Analysis

Labour-force participation on the rise in euro area – United States trending in opposite direction

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Labour is one of the key components of economic growth, alongside capital formation and productivity. Labour supply in the euro area has been supported by a slight uplift in labour-force participation since the financial crisis. This is measured by the labour force participation rate, defined as the total number of employed and unemployed persons relative to the same-age population. By contrast, in the United States labour participation has declined notably. Because the participation rate declines as the population ages, demographic change has eroded the participation rates of both regions. In the euro area, however, increased participation especially among 50–64-year-olds has successfully offset the negative impact of population ageing on the participation rate. Yet what remains troubling is that the labour market participation of young people has declined in both regions.

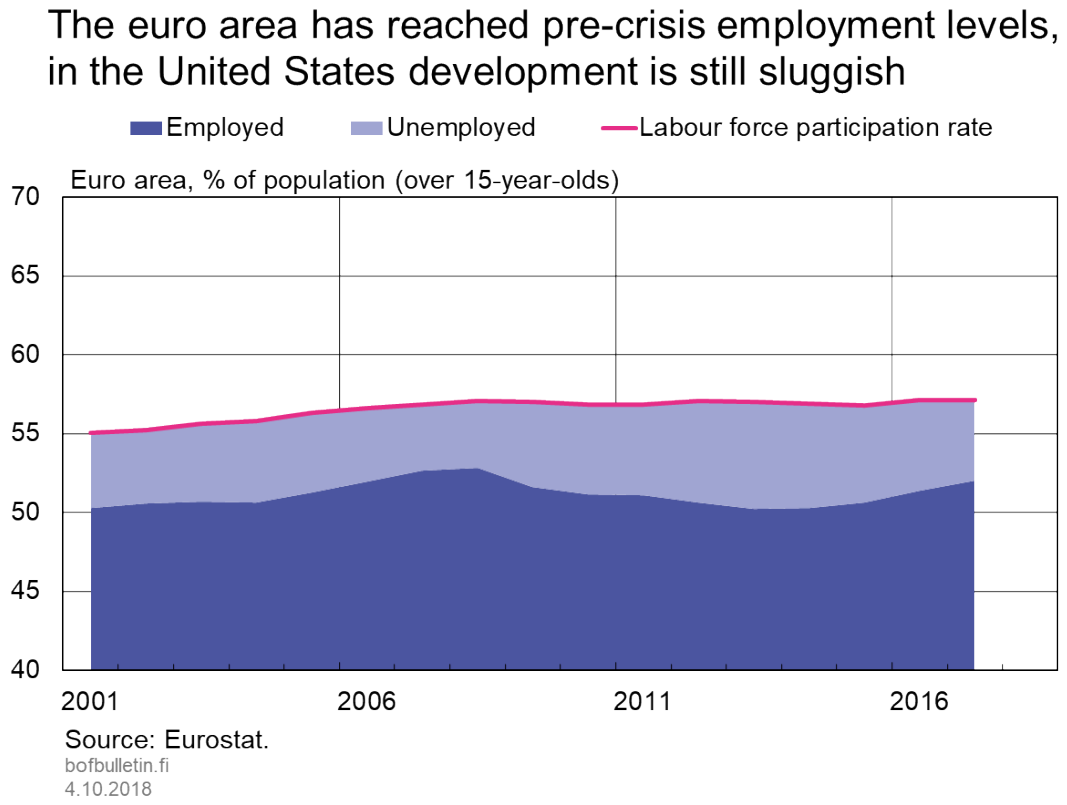


Euro area labour-force participation has caught up with the United States

Among the working-age population (15–64-year-olds) in the euro area, labour-force participation (about 73%) has already caught up with the United States. In 2017, the participation rate for over 15-year-olds was 52.7%, which slightly exceeds levels prior to the financial crisis. Yet while labour market participation has increased in the euro area, in the United States the participation rate for people aged over 16 has fallen by 3.5 percentage points down to about 62.5% (Chart 1) since 2007. The United States' lead in the adult population's participation rate has, in fact, shrunk from about 11 percentage points in 2002 down to 5 percentage points in 2016.

The observed decline in the labour force participation rate in the United States has proved unusual compared with previous recessions. According to Fernald et al. (2017), the declining participation rate combined with weak productivity growth is one of the foremost factors behind the United States' slow recovery from the crisis.[1] If the financial crisis turns out to have pushed a large share of the population permanently outside the labour force, it will have long-term repercussions on economic growth.

Chart 1.



The contrasting development in terms of labour-force participation is similarly reflected in the regions' unemployment (Charts 2 and 3). In the euro area, a growing number of the population has actively engaged in the labour market, which explains the persistently high unemployment even though employment development after the financial crisis has been stronger than in the United States. Thus, in the euro area about 6% of the population aged 15 years and above are unemployed. By contrast, in the United States the share of the unemployed in the total population has dropped close to the pre-crisis level of 3%, but at the same time the population share outside the labour market has increased by almost 2 percentage points.[2]

Chart 2.

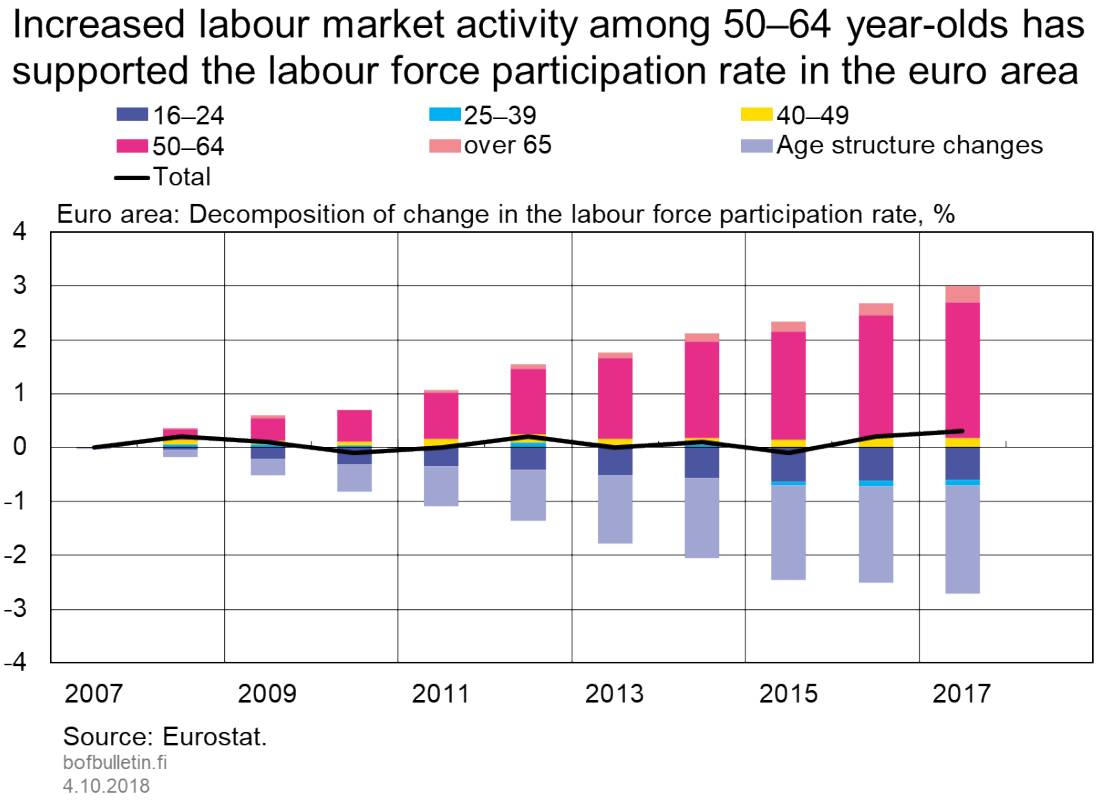
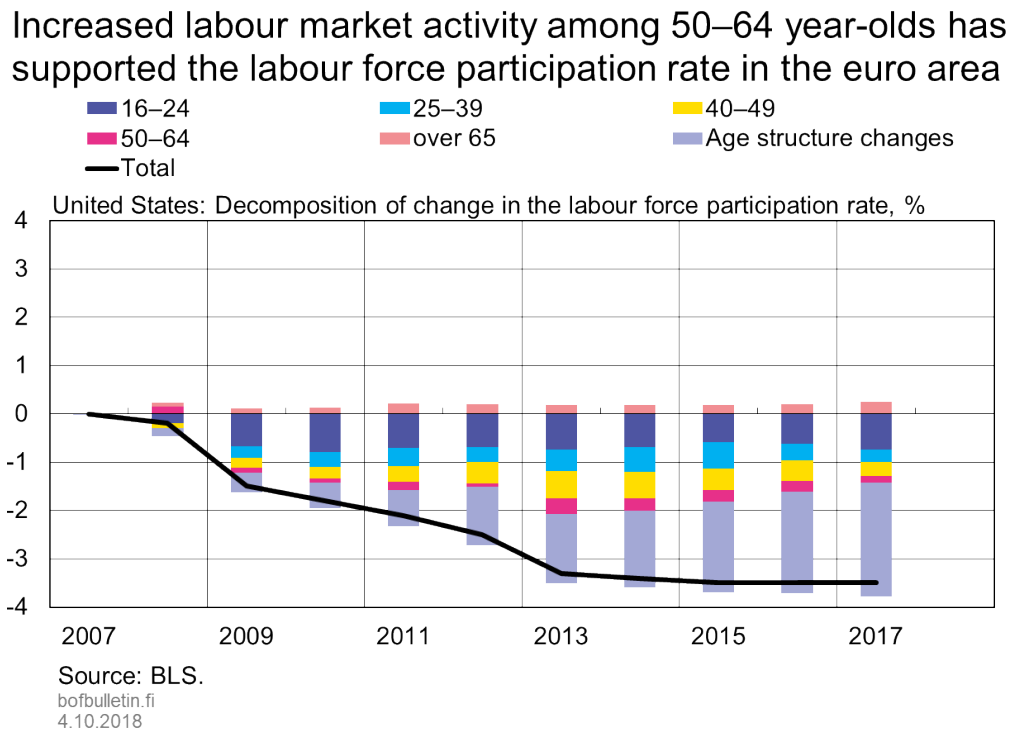


Chart 3.



Population ageing weighing on labour force participation rates

Labour-force participation varies widely according to age, which means that shifts in demographic structure greatly impact the participation rate. Labour market participation is lower both in the youngest age groups and in groups aged over 50 compared with middle-aged cohorts. In the euro area, the population share of those aged over 50 has grown by just under 5 percentage points, whereas in the United States, the increase has been about 3 percentage points. There is also a notable difference in the proportion of young, under 35-year-olds in the total populations of the two regions. The proportion of young people has decreased by three percentage points in the euro area, but in the United States by only one percentage point. Young people currently constitute 32% of the total population in the United States, but only 27% of the population in the euro area. Labour-force participation is lower for young people than for middle-aged people, which is why the current age structure temporarily lowers the aggregate participation rate in the United States more than in the euro area. Yet when considering the long-term outlook of the participation rate, the age structure in the United States appears more favourable than in the euro area.

The participation rate for middle-aged cohorts living in the euro area has not changed significantly compared to what it was before the financial crisis, but youth participation in the labour market

has declined. The participation rate for people aged 50–64 has started to rise considerably, increasing by as much as some 10 percentage points. Proposed causes for the higher participation rate for those aged 50–64 include pension system reforms as well as improvement in the overall health and educational levels of the population.[3] In the euro area, the rise in labour-force participation has been especially strong among women aged 50–64. In several age groups participation rates have already reached the levels in the United States. The only exception are people over 65, for which the participation rate in the United States is almost 15 percentage points higher than in the euro area.

Chart 4.

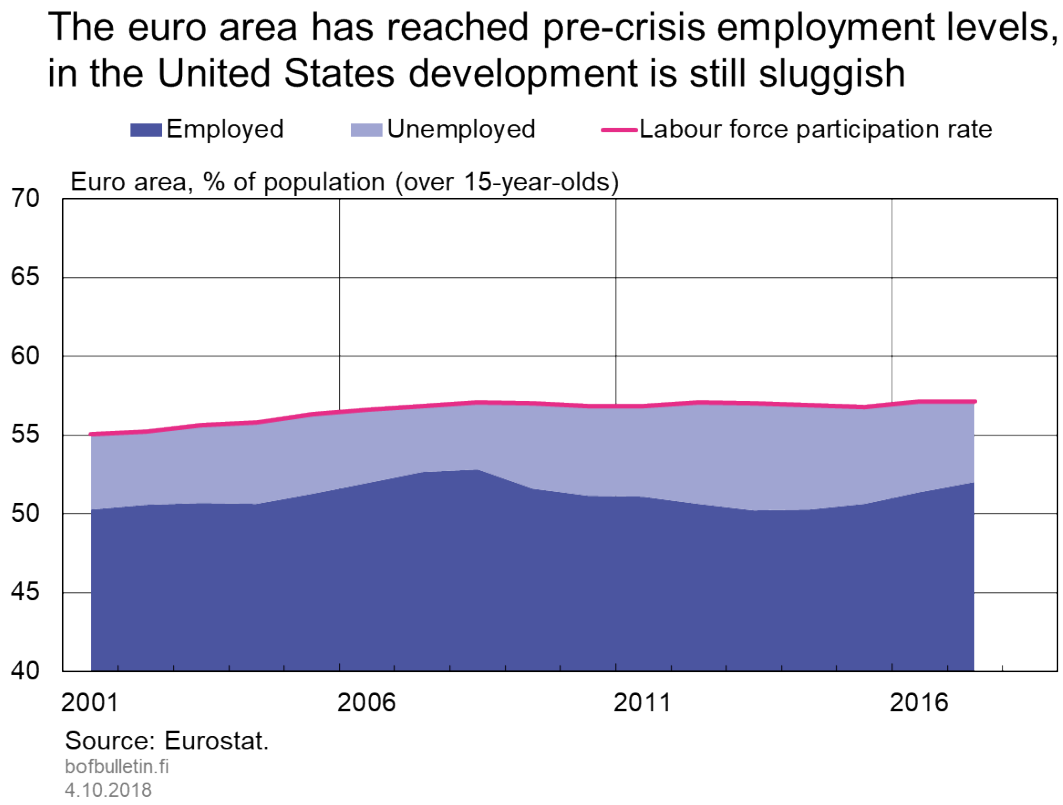
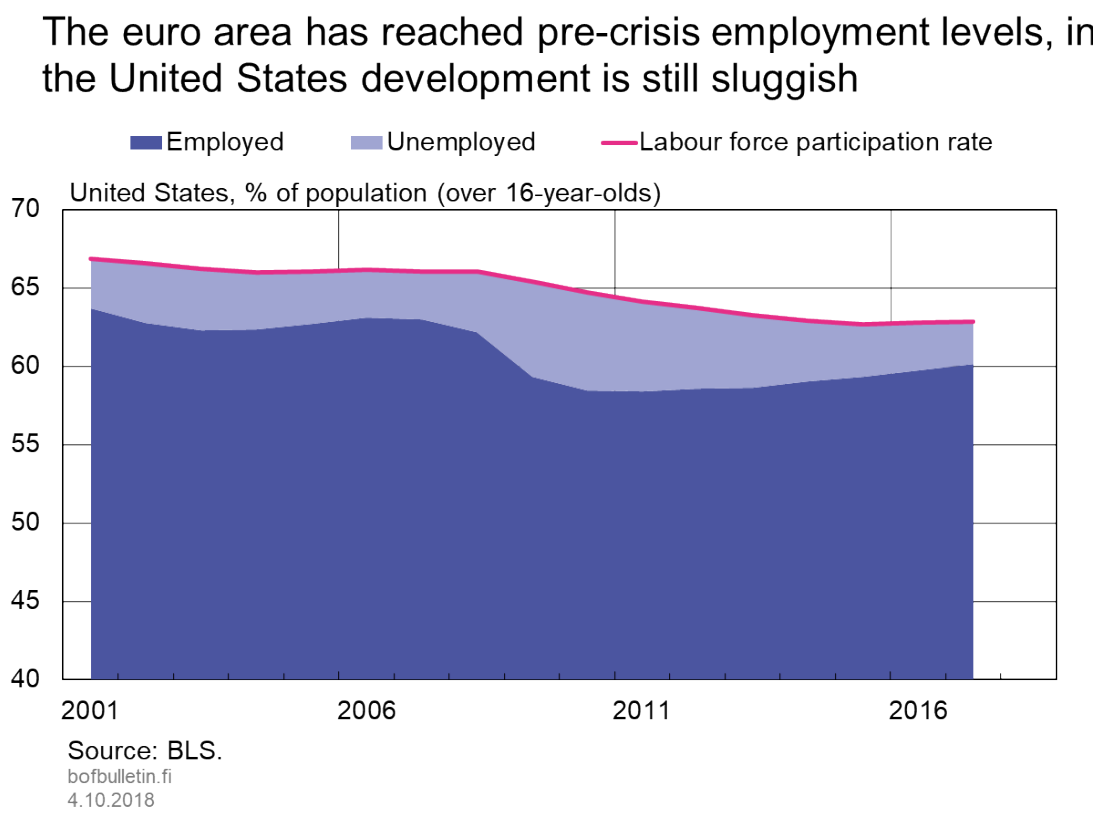


Chart 5.



Charts 4 and 5 illustrates how population ageing and trends in each specific age group have contributed to the development of the overall participation rate in the euro area and in the United States since the financial crisis. Changes in the age structure have lowered labour-force participation significantly in both regions, mostly due to the negative impact on the labour supply brought by population ageing. In the United States, changes in the age structure have lowered the participation rate by nearly 2.5 percentage points since 2007. In the euro area, the corresponding effect has been about 2 percentage points. Additionally, weaker youth participation in labour markets has eroded the participation rate in both regions by 0.5 percentage points.

Notable differences between the two regions can be observed in the development of the participation rates of middle-aged people and 50–64-year-olds. In the United States, participation has dropped in both age groups, leading to a total decline in the participation rate for the adult population by more than 0.5 percentage points. At the same time, the improved labour participation among 50–64-year-olds in the euro area has increased the participation rate of the total adult population by about 2 percentage points. The improvement has been enough to maintain an almost unchanged labour force participation rate, despite strong headwinds from population ageing.

Attracting young people to the labour market would increase potential output

The labour force participation rate in the euro area has been surprisingly high after 2007, considering the headwinds brought about by population ageing. While the strong participation rate has supported the region's recovery from crisis and bolstered its labour supply, it has also depressed the development of wage pressures. From a general perspective, as the participation rate for 15–64-year-olds in the euro area has already reached the level in the United States, it will probably be more difficult to increase it in the future. Population ageing will also begin to demonstrate an effect on the participation rate going forward.

Similarly, two-thirds of the decline in the participation rate of the United States is accounted for by ageing, whereas the remaining third can be explained by other reasons that have discouraged especially 16–39 year-olds from entering the labour market. What remains troubling is that since the financial crisis, labour-force participation among young people has declined in both regions. Drawing young adults back into the labour market in the euro area and in the United States would raise the potential output of both regions above current estimates.

Notes

1. Fernald, J., Hall, R., Stock, J. & Watson, M. (2017) The Disappointing Recovery of Output after 2009. Forthcoming, Brookings Papers on Economic Activity, March 2017. ↑
2. In June 2018, the unemployment rate (i.e. the share of unemployed labour force) was 8.3% in the euro area and 3.9% in the United States. ↑
3. For an assessment of the effects of pension system reforms in the European Union, see Carone, G., Eckefeldt, P., Giamboni, L., Laine, V. & Sumner, S. P. (2016) Pension Reforms in the EU since the Early 2000's: Achievements and Challenges Ahead. European Commission Discussion Paper 042, December 2016. Improved educational levels as the driving force behind increased labour force participation among women has been studied by e.g. Thévenon, O. (2013) Drivers of Female Labour Force Participation in the OECD. OECD Social, Employment and Migration Working Papers, No. 145, OECD Publishing. ↑

Keywords

labour force participation rate, population ageing