ECONOMIC VIEWPOINT

The U.S. Job Market: A Recovery Where Underemployment and Labour Shortage Coexist

By Francis Généreux, Senior Economist

The pandemic hit the U.S. economy hard, but several government measures and the easing of health restrictions have boosted the recovery and real GDP has now surpassed its pre-pandemic level. Unfortunately, that was not the case for the labour market, which is still short several million jobs. Underemployment is rampant in the United States. At the same time, businesses are making it clear that they are having trouble filling all currently vacant positions. This *Economic Viewpoint* will try to make sense of this paradox which is clouding not only economic conditions but also the prospects for the Federal Reserve (Fed) and public administrations.

A Job Market Heavily Affected by the Pandemic

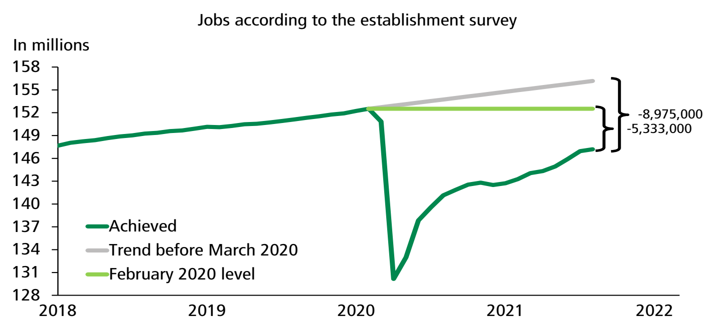
The COVID-19 pandemic hit the U.S. job market harder than any other crisis since the Great Depression of the 1930s. Millions of workers were suddenly affected as health measures and lockdowns forced businesses to close. Weekly jobless claims soared from 212,000 in the first week of March 2020 to an all-time high of 6,149,000 a month later. The monthly establishment survey on employment revealed a total of 22,362,000 jobs lost in March and April 2020. During those two months 16.5% of U.S. private sector workers lost their livelihoods. That catastrophe put an official end to the longest economic cycle in U.S. history, the one that started in July 2009.

It was a sharp decline, but a short-lived one. While recessions undermine economic activity for several quarters, the COVID-19 contraction only lasted two months. The U.S. market started picking up again in May 2020, with 2,833,000 jobs being recovered as several sectors of the economy reopened. That positive trend continued almost uninterrupted (except for a loss of 306,000 jobs in December 2020 when restrictive health measures were reimposed in several regions of the United States). A net total of 17,029,000 jobs were created from May 2020 to August 2021, with monthly gains of almost 1,000,000 in last June and July when most of the remaining health restrictions were lifted.

A Significant Shortfall, Especially for Some Sectors

That said, 16 months after the official end of the recession, the U.S. job market still has not fully recovered. There is still a significant shortfall. Some 5,333,000 jobs would have to be created just to get back to February 2020 levels. And if, hypothetically, the observed trend in the last year of the pre-pandemic business cycle continued (with an average of 202,333 monthly hires as observed between March 2019 and February 2020), the shortfall would be 8,975,000 (graph 1).

GRAPH 1
The U.S. job market's shortfall remains considerable



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

The difference between the current and the pre-pandemic situations seems to be worse for the job market than for the other main indicators of the soundness of the U.S. economy. U.S. real GDP has completely wiped out its total loss of 10.1% during the first two quarters of 2020, and it is now 0.8% over its

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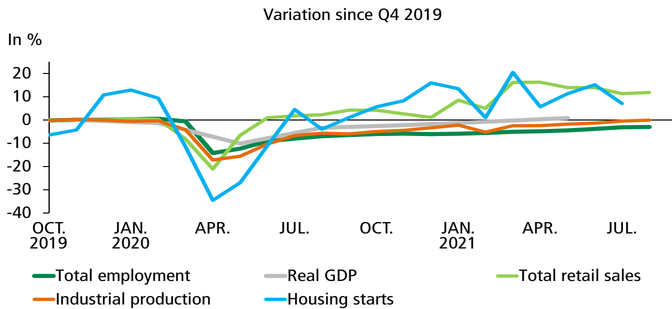
pre-pandemic level. Housing starts and retail sales have exceeded their pre-pandemic levels for over a year now (graph 2).

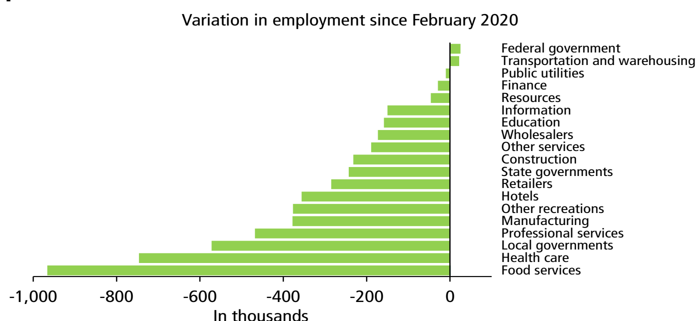
GRAPH 2
Employment has recovered more slowly than the other indicators



Sources: Bureau of Labor Statistics, Bureau of Economic Analysis, U.S. Census Bureau, Federal Reserve Board and Desjardins, Economic Studies

The pandemic did not affect all the sectors the same way. Health measures were much more restrictive for services, while manufacturing, resources and construction were not subject to them for so long. In March and April, 12.1% of jobs were lost in the goods sector and 17.2% in private services. In the hardest hit sectors of recreation and hospitality (including restaurants), 48.6% of the workers lost their jobs. That does not take into account people who did not completely lose their jobs but whose hours were cut. The numbers of workers in all industries have been rising since May 2020. Generally speaking, the deeper the losses in March and April 2020, the higher the gains that followed. That said, there are significant differences between the shortfalls compared to the cyclical high of February 2020. In August 2021, the restaurant industry was short close to 1,000,000 jobs and the health sector was short 750,000 (graph 3). Some sectors that are less badly affected by the pandemic, such as the federal public administration, resources, financial institutions or transportation and warehousing, have surpassed their February 2020 levels or are about to do so.

GRAPH 3
Most industries are still very short of labour compared to pre-pandemic times



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

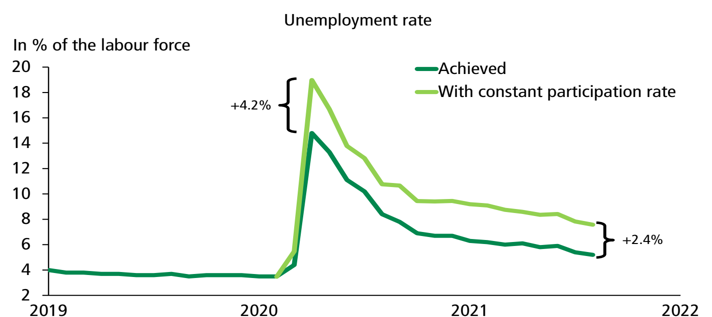
The Unemployment Rate Appears Better Than It Really Is

The plunge and incomplete recovery of the number of jobs can of course be seen in the number of unemployed people (actively searching work). The unemployment rate soared from a cyclical low of 3.5% in February 2020 to 14.8% two months later. That is the highest it has been since before the United States entered World War II (graph 4). The jobless number has decreased considerably since April 2020 and the unemployment rate stood at 5.2% in August 2021, but that is still 1.7% higher than the pre-pandemic level, one more sign that the job market has made some progress but has not entirely recovered from COVID-19. It should also be noted that the jobless number rose by only 2,667,000 from February 2020 to August 2021, while the employment shortfall was practically twice that amount. That is because several laid-off workers were not classed as unemployed, but as they stopped actively looking for work, they were no longer included in the active labour force. That had the effect of artificially boosting the declining unemployment rate. If the decrease in the number of workers was translated exactly into the increase in the number of unemployed, the labour force would have remained stable since February 2020, but the unemployment rate would be much higher: 19.0% instead of 14.8% at the height of the crisis and 7.6% instead of 5.2% last August (graph 5). With a hypothetical unemployment rate

GRAPH 4
The unemployment rate rose sharply at the beginning of the crisis, but is now closer to pre-pandemic levels

Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

GRAPH 5
Fewer job seekers mean the unemployment rate goes down



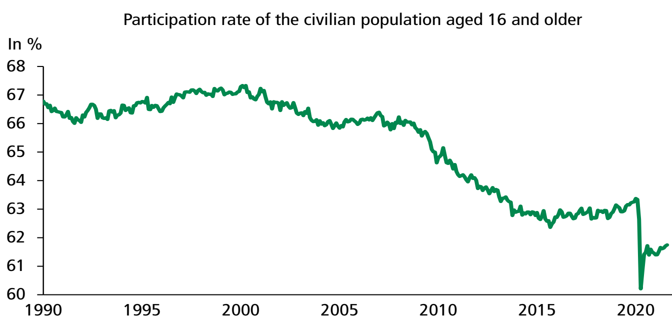
Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

of 7.6%, the job market seems worse off, and the Fed officials ought to be less satisfied with the progress of the U.S. economy.

The Significant Drop in the U.S. Labour Force

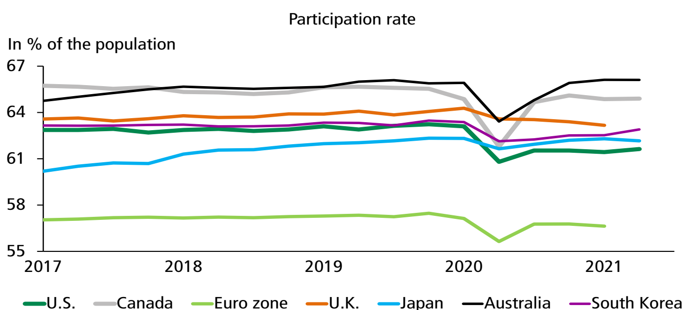
The drop in the labour force since February 2020 is one of the pandemic's primary legacies to the job market. In August 2021, the labour force had 2,911,000 fewer people compared to before the crisis (the total loss was 7,970,000 in April 2020), while the total population aged 16 and over increased by 1,983,000 in the past 18 months. The participation rate went from 63.3% in February 2020 to a low of 60.2% two months later, then started climbing rapidly only to slow down again; it stood at 61.7% in August 2021 (graph 6). That rate is still relatively low, and if we disregard last year's depths, we would have to go back to 1977 to find such a low participation rate, i.e., before the massive influx of women onto the job market. The United States also stands out on the international scene with a relatively low participation rate. The comparison with the Canadian labour market is particularly striking (graph 7).

GRAPH 6
The participation rate (workers and job seekers) is still very low



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

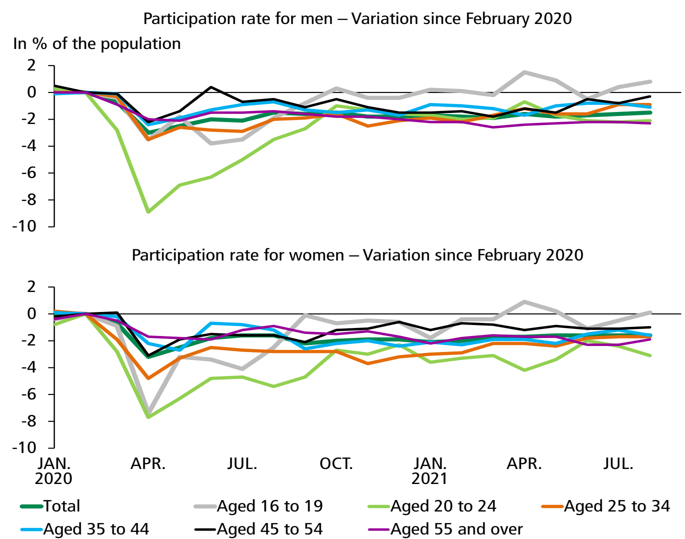
GRAPH 7
The declining participation rate is stronger in the United States



Sources: Organisation for Economic Co-operation and Development and Desjardins, Economic Studies

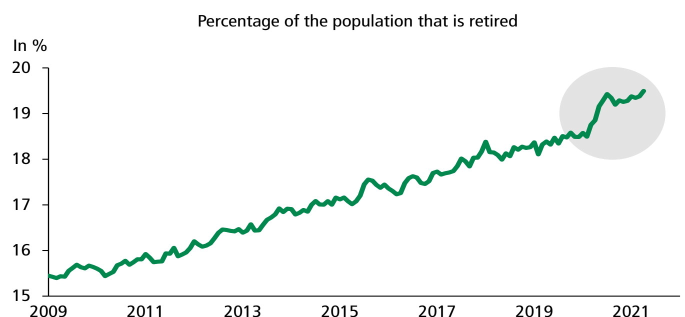
So just who dropped out of the labour force? All categories were drastically low during the most stringent lockdown measures, but it was mainly the younger workers who bore the brunt of them, since so many of them worked in restaurants and retail. When those industries reopened a lot of the younger workers came back, so the participation rate of 16 to 19 year olds is now higher than before the pandemic (graph 8). There are fewer older people, both men and women, in the labour force, and their participation rate is still just as low as it was at the beginning of the crisis. That is due to a speed up of retirements (graph 9). The greater health risks for older people caused by COVID-19 are also a determining factor.

GRAPH 8
The participation rate is still very low for older people and those aged 20 to 24



Sources: Datastream and Desjardins, Economic Studies

GRAPH 9
The pandemic sparked a wave of retirements



Sources: Federal Reserve Bank of Dallas and Desjardins, Economic Studies

Parental responsibilities are probably the main reason why fewer women aged 24 to 50 are in the labour force right now. Several studies, including those from the Brookings Institute, the Federal Reserve Bank of San Francisco and the Peterson Institute for International Economics, demonstrate that being a parent is a major factor, dropping the participation rate among parents (but especially mothers) of young schoolchildren, particularly those aged 5 to 12. The decisions by public authorities to close schools also played a large role: as more U.S. schools switched to remote learning, more mothers had to drop out of the labour force.[1] The participation rate of parents was also affected if they themselves had lower levels of education or were single parents.

So, the return to almost normal school activities in most U.S. states at the end of summer 2021 is an encouraging element that could again raise the participation rate of parents. That said, the recent COVID-19 wave caused by the Delta variant is a new threat, with more than 1,000 schools having to stop in-person classes since the start of the school year.[2]

A Structural Issue

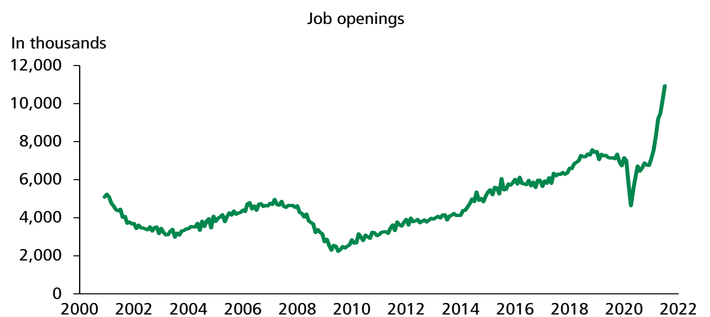
The declining participation rate could well be one of the pandemic's permanent fixtures. That rate could be expected to edge up closer to where it was before the crisis as the job market continues to recover. It is mainly a cyclical phenomenon that occurs after every recession. But, apart from such short-term spurts, recessions have accelerated the participation rate downturn that we have seen since the mid-1990s. The pandemic will likely amplify that downturn over the long term. The main reason the participation rate is declining is that the U.S. population is getting older. People aged 25 to 54 (those most able to work or look for work) accounted for 43.9% of the U.S. population in 1996 but only 38.8% in 2020, and should slip down to 38.4% in 2030. By 2030, all of the baby boomers will be over 65. The Bureau of Labor Statistics (BLS) predicts that the participation rate will fall from 61.7% in 2020 to 60.4% in 2030. The declining participation rate and the slower growth of the labour force will limit the growth of U.S. potential GDP.

And Yet Jobs Are Available

The job market is still far from fully recovering from the pandemic, which means there is still a lot of unused labour capacity in the United States. It is perfectly normal for the supply of workers to exceed demand when coming out of a recession.

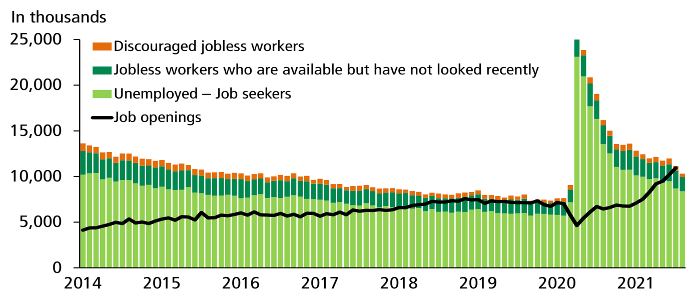
That is not what is happening right now. The current cycle has a very particular feature: there have never been so many available jobs. The BLS figures show that there were nearly 11,000,000 vacant positions last July, the highest number since this statistic started being published in 2000 (graph 10). In fact, the number of job openings last July would just about equal the potential pool of people able to work, i.e., those who were looking for work and those who were not looking actively but would be available (graph 11). It is particularly astonishing to see the ratio between those two groups so low with the new economic cycle barely starting. Number of unemployed persons by job openings was much higher after the recessions of 2001 and 2018–2019 (graph 12 on page 5). The current ratio looks more like the end of a cycle than the beginning of one.

GRAPH 10
And yet many jobs are available



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

GRAPH 11
The pool of jobless is now lower than the number of job openings

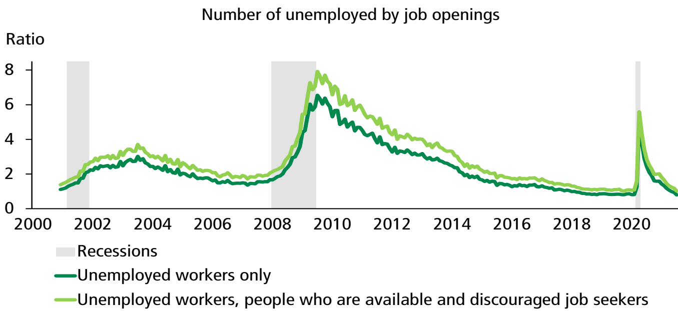


Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

[1] Lauren BAUER et al., *Examining the uneven and hard-to-predict labor market recovery*, Brookings Institution, *Up Front*, June 3, 2021. (Consulted September 17, 2021).

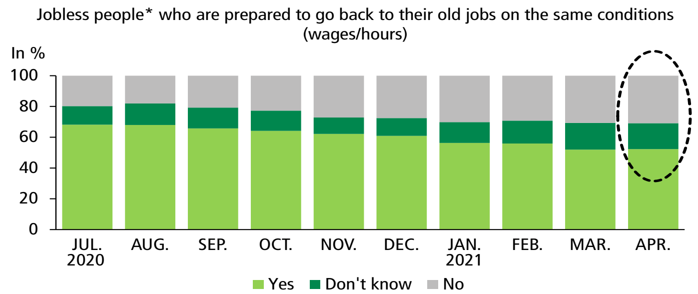
[2] Jeanine SANTUCCI and Grace HAUCK, *At least 1,000 schools in 35 states have closed for in-person learning since the start of the school year: COVID-19 updates*, USA Today, *Health*, September 5, 2021. (Consulted September 17, 2021).

GRAPH 12
The number of unemployed by job openings has gone down to a historic low



Sources: Bureau of Labor Statistics, National Bureau of Economic Research and Desjardins, Economic Studies

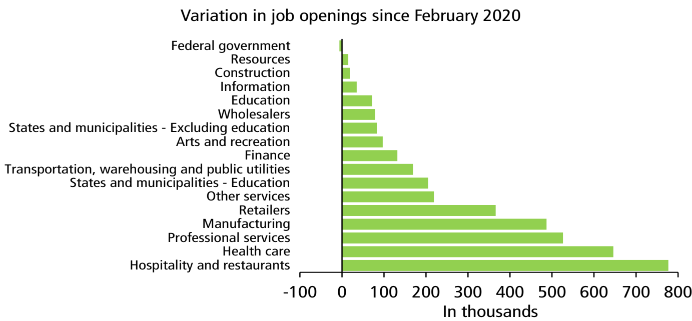
GRAPH 14
Former employees are reluctant to go back to their old jobs



* Dallas Federal Reserve District (Texas and parts of Louisiana and New Mexico), people who had a job in February 2020 but were jobless at the time of the survey.
Sources: Federal Reserve Bank of Dallas and Desjardins, Economic Studies

There may well be some mismatches between the types of jobs available and the people who are currently looking for work. And yet, the job openings are largely in the industries that had to cut them during the pandemic (graph 13). First and foremost are hospitality and restaurants. Health, professional services, manufacturing and retail are also affected by massive layoffs at the beginning of the pandemic, by a still significant shortfall of workers and by a large number of job openings. It looks as if the workers who lost their jobs are not returning to those sectors in droves, hence the unbalance.

GRAPH 13
There are many job openings in the services affected by the pandemic, plus manufacturing



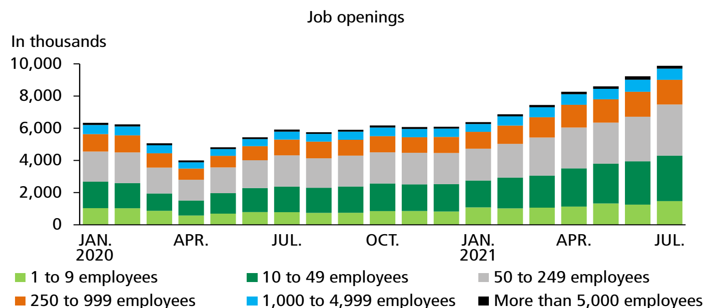
Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

That reluctance of former employees to go back to their former jobs is illustrated in a survey by the Federal Reserve Bank of Dallas. People who had been working in February 2020, but were not working at the time of the survey, were asked whether they were prepared to return to their previous positions on the same terms (wages and hours). Over 30% of the responses were negative last April, and 16.8% were undecided (graph 14).

It seems that some employers are even having difficulty getting their remaining employees to work. A survey by the Federal Reserve Bank of Atlanta reveals that 55% of the respondent companies report that their operating capacity is affected by the employees' availability to come to work. Add to that the 21% of companies that reported they were unable to bring back former employees (either fired or laid off temporarily) or hire new ones.

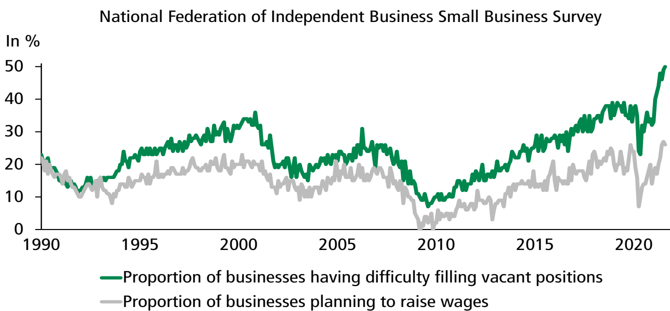
The labour shortage is particularly hard on small and medium-sized businesses (graph 15). That may be due to their activity types (thinking of restaurants, hospitality and small retailers…). A lower capacity to improve working conditions so as to attract former or new employees may be a factor. A monthly survey of small businesses reveals that half of them are having difficulty finding workers, which is historically high. Nevertheless, they seem reluctant to pay their employees significantly more (graph 16 on page 6).

GRAPH 15
Jobs are available mainly in small and medium-sized businesses



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

GRAPH 16
Businesses report difficulties in hiring



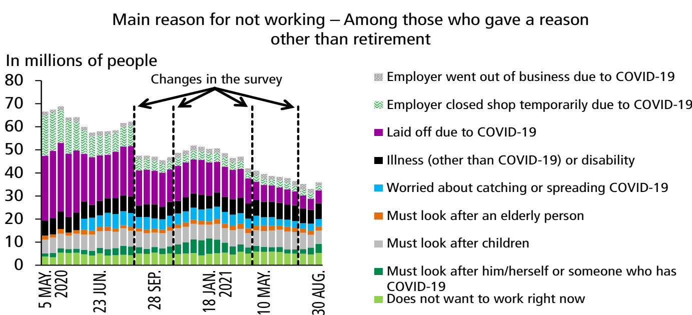
Sources: National Federation of Independent Business and Desjardins, Economic Studies

Restrictions on the Labour Supply

The challenge of finding people to fill the vacant positions is therefore major, and the ability of businesses to meet that challenge is a key issue for the U.S. economic situation. But what is prompting the Americans not to come back to work?

The COVID-19 pandemic is still a huge factor. We talked earlier about the problems parents have had getting back into the job market, especially mothers with young children. Those situations are still common and are exacerbated by other facets of the current crisis. Figures from the U.S. Census Bureau show the main reasons for not working (graph 17). While the pandemic is less and less of a factor (employer that stopped or reduced activities due to COVID-19), the other reasons are still almost as important as they were at the beginning of the pandemic. People who cannot work have to look after children or elderly people, must look after COVID-19 patients or are afraid of catching the disease. We will have to wait until the health situation calms down further and the schools start operating normally before those people are likely to return to work.

GRAPH 17
The immediate reasons for not working have diminished, but other factors remain

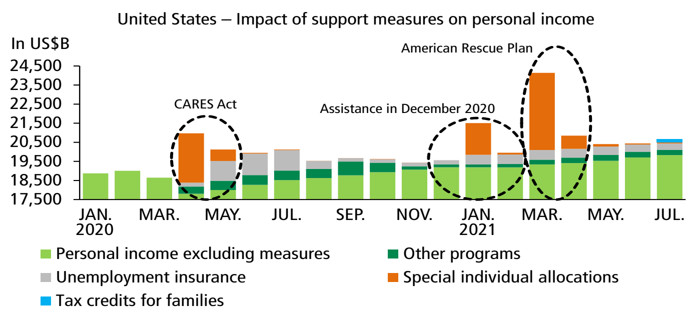


Sources: U.S. Census Bureau and Desjardins, Economic Studies

Government Assistance

People may decide to stop participating and not try to occupy any of the many jobs that are currently available, but they will still have to live and meet their financial obligations. All the personal income assistance measures introduced by the government since the pandemic started have been a major factor in helping households live decently. The three stimulus waves were a great boost for household incomes (graph 18).

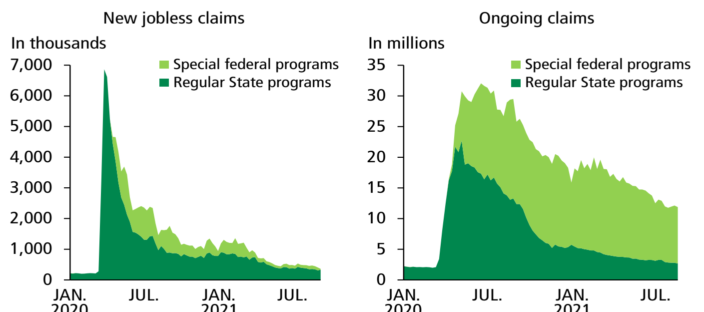
GRAPH 18
U.S. federal government assistance gave a boost to household income



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

Another major measure that affects the job market more directly is the enhanced unemployment insurance program. The number of jobless claimants skyrocketed at the beginning of the pandemic, and States regular programs quickly became insufficient. They did not cover a large segment of the population who had lost their livelihoods (independent workers and contractors...) and those who had to stop working because they were afraid of being infected, had the disease, or had to look after children or parents. The coverage period was also not long enough. The federal government quickly stepped in to plug those gaps by enhancing and extending the assistance, adding additional amounts to the weekly handouts. The initial jobless claims have dropped quite a bit, but the number of recipients remained high (graph 19).

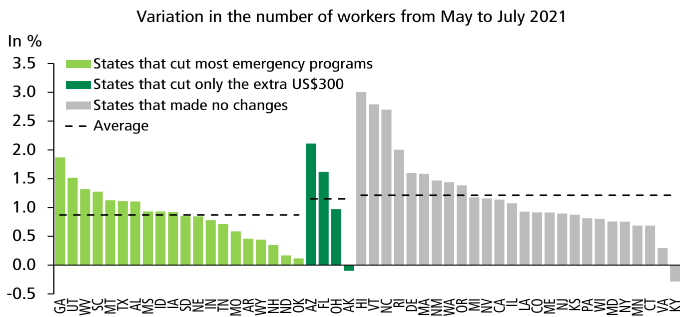
GRAPH 19
New jobless claims fell, but the number of claimants remains high



Sources: U.S. Department of Labor and Desjardins, Economic Studies

There has been much criticism of the magnitude of the new jobless benefits. Several politicians and commentators have deemed the programs too generous and alleged that they encouraged people to stay out of the job market. On the other hand, several people said those programs were necessary while the economy was still fragile and there were still so many health restrictions limiting activities. In some States the critics won the day and got the governors to cut some or all of the federal enhancements as of June 2021. The idea was to get people back onto the job market and help businesses fill their vacant positions. Unfortunately, from May through July employment did not pick up in the States that made the cuts compared to those that kept the federal programs intact (graph 20).

GRAPH 20
The job market did not fare better in the States that cut emergency programs as of June



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

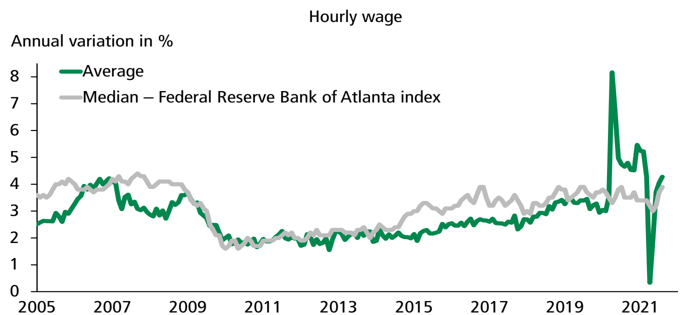
Congress financing of federal enhancements to unemployment insurance ended on September 6. It is still too early to see the real consequences of this change on the job market, but the June experiment suggests that the effect could be relatively small. There is also a risk that the hole it will cause in household incomes will hurt consumption and the economy.

A Balance Must Be Struck, but It May Be Costly for Both Businesses and Consumers

For all the reasons outlined above, the U.S. economy seems to be in a state of underemployment while at the same time it is short of workers. The job market has to rebalance itself if the U.S. economy is to grow satisfactorily. Labour supply will have to be made to correspond to demand. The way to do that would be to adjust prices, i.e., wages.

Average hourly wages have fluctuated wildly during the pandemic (graph 21). The ups and downs in the industries hardest hit by the health measures have upset the sectoral composition of employment. When restaurants and retailers laid off so many people it pushed average wages up (the sectors with higher wages were less affected, so they took on more weight in the overall job market composition). When lower-income workers came back the effect was reversed. In these circumstances,

GRAPH 21
Average wages fluctuated wildly during the pandemic, but the median wage was much more stable

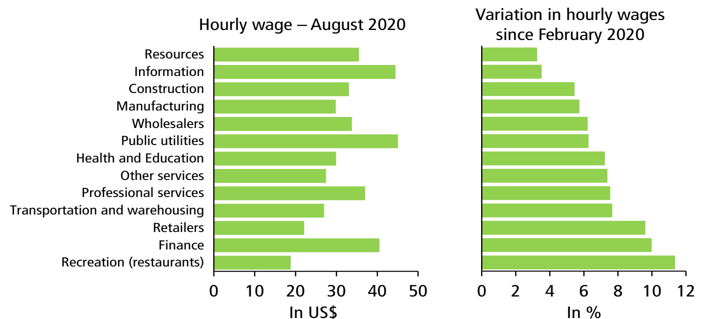


Sources: Bureau of Labor Statistics, Federal Reserve Bank of Atlanta and Desjardins, Economic Studies

median wages are a better indicator of what workers are really being paid.

Looking sector by sector, we see that those where the shortage of employees is most severe are generally those where wages have risen the most compared to February 2020 (graph 22). Those are the recreation sectors, encompassing restaurants and retail. Health and education, coupled with professional services, are not far behind. We also note that several sectors where wages are rising the most and there are many jobs available are also those that pay the lowest wages.

GRAPH 22
Wages rose primarily in sectors where there many positions to be filled



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

That means some rebalancing is already taking place. It may be necessary to pay more in the sectors where jobs are available that job seekers do not like. As we have seen, some businesses (especially the smallest ones) could be reluctant to bump wages up significantly, because in order to do that they will have to either cut into profitability or raise prices.

Notwithstanding an unexpected acceleration of worker productivity, there is therefore a risk that a new balancing of the job market that palliates both the current underemployment

problems and the labour shortage will have two consequences. First, profitability will drop, which could lead to lower stock market returns for the largest businesses. Second, increased labour costs passed on to customers could spark further pressure on prices. Inflation, which is already well over the Fed's traditional 2% target, could stay high for a longer time. That may complicate things for the Fed officials.

Partial solutions from the political sphere could also calm the situation down. The difficulties so many mothers faced during the COVID-19 crisis have put a spotlight on the need for childcare. The White House is already working on the kinds of policies that could encourage women and mothers to enter the job market. A more open immigration policy, as well as the end of COVID-19 related restrictions on the entry of foreign workers, could ease the labour shortage in some sectors. Investments into training programs could also respond to the specific needs of some industries that are severely short of qualified workers. The needs are there, they just have to be met.