Public Policy and the Labor Supply of Older Americans

Stanford G. Ross

Most of the papers prepared for this conference make clear the desirable economic effects if older Americans worked longer and spent fewer years in retirement. Despite a small upturn in labor market participation by older workers in recent years, there is substantial room for significantly greater movement in this direction. The public policy framework is a major determinant of when Americans decide to retire.[1] Both workers and employers take some account of the rules related to retirement that are present in the Social Security laws, tax laws, and regulations governing private pension plans and individual retirement savings. This paper addresses the issue of whether the current set of laws can be changed to provide fewer incentives to retire early and offer more encouragement to work longer.[2]

I. The Current Policy Regime Favors Early Retirement

The current legal and institutional framework in the United States is highly favorable to early retirement. Public policy does far less than it could to encourage older workers to stay in the labor force and firms to employ older workers. Social Security basically allows workers to retire at age 62 (which about 55 percent of Americans currently choose to do) and the vast majority (about 75 percent) do retire under Social Security before the normal retirement age of 65 years. About another 20 percent retire at age 65, and at present very few workers (about 5 percent) work beyond the normal retirement age. Moreover, Medicare benefits are provided at age 65 (and, in the case of disability, at earlier ages). Pensions and other private savings often are available at early ages, which offer

further inducement to retire earlier rather than "later." Indeed, the shift from defined benefit to defined contribution plans makes what assets are accumulated available at even earlier ages.

The Social Security system was not intentionally designed to favor early retirement. The system currently in place has resulted from a historical evolution of almost random political decisions and changing economic and societal circumstances. In 1935, when Social Security was enacted, the retirement age of 65 years was adopted without a great deal of debate or rationale, and only a small percentage of workers at that time survived beyond that age. Since the mid-1930s, life expectancies have grown steadily but the normal retirement age has only been adjusted once. In 1983, largely to help restore Social Security's financial solvency, the normal retirement age was raised to 67 years, albeit with a very long transition over 40 years. The change to age 67, which will affect birth cohorts born in 1960 and later, did not fully reflect the growth in life expectancy that had taken place over recent decades, nor was there any attempt to index the retirement age to take account of future expected gains in longevity.

In 1956, early retirement at age 62 was provided for women (and the benefit formula enhanced), but this was at a time when there were relatively few women in the labor force. Men were allowed to retire at age 62 in 1961 as a response to arguments for equitable treatment and the recession in the late 1950s. These were piecemeal benefit enhancements provided without a full appreciation of the possible long-term consequences.

Significantly, the early retirement age of 62 years was not changed in 1983, when the normal retirement age was raised to age 67. Although the possibility was considered, the increase was not seen as relevant to the system's solvency, the motivating consideration of the legislation, nor worth the political cost. In the case of early retirement at age 62, an actuarially fair reduction of the normal benefit was provided, which reduced somewhat the incentive for early retirement, as did the amendments to the retirement test and the addition of the delayed retirement credit. The labor market implications of leaving the early retirement age unchanged were not seriously addressed.

There have been recent changes in the current policy regime, making it somewhat less favorable to take early retirement. As the normal retirement age rises from 65 to 67, the benefits for early retirees are reduced.

For example, when fully phased in, the benefit at age 62 will be reduced from 80 percent of the normal benefit to 70 percent. The retirement earnings test has been liberalized so that after the normal retirement age individuals can work and retain their earnings without penalty. The law increasingly provides an actuarially fair delayed retirement credit for workers who choose to work after the normal retirement age. When fully phased in, an additional 8 percent will be provided for each additional year of work up to five years. Thus, the normal benefit can be increased 40 percent by working five years longer.

All of these provisions are in the process of being phased in, however, and, to a great extent, constitute "stealth" changes because of the lack of publicity about what is happening over the long transitions. This gradual implementation means that there are no dramatic changes at any given moment to influence behavior in a significant way. For example, if the benefit at age 70–72 years was highlighted as the "full" benefit attainable, it could be pointed out that the early benefit at age 62 is only 50 percent of that amount (rather than 70–80 percent of the normal benefit). Nonetheless, in the final analysis, even after all the presently legislated changes are fully operative, the Social Security regime will continue to be highly favorable to early retirement.

II. Possible Directions for Legislative Changes to Encourage Later Retirement

It would be possible to speed up the transitions to previously enacted later retirement ages. It would also be possible to speed up the delayed retirement credit changes. The benefit formula could also be changed to provide enhancements for continued labor force participation (wages are now indexed only to 60 years of age, and work beyond this age rarely improves a person's ultimate benefit entitlement). But the major change that could make a large difference would be to move the early retirement eligibility age from 62 to 65 years, albeit with an appropriately timed transition phase.

A change in the eligibility age for early retirement would almost necessarily have to be part of a larger package of adjustments, probably including further changes in the normal retirement age, perhaps to 70 years of age (or even beyond) to provide an appropriate structure. Other actions

might include easing the requirements for disability benefits for workers aged 62 to 65 years, and providing a significant minimum benefit for lower-wage workers and others who would be adversely affected by the changes in the early retirement age and the normal retirement age.

It would also be possible to provide tax credits for employers to hire older workers, perhaps through a remission of the employer's share of the Social Security taxes that would otherwise be imposed. Further, a tax benefit could be provided to older workers by remitting their share of Social Security taxes. Income tax credits and allowances could also be provided to employers and workers. In other words, given the political will to change the laws to encourage later retirement, it would be entirely possible to provide greatly enhanced incentives for older workers to remain in the active labor force and for employers to employ these seasoned workers.

III. Why the Prospects are Dim for Major Legislative Changes

What is the likelihood of enacting legislative developments that establish a public policy framework that is more responsive to the realities of the circumstances facing older Americans in the future and confronting the national economy?

To review the history, the Social Security program was established in the 1930s, reconstituted in the 1950s, and expanded in the 1960s and 1970s. Congress adjusted the system in the early 1980s. Yet since the disability reforms enacted in 1980 and major old-age and survivor reforms enacted in 1983, there have not been further changes with the same degree of policy significance. Despite the Social Security financing issues stemming from projected long-term deficits, which first became very apparent in the early 1990s, the political conditions for significant Social Security change have not been present for almost 25 years. The program has largely remained static while the U.S. economy and society have changed dramatically.

Since 1983, the closest we have come to a major Social Security bill was during President Clinton's second term, when he held a series of policy forums across the country and began to assemble popular support for a major reform package. These changes would have involved

restoring long-term financial stability to the traditional Social Security program while introducing the concept of an individual account system, possibly as an add-on to the traditional system with some subsidization of contributions for lower-income workers. The federal budget surpluses then projected from the vantage point of the late 1990s could have been used to help finance these changes. However, once Clinton's personal difficulties began to emerge and he became reliant on the more liberal House Democrats during the impeachment proceedings, the congressional support for such a package collapsed. Liberals would not support the addition of an individual account system and conservatives would not support changes needed to ensure the long-term financing of the traditional system. The opportunity to modernize the program and reset it for the twenty-first century was lost.

During his first term President Bush put a great deal of energy into seeking Social Security reform that would have introduced an individual account system. However, many viewed his approach as substantially undermining the traditional Social Security system, and his proposals never received the popular acceptance and broad bipartisan support in Congress that would be required for such a major overhaul. His adamant persistence after the battle was lost produced adamant opposition, with the result that individual account possibilities may have been doomed for the foreseeable future. This highly partisan experience has clearly postponed any significant opportunity for major Social Security reform until the next presidential administration, at the earliest.

It is important to understand that the problems of the current Social Security system go well beyond the issues of early retirement incentives and long-term solvency. The system has not been modernized and adapted to current societal conditions—it is a mid-twentieth century framework that does not mirror the realities of the twenty-first century. For example, family benefits for spouses and dependents need to be reconsidered in the light of the greater participation of women in the workforce, increases in the rate of divorce, and the greater diversity of family patterns. The program's entire structure and its administration need to be thoughtfully reviewed. In short, a comprehensive reform package designed to make the system sound now and in the future is in order—a challenge for some future president and Congress.

The political sensitivity of addressing the early retirement issue is particularly intense, as the reform efforts of the late Senator Daniel Patrick Moynihan (D-NY) reveal. Moynihan was the leading champion of Social Security during a long and distinguished Senate career, which culminated in his chairing the Finance Committee, which has jurisdiction over Social Security and Medicare. He developed a comprehensive reform bill during the late 1990s as he approached retirement and reflected on how to set the system on the right course for the future. The bill retained 62 years as the early retirement age, and eliminated the retirement earnings test at this age, even as it substantially raised the normal retirement age and provided for increases in Social Security taxes to restore the system's long-term solvency. Moynihan's rationale for retaining the early retirement age at 62 years was to maximize choice for individual workers, although it was apparent that based on a later normal retirement age, with the larger actuarial reduction of the early benefit, many workers taking early retirement would receive lower benefits, and that if some lived long enough, that shortfall could possibly lead to providing Supplemental Security Income (SSI) (means-tested benefits) in greater amounts.

Moynihan's bill, however, would have introduced an individual account system within the Social Security system that allowed workers to achieve more adequate benefits on an individual self-help basis. Moynihan broke with the program's traditional rationale, which had emphasized from the mid–1930s the priority of providing benefit "adequacy," in the traditional system. This was a goal that some felt had only been achieved in 1972, some 37 years after the program began, when benefits were raised substantially and indexed for inflation.

A fallacy of the Moynihan position, to my mind, is that the very workers who will opt for the early benefit are likely to be ones who cannot afford to build up supplementary individual account accumulations or will not want to do so. Furthermore, making larger numbers of workers dependent on SSI would likely undermine the program in the long run (since it could make means-testing other aspects of the program a shorter step).

Looking to an individual account system within Social Security to compensate for an inadequate benefit structure also neglects the fact that there are numerous opportunities for individual savings outside of the

Social Security program that lower income workers do not adequately utilize. While there might be some greater attraction for saving in an individual account system that is part of the Social Security system, it is far from certain how effective this solution might be, particularly for low-income workers, in a period in which the Social Security Administration manifests serious shortcomings in service delivery and government programs in general are on the defensive.

In summary, the point here is not to disparage Senator Moynihan's efforts, but to underscore the political difficulty of raising the early retirement age that is currently in place. Since this benchmark interacts with other important components of the U.S. retirement system, a comprehensive package of balanced reforms designed to better adapt the Social Security program to current socioeconomic conditions should deal adequately with all these components in order to make a later retirement age more attractive and feasible for a significant number of older workers.

The 1983 Social Security reforms and the 1986 tax reforms under President Reagan remain models for principled changes to these large systems. These reforms involved bipartisan, balanced packages, based on a great deal of preparation, and deft management of the political process over an extended period of time. While neither reform package fully realized the policy goals of their major sponsors, and the achievements of both degenerated subsequently, these efforts accomplished a great deal at the time and could have been platforms for further reform if there had been continuity in the political will for more reform. Assuming that this type of broad support and bipartisan cooperation are the fundamental political conditions necessary for any substantial future reforms of the Social Security and tax systems, the question is whether it is realistic to expect such conditions to emerge anytime soon. Currently, the partisanship in Congress and the polarized nature of political discourse makes it seem unlikely that such a consensus would emerge. Thus, it seems unrealistic to expect that in the near term a major Social Security bill might be enacted that would substantially change the incentives for older workers and employers.[3]

In truth, over the last few decades government institutions may be seen as having weakened in terms of the ability to respond constructively to societal needs. Professional expert leadership is often absent in govern-

ment and the policymaking process has given way frequently to ideological formulations and crass political calculations. Major progressive reforms are difficult to achieve and are less frequently undertaken, especially when the gains are very long term, but the political election cycle runs on a short-term schedule.

IV. Why the Prospects for Marginal Legislative Changes are More Likely

At this point in time, healthcare issues may well be the key to where the reconsideration of the public policy framework on entitlement programs develops. The costs of healthcare are rising and its accessibility is diminishing for all Americans. The costs of Medicare are rising and the Social Security cash benefit will inevitably be diminished over time as the rapidly growing Medicare Part B and Part D premiums are deducted from monthly Social Security payments. Private employers are curtailing healthcare benefits, particularly for retired workers, but employed workers are increasingly affected too. Healthcare costs are increasingly a problem in employing older workers. Pension provision has largely shifted from defined benefit plans to providing defined contribution plans, and there are increasingly generous provisions for allowing employees to take their accumulations long before retirement, often when they change jobs at relatively early ages.

All the presidential candidates presently are endorsing major healthcare reform and it seems likely that as we draw closer to the 2008 election the political imperatives for change will intensify. The Medicare Prescription Drug Improvement and Modernization Act enacted in November 2003 under George W. Bush presents many problems as it becomes more fully implemented, and undoubtedly there will be an effort to reconsider this law as part of healthcare reform. The Medicare Part D drug benefit will almost certainly need to be changed, as will many other aspects of the Medicare program.

Any legislation designed to reform how healthcare is provided in the United States will probably not thoroughly consider how such reforms might lead to workers being encouraged to stay in the labor force longer, and how this might affect firms employing older workers. Nonetheless, enacting healthcare reform clearly could provide the opportunity to change the incentives that would encourage longer working lives for many Americans. For example, to relieve the burden on employers of hiring older workers, Medicare could be made the primary (rather than secondary) payer of benefits for workers above age 65.

It is also possible, however, that additional incremental changes will tilt the U.S. retirement regime even further toward taking early retirement. Changes in the Medicare system could allow a buy-in before 65 years of age to make health insurance available to those who are not yet eligible for Medicare. It was a popular reform to eliminate the Social Security earnings test, and the earnings test could also be repealed for retirees under 65 years of age. Such a change might actually increase the number of early retirees who continue to work.

In general, it is easier to extend benefits than to curtail or eliminate these entitlements, which means that politicians seeking to do something in the field of Social Security and Medicare could well make the policy regime even more favorable to early retirement. Elderly Americans vote in larger numbers than do other age groups and are very important politically. As a result, incremental changes that favor older workers could be attractive, particularly if these reforms seem to involve manageable budgetary costs.

V. Real Events are Likely to be More Influential Than Changes in Laws, and Could Lead to Constructive Legislative Change

It seems unlikely that Social Security reform will emerge as a major legislative issue until the financing problems become even more acute than at present. Thus, the current public policy regime is unlikely to be greatly changed in the near term. The "social engineering" approaches in the 1983 Social Security Act and the 1986 Tax Reform Act are unlikely to be achieved in the near future because of a highly partisan political environment. This means that real events in the economy are more likely than any changes in the public policy framework to influence employees to retire, or encourage employers to employ older workers. Adverse changes

in prevailing economic conditions could stimulate changes in private sector behavior. If the economy falters and wealth prospects are diminished, so that individuals feel more insecure, there could be an impetus for working longer. On the other hand, if the economy continues to prosper, the stock market continues to do well, and the housing market remains relatively strong, workers may well accumulate wealth that leads to early retirement.

On the employer side, if major labor shortages emerge, perhaps because immigration is curtailed and outsourcing is restricted, firms may need to adjust to a diminished labor supply by taking steps to employ older workers that previously they might not have seriously considered hiring. Older workers are likely to want more flexibility and even part-time jobs. Here, a precedent that may be instructive is the way employers in many areas have adapted their practices to encourage women to work. In many cases, women have required more flexible work schedules and conditions of employment, including part-time opportunities at certain times in their work lives. Employment conditions can be changed if there is a desire to do so, and older workers would likely respond to encouragement from employers who provide greater incentives adapted to their particular needs.

The changing structure of the U.S. economy, which now is more oriented around industries providing services and knowledge, often involves less physically demanding labor, and this should enable older workers to stay in the workforce longer; in some instances this already seems to be occurring. It is also the case, however, that the newer 24/7 service economy often produces more stresses and strains and there can be greater worker "burn-out." In addition, some employers such as large law and accounting firms increasingly enable, and often force, their workers to retire at early ages in order to allow younger lawyers and accountants to rise within the firms. These are highly competitive fields where the firms do better by keeping their workforce young.

Another factor favoring younger workers is generational. The computer and digital revolution requires the constant learning of new skills. Older workers often have difficulty with this retooling process. It is possible that younger generations that are more computer literate, technically educated and well-trained, will find it easier to adapt and keep up with the rapidly changing technology that is at the heart of much of the contemporary economy.

All of these variables make it difficult to predict whether it will be easier for older workers to stay in the labor force longer, and for employers to better use the skills and experience that older workers can provide.

In the final analysis, changes in real economic and social conditions may lead to changes in the public policy framework as the private sector seeks legislative changes that can help it to adapt to changing circumstances. Over time the laws could be changed to enable workers to work longer and employers to employ older workers, and the economy would benefit from this increased labor supply. In other words, this could be a subject for which change is stimulated from the grassroots level, rather than by the policy establishment.

But the political will for enacting these changes does not seem present now because neither U.S. employers nor aging workers and the organizations that represent them seem particularly motivated to seek such changes. Employers and the institutions that represent their business interests seem to give priority to easing immigration requirements for high-tech workers and other prime-age workers from abroad. In fact, aging workers and the organizations that represent them often see early retirement opportunities as important to preserve and enhance. It will take a massive educational effort to ready the aging U.S. population for the economic realities they will face going forward.

Notes

1. The public policy framework is only one aspect of a complex situation, and what workers and employers actually do depends on a variety of economic and social factors. The public policy framework can be important beyond immediate pecuniary aspects in setting expectations for workers and employers. Non-pecuniary considerations appear to matter a great deal in influencing retirement behavior. There is considerable evidence that workers often make retirement decisions that are financially disadvantageous to their self-interests. Another factor is the information used in making retirement decisions is often inaccurate or incomplete. The government's role, particularly the Social Security Administration and Medicare, in providing useful information, and at times analysis and advice, is a subject that should be carefully explored.

2. The larger question of whether people should work longer at the expense of greater leisure is not addressed. For any individual, the choice between work and leisure is a personal decision. For the society as a whole, it is a value judgment. This comment simply assumes that greater productivity is a public good from an economic standpoint.

3. In a related issue, the disability system is inconsistent in its goals, unfair in its results, and uneven in its administration. Considering its $110 billion annual program cost, and $8 billion administrative cost, it is in imperative need of substantive and procedural reform. But without the fundamental conditions for major reform being present, little can be expected to happen legislatively.

The Seven Deadly Sins in Aging Policy and Research: A Cautionary List for Policymakers and Prognosticators

C. Eugene Steuerle

Pride, envy, gluttony, lust, anger, greed, and sloth—theologians tell us that we become better people by examining these sources of failure.

But my concern here is not with the classic seven deadly sins, but what I feel are the contemporary seven deadly sins being committed in current policy and research on aging. Reflecting on them likewise provides some warning signs for us acting as policymakers, researchers, or prognosticators.

I am not, of course, going to accuse any particular person of committing the sins I am about to discuss, since I am well aware of the Biblical injunction that only one who is without sin in these matters is allowed to cast stones. More to the point, these shortcomings, some of omission and some of commission, are social sins: these overlay the macroeconomic debate on aging even when some of us researchers and policymakers claim personally at a micro-level to have avoided them. Finally, I am sure that some of you have different religious training, and will decide that some of what I label "sins" are actually virtues.

Deadly Sin # 1: Giving Too Little Attention to the Labor Side of the Aging Debate

The first deadly sin is paying too little attention to the labor (as opposed to capital) side of the aging debate. By listing this first, I am obviously preaching to the choir assembled here. I congratulate Cathy Minehan, Bob Triest, and their Boston Fed colleagues for their leadership in taking on this most important, yet usually neglected, issue in the aging policy debate.