The Government We Deserve
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HOW MIDDLE-AGE RETIREMENT ADDS TO RECESSION WOES

As the nation struggles to deal with both an unsustainable budget and an economy in need of growth, one really bad idea needs to be nipped in the bud. Expressed in various forms, the idea is that baby boomers' retirement isn't really a problem until the economy fully revives, that people in late middle age should quit to make room for younger workers, and that the multi-decade failure to adjust retirement ages for longer lives is a can we can keep kicking down the road. Let's face it: our retirement system for middle-agers is hurting us financially right now.

Bad economics, this idea in its various guises also invites a less-than-full economic recovery. The Great Recession is starting to spark notions heard in the Great Depression, when older workers were also encouraged to retire. It didn't do any good: employment rates stayed low for over a decade. It was a bad idea then, and it's a bad idea now.

The economy-wide perspective differs from the firm-level perspective: when people work more, they generate income and spend that income on goods or services—increasing not just the supply of workers, but also the demand for other jobs. Yes, a worker who hangs onto a $50,000 job might prevent someone else from taking that exact job. But that worker then spends (or invests) $50,000 on goods and services that others must produce in other jobs.

Let's put it another way. Suppose a firm in Detroit fires a younger worker, who makes unemployment claims, and an older worker, who decides to retire earlier than planned but still doesn't get counted in the ranks of the unemployed. Is Detroit any better off because the older worker lost his job, even though, unlike the younger worker, he didn't add to unemployment statistics? Of course not. They both add to Detroit's recession woes. And they both add to the "nonemployment" rolls.

How much of an issue is the retirement of older workers? In the short run, it's less important than job losses due to the collapse of the financial and housing markets. Longer run, however, it may be far more serious. If people simply retire at the same ages over the next 20 years as they do today, then the employment drop is equivalent to an increase in the unemployment rate of close to one-third of 1 percent every year. Two decades or so from now, the increase in nonemployment would have about the same effect as a 7 percentage point increase in the unemployment rate. And this increase would be permanent, not just a temporary, recession-led blip.

We don't really have to wait 20 years for the bad economic news to register either. Contrast how we got out of other recessions in earlier decades. Government deficit-led demand alone didn't do the trick. Counting both those employed and those looking for work, we also had a labor force increase of 29 percent in the 1970s, 18 percent in the 1980s, and 13 percent in the 1990s. This last decade is more of a mixed bag, mainly because of the recession, and for each of the two decades from 2010 to 2030, the Census is expecting increases of only about 7 percent. Even that projection assumes some increase in the proportion of older age groups that work. Despite many past recessions with large annual increases in unemployment, by the way, 2009 was the first year in almost six decades with negative labor force growth.

Additional labor force participants didn't just increase the supply of workers; even when they started out with meager jobs, they boosted production and income and the demand for goods and services that helped pull the nation out of past recessions. With lower labor force growth today, there's less of the extra demand that a large net increase in the workforce stokes.

Well, you might say, government can come to the rescue by making up for lost wages. To some extent, that's true. But government help doesn't stop unemployment or nonemployment from rising and taking a toll on the economy as a whole, even if that help lessens the decline in demand. In any case, nobody who does arithmetic pretends that government can run large enough deficits to continually make up for everyone's lost income. Moreover, we've hit the point where efforts at deficit reduction are going to be decreasing—certainly not increasing—government demand.

How about the effect of the international economy? Doesn't any multiplier or snowball effect—from one nonemployed person leading to another—weaken when demand can come from abroad, not just from home? True again. But, by the same token, any multiplier effect from government-created demand also shrinks. That said, the developed world shares both a slowdown in labor force growth and a recessionary slowdown in demand. In both cases, a mutual response is better than an individualized one.

My basic point is simple: when it comes to looking at recessions and the potential for renewed growth, look at the nonemployment rate, not just the unemployment rate. The first wave of baby boomers hit 62—the youngest you can get Social Security benefits—in 2008, and that downtick in labor force and employment came just as the recession began to hit. Boomer retirement may add only moderately to the nonemployment rate in any one recession year, but, unless moderated, its negative force will build steadily year after year for decades.

Encouraging work in late middle age alone won't end the recession or clean up our fiscal mess. And many of those facing nonemployment, whether older or younger, have little control over the situation. But when our elected officials delay action—for instance, continuing to encourage retirement in late middle age and failing to start dismantling barriers to work at older ages—they hurt the economy recovery now, not just economic growth over the long term.

On the positive side, my reading of the data tells me that there's a large undercurrent of demand for older workers, who have now become our largest store of underused human capital and potential. But activating that potential partly requires lowering the barriers and dams in the way. If I'm right, older workers can significantly boost economic output, increase government revenues, and add to their own incomes. Along the way, they can help us recover from recession—if we let them.

The Government We Deserve is a periodic column on public policy by Eugene Steuerle, an Institute fellow and the Richard B. Fisher Chair at the nonpartisan Urban Institute. Steuerle is also a former deputy assistant secretary of the Treasury. The opinions are those of the author and do not necessarily reflect those of the Urban Institute, its trustees, or its sponsors.