October 19, 2015

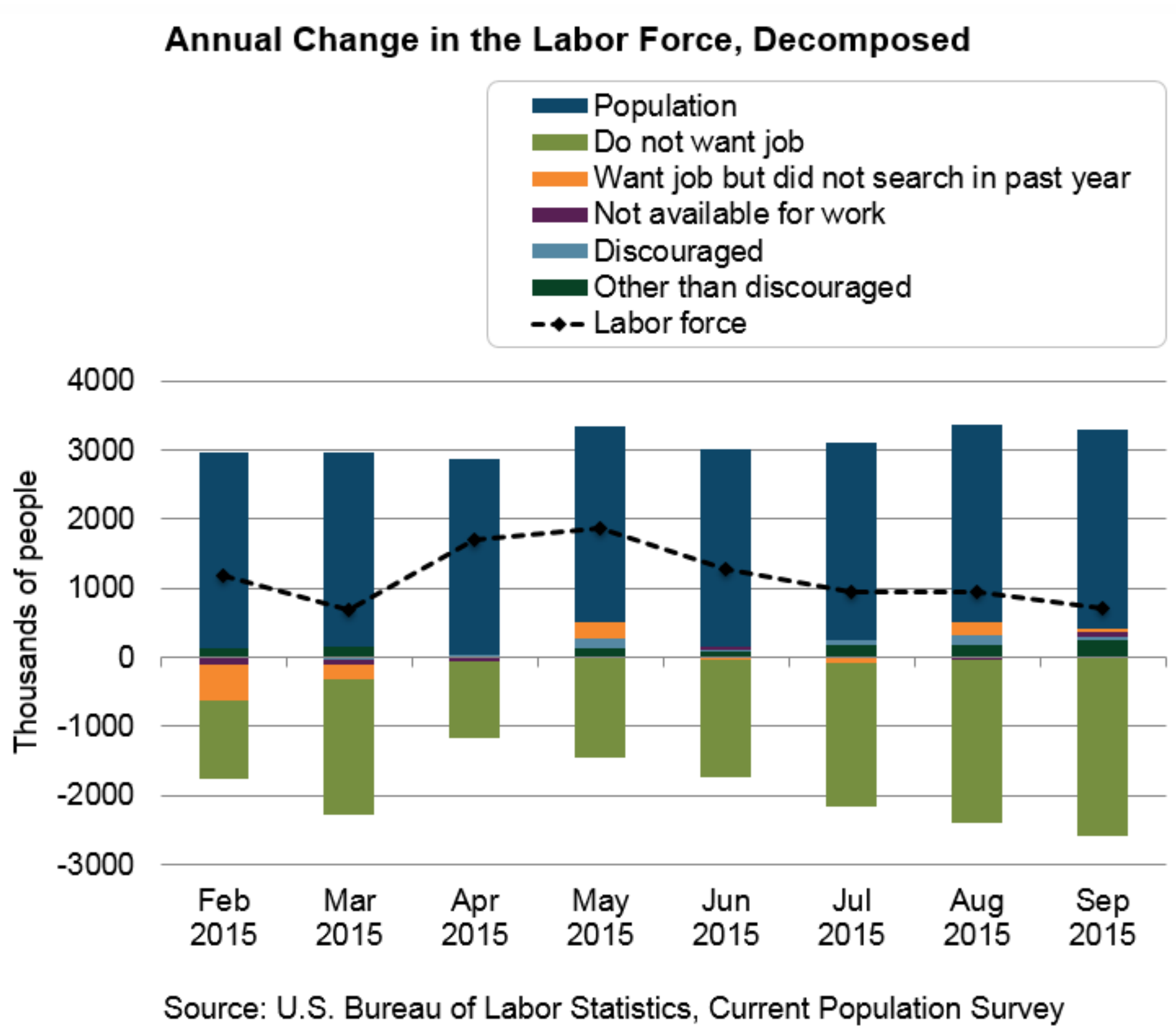
Should We Be Concerned about Declines in Labor Force Growth?

For the second month in a row, the October jobs report from the U.S. Bureau of Labor Statistics (BLS) has revealed a decline in the labor force. From August to September, the labor force lost a seasonally adjusted 350,000 participants. And the August number of participants was a seasonally adjusted 41,000 below July's level. Although two months don't necessarily make a trend, observers have noticed the declines in the labor force (here and here, for example), and they deserve some attention.

Economists might be concerned about these labor force declines for two reasons. First, these losses might indicate that the current unemployment rate doesn't accurately reflect a strong labor market. Second, our economy needs labor to make things, perform services, and continue to grow. Let's take a look at the evidence supporting these two concerns.

Concerns about a shadow weak labor market
Two pieces of evidence suggest that the declines in the labor force don't indicate a weak labor market: employment growth and the reasons people cite for being out of the labor force. Employment growth is robust. According to the Atlanta Fed's Jobs Calculator, the labor market needs to create an average of only 112,000 jobs per month to maintain its relatively low unemployment rate of 5.1 percent. During 2015, the economy has created, on average, 198,000 jobs per month.

But we might be concerned if the workers leaving the labor market were entering into the no-man's land of the marginally attached, a term describing those who want a job, are available to work, have looked for work in the previous year, but recently have stopped looking. Some of these people have stopped looking explicitly because they think jobs prospects are poor (called "discouraged workers"). Others have stopped looking for other reasons such as attending school or taking care of family members. If these categories of nonparticipants were absorbing a large share of those leaving the labor force, we could be concerned that they would, at any moment, reenter the labor market and push that unemployment rate right back up again. The chart below tells us that this possibility is unlikely.



(enlarge)

The chart decomposes the year-over-year changes in the total number of labor force participants into changes in the population and the negative changes among reasons given for nonparticipation in the labor force. (I use year-over-year changes because the reasons given for not being in the labor force are not seasonally adjusted.) Year-over-year changes in the population have been consistent in their contributions to changes in the labor force, propping it up. The growth in the contribution of those not wanting a job (pulling down labor force growth) has been fairly striking.

The share of people giving other reasons for not being in the labor force (discouraged, not available, etc.)—in addition to making relatively small contributions to changes to the labor force—has mostly been *shrinking* since April, meaning that they cannot explain the recent slowing of labor force growth. In other words, only a very small part of the growth in nonparticipants has come from those marginal workers who are most likely to reenter the labor force. So the first fear—that this declining labor force growth is producing a false sense of security in a relatively strong labor market—appears unfounded.

Threats to economic growth
Labor is an important component in the production process. Short of dramatic technological advancements, both the manufacturing and service sectors need a consistent source of labor to fuel output. Even though the economy appears to be on the right track with respect to job creation, ongoing declines in labor force growth could pose a challenge to economic growth. Additionally, as employers compete for fewer workers, we would expect wages to be bid up. Keep an eye on the Atlanta Fed's wage tracker to see how slowing labor force growth plays out in wages.

By Julie Hotchkiss, a research economist and senior policy adviser at the Atlanta Fed

October 19, 2015 in Employment, Labor Markets | Permalink