Do Employees Expect More Now?

Job openings topped 10 million in June, the highest level in the 20-year-plus history of the data. We hear businesses are struggling to fill those openings, and the issue is particularly acute for low-wage positions. This difficulty is, of course, strange given there are about 6.5 million fewer people employed today than in February 2020.

Our contacts offer a variety of reasons why labor supply might lag demand. Some point to a continued fear of infection or logistical barriers related to remote schooling or child care. Others point toward increased retirements or the adverse incentives created by enhanced unemployment insurance. Still others believe workers have reassessed their perspectives on work versus time at home.

Economics has an explanation for this: an increase in the "reservation wage." The reservation wage is the lowest wage an unemployed person is willing to accept for a new job. If an individual's reservation wage rises above an employer's offered wage, then the individual will likely keep looking for another opportunity or even opt out of the labor force.

We have data to validate that reservation wages have increased over the past year, especially for individuals making less than $60,000 per year and those without college degrees. The New York Fed conducts a regular survey that asks respondents for the lowest wage they would be willing to accept for a new job. Between March 2020 and March 2021, the average reservation wage for those making less than $60,000 and those without college degrees went up more than $10,000 (26 percent). This increase is far in excess of the range that the survey has seen historically for these groups.

In comparison, the average reservation wages of those making more

than $60,000 and those with college degrees only increased about 3 percent and 6 percent, respectively, during the same time period. What spurred this increase in reservation wages?

Part of the answer may be the impact of the pandemic experience. Increased health or child care concerns or better understanding the pain of a commute might elevate the costs that individuals associate with a job. At the same time, enhanced unemployment insurance might make staying unemployed more feasible. Bolstered savings might reduce the sense of urgency.

Another force seems to be playing a role: the dialogue around a $15 federal minimum wage. To be clear, efforts to increase the minimum wage have existed for years. But the outpouring of gratitude for essential workers, support for stimulus to jump-start the economy, and a new Congress gave that movement renewed energy this spring. Congress didn't pass a new bill, but there are signs that $15 has become a wage anchor point.

For one, several states and cities are moving toward $15 without waiting for federal change. Pre-pandemic, seven states and the District of Columbia had committed to reach $15 over time. Last year, Florida joined this list, representing a broadening consensus beyond traditional progressive states and localities.

In addition, the private sector increasingly seems to be adopting a similar message. In the last few months, a number of large employers, such as Southwest Airlines and Under Armour, have announced bumps in entry level wages to $15. In perhaps the strongest evidence of the importance of the "$15 anchor," several others, like Chipotle and McDonald's, have announced an *average* $15 starting wage. Presumably, those firms see an advantage to adopting the number in messaging even if they do not adopt the wage floor.

This combination of private and public momentum could be boosting workers' expectations, which in turn raises their reservation wages. Google searches for "$15 minimum wage" reached their all-time high in the first quarter. And higher worker expectations could be pushing employers to raise wages, further cementing the higher wage floor.

Whether due to pandemic factors or expectation shifts, economic theory gives us a pretty good idea of the implications of a reservation wage increase. If fewer jobs meet individuals' standards, then fewer people enter or remain in the workforce. If there are fewer people in the workforce, employers must raise wages or lower their dependency on labor. If employers raise wages, they likely pass on part of the increased labor cost to consumers via higher prices. If they lower their dependency on labor instead, they turn to automation or offshoring, or make adjustments to the quantity or quality of their products.

We already see this theory happening around us. As I discussed in an essay last month, we see wages for lower-skilled workers rising as workforce participation stays stubbornly low. We also see price increases. While other factors, such as supply bottlenecks, are contributing to inflationary pressures, businesses also point to wage pressure. For example, Chipotle linked its latest price hike to wage increases.

And in sectors struggling to find labor, firms are finding ways to reduce their reliance on workers: turning to automation, offloading tasks to customers or third parties, reducing the frequency of service, or sacrificing quality. If you have taken a trip this summer, you have experienced this. Perhaps your airline rescheduled your flight. Perhaps you waited longer to be served at dinner or ordered your meal through a QR code menu. Perhaps your hotel stay came without daily housekeeping.

It is too early to tell whether this increase in reservation wages is temporary or permanent. If labor supply gets a boost over the next few months, as vaccines hopefully help put the virus behind us, enhanced unemployment ceases, and schools reopen, then wage and price pressures should ease, and the incentive to reduce labor should weaken. We will see.

One area to watch in the near term is how employment evolves in states that are ending enhanced unemployment insurance early. I am paying close attention to real-time data on job search activity.

In the longer term, there are a few other areas worth watching.

How durable is the expectation of a $15 minimum wage? While current expectations might act as an effective anchor, this could be less durable than a minimum wage codified in law. It is possible that a negative labor demand shock in the future could lead to lower wages in a way that would not be likely with an official wage floor.

How will businesses' compensation strategy shift? We may see employers tweak the balance between wages and benefits in response to the higher reservation wage. Some may move toward higher wages and away from fringe perks to present an offer that meets workers' mental model of what wages should be. Others may try to better communicate the monetary value of their fringe benefits, as happens with cafeteria plans that place an explicit financial value on a benefits package.

What will be the impact on wages more broadly? Higher entry wages compress pay scales of current workers who often respond with demands for higher compensation for themselves. The broader the reverberations, the greater the resulting pay and price pressure.

The fall will bring much change: Schools will reopen, employees will return to offices, and government assistance will decline. We'll be keeping our eyes on the effects of these factors on the reservation wage and, in turn, on the economy. **EF**

OUR RELATED RESEARCH

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"Incarceration's Life-Long Impact on Earnings and Employment," Economic Brief No. 21-07, March 2021

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"Learning About the Labor Market from High-Frequency Data," *Econ Focus*, Second/Third Quarter 2020

"Projecting Unemployment and Demographic Trends," Economic Brief No. 19-09, September 2019

"Workers' Shrinking Share of the Pie," *Econ Focus*, Second/Third Quarter 2019