



Help (Desperately!) Wanted

The U.S. labor market hasn't fully recovered from its bout with COVID-19. Here's some context.

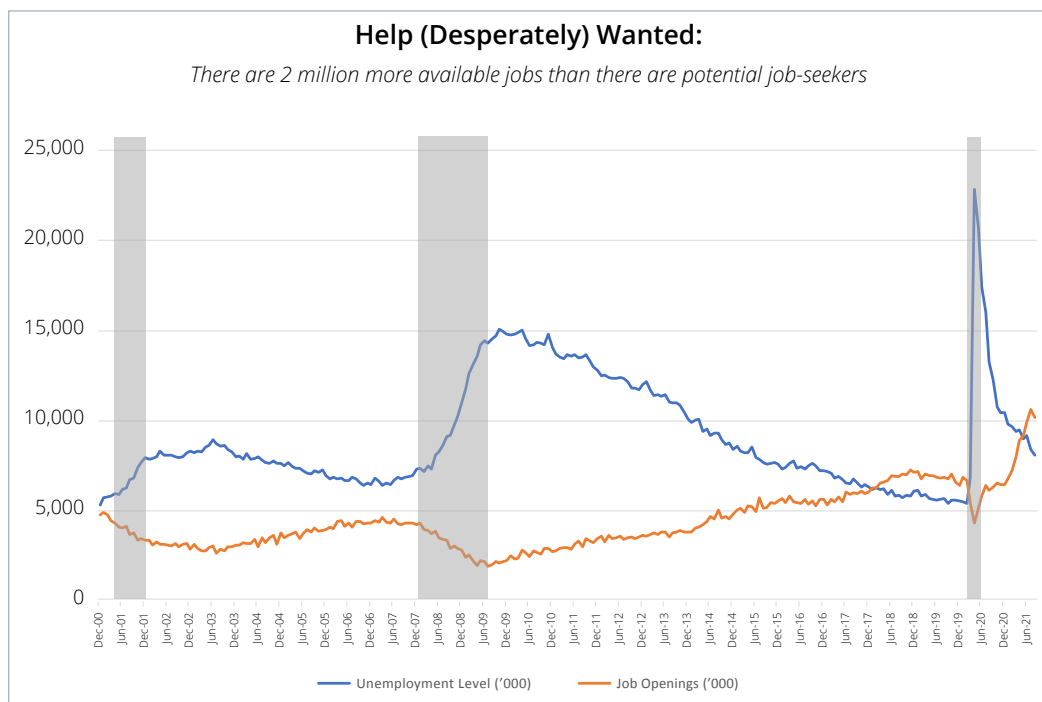


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If you run a business, one thing is probably keeping you up at night: an inability to find workers. According to the National Federation of Independent Businesses (NFIB), a trade group that focuses on small business owners, a record 51% of small businesses have open positions that they simply can't fill.¹ That's unprecedented in the 48-year history of the NFIB's survey and more than twice the historical average. And it's not just small businesses: Job openings across the economy topped 10 million for the first time ever in June and continued to accelerate toward 11 million in July before decelerating slightly in August.² Even then, the number of job openings is still outpacing the number of unemployed workers by around 2 million — an equally unprecedented gap.

But if you've been paying attention, this probably won't surprise you. Longer lines at the grocery store, longer waits at the pediatrician and empty shelves are becoming commonplace, and many of these issues can be traced in one way or another back to difficulties in the job market. While the demand side of the macroeconomic equation has roared back — thanks in no small part to generous pandemic-era stimulus programs and a reasonably successful vaccination program — the supply side of the economy is clearly still suffering the lingering effects of COVID. An inability of businesses to staff back up as demand returns joins well-publicized supply chain bottlenecks as one of the most prominent reasons.

This apparent disconnect between businesses' desire to hire and workers' willingness to return to work is something of a mystery, and anyone who claims they have the answer is fooling themselves. That said, a few factors that seem at least plausible explanations as to why this highly unusual situation persists have been offered by observers. Below, we address a few of them.



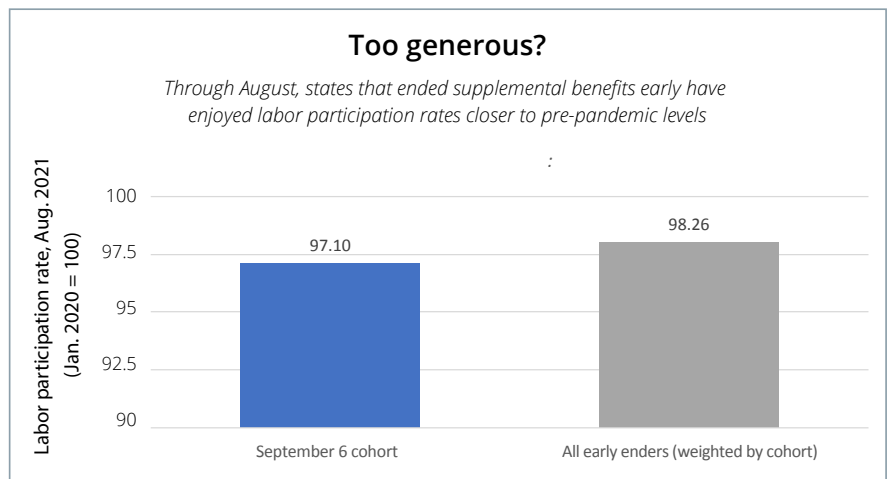


COVID-era unemployment benefits may have been too generous

This is perhaps one of the more intuitively appealing theories about why participation rates remain depressed, but it is also one of the most politically charged and hardest to analyze. That said, it’s possible to find at least some support for the idea by comparing labor force participation rates at the state level to the dates that supplemental benefits ceased in those states. This is hardly the smoking gun that would pin the blame for depressed labor force participation entirely on the generosity of federal taxpayers, and it does little to explain why this phenomenon has occurred outside the United States — perhaps most notably in Europe, where COVID-era support took a much different form. But the data is interesting enough to leave room for sincere debate. It’s also an inherently optimistic message for the future: If additional unemployment benefits were truly excessive, then the expiration of those benefits at the beginning of September should cause participation rates to improve in the very near future.

Some context would probably be helpful: Beginning in June, a handful of U.S. states stopped participating in a federal program that provided supplemental pandemic-related payments to workers receiving unemployment benefits. By the end of July, roughly half of state governments nationwide had ended their participation in the program³ while the other half continued to participate until supplemental benefits expired on September 6 (ironically enough, Labor Day).

If that additional weekly benefit was indeed sufficient incentive to keep at least some displaced workers from rejoining the workforce, then it’s reasonable to expect labor participation rates in those states that ended benefits early to have recovered faster and in a more robust fashion than those that didn’t. As the nearby chart suggests, participation rates for these “early enders,” viewed collectively, were indeed slightly higher (and by August, closer to pre-pandemic levels) than those states that participated through September



6. In addition, national income data shows that transfer payments made under the unemployment insurance program in general declined more rapidly in June and July — the two months that corresponded with the withdrawal dates of the “early enders” — than they did in May, when all states were still participating. That was also true in August — after additional payments had ceased in the “early ender” states but continued in others. Importantly, these month-to-month differences in payments made to unemployment recipients cannot be fully explained by declines in transfers made under the Federal Pandemic Unemployment Compensation Program (FPUC), the program that was terminated early by the early enders.⁴ Said differently, June and July saw total payments to unemployment recipients fall at a faster rate than can be simply explained by the roll-off of extra benefits by early ender states, and August may have represented a lull in that deceleration that could resume in the near future given the full expiration of the FPUC program nationwide on September 6.



Wages are too low to incentivize a return to work

First, it's important to note that hourly earnings data itself is of little help here because the data can be heavily influenced by "mix shift" — the tendency for large increases or declines to appear solely as a function of what types of jobs are being gained or lost in any given month. That was almost certainly the case during the early months of the pandemic, when hourly earnings suddenly jumped higher as lower-wage workers in industries such as food service and hospitality lost their jobs in far greater numbers than those in relatively higher-wage occupations.⁵ The same effect has likely been at work — although in a more subtle fashion — since the spring of this year, when lower-wage workers began returning to work in greater numbers than higher-wage employees, more of whom remained employed throughout the pandemic, thereby keeping the hourly earnings figure slightly lower than it might have been otherwise. It should come as no surprise, then, that attempts to correlate average hourly earnings to indicators of labor force participation such as changes in re-entrants to the labor force and the number of workers not in the labor force have shown little statistical relevance. Moreover, while there seems to be a loose statistical relationship between the nominal minimum wage and participation rates at the state level, the presence of a higher state minimum wage seems to have had no noticeable impact on participation rates as the economy has begun to recover from pandemic-related shut-downs.⁶

Regardless, the wages-are-too-low argument is perhaps intuitively less satisfying as an explanation for persistently low labor force participation for the simple reason that it implies that workers who were satisfied with what they were earning before the pandemic are suddenly dissatisfied enough to remain on the sidelines as COVID recedes. That in turn implies that something fundamentally changed during the pandemic that would cause such workers to reassess their situation.

It's certainly possible that the stress associated with changing work modalities, higher workloads, increasingly poor customer behavior, stagnant wage growth and other grievances made more apparent by the pandemic may have finally convinced harried workers to exit the workforce, particularly after the pandemic afforded these workers more time to reflect. This might also help explain why the so-called "quits rate" also surged to an all-time high in August.⁷

Beyond that, it's at least reasonable to ask whether a sharp and well-documented increase in inflation has suddenly caused wage earners to demand higher wages in the post-COVID economy, but that explanation also falls somewhat short. While inflation has clearly accelerated, consumers seem to have largely taken at face value reassurances from policymakers, the Federal Reserve and others that the spike in prices is temporary. For example, the authors of the University of Michigan's consumer sentiment survey — a gold standard among consumer surveys — recently noted that the tendency of consumers to delay purchases amid rising prices is consistent with a belief that inflation will fade.⁸ Otherwise, they contend, consumers would have engaged in panic buying in hopes of avoiding even higher prices in the future, creating the kind of inflationary spiral that dogged the U.S. economy during the 1970s. It seems plausible that any relationship between these two variables operates on a lag of undetermined length, and it remains true that consumer attitudes regarding inflation could certainly change if and when prices remain stubbornly high. But the inflationary psychology that would likely correspond to a "wage strike" necessary to cause a further acceleration of wages certainly appears as if it has yet to emerge.

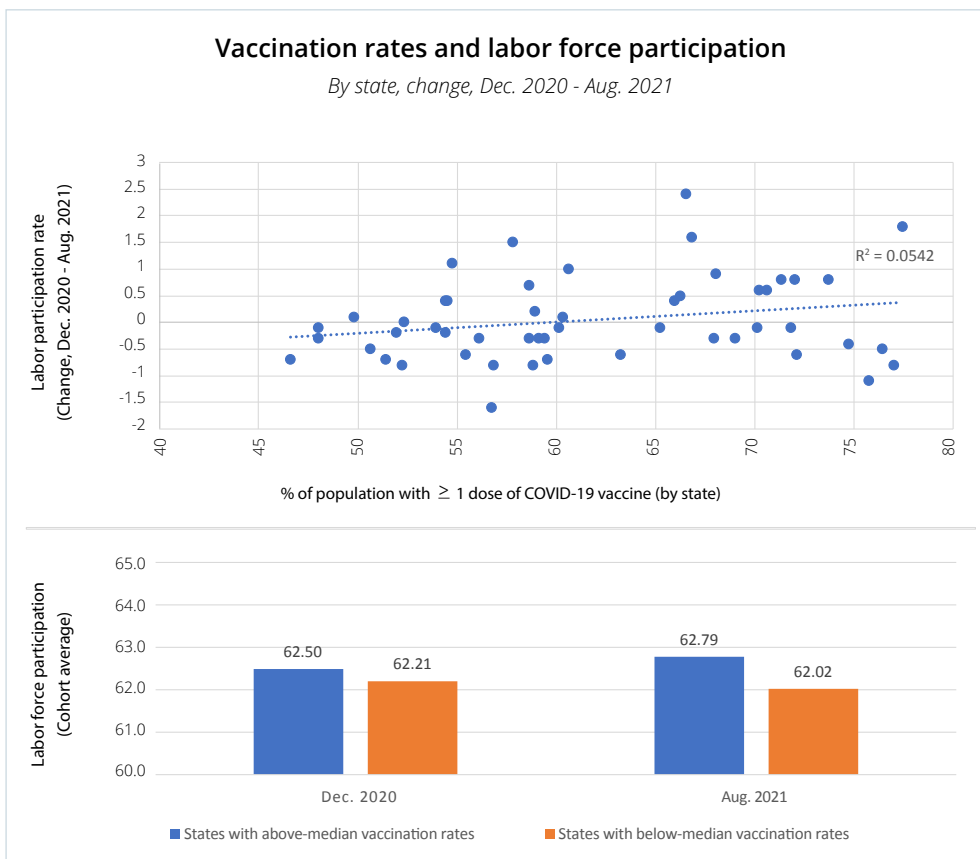


Workers fear becoming infected at work

Another commonly cited reason that labor markets remain out of joint as the economy continues to mend is that workers may simply be unwilling to return to work until the likelihood of becoming infected with COVID-19 diminishes to near zero. Once again, data is ambiguous and hard to interpret. For example, while there does appear to have been a slight tendency for labor market trends in states with higher vaccination rates to improve more quickly than states with lower rates, the differences are small enough to be merely suggestive of a relationship rather than unequivocal evidence that one exists. Specifically, states with vaccination rates higher than the median have seen participation rates, on average, improve marginally since vaccines became widely available while states below the median have indeed seen a marginal decline.

But the relationship is hardly conclusive and may indeed be little more than random chance: Despite the averages, roughly half of the states in the higher-than-median vaccination cohort saw labor force participation rates decline while a third of below-median states saw rates improve.⁹ Moreover, even if a relationship between vaccination rates and labor force participation at the state level does exist, it remains very much an open question whether it has more to do with things such as employer policies regarding vaccination rates or state- and local-level restrictions with regard to business closures and so forth than it does with employees' willingness to return to work.

So the jury remains out as to whether fear of becoming infected is a significant factor in disappointingly low participation rates.



**Childcare responsibilities are preventing a return to work**

Another intuitively appealing theory is that increased dependent care responsibilities as a result of COVID-related school and daycare closures have made workers reluctant to return to work. That is certainly plausible, and I'm fairly certain that most of us can cite examples from our own personal experience where that was in fact the case. And it is once again possible to find at least some evidence that this has been a contributing factor: According to data from the Organisation for Economic Co-operation and Development, labor force participation rates for age cohorts most likely to have school-age children (namely, those aged 25-54 years) have indeed improved more slowly than other age groups less likely to have had both work and child-rearing responsibilities as the U.S. economy has slowly and unevenly reopened (see table nearby).¹⁰

However, it's also possible to find data that serves as a counterpoint to this argument. For example, the U.S. Bureau of Labor Statistics has tracked employment statistics for U.S. women who maintain families since the late 1960s. Perhaps tellingly, the number of employed females who meet that definition never declined as sharply as — and appears to have recovered more quickly than — married males who are currently employed. Perhaps more compelling, while it may be too early to expect much change, there has so far been no obvious or significant increase in labor force participation so far this autumn — even though a majority of schools have returned to in-person (or at least hybrid) learning. In any case, the idea that increased childcare responsibilities continue to represent a significant and durable influence on depressed participation rates seems to have only moderate support.

Workforce participation Rates - United States

	Pre-COVID 4Q19	Nadir 2Q20	Latest Avail. 2Q21	Pre-COVID to TROUGH	Pre-COVID to Curr.	TROUGH to Curr.	% of Pre-COVID
Male, 15-24	51.4	39.8	50.3	-22.7%	-2.3%	26.4%	97.7
Male, 25-54	86.6	77.8	83.0	-10.2%	-4.2%	6.7%	95.8
Male, 55-64	69.8	63.5	67.1	-9.0%	-3.8%	5.7%	96.2
Female, 15-24	51.2	37.6	49.4	-26.5%	-3.6%	31.2%	96.4
Female, 25-54	74.4	65.3	71.2	-12.1%	-4.2%	9.1%	95.8
Female, 55-64	58.2	51.1	56.4	-12.2%	-3.1%	10.4%	96.9

Data: <https://stats.oecd.org/>

**Conclusion: It may simply be an acceleration of a secular trend already in place**

There are naturally other interesting and reasonable theories beyond those discussed above about why the post-COVID employment market is so unusually disconnected. Among these are a higher-than-usual number of early retirements as a result of pandemic-related soul-searching (which we view as likely to be too small to make a material difference) and a lack of necessary skills among job seekers (which, like the theory that wages are too low to compel a return to work, relies on a factor that had been in place long before the COVID pandemic and therefore requires a significant, pandemic-related change of heart that seems to us to be quite unrealistic).

So we're left with a series of potential explanations that are at best only partially or ambiguously responsible. In our view, while each of these may be partially to blame, the one that rings most true is the idea that COVID-era support was too generous to allow a quick and painless transition back to normal labor market dynamics. That is an inherently optimistic view to take, because it suggests that the expiration of some of the most generous benefits in September should allow the labor market to begin righting itself in the very near future.

But it's also worth pointing out that the reason it's so difficult to find empirical support for any of these theories is that the discouragingly low rate of labor force participation might simply be nothing more than an acceleration of a secular trend that has been in place for nearly two decades. Nationwide participation rates peaked immediately before the recession of 2001, declining (as they typically do) throughout the recession. But unlike prior recessions, labor force participation never recovered to pre-recession levels and instead continued lower until — and then through — the next recession in 2008-09. While it's clearly too early to tell whether the short but intense COVID recession represents simply a continuation of that trend, it certainly appears as if it might.

1 National Federation of Independent Businesses Small Business Optimism Index 2021, [nfib.com/surveys/small-business-economic-trends/](https://www.nfib.com/surveys/small-business-economic-trends/).

2 U.S. Bureau of Labor Statistics latest data available as of this writing, October 2021, [bls.gov](https://www.bls.gov/).

3 These benefits originally paid recipients as much as an additional \$600 per week, later reduced to \$300. Twenty-five states originally planned to withdraw from the program before it expired in September, with termination dates ranging from mid-June through the end of July, but one — Maryland — was barred from doing so by the courts and therefore continued to pay benefits until the federal program expired.

4 Bureau of Economic Analysis Personal Income and Outlays, August 2021, [bea.gov/news/2021/personal-income-and-outlays-august-2021](https://www.bea.gov/news/2021/personal-income-and-outlays-august-2021).

5 For example, average hourly earnings as reported by the Bureau of Labor Statistics jumped by \$1.31 in April 2020.

6 A simple regression comparing nominal minimum wage rate (by state) for those states with higher minimum wages than the federal minimum to statewide participation rates for those same states during August 2021 (latest available) yields an R-squared value of 0.089 and a p-value of 0.102. A similar regression comparing nominal minimum wages to changes in participation at the state level yields an R-squared of less than 0.01, a p-value greater than 83% and a regression coefficient that is actually slightly negative. (Source: GWI calculations, using BLS data.)

7 U.S. Bureau of Labor Statistics Economic News Release, October 2021, [bls.gov/news.release/jltst.nr0.htm](https://www.bls.gov/news.release/jltst.nr0.htm).

8 University of Michigan Survey of Consumers, September 2021, [sca.isr.umich.edu/](https://www.sca.isr.umich.edu/).

9 A simple regression comparing state vaccination rates and the change in participation rates between December 2020 and August 2021 yields an R-squared of 0.054 and a p-value of 0.100. (Source: GWI calculations, using BLS and CDC data.)

10 Organisation for Economic Co-operation and Development, [stats.oecd.org](https://www.stats.oecd.org/).

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