

Flowing into Employment: Implications for the Participation Rate

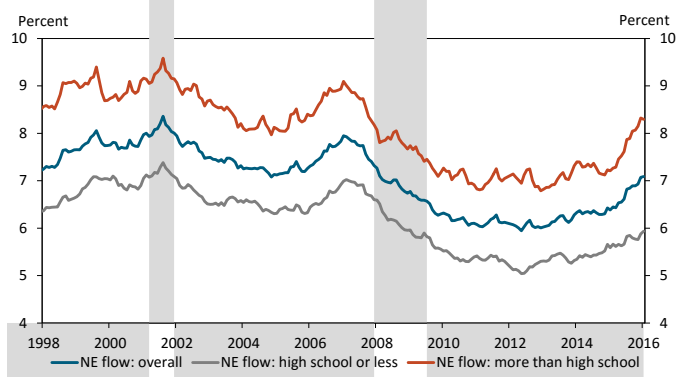
By José Mustre-del-Río, Michael Redmond, and William Xu

After a long stretch of declines, the labor force participation rate has risen in recent months, driven in part by an increase in the share of prime-age people flowing into employment from outside the labor force. So far, this flow has remained largely confined to those with higher educational attainment, suggesting further increases in labor force participation rate could be relatively limited.

After holding steady below its pre-recession norm for much of the recovery, the share of prime-age people (age 25-54) flowing into employment, called the NE flow rate, has increased noticeably in the past year (Chart 1, blue line). This is an encouraging development for the labor market, as increases in this flow, all else equal, drive up the labor force participation rate.

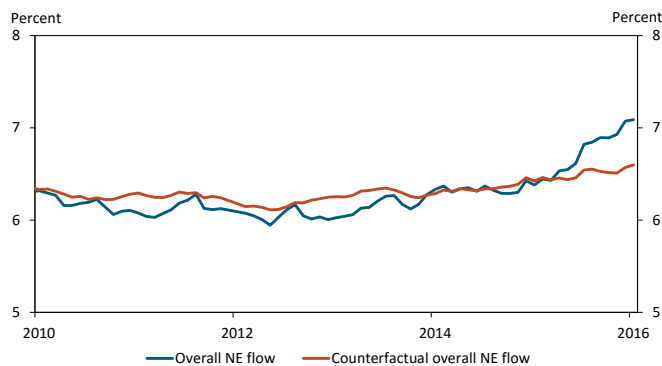
So far, though, the pickup in the prime-age NE flow rate has been mostly limited to those with higher educational attainment.¹ Indeed, Chart 1 shows the NE flow rate for people with more than a high school degree (red line) climbed steeply in 2015. Meanwhile, the flow rate for those with a high school degree or less (gray line), remained comparatively stable.

Chart 1: NE flow rate for the prime-age population



Notes: Gray bars denote NBER-defined recessions. Chart displays non-seasonally adjusted 12-month moving averages.
Sources: Bureau of Labor Statistics and authors' calculations.

Chart 2: NE flow rate scenarios



Notes: Chart displays non-seasonally adjusted 12-month moving averages. The counterfactual flow rate fixes the more-than-high-school flow rate to its 2013–14 average throughout 2015.

Sources: Bureau of Labor Statistics and authors' calculations.

To better gauge the relative contribution of individuals with more than a high school degree to the pickup in NE flows, we consider a counterfactual scenario in which the flow rate of these individuals is held fixed at its 2013–14 average, rather than increasing throughout 2015 (Chart 2). Comparing the actual (blue line) and counterfactual (red line) paths reveals that the overall flow rate would have picked up only slightly in 2015 had the flow rate for those with more than a high school degree held constant. Thus, workers with higher educational attainment appear to have contributed heavily to the pickup in the NE flow rate.

Further increases in the prime-age NE flow rate will tend to increase this group's labor force participation rate, holding other flows constant. To gauge the potential effects of changes in the prime-age participation rate on

the overall participation rate, Chart 3 presents calculations under different assumptions of the prime-age participation rate. Motivated by the previous charts, we differentiate between increases in the prime-age participation rate for individuals with more than a high school degree (red bars) versus high school or less (blue bars). Additionally, we consider scenarios that take into account differences in attachment within the pool of individuals not in the labor force.

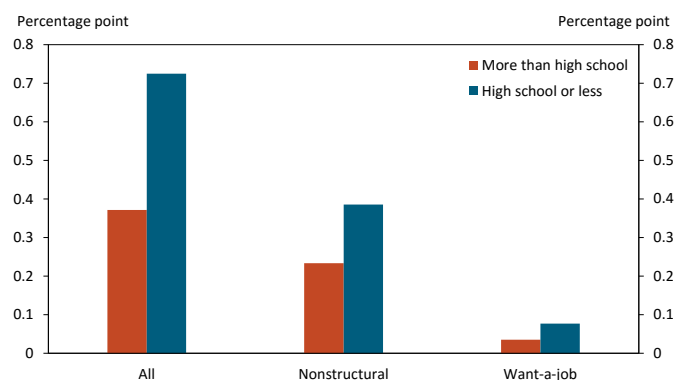
In the “all” scenarios, we assume the participation rate of all prime-age individuals, regardless of attachment, returns to its pre-recession average. If we limit this increase in participation to only those prime-age individuals with more than a high school degree, the overall participation rate rises by about 0.4 percentage point. However, if we allow for those with a high school degree or less to increase their participation to the pre-recession average as well, the overall participation rate rises by an additional 0.7 percentage point.

In the “nonstructural” scenarios, we limit the increase in the prime-age participation rate to individuals who are not retired or on disability.² If we further limit this increase to come entirely from the more than high school group, the overall participation rate rises by roughly 0.2 percentage point. However, if we allow individuals with a high school degree or less to increase their participation as well, the overall participation rate rises by an additional 0.4 percentage point.

Lastly, we also report an estimate that limits the increase in the participation rate to only those prime-age individuals who report they want a job. Previous research shows these individuals are the most likely to seek or take up jobs, suggesting they are highly attached to the labor force.³ Because this group is relatively small, the increase in the overall participation rate is less than 0.1 percent for each educational group. However, the NE flow rate has picked up even for those previously reporting they do not want a job, so this restriction may be too limiting.

Overall, the scenarios show that while more prime-age people could enter the labor force in the coming years, the cyclical improvement in the overall participation rate may be limited to the extent only those with higher educational attainment flow into employment. In addition, the potential increase in the participation rate could be constrained by other factors, such as an increase in the share of the prime-age population that reports they are either retired or disabled and a limited pool of people saying they want a job, even if they have not looked for one recently. Thus, while a higher NE flow indicates the prime-age participation rate could increase further, it will likely remain lower than its pre-recession rate.

Chart 3: Labor force participation rate scenarios



Sources: Bureau of Labor Statistics and authors' calculations.

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¹ We also examine other demographic markers, such as gender and marital status, and find these to be less important in explaining the recent acceleration in the overall NE flow rate.

² Retired and disabled individuals are not in the labor force due to structural reasons and thus are less likely to return even as conditions improve.

³ See for example, Davig and Mustre-del-Río; and Barnichon and Figura.

References

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Davig, Troy, and José Mustre-del-Río. 2013. “The Shadow Labor Supply and Its Implications for the Unemployment Rate,” Federal Reserve Bank of Kansas City, *Economic Review*, vol. 98, no. 3, pp. 5–29.

José Mustre-del-Río is an economist at the Federal Reserve Bank of Kansas City. Michael Redmond is an associate economist at the bank. William Xu is a research associate at the bank. The views expressed are those of the authors and do not necessarily reflect the positions of the Federal Reserve Bank of Kansas City or the Federal Reserve System.