The Future of Retirement

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This is a very interesting time to consider the future of retirement in America. The nation is aging, and the proportion of the population above traditional retirement age is increasing. Over the post-war period, Americans, especially men, retiring earlier and earlier. During the past few years, however, this trend appears to have stopped and may even have reversed. Finally, important changes are currently underway in both public (Social Security) and private (employer) pensions that may encourage workers to stay in the labor force longer than they currently do.

An extensive literature exists on the determinants of individual retirement decisions. This is a good source for suggestions about what might be important in the future. Most of the recent work by economists has focused on the nature, magnitude and impact of the financial incentives in our retirement income programs. This will be a main focus below, both because considerable evidence indicates that these incentives are important and because they can be effective policy instruments - primary means by which public and private policy makers can influence aggregate retirement trends.

I begin with a short section on relevant population and retirement trends, followed by a brief discussion of the economic determinants of the retirement decision and retirement trends. (These issues are covered in more detail by Robert Clark in Chapter II-2.) I then discuss some very recent evidence on the work plans and preferences of older workers, suggesting some conflict between the two. I then offer a look ahead and conclude with a brief summary.

Economists should be humble prognosticators, having predicted 9 out of the past 5 recessions. My bottom line is that future retirement patterns will depend to a great extent on what happens to employer pension plans - on whether they go along with Social Security in reducing the work disincentives currently facing many older Americans or try to offset the Social Security changes by increasing their own financial incentives to retire. This in turn will depend on the state of future labor markets. If labor shortages arise, I am confident that firms will alter their retirement plans to keep valued older workers on the job.

I suspect that most Americans will continue to leave full-time career employment by their early sixties, as they now do. But I think that more will remain in the labor force afterwards, utilizing "bridge jobs", often part-time, between the full-time career work and complete labor force withdrawal. Social Security will be encouraging older Americans to stay on the job. Employee preferences, employer flexibility and the details of individual pension plans will determine whether the transitional stage occurs with the career firm or in a new line of work.

I. Demographic trends

The future of retirement should be discussed within the context of several important demographic trends that are currently underway. One is the aging of the American population, and the others concern the timing and nature of retirement.

A. The aging of America

The U. S. Bureau of the Census (1989) projects that the number of Americans aged 65 and above, about 32 million today, will more than double over the next 40 years, while the number aged 55 to 64 increases by two-thirds. In sharp contrast, the number of Americans under 55 will be almost unchanged. As a result, the percentage of the population aged 65 and over is estimated to increase from under 13% today to nearly 22% by 2030. A third of the population will be 55 and older. The median age will rise from 33 to 42. The nation then will look like Florida today.

The racial composition of the nation will be changing as well. The white population, currently about 84% of the total, is projected to decline to 78% by 2030 and to 73% by 2080. The black population will grow slowly, from 12% today to 15% (2030) and 16% (2080). The most dramatic increases occur for the "other races" category. Currently only about 3.5% of the total, they are projected to double to 7% over the next 4 decades and more than triple (to 11%) by 2080 (ibid.).

Some of the aging of America is due to improved longevity. Life expectancy at birth increased by 14 years between 1920 and 1950 and by another 7 years since then (Kutscher and Fullerton, 1990). In 1900, only about 40% of Americans born could expect to reach age 65, and the life expectancy of those who did was about 12 years. Today, about 80% live to 65, and their life expectancy then is 17 years (U.S. Senate, 1991). By 2050, life expectancy at age 65 will be near 18 years for men and 23 for women.

B. Labor market trends of older workers

These population projections suggest that retirement issues in the years ahead will be even more important than they are today, because they will affect a substantially larger proportion of the population. It is well known that Americans are retiring much earlier than they did only two decades ago. But there are other patterns worth noting, including the importance of part-time and self-employment, and the interesting ways in which many Americans disengage from their career jobs.

1) Retirement

Figures 1 and 2 show labor force participation rates for older Americans, by 5 year age cohorts, in 1966, 1976 and 1986, as well as the most current annual data from 1991. The well-known decline for all groups of men through the mid-1980s is clear (figure 1). The largest absolute decline is for men aged 60 to 64 (23 percentage points - a 30% decline) in only 2 decades. But the proportional declines are even larger for the oldest 2 cohorts - over 40% for men 65 and older. The same trend is obvious among men 55 to 59, and even shows up among those 50 to 54.

What is less well known is that since 1986, after decades of decline, participation rates of older men have been steady. For all the groups shown, the figures today are almost identical to those 5 years ago. It may be too early to call this a new trend, but it does at least suggest an interruption of the old one. It is interesting to note that the latest Labor Department projections forecast virtually unchanged participation rates for both men and women aged 65 and over through the year 2005 (U.S. BLS, 1992b, p. 34).

The data for women reflect two offsetting trends - the increased labor force participation of women, especially married women, and the early retirement trends mentioned above. For women aged 60 and above, the patterns show modest declines from 1966 to 1986, and slight increases since then (see figure 2). Women aged 50 to 59 show steady advances during the first 2 decades, and larger increases (about one percentage point per year) since then.

2) Part-time employment

Labor force participation rates do not distinguish between full-time and part-time employment. The latter is very important for older Americans, as Philip Rones and Sally Coberly describe in Chapters IV-1 and IV-2. Currently, among nonagricultural workers aged 65 and over, nearly half of the men and over 60% of the women work fewer than 35 hours per week, compared to only about 10% of younger men and a quarter of younger women (U.S. BLS, 1992c, Table 33). Over 90% of the elderly part-timers say they are doing so voluntarily. The importance of elderly (65+) part-time work has been increasing over the past 2 decades, from 38 to 49% for men, and from 50 to 60% for women.

3) Self-employment

Self-employment among American workers rises steadily with age. A quarter of employed men aged 65 and over, and 14% of the women, are self-employed (U.S. BLS, 1992c, Table 23). This is about three times the proportions for the younger populations. One reason for this is that those already self-employed tend to retire later than wage and salary workers. In addition, however, some people turn to self-employment late in life, often as a means of gradual retirement (Fuchs, 1982).

4) Exit patterns from career jobs

Recent research suggests that, for many Americans, the transition out of the labor force is much more complex than the stereotypical abrupt change from full-time career work to complete retirement. One analysis of the 1970s indicates that a quarter of wage and salary workers and half of the self-employed did something other than leave the labor force when they left full-time status on their career jobs (Quinn, Burkhauser and Myers, 1990). The vast majority of the wage and salary workers who continued did so on a new job; very few were able to remain part-time on the career job. In contrast, nearly half of the self-employed who left full-time status simply dropped to part-time on the same job; the other half tried something new.

Of those who changed jobs, nearly three-quarters were still working a year later, and nearly 60% remained after two years. Most of the new jobs were in different occupations and industries, and more people moved down the socio-economic ladder than up (from skilled to unskilled and from white collar to blue collar). With the exception of those who just moved to part-time on the same job, many more suffered pay cuts than enjoyed higher wages. There was some weak evidence that those at the ends of the economic spectrum - the rich and the poor - were the most likely to stay in the labor force after leaving career employment. The poor may do so because they have to, and the rich because they want to.

Christopher Ruhm (1991, 1992), using a slightly different definition of a career job, estimates that fewer than half of all older Americans retire directly from a career job. Of those who do not, most switch industry and/or occupation, and many become part-time or self-employed. He also finds that most job changers earn less on the new job, and that this tendency rises with the age of the worker at transition.

C. Summary

Because of increasing longevity and, until very recently at least, the trend toward earlier retirement, there has been a significant increase in the number of post-retirement years in America. In 1900, a male could expect to spend only 1.2 years (about 3% of his life) in retirement. By mid-century, the expectation had risen to 10 years and by 1980, to 14 years - nearly 20% of his expected lifespan (U.S. Senate, 1991). Many older Americans prefer to retire gradually, and utilize second careers, part-time jobs or periods of self-employment to bridge the transition from the primary career to complete labor force withdrawal.

II. Economic determinants of retirement

Labor supply decisions depend on a vast number of factors, only some of which can be observed and measured. Retirement timing is influenced by health, wealth, social networks, pecuniary and non-pecuniary aspects of work, attitudes toward leisure, living arrangements, and expectations. I will emphasize a few that I see as key in assessing the future; these and others are discussed in more detail by Helen Dennis and Robert Clark in Chapters II-1 and II-2.

A. Wealth

The simplest economic explanation for the early retirement trend is that the nation has grown wealthier over time, and one of the "goods" on which we spend this increased wealth is leisure. We start working later, work fewer hours per year, and retire earlier than we once did. For recent cohorts of retirees, this national wealth trend has been augmented because the Social Security benefits they received, in aggregate, vastly exceeded a fair return on the contributions made on their behalf (Burkhauser and Warlick, 1981; Moffitt, 1984; U.S. House, 1992, App. I). There have been large wealth transfers from workers to retirees.

Common sense and casual empiricism suggest a link between wealth gains and earlier retirement, although it is difficult to prove empirically. The largest declines in the labor force participation rates of men aged 60 to 64 occurred after the age of Social Security eligibility was reduced to age 62

(1961) and large real increases in benefits went into effect (1969-1972). Some studies (e.g. Hurd and Boskin, 1984) attribute most of the decline to increased Social Security generosity. Recent work suggests that the impact has been more modest. Jerry Hausman and David Wise (1985) and Richard Ippolito (1990) estimate that Social Security may account for about one-third of the decrease.

B. Age-specific retirement incentives

Equally important are the age-specific retirement incentives (or work disincentives) contained in many of our public and private retirement plans. Both Social Security and most employer pensions promise a stream of income when certain retirement conditions are met. The best summary of the value of one of these agreements is the present discounted value of the promised stream. This is just the asset or wealth equivalent - the pile of money today that, if invested, could generate the same income stream in the future.

An employee who continues to work on a career job after eligibility for Social Security or a pension both loses and gains with respect to these retirement income sources. Most obvious is the loss of current retirement benefits. The gain is that future benefits will probably be higher as additional years are added to the worker's earnings history. Whether one gains or loses on net depends on which stream has the higher current value - one starting earlier but with smaller annual amounts, or one delayed, with fewer, larger checks. The present discounted value calculation makes the comparison easy, because both streams are translated into their equivalent amounts of money today. The larger amount is worth more.

A key insight is that the <u>change</u> in the asset value of pension rights that accompanies another year of work is best viewed as a component of that year's compensation. Someone who earns $30,000 per year and, during that year, enjoys a $6,000 increase in the value of a future pension stream has really earned $36,000. Similarly, if the value of the stream drops by $6,000 during that year (the future increments are worth $6,000 less than the current benefits foregone), then true compensation was not $30,000 but $24,000.

Extensive research (reviewed at length in Quinn, et. al., 1990) has shown that Social Security (at age 65) and many defined-contribution pension plans (at various ages) act like the latter. Workers who delay receipt past some age lose more in benefits up front than they can expect to gain later. Retirement income wealth falls with continued work, and therefore true compensation declines. Such workers suffer a surreptitious pay cut, not via the paycheck, which would be illegal, but via the benefit calculation rules of Social Security or their pension plans.

Those whose Social Security benefits will be based on their own earnings records can generate higher future benefits by working beyond past age 62. (See Nancy Altman in Chapter III-1 for more detail.) There are 2 reasons for this. Their lifetime earnings will be recalculated, and they will enjoy an actuarial adjustment - a bonus on all future checks for each year of delay past age 62. Between the ages of 62 and 65, the bonus (about 7% per year of delay) is close to actuarially fair - future increments approximately offset current benefits foregone. At age 65, however, the adjustment drops from near 7% to only 4% per year of delay, which is far less than actuarially fair. From age 65 to 70, Social Security wealth drops with continued work, and true compensation declines. At 70, the earnings test disappears and recipients can receive full Social Security benefits regardless of earnings.

In the U.S., about half of the private sector work force participates in employer pension plans (Turner and Beller, 1992; Short and Nelson, 1991). Defined benefit plans provide about 70% of primary coverage, and defined contribution plans the remainder (see Chapter III-2 for more detail).

Defined-contribution plans do not contain the age-specific financial incentives described above, but most defined-benefit plans do. They can subsidize or penalize work after pension eligibility by providing future increments that either do or do not adequately compensate for the initial benefits foregone. Researchers who have analyzed specific plans in detail agree that most defined-benefit plans do penalize work after some age, often after the age of earliest eligibility, and that the size of the wealth loss can be significant (Kotlikoff and Wise, 1989). Annual pension wealth losses equal to a third of annual earnings are not unusual. Olivia Mitchell (1992) reports that in 1989, two-thirds of those workers whose benefits were reduced by a fixed factor for early retirement faced reductions of less than 6% per year. This penalty is less than actuarially fair, suggesting that early retirement is being encouraged, or delayed retirement penalized.

Research summarized by Michael Hurd (1990) and by Quinn, et. al. (1990) shows that workers do respond to these financial incentives. Retirements cluster around the key Social Security ages of 62 and 65, and earnings cluster around the Social Security exempt amount, the earnings allowed before benefits are reduced (Burtless and Moffitt, 1984). In many econometric studies with survey data on individuals, the larger the pension or Social Security wealth loss associated with additional work, the more likely workers are to leave the career job and the labor force. As we will see below, these retirement incentives will be very important in determining the timing and nature of future retirement.

C. Industrial and occupational composition

The industrial and occupational structures in the U. S. have changed significantly and will continue to do so. Between 1975 and 1990, for example, the number of professionals, technicians, and executives and managers increased by 60, 76 and 83%, respectively, while the number of clerical, service and crafts workers increased by only a third, and the number of operatives, laborers and agricultural workers stagnated or declined (U.S., BLS, 1992b, p. 63). Similar differences occurred by industry, where jobs in the service-producing sector grew by 56% while those in the goods-producing sector increased by only 10% during these 15 years (ibid., p. 44).

Comparison of these growth rates with the importance of elderly employment in these sectors, however, does not suggest that these compositional shifts have played a major role in the decline of older workers' labor force participation. With the exception of technicians and agricultural. forestry and fishing workers (who together comprise only 6% of total employment), the proportion elderly across occupations is surprisingly similar - all between 11 and 15% in 1988 (U.S. BLS, 1990, Table 6). With the same two exceptions, if there was any trend at all, the fastest growing occupations had slightly more elderly than did the others. This might be used to explain the elderly remaining in the labor force, but not their leaving it.

The story is similar by industry. With the exception of agriculture, all the other industries have between 11 and 14% workers aged 55 and over, and there is no apparent relationship between these growth rates and the modest differences in the percentage elderly.

Ronald Kutscher and Howard Fullerton (1990) performed a similar analysis with earlier data and concluded that "workers aged 55 to 64 are not likely to be affected differently from all workers by shifts in the industry or in the occupational composition of employment because their employment pattern is close to that of prime age workers" (p. 54).

D. Summary

As Michael Hurd (1990) concludes after an extensive review, there are "solid reasons for thinking that Social Security has been responsible for a substantial part of the decline in (elderly labor force) participation" (p. 606). Social Security has both increased the wealth of recent cohorts of retirees, and penalized those who work beyond age 65. Many defined-benefit pensions also contain financial incentives that encourage retirement. The net result is that many older Americans have chosen to retire. The majority of these retirements appear to be voluntary, given the labor market options that older Americans face (Quinn, 1991). As we will see, however, many of them claim that they would prefer to work longer than they do, suggesting that they might respond differently to other labor market options. The nature of these options will be key determinants of future retirement patterns.

III. Plans and preferences of older American workers

A 1989 survey by the Commonwealth Fund asked a sample of 3500 older Americans (women aged 50-59 and men 55-64) about their work plans and preferences. About 2000 had already retired; the rest were still at work. Their responses indicated that for a substantial minority, preferences and current status or plans did not agree.

William McNaught, Michael Barth and Peter Henderson (1991) have analyzed the retired subset. Nearly a quarter said that they preferred to be working and were capable of doing so. The authors then narrowed this sub-sample by requiring that they also pass several specific labor market commitment tests. Even then, nearly 14%, representing over 1 million Americans, indicated that they were willing and able to work, and expressed considerable flexibility with respect to potential jobs. Two-thirds said they would work full-time and nearly seven-eighths would work part-time if that is what were offered.

Richard Burkhauser and I (1992) analyzed the wage and salary workers who were still employed. Sizeable minorities (10% of the men and 13% of the women, representing another 1 million people) said that they expected to stop working earlier than they really wanted to. Many wanted to work substantially more years than they thought they would, and over a third implied that they would like to work as long as possible.

One explanation of these divergent plans and preferences is that these workers do not want to continue under the terms and conditions of employment that they expect to face, but would like to under different circumstances. In fact, the survey asked about employment preferences under alternative scenarios. Over half of the respondents, representing about 5 million older Americans, said that they would work longer under different pension arrangements, if offered a job with reduced hours and responsibilities, or if re-trained for a job with new responsibilities (ibid.).

Despite reasons to be skeptical about subjective questionnaire responses, these data do suggest that substantial minorities of older Americans are willing and able to work longer, and might do so under different terms and conditions of employment.

IV. The Future of Retirement

This brief survey has described some factors that are thought to have influenced retirement patterns in the past, and therefore that might be expected to do so in the future. Some of these factors are already changing in predictable directions; the future of others is less clear. Although the net result is difficult to predict, I foresee older Americans staying on the job longer than they currently do.

A. Wealth

In the future, the growth in the wealth of elderly cohorts should be more modest than it has been in the past. Although it is likely that the nation will continue to grow wealthier, and the elderly with it, the generous inter-generational transfers that have occurred via Social Security will be greatly diminished. Future cohorts of retirees will not receive the windfall gains that their parents and grandparents did (Levine and Mitchell, 1992). Social Security replacement rates, which grew steadily until 1981, have declined significantly since then, and are now designed to stay relatively constant through the middle of the next century (U.S. House, 1992, p. 15). These changes should temper the long term trend toward earlier retirement.

B. Social Security

Recent and planned changes in rules and regulations will reduce real Social Security benefits and work disincentives, and increase the reward for older workers who continue to work.

The Social Security earnings test has often been a sore point among older workers. Many people know that the earnings test disappears at age 70 (it was 72 before 1983), and that recipients can earn any amount without loss of benefits after that age. Few understand its limited relevance before age

65. Although Social Security benefits are reduced by earnings above the exempt amount for those aged 62 to 64, the benefits foregone are returned later, since the adjustments for delayed benefits are close to actuarially fair. It is at age 65, when the delayed retirement credit drops from about 7% to only 4% per year of delay, that the earnings test really becomes effective. And it is just this group for whom the earnings test has been liberalized. Since 1978, those aged 65 to 69 could earn more than for those 62 to 64 before benefits were reduced. In 1992 the exempt amounts were $10,200 and $7,440 per year, respectively, and these are scheduled to increase to $10,680 and $7,800 in 1993 (ibid., p. 19). In addition, in 1990, the benefit reduction rate on earnings over the exempt amount for those aged 65 to 69 was decreased from 1/2 to 1/3. This reduces the implicit tax rate on earnings, and increases the net wage.

Other Social Security amendments are also increasing the reward for continued work. The delayed retirement credit has increased from 3 to 4%. This applies to each year's delay of benefit receipt beyond the age at which "full benefits" are paid (currently, age 65). This credit will continue to increase by 0.5% every other year until it reaches 8% in 2010. This will be close to actuarially fair, and will make Social Security approximately age-neutral; that is, the present discounted value of the benefits will no longer depend significantly on when they are claimed. It will effectively eliminate the earnings test in an actuarial sense, since benefits foregone will be returned later.

The age of "full benefits" is itself scheduled to increase. It will rise from 65 to 66 for those reaching age 62 between the years 2000 and 2005 and then to 67 for those turning 62 between 2017 and 2022. Although these changes are usually described as a shift rightward in the DRC curve (one has to wait longer to receive "full benefits"), they are just as accurately described as a shift downward - an across-the-board decrease in benefits. Figure 3 illustrates this for people age 65 in 1993, 2008 and 2025. For those aged 62-64, both of the shifts shown are declines. For those 65 and over, the shift rightward of the "full benefit" age is initially offset by the increased delayed retirement credit, but there is no such offset later. These benefit declines will lower retirement wealth, and, at the margin, should delay retirement.

C. Employer pensions

Several interesting trends are underway among employer pensions, and some will encourage later retirement. The first is that pension coverage among American workers is no longer growing. According to John Turner and Daniel Beller (1992), the percentage of private sector workers who were active participants in employer pension plans was constant at 45-46% from 1970 to 1987; among full-time workers, coverage was steady at about 52%. Other evidence suggests that participation is now declining (Woods, 1989; Short and Nelson, 1991). Since workers with pension coverage are more likely to retire early, the decline in coverage, if it continues, may induce delayed retirement.

In addition, the relative importance of defined-benefit and defined-contribution plans is changing. The proportion of pension participants whose primary coverage is defined-contribution increased from 13 to 32% between 1975 and 1987. In addition, virtually all supplementary coverage is defined-contribution. Overall, the proportion of active participants in defined-benefit plans (double-counting those covered by more than one plan) fell from

71 to 45% between 1985 and 1987 (Turner and Beller, 1992). If this trend continues, work disincentives will become less widespread, also encouraging later retirement.

Legislation enacted in 1986 requires that firms continue pension contributions, credits and accruals for workers who work beyond normal retirement age, up to the maximum number of years permitted in the plan. Previously, accruals could cease at this age, usually 65. This will increase total compensation for some older workers, and may induce some to delay retirement (Sandell, 1988).

On the other hand, many pension plans have continued to move towards encouraging early retirement. (See Norman Stein in Chapter III-4 for more detail). William Wiatrowski (1990) reports that nearly all defined-benefit plans now include early retirement provisions, and that fewer than a fifth of those eligible face full actuarial reductions in annual benefits if they retire early. In addition, about 12% of participants were in plans (in 1988) that provided supplementary payments during the period between the receipt of pension benefits and eligibility for Social Security. In present value terms, these supplementary benefits, often available at age 55, were about the same size as typical Social Security benefits at age 62.

Olivia Mitchell (1992) estimates that 60% of defined-benefit participants could retire at age 55 in 1980; by 1989, that had risen to 66%. The proportion requiring only 5 years of service at age 55 to be eligible rose from 5 to 9%; those needing 10 years at age 55 rose from 36 to 43%. Only half as many people needed 30 years of service in 1989 than did in 1980.

Many researchers think that the impact of pension incentives, for those who face them, are much more important than those of Social Security. This means that the future trend in employer benefit incentives will be key in determining future retirement patterns. This point is elaborated in the summary section below.

D. Occupation and industrial shifts

As mentioned above, these factors are less important than one would expect. Although growth rates will continue to differ significantly by occupation and industry, the proportion of workers aged 55 and over by sector is surprisingly constant. If anything, the occupations with slightly higher proportions of elderly are expected to grow a little faster than others, which should encourage additional labor force participation by older workers (U.S. BLS, 1990 Table 6; U.S. BLS, 1992a, Table 6). Two exceptions, however, may be important. Agricultural, forestry and fishing employment has been declining for decades, and nearly a quarter of these workers are 55 or older. In addition, the fastest growing category of the future (technicians) has by far the lowest representation of older workers (less than 7% aged 55 and over).

This last fact may indicate a problem, if older workers continue to be underrepresented in technical areas. Both Richard Belous (1990) and the AARP (1990) recently surveyed U.S. firms, and both found that many employers expressed concerns about the ability of older workers to cope with the technological aspects of many jobs. In the AARP survey, a vast majority of the managers interviewed also said that increasing productivity was a top corporate priority, and nearly half mentioned the introduction of new technology as a means to that end. If these negative attitudes are not addressed, older workers could be at a serious disadvantage in an increasingly important occupational sector.

V. Summary

The stage is set, I think, for a gradual increase in the work life of many older Americans. Longevity continues to increase. Mandatory retirement has virtually been eliminated. The financing of Social Security through a "chain letter" effect, with a vast number of workers subsidizing a relatively small number of retirees, is no longer viable. The Social Security work disincentives that currently penalize work after age 65 are being eliminated. In 20 years, the system will be close to age neutral; that is, workers can expect that benefits foregone by continued employment will be returned to them later. In addition, the age of "full Social Security benefits", currently 65, is scheduled to increase to 66 and then to 67. Although early benefits will still be available at age 62, the benefit reduction at 62 will be 30% rather than the current 20%.

In the world of employer pensions, certain trends will also encourage later retirement. Pension coverage is stagnant or declining. Firms with pensions must now continue accruals to employees who work past the normal retirement age. And there has been an increase in the relative importance of defined-contribution plans, which do not have the age-specific work disincentives emphasized above.

Although most retirements today do seem to be voluntary, by healthy workers with demand for their services, many retirees say that they would prefer to be working, and many of those still employed claim they would work longer than they plan to under different employment conditions.

These older Americans who want to work more represent a minority, but a significant one, of their age groups. They tend to be well educated and skilled, and most have a history of stable employment (McNaught et. al., 1991). They claim to be flexible with respect to the jobs they would take, seem willing to commute, work alone, or take seasonal work, and say they would work full-time or part-time, although more prefer the latter (ibid.). A reasonable question is why are they not working if that is what they want.

My hypothesis is that many of them do not want to work under the terms and conditions they face. Continued full-time employment on the career job eventually means significant losses in retirement wealth - in essence, a pay cut - at age 65 for Social Security and often much earlier for employer pension plans. In addition, many older workers may not want to continue full-time. Part-time work on the career job is rarely available for wage and salary workers. Employment on a new job usually entails a significant pay cut, partly because the skills developed on the career job may be less applicable with the new firm. In addition, the new job is likely to be part-time, and these generally pay less than full-time positions do.

Given these options, many older workers leave their career jobs and the labor force as well. In the future, options may be more attractive. Social Security is already starting to encourage continued work, and some workers will respond to the added incentive. Where and how they respond will depend, to a large extent, on the nature of future pension incentives.

Employers used to have two allies that helped to encourage older workers to leave the firm at a specific age - mandatory retirement and Social Security. One is gone, and the other is leaving. The big question is my mind is how firms will respond. Will employer pensions conform to the new age-neutral world of Social Security? Or will they augment their already significant retirement incentives to compensate for the loss of their allies?

Will employers demonstrate the kind of flexibility that many older workers want? Will there be options for career workers to take jobs with reduced hours or different responsibilities? Will there be job-sharing or re-training options? Will pensions rules be changed so that employees can work part-time and collect a reduced "part-time" pension?

If so, then I foresee a world in which many older Americans disengage more gradually from their career employers, taking advantage of their firm-specific human capital as they do. If not, then I foresee more of the type of transitional bridge jobs that we currently observe - self-employment or employment with another firm. In the latter scenario, Social Security says "Keep working," while the pension plans say "But not here." Workers will respond accordingly, as they have done in the past.

Which of these scenarios unfolds will depend on the state of the economy in the future. If labor markets remain slack, then I expect firms to keep their current incentives, and employees to maintain their current exit patterns. But if labor markets tighten, as the demographic projections suggest they might, then I expect firms to respond accordingly, and to alter their compensation and employment packages to keep valued older workers on the job.

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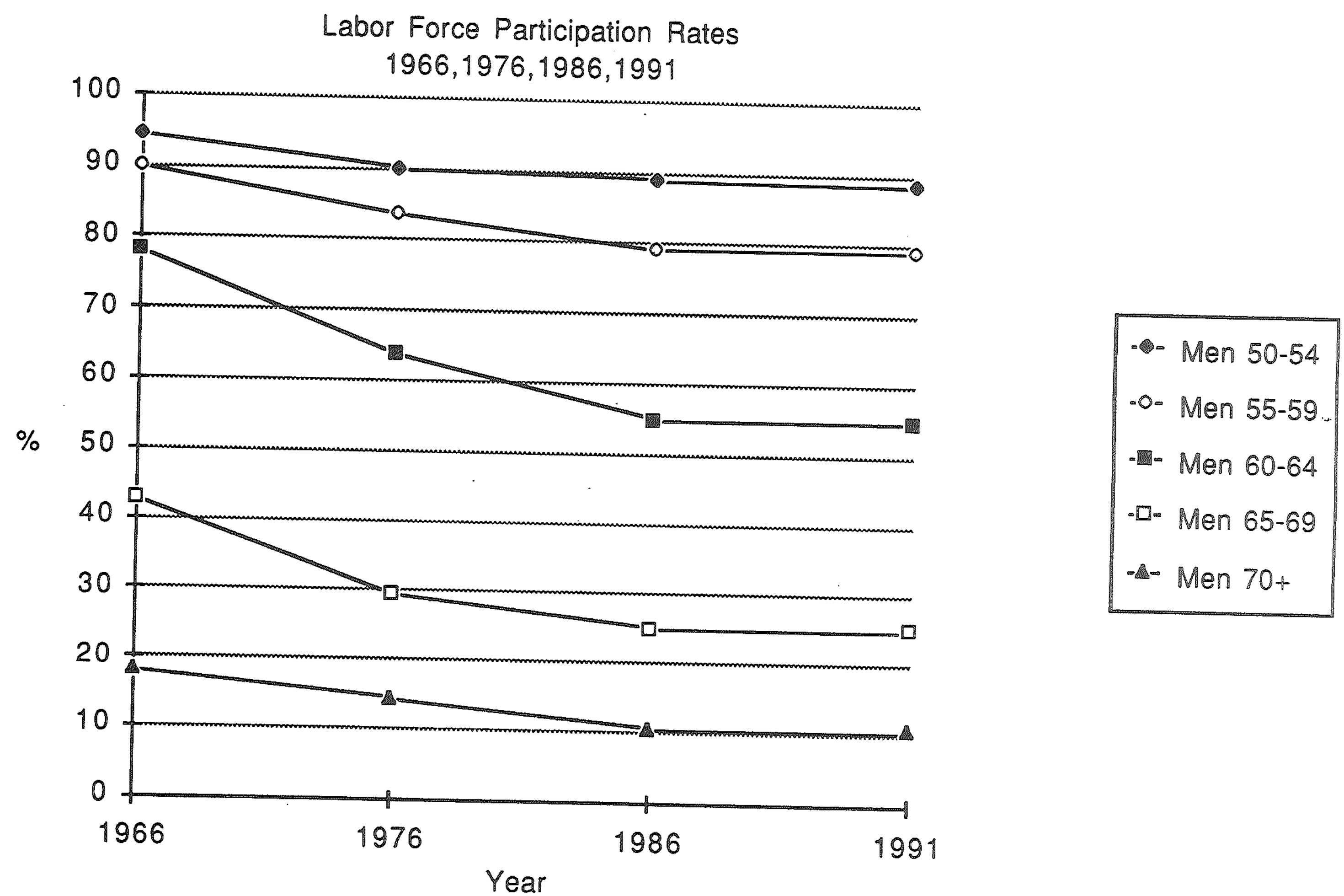
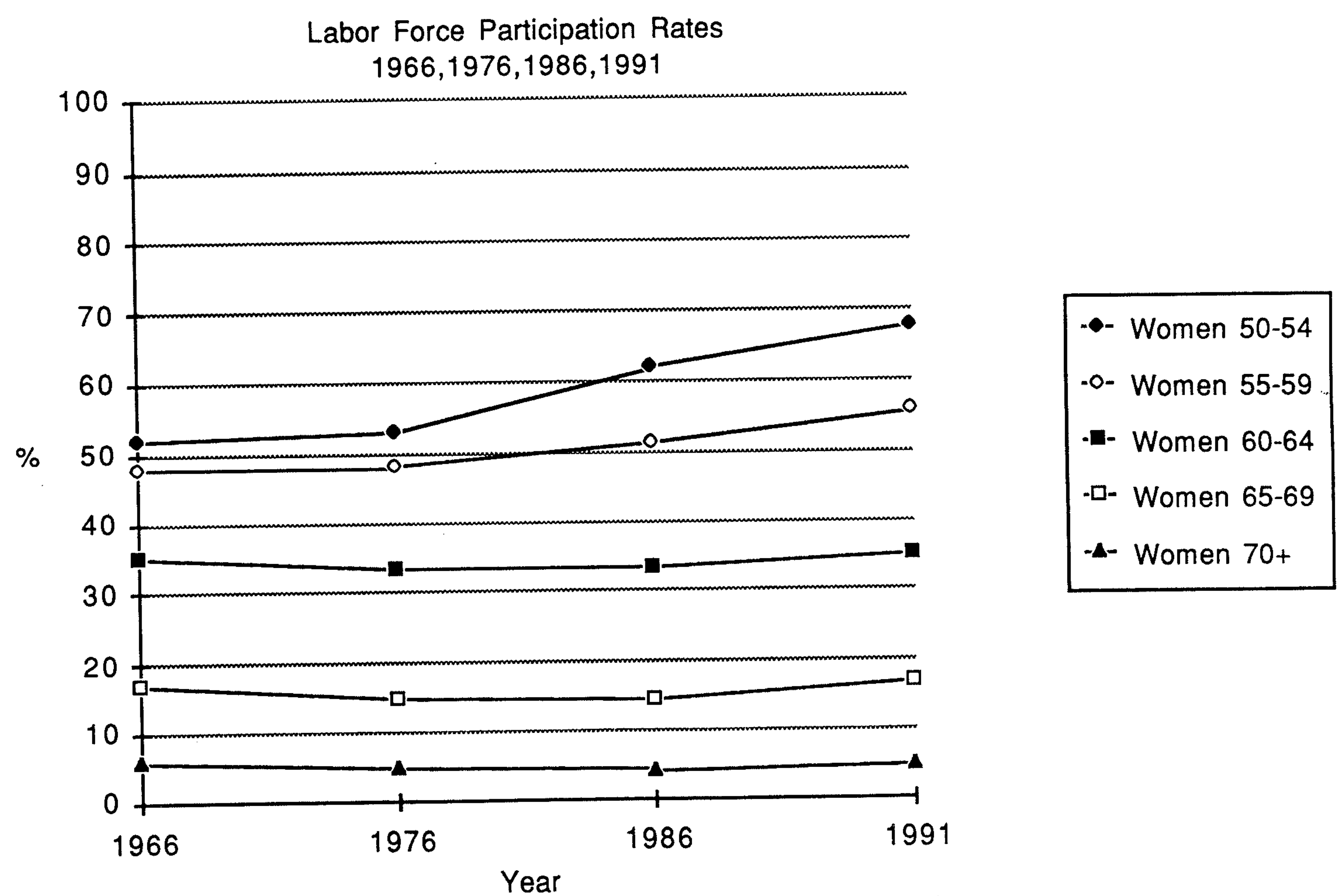
Figure 1: Labor Force Participation Rates, Men



Source: Employment and Earnings, January Issues

Figure 2: Labor Force Participation Rates, Women



Source: Employment and Earnings, January Issues

Figure 3: Delayed Retirement Credit