Work Options for Older Americans:

Employee Benefits for the Era of Living Longer

by John A. Turner

Many of our social and employee benefit policies were designed for an era when people had shorter life expectancy and employers had a large cohort of younger workers to replace those retiring. In light of new demographic trends, this article examines work options for older Americans, provides an overview of benefits policy issues for an aging workforce and lists topics for further benefits policy analysis. The author also identifies policy options to facilitate work at older ages in a number of areas, including changes to employer retirement plans, Social Security, Medicare and disability policy.

Every day, 12,000 baby boomers turn age 50. Continuing improvements in life expectancy mean that those people will live longer on average than any previous generation. The combination of increased life expectancy and an aging workforce has important implications for employee benefits. They raise the cost to employers of some benefits, while they motivate employers to use other benefits to encourage people to work longer.

Many policy analysts believe that public policy should encourage Americans to work longer and retire at older ages. Such policy could benefit both workers and employers. For workers, working longer would help solve the problem of not having saved enough to support a long retirement. That problem arises in part due to increased life expectancy, as well as due to the poor savings habits of many Americans. Diminishing generosity of Social Security also plays a role. For employers, having employees work longer would help solve the problem of an anticipated labor shortage when the baby boom generation (born between 1946 and 1964) retires (Munnell 2007).

Increases in life expectancy have resulted in a large increase in the expected years in retirement. This increase has placed a heavy, and to some extent unexpected, burden on defined benefit pension systems—both Social Security and employer-provided pensions. Thus, an added benefit of working longer could be the positive effects it might have on the financing of Social Security and employer-provided defined benefit pensions. Workers would have more years over which benefits would be financed and fewer years to receive benefits. The net balance of these two effects on pension financing depends in part on the extent to which benefits increase with postponed retirement.

Many of our social policies and employee benefit policies were designed for an era when people had shorter life expectancy. Also, at that time there was a large cohort of younger workers to replace older workers. With the demographic changes occurring, it is time to reexamine those policies to fit the realities of the new demographic era of living longer.

WORK OPTIONS FOR OLDER AMERICANS

The labor market for individual workers changes dramatically as they age, affecting the bargaining that continually takes place between employers and workers. Labor market outcomes, such as work arrangements, benefits and pay, result from a bargaining process between workers and firms where each side weighs the costs and benefits of working longer at older ages. In the United States, which bans mandatory retirement, work is always an option; the question is, are the options that workers want the same that employers offer?

One way to understand how a government policy affects the quality of the work options that older Americans are offered is to consider the effect of the level of Social Security benefits. The amount of pension security a worker has affects the terms of employment an older worker will accept and an employer will offer. A retiree with a healthy pension will demand higher pay and better working conditions than an employee with no pension income. Because employment contracts are constructed privately, the only way the state can affect outcomes is with guidelines, regulations and mandates.

When the government banned mandatory retirement, older workers gained leverage over the choice of retirement age. Amendments to the Age Discrimination in Employment Act in 1978 abolished mandatory retirement for most occupations before the age of 70. Further amendments in 1986 abolished mandatory retirement at any age for most occupations. Employers had to induce retirement with sweeter pensions. The situation for employers with respect to older workers, however, has changed with many employers no longer seeking to encourage the retirement of older workers.

Indirect evidence of this change can be seen with employers moving from defined benefit (DB) plans to defined contribution (DC) plans. *Defined benefit plans* commonly have features encouraging retirement at particular ages. *Defined contribution plans* are neutral concerning retirement at particular ages. They, however, may affect the retirement decision with unpredictable timing through the effect of capital market swings on account balances.

Public policy should provide older people with more choices, rather than fewer. Work effort by the elderly that is all "push" (due to financial need) and no "pull" (due to attractive jobs) is not socially acceptable. Thus, an increase in labor force participation by the elderly that is motivated mainly by a drop in their *reservation wages* (the minimum wage at which they are willing to work) because of decreases in pension income would not be an acceptable development. Much more acceptable is the idea that workers who may have to supplement their pensions are also induced to work because of attractive wages, employee benefits, flexible work hours or the nonpecuniary aspects of work. Some of the attractive nonpecuniary aspects of work for older people include socialization, structure to the day and self-esteem (Raskin 2007). Others include shorter hours, greater vacations and greater flexibility in work schedules.

In a recent book, *Work Options for Older Americans* (Ghilarducci and Turner 2007), a number of authors have laid out proposals for the future of work in America as the workforce ages. The remainder of this article discusses the future of employee benefits at older ages.

AN OVERVIEW OF BENEFITS POLICY ISSUES FOR AN AGING WORKFORCE

Because it is difficult for workers to collect a pension while phasing out work, people may retire earlier than they really want to, doing so to access their pension. Currently, an employer wishing to offer flexible employment faces numerous barriers due to the Internal Revenue Code, the Employee Retirement Income Security Act (ERISA) and the Age Discrimination in Employment Act (ADEA) (Penner, Perun and Steurle 2007).

The government could take a proactive stance and provide guidance to employers, who are chary of experimenting under threat of losing their tax deductions. It could issue guidelines based on the progressive and effective experiments in the public sector and for university faculty covered by TIAA-CREF.

Though, in principle, hardly anyone opposes phased retirement, it seems workers don't find employers' offers for phased retirement very attractive (Hutchens and Chen 2007). While about 80% of older workers work in establishments where employers say that phased retirement is possible, opportunities for phased retirement depend in part on the characteristics of older workers and are frequently not offered to all workers in an establishment. Among the legal issues associated with some options for phased retirement are issues concerning extending health insurance to phased retirees when that is not part of a formal program but is done in special circumstances in which employers want a particular full-time worker to stay on working part time. Since the main barrier to this proposal is the nondiscrimination rules promulgated by the Internal Revenue Service (IRS), the issue is whether this enhanced health insurance for phased retirees favors high-wage workers.

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A major reason for these partial pension/partial retirement arrangements may be that they are aimed to induce employees to declare when they will fully retire. From this perspective, they are a succession planning tool.

Improving longevity among workers causes the increasing pension costs that so many nations are facing, but it also causes increasing costs for employers sponsoring private sector defined benefit plans. In the United Kingdom, the costs to employers caused by unexpected increases in life expectancy are frequently cited as one of the causes of the decline in defined benefit plans (Pensions Policy Institute 2007). The effect of increases in life expectancy on pension costs would be greater in the United Kingdom than in the United States because the United Kingdom mandates that pension benefits be indexed to prices after retirement, which increases the cost of providing benefits to retirees at older ages. However, a similar, though smaller, effect on pension costs also occurs in the United States. In the short run, increases in life expectancy vary, but on average over long periods, the cost increases in the United States are a little less than 1% per year. What are employers doing to reduce this longevity-linked cost they face?

Employers have a number of options to deal with this problem, though some good ones are prevented by U.S. pension law (Muir and Turner 2007). Some employers ignore the problem by choosing to not update mortality tables; others use conservative funding assumptions to offset the misrepresentation of costs that an outdated mortality table yields; other employers cut future benefit accruals; others encourage their employees to take a lump-sum option (though this won't matter if the appropriate mortality table is used). More often the case, firms are switching to defined contribution plans, in which employer costs are immune to the glacial inevitability of improved longevity.

If pension law were changed so that accrued benefits employers were obligated to provide could be expressed to workers in terms of present value, which is the way employers' liabilities are expressed, rather than as annual benefits, firms would be more encouraged to maintain and perhaps even to adopt defined benefit plans. Thus, a possible response to increasing life expectancy, not currently permitted by ERISA, would be to index initial benefits received at retirement to increases in life expectancy. With this indexation, workers' lifetime accrued expected present value of benefits would not be affected by increases in life expectancy, but annual benefits at the point of retirement would be cut to take into account life expectancy increases. In order to shield workers from demographic risk after retirement, no further benefit cuts would occur for improvements in life expectancy occurring during retirement.

With this proposal, the risk that in general people will live longer is largely shifted from employers to workers. Workers are arguably better able to bear this risk than employers because they are also the beneficiaries of the increased life expectancy. They can adjust to the benefit cuts by working longer, which is facilitated by their increased life expectancy.

Employers, however, would still bear idiosyncratic life expectancy risk, which is the risk that a particular worker will live longer than expected. While it is not possible for employers to reduce the cohort life expectancy risk by diversifying across cohorts because all cohorts share in the improvement, they can reduce the idiosyncratic risk by diversifying across workers.

A similar approach for dealing with cohort life expectancy risk, which may have the questionable advantage of being less transparent to workers, would be to index the plan's normal retirement age to increases in life expectancy. Doing so could also result in a reduction in annual benefits, while maintaining the lifetime expected value of benefits. This change is less transparent because it is presented to workers as an increase in the normal retirement age rather than a cut in benefits.

Increases in life expectancy over time are no secret, yet, just as for private pensions, government policy does not explicitly deal with their well-known consequences for Social Security financing. Policies that could be enacted include indexing the early and normal retirement ages to changes in life expectancy, or indexing benefit levels to life expectancy, as just described for employer-provided defined benefit plans. To deal with the hardship these changes might impose on lower-educated workers with physically demanding jobs, who generally start work at a relatively young age, an alternative benefit could be provided for which qualification for receipt was based on lengthy years of work rather than age.

A government policy affecting retirement age, which may partly also be the result of unintended consequences, is the government's apparent encouragement of defined contribution plans over defined benefit plans. This encouragement may be partly an unintended consequence of policies designed to strengthen defined benefit plans but which also increase their costs. It may result in part from government policies designed to reduce the tax expenditure associated with defined benefit pensions. It may also be due to government policies that provide options to 401(k) plans, such as deductibility of employee contributions, that are not provided to defined benefit plans.

The shift to defined contribution plans seems to be partly responsible for workers' higher retirement ages in recent years. In 1995, 51% of males aged 62 were working (Quinn 1999), but by 2005, that figure had risen to 60% (Burkhauser and Rovba 2007).

The shift to defined contribution plans, however, may have unfortunate implications for macrostability—workers may adjust their retirement in ways that don't relate to employers' needs but relate to the status of financial markets. The change in pensions from defined benefit plans to 401(k) plans may account for why the change in older worker labor force participation in the most recent recession is the reverse of past patterns (Hermes and Ghilarducci 2007). In the most recent recession, men and women stayed in and entered the labor force in proportions never seen before. The wealth shock due to the combination of workers' 401(k) pensions being exposed to financial markets in ways they never have before, and the financial markets plunging, suggest that losing pension assets played a major role in older workers' increased rates of labor force participation.

Defined benefit plans have historically been a reliable source of income for many low- and middle-income retirees. These plans do not require employees to make complex financial decisions. While the net merits of defined benefit and defined contribution plans can be debated, because they involve different risks, workers generally are better off having both types of plans. Workers thus are made worse off by the trend toward lower coverage by defined benefit plans.

A negative aspect of the move toward defined contribution plans that has received little attention is its effect on the inequality of resources for older persons. The effect of the growth of defined contribution plans and the decline of defined benefit plans on pension wealth inequality is clear. It has resulted in a large increase in the inequality of pension wealth holdings among workers (Wolff 2007). This change has left many families of older workers unprepared for retirement. A possible consequence of this change is that many workers may delay their retirement compared to what it would have been under a predominantly defined benefit pension system. In addition, the shift toward a defined contribution system makes the level of retirement benefits, and thus the age at retirement, more uncertain.

Some argue that retirement policy is health policy. Any effort to raise the retirement age and have workers voluntarily remain employed will require an ability to have them obtain health insurance without making their employers pay for it, given the expense of an older worker's health insurance coverage (Weller and Wenger 2007). Employer-provided health insurance, coupled with the absence of affordable health insurance that is not tied to employment, appears to promote continued work up to the age of 65, when Medicare becomes available.

A provocative proposal would make Medicare the first medical insurance payer, instead of the secondary payer. This change would lower the cost of em-

▶ THE AUTHOR

John A. Turner is a Social Security and pension policy consultant. His most recent books are *Work Options for Older Americans,* edited with Teresa Ghilarducci, and *Individual Accounts for Social Security Reform: International Perspectives on the U.S. Debate,* published in 2006. He is currently working on *Pension Policy: Finding Better Solutions,* which will be published in 2009. Turner has considerable international experience, including having worked for the International Labor Office in Geneva, Switzerland and consulted for the International Monetary Fund, the United Nations and US AID. He has a Ph.D. in economics from the University of Chicago.

ploying older workers by greatly reducing the cost of employer-provided health insurance for them. In turn, as a result of taxpayers subsidizing the health insurance of older workers, employers could raise wages and provide attractive work schedules to older workers.

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The state is key in deciding if older workers will enter or stay in the labor force with either a great deal of bargaining power or next to none. The Swedish social security system was turned into a massive cash balance plan that lowered the generosity of early retirement benefits. The Swedish government implemented a number of highly specialized job-training programs designed to make work more attractive to the elderly. In that nation, the state induced an altering of work patterns in such a way as to even out the distribution of bargaining power between employers and employees. In the Netherlands, workers can mandate accommodation for their old age in much the same way disabled workers can mandate an accommodation in work schedules. These kinds of protection clearly help the workers' side in the balance of power (Jeszeck et al. 2007).

WHAT IS TO BE DONE?

A number of policy options relating to employee benefits and government-provided benefits would facilitate work at older ages. These include:

- Permit partial work and partial pensions
- Permit defined benefit plans to adjust benefits at the point of retirement for increased life expectancy
- Adjust Social Security early and normal retirement ages to take into account increased life expectancy and the improved health of older workers
- Expand the Americans with Disabilities Act to include accommodations for limitations caused by age
- Make Medicare the primary insurer for workers aged 65 and older
- Address ways to reduce the cost of health benefits for older workers.

FURTHER BENEFITS POLICY ANALYSIS

The contributions here suggest another look at an important policy idea—raising the Social Security early retirement age. Raising the retirement age for collection of full benefits may reduce the pressure on pension plans and keep them stronger. Many policy analysts express concern, however, for the older individuals in poor health who can't work, especially those who started work early because they didn't attend college.

There are several ways that the Social Security early retirement age could be raised to the age of 63. First, it could be raised so that workers would receive the higher benefits at the age of 63 that they would have received under the old system had they postponed retirement to the age of 63. This approach would not save Social Security any money, but it would raise the benefits received by participants who formerly had retired before the age of 63. Such a change might be made as part of a package to offset other changes that reduced benefits. Second, it could be raised so that at the age of 63, workers would receive the same benefits that they would have received at the age of 62. This approach cuts lifetime expected benefits, while the first approach leaves expected lifetime benefits unchanged.

With either approach, the early retirement age could be raised two different ways. First, it could be raised for all workers across the board. Second, it could be raised so that workers with 40 years or more of covered work, or workers with low lifetime average earnings, could receive benefits at the age of 62, with the rest being eligible to receive benefits at the age of 63. This feature would recognize that lower-educated workers with physically demanding jobs tend to start work at younger ages than college-educated workers.

We know that college-educated workers tend to be in better health, have higher salaries and find work later in life to be more rewarding. We also know that college-educated people start work at much older ages than blue-collar and lower-income individuals. One of the reasons that college-educated workers want to work longer is that the eagerness to work at older ages could be related to the number of years one has been working. Another fact that may support that idea is that older women are increasing their labor force participation rates faster than older men and faster than younger women. The problem with basing the eligibility for retirement benefits on how long one has been working is that unemployment spells, child rearing and family care could be reasons people have fewer years in the work force. The new rule could actually hurt low-income workers and women if they are likely the groups to be affected by these life events. However, the adverse distributional issues that this would cause could be taken care of by dependent care and unemployment spells counting toward work credits. ◀

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