WHERE HAVE ALL THE WORKERS GONE?

Why are more people leaving the labor force, and what are they doing?

BY JESSIE ROMERO

Since September of last year, the unemployment rate in the United States has declined nearly a full percentage point, from 9 percent to 8.3 percent. On its face, this is an encouraging signal about the health of the labor market. But some of the change is due to a potentially troubling trend: a dramatic decline in the number of Americans who are part of the labor force. Prior to the recession, 66 percent of the population (not counting active duty military or people in a nursing home or in prison) over the age of 16 was in the labor force. Just four years later, this rate — known as the "labor force participation rate," or LFPR — has fallen to 63.7 percent. While this might not sound like a large decline, it is unprecedented in the postwar era.

The dropoff is all the more striking because it does not include unemployed workers who are actively seeking work; such workers are still considered to be part of the labor force. It is only when the unemployed decide to stop looking for jobs, perhaps because they have given up on the possibility of finding one, that they are considered out of the labor force — although they might still want to work, and would accept jobs if they were offered.

The current low labor force participation rate is the result of both long-term structural changes, such as an aging population and decreased demand for low-skill workers, and cyclical factors, namely the lingering effects of the 2007-09 recession. While it's difficult to distinguish between the effects of demographics and the effects of the business cycle on labor force participation, why people drop out of the labor force — and what they do when they're not working — has important implications for the future growth of the U.S. economy.

Trend Versus Cycle

Beginning in the early 1960s, the LFPR began a four-decades-long increase, from less than 60 percent to a high of 67.3 percent at the beginning of 2000 (see chart). The rise was driven by greater participation of women and by the entry of the baby-boom generation into the workforce, which skewed the population toward age cohorts that have very high participation rates. These demographic changes were large enough to counteract the effects of occasional weak labor markets, and during most postwar recessions, labor force participation held steady or even increased. That changed a decade ago — the LFPR began to fall at the beginning of the 2001 recession and never recovered. Compared to the present, however, the drop then was small: In the four years following the start of the 2001 recession, the LFPR declined 1.1 percentage points, compared to 2.4 percentage points over the same corresponding period since the start of the 2007-09 recession.

Since the beginning of the 2007-09 recession, Fifth District states have fared both better and worse than the nation as a whole in terms of labor force participation. In Virginia, labor force participation has been fairly constant, remaining largely unchanged since the beginning of the recession. In Maryland, the rate declined by 2.0 percentage points, while West Virginia and Washington, D.C., saw declines comparable to the national decline of 2.4 percentage points. In North Carolina, the LFPR has fallen by 3.1 percentage points, and in South Carolina it has

PHOTOGRAPHY: AMY DEVOOGD/PHOTODISC/GETTY IMAGES declined by 3.6 percentage points, the largest decrease in the Fifth District and one of the largest in the nation.

Even before the recession, labor force participation had been trending downward. Teenagers and young adults are remaining in school longer and are less likely to work while they are in school. Women's participation, which fueled much of the growth in the LFPR after 1960, leveled off in the 1990s. And although the participation rate for older workers has been gradually increasing due to improved health and the reduction in defined-benefit retirement plans, the participation rate for the group as a whole is still much lower than for other demographic groups. The increasing share of older workers in the population thus brings down the overall LFPR. In January, for example, it appeared that more than 1 million workers left the labor force, and that the LFPR fell 0.3 percentage point. But the drop was due entirely to revised population estimates based on the 2010 census; there were simply more older people in the population than the BLS originally thought.

Men aged 25-54 traditionally have been the most attached to the labor force, but their participation has been falling for decades. Between 1970 and the beginning of the most recent recession, men's LFPR fell from 96 percent to 90.6 percent. At present, the rate is 88.5 percent. One possible explanation for this decline is relaxed requirements and increased benefits for disability insurance.

In 1984, Congress authorized changes that made it easier for workers suffering from ailments such as mental illness or muscle pain to qualify for disability insurance. Currently, beneficiaries receive an average of $1,150 per month in cash payments and full Medicare benefits. Because workers stop receiving benefits if they demonstrate that they are able to work, the program creates a strong incentive for workers to exit the labor force permanently. (See "The Sharp Rise in Disability Claims," page 24.)

Although demographic and policy changes have contributed to a long-term downward trend in labor force participation, the current decline appears to be too large to be explained solely by these factors. "I think the vast majority has got to be the recession. There's just not enough time for demographics to have changed that much," says Jesse Rothstein, an economist at the University of California, Berkeley and chief economist at the Department of Labor for 2010.

But it's difficult to discern the impact of the business cycle relative to structural change. "The certain answer I can give you is that they're both playing a role. If you want me to divide it proportionally and say how important is each, that's where it becomes much, much more difficult," says Betsey Stevenson, an economist at the University of Pennsylvania. Stevenson served as chief economist at the Department of Labor for 2011.

A recent report by Dean Maki, an economist at Barclays Capital, argued that only about one-third of the recent decline in the LFPR is due to the weak labor market, with the rest due to demographic factors. Economist Willem Van Zandweghe at the Kansas City Fed found that the split is closer to 50-50, as did economists at the Chicago Fed. Van Zandweghe used a model in which the overall unemployment rate is the primary cyclical indicator. When he altered the model to include the long-term unemployment rate, which might be a better gauge of labor market weakness, he found that cyclical factors could explain as much as 90 percent of the decline in the LFPR.

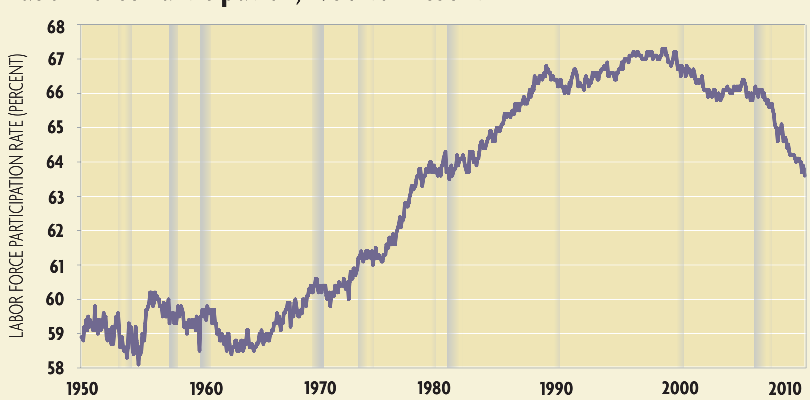
Ins and Outs

Whatever the research eventually shows, the fact remains that millions of people who would like to be working have given up trying to find a job. According to the monthly Current Population Survey (CPS) conducted by the BLS, the share of workers not in the labor force who report that they want a job now increased from 5.5 percent prior to the recession to 8.4 percent in mid-2011, and remains elevated at 7.9 percent today — a total of 6.8 million workers. "There's a large group of people who are counted as out of the labor force who we should be trying to find jobs for, and who would want jobs if they were available," says Rothstein.

Of the workers who want a job, 2.5 million are considered "marginally attached" to the labor force; they have searched for a job within the past year, but not within the past four weeks, and are available to work now. (The remaining workers who want a job either have not searched within the past year or are not available to work.) More than 800,000 marginally attached workers are considered "discouraged workers" — they have stopped looking for work because they do not believe that any jobs are available for them. Other reasons for not looking for work include family responsibilities, attending school or a training program, ill health or disability, or "other," such as a lack of transportation or child care.

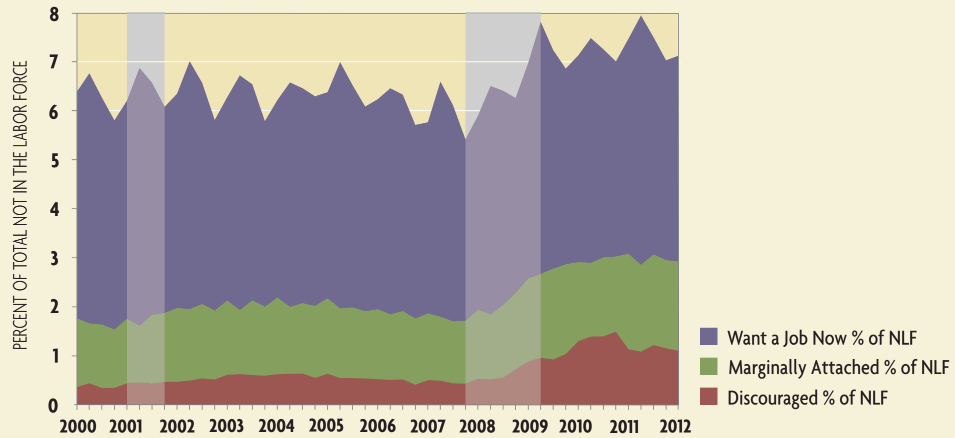
Between 1994 and the end of 2007, discouraged workers made up about 8 percent of workers who want a job, with a high of 11 percent following the 2001 recession. (The BLS made substantial changes to the CPS in 1994,

Labor Force Participation, 1950 to Present



NOTE: Shaded areas denote recessions.
SOURCES: Bureau of Labor Statistics, Haver Analytics

Workers Not in the Labor Force



NOTE: Shaded areas denote recessions.
SOURCES: Bureau of Labor Statistics, Haver Analytics; *Region Focus* calculations

so comparisons to prior years' data are not possible.) From the beginning of the most recent recession until the end of 2010, the share increased from 8.25 percent to 22 percent. Since then, discouraged workers have remained about 15 percent of workers who want a job.

The official number probably understates the true amount of discouragement in the labor market. To be defined as a discouraged worker — a subset of the marginally attached — a worker must have searched for a job within the past year. More than 3.2 million workers say that they do want a job but that they stopped looking more than a year ago. These workers are not counted as discouraged by the CPS, but it's likely that some of them originally quit the labor force because they were pessimistic about job opportunities.

In addition, some of the 80 million workers who say they do not want a job now might have dropped out due to weak job prospects. For example, nearly 50 percent of all workers not in the labor force report that they are retired. They aren't classified as discouraged, but some of them likely decided to retire early rather than continuing to search for a job. (See "Recession on the Eve of Retirement, *Region Focus*, Fourth Quarter 2011.) The average duration of unemployment for workers older than 55 is 60 weeks, compared to 42 weeks for all workers. "At some point it's not worth continuing to look. You say, okay, I'll just retire early," Rothstein says.

Assessing the condition of the labor market is made more difficult by the fact that, in any given month, there is a great deal of fluidity between different states of the labor force. "There are a lot of issues in trying to think about what it means to be unemployed and what it means to be out of the labor force. People flit in and out of these states much more than we thought they did," Stevenson says. Many workers drop out of the labor force for several months, but then begin looking for work and reenter the labor market, according to research by Michael Elsby of the University of Edinburgh, Bart Hobijn and Rob Valletta of the San Francisco Fed, and Aysegul Sahin of the New York Fed. Deciding whether to classify these workers as unemployed or as out of the labor force "is a real philosophical question," says Stevenson. "You have to think about a distinction between people who truly exit the labor force, and people who take a one- or two-month break."

Looking more closely at the flows in and out of the labor force also reveals some counterintuitive trends. Because there are many more unemployed workers today than in previous recessions, the absolute number of workers who move from unemployment to nonparticipation has increased substantially. But it's actually taking longer for workers to become discouraged than they did in previous recessions, and on average, workers are less likely to drop out after being unemployed, according to research by Marianna Kudlyak of the Richmond Fed. Randy Ilg, an economist at the BLS, also found that unemployed workers are waiting longer before giving up and leaving the labor force, a median of 20 weeks compared to 8.5 weeks prior to the recession. One explanation for this trend could be the extension of unemployment benefits during the recession to up to 99 weeks; workers must be actively seeking work in order to qualify, which could encourage them to remain in the labor force for longer.

Despite the persistently weak labor market, Kudlyak also found an increase in the rate at which workers come back into unemployment from nonparticipation, possibly because many workers who had previously left the labor force, such as retirees, lost a significant amount of wealth and thus had to start looking for work. Another explanation could be the "added worker" effect, whereby nonworking women whose husbands were laid off decide to try to find a job, as Sahin of the New York Fed, Joseph Song of Columbia University, and Hobijn of the San Francisco Fed have suggested.

Passing the Time

Some workers leave the labor force for only a month or two, but others drop out for years, if not permanently. How are they spending their time? One recent study by economists Mark Aguiar of Princeton University and Erik Hurst and Loukas Karabarbounis of the University of Chicago begins to paint the picture. The authors examined the results of the American Time Use Survey (ATUS), an annual survey by the BLS that asks respondents to log their activities over a 24-hour period. Comparing the years 2009 and 2010 to the years prior to the recession, the authors found that about 35 percent of the foregone market work hours — time previously devoted to paid employment — were reallocated to home production, such as cooking and cleaning, home maintenance, or child care. About 30 percent of the foregone hours were devoted to sleep and television watching, 20 percent to other leisure activities such as exercising or going to the movies, and 10 percent of the time was spent on education or other civic engagements. Small fractions of time were devoted to work in the informal economy and to job search. The ATUS includes all workers — employed, unemployed, and out of the labor force — so it's not certain that these results apply specifically to workers who are out of the labor force.

About 15 percent of all workers not in the labor force and 8 percent of marginally attached workers are taking care of family members rather than looking for work, according to BLS data. For some of these workers, family care is the reason they leave the labor force, while for others, it's something they turn to after dropping out. "Men who have been out of work for a long time and are discouraged might start to say they're taking care of their family while their wives work, rather than saying they're discouraged," says Rothstein.

Many workers who have left the labor force are furthering their education. The share of adults aged 25-39 who cite schooling as their reason for leaving the labor force has increased from about 15 percent to about 20 percent since the end of the recession, and the share of workers aged 40-59 has increased from 4 percent to 6 percent, according to research by Julie Hotchkiss and Melinda Pitts of the Atlanta Fed and Fernando Rios-Avila of Georgia State University. Community college enrollment is especially countercyclical: A 1 percent increase in the unemployment rate leads to a 4 percent increase in enrollment, found Julian Betts of the University of California, San Diego and Laurel McFarland, executive director of the National Association of Schools of Public Affairs and Administration. The number of people over 50 enrolled in community college has increased 12 percent since 2005, with much of the increase coming since the recession, according to the American Association of Community Colleges.

The recession also likely accelerated the ongoing trend of young people opting for school over work, Stevenson says. "If you're in school full time and there are no jobs out there, eventually the returns to applying for another job instead of doing more of your homework are pretty low."

Making Ends Meet

Most social safety net programs, such as unemployment insurance or Temporary Assistance for Needy Families, require recipients to be working or actively looking for work. But people who have left the labor force might be taking advantage of other programs to help make ends meet.

On average, 45 million people per month received aid via the Supplemental Nutrition Assistance Program (SNAP), also known as food stamps, in 2011. That represents an increase of 70 percent since 2007, according to the Congressional Budget Office. Part of the increase was due to expanded eligibility, including relaxed work requirements. Typically, to qualify for SNAP, able-bodied adults must be working or enrolled in a training program and looking for work. These requirements were waived in 2009 and 2010 by the American Recovery and Reinvestment Act, and since then states that qualify for extended federal unemployment benefits — 46 states in fiscal year 2012 — have been allowed to waive the requirements. Even without the waiver, there are a number of exceptions, such as caring for a child, lack of transportation, or unsuitable or limited job opportunities, that could enable workers who have dropped out of the labor force to receive benefits.

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> — Jesse Rothstein
> University of California, Berkeley

The recession also had an effect on enrollment in Medicaid, a government health insurance program for qualified low-income people. Between December 2007 and December 2009, the average monthly enrollment increased by nearly 6 million people, or 14 percent, according to the Kaiser Family Foundation. Medicaid eligibility is not tied to employment requirements, making it likely that at least part of the increase is due to workers who are no longer in the labor force, and thus have lower incomes and lack employer-based health insurance.

The expansion of benefits such as SNAP and Medicaid might be a cause of the sharp drop in the LFPR since the recession, rather than an effect. Economist Casey Mulligan of the University of Chicago found that more generous safety net programs have contributed to a decline in the "self-reliance" rate from 70 percent to 55 percent since 2007. The self-reliance rate measures the fraction of a household's income that is not replaced by transfer payments or subsidies; a lower self-reliance rate implies decreased incentives to work, since the government provides relatively more of a household's lost income. These programs replace much less income than disability benefits do, however, and thus might not have the same long-term effects on labor force participation.

Many workers, particularly older workers, are spending savings that had been earmarked for retirement. A survey by the AARP (formerly the American Association of Retired Persons) found that 57 percent of workers over age 50 had withdrawn money from their savings account, and 25 percent had completely exhausted their savings. Nearly 20 percent had taken a distribution from a 401(k) or other retirement account. A survey of workers of all ages by the Pew Research Center found that 55 percent of workers who were unemployed for six months or longer withdrew money from their retirement accounts. While the behavior of the unemployed might not match the behavior of workers who have left the labor force, it's likely that these groups have resorted to the same financial coping strategies.

Some workers simply might not be making ends meet. The official federal poverty rate increased to 15.1 percent in 2010, according to the U.S. Census Bureau, the highest rate since 1993. (The official poverty rate does not include in-kind government benefits such as food stamps in its income calculations.) There are some workers who will never reenter the labor force and "will live in poverty for the rest of their lives," says Rothstein. Most workers, however, will likely have to reenter the labor force at some point, albeit for lower pay. "You'll see more people coming back and working in jobs for which they should be overqualified."

Can the Decline be Reversed?

What happens when these workers do return to the labor force? The economy created 163,000 jobs in July, barely enough to keep up with population growth; some observers are concerned that if a large number of people decide to start looking for work, the result could be a spike in the unemployment rate. Demographic changes could offset the inflow of workers who sat out the recession, however. While the Congressional Budget Office projects that the size of the labor force will grow more quickly than its long-term trend between now and 2016 as the economy rebounds, it also projects that this growth will be outweighed by the retirement of the baby-boom generation, which will continue to push the participation rate down.

In fact, the greater concern may be that the labor force is permanently smaller. In the long run, a country's economic growth depends on the number of people working, and how productive those people are. All else equal, unless productivity grows very rapidly, lower labor force participation leads to a lower level of economic activity. That might be part of the explanation for the slow pace of the economic recovery, according to recent work by James Stock of Harvard University and Mark Watson of Princeton University (who is also a visiting scholar at the Richmond Fed). They found that the trend decline in labor force participation accounts for nearly all of the slower GDP growth and half of the slow employment growth relative to the recovery from the 1981-82 recession.

Some of the decline in labor force participation might be beneficial, at least in the long run. To the extent that workers have left the labor force in order to attend school, the effects on growth could be positive. Higher levels of human capital tend to lead to higher rates of economic growth; higher-skilled workers not only use existing technologies more productively but also generate new ideas and new technologies. Workers with more human capital also earn higher wages and tend to be more attached to the labor force later in life, potentially making up for a period of nonparticipation.

Millions of other workers, however, represent a large pool of unused resources. What will it take to bring these workers back into the labor force? If these workers are merely sitting out a weak labor market, then the short answer is job growth. But simply increasing the number of jobs might not be enough to bring certain workers back into the labor force, much less into employment. Research has found that marginally attached and discouraged workers tend to be from demographic groups with higher unemployment rates than average, and are less likely than the unemployed to transition to employment. In addition, skill "mismatch" — the idea that the available workers do not possess the skills in demand by employers — could account for between 0.6 and 1.7 percentage points of the 5 percentage point rise in the unemployment rate, according to Sahin and Giorgio Topa of the New York Fed, Joseph Song of Columbia University, and Giovanni Violante of New York University. This suggests that mismatch could account for a significant portion of marginally attached and discouraged workers as well.

For these workers, job training programs might be the best way to reintegrate them into the labor force. But job training doesn't yield immediate effects. "What should we be training for? For the jobs that will be there in three or four years?" asks Rothstein. "Adding more job training now is useful for the long run, but it's not going to be useful for the short run."

In the short run, there are no easy answers. The current low level of the labor force participation rate is a mix of both structural and cyclical factors, which makes it difficult to predict the path of the LFPR in the future, and thus to predict its effect on the country's economic growth. As the economy continues its recovery from the recession, economists and policymakers will be watching closely to see what labor force participation signals about the health of the labor market. **RF**

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