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THE EFFECT OF ECONOMIC CONDITIONS ON THE EMPLOYMENT OF WORKERS NEARING RETIREMENT AGE

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There has been a dramatic decline in labor force participation of older men since the early 1970s. A large literature evaluates the potential contribution of changes in pension benefits, health, wealth, and retirement preferences to explaining these trends. Yet, during the same period there have been important developments in the United States labor market, such as changes in industry decomposition and a strong decline in manufacturing employment, a rise in the returns to skill, and increases in inequality. Although these changes have potentially important implications for retirement behavior, they have found less attention in the literature.

A small but increasing literature shows that older workers are indeed particularly likely to leave employment after career shocks such as a job loss. Secular changes in the demand for low-skilled labor may thus induce large groups of older workers to seek retirement. If this is the case, retirement may become a shelter from declining labor market opportunities rather than an outcome of an ideal life plan. Such a perspective on recent retirement trends may suggest alternative policy implications relevant for ongoing efforts to keep and reintegrate older workers into the labor force.

The paper analyzes the effect of changes in labor market conditions on the employment outcomes of men nearing retirement age. Thereby, an important insight of the paper is that reduction in the demand for older workers will have particularly strong effects on employment if wages of older workers do not fall to adjust to new market conditions. This is likely to be the case since a large literature suggests older workers are covered by explicit or implicit long-term contracts; moreover, retirement benefits are based on a measure of life-time earnings and adjust only slowly to new market conditions; thus, older workers' reservation wages may be rigid. Thus, it is the interaction between rigid wages and declines in labor demand that may be able to explain declining labor force participation of older men.

A long literature in labor economics suggests that the relative demand for low skilled labor has declined since the late 1970s. Thus, if their wages are rigid, the employment of less skilled older workers should be particularly affected by changing labor market conditions. The paper begins by documenting important differences in the evolution of labor force attachment of high school and college educated workers near retirement age. The relative rate of labor force participation of college vs. high school educated workers has increased strongly for 60 to 64 year old men during the 1975 and 1982 recessions, and somewhat less during the 1990 and 2001 recessions. A similar step-wise reduction in relative labor force participation of lower skilled workers at each major recession is present for younger age groups, but the changes are of much smaller order of magnitude.

After documenting these trends in relative employment by age and skill group the paper proceeds in three steps. First, it shows that relative wages of high vs. low skilled older workers were indeed stable or trending slowly during the 1980s, a period when the relative earnings of younger high-skilled workers increased rapidly. This evidence confirms existing empirical evidence in the literature that suggests older workers' relative wages are less responsive to labor market conditions.

Second, the paper documents the effect of changes in economic conditions in the labor market on employment of older workers. To do so, it examines the effect of measures of 'shocks' in the labor market at alternative measures of aggregation. It first demonstrates that older workers are indeed at risk of large employment and wage losses at an individual career shock; second, it analyzes the timing of employment trends of older workers by skill groups in relation to business cycle trends; third, it estimates the effects on employment of economic trends at the industry and state level.

Preliminary findings support the notion that labor market shocks have an important effect on employment of older workers. First, job loss leads to much stronger reductions in employment and earnings for that age range. Second, output and employment trends at the industry and state level significantly affect employment near retirement. However, from these preliminary results it does not appear that economic shocks lead to a systematic shift of employment against older or less educated workers nor that these patterns have strengthened over time. Thus, while economic conditions do seem to matter, the preliminary results do not support a simple story based on rigidity in labor costs.

Third, the paper then evaluates a series of additional alternative explanations of the relative employment trends of older high vs. low skilled men. First, this includes a detailed discussion of the effect of wage rigidities and secular declines in labor demand for older workers. Declining earnings prospects for low educated workers should have led to increasing replacement rates of social security benefits. This should have led to an increase in the negative effect of various measures of labor demand on employment of men near retirement age has not increased over time. However, this does not seem to be the case. Similarly, the paper argues that the decline in labor force participation of older men is too episodic and concentrated around recessions to be explained by secular changes in labor demand conditions.

Second, the paper shows that the evolution in the relative supply of younger workers has not driven changes in relative employment of older workers. While a well-documented decline in the relative supply of younger college graduates has increased relative earnings of younger workers, there is no effect on relative employment of older workers. Third, changes in the industry decomposition can explain some of the decline in employment of low skilled workers, but the majority of the effect is left unexplained after adjusting for industry decomposition. Similarly, it is not any specific sector that is particularly responsible for the reduction in employment of older low-skilled workers.

The paper concludes by suggesting that permanent destruction of jobs typically held by lower skilled workers during the 1975 and 1982 recessions could possibly explain the step-wise, episodic reduction in relative employment we find. More research is required to establish why the episodic shifts we observe did lead to permanent changes in employment pattern rather then reducing employment of the older cohorts directly affected by these recessions.

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