

# Family Decisionmaking and Labour Force Participation

Shelly Lundberg  
University of Washington

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**A nation's principal source of wealth is the skill and energy of its people.**

# Labor force participation in New Zealand vs. OECD median and OECD top 5 (Bryant, Jacobsen, Bell, and Garrett, 2004)

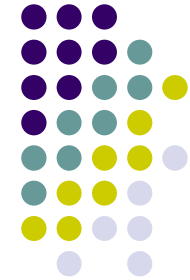
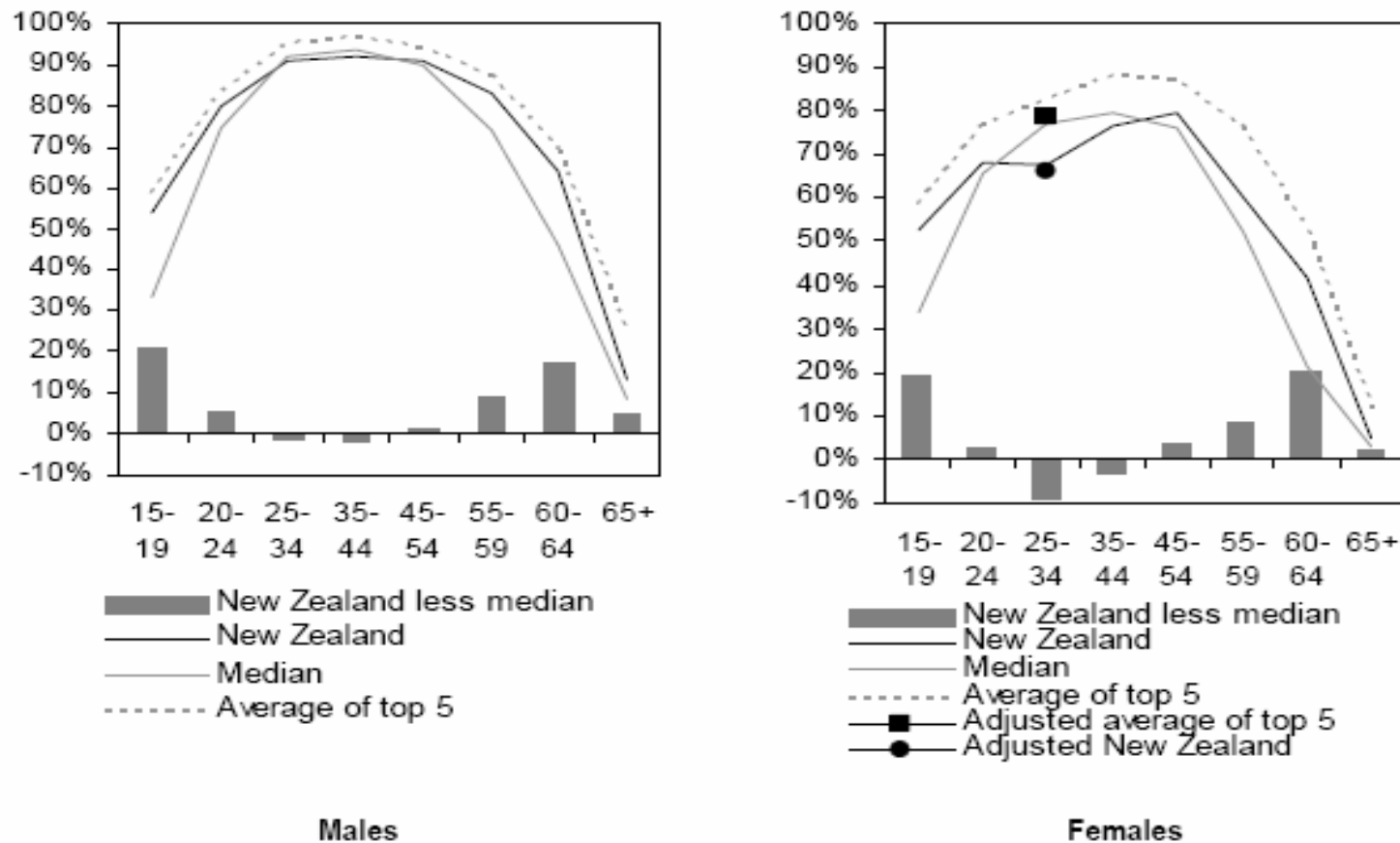


Figure 2 – Labour force participation rates, 2001



Source – Calculated from data in the OECD *Labour Market Data* online database.

# Labour force participation decisions for 3 key groups have a distinct family dimension:



- Youth (age 15-19)
- Young women (25-34)
- “Mature” men and women (55-64)

# Employment rates as a policy issue:



- European Union: Lisbon Strategy for economic reform includes ambitious employment goals for 2010
  - 70% overall, 60% women, 50% older adults

# EU Reform Goal--To create a dynamic and efficient economy.



- Concerns:
  - high rates of unemployment, especially for the young
  - aging population—low fertility rates, pressure on social welfare systems
- Recommendations to member states:
  - “...develop policies to increase labour market participation and entrepreneurship of women, young people, ethnic minorities, immigrants, and of those people at a disadvantage...and ...measures to reconcile work and family life.”

# New Zealand—somewhat different concerns:



- Unemployment relatively low.
- Fertility rate close to 2.
- Desire to restore GDP to or above OECD average—promote income growth
- Keep employment rates for most groups high; encourage more market work for young women?



## Related policy issues:

- Youth—school-to-work transition
  - job quality, human capital development
- Young women—moms (and dads) and jobs?
  - child wellbeing, gender equity
- Older adults—retirement timing
  - “active aging”
- Inequality
  - barriers to employment for the disadvantaged
  - poverty, intergenerational persistence



# The Economics of Labour Force Participation



- A simple static model
- A dynamic, life-cycle model
- Joint decision-making in families
- Equilibrium considerations: economic, political, and social

# A Simple Static Model of Labour Force Participation



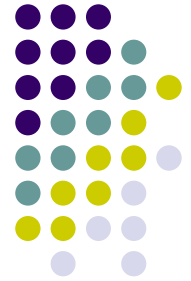
- Join the paid labour force when the marginal return to the first hour in a market job  $>$  marginal return to the best alternative use of that hour
- Complications that don't cause problems:
  - restrictions on work hours
  - non-pecuniary returns to work
  - job search

**Important note: Participation decisions are made by people with something else to do with their time.**



When young mothers enter paid employment, much of the work they were doing at home is replaced by market substitutes—the “marketization” of home production.

# Hours worked per adult are lower in Europe than in the U.S.



- Time-use studies show that total work hours (home and market) are about the same (Freeman & Schettkat, 2005; Schettkat, 2003)
- Europeans (esp. women) spend more time in food prep., care of children and elderly, and cleaning
- U.S. has “marketized” the production of household goods and services more than Europe.

# National income accounting:



- Standard national accounts are a flawed and incomplete measure of welfare
  - do not include value of home production
- Part of the increase in GDP that results from increased employment of young mothers is illusory.
  - Welfare effects < measured effect on GDP



# What do we lose?

- Home childcare and eldercare
  - quality issues, economies of scale
- Other household production
  - the Big Mac effect
- Community externalities
  - volunteering, neighborhood effects

# Policy levers in the static model— increase LFP by increasing the net return to market work:



- Increase value of market work
- Reduce prices of market substitutes for home production
- Remove bureaucratic, legal barriers to work-family juggling

# Labour Force Participation Over the Life-Cycle



- Working now has implications for future opportunities—employment, stable employment, attachment to a particular employer yield higher wages later.
- Retirement to some extent irrevocable—termination of career job
- Women who stay home with children can expect wage losses when they return to work





# The “Family Gap”

- Women with children have lower wages than women without children
- Difference cannot be explained with observable human capital variables—including detailed measures of work experience (Waldfogel, Joshi)



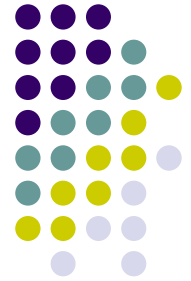
- Some evidence that severing ties to pre-birth employer (Waldfogel), substantial period out of the labour force (Lundberg & Rose) are important sources of the family gap
- Wage gaps are highest for women in middle skill levels—inflexible working conditions? (Anderson, Binder, Krause)
- Parental leave reduces family gap by allowing women to maintain ties to employer

# Incentive effects of parental leave:



- Reduce market work by mothers of very young children
- Long-term: Increase value of employment
  - analogous to Mortensen result about UI
- Employer-provided: Increase returns to acquiring a “good” job

# Policy levers in life-cycle model:



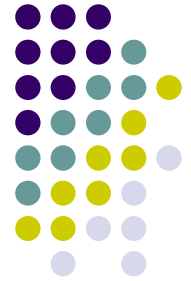
- Facilitate receipt of future returns to labour force participation
- An historical example:
  - Access to fertility control (the pill) increased women's labour force participation in the U.S. after 1970 (Bailey), as well as higher education and career entry (Goldin & Katz)

# Family



- For many, labour force participation is part of joint decisions about specialization and exchange in a long-term relationship with a spouse/partner
- Policy effects will depend on, and potentially change, within-family economic arrangements

# Traditional gender specialization depends on the existence of a long-term contract



- Specialization in home production limits outside options
- Couples have limited ability to enter into binding intertemporal contracts

# Without lifetime marriage, home partner is at a strategic disadvantage



- If relationship ends, and even if it does not
- Incentive to engage in strategic investments prior to union
  - education (Konrad & Lommerud)
  - household production skills (Vaage)

# Does individual control over income/resources affect intrahousehold allocation?



- Substantial evidence from developing countries that resources controlled by women increase wellbeing of women and children
- Weaker evidence from wealthy countries
  - difficult to find measures of individual bargaining power that are exogenous

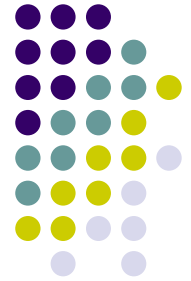


# Does empowering women increase their market participation?



- Contradictory evidence for U.S.
  - Chiappori, Fortin, & LaCroix
  - Gray
- But marital uncertainty does

# Retirement in a family context



- Strong evidence that married couples tend to retire together
- Motives?
  - complementary leisure
  - Gustman & Steinmeier suggest a strategic element
- Aging couples may have divergent interests regarding labour supply, consumption

# Does retirement reduce individual bargaining power?



- Discrete drop in potential earnings
- Source of the retirement consumption puzzle? (Lundberg, Startz, & Stillman, 2003)
- Contrary evidence for New Zealand (Gibson, Le, & Scobie, 2004)
  - importance of policy



# Is family behavior efficient?

- Requires ability to make binding contracts and complete information
- U.S. Retirement Equity Act of 1984
- Response suggests non-unitary households and inefficiency

# Equilibrium considerations for policies that affect labour force participation



- Micro-estimates of labour supply responses to net wages, childcare prices, may not be reliable guides to policy responses
- Heckman and others: education subsidies will change wage structure
- Labour supply changes will lead to new labour market equilibrium



## Other market responses:

- Price and availability of market substitutes for household goods and services
- Residential, leisure options for the retired

# Political responses—labour market changes create new constituencies for:



- Immigration
- Taxation
- Parental leave
- Pensions

# Social externalities: What other people are doing matters



- Rapid decline in U.S. modal retirement age from 65 to 62
  - Axtell and Epstein (2001)
  - Jenkins and Osberg (2004)
- TV and labour supply (Corneo, 2001)
- Decline in marriage/fertility rates in Spain, Italy, Japan (Sevilla-Sanz, 2004)



# Family structure is endogenous



- Most studies estimate labour supply responses of individuals within a particular household arrangement
- Partnering, as well as fertility, will respond to changes in labour force participation
- Marriage tends to be increasing in men's economic opportunities, decreasing in women's



# Akerlof, Yellen, and Katz

- Increases in contraception, abortion availability in 1970s in U.S. reduced “shotgun” marriages
- Changing beliefs about preferences, resources of pregnant partners who chose to bear children
- Change in equilibrium family structure

# Classic economic policy dilemma:



- If women become more able to support themselves and their children, more of them will end up doing it, *ceteris paribus*
- Predicting changes in distribution of outcomes requires more than a partial equilibrium approach



## Bottom line:

- Any policy designed to affect labour force participation will have:
  - secondary effects on household composition
  - life-cycle impacts on fertility and the human capital acquisition of the affected and subsequent generations
- Any direct impacts on growth will be dominated by the indirect effects

**“Because there is an upper bound on the level of labour utilisation, in the long-term it will be growth in labour productivity that will ultimately determine New Zealand’s future real income and its ability to climb back up the international ladder.”**



John Whitehead  
Secretary to the Treasury

***New Zealand’s Economic Growth:  
A Near and A Far View***

Paper presented to the New Zealand Association of  
Economists’ Annual Conference  
30 June 2004

