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**Jay Leno and the Job Market.** I'm really going to miss Jay Leno who has supplied me with more than a few laughs. He ranks right up there with Johnny Carson and Jack Benny as a master of the monologue. His humor was always so topical so I'm inserting some of it in place of my usual *Musings and Amusings* comments. I'm also devoting this newsletter to a single important issue: labor force participation.

Shortly before his departure, Leno joked about the declining labor force participation. Others have been making serious claims that affect our interpretation of important labor market indicators. Although calculation of the labor force participation rate (LFPR) is very simple, the interpretations are not. Part of the decline is cause for concern while part is not.

***Leno: Unemployment is dropping, but critics claim it doesn't include people who have left the workforce. How about people who were asked to leave the workforce like me? Are we included in that?***

**Measurement.** The LFPR is the percent of the civilian working age population that is in the labor force: 63 percent in January 2014. The labor force is the sum the employed plus the unemployed.

### Outlook for Job Growth (annual % )

	2013	2014
Population (thous)	244,663	246,915
Labor Force	155,699	155,460
Participation Rate	63.6	63.0
Employed	143,384	145,224
Unemployed	12,315	10,236
Unemployment Rate	7.9	6.6
Not in Labor Force	88,963	91,455

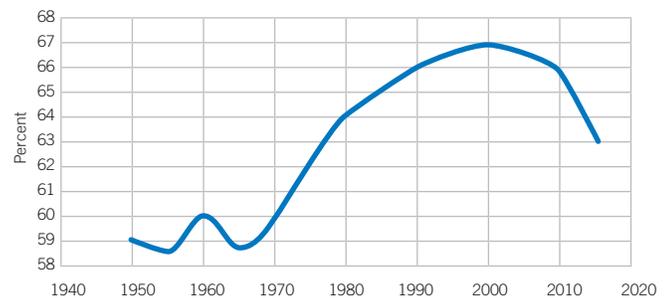
Sources: Source: U.S. Bureau of Labor Statistics.  
 All data are seasonally adjusted

The data come from the huge monthly survey of 50,000 American households. Interviewers ask, "Did you work last month?" If yes, then the respondent is counted as employed. If no, then that person is classified as unemployed if he/she (1) looked for work and (2) was available for work.

*Looking* includes filling out applications and going to a job center. Being *available* means not being in school or ill or in jail. Importantly, it does *not* matter whether the individual was collecting unemployment insurance. So if a person stops collecting, he will be counted as unemployed as long as he continues to look for work. By the way, the unemployment rate is the number of unemployed persons divided by the size of the labor force.

**Trends.** The LFPR showed no particular pattern from the late 1940s to the early 1960s. It then embarked on a steep 40-year climb that ended in 2000. Since then, it has fallen from a little more than 67 percent in early 2000 to 63 percent this past January. The decline has been especially steep during both the Great Recession (December 2008 – June 2009) and the Not-So-Great Recovery since then.

### The U.S. Labor Force Participation Rate



Let's play with the numbers a bit. Over the past year, the unemployment rate has fallen from 7.9 percent to 6.6 percent. Suppose that instead of declining, the LFPR stayed the same. It is tempting to claim the labor force would be 1.6 million persons larger *and* so would the number of unemployed. As a result, the unemployment rate would have been 7.5 percent this past January – rather than 6.7 percent and scarcely any improvement from 2013's 7.9 percent.

***Leno: The Labor Department reported that last month 347,000 people quit looking for work. And in New Jersey, 50,000 people quit DRIVING to work.***

It is even more tempting to say that if the LFPR had not fallen since 2009 then the labor force would be about 5 million larger today. The January 2014 unemployment rate would then be close to 9.5 percent – close to the 10 percent recession peak. This type of calculation prompted one economist to claim that the official unemployment is a "smokescreen" that hides what is really happening.

Both these computations are arithmetically true but analytically misleading. For one thing, it is highly unreasonable to assume that all of those who "dropped out" of the labor force would have been unable to find jobs if they continued to look for work.

It is also unreasonable to assume that the decline in participation simply reflects “dropouts” who gave up looking when they were unable to locate work. The monthly survey does not give us much help in understanding what’s been happening. There is a category of people who are “marginally attached” to the labor force. These are individuals who looked for work at least once during the previous 12 months but not during the latest survey. However, this figure rose by 150,000 over the past year compared to the 1.5 million obtained when we hold the LFPR constant.

Incidentally, the “marginally attached” is one of the two categories that the Labor Department adds to the “official” unemployment count to get something called U6 which is an expanded unemployment rate. Also included are those who are working part-time, but would prefer full-time jobs if they were available. U6 was 12.7 percent in January.

Back to the LFPR – we’re not sure what happened to the rest. Some may have left to attend school. Others may have stopped working to have children. Still others, like Leno, may simply have retired. Unfortunately, the monthly survey gives little insight into this.

However, a number of economists have tried to separate normal withdrawal from that due to poor labor market conditions using a variety of other information. In general, the studies conclude that roughly half of the drop in the participation rate since 2009 is due to the recession followed by slow recovery. The other half reflects changes in lifestyle and demographics such as the Baby Boomers reaching retirement age. The aging of the working age population has a powerful downward effect on the overall participation rate that will continue for years to come.

***Leno: John McCain said the shutdown was, quote, one of the most shameful things he’s seen as a senator. That’s from a guy who saw Lincoln get shot.***

The Congressional Budget Office (CBO) has further estimated that roughly one-third of those who did drop out of the workforce will re-enter as labor market conditions improve over the next several years. The LFPR will still fall, but not as rapidly as if these workers did not return.

**Obamacare and the LFPR.** Early in February, the non-partisan CBO estimated that Obamacare (aka the Affordable Care Act or ACA) will lower the future *supply* of labor substantially. They estimate that the effect is equivalent to the loss of 2.5 million workers over the coming decade. *The Wall Street Journal* stated that the “The Jobless Care Act... will increase unemployment.” Not surprisingly, the *New York Times* headline on the same day said the ACA was “Freeing Workers From the Insurance Trap.”

***Leno: And the worst thing about losing this job, I’m no longer covered by NBC. I have to sign up for Obamacare.***

Who’s right? Well, here’s what the CBO actually said: “Because the longer-term reduction in work is expected to come almost entirely from a decline in the amount of labor that workers choose to supply in response to the changes in their incentives, we do not think it is accurate to say that the reduction stems from people ‘losing’ their jobs.”

The CBO argument is very similar to what researchers find when marginal income tax rates are increased. People will offer less labor because the return to that work has been reduced. In the case of the ACA, some people no longer have to work as many hours in order to have medical insurance.

Ok, so who’s right? Well, *The Wall Street Journal* is inaccurate in claiming that the CBO said the ACA will increase unemployment. The CBO is talking about *voluntary* reductions in labor supply that show up as further decreases in the labor force participation rate. And while the *Times* is correct in stressing the voluntary nature of this reduction, the CBO does not go into the negative consequences of slower overall economic growth in the future, such as reduced Social Security tax receipts.

And contrary to what many people thought when they read the headlines, the CBO was *not* estimating the impact on jobs and unemployment because the medical insurance costs will rise for many employers under Obamacare. This seems to me to be a more important issue for economic policy than what the CBO did examine. (I don’t know about you, but this is starting to make my hair hurt. Is that covered by the ACA?)

**Implications and Conclusions.** The LFPR started declining well before the Great Recession. Only about half of the recent decline in the LFPR is due to the sluggish economy. The other half would have happened anyway.

Obamacare is likely to further reduce the LFPR. Although this is not the same as generating unemployment, it can have negative consequences for long-term economic conditions.

Labor force participation will continue to decline for years to come as a result of our aging population. It will decline even if Obamacare is repealed. As a result, U.S. economic growth is widely forecast to be on the slow side.

***Leno: When I started hosting, Justin Bieber wasn’t even born yet. That’s why we call those ‘the good old days.’***