitive even more daunting.

Demographic trends will have broader impacts than those analyzed for the labour market. To avoid a marked weakening in real GDP growth, productivity gains will have to intensify in the years to come. That represents another challenge that the Québec economy will have to tackle in a situation where economic growth will be less and less supported by demographic factors.

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¹ According to the Institut de la statistique du Québec, the baby-boom generation is generally defined as the cohorts born between 1946 and 1966.

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