

The Need to Cope with the Decline in the Labor Force Participation Rate of Young Persons

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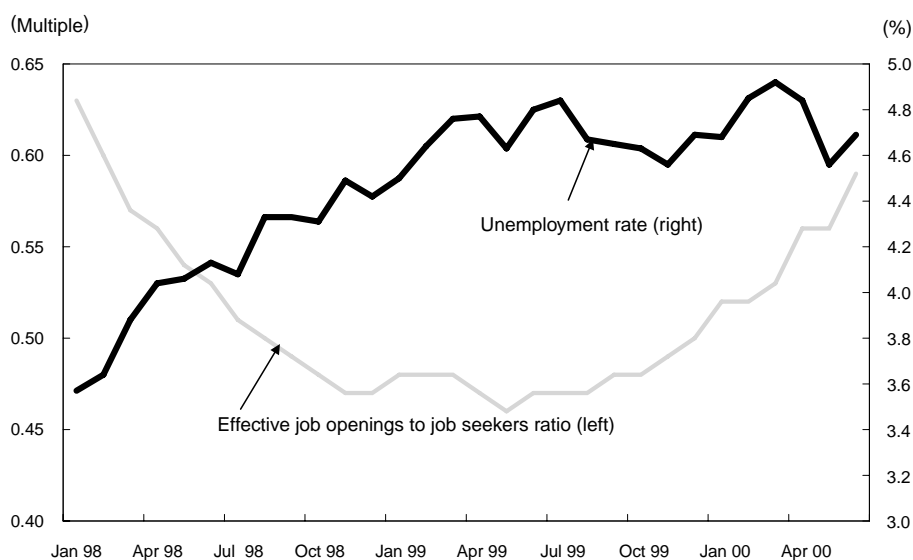
1. Employment Indicators Show Improvement

With the economy on a recovery trend since April 1999, employment indicators have also gradually improved.

First, upbeat production activity has caused unscheduled work hours in manufacturing to increase since the beginning of 1999, and register year-on-year increases by summer. By the end of the year, unscheduled work hours for all industries including the non-manufacturing sector had begun to increase on a year-on-year basis as well. The effective ratio of job openings to job seekers — a measure of labor supply and demand — bottomed out in May 1999 at 0.46, and has risen to 0.59 as of June 2000.

The unemployment rate, which continued to rise after the economy bottomed out, peaked in February and March 2000 at 4.9%, and has edged down to 4.7% as of late.

Figure 1 Employment Related Indicators

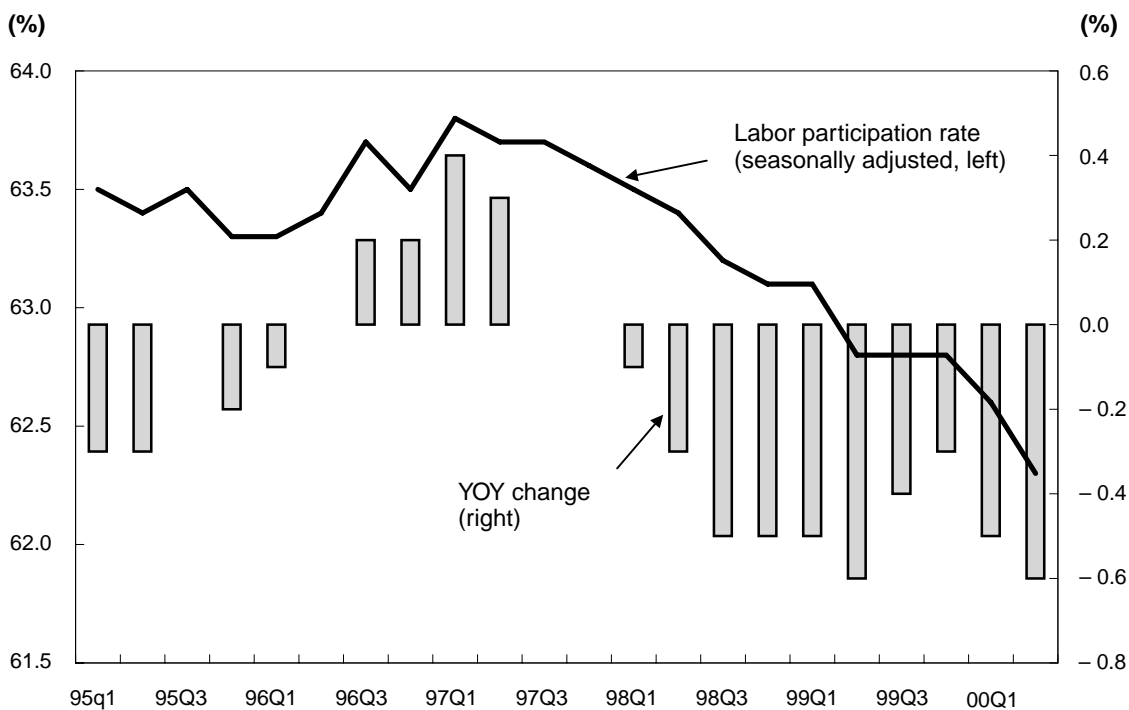


Sources: MACA, *Labor Force Survey*; Ministry of Labor, *Regular & Temporary Employment Placement Through Labor Exchanges*.

2. The Troubling Decline in the Labor Participation Rate

However, despite improvements in these employment related indicators, it would be premature to declare that the employment situation is genuinely improving because the labor force participation rate continues to slide (Figure 2).

Figure 2 Labor Force Participation Rate



Source: MACA, *Labor Force Survey*.

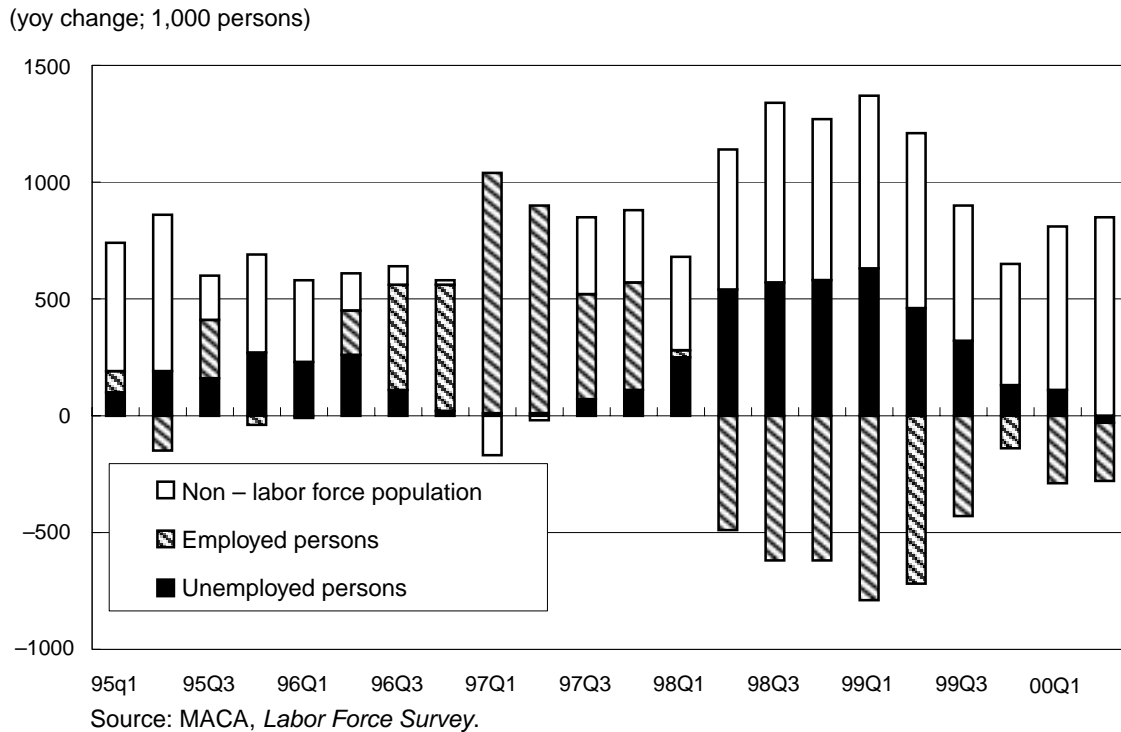
The labor force participation rate is the proportion of employed and unemployed persons in the population age 15 and above — persons presently working and those who are not working but looking for work. In the short term, the participation rate is sensitive to business cycles. That is, the participation rate rises during expansions, when work intentions increase because good jobs are easier to find, and declines in contractions as more people quit searching for jobs and leave the labor force.

However, in the present recovery phase, the participation rate has failed to respond more than one year into the recovery. Since peaking at 63.8% in the previous economic peak in the first quarter of 1997, the participation rate has declined 1.5 percentage points over the past three years, and as of the most recent April-June quarter stands at 62.3%.

In May, the employment situation showed an apparent improvement as the jobless rate declined for the first time in three years. However, the number of employed persons has continued to decline, and the

population not in the labor force is growing at an accelerating pace (Figure 3). Thus the unemployment rate declined not because more people are working, but because more people have quit looking for jobs and are leaving the labor force.

Figure 3 Significant Increase in the Non-Labor Force Population



With fewer people participating in the labor market, the fall in the jobless rate is thus not an entirely favorable sign. In the past three years since the January-March 1997 quarter, the labor force has decreased by 350,000 persons, while the non-labor force population has risen by 2.28 million.

2. Factors Affecting the Labor Force Participation Rate

(1) Long-term Trends by Gender

Below we examine the factors causing the decline in the labor force participation rate.

From a long-term perspective, the participation rate is greatly affected by supply side factors of labor such as aging of the population and level of educational attainment. By gender, the participation rate has trended downward among men since the early 1970s. The participation rate among women dropped sharply in the early 1970s as farm households declined — causing a large decrease in individual proprietors and family employees — but subsequently trended upward in stride with business

cycles (Figure 4). While the participation rate among men has been reduced by aging and higher education levels, these factors have been more than offset among women by their increased social participation and heightened work intentions, thus pushing up the women's participation rate over the long term.

Figure 4(a) Long-term Trend in Labor Force Participation Rate (Men)

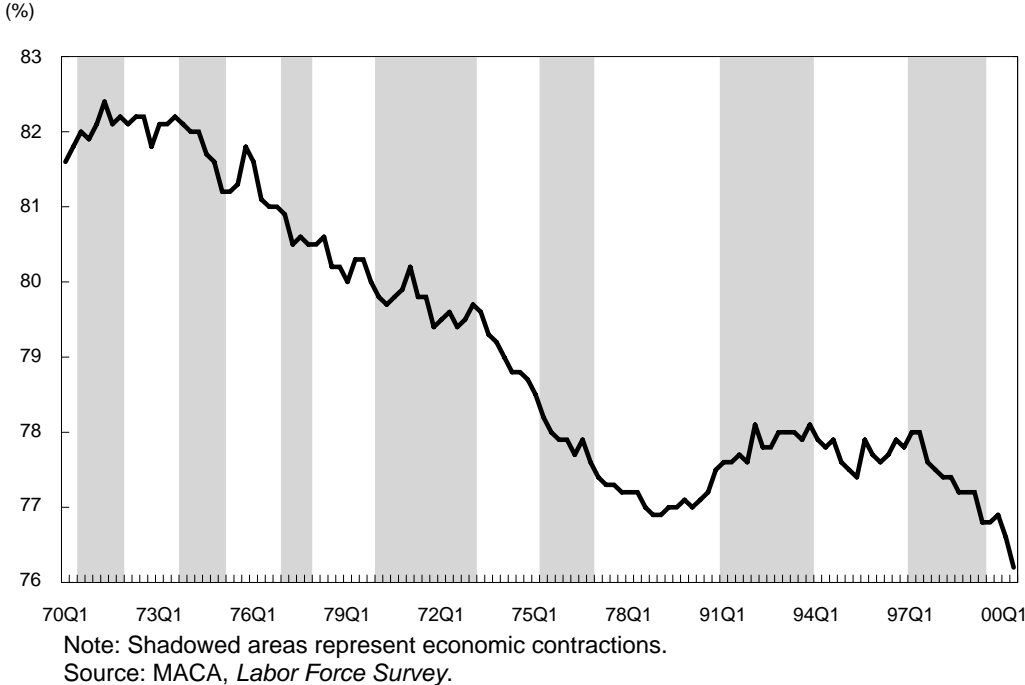
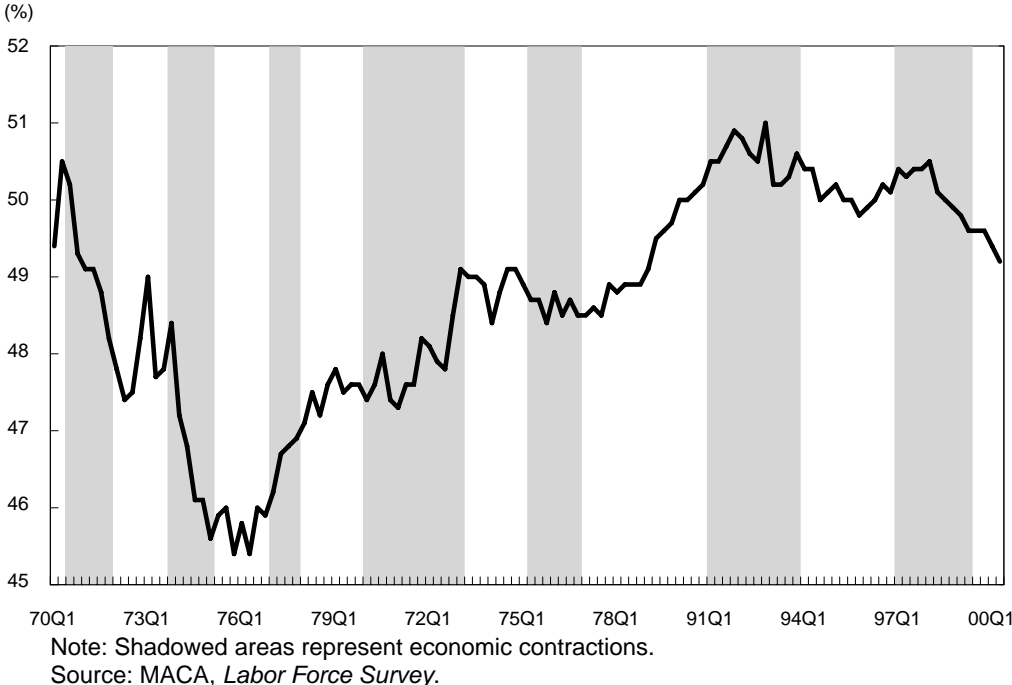


Figure 4(b) Long-term Trend in Labor Force Participation Rate (Women)



(2) Negative Factors Since 1997

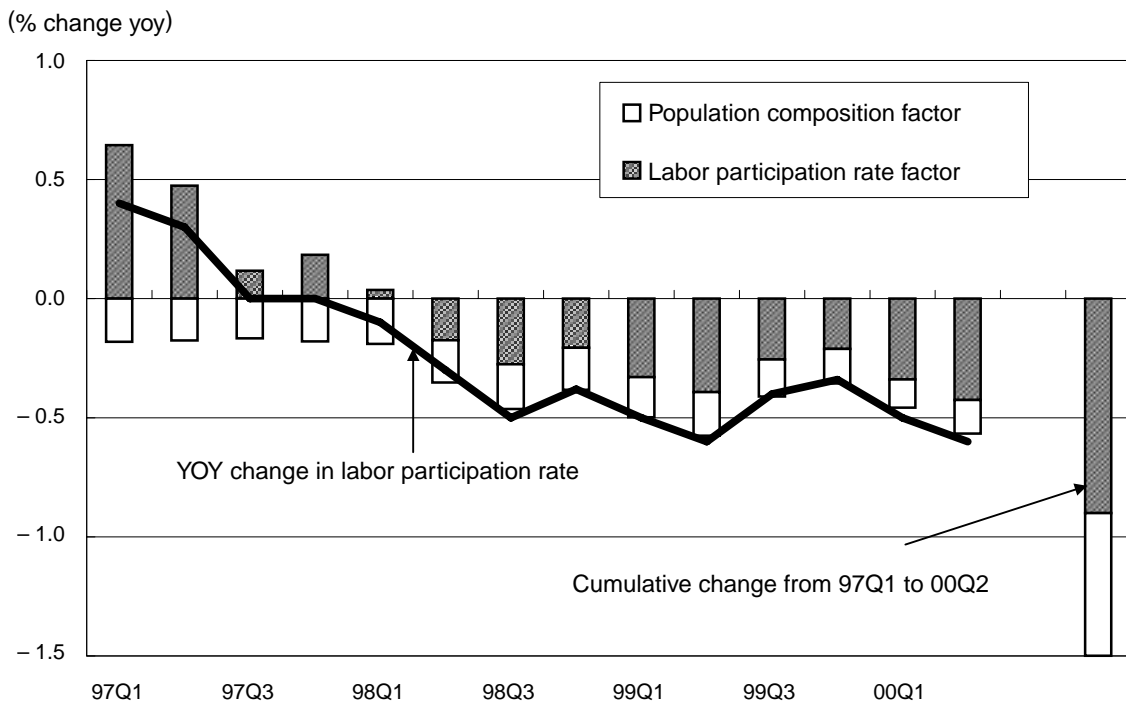
However, participation rates have declined recently among both men and women. This can be attributed to two factors.

1. Population aging

The changing composition of the population due to aging is causing participation rates for both men and women to trend downward. Since participation rates in the segment aged 55 and above are relatively low, as this age segment grows, the overall participation rate declines even if participation rates for other ages remain the same. In recent years, this factor has accounted for an annual 0.1 to 0.2 percentage point decline in the participation rate.

Of the 1.5 percentage point decline since the most recent peak in the first quarter of 1997, 0.6 percentage point is attributable to population composition changes due to aging, and the remaining 0.9 percentage point to participation rate declines by age segment (Figure 5).¹

Figure 5 Factor Analysis of Change in Labor Participation Rate

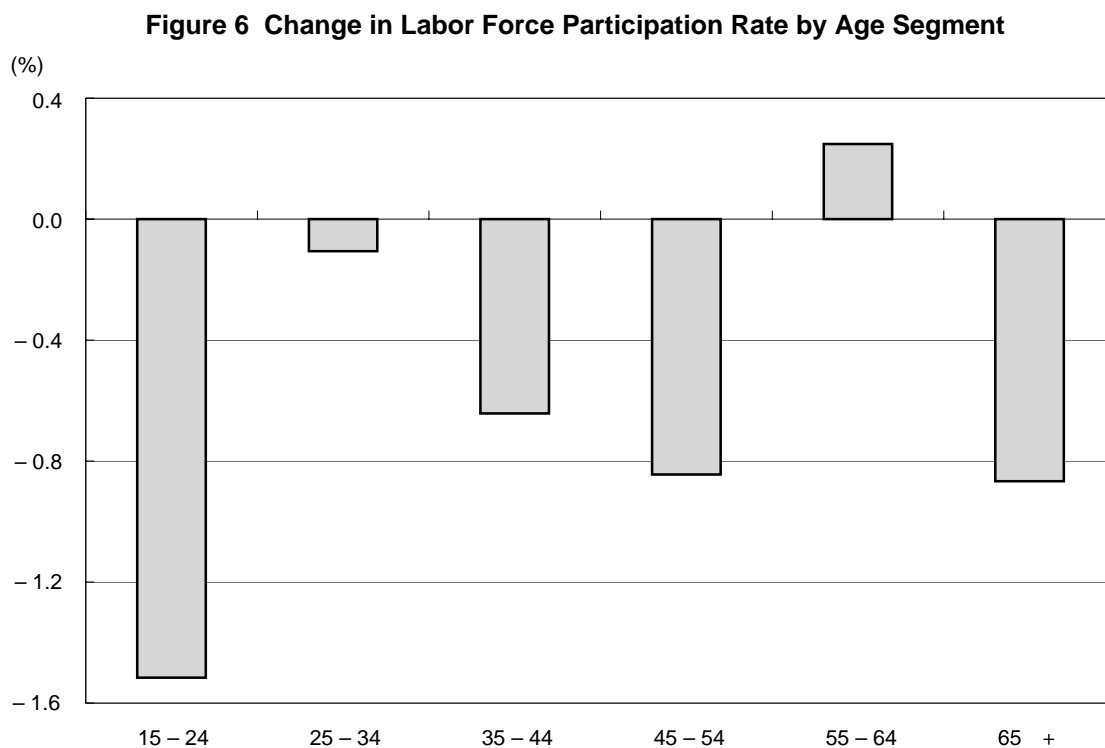


Note: The factor attributable to participation rate changes was calculated by aggregating changes in the participation rate of each age segment.

Source: MACA, *Labor Force Survey*.

2. Decline in work intentions

By population segment, changes in the labor participation rate have declined across the board except for the age 55-64 segment. The large decline among young workers is attributable to unique factors which are explained later. As for the other age segments, the decline in the core working age segment of 35-54 is conspicuous (Figure 6).



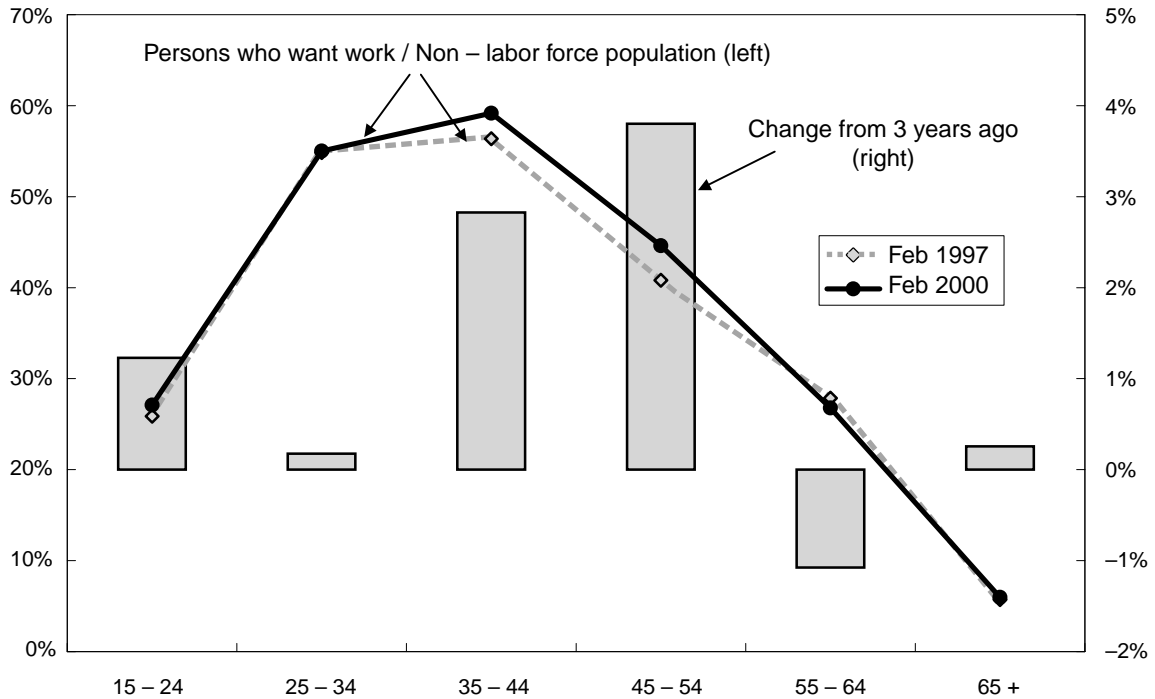
Notes: 1. Shows change from January-March 1997 to January-March 2000.
2. The increase in the 55-64 age segment can be attributed to an increase in companies with a mandatory retirement age of 60 or above.
Source: MACA, *Labor Force Survey*.

Persons who are not presently working are nonetheless considered to be participating in the labor force if they are actively searching for a job; otherwise they are counted in the non-labor force population. For example, persons who may want to work but are not actually searching for a job are considered not to belong to the labor force.

According to the MACA *Special Survey of the Labor Force Survey*, the proportion of the non-labor force population who want to work has increased in the three-year period since 1997 for all age segments except the 55-64 age segment, and is particularly pronounced for the 35-54 age segment (Figure 7). Thus the falling labor participation rate of the 35-54 age segment can be attributed to an increase in discouraged workers — persons who want to work but have quit searching for jobs.

The declining labor participation rates in the past three years for all but one age segment can thus be attributed to the large number of persons discouraged by their job prospects in the weak economy and thus leaving the labor market.

Figure 7 Proportion of the Non-Labor Force Population Who Desire Work



Notes: 1. Persons who want to work are those who are not job-searching and thus do not belong to the labor force.
 2. Bar graph shows percentage point change between February 1997 survey and February 2000 survey.

Source: MACA, *Special Survey of the Labor Force Survey*.

4. The Significant Decline in Labor Participation Rate of Young Persons

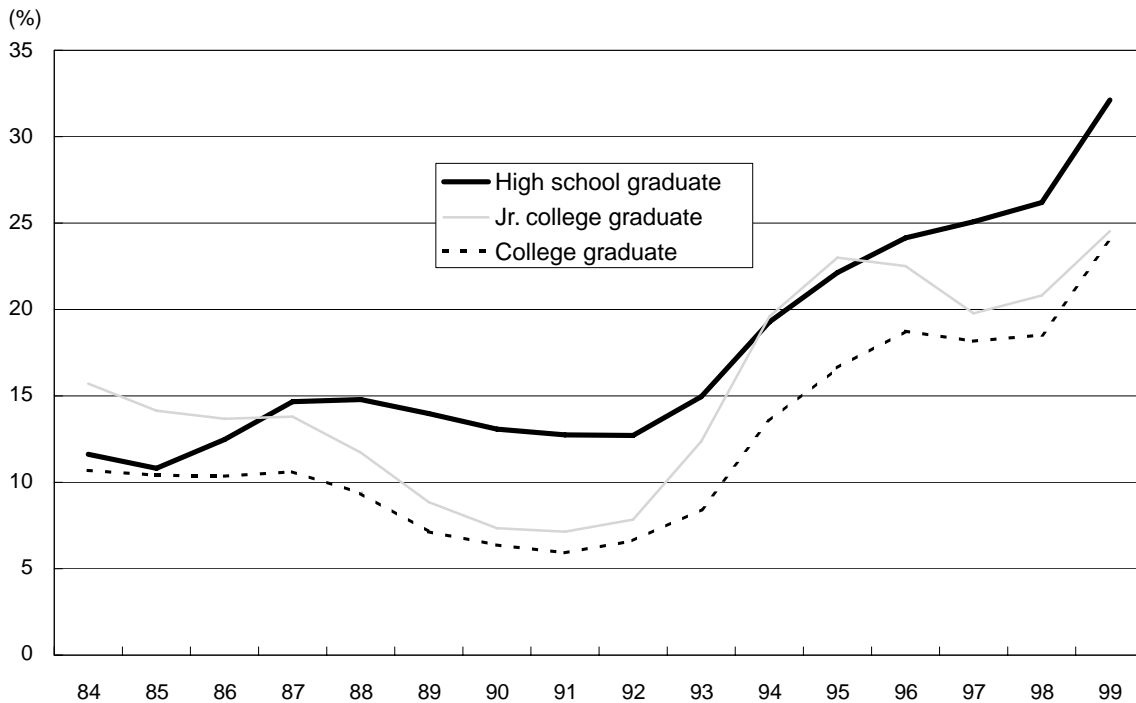
While the decline in labor participation rate among the 35-54 age segment can be attributed to an increase in discouraged workers, the 1.5 percentage-point decline among the 15-24 age segment over the past three years must be explained by other factors.

Two factors immediately come to mind: (1) the tight market for new graduates due to the weak economy, and (2) an increase in the rate of college entrance. However, these factors alone fail to explain the magnitude of the decline. Below we look at other possible causes.

1. Young Persons who Neither Work nor Attend School

A recent problem has been the growing number of young persons who remain idle after graduating from school, neither seeking regular employment nor continuing their education. In 1999, such persons accounted for over 30% of high school graduates, and approximately one-quarter of college and junior college graduates (Figure 8). While the tight job market may partially explain this phenomenon, there has also been a significant increase in persons who simply shun employment.

Figure 8 The Growing Ratio of Idle Graduates



Notes: 1. Idle graduates are those identified as neither seeking regular employment nor advancing their education.

2. Ratio of idle graduates = Idle graduates / (New graduates - Continuing students)

Source: MOL, 2000 *White Paper on Labor*.

Another factor reducing the labor participation rate is the fact that a large proportion of young persons who find jobs later quit voluntarily and leave the labor force.

2. Backdrop to Changes in Work Attitudes Among Youth

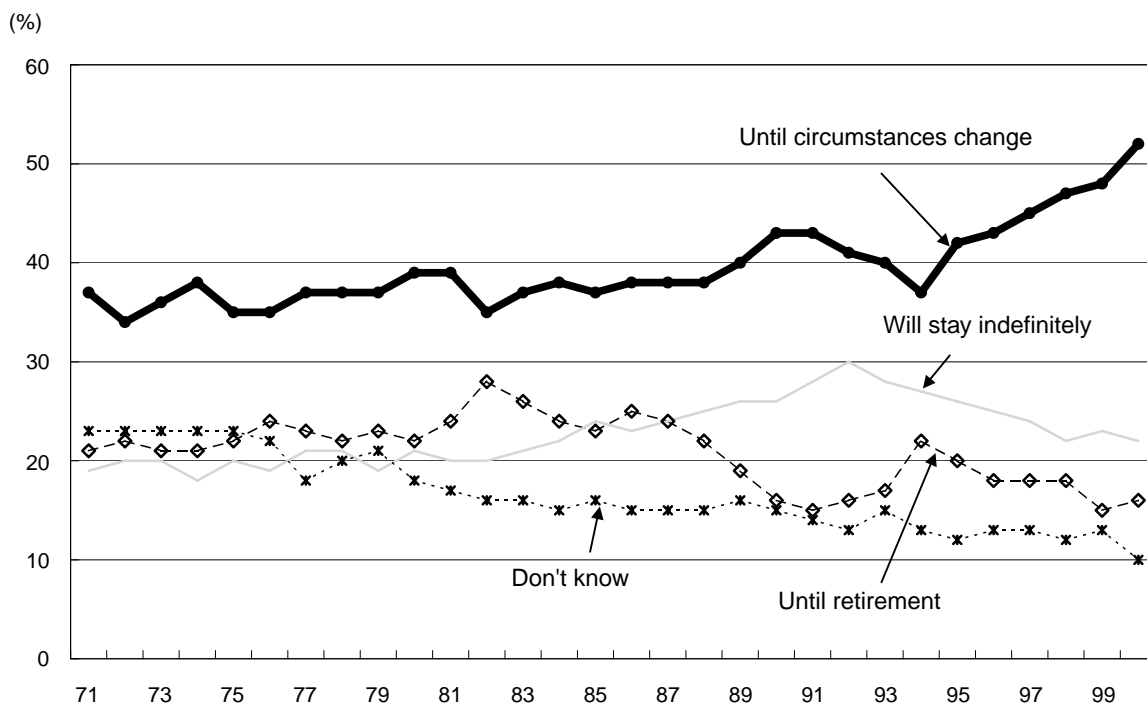
1. Work attitudes among youth

These characteristics of work behavior can be attributed to the changing work attitudes of young persons.

According to the Ministry of Labor's *Survey of Employment Among Young Persons*, when asked why they did not begin work as regular employees immediately after graduation, approximately 40% of respondents either said, "job openings were available, but did not meet my requirements," or "I did not intend to start working" — twice as many as the 20% who said, "I could not find a job."

Moreover, according to a survey by the Japan Productivity Center for Socio-Economic Development entitled *Survey on Attitudes Toward Work*, the proportion of new graduate employees who intend to stay until retirement is declining, while those who want to change jobs as conditions warrant is rising (Figure 9).

Figure 9 Attitude of New Graduate Employees Toward Their Present Employment



Source: Japan Productivity Center for Socio-Economic Development, *Survey on Attitudes Toward Work*.

Thus a growing number of new graduates either do not even try to find jobs, or else find jobs but then quit voluntarily soon thereafter.

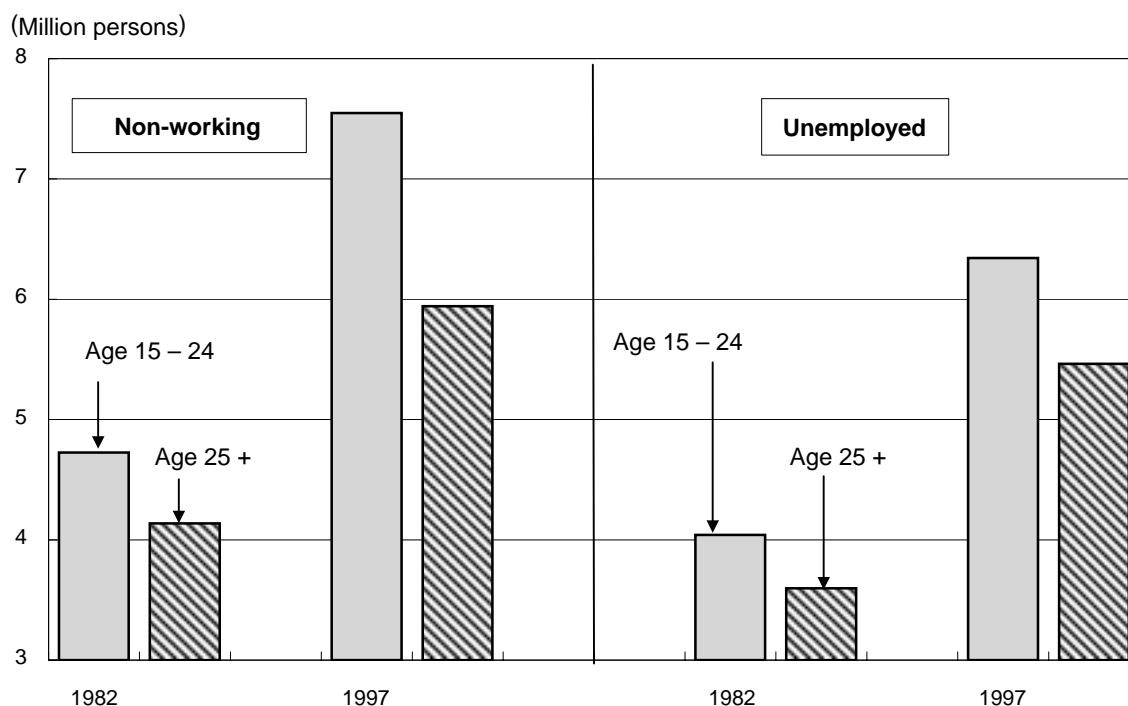
2. Lenient environment for non-working persons

Obviously, these work attitudes of young persons do not exist in isolation from practical considerations; these people could not live this way without some form of financial support.

Drawing on data from MACA's *Basic Survey of the Employment Structure*, we calculated household incomes of non-working persons by age segment.² Not surprisingly, households with non-working per-

sons in the 15-24 age segment have an income of ¥7.55 million (as of 1997), compared to ¥5.94 million for those in other age segments (Figure 10).

Figure 10 Household Incomes of Non-Working (Unemployed) Persons



Notes: 1. Incomes of households with non-working (unemployed) persons were calculated based on data from MACA, 1997 Basic Survey of the Employment Structure.
 2. Unemployed persons are defined as non-working persons who are seeking employment.

A large proportion of the 15-24 age segment lives at home, where they can live comfortably without personal income because of the household income of their parents.

Due to the recent increase in persons abstaining from or delaying marriage, a growing proportion of young persons live at home with their parents. This causes the household income gap to widen between younger and older non-working persons. The same trend appears among households with unemployed persons. This lenient home environment tends to produce young persons who need not work to be financially comfortable, thus affecting their attitudes and behavior toward work.

The recent sharp decline in labor participation rates among young persons can thus be attributed to a combination of the following factors: (1) the weak economy, (2) an increase in proportion of persons staying in school longer, and (3) an increase in non-working persons due to changing work attitudes.

5. Short-term Prospects

As we have explained above, the large decline in labor participation rates since 1997 can be attributed in large measure to the growing number of discouraged workers leaving the labor force due to the weak economy.

Going forward, if the economy continues to recover, we can expect the participation rate to rise in the short term as many of the discouraged workers return to the labor force.

However, a rising participation rate also poses the risk of aggravating unemployment despite the economic recovery. In particular, given the weakness of the present recovery, labor demand is not likely to increase significantly soon. If more people return to the labor market than can be absorbed, many will be left unemployed. Thus ironically, an improved confidence in employment and heightened desire to work could backfire on the economy and worsen the unemployment rate.

Below we illustrate how the unemployment rate will be affected by both an increase in employment and change in the labor participation rate.

We consider two cases in which the number of employed persons increases 0.5% and 1.0%. In the first case of a 0.5% employment increase, if the present participation rate of 62.3% remains unchanged, the unemployment rate will drop to 4.3%. However, an increase in the participation rate to 63.0% would cause the unemployment rate to surge to 5.3%. In the second case of a 1% increase in employed persons, a 63.0% participation rate would not change unemployment from its present level in the mid 4% range (Figure 11).

Figure 11 Effect of Changes in the Labor Participation Rate on the Unemployment Rate

As of Apr–Jun 2000	Increase in employed persons	Participation rate	Unemployment rate
Unemployment: 4.7% Participation rate: 62.3%	0.5%	62.3%	4.3%
		62.6%	4.7%
		63.0%	5.3%
	1.0%	62.3%	3.8%
		62.6%	4.2%
		63.0%	4.8%

Thus some deterioration in the unemployment rate may be unavoidable in the initial stages of a recovery in employment.

When the U.S. economy began improving in the early 1990s, more people began returning to the labor force than the economy could absorb. This increase in the labor participation rate worsened the unemployment rate, and continued to do so well into the recovery. Later as the pace of expansion accelerated and labor demand surged, the jobless rate plunged.

Thus a full-fledged recovery in employment can be declared only when demand is confirmed strong enough to continually reduce unemployment despite the rising labor participation rate.

6. Long-term Prospects

(1) Insufficient Labor Supply in the Long Term

Although higher unemployment due to an enlarged labor force is viewed as a problem in the short term, the long-term problem is actually the opposite — the labor force is projected to decline.

While Japan's general population is predicted to peak in 2007 (median projection of the National Institute of Population and Social Security Research, January 1997), the labor force population is predicted to peak earlier in 2005, and subsequently to decline faster than the general population (Ministry of Labor's Study Group for Employment Policy, May 1999). This earlier peak and faster decline of the labor force is attributed to aging, which causes the age segments with lower labor participation rates to grow faster. The study group projects that the labor participation rate will drop from 62.9% in 1999 to 61.6% in 2010, and the labor force will decline from 67.79 million to 67.36 million.

However, the projection has been criticized for being optimistic because it assumes that participation rates for all but one age segment (the age 65 and above segment) will rise above their present levels. For example, it assumes that participation rates for middle-aged women will rise significantly as a result of policies for childcare and long-term care. Furthermore, it assumes that participation rates for men and women aged 60-64 will rise almost 10% due to the gradual increase in pension age and enhanced employment policies for elderly persons (Figure 12).

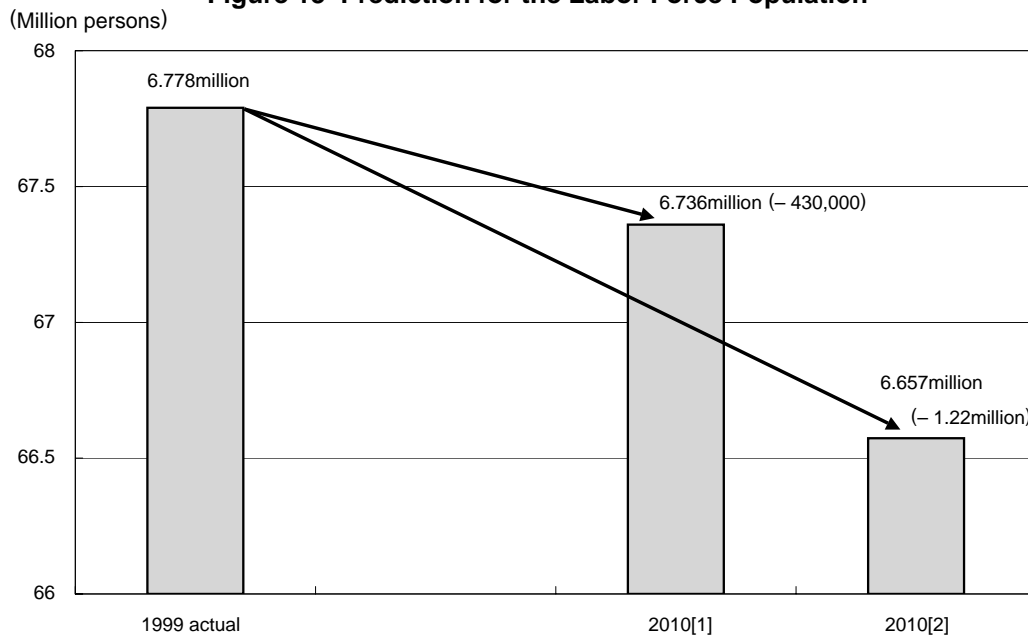
Figure 12 Prediction for Labor Participation Rates by Age Segment

	1999	2010	Difference
Men & women	62.9	61.6	(-1.3)
15 – 19	17.7	18.8	(+1.1)
20 – 24	72.7	75.1a	(+2.4)
25 – 29	83.0	84.4	(+1.4)
30 – 34	77.3	78.7	(+1.4)
35 – 39	79.8	81.6	(+1.8)
40 – 44	83.8	85.2	(+1.4)
45 – 49	84.7	86.2	(+1.5)
50 – 54	82.4	84.1	(+1.7)
55 – 59	76.3	78.6	(+2.3)
60 – 64	56.3	65.2	(+8.9)
65 +	23.4	22.5	(-0.9)

Notes: 1. 2010 values are projections by the Study Group for Employment Policy.
 2. The difference is between actual 1999 values and predicted 2010 values.

However, not all of these assumptions will necessarily be realized. If we assume instead that present participation rates for each age segment remain unchanged in 2010, the overall labor participation rate declines to 60.9%, while the labor force declines by 1.22 million persons to 6.57 million (Figure 13).

Figure 13 Prediction for the Labor Force Population



Notes: 1. 2010[1] is the projection by the Study Group for Employment Policy, while 2010[2] is a projection assuming that labor participation rates for each age segment remain unchanged from 1999.
 2. Numbers in parentheses indicate the difference from the actual 1999 value.

(2) Concern About Declining Productivity

In any case, what is certain is that the labor force will begin declining sometime in the next decade. This means that Japan's economic growth, which has relied on the growth of the labor force and capital accumulation, will no longer be able to count on the former.

To maintain the economy's growth potential under these circumstances, it is of course essential to minimize the labor force decline by creating an environment that encourages higher participation rates among women and elderly persons. However, even more important is the pursuit of labor productivity growth that can offset the decline in population.

The problem that emerges here is the sharp increase in young persons who do not work. As shown above, young workers are prone to quitting voluntarily, and live in an environment where they can enjoy financial support without having to work. The problem at first glance may not appear serious.

However, if left ignored, this problem could develop into something more serious. By remaining idle during the formative years of their work careers, these young people forgo valuable on-the-job training (OJT) opportunities and may thus fail to acquire adequate job skills. Their limited training will result in lower productivity, which will have repercussions in one or two decades when they form the backbone of the labor force — possibly to the extent that the economy suffers from long-term stagnation or other serious problem.

(3) Necessary Social Reforms

1. In the transition from school to work

A major factor behind the rapid growth in non-working and unemployed young persons has been the increasingly complex transition from school to work, something which had occurred relatively smoothly in the past.

Unlike the U.S., Japan has followed a practice of uniform hiring for new graduates in April of each year. Based on a common understanding, schools and companies had built a cooperative relationship to implement this practice. However, the situation is deteriorating rapidly. While young persons seeking employment have changed on the one hand, so too has the hiring stance of companies on the other. To be sure, companies have restricted new graduate hiring due partly to the economy's prolonged slump; but another important cause is that companies are increasingly turning to mid-career hiring to acquire personnel who have professional expertise or are fully trained for immediate use.

But while companies are seeking people with expertise or job related skills, schools have not respond-

ed adequately with their curriculums. School education in Japan still emphasizes basic and general knowledge, and tends to neglect job-related skills and knowledge.

According to the Ministry of Labor's *Survey of Employment Among Young Persons*, almost half of high school and college graduates regard the career guidance they received in school as "not very useful," while approximately 30% of college graduates received no career guidance at all (Figure 14).

Figure 14 Evaluation of Career Guidance

	High school	College
Very useful	4.7 %	2.5 %
Useful	31.0 %	20.0 %
Not very useful	47.5 %	45.8 %
Did not receive any	15.4 %	30.6 %
Unknown	1.4 %	1.1 %

Source: MOL, *Survey of Employment Among Young Persons* (1997).

Thus a basic inadequacy of information on occupations appears to contribute to the growing number of young people who become dissatisfied and quit shortly after starting work. Approximately 50% of new high school graduates and 30% of new college graduates quit their jobs within three years.

Moreover, Japan's present hiring system emphasizes working for a particular company rather than at a particular job. Many people thus enter a company not knowing what kind of work they will eventually perform. This system leads to job dissatisfaction and job changing. Greater awareness is needed on the part of companies in clarifying what expertise they seek, and on the part of employees in choosing their preferred type of work.

Recently, a growing number of internship programs are available to provide students work experience in their chosen field or career. This offers one effective solution to the problem, and needs to be implemented more widely in the future.

2. Importance of developing job competence after graduation

However, there are limits to what can be expected of young new graduates regarding professional competence and clear objectives toward work. In practice, people frequently discover their career objectives and identify the expertise they need after gaining some work experience. In view of this, it would be desirable to have a system in which people can gain work experience first, and then return to school for further training.

For this, the educational establishment needs to implement two measures. First, present college admissions procedures, which are premised on accepting high school graduates, need to be altered to accept persons with work experience who are returning to school for further study. The second measure, which has already been introduced at some universities, is to enhance programs that allow people to work while attending school.

While OJT will continue to form the core of job training, in the future there will be a growing need for opportunities to develop job skills outside of the company. And as more people gain specialized skills in this way, companies need to engage more aggressively in mid-career hiring to support greater labor mobility.

There is a major problem with the growing number of young persons who either do not participate in the labor force or are voluntarily unemployed because they have not found a job that they want to do, or continually change jobs.

As aging advances and the labor force shrinks, this problem needs to be resolved, so that limited human resources can be effectively used and labor productivity increased.

Notes

1. The factor analysis consists of two factors:

$$\Delta\alpha = \frac{\sum (N_i + \Delta N_i / 2) \Delta \alpha_i}{N + \Delta N} \quad (\text{change in labor force participation rate})$$

$$+ \frac{\sum (\alpha_i + \Delta \alpha_i / 2) \Delta N_i - \alpha \Delta N}{N + \Delta N} \quad (\text{change in population composition})$$

Where: N is the population aged 15 and above, α is the labor force participation rate, and i is the age segment

2. This was calculated using data from MACA's *1997 Basic Survey of the Employment Structure* on non-working (including unemployed) persons by age segment and household income level. Specifically, we took the median income level of each income range — i.e., ¥4 million for the ¥4-5 million range, ¥6 million for the ¥5-7 million range, and ¥8.5 million for the ¥7-10 million range — and multiplied these values by the number of persons in each income range to obtain average income levels. Thus the results need to be regarded as rough estimates.