Just the Facts On Retirement Issues

September 2002, Number 5

Center for retirement Research at boston college

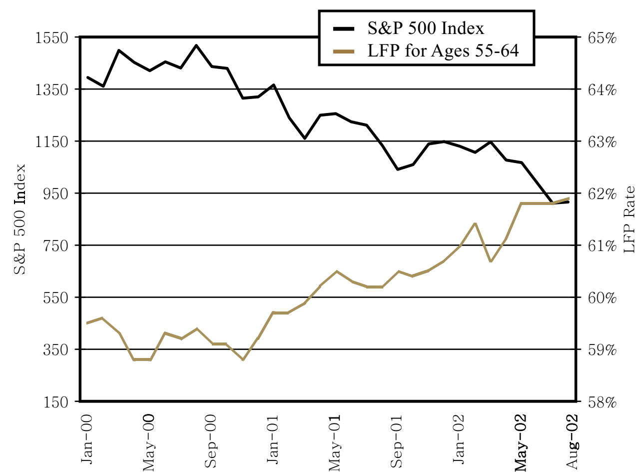
Are Older Workers Responding to the Bear Market?

By Andrew D. Eschtruth and Jonathan Gemus*

Introduction

In the past year, as the economy has weakened and unemployment has risen, the labor force participation rate for older workers (aged 55-64) has jumped by 2.0 percentage points — an increase unprecedented in post-war U.S. economic history. Recessions typically see very slow or even negative growth in labor force participation. A likely factor contributing to this dramatic change is the steep decline in the stock market that has occurred since the spring of 2000. Plunging stock portfolios may have caused some older workers to postpone retirement and convinced some early retirees to rejoin the labor force. Figure 1 shows recent trends in the stock market (S&P 500 Index) and labor force participation for older workers.

Figure 1: Labor Force Participation (LFP) for Older Workers Soars as Market Drops (2000-2002)



Source: U.S. Bureau of Labor Statistics, Current Population Survey, 2000-2002.

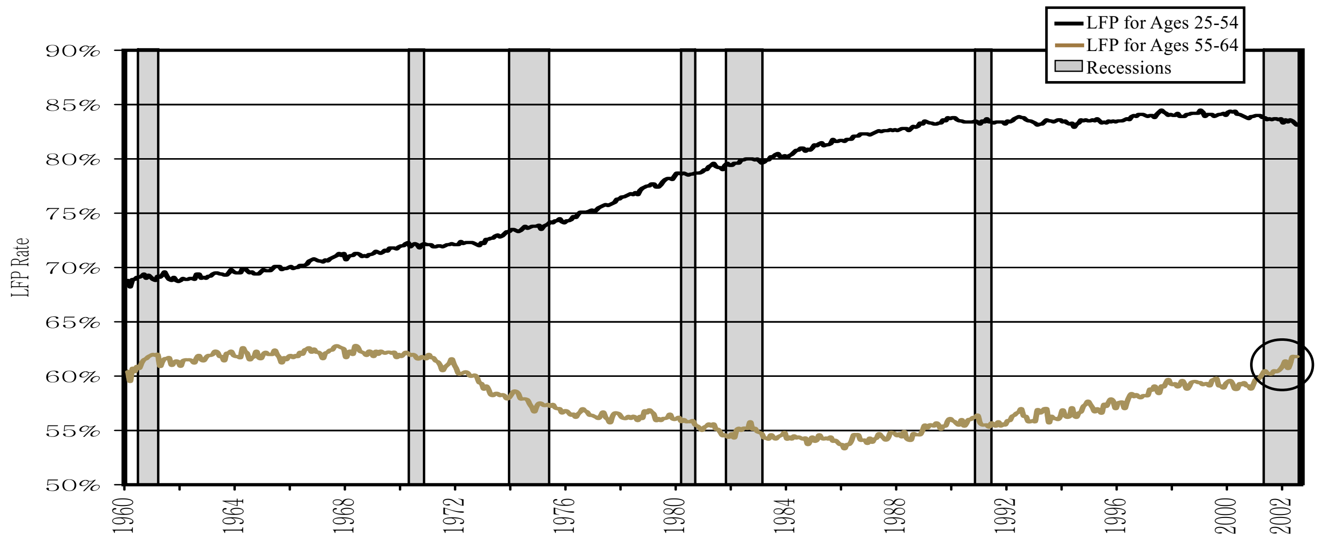
The Surge in Perspective

An examination of long-term trends shows that the share of individuals participating in the U.S. labor force grows during periods of economic expansion. When the economy enters recession, growth in labor force participation rates slows to a halt and may even reverse. Labor force participation includes both the number of people working *and the number actively looking for jobs*, so it is not influenced directly by the unemployment rate. However, when jobs are plentiful, individuals are more likely to enter the labor force and, conversely, during recessions, potential workers are more likely to be discouraged from seeking a job and, therefore, drop out of the labor force.

While the pattern described above is true for workers in general, the participation trends of younger and older workers have often diverged in recent decades (see Figure 2). First, from the early-1970s to the mid-1980s, rates for younger workers rose steadily while rates for older workers declined. This decline was largely a response to economic prosperity, which afforded more individuals an adequate standard of living in retirement through improved Social Security benefits, the creation of Medicare, more generous pensions, and growth in non-pension assets. Second, since the mid-1980s, participation rates for older workers have reversed course, rising significantly while rates for younger workers

* Andrew D. Eschtruth is the Associate Director for External Relations at the Center for Retirement Research at Boston College (CRR). Jonathan Gemus is a Research Assistant at the CRR. The authors wish to thank Gary Burtless of The Brookings Institution for helpful comments concerning the tentative nature of any conclusions about the relationship between labor force participation and stock market values.

Figure 2: Labor Force Participation (LFP) Rates Have Often Diverged Among Older and Younger Workers (1960-2002)



Source: U.S. Bureau of Labor Statistics, Current Population Survey, All Years, and National Bureau of Economic Research.

have increased more modestly. The growing participation of older workers may reflect a number of factors, such as the elimination of age discrimination rules, no further expansion in Social Security benefits, and the movement of private pensions from defined benefit plans (which typically reduce lifetime benefits for workers who retire after a set age) to defined contribution plans (which are neutral with respect to retirement age).

Although trends in labor force participation rates for younger and older workers have often diverged over the past 40 years, during economic recessions they have tended to be more similar. As Table 1 shows, excluding the most recent downturn, the typical change was a very modest growth rate of 0.2 percentage points for younger workers and a decline of 0.2 percentage points for older workers.

In the most recent recession, participation rates for younger and older workers have behaved quite differently (see Figure 3). Between March 2001 and August 2002, labor force participation among younger workers declined. Not only did it decline, but the size of the drop — 0.7 percentage points — was the largest experienced in all of the recessions since 1960. In contrast, the participation of older workers during this period actually *increased* by an even larger amount — 2.0 percentage points. The magnitude of this rise in labor force participation during a period of recession and rising unemployment is unprecedented in post-war U.S. economic history.

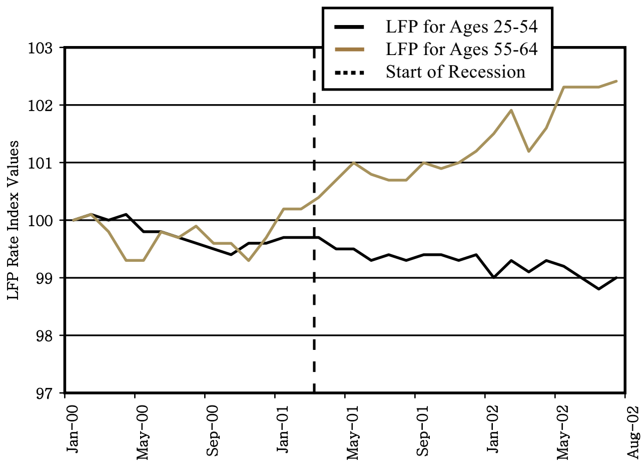
Table 1: Labor Force Participation (LFP) Typically Does Not Grow Much During Recessions

Business Cycles Peak	Trough	*LFP for Ages:* 25-54	55-64
Apr-60	Feb-61	-0.1%	1.2%
Dec-69	Nov-70	0.3	-0.3
Nov-73	Mar-75	0.5	-0.6
Jan-80	Jul-80	-0.1	-0.3
Jul-81	Nov-82	0.7	0.1
Jul-90	Mar-91	0.0	-0.1
Median Values		0.2	-0.2

Source: Authors' calculations using the U.S. Bureau of Labor Statistics, Current Population Survey, All Years.

Note: Table excludes the most recent business cycle. The peak of this cycle occurred in March 2001; no official trough has been declared yet.

Figure 3: Older Workers Outpacing Younger Workers in Labor Force Participation (LFP) (2000-2002)



Source: U.S. Bureau of Labor Statistics, Current Population Survey, 2000-2002.

Why Are More Older Workers in the Labor Force?

Why has the share of older workers active in the labor market risen markedly during a period when employment prospects have generally weakened? One influential factor — consistent with anecdotal evidence — may be the steep decline in the stock market since early 2000. During this period, individuals with significant investments in equities have seen the values of their 401(k)s, IRAs, and other holdings decline sharply. Table 2 displays the values of major market indices in 2000 and 2002. Clearly, this bear market could have had an impact on labor force decisions, convincing some workers to postpone retirement and persuading some recent retirees to rejoin the workforce.

Why hasn't this pattern been apparent during other periods in which an economic slowdown coincided with a slide in the stock market? The answer may lie in the fact that many more people are directly exposed to the risks associated with equities than in the past. This rise in equity exposure is primarily due to the trend in private pension coverage away from traditional defined benefit plans and toward defined contribution plans, specifically 401(k)s. As shown in Figure 4, among households with pension coverage, those relying solely on a defined contribution plan rose from 38 percent in 1992 to 57 percent in 1998. As workers increasingly rely on

Table 2: Market Value Declines

Index	*Market Peak (2000)*	*August 2002*	*Percentage Change (2000-2002)*
S&P 500	1,527	916	-40.0%
Dow Jones	11,723	8,664	-26.1%
Nasdaq	5,048	1,315	-74.0%

Source: Authors' calculations using on-line data from Dow Jones & Company, Inc., Standard & Poors, and The Nasdaq Stock Market, Inc.

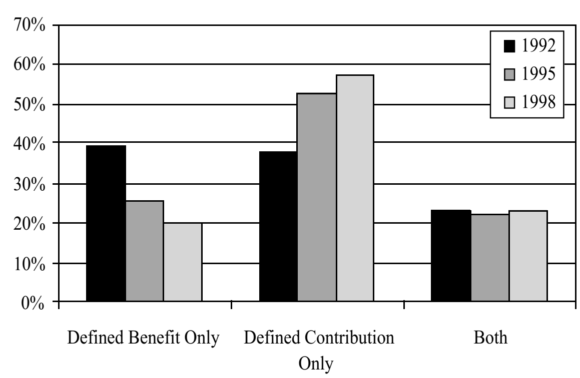
Note: For Market Peak values, S&P and Nasdaq data are from March 2000, Dow Jones data are from January 2000. At the peak of the most recent business cycle in March 2001, the values for the major stock indices were 1,160 for the S&P 500, 9,799 for the Dow Jones, and 1,987 for the Nasdaq.

401(k)s for the bulk of their retirement income, their potential vulnerability to a market downturn will continue to rise in the future.

It is important to recognize that the shift toward 401(k)s has not resulted in any fundamental change in the type of assets held by private pension plans, as both defined benefit and defined contribution plans typically hold significant shares of equities. What has changed dramatically is who bears the investment risk.

Under defined benefit plans, individual workers are largely insulated against the ups and downs of the stock market because the firm bears the risk of funding pensions, and the level of a worker's pension is typically determined by salary and years of service, not the performance

Figure 4: Pension Coverage Has Shifted from Defined Benefit to Defined Contribution Plans



Source: Authors' calculations using the U.S. Board of Governors of the Federal Reserve System, Survey of Consumer Finances, 1992, 1995, and 1998.

of the market.[1] Under defined contribution plans, the worker bears investment risks directly as pension benefits are determined by contributions to the worker's account and the earnings on the account's assets. For workers retiring during a strong bull market, such as the one experienced in the 1990s, the rewards from stock investing can be substantial. However, as is clear from recent events, it is important to understand the risks as well as the rewards when deciding how to invest.

Older workers with 401(k) plans could protect themselves from the higher risk associated with stocks by gradually shifting their holdings to lower-risk assets such as bonds. This type of shift is widely recommended by financial planners and is consistent with basic finance theory, which holds that as an investor's time horizon shrinks, more of her portfolio should be in assets that are less risky and volatile. However, in practice, investors rarely follow this approach, which means that many older workers still retain a significant share of their 401(k) assets in stocks (Ameriks and Zeldes, 2001).

Conclusion

Trends in private pension coverage have changed the environment for many older workers considering retirement. To the extent that these workers maintain a significant share of their assets in stocks, they must face a greater level of uncertainty about their retirement income. This uncertainty will likely make it more difficult for people to make decisions about when to retire and may cause some to remain in the workforce longer than they originally planned, as seems to be happening today. One way to reduce this uncertainty is for workers to gradually shift toward more conservative assets as they age, a prospect that may be more compelling for people now that the stock market bubble has burst.

References

Ameriks, John and Stephen B. Zeldes. "How Do Household Portfolio Shares Vary With Age?" Working Paper (New York, NY: TIAA-CREF Institute).

Dow Jones & Company, Inc. 2002. http://www.dowjones.com.

National Bureau of Economic Research. "U.S. Business Cycle Expansions and Contractions." http://www.nber.org/cycles.html.

Standard & Poors. Security Price Index Record. http://www.freelunch.com.

The Nasdaq Stock Market, Inc. 2002. http://www.marketdata.nasdaq.com/mr4b.html.

U.S. Board of Governors of the Federal Reserve System. *Survey of Consumer Finances*. 1992, 1995, and 1998.

U.S. Department of Labor. U.S. Bureau of Labor Statistics. *Current Population Survey*. Series ID LFS604900 and LFS603300.

[1] In addition, in the event of a firm's bankruptcy, defined benefit pensions are covered up to set limits by the Pension Benefit Guaranty Agency.

The research reported herein was performed pursuant to a grant from the U.S. Social Security Administration (SSA) funded as part of the Retirement Research Consortium. The opinions and conclusions expressed are solely those of the authors and should not be construed as representing the opinions or policy of SSA or any agency of the Federal Government, or the Center for Retirement Research at Boston College.

CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE

Fulton Hall 550, 140 Commonwealth Avenue, Chestnut Hill, MA 02467-3808

phone 617.552.1762 fax 617.552.1750 crr@bc.edu www.bc.edu/crr