

19-1 The Problem of US Labor Force Participation

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Abstract

Despite more robust growth than many advanced economies in Europe and Asia, labor force participation in the United States between 1995 and 2017 was weak. In other countries, job loss has manifested itself as increased unemployment as opposed to labor force exit. For men, the decline in labor force participation appears to be partly structural, as it is common across countries, and partly related to disability. For women, disability was an even more important contributor to the decline in their labor force participation, explaining nearly two-thirds of the decline in labor force participation of prime-aged workers.

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1. INTRODUCTION

As 2018 drew to a close, the jobless rate in the United States had declined to a level not seen since the 1960s. But the hopeful picture presented by a near record low unemployment rate of 3.7 percent is also misleading.¹ While the United States has experienced more robust growth than many advanced economies in Europe and Asia, its labor force participation during the recovery from the financial crisis of 2007–08 was comparatively poor. This participation rate masked a weakness reflecting the fact that many Americans who could have been employed, contributing to the US economy, chose to drop out of the labor force for reasons ranging from illness and disability (aggravated by the opioid crisis) to lack of mobility or simply being discouraged about finding work.

US labor force participation of prime-aged workers (aged 25–54) fell by 1.8 percentage points between 1995 and 2017, compared with increases in most other advanced economies.² Had labor force participation rates remained constant over the period, about 2 million more prime-aged workers would have been in the US labor force by the end of 2017. The employment landscape in the United States thus looks similar to other countries, where unemployment rates are higher. A significant reason for the low US rate is that disability insurance has become an important form of assistance for the long-term unemployed, which has facilitated their departure from the labor force. Since 1995, nearly one million additional people between 30 and 54 began receiving disability payments (SSA 2016).

There are some differences for women relative to men. For men, part of the decline in labor force participation appears to have been structural, as it is common across countries. But while US male labor force participation among prime-aged workers declined by 3 percentage points since 1995, the average across other comparable industrial countries was less than 1 percentage point. Structural change and the rise in disability insurance recipients together explain roughly one-third of the decline in US male labor force participation among prime-aged workers.³ For women,

disability was more important, with over 700,000 additional prime-aged female workers ending up on disability by 2016, explaining about two-thirds of the decline in labor force participation of prime-aged workers over the period.

Finally, other factors at work include regional mobility. Movement across regions in the United States has declined over time, and this may also be an important contributor to the overall decrease in labor force participation.

This paper reviews the factors that have led to a low employment participation rate in the United States despite the slow but steady economic recovery from the financial crisis. The possibility of creating programs to encourage workers to remain in the labor force during periods of adjustment will be examined in a companion paper, which will also assess policies that have succeeded in meeting this challenge in other countries (Bown and Freund 2019, forthcoming).

2. COMPARING LABOR MARKET OUTCOMES IN THE UNITED STATES AND EUROPE

While other advanced economies have faced many of the same pressures from technology and trade, they have not seen the same sharp declines in labor force participation as the United States (figure 1). Because demography is different across countries, the focus here is on prime-aged workers (aged 25–54).⁴ On average, OECD countries experienced a 4 percentage point *increase* in labor force participation compared with a 1.8 percentage point *decrease* in the United States between 1995 and 2017. Among OECD countries, only a handful of small countries experienced declines, all of which have higher labor force participation than the United States.

Both US male and female labor force participation rates have declined since the early 2000s, with US rates now falling well below those of other large and high-income OECD countries (figure 2). Labor force participation among American men has declined especially sharply since the financial crisis of 2007–09 and has struggled to return to precrisis levels. Labor force participation among

1. According to the monthly Bureau of Labor Statistics report, the US unemployment rate as of November 2018 was 3.7 percent.

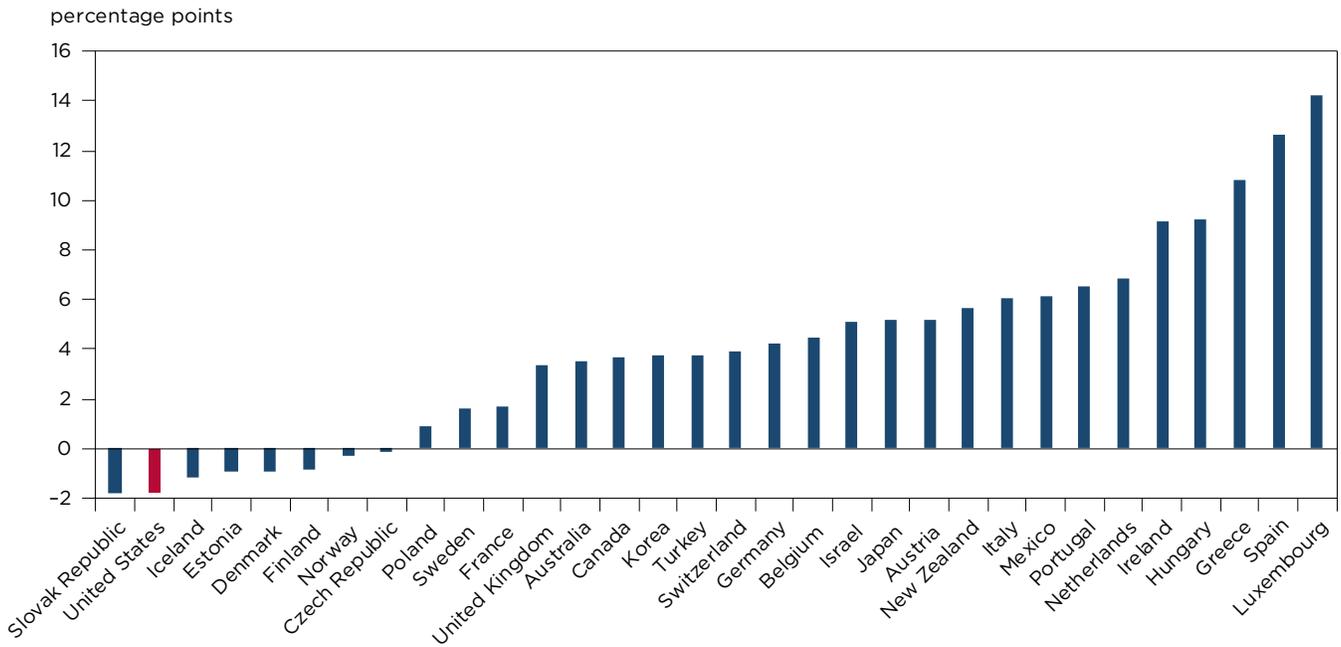
2. By the end of 2018, US labor force participation of prime-aged workers had finally improved so that it was less than 1 percentage point lower than in 1995.

3. From 1996 to 2016, the number of prime-aged men on disability increased by 247,000, accounting for a 0.4 percentage point decline in labor force participation. Define structural change as the average percentage point decline in labor force participation from comparator countries since

1996 (to control for global trends), which is roughly 0.67 percentage point. Then structural change plus the increase in disability in the United States is equivalent to roughly one-third the total decline in US prime-aged male labor force participation over this period.

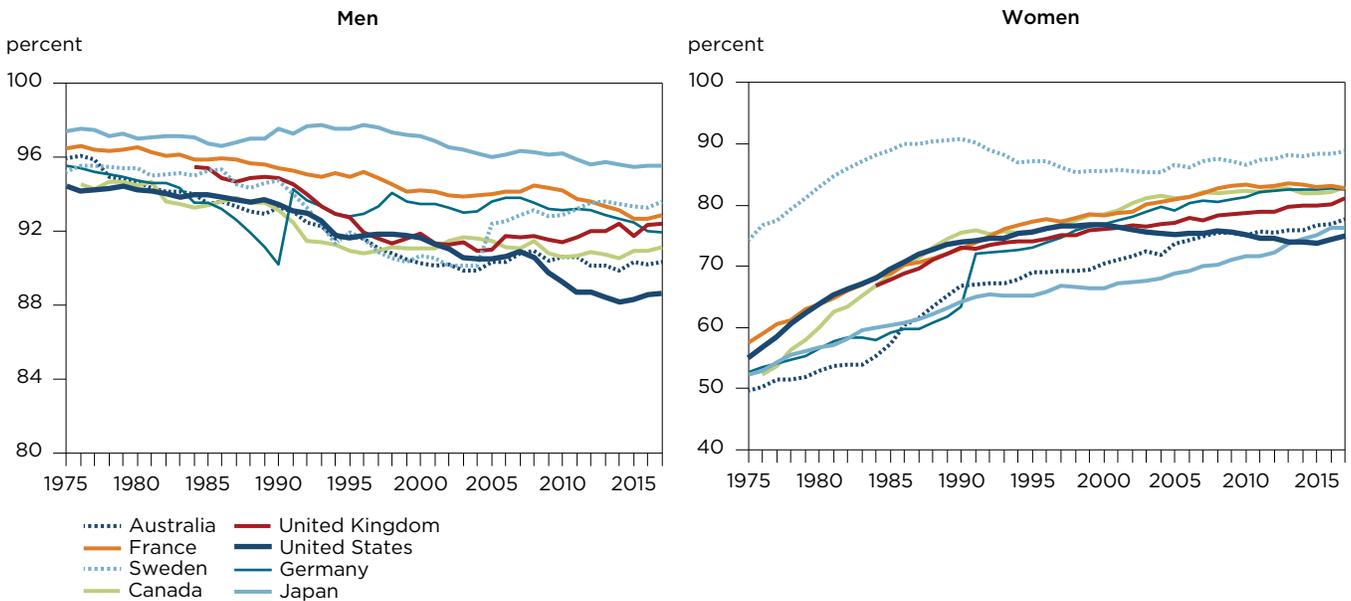
4. Labor force participation is lower for older workers (aged 55–65) because some workers retire early and for younger workers (aged 15–24) because of education. Focusing on prime-aged workers reduces concerns over demographic differences across countries and changes over time (e.g., exit of baby boomers) that affect labor force participation.

Figure 1 Change in labor force participation, prime-aged workers (aged 25-54), 1995-2017



Source: OECD (2018a).

Figure 2 Labor force participation rate, prime-aged workers (aged 25-54), 1975-2017



Source: OECD (2018a).

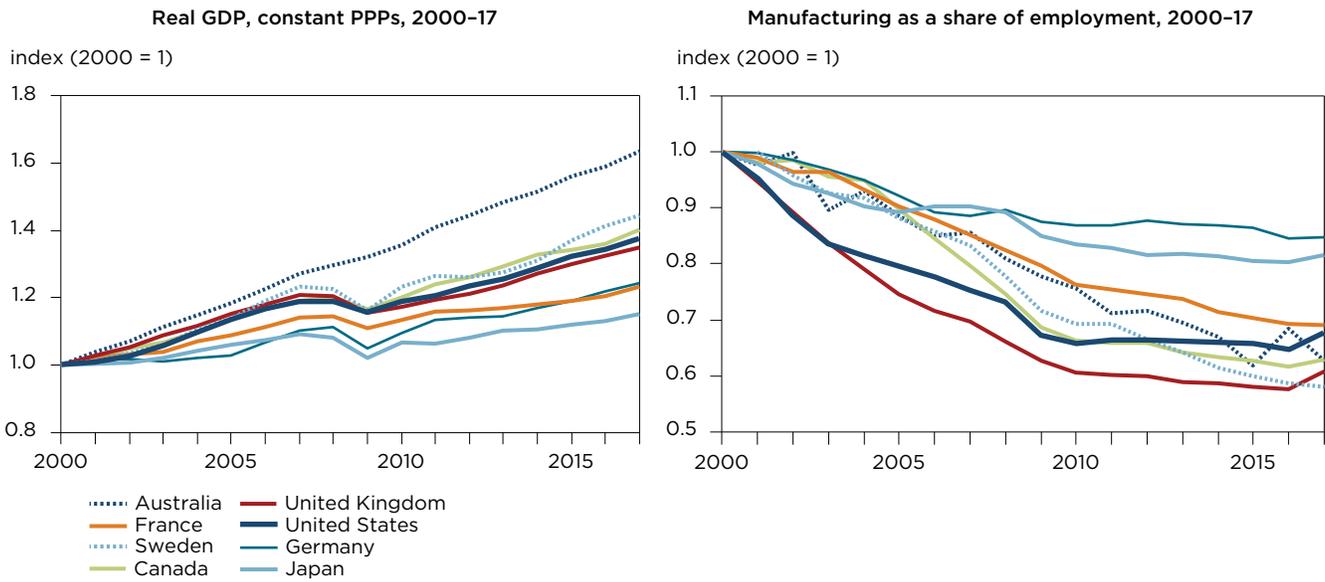
men in other countries has also been declining on average, suggesting that a structural transformation is making men more likely to exit the labor force than in the past.⁵ The

decline in labor force participation among US women since the late 1990s has been unique. Female labor force partici-

5. Freund and McDaniel (2017) show that job opportunities for less educated men, such as metal workers or carpenters,

have been declining, while job opportunities for less skilled women, such as manicurists or health care aides, have been increasing.

Figure 3 GDP growth and manufacturing as a share of employment, 2000-17



PPP = purchasing power parity

Note: Index year for Swedish real GDP and manufacturing data is 2001 because of data availability.

Sources: Real GDP data are from OECD (2018b); Swedish manufacturing data are from OECD (2018c); manufacturing data for all other countries from Haver Analytics (2018).

pation in other countries has continued to increase over the last 15 years, but the share of women in the US labor force has been either flat or in decline over the same period.

One potential explanation for the relatively sharp decline in US labor force participation and low levels is the recession of 2007–09 and dropoff in manufacturing activity since the financial crisis. But, the United States is not an outlier in terms of economic activity. Other countries have had more severe slowdowns and experienced greater reductions in the share of manufacturing in employment (figure 3) without the stark drop in labor force participation. In addition, men make up over 70 percent of US manufacturing employment, but as noted above, recent weak US labor force participation relative to other countries has been apparent for both men and women.

One important difference between the United States and other countries is that American workers are more likely to leave the labor force if they cannot find work. In contrast, in other countries, they become unemployed but remain in the labor force. The US unemployment rate skyrocketed after the financial crisis, reaching 10 percent, but has declined markedly in recent years and is now below the rate before the financial crisis, making it appear as if the US labor market is outperforming other countries. Yet, because joblessness manifests itself as labor force departure in the United States—compared with unemployment in

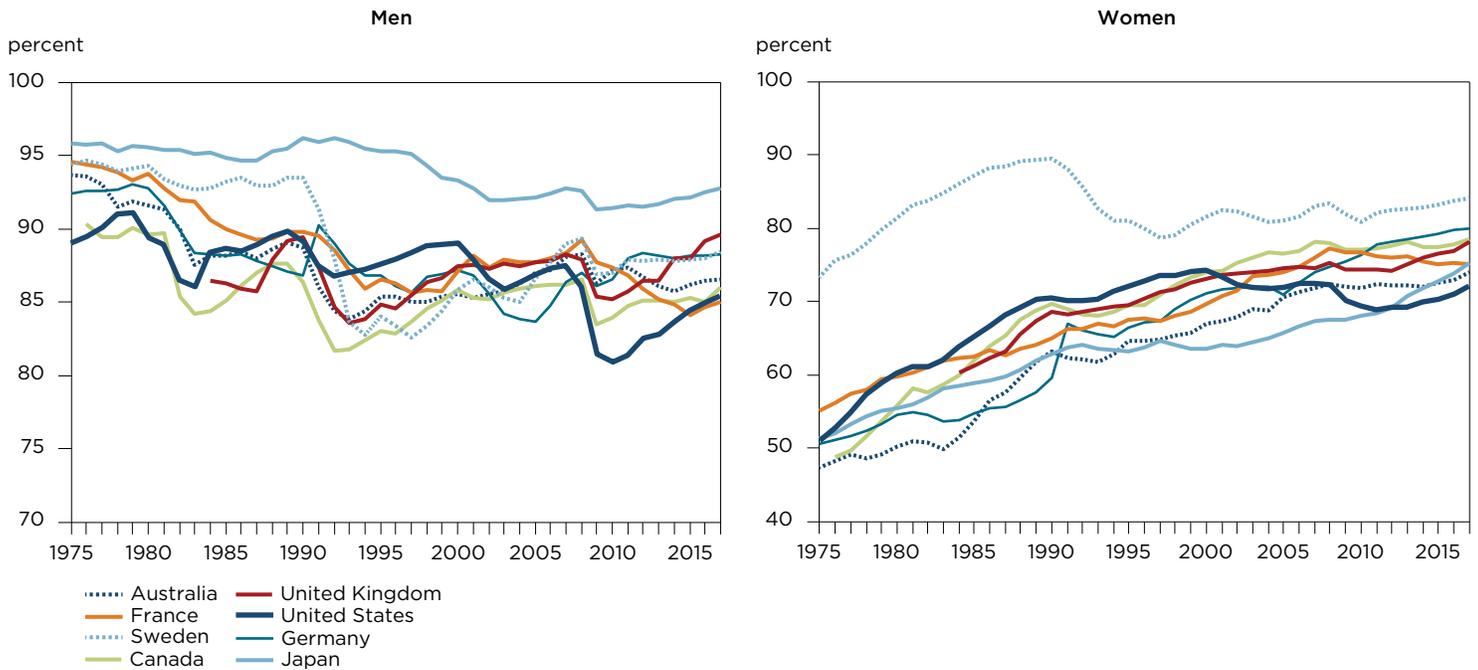
other countries—the United States is less of an outlier in terms of the share of prime-aged workers who are employed (figure 4).

The decline in US unemployment, considering its weak performance in labor force participation, may be a Pyrrhic victory. Yes, unemployment is low, but it is low because millions of workers have left the labor force. Had participation rates remain unchanged since before the Great Recession, over one million more prime-aged Americans, mostly men, would have been in the labor force. Output and growth depend on the United States employing the working-age population productively. The US economy is thus underperforming, even when times are good, because labor force participation is weak.

3. A FOCUS ON CANADA AND THE UNITED STATES

Comparing the labor market performances in Canada and the United States in recent years is especially striking (figure 5). The male employment rate in Canada fell by 0.22 percentage point between 2007 and 2017. Unemployment is 0.20 percentage point higher than it was in 2007, so nearly all of the decline in employment is because of unemployment. In contrast, in the United States, the decline in labor force participation explains the drop in the employment rate over this period. The movements for female workers are

Figure 4 Employment rate, prime-aged workers (aged 25–54), 1975–2017



Source: OECD (2018d).

similar qualitatively. In Canada, the employment rate has increased despite an increase in the unemployment rate; this is due to a larger increase in labor force participation. In the United States, the decline in the female employment rate is largely explained by a similarly sized decrease in female labor force participation. In sum, Canadian unemployed workers have incentives to remain in the labor force that US unemployed workers seemingly do not.

The duration of unemployment spells may help explain why US workers have departed the labor force to a greater extent than Canadian workers. Panel B of figure 5 shows the average unemployment spell over time for workers in Canada and the United States. The financial crisis had an extraordinary effect on the duration of unemployment spells in the United States, which likely explains why such a large share of workers dropped out of the labor force.⁶ The danger is that when millions of American workers stop seeking employment, it may be more difficult to bring them back. In this case, the financial crisis may have inflicted even greater long-term damage to US workers and the economy than anticipated.

6. Another difference between the United States and Canada during this period was the impact on employment in the construction sector. Alongside the financial crisis, the United States suffered a steep reduction in construction jobs, which Canada did not.

4. THE LABOR MARKET AND DISABILITY INSURANCE

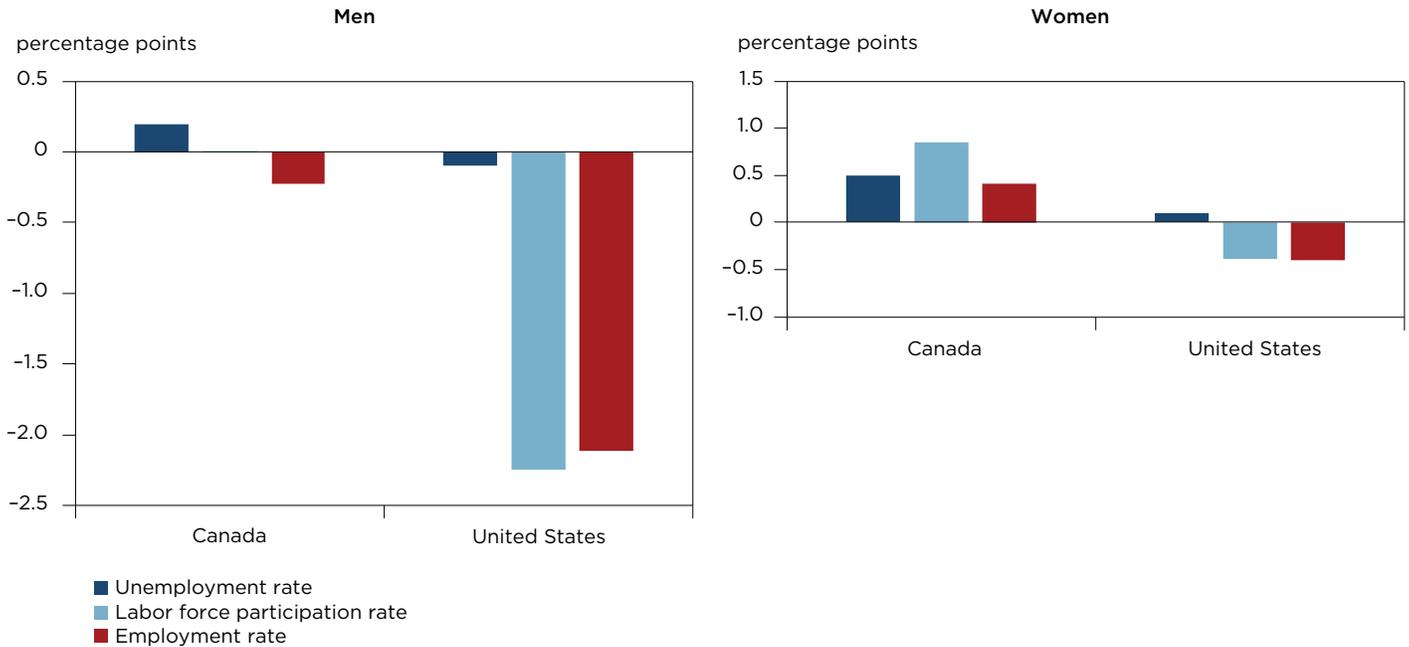
The availability of disability insurance relative to labor market adjustment assistance may have enabled US workers experiencing long unemployment spells to move out of the labor force.⁷ Figure 6 shows the share of spending on labor market policies and on disability in the United States relative to other countries. As a share of GDP, the United States is not an outlier in terms of aggregate disability expenditures; US expenditure rates even exceed those in Germany, Canada, and Japan. Yet, the United States spends far less than other countries on policies designed to keep workers participating in the labor force, such as unemployment insurance, job placement services, and training (Bown and Freund 2019, forthcoming).

The figure also shows the change in spending since 2000. The United States has seen a 40 percent increase in the share of spending on disability compared with declines in most other countries. It is hard to imagine, however, that the United States has experienced a sharper rise in disabled workers than other countries. In fact, data from the Bureau of Labor Statistics (BLS) show that workplace injuries in

7. The number of US workers receiving disability payments peaked at nearly 9 million in 2014 and declined by 1 percent per year between 2015 and 2017 (SSA 2018).

Figure 5 Labor market developments in Canada and the United States

a. Change in unemployment, labor force participation, and employment, prime-aged workers (aged 25–54), 2007–17



Source: OECD (2018d).

private industry in the United States have been in decline, falling from 5 percent in 2002 to 3 percent in 2016. In addition, spending jumped in 2009, as unemployment and unemployment spells were rising, suggesting a link between rising disability takeup and worsening job prospects. Indeed, applications for disability more than doubled from 2000 to 2009 (SSA 2015).

The importance of disability insurance to unemployed and less skilled US workers is well established. The cost of applying for disability insurance is low for unemployed workers and the benefits are relatively high for workers with low and stagnating wages who tend to be unskilled. Autor and Duggan (2003) examine the liberalization of the disability insurance program in 1984, which made it easier to qualify for disability insurance, and show that the change significantly reduced labor force participation and hence unemployment, especially for unskilled workers and during downturns. The results imply that unemployment would have been half of one percentage point higher in the 1990s in the absence of the liberalization.

Disability has also become linked with the opioid crisis. Krueger (2017) finds that about half of prime-aged men who are not in the labor force now report having a serious health condition, and one-third take prescription pain medication. In addition, labor force participation has fallen more in areas where more prescription pain medication is

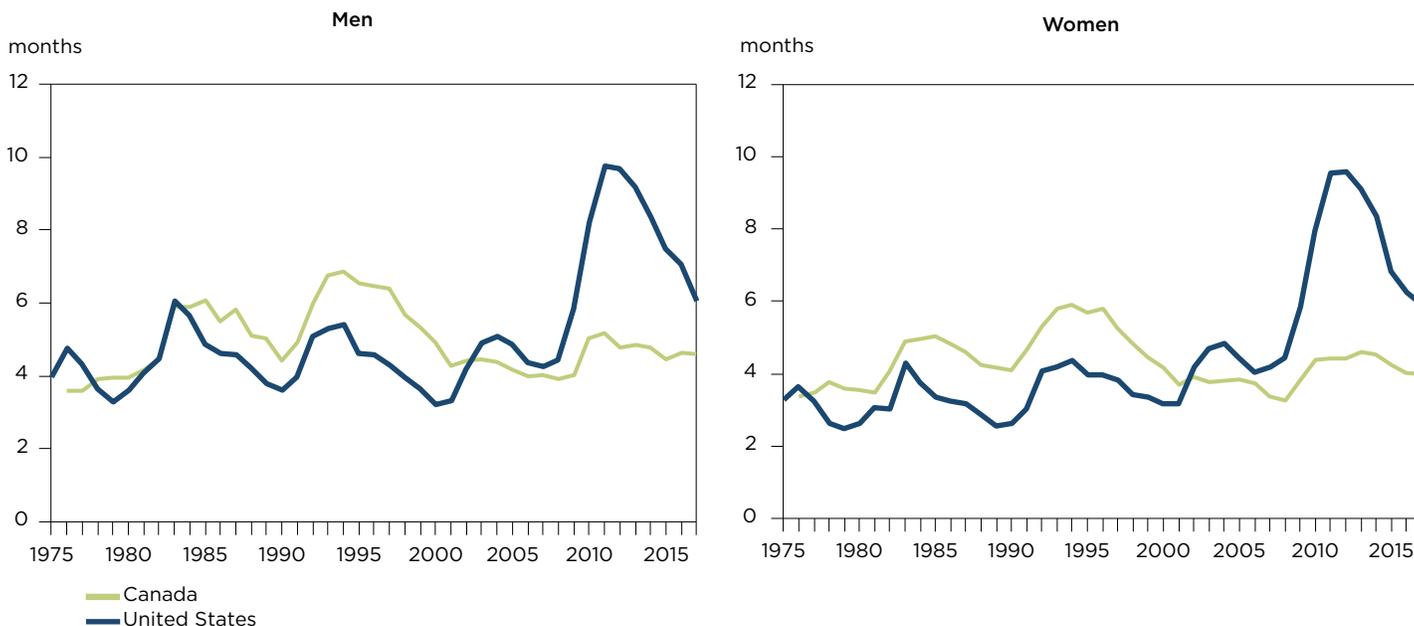
prescribed, suggesting that the recent shift toward disability has become intertwined with the opioid crisis. One possibility is that weak job prospects cause some workers to seek a medical reason to obtain disability insurance, they get prescribed opioids, and they remain on disability insurance, out of the labor force, and on medication for extended periods. Alternatively, pain and addiction to opioids lead them to apply for disability insurance and drop out of the labor force. Research shows that the opioid crisis is at least partly supply driven, implying that health policy—and ease of access to opioids—has significantly influenced labor market outcomes.⁸

The prevalence of disability insurance helps to explain why the United States experienced such a large drop in labor

8. Case and Deaton (2015) argue that pain and the prevalence of opioids contributed to the decline in labor force participation. Powell, Pacula, and Taylor (2015) show that differences in state laws on the prescription of the drugs have an important impact on death rates from opioids, implying that the opioid problem is supply driven. Schnell and Currie (2018) examine national data on opioid prescriptions written between 2006 and 2014 and find that physicians from highly ranked programs are less likely to write prescriptions for the drug, implying that education of medical care providers is important to stem the crisis.

Figure 5 Labor market developments in Canada and the United States

b. Average unemployment duration, prime-aged workers (aged 25–54), 1975–2017



Source: OECD (2018e).

force participation compared with other countries.⁹ In the United States, following the large negative labor demand shock in the aftermath of the financial crisis, there were few programs to help dislocated workers, and many remained unemployed for many months, eventually dropping out of the labor force under disability. In contrast, in other countries, a variety of assistance programs encouraged them to continue looking for work even while they remained unemployed.¹⁰

5. REGIONAL MOBILITY

Another potential explanation for weak US labor force adjustment following the financial crisis is that declining regional mobility in the United States has made it more difficult for workers in distressed parts of the country

to move to more vibrant towns and cities to find jobs. If workers are increasingly reluctant to move out of declining regions where jobs are scarce—or unable to move to urban areas where housing is expensive—then unemployment will rise in parts of the country where economic activity is the weakest.

While regional mobility has weakened in the United States over time, it is difficult to determine its effect on labor force participation.¹¹ Workers are more likely to move when the economy is strong and good opportunities arise, not to escape an extreme downturn. The procyclicality of mobility is borne out in empirical studies, especially for young workers (Saks and Wozniak 2011). Migration rates also rise with education and fall with age, so it is less effective at helping older, less educated workers who are most affected by structural change. While improved regional mobility is important to maintain a strong economy, it may not be a policy priority during hard times and for those workers currently most at risk from unemployment.

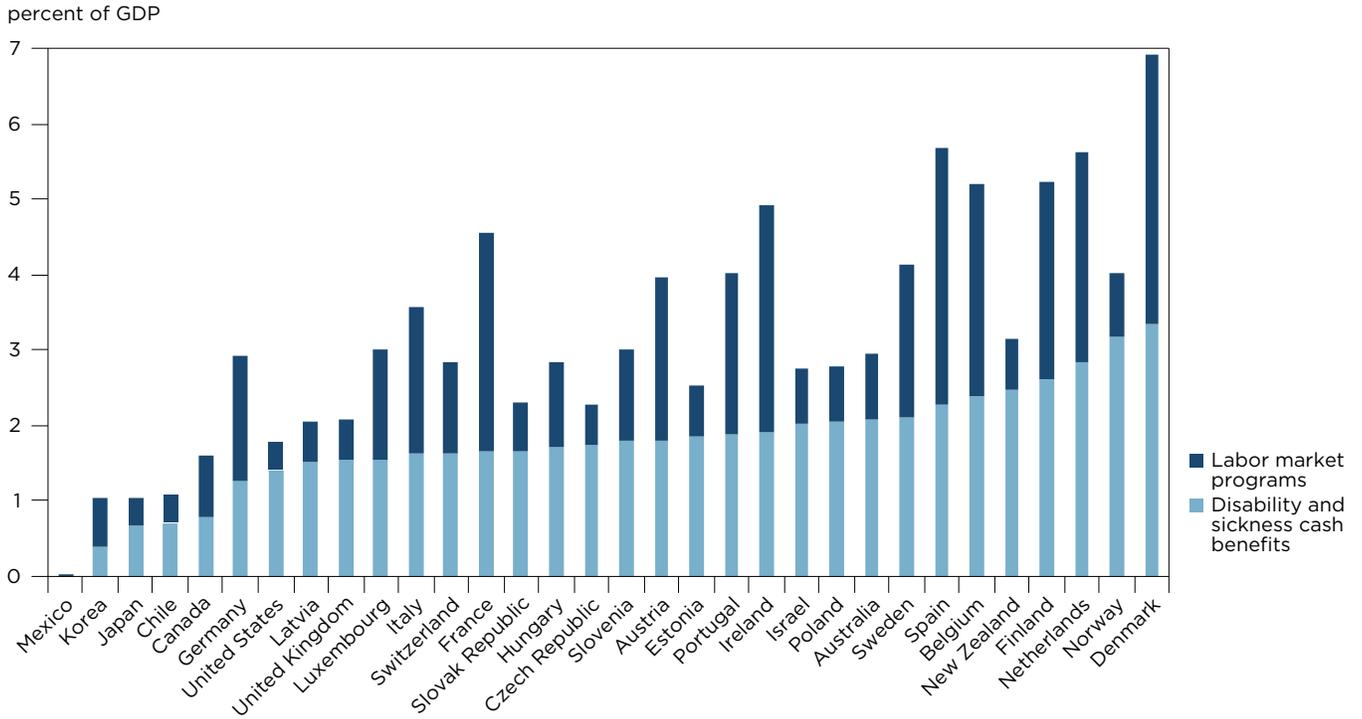
9. CEA (2016) argues that disability is not part of the longer-term decline in labor force participation because labor force participation has fallen by 7.5 percentage points since 1967 and disability insurance receipts has gone up by only 2 percentage points. However, among prime-aged workers, since 1996 one million workers between 30 and 54 went on disability (SSA 2016), accounting for about a 1 percentage point drop in prime-aged labor force participation or about half of the total decline.

10. A companion paper examines active labor market policies used in other countries to look for lessons for the United States (Bown and Freund 2019, forthcoming).

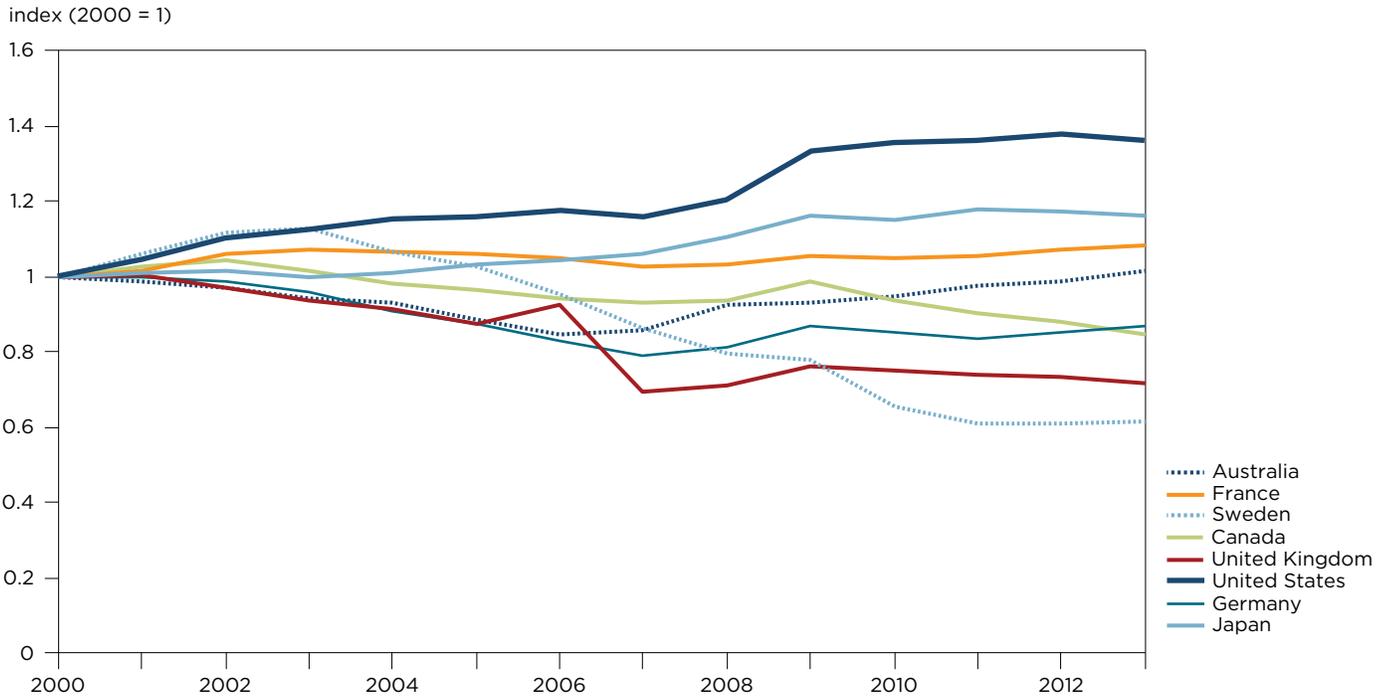
11. Part of the US decline is a result of change in the way it is measured (Kaplan and Schulhofer-Wohl 2012). Data limitations prevent cross-country comparisons of regional mobility.

Figure 6 Disability as labor market policy in the United States, 2013

a. Public expenditure on labor market programs and disability benefits, 2013



b. Public expenditure on disability and sickness cash benefits as percent of GDP, 2000-13



Source: OECD (2018f). Data are for 2011 for the United Kingdom and 2012 for Poland.

6. CONCLUSION

This paper compares the United States with other countries to understand why US workers—especially men—are more likely to leave the labor force. The US decline is related to both the changing structure of labor demand and the increased takeup of disability insurance. US labor force participation dropped sharply after workers faced long spells of unemployment in the wake of the financial crisis. Some workers turned to disability insurance, which aids people exiting the workforce, altering the incentives to remain employed. Workers out of the labor force and on disability have also become increasingly addicted to opiates in recent

years, which is likely preventing them from reentering the labor force.

In contrast to disability insurance, programs that offer assistance to unemployed workers who continue to look for work create incentives for workers to remain in the labor force. Expanding the use of labor market policies would thus increase incentives for workers to remain in the labor force during periods of adjustment. A companion paper (Bown and Freund 2019, forthcoming) offers evidence from other countries on what specific types of policies have been effective at keeping workers in the labor force and helping to reduce the duration of unemployment spells.

APPENDIX A TERMINOLOGY AND DEFINITIONS

Working-age population. People aged 15 to 64.

Employed persons. People aged 15 or over who report that they have worked in gainful employment for at least one hour in the previous week or who had a job but were absent from work during the reference week.

Unemployed persons. People aged 15 or over who report that they are without work, are available for work, and have taken active steps to find work in the last four weeks.

Labor force. Includes all persons who fulfil the requirements for inclusion among the employed (civilian employment plus the armed forces) or the unemployed.

Labor force participation rate. Calculated as the labor force divided by the working-age population. The paper reports the labor force participation rate for the age group 25–54, in which case it is calculated as the labor force aged 25–54 divided by the population aged 25–54. The rate is provided directly by the OECD, not calculated by the authors. Represented as a formula,

$$\text{labor force participation rate} = 100 * \frac{\text{labor force}}{\text{working-age population}}.$$

Employment rate. Calculated as the employed population divided by the working-age population. The paper reports the employment rate for the age group 25–54, in which case it is calculated as the employed population aged 25–54 divided by the population aged 25–54. The employment rate is provided directly by the OECD, not calculated by the authors. Represented as a formula,

$$\text{employment rate} = 100 * \frac{\text{employed population}}{\text{working-age population}}.$$

Unemployment rate. Calculated as the unemployed population divided by the labor force. The paper reports the unemployment rate for the age group 25–54, in which case it is calculated as the unemployed population aged 25–54 divided by the labor force aged 25–54. The unemployment rate is provided directly by the OECD, not calculated by the authors. Represented as a formula,

$$\text{unemployment rate} = 100 * \frac{\text{unemployed population}}{\text{labor force}}.$$

Average unemployment duration. Defined as the average number of months a person recorded as unemployed was seeking or available for work. The reported duration should consist of a continuous period of time up to the reference period. The average unemployment duration is aggregated to months and provided directly by the OECD, not calculated by the authors.

Manufacturing as a share of employment. Defined as the total population employed in manufacturing divided by the total employed population. Data are calculated by the authors. Represented as a formula,

$$\text{manufacturing as a share of employment} = 100 * \frac{\text{persons employed in manufacturing}}{\text{employed population}} .$$

Labor market program expenditure. Public spending on labor market programs, including public employment services, training, hiring subsidies, and direct job creation in the public sector, as well as unemployment services.

Disability and sickness cash benefits. Disability cash benefits comprise cash payments on account of complete or partial inability to participate gainfully in the labor market due to disability. The disability may be congenital or the result of an accident or illness during the victim's lifetime. Sickness cash benefits comprise cash payments for loss of earnings because of a temporary inability to work due to illness. This excludes paid leave related to sickness or injury of a dependent child.

Public expenditure on disability and sickness cash benefits in percent of GDP. Public spending on disability and sickness cash benefits divided by GDP. Data are provided directly by the OECD, not calculated by the authors. Represented as a formula,

$$\text{public expenditure on disability and sickness cash benefits in percent of GDP} = 100 * \frac{\text{public expenditure on disability and sickness cash benefits}}{\text{GDP}} .$$

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