Remarks by Eugene Steuerle to the New England Public Policy Center's 2008 Conference

Employing the Region's Assets: Baby Boomers Meeting New England's Skilled Workforce Needs
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Demographic trends in New England point to a potential shortage of skilled labor, as Baby Boomers begin to retire over the next few years, and a smaller generation of workers follows. The New England Public Policy Center's fourth annual conference held December 3, 2008, explored the role that older workers can play in meeting the region's labor force needs over the coming decades. The conference featured presentations that investigated changing demographics and labor force trends in New England and the nation, and that examined what employers, workers, and the public sector can do to lengthen the labor force participation of New Englanders. Economist Dr. Eugene Steuerle, vice president of the Peter G. Peterson Foundation, gave the opening address.

I am first going to review some data and try to interpret them. Second, I will talk about some of the obstacles to work by older Americans. And third, I will discuss some possible policy solutions. I will try to present the data honestly to you. Yogi Berra once said that 90 percent of baseball is mental and the other half is physical; I try to avoid Yogi Berra math.

It is appropriate that we are meeting here in Boston, as it is one place where some of these labor force issues clearly will play out. The Boston metropolitan region not only faces the same demographic challenges that other regions do, but may also see more changes in the employment of older workers, given high overall levels of educational attainment of the region's workforce and the strong relationship between work and education.

How labor force participation among older Americans is changing

Slide 4 provides a typical graphical representation of labor force participation, here going back to 1948. The dotted line shows an enormous decline in work by men aged 55 and older starting in the 1940s. That declining trend bottoms out in 1990, and then a new upward trend begins. Right now, economists and other social scientists are debating whether this is just a slight uptick, or whether the labor force participation of older men will continue to increase.

For their part, Social Security actuaries now project that this participation level will increase modestly but not a lot. The argument behind this thinking is that leisure is a type of "service" that people want more of as society gets wealthier. Therefore, barring other factors such as very high health costs, the percentage of years people spend in retirement will tend to rise as we demand more leisure, although longer lives might force us to retire a touch later.

I agree that people want more of the services they value as an economy gets richer. However, that does not mean they will quit their jobs for full retirement; they may quit some work activities instead. People may also want more leisure during other parts of their lives, such as when they are raising children.

If you look at the solid line on slide 4, what you see is that people of all ages tended to work more during almost the entire second half of the twentieth century. Labor force participation increased over time, calling into question the notion that we want more leisure as we get richer as a society. At first we might think of this upward trend as simply a social phenomenon, as more women entered the labor force. Several factors contributed to this trend, including birth control, fewer children in the household, equal rights, and the introduction of timesaving household appliances.

However, the social explanation discounts an economic one that must take into account both labor demand and labor supply. We do not estimate either well. When we look at the data, we are observing the intersection of labor supply and labor demand, even though we often call it "labor supply." That is, what we observe is related not only to how much we want to work as individuals, but also how much demand there is for work. Demand for labor, in turn, is based on how much we consume. One could argue, therefore, that the increase in labor force participation of Americans aged 20 and older is a response, at least in part, to strong labor demand.

Now put the pieces together. Over a large part of the end of the twentieth century, women—and Baby Boomers, who also entered the labor force in spades—were able to fill labor demand. That allowed, in part, the large growth in retirement of older male workers. But now women have more or less caught up with men in terms of labor force participation, and Baby Boomers are no longer entering the workforce, but rather are dropping out. Therefore, if labor demand is growing, it must be met some other way.

Who is going to meet this demand? One of the predictions I have made for at least a decade is that, in terms of the labor force, individuals aged 55 and older represent to the first half of the twenty-first century what females did to the second half of the twentieth century. These older individuals—just like women before them—now comprise the largest underutilized pool of human resources and talent we have. I predict that this group will also affect labor demand in some very interesting ways, as people age and demand more goods and services, including nurses and doctors. I have been predicting that this uptick in labor force participation is going to be much stronger than Social Security actuaries project.

However, there are a number of obstacles to this scenario. One, of course, is the worldwide recession. But other strong institutional barriers are also present. Many of these stem from public policy—not least the signals it sends about when older Americans should leave the labor force. For example, we can get "old-age" insurance at age 62, even though we Americans now have close to two decades of life before us at that age, on average. If that and other public policies were to stay constant, labor force participation among older Americans could increase much more slowly than it otherwise would. However, if public policy were to change in response to what is happening with demographics and the economy (which is not unreasonable), labor force participation among older Americans could rise significantly.

Slide 5 breaks down some of the recent trends in labor force participation for different age groups in the more current period, from about 1979 to 2005. We see some fairly remarkable upticks in labor force participation. Men and women aged 65 to 69 (the two solid lines) have increased their labor force participation rates about 40 percent since the late 1980s and early 1990s. Interestingly, we do not see as much of an increase for men aged 62 to 65 (the top dotted line). Part of the reason is that people in that age range have more encouragements to retire, such as disability insurance, earnings tests for Social Security recipients (which now end at the normal retirement age of age 65 to 66), and private pension policies that do not provide cash benefits unless people retire fully. The signals and incentives to stay in or get back into the workforce are sometimes stronger at later ages.

We are in better health. One piece of evidence that we not only might work longer but *can* work longer is that we are living longer and seem to be in better health. If we measure health status by life expectancy, there is no doubt that we are in better health than previous generations. Again, there is some debate over how to interpret this trend. Some say we just have a lot more people on machines for longer periods at the end of life. However, in my view, it's much more likely that increases in life expectancy correlate with other increases in health and well-being. Slide 6, which shows the self-reported health status of adults, supports that claim. The share of older cohorts reporting fair or poor health has been declining over time.

There is another nuance to the data. We talk about aging as if it is defined by numerical age— "old" is over age 62 or 65, for example. However, that is misleading. People aged 65 today have different capabilities and life expectancies than people aged 65 did 40 years ago. Think about measuring age as (expected) age from death rather than age from birth. Men aged 59 in 1940 had the same life expectancy as men aged 65 in 2001. Slide 7 shows how looking at age alone can be misleading. The dashed line shows the labor force participation rate of men with 16 to 17 years of life expectancy. That rate stayed fairly constant from 1940 until the early 1960s. Men aged 65, in contrast, saw a steeper downturn in their labor force participation rate. The main point is that men did not drop out of the labor force until they were eligible for Social Security, Medicare, and retirement benefits (and Baby Boomers started entering the workforce).

So when we try to interpret these data, we want to be careful about how we define who is old. Do we want to keep age constant, or adjust for life expectancy? The aging of the U.S. population may have less to do with its average age or share of population over age 65 than with its life expectancy and health. True, lower birth rates will yield a population with a larger percentage in the second half of life, and a smaller percentage in the first half of life. Demographically speaking, that factor does cause an aging of the population —but it is very different in consequence from the fact that people are simply living longer.

Jobs are less physically demanding. Most evidence shows that the physical demands of jobs have declined, while cognitive demands have risen. Now that generally means that people's employability increases over time, as they gain experience. However, there is a question as to what age that phenomenon extends. It may also play out differently in New England than in other parts of the country, because of the high educational attainment of the region's workforce.

Obstacles to working longer and reentering the labor force

Let me now turn to the obstacles to work at older ages. The first is the cost of health care. Slide 10 shows health care expenditures as a percentage of wages. Rather than just showing health care expenditures by age, this comparison adjusts for the fact that older workers have higher cash wages than younger workers. Health care as a percentage of wages—although it is expensive—does not increase for mid-life workers compared with younger workers. However, health care costs for older workers do rise, adding to the relative cost of employing them. When employers offer health insurance, Medicare aggravates this issue by forcing them to pay for health insurance for older workers, thus imposing a "tax" through the loss of what would otherwise be free Medicare.

Is there a bias against hiring older workers? The research on this topic is mixed. In some cases employers favor older workers, choosing to keep them even though younger employees may be equally valuable and paid lower wages. The one area where research does seem to confirm a bias against older workers is in getting a job interview.[1] So employers tend to favor the older workers they have, but are reluctant to hire new ones.

Do employers invest in older workers? Employers invest less in older workers than they do in younger workers. Some research shows that older workers are less likely to receive employer-sponsored training than younger workers. (According to one study, for example, 51 percent of employees over age 55 receive training, while 79 percent of employees aged 25 to 34 do.[2]) Now one might argue that some of this might be occurring because shorter-term investment is not going to pay off as well as investment that lasts over longer periods of time.

How do retirement plans affect work at older ages? The design of defined-benefit plans still encourages earlier retirement. A worker often maxes out her retirement benefits at a certain age, and if she does not retire at that age, she actually accrues negative economic benefits, because she will receive fewer years of payments at about the same level. Slide 14 illustrates this trend in defined-benefit plans.

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[1] Lahey (2008) found that companies agreed to interview women aged 35 to 45 5.3 percent of the time, based on their resumes, while the firms agreed to interview women aged 50, 55, or 62 just 3.8 percent of the time, based on the same resumes. See Johanna Lahey, "Age, Women, and Hiring: An Experimental Study," *Journal of Human Resources*, Winter 2008.
[2] Gordon B.T. Mermin, Richard W. Johnson, and Eric J. Toder, "Will Employers Want Aging Boomers?" Washington, DC: Urban Institute, 2008.

This often plays out for state and local governments with teachers. We are pushing a huge supply of experienced teachers out of the labor force by creating a strong negative incentive for them to stay on the job (see Slide 16). Some school systems are attempting to adjust for this by rehiring teachers and other public workers as "consultants," sometimes after a time lag, thereby enabling them to collect benefits while continuing to work.

How does taxation affect work at older ages? The tax rate workers face as they get older also affects their retirement decisions. Slide 17 shows that the tax rate on work is moderate to heavy, if we account for all the taxes workers face as they age. Of course, in addition to actual taxes, many people think that the earnings test for Social Security is actually a tax, even though an actuarial adjustment makes working longer a good deal for most people. Still, many workers in their early sixties can get almost as much cash income by retiring as they can by staying on the job—even though they would be a lot better off later with the extra income and higher annual benefits from working longer. But if people simply consider cash income at one point in time, they receive a strong signal that it is time to retire.

How to reform public policy to encourage work

What adjustments can we make to current programs? We could adjust various retirement systems for life expectancy. Slide 18 shows that the earliest retirement age offered by Social Security used to be 65, and then dropped to 62. At the same time, people are living longer. In 1940 and 1950 the average worker retired at age 68. Based on life expectancy, the equivalent retirement age today would be 74. That is, workers who retire at age 74 today would average the same number of years of benefits as those who retired at age 68 in 1940. Projecting ahead to 2065, the equivalent retirement age will be 78. Consider now that most people retire before age 65, often age 62 to 64, and it becomes clearer how extraordinary the increase in the average number of years people spend in retirement has been.

Work can benefit individuals and society. The decision regarding whether to work longer is not just a question of Social Security payments. Working longer also adds to GDP. It also helps individuals by raising the income they will receive post-retirement, as they can then withdraw their resources at a higher rate. Finally, working longer also increases taxes to government—not just Social Security taxes but income taxes, too.

What reforms ought to be considered to encourage more work? We can think about reforming our retirement systems in any number of ways. One approach that would encourage work is to adjust the age of retirement, especially the early retirement age. I am still bothered by the fact that we define age 62 as old—perhaps because I am an early Baby Boomer! As long as we do that, it sends an extraordinary signal to people who are really in late middle age that they should retire. Another reform would be to improve the transparency of our retirement systems. The wage replacement that retirees get declines significantly over time, but we do not tell them that when they are making decisions about retirement in their early sixties.

The British recently reformed both their private pension system and their Social Security system at the same time, and we could try to do so, too. And we could adjust tax-rate options, such as by removing the provision that requires Medicare to be a secondary payer. We should also consider back-loading benefits so people receive a little more income when they are older and tend to need it more, in exchange for less income up front when they are in their sixties.

Conclusion

Retirement and old age ain't what they used to be. Older workers are poised to play the same role in the labor force of the first half of the twenty-first century that women did in the second half of the twentieth century. While older workers today face many obstacles to employment, economic incentives are spurring us to find ways to tap their extraordinary skills and capabilities.