Measuring labor-force participation and the incidence and duration of unemployment

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Opinions expressed herein are those of the authors alone and do not necessarily reflect the views of the Federal Reserve System.

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Current Population Survey

CPS randomly selects address and seeks to classify each noninstitutionalized individual aged 16 and over:

- Employed (E)
  - Worked during reference week for own business or for pay or absent due to vacation, illness, weather
- Unemployed (U)
  - Not employed but made specific efforts to find work any time during last 4 weeks
- Not in labor force (N)

Rotation group structure (4-8-4)

- 1/8 of households enter the survey for the first time, are surveyed four times, leave the survey for 8 months, return to the survey and are surveyed for 4 months.

Key measurement problems → Propose reconciliation

1. Rotation-group bias
2. Non-random missing observations
3. Number preference
4. Inconsistency between reported duration of unemployment and labor-force status

→ **First** to provide a unified approach for reconciliation that allows for time-variation in measurement errors

- Unemployment rate ⇑ **1.9%** (countercyclical) UR UR Error
- Labor-force participation rate ⇑ **2.2%** (countercyclical, slowly rising trend) LFPR LFPR Error
- Mean duration ⇓ **9** weeks (countercyclical) Duration

Problem 1: Rotation-group bias

- The UR and LFPR should be the same across rotations.
- Average UR and LFPR (July 2001-April 2018)
  - 6.8 percent in rotation 1, 5.9 percent in rotation 8
  - 66.0 percent in rotation 1, 64.3 percent in rotation 8

Implication if track fixed group of individuals over time, in typical month find net flows out of U and out of LF.

Solution

- Model statistically the way answers change the more times people have been asked → Rotation-specific interview technology
- Propose a method to calculate measures using any of the 8 interview technologies: first interview technology.

Problem 2: Non-random missing observations

- If someone was sampled last month but missing this month, more likely than general population to have been U last month
- If someone was missing last month but sampled this month, more likely than general population to be U this month

Solutions

- Add a fourth observed category (M = missing)
- Construct data set in which accounting identities relating stocks and flows hold by construction
- Sum of EE, NE, ME, UE transitions between rotation 1 and 2 exactly equals number of E for rotation 2
- Will use observations when individuals are E, N, U to infer something about status when M

Problem 3: Number (digit) preference

When reporting the duration of unemployment, more likely to

- round to months or years
- report in even numbers (2,4,6,8,10 weeks $>$ 1,3,5,7,9 weeks) or rounded numbers (3 months, 6 months, 1 year)

Our solution: represent individuals' perceived duration of unemployment using a parametric monotonic function; model digit-reporting preferences as layer on top of this

Our contribution: our parametric specification allows direct linkage of data on stocks, flows, and durations and includes both digit and interval preference.

Problem 4: Reported durations of unemployment inconsistent with reported labor-force histories

NU^{5+} **transitions**: Consider N in RG1 (t) , U in RG2 $(t+1)$.

- 2/3 say actively looking for work for longer than 4 weeks
- 8% say searching for 1 year and another 8% say 2 years

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Probability of leaving U. VS U. duration: Consider 2011.

- Long-term unemployed had probability 0.25 of exiting U.
- Implied mean duration: no larger than 4 (1/0.25) months.

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Solutions to the inconsistency

- Classify those who make $N_{t-1}U_t^{5.+}$ transitions as U in $t-1$
- Classify some of those who make $U_{t-1}^{15.+}N_t$ transitions as U in t

Notation

- $\pi_t^{[j]} = (4 \times 1)$ vector of observed fractions of each status $X \in \{E, N, M, U\}$ in rotation j in month t
- $\Pi_t^{[j]} = (4 \times 4)$ matrix of probabilities that someone who reports status X_1 in rotation $j-1$ in month $t-1$ will report status X_2 in month t for rotation $j \in J = \{2, 3, 4\} \cup \{6, 7, 8\}$
- Our constructed data exactly satisfy $\pi_t^{[j]} = \Pi_t^{[j]} \pi_{t-1}^{[j-1]}$ for $j \in J$

$$\begin{bmatrix} \pi_{E,t}^{[j]} \\ \pi_{N,t}^{[j]} \\ \pi_{M,t}^{[j]} \\ \pi_{U,t}^{[j]} \end{bmatrix} = \begin{bmatrix} \pi_{EE,t}^{[j]} & \pi_{NE,t}^{[j]} & \pi_{ME,t}^{[j]} & \pi_{UE,t}^{[j]} \\ \pi_{EN,t}^{[j]} & \pi_{NN,t}^{[j]} & \pi_{MN,t}^{[j]} & \pi_{UN,t}^{[j]} \\ \pi_{EM,t}^{[j]} & \pi_{NM,t}^{[j]} & \pi_{MM,t}^{[j]} & \pi_{UM,t}^{[j]} \\ \pi_{EU,t}^{[j]} & \pi_{NU,t}^{[j]} & \pi_{MU,t}^{[j]} & \pi_{UU,t}^{[j]} \end{bmatrix} \begin{bmatrix} \pi_{E,t-1}^{[j-1]} \\ \pi_{N,t-1}^{[j-1]} \\ \pi_{M,t-1}^{[j-1]} \\ \pi_{U,t-1}^{[j-1]} \end{bmatrix}$$

1. Rotation group bias: Fix based on RG1 technology

Halpern-Manners and Warren (2012)

- Saying that you looked for a job hard but failed carries stigma
- Individuals may believe that follow-up questions for U are onerous
  - "What have you done to look for work in the last 4 weeks?"
  - "How long have you been looking for a job?"
- The unemployment rates in rotations 2-8 are likely to understate the truth. $\rightarrow$ fixed based on RG1 technology

Statistical description of the Rotation Group Bias

$R_t^{[j]}$: a [4 by 4] matrix that contains the probabilities that an individual would have answered LFS X^1 using technology 1 given answered LFS X^j in technology j

$$R_t^{[j]}\pi_t^{[j]} = \pi_t^{[1]} = \pi_t^*$$

Π_t^*: LFS transition probabilities if interviewed with RG1 technology

$$\Pi_t^* = R_t^{[j]}\Pi_t^{[j]}(R_{t-1}^{[j-1]})^{-1}$$

$R_t^{[j]}$ can be characterized by

- More missing in RG.1 and 5
- Fewer E/N in in RG.1 and 5 ($\theta_{EM}^{[j]}$, $\theta_{NM}^{[j]}$)
- Rising N, falling U, as surveyed more ($\theta_{NU}^{[j]}$): increased over time!

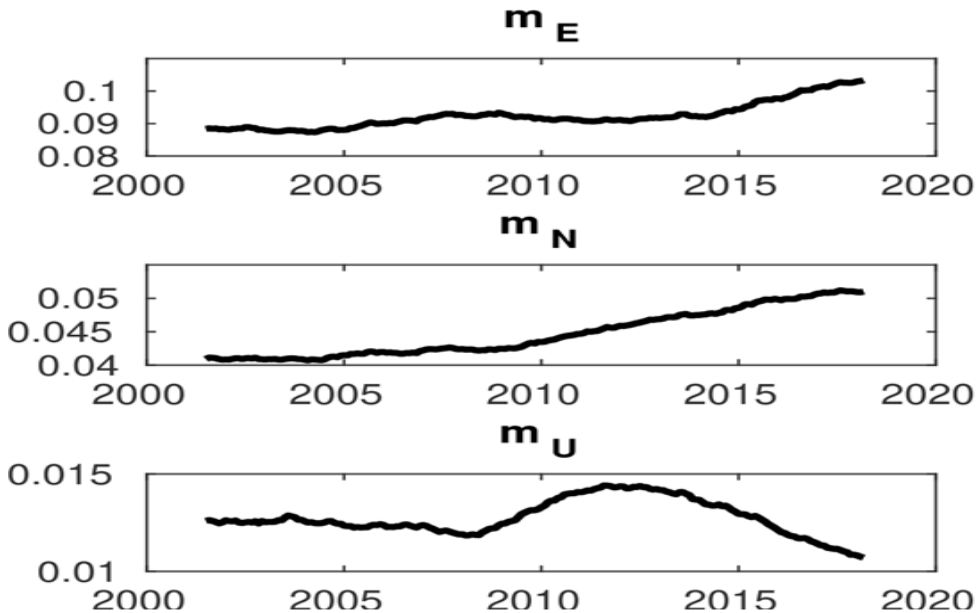
2. Non-random missing observations

After correcting for the rotation group bias

Goal: recover the fraction of E,U, and N from missing individuals

- True LFS of missing individuals might have been E, U, or N
- Probability of becoming E in t of those missing in $t-1=$ weighted average of probabilities of becoming E in t of those who were E,U, and N in $t-1$.
  $\rightarrow ME$ transitions as mixtures of EE, NE, UE
- Same for MN and MU
- Calculate the mixing weights: share of E, U, and N within M
- Allows to count size of missing observations

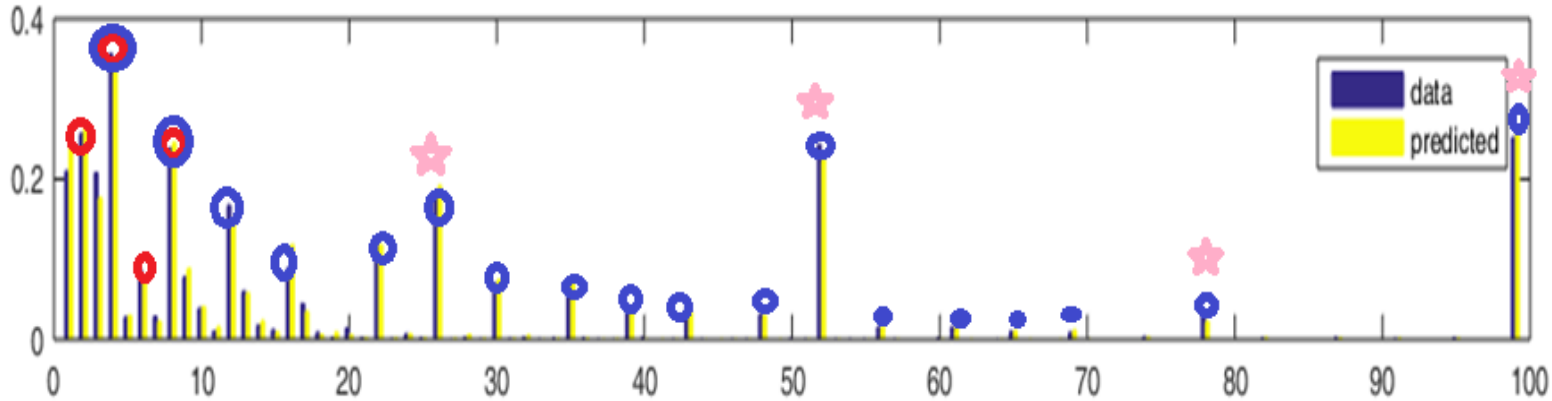
Fractions of M interpreted as E, N, or U each month



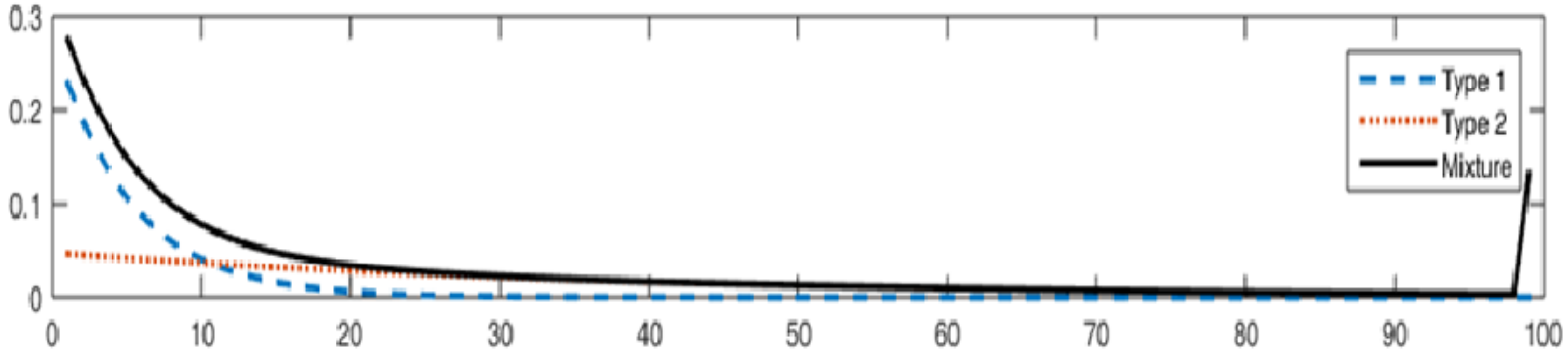
- Rising trend in missing individuals who might have been E/N.
- Countercyclical behavior of m_U: unemployed individuals are more likely to be missed during a weak labor market.

3: Number (Digit) preference

Distribution of unemployment duration



Preference for even numbers (red circle), rounded numbers (rounding to month: blue; half year: pink)



Distribution of U. duration free from number preference

Step 1: Model underlying latent distribution of perceived durations using a parametric monotonic distribution

- Baseline specification: mixture of exponentials

$$\pi_U^{\dagger}(\tau) = w_1(1-p_1)p_1^{\tau} + w_2(1-p_2)p_2^{\tau}$$

- w_i = fraction of unemployed of type i $(w_1 + w_2 = 1)$
- A fraction of the population $\pi_U w_i(1-p_i)$ lose their job each week and have unemployment-continuation prob p_i $(i = 1, 2)$

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Step 2: Model reported durations as probabilistic transformation of perceived durations

- Preference for even numbers, digits and rounded numbers

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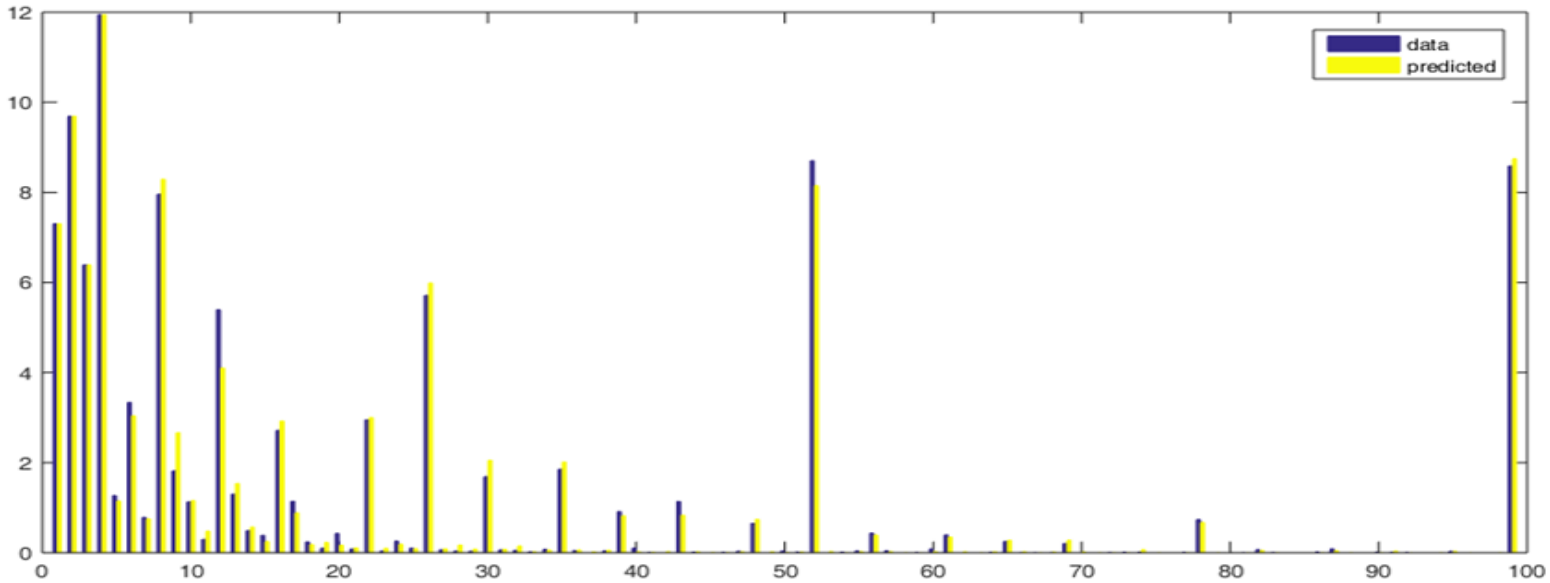
$$\hat{p}_1 = 0.83,\ \hat{p}_2 = 0.97,\ \hat{w}_1 = 0.42,\ \hat{w}_2 = 0.58$$

$\rightarrow$ Also use these parameters for the NU adjustment

4: Inconsistency bw U. duration and LFS: NU^{5+}

Distribution of unemployment duration reported for people who were N in rotation 1 and U in rotation 2



- Those with records $N_{t-1}U_t^{5.+}$ perceive their status at $t-1$ to have been looking for a job (U_t), though they reported N_{t-1}
- Propose to reclassify $N_{t-1}U_t^{5.+} \rightarrow U_{t-1}U_t^{5.+}$: countercyclical!

Corroboration based on LFS history

Preceding *N* carries information similar to *U* in predicting future E.
The pattern of duration dependence is similar b/w *UUU* and *UNU*.

Re-employment probability in month t by LFS history

UUU	Probability	*UNU*	Probability
$U_{t-2}, U_{t-1}^{5.+}$	0.15	$N_{t-2}, U_{t-1}^{5.+}$	0.13
$U_{t-3}^{5.14}, U_{t-2}^{5.14}, U_{t-1}^{15.26}$	0.16	$U_{t-3}^{5.14}, N_{t-2}, U_{t-1}^{15.26}$	0.14
$U_{t-3}^{15.26}, U_{t-2}^{15.26}, U_{t-1}^{15.26}$	0.14	$U_{t-3}^{15.26}, N_{t-2}, U_{t-1}^{15.26}$	0.15
$U_{t-3}^{15.26}, U_{t-2}^{27.+}, U_{t-1}^{27.+}$	0.11	$U_{t-3}^{15.26}, N_{t-2}, U_{t-1}^{27.+}$	0.10
$U_{t-3}^{27.+}, U_{t-2}^{27.+}, U_{t-1}^{27.+}$	0.08	$U_{t-3}^{27.+}, N_{t-2}, U_{t-1}^{27.+}$	0.07

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Marginally attached workers in N category

- 40% of $NU^{5.+}$ transitions: they account for only 2.2 % of N.
- spend as much time for job search as U.(ATUS: 154 vs 143)

5. Inconsistency bw U.duration and UU probability

Probability that someone who is U. in RG 1 with duration τ weeks will still be U in RG 2. $\rightarrow$ Duration dependence in UU continuation

$$\dot{\pi}_{UU}(\tau) = \eta_1(\tau)\gamma_{1,UU} + \eta_2(\tau)\gamma_{2,UU} \ (\gamma_{1,UU} = 0.37, \ \gamma_{2,UU} = 0.58)$$

Are $\gamma_{\hat{U}U}{}^1$ and $\gamma_{\hat{U}U}{}^2$ consistent with $\hat{p}^1$ and $\hat{p}^2$? Without errors, we would also expect

$$\underbrace{\frac{\gamma_{2,UU}}{1-\gamma_{2,UM}}}_{0.63} \approx \underbrace{p_2^{4.33}}_{0.89}$$

Type 2: Perceived durations inconsistent with matched flows.

To reconcile U. duration and UU continuations from the matched flows data, type 2 transitions should be adjusted.

Adjust some *UN* transitions to *UU* continuations

- Similarity b/w *UUU* and *UNU* $\rightarrow$ Some of *UN* $\rightarrow$ *UU*
- Discrepancy b/w flows and stock duration data in Type 2 unemployed's UU $\rightarrow$ Adjust type 2's UU $\rightarrow$ majority of $U_t^{15.+}$

Adjust some *UN* transitions to *UU* continuations

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Reconciliation: Find hidden $U_{t-1}^{15.+}U_t$ from $U_{t-1}^{15.+}N_t$

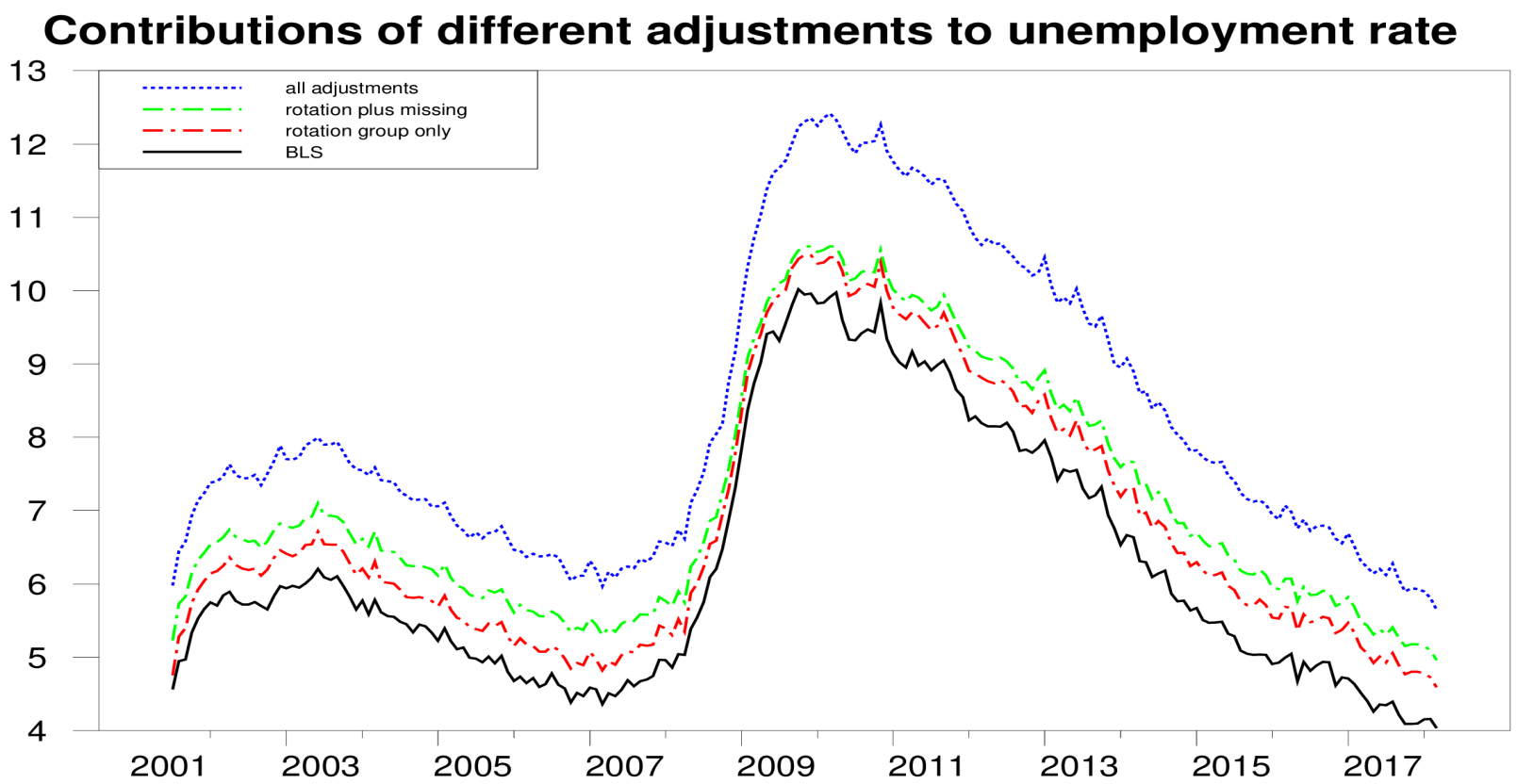
- Fraction ξ_{UN}: $U_{t-1}^{15.+}U_t$
- Fraction $1-\xi_{UN}$: $U_{t-1}^{15.+}N_t^* \approx N_{t-1}, N_t$

Classify 63% of those reported $U_{t-1}^{15.+}N_t$ transitions as U_t. SS flows

$$P(E_{t+1}|N_t, U_{t-1}^{15.+}) = \underbrace{\xi_{UN}}_{=0.633} P(E_{t+1}|U_t, U_{t-1}^{15.+}) + (1-\xi_{UN}) \underbrace{P(E_{t+1}|N_t, N_{t-1})}_{\approx P(E_{t+1}|N_t^*, U_{t-1}^{15.+})}$$

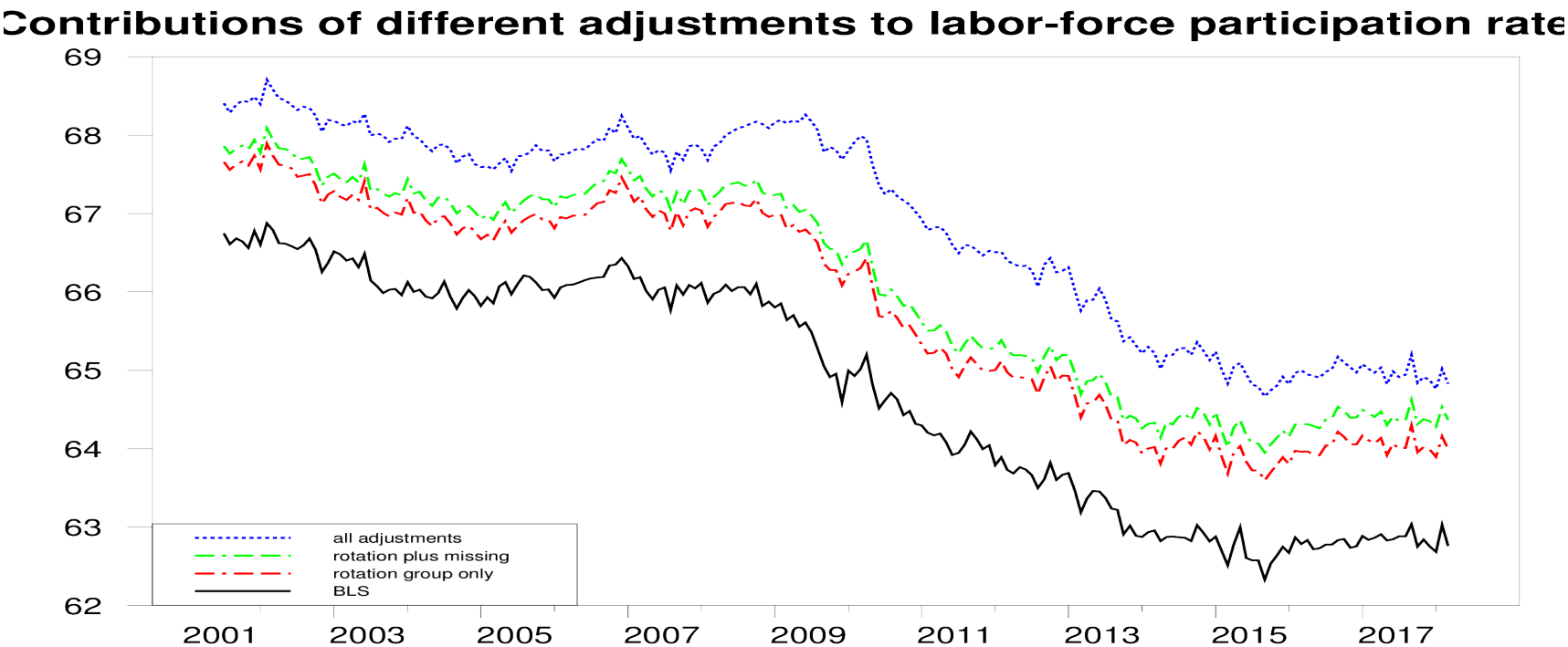
Gap between reconciled and published: weakly countercylical (← NU adjustment) Summary Plot

- RGB(+0.5%p), Missing (+0.3%p), NU adjustment (1.1%p)

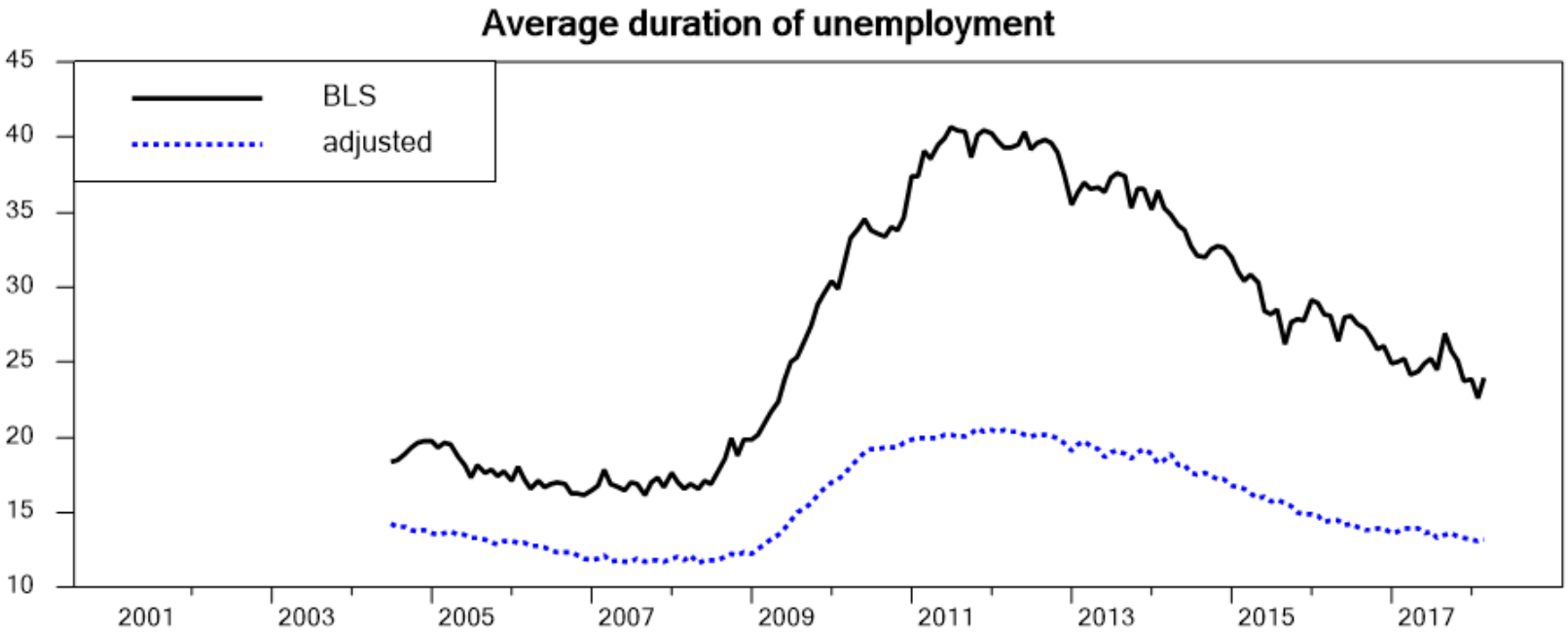


Gap between reconciled and published: weakly counter-cyclical (← NU adjustment) with slowly rising trend (← RGB, missing) Summary Plot

- RGB(+1.2%p), Missing (+0.2%p), NU adjustment (0.8%p)



Published: 25 weeks VS Adjusted: 16 weeks



- $\Uparrow$ Inflows $\leftarrow$ $NU^{5.+}$ adjustment
- Adjusted UU continuation from matched flows data $<$ UU continuation implied by the durations $\leftarrow$ EU^{5+} (on-the-job search spells), perceived durations reflecting discouragement

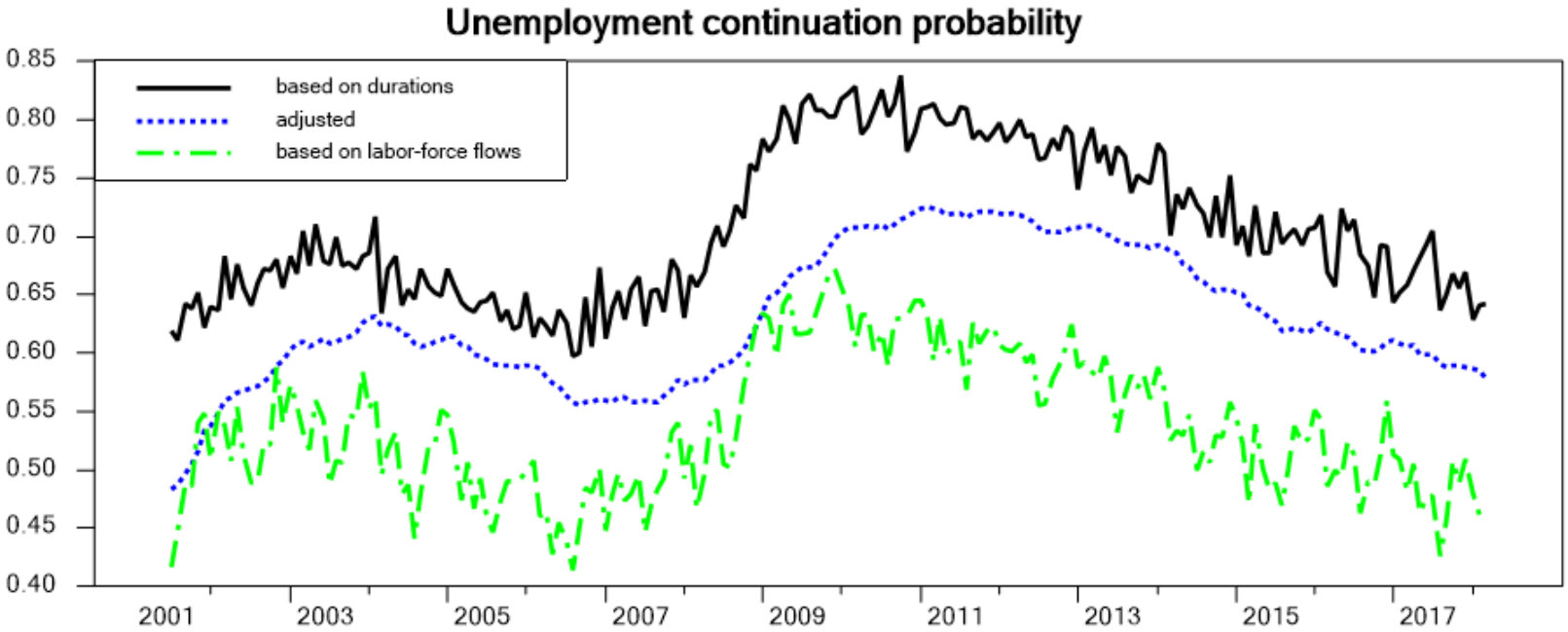
Conclusion

CPS contains multiple internal inconsistencies.

- Rotation group bias
- Non-random missing observations
- Number preference
- Inconsistency between reported durations and LFS histories.

Our paper is the first unified reconciliation, and concludes

- The published unemployment rate and labor-force participation rate are underestimated.
- The new inflows into unemployment are underestimated.
- The mean duration of unemployment is overestimated.

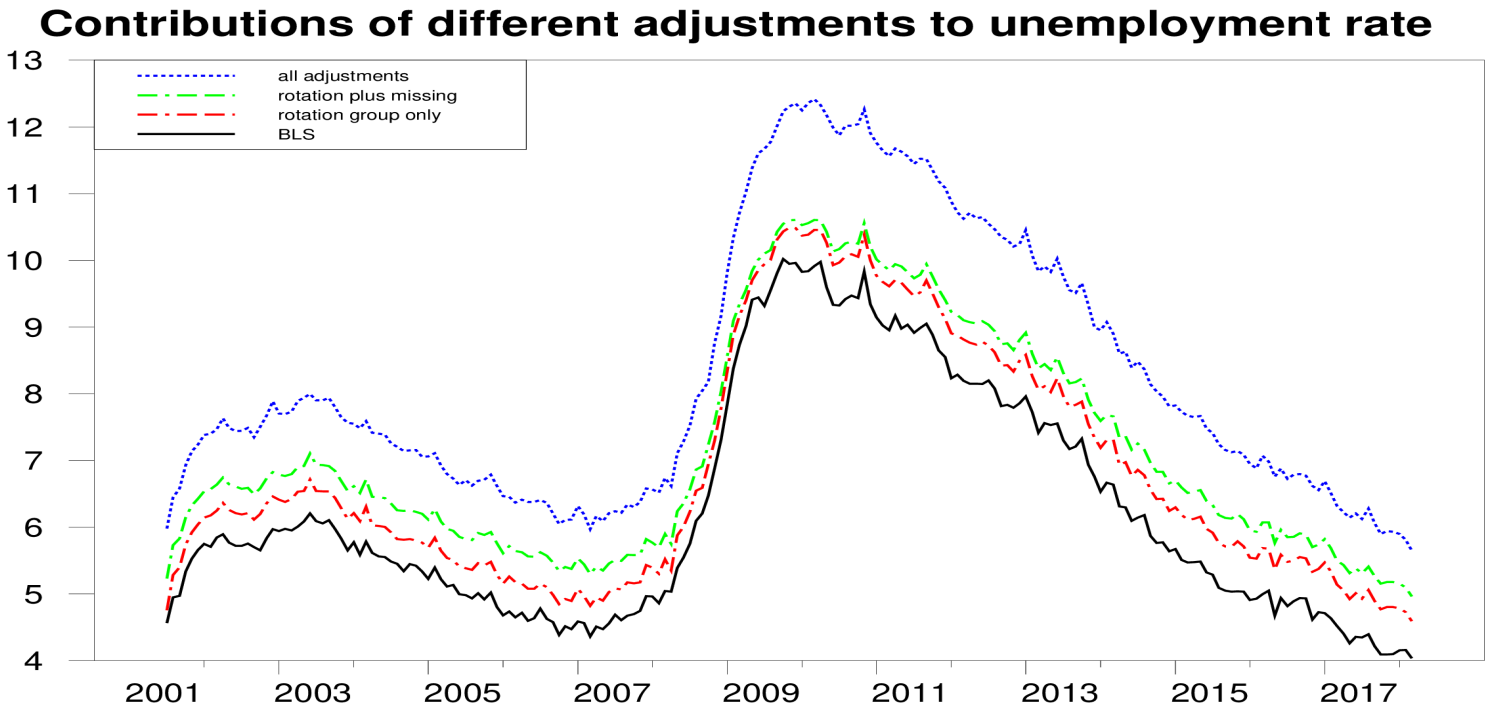


Duration: the ratio of number unemployed for 5 weeks and over in t to number unemployed in $t-1$

Flows: the fraction of those who continue to be U in $t+1$ out of those who are U in t

Adjustments to the unemployment rate

On average, correcting for rotation bias adds 0.5%, missing observations 0.3%, and *NU* adjustment adds 1.1% to UR



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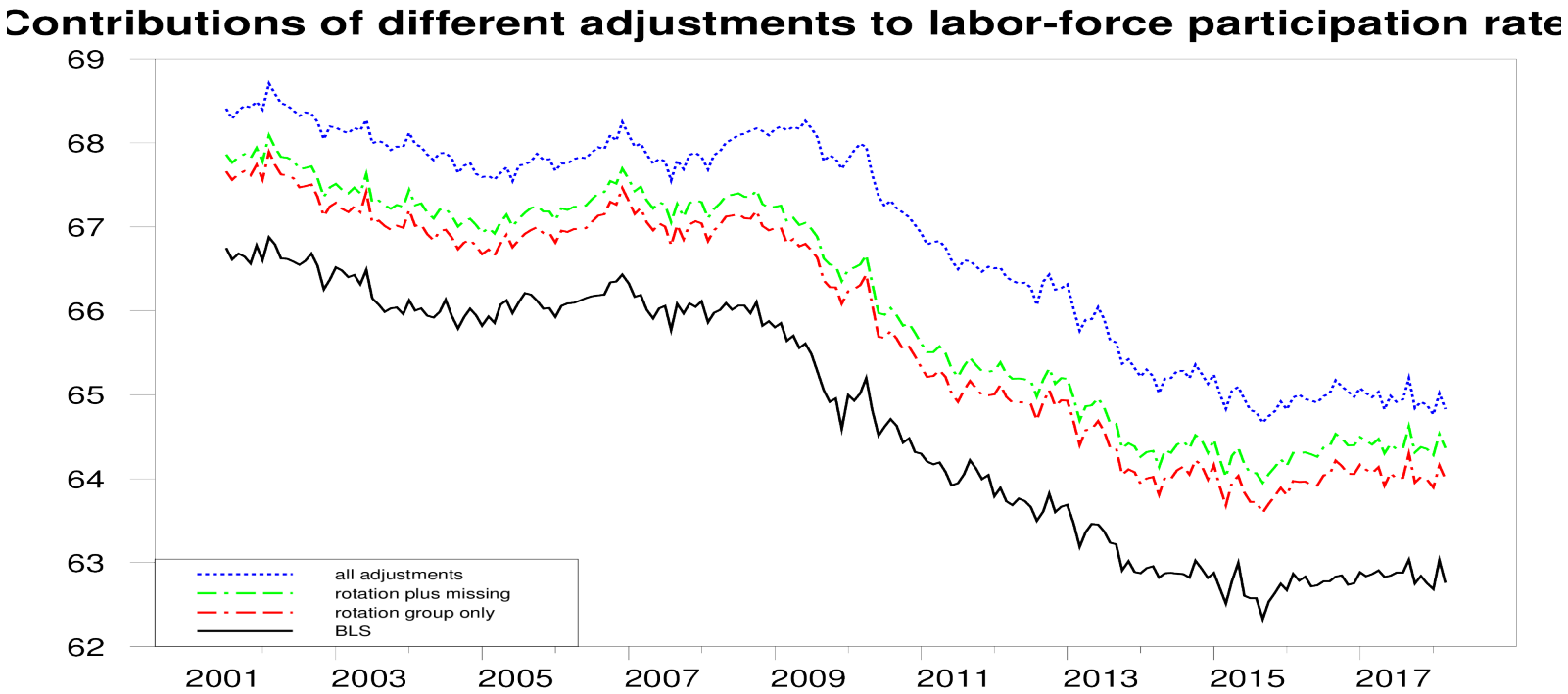
Adjustments to the labor-force participation rate

Correcting for rotation bias adds 1.2%p, missing observations 0.2%p, and NU 0.8%p to LFPR.



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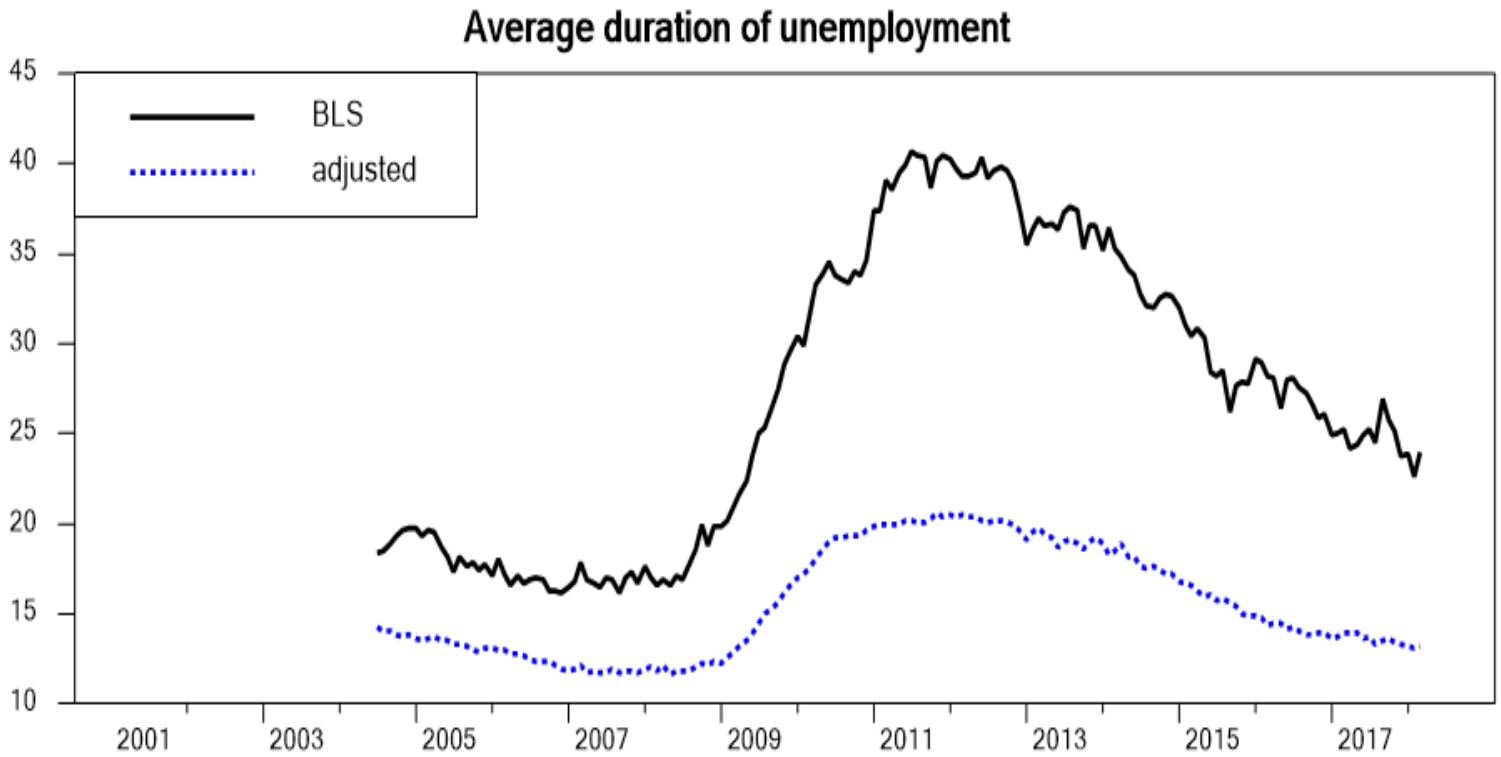
Adjustment to the mean duration of unemployment

Published: 25 weeks VS Adjusted: 16 weeks



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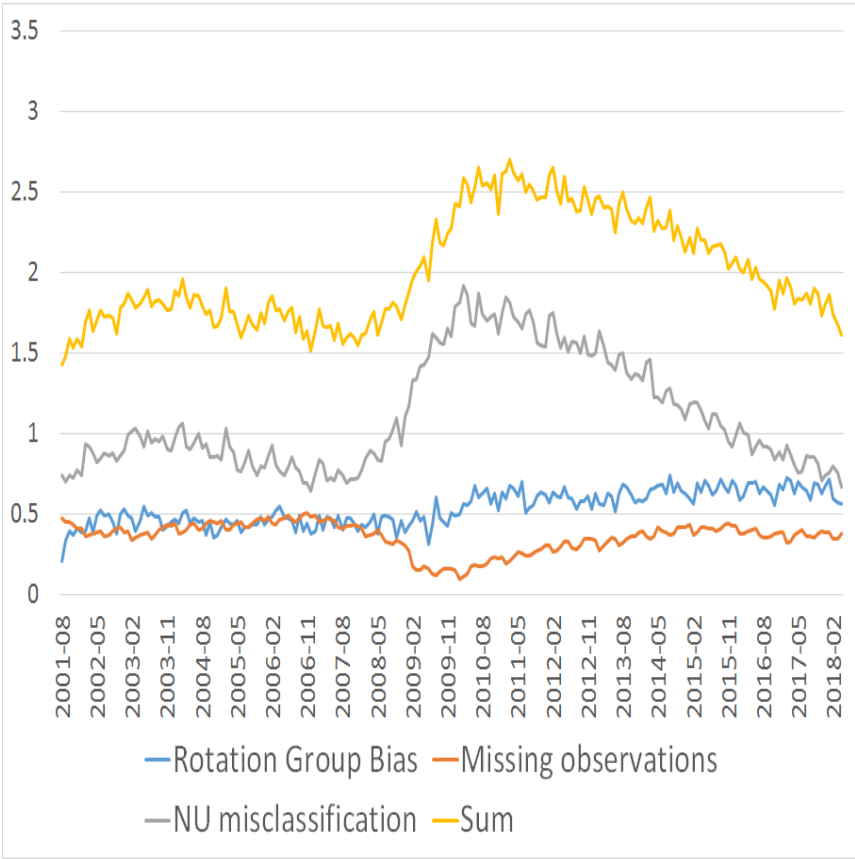
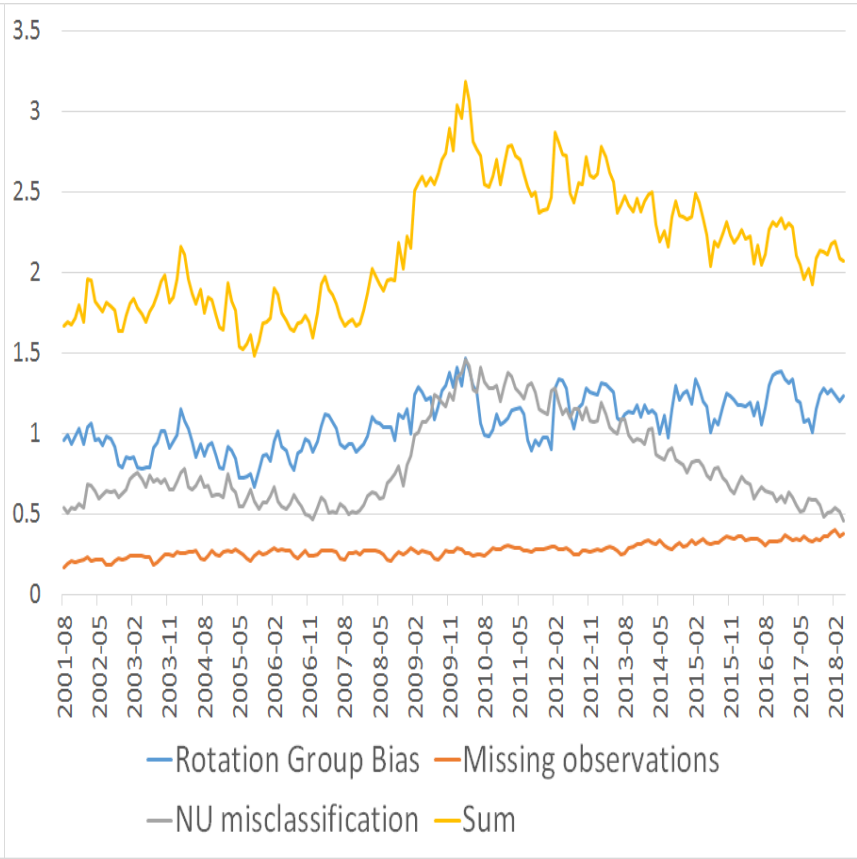
Evolution of measurement errors in UR and LFPR

Unemployment rate



Labor-force participation rate



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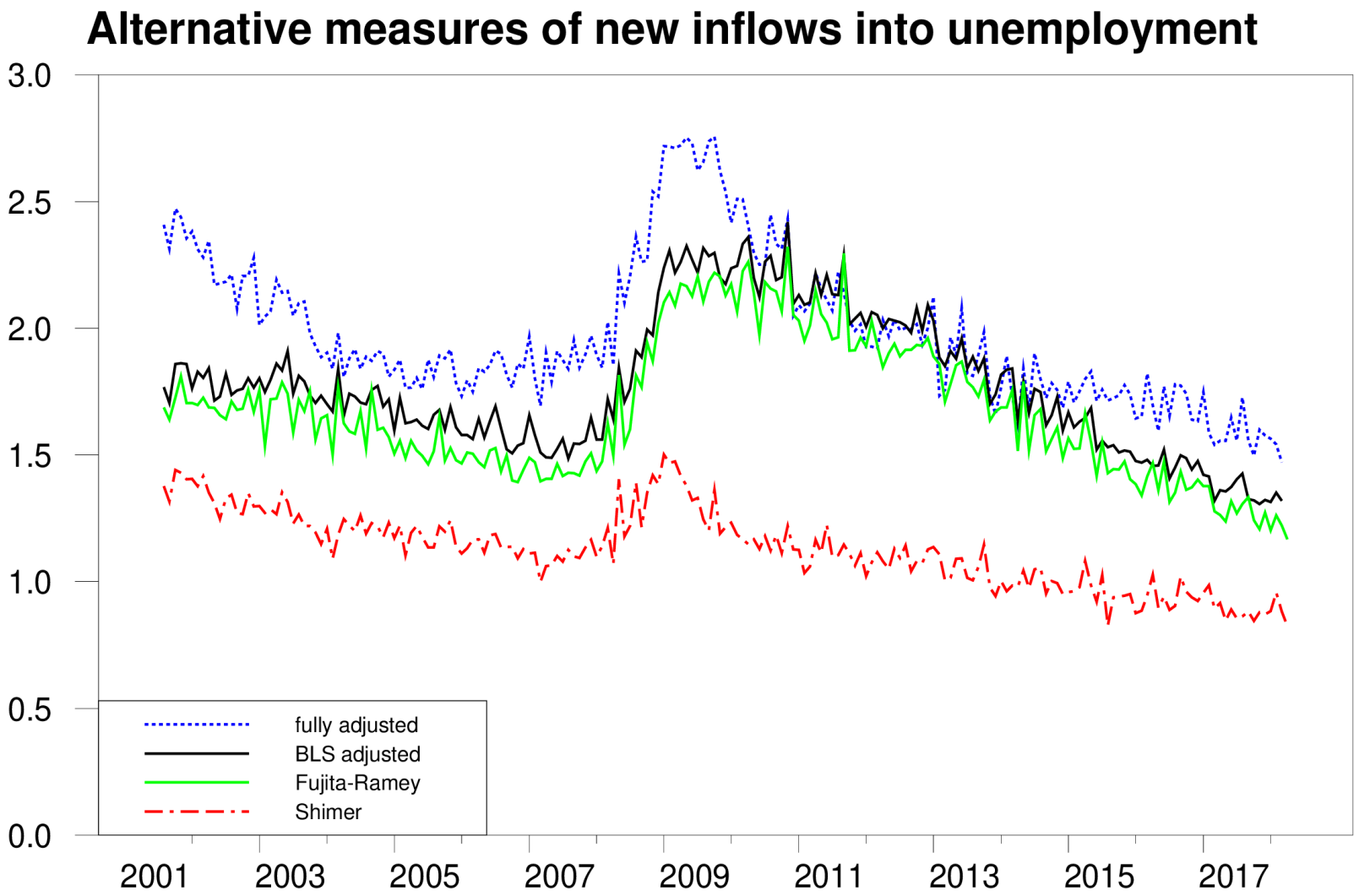

Alternative measures of new inflows into unemployment
3.0
2.5
2.0
1.5
1.0
0.5
0.0
2001
2003
2005
2007
2009
2011
2013
2015
2017
fully adjusted
BLS adjusted
Fujita-Ramey
Shimer

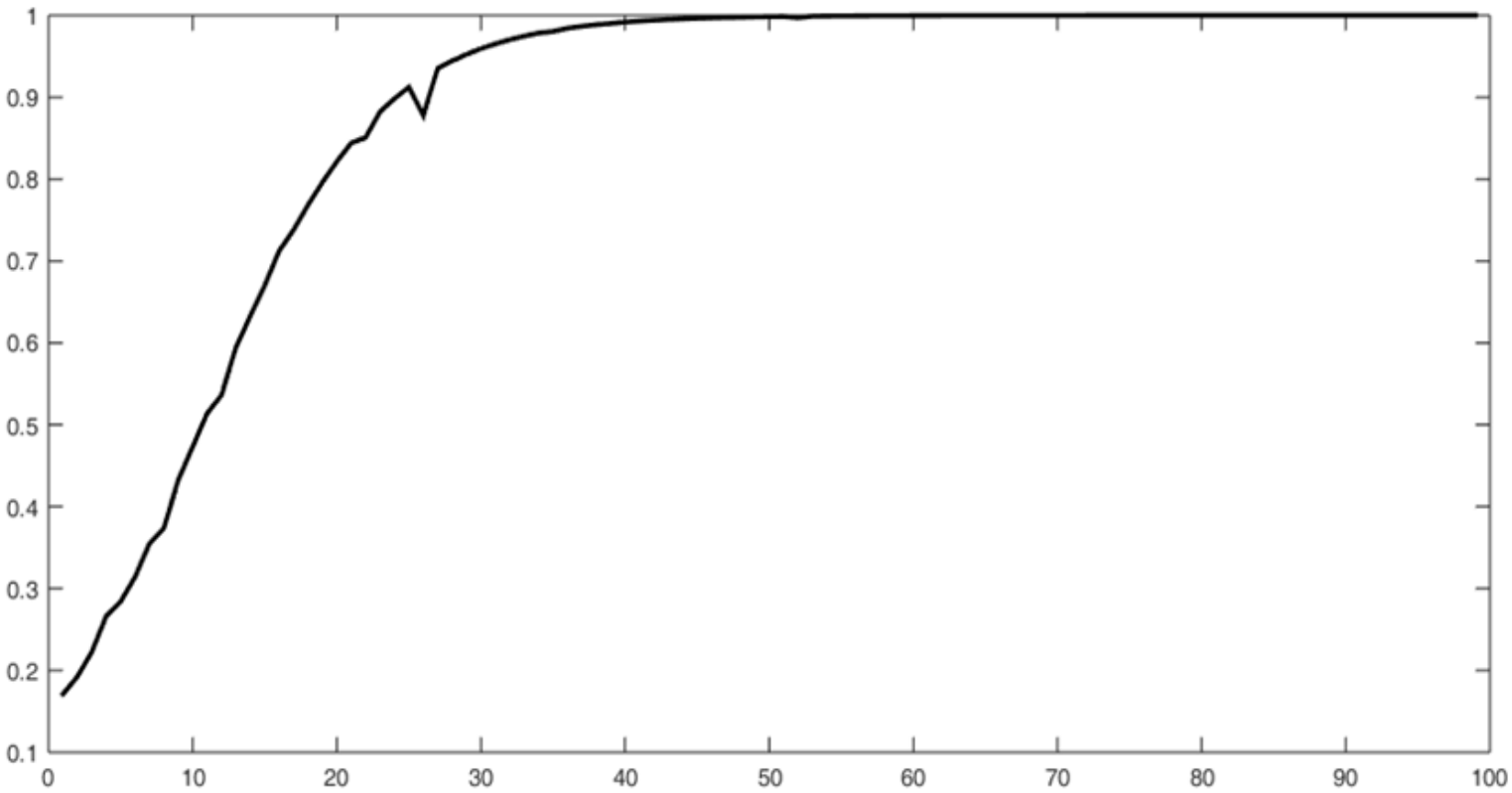
Maximum likelihood estimates

Postulate that probability that someone who is unemployed with duration τ in RG 1 will be $X \in \{E, N, M, U\}$ in RG 2 is $\dot{\pi}_{UX}(\tau) = \eta_1(\tau)\gamma_{1,UX} + \eta_2(\tau)\gamma_{2,UX}$ for $\gamma_{i,UX}$ unrestricted parameters

	[1]	[2]
parameter	Rotation 1 estimate	Standard error
$\gamma_{1,UE}$	0.3183	0.0053
$\gamma_{1,UN}$	0.2179	0.0032
$\gamma_{1,UM}$	0.0909	0.0025
$\gamma_{1,UU}$	0.3729	...
$\gamma_{2,UE}$	0.1153	0.0092
$\gamma_{2,UN}$	0.2353	0.0087
$\gamma_{2,UM}$	0.0735	0.0028
$\gamma_{2,UU}$	0.5759	...

A simple summary of how to use reported duration

$\eta_2(\tau) =$ probability someone who reports duration τ is of type 2



Is this a reasonable estimate? Additional corroboration

- Average fraction of population with reported *NU* that are really type 2 *UU* continuations: 0.0028
- Average fraction of population with reported *UN* that are interpreted as type 2 *UU* continuations: 0.0026

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Adjusting monthly estimates

Estimation of time-varying parameters Filtering idea similar to Kalman filter

We use exponential smoothing to calculate a weighted average of recent observations through date t to infer how the adjustment parameters θ_t are changing over time. If θ_t denotes an estimate using observations from month t alone, we calculate

$$\overline{\theta}_t = (1 - \lambda)\theta_t + \lambda\overline{\theta}_{t-1}.$$

$$\lambda = 0.98$$

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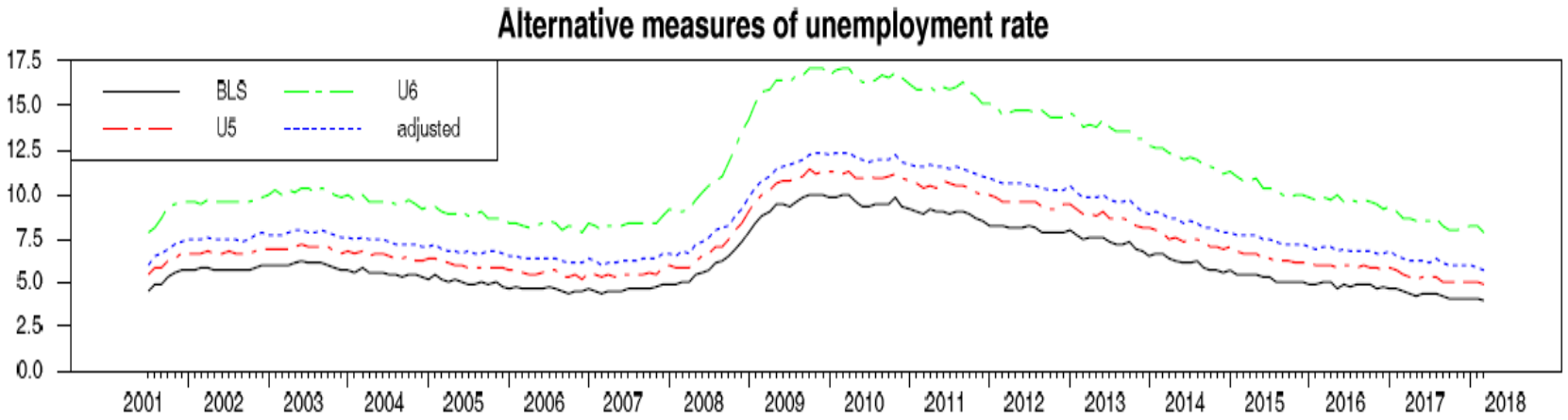
Alternative measures of unemployment rate
BLS
U6
U5
adjusted
17.5
15.0
12.5
10.0
7.5
5.0
2.5
0.0
2001
2002
2003
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2016
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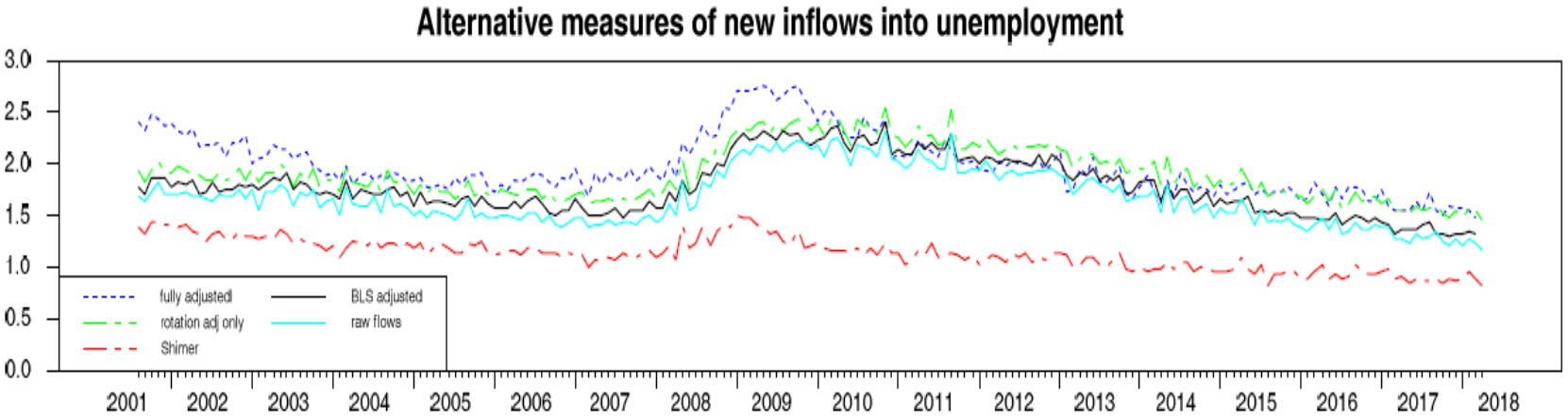
2018


Alternative measures of new inflows into unemployment
fully adjusted
rotation adj only
Shimer
BLS adjusted
raw flows
3.0
2.5
2.0
1.5
1.0
0.5
0.0
2001
2002
2003
2004
2005
2006
2007
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2010
2011
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2013
2014
2015
2016
2017
2018

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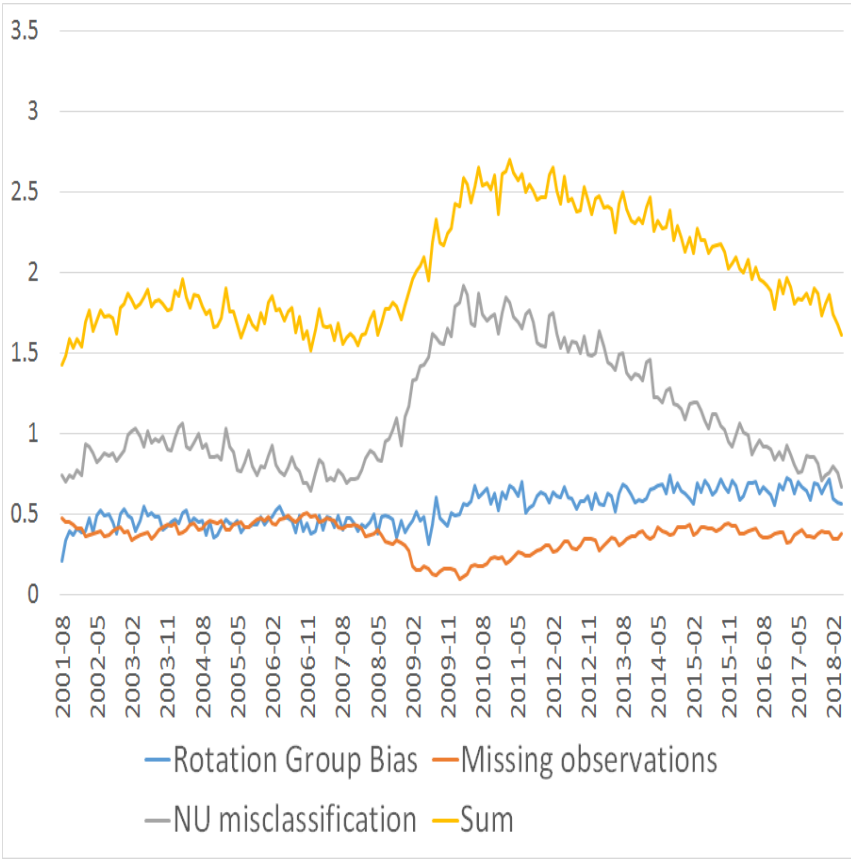
Features of measurement errors in UR and LFPR

	Unemployment rate			Labor force participation rate		
	Mean	Trend	Cycle	Mean	Trend	Cycle
Total	1.9	No	Counter	2.2	Rising	Counter
Rotation group bias	0.5	Slowly rising	No	1.2	Rising	No
Missing observations	0.3	No	Pro	0.2	Rising	No
N/U misclassification	1.1	No	Counter	0.8	No	Counter

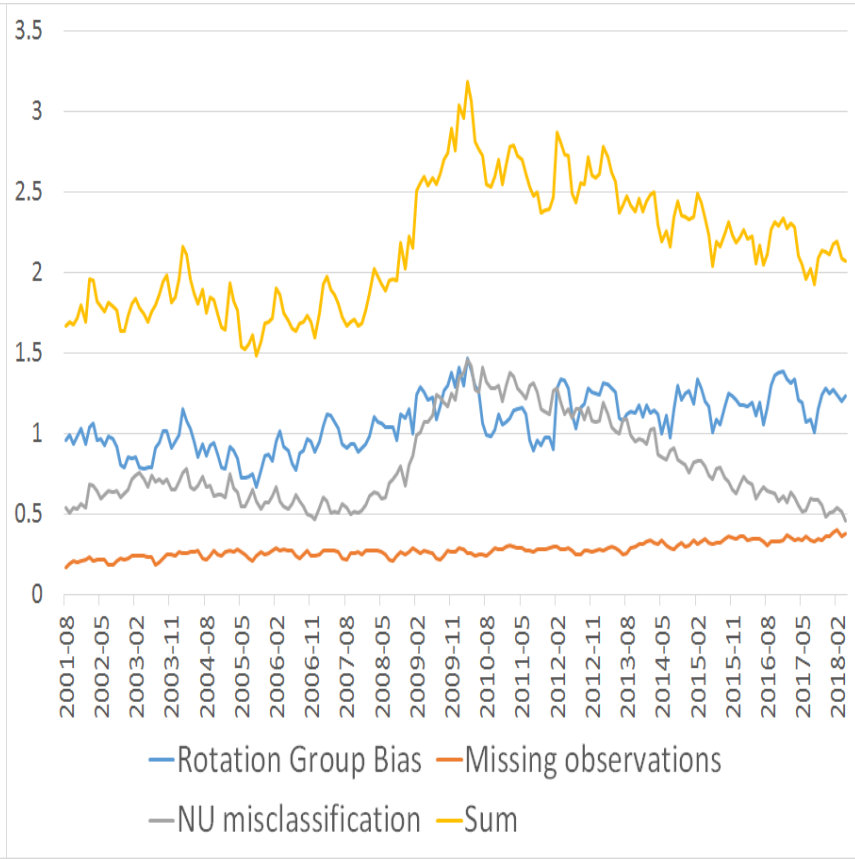
Back to UR Back to LFPR

Features of measurement errors in UR and LFPR

Unemployment rate

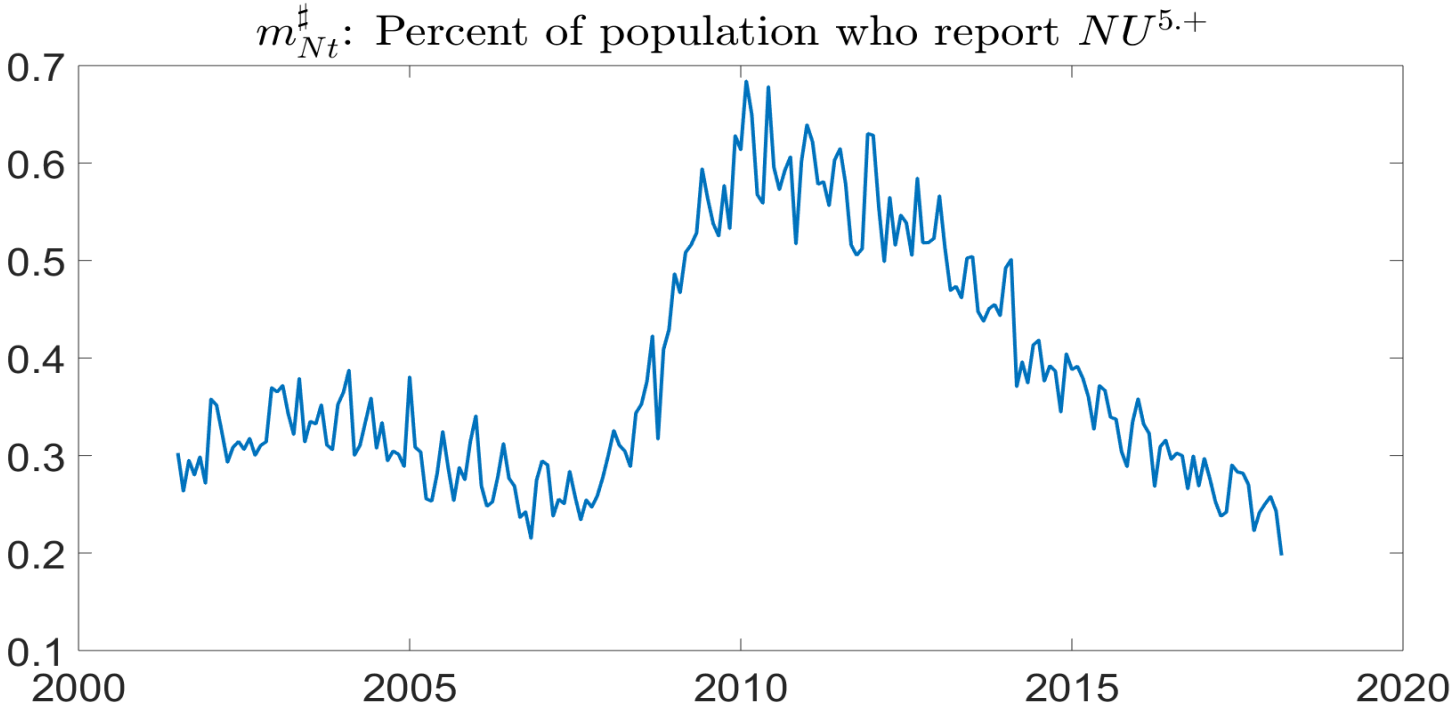


Labor-force participation rate



Back to UR
Back to LFPR

Size of $NU^{5.+}$: Countercyclical



Size of *UN* whom we interpret as *UU*: Countercyclical