

# Mandatory retirement: issues and impacts

The average age of Americans is increasing. The United States Bureau of the Census estimates that in the next fifty years the proportion of our population aged sixty-five or older will rise sharply from its current level of ten in one hundred to seventeen in one hundred. This demographic change has heightened public concern over protecting the civil rights of the elderly and assuring them of continued economic support in retirement. Such concern recently resulted in President Carter's signing of legislation that raises the age of mandatory retirement from sixty-five to seventy. Several states and municipalities already had enacted similar bills.<sup>1</sup>

Although mandatory retirement is unpopular with the public, little study has been made of its import for the American economy. This essay reviews the issues surrounding mandatory retirement and explores some of the potential impacts of the new legislation on this country's retirement patterns, unemployment rates, and costs of supporting the elderly. It concludes that an increase in the age of mandatory retirement is unlikely to reverse the trend toward early retirement. The legislation will probably have little effect on unemployment and will generate only modest savings to pension plans and the social security system. Over time, however, the law could lead to important changes in the structure of job opportunities so as to accommodate better the increasing number of older employees.

<sup>1</sup> In 1976, Florida became the first state to prohibit mandatory retirement of public employees. In 1977, California outlawed mandatory retirement in the private sector and relaxed such provisions for public employees as well. The same year, Maine banned compulsory retirement in the public sector and planned to extend such legislation to private employees, while Los Angeles and Seattle eliminated mandatory retirement at age sixty-five among municipal workers.

## **Mandatory retirement in the United States**

Before the turn of the century, Bismarck's Germany viewed age sixty-five as the bench mark for retirement, but the practice was not introduced into the United States until the time of World War I. It gained widespread recognition when, in 1935, the Social Security Act adopted sixty-five as the age at which workers covered by social security could collect retirement benefits. This decision undoubtedly had a profound impact on the public's perception of retirement age and, thereafter, an increasing number of private and public pension plans established sixty-five as the age of eligibility for retirement benefits. Indeed, the extent to which retirement at age sixty-five had become institutionalized in American society was reflected in the Age Discrimination Act of 1967, which protected workers from dismissal because of age only until they reached sixty-five. Thus, in general, it was both socially and legally acceptable to require an employee to step aside at sixty-five. Sixty-five was maintained as the "normal" age of retirement despite greatly extended life expectancies which have resulted from improved nutrition and medical care. In Bismarck's day, most workers did not live until retirement at age sixty-five. In fact, if the retirement age had increased with longer life expectancies, today's equivalent age would be between seventy-five and eighty. Accordingly, there has been a marked increase in the proportion of a worker's life spent in retirement.

An employer administers a policy of mandatory retirement if he requires employees to step down at a predetermined age. The pattern of mandatory retirements in this country is not completely uniform. Although most forced retirements do occur at age sixty-five, smaller numbers also are observed both earlier and later. Among persons required to retire

earlier, sixty-two is the most common age. Mandatory retirement at sixty-two, if part of a pension plan, was *not* in violation of the law because bona fide pension and retirement programs were exempt from coverage by the Age Discrimination Act. Most Federal employees face mandatory retirement at age seventy.

Since provisions of private pension plans result in the vast majority of forced retirements, it is instructive to examine briefly the workings of such programs. Nearly all plans define a "normal" age of retirement, usually sixty-five, at which an employee becomes eligible to receive retirement income provided his age and service record entitle him to vested rights in the pension fund. Relatively few plans call for unquestioned compulsory retirement at the normal age. Instead, at the employer's discretion, the employee may continue to work for several more years, often until sixty-eight, at which time he must retire regardless of his performance on the job. In practice, most employers strongly encourage retirement at the normal age. The structure of the plans serves to induce the employee to step aside at the normal age because, in most instances, his pension will not rise with additional service. Indeed, an increasing number of plans encourage retirement before the normal age by offering only slightly reduced pension payments to those who retire, say, at sixty-two or even earlier.

The incentives of American private pension plans differ substantially from those in other countries. In Western Europe, where in many other respects society is structured in a manner similar to ours, pension plans encourage the elderly to continue working. The incidence of plans calling for compulsory retirement is lower there than in the United States, and often retirement benefits are augmented by years of service contributed after reaching the pensionable age.

It is difficult to gauge with accuracy the number of persons in the United States subject to mandatory retirement. Private pension plans currently cover an estimated 31 million workers, of which roughly 16 million are subject to some form of mandatory retirement.<sup>2</sup> Federal Civil Service and other government

pension programs extend like provisions to another 13 million,<sup>3</sup> bringing to 29 million the number of Americans working on jobs covered by rules mandating compulsory retirement. Thus, although some individuals not covered by pension programs are subject to forced retirement, it appears that approximately 30 percent of the work force faces eventual mandatory retirement. Of course, the number of employees mandatorily retired in accordance with officially announced company rules may understate the actual number of persons forced from their jobs because of age since some employers may adopt an informal policy designed to pressure elderly employees into retirement.

### Review of the legislation

In March of this year, a joint House-Senate committee reached agreement on a measure to amend the Age Discrimination Act by abolishing mandatory retirement for most Federal employees, increasing to seventy the age of individuals protected by the act and rescinding the exemption previously granted to those provisions of existing pension programs that expressly require retirement before age seventy. This last provision is of most importance because, as noted earlier, the majority of mandatory retirements result from the observance of terms of pension plans. With the exceptions discussed below, the amendments prohibit the forced retirement of workers less than seventy years old by reason of their age alone. The bill, which passed both the House and the Senate by near-unanimous votes, was signed into law by President Carter on April 6.

The law becomes effective in three steps. Immediately upon enactment of the legislation, the exemption granted pension plans under the Age Discrimination Act was rescinded. This voided those provisions, currently incorporated into a small number of pension plans, that compel the retirement of employees before age sixty-five. Next, effective September 30 of this year, mandatory retirement will be completely abolished for most Federal employees. Finally, as of January 1, 1979, the coverage of the Age Discrimination Act will be extended to persons up to seventy years of age.

The law allows several exemptions. Persons subject to mandatory retirement under terms of a collective bargaining agreement in effect on September 1, 1977 are not covered by the amended act until the expiration of the agreement or until January 1, 1980, whichever occurs first. As in the original act, occupations for which age is a bona fide qualification, such as

<sup>2</sup> Private pension coverage in 1974 was put at 29.8 million by A.M. Skolnik, "Private Pension Plans, 1950-1974", *Social Security Bulletin* (June 1976), pages 3-17. Allowing for some growth over the last three years would bring the figure to about 31 million. In 1971, an estimated 58 percent of those covered by private pensions was also subject to mandatory retirement; see H.E. Davis, "Pension Provisions Affecting the Employment of Older Workers", *Monthly Labor Review* (April 1973), pages 41-45. A figure of 45 percent for 1974 is cited by D.R. Kittner, "Forced Retirement: How Common is It?", *Monthly Labor Review* (December 1977), pages 60-61. Although there is other evidence to suggest a fall in this proportion, Kittner's estimate seems to exaggerate the decline. Therefore, an average value of 52 percent was applied to the 31 million to yield an estimate of 16 million persons who are in private pension plans and subject to mandatory retirement.

<sup>3</sup> Nearly all Federal employees are subject to mandatory retirement, and 79 percent of state and municipal pension programs also include such provisions. The latter figure is cited by W.C. Greenough and F.P. King, *Pension Plans and Public Policy* (New York: Columbia University Press, 1976), page 127.

police work, fire fighting, and other jobs entailing unusual risk, are not covered by the new amendments. Nor are persons working in an establishment with less than twenty employees. An executive or policymaker can still be retired at sixty-five if he or she stands to receive in excess of \$27,000 per annum in employer-financed retirement income, and tenured professors at colleges and universities can be retired at sixty-five until July 1, 1982. The law does not prevent employers from dismissing older workers for good cause other than age.

As noted earlier, most pension programs do not grant an employee increased benefits if he works beyond the normal age of retirement. The new legislation does not address this practice. The Department of Labor is charged with the responsibility of rewriting regulations governing the administration of pension programs. Although new guidelines have not yet been issued, the history of legislation involving pension plans suggests that, as in the past, most employees working beyond the normal retirement age will not be entitled legally to additional benefits.

#### **Discrimination and costs to employers**

Discrimination in the labor market may be said to exist when personal characteristics other than productivity are a factor in determining an individual's status in the labor force. In a labor market where wages always reflected productivity, the wage of an aging employee who suffered a decline in productivity would fall accordingly so that his service would remain profitable to the employer. Under these circumstances, employers would perceive no need for a policy of mandatory retirement, and there would be little discrimination against aging workers.

In reality, matters are more complex. If an employer reduces the wage of aging workers whose productivity has fallen, he risks damaging the morale of his employees and is likely to attract widespread criticism for his treatment of the elderly. Two alternatives to reducing wages are to utilize better the employee's deteriorating skills by assigning him to a less demanding position or, in the extreme, simply to fire him. These options will also prove highly unpopular. In addition, disagreement between employer and employee concerning the employee's ability to continue work may result in litigation involving age discrimination, further burdening firms with the costs of legal proceedings. Companies can elect to avoid all these difficulties by permitting the continued employment of workers whose productivity has fallen relative to the wage rate. This strategy, of course, is also costly.

The evolution of mandatory retirement in this country can be viewed, in part, as an attempt of employers

to cope with the problems presented by aging workers. An employer realizes fully that by administering mandatory retirement, he must pay the costs of losing some very capable employees and of contributing to the pensions of his retired workers. Nonetheless, by establishing a normal age of retirement which is accepted by participants in the labor market, it is possible both to replace aging workers without humiliating them and at the same time to avoid the onus of dealing with the particulars of individual retirements. Therefore, mandatory retirement, when combined with pension plans and the social security system, may be an economically efficient method of creating opportunities for promotion among younger employees while assuring retirees both a sense of dignity and reasonable levels of economic support.

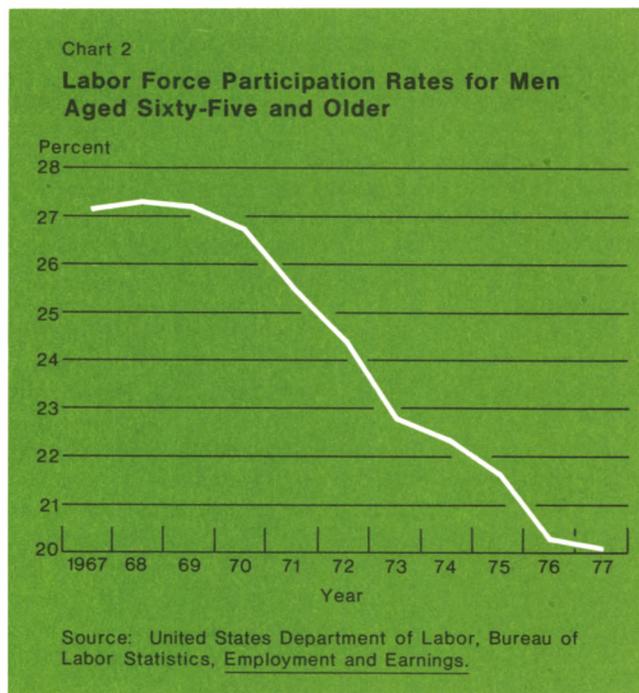
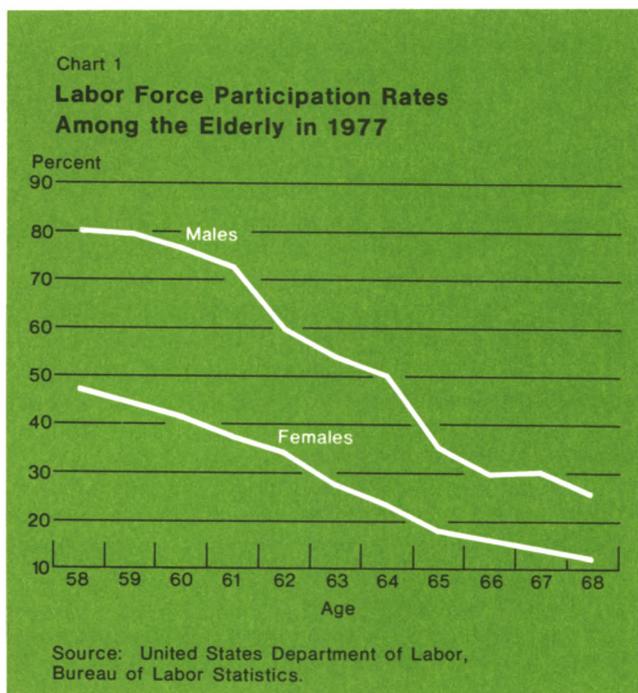
However, in a labor market where workers are subject to mandatory retirement, an older employee is judged by a personal characteristic, *i.e.*, age, which often is unrelated to his productivity. This constitutes discrimination which, in itself, is undesirable. Nevertheless, a question of importance is whether the gains to society from the elimination of discrimination attributable to mandatory retirements more than offset the costs to firms of developing and administering judicial policies regarding the treatment of older workers.<sup>4</sup> The ease with which the legislation passed the Congress emphasizes the extent of governmental interest in the reduction of whatever discrimination exists under our current institutional arrangements.

#### **Unemployment**

When an individual retires from the labor force, his former position is often filled by promotion of another relatively experienced employee. This chain of promotions continues until, finally, an entry level position is made available to a young and relatively inexperienced worker. Therefore, one frequently voiced argument against raising the age of mandatory retirement is that doing so will both jeopardize the advancement of minorities, who only recently gained access to entry level openings, and drive up the national unemployment rate by denying job opportunities to young workers.

A 1968 survey of newly entitled beneficiaries of the social security system revealed that roughly 30 percent of men and 27 percent of women who retired at age sixty-five were compulsorily retired but wished to

<sup>4</sup> Some companies have already developed such plans. At United States Steel, for example, production workers can continue to work regardless of age provided they pass a yearly physical examination.



have continued at their former jobs.<sup>5</sup> When these percentages are applied to the number of men and women who retired in 1977, they suggest that a total of only about 40,000 individuals were involuntarily retired from their work at age sixty-five last year. The effect of the legislation will continue to accumulate fairly rapidly over a five-year period, during which time an estimated 200,000 persons will be affected. Thereafter, as workers turning seventy are mandatorily retired, the total number of employees between the ages of sixty-five and seventy will increase more slowly as the percentage of the population over sixty-five increases. These figures suggest that the impact of the new law on unemployment is likely to be surprisingly small in the near term. The figure of 200,000 represents only about 2/10 percent of the labor force! As the percentage of the population over sixty-five grows, however, the impact could become more substantial. Furthermore, the figures do not capture those who, because of their age, were informally pressured into retirement and subsequently withdrew from the labor force.

<sup>5</sup> United States Department of Health, Education, and Welfare, Social Security Administration, *Reaching Retirement Age* (Washington, D.C., 1976). The figures cited in the Social Security Administration's study are somewhat smaller than those reported in a 1974 survey conducted by Louis Harris and Associates. The Harris poll found that 37 percent of retired employees had been "forced into retirement".

There are, however, reasons to believe that in the long term the labor market will be better able to accommodate both old and young workers. Although an individual's energy and physical resources generally do decline as he reaches advanced age, his skills and accumulated experience still represent valuable assets. Many firms would prefer to keep these employees if given more leeway to adjust the wages and responsibilities of aging workers to reflect their deteriorating skills. Current public attitudes often make such adjustments difficult. However, raising to seventy the age of mandatory retirement greatly increases the costs of employing until retirement age those workers whose capabilities are waning. As a result, many older persons who wish to continue to work may simply be dismissed unless they adopt a realistic view of their declining productivity. Therefore, under the new legislation, both employers and employees can benefit by restructuring careers to achieve a better matching of older workers with jobs that otherwise would not have existed or would have gone unfilled. For example, an aging but experienced foreman might be kept on at a reduced wage in an advisory role. This type of gradual withdrawal from the labor force by older employees makes possible the promotion and hiring of other workers. In this case, postponed retirement need not aggravate unemployment among the young.

There are other reasons to discount the importance

of the impact on the unemployment rate of raising the age of mandatory retirement. First, if a worker is mandatorily retired and at the same time a younger worker is hired, the unemployment rate will *not* fall unless the older worker forced from his job withdraws from the labor force. If he stays in the labor force as an unemployed worker, the overall unemployment rate remains unchanged although the age distribution of unemployment does shift against the elderly. If he succeeds in finding new employment, the overall unemployment rate falls. Second, the unemployment rate fails to include those persons who, following mandatory retirement, withdrew from the labor force but wished to have continued at their former jobs. Therefore, the official measure of unemployment understates the actual extent of discontent among workers, and any increase in unemployment resulting from postponed retirements cannot be interpreted as a decrease in national well-being. Rather, it may merely reflect the accurate measurement of unemployment which previously went undetected but now will be shifted onto younger workers where it can be captured in the official statistics.

In sum, although the new law's impact on unemployment may increase as the percentage of the population over sixty-five rises, the near-term effects appear to be small in percentage terms. Even the long-run effects should be limited, provided there is no dramatic reversal of the trend toward early retirement already under way in this country.

#### **Retirement patterns in the United States**

The estimates presented above were based on the Social Security Administration's 1968 survey of its newly entitled beneficiaries. There are, however, several reasons to question the precision of that survey. First, the results are ten years old and do not reflect more recent changes in the attitudes of workers toward retirement. On average, employees now seem to prefer retiring earlier than they did then, so that the survey's results may overstate the degree of involuntary retirements at age sixty-five. Yet, even if current, such a survey remains problematic. The pressures of living in a work-oriented society could lead respondents to disguise their true feelings by stating a preference for work over leisure. Furthermore, the timing of the survey creates difficulties. Retirees were canvassed shortly after withdrawing from the labor force and may have had insufficient time to assess accurately their sentiments regarding retirement. Given the various biases inherent in the responses, it is important to attempt to infer the extent of involuntary retirement, not from such surveys, but from the actual patterns of retirements observed in this country.

Many people retire either at age sixty-two or at age sixty-five. This fact is clearly reflected in the sharp declines in the labor force participation rates of both men and women of these ages (Chart 1). By far the most common age at which companies apply rules governing mandatory retirement is sixty-five. Such practices could account for the drop in participation rates observed at that age. On the other hand, an employee with prospects of substantial retirement income might be willing to withdraw from the labor force at sixty-five, desiring to have more time to pursue interests not related to employment. The inducement is particularly strong for those with health problems which, although not totally debilitating, render work difficult. Therefore, since workers aged sixty-five usually are eligible for full social security benefits and often are eligible for pension income as well, it is not easy to discern whether a "compulsory" retirement at age sixty-five is voluntary or not.

Some insight into this dilemma is provided by considering the drop in labor force participation which occurs at age sixty-two. Few pension programs force automatic retirement upon an employee at that age. On the other hand, many plans do make available reduced payments to those retiring before sixty-five, and actuarially reduced social security benefits can be collected by those eligible at age sixty-two. Thus, existing institutional arrangements allow one to conclude that many of the retirements occurring at age sixty-two are determined principally by the availability of retirement income, and this conclusion suggests that the same might be true of retirements among those aged sixty-five.

Supporting evidence for this view is provided by Michael Boskin, who studied the decision to retire of one hundred and thirty-one white married men between the ages of sixty-one and seventy.<sup>6</sup> His results suggested that for couples with a potential combined social security pension of \$4,500 per year, the availability of this retirement income had over three times as much influence on the husband's decision to retire as did social customs and institutional arrangements which might have pressured these men into retirement at age sixty-five. Furthermore, Boskin's study may understate the impact of income on the decision to retire because he did not have adequate data on the availability of retirement income from private pension programs and public plans other than social security.

In any event, it is clear that a trend toward earlier rather than later retirement has been under way in the United States for some time. Since 1956, when women

<sup>6</sup> Michael Boskin, "Social Security and Retirement Decisions", *Economic Enquiry* (January 1977), pages 1-25.

became eligible before age sixty-five to collect early retirement benefits under the social security program, the proportion of those eligible who actually collected such benefits has risen steadily to a figure now in excess of 55 percent. In 1961 men were granted the same privilege, and the proportion of those eligible who exercised the option has grown rapidly to over 48 percent. The number of private and other public pension plans offering the option of early retirement is also on the rise.

The latter two developments are clearly reflected by the decline during the last decade in the labor force participation rate of men over the age of sixty-five (Chart 2), and at least part of the decline should be attributed to the concurrent sharp rise in the ratio of retirement to pre-retirement earnings stemming from the liberalization of pension and social security benefits. Whether the abolishment of mandatory retirement at age sixty-five will result in a substantial lengthen-

ing of careers depends, in part, on the future movements of this ratio. In recent years, the proportion has pressed upward strongly, principally as a result of the "overindexation" of social security benefits with respect to inflation (Chart 3). The recent social security act removed this feature, so that the rise in the ratio of retirement income to pre-retirement earnings will likely ease in the near future. In this case one might well observe moderation in the move toward early retirement, but a reversal of the trend is highly unlikely.

### Costs of supporting the retired

The costs to society of supporting the retired portion of the population through the social security system and pension plans depend on two factors: the level of benefits relative to pre-retirement earnings and the proportion of the population achieving retired-worker status. Although, as noted earlier, growth in the ratio of retirement to pre-retirement income should moderate in the near future, it is difficult to predict this factor accurately. However, one certainty is that during the next twenty years the proportion of the population aged sixty-five or older will grow quickly as a result of the decline in birth rates following the surge of the early fifties. This alone will cause substantial increases in the costs of maintaining our retirement programs.

It has been suggested that raising the age of mandatory retirement to seventy is an effective way to lessen the burden on future generations of supporting retired workers, since those who prolong their careers would continue to pay social security taxes without drawing either social security or other pension benefits. Cost reductions will occur, however, only to the extent that careers are in fact lengthened, and the discussion presented here holds little promise for a reversal of the trend toward earlier retirement. Therefore, although the legislation will help improve the financial positions of retirement programs, the resulting savings to such plans are not likely to be dramatic.

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