US Daily: Why Isn't Labor Force Participation Recovering? (Briggs)

- While the unemployment rate continues to fall quickly, labor force participation has made no progress since August 2020. In this *US Daily*, we examine where labor force participation remains weak and potential explanations for its underperformance.
- Most of the 5.0mn persons who have exited the labor force since the start of the pandemic are over age 55 (3.4mn), largely reflecting early (1.5mn) and natural (1mn) retirements that likely won't reverse. The outlook for prime-age persons who have exited the labor force (1.7mn) is more positive, since very few are discouraged and most still view their exits as temporary.
- There are several reasons why workers have delayed labor force reentry. Childcare constraints and elevated fiscal transfers likely weighed on participation earlier in the pandemic but should have small effects going forward, and most households have only accumulated enough excess savings to postpone re-entry for a few months. Labor supply drags from Covid concerns appear sizeable and will likely linger in the medium-term, since it may take some time for some people to feel comfortable returning to work. We also see potential for longer-lasting drags due to wealth effects, and changing lifestyle and work preferences may prompt some workers to voluntarily remain out of the labor force for longer, provided they can afford to do so.
- We continue to expect that the labor force participation rate will increase in the near-term, but we have nudged down our participation rate forecast to 1pp below trend at end-2021 (61.9%) and ½pp below trend at end-2022 (62.1%) following last Friday's data. But because jobs are abundant and residual weakness in participation in mid-2022 will likely be due to changes in fiscal policy, wealth, and worker preferences, we expect that the FOMC will judge any participation shortfall that remains at that point to be structural or voluntary and will update their maximum employment goal accordingly.

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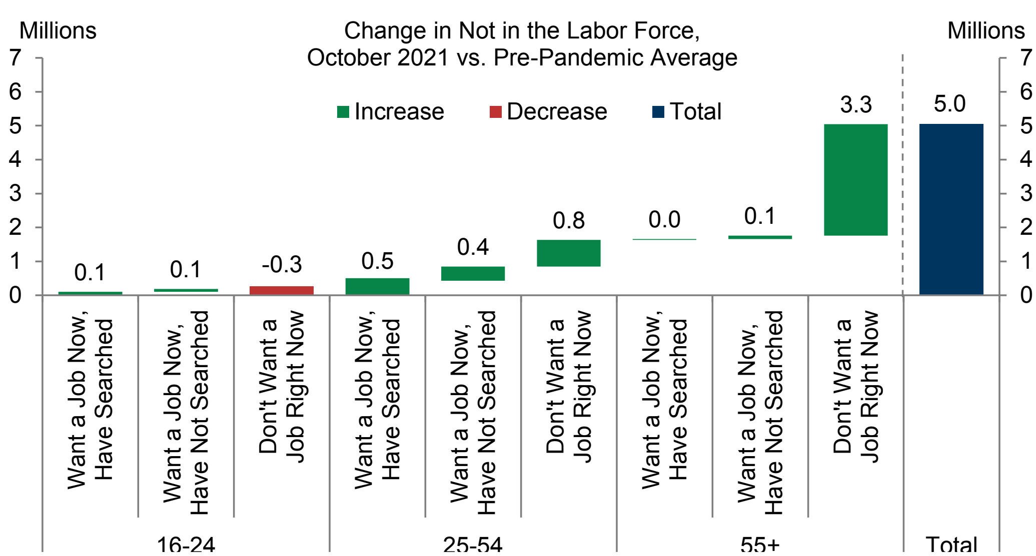
Why Isn't Labor Force Participation Recovering?

The unemployment rate fell further in last Friday's employment report, but labor force participation continued to disappoint and stands below its August 2020 level at 61.6%. In this *US Daily,* we examine where labor force participation remains weak and potential explanations for its underperformance.

Exhibit 1 decomposes the change in persons not in the labor force since the start of the pandemic. The first key takeaway is that most labor force exiters are over age 55 (3.4mn) and do not want a job right now, reflecting 1.5mn early retirements, 1mn natural retirements due to population aging, and 900k exits for other reasons. We expect that an improving virus situation, increased vaccination, and new antiviral drugs from Pfizer and Merck should alleviate the health concerns that are particularly relevant for older workers and encourage some to return to work. However, shifts into retirement tend to be stickier than other labor force exits, and we therefore expect that the participation shortfall from early retirees will unwind relatively slowly through fewer new retirements going forward.

The second key takeaway is that among the prime-age persons who exited the labor force (1.7mn), more either do not want a job right now (800k) or have not searched in the last year (400k) than want a job and have searched in the last year (500k). The low share of prime-age exiters who want a job and have searched (30%) suggests that most prime-age exits are voluntary.

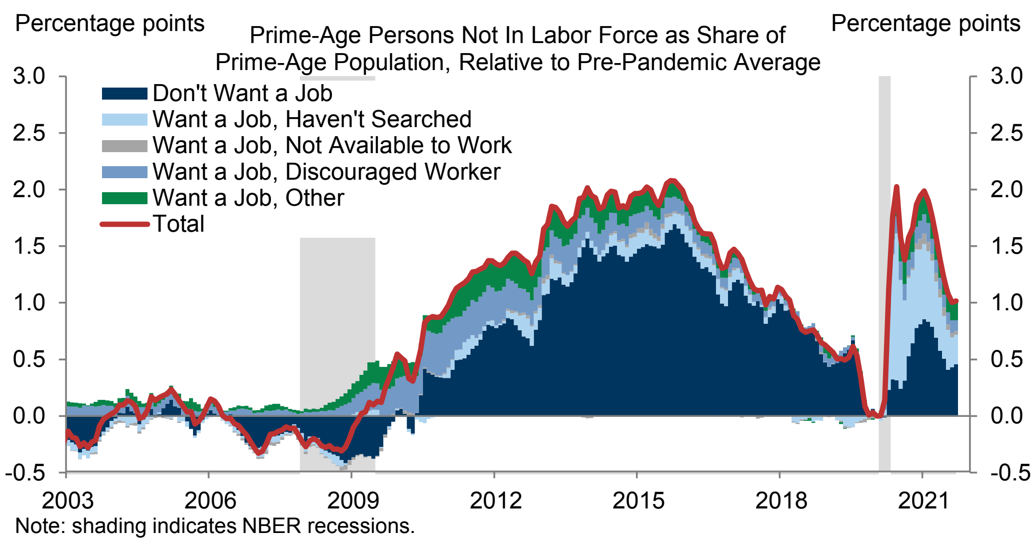
Exhibit 1: The Majority of Labor Force Exits Since the Start of the Pandemic Reflect Older Workers Who Don't Want a Job Right Now



Source: US Bureau of Labor Statistics, Goldman Sachs Global Investment Research

To provide more context around the increase in nonparticipation of prime-age workers during the pandemic, Exhibit 2 shows the evolution of their population share (relative to the pre-pandemic average) by reason since 2003. Early in the last cycle, many persons were discouraged by a lack of job prospects and stopped looking for work. In contrast, in the current cycle more persons who have exited haven't started looking for work yet and very few are discouraged. This is intuitive: it is hard to imagine large numbers of workers dropping out in despair over a lack of job opportunities when jobs are so abundant.

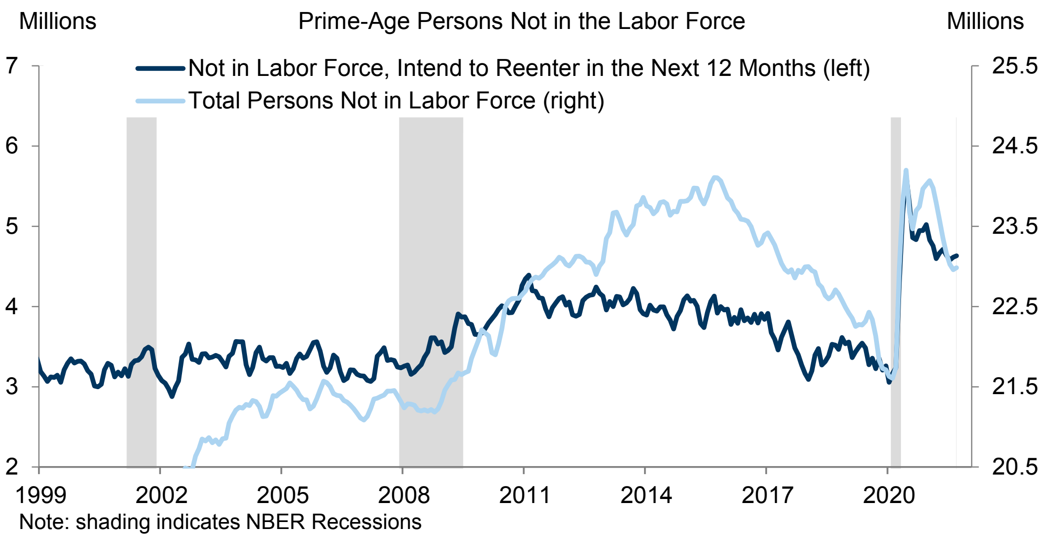
Exhibit 2: Most Prime-Age Labor Force Exiters Want a Job but Haven't Searched, Whereas After 2008 Most Were Initially Discouraged by Lack of Job Prospects



Source: US Bureau of Labor Statistics, Goldman Sachs Global Investment Research

One reason for optimism about the labor force re-entry of prime-age workers is that nearly all workers who left the labor force during the pandemic intend to re-enter in the next 12 months (Exhibit 3), suggesting that most prime-age exiters still view their exits as temporary. This pattern stands in sharp contrast to the rise in nonparticipants who had no intention of returning after the Great Recession, and adds to the evidence that participation dynamics will be very different this cycle.

Exhibit 3: Nearly All Prime-Age Persons Who Have Left the Labor Force Intend to Re-enter in the Next 12 Months

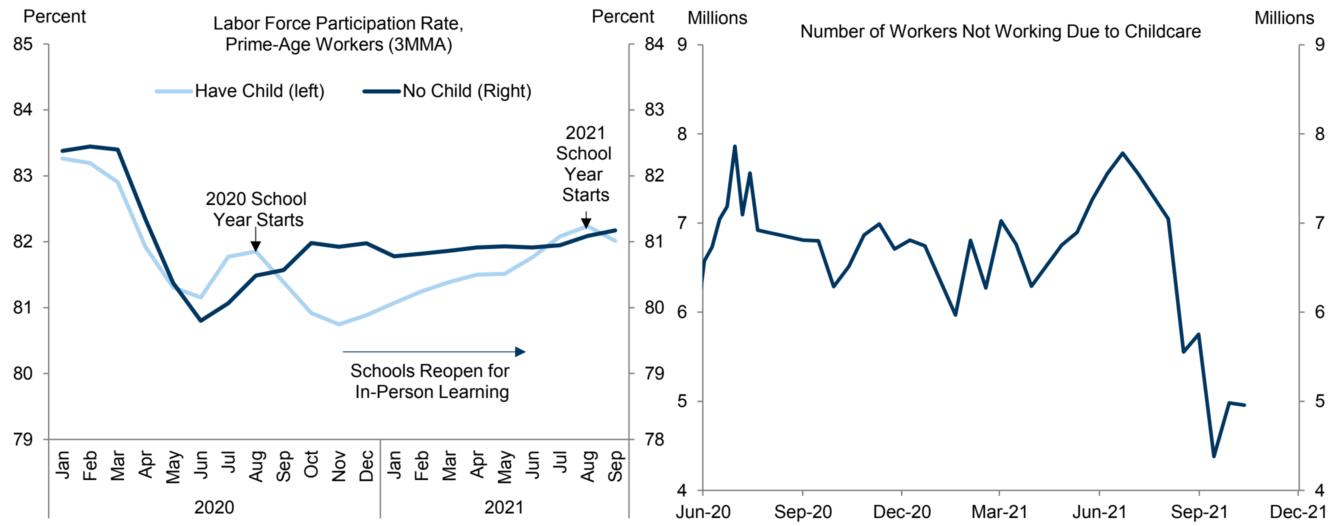


Source: Census Bureau, Goldman Sachs Global Investment Research

Of course, if most prime-age workers intend to re-enter the labor force, why haven't they done so already? Our prior research has noted several factors—for instance, childcare constraints, virus-related health risk, and generous fiscal support—that have limited labor force participation, and we therefore revisit the current evidence surrounding each.

Focusing first on child care constraints, the left chart of Exhibit 4 compares the labor force participation rate of prime-age workers with and without children. The participation rate of parents notably underperformed that of nonparents after the school year started in fall 2020, although much of the gap closed as schools reopened for in-person learning in spring 2021, and it fully closed by fall 2021. Similarly, the Census Pulse Household Survey implies that the number of persons not working due to child care constraints fell sharply after schools reopened this fall (right chart). Taken together, these patterns suggest that childcare disruptions weighed on labor supply earlier in the pandemic, but are less of a constraint now.

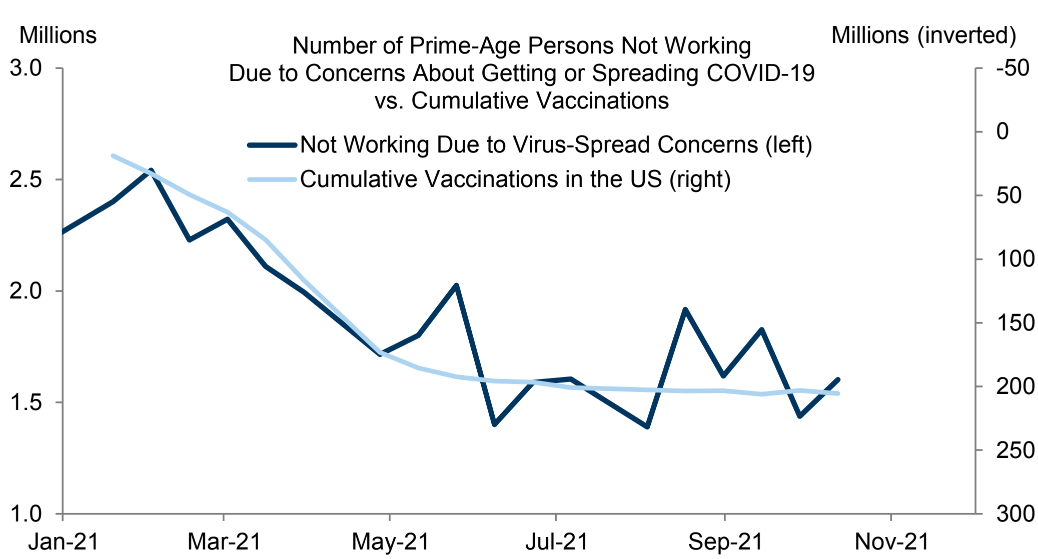
Exhibit 4: Childcare Disruptions Weighed on Labor Supply Earlier in the Pandemic, But Now Appear to Be Less of a Constraint



Source: US Bureau of Labor Statistics, Census Bureau, Goldman Sachs Global Investment Research

Health-risk concerns are a second explanation for a weak labor force participation recovery. According to the Census Pulse Household Survey, the number of prime-age persons who report that concerns about getting or spreading Covid-19 are their main reason for not working declined as vaccinations (inverted) increased this spring (Exhibit 5), but 1.6mn people still report virus-spread concerns as their main reason for not working. We anticipate that an improving virus situation, widespread vaccination at workplaces following the implementation of President Biden's vaccine mandate, and new antiviral drugs should alleviate these concerns for some workers, but that Covid-related concerns will continue to weigh on prime-age labor supply in the medium-term.

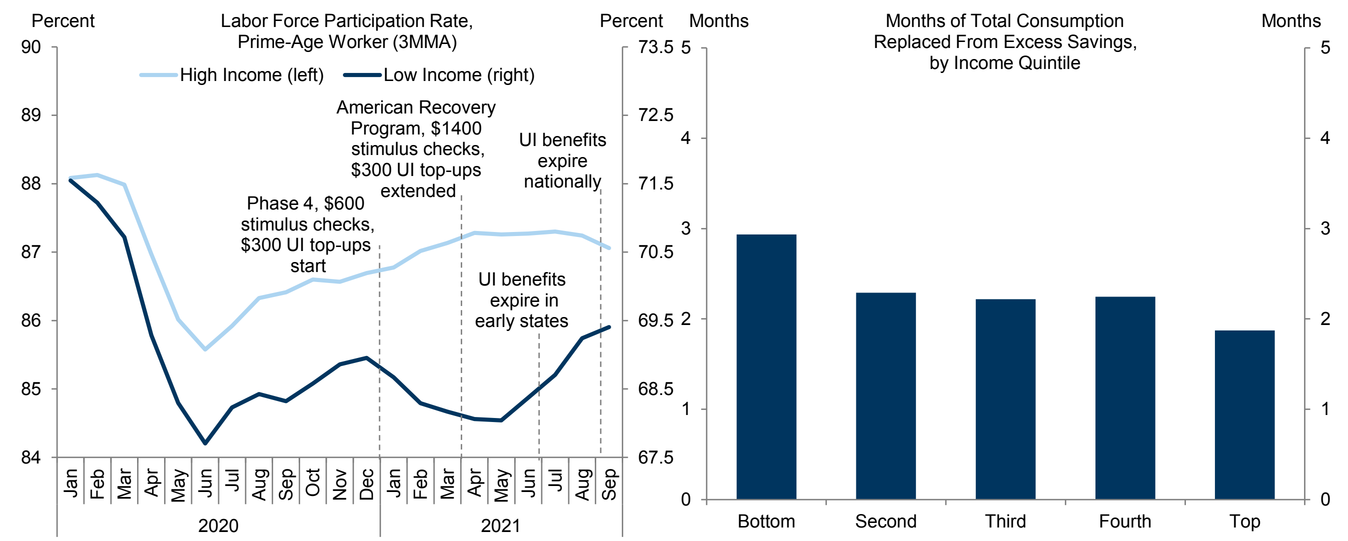
Exhibit 5: Virus Concerns Continue to Discourage Labor Supply



Source: Census Bureau, Goldman Sachs Global Investment Research

A third explanation for the weak labor force participation recovery is that generous fiscal support discouraged labor supply. In previous work we found that unemployment insurance (UI) benefit expiration increased the job finding rates of unemployed workers, but had no effect on labor force re-entry for persons not in the labor force. However, the left chart of Exhibit 6 suggests that participation among lower-income households underperformed higher-income households when stimulus checks were distributed and UI benefits were expanded earlier this year, and the gap closed as transfer payments pulled back this summer. We expect that any drag from past transfers will continue to fade in the near-term, since we recently estimated that most households could fund current spending through excess savings for just 2-3 months if they have no other source of income.

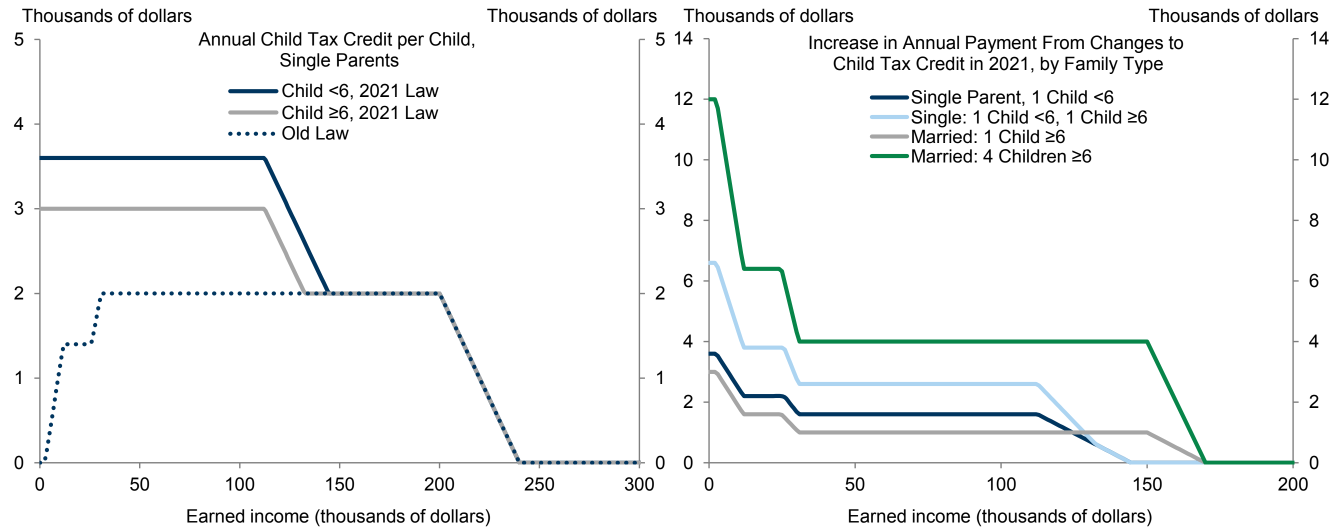
Exhibit 6: Labor Supply of Lower-Income Workers Underperformed After Transfer Payments Increased Last Spring, but Remaining Excess Savings Can Probably Sustain Spending for Just a Few Months Going Forward



However, fiscal transfers that continued this fall may still be weighing on labor supply. The American Recovery Plan increased the Child Tax Credit (CTC) for 2021 and made it fully refundable—meaning that households receive a refund payment if the credit exceeds their total tax liability—and pre-paid, with monthly payments starting in July 2021. Exhibit 7 shows that these changes resulted in meaningful increases in income—particularly for lower-income households—and prior academic research (see Appendix Exhibit 10) suggests that the changes—particularly the shift to full refundability—could discourage labor supply.

The Biden administration has proposed pairing the expanded CTC with an increased Child and Dependent Care Tax Credit (CDCTC) that should have offsetting labor supply incentives. Assuming that either both or neither of these tax credits are passed for 2022, we therefore expect that any labor supply drag from the CTC should be mostly confined to 2021, but see two-sided risks depending on the details and permanence of policy changes in the upcoming reconciliation bill.

Exhibit 7: The Expanded Child Tax Credit May Have Lowered Work Incentives



Source: IRS, Goldman Sachs Global Investment Research

Although we expect that labor force drags from fiscal transfers and excess savings will mostly be confined to the near-term, we do see potential for longer-run drags on participation from the significant appreciation in house prices, stock wealth, and retirement portfolios during the pandemic. Evidence from academic research is somewhat mixed, but some studies find large wealth effects on labor force participation, with several noting that older workers are particularly sensitive to wealth gains, consistent with the increase in early retirements (Exhibit 8).

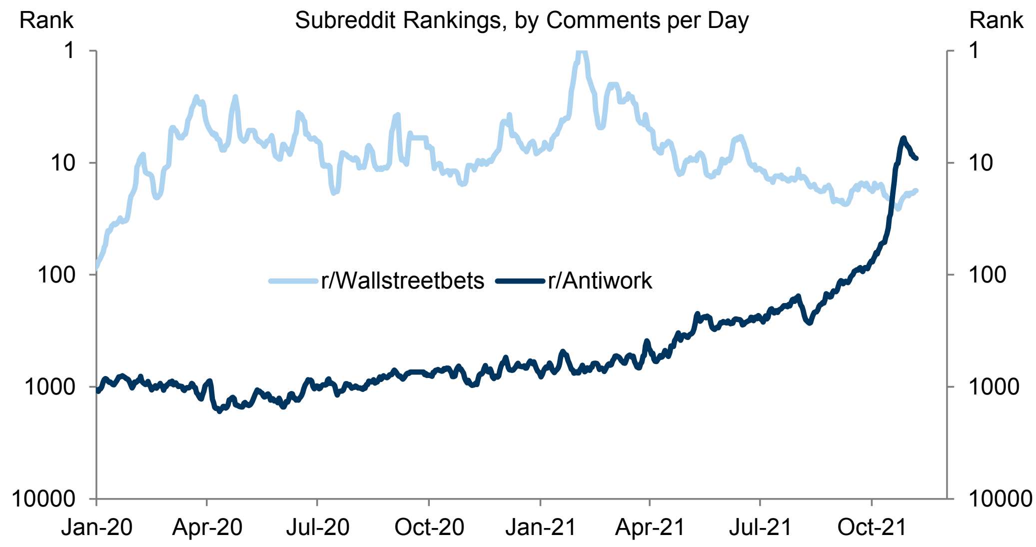
Exhibit 8: Increases in Wealth During the Pandemic Likely Explain Some Labor Force Exits

Effect of Wealth on Labor Supply		
Study	**Details**	**Estimate**
Disney Gathergood (2018)	Changes in house prices in the UK	10% increase in housing wealth reduces labor supply of young women by 1.3%, older men by 4.4%.
Cesarini Lindqvist Notowodigdo Ostling (2017)	Estimate labor supply response to large lottery prizes in Sweden	Each $150k reduces labor supply by 2pp.
Zhao (2017)	Compare changes in labor supply to changes in house prices across states	100% increase in housing wealth reduces labor supply of elderly homeowners by 5%.
Powell (2014)	Compare labor supply responses to 2008 stimulus payments	No effect on labor force participation, small negative effect on earnings.
Imbens Rubin Sacerdote (2001)	Estimate labor supply response to lottery prizes in the US	Each $55k reduces labor supply by 0.3pp.

Source: Goldman Sachs Global Investment Research

A final long-run risk to labor force participation is that some worker's preferences and lifestyles may have shifted after a year and half out of the labor force. The best way to measure this change in taste for work is probably via social media, and as shown in Exhibit 9, Reddit's Antiwork message board—which encourages individuals "to get the most out of a work-free life"—has surged in popularity this fall and is now even more popular than the Wallstreetbets board that drove a surge in retail trading activity earlier this year. As a result, we see some risk that some workers will elect to remain out of the labor force for longer, provided they can afford to do so.

Exhibit 9: Changing Lifestyle and Work Preferences May Slow the Return of Some Workers



Source: Subreddit Stats, Goldman Sachs Global Investment Research

It is hard to know exactly how much each of the factors mentioned above is weighing on participation, especially since most interact positively. However, the continued underperformance of the participation rate suggests some downside risk to the labor supply outlook, despite the lack of discouragement among prime-age workers suggesting that the labor force participation rate will rise.

We continue to expect that the labor force participation rate will increase in the near-term, but we have nudged down our participation rate forecast to 1pp below trend at end-2021 (61.9%) and ½pp below trend at end-2022 (62.1%) following last Friday's data. Because jobs are abundant and residual weakness in participation in mid-2022 will likely be due to changes in fiscal policy, wealth, and worker preferences, we expect that the FOMC will judge any participation shortfall that remains at that point to be structural or voluntary and will update their maximum employment goal accordingly.

Joseph Briggs

We thank Manuel Abecasis for help with this report.

Appendix

Exhibit 10: Academic Research Suggests Changes to the Child Tax Credit in 2021 Might Discourage Labor Force Participation

Effect of Child Tax Credit on Labor Supply		
Study	**Details**	**Estimate**
Lippold (2019)	Eligibility loss when child turns 18 (~$1000 to $2500 reduction)	8.4pp reduction in parental employment due to loss of credit among low income households
Zheng (2020)	Differences in benefit generosity due to differences in number of children and changes in the tax code over time	1.1 percentage point increase in labor force participation per $1000 increase for single mothers
Wingender & LaLumia (2017)	Compare women eligible for different benefit amounts based on childbirth in December vs. January	5-6 percentage point reduction in maternal labor supply for each $1000 in three months after childbirth
Guner, Kaygusuz, & Ventura (2020)	Child tax credit expansion (~$800/child increase)	2.4% reduction in labor supply of married females following expansion

Source: Goldman Sachs Global Investment Research

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