

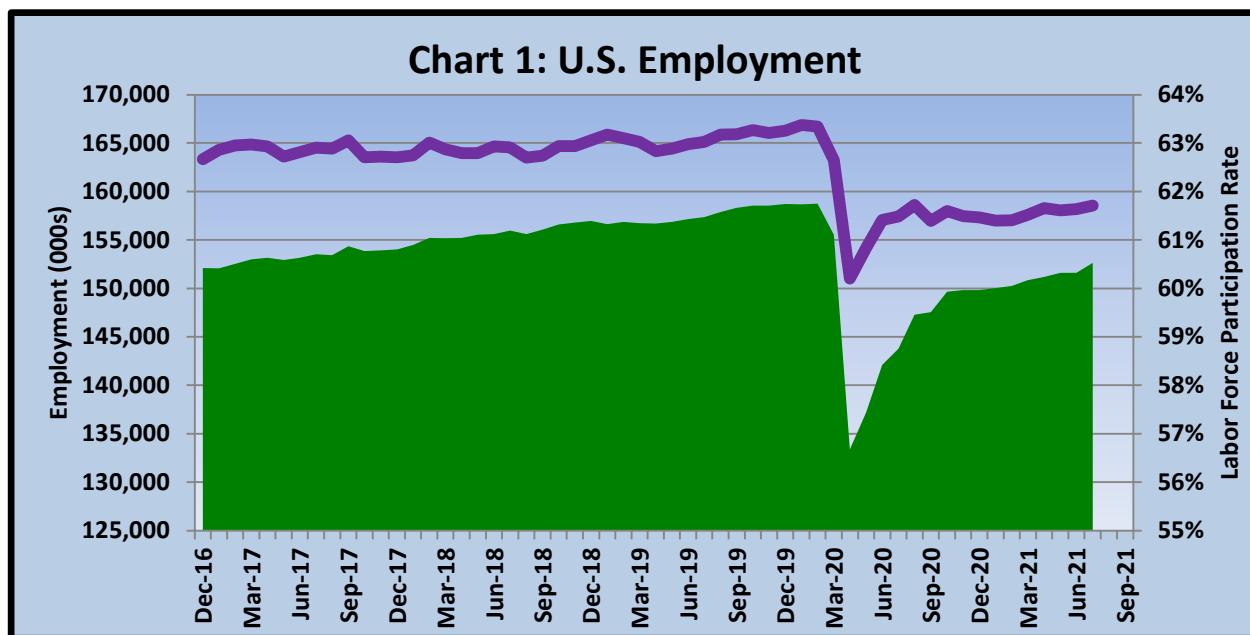
Too Many Jobs? Or Too Few?

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It's easy to say that government policy (and our investment decisions) should be based on actual data rather than on suppositions and theories. It's not quite so easy to implement policies or investment decisions when the data is muddy or even contradictory – and, let's face it, in economics that's most of the time. Today's jobs market is a perfect case in point.

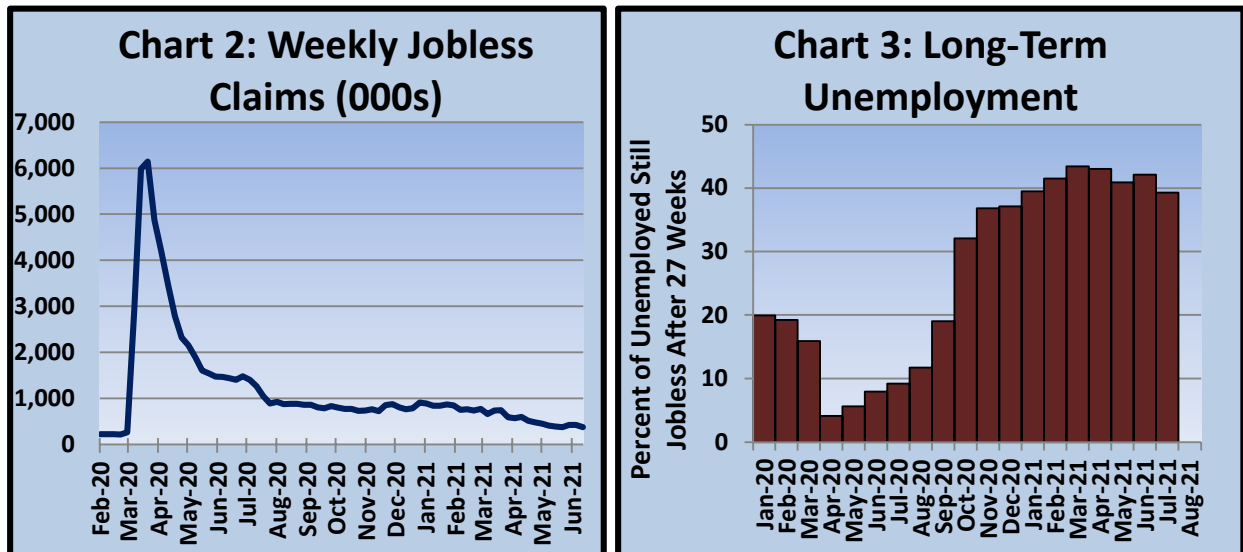
Since the pandemic began 18 months ago, the national business press has been tracking the number of jobs still lost to Covid-19. Chart 1 shows that total U.S. employment peaked in December 2019 at about 158 million jobs, bottomed in April 2020 at 133 million, and by the end of July had rebounded to about 152 million. In other words, the economy is still short about 5.4 million jobs from its peak. Not only that, but the labor force participation rate – the total of employed and unemployed people as a percentage of the total population – also remains well below its pre-pandemic peak (the purple line in Chart 1).



Source: Bureau of Labor Statistics

It's worth noting that the total economic output of the country has already regained its December 2019 level, after adjusting for inflation. We are producing just as much as we did before the pandemic, but we are doing so with 5.4 million fewer workers. This suggests that one side effect of the pandemic was a dramatic increase in productivity; a recent Morgan Stanley research report suggests that output per worker has jumped about 4% over the past year, compared with gains averaging about 1% before the pandemic.

This apparent productivity boost has presented policymakers with a challenge: Although the number of layoffs has fallen nearly to 2019 levels (Chart 2), far too many people still are jobless. As Chart 3 shows, more than one-third of all unemployed people have been out of work for more than six months. From this perspective, the U.S. economy has made great progress but millions of people are nonetheless struggling to get back on their feet. Some members of Congress and the Federal Reserve have latched onto this data and pushed for more job-creation policies.

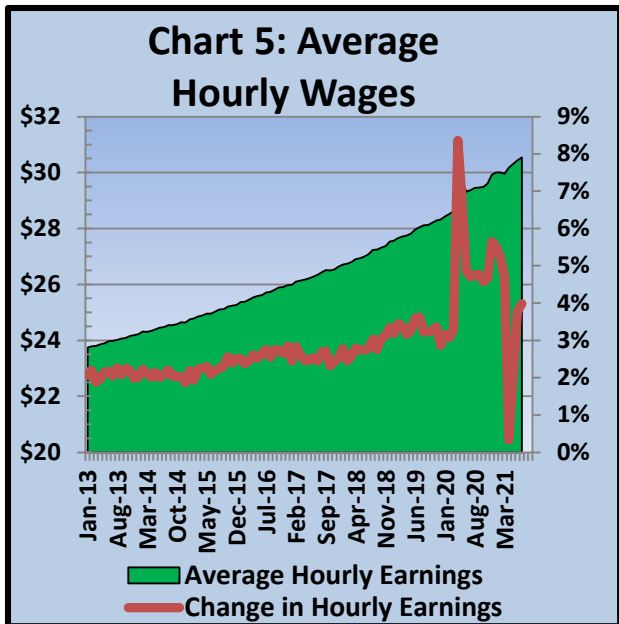
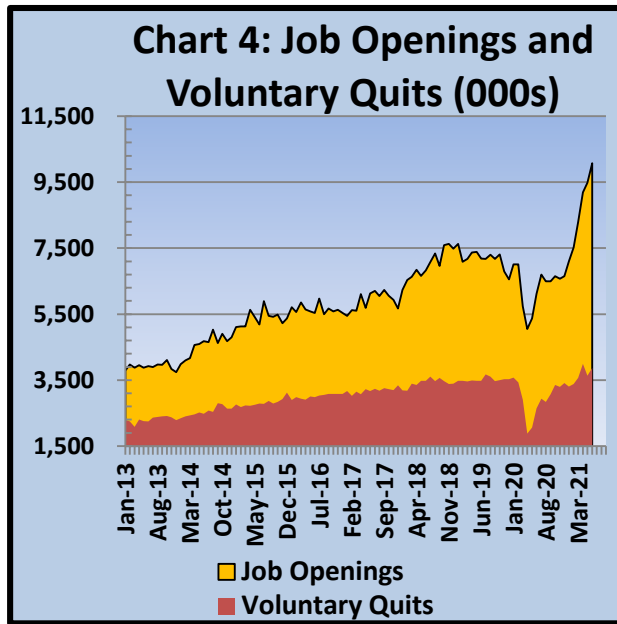


Source (both charts): Bureau of Labor Statistics

On the other hand – here comes the muddy and contradictory data – the local “feet on the ground” story hasn’t corresponded well with the national employment statistics. Turning from the national news to the local papers, it was easy this summer to see articles in which local merchants couldn’t find workers. From restaurants to construction sites, the steady drumbeat was that people weren’t willing to return to work, or were demanding excessive wages, or simply couldn’t be found. Many employers blamed the federal government’s expanded unemployment benefits, saying that workers had no incentive to get back on the job.

These anecdotal reports of labor shortages have sprouted from Cape Cod to Disneyland, and they are supported by the evidence. The red section of Chart 4 (next page) shows that a near-record 3.9 million people quit their jobs voluntarily in July. Concurrently, the number of job openings nationwide has skyrocketed (in yellow on Chart 4); this is partly a function of replacing workers who have quit, and partly one of surging customer demand leading to new job creation. There are more than ten million job openings today, but fewer than nine million unemployed workers.

There is also some evidence that workers are demanding – and getting – higher pay. Chart 5 shows average hourly earnings and the annual rate of change over the past decade. After years of gradual improvements, the pandemic and CARES Act caused wild gyrations in pay rates. But the data seem to suggest that the labor market had been gradually tightening for years before the pandemic, and is now beginning to resume its prior trajectory. Wage rates are currently rising by about 4% annually, which is consistent with the gradual acceleration in the past ten years. The data should still be interpreted with caution because of the wild swings of the past year.



Source (both charts): Bureau of Labor Statistics

Thus the paradox: How can the economy have both a labor surplus (Charts 1 and 2) and simultaneously a labor shortage (Charts 3, 4, and 5)? The answer, perhaps, is that the labor market has undergone some fundamental changes in its supply and demand characteristics. These changes stem partly from the pandemic and partly from long-term trends that had already been in place before Covid.

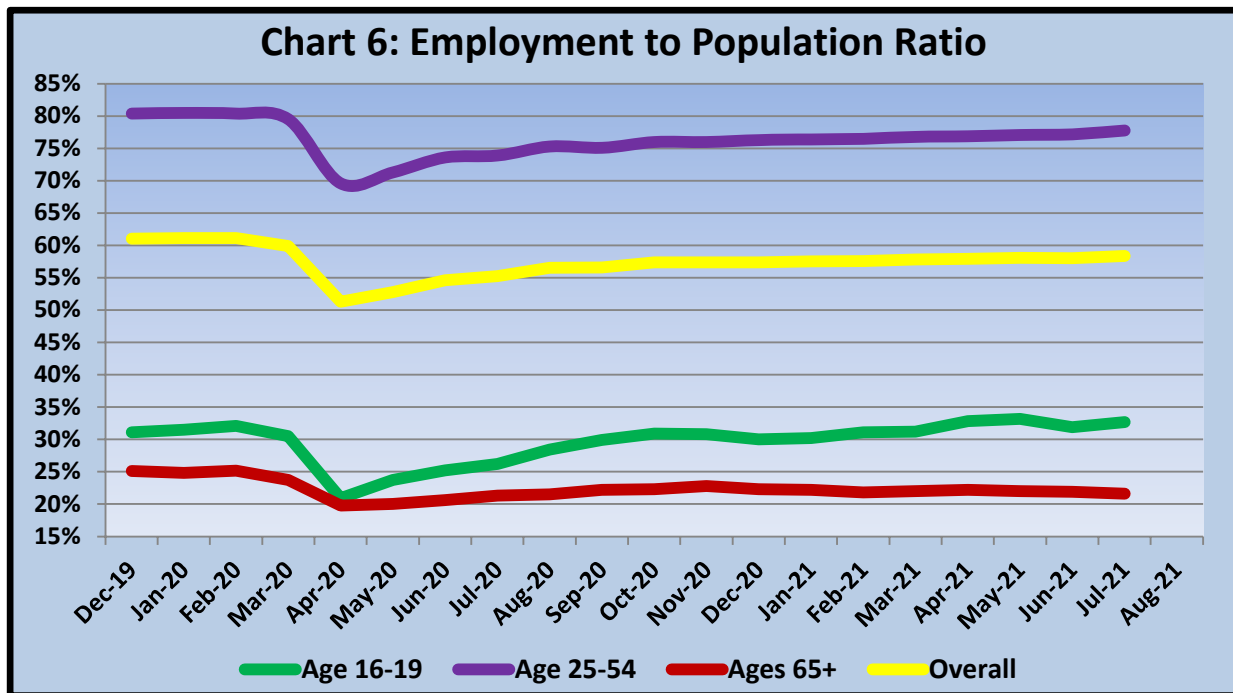
Looking at *demand* for labor first, it's not quite accurate to say that productivity gains have directly led to the high levels of long-term unemployment shown in Chart 3. More precisely, there has been a mix shift in the components of America's economy, which has in turn led to changes in the demand for labor. Since the pandemic began, we have been spending more money on goods and less on services, a trend that has held up even as the economy has begun reopening. Manufactured goods are less labor-intensive than high-touch services such as hospitality, dining, and travel. As a result, the shift in spending away from labor-intensive service industries filters through the statistics and looks like a gain in productivity.

In reality, however, neither labor-intensive service industries nor capital-intensive manufacturing industries have suddenly become meaningfully more efficient. Further, it's yet unclear whether the shift toward goods and away from services will continue after the economy reaches some "new normal." Perhaps we will return to our pre-pandemic behavior, eating out and traveling and going to the cinema and more; but it's also possible that fear of future pandemics may cause us permanently to reduce our spending in these historically labor-intensive industries. If so, millions of jobs will have been permanently lost.¹

¹ These service industry jobs were mostly lower-paying, and had been disproportionately held by women and people of color, so the prospect of permanent loss has exacerbated racial disparities in employment data. Bruce Hornsby saw this coming in 1986: *Standing in line, marking time / Waiting for the welfare dime / 'Cause they can't buy a job ... / Hey you can't go where the others go / 'Cause you don't look like they do ... / That's just the way it is.*

The changing shape of demand in the U.S. does explain some of the changes in the labor market, suggesting that there will continue to be an oversupply of workers in some industries for a long time to come. Conversely, it's also likely that we will have to negotiate talent shortages in other industries, mostly in technology and other high-skill fields. As a society, we haven't done a good job of retraining workers to adapt as the economy has evolved.

Even so, the demand picture doesn't explain why restaurants couldn't find dishwashers this summer, or why short-staffed contractors are turning down projects. To unravel this knot, we need to examine the labor *supply* picture. Chart 6 shows the employment rate of the American workforce since December 2019, taken as a whole (in yellow) and also parsed into demographic age cohorts. (The employment rate is calculated simply as the number of employed people in each cohort, divided into the total population of that cohort. Unlike labor force participation, it does not include unemployed people.)

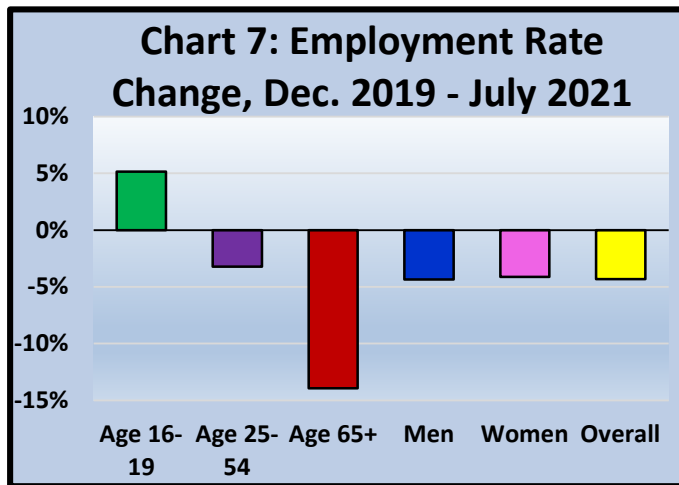


Source: Bureau of Labor Statistics

Not surprisingly, every age cohort lost jobs during the pandemic, though some were hit harder than others; teenagers and “prime-age” (25-54) workers were hardest hit, while the impact to seniors was less severe. In just the four months from December 2019 through April 2020, the employment rate for teenagers dropped by a catastrophic 33%; that compares to a 13% fall for prime-age workers, and 21% for seniors.² Chart 6 also shows that employment rates have improved meaningfully for most demographic groups since the bottom of the recession, but a close reading shows some differences among the groups.

² The sudden recession also hit women harder than men, although the differences were not as pronounced as those for teenagers versus other age groups. The employment rate for all men age 16+ dropped by 14% from December 2019 to April 2020, compared 18% for all women age 16+. By July 2021, that discrepancy had reversed itself.

The most noteworthy difference among these demographic cohorts is that teenagers and prime-age workers have returned in large numbers, while seniors have not. Chart 7 shows the change in employment rate from December 2019 (before the pandemic began) to last month. Overall (in yellow), the total U.S. employment rate remains about five percentage points below its pre-pandemic peak – a strong recovery, with room for more. Impressively, prime-age workers are even closer to their pre-pandemic employment rates; it would be inaccurate to suggest that they are sitting on the sofa collecting unemployment checks rather than seeking work.



Source: Bureau of Labor Statistics, EBWM

But what about the seniors? It is reasonable to read Chart 7 as suggesting that millions of boomers were effectively forced into early retirement, and then opted not to return to the workforce when the economy began to recover. Since the peak year for baby boom births was 1957, the largest group of boomers will be turning 65 next year – and they, too, may already be prematurely retired (whether by choice or not). As these seniors leave the workforce, the pool of available labor has shrunk just as demand has begun to grow.

Even as seniors are leaving the workforce, however, teenagers are diving into it. They are now the only demographic cohort to have a higher employment rate today than they did before the pandemic hit last year. When employers say they can't find workers, they're not imagining things: Employment rates among teenagers and prime-age workers are impressively high. Whether they are replacing retiring boomers or filling new demand, the teenage and prime-age groups are emphatically back on the job. It's no wonder that wage rates have resumed their upward trend. What's more, these trends had all been in place even before the pandemic began; as the economy regains its normal footing, these trends are reasserting themselves.

The data isn't quite as muddy and contradictory as it appears at first blush. It suggests that the economy's rapid recovery is placing strains on the labor market (as it is on commodities and other sectors, too), and these strains are exacerbated by fundamental changes in the workforce as boomers retire faster than younger cohorts can replace them.

It's possible that short-term considerations may overwhelm these longer-term trends. The expiration of enhanced unemployment benefits next month may indeed force some people back to work. As schools reopen, parents may find new freedom to take jobs that otherwise may have been too much for their families to handle. If the Delta variant is better controlled, some workers might feel more comfortable returning to a work environment; people may also start to consider changes to elder care and other family responsibilities. These short-term factors may alleviate some labor shortages in the short term. Sifting it all out, and deciding what policies should be enacted, is still quite a puzzle for the politicians to solve, but at least the data make sense.

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