The Labor Supply of Older American Men

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This chapter summarizes what is known about the labor supply of older American men, defined as those aged 55 years and over. The topic is of great interest because in the coming decades older individuals will comprise a much greater portion of the U.S. population, so the labor supply of older adults will have a significant impact on national output, tax revenues, and the cost of means-tested programs. Most importantly, a greater proportion of older individuals will need to remain in the workforce than is the present case, because the retirement income system is contracting and working longer is the only way for most people to ensure financial security in their old age. The paper's focus is on men, because women's work patterns are changing and increasingly reflect the work patterns of men.

Section I of this paper describes the changes to the U.S. retirement income system that will require people to work longer. Section II summarizes the long-term decline in labor force activity among older men over the course of the twentieth century, and the factors that contributed to this trend. Section III describes the recent turnaround in the labor force activity of older Americans, and the changes in Social Security and employer-provided pension plans that likely led to that reversal. In an attempt to determine whether the labor supply of older workers will continue to increase, section IV describes changes in work patterns that have emerged in the last 20 years, which have led to more labor market mobility and less job tenure among older workers, and the implications of such changes on labor supply. Section V addresses how the health of older people may influence the extent to which they can be expected to

continue in the labor force, and underscores that for 15 to 20 percent of older workers, continued employment will be impossible. Section VI discusses the remaining incentives to retire—namely, the availability of Social Security benefits at age 62 and the lack of flexible employment arrangements. Section VII concludes and estimates labor force participation rates going forward.

I. The Need for Continued Employment

As people age, earnings become dramatically less important as a source of household income, giving way primarily to income from Social Security and employer retirement income plans. Today the share of household income from earnings declines from 81 percent for those aged 55–61 years, to 57 percent for those aged 62–64, to 23 percent for those 65–69, and becomes trivial thereafter; see Figure 3.1. However, both Social Security and employer plans will replace a smaller portion of pre-retirement income in the future than is the case today. This is especially clear for

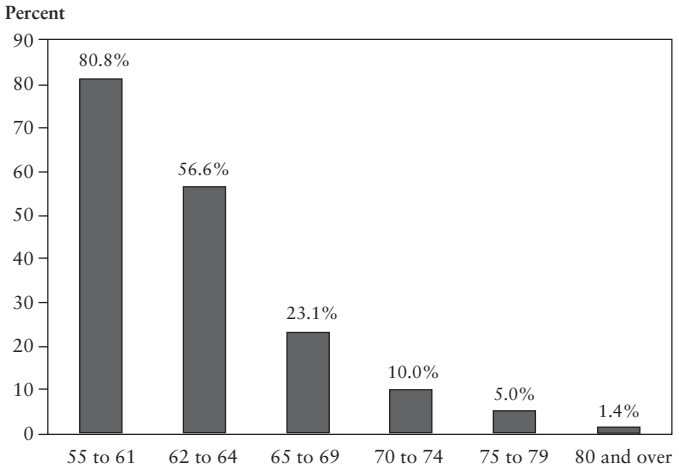

Figure 3.1
2005 Earnings as a Percent of Income, U.S. Households Aged 55 Years and Older, Middle Quintile
Source: U.S. Bureau of Labor Statistics and U.S. Census Bureau (2006), and authors' calculations.

Social Security, which is a significant source of income for most retired Americans.

The Outlook for Social Security

At any given retirement age, Social Security benefits will replace a smaller fraction of pre-retirement earnings in the future. Today, the hypothetical "medium earner" retiring at age 65 receives benefits equal to about 41 percent of his or her previous earnings. After paying the Medicare Part B premium, which is automatically deducted from Social Security benefits before the check goes in the mail, the replacement rate is 39 percent. But, under *current law,* Social Security replacement rates—benefits as a percent of pre-retirement earnings—are scheduled to decline for three reasons. First, the program's Full Retirement Age is currently in the process of moving from 65 to 67, which is equivalent to an across-the-board cut in benefits.[1] Second, Medicare Part B premiums are slated to increase sharply due to rising healthcare costs.[2] (Premiums for the new Part D drug benefit will also claim an increasing share of the monthly Social Security check.) Finally, Social Security benefits will be taxed more under the personal income tax, as the exemption amounts are not currently indexed to inflation. For the medium earner who claims benefits at age 65, these three factors will reduce the net replacement rate from 39 percent in 2002 to 30 percent in 2030; see Figure 3.2. Restoring Social Security's long-term solvency through more benefit cuts would reduce this level of support still further.

The Outlook for Private Sector Employer-Sponsored Pensions

With a diminished role for Social Security in providing retirement income, future retirees will be increasingly dependent on employer-sponsored pension plans. At any moment in time, however, less than half of the private sector workforce aged 25 to 64 years participates in an employer-sponsored retirement income plan of any type. This fraction has remained virtually unchanged since the late 1970s, and is unlikely to improve.[3] Since participation in employer-provided pension plans tends to increase with earnings, only middle- and upper-income individuals can count on receiving meaningful benefits from these plans.

The other issue is that the nature of pension coverage has changed dramatically. Twenty years ago, most American workers with pension

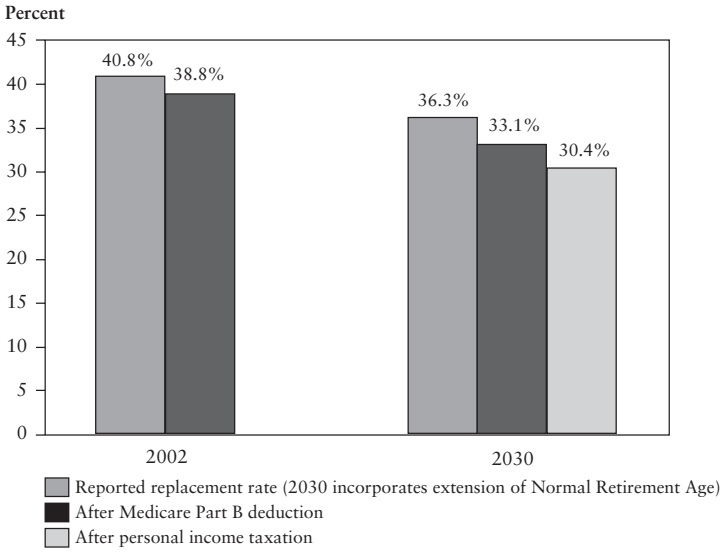

Figure 3.2
Social Security Replacement Rates for the Medium Earner, 2002 and 2030
Source: Authors' calculations based on Munnell (2003).

coverage had a traditional defined benefit plan, which pays a lifetime annuity at retirement.[4] Today the world looks very different, as depicted in Figure 3.3. Most people with an employed-sponsored pension have a defined contribution plan—typically a 401(k)—and 401(k) plans operate like savings accounts.[5] *In theory* workers may accumulate substantial pension wealth under 401(k) plans, but *in practice* they do not. For example, simulations suggest that the worker in the middle of the earnings distribution, who contributes regularly throughout his or her work life, should end up at retirement with about $300,000 in a 401(k) account and/or in an Individual Retirement Account (IRA), as most IRA assets are rolled-over balances from 401(k) plans. This $300,000, when combined with Social Security benefits, would provide an adequate retirement income. Yet reality looks quite different. The Federal Reserve Board's 2004 Survey of Consumer Finances reports that the typical individual approaching retirement had 401(k)/IRA balances of only $60,000, as shown in Figure 3.4.[6] Nor do younger cohorts seem to be on track to accumulate sufficient assets to provide an adequate retirement income. A

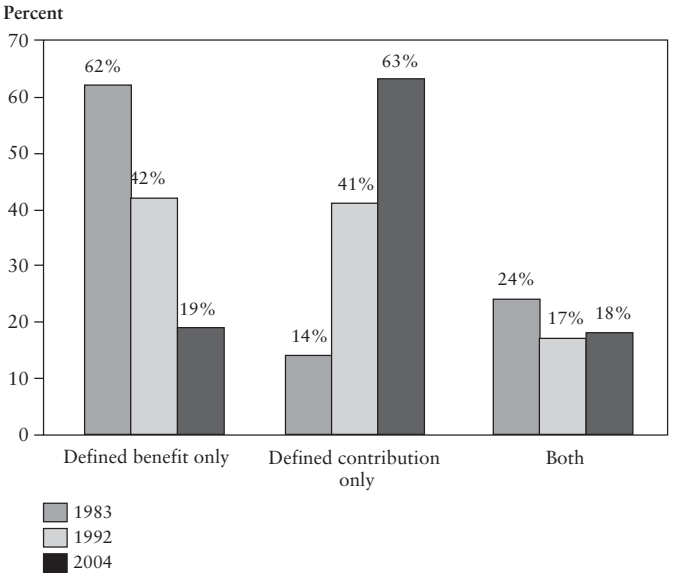

Figure 3.3
Percent of U.S. Wage and Salary Workers with Pension Coverage by Type of Plan
Source: Munnell and Sundén (2006) based on the U.S. Board of Governors of the Federal Reserve System (1983–2004).

critical factor explaining these low balances is that the entire responsibility for retirement saving has shifted from the employer to the employee, and employees make mistakes at every step along the way.[7]

Americans' Decline in Personal Saving

Given the projected decline in Social Security and the increased uncertainty surrounding employer-sponsored pensions, one might have expected to see working age adults increase their personal saving rates. This is certainly what the standard life-cycle model predicts. But a recent study of the U.S. National Income and Product Accounts (NIPA) found that saving by the working-age population has declined, and that virtually all the saving undertaken by the working-age population occurred in employer-sponsored pension plans (Munnell, Golub-Sass, and Varani 2005). In recent years, the saving rate of the working-age population outside of such plans has actually been negative; see Figure 3.5.

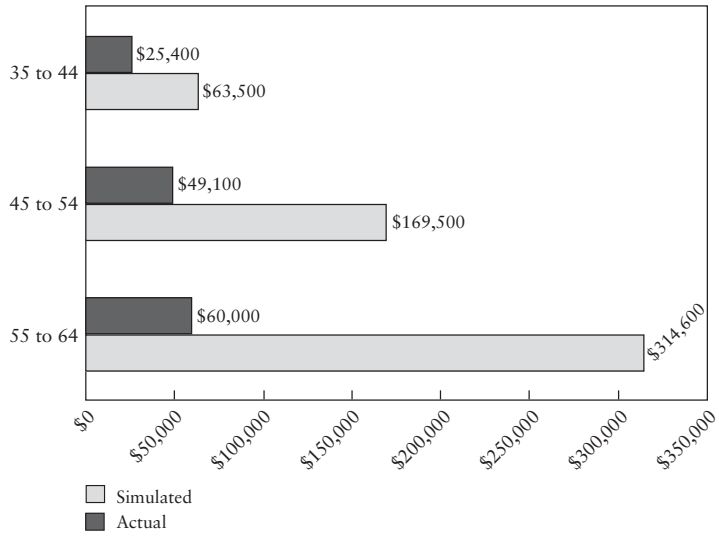

Figure 3.4
401(k)/IRA Actual and Simulated Accumulations by Age Group, in 2004
Source: Munnell and Sundén (2006).

Figure 3.5
National Income and Product Accounts Personal Saving Rate for the U.S. Working-Age Population, with and without Pensions, 1980–2003
Source: Munnell, Golub-Sass, and Varani (2005).

Thus, the outlook for retirement income for future cohorts of retirees is dismal. People are not going to be able to continue to retire at age 63 and maintain their standard of living over an increasingly long period of retirement; see Figure 3.6. Moreover, dramatically rising healthcare costs are going to erode already diminished retirement incomes.[8] Working longer is an obvious solution.[9] Each additional year in the workforce increases income directly through earnings from work and investments. It also actuarially increases Social Security benefits by 7 to 8 percent, allows retirement savings more time to accumulate investment earnings, and reduces the number of years over which those savings need to be spread. The implications are striking. As shown in Figure 3.7, a couple in the middle of the income distribution that delays retirement from 62 to 70 would reduce the assets needed to replace 80 percent of their after-tax pre-retirement income from $555,000 to $128,000.[10] Delaying retirement is clearly a powerful lever for addressing the coming decline in the nation's retirement income system. But is it realistic for most people?

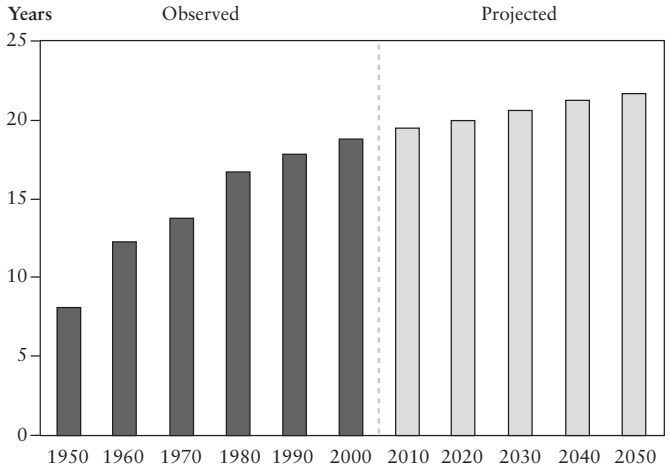

Figure 3.6
Expected Years in Retirement for American Men
Source: U.S. Bureau of Labor Statistics and U.S. Census Bureau (1962–2005), and authors' calculations based on U.S. Social Security Administration (2006).

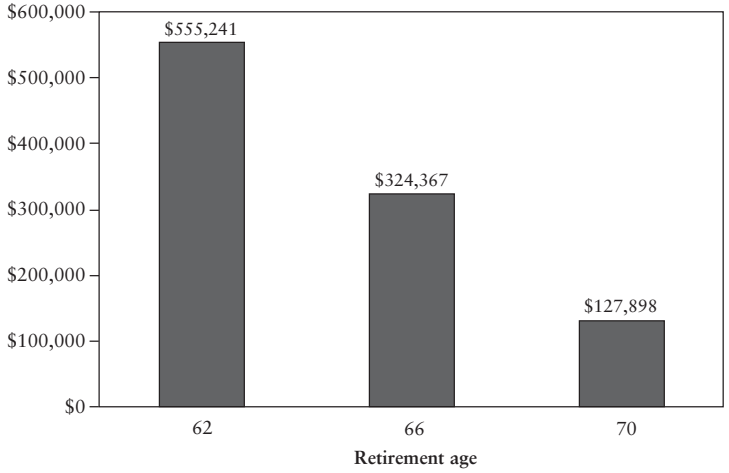

Figure 3.7
Assets Required for a Married Couple Earning $63,660 After Taxes to Maintain 80 Percent of After-Tax Pre-Retirement Income in 2007
Source: Authors' update based on Congressional Budget Office (2004).

II. The Long-term Decline in Employment Rates for Older American Men

The notion of retirement as a distinct and extended stage of life is a twentieth-century innovation. Up to the end of the nineteenth century, people generally worked as hard and as long as they could. Men in their prime put in 60 hours of work each week. And at the end of life they had only about two years of "retirement," often due to ill health. Productive capacity declined with age, as health impairments were much more prevalent and jobs much more physically demanding than is the case today. So in older age people took on less taxing jobs or worked fewer hours. But they generally stopped working only when no longer able.[11]

Beginning around the end of the nineteenth century, the percent of the older U.S. population that continued to work began to decline. This can be seen in Figure 3.8, which shows employment rates by age.[12] The employment rate among men aged 65 years and over fell from about 80 percent in 1880 to about 40 percent in 1940 to 16 percent in 1990.

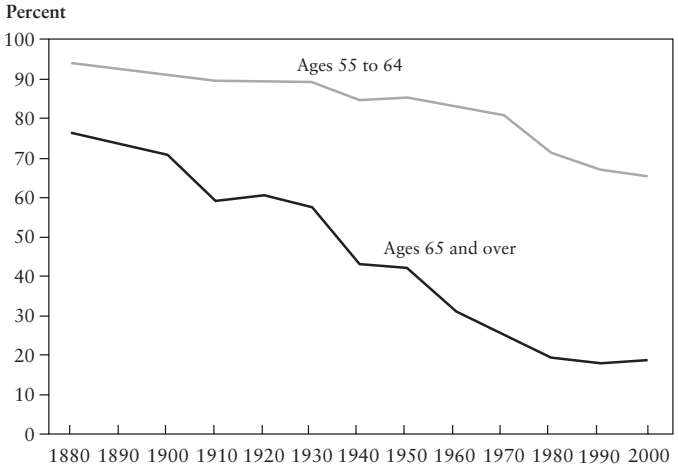

Figure 3.8
Labor Force Participation Rates of American Men Aged 55 to 64 Years, and 65 Years and Older, 1880–2000
Source: Ruggles and Sobek (2004).
Note: From 1880 to 1930, work rates are defined as reporting any gainful occupation. From 1940 to 2000, work rates are labor force participation rates, defined as working or seeking work.

Then and now, people retire for three basic reasons. Poor health may make it impossible for them to keep working. Physical strength, eyesight, hearing, and mental agility decline with age, and the incidence of contracting debilitating conditions and illnesses rises. Second, as the real or perceived productivity of older workers ebbs, employers find it unprofitable to employ them. Third, people acquire enough wealth to forgo earnings from the labor market. That is, as productivity declines and an increased incidence of ailments raises the disutility of work, older people with adequate savings can choose to quit the workforce. In terms of explaining the trend toward longer periods of retirement, increasing personal wealth and the attitudes of employers must be the primary drivers.[13] The health of older American adults has improved, not deteriorated, and would have been expected to lead to later retirement.

Economic growth has been dramatic throughout the twentieth century. Despite the Great Depression, output per hour in 1940 was 2.7 times the

level in 1880 (U.S. Bureau of Economic Analysis 1973). Workers used some of this increased affluence to reduce their labor burden. The length of the work day fell sharply between the 1880s, when the typical worker labored 10 hours a day, 6 days a week, and 1940, when the typical work schedule was 8 hours per day, 5 days per week (Costa 2000). But successful retirement requires more than rising incomes and a decision to consume more leisure. People can retire from the labor force only if they have a source of income once their earnings cease.

In theory, people could save during their working years and then tap those assets to support themselves in retirement. But this saving and investing process requires a good deal of foresight, discipline, and skill. People need to predict their earnings over their lifetime, how long they will be able to work, how much they will earn on their assets, and their life expectancy. Recent surveys suggest that even today, people are not very good at planning for retirement. Moreover, at the turn of the century most people had little reason to save for retirement since most died early, often in middle age.[14]

Instead of saving for retirement, an unexpected and substantial income stream for the elderly appeared at the end of the nineteenth century in the form of old-age pensions provided to the large number of Union Army Civil War veterans. A comprehensive study found that veterans eligible for these pensions had significantly higher retirement rates than did the American population at large (Costa 1998). It is important to note that these pensions did not require workers to retire; beneficiaries could collect these payments while remaining employed. That Union Army pensions produced an upsurge in retirements clearly illustrates the "income effect" of increased wealth on the labor supply of older workers, who often choose to consume a portion of that increased wealth in the form of more retirement.

Labor market participation rates in the United States did not return to their previous levels as the Union Army veterans died off in the early decades of the twentieth century. After a pause, the percentage of the older adult male population in the labor force continued to decline. Various analysts have argued that this reflects the growth of worker incomes (Costa 1998). But employer attitudes were also becoming more important. The U.S. workforce was rapidly shifting from self-employment, most

notably as farmers, to employment in large enterprises. These organizations increasingly imposed mandatory retirement requirements on their employees, and were reluctant to hire older workers seeking employment (Moen 1987; Margo 1993).

The next big decline in the work rates of older American men, and especially of men aged 55 to 64 years, occurred after World War II, as shown in Figure 3.9. One obvious factor was the availability of Social Security benefits. Although the legislation was enacted in 1935, initially only Old Age Assistance welfare benefits were paid. Social Security's retirement benefits were not paid until 1941, and then the value of these benefits were seriously eroded by wartime and postwar inflation. The critical 1950 Social Security Amendments restored replacement rates—Social Security benefits relative to pre-retirement earnings—to 30 percent for the average earner. In the wake of the 1935 legislation, workers chose to consume a portion of their newfound Social Security wealth in the form of more retirement.

The uptick in retirement was probably also due to key features in the program design—the Social Security Retirement Earnings Test and the "take-it-or-leave-it" character of Social Security benefits. The earnings

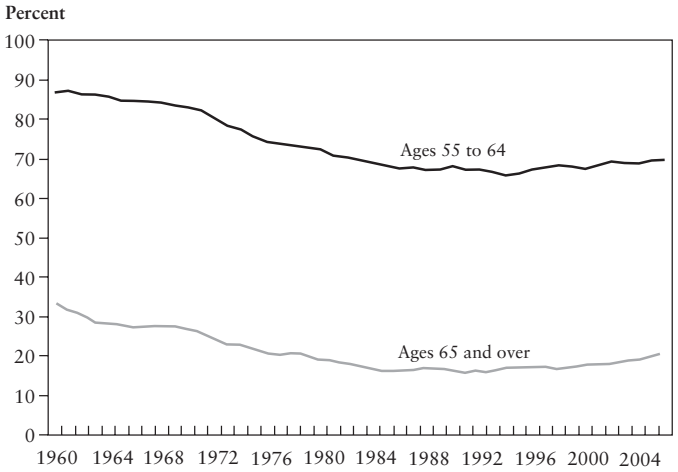

Figure 3.9
Labor Force Participation of American Men Aged 55 to 64 Years, and 65 Years and Older, 1960–2006
Source: U.S. Bureau of Labor Statistics and U.S. Census Bureau (1962–2006).

test meant that workers could not collect benefits if their earnings from work were more than a trivial sum. The "take-it-or-leave-it" character meant that a worker's benefits would not rise if he or she delayed claiming. The effective compensation of a worker who did not retire at age 65 was their compensation less their foregone Social Security benefit (and taxes and work expenses). Social Security thus decreased the value of remaining at work vis-à-vis retirement, and this "substitution effect" contributed to the decline in labor force participation. Employer pension plans had similar features and similar effects. These plans required that a worker retire in order to collect benefits, and offered no increase in benefits if a worker stayed on the job and retired at a later age.

Ultimately, Social Security's low level of earnings replacement was judged inadequate, given the widespread acceptance of retirement as a legitimate period of rest after a lifetime of work, the relative poverty of the elderly U.S. population, and the recognition that employer-provided pensions would never fill the retirement income gap. In response, Congress enacted Medicare in 1965, and in 1972 sharply increased Social Security benefits to roughly a 40 percent earnings replacement rate for the benchmark average earner.

The postwar period also saw the expansion of employer-sponsored pension plans, driven by three main considerations. First, employer-sponsored defined benefit plans had become an essential component of corporate personnel systems of large-scale organizations in the United States, so coverage grew as employment in government and corporate big business blossomed in the mid-twentieth century. Second, the special tax treatment of employer pensions became significantly more valuable in the face of mass income taxation.[15] And third, unions, which had gained powerful collective bargaining rights, made pensions a standard component of labor agreements throughout the unionized sector by the end of the 1950s.

By the early 1970s, the combination of Social Security benefits and employer-sponsored pension plans provided long-serving workers a secure and comfortable retirement income. In the wake of these developments, the labor force participation rates for men 65 and over declined from 33 percent in 1960 to 16 percent in 1985.[16]

Two factors, in addition to the sheer increase in retirement wealth created by the expansion of the retirement income system, also contributed

to a decline in the labor supply of American men in the 55–64 age group. First, many traditional employer-defined benefit plans began to offer significant subsidies for workers taking early retirement. The subsidy arises because companies offer benefits at an early retirement age, such as 55, that are not adjusted sufficiently to reflect the fact that retirees will receive benefits for 10 years longer, and begin collecting earlier, than if they retired at age 65.[17] The subsidy implicit in the less-than-actuarially fair reduction then gradually declines and disappears entirely at the plan's normal retirement age.[18] By decreasing the value of remaining at work vis-à-vis taking retirement, this produces a strong incentive to retire early.

The second factor affecting labor force participation rates for men aged 55–64 years was the availability of Social Security benefits at age 62. When in 1935 Congress established 65 as the age of eligibility for Social Security benefits, it was following precedents set internationally and by employer-sponsored plans. But in 1956, Congress lowered Social Security's Earliest Eligibility Age (EEA) for women to 62.[19] The introduction of an EEA for men followed in 1961, primarily in response to a recession that left many older male workers without employment. These early retirement benefits are actuarially adjusted, and thus involve no clear increase in retirement wealth. But numerous empirical studies, showing a spike in retirements at age 62, support the notion that the availability of benefits at 62 was an important factor in reducing the labor force participation rate of men aged 55–64 years (see Gustman and Steinmeier 1986, Rust and Phelan 1997, Burtless and Quinn 2000).[20]

III. The Recent Trend Reversal in Older Men's Labor Force Participation

The decline in the labor force activity of older American men ended in the mid-1980s. As shown in Figure 3.10, which depicts men's labor force participation rates by age for 1940, 1970, 1985, and 2005, labor force activity at each age was below that for the earlier period until 1985. The pattern then reversed, with older men's labor force participation rate in 2005 above the 1985 level for those 62 and over.[21] Observers have offered a number of explanations for this change in direction (Friedberg 2007; Burtless and Quinn 2002). We discuss some of these changes in this section.

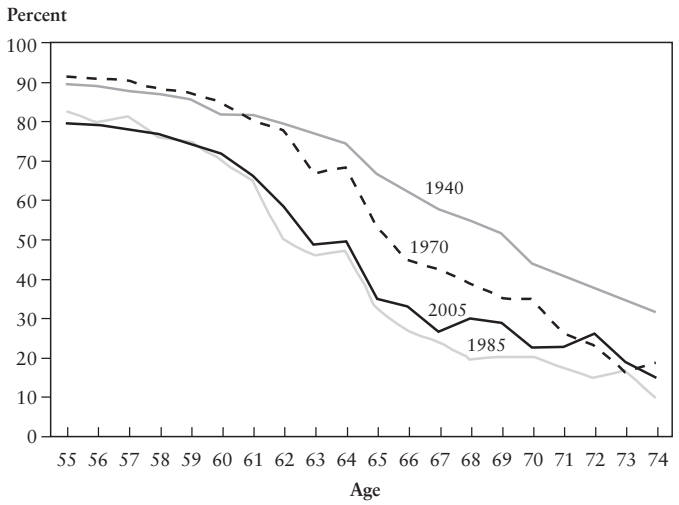

Figure 3.10
Labor Force Participation Rates of American Men Aged 55 Years, and Older, 1940–2005
Source: Authors' calculations based on the U.S. Bureau of Labor Statistics and U.S. Census Bureau (1985, 2005) and Munnell (1977).

Changes in the Social Security Program

Social Security benefits available at any given age have become less generous, and incentives for early retirement have been reduced or eliminated.

Two changes enacted in 1983 have reduced benefit amounts. First, this legislation made up to half of Social Security benefits taxable for people with earnings above a certain threshold.[22] For higher income beneficiaries, the taxable percentage was increased to 85 percent in 1994. For these higher paid workers, subjecting their Social Security benefits to taxation is equivalent to a benefit cut. Second, the 1983 legislation gradually increased the Full Retirement Age from 65 to 67, which is equivalent to an across-the-board benefit cut. Once the increase is fully phased in, for cohorts born in 1960 and later, those retiring at age 62 will receive 70 percent, as opposed to the original 80 percent, of full benefits.

The expected negative "income effect" of such benefit cuts is an increase in the labor supply of older Americans, as workers respond to this decline in wealth in part by consuming less while working, in part by consuming less in retirement, and in part by working more and "consuming" less retirement. But the labor-supply effects of these benefit cuts mainly lie in the future. The Full Retirement Age only began rising for those turning 62 in 2000, and that year the benefit reduction was small.[23] The increased taxation of benefits will also affect a much larger share of the population in the future, as the income thresholds are not indexed for inflation.

The increase in older men's labor force participation since the mid-1980s is more likely due to changes in the Social Security program that made continued work more attractive vis-à-vis retirement. The first change is the liberalization and, for some, the elimination of the earnings test. Since Social Security began as a program insuring workers and their dependents against a loss of earnings due to disability, old age, or death, the government imposed an earnings test: benefits were paid only if earnings were "lost." This test, however, encouraged workers to retire early, because it seemed like a tax. Most workers were unaware that any reduction in the amount of benefits paid out due to their continued employment triggered an increase in benefits later.[24] In recent years, Congress increased the exemption amount that workers could earn without having their benefits reduced. And, for beneficiaries older than the Full Retirement Age, it first reduced the benefit reduction for each dollar earned and then eliminated the test altogether in 2000. For those between age 62 and the Full Retirement Age, the test allows about $12,500 of earnings before reducing benefits by $1 for each $2 of earnings. Most studies suggest that the earnings test and these changes have had a substantial impact on the work effort of older people (see Friedberg 1998 and 2000; Haider and Loughran 2005; Friedberg and Webb 2006; Gustman and Steinmeier 2007), though some conclude that the test has had little effect, at least for older men (Gruber and Orszag 2003).

The Delayed Retirement Credit, which increases benefits for each year an individual postpones claiming Social Security benefits between the Full Retirement Age and age 70, has also improved older workers' incentives to remain in the labor force. When introduced in 1971, the credit increased benefits by 1 percent per year for each year of delay between the Full Retirement Age and age 72. In 1983, Delayed Retirement Credits were only granted up to age 70, but the adjustment was raised to 3

percent per year, and scheduled to increase to 8 percent per year by 2008. When fully phased in, the credit will, roughly speaking, be actuarially fair. The question then becomes what impact this increased credit for delaying claims will have on retirement decisions. Recent studies suggest that the delayed retirement credit may well have been an important factor in raising labor force participation rates among workers 65 and over (Coile and Gruber 2000; Pingle 2006).[25]

The End of Mandatory Retirement

In the early 1970s about half of all employed Americans were covered by mandatory retirement provisions that required they leave their jobs no later than a certain age, usually 65. In 1978, the earliest legal age for mandatory retirement was increased from 65 to 70. In 1986, mandatory retirement was eliminated entirely for the majority of workers. As nearly all American workers in 1986 and after were out of the labor force by age 70, however, this legislation probably had little to do with the subsequent rise in the labor supply of older workers.

Changes in Employer Pension Plans

Various changes in the structure of employer-sponsored retirement income plans have also reduced incentives to retire early. As noted earlier, in the early 1980s about 85 percent of U.S. workers with employer-sponsored pensions were covered by a defined benefit plan; by 2004 the percentage of U.S. workers with defined benefits plans had declined to 37 percent. In contrast to the early retirement incentives commonly found in defined benefit plans, 401(k)s and other defined contribution plans work like savings accounts and contain no incentives to retire at any particular age. Studies have documented that, on average, workers covered by 401(k) plans retire a year or two later than do similarly situated workers covered by a defined benefit plan (see Friedberg and Webb 2005, Munnell, Cahill, and Jivan 2003). Among recently retired workers, however, dependence on defined contribution pensions had not increased dramatically. Thus the labor supply effect of the shift from defined benefit to defined contribution plans primarily lies in the future, not in the past.[26]

Another likely change, albeit poorly documented, is a shift since the mid-1980s away from sweetened early retirement benefits in traditional defined benefit pension plans. According to one industry expert, the elimination of such early retirement incentives was a primary motive behind the conversion of a large number of pension plans, covering over 20 percent of covered workers, to cash-balance formats (see Schieber 2007). From the perspective of workers, cash-balance plans are much like defined contribution plans and neither subsidize nor penalize retirement taken at any given age.[27] In addition, many early retirement sweeteners in the past had been offered in special "one-time" windows. If the conversion to cash-balance formats does reflect a shift away from early retirement subsidies, one would expect a comparable shift away from such one-time offers.[28] The net effect could be an increase of one to two years, much like the effect of a shift from defined benefit to defined contribution plans.

The Shift to Less Physically Demanding and More Psychologically Rewarding Jobs

The nature of employment has changed dramatically in the last 20 years. As U.S. manufacturing industries have declined, the service sector has exploded. This shift, especially the expansion of knowledge-based employment, reflects the growth in jobs often thought to have significant non-pecuniary rewards, found in places such as universities and hospitals, and in occupations such as software development, management consulting, and graphic design. Even within the manufacturing sector, the composition of jobs has changed, as firms have automated or outsourced production and now employ more managers, engineers, and technicians.[29] Generally, American jobs now entail more knowledge-based activities that put less strain on older bodies, and provide more satisfaction for workers of all ages.[30] Less physical strain and more non-pecuniary rewards raises the value of remaining employed vis-à-vis taking retirement, thereby raising the supply of labor. A good portion of the increase in labor force participation since the mid-1980s, especially among workers aged 65 to 69 years, the group which saw the most dramatic gains in labor force participation, may be due to such changes.

Joint Retirement Decisions

Another factor that may be encouraging men's employment at later ages is the movement of married women into the labor force. When only the husband was working outside the home, retirement decisions could be

based on the rewards of work, the generosity of his retirement benefits, and how continued employment would affect those benefits. With wives working, retirement decisions have become more complicated. Now couples need to consider how the decision to stop working will affect the rewards and benefits of both spouses. A growing number of studies suggest that husbands and wives like to retire together.[31] Since in the United States husbands are, on average, three years older than their wives, the increased labor force participation of wives would be expected to lead to the later retirement of men.

The Decline in Post-Retirement Health Insurance

A final factor affecting the labor force participation rates for older men is related to changes in employer-provided health insurance. Among the entire working-age population, employer-provided health insurance coverage may be declining, but it is declining very slowly. In contrast, employer provision of health insurance after retirement has dropped dramatically. According to the Kaiser Family Foundation, the percent of firms with 200 or more employees offering retiree health insurance dropped in half between 1988 and 2005; see Figure 3.11. This drop dramatically changes the incentives facing workers in their late 50s and early 60s. If they stay with their employer, they will continue to receive health insurance. If they leave the workforce before age 65, when they qualify for Medicare, they will be uninsured and forced to purchase insurance on their own—a very expensive undertaking. The combination of a decline in retiree health insurance coverage with the rapid rise in healthcare costs gives workers a strong incentive to maintain their current employer-provided coverage until they qualify for Medicare at 65.

In short, a large number of factors could explain the increase in labor force participation among older male workers since the mid-1980s. The contraction of the retirement income system, which increases participation via an "income effect," is an effect that will take place mainly in the future. But substantial changes in Social Security benefits and employer-provide pension plans have raised the value of work vis-à-vis retirement, which increases labor force participation via a "substitution effect." The fact that the increase in older men's participation has occurred mainly after age 62, and especially after age 65, suggests that changes in the

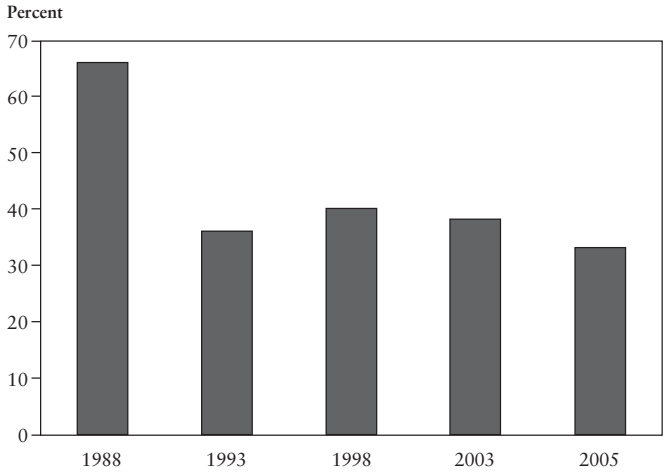

Figure 3.11
Percent of U.S. Firms with 200 or More Workers Offering Retiree Health Benefits, 1988–2005
Source: Kaiser/Health Research and Educational Trust Employer Health Benefits Survey: 2003, 2005; KPMG Survey of Employer-Sponsored Health Benefits: 1988, 1993, 1998.
http://www.kff.org/insurance/7315/sections/upload/7315Section11.pdf.

Social Security earnings test and the Delayed Retirement Credit have been quite important; refer again to Figure 3.10. On the other hand, a recent study focusing on this older segment of the workforce suggests that non-pecuniary considerations might also play an important role (see Haider and Loughran 2001). Older labor force participants tend to be among the more educated, healthiest, and wealthiest elderly Americans. Moreover, the fact that the wages earned at these older ages are lower than those of their younger counterparts, and lower than their own past earnings, suggests that money may not be the prime motivator for their continued labor force participation.[32]

The important question is whether this trend toward later retirement will continue, and whether U.S. workers will respond to the contraction of the retirement income system by remaining in the workforce longer. Boomers certainly claim that they will want to work longer, but will they follow through with their plans?[33] To provide some basis for predicting

future labor force trends, the following sections look at how career patterns have changed over time, the physical health of older workers, and the remaining incentives to retire early.[34]

IV. Patterns of Employment

The above discussion has focused on the labor force participation of older male workers. Another dimension of work patterns is the extent to which and when people change jobs over the course of their working life. This pattern is important because older workers are likely to have an easier time staying employed and enjoy higher wages if they remain with their long-term employer rather than scurrying about the labor market trying to find a new job in their late 50s and early 60s. Evidence suggests that firms are reluctant to hire older workers, and the loss of firm-specific human capital means that productivity, and hence wages, often fall when workers move to a new job (see Lahey 2006, Johnson and Kawachi 2007).

Tenure Patterns

Despite the apparent interest of older workers in remaining with their current employer, one would expect to see shorter tenures and more mobility as a result of the shift from defined benefit to defined contribution plans. The shift in employer-provided retirement plans reflects a diminished interest in career employment on the part of both firms and employees. The original purpose of defined benefit plans was to induce workers to remain with their employer until retirement, then to retire "on time" at the age specified in the plan (Sass 1997). To accomplish this goal, plans based benefits on years of service and earnings in a worker's final working years, so the value of accrued pension benefits increased rapidly as job tenures lengthened and earnings rose, and then declined as workers aged past critical benchmark ages. Workers with defined benefit plans who change jobs prematurely, even when moving to firms with identical plans and immediate vesting, receive significantly lower benefits in retirement than do workers with continuous coverage under a single plan. Both the changing mechanics of employment and changing tastes would lead one to expect more worker mobility and shorter job

tenures in a 401(k)-dominated world. These shifting incentives would be expected to affect primarily older workers, since at younger ages the pension costs of switching jobs have always been minimal.

This expectation is borne out in the median tenure data for employed males taken from the Current Population Survey and presented in Figure 3.12.[35] The results are striking in two respects. First, before 1990 the median years of job tenure is virtually flat for every male age group between age 25 and age 64. These data confirm much of the earlier work on mobility that showed very little change during the 1970s and 1980s (see Neumark 2000, Gottschalk and Moffitt 1999). Second, beginning in 1990, after a decade of 401(k) plans being in place, the median job tenure for men at older ages (55+) starts to decline. If the shift in pension coverage from defined benefit plans to defined contribution plans were to have an effect, this is where and when one would expect to find it. As noted above, pension accumulations are very small at younger ages, and never really impeded mobility among younger workers, so the shift in the

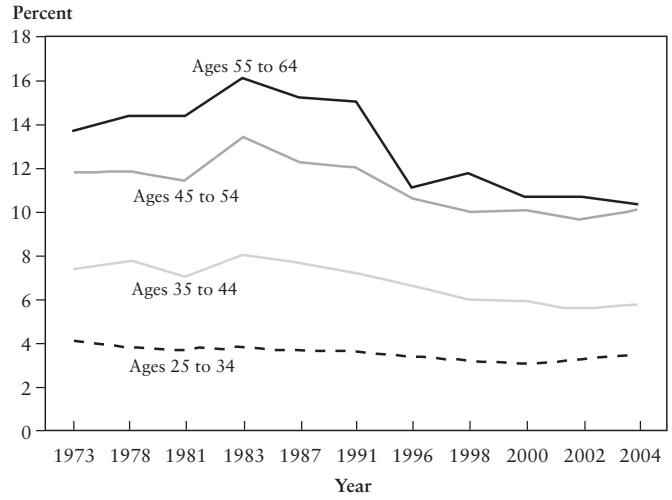

Figure 3.12
Median Years of Tenure for Employed American Men by Age, 1973–2004 (Current Population Survey data)
Source: Authors' calculations from U.S. Bureau of Labor Statistics and U.S. Census Bureau (1973–2004).

type of pension coverage would affect the mobility only of older workers.[36] Similarly, we would not expect the effect to become evident until a significant percent of older workers were covered by 401(k) plans, and this did not happen until the 1990s.

The Current Population Survey data can also be used to see how many workers remain with the employer they worked for when they were age 50.[37] The results for the years 1983 and 2004, which are shown in Figure 3.13, mirror the tenure information presented above. In the early survey, at age 60, almost 80 percent of male workers were working for the same firm as they were when they were 50 years old. By 2003, the picture changes noticeably; at age 60 less than 45 percent were working full time with their age-50 employer. In short, male workers in their 50s appear to be shifting jobs more in a pension world dominated by 401(k) plans than they did when covered by defined benefit plans. The old notion that men settle into some form of lifetime employment by middle age and stay there through retirement no longer holds for the majority of older

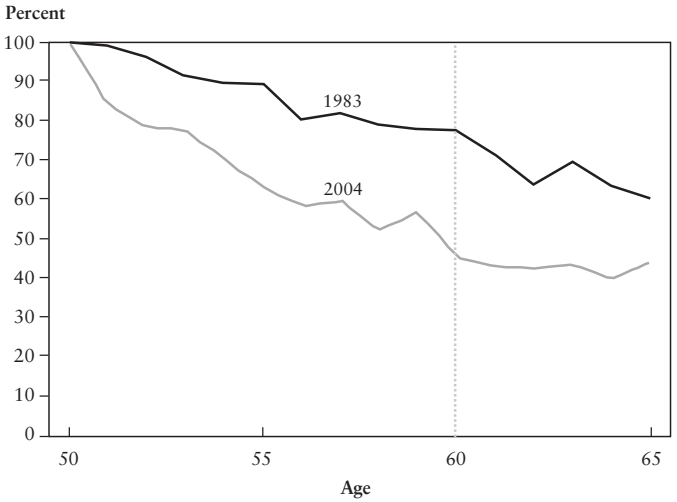

Figure 3.13
Percent of American Men Working Full-Time Who Remained in the Same Job since Age 50, 1983 and 2004
Source: Authors' calculations based on U.S. Bureau of Labor Statistics and U.S. Census Bureau (1983, 2004).

American men. One question this prompts is the extent to which this job switching at older ages is voluntary. That is, do workers move on their own volition or are they laid off from a long-held job, and forced to find a new one? One measure of layoffs is displacement rates. Have job displacement rates increased over time?

Displacement Rates

The Displaced Worker Surveys attempt to measure the number of workers who have lost their job through no fault of their own.[38] The displacement rates for older workers, while cyclical, show no discernable upward or downward trend over the period 1984–2004; see Figure 3.14.

Simple averages, however, cannot reliably indicate whether the plight of older U.S. workers is getting better or worse, because many factors are changing simultaneously. For example, the educational gap between older and younger workers has virtually disappeared, which suggests that older workers—all else remaining equal—should be less likely to be laid off. On the other hand, the shift away from career employment—defined as employment with a single firm from middle-age (at the latest) until

Figure 3.14
Job Displacement Rates by Age Group, 1984–2004
Source: Munnell, Sass, Soto, and Zhivan (2006) based on U.S. Bureau of Labor Statistics and U.S. Census Bureau (2004).

retirement—suggests older workers would be more likely to be laid off. In order to isolate the impact of age on displacement rates, it is necessary to control for the various ways in which older workers might differ from their younger counterparts. This can be done through the use of a probit regression that estimates the probability of being displaced from one's job, and includes variables for gender, marital status, race, education, industry, and full-time status as well as age.[39] Controlling for these other factors, Figure 3.15 shows the effect of age on the probability of being displaced. Being in the 50-54-year-old age group reduces the probability of being displaced by somewhere between 0 percent and 7 percent. Interestingly, the beneficial effect of increased age on job tenure appears to be declining over time.[40] Thus, the results suggest that older workers are slightly more likely to be laid off today then they were in the past.

But that is not the end of the story. Figure 3.16 reports the results for the same type of equation, but this time includes tenure variables, and

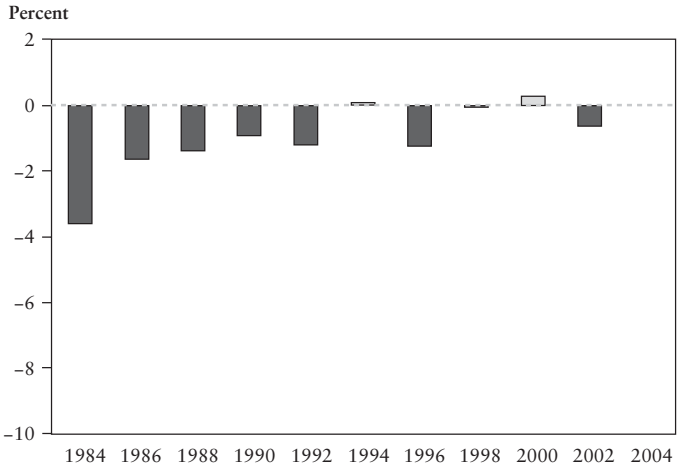

Figure 3.15
Probability of Job Displacement for U.S. Workers Aged 50 to 64 Years, Compared with the Probability for U.S. Workers Aged 20 to 49 Years, 1984–2004 (Displaced Worker Survey)
Source: Munnell, Sass, Soto, and Zhivan (2006) based on U.S. Bureau of Labor Statistics and U.S. Census Bureau (2004).
Note: Gray bars indicate results that are not statistically significant.

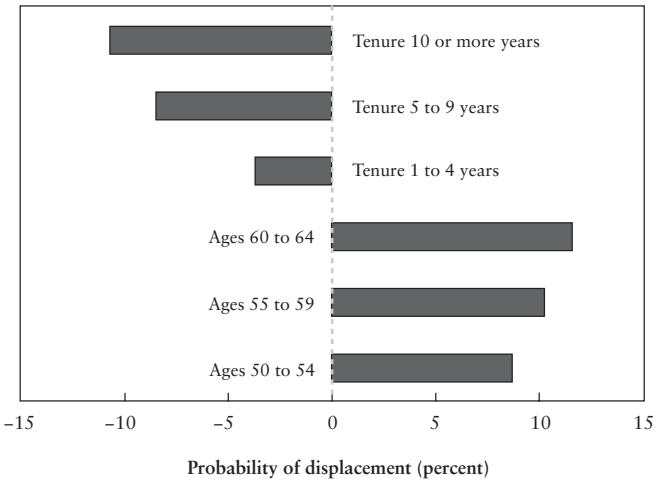

Figure 3.16
The Effect of Job Tenure and Age on the Probability of Displacement for Older U.S. Workers, 2004 (Displaced Worker Survey)
Source: Munnell, Sass, Soto, and Zhivan (2006) based on U.S. Bureau of Labor Statistics and U.S. Census Bureau (2004).
Note: All results are statistically significant.

shows that job tenure—not age—protected older workers from displacement. Holding tenure constant, older workers are actually more likely than their younger counterparts to be displaced.[41] Thus, to the extent that workers change jobs late in their careers, they are increasing their risk of eventual displacement. These older workers lose the protection afforded by long-term tenure and face the increased risk of displacement associated with age. Involuntary displacement has an extremely negative effect on the probability of older workers getting another job (Chan and Stevens 2001). This reduced probability could be the result of workers not being willing to supply their labor at the lower wages they are offered in the labor market, or of employers being unwilling to hire displaced older workers. It is very difficult to untangle the effects of labor supply and labor demand. But it appears that older workers have already experienced some increase in displacement risk, and put themselves more at risk when they change jobs. Therefore, not all of the increase in mobility among older workers appears to be voluntary.

Changes in Compensation and the Effect on Labor Supply

Two recent changes—the rapid rise in the share of older workers in the labor force and the decline of career employment—could significantly affect the compensation received by older workers, and thereby their labor supply.

The share of older workers in the U.S. labor force is increasing significantly. According to the Bureau of Labor Statistics, workers aged 55–64 years rose from 9 percent of the workforce in 1990 to 14 percent today, and are projected to exceed 18 percent in 2020, as shown in Figure 3.17.

Economic theory suggests that the age distribution of the workforce affects the wage structure, and the relative wages of older workers do appear to be inversely related to the share of older workers in the composition of the labor force. The notion here is that workers with different amounts of labor market experience are imperfect substitutes for each other. More experienced workers, who have acquired on-the-job training or simply learned by doing, generally perform different tasks and play

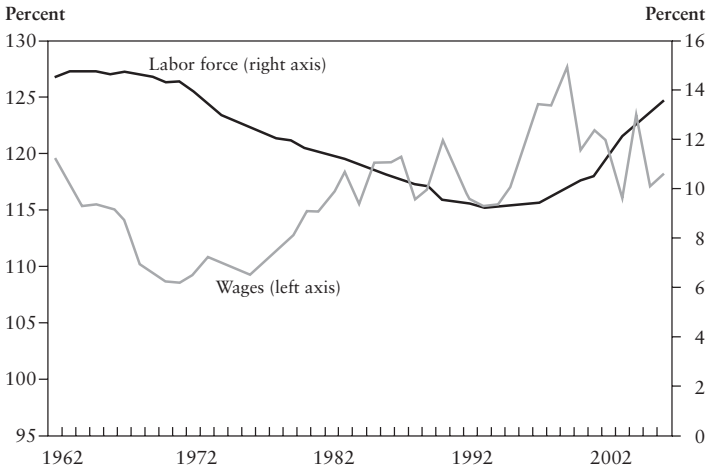

Figure 3.17
Labor Force Shares and Wages of Men Aged 55 to 64 Years as a Percent of Male U.S. Workers Aged 64 Years and Younger, 1962–2006
Source: Authors' calculations based on U.S. Bureau of Labor Statistics and U.S. Census Bureau (1962–2006) and U.S. Bureau of Labor Statistics (2007).
Note: Wages are for those who graduated from high school.

different roles within the organization. As the supply of workers with a given level of experience grows, the wages of that group will decline relative to the rest of the workforce, producing a cohort effect. The magnitude of the wage decline will depend on the extent to which workers with different degrees of experience can substitute for each other.

A number of studies have examined how relative wages have changed as the baby boom generation first entered the market and then aged. A now-famous analysis, subtitled "The Baby Boom Babies' Financial Bust," found that the wages of young white men were reduced relative to those of older white men as the baby boomer cohorts started entering the labor market (Welch 1979).[42] A recent study found that the depression of wages due to cohort crowding follows workers throughout their careers (Triest, Sapozhnikov, and Sass 2006). Thus, it seems reasonable to conclude that the increasing share of older workers in the labor force will depress their wages relative to those of younger workers.

Two further comments are required regarding the cohort crowding effect. First, the shift away from defined benefit plans has reduced the relative *compensation* of older workers even more than indicated by the decline in relative wages. Pensions in defined benefit plans are based on tenure and final salary, and become more costly to the employer as workers approach retirement; so the value of non-wage pension compensation in defined benefit plans rises rapidly at the end of workers' careers. The shift to 401(k) plans has eliminated such differential non-wage compensation received by older workers, which reinforces the finding that the increasing share of older workers in the labor market has an adverse effect on their market value. On the other hand, U.S. labor force growth in general is slated to slow. It is possible that the supply of labor may fall short of demand, thereby putting upward pressure on labor compensation, an effect that could mitigate some of the downward pressure on the compensation of older workers. On balance, however, both the experience premium and pension gains enjoyed by older workers will likely be lower in the future. As a result, work will look less desirable for older Americans relative to retirement and, as a result, they may be less willing to supply their labor.

The second labor-market change that could affect the labor supply of older men is the decline of career employment. This change, which was discussed above, is depicted clearly in Figure 3.18, which classifies the male population aged 55–64 in 1983 and in 2004 as: a) not working; b)

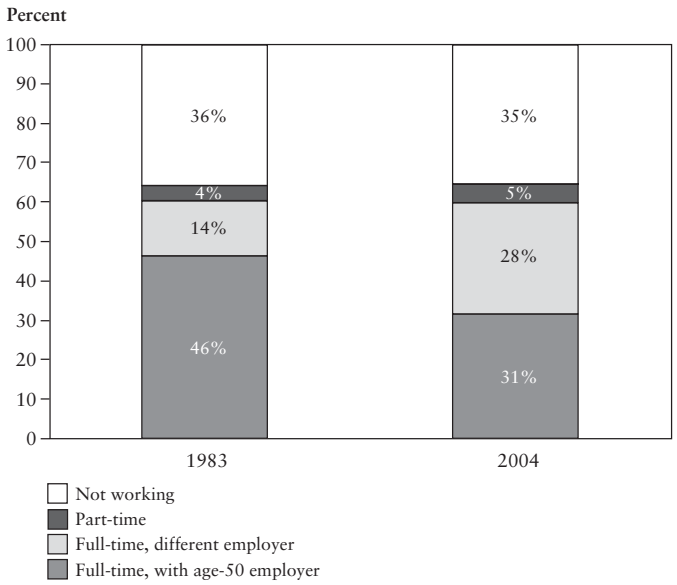

Figure 3.18
Employment Patterns of American Men Aged 55 to 64 Years, 1983 and 2004
Source: Authors' calculations based on U.S. Bureau of Labor Statistics and U.S. Census Bureau (1983, 2004).

working part-time; c) working full-time with same employer as at age 50; or d) working full-time with a different employer. The portion of this age group not working (36 percent–35 percent) or working part-time (4 percent–5 percent) was virtually identical in 1983 and 2004. But the distribution of full-time workers changed dramatically. In 1983, most full-time workers aged 55–64 years were with their age-50 employer, while in 2003 only about half of this same age group was with their same employer.[43]

This increase in mobility would be expected to impact wages. Separations from long-term employment relationships involve a loss of firm-specific human capital. Job changes also involve a loss of seniority-based protections that shield older workers from the consequences of skill erosion. Thus, a shift to a new employer would seem to suggest a fall in wage and benefit compensation. A simple comparison of wages for full-time workers who switch jobs with those who do not reveals that over the

1983–2004 period, the wages of job switchers averaged about 75 percent of those for full-time workers who remained with their age-50 employer; see Figure 3.19.

Interestingly, regardless of the reason why workers leave a long-term employer, their subsequent earnings tend to decline. A recent study (Johnson and Kawachi 2007) used the Health and Retirement Study (HRS) to explore the effect of job changes on wages, benefits, and satisfaction among workers aged 45–75 years who changed employers between 1986 and 2004. Figure 3.20 shows how those older workers leaving jobs held for more than 10 years were distributed by age and by reason for separation: retirement, layoff, voluntary quit, and "involuntary quit" (health, family reasons, personal problems, dissatisfaction with working conditions, etc.) Workers were characterized as retired if they said they left their previous job to retire. Most of the moves recorded in the HRS occurred among workers aged 51–60. Retirements accounted for about one-third,

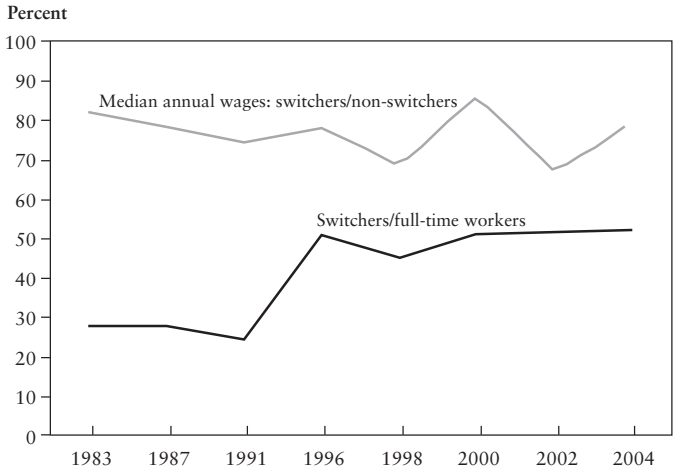

Figure 3.19
Percent of American Men Aged 55 to 64 Years Working Full-time Who Switched Jobs, and Switchers' Wages as a Percent of Non-Switchers' Wages, 1983–2004
Source: Authors' calculations based on U.S. Bureau of Labor Statistics and U.S. Census Bureau (1983–2004).
Note: A "switcher" is one who no longer works for his age-50 employer.

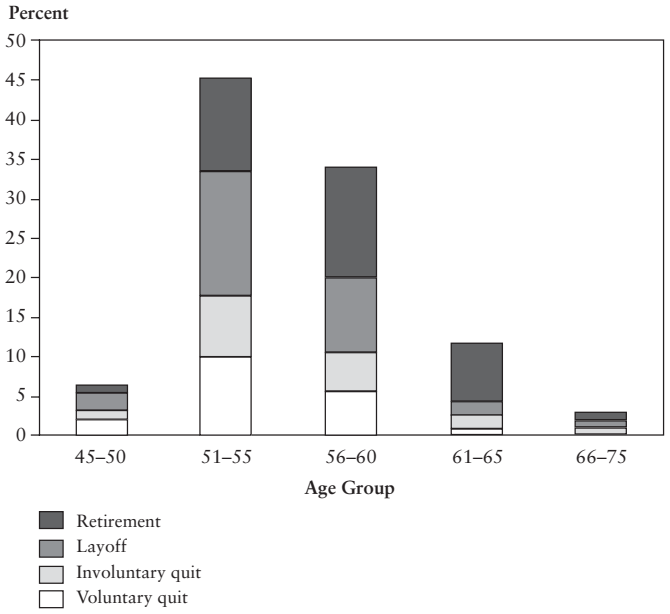

Figure 3.20
Percent of Older American Workers Who Changed Jobs, by Age and Reason for Separation, 1986–2004
Source: Authors' calculations based on Johnson and Kawachi (2007).
Note: Figure refers to those workers in the Health and Retirement Study whose former job lasted more than 10 years. "Involuntary quit" includes leaving job because of relocation, poor health and disability, family or child care responsibilities, marriage, spouse's preferences, personal problems, or dissatisfaction with work hours or length of commute.

layoffs for about one-third, and voluntary and involuntary quits for the remaining third of job separations.

Intuitively, one would think that the relationship between the reason for leaving a job and the workers' subsequent wages would be as follows: wages would fall sharply in the case of retirement, because the purpose of leaving is to work less hard. The second biggest decline would occur in the case of layoffs, because displaced workers usually face a costly search process and end up in an inferior position. A smaller decline might occur among those who quit for personal or health reasons. Finally, one might expect no decline and even an increase in wages for those who quit

voluntarily, presumably to accept "better jobs" with higher compensation and/or more non-monetary rewards. The percent losing pension and health benefits would be expected to follow a similar pattern. Figure 3.21 confirms the expected pattern, with the exception that even those who quit voluntarily suffer some drop in wages.

The conclusion that emerges from this evidence is that increased job mobility, like the effect of cohort crowding, will mean that the relative compensation of older workers will likely decline. This lower compensa-

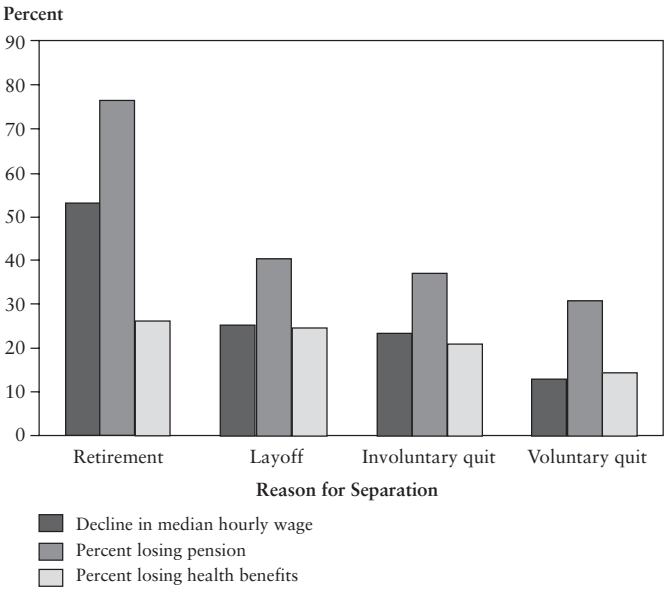

Figure 3.21
Percent Decline in Wages and Fringe Benefits Among Older American Men Who Changed Jobs after 10 Years or More with Former Employer
Source: Authors' calculations based on Johnson and Kawachi (2007).
Note: This figure shows wage and fringe benefit changes for workers whose former job lasted more than 10 years. Loss of pension encompasses those who were covered by a pension on their old job but not on their new job. Loss of health benefits encompasses those who were covered by health benefits on their old job but not on their new job."Involuntary quit" includes leaving job because of relocation, poor health and disability, family or child care responsibilities, marriage, spouse's preferences, personal problems, or dissatisfaction with work hours or length of commute.

tion can be expected to reduce the willingness of workers to supply their labor at older ages. One confounding effect of this conclusion, however, is that laid-off workers, as well as those who quit, report significant nonpecuniary gains (Johnson and Kawachi 2007). The new jobs tend to be less stressful and less physically demanding than their old ones. And more workers report that they enjoy work.

More Heterogeneity in Labor Supply at Older Ages

The shift to 401(k) plans and the increased mobility of older workers also means that in the future retirement is going to become a much messier process than it was in the past.[44] When mandatory retirement was the norm, both parties knew that the employer-employee relationship would end at a certain age. Employers also used traditional defined benefit pension plans to structure an orderly departure. No such structure exists in a 401(k) environment. Employers face the prospect of workers with declining productivity and inadequate 401(k) balances hanging onto their jobs much longer than, from the employer's standpoint, is desirable. In fact, employers in a recent survey employers indicated that they expect half of their older workers will lack the resources needed to retire at their traditional retirement age; that they expect half of these unprepared workers will want to remain on the job; and that the employers were lukewarm about retaining even half of those who will want to stay on (Munnell, Sass, and Aubry 2006). Employers will thus need new severance tools to manage an older workforce. Without such means, employers will avoid retaining or hiring older workers. The severance tool could be a "carrot," such as a generous retirement package, or a "stick," such as some form of mandatory retirement. Of course, the latter would be extremely controversial. But it is important to recognize that the shift away from employer-defined benefit plans means no mechanism exists to ease the bulk of the baby boom into retirement.

V. The Health of Older Workers

Intuitively, people's health affects their ability and desire to participate in the labor force. Poor health can make work seem very difficult and unpleasant, leading people to withdraw from the labor force. Poor health can also reduce people's productivity, leading to lower wages, and lower wages reduce the incentive to work. In the last 35 years, the impact of health on labor force activity has become a major area of research, and virtually all studies show that poor health has a negative effect on the likelihood of remaining in the labor force, and on the expected retirement age, as well as hours worked and wages received.[45] The question is the extent to which health concerns pose an obstacle to people's ability to remain in the labor force longer.

One starting point for exploring the health of older workers is to look at trends in life expectancy at age 50. Figure 3.22 shows life expectancy at age 50 for American males over the twentieth century. Interestingly, life expectancy at older ages rose very slowly at the beginning of the century and then accelerated sharply toward the end of the century. In fact, life expectancy at age 50 was not very different in 1970 than in 1900—23 years versus 21 years. After 1970, however, life expectancy for American men at age 50 took off, rising to 27 years in 2000, and is projected to increase to 30 years by 2030.

Although longer life spans generally imply improvements in health, keeping less healthy people alive could actually increase the percent of the population with disabilities. Thus, for a time, researchers referred to the "failure of success" resulting from improvements in healthcare (see Waidmann, Bound, and Schoenbaum 1995). Today, the notion of such an increase in frailty among the elderly—those aged 65 years and older—has been decisively rejected. In 2002, a technical working group examined disability trends for older Americans recorded across five major national surveys.[46] The group concluded that, when standardizing for the definition of disability, the time period, and the consistent inclusion or exclusion of the nursing home population, all five surveys showed consistent downward trends for two common disability measures—having difficulty with daily activities and requiring help with daily activities—beginning in the early to mid-1990s. The evidence remained mixed for a change in disability rates the 1980s and for the overall trend using a third measure of disability—the use of help or equipment with daily activities.

The fact that the health of older Americans has improved would lead one to conclude that the health of the older *working-age* population has also been getting better. But for a long time, such a conclusion was not

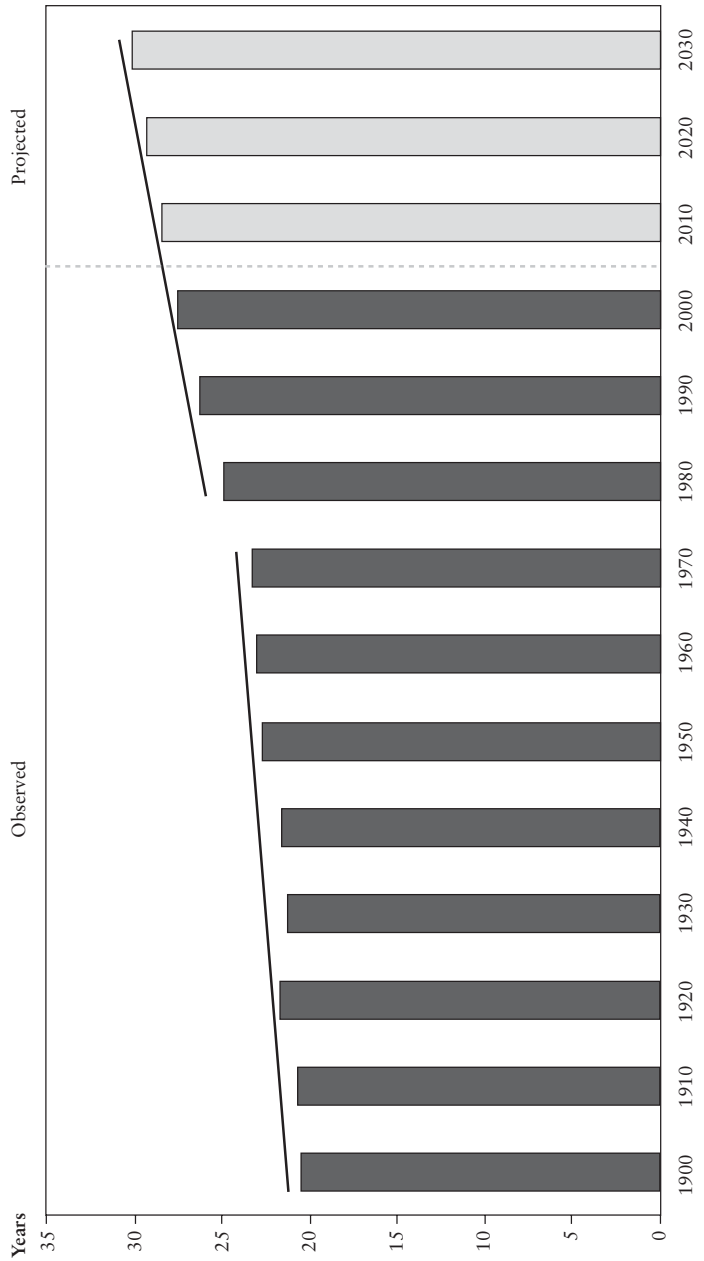

Figure 3.22
Years of Life Expectancy for American Men at Age 50, 1900–2030
Source: Munnell and Libby (2007) based on data from the U.S. Social Security Administration.

obvious. The major survey that tracked disabilities among the working-age population—the National Health Interview Survey (NHIS)—showed the percent of this population with disabilities increasing from the mid-1960s through the early 1980s; see Figure 3.23.[47] Decennial census data also showed an increase in the fraction of both working-age men and women unable to work during the 1970s. Skeptics of the increasing disability story contend that the trend during the 1970s may, at least in part, reflect social factors such as earlier detection and diagnosis of chronic diseases and greater availability of disability insurance.[48] Thus, the trend in the prevalence of disabilities during the 1970s remains controversial.

Since the early to mid-1980s, however, the health of the older U.S. working-age population has unquestionably improved. The percent of those aged 45–64 years with a disability declined through the mid-1990s, as shown in Figure 3.23. Between 1997 and 2004, responses to a similar survey question produced a more stable trend. But the general conclusion emerging from the NHIS data is one of declining disability among

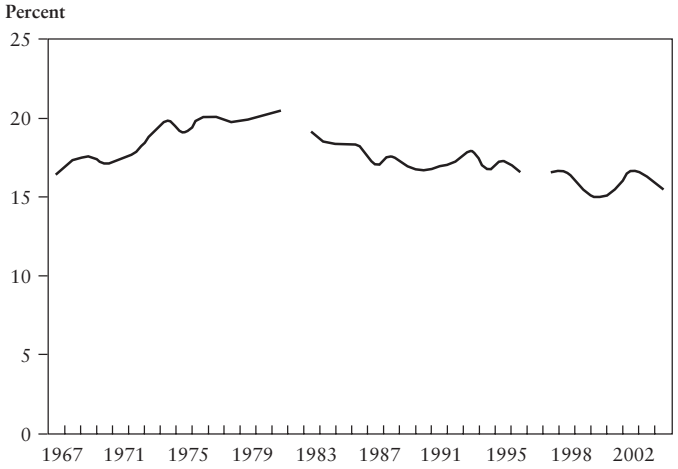

Figure 3.23
Percent of American Men Aged 45 to 64 Years with Disabilities, 1967–2004 (National Health Interview Survey)
Source: National Center for Health Statistics (1967–2004).
Note: From 2002 to 2004, the figure shows work limitations for all persons instead of males only.

older working-age individuals to a level that is at least comparable to that in the mid-1960s. Thus, the evidence suggests that the health of older workers is at least as good today as it was forty years ago. Moreover, as mentioned earlier, today's jobs are much less physically demanding. As a result, physical limitations should not inhibit the ability of the bulk of older Americans to work at least until their mid-60s.

The same data that support the possibility of continued work for the bulk of the older working population also it make clear that, despite a positive trend, 15 to 20 percent of people in their late 50s and 60s will find it virtually impossible to continue participating in the labor force. The data from the NHIS are consistent with responses from the Health and Retirement Study regarding the extent to which retirement was voluntary. As shown in Figure 3.24, 35 percent of those Americans who retired between 1992 and 2002 claimed that their retirement was involuntary, with 18 percent citing poor health as the reason for leaving the workforce. Moreover, many of those people who need to work longer—particularly low-wage workers dependent on Social Security for the bulk of their retirement income—are precisely the same individuals who have physically onerous jobs that stress their health, and who lack education, which has been shown to be important in managing their medical care. Thus, the "working longer prescription" must be administered with care, as some older Americans will simply be unable to adhere to this protocol.

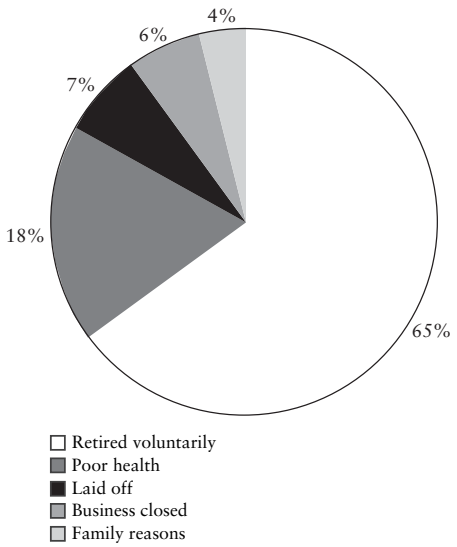

Figure 3.24
American Workers' Reasons for Retiring, 1992–2002
Source: Authors' calculations based on University of Michigan (1992–2002).

VI. Obstacles to the Labor Force Participation of Older American Workers

At least two major obstacles might hinder older workers from offering their services in the coming years and decades. The first is the availability of Social Security benefits at age 62. The second is the fact that employment seems to be an "all or nothing" full-time proposition, with relatively little room for gradually reducing hours or working part-time.

Social Security's Earliest Age of Eligibility

Social Security offers retirement benefits at 62 years of age. The early retirement benefits are actuarially reduced, and the reduction is designed to be "age-neutral." That is, two people with average life expectancy—one who claims benefits at 62, the other at 65—receive equal lifetime Social Security benefits.[49] Despite the actuarial reduction, the vast majority of American workers continue to claim Social Security benefits well before reaching age 65. In 2004, 59 percent of women and 54 percent of men claimed benefits at age 62; see Figure 3.25. The claiming of benefits coincides with the average retirement age, which is now 63 years for men and 62 years for women.[50]

Social Security's retirement age for full benefits is scheduled to increase from 65 to 67 years by 2022.[51] But under current law, the EEA remains unchanged at 62. Raising the full retirement age, however, will increase the actuarial reduction for claiming benefits at age 62 from 20 percent to 30 percent. But people's claiming behavior and retirement decisions appear more sensitive to the availability of benefits than to benefit amounts, so age 62 may well remain an important retirement benchmark for many Americans.[52]

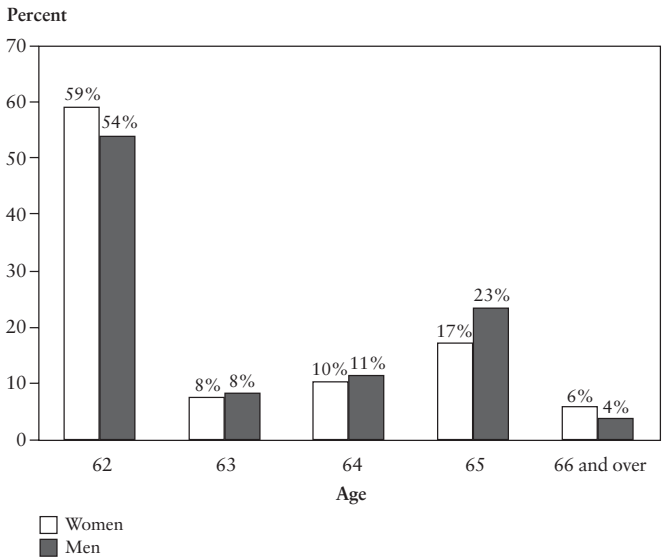

Figure 3.25
Age Distribution of Initial Receipt of Social Security Benefits, 2004
Source: U.S. Social Security Administration (2006) and authors' calculations.

Raising the EEA to 64 would likely encourage people to work longer by removing the opportunity to get benefits earlier. But this proposal is controversial. First, without instituting any other changes, raising the EEA has virtually no impact on the system's long-term finances. Any additional work effort brings in some additional payroll tax revenues, but the fact that the benefits were actuarially reduced means virtually no net savings.[53] Second, as discussed above, a significant fraction of Americans will be unable to work past age 62, either because they are in poor health, because their jobs are physically demanding, or because they have experienced job displacement later in life, and cannot find work at their age.[54] Therefore raising the EEA would inevitably involve some expansion of the disability program for older workers or some similar accommodation. Another problem is that a higher EEA would reduce lifetime Social Security wealth for those with lower-than-average life expectancies. Since African-Americans and low-wage workers have lower-than-average life expectancies, a higher EEA might be considered unfair to these groups. So raising the EEA might need to be part of a larger reform package which includes provisions that offset such losses to particular groups.

Raising the EEA, however, seems like an essential step to ensure that older adults continue to participate in the labor force. Moreover, raising this official age may not only increase the willingness of workers to supply their labor but may also enhance the willingness of employers to retain and hire older workers. A recent survey asked firms about the impact of various characteristics that affect their evaluation of older workers. A major negative factor was the perception that older workers will be on the job for only a short time. To the extent that the likely departure date can be pushed out, employers will be more willing to hire, train, and promote older workers.

Firms' Resistance to Part-Time Employment

Another hurdle to the continued employment of older workers is that they consistently report wanting to work part-time. For example, a study based on the Health and Retirement Study reports that 56 percent of respondents aged 55 to 65 years in 1996 said they would prefer to gradually reduce their hours as they age (U.S. General Accounting Office 2001). Consistent with this finding, older self-employed people tend to reduce their work hours as they approach retirement. But few older workers have part-time positions, and part-time employment does not appear to be increasing; see Figure 3.26.

Currently, part-time employment is concentrated in small business establishments and in firms in the service sector (Montgomery 1988). This remains true even after controlling for other factors that would affect labor demand, such as wages, fringe benefits, seasonal fluctuations in demand, and hiring costs. It is not exactly clear why this is the case. Large firms might avoid hiring part-time workers because such workers tend to have higher turnover rates than full-time employees (Tilly 1991). Part-time work might be more common in the service sector because it is labor intensive and is subject to large fluctuations in demand, and because employers find it is easier to manage these fluctuations by using part-time workers. While all these theories are plausible, these explanations have not been supported by rigorous empirical studies (Hutchens 2001). Without an increase in the availability of part-time employment,

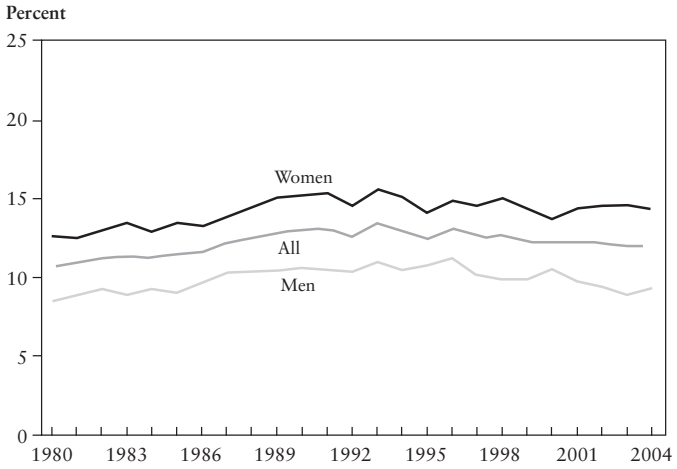

Figure 3.26
Percent of U.S. Workers Aged 55 to 70 Years Employed Part-Time, 1980–2004
Source: U.S. Bureau of Labor Statistics and U.S. Census Bureau (1981–2004).

however, many older adults may be unwilling to keep working. A recent study estimates that increased flexibility in work schedules would double the number of people entering partial retirement (Gustman and Steinmeier 2007).

In short, despite the need to build up their stock of retirement wealth, older workers may find the lack of part-time work opportunities and the availability of Social Security benefits at age 62 too tempting to pass up, and continue to retire early. And not all older people can remain in the workforce into their mid- to late-60s. Some have health problems or have been laid off and are unable to find another job, while others see continued employment as simply too onerous.

VI. Conclusion

Greater labor force participation by older U.S. workers would make an important contribution to national output, increase tax revenues, and dramatically improve retirement income security. Some indication that people might be willing to work longer comes from the fact that the century-long downward trend in the labor force participation of older men has clearly ceased, and their participation has actually been rising since the mid-1990s. The question is whether this upward trend in older men's workforce participation will continue.

Going forward, some key changes in the nation's retirement income system should encourage greater labor force participation by older workers. The share of pre-retirement earnings Social Security will replace at any claiming age is falling. Given rising longevity and the meager balances in the now dominant 401(k) accounts, the replacement income provided by employer plans, for retirement at any given age, is also likely to fall. The "income effect" of such reductions should increase labor force participation. In addition, the shift to 401(k)s and changes in the Social Security program that have essentially eliminated the subsidies for taking early retirement and penalties for taking later retirement should also raise participation rates. The "substitution effect" of these changes is to raise the cost of retirement relative to work to its actuarially appropriate level. Moreover, jobs in today's economy are less physically demanding, and today's older people are healthier than earlier cohorts.

Impediments still remain, however, to the continued employment of older workers. The most important obstacle is the availability of Social Security benefits at age 62. Even today, with the elimination of the earnings test after the Full Retirement Age and an actuarially fair Delayed Retirement Credit, the majority of U.S. workers continue to claim their benefits as soon as they are eligible to do so. Another important factor is the decline in career employment, with the majority of older workers now needing to negotiate the vagaries of the labor market if they are to work into their mid- to late-60s. Enduring extended and difficult job searches, as well as confronting the prospect of only earning low wages, may cause many older workers to simply give up and exit the workforce. Moreover, older people have a strong preference for part-time jobs and flexible work schedules, desires which, to date, many employers have been reluctant to accommodate. Finally, 15 percent to 20 percent of older people are probably not healthy enough to work beyond age 62.

What's the bottom line? Today, approximately 70 percent of American men aged 55–64 years are in the labor force, up from a low of 66 percent in the mid-1990s. Given the contraction of the retirement income system, labor force participation for this group is unlikely to start head-

ing back down. Will it continue to increase? In 1960, before men could claim Social Security benefits at age 62, before the enactment of Medicare and significant increases in Social Security replacement rates, and before employer pensions became a widespread source of retirement income, 87 percent of men aged 55–64 years were in the labor force. We are unlikely to see this high level again, given the increase in household wealth, some of which people want to spend on more leisure at the end of their work life, and the availability of Social Security benefits at age 62. Our best guess is that by 2030, without a significant change, such as an increase in Social Security's Earliest Eligibility Age, labor force participation rates for men 55–64 years may be 75 percent—up five percentage points from today's levels. This number is higher than the Bureau of Labor Statistics projection of 69 percent, as shown in Figure 3.27.

About 28 percent of American men aged 65–74 years are in the labor force today. Again, this percentage is unlikely to decline. Here, the 1960 level of almost 40 percent is a relevant benchmark for comparison. Again, some additional participation is likely to occur by 2030, but not to levels

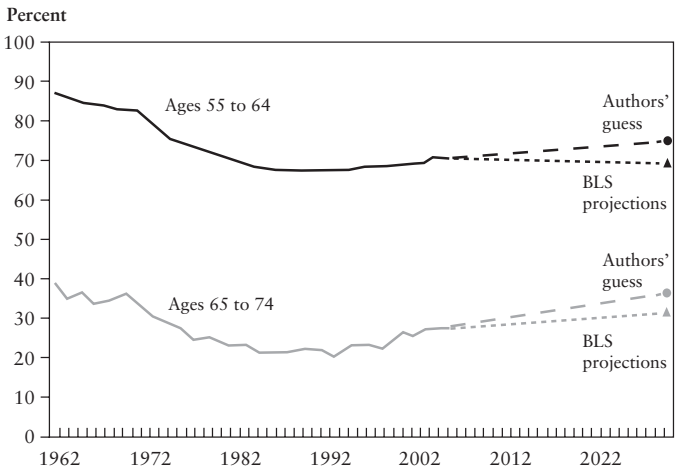

Figure 3.27
Older American Men's Actual Labor Force Participation Rates, 1962–2006, with Projection to 2030
Source: U.S. Bureau of Labor Statistics and U.S. Census Bureau (1980–2006) and U.S. Bureau of Labor Statistics (2007).

seen in the 1960s. On balance, the employment of older workers in the United States will likely rise, but fall well short of levels seen in 1960. Without changes that produce a further increase in participation rates, and raise the average retirement age to 66 or even 67 years, Americans are likely to see a significant drop in living standards in retirement.

■ *The authors would like to thank Jerilyn Libby for excellent research assistance on this project.*

1. Under legislation enacted in 1983, the increase in the Full Retirement Age began with those born in 1938, and turning 62 in 2000, and will be fully phased in for those born in 1960, and turning age 62 in 2022.

2. The premium for Medicare Part B is projected to increase from 9 percent of the average Social Security benefit in 2006 to 11 percent in 2030.

3. The pension coverage data discussed above apply only to individual workers at any given point in time. Over a lifetime and on a household, rather than an individual basis, coverage rates are somewhat higher. For households with two adults aged 55–64 years, the 2001 Survey of Consumer Finances shows that approximately 65 percent of households had some sort of pension coverage in 2001. Pension coverage is much more extensive for high-income households.

4. The annuity might provide a dollar amount per month for each year of service, say $50—so workers with 20 years of service would receive $1,000 per month at age 65. The benefit could also be a percentage of final salary for each year of service, say 1.5 percent; so workers with 20 years would receive 30 percent (20 years at 1.5 percent) of final salary for as long as they live. The employer finances these benefits by making pre-tax contributions into a pension fund; the company holds the assets in trust, directs the investments, and bears the risk. The Pension Benefit Guaranty Corporation (PBGC) insures pension benefits up to specified limits. The PBGC monthly guarantee limit in 2007 is $4,125 at age 65 years, and declines to $1,856 at age 55. Employers pay for this insurance with premiums largely determined by the plan's funding status.

5. For a 401(k), generally the employee, and often the employer, contributes a specified percentage of earnings into the account. These contributions are invested, usually at the direction of the employee, mostly in mutual funds consisting of stocks and bonds. Upon termination of employment or retirement, the worker generally receives the balance as a lump sum, albeit with the option to roll it over to an IRA.

6. This amount includes Individual Retirement Account (IRA) balances, because most of the money in IRAs is rolled over from 401(k) plans after an employer leaves a job. For further details, see Munnell and Sundén (2006).

7. In 401(k) plans, workers must decide whether or not to join the plan, how much to contribute, how to invest the assets, when to re-balance, what to do

about company stock, whether to roll over accumulations when changing jobs, and how to withdraw the money at retirement. The evidence indicates that a significant fraction of participants make serious mistakes at every step along the way. A quarter of those eligible to participate in 401(k) plans choose not to do so. Over half of those that do participate fail to diversify their investments. Many over-invest in company stock. Almost no participants re-balance their portfolios as they age or in response to market returns. Most importantly, many cash out these accounts when they change jobs, rather than rolling them over to another 401(k) or IRA, and very few annuitize these accounts at retirement to guarantee a lifetime income stream. The basic problem is that for most individuals, making their own financial decisions is difficult. Most participants lack sufficient financial experience, training, or time to figure out what to do, and the end result is often a significant shortfall in their retirement savings.

8. Penner and Johnson (2006) estimate that rising healthcare costs and the taxes required to cover these costs in retirement will require a moderate-income couple to work an additional 2.5 years, under the scenario assuming higher healthcare costs and higher tax burdens, to receive as much income in the first year of retirement—net of taxes and out-of-pocket health spending—as they would receive under the low-cost scenario of more moderate healthcare costs and future taxes.

9. In addition to addressing the financial issue, working longer appears to help individuals maintain their overall physical and mental well-being (see Calvo 2006).

10. Similarly, Butrica, Johnson, Smith, and Steuerle (2006) concluded that many people could increase their consumption by more than 25 percent at older ages simply by retiring at age 67 instead of age 62.

11. A 1570 census of the poor, in Norwich, England, thus found three widows, aged 74, 79 and 82 years, "almost past work" but still earning a small income from spinning. Estates left by the elderly in colonial America often included tools used in less strenuous trades, such as tailoring, spinning, shoemaking, and weaving. And well into the nineteenth century, about half of all 80-year-old men in America still worked (Thane 2000).

12. The Census measured the "gainful employment rate" until 1940 and then the labor force participation rate, defined as the percentage of the adult population working or actively looking for work.

13. See Graebner (1980).

14. Life expectancy at age 20 for men in 1900 was 44 years, compared to 59 years in 2000 (U.S. Social Security Administration). Also see Lee (2001) for the rapid rise in the expected length of retirement of workers entering the labor force between 1850 and 1990.

15. Favorable tax provisions had a limited effect on employer-provided pension coverage before World War II, as less than 10 percent of the adult population typically paid income tax. But the postwar growth of mass income taxation made pensions far less costly to employers and workers, and thus encouraged their spread.

16. Using evidence from the coal boom and bust, the collapse of the steel industry, and the general decline in manufacturing, Black and Liang (2005) conclude that the individual retirement decision is sensitive to prevailing economic conditions. This response most likely reflects elements of both labor supply and demand.

17. For example, suppose a person will live for 20 years and is entitled to a pension of $15,000 at age 65; lifetime benefits will equal $300,000 (20 × $15,000). To keep lifetime benefits actuarially constant, if that employee retired at 55, and was expected to live until age 85, his annual benefit should be only $10,000 per year (30 × $10,000 = $300,000). But traditional defined benefit plans typically provide far more because they use an actuarial reduction that is smaller than the full reduction. For instance, these plans might pay, say, $12,000 at age 55, which means that the worker in this example who retires at 55 would receive $360,000 (30 × $12,0000), substantially more in lifetime pension benefits than if he were to retire at 65. This exercise is actually somewhat more complicated because the employee adds to his pension if he continues to work, but the general example illustrates our main point.

18. Often, working beyond the plan's normal retirement age results in negative pension accruals. The law requires that the wage increases of those who work beyond the plan's normal retirement age be reflected in higher retirement benefits. But the law does not prevent firms from capping the years of service used to calculate benefits; nor does it require firms to provide actuarially fair adjustments for the fact that longer-working participants will receive benefits for fewer years (McGill et. al. 1996).

19. The change was made primarily to help younger widows and to allow wives, who were presumed to be two to three years younger than their husbands, to claim benefits at the same time as their husbands. Since it seemed unfair to require women workers to wait until a later age to receive benefits than mandated for non-working women, the EEA was introduced for all women. See Congressional Budget Office (1999).

20. In addition, Blau (1998) concludes that the availability of Social Security benefits is very important to the retirement decision, while changes in Social Security benefits over time have been considerably less important to this decision. On the other hand, Gruber (2000) found a sizable labor supply response to the level of disability benefits when comparing labor force participation in the Quebec system and in the rest of Canada, where disability benefits were increased.

21. For more details on recent trends, see Purcell (2005).

22. Under current law, individuals with less than $25,000 and married couples with less than $32,000 of "combined income" do not have to pay taxes on their Social Security benefits. (Combined income is adjusted gross income as reported on tax forms, plus nontaxable interest income, plus one-half of Social Security benefits.) Above those thresholds, recipients must pay taxes on either 50 or 85 percent of their benefits. Individuals must pay tax on 50 percent of their benefits if their "combined income" is between $25,000 and $34,000, and on 85 percent if above $34,000. A couple must pay tax on 50 percent of their benefits if their "combined income" is between $32,000 and $44,000, and on 85 percent if

above $44,000. (Committee on Ways and Means, U.S. House of Representatives 2000).

23. Benefits were cut a bit more than 1 percent per year until reaching a 6.7 percent cut for the cohorts turning 62 in between 2005 and 2017; the benefit cuts then resume and reach the full 13.4 percent reduction for cohorts turning 62 in 2022 and after. This full reduction will affect those cohorts born in 1960 and thereafter.

24. Prior to the introduction of early retirement, the earnings test was a tax, in that benefits lost in one year did not produce a benefit gain in later years.

25. Coile and Gruber (2000) note that in a context where workers make their retirement decisions based on the full future stream of Social Security benefits, raising the Delayed Retirement Credit could have a larger effect than raising the Full Retirement Age. Changing the Full Retirement Age has both an income effect that encourages work and a substitution effect that discourages work (via lower Social Security benefit accruals); but a change in the Delayed Retirement Credit has only a positive "substitution" effect that encourages work until age 65; after age 65, it has both an income effect (via the increase in Social Security wealth) that discourages continued work and a "substitution effect" that rewards work (via higher Social Security benefit accruals). Before age 65, their study shows that raising the Delayed Retirement Credit from 5 percent to 8 percent would increase labor force participation at age 65 by four percentage points.

26. Some researchers (see Eschtruth and Gemus 2002; Cahill, Giandrea, and Quinn 2006) suggest that those workers covered by defined contribution plans are sensitive to fluctuations in the stock market, and that the 2001 collapse of the stock market might explain why the labor force participation rate for older workers (aged 55–64 years) jumped 2 percentage points between early 2000 and 2002. This was an unprecedented increase that occurred during a recession, when labor force participation usually declines. This result would be consistent with studies by Gustman and Steinmeier (2002) and Coronado and Perozek (2003), which found that the unexpected positive shocks to wealth as a result of the stock market boom of the 1990s led to some additional retirement. Other researchers (Coile and Levine 2006) argue that few households had substantial stock holdings in this same period, and if workers were indeed so sensitive to stock market fluctuations, their labor force participation should have dropped as the market recovered, a decrease which did not happen.

27. In cash-balance plans, as in traditional defined benefit plans, the employer makes the contributions, owns the assets, selects the investments, and bears the risk. The Pension Benefit Guaranty Corporation also insures the benefits. To the employee, however, cash balance plans look very much like defined contribution plans. The employer typically contributes 4 or 5 percent of the worker's pay to a "notional" account, and provides an interest credit on the balances. Employees receive regular statements and generally withdraw the balance as a lump sum when they retire or terminate employment. Since these plans are not backloaded, employees suffer no loss in benefits as they move from job to job, and therefore these plans would not be expected to affect worker mobility. Bank of America created the first cash balance plan in 1985, and by 2003 these plans covered 22 percent of all U.S. employees and 26 percent of all assets in defined benefit plans (see Buessing and Soto 2006). Since 2003, extensive litigation has brought the expansion of cash balance plans to a virtual halt. However, the Pension Protection Act of 2006 clarified the legality of converting defined benefit plans to cash balance form, and this might prompt renewed interest among employers in converting defined benefit plans to cash balance plans.

28. Coronado and Copeland (2003) offer another perspective on the reasons for the shift to cash balance plans. They contend that these conversions occurred in competitive industries with tight labor markets, and were done largely to improve compensation for a more mobile workforce.

29. Massachusetts Office of the Governor (2001).

30. The share of men aged 55 to 60 years in a job that requires "lots of physical effort none or almost none of the time" increased from 31 percent to 38 percent between 1992 and 2002 (see Johnson 2004a).

31. Blau (1998), using the Retirement History Survey, found that among 30 to 40 percent of married couples, the spouses left the labor force within a year of each other. Hurd (1990), using the Social Security Administration's New Benefit Survey, estimated that among one-quarter of couples, the husband and wives retired within one year of each other. Johnson and Favreault (2001), looking at married couples in the 1998 wave of the Health and Retirement Study, calculated that between 22 and 40 percent of husbands and wives retired within two years of each other. These studies show that spouses tend to retire at the same time, generally because they want to spend time together. See also Johnson (2004b).

32. Indeed, a recent study (Lahey, Kim, and Newman, 2006) found that retirees who returned to work were no less financially prepared for retirement than were their counterparts who remained retired. Instead, the influential factors for returning to work were the availability of health insurance, whether or not the initial retirement decision was voluntary, and the degree of satisfaction with retirement. Maestas (2005), using the Health and Retirement Study, also concluded that financial pressures were not the reason for "un-retirement."

33. A recent study (Mermin, Johnson and Murphy 2006), using the Health and Retirement Study, reported a significant 4 percentage point increase between 1992 and 2004 in the expected probability among workers aged 51 to 56 years staying employed full-time past age 62, from 47 to 51 percent, and a similar increase in the probability of staying employed full-time past 65, from 27 to 33 percent. Controlling for other factors, self-employment, more education, and previous higher earnings increased work expectations, while defined benefit pension coverage, employer-sponsored retiree health benefits, and household wealth reduced expectations that older adults would remain in the workforce.

34. Costa (1998) cautioned researchers not to put too much emphasis on the recent uptick in labor force participation of older workers. As long as retirement

remains an attractive option and incomes continue to rise, people will want to use at least some of their increased wealth for retirement. The question is whether—even if income during people's working years continues to rise—the prospective decline in retirement income could provide the impetus for continued work.

35. The Current Population Survey (CPS) has asked respondents about job tenure since 1973. Specifically, CPS tenure supplements are available for 1973, 1978, 1981, 1983, 1987, 1991, 1996, 1998, 2000, 2002, and 2004. All data are from the Workplace Topics I (January/February) supplements, although the 1973 tenure data are from the displaced worker supplement. The job tenure question changes slightly over the period. In 1973, 1978, and 1981, the question refers to time spent working at the present job or business, while for 1983 and later the question refers to working "continuously" for the respondent's present employer. If respondents in the earlier surveys experienced temporary separations from their employer, their responses will make them look like they have more job tenure than they actually had. Since other researchers do not view this as a significant problem and make no adjustment, the raw median tenure data for employed males are presented in Figure 3.11.

36. See Allen, Clark, and McDermed (1988). Gustman and Steinmeier (1993) emphasize how small pension wealth is early in a worker's career, and argue that the main impact of defined benefit pensions would be to deter mobility for long-tenured workers.

37. Specifically, for each survey it is possible to identify those working full-time at age 55, 60, and so on who are still with the same employer they worked for at age 50. Mechanically, this exercise involves simply asking, say, the 55-year-old full-time worker, how long he has been with his current employer. If the response is five years or more, the worker is classified as working with his age-50 employer. The number working for their age-50 employer are then divided by total workers in these age groups to get the proportion in what used to be the typical pattern of employment for older workers.

38. The survey asks workers whether they lost their job for one of the following reasons: their plant or company closed down or moved; their company had insufficient work; their position or shift was eliminated; a seasonal job was completed; a self-operated business failed; other reason. These data do not include all job losses within the economy, because the survey collects and reports information on only one job loss for each individual and the distinction between layoffs and voluntary quits is not always clear. Nevertheless, this survey can be used to determine whether older workers are becoming more or less vulnerable to involuntary job displacement.

39. The analysis is limited to displacement because of plant closures, positions abolished, or slack demand for work. Using a more detailed set of 56 industry dummy variables instead of the set of private goods sector, private service sector, and public sector dummy variables had little effect on the coefficient estimates and standard errors for all other explanatory variables in the regressions.

40. As in earlier studies, women, married people, and those working full time have a low probability of being displaced, and race appears to have no impact on this probability. Private sector workers in goods-producing industries have a higher probability of being displaced than those in private sector service industries. In contrast, public sector employees have a much lower likelihood of being displaced than their private sector counterparts.

41. Over the 1996-2004 Displaced Worker Surveys, displacement rates averaged 15.9 percent for those workers with 0–1 years of tenure; 11.3 percent with those with 1–4 years; 5.5 percent for those with 5–9 years; and 4.0 percent for those with 10 or more years of tenure.

42. A study by Freeman (1979) reached similar conclusions.

43. Benitez-Silva (2002) explores the factors that lead older workers to engage in job search activities. The author finds that previous work attachment and health limitations are key factors in explaining the different job search behavior of both non-employed and employed individuals.

44. Reflecting this heterogeneity, a recent survey by Vanguard identified six different pathways to retirement. See Ameriks, Fergusson, Madamba, and Utkus (2007).

45. For a survey of the literature, see Currie and Madrian (1999); an update can be found in Deschryvere (2005).

46. See Freedman et al. (2004). The five surveys included the Health and Retirement Study (HRS), the Medicare Current Beneficiary Survey (MCBS), the National Health Interview Survey (NHIS), the National Long Term Care Survey (NLTCS), and the Supplements on Aging (SOAs).

47. The NHIS is an annual cross-sectional survey of 100,000 non-institutionalized civilians conducted by the National Center for Health Statistics. Unfortunately, the survey questions have been revised every 10 to 15 years, making it impossible to construct a series over a long period of time. Nevertheless, consistent data are available from 1967–1982, 1983–1996, and 1997–2004. For the period 1983–1996, the survey asked "Does any impairment or health problem now keep [the person] from working at a job or business? Is [the person] limited in the kind or amount of work [the person] can do because of any impairment?" A person who answers "yes" to either question is considered to have a disability that poses a work limitation.

48. See Waidmann, Bound, and Schoenbaum (1995).

49. More specifically, benefits are reduced by five-ninths of one percent for each month these are received prior to the Full Retirement Age (FRA), up to 36 months, and five-twelfths of one percent for each month thereafter. This is equivalent to a 6.67 percent reduction for the first three years prior to the FRA and 5 percent thereafter. With an FRA of age 65, a person who claims benefits at 62 years receives monthly benefits 20 percent lower than the full amount. The scheduled increase in the FRA from age 65 to 67 raises the actuarial reduction for claiming benefits at age 62 from 20 percent to 30 percent.

50. The average retirement age is defined as the age at which 50 percent of the birth-year cohort is out of the labor force.

51. The increase began with individuals born in 1938, for whom the FRA is 65 years plus two months, and increases two months per year until it reaches 66 years. Then, after a 12-year hiatus, the FRA again increases by two months per year until it reaches 67 years for individuals born in 1960 or later.

52. Studies showing that the availability of benefits has the major effect on retirement include Burtless and Moffitt (1984), Hurd (1990), and Gruber and Wise (1998). In a study of 12 countries, Gruber and Wise (2002) conclude that averaging across all countries, a reform that delayed the benefit eligibility by three years would likely reduce the proportion of men aged 56–65 years staying out of the labor force by 23 and would be closer to 36 percent in the long run.

53. However, an increase in the EEA could help set the stage for future increases in the full retirement age, one option for maintaining the solvency of the Social Security program. An EEA of 62 years makes any additional increase in the FRA highly unlikely, since a higher FRA would produce an even steeper reduction in benefits at age 62. A higher EEA, by signaling that retiring in one's early 60s is no longer economically feasible, could prepare the way to raise the FRA beyond age 67.

54. Similarly, a recent survey by Prudential Financial of a nationally representative sample of retired Americans found that 38 percent of them claimed that they had retired involuntarily.

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Comments on "The Labor Supply of Older American Men" by Alicia H. Munnell and Steven A. Sass

Robert Hutchens

The paper by Alicia Munnell and Steven Sass seeks to first examine trends in labor force activity of older men in the United States, and then inquire into the economic forces that shape those trends. Of particular interest is whether the recent increase in the labor force activity of older men is likely to continue into the future.

There are at least two important reasons why we need to understand these trends. First, these trends are likely to influence government tax and transfer policies toward older Americans over the next several years. To illustrate the stakes, consider two scenarios.

> **Scenario A:** Despite reductions in real Social Security benefits, older Americans can easily find jobs and replace any lost Social Security income with wage and salary income. Reduced Social Security benefits cause no increased hardship beyond foregone leisure time.
>
> **Scenario B:** Many older Americans are unable to find jobs or are physically incapable of working. A reduction in real Social Security benefits casts large numbers of older Americans into poverty.

If scenario A is closer to the truth than scenario B, then arguably it would be easier to solve the Social Security financing problem by reducing Social Security retirement benefits—for example, by eliminating the age 62 early retirement benefit. As such, it is important that we understand how easily older Americans can increase their labor supply.

A second reason why the issues addressed in this paper are important concerns the quantity and quality of labor that will be supplied to the U.S. economy in the future. Over the next two or three decades, the baby boom generation will withdraw from the labor force, and they will be replaced

by comparatively small cohorts of young workers. At the same time, we are likely to see continued demand for skilled workers. This is at least part of the reason for the increased real wages at the upper deciles of the earnings distribution over the last three decades. An interesting question is whether older workers will help shore up the supply of skilled workers.

Munnell and Sass begin by noting that for American males over age 55 years, there has been a century-long decline in labor force activity, shown as Figure 3.8 in the paper. In a sense that decline is surprising. Over the twentieth century both life expectancy and health levels have arguably improved; one would think that with longer and healthier lives we would spend more time in the labor market. Of course, the explanation is that the wealth of the nation has continued to grow. That trend, combined with the availability of retirement income in the form of Social Security benefits and employer-provided pension plans, has made it possible for older people to withdraw from the labor force. But now comes the real surprise: despite our growing wealth, since the mid-1980s, the trend toward decreasing labor force activity has turned around and started going the other way. This is illustrated in Figures 3.8, 3.9, and 3.10 in Munnell and Sass's paper.

The paper does a nice job of discussing several explanations for this turnaround. It gives, however, special prominence to changes in employer-provided pensions (the well-documented steady decline in defined benefit plans and the rise of defined contribution pensions), and in Social Security, particularly, the partial elimination of the earnings test and the increase in the delayed retirement credit.

The paper also discusses several other labor market phenomena that occurred at roughly the same time as the turnaround in labor force participation; in particular:

1. A decline in median job tenure at older ages (see their Figures 3.12 and 3.13).
2. An increase in job displacements (roughly speaking, job losses other than voluntary quits) at older ages (see Figures 3.15 and 3.16).
3. A hypothesized decline in the compensation of older workers
4. Improved health and greater longevity of the older population.

The bottom line is that Munnell and Sass expect labor force participation of older men to continue to increase (Figure 3.27). They forecast this in large part because of the predicted contractions in the retirement income system. They quite cogently argue that under current law, Social Security replacement rates will fall over the next few decades, while employer-provided pensions are unlikely to offer a sufficient alternative source of income. Thus, Munnell and Sass predict that more older people will be working in order to augment a meager retirement income from pensions and Social Security.

I like this paper for several reasons. First, it takes a long-run perspective. This view is very useful in that it helps make clear that the turnaround in older male labor force participation in the 1980s is not particularly important in terms of its magnitude. Rather it is important because we have not seen anything like this in more than a century. This finding helps focus attention on the forces underlying the turnaround.

Second, I like the authors' agnostic view of what caused the turnaround. They give us several possible explanations, and choose their preferred explanation, changes in Social Security and pension plans. But they also make clear that the literature is not at the point where we can confidently say what actually caused the turnaround in the labor force participation of older American men.

Third, I like the way the paper brings together several different trends: in particular, employment trends, trends in job tenure, trends in displacement, and trends in health. There is an interesting breadth to the paper.

Finally, I like all the footnotes. We get 54 footnotes in 27 pages, and these are well worth spending time on. There are lots of interesting points about data and what—at least to me—are rather obscure nooks and crannies in the literature.

Let me raise two questions that struck me in reading the paper.

First, what types of older men have been increasing their labor force participation, and what types are particularly likely to do so in the future?

I wish the paper said more about the skill level of the groups that have played a major role in the post-1985 reversal in the labor force participation trends. For example, what does Figure 3.9 look like when drawn for college graduates? What about men who never went beyond a high school education? Do we see the same turnaround for different skill groups? It would be especially nice to do this analysis by deciles in the earnings distribution. But an analysis of labor force participation trends by educational category should give us the basic facts.

In particular, it would be interesting if the turnaround was occurring among men with at least a four-year college degree. Given the rapid rise in educational attainment of older cohorts, that would suggest a rapidly increasing relative demand for well-educated older workers. Perhaps such workers are presently helping to address a vital labor supply need in the U.S. economy?

The point is arguably more important regarding how these trends may play out in the future. Are the predicted increases in Figure 3.27 different by skill level? If the driving force behind the predicted increase in labor force participation is a contracting retirement system, meaning reductions in Social Security benefits and employer-provided pensions, then does that imply particularly large increases in labor force participation at lower skill and wage levels? The answer will be important because it is related to the future quality of the labor force. Looking at trends in the U.S. earnings distribution, I see little reason to think that the United States needs more low-skilled workers. Moreover, this goes back to the issue of hardship in retirement. If low-skilled older people increase their labor supply, how much can they earn to augment their income and retirement savings? Are we perhaps talking about older people who will join the ranks of the working poor?

My second question is, how will employers respond to increased labor force participation of older people?

It is not hard to believe that if the supply of older workers expands, then most will find jobs. Demand curves slope downward, wages adjust, and in the long run most older people who seek work will be able to find it. To my mind, the puzzle concerns the kind of jobs those older people will end up doing. In particular, there are two ways that this expansion in supply can occur. First, older people can delay taking retirement while remaining in a long-term career job. Second, they can leave those long-term jobs and take new jobs—presumably short-term "spot market" jobs. As a group of people from a Federal Reserve Bank can well understand, some expansions are better than others. From a social point of view, I would argue that the first type of expansion is better. If your long-term job was the highest and best use of your labor when you were 50, then that will probably still be the case at age 60 or 70. A person is probably more productive by continuing in that job than in taking a new job. Moreover, by staying in the long-term job, specific human capital is preserved as are professional and personal friendship and social support networks. Finally, by staying in the long-term job, the person is staying out of the market for new jobs; a growing literature indicates that older workers can have real difficulty finding new jobs that match their skill sets.

Of course, it will not always be the case that staying in the long-term job is desirable or even possible. My point is only that to the extent that both employers and employees benefit from workers continuing in the long-term career job, then from a social point of view that is a good thing.

There are many ways that an older worker could delay retirement while remaining in a long-term career job. Suppose the person prefers to cut back on hours. In that case, it is not necessary to change employers. Rather, a phased retirement could be arranged whereby the worker stays with the current employer but shifts to shorter hours. Another example is something like a job bank – whereby retirees are called back during periods of peak demand. Frito-Lay has done this with delivery truck drivers. All indications are, however, that such arrangements are quite rare.[1]

Is the predicted expansion in employment of older workers likely to take the form of delayed retirement while staying with the long-term career job? This paper provides good reason for doubt that the trend will play out in this manner. Looking at the older male labor market after 1980, what we learn is that (a) the fraction of men who remain in the jobs they held at age 50 decreased much more rapidly today than in the 1980s; see Figure 3.13. Moreover, (b) that change is partly because of a higher probability of displacement today than in the 1980s. Finally, (c) it is likely that this increase in job mobility is associated with reduced compensation for older workers. These reasons do not describe a labor market where people are delaying retirement by staying longer in a well-established career job.

I think this issue could be nailed down a bit more. As indicated in their Figure 3.13, one can compute the number of workers who are aged 50 years and over and who have remained at the same firm/employer since age 50. The authors do this for 1983 and 2004, but it could be done for the several years in which the Current Population Survey collected data on job tenure. Thus, one could create a version of Figure 3.9 that plots through time the fraction of men aged 55–64 years and aged 65 years and over who are both in the labor force and who have not changed employers since age 50.

Now, suppose that this new version of Figure 3.9 indicates that since 1990 there has been an increase in the fraction of men who are both in the labor force and have not changed employers since 1990. To my mind, that would be good news. It would mean that the post-1990 expansion in the older male labor force is occurring in a way that preserves specific human capital and social networks. This would indicate that people are tending to remain in the job that was the highest and best use of their labor when they were 50-years-old.

Suppose, on the other hand, that there has been a post-1990 decline in the fraction of older men who are both in the labor force and in the job they held at age 50. Given the evidence in this paper, I suspect that this scenario is what is taking place. I would view confirmation of this development as not particularly good news. While it is good for the economy to have older people working more, the expansion may well be occurring in a way that tends to not preserve specific human capital. Older workers are arguably moving into jobs that do not make full-use of their skills.

To conclude, I think Munnell and Sass have written a very interesting paper. It provides a useful perspective on several important trends in the labor market for older workers. It also continues a line of work that opens up lines of future research on the labor market for older workers. Well done.

Note

1. The Frito-Lay case is in Watson Wyatt Worldwide (2001). See Hutchens (2007) for a discussion of phased retirement.

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Comments on "The Labor Supply of Older American Men" by Alicia H. Munnell and Steven A. Sass

Joyce Manchester

The paper by Alicia Munnell and Steven Sass makes the case that it is sensible for Americans to work longer in the future in order to enhance their retirement income security. Working longer also would be good for national output and tax revenues. The paper then asks the following question: based on what we know now, does it seem likely that American men will choose to work longer? Three current impediments to encouraging such a trend are identified as: 1) the early eligibility age for Social Security benefits that remains at age 62, 2) the increased mobility of workers that exposes them to the vagaries of the labor market, and 3) the significant fraction of people who are not healthy enough to work beyond age 62.

Of course, raising the early eligibility age for Social Security benefits seems like an obvious fix to some observers. But eliminating old-age benefits at 62 could lead to severe hardship for those not able to work in their early 60s, those without other sources of income, or those unlikely to live much longer. But instead of dwelling on these objections, my comments will focus on two other considerations of the question regarding whether Americans will indeed choose to work longer. The first consideration concerns the decision of when to claim old-age Social Security benefits. Specifically, what do we know about workers who choose to claim old-age Social Security benefits earlier compared with those who claim benefits later? A related issue is how recent policy changes have influenced the age at which people claim benefits, and whether those trends can help us predict future behavior. A second consideration regarding the issue of working longer involves the labor force behavior of women. At the same time that men are working less at older ages than they did in the

1960s, women's labor force participation has increased significantly. Can we say something about how their greater work experience and earnings will contribute to household retirement incomes in the future?

The Decision to Claim Old-Age Social Security Benefits

A recent analysis of data from the Social Security Administration (SSA) on the age at which people claim Old-Age and Survivors Insurance (OASI) benefits, using a 1 percent sample of administrative records, shows that:

- The most popular age to claim benefits is 62. For example, among all OASI beneficiaries who claimed benefits at ages 60 through 72 years in 2003, approximately 47 percent became entitled at age 62. The percentage is higher among women, 49 percent, than among men, 44 percent of whom claimed Social Security benefits at age 62.
- Approximately 26 percent of people who claimed benefits in 2003 were 65-years-old; at 31 percent, the percentage was higher among men than the 21 percent for women.

What do we know about people who claim old-age benefits early (starting at age 62 and prior to age 65) compared with those who claim benefits at age 65 or later? Preliminary analysis of a 1 percent sample of SSA data shows that work and earnings activities around the time of claiming vary by the claimant's age. More specifically, people who claim benefits at age 65 or later have stronger and steadier labor force activity than those who claim at age 64 or earlier. For example, the work participation rate up to 10 years prior to benefit claim and three years following benefit claim appears to be lower among those who claim benefits at age 62 than among those who claim benefits at 65; see Figure 3.28. In addition, the average annual earnings of people who claim benefits between ages 62 and 64 are lower than the average earnings of those who claim at age 65 or later. The difference can be seen as much as 15 years prior to benefit claiming as well as three years following benefit claiming; please refer to Figure 3.29. Given the different work and earnings experience of early claimants relative to late claimants, one could speculate that more emphasis on job characteristics such as flexible schedules, part-time work, and help transitioning to jobs that are not physically demanding

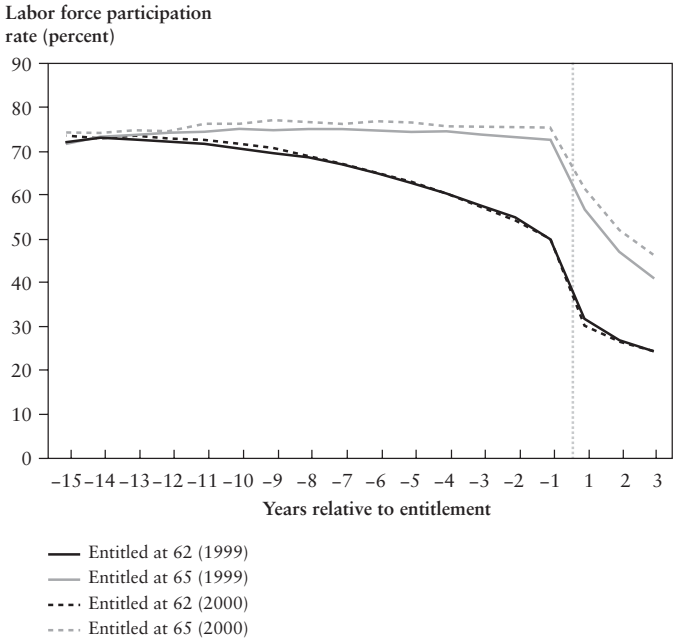

Figure 3.28
Labor Force Participation by Years Relative to Benefit Claim, By Claiming Age of Individuals Who Became Eligible for Entitlement in 1999 and 2000
Source: Tabulations by the Office of Policy, U.S. Social Security Administration, using the 1 percent sample of Social Security Administration administrative files.

could be important in encouraging older workers to remain in the labor force.

Why do so many people claim old-age benefits at age 62? Multiple reasons explain the phenomenon, but two factors that have gained attention recently are the advice commonly found in newspapers and other media, and the effective tax rate on work at older ages. Financial advisors sometimes adopt a "one-size-fits-all" attitude that for many individuals may not be the correct advice. For example, here is the punch line from one recent newspaper column: "When you turn 62, take the money and run." Unless an individual expects to die sooner than the average person in his/her cohort, that advice is usually wrong. Taking benefits early gen-

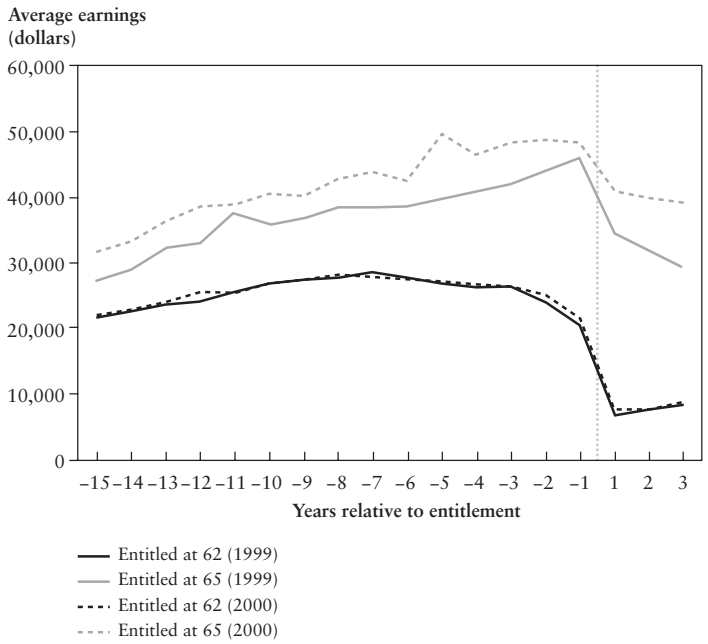

Figure 3.29
Mean Annual Earnings by Years Relative to Benefit Claim, by Claiming Age of Individuals Who Became Eligible for Entitlement in 1999 and 2000
Source: Tabulations by the Office of Policy, U.S. Social Security Administration, using the 1 percent sample of Social Security Administration administrative files.

erally means that person, and any dependents who receive Social Security benefits based on his or her earnings record, will receive lower benefits throughout their lifetimes. The reduction in benefits gets larger as the full retirement age (FRA) rises. Until 2003, the FRA was at 65 years, and a person who claimed benefits at age 62 received 80 percent of his or her full benefits. But when the FRA reaches 67 years in 2022 for individuals born in 1960 or later, the person who claims at age 62 will receive just 70 percent of the full benefit amount. Reductions also affect the widow benefit to some extent.

A second factor that may explain why so many people claim benefits at age 62 is the effective tax rate on work at older ages. Recent research shows that, for many people, work at older ages does not enhance their

Social Security benefit. A study done in the Office of Policy at the SSA using MINT, a microsimulation model developed by the SSA and the Urban Institute, examines the marginal internal rate of return (IRR) on Social Security payroll taxes from working one extra year at the end of one's work life (Reznik, Weaver, and Biggs 2007). The results show that 30 percent of men aged 62–65 years in 2005 would have faced a pure tax from working one extra year, meaning that their additional Social Security taxes paid would not lead to additional benefits. Only 21 percent of men gain from spending an extra year in the labor force at the end of their working lives.[1] Women have somewhat lower marginal internal rates of return than men because many women receive auxiliary benefits based on their spouses' earnings, or have relatively flat earnings histories. But women are somewhat less likely than men to show up as "pure tax" cases because they are more likely to have spotty work histories with years in which they have no earnings. It is still true, however, that the Social Security payroll tax represents a pure tax for 23 percent of women, meaning that 23 percent of women would see no increase in benefits if they worked an additional year. Policies that increase the payoff to work at older ages could encourage more Americans, particularly men, to stay in the workforce longer.

Do we have any evidence that raising the FRA affects the proportion of people who claim benefits early? The answer is yes. Again using a 1 percent sample of SSA administrative data, a couple of recent papers examine changes in the age at which people claim Social Security retirement benefits in response to two recent rule changes: the removal, in 2000, of the retirement earnings test at ages 65 to 69, and the gradual increase in the full retirement age (FRA), also beginning in 2000 for people who turned 62 in that year (Song and Manchester 2007, 2008). Figure 3.30 shows the cumulative distribution of benefit entitlement ages for males and females born in 1930, 1937, and 1940 who claim benefits between 62 and 65 years and 6 months.[2] The distribution of entitlement ages of the 1930 birth cohort should be relatively unaffected by both rule changes. For the 1937 birth cohort, benefit claiming at ages 63 and above took place after the elimination of the earnings test in 2000. Consequently, some members of the 1937 birth cohort clearly delayed claiming benefits between ages 62 and 65 relative to the 1930 birth cohort.

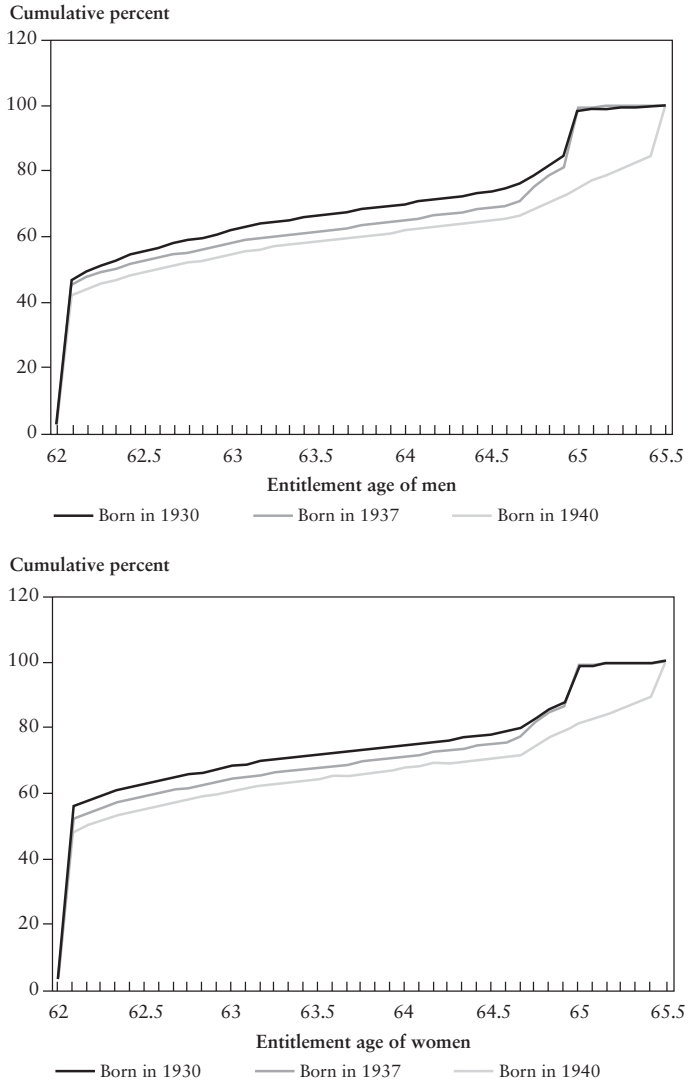

Figure 3.30
Cumulative Distribution of Benefit Entitlement Ages of Men and Women in Selected Birth-Year Cohorts Who Claimed Benefits Between the Ages of 62 Years and 65.5 Years
Source: Song and Manchester (2007).
Note: The cumulative percentages are measured among those who become entitled by age 65 and 6 months.

Further, the elimination of the earnings test in 2000 appears to accelerate benefit claims at age 65, as seen in the vertical distance at 65 years between the curves of the 1930 and 1937 birth cohorts. The 1940 cohort delayed claiming somewhat between 62 and 65 years, but the most noticeable change appears between 65 years and 65 years and 6 months. For the 1940 cohort, full Social Security benefits were not available until age 65 and 6 months, and Figure 3.30 shows that effect clearly. Women show similar, but less pronounced, responses.

It is a difficult task to sort out the economic effects of the benefit reductions from the signaling or institutional role of the FRA, but Figure 3.31 may offer some clues. The plots show the proportion of men and women who became entitled to retirement benefits, using two-month intervals between ages 62 and 65 years and 6 months among the cohorts born in 1937 through 1940. Among the 1937 birth cohort, which was not affected by the increase in the full retirement age to 65, about 42 percent of men and 49 percent of women claimed benefits at age 62, the earliest retirement age for this cohort. These percentages dropped slightly following the increase in the FRA; in the 1940 cohort, about 40 percent of men and 45 percent of women claimed benefits at age 62, the earliest eligibility age. The percentage of people who claim benefits after age 62 and up to a few months prior to the FRA stays relatively stable at about 1 percent at each two-month age increment. Benefit reductions alone affect people who retire prior to age 65, so the drop in the percentage who claim prior to age 65 largely reflects that benefit reduction.

More dramatic changes are evident at ages 65 years and above. About 18 percent of men in the 1937 cohort and 12 percent of women claimed benefits at age 65, the FRA for that cohort. As the FRA moved out by two months per year for the 1938, 1939, and 1940 cohorts, the spike at the FRA moved out as well. In the 1940 cohort, about 16 percent of men and 10 percent of women claimed benefits at 65 years and 6 months, the relevant FRA for that cohort. People who previously would have claimed benefits at age 65 but waited until their new, higher FRA are likely responding to a combination of the benefit reduction and the signaling aspect of the Social Security retirement age. It is also possible that the "full" retirement age in integrated private pension plans influences the age when individuals claim Social Security benefits.

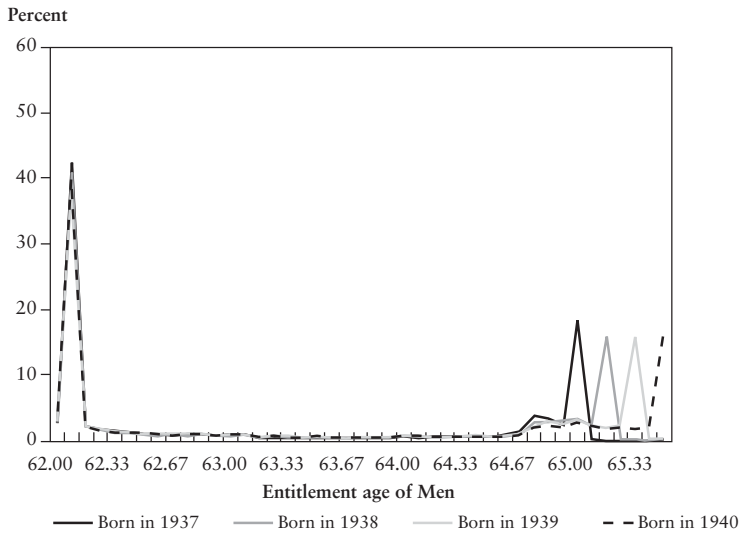

Figure 3.31
Entitlement Age Frequency Distribution by Birth-Year Cohort
Source: Song and Manchester (2007).
Note: The cumulative percentages are measured among those who become entitled by age 65 and 6 months.

Song and Manchester also conducted regression analysis of benefit entitlement status at specific ages using year- and age-specific treatment dummies over the period 2000–2005. Specifically, results show the marginal effects on the probability of entitlement claims given the elimination of the retirement earnings test for ages 65 to 69 and the increase in the FRA, separately for men and women. Both the direction and the magnitude of the estimated effects accord with our expectations. For those aged 65 years in 2000–2002, the change in the earnings test rule increases men's benefit claims by slightly more than 3 percentage points, and women's claims by slightly more than 2 percentage points. The FRA becomes the dominant rule change in 2004 and 2005, however, as the estimated marginal effect for those aged 65 turns negative; this marginal effect rises to 12.5 percentage points for men and 5.4 percentage points for women in 2005. Effects on early claimants are evident as well. Following the six-month increase in the FRA, benefit entitlement rates for men decline by 3.3, 4.4 and 5.2 percentage points at ages 62, 63, and 64 years, respectively and 2.1, 3.3, and 3.5 percentage points for women at these same three respective ages. These estimates suggest that a relatively large response occurs at age 62, and relatively small but incremental responses at ages 63 and 64. Recognizing those responses is important for policymakers who question whether people younger than the full retirement age would change their behavior; these results argue that changing the full retirement age does delay claiming by people who have not yet reached the FRA.

Elasticity estimates show the percentage change in claiming rates at a given age for a 1 percent reduction in benefit amount at that age. At 64 years, derived elasticities range from 1.3 to 1.7 for men and from 0.7 to 1.1 for women. Elasticities at age 62 are 0.8 to 1.3 for men and 0.7 to 1.2 for women. Elasticities near 1 indicate that benefit reductions do cause people to work longer. Looking forward, further benefit reductions as the FRA rises to 67 years are expected to result in longer work lives.

How Will Women's Work and Earnings Contribute to Retirement Income in the Future?

The Munnell-Sass paper points out that future retirees will face lower Social Security benefits at any given age, confront the lower likelihood of

defined benefit pensions, and contend with the vagaries of a more mobile job market. Compared to the 1960s, things look grim. At the same time, the authors see little evidence that men will increase their labor force participation much at older ages, thus compounding the pessimistic outlook. Yet there is a large and growing component of the labor force that is neglected, albeit intentionally, in the Munnell-Sass paper: women. At the same time that men's labor force participation at ages 55–64 was dropping from 87 percent in 1960 to 69 percent in 2005, women's participation rate surged from 37 percent in 1960 to 57 percent in 2005; see Figure 3.32. For men ages 65 years and above, participation dropped from 33 percent in 1960 to 20 percent in 2005. At the same time, labor force participation for women ages 65 years and above stayed approximately constant at 11 percent. Will women's increased work and earnings help to maintain American standards of living in retirement?

Some evidence on the possible contributions of women to household retirement income comes from examining married couples who are near-

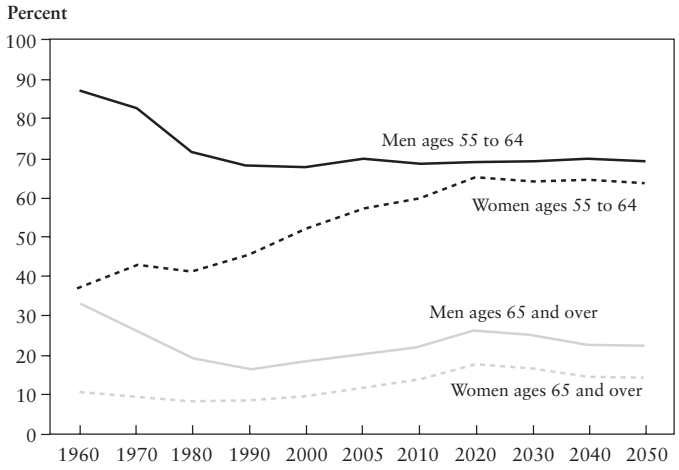

Figure 3.32
Labor Force Participation of American Men and Women, Aged 55 to 64 Years, and 65 Years and Older, 1960–2050, with Projection to 2050
Source: Author's calculations of U.S. Bureau of Labor Statistics data in Fullerton (1999) and Toosi (2006).

ing retirement. A paper by Maestas (2001) based on data from the Health and Retirement Study reports that 75 percent of men nearing retirement age in the 1990s were married, and 40 percent of them had working wives. The MINT model also shows that labor force attachment among married women is on the rise. According to the MINT model, married women in the retiree population of the late 1990s, cohorts which predate the baby boom generation born between 1946 and 1964, averaged 18 years of work experience. This contrasts rather starkly with 29 years in the labor force predicted for the early baby boomer women born in the 1946–1954 period, and 30 years for the late boomer women born between 1955 and 1964. Labor force participation is also projected to increase for non-married women.

More work experience for women translates into a greater likelihood of pension coverage for women; health insurance while they are in the labor force, and perhaps retiree health insurance as well; and receipt of their own Social Security benefits from both Old-Age Insurance and Disability Insurance. Tabulations of the Health and Retirement Study show that the percentage of women aged 55–64 years who have a pension rose from 52 percent in 1994 to 63 percent in 2004 (Iams et al. 2007). Social Security data show that the percentage of women who receive old-age benefits based on their own earnings record rather than from spousal benefits is rising as well.[3] Over the past two decades, the percentage of women with earned worker benefits increased. Current beneficiary women aged 62 to 64 years with retired worker benefits increased from 48 percent in 1984 to 56 percent in 2004, while those with disabled worker benefits doubled from 8 percent to 16 percent.

To conclude, the paper by Munnell and Sass raises a number of important issues regarding the labor supply of older American workers in the twenty-first century. But there is reason to be optimistic about their prospects, both for continuing in the labor force and for their retirement income security, once we examine the evidence to date on how older workers have responded to policy changes. Following the increase in the full retirement age, we have solid evidence that people are claiming Social Security benefits at later ages. We have identified other factors that could be changed to encourage older workers' continued labor force participa-

tion, such as job characteristics, the retirement advice and information offered, or the incentives in the tax-benefit structure of Social Security. And the other half of the potential labor force, women, have increased their contributions to household retirement incomes in recent decades, and a reversal in that trend is unlikely.

■ *These comments were written while Manchester was with the Office of Policy, Social Security Administration; she is now at the Congressional Budget Office. Any findings or opinions expressed here are those of the author and not necessarily those of the Social Security Administration or the Congressional Budget Office.*

Notes

1. In this exercise, individuals "gain" when the marginal internal rate of return is greater than 3 percent in real terms.

2. We include entitlement ages ranging from 62 to 65 years and 6 months because at the time we did the data work, the most recent data came from June 2006. The last birth cohort considered here (1940) reaches 65 years and 6 months, the FRA for that cohort, by the end of June 2006.

3. A general rule of thumb is that married women receive retired-worker-only benefits when their average lifetime earnings are more than 30 percent of their husband's earnings.

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