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International policies to encourage the labour force participation of older workers: Lessons for the United States

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International Policies to Encourage the Labor Force Participation of Older Workers: Lessons for the U.S.

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Abstract

In recent years, the challenges of aging populations have become a topic of increasing concern to the developed nations. These challenges range from the fiscal imbalance in national pension systems to potential economic strains due to shortages of skilled workers. Part of the solution to these challenges could be greater older worker labor force participation. The authors focus on the experiences of three nations–Japan, Sweden, and the United Kingdom--that had displayed high levels of older worker labor force participation in the past and were now implementing policy reforms that continued to emphasize the importance of older workers. They find that the nature of the reforms, the public availability and transparency of information on the reforms, and the strength of the national economy play key roles in extending older worker labor force participation. The authors also find that the U.S. is demographically in a better position than many other nations to address these challenges, although more can be done to encourage the labor force participation of older American workers.

Introduction

As is the case in developed nations around the world, the aging of the U.S. population will pose challenges to U.S. national economy and retirement income programs. Organizations as diverse as the World Bank, the Organization for Economic Cooperation and Development (OECD), the United States Federal Reserve, and others have studied these challenges, which range from the growing fiscal pressures in national pension systems[1] caused by fewer workers having to provide benefits for greater numbers of retirees, to potential economic strains due to shortages of skilled workers as they exit the labor force. Most of these organizations believe that greater labor force participation by older workers can be part of the solution to mitigate the adverse effects of aging populations. This paper draws upon the experience of other high-income industrialized nations in examining the following questions: (1) How does the United States compare with other high-income nations with regard to recent and projected trends in key demographic and labor force characteristics? (2) How are recently enacted retirement policy reforms in high-income nations expected to affect the labor force participation rate of older workers?[2] (3) What did these nations learn from enacting policies that may increase the labor force participation of older workers? We conclude with some observations on the implication of these developments for U.S. labor and retirement policy.

To answer these questions, we compiled and analyzed demographic and labor force data from the OECD, the United Nations Population Division, and the International Labour Organization (ILO), highlighting data from the United States and seven other comparison OECD nations.[3] In addition, we consulted with individual experts in national pension policy and conducted an extensive review of the international retirement literature. On the basis of this preliminary research, we identified three nations—Japan, Sweden, and the United Kingdom—that had displayed high levels of older worker labor force participation in the past and were now implementing policy reforms that continued to emphasize the importance of older worker labor force participation. We then examined these nations' pension systems—both national and employer-provided—and labor market policies through interviews, literature reviews, and site visits. We met with key government officials concerning pension and labor market policy, representatives from employer organizations and labor unions, and well-known scholars who have studied older worker issues in each nation.

Background

The number of persons in the United States over age 55 will grow substantially over the next two decades. Due to the aging of the baby boom generation,[4] older persons are becoming an

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[1]For this paper, the term "national pension system" will be used when referring to "universal" government programs that provide retirement benefits to persons in nations other than the United States. The term "employer-provided pension" refers to retirement benefits businesses make available to their employees.

[2]In this paper, we define older workers as persons 50 years of age and older. In some cases, because of the limitations of available data, we analyze subgroups of older workers, for example, those 55 years of age and older.

[3]Besides the United States, the seven other nations highlighted are the remaining six of the "G-7"—Canada, France, Germany, Italy, Japan, and the United Kingdom—and Sweden. For more details on our scope and methodology and on the national and occupational pension systems and labor market policies of the three nations we studied, see *Older Workers: Policies of Other Nations to Increase Labor Force Participation*, (GAO-03-307, February 13, 2003.)

[4]The baby boom generation is defined as all persons born between 1946 and 1964. For a general discussion of these trends, see *Older Workers: Demographic Trends Pose Challenges for Employers and Workers,* GAO-02-85 (Washington, D.C.: November 16, 2001).

increasingly significant proportion of all persons and workers. In 2002, the U.S. Census Bureau estimates that there were 61 million people over age 55; their numbers are projected to grow to 103 million in 2025. This growth will increase the percentage of the population that is over 55 from 22 percent to 30 percent.

This shift in population age will affect the composition of the labor force. The number of older workers in the United States is projected to grow substantially over the next two decades, and they will become an increasingly significant proportion of all workers. In June of 2002, there were 19.2 million workers over age 55 and their numbers are projected to increase to 31.8 million by 2015. This growth is projected to increase the percentage of the workforce that is over 55 from 14 percent in 2002 to nearly 20 percent in 2015.

The projected growth in the percentage of the labor force over 55 will occur among both men and women. This would shift an earlier trend among older men, whose labor force participation declined from the 1950s until the mid-1990s. Since the mid-1990s, labor force participation among older men has been relatively constant at 67 percent for men age 55 to 64 and 17 percent for men age 65 and older. The Bureau of Labor Statistics (BLS) now projects these levels to rise to 69 percent and nearly 20 percent by 2015. The expected growth in labor force participation rates among older women would continue the current long-term trends of increases in their participation. For example, the percent of women age 55 to 64 in the labor force has steadily increased since the mid-1980s, from 42 to 52 percent in 2000, while rates among women 65 and older have grown from 7 to 9 percent in 2000. BLS projects these numbers to increase to 61 percent and 10 percent by 2015.

There are many factors that influence a person's decision to work at older ages. One key factor is the financial incentive created by the rules regarding eligibility for benefits from the national pension system—Social Security in the United States. Among other factors, the decision to continue working is influenced by the trade-off a worker faces between earnings and leisure time. The availability of Social Security benefits allows workers to substitute non-labor income for their earnings and to enjoy 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. The eligibility age for full Social Security benefits is currently 65 years and 8 months and rising, with reduced benefits available at age 62.[5] If a person elects to start receiving benefits at age 62, 63, or 64, the total lifetime benefits[6] they receive will be roughly equivalent.[7] Even though delaying receipt of benefits for 1 year is on average "actuarially equivalent or neutral," data from the mid-1990s show that most people (60 percent) elect to start benefits at age 62. These benefits

[5]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.

[6]P. Diamond and J. Gruber. "Social Security and Retirement in the United States," *Social Security and Retirement Around the World* (Chicago: University of Chicago Press, 1999).

[7]This calculation is based on living to average life expectancy. If the calculation is based specifically on race or gender, the results may be different since life expectancy differs by race and gender. For example, an African American male, who would be projected to have a lower life expectancy relative to females, and males of other ethnicities, should take benefits at the earliest possible age to maximize his total lifetime benefit.

can be reduced if the beneficiary has earnings above the income threshold when they are age 62-64. There are no earnings limitations on Social Security benefits above age 65.

Another important retirement incentive is eligibility for employer-provided pension benefits.[8] In the United States, about half of the labor force has some type of employer-provided pension coverage. 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.[9] In the United States, benefits in defined benefit plans are insured by the Pension Benefit Guaranty Corporation (PBGC). Under a defined contribution plan, the retirement benefit is expressed as an account balance for the individual employee.[10] This balance results from contributions that the employer, the worker, or both make, as well as from subsequent investment returns on the assets in the account. Under a defined contribution plan, retirement benefits are not guaranteed by the PBGC, and employees bear the risks of investment.

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 often provide incentives for early retirement because they often do not increase retirement benefits in-line with additional years of work with the firm after the early retirement age.[11] Under defined contribution plans, benefits can continue to increase, consistent with continued contributions and positive rates of return on assets. Since workers' accounts increase in size proportional to the amounts that are contributed by them or by their employers, they do not create incentives to retire based on the benefit formula.[12] In the past, a greater percentage of pension-plan participants were covered by defined benefit plans. 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.

Other non-economic factors may also affect the decision to continue working. For example, many persons receive personal satisfaction, meaning or self-fulfillment through their work and much

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[8]Employer-provided pensions outside of any mandatory or universal national pension system comprise what is often called the system of occupational pensions. We use the term employer-provided pensions when discussing occupational pension systems. See U.S. General Accounting Office, *Pension Plans: Characteristics of Persons in the Labor Force Without Pension Coverage*, GAO/HEHS-00-131 (Washington, D.C.: Aug. 22, 2000).

[9]For example, under a defined benefit plan with a final average pay formula, the retirement benefit is a percentage of the participant's final years of pay multiplied by his or her length of service. Under defined benefit plans, contributions are co-mingled funds invested in a pension trust on behalf of all participants, and plan trustees have fiduciary responsibilities for all assets in the pension trust.

[10]An example of a defined contribution plan is the 401(k) plan, named for the section of the Internal Revenue Code that sets out the tax preferences for such plans.

[11]The Employee Retirement and Income Security Act generally requires that tax-qualified plans allow participants to retire with full benefits at no later than age 65. Many plans allow normal retirement earlier than these limits.

[12]However, though they are age-neutral with regard to the benefit formula in comparison to defined benefit plans, defined contribution plans can still influence the retirement decision through their effect on individual wealth. The investment performance of a workers' account can have a large effect on the final pension benefit. High rates of return on an account can lead to larger balances, permitting possible earlier retirement. The degree to which this can occur is also a function of the individual's allocation of portfolio assets. See *Are Older Workers Responding to the Bear Market?* by Andrew D. Eschtruth and Jonathan Gemus, September 2002. JTF No. 5, Center for Retirement Research, Boston College.

research has been conducted on the concept of "quality of work life" issues. Depending on the social qualities or status of the employment options with which they are presented, some workers could be less responsive to pure economic incentives. Family structure and unpaid family duties will also influence the decision to continue working. For example, older persons who care for ill or otherwise incapacitated spouses or family members may or may not choose to continue working, depending on their personal circumstances.

Health status and occupation are other important factors that influence the decision to work at older ages.[13] 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 since health can be affected by work environment. Blue-collar and service workers, such as construction workers and janitors, often face physically demanding work environments that may affect their health status; these consequently lead to health impairments that affect their ability to work to older ages. Although this group continues to face problems, there is evidence that the health of older persons generally is improving. This suggests that, compared with previous generations, today's older age population has an increased capacity to work to older ages.

Although the Age Discrimination in Employment Act (ADEA) protects workers in the United States age 40 and older from employment discrimination,[14] labor force participation is not solely an older worker's decision, as 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 re-entering the labor force after retiring if their retirement income is inadequate. For example, some employers believe that older workers have lower productivity than younger workers, generate higher costs for employee benefits such as health care and pensions, and represent higher costs for recruitment and training since they have less potential time to recoup these up front costs compared with a younger worker. Encountering these obstacles could discourage older workers and influence their decision to retire.

The labor force decisions of older persons are also influenced by the availability of alternative employment arrangements. In the United States, there has been interest among older workers who wish to work longer in seeking employment arrangements that result in "phased retirement" or "bridge employment." Phased retirement usually refers to staying with a career job on a part-time or part-year schedule while phasing out employment over a number of years to complete retirement. Bridge employment usually refers to leaving a career job and moving to part-time work with another firm in the same or different industry, prior to complete retirement. In the United States, nearly half of all workers age 55 to 65 utilize a bridge job before completely retiring.

Older Americans receive income through a variety of sources, with the Social Security program constituting the largest share for most persons. In 2000, 90 percent of households with a person age

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[13]Access to retiree health benefits is a factor influencing older workers' retirement decisions. GAO has reported that the availability of employer-sponsored health insurance coverage for retirees under age 65 declined during the 1990's. See *Retiree Health Insurance: Gaps in Coverage and Availability*, GAO-02-178T (Washington, D.C.: Nov. 1, 2001).

[14]This includes the prohibition of most mandatory retirement policies.

65 or older received Social Security benefits. These benefits constitute more than 50 percent of total income for 64 percent of these households. Social Security benefits, on average, replace about 40 percent of a program-covered individual's pre-retirement income, if benefits are taken at age 62. Other major sources of income for older Americans are asset income (received by 59 percent of households), retirement benefits other than Social Security (41 percent), and earnings (22 percent). Social Security represents 41 percent of aggregate income, earnings represent 23 percent, retirement benefits other than Social Security are 18 percent, and asset income is 17.5 percent.

In the United States, the Disability Insurance (DI) program provides compensation for the reduced earnings for individuals who have worked long enough and recently enough to become insured and have lost their ability to work because of a severe, long-term disability. DI provides benefits to persons who are not able to perform substantial gainful activity due to a physical or mental impairment. DI is not a major source of income for a significant portion of older persons in the United States. In 2000, 7 percent of the population age 50-59 received DI benefits.[15]

Adverse Labor Force and Demographic Trends Less Pronounced in the U.S. but Pose a Challenge

The recent and projected labor force participation and population aging trends for most other high-income nations[16] will be less pronounced in the United States, but the aging of the population will nevertheless pose a challenge to retirement income programs. ILO data for 2000 show that the labor force participation rates for older U.S. workers, though not as high as in previous decades, will be higher than in most other high-income nations. It is expected that, because of higher fertility and immigration rates, the U.S. population will also age more slowly than other high-income nations. However, even though the population of the United States is not aging as rapidly as other countries, the old-age dependency ratio—the number of people over the age of 60 for every 100 working age people (ages 15-59)—is projected to rise from 19 in 2000 to 35 in 2050.[17] This near doubling of the old-age dependency ratio will strain the resources of programs that pay for retirement.

Even though the labor force participation of workers age 50 to 64 is expected to decline in most high-income nations, including the United States, between 2000 and 2010, the United States has and will continue to have higher rates of labor force participation for older workers than most other high-income nations.[18] (See Figure 1.) In some high-income nations, such as France, Germany, and Italy, about 2 to 4 percent of persons age 65 and older participated in the labor force. In contrast,

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[15]We focus on the age range of 50-59 because DI benefits are automatically converted to retired worker benefits at the normal retirement age (currently 65 and 8 months for people reaching age 62 in 2003). New DI participation is discouraged at age 62-64 due to the lengthy determination process that makes many people choose to take Social Security retired worker benefits.

[16]High-income nations refer to the 23 nations that the World Bank has designated as "high income." This group includes the 8 comparison nations highlighted earlier, as well as Australia, Austria, Belgium, Canada, Denmark, Finland, Greece, Iceland, Ireland, Luxembourg, The Netherlands, New Zealand, Norway, Portugal, Spain, and Switzerland.

[17]In the United States, the old-age dependency ratio is typically measured by comparing persons over age 65 with persons 16-64. We presented data for persons over age 60 compared with persons age 15-59 because ILO makes these data available in these age ranges.

[18]We present ILO data because they are the only comparable available data on the high-income nations. However, ILO projections differ from those conducted by BLS that actually project increases in the labor force participation for older U.S. workers between the years 2000 and 2025. In both cases, the labor force participation for older workers in the United States remains comparatively higher than many, though not all, other high-income nations.

the labor force participation rate in 2000 among U.S. workers age 65 and over was 10 percent, the second highest labor force participation rate among selected high-income nations and 1.4 percentage points higher than the aggregate for all 23 nations the World Bank has designated as high-income. (See Figure 2.) Labor force participation among U.S. workers age 50-64 was 66 percent. (See Figure 1.) This trails only Sweden's (79 percent) and Japan's (73 percent) rates for this age group.

The relatively high rate of labor force participation by older U.S. workers is being sustained by an increasing percentage of older women working. In the United States, as in other high-income nations, labor force participation among older men has declined since 1950 and, for the most part, is projected to continue declining through 2010. (See Figure 3.) During that same period, however, labor force participation among older women is projected generally to rise. (See Figure 4.) In the United States, labor force participation among women age 50-64 will nearly double from 1950 to 2010, increasing from 31 percent to 58 percent.[19]

The size of the baby boom generation, rising life expectancy and declining fertility are expected to contribute to a rising median age in high-income nations. Because the baby boom generation is large in number, a growing proportion of the populations in high-income nations will be over 60. In the United States, for example, this will be the case for about a quarter of the population. Moreover, as this generation has grown older, life expectancy has increased in all high-income nations. From 1955 to 2000, life expectancy in the United States increased from 70 to 77 years and is projected to increase to 80 by 2040.

As a result of these trends, the median age of the U.S. population, like that of other high-income nations, is projected to steadily increase in the coming decades, but it will still be lower than that of most high-income nations. Specifically, the median age of the U.S. population in 2030 is expected to be comparable to the current median ages in some high-income nations. For example, the median age of the U.S. population rose from 30 to 36 years from 1980 to 2000 and is projected to increase to 40 in 2030. (See Figure 5.) In contrast, the median age of the populations of high-income countries was 38 years in 2000 and is projected to rise to 45 in 2030. Germany, Italy, Japan, and Sweden have the current and projected oldest populations with median ages ranging from 40 to 41 years in 2000 and projected increases to 51 to 54 years in 2050.

Two factors will slow the trend toward an older population in the United States compared with most other OECD nations: fertility and immigration rates. Although fertility rates in high-income nations have declined overall since 1980, during the same time they have increased from 1.8 to 2.0 in the United States. The United States also has an immigration rate more than four times as high as Sweden and Japan, almost three times as high as the United Kingdom, and higher than that of most high-income nations.[20]

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[19]Sweden has experienced the most dramatic rise in labor force participation among women age 50-64, with rates tripling from 25 percent to 76 percent since 1950.

[20]The net immigration rate in the United States from 1995 to 2000 was 4.53 persons per 1,000 residents. Source: *World Population Prospects: The 2000 Revision*, United Nations Population Division. Found in Nyce, Steven A. and Sylvester J. Schieber. 2001. "Our Assumptions About Aging and What We Are Doing About It," draft manuscript.

The consequences of these demographic trends are most evident in the elderly dependency ratio. In most high-income nations, this ratio has been rising throughout the last 50 years and is projected to grow at a faster rate in the next half century. (See Figure 6.) The ratio in the United States is relatively low compared with other high-income nations. For every 100 people of working age (15 to 59) in the United States, approximately 19 people were in or nearing retirement age (60 or above) in 2000 compared with a ratio of 22 for the aggregate of 23 nations the World Bank has designated as high-income. This difference is projected to grow. By 2050, this ratio for other high-income countries is projected to be 47 in comparison with 35 for the United States. Even though the United States ratio will be smaller than that of other high-income nations in 2050, it represents an increase of over 75 percent from the 2000 ratio.

Reforms in Other Nations Expected to Increase Labor Force Participation of Older Workers

Recently enacted retirement policy reforms in Japan, Sweden, and the United Kingdom are expected to lead to higher labor force participation of older workers. Reforms adjusting benefits in the national pension systems of each of these nations provide incentives for older workers to extend their working lives. National and employer-provided pension reforms that introduce defined contribution features that do not link benefits to a specific age are also expected to encourage greater labor force participation of older workers. Other reforms that seek to limit the use of disability benefits as a route to early retirement will also influence older worker labor force participation. Acknowledging that improving the employment opportunities of older workers is an important consideration, each of these nations is studying or has enacted reforms that address the issues of older worker's employment more generally. Such reforms include loosening or eliminating mandatory retirement age standards, encouraging the elimination of age discrimination in employment, improving older worker training, providing employment earnings incentives, and exploring quality-of-work life issues such as the flexibility of work arrangements.

Reforms in the United Kingdom, Japan, and Sweden that increase the age at which workers are eligible for benefits or allow flexibility in when and how pension benefits can be taken are some of the policy changes that may encourage older workers to stay in the workforce. The United Kingdom will phase in an increase in the age at which women become eligible for national pension benefits, so that, beginning in 2020, men and women will no longer be able to draw benefits before age 65. Japan has also enacted reforms that will gradually increase the full eligibility age for its earnings-based national pension system. In Japan, by 2025 for men and 2030 for women, the earliest age when this pension can be claimed will have risen from 60 to 65. Rather than increasing the age for benefit eligibility, pension reforms in Sweden allow older workers to take a full or partial national pension (i.e., one-fourth, one-half, or three-fourths of a full pension) at age 61 or later with no upper age limit and continue working.[21] This flexibility may make it easier to retire gradually with a mix of pension benefits and earnings.

Pension reforms that change benefit calculations so they reward continued work or discourage early retirement may also promote continued labor force participation by older workers. Sweden changed

[21]For example, if a worker "retires" from his/her full time job at age 61 and continues to work part time while drawing 50 percent of his/her national pension, these earnings will continue to add to the value of his/ her pension account. When the worker retires completely, the pension will be recalculated to take into account these additional earnings. See *Older Workers: Policies of Other Nations to Increase Labor Force Participation*, (GAO-03-307, February 13, 2003.)

its benefit calculation to reward those who work longer. Under the new pension system in Sweden,[22] pensions are based on lifetime earnings, instead of the highest 15 out of 30 years of earnings as they were under the old system. The United Kingdom adjusted its benefit calculation formula to increase the reward for those who defer drawing benefits from the national pension system. For example, by 2010, individuals who defer drawing their pension benefits will receive benefits that are 10.4 percent, rather than 7.5 percent, larger for each year deferred.[23] In Japan, reforms have changed how pensions are calculated, reducing the level of benefits for future retirees through lower accrual rates. The expected effect of these changes is a 20-percent reduction in lifetime benefits by 2020, thereby making early retirement less affordable.

Finally, reforms in Sweden and the United Kingdom, in changing how pension benefits are indexed, may discourage early retirement. The new pension system in Sweden indexes pension benefits to life expectancy.[24] With increasing life expectancy, different generations of individuals with similar work and earnings histories will have to work longer to maintain a comparable standard of living in retirement. This benefit adjustment provides incentives for increased labor force participation by requiring individuals to bear the cost of increased life expectancy, either through additional work or lower benefits. The United Kingdom also revised the index it used to adjust benefits in the portion of its pension that provides flat-rate benefits. Prior to the reform, the United Kingdom adjusted benefits using either the higher of increases in average prices or average wages as an index. Now the United Kingdom uses only average price increases.[25] Since prices tend to increase more slowly than wages, this reform has effectively reduced benefits relative to earnings.[26]

Each of the nations we studied implemented reforms that included defined contribution features in their national and employer-provided pension systems, although this shift was more pronounced in Sweden and the United Kingdom than in Japan. Defined contribution pensions are more retirement age neutral than traditional defined benefit pension plans. As part of its recent national pension reform, Sweden instituted a pay-as-you-go pension system with defined contribution features,

[22]Sweden switched from a traditional pay-as-you-go defined benefit plan to system that combines a fully funded defined contribution plan and a pay-as-you-go "notional" defined contribution plan with automatic adjustments to preserve financial stability. The notional defined contribution is the larger of the two plans, accounting for 86 percent of all national pension contributions. See *Older Workers: Policies of Other Nations to Increase Labor Force Participation*, (GAO-03-307, February 13, 2003.)

[23]Experts we spoke with disagreed about the effectiveness of this reform in increasing older worker labor force participation. However, the government has considered changes to this reform. For example, it is considering allowing people a choice between taking the benefit increase as a lump-sum payment or as increases in each benefit payment. It is also considering pushing up the implementation of the benefit increase so that it will take effect in 2006 rather than 2010. This could increase the incentive for older worker labor force participation.

[24]For example, a person's pension in the notional defined contribution plan is calculated by dividing their pension account (the value of their accumulated pension rights) by an annuity factor. Estimated cohort life expectancy is the key element in the determination of the annuity factor, which is also determined by the "norm" real rate of return (a 1.6-percent increase in average real wages) and age at retirement. A higher average life expectancy for a cohort will increase the size of the annuity factor for that cohort compared to preceding cohorts. Consequently, individuals in later cohorts retiring at the same age and with the same pension account as those in earlier cohorts will receive a lower pension. See GAO 03-307.

[25]The U.K. government announced in December 2002 that it will increase flat-rate pension benefits in future years by at least 2.5% per year, even if this is larger than the increase in average prices.

[26]This change was introduced in 1980. Experts believe that the flat-rate basic portion of the U.K.'s national pension, which currently amounts to about 15 percent of average male earnings, will drop to 7 percent of average male earnings by 2050. However, means-tested benefits indexed to earnings growth are available to low-income individuals from age 60. See GAO 03-307.

including among other things a fixed contribution rate and notional individual accounts (the "notional defined contribution pension").[27] The new Swedish pension system also includes a smaller, funded defined contribution plan with an account for each individual worker (the premium pension). Reforms introduced in the United Kingdom in 1988 and 2001 permitted individuals to opt out of part of the national pension plan by participating either in employer-sponsored defined contribution plans or defined contribution individual pension plans called "personal pensions."[28] To participate in the individual plans, workers obtain an account from a financial institution and make contributions into their account or are provided access to a pension by their employer.[29] Japan implemented legislation permitting employer-provided and personal defined contribution pension plans in 2002.[30]

In Sweden and the United Kingdom, the inclusion of defined contribution features in the national pension system has prompted complementary changes among the employer-provided pensions. In Sweden, three of the four major employer-provided pension plans converted from defined benefit plans to pure defined contribution plans or plans with a mix of both features following the national pension reform.[31] In the United Kingdom, many employers have closed their defined benefit plans to new workers and replaced them with defined contribution plans. For Japan, where defined contribution pensions were only recently introduced, there is currently little data on the number of individual or employer-provided plans being formed or on the degree to which employers are substituting defined contribution plans for existing defined benefit plans.

The inclusion of defined contribution features in national and employer-provided pension systems is expected to encourage greater labor force participation of older workers. Because workers will have a greater responsibility for ensuring retirement through contributions and the returns they can earn on them, it will be in their best interest to make contributions for as long as they can. In addition, because defined contribution plans often have greater portability than defined benefit

[27]This plan is called a notional defined contribution plan because pension rights (i.e., claims on future pension income), not actual financial assets, are credited to the individual's notional accounts. In the U.S. context, this component of the Swedish national pension could be considered analogous to "cash balance" plan, a type of defined benefit plan.

[28]Prior to 1988, the United Kingdom's national pension system had allowed individuals to opt out of the earnings-related part of the national pension system for employer-provided defined benefit plans only. See *Older Workers: Policies of Other Nations to Increase Labor Force Participation*, (GAO-03-307, February 13, 2003.)

[29]Workers opting out of the earnings related portion of the national pension system for individual pension plans continue to pay contributions to the national pension system, but the government transfers a portion of contributions to the workers' individuals pension account to compensate them for foregoing earnings-related national pension benefits. See *Older Workers: Policies of Other Nations to Increase Labor Force Participation*, (GAO-03-307, February 13, 2003.)

[30]The law specifies the earliest age of withdrawal of pension funds from these defined contribution plans as 60 if enrolled for 10 or more years, or 65 if enrolled for less than 10 years.

[31]Employer-provided pensions, which are negotiated through collective bargaining, cover close to 90 percent of Swedish workers. See *Older Workers: Policies of Other Nations to Increase Labor Force Participation*, (GAO-03-307, February 13, 2003.).

plans, older workers may have greater ability to shift to jobs that suit their leisure and health needs rather than retiring.[32]

Both Sweden and the United Kingdom, where disability insurance has traditionally been an avenue to early withdrawal from the labor force, have introduced reforms in recent years that will tighten eligibility of disability benefits.[33] In efforts to reduce the amount of early retirement financed through disability pensions, throughout the last decade Sweden has implemented successive reforms to tighten the eligibility requirements for disability insurance. This has included eliminating the ability of older workers to take a disability pension solely on the basis of long-term unemployment or a combination of unemployment and medical reasons. Medical reasons now provide the only valid criteria for granting a disability pension in Sweden. As part of its efforts, the United Kingdom, since the mid-1990s has tightened eligibility requirements, reduced paid benefits, and provided more support for returning to the workforce after an absence. For example, the government now reviews claims of incapacity to work every 3 years compared to the previous policy of not reviewing claims after the initial application, reduces or offsets disability benefits if the recipient also receives an employer-provided pension over a certain minimum level, provides services such as job search assistance to the disabled as a way to enable their return to work, and will test a policy allowing recipients to keep a portion of their wages if they return to work.[34]

Each nation we studied has enacted, or is considering, policies that address barriers to older workers' continued employment such as mandatory retirement and age discrimination. In conjunction with its national pension reform, Sweden has already passed legislation giving employees the right to remain in employment until the age of 67, prohibiting the widespread practice of collective bargaining agreements prescribing mandatory retirement at age 65.[35] As members of the European Union, both Sweden and the United Kingdom must legislatively prohibit employment discrimination based on age by 2006. It is unknown how the European Union requirement will affect mandatory retirement ages in specific industries or occupations in the United Kingdom.

In the absence of legislation, both the United Kingdom and Japan have encouraged employers to voluntarily end age discrimination. The United Kingdom, for example, has publicized the benefits of an age-diverse workforce, and issued best practices for eliminating age discrimination. Like the United Kingdom, Japan has also encouraged firms to voluntarily modify employment practices and retirement policies. The government has programs that subsidize the wages of workers who take

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[32]Defined contribution plans likely increased the portability of benefits for many United Kingdom workers previously covered by defined benefit plans. In Sweden, workers' pension benefits were more portable under the old employer-provided pension plans than under the defined benefit plans in many other nations. However, some Swedish pension experts noted that because pension premiums are generally higher for older workers, and a workers' final employer has typically been responsible for paying their pension benefits, it has been difficult for older workers to change jobs later in their careers. These experts argued that with the recent negotiated pension plan changes the cost burden on the final employer is reduced.

[33]In contrast, statistics provided by a Japanese official indicate that workers have not used disability insurance as a major means of withdrawing early from the labor force.

[34]The policy that will allow disability recipients to keep a portion of their wages if they return to work is subject to means testing and a 1-year time limit.

[35]It should be noted that reaching an agreement on changing the mandatory retirement age in Sweden was difficult, and the legislation that implemented this change has been controversial.

jobs at reduced pay after mandatory retirement and subsidizes companies that modify their employment practices to accommodate older workers.

Each of the nations we studied has also made some efforts to provide older workers with access to training, job search assistance, and workplace flexibility. In the United Kingdom, for example, one government program provides job search assistance for people age 50 and older when they have been out of work 6 months or longer and also offers training opportunities and a wage enhancement.[36] As part of its efforts, Japan has employment job assistance centers (called "Silver Human Resource Centers") that provide older workers temporary jobs or volunteer opportunities. The Japanese government has also promoted a program to match older workers with suitable employers. In Sweden, efforts include the creation of a commission to explore policies to promote increased flexibility in working arrangements, such as granting older people a legal right to work part-time, and adjusting the public financing of education to promote skill development among older workers.

Other Nations' Experiences with Reforms that Increase Labor Force Participation of Older Workers

The experiences of other nations suggest that the scope and comprehensiveness of reforms, the transparency and availability of information, and the strength of the economy play important roles in encouraging labor force participation by older workers. According to government officials in Japan, Sweden, and the United Kingdom, reforms have a better chance of succeeding if they are comprehensive and complementary. In addition, they said that education and information is important for helping workers understand what the reforms will mean for their retirement income. Officials also agreed that a strong economy was important for success.

Officials from each of the nations we studied said that the success of national pension reform, including those elements that influence older workers' labor force participation, depends, in part, on the scope and purpose of the reforms. Officials from all three nations noted that reforms are most successful when they are comprehensive in scope. Both Sweden and the United Kingdom, for example, in reforming their pension systems also made changes to both their disability insurance programs and labor market policies. Some officials also stressed that reforms should be designed so that the intent of a particular reform is not thwarted by countervailing policies in other areas. For example, Swedish pension experts and other officials have acknowledged that the continued presence of mandatory retirement ages in collective bargaining agreements and labor regulations can work at cross-purposes with features in the new national pension system that now relate benefit levels to retiree life expectancy and that essentially have no upper retirement age. They noted that to increase the effectiveness of the work incentives in their national pension reforms, these impediments will have to be resolved, as well as the need to establish complementary reform policies that foster alternative work arrangements and quality of work-life issues generally. Other nations also acknowledged the importance of complementary reforms. Japan has supplemented its national pension reforms with wage subsidies to encourage older employees to continue to work.

[36]All clients are eligible to receive services to help them find employment; clients are also eligible for up to £60 per week wage enhancement if they meet certain criteria. See *Older Workers: Policies of Other Nations to Increase Labor Force Participation*, (GAO-03-307, February 13, 2003.)

Japan and the U.K. also support their national pension reforms by committing additional resources to organizations and services that provide job search assistance to older workers.

Officials in each nation that we studied emphasized that access to information and public education about how the reforms will affect retirement income would also be needed if the reforms were to have their intended effect. There is concern in these nations that many workers are currently unaware of the implications of the reforms. For example, surveys conducted by the Swedish government and advocates for senior citizens indicate that many individuals do not yet have a detailed understanding of the new pension system. Similarly, U.K. government officials expressed concern that their citizens could have comparable difficulties understanding recent pension reforms. To help their citizens understand that they may need to work longer or save more in order to ensure an adequate retirement income, each of the nations we studied has taken steps to educate workers. In Sweden, the government has launched several large information campaigns since the new pension system's implementation. In addition, participants receive annual statements of their account balances in both the notional defined contribution and premium pensions. To help educate its workers, the U.K. government has created a pension forecast tool that will present workers with estimates of pension income from both government and nongovernment sources. In Japan, because defined contribution pensions are very new and offer both advantages and disadvantages to participants, employers are required to provide information to employees about defined contribution plan features and management.

In addition to the importance of information and education, government officials and pension experts agreed that a strong national economy is necessary for the success of pension and labor market reforms that may contribute to higher labor force participation by older workers. A strong economy eases the implementation of pension reform by offering increased employment opportunities for older workers. High unemployment and low economic growth will limit older workers' ability to remain employed, forcing them into complete retirement. Experts we spoke with believe that the low growth of the Japanese economy during the last decade has been a factor limiting the scope of pension and labor market reform, for example, in the area of mandatory retirement ages. Fiscal constraints also preclude more fundamental reform of pension system financing and structure. In contrast, the currently strong U.K. economy acts as an incentive for employers to retain their older workers and there will likely be an increased need for older workers in the long term, particularly as the workforce ages between now and 2020. The current tight labor market also makes it easier for job search assistance programs to find jobs for clients.

Concluding Observations

In each of the nations we studied, adverse financial and/or demographic projections have led to efforts to reform their national pension systems. Yet despite their obvious differences, officials from each of the three nations emphasized the importance of increasing the labor force participation of older workers in their own nation's reform efforts. Encouraging workers to stay in the labor force longer can help alleviate the fiscal and budgetary stress induced by rising national pension expenditures and can potentially enhance economic growth. In those nations where national pension reform has included benefit reductions, working longer might also help to mitigate serious reductions in retiree living standards.

In some ways, the U.S is ahead of many nations in fostering the labor force participation of older workers. Among private U.S. employers, for example, the 25-year-old shift away from traditional defined benefit retirement plans toward plans with defined contribution features continues. This shift not only includes an increase in the number of pure defined contribution plans like 401k plans but also includes a conversion of traditional defined benefit plans to hybrids with defined contribution features.[37] Even within the U.S. public sector, where the dominant retirement plan continues to have a traditional defined benefit structure, employers have responded to current or incipient labor shortages among teachers and public safety workers by creating incentives within these retirement plans for near retirees to extend their employment.[38] The U.S. is also increasing its normal retirement age for Social Security benefits to 67, an age higher than in many other nations. The U.S. has already forged ahead in labor market flexibility, leading the world in prohibiting age discrimination and mandatory retirement ages, and through its public discussion of bridge employment, phased retirement, and other alternative employment arrangements.

However, the U.S. still has room to strengthen its policies affecting older workers and has much to learn from others. A key finding of our work is that the scope and comprehensiveness of the reforms themselves play important roles in encouraging labor force participation by older workers. At this time, there has been little effort to develop comprehensive national employment policy for older workers in the U.S. and what has been done has been largely focused on ensuring employer flexibility in hiring older workers by minimizing any regulatory burden or potential for litigation.[39]

While employer flexibility is clearly an important issue on its own, current policy efforts have failed to focus on other issues central to the living standards and quality of life of older workers. First, a major impetus for the Social Security program itself and indeed a major policy consideration in its own right would be to minimize the extent to which policies seeking to foster increased senior labor force participation result in additional employment that becomes necessary for many persons simply to avoid poverty or near- poverty standards of living in retirement. Yet isolated or narrowly focused policies to foster work that fail to recognize their interaction with adverse trends in other sources of retirement income could result in precisely the generation of such essentially “coercive or involuntary” employment.

The trends in sources of retirement income other than work suggest that the potential for the growth of involuntary employment among older persons is significant. For example, economists have lamented the U.S.’s chronically low savings rates, including saving for retirement. Regarding

[37] See *Private Pensions: Implications of Conversions to Cash Balance Plans* (GAO/ HEHS-00-185) September 29, 2000 and *Cash Balance Plans: Implications for Retirement Income* (GAO/HEHS-00-207) September 29, 2000.

[38] For example, some state and local government employers have implemented Deferred Retirement Option Plan (DROP) features into their defined benefit plans. DROPs allow a pension participant, at an eligible retirement age, to have pension benefits start even though he or she continues to work. Under a DROP, instead of paying a pension benefit directly to the participant, it is placed into a separate account in the individual’s name. When the participant retires, he or she receives the accumulated balance with interest in addition to the ongoing pension benefit. DROP features are very common in plans covering teachers, firefighters and law enforcement personnel. See *Older Workers: Demographic Trends Pose Challenges for Employers and Workers* GAO-02-85 November 7, 2001.

[39] For example, Labor’s ERISA Advisory Council, after receiving testimony from employers and other interested parties on federal policy with regard to phased retirement and the older worker issue, made recommendations to the Secretary of Labor, most of which had this general orientation. The ERISA advisory Council was established by the Employee Retirement Income Security Act to advise the Secretary of Labor with respect to carrying out responsibilities under the act. See *Older Workers: Demographic Trends Pose Challenges for Employers and Workers* GAO-02-85 November 16, 2001.

pensions, only about 50 percent of the labor force is covered by any pension plan at any one time. In addition, the decline in equity prices, and the reduced willingness of some employers to continue to match employee contributions has resulted not only in a diminution of many 401K accounts but also in the reduced participation of workers in those defined contribution plans.[40] Finally, the backstop of retirement income, the Social Security program already has a much lower replacement rate than the national pension systems of many other nations and is facing insolvency during the next several decades. The extent to which current efforts to reform Social Security result in benefit reductions could create additional pressures on retirement incomes. All of these developments imply that policies to encourage the labor force participation of older workers, if not carefully crafted, could unduly sharpen the tradeoff between work and an adequate retirement income; that for too many of our nation's seniors, work may become a necessity rather than a choice.

A balanced national policy on older worker labor force participation would also be sensitive to any distributional consequences that could occur within the unique context of U.S. history, society and institutions. For example, reforms that more closely link benefits to life expectancy, as have been suggested and implemented in other nations, could have significantly different and more adverse distributional effects in the United States than in these other nations. American subpopulations with lower average life expectancies, such as African Americans, would be more adversely affected by such policy changes since they would collect benefits for shorter time periods relative to other demographic groups. African American men, for example, have shorter life expectancies at birth and at age 65 compared to males of other ethnicities.

The focus on extending the labor force participation of older workers internationally has also led to a reconsideration in other nations of the traditional binary definition of retirement where a person is either considered working or retired, to a definition that is more flexible or continuous in nature. The long-term trend of improved health and longevity of older persons throughout the high-income nations now permits a range of options beyond the traditional full time career employment/ complete out-of-the-workforce retirement tradeoff and also makes the notion of "life-long learning" an increasingly realistic possibility for a much greater number of workers. These developments also have implications for reforming existing U.S. employment programs in ways to more effectively encourage the elderly to work. On one hand, the U.S. labor market, with its considerable flexibility in terms of part-time employment, scheduling and other alternative employment arrangements, is very congenial to these concepts.[41] Yet, on the other hand, some basic U.S. employment programs remain anchored on the past notion of a binary retirement choice. For example, today, few state Unemployment Insurance (UI) programs have implemented work sharing benefit provisions or pay benefits to claimants looking exclusively for part-time work.[42] In

[40] See "Bailing Out of the Retirement Plan," *The Wall Street Journal*, March 11, 2003 p. D1.

[41] It is interesting to note that in actuality, few U.S. employers have so far focused on making such options available to their older employees on any widespread basis. This is partially because few private employers have yet felt any necessity to do so and there are other regulatory obstacles that might discourage such employers from initiating such efforts. For a discussion of these and related issues, see U.S. General Accounting Office, *Older Workers: Demographic Trends Pose Challenges for Employers and Workers*, GAO-02-85 (Washington, D.C.: Nov. 16, 2001).

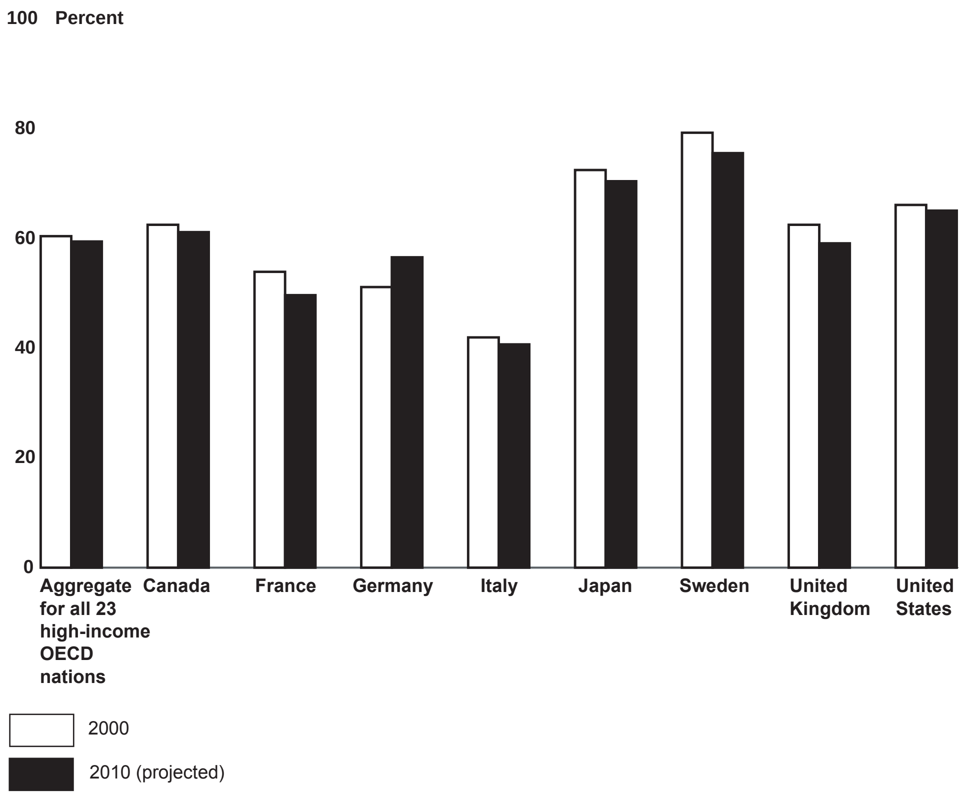
[42] The Unemployment Insurance program provides income to workers who are unemployed through no fault of their own and are actively seeking work. Worksharing is a plan under which an employer, faced with the need for layoffs because of reduced workload, might spread the hours of work required to produce a given product of goods or services, avoiding layoffs by reducing the number of regularly scheduled hours of work for all employees in an establishment. UI benefits would be payable to workers for the hours of work lost by this action, as a proportion of the benefit amount for a full week of unemployment. As of August 2002, 18 states had worksharing features in their UI programs. See http://ows.doleta.gov/unemploy/uilawstable.asp.

addition, key national job training programs have built-in performance incentives that discourage the training and job placement of older workers.[43]

Finally, consideration must be given to the effects of policies to foster older labor force participation on the level of community service and unpaid family work performed to assist the household members who might need care. Community service remains a strongly rooted tradition in the United States, particularly among senior citizens. It is unclear what the effects on cities and towns, non-profit organizations and other entities would be if the elderly substituted paid market work for community service on a significant level. To the extent that policies to foster older workers to extend their labor force participation contains a significant "coercive" element, the tension between providing "unpaid care" and ensuring an adequate standard of living will only be intensified. Given the employer community's historical opposition to mandated family and elder care leave at the federal and state levels, it is likely that legislative efforts to balance these two competing needs would be controversial and difficult to negotiate. Yet the division between paid and unpaid work, between community or family and the market, will forcefully shape future American society. The challenge that the U.S. now faces is to develop policies to extend the work-lives of older employees that recognize the demographic and fiscal realities of the 21st century, that respond to the imperatives of economic growth and that ensure employers a supply of experienced skilled labor, without requiring "Senior America" to work simply to evade the specter of twilight poverty.

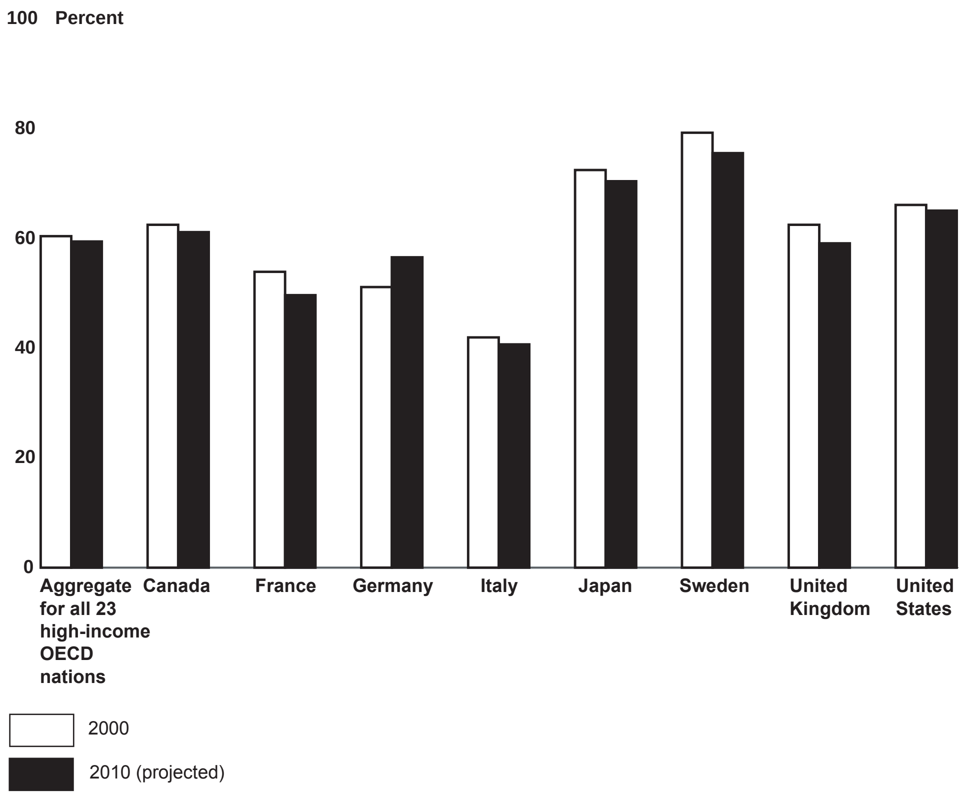
[43]For example of such incentives in training programs under the Workforce Investment Act, see *Older Workers: Employment Assistance Focuses on Subsidized Jobs and Job Search, but Revised Performance Measures Could Improve Access to Other Services*, GAO-03-350, January 24, 2003. The Workforce Investment Act provides job search assistance and training to adults, youth, and individuals who have lost their jobs because of layoffs or plant closings, have incentives. It is the largest federal employment-training program.

Figure 1: Labor Force Participation Rates for Persons Age 50 to 64 in High-Income Nations, 2000 and 2010



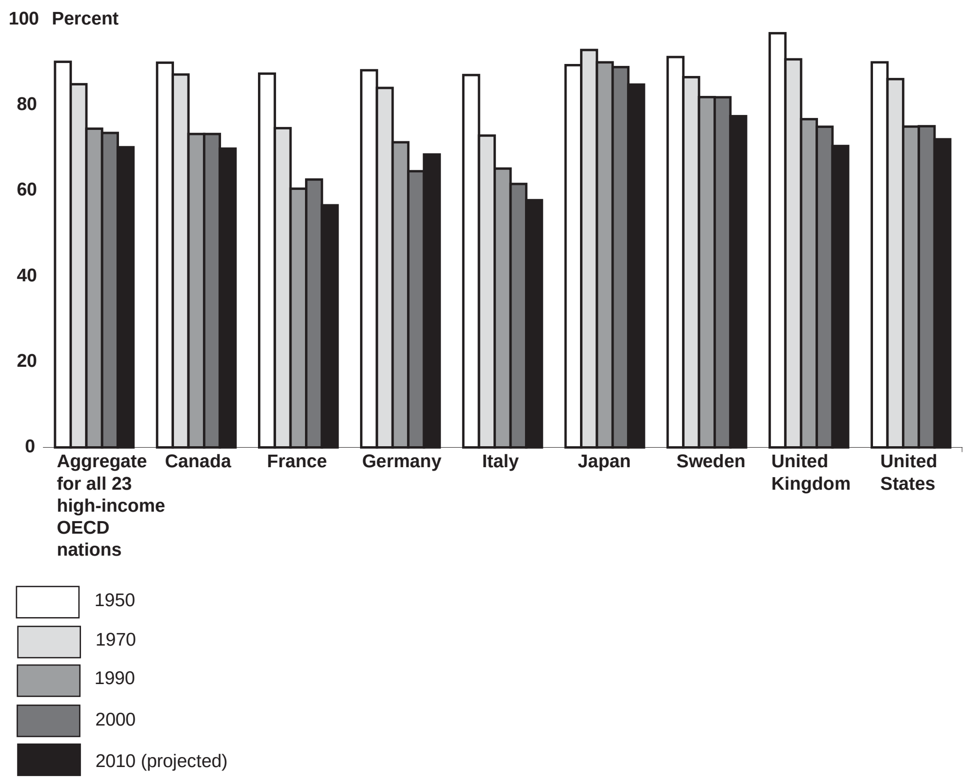
Source: Economically Active Population 1950-2010, 4th Edition, Rev. 2, International Labour Organization, Geneva, 2002.

Figure 2: Labor Force Participation Rates for Persons Age 65+ in High-Income Nations, 2000 and 2010



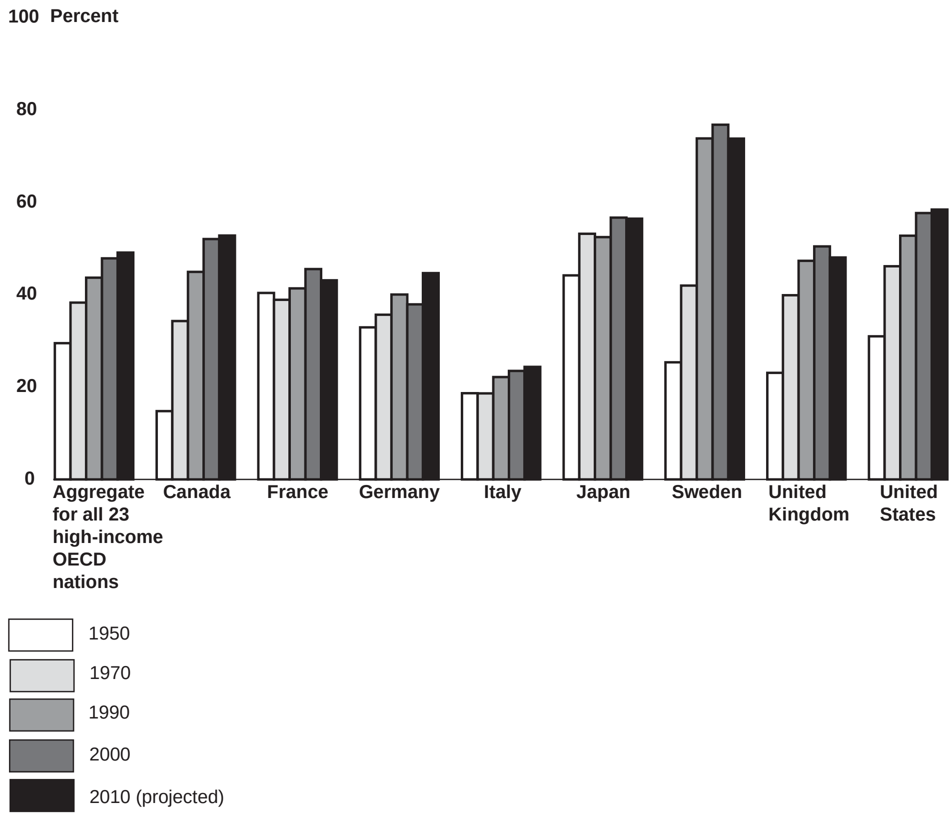
Source: Economically Active Population 1950-2010, 4th Edition, Rev. 2, International Labour Organization, Geneva, 2002.

Figure 3: Labor Force Participation Rates for Men Age 50 – 64 in High-Income Nations, 1950 and 2010



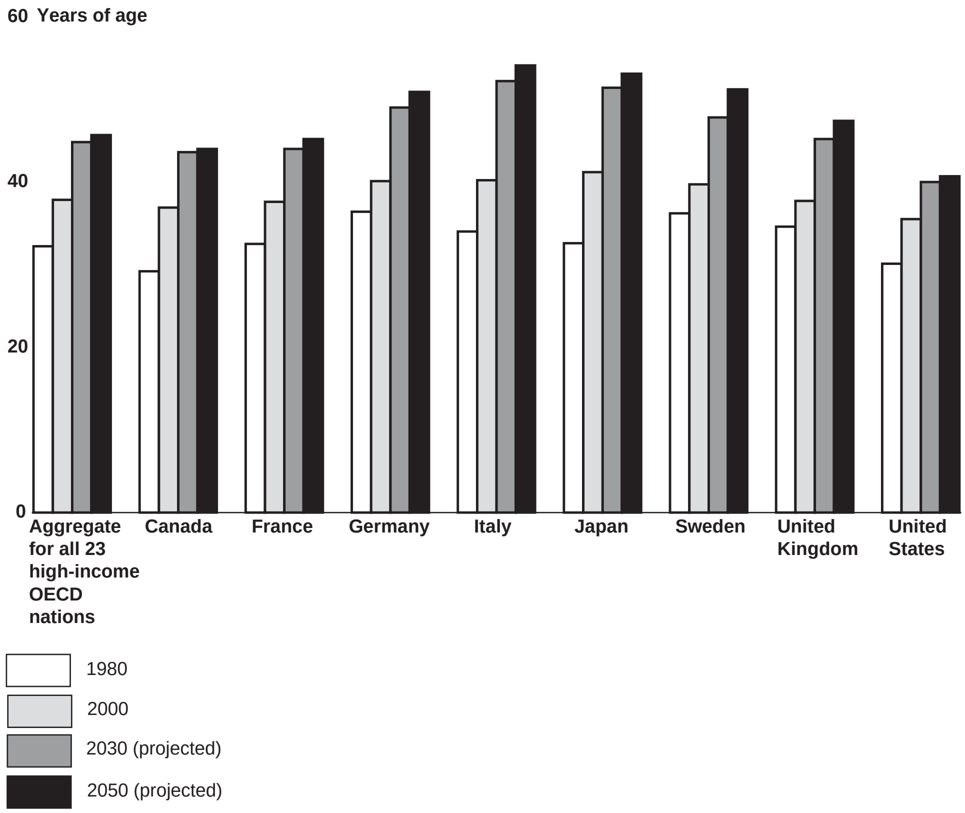
Source: Economically Active Population 1950-2010, 4th Edition, Rev. 2, International Labour Organization, Geneva, 2002.

Figure 4: Labor Force Participation Rates for Women Age 50 to 64 in High-Income Nations, 1950 to 2010



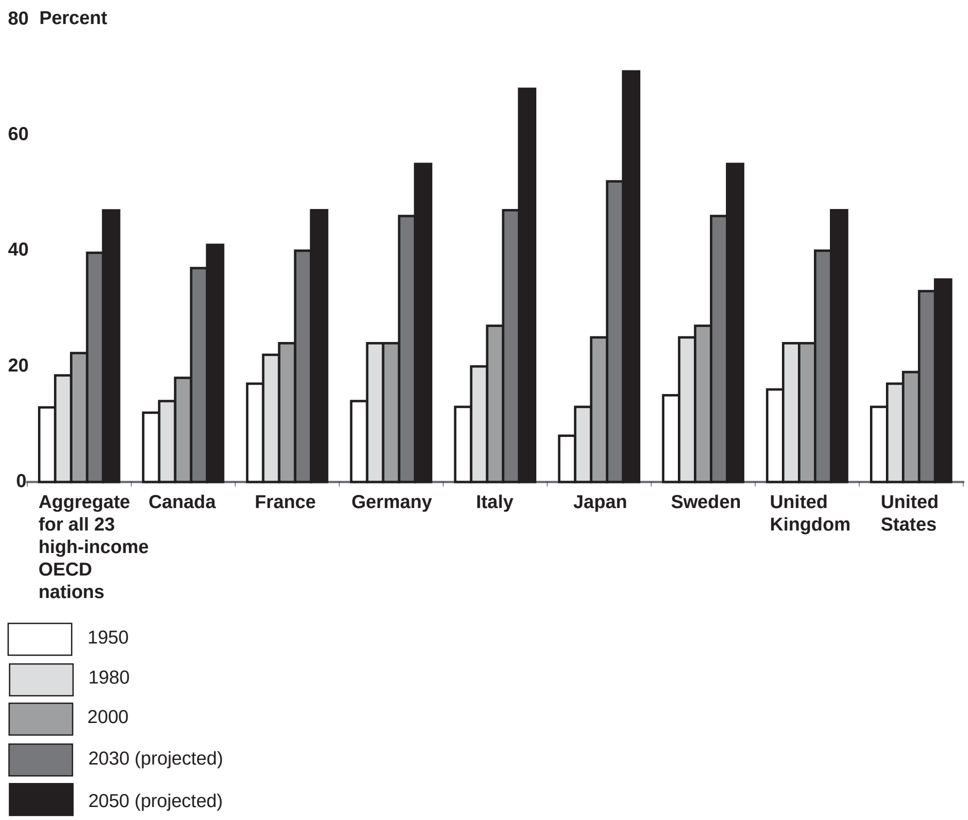
Source: Economically Active Population 1950-2010, 4th Edition, Rev. 2, International Labour Organization, Geneva, 2002.

Figure 5: Median Age of the Population in High-Income Nations, 1980 - 2050



Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: 2000 Revision and World Urbanization Prospects: 2001 Revision.

Figure 6: Elderly Dependency Ratio in High-Income Nations, 1950 to 2050



Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: 2000 Revision and World Urbanization Prospects: 2001 Revision.