OUTLOOK Economic Data and Commentary

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Causes and Challenges of 'Underemployment'

By many measures, the U.S. job market is trending in the right direction. Unemployment, while still at a historically high level of 6.3 percent, has declined by more than 1.5 percentage points over the past year and a half. And the economy has been generating an average of 214,000 new jobs per month since the beginning of 2014 – more than 10 percent higher than last year's average.

But political scientist William Galston looks beneath the surface and finds continued cause for alarm. Specifically, Galston worries about those who are "underemployed" – college graduates working as baristas or in other jobs where required skills aren't in line with their education.

Galston, a fellow at the left-leaning Brookings Institution who also writes regularly for *The Wall Street Journal*, formerly served as a policy advisor to U.S. President Bill Clinton. He recently spoke with *OUTLOOK* about underemployment and what it portends for the nation's economic and social fabric.

OUTLOOK: Why are you discouraged about the current state of the U.S. labor market?

William Galston: This has been a painfully slow economic recovery from the standpoint of employment. The post-recession rate of growth has been substantially lower than in virtually every recession since the end of the World War II, and so has the pace of job generation.

The May 2014 jobs report indicated that for the first time after the official end of the Great Recession in 2009, the number of employed Americans has finally reached and slightly exceeded the pre-recession peak. The period between the previous and the current peak – nearly six years – was about twice as long as it took to regain previous employment levels in any recession since the end of World War II.

But even that understates the difficulties of the labor market. Statistically speaking, median wages corrected for inflation have not risen at all since the recovery began. Even more alarming, the rate of labor force participation – people employed plus people looking for work as a share of the total

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population – has declined by an unprecedented amount. If people were still participating in the paid work force to the same extent as they were six years ago, the official rate of unemployment would be significantly higher than what is being reported.

It is not by any stretch of the imagination a healthy labor market.

OUTLOOK: You use the phrase 'Well-Educated Barista' to describe the increasing incidence of underemployment among college graduates. To what extent is this happening?

WG: A recent report by the New York Fed documents not only a rise in unemployment rates for college graduates, but also underemployment. An increasing number of graduates are working part-time when they'd like to work full-time. There also are many graduates who are working in jobs that don't make use of their college skills and training.

The report shows a very sharp decline in the share of college graduates taking non-college jobs who are in so-called "good jobs," which offer wages at or even above the median income. There's been a corresponding increase in the share of college graduates who have been forced to take lower-wage jobs.

If people with college degrees are being bumped down the labor market ladder and taking lower-wage jobs, then people with low levels of education and training are going to fall off altogether. That's what the statistics are showing.

OUTLOOK: Where are college graduates having the most success finding jobs?

WG: Some sectors of the economy are doing very well, not unexpectedly. The Fed report gives an interesting summary of the outcome for different college majors. They surveyed not only percentages of people who are employed and unemployed with those majors, but also the percentages of those people with those majors who are actually making use of their college degrees in the work that they do. That's a very good indicator of where the demand is in different sectors.

The high scorers are engineering, education, health care, math and computers, and architecture and construction. Those are the areas where people are not just earning, but also making use of their college degrees.

About this article

William A. Galston holds the Ezra K. Zilkha Chair in the Brookings Institution's Governance Studies Program, where he serves as a senior fellow. A former Presidential policy advisor, Galston is an expert on domestic policy, political campaigns, and elections. His current research focuses on designing a new social contract and the implications of political polarization.

Galston is also College Park Professor at the University of Maryland. Prior to January 2006, he was Saul Stern Professor and Acting Dean at the School of Public Policy, University of Maryland, director of the Institute for Philosophy and Public Policy, founding director of the Center for Information and Research on Civic Learning and Engagement (CIRCLE), and executive director of the National Commission on Civic Renewal, co-chaired by William Bennett and Sam Nunn.

Galston is the author of eight books and more than 100 articles in the fields of political theory, public policy, and American politics.

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There are many other areas where people with college degrees are eventually getting jobs but in lower-wage occupations that do not make use of their college training and skills.

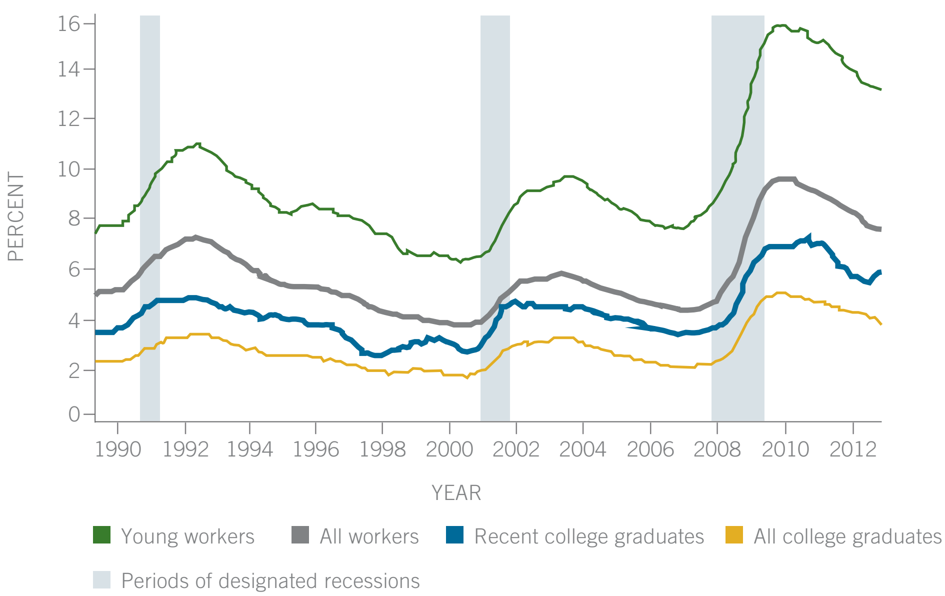
OUTLOOK: Is there any indication that college students are changing their behavior and concentrating on more marketable degrees?

WG: Despite some encouraging anecdotes, I haven't seen clear and compelling evidence that this is happening across the board. Commencement speakers continue to urge undergraduates to "follow your dreams" and "do what you love." Many students fail to form clear career goals and drift through their four years.

OUTLOOK: To what extent are colleges and industry addressing this problem?

WG: It's not being addressed adequately. Employers need to communicate directly with people who are in charge of institutions of education and training, and let them know the trends they are seeing and what skills they are going to need. It shouldn't be a game of *20 Questions* for either side. With billions being spent on education and training in this country, there needs to be a better mutual dialogue.

UNEMPLOYMENT RATES FOR RECENT COLLEGE GRADUATES AND OTHER GROUPS



Source: U.S. Census Bureau and U.S. Bureau of Labor Statistics, Current Population Survey.

Notes: Rates are calculated as a twelve-month moving average. *All workers* are those aged 16 to 65; *college graduates* are those aged 22 to 65 with a bachelor's degree or higher; *recent college graduates* are those aged 22 to 27 with a bachelor's degree or higher; *young workers* are those aged 22 to 27 without a bachelor's degree or higher. All figures exclude those currently enrolled in school. Shaded areas indicate periods designated recessions by the National Bureau of Economic Research.

> Technological substitution used to be focused on assembly line operations. Now it's spreading and has become a fundamental economic phenomenon of our times.

OUTLOOK: What economic factors are driving underemployment?

WG: It is reasonably well established that downturns sparked by financial crises are deeper and longer than ordinary cyclical downturns. The crash of 2007 and 2008 was generated by financial panic.

We were very fortunate to have had policy instruments that could be deployed to keep the crash from turning into a sustained depression. Other policy, however, proved much less effective in restarting the engine of economic growth post-financial crash. One important reason for that is that so much wealth was wiped out. Between stock market and housing market losses, combined with other major sources of wealth in American households, $17 trillion of wealth was wiped out. That had a huge effect on people's ability and willingness to make purchases.

Only recently has aggregate household wealth regained its pre-recession peak, and the evidence suggests that the distribution of that wealth became much more unequal. Housing prices remain well below their peak in most areas, and many middle-class workers deserted the stock market after the crash.

OUTLOOK: What trends in the private sector are affecting the creation of quality jobs?

WG: U.S. business people understand that they're in an increasingly competitive global market. That has had the effect of making them look at ways of improving productivity. A lot of them have concluded that on a long-term cost basis, substituting technology for human labor is an important tool in improving their competitiveness and financial performance.

For example, I visited my local drugstore this morning. Two years ago, I would have taken my purchases to a check-out line manned by a clerk. No more. Instead of three people managing electronic cash registers, you have three automated check-out machines and one employee helping customers with the process. Multiply that dynamic by hundreds of thousands or millions and you begin to have an employment problem.

This kind of technological substitution used to be focused on assembly line operations. Now it's spreading and has become a fundamental economic phenomenon of our times. The classical theory is that this process always leads to greater opportunity, income, and wealth in the long term. Some economists are beginning to wonder whether that pattern will prevail in the current technology cycle.

OUTLOOK: Is technological substitution also affecting high-skill jobs?

WG: During the first phase, which began in the late 1970s, technological substitution principally affected mass production. But with the information revolution, it can also affect higher-skill services jobs that can be reduced to computerized programs. In the long run, for example, products like TurboTax may displace a large number of H&R Block tax preparers. A related example is the displacement of customer service representatives by automated programs.

OUTLOOK: What happens when thousands of people go into debt to finance a college degree and then can't get a good job to pay it off?

WG: While there is an ongoing controversy among experts in education finance about the extent of this problem, it is pretty clear that delinquency and default rates are on the rise. Pressure is growing on the federal government to liberalize repayment terms by lowering interest rates, broaden opportunities to refinance existing debt, and forgive a share of the debt for those who go into lower-paying public service jobs.

OUTLOOK: How is underemployment affecting other parts of the economy, like the housing market?

WG: Much of the housing recovery was induced by investors with large pools of cash, which they used to buy foreclosed properties. They did some rehab and put them back on the market as rentals. So the market substantially cleared in many areas not because of individual purchasers, but because of large institutional investors.

That wave of investors crested and has now subsided. We are left increasingly with the individual market, and a key part of that market – young adults – is struggling. Both recent college graduates and undereducated adults are not only postponing marriage, they are having difficulty finding their first serious job and postponing the purchase of their first home.

This means that people who purchased homes 10 or 15 years ago – now in their 40s – are having a more difficult time moving up. If the people behind them don't have the means and the will to take the first step into the housing market and buy those starter homes, then there's a problem. That problem slows down the market for existing housing, and it also serves as a deterrent to homebuilders who, prior to the Great Recession, might have taken a risk on a tract housing development.

That's not happening now. New housing starts have not recovered to their level prior to the financial crisis.

"American optimism about the future may take a long time to return to previous levels, perhaps even a decade or more.

OUTLOOK: To what extent are these changes systemic versus cyclical? Do you believe this is a long-term or even permanent trend?

WG: It's not a clean choice. If you assume that this agonizingly slow recovery will continue for another two or three years and that the pace of job generation continues at about 200,000 new net jobs per month, the labor markets will get significantly tighter. The level of confidence will increase as the memory of the Great Recession begins to fade. You could very well have an improvement in the labor market as a whole, and for young adults in particular.

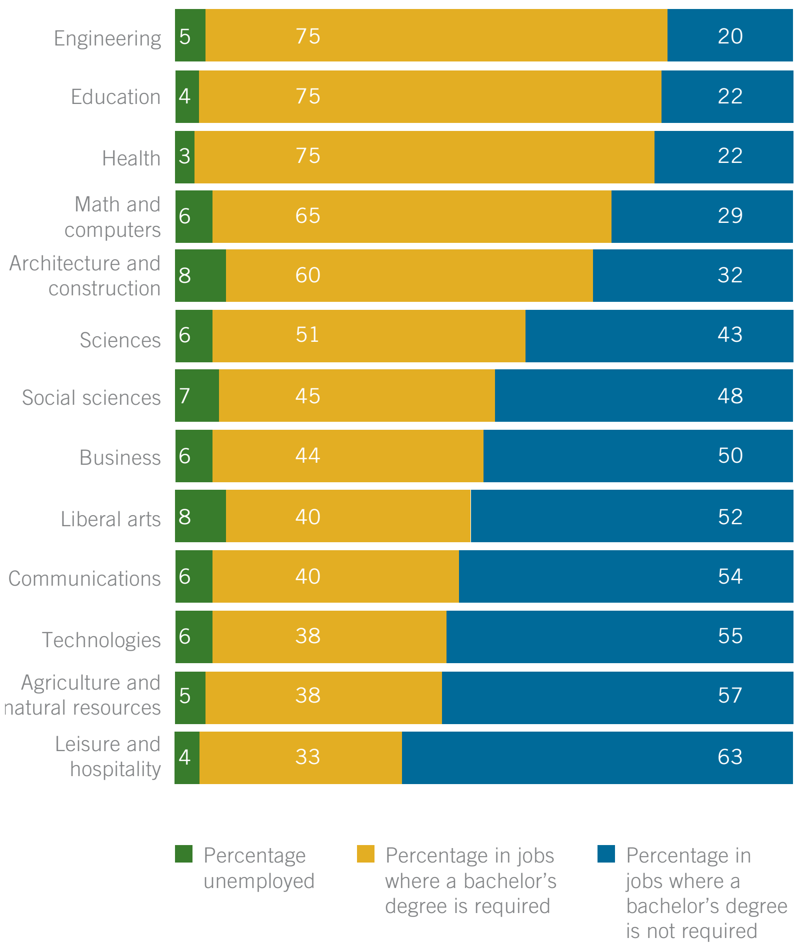
Having said that, political scientists and sociologists who studied the Great Depression, which lasted for more than a decade, found a permanent imprint of that prolonged experience on the outlook and behavior on the people who grew up during it. They are very cautious, very security conscious. They started out rebellious, but they ended up being grateful for having more modest lives than they might have expected otherwise.

I think it's reasonable to speculate that given the depth and length of the Great Recession, it may leave behind a permanent residue. American optimism about the future may take a long time to return to previous levels, perhaps even a decade or more. All other things being equal, I think it might restrain the pace of economic growth and job generation above and beyond the restraints that still exist in the economy.

It's similar on the business side. Small-business people are saying: 'I'm running a small business but I'm also doing a lot of the day-to-day production and work myself. I'd like to hire someone new, but on the other hand I remember what happened five years ago and we're just now recovering from that experience. Maybe I should wait.'

When you add up the internal dialogue going on in the heads of small business owners or even the heads of corporations, you get a slower pace of hiring, a more cautious attitude towards adding costs through labor force increases. I'm convinced that that is one of the factors slowing things down.

EMPLOYMENT OUTCOMES FOR RECENT COLLEGE GRADUATES BY MAJOR, 2009-2011



*Source: U.S. Census Bureau, American Community Survey; U.S. Department of Labor, O*NET.*

Notes: *Recent college graduates* are those aged 22 to 27 with a bachelor's degree or higher. All figures exclude those currently enrolled in school. Because of rounding, figures in each bar may not sum to 100.

OUTLOOK: You support an increase in the minimum wage. Can you explain your views there?

WG: There's still plenty of debate, but I believe there is an emerging consensus among economists that relatively modest and slowly phased-in increases in the minimum wage are likely to benefit many people, with only modest collateral damage on the employment front. If you raise the minimum wage too far, too fast, there will be a very different conclusion.

The recent increase of the minimum wage to $15 in the city of Seattle has given us the unusual opportunity to witness a natural experiment. If Seattle actually phases in a $15-an-hour minimum wage on the schedule that's recently been approved, over the next five or so years we'll be able to see in real-time what happens to wages and employment in Seattle compared to some adjoining areas with similar characteristics. It's going to be very interesting to watch.

One of the reasons the minimum wage issue is so imponderable is that everybody knows in principle that if you raise the price of something, you're going to have some effect on the demand for it. But nobody knows what the trade-off – the elasticity – is going to be. It's an empirical issue. You only know it when you see it, and not before.

In any event, an increase in the minimum wage, however necessary and proper it may be, is only a small piece of the answer to a much larger problem.

OUTLOOK: What other policy changes need to be made to get us past this stage and resume higher levels of growth and employment?

WG: A good place to start is the decline in entrepreneurship and why new net business starts are down significantly in recent years. Since a substantial portion of new job creation comes through those starts, we ought to be asking ourselves some hard questions about why the decline is occurring and what we can do about it. Is it a question of access to capital for small business? Is it a question of regulatory constraints? We need answers to these questions so that we can begin to turn this trend around.

"We need to find a way of diminishing incentives for corporations to take their jobs and headquarters overseas. That is not good for our country.

In my judgment, we do not have a tax code that is really oriented towards growth and job creation. I think we need fundamental, comprehensive tax reform that puts jobs and growth first.

We also need to work on the area of public investment – infrastructure and investment in basic and applied research. Throughout U.S. history, they have produced a positive return and they are being cut in the current fiscal environment.

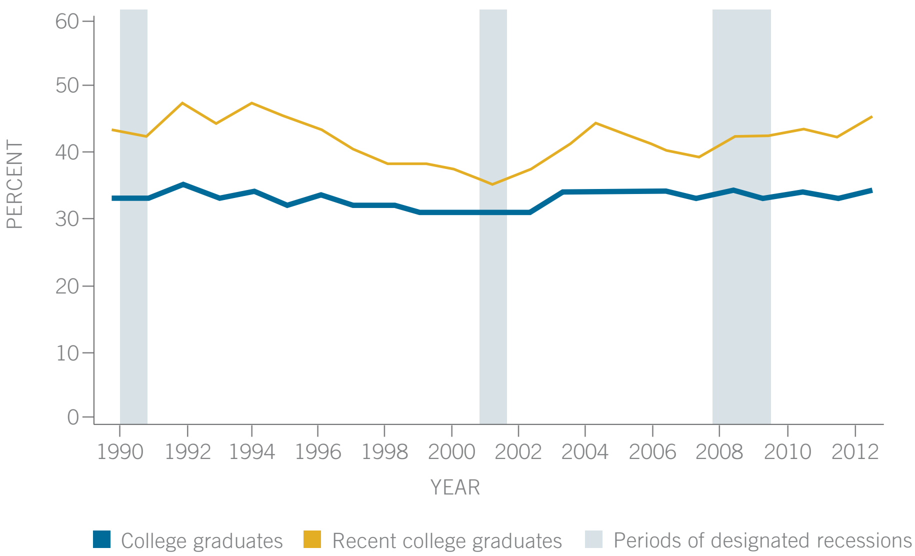
And we obviously need to find a way of diminishing incentives for corporations to take their jobs and headquarters overseas. There have been some very alarming announcements just in recent weeks. That is not good for our country.

OUTLOOK: What is the status of labor markets in other developed economies – Canada, the EU countries? Are they experiencing similar issues?

WG: Canada strikes me as quite a success story. The Canadian housing market and its system of housing finance and regulations were relatively unscathed while the U.S. and Europe paid a heavy price for their short-sightedness and outright misconduct. Since the Canadians had their own crisis in the mid-1990s, they've done pretty well managing their economy, arguably better than we have.

The other obvious success story is Germany, whose employment and output didn't decline as far as ours did, let alone the rest of the EU. If you look at the EU minus Germany – notwithstanding some successful outliers like Poland – you get a very different picture. In France and the southern tier of Europe, there is a very unpleasant picture with devastated labor markets. In some countries, such as Greece and Spain, overall unemployment rates went as high as 25 percent. For many of them, unemployment rates among young adults approached 50 percent, which is an outright depression.

UNDER13EMPLOYMENT RATES FOR COLLEGE GRADUATES



*Source: U.S. Census Bureau and U.S. Bureau of Labor Statistics, Current Population Survey, March Supplement; U.S. Department of Labor, O*NET.*

Notes: *College graduates* are those aged 22 to 65 with a bachelor's degree or higher; *recent college graduates* are those aged 22 to 27 with a bachelor's degree or higher. All figures exclude those currently enrolled in school. Shaded areas indicate periods designated recessions by the National Bureau of Economic Research.

Many young adults in those countries are finding it impossible to get a foothold in the official economy. There is debate about the extent to which European labor market policies have contributed to 50 percent unemployment in the young adult sector, but it is a very troublesome trend that needs to be addressed quickly.

OUTLOOK: What does the future hold – 10 or 20 years from now? Are we beginning to experience a new normal in terms of the labor market?

WG: Some of the underlying trends are unfavorable, in particular the ongoing substitution of technology for human labor, coupled with the current inability of our education and training system to produce more of what employers say they want. There are better public policies that we could put in place that could not only take the edge off some of the negative trends, but begin to set some more positive forces in motion.

Along with those policies, I strongly believe that we need new kinds of partnerships between the private and public sector so that the education system is not trying to guess what employers want. They need to work together in real-time to create programs that build a bridge between education and training on the one hand, and employment and jobs of the future on the other.

It's a question of getting ourselves organized with the requisite degree of urgency for a global economy characterized by high rates of technological substitution for human labor.

Charts and data are provided courtesy of the Federal Reserve Bank of New York. Jaison R. Abel, Richard Deitz, and Yaqin Su, "Are Recent College Graduates Finding Good Jobs?" Federal Reserve Bank of New York *Current Issues in Economics and Finance*, vol. 20, no. 1 (2014), available at http://www.newyorkfed.org/research/current_issues/ci20-1.html

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 5/31/14. They are intended to provide rate or cost indications only and are for notional amounts in excess of $5 million except for forward fixed rates.

KEY ECONOMIC INDICATORS

Gross Domestic Product (GDP) measures the change in total output of the U.S. economy. The Consumer Price Index (CPI) is a measure of consumer inflation. The federal funds rate is the rate charged by banks to one another on overnight funds. The target federal funds rate is set by the Federal Reserve as one of the tools of monetary policy. The interest rate on the 10-year U.S. Treasury Note is considered a reflection of the market's view of longer-term macroeconomic performance; the 2-year projection provides a view of more near-term economic performance.

ECONOMIC AND INTEREST RATE PROJECTIONS

Source: Insight Economics, LLC and Blue Chip Economic Indicators

				US Treasury Securities	
2014	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q2	3.40%	2.20%	0.09%	0.44%	2.75%
Q3	3.00%	2.10%	0.10%	0.58%	2.96%
Q4	3.10%	1.80%	0.12%	0.72%	3.14%
2015	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	3.00%	1.90%	0.16%	0.89%	3.28%
Q2	3.00%	2.00%	0.26%	1.07%	3.43%

PROJECTIONS OF FUTURE INTEREST RATES

The table below reflects current market expectations about interest rates at given points in the future. Implied forward rates are the most commonly used measure of the outlook for interest rates. The forward rates listed are derived from the current interest rate curve using a mathematical formula to project future interest rate levels.

IMPLIED FORWARD SWAP RATES

Years Forward	3-month LIBOR	1-year Swap	3-year Swap	5-year Swap	7-year Swap	10-year Swap
Today	0.24%	0.26%	0.94%	1.71%	2.23%	2.70%
0.25	0.23%	0.32%	1.12%	1.86%	2.35%	2.80%
0.50	0.25%	0.42%	1.31%	2.02%	2.48%	2.90%
0.75	0.32%	0.58%	1.51%	2.19%	2.61%	3.00%
1.00	0.47%	0.79%	1.73%	2.36%	2.75%	3.11%
1.50	0.88%	1.28%	2.14%	2.67%	3.00%	3.30%
2.00	1.42%	1.81%	2.53%	2.96%	3.19%	3.47%
2.50	1.88%	2.21%	2.82%	3.17%	3.38%	3.60%
3.00	2.34%	2.61%	3.11%	3.39%	3.56%	3.73%
4.00	2.97%	3.20%	3.47%	3.68%	3.80%	3.91%
5.00	3.37%	3.56%	3.75%	3.85%	3.96%	4.03%

HEDGING THE COST OF FUTURE LOANS

A forward fixed rate is a fixed loan rate on a specified balance that can be drawn on or before a predetermined future date. The table below lists the additional cost incurred today to fix a loan at a future date.

FORWARD FIXED RATES

Cost of Forward Funds

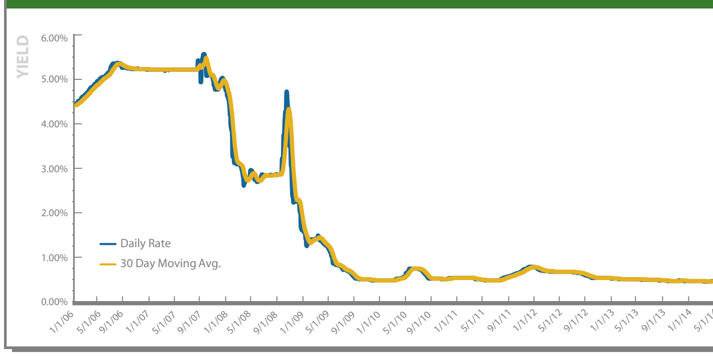
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	7	8	7	6
90	17	20	18	13
180	31	38	34	25
365	75	78	67	48

Costs are stated in basis points per year.

SHORT-TERM INTEREST RATES

This graph depicts the recent history of the cost to fund floating rate loans. Three-month LIBOR is the most commonly used index for short-term financing.

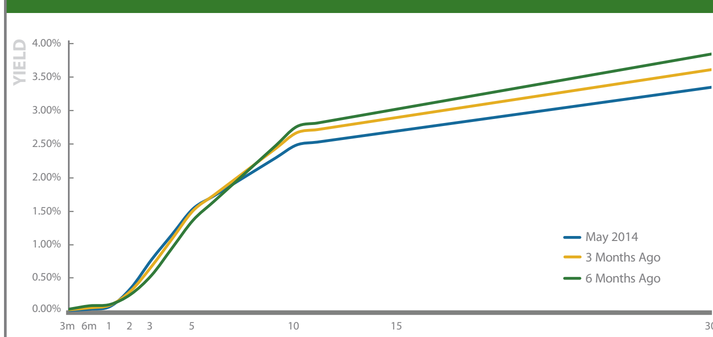
3-MONTH LIBOR



RELATION OF INTEREST RATE TO MATURITY

The yield curve is the relation between the cost of borrowing and the time to maturity of debt for a given borrower in a given currency. Typically, interest rates on long-term securities are higher than rates on short-term securities. Long-term securities generally require a risk premium for inflation uncertainty, for liquidity, and for potential default risk.

TREASURY YIELD CURVE



CoBank Supports Tornado Relief in Nebraska

Contribution to American Red Cross Will Support Immediate Relief Efforts to Impacted Communities

CoBank has joined with two other Farm Credit organizations in a $25,000 contribution to support tornado relief efforts in Nebraska.

The joint contribution to the American Red Cross comes from CoBank as well as AgriBank (St. Paul, Minn.) and Farm Credit Services of America (Omaha, Neb.) Following recent storms, the Red Cross is providing temporary shelter for tornado victims, mobile food programs and first aid services, as well as emotional support. The Farm Credit funds help the Red Cross meet the needs of individuals and entire communities.

"We are grateful to Farm Credit for their generous gift and timely response," said Tina Labellarte, Region CEO, American Red Cross. "The Red Cross responds to more than 70,000 disasters in the United States every year. We couldn't do what we do without the generosity of our donors."

Mike Hechtner

"All Farm Credit organizations share a common mission, which is to support agriculture and the other key sectors of the rural economy in good times and bad," said Mike Hechtner, central region president for CoBank in Omaha. "Our hearts go out to the people who have been impacted by these storms, and we hope that this contribution will help to address some of the most immediate needs in the community."

"Our employees have had the opportunity to work alongside storm victims as they clean up their homes, farms and communities," said Doug Stark, CEO and president of Farm Credit Services of America. "The determination and can-do spirit shown by those whose lives have been upended is inspirational. But we also understand that it will take time and resources for affected communities to recover. Our hope is that these donated funds serve as a foundation for rebuilding."

Keri Votruba, a cattle and grain operator in Hemingford, Neb. and a member of the AgriBank Board of Directors said the gift was personal for him: "The devastation is heartbreaking," he said. "And it puts the spotlight on rural communities – like mine – that often get overlooked because their populations are small. But their contribution is huge. These communities are the lifeblood of American agriculture. And we want to honor that contribution by being there for them in their time of need."

About CoBank

CoBank is a $102 billion cooperative bank serving vital industries across rural America. The bank provides loans, leases, export financing and other financial services to agribusinesses and rural power, water and communications providers in all 50 states. The bank also provides wholesale loans and other financial services to affiliated Farm Credit associations serving farmers, ranchers and other rural borrowers in 23 states around the country.

CoBank is a member of the Farm Credit System, a nationwide network of banks and retail lending associations chartered to support the borrowing needs of U.S. agriculture and the nation's rural economy.

Headquartered outside Denver, Colorado, CoBank serves customers from regional banking centers across the U.S. and also maintains an international representative office in Singapore.

For more information about CoBank, visit the bank's web site at www.cobank.com.