The Economy and Higher Education
Forum for the Future of Higher Education

The Brookings Institution
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<u>Economic Outlook: Where We Stand</u>

Betsy Stevenson is a member of the Council of Economic Advisers. She is on leave from the University of Michigan's Gerald R. Ford School of Public Policy and the Economics Department where she is an Associate Professor of Public Policy and Economics. She served as the Chief Economist of the US Department of Labor from 2010 to 2011, and has taught at the University of Pennsylvania's Wharton School and Princeton and been a visiting scholar at the Philadelphia and San Francisco Federal Reserve Banks. Stevenson is a labor economist whose research examines the impact of public policies on the labor market, with a focus on women's labor market experiences, the economic forces shaping the modern family, and the potential value of subjective well-being data for public policy. She focused her remarks on the areas of the U.S. economy where she sees strength--housing, slowing health care costs and domestic energy production --as well as the parts of the economy where she sees ongoing challenges--long-term unemployment, stagnating wages and inequality.

Key Observations

Growth going into the second half of 2013 was better than expected given the enormous fiscal drag from the sequester. Fourth quarter 2013 GDP growth was lower but the broad trend for 2014 is growth.

2013 was a much stronger year for employment growth if one removes the government sector and only looks at the private sector.

Housing has been recovering and there's still a lot of upside potential. Housing markets remain affordable even with interest rates rising during 2013.

Declining growth of real per capita national health spending is a positive for the economy. If these costs continue to come down, workers will get more compensation in the form of wages.

Another upside for the economy has been an enormous increase in the domestic production of oil, which now exceeds imports. That's had an impact on the trade deficit, which is narrower than pre-crisis years.

The biggest challenge is our long-term unemployment rate, which creates a systemic problem for the economy.

The United States labor market has historically been characterized by a lot of churn as people look for jobs that better fit their talents. But this churn has slowed down, creating fewer openings and making it even harder for the long-term unemployed to find jobs.

Divorcing jobs from health insurance is very important to having a healthy labor market, and is probably one of the Affordable Care Act's most important accomplishments. People should choose their job based on where their talents will be best utilized and not on other factors.

The unemployment rate for college graduates remains elevated, largely because older college graduates who are long-term unemployed are having a hard time finding their way back into the labor force.

Real wages have been stagnating for quite some time. Overall U.S. income has grown but it's going to the top. This is not anything new, but we have not made much progress in slowing this increase in wage inequality.

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Betsy Stevenson, The Council of Economic Advisors

Barry Bosworth, Senior fellow in the Economic Studies Program at Brookings

Introduction

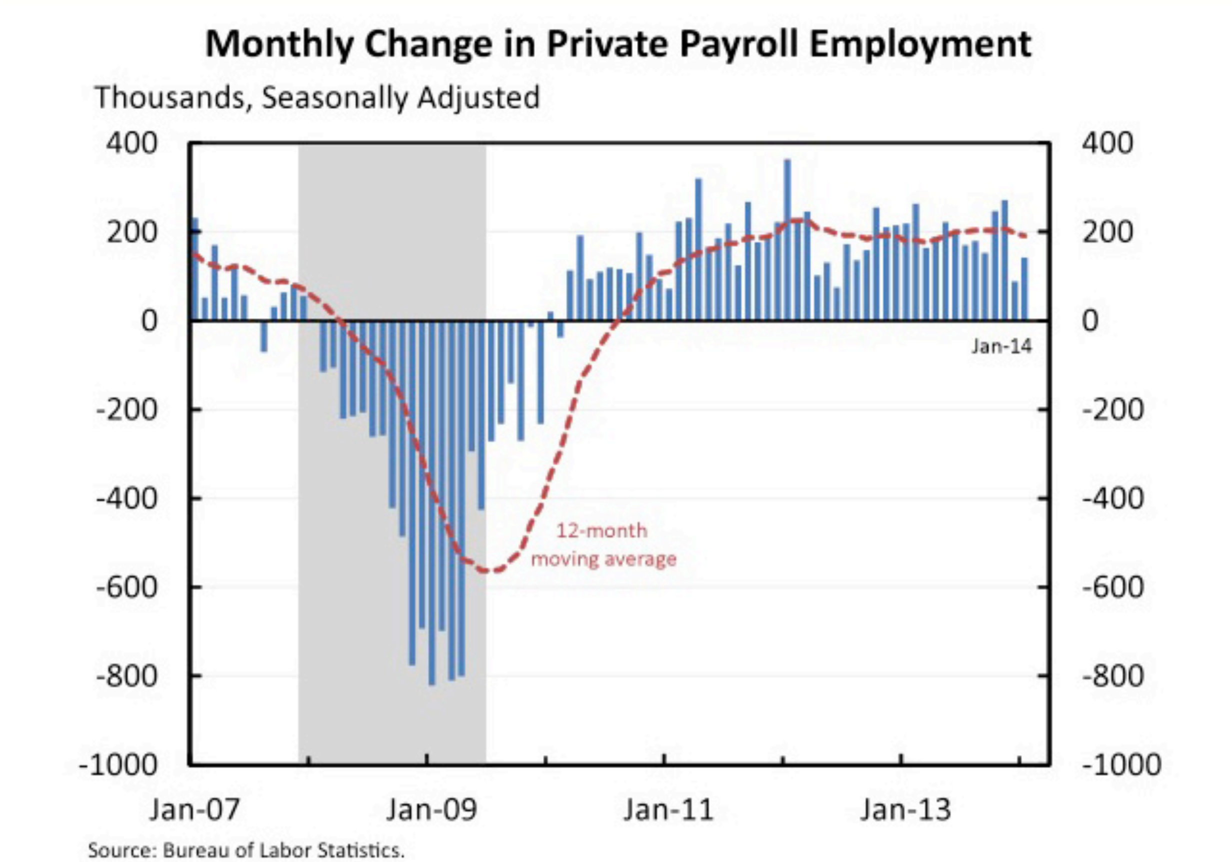
MODERATOR: Good morning and welcome all to Brookings and our sixth annual program on The Economy and Higher Education. This program was launched in 2008 as the financial crisis was gathering steam and the great recession was starting to unfold. The aim of earlier meetings was to help support institutional decision making in a time of great uncertainty. Our purpose today is to continue to support institutional planning and to provide an informed and independent outlook on the state of the economy, the prospects for financial markets, the condition of employment and labor markets and other topics of interest to higher education. To help us, we are joined by a group of prominent and highly accomplished scholars and thinkers from Brookings, from government and from campus. It's my pleasure to turn things over to Barry Bosworth and Betsy Stevenson.

MR. BOSWORTH: Thank you everybody. Welcome again. We want to start off today with someone from the administration and we're very lucky to have Betsey Stevenson from the Council of Economic Advisors come and talk about the economic outlook. It's a good time to hear from the Administration because the budget should be coming out pretty soon. Betsey, why don't you start?

MS. STEVENSON: Thank you for inviting me. It's a pleasure to come and talk with you today. I'm going to give you a little bit of a sense of what the year looked like last year and what 2014 looks like it's shaping up to be. We'll start with an overview of jobs, growth and the deficit, and then I'll point to where I think the strengths are: housing, slowing health care costs and domestic energy production. Then we'll talk about some of the challenges still facing the economy, namely long-term unemployment, stagnating wages and inequality.

As a labor economist I always start with the job situation. The last two months have not been the strongest months of job growth. Total non-farm payroll employment rose by 113,000 jobs in January, and then 89,000 in December after rising an enormous 272,000 in November. If you look at exhibit 1 you can see that we've been adding, on average, about 200,000 jobs a month. The last two months could indicate a slow down or that some of the jobs that should have been added in December and January were added in October and November, because you can see that we had robust job growth in October, November.

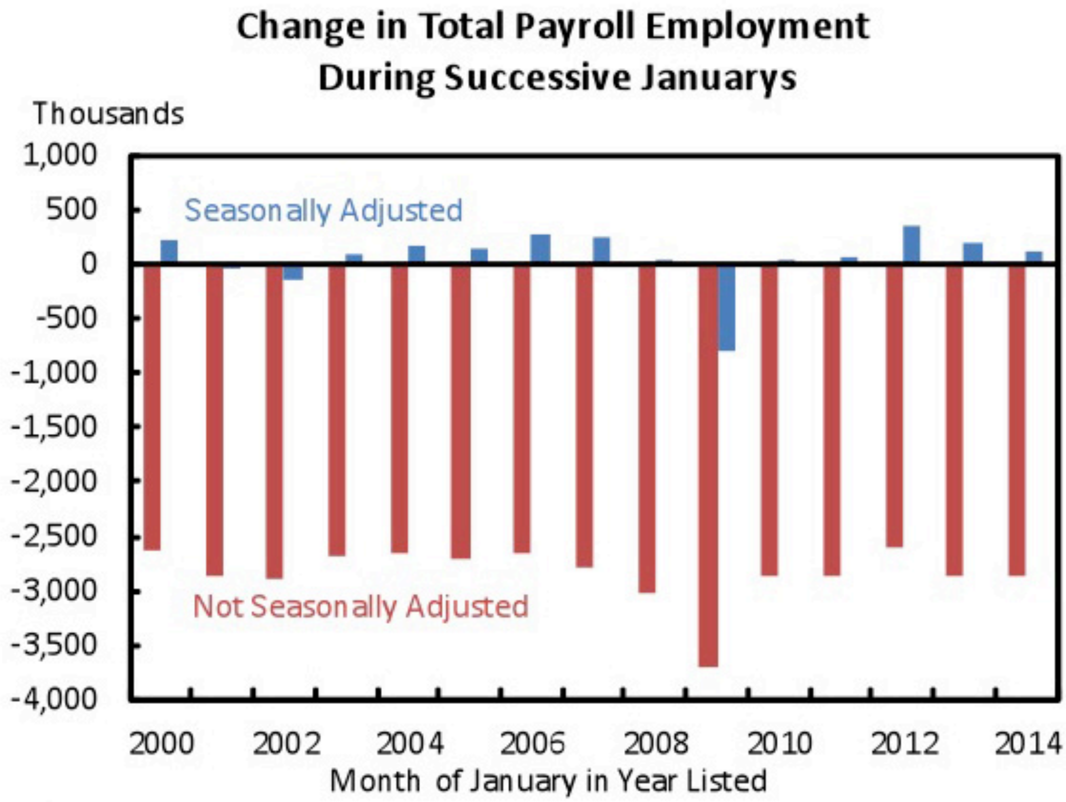
Exhibit 1:



It's very difficult to get a good estimate on the job number because the labor market actually changes dramatically every month. We try to put aside the normal swings in the labor market that we see every month that are based on weather, or the Christmas shopping season when everybody's hiring, and try to figure out what is the real underlying trend in the economy. I think January illustrates why we have such a hard time getting a good estimate on the jobs number.

This second exhibit is my absolute favorite graph because it shows that every January we lose roughly three million jobs after the big build up of employment every fourth quarter for the holiday season. What we're trying to figure out is -- was that decline supposed to be 2.8 million, 2.7 million or 2.9 million? What's the true number, and how much of that is actual underlying real growth? So that illustrates why we have such a difficult time at any given moment actually understanding exactly where the economy is.

Exhibit 2: The Economy Typically Experiences a Sharp Seasonal Swing in Employment During January



Source: Bureau of Labor Statistics.

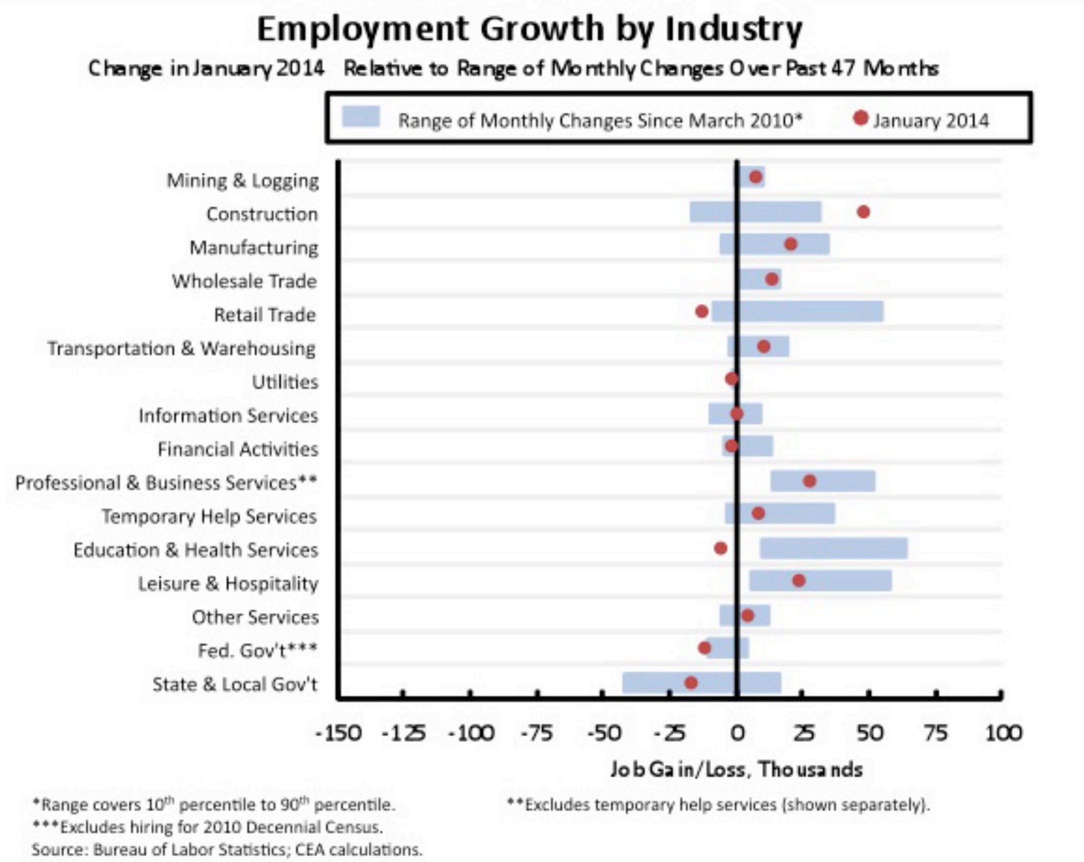
Adding to the difficultly is that these numbers get revised every month, and then revised a year later when we actually compare the jobs numbers to the tax records, using unemployment insurance.

As for GDP, we've actually had some pretty robust growth going into the second half of 2013, which frankly is somewhat of an upside surprise given the enormous fiscal drag coming from the sequester.

We have a good sense of what was going on in the third quarter of 2013; namely that there was a large buildup of inventories, which led people to predict that Q4, 2013 GDP growth would be a bit lower. That's proven to be true, and 2014 Q1 is predicted to be a little bit lower yet. But I think the broad sweeping trend we see is a year of growth in 2014. One reason is we now actually do have a budget agreement that has removed some uncertainty and also removed some of the fiscal drag by relieving some of the sequester. This leads most economists to predict that 2014 will be a more robust year of growth than we saw in 2013.

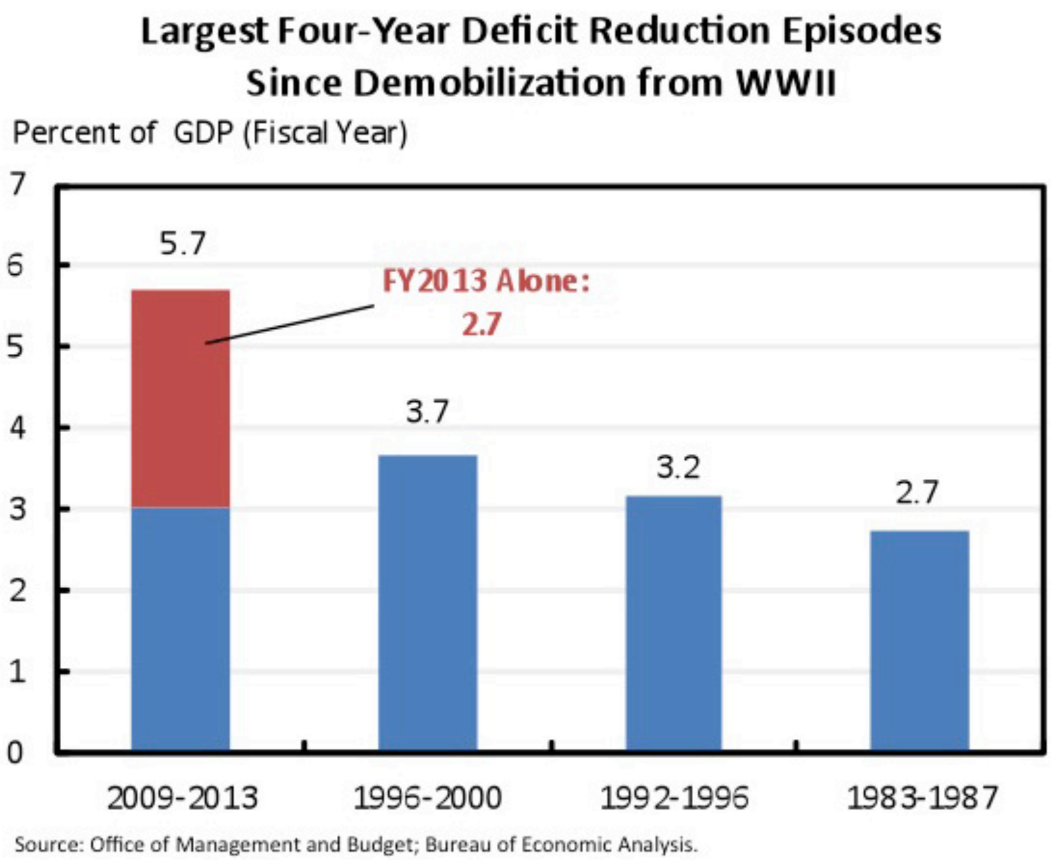
It is worth noting that 2013 was a much stronger year for employment growth if you take out the government sector and only look at the private sector. We have faced something unusual in this recovery, which is that we have had local, state and federal government employment declines, and these declines have actually been a pretty big drag. Exhibit 3 shows broad-based employment growth over time, with one exception: state and local government.

Exhibit 3: Employment Growth By Industry



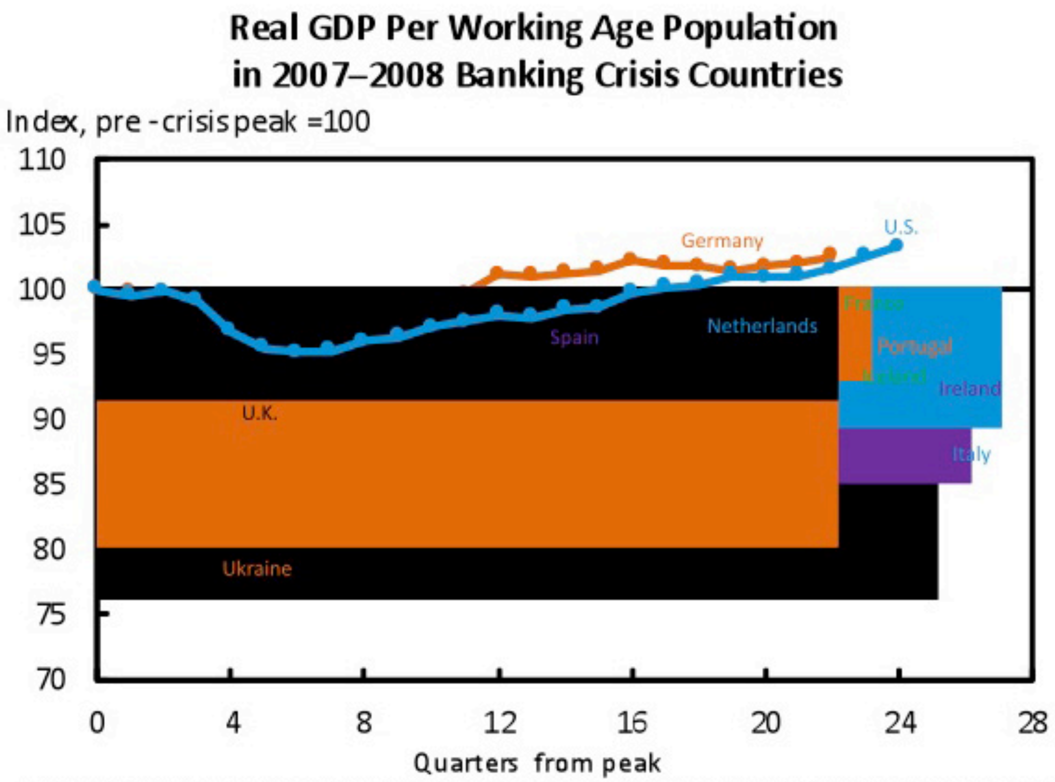
At the same time, the decline in the deficit since fiscal year 2009 is the largest four-year improvement since the demobilization of World War II. As you can see from exhibit 4, we've had a 5.7 percent decline and half of that actually came from fiscal year 2013 alone. It is very unusual to have such a large decline in a single year. Even over the four year period it's unusual to have such a large decline. Hence the very large fiscal drag in 2013.

Exhibit 4: Largest Four Year Deficit Reductions



I want to put the U.S. recovery into a more international perspective because I think there's a lot of debate about how our recovery has fared. Has it been stronger than or weaker than it should have been? As you can see from exhibit 5, of all the countries that experienced a systemic financial crisis, the U.S. and Germany are the only two that have seen output per working age population recover.

Exhibit 5: Real GDP per Working Age population



Note: U.S. as of 2013:Q4, all others as of 2013:Q3 except Iceland (Q2). Working age population is 16-64 for U.S. and 15-64 for all others. Population for Ukraine is interpolated from annual estimates. Selection of countries based on Reinhart and Rogoff (forthcoming).
Source: Statistical Office of the European Communities; national sources; CEA calculations.

Greece, as we all know, is still a mess. But even looking at countries like the Netherlands, France, Iceland, Portugal, Italy, Ireland -- none of them have been able to fully recover. We have done a lot of amazing things to try to pull the U.S. out as quickly and as robustly as we can. Of course, there's more to be done, there's still a lot of people hurting and I do want to get to what I think is the weaknesses in the economy.

But let me start with the strengths. Housing has been recovering and there's still a lot of upside potential. We are nowhere near the peak, but we don't necessarily want to go back to the peak. Housing markets remain affordable even with interest rates rising during 2013; the composite housing affordability index shows that housing has still never been quite as affordable as it is now.

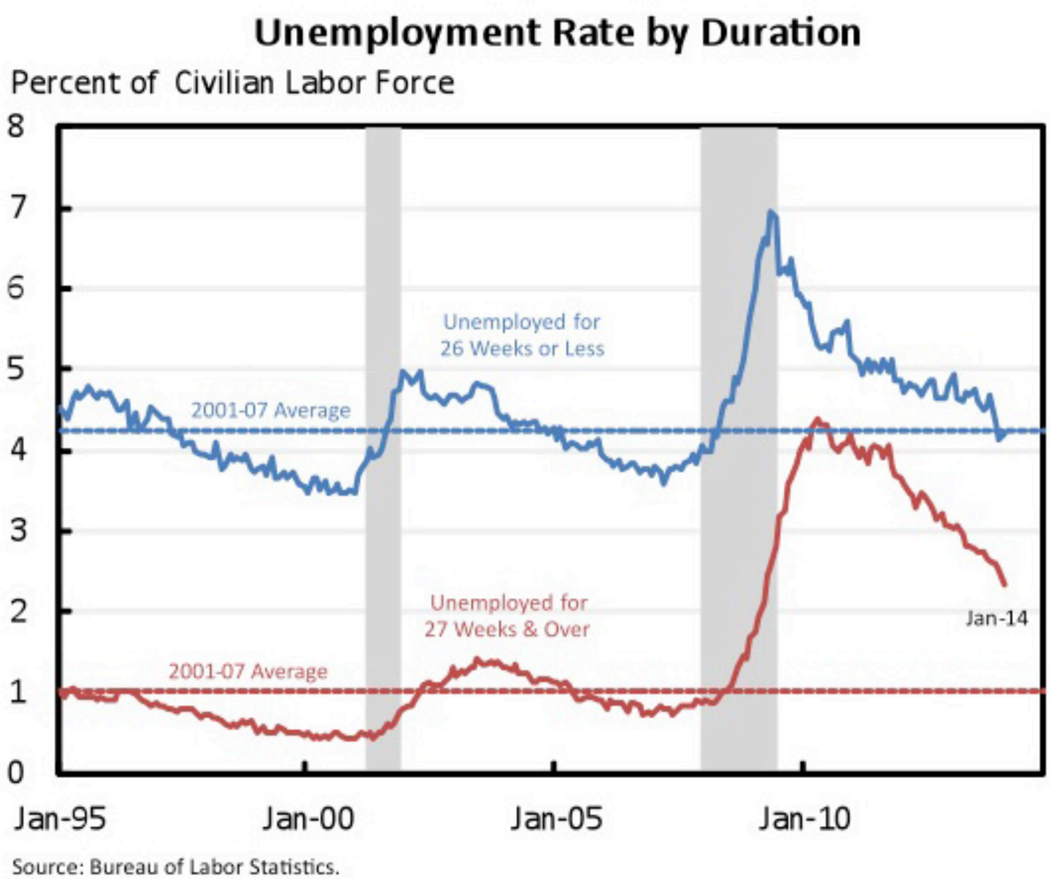
Perhaps the most significant upside of the economy has been the decline in the growth of real per capita national health spending. I think this phenomenal fact has been overlooked because the declines were happening during a recession and people wondered if the growth would bounce back once we get out of the recession. I think we're now starting to get enough information to see that these are real declines, some of which are tied to the Affordable Care Act. This is important because one of the things that's been keeping wage growth down is that compensation increases have gone largely toward spending on health insurance for employees. If we can control the costs of the health spending, it's good for workers because more of their compensation increases will go towards wages.

Another upside has been an enormous increase in domestic production of oil. Imports have been coming down, domestic production has been coming up and now our domestic production exceeds our imports. That's had an impact on our trade deficit, which is narrower than pre-crisis years. That combined with export growth in recent years has really helped bring the trade deficit down.

Now let me turn to the biggest challenges left in the economy; perhaps the biggest challenge is our long-term unemployment rate. An unemployment rate that is composed of a larger share of the long term unemployed represents a more systemic problem for the economy than one that is mostly composed of people who have been out of work for a very short period of time. In fact, the United States has typically been characterized as a labor market with a lot of churn. In other words, people are always looking for the next best thing, they're changing jobs, they're looking for the promotion, the better fit for their talents, and so there are a lot of people changing jobs in the U.S. Unfortunately, during the recession, and even pre-dating it, we've seen a slowdown in this churn. People are not moving jobs as much as they used to. When they're not moving jobs as much, openings aren't being created. When there are not openings being created, it's harder for people who do find themselves unemployed to actually find an opening. And when the unemployment rate is driven more by people who are having a hard time finding any kind of job that is a much more difficult problem to address.

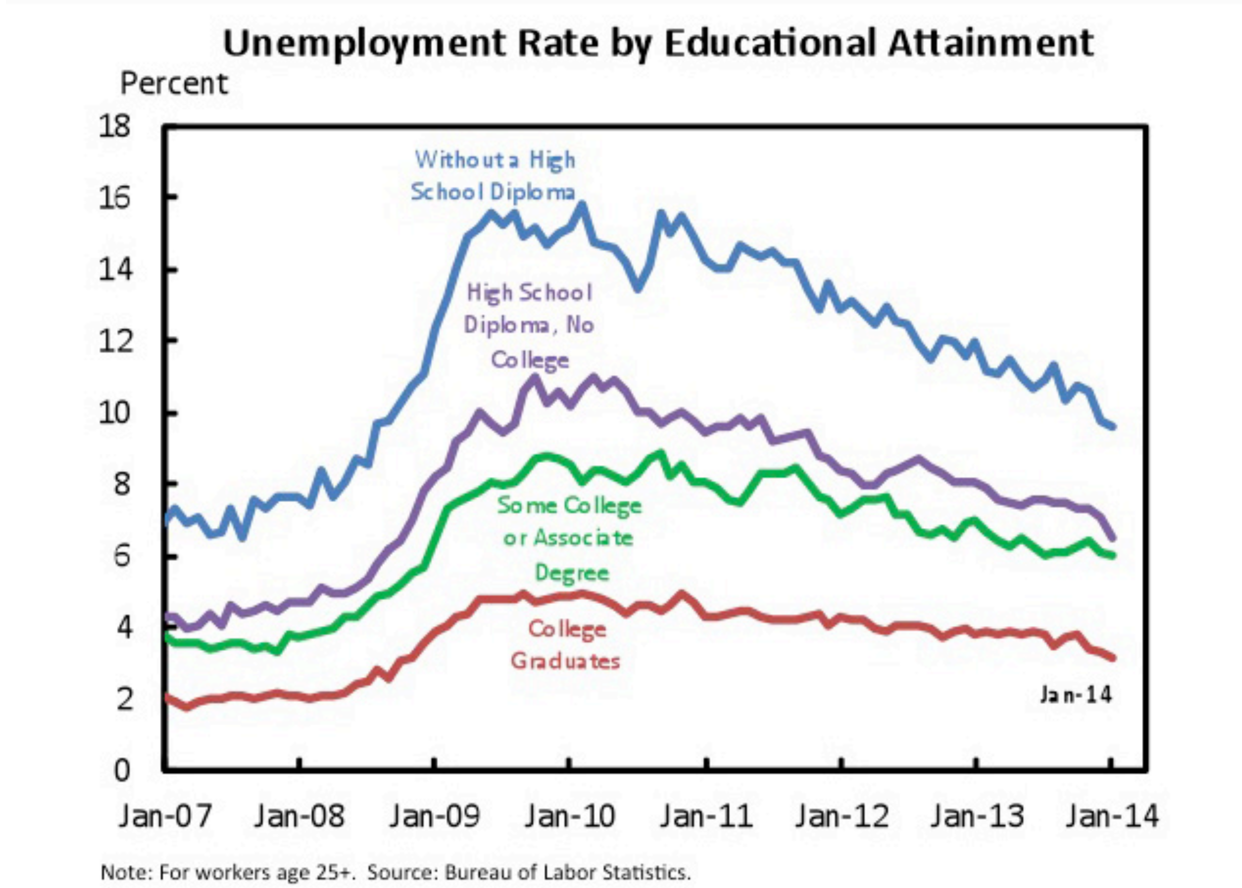
You can see in exhibit 6 that short-term unemployment, those unemployed for 26 weeks or less, is now down at the 2001 to 2007 average. Frankly, I'd like to see it come even a little bit lower, maybe another 0.2, 0.3 of a percentage point. But the long-term unemployment rate is still elevated by an entire percentage point over the 2001-2007 average. In recent months it's been coming down a bit, but we want to make sure it's coming down because people are finding jobs and not because they're exiting the labor market. So long-term unemployment remains one of our challenges.

Exhibit 6: Unemployment by Duration



Also, the unemployment rate differs enormously by education. As you can see in exhibit 7 the unemployment rate for college graduates is always quite low, always much lower than those for high school graduates. But you'll notice that the unemployment rate for college graduates does remain elevated, and I think that's largely coming from older college graduates who are long-term unemployed and are having a hard time finding their way back into the labor force. There is definitely a role for colleges and universities to help their older alumni when they're having a hard time finding employment; those employment services are helpful not just for your 22 year olds, but for your 42 and 52 year olds.

Exhibit 7: Unemployment Rate by Educational Attainment



The other challenge I wanted to highlight is the growth and real hourly average earnings for production and non-supervisory workers. Real wages have been stagnating for quite some time. And you can see in exhibit 8 that real wages declined during the worst parts of the recession. Real wages have come back up from that and growth turned positive for most of 2013, but these are very very small increases.

Exhibit 8: Growth in Real Average hourly earnings

Overall U.S. income has grown but it's going to the top. This is not anything new, but we have not made much progress in slowing this increase in wage inequality, which has been going on for quite some time now. So why don't I end there and we can open it up for discussion.

MR. BOSWORTH: Thank you very much Betsey. We already have some questions.

SPEAKER: Nancy, when is the drag of shedding government jobs going to end?

MS. STEVENSON: The hope is that as private employment goes back up and, hopefully, as wages start to go back up, government revenues will go back up and they'll stop shedding jobs. Many of us hope that that's happening now, but some of the states and local governments are in difficult fiscal situations and they're trying to dig themselves out of that. There was assistance in the Recovery Act that helped them for a while but this federal assistance has gone away and that's been one of the challenges they face.

SPEAKER: To what extent are the states allocating new revenue to deal with their post-retirement liability problems?

MS. STEVENSON: One of the issues that states have to grapple with is how to deal with their liabilities versus new spending, and obviously every state and local government is going to make that decision separately.

SPEAKER: I notice that CBO has been placing a lot of emphasis on the employment-to-population ratio as opposed to the unemployment rate. And it's striking that there's just no improvement in the employment-to-population ratio since the end of the recession. How much of this is due to demographic trends, and how much of it is discouraged workers who have left the labor force?

MS. STEVENSON: This is something that I think everybody's paying a lot of attention to. The employment-to-population ratio has improved a little bit, but just a little, little bit. At least half of that is due purely to the demographics. Between the ages of 55 and 65, labor force participation falls from something like 70 percent to 20 percent. We have people exiting the labor force to retire, and that has been playing a big role.

The other thing is that students are working less. There's been no change in the percent of 16 to 24 year olds who are neither in the labor force nor in school. But there's been a big change in the percent of 16 to 24 year olds who are both in the labor force and in school. Some come from wealthier families, so at the top maybe you have kids working a little bit less. You also have students who are finding it difficult to find jobs and so because they have something else they're doing, being in school, they're not bothering to look. And you have more students staying in school. The high school graduation rate of Latinos in particular has improved enormously over the last few years. So we have more people staying in school. We have more people going on to college and of those people fewer are combining it with work. So that's another part of the decline in labor force participation.

I remember when we got the results from the 2010 census and they counted up all the people in the U.S. and they all of a sudden revised the labor force participation rate down. The press made a big deal of this. But what had happened was they discovered people weren't dying as fast as they had expected them to. The projections of our elderly population had been off because of this staying alive business, and that caused the government to revise down labor force participation because even though ninety year olds are staying alive, they're not going back to work. So there is this trade-off. We should celebrate the fact that people are living longer, but the fact that they're living longer and not working brings down our labor force participation rates.

And it does mean that there's a real challenge around how we support people when they're in retirement for very very long periods of time and what should retirement look like. Older workers have increased their labor force participation, but when I say working more I mean twenty-five percent, not seventy percent. Also, in every down turn there is a cyclical drag on labor force participation. People are smart and they don't bother looking for jobs when there are not a lot of jobs available; likewise, when there are a lot of good opportunities available it draws people out of the woodwork. So we always have higher labor force participation in a boom, and lower labor force participation in a downturn. Since we're recovering now we should be pulling more of those people back in.

All of that said, there is still a group of people that we don't understand why participation has declined. It is a much smaller group than people tend to think, but it is actually the troubling group. These are prime age adults and we're trying to figure out why participation has gone down, and what are the things we can do. Some of it may be due to long term unemployment. So having a lot of churn, having mobility, being able to change jobs, is really important. And this is why the elimination of "job lock" by the Affordable Care Act is probably one of the Act's most important accomplishments. The President thinks giving people health insurance is its most important accomplishment. But as a labor economist, I can tell you that divorcing the job from health insurance is very important to having a healthy labor market. People should choose their job based on where their talents will be best utilized and not on other factors.

SPEAKER: Have you considered the possibility that there are a huge number of jobs for which we don't have trained people -- that there's a real skill gap? Is that part of the problem?

MS. STEVENSON: The administration and the President thinks seriously about the skills needs of our employers and designing training programs to meet those skills needs. And I think understanding the skills needs in the future is extremely important. Now, all of that said, I have looked for evidence of a skills gap and I don't see it. I know that there are employers who wish that they could get workers with certain skills for cheaper, but I think that's always going to be the case. In a true skills gap one of the first things you look for is upward pressure on wages. If everybody's really looking for software engineers and they just can't find them, we should see their wages going up. I've gone through occupation by occupation looking to see which markets are heating up. Who's getting hired the most? Who is batting down job offers because there's so much need for their skills? And it's hard to find those people. There are two forms of mismatch that I see out there. One is that the labor markets have become so complicated and the skills people want become so nuanced that employers have a difficult time finding the people who are a really good match for them. There are now thousands of types of workers, hundreds of thousands that have a specific bundle of skills. The person's out there, but it's becoming more like finding a needle in a haystack.

So I really want to think about what employers should be doing differently, and what can the government do to help assist that matching process. I think we need to make sure that employers and workers can find each other, and the President has called upon the Vice-President to lead this effort. We also need to make sure that we're training people for the jobs that are going to be out there. But if you look at what's holding job growth back in the U.S., I don't think it's that our workers don't have skills. In fact, many of them have incredible skills, and a lot of the long-term unemployed are college grads with really great skills. But older workers tend to have a hard time thinking about how they can use their skills in a different way from exactly the same way they were using them before they left their job. So they keep applying for the exact same job over and over again and they need to broaden their skill base.

But it's also the case that employers do perceive younger workers as being more flexible, and they also perceive workers who haven't been long-term unemployed as less damaged and more flexible. So the White House has led a huge effort to get employers to eliminate hiring practices that discriminate against the long term unemployed. I heard one amazing story from a CEO who said that when he found out that his company was engaging in employment practices that were preventing the long-term unemployed from getting jobs, he asked his HR system to look through all of their hiring practices for the skills that mattered most. He found that people who had volunteer experience tended to be more loyal workers and therefore were less costly. And it turned out the long-term unemployed were more likely to have volunteer experience because they were the ones who had the time. He then asked his HR systems to start positively screening for volunteer experience, which means that he had a good business rationale for not only correcting the bias against the long-term unemployed but actually helping them out. So that's some of what has to happen to get people back to work.

SPEAKER: Is the global economy affecting the unemployment rate? Also, is the extremely low unemployment rate for certain industries evidence of a skills gap?

MS. STEVENSON: We definitely pay a lot of attention to which jobs look like they're going overseas, but actually one of the remarkable shifts in the economy is the returning of jobs that went overseas. Bringing down energy prices has been helpful for bringing jobs back, but also U.S. workers are some of the most productive workers in the world, and they're some of the most skilled, creative workers in the world. And I think a lot of employers have realized that the skills that American workers bring are unique and valuable and not easily sent off shore.

As for the skills gap, every year, no matter what's the state of the economy, no matter how far back we go, lots and lots of employers say I can't find people. It takes workers a long time to find jobs. This is actually why we have this thing called the natural rate of unemployment. We recognize that it takes a while for workers and firms to find each other and you can't make it happen overnight.

And that's a frustrating period. If you're a firm and you want to produce more and sell more, the fact that it's taking you eight weeks to find someone is frustrating. It's also frustrating because it takes real resources.

SPEAKER: Is it possible that the structural unemployment rate is going to be higher because fewer jobs will be created due to automation, robotics and technology?

MS. STEVENSON: In the past, technology has always been our friend. When we have technology, it helps us produce more, and when we produce more we can get paid more. Technology is typically something that helps workers out. There has been concern expressed that this time is different, that technology this time is going to create more unemployment. But I'm a technology optimist. Technology has made me way more productive than an economist thirty years ago and I actually don't even know how I would have been an economist thirty years ago. I rely on downloading the CPS and running the numbers in a half an hour to produce charts, whereas that would have taken a team of people a supercomputer and punch cards. Bu I think we always have to make sure that we're training workers so that they have the skills to be adaptive and move as the economy moves and change jobs and change their skill set as technology changes in order to reap the benefits of technology.

MR. BOSWORTH: We promised to give Betsey a chance to leave on time because she has this endless list of meetings, but I think we have time for one more question.

MS. STEVENSON: Why don't we do two more?

MR. BOSWORTH: Okay.

SPEAKER: I'm on the board of a small liberal arts college and in the last two or three years it's as if people have decided there's a fixed maximum amount they're going to pay for this and it doesn't matter what our sticker price is or what our aid policy is. They are behaving differently. Are behavioral relationships changing because the world's changing around us?

MS. STEVENSON: That's kind of hard to answer. I tend to not put a lot of stock in the idea that human beings dramatically change their behavior quickly over periods of time. People become fixated on certain issues -- what's happening to gas prices, what is happening to college prices, but I wouldn't say that their fundamental behaviors are changing.

SPEAKER: Is there something you can say about the U.S.

attracting foreign, highly educated talent, Ph.D.'s for example, that have been trained in the U.S. Traditionally they might have stayed in the U.S. but perhaps they don't have those opportunities now because of immigration rules.

MS. STEVENSON: CBO has scored immigration reform as something that would help the economy enormously. Highly skilled immigrants are extremely important and I will say that, as a Ph.D., I take for granted my ability to move around the world freely to where my talents are needed. But it's also important that we think about national immigration policy in a comprehensive holistic way, not pulling out high skilled or low skilled workers.

MR. BOSWORTH: Okay, thank you very much Betsey, for that presentation.