

IS EARLY RETIREMENT ENDING?

Introduction

People are now living longer, and living healthier lives for most of that added time. Although increased longevity and improved health represent major accomplishments, the combination of early retirement and longer life places strains on the Social Security and employer pension systems.

Some argue that people who expect to live longer should work longer as well. Longer careers could be good for workers, who would benefit from the added mental and social stimulation as well as the opportunity to accumulate more retirement assets. Society, in turn, would benefit from being able to retain experienced workers longer and from fiscal relief to the Social Security system.

In *Is Early Retirement Ending?*, Sophie M. Korczyk of Analytical Services reviews recent trends in labor force participation and Social Security pension receipt among older workers. She then examines selected descriptive statistics, economic research studies, and literature reviews on how the structure of Social Security benefits, older workers' health status, access to health care coverage, and labor market conditions affect older workers' work and pension receipt decisions. Her examination provides a context for developing policy options to encourage older workers to work longer and delay claiming pension benefits.

Findings

Reports of the "end of early retirement" may be premature. After about 15 years of almost no change, the median age at labor force exit began to decline again in the late 1990s. On the other hand, the average age at which workers claim Social Security retirement benefits has been virtually unchanged since 1985, at about 63½ years.

The Social Security program is both an important tool and a target of retirement policy. Yet recent research on the likely retirement effects of program design changes is not encouraging.

Many people are likely to work longer if the early retirement age (ERA) is raised, but their benefits at retirement would increase as well. As a result, raising the ERA might have no net effect on the Social Security trust funds. In contrast, cuts in early retirement benefits—holding the benefit eligibility age constant—seem less effective in encouraging longer workforce participation, and could also have undesirable distributional effects, particularly on workers in poor health.

Increasing the normal retirement age (NRA) is less likely to affect labor force participation and pension receipt decisions, in part because so many workers claim Social Security benefits upon reaching the ERA, and have done so for many years. Increasing the delayed retirement credit (DRC) for workers who delay applying for benefits past NRA would have more impact on labor force participation and pension receipt delays than changes in the NRA, but even this effect is not large. Liberalizing the Social Security earnings test appears to have little effect on the labor force participation decisions of older workers, but may increase the proportion of beneficiaries who claim benefits at ERA.

The desirability of various options depends on whether the primary goal is getting people to work longer or reducing Social Security program liabilities. Some analysts believe changing the ERA would not affect the financial status of the Social Security trust funds even if it affected labor supply; on the other hand, changing the NRA would affect the trust funds favorably but is unlikely to affect the labor supply in any substantial way.

Health status may moderate the effect of changes in Social Security benefits on retirement decisions. Poor health accelerates

the timing of retirement, as do adverse changes in health. Although logic might suggest that people in physically demanding jobs retire sooner due to the toll such jobs take on their health, the research on that issue is not conclusive. Some research suggests, instead, that people take jobs that match their physical capacities, and thus people in physically demanding jobs may not retire sooner than those in less demanding jobs.

The availability of health care coverage plays a role in workers' decisions about the receipt of both Social Security retirement and disability benefits. Having coverage only through one's own employment discourages claiming of both types of benefits, but having an alternative source of coverage such as through a spouse or in an employer-sponsored retiree health plan encourages it.

The evidence on labor market conditions facing older workers is mixed. Descriptive statistics suggest that most who want jobs stay employed, but that those who lose their jobs in the last decade before NRA can face long periods of unemployment. Econometric evidence suggests that those who lose jobs at this time of life are more likely to retire than those who have not experienced a job loss. Among those who continue to work after claiming a pension, circumstances vary as well. Many older workers continue to work because they have to, while for others, work takes on the characteristics of a leisure activity chosen in preference to unstructured time.

Conclusions

The report concludes that a great deal is known about the determinants of retirement: some people retire because they can, others because they need to do so. Although eligibility for Social Security benefits underlies most workers' retirement decisions, other factors can be far more powerful and

operate long before the ages when most people become eligible for Social Security benefits. The research on the determinants of retirement suggests that older workers face very diverse circumstances. Therefore, Social Security changes alone might not change very many decisions, and multiple strategies might be required to promote increased labor force participation in later life.

The literature reviewed in the report suggests two broad groups of strategies: (1) changing how workers see their choices between work and retirement and (2) changing the options they face in choosing between work and retirement.

For example, people might choose to work longer if they got more or better information about their economic prospects in retirement, or if they had a better understanding of the structure of Social Security benefits.

There is evidence that older workers have not caught on that providing for their retirement is largely up to them. Older workers without adequate savings may be ready to hear the message that working longer is an option.

If it is desired to keep more people in the labor force longer and discourage them from claiming early Social Security retirement benefits, simply educating them about the structure of those benefits could also work. There is some evidence of a relationship between education and early claiming. It may be that more education about claiming and better education about the value of delaying benefits could reduce early retirement rates.

People might want to work longer if work became more attractive and if they felt more comfortable with the skills required. Changing health care coverage arrangements would also change both the employee's reward for working and the cost to employers of expanding employment of older workers.

Source: Sophie M. Korczyk, *Is Early Retirement Ending?*, prepared for the AARP Public Policy Institute, October 2004. © AARP.

A copy of the full report can be obtained at www.aarp.org/ppi, or write for PPI Issue Paper 2004-10, Public Policy Institute, AARP 601 E Street, NW, Washington, DC 20049.