Research Department
Federal Reserve
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San Francisco

November 18, 1983

FRBSF Weekly Letter

# Jobs and Unemployment

The latest recession, which lasted from July 1981 to last November, was the worst in the post-war period in terms of unemployment. The recovery, which began in December 1982, saw little change in the number of people employed for the first six months. Then, in June, 1.2 million people found jobs. It was an unprecedented monthly increase and a remarkable improvement, but because the unemployment rate edged down only slightly (from 10.1 percent in May to 10.0 percent in June), it went largely unnoticed. In contrast, July showed an employment gain half as large, but the unemployment rate plunged to 9.5 percent and wrote headlines around the country.

The events of June and July illustrate two points about the labor market. First, news of the job market focuses upon the unemployment rate, and tends to neglect what is actually happening to employment. Second, there is seldom a one-to-one correspondence between more jobs and a smaller unemployment rate. Last June, for instance, the unemployment rate hardly changed because the record increase in employment was almost matched by an increase in the labor force. In July, the size of the labor force remained the same and this allowed that month's increase in employment to show up as a sizable decrease in the unemployment rate.

We can expect further large increases in the labor force over the next year and a half although monthly changes are likely to be erratic. Some will come from the growing working-age population who are more willing than ever to work, as evidenced by the steady rise in the labor force participation rate. As well, there is a pool of workers now outside the labor force, called the labor reserve, who can be expected to enter the job market as conditions improve. As a result, many more jobs than are suggested by a count of the unemployed must be created to bring the unemployment rate down. This *Letter* will explain the composition of the potential work force, look at the magnitudes involved, and suggest when "full employment" may be achieved.

**Explaining the totals**

The 9.9 million unemployed in October of this year comprised 8.8 percent of the civilian labor force. The numbers come from the Department of Labor's monthly survey of a sample of 60,000 households. To be counted among the unemployed, a person must have looked for work in the month preceding the survey, although the form of the search may range from reading a want ad to participating in an actual job interview. A person is also unemployed if he has been temporarily laid off or is waiting to report to a new job within the month. Just over half the unemployed in October were between 25 and 54 years old, considered "prime-age" workers by labor market definitions, and about 60 percent of the unemployed were men.

To judge whether the unemployment in October was high in some sense one must have some benchmark for comparison. One such benchmark is the number of unemployed under so-called "full employment conditions." One definition of these conditions is when there is no pressure on the inflation rate. This definition takes into account that there will always be some people unemployed, such as those between jobs. The idea is that unemployment in excess of this minimum, frictional level eases wage and cost pressures and tends to keep the inflation rate down, while tight labor markets cause wage settlements to rise, which are then passed through in the form of higher price increases.

Most analysts believe that the unemployment rate consistent with stable inflation is between 6 and 7 percent. The midpoint of

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6.5 percent unemployment provides one rough estimate of full employment in today's economy. According to this concept of full employment, the unemployment rate of 8.8 percent in October is about 2.3 percentage points too high. This translates into about 2.6 million people who were cyclically unemployed in October because the economy had not recovered from the two back-to-back recessions that started in 1979.

**Labor reserve**

The unemployed compete for jobs with people from another group who are not counted as unemployed or as being in the labor force by the Department of Labor. We shall refer to this group as the labor reserve —people who move out of the job market or who postpone entry when work is hard to find. During a business recession, it is generally observed that the labor force grows more slowly than normal and, during some months, may actually decline as people leave the job market and become part of the labor reserve. Conversely, as economic conditions improve, people in the labor reserve resume or begin actively to seek jobs, which adds to the numbers in the labor force. At full employment, the labor reserve is depleted.

Although there is no official measure of the labor reserve, it may be estimated as the difference between the actual labor supply in any month or quarter and the labor supply that would exist if there were full employment at that time. Using this definition, it is estimated that the labor reserve averaged 1.8 million, during the second quarter of 1983. But as employment conditions improved during the third quarter about one half million in the labor reserve began or resumed actively searching for work. These half million represented 50 percent of the total increase in the labor force between the second and third quarter.

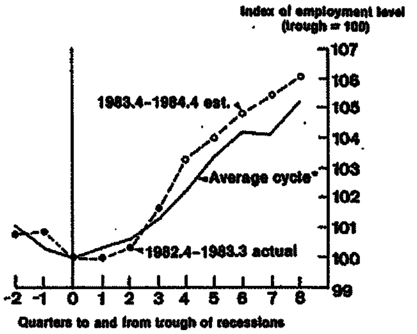
The Department of Labor does keep count of some of the people who are in the labor reserve, often referred to as "discouraged workers." These are people who want to work, but who have not looked for work during the past month or more because they believe no jobs are available for them. Because they have not actively searched for a job recently, the Department of Labor does not count them in the labor force. Some discouraged workers, however, have searched for work for extended periods, found no suitable employment and stopped looking. Others have not seriously looked, although they want a job, because they believe searching would be fruitless.

There were 1.6 million discouraged workers during the third quarter of this year. About half were prime age workers and most were women, although the gap between the sexes has been narrowing. Ten years ago, 30 percent of all discouraged workers were male but this increased to 40 percent this year. Young people, 16–24 years, are the next largest group and account for 30 percent of the discouraged.

While many discouraged workers will look for work when job opportunities arise, some are not likely to look for work under the best of labor market conditions. Thus, not all of the discouraged workers should be viewed as being in the labor reserve. Historically, when full employment has existed, as in the mid 1960s and late 1970s, a considerable number of discouraged workers did not actively search for work. Our research suggests that almost 800 thousand will be discouraged by job market prospects even under full employment conditions. This suggests that only the remaining 800 thousand of the 1.6 million discouraged workers that existed in the third quarter should be included in the labor reserve.

The other group in the labor reserve, numbering about one-half million currently, are those outside the labor force who contend at the time of the Department of Labor's survey that they do not want work and are not available for work, but who nevertheless jump

COMPARISON OF CYCLICAL EMPLOYMENT TRENDS




*Average of past five recessions. Trough quarters 1954.2, 1958.2, 1961.1, 1970.4, 1975.1.

into the job market when conditions improve. These people initially report that they are not interested in a job because of other responsibilities. Some, for example, keep house or are retired. It is not clear what changes their minds as economic conditions improve. One possible explanation is that an increasing number of employment opportunities decreases the out-of-pocket costs of job hunting and may thereby entice entry into the market.

**Population and participation**

Not only will the cyclically unemployed and the labor reserve seek jobs in the near future, but jobs will also be needed for an increasing number of people simply because the working age population is increasing and the percentage of this population entering the labor force (the participation rate) is rising. During the 1960s, the working age population increased an average 2 million each year, and, during the 1970s, close to 3 million a year as the post-war baby boom reached working age. Growth has slowed substantially in the 1980s because of the subsequent decline in the number of teenagers, but the working population should increase about 2 million in both 1983 and 1984 according to the Census Bureau.

Both the increase in the working age population and the willingness of the population to work affect the size of the labor force. The labor force participation rate averaged close to 59 percent from the late 1940s through the mid-1960s. After that the participation rate began to move upward as an increasing percentage of women entered the labor force. According to our estimates, it will average 64 percent and 64.4 percent, in 1983 and 1984, respectively.

As a result of both the upward trend in the labor force participation rate and in the growth of the working age population, the labor supply should increase about 2.0 million between October and the end of next year.

**How many jobs?**

To these 2.0 million people, we must add the current size of the labor reserve and the number of cyclically unemployed. According to the estimates made above, the labor reserve is 1.3 million people, about 800,000 of whom are discouraged workers and 500,000 people who now contend they they do not want work but who will actively seek work when economic conditions improve. The cyclically unemployed now total 2.6 million. The sum, 5.9 million, are the jobs needed by the end of 1984 if the labor force is to be fully employed.

To supply that many jobs by the end of next year requires an annual growth rate of about 8 percent in our inflation-adjusted or *real* Gross National Product. However, most forecasters believe that this rate of growth is unlikely and instead are estimating real growth closer to 5 percent. Although substantial for the second year of a recovery, this growth rate will not bring the unemployment rate down to the 6.5 percent required for full employment. More likely, the unemployment rate will average between 7.5 percent and 8.0 percent by the fourth quarter of 1984.

This means that between the third quarter of this year and the end of next, about 3.5 million people will find jobs. This represents a larger increase in employment than is average for post-war recoveries. But despite this, the cyclically unemployed will total about 1.5 million by the end of next year and the labor reserve, about 1.0 million. If the growth of real GNP continues at 5 percent, it will probably not be until late 1985 to mid-1986 before full employment, in the sense we have used it here, will be achieved.

**Rose McElhattan**

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## BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

| Selected Assets and Liabilities Large Commercial Banks | Amount Outstanding 11/2/83 | Change from 11/26/83 | Change from year ago Dollar | Change from year ago Percent |
|---|---|---|---|---|
| Loans (gross, adjusted) and investments* | 163,350 | 1,044 | 1,089 | 0.7 |
| Loans (gross, adjusted) — total# | 143,273 | 1,013 | 1,461 | 1.0 |
| Commercial and industrial | 43,795 | 582 | − 1,633 | − 3.6 |
| Real estate | 57,390 | 39 | 103 | 0.2 |
| Loans to individuals | 24,972 | 37 | 1,551 | 6.6 |
| Securities loans | 3,041 | 251 | 761 | 33.4 |
| U.S. Treasury securities* | 7,592 | 55 | 932 | 14.0 |
| Other securities* | 12,484 | − 24 | − 1,304 | − 9.5 |
| Demand deposits — total# | 43,191 | 2,857 | 1,032 | 2.4 |
| Demand deposits — adjusted | 29,156 | 457 | 448 | 1.6 |
| Savings deposits — total† | 66,232 | 405 | 33,578 | 102.8 |
| Time deposits — total# | 68,671 | 196 | − 32,213 | − 31.9 |
| Individuals, part. & corp. | 63,141 | 315 | − 27,452 | − 30.3 |
| (Large negotiable CD's) | 16,890 | − 88 | − 20,711 | − 55.1 |

| Weekly Averages of Daily Figures | Week ended 8/31/83 | Week ended 8/24/83 | Comparable year-ago period |
|---|---|---|---|
| **Member Bank Reserve Position** | | | |
| Excess Reserves (+)/Deficiency (−) | 94 | 64 | 81 |
| Borrowings | 7 | 16 | 39 |
| Net free reserves (+)/Net borrowed(−) | 87 | 48 | 42 |

* Excludes trading account securities.
# Includes items not shown separately.
† Includes Money Market Deposit Accounts, Super-NOW accounts, and NOW accounts.

**Editorial comments may be addressed to the editor (Gregory Tong) or to the author . . . . Free copies of this and other Federal Reserve publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 974-2246.**