President's Message

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Decline in Labor Force Participation Could Lower Standard of Living

The United States is at a turning point in labor force participation. For more than 50 years after World War II, the percentage of the working-age population (16 and older) in the labor force rose each year. Since 2000, this number has teetered up and down, but the trend is most certainly downward.

The explanations for this reversal are both obvious and, perhaps, surprising. The consequences are much less clear.

As one might guess, a major portion of the decline in labor force participation is due to the baby boomers, who have finally started to retire in droves. So many are kicking off their wing tips in favor of Birkenstocks that even the large influx of immigrants can't make up the difference. Contributing unexpectedly to this decline in labor force participation is the American teenager. Fewer are working because—hold on to your hats—they apparently are listening to their elders and staying in school.

What all this means is that fewer workers are producing income and output relative to the total number of U.S. residents. Because the output of each worker must sustain the consumption of a larger number of individuals, maintaining the per capita standard of living in this country will become increasingly difficult.

Making matters worse, tax revenue will grow more slowly as labor force growth slows. Not only will Social Security and Medicare finances become strained, but all growth in total discretionary government spending, including that for the military, may have to be cut back.

The possible solutions to these problems are many. The government could cut spending and/or increase taxes. Baby boomers could be persuaded to stay on the job a bit longer. (Some already are, and for a variety of reasons—they need health insurance, they lost their pension, they fear cuts in Social Security or, simply, they feel too young to end their careers.)

Boosting productivity could also compensate for the loss of workers. A better educated workforce would go a long way toward obtaining more output per hour of labor input. (Think of those teens who are staying in school.) An increase in research would help, too. One study says that half of the economy's growth in the second half of the 20th century can be linked to rising research activity. To transform research results into production, entrepreneurs need the right conditions (less regulation, adequate financial rewards). Finally, increased saving by both individuals and the government could help provide sufficient capital for offices, factories and equipment—all of which are needed to boost production.

Because the slowdown in labor force growth is still quite new, there is much uncertainty about what's actually happening. For example, job growth has been falling over the past 10 years, from about 250,000 jobs a month to maybe half of that today. Such changes concern those of us in charge of monetary policy because we believe full employment goes hand in hand with price stability. The creation of only 70,000 jobs a month would have triggered fears of a recession in the past—and would have set off appropriate actions by monetary policymakers. But next year, 70,000 new jobs a month might be enough to constitute full employment—if there truly are far fewer people in the workforce.

So as not to needlessly stimulate or rein in the economy, policymakers will have to hunt hard for better scraps of information to supplement the standard labor force statistics released every month.