TESTIMONY

Encouraging Work at Older Ages

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CT-350

July 2010

Testimony presented before the Senate Finance Committee on July 15, 2010

RAND
CORPORATION

Published 2010 by the RAND Corporation
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I would like to thank the Committee for the opportunity to testify. I will address my comments to the issue of encouraging work at older ages, drawing on recently published RAND research. The economic challenges posed by an aging society are significant. As the Baby Boomers age and retire, the ratio of nonworkers to workers in the population is rising, causing society's consumption needs to outpace growth in our productive capacity, and ultimately, straining Social Security and Medicare and slowing economic growth.

The impact of population aging on our standard of living in the future depends in part on how long people choose to work before they retire from the labor force. Fortunately, here there is reason for optimism: the end of the 20th century witnessed a profound change in retirement behavior. For over a century, the labor force participation rate of men over age 65 declined. At the end of the 20th century however, the labor force participation rate of older men began to rise. The labor force participation rate of older women rose as well, following a remarkable increase in labor force participation among younger women over many decades.

Changes in the *level* of labor force participation over time can result from changes in either labor force *entry* or labor force *exit* behavior. For example, an increase in labor force entry at younger ages could lead to a higher fraction of the population employed at older ages, as could a decrease in the rate of retirement at older ages. Recent evidence favors the latter explanation. Labor force participation rates for younger men have actually fallen over time, and retirement rates are indeed lower among recent cohorts.

The most important forces behind the historical turnaround in labor force participation were rising education levels and technological change leading to less physically demanding jobs. Work at older ages is likely to continue rising in the future, but it will be propelled by different forces. Chief

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among these is the scheduled increase in the Social Security Full Retirement Age (FRA). The increase from age 65 to age 67 will not be fully implemented until 2022, when the 1960 birth cohort turns 62. Second is the restructuring of employer pension plans from traditional defined benefit pension plans with early retirement incentives to 401(k)-style pension plans that have no such retirement incentives. In addition, legal barriers to phased retirement have only recently been partially relaxed. The Pension Protection Act of 2006, while stopping short of explicit guidelines, effectively permits pension payments to employees beginning at age 62 *even if* they have not reached their plan's normal retirement age. The extent to which employers and thus employees will choose to make use of this option and its effect on total hours of work remains to be seen. On one side, greater use of phased retirement may keep older workers partially in the workforce when they otherwise would have fully retired; on the other side, a phased retirement option may lead some workers who would have kept working full-time to choose partial retirement instead.

Third, as the labor force participation rate of younger women has risen over time, more and more women qualify for Social Security benefits on the basis of their own work history, rather than their husband's. In particular, for an older woman with early-career gaps in earnings due to child rearing, the increase in earnings and pension wealth coming from another year of work could be larger than that of a same-aged man with a continuous earnings history. And importantly, when women work longer, so do their husbands. Fourth is a continued gain in life expectancy. The linear increase in life expectancy over the past 165 years shows no signs of deceleration. People will increasingly need to work longer in order to support consumption over a longer life span.

A Changing View of Retirement

As labor force participation at older ages has risen, the ways in which men and women work at older ages has been changing, too. The traditional view of retirement as a permanent and complete exit from the labor force and from a full-time job held since middle age does not describe most workers today. For many workers, an exit from the labor force after age 50 is temporary. Only 40 percent of those who stop working in their 50s and 60s stay out of the labor force; 40 percent return to work, and 20 percent pass through a period of partial retirement (part-time work following retirement). Sixty-one percent of re-entering workers change occupations, with a notable shift from managerial and professional specialty occupations to sales, administrative support and services positions. A parallel shift in industry is evident, as many individuals move from the manufacturing sector to the services sector. The prevalence of self-employment at older ages has also risen, with one in four 65-year olds working in self-employment.

Potential Challenges Ahead

Despite this good news, there are some potential challenges. On the employee side, continued progress toward better health during our longer lives will depend in part on the adoption of healthier behaviors such as less smoking, more exercise, and better diets. While on many dimensions of health, age 60 does seem to be the new 50, the well documented rise in obesity among younger cohorts portends the possibility of a reversal in the rising trend in "healthy" life-expectancy. Another potential employee-side constraint on labor supply in the future is that with increasing life expectancy, older Americans will feel the pull of family care giving responsibilities from many directions—their elderly parents, their spouse, and even their grandchildren. In deciding whether to work, older workers face tradeoffs that interestingly mimic those often faced by younger married women; the value of their alternative use of time (care-giving) is relatively high and the market may not provide a close substitute.

Even so, many older Americans would apparently like to work but cannot find jobs. Even *before* the current recession, only about one-half of older job-searchers found jobs within two years; one-third of them wanted part-time jobs, but these jobs were the hardest to find. One potential barrier on the employer side is the perception that older workers are less productive. Research in cognitive neuroscience finds that many aspects of cognition, including processing speed, long-term memory, and reasoning abilities do indeed decline from about age 20, and by some estimates, decline faster after age 60. But, other valuable skills such as emotional processing, semantic knowledge, autobiographical memory and short-term memory remain relatively stable as one ages—and the extent to which individuals can use accumulated knowledge and experience to compensate for any limitations is not well understood. Productivity need not decline steeply with age if compensatory behavior is possible or if skills that do not decline with age are primarily used on the job. Still, evidence continues to mount that statistical discrimination, judgment based on a group's characteristics rather than the individual's, is an important factor in the hiring and retention of older workers. An experimental labor market study found that a younger woman is 40 percent more likely to be offered an interview for an entry-level job than an older woman.

Another constraint on employer demand for older workers is health care costs. As the workforce ages, its average health declines and health care costs rise. The extent to which expected health care costs depress employer demand for older workers is unknown but may be substantial. Although age discrimination laws prevent employers from varying health insurance coverage by employee age, employers are permitted to vary coverage by employment class. For example, it is legal to exclude part-time employees from coverage offered to full-time employees. Even when the employee is Medicare eligible, as long as the employer offers coverage to others in the same employment class (e.g., other full-time workers), the employer is the primary payer and Medicare is the secondary payer, paying only what the employer plan does not cover (up to coverage limits). An alternative would be to make Medicare the primary payer under all circumstances, decreasing the cost of employing an older worker relative to a younger worker but increasing Medicare's expenditures.

Even though part-time workers need not be provided health and pension benefits, employer demand for older workers may be low in part because high turnover rates among workers nearing retirement make it difficult to recoup fixed costs associated with hiring and training over a short horizon. Still, this concern applies to both part-time and full-time workers and increasingly applies to younger workers too, as the gap in expected job tenure between older and younger workers is falling. Yet another issue for employers may be the challenge of adapting production processes to accommodate the flexible, part-time work schedules desired by older workers.

Incentivizing Work at Older Ages

A key question for policy makers is how to support the forces already in motion and ease some of the challenges? As noted earlier, two types of behavior could be targeted: workforce entry (or re-entry) behavior and workforce exit behavior. Should we encourage people to delay retirement in the first place, or encourage them to retire but later re-enter the workforce in a different capacity? As an individual decides whether to enter, exit, or re-enter the workforce, he or she weighs the benefit—net compensation—against the cost—the value of foregone leisure. For an older worker, the value of foregone leisure can be high especially if retirement is expected to be a fun time in life or if family members need care. Moreover, the availability of guaranteed retirement benefits as a replacement for earnings means that the marginal value associated with a dollar of earnings is lower than it was before benefits became available.

It is likely easier to incentivize an older worker to defer retirement than to re-enter the labor force after already having left. In large part, this is because of the return to job tenure. Although the return to tenure appears to be declining, tenure is an important determinant of total compensation. Leaving a job held for a long time for a new job typically results in a wage loss (especially if the job is a part-time job), reducing the financial return associated with re-entry. Making work attractive to an older individual with guaranteed retirement benefits and whose outside option is highly valued may require firms to compete on the non-pecuniary dimensions that are valued by older workers, such as part-time hours, flexible schedules, and reduced responsibilities and work stress.

Policy options to encourage work at older ages include eliminating the remaining major work disincentive in the Social Security system, the retirement earnings test between ages 62 and the Full Retirement Age, raising the early retirement age, and formalizing phased retirement rules to encourage partial retirement instead of full retirement (while being careful not to encourage too many to choose partial retirement instead of full-time work). In addition, a growing body of evidence suggests that people do not fully understand the rules governing their Social Security benefits; policy could seek to help people understand that by taking early Social Security benefits, they lose nearly 30 percent in annuity value.

There may also be ways for policymakers to encourage employers to hire and retain older workers. But some caution is warranted here—we do not yet understand whether the biggest barriers faced by employers are with respect to the productivity of older workers, healthcare costs, high turnover rates that make it difficult to recoup hiring and training costs, or production processes that are difficult to adapt to flexible, part-time work schedules. It is also worth asking how we could attract more middle-aged women into the labor force. Despite tremendous gains in labor force participation, women continue to work at lower rates than men at all ages, they retire at younger ages than men, and they work fewer hours. Attracting a middle-aged woman into the labor force may pay a double dividend later on if it means her husband is more likely to delay retirement.

Encouraging work at older ages serves a variety of social goals, including counteracting the slowdown in labor force growth and shoring up the finances of Social Security and Medicare. As men and women extend their working lives, they enhance their own retirement income security and may ease the strain of an aging population on economic growth.

This testimony is based on RAND research reported in Maestas, N. and J. Zissimopoulos, “How Longer Work Lives Ease the Crunch of Population Aging,” *Journal of Economic Perspectives,* Vol. 24, No. 1, pp. 139–160, Winter 2010; Maestas, N., “Back to Work: Expectations and Realizations of Work after Retirement,” *Journal of Human Resources*, Vol. 45, No. 3, pp. 718–748, Summer 2010; and Zissimopoulos, J. and Karoly, L., “Labor-Force Dynamics at Older Ages: Movements into Self-Employment for Workers and Nonworkers,” *Research on Aging*; 31: 89, 2009.