

# Economic SYNOPSES

short essays and reports on the economic issues of the day



2014 ■ Number 13

## Where Is the Slack in the Labor Market?

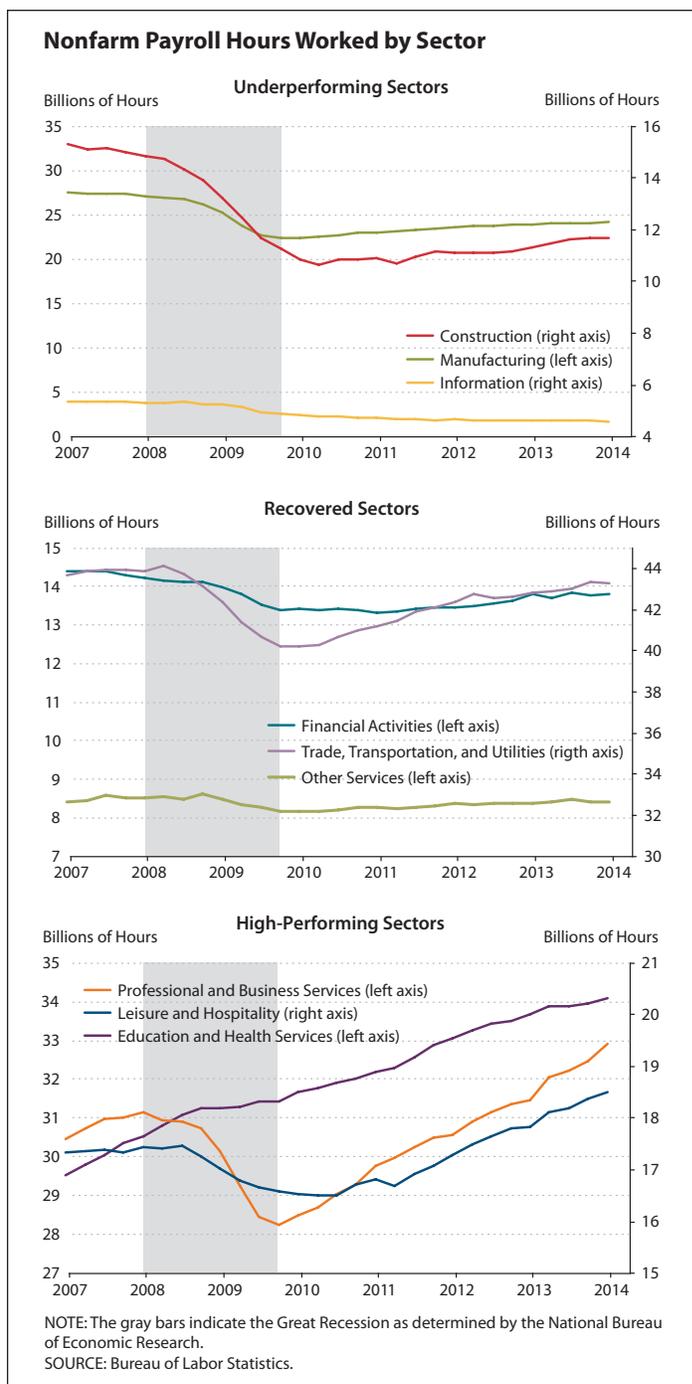
Carlos Garriga, *Research Officer and Economist*

The unemployment rate is perhaps the most common measure of slack in the labor market, but is only one of many such indicators. In a recent press conference, Federal Reserve Chair Janet Yellen cited nine different indicators to argue that considerable slack remains in the labor market and to justify continued Federal Reserve stimulus.

Quantifying the magnitude of the slack in the economy (idle resources, including labor) can be a challenge, which is why economists use a wide range of economic indicators for the task. These measures include the traditional notion of the output gap, capacity utilization, and various definitions of unemployment (i.e., short-term or cyclical). Each of these measures is generally reported as a percentage above or below the economy's full capacity—that is, its “potential” or “target” level of activity. A very simple alternative measure of slack in the labor market is aggregate nonfarm payroll hours worked as reported by the Bureau of Labor Statistics. This measure reports hours worked at the aggregate level and in different sectors of the economy, allowing for comparison of performance across sectors and time periods. For example, if a firm needs 40 hours' worth of labor input to complete a task, it can use multiple combinations of workers to supply those hours. This measure captures changes in the desired total number of hours, but not how the firm allocated its resources to accomplish the task.

**Current slack in the economy may be caused primarily by the construction sector.**

The three charts show hours worked for the largest sectors in the economy, grouped by performance relative to pre-Great Recession levels. These data provide insight into current sources of slack in the labor market. The Great Recession took a severe toll on total hours worked across all of these sectors. Excluding the education and health services sector, the decline has been much larger than in previous recessions. And while all of the sectors except



education and health services experienced declines, the recovery has been relatively uneven across sectors. Three sectors have not bounced back, but all of the others have either completely recovered or actually surpassed their pre-recession levels.

Hours worked for the three underperforming sectors—manufacturing, construction, and information—remain well below their pre-Great Recession levels. The decline in the manufacturing sector is particularly significant because the sector represents around 20 percent of gross output.<sup>1</sup> The decline in the information sector is substantially less relevant to the overall economy because the sector represents only about 5 percent of gross output and less than 2 percent of aggregate hours.<sup>2</sup> However, for both sectors, the Great Recession is only one episode in a secular downward trend that began around the turn of the century. From the first quarter of 2000 to the fourth quarter of 2007, aggregate hours worked dropped around 20 percent for each sector. The drop in the construction sector is more directly attributable to the recession. Unlike the manufacturing and information sectors, the construction sector, which represents about 5 percent of aggregate hours, had experienced a long upward trend prior to the Great Recession. During the recession, hours worked in construction fell far below trend and have not yet recovered, whereas hours worked in manufacturing and information have nearly recovered to their pre-recession downward-trend levels.

Despite the underperforming sectors, total hours worked for all sectors have nearly recovered to pre-Great Recession levels. Growth in other sectors has offset much of the decline. If there is some slack in the labor market, it is likely attributable to the performance of the construction sector and related activities. ■

## NOTES

<sup>1</sup> The manufacturing sector includes the mechanical, physical, or chemical transformation of materials, substances, or components into new products.

<sup>2</sup> The information sector includes the production and distribution of information and cultural products, data, or communications.