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Falling Labor Force Participation: Demographics or Lack of Jobs?

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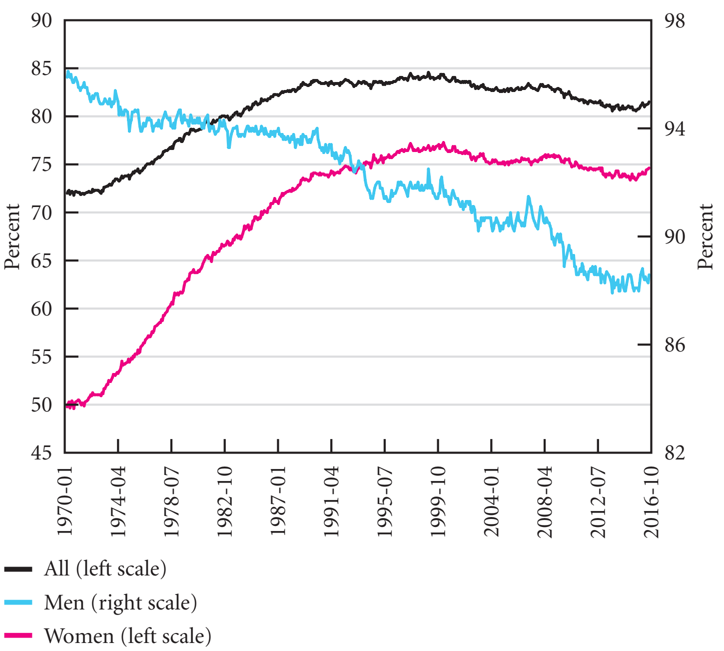
President Obama stepped out of office with the longest uninterrupted streak of job creation on record, with 15.8 million private sector jobs added since 2010. However, the overall labor force participation rate (LFPR) has been falling since its historical peak in 2000. This is commonly attributed to demographics: aging of the population pulls down the LFPR due to lower participation of retirees 55 and older. Nonetheless, the share of the population aged 55 and older that continues to work has been rising, attenuating the negative impact of aging on the total LFPR.

Most important, such age demographics cannot explain the falling LFPR for prime-working-age civilians (ages 25–54), which has also been falling since 2000. In particular, as can be seen in the figure below, the LFPR for prime-age male workers has been on a long-term downward trajectory since 1970. Until 2000, the strong influx of prime-age women into the workforce more than offset men's withdrawal from the labor market. But since then, the LFPPR for both genders has declined. Today, it remains significantly below prerecessionary levels.

Some have emphasized other structural forces at play. John Williams, president of the Federal Reserve Bank of San Francisco, argues that a growing percentage of younger Americans are leaving the labor force to care for children and older family members, obtain more education, or enjoy leisure, and that more generous social safety net benefits, combined with the increasing number of families with two working spouses, have reduced the costs associated with labor force withdrawal. Prime-age workers are more likely to drop out rather than take jobs that require inferior skill levels or pay much lower wages, according to this argument.

Prime Working Age LFPRs: Men vs. Women, January 1970 – October 2016



Source: BLS

While some of the decline in labor force participation may be due to such "social shifts" and other supply-side and institutional factors, it is unlikely that a large number of Americans are voluntarily leaving the labor force. The number of those not in the labor force who report not wanting a job now has declined for those aged 16–54. Also, participation has declined steadily for prime-age workers without children, and fewer than 25 percent of the prime-age people who are not participating in the labor force have a working spouse—and nearly 36 percent of them are living in poverty. None of these facts is obviously consistent with the "lifestyle changes" argument.

Participation has fallen more steeply for less-educated men at the same time that the demand-driven wage premium for education has increased. Using wage pressure as a proxy for demand, and educational achievement as a proxy for skills, lack of demand for lower-skill workers has been an important driver of falling participation. According to President Obama's Council of Economic Advisers, the correlation between labor force participation and relative wages is the strongest for those at the 10th percentile of the wage distribution.

Depressed labor force participation for prime-age workers is likely due to a combination of insufficient aggregate demand, weak job creation, and stagnant wages—all of which have been persistent problems over the past three or four decades. While short-lived economic expansions have occasionally counteracted these trends, this temporary relief has been provided by unsustainable asset-price bubbles (dot-com stocks, commodities, housing prices) that increase fragility and do little for those at the bottom of the income ladder. Further, once the bubbles burst, we return to secular stagnation.

Although insufficient aggregate demand is the main problem, general "Keynesian" pump priming is not the answer. Stimulus needs to take the form of targeted job creation to tighten labor markets for less-skilled workers. If President Trump were serious about improving the conditions of working America, he would revisit Roosevelt's New Deal jobs programs and Hyman Minsky's employer-of-last-resort proposal to directly create jobs where they are needed while improving public infrastructure and the provision of public services.

A more detailed discussion of the issues can be found at levyinstitute.org/publications/full-employment-are-we-there-yet.

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