Employee benefits for older workers

Americans are, on the average, living longer and many are working later in life; public and private benefits plans can send mixed messages to these workers, as some provide an impetus to retire while others encourage continued labor force activity

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With average life expectancy increasing by over 7 years and birth rates decreasing by more than one-third between 1950 and 1990, the U.S. population has grown older. Compared with earlier generations, this older population has better overall health and a greater number of choices as to how to spend their later years. Legislation against mandatory retirement in 1986 opened the labor market to today's older people, permitting them to stay employed, if they so choose, well beyond the retirement age of their counterparts 20 or 30 years earlier. At the same time, today's older Americans have greater employment opportunities compared with earlier generations, resulting from expansion in the service sector and overall job growth. Thus, while retiring earlier has become more prevalent in the United States, many older Americans continue to work.

With the expanded options and new opportunities come a number of questions, such as: What factors enter into the decision to retire? How are benefits affected once employees turn 65 and continue to work full-time? How are benefits different for part-time employees? Is sufficient retirement income available, and how does it vary by age at retirement?

This article explores these questions. It discusses choices available to older workers and the possible effects of these choices on income and benefits. Data sources include the Bureau of Labor Statistics' Employee Benefits Survey,[1] which reveals, for example, that the amount of financial security an employer-provided retirement plan can afford varies significantly depending on work history, plan provisions, and age at retirement. Working 10 years longer may in some cases double the percent of preretirement income that a pension will replace.

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Age data

One of the signs that a population is aging is the growth in the proportion of older population to the total. Between 1950 and 1990, the share of the U.S. population aged 65 and older grew from 8.1 percent to 12.5 percent.[2] This growth is due in part to the fact that Americans are living longer. Expected remaining years of life at age 65 for both sexes increased from 13.9 in 1950 to 17.2 in 1990, and from 8.7 to 10.9 at age 75 over the same period.[3]

The aging of the population is also the result of a decline in birth rates, from an average 3.1 children born per woman in 1950 to 2.1 in 1990.[4] An important exception to this general tendency of falling birth rates were the years between 1946 and 1965, the period known as the "baby boom." Higher birth rates sustained over these years re-

sulted in several unusually large birth cohorts, especially compared to those that came immediately before and after. As these large birth cohorts move through time, the age composition of the total population and of the labor force is altered.

According to the Bureau of Labor Statistics' labor force projections, between the years 1992 and 2005, the highest rate of growth, 2.5 percent per year on average, is expected to occur in the "55 years and older" segment of the labor force,[5] as the oldest members of the baby-boom generation begin to enter this age group. The lowest rate of increase, 1.1 percent, is projected to occur in the 25- to 54-year-old cohort, followed by 1.3 percent in the 16- to 24-year-old group.

While the population as a whole is aging, labor force participation among Americans aged 65 and older declined from 27 percent in 1950 to 12 percent in 1990.[6] A different picture emerges, however, when labor force participation rates for men aged 65 and older are compared to those for older women. While rates for such men declined throughout the 40-year period, there was little overall change recorded for women. This is the result of two counterbalancing forces: the overall tendency toward earlier retirement on the one hand, and the increased labor force participation of older women on the other. (See table 1.)

Over the last several decades, the United States has experienced a sharp increase in labor force participation by women, especially those of child-bearing age. Between 1950 and 1990, participation rates for women aged 35 to 44 grew from 39.1 percent to 76.5 percent.[7] As these cohorts of women begin to approach retirement age, some may stay in the labor force to more advanced ages. Some of the reasons for this include the higher incidence of widowhood among women than among men of the same age,[8] high rates of divorce,[9] and the presence in this age group of women who took a number of years off work to care for their children or began working for the first time after having raised their children; these woman may wish to stay employed longer because a few extra years of work may boost their retirement income.

Table 1. **Labor force participation rates per 100 persons in the older population over the last four decades**

Age groups	1950	1970	1980	1990
All:				
55–64	57	62	56	56
65 and older	27	17	13	12
Men:				
55–64	87	83	72	68
65 and older	46	27	19	16
Women:				
55–64	27	43	41	45
65 and older	10	10	8	9

The aging American population, and specifically the aging work force, may have unique needs. Protections for these workers and their families against income loss resulting from failing health and death can be provided by employers, but such protection may be costly. The following section includes a discussion of adjustments made by employers in the levels of benefits provided to older workers.

Employee benefits for older workers

According to the Employee Benefits Survey, workers in the United States get a package of benefits that can vary by establishment characteristics or occupation. For example, during the 1992–93 survey period, medical care benefits were available to 82 percent of employees in medium-size and large private establishments compared to 93 percent in State and local governments and 71 percent in small private establishments. In small private establishments, 43 percent of employees in the professional, technical, and related occupational group were provided long-term disability insurance in 1992, while only 10 percent of blue-collar workers were provided this benefit. Beyond such variations in benefit availability, employers may adjust the level of benefit depending upon an employee's age, although certain rules against discrimination in the workplace must be followed.

Under the Age Discrimination in Employment Act, employers are not allowed to withhold benefits from older workers. (See boxnote, p. 24.) Because the cost of providing many benefits, such as life, health, and long-term disability insurance, for older employees is higher than the cost of providing the same level of coverage for their younger counterparts, employers are permitted to reduce the level of benefits to offset increased costs. Providing insurance coverage for older employees costs more because older persons are generally classified by actuaries into higher risk groups based on the probability of their becoming sick or disabled, or dying.

For active employees, life insurance is one of the most frequently offered employee benefits. In 1993, 42 percent of life insurance plan participants were in plans that reduced the amount of basic life insurance available to active employees once they reached a specified age, most commonly age 65 or 70. This reduction in the level of coverage for older enrollees is designed to offset the higher costs of premiums associated with insuring "higher risk" groups. The most prevalent reduction was to 50 percent of the origi-

Sources of jobs for older workers

The precise effect of a variety of demographic changes on the numbers of older workers expected to stay in or rejoin the work force is difficult to estimate. Over the next 20 years or so, some industries and occupations may not find sufficient labor due to expected lower rates of expansion in the pool of younger workers. Employers in these industries will have to draw a greater than usual percentage of their employees from among the older, faster growing segment of the population. While it is difficult to predict the industries and occupations in which older workers will be employed, it is likely that a large percentage of the older work force will hold service sector jobs.

In the United States, economic growth in recent years was accompanied by relatively high rates of expansion in the services industries. Total employment in services has more than doubled since 1950. (See Ronald Kutscher and Valerie Personick, "Deindustrialization and the shift to services," *Monthly Labor Review*, June 1986.) Such rapid growth in the jobs available in the service sector may be beneficial to those older persons who wish to continue working; these jobs tend to be less demanding physically. In 1989, 42 percent of all workers aged 65 and older were employed in the service sector compared with 35 percent of workers of all ages. (Source: Current Population Survey, Basic Tables, *Employed Persons by Major Industry, Sex, Race, and Hispanic Origin, 1993.*) With the projected growth in the older segments of the work force and the expected continuing expansion in the services sector, it is probable that many future service jobs will be held by older workers.

Mcdonald's Mcmaster's program is an interesting example of an older workers' recruitment program. In place since 1986, it has attracted and retained over 1,000 older workers according to the McMaster's program coordinator. Mcdonald's officials claim that the program saves the company money by reducing turnover costs. It also serves communities by providing employment to older persons, who have the reputation for being dependable employees with low absenteeism rates. Normally, older workers in this program are employed part time and are not eligible for benefits offered to full-time employees. (Those over 65 are usually eligible for medicare and Social Security.)

Other examples of successful programs of recruitment and retraining of older workers include those implemented by Days Inn of America, Travelers' retiree job bank, and, in England, B&Q—an experiment in which a store in one of the company's locations was staffed entirely by workers over 50. Days Inn's officials claim that their turnover rates and training costs have dropped considerably; Travelers attributes savings of $871,000 in 1989 alone to its retiree job bank; and the B&Q "older worker" store boasts an 18-percent increase in productivity, among other improvements, as compared to other stores. All three organizations contend that dedication, reliability, and quality of work are superior among older workers. (See *The Untapped Resource* (The Commonwealth Fund, November 1993.)

nal amount for which the individual had been insured. Some plans reduced benefits only once, while others applied the reduction in several stages.

Continued full-time employment will allow employees to maintain life insurance coverage, perhaps at a reduced level. In contrast, employers are not required to continue such protection after retirement. A little over half of life insurance plan participants would have their coverage discontinued if they chose to retire. Almost universally, the amount of basic life insurance in plans that continued to cover retirees is reduced at least once after retirement.

Long-term disability insurance is another benefit with provisions that may vary depending on an employee's age. Such benefits replace, in most cases, a fixed percentage of predisability earnings, usually between 60 and 70 percent. If plan administrators determine that a person is unable to work due to illness or injury,[10] benefits are paid for prolonged periods.

In 1993, 74 percent of long-term disability insurance participants were in plans that limited duration of benefits for people whose disability began after a certain age, typically age 60. Provisions usually stipulate that for people whose disability begins between the ages of 60 and 65, benefits continue until no later than age 66, while for disabilities occurring after age 65, benefits continue until no later than age 70. For younger workers, benefits generally continue throughout their worklife—until retirement benefits are available. Limits on the duration of long-term disability benefits for older workers are designed to offset costs of insuring older workers, whose risk of becoming disabled is higher than that of employees in other age groups.

Antidiscrimination legislation

In recognition of the problems of older workers in the labor market, Congress enacted the Age Discrimination in Employment Act (ADEA) in 1967. ADEA stipulated that no employee over 40 could be discriminated against in employment practices because of his or her age. Protection against discrimination was guaranteed to employees up to age 65. In 1978, such protection was extended to workers up to age 70. It was not until the 1986 amendment to ADEA that all workers over 40 were protected against discrimination.

In 1990, amendments to ADEA enacted in response to a Supreme Court ruling specifically spelled out the terms under which employee benefits may be provided to older workers. In the case before the Court, an employee had been denied disability retirement benefits and was forced instead to accept a less generous early retirement benefit because of her age. (In the *Ohio* vs. *Betts* case, the Court ruled the the ADEA did not include specific provisions on benefits; the Older Workers Benefits Protection Act legislated such protection.) Following this ruling, amendments to the ADEA, known as the Older Workers Benefit Protection Act, specifically included protection against discrimination in the administration of employee benefit plans for older employees (defined as persons over age 40). While the law prohibits employers from withholding benefits from older employees, it allows adjustments in the level of benefits to offset the higher cost of providing such benefits to older employees as compared with other age groups.

The multi-step reduction in the duration of long-term disability insurance benefits when disability occurs at later ages is also a way of coordinating disability benefits with income from other sources. Most workers are eligible for full Social Security benefits at age 65, and most employer-provided retirement benefits can be received with no reduction at the same age. In many cases, service continues to accumulate for the purposes of calculating pension benefits while disability benefits are received. Thus, retirement income benefits, based on years of service to retirement age, begin when disability payments cease.

Health care plans do not reduce benefits based on age. Differences exist, however, in the relationship between employer health care plans and medicare for retirees and active employees. While, with a few exceptions, all persons aged 65 or older are eligible for medicare, employer health care plans are considered "primary" providers for active employees, regardless of age.

Medicare, the Federal health benefits coverage for older Americans, is the primary provider of health benefits for retirees. However, at age 62, when many employees become eligible to receive early retirement benefits, medicare is not available. Such early retirees are allowed by law to continue coverage under their former employer's plan.[11] However, there is no requirement for the employer to pay any cost of coverage.

According to the Employee Benefits Survey, continued coverage for retirees under 65 years of age, with premiums paid for, at least in part, by employers, was available to 40 percent of full-time workers participating in health care plans in medium-size and large private establishments in 1993. Because medicare does not begin until age 65, the availability of employer-provided health care benefits to retirees may be an important consideration as older Americans decide to continue working or retire.

Specifics of health care benefit coordination may influence an older employee's decision to continue working or to retire. Under the coordination of benefits provision, a primary plan will pay first, leaving the balance of unpaid benefits to the secondary plan. While medicare covers most standard medical benefits, it does not cover outpatient prescription drugs. With prescription drug costs rising at a rate second only to that of inpatient hospitalization among medical supplies and services,[12] the availability of an employer-provided health care plan with prescription drug coverage may provide an incentive to keep working.

The availability of other health related benefits for active workers may also influence the decision to retire. For example, about half of all full-time employees in medium-size and large private establishments had employee assistance programs and wellness programs available. Such programs would likely be lost once an individual retired.

Benefits for part-time employees

The tendency among the older segment of the U.S. labor force to work part time has increased in the recent decades. In 1990, 25 percent of all employed persons aged 55 and older were working part time (defined as fewer than 35 hours per week) compared to 19 percent in 1970. In the 25- to-54 age group, part-time employment is

less prevalent, accounting for 10 percent of the employed in 1970 and 11 percent in 1990.[13]

Can a part-time job yield enough income and provide enough benefits to satisfy the needs of older Americans? The Employee Benefits Survey data reveal that part-time employees are considerably less likely to be covered by major benefits programs than their full-time counterparts. As in the case of full-time workers, the incidence of benefits provided to part-time employees and the extent to which the cost of these benefits was assumed by employers vary by establishment size and type, and by occupation.

In medium-size and large private establishments (those with 100 workers or more), medical care benefits were provided to 82 percent of full-time employees, but to only 24 percent of part-time employees in 1993. Part-time professional employees were more likely to be covered by medical benefit plans—33 percent compared with 24 percent of blue-collar employees. Individual coverage was fully employer-paid, however, for less than a quarter of the covered professional part-time employees. In State and local governments, medical care benefits were provided somewhat more frequently to part-time employees—to nearly 43 percent in 1992; for the majority of them, individual coverage was fully employer-paid. Part-time employees in small private establishments are the group least likely to receive coverage for medical care through their jobs—only 5 percent had such coverage in 1992.

Other benefits of interest to older workers include dental care, life insurance, and pension benefits. Dental care was available to 62 percent of full-time employees in medium and large private establishments in 1993 and to only 17 percent of part-time employees. Again, white-collar part-time employees were almost twice as likely to receive these benefits. Life insurance, although usually with a reduction after age 65, was offered to 91 percent of full-time employees with relatively small differences between occupational groups, and to only 25 percent of part-time employees, with the coverage somewhat more often available to white-collar employees. Retirement benefits were available to only 40 percent of part-time employees in 1993, compared with 78 percent of full-time workers.

Continued work and retirement income

One of the most decisive factors influencing the decision to retire may be the adequacy of available income. Retirement income comes from one or more of three sources: Social Security, employer-provided defined benefit pension plans, and savings, the latter either through personal savings or an employer-provided defined contribution plan. The percentage of preretirement income replaced by these sources, and, therefore, the degree of financial protection provided, can vary depending on a person's work history and the provisions of his or her pension plan.

As their name suggests, defined benefit pension plans specify a formula according to which the retirement benefit is calculated. Defined benefit pensions can generally be received with no reduction at a given age (normal retirement age) or at a reduced level if received earlier than the normal retirement age (early retirement age). The traditional normal retirement age is 65, although it is not uncommon to provide unreduced benefits at younger ages to employees with long careers. Several types of formulas are used to calculate benefits, most commonly a percentage of earnings or a dollar amount per year of service. Typically, pension benefits increase with service. The rate of increase in the amount of benefit with additional years of service is a function of several variables: the size of early retirement reduction, if any; the existence of a maximum placed on the number of years of service allowed to accumulate for benefit calculation; the length of service; and the employee's salary history.

Because pension benefit formulas vary, it is, perhaps, easier to assess the effect on pension benefits of decisions as to how long to continue working by examining the portion of preretirement income that pension plans replace. Replacement rates can be viewed as a measure of a degree of financial security that a defined benefit pension will afford upon retirement.[14] According to calculations based on Employee Benefits Survey data, workers with defined benefit pension plans who decide to retire at age 55 with 20 years of credited service and preretirement earnings of $25,000 a year will receive a retirement benefit replacing on average 14 percent of their preretirement income. For most of these enrollees, this percentage reflects the reduction in benefits due to early retirement.[15] At age 60, the average replacement rate for all enrollees eligible for reduced benefits would rise to 21 percent, assuming the level of earnings remained the same during the intervening 5 years. This increase is partly due to the 5 additional years of credited service and partly to the smaller reduction for early retirement.

If the decision is to prolong employment by another 5 years to the normal retirement age of 65, allowing the number of credited years of service to accumulate to 30, the replacement rate would rise to 33 percent; this again reflects the addition of 5 more years of service as well as the elimination of the early retirement reduction. Increases in earnings over these extra years of service will also add to retirement benefits. Thus,

continuing working past age 55, the earliest possible retirement age under many defined benefit plans, to age 65, the most common normal retirement age, may more than double retirement income.

Would continuing working for yet 5 more years be advantageous in terms of the amount of the pension benefit? For those employees whose credited service cannot accumulate beyond 30 years, income replacement rates will stay the same as if they were to retire after 30 years of service.[16] The only advantage of continued work would be the effect of higher earnings during the additional years worked. When benefits are calculated using a "percent of terminal earnings" formula, higher earnings in the years preceding retirement result in somewhat higher amounts of pension benefits.

One might expect that because employees lose a substantial percentage of their pension benefits if they choose to retire early, pension plans would reward them for continuing working beyond normal retirement age. In fact, some plans provide actuarial increases for postponed retirement. Such increases are rare, however; only 6 percent of all full-time employees who were defined benefit plan participants were in plans that provided such increases in 1991. In the absence of an increase for postponed retirement, there is little financial advantage in continuing to work beyond normal retirement age.

As opposed to defined benefit plans, defined contribution plans do not guarantee a level of retirement benefits. The amount of the benefit, sometimes paid in a lump sum, varies depending on the amount of contributions made to the plan, the number of years during which the employee participates, and the rate of return on investments. The amount of savings available upon retirement can rise dramatically if enrollees choose to continue working. For example, retiring with 15 years of service instead of 10 can increase a lump-sum benefit amount by 48 percent, from around $40,000 to slightly over $59,000.[17]

Social Security was enacted in 1935 to provide older Americans with a minimum level of financial protection. The formula used to calculate the benefit takes into account length of service during which the Social Security taxes were paid, earnings, and the age at which benefits begin. The formula is designed to provide a relatively higher replacement rate to retirees with lower earnings.

Social Security provisions may also yield conflicting information as to the desirability of earlier and later retirement. First, there is a 6.6-percent-per-year reduction in benefits received before age 65. Second, there is a 3.5-percent-per-year increase in benefits if they are received after age 65.[18] Finally, Social Security recipients earning additional income over a certain amount will have their benefits reduced. Both the amount of additional income allowed before the reduction applies and the rate of reduction decrease as a recipient's age increases. The reduction no longer applies at age 70. Although a matter of debate among economists, this "earnings test" is perceived by many as a disincentive to work because of the loss of Social Security benefits that occurs if paid work is performed by persons under age 70.[19]

THE AMERICAN POPULATION is aging, and older Americans have more options than ever before. Although the most prevalent tendency has been to retire earlier, many older people choose to continue working. Private and public retirement plans send out mixed signals: some features act as incentives while others provide disincentives to retire. Similarly, insurance benefits, such as health care, life, and disability insurance, differ in their provisions for older workers. □

Footnotes

[1] The survey provides data on such benefits as paid and unpaid time off; life, health, and disability insurance; retirement benefits; and a variety of other benefits financed, at least in part, by employers. Data are provided for full- and part-time employees and for three broad occupational groups. Data for small private establishments (fewer than 100 employees) and for State and local governments are collected in even-numbered years; data for medium-size and large private establishments (100 employees or more) are collected in odd-numbered years.

[2] *Estimates of the Population of the United States and Components of Change by Age, Color, and Sex, 1950–1960, Current Population Reports,* Series P–25, No. 310 (Bureau of the Census, 1965). *The 1990 Census of Population and Housing*, Series CPH-L–74 (Bureau of the Census, 1991).

[3] National Center for Health Statistics, *Vital Statistics of the United States, 1990,* vol. 2, sect. 6, "Life Table" (Washington, U.S. Public Health Service, 1994). For more information, see R.A. Cohen, J.F. Van Norstrand, and R. Suzman, eds., *Trends in the Health of Older Americans, United States, 1994* , Series 3 (National Center for Health Statistics, Vital and Health Statistics, (in press)).

[4] The National Center for Health Statistics, *Vital Statistics of the United States, 1990,* vol. 1, "Natality" (in press).

[5] The high rate of growth in the 55- to 64-year-old cohort of the labor force is the result of high birth rates in the late thirties and the forties combined with high labor force participation among this cohort. For more information, see Howard Fullerton, "Another look at the labor force," *Monthly Labor Review*, November 1993, pp. 31–40.

[6] It should be noted, however, that some of the earlier labor force exit may not be voluntary, but instead may be caused by displacement due to downsizing, corporate restructuring, and other similar economic events. For a fur-

ther discussion of displacement, see Jennifer Gardner, "Recession swells count of displaced workers," *Monthly Labor Review*, June 1993, pp. 14–23

[7] Ronald E. Kutscher, "Historical trends, 1950–1992, and current uncertainties," *Monthly Labor Review*, November 1993, pp. 3–10.

[8] In 1990, 19.7 percent of women aged 60 to 64 were widowed compared to 4.5 percent of men and 35.4 percent of women aged 65 to 74 versus 8.8 percent of men. *Nineteen Ninety Census of Population. General Population Characteristics, United States* (Bureau of the Census, 1992), table 34.

[9] In the United States, divorced persons as a share of the population have grown from 2.2 percent in 1950 to 8.4 percent in 1990. See *Marital Status of the Population, by Age and Sex: 1890 to present*, Series A160–171 (Bureau of the Census, 1992).

[10] Most long-term disability plans define disability for benefit eligibility purposes as inability due to nonoccupational sickness or injury to engage in gainful employment reasonably suitable to the enrollee's training for the first 24 months and in any gainful employment thereafter. For more information on these plans, see Diane B. Hill, "Employer-sponsored long-term disability insurance," *Monthly Labor Review*, July 1987, pp. 16–22.

[11] Under the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985, requiring employers to extend coverage for 18 months following a "qualifying event," early retirees have the right to continued coverage at group rates.

[12] *CPI Detailed Report* (Bureau of Labor Statistics), April 1990.

[13] *Labor Force Statistics Derived from the Current Population Survey. Full- or part-time status of the civilian labor force by age and sex, 1970,* unpublished data (Bureau of Labor Statistics), table 9; and *Employed and Unemployed full- and part-time workers by age, sex, race, and hispanic origin, 1990* (Bureau of Labor Statistics), table 12.

[14] For further discussion on replacement rates, see William J. Wiatrowski, "New survey data on pension benefits," *Monthly Labor Review*, August 1991, pp. 8–23.

[15] Early retirement reductions are typically calculated by multiplying the number of years by which the early retirement age precedes the normal retirement age by a percentage, most commonly 6 percent per year. Thus, at age 55, the reduction from age 65 would be 60 percent, while at age 60, it would be exactly half of that.

[16] While the law allows plans to limit service credits, plans are prohibited from providing a substantially higher benefit for service in later years than in earlier years. Such a practice, known as "back loading," is prohibited to prevent employers from paying substantially greater benefits only in the few last years, thereby making it disproportionately more attractive to work longer.

[17] For further information on defined contribution plans, see Michael Bucci, "Contributions to savings and thrift plans," *Monthly Labor Review*, November 1990.

[18] The normal retirement age for Social Security benefits, currently 65, is going to change beginning in the year 2000. The change will be take effect gradually depending on recipients' year of birth, and will eventually become 67. The minimum early retirement age when reduced Social Security benefits can be paid will remain 62. The reduction will be 5/9 of 1 percent for each month by which early retirement age precedes the recipient's normal retirement age.

[19] For more information, see E. Steuerle and J. Bakija, eds., *Retooling Social Security for the 21st Century, Right and Wrong Approaches to Reform* (Washington, The Urban Institute, 1994).