# Long-Term Trends in the U.S. Labor Force and Implications for Policymakers

Remarks By

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Good morning. First, let me thank the organizers: the Finnish Government, Governor Rehn and his staff at the Bank of Finland, and the Global Coalition on Aging for inviting me to participate in this very important forum on the Silver Economy. It is an honor to join with these experts who bring insight to both the challenges and opportunities we are going to face with an aging population.

Certainly, demographic trends are reshaping the U.S. labor force, and it is leading economists and policymakers to rethink the key macroeconomic parameters that drive our decision making. Monetary policymakers, like myself, have had to reassess their views about the economy's longer-run growth potential, the natural rate of unemployment, and how we think about interest rates.

Like melting glaciers, the changes in global demographic trends are often difficult to see in the near term, but over time they will reshape the landscape. Looking over the past quarter century at the U.S. economy, structural changes have only gradually reduced the economy's potential growth rate, its natural rate of interest, and unemployment, but they must be considered in the context of how we respond to business cycle fluctuations and potentially underlying inflation.

I'd like to make three brief observations about these demographic trends affecting the labor force's composition, the job market, and the housing market. Then I will briefly describe some of the challenges monetary policymakers face as they confront these trends.

<u>Long-Term Trends in the Composition of the U.S. Labor Force</u>

First, the age of the labor force in the United States has changed significantly over the past 25 years. The share of older individuals (age 55 and up) in the labor force has continued to increase. Twenty-five years ago, older individuals made up roughly 10 percent of the workforce; today, that share has more than doubled to over 20 percent. At the same time, the shares of prime-age (age 25 to 54) and young individuals (age 16 to 24) in the labor force have declined. These demographic factors, particularly the increasing share of the older so-called baby-boom generation that are retiring, continue to put downward pressure on labor force participation.

Starting in the last recession, we saw that labor force participation rates declined steadily. Over the past five years, the participation rate has stabilized as market conditions have improved and boosted participation enough to offset some of the downward pull from an aging population.

One of the important implications of these long-term demographic changes relevant for policymakers is related to what is known as the trend unemployment rate. The unemployment rate tells you something about the health of the labor market today, but where it stands in relation to what we think of as a natural rate – or a trend unemployment rate – is far more informative for policymakers. Research by my own staff at the Kansas City Fed shows that the changes in the age and skill composition of the labor force have systematically lowered the trend unemployment rate over the past 25 years.[1]

As these estimates of the natural rate of unemployment have declined, the scope for monetary policy to foster lower rates of unemployment without generating inflationary pressures has increased. Of course uncertainty about exactly where those natural rates of unemployment might currently lie requires us to be cautious, examine a wide range of information and continually update the parameters we use as new data arrive.

[1] Tüzemen, Didem. "Job polarization and the natural rate of unemployment in the United States." *Economics Letters,* 175 (2019): 97-100.

Job Polarization

My second observation is that this shift in the composition of the labor force to older workers has coincided with dramatic changes in skills demanded by employers. This change, due to technological advancements, has resulted in a phenomenon known as job polarization. More specifically, job opportunities have shifted away from middle-skill occupations that lead to a middle-class standard of living and toward high- and low-skill occupations.

Skills demanded in the labor market are rapidly changing, and technological advancement has rendered the skills of many less-educated workers obsolete. As we've witnessed in the U.S., this lack of job opportunity, in turn, may lead to depression and illness among displaced workers, and these health conditions may become further barriers to their employment. Equipping workers with the new skills employers are demanding in the face of rapid technological advancements continues to be a key issue for labor force participation and policymakers.

Demographic Forces and the Housing Outlook

Finally, my third observation relates to how these demographic forces are interacting with, and influencing the outlook for, key sectors of the U.S. economy. In the housing sector, for example, a combination of forces has resulted in high levels of housing prices and rents. These high prices disproportionately impact younger adults, and as a consequence younger adults are delaying forming their own households. For example, the share of adults in their late twenties through late thirties living with their parents has increased steadily. This delayed household formation is also likely contributing to young adults delaying marriage and having children.

Looking forward, downsizing by baby boomers could significantly increase demand for new multifamily construction, especially in metropolitan suburbs. This downsizing, together with the mortality associated with age, would be expected to free up existing single-family homes for re-occupancy. Younger households who move into these homes from rental units will in turn free up multifamily units for newly forming households.

With housing being a key fulcrum of monetary policy and a sector we know can be prone to boom and bust cycles, these developments will require careful monitoring.

## Implications for Monetary Policy

This brings me to the implications of demographic change and other key structural economic relationships for monetary policy.  We have already seen this play out at the Federal Open Market Committee in terms of revisiting our estimates of economic parameters. For example, according to the Federal Reserve's Summary of Economic Projections, popularly referred to as the "dot plot," the median projection for the long-run growth rate of real GDP has come down, the median projection for the long-run unemployment rate has also fallen dramatically and the median projection for the long-run interest rates has come down notably.

Understanding of course that considerable uncertainty remains around these estimates, policymakers must remain attuned to changes in macroeconomic trends such as aging demographics if we are to achieve our objectives for the economy.