



# Minnesota state economist Laura Kalambokidis

Tightening labor market means state cannot afford to leave any workers on the sidelines

A Civic Caucus Focus on Human Capital Interview

*January 9, 2015*

## Present

John Adams, Dave Broden (vice chair), Pat Davies, Paul Gilje (executive director), Randy Johnson, Dan Loritz (chair), Dana Schroeder, Clarence Shallbetter, Fred Zimmerman. By phone: Janis Clay, Paul Ostrow.

## Summary

The aging of the population is resulting in a slowing of labor force growth in the U.S. and in Minnesota, according to Minnesota State Economist Laura Kalambokidis. This slower growth is one of the reasons that, while forecasters still expect growth in U.S. GDP over the next year, the rate of that growth will be slower going forward than forecast earlier.

Kalambokidis reports that the average annual growth in Minnesota's labor force was 0.9 percent from 2000 to 2010, but that figure is predicted to fall until it reaches an average annual growth rate of 0.1 percent between 2020 and 2025. With that slower labor force growth, she says, improving productivity (output per person) will be key to keeping Minnesota's economy healthy.

Kalambokidis says Minnesota's low unemployment rate, low layoff rate, high job vacancy rate, and the high and increasing average number of hours worked per week in the private sector all point to a tightening of the labor market in Minnesota and more competition for the workers we have. But, she notes, the wage growth these conditions were expected to bring did not occur in 2014 and will be lower going forward than forecast earlier.

She confirms that with its tightening labor market, Minnesota will be in competition with all other states for workers, since other states, too, face the same challenges. She's optimistic about Minnesota's economy, but cautions that going forward, the state is looking at a labor market where we need *everybody* in the game and no groups of people on the sidelines.

## Biography

Laura Kalambokidis is Minnesota State Economist, a position she has held since July 2013. In that position, she heads Economic Analysis at the Minnesota Department of Management and Budget (MMB), which is responsible for producing and presenting the state's revenue and economic forecasts.

She is also a Professor in the Department of Applied Economics at the University of Minnesota and an Extension Economist there. She teaches public finance and does research on a range of federal and state tax issues. Her current research concerns tax incentives for economic development, state business tax policy and subsidies for charitable contributions.

Kalambokidis was a member of the Minnesota State Budget Trends Study Commission in 2007-2008 and the Minnesota Tax Expenditure Review Study Group in 2010-2011. Prior to joining the University of Minnesota, she worked as a financial economist in the U.S. Department of Treasury's Office of Tax Analysis, where she provided economic analysis of tax policy issues and developed models to estimate the revenue effects of proposed tax changes.

She holds a Ph.D. in economics from the University of Michigan and an undergraduate degree in economics from the University of Minnesota.

## Background

Since the Civic Caucus issued its [statement on human capital](#) in September 2014, it has concentrated on learning more about the challenges to maintaining a strong workforce in Minnesota in the coming years. The Civic Caucus interviewed State Economist Laura Kalambokidis to get her perspective on the implications of a slower-growing workforce for Minnesota's economy.

## Discussion

**The U.S. economy and the Minnesota economy are closely tied.** According to State Economist Laura Kalambokidis, much of the volatility in the Minnesota economy is connected to volatility in the U.S. economy. The state released its latest economic forecast on December 5, 2014. The U.S. economic outlook has weakened since the last state forecast in February 2014, so while forecasters still expect growth in the U.S. GDP over the next year, the rate of growth will be slower going forward than forecast earlier.

The 20-year average annual growth in U.S. real GDP prior to the 2008-2009 Great Recession was 3.1 percent. In February 2014, real GDP growth was forecast to be equal to or above 3.1 percent for the next three years: 2015, 2016 and 2017. As of November, however, the real GDP growth forecast for those three years is now 2.6 percent, 2.8 percent and 3.0 percent, respectively.

**One of the reasons for the slower rate of growth in the U.S. economy is a slowing in the nation's labor-force growth.** Kalambokidis said the aging of the population is resulting in slower labor-force growth in the U.S. and in Minnesota. From 2000 to 2010, the average annual growth in Minnesota's labor force was 0.9 percent. This figure is expected to drop to 0.5 percent for 2010 to 2015, to 0.3 percent for 2015 to 2020 and to 0.1 percent for 2020 to 2025.

With the lower labor-force growth, productivity growth will be a key element in keeping the economy healthy both in Minnesota and in the U.S., she said. In order to produce the same amount of output with fewer people, the output per person must increase.

**Minnesota's distribution of employment across industrial sectors is diverse and very similar to that of the U.S. as a whole.** Kalambokidis said there are, however, several key sectors in which we're different from the U.S. "We're overrepresented in the health care sector," she said. "Health care and private education is the largest industrial sector in Minnesota." She called that positive, because that sector grew during the recovery.

She said Minnesota is also overrepresented compared with the U.S. in durable and nondurable manufacturing, but not as much as some other Upper Midwest states are. The manufacturing sector added jobs in Minnesota during the recovery and is continuing to add jobs.

**Minnesota will be in competition with all the other states for workers.** Kalambokidis said there is already a labor-force tightening in Minnesota. She pointed out that Minnesota has recovered all the jobs it lost during the recession. Minnesota's unemployment rate is 3.6 percent (seasonally adjusted), compared with 5.6 percent for the U.S. The 3.0 percent November 2014 unemployment rate in the Minneapolis-St. Paul metropolitan region was the lowest in the country among large U.S. metro regions. The unemployment rates in all of the state's major regional metro centers fell between November 2013 and November 2014. And the number of unemployed people in the state is falling.

The layoff rate is very low right now, the number of hours worked per week in the private sector is high and the job vacancy rate is high, she reported. The average number of hours worked per week in the private sector in Minnesota is 34.4 hours, which Kalambokidis called high. And she said it's increasing, as employers are adding hours.

"All of those things are pointing to a tightening of the labor force and competition for the workers we do have," she said. Those conditions should bring about wage growth, but that didn't happen in 2014. "We still expect wage growth to accelerate, but we're forecasting lower wage growth now, since the wage growth we forecast for 2014 did not take place," she said.

An interviewer pointed out that while wages may not have grown, total compensation has grown, as health care benefit costs continue to increase. Kalambokidis replied that there might be some shifting between wages and total compensation. She also said that during the recovery from the Great Recession, many part-time and temporary jobs were added, which typically pay less.

**In some sectors, wages need to come up before we can be sure there's a skills gap.**

Kalambokidis said in theory, excess demand for labor should mean employers raise wages. Workers are then attracted to that sector. If they don't have the skills to work in that industry, they would seek the necessary training. "That's the way we would expect this to happen," she said.

"When that doesn't happen, we ask, 'Is there some reason people are not seeing that wage signal? Is the wage signal not there? Or is there a barrier to people getting the training they need to move into that industry?'" Kalambokidis asked. She added that transition costs can keep this process from happening smoothly.

**The disappointing wage growth is not unique to Minnesota; it's true nationally.** Some of the explanations offered for this, Kalambokidis said, are (1) that the jobs added during the recovery are lower-paying than the jobs lost in the recession; (2) that younger people are paid less than the older, more experienced people who are retiring; and (3) that during the recession, employers didn't bring workers' wages down that much, so now they don't have enough room to raise wages.

"We do anticipate wage growth," she said. "We just had to lower the forecast rates of growth, because wage growth didn't materialize in 2014."

**In order for Minnesota to meet the supply challenge of slowing labor force growth and still thrive economically, we will need to increase the productivity of the workers we do have.**

**In some industries, technology has brought productivity up enough that we don't need as many people in those sectors.** Kalambokidis offered the example of agriculture, where capital has replaced labor to a large degree.

**In the on-demand economy, people are using technology to match service needs with workers.** Kalambokidis said people with available time, skills and equipment are matched to employers who need those things. "From an economist's standpoint, this is grand," she said. "It takes excess capacity and uses it. It offers people flexibility in choosing where they work and when they work. It's important and increases efficiency. It's just part of the shift the U.S. economy has made away from a goods-producing economy to a service economy. The on-demand economy is about services. But the on-demand economy is not creating high-paying jobs; it's creating efficiency in lower-paying jobs."

**The choices that leaders make today will influence the state's ability to thrive in the future.**

Kalambokidis is referring to government leaders, business leaders, community leaders and organization leaders. She said we must make investments in the future to increase productivity.

- Investments in educating the workforce will bring benefits, from early childhood to technical education to retraining people so they can move from sector to sector.
- Health of the workforce will be important to productivity.
- Innovation and technology that improve productivity will help.
- Investing in infrastructure is important. Getting people from where they live to where they work more efficiently will increase productivity.

- Infrastructure is also important to moving goods. Manufacturing jobs have helped Minnesota recover and we need to be able to move commodities around the state. This is particularly important to Greater Minnesota.

She said leaders must also resolve to leave no worker or entrepreneur behind and to reduce uncertainty for business.

**Manufacturing in Minnesota has more than recovered the jobs lost during the recession.**

Kalambokidis said Minnesota has outperformed some other places in that regard. One reason for that is nondurable manufacturing, which in Minnesota is dominated by food production, which is growing.

**Where you can charge user fees for public goods, you should do so, because it's more efficient.** Kalambokidis said, however, there are limitations to that principle. Sometimes limitations to technology make it too inefficient to charge user fees. Sometimes it's too difficult to tell who's benefitting from a general public good to charge user fees. Also, if providing a public service, like public transportation, to an underserved or low-income portion of the community is benefiting the whole community, we consider it unfair to charge user fees to those using the service.

"The benefits-received principle is the ideal where we start, but let's fully recognize that in the real world there are limitations on our ability to do that," she said.

**The fact that Minnesota has a diverse economy serves all of us, because a more diverse economy is more resilient in downturns.** Kalambokidis pointed out that with a diverse economy, if one sector is contracting and releasing workers, another part of the economy might be expanding and hiring workers. She said it's easier to recruit workers if there is economic diversity in a metropolitan area, since the workers may have spouses who will find it easier to get jobs. Also, it's less risky for workers to move to an area that is economically diverse than to a one-company town.

**On net, Minnesota loses people to other states through domestic migration.** Kalambokidis said in the U.S., people tend to move from the Northeast and Midwest to the South and West. But looking at overall migration, international and domestic, Minnesota gains people on net, because international migration into the state more than makes up for domestic migration out of the state. From 2010 to 2013, Minnesota gained a net of 11,935 people through international migration and lost a net of 4,358 through domestic migration. So, the state posted a total net gain of 7,577 from all migration.

She said Minnesota is in the same situation as a lot of other states, facing the challenge of an aging population and slowing labor force growth. Like Minnesota, they're all going to try to attract productive workers to their states. "Not every state's going to win that," she said, "because there are only going to be so many people to go around."

**Going forward, Minnesota is looking at a labor market where we need *everybody* in the game.** "We can't afford to have groups of people on the sidelines," Kalambokidis said. "Who's on the sidelines that we need to draw into the game? The unemployed, especially groups like African Americans and Hispanics with high unemployment rates. Let's get all those people into the labor market."

She said Minnesota must be a state where people want to live and work and do business, with the natural and cultural amenities that attract people to the state. We should also be looking at drawing older people and disabled people into the workforce, she said.

**The employers who will thrive in the future in Minnesota are the ones who can attract, train and retain workers.**

**Minnesota has limitations and challenges, but it also has a great number of assets.**

Kalambokidis said she is optimistic about Minnesota. The limitations and challenges facing the state include an expected slower GDP growth in the U.S. and the fact that lots of other states are facing the same situation of slowing labor-force growth. But, she said, the state also has a number of assets: a strong, diverse economy; a more educated and trained workforce; and natural and cultural amenities that make Minnesota a place where people like to live.