WHITE PAPER

Work in America

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Economics is known as the dismal science, but it can actually be quite entertaining due to constant surprises. After all, economic activity is the result of decisions by policy makers, corporate executives, investors, and consumers, all of whom are human and subject to swings in emotion and errors in judgment. One segment of the economy that currently has many observers scratching their heads is the behavior of labor markets. Specifically, there was a record high 10.1 million unfilled jobs in June; however, at the same time there are 8.7 million unemployed Americans actively looking for work and another 1.2 million, who have not searched for a job in the past month but state they would like to be employed. So the number of unfilled jobs and the pool of available workers roughly balance each other out. Where is the disconnect?

Here is another mystery. In the past year, wages rose at the fastest clip in 35 years, which is not supposed to happen during periods in which a large number of people are searching for work. Has supply/ demand stopped working?

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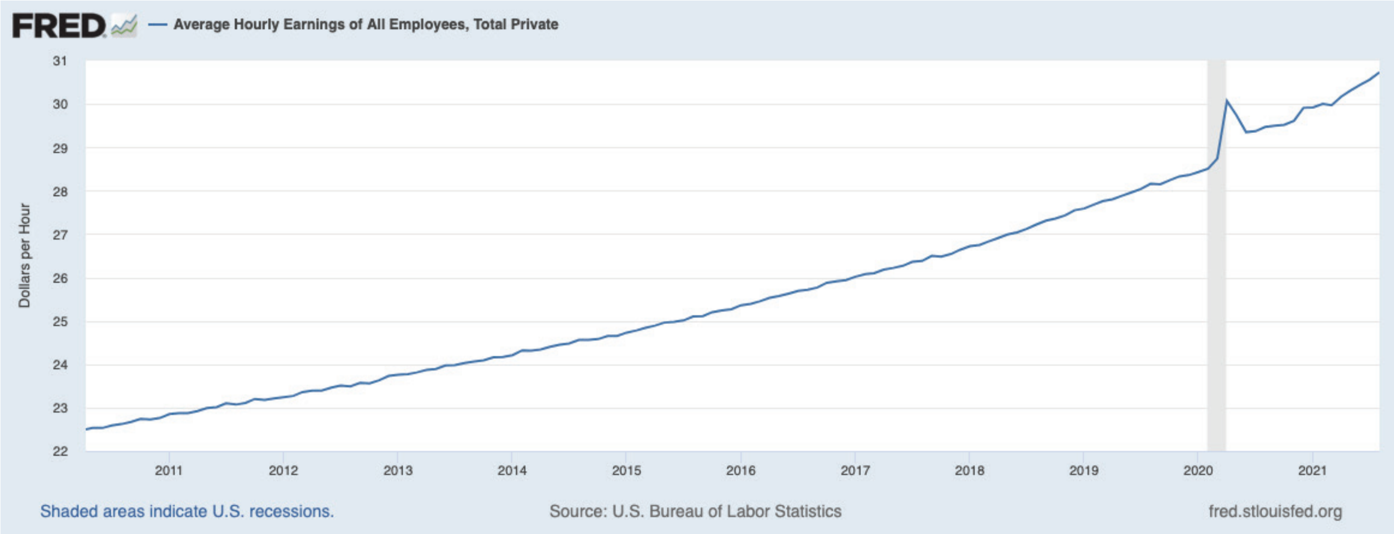
Additional complications include the whole question of how and whether people return to traditional workplaces, the impact of artificial intelligence and robotics on many job categories, and the fact that many of us are apparently reassessing careers, personal priorities, and so on. Finally, the inflation rate for the past twelve months was 5.3%, suggesting that the living standard of many workers did not really improve despite healthy wage increases. Do wage increases portend future inflation or are recent price increases the result of temporary supply chain bottlenecks? Finally, if higher wages are here to stay, will that motivate companies to employ more technology ultimately reducing the demand for labor in some occupations? Whew, this is a complex, confusing, yet fascinating time!

The Phillips Curve

In 1958, economist A. W. Phillips published a paper with extensive data supporting the premise that there is an inverse relationship between the level of unemployment and wage increases. When most people are employed, employers must scramble for workers, which compels them to raise wages. In contrast, widespread unemployment tilts bargaining power in favor of employers, resulting in more modest wage growth. While this relationship makes absolute sense, recently the reality has been very different. From 2009 to early 2020, the unemployment rate fell from 9.8% to 3.5%, yet hourly wages only grew 2.4% per annum as compared to a longer run average of 4.1%. In contrast, from the beginning of the pandemic through today, wages grew at a 5% annual rate despite average unemployment of 7.5%. Take a look at the following chart: The shaded area represents the brief recession that was associated with the lockdown. Despite record unemployment (15%), average hourly earnings surged. And while they pulled back somewhat as the economy began to recover, the trajectory is once again positive from what appears to be a higher base.



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One sector of the economy is particularly confounding. With the overall unemployment rate at 5.4%, unemployment in the Leisure and Hospitality sector is currently 9%. Yet wages in that sector grew at a 6.6% annual rate over the past two years - go figure! The Phillips Curve seems to be upside-down!

The problem is that there is a large number of mismatches between available jobs and the skills, location, and preferences of available workers.

Underneath the Hood

Unfortunately, a complicated topic with lots of nuances has become mired in a contentious war of political sound bites. Is there really a labor shortage? One camp argues that generous unemployment benefits take away the incentive for many to work. The other side posits that there would be no shortage of workers if employers only paid a decent wage. I will leave that debate to political types!

Despite numerous headlines regarding employers who are unable to fill jobs, the data suggests there are actually plenty of workers. The overall labor force did shrink slightly from pre-pandemic levels, but the statistics cited above indicate there is a rough balance between the number of available workers and unfilled jobs. So something else must be going on. The problem is that there is a large number of mismatches between available jobs and the skills, location, and preferences of available workers. I chronicle several of these mismatches and then focus on one particular sector that represents the poster child for the complexities of the labor markets.

Skills

First, there are mismatches between available job requirements and workforce skills, and the mismatches actually work both ways. A great deal has been written about CEOs who lament the fact that our educational system does not equip employees with requisite skills in mathematics, computer coding, communication, and teamwork. While some companies have initiated *upskilling* programs, many others have been unable to do so because they have been forced to develop remedial classes to overcome shortfalls in the three Rs.

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Many companies are already raising the bar in terms of required skills, and this trend will undoubtedly continue or accelerate as technology transforms jobs that were formerly high-labor intensive. The other side of the coin is that more highly-trained workers, who are unemployed, are understandably loathe to accept jobs with lower skill requirements and correspondingly lower compensation. The result is that some very skilled workers either drop out of the labor force entirely or fall into the category of the long-term unemployed.

Location

A second problem is that workers and available jobs are not necessarily in the same location. Interestingly, this mismatch also works several different ways. Data from 30 million U.S. Postal Service change of address forms indicates two major trends in geographical population shifts since the onset of the pandemic. First, the general migration toward the South and West that has been in place for many years continued. Second, a large number of people moved from urban centers to vacation destinations, as well as to suburban and rural areas. The two major cities with noteworthy outflows were New York and San Francisco. Interestingly, a large number of the urban departures landed within the same state or region.

In recent months, there has been a partial snapback in hiring in sectors that were particularly impacted by the pandemic, such as restaurants and retail (Although it is possible that these gains could be lost to the impact of the Delta variant.). However, more sustainable job growth is occurring in areas, such as warehousing, trucking, pharmacies, logistics, information technology, health care, and manufacturing. The problem is that many of these activities are located in or near major urban areas or transportation hubs, creating unworkable commutes for those who have moved outward. A second issue is that the exodus from the cities created shortages of workers in many urban service jobs, particularly those with lower-skill requirements. Finally, smaller towns and rural areas that have been the beneficiaries of population shifts find they do not have enough workers to keep up with the demand for services from the new-found population.

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Preferences

The final source of what economists call employment reallocation friction is changing employee preferences, which in many cases have been accelerated by the pandemic. Some have argued that we do not have a labor shortage at all but instead a broad-based reassessment of the nature of work. Most of this information comes from surveys, so a good deal of it is anecdotal and subject to error. Having reviewed a large number of articles and surveys, however, I believe these points are a fair representation of the current state of mind of many workers.

- **Work from home/ Flexibility** - A survey of working professionals by networking site, Blind, indicated that 64% of respondents would be willing to pass on a $30,000 raise in exchange for the ability to continue working from home. There is some variability in surveys, but several found that something on the order of 20% of employees prefer to work exclusively at home while another 20% or so would be willing to head to the office once a week. Anecdotally, there is some evidence that preferences are generational with younger workers more interested in returning to the worksite, while their older colleagues prefer work from home. Some companies are responding with more flexible work schedules, while others are insisting that employees return to the workplace in the interest of teamwork, firm culture, and productivity. My informal poll of friends and colleagues points to a hybrid model with one or two days in the office and the remainder remote. Obviously, none of this is relevant to a large number of industries, such as transportation, construction, and manufacturing.

- **Fear of virus** - Many have left jobs that require a good deal of face-to-face contact. This is particularly common among former employees of nursing homes, as well as home-health-care workers and other similar occupations.

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- **Childcare** - This may not actually fall under the heading of preferences, but many employees, particularly women, have either left the labor force or are limiting their job search to positions with predictable hours and access to quality childcare.

- **Retirement** - The combination of pandemic stress and the booming stock market has motivated a number of employees over the age of 50 to accept early retirement. This can be particularly problematic in that older workers are obviously more experienced and often highly skilled.

- **Predictable working hours** - One of the positive impacts of the lockdown is apparently a renewed sense of the importance of family and leisure time. Many job searchers are avoiding categories requiring variable shifts and unpredictable hours. Similarly, there seems to be a strong preference for steady and predictable income. As will be discussed later, these preferences are particularly troubling for the restaurant, hospitality and retail sectors.

- **Meaning, respect, working environment** - These are *soft* factors; however, surveys clearly indicate that employees seek positions that are psychically rewarding. They are avoiding jobs that entail abuse, such as that from unruly customers and are increasingly concerned about the overall work environment. While there is nothing new about many of these issues, it seems that job searchers are emboldened and increasingly making decisions on the basis of quality-of-life factors in addition to compensation.

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Calling it Quits

One fascinating aspect of current labor markets is the number of workers, who are or are considering, leaving their jobs voluntarily. A survey of 30,000 workers by Microsoft revealed that 41% of respondents were considering quitting or changing professions this year. Even more dramatic was a survey by Monster.com that found that 95% of respondents were considering quitting and 92% were willing to switch industries in pursuit of a new position.

The following chart provides data for the overall economy, as well as selected industries on what is known as the job-quit rate, which represents the number of people voluntarily leaving jobs as a percent of the labor force. The chart was produced by *The Economist Magazine* and is based on data from the U.S. Bureau of Labor Statistics. First, note that the overall quit rate (the red line) slowly but steadily increased from 2011 until the onset of the pandemic, when it unsurprisingly plunged. However, over the past year, the number of monthly quits increased 46% and is now running at 2.7% of the labor force, which is the highest level recorded since the BLS began tracking this statistic in 2000. The quit rates for construction and manufacturing are very similar to that of the overall economy, but note the turmoil in retail and hospitality. This provides a nice segue to the next section, which focuses on those problematic sectors of the economy.

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Retail and Hospitality

The retail and hospitality sectors are two of the largest employers in the overall economy together accounting for about 21% of the workforce. These industries are at the center of discussions regarding the fairness of wages and are frequently cited as examples of the difficulty in filling jobs.

70% of job seekers, who last worked in these categories, are looking for work in a different industry.

As compared to the overall unemployment rate for the economy of 5.4%, unemployment in retail is 6% and a whopping 9% in the leisure and hospitality sectors. In total, this amounts to 2.5 million unemployed individuals. However, there are also 2.5 million job openings in these categories. At least theoretically, the market should be able to clear, but that is obviously not occurring due to many of the factors cited above. These sectors are characterized by relatively low wages, unpredictable and long hours, and difficult working conditions. Moreover, many of these workers are understandably concerned about health risks, as was discussed in the Preferences section. The net result is the very high quit rate depicted in the chart above. Not only are retail and hospitality workers quitting in droves, they are looking elsewhere. A recent survey by ZipRecruiter found that 70% of job seekers, who last worked in these categories, are looking for work in a different industry. The National Restaurant Association reports overall employee turnover of 75% per annum, while a CNBC study found rates of 130-150% in casual fast food establishments. Similarly, the BLS estimates the turnover rate at 75% for the lodging industry. These statistics are a year old, so it is likely they will be much higher when 2020 and 2021 data are eventually reported.

Hourly wages in retail and hospitality increased 4.4% and 9.6%, respectively, over the past twelve months as compared to 4% for the overall economy. There are also widespread reports of employers in these categories offering payments for simply agreeing to an interview, and bonuses and enhanced benefits are becoming more common. On the one hand, raising wages is a logical strategy for overcoming the difficulty in attracting workers. However, the Phillips Curve suggests significant wage increases should not be required in industries with a high unemployment rate.

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Another complication is that many restaurants are finding it very difficult to raise prices to counteract wage increases and food costs that have also risen 3-6% over the past year depending upon the category. Hotel occupancy in mid-August was approximately 68%, down 8% from the same period in 2019, so that industry is financially challenged as well. While these industries do have some unique characteristics and problems, I focus on them because they capture many if not most of labor issues facing the overall economy.

The Future of Work

My research leads me to a couple of conclusions and a number of imponderables. With respect to my conclusions, others will certainly disagree, which is what makes the financial world interesting.

First, I believe wage pressures and resulting higher wages are here to stay. As discussed above, the difficulty in finding workers is a function of inadequate wages and poor working conditions in many sectors, rather than a national shortage of workers. Power began shifting from labor to capital in the early 1980s, and it may well be that we are witnessing a partial reversal of that trend. Or perhaps recent trends are temporary and the status quo ante will reemerge as the pandemic recedes. In either case, I am not particularly concerned about the impact of higher wages on inflation because corporate profitability is at record levels, which should allow companies to absorb higher wages without significant price increases.

Second, workers are voting with their feet with respect to working conditions, flexibility, work-life balance, predictability of hours and incomes, the availability of childcare, and so on. Once again, I believe these factors are here to stay and that employers are and will be forced to adapt their operations and culture. Now for the imponderables.

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I have written many times about the likelihood of future job losses due to the impact of artificial intelligence and robotics. If anything, the pandemic accelerated this trend and higher wages may well induce corporations to further employ labor-saving devices. During past technological revolutions, new industries were created that offset the temporary loss of jobs in obsolete sectors. Will that happen again? I am hopeful, but in any case, I am certain that we need to be much more deliberate and innovative in enhancing education, creating job training programs, and providing assistance to help displaced workers in their transition to the new economy.

Finally, there remain dozens of questions regarding the long-term impact of the pandemic. Will the migration from cities to rural areas reverse? If not, what will be the impact on urban services and real estate values? Is the rise of *second tier* cities at the expense of the Gateway Cities the new normal? If work from home persists, will it permanently damage corporate cultures, diminish teamwork, and reduce innovation and creativity? Those of us, who were around in the 1960s, will recall a frequently-used exclamation: Wow-heavy duty!

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