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## **Older Workers: Employment and Retirement Trends**

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# Older Workers: Employment and Retirement Trends

## Summary

As the members of the “baby boom” generation — people born between 1946 and 1964 — approach retirement, the demographic profile of the U.S. workforce will undergo a substantial shift: a large number of older workers will be joined by relatively few new entrants to the labor force. According to the U.S. Bureau of the Census, while the number of people between the ages of 55 and 64 will grow by about 11 million between 2005 and 2025, the number of people who are 25 to 54 years old will grow by only 5 million. This trend could affect economic growth because labor force participation begins to fall after age 55. In 2003, 91% of men ages 25 to 54 and 76% of women in this age group participated in the labor force. In contrast, just 69% men ages 55 to 64 and 57% of women ages 55 to 64 were either working or looking for work in 2003.

Recent Census Bureau data show men and women working longer. From 1995 to 2004, while there was little change in the rate of employment among men age 55 to 61, the percentage of 62- to 64-year-old men employed in March of each year rose from 42% to 48%. The percentage of 65- to 69-year-old men who were employed increased from 27% to 31% during the same period. Among women age 55 to 61, employment increased from 54% in 1995 to 60% in 2004. At the same time, the percentage of 62- to 64-year-old women employed in March of each year rose from 31% to 38% and the percentage of 65- to 69-year-old women who were employed increased from 18% to 25%.

The rate of employment among persons age 55 and older is influenced by general economic conditions, eligibility for Social Security benefits, and the prevalence and design of employer-sponsored pensions. Labor force participation among people 55 and older could, for example, be affected by the trend away from defined-benefit pension plans, which often include early-retirement subsidies and pay a guaranteed benefit for life, toward defined contribution plans, which are age-neutral and often pay a lump sum at retirement. Also, the repeal in 2000 of the Social Security *earnings test* for individuals at or above the “full retirement age” (65 years and 4 months in 2004), could induce more people to work beyond age 65.

As more workers reach retirement age employers may try to induce some to remain on the job, perhaps on a part-time schedule. This is sometimes referred to as “phased retirement.” Several approaches to phased retirement — job-sharing, reduced work schedules, and rehiring retired workers on a part-time or temporary basis — can be accommodated under current law. Some of these approaches, however, require the individual to separate from the firm before returning under an alternative work arrangement. Under current law, a pension plan cannot pay benefits unless the recipient has either separated from the employer or reached the pension plan’s *normal retirement age*. Some employers would like to pay partial pension distributions to workers at the plan’s *early retirement age* and to be allowed to limit participation in the phased retirement arrangement to workers in particular occupational categories. However, targeted participation could cause a pension plan to violate the provisions of the tax code that prohibit retirement plans from discriminating in favor of highly compensated employees.

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# Older Workers: Employment and Retirement Trends

Deciding when to retire is a choice that will affect an individual's economic circumstances for the rest of his or her life. The retirement of older workers also can have an impact on the nation's economy. The number of people retiring each year affects the size of the labor force, which has a direct impact on the economy's capacity to produce goods and services. Other things being equal, fewer retirements in any given year would result in a greater supply of experienced workers available to employers and fewer people relying on savings, pensions, and Social Security as their main sources of income. Consequently, changes in the age-profile of the population or the average age at which people retire will have implications for both national income and the size and composition of the federal budget.

To understand the factors that affect the retirement decision, one must first know what it means to "retire." Retirement is most often defined with reference to two characteristics: nonparticipation in the paid labor force, and receipt of income from pensions, Social Security, and other retirement plans. An individual who does not work for compensation and who receives income only from pensions, Social Security, and financial assets would meet this definition of retirement. An individual who works for compensation and receives no income from pensions or Social Security would not be retired according to this definition.

Between these two extremes, however, are those who might be considered to have "retired" based on one part of the definition but not the other. For example, individuals who have retired from careers in law-enforcement or the military — both of which typically provide pensions after 20 years of service — often work for many years at other jobs, while also receiving a pension from their prior employment. In such cases, having retired from a particular occupation does not necessarily mean that one has retired from the workforce. On the other hand, many people who retire from full-time employment continue to work part-time to supplement the income they receive from pensions and Social Security. If the majority of their income is provided by Social Security, pensions, and savings, economists typically classify them as retired, even though they continue to engage in paid employment. As these examples suggest, not everyone who receives pension income is retired, and some people who work for pay actually are retired.

This report begins by describing the change in the age distribution of the U.S. population that will occur between 2005 and 2025 and summarizing the historical data on the labor force participation of older workers. This discussion is followed by an analysis of data from the Census Bureau's *Current Population Survey* on employment and receipt of pension income among persons age 55 and older. Employment trends among older workers are then discussed in the context of data from the Social Security Administration on the proportion of workers who claim

retired-worker benefits before the full retirement age (currently 65 years and 4 months). The final section of the report discusses recent proposals to promote “phased retirement” through amendments to the sections of the Internal Revenue Code that govern the taxation of pension income.

## The Aging of the Labor Force: 2005 to 2025

As the members of the “baby boom” generation — people born between 1946 and 1964 — reach retirement age, the demographic profile of the American population will undergo a profound change. According to the Bureau of the Census, the proportion of the U.S. population age 65 and older will increase from 12.3% in 2002 to 18.2% by 2025. The age-distribution those 25 to 64 years old already is undergoing a substantial shift toward a greater number of older individuals and a relative scarcity of young people entering the labor force.

The data presented in **Table 1** show how the age profile of the U.S. population will change between 2005 and 2025. According to estimates prepared by the U.S. Bureau of the Census, there will be 193 million Americans age 25 or older in 2005. By 2025, this number will increase by 22% to almost 236 million. However, the number of people ages 25 to 54 — the ages when labor force participation rates are at their highest levels — will increase by only 3.8%. At the same time, the number of people between the ages of 55 and 64 is projected to increase by 11 million, or more than 36%. In other words, while the number of people between the ages of 25 and 64 is projected to increase by about 16 million between 2005 and 2025, more than two-thirds of the increase is projected to occur among people between the ages of 55 and 64.

**Table 1. U.S. Population Age 25 and Older, 2005 and 2025**  
(Numbers in thousands)

Year	Age groups					Total
	25 to 34	35 to 44	45 to 54	55 to 64	65 and up	
<b>2005</b>						
Male	20,081	21,773	20,852	14,618	15,299	<b>92,623</b>
Female	19,608	21,878	21,589	15,758	21,398	<b>100,231</b>
<b>Total</b>	<b>39,689</b>	<b>43,651</b>	<b>42,441</b>	<b>30,376</b>	<b>36,697</b>	<b>192,854</b>
<b>2025</b>						
Male	22,529	22,886	20,241	20,130	27,801	<b>113,587</b>
Female	21,906	22,512	20,485	21,290	35,724	<b>121,917</b>
<b>Total</b>	<b>44,435</b>	<b>45,398</b>	<b>40,726</b>	<b>41,420</b>	<b>63,525</b>	<b>235,504</b>
<b>Change</b>	<b>4,746</b>	<b>1,747</b>	<b>-1,715</b>	<b>11,044</b>	<b>26,828</b>	<b>42,650</b>
<i>% change</i>	<i>12.0%</i>	<i>4.0%</i>	<i>-4.0%</i>	<i>36.4%</i>	<i>73.1%</i>	<i>22.1%</i>

**Source:** U.S. Department of Commerce, Bureau of the Census.

## Long-Term Trends in Labor Force Participation Rates

The *labor force participation rate* — the percentage of the population that is either employed or unemployed and looking for work — varies by age and sex. Moreover, labor force participation rates have changed over time as people have responded to economic incentives and as the norms and values of society have changed with respect to the employment of women and the retirement of older workers. Also, as the United States has moved from an economy based on “smokestack industries” such as mining and manufacturing to one in which producing and distributing *information* is paramount, there has been an increase in demand for highly-educated workers and relatively less demand for workers who are able to perform physically demanding labor. At the same time that the economy has been producing jobs that can be done by workers of more varied physical abilities, the two-earner couple has become the rule rather than the exception it was 30 or 40 years ago. Finally, with near universal coverage by Social Security and about half of all workers participating in an employer-sponsored pension or retirement savings plan, many workers now anticipate retirement as an opportunity for leisure and recreation rather than as a time of financial dependency on their children.

Men who are over the age of 55 are less likely to participate in the labor force today than were their counterparts a half-century ago.<sup>1</sup> According to data from the Bureau of Labor Statistics, in the 1950s, 5 out of 6 men ages 55 to 64 participated in the labor force — that is, they were either working or actively looking for work.<sup>2</sup> (See **Table 2**). By 1985, only 2 out of 3 men in that age group participated in the labor force. Most of the decline occurred over a relatively brief period, from about 1970 to the mid-1980s. Among men 65 and older, the decline in labor force participation began earlier, but it also appears to have ended around 1985. Between 1950 and 1985, the labor force participation rate among men 65 and older fell from 46% to about 16%. Since the mid-1980s, the labor force participation rate among men ages 55 to 64 years has remained in the range of 66% to 69%, while the rate for those ages 65 and older has increased modestly, from 16% to 19%.

From 1950 to the present, women’s labor force participation has steadily increased. Among women ages 55 to 64, the labor force participation rate rose from 27% in 1950 to 45% in 1990, and to 57% in 2003. Among women 65 and older, however, the labor force participation rate has changed very little over the last 50 years, remaining between 8% and 10% over most of the 1950 — 2003 period.

The stability of labor force participation rates among men ages 55 and older since the mid-1980s is likely attributable to several factors. First, Social Security

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<sup>1</sup> For more information, see *Retirement Patterns and Bridge Jobs in the 1990s* by Joseph F. Quinn, Issue Brief 206, Employee Benefit Research Institute, Washington, DC, February 1999.

<sup>2</sup> Labor force participation rates are annual averages from the monthly CPS data. For more information on the CPS, see the *BLS Handbook of Methods*, Bulletin 2490 (Bureau of Labor Statistics, April 1997), chap. 1, pp. 4-14.

now covers virtually all private-sector nonfarm workers in the United States.<sup>3</sup> The earliest age of eligibility for Social Security retired worker benefits was set at 62 for women in 1956 and for men in 1961 and has not changed since. Second, in the private sector, the expansion in pension coverage that occurred in the 1950s and 1960s had ended by 1980. About half of all workers were covered by an employer-sponsored retirement plan in 2003, virtually the same percentage as were covered in 1980. Finally, most traditional defined-benefit pension plans have minimum age and length-of-service requirements that must be met before pension benefits can be paid. These provisions, in effect, establish a minimum age below which retirement is not a viable option for most workers. According to the Department of Labor's *National Compensation Survey*, among employees in the private sector who participated in a defined benefit pension in 2000, 23% were covered by plans that did not allow early retirement, and 67% were in plans that specified a minimum age requirement for early retirement benefits. Among workers whose pensions specified a minimum age for early retirement, 79% of were covered by plans that had a minimum retirement age of 55 years or older.<sup>4</sup>

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<sup>3</sup> Approximately one-quarter of the employees of State and local governments — about 5 million people — work for governments that have elected not to participate in Social Security. This is the only remaining large group of workers not covered by Social Security.

<sup>4</sup> See U.S. Department of Labor, *National Compensation Survey: Employee Benefits in Private Industry in the United States, 2000*, Bulletin 2555 (January 2003), table 70, p. 63.

**Table 2. Labor Force Participation Rates, 1950 to 2003**

<b>Men</b>		<b>Age groups</b>		
<b>Year</b>	<b>25 to 54</b>	<b>55 to 64</b>	<b>65 and up</b>	
1950	96.5%	86.9%	45.8%	
1955	97.4	87.9	39.6	
1960	97.0	86.8	33.1	
1965	96.7	84.6	27.9	
1970	95.8	83.0	26.8	
1975	94.4	75.6	21.6	
1980	94.2	72.1	19.0	
1985	93.9	67.9	15.8	
1990	93.4	67.8	16.3	
1995	91.6	66.0	16.8	
2000	91.6	67.3	17.5	
2001	91.3	68.1	17.7	
2002	91.0	69.2	17.8	
2003	90.6	68.7	18.6	

<b>Women</b>		<b>Age groups</b>		
<b>Year</b>	<b>25 to 54</b>	<b>55 to 64</b>	<b>65 and up</b>	
1950	36.8%	27.0%	9.7%	
1955	39.8	32.5	10.6	
1960	42.9	37.2	10.8	
1965	45.2	41.1	10.0	
1970	50.1	43.0	9.7	
1975	55.1	40.9	8.2	
1980	64.0	41.3	8.1	
1985	69.6	42.0	7.3	
1990	74.0	45.2	8.6	
1995	75.6	49.2	8.8	
2000	76.8	51.8	9.4	
2001	76.4	53.0	9.7	
2002	76.0	55.1	9.9	
2003	75.6	56.6	10.6	

Source: U.S. Department of Labor, Bureau of Labor Statistics.



## Recent Employment Trends among People Age 55 and Older

Factors that influence the rate of employment among persons aged 55 years and older include the rate of economic growth, eligibility for Social Security benefits, and both the prevalence and design of employer-sponsored pensions. Labor force participation among people 55 and older might also be affected by the trend away from defined-benefit pension plans, which often include early-retirement subsidies and pay a guaranteed benefit for life, toward defined contribution plans, which are age-neutral in design and often pay out a single lump sum at retirement. The *National Compensation Survey* indicates that in 2003, only 20% of workers in the private sector participated in defined-benefit pension plans, which by law must offer retirees the option to receive their pension as an annuity.<sup>5</sup>

Data collected by the Census Bureau indicate that from 1995 to 2004, employment remained generally steady among men 55 to 61 years old and rose among women in this age group.<sup>6</sup> (See **Table 3** and **Table 4**). Of men ages 55 to 61, 72.6% were employed in 2004, compared to 72% in 1995. Employment among women ages 55 to 61 rose from 54% in 1995 to 60% in 2004. Among both men and women ages 62 to 64, employment rose steadily throughout the period. About 48% of men were employed in 2004, compared to 42% in 1995. Among women ages 62 to 64, employment increased from 31% in 1995 to 38% in 2004.

Among men 65 to 69 years old, an average of 26.4% were employed each year from 1995 through 1999. From 2000 to 2004, an average of 30.8% of men in this age group were employed. Among women ages 65 to 69, employment also has increased since 1995. An average of 17.9% of women in this age group were employed in each year from 1995 through 1999. From 2000 through 2004, the average rate of employment among women 65 to 69 years old was 21.1%. Among both men and women age 70 and older, rates of employment changed little from 1995 through 2004. During this period, the employment rate averaged 11.6% among men 70 and older and 5.7% among women age 70 and older.

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<sup>5</sup> *National Compensation Survey: Employee Benefits in Private Industry*, Summary 04-02, U.S. Department of Labor, Bureau of Labor Statistics, April 2004.

<sup>6</sup> The labor force participation rates discussed in the previous section were based on annual averages of monthly data. The employment data in this section are from the March supplement to the CPS, and show employment in the week prior to the CPS interview. The March CPS files were used for this analysis because they include detailed data about sources of income in the previous year. CRS used information about current labor force status rather than information about labor force status in the previous year because an individual who reported that he or she both worked and received pension income during the previous year might have worked and received pension income consecutively rather than concurrently.

**Table 3. Employment of Men Age 55 and Older, 1995 to 2004**

Age in March:	Population (000s)	Number employed (000s)	Percent employed	Employment:	
				full-time	part-time
<b>55 to 61</b>					
1995	6,993	5,035	<b>72.0%</b>	91.5%	8.5%
1996	7,409	5,349	<b>72.2</b>	91.2	8.8
1997	7,523	5,404	<b>71.8</b>	90.6	9.4
1998	7,855	5,664	<b>72.1</b>	91.4	8.7
1999	8,174	5,990	<b>73.3</b>	91.7	8.3
2000	8,204	5,849	<b>71.3</b>	92.3	7.7
2001	8,479	6,138	<b>72.4</b>	91.6	8.4
2002	9,307	6,608	<b>71.0</b>	91.9	8.1
2003	9,870	7,050	<b>71.4</b>	92.0	8.0
2004	10,388	7,537	<b>72.6</b>	92.0	8.0
<b>62 to 64</b>					
1995	2,879	1,206	<b>41.9%</b>	79.0%	21.0%
1996	2,681	1,159	<b>43.2</b>	77.8	22.2
1997	2,733	1,255	<b>45.9</b>	79.2	20.8
1998	2,812	1,283	<b>45.6</b>	80.9	19.1
1999	2,785	1,297	<b>46.6</b>	78.4	21.6
2000	2,927	1,380	<b>47.2</b>	77.9	22.1
2001	2,771	1,284	<b>46.3</b>	77.2	22.8
2002	3,059	1,491	<b>48.7</b>	78.1	21.9
2003	3,279	1,539	<b>46.9</b>	79.7	20.3
2004	3,143	1,517	<b>48.3</b>	81.6	18.4
<b>65 to 69</b>					
1995	4,395	1,169	<b>26.6%</b>	54.7%	45.3%
1996	4,522	1,237	<b>27.3</b>	56.7	43.3
1997	4,321	1,150	<b>26.6</b>	56.8	43.2
1998	4,286	1,085	<b>25.3</b>	57.0	43.0
1999	4,298	1,136	<b>26.4</b>	55.7	44.3
2000	4,376	1,330	<b>30.4</b>	60.5	39.5
2001	4,449	1,328	<b>29.9</b>	63.2	36.8
2002	4,451	1,358	<b>30.5</b>	60.0	40.0
2003	4,318	1,385	<b>32.1</b>	63.2	36.8
2004	4,566	1,425	<b>31.2</b>	63.5	36.5
<b>70 and older</b>					
1995	8,607	970	<b>11.3%</b>	44.9%	55.1%
1996	8,738	989	<b>11.3</b>	44.2	55.8
1997	9,083	1,063	<b>11.7</b>	45.7	54.3
1998	9,238	970	<b>10.5</b>	48.0	52.0
1999	9,429	1,030	<b>10.9</b>	44.8	55.2
2000	9,510	1,169	<b>12.3</b>	48.5	51.5
2001	9,730	1,198	<b>12.3</b>	48.1	51.9
2002	9,785	1,141	<b>11.7</b>	51.1	48.9
2003	10,210	1,209	<b>11.8</b>	54.2	45.8
2004	10,230	1,264	<b>12.4</b>	50.4	49.6

**Source:** CRS analysis of the annual March supplement to the *Current Population Survey*.

**Table 4. Employment of Women Age 55 and Older, 1995 to 2004**

Age in March:	Population (000s)	Number employed (000s)	Percent employed	Employment:	
				full-time	part-time
<b>55 to 61</b>					
1995	7,716	4,196	<b>54.4%</b>	74.1%	25.9%
1996	7,947	4,314	<b>54.3</b>	74.5	25.5
1997	8,142	4,582	<b>56.3</b>	77.1	22.9
1998	8,515	4,896	<b>57.5</b>	77.7	22.9
1999	8,743	4,904	<b>56.1</b>	76.8	23.2
2000	9,041	5,250	<b>58.1</b>	77.2	22.8
2001	9,296	5,365	<b>57.7</b>	77.3	22.7
2002	10,023	5,881	<b>58.7</b>	76.7	23.3
2003	10,677	6,529	<b>61.2</b>	78.2	21.8
2004	11,206	6,696	<b>59.8</b>	77.4	22.6
<b>62 to 64</b>					
1995	3,162	975	<b>30.8%</b>	58.3%	41.7%
1996	3,044	968	<b>31.8</b>	59.3	40.7
1997	3,069	1,047	<b>34.1</b>	62.5	37.5
1998	3,065	1,040	<b>33.9</b>	61.2	38.8
1999	3,199	1,102	<b>34.4</b>	60.1	39.9
2000	3,209	1,109	<b>34.6</b>	61.4	38.6
2001	3,236	1,185	<b>36.6</b>	62.6	37.4
2002	3,479	1,306	<b>37.6</b>	61.9	38.1
2003	3,552	1,307	<b>36.8</b>	62.1	37.9
2004	3,618	1,381	<b>38.2</b>	65.3	34.7
<b>65 to 69</b>					
1995	5,263	919	<b>17.5%</b>	36.3%	63.7%
1996	5,224	865	<b>16.6</b>	40.4	59.6
1997	5,180	936	<b>18.1</b>	42.1	57.9
1998	5,075	941	<b>18.5</b>	44.5	55.5
1999	5,022	941	<b>18.7</b>	40.9	59.1
2000	4,976	983	<b>19.7</b>	44.2	55.8
2001	4,933	947	<b>19.2</b>	42.3	57.7
2002	5,146	982	<b>19.1</b>	49.6	50.4
2003	5,121	1,152	<b>22.5</b>	51.7	48.3
2004	5,252	1,303	<b>24.8</b>	48.7	51.3
<b>70 and older</b>					
1995	13,001	650	<b>5.0%</b>	30.4%	69.6%
1996	13,174	681	<b>5.2</b>	30.3	69.7
1997	13,294	639	<b>4.8</b>	32.8	67.2
1998	13,484	740	<b>5.5</b>	31.9	68.1
1999	13,646	807	<b>5.9</b>	35.0	65.0
2000	13,759	816	<b>5.9</b>	36.3	63.7
2001	13,866	840	<b>6.1</b>	39.3	60.7
2002	14,388	850	<b>5.9</b>	38.0	62.0
2003	14,585	896	<b>6.1</b>	40.7	59.3
2004	14,610	937	<b>6.4</b>	41.0	59.0

Source: CRS analysis of the annual March supplement to the *Current Population Survey*.

## Retirement Income among Older Workers

An important consideration for anyone contemplating retirement is whether future sources of income will be adequate to maintain his or her desired standard of living. **Table 5** shows the proportion of men and women age 55 and older who reported on the Census Bureau's *Current Population Survey* (CPS) that they received pension income of some kind during the calendar year prior to the survey. In this table, "pension income" includes employer-sponsored pensions (including military retirement), veterans' pensions, and periodic payments from annuities, insurance policies, individual retirement accounts, 401(k) accounts, and Keogh plans for the self-employed. Not surprisingly, the proportion of men and women who receive income from a pension or other retirement plan increases with age. In 2003, only 18% of men ages 55 to 64 received income from a pension or other retirement plan. Among those age 65 or older, 45% had income from pensions or retirement savings plans. The patterns among women were similar: only 11.5% of 55- to 64-year-old women received income from pensions or retirement savings plans in 2003, while 28% of those age 65 or older received such income.

The 18% of men ages 55 to 64 who were receiving pension income in 2003 represents a decline from 23% who received such income in 1994. Over the same period, the proportion of men age 65 or older receiving pension income also fell slightly, from 47% to 45%. The proportion of women ages 55 to 64 with pension income was more stable, at 11% to 12% throughout the 1994 — 2002 period. Among women 65 or older, 28% received income from pensions and retirement savings plans in 2003, about the same as in 1994.

To study the relationship between employment rates and receipt of pension distributions, we grouped the men and women into two age groups, 55 to 64 and 65 and older and calculated the correlation coefficient between employment and receipt of pension income. Among men, there is a strong negative correlation between receipt of pension income and employment. Over the period from 1994 to 2003, the correlation between receipt of pension income and current employment was -0.79 for men 55 to 64 years old and -0.73 for men 65 and older. However, the statistics do not tell us *why* employment has risen among men 55 and older while the receipt of pension income has fallen. One possible explanation is that each year a smaller percentage of workers are covered by defined benefit plans, which often have generous early retirement subsidies and pay a monthly benefit that is guaranteed for life. Workers whose main retirement plan is a defined contribution plan (such as a 401(k)) might be choosing to delay retirement in order to build up larger account balances — or in the wake of recent declines in the stock market — to make up for investment losses.

Among women, employment rates and the receipt of pension income are not strongly correlated (-0.16 for women 55-64 and 0.21 for women 65 and older). This is partly due to the fact that the rate of labor force participation among women under age 65 has been rising steadily over many years. Thus, one reason that the percentage of *all* women 55 and older who receive pension income has not fallen along with that of men is that an increasing percentage of women have earned retirement benefits through their own employment. This could mask a decline in the percentage of working women who are (or will be) eligible to receive pension distributions.

**Table 5. Receipt of Income from Employer Pensions and Retirement Savings Plans**

	<i>All individuals age 55 and older (000s)</i>					
	Individuals 55 to 64 years old			Individuals age 65 and older		
	Number of people	Number of recipients	Percentage	Number of people	Number of recipients	Percentage
<b>Men</b>						
1994	9,872	2,303	23.3%	13,001	6,108	47.0%
1995	10,090	2,279	22.6	13,260	6,206	46.8
1996	10,256	2,177	21.2	13,404	6,316	47.1
1997	10,667	2,152	20.2	13,524	6,317	46.7
1998	10,959	2,195	20.0	13,727	6,457	47.0
1999	11,131	2,174	19.5	13,886	6,358	45.8
2000	11,249	2,124	18.9	14,179	6,099	43.0
2001	12,366	2,371	19.2	14,235	6,276	44.1
2002	13,149	2,372	18.0	14,527	6,414	44.2
2003	13,531	2,450	18.1	14,797	6,656	45.0
<b>Women</b>						
1994	10,878	1,316	12.1%	18,264	5,252	28.8%
1995	10,991	1,164	10.6	18,398	5,025	27.3
1996	11,210	1,287	11.5	18,474	4,933	26.7
1997	11,580	1,253	10.8	18,559	5,114	27.6
1998	11,943	1,403	11.7	18,668	5,186	27.8
1999	12,250	1,439	11.7	18,735	5,513	29.4
2000	12,532	1,475	11.8	18,799	5,426	28.9
2001	13,501	1,525	11.3	19,535	5,412	27.7
2002	14,229	1,572	11.0	19,706	5,379	27.3
2003	14,824	1,705	11.5	19,862	5,610	28.2

**Source:** CRS analysis of the March supplement to the *Current Population Survey*.

**Notes:** Retirement plans may include a traditional pension, a retirement savings plan, or both. The year shown is the year when the income was received, which is the calendar year preceding the March CPS interview.

**Employment among Recipients of Retirement Income.** The data displayed in Table 5 show the number and percentage of people 55 and older who received pensions or distributions from retirement accounts. The data in **Table 6** show that, among men ages 55 to 64 who received income from a pension or retirement savings plan during 2003, 39.1% were employed either full or part time in March 2004. Relatively few men age 65 or older who received income from pensions or retirement savings plans also engage in paid employment: only 10% to 12% were employed, on average, at any point in the ten-year period shown in the table. Women who receive pension income were less likely than men to be employed. Among 55- to 64-year — old women who received income from a pension or retirement savings plan in 2003, 32.9% were employed in March 2004. Among women age 65 or older who received income from a pension or retirement savings

plan, only 6% to 8%, on average, were employed at any time during the ten-year period in the table.

**Table 6. Employment of Recipients of Employer Pensions and Retirement Savings Plans**

	<i>Retirement income recipients age 55 and older (000s)</i>					
	Recipients, age 55 to 64			Recipients, age 65 and older		
	Number of recipients	Number employed	Percentage	Number of recipients	Number employed	Percentage
<b>Men</b>						
1994	2,303	864	37.5%	6,108	727	11.9%
1995	2,279	831	36.5	6,206	726	11.7
1996	2,177	832	38.2	6,316	724	11.5
1997	2,152	778	36.2	6,317	648	10.3
1998	2,195	870	39.7	6,457	706	10.9
1999	2,174	799	36.7	6,358	739	11.6
2000	2,124	797	37.5	6,099	721	11.8
2001	2,371	907	38.3	6,276	739	11.8
2002	2,372	827	34.9	6,414	745	11.6
2003	2,450	959	39.1	6,656	839	12.6
<b>Women</b>						
1994	1,316	410	31.2%	5,252	326	6.2%
1995	1,164	324	27.9	5,025	281	5.6
1996	1,287	416	32.3	4,933	277	5.6
1997	1,253	363	29.0	5,114	404	7.9
1998	1,403	370	26.3	5,186	426	8.2
1999	1,439	442	30.7	5,513	401	7.3
2000	1,475	488	33.1	5,426	436	8.0
2001	1,525	439	28.8	5,412	393	7.3
2002	1,572	530	33.7	5,379	425	8.0
2003	1,705	560	32.9	5,610	454	8.1

**Source:** CRS analysis of the March income supplement to the *Current Population Survey*.

**Note:** Retirement plans may include a traditional pension, a retirement savings plan, or both. The income year is the year prior to the survey. Employment is in current year.

## Social Security Retirement Benefits

**Age When Benefits Begin.** In 2004, the “full retirement age” under Social Security is 65 years and 4 months. Social Security retired-worker benefits are first available at age 62, but benefits that begin before the full retirement age are permanently reduced. In 2004, a worker who begins receiving Social Security at age 62 has his or her benefit permanently reduced by about 24% below the amount that would be payable at the full retirement age. As a result of the *Social Security Amendments of 1983* (P.L. 98-21), the Social Security full retirement age is being increased to 67 incrementally over a 22-year period. Reduced benefits will continue to be available as early as age 62, but when the full retirement age reaches 67, the benefit payable at 62 will be just 70% of the amount that would be paid if not for the early retirement reduction.

Most people choose to begin receiving Social Security retirement benefits before age 65. The data presented in **Table 7** show that 77% of men and 81% of women who began receiving Social Security retired worker benefits in 2002 applied for benefits before age 65. In 2000, the distribution of benefit awards to retired workers shifted temporarily, with a higher-than-average percentage of new benefits awarded to persons 65 and older. This was mainly attributable to the repeal of the Social Security *earnings test* for workers who are at or above the Social Security normal retirement age. Prior to 2000, the earnings test reduced the Social Security benefits of recipients under age 70 whose earnings exceeded specific thresholds. P.L. 106-182 eliminated the earnings test for people at the *full retirement age* (currently 65 and 4 months) or older, effective January 1, 2000.<sup>7</sup> The earnings test now applies only to Social Security beneficiaries who are under the normal retirement age. With the repeal of the earnings test for people age 65 and older, workers who had deferred receipt of Social Security benefits because their earnings would have resulted in a benefit reduction had an incentive to apply for Social Security benefits. Workers who delay receipt of benefits until they are beyond the full retirement age remain eligible for the *delayed retirement credit*, which permanently increases their benefits, thus providing an incentive for older workers to remain in the labor force.

**Table 7. Social Security Retired Worker Benefit Awards, by Age**

	<i>Age in year when retired worker benefits began</i>					
	<b>62 to 64</b>		<b>65</b>		<b>Over 65</b>	
	<b>Men</b>	<i>Percentage of all awards</i>	<i>Percentage of all awards</i>	<i>Percentage of all awards</i>	<i>Percentage of all awards</i>	<i>Percentage of all awards</i>
	<i>Awards</i>		<i>Awards</i>		<i>Awards</i>	
1990	637,100	74.4%	158,300	18.5%	60,800	7.1%
1995	614,700	76.1	144,400	17.9	48,700	6.0
1999	623,800	75.9	139,200	16.9	58,700	7.2
2000*	637,000	64.5	226,000	22.9	124,800	12.6
2001	650,000	75.1	179,000	20.7	36,700	4.2
2002	673,000	76.9	171,600	19.6	30,300	3.5
<b>Women</b>	<b>62 to 64</b>		<b>65</b>		<b>Over 65</b>	
	<i>Percentage of all awards</i>	<i>Percentage of all awards</i>	<i>Percentage of all awards</i>	<i>Percentage of all awards</i>	<i>Percentage of all awards</i>	<i>Percentage of all awards</i>
	<i>Awards</i>		<i>Awards</i>		<i>Awards</i>	
1990	494,800	80.0%	85,900	13.9%	37,700	6.1%
1995	492,900	79.9	87,800	14.2	36,300	5.9
1999	524,800	79.1	92,000	13.9	46,400	7.0
2000*	574,700	74.5	118,700	15.4	77,700	10.1
2001	556,200	78.5	102,000	14.4	50,100	7.1
2002	581,700	80.7	103,500	14.4	35,400	4.9

\* The earnings test was repealed in 1990 for workers above the Social Security full retirement age.

**Source:** *Annual Statistical Supplement to the Social Security Bulletin*, various years.

**Note:** Initial awards exclude conversions from disabled worker benefits to retired worker benefits.

<sup>7</sup> In 2004 a Social Security recipient under the full retirement age can earn up to \$11,640 without a benefit reduction. Benefits are cut by \$1 for each \$2 earned over that amount.

**Retired Worked Beneficiaries as a Percentage of Each Age Category.** The data presented in **Table 8** show that in 2002 the proportion of men ages 62 to 64 who were receiving Social Security retired worker benefits was 6.4 percentage points lower than in 1995. This decline coincided with the rising employment rates among men in this age group. (See **Table 4**.) The decline in the percentage of 62- to 64-year-old men receiving Social Security benefits during this period could have several causes, including the move away from defined benefit plans to defined contribution plans among employers in the private sector and the desire among workers under age 65 to remain covered under an employer-sponsored health insurance plan until they become eligible to participate in Medicare at age 65. Among women, the percentage of 62- to 64-year-olds who were receiving Social Security retired worker benefits was generally stable over the period from 1990 to 2000 at about 36%, and then fell slightly in 2001 and 2002.

Among men ages 65 to 69, the proportion who were receiving Social Security retired worker benefits rose abruptly from 84% in 1999 to 91% in 2000, coinciding with the repeal of the earnings test for workers at or above the full retirement age. Among women ages 65 to 69, the proportion who were receiving Social Security retired worker benefits increased from 56% in 1990 to 63% in 2000. This trend is consistent with the long-term increase in the proportion of women who are eligible for Social Security benefits based on their own earnings histories rather than as spouses of retired workers.

**Table 8. Social Security Retired Worker Beneficiaries, by Age**

<i>(Retired worker beneficiaries, in thousands)</i>						
<b>Men</b>	<b>62 to 64</b>		<b>65 to 69</b>		<b>70 and over</b>	
	Number	Percentage of age group	Number	Percentage of age group	Number	Percentage of age group
1990	1,336	45.3%	3,898	83.8%	7,751	91.7%
1995	1,320	46.8	3,900	83.4	8,694	91.2
1999	1302	43.4	3790	84.3	9238	89.9
2000	1,330	43.2	4,076	90.8	9,366	90.3
2001	1,333	41.8	4,125	91.4	9,473	90.3
2002	1,333	40.4	4,198	91.0	9,578	91.1
<b>Women</b>	<b>62 to 64</b>		<b>65 to 69</b>		<b>70 and over</b>	
	Number	Percentage of age group	Number	Percentage of age group	Number	Percentage of age group
1990	1,167	35.9%	3,067	55.6%	7,607	55.9%
1995	1,128	36.8	3,058	56.7	8,570	57.7
1999	1,180	35.6	3,070	60.1	9,203	59.4
2000	1,223	36.0	3,209	63.1	9,302	59.7
2001	1,237	35.3	3,284	64.5	9,390	60.0
2002	1,246	34.4	3,369	63.2	9,480	59.6

**Source:** Annual Statistical Supplement to the Social Security Bulletin, various years.



## Older Workers and “Phased Retirement”

In the traditional view of retirement, a worker moves from full-time employment to complete withdrawal from the labor force in a single step. In fact, however, some workers choose to continue working after they have retired from their “career” jobs. The process of retiring often occurs gradually over several years, with many workers retiring from year-round, full-time employment and moving to part-time or part-year work at another firm, often in a different occupation. The data in **Table 6**, for example, show that 39% of men and 33% of women aged 55 to 64 who received income from private pension plans in 2003 were employed in March 2004.

As members of the baby-boom generation begin to retire, millions of skilled and experienced workers will exit the labor force. As this occurs, employers may find it necessary to alter their employment practices and pension plans to induce some of those who would otherwise retire to remain on the job, perhaps on a part-time or part-year schedule. This process is sometimes referred to as *phased retirement*. No statutory definition of phased retirement exists, but one analyst has described it as “the situation in which an older individual is actively working for an employer part time or [on] an otherwise reduced schedule as a transition into full retirement. [It] may also include situations in which older employees receive some or all of their retirement benefits while still employed.”<sup>8</sup>

Advocates of phased retirement contend that many people would choose to continue working if employers could offer them the opportunity to collect pension benefits while still on the employer’s payroll. Under current law, this option can be offered only to employees who have reached a pension plan’s *normal retirement age*. By law, the normal retirement age at any age cannot be greater than 65. Some employers have suggested phased retirement would be embraced by more firms if this option could be offered to employees at the plan’s *early retirement age*. Employers generally would prefer to offer the option of receiving these “in-service” distributions only to selected categories or classifications of plan participants.<sup>9</sup> In order for either of these actions to be taken, however, the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA) would need to be amended.<sup>10</sup>

**Current Approaches to Phased Retirement.** Surveys of employers indicate that few have adopted formal phased retirement programs. A study conducted by Watson Wyatt Worldwide in 2000 found that 16% of the 586 firms participating in the survey offered some form of phased retirement to their employees.<sup>11</sup> Of 232 employers surveyed by William M. Mercer, Inc. in 2001, 23%

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<sup>8</sup> Testimony of Wilma K. Schopp on behalf of the Association of Private Pension and Welfare Plans before the U.S. Senate Special Committee on Aging, April 3, 2000.

<sup>9</sup> This discussion refers to in-service distributions under *defined benefit* pension plans. In-service distributions under *defined contribution* plans are discussed later in this report.

<sup>10</sup> See, for example, *New Opportunities for Older Workers*, issued by the Committee for Economic Development, Washington, DC, 1999.

<sup>11</sup> Laurene A. Graig and Valerie Paganelli, “Phased Retirement: Reshaping the End of Work,” *Compensation and Benefits Management*, vol. 16 no. 2 (Spring 2000).

reported that they had adopted formal policies to accommodate phased retirement.<sup>12</sup> Although the firms participating in these surveys might not be representative of all employers, their practices with respect to phased retirement offer some insights into the strategies that firms have been able to employ under current law to promote phased retirement among their employees.

Employers have devised a number of strategies to retain the services of valued employees who are eligible for retirement and who might be lost to the firm if the only options available were full-time employment or full-time retirement. Some firms allow retirement-eligible employees to work fewer days per week or fewer hours per day. Some also permit employees to reduce their workload through job-sharing. Firms sometimes rehire retired employees on a part-time or temporary basis, or bring them back as contractors rather than as regular employees. Two of these arrangements — hiring retired former employees on a part-time or temporary basis and hiring retirees as contractors — require the individual to separate from the employer before returning under an alternative work arrangement. This introduces considerable uncertainty into the process for both the retiree and the employer, because once the employment relationship is severed, neither party is legally bound to renew it.

***Phased Retirement and Pension Distributions.*** Unless an employee has reached a pension plan's normal retirement age, the plan cannot pay retirement benefits to the individual while he or she remains employed by the firm, even if only on a part-time basis. In order to qualify for the favorable tax status granted to tax-qualified pension plans, the plan must pay benefits only on condition of death, disability, termination of employment, plan termination, or at the normal retirement age.<sup>13</sup> A plan that pays benefits to an employee who has not yet reached the plan's normal retirement age could lose its tax-qualified status.<sup>14</sup> An employee who has reached the pension plan's *normal retirement age* can begin to receive distributions from the plan, even if he or she continues to be employed by the firm.<sup>15</sup> Likewise, an employee who has reached the plan's *early retirement age* can begin to receive distributions from the plan upon separation from the firm, provided that he or she has completed the required number of years of service stipulated by the plan. If a participant has separated from the employer and has begun receiving distributions from the plan at the early retirement age, he or she can continue to receive these distributions, even if at some future date the participant becomes re-employed by the

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<sup>12</sup> Anna M. Rappaport, "Employer Strategies for Changing Workforce: Phased Retirement and Other Options," *Benefits Quarterly*, volume 17 (4), Fourth Quarter 2001.

<sup>13</sup> 26 C.F.R. § 1.401-1(b)(1)(i).

<sup>14</sup> In a "tax-qualified" plan, employer contributions to the plan are deductible business expenses for the firm and neither the employer contributions nor investment earnings on those contributions are counted as income to the employee in the years that they occur; instead, pensions are taxed as income when the benefits are paid to plan participants in retirement. Usually, retirees are taxed at a lower marginal tax rate than when they worked.

<sup>15</sup> If a plan participant continues to work for an employer beyond the plan's normal retirement age, the plan must meet the statutory requirements for continued benefit accruals; see 26 U.S.C. § 411(b)(1)(H).

plan sponsor. In order to retain the plan's tax-qualified status, however, the employer may be required to demonstrate to the Internal Revenue Service that "both a bona fide retirement (or other termination of employment) and a legitimate rehire have occurred."<sup>16</sup>

**Policy Issues.** Some employers see the statutory prohibition on making in-service pension distributions to employees who have not yet reached normal retirement age as an obstacle to establishing phased retirement plans. Some older workers would find it financially impractical to cut back to a part-time or part-year work schedule if they were unable to supplement their earnings with pension income. One way for a firm to offer phased retirement to these workers under current law, without jeopardizing the tax-qualified status of its pension plan, would be to lower the normal retirement age. For example, if the normal retirement age under the plan is 62 and the early retirement age is 55, the firm could reduce the normal retirement age to some age between 55 and 62. From the employer's point of view, there would be at least two potential drawbacks to such an approach. First, it could result in an unintended exodus of workers into retirement, because all eligible plan participants would be able to receive full pension benefits at an earlier age than previously. Second, it could increase the cost of funding the plan, because full benefits would be payable at a younger age.

Rather than reduce the normal retirement age in their pension plans, some employers would prefer that Congress amend the Internal Revenue Code to allow in-service pension distributions to employees who have reached the plan's early retirement age (or some age between the early and normal retirement ages).<sup>17</sup> Some observers believe, however, that such a policy would be contrary to the main purpose of pension plans, which is to replace wage income during retirement. If employers were permitted to pay pension benefits to individuals still engaged in gainful employment, the benefits would become a tax-subsidized supplement to wages. Permitting in-service distributions to current employees who have not reached the plan's normal retirement age might allow employers to compensate current employees with pension funds, effectively reducing their operating expenses by shifting some costs that would otherwise be paid as wages to the pension fund.

In 2003, about 2.8 million workers in the United States received pension payments from a former employer. Almost 1.8 million of these workers were under age 65. (See **Table 6.**) Current law allows an individual who has separated from a firm and is receiving pension distributions under an early retirement provision of the plan to become re-employed by that firm, while continuing to receive those benefits. Some employers have argued that it should be permissible to allow eligible employees to receive partial distributions under an early retirement provision without first having to separate from the employer and then be rehired. Such an option would require an amendment to the Internal Revenue Code.

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<sup>16</sup> Vivian Fields and Robert Hutchens, "Regulatory Obstacles to Phased Retirement in the For-Profit Sector" *Benefits Quarterly*, volume 18 (3), Third Quarter 2002.

<sup>17</sup> Requirements for qualification of pension plans are defined at 26 U.S.C. § 401(a).

An amendment to the tax code to permit in-service distributions at the early retirement age would alter incentives to work or retire, as well as how much to work and for whom to work. Consequently, it would affect both labor force participation and hours worked among older employees. The net effect of these changes in labor force participation and hours worked would be almost impossible to predict. Some workers who otherwise would have fully retired before the plan's normal retirement age would choose instead to continue working for their current employer on a reduced schedule, because they would be able to take partial pension distributions while still employed. This would tend to increase labor force participation. Other workers who would have taken early retirement and then sought other employment might choose instead to remain with their current employer on a reduced schedule. The effect of this change in behavior on hours worked might be close to neutral, depending on the wages available from alternative employment and the income received from pension distributions. Finally, some employees who otherwise would have chosen to continue working until reaching the plan's normal retirement age might instead reduce their work schedule and supplement their earnings with partial distributions from the retirement plan. This would tend to reduce total hours worked.

**Distributions from 401(k) Plans.** In-service distributions from defined contribution plans that occur before the participant reaches age 59 1/2 are subject to a 10% excise tax in addition to ordinary income taxes. Distributions may begin as early as age 55, however, if the employee separates from his employer under an early retirement plan. Some advocates of phased retirement arrangements have suggested that the minimum age for in-service distributions from defined contribution plans should be lowered from 59 1/2 to 55.<sup>18</sup> The effect on labor force participation of such a change in tax policy would likely be very similar to the effect of allowing in-service distributions from a defined benefit plan at the plan's early retirement age. Some workers who might have fully retired from the labor force earlier than age 59 1/2 so that they could begin taking distributions from the plan would be induced to work longer. Others who would have taken early retirement and then sought work elsewhere would remain with their current employers, because they would be able to combine wages from part-time work with distributions from the retirement plan. Finally, some employees who otherwise would have chosen to continue working until age 59 1/2 or later would reduce their work schedules and supplement their earnings with distributions from the retirement plan.

H.R. 4837 and S. 2853 of the 106<sup>th</sup> Congress, both titled the *Phased Retirement Liberalization Act* would have amended the Internal Revenue Code to permit in-service (preretirement) distributions from a defined benefit or defined contribution

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<sup>18</sup> It might also seem reasonable that if legislation were passed to allow in-service distributions from an employer's defined benefit plan at the plan's early retirement age, then distributions from the employer's defined contribution plan should be permitted at the same age (perhaps with a lower limit of 55). However, such a policy would suffer from at least two drawbacks. First, the minimum age for in-service distributions from defined contribution plans, which is now the same for all such plans, would differ from firm to firm, thus making the retirement planning process even more confusing for workers and their families. Second, it would be administratively difficult — and in some cases, perhaps, impossible — to tie the minimum age for in-service distributions in the defined contribution plan to the early retirement age specified in the employer's defined benefit plan.

plan when the participant has either reached the plan's normal retirement age, reached age 59 1/2, or has completed 30 years of service, whichever comes first. Currently, such distributions cannot be made from a defined benefit plan before the participant has reached the plan's normal retirement age or from a defined contribution plan before age 59 1/2. Neither bill was re-introduced in the 108<sup>th</sup> Congress.

**Flexibility versus Nondiscrimination.** Pension plans that provide benefits mainly to the owners of a firm or to highly paid employees do not qualify for favorable tax treatment under the Internal Revenue Code.<sup>19</sup> The tax code defines specific tests that must be applied to a pension plan to determine whether or not it discriminates in favor of highly compensated employees in terms of either benefits or employer contributions.<sup>20</sup> These tests consist of computations of the percentage of plan participants who are highly compensated employees and the percentage of contributions to the plan or benefits paid by the plan that are made on behalf of highly compensated employees.

It is a relatively common practice for firms to establish separate nonqualified retirement plans for company owners and senior executives. However, if a plan that was originally established as a tax-qualified plan were subsequently found to discriminate in terms of coverage or benefits in favor of highly compensated employees, it could lose its tax-qualified status. In most such cases, the only viable option available to the plan sponsor would be to remove the discriminatory provisions of the plan or terminate the plan. Covering rank-and-file employees under a nonqualified plan usually would not be practical because of the substantial tax liability that would result for both the plan sponsor and plan participants.

In general, employers would prefer the flexibility to offer phased retirement to some — but not all — pension plan participants. Some analysts have suggested that, even if Congress were to amend the Internal Revenue Code to allow in-service distributions from pension plans before the normal retirement age, it would do little to spur the growth of phased retirement unless employers also were permitted to limit eligibility for this benefit to employees with particular skills or abilities. However, a phased retirement option that offered in-service distributions only to managerial or professional employees could result in the plan failing to meet the nondiscrimination requirements of the Internal Revenue Code by altering the distribution of benefits among plan participants in a way that favored the highly compensated group.<sup>21</sup> A phased retirement option that offered in-service distributions to all participants

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<sup>19</sup> 26 U.S.C. § 401(a)(4) states that a qualified pension trust is one in which “the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees (within the meaning of section 414(q)).” The term “highly-compensated employee” is defined at 26 U.S.C. § 414(q) as a person who is at least a 5-percent owner of the firm or is paid compensation of at least \$85,000 and is among the top 20 percent of employees in the firm with respect to compensation.

<sup>20</sup> 26 U.S.C. § 410(b).

<sup>21</sup> Employers whose approach to phased retirement does not affect eligibility for pension distributions are less likely to violate the IRC nondiscrimination provisions. Examples would be phased retirement plans that involve only reductions in hours of work, job sharing, transfers to other duties, or that are based on rehiring retired former employees. These are conditions of employment rather than characteristics of the pension plan.

meeting specified age and length-of-service requirements would not conflict with the IRC anti-discrimination requirements.

Section 410(b) of the Internal Revenue Code prescribes specific tests for determining if a pension plan's coverage or benefits discriminate in favor of highly compensated employees. These calculations show the proportion of contributions made or benefits paid on behalf of highly compensated employees. Some plan sponsors would prefer to have these tests for nondiscrimination replaced by the more subjective method of testing that was in effect until 1994, which was based on the "facts and circumstances" surrounding the operation of the plan. In some cases, a phased retirement option that failed the mathematical tests for nondiscrimination under current law might not fail if tested under the earlier (pre-1994) approach.

On May 14, 2003, the House of Representatives passed H.R. 1000, the *Pension Security Act of 2003* by a vote of 271-157. Among many other pension reforms, this bill would have authorized the Secretary of the Treasury in some cases to employ a test based on facts and circumstances in testing for nondiscrimination. The bill was referred to the Senate Committee on Health, Education, Labor, and Pensions.

## **Policy Responses to an Aging Population**

The federal government influences employers' decisions about whether to offer benefits like pensions and health insurance through direct regulation, such as ERISA and the *Age Discrimination in Employment Act*; through social insurance programs, such as Social Security and Medicare; and through the financial incentives created for both employers and employees by the Internal Revenue Code. In turn, workers' decisions about where they will work and how much they will work are directly affected by employers' decisions about the amount and type of compensation that they offer to employees.

Social insurance programs and the tax code differ from direct regulation in that their primary objectives are, respectively, to provide benefits to individuals and to collect revenue for government operations. Nevertheless, both Social Security and the tax code affect the labor market behavior of employers and workers by establishing financial rewards or sanctions for certain actions. The rules that govern eligibility for Social Security benefits, for example, have a substantial influence on workers' decisions about when to retire. Empirical evidence indicates that more retirements occur at age 62 — the earliest age at which reduced retired worker benefits are available — and age 65 — the earliest age at which full retired worker benefits are available — than at other ages. In addition, the "earnings test," which reduces benefits for some Social Security beneficiaries who work, and the "delayed retirement credit," which increases benefits for workers who defer their benefits until after age 65, also may influence the decisions to work and how much to work after becoming eligible for Social Security.

At times, each of these provisions has been amended to provide greater incentives for individuals who are eligible for Social Security to continue working. The *Social Security Amendments of 1983* mandated a gradual increase in the age at which individuals are eligible for full retirement benefits from its current level of 65 years to 67 years in 2022. As a result, the actuarial reduction in Social Security

benefits for those who retire at 62 will increase from 20% to 30%, creating a financial incentive to delay receipt of Social Security and continue working. The 1983 amendments also provided for an increase in the delayed retirement credit (DRC) for workers who defer their application for Social Security benefits until after age 65. In 1977, Congress set the DRC at 3 percent, meaning that benefits were permanently increased by 3% for each year that a worker delayed receipt of Social Security beyond age 65. The 1983 amendments provided for a gradual increase in the DRC beginning in 1990. When fully phased-in, the DRC will be 8% per year for people who turn age 65 in 2008 or later, which will result in a DRC that is close to being “actuarially fair” for the average worker.

In April of 2000, the Social Security Act was amended to repeal the earnings test for beneficiaries who are 65 or older. As a result of P.L. 106-182, the earnings test was eliminated for people at or above the full retirement age (65 and four months in 2004), effective January 1, 2000. The earnings test remains in effect, however, for beneficiaries who are under the full retirement age. In 2004, Social Security recipients under age 65 have their benefits reduced by \$1 for each \$2 of earnings in excess of \$11,640.

Some employers have suggested that Congress amend the tax code to allow them greater flexibility in designing phased retirement programs for their employees. One proposed amendment would permit in-service pension distributions to employees who have not yet reached the pension plan’s normal retirement age. This, some employers say, would allow them to offer older employees the chance to cut back their work schedules to part time, while supplementing their reduced salaries with pension income. Under current law, such an arrangement would be permissible only for plan participants who have reached the plan’s normal retirement age.

Allowing in-service pension distributions to begin when a participant has reached the earliest of a plan’s normal retirement age, age 59 1/2, or the completion of 30 years of service might promote continued employment among older workers who — if given the choice between working full time and taking early retirement — would otherwise have chosen to retire. A more complicated question is whether employers should be permitted to offer such an option only to specific categories of workers.