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WORKERS ARE GAINING AT THE EXPENSE OF SHAREHOLDERS

The supply of labor will be constrained for years to come, eating into profits unless companies can find a way to boost productivity.

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We just learned from the Centers for Disease Control and Prevention that life expectancy contracted by 1.5 years in the U.S. in 2020, the biggest decline since at least World War II. Covid-19 has killed about 611,000 Americans and exacerbated drug overdoses and homicides as well as the deaths of people who skipped treatments for diabetes and other chronic diseases during the lockdown. Then there are those that suffered from isolation and stress, interrupted their normal diet and exercise routines and overused alcohol.

The resulting negative effects on population will constrain the supply of labor in future years, enhancing the shift away from corporate profits and to employee compensation in the broad makeup of national income. This is a favorable trend for wage-earners but bad news for shareholders, unless the effects of this transition are offset by more efficient use of labor and more rapid productivity growth.

History shows that pandemics curb labor supplies and push real wages higher while real interest rates and, therefore, returns on capital are depressed. A research paper by the economist at Federal Reserve Bank of San Francisco titled "Longer-Run Economic Consequences of Pandemics" focused on 15 major pandemics, starting with the Black Death in the 14th century, when more than 100 million people, or 30 percent to 60 percent of Europe's population, died. The economic effects generally persisted for 40 years after major pandemics.

The reason why the aftermath of pandemics push up real wages is because of the shortage of labor. And the reason why real interest rates decline is because there is an excess of capital per active worker and saving rates rise as survivors rebuild assets and prepare for future crises. Pandemics kill people but don't destroy plant and equipment.

Only 0.2 percent of the U.S. population has died from Covid-19, but many have dropped out of the labor force as the pandemic made them rethink their lifestyles. As a result, the 9.2 million job openings in May vastly exceeded the 5.9 million new hires. In April, 19.5 percent of the population was retired, 1.6 million more than if the already-surging number of postwar babies had continued its pre-Covid-19 trend. Also, wages are rising, especially for those in low-paying industries. In June, employees in leisure and hospitality who only earn 46 percent of the average private sector weekly wage saw their compensation jump jumped 10 percent from a year earlier, according to the Labor Department.

National income is the same total as gross domestic product, but breaks it down by who gets the income as opposed to who does the spending. Two important components, employee compensation and corporate profits, are mirror images. And they oscillate with neither labor nor capital permanently getting the upper hand, just as you'd expect in a democracy. Since the first quarter of 2020, profits' share has fallen from its peak of 14.3 percent of national income to 12.4 percent while compensation's portion has jumped from a low of 60.4 percent to 63.8 percent. And note that these trends were well-established even before the fiscal policy responses to the pandemic hyped household incomes.

The movement in favor of labor compensation and away from corporate profits was probably destined to persist even without the labor force-depressing effects of the pandemic. The Biden administration's policies are definitely in that direction. President Joe Biden plans to make it easier for labor unions to organize private sector industry and increase pay, especially after the rejection in April of union representation by Amazon.com Inc. warehouse workers in Alabama. More recently, Biden has mounted an attack on big business by directing all regulatory agencies to consider breaking them up in the name of enhancing competition.

American businesses probably can't stop the ongoing gains in employee compensation but they are offsetting some of them by cutting labor costs through enhanced productivity. Real GDP in the first quarter was slightly above its early 2020 pre-pandemic level and is up 10.3 percent from its bottom in the second quarter of last year. But payroll employment has risen just 7.2 percent and is still 4.4 percent, or 6.8 million, below its pre-pandemic level. Nonfarm productivity leaped 5.4 percent in the first quarter from the last three months of 2020 and 4.1 percent from a year earlier.

Some businesses such as airlines and leisure and hospitality have seen big increases in output per labor hour just by putting back to work people who remained on their payrolls. But what's important for corporate earnings and equity investors in the future is the willingness and ability of businesses to keep pushing productivity. This can be an important screen for your stock portfolio and for providing a bigger economic pie for employees, shareholders and tax collectors to split.

Adding to the importance of productivity is the likely slowing in economic growth and corporate revenues. The consensus of forecasters is drifting toward my continuing belief that without further massive fiscal stimulus, and with households' continuing zeal to save and not spend, the recovery surge of 6.4 percent in real GDP in the first quarter will drop back to 2 percent to 3 percent.