

May 20, 2024

## The Great COVID Labor Reform

The COVID-19 pandemic of 2020 is now starting to fade from memory. Four years after the sudden outbreak of the disease sparked mass economic shutdowns, mask wearing, and millions of deaths, it's tempting to think the crisis is becoming just another episode of history. However, the pandemic clearly led to changes in the global economy. For example, it helped usher in an era in which governments and companies worry a lot about potential supply chain disruptions.<sup>1</sup>

In this report, we discuss how the pandemic changed the United States labor supply. We focus on two key developments during the pandemic: *1) the mass excess retirements and deaths of baby boomers,*<sup>2</sup> and *2) the generous income support programs* implemented by the federal government. Considering these developments as a package, we show how they essentially amount to a labor market reform — perhaps the most significant US labor market reform in decades. We then examine how these labor market changes could help spur outsized US economic growth in the coming years, albeit with additional upward pressure on consumer price inflation and interest

<sup>1</sup> This would not be the first time a pandemic affected the labor markets. The “Black Death” in the 1300s killed so many workers that the lucky survivors saw a [jump in real wages](#). After the Spanish Flu epidemic of 1918, [something similar occurred](#).

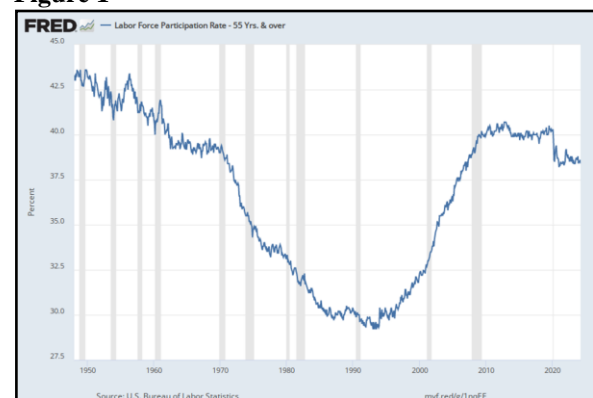
<sup>2</sup> The baby boomer generation is conventionally considered to be all those born from 1946 to 1964.

rates. We wrap up by examining the implications for investors.

## Mass Baby Boomer Retirements

To understand the impact of boomer retirements and deaths during the pandemic, it's first necessary to understand the impact of the *lack* of boomer retirements before it. As shown in *Figure 1*, the share of the civilian, non-institutionalized population aged 55 years and older that was either working or looking for work had begun to trend upward in the 1990s. This increasing labor force participation rate for older workers probably reflected several factors, such as improved health and a decline in the share of workers covered by defined-benefit pension schemes. In any case, it appears that millions of boomers were hanging onto their jobs well past the age at which earlier generations had stopped working.

Figure 1



This phenomenon helped make the labor market relatively stagnant in the years before the pandemic. Since the boomers holding onto their jobs were relatively older and more experienced, they were likely concentrated in the higher levels of their

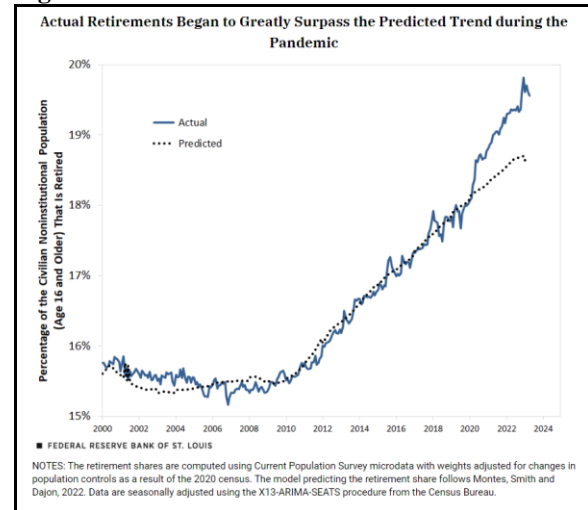
organizations, or at least the higher levels of their function. That meant the mid-career workers below them had fewer opportunities to be promoted, which therefore reduced the chances for young workers and entry-level workers to be promoted as well. We believe such a clogged promotion pipeline would have impeded mid-career and younger workers' pay raises, opportunities for skill development, and incentives to innovate.

Things changed dramatically with the sudden onset of the pandemic. To reduce their risk of getting the disease and/or take advantage of sharply rising asset values, legions of boomers near the top of their organization or function finally retired. [The Federal Reserve Bank of St. Louis has estimated that 2.4 million to 2.9 million more boomers retired during the pandemic than would have been expected if the crisis hadn't occurred](#) (see *Figure 2*). [Other studies estimate the US had about 2.1 million excess deaths because of the pandemic](#). Given that older people are more vulnerable to the disease, that number probably includes many boomers who had still been working. Taken together, these figures suggest that as many as 5 million boomers left their jobs because of pandemic-related death or unplanned retirement. That figure would represent about 3% of the entire US workforce right before the pandemic.

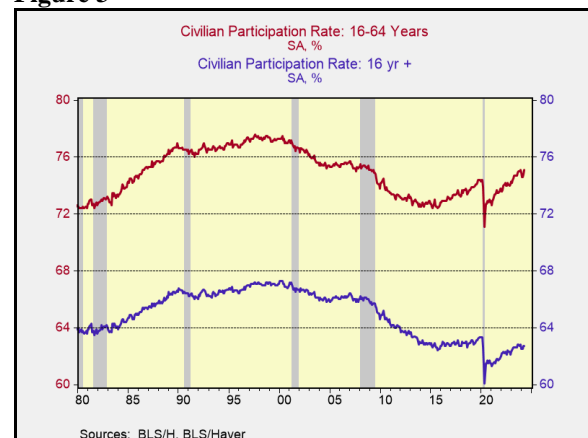
While many mid-career and younger workers also left the labor force due to getting the disease, needing to care for children, etc., the excess retirements and deaths of the boomers probably had an outsized impact on the labor market. By creating many new job vacancies near the top of their organizations, the mass boomer retirements and deaths likely advanced opportunities for mid-career and younger workers to finally obtain a promotion, raise,

new opportunities for skill development, and new incentives for innovation and productivity growth. As shown in *Figure 3*, the improved labor demand and working conditions for those workers help explain why the labor force participation rate for “prime aged” people (those aged 16 to 64) has not only rebounded to its pre-pandemic level but has now substantially surpassed it. In contrast, the overall participation rate, which includes people aged 65 and older, remains below its pre-pandemic level.

**Figure 2**



**Figure 3**



### Government-Supported Lateral Moves

The other major development in the pandemic economy was the government's [massive income support programs to help](#)

[those hurt by the economic shutdown](#). For example, the US Treasury sent three rounds of “Economic Impact Payments,” i.e., checks of up to \$1,400 per round, directly to individuals. These payments were made regardless of the recipient’s employment or tax status. [The government also broadened and extended unemployment insurance coverage and sharply increased the benefit amounts by as much as \\$600 per week](#).

Other tax, housing, education, and healthcare provisions related to the pandemic also channeled funds to workers and the unemployed.

It’s hard to trace exactly how people used these funds. Anecdotal evidence suggests many people used them to pay down debt, invest, buy consumer goods and services, or just take a break from work. However, various labor-market indicators suggest many workers used the money to improve their employment situation or prospects. For example, it appears from *Figures 4 and 5* that many people used the funding to quit their jobs, either to move to a better position with a different organization or to start their own business.

**Figure 4**



Just as important, government funds also probably helped many people go back to school (probably online) or pick up a new skill. We suspect many people essentially

used the funding to take a kind of sabbatical and re-think what kind of work they wanted to do, where they could make more money, or how they could be more productive. To the extent that people took the opportunity to re-strategize their approach to work, it could have helped them figure out how to leave less attractive jobs and find better ones.

**Figure 5**



### Economic Impacts

In sum, it appears that the baby boomer retirements and stimulus funds during the pandemic spurred increased vertical and lateral movement in the labor market, making it significantly more dynamic than before the crisis. We think this had a big impact on the supply of labor at different skill levels as well as worker incomes and productivity.

**Labor Shortages.** If the experienced, highly skilled boomers who left the labor force because of death or retirement were replaced by newly promoted mid-career or younger workers, the number of workers in the upper echelons of firms would not have changed. However, filling the jobs vacated by newly promoted mid-career and younger workers would require promoting a lot of entry-level workers. Along with the loss of other workers due to COVID-19, this created a “hole” in the supply of relatively low-

skilled, entry-level employees. Indeed, the available data suggests labor shortages have become endemic in industries that rely heavily on lower-skilled workers whose jobs can't be done remotely, such as hotel and restaurant workers.

**Higher Wage Rates.** For any given stratum of employee tenure or skill, filling the positions vacated by COVID-19 casualties, retirees, or other exits from the labor force probably shouldn't have had much impact on average wage rates. However, to the extent that workers made lateral moves to better positions in other firms or started businesses, those moves could boost their wage rates. *Figure 6* provides some evidence for this by showing that those who switched jobs saw bigger wage jumps than those who stayed put. In addition, various data shows that wage rates for relatively lower-skilled workers have risen especially fast since the pandemic, consistent with the hole in the labor force at that level and the resulting shortage of lower-skilled labor.

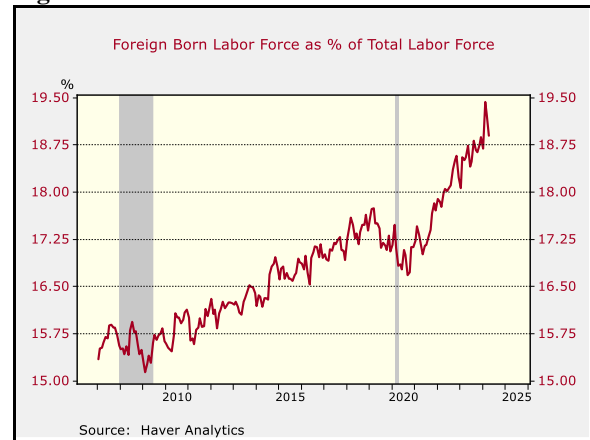
**Figure 6**



**Increased Immigrant Labor.** Looking to the future, a key question is how today's labor shortages, especially in lower-skilled professions, will be filled. Given the falling US birthrate and the shrinking number of high school graduates, new domestic workers probably won't be sufficient to fill

the gap. However, it may be filled in large part by the recent surge of migrants over the southern border. That immigration wave is certainly chaotic and potentially dangerous for national security. All the same, many of these new arrivals could be well suited to filling today's empty jobs. Some Fed officials have posited that the influx of immigrants is already boosting the labor supply, and there is some evidence of this in the economic data (see *Figure 7*, for example). If political resistance to the idea eventually declines, immigrants could fill many more empty jobs in the future.

**Figure 7**

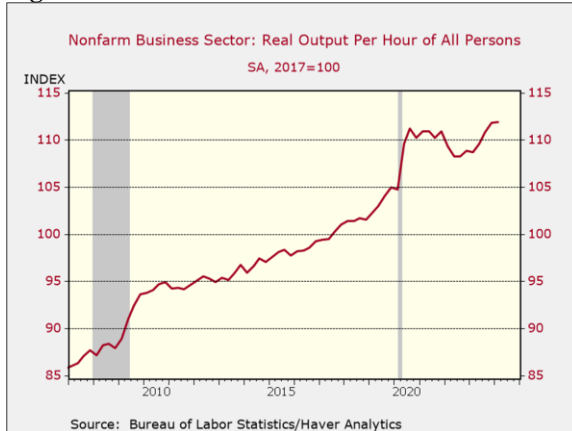


**Increased Automation.** Continuing labor shortages are also likely to spur companies to adopt more labor-saving automation. More broadly, the pandemic-driven labor shortages have already been partially addressed by technology such as video conferencing and other remote-work technologies, which have helped keep or boost the number of certain workers in the labor force, such as women with children.

**Accelerating Productivity Growth.** Finally, the increase in worker mobility and more automation have at least temporarily boosted US productivity (defined as the average value of output per hour worked). As illustrated in *Figure 8*, the interplay between

overall output growth and hours worked can lead to big swings in output per hour.

**Figure 8**



Nevertheless, now that the economy has largely moved past the pandemic, productivity stands at a record high. Indeed, it is at a level somewhat above where the pre-pandemic trend would have suggested. Of course, there is some chance that the changes discussed in this report may only be a one-time change, so productivity growth could weaken again. However, we think the new opportunities for skill attainment, the new business formation, and the greater incentives for innovation and growth discussed here could well produce continued productivity gains in the coming years.

### Implications for US Competitiveness

We've noted in many other reports that the growing US-China rivalry and other factors are fracturing the world into relatively separate geopolitical and economic blocs. One result, as companies are encouraged to "near shore" production, is that the US is now re-industrializing. If that's true, the improved labor mobility and spur to productivity discussed here will probably put the US in a better position to staff the new factories and other industrial facilities being brought back home.

Further, if this "labor reform" really does help facilitate US re-industrialization and stronger economic growth compared with other countries, it will also likely support higher US interest rates, thereby buoying the value of the dollar. Of course, fast productivity growth can help reduce consumer price inflation by keeping a lid on unit labor costs. However, we suspect the improved productivity growth won't be enough to offset all of the inflationary pressure from bringing production back to the US and making it more resilient to national security risks.

Finally, if these labor market changes do set the stage for greater US competitiveness and a stronger dollar, it would mark an ironic turn of events versus Europe's experience of the pandemic. In the midst of the pandemic, many economists looked favorably on the typical European policy, which focused on keeping people in their jobs even as economic activity shut down. That may have reduced the trauma of the pandemic and been a cheaper alternative for European governments, but according to our analysis, it may have also deprived the Europeans of the jolt to labor mobility and productivity enjoyed in the US.

### Investment Implications

In sum, we think that if the pandemic-driven boomer retirements and lateral employment moves are considered as a package, they essentially amount to a labor market reform (see *Figure 9*, next page). Importantly, it isn't yet clear if the labor changes discussed here will last. The apparent positive impact on labor mobility and productivity growth could prove to be short-lived. Nevertheless, if the impact is longer-lasting, we think one key investment implication is that corporate profit growth in the future will be stronger than it would have been otherwise.

Increased productivity would allow firms to



boost output and revenues more than enough to offset any increase in wages paid to their employees. That could help keep corporate profit margins high and support *US stock prices* going forward. Of course, industries that are heavily reliant on relatively low-skilled workers may continue to face labor shortages and skyrocketing wage costs. But as they rely more heavily on technology and revamped operational models, they will likely regain their profit growth. Of course, industrial stocks focused on automation products could do especially well.

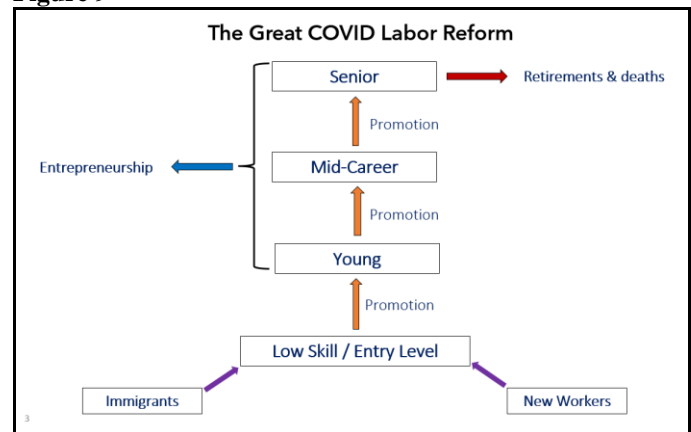
At the same time, the expected strength in the greenback and the fact that other countries generally didn't follow the lead of the US will likely present further headwinds for *foreign stocks*. Investors will probably want to maintain some exposure to foreign stocks for purposes of diversification and to have exposure to the many great companies outside the US, but broad, indexed approaches to foreign investing may face challenges.

Finally, these labor-market developments probably add to the headwinds that we expect for *fixed income*. Among the headwinds that we've discussed before, we think global fracturing and the upward pressure on commodity prices because of geopolitical tensions will make US

consumer price inflation higher and more volatile than in recent decades. That will probably lead to higher and more volatile interest rates as well. Of course, there is some chance that rising government deficits will prompt officials to adopt policies that artificially hold down interest rates, but within the context of higher inflation, that would likely erode the real purchasing power of bond interest. In sum, this analysis is further evidence that bond investments may produce reduced returns going forward.

Patrick Fearon-Hernandez, CFA  
 May 20, 2024

Figure 9



*This report was prepared by Patrick Fearon-Hernandez of Confluence Investment Management LLC and reflects the current opinion of the author. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.*

**Confluence Investment Management LLC**

Confluence Investment Management LLC is an independent Registered Investment Advisor located in St. Louis, Missouri. The firm provides professional portfolio management and advisory services to institutional and individual clients. Confluence's investment philosophy is based upon independent, fundamental research that integrates the firm's evaluation of market cycles, macroeconomics and geopolitical analysis with a value-driven, company-specific approach. The firm's portfolio management philosophy begins by assessing risk and follows through by positioning client portfolios to achieve stated income and growth objectives. The Confluence team is comprised of experienced investment professionals who are dedicated to an exceptional level of client service and communication.