

## What the Unemployment Rate Really Measures

The unemployment rate is perhaps the most well known and most cited economic statistic. The most recent rate is frequently reported not only by business news outlets but by general news media of all types often within minutes of its release. Indeed, in some instances the level of the unemployment rate is used as a proxy for the health of the entire economy. The figure has a certain intuitive appeal: the percentage of the labor force that is unemployed. However, despite its widespread use the unemployment rate is not well understood by the general public. A better understanding of the rate and how it is calculated allows it to be placed in its proper context.

The U.S. Bureau of Labor Statistics (BLS), a federal agency within the Department of Commerce, reports the national unemployment rate each month along with unemployment rates for states, counties, cities, and certain metropolitan areas. An important aspect of the process to keep in mind is BLS conducts a survey each month, not a census, which would be cost- and time-prohibitive. The sample size the agency uses consists of about 60,000 households, which represents around 110,000 individuals, and the sample is designed to be representative of the U.S. population. In addition, a significant portion of the sample is maintained from month to month for consistency. The unemployment rate is calculated from the Bureau's estimates of the labor force and the total unemployed as follows:

$$\text{percent unemployed} = \frac{\text{total unemployed}}{\text{labor force}}$$

The key to understanding the unemployment rate is understanding how these components are determined by BLS.

The labor force equals the sum of those who are employed and those who are unemployed. What individuals are not in the labor force? First, no one under sixteen years of age is included in any type of employment calculations. Next, the labor force excludes the institutionalized population, which consists of those individuals residing in nursing homes and mental health facilities and individuals currently in prison. Active duty military personnel are not counted in the labor force, nor are full-time college students who are not working for pay. Finally, other individuals who are not working or seeking work for pay or profit are not included in the labor force. This group includes individuals such as stay-at-home parents and retirees. However, as long as an individual is at least sixteen years old, his or her age has no bearing on if he or she is counted in the labor force.

An individual is classified by BLS as employed if he or she worked for pay or profit during the week the agency conducted its survey. Obviously, full-time employees are included among the employed; however, BLS also counts part-time and temporary workers as employed. In addition, BLS considers as employed a group known as unpaid family workers. These are individuals who spent at least fifteen hours during the week of the survey working in a family-owned business without pay, such as a son at least sixteen years old working on a family farm. Thus, the definition of employed BLS uses as part of determining the unemployment rate is considerably more extensive than full-time employees or self-employed individuals.

BLS considers the unemployed as those individuals without a job who have looked for one in the past four weeks and are available to work. Looking for work involves an individual taking some action to obtain a job, such as completing an application, sending out a resume, contacting an employment center, etc. Individuals who have been temporarily laid off are considered unemployed regardless if they have looked for work in the last four weeks.

Thus, based on the information in the components, what is not included in the unemployment rate is likely as important as what is included. For example, an individual who has not looked for a job in more than four weeks at the time of the survey but who would like to have one is not considered unemployed nor is he or she counted as part of the labor force. If such an individual was previously counted as unemployed, removing him or her from both the ranks of the unemployed and the labor force (the numerator and denominator, respectively, in the above calculation) effectively lowers the unemployment rate. Similarly, underemployed individuals are not reflected in the unemployment rate calculation. An underemployed individual includes someone who would like to work full-time but can only find a part-time job. Another example of underemployment includes someone who performs a job he or she is overqualified for because he or she cannot find other employment, such as the extreme example of a doctor driving a taxi cab. In both of these cases, the underemployed individual is counted the same as all other employed individuals and the unemployment rate does not capture their status. Changes to the labor force can also affect the unemployment rate without changing the number of unemployed. For example, someone who retires or decides to go back to school full-time is removed from the labor force, which reduces the size of the denominator in the unemployment rate calculation, effectively lowering the rate. Therefore, as these examples demonstrate, the unemployment rate can change considerably from one month to the next without any actual change to the number of unemployed occurring.

In addition, BLS reports as many as six different unemployment rates; the official unemployment rate is known as the U-3 unemployment rate. BLS refers to the other five rates as “alternative measures of labor underutilization.” The U-1 and U-2 rates are more limited measures of unemployment while the U-4 through U-6 rates reflect broader classifications. These latter groups include the discouraged workers mentioned above who have given up looking for work, part-time workers, and “all persons marginally attached to the labor force.” A number of economists argue the U-4 to U-6 rates represent more accurate depictions of unemployment. While these alternative measures are available from BLS each month, the U-3 rate—the official unemployment rate—is almost always the only rate reported by news media.

In conclusion, while the unemployment rate is frequently reported and cited in the press, it is not well understood by most people. Moreover, knowledge that the rate changed without an understanding as to why it changed can result in misleading conclusions. The unemployment rate alone should not be used to estimate the health of the labor market, and never the condition of the economy as a whole. In order to understand the workings of the economy at a point in time, a collection of statistics should be considered in order to form a more complete picture.