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Retirees Replaced by Lower Paid Weigh on Growth: Economy

By Steve Matthews - Oct 30, 2013

Retired Ford Motor Co. worker Tony Fransetta scrimps on every expense after earning about a third of his previous pay since leaving the auto company in 1990.

“There is no magic bullet,” said Fransetta, 77, who lives in Wellington, Florida, near West Palm Beach. “I have cut vacations and travel. You have to manage your food very closely. You don’t go out and buy expensive cuts of beef. You have to catch things on sale.”

As millions of baby boomers join Fransetta in retirement, income growth will provide less oomph for the economy in the next 20 years. The labor force that remains will include a growing share of workers with less earning power. Together, the trends will act as a brake on consumer spending, limiting the economy’s long-term growth potential.

“If we don’t change, we are grinding to a halt,” said James Paulsen, the Minneapolis-based chief investment strategist at Wells Capital Management, which oversees about $340 billion of assets. “The capability of the economy, its potential to grow, is far less.”

Decades of accelerating earnings ended in the last recession, and the outlook for a return to the growth rates of the past is less than promising as more Americans reach retirement age.

The bottom line for the economy is long-term growth of about 2 percent over the next two decades, down from 3 percent in the late 1990s, according to Dean Maki, the New York-based chief U.S. economist for Barclays Plc and a former economist at the Federal Reserve.

Fed’s Research

Fed officials also are seeking to determine how demographic changes are affecting the outlook for the labor market and the economy. As more workers retire, smaller advances in payrolls will be enough to hold the unemployment rate steady. Researchers at the Fed Bank of Chicago projected in June the jobless rate will stabilize with job gains of about 80,000 a month, rather than earlier estimates of 100,000 to 150,000.

"This has ramifications for the potential speed at which the economy can grow in the future," the researchers wrote.

Making matters worse is a slowdown in the birth rate. Fewer than 4 million babies were born in 2012, near a 14-year low, according to the National Center for Health Statistics.

Such trends have prompted the Fed to reduce its estimates for the economy. The Federal Open Market Committee at its meeting in September projected long-term growth of 2.2 percent to 2.5 percent, down from as much as 2.8 percent in its November 2010 forecast. Policy makers completing a two-day meeting today decided to press on with $85 billion in monthly bond purchases, saying they need to see more evidence that the economy will continue to improve.

Income Hit

Americans' mean income peaks at about age 55. Those 70 and over earn about a third less than peak income, and those over 80 earn about half, according to estimates by economists Richard Burkhauser of Cornell University in Ithaca, New York, and Jeff Larrimore of the U.S. Congress's Joint Committee on Taxation.

"Income drops sharply for many people after retirement," said demographer Mark Mather, associate vice president for U.S. programs for the Population Reference Bureau in Washington. "An aging population can reduce average household income because you will have a greater share of the population making less money."

Younger people who follow retirees in the work force may be less inclined to start new businesses that would contribute to higher productivity, said Edmund Phelps, professor at Columbia University in New York and winner of the Nobel Prize in Economic Sciences in 2006.

Phelps Book

"We really have to have a national conversation on the tremendous slowdown in innovation," said Phelps, author of a new book titled "Mass Flourishing: How Grassroots Innovation Created Jobs, Challenge, and Change."

"Young people feel the pull of family and friends more than in the 19th century where there was strong pioneering spirit and the advice was 'Go west, young man.'"

"There has been a devaluation of achievement and an increased emphasis on just hanging out," Phelps said. Government regulations that protect existing industries have also discouraged new entrants, he said.

Baby boomers started turning 65 in 2011, and every day for the next 16 years, about 10,000 more will hit the age that historically has been associated with retirement, according to the Pew Research Center in Washington. An estimated 19.8 percent of the population will be 65 and older in 2030, compared with 12 percent in 2000, according to projections by the U.S. Census Bureau.

Demographic Shift

The demographic shift will reduce median-income growth by 0.5 percentage point a year through 2030, Burkhauser and Larrimore said in an August 2013 paper released by the Russell Sage Foundation of New York, which funds research in the social sciences.

That would be a further drag on household budgets that took a hit during the recession. Median household income dropped 8.3 percent to $51,017 in 2012 from the end of 2007, when the economic downturn began, the Census Bureau reported last month. In the decade ended in 2003, incomes climbed 10.6 percent after a 6.8 percent increase in the 10 years through 1993.

The proportion of those living in poverty was 15 percent in 2012, little changed from the previous year, the Census Bureau reported Sept. 18. The poverty rate remains 2.5 percentage points higher than in 2007.

"Consumer spending is not going to grow as rapidly as it once did," said John Lonski, chief economist at Moody's Capital Markets Research Group in New York.

Next iPhone

Older Americans with jobs will probably earn less money, and those in retirement will be "much more conservative" in their shopping habits, he said.

"They are less inclined to be slaves to fashion like younger people," he said. "They will not be in line for the next iPhone."

Baby boomer Myron Wettrich, who retired from the U.S. Centers for Disease Control and Prevention in 2008, said he knows "that day will come" when he and his wife Mary have to cut back. In the meantime he has taken a part-time job as a personal trainer to earn "a few extra bucks" and stay in shape for triathlon competition.

"I don't want to outlive our money," said the 64-year-old from Naples, Florida.

Earnings Gap

Expected increases in the black and Hispanic share of the population could also limit median income growth unless the earnings gap with white Americans closes, Burkhauser and Larrimore said in their paper.

Minorities, mostly black and Hispanic, will account for about 35 percent of the population in 2030, up from about 29 percent in 2010, according to U.S. Census projections.

Minority incomes have been about 60 percent of those of whites, which Burkhauser said probably stems from "lower levels of education and training." Blacks' earnings have remained around 59 percent to 62 percent of whites' since 1979, while the income gap for Hispanics has widened, Larrimore said.

"Racial economic inequality is a serious barrier for the country," said Dedrick Muhammad, senior director of the civil rights group NAACP's economic department in Washington. "There has not been any progress in income inequality. If consumers don't have sustained middle-class wealth, that is going to be a huge blow to the economy."

One reason for the widening income gap among Hispanics is that "Hispanic immigration has been dominated by low-skill migrants," even as Hispanic Americans who arrived earlier have seen their earning power increase, according to Gary Burtless, a senior fellow at the Brookings Institution in Washington and former economist at the U.S. Labor Department.

Young Acculturate

"The second and third generations could see an improvement in their relative earnings as youngsters acculturate to U.S. norms with regard to language and schooling attainment," Burtless said. "However, if unskilled immigration" from Latin America "continues to run at high levels, the ratio of Hispanic to white natives' earnings could remain low."

While a larger share of minorities in the work force could restrain income growth, economists said that's not inevitable if policy makers counteract the skills gap.

Immigration Policies

Immigration policies aimed at driving labor-force growth would help, said Joseph LaVorgna, chief U.S. economist at Deutsche Bank Securities Inc. in New York.

"The only way to offset people dropping out of the labor force is to get them to work from other places," he said. The alternative is something similar to Japan, which suffers from "an aging workforce with little immigration."

If policy makers are seeking to increase incomes, they could target immigration policies at attracting the most skilled workers, said Burtless.

That, coupled with improvements in education and training programs, would help "boost average income and productivity growth," he said.

"Improve the early childhood experiences and K-12 schooling, especially of low-income kids," Burtless said. "Many, many countries do a better job at this than the U.S. If our policy makers and educators were humble enough to learn from other countries, perhaps we could improve the effectiveness of our existing schools and programs."

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