The Washington Post Print

Three reasons the U.S. labor force keeps shrinking

By Brad Plumer, Updated: September 6, 2013

The U.S. labor force keeps shrinking rapidly. Back in 2007, 66 percent of Americans had a job or were actively seeking work. Today, that number is at 63.2 percent — the lowest level since 1978:

The above chart helps explain a seeming contradiction in the jobs numbers — the official unemployment rate keeps dropping even though job creation has been relatively soft.

Over the past three months, the U.S. economy has averaged 148,000 new jobs per month. That's actually a slower pace than the previous six months. Yet the unemployment rate keeps dropping precipitously, reaching 7.3 percent in August — the lowest since December 2008.

The reason? Between July and August, 312,000 people dropped out of the labor force. But because the official unemployment rate counts only those workers who are actively seeking work, the unemployment rate fell.

To put this in perspective: If the same percentage of adults were in the workforce today as when Barack Obama took office, the unemployment rate would be 10.8 percent.

So why is the labor force dropping? There are a couple big factors going on here. Older Americans are retiring, younger Americans are going back to school, and many workers have been discouraged by the weak U.S. economy. Here's an updated breakdown:

1) The aging of America. One big reason the participation rate dropped involves long-run demographic trends that have nothing to do with the current economy. Baby boomers are starting to retire en masse, which means that there are fewer eligible American workers.

Demographics have always played a big role in the rise and fall of the labor force. Between 1960 and 2000, the labor force in the United States surged from 59 percent to a peak of 67.3 percent. That was largely due to the fact that more women were entering the labor force while improvements in health and information technology allowed Americans to work more years.

But since 2000, the labor force rate has been steadily declining as the baby-boom generation has been retiring. Because of this, the Federal Reserve Bank of Chicago expects the labor force participation rate to be lower in 2020 than it is today, regardless of how well the economy does.

One way to see that change is in this chart from Derek Thompson.

Americans over the age of 65 are *much* less likely to work than prime-age Americans. And since that subset of Americans is swelling, that drives the labor-force participation rate down. Note that this is happening even though older Americans are staying on the job for longer than they did during the 1990s.

Economists disagree, however, on exactly how much demographics are responsible for the fall in the participation rate. The Chicago Fed estimates that retirements accounted for only one-fourth of the drop in labor force participation since the recession began. Other analysts, including Barclays, have suggested that aging Boomers could account for a majority of the fall.

2) The bad economy is keeping workers in school and out of the labor force. Demographics can't entirely explain of the labor force fall, however. For one, the number of Americans working or actively seeking work has actually fallen faster than demographers had predicted:

And here's another clue that this isn't just a demographic story: The participation rate for workers between ages 16 and 54 fell sharply during the recession and still hasn't recovered. Obviously retirements can't explain this:

So what's going on? One theory is that the weak job market is causing people to simply give up looking for work — they're crumpling up their resumes and going home. A recent paper (pdf) from the Boston Fed suggested that these "non-inevitable dropouts" might even account for the bulk of the decline.

Other analyses have put a different twist on that story. According to a recent paper (pdf) from the Urban Institute, the rate of labor force *exit* is actually lower than it was in the aftermath of the 2001 recession. That is, labor force drop-outs aren't the big story here.

Instead, the report notes, what's happening is that workers aren't *entering* the labor force at the same rates they used to. That's especially true for women, who are much less likely to enter the labor force today than they were in 2002 and 2003. Many are deciding to stay at home to raise the kids or enrolling in school instead.

That's not always a bad sign: The fraction of 16- to 24-year-olds pursuing an education has been growing over time, for instance. That could mean a more skilled workforce in future years (though it will also mean more young Americans with burdensome student debt).

But the economic story is also bleak in places, particularly for older workers: Another recent paper noted that the decline in U.S. manufacturing jobs may be partly responsible for the fall in the participation rate. During the housing boom in the 2000s, many of those manufacturing workers could find jobs in the construction sector. But once housing went bust, they were left adrift, unable to find new work.

3) More workers are going on disability insurance: There are now roughly 8.8 million Americans receiving disability benefits, a number that has doubled since 1995. Could that be a factor pulling people out of the labor force?

Possibly, although this is likely only a small part of the story — the Federal Reserve Bank of Cleveland estimates that changes in eligibility criteria for disability only accounts for about 0.5 percentage points of the fall in the participation rate.

The University of Chicago's Harold Pollack also cast doubt on the claim that the lure of disability benefits were taking workers out of the workforce: "One way to see this is to look at the employment rates for people who applied for disability but were then denied," he told me. "And those are actually quite low, below 50 percent. That suggests we're not pulling people out of the workforce who would otherwise be there."

So why does the size of the labor force matter? For one, if people are leaving the labor force for economic reasons (and they're not going back to school), it would mean the economy is in much worse shape than the official unemployment rate suggests.

The size of the labor force also goes a long ways to determining America's growth prospects. If, say, Baby Boomers are retiring faster than expected, then long-run U.S. economic growth will be lower than projected.

Even worse, if discouraged workers are dropping out of the labor force entirely, they may never make their way back into jobs — they may become unemployable. That's a massive human tragedy. It could also mean the U.S. economy will be significantly weaker in future.

Further reading:

— My colleague Jim Tankersley had a great discussion with the Wall Street Journal's Ben Casselman a few months ago on why the labor force participation rate matters.