s-labor

ECONOMIC AND LABOR TRENDS IN THE 1990s
Remarks by Robert P. Forrestal, President
Federal Reserve Bank of Atlanta
To the Fisher and Phillips Seminar
November 18, 1988

Good morning! It is a pleasure to be with you today and to have the opportunity to give you my perspective on labor markets and economic developments for the remainder of this century. I should say at the outset that it is difficult enough to form an outlook for business and labor developments over the coming 12 months, let alone for the next 11 years. The globalization of markets has complicated the interplay of factors that affect the course of economic events. At the same time, unanticipated changes are increasingly possible given today's rapid pace of technological innovation.

Sorting through all the variables, though, I can isolate two themes that will influence virtually every business and economic policy decision through the year 2000. The first has mostly to do with demographics, particularly the continuing changes under way in the workplace in conjunction with the baby boom generation. The second is our difficulties in dealing with the federal budget deficit. Demographics and deficits leave room for a variety of responses on our part. Therefore, as I review each of those issues, I shall point out the options and indicate my own preferences.

The Baby Boom and Related Demographic Trends

Let me first discuss demographic trends. There are really several developments that seem noteworthy to me. The first revolves around the fact that baby boomers have completed their entry into the labor force and are now becoming mature workers. The second is the incorporation of women and minorities into the mainstream of business. The third centers on the labor shortages associated with the more recent "baby bust."

The baby boom, of course, refers to that well-publicized bulge in our population

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

caused by increased birth rates between 1946 and 1964. This generation has elicited significant investments from American society. In the 1950s and '60s we invested in their education. The United States was willing to give this group the best education that any generation has ever received. As the baby boomers entered our school systems, we increased funding to provide adequate teachers and classrooms. After the Soviet success with Sputnik, we refocused our attention on curriculum, stressing science and math as key ingredients for competitiveness. In the next decades, the two-year college grew in importance as an alternative avenue to higher education. More young people than ever were thereby able to receive at least some advanced training.

As this generation entered the working world, once again the effects were significant. Absorbing so many people into the labor force and enabling them to acquire job-specific skills and experience exerted a temporary drag on overall productivity. However, it also represented a form of investment. Now that these workers have moved up the learning curve, they are becoming productive, mature workers. In addition to measurable productivity gains, I am confident that this generation will bring fresh approaches to problem-solving as their excellent educational backgrounds combine with practical experience.

A second past investment that will bring more and more paybacks involves the extension of equal economic opportunities to groups that were more or less excluded in the past. We have devoted considerable energy to bringing women and minorities into positions that were formerly reserved almost solely for white males. This process may have involved initial costs as businesses adjusted to changing conditions. In the future, however, our progressive social action should have a positive effect on productivity. Just as the educational assets of the baby boom will enhance U.S. productivity, so will these groups open sources of creativity as yet untapped. Meanwhile, our global competitors still have this process ahead of them. Higher living standards and better education

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

abroad will create pressures to include women in more responsible positions in many countries.

Both investments--in the baby boom as well as in increasing the participation of women and minorities--should sharpen America's competitive edge in years to come. Profitable, income-boosting economic activity will continue to favor products based more on intellectual than physical input. Data processing, engineering, financial, and other service sector jobs will grow in numbers. Meanwhile, employment will stay relatively flat in manufacturing, where the trend will be toward the use of smart machines run by technicians. The workers who run these machines will have to be more highly qualified and flexible than their predecessors on the factory floor. Thus, we have properly positioned ourselves in this regard for the rest of the century.

While I am optimistic about our labor force, I want to emphasize that demographic shifts still pose challenges. Foremost among these is the relatively short supply of workers entering the labor force in the baby boom's wake. The boom has been followed by a relative bust. Three million new workers entered the workforce in the peak year of 1978. Only one and a quarter million will do so on average each year between now and the year 2000. Businesses seeking entry-level employees are already experiencing the effects of this demographic shift. In the suburbs of Atlanta and many other cities, restaurants, hotels, and other retailers, in particular, face an ongoing shortage of workers. As the shortage intensifies, it could lead to higher costs. This concern is especially true for the more labor-intensive service sector, where prices have already been rising faster than in most industries. This development could thus have inflationary consequences. It could also worsen our trade deficit. Even service-sector jobs can find their way overseas through computer and communication technology. We have already seen this shift to some extent in data processing, just as we saw it in a major way in manufacturing when costs soared while quality sagged.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Speaking of quality, I am also worried about the quality of education among the post baby-boom cohort. Standards seem to have slipped dramatically in comparison to the baby boom's education. Every week we read of disappointing test results or a survey showing that American students cannot identify our major trading partners on a map. This is simply not acceptable in a global economic environment. Our competitors are teaching their children English and American culture in addition to the solid math and science curriculum we took for granted here when the baby boomers entered school.

Alternative Sources of Labor

There are various ways to deal with these shortages of qualified workers. One obvious group to draw from is the millions of poor who are still on the outside looking in at the prosperity of the eighties. Entry-level job vacancies in the suburbs, for example, could be filled by the surplus of unemployed youths in the inner city; but making more use of this labor resource involves a number of measures. Investments in better transportation networks may well be required as a first step. In addition, better health care and possibly day care may be needed, since a large share of today's poor are single mothers. Also, the poor will not be able to help us solve the labor shortages of the baby bust era unless we make determined efforts to improve their schooling.

Another source of additional labor might well be found among older workers. For a number of reasons many will stay on the job longer as time passes. Revisions in Social Security already in place will help alter the view that retirement at age 65 is a given. For individuals born after 1960, for example, the retirement age will rise to 67. In the private sector, labor shortages could lead businesses to raise or even eliminate mandatory retirement ages and curtail inducements for early retirement. Finally, workers who want to continue working into their late 60s or 70s may be aided by the ongoing shift from manufacturing to services, since many service jobs are less demanding physically than factory work.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

On the other hand, career frustrations may induce many baby boomers to leave their jobs earlier than expected. Their sheer numbers will tend to clog channels of upward mobility. At the same time, the fact that more members of this generation have earned advanced degrees will raise their expectations of promotions to upper management slots. Aside from the surfeit of candidates for these positions, the belt-tightening most large businesses have undergone in the 1980s should make it unlikely that career aspirations will be met.

Therefore, keeping people interested and involved in their work will be a challenge to management in the next 11 years. A trend toward more participatory management styles has already begun. I expect it to accelerate as baby boomers themselves enter top management positions in the mid-to-late 1990s. We should welcome this development. It will enhance U.S. workers' job satisfaction. At the same time it should improve our posture in global markets in much the same way that innovative management techniques have aided Japan. By increasing worker involvement in ways that respond to uniquely American conditions, our own industries will renew their competitiveness.

Another means of addressing labor shortages is also sure to be suggested. That is revising immigration practices to draw on labor pools outside the country. I recognize that the assimilation of foreigners into our culture is already a controversial subject. Witness, for example, the public debate over language associated with the large concentration of Hispanics. A relaxation of immigration quotas may lead to the situation Europeans have experienced with guest workers. These people now fill many of the more menial jobs in some countries. At the same time vast numbers of unemployed native-born workers have kept jobless rates in double-digits during much of the 1980s. Our melting pot society should be better able to deal with such social cleavages than many other industrialized countries. Still, we need to be giving thought to these issues now.

All these alternatives should prompt us to invest more in our human as well as our

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

mechanical and structural capital. Established workers need to adapt, retrain, and even change careers if they and their employers are to keep pace in today's highly competitive global markets. Failure in this regard will make us vulnerable--not just to the Taiwans, Hong Kongs, and other newly industrializing countries of the world, where wages and cost structures are far cheaper, but also to advanced economies. These countries have reputations for high quality. They also have a tradition of high savings, which they will no doubt continue to use to finance necessary investments. This point brings me to the second important economic factor in the 1990s. That is the federal budget deficit. We must come to grips with this problem before we can begin financing the kind of investments that will keep us competitive in the 1990s.

Deficit Gridlock

Those investments will require more savings and less government debt. Yet our large and persistent federal budget deficit moves us in just the opposite direction. It is true that the deficit's impact in this decade has been exacerbated by debt in other sectors of society. Corporate borrowing, especially the flood of debt associated with leveraged buyouts, has absorbed substantial savings. Consumer debt is also at relatively high levels. Demographic developments have contributed to this squeeze. The baby boom's debt accumulation reached a peak early in the 1980s. As they set up households, they made major first-time purchases like homes and furnishings. It is not surprising that they were left with little to save. Fortunately, this pattern should reverse as they enter their peak earning years and begin saving for retirement. Thus one of the pressures that has aggravated the effect of the budget deficit should be reduced.

Nonetheless, our federal budget deficit remains a large burden. In the past few years the reported reductions have been achieved largely through the inclusion of surpluses from the Social Security trust fund. These were planned to accommodate the expected bulge in demand when the baby boom retires. Thus, we could face serious

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

problems as the fund is drawn down.

Rather than try to push the day of reckoning into the future, true budgetary discipline is vital if we hope to free up more funds for much needed investments. The shortage of savings in recent years has forced us to sacrifice educational programs that would contribute to preparing our labor force for global competition. We have fallen behind in necessary investments for keeping our highways, bridges, and other infrastructure serviceable. We have left an unconscionable number of poor to wander aimlessly on the fringe of our prosperity. Similarly, health care--including Medicare and corporate medical benefits to retirees--presents a challenge that consumers, employers, and government must all address. This is especially true if we are to rely more on the elderly and poor to fill some of the anticipated labor shortages.

Clearly, our economy will be profoundly influenced by our decisions about this list of spending needs. Our choices are clear. One is to keep trying to muddle through as we have for some time, deferring action until some crisis forces us to come up with a second-best solution. We do not have to look far to find potential crises large enough to bring this scenario into play. The hemorrhaging of the FSLIC is one example.

A second course--accepting considerably higher rates of inflation--is one that I do not consider viable. Even though it might allow us to pay down our debt with cheaper dollars, Americans would suffer an unacceptable erosion of their living standard. Yet pressure is building toward this option. If foreigners become resistant to buying government securities, they will demand higher rates of return. Interest rates would rise across the board and tend to slow the economy. The Fed would then be left with the uncomfortable alternatives of sacrificing growth in the domestic economy or stimulating it at the risk of higher inflation. The possibility of some external shock to the economy like an LDC debt default could also trigger upward price pressures as did the oil shocks of the 1970s.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Fortunately, we can choose a third option. We can take immediate positive steps while the problem is still relatively tractable. By formulating a realistic plan to reduce the government's credit demand over the next five years, I feel we could make considerable progress. The elements of this plan do not have to be as simplistic as a tax increase or cuts in strongly supported social programs. Indeed, the social programs that remain in effect appear to be an integral part of our economic fabric. Government reductions would surely just shift the burden to businesses. Instead, we should revise tax laws in a way that would encourage savings and discourage borrowing. The opening days of a new administration are a good time to take bold, creative action of this nature. If we choose this alternative, I believe we can play a more forceful role in shaping economic conditions in the years ahead.

Conclusion

In summary, I am optimistic about the potential directions of labor and economic trends in the 1990s. Toward the end of the century I expect to see America's competitive vigor renewed by the paybacks from our past investments in education and social progress. These potential rewards make the deficit gridlock that limits new investment even more frustrating. Still, direct action on the deficit will allow us to remain more in control of our own destiny even if it entails some short-term stringency. Since our political cycle is about to begin anew, I hope we can overcome our fiscal paralysis. We need to move decisively to ensure continued improvement in our living standard through the opening years of the twenty-first century.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis