LABOR MARKET SLACK PERSISTED, BUT JUST HOW MUCH?

“We used to see a big glut of retirements for people around 60 years old, but with the challenged economic situation we found ourselves in, that 60 moved to about 62 years old. People have stayed longer.”

TOM FANNING, CEO, Southern Company, Atlanta, Georgia; an energy company serving, through its subsidiaries, 4.4 million customers in a 120,000-square-mile territory in the Southeast
Shifting labor force participation clouded unemployment picture

Although the labor force participation rate (LFPR) has trended down since early 2000 (when the LFPR was 67 percent), the recession exacerbated the decline (see the Labor Force Participation Rate chart). At the end of 2014, roughly 62.7 percent of the working age population was either employed or actively seeking work, the lowest level since the 1970s.

A key issue for Fed policymakers is how much of the decline is tied to the weak economy—because people have given up looking for work or have stayed longer in school, for instance—and how much is due to longer-term structural trends.

Atlanta Fed research suggests that about half of the decline since 2007 is due to demographic changes, especially the aging population. Weak employment prospects have also played a role. As a result, improving labor market conditions may lure discouraged workers from the sidelines, in turn putting upward pressure on labor force participation.

That may be happening already. The LFPR decreased only 0.1 percentage point in 2014, the smallest 12-month decline in six years.

Marginally attached workers a "shadow labor force"

About 2.2 million of those no longer in the labor force were considered “marginally attached” in the fourth quarter of 2014, meaning they wanted and were available to work but had not looked for a job in the most recent month.

People in this category are not counted among the unemployed, yet they are a “shadow labor force” of sorts because they tend to reenter the job market at relatively high rates. About 40 percent of the marginally attached in any given month join the official labor force in the subsequent month, according to Atlanta Fed research. Thus, there’s a strong argument for including at least a share of the marginally attached as unemployed, said Atlanta Fed President Dennis Lockhart in an early 2014 speech. “To get close to full employment... would involve substantial absorption of this ‘shadow labor force,’” he said.

Broader measures provide clues on full employment

As policymakers look for signs that the economy is nearing full employment, they have paid particular attention to a broader measure of unemployment, officially called the U-6, which counts marginally attached and involuntary part-time workers among the unemployed (see the Components of U-6 and the U-3 versus U-6 charts on page 22). At 11.6 percent in December, nearly double the official unemployment rate (U-3), this broad measure painted a picture of continued slack. A narrowing of the gap between the two rates would indicate that the supply of labor resources is tightening, moving the economy closer to full employment.
In addition to the headline unemployment rate, also known as U-3, there’s a broader statistic called U-6. U-6 incorporates people who are working part-time but want a full-time job.

Usually, U-3 and U-6 track each other, and so little is lost by focusing just on U-3. But the two statistics have diverged since the recession, as the number of people involuntarily working part-time has not declined as rapidly as the number of unemployed.

As monetary policymakers, we’re currently watching for U-3 and U-6 to fall and converge. This would indicate the economy is absorbing labor market slack. When the supply of labor resources is tighter, we are moving closer to the Fed’s goal of full employment.

John Robertson
Vice president and senior economist
Federal Reserve Bank of Atlanta
**Labor Force Participation Rate**
The Percent of people working or seeking work continued a long-term decline.

Note: Shaded areas indicate recession.

**U-3 Versus U-6**
The broader measure of unemployment indicated persistent labor market slack.

Components of U-6
People working part-time for economic reasons made up a large share of the U-6 unemployment rate.

Note: Shaded areas indicate recession.
Sources: Board of Governors of the Federal Reserve System