

June 22, 2016

Was May's Drop in Labor Force Participation All Bad News?

The unemployment rate declined 0.3 percentage points from April to May, and this was accompanied by a similar drop in the labor force participation rate. It is tempting to interpret this as a “bad” outcome reflecting a weakening labor market. In particular, discouraged about their job-finding prospects, more unemployed workers left the labor force. However, a closer look at the ins and outs of the labor force suggests a possibly less troubling interpretation of the outflow from unemployment.

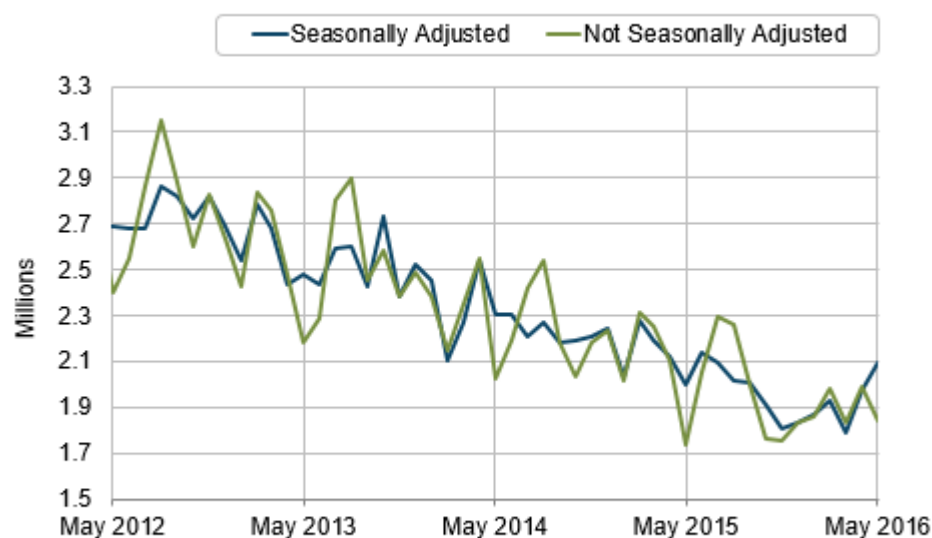
To get a handle on what is going on, it is useful to look at the number of people that transition among employment, unemployment, and out of the labor force. It is not that unusual for an individual to search for a job in one month and then enroll in school or assume family responsibilities the next. In fact, each month millions of individuals go from searching for work to landing a job or leaving the labor force, and vice versa.

The U.S. Bureau of Labor Statistics (BLS) publishes estimates of these gross flows. Analyzing these data shows that there was indeed an unusually large number of unemployed persons leaving the labor force in May. Curiously, the outflow was concentrated among people who had only been unemployed only a few weeks. It wasn't among the long-term unemployed. Therefore, it seems unlikely that discouragement over job-finding prospects was the main factor. Although it is plausible that people who say they are now doing something else outside the labor market feel disheartened, the number of unemployed who said they gave up looking because they were discouraged was largely unchanged in May.

So why was there an increase in the number of short-term unemployed who left the labor force in May? One clue is provided by the fact that the short-term unemployed tend to be relatively younger than other unemployed. Moreover, the single most common reason that unemployed young people leave the labor force is to go to school. Hence, there is a very distinct seasonal pattern in the outflow. It tends to be relatively low around May when school is ending and high around August when school is starting. Seasonal adjustment techniques correct for these patterns by lowering the unadjusted data in the fall and raising it in late spring.

The following chart shows the seasonally adjusted and unadjusted flow from unemployment to departure from the labor force. Although the trend has been declining during the last few years, a relatively large increase in the seasonally adjusted outflow took place in May of this year.

Monthly Exit from Unemployment Leaving the Labor Force



Note: Data are through May 2016.
Source: Bureau of Labor Statistics

When I looked at the unadjusted microdata from the Current Population Survey (CPS), I found that the number of people who were unemployed in April 2016 but in May said that they were not in the labor force because they were in school *did not* exhibit the usual large seasonal decline. Therefore, when the seasonal adjustment is applied, the result is an increase in the estimated flow from unemployment to out of the labor force.

Taking the seasonally adjusted data at face value, it's not obvious that this is bad news. We know that people who leave unemployment to undertake further education tend to rejoin the labor force later. Moreover, they tend to rejoin with better job-finding prospects than when they left. Alternatively, it could be just a statistical quirk of the May survey. After all, the CPS has a relatively small sample, so the estimated flows have a large amount of sampling error. Either way, I don't think it is wise to conclude that the decline in the labor force participation in May reflected a marked deterioration in job-finding prospects. In fact, the job-finding rate among unemployed workers improved in May from 22 to 24 percent, contributing to the decline in the unemployment rate.



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