

RETIREMENT TRENDS AND POLICIES TO ENCOURAGE WORK AMONG OLDER AMERICANS

by

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Abstract

The trend toward earlier and earlier retirement was one of the most important labor market developments of the twentieth century. It was evident in all the major industrialized countries. In the United States, however, the trend toward earlier retirement came to at least a temporary halt in the mid-1980s. Male participation rates at older ages have stabilized or even increased slightly. Older women's participation rates are clearly rising. This paper examines the environmental and policy changes contributing to the long-term decline in the U.S. retirement age as well as developments that contributed to the recent reversal.

The dominant source of earlier retirement was the long-term increase in Americans' wealth, which permitted workers to enjoy rising living standards even as they spent a growing percentage of their lives outside the paid work force. The expansion of Social Security pensions and of employer-sponsored pension plans and the introduction of mandatory retirement rules also encouraged earlier retirement over much of the last century.

Many public policies and private institutions that encouraged early retirement have been modified in recent years. Mandatory retirement has been outlawed in most jobs. Social Security is no longer growing more generous, and worker coverage under company pension plans is no longer rising. Both Social Security and many private pensions have become more "age neutral" with respect to retirement. Public and private pension programs now provide weaker financial incentives for workers to retire at particular ages, such as age 62 or age 65, and offer stronger incentives for aging workers to remain in the labor force. The paper outlines additional policies that could encourage later retirement. An open question is whether such policies are needed. Rising labor productivity and increased work effort during the pre-retirement years mean that Americans can continue to enjoy higher living standards, even as improved longevity adds to the number of years that workers spend in retirement. If opinion polls are to be believed, most workers favor preserving the institutions that allow early retirement even if it means these institutions will require heavier contributions from active workers.

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THE UNITED STATES and other industrial nations face key challenges associated with a graying population. Depressed birth rates and rising longevity have increased the dependency ratio throughout the industrialized world. Population projections of the Social Security Trustees suggest the U.S. aged-dependency ratio -- the ratio of Americans older than 64 to Americans aged 20 to 64 -- will increase almost 70 percent between 2000 and 2030. The increase will be even larger in some other rich countries. As the U.S. population grows older, the cost of paying for pension and health benefits must rise, boosting tax burdens and impairing the nation's ability to pay for other government obligations. The burden imposed by an aging population would rise more gradually if workers could be persuaded to delay their retirements and continue contributing to the health and pension systems.

In this paper we consider long-term trends in retirement as well as recent trends that signal at least a pause in the historical pattern of earlier withdrawal from the work force. We also discuss public policies that might reinforce the very recent trend toward greater labor force participation among older workers.

Retirement trends

At the beginning of the last century, retirement was relatively uncommon but not unknown. Two out of three American men past age 65 were employed, but one-third were not (U.S. Department of Commerce 1975, pp. 132).¹ By middle of the twentieth century retirement was far more common. Fewer than half of men 65 and older held a job in 1950. By 1985 the proportion at work fell still further. Just 16 percent of men over 65 were employed or actively seeking a job. Eighty-four percent were outside the active labor force. The percentage of women past 65 who were employed or looking for work also shrank during the first four decades after World War II, though this was mainly because the average age of women past 65 was

rising. The reduction in women's employment was far smaller than among men because the percentage of older women who worked outside the home had never been high.

The decline in labor force participation at older ages has not been confined to the United States. It is characteristic of all rich industrialized countries. In most European countries employment rates among the elderly are now significantly below those in the United States (Quinn and Burkhauser 1994). Along with a shrinking work week and rising paid employment among married women, earlier retirement among men has been a distinctive feature of economic progress in all the developed countries.

Trends in the United States. The pattern of declining work among older men is clearly evident in Figure 1. Each line in the figure traces the labor force participation rate of older American men, by age, in a different year of the past century.² (A person is considered to be a labor force participant if he or she holds a job or is actively seeking work.) The top line shows age-specific participation rates of older men in 1910. Note that there is a clear pattern of labor market withdrawal with advancing age. Even at age 72, however, the male participation rate in 1910 was over 50 percent. Participation rates in 1940, 1970, 1984-85, and 1998-99 are displayed in the lower four lines. Each of these lines shows a characteristic pattern of labor market withdrawal as men grow older. The crucial difference between 1910 and later years is that the fall-off in labor force participation begins at an earlier age and proceeds at a faster pace.

The decline in male participation was neither smooth nor uniform over the century. By far the largest proportionate declines in participation occurred among men past the age of 65. In 1998-99, for example, the participation rate among 72-year-olds was only one-quarter the equivalent rate in 1910. The fall-off in participation was smaller at younger ages. In general, large declines in participation occurred in the early and middle parts of the century for the oldest age groups; major declines occurred after 1960 among younger men. The largest percentage declines among men older than 70 occurred between 1910 and 1940. The fastest declines among 65-to-69 year-olds took place between 1940 and 1970. The biggest declines among men under 65 did not occur until after 1960, after the earliest age of eligibility for Social Security benefits was reduced to 62. A striking feature of Figure 1 is that there has been *no* decline in older men's participation rates since the mid-1980s. After a long period of decline, the participation rates of older men stabilized or even increased slightly after 1985.

The story for older American women is different. Older women's participation rates in the post-World-War-II era have reflected two partially offsetting phenomena – the early retirement trend of older workers in general and the increasing labor force participation of married women. As a result of the latter, the participation rates of older women did not exhibit the dramatic post-war declines seen among men. Instead, as shown in lower panel of Table 1, age-specific labor force participation rates generally increased among women. Between 1950 and 1998-99, the female participation rate rose 39 percentage points at age 55, 26 points at age 60, 8 points at age 65, and 7 points at age 70.

What is similar to the male experience is the shift in trends after 1985. As with men, there is a noticeable break from the earlier trend in older women's labor force participation. Between 1970 and 1985 older women's labor force participation rate barely increased at all and even declined among people past age 62. In contrast, female participation rates surged in the 15 years after 1985. Figure 2 shows the annual percentage-point change in participation at selected ages in the two different periods. The lighter bars show changes between 1970 and 1985; the darker bars show changes between 1985 and 1999. The top panel shows trends in the participation rate of older men, and the lower panel shows trends at the same five ages for women. At age 62, the male participation rate fell 1.5 percentage points a year from 1970 to 1985. The rate among 62-year-old women declined 0.2 points a year over the same period. Between 1985 and 1999, the male participation rate at age 62 rose 0.3 percentage points a year; the female rate increased 0.7 points a year. At each age the rate of increase in participation rates accelerated, the rate of decline in participation rates shrank, or a decline in participation rates was reversed. The similarity of the break points in the male and female time series is striking (Quinn 1999b). Women's participation rates at older ages have risen strongly over the past 15 years, while among older men the long-term decline in participation rates has ended and may even have reversed.

Historical information about participation rates can be used to trace out the long-term trend in retirement. Figure 3 shows the trend in the "average" male retirement age if we define that age as the youngest age at which fewer than half the men in the age group remain in the work force. Under this definition, the average male retirement age fell from 74 years in 1910 to 63 years in 1998-99, a drop of about 1.2 years per decade. The tabulations in Figure 3 also

indicate, however, that the trend toward earlier male retirement has recently slowed and may even have ceased.

The decline in the average retirement age has occurred in an environment of rising life expectancy among older Americans, especially in the period since 1940. Falling mortality rates among the elderly added almost four years to the expected life span of a 65-year-old man and more than 5½ years to the life expectancy of a 65-year-old woman after 1940. Since expected male life spans increased about 0.8 years per decade during a period in which the retirement age dropped 1.2 years per decade, the amount of the male life span devoted to retirement climbed about 2 years per decade, adding almost 12 years to the amount of time men spend in retirement. Retirement now represents a substantial fraction of a typical worker's life. For many workers, retirement will last longer than the period from birth until full-time entry into the job market.

Trends in other rich countries. The long-term trend toward earlier retirement in the United States has been matched – and usually surpassed – by equivalent trends in other rich countries. In a recent survey of the determinants of retirement in rich countries, OECD economists produced estimates of the average retirement age in 24 high-income nations (Blöndal and Scarpetta 1998). They estimated the average age at which men and women withdrew from the active workforce for selected years between 1950 and 1995. Their estimates show that the average retirement age has declined in nearly all of the countries since 1950. In 1950 the average retirement age for men was 65 or higher in almost all the 24 countries. By 1995 the male retirement age had fallen everywhere except Iceland. In most countries the drop in the average retirement age was at least three years. In a quarter of the countries, an average male now leaves the work force before attaining age 60. The drop in the average retirement age of women has been even faster.

As one of the richest OECD countries, the United States might be expected to have one of the lowest retirement ages. Instead, it has one of the highest. In 1950 its average retirement age placed the United States in the middle of the 24 countries surveyed by the OECD. By 1995 it had one of the oldest retirement ages. Only four out of the 24 countries had a higher male retirement age (Iceland, Japan, Norway, and Switzerland), and only five had a higher female retirement age (Iceland, Japan, Norway, Sweden, and Turkey). Figure 4 shows the 1960-1995 trend in average retirement ages in the seven largest OECD economies, separately for men and women. In all seven countries women retire at a younger age than men. (The male-female gap

in retirement ages averaged 2½ years in 1995.) And in all seven countries the average retirement age of both men and women has fallen over time. But the decline has been smaller in the United States and especially in Japan than in the other five countries.

Some of the recent divergence in retirement trends is due to differences in the state of the overall job market. The United States and Japan maintained much lower unemployment rates than the other five countries through most of the 1990s. The tighter labor markets in those two countries probably encouraged older workers to remain employed longer than they would have if the unemployment rate approached European levels. It is also likely, however, that cross-country differences in old-age and disability pensions, unemployment benefits, and health insurance coverage played important roles in keeping older American and Japanese workers in the labor force (Gruber and Wise 1999).

The retirement-age trends displayed in Figure 4 obviously have different implications for a nation depending on whether its working-age population is growing or shrinking. The extra burden implied by an earlier retirement age is easier to bear if the working-age population is expanding rapidly, either as a result of natural population increase or immigration. In this respect Canada and the United States enjoy a significant advantage over the other five countries. High immigration and moderate fertility rates ensure substantial labor force growth in North America over the next few decades, even if U.S. and Canadian retirement ages should continue to fall. Germany, Italy, and Japan face much less favorable prospects. Fertility in all three countries is extremely low, and immigration into Japan is negligible. The three countries face a future in which their active working populations will decline, even if the average retirement age remains unchanged (Bosworth and Burtless 1998). If the average age at retirement continues to decline, these countries will face even heavier burdens in supporting their growing elderly populations.

Explaining the trends

Research by economists and others has shed valuable light on the evolution of retirement in the United States. Most of the early research on American retirement trends was conducted by analysts in the Social Security Administration using survey information from retired workers receiving Social Security benefits or workers who had recently retired (Quinn et al. 1990, pp. 43-53; Quinn 1991, pp. 119-23). In the earliest surveys of new retirees an overwhelming majority

of male respondents said they retired because they were laid off by their last employer or were in such poor health that further work was unappealing or impossible. In the 1940s and early 1950s, fewer than 5 percent of new retirees reported leaving work because of a wish to retire or enjoy more leisure. About 90 percent left because of poor health or a layoff. These explanations for retirement dominated survey responses and the research literature from the 1940s through the early 1970s. Only a very small percentage of retired men reported leaving work because they wanted to retire. An early analyst suggested that “most old people work as long as they can and retire only because they are forced to do so... [O]nly a small proportion of old people leave the labor market for good unless they have to” (Quinn 1991, pp.120).

In recent surveys of new Social Security beneficiaries, a larger percentage of pensioners reports leaving work because of a desire to enjoy additional leisure or to retire. By the early 1980s, the desire to leave work explained nearly half of all retirements among men 65 or older, while poor health accounted for only a little over a fifth and involuntary layoff about 15 percent of retirements. The proportion of workers who say they have retired for purely voluntary reasons is plainly on the increase.

Many people will accept these responses at face value, but there are reasons to be skeptical of the story they tell. From 1940 through the early 1970s, well over a third of respondents explained their entry into retirement as the result of involuntary job loss. While this explanation might seem plausible, labor economists recognize that millions of workers lose their jobs each year without choosing to retire. The overwhelming majority of workers who state that job loss was the reason for their retirement lost several jobs earlier in their careers, but on no previous occasion did their layoffs cause them to permanently exit the labor force. When forced into unemployment at younger ages, these same workers looked for another job and eventually found one. It is natural to ask why job loss pushed them into retirement on this one occasion but not on the others.

Even the explanation of “poor health” should be treated with caution. Social Security beneficiaries may account for their retirement with the explanation that bad health left them no alternative, but it seems reasonable to ask whether their decision to retire would have been different if Social Security or other pensions were unavailable. In the early post-war era some retirees may have explained their employment status in terms of job loss or bad health because the desire for more leisure was not yet considered an acceptable reason to be without a job. As

retirement has come to be considered a normal and even desirable part of life, workers may feel less reason to describe their joblessness as involuntary.

Wealth, health, and the physical demands of work. However we interpret the survey responses of people who collect pensions, it should be plain the long-term trend toward earlier male retirement has had an important *voluntary* component. The trend in survey responses suggests this is true, and a growing body of research evidence also supports the conclusion. The simplest and probably most powerful explanation for earlier retirement is rising wealth. The United States and other industrialized countries have grown richer over time. Real per capita GDP in the United States has more than doubled since 1960, increasing about 2 percent a year. Some of this increased wealth has been used to purchase more leisure. Americans stay in school longer than they once did, enter the workforce later, work fewer hours per year, and leave the labor force earlier.

For many of today's retired workers, the increases in wealth flowing from greater national prosperity have been augmented by windfall gains from two sources – higher prices for the houses they own and generous benefits from Social Security and Medicare. Because the Social Security system has historically been very generous, most generations retiring up to the present have received larger pensions than their contributions alone could have paid for if the contributions had been invested in safe assets. Workers who retired under Social Security before the mid-1980s received pensions well in excess of the benefits they would have received if Social Security offered normal returns on their contributions (Leimer 1994; Geanakoplos et al. 1998). Retired Americans continue to receive Medicare benefits that are vastly larger than those that could be financed solely out of their contributions and the interest earnings on those contributions. This fact is well known to students of social insurance, who recognize that most early contributors to a pay-as-you-go retirement system obtain exceptional returns on their contributions. The exceptional returns on Social Security and Medicare taxes, like those on owner-occupied homes, have increased the amount of consumption that older Americans can afford. One way workers have used these windfall gains is to retire at a younger age.

While some researchers have attributed most of the post-war decline in male labor force participation to the introduction and liberalization of Social Security, most specialists think the impact on retirement has been considerably smaller. Because of the long-term rise in productivity, workers are much wealthier today than they were at the beginning of the twentieth

century. This would have led workers to retire earlier than previous generations, even in the absence of Social Security and Medicare. Social Security, Medicare, and employer-sponsored retirement plans were established and expanded in part to help workers achieve the goal of living comfortably without work in old age. If these programs had not been developed, it is likely that workers and employers would have found other ways to achieve the same goal.

Of all the explanations advanced for earlier retirement, two of the least persuasive are declining health and the changing physical requirements of work. While nearly all good retirement studies find that health plays an important role in the timing of retirement, there is no convincing evidence that the health of 60-year-olds or 65-year-olds was declining over the period in which older Americans' labor force participation rates were falling. Declining mortality rates as well as recent evidence about the trend in the physical disabilities of the aged suggest instead that the health of Americans is improving, at least in early old age. Moreover, analyses of the growth of different kinds of occupations and in their physical requirements imply that the physical demands of work are now easier to meet than they were in the past. A much smaller proportion of jobs requires strenuous physical effort; a larger percentage requires only moderate or light physical exertion (Manton and Stollard 1994; Baily 1987). Of course, within every generation there will be workers who are in poor health and who work in physically demanding jobs. These workers will be among the first to retire. But it seems unlikely that general health deterioration or widespread increases in the physical demands of employment can explain the general tendency for recent generations to retire earlier than workers in the past.

Financial incentives. Besides increasing most current retirees' lifetime wealth, the Social Security system also affects the financial attractiveness of remaining at work. Most workers can choose to collect Social Security starting at age 62, and many do. The effect of Social Security on retirement behavior before age 62 depends on the Social Security tax and on the benefit formula that links eventual monthly pensions to a worker's past covered earnings. Employers and workers pay a combined tax equal to 12.4 percent of wages into the system. The tax thus reduces workers' wages by about 12 percent in comparison with the wages they would earn if the program did not exist. On the other hand, contributions allow a worker to earn credits toward a Social Security pension. The pension entitlement goes up as the worker's covered lifetime wages increase. Whether the increase in the pension entitlement is large enough to compensate a worker for his extra contributions is an empirical question. Low-wage workers typically receive

favorable treatment under the Social Security benefit formula, so they often receive a generous return on their extra contributions. High-wage workers usually receive lower returns. For any worker who is less than 62 years old, Social Security affects the marginal return from working by reducing net current pay by about 12 percent and increasing the present value of future Social Security pensions. Whether this increases or reduces the willingness of a worker to continue working depends on the exact amount of the future pension increase (which depends on the worker's expected longevity) and on the worker's feelings about the relative value of current versus future income and the attractiveness of immediate retirement.

Starting at age 62 Social Security has a different kind of effect on the retirement decision. When a worker delays receipt of retirement benefits by working another year after the earliest age of eligibility, two things happen, one good and one bad. The bad news is that the worker passes up the chance to collect a Social Security check. The good news is that future retirement benefits will be higher because average lifetime earnings are recalculated and because the monthly pension check is increased for every month of delay in asking for benefits. If a worker is entitled to a \$500-per-month pension, for example, she sacrifices \$500 in retirement income every month she postpones retirement past age 62. If her regular monthly pay is \$10,000, this represents a small sacrifice. But if her usual pay is \$1,000, the sacrifice amounts to half her wage. Between the ages of 62 and 64 the Social Security formula offers average workers a fair compensation for giving up a year's benefits. Monthly benefits are adjusted upwards about 8 percent for each year's delay in claiming them. For workers with average life expectancy and a moderate rate of time preference, this adjustment is just large enough so that the sacrifice of a year's benefits is compensated by eligibility for a higher pension in the future. After age 65, however, the benefit formula has historically been less generous toward delayed retirement. Postponement of retirement after that age was not fairly compensated by increases in the monthly pension. For most workers this is true even taking account of the fact that the basic pension calculation gives them extra credit for their most recent wages.³ In essence, the Social Security formula forces workers who delay retirement after 65 to accept a cut in the lifetime value of their Social Security payments. This is a clear inducement to retire no later than age 65.

It is worth noting that almost no workers are "average." A benefit calculation rule that is age-neutral or actuarially fair on average can still provide strong financial incentives to retire for a worker who has below-average life expectancy. This worker may not expect to live long

enough for the future benefit increase to make up for the benefits he gives up by delaying retirement for one more year. Similarly, a worker who applies a high discount rate when evaluating future benefits may not be impressed that the pension adjustment is “fair” for an average worker. For workers who are impatient to consume, an 8-percent hike in benefits starting one year from today may not be enough to compensate for the loss of twelve monthly benefit checks over the next year. Even an actuarially fair pension adjustment might be insufficient to persuade workers who are tired of their jobs to delay retirement.

One reason that many people must retire in order to collect a Social Security check is that the program imposes an earnings test in calculating the annual pension. Workers who are between 62 and 64 and who earn more than \$10,800 a year lose \$1 in annual benefits for every \$2 in earnings they receive in excess of \$10,800. Workers between 65 and 69 lose \$1 in benefits for every \$3 in annual earnings in excess of \$17,000. (Pensioners age 70 and older do not face an earnings test.) At one time the earnings limits were much lower, discouraging pensioners from work and possibly encouraging them to postpone claiming a pension until they were confident their earnings would remain low.

Many employer-sponsored pension plans are structured similarly to Social Security pensions. Workers who are covered under an old-fashioned defined-benefit plan earn pension credits for as long as they work for the employer that sponsors the plan (sometimes up to a maximum number of years). The longer they work under the plan, the higher their monthly pension. Most defined-benefit plans are structured to encourage workers to remain with the employer for a minimal period – say, 10 years – or until a critical age – say, age 55. Workers who stay for shorter periods may receive very little under the plan. On the other hand, workers who stay in the job too long may see the value of their pension accumulation shrink. This would happen if the plan offered benefits to workers starting at age 55 but then failed to significantly increase the monthly benefit for workers who delayed retirement after age 55. If a 55-year-old worker can collect a monthly pension of \$1,000 when he retires immediately and a monthly check of \$1,001 if he delays his retirement one year, he will clearly lose a substantial amount of lifetime benefits – nearly \$12,000 – for each year he postpones receipt. The worker essentially suffers a pay cut when he reaches age 55, and the cut is equal to the loss in lifetime benefits he suffers by postponing retirement. Such a pay cut might seem illegal under U.S. age discrimination laws, but it is perfectly legal as long as the pay cut is reflected in reduced lifetime

pensions rather than reduced money wages. Many employers find this kind of pension formula to be an effective prod in pushing workers into early retirement.

There is one important difference between Social Security and employer-sponsored defined-benefit pensions. Social Security imposes an earnings test on income received from *all* employment, including self-employment. Employer-sponsored pensions may impose an even tougher earnings test, but the test applies only to earnings received from the sponsoring employer or group of employers. Workers who wish to claim a pension may be forced to leave the job on which they earned the pension, but they are not forced to leave work altogether. Nevertheless, the effects of employer-sponsored pensions on retirement may be similar to those of Social Security, because many older workers find it hard to get attractive job offers after they have retired from their career jobs.

This explanation of the financial incentives in Social Security and employer-sponsored pensions sheds some light on the retirement trends discussed earlier. Social Security is now the main source of cash income of households headed by someone 65 or older. The program provides slightly more than 40 percent of the total cash income received by the aged. Among aged households in the bottom 60 percent of the elderly income distribution, Social Security provides over three-quarters of cash income. Until 1941, Social Security provided no income at all to the aged. Today the program replaces about 42 percent of the final wage earned by a full-career single worker who earns the average wage and claims a pension at age 65. If the worker has a non-working dependent spouse, the benefit replaces 63 percent of the worker's final wage. Benefits are clearly large enough so they can be economically significant in influencing the choice of retirement age.

The distributions of male retirement ages in 1940, 1970, and 1998-99 are plotted in Figure 5. The chart shows the percentage of men leaving the labor force at each age from 56 to 72, computed as a fraction of the men in the labor force at age 55.⁴ The calculations are based on the data displayed in Figure 1. Not surprisingly, the retirement-age distributions for 1970 and especially for 1998-99 are skewed toward the left. Labor force withdrawal occurred at earlier ages in those years than it did in 1940. Both the 1970 and 1998-99 distributions show evidence of clustering in retirement at particular ages. In 1970 the peak rate of retirement occurred at age 65; by 1998-99 the peak occurred at age 62. There are peaks in the distribution of retirements in

1940 at ages 65 and 70, but these are far lower than the peaks in 1970 and 1998-99 when the timing of retirements was influenced by Social Security.

Our description of the financial incentives in Social Security suggests a simple explanation for the clustering of retirements at ages 62 and 65, at least in years after 1940. Workers who continued to work beyond age 65 give up Social Security benefits for which they were not fairly compensated. This feature of the benefit formula clearly encourages retirement at age 65. The clustering of retirements at age 62 can be explained using similar logic. Starting in 1961, age 62 became the earliest age at which men could claim a Social Security pension. Before 1961 there was no evidence of clustering in retirements at age 62, but by 1970 retirement was more common at 62 than at any other age except 65. By the mid-1990s, age 62 was by a wide margin the most popular age of retirement. In principle, the Social Security formula fairly compensates “average” workers if they delay claiming a pension past age 62. As we have seen, however, a worker with a high rate of time preference or short life expectancy might not regard the compensation as fair. In that case, we should expect many workers to prefer retiring at age 62 rather than a later age.

Of course, the clustering of retirements at ages 62 and 65 may be due to factors other than Social Security. It is hard to believe, however, that health or work opportunities decline abruptly at particular ages. Another explanation is that some workers were affected by mandatory retirement rules. This explanation may have been valid in 1940 and 1970, when mandatory retirement rules covered up to one-half of American workers, but it is not persuasive today. Amendments to the Age Discrimination in Employment Act passed in 1986 prohibit employers from dismissing workers solely on account of their age.

The simplest alternative explanation for the clustering of retirement ages is that workers are affected by employer-sponsored pension plans. But many older workers are not covered by an employer plan. The Current Population Surveys suggest that employer-sponsored pensions do not provide a large percentage of income to older Americans, except in more affluent households. But for those workers who are covered by a private pension plan, the financial incentives in the plan may provide powerful incentives for workers to leave their career jobs at a particular age.

Health insurance. Unlike most other industrialized countries, the United States does not provide universal health insurance to its citizens. Instead, most working-age Americans receive

health insurance coverage as part of an employer's compensation package. In 1995, 72 percent of American workers between 18 and 64 had health insurance coverage under an employer-based plan, either through their own employer or through the employer of another family member. Some workers obtain insurance through publicly provided Medicaid or privately purchased health plans, but 18 percent of American workers were left uninsured. Some employers offer continuing health insurance to their workers, even after they leave the firm. In 1995, of those full-time employees in medium and large firms who had health insurance on their jobs, 46 percent also had retiree health coverage before age 65, and 41 percent had retiree coverage at ages 65 and older. The percentage of the labor force employed by firms offering such protection is shrinking, and many employers now require their retired workers to pay for more of the cost of the plans (EBRI 1997a).

The nation's peculiar health insurance system provides a complicated set of incentives for retirement. Health insurance is particularly important for workers who are past middle age but not yet eligible for Medicare, because many of them face high risk of incurring heavy medical expenses. Workers with health insurance on the job who would lose it if they retire have an obvious incentive to remain on the job, at least until age 65 when they become eligible for Medicare. Those with post-retirement health benefits have less incentive to remain employed, although how much less depends on how the insurance costs after retirement are shared between the employee and employer.

As with Social Security and private pensions, there is considerable evidence that health insurance coverage before and after retirement has an important influence on individual retirement decisions. Alan Gustman and Thomas Steinmeier find, for example, that the effects of insurance plans are similar in nature to those of employer-sponsored pension plans (Gustman and Steinmeier 1994). If workers can become eligible for retiree health benefits only after a delay, the availability of the plan tends to delay workers' retirements until they gain eligibility. After eligibility has been achieved, the availability of retiree health benefits encourages earlier retirement than would occur if no benefits were offered. Quinn estimates that men and women in career jobs in 1992 were 8 to 10 percentage points less likely to leave their jobs over the next four years if they would lose health insurance coverage by doing so (Quinn 1999b). Inferring the overall effect of health insurance incentives on retirement patterns is tricky, however. A number of components of employee compensation, including wage rates, pension coverage, health

insurance, and retiree health benefits, tend to be highly correlated with one another. This makes it difficult to distinguish statistically between the separate effects of each component of compensation. Nonetheless, the rising importance of health insurance coverage to older Americans suggests that the evolution of the public and private health insurance system may have had a sizable impact on retirement patterns.

The change in retirement trends after 1985. There are two types of explanation for the slowdown or reversal of retirement trends in recent years. One hypothesis is that permanent changes in the retirement environment have encouraged additional work by older Americans. Under this conjecture, the long-term trend toward earlier retirement is over. Another view is that temporary cyclical factors are responsible for a pause in the historical retirement trend. When these cyclical factors are behind us, the historical trend toward earlier retirement will resume. Although it will be many years before we can be sure of the relative importance of these explanations, it is possible to assess some of the permanent and temporary factors that have influenced recent retirement trends.

The most important cyclical factor affecting retirement is the state of the economy. The American economy is currently growing strongly, and the unemployment rate is near a 30-year low. The second half of the 1980s and the 1990s saw lengthy economic expansions and strong employment growth. There was only one recession after 1985. These factors made it easier for workers to find jobs when they were dismissed and more likely to find the terms and conditions of employment that they desire. In contrast, economic growth was much less even in the 15 years after 1970. The period saw three recessions. Two of the recessions – in 1974-75 and 1981-82 – were the worst of the post-war era. Weak labor demand discourages jobless workers from persisting in their job search. Strong demand creates employment options for older workers who want to keep working.

Although we think a strong economy has contributed to the recent rise in older Americans' participation rates, it is probably not a big part of the story. The economy also grew strongly and unemployment reached very low levels in the 1960s, yet older men's labor force participation rates fell in the decade and older women's participation rates changed very little (see Table 1). In earlier work, Quinn estimated the impact of the business cycle on older workers' participation rates, and found that changes in the overall unemployment rate account for a relatively small proportion of the change in participation trends since 1985 (Quinn 1999b).

Most of the change in participation trends since 1985 is probably due to factors other than the cyclical movement in economy-wide unemployment.

It is easier to point to factors in the retirement environment that have permanently changed in a way that encourages later withdrawal from the job market. One important change is that the nation's main pension program, Social Security, is no longer growing more generous. Workers who retired between 1950 and 1980 retired in an environment in which Social Security benefits were rising, both absolutely and in relation to the average earnings of typical American workers. Most workers received pensions that were higher than those they would have obtained if their Social Security contributions had been invested in safe assets. The maturation of the Social Security program meant that fewer workers who retired after 1985 received windfalls from the program. The Social Security amendments of 1977 and 1983 brought an end to a four-decade expansion and liberalization of benefits. In fact, the amendments trimmed retirement benefits modestly in order to keep the program solvent.

Congress has changed Social Security rules and the pension formula to make work late in life more attractive. The amount of income a recipient can earn without losing any Social Security benefits has been increased, and the benefit loss for each dollar earned over the exempt amount has been reduced (from 50 to 33 cents) for pensioners between 65 and 69. In the 1977 and 1983 Social Security amendments, Congress also increased the reward that workers receive for delaying initial benefit receipt past the normal retirement age (NRA). Instead of penalizing work after the NRA, Social Security is becoming more age-neutral. When this formula change is fully implemented, for workers attaining age 62 after 2004, the adjustment for delayed benefit receipt will be approximately fair for retirements up through age 70. It is nearly so today. (At age 70 workers receive full pensions regardless of the amount they earn.) There will be no retirement penalty for delaying retirement beyond the normal retirement age.

Important changes have also occurred in the private sector. There has been a sharp increase in the relative importance of defined-contribution pension plans and a continuing decline in the importance of old-fashioned defined-benefit plans. Defined-contribution plans are age-neutral by design, and therefore they have none of the age-specific work disincentives that are common in traditional defined-benefit plans. As a growing percentage of workers reaches retirement age under defined-contribution plans, there will be less reason for workers to leave their jobs to avoid a loss in lifetime retirement benefits.

Some changes in the environment are the result of policy initiatives aimed specifically at encouraging more work at older ages. For example, mandatory retirement has been nearly eliminated in the United States. In the early 1970s about half of all American workers were covered by mandatory retirement provisions that required them to leave their jobs no later than a particular age, usually age 65. In 1978 the earliest legal age of mandatory retirement was raised from 65 to 70, and in 1986 mandatory retirement provisions were outlawed altogether for the vast majority of workers. The increase and eventual elimination of mandatory retirement ages not only increased the options open to older employees who wanted to remain on their jobs, but also sent an important message to Americans about the appropriate age to retire.

This message was reinforced by a provision of the 1983 Social Security amendments that is gradually raising the normal retirement age in Social Security from 65 to 67. The higher NRA will become fully effective for workers who reach age 62 in 2022. So far as we know, the United States was the first industrial nation to pass a law lifting the retirement age under its main public pension program. Although few workers may be aware of the higher retirement age, many are affected by it already. Workers reaching age 62 in 2000 face a normal retirement age of 65 years and 2 months, which means that they will qualify for age-62 pensions that are 1 percent smaller than age-62 benefits under the traditional NRA. The delay in the eligibility age for unreduced pensions has an effect on benefit levels that is almost identical to across-the-board benefit cuts.

These changes in the retirement environment suggest that the future will not look like the past. The relative attractiveness of work and retirement at older ages has been altered in favor of work, though the changes may have produced only modest effects so far. The break in the early retirement trend that occurred in the mid-1980s suggests that changes in the retirement environment are having an impact in the expected direction.

Should we encourage later retirement?

Even if the trend toward earlier retirement has stopped, it is natural to ask whether the nation should take additional steps to encourage later retirement. One reason often mentioned to induce later retirement is concern over public finances. Social Security is the largest item in the federal budget. In 1995 Social Security outlays represented 4.6 percent of GDP and a little less than 22 percent of overall federal spending. After the income tax, the program is the most

important source of federal tax revenues. Over the next 10 to 15 years the financial outlook for Social Security is relatively secure, even under pessimistic assumptions about the state of the economy. When the baby boom generation reaches retirement age in the second decade of the next century, however, benefit payments will begin to climb much faster than tax revenue. Outlays will exceed taxes and will eventually exceed tax revenues plus interest payments earned by the Trust Funds. Under the intermediate assumptions of the Social Security Trustees, the Trust Funds will begin to shrink. Unless benefits are trimmed or tax rates increased, the Trust Funds will eventually fall to zero, making it impossible under current law to make timely benefit payments. The financial condition of the Medicare program is more perilous than that of Social Security. The reserves of the system are smaller, and they will be depleted much sooner than the OASDI Trust Funds.

Restoring both Medicare and Social Security to long-term solvency will be costly. The federal budgetary cost of achieving solvency would obviously be smaller if workers' eligibility for benefits under the two programs were delayed. In the remainder of this paper we focus on options to encourage later retirement under the Social Security program.

The solvency of Social Security, like that of any pension program, depends on four crucial elements: (1) the contribution rate imposed on workers and their employers; (2) the pension fund's rate of return on its investments; (3) the age of eligibility for pensions; and (4) the average monthly pension paid to retirees. The first two elements determine the annual amount of funds flowing into the system; the last two determine the annual amount flowing *out* of the system. Each of the four elements must be carefully calibrated to ensure that benefit promises are matched by expected future revenues. If a pension program is exactly solvent and one of the four elements changes, some adjustment in the other three elements may be necessary to restore the solvency of the program. For example, if the rate of return on pension fund investments falls, it will be necessary to increase the contribution rate, delay the age of eligibility for pensions, or lower monthly pensions in order to restore the pension program to solvency.

Improvements in life expectancy increase the funding requirements of a pension plan. If contributors live one additional year in retirement, the plan must find enough extra resources to finance the added benefit payments. To keep the pension system solvent, this requires higher contributions to the program, a higher rate of return on investments, a delay in the retirement age, or a reduction in monthly benefits. It is worth emphasizing that this is true for every type of

pension plan whether public or private. If Social Security had never been established, increases in American life spans over the past half century would have required private pension plans to increase their contribution rates, find investments that yield higher rates of return, delay the age of eligibility for pensions, or reduce monthly pension payments.

A large part of Social Security's long-term funding problem arises because of good news about longevity.⁵ Americans now live longer than their parents and grandparents did. Their children and grandchildren can be expected to live longer than we do. The improvements in longevity mean that living Americans will survive much longer past age 65 than was true when Social Security was established in the Great Depression. The longevity increases provide the equivalent of a benefit increase to Social Security recipients. The benefit increase must be paid for if the system is to remain solvent.

Political unpopularity. While it might seem logical to raise the retirement age in Social Security to reflect improvements in longevity, that logic has so far escaped the general public. American voters and workers routinely reject the idea of a higher retirement age when it is suggested as a solution to Social Security's problems. Lawrence Jacobs and Robert Shapiro recently summarized the findings of 18 polls that asked Americans about their attitudes toward an increase in the retirement age (Jacobs and Shapiro 1998, pp. 381-384). The polls were conducted over a twenty-year period ending in 1997, and each poll was administered to at least 750 respondents. With rare exceptions, solid majorities of respondents reject any proposed hike in the retirement age. The size of the majority opposing a higher retirement age was higher in the 1990s than it was in the 1980s. Political leaders apparently take their cue from the polling numbers. Nearly all of the presidential candidates in both political parties have expressed strong opposition to the idea of a higher Social Security retirement age.⁶

Americans' hostility to a higher retirement age does not provide much guidance to policymakers, however. Solid majorities also oppose other basic steps that would solve Social Security's long-term funding problem. Most poll respondents are against higher payroll taxes, lower monthly benefits, and investment of Social Security reserves in stocks, where they would earn a higher return (Jacobs and Shapiro 1998; EBRI 1997c, pp. 11). Many workers' may oppose a higher retirement age in Social Security because they intend or at least hope to retire several years before attaining the *early* eligibility age for Social Security benefits. When asked in an EBRI poll when they hope to start retirement, one-third of active workers answered "age 55

or younger.” When asked when they actually *expect* to retire, however, only 15 percent thought their retirements would occur before age 56 (EBRI 1997b, Chart 1). If the Social Security retirement age were increased, early retirement would become a less affordable dream.

Other options. There is no compelling reason to raise either the Social Security retirement age or the average retirement age, of course. If Americans’ incomes continue to grow 1 or 2 percent a year, some fraction of the increase can be used to finance comfortable incomes during longer spells of retirement. This means, however, that more of the income earned by active workers must be set aside to pay for longer retirements. This could take the form of higher payroll or income taxes to pay for Social Security benefits to the currently retired or higher personal saving to make up for the loss of monthly Social Security benefits if Social Security pensions are trimmed to preserve solvency. There is some evidence that workers understand this trade-off. When forced to choose between the option of making larger contributions to pay for retirement or accepting smaller pensions after they retire, most workers opt to make larger contributions. By a 2-to-1 majority, workers favor higher payroll taxes over reduced Social Security pensions (EBRI 1997b, Chart 6). This suggests a simple conclusion: Americans would rather set aside more of their wages for retirement than postpone their retirement.

Workers can offset the effect of higher retirement contributions by working longer hours during their prime working years. There is some evidence this is occurring. American work patterns have changed slowly but significantly over the past generation. Since the 1960s three major trends have affected adults’ use of time. Women have joined the paid work force in record numbers; men have retired from their jobs at younger ages; and both men and women have devoted more years to formal schooling. The effects of these trends on average work effort can be seen in Figure 6, which shows changes in weekly hours of paid work between 1968 and 1998. The darker bars show average hours on a job during the second week of March 1968; the lighter bars, average hours exactly 30 years later in March 1998. The weekly average is calculated as the total hours of work during the survey week divided by the total number of men and women in the indicated age group. People who do not work are included in these estimates. (The estimates would show higher average hours if they reflected the work effort only of people who held jobs.)

In spite of the trend toward earlier male retirement since 1968, the figure shows a sizable jump in the total amount of time that Americans spend at work. The increase in hours was

driven almost entirely by the surge in women's employment. The CPS interviews show only a small change in average weekly hours among men and women who actually hold a job. Averaging across all ages, women worked 49 percent more hours in March 1998 than they did in March 1968 (20.3 hours a week in 1968 versus 13.6 hours in 1968). The rise was due to a 45 percent jump in the fraction of women holding jobs. Partly offsetting the rise in women's employment was the dip in men's paid work. Most of the drop occurred as a result of sinking employment among men past age 54. Across all age groups, the male employment rate slid 6 percentage points (or 8 percent) between 1968 and 1998, but it fell 15 percentage points among men between 55 and 64 and 9 points among men past 64.

The combined effects of the shifts in male and female work patterns are displayed Figure 6. Averaging the trends of both men and women, we see that hours spent on the job increased for people 18 to 54 years old and declined for people past age 54. Older Americans clearly enjoyed more free time in 1998 than their counterparts in 1968, mainly because of earlier male retirement. For adults between 25 and 54, however, the estimates imply that paid employment consumes a much bigger percentage of available time. The employment rate of people in their prime working years jumped 11 percentage points – almost 17 percent – between March 1968 and March 1998, boosting the average amount of time spent in jobs from 28 hours to 32 hours a week. This increase is equivalent to five extra 40-hour work weeks a year for adults between 25 and 54. In short, Americans are working longer hours between 25 and 54. The increase in hours should help them pay for shorter hours and longer retirements when they are older than 55.

How could we encourage later retirement?

Assuming that it is desirable to do so, how might we encourage American workers to delay their retirements further? In this section we consider some alternatives and discuss their likely impact on future trends in the average retirement age.

Changing the incentives in Social Security. Since the eligibility age for pensions is one of the main features of Social Security affecting its solvency, it is sensible to consider adjustments in the eligibility age to help restore the system's financing. One possibility is to accelerate the increase in the NRA already scheduled under present law. Instead of phasing in the increase over 23 years (with a 12-year hiatus between the change from 65 to 66 and the change from 66 to 67), Congress could phase in the NRA change over just 12 years. This would

mean that the higher NRA will be fully implemented for workers reaching age 62 in 2011, rather than 2022.

A second possibility is to increase the NRA automatically in line with increases in life expectancy after 65. A majority of members of the 1994-96 Social Security Advisory Council proposed increasing the NRA as necessary after 2011 to maintain a constant ratio of retirement years to potential years of work. “Retirement years” is defined as life expectancy at the NRA, and “potential years of work” as the number of years from age 20 to the NRA. Under the Social Security Trustees’ intermediate assumptions, this proposal would push up the NRA to age 70 by about 2080. The Social Security Actuary estimates that the combination of accelerating the NRA increase and then increasing the NRA in line with longevity improvements eliminates nearly one-quarter of Social Security’s long-term funding gap.

Lifting the NRA while leaving the early eligibility age (EEA) unchanged produces almost exactly the same effect on retired workers’ Social Security benefits as a proportional reduction in the full pension (usually referred to as the “primary insurance amount” or PIA). Even though most people describe an increase in the normal retirement age as a “delay” in the retirement age, it is in fact closer to a reduction in the monthly benefit amount. Workers can still obtain pensions at the same age as before, but their monthly pensions are smaller, no matter what age they choose.

There are some important *noneconomic* differences between raising the NRA and cutting the full Social Security pension, however. First, increasing the NRA signals to workers that the same monthly benefit can be obtained by postponing retirement, which may encourage some workers to delay retirement rather than accept a lower pension. Sponsors of employer pension plans might also be induced to modify their plans to encourage delayed pension acceptance if the Social Security NRA were increased. Second, in light of the well-known improvements in life expectancy, American workers might find increases in the retirement age to be more understandable and fairer than equivalent reductions in full pensions. By increasing the retirement age rather than reducing full pensions, Congress conveys the message that the benefit level is appropriate, but the timing is not – workers ought to postpone their retirements.

Congress might increase the early eligibility age (EEA) at the same time and at the same pace as it increases the NRA. An increase in the EEA is fundamentally different from an increase in the NRA. If the EEA is increased above age 62, 62-year-old workers will be

prevented from obtaining old-age pensions. Under current law they can collect reduced old-age pensions or they can apply for Disability Insurance (DI) pensions. When the possibility of obtaining old-age pensions is eliminated, some 62-year-olds who otherwise would have received old-age pensions will apply for DI. This will increase Social Security administrative costs, because eligibility is much more expensive to determine in the DI program. It may also impose serious hardship on workers whose DI applications are denied.

These consequences of increasing the early eligibility age make many people reluctant to tamper with it. Many policymakers are more uneasy about a reform that denies benefits completely to an identifiable class of people than they are about one that reduces benefits modestly to a much wider population. It is important to recognize why Social Security has an early eligibility age, however. If workers could apply for benefits as soon as they accumulated enough earnings credits, some low-income workers would be tempted to apply for benefits in their late 50s or even their late 40s. But their monthly benefits would be very low, because early pensions are reduced below the full pension in proportion to the number of months between the age a worker claims benefits and the NRA. The low level of the initial pension might not represent a problem for a worker who is 50 or 60 years old and can supplement monthly pensions with modest wages or an employer-sponsored pension. But it could cause serious hardship when a worker reaches age 68 or 70 and finds she is no longer able to work and the company pension no longer covers the cost of groceries and the monthly rent. The existence of the early entitlement age prevents short-sighted workers from applying for pensions that will be too small to support them throughout a long retirement.

When the NRA eventually reaches 67, workers claiming early pensions at age 62 will receive 70 percent of a full pension – a 30 percent reduction below the full pension rather than the current 20 percent reduction. If the NRA were eventually increased to 70 and the early eligibility age remained unchanged, workers claiming pensions at age 62 would receive monthly benefits as low as 52 percent of a full pension – probably too little to live on for a low-wage worker with few other sources of income. If the NRA is increased above 67, it seems sensible to increase the early eligibility age as well. Since Social Security is intended to assure a basic floor of support for retired Americans, it seems perverse to allow full-career workers to claim benefits so early that their monthly benefit will be too low to live on. This implies that the early eligibility age must eventually be raised above 62 if the NRA rises much above 67. In order

to implement this reform in a humane way, Congress might consider liberalizing eligibility requirements for Disability Insurance benefits starting at age 62. People who have worked in physically demanding occupations and are in impaired health could be given access to benefits that permit them to retire with a decent standard of living, even if they do not meet the strict standard for health impairment that is used to evaluate DI applications today.

Effects of changing the NRA and EEA on actual retirement ages. It is natural to ask whether increasing the early and normal retirement ages would have much effect on when workers actually retire. Almost all researchers who have examined this question agree that such reforms would tend to increase the average age at retirement, though the effect may not be large. This conclusion was reached in a great majority of economists' studies conducted in the 1980s and early 1990s. Most studies found that even big changes in Social Security would cause only small changes in the average retirement age. Burtless and Robert Moffitt estimate, for example, that increasing the normal retirement age in Social Security from 65 to 68 would add only a little more than 4 months to the full-time working careers of men who have no disabilities (Burtless and Moffitt 1985).⁷

One way to assess the impact of Social Security reforms is to examine differences in retirement patterns among people who face different incentives because the program has been changed in an unanticipated way. In 1969 and again in 1972 Social Security benefits were increased much faster relative to wages than at any time in the recent past. By 1973 benefits were 20 percent higher than would have been the case if pensions had grown with wages as they did during the 1950s and 1960s. In 1977 Congress passed amendments to the Social Security Act sharply reducing benefits to workers born in 1917 and later years (the "notch" generation) in comparison with benefits available to workers born before 1917. Burtless examined the first episode, and Alan Krueger and J.S. Pischke examined the second (Burtless 1992; Krueger and Pischke 1992).

Both studies reached an identical conclusion: Major changes in Social Security generosity produced small initial effects on the retirement behavior and labor force participation of older men. Burtless found, for example, that the 20-percent benefit hike between 1969 and 1973 caused only a 2-month reduction in average retirement age of men who were fully covered by the more generous formula. This is equivalent to a reduction in the labor force participation

rates of 62-year-old and 65-year-old men of less than 2 percentage points. The effects of the 1977 amendments found by Krueger and Pischke were even smaller.

These findings suggest that an increase in the normal retirement age will probably have only a small effect on the age that male workers withdraw from the work force. It is harder to predict the effects of an increase in the early retirement age because we do not have good enough historical evidence to evaluate the impact of this kind of change. When the earliest age of eligibility for Social Security retirement benefits was decreased from 65 to 62 (in 1956 for women and in 1961 for men), labor force participation rates fell significantly, and much faster than they had previously. The reversal of this policy would likely have a larger impact than the change in the normal retirement age, especially for low wage workers who have no other sources of retirement income except Social Security. The magnitude of the increased labor force participation would depend, in part, on how employer pensions responded to the change in Social Security rules and the extent to which eligibility criteria for DI benefits were loosened.

Employer responses. Some people wonder how employers would respond to changes in the early and normal retirement ages in Social Security. Would firms with defined-benefit pension plans increase their early retirement incentives, to offset the loss of the Social Security incentives, or make their plans more age-neutral? If workers wanted to delay their retirements to become eligible for more generous Social Security pensions, could the economy create enough extra jobs to employ them? Would employers discriminate against older job seekers, making it hard for them to find and keep jobs?

Historical evidence about the job creating capacity of the U.S. market is reassuring. Over the long run, the U.S. labor market seems capable of absorbing large numbers of extra workers without a significant rise in joblessness. From 1964 through 1989, when the baby boom generation reached adulthood and entered the job market, the labor force grew by 50.4 million persons, or slightly more than 2 million new entrants a year. Most of this surge was driven by the jump in U.S. fertility between 1946 and 1964, but part was also due to a growing demand for employment by women, who entered the workforce in record numbers. From 1964 to 1989 the number of Americans holding jobs climbed by 47.7 million, or slightly more than 1.9 million workers a year. In other words, about 95 percent of new job seekers in the period were able to find jobs, though the number of people available for work swelled by two-thirds. The unemployment rate rose only slightly, increasing from 5.0 percent to 5.2 percent.

Many people find it surprising that so many extra job seekers can be absorbed by the labor market. They overlook a basic reality of flexible labor markets like those in the United States. In the long run employers are free to change their product lines and production methods to exploit the availability of a newly abundant type of labor, and they can adjust relative wages in response to the entry and exit of different classes of workers.

In the 1970s, for example, the wages received by younger workers fell in comparison with those earned by older workers, in large measure because younger workers became much more abundant. Faced with a huge increase in the availability of workers who had limited job experience, employers adopted production methods that took advantage of less experienced workers. Restaurant meals were prepared and served by eleventh grade students and high school dropouts rather than by experienced cooks or waiters. Gardening and domestic cleaning were performed by unskilled and semi-skilled employees rather than by homeowners themselves. In the end, 95 percent of new job seekers were successful in finding jobs. Of course, many of the new jobs were not particularly well paid. The huge increase in the abundance of less experienced workers is one reason that pay in many jobs fell.

If older workers were forced to wait for two or three extra years for full Social Security retirement benefits to begin, many would choose to remain in their career jobs for a few months or years longer than workers presently do. Older workers who lose their jobs would try harder and more persistently to find new jobs. The jobs that many find would pay lower wages than the jobs they previously held, as is the case for most workers who leave career jobs today. The availability of increased numbers of older workers would almost certainly depress the relative wages of aged job seekers. But low U.S. fertility means the future labor force will grow slowly, placing some pressure on employers to retain older workers and make jobs attractive to older job seekers.

Although some observers are pessimistic about the willingness of employers to accommodate the special needs of an aged workforce, such pessimism may be misplaced. Employers have created millions of part-time jobs to accommodate the needs of students and mothers who are only available to work short weekly hours. People who work on part-time schedules pay a price for short hours in terms of low weekly earnings and lost fringe benefits, but they accept these jobs nonetheless. Comparable accommodations could be made for the special needs of older workers. Many older workers who want jobs to tide them over between the time

their career jobs end and eligibility for full Social Security pensions will be able to find suitable employment.

Other policies. As noted above, Social Security rules are moving toward age-neutrality. Employer pension coverage is shifting toward defined-contribution plans, which have none of the age-specific retirement incentives present in traditional defined-benefit plans. Mandatory retirement has been eliminated for the vast majority of American workers, and equal employment opportunity laws forbid employment discrimination based on age. Federal policies have been enlightened in these areas and are partly responsible for the changes in men's and women's retirement patterns over the past 15 years. Are there other policies that would improve the employment prospects of older Americans? Several come to mind:

- ◆ Permit workers aged 65 or older to opt out of additional Social Security contributions. If this option were chosen, workers would also forego the increases in future benefits that these earnings would have caused. A variant of the same idea would be to exempt earnings up to some dollar limit from F.I.C.A contributions as well as Social Security benefit recalculation. This would lower employers' cost of hiring older workers, because their payroll tax liabilities would fall, and it would make older workers relatively more attractive to hire and retain. It would also require Congress to find a source of revenue to make up for payroll taxes lost as a result of the reform.
- ◆ Allow employers to offer pro-rated fringe benefits for employees working less than full-time hours rather than requiring them to provide the same fringe benefits to all employees working more than 1,000 hours per year (as the Employee Retirement Income Security Act, or ERISA, currently mandates). The present law encourages employers to restrict the hours worked by part-time employees to fewer than 1,000 per year. Giving employers more flexibility would allow older employees and employers to work out mutually agreeable fringe benefit packages that might keep more older workers employed.
- ◆ Make Medicare the first source of health insurance coverage for workers over age 65. Current law requires that the employer's health plan serve as "first payer" for a worker who has dual insurance coverage. Employers could provide additional insurance coverage if they chose. The reform would lower employers' cost of hiring or retaining older workers. Of course, it would also increase Medicare outlays, which in turn would require lawmakers to find additional sources of revenue for that program.
- ◆ Expand the Earned Income Tax Credit to include workers aged 65 and older who have no dependent children. This would provide a federal earnings subsidy to aged low-wage workers who are currently ineligible for the credit, and it could boost the available supply of older workers.
- ◆ Repeal the earnings test to eliminate the perception that pensioners who continue to work after age 62 lose Social Security benefits by doing so. It is true that workers do lose benefits during any year in which their earnings exceed the exempt amount. But for the average worker, the actuarial adjustment before age 65 and the delayed retirement credit between 65

and 69 return all or most of the foregone pensions through higher future benefits. Of course, most workers are not average, and those who anticipate shorter than average life expectancies or who have high discount rates will still find the earnings test a disincentive to work. Even for average workers the existing test can act as a work disincentive. Most Social Security recipients seem unaware of the benefit adjustment, so the current earnings test discourages them from earning more than the exempt amount. The repeal of the earnings test would probably increase recipients' earnings modestly, and the long-term budgetary cost would be negligible.

In an economy as strong as the one we have enjoyed over the past five years, none of these reforms may be needed to encourage higher employment among the aged. But if voters and policymakers want to provide incentives that will delay workers' exit from the labor force or change employers' attitudes toward older job applicants, some or all the reforms could be helpful.

Conclusion

After a long period of decline, the trend toward earlier retirement came to at least a temporary halt in the mid-1980s. Labor force participation rates of American men past age 60 leveled off, and in the past few years they have actually increased slightly. Participation rates among older women have risen significantly since 1985, though this trend may be the result of the historic shift in women's attitudes toward career employment rather than to a change in their retirement behavior *per se*. Along with workers in Japan and Scandinavia, Americans now leave the paid work force later than workers almost anywhere else in the industrialized world.

The question is, do Americans retire at an age that will ultimately prove unaffordable? As life spans increase, the fraction of life spent in retirement will rise unless we delay our exit from paid work. Improved longevity places heavier burdens on active workers if retirees are supported by contributions from current payrolls. Even without any further improvement in longevity, the long-term decline in birth rates has slowed labor force growth and will eventually increase the ratio of retired to active workers. This will place extra pressure on retirement programs like Social Security and Medicare that depend on payroll taxes for most of their funding. To reduce this pressure, the country could adjust the age of eligibility for early and/or normal retirement benefits and take other measures to encourage workers to postpone their exit from the labor market. These steps would directly improve the finances of Social Security and Medicare. They would encourage some workers to delay their departure from career jobs and

induce others to find bridge jobs to tide them over until full retirement benefits begin. The United States has already taken several steps in this direction, and these steps have contributed to the recent growth of employment among older Americans.

Although most workers today claim that they expect to keep working after age 65, or “retirement,” most oppose additional changes in the retirement system that would push them to retire at a later age. A majority resists the idea that a higher retirement age is needed to protect Social Security. The United States is a rich country and will become wealthier in the future. It can certainly afford to maintain current retirement patterns if its citizens choose to spend their additional wealth in this way. The important public policy issue is the importance of this goal in comparison with other legitimate uses of the rise in wealth.

Proponents of a higher retirement age often focus on the long-term trend in older people’s employment rates without considering what has happened to work effort and productivity among people before they reach the retirement age. They worry about the budget cost of retirement at age 62 without reflecting on the fact that younger workers may be paying for their longer and healthier retirements by working harder and more productively in their pre-retirement careers. As long as productivity continues to improve, American society and individual workers can choose how they want to allocate the income gains that flow from higher productivity. The evidence of the twentieth century suggests they will use at least part of it to pay for a longer retirement.

Endnotes

¹ Retirement patterns were much more difficult to measure among women because most worked primarily within the home (and without pay) during most of their adult lives.

² Labor force participation rates for 1910, 1940, and 1970 are based on responses to employment questions in the decennial censuses. See Ransom et al. (1991), especially pages 45-46, and Munnell (1977), page 70. Rates for 1984-85 and 1998-99 are the arithmetic average participation rates on the March Current Population Survey (CPS) files for 1984, 1985, 1998, and 1999. Participation rates measured on the Census differ somewhat from those measured by the CPS, partly because the main goal of the CPS is to obtain reliable labor force statistics. Adjusting the decennial Census statistics to make them strictly comparable to the CPS estimates would have only a slight effect on the patterns displayed in Figure 1, however.

³ Before their 62nd birthdays, workers who contribute to Social Security for an additional year obtain better future pensions because the basic pension formula is based on workers' average lifetime wages. Between ages 62 and 64 workers who contribute to Social Security obtain that benefit enhancement *plus* an actuarial increase equal to about 8 percent of the basic pension to compensate them for giving up one year's benefit payments.

⁴ If the labor force participation rate at age 63 is designated $LFPR_{63}$, the retirement rate at age 63 is calculated as $(LFPR_{62} - LFPR_{63}) / LFPR_{55}$. This calculation ignores the complications involved in computing true cohort distributions and the effects of mortality rates, immigration, and temporary withdrawal from the labor force. It offers a picture of the timing of labor market withdrawal based on the participation choices of men aged 55 through 72 in a particular year.

⁵ Much of the future funding problem is due to the maturation of the program (most future retirees will reach the retirement age with enough earnings credits to receive a full pension), slow growth in the future working population, and a long-term slowdown in the rate of real wage growth (which has deprived the system of anticipated revenues). Increased longevity explains only part of the system's funding shortfall.

⁶ In the GOP presidential candidates' debate in Manchester, NH, on December 5, 1999, Steve Forbes, Senator John McCain, and Governor George W. Bush all expressed views on increasing the retirement age. Forbes described the idea as a "betrayal": "That's not fair to the people. They were made a promise and it should be kept." McCain said that a retirement age increase was unnecessary. Governor Bush flatly ruled out the possibility he would ask for a retirement-age increase for people already near retirement, and he expressed "hope" such a step would not be needed for younger workers. The Democratic presidential candidates have been equally vehement in their opposition. When asked by Tim Russert whether he supported or opposed hiking the retirement age, Vice President Gore responded "Tim, I strongly oppose raising the retirement age." When Gore posed the same question to Bill Bradley, Bradley responded "We said no. We said no. ... OK?" (*Meet the Press*, December 19, 1999).

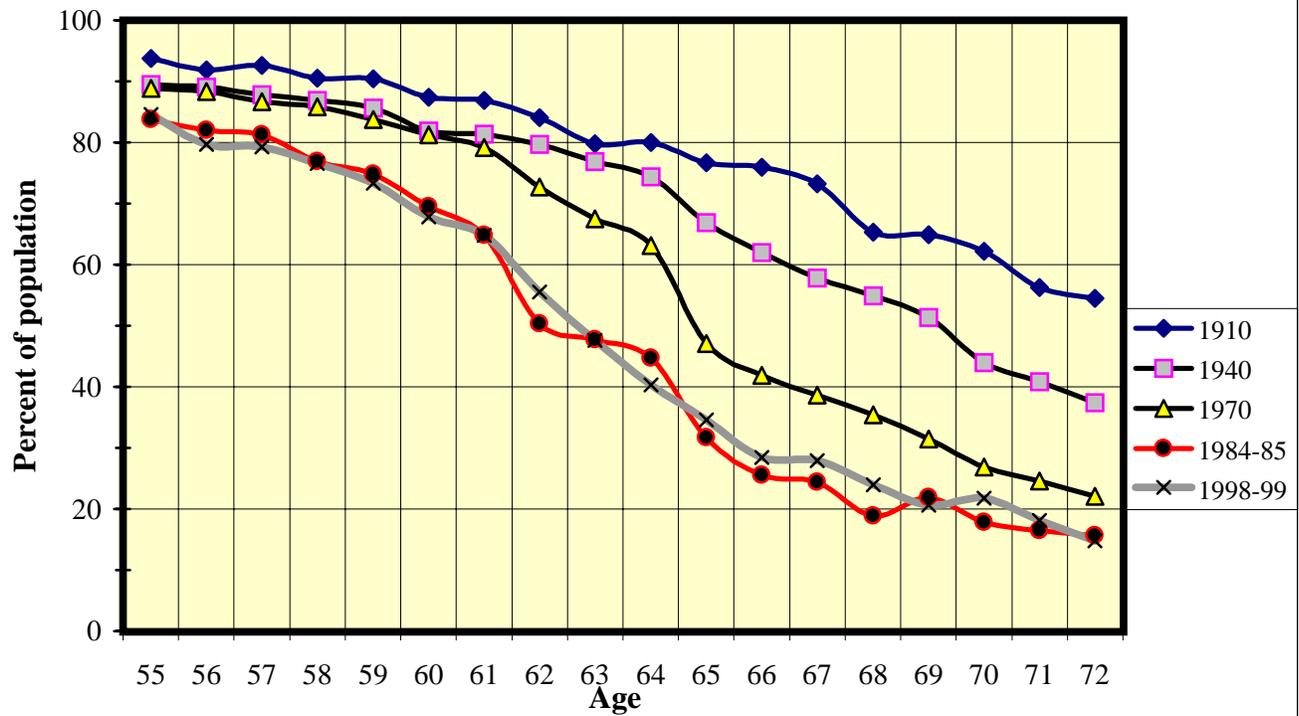
⁷ Other economists' predictions are discussed in Joseph Quinn et al. (1990).

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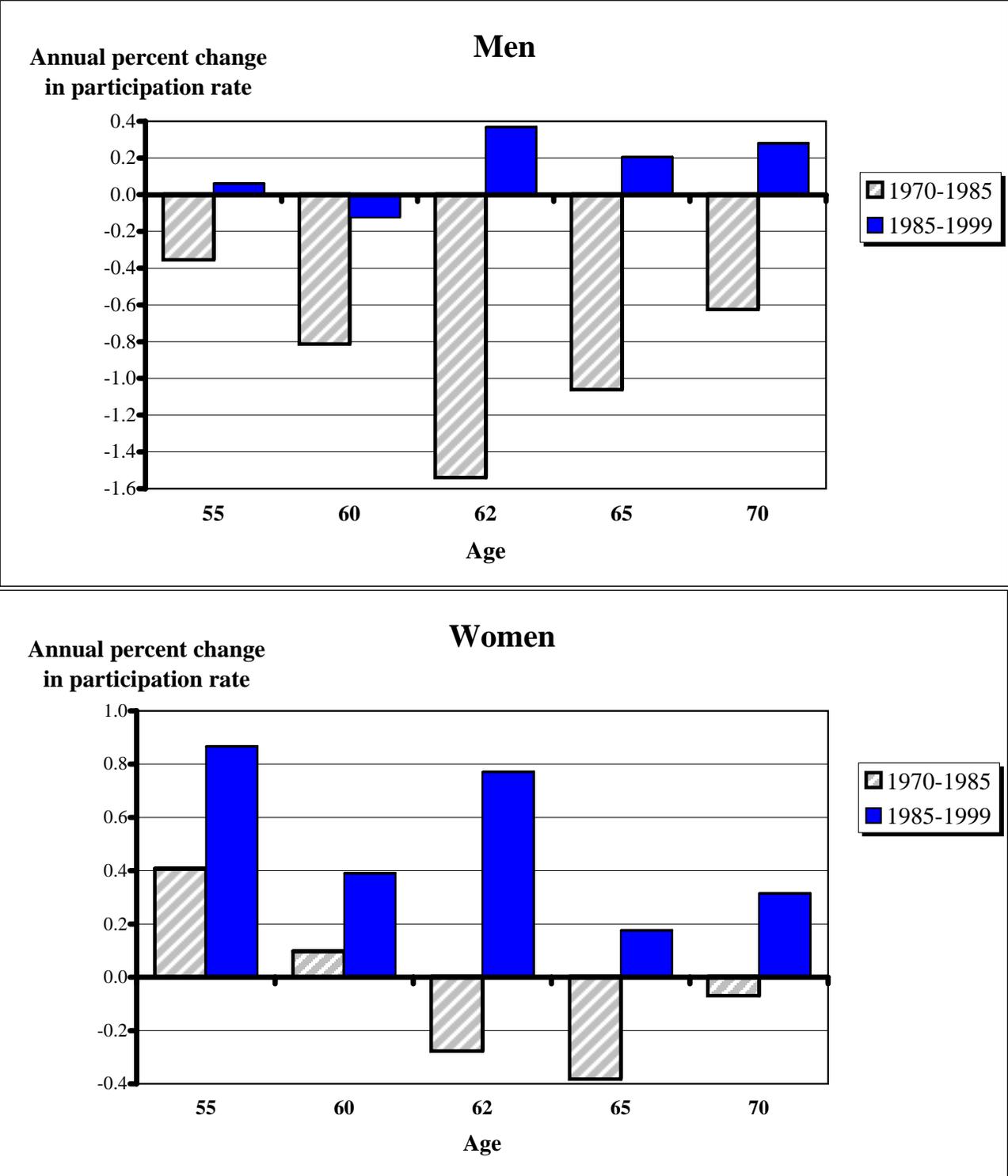
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Figure 1. Labor Force Participation of Men at Specific Ages, 1919-1999



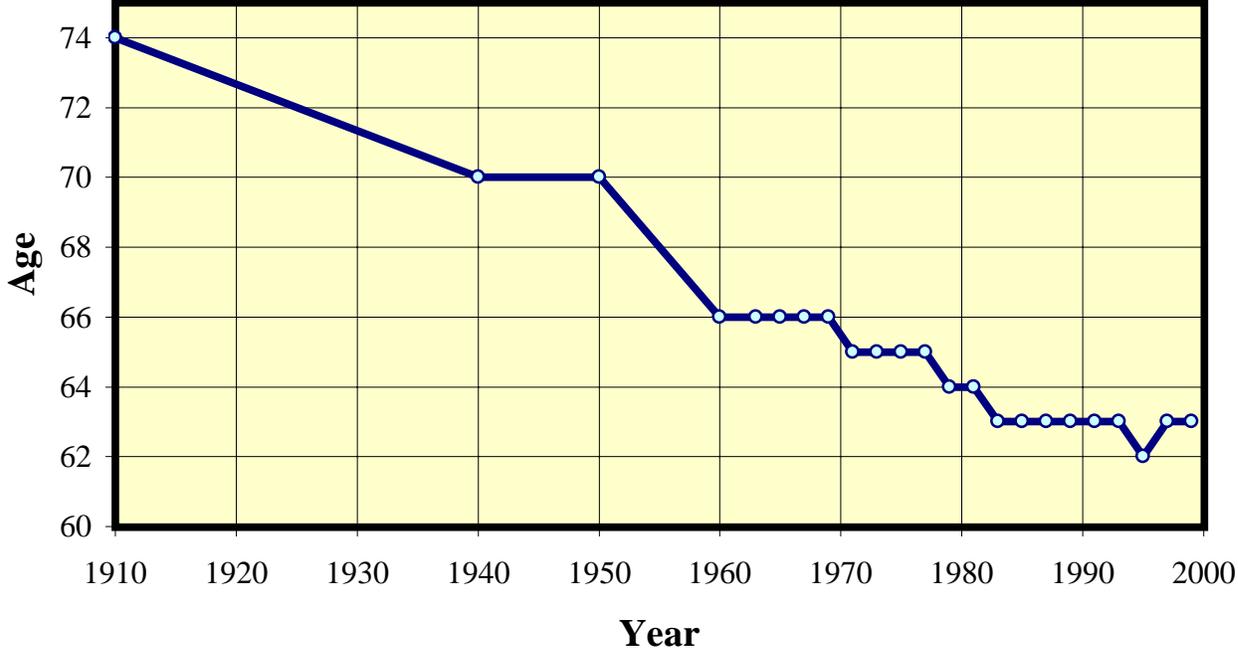
Source: Ransom, Sutch, and Williamson (1991); Munnell (1977); and authors' tabulations of March Current Population Survey files for 1984-85 and 1998-99.

Figure 2. Annual Change in Labor Force Participation Rate at Selected Ages, 1970-1985 and 1985-1999



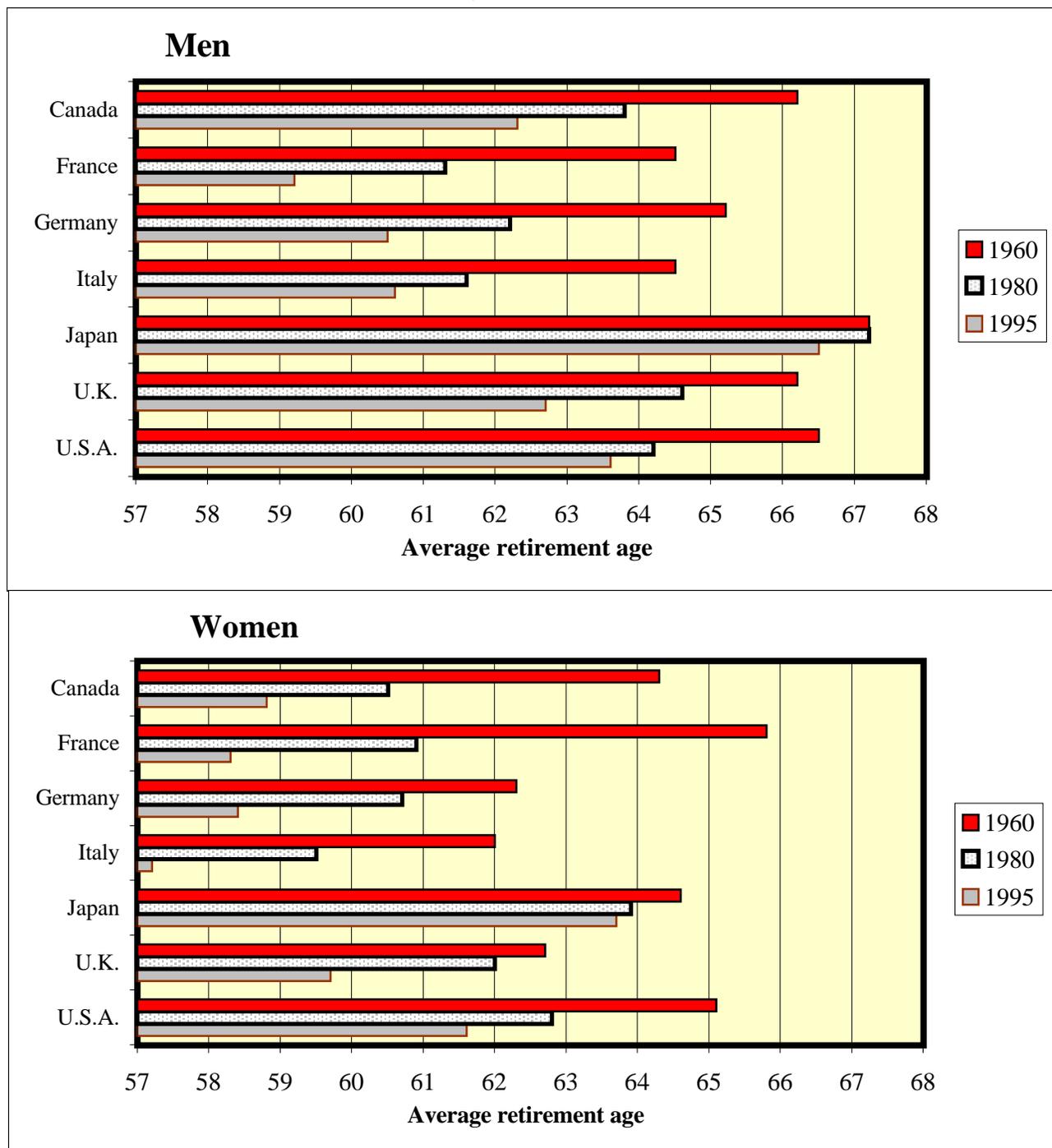
Source: Authors' tabulations based on Munnell (1977), p. 70, and March CPS files for 1984, 1985, 1998, and 1999.

Figure 3. Average Retirement Age of American Men, 1910-1999



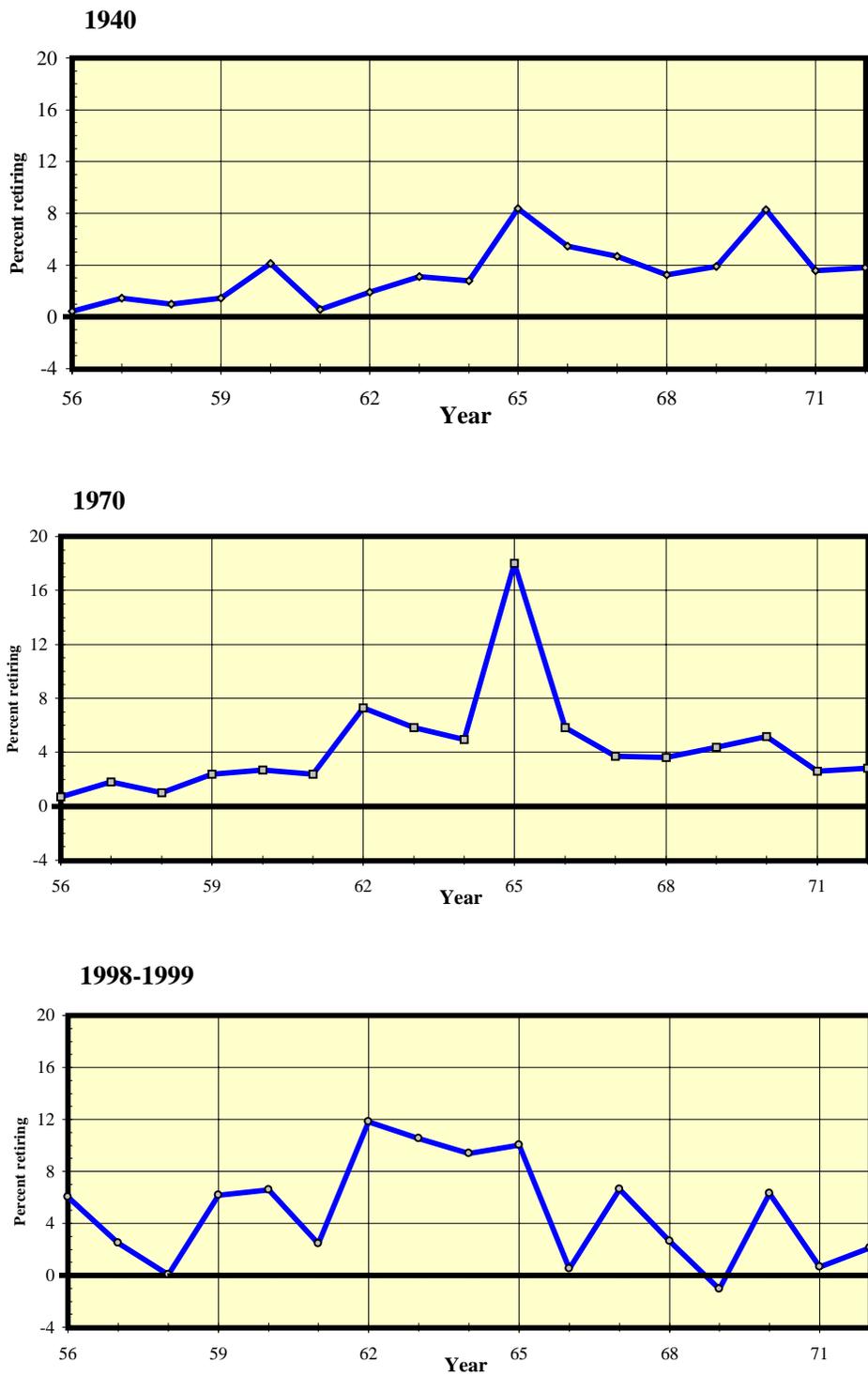
Note: The average retirement age is the youngest age at which at least half of men have left the labor force.

Figure 4. Estimates of the Average Age of Transition out of Active Workforce in the G-7 Countries, 1995



Source: Blondal and Scarpetta (1998), Table II.1.

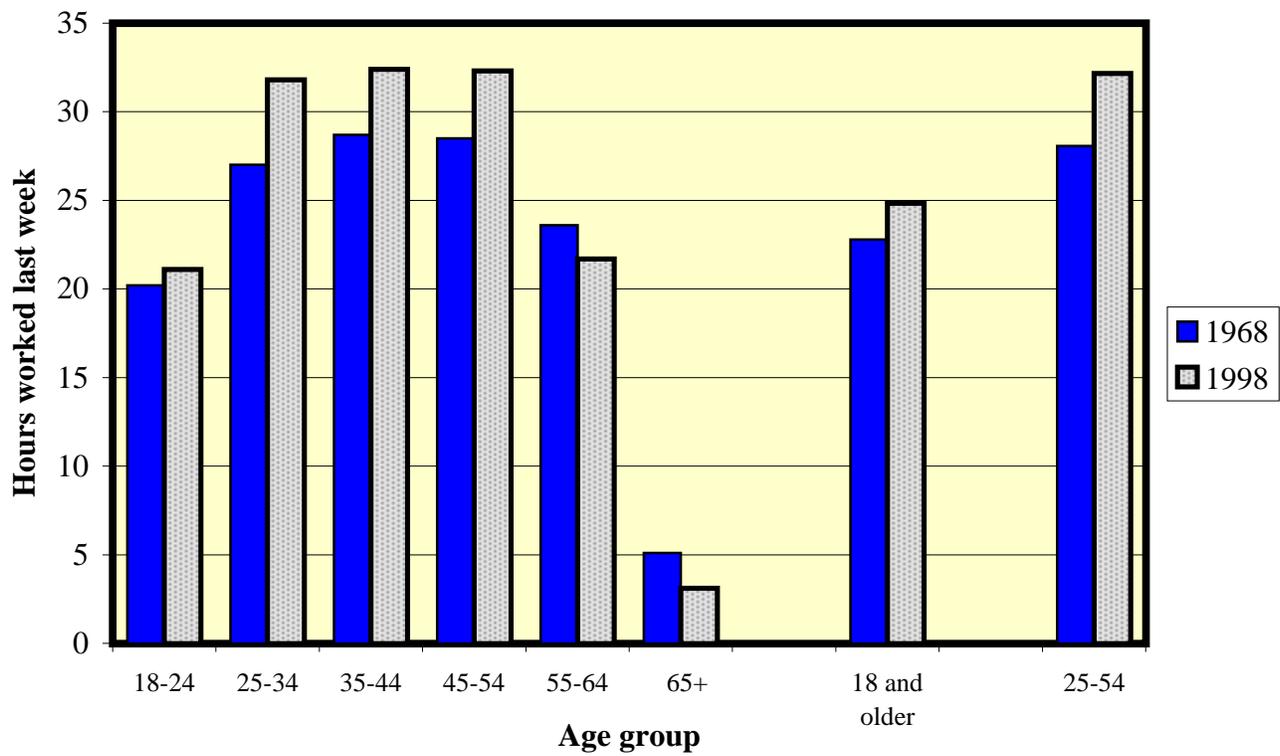
Figure 5. Male Retirement Rate bs Age, 1940 - 1999



Note: Percent retiring each year is a constructed number reflecting the fraction of men leaving the workforce at the designated age, measured as a percent of men in the labor force at age 55.

Source: Authors' tabulations of participation rates in Munnell (1977), p. 70, and estimates from the March 1998 and March 1999 CPS files.

Figure 6. Average Hours of Work, by Age Group, in the U.S. Population, 1968 and 1998



Source: Authors' tabulations of March 1968 and March 1998 CPS

Table 1. Labor Force Participation Rates at Selected Ages by Sex, 1940-1999

Percent of population

Year	Age				
	55	60	62	65	70
Men --					
1940	90	82	80	67	44
1950	88	82	80	68	45
1960	90	83	79	54	33
1970	89	81	73	47	27
1984-85	84	70	50	32	18
1998-99	85	68	55	35	22
Women --					
1940	20	17	15	12	6
1950	28	23	21	16	8
1960	43	35	29	20	12
1970	50	43	36	22	11
1984-85	55	44	32	16	10
1998-99	68	49	43	19	14

Source: Munnell (1977), p. 70, and authors' tabulations of March CPS files for 1984, 1985, 1998, and 1999.