



Is Unemployment Worse than It Appears?

William R. Cline says the decline in labor participation, which some say has occurred because workers are discouraged from seeking jobs, is largely due to the retirement of the “baby boom” generation.

Transcript of interview recorded July 31, 2014. © Peterson Institute for International Economics.

Steve Weisman: The US unemployment rate has gone down to 6.1 percent, the lowest in many years and it seems likely to go down further. [It was 6.2 percent for July.] But the downside, according to many economists, is that many people have dropped out of the workforce and are no longer looking for jobs. And if they were, the unemployment rate would theoretically be higher.

William Cline of the Peterson Institute for International Economics is here with me, Steve Weisman, to analyze that criticism by some economists. Bill, you’ve done your own study of this issue of labor force participation. First tell me your main conclusion and then we can talk about your methodology.

William Cline: The main conclusion is that there is some influence of discouragement of workers as a cause for the decline in participation in the labor force. The argument is that the unemployment rate of 6.1 percent is disguised and it would be a lot higher if people hadn’t left the labor force because of discouragement.

My main thesis is that the reason people left the labor force is primarily because the Baby Boom generation arrived at the age of retirement, and that two thirds of the decline in the labor force participation rate, which has gone down from about 66 percent of people over 16 years of age, to 63 percent, is that two thirds of that decline is because of the aging of the labor force of the population. And only about one third can be statistically associated with the high unemployment of the Great Recession.

Steve Weisman: Do you think it’s possible on the other hand, that some people at about the retirement age or in their 60s might have accelerated their retirement plans because of the discouraging job market?

William Cline: Well, I think the thing is that this influence of the aging, I track starting as early as 2000. The statistical relationship is persistent through this whole period.

Steve Weisman: So it hasn’t really gone up?

William Cline: No. And in fact, if anything there’s been a little bit of an uptake in the participation of the older groups.

Steve Weisman: Yes. I’ve read that one of the factors in the recession is that the older workers have tended to stay on the job.

William Cline: Right, but the difference is sufficiently great. I know that the labor force participation rate is quite a bit lower for people over 55, that even if it’s ticked up a little bit it can’t compensate for the much higher share of the population that’s now over 55.

Steve Weisman: You, as always Bill, bring your own particular gift for devising some kind of methodology to study this problem and you worked, I should have mentioned earlier, with your research analyst, Jared Nolan, at the Peterson Institute. Did you have any particularly novel way that you employed to study this phenomenon?

William Cline: Well, I simply did what's called a statistical regression, using monthly data from 2000 to 2014 of the labor force participation rate, which we're trying to explain, and then as the economic variables that are pushing it. I've got a fraction of the population that's over 55 and lagged employment and unemployment, particularly of those who have been unemployed over 27 weeks, long-term unemployment. Those are the explanatory variables.

I think probably it's one of those "fools that rush in where angels fear to tread" [things] because there's this whole field of statistical analysis called time series analysis. Basically it says, "Boy, you can really get things wrong, because different things are having time trends and you can wind up getting silly explanations." And they'll estimate lags of one, two, three, four, or five months going back. They'll even have leads of one, two, three, four, five, six months going forward. Maybe the causation's the other way.

I just simplified and said, "Let's use a one-year lag from the unemployment shock to people's labor force participation. Let's not try to make fancy lots of lags and so forth and let's encapsulate the entire structural transformation by simply [taking] the share of the population that is over 55 old, a single variable." And it turns out that this is fairly powerfully captures the trends. You can predict quite nicely what the labor force participation rate is with just a very simple model.

There's lots of literature out there. One study has something like 45 different combinations of this and that and the other thing, age and all kinds of things. So, in a sense it's an appeal to a simple approach to get at the heart of it, so that statistics allow the two forces to compete. You let the high level of unemployment, 10 percent is what it reached in September 2009, October, I should say. That's very high. Let that unemployment rate compete as one of the explanatory variables of labor force participation, but let it compete against the dramatic factor that was happening by this time as the Baby Boomers turned 62 in 2008, right at the time of the Great Recession.

So you've got these two forces and I basically find that for labor force participation, the Baby Boom aging was more important than the Great Recession.

Steve Weisman: There is a tendency, not just among economists, but all journalists and all analysts, to want to look at the most pessimistic side of any development. Every time you read some kind of positive economic news, there's always somebody who's saying, "Hold on, it's not as good as it appears."

William Cline: What I did find was that it's more in the popular press that says, "Don't believe these unemployment rates." Everybody's been discouraged. The *New York Times*, in an editorial recently said that the unemployment rate would be 9.6 percent if you didn't have all these people who'd been discouraged. But if you get into the technical literature and you look at what the Council of Economic Advisers has done, what the Congressional Budget Office has done, and what most of the academic studies have done, they get a result that's much more like what I find, which is at about a half, at least, of the decline in labor force

participation is associated with the aging of the population, rather than discouragement from the Great Recession.

Steve Weisman: You said it was actually even more than-

William Cline: Yes. I guess I'd favor the two thirds. The reason I have a range of half to two thirds is that it's two thirds of what the model explains. But by the end of the period the actual participation rate is a little bit lower than the model predicts.

Steve Weisman: So for the gloom-and-doomy pessimists among us, you still would acknowledge that the unemployment rate would be a bit higher?

William Cline: Well, yes. And one of the things that I actually had to realize is that one percentage point on the participation rate translates into one and a half percentage points on unemployment. I hadn't focused on it, but it's because the employment or the labor force is only two thirds of the adult population. So a percentage point's move in the participation rate is going to be one-and-a-half points on the unemployment rate. So yes, it turns out that the 6.1 percent unemployment, you could say that there's another one-and-a-half points there that's being disguised because of a lagged effect of the very high unemployment.

Steve Weisman: Final question. Do you suppose though that that's been the case after many recessions?

William Cline: No doubt. And in fact, most of these studies look at how much of the participation rate is just reflecting the cyclical status. But the thing is that this was such high unemployment and I've got more than a very powerful coefficient, especially on the long-term unemployment, that's it's a larger factor at this time.

Steve Weisman: Thanks Bill. And for listeners and readers, Bill's working paper is on the Peterson Institute website in our series of working papers.

