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Hamilton Place Strategies

Jobs Preview 2012:
The Year of the Missing Worker

"You ought to be modeling how many people need to leave the workforce, not how many jobs need to be created."

That was a joke from someone who has been following the HPS projections of job creation needed to get below 8 percent unemployment by Election Day. Like most good jokes, it also happens to have a bit of truth to it.

Because of the significant declines in the labor force during this recovery, it will be exceedingly difficult for net job growth to get the unemployment rate below 8 percent by Election Day without an increase in the labor force pushing the unemployment rate back up.

There are currently over 3 million "missing" workers who should be participating in the labor force but are not actively seeking work.

This white paper explores the impact of labor force changes on the current employment situation and looks at how different scenarios of job growth and labor force growth could impact the unemployment rate on Election Day.

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The Role of Labor Force Participation in the Unemployment Rate

The size of the labor force makes a big difference in the unemployment rate, and labor force growth has been lagging estimates since the end of the recession – many people have either dropped out of the labor force, or have not entered in the first place. This has contributed significantly to the decline in the unemployment rate over time. (See Exhibit 1)

Exhibit 1

A LARGE FACTOR IN UNEMPLOYMENT DECLINE HAS BEEN A DROP IN LABOR FORCE PARTICIPATION
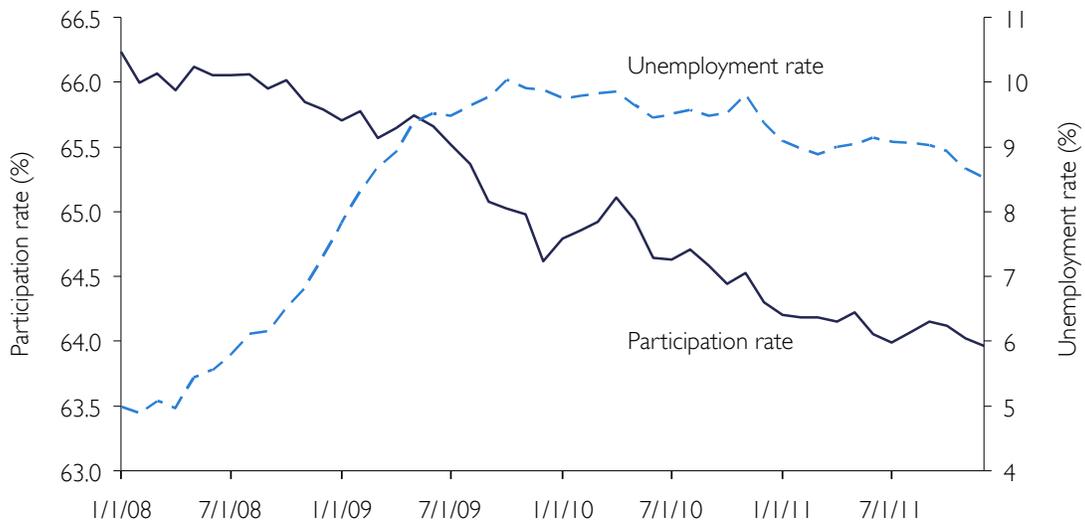
Source: BLS

To understand how participation impacts the unemployment rate, consider the basic math. The unemployment rate is a function of the number of people looking for work, and the total of those in the labor force:

$$Unemployment\ rate = \frac{Unemployed\ looking\ for\ work}{Labor\ force}$$

The labor force, in turn, is a subset of the eligible, working age population (defined as those 16 and over who are not institutionalized or in the military). It is helpful to think of it in terms of labor force participation:
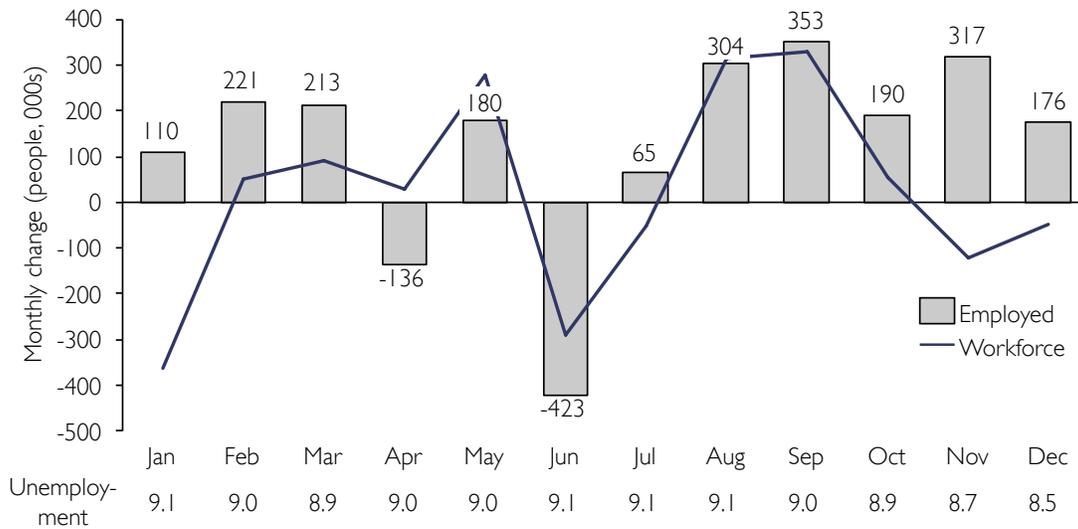
$$Labor\ force\ participation\ rate = \frac{Labor\ force}{Noninstitutional\ civilian\ population}$$

There are a couple of important aspects to these equations. First, the unemployment rate is not really a function of those who aren't working; it's a function of those who are actively looking for work and have not found it. Second, those who are unemployed but not looking for work are not captured in the unemployment rate, but are reflected in the labor force participation rate, which declines as people drop out of the workforce or choose not to pursue work at all. (See Exhibit 2)

Exhibit 2

UNEMPLOYMENT DROPS WHEN EMPLOYMENT CHANGE IS ABOVE WORKFORCE CHANGE

Household Survey (CPS)

|	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Unemploy-ment	9.1	9.0	8.9	9.0	9.0	9.1	9.1	9.1	9.0	8.9	8.7	8.5

Source: BLS

How is labor force participation looking today? At 64 percent, it is well below the peak of 67 percent during the dotcom bubble, and significantly below the steady state of 66 percent we saw during the 2000s. Given the Baby Boom retirement and other demographic shifts, CBO projections expected it to be declining – 65.3 percent at the beginning of 2012. We are now 1.3 percentage points below that demographic estimate, the equivalent of 3.2 million "missing" workers. If the "missing" people were in the labor force, the unemployment rate today would be 10.4 percent, not the current 8.5 percent. (See Exhibit 3)

Exhibit 3

GROWTH IN THE WORKFORCE HAS NOT KEPT PACE WITH PROJECTIONS OR POPULATION GROWTH
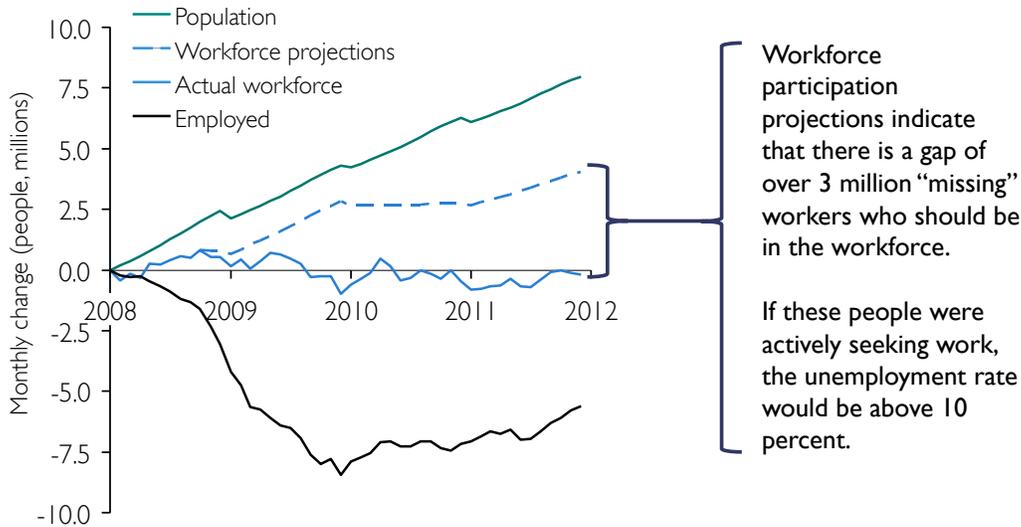
Source: BLS, CBO
Note: "work eligible population" is defined by BLS as "persons 16 years of age and older not in institutions or the military

Part of our modeling over the past year has been based on the number of workers projected to enter the labor force. CBO had estimated last spring that in 2011 and 2012, the labor force would expand by roughly 2.9 million workers. Instead, at the midpoint of that period, the labor force has expanded by less than 300,000.

We had assumed in our model that these workers might not all come into the labor force at once, but that in time those 2.9 million would eventually appear. As the job market has dragged on with incremental growth below what is needed to get people back to work, it has become less clear when the jobless will once again start to re-enter the labor force and look for work.

Scenarios for Unemployment on Election Day

Given the possibility that the labor force participation rate remains depressed relative to projections, we have expanded our jobs/election modeling to accommodate different scenarios of labor force growth. Instead of assuming one path to the forecasted trend for labor force participation, we have calculated the unemployment rate on Election Day under a range of labor force participation paths back to full participation. We have examined four basic scenarios for the coming year (See Exhibit 4):

Scenario 1: Continued decline – The participation rate continues the gradual decline we have seen over the previous year, with little growth in the labor force.

Scenario 2: Stabilization – The participation rate stabilizes at the current rate of 64 percent. Labor force growth picks up to keep pace with population growth.
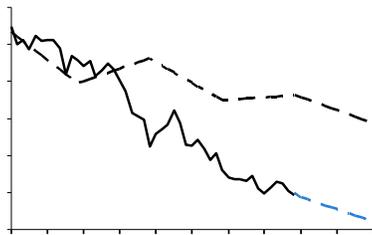
Scenario 3: Two-year return to trend – The participation rate rises back to trend over the coming two years as people reenter the labor force.

Scenario 4: One-year return to trend – The participation rate picks back up to trend over the next year as workers respond to stronger job growth.
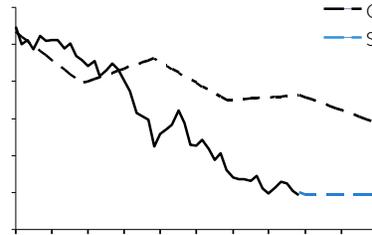
Exhibit 4

THERE ARE FOUR WORKFORCE PARTICIPATION SCENARIOS TO CONSIDER OVER THE YEAR
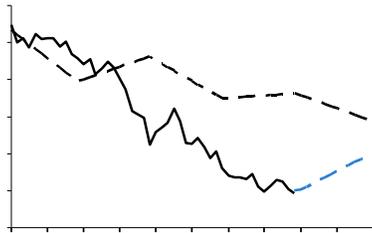
Scenario 1: Continued decline
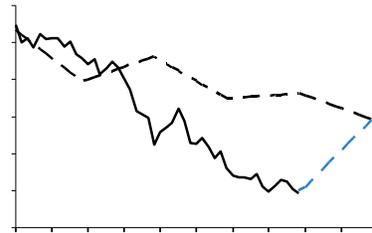
Scenario 2: Stabilization

— Actual participation
--- CBO projections
— Scenarios

Scenario 3: Two-year return to trend

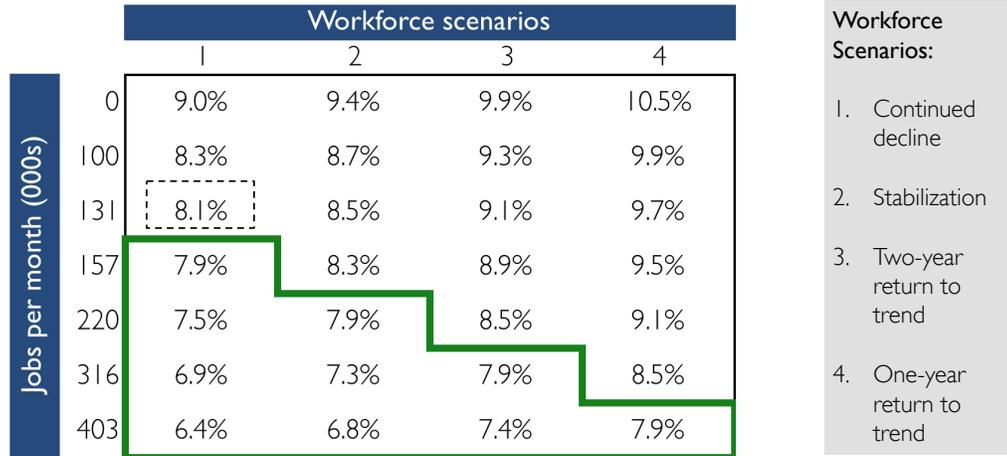Scenario 4: One-year return to trend

Source: BLS, CBO, HPS Insight

Using these four scenarios, we can get a sense of the dependency of the unemployment rate on the size of the workforce and determine the number of jobs needed to get below 8 percent by Election Day under each scenario. As the participation rate returns to trend, the jobs needed to get below 8 percent becomes that much higher (See Exhibit 5).

Exhibit 5

IF THE WORKFORCE RETURNS DURING 2012, MORE JOBS ARE NEEDED TO REDUCE UNEMPLOYMENT

Unemployment rate on Election Day under different scenarios

☐ 2011 trend

Jobs per month (000s)	Workforce scenarios				Workforce Scenarios:
	1	2	3	4	
0	9.0%	9.4%	9.9%	10.5%	1. Continued decline
100	8.3%	8.7%	9.3%	9.9%	
131	8.1%	8.5%	9.1%	9.7%	2. Stabilization
157	7.9%	8.3%	8.9%	9.5%	3. Two-year return to trend
220	7.5%	7.9%	8.5%	9.1%	
316	6.9%	7.3%	7.9%	8.5%	4. One-year return to trend
403	6.4%	6.8%	7.4%	7.9%	

Source: BLS, CBO, HPS Insight

Our modeling projects that if the trends of the past year continue (131,000 jobs per month, decline to 63.6 percent labor force participation), the unemployment rate on Election Day will be 8.1 percent.

As job creation increases and the unemployment rate declines, the participation rate should increase in response, moving us toward better workforce scenarios and increasing the number of jobs needed to get below 8 percent by Election Day. If we return to the historic pattern of labor force participation over the coming year, we would need 400,000 jobs per month to break 8 percent on Election Day.

Conclusion

This is the "no-win" situation the President faces as he begins his reelection campaign. Even as we have seen a marginal improvement in economic activity at the end of 2011, we have not yet seen a return of the "missing" labor force. As these workers return, there will be significant upward pressure on the unemployment rate.

While there is still time for economic growth to improve in 2012, it is our assessment that the large number of people waiting to reenter the workforce makes it is exceedingly unlikely that the unemployment rate will drop below the politically important 8 percent level by Election Day.

About Hamilton Place Strategies

This report was prepared by Matt McDonald, a partner at Hamilton Place Strategies and a veteran of two Presidential campaigns and the White House. Prior to joining HPS, Matt worked for McKinsey and Company. He holds an MBA from MIT's Sloan School of Management and a degree in economics from Dartmouth College.

Hamilton Place Strategies is a policy and communications consulting firm based in Washington. As a firm, our focus and expertise lie at the intersection of government, business and media. Our deep experiences on all of these dimensions allow us to serve industry leaders seeking to navigate the paths between Washington and the private sector.

HPS works with clients on a host of challenges, from crisis management and reputation building to policy analysis and business strategy. Our support includes outside advisory, as well as transformational work to directly improve client capabilities.

Our collective prior work entails decades of experience at the highest levels of government, business and communications, including work in Congress, the White House, the Treasury Department, Presidential campaigns as well as management consulting and law.

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