VIEWS & VISIONS

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Investing in People for Long-Term Prosperity

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Federal Reserve Bank of Richmond

Jeffrey M. Lacker took office as president and CEO of the Federal Reserve Bank of Richmond in August 2004.

As president, Mr. Lacker serves on the Federal Open Market Committee, which conducts monetary policy for the Federal Reserve. Prior to his appointment, he was a senior vice president and the director of research for the Richmond Fed, a position he assumed in 1999. Mr. Lacker joined the bank in 1989 as an economist, was named a research officer in 1994 and was promoted to vice president in 1996.

Before joining the Fed, Mr. Lacker was an assistant professor of economics at the Krannert School of Management at Purdue University and previously worked at Wharton Econometrics in Philadelphia. He earned a doctorate in economics from the University of Wisconsin and received a bachelor's degree in economics from Franklin & Marshall College.

He is the author of numerous articles in professional journals on monetary, financial and payment economics. From 1992 through 1993, he taught at The College of William and Mary, and in 1997 was a visiting scholar at the Swiss National Bank.

Mr. Lacker serves on the University of Richmond board of trustees and on the board of directors of the Council for Economic Education.

The key to a region's economic vitality is human capital: the knowledge and skills that make people productive. Investment in human capital ensures that we have a skilled workforce, capable of developing and implementing new technologies, and that workers are able to reap the benefits of economic growth. This fact, along with the burgeoning research activity focused on labor market dynamics in the wake of the recent recession, has motivated us at the Richmond Fed to review what the economics literature has to say about enhancing workforce skills. We've identified several key opportunities for improving human capital investment: providing students with a better understanding of college preparedness; informing them about multiple career and postsecondary education options; and laying the foundation for success with early childhood education.

A number of indicators suggest we are failing to keep pace with our economy's growing demand for skilled workers. First, the "college premium" – the increase in wages the average college-educated worker can expect relative to the average worker without a college degree – has been consistently high and rising since around 1980. High dropout rates in high school and college, particularly among low-income and minority students, also suggest that we are not adequately preparing the next generation

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of workers. And, there is substantial anecdotal evidence that employers are having difficulty finding workers with the right skills.

We should be concerned about this for two reasons. First, it has implications for long-run growth in standards of living. There is a consensus among economists that such growth occurs not only because we have more people working or more machines (or, in economic terms, more labor and more capital), but also because technological advances make existing workers more productive. Such advances might be entirely new types of machines, such as the steam engine or the transistor, or they might be new techniques for making existing products.

How and why do such advances occur? There are a variety of economic forces and incentives at work, but a large body of research suggests that human capital is a critical factor. Skilled workers are essential not only to operate new technologies, but also to develop the new technologies in the first place.

The second concern is that the slowdown in the supply of skilled workers affects the distribution of income in our society. Recent data on economic inequality and economic mobility show that inequality has increased in recent years, while mobility has either decreased or remained flat. In other words, the rich are likely to remain rich and the poor are likely to

remain poor. Many factors contribute to inequality and the persistence of that inequality both within and across generations. But, the growing disparity in skill acquisition, often in the form of college education, appears to play a significant role.

The key question is, what can we do to increase the supply of skilled workers? The large increase in the college premium has led many policymakers and educators to advocate college for all. But, the high college dropout rate suggests that many students could benefit from more information about what is required for college success. I also believe we should supplement information about college preparedness with information about other career and postsecondary education options. Community colleges, for example, are a venue where students can learn more about their interests and aptitudes and hone the skills that are required for success at four-year schools. Moreover, there are a range of other post-high school educational institutions that can help students acquire the skills they need to succeed without a college degree.

On the other hand, we can do more to ensure that well-qualified students don't forgo college because of perceived obstacles such as cost or because of social norms that cause them to underestimate the potential benefits or their likelihood of success. Researchers have found that providing these students with targeted information and assistance – a fairly low-cost intervention – can increase their matriculation rates and can play an important role in changing the beliefs of students who erroneously think they're not college material.

So far I have discussed ways to increase cognitive skills, the specific things we learn through formal education or on-the-job training. But, non-cognitive skills such as patience, work ethic and following directions also are critical. These are the skills that make it possible for us to acquire more complex cognitive skills, and they also are critical for success in the labor market. Economists and other social science researchers have come to a consensus that the foundation for these skills is laid very early in life, and that it can be difficult for children who fall behind to catch up. High-quality early childhood education thus should be a crucial – and cost-effective – element of a comprehensive strategy to improve human capital investment.

To sum up, our reading of the research literature supports a balanced portfolio of human capital strategies that address the full range of educational stages and options. I believe these strategies can help not only to increase our nation's prosperity, but also to provide our citizens with the skills they need to share in that prosperity.

Note: The views expressed are those of the author and should not be attributed to anyone else in the Federal Reserve System.