Papers

Policies to encourage older people to remain in the workforce

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Abstract If older people in G7 countries continue to withdraw from the workforce by their early 60s, many will not have enough income to ensure a secure retirement. Combine the retirement income crunch with the dramatic increase in life expectancy, and continued employment in later life appears to be a promising option for ensuring the financial security of older people. The hard questions are whether older people will offer their services and whether employers will retain or hire them. This paper, which focuses primarily on the US experience, explores the potential supply of and demand for older workers and looks at some proposals to help increase their workforce participation. From the workers' perspective, the need for additional income suggests that they will wish to remain in the workforce longer. From the employers' side, older workers have potential advantages and disadvantages. The paper also assesses policy proposals for improving the prospects for older workers in the US.

Keywords: *older workers, workforce participation, retirement, population aging, productivity, employment opportunities*

Introduction

If older people in G7 countries¹ continue to withdraw from the workforce by their early 60s, many will not have enough income to ensure a secure retirement. Combine the retirement income crunch with the dramatic increase in life expectancy, and continued employment in later life appears to be a promising option for ensuring the financial security

of older people. The hard questions are whether older people will offer their services and whether employers will retain or hire them.

This paper, which focuses primarily on the experience of the US, explores the potential supply of and demand for older workers and looks at some proposals to help increase their workforce participation. The first section summarises

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Figure 1: Life expectancy of males at age 65, 1960–2002

Source: Organisation for Economic Cooperation and Development (2005) 'Society at a Glance: OECD Social Indicators — 2005 Edition', Paris, France, Table HE1: Life Expectancy

today's retirement patterns throughout the G7 and argues that pressure on retirement programmes will require older people to work longer. The second section shifts to the employers' side and looks at the potential advantages and disadvantages of older workers. The third section explores some policy proposals to improve prospects for older workers in the US. The final section concludes that keeping older workers in the workforce may well be good for both workers and employers, but it is not obvious that it will happen.

Workers: The need for continued employment

When discussing older workers, the first step is to identify the group under consideration. This analysis focuses on those aged 55–70, because at age 55 the workforce activity of both men and women starts to decline markedly, and by age 70 most people should have accumulated enough resources to be able to support themselves comfortably in retirement.

Increases in average life expectancy

(see Figure 1) together with a sharp decline in fertility rates suggest that most developed countries are likely to face a number of major challenges due to population aging. The old-age dependency ratio — defined as the ratio of the population aged 65 and over to the population aged 15–64 — is projected to rise by 2050 to around 70 per cent in Italy and Japan, between 40 and 50 per cent in Canada, France and Germany and above 30 per cent in the UK and the US.² Moreover, as shown in Figure 2, Europe and Japan are likely to face a tougher challenge than Canada and the US, because their working-age populations actually decline in absolute — rather than simply relative — terms.

As shown in Figure 3, workforce participation of males aged 60–64 has dropped since 1960. The decrease varies from country to country, with the highest decline in France (50 per cent) and the lowest in Japan (10 per cent). As shown in Figure 4, workforce participation also drops between ages 50–60 — by about 20 percentage points in all countries. However, there are country-specific differences in

Figure 2: Working age population aged 15–64, 2005–2050 (2005 = 100)

Source: United Nations Population Division (2005) 'World Population Prospects: The 2004 Revision Population Database', New York, NY.

Figure 3: Labour force participation rate of males aged 60–64, 1960–2004

Source: Organisation for Economic Cooperation and Development (2005) 'Labour Market Statistics — Data', Paris, France.

participation rates at older ages. The proportion of individuals aged 60–64 in the workforce as of 2004 goes from 55 per cent in Japan to as low as 20 per cent in Italy and France. Clearly, an increase in the share of the population aged 65 or over without an increase in participation rates of older workers puts significant pressure on governments' finances.

Today, in OECD countries, the

hypothetical average earner retiring at the normal retirement age currently receives benefits worth about 70 per cent of end-of-career earnings, a measure known as the net replacement rate. However, the patterns vary depending on the generosity and coverage of public-sponsored social security programmes: the percentage is higher in Italy (89 per cent) and Germany (72 per cent), about average in France (69 per

Figure 4: Labour force participation rate by age, 2004 Age

Source: Organisation for Economic Cooperation and Development (2005) 'Labour Market Statistics — Data', Paris, France.

Figure 5: Annual growth in GDP per capita in the G6, 1970–2004 and 2005–2040

Sources: Wilson, D. and Purushothaman R. (2003) 'Dreaming with BRICs: the path to 2050', Goldman Sachs Global Economics Paper No. 99, New York, NY; Organisation for Economic Cooperation and Development (2005) 'Annual National Accounts for OECD Member Countries — Data from 1970 onwards', Paris, France; United Nations Population Division (2005) 'World Population Prospects: The 2004 Revision Population Database', New York, NY.

cent) and below average in Japan (59 per cent), Canada (57 per cent), the US (51 per cent) and the UK (48 per cent).³ Moreover, estimates suggest that a rising dependency ratio will reduce per capita GDP growth in the G6⁴ from an average of 2.4 per cent per year between 1970 and 2004 to 1.6 per cent between 2005 and 2040, making it more difficult for workers to support an aging population (see Figure 5).

Due to increased uncertainty surrounding future retirement income, in particular in the US and the UK where replacement rates are low, one

might have expected to see current workers increasing their personal saving. But household saving rates have declined recently in some G7 countries — particularly in the US, which now has a saving rate close to zero (see Table 1).

Thus, the retirement income outlook for future cohorts of retirees is rather dismal. People are not going to be able to continue to retire at or before 62 or 63 and maintain their pre-retirement living standards over an increasingly long retirement period. Working longer is an obvious solution.

Table 1: Saving rates as a percentage of disposable household income, 2000–2003

Country	2000	2001	2002	2003
Canada	4.7	4.6	3.2	1.4
France	11.0	11.5	12.1	11.1
Germany	9.7	10.2	10.5	10.7
Italy	9.2	10.3	10.6	10.5
Japan	9.5	6.6	6.4	6.3
UK	5.0	6.5	5.3	5.5
US	2.3	1.8	2.0	1.4

Source: Organisation for Economic Cooperation and Development (2004) 'OECD Economic Outlook', No.76, OECD, Paris, France.

Employers: Potential demand and impediments to hiring older workers

Given aging populations and the continued trend toward early retirement, employers could potentially have difficulty finding enough workers. They may therefore view continued employment of older workers as an attractive option. However, employers may also be wary of older workers because older workers tend to cost more; they often prefer flexible work hours that may not meet employers' needs; and age discrimination may still exist.

Potential demand for older workers

An aging population is likely to produce a higher ratio of consumers to workers, which would increase labour demand relative to labour supply, putting upward pressure on wages. In theory, employers could respond to this wage pressure by using more capital, tapping immigrants and women and/or relocating jobs. However, as discussed below, each of these options is likely to provide only limited relief.

With respect to capital investment, employers have an incentive to respond to higher wages by using more equipment and advanced technology to automate their production processes. The problem with the use of more capital,

however, is that the cost of financing it is likely to rise because the same demographic trends that lead to the aging of the population are likely to reduce both personal and government saving. On the personal side, the dissaving by large numbers of retirees as they leave the workforce is likely to swamp the saving undertaken by smaller incoming cohorts. On the government side, the claims of retiring workers on social security are likely to reduce government saving.

An alternative to adding more capital is to increase the workforce by turning to untapped sources, such as women and immigrants. However, women have already vastly increased their participation in the workforce. Given, also, that women remain primarily responsible for the care of the home and children, they are likely to need higher pay and/or substantial improvement in child care facilities in order to enter the workforce in greater numbers. In terms of immigration, estimates of the United Nations Population Division conclude that, for most G7 countries, increased immigration is not a realistic answer to stabilise the working age population in future years (see Figure 6).

Finally, firms might respond to the pressure on wages by relocating overseas or outsourcing. Here too, however, the potential may be limited. For example, according to the US Bureau of Labor Statistics, only 4 per cent of the roughly 900,000 layoffs a year (2002–2003) in the US were from overseas relocation.⁵ Other surveys show more substantial numbers, particularly in terms of projections over the next decade.⁶ While the future of outsourcing is clearly uncertain, if it remains modest it will not alleviate the wage pressure created by an increasing ratio of consumers to workers.

If increased capital, more female workers, a surge of immigrants, and/or

Figure 6: Average annual immigration currently projected and immigration required to stabilise working age population, 2000–2050

Source: United Nations Population Division (2000) 'Replacement Migration: Is it a Solution to Declining and Aging Populations?', New York, NY.

relocation do not relieve the pressure on wages, will employers turn to older workers? In many ways, this response seems logical.

Tomorrow's older workers will be well educated, they will have a lifetime of experience, they will be healthier than older workers were in the past, and the jobs employers need filled have become much less physically demanding. First, the educational gap between older and younger workers is now a thing of the past. For example, educational levels for men aged 55–64 in the US are actually higher than levels for younger men. Secondly, in terms of work experience, older workers have logged a great many years in the workforce and have generally acquired valuable skills in the process. Thirdly, with respect to health, this generation of older workers is in better shape than previous generations. Between 1982 and 1999, the share of those 65 and older with severe disabilities, measured roughly in terms of lack of ability to function independently with ease, dropped from 26.2 per cent to 19.7 per cent.⁷ Finally, complementing this trend toward better health is a decline in the

share of jobs requiring heavy physical labour, as the economy has moved away from manufacturing and toward services.

Impediments to hiring older workers

Although increased employment of older workers seems like it would alleviate the problems of workers and employers alike, a number of impediments stand in the way.

First, older workers are expensive. In general, earnings rise with age, possibly more than can be justified by productivity. In the US, fringe benefits — health insurance and pensions — are also high for older workers. Healthcare costs are higher both because older workers are more likely to have employer-provided coverage and because the cost of health insurance rises with age. Increasing pension costs are primarily an issue for traditional defined benefit plans, where accrual rates typically rise sharply with age. This latter source of cost pressure is becoming less important in the US with the widespread shift to defined contribution plans.

Secondly, employers resist part-time employment, which older workers disproportionately favour. Today, two part-time workers are more expensive than one full-timer due to a number of costs that are unrelated to hours worked. In the future, the price of part-time workers could decline if large numbers of older workers were willing to accept lower wages in order to attain a part-time slot.

Finally, age discrimination, at least to some extent, probably continues to exist. One problem in gauging the importance of age discrimination is the lack of definitive measures. Unlike other types of discrimination, it is very difficult to detect, so even though the US and other countries have taken actions to prevent it,⁸ the effectiveness of these policies is uncertain.

Policies to encourage older people to remain in the workforce

Several important changes have occurred in the last 20 years that have altered employer attitudes toward older workers or alleviated disincentives to work on the part of older workers. These changes have helped remove barriers to working longer. However, additional policies will likely be necessary.

Changes to date

The US Government outlawed mandatory retirement before age 70 in 1978 and effectively abolished it altogether in 1986. Another significant policy change was an increase in the reward that workers receive for delaying initial receipt of Social Security benefits past the normal retirement age. This change means that, for a worker with average life expectancy, lifetime Social Security benefits will be about the same

Table 2: Percentage distribution of initial Social Security benefit awards in the US, 2003

Age	Women	Men
62	58.6	53.3
63	7.3	7.9
64	11.6	13.1
65	16.5	22.4
66-69	3.0	2.3
70 and over	2.9	1.0
Total	100.0	100.0

Source: US Social Security Administration (2005) 'Annual Statistical Supplement, 2004', Washington, DC and author's calculations

regardless of whether the pension begins at age 62, age 65, or age 70. As noted earlier, many pensions in the private sector have shifted from defined benefit to defined contribution plans. Defined benefit plans tend to provide incentives for workers to retire at a particular age while defined contribution plans do not. Taken together, the changes described here have made the climate more encouraging for older people to participate in the workforce.

Proposals to increase the supply of older workers

One powerful way to encourage later withdrawal from the workforce is to change the early retirement age. In the US, workers are allowed to receive Social Security benefits at age 62. While such benefits are actuarially reduced, the vast majority of men and women jump at this option (see Table 2). Raising this early eligibility age would likely have a major effect on retirement behaviour.

Other policies to encourage the workforce participation of older people may also be desirable. In particular, as discussed above, flexibility in working hours could increase part-time employment of older people, which could make gradual retirement a more viable alternative to full early retirement. However, it is far from

Figure 7: Public expenditure on labour market programs as a percentage of GDP, 2001

Source: United Nations Economic Commission for Europe (2003) 'Trends in Europe and North America: The Statistical Yearbook of the Economic Commission for Europe, 2003', New York, NY.

clear that employers will find this option attractive.

the effect would probably be relatively small.

Proposals to increase the demand for older workers

The only real way to increase employer demand for older workers is to reduce their cost or boost their productivity. As discussed above, older workers tend to be more expensive than younger ones.

One commonly discussed approach is to encourage training of older workers in order to improve their skills. While this approach might work in some countries, it seems unlikely in the US, which ranked last in a study of public expenditure on labour market programmes in 20 countries (see Figure 7).

A more modest, yet slightly more realistic, proposal for boosting demand for older workers in the US is to exempt older workers from Social Security taxes once they reach the normal retirement age. While this change would reduce Social Security's tax revenue somewhat,

Conclusion

If population aging occurs with no change in the current workforce patterns of older people, the result will be insufficient retirement income for many and significant strains on governments' finances. The solution is to encourage people to stay in the workforce longer.

These demographic shifts may put employers in a tight situation as well. They will no longer be able to rely on a rapidly growing group of younger workers in the future. Moreover, with an increasing ratio of consumers to workers, labour demand is likely to rise relative to labour supply, putting upward pressure on wages. Expanding the use of capital, women, and immigrants and/or relocating may not be enough to make up for the labour shortfall.

Although increased employment of older workers may well be in the interest of both workers and employers, mutual

interest is not enough. Active policies are needed to increase both supply of and demand for older workers. The US and most other developed countries have already introduced reforms to reduce early retirement incentives and enhance older workers' employment opportunities. However, progress will depend on a myriad of small efforts on the part of both employees and employers to be more flexible in their requirements.

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- 4 The G6 is the same as the G7 with the exclusion of Canada.
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- 8 Besides specific country legislation, EU members have introduced a package of measures to combat age discrimination. See Employment Equality Directive (2000/78/EC).