Changing retirement age: ups and downs

In recent years, legislative changes, new types of retirement plans, and increases in life expectancy have led to differences in retirement ages; workers now have many alternatives to traditional retirement at age 65

William J. Wiatrowski

I grow old … I grow old …
I shall wear the bottoms of my trousers rolled.

—T.S. Eliot
"The Love Song of J. Alfred Prufrock"
The Waste Land and Other Poems
(Harcourt, Brace Jovanovich, 1934)

In Eliot's well-known poem, the narrator acknowledges that he is growing old. In today's world, he might get confused trying to figure out what constitutes old age—or more exactly, what constitutes retirement age. Consider the following:

- A child born today can be expected to live until age 76.
- Someone who turns age 65 today can expect to live until age 83.
- The fastest growing segment of the population is those aged 85 and older.
- The age at which full Social Security retirement benefits can be received has been increasing gradually to age 67.
- Many defined benefit pension plans allow retirement with full benefits at age 60 or 62.
- Most defined benefit pension plans allow early retirement at age 55 or earlier.
- The fastest growing types of retirement plans allow participants to leave their employer and take their benefits at any time, regardless of age.
- Certain retirement accounts can be accessed without penalty once an individual reaches age 59½.
- Some accounts require distributions beginning no later than age 70½.
- There is no longer a mandatory retirement age for most workers, and Federal law protects older workers against discrimination regardless of their age.

In the past, age 65 was considered retirement age. Retirement benefits were available at age 65, and in many cases retirement at that age was mandatory. Today, workers face many choices regarding retirement age. This article will consider those choices, look at some recent developments regarding retirement ages, and explore some of the decisions and responsibilities that confront older workers.

The concept of retirement is not easy to define—it could imply eligibility for benefits, withdrawal from the labor force, changes in lifestyle, changes in family or living situations, or some combination of these characteristics. While this article focuses to a large extent on changing rules and practices regarding retirement income benefits, other concepts also are explored. For example, the employment patterns of older Americans suggest that one can be "retired" and still be employed, at least part time. For older Americans in the future, their concept of retirement may be shaped by the decisions they make today.

William J. Wiatrowski is an economist in the Division of Compensation Data Analysis and Planning, Bureau of Labor Statistics.

Americans are getting older

Concern about adequate income during retirement begins with the supposition that individuals will live for several years past their retirement—that is, past the point when they leave the labor force. At the beginning of the 21st century, retirement is a common phenomenon, and individuals often live for many years after they retire. Such was not always the case, however. In the middle of the 19th century, the United States was largely an agrarian society. Thus, many individuals worked on the family farm for as long as they were able, while those who were not able to work stayed at home and were supported by their families. Life expectancy in 1850 was about 38 years at birth and about 28 years for those age 40. The concept of retirement—at least as we know it today—hardly existed.[1]

Toward the end of the 19th century, the center of work life moved off the farms and into the major industrial centers of the Northeast and Midwest. More and more Americans found themselves employed at workplaces like the one described by Theodore Dreiser in his novel *Sister Carrie*[2]:

> The firm of Speigelheim & Co., makers of boys' caps, occupied one floor of the building, fifty feet in width and some eighty feet in depth. It was a place rather dingily lighted, the darkest portions having incandescent lights, filled with machines and work benches. At the latter laboured quite a company of girls and some men. The former were drabby-looking creatures, stained in face with oil and dust, clad in thin, shapeless, cotton dresses and shod with more or less worn shoes.

As was true on the farm, the need for retirement plans among these early factory pioneers was limited. Life expectancy at the turn of the 20th century was approximately 49 years at birth and about 12 years for those age 60. Workers continued to work for as long as they were able. Employer-provided retirement benefits were rare—in fact, employer benefits of any type were uncommon.[3] Benefits that did exist took the form of benevolent associations of workers, providing a common pool of funds to assist those in need due to death or disability. Often workers in a given location or industry were immigrants from the same country; the benevolent associations were their means of sticking together and helping their fellow immigrants. Those who did leave the workforce, typically because they were no longer able to work, survived on the generosity of their friends and neighbors, their church, or similar charitable assistance.[4]

In the mid-1930s, when the Social Security system was established, life expectancy was about 60 years at birth and about 12 years for those age 60. With the Social Security retirement age set at 65, the system would typically pay benefits for only a few years. Similarly, when many employers and unions began introducing pension plans in the 1950s and 1960s, the retirement age generally was 65, while life expectancy (at birth) was less than 70 years. Those age 65 at the time could expect to live another 14 years.

Things have changed. At the beginning of the 21st century, life expectancy in the United States is 76 years at birth, while those age 65 in 2000 can expect to live an additional 18 years. As a result, retirement benefits—both Social Security and employer-provided plans—that in the past were expected to provide benefits for a few years must now provide benefits for many years.

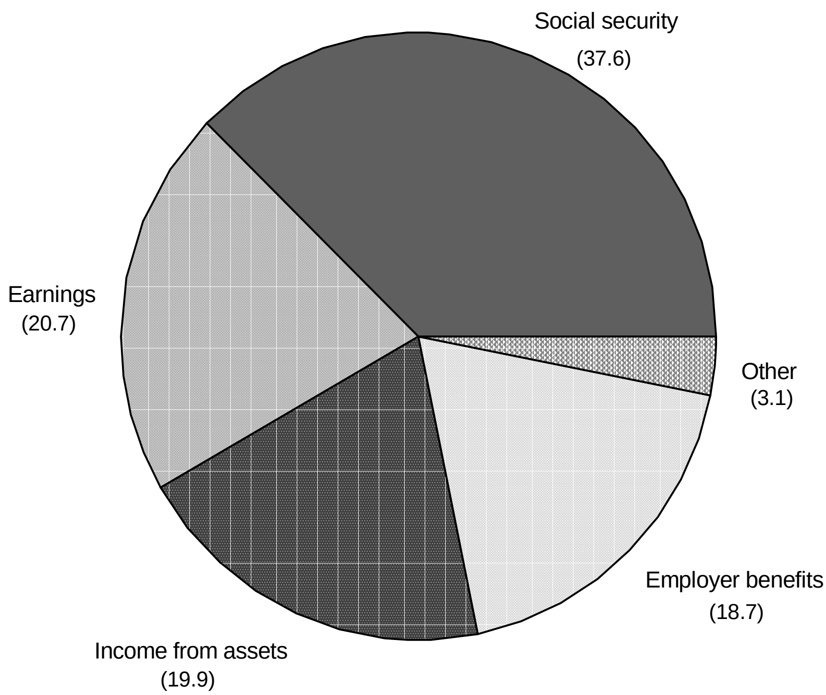
How have benefit plans accommodated this rise in life expectancy? The answer, as described in the sections that follow, varies considerably by type of plan. In general, age-related features of retirement benefit plans have changed in inconsistent ways, not always in line with the change in life expectancy. These inconsistencies require careful planning and decision-making by those nearing retirement age.

And what will the future bring? The percent of the population aged 65 years and older will continue to grow. In fact, the fastest growing proportion of the population is those aged 85 years and older, sometimes called the "older old." This trend, like many trends in the latter half of the 20th century, is fueled by the large population cohort known as the baby-boom generation (those born between 1945 and 1964). Baby boomers are getting older, and many are beginning to reach retirement age. To continue their preferred lifestyle and current standard of living, they will need substantial amounts of income throughout their retirement years. Careful planning to meet their needs may have to start long before retirement age.

Sources of retirement income

The traditional model of retirement income is a three-legged stool—Social Security, employer retirement benefits, and personal savings.[5] The stool could not stand with only two legs, because retirement income would not be sufficient from just two of the three sources of income. While this academic model may describe the ideal scenario for retirement income, it has never actually been achieved, largely because employer-provided plans are not universal and many retirees have little or no savings. Data on income sources for older Americans indicate that Social Security is the single largest source of income. In 1998, Social Security accounted for 38 percent of the income of those aged 65 years and older and 52 percent of the income of those aged 85 years and older. (See chart 1.) Moreover, Social Security was the *only* source of income for 17 percent of those aged 65 and older in 1998, and only 43 percent had income from an employer retirement plan. Finally, a little more than a third of this age group had no income from assets, meaning that, for these individuals, the savings leg of the stool does not exist.[6]

Chart 1. Percent distribution of income by source for those aged 65 years and older, 1998



SOURCE: Social Security Administration, March 2000.

Data on retirement plan coverage among active employees suggests that, in the future, there still will be gaps in the availability of income from employer retirement plans. Such plans are available to 62 percent of full-time employees in private industry, while only 20 percent of their part-time counterparts have these benefits.[7]

The three-legged stool model also fails to account for changes in retirement income sources. (See the box on pages 6–7 for a description of age-related features of retirement plans.) While the model suggests a system in which employer-provided benefits are separate from personal savings, the recent growth of defined contribution plans (one type of employer plan) has blurred the lines between employer plans and savings. Most defined contribution plans, as defined by the Bureau of Labor Statistics, are savings and thrift plans with a 401(k) feature. Employees make voluntary contributions to the plan, with two incentives: 1) Some or all of the contributions are pre-tax (meaning that income is excluded from taxable income in the year it is contributed), and 2) typically the employer matches a portion of the employee's contribution.[8] Participation in savings and thrift plans has grown rapidly since section 401(k) was added to the Internal Revenue Code in 1978. (See table 1.) With individuals saving through their employers, they may see less need or lack the funds for other forms of savings. Thus, the lines between employer plans and personal savings are less distinct than in the past.[9]

Individual Retirement Accounts (IRAs) also serve to blur the distinction between employer retirement plans and personal savings. Like many defined contribution plans, IRAs allow individuals to defer taxes on deposits until they are withdrawn. IRAs were first introduced into the tax law in 1974. Since then, the relationship between IRAs and employer-provided retirement plans has changed several times, as policymakers attempt to target the greatest advantage of IRAs to those without an employer-provided retirement plan. At present, tax deductible deposits into IRAs are, for the most part, available to those who do not have an employer retirement plan.[10] Thus, some may consider saving through IRAs and employer retirement plans to basically be trade-offs. On the other hand, nondeductible IRAs and Roth IRAs are available to workers who also have employer retirement benefits. These kinds of IRAs do not provide the immediate tax benefits of a deductible IRA, but they do provide vehicles for deferred or tax-free investment earnings.[11]

Another change in the traditional retirement income model is the growth of earnings from work as a source of income for those of retirement age. In other words, while most indi-

Various retirement plans and how age affects the level of benefits provided

Social Security provides nearly universal coverage of American workers.[1] Contributions from employers and employees fund Social Security, which in turn pays monthly retirement, disability, and survivor benefits. Benefit levels are based on income and are proportionally higher as a percent of income for those with lower income. (See the chart at the top of page 7.) Retirement benefits are first available at age 62, with a reduction for each month that benefits are received prior to the Social Security normal retirement age. Unreduced benefits are available at the normal retirement age, which was set at age 65 when Social Security was enacted in 1935. The normal retirement age was raised as part of the 1983 Social Security reform legislation. The age rises gradually for those born in 1937 or later. Under present law, the highest normal retirement age will rise to 67, which will apply to those born in 1960 and later.

The following tabulation shows the mean age of persons initially awarded Social Security retirement benefits, by sex, 1950–2000:

Year	*Men*	*Women*
1950	68.7	68.0
1955	68.4	67.8
1960	66.8	65.2
1965	65.8	66.2
1970	64.4	63.9
1975	64.0	63.7
1980	63.9	63.5
1985	63.7	63.4
1990	63.7	63.5
1995	63.7	63.5
1999	63.7	63.6

SOURCE: Social Security Administration, *Social Security Statistical Abstract, 2000.*

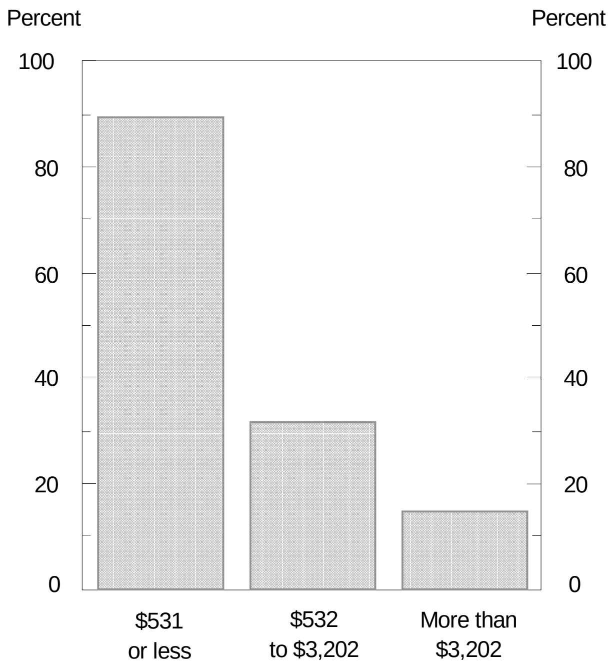
Reduced Social Security benefits at age 62 were first made available to women in 1956 and then to men in 1961.[2] The average age at which workers first receive Social Security benefits dropped steadily during the 1960s, as these early retirement benefits went into effect. Since the early 1980s, the average age of first receipt of Social Security benefits has held steady at just below 64 years.[3]

Individuals may delay the receipt of their Social Security benefits beyond the normal retirement age. Those who do not have considerable work history at normal retirement age and want to continue to work traditionally opt for such a delay. Benefits delayed beyond the normal retirement age are increased to account for their receipt over a shorter life expectancy. As part of the Social Security reforms that increased the retirement age to 67, the percentage increase applied to delayed benefits also rose, providing an additional incentive to delay receipt of benefits. Because benefits are based on income, they may also increase due to additional earnings during the delayed retirement years.

Employer retirement plans take two basic forms—defined benefit plans and defined contribution plans. Under a *defined benefit plan*, future benefits are based on earnings and years of service. Employers bear the risk of maintaining sufficient funds in the plan to pay for future benefits. Plans set a retirement age at which full benefits are payable, and they also typically set an early retirement age at which reduced benefits are available. Early retirement benefits are reduced to account for their receipt over a longer lifetime. While such reductions can be computed using assumptions about life expectancy to determine an actuarially equivalent benefit, some employers subsidize early retirement benefits by imposing reductions that are less than actuarial.

Defined contribution plans are the alternative form of employer retirement plan. In these plans, employer (and often employee) contributions are placed in an individual account in the name of the employee. These funds are invested, and at any given time, the employee's account consists of employer and employee contributions and the returns from the investments. Once vested,[4] benefits are available to employees when they leave the employer, regardless of age. Because the account is designated for retirement purposes, however, the Internal Revenue Code imposes a tax penalty on the receipt of benefits before age 59½, or age 55 if the individual is separated from service.

Percent of monthly earnings used to compute Social Security benefits, 2000



NOTE: Earnings are defined as average indexed monthly earnings; indexing adjusts an employee's earnings to current earnings levels.

Hybrid employer retirement plans, such as *cash balance plans* and *pension equity plans*, have features of both defined benefit and defined contribution plans.[5] While the Internal Revenue Service considers these to be defined benefit plans, such plans communicate the value of benefits to employees as if each employee had an individual account. Plan funding follows the defined benefit approach, with employers bearing the risk of maintaining sufficient funds in the plan to pay future benefits. The value of the account is guaranteed by the employer and is paid out to the employee upon leaving the plan. Unlike a traditional defined benefit plan, there is no specific retirement age and there is no concept of early retirement, although payments are subject to IRS restrictions on early receipt of retirement benefits.

Individual retirement accounts are similar in many respects to defined contribution plans. Individuals have funds invested in their own accounts, and typically they have access to those accounts at any time. Under a traditional (non-Roth) IRA, funds withdrawn before age 59½ are subject to a tax penalty. In addition, distributions from such plans must begin no later than age 70½, and recipients must show their intent to withdraw their entire account over their remaining lifetime. Such funds are included as taxable income in the year they are received.[6]

Because funds in Roth IRAs are not taxable when distributed (the contributions have already been taxed and the earnings are tax free), there is no specific age at which such funds must be withdrawn.

Notes

[1] Those not covered by Social Security include certain Federal, state, and local government employees, those subject to the Railroad Retirement Act, and a few other categories of workers. See Avram Sacks, *2000 Social Security Explained,* CCH Incorporated, 2000.

[2] From the introduction of early retirement benefits until just recently, that reduction was 20 percent, computed as five-ninths of 1 percent per month for each month prior to age 65. With the Social Security normal retirement age gradually increasing to age 67, early retirement benefits will now be reduced even further. The reduction will continue to be five-ninths of 1 percent per month for the first 36 months of retirement prior to the normal retirement age, plus five-twelfths of 1 percent for each additional month. When the normal retirement age reaches 67, the reduction at age 62 will be 30 percent.

[3] See Murray Gendell and Jacob S. Siegel, "Trends in retirement age by sex, 1950–2005," *Monthly Labor Review,* July 1992, pp. 22–29.

[4] Vesting is the nonforfeitable right to future benefits. An employee is typically vested after completing some length of service, often 5 years.

[5] See Kenneth R. Elliott and James H. Moore, Jr., "Cash Balance Pension Plans: The New Wave," *Compensation and Working Conditions,* Summer 2000, pp. 3–11.

[6] The intent of the distribution rules for traditional IRAs is to ensure that the funds in the account are included in the individual's taxable income during the individual's actual lifetime. Regulations that were drafted in early 2001 are designed to simplify the process of determining the proper distribution of IRA funds. See the *Federal Register*, January 17, 2001, pp. 3928–54.

viduals do begin to move out of the labor force between the ages of 62 and 65, some move from full-time employment to part-time work. The following table indicates the percent of older Americans in the labor force as of the end of 2000:

Age group	*Percent in labor force*
Ages 55–59	68.8
Ages 60–64	47.1
Ages 65–69	24.4
Ages 70–74	13.5
Ages 75 and older	5.3

The percent of men aged 62 to 64 who are in the labor force declined steadily from the 1960s—when early retirement at age 62 was made available through the Social Security system—through the mid-1980s. (See table 2.) Data for women in the same age group show different results, however, due mainly to competing trends among men and women. Regardless of age, women's labor force participation rates have increased since the 1960s. In addition, women are more likely than men to leave the labor force during their child-rearing years and thus may need to work additional years later in life to obtain the required years of service for certain retirement benefits.[12]

For older Americans who continue to work, there is often a move to part-time employment. Among those aged 55 to 64 who are in the labor force, 83 percent work full time. Among labor force participants aged 65 and older, however, only 49 percent work full time.

This continuation of work at later ages is reflected in the income sources of older Americans—there is a gradual reduction in the proportion of income from employment as age increases. For example, among those aged 55 to 61 in 1998, 81 percent of their income came from employment. Among those aged 62 to 64, only 61 percent of their income came from employment. Finally, among those aged 65 years and older, the figure drops to 21 percent, and for those aged 85 years and older, it drops to 6 percent.[13]

Clearly, the three-legged stool model is changing. Because retirement benefits become available at different ages, older Americans may have to continue to work or spend their savings to ensure adequate income.

Table 1. Percent of full-time employees participating in various retirement plans, medium and large private establishments, 1985–97

Type of plan	1985	1989	1993	1997
All retirement	91	81	78	79
Defined benefit	80	63	56	50
Defined contribution	41	48	49	57
Savings and thrift	27	30	29	39
401(k)	26	33	36	46

NOTE: Data for 1989–97 are for establishments with 100 workers or more; data for 1985 are for establishments with a minimum of 50 to 250 workers, varying by industry. Differences in the data between 1985 and 1989 reflect in part this change in the survey definition.

Table 2. Percent of civilian noninstitutional population ages 62-64 in the labor force, by sex, 1963–97

Year	Men	Women
1963	75.8	28.8
1965	73.2	29.5
1970	69.4	32.3
1975	58.6	28.9
1980	52.6	28.5
1985	46.1	28.7
1990	46.5	30.7
1995	45.0	32.6
1997	46.2	33.6

Changes in retirement age

In simpler times, age 65 was the only retirement age; in fact, retirement at age 65 often was mandatory. It was the age at which full benefits were available from Social Security. Employer-provided retirement benefits, if available, came from a defined benefit plan, and such a plan provided full benefits at age 65.[14] Defined benefit plans often stopped crediting service for those who had reached age 65, and these plans also excluded certain older employees. There were few options and little confusion. The following provisions, which are from a large manufacturing company's pension plan in the 1960s,[15] are typical of the times:

- Participation requirement: an employee must work for 5 years before becoming a member of the plan;
- Normal retirement: Retirement benefits were not available until age 65;
- Years worked after age 65 were not used to compute benefits;
- Early retirement: Reduced benefits prior to the normal retirement age were not available.

Changes to retirement age requirements introduced in the late 1950s and early 1960s largely reinforced the fact that retirement occurred no later than age 65. Social security introduced early retirement benefits at age 62, but maintained 65 as the age at which unreduced benefits were available. Employer defined benefit plans also introduced early retirement features, often for employees as young as age 55.[16] But such plans did not lower the age at which unreduced benefits were available and continued to impose *involuntary retirement* provisions. A BLS study[17] of pension plans in 1963 described the following involuntary retirement provisions:

> Compulsory retirement age is that age at which the worker can be retired by reason of age alone. It is that point at which the worker loses the privilege of deciding whether he should retire or continue in his job. A worker may, however, be permitted to continue employment on a year-to-year basis, in some cases subject to passing annual physical examinations or meeting standards of job performance.
>
> Automatic retirement age is that age at which the worker must cease his employment, the plan having irrevocably established this age as a maximum.

Legislative changes in the late 1960s and early 1970s provided older workers and retirees with greater protections, but many of these types of involuntary retirement provisions were allowed to continue. In 1967, the Age Discrimination in Employment Act (ADEA) prohibited employers from discriminating against workers on the basis of age—up to age 65. Involuntary retirement provisions were allowed, as long as they were not imposed prior to age 65. In 1974, the Employee Retirement Income Security Act (ERISA) imposed comprehensive standards for retirement plans. Included in this legislation was the provision that plans begin to pay benefits at age 65, which followed the existing ADEA rules.[18] In 1979, a U.S. Department of Labor Interpretive Bulletin allowed defined benefit plans to stop accruing benefits for employees who work past the plan's normal retirement age.[19] These laws further reinforced the notion that age 65 was the standard retirement age.

The following five events, occurring from the late 1970s through the mid-1980s, brought about changes to the concept of retirement age, although not always consistent changes:

- First, the ADEA was amended in 1978 to provide protection against employment discrimination for those up to age 70. As a result, employers had to amend their defined benefit pension plans to eliminate involuntary retirement provisions prior to age 70.
- Second, also in 1978, section 401(k) was added to the Internal Revenue Code, allowing employees to defer income into certain retirement plans. Regulations covering such plans were not finalized until the early 1980s, at which time employers began introducing defined contribution plans with 401(k) features. Such plans do not have an actual retirement age.
- Third, changes to rules for Individual Retirement Accounts made such plans very popular in the early 1980s. IRAs allow individuals to begin withdrawing benefits from their accounts without penalty at age 59½ and require distributions beginning at age 70½. The rules for IRA participation have changed since the early 1980s, but the age of benefit availability has remained the same.
- Fourth, Social Security laws were changed in 1983 to raise gradually the age at which full benefits are available to age 67. This change was enacted as part of a number of reforms designed to shore up the financial strength of the Social Security system.
- Fifth, the ADEA was amended again in 1986, this time removing any age restriction. Workers were protected against discrimination in employment regardless of age, and involuntary retirement clauses were no longer allowed. Additional amendments to ADEA specifically prohibited retirement plans from reducing benefit accruals or allocations on account of age. Finally, plans could no longer deny plan participation to older workers.[20]

From the mid-1970s through the early 1980s, there was a continued trend toward lower retirement ages in defined benefit pension plans. An analysis of provisions in a cohort of plans common to two separate studies—one conducted in 1974 and the other in 1983—found that many plans had lowered their retirement age during the period between the studies. The percent of plans that provided unreduced benefits at age 62 or earlier rose from a little more than 50 percent in 1974 to nearly 80 percent in 1983. Similarly, the number of plans that allowed reduced early retirement at age 55 or earlier rose from 76 percent in 1974 to 85 percent in 1983.[21]

From the mid-1980s to the present, the trend has been toward greater use of defined contribution plans and IRAs, which sever the link between long-term attachment to a single employer and retirement income that is inherent in a defined benefit plan.[22] Individuals can build their retirement income from multiple sources, without regard to age. However, such responsibility also imposes certain risks. Plan participants must be knowledgeable about the investment of their accounts, and when they retire they must withdraw their funds incrementally to ensure lifetime income.

Defined benefit plans have not disappeared, however, and they have in fact begun to introduce new features designed to recognize worker mobility and changes in retirement age. Retirement ages have remained very consistent since the early 1980s; BLS studies have uncovered only a few plans that have increased their retirement age to correspond to increases in the Social Security retirement age. In general, unreduced benefits from defined benefit plans are available at ages 60 to 62, while reduced early retirement benefits are often available at age 55.[23] Although limited, some plans offer supplemental benefits or special early retirement incentives in recognition of the fact that early retirement may leave retirees with employer retirement benefits before the age at which Social Security is available.[24]

During the 1990s, more defined benefit plans began to provide separating employees with the option of receiving a lump sum from the plan. If the present value of the future benefits is less than $5,000, the employer may choose to cash out the benefits without the employee's consent; if the present value is greater than $5,000, the covered employee's consent is required. Such cashed-out benefit amounts are taxable to the employee, and may be subject to a tax penalty. To avoid taxation and penalties, recipients may deposit these funds into an Individual Retirement Account.

Also during the 1990s, other portability arrangements have gained attention. In a limited number of cases, workers can transfer funds or credits from the defined benefit plan of the employer they are leaving to the plan of their new employer. Administrative difficulties make such arrangements uncommon, but they have grown in prevalence since the early 1990s.[25]

Newer types of defined benefit plans have begun to emerge. For example, *cash balance pension plans* and *pension equity plans* both express benefits as a lump sum. This is in contrast to traditional defined benefit plans, which express benefits as a monthly amount a participant will receive at retirement age. These new plans often do not specify a retirement age. Participants may take the account value whenever they leave the plan—regardless of age and subject to tax consequences.

Defined contribution plans have changed in many ways in recent years as well, often to give participants greater responsibility. Because such plans do not specify a retirement age, recent changes have had little or no effect on retirement age. In contrast, the introduction of Roth IRAs in 1999 provided yet another change to the retirement age. Under such plans, contributions are not tax deferred but all earnings are tax free, unlike traditional IRAs, where earnings are tax deferred until distribution. This tax-free provision eliminates the need to impose a mandatory distribution age; thus, there is no requirement that individuals begin taking distributions from their Roth IRA at any particular age.

A recent change related to retirement age was the liberalization of the Social Security "annual earnings test," a provision that has been included in the Social Security law since its inception. The earnings test reduces Social Security benefits for those who continue to work while receiving benefits; earnings above an annual threshold result in reduced benefits. During 2000, the earnings test was scaled back and now applies only to those receiving early retirement benefits prior to the normal retirement age. Once a worker reaches normal retirement age, benefits are not reduced regardless of the amount of earnings received.[26] This change provides another opportunity for older workers to make their own decisions regarding retirement.

The future retirement age

There is much evidence over the past quarter century that a single standard retirement age no longer exists. There is also evidence to suggest that more changes will occur in the future. New types of retirement plans are regularly being developed, and there continue to be many debates among policymakers about the future of Social Security, including proposals to raise further the retirement age and to establish individual accounts. A still higher Social Security retirement age would separate further Social Security and employer retirement plans, while the introduction of accounts may lead to calls for account access prior to Social Security retirement age.

A concept that has gained attention recently is *phased retirement*, a process of transitioning employees from full-time work to full-time retirement.[27] Phased retirement can take many forms, including various combinations of the following:

- Rehire retirees as consultants or as part-time, seasonal, or temporary workers;
- Reduce the work hours of employees gradually;
- Allow employees to take a leave of absence while still employed, to "try out" retirement;
- Allow older workers to enter job-sharing arrangements, thus reducing their work hours;
- Move older workers to different jobs, perhaps with less stress or fewer hours.

While there is much interest in phased retirement, there are actually few examples of existing programs. Several educational institutions have phased retirement programs, including the following example:[28]

> The university has had a reduction in duties policy that allows faculty to request a phased-in retirement. Reductions in anticipation of a move to emeritus status may be granted for a period not to exceed 6 years. Such reductions may be for 10 percent, 20 percent, 30 percent, 40 percent, or 50 percent of full duties. Such reductions are accompanied by a proportional reduction in salary and those benefits that are salary-based. If age 59½, those in reduced duty status are able to begin to withdraw funds from their tax-deferred annuity.

Among the issues raised about phased retirement is the current Federal tax law that prohibits *in-service distributions* from an employer's retirement plan. In effect, an individual cannot continue to work and also receive benefits from a retirement plan. This rule only applies to those who have not reached the plan's normal retirement age. Once that age is reached, workers may receive retirement benefits from the plan and also continue to work.[29]

There are additional questions about how a combination of partial work and partial retirement will work:

- Most defined benefit plans include a formula that bases benefits on earnings in the final years prior to retirement. If an individual entered a phased retirement program, with reduced hours (and commensurate reduced salary), would the lower salary affect the calculation of future retirement benefits?
- Do years of service continue to accrue if an employee works part time and receives a partial pension?
- How do years of part-time service affect the calculation of total years on the job?
- Are benefits recalculated after the employee ceases work all together?

There are ongoing efforts to remedy this problem. Legislation introduced in Congress in July 2000 would have allowed in-service distributions from retirement plans for those who reach age 59½ or 30 years of service. While this legislation did not pass in the 106th Congress, the issue clearly is on the minds of policymakers. Moreover, phased retirement has been the subject of recent articles and debate, and discussion on this topic is likely to continue.[30]

Phased retirement is just one topic of discussion as the debate over retirement age moves into the 21st century. In 100 years, the Nation has gone from a society that needed few retirement benefits, through a period of closely structured retirement plans and ages, to a more flexible period characterized by varying plans and ages. The current retirement system in the United States offers opportunities for older Americans to choose their retirement age and to have sufficient income during retirement. But the current system also requires workers to be aware of their available benefits and to take responsibility to make the right choices throughout their work life.[31] □

Notes

[1] Data on life expectancy from 1850 are for Massachusetts only; see *Historical Statistics of the United States, Colonial Times to 1957* (Bureau of the Census, 1960). Other data on life expectancy are for the United States; see *Health United States 1999* (U.S. Department of Health and Human Services, 1999), pp. 30–31.

[2] Theodore Dreiser, *Sister Carrie*, Houghton Mifflin Company, 1959.

[3] Patrick W. Seburn, "Evolution of employer-provided defined benefit plans," *Monthly Labor Review*, December 1991, pp. 16–23.

[4] See William J. Wiatrowski, "Family-related benefits in the workplace," *Monthly Labor Review*, March 1990, pp. 28–33 and Boris Emmet, "Disability Among Wage Earners," *Monthly Labor Review*, November 1919, pp. 20–39.

[5] According to the Historian's Office at the Social Security Administration (SSA), the earliest use of the three-legged stool metaphor was by Reinhard A. Hohaus, an actuary for Metropolitan Life Insurance Company and an authority on Social Security. See "History Page," part of SSA's official website, on the internet of the **http://www.ssa.gov/history/stool.html**, visited August 10, 2000. In recent years, other experts have used variations on this metaphor to explain changes to the structure of retirement benefits in the United States.

[6] Data on income sources for older Americans are from *Income of the Population 55 or Older, 1998* (Social Security Administration, March 2000).

[7] See Ann C. Foster, "Private Sector Employee Benefits, 1996–97," *Compensation and Working Conditions,* Summer 2000, pp. 17–22.

[8] As identified in data on employee benefits from the Bureau of Labor Statistics, most 401(k) plans are savings and thrift plans with required employee contributions and employer-matched contributions. Other types of 401(k) plans do exist, including plans that allow employees to defer income (and tax), but that do not include an employer match. For more information, see *Employee Benefits in Medium and Large Private Establishments, 1997*, Bulletin 2517 (Bureau of Labor Statistics, September 1999).

[9] There is much debate over the relationship between employer-sponsored savings programs and personal savings of individuals. Three articles in the Fall 1996 issue of the *Journal of Economic Perspectives* provide considerable discussion on the issue. See R. Glenn Hubbard and Jonathan S. Skinner, "Assessing the Effectiveness of Savings Incentives," pp 73–90; James M. Poterba, Steven F. Venti, and David A. Wise, "How Retirement Saving Programs Increase Savings," pp. 91–112; and Eric M. Engen, William G. Gale, and John Karl Scholz, "The Illusory Effects of Savings Incentives on Savings," pp. 113–38.

[10] Tax-deductible IRAs are also available to workers with an employer-provided retirement plan, as long as the worker's income is below a certain threshold.

[11] With a Roth IRA, named after former Delaware Senator William Roth, contributions are not tax deductible when deposited, but earnings on all contributions are tax free when withdrawn. Eligibility for Roth IRAs is limited to workers below certain earnings thresholds. Withdrawals may begin once funds have been deposited for at least 5 years. With a nondeductible IRA, contributions are not tax deductible when deposited, but earnings on all contributions are tax-deferred until they are withdrawn. Withdrawals may be made at age 59½ or later, and must begin by age 70½.

[12] Labor force data are from the BLS Current Population Survey. For a detailed discussion of the employment patterns of older Ameri-

cans, see Patrick J. Purcell, "Older workers: employment and retirement trends," *Monthly Labor Review*, October 2000, pp. 19–30.

[13] See *Income of the Population 55 or Older, 1998.*

[14] Defined benefit pension plans were often designed to compliment Social Security. For example, defined benefit plans often had the same retirement age as Social Security. In addition, defined benefit pension plan formulas were allowed by law to be "integrated" with Social Security; that is, a portion of the benefit could be reduced to account for the retiree's receipt of Social Security. For a detailed discussion of defined benefit pension plan integration with Social Security, see Avy D. Graham, "Coordinating private pension benefits with Social Security," *Monthly Labor Review*, March 1994, pp. 35–38.

[15] See *Digest of 50 Selected Pension Plans for Salaried Employees, Spring 1963*, Bulletin 1373 (Bureau of Labor Statistics, August 1963).

[16] Harry E. Davis and Arnold Strasser, "Private pension plans, 1960 to 1969—an overview," *Monthly Labor Review*, July 1970, pp. 45–56.

[17] See *Digest of 50 Selected Pension Plans for Salaried Employees* (Bureau of Labor Statistics, August 1963).

[18] ERISA indicated that benefits were to begin at the later of (1) age 65 or the plan's earlier normal retirement age, (2) after 10 years of participation in the plan, or (3) the employee's termination of service. The 10-year rule restricted benefits for those who join the plan at a later age; this has since been reduced to 5 years. The "termination of service" rule restricted benefits to those who were retired.

[19] U.S. Department of Labor Interpretive Bulletin, 44 Fed. Reg. 30658, codified as 29 CFR 860.120, May 25, 1979.

[20] Plans may require new employees to be participants for 5 years before they are eligible to receive benefits, regardless of the age at which they joined the plan. This 5-year period is the same as the plan's vesting period.

[21] See Donald Bell and William Marclay, "Trends in retirement eligibility and pension benefits, 1974–83," *Monthly Labor Review*, April 1987, pp. 18–25.

[22] Certain features of traditional defined benefit plans make them more beneficial to long-service employees. See Ann C. Foster, "Portability of pension benefits among jobs," *Monthly Labor Review*, July 1994, pp. 45–50.

[23] For more information on current defined benefit plan provisions among larger private employers, see *Employee Benefits in Medium and Large Private Establishments, 1997.* Among workers in State and local governments, defined benefit pension plan retirement ages tend to be lower. For example, the majority of full-time workers in State and local governments with a defined benefit pension plan in 1998 could retire with unreduced benefits at age 55 or earlier, provided they had completed the required number of years of service. See *Employee Benefits in State and Local Governments, 1998*, Bulletin 2531 (Bureau of Labor Statistics, December 2000).

[24] For detailed information on pension supplements, see William J. Wiatrowski, "Supplementing retirement until Social Security begins," *Monthly Labor Review*, February 1990, pp. 25–29.

[25] See Ann C. Foster, "Portability of pension benefits among jobs," *Monthly Labor Review*, July 1994, pp. 45–50.

[26] For information on the Social Security earnings test and the changes to the law in 2000, see Thomas P. Burke, "Social Security Earnings Limit Removed," *Compensation and Working Conditions*, Summer 2000, pp. 44–46.

[27] *Phased Retirement—Reshaping the End of Work* (Watson Wyatt Worldwide, 1999).

[28] This text is excerpted from information provided to the faculty of the University of Pennsylvania. For more information, see the University of Pennsylvania website, on the Internet at **http://www.upenn.edu/v46/n04/retire.html**, visited April 19, 2001.

[29] Internal Revenue Code section 411(b)(1)(H) specifies that a plan may distribute benefits after an employee reaches retirement age, even if they are still working.

[30] The Phased Retirement Liberalization Act was introduced in Congress on July 12, 2000. The 106th Congress did not pass this bill. For a detailed discussion of phased retirement issues, see Patrick J. Purcell, "Older workers: employment and retirement trends, *Monthly Labor Review*, October 2000."

[31] For a discussion of changing employee responsibilities for retirement income, see Olivia S. Mitchell and Sylvester J. Schieber, eds., *Living with Defined Contribution Pensions* (The Pension Research Council, Wharton School of Business, University of Pennsylvania, 1998).