

Prosperity: Just How Good Has It Been for the Labor Market?

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Almost everyone is familiar with the strong economic performance of the United States over the last eight years. Consider the highlights: Since 1992, growth of real per capita GDP has averaged 3.7 percent per year, compared with an average growth rate of 2.6 percent over the prior 20 years; the unemployment rate has fallen to its lowest level in almost 30 years; and employment has grown steadily, so that today about 18 million more people have jobs. To top it off, this fine performance has been achieved during a period in which inflation has been at or below 3 percent. The state of Missouri has shared in this growth. Its latest unemployment rate was even lower than for the country as a whole, 3.3 percent, and there are 276,000 more people employed here than there were in 1992.

Despite all of this good news, many are still worried that gains from this remarkable expansion have not been distributed very broadly and that significant segments of society are being left behind. High on the list of concerns are increases in wage inequality and stagnant or falling wages for some groups at the low end of the wage distribution.

Our nature in this country is to be unsatisfied with where we are, and that is good. All of us who study these issues are well aware that the benefits of prosperity are far from being equally shared. Still, we need to be careful not to mischaracterize the situation. What I want to discuss today is what exactly our labor market situation looks like in the United States.

Before proceeding, I want to emphasize that the views I express here are mine and do not necessarily reflect official positions of the Federal Reserve System. I thank my colleagues—especially Howard Wall, who is a co-author of this speech—at the Federal Reserve Bank of St. Louis for their comments, but I retain responsibility for errors.

I believe that the balance of the evidence shows that there is less to worry about than some have described, and that there have been strong employment and wage gains for most broad categories of the population. In fact, some groups that began the period in the worst economic shape, including teenagers and those at the bottom end of the education and income distributions, have enjoyed substantial gains. Sustained prosperity has brought greater opportunities for groups sometimes excluded from employment and, in the process, has transformed labor markets. Perhaps the most remarkable of these transformations has been increased employment opportunities for blacks and women. In fact, the shares of total employment for both groups are higher than they have been for many years.

The effects of continued prosperity on labor markets are best illustrated by presenting and dissecting some of the aggregate employment numbers. In doing so, I'm going to present a picture of an economic expansion that, in terms of falling unemployment, greater employment opportunities and rising incomes, has benefited a broad cross-section of the population.

I hope it will be apparent that sustained real economic growth is important if we are to con-

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tinue improving the labor market situation for all segments of society. Once you are convinced of that, I would also like to outline why I believe that the only way that the Federal Reserve can assist in ensuring that these gains persist in the long run is to remain vigilant about inflation.

UNEMPLOYMENT RATES

Because it is the most widely used indicator of labor market performance, let me start dissecting the data with the unemployment rate. Since peaking at 7.8 percent in June 1992, the unemployment rate has fallen steadily, reaching 4.3 percent in December 1998, where it has hovered ever since. When we disaggregate these unemployment numbers, it becomes apparent that the expansion has been very beneficial for groups that began the period in the worst situations: blacks, teenagers, and the less-educated.

The employment picture for blacks was grim in 1992, when the unemployment rate for this group averaged 14.2 percent. That rate has since fallen to 7.8 percent, and the average rate for 1999 looks like it will be even lower than last year, when it was lower than at any time since 1972. The continuing fall in black unemployment—one full percentage point during the past year—contrasts with the unemployment rate for whites, which has been mostly unchanged for 18 months. So, although the unemployment rate for whites continues to be lower, continued economic growth has meant that the unemployment gap between whites and blacks has been narrowing. And there is good reason to believe that ongoing economic growth will narrow the gap even further. The decline in the black unemployment rate from 14.2 percent to 7.8 percent between 1992 and today is a measure of our nation's progress, but the current rate is a measure of the substantial distance we still have to go.

The expansion has also meant good news regarding the teenage unemployment rate, which in 1992 averaged 20.1 percent (all races). Since then, the teenage unemployment rate has fallen to around 13 percent, a 30-year low. Even during

the strong but shorter-lived growth of the 1980s, teenage unemployment didn't fall below 15 percent, a level that this expansion achieved nearly two years ago. Black and white teenage unemployment are both at their lowest levels in 30 years, although the white teenage unemployment picture is still much better than that for black teenagers.

Well-educated workers, of course, continue to be sought after by employers. Nevertheless, the less-educated have clearly reaped many of the benefits of economic growth in the 1990s. In August of this year, the unemployment rate for those older than 25 who did not have a high school diploma was 7.1 percent; this rate had been 12.2 percent in mid-1992. For those with a high school diploma but no college training, unemployment was at 3.5 percent in August, a drop from 7.3 percent in mid-1992. These data make very clear the tremendous importance of improving the education of our citizens. Here again, we have a great challenge for the future.

It appears, then, that despite the concern that an increasingly high-tech economy will leave the less-educated behind, the economy has found room for the relatively unskilled. What has happened, as anyone can confirm by talking to employers, is that the shortage of well-qualified workers has led firm after firm to hire less-educated workers, and workers with poor employment histories, and train them. On-the-job training has assumed increasing importance in the United States, and the results are gratifying. Firms find that not everyone hired works out, but many do. As a result, the U.S. economy is not only generating employment for many left behind in earlier years, but also helping these workers develop new skills that open up opportunities for them.

EMPLOYMENT/POPULATION RATIOS

Unemployment rates tell only part of the employment story. During any period in which employment opportunities are expanding, two things happen: First, more people become employed; and, second, more of the people who

had chosen to stay out of the labor force decide to reenter, or to enter it for the first time. Although both of these effects are important, newspaper reporters and TV newscasters tend to look only at the first and to ignore the second. Focusing on the unemployment rate and ignoring the growth of employment means missing out on some dramatic changes that have transformed the labor market, perhaps permanently, as relatively larger proportions of certain groups have been drawn into it. Moreover, concentrating only on unemployment rates misses completely a major part of the U.S. success story in the global economy.

One way to get an idea of how the labor market has been transformed by the current expansion is to look at the ratio of employment to population for various demographic groups. These ratios tell us the share of the population that is successfully engaged in the labor market. Examining these ratios will also demonstrate that U.S. success is not a phenomenon that began just in 1992. For the civilian population as a whole, ages 16 and over, the ratio rose by 2 percentage points in the 1960s, by another 2 points in the 1970s, by 3 points in the 1980s, and by an additional point so far in the 1990s. The U.S. economy is truly a fantastic job machine.

Moreover, employment-to-population ratios highlight one of the great successes of the recent expansion—bringing increasing shares of women and blacks into employment. Between 1992 and August 1999, the share of adult white women who were employed rose by 3.1 percentage points; that of black men rose by 3.1 percentage points; and the share of black women rose an astounding 10.7 percentage points. Compare these numbers with those for the 20 previous years. Between 1973 and 1992, the share of black men employed actually fell by 8.7 percentage points and the share of black women grew by 7.1 percentage points.

One of the reasons that blacks have been making such steady gains in the 1990s compared with the previous two decades is that the economy has experienced steady growth. So far, we have avoided the deep downturns that have hindered or reversed gains made during upturns. As a result, the face of the working population has

been transformed as women and blacks make up larger shares of employment than at any time since the end of the Second World War. These changes are part of a long-term trend that has been disrupted frequently by periods of economic downturn. The longer the current expansion is sustained, the more likely it is that these gains will become permanent, as these groups become entrenched in the workforce.

EARNINGS, POVERTY, AND INCOME DISTRIBUTION

So far, I've presented evidence that employment opportunities have improved for broad classes of people, but have said nothing about their economic well-being. We can measure well-being in many ways, the most common being wages, income and earnings. Based on these broad income measures, the average person has been doing better since 1992, as per capita real disposable personal income has risen by more than 12 percent.

Despite these data, various studies, news articles, and pundits have claimed that the expansion has left behind the poorest, claiming that their real wages have stagnated or even declined. The argument is usually based on data showing that the average real wage has not increased very much, or that the average real wage of the lowest quintile or lowest quartile is not much higher, or is even lower, than before the expansion began.

We should be wary, however, of any claims based on average wages. Recall the evidence presented earlier that the current expansion has increased the employment of many who were previously excluded. Also note that the wages of many of these newly employed persons would be lower than those of the already employed. As these low-wage workers are added to the ranks of the employed, the average wage for all workers is necessarily pulled down, even if everyone else's wages are unchanged.

We can see how this process works using an illustration: Let's say that there are two groups of workers—long-term, or *L* workers, and newly

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employed, or N workers. The N workers are relatively unskilled and join the ranks of employed persons at relatively low wages. The change in the average wage of all workers from one year to the next reflects two forces: The first is the increase in the wages of L workers, and the second is the addition of N workers, who were not previously employed.

Keeping this simple so I can make the calculations in my head, suppose there are 10 L workers in Year 1 each earning \$20 per hour. Each of these workers receives a 10 percent pay increase, to \$22 per hour, in year 2. But in Year 2, two N workers are hired at \$10 per hour. The average wage for the 12 workers in Year 2 is easy to calculate. Ten workers are paid \$22 each, for a total of \$220. Two workers are paid \$10 each, for a total of \$20. The 12 workers together are paid \$240, or an average wage of \$20 each.

In this illustration, there has been no change at all in the average wage from Year 1 to Year 2! But, and this is a very important “but,” 10 workers enjoyed wage increases of 10 percent, and two workers went from unemployment to jobs paying \$10 per hour. I believe this simple illustration helps to understand why most workers feel better off despite the slow growth in average wages. Those with continuing employment histories are receiving wage increases and the newly employed, while often battling numerous problems, at least find that their new jobs bring more income and more personal satisfaction than they enjoyed while unemployed.

For a better measure of how economic well-being at the low end has changed, we need to look at the entire population. One straightforward approach is to look at the percentages of households in various income classes. Using data for 1997, the latest available, we can gain a feel for what has been going on. We can divide all of the households in the United States into three real income categories: those in the low group have incomes below \$25,000, those in the middle group have incomes between \$25,000 and \$50,000, and those in the high group have incomes above \$50,000. In 1992, 36 percent of households were in the low group; by 1997, only five years later,

that number declined to 34 percent. Households in the middle group fell from 31 percent to 30 percent of all households. The high group, therefore, went from 33 percent to 37 percent of all households. (The shares for 1997 add up to 101 percent, due to rounding errors.) My best guess is that this mobility has continued after 1997, so that larger shares of the population have moved into higher income groups. While this evidence is by no means definitive, it does illustrate that the current expansion has raised the economic well-being of many of those at the low end.

PRO-EMPLOYMENT PRICE STABILITY

I have been emphasizing that the current expansion has benefited a wide range of people and that future economic growth will lead to more gains. All of us want employment opportunities to continue to grow, and income levels adjusted for inflation to continue to improve. As significant as recent gains have been, we all recognize that the United States faces a great challenge for the future.

Meeting the challenge will require improvements in many different directions. Better education, especially for those in disadvantaged circumstances, is clearly very important. I’m sure that each of us can add other important tasks for the future, such as soundly administered social programs and tax policies, technology improvement, reduced crime rates, and many others. The agencies, businesses, and families responsible for these areas are working hard and have much to do.

We at the Federal Reserve also have a contribution to make to a brighter future, and it flows from the three main areas of our responsibility: First, general monetary policy to maintain a low and stable rate of inflation. Second, maintenance of a sound banking system through efficient bank supervision and regulation. Third, provision of efficient payment services through managing the nation’s currency and playing a central role in check-processing and various electronic payment mechanisms.

I want to focus on the Fed's monetary policy responsibilities, for this area is the most difficult technically and offers the greatest possibility for error. We at the Fed are convinced that the critical contribution we can make toward maximum sustainable economic growth is to maintain low and stable inflation—price stability, for short.

So far, the Federal Reserve has been successful in fending off inflation. The battle against inflation, however, is never permanently won. No matter how long the inflation rate stays low, we can never pack our bags and go home. We must remain vigilant because the return of price instability could jeopardize the expansion and the employment gains I outlined earlier. If inflation takes hold, recession will almost certainly follow within a relatively few quarters. Why? Because inflation is always accompanied by greater uncertainty about the future, which makes it difficult for businesses and households to plan efficiently. With inefficient planning come frequent and unavoidable mistakes, resulting in greater variability in growth and employment.

Given the central importance of low inflation to our prosperity, frequent references in the press to financial market fears that the Fed will raise interest rates strike me as unfortunate. If the market is to have any fears about the Fed, the appro-

priate thing to fear is that the Fed might not act when it needs to for inflation to remain low. Maintaining low inflation contributes to maximum sustainable economic growth. Low inflation is investor-friendly and employment-friendly.

I do not know what monetary policy actions will be required to keep inflation low over the months and years ahead. And I certainly will not speculate on possible Fed action next week. But I do want to assure you that I will do what I can to contribute to Fed decisions to change interest rates in the direction necessary and at the time necessary. Changing rates when necessary also means that we will leave rates alone when necessary. Those decisions require that we look several years ahead, being careful not to let the current flow of data and short-run market fluctuations divert us from our long-run path of seeking continuing good inflation performance.

This is our task, and if we are not always clear about what needs to be done because of the great uncertainty about how the economy works, at least you know without any question what our objective is. An excellent roadmap is worthless unless you know where you want to go. At the Fed, we do know where we want to go, and I'm convinced that our roadmap, while far from perfect, is good enough to get us there.