A MICRO-LEVEL ANALYSIS OF RECENT INCREASES IN LABOR FORCE PARTICIPATION AMONG OLDER WORKERS

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The 2001 recession in the United States was unique in that older workers experienced increases in labor force participation rates while other workers’ rates followed the typical pattern during a recession and declined. Older workers’ choices during this recessionary period were even more notable because their decisions reversed a broader trend of ever-earlier retirements that bottomed out in the mid-1980s. In addition, today’s retirees are changing the way older workers exit the labor force. Traditional one-time, permanent retirements appear to be the exception rather than the rule, as older workers increasingly change jobs later in life or reenter the labor force after “retiring.”

The pro-work mindset of many of today’s older Americans is likely a reflection of many factors, for both labor supply and demand. People are living longer, are healthier, and have higher levels of formal education compared to earlier generations. Jobs are also less physically demanding now than in the past, as the economy shifts away from manufacturing occupations towards service jobs. At the same time, a strong labor market, like that of the 1990s and mid-2000s, provides older workers with many job opportunities. These changes have enabled older workers to remain productive well beyond their late 50s and early 60s.

Many of the financial incentives surrounding retirement have changed as well. Defined-benefit pension plans that offer a set annuity payment upon retirement are less common in today’s private sector and many existing defined-benefit plans are being converted to cash balance plans or replaced with defined-contribution plans managed by the worker. Social Security, the bedrock of financial security late in life, is facing financial strain and will likely provide lower replacement rates than in the past. Finally, private saving, the third pillar of retirement income, is currently near record low rates. As a result, today’s retirees have experienced a general shift towards a “do-it-yourself” approach to retirement, and are now in charge of their retirement finances more than at any time in the post-war era.

While these changes will undoubtedly impact retirement patterns in the long run, they do not, in and of themselves, explain why labor force participation rates among older workers jumped so abruptly in the early part of this decade. For insight regarding this question, we examine how long-term changes have made retirees vulnerable to short-run market forces. Perhaps it took a shock in the financial markets, such as the 2001 recession, to uncover the impact of the “do-it-yourself” approach. Seen this way, the key
to understanding workers’ retirement decisions in recent years is to understand the interaction between long-run incentives and short-term market fluctuations. This interaction may also explain why increases in labor force participation since 2000 have subsided somewhat most recently as the economy improved.

Under this hypothesis, we might expect the timing of retirement to be cyclical, as workers’ expectations and plans are continuously updated in response to the changing state of their financial position. This is a fundamental shift from the past. Previously, the timing of retirement was largely immune to changes in market conditions, as investment risk was borne by the federal government and an individual’s employer. With the advent of 401(k)s and with the extension of Social Security’s Normal Retirement Age (NRA) from 65 to 66, and eventually to 67, a worker’s retirement benefit now depends on the current state of the market as cyclical effects help determine the stock of retirement assets. One possible implication, going forward, is that some older workers can be expected to postpone retirement or reenter the labor market during a recession, and then retreat from the labor force during a boom.

Aggregate data on workforce participation are consistent with this explanation; however, micro-level data are required to examine this hypothesis. We analyze data from two cohorts of older Americans in the Health and Retirement Study (HRS), those aged 51-61 in 1992 and those aged 51-56 in 1998. This paper focuses on labor force exit and retirement patterns, and we therefore exclude respondents with no work experience after age 49. For the analysis of gradual retirement, we make an additional restriction based on whether these HRS respondents had a full-time career (FTC) job since age 49, defined as one that consists of at least 1,600 hours per year (“full time”) and that lasts ten or more years (“career”). We find that over 70 percent of men and approximately 50 percent of the women had a FTC job since age 49.

We find that work status across cohorts was similar over time among men while some differences exist for women, in particular, with the younger cohort more likely to have worked at later ages. Gradual retirement was also common across both cohorts, as younger Americans were just as likely as older ones to take a “bridge job” (i.e., one that follows a FTC job and precedes retirement). About two thirds of those making a transition from FTC employment took a bridge job.

Overall, key determinants of retirement, such as age, health status, and health insurance and pension status, influenced work decisions across all groups, and cohort differences were more pronounced among women than men. We also found that cross-cohort differences in terms of the work-leisure decision and hours worked per year became blurred after 2000, all else equal. One possible explanation, consistent with aggregate findings, is that the older HRS Core respondents altered their work decisions during the recession and recovery period to the point where they eventually resembled their younger counterparts. This is consistent with the idea that workers on the cusp of retirement were responding to changes in the market, although we note that other explanations exist as well. It will be interesting to see how this plays out in the years to come. Another finding of note is that self-employment may be used as a mechanism by which retirees gain work flexibility later in life. Those who were self-employed were much more likely to be working in general, and their number of hours worked on the FTC job resembled those in wage-and-salary employment. This fact changes on the bridge job, as those who were self-employed worked significantly fewer hours.

Placing these results in the context of the overarching theme of this study, the shift towards “do-it-yourself” retirement has both positive and negative consequences. On the one hand, workers have more control of their retirement assets and, as shown in this paper and others, they respond to many of the financial incentives associated with retirement by working longer and by taking on bridge jobs after FTC
employment. The implication is that if retirement assets are less than expected upon retirement many older workers may remain active members of the labor force well into their late 60s and 70s. On the other hand, if work later in life is not an option, because of factors such as health or inflexible work options, some retirees’ long-run well being will be vulnerable to short-term fluctuations in market conditions.

What is clear is that retirement incentives have changed and these changes will likely influence the retirement decisions of older workers for years to come. With pre-emptive action by today’s middle-aged and younger workers, in the form of increased savings or more realistic work expectations, the timing of retirement may be less susceptible to short term macro-level influences.