United States Congress
Joint Economic Committee

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“Help Wanted: A Stronger Labor Market for Robust Growth”

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Summary
Good afternoon. Thank you for inviting me to testify at this hearing before the Joint Economic Committee. My name is Skanda Amarnath, and I am the Executive Director of Employ America, a research and advocacy organization that seeks macroeconomic policies that promote sustainably tighter labor markets. When labor markets are sustainably tighter, businesses are incentivized to make investments that improve the productivity of their workforce and actively compete for workers.

Macroeconomic policy choices play an underrated role in creating and sustaining a labor market in which high-quality employment opportunities are sufficiently abundant, and workers can translate their capabilities into persistent gains in compensation and bargaining power. This dynamic is clearest among workers who tend to be most systematically marginalized, including those with lower levels of educational attainment and income.

Until we can put the pandemic fully behind us and all pandemic-affected sectors are able to return to a normal operating environment, the recovery is unlikely to be completed. However, the pace of this recovery should make us optimistic about achieving a sustainably tighter labor market. Unlike the previous three recoveries from recessions, which saw a multi-year “jobless recovery” phase of stagnant or deteriorating employment outcomes, this recovery has been more immediate, rapid, and sustained. The responsiveness of monetary and fiscal policy has likely played a key role in staving off the vicious cycles typically associated with recessions and jobless recoveries. We are not there yet, but the timeline for getting back to pre-pandemic employment outcomes is likely to be substantially more compressed than the timeline for recovering from any of the last three recessions.

It is true that as a byproduct of this uncharacteristically rapid recovery, new challenges have emerged, from microchips to ports to childcare. These challenges only strengthen the case for making focused investments that enhance the resilience and capacities of businesses and workers alike. Contrary to popular conception, monetary and fiscal policy choices do not merely affect labor market outcomes in the short run; it is precisely
through their ability to shape outcomes in the short run and to motivate supply-side responses that higher heights can be made attainable over the longer run.

I will begin with 1) an assessment of labor market health and 2) the role that policy has played in getting us to our current state. I will then follow that with some thoughts on 3) the benefits of a tighter labor market and 4) the case that the current environment intrinsically makes for pursuing an ambitious public investment agenda right now.

1.) Monitoring The Incomplete But Rapid Recovery

The most commonly cited metric of labor market health among media members and some economists - the 5.1% unemployment rate, as of the third quarter - does a disservice to our understanding of where we stand in the recovery. While it currently sits just 1.6 percentage points above the pre-pandemic minimum, this understates the underlying employment shortfall since the pandemic.

I am sure many economists have testified here about the importance of raising participation rates and the limitations of the unemployment rate, but both of these metrics are needlessly complex and flawed for the same reason. The surveying method for assessing “who is” and “who is not” in the labor force lacks both accuracy and consistency.1 While we can say with high certainty whether a household is employed or not, the line that defines who is in or out of the labor force is increasingly hazy.

There is a simpler way to track the health of the labor market: an age-adjusted ratio of employed persons to the corresponding population level, such as the 25-54 year old prime-age employment rate (PER).2 On that score, we are still 2.4 percentage points from the pre-pandemic peak as of the third quarter, in contrast to the 1.6% unemployment differential. Although there is still ground to cover, the pace of the recovery on this metric has been encouraging. We saw a 0.8% increase in the third quarter alone despite the downside effects of the pandemic on key services sectors in August and September. Sustaining that same pace would imply a pre-pandemic peak achieved as early as the summer of next year.

The rapid gains in PER from its pre-pandemic peak are especially encouraging when we compare it to the last three recoveries. In contrast to the current gains, if we look a PER five quarters after each of the previous three recessions officially ended, PER was still in decline and had not bottomed out. PER took more than six years to recover back to its pre-recession peak in the 1990s. PER never recovered in the 2000s expansion from its pre-recession peak. Only after eleven years did PER recover to the local peak achieved before the Great Recession. While much can still disrupt the current trajectory

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of the labor market, odds are the timeline for a complete recovery will be substantially shorter.

In the latter half of the 2010s, we saw that as the prime-age unemployment rate declined to lower levels, the prime-age labor force participation rate began rising.\(^3\) This transition happened almost seamlessly and without an obvious catalyst, such that PER was steadily making gains even as the source of employment gains was technically shifting to a new pool of the potential labor force. This only further illustrates the value of avoiding the labor force distinctions within the prime-age population that unemployment and participation rates lean on. These new “labor force entrants” were going straight from the sidelines into a job, with no transition period as an “unemployed participant.”\(^5\) As the recovery advances and certain constraints potentially abate, we are likely to see more people on the sidelines who transition directly into employment, just as we did in the latter half of the 2010s.

While it will take ongoing employment gains to make the labor market sustainably tight, the current pace of labor demand growth is palpable in many datasets. The churn associated with firms trying to scale up for a post-pandemic economy has pushed hiring and job-switching rates to historic highs.\(^6,7\) Compensation growth also appears to have picked up because of the current churn.\(^8\)

When celebrating the speed of the labor demand recovery, we must take care not to misconstrue the meaning of certain facts or datapoints, like the raw count of job openings. The historically high quantity of job openings, currently more than the number of unemployed persons, has led some speculation as to whether the currently unemployed even want a job. It is worth remembering that the ratio was similar in 2019, when hiring activity and wages were both decelerating, in contrast to today’s acceleration.\(^9,10\) The research is quite clear that recruiting intensity can vary between job openings and over

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time; not all job openings need to be urgently filled. Moreover, it is only getting easier and cheaper to post a job opening thanks to technology. I would caution against using crude ratios of job openings to the unemployed to understand the labor market, even as I would otherwise agree that the pace of labor demand is currently strong, and that certain sectors, such as manufacturing and construction, face some genuine workforce shortages.

2.) The Role of Policy In Supporting The Current Labor Market

A major reason for the markedly faster recovery this time around is the drastically different policy responsiveness from the Fed, the White House, and Congress. This responsiveness began in March 2020 with FFCRA and the CARES Act and persisted through at least February 2021 with ARP. It will be convenient to “otherize” this recession and recovery from previous recessions, but we should not forget that this recession also involved a substantial market crash, a “dash for cash,” and a rash deleveraging dynamic that bears strong resemblance to the onset of the previous three recessions. What most likely stopped this ugly dynamic from turning into a vicious cycle of layoffs and cutbacks from businesses and households was the policy response from the federal government.

While policy implementation in a crisis always leaves much to be desired, the scale of the efforts to keep households and businesses whole and thereby avoid harsh cutbacks (which would be hard cuts to someone else’s income) helped short-circuit a brewing economic panic which the Great Recession typified. In the absence of credit and income supports, businesses would likely be considering how to downsize in the face of weak final demand and households would likely be cutting consumption to hedge against income uncertainty.

The enhanced unemployment benefits provisioned during the pandemic, including the fixed $600 weekly FPUC payments, have been a source of controversy, but the best evidence available suggests that they too were ultimately a net positive and that the disincentive effect was barely identifiable, if it even existed. The states that cut off enhanced benefits prematurely saw weaker employment gains in the weeks subsequent to

If the fixed payment was playing such a dominant role, it should have slowed down job growth disproportionately in lower wage sectors, and yet to the extent there has been employment disappointment, it appears to have been mostly in middle of the wage spectrum. We would have at least expected employment to accelerate in the lead-up to the expiry of enhanced unemployment insurance benefits in September, but we see precisely the opposite trend.

Meanwhile, the income- and consumption-supporting benefits of fixed payments are more identifiable. In the absence of such payments, the share of households facing sharp declines in income would have substantially increased. Despite the cost of expenditures rising in this cyclical upswing and locally compressing certain measures of “real wages,” households across the distribution of income and wealth have seen their liquid cash buffers improve by more than 40% since the pandemic.

3.) The Benefits of a Tighter Labor Market

A tight labor market is an inclusive labor market. In addition to pulling sidelined workers – whom survey measures treat as “non-participants” – into employment, a tighter labor market is also one in which differentials in employment rates among white and black persons compresses.

Towards the latter phases of business cycle expansions, wages also show signs of compression, as lower wage workers are no longer so dispensable and see the fastest wage gains. That dynamic emerged in 2015 and has surprisingly continued through the pandemic and this recovery.

In the 2010s, there was a substantial debate about how many of the unemployed were structurally unemployed because they simply lacked the skills to adapt to the

economy’s needs. Residential construction workers were allegedly lacking in skills that were going to be needed after the housing bust. One economist even suggested that much of post-crisis unemployment was explainable by the lack of a college education.23

With the benefit of hindsight, the precise opposite conclusion now seems apparent. As the labor market healed, so too did the differential in employment rates among those with a college education and those with only a high school education. Meanwhile, the construction sector now reports persistent labor shortages.24 Had policymakers pursued tighter labor markets more aggressively during and after the Great Recession, these benefits could have materialized for a broader group of workers.

4.) The Rapid Recovery’s Challenges Make The Case For Deeper Investments

The current headlines surrounding this recovery have now shifted to the challenges associated with a booming high-growth economy with individual constraints more identifiable now. Had policy chosen the kind of jobless recovery markets have become used to, these constraints may have lain dormant. These problems are serious, but they also reflect an affirmative challenge to coordinate solutions that, if resolved, ultimately accrue to our benefit in the form of higher production and a higher standard of living. The inflationary effect of these particular challenges can also be distinguished from the claim that labor costs and labor market tightness are driving the current set of inflationary pressures. These challenges require investments that make existing capacity more resilient and pave the way for increased productive capacity over the longer run.

The automobile supply chain was gravely affected by automakers’ need to scale up production after initially cutting their orders of microchips during the recession.25 This 360-degree spin has strained their supply chains, exposing them to delays from global COVID outbreaks26, and temporarily constraining production27. These production constraints are not a function of labor costs within the supply chain going up. It would be a mistake to view this source of inflation as a reason to back down from ambitious goals for the US labor market. Likewise, while port capacity has been strained by consumer demand for goods in a services-constrained pandemic economy28, this shortage is not one

that stems from excessive labor market tightness. It is a welcome sign that Congress seems ready to pass measures that expand capacity on both of these dimensions.2930

The pandemic economy has also revealed the importance of affordable provisioning of childcare, which has been persistently reported as a reason why parents are unable to work.31 There is a catch-22 in terms of how core services are still primarily provisioned through the labor market, even though a recession can lock people out of those same services, which are necessary for their employment. Investments in a more coordinated solution would remove these labor market frictions while enhancing employment outcomes ultimately.

The United States ranks among the worst performing advanced economies in terms of PER, with much of the underperformance is attributable to the still low rates of formal employment among women. Canada, UK, France, Germany, Sweden, Japan, Australia, and New Zealand all have higher PERs than the U.S.32 Much of that outperformance can be attributed over time to their ability to maintain long business cycle expansions and preserving employment in macroeconomic downturns, but these economies have also taken conscious steps to remove the frictions that might otherwise prevent workers from seeking out jobs that optimally fit their skill set. In the Canadian province of Quebec, where childcare is universally provisioned33, its PER is 7.4 percentage points higher than the U.S. as of September.34

If the U.S. is looking to catch up to the rest of the world on labor market outcomes, it will require ambitious investments and macroeconomic policies that promote and sustain a tight labor market. Thank you for your time, and I look forward to your questions.

34 As of September, PER is 78% in the U.S. and 85.4% in Quebec. Statistics Canada. Table 14-10-0287-02 Labour force characteristics by age group, monthly, seasonally adjusted, (Accessed on 25 October 2021) https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1410028702