Notes on the Labor Market

The labor market, specifically the unemployment rate, is arguably the economic measure of most interest to the public and policy makers. These notes briefly detail the discussion of the labor market in class on September 5, just after the Bureau of Labor Statistics released its August report.

Most reporting around the August report interpreted it as showing a weakening job market with slower than expected employment growth and gradually rising unemployment. At 4.3%, the unemployment rate is still low, but rising. This reporting largely focused on the establishment (firm) survey..

We discussed the following measures from the household survey:

1. The civilian institutionalized population attempts to count all people who might choose to work. It thus excludes children (15 or younger), those in institutions such as mental institutions, prisons, and nursing homes, and members of the military.

2. The labor force consists of employed and unemployed workers who are actively seeking work. As of August, it equaled 62.3%.

3. The labor force participation rate is simply the labor force divided by the population. in the short-term, higher labor force participation may be a sign of a stronger economy. In the long-term, broader societal trends such as the entrance of more women in the labor force (1960s through 1990s) or an aging population (currently) might cause movements.

4. The labor force excludes retirees, full time-students, and homemakers, it also excludes the underemployed (part time for economic reasons) and discouraged workers, those who have given up looking for a job.

5. The U-3 unemployment rate is simply the ratio of unemployed workers to the labor force. This is the unemployment rate that is typically cited in the media. As of August, it equaled 4.3%.

6. The U-6 unemployment is an alternate measure. It adds underemployed workers to the numerator and discouraged workers to both the numerator and denominator. It is always higher than U-3. As of August, it equaled 8.1%.

We considered the following example: An economy has 8 full time employees, 2 unemployed workers actively seeking work, and 2 discouraged workers. this yields a U-3 unemployment rate of $\frac{2}{8+2} = 20\%$ and a U-6 unemployment rate of $\frac{2+2}{8+2+2} = 33\%$.

Consider a case where one unemployed worker finds a job. The U-3 unemployment rate now falls to $\frac{1}{10} = 10\%$, suggesting a better labor market. In this case, a lower unemployment rate does accurately reflect a stronger economy.

Now consider a case where 1 unemployed workers switches to becoming a discouraged worker. The U-3 unemployment rate now falls to $\frac{1}{9} = 11\%$. In this case, the lower unemployment rate is misleading. The labor market is not stronger.

The prior example shows that the unemployment rate may fall either if unemployed workers find jobs, or if they leave the labor force. These scenarios have very different implications and it is important to discriminate between them.