

Ageing Workforce, Productivity and Labour costs of Belgian Firms

V. Vandenberghe and F. Waltenberg

Discussion Paper 2010-3

Institut de Recherches Économiques et Sociales
de l'Université catholique de Louvain



Ageing Workforce, Productivity and Labour costs of Belgian Firms *

V. Vandenberghe^{**} and F. Waltenberg^{***}

Abstract

The Belgian population is ageing due to demographic changes, so does the workforce of firms active in the country. Such a trend is likely to remain for the foreseeable future. And it will be reinforced by the willingness of public authorities to expand employment among individuals aged 50 or more. But are employers willing to employ older workers? The answer depends to a large extent on the ratio between older workers' productivity and their cost to employers. To address this question we tap into a unique firm-level panel data set to produce robust evidence on the causal effect of ageing on productivity and labour costs. Unobserved firm fixed-effects and short-term endogeneity of workforce age pose serious estimation challenges, which we try to cope with. Our results indicate a negative productivity differential for older workers ranging from 20 to 40% when compared with prime-age workers, and these productivity differentials are not compensated by lower relative labour costs. Furthermore, the (now dominant) service sector does not seem to offer working conditions that mitigate the negative age/productivity relationship. Finally, older workers in smaller firms (<100 workers) display a larger productivity differential and a productivity that is less aligned on labour costs.

JEL Classification: J24, C52, D24

Keywords: Ageing, Labour Productivity, Panel Data Analysis.

* Funding for this research was provided by the Belgian Federal Government - SPP Politique scientifique, programme "Société et Avenir", The Consequences of an Ageing Workforce on the Productivity of the Belgian Economy, research contract TA/10/031A. We would like to thank Andreas Ariu and Daniel Borowczyk Martins for their helpful comments and suggestions on previous versions of this paper.

** Corresponding author. Economics Department, IRES, Economics School of Louvain (ESL), Université catholique de Louvain (UCL), 3 place Montesquieu, B-1348 Belgium email : vincent.vandenberghe@uclouvain.be.

*** Economics School of Louvain (ESL), Université catholique de Louvain (UCL); Departamento de Economia and Centro de Estudos sobre Desigualdade e Desenvolvimento (CEDE), Universidade Federal Fluminense (UFF), Brazil. E-mail: waltenberg@iets.org.br.

1. Introduction

The Belgian population is ageing due to demographic changes¹, so does the workforce of firms active in the country. Between 1998 and 2006, the average age of workers rose by almost 3 years: from 36.2 to 39.1 (Table 1). Such a trend is likely to remain for the foreseeable future. In the coming years, in order to comply with EU recommendations² and to alleviate the rising cost of old-age public pension schemes, the Belgian authorities will certainly try to expand employment among individuals beyond 50 years-old³, reinforcing the demographic trends. But ageing and policies aimed at maintaining older individuals in employment raise crucial issues that have received too little attention so far. Many existing studies look at the consequence of *ageing population* in terms of higher dependency rates and rising social security costs (Gruber and Wise, 2004). Another strain of the literature on ageing examines the retirement behaviour of older individuals (Mitchell & Fields, 1983) meaning that it primarily covers the supply side of the old-age labour market. But the consequences of *an ageing workforce* from the point of view of firms, forming the demand side of the labour market, have largely been overlooked. This empirical paper intends to fill that void using a unique set of Belgian firm-level data and state-of-the-art econometrics.

It examines two key issues. The first one is the effect of the ageing workforce on the productivity performance of firms, and, by extension, of the whole economy. The second one is whether employers are willing to employ older workers. We argue that the answer to this second question largely depends on the relationship between older workers' productivity and what they cost to employ. And we posit that a sizeable negative productivity- vs. labour costs gap is likely to adversely affect the labour demand for older workers.

Turning to the general economic literature, a natural starting point to discuss the consequence of an ageing workforce is human capital theory. Within that approach, there are conflicting predictions regarding the evolution of productivity with age.⁴ On the one hand, one would expect productivity to go down with age, due to: *i*) a natural or biological decline in physical and mental capacities, *ii*)

¹ Between 1999 and 2009, the share of individuals aged 50-65 in the total population aged 15-65 rose from 25.2% to 28.8% (<http://statbel.fgov.be>).

² The Lisbon Agenda suggested raising employment of individuals aged 55-64 to at least 50% by 2010.

³ See Annex 1 for 2008 statistics about the employment rate of older workers in Belgium and in the EU.

⁴ Of course, at some point in a person's life his/her potential productivity should tend to go down because of increasingly severe health problems, until reaching the limiting case of no productivity at all. Having said that, it is relevant to understand from what moment in the career the productivity actually goes down and how fast it progresses.

depreciation or obsolescence of the human capital stock, *iii*) declining investments in on-the-job training after a given worker's age, due to the limited horizon for returns to come about. On the other hand, one would also predict a productivity increase or stabilization with age, due to: *i*) benefits accruing from a worker's experience or learning-by-doing effects *à la* Becker or Arrow⁵; *ii*) the possibility that workers/employers devise mitigating strategies when they observe signs of physical or mental decline (Volkoff *et al.*, 2000).⁶

Regarding the relative level of productivity and labour costs, while human capital theory would predict wages to generally follow the trend in the productivity curve, alternative approaches do not endorse such prediction, assuming that wage structures are designed, not to compensate productivity in the short run, but rather to magnify incentives to effort, such as in efficiency-wage models (Shapiro & Stiglitz, 1984) or to permit economies of job-searching costs (Mirrlees, 1997), or in deferred-compensation-schemes arguments (Lazear, 1979). Although relying on different channels or mechanisms, all these strands of the literature would consider it likely to observe a decoupling of a worker's productivity and his wage along the lifecycle. This said, this literature would still support the idea that, on average over the duration of the employment contract, labour costs should remain in line with productivity.

The existing empirical evidence on *individual productivity*⁷ and ageing, or the one emerging from works investigating *age-related health* problems, do not provide indisputable conclusions as well. In a survey, Lumsdaine & Mitchell (1999), mention, on the one hand, that “there is a psychological literature examining the link between performance on certain clinical tests and age, and it shows that in many manual dexterity areas older people are less able”; on the other hand, the same authors report that other studies claim that “in several other regards older people have superior skills than do their younger peers”. While some studies point to an absence of a strong age effect on productivity, e.g., in academic performance (Smith, 1991), others state that fatal accidents are more

⁵ This assumption is supported by numerous Mincerian wage equations in which the coefficient of the experience term is positive. It is also by anecdotal evidence, like that of the Horndal steel-plant in central Sweden (Malmberg, Lindh & Halvarsson, 2005). Between 1920 and 1950 this plant experienced strong productivity gains of 2.5 percent per year, in spite of a very aged workforce and the fact that no major investments were undertaken. In 1930, a third of the workers were older than 50; in 1950 these represented more than half of the total. The Horndal experience thus suggests that an ageing workforce could be compatible with rapid increases in labour productivity through a learning-by-doing effect.

⁶ In a recent experiment, BMW decided to staff one of its production lines with workers of and an age likely to be typical at the firm in 2017. At first “the pensioners’ assembly line” was less productive. But the firm brought it up to the level of the rest of the factory by introducing 70 relatively small changes, such as new chairs, comfier shoes, magnifying lenses and adjustable tables (The Economist, 2010).

⁷ Meaning that labour productivity is measured directly at the individual level, whereas, in this paper it is evaluated at the level of the firm.

frequent among older workers (Mitchell, 1988). Studying US athletics records by age for men over 35 years-old, Fair (1994) tried to estimate how fast their performance worsens with age, concluding that remarkable performances can be attained at very advanced ages through appropriate training.⁸ Costa (1995) finds that male's labour force participation is much less responsive to body mass index today than it was in the beginning of the 20th century, suggesting that in the long run, health – and thus ageing – becomes less relevant in determining retirement decisions; it might also have become less relevant in determining productivity. Based on the SHARE database, Kalwij & Vermeulen (2008) find that bad health status is correlated with early retirement in most European countries, and particularly so in Belgium. What is not clear, however, is whether the early retirement event is mainly driven by labour supply decisions or by demand side behaviour.

Quite surprisingly, the empirical evidence on the economic consequences of ageing, investigated at the level of the firm and using extensive firm-level data, as we do in this paper, remains limited. As stated above, labour supply has been more often studied, be it in Belgium⁹ or elsewhere. Employer-side models of *demand* for older workers, however, have lagged behind the supply-side developments (Lumsdaine & Mitchell, 1999). In particular there is a lack of systematic evaluation of the relationship between age, productivity, and labour costs.

There are some noteworthy exceptions. According to Malmberg, Lindh, & Halvarsson (2006), an accumulation of high shares of older adults in Swedish manufacturing plants does not seem to have a negative effect on plant level productivity. But that article does not examine the relationship between age and labour costs (or wages). Gründ & Westergård-Nielsen (2008) also focus exclusively on firm productivity. They find that both mean age (and age dispersion) in Danish firms are inversely u-shaped related to firm productivity.

One of the first contributions to focus on productivity and wages/labour costs simultaneously was the paper of Hellerstein *et al.* (1999). They estimated productivity and wages of different types of workers in American firms – including different age groups – finding that both wages and productivity tend to grow with age. Aubert & Crépon (2003), in turn, observed that the productivity of French workers rise with age until around the age of 40, before stabilizing, a path which is very similar to those of wages. But a negative productivity-wage gap is observed for

⁸ It is of course questionable whether such results would apply to an average worker, who does not need to be constantly performing at maximal levels, and whether they would extend to primarily intellectual tasks.

⁹ See Sneessens & Van der Linden (2005) or de la Croix & Pestieau (2007) for recent examples (written to non-economic readers, though).

workers aged more than 55. Using data for Canadian plants, Dostie (2006) obtained inverted u-shape age-productivity profiles. Significant negative productivity-wage gap occurs only with one particular type of worker, namely, males aged 55 and more, which have at least an undergraduate degree.

Our Belgian data also allow for simultaneous estimation of age/productivity and age/labour costs equations.¹⁰ This permits comparing labour costs and productivity of different categories of workers (older, prime-age and younger), and drawing conclusions about relative labour demand of firms towards these types of workers. Our measure of firms' productivity (*i.e.*; the valued added) enhances comparability of data across industries, which vary in their degree of vertical integration (Hellerstein *et al.*, 1999). Moreover, given the availability firm identifiers, we do not need to assign workers to firms using statistical matching methods like in Hellerstein *et al.* (1999). We have information on firms' capital stock, which is not the case in some of the previous contributions in the literature (e.g. Dostie, 2006). We know with great accuracy how much firms spend on their employees. Some studies use individual information on gross wages, whereas we use firm-level information on gross wages *plus* social security contributions and other related costs. Moreover our data contain information on firms from the large and expanding service sector¹¹, where administrative and intellectual work is predominant.¹² Finally, it is worth stressing that our panel comprise a sizeable number of firms (8000+) and is relatively long, covering a period running from 1998 to 2006.

In this paper we test for the presence of productivity- vs. labour cost gap for older workers (50-65) employing a methodological approach pioneered by Hellerstein and Neumark (1995). This presents two main advantages. First, it provides a direct measure of productivity *differences* across age groups that can be immediately compared to a measure of labour cost differences, thereby identifying productivity- vs. labour cost *gaps*.¹³ Second, it measures, and tests for the presence of, a

¹⁰ The raw firm-level data are retrieved from Belfirst. They are matched with data from Belgian's Social Security register containing detailed information about the characteristics of the employees in those firms, namely their age.

¹¹ According the most recent statistics of the Belgian National Bank (<http://www.nbb.be/belgostat>), at the end of 2008 services (total employment – agriculture, industry and construction) accounted for 78% of total employment, which is four percentage points more than 10 years before. Similar figures and trends characterize other EU and OECD countries.

¹² Many observers would probably posit that age matters less for productivity in a service-based economy than in one where agriculture or industry dominate.

¹³ As to the terminology used in the paper, the reader should bear in mind that the term “differential” designates the productivity (or labour costs) differences between the considered age group and the reference (*i.e.* prime-age 30-49 workers); whereas the term “gap” refers to the difference between the productivity and the labour costs differentials characterizing an age-group.

concept of market-wide productivity- vs. labour cost gap than can impact on the overall labour demand for the category of workers considered. Extensions of the basic methodology include enlarging the scope of workers characteristics, such as gender, race and marital status, e.g. Hellerstein & Neumark (1995), Hellerstein *et al.* (1999), Borowczyk Martins & Vandenberghe (2010), and the consideration of richer data sets regarding employees, e.g. Crépon, Deniau & Pérez-Duarte (2002). In this paper, we focus exclusively on age.

From the econometric standpoint, recent developments of HN's methodology have tried to improve the estimation of the production function by the adoption of alternative strategies to deal with potential heterogeneity bias (unobserved time-invariant determinants of firms' productivity) and simultaneity bias (endogeneity in input choice in the short run that includes the age mix of the firm). Aubert and Crépon (2006) control for the heterogeneity bias using a «within» transformation, thereby identifying the gap solely from intrafirm variation, and deal with the simultaneity bias by estimating Arellano and Bond's (1991) GMM (Generalized Method of Moments) estimator. Dostie (2006) alternatively controls for the short-term endogeneity in input choice by applying Levinsohn and Petrin's (2003) intermediate good proxy approach (LP hereafter) and takes into account both firm and workplace heterogeneity in the model of wage determination (more on this in Section 2).

We follow these most recent applications of HN's methodology, in particular the LP strategy using the good-quality information we have on firms' intermediate good consumption (more on this in Section 2). But we also innovate, as with combine the LP intermediate-good approach (that is suited to cope with short-term simultaneity bias) with within-firm analysis to control for unobserved long-term heterogeneity.

Our main results suggest that an increase of 10 percentage points in the share of older workers (>50) in a firm depresses its productivity (i.e added value) by 2 to 4%, depending on the estimation method chosen, with an intermediate results of about 3.2% in our preferred model. Our results indicate a negative (and large) productivity differential for older workers (50-65) of up to 40% when compared with prime-age (30-49) workers. What is more, these productivity differentials are not compensated by lower relative labour costs for employers, creating a sizeable negative productivity- vs. labour cost *gap*. We also examine the situation of young adults (18-29)¹⁴ for whom we find a significant positive productivity- vs. labour costs gap ranging from 8 to 12 percentage points. It is however of much smaller magnitude than the negative gap characterizing older workers,

¹⁴ Prime-age (30-49) workers form the reference group.

and is thus probably insufficient to support older employment via deferred-compensation schemes *à la* Lazear.¹⁵

The rest of the paper is organized as follows. In Section 2, our methodological choices are unfolded, regarding the estimation of both the production function and the labour costs equation. Section 3 is devoted to an exposition of the dataset. Section 4 and 5 contain the results and the conclusions, respectively.

2. Methodology

In order to estimate age-productivity (and similarly age-labour cost profiles), following many authors in this area, we consider a Cobb-Douglas production function (Hellerstein *et al.*, 1999; Aubert & Crépon, 2003; Dostie, 2006):

$$\ln Y_{it} = \alpha \ln L_{it}^A + \beta \ln K_{it} \quad (1)$$

where: Y is the value added by firm i at time t , L^A is an aggregation of different types of workers, and K is the capital stock.

The key variable in this production function is *the quality of labour aggregate* L^A . Let L_{ikt} be the number of workers of type k (young, prime-age, old) in firm i at time t , and μ be their productivity. We assume that workers of various types are substitutable with different marginal product. And each type of worker k is assumed to be an input in the production function. The aggregate can be specified as:

$$L_{it}^A = \sum_k \mu_{ik} L_{ikt} = \mu_{i0} L_{it} + \sum_{k > 0} (\mu_{ik} - \mu_{i0}) L_{ikt} \quad (2)$$

where: L_{it} is the total number of workers in the firm, μ_0 the productivity of the reference category of workers (*e.g.* men). It should be noted that, while Hellerstein *et al.* (1999) originally developed a more general setting in terms of workers' types (race, gender, age...), here those types refer exclusively to different age groups.

If we further assume that a worker has the same marginal product across firms, we can drop subscript i and rewrite equation (2) as:

¹⁵ Assuming that lifetime employment is still relevant for some sectors or firms.

$$\ln L_{it}^A = \ln \mu_0 + \ln L_{it} + \ln (1 + \sum_{k>0} (\lambda_k - 1) P_{ikt}) \quad (3)$$

where $\lambda_k \equiv \mu_k/\mu_0$ is the relative productivity of type k worker and $P_{ik} = L_{ik}/L_{i0}$ the proportion/share of type k workers (e.g. share of young adults or older workers) over the total number of workers in firm i .

Since $\ln(1+x) \approx x$, we can approximate (3) by:

$$\ln L_{it}^A = \ln \mu_0 + \ln L_{it} + \sum_{k>0} (\lambda_k - 1) P_{ikt} \quad (4)$$

And the production function becomes:

$$\ln Y_{it} = \alpha [\ln \mu_0 + \ln L_{it} + \sum_{k>0} (\lambda_k - 1) P_{ikt}] + \beta \ln K_{it} \quad (5)$$

Or, equivalently, if $k=0, 1, \dots, N$ with $k=0$ being the reference group (e.g. prime-age workers)

$$y_{it} = A + \alpha l_{it} + \eta_1 P_{i1t} + \dots \eta_N P_{iNt} + \beta k_{it} \quad (6)$$

where:

$$\begin{aligned} A &= \alpha \log \lambda_0 \\ \lambda_k &= \mu_k/\mu_0 \quad k=1 \dots N \\ \eta_1 &= \alpha (\lambda_1 - 1) \\ &\dots \\ \eta_N &= \alpha (\lambda_N - 1) \\ y_{it} &= \ln Y_{it} \\ l_{it} &= \ln L_{it} \\ k_{it} &= \ln K_{it} \end{aligned}$$

Note first that (6) being loglinear in P the coefficients can be directly interpreted as the percentage change in productivity of a 1 unit (here 100%) change of the considered type of workers' share among the employees of the firm. Note also that, strictly speaking, in order to obtain a type's relative productivity, (i.e. λ_k), coefficients η_k have to be divided by α , and 1 needs to be added to the result.

In order to test the null hypothesis of no productivity- vs. labour costs gap we still need to define a labour costs/wage equation to obtain an estimate of the older workers' labour cost differential. Under the identifying assumptions of spot labour markets and cost-minimizing firms, young, prime-

age or older workers should be paid according to their marginal product. Let the total labour costs of a firm (LC) be decomposed in two components: labour costs with prime-age workers ($k=0$) and labour costs with young/older workers ($k>0$). By assumption, firms operate in the same labour market. So they pay the same wages to the same category of workers (we can thus drop subscript i), which in our framework is the only feature that differentiates workers. Let π_k stand for the remuneration of type k workers. Then:

$$LC_{it} = \sum_k \pi_k L_{ikt} = \pi_0 L_{it} + \sum_{k>0} (\pi_k - \pi_0) L_{ikt} \quad (7)$$

Taking the log and using again $\log(1+x) \approx x$, we can approximate this by:

$$\ln LC_{it} = \ln \pi_0 + \ln L_{it} + \sum_{k>0} (\Phi_k - 1) P_{ikt} \quad (8)$$

where the Greek letter $\Phi_k \equiv \pi_k / \pi_0$ denotes the yearly labour costs differential between old/young ($k>0$) and prime-age ($k=0$), hereafter referred to as the labour cost differential, and $P_{ik} = L_{ik} / L_{i0}$ is the proportion/share of type k workers over the total number of workers in firm i .

The labour costs/wage model finally becomes:

$$w_{it} = B + \rho_1 P_{i1t} + \dots + \rho_N P_{iNt} \quad (9)$$

where:

$$\begin{aligned} B &= \ln \pi_0 \\ \Phi_k &\equiv \pi_k / \pi_0 \quad k=1, \dots, N \\ \rho_1 &= \Phi_1 - 1 \\ &\dots \\ \rho_N &= \Phi_N - 1 \\ w_{it} &= \ln LC_{it} - \ln L_{it} \end{aligned}$$

Note in particular that the dependent variable corresponds to the average labour cost per worker. By estimating equation (9) we can directly obtain an estimate of the labour cost differential by adding 1 to estimated ρ_k :

The productivity- vs labour cost gap hypothesis test can now be easily formulated. Assuming spot labour markets and cost-minimizing firms the null hypothesis of no gap for type k worker implies $\lambda_k = \Phi_k$. Moreover, the gap between the productivity differential and the wage differential provides a

quantitative measure of the disincentive to employ the category of workers considered.¹⁶ As it will be made clear in Section 5, this is a test we can easily implement in our econometric specifications of the production function and the labour costs equation.

We now consider the econometric version of our linearised Cobb-Douglas model (10). Note first that we have added a matrix F_{it} , wherein we concentrate region¹⁷, year, sector¹⁸ and interaction of year and sector dummies. The extension of the production function by introducing F_{it} , allows for systematic and proportional productivity variation among firms along these dimensions. This assumption can be seen to expand the model by controlling for year- and sector- specific productivity shocks, labour quality and intensity of efficiency wages differentials across sectors and other sources of systematic productivity differentials (HN, 1995). More importantly, since the data set we used did not contain sector price deflators, the introduction of these sets of dummies can control for asymmetric variation in the price of firms' outputs at sector. An extension along the same dimensions is made with respect to the labour costs equation.

We recall that the labour costs equation is definitional: under the assumption of cost-minimizing firms that operate in the same competitive labour market, all workers in the same demographic categories earn the same wage. By introducing year, region and sector controls we consider the possibility that firms operate in year-, region- and sector-specific labour markets¹⁹ and, therefore, allow for wage variation along these dimensions. Of course, the assumption of segmented labour markets, implemented by adding linearly to the labour costs equation the set of dummies, is valid as long there is proportional variation in wages by age group along those dimensions (HN, 1995).

But from an econometric point of view, the main challenge consists of dealing with the various constituents of the residual ε_{it} of the production function (10). First, the *unobservable* (time-invariant) *heterogeneity* across firms, θ_i .

$$y_{it} = A + \alpha l_{it} + \eta_1 P_{i1t} + \dots \eta_N P_{iNt} + \beta k_{it} + \gamma F_{it} + \varepsilon_{it} \quad (10)$$

where $\varepsilon_{it} = \theta_i + \omega_{it} + \sigma_{it}$

where: $cov(\theta_i, P_{i1,t}) \neq 0$ and/or $cov(\theta_i, P_{i2,t}) \neq 0$, $cov(\omega_{it}, P_{i1,t}) \neq 0$ and/or $cov(\omega_{it}, P_{i2,t}) \neq 0$, $E(\sigma_{it})=0$

¹⁶ We assume for presentational simplicity that older workers are less productive than prime-age one, so that the productivity differential is below 1.

¹⁷ NUTS1 Belgian regions : Wallonia, Flanders and Brussels.

¹⁸ NACE 1 level.

¹⁹ It is probably the sector dimension that is the most relevant in the case of Belgium.

The latter corresponds to specific characteristics of the firm, which are unobservable but driving the productivity. For example the age of the plant, the vintage of capital used, firm-specific managerial skills, location-driven comparative advantage²⁰.... What is more these might be correlated with the age-structure of its workforce. Older worker for instance might be overrepresented among plants built a long time ago using older technology. The panel structure of our data allows us to use fixed-effect (or within) methods, attenuating that problem in many of the specifications.

Second, the greatest econometric challenge, however, is to go around *simultaneity or endogeneity bias* (Griliches & Mairesse, 1995). The economics underlying that concern is intuitive. In the short run firms could be confronted to productivity shocks, ω_{it} (10); say, a positive shock due to a turnover, itself the consequence of a missed sales opportunity). Contrary to the econometrician, firms may know about this and respond by expanding recruitment of temporary- or part-time staff. Since the latter is predominantly young, we should expect that the share of older worker to decrease in periods of positive productivity shocks and increase in periods of negative shocks. This would generate negative correlation between the share of older workers in the labour force and the productivity of firms, thereby leading to overestimated OLS estimates of the age productivity differential.

Instrumenting the age by lagged values is a strategy regularly used in the production function literature (Arellano & Bond, 1991) to cope with this short-term simultaneity bias. Nevertheless, it has some limits, among which concerns about the quality of lagged values as instruments, and the large standard errors usually found, which make it difficult to draw solid conclusions.²¹ A development of that procedure, which has been proposed by Blundell & Bond (2000), is a system-GMM, in which the endogenous variables are instrumented with variables considered to be uncorrelated with the fixed effects and estimated by GMM. Still in this case, there are at least two types of problems: *i*) the estimated results are typically extremely sensitive to a great number of methodological choices (e.g., the number of lags for each variable), and, *ii*) instruments are often weakly identified, casting doubts on the quality of the estimations.

An alternative that seems to be particularly promising and relevant given the content of our data it to adopt the approach suggested by Levinsohn & Petrin (2003) and used, for example, by Dostie (2006). Their idea is that firms primarily respond to productivity shocks ω_{it} by adapting the volume

²⁰ Motorway/airport in the vicinity of logistic firms for instance.

²¹ These limits have been acknowledged by Aubert & Crépon (2003), who applied such strategy to French data, and are also mentioned by Dostie (2006) or Roodman (2007).

of their *intermediate inputs*. Whenever such kind of information is available in a data set — which happens to be the case with ours — they can be used to proxy productivity shocks. An advantage with respect to the system-GMM method mentioned above is that this method based on intermediate inputs does not carry the burden of relying on instruments that lack a clear-cut economic meaning and which are, as mentioned above, typically weak.²² Moreover, by using the LP method, the number of discretionary methodological choices that have to be made by the researchers is reduced, contributing to providing results which are easier to understand and to compare with others in the literature.²³

Formally, the demand for intermediate inputs would be a function of productivity shocks as well as the level of capital:

$$int_{it} = I(\omega_{it}, k_{it}) \quad (11)$$

Assuming this function is monotonic in ω and k , it can be inverted to deliver an expression of ω_{it} as a function of int and k . Expression (10) thus becomes:

$$y_{it} = A + \alpha l_{it} + \eta_1 P_{i1t} + \dots \eta_N P_{iNt} + \beta k_{it} + \gamma F_{it} + \theta_i + \omega_{it}(int_{it}) + \varepsilon_{it} \quad (12)$$

with: $\omega_{it}(int_{it})$ that can be approximated by a polynomial expansion in int .

While the latter technique is our preferred one, we have decided to report results of different econometric techniques, because of the well-known challenges and controversies involved in the estimation of any production function (Griliches & Mairesse, 1995).

3. Data

We are in possession of a panel of around 9,000 firms with more than 20 employees, largely documented in terms of sector, location, size, capital used, wage levels, productivity and profits. These observations come from the Belfirst database. Via the so-called Carrefour data warehouse, using firm identifiers, we have been able to inject information on the age of (all) workers employed by these firms, and this for a period running from 1998 to 2006, which is a long panel as compared

²² That is instruments that are only weakly correlated with the included endogenous variables.

²³ For example, employing the Arellano-Bond method, Aubert & Crépon (2003) have used a different number of lags for labour (2 lags) and other variables (all lags). Although they chose to reduce the number of lags for labour in order not to inflate too much the orthogonality conditions, it is not clear what procedure has been used to set those lags on the specific values they have chosen. We do not know whether their main results would be robust to different lag choices.

to what is usually found in the literature.

One great advantage of our Belgian data is that they contain information on firms from the (now dominant) service sector, where administrative and intellectual work is predominant. Just as in Aubert & Crépon (2003) and Dostie (2006), we have a measure of firms' productivity (the net valued added), which is measured independently from firms' labour costs. Moreover, since our two databases are linked through firm identifiers, we do not need to assign workers to firms using statistical matching methods like in Hellerstein *et al.* (1999). Finally, contrary to Dostie (2006), we do have a measure of firms' capital stock, such that no imputation method is required. The intermediate inputs to which we assign a great role in this paper correspond to the value of "services and other goods" that firms declare buying on the market to ensure production.

Descriptive statistics are reported in Tables 1 and 2. They suggest that firms based in Belgium have been largely affected by ageing over the period considered. Between 1998 and 2006, the percentage of old workers (50-65) has risen steadily from 12% to 19%. But the proportion of prime-age workers has also risen from 39% to almost 45%. The first consequence of ageing is to increase the proportion of what basic human capital theory would consider as the most productive group: the prime-age workers (30-49).

Table 1: Belfirst-Carrefour panel. Basic descriptive statistics. Mean (Standard deviation in italics).

Year	Nobs	Net value-add (th.€)	Labour costs (th.€)	Number of employees ^a	Capital (th.€)	Mean age	Share of 18-29	Share of 30-49	Share of 50-65	Intermediate input (th. €)
1998	8265	7822	4796	103.09	6402	36.16	0.49	0.39	0.12	27991
		<i>48627</i>	<i>31591</i>	<i>443.06</i>	<i>95642</i>	<i>4.29</i>	<i>0.19</i>	<i>0.15</i>	<i>0.10</i>	<i>158639</i>
1999	8432	8231	5008	110.31	6561	36.44	0.47	0.40	0.13	28466
		<i>52816</i>	<i>31289</i>	<i>555.40</i>	<i>99479</i>	<i>4.24</i>	<i>0.19</i>	<i>0.14</i>	<i>0.10</i>	<i>162346</i>
2000	8625	8835	5286	109.99	6842	36.65	0.46	0.41	0.13	34447
		<i>53436</i>	<i>31382</i>	<i>463.24</i>	<i>107771</i>	<i>4.21</i>	<i>0.18</i>	<i>0.13</i>	<i>0.10</i>	<i>222657</i>
2001	8825	9034	5607	112.46	7424	37.01	0.44	0.42	0.14	35869
		<i>52081</i>	<i>31782</i>	<i>455.26</i>	<i>114725</i>	<i>4.19</i>	<i>0.18</i>	<i>0.13</i>	<i>0.10</i>	<i>256231</i>
2002	8967	9620	6136	118.23	7960	37.39	0.43	0.43	0.15	37472
		<i>57884</i>	<i>37765</i>	<i>677.41</i>	<i>125480</i>	<i>4.16</i>	<i>0.18</i>	<i>0.13</i>	<i>0.11</i>	<i>271372</i>
2003	9053	10126	6324	119.40	8388	37.99	0.41	0.43	0.16	38148
		<i>56938</i>	<i>36648</i>	<i>665.52</i>	<i>133159</i>	<i>4.26</i>	<i>0.18</i>	<i>0.12</i>	<i>0.11</i>	<i>254523</i>
2004	9061	10935	6610	122.21	8725	38.35	0.39	0.44	0.17	42160
		<i>61691</i>	<i>36344</i>	<i>622.20</i>	<i>141718</i>	<i>4.28</i>	<i>0.17</i>	<i>0.12</i>	<i>0.12</i>	<i>296394</i>
2005	9038	11363	6831	122.05	7975	38.73	0.38	0.44	0.18	47585
		<i>62527</i>	<i>36381</i>	<i>589.10</i>	<i>60530</i>	<i>4.24</i>	<i>0.17</i>	<i>0.12</i>	<i>0.12</i>	<i>416106</i>
2006	8954	12234	7214	126.62	8158	39.10	0.36	0.45	0.19	52744
		<i>66647</i>	<i>38292</i>	<i>618.50</i>	<i>59775</i>	<i>4.25</i>	<i>0.17</i>	<i>0.12</i>	<i>0.12</i>	<i>509653</i>

Table 2: Belfirst-Carrefour panel. Basic descriptive statistics

Firm size	Nobs
1-49	44354
50-99	14664
100+	13928
Sector	
Commerce	20199
Industry	36248
Service	22773
Region	
Brussels	10722
Vlaanderen	46008
Wallonia	16216

Figure 1 shows an expected pattern: a positive relation between firms' net value added and their labour costs, with an overwhelming majority of firms reporting lower labour costs than their net value added.²⁴

Figure 1: Firms' labour costs versus firms' net value added

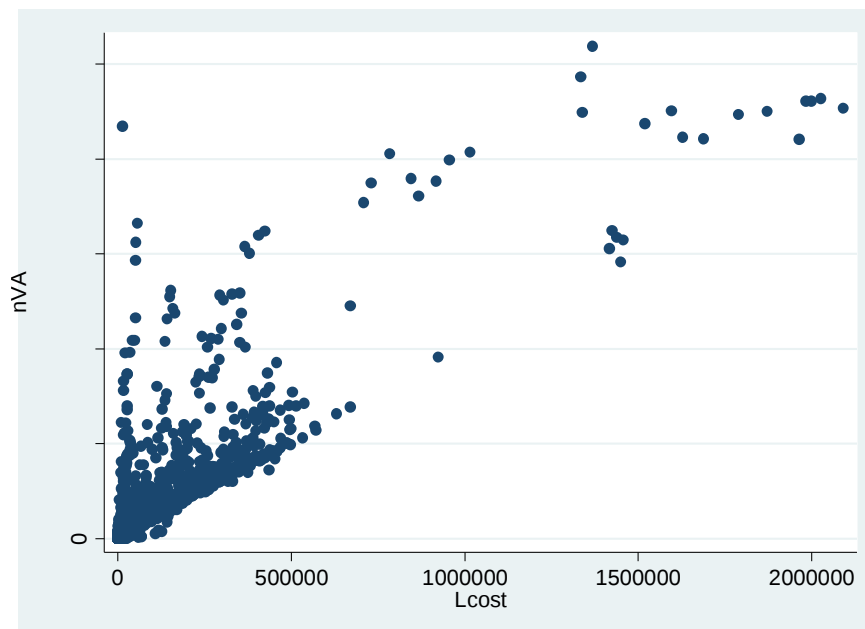


Figure 2 reveals that firms presenting higher net value added per employee tend to have an intermediately aged workforce, whilst firms with either relatively younger or relatively older

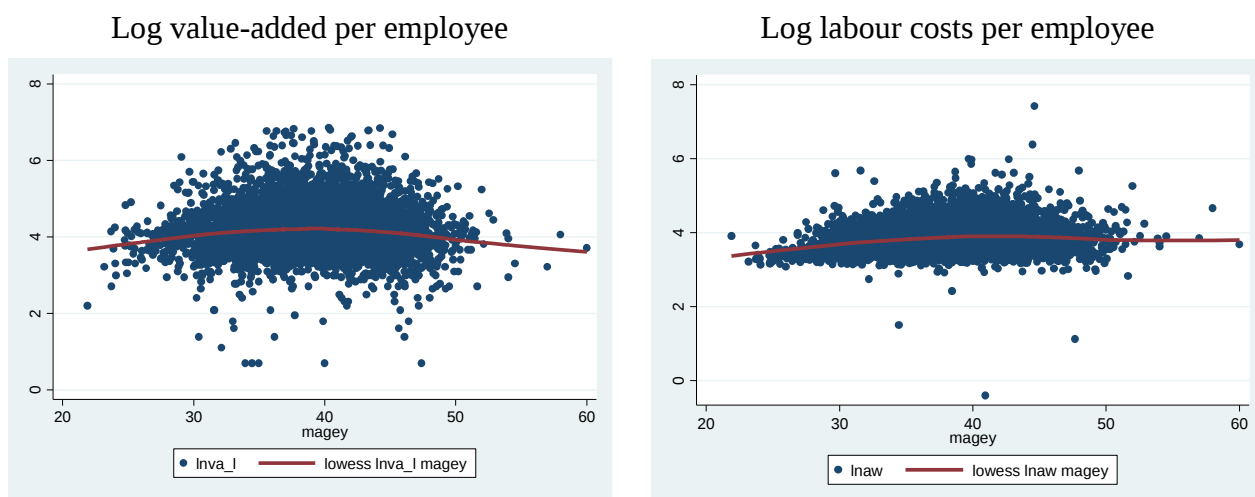
²⁴

One we regress one variable against the other, we find that *net value added* = 1.43 *labour cost*.

workforces have lower product per capita. It should be mentioned that this graph is extremely similar to the analogous one reported by Grund & Westergård-Nielsen (2005) for Danish firms.

Finally, intermediate inputs pay a key role in our analysis, as they are central to our strategy to overcome the simultaneity or endogeneity bias. It is calculated here as the difference between the firm's turnover (in nominal terms) and its net value-added. It reflects the value of goods and services consumed or used up as inputs in production by enterprises, including raw materials, services and various other operating expenses (see last column of Table 1 for descriptive statistics).

Figure 2: Average age of workers (on the horizontal axis) versus firms' i) log of net value added per employee ii) log of labour costs per employee. Year 2006. Scatter plot and non-parametric regression



Source: Carrefour, Belfirst

4. Econometric results

In Table 3 we present results of the independent estimation of production and the labour costs equations under six alternative econometric specifications: standard OLS, using total variation [1], between-firm variation [2] and within-firm variation, centring on firm-average [3], or via first-differencing [4], and the HP estimation procedure using total- [5] and within-firm [6] variation. Further ahead, in Table 4, we will focus on the *simultaneous* estimation of these two functions using our preferred specification [6] and the statistical significance of the gap between age productivity vs. labour costs differentials.

Specification [6] is a priori the best insofar as the coefficients of interest are identified from within-firm variation and that it controls for potential heterogeneity and simultaneity biases using the HP intermediate input proxy strategy. Heterogeneity bias might be present since our sample covers all sectors of the Belgian private economy and the list of controls included in our models is limited. Even if the introduction of the set of dummies (region, sector, year) can account for most of this bias, the «within firm» transformation is still the most powerful way to account of inter-firm unobserved heterogeneity.

On the other hand, the endogeneity in input choice is a largely well documented problem in the production function estimation literature (*e.g.* Griliches and Mairesse, 1995) and also deserved to be properly treated. Moreover, given that our data do not distinguish between temporary and permanent workers and that there is evidence from the Belgian labour market indicating that youth tends to be overrepresented temporary employment, the presence of simultaneity bias may overestimate the OLS estimates of the age productivity differential.

Results on display in Table 3 unambiguously suggest that older worker (50-65) are less productive than prime-age (30-49) ones. While the negative sign of the estimated coefficient is to be found across the range of models estimated, the magnitude varies considerably, highlighting the importance of using a wide range of techniques. These results suggest that an increase of 10 percentage points (say, from 40% to 50%) in the share of older workers in a firm on average depresses its added value by 2 to 4%, depending on the estimation method chosen. Our preferred model [6] proxies short-term endogenous productivity shock with intermediate inputs, and uses firm fixed effects. Its results are that an increase of 10 percentage points in the share of older workers in a firm would depress its added value on average by around 3.2%, a value which incidentally is very close to the average of all estimated coefficients.

Remember that, strictly speaking, the coefficients reported in the upper parts of Table 3 for age group k are equal to $\alpha(\mu_k/\mu_0-1)$. In order to properly reflect their relative productivity in percent the coefficients have to be divided by the estimated coefficient of labour variable α . The outcome of these minor transformations is reported in the lower part of Table 3. It is supportive of the existence of large (negative) productivity gaps for older workers ranging from 29 to 45%.

Table 3 also reveals that younger workers (18-29) are less productive than prime-age workers, but such result is less robust, since the estimated coefficients are not always statistically different from zero. In model [6] the coefficient associated with the share of younger workers is slightly positive,

but not stable enough to be statistically different from zero.

The labour cost estimations are reported in the central part of Table 3. For young workers the magnitude of the coefficients is smaller than those observed for the production equation, implying a positive productivity- vs. labour cost gap (lower part of Table 3). In other words, young adult workers are paid *below* their productivity that we estimate to be in the range of 15 percentage points with model [6]. The situation is completely different for the older workers. The focus on within firm variance (models [3], [5] and [6]) suggest that, unlike productivity, labour costs do not decline with age. Model [6] in particular points at 1 percentage point (non significant) increment of the labour cost. When related to the 45 percentage points productivity differentials mentioned above, this leads to a 47 percentage point productivity- vs. labour cost gap. Simply said, older workers in Belgium seem to be paid well above their productivity.

We have undertaken three further steps in our analysis:

- i) the crucial test of whether, for each age group (bar the reference group), labour cost differentials are statistically different from productivity differentials;
- ii) whether we reach substantially different conclusions, with regards to those coming from the pooled sample results displayed so far, when we partition the sample across three sectors largely defined;
- iii) whether our results change much when we partition the sample in terms of firm size.

For each of these three extensions, the focus will be on the results of the model with intermediate inputs *à-la*-Levinsohn-Petrin with firm fixed effects.

Table 3: Separate estimation of Production Function and Labour Costs Equations

Method:	[1]-OLS	[2]-Between	[3]-Within (firm fixed effects)	[4]-First Differences	[5]-Intermediate inputs (LP ^{\$})	[6]-Within (firm fixed effects+ intermediate inputs LP ^{\$})
Productivity equation						
Share of 18-29 workers	-0.324***	-0.460***	0.009	0.081***	-0.334***	0.022
<i>p-value</i>	0.0000	0.0000	0.5134	0.000	0.0000	0.2043
Share of 50-65 workers	-0.253***	-0.396***	-0.293***	-0.178***	-0.295***	-0.321***
<i>p-value</i>	0.0000	0.0000	0.0000	0.000	0.0000	0.0000
Controls	capital, number of employees + fixed effects: year, NACE1, region	capital, number of employees + fixed effects: year, NACE1, region	capital, number of employees + fixed effects: firm	capital, number of employees	capital, number of employees + fixed effects: firm, year	capital, number of employees + fixed effects: firm, year
Nobs.	76,512	76,512	76,512	66,615	61,975	61,975
Labour cost equation						
Share of 18-29 workers	-0.450***	-0.615***	-0.122***	-0.084***	-0.491***	-0.118***
<i>p-value</i>	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Share of 50-65 workers	-0.191***	-0.381***	-0.012	0.015	-0.202***	-0.0085
<i>p-value</i>	0.0000	0.0000	0.3559	0.4576	0.0000	0.5999
Controls	fixed effects: year, NACE1, region	fixed effects: year, NACE1, region	fixed effects: firm, year	capital, number of employees	fixed effects: year, NACE1, region	fixed effects: firm, year
Nobs.	77,696	77,696	77,696	67,854	61,973	61,973
Productivity vs labour cost differentials						
productivity (λ) 18-29	0.63***	0.50***	1.01	1.17***	0.62***	1.03
Labour cost (Φ) 18-29	0.55***	0.38***	0.88***	0.92***	0.51***	0.88***
Gap ($\lambda-\Phi$) 18-29	0.08	0.11	0.14	0.25	0.11	0.15
productivity (λ) 50-65	0.71***	0.56***	0.57***	0.63***	0.66***	0.55***
Labour cost (Φ) 50-65	0.81***	0.62***	0.99	1.01	0.80***	1.01
Gap ($\lambda-\Phi$) 50-65	-0.10	-0.05	-0.41	-0.38	-0.14	-0.47

*p < 0.05, **p < 0.01, *** p < 0.001 ; ^{\$} Levinsohn and Petrin's

4.1. Testing the significance of the productivity- vs. labour cost gap

So firstly, employing only preferred model [6], we test the hypothesis of equality of labour cost and productivity differentials for older workers (and also younger ones). We now make a final justification for our preferred joint estimations of production and labour cost equations (Table 4). We recall that the focus of our analysis is the implementation of the productivity- vs. labour cost gap test, which involves testing the equality of estimates of productivity (λ) and labour costs (Φ) differentials, obtained from estimations of the production function and the labour costs equation. Options here are essentially twofold.

We first embark in a series of Seemingly Unrelated Regressions (SUR) to estimates the two equations. We recall that the arguments for SUR — what corresponds to *system FGLS* estimation in Wooldridge (2002)’s terminology²⁵ — are essentially two. One is that joint estimation provides a direct way to implement a Wald test of the equality of a non-linear combination of coefficients across equations. If there are unobservables in both equations that bias the estimates of λ and Φ , as long as they affect the two equations equally, which should occur under the null, their effect on the Wald equality test is neutralized. Another is that joint estimation makes use of cross-equation correlations in the errors, thereby increasing the efficiency (i.e. generate smaller standard errors) of the coefficient estimates.

Alternatively, one can perform so-called *system OLS* estimations. This consists of estimating the two equations separately, but to use those estimates to construct a cluster-adjusted²⁶ robust sandwich variance-covariance matrix, which can be used to perform a Wald test of equality of the two coefficients.²⁷

The choice between system OLS and SUR/system FGLS can be viewed as a trade-off between robustness and efficiency. On the one hand, system OLS is more robust (i.e. generate coefficient that are less likely to be biased). It is consistent under the milder assumption of contemporaneous exogeneity, while the consistency of system FGLS is conditional on strict exogeneity of the

²⁵ See chapter 7 of Wooldridge (2002) for a derivation of the properties of system OLS and system FGLS estimators.

²⁶ Here, a cluster is a firm.

²⁷ See Weesie (2000) for a description of the Stata procedure that constructs a cluster-adjusted robust sandwich estimator from two or more sets of independent estimates.

regressors. Moreover, the Wald test computed from system OLS estimation can be made robust to arbitrary heteroskedasticity and serial correlation in the error term, while system FGLS does so under the assumption of system homoskedasticity. In principle, we could construct a cluster-adjusted robust sandwich variance-covariance matrix from the FGLS estimates. However, the STATA command that implements FGLS, *SUREG*, does not permit its computation from standard commands. On the other hand, system FGLS takes advantage of increased efficiency from cross-equation correlations in the errors.

We decided to implement system OLS in addition to the more common SUR/system FGLS (used for instance by HN (1995) and Hellerstein *et al.* (1999) for four reasons. First, because we are using panel data, so that the error term should normally be serially correlated for the same firm, the ability to control for arbitrary heteroskedasticity and serial correlation across time is a strong advantage. Second, the advantage of controlling for potential unobservables is substantially smaller in our case: while HN (1999) and HNT (1999) used cross section data and implemented standard OLS and IV estimators, instead, we use panel data and implement estimation procedures specifically designed to deal with potential biases due to unobservables. Third, the importance of cross-equation correlation in the errors needs to be assessed vis-à-vis the efficiency of the estimates obtained from independent estimations. In our case, the precision of coefficient estimates using system OLS is fairly satisfactory. Fourth and last, the assumption of strict exogeneity is very strong for production function estimation. That said, the efficiency gains associated with system FGLS seem to be high for our data set: the cross-equation correlation of the residuals is high both for the raw and the transformed data, respectively 69%, for total-firm variation, and 56% for within-firm variation, and 60%, for total-firm variation, and 40% for within-firm variation.

The results of joint estimations largely accord with those already visible in Table 3. System FGLS points at a positive gap for young workers of 8 percentage points (*i.e.* young adults are paid below their productivity), whereas it confirms the existence of a sizeable (23 percentage points) negative gap for old workers which are clearly paid above their productivity. Results for system OLS are similar, although they suggest gaps of larger magnitude : + 12 and -42 percentage points for young and old workers respectively.

More importantly, we exploit here one of the features of STATA, namely the possibility to test the equality of estimated coefficients across two equations. We use in particular the possibility for these

tests to be non-linear.²⁸ The rationale for non-linear testing derives from the fact the estimated coefficients for the production function (equ. 6) correspond to $\alpha(\mu_k/\mu_0 - 1)$ and that we are primarily interested in the labour productivity component ($\mu_k/\mu_0 - 1$). Hence, the cross-equations equality test has to be carried out on $\alpha(\mu_k/\mu_0 - 1)$ divided by the estimated total labour coefficient α .

Estimated χ^2 (and corresponding p -values) are reported in the far-right column of Table 4 and they suggest that the equality assumption ($\lambda = \Phi$) can be rejected confidently for both system FGLS and system OLS, meaning in particular that the older workers productivity gap is very unlikely to be compensated by an equivalent labour-cost gap.

Table 4: Joint estimates of productivity and labour costs differentials. Within (firm fixed effects) + intermediate inputs (Levinsohn-Petrin). Cluster-robust estimation of standard-errors.

	Production diff. (λ): ref=30-49	Labour-cost diff (Φ): ref=30-49	Gap ($\lambda - \Phi$)	Wald Hyp. Test ($\lambda = \Phi$)	
				χ^2	Prob> χ^2
System FGLS					
18-29	0.93	0.86	0.08	19.71	0.0000
50-65	0.78	1.01	-0.23	81.73	0.0000
System OLS					
18-<30	0.98	0.86	0.12	9.76	0.0018
50-<65	0.59	1.01	-0.42	46.43	0.0000

4.2. Sectors

Secondly, we have re-estimated both the production function and the labour-cost one, employing only our preferred model again, but now partitioning the sample across three sectors, largely defined, namely: industry, services, and trade.²⁹

The results from simultaneous estimation of the equations are reported in Table 5. For older workers in particular, they do not differ in qualitative terms from those obtained using the pooled sample. Productivity- vs. labour cost gaps in industry range from -15 (system FGLS) to -35 (system OLS) percentage points.

²⁸ Non-linear testing (NLTEST) is a postestimation option of the STATA estimation procedure used here.

²⁹ A detailed definition of these three sectors in terms of NACE 2 categories is to be found in Annex 2.

There is a point worth stressing however concerning the productivity of older workers. The service sector does not seem to translate into a lower gap, on the contrary. For that sector our estimates suggest a gap ranging from -28 to -44 percentage points (lower part of Table 5). This result is at odds with the prediction that ageing would be less of a problem for productivity in a de-industrialized world where the share of the service industry is large and still expanding.

Table 5: Joint estimates of productivity and labour costs differentials. Within (firm fixed effects) + intermediate inputs (Levinsohn-Petrin). Cluster-robust estimation of standard-errors. Partition by sector.

				Wald Hyp. Test ($\lambda=\Phi$)	
	Production diff. (λ): ref=30-<50	Labour-cost diff (Φ): ref=30->50	Gap (λ - Φ)	χ^2	Prob> χ^2
Industry					
System FGLS					
18-29	1.05	1.04	0.01	35.20	0.0000
50-65	0.88	1.03	-0.15	17.91	0.0000
System OLS					
18-29	1.15	0.90	0.24	17.19	0.0000
50-65	0.68	1.03	-0.35	14.01	0.0002
Commerce					
System FGLS					
18-29	0.96	0.87	0.09	5.22	0.0224
50-65	0.70	0.99	-0.29	24.38	0.0000
System OLS					
18-29	1.00	0.87	0.12	2.23	0.1354
50-65	0.53	0.99	-0.46	12.15	0.0005
Service					
System FGLS					
18-29	0.77	0.78	-0.01	0.08	0.7798
50-65	0.74	1.02	-0.28	30.67	0.0000
System OLS					
18-29	0.78	0.78	0.00	0.00	0.9476
50-65	0.58	1.02	-0.44	16.61	0.0000

4.3. Firm size

Thirdly, we have re-estimated our equations simultaneously using model [6], but partitioning the sample according to firm size³⁰ (<50, 50-99 , 100+). Results are reported in Table 6.

Once again, for older workers the results follow closely the pattern we have described so far; with large productivity- vs. labour costs gaps ranging from -16 to -55 percentage points. It is noteworthy that the productivity gap characterising older workers is less important inside larger firms that employ more than 100 workers. Our system OLS estimates suggest a -32 percentage points gap for these firms, whereas is it of -55 percentage points for medium-size ones and -40 percentage points in the case of small firms (Table 6).

³⁰ Defined as the number of employees.

Table 6: Joint estimates of productivity and labour costs differentials. Within (firm fixed effects) + intermediate inputs (Levinsohn-Petrin). Cluster-robust estimation of standard-errors. Partition by firm size.

	Production diff. (λ): ref=30-49	Labour-cost diff (Φ): ref=30-49	Gap ($\lambda-\Phi$)	Wald Hyp. Test ($\lambda=\Phi$)	
				χ^2	Prob> χ^2
Small firms (<50)					
System FGLS					
18-29	0.90	0.91	-0.01	0.76	0.3841
50-65	0.76	1.01	-0.24	57.22	0.0000
System OLS					
18-29	0.91	0.88	0.03	0.57	0.4490
50-65	0.61	1.01	-0.40	34.03	0.0000
Medium-size firms (50-99)					
System FGLS					
18-29	1.07	0.84	0.23	28.79	0.0000
50-65	0.82	1.08	-0.26	16.75	0.0000
System OLS					
18-29	1.22	0.87	0.34	16.74	0.0000
50-65	0.53	1.08	-0.55	12.38	0.0004
Big firms (100 +)					
System FGLS					
18-29	0.99	0.76	0.23	25.06	0.0000
50-65	0.78	0.94	-0.16	5.41	0.0201
System OLS					
18-29	1.08	0.78	0.30	10.88	0.0000
50-65	0.62	0.94	-0.32	3.71	0.0541

5. Conclusions

As a socio-economic phenomenon, population ageing will affect much more than the social security system as it will also affect the age structure of the *workforce*. In particular, the share of older workers (aged 50 plus) will rise significantly due to demographics. And this trend will be reinforced by policies aimed at maintaining more of those older individuals in employment. Optimists may believe that an ageing workforce will have only a minimal impact on firms' performance and labour markets. This paper contains evidence suggesting the opposite. We show that the age structure of firms is a key determinant of their productivity. Rising shares of workers aged 50-65 is likely to translate into lower productivity *ceteris paribus*. An increase of 10 percentage points in the share of older workers (50-65) in a firm located in Belgium depresses its added value by 2 to 4%, depending

on the estimation method chosen, with an intermediate result of 3.2 % in our preferred model.

Our paper also investigates the consequences of an ageing workforce for the labour market. We ask in particular whether firms are a priori willing to employ more older workers. The answer is no, as we find robust evidence of large productivity- vs. labour cost gap³¹ for older workers, ranging for -22 to -42 percentage points. The lower productivity of older workers is not compensated by lower labour costs. We posit that is likely to depress the labour demand for older workers.

This key result is reproduced when we turn to a sector-by-sector analysis, or to one that separate firms according to their size. One important observation however is that the (predominant) service sector does not seem to offer working conditions that mitigate the negative relationship between age and productivity, on the contrary. Another important result is that older workers in smaller firms display a larger productivity differential and their productivity is less aligned onto labour costs, which suggests that small firms are a priori less inclined to employ/recruit them.

We finish by briefly mentioning some limits that should be held in mind when interpreting our results. First of all, we lack further information about the composition of workforce (education skills, previous training etc.). Secondly, only “average firm profiles” are calculated. Thirdly, the worker’s sample might not be representative of the population and there is a risk of a *selection bias*, in particular due to early ejection from workforce of older workers due to their lower (and financially uncompensated) productivity. To the extent that this selection bias is an issue, we could view our estimated coefficients for older workers’ productivity differentials as upper-bounds.³²

References

- Arellano. M. and S. Bond (1991). “Some tests of specification for panel data: Monte Carlo evidence and an application to employment equations”. *Review of Economic Studies*. 58: 277-97
- Aubert. P. and B. Crépon (2003). “La productivité des salariés âgés : une tentative d’estimation”. *Economie et Statistique*. 368. 95-119.
- Borowczyk Martins. D. and V. Vandenberghe (2010). Using Firm-Level Data to Assess Gender Wage Discrimination in the Belgian Labour Market. *mimeo*. Economics School of Louvain. IRES. UCL.

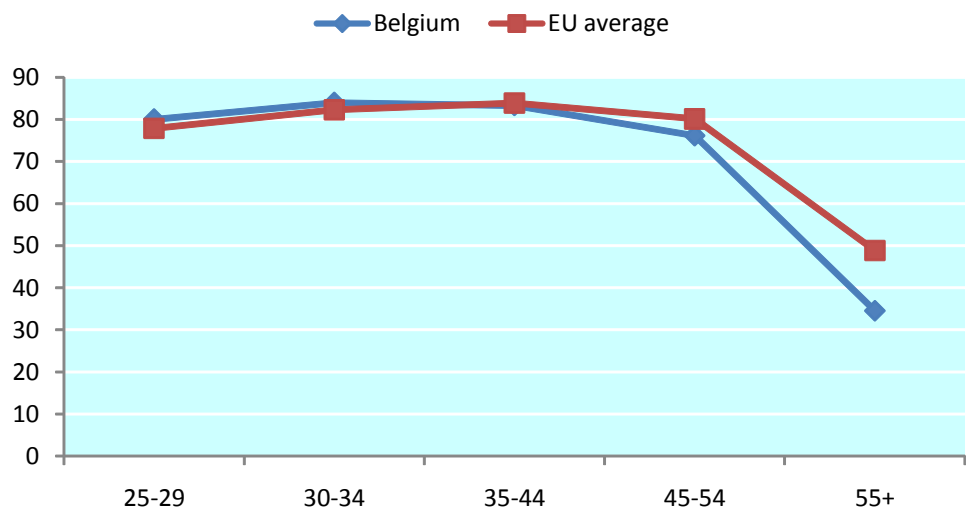
³¹ Remember that the term “differential” designates the productivity (or labour costs) differences between the considered age group and the reference (*i.e.* prime-age workers); whereas the term “gap” refers to the difference between the productivity and the labour-cost differentials characterizing an age-group.

³² In other words, they could be even more negative if all the older individuals were still working and part of our sample.

- Börsch-Supan. A. (2006). "Introduction". In: Börsch-Supan. A., A. Brügiavini, J. Jürges, J. Mackenbach, J. Siegrist, G. Weber (eds.). *Health, ageing and retirement in Europe. First Results from the Survey of Health, Ageing and Retirement in Europe*. Mannheim Research Institute for the Economics of Aging
- Costa. D. (1995). Pensions and Retirement: Evidence from Union Army Veterans. *The Quarterly Journal of Economics*. 110(2). pp. 297-319.
- Crépon. B., N. Deniau, et al. (2002). "Wages, Productivity, and Worker Characteristics: A French Perspective.". *Serie des Documents de Travail du CREST*. Institut National de la Statistique et des Etudes Economiques.
- Currie. J. and B.C. Madrian (1999). "Health, health insurance and the labor market". In: Ashenfelter. O. and D. Card (eds.) *Handbook of Labor Economics*. vol. 3C. North-Holland: Elsevier. pp. 3309-3416
- Daniel. K. and J.S. Heywood (2007). "The determinants of hiring older workers: UK evidence". *Labour Economics*. n.14. p.35-51
- de la Croix. D. and P. Pestiau (2007). "Réformer le système des retraites belge". *Regards Economiques* n° 51
- Dostie. B. (2006). Wages, Productivity and Aging. *IZA. Discussion Paper No. 2496*. Bonn. Germany.
- Fair. R. C. (1994) "How fast do old men slow down?". *The Review of Economics and Statistics*. 76 (1): 103-118
- Griliches. Z. and J. Mairesse (1995). Production functions: the search for identification. *NBER working paper, No 5067*, NBER, Ma.
- Gruber, J. and D. A. Wise (Eds) (2004), *Social Security Programs and Retirement around the World: Micro-Estimation*, NBER Book Series - International Social Security, University of Chicago Press.
- Grund and Westergård-Nielsen (2008). *International Journal of Manpower*. Vol. 29(5). pp. 410-422.
- Hellerstein. J.K. and Neumark. D. (1995). 'Are Earning Profiles Steeper than Productivity Profiles: Evidence from Israeli Firm-Level Data'. *The Journal of Human Resources*. vol. 30. 1. pp. 89-112.
- Hellerstein. J.; Neumark. D.; Troske. K. (1999). Wages, Productivity, and Worker Characteristics: Evidence from Plant-Level Production Functions and Wage Equations. *Journal of Labor Economics*. Vol. 17 (3). pp. 409-446
- Kalwij. A. and F. Vermeulen (2008). "Health and labour force participation of older people in Europe: what do objective health indicators add to the analysis?". *Health Economics*. Vol. 17 (5). May 2008. pp. 619-638
- Lazear. E. (1979) "Why is there mandatory retirement?". *Journal of Political Economy*. vol. 87. n.6. pp. 1261-1284
- Levinsohn. J. and A. Petrin (2003). Estimating production functions using inputs to control for unobservables. *Review of Economic Studies*. 70 (2). 317-341

- Lumsdaine. R. and O. Mitchell (1999). "New development in the economic analysis of retirement". In: Ashenfelter. O. and D. Card (eds.) *Handbook of Labor Economics*. vol. 3C. North-Holland: Elsevier. pp. 3261-3307
- Malmberg. B. Lindh. T & Halvarsson. M.. (2005). Productivity consequences of workforce ageing - Stagnation or a Horndal effect?. *Arbetsrapport* No 2005:17. Institute for Futures Studies. Stockholm.
- Mincer. J. (1994). "Human Capital: a Review". In: Kerr. Clark. Staudohar. Paul (ed.). *Labor economics and industrial relations: Markets and institutions*. Cambridge. Mass. and London: Harvard University Press. 109-141.
- Mirrlees. J. (1997). Information and Incentives: The Economics of Carrots and Sticks. *The Economic Journal*. 107(444). pp. 1311-1329.
- Mitchell, O.S. and G. S. Fields (1983), The Economics of Retirement Behavior, *NBER working paper*, No 1128, NBER, Ma.
- Mitchell, O.S., (1988), The relation of age to workplace injuries, *Monthly labor review*, 111, pp. 8-13.
- Neal. D. and S. Rosen. (2000). "Theories of the distribution of earnings". In: Atkinson. A. and F. Bourguignon (eds.), *Handbook of Income Distribution*. vol. 1. North-Holland: Elsevier, pp. 379-427.
- Roodman. D. (2006) "How to Do xtabond2". *unpublished note*
- Roodman. D. (2003) "XTABOND2: Stata module to extend xtabond dynamic panel data estimator". updated in 2008. (available at: <http://ideas.repec.org/c/boc/bocode/s435901.html>)
- Smith. S.P. (1991). Ending Mandatory Retirement in the Arts and Sciences. *American Economic Review*. 81(2). pp. 106-110.
- Shapiro. C. and J.E. Stiglitz (1984). Equilibrium Unemployment as a Worker Discipline Device. *The American Economic Review*. 74(3). pp. 433-444.
- Sneessens. H. and B. Van der Linden (2005). "Les préretraites: une méthode efficace de gestion des carrières et de l'emploi? " *Regards Economiques*, No 33, IRES, Université catholique de Louvain.
- The Economist (2010), The silver tsunami. Business will have to learn how to manage an ageing workforce, *The Economist*, Schumpeter column, Feb. 6th.
- Volkoff. S. A.-F. Molinié et A. Jolivet (2000). "Efficaces à tout âge ? Vieillesse démographique et activités de travail. " *Dossier n° 16*. Centre d'Etudes de l'Emploi.
- Weesie. J. (2000). 'Seemingly Unrelated Estimation and the Cluster-adjusted Sandwich Estimator'. *Stata Technical Bulletin*. 9(52). pp. 34-46.
- Wooldridge. J. (2002). *Econometric Analysis of Cross Section and Panel Data*. Cambridge. Mass.: MIT Press.

Annex 1 – Age and employment rate. Belgium vs. EU, 2008



Source : EU Labour Force Survey

Annex 2: Sectors (Industry, Commerce and Service) and NACE2 codes/definitions

10="I_Industries alimentaires "
11="I_Fabrication de boissons"
12="I_Fabrication de produits à base de tabac"
13="I_Fabrication de textiles"
14="I_Industrie de l'habillement"
15="I_Industrie du cuir et de la chaussure"
16="I_Travail du bois et fabrication d'articles en bois et en liège, à l'exception des meubles; fabrication d'articles en vannerie et sparterie"
17="I_Industrie du papier et du carton"
18="I_Imprimerie et reproduction d'enregistrements"
19="I_Cokéfaction et raffinage"
20="I_Industrie chimique"
21="I_Industrie pharmaceutique"
22="I_Fabrication de produits en caoutchouc et en plastique"
23="I_Fabrication d'autres produits minéraux non métalliques"
24="I_Métallurgie"
25="I_Fabrication de produits métalliques, à l'exception des machines et des équipements"
26="I_Fabrication de produits informatiques, électroniques et optiques"
27="I_Fabrication d'équipements électriques"
28="I_Fabrication de machines et d'équipements n.c.a."
29="I_Construction et assemblage de véhicules automobiles, de remorques et de semi-remorques"
30="I_Fabrication d'autres matériels de transport"
31="I_Fabrication de meubles"
32="I_Autres industries manufacturières"
33="I_Réparation et installation de machines et d'équipements"
35="I_Production et distribution d'électricité, de gaz, de vapeur et d'air conditionné"
36="I_Captage, traitement et distribution d'eau"
37="I_Collecte et traitement des eaux usées"
38="I_Collecte, traitement et élimination des déchets; récupération"
39="I_Dépollution et autres services de gestion des déchets"
41="I_Construction de bâtiments; promotion immobilière"
42="I_Génie civil"
43="I_Travaux de construction spécialisés"
45="C_Commerce de gros et de détail et réparation véhicules automobiles et de motocycles"
46="C_Commerce de gros, à l'exception des véhicules automobiles et des motocycles"
47="C_Commerce de détail, à l'exception des véhicules automobiles et des motocycles"
49="S_Transports terrestres et transport par conduites"
50="S_Transports par eau"
51="S_Transports aériens"
52="S_Entreposage et services auxiliaires des transports"
53="S_Activités de poste et de courrier"
55="S_Hébergement"
56="S_Restauration"
58="S_Édition"

59="S_Production de films cinématographiques, de vidéo et de programmes de télévision; enregistrement sonore et édition musicale"

60="S_Programmation et diffusion de programmes de radio et de télévision"

61="S_Télécommunications"

62="S_Programmation, conseil et autres activités informatiques"

63="S_Services d'information"

64="S_Activités des services financiers, hors assurance et caisses de retraite"

65="S_Assurance, réassurance et caisses de retraite, à l'exclusion des assurances sociales obligatoires"

66="S_Activités auxiliaires de services financiers et d'assurance"

68="S_Activités immobilières"

69="S_Activités juridiques et comptables"

70="S_Activités des sièges sociaux; conseil de gestion"

71="S_Activités d'architecture et d'ingénierie; activités de contrôle et analyses techniques"

72="S_Recherche-développement scientifique"

73="S_Publicité et études de marché"

74="S_Autres activités spécialisées, scientifiques et techniques"

75="S_Activités vétérinaires"

77="S_Activités de location et location-bail"

78="S_Activités liées à l'emploi"

79="S_Activités des agences de voyage, voyagistes, services de réservation et activités connexes"

80="S_Enquêtes et sécurité"

81="S_Services relatifs aux bâtiments; aménagement paysager"

82="S_Services administratifs de bureau et autres activités de soutien aux entreprises"

92="S_Organisation de jeux de hasard et d'argent"

93="S_Activités sportives, récréatives et de loisirs"

94="S_Activités des organisations associatives"

95="S_Réparation d'ordinateurs et de biens personnels et domestiques"

96="S_Autres services personnels"

97="S_Activités des ménages en tant qu'employeurs de personnel domestique"

98="S_Activités indifférenciées des ménages en tant que producteurs de biens et services pour usage propre"

99="S_Activités des organisations et organismes extraterritoriaux"