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A Meta-Analysis of the Decline in the Labor Force Participation Rate

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The U.S. labor force participation (LFP) rate, which measures the fraction of the population that are either employed or unemployed but actively looking for a job, peaked at 67.3 percent in early 2000 after increasing for about 40 years. Since then, the LFP rate has been declining for most of this century. In particular, it declined to about 66 percent by the end of 2004, remained roughly flat for more than two years until the start of the Great Recession in the second half of 2007, and then declined to 62.4 percent in September 2015. The LFP rate has remained slightly below 63 percent in the last two years. A closer look at the LFP rate by age, gender, and education reveals that it declined for most of the demographic groups.

The decline in the LFP rate has attracted a lot of attention with many explanations proposed. Some examples are the aging of the population, the increase in school enrollment among youths, the increase in the number of individuals with mental and physical health issues, the rise in incarceration and criminal records, the stagnation of real wages for low-skilled workers and the rising wage inequality, and technological changes that may have either reduced the demand for labor through, for example, the automation of routine tasks and the use of robots.

While each of the proposed explanations may contribute to the recent decline in the LFPR, their relative importance is not well understood. This project attempts to fill this gap. We examine the evolution of LFP rate for different demographic groups to gauge the effect of demographic changes. We estimate the transition rates across different labor market statuses to see whether more workers are leaving the labor force or fewer workers are entering the labor force. We also use wage data to get a sense of the relative importance of demand and supply factors. Overall, we find that roughly half of the decline in LFP is attributable to demographic shifts,

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but that LFP within most demographic groups has been continuously declining. Disability is an increasingly common impediment to work, but wage incentives also play a role, as declines in LFP seem to be associated with weakening wage incentives to enter or re-enter the labor force.

The recent decline in the LFP rate has important implications for both national economic growth and individual well-being. By investigating the factors behind this decline, this project provides useful information regarding the effects of current policies. This project can inform us on what types of policies could potentially be used to raise the LFP rate. For instance, the expansion of Social Security disability insurance may have contributed to the decline in the LFP rate, as increasing numbers of workers report work-limiting disability. However, the LFP rate decline also seems to be associated with wage stagnation, in particular a rising wage penalty for unemployment spells, suggesting a mismatch between the skills required by firms and the skills provided by workers.

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