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

Jason Furman
Chairman, Council of Economic Advisers

World Bank Group
January 28, 2016
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

Percent of Labor Force

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

- Overall Unemployment Rate (UR): 90, 106
- Male UR: 106, 103
- Female UR: 74, 109
- White UR: 99, 103
- Black UR: 72, 121
- Hispanic UR: 99, 103
- Asian UR: 89, 111
- U-4 (U-3 + Discouraged): 92, 103
- U-5 (U-4 + Other Marginally Attached): 84, 102
- U-6 (U-5 + Part-Time for Economic Reasons): 87, 90
- Short-Term UR: 64, 120
- Long-Term UR: 28, 91

Percent Change in Indicator Relative to 2001-07 Average

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

Average Hourly Earnings for all Private Workers (Dec-15)

Consumer Price Index - All Urban Consumers (Nov-15)

Source: Bureau of Labor Statistics; CEA calculations.
The First Challenge: Labor Force Participation

Labor Force Participation and Employment-Population Rates

- Labor Force Participation Rate
- Employment-Population Ratio

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+

Note: Year axis denotes first quarter of year noted. See 2015 Economic Report of the President for methodological details.

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

Labor Force Participation Decomposition
Including Mean Duration of Unemployment

Regression of Quarterly Differences in Detrended Participation Rate

<table>
<thead>
<tr>
<th>Independent Variables (Year-over-Year Differences)</th>
<th>Unemp. Gap</th>
<th>Unemp. Gap (t-4)</th>
<th>Unemp. Gap (t-8)</th>
<th>Mean Duration</th>
<th>Mean Duration (t-4)</th>
<th>Mean Duration (t-8)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-0.0330*</td>
<td>0.00429</td>
<td>0.0151</td>
<td>-0.00406</td>
<td>-0.0142*</td>
<td>0.00222</td>
</tr>
<tr>
<td></td>
<td>(0.00914)</td>
<td>(0.0146)</td>
<td>(0.0114)</td>
<td>(0.00534)</td>
<td>(0.00524)</td>
<td>(0.00527)</td>
</tr>
</tbody>
</table>

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)

Source: Bureau of Labor Statistics; Aaronson et al. (2006); CEA calculations.
Structural Declines in Employment-Population Ratios

Note: Shading denotes recession.
Source: Bureau of Labor Statistics; CEA calculations.
Prime-Age LFPR Across G-7 Economies

Prime-Age Female Labor Participation Rates

Prime-Age Male Labor Force Participation Rates

Source: Organisation for Economic Co-operation and Development.
Prime-Age LFPR Across OECD Economies

Source: Organisation for Economic Co-operation and Development.
U.S. Labor Market Has High Flexibility But Low Supportiveness

**OECD Measures of Labor Market Flexibility**

<table>
<thead>
<tr>
<th>Measure</th>
<th>US Percentile Rank (100=Most Flexible)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Labor Market Regulation</td>
<td>100</td>
</tr>
<tr>
<td>Employment Protection for Regular Employment</td>
<td>100</td>
</tr>
<tr>
<td>Scope of State Intervention</td>
<td>94</td>
</tr>
<tr>
<td>Minimum Cost of Labor</td>
<td>92</td>
</tr>
<tr>
<td>Coverage of Collective Bargaining Agreements</td>
<td>90</td>
</tr>
<tr>
<td>Labor Taxation</td>
<td>71</td>
</tr>
<tr>
<td>Barriers to Entrepreneurship</td>
<td>62</td>
</tr>
</tbody>
</table>

**OECD Measures of Institutional Labor Market Support**

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

Source: Organisation for Economic Co-operation and Development.
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

Note: Data for all countries exclude capital gains.
Source: The World Wealth and Income Database.
The “Competitive” Explanation of Inequality: Skill-Biased Technical Change, Job Polarization, and Globalization

Change in Employment by Detailed Occupation, 1989–2014

Change in Total Employment, Thousands

Note: Excludes five small outlier occupational categories.
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

Source: Census Bureau, 1980 Census; Census Bureau, 2012 American Community Survey; calculations by David Autor and Brendan Price.
The “Rents” Explanation of Inequality: Income Differences May Reflect Non-Competitive Rent Collection Rather than Productivity Differences

Corporate Profits and Returns to Capital

Corporate Profits as a Share of Private-Sector GDP

1-Year Real U.S. Treasury Rate

Note: The real U.S. Treasury rate is defined as the nominal rate less CPI inflation.

Source: Bureau of Economic Analysis; Bloomberg Professional Service.

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

<table>
<thead>
<tr>
<th>Industry</th>
<th>Percentage Point Change in Revenue Share Earned by 50 Largest Firms, 1997-2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transportation and Warehousing</td>
<td>12.0</td>
</tr>
<tr>
<td>Retail Trade</td>
<td>7.6</td>
</tr>
<tr>
<td>Finance and Insurance</td>
<td>7.4</td>
</tr>
<tr>
<td>Real Estate Rental and Leasing</td>
<td>6.6</td>
</tr>
<tr>
<td>Utilities</td>
<td>5.6</td>
</tr>
<tr>
<td>Wholesale Trade</td>
<td>4.6</td>
</tr>
<tr>
<td>Educational Services</td>
<td>2.7</td>
</tr>
<tr>
<td>Accommodation and Food Services</td>
<td>2.6</td>
</tr>
<tr>
<td>Professional, Scientific and Technical Services</td>
<td>2.1</td>
</tr>
<tr>
<td>Administrative/Support</td>
<td>0.9</td>
</tr>
<tr>
<td>Other Services, Non-Public Admin</td>
<td>-1.5</td>
</tr>
<tr>
<td>Arts, Entertainment and Recreation</td>
<td>-2.3</td>
</tr>
<tr>
<td>Health Care and Social Assistance</td>
<td>-3.7</td>
</tr>
</tbody>
</table>

Source: Census Bureau, Concentration Ratios.
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

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

Source: Koller et al. (2015); McKinsey & Company.
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

Worker Flows have been Declining Since the 1990s

Employer, Occupation, and Industry Transitions

Percent of Total Population Age 16+

Source: Molloy, Smith, and Wozniak (2014).
Worker Flows have been Declining Since the 1990s

Share of Population Finding and Exiting Jobs per Month

Number Who Found a Job
Number WhoExited Job
Dec-15

Note: Shading denotes recession.
Source: Bureau of Labor Statistics; CEA calculations.
Business Entry Rates Have Also Declined

Firm Entry Rate, 1978-2013

Source: Census Bureau, Business Dynamics Statistics; CEA calculations.
Benefits from Job Switching Have Declined

<table>
<thead>
<tr>
<th>Data Source</th>
<th>Age Group</th>
<th>Time Period</th>
<th>Gain to Switching Jobs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Topel and Ward (1992)</td>
<td>LEED</td>
<td>18 to 34</td>
<td>1957:Q1 - 1972:Q4</td>
</tr>
<tr>
<td>Molloy, Smith, and Wozniak (2014)</td>
<td>PSID</td>
<td>22 to 29</td>
<td>1983-1994</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1995-2001</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2003-2011</td>
</tr>
<tr>
<td></td>
<td>NLSY</td>
<td>22 to 29</td>
<td>1966-1981</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1979-1994</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2002-2011</td>
</tr>
<tr>
<td>Fallick, Haltiwanger, and McEntarfer (2012)</td>
<td>LEHD</td>
<td>25 to 55</td>
<td>1995:Q2</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1999:Q2</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2001:Q2</td>
</tr>
</tbody>
</table>

Note: Topel and Ward (1992) and Molloy, Smith, and Wozniak (2014) are wage regression models, while Fallick, Haltiwanger, and McEntarfer (2012) use sample earnings medians from job switchers. All regression estimates are statistically significant, except for the Molloy, Smith, and Wozniak (2014) estimates from the 2000s.
Occupational Licensing Has Grown & Interstate Mobility is Much Lower for Workers in Licensed Occupations

**Share of Workers with a State Occupational License**

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent of the Workforce</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950s</td>
<td>5</td>
</tr>
<tr>
<td>1960s</td>
<td>10</td>
</tr>
<tr>
<td>1970s</td>
<td>15</td>
</tr>
<tr>
<td>1980s</td>
<td>20</td>
</tr>
<tr>
<td>1990s</td>
<td>25</td>
</tr>
<tr>
<td>2000</td>
<td>30</td>
</tr>
<tr>
<td>2008</td>
<td>35</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Category</th>
<th>Percent Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>All</td>
<td>-5.0</td>
</tr>
<tr>
<td>Under Age 35</td>
<td>-10.0</td>
</tr>
<tr>
<td>Age 35 or Older</td>
<td>-15.0</td>
</tr>
</tbody>
</table>

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

Jason Furman
Chairman, Council of Economic Advisers

World Bank Group
January 28, 2016