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Economics Group

Special Commentary

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Diverging Fortunes: Labor Force Participation Trends in Large and Small Metro Areas

Executive Summary

The U.S. labor force participation rate has been fairly steady the past few years despite the downward impulse from an aging workforce. Participation trends, however, have varied between different segments of the workforce. They have also varied by “place”. Labor force participation in the largest third of the nation’s metro areas (based on population size) has been climbing in recent years, while participation has continued to edge lower in mid-size and small metros.

The divergent participation trends between large and small metros stem from both cyclical and structural factors, the latter of which will be hard to reverse by a strong economy alone. On the cyclical side, employment growth has been weaker in smaller metro areas, which has limited job opportunities for workers currently outside the labor force. However, the industry structure of smaller metros has contributed to the slower jobs recovery. Employment in smaller metros is skewed more toward the goods sector, while the nation has become an increasingly service-based economy and reliant on knowledge spillovers that are fostered in densely populated areas. At the same time, smaller metros tend to be older and less educated, two factors associated with lower participation.

For those discouraged over job opportunities in areas where employment growth has been weaker, moving is not the option it once was. Home prices in already expensive large metros have been rising faster than small areas in recent years. As a result, we wouldn’t be surprised to see the gap in labor force participation rates between large and smaller metro areas continue to widen. The divergent participation paths highlight the observation that the economic gains of the current expansion have not been spread evenly.

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Large Metros Driving Improvement in Labor Force Participation

Low labor force participation has been a glaring example that, despite a nearly 50-year low in the unemployment rate, the U.S. jobs market is not what it once was. Labor force participation—the share of the population ages 16+ either employed or actively seeking work (i.e., unemployed)—fell from 66.0% at the start of the Great Recession to 62.4% in September 2015. Since then, labor force participation has inched up somewhat and hovered within a range of 62.7–63.2% (Figure 1).

The extent to which labor force participation can recover bears on how much slack, if any, is left in the labor market. Labor force participation trends have not only been shaped by the business cycle, but by demographic and other longer-term secular trends. To better understand the outlook for the labor force, we have often looked at how participation rates have evolved based on age, gender and education. Participation trends have also varied on a geographic basis, however, making “place” another consideration in the outlook for the U.S. labor market.

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Trends in labor force participation have diverged between urban and rural areas.

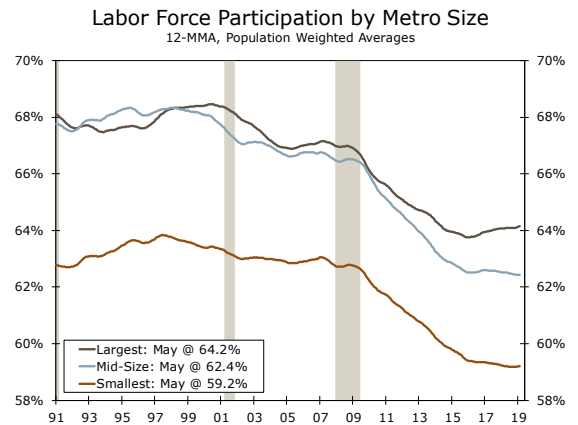
In recent years, trends in labor force participation have diverged between urban and rural areas.¹ Even among “metropolitan” areas, there is a wide range in population size.² For example, the largest ten metros have an average population of 8.7 million, while the smallest ten metros had an average population of just 73,000. To better understand how participation trends have varied by “place,” we divide the 383 U.S. metro areas into three groups based on population sizes.³ Today, the largest third of metro areas has an average population of 1.8 million, while the middle third of metros averages 261,000 and small metros average 122,000.

As shown in Figure 2, smaller metros have seen a larger decline in labor force participation over the current cycle than large metropolitan areas. Since 2007, labor force participation has fallen 4.0 and 3.5 points in the middle and smallest third of metros, respectively, compared to only 2.8 points among larger metro areas. What’s more, the increase in overall labor force participation since late 2015 has been almost entirely driven by the nation’s largest cities. No longer are participation rates between the biggest and mid-size metros tracking closely together; instead the gap is at a record high.

Figure 1



Figure 2



Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities

The amount of slack in the labor market depends on labor force participation trends.

The yawning gap calls into question how much more labor force participation can rise in this cycle, and therefore how much slack is left in the labor market. If participation rates have been held down in smaller metros by cyclical factors like a slower economic recovery, there may still be slack in the nation’s labor market. If structural forces, on the other hand, are keeping participation rates lower in smaller metros, then the labor market still looks to be fairly tight.

Some of the gap does indeed look structural. Smaller metro regions tend to have an older population. For example, more than 17% of the population in smaller metros is over the age of 65 compared to almost 15% in large metros. Older workers are more likely to be out of the workforce due to retirement or health reasons, leading to lower participation rates. Similarly, fewer adults in small metros have a college degree (25% versus 29% in mid-size and 35% in large metros), and education is positively associated with labor force participation. But even controlling for those factors, research shows rural areas have seen weaker recoveries in participation than metro areas, suggesting a similar pattern between large and small metro areas.⁴

¹ Weingarden, Allison (2017). “Labor Market Outcomes in Metropolitan and Non-metropolitan Areas: Signs of Growing Disparities.” FEDS Notes 2017-09-25. Board of Governors of the Federal Reserve System.
² Metropolitan areas are defined as an urbanized area with at least 50,000 residents in 2010 and include surrounding counties that are economically integrated. For more details, see the [Census explanation](#).
³ We base the three metro tiers on the population size in 2010, with the top tier comprising the largest third of 383 metro areas, the middle tier comprising the middle third, and the smallest tier comprising the smallest third.
⁴ Weingarden (2017).

All About that Big-City Job?

While demographic and social forces have overshadowed cyclical changes in labor force participation over the past half century, there remains a cyclical element to labor force participation. As job opportunities become more widely available, a higher share of workers join or stay in the labor force. But what if job opportunities are not becoming available evenly across the country? Smaller metropolitan areas have seen noticeably slower employment growth over the course of the labor market’s recovery and ongoing expansion (Figure 3). Relative to pre-recession levels, employment has risen 11% in larger metros, but only about 6% and 4% in the middle and smallest third of metros, respectively. Said differently, big metros have accounted for a disproportionately large share of employment growth. The 127 largest metro areas have accounted for roughly 90% of the net new jobs added since the Great Recession, even though they account for only 71% of the nation’s population.

Big metros have accounted for a disproportionately large share of employment growth.

Figure 3

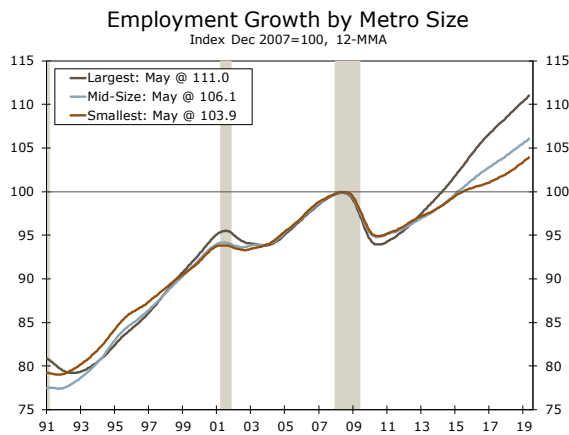
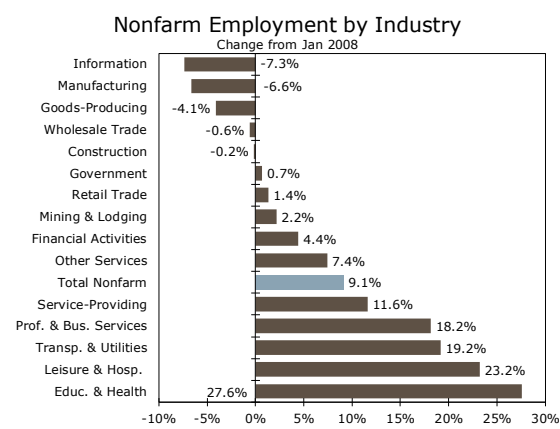


Figure 4



Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities

Slower employment growth in smaller metropolitan areas is, in part, tied to the industry composition of those areas. On the national level, employment growth has varied across industries. Service-providing industries, such as education & health and leisure & hospitality, have seen the largest gains in employment growth since the Great Recession, while goods-producing industries, like manufacturing, have yet to return to pre-recession levels (Figure 4). A majority of U.S. employment is in the service sector, and larger metros have seen service-oriented jobs rise faster. For example, the largest third of metros has seen leisure & hospitality employment rise 27%, compared to the smallest third which has seen a 16% rise. Furthermore, the slow recovery in goods-producing industries has limited the scope of job gains in smaller metropolitan areas, where the goods sector represents a larger share of employment (17%) than it does in the largest metros (13%).

The sheer size of smaller metropolitan areas is another hurdle to job growth. One of the major economic benefits of cities is the extensive co-location of people and businesses. Larger cities tend to be more productive, benefitting from the cost saving and spillover effects of firms and workers being closely located.⁵ Population density is a useful proxy for such “agglomeration” and presents a key advantage to larger cities. Not surprisingly, the largest metros have higher population densities, with density in the largest third of metros four times greater than the middle third and seven times greater than the smallest third. However, density has risen more quickly in large metro areas during this cycle due to stronger population growth. The stronger population growth has supported a virtuous circle of labor supply for businesses and job opportunities for labor.

Population density is a key advantage to larger cities.

⁵ Parilla, Joseph and Mark Muro. “[Understanding Productivity Trends from the Ground Up.](#)” Brookings Institute, March 15, 2017.

Decreasing housing affordability inhibits geographic mobility.

From Starry Nights to City Lights?

If a lack of job opportunities is keeping residents of smaller communities outside of the labor force, then why aren't more people moving to cities where jobs are more plentiful? Simply put, a lack of affordable housing is becoming a higher barrier of entry into many of the country's largest labor markets. New residential construction has generally been subdued in recent years, restrained by mounting land, labor and regulatory costs. The shortfall in development has led to rents and home prices rising well ahead of income growth for much of the expansion. Deteriorating housing affordability may help explain why overall geographic mobility has undergone a structural decline since the 1980's, a trend that continued in 2018 when the share of the population that moved within the United States fell to a modern-era low of 9.8% (Figure 5). The rapid run-up in home prices in the nation's largest metros is likely dissuading potential movers from mid- and small-sized areas, as the higher cost of living and nonpecuniary costs of moving to a new community offset any benefit from a higher nominal wage (Figure 6).

Figure 5

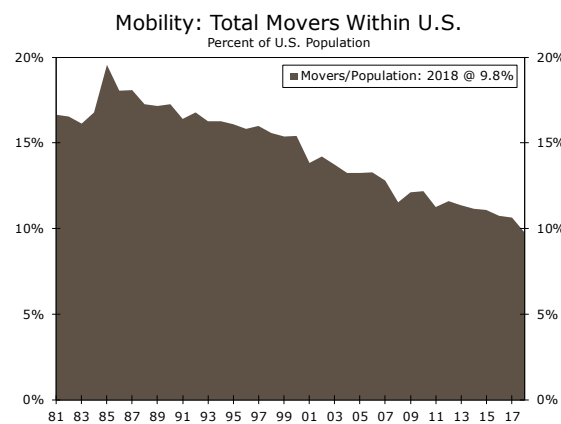
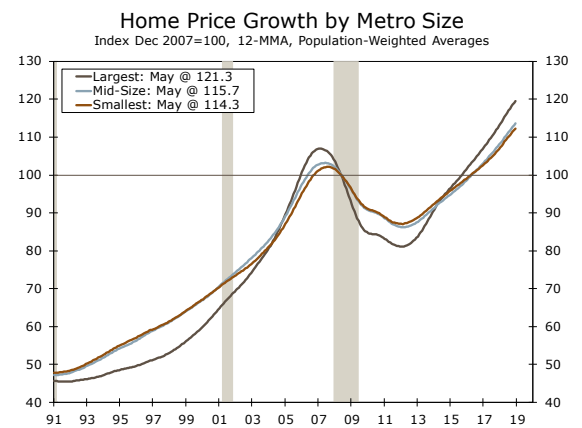


Figure 6



Source: U.S. Department of Labor, CoreLogic, Inc. and Wells Fargo Securities

Conclusion: Labor Force Participation Underscores Divergent Growth

While slower job growth in small metro areas has weighed on local participation, housing affordability has challenged the ability of workers to move where job growth has been stronger. Weaker labor force participation in smaller communities therefore looks to be in part structural, as the workforce of smaller metros tends to be older and less educated. As a result, the gap in labor force participation rates between large and smaller metro areas will likely continue to widen, and there is likely little remaining slack in the national labor market despite the varying trends in participation by “place.”

Labor force participation is crucial for small metros to keep up with larger cities.

Beyond the labor market, the divergence in labor force participation rates highlights the observation that the economic gains of the current expansion have not been spread evenly which has fueled concern that smaller communities are being left behind. Alongside the decline in geographic mobility, regional income convergence has also slowed over the past 30 years, which means a previously narrowing wage gap between high- and low-income areas has widened.⁶ Economic growth can be boiled down to productivity and labor force growth, which is a function of population growth and labor force participation. With smaller metros seeing slower productivity and population growth in recent years, labor force participation becomes a crucial factor in helping narrow the growth gap between ever-larger cities and smaller metros struggling to keep up.

⁶ Ganong, Peter and Daniel W. Shoag (2017). “Why Has Regional Income Convergence Declined?” NBER Working Paper No. 23609, July 2017. National Bureau of Economic Research.

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