Employment Policies to Increase the Labor Force Participation of Older Workers[1]

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Abstract

The aging of the U.S. population will strain the financial resources of retirement public retirement programs such as Social Security and Medicare. Drawing on the labor resources of people age 55 and older, who currently have a labor force participation rate of 34.7%, could mitigate some of this financial problem and add to the growth rate of the economy by adding to the growth rate of the labor force. Some promising steps have been taken recently by private and public sector employers to encourage older persons to work to later ages. Private sector programs, however, are not currently available to significant numbers of older workers. Pension incentives in the public sector have met with success in retaining older workers, but similar incentives are unlikely to occur in the private sector due to Employee Retirement Income Security Act (ERISA) restrictions on in-service distributions.

The maturation of the baby boom generation (persons born between 1946 and 1964) has progressed to the point where boomers will soon begin moving from the traditional working ages to the ages when many people start to retire. The first wave of the baby boom generation will start to turn age 65 in 2011, and the last of the boomers will be 65 in 2029. This development will lead to significant changes in the ratio of the working age population (defined as 20–64 years of age) to the population age 65. This ratio, called the "aged dependency ratio" because it provides an estimate of how many workers will be available to support each retiree, was 21 percent in 2000, or five working-age individuals for every person over age 65. By 2030, it will reach 35 percent, meaning that there will be fewer than three persons of traditional working age for every person over 65.

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To the extent that individuals work to later ages, some of the fiscal problems associated with an aging population can be mitigated. The large shift in the aged dependency ratio will strain public and private retirement programs if current retirement patterns hold. Currently, the Old Age, Survivors, and Disability Insurance trust fund is projected to be insolvent in the year 2041, and the Medicare trust fund's insolvency date is 2030. If people work to later ages, they will pay for an increased share of their Social Security and defined-benefit pension benefits, as well as their Medicare benefits. Moreover, having larger numbers of older workers in the labor force should increase economic growth. According to Bureau of Labor Statistics data, labor force growth is projected to stagnate to an annual average of 0.02% from 2015 to 2025, down from an annual average of 1.5% from 1950 to 2002. Drawing on the labor resources of people age 55 and older, who currently have a labor force participation rate of 34.7%, could mitigate some of this projected fall in the growth rate of the labor force.

Some promising steps have been taken recently by private and public sector employers to encourage older persons to work to later ages. Private sector corporations have created flexible employment programs to assist older workers in staying at their jobs. Besides a few notable examples, however, these programs are not widespread. In the public sector, most notably in efforts to retain older teachers, employers have been experimenting with financial incentives to keep older workers on the job. This paper will discuss the factors that influence retirement and how flexible employment policy changes have addressed them.

Factors Influencing the Decision to Retire

There are many factors that influence a person's decision to work at older ages. The decision to continue working is primarily related to the trade-off between continued earnings or increased leisure time. The availability of benefits from Social Security and pensions allows workers to substitute their earnings with nonlabor income and take more leisure. Depending on the eligibility rules and schedule of benefits, it can be more or less advantageous for workers to retire at an earlier age rather than to continue employment. In the United States, about half of the labor force has some type of employer-provided pension coverage (U.S. General Accounting Office 2000). Employer-provided pensions are customarily classified into two major categories: defined-benefit and defined-contribution plans. A defined-benefit plan promises a retirement benefit amount that is usually expressed as an annual payment, derived from a formula based on a worker's years of employment, earnings, or both. Under a defined-contribution plan, the retirement benefit is expressed as an account balance for the individual employee.

As different types of pension plans, defined-benefit and defined-contribution plans provide workers with different incentives for either retiring or continuing work. Defined-benefit plans can provide an incentive for early retirement because they often do not increase retirement benefits in line with additional years of work with the firm after normal retirement age. Under defined-contribution plans, benefits continue to increase, consistent with continued contributions and positive rates of return on assets. Because workers' accounts increase in proportion to the amounts they or their employers contribute, they do not create incentives to retire based on the benefit formula. In the past, a greater percentage of pension-plan participants were covered by defined-benefit plans, but there has been a dramatic shift in coverage over the last couple of decades. In 1998, according to the Employee Benefits Research Institute, 20 percent of households had defined-benefit coverage only, 57 percent had defined-contribution coverage only, and 23 percent had both types of coverage.

Health status and occupation are other important factors that influence the decision to work at older ages. As people age, they tend to encounter more health problems that make it more difficult to continue working. Thus, jobs that are physically demanding, usually found in the blue-collar and service sectors of the economy, can be difficult for many people to perform at older ages. Moreover, health status and occupation are often interrelated, because health can be affected by work environment. Blue-collar and service workers often face physically demanding work environments that may affect their health status and consequently lead to health impairments that affect their ability to work to older ages (U.S. General Accounting Office 1999). Although this group continues to face problems, there is evidence that the health of older persons is improving for the population as a whole (Manton et al. 1997). This suggests that, overall, the older age population has an increased capacity to work to older ages.

Labor force participation is not solely an older worker's decision; there must also be a demand for their labor. Employers' perceptions of older people may form barriers to older workers' retaining their current jobs, finding new jobs if they are laid off, or reentering the labor force after retiring if their retirement income is inadequate. For example, some employers believe older workers are less productive than younger workers, have higher costs for employee benefits such as health care and pensions, and have higher costs for recruitment and training because they have less potential time to recoup these up-front costs compared to a younger worker. Encountering these obstacles could discourage older workers and influence their decision to retire.

Private Sector Employment Policies to Encourage Employment to Older Ages

Some employers and employees are experimenting with flexible employment arrangements that would allow older workers to continue to work (see Table 1). These flexible employment arrangements come in many different forms, including part-time work, seasonal or part-year work, consulting or contracting for limited periods of time, or a reduction of job responsibilities. For example, CVS, a large retail drug store chain, accommodates older workers by offering them part-time or part-year schedules and allows them to work in multiple locations throughout the country. Under this approach, an older worker can work in New York during the spring and summer and in Florida during the fall and winter. Monsanto, a large chemical manufacturer, has established an in-house Retiree Resource Corps that serves as a clearinghouse for matching retirees' skills and the company's employment needs for retirees who wish to work on a temporary basis. Retirees must separate from the company for six months prior to entry into the program and are limited to less than 1,000 hours of work per year.[2] Employees who work more than the maximum have their pension benefits ceased and must terminate from the program to have their benefits reinstated. The Dole Food Company, a large fruit-canning employer, hires older workers on a part-year basis to work in their canning factory that operates from July to mid-September. The benefit of this employment policy is that older workers are more likely to be available for the part-year work than younger workers, who are more interested in full-time jobs. Vita Needle, a needle manufacturer, has been successful in recruiting older workers by allowing them to choose the days they want to work.

Although a few notable examples exist, flexible employment arrangements are not yet widespread in the private sector. In many instances, these arrangements or programs are provided only on an ad hoc basis and to limited groups of employees. The employees involved in these arrangements tend to be skilled workers with an expertise for which an employer has a special need. Though these programs can be expensive, some firms have shown that they are willing to pay to retain the more highly skilled employees who are hardest to replace. According to a study by Watson Wyatt, a large human capital consulting services firm, 16 percent of employers participating in their survey offer some type of flexible employment arrangement; however, they defined such an arrangement as any type of accommodation that was being made to an older worker either on a programmatic or individual basis. The American Association of Retired Persons (AARP) and the Society for Human Resource Management (SHRM) also conducted a study of flexible employment programs

TABLE 1
Private Sector Flexible Employment Programs

Employer	Type of Program(s)	Participant Data
Aerospace Corporation	Work part-time Leave of absence prior to retirement Rehire retirees part-time or as contractors	Not available
CVS	Work part-time or part-year Work in multiple locations throughout the year	15 percent of employees are 55 or older
Del Monte Plant 25	Work part year	28 percent of employees are age 55 or older
Frito-Lay	Rehire retirees	200 (mainly drivers)
GE Global Exchange Services	Rehire retirees	An estimated 50 percent of retirees have worked in the program since its inception
GTE (company was purchased by Verizon)	Retirees are used to establish new company ventures overseas	Company survey found 725 retirees who would like to participate (actual participants not available)
GEICO	Informally rehire retirees, typically on a part-time basis	50–60 participants
Lockheed Martin Missiles and Fire Control – Dallas	Rehire retirees for up to 999 hours per year	20–40 participants
Manpower	Increased efforts to recruit older workers	25 percent of workforce consists of older workers
Monsanto	Rehire retirees for up to 999 hours per year	300 participants
Prudential	Informally rehire retirees to fill specific company needs	Not available
Varian Medical Systems	Reduction of work schedule over a three-year period prior to retirement	Less than 10 participants
Vita Needle	Allows workers to choose the days they want to work	Average age of 35 employees is 73 years

and estimated that about 2 percent of employers offer such arrangements to older workers. Neither of these studies is nationally representative.[3]

According to interviews with union officials in the manufacturing and telecommunications industry, unions have not yet addressed flexible employment programs broadly in collective bargaining agreements, because of employers' lack of interest and difficulties in establishing flexible schedules in many manufacturing settings. In the manufacturing industry, flexible employment programs are difficult to establish because the work environment tends to require team production from employees on full-time schedules. Unions in the telecommunications industry have proposed some flexible employment arrangements in bargaining, but employers have not shown an interest because they do not yet see worker retention as an important issue.

The hesitancy on the part of employers to offer flexible employment programs appears to be at odds with the desire of older employees to have the option of participating in such programs, and thus possibly extending their worklives. According to 1996 data from the Health and Retirement Survey, 56 percent of persons age 55 to 65 would prefer to gradually reduce their hours of work as they age, but only 16 percent of full-time workers in this age group said their employers would be willing to allow them to reduce their hours. Another survey of workers age 54 to 74 who were employed in their career occupations found that 48 percent of workers wanted to work significantly fewer hours—citing workload and job demands (41 percent) and financial factors (28 percent) as their reason for working more hours than they would prefer (Moen et al. 2000). A reduction in work hours seems to be a fairly common desire: 71 percent of retirees who have returned to work said the reason they initially retired was to have a more flexible work schedule. Furthermore, this option seems to be less available to rank and file workers, with managers and professionals more likely to believe a reduction in hours was possible (64 percent) than were workers in service and production occupations (31 percent).

Public Sector Employment Policies to Encourage Employment at Older Ages

A growing number of state and local public employers have implemented, or are considering implementing, pension features as incentives to encourage older employees to remain on the job. These efforts have largely been targeted at retaining older primary and secondary level teachers, because of a growing nationwide shortage of persons in this profession. An innovative method of providing an incentive to keep older teachers employed is starting a deferred retirement option plan (DROP). DROPs allow a pension participant at an eligible retirement age to have pension benefits start even though he or she continues to work.[4] For example, Arkansas has a DROP program in which all teachers who meet length of service requirements can have 70 percent of their monthly pension payments deposited into an account that is payable as a lump sum along with other options for payment.[5] Teachers can stay in the DROP program for as long as 10 years. The state also allows teachers who are eligible for retirement to draw their full pension and a full salary if they teach one of four subject areas deemed to have a critical shortage of teachers (math, science, foreign language, and special education) and if they separate from employment for 30 days.[6]

Louisiana has a variety of programs to encourage older teachers to stay on the job, and 4,300 teachers participated in them last year. The DROP program has been popular among the teachers because they can earn a lump sum in the range of $70,000 to $80,000 in three years. Most teachers in Louisiana never have the opportunity to save this amount of money. Two-thirds of eligible teachers participate in the DROP program and may do so for up to three years, after which they can continue working and will resume earning pension credits in their defined-benefit system. The myriad of other Louisiana programs established to retain or attract retired teachers are being phased out and replaced with one program that allows retired teachers to earn their full pension while continuing to teach after a twelve-month break in service.

Some public employers are using other pension incentives to retain teachers. For example, facing a projected shortfall of 300,000 teachers over the next decade, the California legislature enacted several measures modifying the state teacher pension plan to encourage older teachers to continue working. Starting in 2001, teachers who retire and then separate from employment for one year can return to teaching and earn a full salary while continuing to receive full pension payments. In addition, pension benefits have been enhanced in three ways: a longevity bonus of up to $400 per month has been added for thirty to thirty-two years of service; a 0.2 percent addition to the pension benefit has been granted for each year beyond thirty years of service; and 2 percent of salary is paid into a supplemental retirement account which is then payable as a lump sum.[7]

Nearly 10 percent (approximately 17,000 teachers) of Ohio's teaching workforce consists of rehired retirees. Ohio teachers can draw a full salary and full pension benefits after a two-month break in service. This provision also applies to other Ohio public employees in the event of a future shortage of employees.

The pension incentives being provided to teachers in several states would be nearly impossible to establish for workers in the private sector. ERISA regulations on in-service defined-benefit pension distributions do not allow employers to pay pension benefits to older workers who become eligible for retirement income before the plan's normal retirement age. Therefore, it would be difficult, if not impossible, for a private sector employer to provide a defined-benefit DROP plan, or an in-service pension payment, to workers who are younger than the pension plan's normal retirement age. Older workers who are eligible for early retirement benefits would have to choose between continuing to work for the same employer or collecting their benefits. Quite often the increase in pension benefits that a worker earns for continuing to work to the full eligibility age is not sufficient to compensate them for the foregone benefits. Thus, many older workers exit the labor force early because of the inability to access their pension benefits without separating from their employer. Some older workers, of course, can avoid these restrictions by taking early retirement and working for a new employer while collecting pension benefits from their previous employer's plan.

Conclusion

There are a few innovative programs in the private sector that show promise for extending the labor force participation of older workers. These programs, however, are not currently well established and not available to significant numbers of older workers. Some private employers have indicated an awareness of the need to retain older workers and are experimenting with different options to extend the work lives of their older employees. These programs, however, remain small and are often administered on an ad hoc basis. Flexible employment programs have also yet to be addressed by employers and workers in the collective bargaining context.

Public employer efforts to retain or rehire older workers have been broader in response to labor shortages in teaching. The most popular incentive being provided to teachers is the payment of pension benefits prior to the full eligibility age through DROP programs or reemployment after a short break in service. The popularity of these programs in the public sector could give an incentive for policy makers to revisit the ERISA rules on in-service distributions in the private sector. If employers are given more leeway on when and how they can pay pension benefits to workers, a larger number of older persons may stay in the labor force to older ages. The issue of allowing employers to pay early retirement benefits, however, still raises the problems of workers taking reduced benefits that may not provide sufficient income at older ages and employers substituting pension benefits for wages. An innovative solution is needed to address all of these issues.

Notes

1. This paper is based primarily on research conducted by the General Accounting Office for "Older Workers: Demographic Trends Pose Challenges for Employers and Workers," GAO-02–085. Its contents, however, should not be attributed to the GAO. The opinions expressed in this paper are the author's.

2. Under ERISA, an employer who sponsors a pension plan may not exclude workers from pension coverage if they work at least 1,000 hours per year.

3. The Watson Wyatt study was conducted on their clients who tend to be middle-sized to large employers who would be more likely to offer programs. The AARP/SHRM study was focused on a small sample of employers that were identified by *Working Woman* magazine to be employee friendly places to work.

4. DROPs allow a pension participant, generally for a fixed maximum period, to have his or her pension benefits start on a particular date even though he or she continues to work with the employer providing the pension. After that period, either the participant is expected to retire or the pension payments stop until the participant actually retires. Under a DROP, instead of paying a pension benefit directly to the participant, it is placed in a separate account in the individual's name. This individual account is also invested so that when the participant ceases employment and accepts retirement, he or she receives the accumulated account balance in addition to the ongoing pension benefit. By allowing a pension participant to gain access to or be credited with pension benefits while still working, DROPs remove a key incentive for older workers to retire.

5. The Arkansas program was not started with the intention of encouraging older teachers to stay on the job, even though it has served that purpose.

6. States can set their own length of time for what constitutes a break in service before someone returns to work and draws their salary and pension payments before the pension plan's normal retirement age. The length of time for a break in service is supposed to constitute a clear separation of employment. States have chosen different time periods to meet this requirement.

7. This supplement does not reduce the benefit paid by the defined-benefit pension plan. All participants who are covered by the pension plan are receiving this supplement, not only older teachers.

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