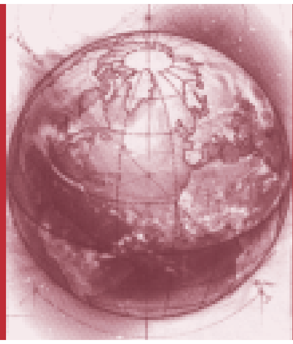

Research Highlights

in the Demography and Economics of Aging

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Early Retirement in the United States

Many workers in the United States retire in their late 50's and early 60's. At age 65, only 21 percent of men and 11 percent of women are still working full-time; and only 31 percent of men and 23 percent of women are working even part-time. The widespread availability of post-retirement benefits is an important aspect of this national trend. Eligibility for employer-provided retirement benefits can begin as young as age 50, and occurs quite frequently at age 55. Eligibility for Social Security benefits begins at age 62. Eligibility for Medicare begins at age 65.

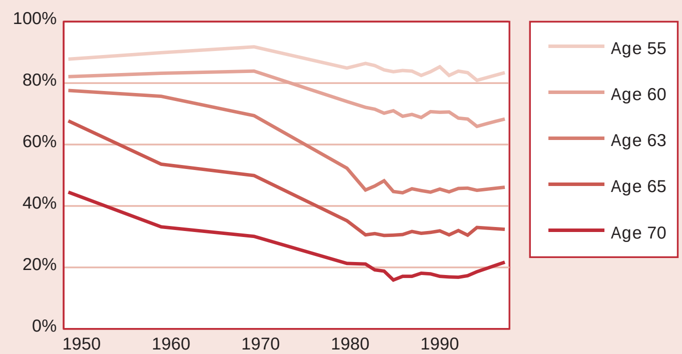
As the population ages, the implementation of cost-saving reforms in retirement programs has become an increasing policy concern. To sustain the major public entitlement programs, proposals have been made to raise the age of eligibility for Social Security and Medicare, or to reduce benefit levels, or to target benefits to those most in need. Other cost-saving changes have been considered, and in many cases implemented, in employer-provided retirement benefits. What does this mean for the future of early retirement, and for the well-being of those who currently choose to retire early?

This issue of *Research Highlights* reports on some new insights from research on early retirement. The research, supported by the National Institute on Aging (NIA), addresses three sets of issues. One line of research focuses on the health and economic characteristics of those who currently take early Social Security benefits when they become eligible at age 62, as compared with those who postpone benefits. These early Social Security "takers" would be affected most directly by an increase in the age of eligibility for benefits. A second area of research focuses on those who retire early as a result of health limitations. It examines the particular vulnerabilities of early retirees who are in poor health and who may not have the option of working longer. The third area of research focuses on pension plans and the large role of pensions in inducing early retirement. It emphasizes the importance of benefit eligibility and related incentives in influencing when people decide to retire. The report begins with a background overview of trends in early retirement and patterns of labor force departure in the United States today.

Trends in Early Retirement

With improvements in health and longevity over the last few decades, people might have been expected to work longer and retire later. But the historical trend has been just the reverse. The number of American workers choosing early retirement has increased steadily. Figure 1 illustrates this long-term trend for men. The figure shows the labor force participation rates of men at ages 55, 60, 63, 65, and 70. During the 1950's and 1960's, the drop in labor force participation rates occurred primarily among those aged 65 and older. During the 1970's

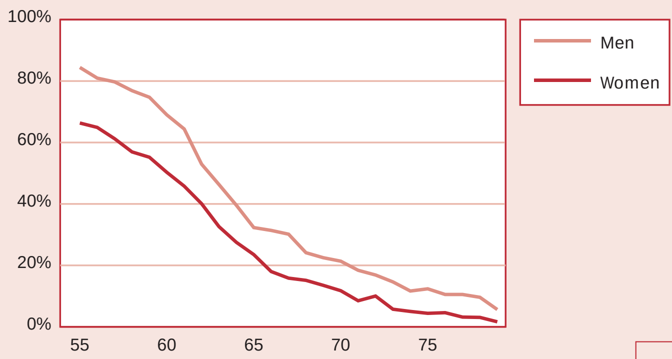
Fig. 1 LABOR FORCE PARTICIPATION RATE
Men by Age, 1950 – 1997



and 1980's, labor force participation rates also dropped steadily among men in their late 50's and early 60's. Some stabilization in this long-term trend appears to be occurring in the 1990's.

Among older women, labor force participation rates combine two offsetting trends. First, more women of all ages are working in the formal labor market. This has increased labor force participation rates of women at all ages. Second, women (like men) are retiring earlier. This offsets the increase in labor force participation, but only among older women. Thus the total labor force participation rate of women between ages 25 and 59 has almost doubled since 1960, from 41 percent to 75 percent. Yet the labor force participation rate of women age 60 and older has remained steady at about 16 percent.

Fig. 2 LABOR FORCE PARTICIPATION RATE
Men & Women by Age, 1997



Today, American workers start retiring in significant numbers around age 55; and the percentage of the population that continues working declines steadily thereafter. Figure 2 (above) shows the age-specific pattern of labor force participation in 1997 (including part-time workers). Based on these participation rates, about half of those working at age 55 will have fully retired from the labor market by age 63, and about two-thirds will have retired by age 65.

Who Takes Early Social Security Benefits?

Many of the Social Security reform proposals currently under consideration would raise the age of eligibility for Social Security benefits, or reduce benefit levels for early retirees. This raises important questions about how such reforms would affect the well being of early retirees. To begin to address these questions, Richard Burkhauser, Kenneth Couch and John Phillips have compared the characteristics of those who currently take early Social Security benefits as soon as they are eligible at age 62 (the "takers") with those who postpone their Social Security benefits until later (the "postponers"). They consider first whether people taking early Social Security are worse off financially than those who postpone, at least on average, and second whether "takers" tend to have health conditions that might limit their ability to work longer.

Some of the findings of Burkhauser, Couch and Phillips are shown in Table 1. The data are derived from a sample of individuals in the Health and Retirement Study (HRS) who reached age 62 in 1993 or 1994. Most of the reported data are from 1992, just before their decision of whether or not to take early Social Security benefits at age 62. Data on employment status and household pension income is also provided for 1994, illustrating the decrease in employment and increase in pension receipt that occur in conjunction with Social Security eligibility.

The first question addressed by Burkhauser, Couch and Phillips is whether those who take early Social Security benefits are worse off financially than those who postpone benefits. While the specific financial comparisons are mixed, the investigators conclude that the typical person who takes early Social Security benefits is about as well off as the typical person who postpones benefits. The median net worth of early Social Security takers is found to be higher than that of postponers, especially among women. Median income (as measured just before Social Security eligibility) is modestly lower among early Social Security takers, compared with postponers, but this is in part because more of the early Social Security takers have already stopped working by the time they are eligible for Social Security. Related to their younger retirement, many more early Social Security takers have

TABLE 1: A COMPARISON OF THOSE WHO TAKE SOCIAL SECURITY BENEFITS AT AGE 62 WITH THOSE WHO POSTPONE BENEFITS

	TAKERS	POSTPONERS
MEN		
Median Net Worth	$162,800	$144,750
Median Income	$40,124	$45,014
In Poverty	9%	7%
In Poor Health	16%	16%
Employed		
Before Age 62 (1992)	56%	78%
After Age 62 (1994)	22%	66%
Household Pension		
Before Age 62 (1992)	38%	19%
After Age 62 (1994)	67%	30%
WOMEN		
Median Net Worth	$152,600	$106,400
Median Income	$31,000	$33,468
In Poverty	15%	13%
In Poor Health	23%	18%
Employed		
Before Age 62 (1992)	38%	57%
After Age 62 (1994)	23%	45%
Household Pension		
Before Age 62 (1992)	41%	28%
After Age 62 (1994)	54%	40%

pension income from either their own pension plan or from a spouse's plan. In fact, the availability of an employer-provided pension appears to be an important reason for both the earlier labor force departure of this group, and their decision to take early Social Security benefits.

The second question addressed by Burkhauser, Couch and Phillips is whether those taking early Social Security benefits tend to be in poorer health than those who postpone benefits. While the percentage of early Social Security takers in poor health is similar among men, and somewhat higher among women, the large majority of both groups is in good health. Based on these health data, and the pension data referred to earlier, the researchers conclude that the "typical" person taking early Social Security benefits is physically able to continue working, or is eligible to receive an employer-provided pension benefit, or both.

While Burkhauser and colleagues focus on the most common characteristics of those taking early Social Security benefits, researchers have also pointed to the diversity of circumstances among early retirees, and the diversity of reasons for their early retirement decision. In particular, some people do retire early because of health limitations. And some early retirees do face significant financial hardship in retirement. For these early Social Security takers, an increase in the early retirement age, or a reduction in early retirement benefits could impose more serious hardship. As more information is collected from HRS participants over time, more will be learned about the diversity of circumstances of early retirees, and the longer-term consequences of their early retirement decisions.

Health Limitations and Early Retirement

There is a sizable minority of early retirees who report health limitations as an important factor in their decision not to work. Many receive Social Security Disability Insurance benefits well before they would be eligible for Social Security retirement payments. John Bound, Michael Schoenbaum, and Timothy Waidmann have studied the characteristics of non-working individuals between ages 51 and 61 in the HRS, comparing those with and without self- reported health limitations. They find that individuals with health limitations tend to be less well educated, have lower incomes, and are more likely to be from minority populations. A much higher share of their income comes from Social Security Disability Insurance (DI) and Supplemental Security Income (SSI), and a much smaller share from private pensions or assets.

Mark McClellan has also explored the relationship between health limitations and retirement, focusing on the onset of an adverse health event. He, too, finds that health events are more common among individuals with lower education, income and wealth. He also shows how the onset of an adverse health event can have a significant effect in inducing retirement. For example, employed men who experience a major health event (such as a heart attack or stroke) are about 25 percentage points more likely to transition to zero hours of work than employed men without a health event; and their average number of work hours declines by more than 600 hours per year. If the acute health event is accompanied by a major decline in functional status, then they are about 75 percentage points more likely to transition to zero hours of work; and their average number of work hours declines by about 1700 hours more than men with no health events. While these results are based on the limited number of health events occurring between HRS waves one and two, and with no long-term follow-up of labor market behavior, they are suggestive of significant health effects on work and retirement decisions at older ages.

The link between health limitations and early retirement has implications for retirement policy reform. Bound, Schoenbaum and Waidmann suggest that the effects of policy reform on those with health limitations may be very different from the effects on those in good health. To illustrate this difference, they simulate the labor market changes that would result from an increase in the early retirement age of Social Security from age 62 to age 65. They find only modest increases in labor force participation among those with health limitations, as compared with those in good health. The effects are modest, they suggest, because most early retirees who report health limitations have already left the workforce by the time they reach age 62. Many also receive disability insurance benefits that are independent of their eligibility for Social Security retirement benefits.

Pensions and Early Retirement

Eligibility for an employer-provided pension is another key factor in the early retirement decision of many American workers. Retirement incentives are implicit in the economic structure of essentially all traditional pension plans in the United States. Each pension plan defines an "early retirement age," most commonly age 55, when a worker can choose to retire and initiate pension payments. From that time on, workers are giving up those pension payments for as long as they continue to work. This acts as a financial penalty for continuing to work, offsetting the wages and other compensation that one gains from work. Robin Lumsdaine, James Stock and David Wise have quantified this penalty, based on actual pension plan provisions, and actual employment histories at several Fortune 500 companies. What they find is that the ages of retirement at these firms correspond almost perfectly to the financial incentives in their pension plans.

Because almost all traditional pension plans contain retirement incentives at ages younger than 65, and often beginning at age 55, many workers who are covered by pension plans in the United States choose early retirement.

A recent study by Charles Brown has explored another type of pension incentive known as an "early retirement window." An increasing number of companies are offering temporary pension supplements as a means of downsizing their workforce. These early retirement windows provide larger pension payments to older workers who agree to retire immediately. According to Brown's analysis of the HRS, about 9 percent of workers between ages 51 and 63 have been offered one or more early retirement window opportunities, and about half of these workers have accepted an offer. As expected, he finds that the more generous window offers, with the larger incentives to retire, are more likely to be accepted than the smaller offers. Lumsdaine, Stock and Wise have also explored the effects of window plans on retirement, and have found that workers respond very much as one would predict from the supplementary financial incentives in those plans.

The link between pensions and early retirement also has implications for policy reform. In evaluating potential policy reforms, a distinction needs to be made between those with and without an employer-provided pension, much as one is made between those with and without health limitations. In simulating the effects of policy reform on workers who are covered by both Social Security and an employer pension plan, for example, Lumsdaine, Stock and Wise find that the impact of changes in the pension provisions on when people retire is much stronger than the impact of Social Security reform. Thus future reforms in Social Security will almost certainly have a bigger effect on workers who do not also have an employer-provided pension. Widespread changes in private pension policy, however, could have a larger impact on pension-eligible workers. Indeed the gradual trend in the United States away from traditional pension plans and toward "savings" style retirement plans (such as 401(k) plans) may moderate the extent of early retirement incentives in the labor market as a whole.

Concluding Comments

There are many reasons for early retirement. For some, eligibility for employer-provided pension benefits is the key factor. For some, eligibility for Social Security or Medicare are most important. For some, a decline in health is the critical factor. And for others, the key factor may be accumulated savings, inheritance, the need to provide care to a family member, undesirable job circumstances, or any number of other reasons. A key theme of research, as reported in this issue of *Research Highlights*, as well as companion issues on "Health Insurance and Retirement" and "Social Security and Retirement Around the World" is that retirement decisions are affected by both individual circumstances, such as health, and by the policy environment in which retirement decisions are made. And future policy reforms will affect not only the well being of people as they age, but also the work and retirement decisions that they will make.

What also seems clear is that we are at a time of transition. Population aging will in itself affect the opportunities of older persons in both work and retirement. There will also be cost-saving reforms in both public and private retirement policies, and these will affect the relative financial incentives to work or retire at particular ages. There are also increasing accumulations in targeted retirement saving programs, such as IRAs and 401(k) plans, and these savings will change the opportunities for early retirement for at least some households. Figuring out how these changes interact, and how they affect individuals in diverse circumstances is an ongoing objective of NIA, and those engaged in aging-related research with NIA support.

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