

**The Outlook for Growth
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Thank you for inviting me to join you today. I was sorry to miss you last year, but hope you will forgive me as I'd been on the job in Richmond for all of five days. Now that I've got a year under my belt, I hope I've learned enough to have something interesting to share. But you'll be the judge of that! Before I say more, I have to note that the views I express are my own and not necessarily those of my colleagues on the Federal Open Market Committee (FOMC) or in the Federal Reserve System.¹

With apologies to the familiar faces in the room (including many members of our Baltimore Board of Directors), I'd like to start by telling you a little bit about myself and what we're hoping to accomplish at the Richmond Fed. I'll then turn to our country's prospects for sustained economic growth, particularly several critical levers. And then I'm looking forward to taking your questions.

“On the Ground” in the Fifth District

I came to Richmond after a 30-year career at McKinsey in Atlanta, where in addition to consulting I had many line roles, including CFO. While there, I had the opportunity to serve on the Atlanta Fed's Board of Directors, and I was inspired by the role the Bank played during the financial crisis and by its broader role in the community. When I got the phone call about the job

in Richmond, I was nearing retirement. I thought it would be a wonderful chance to keep giving back and (more selfishly) to keep learning and growing.

So what am I hoping to accomplish? First, I hope to bring a different perspective to the FOMC. My colleagues are quite talented economists, regulators and bankers. But I hope I bring a unique perspective as a businessperson on topics such as pricing, the impact of tariffs or tax cuts and the real drivers of wages, to name a few.

To make that effective, I want to be “on the ground” throughout our District, which spans from Maryland to the Carolinas. During the past year, I’ve done just that—traveling pretty much nonstop (although still less than I traveled as a consultant). I am trying to be in Maryland every month.

As I’ve traveled, I’ve seen areas of our District that are thriving and areas that are struggling. I think the Richmond Fed has a real opportunity—and responsibility—to improve our understanding of the challenges people face and to search for opportunities to make a difference. For example, there are large disparities in employment, education and earnings between urban and rural areas, and also within urban areas. Here in Baltimore, at the same time new shops and restaurants are being built on Pratt Street and apartment towers are rising on Light Street, there are parts of the city where people can’t find jobs and rowhouses sit vacant. We can bring our research to bear to help change things.

Economic Growth

Let's turn to the national economy. I don't need to tell this group that it looked very strong in 2018. GDP growth averaged 3.3 percent through the third quarter; consumer spending has been strong; there are more job openings than people looking for jobs, as unemployment reached a nearly 50-year low of 3.7 percent; and inflation is roughly at target. In that context, the Fed has been returning rates toward normal levels, most recently in December. I forecast growth to continue this year, though at a somewhat slower pace. But as we enter 2019, I hear a lot of concern. Some is environmental, driven by trade or politics. Some is market driven, as volatility has increased and the yield curve has narrowed. Some is margin pressure. But overall, the question I hear most is, "How long can this growth continue?"

That's the question we're here today to discuss, but I'm actually not going to focus too closely on 2019. Instead, I'd like to focus on the longer term; it's often easier to look out at the horizon than down at your feet. For example, even for 2020, you'll see a pretty wide range of opinions. The Office of Management and Budget forecasts 2020 GDP growth of 3 percent, while the Congressional Budget Office and the Fed's most recent Summary of Economic Projections put growth closer to 2 percent.

With appropriate humility about all of our forecasting records, I thought I might lay out what needs to happen to sustain growth at the high end of the forecast range and where some of the critical levers lie.

Before I do, let me emphasize why high-end growth matters. Stronger growth is the sign of a healthy economy. Stronger growth creates revenues to reduce the federal budget deficit at a time when it seems unlikely to be addressed otherwise. Stronger growth improves everyone's living standards.

Let me also emphasize that the levers for growth range far from monetary policy, and are well beyond the Fed's powers and its dual mandate to promote maximum employment and stable prices. But here we go.

Population and Labor Force Growth

At one level, the math of economic growth is pretty simple. More people need to work, and/or they need to be more productive. With respect to the workforce, the native-born population is growing slowly, and the Census Bureau projects it will slow even more in the future. (It's not just the United States; fertility rates have fallen in nearly every developed country.) Since the 1990s, immigration has driven about half of the growth in the labor force, but that trend is under threat, as there are proposals to reduce even legal immigration.

At the same time population growth is slowing, a smaller share of the population is working. Since the early 2000s, labor force participation has declined around 4 percentage points. A large part of this is demographics, as my generation retires and more young people attend college. That means to grow the economy, people need to come off the sidelines. Which segments offer the greatest potential?

Our country's largest metro areas are thriving, while many smaller cities and rural areas are struggling. In our District, the employment-to-population ratio for prime-age workers in rural areas is almost 6 points lower than it is in urban areas. If the employment-to-population ratio for prime-age workers across the country as a whole were equal to the ratio for counties in the largest metro areas, an additional 3.5 million people would be working. More than 840,000 of these workers would be in the Fifth District alone.

People with less education face challenges in the labor market. The employment-to-population ratio for people with only a high school degree is less than 56 percent, while for those with at least a bachelor's degree it's around 72 percent. Closing this gap would put more than 10 million additional people to work.

Women's labor force participation, after rising steadily for four decades, leveled off and then began to decline around 2000. This is a divergence from other developed countries. In the late 1990s, the participation rate for prime-age women in Canada was the same as in the United States. Now it is 8 points higher. If the United States had the same participation rate as Canada, an additional 5.2 million women would join the labor force.

Another challenge we're all too familiar with in the Fifth District is the opioid epidemic. Maryland, D.C. and especially West Virginia are among the top seven states for overdose death rates. With respect to the labor market, it's hard to tease out cause and effect—do people abuse opioids while they're out of work, or are they unable to work because they have a drug abuse problem? But some research does suggest that the epidemic has had a direct effect on labor force

participation, lowering it by as much as 4.6 percentage points for prime-age men in counties with higher rates of opioid prescriptions.²

The net is a challenge for growing our economy. Unless immigration increases or people come off the sidelines, the Bureau of Labor Statistics projects the labor force will grow just 0.6 percent annually over the next decade.

Productivity Growth

The second half of the growth equation is productivity. Between 1985 and 2005, the United States had a productivity boom, with average annual growth of 2.3 percent. I see a number of drivers, including an increased emphasis on shareholder value in the corporate sector, deregulation that increased competition and reduced global trade barriers. Productivity also increased due to new technologies that enabled efficiency, such as automation, internet distribution, global sourcing and outsourcing, and lean management. At the same time, these technologies spread through enhanced diffusion via the business press, greater talent mobility and, if I may say so, growth in consulting.

Over the past decade or so, however, productivity growth has slowed—just 1.3 percent average annual growth between 2006 and the present. I find this very surprising from my perspective as a businessperson, as I didn't observe any particular cliff around 2005. In fact, I saw management equally motivated to drive a focus on the bottom line. I saw clients continuing to invest, to automate and to drive operating performance. And I saw new, powerful practices being

implemented, such as artificial intelligence, offshoring overhead, voice recognition and digitization. In short, I saw my individual clients get more productive.

I've been on a journey to understand what's going on, recognizing that every sector has its own story. One possibility is that the mix of businesses has shifted, for example because of the growth in services or offshoring productive sectors. But the slowdown is widespread. Nearly every sector has experienced some decline in productivity growth since the mid-2000s (although the extent varies across sectors).³

Another possibility is mismeasurement. Some surely exists; for example, the leisure value of free apps on a smartphone isn't measured, while toys are. But again, the widespread nature of the decline makes mismeasurement unlikely as an across-the-board explanation.

Maybe this is just the pause before an acceleration due to AI and digitization. That would be great! But I never saw the pause in practice, and I worry about hope as a strategy.

Finally, for this audience, I've thought about regulatory burdens and the cost of cybersecurity. Clearly costs have been created that don't create revenues. But these costs can't explain all the slowdown in this sector or across sectors.

So what do I think I know? I believe the productivity slowdown is real, and part of the explanation is nearly two decades of business underinvestment. Since 2000, investment has been low relative to measures of corporate profitability, driven by industry leaders not investing in

growth the way they once did.⁴ Airlines have moderated capacity growth, banks aren't adding branches and even successful retailers aren't adding stores. And in my view, it's easy to draw a line from lower investment to lower productivity growth.

That leads me to the question, why has investment been low? My sense is that short-termism is increasing as CEO tenure decreases and corporate activism escalates. In addition, share repurchases have become a compelling alternate use of capital. And finally, some companies are still feeling hungover from the Great Recession. For example, I've spoken with business leaders who, even if they see opportunities for investment, are reluctant to take them. They continually see the next recession as "just around the corner." As I said earlier, that's a real issue today, as the economy's numbers look strong but business sentiment has weakened considerably.

Another factor in slowing productivity growth is declining start-up rates. Successful entrants drive innovation, which drives productivity. But the data show a massive reduction in entry rates, in all states and all sectors. Start-ups accounted for 12 percent of all firms in the late 1980s. That fell to 10.6 percent in the mid-2000s, and to 8 percent after 2008.⁵ I certainly see this in the banking sector, with only 13 de novo banks since 2010, compared to hundreds each year before the financial crisis (not that hundreds is necessarily the target). As with investment, some of this decline might be lingering risk aversion after the Great Recession. Some might be the impact of regulation. Research also points to the slow growth of the working age population as an explanation.⁶ In addition, I hear that there are tangible impediments—such as acquiring the necessary technology and talent—to building the scale and sophistication entrants require to be successful.

What To Do?

If the workforce grows just 0.6 percent per year, and productivity growth continues at about 1.3 percent annually, “trend” core growth is only in the 1.9 percent range—far slower than today. That’s the driver of the lower estimates you see. So what can be done to change that trend?

The first step is to look at policies that could help draw more people back to the labor force, such as policies to support women’s participation in the workforce. One of the biggest differences between the United States and other developed countries is the availability of paid leave and subsidized child care, both of which have been shown to increase women’s labor force participation.⁷

As I noted a few minutes ago, people with less education are less likely to be working. So another critical area is workforce development initiatives to help people improve their skills. This is particularly important in rural and inner-city communities. It starts with programs to help adult workers acquire in-demand skills. But workforce development needs to start much earlier, at the K-12 level or even in early childhood.⁸ In this way, students who want to attend college can receive the preparation they need to graduate, because far too many students do not. Roughly 40 percent of students who enroll in a four-year college don’t graduate within six years, and many of those who leave without a degree are still left with significant debt. The workforce can grow if students who enter college can graduate, and young people have, and know about, viable alternatives to four-year colleges.

In addition, legal immigration is a huge opportunity to grow our workforce and increase our country's human capital and entrepreneurial energy. I empathize with concerns that immigration could be detrimental to the employment and wages of Americans. But the economic research shows that immigration boosts productivity and start-up rates.⁹ Our country's competitive advantage is that the most talented people in the world want to live here. That's why so many of our grandparents came and started businesses (in my family's case, a shoe store and doughnut shop). Our country should embrace this advantage.

Speaking of productivity, the United States needs to promote a healthy environment for business investment. Business investment has grown significantly in five of the last six quarters. But, as I said, uncertainty is currently a real issue for the businesspeople I've spoken with throughout our District. This is particularly true when it comes to trade, but it's also an issue in sectors such as health care, where the regulatory environment is unclear. American businesses are practical and innovative. If the rules are clear and the political environment is stable, they will find a way to grow.

Conclusion

In sum, the United States faces a slow growth trend that isn't in any of our interests. Changing the slope is doable via initiatives to expand the workforce and boost productivity growth. It's an opportunity this country can't afford to pass up.

Thank you, and I welcome your reactions and questions.

¹ Thank you to Jessie Romero for assistance preparing these remarks.

² Dionissi Aliprantis and Mark E. Schweitzer, "[Opioids and the Labor Market](#)," Federal Reserve Bank of Cleveland Working Paper no. 18-07, May 2018.

³ Martin Baily and Nicholas Montalbano, "[Why is U.S. Productivity Growth So Slow?](#)" Brookings Institution Hutchins Center Working Paper no. 22, September 2016.

⁴ German Gutierrez and Thomas Philippon, "[Investmentless Growth: An Empirical Investigation](#)," *Brookings Papers on Economic Activity*, Fall 2017.

⁵ Ryan Decker, John Haltiwanger, Ron Jarmin, and Javier Miranda, "[The Role of Entrepreneurship in U.S. Job Creation and Economic Dynamism](#)," *Journal of Economic Perspectives*, Summer 2014, vol. 28, no. 3, pp. 3–24.

⁶ Fatih Karahan, Benjamin Pugsley, and Aysegul Sahin, "[Demographic Origins of the Startup Deficit](#)," Manuscript, May 2018.

⁷ Janet Yellen, "[So We All Can Succeed: 125 Years of Women's Participation in the Economy](#)," Speech at Brown University, Providence, Rhode Island, May 5, 2017.

⁸ For example, see Kartik B. Athreya, Urvi Neelakantan, and Jessie Romero, "[Expanding the Scope of Workforce Development](#)," Federal Reserve Bank of Richmond Economic Brief no. 14-05, May 2014.

⁹ For example, see Giovanni Peri, "Immigration, Productivity, and Labor Markets," *Journal of Economic Perspectives*, Fall 2016, vol. 30, no. 4, pp. 3-30; and Kauffman Foundation, "[Research on Immigration and Entrepreneurship](#)," October 2016.