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The labor market...

Some years ago, when I was a younger (and slimmer) economist, I spent a year on the staff of the President's Council of Economic Advisors in Washington. One of my most exciting duties was to go to the Labor Department the day before the unemployment rate was released and bring the data back to the Council offices so we could provide interpretation for the White House. I was always awed by the fact that for a few hours, at least, I was one of a handful of people who knew this was very important information. And I worried that I would lose the report on my way back and cause some sort of major incident, but these secrets were safe with me.

Even today, the monthly labor data still gets more attention than any other economic indicators. Financial markets wait anxiously for the information to appear at exactly 8:30 a.m., usually on the first Friday of the month. Depending on the outcome, the values of stocks and bonds can change dramatically as markets try to second guess how the Federal Reserve will respond. This information will likely become even more important if, as many believe, unemployment will soon start rising as economic growth slows in the wake of higher interest rates and higher energy costs.

The labor market data are derived from two separate government surveys. The unemployment rate comes from a huge monthly poll of some 60,000 U.S. households. Interviewers ask over the phone and in person whether members of the household worked in the preceding month. If so, then they are counted as employed. If they didn't, but were available for work and looked for work, they are counted as unemployed. The survey yields a wealth of demographic data on labor market status by age, sex, race and geographic location.

It is a common mistake to think that people have to be collecting unemployment insurance to be counted unemployed. They simply have to be looking for work. For example, recent college grads and people re-entering the workforce would not normally be eligible for unemployment insurance, but they would be counted as unemployed if they searched. About 2.5 million people are currently collecting unemployment insurance compared to the 7.1 million individuals counted as unemployed in the household survey.

The monthly survey of 160,000 hiring establishments is commonly referred to as the payroll survey. It asks businesses, nonprofits and governments how many people they had on the payroll during the middle of the previous month. This is the source of the familiar headline that goes something like "Jobs rose (fell) by 175,000 last month." The survey also yields information on average hourly earnings, the workweek and the distribution of jobs by industry.

As seen in the table, the two surveys produce two different measures of employment. Normally, the establishment or payroll survey is viewed as the better source of month to month and even year to year jobs growth. The household survey tally is larger because it includes the self-employed as well as farm workers. A person holding down two jobs would be counted once in the household survey but twice in the payroll survey.

So far, the labor market data shows that the economy has slowed somewhat in recent months, but conditions are still pretty good. At 4.7%, the unemployment rate is close to what most economists would consider to be "full employment" (more about this below). The

Musings & Amusings

Sam Goldwyn was a famous movie producer (the G in MGM) with a real knack for malaprops.

"An oral agreement isn't worth the paper it is written on."

"Anybody who goes to see a psychiatrist ought to have his head examined."

"We're overpaying him but he's worth it."

growth of payroll jobs has slowed recently to about 120,000 per month compared to 165,000 last year. Wage gains have been gaining momentum.

A recent poll of economists (myself included) by the Wall Street Journal forecasts payroll job gains of 115,000 per month during the coming year. The unemployment rate is projected to rise slightly to 4.9%. Because of new entrants into the labor force looking for work, jobs need to grow somewhere around 140,000-150,000 per month to keep the unemployment rate from rising.

U.S. LABOR MARKET: AUGUST 2006

HOUSHOLD SURVEY	
CIVILIAN LABOR FORCE (MIL.)	151.7
EMPLOYED	144.6
UNEMPLOYED	7.1
UNEMPLOYMENT RATE (%)	4.7
ESTABLISHMENT SURVEY	
NONFARM JOBS (MIL.)	135.5
AVERAGE HOURLY EARNINGS	$16.79

REGIONAL LABOR MARKET: AUGUST 2006

	JOBS GROWTH* % CH	UNEMPLOYMENT RATE %
CONNECTICUT	0.5	4.5
MASSACHUSETTS	0.9	4.9
NEW YORK	0.9	4.7
RHODE ISLAND	0.3	5.6
UNITED STATES	1.3	4.7

*from August 2005

Source: U.S. Bureau of Labor Statistics

There are some who claim that the reported unemployment rate substantially understates actual unemployment. They point, for example, to the 450,000 "discouraged workers" who want work but aren't looking because they don't believe any is available. They also cite the 4 million persons who are working part-time for "economic reasons" because their hours have been cut back or they can't find full-time work.

While these are valid concerns, they are offset elsewhere. For example, the household survey doesn't ask about intensity of job search. Hence, the fellow who glances at the help-wanted ads on his way to the sports page is counted just as much as that diligent person in the outplacement office who spends every waking hour networking and circulating resumes. Practically all experts agree that the surveys do a very good job in measuring changes in labor market conditions.

So what is full employment? Back in the 1960s, most economists believed that there was a more or less permanent tradeoff between inflation and unemployment. This was the so-called "Phillips Curved" view of the world named after the British economist who first charted the relationship. You could have lower unemployment but at the price of higher inflation. It was up to policy makers, such as the folks at the Federal Reserve, to pick the right combination.

The stagflation of the 1970s, where we had more inflation and more unemployment, discredited the tradeoff view. Now most economists believe in something inelegantly called the NAIRU, which stands for the non-inflationary rate of unemployment. If the jobless rate goes below NAIRU, inflation will accelerate more and more. It won't go to a higher rate and stay there. If unemployment goes above, inflation will slow down. NAIRU is what most economists mean by full employment.

NAIRU is easier to describe than to quantify. Part of the problem is that it can shift over time. If large numbers of teenagers are entering the workforce, unemployment will be bloated. If labor market policies and practices match workers with jobs more quickly, then NAIRU can fall.

The Federal Reserve has a "dual mandate" from Congress to maintain price stability and promote maximum sustainable employment. Mr. Bernanke is more likely to be explicit about the long-term inflation target, which most experts put in the 1-2% range, than about what constitutes full employment. My guess is that -- if the forecasts are right -- he'll be grilled about jobs and rising unemployment when he makes his next scheduled Congressional appearance in February to talk about the economy.

Regional labor market data are closely related to the national numbers. Since the household survey is not large enough to provide reliable monthly estimates for most states and areas, the survey results are supplemented by other information, such as new applications for unemployment insurance. Regional jobs data are based primarily on employer filings with the state unemployment insurance programs. Every year, the findings from the national payroll survey are reconciled with those from the state unemployment compensation programs in a process known as "benchmarking."

Jobs in southern New England and New York have been growing less rapidly than the nation as a whole. And with the exception of Connecticut, unemployment is at or above the national average.

However, there are some important differences across these states. Job gains have slowed in Connecticut and Rhode Island but picked up somewhat in Massachusetts. On the other hand, Massachusetts has only recovered about 20% of the jobs it lost several years ago during the recession compared with 50% in Connecticut and 70% in New York. Like the United States, Rhode Island has gotten back all the jobs it lost and then some.

By industry, there are marked contrasts across the states. Construction employment is falling in Connecticut, rising rapidly in Rhode Island and slowing (but still growing) in Massachusetts and New York. Financial services jobs are growing fast in Rhode Island and more moderately in the other three states. I'll cover the regional outlook in a future issue of this publication.

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