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Executive Summary

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CHANGING SOURCES OF INCOME AMONG THE AGED POPULATION

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Over the past two decades, there has been a major shift in the composition of income received by the elderly aged 65 and over. The proportion of income derived from their own saving has fallen to less than half the level in 1990, but it has been offset by an equal increase in the share of income derived from continued employment – wage and self-employment income. Meanwhile the proportion of income derived from Social Security, employer pensions and transfers has remained virtually constant.

This study used data from several household surveys to evaluate these developments. Does the fall in the income of the elderly from their own assets follow from widespread reports of reduced retirement saving in prior decades? Does the growing importance of earned income reflect the inadequacy of other retirement resources and a need to stay in the labor force for more years in order to maintain their pre-retirement standard of living? Alternatively, the rise in the labor force participation of older workers could reflect the positive influences of longer life expectancy, reduced rates of morbidity, less onerous jobs, and the increase in incentives to remain in the workforce.

In the first part of the study, we compare the estimates of the incomes of aged households in the *Annual Social and Economic Supplement* (ASEC) to the *Current Population Survey* and the *Health and Retirement Study* (HRS) over the period from the mid-1990s to 2010. Each of these surveys has important advantages. The ASEC is the oldest and largest survey of American households and provides a comprehensive measure of incomes on an annual basis that is widely used in research and public discussions. The HRS is limited to older persons – primarily those over age 55 – but it has an important panel dimension with follow-up interviews every two years, and it includes a vast array of socio-economic characteristics that can be linked to the changes in income. Finally we use the *Survey of Consumer Finances* (SCF) as a source of verification of data in the HRS with regard to the wealth of aged households.

We find that the HRS consistently reports a higher level of overall income, averaging 123 percent of the ASEC over the last seven survey waves. The largest dollar differences are in asset, pension and self-employment incomes. The HRS reports a slightly larger value for the Old- Age, Survivor and Disability Insurance (OASDI) programs, and proportionately larger transfer-type income, but the latter category is small. When incomes in the two surveys are arrayed using the quintile breaks of the ASEC, the dollar magnitudes of the discrepancies are highly concentrated in the top fifth of the income distribution, but that pattern is less evident when the discrepancies are reported as a percentage of income. There is no systematic difference between the HRS and the ASEC in the middle three quintiles of the distribution.

Despite the differences in levels of aggregate income, the HRS and ASEC show very similar trends with respect to the rise in the share of income of those over age 65 from earnings and the fall in the share of asset income. Between 1998 and 2010, the earnings' share rises by 10 percentage points in the ASEC and 11 percentage points in the HRS. Meanwhile the asset share falls by 9 percentage points in the ASEC and 11 percentage points in the HRS. Thus, the basic pattern of change in the composition of income is true in both surveys.

The HRS shows a close agreement with the *Current Population Survey* in reporting a substantial rise in labor force participation by older Americans. The HRS consistently indicates a higher level of labor market participation, but that can be traced to the inclusion in the labor force of the partly retired, a classification that is not part of the standard definition of those in the labor force for the ASEC. The two surveys indicate very similar trends for both men and women.

We also compare the estimates of wealth from the HRS with those of the SCF. The HRS dramatically underestimates the wealth of older households, missing about half of the total shown in the SCF, but the discrepancy is very concentrated at the top of the wealth distribution. When the comparison is restricted to the households below the 95th percentile of the distribution of the SCF, however, the two estimates are virtually identical.

We use information on market interest rates and the wealth values of the HRS to construct estimates of the annuitized income equivalent of the respondents' wealth and compare them with the measures of asset income reported in the ASEC and HRS estimates of money income. The use of annuity concepts eliminates the prior evidence of a declining importance of asset income. The rise in the wealth holdings of older households more than offsets the decline in market interest rates.

The second part of the study uses a statistical regression model applied to the micro data from the HRS to determine the factors that are responsible for inducing older workers to remain in the workforce for a long period of time. We identify three factors that appear to be primarily responsible for the rise between 1994 and 2010. First, the sharp fall in retiree health insurance coverage has encouraged workers to remain in the workforce in the years prior to Medicare eligibility. Second, the replacement of defined-benefit retirement plans with defined-contribution plans has reduced a major inducement for retirement, because the DB plans typically did not incorporate an actuarial adjustment for those who delayed retirement. Third, there has been a steady increase in the education attainment of older workers. The labor force participation rates of college graduates over the age of 65 are roughly twice those of individuals with less than a high school degree. Thus, the shift toward a more educated population has raised the overall rate of labor force participation.

We conclude that the increase in the labor force participation of older persons is largely a favorable development that reflects the desire by more educated and healthy members to remain in the work force. It is concentrated among individuals at the top of the earnings distribution and those with the most education. Job satisfaction has actually increased somewhat and the shift in the composition of the private pension system away from defined-benefit plans represents an important reduction in the disincentives to remain in the work force. Furthermore, we find little evidence that wealth or the income from wealth has exercise a major effect on labor market participation. Overall, we believe that the changes in the source of income of the elderly are consistent with sustained improvement in their economic well-being.

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