The Baby-Boom Boom

Despite a recent slowdown, the U.S. economy has achieved its longest period of sustained growth on record. In particular, the American economy has prospered since 1997 with relatively low inflation, despite the unemployment rate remaining consistently below 5 percent. How could this be? Economists previously estimated the natural rate of unemployment to be between 5 and 7 percent. Standard economic intuition suggests that when unemployment persists below the natural rate, inflation will increase. One explanation is that “New Economy” technological advancement has lowered the natural rate of unemployment. An alternative explanation contends that the natural rate depends on the composition of the labor force.

In 1985, 28.3 percent of the labor force was over age 45; in 2000, that share is estimated to be 34.4 percent (according to the Current Population Survey). This shift reflects the aging of the baby boomers, who are now between the ages of 36 and 54. The projection for 2005, given current population trends, is that 37.4 percent of the labor force will be over age 45. What impact does this change in the makeup of the workforce have on the economy? Consider both the NAIRU\(^1\) and the median age of the U.S. labor force depicted in the accompanying figure. On average, unemployment rose during the 1970s as the baby boomers entered the labor force and the median age of the labor force declined. Since 1980, as the baby boomers have entered middle age, the median age of the labor force has risen while the trend unemployment rate has fallen.

What accounts for this apparent relationship? Two effects are observed as workers age. First, employers can more easily evaluate a worker’s skills and productivity, based on work experience. Second, older workers are more likely to be matched with suitable employers for the long term. Poor matches are severed relatively early in people’s careers, and new relationships are formed. As workers mature, it becomes more likely that their job matches survive. An aging workforce implies less transitional unemployment—less shifting to find the optimal match. Employment data appear to verify this phenomenon. Since 1960, in the United States, the unemployment rate for workers under 45 has been significantly higher than the rate for those over 45. One study indicated that the aging of the baby boomers can account for a reduction in the natural rate of unemployment of 1.45 percentage points between 1980 and 1993.\(^2\)

One does not have to attribute all of the apparent reduction in the natural rate of unemployment to “New Economy” technologies. The natural rate of unemployment appears to be subject to demographic changes in the same way that the crime rate depends on demographic factors. If this is true, the economy could be riding a wave of low unemployment for some time, notwithstanding any cyclical downturns the economy might face along the way.

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\(^{1}\) Nonaccelerating inflation rate of unemployment, a commonly used measure of the natural rate of unemployment, from the Congressional Budget Office.