WHY OLDER AMERICANS DON'T WORK

by

Richard Burkhauser and Roberta Kimmel

Retirement, to some, genuinely means the "golden years"—full-time leisure for indulging in travel, hobbies, and other pastimes that were previously limited by the constraints of employment.[1] For a considerable segment of older citizens, however, the decision to retire represents an uneasy financial compromise, marked by the onset of boredom, anxiety, and the mental strain of feeling suddenly useless to society. Recent legislation liberalizing mandatory retirement rules has been hailed as a milestone in policy that will significantly increase the employment of older persons: The 1978 Amendments to the Age Discrimination and Employment Act raised to 70 the minimum mandatory retirement age for nonfederal employees, while for employees of the federal government, age can no longer be used as the sole criterion for dismissal. But a closer look at the reasons for retirement suggests that this type of antidiscrimination policy may actually have little effect on the underlying economic incentives which induce most workers to retire "voluntarily" well before age 70.

Are Pensions Rigged Against Work?

The decline in work by older men represents a significant evolution in the American economy. In 1948, one-half of all men over 65 were still in the labor force; today fewer than one in five are at work. Since 1961, the proportion of employed men aged 62-64 has fallen from eight in ten to six in ten. These figures in themselves do not signal a problem. Indeed, our society places a high value on leisure and views it as a just reward for time spent working. The increasing segmentation of life into a period of full-time work followed by total retirement, however, has consequences that have only recently come to be questioned.

Studies of the labor market activities of older men fall into two broad categories. The first type stresses factors outside the control of individuals, such as state of health and mandatory retirement rules. These factors are undeniably important but fail to recognize the economic incentives influencing retirement decisions—the focus of the second type of study and our emphasis here. Older workers eligible for a private pension or Old Age Survivors Insurance (OASI)—the retirement program of Social Security—must weigh the consequences of continuing work and receiving wages against the consequences of accepting retirement benefits. While retirement will lead to benefit payments, OASI benefits are reduced for those who earn wage and salary income, and private pensions usually require workers to leave their jobs and in some cases restrict earnings in other jobs. In the presence of both restrictions on wage earnings and a fall in the value of a postponed pension (private or OASI), many workers reduce their hours of work or even completely retire. While this choice is voluntary, its timing is influenced by the antiwork biases of the pension system.

Richard Burkhauser and John Turner, "The Effects of Pension Policy across Life," Institute for Research on Poverty Discussion Paper no. 523-78.

Richard Burkhauser and George Tolley, "Older Americans and Market Work," *The Gerontologist* 18, no. 5 (1978): 449-453.

Related Publications:

Richard Burkhauser and John Turner, "A Time Series Analysis on Social Security and Its Effects on the Market Work of Younger Men," *Journal of Political Economy* 86, no. 4 (1978): 701-715. Also Institute for Research on Poverty Reprint no. 307.

Richard Burkhauser, "The Pension Acceptance Decision of Older Men," *Journal of Human Resources* 14, no. 1 (1979).

George Tolley and Richard Burkhauser, "Integrating Social Security into Income Policy," in George Tolley and Richard Burkhauser (eds.), *Income Support Policies for the Aged* (Cambridge, Mass.: Ballinger Publishing Co., 1977). Also Institute for Research on Poverty Reprint no. 267.

Richard Burkhauser, "An Asset Maximization Approach to Early Social Security Acceptance," Institute for Research on Poverty Discussion Paper no. 463-77.

Joseph Quinn, "Microeconomic Determinants of Early Retirement: A Cross-Sectional View of White Married Men," *Journal of Human Resources* 12, no. 3 (1977): 329-346. Also Institute for Research on Poverty Reprint no. 256.

Discrimination against work in the pension system is all too apparent. Consider a married worker aged 65 in 1978, earning $12,000 per year, who is entitled to average OASI benefits of $4,900. Because of the earnings test, continuing to work for one more year would mean a loss of $4,000 in benefits.[2] In addition, the worker must pay federal and state income tax on earnings. (OASI benefits, on the other hand, are tax-free.) Such a worker faces a true tax rate of close to 75%; he takes home only 25 cents out of every additional dollar earned. If he or she is eligible for a private pension—and the majority of male workers aged 65 or older now are—any benefits from the private pension not taken currently are usually lost. If, for example, the pension amounts to 25% of current salary, an additional $3,000 is forfeited.

It isn't surprising that older workers react to such powerful antiwork incentives by leaving their jobs. Our Social Security system, in effect, levies a special tax on work as we get older, a tax that has become increasingly significant as benefits paid through the system have increased.

The percentage of male workers aged 65-71 who are eligible for OASI benefits and have accepted them, with the accompanying constraint against work, has increased from 62% in 1955 to 90% in 1975. Since the inception in 1961 of early OASI benefits for men aged 62-64, the percentage of eligibles who have accepted the benefits has steadily risen and was at 49% in 1975.[3] The introduction of the Supplemental Security Income program (SSI) in 1974 promises to strengthen this trend. Monthly OASI benefits are reduced by an actuarial penalty when taken before age 65. However, for low-income persons over 65 the payments are, in effect, taken over dollar for dollar by SSI benefits (except for a small exclusion). This produces a potentially strong incentive for low earners to take reduced OASI benefits at age 62, since these three years of early benefits would otherwise be lost entirely.

A number of recent empirical studies using economy-wide data from the Social Security Administration offer evidence that our current pension system reduces the market work effort of older men. In addition, a detailed study of the automobile industry pension plan shows that workers responded to an early pension whose asset value fell if postponed by "voluntarily" retiring before the mandatory retirement age.

There are some private pension plans in which deferred payments are increased in an actuarially fair manner—that is, for every year a worker postpones acceptance of benefits, future benefits increase such that the expected lifetime value does not change. The Teachers Insurance and Annuity Association (TIAA) plan is one type of plan that is neutral with respect to its influence on the timing of acceptance. It does not link acceptance of benefits to the retirement decision, and furthermore it doesn't subject benefits to an earnings test.

The Life-Cycle Effect of Pensions

If the trend has been toward a shorter work life, has time in the work force at younger ages also decreased? Curiously, the work week for prime-age males declined steadily from 1900 through World War II (from 58 to 42 hours), but since the 1940s it has remained relatively stable at 42 hours—this despite the fact that real income has increased considerably. One explanation emerges when we examine the situation from a life-cycle perspective: The increase in lifetime income has increased the lifetime consumption of leisure, but leisure is now taken in a lump sum during old age. Responsibility for the lack of decline in hours worked, it can be argued, may again be placed on the pension system.

Let us look again at constraints imposed by OASI. By effectively decreasing the wage rate for work performed at older ages, the OASI earnings test (in the presence of a delayed retirement credit that is less than actuarially fair) induces workers to substitute more leisure at older ages for work at that age. Moreover, it encourages them to continually adjust to the earnings test throughout their lives by working more at younger ages. For example, a person who wishes to accumulate a given amount of assets will be pushed into working more at an earlier age in order to do so. Although the level of net wages earned at younger ages is obviously not affected directly by the earnings test, wages during that period are relatively higher than the net wages that are tax-reduced in older age. This results, we maintain, in a shift in the pattern of work over life: The higher the wage during one period of life, the greater the work in that period and the less during the other period. Thus we have the almost paradoxical result that as work has evolved from predominantly heavy toil to more skillful and cerebral tasks, we have concentrated a greater share of our work life at a younger age.

There are those who feel that the effect of Social Security and private pensions on the work of the aged is a virtue rather than a fault. By removing older persons from the labor force, it is argued, more jobs are freed for unemployed youth. But the problem of unemployment is not so simple. For one thing, federal monetary, fiscal, and social policies play a more crucial role in combating unemployment. For another, youth unemployment is in some measure tied to lack of skill and training; vacancies left by skilled labor force veterans cannot directly remedy this.

Future Directions for the Pension System

If the model of life-cycle work described here is based less on worker preference than on economic biases built into pension systems, how can this pattern be reversed? There are three main areas in which important improvements can be made.

A first step toward reducing the distortion in the system would be to abolish the OASI earnings test. In the debate over the 1977 Amendments to the Social Security Act, liberalization of the earnings test had strong support, the earnings-test-exempt amount was increased and, beginning in 1982, the test itself will not operate after age 70. In addition, a token attempt to make the delayed retirement credit actuarially fair resulted in an increase in benefits to 3% (up from 1%) for every year they are postponed beyond age 65.[4]

Another step would be to permit the same tax concessions to pensions not directly tied to a job as are currently made to job-related pensions. In 1975 Individual Retirement Annuities (IRAs) were introduced and tax restrictions on Keogh plans were greatly liberalized. These pension plans allow workers to spread taxable income across their lives in

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much the same manner as job-related pension plans, but benefit acceptance is not tied directly to leaving a specific job. Contributions to IRA plans, which are for employees not covered by group pension plans, are limited to the lesser of 15% of yearly salary or $1,500. Annual contributions to Keogh plans for the self-employed are allowed up to the lesser of 15% of yearly salary or $7,500. As the contribution limits of these plans are raised to levels more consistent with those available for other pensions, a full-fledged alternative form of pension saving is likely to develop. A recent Supreme Court decision restricts actuarial treatment of workers by sex in most firm-specific pension plans but does not prohibit differential benefits based on sex in the private annuity market.[5] If this continues unchecked it may well further encourage the use of IRAs. That decision could also unintentionally contribute more to increasing the employment of older Americans than the recent mandatory retirement law.

Finally, the liberalization of mandatory retirement rules mentioned at the outset should, together with projected increases in the proportion of older persons in the population, make firms less willing to screen employees on an age criterion alone, and could lead to the possibility of more part-time work opportunities in older age.[6] Still, it is unlikely to have much immediate impact as long as the pension system continues to discourage work at older ages.

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[2]The 1977 Amendments to the Social Security Act raised the annual exempt amount from $3,000 to $4,000 in 1978. This exempt amount will increase yearly in units of $500 until it reaches $6,000 in 1982. As the annual exempt amount increases, the loss in benefits for working OASI recipients will fall. Thus, in 1979, this same married worker will lose $3,750 in OASI benefits.

[3]U.S. Department of Health, Education, and Welfare, Social Security Administration, *1975 Annual Statistical Supplement, Social Security Bulletin* (Washington, D.C.: Government Printing Office, 1975).

[4]This article has emphasized efficiency problems in the current pension system. For a discussion of the success of OASI as a redistributive mechanism see R. Burkhauser and J. Warlick, "Disentangling the Annuity and Redistributive Aspects of Social Security," presented at Econometric Society Meetings, Chicago, August 1978; and R. Burkhauser, "Are Women Treated Fairly in Today's Social Security System?" presented at Gerontological Society Meetings, Dallas, November 1978. (Available from the authors.)

[5]*Manhart* v. *Dept. of Water and Power, City of Los Angeles, 1978.*

[6]In 1975 there were about five people in the 20-64 age bracket for every individual over 65. If this ratio remains constant while fertility rates stay at their current low levels (and even without taking rising longevity rates into account), the ratio could fall below three to one 50 years from now.

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