

# WORKING PAPER

## *Executive Summary*

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## RECESSIONS, WEALTH DESTRUCTION, AND THE TIMING OF RETIREMENT

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A recession can affect the timing of retirement through two channels, a weaker job market and lower household wealth. The two phenomena have opposite effects. Lower aggregate demand increases the pressure on employers to dismiss workers, both young and old, and it reduces the number of new job openings, making it harder for the unemployed to find a job. On the other hand, a fall in household wealth, caused by declines in asset prices, may induce some older workers to postpone retirement and others to return to the labor force.

Our paper analyzes the competing effects of a weaker job market and falling asset values on retirement in a recession. We examine the impact of the business cycle on the take-up of social security retired-worker benefits and old-age labor force participation and employment rates using a combination of aggregate time series data and micro-census data on workers' labor force attachment. There are important differences between benefit take-up and labor force participation decisions. A worker's decision to apply for a pension cannot be treated as synonymous with the decision to retire. Some workers may plan for gradual retirement from full-time work and combine social security benefit acceptance with earnings from a full- or part-time job.

Our analysis produced a number of findings.

- The impact of a higher unemployment rate on new retired-worker awards for 62-69 year-old men is positive and statistically significant, though the initial effect of a jump in unemployment is substantially reversed in the second year. In contrast, a higher prime-age unemployment rate has little effect on the fraction of insured 62-69 year-old women who claim retired worker benefits.
- We find a noticeable impact of higher unemployment on new benefit awards to people who have just attained the early entitlement age (62). Our estimates for the combined male and female caseload suggest that a one-percentage-point rise in the prime-age unemployment rate would increase the number of Old-Age Insurance (OAI) awards made to 62-year-olds by 0.7% of the number of social-security-insured workers who are that age. Part of the increase is reversed if the rise in unemployment is sustained for another year. The effects of a sustained unemployment increase are concentrated on 62-64 year-old men. They are much smaller for women the same age and are essentially undetectable for men and women age 65 and older.
- We performed two analyses of business cycle effects on the labor force attachment of older age groups. The first is based on aggregate monthly time series analysis of labor force participation and employment rates within three age groups – 55-59, 60-64, and 65-69 year-olds – and further subdivided into male and female subgroups. We estimated statistical models of the joint effect on labor force status of the current and lagged prime-age unemployment rate, the three-year trailing real return on U.S. stocks and bonds, and the trailing real rate of house price appreciation.

- We found little evidence that the prime-age unemployment rate affects the labor force participation decisions of older women.
- The participation rate of men who are between 55 and 59 shows little responsiveness to the unemployment rate. However, among 60-64 year-old men the participation rate drops between 0.2 and 0.3 percentage points in response to a 1-point rise in the jobless rate. Among 65-69 year-old men, the estimated drop in participation ranges between 0.2 and 0.5 percentage points depending on the other variables included in the model. In the recent recession the prime-age unemployment rate increased 4.6 percentage points. Our results for men imply that this increase could have reduced the labor force participation rate by 0.8 to 1.5 percentage points among 60-64 year-old men and by 0.8 to 2.3 percentage points among 65-69 year-old men.
- The impacts of both stock and bond returns on women's labor force status are in the expected direction, but the effects are small. For example, a one-standard-deviation (10.1-percentage-point) increase in the trailing real return on stocks would only reduce 55-59 year-olds' participation rate by 0.4 percentage points, or about 1.1% of the average participation rate in the estimation period.
- The estimated effects of increased stock and bond returns on older men are usually in the expected direction, but similar to the results for women they suggest quantitatively small responses to increases or reductions in the trailing real return. For example, a 1-standard-deviation increase in the real return on stocks is predicted to reduce the labor force participation rate of 60-64 year-old and 65-69 year-old men by 0.2 to 0.3 percentage points.
- For both men and women past age 60 we find that an increase in house appreciation is associated with a small increase in labor force participation. However, this finding is reversed in our analysis of micro-census files, where we can use state-level rather than national-level estimates of house prices to measure the rate of house price appreciation.
- Our second analysis of labor force attachment is based micro-census records.
  - The results for older women uniformly show a quantitatively small and statistically insignificant impact of the unemployment rate on labor force participation. In contrast, higher national and state unemployment rates tend to reduce labor force participation among older men, and the effect is progressively larger at more advanced ages. The estimated effects are close to the ones obtained in our aggregate time series analysis.
  - The estimated effects of trailing real stock and bond returns and home price appreciation on older women's participation rates usually have the expected sign, but the impacts are typically small. A partial exception is the response of 60-64 year-old women to trailing stock returns and 65-69 year-old women to both stock and bond returns. Thus, there is some evidence that women near the normal retirement age are modestly sensitive to stock and bond returns. The results for older men show smaller and less consistent effects of trailing returns on participation rates. The effects of house price appreciation on the labor force participation of older men and women have the anticipated sign, but they are quantitatively small.

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