

Watching Labor Force Participation

BY JOHN A. WEINBERG

A central concept in evaluating economic performance is how fully an economy is using its resources. Of particular interest in this regard is the utilization of labor resources, both because labor accounts for the bulk of production and because labor income is the key to the broad well-being of households. Accordingly, the unemployment rate, as a measure of unutilized labor resources, has always received considerable attention from policymakers, politicians, and the general public.

Like most of our efforts to measure the economy, however, the unemployment rate is an imperfect indicator of how effectively our labor markets are working. First, the nature of labor markets — the fact that employment is usually the result of a process by which workers and employers search for a match between workers' skills and employers' needs — means that there is always some amount of unemployment. And the amount of unemployment arising from that process may vary over time, depending on shifts in the supply and demand for different types of skills. The extent to which persistently high unemployment in the wake of the Great Recession is the result of increased difficulty in finding good matches — many refer to this as an increase in “structural unemployment” — has been the subject of considerable debate.

A second aspect of the unemployment rate that makes it hard to interpret as a measure of labor market performance lies in its definition. We define the unemployment rate as the fraction of the labor force that is not employed. The labor force, in turn, is defined as all employed people plus those in the working-age population who do not have jobs but are seeking employment. The unemployment rate is silent on people who, for whatever reason, are neither working nor searching.

Another measure of labor-market activity is the labor force participation rate — that is, the share of the population in the labor force. Unlike the unemployment rate, this measure does provide information about those who are not working or searching. Changes in this measure are usually dominated by demographics and other trends that play out over time periods longer than the typical business cycle. For instance, from the 1970s through the end of the 20th century, the participation rate rose from around 60 percent to 67.3 percent as women increasingly entered and remained in the workforce. But this shift had largely played itself out by 2000, and participation has been trending down since then, standing at 66 percent at the end of 2007.

Then, during and since the recession, the pace of decline sped up, with participation currently at 63.3 percent, about where it was in 1980.

There are a number of reasons why potential workers might leave the labor force or remain outside of it. They may be pursuing education or caring for family members. They may be disabled or retired. Also, an individual is classified as not in the labor force if he or she is not searching for work out of a belief that it isn't possible to find a job. For example, the person may have tried to find work and gave up. These so-called discouraged workers are in some ways more similar to the unemployed than they are to others who are not in the labor force: They represent potential labor supply that might be expected to quickly flow back into the labor force as conditions improve.

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The behavior of labor force participation is central to how one interprets the evolving outlook for labor market performance. Suppose economic growth were to continue at the roughly 2 percent annual pace that it has averaged since the end of the recession. That pace of growth would likely continue to produce net employment gains similar to the post-recession

average, around 180,000 jobs a month. If labor force participation remains low, or even continues its recent decline, such a pace of job growth might cause the unemployment rate to fall relatively quickly. If, on the other hand, participation picks up as discouraged workers flow back into the market, then for a given pace of job growth, the unemployment rate will fall more slowly or may even rise.

Determining the sources of nonparticipation is difficult. Some recent work has suggested that a substantial share of the decline in participation is a product of the recession, which tends to be more consistent with the notion of people withdrawing from the labor force because of poor employment prospects. But a cyclical decline of the magnitude suggested by that work would be unusual in the historical record.

Regardless of whether the decline in labor force participation is rooted mainly in the recession or in structural changes in the economy, it is an important phenomenon, one unprecedented in our postwar experience. The behavior of labor force participation is likely to remain a challenging aspect of the economic data — for forecasters and policymakers alike — for some time. **EF**

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