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Wage Pressures in the Labor Market: What Do They Say?

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Summary:

Wage pressures among the newly employed in low-wage service occupations appear to be the result of normal economic forces, likely reflecting demand surges for—and a reluctant supply of—workers in occupations particularly hard hit by pandemic-induced economic shutdowns.

Key findings:

1. There is evidence of significant wage pressures among low-wage service occupations.
2. A combination of surging demand and reluctant supply appears to be driving current wage pressures.
3. It's too soon to know if wage pressures will expand to other occupations.

Center affiliation: Center for Human Capital Studies
JEL classification: J2, J3
Key words: Labor demand, labor supply, reservation wage, COVID recovery, inflation pressures

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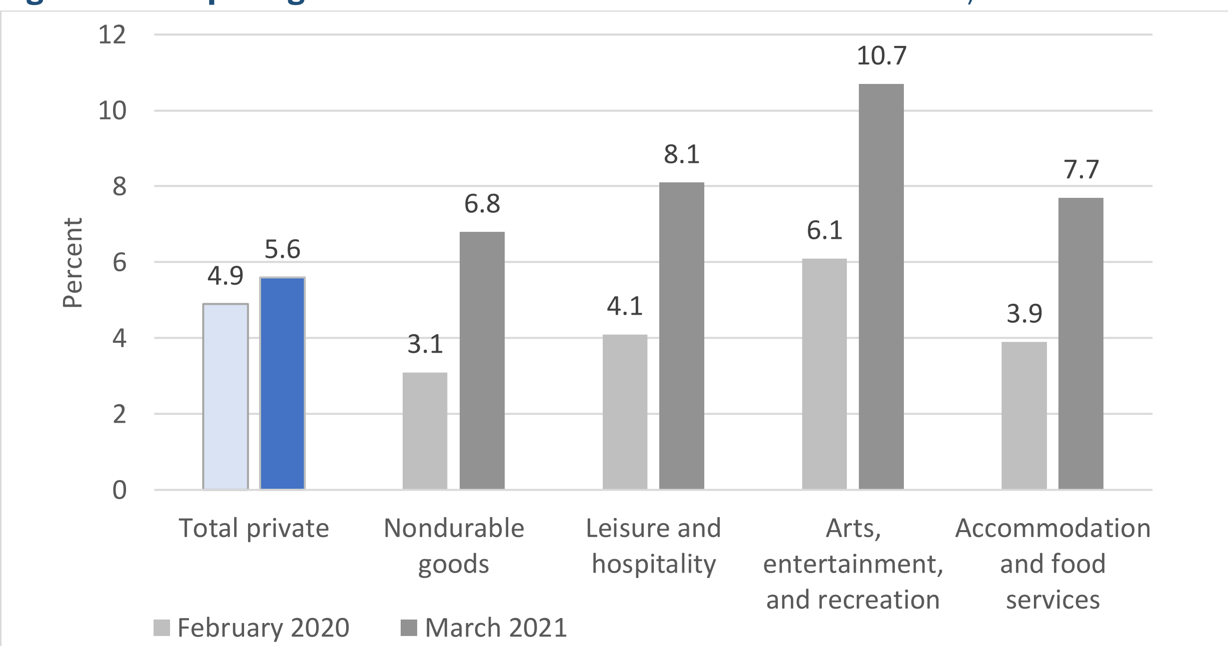
During the past few weeks, as the light at the end of the pandemic tunnel has been coming into focus, the real world has thrown economic prognosticators some curve balls.

While many economists expected nearly one million additional payroll jobs to be added to the economy in April, it turns out the gains were only one quarter that amount (U.S. Bureau of Labor Statistics 2021a). Additionally, whereas we were braced for the April CPI to reflect prices about two-tenths of a percent higher than they were in March, the actual increase came in four times higher, at eight-tenths of a percent (U.S. Bureau of Labor Statistics 2021c).

Before conjuring ghosts of 1970s stagflation, it's important to keep things in perspective. The slower-than-expected job growth might not reflect less demand for workers. On the contrary, many employers—especially in industries emerging from a particular battering from COVID—are reporting difficulties finding workers (Federal Reserve Board 2021). Their challenges can be seen in the job opening rates found in the latest report from the Job Openings and Labor Turnover Survey (U.S. Bureau of Labor Statistics 2021b). Figure 1 shows four industries with the highest high job-opening rates in March 2021, relative to the total private job-opening rate, and relative to their prepandemic experiences.

Nondurable goods employment includes workers producing items, for example, used by firms in the other three industries shown, such as ketchup packets, processed meat, and commercial toilet paper.

Figure 1: Job Opening Rates for Total Private and Selected Industries, March 2021



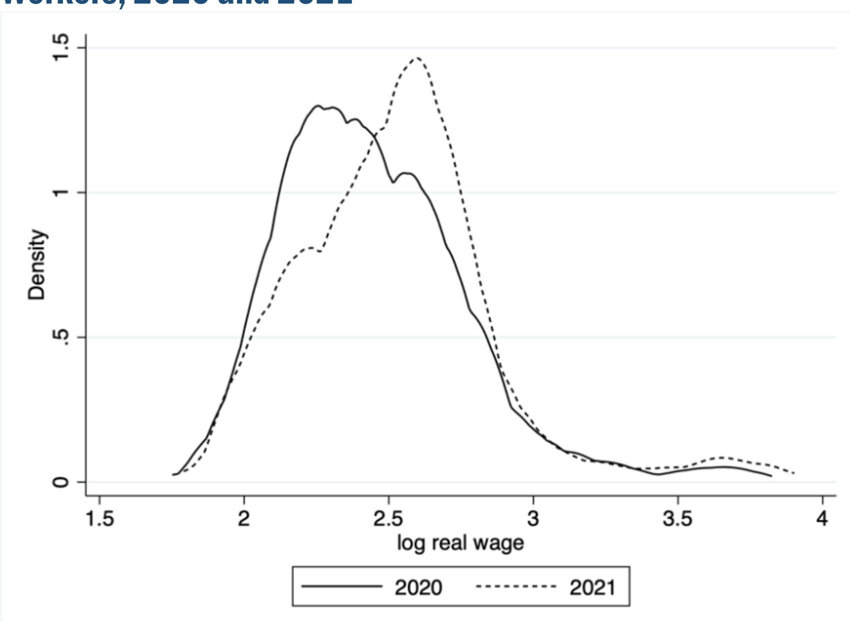
Note: The job opening rate is computed by dividing the number of job openings by the sum of job openings and total employment. Job openings include all positions open on the last business day of the month for which an employer is activity recruiting.
Source: Job Openings and Labor Turnover Survey, U.S. Bureau of Labor Statistics, https://www.bls.gov/news.release/jolts.t01.htm

On the inflation question, industries seeing price surges (such as automobile manufacturing and construction) are facing both strong demand from the economy reopening and pandemic-induced supply-chain shortages (Valinsky 2021; Institute for Supply Management 2021). The natural consequence is rising prices until supply catches up with particularly robust demand.

Another place to look for evidence of potential additional concern about the implications of the recent economic reports is wages. If workers convince employers (who are desperate for workers) to raise their wages to keep up with higher prices in the grocery store, then employers may pass some of those higher wages on to customers, who will then have their fears of inflation confirmed, demanding higher wages from *their* employers, etc. (Powell and Wessel 2020).

The evidence we're seeing so far, however, is that the strongest wage pressures are isolated to roughly 1 percent of the total employed: newly employed workers in low-wage service occupations. Figure 2 shows that the distribution of reported (log) real hourly wages for these workers in January–March 2021 has shifted to the right of the wage distribution from the same months in 2020. Data for other occupational groups do not show a similar shift.

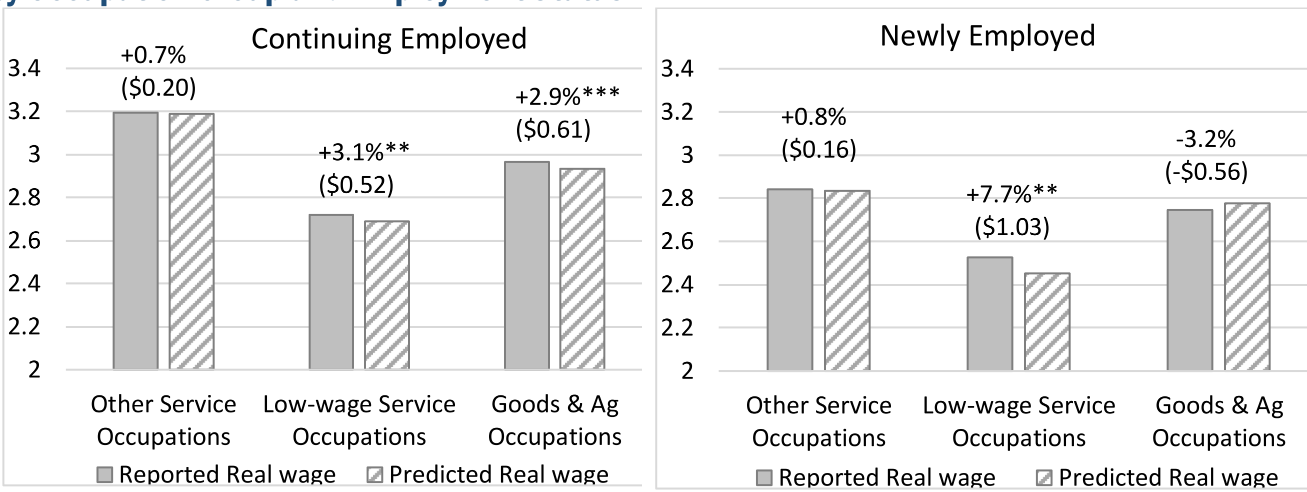
Figure 2: Log Real Wage Distributions for Newly Employed Low-Wage Service Workers, 2020 and 2021



Note: Wages are in 2020 dollars. Newly employed workers are workers who were not employed in at least one of the two previous months.
Source: Author's calculations from the Current Population Survey, January–March 2020 and 2021

The wage distributions in figure 2 don't control for characteristics that might be specific to workers in this group. To obtain more definitive evidence of wage pressures, the Current Population Survey (CPS) allows comparison of reported hourly wages of workers during January through March 2021 to wages that would be predicted for the same workers using data from January through March 2020. In other words, holding everything else about workers constant, are they earning higher wages now than they would have prepandemic? Figure 3 shows this comparison.

Figure 3: Average Reported versus Predicted Wages for Workers in January–March 2021, by Occupation Group and Employment Status



Note: Newly employed workers are workers who were not employed in at least one of the two previous months. Reported wages are from January to March 2021. Predicted wages are calculated for workers in January–March 2021 using OLS wage regression parameters estimated from data in January–March 2020. Log real wage regressors include age, age squared, female and married indicators, five education categories, three race categories, 13 industry categories, nine census division categories, and month indicators. **, *** indicate that the difference between reported and predicted wages is statistically significantly different at the 95 and 99 percent confidence level, respectively.
Source: Author's calculations from the Current Population Survey

"Low-wage service" occupations include workers whose jobs have been the most affected by the pandemic-induced economic shutdowns. These include workers employed in protective services, food prep and cleaning services, and personal services. These are also some of the jobs for which employers are reporting difficulty finding workers (see figure 1). "Other service" occupations include workers employed as managers, professionals, technicians, salespeople, and office administrators; these are, generally, higher-paying service jobs. "Goods and ag" includes workers employed in production, craft, and repair; operators, fabricators, and laborers; and agriculture. This group includes workers in nondurable goods manufacturing, seen in figure 1 as also experiencing higher-than-usual worker demand (such as in chicken processing, for example; see Quinn 2021). Further details of the analysis are in the notes to the figure.

The first thing to notice in figure 3 is that, within an occupational group, continually employed workers earn higher wages than newly employed workers. Secondly, and more to the point, reported wages in low-wage service occupations are 7.7 percent higher in the first quarter of 2021 than predicted—the largest difference among all occupational groups depicted.

Reported wages exceed predicted wages by a smaller (but statistically significant) amount in the continually employed low-wage service and goods workers.[1] The obvious question, then, is, "What

[1] Repeating the analysis of figure 3 for other time periods, namely 2010 and 2020, we don't see the same patterns. In fact, neither continually nor newly employed workers in low-wage service occupations report wages significantly higher than predicted from the previous year, whereas those in other service and goods do.

implication does the wage pressure seen in Figure 3 have for the broader economy, and, specifically, inflation?"

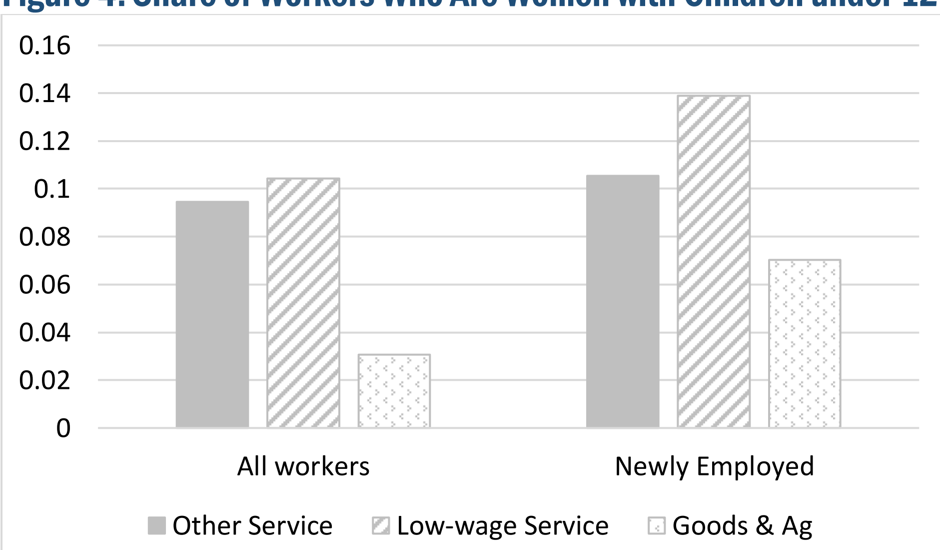
One source for wage pressures might be job applicants' fears about inflation and, thus, demand wages high enough to cover an expected rising cost of living. If inflation fears are driving what we see in figure 3, then significant wage pressures should be showing up among all of the newly hired, not just those in one occupation category.

What figure 3 might be showing us is, simply, a well-functioning labor market. So far, it appears that outsized wage pressures are concentrated in those occupations for which workers are in relatively high demand (as seen in figure 1). The reopening economy is disproportionately affecting firms in industries such as leisure and hospitality and personal services, where many of those workers are employed. Additionally, workers in those occupations may have good reasons to need extra incentives to get back to work.

A key characteristic of low-wage service occupations is that they often come with higher customer contact. And, in spite of rising vaccination levels, COVID fears about close human interaction may linger. Additionally, the American Rescue Plan of 2021 may be contributing to a short-run reluctant supply of workers. In addition to providing cash payments broadly, the plan authorizes an additional $300 compensation weekly to unemployed workers. Both the cash payments and additional unemployment compensation represent a larger share of take-home pay for low-wage service occupations relative to the other two groups (Petrosky-Nadeau and Valletta 2021), which would reduce incentives to look for work.

Further, the data also show that low-wage service occupations employ a higher share of women with young children. As shown in figure 4, this is not only the case among all workers, but the concentration of women with young children is even larger among the newly employed. Going back to work for these women is particularly challenging right now as many of the more affordable childcare options went out of business during the economic shutdown (Mongeau 2021).

Figure 4: Share of Workers Who Are Women with Children under 12 Years Old



Source: Author's calculations from the Current Population Survey, January–March 2020 and 2021

For these two reasons—surging demand for workers in some industries and more reluctant supply—the largest wage pressures showing up among low-wage service workers make sense. So far, the evidence in figure 3 appears to be simply reflecting normal, narrowly focused economic forces. Something to watch going forward will be evidence that large wage pressures are spreading more broadly than seen here. Of course, as is always the case, we'll know more in a few months.

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