Remarks as Prepared for Delivery

EMBARGOED UNTIL 8:40 A.M. U.S. Eastern Time,
Friday, November 18, 2022 – OR UPON DELIVERY

"Parsing the Pandemic's Effects on Labor Markets"

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Opening Remarks
at the Bank's 66th Economic Conference,
"Labor Markets During and After the Pandemic"

November 18, 2022

The views expressed today are my own, not necessarily those of my colleagues on the Federal Reserve Board of Governors or the Federal Open Market Committee.

Key Takeaways

1. The Fed's focus on the U.S. labor market is grounded in its dual mandate to achieve price stability and maximum employment. Restoring price stability remains our current imperative as monetary policymakers, and it is clear there is more work to do. Understanding how the pandemic is affecting employment in the short and longer term, while challenging, is essential for that effort.

2. There has been a significant amount of work on COVID-19 and the labor market among academic economists as well as researchers within the Federal Reserve System. This conference brings together leading experts on the topic, enabling us to benefit from their perspectives and learn about remaining questions to be answered.

3. Answering key questions about the pandemic's effects on labor demand and labor supply is important for calibrating monetary policy and reducing inflation back to 2 percent. By raising rates, we are aiming to slow the economy and bring labor demand into better balance with supply. I remain optimistic that there is a pathway to re-establishing labor market balance with only a modest rise in the unemployment rate – while remaining realistic about the risks of a larger downturn.

4. Potentially long-lasting effects of the pandemic on the labor market, such as increased remote work and accelerated automation of service-sector jobs, are likely to have differential effects across the workforce. Understanding these differences is important for achieving the Fed's mission of a vibrant, inclusive economy in the wake of COVID-19.

Good morning. It is my great pleasure to welcome everyone to the Federal Reserve Bank of Boston. We are also pleased to be joined by those watching on the public livestream.

This is the 66th economic conference organized by the Boston Fed. And while it is my first conference as the Bank's president, it is wonderful to be reconnecting with many friends and colleagues attending today to explore some very important issues.

I'm delighted to now be part of the Boston Fed's long conference series. These meetings foster analysis and discussion – among a diverse set of researchers, central bankers, and other policymakers. They focus on complex issues where the work presented and discussed can inform, and make a difference – consistent with the Fed's goal to support a vibrant, resilient, and inclusive economy. Our conference this year is a prime example, and I want to commend our economic research team – led by our Director of Research Geoff Tootell – for designing such a timely and impactful agenda.

Before beginning, I note as always that the views I share today are my own. I am not speaking for colleagues at the other Reserve Banks or the Board in Washington.

Context: Maximum Employment and Price Stability

Let me start with some context. At the Fed, policy-relevant discussions are rooted in the dual mandate assigned to us by Congress – maximum employment and price stability. We define price stability as 2 percent inflation. Maximum employment is less specifically defined; but I see it as a broad, inclusive goal of job opportunities for all.

I've noted in past remarks that these two mandates are *intertwined*. Price stability is key for achieving sustained maximum employment – meaning, only when inflation is low and stable can the economy in general, and the labor market in particular, work well for all Americans. Labor market conditions also influence inflation dynamics, as we have seen recently with very tight labor markets contributing to high inflation.

At the Fed we approach our mandate with the utmost seriousness, and conferences like this help in achieving our goals – by providing insights, challenging assumptions, and exploring central questions about the economy. And coming out of the acute phase of the pandemic, there are many relevant questions about the U.S. labor market to explore. For instance:

- How has the pandemic affected job opportunities, and how is labor supply responding to those changes?
- Which recent changes in the labor market reflect transient, cyclical conditions; and which reflect developments in long-run, structural forces that monetary policy has little influence over?

These sets of questions are important for the key task the Fed faces today: lowering inflation back to 2 percent. By raising rates, we are aiming to slow the

economy and bring labor demand into better balance with supply. The intent is *not* a significant downturn. But restoring price stability remains the current imperative and it is clear that there is more work to do. I expect this will require additional increases in the federal funds rate, followed by a period of holding rates at a sufficiently restrictive level for some time. The latest data have not reduced my sense of what sufficiently restrictive may mean, nor my resolve. Still, despite being realistic about the risks, I look at current conditions[1] and remain optimistic that there is a pathway to reestablishing price stability with a labor market slowdown that entails only a modest rise in the unemployment rate.

In my remarks today, I will begin with the issue of structural versus cyclical labor market developments, then touch on aspects of the labor market that are especially salient for the current conduct of monetary policy, and finally consider some longer-run issues related to full employment in an inclusive economy.

Structural Trends Versus Cyclical Movements

Distinguishing long-run trends from temporary cyclical movements in the economy and labor market is challenging. And it is vital for calibrating monetary policy, so as to ensure we restore price stability in a reasonable timeframe without slowing real activity more than necessary.

Changes in the labor market are typically driven by a combination of structural and cyclical forces, and parsing their relative impact is complex. For example, manufacturing employment is highly cyclical, but the two recessions in the decade from 2000 to 2010 likely brought forward some of the longer-run declines in factory jobs that would have happened anyway, from increased automation and globalization. In other words, structural change can be concentrated in recessionary periods.[2,3]

Of course, structural influences have not prevented the job market's return to a healthy state during ensuing economic recoveries. That was the case after the COVID-19 recession, as the unemployment rate quickly returned to low, pre-pandemic levels.

Even so, there are potentially many long-lasting implications of the COVID-19 recession for the labor market. It is quite possible that COVID-19 brought significant

[1] For example, it appears many firms are still "catching up" to fill staffing vacancies even as demand slows. In addition, strong household balance sheets should help support consumer spending.
[2] See for example "Why does structural change accelerate in recessions? The credit reallocation channel" by Cooper Howes, in the *Journal of Financial Economics*, Volume 144, Issue 3, June 2022, pgs. 933-952.
[3] More generally, fears of increased structural unemployment have often followed recessions, going back at least to the early 1960s. In 2011 the Federal Open Market Committee (FOMC) discussed whether a significant amount of the high unemployment that remained after the Great Recession was structural. See, for example, a now-public memo on structural unemployment presented to the FOMC in 2011.

changes that bear directly, and over the long term, on the Fed's goal of a thriving, inclusive economy.

Consider that in addition to a significant decline in *aggregate demand*, the COVID-19 recession also saw large changes in *aggregate supply* as firms shut down early in the pandemic. Firms have re-opened, but pandemic-related adjustments like increased remote work and the accelerated automation of service-sector jobs have the potential to affect aggregate supply in the longer run.

And these trends will probably have differential impacts on workers with different characteristics. This is important because the Fed's mandate is to support a healthy economy characterized by price stability and maximum employment – for everyone. To do so, policymakers must assess which of the labor market changes originating in, or altered by, the pandemic are likely to *last*. For example, there have long been troubling gaps in the rate of unemployment for Black and Hispanic workers relative to national averages. Beyond their human toll, these gaps reflect underutilization of our country's labor resources, and adversely affect productivity and prosperity. It is important to understand the factors behind these gaps in general, *and* how (and for how long) they are affected by labor market disruptions like Covid-19.

Parsing the Pandemic's Effects

One way the COVID-19 recession's aftermath has played out differently than that of past recessions involves the relationship between the unemployment rate and other labor market variables. In contrast with recent recoveries, unemployment returned quite quickly to its prior rate after the COVID-19 recession and has remained between 3.5 and 3.7 percent since March.

However, other indicators are now quite different than they were pre-pandemic. A challenge for current monetary policy is determining whether the changes in the relationship between the unemployment rate and other labor market variables stem from temporary effects of the pandemic, or from longer-lasting labor market trends that the pandemic might have influenced.

In particular, both price and wage inflation are now much higher than before the pandemic, even though the unemployment rate is back to pre-pandemic levels.

One explanation for a higher *inflation* rate coinciding with the pre-pandemic *unemployment* rate has to do with the tradeoff between unemployment and inflation as captured by the Phillips Curve. More specifically, the Phillips Curve may be steeper at unemployment rates near 3.5 percent.[4]

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[4] Demand pressures appear much more pronounced now than before the pandemic. With a much steeper Phillips Curve at low unemployment rates, these additional demand pressures would result in much

A key question for monetary policy is whether relationships at this low unemployment rate are symmetric. If true, this would raise the likelihood of a similarly rapid *decline* in inflation associated with modest increases in unemployment, as tight monetary policy eases demand pressures. But we cannot rule out other explanations that would point to a less favorable tradeoff between inflation and unemployment, such as an increase in inflation expectations relevant for wage and price setting.

The pandemic has also highlighted challenges in measuring labor market slack. Vacancies relative to the unemployment rate, as captured by the so-called Beveridge Curve, are now at historically high levels. One reason could be that firms are struggling to replace workers who move from job to job to obtain higher wages. Alternatively, the recent increase in vacancies could signal a longer-lasting increase in frictional unemployment, and therefore in the natural rate of unemployment.[5]

These alternative explanations for the recent observed vacancy-to-unemployment relationship matter for monetary policy, and how we think about labor market slack. *If* the substantial increase in vacancies mostly reflects temporary factors, then a slowdown in labor demand could work primarily through lower vacancies, rather than higher unemployment. This scenario for the Beveridge Curve would be consistent with a steeper Phillips Curve at low unemployment rates – the possibility I just mentioned.

Longer-Run Issues Affecting the Labor Market

The increase in remote work is just one example of longer-term trends that the pandemic may have accelerated, or in other cases slowed. These trends are relevant because they affect our understanding of the cyclical position of the economy, and also because they matter for what the Fed considers to be maximum sustainable employment. Moreover, trends affected by COVID-19 could have disparate effects on different groups in the labor force.

I'll briefly highlight three key trends that we will explore in more detail over the next day and a half – remote work, education, and automation.

First, *remote work*, while not an option for all jobs, could alter employment opportunities at the individual, sectoral, and regional levels. Given all the considerations for employees and employers, these changes are unlikely to apply uniformly across workers and firms. Nevertheless, at the individual level, the ability to work remotely

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higher inflation, with little further reduction in the unemployment rate. In this view, the pandemic has traced out a portion of the Phillips Curve that may have always existed but was not empirically relevant in recent decades.

[5] For example, workers may not live in areas of increased labor demand due to a lack adequate housing in those places. Although housing markets may eventually adjust, restoring regional balance between labor demand and supply may take a long time.

could help people with family responsibilities or physical limitations participate in the labor force to a greater degree. At the regional level, the ability to work in remote locations could help spread the population more widely and limit the disproportionate growth of job opportunities in high cost, "superstar" cities.[6]

However, remote work may not ameliorate troublesome geographic disparities. Rather than repopulating cities that had lost manufacturing jobs, remote workers may instead flock to places with relatively high consumption amenities, which may worsen the housing shortages in those places. And given that higher-income, college-educated workers were more often able to work from home during the pandemic, they may be more likely than others to benefit from a long-run shift toward remote work.

Second, we need to parse the pandemic's effects on *education* – a topic near and dear to me, and very important to the labor market. College enrollment was 6.8 percent lower for students graduating from high school in 2020 than in the previous year.[7] This unprecedented decline could reduce the lifetime college attainment rate for the affected cohort – and was more pronounced among students from disadvantaged high schools.

Third, *automation* may well extend beyond assembly-line and clerical jobs, which have been disproportionately automated during the last several decades, to encompass more jobs in the service sector. The push for additional automation may be fueled in part by limited labor supply in the service sector following the pandemic. In general, economists view favorably the application of new technologies to production since productivity growth is the ultimate source of rising living standards. But economists also recognize that there are often winners and losers from automation. Increased automation of service-sector jobs could exacerbate wage inequality.

Concluding Observations

The sessions at this conference will address critical labor-market issues – including the effect of COVID-19 on labor supply, the future of remote work, the effects of automation, retirement trends, immigration, short-time compensation, and new firm formation. The analysis and discussion will help illuminate COVID-19's implications.

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[6] A few months before the pandemic began, the Boston Fed hosted a conference on regional disparities. The growth of remote education and work has the potential to ameliorate some problems the conference highlighted.

[7] A March 2021 report from the National Student Clearinghouse Research Center (NSCRC) documents COVID-19's effect on college enrollment among students graduating from high school in 2020. The report notes that the pandemic "disproportionately affected graduates of low-income, high-poverty, and high-minority high schools, with their enrollments dropping more steeply than their more advantaged counterparts. For instance, enrollment declines are 2.3 times steeper for low-income high schools compared to higher income schools."

While fascinating in their own right, the conference sessions are highly relevant for monetary policy given the Federal Reserve's dual mandate. At the Fed we are committed to returning inflation to the 2 percent target in a reasonable amount of time. Only when inflation is low and stable can the economy in general — and the labor market in particular — work well for all Americans.

Clearly, policymaking benefits from careful, ongoing study of all the ways the pandemic has changed the labor market. So it is a fitting time to gather, and deepen our understand of the labor market during and after the pandemic.

Thank you again for being here. Now we'll move into the first session. This mornings' sessions will be moderated by Catalina Amuedo-Dorantes from the University of California, Merced.