Views on Labor Force Participation and the Unemployment Rate

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Issues in Projecting Labor Force Participation

Secular decline in LFP of prime-age men and young people

Secular increase in LFP of older workers

Distinguishing cyclical from structural factors

Prime-Age Labor Force Participation Rate (LFPR)
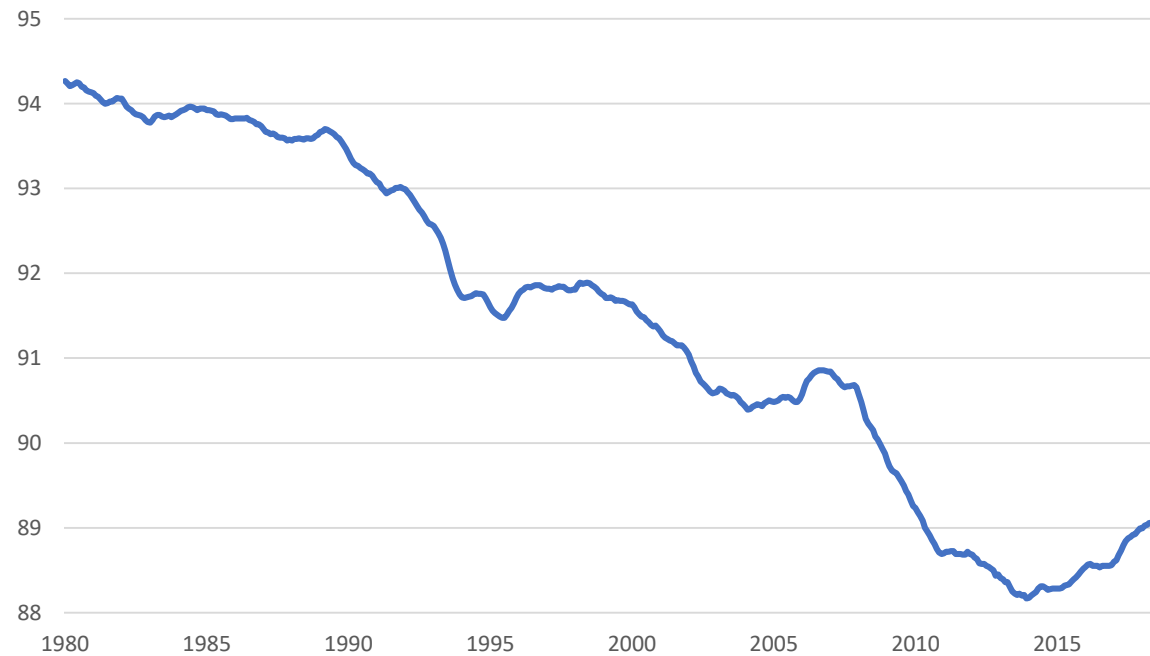## (ages 25-54)

Decades long decline in prime-age LFPR for men; about two decades decline for women.

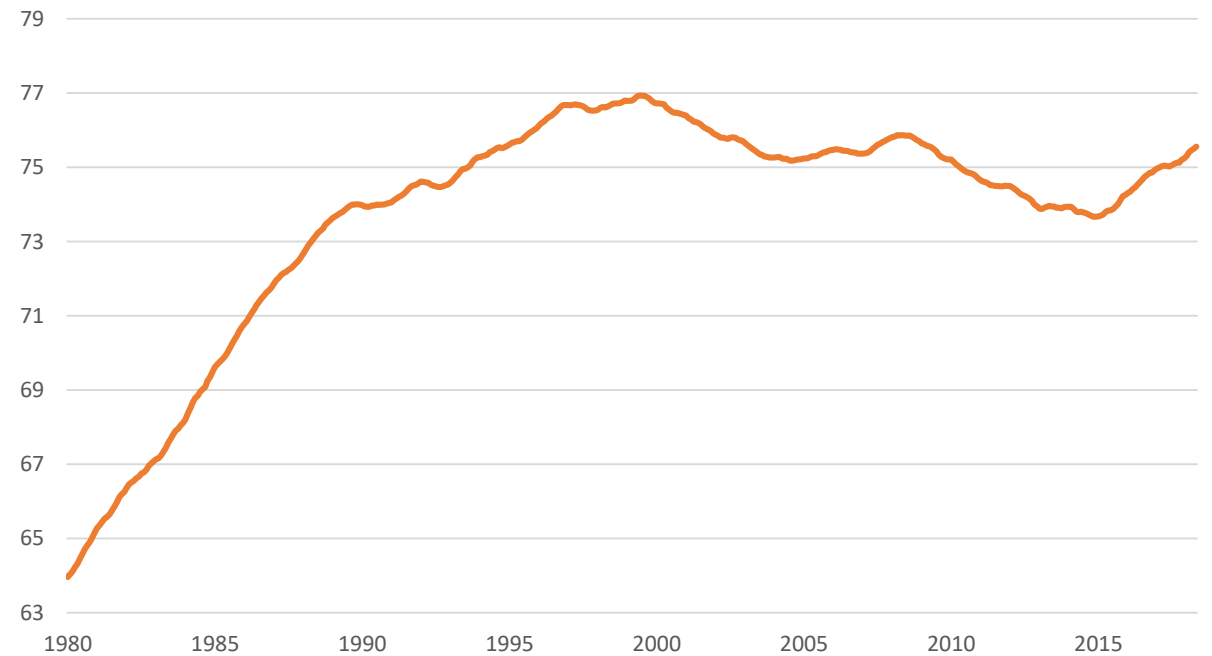Speed of decline accelerated during GR

LFPR fell 3 ppt for men and 1.5 ppt for women from 2008-2014.

LFPR has increased 1.3 ppt for men and 1.5 ppt for women since early 2014.
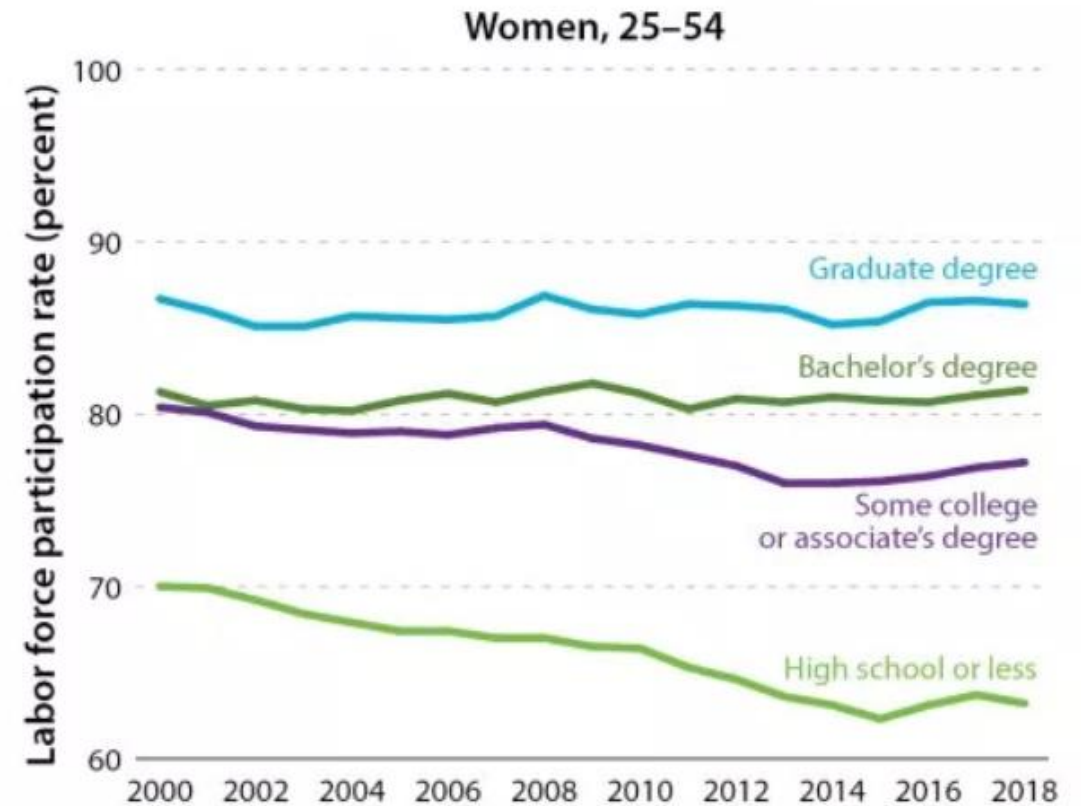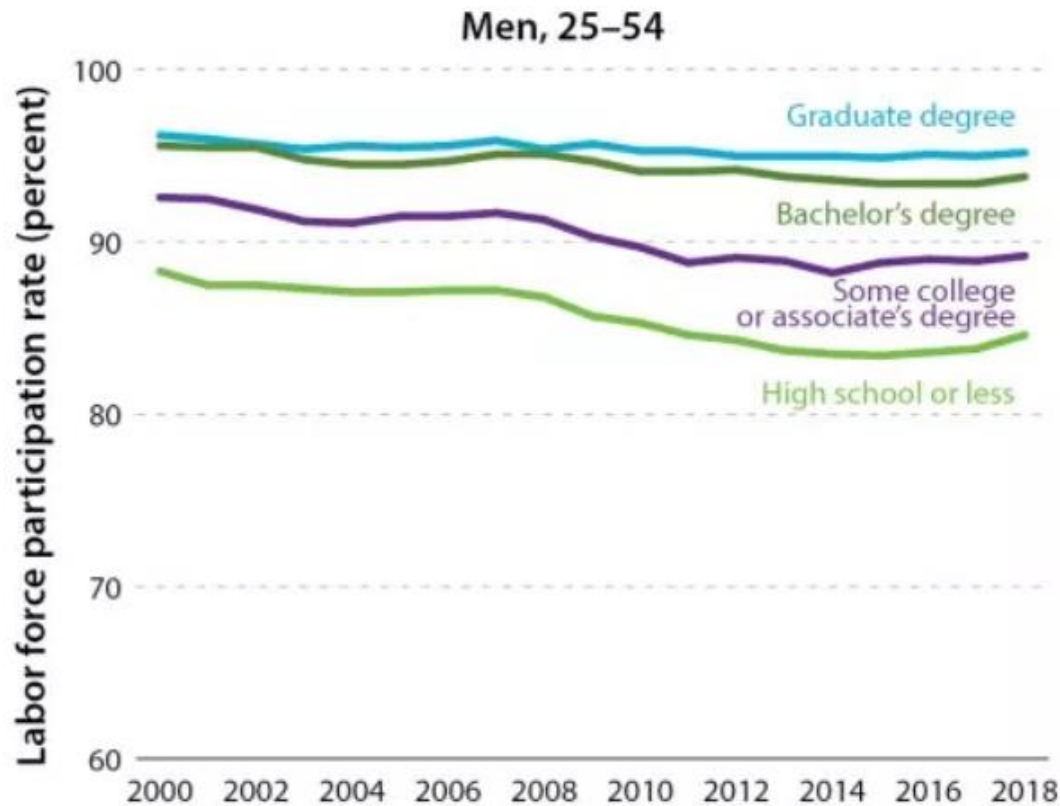

Prime-Age LFP Men

Prime-Age LFP Women

Decline driven by less-educated, likely reflecting fall in demand, partly offset by increased educational attainment over time
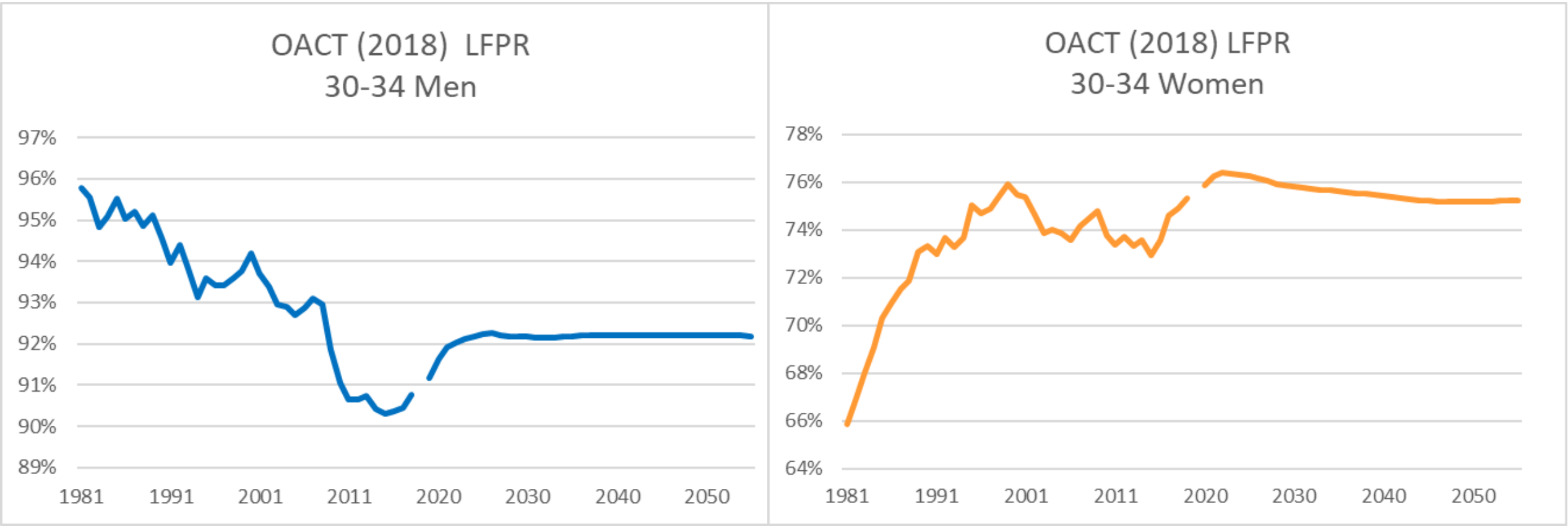

Labor Force Participation by Gender and Educational Attainment, 2000–18

Source: Current Population Survey 2000–18.
Note: 2018 includes values through May 2018

OACT projects prime-age LFPR will edge up and then flatten
(Using 30-34 here as an example)

OACT (2018) LFPR 30-34 Men

OACT (2018) LFPR 30-34 Women

Issues

Sharp drop in prime-age LFPR and the turnaround in recent years suggest a good part of the decline from 2008-2014 was cyclical.

If so, then hard to interpret the uptick as evidence of an end to the longer-run secular trends, particularly for men.

So what causes these trends to stop, and stop immediately, in OACT projections?

What has changed in labor market, productivity, firm power, skill-biased technological change, etc?
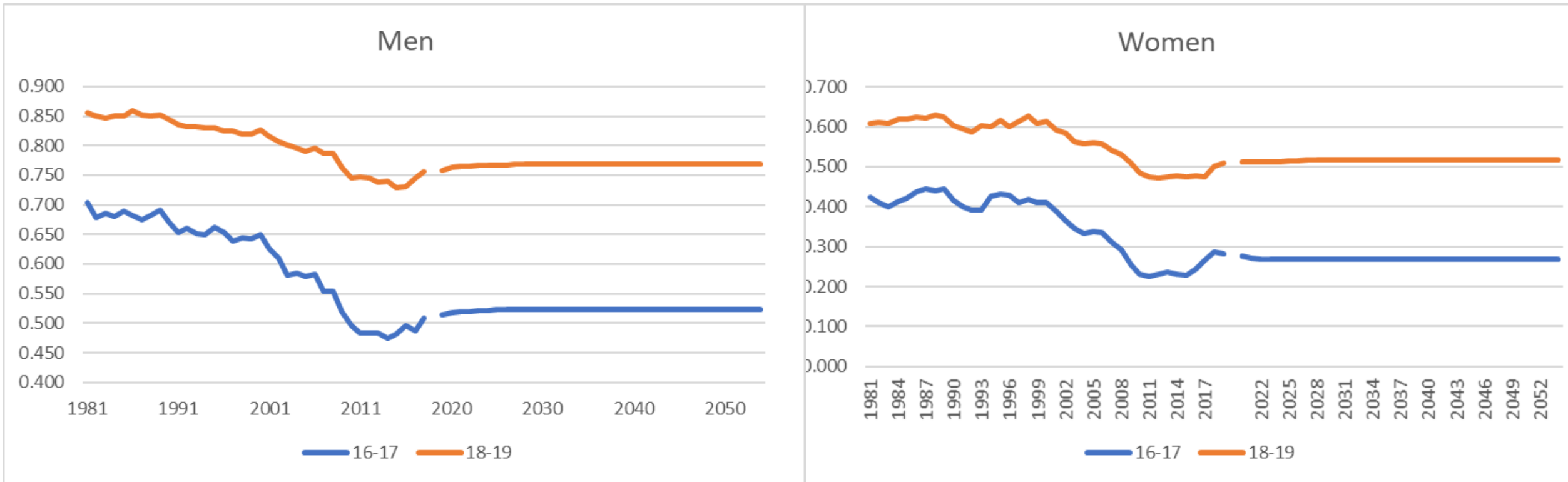
Similar story for 16-19 year olds

Source of decline in participation less well understood
Could be driven by some of the same factors—lower demand for skilled-workers means fewer jobs for teens
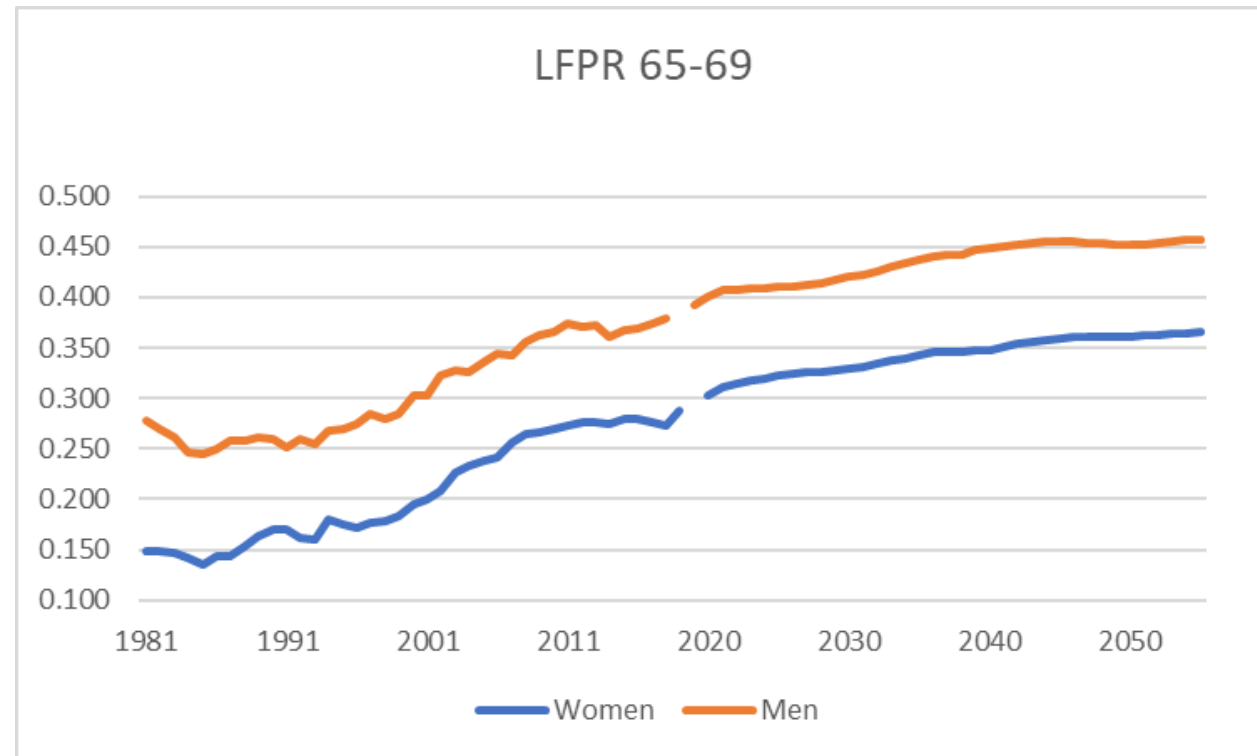Increased recognition of value of college degree, increased ability to borrow for college?
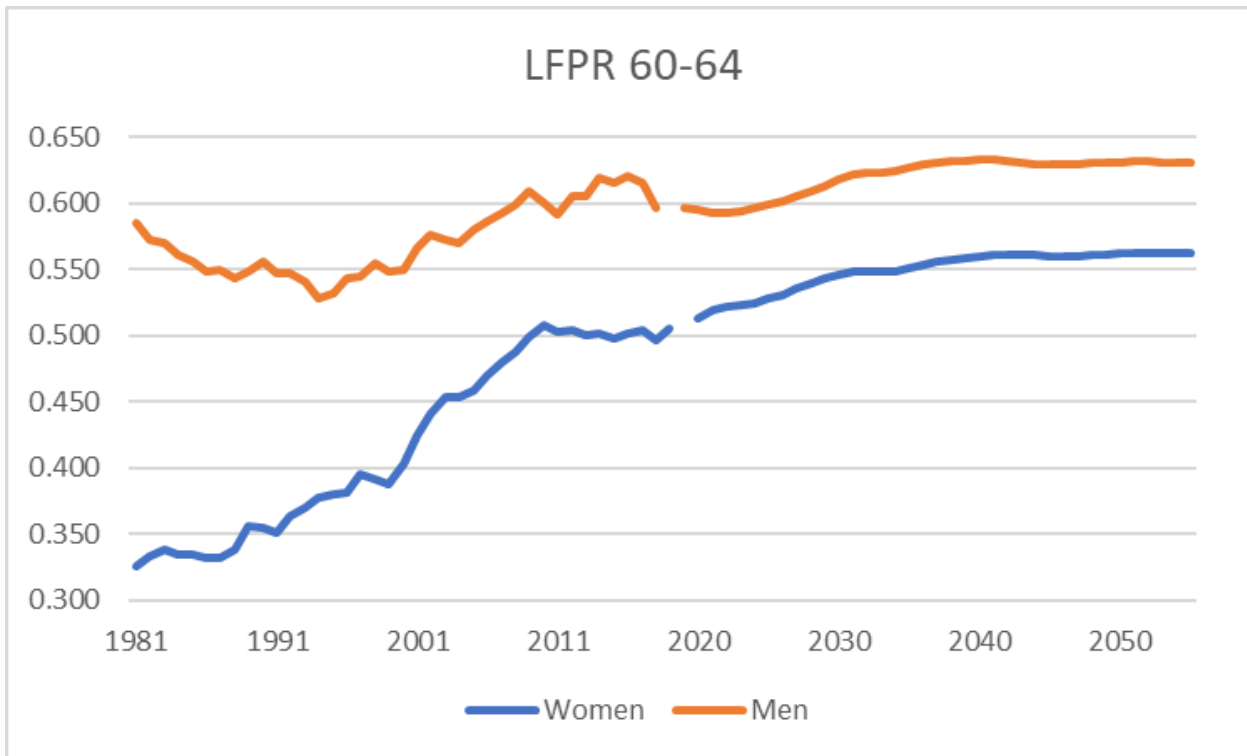What makes this stop?

Secular increase in LFP at Older Ages

Attributed to changes in Social Security retirement age, better health, longer life expectancy, more education, private pensions
Not sure what drives OACT projection (increase for a while, then about flat)

Putting it all together:
OACT 2018 Age-Adjusted LFPR

OACT projections have sizable increases in LFPR
For men, much of the decline is reversed. By 2025, LFPR is just above 2003 level
By 2043, LFPR is back to level seen in 1996, almost 2 percentage points higher than today
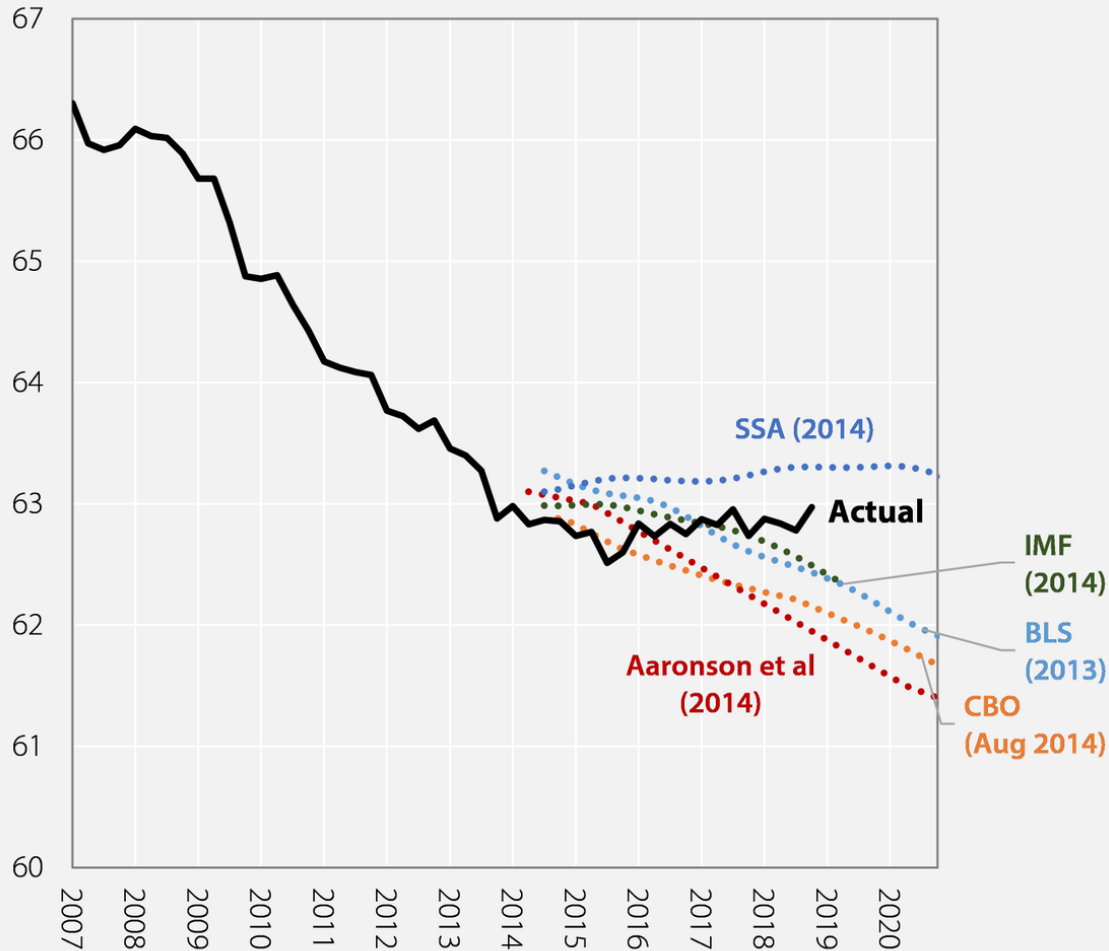
For women, LFPR rises to highest level, but still well below men
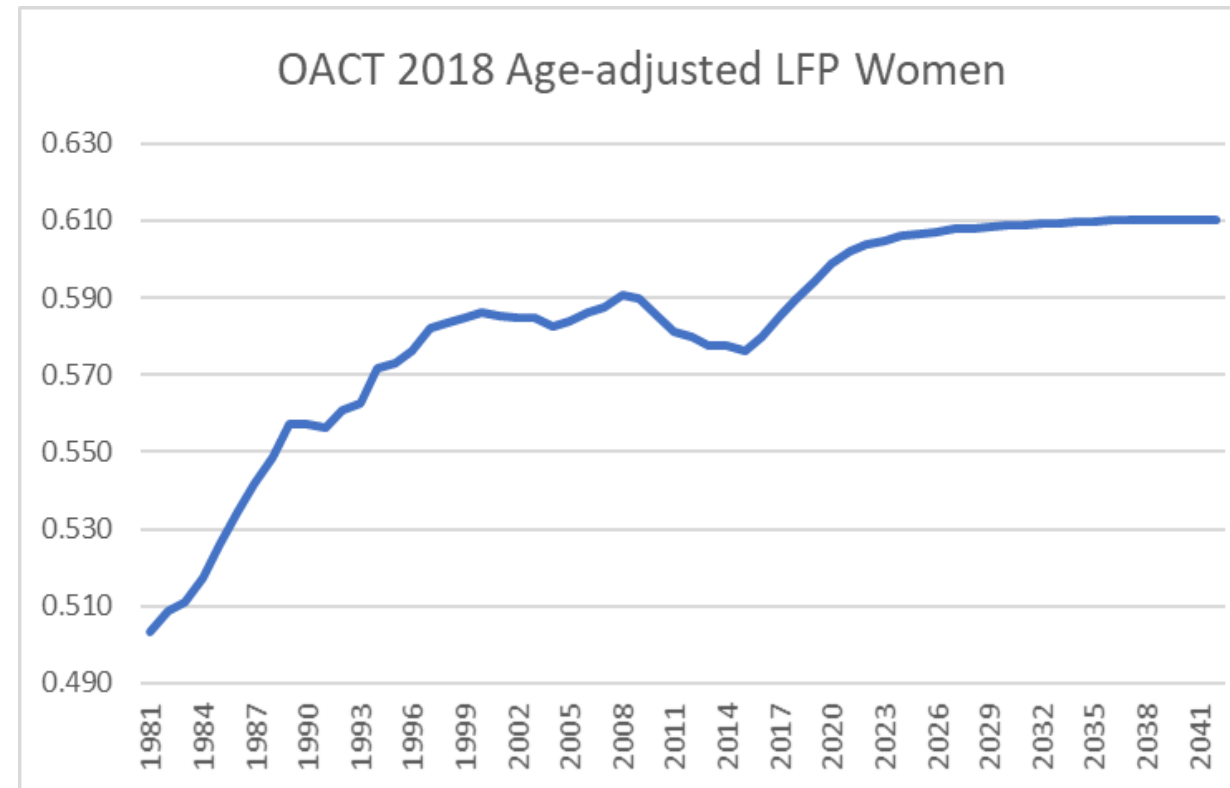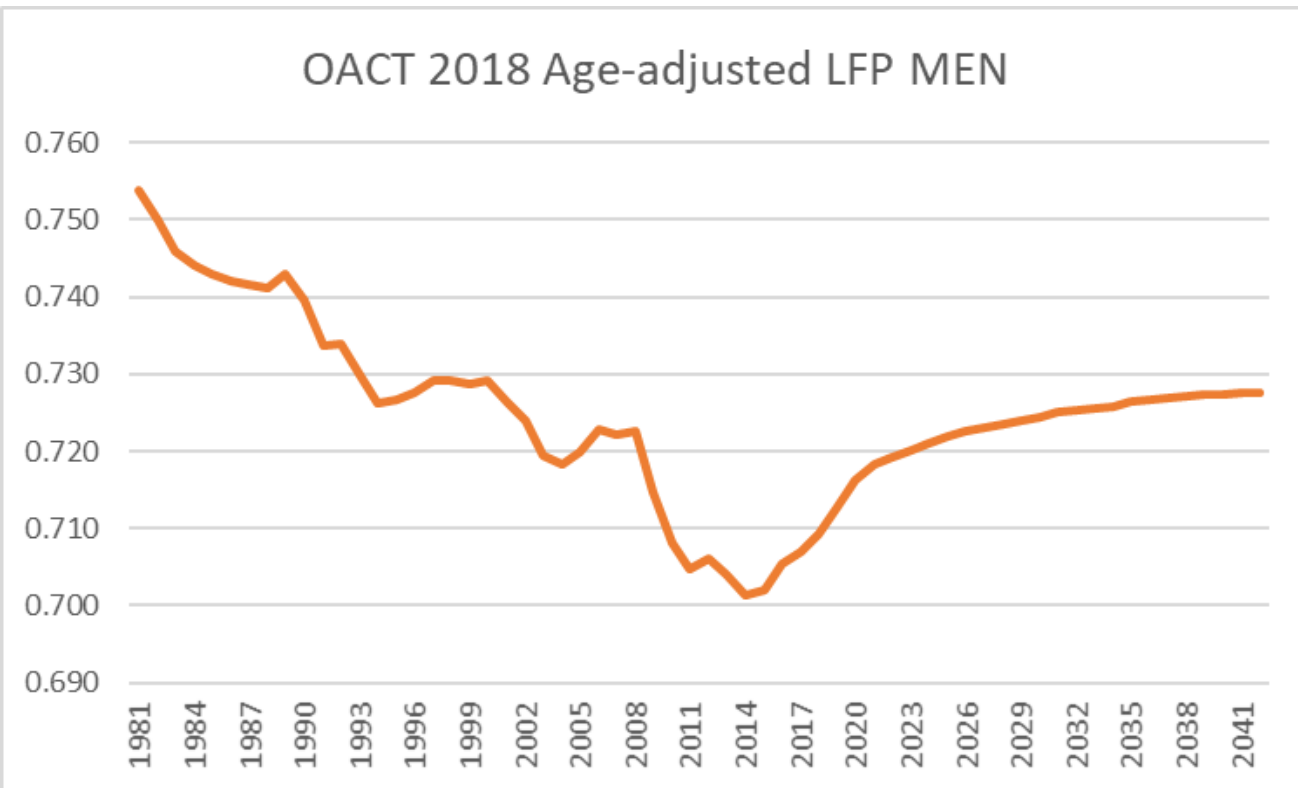
OACT did better than others in recent years, but does this mean model is right?

Labor Force Participation Rate
Actual and projections

SSA (2014)

Actual

IMF (2014)

BLS (2013)

Aaronson et al (2014)

CBO (Aug 2014)

Source: CBO, BLS, author's calculations.

@ernietedeschi

Burtless presentation: OACT was too optimistic about LFPR of younger and older workers, too pessimistic for prime-age

But still, OACT didn't assume big decline during GR was structural, others did.

But just because OACT was right on structural/cyclical, doesn't mean structural part won't reemerge.

Hot labor market can be masking long-term trends now.

Unemployment Rate
Actual and OACT Projection
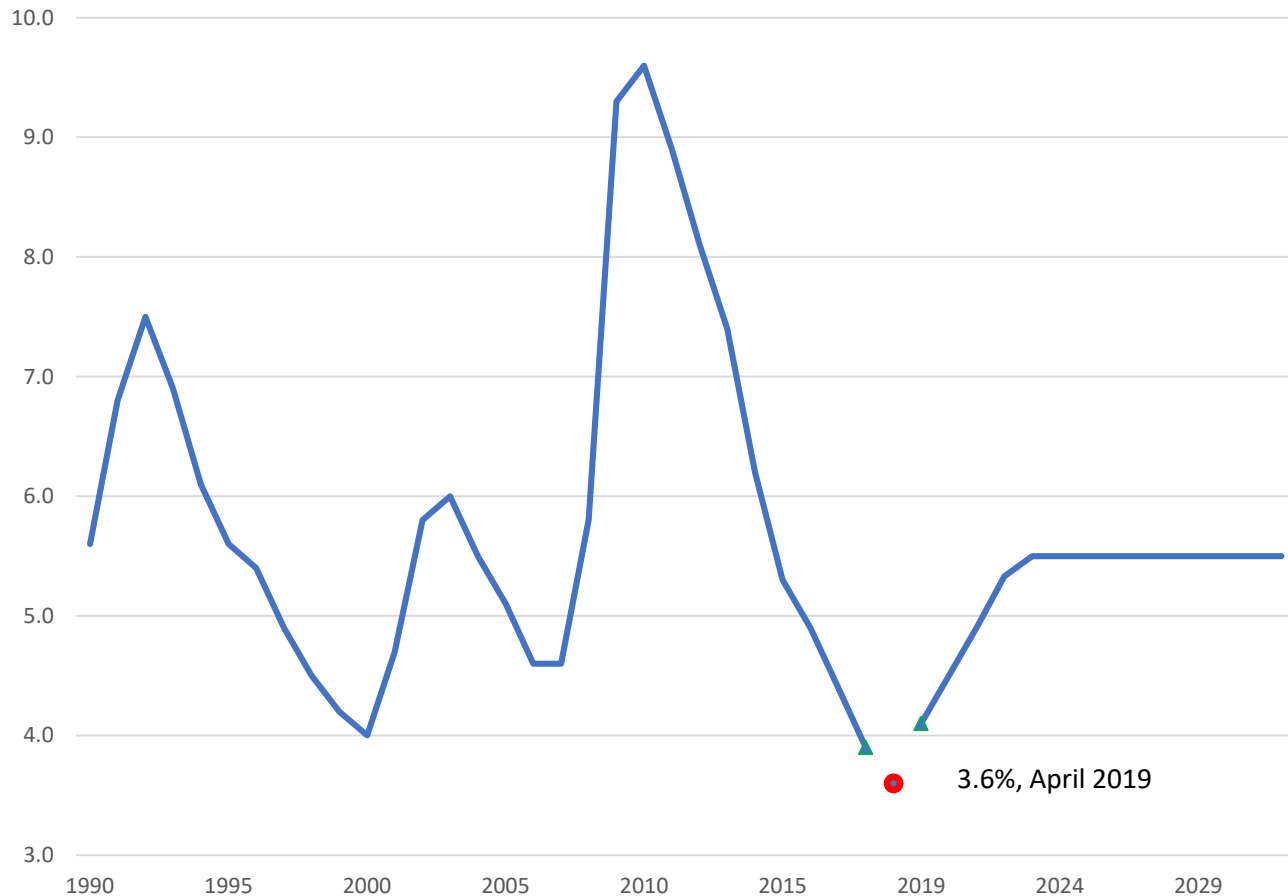
OACT ultimate UR: 5.5%

Much higher than most other forecasters, gets there quickly.

FOMC Median Long-Run UR: 4.3%
CBO Long Run UR: 4.5%

Some think "natural rate" of unemployment may be much lower: UR 3.6% in April, and inflation still muted

3.6%, April 2019

Relationship between UR and LFP

LFP rate is cyclical—question is how much.

Aaronson et al (BPEA 2014) find 1 ppt increase in UR lowers LFP by 0.1-0.4 ppt. Recent experience suggests top end of the range might make sense.

- If current UR is 1.6 percentage point below U*, then current LFP is 0.15-0.6 ppt <u>above</u> trend

- If NAIRU much lower (3.6% UR in April and inflation still low), then perhaps trend LFPR is higher than we thought (but then would need to change UR assumption).

- Do effects of hot labor market last? Or will LFP move back down as economy cools.

Employment-Population Ratios (EPOP)

EPOP = LFPR * (1-unemployment rate).

Big increase in UR during GR meant EPOP <u>fell much more than LFP</u> and <u>recovered much more</u> as well when unemployment rate fell.

So looks like EPOP is practically back to where it was.

But actually, not that different. For 30-34 year olds, LFPR for men is 2.5% below mid-2007 level, and EPOP is 2.2% below; For women, EPOP is 3.3% above and LFPR is 2% above.

Difference between them because UR lower now. The decline in UR is a level shift—not expected to continue to decline—so even if it stays this low, cyclical trends in LFPR will show through to EPOP again. And if UR goes back up, EPOP falls.

I think better to examine UR and LFPR separately, rather than together.

Epop 30-34 Men

Epop 30-34 Female
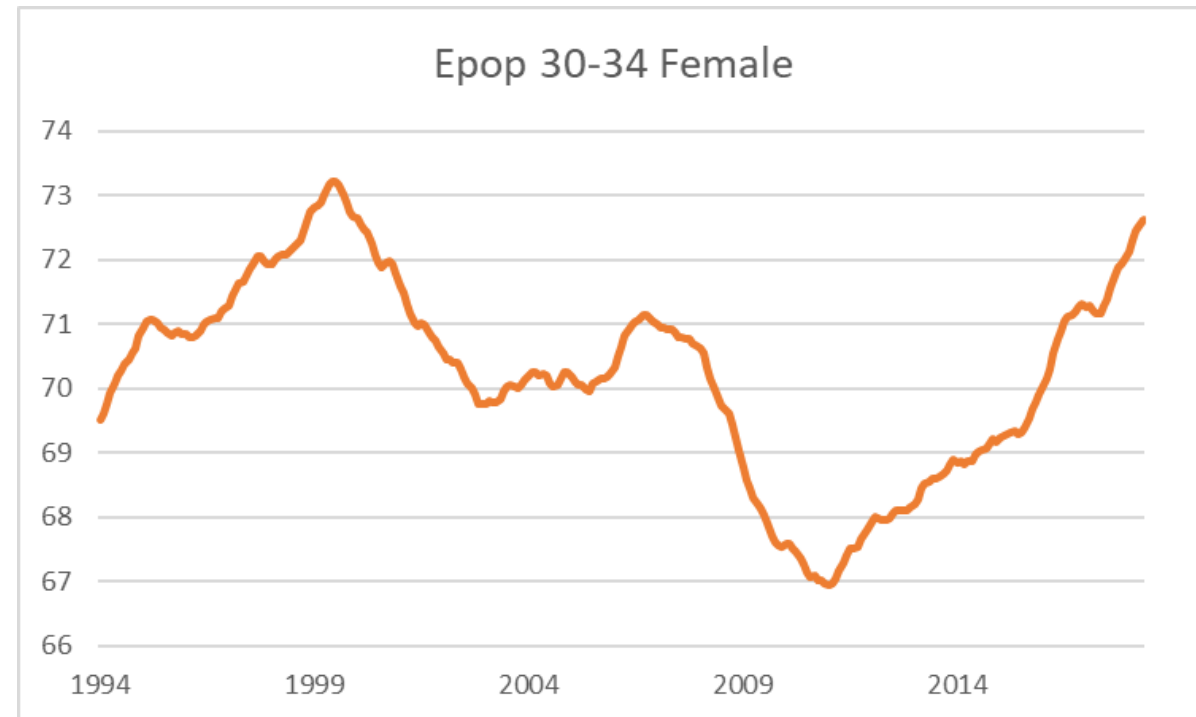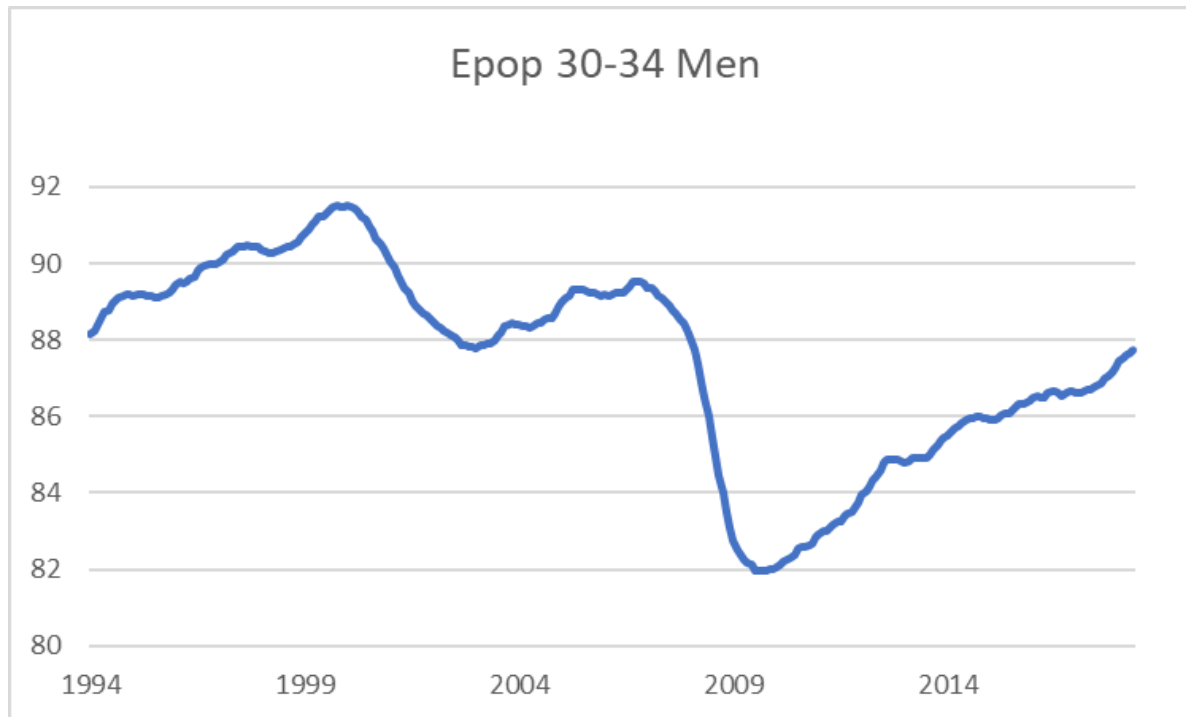
Modeling Issues

Linkages between UR and LFPR already noted

- What about linkages between LFPR and average wages, average hours?
- If increase coming from LFPR of 16-19 year olds, what will that do to average wages?
- If falling LFP of those with low education has been keeping up wages, should increased participation lower them?

Assumption about getting to long run

- Seems clear that LFP can't trend down forever. But some shocks (like declining demand for low skilled workers) can be long lasting.
- Would it be better to allow some trends to dissipate more slowly over time?

Summary and thoughts

Technical panel on labor force participation thought there would likely not be much cyclical recovery in LFP of prime age workers. For men, still haven't seen much. For women, have seen a lot.

That doesn't address why secular decline in prime-age male LFP is assumed to be over. This projection seems unbalanced. Risks on the downside. I think some decline in prime-age male LFPR should be assumed going forward. Technical panel wanted projections by education and an analysis of how model would have done predicting decline in the past. (Guess—not well.)

Similarly, LFP seems too optimistic for those younger than 20.

There are some upside risks: increase in LFPR of older workers could be larger. Women's LFPR could start to close the gap with male's.