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# REDEFINING RETIREMENT

# Options for Older Americans

Statement of Barbara D. Bovbjerg, Director
Education, Workforce, and Income Security



April 27, 2005

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## Options for Older Americans

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Highlights

Highlights of GAO-05-620T, a report to Special Committee on Aging, U.S. Senate

### Why GAO Did This Study

In the 21st century our nation faces a growing fiscal imbalance. A demographic shift will begin to affect the federal budget in 2008 as the first baby boomers become eligible for Social Security benefits. This shift will increase as spending for federal health and retirement programs swells. Long-term commitments for these and other federal programs will drive a massive imbalance between spending and revenues that cannot be eliminated without tough choices and significant policy changes. Continued economic growth is critical and will help to ease the burden, but the projected fiscal gap is so great that it is unrealistic to expect that we will grow our way out of the problem. Early action to change existing programs and policies would yield the highest fiscal dividends and provide a longer period for prospective beneficiaries to make adjustments in their own planning. One of the potential policy changes is assisting older workers who want to stay in the workforce past retirement age.

The Chairman and Ranking Member of the Senate Special Committee on Aging asked GAO to discuss demographic and labor force trends and the economic and fiscal need to increase labor force participation among older workers. This testimony will address those factors making it important to encourage those who want to work to continue doing so, as well as factors affecting older Americans' employment decisions.

www.gao.gov/cgi-bin/getrpt?GAO-05-620T.

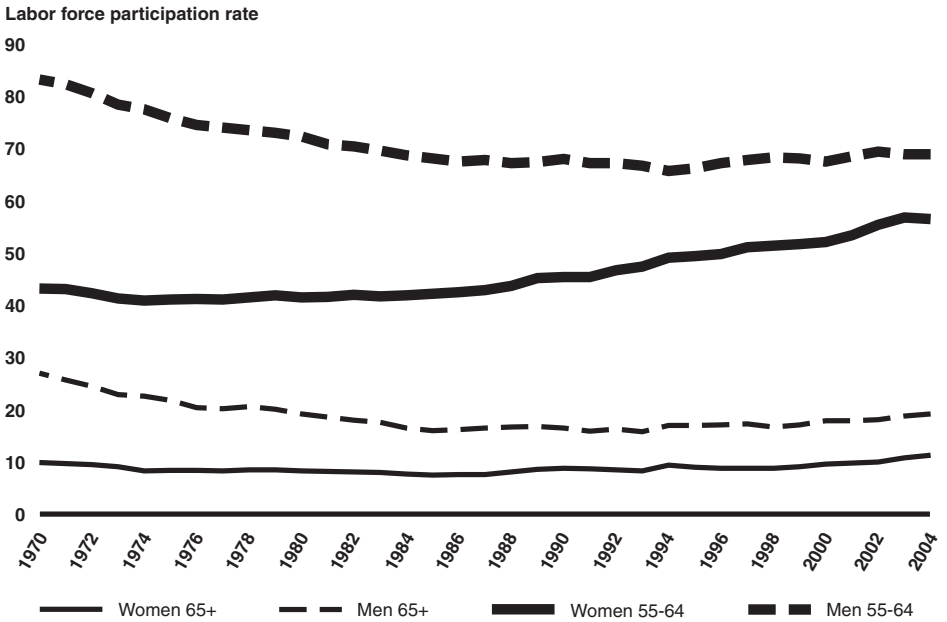
To view the full product, including the scope and methodology, click on the link above. For more information, contact Barbara Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

### What GAO Found

The aging of the baby boom generation (those born between 1946 and 1964), increased life expectancy, and falling fertility rates pose serious challenges for our nation. These trends will affect the size and productivity of the U.S. labor force and its output and will have real and important impacts on employers and the economy. With the impending retirement of the baby boom generation, employers face the loss of many experienced workers and possibly skill gaps in certain occupations. This could have adverse effects on productivity and economic growth. Furthermore, the expected increasing ratio of the elderly to those of working ages will place added pressure on Social Security and Medicare, both of which face long-term financial problems. Increasing the labor force by encouraging Americans to work longer may be one part of solutions to these problems.

Although some people can benefit by remaining in the labor force at later ages, others may be unable or unwilling to do so. For those who are able, there are many factors that influence their choices. These include the eligibility rules of both employer pension plans and Social Security, an individual's health status, the need for health insurance, personal preference, and the employment status of a spouse. The availability of suitable employment, including part-time work or flexible work arrangements, may also affect the retirement and employment choices of older workers.

**Labor Force Participation Rate at Older Ages is Projected to Rise Slightly**




Source: United States Bureau of Labor Statistics, Labor Force Statistics from the Current Population Survey, http://www.bls.gov/data/home.htm.

Mr. Chairman and Members of the Committee:

Slow labor force growth coupled with an aging population pose serious economic and fiscal challenges to America in the 21st century. Policies that encourage those older workers who want to work to continue doing so or that remove work disincentives for this age group could help mitigate the problem. I am pleased to be here today to discuss the importance of older workers to the labor force, the economy, and the future health of U.S. retirement programs.

Today I would like to look at older workers from two perspectives, considering first those factors making it important to encourage those who want to work to continue doing so and second factors affecting older Americans' employment decisions. GAO has conducted several studies related to older worker issues, including demographic trends and their effects on employers, older workers, the federal budget, and the economy.[1] My statement is based on some of this prior GAO work. We are currently working on a study in greater depth of older workers' perspectives concerning employment and retirement options. We expect to publish a report in the fall.

In summary, the aging of the baby boom generation (those born between 1946 and 1964), increased life expectancy, and falling fertility rates pose serious challenges for our nation. These trends will affect the size and productivity of the U.S. labor force and its output and will have real and important impacts on employers and the economy. With the impending retirement of the baby boom generation, employers face the loss of many experienced workers and possibly skill gaps in certain occupations. This could have adverse effects on productivity and economic growth. Furthermore, the expected increasing ratio of the elderly to those of working ages will place added pressure on Social Security and Medicare,

[1]For further information on older worker issues please see the following reports and testimonies: GAO, *Older Workers: Demographic Trends Pose Challenges for Employers and Workers*, GAO-02-85 (Washington, D.C.: Nov.16, 2001); *Highlights of a GAO Forum: Workforce Challenges and Opportunities For the 21st Century--Changing Labor Force Dynamics and the Role of Government Policies* , GAO-04-845SP (Washington, D.C.: Jun.1, 2004); *Retiree Health Insurance: Erosion in Employer-Based Health Benefits for Early Retirees*, GAO/HEHS-97-150 (Washington, D.C.: Jul.11, 1997); *Private Health Insurance: Declining Employer Coverage May Affect Access for 55 to 64 Year Olds*, GAO/HEHS-98-133 (Washington, D.C.: Jun.1, 1998); *Older Workers: Policies of Other Nations to Increase Labor Force Participation*, GAO-03-307 (Washington, D.C.: Feb.13, 2003).

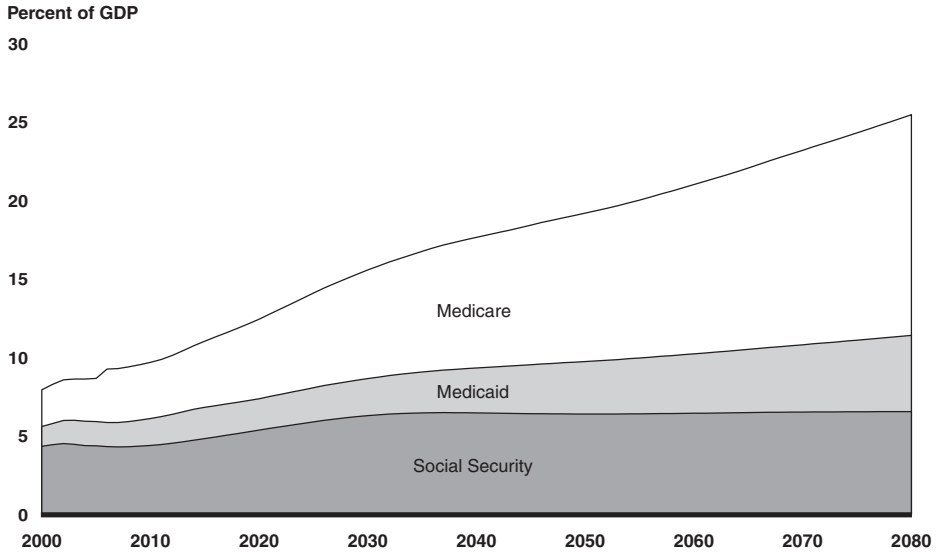
both of which face long-term financial problems. Increasing the labor force by encouraging Americans to work longer may be one part of solutions to these problems.

Encouraging Americans to work longer, if they are able to, requires first understanding the factors influencing that decision. These include retirement income, the availability of health insurance, an individual's health status, and the employment status of a spouse. The availability of suitable employment, including part-time work or flexible work arrangements, also may affect older workers' choices regarding retirement and employment. Given these options, federal policymakers may want to consider creating incentives for older Americans who are able to work to remain in the workforce and ensuring that federal policies do not discourage the choice to work longer. Doing so could enhance future supplies of skilled workers, bolster economic growth, and help many people secure adequate retirement income.

## Background

In the 21st century the nation faces a growing fiscal imbalance. A demographic shift will begin to affect the federal budget in 2008 as the first baby boomers become eligible for Social Security benefits. This shift will increase as spending for federal health and retirement programs swells. Long-term commitments for these and other federal programs will drive a massive imbalance between spending and revenues that cannot be eliminated without tough choices and significant policy changes. Over the past several years, GAO has called attention to this problem. Long-term budget simulations by GAO, the Congressional Budget Office (CBO), and others illustrate the growing fiscal imbalance. (See fig. 1.)

**Figure 1: Social Security, Medicare, and Medicaid Spending as a Percent of GDP**




Source: GAO analysis based on data from the Office of the Chief Actuary, Social Security Administration, Office of the Actuary, Centers for Medicare and Medicaid Services, and the Congressional Budget Office.

Note: Social Security and Medicare projections are based on the intermediate assumptions of the 2005 Trustees' Reports. Medicaid projections are based on CBO's January 2005 short-term Medicaid estimates and CBO's December 2003 long-term Medicaid projections under midrange assumptions.

Continued economic growth is critical to addressing this challenge and will help to ease the burden, but the projected fiscal gap is so great that it is unrealistic to expect that the United States will grow its way out of the problem. Early action to change existing programs and policies would yield the highest fiscal dividends and provide a longer period for prospective beneficiaries to make adjustments in their own planning. One of the potential policy changes that could address both the demographic shift and the need for robust economic growth is assisting older workers who want to stay in the workforce past retirement age.

These demographic problems are not unique to the United States. Other countries are also confronting the economic and labor force consequences of aging populations. In fact, the challenges arising from these demographic shifts alone will be less pronounced in the United States than in several other high-income nations. In prior work that we conducted for this committee, we found that Sweden, Japan, and the United Kingdom had enacted retirement policy reforms that included incentives for older

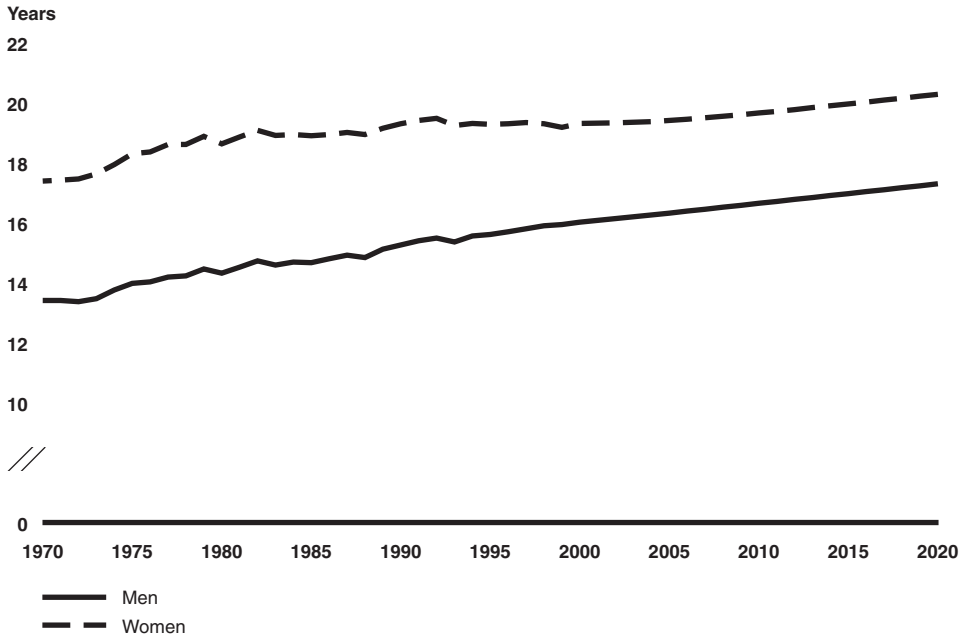
workers to extend their working lives.[2] At the same time, these countries were also seeking policies that would reduce barriers to employment for older workers.

## Economic and Demographic Trends Call For Policies Encouraging Longer Working Lives

In the 21st century, older Americans are expected to represent a growing share of the population, have a longer life expectancy than previous generations and spend more years in retirement. The baby boom generation is fast approaching retirement age; the oldest baby boomers will start to turn 65 in 2011, just 6 years from now. In addition, life expectancy is increasing. The average life expectancy at age 65 for men has increased from just over 13 years in 1970 to 16 years in 2005, and is projected to increase to 17 years by 2020. Women have experienced a similar rise--from 17 years in 1970 to over 19 years in 2005. Women's life expectancy at age 65 is projected to be 20 years by 2020. (See fig. 2.)

[2] GAO, *Older Workers: Policies of Other Nations to Increase Labor Force Participation*, GAO-03-307 (Washington, D.C.: Feb.13, 2003).

**Figure 2: Life Expectancy Has Risen Steadily and May Continue to Do So**



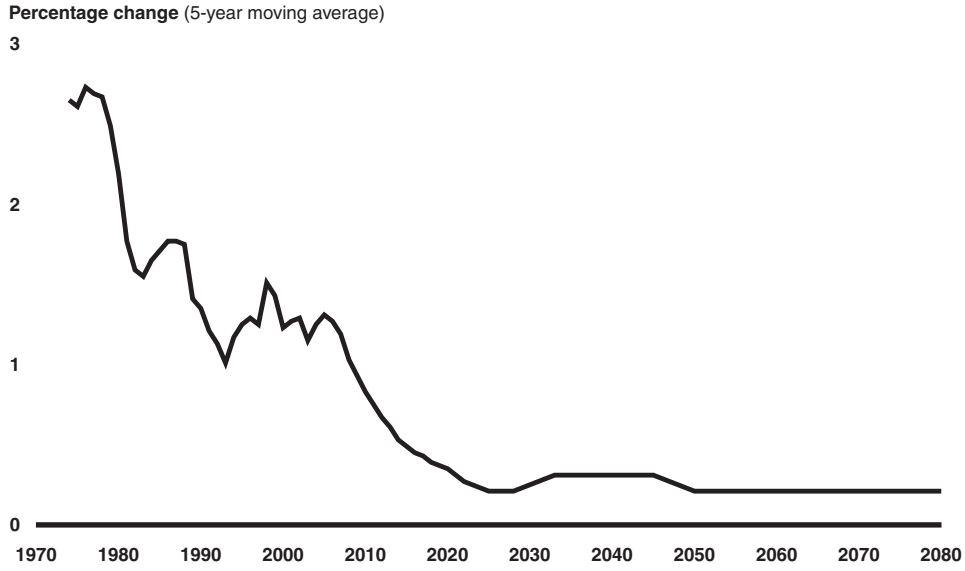

Source: Felicitie C. Bell and Michael L. Miller, "Life Tables for the United States Social Security Area 1900-2100," Actuarial Study No. 116, http://www.ssa.gov/OACT/NOTES/as116/as116TOC.html.

As a consequence of life expectancy increases, individuals are generally spending more years in retirement. The average male worker spent 18 years in retirement in 2003, up from less than 12 years in 1950.

A lower fertility rate is the other principal factor underlying the growth in the elderly's share of the population. In the 1960s, the fertility rate was an average of three children per woman.[3] Since the 1970s, the fertility rate has hovered around two children per woman. This decline in the fertility rate is a major factor in the slowing growth of the labor force over the last decade, a trend that is expected to continue. By 2025 labor force growth is expected to be less than a fifth of what it is today, as shown in figure 3.

[3]The fertility rate is defined as the total number of children born per 1000 women aged 15 to 44 years.

**Figure 3: U.S. Labor Force Growth Will Continue to Decline**

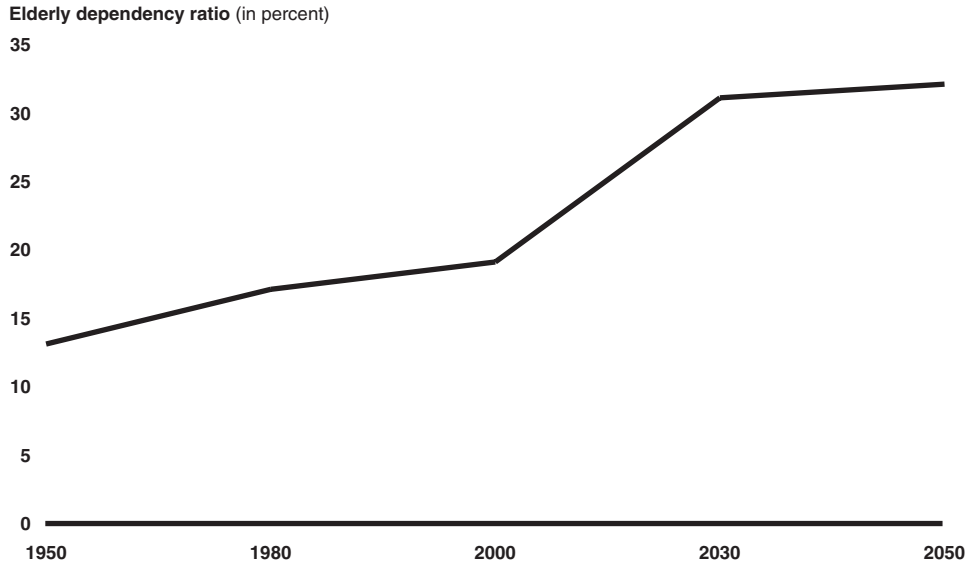



Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration.

Note: Percentage change is calculated as a centered 5-year moving average of projections based on the intermediate assumptions of the 2004 Trustees' Reports.

As a result of these trends, the share of the population aged 65 and older is projected to increase from 12 percent in 2000 to almost 20 percent in 2030. These developments will lead to significant changes in the elderly dependency ratio--the estimated proportion of people aged 65 and over to those of working age. In 1950, there was one elderly person for every 7 workers. The ratio increased to 1 to 5 in 2000 and is projected to rise to 1 to 3 by 2050. (See fig. 4.)

**Figure 4: U.S. Elderly Dependency Ratio Has Increased Substantially**




Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, *World Population Prospects: 2002 Revision and World Urbanization Prospects: 2001 Revision.* Data for 2030-2050 are projected.

Note: The elderly dependency ratio is the ratio of the population aged 65 years or over to the population aged 15 to 64.

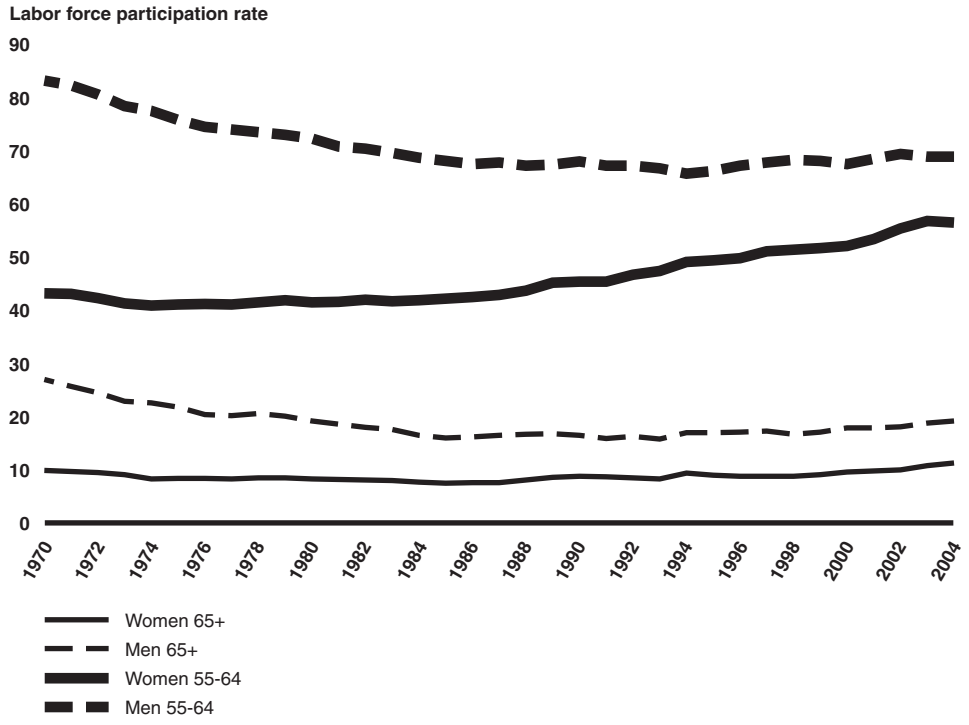
These demographic developments have real implications for the nation's economy. If labor force growth continues to decline as projected, relatively fewer workers will be available to produce goods and services. Without a major increase in productivity or higher than projected immigration, low labor force growth will lead to slower growth in the economy and to slower growth of federal revenues. This in turn will accentuate the overall pressure on the federal budget.[4] Another concern is the possible loss of many experienced workers as the baby boomers retire. This could create gaps in skilled worker and managerial occupations, leading to further adverse effects on productivity and economic growth.

Though long-term trends in labor force growth present significant challenges, there is some reason for optimism. In recent years, the labor

[4]For more information on long-term fiscal and economic challenges, please see GAO, *Social Security: Long-Term Challenges Warrant Early Action*, GAO-05-303T (Washington, D.C.: Feb. 3, 2005); *Social Security Reform: Early Action Would be Prudent*, GAO-05-397T (Washington, D.C.: Mar. 9, 2005); and GAO's Web site on long-term fiscal challenges: http://www.gao.gov/special.pubs/longterm/.

force participation rate of men over age 55 has increased, and it is projected to continue to increase in the future. After hitting a low point of approximately 65 percent in 1994, the rate for this group rose to more than 69 percent in 2002, and the Bureau of Labor Statistics (BLS) projects it will be almost 70 percent in 2012. For men 65 and older, the rate also increased, to about 19 percent, and is projected to rise to nearly 21 percent by 2012. Similarly, the labor force participation rate of women over 55 has continued to increase. For women 55 to 64, the rate rose to more than 56 percent by 2004 and is projected to grow to over 60 percent by 2012. (See fig. 5.)

**Figure 5: Labor Force Participation at Older Ages Is Projected to Rise Slightly**




Source: United States Bureau of Labor Statistics, Labor Force Statistics from the Current Population Survey, http://www.bls.gov/data/home.htm.

These recent increases in labor force participation by older workers are encouraging. If Americans increase the number of years they work it could ease pressure on government retirement programs by increasing revenues to the Social Security and Medicare trust funds. In addition, individuals can significantly improve their standard of living in retirement. By remaining in the labor force, workers continue to earn income and delay drawing down assets such as pensions and personal savings, resulting in a

shorter period over which they have to budget their resources. Some researchers have found that delaying retirement can substantially increase annual income in retirement.[5] For example, they found that postponing retirement from age 55 to age 65 could nearly double real annual income at age 75.

## Many Factors Influence Workers' Retirement and Employment Decisions

Although some people can benefit by remaining in the labor force at later ages, others may be unable or unwilling to do so. For those who are able, there are many factors that influence their choices. These include the eligibility rules of both employer pension plans and Social Security, an individual's health status, the need for health insurance, personal preference, and the employment status of a spouse. The availability of suitable employment, including part-time work or flexible work arrangements, may also affect the retirement and employment choices of older workers.

### Eligibility Rules

Depending on the eligibility rules and schedule of benefits, it can sometimes be more advantageous for workers to retire than to continue employment. The eligibility age for full Social Security benefits is currently 65 years and 6 months and rising, with reduced benefits available at age 62.[6] Data from 2002 show that a majority of people (56.1 percent) elect to start benefits at age 62.[7] Another important retirement incentive is eligibility for employer-provided pension benefits. In the United States, less than half of the labor force has some type of employer-provided pension coverage. In some cases the rules governing these plans create incentives to retire, even for those who may prefer to continue working.

### Health Status

Health status and occupation are other key factors that influence the decision to work at older ages. As people age, they tend to encounter more

[5]Butrica, Johnson, Smith, and Steuerle, "Does Work Pay at Older Ages?" Urban Institute. December 2004.

[6]The full eligibility age (or normal retirement age) for Social Security benefits is being raised from 65 to 67 from 2000 to 2022. The reduction for taking benefits at age 62 was 20 percent when the full eligibility age was 65. When the age increase to 67 is fully implemented, the reduction will be 30 percent.

[7]"2004 Green Book: Background Material and Data on the Programs within the Jurisdiction of the House Committee on Ways and Means," March 2004, p. 1-47.

health problems that make it more difficult to continue working or to work full-time. 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 since health can be affected by work environment. Although blue-collar and service sector workers may continue to face significant health problems, there is evidence that the health of older persons generally is improving. Research has shown that the majority of workers aged 62 to 67 do not appear to have health limitations that would prevent them from extending their careers, although some could face severe challenges in attempting to remain in the workforce.[8] In general, however, today's older population may have an increased capacity to work compared with that of previous generations.

## Health Insurance

Rising health care costs have made the availability of health insurance and anticipated medical expenditures important factors in the decision to retire. As health care costs continue to rise, many employers have decided to discontinue their retiree health benefits. A recent study estimated that the percentage of after-tax income spent on health care will approximately double for older married couples and singles by 2030.[9] People at the lower end of the income distribution will be the most adversely affected. The study projected that by 2030 those in the bottom 20 percent of the income distribution would spend more than 50 percent of their after-tax income on insurance premiums and health care expenses, an increase of 30 percentage points from 2000. Continued employment could provide older workers with more income to help finance health care and in some cases could provide them with employer-sponsored health insurance. However, those least able to work at older ages may also be those with higher health care expenses.

## Personal Preference

Researchers have also found that some older workers choose to remain in the labor force for reasons of physical and mental well-being. In recent

[8]See GAO, *Social Security Reform: Raising Retirement Ages Improves Program Solvency but May Cause Hardship for Some*, GAO/T-HEHS-98-207 (Washington D.C.: July 15, 1998).

[9]Richard W. Johnson and Rudolph G. Penner, "Will Health Care Costs Erode Retirement Security?" *Issue in Brief*, Center for Retirement Research at Boston College, October 2004, No. 23.

surveys by AARP,[10] Watson Wyatt,[11] and the Employee Benefit Research Institute (EBRI),[12] older workers and retirees indicated that, in addition to financial considerations, enjoyment of work and a desire to stay active were important reasons to decide to work in retirement. For example, in the 2004 Retirement Confidence Survey done by EBRI, retirees most often said they worked for pay because they enjoyed working and wanted to stay involved (66 percent); yet a large majority also identify at least one financial reason for having worked (81 percent).

## Spouse

In addition, the labor force status of a spouse affects the retirement decision of an older worker. A recent study found that older married couples tend to retire at the same time.[13] Another study which analyzed the retirement behavior of married men and women separately found that men were more likely to retire if their wife was also retired, but women were not significantly affected by the labor force status of their husbands.[14]

## Alternative Work Arrangements

The labor force decisions of older persons are also influenced by the availability of alternatives to full-time employment. In the United States, there has been interest among older workers who wish to work longer in seeking employment arrangements that allow them to work part-time in retirement. We define partial retirement as a reduction in hours from full-time to part-time work. A partial retiree may have transitioned directly from full- to part-time work at either a current or a new job, or may have returned to work after full retirement. Although surveys indicate that

[10]S. Kathi Brown, "Attitudes of Individuals 50 and Older toward Phased Retirement," AARP Research Report, March 2005.

[11]Watson Wyatt, *Phased Retirement: Aligning Employer Programs with Worker Preferences.* 2004

[12]Employee Benefit Research Institute, *Encouraging Workers to Save: The 2005 Retirement Confidence Survey.* Issue Brief No. 280, April 2005.

[13]Richard W. Johnson, "Do Spouses Coordinate Their Retirement Decisions?" *Issue in Brief*, Center for Retirement Research at Boston College, July 2004, No. 19.

[14]Courtney Coile, "Retirement Incentives and Couples' Retirement Decisions," NBER Working Paper No. 9496, February 2003.

many older workers would like to partially retire,[15] prior GAO work found that offering such options is not a widespread practice among private employers and does not involve large numbers of workers at individual firms.[16]

## Employment Opportunities

Labor force participation is not solely the workers' decision—there must also be an effective demand for their labor. Employers' perceptions or biases against older workers may form potential barriers to older workers' retaining their current jobs, finding new jobs, or reentering the work force after retiring. For example, employers may feel that it is more difficult to recoup the costs of hiring and training older workers. All other things being equal, older workers can also raise an employer's cost of providing health insurance. Older workers may also face an obstacle because of a negative perception among employers about their productivity. Although the Age Discrimination in Employment Act protects those age 40 and over from age-based discrimination in the workplace, complaints to the Equal Employment Opportunity Commission suggest that such discrimination does still occur.

# Conclusions

To the extent that people choose to work longer as they live longer, the increase in the amount of time spent in retirement could be diminished. By staying in the workforce, older workers could ease financial pressures on Social Security and Medicare, as well as mitigate the expected slowdown in labor force growth. The additional income from earnings also could provide older Americans with greater resources in retirement and improve their financial security.

Many older Americans are both willing and able to continue working at older ages. As described above, increased labor force participation of older workers would benefit both the economy and individuals. Thus, it is important to (1) encourage more widespread availability of flexible employment arrangements, such as partial retirement, which would make

[15]See Laurene A. Graig and Valerie Paganelli, "Phased Retirement: Reshaping the End of Work," *Compensation and Benefits Management*, Vol. 16, No. 2, Spring and S. Kathi Brown, "Attitudes of Individuals 50 and Older toward Phased Retirement," AARP Research Report, March 2005.

[16]See GAO, *Older Workers: Demographic Trends Pose Challenges for Employers and Workers*, GAO-02-85 (Washington D.C.: November 2001).

it easier for older workers to continue working, and (2) remove incentives that may induce older workers, who would otherwise choose to continue working, to retire.

For those older Americans who are able to work, policies, programs, and alternative employment arrangements that help to extend their working life can enhance future supplies of skilled workers, bolster economic growth, and help many people secure adequate retirement income. We at GAO look forward to continuing to work with this Committee and the Congress in addressing this and other important issues facing our nation.

Mr. Chairman, Mr. Kohl, members of the Committee, that concludes my statement. I'd be happy to answer any questions you may have.

## GAO Contacts and Staff Acknowledgments

For further information regarding this testimony, please contact Barbara D. Bovbjerg, Director,or Alicia Puente Cackley, Assistant Director, at (202) 512-7215. Other individuals making key contributions to this testimony included Mindy Bowman, Sharon Hermes, and Kristy Kennedy.

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