The Intrinsic Value of Inclusive Growth

Pennsylvania Economic Association Annual Conference

Alvernia University

Reading, PA

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President and Chief Executive Officer
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Good afternoon and welcome; it's a pleasure to be here.

Today, I'd like to give an overview of the economic outlook, including my views on monetary policy, then talk a bit about a subject that's crucial to economic success on a local, regional, and national level but that often gets treated as a separate subject: economic growth and mobility.

Before I do that, let me perform the sacred Fed ritual of delivering the standard disclaimer: The views I express today are mine alone and do not necessarily reflect those of anyone else in the Federal Reserve System, including my colleagues on the Federal Open Market Committee (FOMC).

The Economic Outlook

I'll start with the outlook, which, overall, is pretty good.

First quarter GDP growth was quite weak. The most recent revision puts that number at 1.2 percent, which is better than the previous 0.7 percent estimate. This actually illustrates a point I want to make because I think it's a mistake to give either number too much weight.

We've seen weak first quarter growth for several years now to the extent that it's essentially become the new normal. This year's culprits were weather, low inventory investment, and our old friend seasonality. These effects are likely transient, and they've proved to be so in the past. I project overall GDP growth of 2.3 percent for 2017, which is pretty much what we should consider normal for the medium term.

Turning to inflation, things are still on track, despite a couple of months trending in the wrong direction. Both headline and core PCE ticked down in April, to 1.7 and 1.5 percent year-on-year, respectively, but I still think we're doing fine. We spent a lot of the past few years waiting for inflation to rise to meet our 2 percent target. Now we're on track, and two reports showing slight downward trends don't derail my outlook.

Much like the disappointment over slow first quarter GDP growth, I think the concern over a couple of months of less-than-perfect inflation data is unwarranted.

We're essentially at normal now, and it's a mistake to get caught up in a single report, or month, or even quarter's worth of data. It's much more important to take a step back and look at underlying trends and what they mean for the medium term. In this case, my forecast remains that we should reach our inflation goal around the end of the year.

On the other side of our mandate, I see very little slack left in the labor market.

In May, unemployment reached its lowest rate in 16 years, reaching 4.3 percent. I see it moving down even further — dropping as low as 4.2 percent by the end of next year. Upward pressure on wages is finally starting to assert itself, and I estimate wage growth of between 2.5 and 3 percent this year. This is a very good sign; it's one of the things that's been missing as the recovery has unfolded.

Job creation is still strong. We had 138,000 jobs in May, which is a good number. I see job creation eventually falling to about 100,000 a month by the end of 2019.

Just as I think we need to put monthly fluctuations in inflation data in perspective, I think we need to put job growth in context. In the very near future, we're not going to need to create jobs at the intense pace we've been experiencing over the past few years.

The 100,000-jobs-a-month rate is going to be more than sufficient to keep up with population growth. That's more or less the rate we'll need in a normal, healthy economy.

Based on the strength of the economy, I still see three rate hikes of 25 basis points each as appropriate for 2017.

I also believe that we will begin unwinding the balance sheet sometime this year, although I'm not tying that to a date on the calendar or a data point on an inflation report. It will be slow, steady, incredibly boring, and essentially on autopilot.

And, of course, all of this is predicated on the assumption that things continue to unfold as they have been.

The Costs of Poverty and Inequality

I say "based on the strength of the economy," and I do believe that we are more or less at full health. The small adjustments that need to be made here and there are not earth-moving numbers, they're just needed to ensure that the foundation is strong.

But that, of course, is the macro view. And that doesn't take into account the places across the country, and within the Third District, that haven't recovered the way their neighbors have.

You'll hear a presentation later today that delves deeper into the state's economy, and, of course, I'm speaking to the Pennsylvania Economic Association, so I'm sure you're fully aware that there are pockets of the state that haven't made their way back yet. You're aware that Philadelphia is the poorest of the top 10 cities in the U.S. You're aware that some of the cities and towns right next door are struggling economically.

One of the things the Fed does that doesn't get much attention is our Community Development work. It's almost our best-kept secret, which is too bad, because it's incredibly important. I'd therefore like to talk a bit today about why that is and what we're doing at the Philadelphia Fed to work with communities of all economic profiles across the Third District.

From my personal perspective, there is an ethical obligation to do what we can to help each other. But Congress didn't charge us with determining moral imperatives, which, obviously, rely much less on data than a wonky policymaker would be comfortable with.

So, I'll stick to the pragmatic argument, which is that inclusive growth is good for the overall economy, and conversely, that both poverty and inequality in income are detrimental to the economic well-being of the country.

The current poverty line in the United States is an annual income of $24,339 for a family of four. According to the most recently available data, the U.S. has over 43 million people living in poverty. That's over 13 percent of the population.[1] As for inequality, the United States ranks 43rd in the world by the Gini index.[2] There is growing debate within the field of economics on the impact of inequality. But while some inequality is inevitable in any free-market society, I'm in the camp that says too much inequality, or too much breadth in inequality, ultimately costs us.

Childhood poverty alone costs the U.S. close to $500 billion annually.[3] And research shows the effects of inequality on GDP is significant as well. For instance, when additional income goes to the top quintile of earners, GDP actually falls by 0.08 percent. But when the same happens for the bottom quintile, GDP *rises* by almost 0.4 percent.[4]

Then there is the simple fact that this vast and diverse country is made up of micro- and macroeconomies that are intertwined and overlap and have ripple effects beyond city, county, or state lines. Our economic fortunes are tied to one another.

So, if the problems facing some of us ultimately translate into the problems that face all of us, what do we do about it?

EGMP: The Economic Growth & Mobility Project

For our part, the Philadelphia Fed has launched the Economic Growth & Mobility Project to look for practical applications for the abundance of research in the field. We have a lot of data and in-depth studies that can inform issues across the District and, hopefully, across the country as well.

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[1] See Poverty Thresholds, U.S. Census Bureau, www.census.gov/data/tables/time-series/demo/income-poverty/historical-poverty-thresholds.html; see Income and Poverty in the United States: 2015, U.S. Census Bureau, www.census.gov/library/publications/2016/demo/p60-256.html.
[2] See the World Factbook, Central Intelligence Agency, North America: United States, www.cia.gov/library/publications/the-world-factbook/geos/us.html.
[3] Harry J. Holzer et al., *The Economic Costs of Poverty in the United States: Subsequent Effects of Children Growing Up Poor*, Center for American Progress, 2007.
[4] Era Dabla-Norris et al., "Causes and Consequences of Income Inequality: A Global Perspective," *IMF Staff Discussion Note*, International Monetary Fund, 2015, www.imf.org/external/pubs/ft/sdn/2015/sdn1513.pdf.

I'm a huge fan of research, as I'm sure everyone here is as well. It's the fuel that keeps academics going. But there's an added energy when our research has a practical application.

The work in the field of economic mobility has incredible potential, and we're lucky enough to be sitting in the middle of a natural laboratory.

I say it pretty frequently, but it bears repeating — while the Third District is the Fed's smallest, it provides a unique perspective. It covers Pennsylvania from about Johnstown and east; southern New Jersey; and all of Delaware. Although it's geographically very compact, the District encompasses urban centers, suburban expanse, post-industrial cities and towns, and rural areas.

That means it's a microcosm of America. We know that the challenges that Philadelphia faces aren't the same as the ones we find in Reading. The footprint of the Third District means we have the opportunity to find custom-fit solutions for both of those profiles and others as well.

EGMP: Workforce Development

One of our primary areas of focus is skills training and workforce development. We're starting to see a different set of issues emerge than we were contending with at the height of the recession, when unemployment peaked at 10 percent. Now we've got jobs going unfilled.

This isn't just what I hear from my contacts in the community; it's in the data. We've come to a point in the labor market where the competition is among the employers trying to fill slots rather than the applicants vying for them. But there's a skills mismatch. There just aren't enough people with the right training to do the jobs that are out there.

I'll give you an example: A contact of mine has a trucking repair business in Pennsylvania, and he's doubled the number of bays because business is so good. But half of them are sitting empty because he can't find qualified mechanics. He's paying over $100,000 a year, but he just can't find workers who are equipped to do the job. It's no longer just mechanical; now that so much of truck repair is computerized, workers need digital skills as well.

So, what do we do? There is obviously a need for training programs and more investment in practical education. But there's also a cultural shift that needs to happen. At some point along the way, we decided to burden vocational education with a negative connotation. We seem to have collectively decided that education should be one-size-fits-all. And I don’t understand that.

Not everyone wants to take the road more traveled, and it’s not in everyone’s best interest to do so. There are good jobs out there that don’t insist on a traditional college plan.

My staff has done research on these in conjunction with the Cleveland and Atlanta Feds. They’re calling them “opportunity occupations”: jobs that pay at or above the median wage that don’t require a four-year degree. A lot of them are in health care, which is an industry with immense growth potential.

If we can be more strategic about the way we encourage and train our rising workforce, we can benefit both the workers and the employers.

There is one caveat that I should mention. Because, of course, there’s very little under the sun that is devoid of nuance or, frankly, potholes.

In follow-up research by my staff, they found that during the recession and slow recovery, the competition for jobs meant some employers began to upskill job requirements, even though it wasn’t strictly necessary. That is, for a job that had previously required an associate’s degree or technical training, they could now ask for a bachelor’s.

That has remained somewhat sticky as the labor market has tightened. But I believe that as time passes, we’ll start to see things come back into balance again. And I’d like to see that. Because the pathway to an economically secure middle-class life can and should be paved by different forms of education.

At the end of last year, I visited Roxborough High School in Philadelphia, which has an Academies program that allows students to pick a course of concentration while they study the regular curriculum.

It’s a pretty brilliant model because it sets them up to enter the workforce directly from high school if they want to, which means they can earn a good salary if they want to take a couple of years on the job before returning to school, work part-time while continuing their education, or just start their climb up the professional ladder immediately.

I should mention that all of the students I talked to thought the practical aspect of their learning was a huge positive.

Some of them get up at 5:00 a.m. and take three buses just to get to school because they see a place in this program as a stepping stone to a bright future. After high school, some of them may go the route of the traditional four-year degree, and some will do something different. One of the young women I spoke with wants to be an anesthesiologist, for instance, while another is thinking about a social media start-up.

But regardless of which track they choose, there's no limit to their choices in life; none of them see their vocational training as anything but a competitive edge.

They're right; after talking with them, I'm pretty sure at least a couple of them are going to be running the country soon enough.

I really want their attitudes toward creative paths to education and training to be the prevailing ones: We all have our own ways of getting to the endpoint, and for the United States to have a labor market that is truly running on all cylinders, we need a workforce that is as innovative and creative as the sectors they represent.

EGMP: Transportation

Of course, no difficult problem or economic issue has one root cause; if it did, our job in Community Development would be much easier.

It's clear that even if we arm people with the skills and training to get good jobs, it might not be enough. Because at the end of the day, not everyone can *get to* the good jobs.

Transportation isn't generally seen as an exciting topic, which is fine, because neither is monetary policy. But it's an important one nonetheless. Some of the most intractable issues we face with social mobility are caught up in these kinds of basic infrastructure matters.

The ways we've migrated in this country, socially and economically, have changed over the decades and centuries. Where we once found the hubs of commerce, we also found residential areas.

Then we began the immense wave of suburbanization that fundamentally changed the way we live and work and travel between the two.

Now, we're seeing the reversal of the trend that characterized the latter half of the 20th century and find people returning to city centers.

We have a transportation system, however, that was largely developed during the retreat from urban living and therefore built to bring people from the satellites into the center. But that's not necessarily the best structure now.

Our Community Development team has been working with the city of Scranton on exactly this issue. The Economic Growth & Mobility Project I mentioned is going to focus on action labs, which we'll convene to find practical means to solving challenges identified by the communities we partner with. For instance, we've been working with stakeholders from across Scranton for the past several months to better understand their challenges in getting low-income residents connected to work and helping them identify solutions.

One of the biggest growth areas in the region is distribution centers, and there are a lot of jobs attached to them. But our transportation system is set up to bring people to the city center, not out to the areas where those distribution jobs are. The basic arithmetic is that, if you can't get to a job, it doesn't matter how many there are. And if you can't fill the jobs, your business can't expand.

We're working with a local foundation to help bring people together to address Scranton's specific needs. Then, hopefully, we can export that model and the lessons we learned to similar cities around the country.

EGMP: Future Work

There's a lot more in the pipeline and a world of work open to us. We have opportunities to partner with businesses, civic groups, not-for-profits, and philanthropies across the District and the country to find innovative solutions to problems in diverse areas.

The fact is that economic health is the sum of multiple parts, and investments in one area have huge implications for others. A better educated population, for instance, means a more skilled workforce pumping more money into the economy. More people employed in good jobs means lower crime and safer neighborhoods. Safer neighborhoods mean higher property values.

The work we do in Community Development to strengthen local economies will have effects that resonate beyond those areas, from Scranton to Reading to Wilmington and beyond.