CRS INSIGHT

How Much Slack Remains in the Labor Market?

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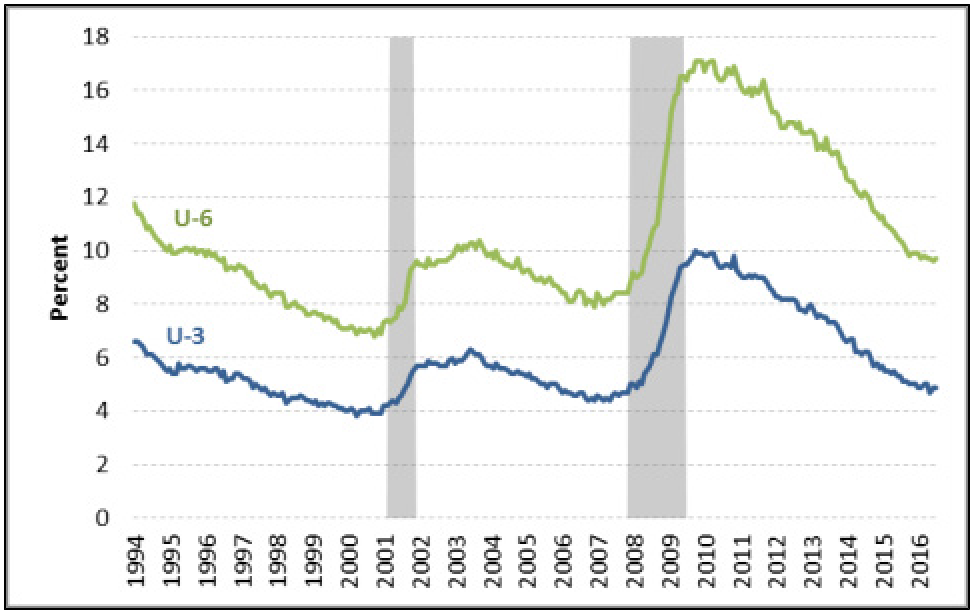
The amount of "slack" in the labor market—jobless or underemployed workers—has consequences for the appropriate stance of monetary policy, the future path of the budget deficit, and counter-cyclical spending on programs such as unemployment insurance. Economists use several indicators to assess the state of the labor market. The official unemployment rate—specifically the Bureau of Labor Statistics (BLS) U-3 rate—is a familiar and commonly reported statistic that currently indicates there is little slack in the labor market. The unemployment rate has been 5% or lower since October 2015, and a recent *Wall Street Journal* survey of economists shows most economists do not expect it to fall much further. For example, it never dipped below 4.4% in the 2001-2007 expansion and the Federal Reserve estimates a long-term unemployment rate of between 4.6% and 5.0%. Other measures seem to indicate that more slack remains in the labor market, a point that Federal Reserve Chair Janet Yellen recently made during her testimony to the Senate Committee on Banking, Housing and Urban Affairs. To illustrate, this *Insight* compares the unemployment rate to one broader measure of labor market slack, the BLS U-6 rate (see **Figure 1**).

Figure 1. Two Measures of Labor Market Slack, 1994-2016



Source: Bureau of Labor Statistics (BLS).

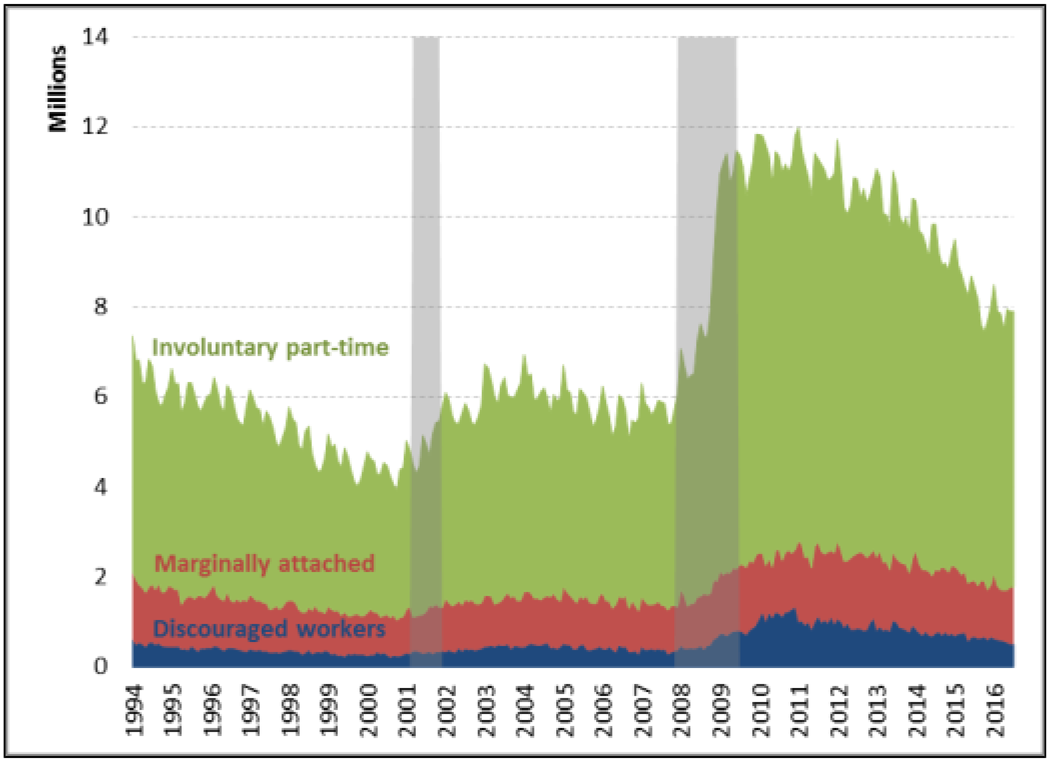
Note: Grey bars denote recessions.

U-3 vs. U-6

An explanation of how U-3 and U-6 define labor market slack differently helps illuminate the recent disconnect between the two. Under U-3, individuals are considered officially unemployed if they satisfy three criteria: (1) they do not have a job, (2) they have actively looked for work in the previous four weeks, and (3) they are currently available to work. Individuals are considered employed if they worked for pay or profit in the previous week. Thus, the U-3 is a relatively narrow measure of joblessness, as it is limited to those actively seeking work.

To derive U-6, BLS includes workers who are discouraged, otherwise marginally attached to the labor force, and individuals involuntarily working part-time, in addition to the unemployed as defined under U-3. The number of individuals included in these three additional groups is plotted over time in **Figure 2**. BLS defines marginally attached workers as workers who "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 past 12 months." Discouraged workers are marginally attached workers who "have given a job-market related reason for not currently looking for work." Involuntary part-time workers "want and are available for full-time work but have had to settle for a part-time schedule." All three of these groups are still at elevated levels compared to levels during the 1991-2001 and 2001-2007 expansions, as shown in **Figure 2**. When these three groups are added to the U-3 unemployed, the resulting U-6 measure is currently 9.7%

Figure 2. Components of U-6, 1994-2016



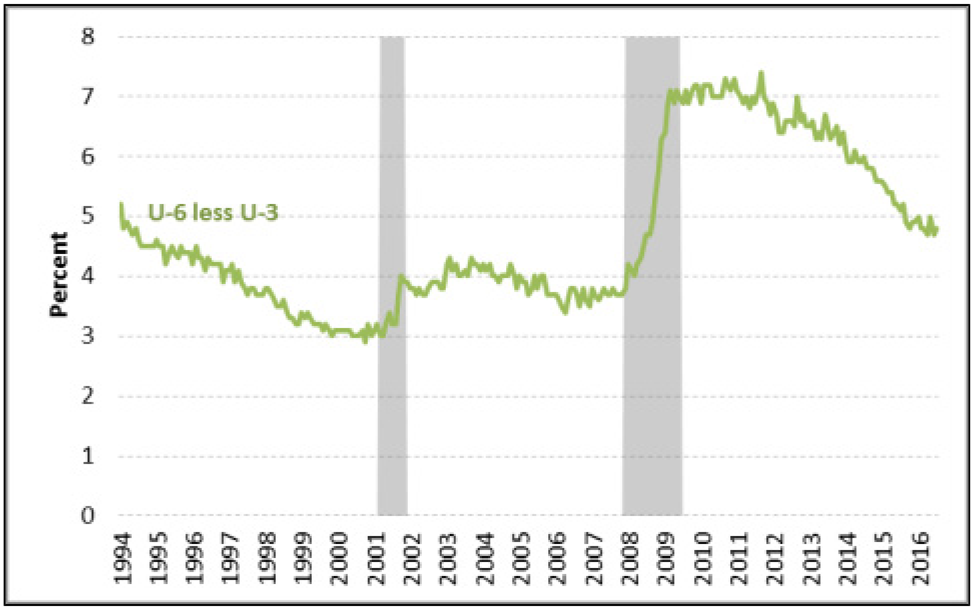
Source: BLS.

Notes: Grey bars denote recessions. Seasonally adjusted data are not available. Discouraged workers are a subset of workers marginally attached to the labor force. See text for details.

Slack by Which Measure?

To illustrate the potential disconnect between the official unemployment rate and the broader labor market, **Figure 3** plots the gap between U-3 and U-6. The gap reached an all-time high after the financial crisis, as U-6 increased even more than U-3. The gap has remained elevated after the recession ended because U-3 improved more rapidly than the other broader measures of slack shown in **Figure 2**. Since the end of 2011, the gap has narrowed, but is still greater than it was at any time between mid-1994 and the financial crisis. Whereas U-3 has decreased close to its level at the peak of the previous economic expansion, U-6 is still closer to the elevated level of slack that resulted shortly after the 2001 recession.

Figure 3. Unemployment Measure Gap, 1994-2016



Source: CRS calculations based on data from BLS.

Note: Grey bars denote recessions.

Which of these measures better captures remaining slack in the labor market is a recent topic of discussion. The unemployment rate is one of the most cited indicators because it is an intuitive and typically accurate proxy for the overall state of the labor market. However, the Great Recession may have disrupted the normal functioning of the labor market. Other labor market indicators, such as the long-term unemployment rate and the labor force participation rate, are more in line with the behavior of the U-6 than the U-3 in the current expansion. In contrast, because of methodological changes, U-6 is only available back to 1994. Unfortunately, this means that the data only cover one full business cycle, limiting researchers' abilities to make comparisons across previous business cycles, whereas U-3 data is available to 1948.

Finally, involuntary part-time employment could potentially be sending an ambiguous signal about the state of the labor market. As shown in **Figure 2**, involuntary part-time workers make up most of the difference between U-3 and U-6. Involuntary part-time workers could increase because of a strengthening labor market (if the part-time worker is transitioning from unemployment) or weakening labor market (if the worker is transitioning from full-time work). One study shows that the number of involuntary part-time workers has remained elevated in recent years because of workers transitioning from unemployment. Thus, involuntary part-time may currently be more of a lagging indicator of improving economic performance.

Although U-6 is still elevated relative to U-3, all of its components have been rapidly improving. Even if U-6 is not currently at full employment, at the current rate of improvement, it would return to its lowest level in the last expansion in about a year and a half. Thus, the economy may not be at full employment yet, but, on the current path, these indicators suggest it would reach it soon.