Introduction

GARY BURTLESS AND HENRY AARON

Americans past the age of 60 are delaying their withdrawal from the labor force. This trend is relatively recent and only became detectable in the 1990s. It reverses a century-long trend toward earlier retirement that began in the late nineteenth century. Along with gradually increasing life-expectancy, the historical trend toward early retirement meant that, during the first nine decades of the twentieth century, successive generations of workers spent a growing portion of their lives in retirement.

Since the introduction of Social Security in the 1930s and Medicare and Medicaid in the 1960s, the government has assumed a growing role in providing income and health insurance to the retired elderly. The trend toward earlier retirement increased the budget burden of supporting the aged for two reasons. It reduced the tax payments of the elderly, because retirement income, including social security, is more lightly taxed than earned income. And it increased current government outlays on the aged, because retirees are more likely to need and qualify for public transfers and health insurance than people who continue to work. The reversal of the trend toward earlier retirement almost certainly lessens the budget burden of supporting the aged, but by how much?

This volume summarizes the findings of a project that investigated this question. The researchers did so by answering a related question: How would the budget outlook change if the trend toward *later* retirement accelerated? How much would government revenues grow and how much would outlays shrink if workers on average retired later?

Public and private decision makers have a shared interest in the answer to this question. Although the long-term budget outlook is uncertain, it seems likely the cost of programs for the aged will outpace tax revenues available to pay for them. In view of this budgetary challenge, policymakers and voters should be interested in assessing policies that increase the portion of adult life that people spend in paid employment.

The benefits for taxpayers of such an extension should be clear. If Americans spend an increased fraction of their adult lives earning incomes and supporting themselves, they will need less support in the form of retirement pensions and health benefits. The cost of public provision for old-age income security would be reduced. Past low birth rates and rising longevity, which push up the percentage of the population that is older than the traditional retirement age, raise the budgetary consequences of such a shift. The impending retirement of the baby boom generation, which will boost the fraction of retirees in the population, makes it more urgent to understand the potential impacts of a higher average retirement age on the revenues, outlays, and net budget balance of the government.

The essays in this volume address four kinds of questions about past and future retirement trends and public policies to influence them.

—What kinds of workers have delayed their retirement in the past two decades, and in what way have they extended their work lives?

—How would an increase in the average retirement age, absent any change in public policy, affect the federal budget?

—Can and should public policy be changed to encourage Americans to retire later? What would such measures look like? Whom would they help, and whom would they hurt?

—What companion policies could protect older or impaired workers who find it difficult or impossible to remain employed?

The studies in this book address these questions. They were carried out with generous support from the Alfred P. Sloan Foundation's Working Longer program.

The book begins with two chapters by Gary Burtless. The first describes past trends in labor force participation among older workers. In brief, retirement ages fell throughout most of the twentieth century. That trend stopped in the late 1980s and early 1990s. Over the next two decades, labor force participation rates among older workers rose substantially. Several forces contributed to the increase. The relative importance of each of those forces is difficult to gauge. Better educated workers tend to remain economically active until later ages than do less-well-educated workers; and average education levels of the aged and near-aged increased. In addition, male retirement ages within each education group have also increased. Among women, labor force participation increased among all groups, and this shift reinforced the effect of improved education. The move from defined-benefit pensions, which tend to encourage early retirement, to defined-contribution plans, which are generally neutral in their retirement incentives, also promoted later retirement. Both full- and part-time work increased among elderly and near-elderly workers. Workers with comparatively high earnings were more likely than workers with lower wages to remain in the labor force. There is little evidence to suggest that the growth in work took the form of shifting to less-stressful or temporary "bridge" jobs. Employment in those kinds of jobs increased, but so did continuation in career jobs.

The second chapter presents a scenario under which retirement ages continue to increase. This scenario contrasts with a "baseline projection" prepared by the Social Security actuaries for the 2011 Social Security Trustees' report, the "The 2011 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds." The trustees' projections are based on the assumption that the trend toward later retirement, which began in the late 1980s and early 1990s, will dramatically slow or end. In contrast, Burtless creates an alternative scenario in which the trend of the past two decades toward later retirement continues more or less unchanged through 2040. As a result, he projects a larger future labor force than the Social Security Trustees forecast in their report. The larger labor force means that potential gross domestic product (GDP) *at full employment* can be larger than the trustees predict. A larger GDP means greater tax collections—through higher payroll taxes, personal income taxes, and corporation income taxes. Delays in retirement would also mean that pension expenditures are delayed. Both developments improve the government's budget prospects.

The analytical challenge is to estimate the size of the increase in GDP and of the positive impact on budget balance. That impact depends on how much the additional workers add to national output and taxes and how long pension benefits are delayed, which in turn depends on the characteristics of the workers who are predicted to remain economically active. The third chapter deals with this analytical challenge. Its authors, Karen Smith and Richard Johnson, use the Urban Institute's Dynamic Simulation of Income Model (DYNASIM) to identify which workers would be most likely to remain economically active if labor force participation among older age groups increased. Because well-educated people with comparatively high earning potential tend to remain economically active in the baseline forecast, Smith and Johnson predict that the big changes in behavior will occur in the bottom half of the earnings distribution.

To estimate the impact on national output of this increase in the workforce, the project contracted with Moody's Econometrics, a macroeconomic forecasting firm. Its goal was to make plausible projections of future GDP and employment, taking into account the reality that many people who wish to hold jobs will be unable to find them. In developing a macroeconomic projection for the baseline scenario, Moody's task was made easier by the fact that its own forecast was adjusted to conform with the Social Security Trustees' forecast of future GDP and employment. Creating an alternative projection in which the desired labor force participation rate of the aged is higher represented a more formidable challenge. When the analysis was performed, the U.S. economy had not fully recovered from the deep recession that began in 2008. Under these circumstances, an increase in the labor force that makes more people available for work would not necessarily translate into additional employment. As long as demand is inadequate to generate enough jobs for the current labor force, an increase in the number of labor force participants will result in a much bigger increase in the number of unemployed than in the number of employed. If labor supply increases and not all workers can immediately find employment, it is necessary to develop a sound basis for identifying which workers will find work and which ones will remain jobless.

There is no single best solution to these analytical challenges. The solution we adopted was to prepare three projections of future employment change when there is inadequate overall demand for workers. Under first scenario, Moody's and Smith and Johnson assume that the unemployment rate immediately falls to a level deemed consistent with full employment, thus absorbing the increased number of aged and near-aged assumed to enter the labor force. This scenario is unrealistic, but it shows the full increase in potential GDP, taxes, and earnings that would result from an increase in desired labor supply among the aged. Smith and Johnson identify which older Americans will attempt to join the labor force based on workers' observable characteristics and work histories. Those identified as joining the workforce have characteristics and previous behavior that put them closest to the margin of working. The workers who defer retirement in this scenario will not have the same characteristics—earnings levels and productivity—as those who are in the labor force in the baseline. As noted above, workers who are comparatively well educated and well paid tend to work until later ages in the baseline than do those with low wages and education. Consequently, the average productivity, contribution to GDP, and earnings of the added workers will on average be lower than those of workers who are employed in the baseline.

Under the two other scenarios, the economy is assumed to recover gradually, returning to full employment during or shortly after 2017. Until full employment is achieved, it is necessary to specify which members of the enlarged labor force will find work and which will be unemployed. In both these scenarios Smith and Johnson rely on Moody's macroeconomic forecast to determine the total number of additional labor force participants who will find jobs. Actual employment gains are limited by the future path of aggregate demand. As long as demand is depressed, too few workers will find work to attain full employment. Under one scenario, Smith and Johnson assume that all the additional unemployment caused by the increase in old-age labor force participation will be divided among participants who are 55 or older, the subpopulation predicted to have increased labor supply. Under the other scenario, Smith and Johnson assume the added unemployment resulting from higher old-age participation rates has spillover effects on the unemployment of younger workers. The additions to unemployment are "shared" among the young and the old.

After 2018, when full employment is assumed to be achieved, there is little difference among the projections generated by the three scenarios.The labor force participation rate of the aged is higher than it is in the baseline forecast, which is derived from the Social Security Trustees' projections, but the overall unemployment among young and old is the same as it is in the baseline projection.

The simulations by Smith and Johnson and Moody's Econometrics, based on Burtless's labor force projections, suggest that by 2040 the U.S. labor force would be more than 3 percent larger than projected by the Social Security Administration. The biggest percentage increases are projected to occur among workers in their late 60s and early 70s. Labor force participation among some age groups will rise by roughly one third. As a result, earnings increase substantially, particularly among people near the bottom of the income distribution, few of whom are economically active in the baseline. The increase in work and earnings boosts government revenues during the simulation period by more than $2 trillion and lowers expenditures on Social Security and Medicare by more than $600 billion. Higher revenues and lower spending reduce government debt and associated interest payments. Overall, the simulations indicate that government debt would be lower by more than $4 trillion if the labor force expanded by as much as Burtless's projections indicate.

Whether such savings comprise a large or a small *proportion* of any future budget gap obviously depends on the size of the gap. The Congressional Budget Office (CBO) publishes two long-term budget projections. Under its "Extended Baseline" projection, the ratio of federal government debt to GDP remains relatively stable through 2040. Under CBO's "Alternative Budget Scenario," deficits grow rapidly and the ratio of debt to GDP grows explosively. Compared with CBO's Extended Baseline projection, the savings shown in the Smith-Johnson simulations represent a sizeable fraction of the projected deficit in 2040. In contrast, the savings have a negligible proportional impact on the huge growth of debt under CBO's Alternative Budget Scenario. Thus, whether one believes the impact of delayed retirement is significant from the standpoint of the budget depends on one's view of the likely future course of the deficit. If one is pessimistic about future budget prospects, the changes to future revenues and outlays that would be caused by later retirement only marginally affect the outlook. If one is optimistic and accepts CBO's Extended Baseline forecast, the changes are much more significant. Under CBO's Extended Baseline projection, however, the government's long-term deficit does not appear to be a serious problem.

In comments on the analytical findings, Eugene Steuerle expresses the view that the actual increase in the labor force would likely be even larger than Burtless's projections indicate. He notes that past projections of employment by the Social Security Administration (SSA) have underestimated the increase in employment among older workers. When the relative supply of younger workers declines as a result of earlier drops in fertility, Steuerle argues, employers will increase their demand for older workers and improve the attractiveness of work for this group. Thus, the positive impact on public budgets and the incomes of older workers (especially those who otherwise would have low incomes) could be considerably larger than the Smith-Johnson simulations indicate.

Joyce Manchester of the Congressional Budget Office notes that CBO has already increased its projections of future labor supply in comparison to those made by the SSA. In fact, the current CBO assumptions about future labor supply lie roughly half-way between their former levels—which were similar to those from the SSA that Smith and Johnson used in their baseline projections—and the alternative forecast supplied by Burtless. Thus, CBO has already incorporated into its own projections much of the fiscal gain shown in the Smith-Johnson simulations.

Manchester also points out that the gradual increase in the age at which Social Security pays unreduced benefits has had a demonstrable impact on the ages at which workers actually claim benefits. That said, more workers continue to claim retirement benefits as soon as they can, at age 62, than claim benefits at the age when Social Security pays unreduced benefits. This finding underscores the potential for changes in public policy to boost labor supply among older workers.

The second part of the book addresses potential policy changes. In chapter 4, Henry Aaron reviews a number of policy changes that have been widely discussed in recent years and presents one new one. Previously introduced changes include across-the-board benefits cuts (often misleadingly described as "raising the retirement age"), raising the age at which retirement benefits may first be claimed, and combining these two changes. These reforms would reduce current benefit payments and thereby contribute to near-term deficit reduction. The expenditure reductions would be permanent in the case of across-the-board benefit cuts. Raising the age of initial eligibility is not an across-the-board benefit cut. Although workers who otherwise would claim retirement benefits at age 62 would be forced to delay benefit claiming to a later age, they would be fully compensated for the delay by collecting larger monthly checks after benefits begin. Thus, the increase in the early entitlement age would cut spending only temporarily. Because expected lifespans have lengthened and interest rates are exceptionally low, the adjustment factor currently used to compensate workers for delayed benefit claiming probably raises the lifetime value of benefits for the average worker.

By reducing pensions or delaying their availability, most proposed reforms would impose hardships on workers for whom continued work would be difficult or impossible. Accordingly, analysts have long sought measures that would offset such hardships by providing targeted protections to those who are particularly vulnerable. Such "safety valves" include liberalized access to Social Security Disability Insurance (SSDI) (for example, by relaxing the current requirement that disability insurance recipients must have worked in five of the most recent ten years) or eased access to Supplemental Security Income (SSI) based on either relaxed disability standards or increased thresholds in income and asset tests. Alternatively, benefit cuts could be imposed only on workers with relatively high average lifetime earnings. One variant of this kind of reform is "progressive indexing," under which benefits would be reduced increasingly over time for successive retiree cohorts but only for workers who had comparatively high average lifetime earnings.

Aaron suggests a new way to encourage later retirement—allowing workers to continue to claim Social Security benefits as early as age 62 but cutting benefits only for early retirees with comparatively high earnings.

The increase in the number of people receiving Social Security disability benefits, the persistently low rates of exit from the disability–insurance program, and the lengthy and expensive process by which people are found eligible for benefits have all led to a sense that the SSDI program needs a thoroughgoing reexamination and overhaul. The fact that the Disability Insurance Trust Fund is projected to be exhausted in 2016 virtually guarantees such scrutiny. Because the average age at which people are being found eligible for disability benefits is falling, the payoff to finding ways to help people recover earning capacity or maintain residual earning capacity is increasing.

Three discussants offer comments on the policies described in Aaron's chapter and present ideas of their own. Nicole Maestas remarks that one's ranking of various policies to encourage later retirement depends in large part on the reasons why one seeks to extend working lives. Is early retirement bad for the budget, bad for workers themselves, or a reflection of poorly designed disability policy? How one answers those questions helps determine which policy changes appear most attractive.

As evidence of the difficulty of determining who is disabled, she presents evidence that the health status is similar among those who file successful claims for disability insurance and those whose applications for benefits are unsuccessful. She also points out that one development contributing to later retirement—the increase in the education level of successive birth cohorts—is winding down, as increases in the education levels of successive age groups are slowing. But the impact on retirement decisions from the changed structure of pensions could continue to increase because most workers who have been affected by the shift from defined-benefit to defined-contribution pension plans are still working.

Richard Burkhauser notes that actions must be taken at some point to close the projected long-term deficit in Social Security and that such changes can be structured to encourage workers to retire later. Rising life expectancy, he argues, justifies ending the early-retirement option under Social Security. This shift in policy would seriously hurt only a small fraction of those who now claim such benefits, namely those whose health is poor and who have access to few other sources of income. The way to support this group, Burkhauser maintains, is through income- or means-tested benefits.

Burkhauser also proposes shifting the way in which the Social Security benefit formula is adjusted over time. The formula for initial pension benefits is currently adjusted based on the annual growth of economywide average earnings. This policy tends to hold roughly constant the ratio of average benefits to average earnings. As real earnings rise, so does the real value of pensions. Burkhauser proposes adjusting the formula based on the annual change in prices. This policy would hold constant the *real* value of pensions. As real earnings rise, the ratio of pensions to earnings would gradually fall. The savings from such a change could be better used, he argues, to raise benefits in such means-tested programs as SSI.

Debra Whitman stresses that the major policy challenge to advocates of curtailing benefits for those who retire early is to identify ways to protect those for whom retirement is more a necessity than a choice. She emphasizes that the increase in life expectancy that many cite as a justification for raising the age of initial eligibility for Social Security or for cutting benefits is not evenly distributed. High earners have experienced large increases in life expectancy, but low earners have not. For that reason, basing policy reform on population averages can do unintended harm. She also draws attention to the political obstacles to increasing access to SSI. Aged and disabled adults who become entitled to SSI automatically become eligible for Medicaid, which imposes heavy fiscal burdens on states. She also urges policymakers to draw lessons from behavioral economics, which has shown that seemingly minor shifts in choice frameworks, or "nudges," can materially influence behavior. Because early retirement is, in fact, often an economically unwise decision given that it entails a permanent reduction in benefits, such nudges could significantly improve welfare. She singles out one change in Social Security for criticism: the proposal to adjust currently payable benefits based on a new price index that increases more slowly than the one now used to adjust benefits. Such a shift, she argues, would impose gradually increasing burdens the longer that people are on the rolls—a serious matter for the very old and the long-term disabled.[1]

The volume concludes with a chapter by John Shoven and comments by Steve Pearlstein. Shoven challenges the notion that people are now retiring when they are "older" than workers who retired twenty years ago. If age is measured not by years-since-birth, but by years-until-death, people retiring now are no older than they were two decades ago, because average life expectancy has increased as much as the average age of retirement. More basically, Shoven points out that given current life expectancies and typical ages of retirement—64 for men and 62 for women—spouses can expect to work for perhaps forty years and will spend an average of about twenty-eight years in retirement until both spouses have died. This mix, Shoven points out, requires that more than one-third of lifetime consumption will occur during retirement if living standards are relatively constant throughout life. That arithmetic fact, in turn, requires that something approaching half of their earnings must be saved in one form or another by active workers to support retirement living standards. The savings can occur through individual savings or group pensions, private or public. In any case, Shoven suggests that such saving rates or transfer payments will be highly problematic and may prove impossible to sustain.

For this reason, Shoven argues, the trend toward later retirements will and must continue. He proposes two specific policies to encourage such trends. The first policy would excuse workers with forty years of employment and their employers from having to pay payroll taxes for Social Security and Medicare. Such workers would be treated as "paid up." The tax relief would be considerable, as payroll taxes are levied at a rate of 12.4 percent for Social Security on earnings up to $113,700 and at 2.9 percent for Medicare on earnings up to $200,000 for individuals and $250,000 for couples and 4.7 percent on earnings above these thresholds. Depending on adjustments in wages that might occur because of a cut in payroll taxes after forty years of work, either take-home pay for workers would increase or the cost to employers of hiring older workers would fall. This policy should boost employers' demand for older workers and increase workers' willingness to remain in the labor force.

Shoven's second proposed policy would make Medicare the primary insurer for all workers who are Medicare eligible. Under current law, Medicare covers only the cost of medical care that is not covered by private, employer-sponsored health insurance (unless the employer has fewer than 20 employees). Under the policy

1. Whitman was referring to the particular measure of price change that is used to give annual cost-of-living adjustments to Social Security beneficiaries who are currently collecting a benefit. This differs from the indexing change proposed by Richard Burkhauser, who suggested a reform in the indexing formula used to determine pensioners' *initial* Social Security benefit.

Shoven proposes, Medicare would be the first payer and an employer's private insurance would cover only those services that are included in private coverage but not in Medicare. Because health costs for older workers are several times higher than those of younger workers, this policy shift would considerably lower the relative cost to employers of hiring and retaining older workers.

Shoven also draws attention to calculations showing that most workers would be well advised to delay claiming Social Security as long as possible. The reason is twofold. By waiting to claim Social Security workers receive a larger fully inflation-indexed annuity that is completely safe. No private asset has all of these attractive features. Furthermore, the price of this annuity is lower than that of any privately available annuity. The cost of claiming "too early" can exceed $200,000 in some cases. Although waiting is usually the better financial strategy, more workers claim benefits as soon as they are eligible than at any other age, and more than 80 percent claim before age 66. Helping workers understand the value of waiting to claim benefits may also nudge them into a decision to work a bit longer than most do now.

Steve Pearlstein questions whether it would be in the public interest to shrink payroll tax revenues and boost Medicare liabilities through the policy changes that Shoven proposes. The budget is in deficit, and both Social Security and Medicare currently have too little future revenue to cover their long-term obligations. Shoven replies in later discussion that if the policies induced as many people to work as current estimates of the labor supply elasticity of older workers suggest, then the added payroll and income tax revenues from increased national output would offset the direct revenue loss. Pearlstein also warns against assuming that jobs would materialize for the increased labor supply resulting from deferred retirement. However, he joins Shoven in concluding that increased life expectancies virtually require later retirement ages. Without them, the implied transfers from workers to retirees would be problematic. Even more important than these financial questions, he suggests, are the preferences of the elderly themselves. Drawing on Gary Burtless's and Eugene Steuerle's observations about past increases in labor supply and the likelihood they would continue, Pearlstein observes that markets seem to be working reasonably well and suggests that perhaps the best course for public policy would be to stay neutral, neither discouraging nor actively encouraging extended working lives.