

Special Commentary — May 21, 2024

Do We Have Potential?: An Analysis of U.S. Potential Economic Growth

Part II - Labor Force Growth

Summary

- Labor force growth is one of the primary determinants of an economy's potential rate of economic growth. The American labor force grew at an average annual rate of 1.8% in 2022 and 2023, considerably above its growth rate of the past decade.
- Recent strength in labor force growth reflects, in part, strong population growth that stems from immigration. Foreign-born nationals, who currently represent about 20% of the labor force, have accounted for more than one-half of its growth over the past two years. A rise in the labor force participation rate (LFPR) from its pandemic-induced plunge has also supported growth in the labor force.
- Looking forward, it does not seem likely that the labor force will continue to grow at the same robust rate that it has over the past two years. Although it is difficult to predict the path of immigration in coming years—yet-to-be-determined policy choices and economic conditions in the United States as well as in foreign countries will affect immigration flows—the aging of the population and marked drop in the U.S. fertility rate in recent years means that the “natural” growth rate of the workforce will slow.
- There are some factors that could boost the LFPR further in the near term. More remote work could lift the participation rate, particularly for women with young children, as it has done over the past few years. Strength in cyclically-sensitive industries, which tend to be male dominated, could raise the LFPR rate of prime-age men. That said, the aging of the labor force will likely pull the participation rate lower over the longer-term.
- On balance, we estimate that faster labor force growth over the next several years, via more immigration and labor force participation, could raise the potential economic growth rate of the United States by 0.1-0.3 percentage points per annum over the 1.8% potential GDP growth rate that was registered during the last decade.
- That noted, there is uncertainty about whether the immigration boom will continue and whether more lofty participation rates will be realized. Additionally, potential GDP growth that is slightly above 2% rather than slightly below would still leave it well short of the +3% trend growth rate that prevailed for much of the second half of the 20th century.

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Do We Have Potential?: An Analysis of U.S. Potential Economic Growth

[Part I: Introduction](#)

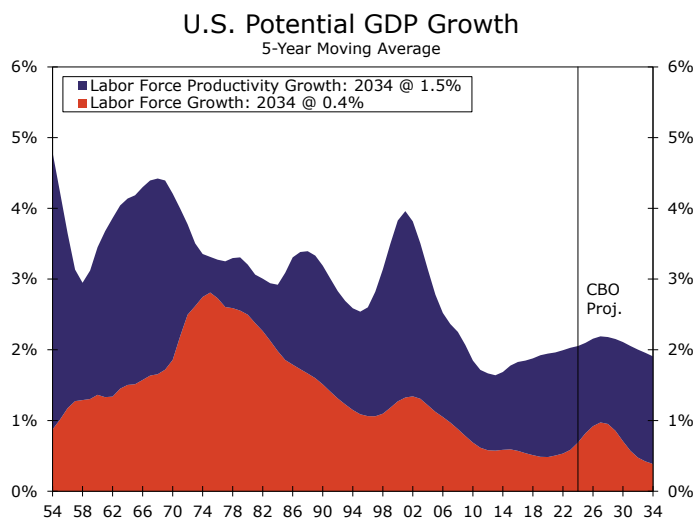
Labor Force Growth: The Population Factor

As we noted in the [first installment](#) of this five-part series, labor force growth is one of the primary determinants of an economy's potential rate of economic growth ([Figure 1](#)). The downward trend in the rate of potential U.S. economic growth that has been in train for the past few decades reflects, in part, deceleration in the labor force that itself is a function of slower population growth. But in recent years, labor force growth has been strong, averaging 1.8% per annum in 2022 and 2023. Part of the recent acceleration in the workforce simply reflects a rebound from its pandemic-related nosedive, but population growth also has strengthened recently.

The Bureau of Labor Statistics (BLS) estimates that the civilian non-institutional population, which reflects the economy's potential pool of workers, has risen about 1% per year over the past two years.¹ This recent pace is a tenth or so stronger than the average annual rate in the 2010s and a notable pickup from 2020-2021 when the COVID-19 pandemic drove mortality rates higher. A sharp rise in immigration also has spurred the pickup in population growth since 2021 and raised the possibility that stronger labor force growth could shift U.S. potential economic growth into a higher gear. The Congressional Budget Office (CBO) estimates net immigration in 2022 and 2023 totaled 2.7 million and 3.3 million individuals, respectively, a pace that is about three times the annual average of the 2010s. The leap partly reflects a rebound in work-related visas that began in 2022. However, the net boost to the immigrant population from those with work or student visas, as well as lawful permanent residents, has been similar to that of the prior decade ([Figure 2](#)).

A sharp rise in immigration has spurred a pickup in population growth since 2021 and raised the possibility that stronger labor force growth could shift U.S. potential economic growth into a higher gear.

Figure 1

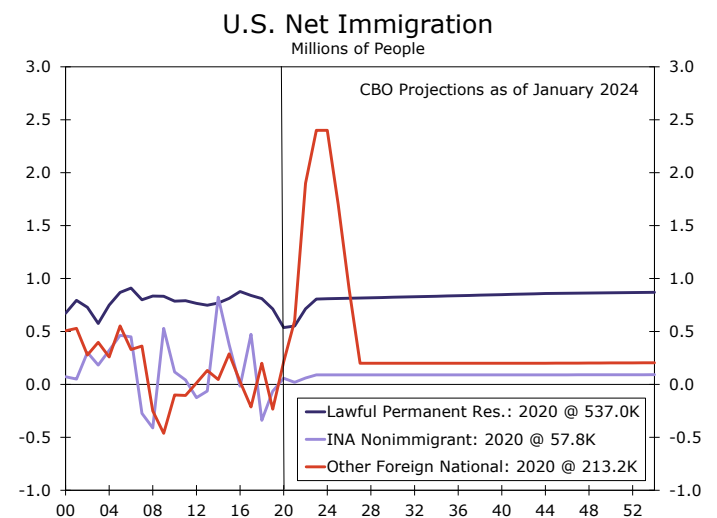


Source: Congressional Budget Office and Wells Fargo Economics

CBO estimates that the bulk of the recent jump in immigration has sprung from “other foreign nationals” (i.e., persons without legal status). Specifically, CBO estimates an additional 2.9 million individuals will be in the labor force this year compared to its prior estimate published in early 2023, with “most of that increase resulting from higher projected net immigration.”² Separate data published by the BLS also show foreign-born workers have been a sizable source of labor force growth in recent years. The BLS data do not distinguish between foreign-born persons legally admitted to the United States and undocumented immigrants, but total foreign-born workers have accounted for 56% of the growth in the U.S. labor force over the past two years ([Figure 3](#)).

Despite strength over the past two years, the BLS and CBO both project population growth will slow in coming years from its recent above-trend rate. Specifically, both agencies project the civilian non-institutional population (CNIP) will increase by less than 1.0% per annum between 2024 and 2032 ([Figure 4](#)). Excluding individuals of traditional retirement age (65+), the CNIP is estimated to grow less than half a percent per year, which would mark a significant slowdown in the growth of the potential pool of labor compared to prior decades. The outlook for historically slow growth in the working-age population is one contributing factor to expectations that U.S. economic growth will be slower in the

Figure 2

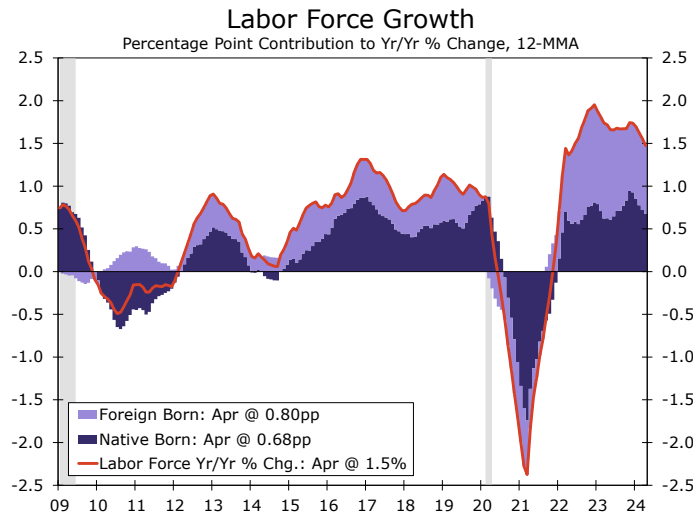


Source: Congressional Budget Office and Wells Fargo Economics

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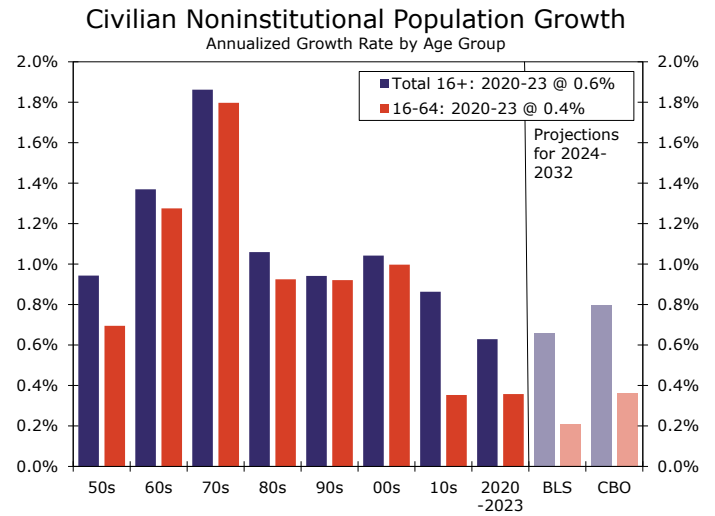
years ahead compared to the roughly 3.5% historical average that prevailed between the end of World War II and the 2008 financial crisis.

Figure 3



Source: Bloomberg Finance L.P. and Wells Fargo Economics

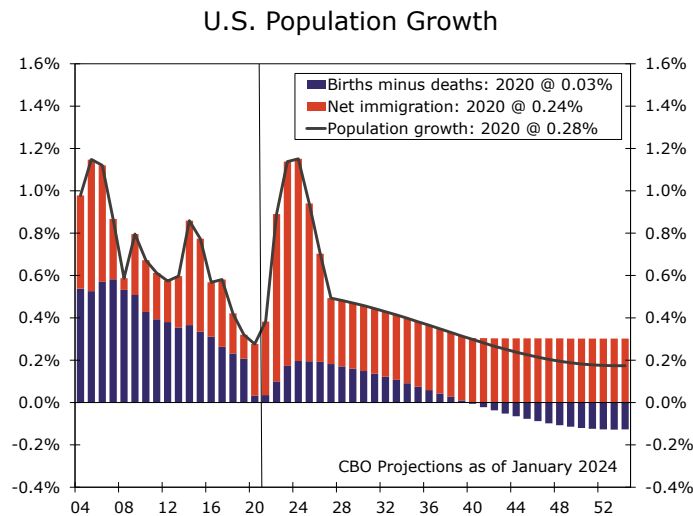
Figure 4



Source: U.S. Department of Labor, Congressional Budget Office and Wells Fargo Economics

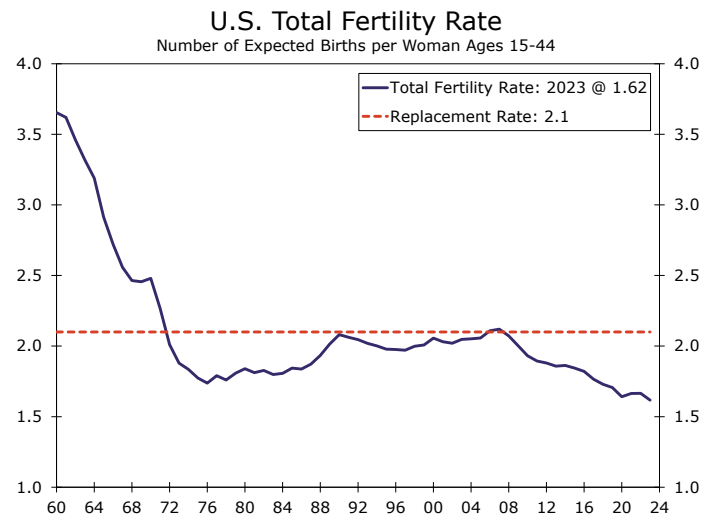
Immigration is likely to be the most important swing factor in the outlook for U.S. population growth. CBO estimates that over the next decade, natural growth in the population—the net of births minus deaths—will slow to about half the pace registered in the 2010s (Figure 5). Immigration, however, is expected to blunt the impact to overall population growth from an aging population. CBO estimates net immigration will remain elevated over the next few years before reverting to a pace more in line with recent history. Yet, there remains considerable uncertainty around these estimates.

Figure 5



Source: Congressional Budget Office and Wells Fargo Economics

Figure 6



Source: World Bank, CDC and Wells Fargo Economics

Economic conditions and policy choices in the United States and abroad influence the rate of immigration, making the pace difficult to predict. From a more technical standpoint, estimates of immigration can be challenging due to the need to make assumptions around the number of individuals who enter the U.S. undetected, the share of those encountered at the border who stay in the country as well as the rate at which individuals over-stay temporary visas. Nevertheless, the aging U.S. population along with the sharp drop in fertility since 2007 point to a clear downshift

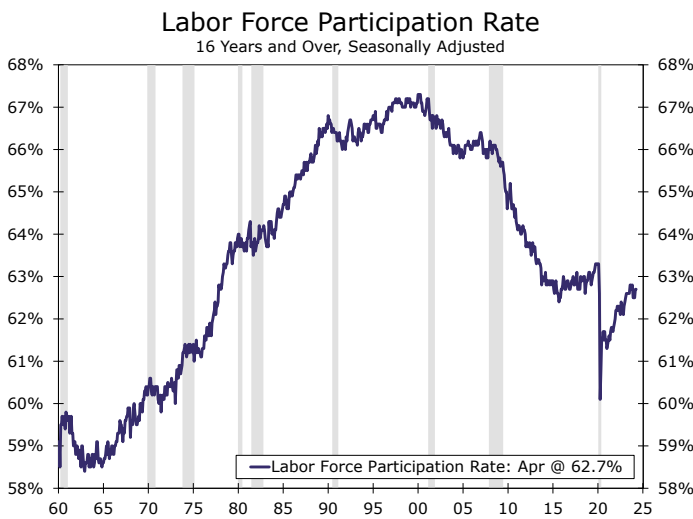
A sharp drop in fertility since 2007 puts labor force growth on a downward trajectory without an offset from the foreign-born population or a rise in labor force participation.

in the “natural” contribution to U.S. population growth (Figure 6). This puts labor force growth on a downward trajectory without an offset from the foreign-born population or a rise in labor force participation, a topic to which we now turn.

Not Just About the Size of the Pie: Labor Force Participation

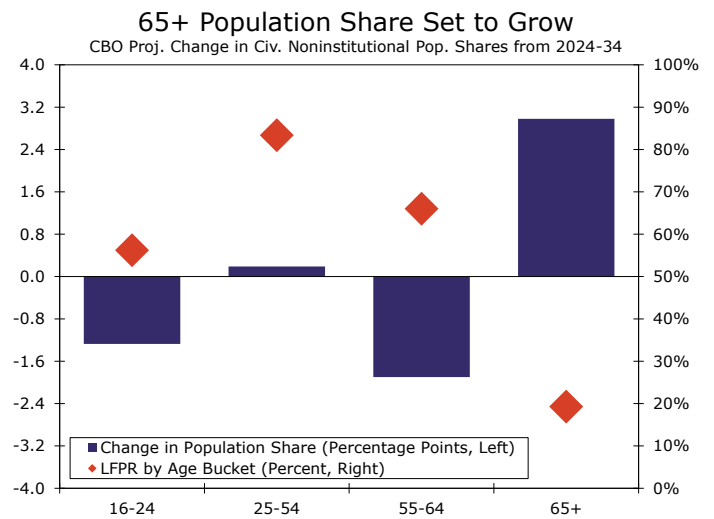
Population growth is not the only factor that determines the contribution to potential GDP growth from hours worked. The labor force participation rate (LFPR) is also critical to the outlook for economic growth in the decade ahead. To use an analogy, it is not just about the size of the working-age pie, but also what share of the pie is working. The civilian LFPR for the 16-and-older population peaked in 2000 and has declined in fits and starts since then (Figure 7). This decline can be attributed in part to the aging of the population over the past quarter century. As a greater share of the population aged 16+ moves out of their prime working years, the LFPR declines, all else equal.

Figure 7



Source: U.S. Department of Labor and Wells Fargo Economics

Figure 8



Source: U.S. Department of Labor, Congressional Budget Office and Wells Fargo Economics

Perhaps unsurprisingly, most analysts expect the LFPR to decline further in the decade ahead as the population continues to age. CBO projects the share of the population ages 65+ will rise by nearly 3 percentage points over the next decade (Figure 8, blue bars). With adults ages 65+ significantly less likely to participate in the labor market (Figure 8, red diamonds), population aging is expected to be a key factor in the total LFPR declining from 62.7% today to 61.4%. That said, the LFPR has had a habit of surprising to the upside over the past decade. CBO persistently overestimated the decline in the LFPR in the second half of the 2010s, and a similar phenomenon has played out over the past few years (Figure 9). To what extent could a higher LFPR in the decade ahead contribute to faster potential GDP growth?

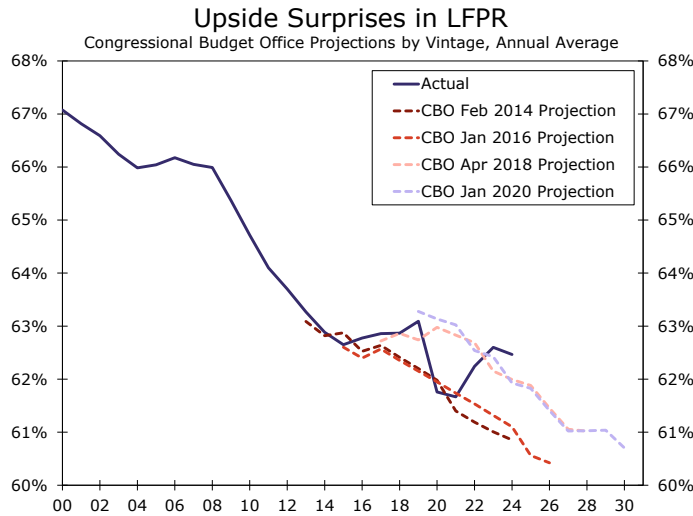
Most analysts expect the labor force participation rate to decline in the decade ahead as the population continues to age.

To illustrate this outcome, we generated a scenario in which the LFPR is 0.5 pp higher on average over the next decade compared to CBO’s projections. Under this scenario, the labor force grows by 0.7% per year compared to 0.6% per year in CBO’s baseline projections, and labor’s contribution to potential GDP growth is roughly 0.1 pp higher than in CBO’s baseline, all else equal.

Potential GDP growth would increase by roughly 0.1pp per year if the labor force participation rate is 0.5pp higher on average over the next decade compared to CBO’s projections, all else equal.

Notably, a ~0.5 pp jump in the labor force participation rate relative to CBO’s baseline would not be unprecedented. CBO’s 10-year projections published in early 2014 estimated the labor force participation rate would average 62.1% from 2014-23 (Figure 9). Looking back now with historical data in hand, the labor force participation rate averaged 62.5% over the decade, or about 45 bps higher than CBO’s projections.³

Figure 9

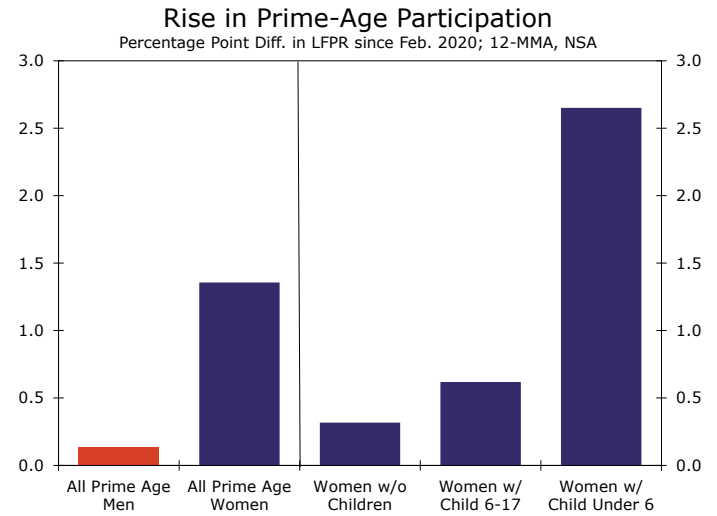


Source: Congressional Budget Office and Wells Fargo Economics

Upside Risks to Labor Force Participation in the Years Ahead

We see a few potential tailwinds ahead that could lend support to the labor force participation rate in the coming years and potentially help it once again surprise to the upside. For starters, remote work could prove stickier or diffuse further as businesses compete for a slower-growing pool of potential workers. Despite headlines about companies pushing to “return-to-office,” the share of workers teleworking some or all hours has risen over the past year.⁴ While increases have been broad-based across demographic groups, women have experienced more pronounced increases in remote work. The flexibility offered from telework has come alongside sharp rebounds in the LFPR of women in their prime working years (25-54), particularly those with young children (Figure 10). Furthermore, a continuation in the trends of more women obtaining higher education, [delaying marriage](#), starting families later and having fewer total children could also support a further secular rise in the labor force participation rate among women.⁵

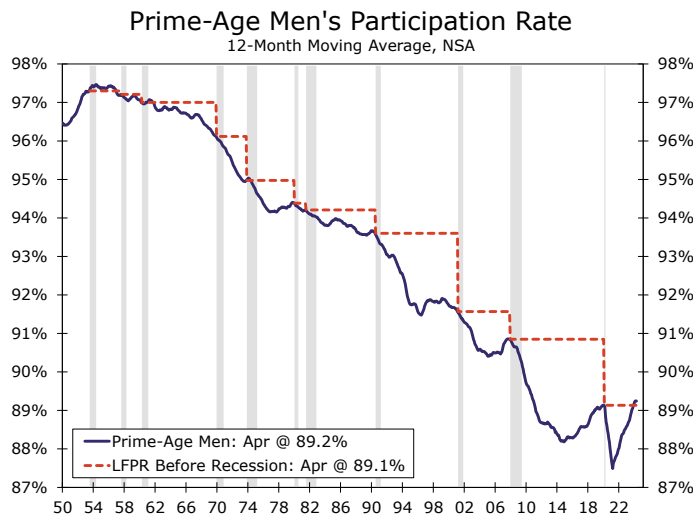
Figure 10



Source: IPUMS USA and Wells Fargo Economics

The flexibility offered from telework has come alongside sharp rebounds in the labor force participation rate of women in their prime working years (25-54) with young children.

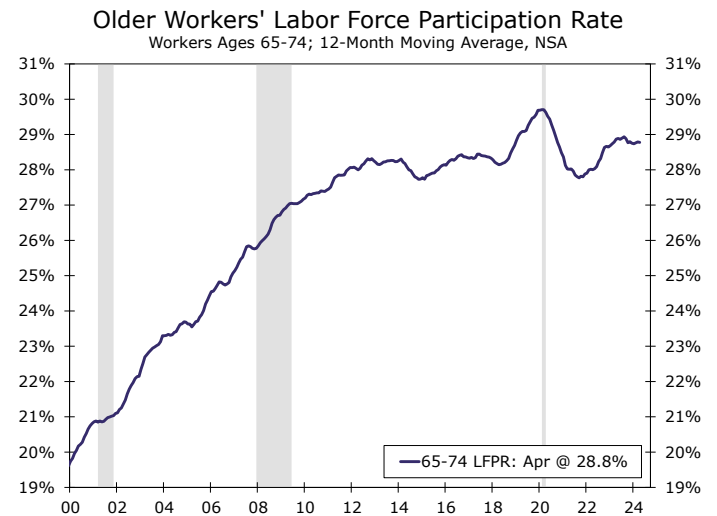
Figure 11



Source: U.S. Department of Labor and Wells Fargo Economics

The LFPR for prime-age men also has rebounded impressively this cycle, and for the first time since the early 1960s, it has surpassed its prior cycle peak (Figure 11). The recovery has been fueled by the general strength of the jobs market as well as the resilience of employment in more cyclically sensitive

Figure 12



Source: U.S. Department of Labor and Wells Fargo Economics

—and male dominated—industries, such as construction, manufacturing and mining. Fiscal support for infrastructure spending, such as the Infrastructure Investment & Jobs Act and the Chips & Science Act, private-sector efforts to de-risk supply chains and keep production closer to the U.S. market and a structural shortage of housing could help labor force participation among prime-age men climb further in the years ahead via support to male-dominated industries.

Labor force participation among older workers also could have scope to climb further.

Labor force participation among older workers also could have scope to climb further. Older workers are less likely to transition back into the labor force after exiting than younger workers, which has contributed to a slower and incomplete recovery this cycle (Figure 12). Yet without such a unique a shock as COVID-19 to knock retirement-age workers out of the jobs market, the participation rate among this group could climb further due to a lower exit rate. The decline in the share of workers employed in physically demanding jobs, rising longevity and the decades-long trend of retirement plans moving away from defined benefits and toward defined contributions could lead to a resumption of the upward trend in “retirement-age” workers’ participation rate that began around the mid-1980s.

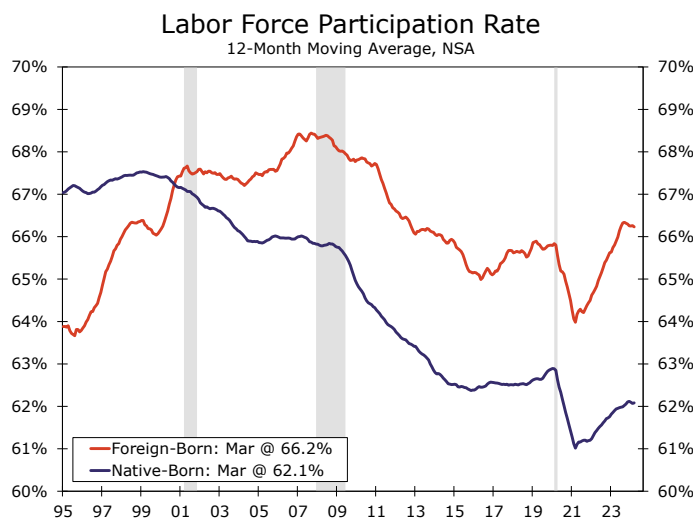
Lastly, more persistent immigration than what is currently projected could also help generate a higher LFPR than CBO’s baseline. Foreign-born workers have a higher propensity to engage with the labor market. The participation gap between the foreign-born and native-born populations has widened to over four percentage points over the past year (Figure 13). The higher LFPR among foreign-born workers stems from the population skewing younger than the native population, with 59% of the foreign-born population in their “prime” working years of 25-54 versus 46% for the native-born population.

Downside Risks to Labor Force Participation

Yet there are also reasons to be cautious about the path of labor force participation ahead. While the prime-age participation rates of men and women have recovered impressively since the pandemic, the pace has lost steam over the past year and highlights that further increases may be harder to come by. Remote work has supported the rebound in labor force participation, but in order for it to provide more than a one-time boost to the level of the participation rate, and instead lift the LFPR on a reoccurring basis, telework would need to continue to grow in prevalence. This could be difficult, as most companies have already been forced to experiment with remote work, suggesting further diffusion of telework is likely to be more incremental, or possibly reverse, in a labor market where employers hold more sway than during the hiring frenzy of 2021-2022.

While the prime-age participation rates of men and women have recovered impressively since the pandemic, further increases may be harder to come by.

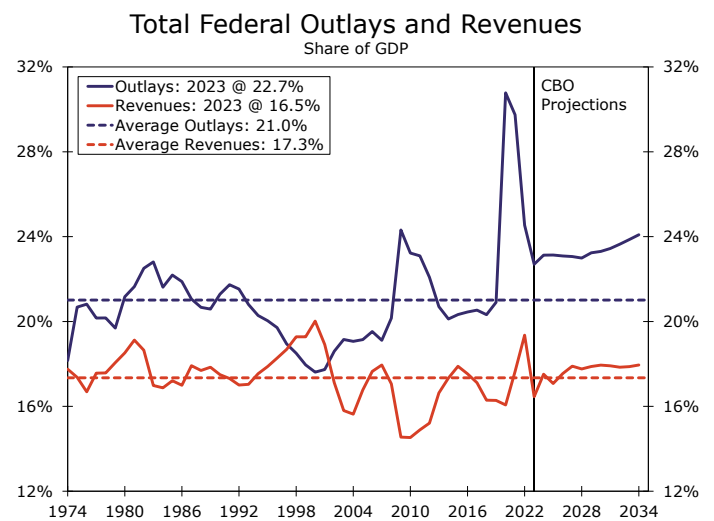
Figure 13



Source: IPUMS USA and Wells Fargo Economics

There is also the risk that the increase in participation derived from the influx of foreign-born workers subsides more quickly than expected. This could occur due to policy changes on either side of the border, or changes in economic conditions domestically and/or abroad that reduce the “push” and “pull” factors for foreign-born workers to head to the United States.

Figure 14



Source: Congressional Budget Office and Wells Fargo Economics

More generally, with the labor market quick to snap back from the pandemic and offering ample opportunities for workers in recent years, there may be only a shallow pool of labor that can be wooed off the sidelines. The better-than-expected outturn in the labor force participation rate over the past 10 years relative to CBO's 2014 baseline came as a rebound from the Great Financial Crisis (GFC) among prime-age workers finally started to emerge. In 2014 the participation rate for prime-age workers was still 2.2 percentage points below its pre-GFC peak, providing scope for a recovery if job opportunities became more plentiful, whereas today the labor force participation rate for 25-54 year olds is already 0.3 points higher than its prior cycle peak.

A tightening in fiscal policy over the next decade to address chronic budget deficits could further serve as a headwind to labor force participation. Whereas individual and corporate taxes were reduced in 2018, the yawning gap between revenues and outlays shown in [Figure 14](#) heightens the prospect of tax increases in the coming years to get the U.S. deficit on a more stable trajectory. If realized, higher tax rates on labor income would, on the margin, reduce the number of hours some individuals choose to work and lead some to choose not to participate in the labor market at all.

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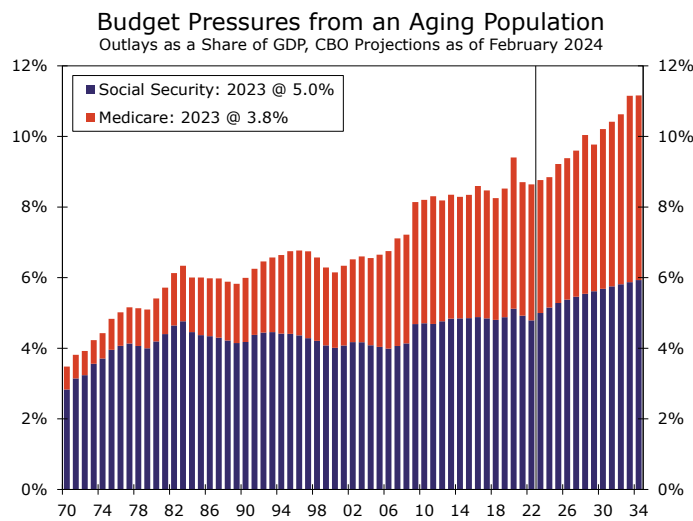
All told, we suspect that once accounting for the country's aging demographic profile, the tailwinds to the labor force participation rate overshadow the headwinds. However, even with risks tilted to the upside, the impact of a higher LFPR on potential GDP growth is likely to be small.

Labor's Contribution Is Important, but Productivity Is the Secret Sauce

On balance, the combination of faster population growth via more immigration and higher labor force participation rates could increase potential GDP growth by 0.1-0.3 percentage points per year over the next decade relative to what prevailed in the 2010s. That said, there are some important caveats. First, there is uncertainty about whether the immigration boom will continue and whether more lofty participation rates will be realized. Second, potential GDP growth that is slightly above 2% rather than slightly below would still leave it well short of the +3% trend growth rate that prevailed for much of the second half of the 20th century (refer back to [Figure 1](#)). Third, it is important to note that these factors can boost *aggregate* economic growth, but they do not necessarily boost *per capita* GDP growth. It is the latter indicator that is most consistent with rising living standards for the average person.

Faster population growth via more immigration and higher labor force participation rates could increase potential GDP growth by 0.1-0.3 percentage points per year over the next decade relative to what prevailed in the 2010s.

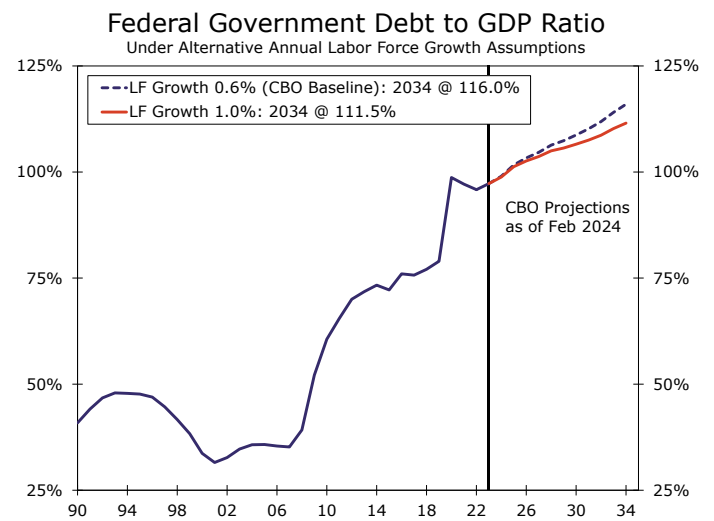
Figure 15



Source: Congressional Budget Office and Wells Fargo Economics

Of course, this is not to say that faster potential GDP growth has no real world impact. For example, more robust labor supply could help improve the federal fiscal outlook. The aging of the U.S. population is putting significant structural pressure on the federal budget via slow labor force growth and robust outlay growth on mandatory spending programs such as Medicare and Social Security ([Figure 15](#)). Labor force growth that is 1.0% per year over the next decade would reduce the federal government's debt-to-GDP ratio by about five percentage points compared to CBO's baseline projection of 0.6% labor force growth per year, all else equal ([Figure 16](#)). Such a difference is not

Figure 16



Source: Congressional Budget Office and Wells Fargo Economics

enough to single-handedly solve America's [long-run fiscal challenges](#), but every bit helps, and faster labor force growth does not involve painful policy trade-offs such as cutting benefits or raising taxes.

That said, labor productivity growth is ultimately the secret sauce that leads to rising living standards over the longer-run. In Parts III and IV, we explore the outlook for labor productivity growth in the decade ahead.

Endnotes

1 – The civilian noninstitutional population (CNIP) is narrower in scope than the total U.S. population. The Bureau of Labor Statistics defines the CNIP as persons 16 years of age and older residing in the 50 states and the District of Columbia, who are not inmates of institutions (e.g., penal and mental facilities, homes for the aged), and who are not on active duty in the Armed Forces. ([Return](#))

2 – See Box 2-1 of [The Budget and Economic Outlook: 2024 to 2034](#). Congressional Budget Office. February 2024. ([Return](#))

3 – Congressional Budget Office. [The Budget and Economic Outlook: 2014 to 2024](#). February 2014. ([Return](#))

4 – See the [Telework or work at home for pay data](#) published by the BLS starting in October 2022. ([Return](#))

5 – Educational attainment is positively associated with labor force participation. Never-married women have higher rates of labor force participation than married women, while women without children under age 18 have higher labor force participation rates than women with children. ([Return](#))

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