IS WORKING LONGER THE ANSWER FOR AN AGING WORKFORCE?

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Executive Summary

One of the most important labor market developments of the last century was the sustained trend toward earlier retirement among American men. This trend came to at least a temporary halt in the mid-1980s. Since then, male participation rates at older ages have stabilized or even increased slightly, while older women's participation rates have begun rising dramatically.

The dominant factor driving the trend toward earlier male retirement was a long-term increase in economic wealth, which permitted workers to enjoy rising living standards even as they spent a growing percentage of their lives outside the workforce. The expansion of Social Security and of employer-sponsored pension plans, and the introduction of mandatory retirement rules, also encouraged earlier retirement over much of the last century.

In recent years, many public policies and private institutions that encourage early retirement have been modified. Mandatory retirement was outlawed in most jobs. Social Security is no longer growing more generous, and coverage under company pension plans is no longer rising. In addition, both Social Security and private pensions have become more "age neutral," meaning that they provide either weaker incentives or no incentives to retire at particular ages, such as age 62 or age 65. Finally, the scheduled rise in Social Security's normal retirement age over the next two decades will encourage later retirements, at least modestly.

An open question is whether further changes are needed. Given that labor force growth is slowing and Americans are enjoying longer and healthier lives, efforts to encourage people to work longer could have important benefits both for individuals and for the national economy.

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On the other hand, rising labor productivity, increased work effort, and more saving during the pre-retirement years could allow Americans to enjoy higher living standards even if they choose to spend more years in retirement. If opinion polls are to be believed, most workers favor preserving options for early retirement, even if it means heavier contributions to the retirement system during their working careers.

Introduction

The graying of the population represents a major economic challenge for the nation. How will the country respond to a rapidly rising ratio of older people to workers? Exacerbating the demographic shift is the long-term trend toward earlier retirement. Nearly half of all men now leave the labor force by age 62 and almost half of all women are out of the workforce by age 60. If workers were to delay their retirements and continue contributing to the health and pension systems, they could ease the burden of an aging population.

The decline in the average retirement age has occurred in an environment of rising longevity for the elderly. Falling mortality rates have 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 since 1940. Combined with earlier retirements, the amount of time men spend in retirement climbed about 2 years per decade, adding almost 12 years since 1940. Despite a substantial rise in the time devoted to schooling at the other end of the lifespan, the time spent in retirement is now often longer than the period from birth to full-time entry into the job market.

In addition to the economy-wide implications of longer average retirements, there are also implications for individuals to consider. For example, if people choose to retire at relatively early ages and do not save diligently in their pre-retirement years, they run the risk of outliving their retirement savings. In addition, early retirees may find that they miss the psychological satisfaction and social connections associated with the workplace.

This *issue in brief* examines the long-term decline in the retirement age and its recent halt. It explains how public and private pension policies have influenced these historical trends. It then analyzes the potential impact of policy options that might encourage greater labor force participation among older workers. The *brief* concludes by describing Americans' attitudes towards delaying retirement and discusses a potential alternative for responding to the economic and budgetary challenges of an aging population — increased saving.

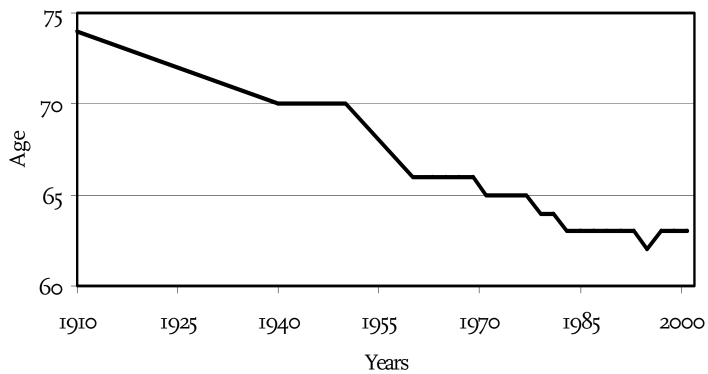
Retirement Trends

At the beginning of the last century, retirement was relatively uncommon. Two out of three American men over the age of 65 were employed (U.S. Department of Commerce 1975). By the middle of the twentieth century, retirement had become far more common. Fewer than half of men 65 and older held a job in 1950. By 1985, just 16 percent of men over 65 were employed or actively seeking a job. The percentage of women past 65 who were employed or looking for work also shrank during the first four decades after World War II. The reduction was far smaller, however, because the percentage of older women who worked outside the home had never been high.

The pattern of declining work among older men is clearly evident in Figure 1.[1] The top line shows age-specific labor-force participation rates of older men in 1910. (A person is considered a labor force participant if he or she holds a job or is actively seeking work.) Note the clear pattern of labor market withdrawal with advancing age. The crucial difference over time is that the fall-off in labor force participation begins at earlier ages and proceeds at a faster pace. The largest percentage declines among men older than 70 occurred between 1910 and 1940; among 65-to-69 year-olds between 1940 and 1970; and among men under 65 after 1960, after eligibility for Social Security benefits at age 62 was introduced. A striking shift, illustrated in Figure 1, is that the participation rates of older men have stabilized or even increased slightly since 1985.[2]

Figure 2 shows the decline in the average male retirement age — defined here as the youngest age at which fewer than half the men in the age group remain in the workforce. The average male retirement age fell from 74 in 1910 to 63 in 1983, a drop of about 1.5 years per decade. Figure 2 also indicates that this long-term trend toward earlier retirement has recently slowed and may even have ceased.

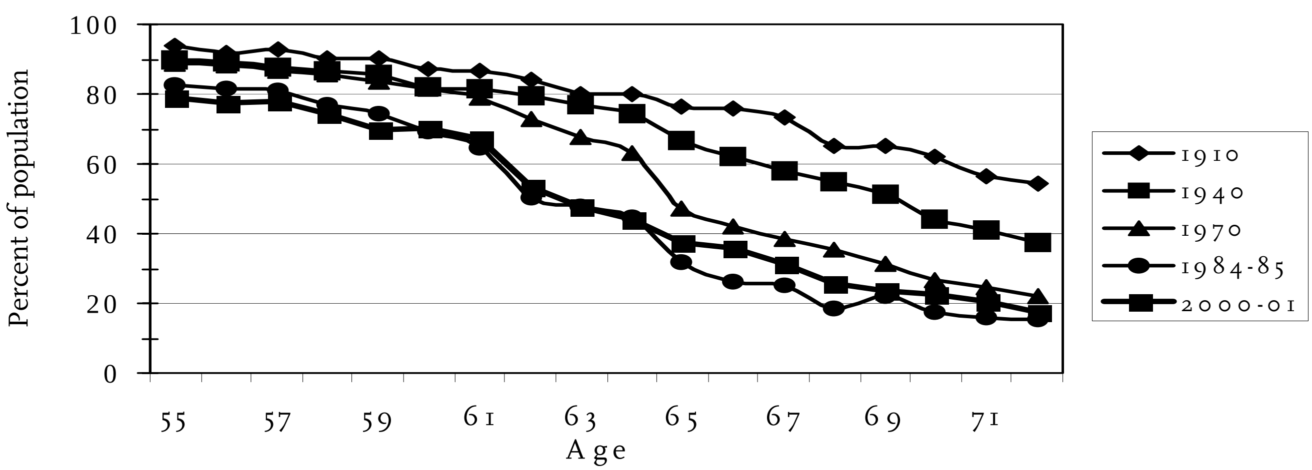
Figure 2: Average Retirement Age of Men, 1910-2001



Source: Ransom et al. (1991), Munnell (1977), and authors' tabulations of March CPS files.

Note: The average retirement age is the youngest age at which at least half of men have left the labor force. For years 1963 and later, the labor force participation rate at each year of age was calculated by averaging two years (e.g., "1963" = average of March 1962 and March 1963; "2001" = average of March 2000 and March 2001).

Figure 1: Labor Force Participation of Men at Specific Ages, 1910-2001



Source: Ransom et al. (1991), Munnell (1977), and authors' tabulations of March CPS files.

1 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 2000-01 are the arithmetic average participation rates on the March Current Population Survey (CPS) files for 1984 and 1985, and for 2000 and 2001. 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.

2 Older women's participation rates in the post-World-War-II era reflected two phenomena — the early retirement trend of older workers in general and the increasing labor force participation of married women. As in the case of men, there is a shift in the overall trend after 1985. Older women's labor force participation rate barely increased at all between 1970 and 1985, then surged after 1985.

What Might Explain the Long-Term Trend toward Earlier Retirement?

Of all explanations advanced for earlier retirement, declining health is among the least persuasive. Nearly all retirement studies find that health plays an important role in the timing of individual retirement decisions. But there is no convincing evidence that the health of 60-70 year-old Americans declined over the period in which their labor force participation was falling. Increasing longevity, as well as recent evidence about the decline in the physical disabilities of the aged, suggests instead that their health was improving.

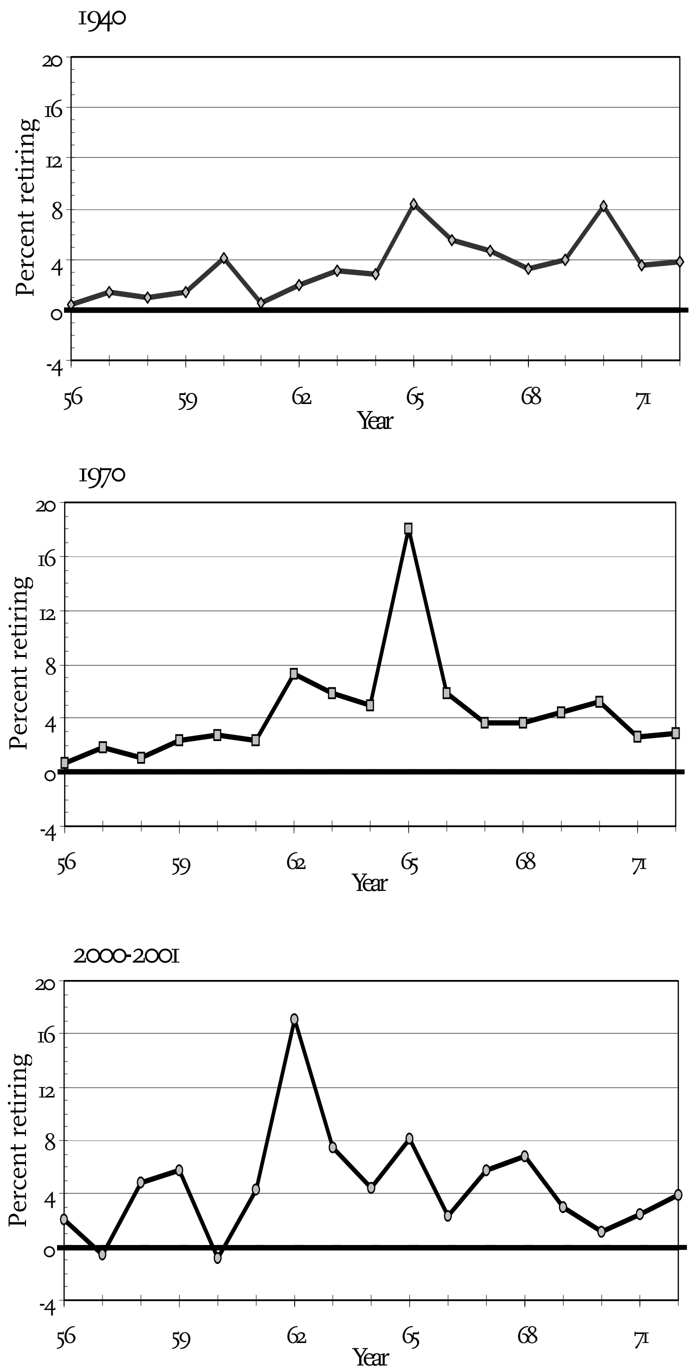
Nor do the changing physical requirements of work explain the trend toward earlier retirements. In every generation, workers who are in poor health or who work in physically demanding jobs will be among the first to retire. But today, a much smaller share of jobs requires strenuous physical effort and a larger percentage requires only moderate or light physical exertion (Manton and Stollard 1994 and Baily 1987).

More important than factors pushing workers out of employment were factors pulling them into retirement. The long-term trend toward earlier retirement had an important *voluntary* component. One significant factor in workers' decisions to retire is the amount of income they can expect to receive when they leave the workforce. The rapid economic growth experienced by the United States in the post-war period caused real per capita disposable income to more than double between 1947 and 1985 (U.S. Department of Commerce 1998). For many of today's retired workers, the increased wealth flowing from greater national prosperity has arrived in the form of windfall gains from two sources — higher prices for the houses they own and generous benefits from Social Security and Medicare.

The rise in the availability of retirement pensions has been particularly important. Until 1941, Social Security provided no income at all to the elderly. Nowadays, Social Security provides 40 percent of the total cash income received by the aged and over 80 percent of the cash income of households in the bottom 40 percent of the income distribution of this population. In terms of income replacement, the program provides about 40 percent of the final wage earned by a full-career single worker who earns the average wage and claims benefits at the normal retirement age (traditionally age 65, but rising gradually to 67).

Besides increasing most current and past retirees' lifetime wealth, the Social Security system also affects the financial attractiveness of remaining at work at different ages. Until recently, the system defined the "normal retirement age" (NRA) as 65. Since 1961, most men could choose to collect reduced Social Security benefits starting at age 62. This "age of earliest eligibility" (AEE) for females has been 62 since 1956. The size of the Social Security program, and the incentives it provides, are clearly large enough to influence retirement decisions in a significant way. For example, Figure 3 shows the pattern of male retirement in 1940, 1970, and 2000-01. The 1970 and 2000-01 distributions show evidence of clustering at

Figure 3: Male Retirement Rates by Age, 1940-2001



Source: Authors' tabulation of participation rates in Munnell (1977), page 70, and estimates from the March 2000 and March 2001 CPS files.

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

ages 62 and 65, which suggests that Social Security policy has likely influenced retirement decisions.

Age 62 is a popular retirement age because many people are eager to leave the workforce, and they seize the opportunity as soon as the availability of a dependable pension allows them to support themselves. For this group, the ability to claim Social Security benefits may be an important factor in workforce withdrawal at age 62. When workers delay receipt of retirement benefits by continuing to work past age 62, they pass up the chance to collect a Social Security check. On the other hand, withdrawing from the workforce at 62 also requires a tradeoff, because workers would become eligible for even higher retirement benefits if they delayed their retirement until after the early entitlement age. If a worker retires at 63 instead of 62, retirement benefits would be higher, both because average lifetime earnings are recalculated based on higher lifetime wages and because the pension check is increased for every month of delay by about 2/3 of 1 percent, or about 8 percent per year of deferment.

After age 65, the adjustment in the monthly benefit was historically much less generous toward delayed retirement. Until recently, postponement after that age was not fairly compensated by increases in the monthly pension.[3] For most workers this was true even after taking account of the fact that the basic pension calculation gives them extra credit for their most recent wages. In essence, the Social Security formula forced workers who delayed retirement after 65 to accept a cut in the lifetime value of their benefits — the equivalent of a pay cut. This was a clear inducement to claim Social Security benefits by age 65.

Another reason why some people who collect a Social Security check stop working is that the program imposes an earnings test in calculating the annual pension. The historical details of the earnings test are quite complicated, but, in essence, workers affected by it have their Social Security benefits reduced if their annual wage income exceeds a threshold amount.[4] For workers younger than the NRA, the earnings test was (and still is) designed to be neutral with respect to lifetime income. Individuals who have their benefits reduced by the earnings test receive an offsetting increase in their future benefits when they reach the NRA. Despite this neutral design, some Social Security pensioners undoubtedly perceive the earnings test as a disincentive to continued work. This perception may have been more common in the past than today as the earnings limit is now much higher and applies to fewer people. For workers older than the NRA — prior to 2000, when the test for this age group was repealed — benefit losses caused by the earnings test were not fairly compensated. In essence, for this group, the earnings test represented a heavy tax on wages above the annual exempt amount.

Many employer-sponsored pension plans are structured similarly to Social Security. Most traditional defined benefit plans are designed to encourage workers to remain with the employer for at least a minimal period (e.g., 10 years) and until a critical age — often the earliest age of pension eligibility. Workers who remain employed for shorter periods may receive very little in pension benefits. On the other hand, workers who stay in the job too long may see the total lifetime value of their future pension benefits shrink. This would happen, for example, 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. A 55-year-old worker who can collect a monthly pension of $1,000 should he retire immediately and $1,001 should he delay his retirement one year will lose a substantial amount of lifetime benefits — nearly $12,000 — for each year he postpones claiming a pension. Such a worker essentially suffers a pay cut when he reaches age 55 — a cut equal to the loss in lifetime benefits he suffers by postponing retirement and continuing to work.[5] Many employers find this kind of pension formula to be an effective incentive for convincing workers to opt for retirement at a specific age.[6]

3 The increase in benefits for individuals who delay claiming benefits until after the normal retirement age occurs through the delayed retirement credit (DRC). The DRC has been rising gradually over time, beginning in 1987 and ending in 2005.

4 Policymakers have made numerous changes to the earnings test over time. Details of the earnings test are spelled out in Burke (2000). In the year 2000, Social Security recipients aged 62-64 were subject to an earnings test if their annual earnings were greater than $10,080. Their benefits were reduced $1 for every $2 of earnings in excess of this threshold. Social Security recipients aged 65-69 faced a higher earnings threshold. Earnings in excess of $17,000 per year resulted in a benefit cut equal to $1 for every $3 of earnings above the threshold. Recipients aged 70 and older were not subject to an earnings test. The Senior Citizens Freedom to Work Act, enacted in April 2000, eliminated the earnings test for Social Security recipients starting in the month they attain the normal retirement age. Thus, Social Security recipients are now only subject to the test from age 62 up through the normal retirement age.

5 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.

6 There is one important difference between Social Security and employer-sponsored defined benefit pensions. For individuals from age 62 to the normal retirement age, 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, sometimes, a 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 some older workers find it hard to get attractive job offers after they have retired from their career jobs.

What Might Explain the Halt in the Trend toward Earlier Retirement after 1985?

One explanation for the change in retirement trends after 1985 is the robust state of the overall economy since that time. The second half of the 1980s and most of the 1990s saw a vigorous economic expansion with strong employment growth. Since 1985, there have been only two relatively mild recessions. The expanding economy made it easier for workers to find jobs when they were dismissed or left a career job. Dismissed workers were more likely to find jobs with the terms and conditions of employment that they desired. In contrast, the 15 years after 1970 had three recessions, two of which — in 1974-75 and 1981-82 — were the worst of the post-war era. Weak labor demand increases dismissals, discourages unemployed workers from persisting in their job search, and encourages retirement. This "business cycle" explanation would suggest that the post-1985 change in retirement trends might be temporary, lasting only as long as the strong economy.

One important change, in addition to the relatively strong economy, 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 relative to the average earnings of typical American workers. The Social Security amendments of 1977 and 1983 brought an end to a four-decade liberalization of benefits. In fact, the amendments trimmed future retirement benefits in order to keep the program solvent longer.

Congress has also changed Social Security's benefit calculation rules to make work late in life more attractive. Under the earnings test, the amount of income a recipient can earn without losing any Social Security benefits has increased. For pensioners between 65 and 69, the benefit loss for each dollar earned over that exempt amount was first reduced (from 50 to 33 cents) and then eliminated altogether beginning in 2000. Congress also increased the reward that workers receive for delaying initial benefit receipt past the NRA. When this formula change is fully implemented, for workers attaining age 62 after 2004, the adjustment for delayed benefit receipt will be actuarially fair, or age neutral. This means that, for a worker with average life expectancy, lifetime Social Security benefits will be about the same regardless of whether the pension begins at age 62, age 65, or age 70.

Important changes have also occurred in the private sector. There has been a sharp increase in defined contribution 401(k)-type plans and a continuing decline in the relative importance of traditional defined benefit pension plans. Defined contribution plans are age neutral by design, and therefore have none of the age-specific work disincentives that are common in defined benefit plans. As a growing percentage of workers reaches retirement age under defined contribution plans, they will have less reason to leave their jobs to avoid a loss in lifetime retirement benefits.

Some changes in the environment are the result of policy initiatives that specifically encourage 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. In 1986, mandatory retirement was 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 that there is no single appropriate age at which to retire.

This message was reinforced by a provision of the 1983 Social Security amendments that is currently raising the NRA in Social Security from 65 to 66, and later to 67. Workers reaching age 62 in 2002 face a NRA of 65 years and 6 months and those turning age 62 in 2005 will have a NRA of 66. The age 67 NRA will become fully effective for workers who reach age 62 in 2022 or later. These increases in the eligibility age for unreduced pensions are equivalent to an across-the-board benefit cut, discouraging retirement at the margin.

These changes in the retirement environment mean that the future will not look like the past. The relative attractiveness of work versus retirement at older ages has been altered in favor of work. 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.

Policy Options for Further Encouraging Later Retirement

For both social and economic reasons, policymakers may be interested in considering additional ways to encourage people to work longer. First, given longer lifespans, many individuals retiring in their early 60s can expect to live for another two decades or more. This is a long period of time for healthy and productive individuals to be idle. Many older

Americans might benefit by staying active in the workforce longer — at least on a part-time basis — simply because they derive satisfaction from working and from the social relationships they develop in the workplace.

Second, if people continue to retire in their early 60s, they are at much greater risk of having inadequate incomes when they are older. For example, early retirees give up labor income, receive a reduced monthly benefit from Social Security, and lose the ability to contribute to an employer-sponsored pension, such as a 401(k) plan (assuming their employer provides such coverage).

Finally, given current retirement patterns, it may be difficult to trim future spending in Social Security and Medicare without causing significant hardship for some individuals. If, instead, individuals were to retire later, they would likely have more income and assets from other sources (plus larger monthly Social Security checks), allowing them to better weather any subsequent changes to Social Security or Medicare.

Assuming that it is desirable to do so, how might policymakers encourage American workers to delay their retirements further? This section examines various options that have been proposed and considers their likely overall effects on the timing of retirement and on the finances of the Social Security program. Some of these options may succeed in delaying retirement but will not affect Social Security's finances; others may improve Social Security's finances but leave work patterns unchanged. For example, encouraging later retirement is often linked with raising the NRA under Social Security. Raising the NRA would certainly save Social Security money, but its effect on actual retirement ages may be modest. Alternatively, raising the early retirement age might not save Social Security much money, but it would almost certainly affect the timing of some workers' retirements.

Options for Raising the Retirement Age

One way to change the NRA for Social Security benefits is to accelerate the increase already scheduled under present law. Instead of phasing in the increase over 23 years — two months a year, 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. The higher NRA would then be fully implemented for workers reaching age 62 in 2011, rather than 2022.

A second option is to increase the NRA automatically in line with increases in life expectancy after 65.[7] Under the Social Security Trustees' intermediate assumptions, this proposal would push the NRA to age 70 by about 2080. The Social Security Actuary recently estimated that accelerating the NRA increase and then raising the NRA in line with longevity eliminates nearly one-quarter of Social Security's 75-year funding gap.

As indicated above, lifting the NRA while leaving the age of early eligibility (AEE) unchanged produces the same effect on benefits at a particular age as a proportional reduction in the full pension (usually referred to as the "primary insurance amount," or PIA). 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, however, important *non-economic* differences between raising the NRA and cutting the PIA. First, increasing the NRA reminds workers that the same monthly benefit can be obtained by postponing retirement, which could encourage some workers to delay retirement rather than accept a lower pension. Second, workers might view increases in the retirement age as more understandable and equitable, in light of the well-known improvements in life expectancy, than equivalent reductions in full pensions. By increasing the retirement age, policymakers would convey the message that the benefit level is appropriate but the timing is not — and that workers ought to postpone their retirements.

Congress could increase the AEE at the same time and at the same pace as it increases the NRA. An increase in the AEE, however, is very different from an increase in the NRA. If the AEE were increased, 62-year-old workers would be unable to receive Social Security old-age benefits. If the possibility of obtaining old-age pensions were eliminated, some 62-year-olds who otherwise would have received old-age pensions would apply for Disability Insurance (DI).[8] The pool of potential new DI applicants would, however, be somewhat reduced because a significant share of 62-year-old workers, particularly women, are not eligible for DI (Mitchell and Phillips 2001). But, to the extent that more people in this age group did apply to DI, it would increase Social Security administrative costs, because eligibility is much more expensive to determine in the DI program. It may also impose

7 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. "Potential years of work" are defined as the number of years from age 20 to the NRA.

8 Raising the NRA without changing the AEE would also likely produce some increase in DI applications, because workers are allowed to apply for DI up until the NRA. A higher NRA would, thus, allow more time for potential DI applicants.

serious hardship on workers whose DI applications are denied. These consequences make policymakers reluctant to increase the AEE. Elected officials may be more uneasy about reforms that deny benefits completely to an identifiable class of people than about reforms that reduce benefits modestly to a much wider population.[9]

Increasing the AEE also differs from increasing the NRA in its budgetary effects. While a higher NRA means lower lifetime Social Security benefits, a higher AEE does not because monthly benefits would rise to compensate for the later retirement age. This adjustment occurs because, as noted earlier, lifetime benefits are designed to be approximately equal regardless of the age when they are first claimed.

It is important to recognize why Social Security has an age of eligibility. 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 50s or even late 40s. But their (drastically) reduced monthly benefits would be very low. This might not represent a problem for workers who are 50 or 60 years old and can supplement their Social Security benefits with wages or an employer-sponsored pension. But the low monthly pension could cause serious hardship when a worker is no longer able to work and when company pension benefits — which are seldom increased with inflation — can no longer cover the cost of groceries and monthly rent. The existence of the early entitlement age in Social Security prevents shortsighted 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 rather than the current 20 percent cut. If the NRA were eventually increased to 70 and the AEE remained unchanged, workers claiming pensions at age 62 would receive monthly benefits as low as 52 percent of a full pension — probably too little for a low-wage worker who has few other sources of income. It thus seems sensible to increase the AEE if the NRA is increased above 67. To implement this reform in a humane way, policymakers might also consider liberalizing eligibility requirements for DI 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 on actual retirement ages. It is natural to ask whether increasing the NRA would have much effect on when workers actually retire. While almost all researchers who have examined this question agree that such a reform would tend to increase the average age at retirement, they also agree that the effect of increasing the NRA alone is likely to be modest.[10]

Raising the AEE would probably have a larger impact than a change in the NRA alone, especially for low-wage workers who have no other sources of retirement income except Social Security. We have some historical evidence with which to evaluate the impact of this kind of change. When the earliest age of eligibility for Social Security retirement benefits was reduced from 65 to 62, labor force participation rates of 60-64 year-old men fell significantly, and much faster than before. It is therefore reasonable to anticipate that reversing all or part of this change would have a significant impact in the opposite direction. Nevertheless, the magnitude of the increased labor force participation is unknown and would depend 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. If Congress changes the AEE and NRA in Social Security, would firms change their pension programs? Would companies with defined benefit pension plans increase their early retirement incentives to offset the loss of the Social Security incentives, or move in the other direction by making their plans more age neutral? If workers wanted to delay their retirements, 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?

As noted above, Social Security rules are moving toward age neutrality for the average worker. Employer pension programs are moving in the same direction, since coverage is shifting toward defined contribution plans, which have none of the age-specific retirement incentives present in traditional defined benefit plans.

Historical evidence about the job-creating capacity of the U.S. economy is reassuring. Over

9 An alternative to raising the early eligibility age was suggested by members of the President's Commission to Strengthen Social Security. The Commission's "Model 3" proposal would make no changes to either the AEE or the NRA, but it would reduce benefits for anyone retiring early (i.e. before the NRA) and increase benefits for anyone retiring later. This adjustment is intended to strengthen the incentives for working longer (President's Commission to Strengthen Social Security 2001).

10 For further details, see Burtless and Moffitt (1985), Burtless (1986), Kreuger and Pischke (1992), and Quinn et al. (1990).

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 women entered the job market in record numbers, the labor force grew by two-thirds. Nevertheless, the jobless rate rose only slightly, from 5.0 percent to 5.2 percent.

If older workers were forced to wait two or three extra years for full Social Security retirement benefits, many would choose to remain in their career jobs for a few months or years longer than workers presently do. Those who were dismissed from their jobs would try harder and more persistently to find new ones. The increased availability of older workers might 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. Most workers who want jobs to tide them over between the end of their career jobs and eligibility for full Social Security pensions would be able to find suitable employment, although many of them might be disappointed by the wage cut they would have to accept in order to get a job.

Policies to Improve Employment Prospects for Older Workers

If changing the AEE or NRA in Social Security increased older workers' desire for continued employment, several policies could improve their employment prospects:

- Permit workers to opt out of additional Social Security contributions when they reach the NRA. 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 payroll tax 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 policymakers 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 employers and older employees 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.
- Liberalize the Earned Income Tax Credit for workers aged 65 and older who have no dependent children.[11] This would provide a more generous federal earnings subsidy to aged low-wage workers who are currently eligible for only a small credit, and it could boost the available supply of older workers.

In an economy as strong as the one we have enjoyed over the past two decades, 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 of the reforms could be helpful.

Conclusion

While it might seem logical to consider raising the retirement age in Social Security to reflect improvements in longevity, that logic does not hold much appeal for the U.S. 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 summarized the findings of 18 polls conducted between 1977 and 1997 that asked Americans about their attitudes toward an increase in the retirement age (Jacobs and Shapiro 1998). With rare exceptions, solid majorities of respondents reject any proposed increase. The size of the majority opposing a higher retirement age was larger in the 1990s than it was in the 1980s. Political leaders apparently take their cue from the polling numbers, as many of them in both political parties have expressed strong opposition to the idea of further increases in the Social Security retirement age.

11 The Earned Income Tax Credit can be claimed by workers whose income is below certain threshold amounts. It is aimed at improving work incentives for lower-income individuals.

What is the alternative to later retirement? 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. The required extra contributions for retirement could take the form of higher payroll or income taxes or higher personal saving rates. (Higher saving would be needed to make up for the loss of monthly Social Security benefits if voters refuse to boost the taxes that pay for benefits.) When forced to choose between the option of making larger contributions to pay for retirement or accepting smaller pensions after they retire, most Americans claim to prefer larger contributions. By a 2-to-1 majority, workers favor higher payroll taxes over reduced Social Security pensions (EBRI 1997). This suggests a simple conclusion: Americans would rather set aside more of their wages for pensions than postpone their retirement.

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. There are many other legitimate uses for increased wealth, however, including better education and health care. Voters should carefully consider whether a longer and costlier retirement is really the best use for future additions to our national wealth. In addition to freeing up more resources for other purposes, older individuals themselves may derive social, economic, and psychological benefits from continued labor force activity.

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The Center for Retirement Research at Boston College, part of a consortium that includes a parallel center at the University of Michigan, was established in 1998 through a 5-year grant from the Social Security Administration. The goals of the Center are to promote research on retirement issues, to transmit new findings to the policy community and the public, to help train new scholars, and to broaden access to valuable data sources. Through these initiatives, the Center hopes to forge a strong link between the academic and policy communities around an issue of critical importance to the nation's future.

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