Economic and Market Insights

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Where have all the workers gone?

Despite the highest level of U.S. employment ever and nearly the lowest unemployment rate since 2007, economists at the Federal Reserve (Fed) remain perplexed over how demographics are changing and shaping our workforce, what constitutes full employment today versus years past, and how large the pool of the persistently (structurally) unemployed has become.

Are we nearing full employment, or are there still hidden pockets of lost or discouraged workers waiting to get back in the economy? Are there dislocated workers who are so mismatched with the modern economy that they will never realistically rejoin?

The question is not an esoteric one as the answers affect Fed policy impacting all of us -- the wealthy, the comfortable and the struggling. The answers impact whether or not the economy can jump into a higher gear, whether interest rates need to be raised as planned, or whether other policy decisions that could be affecting the shape of our workforce should be considered.

To make informed public policy, economic indicators need to adapt to the changing nature of today's labor force. As it stands, Fed Chair Janet Yellen relies on her dashboard of jobs data (e.g., Atlanta Fed wage tracker, U6 underemployment rate,* nonfarm payrolls, jobs opening, etc.) in most of her public policy statements. You can Google her list on any given day.

The Fed has said all along that it will be "data-dependent," meaning that it will use the economic metrics to prescribe whatever monetary policies are necessary to address its dual mandate of achieving both maximum sustainable employment and price stability. While the Fed has defined price stability as 2% long-term inflation, there is no consensus on what metric measures maximum sustainable employment.

As such, the last government labor report surprised on the upside with 227,000 new hires. Interestingly though, unemployment moved up one-tenth of 1% (from 4.7% to 4.8%) last month because dislocated workers who had given up looking for a job may have been drawn back into the economic workforce. This, in turn, tells us that there may still be some slack in the number of working-age people who want to be part of the paid labor force.

No one is certain how many people have temporarily disappeared from the labor force, if they are returning, or how big that pool might be.

Bloomberg Business recently spent some time chronicling anecdotal examples of who is *not* in the modern labor force, the so called structurally unemployed. The stories were grim for some who wanted to work, indicating society would be better off if the government could figure out how to help them transition back into today's workforce.

For example, deeply ingrained regional economic blight in pockets of the country (think rust belt, coal country, pockets of the South) can make it nearly impossible to find local employment, and moving away from family in those areas to cities is a challenge for laborers without resources.

And it's just not rural versus urban areas. Many are stuck in poverty pockets of major cities with no transportation to get to the suburban areas where entry-level jobs exist. Other potential workers on the edge include those with disabilities who are "softly" discriminated against, most all of the people who have an arrest record, and the growing proportion of people who can't pass an employment drug test. One way or another, they are excluded from mainstream jobs and unable to break their cycle of unemployment.

Statistically speaking, a fully employed economy helps bring some upward mobility to those on the fringe, and this cycle can lift standards of living across the board.

So the nature of full employment has to be understood and accounted for by the Fed. Relevant data may be particularly important now as the national immigration debate rages. Illegal immigration notwithstanding, astonishingly, half of the nation's current 0.8% population growth comes from outside our borders. The Census Bureau projects that over the next 30 years, much more than half of the nation's population increase will happen through immigration.

So what is the appropriate level of unemployment that doesn't spark material inflation? Is it lower than it used to be because an aging healthy workforce can work longer now than they used to (or maybe they simply need to)? Aren't there a lot of part-time workers who want full-time jobs who could help pick up the slack as the economy expands? Or is the natural rate of unemployment higher now because so many seem to be structurally unemployable and immigration policy may be changing?

The reason this is important to all of us is that there appears to be no appreciable inflationary pressure yet from wage increases in our slowly growing economy. But if the unemployment model is flawed, the Fed can't optimize policy, perhaps raising rates too soon to combat nonexistent inflation or, conversely, allowing employment to overheat, forcing the Fed to respond even more aggressively and cut short our economic expansion.

No matter where your politics are, you should be hoping that the U.S. economy isn't, in fact, already bumping up against its employment speed limit, and be rooting for policies that help grow our labor force and help those who are chronically unemployed get a job. As Bloomberg reported, if the economy had grown since the end of 2007 at the average pace it did from 1947 to 2007, it would be 22% bigger than it is today. That's a difference in annual

GDP of more than $4 trillion. And it will take a combination of business ingenuity, smart policy and additional workers to ever grow our economy like we used to.

* *U3 is the official unemployment rate. U5 includes discouraged workers and all other marginally attached workers. U6 adds on those workers who are part-time purely for economic reasons.*