

Underemployment Poses Long-Term Financial Risk to More Workers

By Anil Kumar and Michael Weiss

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In the aftermath of the Great Recession, a significant portion of the potential labor pool remains largely unnoticed. The underemployed and the discouraged—those who have given up trying to find work—are additional indicators of labor dislocation. These are individuals whose diminishing skills and reduced earning capacity may linger well into the recovery.

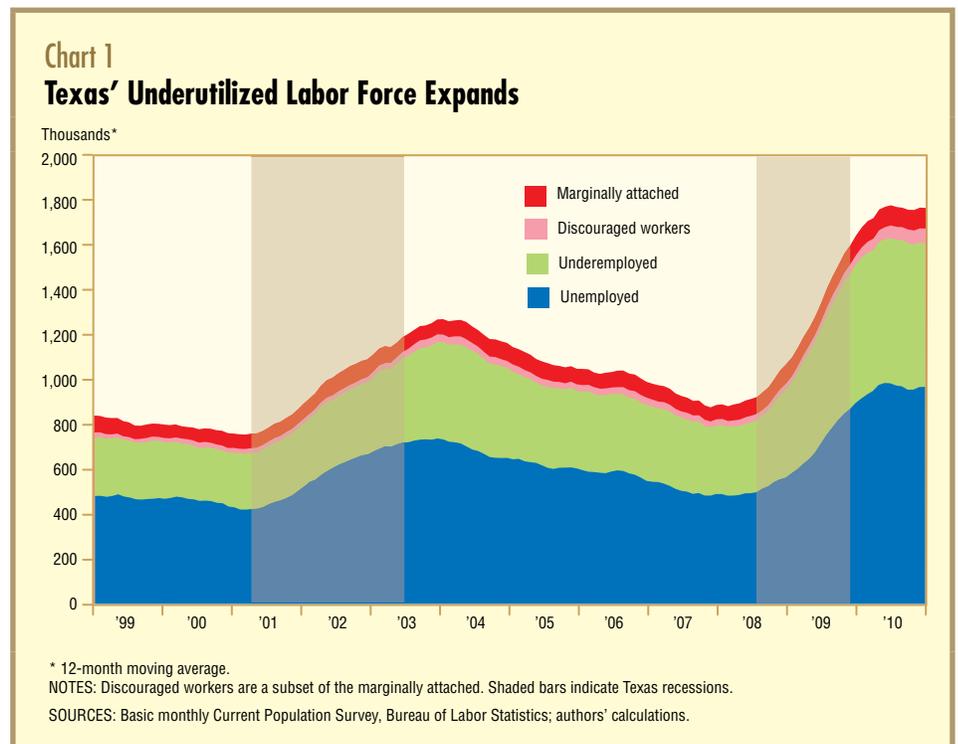
For every five unemployed Texans last December, four others either were underemployed (working 35 hours or less while reporting they sought full-time jobs) or had sought work but quit looking, according to the Bureau of Labor Statistics' (BLS) Current Population Survey (*Chart 1*).

Nationally, the underemployment rate, which varied considerably across states, averaged 6.4 percent for 2010, with unemploy-

ment accounting for another 9.6 percent.¹

Texas, with a 5.7 percent underemployment rate, fared better than the nation and most other states, including the traditional Sunbelt growth states—Georgia, Florida and Arizona. The latter two were especially hard-hit by the residential building bust, a lesser factor in Texas.

If wages were completely flexible and labor markets perfect, unemployment and underemployment would be largely transitory and low: When the number of willing workers exceeded the number of jobs, wages would fall, reducing labor costs and making it profitable for companies to hire. Yet, many imperfections can keep wages from adjusting freely, and unemployment and underemployment can rise, particularly during economic downturns.



Underscoring recent market slack, the top-line unemployment rate for the nation reached a postwar high of 10.1 percent in October 2009. Nationally, the jobless rate rose nearly twice as much in 2009 as predicted by Okun's law, which links rising unemployment with falling national output. Such performance is indicative of highly disproportionate job loss relative to the decline in economic activity.²

Underemployment Counts

To fully capture labor force slack, the BLS constructs six measures of underutilization. The broadest includes the unemployed, the underemployed and those the Labor Department categorizes as marginally attached—people who unsuccessfully sought work at some point in the past 12 months but not in the past four weeks. Together, they totaled 14.4 percent of the combined total Texas civilian workforce and marginally attached in 2010. That compared with 22.1 percent of such workers in California, 23.6 percent in Nevada and a U.S. average of 16.7 percent. In 2006, as the economy boomed before the recession, Texas underemployment averaged 2.9 percent, with a total of 8.6 percent including the unemployed and marginally attached.

“Discouraged workers” are a subset of the marginally attached. These are people out of the labor force because no employ-

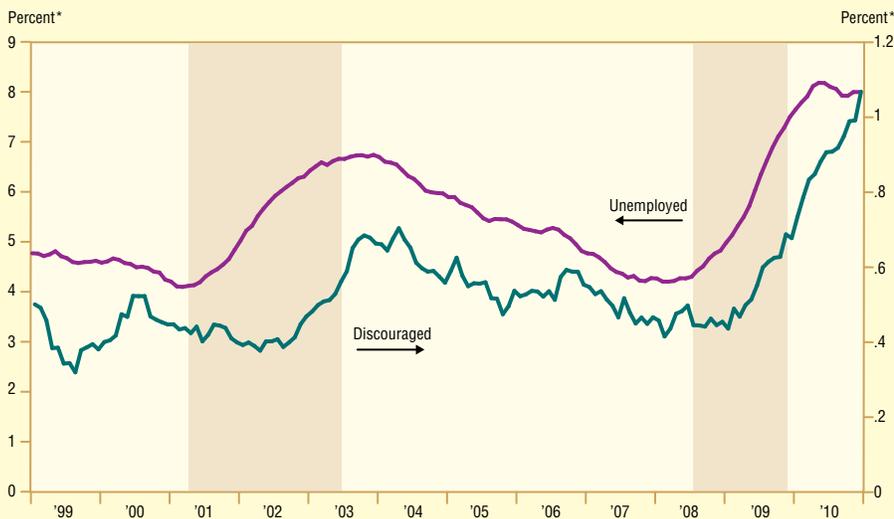
ment is available, they couldn't find work or they have given up, perhaps because they think they are too young or too old or sense some other form of discrimination. Of the Texans marginally attached as of December, about 45 percent (on a non-seasonally adjusted basis) were discouraged workers, compared with more than 50 percent nationally.

Even as unemployment shows signs of easing, the upward trend of discouraged workers, as a percentage of the Texas labor force, remains little changed, pointing to a still-nascent recovery (*Chart 2*). However, compared with the nation, Texas retains an advantage in all measures of labor force underutilization (*Chart 3*).

This labor force underutilization occurred in tandem with the historic rise in long-term unemployment as people, off the job for more than six months, stopped looking for work and became marginally attached or settled for part-time work as a stopgap, adding to the ranks of the underemployed. The persistence of unemployment is reflected in the average number of weeks that the jobless are out of work. The national figure, compiled since 1948, stood at a seasonally adjusted 36.9 weeks in January, a record. That is more than 50 percent greater than the next-highest, 20.8 weeks in June 1983 following the recession of the early 1980s.

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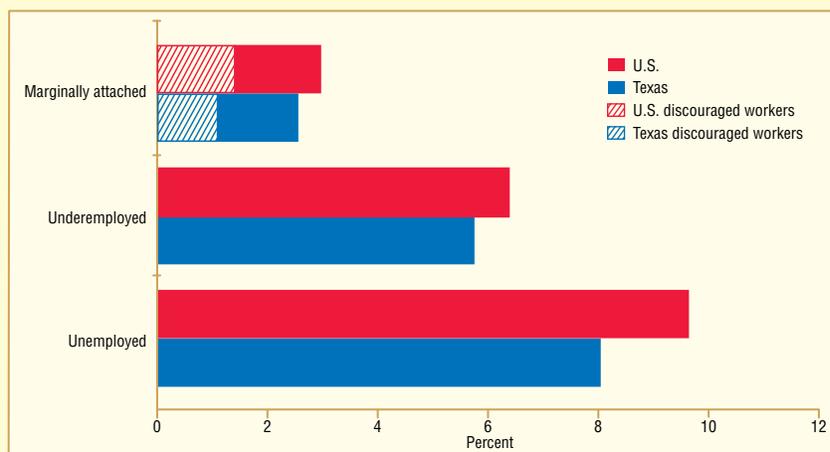
Chart 2
Joblessness Eases in Texas, but Ranks of Discouraged Workers Continue to Rise During Recovery



* 12-month moving average.
 NOTE: Shaded bars indicate Texas recessions.
 SOURCES: Basic monthly Current Population Survey, Bureau of Labor Statistics; authors' calculations.

The negative association between underemployment and the subsequent year's earnings is more pronounced for workers with a college degree than for those who dropped out of high school.

Chart 3
Underutilized Labor Force: Texas vs. U.S.
 (Annual average 2010)



NOTE: Percent marginally attached is inclusive of discouraged workers.
 SOURCES: Basic monthly Current Population Survey, Bureau of Labor Statistics; authors' calculations.

Lowered Earnings

To be sure, joblessness and underemployment are an integral part of labor market reallocation, as firms and workers each seek an optimal situation. Some unemployment can exist while workers canvass the marketplace to determine for whom they want to work. Short periods of unemployment can enhance economic efficiency if, in the process, poor matches between firms and workers are replaced by better ones. This frictional unemployment is distinct from cyclical unemployment, which is largely involuntary and often results in future earnings losses.

A negative correlation between underemployment and future earnings is evident when annual average real weekly earnings—obtained from the monthly Current Population Survey for the U.S. for 1998 through 2010—are plotted against the incidence of job loss and underemployment among groups defined by age, race, sex and year (*Chart 4*).

The negative association between underemployment and the subsequent year's earnings is more pronounced for workers with a college degree (seen in the steeper downward line) than for those who dropped out of high school. A similar relationship holds for older workers (55+ years), suggesting that these groups suffer the greatest job quality deterioration.

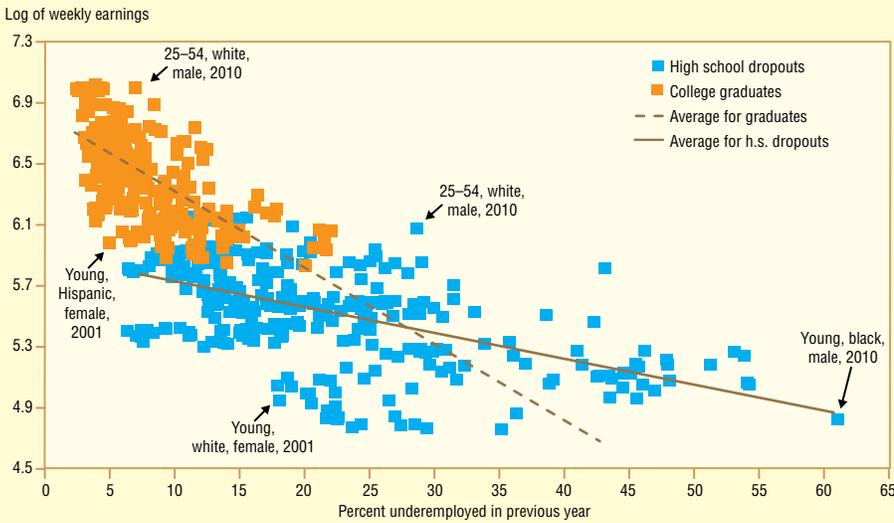
Erosion of earnings and job quality, particularly among the highly educated and

older workers, is not surprising. Employed workers accumulate two types of skills—general skills applicable at a variety of jobs and nontransferable company-specific proficiencies accumulated through experience and training. Older workers accrue more firm-specific skills due to longer tenure. The highly educated have lower turnover and benefit the most from on-the-job training, as education and training are often complementary.³

Firm-specific skills become largely obsolete when workers join a new company. Even more-widely applicable skills erode significantly if workers are long-term unemployed. Although much of the earnings lost due to joblessness can be recouped following reemployment, longer duration unemployment can produce a persistent income drag. Research indicates an immediate 30 to 40 percent earnings decline that is only partially recouped with a new job. After six years back on the job, workers still confront a 10 to 15 percent earnings reduction.⁴

With one in five jobs held by people over age 55, up from one in seven 30 years ago, the baby boom, post-World War II demographic bulge is particularly at risk of earnings losses. Younger workers, by comparison, are likely to leave the workforce, returning to school for additional training. However, they may also suffer a long-term earnings loss. One study found that college graduates entering the workforce during a recession, and thus more likely facing

Chart 4 Underemployment Particularly Depresses Future Earnings of College Graduates



NOTE: Each box represents a particular demographic group in a given year. Specific examples are labeled.

SOURCES: Basic monthly Current Population Survey (1998–2010), Bureau of Labor Statistics; authors' calculations.

underemployment, earned 2.5 percent less than they otherwise would 15 years after starting on the job. This suggests that “workers who graduate in bad economies are unable to fully shift into better jobs after the economy picks up.”⁵ Often, the newest graduates with the latest skills obtain employment ahead of those who finished school earlier and haven’t found full-time work.

Choosing Underemployment

With underemployment and unemployment potentially costly, policymakers might want to get workers back to work as soon as possible. However, while unemployment compensation helps maintain income, it also discourages a return to work.⁶ Last December, President Obama signed a reauthorization of federal unemployment extension benefits, providing 13 additional months, to a maximum of 99 weeks of payments. A Chicago Fed study suggests that extended jobless benefits added close to 1 percentage point to the national unemployment rate.⁷ While the U.S. relied primarily on the fiscal stimulus and jobless benefits to protect workers during the recession, other countries followed different approaches.

One example is Germany’s “Kurzarbeit” short-time work program. Although many factors may have shielded the German labor market during the recession, the short-time work plan is widely believed to have played a role. It encourages firms to lower

their labor costs by reducing total hours instead of cutting jobs. So while the German gross domestic product shrank 2 percentage points more than that of the U.S. from peak to trough in the Great Recession, Germany’s unemployment rate remained largely flat.

The plan, in effect, promotes underemployment over unemployment by spreading the downturn’s impact on hours and earnings across many workers rather than a few. Under the program, the government replaces 60 to 67 percent of lost earnings of the underemployed and reimburses half of the firm’s public pension contribution due to lost hours. By keeping workers employed, the plan limits skill deterioration during the downturn and helps firms expand quickly during the recovery. On the other hand, Kurzarbeit interferes with labor market reallocation and may be inefficient in the long run.⁸

Slack in the Workforce

The number of people engaged in involuntary part-time employment or who have sustained a reduction in the terms of employment—mandatory unpaid time off, demotion, reduced pay and benefits—is characteristic of the economic downturn from which the country is slowly emerging. Longer-term implications include worker obsolescence that may slow economic growth as employers search for properly skilled individuals. Moreover, such labor slack in the economy, as evidenced by still relatively high unemployment

and underemployment rates regionally and nationally, helps account for a lingering economic malaise and pessimistic sentiment amid the slow pace of recovery.

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Notes

¹ 2010 is the last full year for which data are available; unless otherwise specified, all analysis in this article is restricted to 2010.

² Okun’s law states that for every 2 percent decline in GDP relative to long-term trend, the unemployment rate should increase by 1 percentage point. See “Okun’s Law and the Unemployment Surprise of 2009,” by Mary Daly and Bart Hobijn, *FRBSF Economic Letter*, Federal Reserve Bank of San Francisco, March 8, 2010.

³ “Education and Unemployment,” by Jacob Mincer, National Bureau of Economic Research, Working Paper no. 3838, September 1991.

⁴ “Earnings Losses of Displaced Workers Revisited,” by Kenneth A. Couch and Dana W. Placzek, *American Economic Review*, vol. 100, no. 1, 2010, pp. 572–89.

⁵ See “The Long-Term Labor Market Consequences of Graduating from College in a Bad Economy,” by Lisa B. Kahn, *Labour Economics*, vol. 17, no. 2, 2010, pp 303–16.

⁶ “Unemployment Insurance and Job Search Decisions,” by Dale T. Mortensen, *Industrial and Labor Relations Review*, vol. 30, no. 4, 1977, pp. 505–17.

⁷ “How Did Unemployment Insurance Extensions Affect the Unemployment Rate in 2008–10?,” by Bhash Mazumder, *Chicago Fed Letter*, Federal Reserve Bank of Chicago, April 2011.

⁸ For details, see “Short-Time Work: The German Answer to the Great Recession,” by Karl Brenke, Ulf Rinne and Klaus F. Zimmermann, IZA Discussion Paper no. 5780, Institute for the Study of Labor (IZA), June 2011.