Major federal and employer policy changes may be needed if the goal is to reverse one of the strongest labor market trends witnessed to date -- the trend toward early retirement.

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Economic Incentives for Retirement in the Public and Private Sectors

Policymakers and employers are beginning to consider the ramifications of a retiree population that is expected to double by the middle of the next century.

Today's retirement patterns could change as the "baby boom" reaches retirement age. But current trends, as reflected in the declining labor force participation among those over age 55, run counter to expressed desires for more paid work beyond retirement. Despite increases in part-time work and anecdotal evidence of more second careers after retirement, the prevailing trend is still for workers to leave the paid labor force at relatively early ages, largely in response to economic incentives.

The aging of the work force will substantially increase both public- and private-sector spending for retirement income, acute health care for retirees, and long-term care. Because public-sector programs are financed from taxes, they may also have important effects on private-sector benefits. The costs of retirement and benefit packages will be viewed by employers in conjunction with their related costs in financing public spending. Together, these escalating future costs may cause employers to reevaluate the retirement incentives they offer workers.

Congress is reviewing federal and private-sector policies with an eye toward encouraging increased labor force participation by older workers. The 1983 Social Security Amendments prospectively reduce early retirement benefits and soften the benefit penalties imposed on Social Security beneficiaries under the earnings test. In 1986, legislation has been passed to reduce early retirement benefits for certain federal civilian and military retirees. Serious consideration is being given to requiring pension accruals for workers beyond age 65, and legislation to abolish mandatory retirement at age 70 is now moving through Congress. The immediate impact of halting forced retirement at age 70, however, is likely to be small because relatively few individuals over age 70 remain in the labor force. At most, an estimated 25,000 to 49,000 more men and 16,000 to 28,000 more women would have been in the labor force in 1985 had mandatory retirement been abolished.
Introduction

Although the baby boom generation has just started to turn forty, policymakers are pondering the sizable federal expenditures slated to finance the baby boom's retirement. Some employers have also started to analyze how their compensation packages can shape the future structure of their work forces and reduce the long-run costs of their retirement programs. Moreover, younger workers themselves have expressed concern about the ability of the Social Security system to pay out benefits when they reach retirement age. These issues are investigated by reviewing recent trends in retirement and analyzing potential developments that may affect retirement patterns in the future.

This Issue Brief first examines recent patterns of retirement among older workers. Because retirement is a complicated concept, several measures, including the labor force participation rate and the Social Security benefit acceptance age, are used to analyze recent trends in retirement. To understand why individuals retire, attitudes expressed by workers about retirement are compared to the response of workers to financial incentives and health limitations.

Trends in the retirement provisions of employer-sponsored pension plans are outlined to examine what incentives employers provide to encourage retirement. Most employer-sponsored plans qualify participants for retirement according to normal retirement and early retirement provisions. Periodically, employers use special early retirement options to shape their work forces.

After reviewing current conditions, the future implications of an aging work force are discussed. Public-sector projections include increased costs to the Social Security Administration's Old Age and Survivors Insurance program (retirement benefits), and increased costs to Medicare and Medicaid. Consequently, employer and employee contributions to Social Security are scheduled to increase. Direct private-sector retiree costs follow the same patterns. Pension funds will have to grow to provide retirement income in the next century. Furthermore, the costs of employer-provided retiree health insurance, which are not funded, are likely to soar. And the future costs of long-term care may increasingly become an employer concern.

Will any of these factors have an impact on retirement?

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patterns? This Issue Brief indicates current legislative interest in increasing work among the elderly through changes in Social Security provisions and tax reform. The impact of the proposed abolition of mandatory retirement is also examined. Projections of labor force participation and compensation are reviewed to determine whether forecasting models anticipate any future changes in the pattern of retirement. Costs not incorporated in forecasting models that may influence employer-sponsored programs are also discussed, including greater-than-anticipated increases in longevity which could eventually lead to changes in pension plan provisions.

Trends in Work and Retirement

One of the most pervasive labor force developments over the past few decades has been the trend toward earlier retirement. The only other labor force change of equal importance is the increase in the proportion of women working at paid employment. Because retirement is a complex life-cycle event, a combination of measures is required to understand the labor force patterns of older Americans.

Perhaps the easiest way to review the trend toward retirement is to look at labor force participation among older workers. Even over the past 15 years, participation has been declining steadily. In 1970, 83 percent of all men age 55 to 64 were in the labor force; this rate dropped to 67.9 percent in 1985 (chart 1). The participation rate for older women (age 55-64) also edged off slightly during this period -- from 43.0 percent to 42.0 percent -- in the face of a strongly rising participation-rate trend among all other age groups. Few men and women over age 65 were working in 1984 -- only 15.8 percent of men and 7.3 percent of women. These rates also declined sharply from 1970.

A recent Bureau of Labor Statistics Study (Rones, 1983) indicates the strong trend away from work for men between the ages of 55 and 74 over the 20-year span between 1963 and 1983 (table 1). Labor force participation of men age 55 declined moderately from 92.8 percent in 1963, to 85.7 percent in 1983. Perhaps the sharpest shift took place at age
63. In 1963, over three-quarters of all men that age were in the labor force. By 1983, the number of workers dwindled to a minority of just under 47 percent. Many still think of age 65 as the normal retirement age. Perhaps it could be so regarded in 1963, when somewhat over half of all male 65-year-olds were working; by 1983, however, just under one third were still in the labor force. These trends are strong and pervasive.

Labor force participation rates do not indicate the specific ages at which individuals retire. The age of retirement is one of the most frequently asked questions about the retirement decision. Participation rates also provide a somewhat deceptive picture of the extent of retirement, because some individuals have never worked, and others have left the labor market at earlier ages because of disability. A complementary indicator of the trend toward earlier retirement is the decline in the average age of acceptance of Social Security benefits. In 1940, the average age of initial benefit acceptance among men was 68.8 years (chart 2). This age fell to 66.8 years in 1960 and to 63.7 years in 1982. Of course, some workers retire before they start collecting Social Security. Others continue to work after they receive benefits, particularly on a part-time basis. Persons receiving other pensions are probably most likely to retire before Social Security acceptance. Yet not all of these recipients actually stop working, particularly those at younger ages. Among persons age 45 to 54 receiving nonmilitary pensions in 1982, 44 percent were not in the labor force in 1983 (table 2). Many of these "true" young retirees probably were receiving disability benefits. Far fewer military retirees had stopped working. By age 65, however, over 80 percent of those receiving any employer-sponsored pension had left the labor force.

Along with the decrease in labor force participation among those over age 55, part-time participation has increased among those still working. In particular, a greater proportion of workers age 65 and over are now in the labor force on a part-time basis. In 1960, 70 percent of working men age 65 and over worked full-time schedules and 30 percent worked part-time. By contrast, in 1985, 53 percent of those working at age 65 and over were full-time participants and a full 47

Chart 2
Average Age of First Social Security Benefits, 1940-1982

![Chart 2](chart2.png)

percent chose part-time work. The same pattern is evident for women, with the full-time/part-time split at a 57 percent/43 percent ratio in 1960, changing to a 39 percent/61 percent split by 1985.

Worker Attitudes

The attitudes of retirees and workers toward work and retirement sometimes present confusing signals. Despite a continuing exodus from the labor force, attitudinal surveys of retirees suggest that many would like to work. In particular, a Louis Harris and Associates survey (1981) reported that 31 percent of all persons 65 years of age and over who indicated they were retired would like to have some type of work. Only 13 percent of the retirees surveyed actually were working. Current workers also report that they expect to continue working after retirement. Among the general population, 76 percent said they would still want to work for pay.

According to the same Harris survey, current workers said they planned to retire at relatively later ages. Among those age 55 to 64 in 1981, 67 percent did not plan to retire before age 65, compared to a 57 percent rate reported for comparable workers in 1974. But when men were asked what they would miss most if they retired, 42 percent said the money; 18 percent said the sense of being useful; 16 percent said the people; 9 percent said the activity; and only 7 percent said they would miss the work itself. Nevertheless, most retirees did not report looking for work despite their reported attitudes. According to an earlier Harris survey (1975), only 10 percent of retirees age 55 to 64 said they looked for a job but could not find one. Among those age 55 to 64, only 9 percent of men and 26 percent of women reported that they could not work because of lack of opportunity. Among those over age 65, these percentages were 18 percent for men and 11 percent for women. In other words, a very small percentage of those who made an effort to find work felt they were stymied for job market reasons. Many more cited poor health as the reason they did not work although they wanted to do so.

The unemployment rates for older workers, who have reported recently looking for work, have consistently been below national averages. The unemployment rate for men age 55 to 64 was 4.3 percent in 1985, compared to a national rate of 7.0 percent (chart 3). The unemployment rate for women age 55 to 64 was also 4.3 percent. Unemployment among those age 65 and older was only 3.1 percent among men and 3.3 percent among women—only a fraction of the national rates. Although those older workers who lose their jobs are likely to be unemployed longer than younger workers, their incidence
of unemployment has historically been lower than that of other workers. Studies have shown that adding the number of discouraged workers will increase the unemployment rate for persons over age 60. Still, neither unemployment nor discouragement can account for the decreasing labor force participation rates.

Economics of Retirement

Research has shown that retirement income from Social Security and employer-sponsored pensions provides a substantial inducement for retirement. Social Security entitlement has now become virtually universal among those reaching the age of benefit eligibility. Recipiency from employer-sponsored pensions has grown substantially over the past 20 years. In 1962, only 16 percent of married couples received private-sector pensions. That figure grew to 35 percent of all couples in 1984. Recipiency of government pensions among couples increased from 8 percent in 1971 to 18 percent of couples over 65 years of age in 1984.

Studies of the retirement decision usually concentrate on the choices individuals make by comparing the additional earnings from continued work to the increase in leisure activities from not working, and the income available from pensions after retirement. These studies implicitly measure the impact of how individuals value their leisure time through statistical estimates of the effects of factors such as earnings, pensions, and health status. One study by Fields and Mitchell (1984) finds that economic factors account for three-quarters of the explained variation in the choice of retirement age (defined as the worker's decision to take a pension and leave the company), while health factors only account for one-quarter of that variation. They find that workers who have more retirement income are likely to retire earlier. They also find that mandatory retirement rules do not explain the choice of retirement age, suggesting that workers make their choices primarily based on the retirement income they expect to receive over their lifetimes. These results, with their emphasis on the importance of income in influencing workers to retire, are consistent with those of other researchers.
Bazzoli (1985) examines the relative roles of income and health in the decision of workers to retire early (between ages 58 and 63 in 1968). Her study represents the most recent economic investigation of early retirement, an area that has been studied less than normal retirement. Bazzoli also finds that economic factors play a larger role than health in the decision to retire. The finding that economic factors are significant is particularly important because in the past, workers have tended to report they retired because of health reasons. Recent data indicate retirees are less likely to cite health as the reason for retirement (Packard, 1985). While this finding may be interpreted in a number of ways, the influence of economic factors on retirement may be even stronger among recent retirees.

Economic literature also has started to recognize explicitly that retirement is not necessarily a cut-and-dry decision. Gustman and Steinmeier (1984), in particular, study partial retirement, i.e., reduced work schedules and part-time work. They find part-time work is most common among older workers who have retired from their career employment and taken part-time work at new jobs. Using essentially the same data as Bazzoli, they report that between one-fourth and one-third of workers studied were partially retired between 1969 and 1975. But, they find that those with private pensions are less likely either to work full-time or partially retire, than those without pensions. Thus, while many retirees appear to work part-time at some point after leaving their main jobs, economic factors are also important in those decisions.

These studies suggest that barring poor health, economic incentives are the primary reason workers retire. Although retirees state they would like to work, they would probably need a significant salary to induce them back into the labor market. Most retirees seem to know that employers cannot meet the wages they would demand and, therefore, do not look for a job. Even part-time employment is not common within the retired population, despite the significant minority that engages in part-time work at one time or another. In other words, the combined effects of Social Security and employer-sponsored pensions have effectively provided irresistible incentives for older workers to accept a pension and spend their time in a host of other types of activities, which include travel for those with greater income and many different types of hobbies and volunteer work.

Costs and Benefits to Employers

Public policy and corporate policies have worked together to provide the income allowing employees to retire at earlier ages. While the age to receive full Social Security benefits is 65, many employees (50 percent) take advantage of the reduced benefits at age 62. Employer-sponsored pensions usually offer benefits at a normal retirement age and an early retirement age.

According to the Bureau of Labor Statistics, retirement age provisions in medium and large private-sector firms vary considerably, but that variation generally spans the 55 to 65 age range (chart 4). The most frequent normal retirement age is 65 years, but only 33 percent of all participants belong to a plan with this type of requirement. This represents a considerable shift since 1980, when a full 45 percent of plan participants faced an age-65 normal retirement age. Other participants may typically retire at earlier ages (with appropriate years of service under the plan). In 1985, 36 percent of all participants could retire with normal benefits at age 60 or 62. Fourteen percent of all pension plan participants in 1985 could retire with 30 years of service (generally) at any age. Production workers are most likely to have service-only retirement standards. In fact, in 1985, fully 20 percent of all production workers could retire at any age with generally a 30-year service requirement. This represents a considerable easing of the normal retirement option since 1980, when only 17 percent of production workers participated in plans with no specified retirement age.

Virtually all plans in medium and large firms also have early retirement provisions. By comparison to normal retirement ages, early retirement requirements have remained relatively stable. In 1985, 67 percent of all plans used age 55 as the early retirement age. Eight percent of plans had ages ranging to age 60, and 8 percent had early retirement ages of under age 55. Other early retirement options involved service requirements only or a combination of age and years of service. With normal retirement ages reduced and early
retirement prevalent, employers appear to be encouraging their employees to retire earlier than before. Another development appearing in recent years has been the greater use of special early retirement options, which provide some workers, generally in their fifties, a window of opportunity for an advantageous early retirement. According to a recent Hewitt Associates (1986) survey of 529 small, medium, and large companies, 32 percent of the responding companies reported offering some type of voluntary separation plan. In nearly three-fourths of these cases, the voluntary separation plan took the form of an early retirement window. These employers most frequently reported that the prevalent reason for such a plan was to avoid mandatory layoffs and to respond to sluggish economic conditions.

Recently, Du Pont used this approach by giving workers who volunteered to quit five years additional seniority, thus making early retirement feasible for many. The popular employee response to Du Pont's offer was similar to other companies that made their employees an advantageous offer. At Du Pont, 9,200 workers decided to retire, combined with another 2,000 from Conoco operations. Du Pont had estimated that between 4,500 and 6,500 would retire from Du Pont operations alone. Du Pont studies indicated that a significant number of employees would need to be reduced in 1985-1987. Du Pont reported it was pleased with this response to the voluntary program and with this one program was able to achieve staff reductions expected to require an additional two years. This type of oversubscription, however, could be costly for a firm underestimating the number of employee volunteers, which then would need to fill vacancies. Such firms would have to start the costly process of hiring new workers to take the place of unanticipated retirements. Observers say higher-compensated employees tend to be more likely to take advantage of early retirement windows. But training a new work force would impose additional costs upon the company. Observers also say the loss of corporate memory from a large early retirement program can be a significant, though intangible, cost to the firm.

Why Retirement and Early Retirement

Employers appear to encourage their employees to retire at normal or early retirement ages through the use of pension plans. Strong retirement incentives are found among both private-sector employers and government pension plans. While pressure for liberalized retirement age provisions may stem from the collective bargaining process in some industries, evidence suggests that employers have been interested in promoting retirement -- even without union encouragement -- to shape their work forces and enhance productivity. Certainly military pensions and those of other uniformed services are explicitly designed to encourage retirement after 20 years of service.

The most recent spate of private-sector, special early retirement windows are intended to restructure work forces of industries wanting to improve future competitive positions. Under a pension plan that is adequately funded, an employer can reduce personnel costs while minimizing the number of workers who have to be fired. For this reason, both special and normal retirement policies have been criticized as a means of forcing out employees who are no longer wanted by the firm. The alternative is not necessarily employee retention, although discriminatory firing of older workers is illegal. While early pension recipients have higher unemployment rates than others in their age groups, unemployment with a pension is preferable to unemployment without. Trends in retirement and surveys of retirees, however, do not indicate that forced retirement is prevalent. Rather, both employers and employees seem to have moved voluntarily toward earlier retirement ages.

Surprisingly, research on employer motives for encouraging retirement is inconclusive. Some have suggested that older workers are less productive than younger workers and therefore should be retired. Studies have been unable to show clear productivity losses in cognitive ability among workers of different ages that are either significant for most types of work or cannot be offset by other productivity gains. For instance, evidence of faster reflexes among younger employees is often balanced by evidence of greater prudence among older workers. Furthermore, older workers generally are not replaced by younger workers, but by workers nearer their age. Research does not indicate that legislation such as the Age Discrimination in Employment Act (ADEA), which requires

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equal pay for older workers, has resulted in accelerated retirement.

Even if productivity declines among older workers can be demonstrated, employers may adjust for those declines through the compensation package. Earnings are not necessarily highest among workers who have reached retirement age. While defined benefit pensions may accrue at a faster rate for older workers and health care costs may be higher, no iron rule suggests that older employees are paid more than they are worth. One argument put forth by Lazear (1983) suggests that workers are paid less than their worth when young and more when they are older. Lazear argues that retirement benefits act as a sort of severance pay. He assumes that employers pay workers less when they are young and more when they are older, under an implicit long-term contract. Retirement benefits ensure that the relatively higher compensation paid to older workers stops before the expected value of their lifetime output exceeds their lifetime compensation. Others have been concerned about similar issues (Wise, 1985) and suggest a number of theoretical constructs to demonstrate how employees and employers may implicitly form long-term contracts covering the entire compensation structure, including benefits, based on a long-run view of employment. No matter which labor market theory gains acceptance, however, common sense dictates that the retirement policies of most employers are consistent with their overall productivity requirements and desires of their workers. And, in general, employers will use special early retirement windows productively to restructure their work forces.

◆ The Future Benefit Costs of An Aging Work Force

Retirement patterns as we know them today could change as the baby boom reaches retirement. The aging of the work force will have a substantial impact on both public- and private-sector expenditures for retirement income, acute health care for retirees, and long-term care. Since the contributions for public-sector programs stem from taxes, public-sector expenditures also may have important secondary private-sector impacts. The costs to employers of financing their retirement and benefit packages will be viewed in conjunction with related costs imposed on employers to finance public programs. Together, these costs may cause employers to reevaluate the retirement incentives they offer workers.

Public-Sector Implications

The retirement income implications of a growing retiree population formed part of the the 1983 Social Security reform debate. Concisely, because Social Security is a pay-as-you-go system, the cost of the program is borne by current workers. In the future, the ratio of the population age 65 and over to those age 20 to 65 is expected to increase from 0.20 in 1985, to 0.30 by 2020, and 0.40 by the middle of the century. Of course, with earlier retirement, the "true" dependency ratio would be even higher. This could be balanced, however, by higher labor force participation rates among the working-age population.

In any case, with the dependency-ratio increase in mind, the 1983 Social Security Amendments specified that the trust fund be built up to partially self-finance the retirement of the baby boom generation and that Social Security's normal retirement age be slowly increased from 65 years to 67 years by the time the baby boom reaches retirement.

Public-sector implications of an aging population are even broader, as the total costs of Medicare and Medicaid will also

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increase when the baby boom reaches retirement age. Under current assumptions for the Hospital Insurance (HI) portion of the Medicare program, which helps finance hospital expenditures for the elderly, costs are scheduled to exceed contributions long before the baby boom reaches retirement, unless legislative changes are made in the program.

The Supplementary Medical Insurance (SMI) portion of Medicare, which helps finance the elderly's medical expenditures, is essentially yearly, renewable term insurance financed from premium income paid by enrollees and from income from general revenue. While the Medicare Trustee's Report (1986) concludes that the SMI program is actuarially sound, there is concern about the rapid growth in the cost of the program.

The Medicaid program pays for a substantial proportion of nursing home costs for the elderly after personal assets are
spent to meet expenses; Medicare pays only a very small portion of long-term care needs. Because the Medicaid program is financed out of general revenues and is not part of the Social Security trust fund system, future long-term costs are not estimated. Nonetheless, they are likely to be substantial.

Implications For Employers

Potential employer costs mirror those of the public sector. They include retirement income, health care costs, and the potential costs of long-term care. In addition to the direct costs of a larger retiree population for employers, Social Security payroll taxes will increase to fund the public-sector trust fund programs.

Pension Plans — The impact of a larger retiree population will be limited for retirement plans that are conservatively funded. By definition, defined contribution plans will not be affected by the growing retiree population, although retirees would need to carefully plan their expenditures for any plan that does not pay out benefits in the form of an annuity. Defined benefit plans under ERISA generally should not experience any untoward difficulties if the current degree of funding holds. Plan sponsors tend to use very conservative actuarial assumptions, adjusting for increases in longevity, plan performance, inflation, and other economic factors.

With normal retirement ages reduced and early retirement prevalent, employers appear to be encouraging their employees to retire earlier than before.

While the increase in the normal retirement age for Social Security benefit entitlement when the baby boom reaches retirement will create some additional costs for plans integrated with Social Security, the planning period is long enough for employers to gradually shift the composition of their total compensation packages to adjust for any additional pension contributions. Consequently, barring unforeseen shocks to the system, retirement benefits ought to be easily met by private-sector employer-sponsored plans. Some potential shocks are discussed later.

In contrast to private-sector employer plans, those plans sponsored by state and local government entities that are not funded could face serious financial problems, even in the absence of unforeseen events. These unfunded retirement benefits could require significant additional taxes to make up the funding gap if pension promises are to be kept when the baby boom retires.

Health Insurance — The status of postretirement health insurance benefits is quite different. National data on medium and large firms indicate that in 1985, 54 percent of retirees age 65 and over who participated in health insurance plans were promised retiree health insurance at no cost to themselves. According to a Labor Department study (DOL, 1986), employers paid an average of 58 percent of the health insurance premium of retirees over age 65 and their dependents in 1977.

Most of these retiree health benefits are not prefunded and never have been. Even if employers wished to advance-fund, the Deficit Reduction Act of 1984 (DEFRA) severely narrowed employer options by limiting deductible contributions. Employer costs for health insurance could grow substantially as the retiree population grows. DOL estimated conservatively that the accrued liability for retiree health benefits was $98.1 billion in 1983. According to an EBRI Issue Brief (October 1985) on retiree health insurance, the unfunded liabilities of individual plans could be 4 to 50 times the amount employers now pay annually for health insurance benefits. In addition, the Financial Accounting Standards Board (FASB) has published a requirement that employers disclose these liabilities in financial statement footnotes and is considering disclosure in the financial statements themselves. Without the ability to advance-fund on a tax-effective basis, employers may provide less generous benefits in order to reduce liabilities.

Furthermore, some recent court cases have held that retirees have vested rights to their health benefits that are not subject to the discretion and financial situation of the firm. These decisions represent rulings contrary to the expectations of employers providing the benefits. The implicit vesting mandated by some courts and the limitations to funding could discourage the establishment of new plans or restrict existing plans by the time the baby boom reaches retirement, particularly in conjunction with expected changes in Medicare that could raise the costs of employer-sponsored plans. The uncertainties in this area are considerable and could range from unprecedented costs for retiree health care coverage to greater
medical uncertainty and higher individually paid medical expenses for future retirees.

**Long-Term Care** --- Currently, most retiree health plans only cover acute care expenditures paralleling Medicare. Today, an estimated 6.6 million persons age 65 and over need long-term care. With the growth of the older population as the baby boom ages and life expectancy increases, the costs of long-term care will increase as well. The number of elderly in need of long-term care is projected to increase to 9.3 million by the year 2000, to 12.9 million by 2020, and almost 19 million by 2040 (EBRI Issue Brief, November 1985).

Long-term care financing is one of the most serious challenges confronting the nation. No consensus has been reached on how these costs should best be met in the future. One possibility is to encourage employers to provide a long-term care benefit as part of their future compensation package. Suggestions have ranged from employer-offered long-term care insurance to employer-based long-term care individual retirement accounts (IRAs). The way in which this future medical expense is financed may influence both employer and employee labor market responses.

◆ **Retirement and Public Policy**

In recent years federal policymakers have expressed concern about the rising government costs of programs for the elderly and the increasing tendency for still earlier retirement. One response to this concern was the increase in the age at which retirees would be eligible for full Social Security benefits through the Social Security Amendments of 1983. As a result, early retirement benefits payable at age 62 to 64 will be significantly reduced. Most analysts, however, feel that this change in the benefit structure will have a relatively small effect on the retirement age of future retirees (Fields and Mitchell, 1984).

Others have suggested that the Social Security earnings test be abolished to encourage continued labor force participation. Currently, benefits are reduced by one dollar for each two dollars¹ of annual earnings in excess of $5,760 for those under age 65. For those recipients age 65-69, this limit is $7,800. Beginning with age 70, Social Security beneficiaries can earn any amount of income without a benefit reduction. Of course, as retirees earn more income, they also continue to pay Social Security taxes. According to the Maxfield and Reno study (1985), the median monthly earnings of retirees newly entitled to Social Security benefits in 1982 were quite close to the exempt amounts under the Social Security earnings test. This finding suggests that retirees limit labor force participation to prevent benefit reduction and the implicit 50 percent additional tax on their labor.

Further concern about early retirement led the House Select Committee on Aging to request the U.S. General Accounting Office to study retirement trends and the possible impact on federal revenues. Their report, "Retirement Before Age 65: Trends, Costs and National Issues," is scheduled to be released by the House Select Committee shortly.

Tax reform also may have some impact on early retirement for at least some retirees. In the Senate version of H.R. 3838, limits on the maximum pension allowable under a defined benefit plan would be reduced for retirement earlier than age 65. For instance, the maximum annual pension a 62-year-old retiree could receive would be between $61,000 and $69,000 annually, depending on the actuarial assumptions used, compared to $90,000 allowable today. The maximum for a 55-year-old retiree would be between $27,000 and $39,000 annually, compared to $75,000 today. Given the reduction in plan retirement ages and in employee retirement decisions, these limits could affect far more higher-paid employees than previous proposals to simply reduce the maximum benefit cap. Policy proposals to limit other types of early retirement options that are not actuarially reduced are relatively easy to imagine.

Sen. John Heinz (R-PA) has introduced legislation to abolish mandatory retirement by employers for employees of any age (S. 1054). Parallel legislation was introduced in the House (H.R. 4154) by Rep. Claude Pepper (D-FL). These bills would amend ADEA, which now permits forced retirement for most private-sector employees at age 70. The mandatory retirement age had been raised from age 65 through the 1978 ADEA amendments. The House Education and Labor Committee approved H.R. 4154, after adding amendments that require DOL and the Equal Employment Opportunity Commission to study and report to Congress on guidelines for the administration and use of physical and mental fitness tests to measure the ability and competency of police officers and firefighters to perform the requirements of their jobs. H.R. 4154 will be considered by the full House shortly, and further amendments may be offered at that time.

¹ Under the 1983 Social Security Amendments, benefits will be reduced by one dollar for every three dollars of annual earnings in excess of the annual limit, beginning in 1990.
These bills are another indicator of congressional interest in lengthening the working lives of older workers. The immediate impact of the legislation, however, is likely to be small since relatively few individuals over age 70 remain in the labor force. The labor force participation rate among men age 70 and over is 10.5 percent; the participation rate for women is 4.3 percent. According to the Social Security Administration's 1982 New Beneficiary Survey, only 11 percent of recent, interviewed retirees age 66 and over felt they were affected by mandatory retirement.

Following estimates submitted by DOL (U.S. Congress, House; 1978) on the impact of increasing the mandatory retirement age from 65 to 70, EBRI estimates indicate that a maximum range of 25,000 to 49,000 more men and 16,000 to 28,000 more women would have been in the labor force in 1985 if mandatory retirement had been abolished. These figures represent a 2.5 percent increase in employment among men and a 2.2 percent increase in employment among women age 70 and over. Since these estimated labor force effects are so small, the proposed ADEA amendment primarily represents a civil rights measure to require the equal treatment of all older workers.

- Current Forecasts and Unforeseen Developments

Future demographic trends have been forecast by the Census Bureau based on current mortality assumptions. According to the Census Bureau, individuals age 65 and over are slated to increase from about 12 percent of the total population in 1985, to 13 percent as the baby boom begins to retire, and 19 percent by the middle of the next century. The so-called "old-old," those age 85 and over, will grow from 1 percent today to over 5 percent by midcentury -- accounting for 25 percent of those over 65 by 2050, compared to about 10 percent of the over-65 population today. Are these demographic trends strong enough to induce changes in employer and employee responses to the retirement decision? While this question can only be answered as the events of the next 30 to 40 years unfold, current economic models forecast little change in the trend in labor force participation among the elderly.

According to the Bureau of Labor Statistics, the labor force participation rates for older workers will continue to decline through the 1990s, to 64.5 percent for men age 55 to 64 and 13.3 percent for men age 65 and over. The labor force participation of older women is expected to remain relatively more stable. With this forecast of continued early retirement, a growing percentage of the baby-boom generation will be living on retirement income rather than earnings.

The National Institute on Aging (1984) has published forecasts based on the long-run macroeconomic model it sponsored. The most interesting results of the model are its age- and sex-specific projections of employment and compensation rates. The model takes into account

Observers report higher compensated employees tend to be more likely to take advantage of early-retirement windows. But training a new work force would also impose additional costs upon the company. Observers also say the loss of corporate memory from a large early retirement program can be a significant, though intangible, cost to the firm.

employment tradeoffs between workers of different ages. It estimates the degree to which employers will substitute relatively plentiful, and hence cheaper, baby boom workers for those smaller cohorts which precede and follow them. Wage growth and employment forecasts are determined by these interactions.

The base case simulation of the future projects the likely wage effects of different size age cohorts moving through the society. The annual rate of compensation increase will be highest for workers above age 65, at 1.72 percent per year between 1980 and 2055, exceeding the 1.5 percent average for all age groups. The rate of growth of compensation for workers age 55 to 64 is below average for the years 1980 to 2010, as the baby boom approaches retirement, and exceeds the average from 2010 to 2055. These higher rates of increase for compensation of older workers in the next century reflect, in part, the increasing demand for older workers in view of the smaller generations of younger workers.

2 This compares to an estimated range of 116,000 to 167,000 men and 41,000 to 45,000 women who would have stayed on the job if mandatory retirement had been set at age 70 rather than at age 65 in 1978 before the ADEA amendments.
These growth rates affect the ratio of hourly compensation for these older workers relative to that of prime-age workers (35 to 44 years). Despite the high rate of increase forecast, wage rates forecast for workers over age 65 are nevertheless projected to be considerably below those of prime-age employees, probably because of the prevalence of part-time employment among retirees, which usually pays less than full-time work. Hourly compensation for those in the 55 to 64 age group fluctuates from a high of 104 percent of prime-age compensation in 2055, to a low of 91 percent of prime-age compensation in 2020. In other words, the size of the aging cohort does affect wage rates over time. These wage rates also affect labor force participation rates as employers modify their demand for workers of different ages and employees decide whether or not to retire.

A number of demographers and actuaries anticipate far greater declines in mortality than most of our current forecasts incorporate. If these analysts are correct, many pension plans will find their liabilities greater than originally anticipated.

Modeling Gaps and Unforeseen Developments

Long-run models of the type cited cannot include all the factors that may influence the timing of retirement. Employer-sponsored plans will face potential increases in the costs of retiree health care, and employers or employees will face increased long-term care costs to be financed over relatively shorter working lives. These cost increases would make retirees more costly for firms and could induce employers to try to retain more of their older workers. These workers will be relatively less expensive than younger workers when baby boomers reach retirement age.

Life expectancy is also an area of current controversy. A number of demographers and actuaries anticipate far greater declines in mortality than most of our current forecasts incorporate. If these analysts are correct, many pension plans will find their liabilities greater than originally anticipated. These increased costs would provide employers additional financial incentives to encourage workers to stay on the job longer.

Social Security taxes are scheduled to increase in the future. While these tax increases would increase employer costs in the short run, many analyses assume that in the long run such costs will be shifted to workers, reducing both current wages and future pension benefits. These reductions may induce individuals to work longer. Furthermore, if improvements in the health of older persons accompany longer life expectancies, a larger proportion of workers who formerly would have had to leave for health reasons may decide to stay on the job longer.3

Long-run models are unlikely to incorporate these factors, or to respond to them if incorporated, because the extremely strong trend toward earlier retirement has dominated the labor force participation of older workers over the past decades. Given recent evidence, few workers are likely to be interested in retiring later. If employers want to change this pattern because of increased corporate retirement costs, they would need to provide significant incentives to convince their older workers to stay on the job. These incentives could take the form of higher wages to encourage later retirement or other inducements such as part-time employment to meet the needs of their older work force.

Increased retraining of older workers also might be adopted if employers wished to reduce retirements. A few firms already retain older workers to upgrade skills or provide new skills. More frequently, employers provide training to younger workers because older workers have fewer anticipated years in the work force and employers may feel that there is not time enough to recapture their investment (National Commission for Employment Policy, 1985). Long-term planning for retraining, which focuses on workers in their fifties, could help promote better work force utilization combined with later retirement and a longer period to recoup the benefits of that investment.

Revising pension plans to change retirement behavior could also be considered by employers. For instance, if later retirement were desired, employers might start reducing early retirement provisions and increasing the normal retirement age in conjunction with Social Security to maintain their work.

3 A forthcoming study by the Social Security Administration, mandated by the 1983 Social Security Amendments, may clarify this important issue.
force. Over the past decade, there has been greater expansion of defined contribution plans relative to defined benefit plans. This shift is likely to continue as employment becomes more concentrated in the service sector. Recent data also indicate that some employers who have terminated their defined benefit plans have replaced them with defined contribution plans. Among plan terminations awaiting approval (with asset reversions in excess of $1 million), just over one-third of these plans were to be replaced with a defined contribution plan (EBRI Issue Brief, May 1986). These actions may represent a structural shift in the types of incentives provided by employer-sponsored plans. They also place more risk/reward tradeoffs of investment decisions on the individual worker.

Recently, some employers have started to restructure their plans from defined benefit plans to cash balance plans, which guarantee a rate of return to employer contributions rather than a specified benefit at retirement. Some employers have shifted to cash balance plans, in part, to better meet the desires of their employees who are part of the baby boom. It may also represent a strategy to deal with the future costs of retirement.

The escalating costs of federal retirement and health programs could also propel the government to make changes in Social Security and pension legislation. This could force employers to significantly change their benefit structures and/or reduce federal benefits available to employees at retirement. In sum, both federal program costs and employer costs in the face of increasing longevity could induce employers to try to reverse one of the strongest labor market trends we have witnessed to date -- the trend toward early retirement.

**Conclusion**

The decline in labor force participation among those age 55 and over appears to be strongly predicated on the increased availability of retirement income. The effect of income on the retirement decision helps explain the divergence between attitudinal studies -- which indicate that retirees are willing to work -- and the behavior of retirees, which, apart from occasional part-time work, is directed strongly away from the labor market. Restricted benefits or higher wages would be needed to reverse the trend among older workers toward earlier retirement.

On the employer side, firms have encouraged earlier retirement by substantially reducing the normal retirement age under employer-sponsored pension plans. With reduced Social Security benefits available before age 65, many employees can claim both Social Security and employer-sponsored pensions at earlier ages. Firms also encourage early retirement and present some employees special early retirement windows to help restructure the work force of the firm. Although researchers are still grappling with the more subtle theoretical underpinnings on the existence and function of pension plans, the use of these early retirement arrangements and their inducements to retire apparently enhances the productivity of the firm.

The increased costs of supporting a larger retiree population in the next century come in the wake of earlier retirements. Although the 1983 Social Security Amendments increased the normal retirement age to reduce future program costs, the impact of higher health care costs has not yet been addressed. The HI portion of Medicare is facing an impending financial crisis. The future costs of providing long-term care under Medicaid could be overwhelming.

Employers are also likely to incur increased costs for retiree health care. Under current law, which now appears to preclude health plan benefit reductions for current retirees, some employers may cancel their retiree health benefits for future retirees, and few employers are likely establish new retiree health plans. It is too early to tell whether employers will provide long-term care benefits for retirees, whether employees will finance their own care, or whether Medicaid and the families of individual retirees will continue to pick up the bulk of the burden.

Federal policymakers have indicated that they are concerned about the federal costs of earlier retirement through recent legislation, such as the 1983 Social Security Amendments, through proposed tax reform legislation, and through studies requested by Congress on retirement issues. Recently, legislation has been proposed to amend ADEA to abolish mandatory retirement, which is currently permitted among private-sector workers age 70 and older. Although this legislation is likely to affect relatively few workers given the trend toward earlier retirement, it, in part, indicates federal interest in reducing barriers to continued employment at older ages.

Forecasters project declining labor force participation rates among older employees in the years to come, despite changing demographic patterns within the work force. But factors not included in forecasting models, such as the costs of unfunded retiree health benefits, could change employer policies toward the retirement ages of the work force. Overly
conservative assessments of improvements in mortality could increase the costs of employer-sponsored pension plans. Should employers want to retain older workers longer to reduce employer expenses for retirees, strong incentives would be needed to offset the ongoing trend toward earlier and earlier retirement.

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