

# Profound Changes in Store for Labor Market

Working more years before retiring might not sound appealing to everyone. But it could be critical to the nation's future economic health.

The macroeconomic impact of population aging will depend significantly on how long people remain in the workforce as they age. That's because the decision on whether to continue working, or continuing to look for work, will affect the size of the overall labor force. In turn, the size of the labor force is a key ingredient in the economy's growth potential. Put in the simplest terms, the economy's long-term growth rate is the sum of the growth rate of labor employed plus the growth rate of the productivity of that labor.

For the moment, at least, the first part of that equation—labor force growth—doesn't look especially promising. Already slowing, the rate of labor force growth is projected to decline further as 77 million baby boomers continue moving into older

age and retirement. The oldest boomers hit 62 in 2008 and turn 70 in 2016. As large numbers of aging workers retire, there is a comparatively smaller cohort of younger workers to replenish the labor force. (See chart 1.)

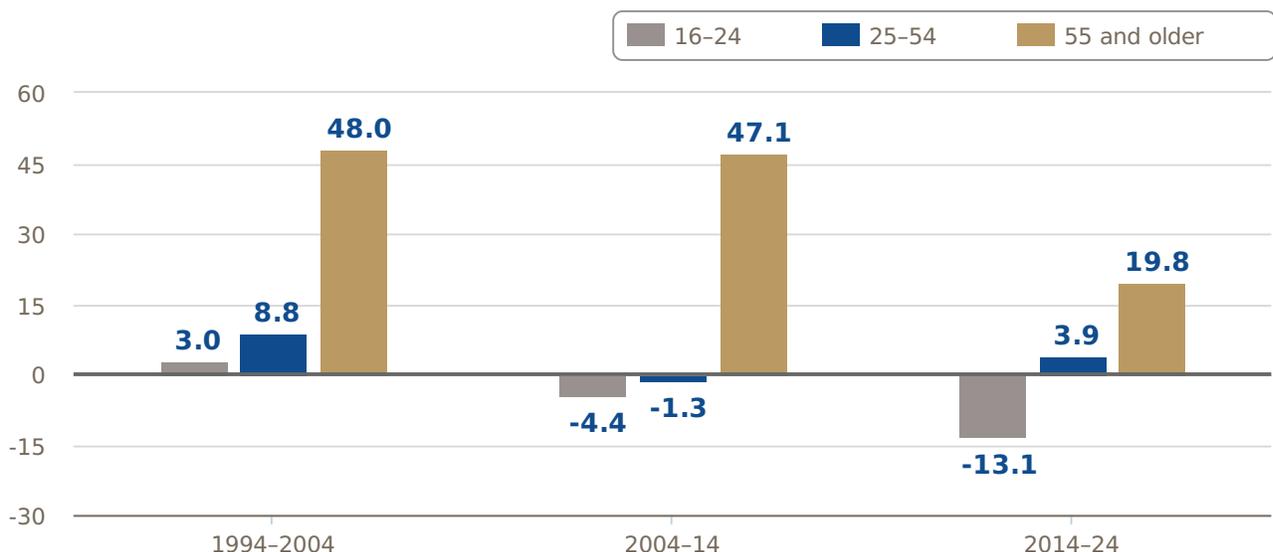
## Aging population a big reason labor force growth is already slowing

The demographic erosion of the labor force from an aging population is powerful and appears unstoppable, absent a significant change such as a large influx of immigrants or a steep decline in the rate of retirement.

Several organizations, including the U.S. Bureau of Labor Statistics (BLS) and the Congressional Budget Office (CBO),

### Chart 1 Seniority Rising

Percent change in civilian labor force by age group for 10-year periods



Source: U.S. Bureau of Labor Statistics



## More Work...

predict the labor force will expand about 0.5 to 0.6 percent a year on average between now and 2050. That's less than a third of the annual growth rate of 1.7 percent between 1970 and 2007. That slowdown is largely the result of an aging population, economists say.

Indeed, the rate of labor force growth has already slowed. That's partly because weak job prospects during the Great Recession of 2007 to 2009 pushed some discouraged job seekers out of the labor force entirely. To be counted as part of the nation's labor force, one must be working or seeking a job. While cyclical economic factors played a part, the dominant longer-term issue of population aging has accounted for more than half of the decline in labor force participation since 2007, according to the Federal Reserve Bank of Atlanta's Center for Human Capital Studies.

An aging population is not only slowing the growth of the nation's pool of workers. It could also be constraining wages. Research published in March by San Francisco Fed economists Mary C. Daly, Bart Hobijn, and Benjamin Pyle suggests that since the Great Recession, aging is partially responsible for slow growth in average wages. (Go to [frbsf.org/economic-research/publications/economic-letter/2016/march/slow-wage-growth-and-the-labor-market/](http://frbsf.org/economic-research/publications/economic-letter/2016/march/slow-wage-growth-and-the-labor-market/).)

Rising pay has been a key missing ingredient amid otherwise healthy labor market indicators during the recovery from the recession. There's no consensus explanation among economists of why growth in average wages has lagged even as unemployment has declined. But according to the new San Francisco Fed research, as higher-earning baby boomers have retired, lower-wage younger workers have taken new full-time jobs. So as lower-paid workers move into the workforce and higher-paid baby boomers retire, those two changes together have suppressed measures of growth in wages.

### Longer working lives could boost labor force

One important factor could stem at least some of the erosion of labor force growth: longer working lives.

Labor economists concur that there is untapped capacity for work among older Americans. For one, life expectancy has increased, and people have become generally healthier in their later years. A 67-year-old in 2007 had about the same mortality rates as a 60-year-old in 1977, according to *Aging and the Macroeconomy*, a 2012 book compiled by the National Research Council (NRC). Plus, most jobs today are not as physically demanding as they once were, so more older people can perform them (See [nap.edu/read/13465/chapter/1.](http://nap.edu/read/13465/chapter/1.))

Careers are already lengthening. An almost 50-year trend toward earlier retirement reversed in the mid-to-late 1990s. From 1950 through 1995, the labor force participation rate of men 55 and older dropped from nearly 70 percent to about 38 percent, according to *Aging and the Macroeconomy*. As more men began retiring later, the participation rate for men 55 and older has since moved back up to 46 percent, though it has flattened and dipped a bit in the past couple of years, the BLS reports. (See chart 2 and see sidebar, "Retirement as We Know It Is a Modern Concept.")

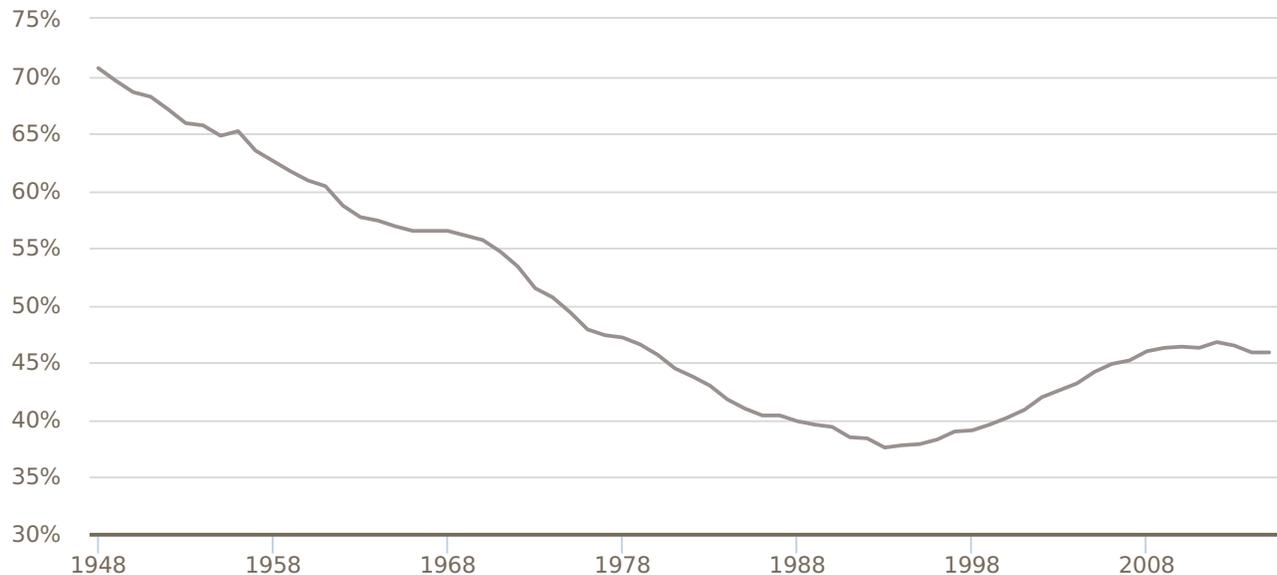
It's clear there are more older workers—partly because there are more older people in the population, and partly because of a higher rate of labor force participation. The number of employed wage and salary workers age 65 and older has more than doubled in the 21st century, from 2.97 million in 2000 to 6.41 million in 2015, according to the BLS. Nearly two-thirds of those older employees are working full-time, up from less than half in 2000. (See chart 3.)

It appears the shift toward longer working lives will last. Even as overall labor force participation is projected to keep falling, the participation of older people is widely expected to resume climbing. (See infographic on page 26.)

It's not completely clear why older people began working longer in the 1990s, according to many experts including Atlanta Fed economists Julie Hotchkiss, Toni Braun, and

Karen Kopecky. There's likely a combination of reasons. Some elderly people keep working for financial reasons, while others choose to work because they are healthy enough and

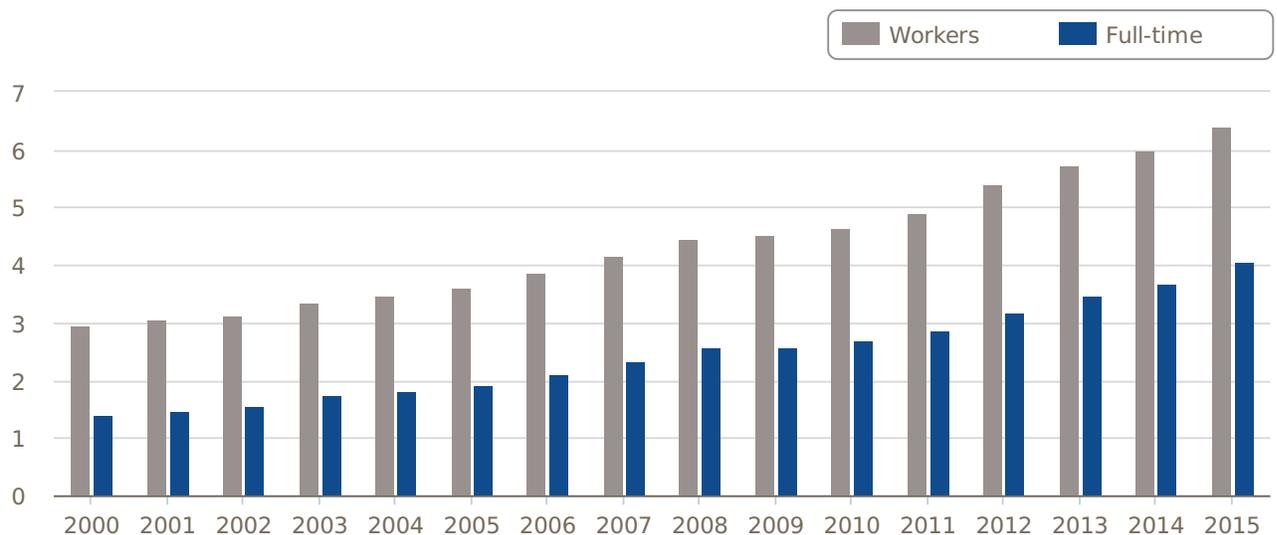
## Chart 2 Labor Force Participation Rate, Men 55 and Over



Source: U.S. Bureau of Labor Statistics

## Chart 3 Working Overtime

Employed wage and salary workers, 65 and over, in millions



Source: U.S. Bureau of Labor Statistics

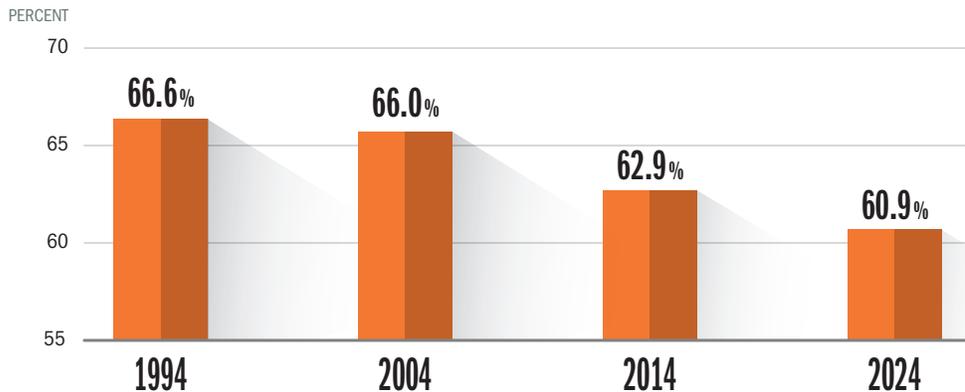
simply want to stay busy. What's more, the idea of "phased retirement," as opposed to abruptly walking away from work entirely, is becoming more common in the United States and other countries, according to the Organization for Economic Cooperation and Development's OECD Pensions Outlook 2014. (See [oecd.org/finance/oecd-pensions-outlook-23137649](http://oecd.org/finance/oecd-pensions-outlook-23137649).

htm.) Allowing workers and employers more flexibility to gradually phase in retirement is important to promote longer working lives, according to the OECD and other researchers.

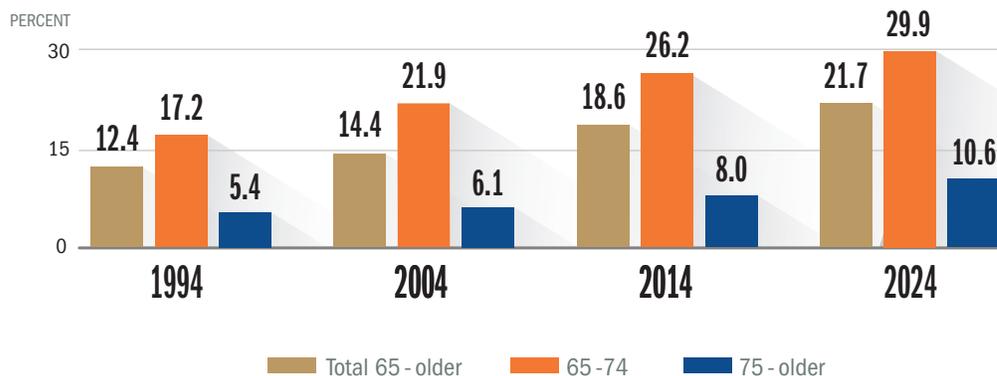
Changes in financial incentives can affect employment decisions. For example, certain tax rules and provisions in pension plans and retiree health insurance plans encourage earlier retirement and make it more costly for employers to keep older workers on the payroll. An extensive body of research indicates

that average retirement age is strongly influenced by early retirement incentives in plan provisions. For instance, public pension plans in many countries do not allow those who delay retirement to collect additional annual benefits to offset those they would have collected had they retired sooner. In the United States, however, Social Security is more "actuarially fair," as researchers term it, because if you retire later—say, at 67 instead of the current earliest eligibility age of 62—you collect more benefits each year than if you begin collecting benefits at 62.

Defined-benefit pension plans are another story. Traditional pension plans are much less common in the private sector than they used to be, but are still widespread in the public sector. In those plans, benefits generally do not go up enough to make it worthwhile to delay retirement,



## OVERALL LABOR FORCE PARTICIPATION RATE IS EXPECTED TO KEEP FALLING... BUT NOT FOR OLDER PEOPLE



Source: U.S. Bureau of Labor Statistics

according to the NRC. Thus, the advent of personal defined-contribution plans, such as 401(k)s in the 1980s, is probably one reason why older people began staying in the workforce longer in the mid-1990s, the NRC says in *Aging and the Macroeconomy*.

Another disincentive to work at older ages is a higher effective tax rate. The Social Security and Medicare payroll tax for those 60 and over is often a “pure tax” on work because older workers have often already put in the 35 years that count toward Social Security benefits, according to a 2011 paper by economists Gopi Shah Goda, John B. Shoven, and Sita Nataraj Slavov at Stanford University and the American Enterprise Institute. (Go to [nber.org/chapters/c12222.pdf](http://nber.org/chapters/c12222.pdf).) Therefore, depending on their pay, older workers may earn no incremental Social Security or Medicare benefits for staying in the workforce longer.

Employer-provided health benefits also create an implicit tax for many workers age 65 and over. If they receive health insurance from an employer with more than 20 employees, then Medicare doesn’t cover the workers. This policy is known as “Medicare as a secondary payer.” Under such circumstances, employees, along with their employer, pay for health insurance even though those workers are otherwise eligible for Medicare, according to the NRC. “This creates

another large gap between the employer’s cost of employing an older worker and the employee’s net wage,” says the NRC’s *Aging and the Macroeconomy*.

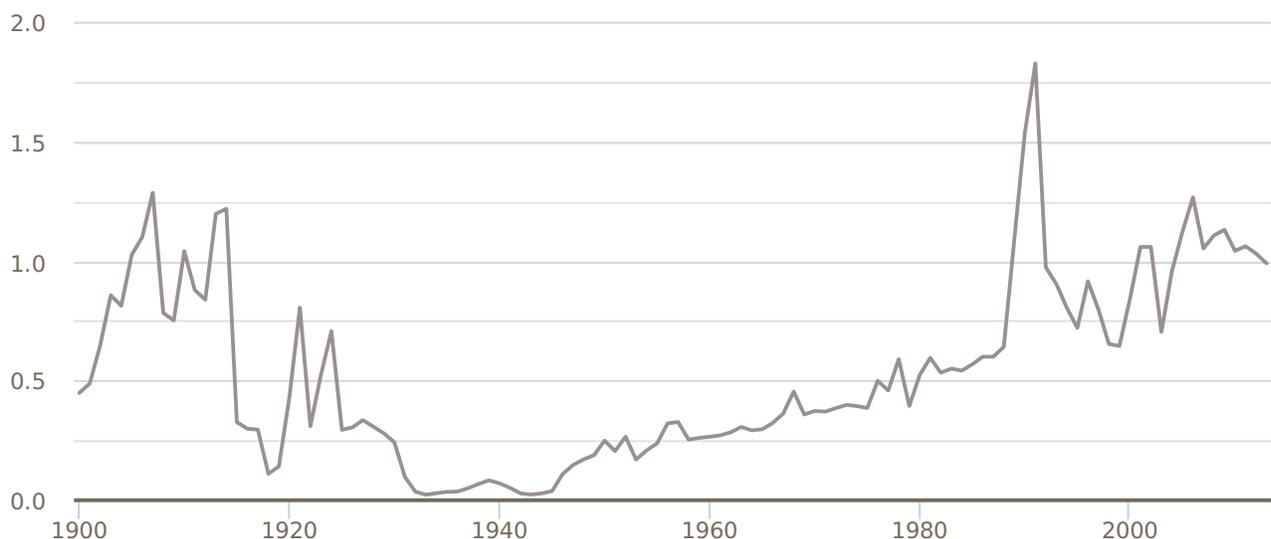
### Changing tax, Medicare policies would equate to a pay raise for older workers

Removing these extra costs would encourage workers to work longer because they would effectively get a pay raise. At the same time, employers’ costs of employing older workers would also fall. Some economists have proposed creating a new category of older workers who, having paid their share of Social Security and Medicare payroll taxes over 35 or 40 years, would no longer be subject to the tax.

The NRC book suggests eliminating the “Medicare as a secondary payer” policy by simply granting Medicare benefits to workers 65 and over regardless of whether their employer provides a health plan. That way, neither the worker nor the employer would pay for private health coverage. The worker would theoretically also see a significant increase in net wages. While these ideas might help to increase labor force participation among older citizens, thus reducing the number of people supported by social insurance, the measures might also worsen the financial positions of the Social Security and Medicare trust funds.

## Chart 4 Immigration Ebbs and Flows

Millions of persons obtaining lawful permanent resident status, 1900-2013



Source: U.S. Department of Homeland Security

Some European countries have had success with incentives aimed at encouraging workers to retire later. While the labor force participation rate of 55- to 64-year-olds in the United States leveled off around 2007 after rising over the prior couple of decades, the participation rate of this group continued climbing in several euro area nations. In the past several years, European nations raised retirement ages for pension benefits by an average of about two years and restricted early retirement eligibility. Also, Germany in the mid-2000s began instituting policy incentives for hiring older workers.

Clearly, American policymakers face difficult choices when it comes to aging and the course of the labor force and, more broadly, the macroeconomy.

### **The role of immigration in boosting labor force growth**

Although a potentially effective tool for boosting the labor force, immigration policy is particularly contentious. An increase in future immigration would effectively be an increase in the projected labor force, according to the BLS. Recent history supports that view. From 1996 to 2014, according to BLS figures, the nation's labor force increased by about 21.9 million people. (Go to [bls.gov/news.release/pdf/forbrn.pdf](http://bls.gov/news.release/pdf/forbrn.pdf)). Even though foreign-born workers are only a small share of the nation's labor force, they accounted for more than half of the increase in the labor force between 1996 and 2014. (See [bls.gov/spotlight/2013/foreign-born/](http://bls.gov/spotlight/2013/foreign-born/).)

Historically, immigration responds to labor shortages. In a 2012 paper, economists Federico Mandelman of the Atlanta Fed and Andrei Zlate of the Federal Reserve Board of Governors wrote that as business conditions in the United States improved, immigration from Mexico in particular increased. (Go to [sites.google.com/site/federicomandelmanhomepage/PaperImmRem.JME.pdf](http://sites.google.com/site/federicomandelmanhomepage/PaperImmRem.JME.pdf).) Many of the foreign-born workers then returned to their home country when job opportunities in the United States dried up, and came back again when jobs were plentiful.

However, that pattern has changed. Since the U.S. government stepped up border enforcement in 2000, many immigrant workers have chosen to remain in America even during economic downturns. They don't want to risk going home and then not being able to return to the States, according to Mandelman and Zlate.

One reason immigration is a potentially potent antidote to slow labor force growth is that immigrants tend to be young. In 2012, for example, 76 percent of foreign-born members of the

labor force were between the ages of 25 and 54, compared to 63 percent of the native-born labor force, the BLS reports. Forecasting immigration, and thus its future impact on the labor force, is fraught with uncertainty, as the Congressional Budget Office notes. Immigration numbers have fluctuated for a long time. Averaged over five-year periods, net annual immigration has ranged from nearly seven to fewer than two immigrants per 1,000 people in the U.S. population, according to the CBO's 2015 Long Term Budget Outlook. Go to [[cbo.gov/publication/50250](http://cbo.gov/publication/50250)]). Since 1970, the number of people obtaining lawful permanent resident status in the country has ranged from 373,000 in 1970 to 1.8 million in 1991, according to the U.S. Department of Homeland Security's 2013 Yearbook of Immigration Statistics. (See chart 4.) While warning of a "great deal of uncertainty" involved in long-range predictions, the CBO projects net annual immigration of 1.2 million people in 2026 and 1.3 million in 2040. That would not amount to a huge increase over recent levels. (Go to [dhs.gov/publication/yearbook-2013](http://dhs.gov/publication/yearbook-2013).)

### **Potential macroeconomic effects**

The future population of older Americans is going to grow a lot. That much is clear. Immigration would help mitigate the effect of an aging population on labor force growth. But future levels of immigration are highly uncertain. Also subject to some uncertainty is the future rate of labor force participation of older workers. Although the trend toward greater participation has actually flattened in the last few years, the BLS projects it will increase over the next decade. If this happens, longer working lives would help fuel labor force growth and, in turn, boost the macroeconomy. An increase in the number of older workers would also lower the number of retirees that workers help to support.

If older workers indeed raise their labor force participation rate, tax revenues would also rise, which could strengthen funding for public old-age support programs such as Social Security and Medicare. If longer working lives lessen the burden on elderly support programs, they might also release more resources to fund other public priorities, including education of the young.

Government policy on retirement and work incentives will have a significant effect on the future growth of the labor force. Policy decisions will also affect the degree to which immigration supports labor force growth.

# Retirement as We Know It Is a Modern Concept

Retirement as we know it is a relatively recent phenomenon.

We didn't always spend the golden years traveling, gardening, and cycling. Even though average retirement ages have been inching upward since the mid-1990s, fewer than 20 percent of Americans age 65 and older today are in the workforce.

"The United States was quite a different place in 1880, when more than 75 percent of men over the age of 65 were participating in the labor market," Federal Reserve Bank of Atlanta research economist Karen Kopecky writes in a 2011 research paper. (See [onlinelibrary.wiley.com/doi/10.1111/j.1468-2354.2011.00629.x/full](https://onlinelibrary.wiley.com/doi/10.1111/j.1468-2354.2011.00629.x/full).)

A graphic in Kopecky's paper illustrates that in 1850, only 20 percent of men 75 to 79 were retired. Of course, a smaller share of the population lived to 75 in the antebellum years. Even 100 years later, in 1950, nearly half of U.S. men age 65 and older were in the labor force, according to the U.S. Bureau of Labor Statistics. The share of senior men in the workforce fell steadily to 16 percent by 1990 before starting a gradual climb to about 19 percent today.

## Men spend 50 percent more time retired today than in the 1960s

In the big picture, though, retirement has become a more significant part of a typical American life. In the United States, the median number of years men spend in retirement increased almost 50 percent between 1965 and 2003, from 13 years to almost 19 years, according to the National Research Council's (NRC) book *Aging and the Macroeconomy*. About half of these additional years were a result of living longer and half were thanks to retiring earlier, the NRC says.

Men appear to be using those retirement years to relax. Kopecky writes that men age 55 to 64 years spend about 19 percent more time on recreation than men age 25 to 54,

whereas men 65 and older spend nearly 43 percent more time in leisure activities than men 25 to 54. (She focused her study on men because in the early years she studied, women made up a tiny percentage of the nation's workforce.)

Kopecky argues that a blend of cheaper and higher-quality leisure goods—entertainment, books, sports gear, travel, and so on—and rising real wages created the retirement culture that emerged in the 20th century. Those two forces, she writes, "have made the leisure-intensive retirement lifestyle more affordable, driving a rise in retirement."





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