A Promising Outlook and an Opportunity for Community Colleges

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Introduction

Thank you for the opportunity to speak with you today. Community colleges have an important mission, serving many educational needs of our diverse community and helping our future workforce develop critical skills. It's a great pleasure today to share some of my thoughts with you on the course of the economy and some roles community colleges might play in the outlook. But before I begin, I should note that these views are my own and do not necessarily represent those of my colleagues on the Federal Open Market Committee (FOMC) or others in the Federal Reserve System.

Needless to say, it has been a very challenging year in so many respects. With regard to the Fed, we, as the monetary policy authority, still have some ways to go before we reach our dual mandate goals of maximum and inclusive employment and inflation that averages 2 percent. We also face many uncertainties and risks on the road ahead. But I am very optimistic about our economy's growth prospects, and am hopeful that our employment goal will be in sight before too long. Achieving our inflation goal, however, may prove more difficult. As we seek an equitable recovery, two-year colleges—with their proven track record for positive returns to their diverse graduates—can play a critical role.

The large and uneven impact of the pandemic

The pandemic has had a devastating impact on our nation. It has taken a horrible number of lives and caused immeasurable hardship in so many different ways. It is difficult to overstate the human costs of this tragedy. Economic developments over the past year also have been largely dictated by the pandemic and our efforts to contain it. After huge declines in output with the onset of the pandemic, the economy rebounded sharply in the second half of last year, and it is moving forward with a good deal of momentum today. Indeed, I—like most forecasters—have been surprised by its resiliency.

A key reason for this resiliency has been the ability of so many households, businesses, and nonprofit organizations to successfully adapt and operate safely in the midst of the pandemic. Consequently, activity in many sectors of the economy, such as manufacturing, has returned near—or even surpassed—its pre-pandemic level. The efforts have been truly impressive. Part of this resiliency also is due to the support provided by fiscal and monetary policies.[1] Throughout the crisis and recovery, federal funds flowing to the private sector and state and local governments, along with low borrowing rates, have helped support the economy.[2]

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[1] The $2.2 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law on March 27, 2020, and an additional $900 billion in relief was provided as part of a government spending bill called the Consolidated Appropriations Act, 2021, which was enacted on December 27, 2020. More recently, the $1.9 trillion American Rescue Plan Act (ARP) was signed into law on March 11, 2021. These bills have provided loans to businesses, direct payments and other benefits to individuals, and funding for health care providers and to state and local governments, as well as other means of support to various segments of the economy.

[2] For instance, personal income in February 2021 from wages and salaries plus pandemic relief provided by the government was nearly 8 percent above its year-ago level. In addition, the interest rate on 30-year mortgages declined 1 percentage point from 3.9 percent in March of last year to 2.9 percent in January of this year before rising to 3.3 percent in recent weeks.

One not-surprising feature of the recovery is that sectors of the economy where in-person contact is not necessary are doing much better than those for which social distancing is more difficult. For example, consumer spending on housing, autos, and other goods has increased at a solid pace.[3] In contrast, the leisure and hospitality sector is still suffering immensely. Indeed, before the pandemic, employment in leisure and hospitality accounted for only about a tenth of total payrolls in the economy. Yet the job losses in this sector account for nearly 40 percent of the 8.5 million current shortfall in total employment from its pre-pandemic level.[4] The impact of the pandemic has been uneven across a number of other dimensions as well. For example, because a disproportionate number of women, minorities, and lower-wage workers are employed in leisure and hospitality or other vulnerable sectors, these demographic groups have been particularly hard hit. I will return to this topic later in my talk.

All told, even though the economy is recovering, we still have a long way to go before economic activity returns to its pre-pandemic vibrancy. Even after the very strong March employment report, at 6.0 percent, the unemployment rate is well above the 3.5 percent we saw on the eve of the pandemic. And many other workers have stopped looking for a job and exited the labor force.

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[3] Even with the impact of severe winter weather, single-family permits in February 2021 were more than 15 percent above their year-ago level. Real consumer spending on goods in February 2021 was nearly 9 percent above a year ago, and auto sales in the first quarter of 2021 were at nearly pre-pandemic levels.

[4] Between February 2020 and March 2021, total nonfarm employment decreased 5.5 percent, according to data from the U.S. Bureau of Labor Statistics. Over the same period, employment in leisure and hospitality declined nearly 19 percent. Some of the other industries seeing large employment declines over this span include air, water, rail, and ground passenger transportation (–22.8 percent), education services (–8.2 percent), mining and logging (–11.6 percent), and motion picture production (–40.3 percent).

Optimistic outlook for growth

Despite these numerous hardships, I am optimistic that the economy is poised for strong growth later this year, which will bring with it further significant improvements in the labor market. One important reason for my optimism is that we have made good progress on the health front. Though we've seen an uptick in new cases over the past couple of weeks, the numbers are much lower than they were at the turn of the year. Moreover, each day more and more people are getting vaccinated, and hopefully, before too long, much of the population will be able and willing to resume activities such as traveling, attending events, and dining out.[5]

Fiscal policy will also provide a big boost to the economy. Over the past four months, we have seen two large stimulus packages enacted: the $900 billion in relief from the Consolidated Appropriations Act in late December and the $1.9 trillion American Rescue Plan Act, or ARP, in early March. This legislation provides further direct stimulus payments to individuals; extends unemployment insurance and lending to small businesses; provides substantial funding to state and local governments; and spends on programs such as those for vaccines and testing, childcare, housing assistance, and education.[6] Roughly $40 billion is going to colleges and universities.

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[5] According to the Centers for Disease Control and Prevention (CDC), as of April 1, 2021, over 38 percent of the U.S. population aged 18 and over had received at least one Covid-19 vaccine dose and nearly 22 percent were fully vaccinated. CDC updates on the state of Covid-19 vaccinations across the United States are available online, https://covid.cdc.gov/covid-data-tracker/#vaccinations.

[6] The extension of unemployment benefits applies to the Federal Pandemic Unemployment Compensation (FPUC), Pandemic Unemployment Assistance (PUA), and Pandemic Emergency Unemployment Compensation (PEUC) programs created by the CARES Act.

My staff found a calculation on the American Council on Education's website that estimates Prairie State could be allocated about $10 million.[7] Don't hold me to that number.

With these developments, my outlook for growth and unemployment is much more positive today than it was just a few months ago. Since my forecast is similar to those made by my colleagues on the FOMC, let me discuss mine in the context of theirs. Four times a year each FOMC participant provides projections of key economic variables. These are released in our Summary of Economic Projections, or SEP—the most recent of which came out last month.[8] In March, the median forecast for gross domestic product (GDP) growth in 2021 was 6.5 percent. This quite strong figure reflects the return to more normal operations in sectors still impacted by the virus today, as well as the big boost from fiscal policy. As these factors run their course, growth is then expected to moderate to 3.3 percent next year and 2.2 percent in 2023.[9] The median FOMC participant sees the unemployment rate declining steadily from 6.0 percent today to 4.5 percent by the end of this year and then to 3.5 percent by the end of 2023—back to where it was prior to the pandemic.

Of course, there are always uncertainties underlying such projections. A very important one today surrounds the path for the virus. My base case is that the virus will become much less of a public health concern by the second half of this year.

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[7] The American Council on Education's simulated distribution of ARP emergency relief funds to institutions of higher education (including Prairie State College) is available online, https://www.acenet.edu/Policy-Advocacy/Pages/HEA-ED/ARP-Higher-Education-Relief-Fund.aspx

[8] Federal Open Market Committee (2021a).

[9] While economic growth is projected to moderate in the next two years, it is expected to remain above the economy's long-run growth rate—which is estimated to be 1.8 percent by the median FOMC participant.

But that is not assured; and there are downside risks if people become less vigilant or vaccine-resistant variants of the virus take hold. The size and timing of the impact from fiscal policy also are uncertain. For example, with regard to the stimulus payments, those whose livelihoods have been most severely harmed by the pandemic will spend them quickly, but others will save theirs and spend them gradually.[10] Similar uncertainties surround other elements of the recent fiscal packages. And then there is the possibility that further spending and tax changes will be coming soon. So, we could see more—or less—impact from fiscal policy than I've built into my projections.

Inflation is likely to increase this year

Let me turn now to the price stability element of our dual mandate. This is a far more nuanced story. To set the stage, the FOMC has an inflation target of 2 percent.[11] Since the Great Financial Crisis, inflation has persistently run under our target, only fleetingly touching 2 percent a couple of times prior to the pandemic. The pandemic further depressed inflation as demand plummeted for many goods and services, with outright price declines in sectors hardest hit by the pandemic, such as air travel and hotel accommodations. To be sure, prices rose for other items that were in higher demand—such as hand sanitizers, autos, and household appliances. But if you look at the overall basket of goods and services purchased by households—as measured by the Personal Consumption Expenditures Price Index excluding food and energy (or core PCE for

[10] See, for example, Karger and Rajan (2020).
[11] The Committee's inflation goal is measured by the annual change in the Personal Consumption Expenditures (PCE) Price Index.

short)—inflation has declined from 1.9 percent just before the pandemic to 1.4 percent this February.[12]

I expect inflation to increase in the coming months. Part of the increase will be purely mechanical as the low inflation readings from March and April of last year fall out of the 12-month calculation.[13] In addition, as the virus subsides and people resume normal activities, demand should pick up for those goods and services that are most affected by the pandemic, pulling their prices up to more typical levels. Finally, we could also see supply chain bottlenecks develop as activity picks up rapidly in some sectors, which would contribute to temporary price pressures in some selected industries.

But what happens once prices renormalize and supply chains adjust? Will inflation just settle back down to 1-1/2 percent, or will we see a more persistent increase in underlying inflation? To generate persistently higher inflation, we need higher inflation expectations—that is, we need to see households and businesses begin to incorporate a higher underlying rate of inflation into their decisions today and their plans for the future. Given the low inflation experienced over the past 15 years, it is highly likely that inflation expectations have drifted noticeably below 2 percent. If they stay there, then we will only see a temporary boost to inflation this year. If they move up, then we could make some real progress toward reaching our inflation target. So, we will be watching measures of inflation expectations very carefully.

[12] Core PCE inflation is a better gauge of underlying inflation trends than total PCE inflation.

[13] For instance, if we assume that the monthly change in core PCE inflation in March and April of this year will be 0.1 percent (the average reading over the past six months), then 12-month core PCE inflation would rise from 1.4 percent in February to 1.6 percent in March and 2.2 percent in April solely based on these base effects.

What are forecasters looking for? Well, according to the March SEP, the median FOMC participant sees core inflation rising to 2.2 percent by the end of this year and then slowing to 2.0 next year before moving up slightly to 2.1 percent in 2023. That's a lot better than the 1.4 percent we have today. But does it mean we've reached our inflation goal?

Policy to remain accommodative for some time

Before I answer this question, let me say a few words about our policy goals. Congress gave the Federal Reserve a dual mandate to achieve maximum employment and price stability. Last August, after a lengthy review, the FOMC revised our long-run strategy statement that operationalizes this mandate.[14] First, we stated that our employment goal is broad-based and inclusive and that our aim is to eliminate shortfalls of employment from our assessment of its maximum level.[15] The term "shortfalls" is significant—in the past we characterized our employment mandate in terms of eliminating deviations from some long-run normal level of employment. Under the new framework, the FOMC will not be concerned about high employment—or low unemployment—unless it is also associated with undesirable inflationary pressures.

With regard to our price stability objective, we indicated we want to achieve inflation that averages 2 percent over time. This averaging is important in order to center longer-term inflation expectations at 2 percent and thus achieve our target on a persistent basis. Therefore, if inflation has been running persistently below 2 percent, we need to have

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[14] Federal Open Market Committee (2020).
[15] We consider a wide range of indicators in making that assessment; see Federal Open Market Committee (2021c)—which is the very latest version of the long-run strategy statement (reaffirming the 2020 version).

inflation overshoot our goal moderately for some time to bring the average back to 2 percent.

As you know, even before we adopted this new framework, monetary policymakers responded to the pandemic swiftly and strongly. In order to support the overall economy, we brought the federal funds rate down to nearly zero, introduced a host of liquidity and credit facilities, and purchased U.S. government securities on a large scale. While the emergency actions are behind us, today the fed funds rate remains near zero and we continue to purchase securities at a pace of $120 billion per month.

I expect monetary policy will have to remain accommodative for some time to ensure that we meet the policy goals laid out in our new framework. With regard to our employment mandate, an important gauge is the unemployment rate. The median FOMC participant estimates that the longer-run unemployment rate is 4.0 percent. In other words, after the effects of various shocks to the economy dissipate, the unemployment rate should naturally settle at 4.0 percent. The median FOMC forecast sees the unemployment rate falling below this level by the end of 2022. So, our employment mandate is within sight. Now, the median inflation forecast I just mentioned is at or somewhat above 2 percent. But after years of underrunning our target, in my view those increases and, down the road, some even higher rates of inflation are needed to get inflation to average 2 percent and to solidify inflation expectations about that number. So, I see the need for continued accommodative monetary policy to reach our goals.

What does this mean in terms of our policy tools? The FOMC statements, released after each meeting, provide some guidance. The one we just issued in March reaffirmed that it will be appropriate to maintain the current target range for the federal funds rate until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time. In addition, the Federal Reserve will continue to purchase assets until substantial further progress has been made toward the Committee's maximum employment and price stability goals.[16] Judging from the most recent SEP, those conditions will not be met for a while. The median FOMC participant expects the federal funds rate to stay in its current low range of 0 to 1/4 percent through at least the end of 2023. So, policy is likely on hold for some time.

The potential role of two-year colleges in the recovery

Let me now return to a topic I mentioned briefly earlier—the uneven economic impact of the pandemic across segments of society. As I noted earlier, because women, minorities, and lower-wage workers are disproportionately employed in leisure and hospitality or other vulnerable sectors, these demographic groups have been particularly hard hit. Furthermore, disruptions to education and childcare have placed an additional burden on families as they struggle to balance household demands and employment responsibilities. The toll has been enormous. We are seeing unequal impacts on health and economic outcomes across income, racial, and ethnic groups and between small and large firms. Worryingly, these shifts are magnifying the longstanding inequalities among these segments of our society. And depending on the path of the recovery, some of the recent changes may leave unfortunate longer lasting

[16] Federal Open Market Committee (2021b).

marks as well. Our economy cannot fully recover if a substantial portion of the population is left behind.

The path ahead depends on many factors. And, while the Federal Reserve's pursuit of its inclusive maximum employment goal is very important, other institutions have key roles to play. One of those institutions is two-year colleges. They have a proven track record in broadening access to higher education and, through this, contributing to greater and more equitable economic resiliency among workers.

For example, research has shown that workers who have lost their jobs, as well as those who enroll while still employed, can achieve large economic returns by attending two-year colleges.[17] Certification programs, retraining for new occupations, and associate's degrees all boost wages immediately upon completion, and the gains grow over time.[18] Indeed, a well-known study has shown that the returns to credits earned at two-year colleges appear similar to those earned at four-year colleges. In fact, students who initially enrolled at a two-year college and transferred to complete a bachelor's degree at a four-year college had the same average earnings as those that completed all their credits at a four-year college.[19] But the transfer students achieved these earnings while facing substantially lower tuition, making the cost–benefit proposition of two-year colleges quite impressive.

Given these facts, two-year colleges could play an important role in bolstering the economic prospects for many in the recovery ahead. Indeed, in the current economy,

[17] Jacobson, LaLonde, and Sullivan (2005).
[18] Minaya and Scott-Clayton (2020)
[19] Kane and Rouse (1995).

the returns of two-year colleges should seem highly alluring. However, enrollment in two-year colleges actually declined by about 10 percent in the 2020–21 academic year.[20] Usually in recessions, two-year college enrollment goes up as more people take the time to acquire new job skills.

There are a number of possible reasons for this drop. The timing and uncertain duration of the pandemic might have discouraged potential students from committing to months of additional education, particularly when they were continually being told the economy might "open up" soon and they could then go back to their old jobs. Many who lost their jobs during the pandemic had worked in industries such as leisure and hospitality. This industry typically has a lot of labor turnover, and so workers from that sector may not be accustomed to retraining. Furthermore, there is a good chance that their old or similar jobs are coming back when the economy reopens. So these workers may not be aware of the potential returns to building skills or seeking retraining at a two-year college. And some students might have chosen to defer enrollment until the prospect of in-person education is less daunting or until their families' economic situations improve so that tuition payments and student loans would be less of a hardship. Finally, many of the vocational programs at community colleges require hands-on work that can be difficult to impossible to do online. Regardless of the exact reasons, the decline in two-year college enrollment is disappointing.

Still, there is little doubt that two-year colleges have a substantial role to play in supporting a more equitable recovery from this recession. Clearly, the benefits to

[20] National Student Clearinghouse Research Center (2020).

"traditional" two-year college students are as essential as ever. And there are new opportunities as well. Research has shown that relatively few workers displaced from jobs outside of the manufacturing sector turn to two-year colleges for new certifications or degrees.[21] What can two-year colleges do to reach these individuals who have been so disproportionately impacted in this recession? Additionally, the economic hardships imposed by the pandemic are likely to prevent many students from starting a four-year college program. Two-year colleges can play a crucial role in allowing these students to continue their education plans without interruption. Lastly, it might be valuable for two-year colleges to develop and offer new virtual classes at scale to expand their reach and benefit a broader range of students.

But these opportunities also come with challenges. Can two-year colleges continue to be a high-value, high-return proposition while adjusting to a potentially different composition of students? What about the competition with four-year colleges that may be adapting their admissions policies in the wake of their own declining enrollments?[22] Can virtual options be developed that are effective substitutes for in-person learning? And, finally, will two-year colleges have the capacity and funding needed to make these adaptations? The answers to each of these questions are important elements of the conversation about equitable access to higher education, as well as the economic resiliency it provides, for years to come.

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[21] Minaya, Moore, and Scott-Clayton (2020).

[22] See Lovenheim and Reynolds (2011) for a discussion of some of the trends and evidence of this phenomenon before the pandemic.

Conclusion

To sum up, I am quite optimistic about the growth prospects for our economy. Nonetheless, we have a long way to go before we return to the pre-pandemic levels of economic activity and achieve our average 2 percent inflation goal. Two-year colleges can play a critical role by increasing the skills and resiliency of our diverse workforce in the current recovery and beyond.

Thank you.

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