Testimony

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Trends in the U.S. Labor Market and Their Impact on Economic Growth

My name is Stephen Moore and I am a senior fellow in economics at the Heritage Foundation and a former Trump senior economic campaign advisor. In compliance with the Truth in Testimony rules, I wish to report that neither I nor the Heritage Foundation take any federal, state or local government funds.

ECONOMY BOOMING

I am happy to report that the economic situation today in the United States is in many ways healthier than it has been in nearly two decades. The latest forecast from the Atlanta Federal Reserve Bank is that economic growth will exceed 4% in the second quarter of 2018 and may reach 5%. We haven't had growth that high in at least 15 years. The outlook for growth is strong for at least the next eighteen months. Tax cuts and deregulation policies have had a salutary effect on employment and growth.

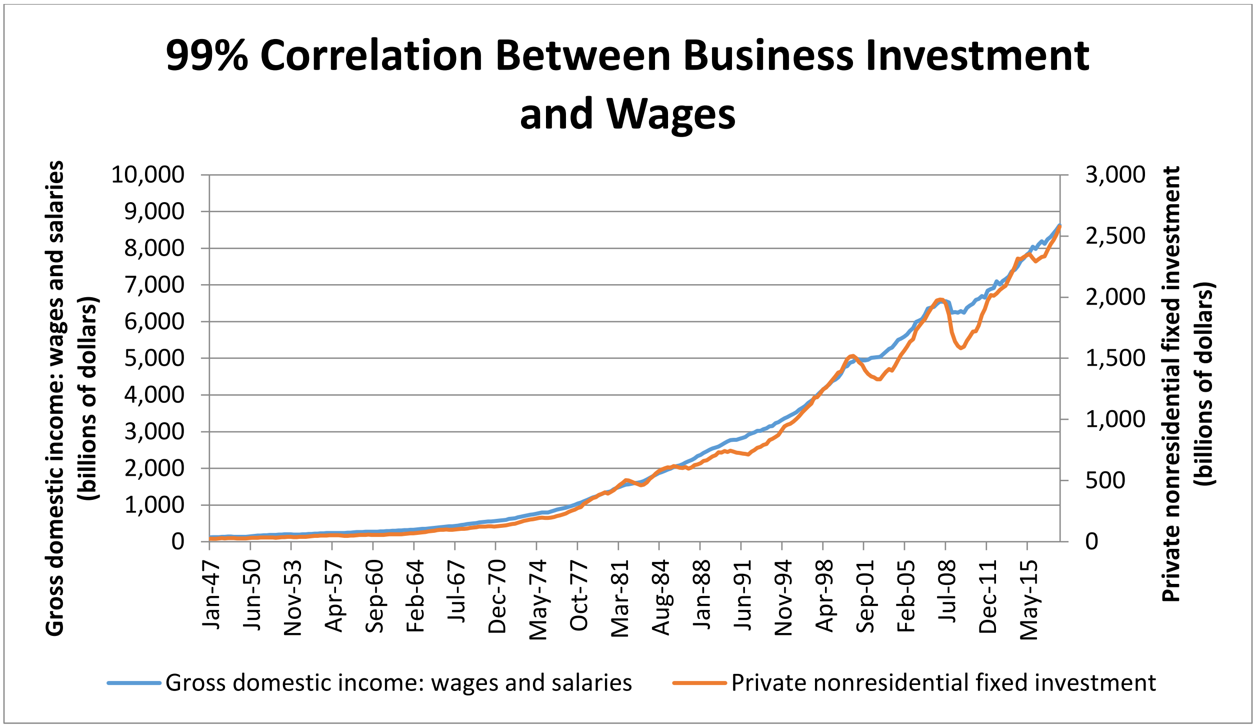
This growth spurt has created a very tight labor market. Bureau of Labor Statistics data tell us that today there are nearly 7 million jobs that are unfilled and fewer than that number of Americans looking for work to fill them. We are, in short, near full employment (4% unemployment rate), as economists conventionally measure things.

I served as a senior economic advisor to the Trump campaign and helped draft the Trump tax plan with my colleague Larry Kudlow, now Donald Trump's National Economic Council chairman. Our mission was to help design policies that would get the U.S. economy back to a sustained 3 to 4% growth path and to help raise middle class wages and salaries, which have been flat since 2000.

Many economists, such as Larry Summers, a former chief economist for President Obama, and Nobel-prize winner Paul Krugman, have argued that 3 to 4% growth will be impossible to achieve and that "secular stagnation" will condemn America to at best 2% growth for the foreseeable future.

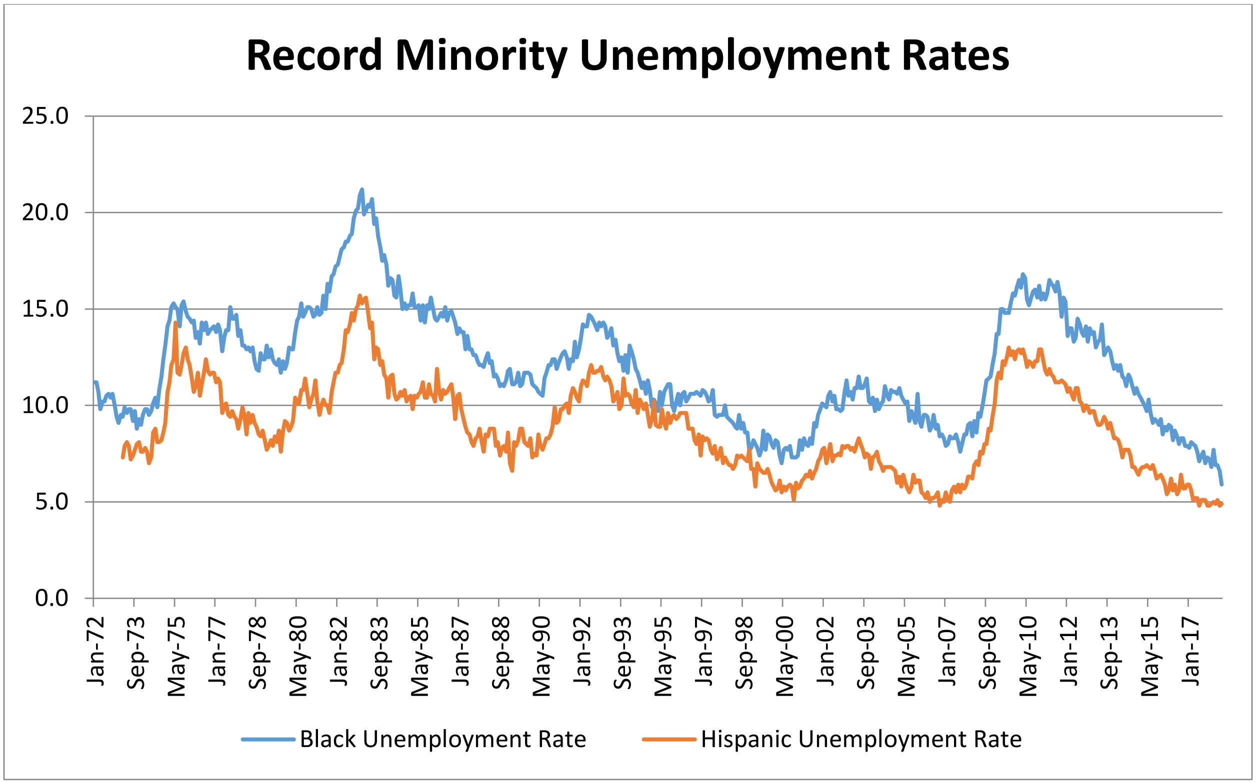
That's clearly wrong. We are already at three percent growth, but the central challenges to sustaining and accelerating that growth rate is 1) increasing the productivity of the workforce, which will raise wages, and 2) incentivizing more working-age Americans, who are sitting on the sidelines to enter the workforce.

The Trump tax cut will help with that first goal. Worker productivity is a function of capital investment. Three features of the Trump tax cut – the new 21% corporate tax rate, the 10% tax on most repatriated capital brought back to the United States, and the immediate expensing for capital purchases – encourage business capital investment. The rate of business investment has risen markedly over the past two years, more than 30%. The attached chart shows that business investment is about 99% correlated with higher wages over time.



MINORITIES HAVE BENEFITTED THE MOST

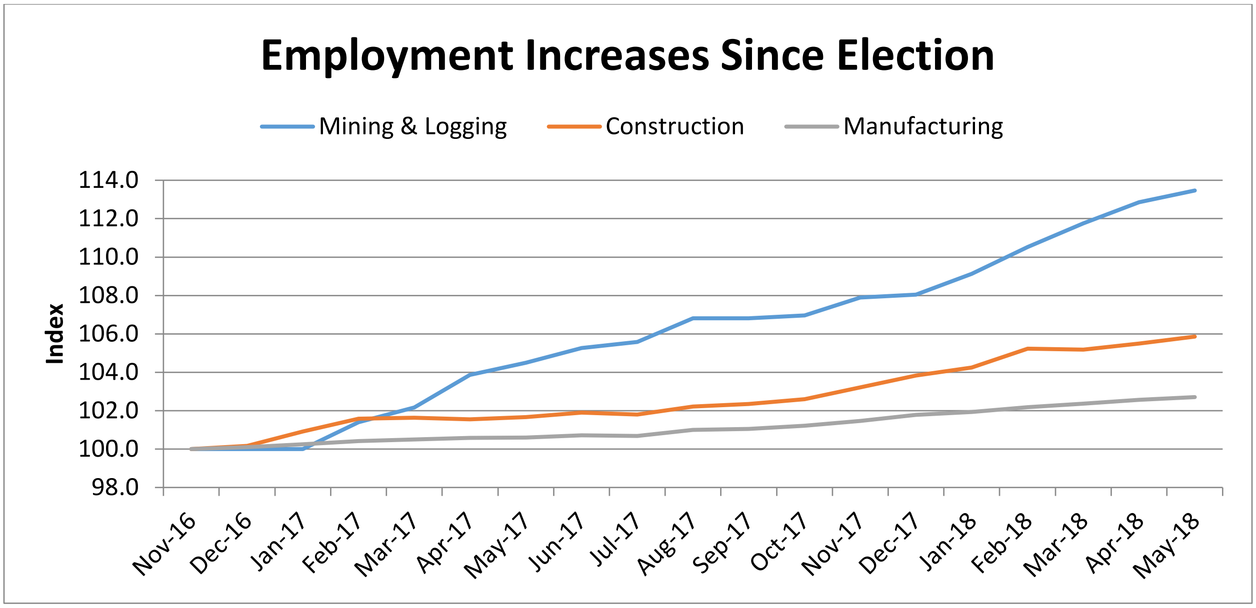
The black and Hispanic unemployment rates have come down the most. For both blacks and Hispanics the unemployment rates hit an all-time recorded low in May of 2018. This suggests that the expansion of the last 18 months has benefited those at the bottom of the income ladder, not just those at the top.



More good news is that we have seen an increase in the black labor force participation rate. This is a sign of economic health for minorities because the percentage of blacks outside the labor force soared during the 2008-09 recession and stayed high through the early stages of the recovery. Minority household incomes actually fell from 2009-14, according to Census Bureau data.

BLUE COLLAR JOBS COMING BACK

President Trump made a priority bringing back middle-class jobs especially in Midwestern states where the recovery was tepid at best. The chart below shows the turnaround in three major areas of blue-collar, middle class jobs where employment had continued to decline or lag behind other industries. These are manufacturing, mining and construction. Between November 2016 and May 2018, the number of new jobs in these industries has dramatically increased, with a net gain of almost 800,000 jobs.



Manufacturing has added 83,000 jobs

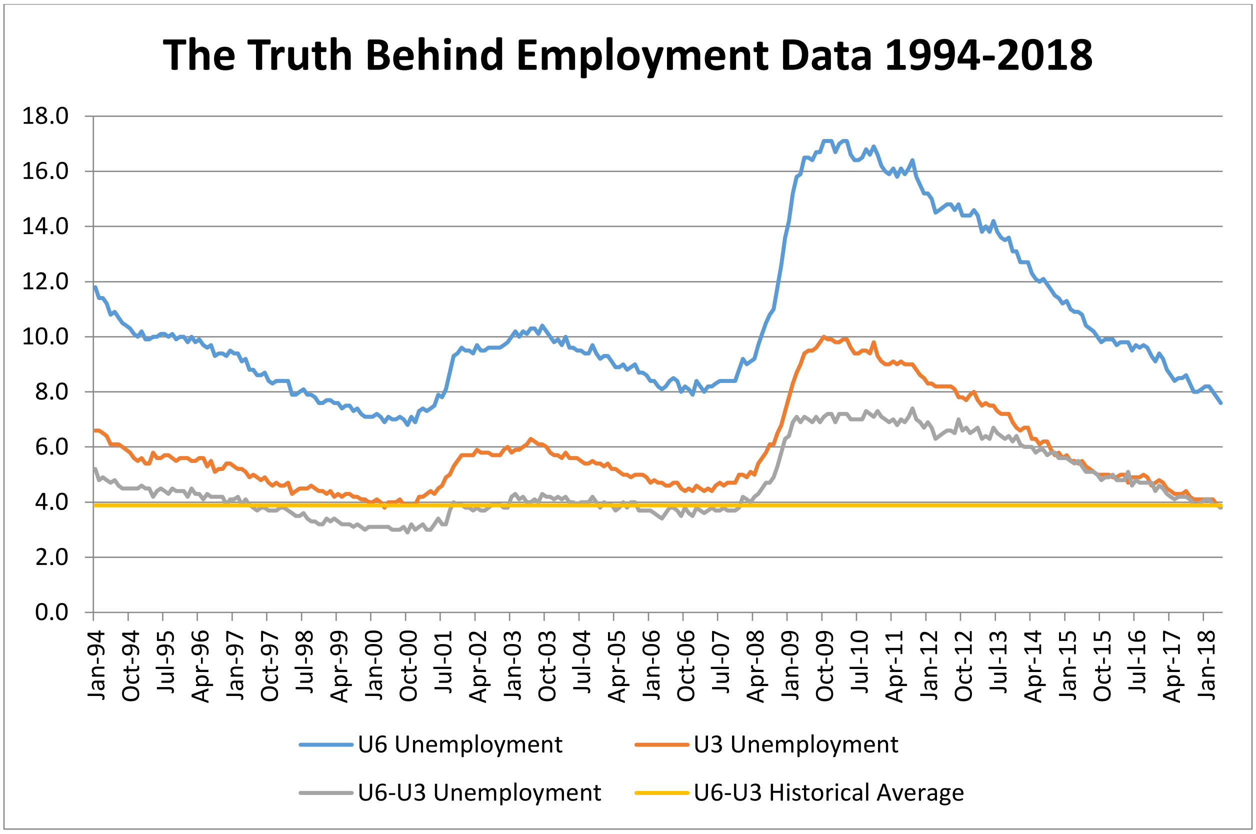
Construction has added 374,000 jobs

Mining and Logging have added 316,000 jobs

LABOR FORCE PARTICIPATION STILL WAY TOO LOW

The major issue confronting this Committee is: How do we get more Americans who could and should be working, into the labor force? In 2015, we reached an unhealthy milestone with just under 100 million Americans over the age of 16 out of the workforce. That number has dropped to closer to 95 million outside the workforce, but is still way too high to maximize our growth potential. The chart below shows the official "headline" unemployment rate, with the U-6 rate, which includes discouraged workers and those who are in part time jobs but want a full time job. It also shows the differential between these two rates.

The U6 rate went up much faster than the official unemployment rate during the recession and the slow recovery. But the U6 rate is still around 8% and there is room for improvement in bringing this number down. The chart below shows the good news that the gap between the U6 and headline unemployment rate (U3) has fallen from as high as 7.5% under Obama to about 4% today. Not only are we creating more jobs, but more full time jobs that pay a full time salary.



WHERE DID ALL THE WORKERS GO?

This presents a conundrum. In the U.S. today, we still have very high numbers of working-age Americans out of the labor force at the same time we have businesses desperately trying to find workers. For example, the Washington Post reported in April that in some areas of the country employers are offering signing bonuses of up to $25,000 for blue collar workers. According to the article:

> *BNSF is offering something rare in blue-collar America: signing bonuses up to $25,000 for hourly workers, including electricians, boilermakers and pipefitters.*
> *"We want to meet our customers' needs, and we're going to do what we need to do to hire for our company," said Amy Casas, the railroad's director of corporate communications.*

The American Transportation Research Institute estimated recently that there were about 60,000 trucker jobs that could be filled tomorrow if workers would take these jobs:

> *"We've probably never had a situation like we have today, where the demand [for workers] is strong and capacity is constrained,"*

says Bob Costello, chief economist of the American Trucking Associations (ATA).

For skilled and reliable mechanics, welders, engineers, electricians, plumbers, computer technicians and nurses, jobs are plentiful. If you're good at a trade and are a reliable worker, in most areas of the country, you can often find a job in 48 hours.

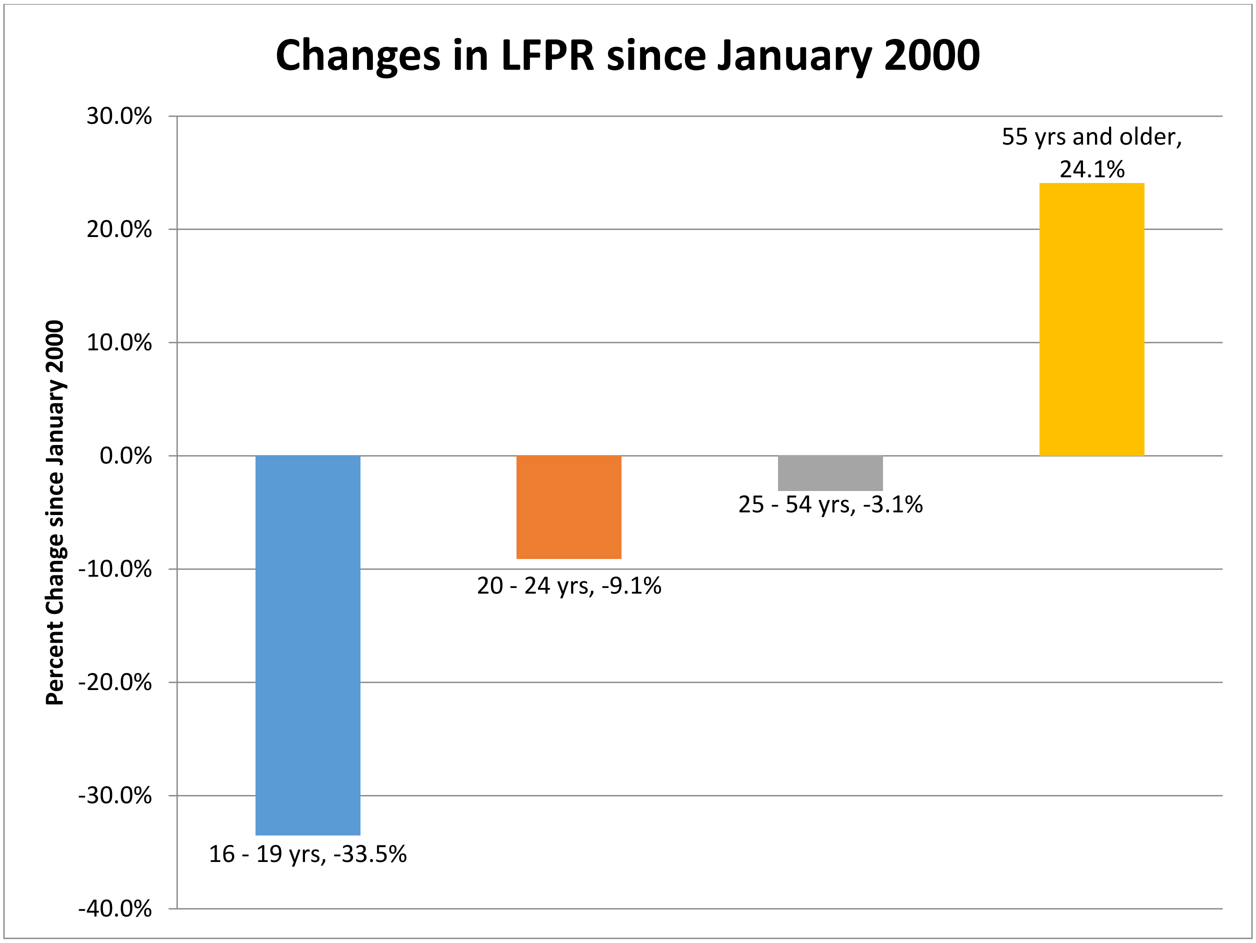
When Wal-Mart announced at the start of the year that starting wages for many workers would rise to $11 an hour — well above the federal legal minimum — they weren't being humanitarians. They were responding to a tightening labor market. Costco, another major employer has raised starter wages to attract and retain workers that are increasingly hard to find.

Where did all the workers go? The labor force participation rate for those 16 + dropped from 65.8% at the start of the Obama presidency to just 62.9% at the end of the Obama presidency and is now just creeping up again.

This is partially explained by baby boomers retiring – at the pace of nearly 10,000 a day. But this excuse masks the real and acute problem afflicting our economy. We've known for decades that some 75 million baby boomers would be retiring in the first two decades of this new century. But if we examine the age-adjusted retirement ages, there is good news with baby boomers. Their age-adjusted labor force participation rate has INCREASED. They are MORE likely to be working past the age of 65 than previous cohorts.

WE NEED MORE YOUNG AMERICANS WORKING

The largest reduction in the workforce has been among the millennials. Under Obama the labor force participation rate for the 16 to 24 age group fell to 55.1% down from 60.8% a decade ago and more than 66% back in the late 1990s. We're headed toward Greece where half the young people don't work. Even workers in their prime working years, the 25 to 54 age group, have seen a slight downturn in work participation.



If the three younger age groups were still at their labor force participation rates from January of 2000, there would be 2.56 million more people working in the 16 to 19 age group, 1.4 million more people working in the 20 to 24 age group, and 3.18 million more people working in the 25 to 54 age group, for a total of more than 7 million more Americans that would be working. That would be more than enough to fill all available jobs, assuming these workers had the skills to take them.

So why aren't Americans of working age filling available jobs — or getting the skills necessary to fill them? I would posit several impediments to putting more Americans back to work:

First, welfare is replacing work. Welfare consists of dozens of different and overlapping federal and state income support programs. A recent Census Bureau study found more than 100 million Americans collecting a government check or benefit each month. The spike in families on food stamps, Supplemental Security Income, disability, public housing and early Social Security remains very high even five years into this recovery. This should come as no surprise given the combination of the scaled-back welfare work requirements and the steep phase-out of benefits as a recipient begins earning income. Economist Casey Mulligan of the University of Chicago has shown that workers with modest incomes and qualifying for an array of welfare programs can lose nearly 50 cents on the dollar for every additional dollar they earn from work. Professor Mulligan found:

> *"a startling amount of work incentives eroded by the labyrinth of new and existing social safety net program rules. Using prior results from labor economics and public finance, I estimate that the labor market contracted two to three times more than it would have if redistribution policies had remained constant, thus altering the path of the economy and making the recession one of the deepest and longest in decades."*

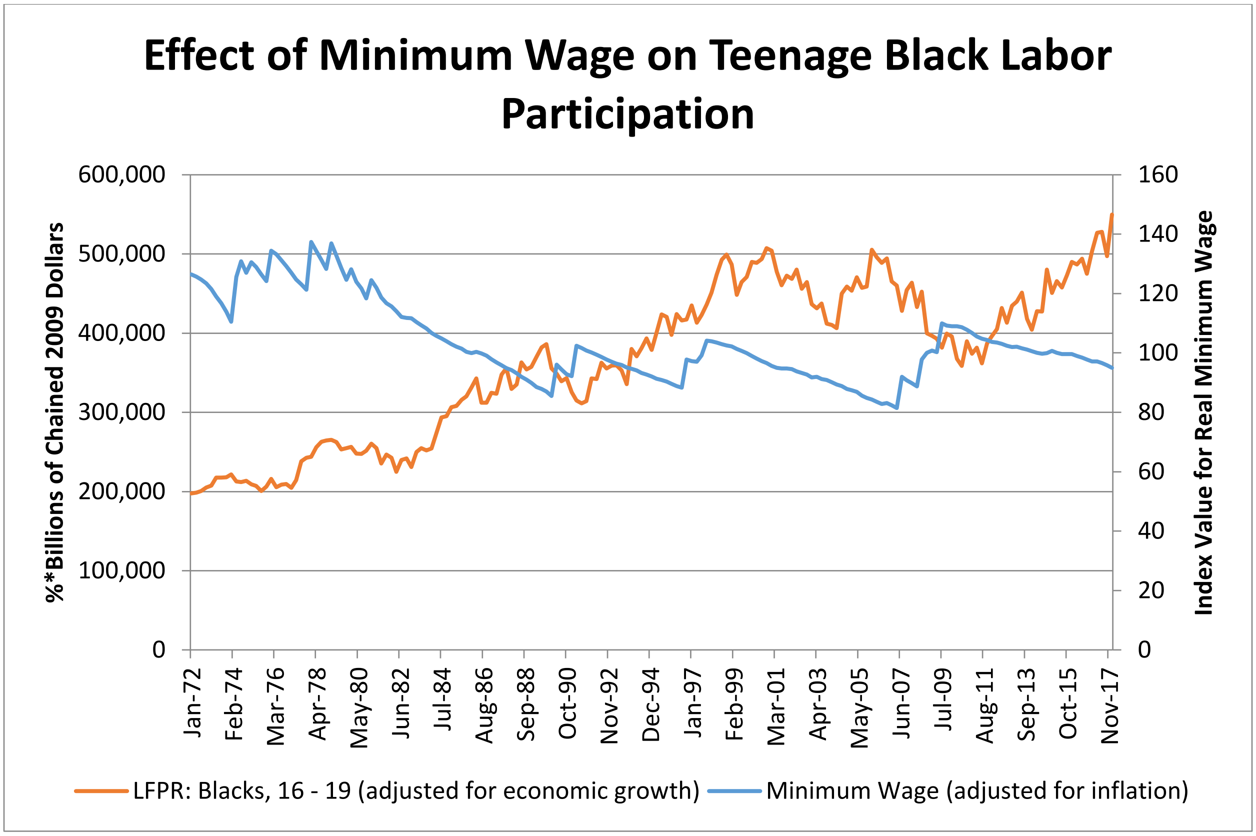
Mulligan found that many workers would only "earn" about $2 an hour extra pay for working rather than staying home. What is disturbing is that to this day, many of these welfare expansions remain in force. For many low-income Americans, work doesn't pay.

Second, there is an ethic in America that young people should get more years of schooling and should not work. I believe that is a completely misguided concept. Yes, of course, more years of schooling is associated with higher lifetime earnings. But the earlier in life one begins working is also associated with higher lifetime earnings and economic success. The academic studies are clear on this point. Developing work skills at an early age may be as important as gaining more years of schooling. Working while in school delivers double benefits. It is especially counter-productive to have college age students completely outside the workplace.

Third, our public school system often fails to teach basic skills. Whatever happened to shop classes? We have schools that now concentrate more on ethnic studies and tolerance training than teaching kids how to use a lathe or a graphic design tool, or bookkeeping and personal finance. Charter schools can help remedy this. Universities are even more negligent. Kids are graduating commonly from four-year colleges with $100,000 or more of debt and little practical or vocational training. A liberal arts education is valuable, but it should come paired with some practical skills.

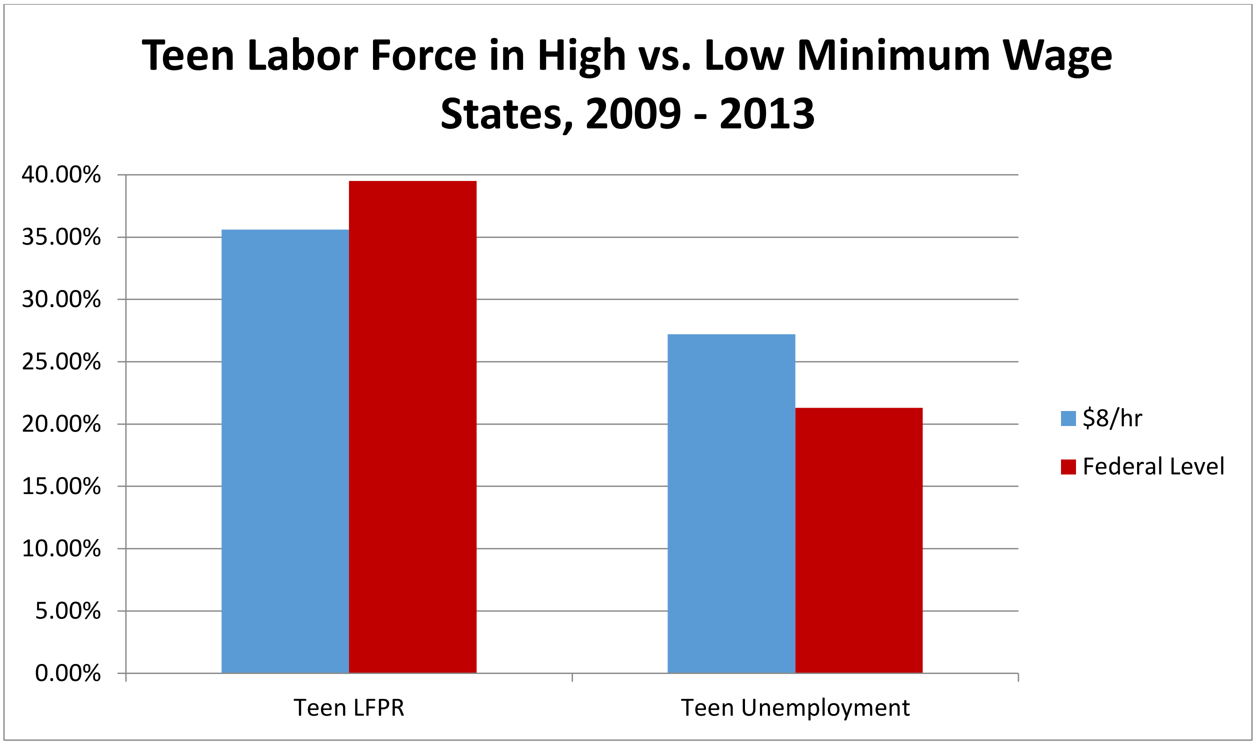
Fourth, there is a pervasive over-emphasis on going to college and negative attitudes toward blue-collar work. I've talked to parents who say they are disappointed if their kids want to become a craftsman – instead of going to college.

Fifth, higher minimum wage laws have a statistically negative effect on labor force participation, particularly among the young, and even more so among black teenagers.



I have conducted my own research on this subject and have followed the economic literature closely. From 2009 to 2013 (right after the federal minimum wage was raised) 8 states had a minimum wage averaging $8 or higher. In those states the teen labor force participation averaged 35.6%. Teenage unemployment averaged 27.2%. In the 31 states which did not exceed the federal level, the labor force participation rate was nearly 4 percentage points higher (39.5%) while the unemployment rate was nearly 6 percentage points lower (21.3%). These are big statistical differences.

A more complex analysis we conducted at Heritage for 2009-2013 for all 50 states and the District of Columbia shows a small negative correlation between labor force participation and minimum wage (-0.14) for those age 16 to 19. There is a larger positive correlation between teen unemployment and minimum wage (0.36). Over a longer period (1999 to 2013), the correlations are nearly the same at -0.15 and +0.32, respectively. In short, higher minimum wages correspond with lower labor force participation and increased unemployment amongst teenagers.



Texas A&M University Economists Jonathan Meer and Jeremy West recently published a 2014 study through the prestigious National Bureau of Economic Research (NBER) "indicating that job growth declines significantly in response to increases in the minimum wage…" Additionally, the economists found this decline in jobs growth to be "primarily driven by a reduction in job creation by expanding establishments, rather than by an increase in job destruction by contracting establishments." The study by Meer and West concluded that "the effect on job growth is concentrated in lower-wage industries and among younger workers."

My point is that one of the single greatest constraints on economic growth and prosperity for American families is the falling labor force participation rate. Some of this is due to rising affluence – that as Americans get richer, they work less. But some of it is due to poor policy decisions by Congress that inhibit work. If you tax something, you get less of it. If you subsidize something, you get more of it. We tax work and subsidize non-work and we are paying a price for these poor decisions.

REFORMS IN LABOR POLICY TO ENCOURAGE WORK

In closing, I would suggest the following reforms in labor policy:

1) Reinstate the work for welfare requirements of 1996 that helped pull Americans out of welfare dependency and into the workforce. These helped reduce welfare caseloads in the late 1990s by half and those who moved into work, generally, moved up the economic ladder.

2) Impose work requirements on all welfare programs including Medicaid and food stamps for all able-bodied recipients.

3) Create a new teen federal minimum wage at $5 to $7 an hour to encourage young workers to get job experience.

4) Encourage apprenticeship programs that would give young Americans a “college degree equivalent” for successfully learning a useful trade. President Trump has proposed such changes.

5) Make the Trump tax cuts permanent, especially the immediate expensing provisions that encourage business capital spending.

6) Allow employers to “opt out” of ObamaCare mandates and requirements if they provide lower cost health insurance coverage to their workers. ObamaCare has corresponded to about a $3,000 rise in health insurance premium costs with more escalations expected in 2019 and 2020. These higher insurance costs to employers are crowding out pay raises for workers and thus reducing work incentives.

The great American work ethic has not been lost, but it has been eroded by years of dumb government policies that could and should be corrected.