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DEMOGRAPHIC AND ECONOMIC FORCES ON RETIREMENT AGE

An Address by
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Introduction

As a potential attendee reading the program booklet for this special pension meeting of the Society, I was surprised and disappointed to learn the identity of one of the featured speakers. I am not referring to tomorrow's luncheon speaker, who is from outside our profession, and speaking within his field of expertise. I am referring to the man who appears before us now. Not only is he "old hat", in the sense that he has appeared before us way too often, but he has no expertise as a demographer, an economist, a sociologist, or a psychologist; yet he proposes to talk on these subjects. If he has any credentials at all, they are related to his claim that he is an actuary--whatever that may be. Still I suppose it is only common courtesy to hear him out. At least the subject he has chosen is of interest to a pension audience. He will give us his thoughts on whether the normal retirement age may eventually rise.

Let me now forget, if I can, that I am a disappointed attendee at a Society meeting--and remember, if I can, that I have some thoughts about the age at which people retire today and how this age might be changing. I propose to present these thoughts today by asking and then attempting to answer, seven specific questions. The first six lead up to the seventh, which will act as a summary.

1. Why is 65 the common age of "normal" retirement?

   Although the emphasis in this meeting today is on private pensions, we must look to the social insurance programs of the United States and Canada to see why age 65 is the accepted age of normal retirement.

   From the earliest days of the United States Social Security, back in the depression years of the 1930's, the law has specified that old-age or retirement benefits can begin at age 65. It was nearly 20 years later that the law was amended to permit early retirement--on a 20% reduced pension--at age 62. Although there have been many changes in Social Security benefits since, the provisions regarding age at retirement have been remarkably stable.

   The original social insurance program in Canada was what social insurance technicians call a "demogrant"--a flat pension for each citizen reaching some specified age. In the 1950's Canada put such a plan into effect, providing $70 per month at age 70. Since then a wage-related social insurance arrangement more like the United States system has come into being in Canada and with it a lowering of the normal retirement age to 65.

Of course it is only a partial answer to the question--what is so unique about age 65--to blame it all on Social Security. Why did the designers of the United States Social Security system pick age 65? There is no clean-cut answer to this question. One piece of the conventional wisdom is that age 65 goes back to Bismarck who established in Germany a social insurance system in the late 19th century! A bit of research by Bob Myers, reported in the April, 1978, issue of THE ACTUARY, throws cold water on this attractive fable. Bob finds that retirement age under the German system was originally 70, lowering to 65 about the time of World War I.

Perhaps the German system did have some influence on the choice of age 65 for the United States system, but more likely local influences were at work. In the 1930's there was a proposal, known as the Townsend plan, for a demogrant of $200 per month at age 60. There were also private plans in existence, particularly for railroad employees, that provided for retirement at age 70. Probably the spirit of political compromise was at work. The Townsend plan age 60 was considered too low, age 70 too high, and age 65 a happy compromise. At least we can be reasonably sure that the choice was not a very scientific one.

2. Has there been a trend toward earlier retirement?

There are indications of such a trend. In trying to answer this question, however, we must distinguish between (1) the establishment of an age lower than 65 at which a full or normal pension can be drawn, and (2) a provision whereby an employee can retire at a reduced pension at some earlier age.

As to the latter, provisions for early retirement on a reduced pension came into private pension plans long before the age 62 provision came into Social Security. The earliest early retirement provisions followed the principle of actuarial equivalence and many (including Social Security) still do. Some employers, however, have chosen to encourage early retirement by granting larger pensions at early retirement than called for by a strict application of the equivalence principle.

Plans that provide for a full or unreduced pension before age 65 are usually those that emphasize years of service and downplay age. Plans for the military services or for fire and police, have often set retirement upon 20, 25 or 30 years of service, regardless of age. In the civil service retirement system those with 35 years of service can retire at age 55. Some union-negotiated plans also employ the service principle, the 30-years-and-out program in the auto industry being an example.

These sorts of developments, coupled with the observation that as many claim Social Security benefits at 62 as wait until 65, leads to the feeling that at least some of us share--that retirement is becoming earlier and earlier in North America. Part of this feeling is associated with the idea that the United States and Canada are rich nations --and becoming richer--and that the newer generations will not have to work as hard or as long as their predecessors.

3. Are we to expect that trends toward earlier retirement will be reversed?

Here my answer depends entirely upon the time frame. Over the next decade, I would not expect any great change. For quite some time age 65 will continue to be a satisfactory normal retirement age for most. Early retirement provisions will be offered (on at least as favorable terms as in the past); and they will be elected, perhaps more extensively than in the past. Late retirement may also become more common with the elimination of most mandatory retirement requirements. In the short run, we might expect a wider range of actual age at retirement with no important trend in the normal retirement age.

I see it differently, however, over a longer time frame--say the next 25 years. It seems to me that there are demographic and economic forces--and some psychological ones--that after the turn of the century could well push the normal retirement age upward. No one of these is compelling, per se, and yet all seem to point in the same direction. In the next three questions we will go more deeply into these.

4. What are the "demographic" reasons for thinking that the normal retirement age might eventually be higher?

Largely because of changing patterns of fertility, the distribution of the population by age will certainly change. At the same time the health of the older population is improving, making it possible for many to work longer. I think of both of these matters as demographic, though some might otherwise classify the latter. Let us look at the age distribution matter first.

Birth rates in the United States have had a most remarkable history over the period since the end of World War I. From a level of about 3 million annually in the mid-1920's, the number of births fell below 2½ million in the depression years of the mid and late 1930's. During World War II, the 3 million level was regained. The post war 1946-1964 years were the years of a "baby-boom", the number of births crossing the 4 million mark in 1954, peaking at the 4.3 million level in 1957, and holding above the 4 million level until 1965. Since then the number of births has fallen back to the 3 million level, about what it was 50 years earlier.

The annual number of births is a very crude measure since it does not take into account the number of women in the child-bearing ages. The total fertility rate (TFR), defined as the number of children that will be born to the average woman if age-specific rates of fertility are to remain constant, has shown even more dramatic change. The TFR peaked in 1957 at 3.7 children per woman, and has since fallen to 1.7. Were it not for the large cohort of potentially fertile women, the legacy of the baby-boom, today's number of births would be considerably lower. If the TFR stays at its low current levels, the number of births will once again decline as the trailing end of the baby-boom passes out of the child-bearing ages.

These changes in birth and fertility rates have already been keenly felt, especially in declining school enrollments, after a period of rapid expansion to meet the educational needs of the children born during the baby-boom.

New entrants to the labor force, assumed for the purposes of this talk to be represented by those attaining age 20, have been very numerous during the 1970's, peaking in 1977. Labor force entrants will continue at a high level until the mid-1980's after which the drop will be distinctly noticeable.

Those reaching age 65 today were born about the time of World War I. The number of new retirees can be expected to remain fairly constant until 1990, fall for the next 20 years, then begin a rapid growth as the early end of the baby-boom reaches retirement age.

The implications for United States retirement systems are fairly clear. The ratio of those age 65 and older to those age 20-64 is currently about 20%. This ratio can be expected to hold steady, or even fall slightly, over the next two decades, but beginning about 2010 it will start a rapid rise, reaching 30% in the mid 21st century. The increase in those crossing age 65, and the decrease in those crossing age 20, combine to have this upward effect on the ratio; the retirees in the numerator increase, the growth of the working age population in the denominator is held back. Neither the baby-boom nor the baby-bust is solely responsible for the projected sharp increase in the retirement dependency ratio but together they have this effect.

The financial effect of these demographic factors on the Social Security system is most noticeable. The theoretical payroll tax rate necessary to keep income in balance with outgo is estimated to fall in the rather narrow range of 10% to 11% for the remainder of the 20th century. For the first decade of the 21st, an 11%-12% range looks likely. Beginning around 2010, however, the proportion of the population already retired begins to increase, driving the theoretical payroll tax rate to the 16% level by 2025. Whether the public will be able and willing to pay taxes at these greatly increased rates is a matter of real concern.

Now let me turn to the effects of lower mortality rates and improved health.

Forty years ago, when the original Social Security Act was passed and age 65 as a normal retirement age was thus established, the life expectancy at age 65 was 12.1 years for males, 13.6 years for females.

Since that time mortality rates have improved dramatically, first at the younger ages, later at the higher. Female mortality has improved more than the male, so life expectancy differences between the sexes have widened. As of 1978, the life expectancies for males and females at age 65 are 14.1 and 18.2.

As time goes on, we can expect more mortality improvement. While the nature and scope of this improvement is subject to considerable doubt, it seems highly likely that the trend toward lower mortality will continue. The trustees of the Social Security system have used mortality improvement assumptions in connection with their projections of program costs. If these prove to be accurate, the expectations of life by the year 2010 will look something like this:

	Male	Female
Age 65	14.8	19.3
Age 70	11.8	15.5

A study of the results shown above indicate rather clearly that men age 70 in 2010 are likely to have almost the same life expectancy as those age 65 in 1938. For women, the expectancy at 70 may be nearly two years longer than for those age 65 in 1938. If age 65 was right when Social Security was first established and if the life expectancy at retirement is the criterion, an eventual retirement age of 70 or higher would be indicated.

The foregoing argument may not appeal to some. The criterion should be the robustness of the average individual as measured by his ability to perform the job rather than his ability to stay alive. In the absence of reliable productivity indices by attained age, indices of life expectancy are not necessarily a satisfactory substitute; and this line of thinking could lead toward higher retirement ages for women, a result out of step with the times.

Still, many people are convinced that the individual age 68 some years hence will on the average be as productive as the otherwise similar individual age 65 some years ago. It could well be noted, too, that increased longevity is a factor in the likely sharp increase (noted earlier) in the retirement dependency ratio. All in all, the observed improvement in mortality at the older ages, from which we can infer improvement in the general health of older Americans, leads one to believe that a higher retirement age may make sense.

5. Are there economic factors that suggest a higher normal retirement age?

It seems to me that the answer to this question is yes. At the risk of oversimplification, I will claim that these economic factors are two-fold: inflation and unemployment.

Social Security benefits are indexed to the Consumer Price Index. This automatic adjustment for price inflation was enacted in 1972 and now seems to be a fixture in the United States social insurance scene.

Not so, however, with respect to the private pension movement. With relatively few exceptions, private pensions are level, or are now-and-then adjusted upward on an ad-hoc basis. Private pensions have not, in general, found it practical to provide pensions indexed to the cost of living. The additional cost of inflation-adjusted pensions is difficult to predict; but it is clear that, at current levels of inflation, the indexing of the pension benefit is too expensive for most employers to consider seriously.

The implications of Social Security benefits increasing with consumer prices, while private pension benefits remain relatively static, are not conducive to the long range health of the private pension movement. Assume a situation where the initial pension is $1,000 monthly, $500 coming from Social Security, $500 from a private pension program. Further assume a rate of inflation of about 7%, such that the CPI doubles each ten years. The original 50-50 Social Security to private plan ratio becomes 2/3-1/3 after 10 years, 80-20 after 20 years, unless the private plan benefits are somehow adjusted upward. The pensioner will soon recognize that the private plan has not kept up with price inflation and has not served its function--while the social insurance arrangement has. Many astute observers of the private pension scene view the seeming inability of private pension arrangements to deal with rapid inflation a sort of Achilles heel.

Turning for the moment from the private pension scene to that of public employee retirement systems, we find the same problem of coping with inflation, though in a slightly different form. The majority of employees of Federal Government, and a substantial proportion of the employees of state and local governments, already enjoy pensions adjusted for the cost of living. Because the extra cost associated with indexed pensions has been poorly recognized, however, many public employee retirement systems are proving to be more costly than the legislators realized when the indexing provisions were put into effect. While private arrangements find it difficult to grant indexed pensions, public employee systems have less difficulty in putting the indexing into effect, but in inflationary times considerable difficulty in finding the needed financing.

The association of the inflation problem with that of the normal retirement age is not immediately obvious, until one recognizes that the extra cost of an indexed pension can be offset, at least partially, by an upward movement in the retirement age. If inflation averages 5% annually, indexed pensions beginning at age 68 are approximately as costly as level pensions beginning at age 65.

Concerns for the continued viability of both private pensions and public employee retirement systems are thus another reason why a higher retirement age may eventually make sense in the United States.

Questions of unemployment have always loomed large in the retirement thinking of the United States public. A reason commonly advanced for the retirement of the older worker is the opening of job opportunity for the labor force new entrant. Unemployment rates remain higher than Americans like; and the possibility of even higher unemployment rates if later retirement should become the norm is one that must be faced.

Another look at the demographic trends already discussed in another setting may do much to alleviate these concerns. The United States work force has grown very rapidly over the past decade, under the influence of both (1) the coming of age of the babies born in the late 1940's and the 1950's, and (2) the entry of so many women, previously homemakers, into the labor force. It is somewhat surprising, given these two very strong forces, that unemployment rates have not been higher. The economy has shown a remarkable ability to create sufficient new jobs to absorb such an influx of new labor force participants.

As to the future, however, things look different. The number attaining age 20 is already past its peak, and after holding up pretty well to the early 1980's can be expected to fall off sharply. By 1985 the age 20 cohort will be only 85% of the similar group in 1979, and the numbers will continue to fall. At the same time the proportion of married women working, while not likely to decrease, must somewhere level out. The growth in the work force will almost surely slow down, giving rise to the possibility that the nation's employment problems may shift from those of underemployment to the opposite.

The thesis that the United States may later on become a labor-short nation has not been proved. Increased immigration, an even higher proportion of women working, a longer work week, technological advance reducing the need for man or woman power--all could counteract the influences noted. Even so, the possibility that the country will have a place for a higher proportion of its older citizens as active members of the work force is real; and the resistance to a higher retirement age, based on fears of high unemployment among the young, may well lessen.

6. <u>What do we know about the psychology of retirement? Will any substantial number of workers be willing to work beyond age 65?</u>

We now leave the relatively firm ground of demography and economics, and venture upon the uncharted seas of human behavior. We must ask ourselves whether the individual's attachment to work is largely economic--i.e., does he work only for the money--or is there some strong psychological need to work? There is some evidence that some workers suffer an identity crisis upon retirement, losing their sense of self-worth. Clearly some workers would prefer to continue an active employment for as long as they view themselves as productive.

Let us ask whether the person who works beyond the typical retirement age (simply because he or she prefers to) is the rare exception, or is this kind of personality more common than we assume. What we know about the psychology of retirement is all too little--but there is some evidence nonetheless.

First, we might point out the popularity of the move to eliminate mandatory retirement provisions from the employment practices of United States employers. The speed with which the legislation went through Congress was amazing to us all. The American worker may or may not want to remain in active employment beyond age 65; but he clearly wants the choice in his own hands. The right to work as long as the worker remains productive has now been granted. It remains to be seen how many workers will avail themselves of this right.

There are some employers, of course, who have never had a policy of mandatory retirement. The actual experience of such employers throws some light on the matter. The Bankers Life and Casualty of Chicago, Illinois--not to be confused with The Bankers Life, 350 miles to the west that furnishes our disappointing speaker--has had a non-mandatory retirement policy for over 30 years. The <u>National Underwriter</u> of April 21 reports that more than 70% of BL&C employees reaching age 65 choose to go on working. Others retire, then change their minds and come back later. One employer, at least, is well satisfied as to the productivity of the older worker who works because he prefers to, not because he must.

Let me now bolster this argument by quoting, with permission, the results of a nationwide survey of employees and retirees. The study to which I refer was commissioned by Johnson & Higgins. It was conducted by Louis Harris and Associates, Inc. The study inquires into attitudes toward pensions and retirement. The interviews on which the study is based were conducted during 1978 and the study has just been published. Copies of a summary of this 1979 study are available through Ken Keene, FSA.

Although the study delves into other matters, I will relay to you only what the study has to say about public attitudes as to work vs. retirement. I cannot give you the entire flavor, because several of the survey questions are apropos. Fifty-one percent of the employees currently working express a preference for continuing in some type of employment beyond normal retirement age. There is some difference, not as marked as I would have thought, between hourly wage, salaried and self-employed.

Another question in the survey, this one asked of persons already retired, is directed at the retiree's preferences as of the date of the survey. Fifty percent would prefer to be working now and 4% are not sure. When a similar question is directed to preferences as of the date of retirement, 53% would have preferred to have continued in some kind of employment. Certainly this important and well designed study contradicts the conventional wisdom that workers will retire as soon as they can justify it economically.

7. <u>What may we expect as to the ages at which employees retire in the future</u>?

I ask this final question as a way of summarizing what has gone before. Before I attempt an answer, let me state clearly that my crystal ball is as cloudy as any other--my opinion no better than yours. Still I have thought more about this intriguing matter than most and my background as a long-term pension and social insurance actuary perhaps gives me some degree of credence. So for what it may be worth, I present--but not dogmatically--the following scenario.

a. For the next five years or so nothing dramatic will happen to the age at which persons retire. Experience under the new non-mandatory retirement framework will grow, more surveys and studies of public attitudes will be undertaken, interest in the demographic and economic factors that seem to lead to a raising of the normal retirement age will quicken. Much more will be said and written on the retirement age subject and the public debate will sharpen. This debate will be largely focused on the normal retirement age under Social Security.

b. Sometime around 1985 Congress will change the law, such that the normal retirement age for OASDI purposes shall move slowly upward. The movement may well be delayed for another ten years, be at some slow pace once it starts and stop by 2010 or so at some age as 68. This possibility, initiated by the 1975 Advisory Council on Social Security and being discussed in the 1979 Council now meeting, will be debated during the early 1980's. Opposition will center around the two ideas that

(1) raising the retirement age is a reduction in benefits, and as such is a breach of an implied contract, and

(2) we are a rich and affluent nation where the public expects to work less rather than more.

In my scenario these arguments will gradually be overcome. One powerful force on the other side will be the continuing actuarial deficit for the period beginning in the second decade of the 21st century and the demonstration that much of this deficit will disappear if the normal retirement age is raised.

c. Once OASDI has led the way and the public has become used to the idea that the normal retirement age will slowly rise, employers in the private sector will quickly follow. Defined contribution plans will automatically provide more adequate benefits; defined benefit plans will become less expensive. It is hoped that the savings realized will be used to give the retiree inflation protection after retirement.

d. While this process is going on, there will be a companion development toward making more practical the gradual phase out of the older employee's work effort. Arrangements for part-time, or full-time but less arduous, work will evolve--as will better dovetailing of wage or salary with retirement income. If the country puts its mind to it, adjustments to the retiring process can be easier, with substantial gain to employer and employee alike.