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Working Longer, Retiring Later

Are Employers Ready for the New Employment Trend?

Robert L. Clark and Melinda Sandler Morrill

Policy analysts, economists, and demographers argue that individuals must extend their work lives if they are to achieve their desired standards of living in retirement. Increases in longevity imply that those who leave the labor force at traditional retirement ages must either save more during their working careers or consume less during their retirement.

The logic behind later retirement from the employee's perspective is clear and has been studied in detail: remaining in the labor force for additional years is needed to support increasing years in retirement. However, relatively few studies have directly addressed how employers feel about having workers remain on the job until older ages. Our book, *Extending Work Life: Can Employers Adapt When Employees Want to Delay Retirement?*, which was recently published by the Upjohn Institute (see p. 7), seeks to fill this gap by providing a comprehensive assessment of the costs and benefits to employers of accommodating later retirement ages. Through their employment and compensation policies, employers can either assist or restrict workers' ability to remain on the job.

Economic theory of the firm indicates that companies determine the optimal number of workers to hire and the appropriate age and skill composition of their workforces. A firm will need a mix of employees of different skill types, skill levels, and vintages of human capital. Changes in the age structure of a firm's workforce due to delayed retirement can affect labor costs, productivity, profitability, and sustainability. Companies develop their compensation policies to attract, retain, motivate, and ultimately retire their desired workforces. As a result, shifts in worker preferences may lead to changes in company policies.

Employers must consider the advantages and costs of retaining or hiring older workers. Older workers often are relatively highly compensated, and some will experience diminished productivity at older ages. Furthermore, as employers retain older workers, the opportunities for advancement by younger workers might be restricted. Employers must address the changing demographics in their workforces. By creating compensation and employment policies to accommodate prolonged or delayed retirement transitions, employers will be better positioned to reap the benefits of employing older workers.

What factors influence a firm's willingness to retain older workers? Can companies develop transitional

ARTICLE HIGHLIGHTS

- *Between 1994 and 2014, the labor force participation rate for men aged 65–69 rose from 27 to 36 percent.*
- *By creating compensation and employment policies to accommodate prolonged or delayed retirement transitions, employers will be better positioned to reap the benefits of employing older workers.*

employment contracts so workers can shift to new areas, perhaps with less responsibility and lower compensation, while remaining with their career employers? While exploring the bottlenecks and constraints that might inhibit the development of delayed retirement policies, our book provides new insights into how retirement transitions might develop in the coming years and the potential implications for legislative and employer policies regarding retirement ages.

Changing Patterns of Retirement

Throughout most of the twentieth century, labor force participation rates of older individuals steadily declined as real income increased. The establishment of Social Security in 1935 promised workers a base income in retirement. In the post–World War II period, employers began offering pension plans that provided additional retirement income. As these plans gained popularity, employers developed pensions that provided significant incentives for workers to retire at or before age 65. Employers encouraging retirement at relatively young ages was the result of a rapidly growing population that enabled firms to hire younger workers at lower wages. Increases in educational attainment and the emergence of new technologies reduced the competitive advantage of experience. Thus, changing economic and demographic conditions provided the impetus for employers to develop employment and compensation policies that encouraged retirement at specific ages.

In the past twenty-five years, there have been substantial changes in the proportion of older persons in the labor force. As Figure 1 shows, between 1994 and 2014 the largest changes for men have been for individuals aged 62 and older. The labor force participation rate for men aged 62–64 increased from 45 to 56 percent during this period, while the rate for men aged 65–69 rose from 27 to 36 percent. Participation rates for women followed a similar pattern; however, the increases were greater for younger women. The proportion of women aged 55–59 who were in the labor force rose from 59 to 66 percent, and the rate for women aged 60–61 increased from 45 to 58 percent. These trends in increased labor force participation are projected to continue. That, combined with the aging of the population, has resulted in a more than doubling of the number of workers aged 55 and older, from 15.5 million in 1994 to 33.9 million in 2014. As workers seek to delay retirement, firms must review their policies and determine whether and how they will accommodate later retirement.

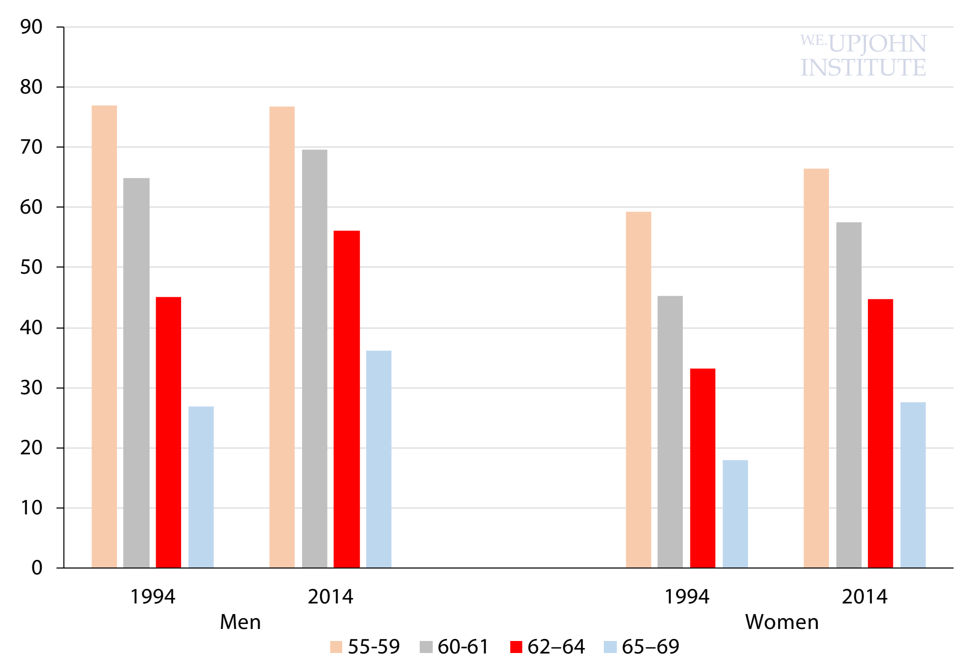
Employer Concerns about Delayed Retirement

The most important issue for employers associated with delayed retirement is the impact of an aging labor force on productivity and labor costs. Many employers believe that at some point productivity begins to decline. At the same time, wages and salaries typically rise with years on the job. The cost of employee benefits—especially health insurance, pension contributions, and paid time off—also increases with age. Economic theory indicates that when a worker's marginal productivity falls below the marginal cost to the firm, then a firm has an economic rationale to want this employee to retire.

Through their employment and compensation policies, employers can either assist or restrict workers' ability to remain on the job.

Pay scales and benefits help firms attract the desired labor force and then retain them. Companies also develop policies to incentivize employees to retire when it is optimal for the employer. If workers do not retire around these ages, the company will be adversely affected. Thus, many employers will resist later retirement

Figure 1 Labor Force Participation Rates for Men and Women Aged 55 and Older (%)



SOURCE: Toosi (2015).

because they believe it will lower productivity, raise costs, and alter the optimal age distribution of their workforce.

Employer Policies for the Future

Assuming that employees will continue to desire later retirement, employers must decide how they will respond. They may seek to develop new compensation and employment policies. They might find that, all else equal, it is optimal to accommodate workers' preferences for working longer by modifying job assignments and compensation policies. However, employers may also face barriers when making adjustments to working conditions and/or compensation, such as union contracts, age discrimination laws, tax law and pension regulations, and production techniques.

Many employers will resist later retirement because they believe it will lower productivity, raise costs, and alter the optimal age distribution of their workforce.

In some settings, phased retirement and return-to-work policies might make sense to both employees and employers. Many workers may prefer restructured compensation while remaining with their current employers rather than retiring and seeking new employment in a bridge job. Despite this, the use of these policies in today's workforces is somewhat limited. Employers may have informal policies with the aim of keeping the best workers but may be reluctant to have a broad program that offers phased retirement to all qualified employees. Employers might also be reluctant to adopt such policies for fear that they might run afoul of federal and state age discrimination policies.

It seems likely that firms will face increasing demand from employees to delay retirement. New research is needed to provide a better framework in which to evaluate the impact of this expected change on labor costs and productivity. For example, would individuals actually prefer a decreasing wage profile at the end of a career prior to complete retirement? Would this type of contract be more appealing if framed as a lifetime compensation package rather than a decline in salary at the end of career? The presence of bridge jobs suggests that lower wages and fewer hours are appealing to some older workers.

In the longer term, if employers accommodate later retirement, does this lead to new types of employment contracts? For example, if the incidence of phased retirement increases, then we might expect adjustments in employment contracts that pre-commit workers to lower salaries and/or benefits at older ages. Do employers find it more efficient to set up formal policies regarding retirement transitions, such as phased retirement options or return-to-work postretirement? If so, are tax policies and government-provided retirement benefits designed optimally to allow for new types of employment relationships? What new types of employment contracts are currently being introduced to accommodate trends toward working longer?

If working longer is deemed to be beneficial for individuals, society, and the economy, legislative policies could be adopted to increase incentives for individuals to remain in the labor force and for firms to employ older workers. Policymakers could identify and remove any real or perceived age discrimination issues associated with phased retirement programs. This would signal the benefit of modifying working conditions and compensation policies to ensure employing older workers is cost-effective. Redesigned jobs and reduced working hours, combined with access to retirement benefits when entering phased retirement, could make employees more willing to leave full-time employment and accept these new conditions.

Much of this analysis focuses on the impact of delayed retirement on individual employers, holding constant market forces. In many aspects, this is how a firm would view these changes. However, demographic changes and any ensuing macroeconomic shifts will alter the labor market over time. For example, downward pressure on market wages will increase the willingness of firms to accommodate preferences for older retirement ages.

Extending Worklife outlines how individual employers might view sudden changes in the retirement ages of their workforce. We emphasize how the push toward delayed retirement might not be desirable to individual employers. We speculate that as individuals choose to delay retirement, firms will respond by trying to form new types of employment contracts more suited to the preferences of older workers and consistent with their changing value to firms.

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