Labor Market Trends and Monetary Policy

Remarks by

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I am pleased to have this opportunity to speak here in Austin. Understanding the dynamics of the nation's labor market plays an essential role in the work of the Federal Reserve and for me as a regional Federal Reserve Bank president.

In my role, I meet with business, labor and community leaders throughout the Federal Reserve's Tenth District, which encompasses Colorado, Kansas, Nebraska, Oklahoma, Wyoming, and portions of Missouri and New Mexico. I regularly hear about the importance of a strong alignment between employers' needs and the skills available in the local labor force. The challenge is to find the best opportunities and partnerships across a wide range of organizations.

In my remarks today, I'll discuss the progress that has been made in the current economic expansion toward full employment. I'll then turn to longer-term shifts in the types of jobs that are offered by employers, and how these shifts in demand for skills have affected workers. Finally, I'll conclude my remarks with some comments on the current stance of monetary policy as the Federal Reserve seeks to promote long-run sustainable growth by fostering maximum employment and price stability.

Labor Market Dynamics in the Current Economic Expansion

This is the 100th consecutive month of the ongoing economic expansion. In historical terms, it is the third-longest U.S. expansion on record going back to 1850. Total employment has increased on net by 17 million workers since 2009, which is double the number of jobs lost in the most recent recession. As employment has steadily increased, the unemployment rate has fallen from 10 percent in 2009 to its current level of 4.4 percent. This level of unemployment is below nearly all estimates of the natural rate of unemployment, which is the level of unemployment that is estimated to prevail in the longer run in the absence of cyclical fluctuations.

While the headline variables indicate that much of the labor market has returned to pre-recession levels, other indicators reveal broader shifts taking place. For example, the percentage of people participating in the labor force has declined notably since the recession and has not made much of a recovery. In 2007, 66 percent of the U.S. adult population (ages 16 and over) either had a job or were actively looking for employment. By 2015, the labor force participation rate had declined to 62 percent—this represents a shift of 10 million people out of the labor force based on our current population. A large portion of this decline was due to the aging of the population, with many baby boomers reaching retirement age. However, some of the decline was due to workers being discouraged about their job prospects and no longer seeking employment.

Over the past two years, we have seen a modest pickup in the labor force participation rate, which is a sign of improving labor market conditions. Research by my staff has investigated this improvement to better assess its underlying dynamics.[1] While an increase in the participation rate may seem to suggest a surge of new workers entering the labor force, entries actually slowed in 2016. The increase in the participation rate was instead a result of a decline in the number of people exiting the labor force. This decline, in combination with steady increases in employment, suggests workers are now more attached to the labor force than in earlier years during the recovery. As workers are matched to better and more stable jobs, the rotating of workers in and out of employment and in and out of the labor force slows. An additional contributing factor was that the group experiencing the largest slowing in labor force exits was the population aged 55 and older. This suggests that for older workers, the reduction in exits may indicate that some workers were delaying retirement decisions.

[1] Tüzemen, Didem and Jonathan Willis. 2016. "What is Behind the Recent Increase in Labor Force Participation?" *The Macro Bulletin*, Federal Reserve Bank of Kansas City, November.

Job Polarization

Despite overall improvements in employment and the participation rate, we know there are still segments of the working-age population that have not experienced as much of a recovery as we would like. This group has been impacted by longer-term trends. In particular, workers in middle-skill jobs have seen the demand for their skills steadily decline. For decades, these jobs were the gateway to the middle class.

The decline in middle-skill jobs is the result of a number of sweeping changes affecting the economy. If we look back to the 1980s, examples of middle-skill jobs that were much more prevalent than we see today include assembly-line manufacturing jobs and clerical and administrative positions. In 1983, nearly 60 percent of all jobs were in middle-skill occupations.[2] Today, that employment share has declined to 43 percent. Based on current employment levels, this shift would be equivalent to moving 22 million jobs away from middle-skill occupations.

Many of the employment opportunities in our economy have shifted toward high-skill jobs, which are jobs that typically require a college education. Since 1983, the share of high-skill jobs has increased from 26 percent to 39 percent.

What is perhaps more surprising is what we have seen at the other end of the spectrum. The share of employment for low-skill jobs has also increased, from 15 percent to 18 percent. Workers in these jobs typically have little formal education beyond high school, and they work in occupations that are service-oriented and cannot be easily automated, such as food preparation, cleaning and security services.

[2] Tüzemen, Didem and Jonathan Willis. 2013. "The Vanishing Middle: Job Polarization and Workers' Response to the Decline in Middle-Skill Jobs." *Economic Review*, Federal Reserve Bank of Kansas City, first quarter, pp. 5-32.

This shift of employment toward both high- and low-skill jobs and away from middle-skill positions has been labeled "job polarization."

Job Polarization: Gender and Race

As a result of this development, the current generation entering the workforce finds a very different landscape than the labor market of the 1980s. How have new entrants to the labor force adapted over time to be better prepared for the current labor market? Understanding these trends is particularly relevant to those of you focused on developing today's workforce.

I'd like to use two demographic lenses to illustrate how the population is adapting to job polarization—looking first at shifts by gender and second at shifts by race.

Over the past three decades, both men and women experienced declines in the shares of employment in middle-skill jobs, but for different reasons. For women, the main losses in the share of middle-skill employment were in office and administrative occupations, likely related to the replacement of many secretarial and clerical jobs with desktop computing. For men, major losses were in production occupations, likely related to the decline in employment in the manufacturing industry.

Women and men responded very differently to these developments.

For women, the decline was accompanied by an almost equally large increase in the share of high-skill jobs, particularly in managerial, professional and technical occupations, such as engineering, finance, management and medicine. Based on the shift, women today occupy a larger portion of high-skill jobs compared to the 1980s.

For men, the shift away from middle-skill occupations led to almost equal increases in the shares of employment in both low- and high-skill occupations. Accordingly, a larger portion of low-skill occupations, which are primarily service jobs, are held by men today as compared to the 1980s.

Gender differences in job shifts line up closely with gender differences in educational attainment. While levels of attainment increased for both male and female workers over the past three decades, the change was more pronounced for women. The strong shift toward high-skill jobs for women was associated with a large increase in the share of women with a bachelor's degree or higher. Educational attainment of men has risen more modestly, in line with the smaller shift of male employment toward high-skill jobs.

While we see very different responses to job polarization between men and women, the responses across racial groups are more similar, with differences predominately reflecting historical disparities in levels of educational attainment.

To illustrate the responses to job polarization by race, I will focus on two groups, African American and Caucasian workers, who together account for 90 percent of employment in the United States. First, however, let me describe the terms and information I'm using. The statistics come from the Current Population Survey (CPS), which is the survey used to construct the unemployment rate. The terms I'll use for race also require clarification. The terms African American and black are used synonymously in the official data collection and so I will use the term black to mean African American and white to mean Caucasian. Finally, I'd like to note that in this survey, Hispanic workers account for 16 percent of total employment, and many likely self-identify as white when identifying their race in the survey. They have the option of identifying as Hispanic in a separate question on ethnicity.

Over the past two decades, both white and black workers have experienced similar shifts in job opportunities consistent with job polarization. Both groups experienced a significant decline in the employment share of middle skill jobs.[3] And employment for both populations shifted toward high- and low-skill jobs, with a stronger shift toward high-skill jobs.

While employment shifts were similar, white workers have had a consistently larger share of employment in high-skill occupations. In 2017, 40 percent of white workers were employed in high-skill jobs, relative to 30 percent of black workers. Both populations have a similar share of workers in middle-skill jobs—approximately 45 percent. This implies that there is a larger share of black workers in low-skill jobs than white workers: 24 percent of black workers and 17 percent of white workers.

As employers have increased the share of high-skill jobs, workers have responded by obtaining higher levels of education than previous generations. The share of workers with a bachelor's degree has increased by approximately 10 percentage points over the past two decades for both black and white workers. But underlying this shift in educational attainment, a persistent education gap exists between black and white populations. In 2017, 36 percent of white workers had a bachelor's degree, relative to 28 percent of black workers.

The difference in educational attainment is very important. It is increasingly challenging for a worker to obtain a high-skill job without having a bachelor's degree. During the past 20 years, workers with a high school diploma or some college education have experienced a decrease in the likelihood of obtaining one of these jobs.

Of particular concern is the divergence in opportunities between those with a bachelor's degree and those with some college education. For those with a college degree, the opportunities are clear: high-skill jobs. However, individuals with some college education or an associate's

[3] Kansas City Fed Economic Research Department. 2017. "Assessing Differences in Labor Market Outcomes Across Race, Age, and Educational Attainment." Federal Reserve Bank of Kansas City, Research Working Paper no. 17-03, April.

degree are struggling to find good employment opportunities. Especially in the case of black workers, individuals with some college education are increasingly ending up in low-skill jobs.

The workforce development challenge is steadily shifting to how to best equip workers with the skills in demand by employers. More than 60 percent of workers do not have a college degree, and are thus most likely competing for middle-skill jobs. Employers will no longer simply welcome a young worker with a high school diploma and say, "I'll train you," but are more likely to ask, "What skills do you already have?" Young people today who do not see college as their best path forward need to have better awareness and opportunities for vocational training and post-high-school certification and training programs in areas such as skilled trades, healthcare, and coding. With improved training, they will be better equipped for today's middle-skill jobs, which despite declines, still account for 43 percent of all jobs.

The Federal Reserve System is actively involved in a range of activities to promote better outcomes for workers. We are engaged in research, roundtable conversations with industry and labor leaders, conferences like this one, and publications, such as our recent publication exploring workforce development policies for the 21st century.

The Role of Monetary Policy

As the Federal Reserve determines the appropriate settings for the nation's monetary policy, it must weigh a variety of economic factors, including the labor market trends that I have described today. In the short run, I look across a wide range of business sectors and assess their performance, monitoring their demand for workers in a tightening labor market and their capital investment plans. In the longer run, I evaluate trends such as job polarization and an aging workforce, and consider what those structural forces imply for the Federal Reserve's goals of maximum employment and price stability. These are challenging economic factors to evaluate, with different forces typically pushing the economy in different directions at the same time. Monetary policy is a blunt tool with limited ability to influence any specific segment of the economy. It is most adept at addressing factors related to the business cycle and least adept at addressing the longer-run trends such as job polarization and an aging workforce.

For monetary policy makers, the key question centers on the appropriate level of accommodation, at this stage of the economic expansion, to best foster long-run sustainable growth. At the most recent Federal Open Market Committee (FOMC) meeting, the Committee announced plans to initiate its balance sheet normalization program in October. Large-scale asset purchases (LSAPs), better known as quantitative easing, or QE, transformed the size and composition of the Fed's balance sheet from less than $1 trillion in mid-2008 to approximately $4.5 trillion today. This unconventional policy was implemented because the Federal Reserve's conventional policy tool, the federal funds target rate, had been lowered to zero in December 2008, and the Federal Reserve determined that additional measures were warranted. Beginning this month, the FOMC plans to gradually reduce its securities holdings by decreasing reinvestment of the principal payments received from maturing securities. This gradual reduction in securities holdings will continue "until the FOMC judges that the Federal Reserve is holding no more securities than necessary to implement monetary policy efficiently and effectively."

In regard to interest rates, the FOMC has maintained a very accommodative stance of policy up to this point. The target range for the federal funds rate was set at the zero lower bound from 2008 until the end of 2015. Starting in December 2015, the federal funds rate has been raised a total of four times to its current target range of 1 to 1¼ percent. During this first phase of monetary policy normalization, economic growth has remained above trend and the unemployment rate has declined from 5.0 percent to 4.4 percent.

Looking forward, policymakers face the challenge of setting the appropriate path of interest rates to promote the FOMC’s objectives of maximum employment and price stability.

Based on my own economic outlook, further gradual rate adjustments will be needed to move the federal funds rate toward its longer-run level. With an economy growing at an above-trend rate and unemployment at a low level, postponing the removal of accommodation poses risks to sustainable growth and financial stability. At this stage of the expansion, it is appropriate to move cautiously. But waiting too long risks more aggressive moves, which, history shows can invite prospects of recession. And a continuation of current levels of accommodation risks similar distortions in capital allocation toward less fruitful, or perhaps excessively risky, endeavors that could result in financial imbalances.

Moving interest rates at a gradual pace toward a level consistent with longer-run growth is the best step to help promote a continuation of the economic expansion. For the Federal Reserve, such efforts are the most likely course, in my view, to meet our long-run goals of maximum employment and price stability. And by doing so, we can best foster conditions to support workforce development efforts to invest in workers and build a stronger economy.