Investing in People as an Economic Growth Strategy

It might not be obvious why the president of a Federal Reserve Bank would be interested in workforce development — what does it have to do with interest rates and inflation? But workforce development is intimately related to part of the Fed's legislative mandate, which is promoting maximum employment. That has proven to be a difficult task in the wake of the 2007-2009 recession, as I'm sure you are all too aware. This has led me and other policymakers to ponder a difficult question: Given the limitations of monetary policy, what can be done to improve labor market outcomes in the long run?

At the Richmond Fed, our research suggests that much of what we're currently seeing in the labor market reflects structural trends rather than a primarily cyclical change in labor market behavior. That has prompted us to think about long-term strategies to prepare workers for the labor market. We've been thinking about workforce development at the level of the individual: What can be done to improve people's skills and adaptability, which economists call "human" capital?

To think about those strategies, it's helpful to begin in the early 1960s, when economists began seriously studying the forces and decisions that lead people to differ in their capabilities. They proposed thinking about knowledge and skills as simply another form of capital that makes workers productive, just like physical capital such as machines or computers. Workers acquire this human capital by making investments, such as attending school, getting on-the-job training, or even receiving medical care.

More recently, a consensus has developed that human capital is more than just the number of years spent in school or on the job. Research suggests that noncognitive skills — such as following instructions, patience, and work ethic — lay the foundation for mastering more complex cognitive skills and may be just as important a determinant of future labor market success. These basic emotional and social skills are learned very early in life, and it can be difficult for children who fall behind to catch up: Gaps in skills that are important for adult outcomes are observable by age 5 and tend to persist into adulthood.

What does the economics of human capital imply for workforce development programs? Several insights are especially relevant. First, it makes economic sense to concentrate intensive human capital investment in the form of formal schooling on the young: The earlier workers invest, the longer they have to profit from their investments. In addition, because earnings typically increase with age, young people attending school tend to sacrifice less by way of forgone earnings than older workers. Another key takeaway is that investments in early childhood can affect later decisions about formal schooling. If the foundations for learning are laid very early, then even mild delays in acquiring noncognitive skills might make skill acquisition more challenging later in life; after all, why try as hard to get good grades, stay in high school, or enroll in college when those efforts might not pay off?

Human capital economics also implies that higher education should lead to higher future wages, both because education is costly to acquire and because it can elevate a person's productivity. Indeed, the data confirm that the payoff to education is quite high.

Just as this view of workforce development points toward investment early in life, it also points toward the challenges confronting later interventions. Asking adults to reinvent themselves in the face of a relatively short remaining working horizon, when early retirement and exiting the labor force become viable options, is asking a lot of both the workers and the workforce development professionals who train them. And, indeed, research suggests that workforce development efforts that focus solely on training or retraining adult workers might have only modest effects on employment and job retention.

Of course, this does not mean that adults cannot or should not learn new skills; I am deeply sympathetic to the plight of workers who have been laid off from jobs they performed admirably for decades, and I commend those who wish to complete or further their education. But we may need to be cautious about treating older workers' difficulties as remediable through training, when the appropriate course of action may actually involve greater use of the social safety net.

We may be able to help a large number of future workers, however, by expanding our focus and thinking about workforce development not as a cure for the short-term shocks that individuals may experience, but rather as a long-term vaccine that will protect them against future shocks. **EF**

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This message was excerpted from a speech delivered June 26, 2014, and appears here as condensed by the *Washington Post* on July 14, 2014.