The Great Job Reshuffling

Hiring has become easier than it was early last year. Yet everywhere I go, from farms to factories to ballparks, I still hear that labor is in short supply. And the numbers back this up: In February 2020, 61.1 percent of the population was employed. Today, that number is down 0.9 percentage points — equivalent to nearly 2.3 million fewer workers.

If good workers remain hard to find, wages could rise further, pressuring margins and prices in turn. So it's important to understand what's happening in the labor market, and where it may go from here.

FROM LABOR ABUNDANCE TO SHORTAGE

The shrinkage in the number of employed workers relative to the country's population has occurred at a time when economic activity has been expanding: Real GDP has increased more than 6 percent since before the pandemic. That gap helps explain why labor feels so short. It is.

Demographics play a role. Some decline in labor supply was predictable due to natural aging of the baby-boom generation. But the rest of the gap is almost entirely attributable to lower participation rates for those at or near retirement age, perhaps supported by stronger 401(k) plans or the desire to help with child care for grandkids.

Demographers have forecast this reduction in the workforce for a while. For decades, our economy operated with a growing labor force. We benefitted from the baby boom, women more fully entering the workforce, increased educational attainment better preparing workers, improved health leading to longer careers, and historically high levels of immigration. All of that was supplemented by access to ever-growing pools of offshore, low-cost labor.

These tailwinds look like they are becoming headwinds. The growth of the working-age population is relatively straightforward to forecast, and the predictions aren't good. Fertility rates are down. K-12 school enrollment is projected to decline by nearly 8 percent between 2019 and 2031. My generation is aging out of the workforce. Immigration policy looks unlikely to materially change soon. Offshoring has been complicated by increased awareness of the risk associated with dependence on foreign labor sources.

THE GREAT RESHUFFLING

But it's more than the overall numbers that are discombobulating employers. It's not just the level of supply but its distribution.

Over time, employers had become comfortable with where their jobs rated versus those offered by others. Think of it as a job hierarchy. They knew the level of investment in wages, benefits, and working conditions they needed to make to hire and retain workers in what was a relatively stable marketplace.

But the pandemic era seems to have reshuffled that hierarchy considerably, making the job market less predictable and leaving a number of employers scrambling. Three things happened during COVID-19. The first was a shift in relative compensation. Firms didn't sit idly by as the pandemic created labor shortages. Growth sectors, like warehousing, filled their needs by offering high entry wages. Employers that found themselves short offered new perks or higher wages to convince workers to come. In leisure and hospitality, for example, wages have increased much faster than in the private sector overall. Segments that struggled to find the money to raise wages, such as state and local government, fell behind.

The second shift was that the COVID-19 experience made a number of jobs objectively less attractive. Whole sectors, like restaurants and theme parks, shut down for a time, sending a message that those sectors weren't as secure as they had seemed. Supply chain challenges increased stress on those in manufacturing. And for some workers, like teachers, nurses, and child care providers who had historically earned points for the revered roles they hold in our society, the pandemic also crystallized that they face higher health risks, at least during a crisis.

Third, there was a shift in employee attitudes. The most obvious place is in a preference for remote work. Jobs that can provide days at home have rocketed up the hierarchy. But there seems to be an even broader change in employee willingness to trade off intangibles. My travels in the Fifth District drive this home. I talked to a coal company that in part can't hire miners, despite high pay, because cell phones don't work in the mine shaft. And I heard from a manufacturer in South Carolina that was losing workers to the Bojangles down the street. The pay gap between the two companies may have shrunk, yes. But the attrition seemed more linked to the ability to control work schedules and work in an indoor environment. Conditions taken in stride prior to the pandemic, such as last-minute overtime shifts or grueling physical labor, seem to require more of a premium now.

HOW EMPLOYERS ARE REACTING

Those employers caught short aren't standing still.

Many are investing to increase the supply of labor. This is good for workers, good for growth, and good for reducing inflationary pressure. I hear of a number of efforts to bring in new workers off the sidelines, through training partnerships with community colleges, apprenticeships and internships, and investments to reduce barriers to work like transportation, child care, and access to housing. This investment in talent could be particularly important given the impact of the pandemic on the social and educational preparedness of those entering the workforce.

Others are investing to reduce demand for labor. You can see that clearly in hotels, where housekeeping is no longer always automatic every day, and many lounges are still closed. More fundamentally, wage and staffing pressure has made automation more economically compelling. McKinsey Global Institute estimates that automation, including AI, could replace tasks that account for about 30 percent of the hours worked in the United States by 2030. All else equal, these investments are also likely disinflationary and increase capacity for growth. But, while the buzz around automation and AI is inescapable, most jobs won't change overnight.

And, of course, we are seeing employers fight their way up the job hierarchy by adjusting wages, benefits, and the work environment. Some are doing so by improving working conditions, limiting overtime or last-minute scheduling, offering more flexible work arrangements, or installing air conditioning. But those who can afford to reprice are doing so, raising wages to remain competitive. After all, workers expect more now. The New York Fed's Survey of Consumer Expectations suggests that the average reservation wage — the lowest wage someone would accept for a new job — has increased over 20 percent from its pre-pandemic level. This has been quite visible in recent labor negotiations between unions and parcel companies, airlines, and autos, but it's true in nonunion environments, too.

It's worth noting that these wage gains are unlikely to reverse. Simply put, nominal wages seldom decline — even in a recession. And in today's environment of strong demand, employers who are losing out on workers eventually will raise their wages to match. We can expect the net effect to be inflationary, barring any adjustments to monetary policy.

WHAT'S AHEAD?

It is hard to know how this will balance out. Will labor supply come back even further as employers invest in training and retirees find themselves bored or squeezed? Will labor demand settle as automation rolls out or as the economy weakens? Will employees return to their pre-COVID-19 preferences? Or will employers bite the bullet and increase wages and then prices even further?

The range of potential outcomes, to me, is still pretty broad. That's why I supported our decisions to hold rates steady at the last several Federal Open Market Committee meetings. We have time to see whether we've done enough. The path forward to me depends on whether we can convince ourselves inflationary pressures are behind us, or whether we see them persisting. I will be watching the labor market closely for those signals.

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A longer version of this essay was delivered as an address to the Money Marketeers of New York University on Sept. 28, 2023.

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