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What is Behind the Recent Increase in Labor Force Participation?

By Didem Tüzemen and Jonathan L. Willis

Over the past year, the labor force has increased by 3 million people. While a growing labor force would seem to suggest a surge of new and previously discouraged workers entering the labor force, entries into the labor force actually declined in the past year. The growth in the labor force was instead the result of declining exits, likely due to workers remaining in their jobs for longer periods of time and older workers delaying retirement.

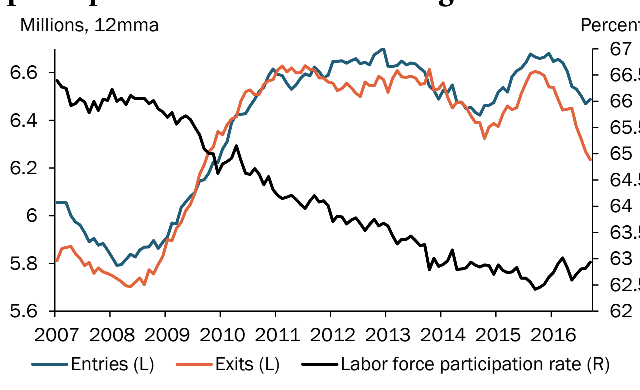
Over the past 12 months, the labor force—those who are either employed or unemployed and actively looking for work—has grown by about 3 million individuals, the fastest growth since 2000. The rapid growth in the labor force has in turn pushed up the labor force participation rate from 62.4 percent in September 2015 to 62.9 percent in September 2016. While the rapid rise in participation is a welcome development, it is also important to understand the primary factors driving this increase to better assess labor market conditions.

Overall, changes in the labor force are driven by the combination of entries into and exits from the labor force. Entries consist of individuals who previously did not have a job and were not looking for work flowing into the labor force. Exits consist of individuals who were previously employed or actively looking for work moving out of the labor force.

The recent increase in the labor force could have occurred in one of two ways. First, the number of people entering the labor force could have accelerated faster than the number of people exiting the labor force. Second, the number of people exiting the labor force could have declined faster than the number of people entering it. We show that the latter explanation is behind the recent increase in the labor force participation rate.

Chart 1 plots flows into and out of the labor force along with the labor force participation rate since 2007. The number of individuals exiting the labor force increased rapidly following the Great Recession, as some who lost jobs in the recession became discouraged and stopped looking for work. In addition, some discouraged job losers who were close to retirement chose to retire earlier than previously planned. As exits increased, entries into the labor force also rose. The increase in the number of individuals entering the labor force from 2009 to 2011 was likely driven by individuals who resumed working or looking for work after short periods of not looking for work. While both flows rose during this period, exits exceeded entries, contributing to a decline in the labor force participation rate.

Chart 1: Labor force entries, exits, and participation rate for individuals age 16 and over



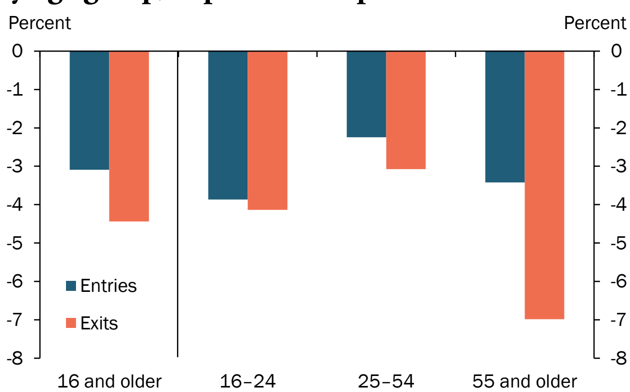
Source: Bureau of Labor Statistics

This period of strong flows into and out of the labor force—in the context of a falling labor force participation rate—illustrates the "revolving door" nature of the labor market. In any given month, the number of people flowing into and out of the labor force is far greater than the net change in the labor force. For example, in 2010, the labor force increased by 45,000 people per month on average. But the numbers of entries and exits each month were much larger: 6.62 million people entered the labor force on average, while 6.57 million people exited it. Given the large number of entries and exits each month, small changes in these flows can lead to large changes in the size of the labor force over the course of a year.

From 2011 to 2013, as the economy started to recover, both exits and entries somewhat stabilized. However, the labor force participation rate continued to decline, as modest growth in the labor force did not keep pace with population growth.

In September 2015, this pattern changed: both exits and entries decelerated. More importantly, the number of people exiting the labor force fell more sharply than the number of people entering the labor force, leading to a pick up in the labor force participation rate.

Chart 2: Changes in labor force entries and exits by age group, Sept. 2015–Sept. 2016



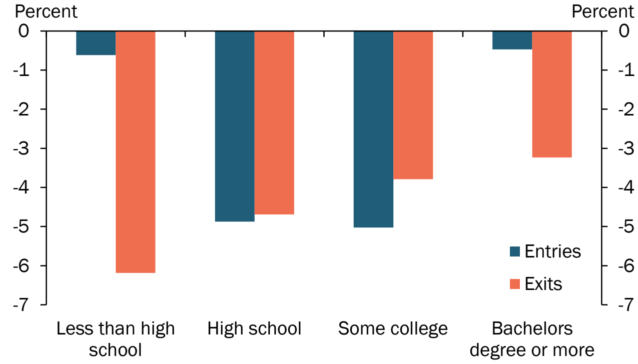
Sources: Current Population Survey and authors' calculations

The decline in exits from the labor force occurred for all age groups but was most pronounced for older workers, who may be delaying retirement. Chart 2 shows the percentage change in labor force entries and exits from September 2015 to September 2016. For all workers, entries declined by 3 percent, while exits declined by over 4 percent. For workers age 16–24, the declines in entries and exits were similar to the overall average. For workers age 25–54, the decline in exits exceeded the decline in entries, suggesting that people are remaining in their jobs for longer. The most notable decline in exits was for workers age 55 and older, who experienced a decline of over 7 percent in exits from the labor force.

The decline in exits, in combination with steady increases in nonfarm payroll employment, suggests workers are now more attached to the labor force than in the earlier years of the recovery. In other words, the "revolving door" of the labor force is slowing down as workers are matched to better, more stable jobs. A few factors likely contributed to the decline in exits. First, unemployed individuals are now less likely to become discouraged and exit the labor force, as measured by labor flows data from the Bureau of Labor Statistics. Second, improvements in job quality and rising wages may encourage workers to remain employed for longer stretches of time.[1] In addition, the recent pickup in wages has likely encouraged more individuals to continue searching for jobs, which reduces the number of discouraged workers exiting the labor force. Finally, for older workers, the decline in exits may suggest that some workers are delaying retirement decisions.

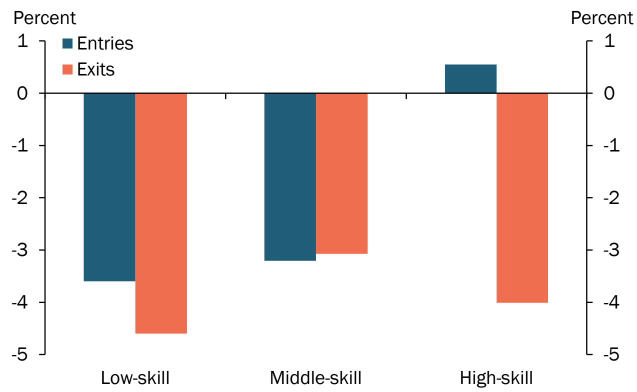
The decline in labor force exits relative to entries is more pronounced for workers with the least and the most educational attainment. Chart 3 displays the percentage change in labor force entry and exit flows from September 2015 to September 2016 for workers with four levels of educational attainment: less than high school, high school, some college, and a bachelor's degree or higher. For workers with less than a high school education, labor force exits declined by over 6 percent, while entries declined by less than 1 percent. For workers with a bachelor's degree or higher, exits declined by over 3 percent with only a modest decline in entries. These patterns suggest that labor market conditions have improved for workers with the highest and lowest educational attainment over the past year. Entries declined more than exits in the two middle groups, suggesting labor market conditions have improved less for these workers.

Chart 3: Changes in labor force entries and exits by educational attainment, Sept. 2015–Sept. 2016



Sources: Current Population Survey and authors' calculations

Chart 4: Changes in labor force entries and exits by occupation, Sept. 2015–Sept. 2016



Sources: Current Population Survey and authors' calculations

Consistent with labor force flows by education, exits for workers in low-skill and high-skill occupations declined the most over the last year (Chart 4). The Great Recession had the most adverse effects on workers in middle-skill jobs; these workers have experienced only modest recovery in recent years (Tüzemen and Willis). Similar declines in entries and exits for middle-skill workers suggest job opportunities for this group have not yet picked up. Exits declined more rapidly than entries for workers in low-skill occupations, suggesting labor market opportunities are finally improving for this group after weak employment growth from 2010 to 2015 (Tüzemen and Willis). Labor force entries increased only for workers in high-skill occupations, while exits decreased by 4 percent. The growing entries and declining exits suggest both that employment growth continues to be strong for workers in high-skill occupations and that these workers are remaining in existing positions longer.

Over the past year, the labor force has increased by 3 million people. While a growing labor force would seem to suggest a surge of new and previously discouraged workers entering the labor force, entries into the labor force actually declined in the past year. The growth in the labor force was instead the result of declining exits, likely due to workers remaining in their jobs for longer periods of time and older workers delaying retirement.

[1] From September 2015 to September 2016, the probability of an individual transitioning from employment to non-employment fell from 4.2 percent to 4.0 percent based on 12-month averages of labor flows data from the Bureau of Labor Statistics.

References

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