Where Have All the Workers Gone?
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We are now five years and four months removed from the previous business cycle peak in December of 2007, and by some indicators the economy has yet to regain the lost ground. This is not surprising given the length and severity of the recession. The recession, from peak to trough, lasted 18 months, making it the longest in the postwar era. It was also the most severe postwar recession with output falling 5.1 percent and employment falling 6.3 percent; both of which are outliers compared to the other recessions. Output or real gross domestic product rebounded to its 2007 peak four years later at the end of 2011, but employment tells a less optimistic story and may portend some serious hurdles ahead. Digging deeper, slower economic growth can be expected, unless a new tack is taken.

Reviewing the series in Figure 1 helps illustrate the potential hurdles ahead. The economic indicators are indexed to their respective values in the fourth quarter of 2007 and the income and expenditure series are on a per-capita basis. The final value for each series reflects the first quarter of 2013. Real per capita personal consumption expenditures are now at the same level as they were over five years ago. And while real personal income has also almost recovered to its previous peak, the two more telling indicators, per capita income excluding transfer payments and the employment ratio of prime-aged adults, are both at least five percent lower than their peak levels.

Per-capita income without transfer payments is a better indicator of the health of the producing economy than personal income. The role of transfer payments in buoying personal income and maintaining consumption can be seen by the difference between the personal income series and the series without transfers. But transfers cannot be made in the long run without earned income. And the falling employment ratio of prime-aged adults illustrates that labor market opportunities have not drawn potential workers back to jobs. In December of 2007, 79.7 percent of all Americans

Figure 1. Real Per Capita Income, Consumption, and Employment Indexed to Previous Peak
2007, Q4

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25 to 54 years of age worked and in April of this year, only 75.9 percent worked, or about one in four are not working.

Taking a longer view of the employment ratios of all prime-aged Americans and considering men and women separately suggests that male employment suffers the most during recessions, the long-run trend of women entering the labor force has offset their employment losses during recessions, but overall employment appears to have peaked in 2000. These trends are depicted in employment ratios in Figure 2 for prime-aged men, women, and men and women combined.

The employment ratio for men exceeds the ratio for women, but with each business cycle there is typically a distinct downward step. In 1948, 94 percent of men were employed, but in April of this year only 83 percent were employed. In contrast, the percent of employed women grew steadily from January 1948, when it stood at 33 percent, to April 2000, when it peaked at 75 percent. So, for fifty plus years women’s employment was on the rise while men’s employment was gradually falling. What is of concern now, is the recent general decline in employment for both prime-aged men and women.

The evolution of employment ratios associated with the postwar business cycles are presented in Figure 3. The figure shows the percent change in the employment ratios four years after their values at the peak of each business cycle. For example, the peak of the 1948 business cycle occurred in November of that year and the employment ratio for women was 34.1 percent. Four years later it was 37.5 percent, about 10 percent higher as shown in the figure for the 1948 business cycle. Women’s employment grew...
by the fourth year after the peak in the first nine of the eleven postwar business cycles. Men’s employment only rose, and modestly at that, by the fourth year following two of the business cycle peaks, 1948 and 1960. Most notable are the significant employment drops for men and women associated with the last two business cycles of 2001 and 2007. The employment ratio dropped by 2.6 percent and by 5.4 percent four years after the respective peaks of the last two cycles.

What explains these declines in employment? Given that the series focus on prime-aged individuals, typical retirement decisions are not driving the decline, though some of the decline can be attributed to the effect of early retirements by members of the baby boom generation, who were between 36 and 54 years of age when the employment ratio peaked in 2000. The rise in the incidence of prime-age workers claiming disability insurance (and Medicare) under the Social Security program is often noted in accounting for some of the employment decline. Since 2000, the percentage of all prime-age workers claiming disability insurance has risen in each age group. For example, among insured workers between 50 and 54, 5.9 percent claimed disability benefits in 2000 but by 2011, 7.7 percent were on the disability rolls. Other transfer payments have also risen over time, with a dramatic increase occurring with the current business cycle.

While the rise in the prevalence of workers turning to disability benefits or other transfer payments provides a partial accounting of what has happened to those who are no longer employed, it does not explain why they are not employed. Individuals face the decision to remain unemployed, look for work, pursue a disability claim, or consider the benefits of other non-work options. The formula for calculating disability benefits has not changed in recent years, so a rise in the value of benefits is not the explanation. However, the relative ease of receiving benefits has increased over time, reducing the cost of making a disability claim. Other things equal, the ongoing transition of the types of jobs in the United States from those based on physical skills to those based on intellectual skills should result in a decline, rather than, a rise in the prevalence of disability.

Also factoring into workers’ decisions to remain employed is their market wage and for those not working their potential wages must be high enough to bid them into the labor force. If real wages are stagnant or declining for some segments of the workforce, the non-work options become more attractive. In the case of married workers, the rise in female labor force participation over time has reduced the prevalence of single income families, and this partially explains the general decline in men’s employment.

It may be surprising, but bucking the trend of declining employment seen among prime-age workers since the start of the recession is the steady employment ratios of those 55 and above. Further, the labor force participation rate has actually risen by over 15 percent for those 65 and above. Older workers are using their human capital to insure against their losses in the housing and financial markets.

Policy makers have some tough choices to consider if they want to see prime-age Americans return to work. They have several policy tools that increase the returns to work and reduce the returns to not working. The most straightforward way to increase returns to work is to move away from labor taxes in favor of consumption taxes. Many politicians are, however, unwilling to give up the vote-garnering machine of the federal income tax code.

Reducing the returns to not working requires a substantial change in the direction of recent public policy. An overhaul of eligibility rules for the Social Security disability program is a starting point. But, several provisions of the about-to-be implemented Affordable Care Act reduce the incentives to work while raising the benefits of not working. For example, some workers will exit the labor force as a result of the potential availability of subsidized health care not tied to a job. Looking forward, the prospect of robust economic growth will be hampered as long as the relative attractiveness of work declines.