

Working Longer in an Aging Society: Employer Concerns and Worker Preferences

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Living Longer, Working Longer?

- As life expectancy increases, how will individuals allocate their additional years of life?
- Individuals want to divide extra years between working longer and extended retirement but how do employers feel about later retirement.

Delayed Retirement: The Players and Their Preferences

- Individuals:
 - Greater life expectancy means individuals must either:
 - Save more while working
 - Have lower consumption in retirement
 - Delay retirement and work more years

Working until older ages is one of the most efficient methods for many individuals to finance increased number of years in retirement

- Thus, one can expect that many individual will have a preference for working until older ages.

Delayed Retirement: The Players and Their Preferences

- Governments:
 - Individuals who remain working past traditional retirement ages continue to pay taxes and contribute to national output
 - These individuals are less reliant on national retirement programs – SS and Medicare along with other transfer programs
 - Delayed retirement increases tax revenues and reduces spending on retirement programs

Delayed Retirement: The Players and Their Preferences

- Employers:
 - Demand for labor is an essential input in the production process.
 - Firms seek to have the optimal size and composition of their labor force
 - Cost and productivity of older workers determine the impact on firms of delayed retirement
 - Key question is whether, employers will want to facilitate delayed retirement or attempt to retard the trend toward later retirement

Individuals: Living Longer, Working Longer?

- From a lifecycle perspectives it seems like a reasonable prediction that individuals with longer lifespan will want to divide these extra years of life into more work years and more years of retirement

Impact of Longevity Gains on Retirement Income

<u>Years of remaining life</u>	<u>Account balance of \$250,000 provides annual payout of</u>	<u>Account balance needed to yield annual distribution of \$25,000</u>
14	\$22,132	\$282,402
15	\$20,942	\$298,448
16	\$19,903	\$314,028
17	\$18,988	\$329,153
18	\$18,177	\$343,838
19	\$17,453	\$358,095
20	\$16,804	\$371,937

NOTE: Values are determined using a 3 percent interest or discount rate with annual payments occurring at the end of each year. The values shown in column (1) indicate the annual payout from an account balance of \$250,000 for the indicated number of years. The values shown in column (2) indicate the account balance needed to provide an annual payout of \$25,000 throughout retirement.

Life Expectancy at Age 65 in 2015: US and Malaysia

Malaysia

Men 14.9

Women 16.9

Gain since 2010

Men 0.6

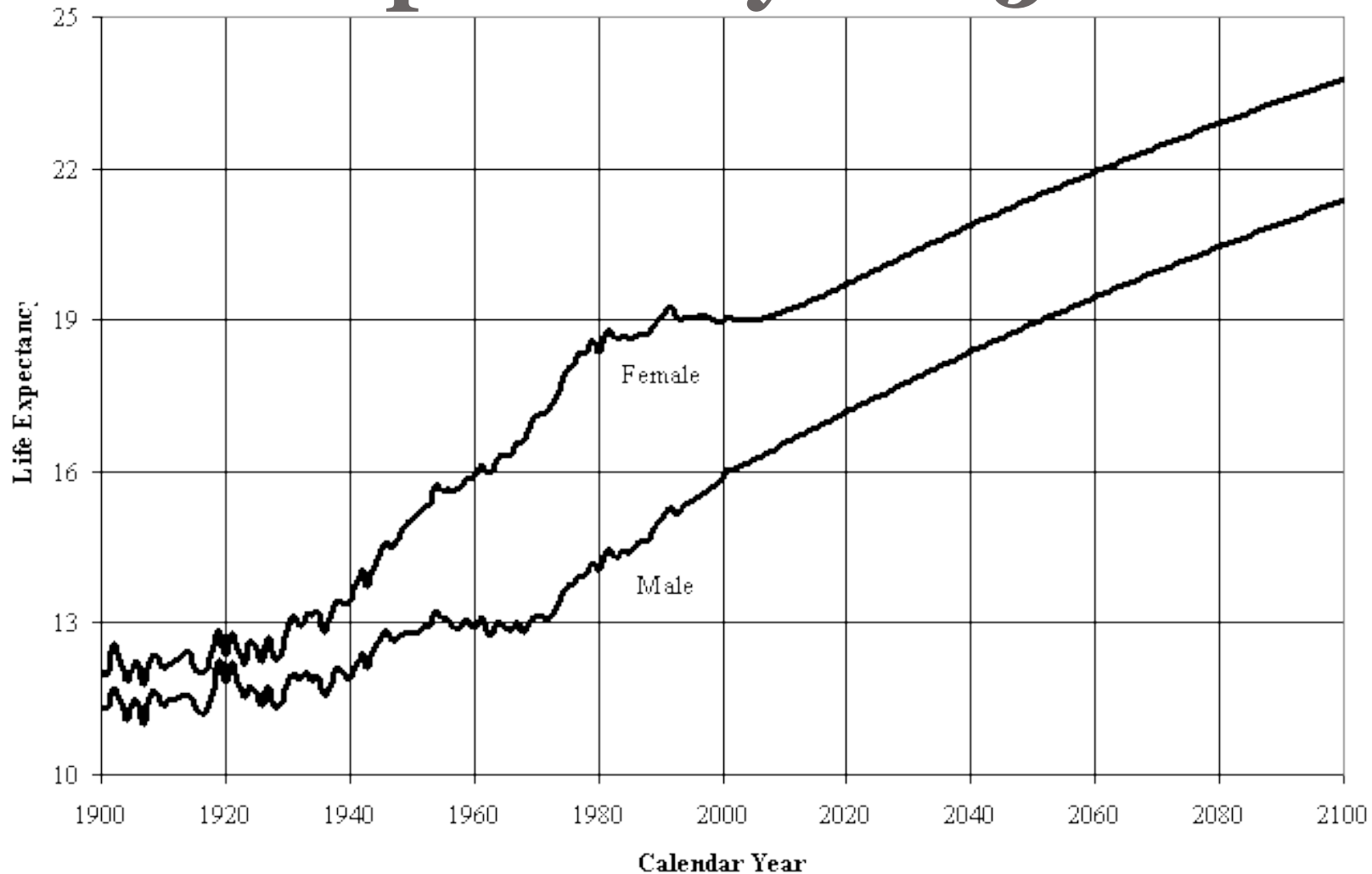
Women 0.8

United States

Men 19.3

Women 21.6

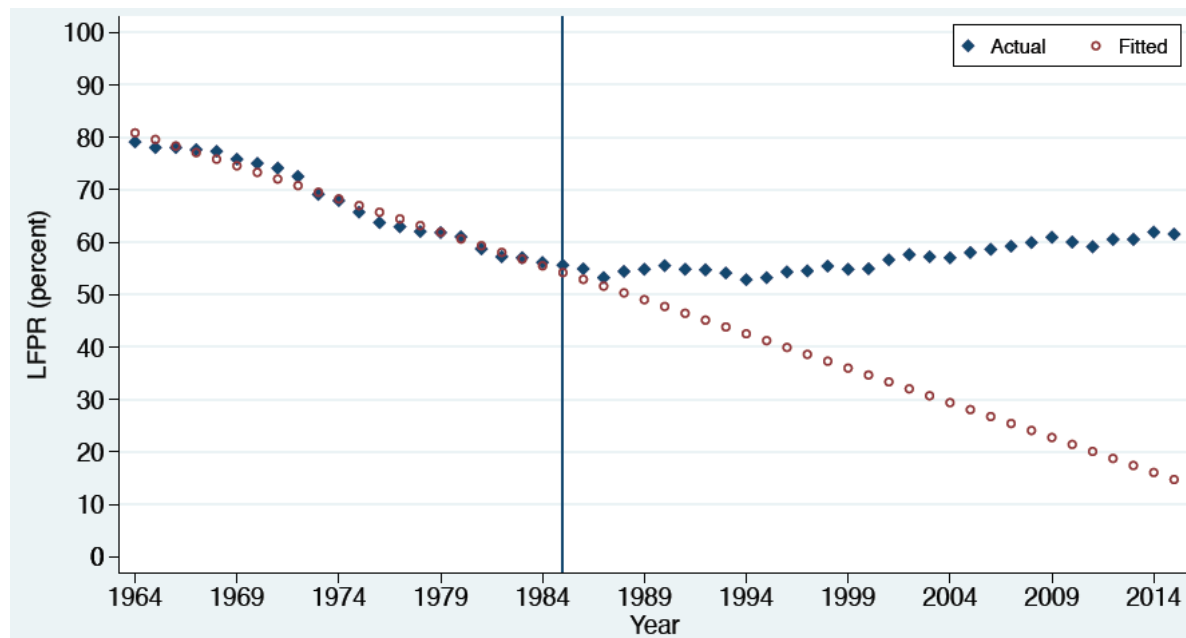
Life Expectancy at 65 in US



Individuals Are Living Longer and Working Longer

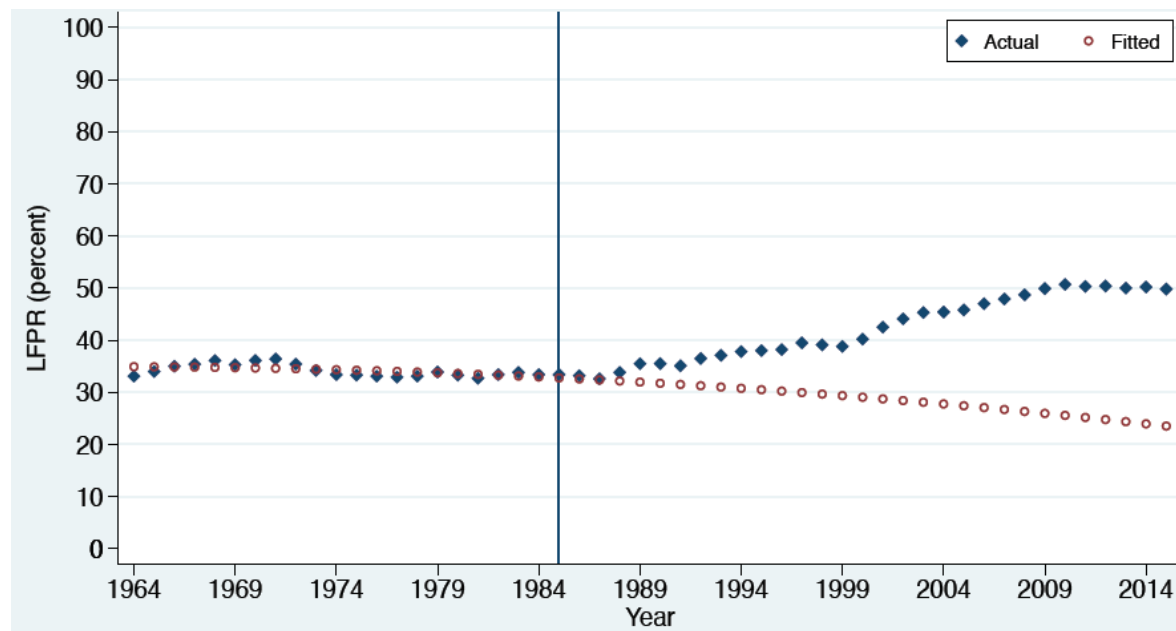
- But throughout the 20th century, the opposite occurred: life expectancy increases and retirement ages declined.
- What drove the trend toward early retirement?
 - Rising real income
 - Economic incentives in SS and defined benefit

Labor force participation rates: men 60-64 actual/fitted values, 1964 to 2015



Source: Authors' calculations based on US Bureau of Labor Statistics, Employment and Earnings.

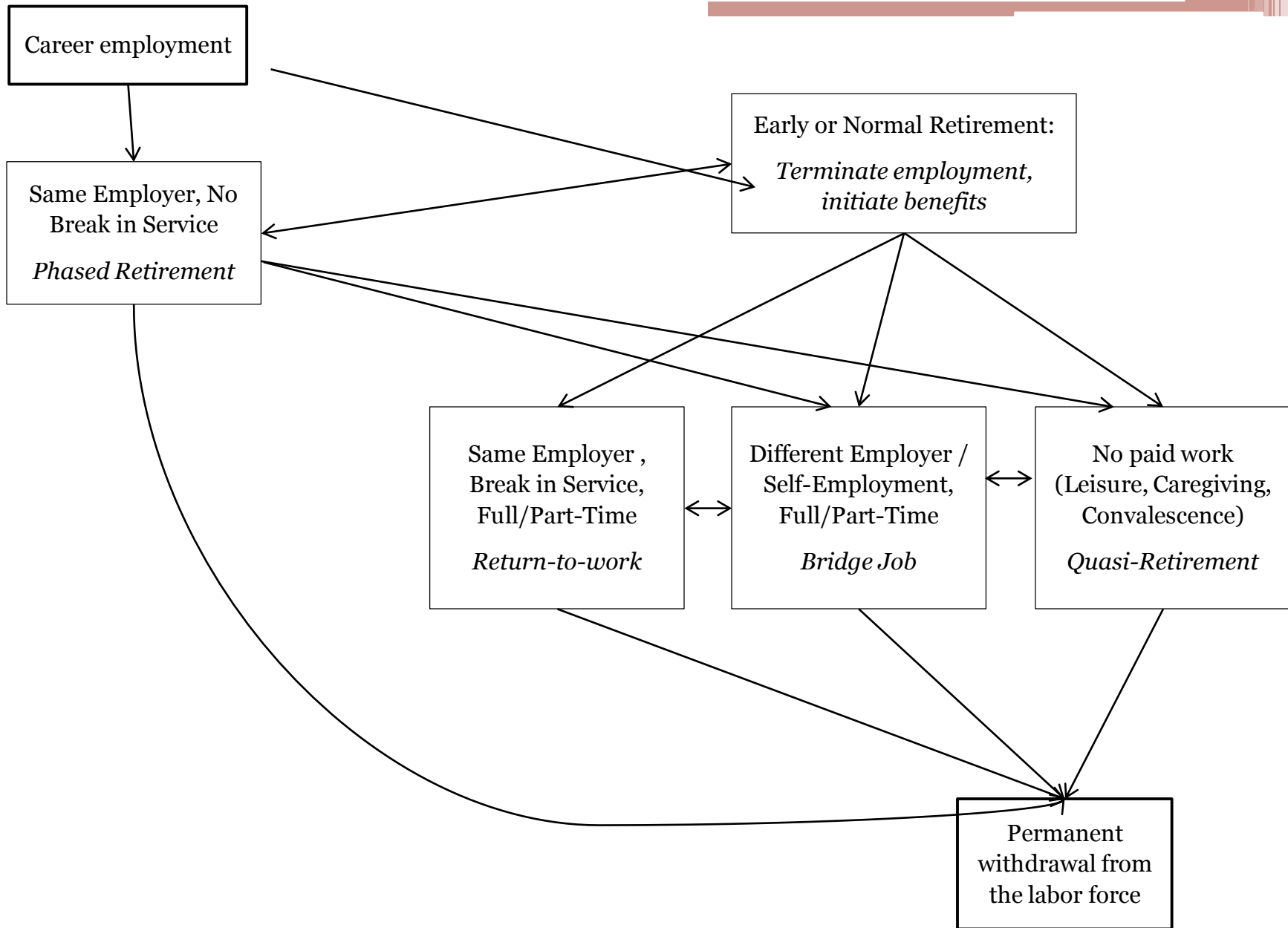
Labor force participation rates: women 60-64 actual and fitted values 1964 to 2015



Source: Authors' calculations based on US Bureau of Labor Statistics, Employment and Earnings.

How can individuals extend worklife?

- Remain on career job
- Shift to phased retirement with career employer
- Move to new jobs: shorter hours, less stress
- Move to self-employment



Governments Face Funding Challenges for Retirement Programs

- Governments develop policies to encourage delayed retirement
 - Older ages of eligibility for retirement benefit programs
 - Reduced retirement benefits encouraging delayed retirement
 - Age discrimination policies

Employer Objectives

- Objectives of employers are often ignored in the assessment of delayed retirement as analysts focus on individuals and their desire for later retirement
- Will employers be willing to accommodate delayed retirement with the same working conditions as currently are in place?

Employer Concerns

- Optimal size and age structure of labor force
- Total compensation of older workers relative to younger employees
- Age profiles for cost and productivity
- Promotional prospects for younger workers

Age Structure of Labor Force

- Do firms care about the age structure of their workforce? Or are they only interested in the number of employees?
 - Older workers are different from younger workers: vintage of human capital, experience
 - Different: not necessarily better or worse but different age/experience workers bring different skills to the job

Age Structure of Labor Force

- Elasticity of old and young workers is not infinite
- Firms will want to have an optimal mix of young and old workers
- When retirement is delayed, the firm will have more older workers and fewer younger workers; how will this affect production costs?

Age Structure of Labor Force

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- Of course, optimal mix is a function of relative prices of young and old workers

A Delayed Retirement Parable

- Consider a firm with a production function:

$$Q = f(K, L(\text{junior}), L(\text{middle}), L(\text{senior}))$$

- Company determines the number of each type of workers needed to maximize profits and develops compensation policies that allow it to hire the optimal number of each type of workers

Policy Dynamics

- L(s) type of workers decide that they want to delay retirement
- As L(s)s work longer, the company can afford to hire fewer L(j)s
- Firm has the right number of workers but a suboptimal mix of the type of workers

Policy Dynamics

- In an effort to restore its optimal age structure, the firm decides to adopt new retirement policies to discourage older workers from remaining on the job
- Firm adopts early retirement incentive plans
- Fewer workers delay retirement and the firm once again achieves the desired age structure of its workforce

Compensation and Productivity

- Theories of compensation: spot market vs long term contracts
 - Spot market: workers are paid their productivity each period; thus per unit of production, older workers are no more costly than younger workers, productivity and compensation profiles are aligned
 - Long term (Lazear type) contracts: young workers are underpaid and older workers are over paid relative to their productivity

Compensation and Productivity

- If career workers are paid according to the long term contract model, firms need an end date to terminate the period of overpaying.
 - Age of mandatory retirement, now illegal
 - Age of eligibility for employer provided retirement benefits
 - If workers do not retire at the desired ages, labor costs will rise

Tournaments

- Some labor economist argue that compensation is more like prizes from a tournament.
- Many competitors are paid less than their marginal product for the opportunity to compete for the ultimate prize of higher salaries.
- Winners are paid more than MP and so ultimately, firm would like them to retire.

Compensation and Productivity

- Remember: it is total compensation, not just cash wage that is important
- Health care costs rise with age
- Pension costs rise with age
- Other benefits may be linked to years of service, vacation days

Compensation and Productivity

- Labor markets can adjust!
 - With more older workers seeking to remain on the job, the age compensation profile could flatten at older ages making older workers relatively less expensive
 - At lower wages, older workers are more competitive and firm is willing to allow them to remain on the job.

Adjusting the labor force

- Do organizations and firms really care about the age structure of their workforce?
- YES
- Do HR and compensation policies influence worker decisions?
- Yes

Compensation and Productivity

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Delayed Retirement and Promotional Prospects

- How will delayed retirement be managed?
 - If older workers remain on their same job with the same level of responsibilities, there will be fewer promotional opportunities for younger workers
 - Will an older age of retirement make a career at firms more or less desirable to job candidates?

Delayed Retirement and Promotional Prospects

- Will firms be able to develop employment contracts that allow workers to delay retirement but with reduced responsibility and lower compensation?
- Will such human resource policies be legal or viewed as age discrimination?
- Will phased retirement policies become the new norm?

Government Policy Changes

- The federal government could adopt policies that would reduce the employer cost of increased retirement ages
 - Eliminate payroll taxes for SS and Medicare once workers achieve the normal retirement ages
 - Make Medicare the primary payer for workers as well as retirees after age 65

Labor Market Responses

- Labor markets are dynamic
- Relative wages change with market conditions
- If the relative wage of older workers declines, firms will be more willing to raise retirement ages

Final Thoughts

- Workers of different ages and with different vintages of human capital and different levels of experience are not perfect substitutions.
- Thus, firms will seek to obtain and retain an optimal age structure of their work force.

Final Thoughts

- The optimal age structure depends on relative productive (the age productivity profile), the degree of substitutability, and the relative cost of different types of workers.
- Labor markets are dynamic and relative prices can change making one type of worker relatively cheaper over time.

Final Thoughts

- Employment contracts and job responsibilities can be altered but will this be viewed as age discrimination?
- Governments can encourage firms to hire more older workers
- Workers can accept alternative working conditions

Remember the Employer

- If work life is to be extended and retirement delayed, the interest of the employer must be considered.
- Will employers seek to accommodate the desire of individuals to remain on the job longer or will they adopt policies to make this more difficult?