**Richmond Fed**

**Tom Barkin**

# Is a Labor Challenge Coming?

**Dec. 2, 2022**

**Tom Barkin**
**President, Federal Reserve Bank of Richmond**

2022 Virginia Economic Summit and Forum on International Trade Greater Richmond Convention Center

**Highlights:**

- Our economy has operated with a growing labor force for decades. This excess labor world kept wages and benefits, and effectively cost-push inflation, down.
- That's certainly not the world we find ourselves in now. And labor supply looks like it will remain constrained.
- Fewer workers would constrain our growth and pressure inflation until businesses and governments can deliver productivity enhancements and/or structure incentives to bring more workers into the workforce.
- Increasingly, I fear we are moving to an environment where labor is short, not long. That situation can be managed, as other countries have proven, but it requires real intentionality.

*The following text was prepared prior to the BLS Employment Situation release on December 2, 2022.*

---

Thanks for that nice introduction. As you know, the Fed's dual mandate is to promote stable prices and maximum employment. Over the last year, that first goal – stable prices – has been front and center. But this is an economic development conference, so it seems right for me to focus on the second part of the mandate today and talk about how we get our economy to its full employment potential. I should note these views are mine alone and not necessarily those of anyone else in the Federal Reserve System.

Let's start with the workforce before COVID. It seemed amazingly healthy. We added jobs every month after 2010. In the months before the pandemic, the unemployment rate hit 50-year lows. And despite projections that demographics were working against us, labor force participation kept improving as the strong labor market pulled people off the sidelines.

Then COVID hit. In a two-month span, we lost nearly 22 million jobs -- the deepest drop on record. The unemployment rate hit 14.7 percent in April 2020. Participation fell over three percentage points, to levels last seen in the early 1970s.

But the economy bounced back, supported by historic levels of fiscal and monetary stimulus. Unemployment dropped and is now basically at pre-pandemic levels. Yet participation was slow to return. At first, that seemed to be due to sickness and quarantining, child care responsibilities, and enhanced unemployment benefits. But even once the economy and schools reopened, vaccines rolled out, benefits ceased, and wages increased significantly, participation remained stubbornly below its pre-COVID levels.

The result has been unprecedented labor market tightness. Job openings have hit record highs. Businesses have struggled to hold on to or find enough workers, especially in industries with lower pay and less attractive jobs. This issue is particularly pronounced in skilled trades, like nursing or welding or truck driving. In November 2021, the quits rate reached a new record. In March, we reached two open jobs for every unemployed person. We are not far from that high today.

This labor shortage has helped feed inflation. The Personal Consumption Expenditures Price Index is at 6.0 percent headline and 5.0 percent core, near 40-year highs.

The Fed has taken aggressive action to bring inflation under control, raising the fed funds rate steeply to just under 4 percent and making clear our intent to do more. Even so, we have seen labor demand continue to run ahead of supply.

We added 261,000 jobs in October, over two times the breakeven level of workforce growth. The unemployment rate was still at a historically low 3.7 percent. Despite recent news from the tech sector, layoffs remain muted as businesses seem reluctant to shed workers they have fought hard to hire. Wages in nominal terms were up over 14 percent from their pre-pandemic level and up 4.7 percent year over year. In the decade prior to the pandemic, their growth averaged 2.4 percent. And participation? Participation hasn't moved meaningfully since the beginning of this year and last month moved to 62.2, well short of the 63.4 percent of February 2020.

**All of this leads me to ask: Have we moved from a long-labor world to a short-labor one?**

Our economy has operated with a growing labor force for decades. We benefitted from the baby boom, from women more fully entering the workforce, from increased educational attainment making more people ready for more jobs, from better health allowing workers to work longer, and from historically high levels of immigration. All of these were supplemented by access to ever growing pools of offshore, low-cost labor.

Businesses adapted, as you might expect. They chose to hire from outside rather than grow their own; for example, the huge and attractive bank training programs of my era were largely eliminated in the '90s when banks realized the market had surplus bankers. Firms got more comfortable with higher attrition staffing models, reoriented toward part-time work and outsourcing, and became more willing to do layoffs rather than commit to job security. They reduced retirement and health care benefits.

This excess labor world kept wages and benefits, and effectively cost-push inflation, down. Labor share of income dropped. This was good for businesses and good for investors. It was less good for the existing workforce.

Now, there were many predictions over the last 10 years that as baby boomers aged, we would see participation reverse its positive trend. But, as I said earlier, in the recent historically long upturn, we saw participation overperform. Perhaps the sheer duration of that upturn brought hesitant people on the margin back to work. Or maybe the Great Recession forced near-retirees to work longer. Or perhaps the rise of certificate programs better connected workers to the workforce. And don't forget the growth of the gig economy. Regardless, the net was – despite some complaints at the end – labor was fully available. Wage growth was relatively modest.

That's certainly not the world we find ourselves in now.

It's possible that labor force participation will recover — in time — to our pre-pandemic normal. But what if it doesn't? What if the aberration isn't today but instead the above-trend participation at the end of the last upturn? There are many reasons to think that might be the case.

The growth of the working-age population is relatively straightforward to forecast, and predictions aren't good. Fertility rates are down, and that trend would take a generation to reverse. My generation, the baby boomers, are aging out of the workforce, and the many retirements we saw during the pandemic are unlikely to come back. As of October, we were still down about 1.4 million older workers. Immigration policy also looks unlikely to materially change any time soon. As of October, we were missing about half a million prime-age immigrants versus our 10-year pre-COVID trend. Offshoring has been complicated by increasing wages in developing countries and heightened awareness of the risk of being dependent on foreign labor sources.

And participation is clearly challenged too. COVID has had to have had some impact, especially given the added pressure of child care and elder care. This seems most pronounced for working class women, who may no longer be able to make the math work to stay in the labor force, and for the many recent retirees taking care of their parents, spouses or grandkids.

So, labor supply looks like it will remain constrained. And the Fed's efforts to bring demand back into balance won't be easy when Americans still have about $1.3 trillion more in savings than they did pre-pandemic and fiscal stimulus continues -- for example, the outlays coming from the infrastructure package.

**What would a short-labor world mean?**

Fewer workers would constrain our growth and pressure inflation until businesses and governments can deliver productivity enhancements and/or structure incentives to bring more workers into the workforce.

As I travel my district, I hear many initiatives already underway to bring people off the sidelines. I've talked to a steel company that invested in full-time recruiters and a tool distributor that started its own soft-skills training program. I've talked to a poultry provider that has widened the profiles of who they are open to hiring, dropping drug tests and background checks. Employers are reconsidering working conditions, revising schedules and redesigning jobs to better match worker preferences. They are investing in partnerships with community colleges to better attract and develop skilled trades. Particularly intriguing have been initiatives to provide child care or housing support for employees, taking a more active role in tackling barriers to work. I'm reminded of what used to happen in company towns the last time labor was this short in the early '50s, when employers attracted workers by investing in the broader environment, including housing and amenities.

But not all responses will be good for workers. I talked to a fast-food brand that described how automation and robotics could reduce store staffing by half. Employers who pay more will demand higher productivity or raise prices, thereby lessening demand and eventually jobs. You are seeing lower service standards already, e.g., hotels lessening their cleaning protocols or restaurants taking your order via QR code. We may see an increase in offshoring to markets without geopolitical pressures. All of these are particularly threatening to the last people into the workforce who might find entry is more of a mountain to climb with entry-level jobs increasingly scarce.

Governments and nonprofits will want to think through how they approach this as well. Constrained longer-term economic growth isn't good for our tax base, our competitiveness or our workers in the longer run. They should be exploring policies that work the supply side by encouraging workforce participation and preparation.

Canada's prime-age women's participation grew over five points in the 20 years before the pandemic, while the U.S. rate dropped nearly a full point. Research from the San Francisco Fed points to parental leave policies in the two countries as a key differentiator. The same research highlights flexible work arrangements as a driver of increased women's participation in other industrialized countries. And the two countries tax second earners much differently as well.

Similarly, between 2000 and 2019, the employment-to-population ratio for Japanese adults ages 60 to 64 increased 19.3 percentage points to 70.3 percent. For context, the U.S. ratio was 56 percent. Japan (where population is, to be fair, healthier) has pursued several policies to increase employment of older workers, including subsidies and pushback against mandatory retirement ages. It has fielded a training program for employers on how to make jobs friendlier for older workers.

These ideas are worth exploring in the U.S. Additionally, it is worth exploring increased legal immigration, bringing those with skills, work ethic and entrepreneurship into our workforce. On participation, there could be significant leverage in further investment in education, job training, licensing capacity and rehabilitation, as well as in reimagining the child and elder care industries and in exploring benefit and tax policy changes that could incent further workforce participation.

To sum it up, COVID has caused businesses, governments and – yes – even economists to reassess their assumptions on the labor market. Increasingly, I fear we are moving to an environment where labor is short, not long. That situation can be managed, as other countries have proven, but it requires real intentionality. With that, I welcome your questions and comments.