

Three Challenges in the U.S. Labor Market: Participation, Inequality, and Fluidity

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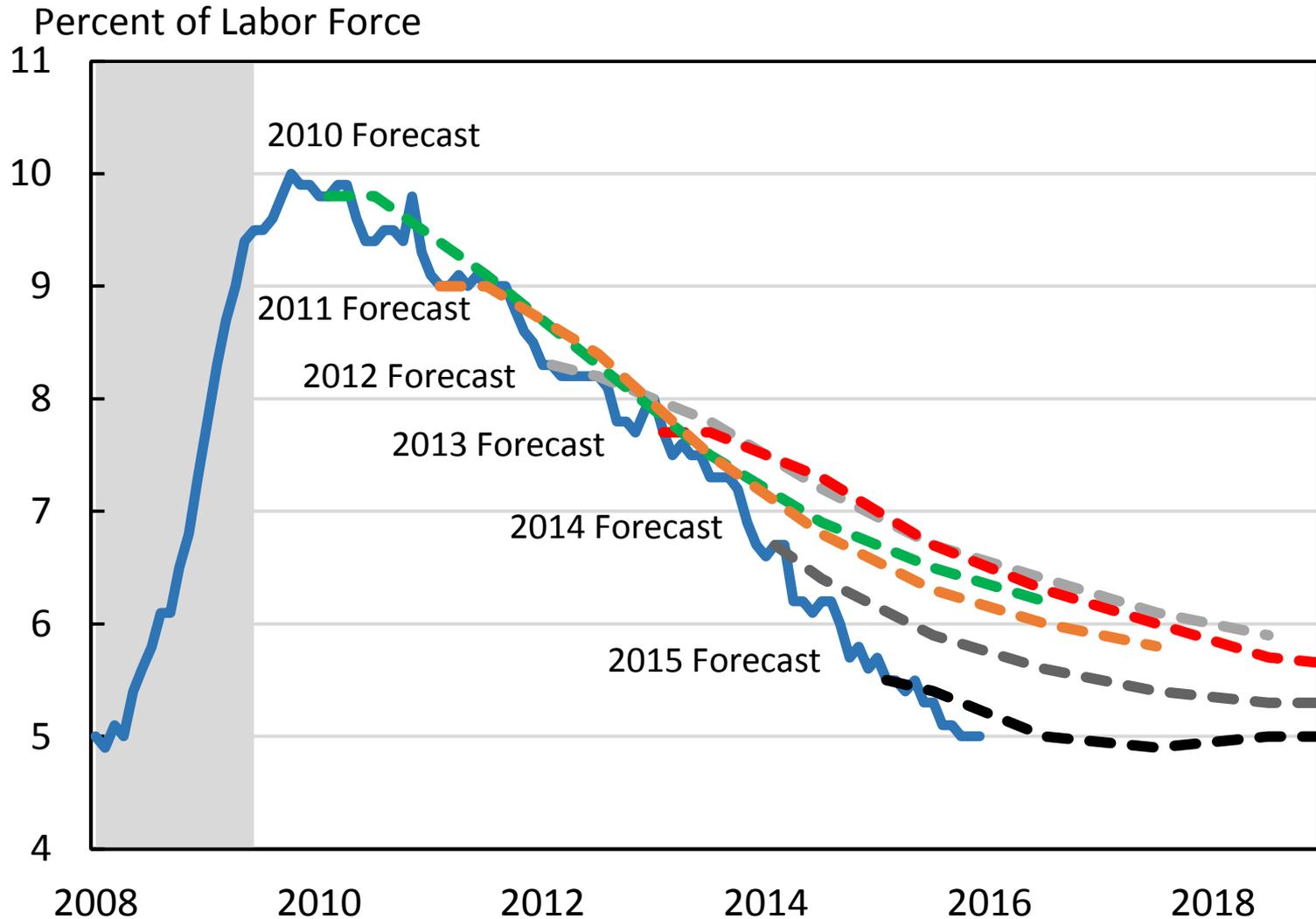
**World Bank Group
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Overview

1. Strength of the Labor Market Recovery
2. Three Long-Standing Challenges:
 - a) Labor Force Participation
 - b) Income Inequality
 - c) Labor Market Fluidity
3. (Brief) Policy Implications

The Unemployment Rate Fell to 5.0 Percent in October, Years Ahead of Most Economists' Forecasts

Unemployment Rate and Consensus Forecasts



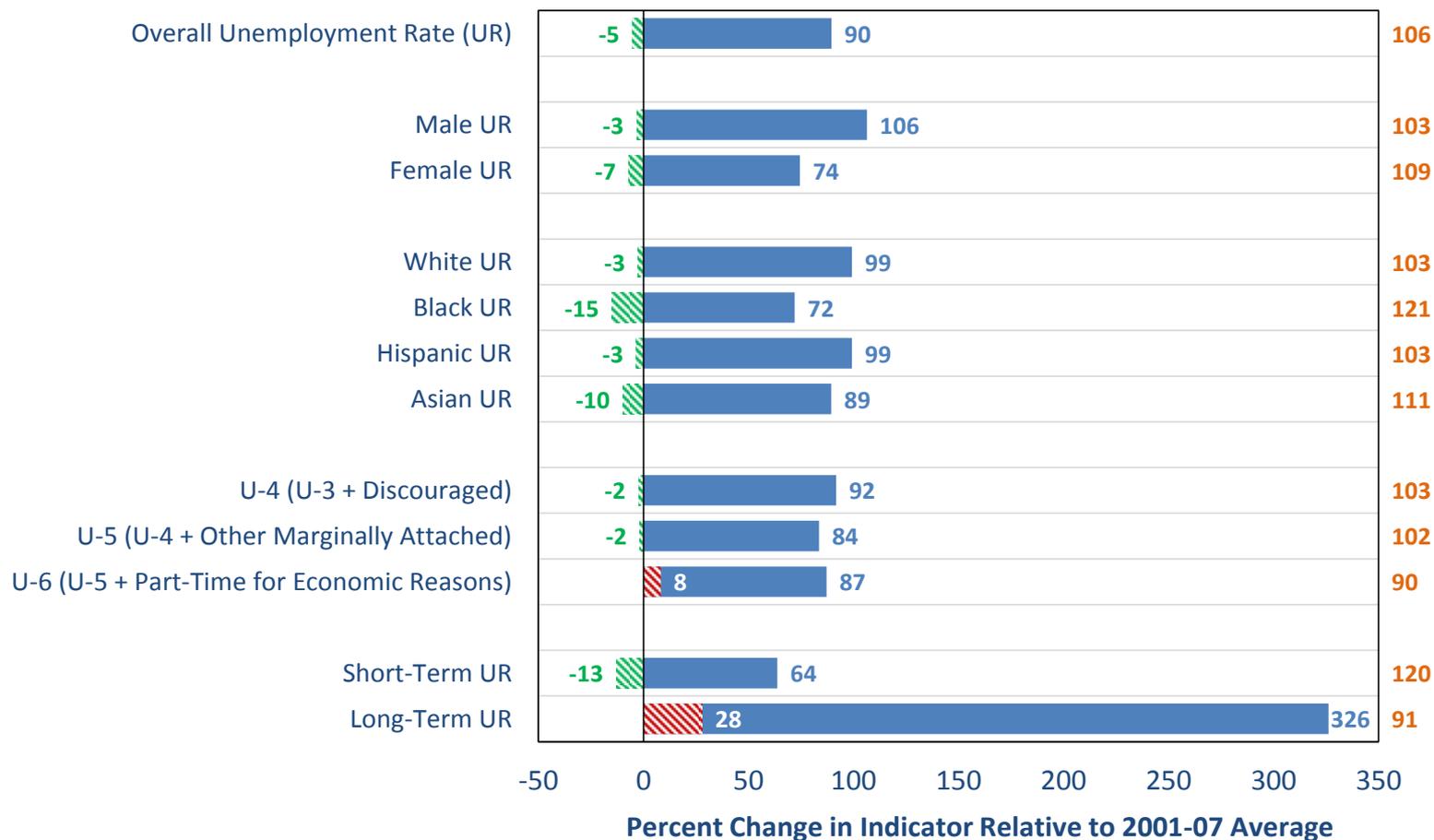
Note: Annual forecasts are current as of March of the stated year. Shading denotes recession.
Source: Blue Chip Economic Indicators; Bureau of Labor Statistics, Current Population Survey.

Labor Market Recovery is Broad Based, But Still Some Elevation in the Broadest Measures and Long-term Unemployment

Tracking the Recovery Across Labor Market Indicators

All Data as of December 2015

▨ Remaining Elevation as of December 2015 ■ Percent Increase to Great Recession Peak ■ Percent Recovered



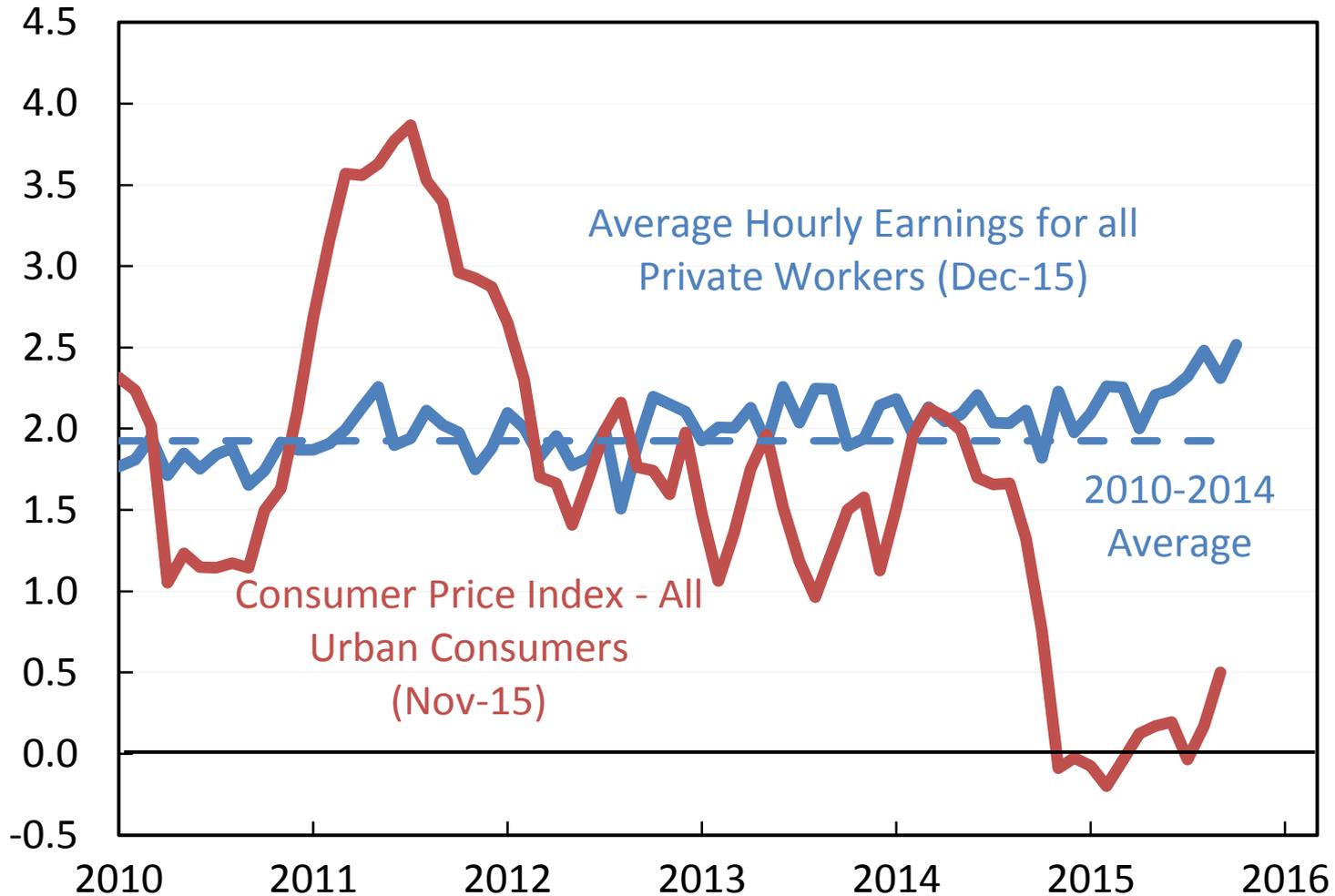
Note: Unemployment rates by education are for persons age 25+. All other rates for persons age 16+ unless noted.

Source: Bureau of Labor Statistics; CEA calculations.

Nominal Wages are Rising Somewhat Faster Than Earlier in the Recovery, and Low Inflation is Boosting Real Wage Growth

Average Hourly Earnings Growth and Consumer Inflation

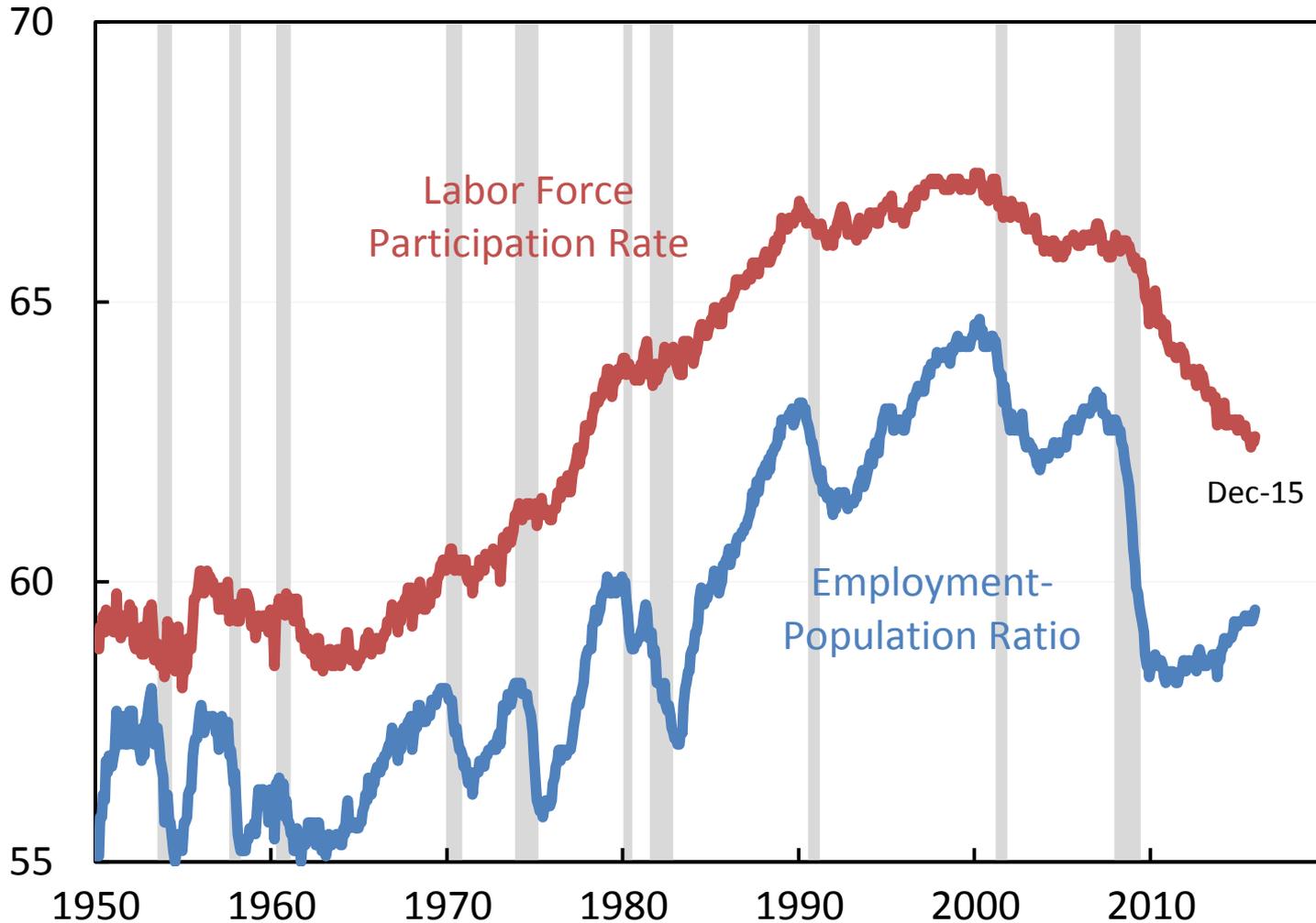
12-Month Percent Change



The First Challenge: Labor Force Participation

Labor Force Participation and Employment-Population Rates

Percent



Four Potential Explanations of the Decline in Labor Force Participation

The labor force participation rate fell 3.4 percentage points from 2007-Q4 to 2015-Q4. This can be attributed to:

Structural

1. Aging of the population. This is the mechanical impact of, for example, having fewer 55-59 year olds (male LFPR = 77%) and more 70-74 year olds (male LFPR = 23%).
2. Non-aging trends. Male participation rates have been declining since the early 1950s and female participation rates have been declining since the late 1990s.

Cyclical

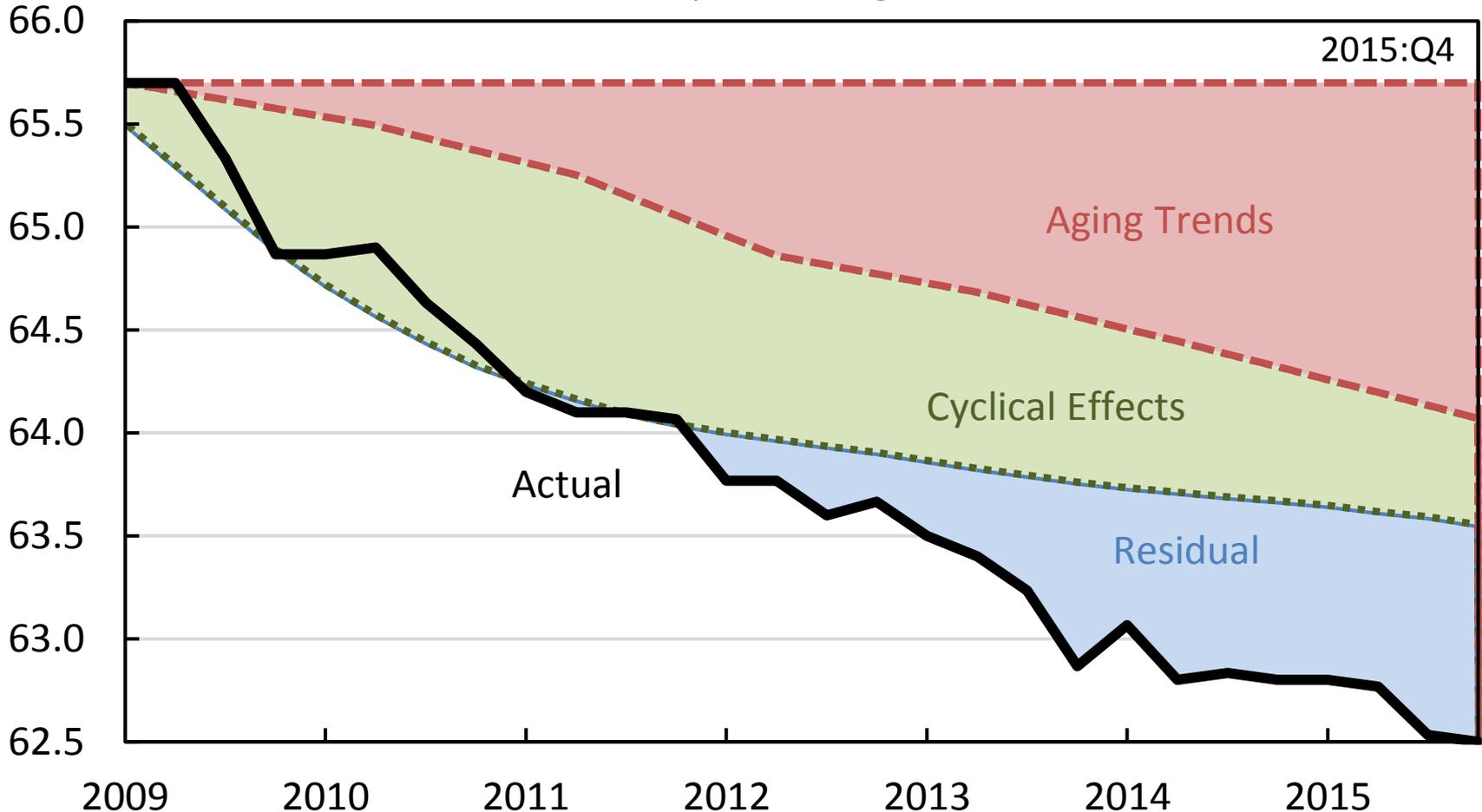
3. Normal business cycle. Historically, for every 1 percentage point elevation in the unemployment rate, the participation rate is 0.1 to 0.2 percentage points lower.
4. Unusual business cycle. The Great Recession was unusually severe and hit a labor market that has undergone structural changes, making the cyclical impact different.

Note – CEA's statistical analysis combines 2 and 4 as a residual.

CEA's Decomposition of the LFPR Decline

Labor Force Participation Decomposition

Percent of Civilian Non-institutional Population Aged 16+



2015:Q4

Aging Trends

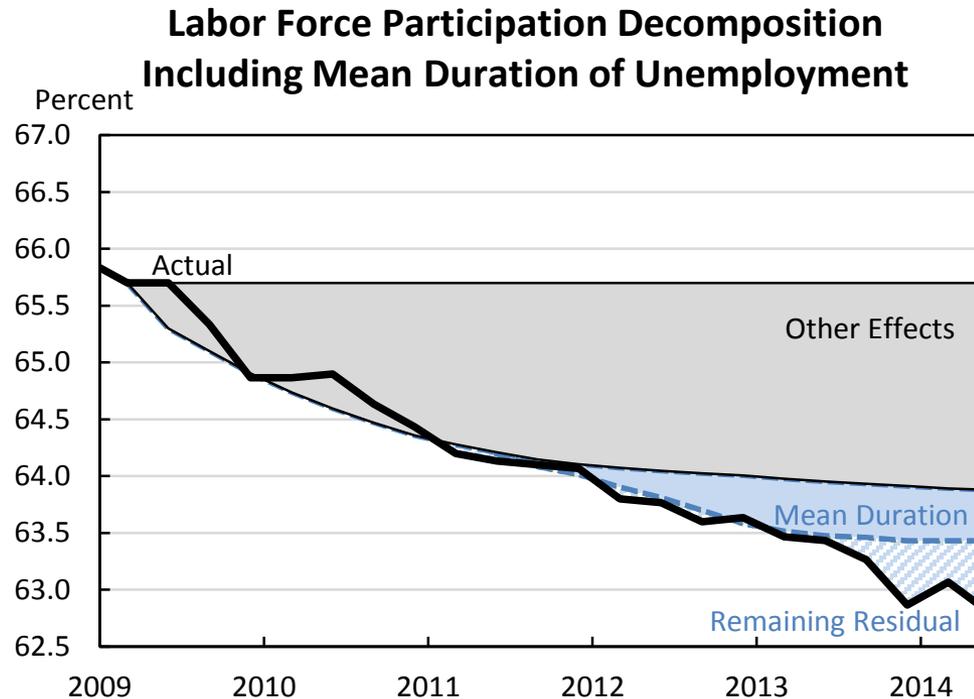
Cyclical Effects

Actual

Residual

Note: Year axis denotes first quarter of year noted. See 2015 *Economic Report of the President* for methodological details.
Source: Bureau of Labor Statistics, Current Population Survey; CEA calculations.

The Case for the Residual Being Unusual Business Cycle (i.e. Hopefully Cyclical)



Regression of Quarterly Differences in Detrended Participation Rate

Independent Variables (Year-over-Year Differences)					
Unemp. Gap	Unemp. Gap (t-4)	Unemp. Gap (t-8)	Mean Duration	Mean Duration (t-4)	Mean Duration (t-8)
-0.0330*	0.00429	0.0151	-0.00406	-0.0142*	0.00222
(0.00914)	(0.0146)	(0.0114)	(0.00534)	(0.00524)	(0.00527)

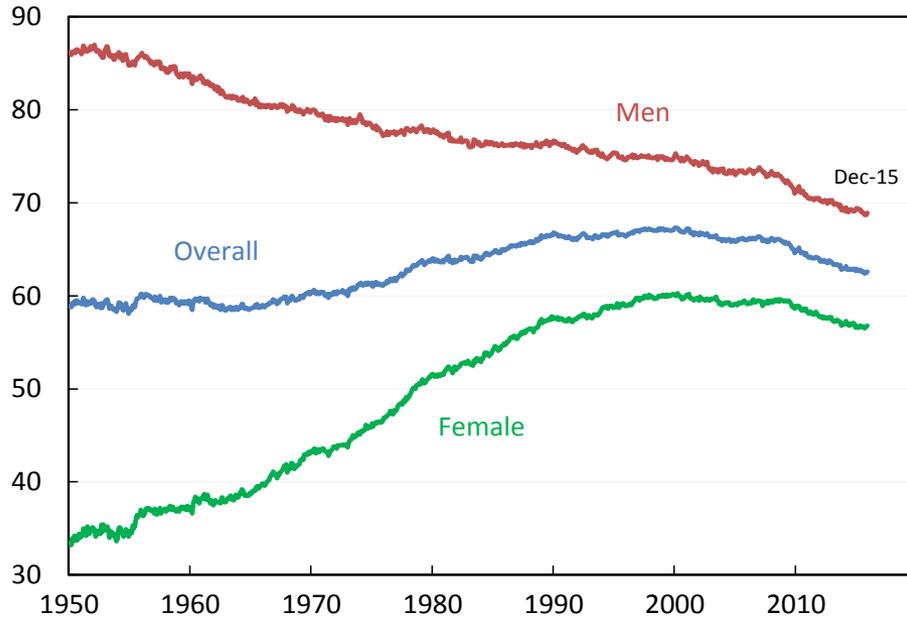
Note: Regression is estimated using data from 1960:Q1 to 2014:Q2. Newey-West standard errors using a maximum lag of 12 are reported in parentheses. Participation rate and unemployment gap are detrended using the procedure described in Appendix A. F-tests are joint significance tests of the disability insurance, mean duration, and schooling variables. * p<0.01.

Source: Bureau of Labor Statistics; CEA calculations.

The Case for the Residual Being Non-aging Trends (i.e. Structural)

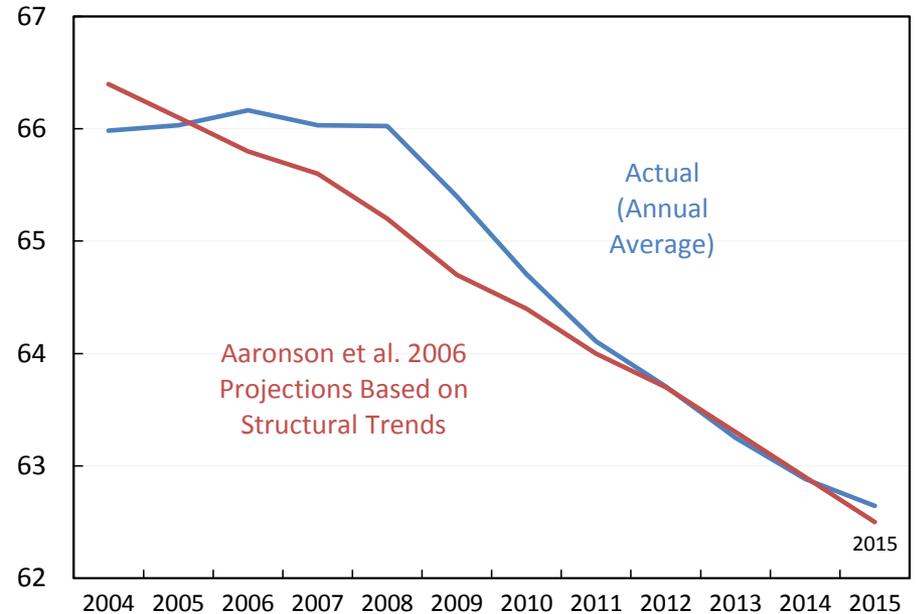
Labor Force Participation by Gender

Percent of Civilian Non-institutional Population Age 16+



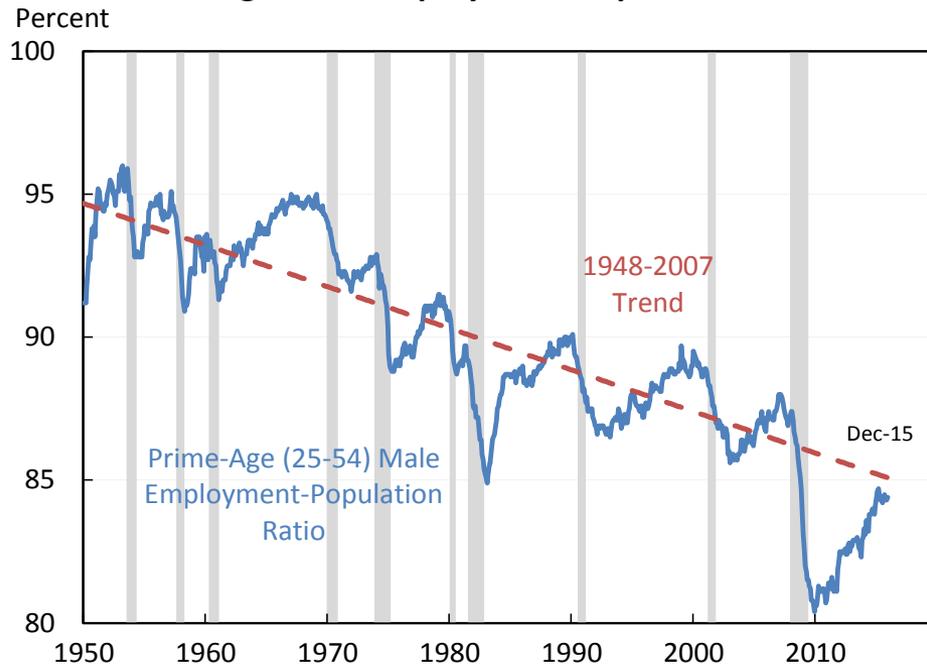
Labor Force Participation vs. Pre-Crisis Structural Projections

Percent of Civilian Non-institutional Population Age 16+

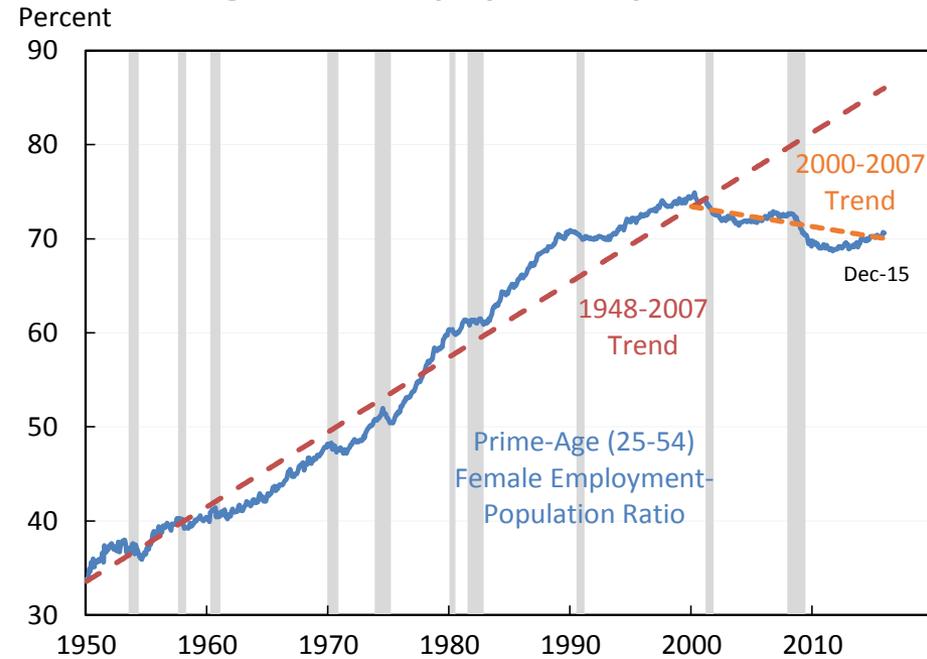


Structural Declines in Employment-Population Ratios

Prime-Age Male Employment-Population Ratio

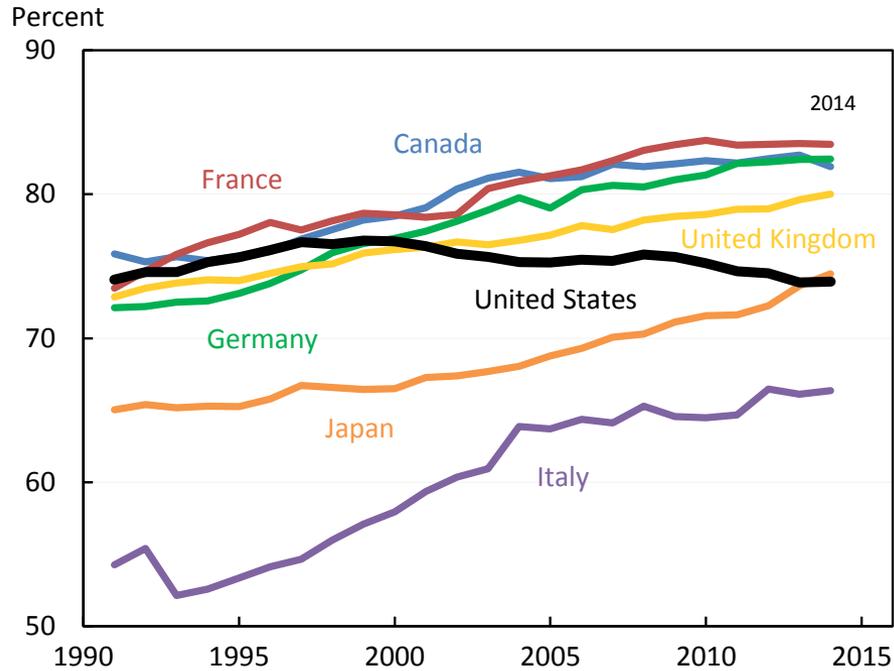


Prime-Age Female Employment-Population Ratio

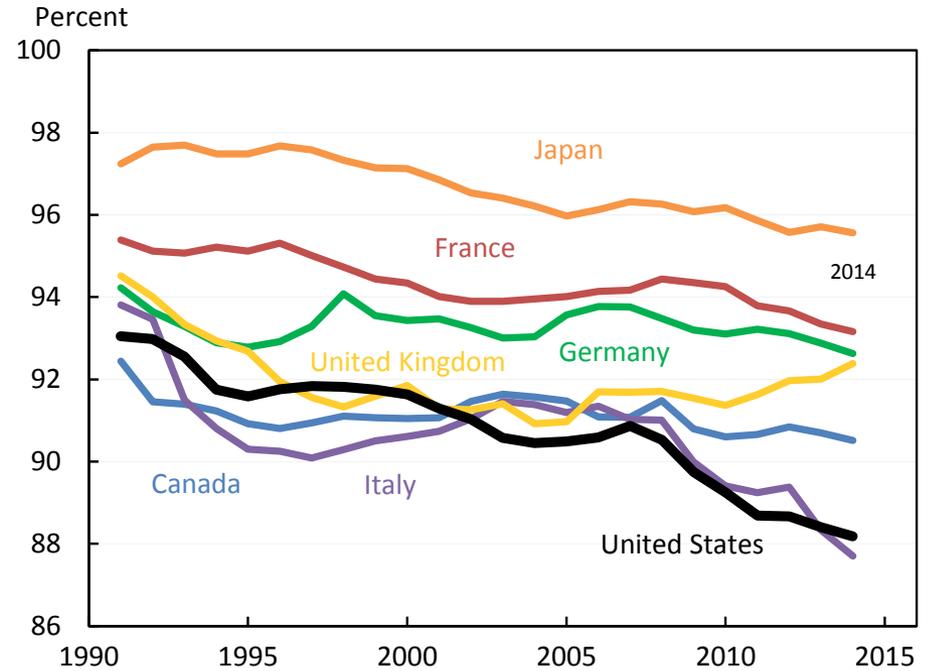


Prime-Age LFPR Across G-7 Economies

Prime-Age Female Labor Participation Rates



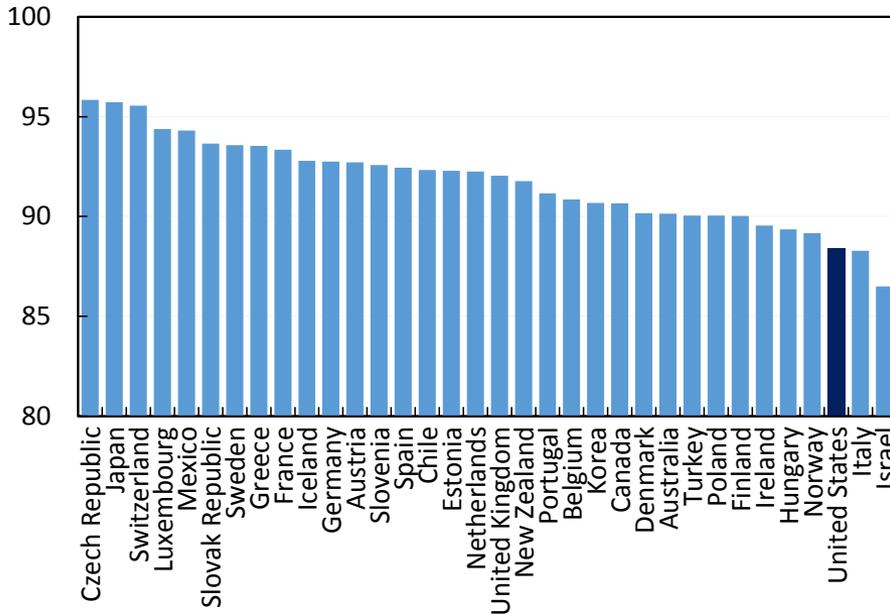
Prime-Age Male Labor Force Participation Rates



Prime-Age LFPR Across OECD Economies

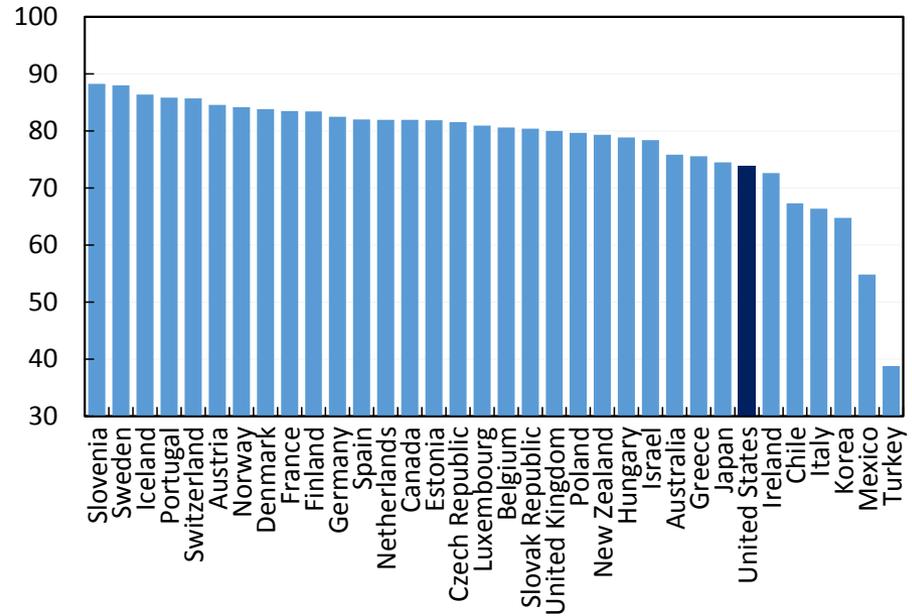
Prime-Age Male Labor Force Participation

Percent of Population



Prime-Age Female Labor Force Participation

Percent of Population



U.S. Labor Market Has High Flexibility But Low Supportiveness

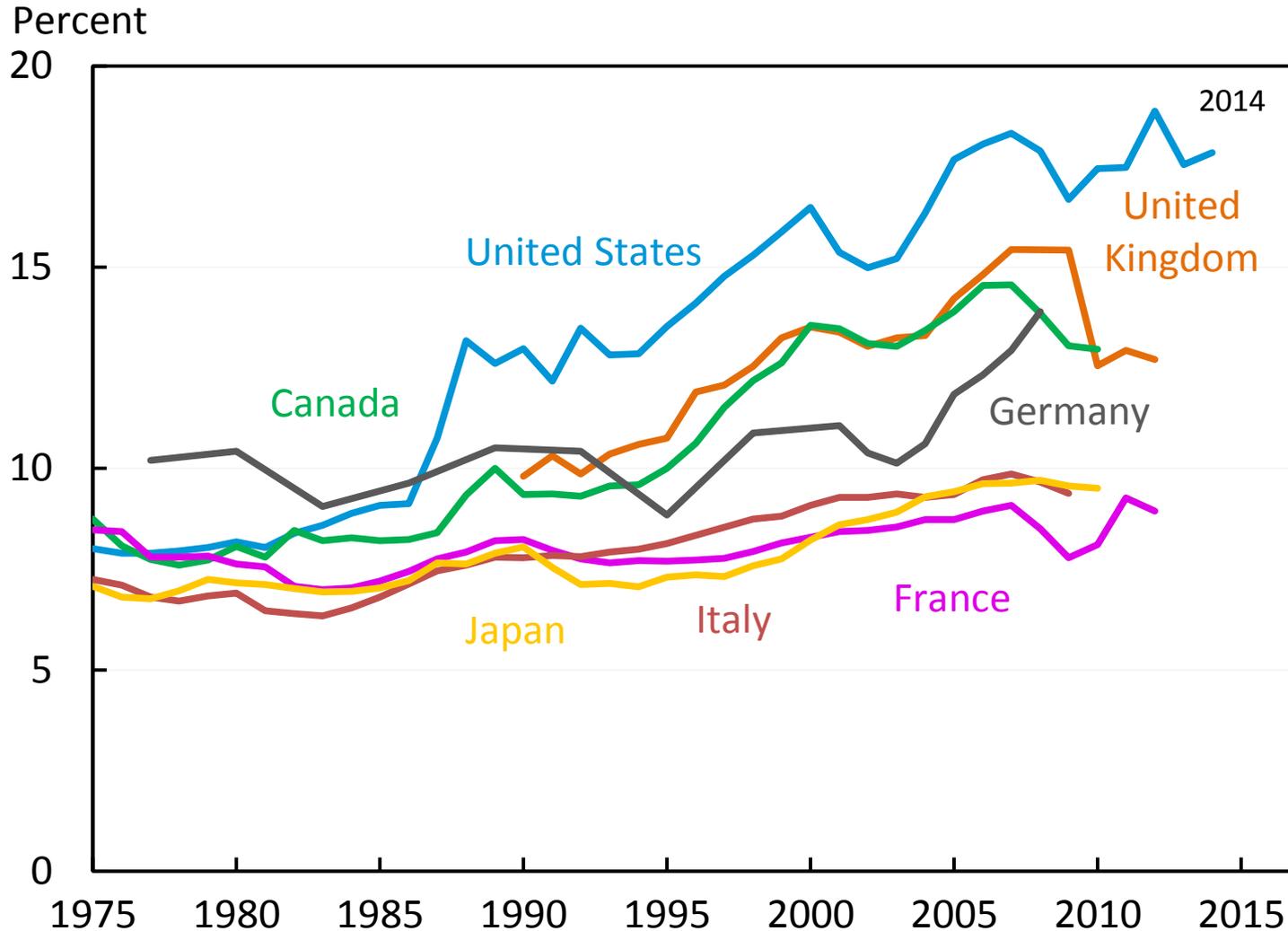
OECD Measures of Labor Market Flexibility	US Percentile Rank (100=Most Flexible)
Overall Labor Market Regulation	100
Employment Protection for Regular Employment	100
Scope of State Intervention	94
Minimum Cost of Labor	92
Coverage of Collective Bargaining Agreements	90
Labor Taxation	71
Barriers to Entrepreneurship	62

OECD Measures of Institutional Labor Market Support	US Percentile Rank (100=Most Supportive)
Expenditure on Active Labor Market Policies	3
Net Childcare Costs, Lone Parent	6
Implicit Tax on Returning to Work, Lone Parent	9
Unemployment Benefits (1 Year)	11
Unemployment Benefits (5 Years)	11
Number of Weeks Lost Due to Sick Leave	11
Net Childcare Costs, Couples	13
Implicit Tax on Returning to Work, 2nd Earner	13
Tax Wedge: Single Earner vs. Second-Earner Couples	25
Public Expenditure for Childcare	29

The Second Challenge: Income Inequality

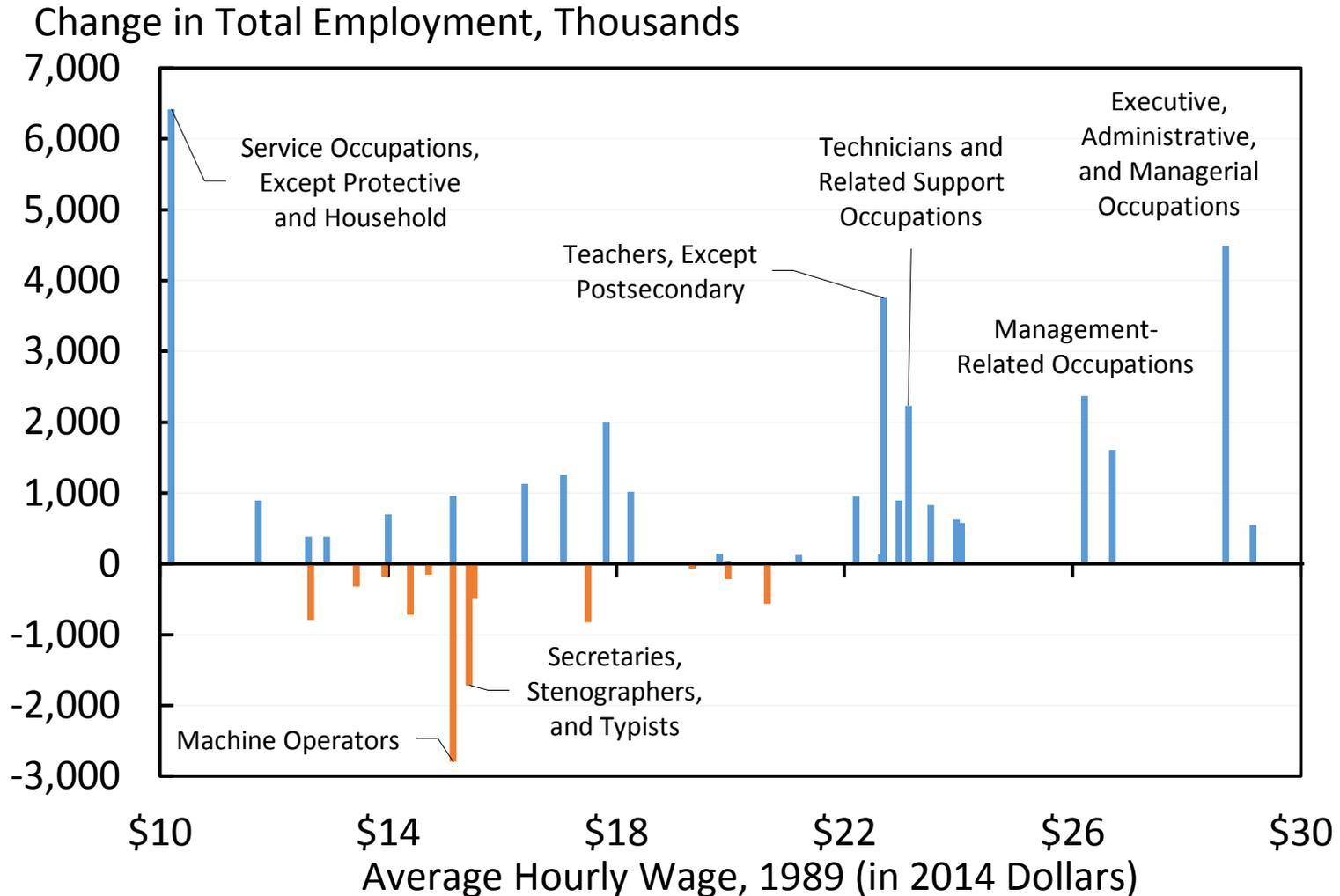
Top 1 Percent's Share of Income Rose from 8% in 1970 to 18% in 2014

Share of Income Earned by Top 1 Percent, 1975–2014



The “Competitive” Explanation of Inequality: Skill-Biased Technical Change, Job Polarization, and Globalization

Change in Employment by Detailed Occupation, 1989–2014

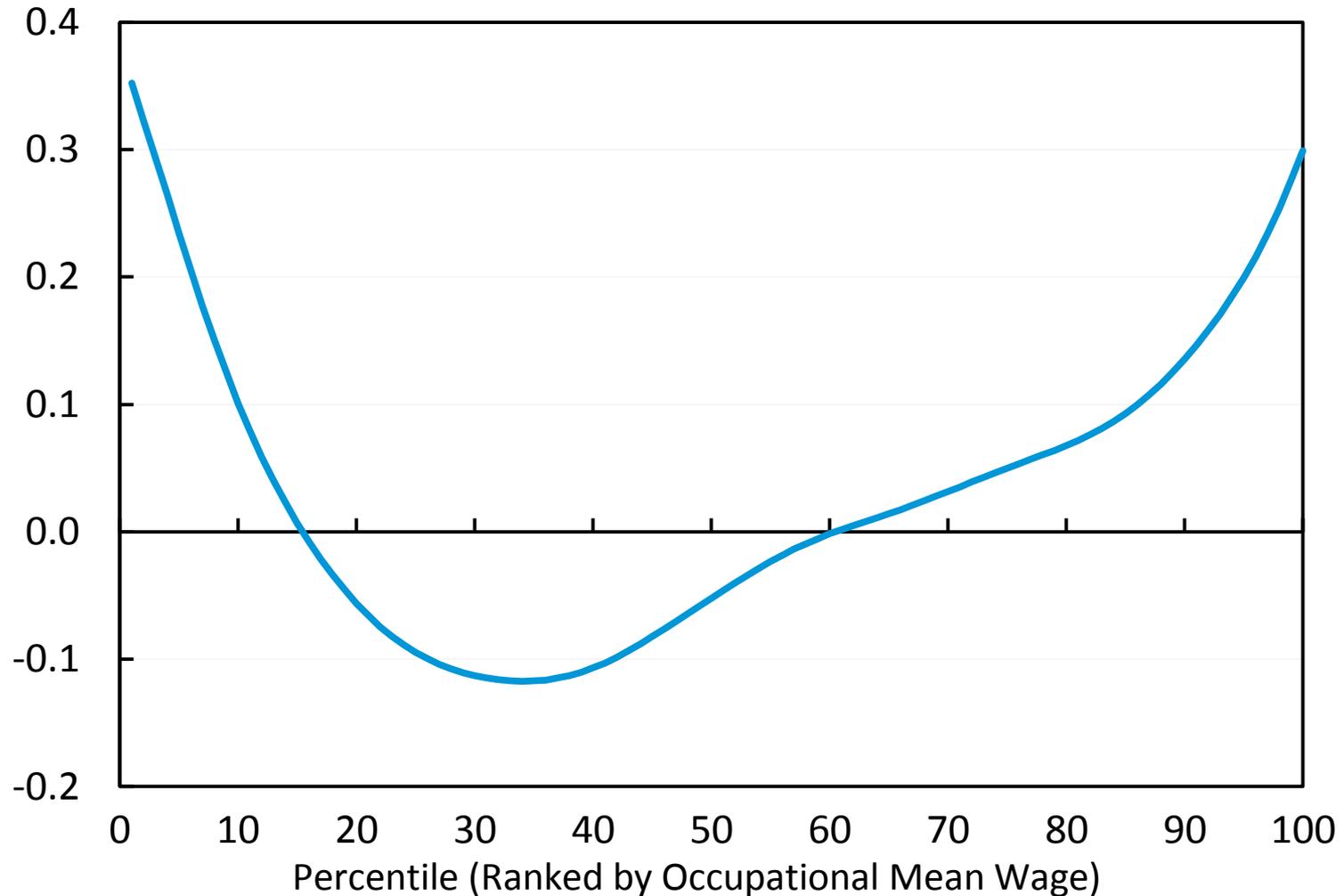


Note: Excludes five small outlier occupational categories.
Source: Bureau of Labor Statistics, Current Population Survey; CEA calculations.

The “Competitive” Explanation of Inequality: Skill-Biased Technical Change, Job Polarization, and Globalization

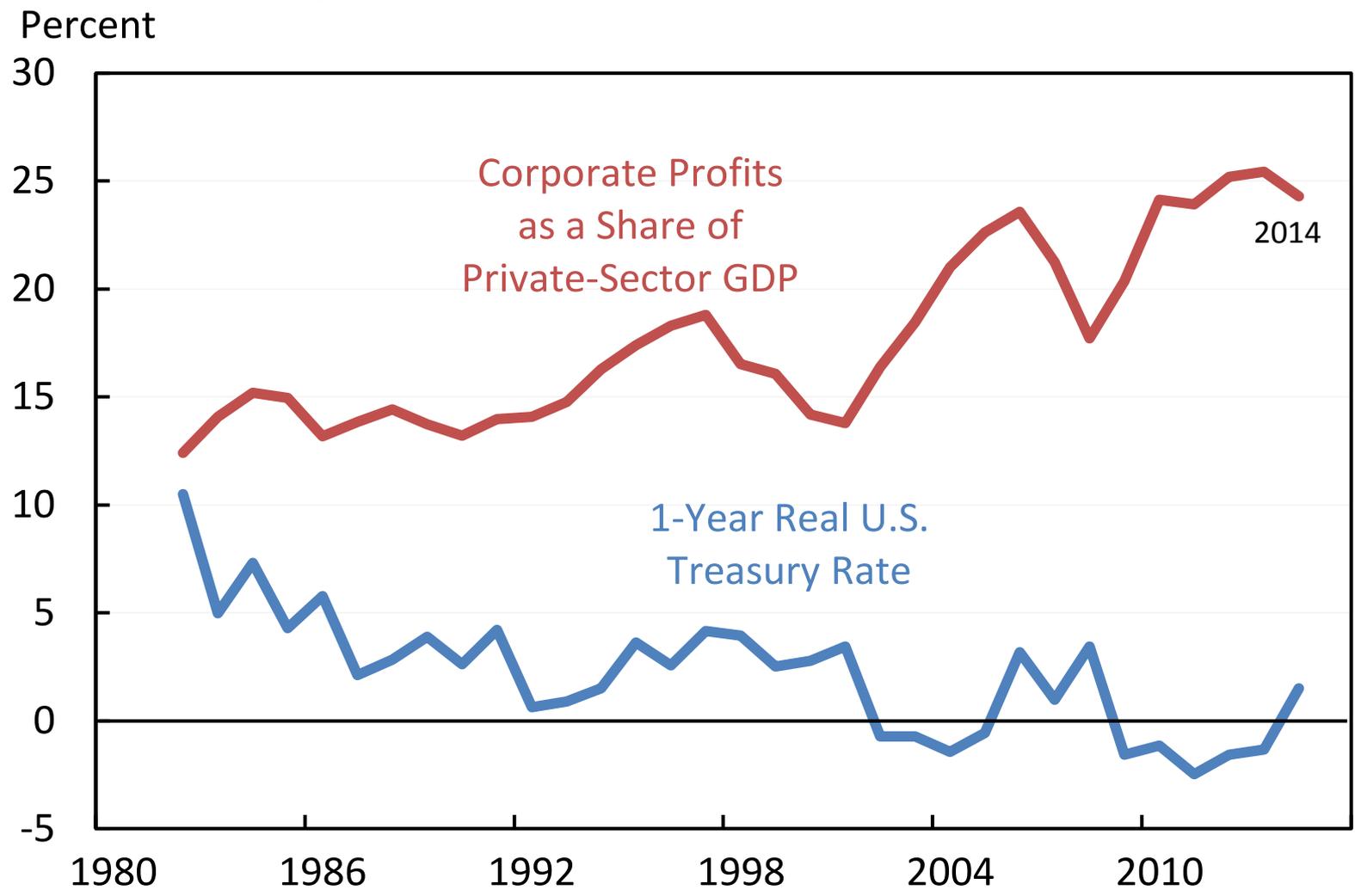
Changes in Employment by Occupational Wage Percentile

Change in Employment Share, Percentage Points



The “Rents” Explanation of Inequality: Income Differences May Reflect Non-Competitive Rent Collection Rather than Productivity Differences

Corporate Profits and Returns to Capital



Note: The real interest rate is defined as the nominal U.S. Treasury yield less the trailing 1-year rate of CPI inflation.
Source: Bureau of Economic Analysis; Robert Shiller (Yale University).

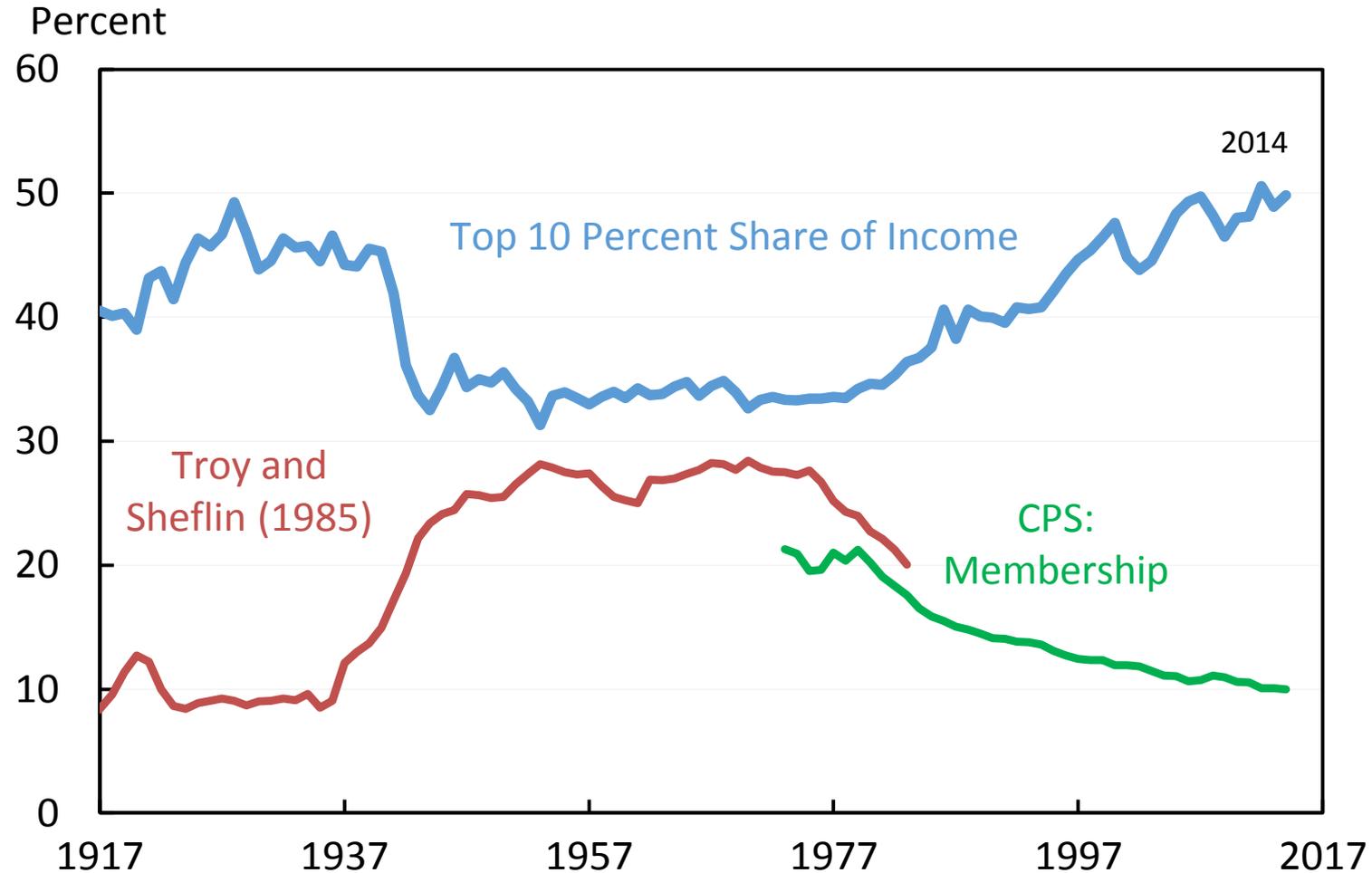
The “Rents” Explanation of Inequality: Income Differences May Reflect Non-Competitive Rent Collection Rather than Productivity Differences

Industry Percentage Point Change in Revenue Share Earned by 50 Largest Firms, 1997-2007

Transportation and Warehousing	12.0
Retail Trade	7.6
Finance and Insurance	7.4
Real Estate Rental and Leasing	6.6
Utilities	5.6
Wholesale Trade	4.6
Educational Services	2.7
Accommodation and Food Services	2.6
Professional, Scientific and Technical Services	2.1
Administrative/Support	0.9
Other Services, Non-Public Admin	-1.5
Arts, Entertainment and Recreation	-2.3
Health Care and Social Assistance	-3.7

The “Rents” Explanation of Inequality: Declining Union Membership May be Driven by and May Contribute to Rent-Seeking Behavior

Union Membership as Share of Total Employment and Share of Income Accruing Top 10 Percent of Income Distribution

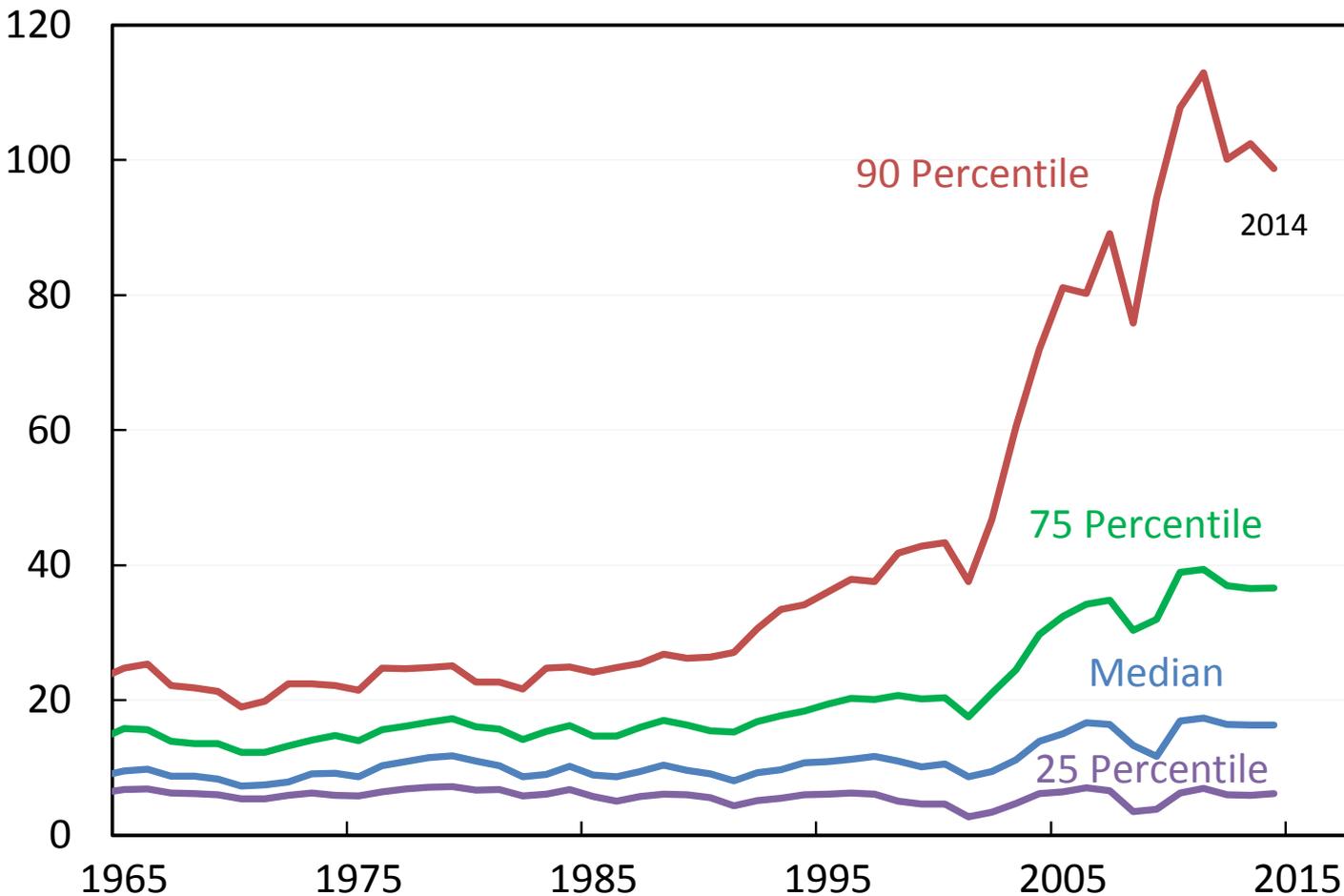


Note: Total employment from 1901 to 1947 is derived from estimates in Weir (1992). For 1948 to 2014, employment data are annual averages from the monthly Current Population Survey. Source: Troy and Sheflin (1985); Bureau of Labor Statistics, Current Population Survey; Weir (1992); CEA calculations.

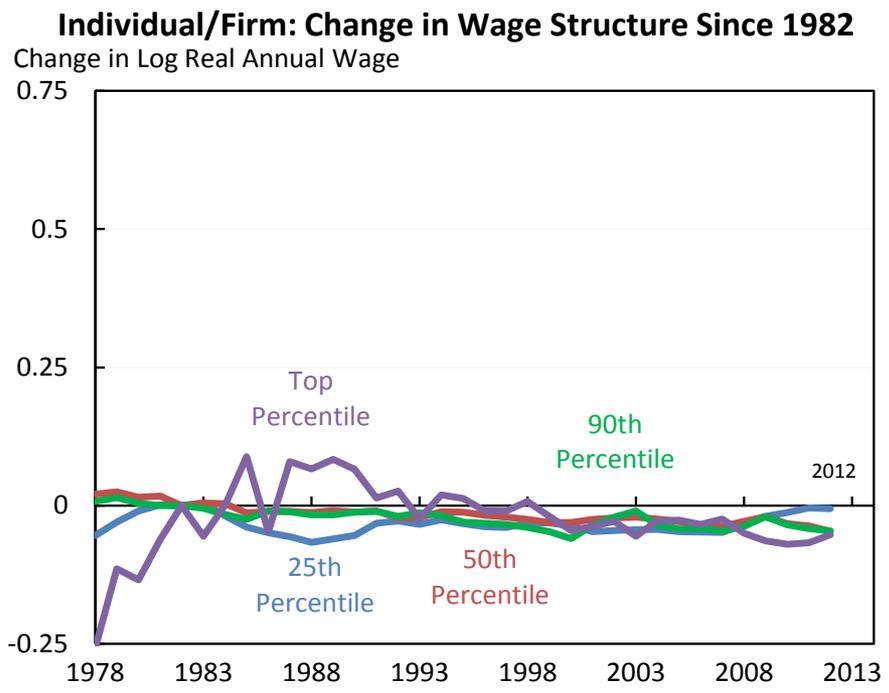
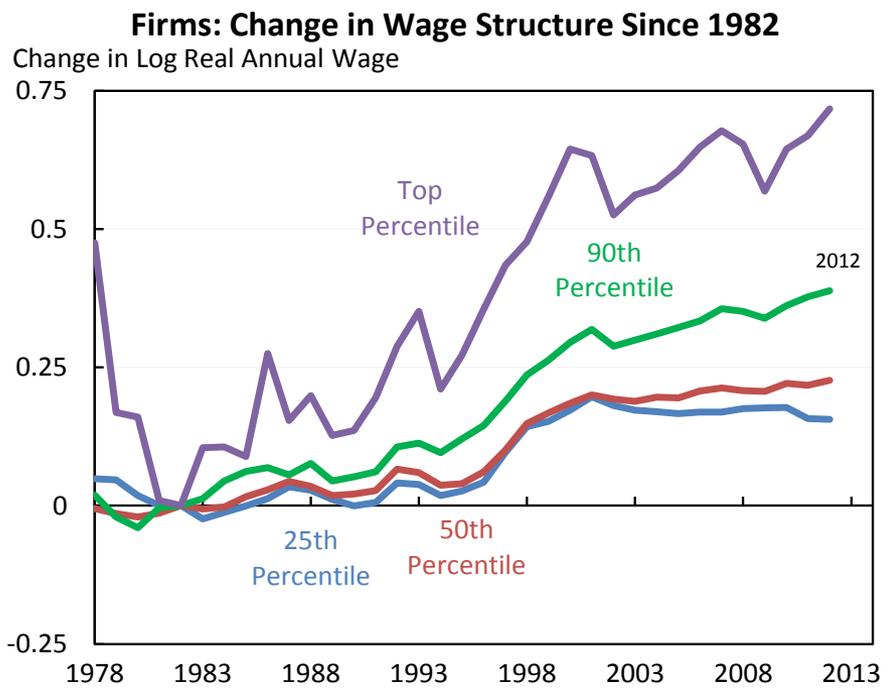
The “Rents” Explanation of Inequality: The Prevalence of Super-Normal Returns Have Grown Over Time

Return on Invested Capital Excluding Goodwill, U.S. Publicly-Traded Nonfinancial Firms

Percent



The “Rents” Explanation of Inequality: Virtually All of the Rise in Wage Inequality is Due to Inter-Firm as Opposed to Intra-Firm Dispersion

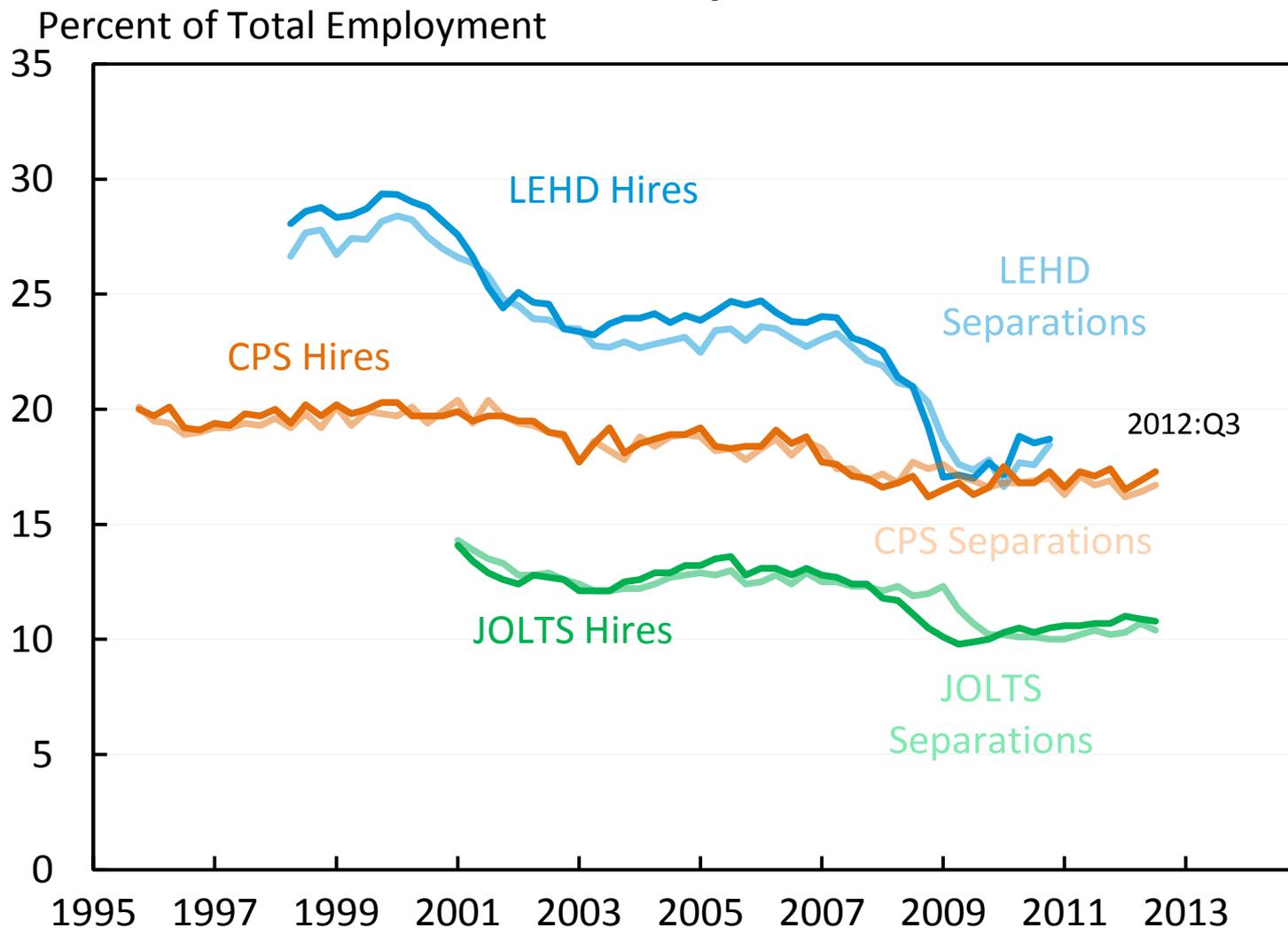


Source: Song et al. (2015).

The Third Challenge: Labor Market Fluidity

Worker Flows have been Declining Since the 1990s

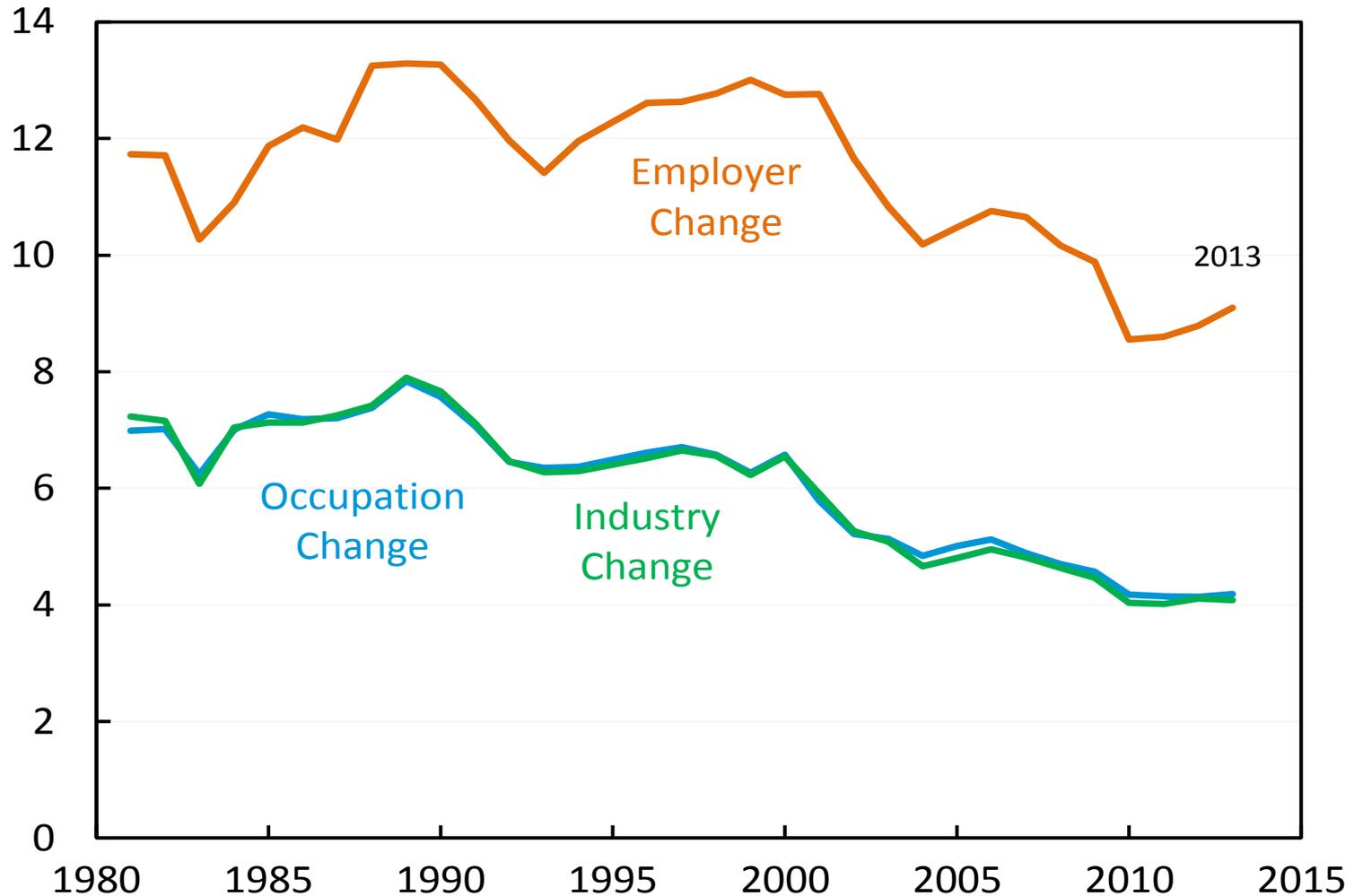
Trends in Hires and Separations, 1995-2012



Worker Flows have been Declining Since the 1990s

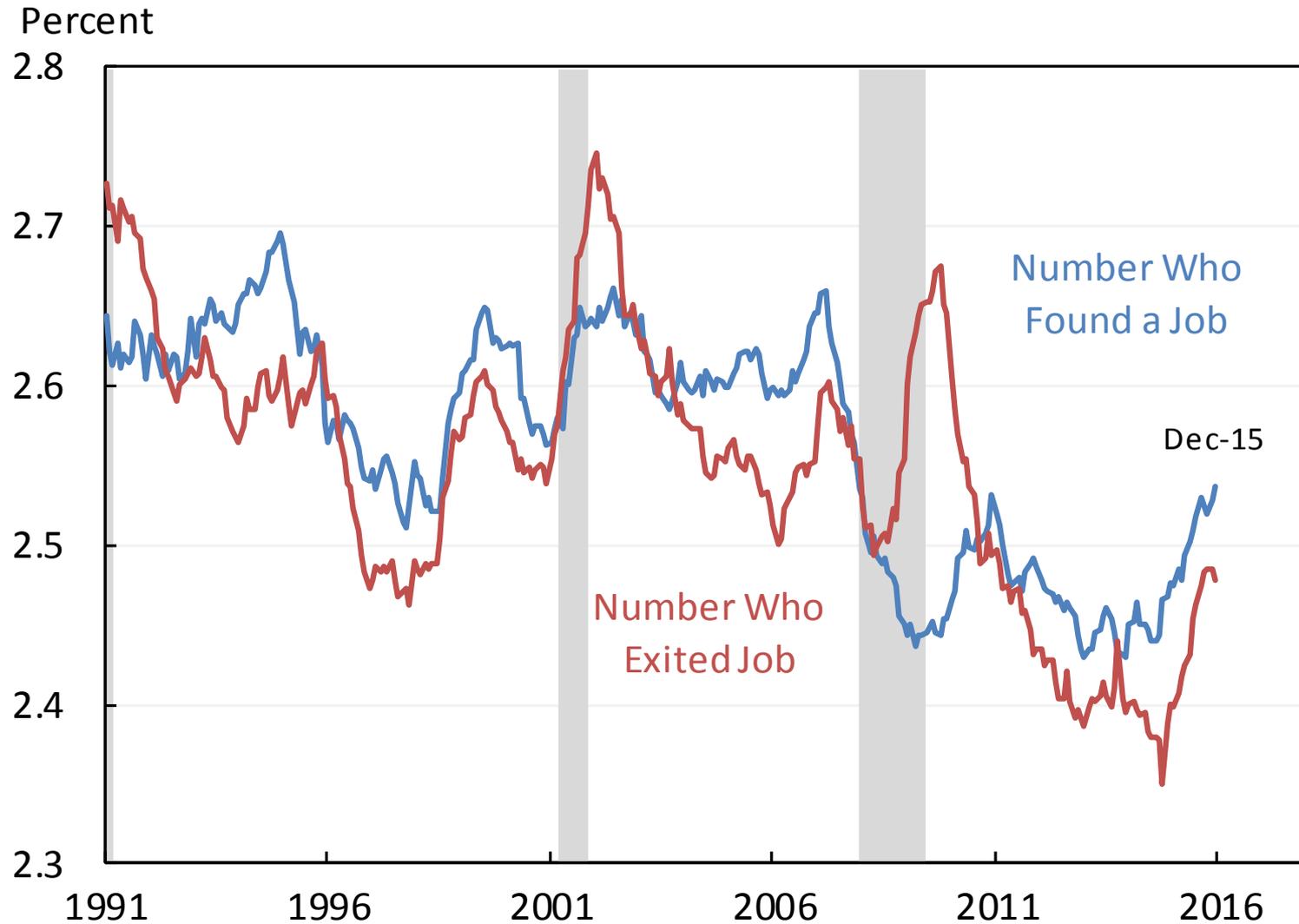
Employer, Occupation, and Industry Transitions

Percent of Total Population Age 16+



Worker Flows have been Declining Since the 1990s

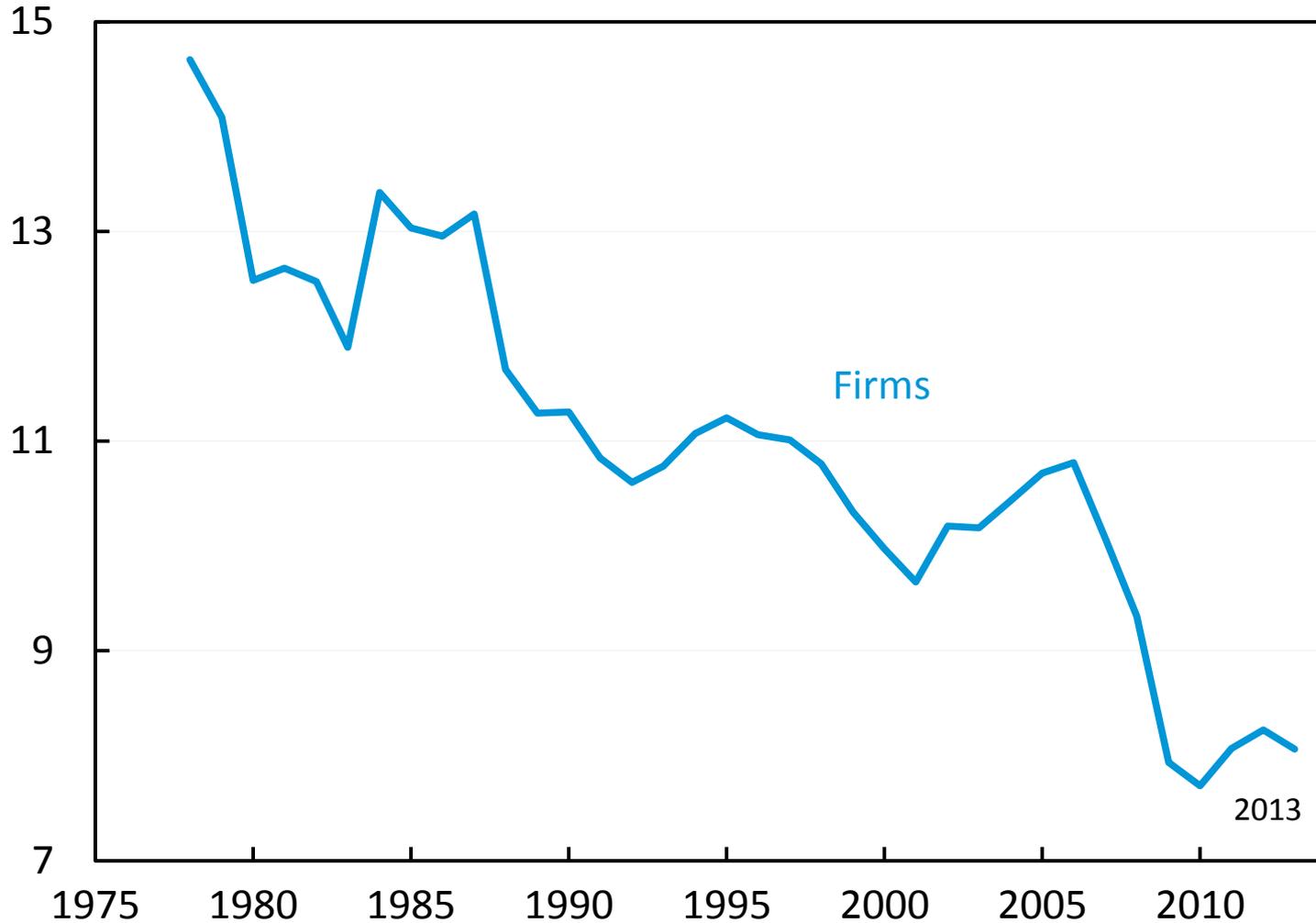
Share of Population Finding and Exiting Jobs per Month



Business Entry Rates Have Also Declined

Firm Entry Rate, 1978-2013

Percent of Total Firms



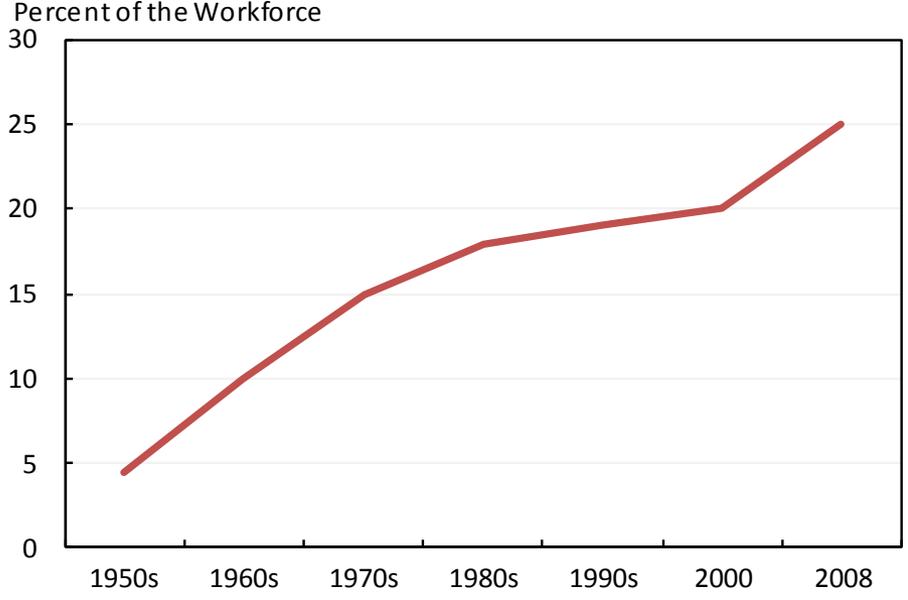
Benefits from Job Switching Have Declined

Wage and Earnings Gains Associated with Job Switching

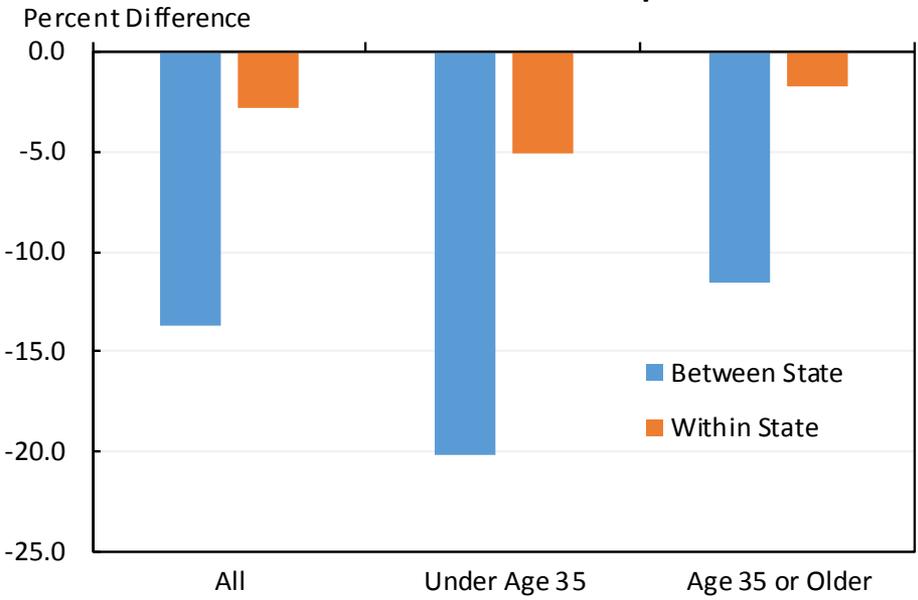
	Data Source	Age Group	Time Period	Gain to Switching Jobs
Topel and Ward (1992)	LEED	18 to 34	1957:Q1 - 1972:Q4	9%
Molloy, Smith, and Wozniak (2014)	PSID	22 to 29	1983-1994	4%
			1995-2001	10%
			2003-2011	2%
	NLSY	22 to 29	1966-1981	7%
			1979-1994	3%
			2002-2011	4%
Fallick, Haltiwanger, and McEntarfer (2012)	LEHD	25 to 55	1995:Q2	8%
			1999:Q2	14%
			2001:Q2	6%

Occupational Licensing Has Grown & Interstate Mobility is Much Lower for Workers in Licensed Occupations

Share of Workers with a State Occupational License



Difference in Migration Rates of Workers in Most vs. Least Licensed Occupations

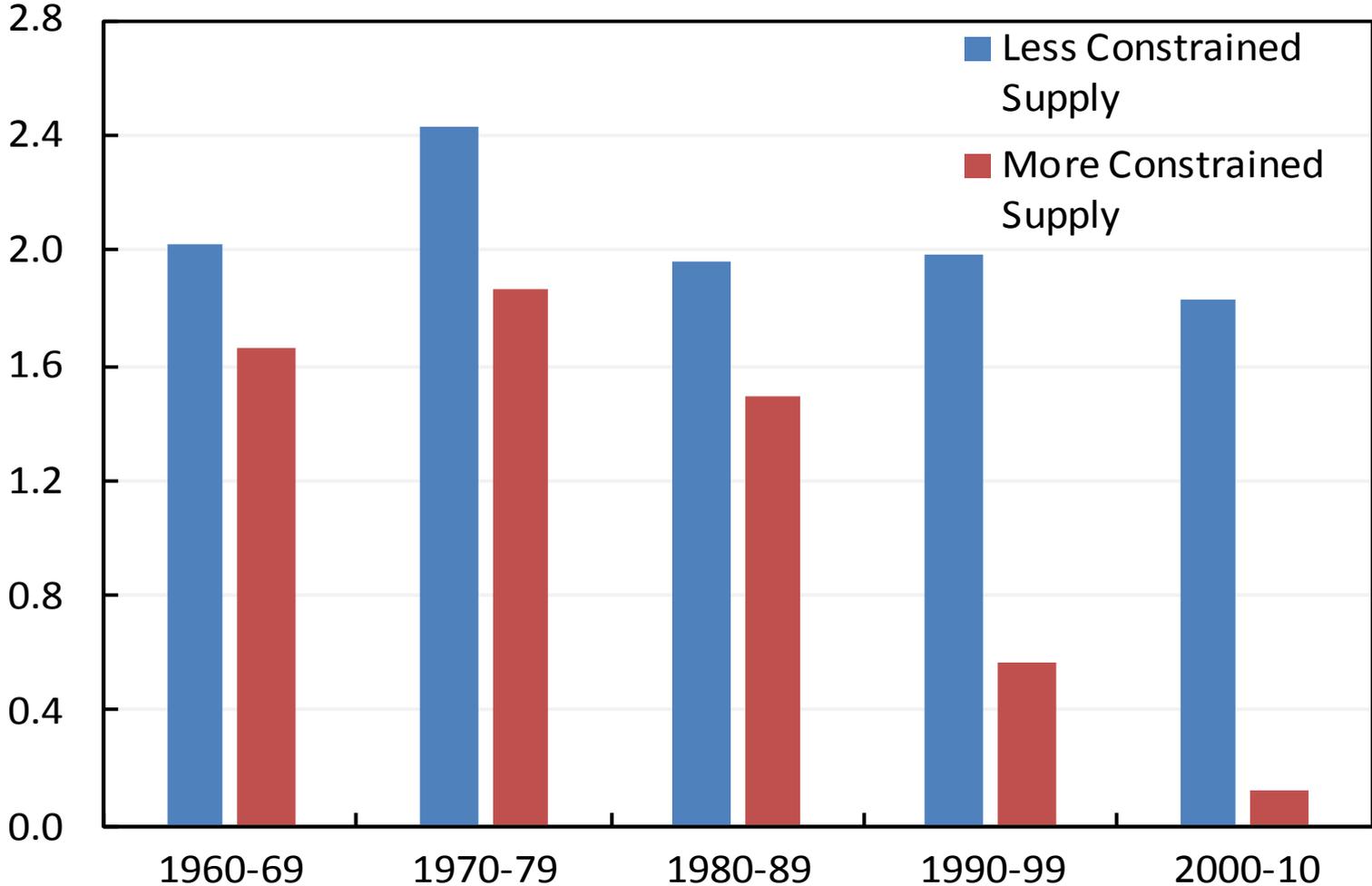


Source: The Council of State Governments (1952); Greene (1969); Kleiner (1990); Kleiner (2006); Kleiner and Krueger (2013), Westat data; Census Bureau, American Community Survey 2010-2013; CEA Calculations. Number on left chart is calculated from an OLS regression controlling for race, citizenship, sex, citizenship, number of children, marital status, education, income, year, and state. Ages 25 to 65 were included. 27

Housing Supply Constraints Slow Income Convergence

Speed of Income Convergence Across States by Housing Supply

Average Percent of Income Gap Closed Each Year



Source: Ganong and Shoag (2015); CEA calculations.

(Brief) Policy Implications

1. Improving labor force participation:

- Continue to strengthen the economy
- Flexible workplace practices including access to paid leave, paid sick days
- Greater access to high quality child care
- Reform taxes for secondary earners
- Training and other assistance finding jobs

2. Reducing inequality:

- Education from early learning through college and apprenticeships
- Raise the minimum wage and support worker voice
- More progressive tax system, including expanded childless EITC
- Product market reforms to promote competition

3. Promoting more fluid labor markets:

- Occupational licensing reform
- Reducing land use restrictions
- Wage insurance to support job transitions

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