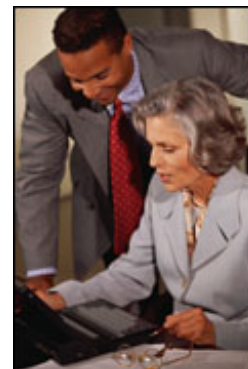




## Redefining Retirement in the 21st Century

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The demographics of today's workforce, employee expectations about retirement and the types of retirement options offered are all in a state of flux, making retirement policy a moving target for those charged with researching and administering pension plans. That was the message at a recent Wharton conference titled "Reinventing the Retirement Paradigm," hosted by [Olivia Mitchell](#), executive director of [The Pension Research Council](#) at Wharton, and Robert L. Clark, professor of business management and economics at North Carolina State University.



This article is the second of two; the first article, published in our last issue, covered retirement policy issues ranging from pension fund management to accounting reform to transparency. This article focuses on pension planning as it relates to employment trends among both younger and older workers.

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### One Option: "Phased Retirement"

According to Patrick Purcell, an economist with the Congressional Research Service of the Library of Congress, 27% of the population will be over 65 by 2035 compared to 17% now. Growth in the population aged 20-54 will accelerate briefly, then fall sharply, which will have implications for employers trying to fill jobs. Among men, 90% between the ages of 20 to 54 are employed but it drops to 68% for men aged 55 to 64. For women aged 20 to 54, 75% are working, but after age 55 employment drops to 55%.

Overall, pension coverage has remained at 50% for more than 40 years, but there has been a substantial shift from defined benefit plans, which provide guaranteed lifetime benefits to employees, to defined contribution plans such as 401ks, which provide savings incentives but leave their management up to employees. In 2001, only 1 in 5 workers in the private sector were in a defined benefit plan, although Purcell said defined benefit plans tend to get more attention because they are offered at larger, more visible firms. Many defined benefit plans subsidize early retirement, while defined contribution plans are generally age-neutral. "That's a vestige of another time when we needed to move older workers out," Purcell said.

He discussed the idea of "phased retirement," in which older workers continue with their employers on a part-time basis. To make that work financially, many workers need to unlock some early retirement benefits. That, however, is problematic; defined-benefit plans often require an employee to stop working before receiving benefits. Meanwhile, legislation has been introduced that would allow phased retirement plans, but it has not generated much interest, Purcell said, asking the question: "Should tax subsidies that have been created to promote pensions be extended to include people who have not yet retired? Do we really want to make that fundamental change?" He expects that strong workforce participation levels among those aged 55 to 64 will continue, with health insurance coverage being a major driver.

Katharine G. Abraham, professor of survey methodology at the University of Maryland, suggested that changing workforce demographics have made companies more interested in employing older people. “Employers are concerned about the ability to recruit workers,” said Abraham, adding that policy makers are worried about “the solvency of Medicare and the Social Security system.” She also noted that while many employees say they would like to continue to work beyond retirement age, few actually end up doing so.

## Looming Labor Shortages

According to research by Abraham and Susan Houseman, senior economist at the W. E. Upjohn Institute for Employment Research, only a quarter of older workers surveyed said they planned to stop working entirely at retirement age. Of the rest, 18% said they planned to work fewer hours, 5% said they wanted to change jobs and the rest said they did not have plans. When interviewed two years later, two-thirds of the people who planned to stop work actually did so, but most of those who planned to work fewer hours had not followed through. Abraham said the disconnect may have to do with the employment that is available. “Most of them are doing exactly what they were doing before or stopped working altogether.”

Houseman noted that perhaps those who reduced their hours were working more than 40 hours to begin with, so the reduction in hours did not reduce their salary. Other workers had been working two jobs and cut one out. “They are not fundamentally renegotiating their employment,” she said.

The research also indicated that those with pension plans were more likely to plan to retire; within that group, workers with a defined benefit plan were more likely to quit than those with a defined contribution plan. “Becoming eligible to receive a defined benefit greatly increases the probability of retirement,” said Houseman, adding that health insurance is also a factor. Those covered by a plan or through their spouse’s employer were more likely to reduce hours, and those with medical plans covering them in retirement were more likely to stop working.

The self-employed were more likely than other workers to continue working and less likely to stop altogether, although Houseman said that could be because self-employment comes with inherent flexibility. Other factors that can influence retirement plans include a change in health status or assets, such as job loss and/or the decline in 401k portfolios.

Research also indicates that workers do not understand their finances or don’t incorporate them into retirement planning until they are right up against the decision point, according to Houseman. She suggested that the gap between people who would like to continue to work, but work less in retirement, and those who actually do may indicate a need for new policies to help older workers transition to full retirement. “We already have programs to assist older workers who are unemployed or dislocated. There may be broader need for this kind of policy.”

Anna Rappaport, a partner at Mercer Human Resource Consulting, noted that many companies have dropped prohibitions against rehiring retirees to fill gaps in their labor force. “The action is heavily around the rehiring of retirees. There is a lot of that happening out in the private sector.”

She said that as the first wave of baby boomers begins to take early retirement, certain industries – like

aerospace, utilities and healthcare – are already facing severe labor shortages. “Phased retirement is important to workers and employers,” said Rappaport, “and in the case of aerospace, to the national security of this country.”

She advised employers to analyze the demographic makeup of their workforce and find out where they have gaps developing. Individuals, too, should evaluate their resources, financial options and skills. “People work after retirement for very different reasons. There is a significant number of people who do it out of economic need, whether for healthcare or for money ... We’re in a situation where our policy actions can give people the opportunity to create their own future.”

## **Impact of Baby Boomers**

In a panel on “Managing the Retirement Promise,” Janemarie Mulvey, assistant director of the Research Information Center at Watson Wyatt Worldwide, discussed strategies to retain older workers that balance the promise of retirement income with changing workforce demographics.

She pointed out that the Employee Retirement Income Security Act (ERISA) guarantees pension benefits that are already accrued, but does not require employers to continue to provide pension benefits in the future. Employers offer pensions voluntarily to minimize turnover and receive certain tax benefits, she noted, but also pointed out that pensions are growing increasingly more costly to administer, with costs tripling since 1981. As a result, she said, 64% of companies with fewer than 1,000 workers dropped defined benefit plans between 1990 and 2002. For companies larger than that, 11% dropped their defined benefit plans.

Mulvey also noted that 21% of defined benefit participants are in hybrid plans that combine elements of defined-benefit and defined-contribution plans and that cater to a more mobile workforce. However, she said, many employers are not able to offer such plans because of regulatory constraints. A common criticism of hybrid plans is that they are a way for employers to cut employee benefits, but Watson Wyatt data indicate hybrid plans add costs to employers and protect older workers.

By 2020 all baby boomers will be over age 55, with strong implications for the labor markets, Mulvey said, adding that by 2010 the U.S. will experience a 6.6 % shortfall of workers which will grow to 13% in 2020. Meanwhile, many retirement plans encourage workers to leave before age 65. A study of data gathered from 50 large employers showed that women over age 55 with early retirement plans retired a year earlier than other female workers, while men with those plans left eight months earlier. If a company offers medical benefits for early retirees, the numbers increase, with women retiring 2 years earlier and men 1.5 years sooner. In companies with more restrictive medical plans, such as caps on service, there is a smaller effect, said Mulvey.

Still, even with a labor shortage looming, employers are reluctant to change their incentive plans, particularly for those closest to retirement. Rather than cut early retirement benefits, Mulvey suggested that employers consider two incentives – elder care programs to help assist with the care of older relatives, and phased retirement programs that allow older workers to cut back on their hours without losing benefits. Of those surveyed, 25% of the women who retired early were responsible for caring for an older relative, she noted. “These are the softer side of benefits, but they matter and they’re not too costly to implement.” While men seemed less responsive to phased retirement programs, Mulvey said many men are retiring early and returning to their employers on a contract basis.

## Comparing Pension Benefits

Workforce issues could have broader economic implications, according to Steven A. Nyce, senior retirement research associate with the Research and Information Center of Watson Wyatt Worldwide. “If we do not find enough workers and if productivity is not high enough, it’s likely companies will not be able to meet the consumption in society and the result will be higher inflation ... For decades on end we have enjoyed prosperous growth,” he said. “What’s going on in outsourcing is some of the reaction to the labor shortage and it might mitigate some of the inflation down the road.”

David McCarthy, a researcher and faculty member at Imperial College in London, studied the portfolio value of pension plan types. He said there are three economic perspectives at play in determining occupational pension type: labor market conditions, portfolio theory and corporate finance, which is most relevant for defined benefit plans. Laws and taxes also play a role, but they add so much complexity he left them out of the model. “The optimal pension choice is influenced by all three areas,” said McCarthy. “Companies need to take both the labor-market effects and the employee-portfolio effects into account when designing compensation strategies.” For many people in the U.S. and other countries, their pension is an extremely important asset, up to 40% to 60% of their total assets, he added.

Economists have developed life-cycle models that indicate defined benefit plans are less desirable for younger workers than for older employees. McCarthy compared pension benefits to being paid in movie tickets. He said he usually goes to two movies a month, so the first two tickets would be worthwhile. The third ticket, and those paid to him after that, would have less value. The same would be true of pension benefits; at a certain point they become less meaningful.

But where is that point? McCarthy developed a model to measure the effects of various pension plans, although he cautioned that his work does not take into account two large sources of pension risk in defined-benefit plans – early separation and employer insolvency. “Results indicate that even for the most generous DB (defined benefit) pensions offered to younger workers, required productivity increases are small from the point of view of lifetime income, but large relative to the value of the pension. However, for older workers and less generous DB pensions, the required productivity increases are small relative to both the cost of the pension and lifetime income,” McCarthy’s paper states.

Donald Elbaum, director of actuarial studies in the treasurer’s office of Ford Motor Co., said the idea of reducing early retirement subsidies is gaining ground in national pension plans around the world and in private schemes. The changes have been driven largely by cost as retirees live longer. “In the U.S. there are some regulatory obstacles that could present themselves in trying to reduce early retirement benefits already accrued. To some degree your hands are tied.” To change the packages for future employees would require that companies strike a balance between flexibility and the ability to select certain employees for the benefits without violating non-discrimination rules.

Elbaum also said researchers may want to consider how the current boom in offshore employment may impact the economy and pensions, and he pointed out that the tightening of the labor pool will first manifest itself among younger workers. “When someone retires at Ford we don’t replace them with someone coming in the door. In some sense, the first battleground will be trying to find strategies for retention of employees in the early years when turnover is high.”

According to Elbaum, defined benefit plans are not highly valued by younger workers. He said Ford took that into account when it closed its 50-plus early retirement program to new employees, replacing those

benefits with a cash plan. Structuring employment to allow more part-time work might keep some people in the workforce, he said, but it might also provide incentives for people who would have worked full-time to cut back.

Mulvey suggested that employers who have been intent on reducing costs and cutting workers during the past years of slow economic growth need to look ahead and plan for a different future. “We try to know what’s down the road,” added Elbaum. “At the same time, it’s hard to keep a bench workforce in waiting. We’re measured against our competitors. We have to make sure we are staffed appropriately.”

And if workers are not available in the U.S., Ford has options overseas. “As a global company we do have alternate locations available,” he said. “That’s not to say this is our strategy, but it’s something we grapple with.”

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