

Toward a More Inclusive Labor Market and Stronger Economy



**Loretta J. Mester
President and Chief Executive Officer
Federal Reserve Bank of Cleveland**

**Remarks for the Session “The Future of Work and Alternative Work Arrangements”
at the Conference on Uneven Outcomes in the Labor Market:
Understanding Trends and Identifying Solutions**

**Organized by Community Development Staff at the Federal Reserve Banks of Atlanta, Boston,
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(via videoconference)**

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I thank the conference organizers for the opportunity to provide opening remarks for today's session on the future of work and alternative work arrangements, part of the conference on uneven outcomes in the labor market. But more broadly, I also thank the staffs in community development from across the System – at every Federal Reserve Bank and the Board of Governors – for the enormous body of analysis and outreach that you have produced in light of the pandemic. The community development function's efforts have contributed mightily to the Federal Reserve's understanding of the myriad effects the pandemic is having on our communities, households, and small businesses. Your work has informed Federal Reserve policy decisions and I expect that to continue as we work together to ensure a broad-based, sustainable economic recovery. You were able to bring these essential insights to the discussion because of the work you have done over many years to understand the issues affecting low- and moderate-income communities, work that will yield dividends well after the pandemic is behind us. Before I continue, let me remind you that, as always, the views I will present are my own and not necessarily those of the Federal Reserve System or of my colleagues on the Federal Open Market Committee.

It is now clear that the adverse effects of the pandemic have not been evenly distributed and there are wide disparities in the recovery across business sectors, geographic areas of the country, and demographic groups. The burdens of the pandemic have been borne by many of the most vulnerable in our economy: lower-income and minority workers and communities; those who do not have the opportunity to work from home; those who don't have access to reliable telecommunications and internet services or to adequate healthcare; and the smallest of small businesses. Since last spring, Blacks and Hispanics have been faring less well in the job market than whites, and those without a bachelor's degree have made less progress than those with a bachelor's degree. Rehiring by employers has been considerably slower for low-wage workers than for high-wage workers, whose employment level has now returned to its pre-pandemic level. Among workers in the prime working ages of 25 to 54, the labor force participation rate of women has recovered less than that of men, because the need to provide childcare for pre-school

children or those being schooled remotely is disproportionately affecting women's ability to remain in the workforce or work their usual number of hours.

One source of the disparities across groups stems the fact that the distribution of the types of jobs held by members of a particular group varies across groups and the pandemic has hit some industries much harder than others. Analysis by the Cleveland Fed indicates that one factor that has contributed to a rising earnings gap between whites and Blacks in Pittsburgh, Pennsylvania, and, Dayton, Ohio, is that the distribution of workers across occupations differs by race.¹

It is important to remember that differences in economic outcomes did not start with COVID-19. Many of the economic disparities in our economy are long-standing ones and stem from the fact that the U.S. economy does not offer the same opportunities to all. There are racial disparities in educational attainment, labor market outcomes, and access to credit. People born into areas of concentrated poverty or predominantly minority areas are disadvantaged over their entire lifetimes, and so are their children. These disparities have been propagated across generations. Things cannot be expected to improve on their own. Actions will need to be taken to promote an inclusive economy – one in which people have the chance to move themselves and their families out of poverty, one in which systemic racism does not limit opportunities, and one in which all people can fully participate and have access to economic opportunity.

Economic inclusion and opportunity intersect with the Federal Reserve System's mission to promote a healthy economy and stable financial system in the United States. Our monetary policy decisions, our actions as supervisors and regulators of banks, our role in the payments system, and our efforts to promote community development in low- and moderate-income areas all contribute to achieving a well-

¹ Bailey, Layisha, and Emily Garr Pacetti, "Recovery for Whom? Trends in Dayton, Ohio, and Pittsburgh, Pennsylvania, Exemplify a Growing Gap in Earnings between Minority and White Workers Present in Many US Regions," *Community Development Briefs*, Federal Reserve Bank of Cleveland, November 2019. (<https://www.clevelandfed.org/en/newsroom-and-events/publications/community-development-briefs/db-20191126-earnings-gap.aspx>)

functioning economy and financial system in which everyone can participate. Opportunity and inclusion are important for achieving a strong economy, one that is able to live up to its full potential. The fact that a more inclusive economy will be a stronger economy is not difficult to see if we take a step back and look at what determines a country's standard of living. Increases in living standards, as measured by income per person, are inextricably tied to a country's long-run, potential growth rate, which is driven by growth in productivity. Important determinants of productivity are investment in human capital to increase the knowledge and skills needed to productively use capital, and investment in R&D and new technologies. If we want to have a strong economy, it is important that we ensure that everyone has the opportunity to fully participate in the labor force and that they have the skills to create new ideas and technology and to use that technology effectively.

A top priority for increasing economic inclusion and opportunity must be increasing access to high-quality education at all levels from pre-school through college. Education can be transformational, changing the path of a person and that of future generations. The GI Bill allowed many soldiers returning from World War II to become the first college graduates in their families, raising their and their children's standard of living. Education is a path toward better economic outcomes not only for individuals and households but also for communities. Education levels tend to predict a state's per capita income growth and poverty rates. And cities with more highly educated populations experience lower unemployment rates, higher productivity growth, and higher growth in entrepreneurship than what would have been predicted by considering only the educational levels of individuals.² So education provides a positive externality. Education can raise labor force participation rates, and the better educated tend to have higher wages and lower levels of unemployment. The median income for families whose head has a college degree is more than twice as high as that of a family whose head has only a high school diploma.

² For further discussion of the research linking educational attainment and economic outcomes of communities, see Loretta J. Mester, "Community Development and Human Capital," remarks at the 2015 Policy Summit on Housing, Human Capital, and Inequality, sponsored by the Federal Reserve Banks of Cleveland, Philadelphia, and Richmond, June 19, 2015. (<https://www.clevelandfed.org/newsroom-and-events/speeches/sp-20150619-community-development-and-human-capital>)

The gap in wages between those with a college degree and those without, the so-called skill premium, has widened substantially over time, more than doubling since the 1970s. Similarly, median net worth is considerably higher for those with a college degree.³ Higher educational attainment gives people more labor market security. Over the last expansion, the unemployment rate for those with a bachelor's degree or higher averaged 3.2 percent compared to 6.6 percent for those with a high school diploma and no college. And while all groups' unemployment rates are higher than they were before the pandemic, the gap between the current unemployment rate (as of December 2020) and the pre-pandemic level (as of February 2020) is 1.9 percentage points for those with a college degree but 4.2 percentage points for those with a high school diploma but no college.

But not all groups have benefited from a college education. While our workforce as a whole has become more educated over time, educational attainment differs by race. According to the Fed's 2019 Survey of Consumer Finances, 41 percent of white heads of household held a college degree compared to 26 percent of Black heads of household and 16 percent of Hispanic heads of household. The likelihood of completing a degree also differs by race and by type of institution. The completion rates have remained particularly low at for-profit institutions for all races, with less than 20 percent of Black students who started at a for-profit institution in 2012 having earned a degree by 2018 and less than 40 percent of white students having done so. At both public and nonprofit private institutions, the graduation rates for whites, Hispanics, and Asians have all risen over time, but those of Blacks remain well below those of these other groups and have shown no progress over time.

Cost can be an important barrier to entering and staying in college, particularly for those coming from lower-income families. According to the Fed's survey of economic well-being, of those respondents who

³ According to the Federal Reserve System's 2019 Survey of Consumer Finances, in 2019, the median income of families whose head has a college degree was \$95,700 compared with \$45,800 for families whose head had only a high school diploma. See *2019 Survey of Consumer Finances*, Federal Reserve System (2020). (<https://www.federalreserve.gov/econres/scfindex.htm>)

could not complete their associate or bachelor's degree, among other reasons, 56 percent said it was because it was too expensive.⁴ The average cost of tuition and fees at four-year institutions is now over \$16,000 a year, and adjusted for inflation, it has more than doubled over the past three decades.⁵ According to the Fed's survey on economic well-being, as of late 2019, over 40 percent of those who went to college had taken on debt for their education and about half of those people still owe money on this debt.⁶ New York Fed analysis shows that compared to borrowers in majority white areas, those in majority Black areas have higher student loan balances and those in majority Black and majority Hispanic areas have higher rates of default on those loans.⁷ These defaults can follow a person over time, making it harder to access credit in the future. So while on average and for society as a whole, the return to investing in education is positive, for some individuals it is not, especially if they have to take on high levels of debt. Making college more affordable would help align private and social incentives in the choice of education.

In addition to cost, another barrier to entering and completing college is not being adequately prepared. According to the Fed survey, 22 percent of respondents not completing a college degree said that one of

⁴ Respondents could choose more than one reason, and 52 percent also said it was because they needed to earn money to take care of their family. See Board of Governors of the Federal Reserve System, "Report on the Economic Well-Being of U.S. Households in 2019, Featuring Supplemental Data from April 2020," May 2020, Table 23, p. 41. (<https://www.federalreserve.gov/publications/files/2019-report-economic-well-being-us-households-202005.pdf>).

⁵ For further discussion, see Loretta J. Mester, "Toward a More Inclusive Economy," remarks at the Economic Equality Webinar, African American Chamber of Commerce of Western Pennsylvania, Pittsburgh, PA (via videoconference), September 28, 2020. (<https://www.clevelandfed.org/newsroom-and-events/speeches/sp-20200928-toward-a-more-inclusive-economy>)

⁶ See Board of Governors of the Federal Reserve System, "Report on the Economic Well-Being of U.S. Households in 2019, Featuring Supplemental Data from April 2020," May 2020, pp. 43-46. (<https://www.federalreserve.gov/publications/files/2019-report-economic-well-being-us-households-202005.pdf>)

⁷ See Chakrabarti, Rajashri, William Nober, and Wilbert van der Klaauw, "Measuring Racial Disparities in Higher Education and Student Debt Outcomes," Federal Reserve Bank of New York Liberty Street Economics, July 8, 2020. (<https://libertystreeteconomics.newyorkfed.org/2020/07/measuring-racial-disparities-in-higher-education-and-student-debt-outcomes.html>)

the reasons was low grades.⁸ This suggests that some people aren't prepared for college when they enter. Research is increasingly pointing to the fact that the foundation has to be laid very early in life – at the pre-school level. When children fall behind early on, it is often difficult to catch up.

So we need to increase investment in early childhood, elementary, and high school education so that students are better prepared for college. This investment includes financial support to the schools and to families, as well as tutoring and mentoring to support children as they learn. Even before the pandemic, a large part of formal and informal education was being delivered digitally. So one part of the investment has to be in closing the digital divide between low-income areas and higher-income areas. Usage of broadband at home is comparatively higher for whites, those with higher incomes, and those in urban and suburban areas.⁹ Blacks and Hispanics are less likely than whites to have a computer or broadband at home, and when they do have a computer, they are less likely to have broadband service at home. This puts Black and Hispanic families at a disadvantage, especially now, given the pandemic, when remote in-home learning is the norm rather than the exception. The situation in Cleveland is particularly bad. Among communities with a population of 100,000 or more, the city of Cleveland has among the lowest home broadband access in the nation. Business leaders through the Greater Cleveland Partnership are working with the city's governmental leaders and other organizations to ensure that all residents in the Greater Cleveland area have access to in-home high-quality broadband and the devices needed to access it.

The need to ensure that all families have access to high-quality education as a path toward economic

⁸ See Board of Governors of the Federal Reserve System, "Report on the Economic Well-Being of U.S. Households in 2019, Featuring Supplemental Data from April 2020," May 2020, Table 23, p. 41. (<https://www.federalreserve.gov/publications/files/2019-report-economic-well-being-us-households-202005.pdf>)

⁹ For further discussion, see Loretta J. Mester, "Toward a More Inclusive Economy," remarks at the Economic Equality Webinar, African American Chamber of Commerce of Western Pennsylvania, Pittsburgh, PA (via videoconference), September 28, 2020. (<https://www.clevelandfed.org/newsroom-and-events/speeches/sp-20200928-toward-a-more-inclusive-economy>)

opportunity and inclusion and a strong economy is becoming even more important over time.

Technological change is transforming many aspects of the economy, including work – the topic of this session. For any given type of capital, a more knowledgeable worker is a more productive worker. But changes in technology demand even more highly skilled workers. Technology has changed how we do our jobs, how we recruit for workers, and how we search for new positions. The intersection of technology and work means that the type of skill sets in demand are going to be different than in the past, and include things like problem-solving and how to deal with ambiguity in the face of a rapidly changing environment. A worker's attachment to a particular employer or even a particular career path is likely to be different as well.

Evidence suggests that technological change has led to an increase in demand for high-skill workers relative to low-skill workers. Even industries often viewed as less skill-intensive have increased their demand for skilled labor. The manufacturing plant of the 1970s looks little like the one of today. Middle-skill jobs are less in demand than they used to be because technology is able to do the routinized work of these jobs. Computers are less suited to replacing workers in occupations that require abstract thinking, high levels of cognition, and higher levels of education or workers in non-routine more manual types of work. This shift in the distribution of jobs helps to explain the wider gap in wages for highly skilled vs. low-skill workers, and the increasing return to gaining the education required to obtain those skills. Cleveland Fed economists investigated the overall increase in U.S. wage inequality in the last 30 years and found not only that educational attainment is a key driver of wage inequality, but that education has become fundamental to boosting worker productivity.¹⁰

The positive externalities from education to the economic health of communities and the country as a whole mean we are likely under-investing in education from society's viewpoint. Indeed, the U.S. does

¹⁰ See Pinheiro, Roberto, and Murat Tasci, 2019, "Firms, Skills, and Wage Inequality," Federal Reserve Bank of Cleveland, Working Paper no. 17-06R. (<https://www.clevelandfed.org/en/newsroom-and-events/publications/working-papers/2019-working-papers/wp-1706r-firms-skills-and-wage-inequality.aspx>)

seem to lag behind other advanced economies in terms of educational achievements and skill levels. The Organization for Economic Cooperation and Development's (OECD) latest survey assessing adult skills indicates that the U.S. ranks 15th in terms of literacy and 24th in terms of numeracy among the 32 OECD countries that participated in the assessment of these skills, and 15th in terms of problem-solving out of the 29 OECD countries that participated in that part of the assessment.¹¹ In a different OECD survey of the skills of 15-year-olds, the U.S. ranked 9th out of 36 OECD countries in reading, 31st out of 37 OECD countries in math, and 13th out of 37 OECD countries in science.¹²

These results are troubling but not insurmountable. Thoughtful and deliberate policies to make quality education the reality for all students can increase economic opportunity and inclusion for people who have not had those opportunities in the past, better prepare us no matter how the nature of work changes, and strengthen the U.S. economy now and in the future.

¹¹ The survey was conducted in three rounds: 2011-2012, 2014-2015, and 2017-2018. See the OECD's Programme for the International Assessment of Adult Competencies (PIAAC) (<https://www.oecd.org/skills/piaac/>) and OECD, *Skills Matter: Additional Results from the Survey of Adult Skills*, OECD Skills Studies, OECD Publishing: Paris, 2019. (<https://doi.org/10.1787/1f029d8f-en>)

¹² The latest results from this triennial survey are from 2018. See the OECD's Programme for International Student Assessment (PISA). (<https://www.oecd.org/pisa/publications/pisa-2018-results.htm>). In terms of statistically significant (at the 5 percent level) differences, the U.S. was out-ranked by 4 OECD countries in reading, 24 OECD countries in math, and 6 OECD countries in science. See the National Center for Education Statistics, PISA 2018 U.S. Results. (<https://nces.ed.gov/surveys/pisa/pisa2018/#/>)