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High Turnover, Low Productivity

Workers take time to reach their full potential in new jobs.

By Ryan James Boyle

We have **written at length** about the unusual recovery in labor markets. The conclusion is fundamentally favorable for workers: As openings grew faster than the labor pool, workers found opportunities to step into new sectors and higher-paying jobs. New hires enter an exciting honeymoon phase of exploring a new role and gaining new skills. But those job changes cause ripple effects, which **impair productivity**.

Employees starting new jobs must climb a learning curve. Those who made career transitions or **struck out on their own** will take the longest to reach their best levels of output. And one of

the characteristics of this cycle has been a rush toward **early retirements**. The most seasoned employees were the first to move along. They were the veterans with experience to quickly fix problems as they arise, often with irreplaceable institutional knowledge.

Employers bear a cost, as well. They must recruit replacement labor, often at much higher wages than the departed employee earned. Those new hires then need training.

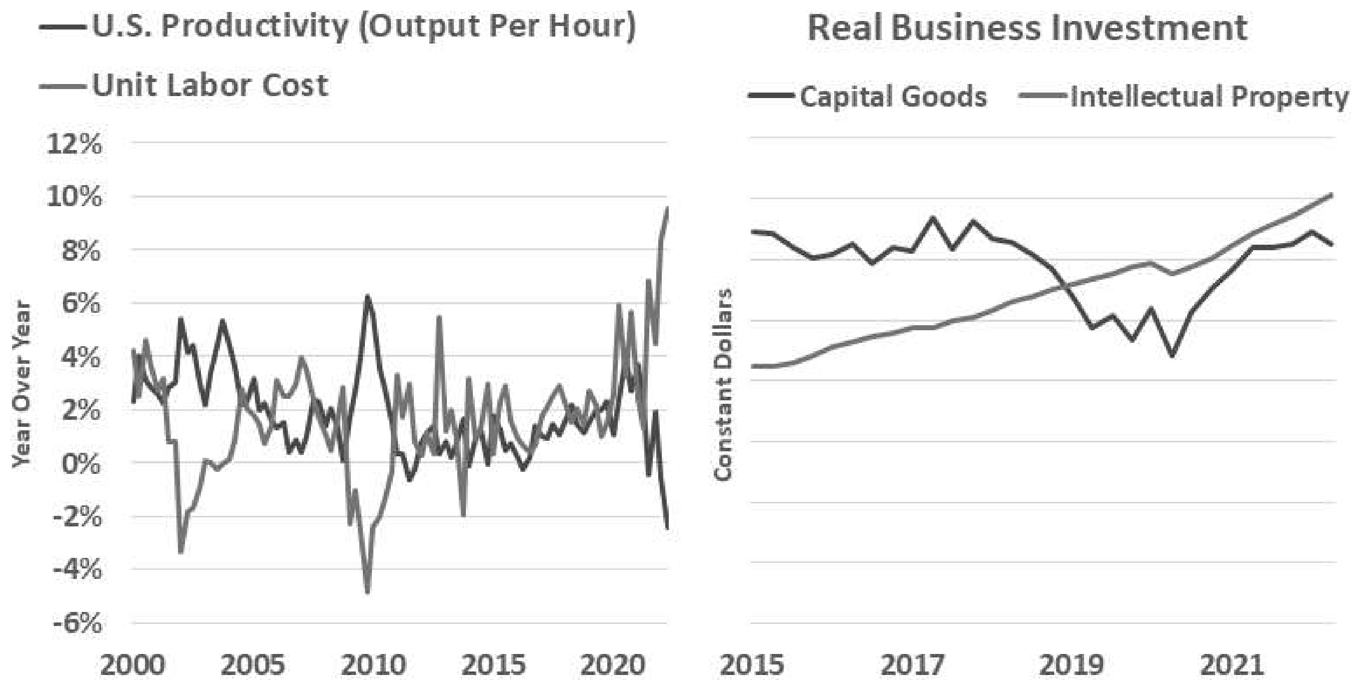
Today's high-turnover environment is thus a hindrance to productivity gains. Productivity is a simple ratio of output per worker, or output per dollar of labor cost. Both the numerator and denominator of that ratio are challenged today. Output has been diminished by both supply chain complications and novice workers. Meanwhile, unit labor costs are soaring as employers raise wages to attract and retain employees.

Predictably, broad measures of productivity across developed markets in the first half of the year showed substantial declines, as compensation grew faster than output. And in public statements, many companies have pointed to the challenge of training new hires. For instance, air travel has been a frustrating experience this year, as the system struggles to keep pace with demand. In an earnings call, a major U.S. airline noted that their headcount was back to 95% of its pre-pandemic level, but their capacity had **only recovered to 85%**.

There are many ways to improve productivity. Doing nothing is an option: The measure will improve cyclically as newer employees gain experience. For more rapid gains, employers can simply reduce headcount. Fewer employees makes for lower staffing costs and will bring about a one-time productivity boost.

Of course, this is an implausible tactic in an environment of strong ongoing demand. As long as a company's output is positioned to grow, an employer will be better off retaining and training staff. In tight labor markets, employers can no longer assume that workers are standing by to take jobs as soon as positions are opened. As a result, layoffs have stayed low throughout the year.

Productivity improvements are essential for economic growth.



Sources: BLS, Census Bureau, BEA, Haver Analytics

Over a longer horizon, productivity improves through investments in technology, whether that takes the form of automated production, self-service retail kiosks or improved information systems. These investments allow for more output from the same or smaller number of employees. Productivity-enhancing projects will bring a positive return under most circumstances, and a tight labor market has only improved the case for investment. New orders of capital goods grew after the pandemic shutdowns and have held strong ever since, while intellectual property has been the fastest-growing component of business investment. Against a backdrop of an aging population and slow immigration, restoring productivity is central to today's economic recovery and tomorrow's economic vitality. A more settled labor market and additional investments in efficiency will be critical to sustaining economic growth.

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