Reducing Incentives to Early Retirement

OECD member governments have been active in reducing or removing incentives for early retirement over the past decade. One important aspect of these efforts is the reform of public pension systems. A variety of measures to delay retirement have been taken, although the type of policy varies considerably across countries (Table 1).

Increases in the normal retirement age have been a key measure. The United States, Italy, Japan, Iceland and Hungary have all taken steps to raise the normal retirement age that will be phased in over the next twenty years. Equally, by increasing the number of contribution years required for a full pension, the French government has sought to discourage retirement at the earliest legal age (60). Early pensions based on long service are being phased out in Germany and Italy. Early pensions because of unemployment are being phased out in Germany, and the age of eligibility for such a pension is being raised in Finland.

A number of countries have moved towards more flexible retirement and stronger incentives to continue work (Table 2). The cost of retirement before the normal age of retirement has been increased in Finland by lowering the accrual rate for the age pension earned by people on pre-retirement benefits, and the incentive to retire later has been increased by raising the public pension accrual rates for those who work after 60. Italy and Sweden introduced notional-defined contribution systems during the 1990s that permit early retirement but apply a form of actuarial reduction to the benefits received. Later retirement is encouraged by benefit appreciation in the German and Swedish system and by a tax-free bonus in the Australian system to those who work beyond 65.

Given the variety of pathways to enter retirement, most countries have also acted to limit access to disability pensions for medically identifiable conditions and have taken steps to shift the costs of disability pensions back to employers. Some countries such as the United States and Germany have also introduced more frequent medical reviews of disability cases, complemented by greater incentives to return to work, increased emphasis on rehabilitation, or the end to the award of permanent benefits. While improving incentives to remain in the labour market is important, those who do so must also keep their jobs or be able to find new ones if they

Table 1

Reforms to pension systems: Encouraging later retirement

Country	Measures to delay retirement [a]						
	"Regular" retirement programmes					Access to other "early retirement" programmes	Other
	Increasing "normal" retirement age	Upward adjustment of women's retirement age	Lengthening contribution periods for full pension	Limiting access to early pensions	Improved actuarial characteristics		
Australia		+			+	+	
Canada							
Finland	+ [b]				+	+	+
France			+				+ / –
Germany		+		+	+	+	–
Hungary	+	+	+			+	
Iceland	+ [b]						
Italy	+	+ [c]		+	+		
Japan	+						
Korea	+						
Netherlands					+	+ / –	+ / –
Norway					+	–	
Spain					–	–	
Sweden	+		+		+		
Switzerland		+					
United Kingdom		+				+	+
United States	+				+		

[a] A "+" indicates a measure which should induce a rise in the effective age of retirement in the case of policies affecting the age of retirement, a fall in average benefits in the case of policies affecting average benefits, and an increase in the employment of older workers form measures affecting employment. A negative sign indicates the opposite. Based on Table 2. – [b] Civil servants only. – [c] New labour-market entrants only.

Source: Casey, B. et al. (2003), p. 43.

are laid off. In this context, cross-country evidence is encouraging. Countries vary widely in the participation rates of older workers but equally widely in employment rates, suggesting that there are no inherent barriers to the employment of older workers. Policies that improve the overall functioning and flexibility of the labour market may be particularly important for older workers, who may be more vulnerable to dismissal and less attractive to hire. In this latter respect, employment protection legislation that constrains employers to retain work once hired is likely to have a negative impact on labour demand.

Flexibility in adjusting wages to productivity may well be important to maintain the demand for

Table 2

Reforms to pension systems since the early 1990s

Country	Measures to remove incentives to early retirement/increase incentives to later retirement[a)]
Australia	Tax-free bonus for those working after pension age; phased lifting of retirement age for women to 65 from 1997 to 2013; phased increase in the age at which the Superannuation Fund can be drawn to 60 over period to 2025.
Canada	Flexible retirement age to 70 introduced (1987); reduction of some disability-type benefits.
Finland	Reforms in 1990s: employee contributions introduced; public sector workers retirement date increased by two years with reduced accrual rate and long phase in period; Raised accrual rate for persons age 60-64; raised age of eligibility for certain early pensions by two years; lowered accrual rights to old age pensions for those in early retirement programmes; unemployment benefit for older workers reduced from five to three years. Reforms in 2003: Flexible retirement between 62 and 68 with actuarial adjusted benefit and accrual to pension rights rising with age; ceiling on pension abolished; pension based on earnings over entire work career; system will adjust to increased life expectancy; indexing of rights and of benefits gives heavier weight to prices.
France	Extension of contribution period for access to full pension (1994) from 37$^1/_2$ years to 40 years; increased costs to employers of making older employees redundant.
Germany	Raised lower age limit and minimum number of contribution years for early retirement; accelerated phased abolition of early pensions for unemployment and long service; introduction of benefit reductions and measures for early and late retirement; upward equalisation of retirement age for women from 2000–2004 (1992). Ability of unemployed employees to claim old age pensions modified to reduce pension benefits. Early retirement at 62 allowed from 2012 with 35 years contribution.
Hungary	Raised official retirement age to 62 from 60m/55w to be achieved between 1997 and 2001 for men and 2009 for women; abolished special programme allowing early retirement for labour market reasons.
Iceland	Government employees no longer able to claim pension from age 60 (1997); accrual rate for retirement delayed beyond 65 increased (1998).
Italy	Progressive move into a notional defined contribution scheme whereby benefits are related to longevity and to contributions; abolition of “seniority pension” by 2008; increase in the number of contribution years for early retirement to 40 years by 2008; lifting of normal retirement age by five years (to 65m/60w); equalisation of retirement age for men and women for new entrants.
Japan	Flat rate portion of Old Age Employees Pension raised from 60 to 65 phased in over period 2001-2013 (1994); proposed increase in the earnings related component to 65 over the period 2013 to 2025.
Korea	Increase in the age at which flat-rate benefits are received from 60 to 65 (phase in period ending in 2013).
Netherlands	Increased costs placed on employers responsible for disability retirement; removal of tax privileges from voluntary early retirement schemes; changed tax rules governing occupational pensions to increase amount accrued if more years worked; transformation of VUT early retirement schemes into flexible retirement arrangements with the cost of early retirement shifted onto the individual rather than the collectivity.
Norway	Introduced an early retirement scheme (AFP) and reduced the eligibility age from 66 to 82 (1998). Access to this scheme was recently tightened up. Reduced the deduction from pensions payable due to income from work (1997); reduced rate of pension entitlements for each year of work.
Spain	Opened early retirement to all people who have been unemployed for at least six months from age 61; reduced the actuarial reduction for early retirement from eight to six per cent.
Sweden	Progressive move into a notional defined contribution scheme whereby benefits are related to longevity and directly to contributions to make the system more neutral with respect to the retirement decision; upper age limit for actuarial adjustment for a deferred pension abolished (1999). New legislation in the labour market area allows employees to remain in the labour force until 67.
Switzerland	
United Kingdom	Tightened access to disability pension; upwards equalisation of retirement age for women.
United States	Increase in the age for receiving a full pension to 67 (legislated 1983, phase-in period until 2027); increase in the appreciation of benefits when taken after “normal” retirement age.

[a)] Covers both “regular” and special retirement programmes.

Source: Casey, B. et al. (2003), p. 44.

older workers, even though declining wages will reduce the supply of older workers. There can be a link here with pension arrangements for early retirement as overly generous replacement rates may generate strong disincentives to downwards adjustment of wages. Wage subsidies for employers who hire older unemployed people have been introduced in France and Korea and extended in Germany to improve the employment opportunities for older workers. In Japan a new wage subsidy was introduced, payable to older people who accept lower paid work when they have reached the mandatory retirement age of firms (usually 60). In Korea, firms are encouraged to hire older workers (55+) and receive a subsidy if they have more than six percent of their staff over this age.

As individuals move towards retirement, investment in marketable skills through training declines as the period over which this investment can be amortised becomes progressively shorter. Therefore if policy reforms manage to raise retirement ages this is in itself likely to raise the incidence of training among older workers. Most reforms in this area have not put in place specific programmes for older workers, but rather they attempt to ensure that older workers are not excluded from such programmes. Going beyond that, the United Kingdom has introduced new training policies specifically targeted at older cohorts. The Netherlands introduced tax incentives for the training of workers over 40, and Finland has established specific research agendas aimed at providing a better understanding of the situation and needs of older workers.

Greater flexibility in working hours will be important for retaining in the labour force those older workers who are willing to work part time as an alternative to full early retirement. In Finland, the age of access to individual early retirement benefits was lifted whilst the age of eligibility for its part-time pension was lowered. In 1992, Germany enabled individuals to take 1/3 to 2/3 of a regular old-age pension and to continue working part time. In 1997, workers over the age of 55 were granted access to another part-time early-retirement arrangement. In contrast, a similar, long-standing and widely used part-time pension scheme was dropped in Sweden, since it was seen as encouraging early withdrawal from work.

W. O. and J. S.

Reference

Casey, B., H. Oxley, E. Whitehouse, P. Antolin, R. Duval and W. Leibfritz (2003), “Policies for an Ageing Society: Recent Measures and Areas For Further Reform“, *OECD Economics Department Working Papers*, no. 369.