

Trends and Cycles in Labor Force Behavior: Are Older Workers Different from Everyone Else?

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Abstract

Labor force participation (LFP) behavior at older ages has many distinctive features, but some analysts argue that the most important driving forces behind trends in LFP at older ages are broad economy-wide trends that affect all age groups, such as rising economic returns to skill. But LFP trends for men have diverged by age in recent years, with LFP *rising* at older ages and *falling* at younger ages. This paper assesses whether recent trends in LFP at older ages are closely related to broader trends affecting the labor market, or are specific to older ages. We focus on three main issues: Can observed differences in trends by age be explained by age-related demographic composition effects, specifically race, ethnicity, education, and marital status? How has the “Great Recession” affected unemployment incidence and duration by age? How have reforms to old age Social Security affected enrollment in Social Security Disability Insurance?

1. Introduction

In an often-cited article, Perrachi and Welch (1994) summarize empirical findings from their analysis of labor force behavior of older workers as indicating that “the forces shaping employment for younger men do not appear to be fundamentally different from the forces determining the participation behavior of the oldest.” (Page 238). On the basis of this evidence they argue that

“the search for explanations of trends in the labor force behavior of older people should primarily emphasize the larger question surrounding participation in general, and only secondarily should the peculiarities of advancing age be addressed. ...we believe that the retirement literature is too specialized. Obviously, old age has its distinguishing aspects, but it seems that the major trends in the data cannot be attributed to them.” (p. 212).

To economists who specialize in the study of labor force behavior of older individuals, these recommendations may seem strange. Workers rarely withdraw permanently from the labor force

in their prime working years, but the great majority of workers do exactly this at older ages. Older workers often leave the labor force around the time at which they become eligible for old age Social Security benefits, or benefits from an employer-provided pension, or health insurance coverage from Medicare. Obviously, these institutions were created precisely to deal with the “distinguishing aspects” of old age, and there is abundant evidence that the labor force incentives embedded in these programs influence labor force behavior (as well as other behaviors, such as saving).

Nevertheless, the time trends and cyclical behavior of LFP documented by Perrachi and Welch (P&W) do in fact show many similarities across age groups. And differences in the institutional environments facing older and younger workers are not as large as one might think. The major social insurance program available to prime age workers who wish to withdraw from the labor force is Social Security Disability Insurance (SSDI). SSDI is an increasingly important source of support for individuals who are deemed unable to work and are not yet eligible for retirement benefits. Recent studies suggest that SSDI is becoming a defacto long term unemployment insurance program for low wage workers (Autor and Duggan, 2006). And SSDI recipients are eligible for Medicare two years after enrolling in SSDI. Thus the case that aggregate trends in the labor market are more important than age-specific factors in explaining the behavior of older workers is not completely implausible.

P&W and others have pointed out that the characteristics of older workers who tend to retire relatively early are similar to those of workers who withdraw from the labor force during the prime working years: poor health, low education, black, and for men, unmarried. Not coincidentally, these characteristics are associated with low wage rates. The opportunity cost of

withdrawing from the labor force is relatively small for low-wage workers, regardless of age. Older low-wage individuals face an especially low opportunity cost of labor force exit, thanks to progressivity of the Social Security system, because benefits replace a much higher fraction of earnings of low wage relative to high-wage workers. P&W suggest that aggregate trends such as the rising returns to skill and increased global competition deserve more attention in the retirement literature.

The last year of data used by P&W was 1990. In the two decades since 1990, there were major changes in labor force behavior at older ages. P&W noted that the long downward trend in LFP at older ages had flattened out by 1990, but since 1990 the labor force participation rate of older workers has *increased* substantially. The LFPR for men aged 65-69 increased from 24% in 1985 to 33% in 2005 (Blau and Goodstein, 2010). For men aged 60-64, the increase was from 55% to 58%. However, the LFPR of men aged 25-54 *declined* from 93.9% in 1985 to 90.5% in 2005 (Purcell, 2009).¹ The institutional environment has also changed in important ways. Social Security reforms that affected cohorts reaching their 60s during the 1990s and 2000s raised the Full Retirement Age (FRA) from 65 to 66, and increased the Delayed Retirement Credit (DRC).² Defined Benefit pension plans have become increasingly scarce in the private sector, largely replaced by Defined Contribution plans such as 401k's (Poterba, Venti, and Wise, 2007). The

¹More recent data indicate that from 2005 to 2008, the LFPR at ages 25-54 remained unchanged while participation rose from 69.3% to 70.4% for men aged 55-64, and from 19.8 to 21.5% for men aged 65 and older (Purcell, 2009).

²The increase in the FRA is equivalent to a benefit cut. The FRA was increased in two month increments from 65 to 66 for birth cohorts 1938-1943. It is scheduled to remain at 66 for birth cohorts 1944-1954, and rise from 66 to 67 in two month increments for birth cohorts 1955-1960, and remain at 67 thereafter. The DRC is the percent increase in monthly benefits per year of delay in claiming past the FRA. It increased from 3.5% for individuals who turned 62 in 1987-88 to 8.0% for individuals who turned 62 in 2005 or later. Also, the Social Security Earnings

rapid growth in labor force participation of married women that was in progress up to 1990 has continued to the present. As a result, the proportion of older married men whose wives have had significant attachment to the labor force has increased substantially, making joint labor force decisions of greater importance (Schirle, 2008).

In light of these changes, the time seems ripe for an updated analysis of trends in labor force participation across the age spectrum. The main goal of the analysis in this paper is to assess whether the major recent trends at older ages are closely related to broader trends in the labor market, or are specific to older ages. The answer to this question has important policy and macroeconomic implications. The behavior of older workers will be very influential on the economy in the next two decades, as the large baby boom cohorts move reach traditional retirement ages. Efforts to reform Social Security so as to encourage work at older ages could be counteracted if baby boomers respond to such reforms by increasing their SSDI enrollment, as occurred in response to previous reforms (Duggan et al, 2007). This would increase the already rapid growth in the SSDI program, jeopardizing its finances (Autor and Duggan, 2006). Medicare is also in serious financial trouble, so efforts to trim the Medicare rolls could be thwarted by large increases resulting from growth in SSDI enrollment.

In the first part of the analysis, we replicate and update key parts of the analysis of Perrachi and Welch. This part of the analysis uses matched and unmatched March Current Population Survey (CPS) data for the years 1968 through 2010. For this part of the analysis, the main advantages of the CPS over richer but more specialized data sets such as the Health and Retirement Study (HRS) are a longer time span and a broader age range. The main question of

Test was eliminated in 2000 for workers who have reached their FRA.

interest here is whether the similarities in time trends and cyclical behavior of LFP by age documented by P&W have dominated factors specific to older ages. The analysis focuses on trends in levels of labor force participation, as well as trends in transitions in and out of the labor market.

The second part of the paper expands the focus of the analysis to study trends in unemployment by age. Perrachi and Welch noted that cycles in labor force participation behavior were similar across ages in timing, but of smaller amplitude at older ages. Cyclical aspects were not the main focus of their analysis, and they did not analyze unemployment. An important question is whether the major recession of 2008-2009 and the continuing high rate of unemployment have had a larger impact on older workers, relative to their younger counterparts, than in previous recessions. The recession has caused dramatic increases in long term unemployment at all ages: 40% of the unemployed at the end of 2009 had been unemployed for more than six months, compared to only 20-25% in previous recessions (US Bureau of Labor Statistics, 2010). Conditional on entering unemployment, older workers have the slowest job finding rate. Anecdotal evidence suggests that earlier-than-intended claiming of SS benefits is a common response among older workers who have searched for work fruitlessly and exhausted UI benefits (Columbus Dispatch, August 9, 2010, page A1). This part of the analysis uses monthly CPS data to measure gross flows and duration of unemployment by age, and also uses the March data to measure annual transitions from the composite state of “unemployed and not receiving OASI or SSDI benefits” to “out of the labor force and receiving OASI or SSDI benefits.”

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