FEDERAL RESERVE BANK OF SAN FRANCISCO

"Beyond Fairness: The Value of an Inclusive Economy"

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Introduction

Thank you so much for the invitation to be here. It's a real honor.

The issues of our day require a commitment to dialogue. Allowing diverse groups to discuss, debate, and learn raises the best ideas and creates better outcomes.

The Los Angeles World Affairs Council and Town Hall Los Angeles have promoted such dialogue for decades. And now that you've joined forces, I know your legacy will grow even more. I'm personally delighted to be one of the first speakers of this new partnership.

Today, I'm going to talk about one of the most critical issues of our day: economic growth. How we are growing now… growth we've experienced in the past… and what factors could temper or spur our growth in the future.

But before I begin, I need to give the standard disclaimer: the remarks I'm about to deliver are my own and don't necessarily reflect the views of anyone else within the Federal Reserve System.

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Current conditions

So let's start with growth today. How's the economy doing?

Here, the news is largely positive. The economy continues to expand at a solid pace. Job growth is strong, unemployment is low, consumer spending is healthy, and households remain confident. These are all really good signs.

On the other hand, we've yet to achieve our inflation goal on a sustained basis. And a number of headwinds – such as trade uncertainty and slower global growth – have started to gust. This has caused manufacturing and business investment to soften considerably over the course of the year.

To ensure we sustain the expansion against these headwinds, the Fed has adopted a more accommodative monetary policy position – cutting the federal funds rate in both July and September. This accommodation should help the economy continue to grow so that we can make further progress on our mandated goals of full employment and price stability.

Drags on future growth

But what is the pace of growth we're trying to hit? What's sustainable?

This number has changed dramatically over time. During the 60 years prior to the Great Recession, GDP growth averaged around 3.5 percent.

During the current expansion, growth has averaged only 2.3 percent. And this slower pace, far from being an anomaly, is expected to continue. Most economists and forecasters, including me, predict GDP growth will average a bit under 2 percent for the foreseeable future.[1]

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[1] Board of Governors (2019). The median of FOMC member projections of longer-run growth is 1.9 percent.

So what's going on? Why is America's economy expanding at a much slower pace than it used to?

To explain, we need to look at the fundamental drivers of economic growth: productivity and the labor force.

Let's first consider productivity growth. Although it's fluctuated over time, it's generally contributed a little over 1 percentage point to overall GDP growth since the 1970s. It's forecast to do about the same going forward. So the reason for slower growth likely isn't productivity.[2]

Labor force growth tells a different story. In the 1970s, when the U.S. population was increasing rapidly and women were entering the workforce in large numbers, labor force growth *alone* averaged 2.7 percent annually. That means – even if productivity growth had been zero – the economy would have expanded at 2.7 percent. That's faster than the pace of our current expansion.

Since that peak, the number has come down substantially. The labor force has grown less than 0.5 percentage point annually for the past decade – and it's forecast to stay that way for at least another ten years.[3]

Much of this decline in labor force growth is due to simple demographic changes. Our population is aging. Fewer babies are being born. This dynamic isn't unique to the United States – countries around the world are experiencing similar trends.

But there's something that *is* different in America. We've experienced a decline in labor force participation for people between the ages of 25 and 54 – what we often call prime-age workers. And right now, there is a smaller

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[2] Fernald and Li (2019).
[3] Congressional Budget Office (2019) and Fernald and Li (2019).

fraction of this group working or actively seeking work than we had back in the late 1980s and 1990s.

This raises an important question: why aren't more prime-age Americans working?

There isn't a simple answer. There's a whole host of issues at play.

On one end of the spectrum, research suggests that some of the drop may be attributed to wealthier families choosing to have only one earner.[4] So families with the financial ability to make these work-life choices may account for some of the lost labor force participation.

On the other end of the spectrum, many people stay home to take care of children not out of choice, but out of necessity. Rising childcare costs and lack of access to parental leave likely contribute to lower labor force participation rates, especially among women.[5]

Then there's the changing labor market, which is leaving many people on the sidelines – wanting to work, but not having the skills or education to keep pace with the ever-evolving economy.[6]

More jobs currently require a bachelor's degree than a high school diploma.[7] Unfortunately, college completion rates haven't kept up with demand. Recent data tells us only 37 percent of 25- to 29-year-olds have a college education.[8] And we see that much of the decline in prime-age workforce participation is concentrated among individuals who lack a college degree.[9]

[4] Hall and Petrosky-Nadeau (2016).
[5] Daly et al. (2018) and Blau and Kahn (2013).
[6] Valletta and Barlow (2018) and Charles, Hurst, and Schwartz (2019).
[7] Carnevale, Jayasundera, and Gulish (2016).
[8] National Center for Education Statistics (2018).
[9] See Tuzemen (2018), who focuses on prime-age men.

These are just a few of the factors driving down labor force participation in the United States. We could also talk about the talent being lost to opioid addiction. Or geographic mismatches that leave rural communities with affordable housing and few jobs, and urban communities with plentiful jobs and skyrocketing housing costs.

Whatever the reason, we have more people sitting on the sidelines than in the past. This poses obvious problems for individuals and families – but it also poses problems for our economy.

Absent a surge in productivity growth, slow growth in the workforce is going to be a significant structural restraint on America's economic future.

The present doesn't have to define the future

So what can we do? Are we really destined to grow at just 2 percent moving forward? The answer is likely yes… unless we make significant changes that better engage all that talent we're leaving on the sidelines. This will require a concerted effort from many stakeholders – including the Federal Reserve.

At the Fed, our job is to support a healthy economy and achieve the dual mandate goals of full employment and price stability. The logic of our mandate is that a strong economy benefits everyone. And we can see this in the current expansion.

Ten years of sustained growth have reduced unemployment rates to near historic lows and pulled millions of Americans back into the labor force. This long and robust expansion has been particularly beneficial to historically less-advantaged workers, including African Americans, Hispanics, and those with less than a college degree.

This makes sense. When labor markets are tight, as they are now, businesses have to compete for workers and find new ways to fill jobs. They recruit more intensively, adjust hiring standards, and look to a broader pool of potential employees. This creates new opportunities for less advantaged workers and allows them to get a foothold in the labor force.[10] Indeed, the data tell us that the strength of the current expansion has narrowed long-standing gaps between more and less advantaged groups.[11]

But while these gaps are narrowing, they still persist. And monetary policy alone isn't enough to close them. Reducing the structural barriers that limit workforce participation or keep individuals from reaching their full potential requires taking a hard look at some of our social and workplace policies.

There are any number of examples we could consider, but I'd like to focus on two from recent research.

The first looks at women. In the mid-1990s, a gap began to form in the participation rates of women in the United States and Canada. By 2017, the prime-age participation rate for American women was 8 percentage points lower than for similar women in Canada. This is a startling difference. It represents about 5 million U.S. women who could be in the labor force. A growing body of work suggests that this difference can be attributed in part to Canada's generous parental leave policies and childcare subsidies, which allow women to remain attached to the labor market after child birth.[12]

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[10] Petrosky-Nadeau and Valletta (2019).
[11] Aaronson et al. (2019).
[12] Daly et al. (2018).

My second example relates to educational attainment and career opportunities. African Americans and Hispanics receive four-year degrees at about half the rate of whites.[13] And even when they do get degrees, their career paths have a flatter trajectory.[14] In economics parlance, we call this is a misallocation of talent.

But how costly is this sort of misallocation? It's hard to know in real time, but we can look to history for some indication. Researchers at Stanford and the University of Chicago examined growth in U.S. per capita output between 1960 and 2010. They asked how much of that growth was due to the removal of structural barriers, such as direct discrimination, lower school quality in minority communities, and financial obstacles that kept less-advantaged people from pursuing high-paying careers in fields like medicine and law. The findings were striking. They estimated that the removal of structural barriers accounted for up to 40 percent of the gains in U.S. per capita output.[15]

So talent misallocation affects our bottom line. This suggests that equalizing educational attainment rates and career opportunities for less advantaged groups could produce a considerable economic boost.

One person at a time

Up until now, I've talked about what institutions can do to help get talent off the sidelines and into the labor force. But I want to end with what people can do. Because this is what gives me the most hope.

[13] National Center for Education Statistics (2018).
[14] Daly et al. (2017).
[15] Hsieh et al. (2019).

Let me take you to Firebaugh, California, about four hours north of here in Fresno County. It's a rural agricultural community. Many of the people living there don't speak English as their first language. It's one of the poorest regions in America.

And yet… 97 percent of Firebaugh's kids graduate from high school. That's 12 percentage points higher than the national average. And most of them go on to college or other post-secondary study.[16]

So how do they do it? The entire community of Firebaugh – from parents to teachers to students to local leaders – have made education a singular priority.

But they're not the only one.

Barrio Logan, near downtown San Diego, is a mostly Latinx community. The average annual income for a family of four there is $25,000. Only 38 percent of adults have a high school diploma. Just 3 percent hold a bachelor's degree.

But the Barrio Logan College Institute is helping change that narrative. They start preparing first generation students for college in third grade. For kids enrolled in their program, 100 percent end up graduating from high school – and 100 percent go on to enroll in college.[17]

These are inspirational success stories. They tell us the power of people. And they show us what's possible when people come together to decide that their state today doesn't have to determine their state tomorrow.

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[16] Firebaugh High School (2017).
[17] Barrio Logan College Institute (2019).

Conclusion

So how do we change the future? How do we scale places like Firebaugh and Barrio Logan?

The answer is simple: with intention.

Fairness has been a long-standing aspiration of our society. But aspiration isn't enough. We have to turn our desire to be *fair* into a commitment to *include*. Inclusion has to become our practice.

We have to come together. We have to combine the forces of our institutions… our communities… our people.

That's the way we rise above what the data tell us is possible. That's the way we'll give the next generation a better future than the one we inherited.

Thank you.

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