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CHANGES IN THE DISTRIBUTION OF LONG-RUN EARNINGS AND RETIREMENT INCOMES—HAVE RECENT COHORTS FALLEN BEHIND?

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This study is motivated by the well-documented increase in wage inequality during the 1980s and the continued high levels of inequality during the 1990s. Specifically, we examine changes in the distribution of long-run earnings and changes in economic mobility for recent cohorts. These cohorts, who either entered retirement in the 1990s or are nearing retirement, experienced very different labor market conditions during their working lives than did earlier cohorts. Economic growth led to higher mean earnings for recent cohorts but the distribution of yearly earnings became less equal. As a result of these changes, the average worker nearing retirement had higher long-run earnings than members of previous cohorts. This, however, need not have translated into higher long-run earnings across the board. Those at the bottom of the distribution of long-run earnings might actually have had lower accumulated earnings than previous cohorts if the gains from growth were more than offset by the increase in inequality of earnings during the 1980s. If the accumulated earnings of those at the bottom of the distribution fell, then this could have had an impact both on decisions about whether to continue to work after the period of normal retirement and on Social Security benefits.

The second, and related, policy question is whether mobility has increased. If mobility has increased, then this may partially offset the impact of the increase in earnings inequality. Outcomes may be less equal, but there is less chance of being stuck with a bad outcome. Our ability to measure earnings mobility for five cohorts spanning a twenty-five-year period allows us to address this important question.

Data and Methodology

Our study explicitly recognizes that yearly earnings may be a poor measure of permanent earnings, especially if there is substantial mobility. We, therefore, use the Summary Earnings Records (SER), Detail Earnings Records (DER), and Master Beneficiary Records (MBR) which are collected by the Social Security Administration. These longitudinal data sets cover nearly half a century of reported earnings.

We group all sample members into five-year cohorts starting with those born between 1915 and 1919 and ending with persons born between 1935 and 1939. Pre-retirement earnings of members of the earliest cohort, born between 1915 and 1919, were largely unaffected by the rise in inequality during the 1980s since members of this cohort were 61 to 65 in 1980. At the other extreme, the cohort born between 1935 and 1939 was 41 to 45 in 1980. They were, therefore, in their prime earnings years during the 1980s.

We measure long-run earnings for each individual as the sum of real earnings received between the ages of 36 and 60. These data are then used to study changes in inequality of long-run earnings and changes in mobility for each cohort. We are particularly interested in changes for persons at the bottom of the distribution of long-run earnings. Did those in recent cohorts, who experienced an increase in yearly earnings inequality also experience an increase in long run earnings inequality? Was there an offsetting increase in earnings mobility?

We then turn to earnings and retirement income for these cohorts in order to see whether the cohorts who fared badly during their normal working lives also fared badly after entering their 60s. Specifically, did they have to continue to work later in life than persons in previous cohorts? Did their OASDI income partially offset the changes they experienced in labor market earnings?

Findings

Our findings can be summarized in terms of the three broad questions addressed in this study: (1) Did recent cohorts, who were in their early 40s when earnings inequality started rising, experience an increase in inequality of permanent earnings? (2) Did these cohorts experience an increase in the amount of economic mobility, which would have partially offset the increase in inequality during the 1980s? (3) How did those in the bottom of the distribution of long-run earnings fare after reaching 65? Did they end up working more? Did OASDI benefits cushion their drop in lifetime earnings?

The answer to the first question is clear. While the median permanent earnings of recent cohorts is at an all-time high, those at the bottom of the distribution lost ground. Cohorts who were in their prime earning years during the 1980s when earnings inequality started rising dramatically, experienced a real decline in the permanent earnings at the bottom of the distribution relative to cohorts born 20 years earlier.

This increase in inequality of long-run earnings did not offset the increase in inequality of earnings. The probability of leaving the lowest quintile of the distribution of long-run earnings (measured over a twelve-year span) was roughly 30 percent for each cohort we follow. Not only are these escape rates low, but most of the transitions that did occur were only to the second quintile. As a result, less than ten percent of those started in the lowest quintile moved more than one quintile.

Finally, we find that members of the most recent cohort at the bottom of the distribution of long-run earnings also had different experiences when they entered the normal retirement years. They were substantially more likely to work at age 65, which could indicate that they continued to work to compensate for their lower long-run earnings. Furthermore, those who did work had higher earnings. OASDI benefits were higher than for similar persons in earlier cohorts, but this seems to be a cohort effect.

We conclude that the long-run labor market and retirement experience of the average person in recent cohorts was considerably better than the average expericne of persons in earlier cohorts. But, as is often the case, the average experience should not be generalized to all members of a cohort. For persons at the bottom of the distribution of long-run earnings, the picture was considerably bleaker. Their long-run earnings had not grown with the median and were, in fact, not much higher than for persons born 20 years earlier. This indicates that effects of the rise in inequality of yearly income does not dissipate over the lifecyle.

It is still too early to know what will happen to this cohort in retirement. However, their labor market outcomes at 65 indicate that they are continuing to work in record numbers, even when compared to other memebers of their own cohorts. This may indicate a need to compensate for their lower earnings during their earlier working lives.

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