What Does the Unemployment Rate Indicate About the Weak Labor Market?

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Chairman McDermott, Ranking Member Weller, and distinguished members of the Committee, I appreciate the opportunity to talk with you today about the state of the labor market and its implications for policy. I plan to make several remarks about the labor market and its current problems and then discuss the implications of these facts for the debate over extended benefits.

The discussion of potential recession has dominated the economic news over the past few months. Yet the unemployment rate – one of our most-utilized measures of labor market weakness -- has stayed relatively low. It was at or below 5% for the past two and a half years; the data release last Friday showed that it crept up to 5.1% in March 2008. While a significant increase, this is still relatively low compared to past recessions.

Some have argued that this relatively low unemployment rate means that it's too early to think about extended benefits. In the past few recessions, extended benefits have not been enacted until unemployment rates were at six percent or higher. I want to make two primary points in this testimony. First, the current unemployment rate cannot be easily compared to past unemployment rates. If we had a similar population in the labor force today as in earlier periods, our current unemployment rate would be much higher. Second, a variety of other labor force measures suggest that those Americans who lose their jobs are facing serious economic problems.

Changes in the Composition of the Labor Market Have Driven Unemployment Rates Down

There are two primary reasons why unemployment rates in 2008 are not entirely comparable to those from earlier periods.

Most important is the *shifting age distribution of the civilian labor force*. As the baby boom generation has aged, the share of workers in older age groups has steadily grown, while the share in younger age groups has fallen. This has the effect of lowering the overall unemployment rate because older workers tend to have lower unemployment rates. Columns 1 through 3 of Table 1 show the unemployment rate by age group at the beginning month of each of the last two recessions, in July 1990 and March 2001, as well as our most recent statistics in March 2008. Columns 4 through 6 show how the share of workers within each age group has shifted over this time period. There is a steady growth in the share of older workers and a decline in the share of younger workers.

It is apparent from Table 1 that *unemployment is higher among every age group of workers in March 2008 compared to March 2001, and higher among most groups compared to July 1990 even though overall unemployment is lower*. This is because the weights across the age groups have shifted.

Table 1

Unemployment Rate by Age and Labor Force Share in Selected Months

	Unemployment Rate (percent)			Share of Labor Force (percent)		
Ages	Mar-08	Mar-01	July-90	Mar-08	Mar-01	July-90
16-19	15.8	13.4	15.0	4.4	5.6	6.2
20-24	9.3	8.1	8.5	9.8	10.2	11.7
25-34	5.3	4.3	5.6	21.7	22.6	28.5
35-44	3.8	3.4	4.2	22.8	26.2	25.5
45-54	3.5	2.8	3.3	23.3	22.2	16.1
55+	3.4	2.6	3.1	17.9	13.3	11.9
Total Labor Force Share				100.0	100.0	100.0
Aggregate Unemployment Rate	5.1	4.3	5.5			
Mar-08 Unemployment weighted by Mar-01 Labor Force Share		5.3				
Mar-08 Unemployment weighted by July-90 Labor Force Share			5.5			

Source: U.S. Department of Labor, Bureau of Labor Statistics, http://www.bls.gov/home.htm. Labor force shares by age and weighted unemployment rates are author's tabulations from BLS data.

Notes: July 1990 and March 2001 are the beginning months of the last two recessions, according to the Business Cycle Dating Committee of the National Bureau of Economic Research; March 2008 is the most recent month for which data is available. All reported data are seasonally adjusted.

If you take the age-specific unemployment rates in March 2008 and weight them as if the labor force looked as it did in July 1990, the unemployment rate in 2008 would be 5.5% rather than 5.1%, the same as the actual unemployment rate of 5.5% in July 1990. Similarly, the March 2008 unemployment rate would be 5.3% if age groups are weighted by the March 2001 labor force weights, far above the actual March 2001 unemployment rate of 4.3%.

In short, the shifting age distribution in the population should change our expectations about what constitutes low versus high unemployment. Because older workers have lower unemployment rates, base unemployment rates have fallen with an aging workforce. Hence, the same unemployment rate in March 2008 signals more problems than it would have in early 1990 or even in early 2001. From the point of view of any worker who compares herself to her age peers, unemployment is worse now than at those earlier moments in time.

There is another effect depressing unemployment rates, and that is *the rising share of younger men in jail or prison*. I suspect most of you saw the report from the Pew Foundation in February noting that 1 out of every 100 adult Americans are now in prison (Pew Center on the States, 2008). Our labor force statistics are based on civilian non-

institutionalized persons. Those in prison are not counted. This particularly affects younger men. Of course, the civilian labor force data also excludes those in the Armed Forces, all of whom are employed. This also disproportionately affects younger men.

Rather than working with the civilian non-institutionalized population, I add Armed Forces personnel and those in jails and prisons to the population numbers and add Armed Forces personnel to the employment numbers. I do this calculation for 2006, the latest year for which all these data are available.

It has hard to calculate an adjusted unemployment rate because we are not sure how many men currently in prison would be actively seeking work. For a back-of-the-envelope calculation, I assume that 80% of those in prison would be in the workforce if they were not in prison, and that the unemployment rate among these men would be 25%. (This is only slightly higher than the current 21% unemployment rate among young men ages 16-19.) Under these circumstances, the 2006 male unemployment rate would rise from its reported level of 4.6% to 4.9%.

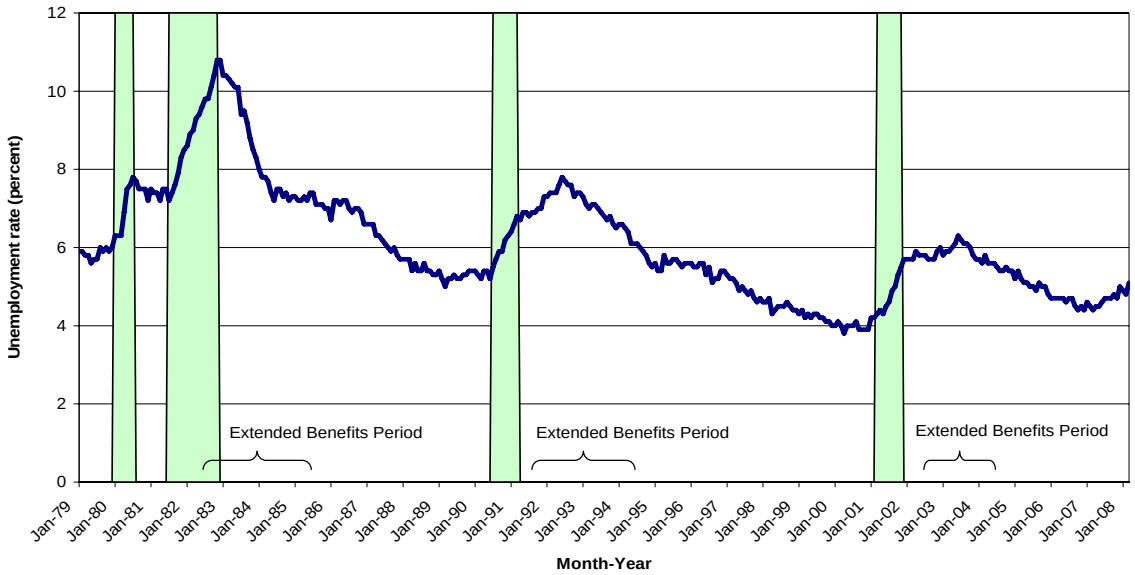
Of course, most of the men in prison or in the Armed Forces are younger. If I assume that all of these men are between the ages of 16 and 34, I can look at the effect on employment-to-population ratios and on the unemployment rate for that group in the population. Taking account of both the Armed Forces and the large number of men in prisons or jails, the 2006 employment-to-population ratio among men ages 16-34 would fall from 72.3% to 69.5%. Their unemployment rate would rise from its reported 2006 level of 7.2% to an estimated 7.8%.

In short, by expanding the prison population, we have removed more and more young men from our labor market count. This reduces aggregate unemployment rates and raises employment shares, since these are often persons who would have difficulty finding jobs if they were not in prison.

These two shifts – in the age distribution of the population and in the share of men who are part of the civilian labor force – mean that the equivalent unemployment rates are lower now than in the past. If we had a similar population now as in 1990, the unemployment rates in both periods would very similar. Hence, we can't just compare the level of today's unemployment rate to earlier periods without realizing that equivalent problems are occurring at a lower level of reported joblessness today than in the past.

Finally, if we want to understand why unemployment rates look low right now, there is one other very important comment to make: *Unemployment rates and employment changes are lagging indicators of an economic slowdown*. Unemployment rates are typically low at the point a recession begins. They rise during a recession and often peak after a recession has ended. Hence, unemployment rates are NOT a good indicator of whether an economy has entered a recession. Figure 1 plots unemployment rates over the past 25 years. The shaded areas indicate periods of recession. In every recession, unemployment rates are low in the first month, and often peak after the end of a recession.

Figure 1.
Unemployment Rate, January 1979 to March 2008
(Shaded areas denote recessions and brackets denote claim periods for extended benefits)



Sources: U.S. Department of Labor, Bureau of Labor Statistics, http://www.bls.gov/home.htm. National Bureau of Economic Research, Business Cycle Dating Committee, "Business Cycle Expansions and Contractions," http://www.nber.org/cycles.html.
Note: Employment data are seasonally adjusted.

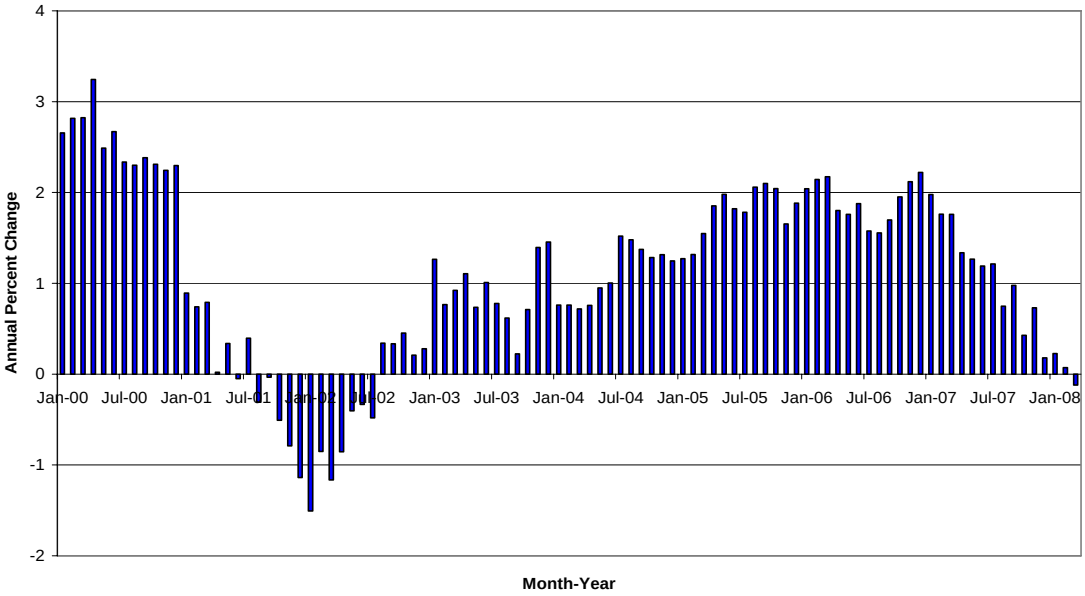
Because unemployment rises slowly, the political impetus to enact extended benefit legislation often occurs later in a recession, once unemployment rates are higher. Figure 1 indicates that extended benefits have been enacted quite late in past recessions. In fact, in both the early 1990s and the early 2000s, extended benefits were enacted after the official end of the recession (but at a time when unemployment rates were still rising.)

What Other Evidence Do We Have of Problems in the Labor Market?

The unemployment rate is hardly the only measure of labor market health. Let me summarize five other indicators that suggest there are serious problems in today's labor market.

First, recent months have shown a *marked slowdown in employment growth*. From March 2006 through March 2007, employment grew by 1.8%. Over this past year, from March 2007 through March 2008, employment actually declined by 0.1% Figure 2 shows the annual changes in unemployment from month to month; the recent slowdown in employment growth is clearly visible over the past year, and very reminiscent of the pattern at the beginning of past recessions.

Figure 2.
Annual Change in Employment, January 2000 to March 2008

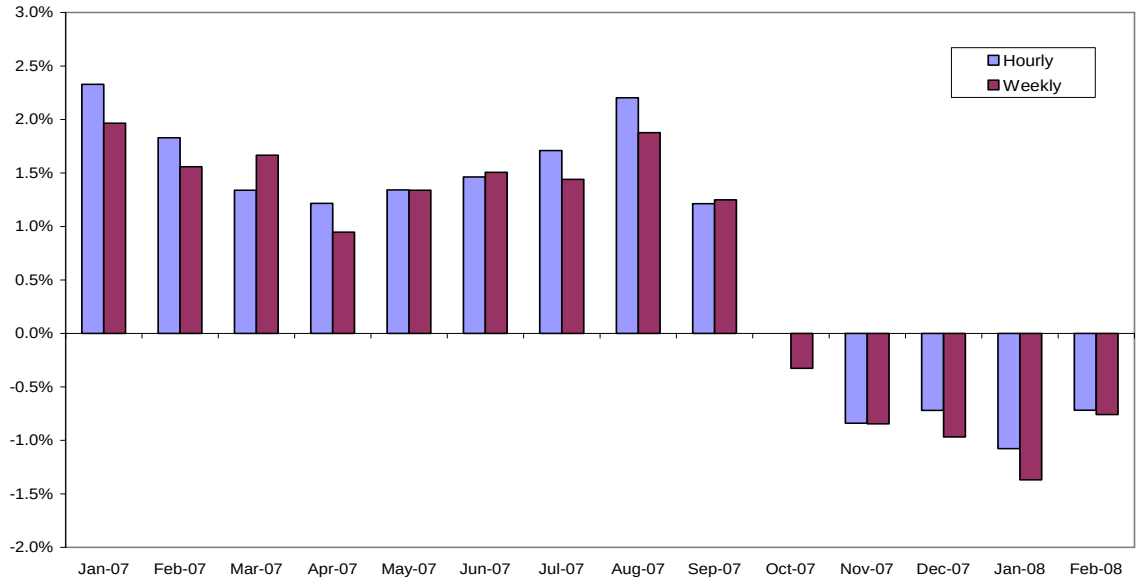


Source: U.S. Department of Labor, Bureau of Labor Statistics, http://www.bls.gov/home.htm.
Note: Employment data are seasonally adjusted.

Second, the *declines in employment are widespread in the economy*. In the last month, employment fell or was flat in almost every industry except health care services, food services, and local government. This widespread job loss is particularly worrisome, and I take it as a sign that we are almost surely in recession in this country. We don't have an economy with some weak spots and some areas of ongoing strength. The employment data suggests weakness in almost all sectors.

Third, *wage growth has slowed over the last six months*. Figure 3, taken from a chart constructed by Jared Bernstein at the Economic Policy Institute (Bernstein, 2008), indicates that the annual change in real earnings has been negative since October. This is due to the combination of very slow growth in nominal wages and faster inflation, leading to a decline in real (inflation-adjusted) wages.

Figure 3.
Yearly Change in Real Earnings, Hourly and Weekly, Jan07-Feb08



Source: Figure and data for January 2007 to January 2008 provided by Jared Bernstein at the Economic Policy Institute, originally published online at http://www.epi.org/content.cfm/webfeatures_snapshots_20080220se (February 20, 2008). Data for February 2008 are author's own tabulations. Original wage data from the Bureau of Labor Statistics.

Fourth, *the share of the population that is working or looking for work has fallen over the past year*. If we're losing jobs, but unemployment hasn't increased, this means that some people are dropping out of the labor market entirely. This 'discouraged worker' effect is often a sign that workers are pessimistic about their chances of finding a new job. The declines in labor force participation are particularly noticeable among high-risk groups of workers, namely, younger workers and those with low skill levels. If unemployment remains low because the number of discouraged workers is rising, that's not a good sign for the labor market.

Fifth, *indicators of labor market slackness are at high levels*. Table 2 shows three alternative measures of labor market slackness. Overall unemployment rates are higher now than at the beginning of the 2001 recession, but slightly lower than at the beginning of the 1990 recession. Long-term unemployment measures the number of workers whose unemployment spell has lasted 27 weeks or longer. Long-term unemployment is currently quite high, with almost 1% of the workforce in long-term unemployment in March 2008.

The standard unemployment rate measures those who actively looked for work. The Bureau of Labor Statistics also computes a measure of those they call "marginally attached," which are those who want a job and have recently looked for a job, but are currently not looking because jobs are so scarce. They also measure those who are working only part-time because of economic reasons, the so-called 'involuntary part-time workers.' If one expands the labor force to include marginally attached workers, and looks at the share who report themselves as either unemployed, marginally attached, or

involuntarily working part-time, this is 9.1% of the labor force in March 2008, shown in Table 2. In March 2001, the beginning of the last recession, this number was only 7.3%.

Table 2
Alternative Measures of Labor Utilization

-	Unemployment Rate		
	Mar-08	Mar-01	July-90
Official Unemployment Rate	5.1	4.3	5.5
Long-Term Unemployment Rate[1]	0.8	0.5	0.5
Total unemployed + marginally attached workers + employed part-time for economic reasons, as a percent of civilian labor force + marginally attached workers[2]	9.1	7.3	N/A

Source: U.S. Department of Labor, Bureau of Labor Statistics, http://www.bls.gov/home.htm

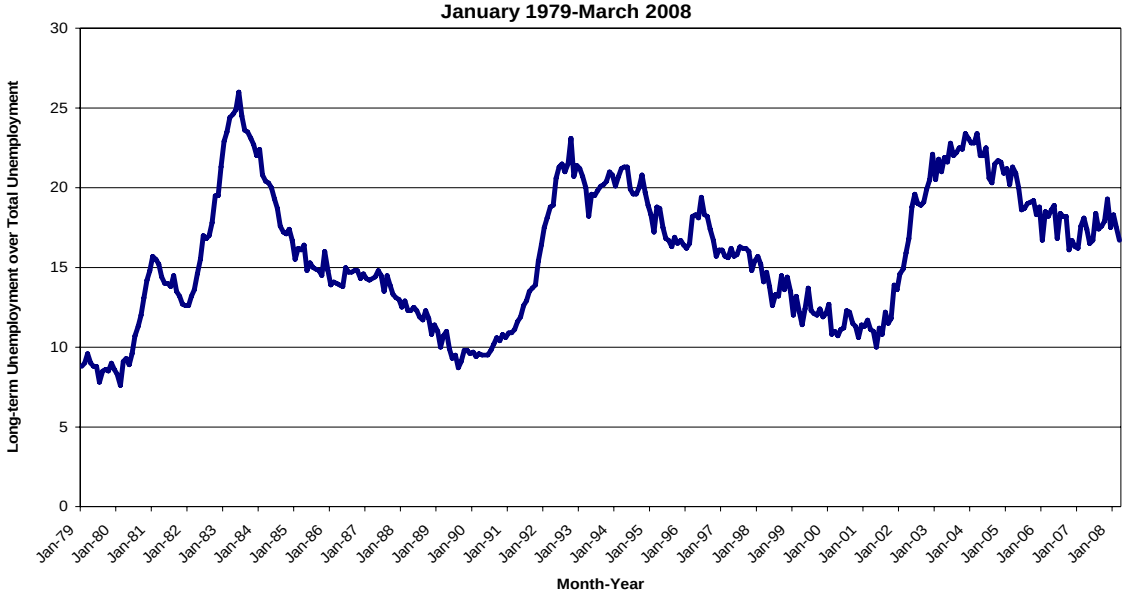
Notes: July 1990 and March 2001 are the beginning months of the last two recessions, according to the Business Cycle Dating Committee of the National Bureau of Economic Research; March 2008 is the most recent month for which data is available. All reported data are seasonally adjusted.

[1] Share of labor force that has been unemployed for 27 weeks or more.

[2] Marginally attached workers are persons who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the recent past. (Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not currently looking for a job.) Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule.

Figure 4 shows long-term unemployment as a share of overall unemployment. As of March 2008, 16.7% of the unemployed had been unemployed for more than a half year. This is substantially higher than in 1990 (at 12.9%) or 2001 (at 11.1%). This suggests that a substantial fraction of those who lost jobs in 2007 are having serious difficulties finding reemployment.

Figure 4.
Long-term Unemployment as a Percentage of Total Unemployment, January 1979-March 2008



Source: U.S. Department of Labor, Bureau of Labor Statistics, http://www.bls.gov/home.htm.
Notes: Employment data are seasonally adjusted. Long-term unemployment defined as the number of unemployed workers out of work for 27 weeks or more as a percentage of the civilian labor force.

Do Extended Benefits Make Sense in the Current Labor Market?

If you believe the U.S. economy is entering a serious economic slowdown, unemployment rates are likely to increase steadily in the months ahead. Should we enact extended benefits now or, as in past recessions, wait for the unemployment rate to rise further? Even adjusting for population shifts, the unemployment rate is still lower than it was when extended benefits were put in place in past years. This might argue for waiting.

I would recommend an extended benefits bill for two primary reasons. First, the unusually high rates of long-term unemployment in the current economy suggest that a growing share of the unemployed who receive unemployment benefits will exhaust them without finding a job. Extended benefits can particularly assist long-term unemployed workers who are having difficulty finding jobs.

Second, I believe that we waited too long in past recessions. Waiting until after a recession has ended to enact extended benefits makes little sense. We know that unemployment rates are a lagging indicator. Given the serious problems signaled by many economic indicators, there is every reason to believe that labor market problems will rise steadily in the months ahead. We should take proactive measures to protect workers who become unemployed, rather than waiting until the problem has grown much larger.

Let me respond to two concerns often raised with regard to extended benefits. Unemployment Insurance is received by only a minority of the unemployed, and the share receiving UI has been falling in recent years. Only 34% of the unemployed received UI at the end of 2007 (U.S. Department of Labor, 2007). For the many unemployed who are not eligible or who do not take unemployment benefits, extended UI benefits will have little effect on their economic situation.

I would note that those who face long-term unemployment are much more likely to be eligible for and to receive UI. In part this is because a higher share of the long-term unemployed are displaced workers, who lose jobs due to plant closures or large-scale layoffs. Virtually all of these workers are eligible for unemployment insurance and many of them receive information encouraging them to apply. A recent study by CBO notes that more than 60% of those in long-term unemployment spells receive UI benefits (CBO 2007). This is the group most likely to benefit from extended benefits.

(Of course, the very low receipt of UI among the unemployed is an important issue, but beyond the scope of this morning's hearing. In the longer run, reform of the entire UI program is necessary if you want more unemployed workers to have access to an economic cushion when they lose their jobs.)

Another concern about extending UI benefits focuses on the unequal distribution of unemployment across the states. Some states have very high unemployment at present, in excess of 6%, particularly some of the upper Midwestern states like Michigan or Ohio. Other states have relatively low unemployment rates, below 3%. If long-term unemployment is concentrated in high unemployment states, it might make sense to limit extended benefits only to states with particularly high unemployment rates.

Unfortunately, long-term unemployment is not particularly concentrated in the high unemployment states. Long-term unemployment data by state is not reported by the BLS, but these numbers can be calculated. Using data provided by the Economic Policy Institute for the year 2007, Table 3 groups the states in four groups. The top group is the five states with the highest rates of unemployment. These states contain about 10% of the labor force, but 13% of the unemployed. The share of long-term unemployed in these states is 15%, quite close to their share of overall unemployment. This means that long-term unemployment is not disproportionately concentrated in high-unemployment states. Indeed, if you provided extended unemployment benefits only to these high-unemployment states, 85% of the long-term unemployed would not benefit.

The bottom of Table 3 shows the 24 states with the lowest unemployment rates. These states constitute 53% of the labor market, and 47% of the unemployed. Among the long-term unemployed, 46% are in these lower-unemployment states. In short, concentrating extended benefits only on high unemployment states will not help the vast majority of long-term unemployed, who are present in all states. If we were to focus extended benefits on a small group of high unemployment states, we would be denying assistance to the majority of the long-term unemployed.

Table 3

National Labor Force and Unemployment Shares Grouped by State Unemployment Levels, 2007

	Share of Labor Force (percent)	Share of Unemployed (percent)	Share of Long-term Unemployed (percent)
5 states with highest unemployment rates (5.6%<=UR<=7.2%)			
Michigan, Mississippi, Alaska, South Carolina, Ohio	9.7	13.1	15.0
5 states with second highest unemployment rates (5.0%<=UR<=5.5%)			
Kentucky, California, Arkansas, Oregon, Rhode Island	15.8	18.3	16.5
10 states with the next highest unemployment rates (4.6%<=UR<=5.0%)			
Missouri, Illinois, Wisconsin, Nevada, Tennessee, North Carolina, Maine, West Virginia, Minnesota, Connecticut	18.4	19.1	20.8
24 states with the lowest unemployment rates (2.6%<=UR<=4.5%)			
Washington, New York, Massachusetts, Indiana, Pennsylvania, Georgia, Texas, Oklahoma, New Jersey, Kansas, Florida, Vermont, Louisiana, Iowa, Colorado, Arizona, New Hampshire, Maryland, Alabama, Delaware, Virginia, South Dakota, Nebraska, Hawaii	52.9	47.4	46.3

Sources: Annual labor force and unemployment data by state published by the Department of Labor, Bureau of Labor Statistics, *Local Area Unemployment Statistics (LAUS).* Available at http://www.bls.gov/LAU/. Long-term unemployment data comes from an Economic Policy Institute (EPI) analysis of Current Population Survey data, Economic Snapshots: "Extending unemployment benefits stimulates economic and helps workers." January 30, 2008. Available at http://www.epi.org/content.cfm/webfeatures_snapshots_20080130.

Notes: Long-term unemployment data available for 44 states only. Missing long-term unemployment data for Idaho, Utah, Wyoming, Montana, North Dakota, and New Mexico due to small sample size. National shares do not total to 100 as a result of these omissions.

Conclusions

Given all of these facts, now is the time to enact extended unemployment benefits. This will assist the long-term unemployed as they continue to search for work. The unusually high share of long-term unemployed workers at this relatively early stage in the economic slowdown is a warning sign; history suggests these numbers will grow as the recession affects more and more jobs. Waiting for the unemployment rate to rise higher before we act would be a mistake.

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