



Early Childhood Education and Our Economic Future

Introduction

My parents left their families and friends in Italy and moved my siblings and me to this country so that we would have better opportunities, especially opportunities for a good education. So I spend a lot of my time thinking about why this country, which for my family offered hope and possibilities, is now struggling to educate many of our children.

I was intrigued when I saw the agenda and the title of this session: Why Care? The Impact on Industry and Our Economy. It's really quite a valid question, when you think about it. Why should we care about investments in early childhood education? I think we all know why parents and students should care: we have heard this morning that the individual returns to early childhood investments are large.

I want to expand on the comments of this morning's speakers, who discussed the results of research on the costs and benefits of early childhood education. I am not an expert in this area, and I do not intend to go over the same ground they have covered. But if the benefits include higher future levels of education and increased skills, then as an economist and a Federal Reserve Bank CEO, I can tell you some of the broader benefits our nation can achieve from making those investments.

This morning, I will focus on why a successful economic future requires us to do a better job of educating our children. By doing so, we will increase labor force skills and productivity, we will spend fewer resources on social programs, and we can sustain better economic policies.

Labor Force Skills and Productivity

We have evidence that the benefits of preschool education accumulate throughout a child's primary and secondary education. However, today the United States actually lags many other developed countries in the share of children under age four who are enrolled in preschool. We also know that in order to improve our primary and secondary education systems, we will have to find better ways for school administrators, families, teachers, and taxpayers to work together. The challenges confronting us are large, but not nearly as great as the cost of failure.

The economy in my Federal Reserve district, which includes Ohio, western Pennsylvania, eastern Kentucky, and a portion of West Virginia, has been under-performing the U.S. economy for several decades. We have seen our population, employment, and personal incomes grow more slowly than in other areas of the country. Many

Additional Information

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**Conference on Building the Case for
Investments in Preschool**

The Grand Hyatt Hotel, New York, NY

January 10, 2006

different factors are associated with these trends, and our region's situation is by no means unique, but I am increasingly convinced that education plays a prominent role in explaining what has been occurring.

Shortly after I became president of the Bank, in 2003, I asked our research department to take a sharper focus on understanding the forces that have been shaping our region's economy. Education was at the top of their list.

Some businesspeople in my District have been expressing concerns about increasing competition from foreign companies. Political leaders worry about jobs moving offshore. In this global economy, I believe that how we address our education challenges will be a decisive factor in our economic performance. I am not terribly worried that our unemployment rate will rise over time as a result of not keeping pace with the educational attainment levels reached in other countries. Over the past five decades, the U.S. economy has consistently employed about 95 percent of the people participating in the labor force - and I expect that trend to continue. What is at stake is not the number of jobs, but the quality of those jobs - and the compensation earned by the people who fill them.

Economic research tells us that productivity and incomes are closely related at both the regional and national levels. Incomes rise in regions and countries as people become more productive. Developing nations are replacing subsistence-level employment with jobs that enable people to acquire more goods and services, to save a little, and perhaps even to enjoy some more leisure time. Opportunities for highly educated people are booming in many developing countries, as everyone moves up the development ladder. The United States is not competing with other countries for a fixed number of global jobs, but we should recognize that our relative standard of living in this global economy will depend, ultimately, on our relative levels of education and productivity.

I am not alone in paying close attention to these connections. My friend and colleague Michael Moskow, who is president of the Federal Reserve Bank of Chicago, spoke last fall at an education conference we hosted at our Bank. He told us that he is ".constantly tracking productivity growth because it is a key determinant of our standard of living. And an important factor driving productivity growth is worker quality, which includes the education and the experience of the workforce."

President Moskow's team of economists estimates that almost a quarter of a percentage point of the average annual growth in labor productivity from 1965 to 2000 can be linked to labor quality. He noted that changes in age, education, and labor force participation cause this amount to vary over time, and he expressed some concern that retirements among highly experienced baby boomers could depress our productivity growth rate unless they are offset by remaining employees who improve their skills and by new employees who enter the workforce with a high level of skills.

Just how important is the role of education? At the regional level, we can see tangible evidence of the link from education to productivity to income. States that have had the largest growth in per capita incomes in the United States over the past half century also tend to be the states that have had the largest increases in educational attainment. Numerous studies, including some that we are doing at the Federal Reserve Bank of Cleveland, indicate that educational attainment is a key variable in accounting for differences in per capita income growth among either metropolitan areas or states.

Educational attainment also affects labor force participation and

unemployment rates. Today, only about 45 percent of high school dropouts are in the labor force, versus nearly 80 percent of college graduates. The unemployment rate of high school dropouts is almost 8 percent, but for college graduates it is only about 3 percent. So it follows that with greater levels of education, not only will more people be willing to work, but more of them will have jobs, all else being equal. Not only should we expect those who are working to be earning more, but we should expect more people to be working to take advantage of their investment in education. The result will be an increase in our nation's sustainable rate of economic growth, which surely makes our nation stronger.

There is also a connection between education, productivity, personal income, and corporate profits. Better-educated and better-prepared employees produce more output at a lower cost, meaning that they can earn higher incomes and that their employers can make higher profits. It's a beautiful thing--both employees and businesses win.

Education and Social Benefits

Now I would like to turn to the social benefits of education. This morning's panelists explained that some of the benefits from more effective preschool education accrue to the individuals, families, and companies making the investments, while other benefits accrue to the cities, states, and the nation as a whole through "spillover effects." You will notice that so far I have not distinguished between these two channels - the gains in productivity, incomes, and employment that I described could come from a combination of these benefits.

But clearly, having higher living standards gives us a greater capacity to ease the burden on the less fortunate among us. At the same time, it offers the prospect of reducing the number of people who require certain kinds of income support in the first place.

Let me share an example of why this is so important at the national level. We hear a lot about our nation's growing fiscal imbalance and what it may mean for future spending on our Medicare, Medicaid, and Social Security programs. The trustees of the Social Security Administration periodically produce 75-year projections of the System's finances. To do this, they must choose a rate of growth for output and incomes to gauge the solvency of the program out into the distant future.

The number of retirees per worker is increasing, leading to calls for reforms of the Social Security System. In their most recent report, the trustees assume a productivity growth trend of 1.6 percent per year for the intermediate-cost projection. Using this assumption, in 75 years real output in the economy will grow by a little more than threefold.

Unfortunately, we cannot estimate our economy's productivity growth trend into the distant future with any great precision. If productivity growth were to average 2.25 percent per year, we would see output and incomes not threefold, but fivefold greater after 75 years. Improving our productivity from 1.6 percent to 2.25 percent would add additional resources to our economy each and every year into the future, and result in a very large increase in our national living standard.

A more productive labor force would be able to contribute more taxes and perhaps would require fewer public benefits as well. At the same time, if more people were working and fewer of them were unemployed, then fewer resources would be needed to pay for our state and federal unemployment insurance programs. As a result, the taxes imposed on businesses and workers to pay for this insurance

could be lower. Similarly, some of the resources that we now devote to remedial education or fighting things like crime and drug abuse could be either rebated to taxpayers or channeled in other directions.

Education and Better Economic Policy

Finally, I would like to make a few comments about how a better-educated population can help us achieve better economic policies. Even though I have just outlined how higher skill levels in our labor force can improve economic growth over time, all may be lost if our nation's economic policies are not designed and implemented to achieve sustainable long-run growth.

Often, decisions that appear unpopular in the short run are exactly the policies we need for the long-run health of the economy. I find that to be very true in my role as a policymaker on the Federal Open Market Committee. When I meet with businesspeople, I sometimes hear comments to the effect that rising interest rates are inflationary, since they add to borrowing costs. But the fact is that short-term actions by the Federal Open Market Committee are sometimes essential to producing longer-term price stability. Appropriate policy moves today can bring about moderate long-term interest rates and maximum economic growth for the long run.

Many other economic policies - such as tax policies, trade agreements, regulatory policies and government spending initiatives - affect the performance of our national economy over time. I could give you countless examples of policies that appear to provide short-term benefits to our economy, but in fact could have negative consequences over the long haul.

The Federal Reserve also confronts the consequences of adult illiteracy, especially financial illiteracy, in its capacity as a regulator. We know that our financial system can be daunting even for highly educated and market-savvy individuals, let alone those with less education and experience with financial transactions. We see the consequences of poorly educated consumers every day when we see the numbers of people who have poor credit ratings, who have filed for bankruptcy, and who may have lost their homes to predatory lenders. The private and public costs of dealing with these unfortunate outcomes are considerable. So, just as better educated people can make our workforce more productive, they also can make for smarter consumers and savers.

Conclusion

I hope that I have given you some insights this morning into how a more educated population and more highly skilled labor force can lift our nation's economic performance over time.

We all should care about this issue, and I am convinced that it begins with early childhood education. If we can reach children early and help them value educational attainment, we can accomplish some incredible things:

- We can raise levels of employment, productivity and incomes;
- We can reduce the fiscal burden associated with programs such as Social Security and unemployment insurance; and
- We can promote public understanding and support for policies that benefit all of us over the long run.

Yes, there are good reasons to be excited about the many benefits to our country that can come from investing more resources in preschool education and early child care. I know that we will be hearing from some speakers later in the program about how to channel this enthusiasm into action.

Without tempering that enthusiasm, I do feel compelled to say that as an economist and a CEO, I know that investments in human capital, just like investments in physical capital, can be made wisely or poorly. We have a lot to learn about how to do this right, so it will be important to collect data and support good program analysis as we move forward.

I also know that investments at the early childhood level will not, by themselves, be sufficient to build the kind of educated population our economy needs today and in the future. In the language of business, this means that we need to strengthen the entire supply chain. Those of you who are in business know that a quality product begins with a quality process, and that it costs much more to fix defects in the later stages of product assembly than doing it right at the outset. Prudent investments in the early stages have the potential for paying a stream of dividends for all of us well into the future.

In the case of early childhood education, these investments hold the promise of narrowing some of the skill gaps that we see in our society today, creating higher employment levels, and helping us achieve better economic policies.