United States General Accounting Office

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Report to the Ranking Minority Member, Special Committee on Aging, U.S. Senate

February 2003

OLDER WORKERS

Policies of Other Nations to Increase Labor Force Participation

Accountability * Integrity * Reliability

GAO-03-307

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GAO Accountability•Integrity•Reliability

Highlights

Highlights of GAO-03-307, a report to the Ranking Minority Member, Special Committee on Aging, United States Senate

Why GAO Did This Study

In recent years, the challenges of aging populations have become a topic of increasing concern to the developed nations. These challenges range from the fiscal imbalance in national pension systems caused by fewer workers having to provide benefits for greater numbers of retirees, to potential economic strains due to shortages of skilled workers. Part of the solution to these challenges could be greater older worker labor force participation.

GAO identified three nations–Japan, Sweden, and the United Kingdom–that had displayed high levels of older worker labor force participation in the past and were now implementing policy reforms that continued to emphasize the importance of older workers. The experiences of these nations suggest that the nature of the reforms, the public availability and transparency of information on the reforms, and the strength of the national economy play key roles in extending older worker labor force participation.

www.gao.gov/cgi-bin/getrpt?GAO-03-307.

To view the full report, including the scope and methodology, click on the link above. For more information, contact Barbara Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

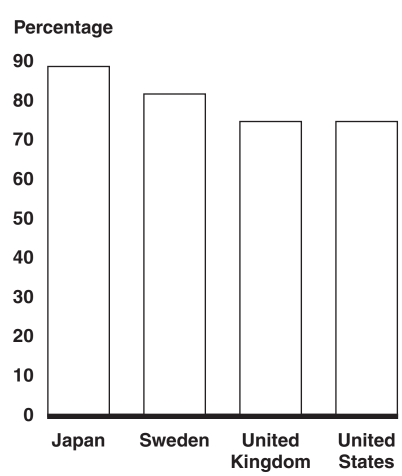
What GAO Found

The retirement policy reforms in Japan, Sweden, and the United Kingdom are expected to lead to higher labor force participation of older workers.

- Japan is facing the most severe aging trend of the nations GAO studied, as its median population age is projected to be 28 percent higher than the United States in the coming decades. In response, Japan has enacted substantial benefit cuts to its national pension system by raising the eligibility age and reducing benefit levels to maintain fund solvency. Due to these changes, some Japanese workers will have to work to later ages.
- Sweden undertook the most significant reform by changing the structure of its national pension system from a traditional pay-as-you-go defined benefit plan, like the U.S. Social Security program, to a system where participants' benefits are more in line with their contributions. These reforms are expected to extend workers' careers by rewarding longer labor force participation with higher benefits. The system also incorporates flexibility by automatically adjusting benefits to changes in the economy and life expectancy to preserve financial stability.
- The United Kingdom will phase-in an increase in the women's national pension eligibility age so that it will be equal to the higher male age of 65. It also revised its benefit formula to raise the annual incremental increase for those who defer drawing their pension benefits. These changes either reward continued employment or discourage earlier retirement, and thus may promote continued labor force participation.

However, although incentives to work to later ages have been created through reforms to their national and employer provided pension systems, officials from each nation stressed that these policy changes must be accompanied by labor market reforms and economic growth to provide job opportunities to older workers if they are to be effective.

Labor Force Participation Rates for Men Age 50 to 64, 2000



Source: Economically Active Population 1950-2010, 4th Edition, Rev. 2, International Labour Organization, Geneva, 2002.

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Abbreviations

ADEA	Age Discrimination in Employment Act
CPI	Consumer Price Index
CSIS	Center for Strategic and International Studies
DI	Disability Insurance
EPF	employee pension funds
IB	Incapacity Benefit
IVB	Invalidity Benefit
ILO	International Labour Organization
MIG	Minimum Income Guarantee
NDC	notional defined contribution
OECD	Organization for Economic Cooperation and Development
PBGC	Pension Benefit Guaranty Corporation
TQPP	tax-qualified pension plans

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United States General Accounting Office
Washington, DC 20548

February 13, 2003

The Honorable John Breaux
Ranking Minority Member
Special Committee on Aging
United States Senate

Dear Senator Breaux:

As is the case in developed nations around the world, the aging of the U.S. population will pose challenges to our national economy and retirement income programs. Organizations as diverse as the World Bank, the Organization for Economic Cooperation and Development (OECD), the United States Federal Reserve, and others have studied these challenges, which range from the growing fiscal pressures in national pension systems[1] caused by fewer workers having to provide benefits for greater numbers of retirees, to potential economic strains due to shortages of skilled workers as they exit the labor force. Most of these organizations believe that greater labor force participation by older workers can be part of the solution to mitigate the adverse effects of aging populations.

In light of the economic and labor force challenges posed by an aging population, you asked us to draw upon the experience of other high-income industrialized nations in examining the following questions: (1) How does the United States compare with other high-income nations with regard to recent and projected trends in key demographic and labor force characteristics? (2) How are recently enacted retirement policy reforms in high-income nations expected to affect the labor force participation rate of older workers?[2] (3) What did these nations learn from enacting policies that may increase the labor force participation of older workers?

[1]For this report, the term “national pension system” will be used when referring to “universal” government programs that provide retirement benefits to persons in nations other than the United States. The term “employer-provided pension” refers to retirement benefits businesses make available to their employees.

[2]In this report, we define older workers as persons 50 years of age and older. In some cases, because of the limitations of available data, we analyze subgroups of older workers, for example, those 55 years of age and older.

To answer these questions, we compiled and analyzed demographic and labor force data from the OECD, the United Nations Population Division, and the International Labour Organization (ILO), highlighting data from the United States and seven other comparison OECD nations.[3] In addition, we consulted with individual experts in national pension policy and conducted an extensive review of the international retirement literature. On the basis of this preliminary research, we identified three nations—Japan, Sweden, and the United Kingdom—that had displayed high levels of older worker labor force participation in the past and were now implementing policy reforms that continued to emphasize the importance of older worker labor force participation. We then examined these nations' pension systems—both national and employer-provided—and labor market policies through interviews, literature reviews, and site visits. We met with key government officials concerning pension and labor market policy, representatives from employer organizations and labor unions, and well-known scholars who have studied older worker issues in each nation. We conducted our work between February 2002 and January 2003 in accordance with generally accepted government auditing standards. For more details on our scope and methodology, see appendix I. For more details on the pension systems and labor market policies of our sample of nations, see appendixes II to IV.

Results in Brief

The recent and projected adverse labor force and demographic trends for most other high-income nations will be less pronounced in the United States, but the aging of the population will still pose a challenge to retirement income programs. Although U.S. labor force participation rates for older workers are not as high as in previous decades, ILO data for 2000 show that they are higher than most other high-income nations. The situation is similar for demographic trends. In 2000, for example, the median age of the U.S. population was 36, which was slightly lower than the other high-income nations we examined. However, by 2050 the projected U.S. median age of 41 will be 10 or more years lower than the median ages projected for four of the seven other comparison nations. Relatively higher fertility and immigration rates are two factors contributing to the comparatively slower aging of the U.S. population. The United State's lower median age contributes to an elderly dependency ratio, the ratio of persons older than 60 to persons age 15-59, that will be

[3] Besides the United States, the seven other nations highlighted are the remaining six of the "G-7"—Canada, France, Germany, Italy, Japan, and the United Kingdom—and Sweden.

between 6 and 36 percentage points lower than that of the other comparison nations by 2050. However, the U.S. ratio at that time will still be almost double its rate in 2000, primarily due to the aging of the baby boom generation.

The retirement policy reforms in some high-income nations are expected to lead to higher labor force participation of older workers. National pension reforms in Japan, Sweden, and the United Kingdom that increase eligibility ages, reduce pension benefits, and increase benefits when claimed at a later age may encourage or require older workers to remain in the labor force longer. National and employer-provided pension reforms in each nation have moved toward the adoption of defined contribution features.[4] Such changes may also tend to foster greater labor force participation by older workers as the link between contributions and retirement benefits is more transparent as benefits grow in line with contributions and returns on account balances. In addition, two of these nations have taken steps to reduce the use of disability insurance as a path to early retirement by tightening the eligibility requirements for disability pensions. Each of the three nations has begun to study or enact policies that have the objective of reducing the barriers to employment at older ages. Such reforms include loosening or eliminating mandatory retirement age standards, encouraging the elimination of age discrimination in employment, improving older worker training, providing employment earnings incentives, and exploring quality-of-work life issues such as the flexibility of work arrangements.

The experiences of other nations we studied suggest that the scope and comprehensiveness of reforms, the transparency and availability of information, and the strength of the economy play important roles in encouraging labor force participation by older workers. Officials from these nations agree that for reforms to be successful in increasing the labor force participation of older workers, they should be comprehensive in scope. This would suggest, for example, that any reforms in the national pension systems be accompanied by reforms in the employer-provided pension system, in related social insurance programs (such as disability insurance) as well as in labor market policies. Such comprehensive reform should also be complementary in nature, so for example, changes in labor

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[4]Under a defined contribution plan, the retirement benefit is expressed as an account balance for the individual employee. This balance results from contributions that the employer, the worker, or both make, as well as from subsequent investment returns on the assets in the account.

market policies (such as prohibiting age discrimination in employment against older workers) would reinforce the purpose of national pension reforms that encourage older workers to work longer. There was also agreement that reforms directed at older workers cannot achieve their intended purpose unless workers can recognize and understand the incentives being provided. Reforms must, therefore, be transparent, and workers must receive information about the changes that is understandable and useful to permit workers to make knowledgeable decisions. Finally, officials from all the nations agreed that a strong national economy that provides employment opportunities for all workers was a key component for the success of reforms that can raise the labor force participation by older workers.

Background

The number of persons in the United States over age 55 will grow substantially over the next two decades. Due to the aging of the baby boom generation,[5] older persons are becoming an increasingly significant proportion of all persons and workers. In 2002, the U.S. Census Bureau estimates that there were 61 million people over age 55 and their numbers are projected to grow to 103 million in 2025. This growth will increase the percentage of the population that is over 55 from 22 percent to 30 percent.

This shift in population age will affect the composition of the labor force. The number of older workers in the United States is projected to grow substantially over the next two decades, and they will become an increasingly significant proportion of all workers. In June of 2002, there were 19.2 million workers over age 55 and their numbers are projected to increase to 31.8 million by 2015. This growth is projected to increase the percentage of the workforce that is over 55 from 14 percent in 2002 to nearly 20 percent in 2015.[6]

The projected growth in the percentage of the labor force over 55 will occur among both men and women. This would shift an earlier trend among older men, whose labor force participation declined from the 1950s until the mid-1990s. Since the mid-1990s, labor force participation among older men has been relatively constant at 67 percent for men age 55 to 64

[5]The baby boom generation is defined as all persons born between 1946 and 1964.

[6]For a general discussion of these trends, see U.S. General Accounting Office *Older Workers: Demographic Trends Pose Challenges for Employers and Workers*, GAO-02-85 (Washington, D.C.: Nov.16, 2001).

and 17 percent for men age 65 and older. The Bureau of Labor Statistics now projects these levels to rise to 69 percent and nearly 20 percent by 2015. The expected growth in labor force participation rates among older women would continue the current long-term trends of increases in their participation. For example, the percent of women age 55 to 64 in the labor force has steadily increased since the mid-1980s, from 42 to 52 percent in 2000, while rates among women 65 and older have grown from 7 to 9 percent in 2000. BLS projects these numbers to increase to 61 percent and 10 percent by 2015.

There are many factors that influence a person's decision to work at older ages. One key factor is financial incentives created by the rules regarding eligibility for benefits from the national pension system—Social Security in the United States. The decision to continue working is primarily related to the trade-off between earnings and leisure time. The availability of Social Security benefits allows workers to substitute non-labor income for their earnings and to enjoy more leisure. Depending on the eligibility rules and schedule of benefits, it can be more or less advantageous for workers to retire at an earlier age rather than to continue employment. The eligibility age for full Social Security benefits is currently 65 years and 8 months and rising, with reduced benefits available at age 62.[7] If a person elects to start receiving benefits at age 62, 63, or 64, the total lifetime benefits[8] they receive will be roughly equivalent.[9] Even though delaying receipt of benefits for 1 year is on average "actuarially equivalent or neutral," data from the mid-1990s show that most people (60 percent) elect to start benefits at age 62. These benefits can be reduced if the beneficiary has earnings above the income threshold when they are age 62-64. There are no earnings limitations on Social Security benefits above age 65.

[7]The full eligibility age (or normal retirement age) for Social Security benefits is being raised from 65 to 67 from 2000 to 2022. The reduction for taking benefits at age 62 was 20 percent when the full eligibility age was 65. When the age increase to 67 is fully implemented, the reduction will be 30 percent.

[8]P. Diamond and J. Gruber. "Social Security and Retirement in the United States," *Social Security and Retirement Around the World* (Chicago: University of Chicago Press, 1999).

[9]This calculation is based on living to average life expectancy. If the calculation is based specifically on race or gender, the results may be different since life expectancy differs by race and gender. For example, an African American male, who would be projected to have a lower life expectancy relative to females, and males of other ethnicities, should take benefits at the earliest possible age to maximize his total lifetime benefit.

Another important retirement incentive is eligibility for employer-provided pension benefits.[10] In the United States, about half of the labor force has some type of employer-provided pension coverage.[11] Employer-provided pensions are customarily classified into two major categories: defined benefit and defined contribution plans. A defined benefit plan promises a retirement benefit amount that is usually expressed as an annual payment, derived from a formula based on a worker's years of employment, earnings, or both.[12] In the United States, benefits in defined benefit plans are insured by the Pension Benefit Guaranty Corporation (PBGC). Under a defined contribution plan, the retirement benefit is expressed as an account balance for the individual employee.[13] This balance results from contributions that the employer, the worker, or both make, as well as from subsequent investment returns on the assets in the account. Under a defined contribution plan, retirement benefits are not guaranteed by the PBGC, and employees bear the risks of investment.

As different types of pension plans, defined benefit and defined contribution plans provide workers with different incentives for either retiring or continuing work. Defined benefit plans often provide incentives for early retirement because they often do not increase retirement benefits in-line with additional years of work with the firm after the early retirement age.[14] Under defined contribution plans, benefits can continue to increase, consistent with continued contributions and positive rates of return on assets. Since workers' accounts increase in size proportional to the amounts that are contributed by them or by their employers, they do

[10]Employer-provided pensions outside of any mandatory or universal national pension system comprise what is often called the system of occupational pensions. We use the term employer-provided pensions when discussing occupational pension systems.

[11]See U.S. General Accounting Office, *Pension Plans: Characteristics of Persons in the Labor Force without Pension Coverage*, GAO/HEHS-00-131 (Washington, D.C.: Aug. 22, 2000).

[12]For example, under a defined benefit plan with a final average pay formula, the retirement benefit is a percentage of the participant's final years of pay multiplied by his or her length of service. Under defined benefit plans, contributions are co-mingled funds invested in a pension trust on behalf of all participants, and plan trustees have fiduciary responsibilities for all assets in the pension trust.

[13]An example of a defined contribution plan is the 401(k) plan, named for the section of the Internal Revenue Code that sets out the tax preferences for such plans.

[14]The Employee Retirement and Income Security Act generally requires that tax-qualified plans allow participants to retire with full benefits at no later than age 65. Many plans allow normal retirement earlier than these limits.

not create incentives to retire based on the benefit formula.[15] In the past, a greater percentage of pension-plan participants were covered by defined benefit plans. In 1998, according to the Employee Benefits Research Institute, 20 percent of households had defined benefit coverage only; 57 percent had defined contribution coverage only; and 23 percent had both types of coverage.

Health status and occupation are other important factors that influence the decision to work at older ages.[16] As people age, they tend to encounter more health problems that make it more difficult to continue working. Thus, jobs that are physically demanding, usually found in the blue-collar and service sectors of the economy, can be difficult for many people to perform at older ages. Moreover, health status and occupation are often interrelated since health can be affected by work environment. Blue-collar and service workers, such as construction workers and janitors, often face physically demanding work environments that may affect their health status; these consequently lead to health impairments that affect their ability to work to older ages. Although this group continues to face problems, there is evidence that the health of older persons generally is improving. This suggests that, compared with previous generations, today's older age population has an increased capacity to work to older ages.

Although the Age Discrimination in Employment Act (ADEA) protects workers in the United States age 40 and older from employment discrimination,[17] labor force participation is not solely an older worker's decision, as there must also be a demand for their labor. Employers' perceptions of older people may form barriers to older workers' retaining

[15]However, though they are age-neutral with regard to the benefit formula in comparison to defined benefit plans, defined contribution plans can still influence the retirement decision through their effect on individual wealth. The investment performance of a workers' account can have a large effect on the final pension benefit. High rates of return on an account can lead to larger balances, permitting possible earlier retirement. The degree to which this can occur is also a function of the individual's allocation of portfolio assets. See *Are Older Workers Responding to the Bear Market?* by Andrew D. Eschtruth and Jonathan Gemus, September 2002. JTF No. 5, Center for Retirement Research, Boston College.

[16]Access to retiree health benefits is a factor influencing older workers' retirement decisions. GAO has reported that the availability of employer-sponsored health insurance coverage for retirees under age 65 declined during the 1990's. See *Retiree Health Insurance: Gaps in Coverage and Availability*, GAO-02-178T (Washington, D.C.: Nov. 1, 2001).

[17]This includes the prohibition of most mandatory retirement policies.

their current jobs, finding new jobs if they are laid off, or re-entering the labor force after retiring if their retirement income is inadequate. For example, some employers believe that older workers have lower productivity than younger workers, generate higher costs for employee benefits such as health care and pensions, and represent higher costs for recruitment and training since they have less potential time to recoup these up front costs compared with a younger worker. Encountering these obstacles could discourage older workers and influence their decision to retire.

The labor force decisions of older persons are also influenced by the availability of alternative employment arrangements. In the United States, there has been interest among older workers who wish to work longer in seeking employment arrangements that result in "phased retirement" or "bridge employment." Phased retirement usually refers to staying with a career job on a part-time or part-year schedule while phasing out employment over a number of years to complete retirement. Bridge employment usually refers to leaving a career job and moving to part-time work with another firm in the same or different industry, prior to complete retirement. In the United States, nearly half of all workers age 55 to 65 utilize a bridge job before completely retiring.

Older Americans receive income through a variety of sources, with the Social Security program constituting the largest share for most persons. In 2000, 90 percent of households with a person age 65 or older received Social Security benefits. These benefits constitute more than 50 percent of total income for 64 percent of these households. Social Security benefits, on average, replace about 40 percent of a program-covered individual's pre-retirement income, if benefits are taken at age 62.[18] Other major sources of income for older Americans are asset income (received by 59 percent of households), retirement benefits other than Social Security (41 percent), and earnings (22 percent). Social Security represents 41 percent of aggregate income, earnings represent 23 percent, retirement benefits other than Social Security are 18 percent, and asset income is 17.5 percent.

In the United States, the Disability Insurance (DI) program provides compensation for the reduced earnings for individuals who have worked

[18]Replacement rates from national pension systems in some other high-income nations are substantially higher. For example, the replacement rate in Sweden is approximately 55 to 65 percent.

long enough and recently enough to become insured and have lost their ability to work because of a severe, long-term disability. DI provides benefits to persons who are not able to perform substantial gainful activity due to a physical or mental impairment. DI is not a major source of income for a significant portion of older persons in the United States. In 2000, 7 percent of the population age 50-59 received DI benefits.[19]

Adverse Labor Force and Demographic Trends Less Pronounced in the United States but Pose a Challenge

The recent and projected labor force participation and population aging trends for most other high-income nations[20] will be less pronounced in the United States, but the aging of the population will nevertheless pose a challenge to retirement income programs. ILO data for 2000 show that the labor force participation rates for older U.S. workers, though not as high as in previous decades, will be higher than in most other high-income nations. It is expected that, because of higher fertility and immigration rates, the U.S. population will also age more slowly than other high-income nations. However, even though the population of the United States is not aging as rapidly as other countries, the old-age dependency ratio—the number of people over the age of 60 for every 100 working age people (ages 15-59)—is projected to rise from 19 in 2000 to 35 in 2050.[21] This near doubling of the old-age dependency ratio will strain the resources of programs that pay for retirement.

[19]We focus on the age range of 50-59 because DI benefits are automatically converted to retired worker benefits at the normal retirement age (currently 65 and 8 months for people reaching age 62 in 2003). New DI participation is discouraged at age 62-64 due to the lengthy determination process that makes many people choose to take Social Security retired worker benefits.

[20]High-income nations refers to the 8 nations listed in footnote 3. These nations are included in the 23 nations that the World Bank has designated as high-income. For a complete listing of all 23 nations, see appendix I.

[21]In the United States, the old-age dependency ratio is typically measured by comparing persons over age 65 with persons 16-64. We presented data for persons over age 60 compared with persons age 15-59 because ILO makes these data available in these age ranges.

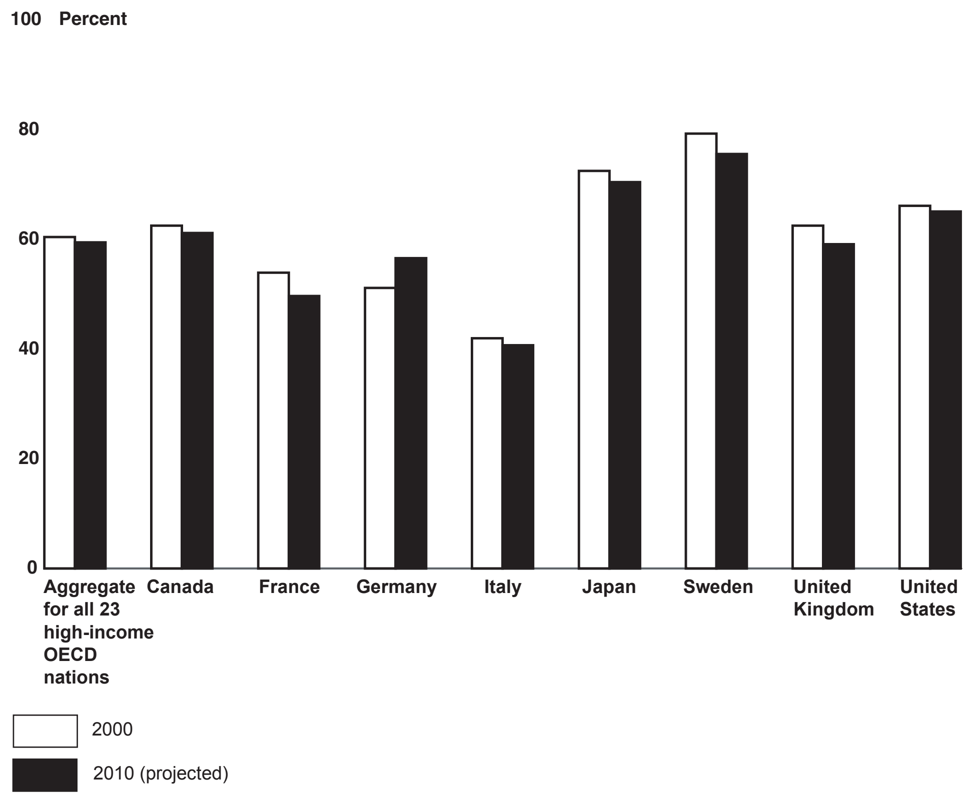
Older Workers' Labor Force Participation Expected to Decline in Most High-Income Nations, although Rates Expected to Remain Relatively High in the United States

Even though the labor force participation of workers age 50 to 64 is expected to decline in most high-income nations, including the United States, between 2000 and 2010 (see fig.1), the United States has and will continue to have higher rates of labor force participation for older workers than most other high-income nations.[22] In some high-income nations, such as France, Germany, and Italy, about 2 to 4 percent of persons age 65 and older participated in the labor force. In contrast, the labor force participation rate in 2000 among U.S. workers age 65 and over was 10 percent (see fig. 2), the second highest labor force participation rate among key high-income nations and 1.4 percentage points higher than the aggregate for all 23 nations the World Bank has designated as high-income. Labor force participation among U.S. workers age 50-64 was 66 percent (see fig. 1). This trails only Sweden's (79 percent) and Japan's (73 percent) rates for this age group.[23]

[22]We present ILO data because they are the only comparable available data on the high-income nations. However, ILO projections differ from those conducted by BLS that actually project increases in the labor force participation for older U.S. workers between the years 2000 and 2025. In both cases, the labor force participation for older workers in the United States remains comparatively higher than many, though not all, other high-income nations.

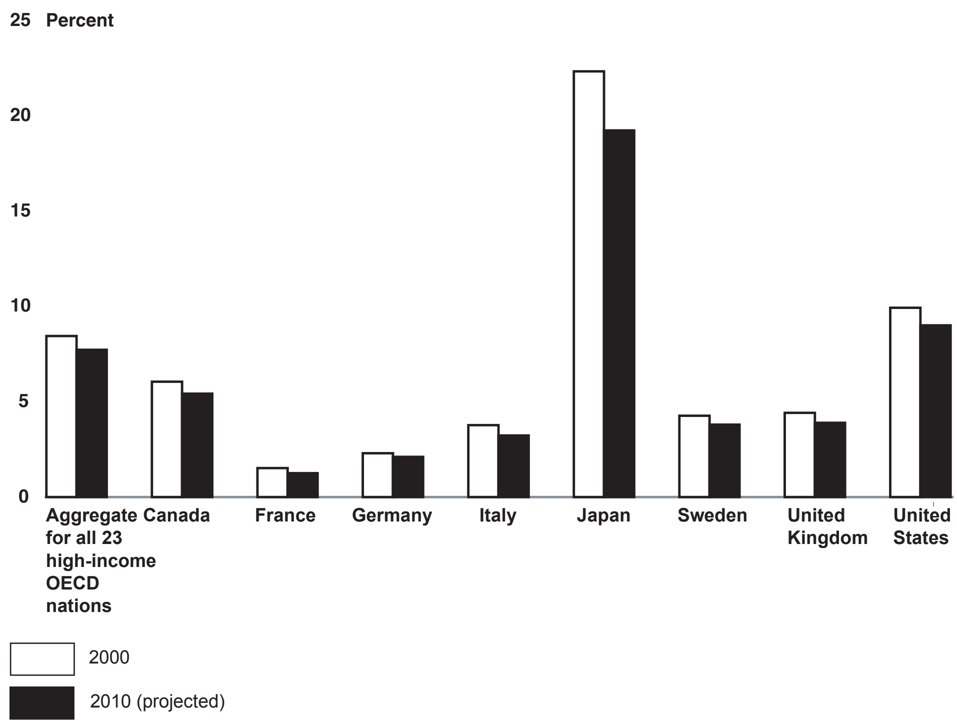
[23]Possible explanations for Japan's and Sweden's high older worker labor force participation rates are both cultural and economic. Experts have told us that older people in Japan attach a high value to work and making a contribution to society. One factor that may have further influenced labor force participation rates of older workers in Japan is that Japan only instituted a national pension system in the 1960s. The traditionally high labor force participation rates for older workers in Sweden are seen to reflect the fact that until the early 1990s, Sweden had very low unemployment rates for all workers. In addition, Sweden has always had the same retirement age for men and women and includes older workers in re-employment programs.

Figure1: Labor Force Participation Rates for Persons Age 50 to 64 in High-Income Nations, 2000 and 2010



Source: Economically Active Population 1950-2010, 4th Edition, Rev. 2, International Labour Organization, Geneva, 2002.

Figure 2: Labor Force Participation Rates for Persons Age 65+ in High-Income Nations, 2000 and 2010

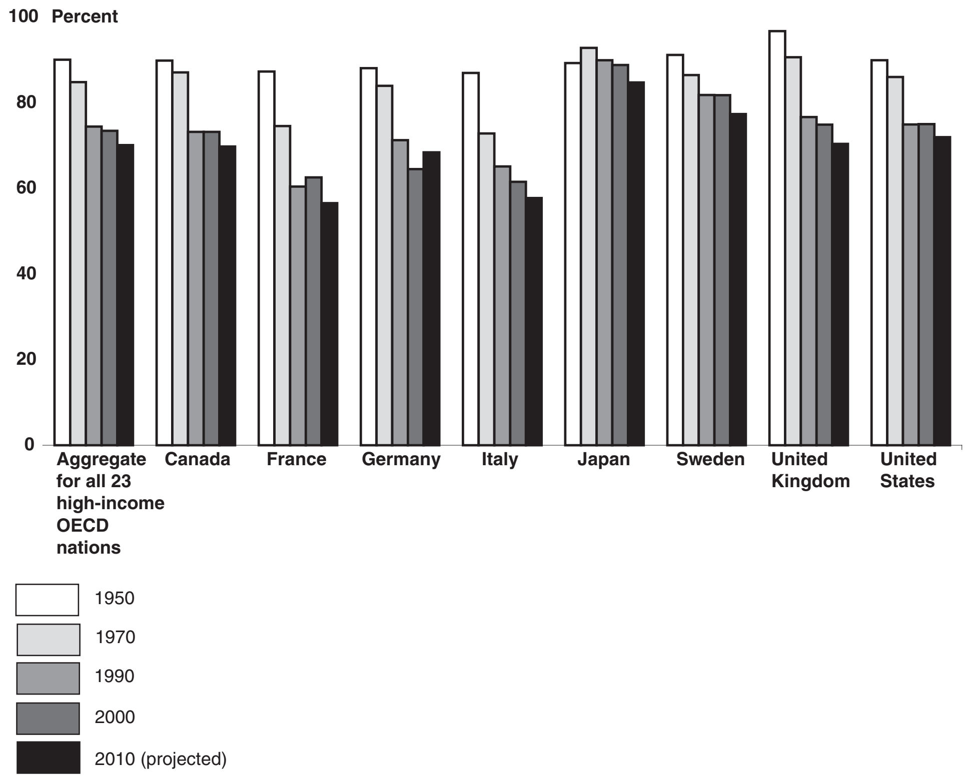


Source: Economically Active Population 1950-2010, 4th Edition, Rev. 2, International Labour Organization, Geneva, 2002.

The relatively high rate of labor force participation by older U.S. workers is being sustained by an increasing percentage of older women working. In the United States, as in other high-income nations, labor force participation among older men has declined since 1950 and, for the most part, is projected to continue declining through 2010 (see fig. 3). During that same period, however, labor force participation among older women is projected generally to rise (see fig. 4). In the United States, labor force participation among women age 50-64 will nearly double from 1950 to 2010, increasing from 31 percent to 58 percent.[24]

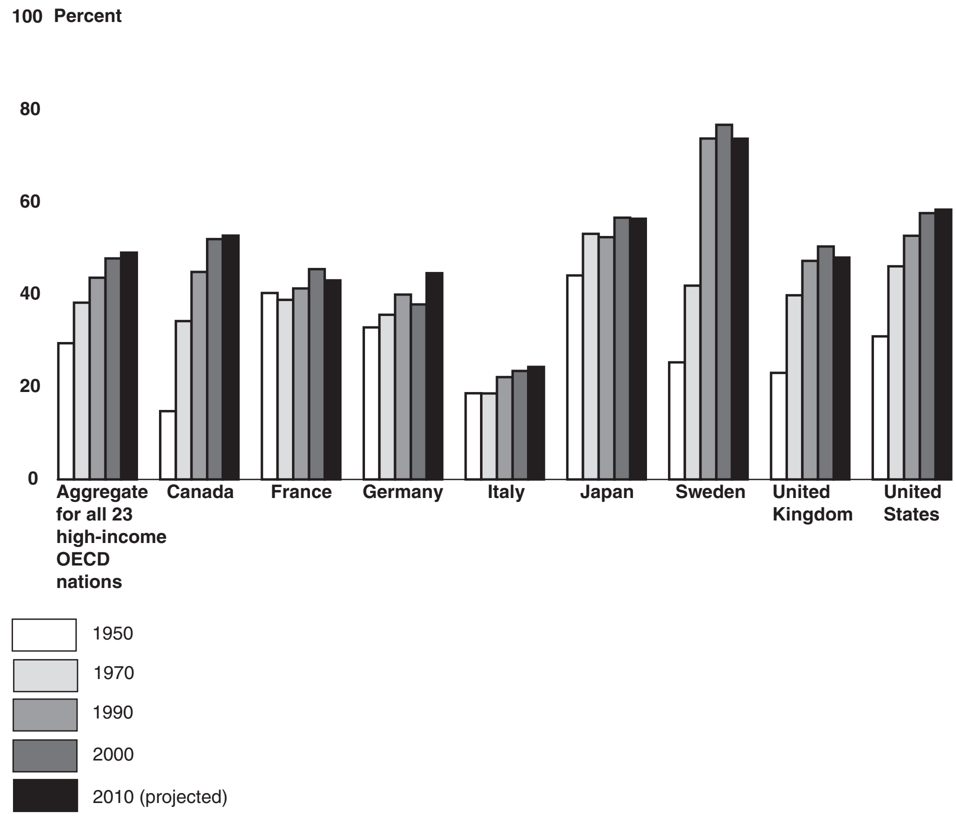
[24]Sweden has experienced the most dramatic rise in labor force participation among women age 50-64, with rates tripling from 25 percent to 76 percent since 1950.

Figure 3: Labor Force Participation Rates for Men Age 50-64 in High-Income Nations, 1950 to 2010



Source: Economically Active Population 1950-2010, 4th Edition, Rev. 2, International Labour Organization, Geneva, 2002.

Figure 4: Labor Force Participation Rates for Women Age 50 to 64 in High-Income Nations, 1950 to 2010



Source: Economically Active Population 1950-2010, 4th Edition, Rev. 2, International Labour Organization, Geneva, 2002.

Adverse Demographic Trends Less Pronounced in the United States Compared with Other High-Income Nations

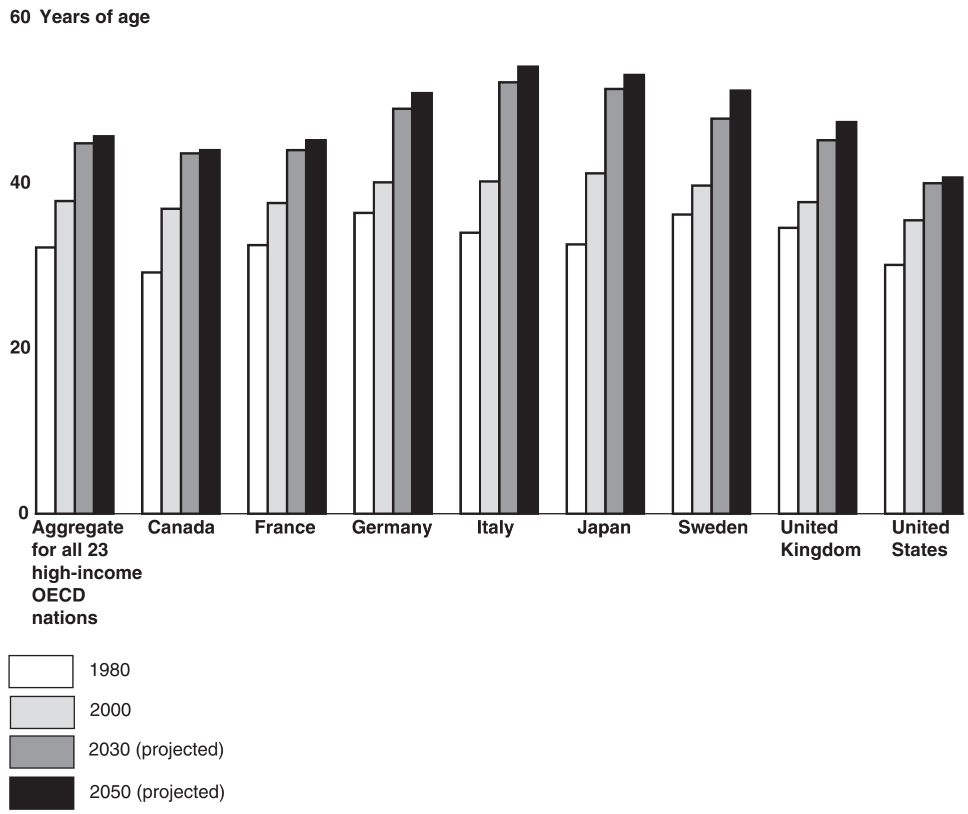
The size of the baby boom generation, rising life expectancy and declining fertility are expected to contribute to a rising median age in high-income nations. Because the baby boom generation is large in number, a growing proportion of the populations in high-income nations will be over 60. In the United States, for example, this will be the case for about a quarter of the population. Moreover, as this generation has grown older, life expectancy has increased in all high-income nations. From 1955 to 2000, life expectancy in the United States increased from 70 to 77 years and is projected to increase to 80 by 2040.

As a result of these trends, the median age of the U.S. population, like that of other high-income nations, is projected to steadily increase in the coming decades, but it will still be lower than that of most high-income nations. Specifically, the median age of the U.S. population in 2030 is expected to be comparable to the current median ages in some high-income nations. For example, the median age of the U.S. population rose from 30 to 36 years from 1980 to 2000 and is projected to increase to 40 in 2030 (see fig. 5). In contrast, the median age of the populations of high-income countries was 38 years in 2000 and is projected to rise to 45 in 2030. Germany, Italy, Japan, and Sweden have the current and projected oldest populations with median ages ranging from 40 to 41 years in 2000 and projected increases to 51 to 54 years in 2050.

Two factors will slow the trend toward an older population in the United States compared with most other OECD nations: fertility and immigration rates. Although fertility rates in high-income nations have declined overall since 1980, during the same time they have increased from 1.8 to 2.0 in the United States. The United States also has an immigration rate more than four times as high as Sweden and Japan, almost three times as high as the United Kingdom, and higher than that of most high-income nations.[25]

[25]The net immigration rate in the United States from 1995 to 2000 was 4.53 persons per 1,000 residents. Source: *World Population Prospects: The 2000 Revision*, United Nations Population Division. Found in Nyce, Steven A. and Sylvester J. Schieber. 2001. "Our Assumptions About Aging and What We Are Doing About It," draft manuscript.

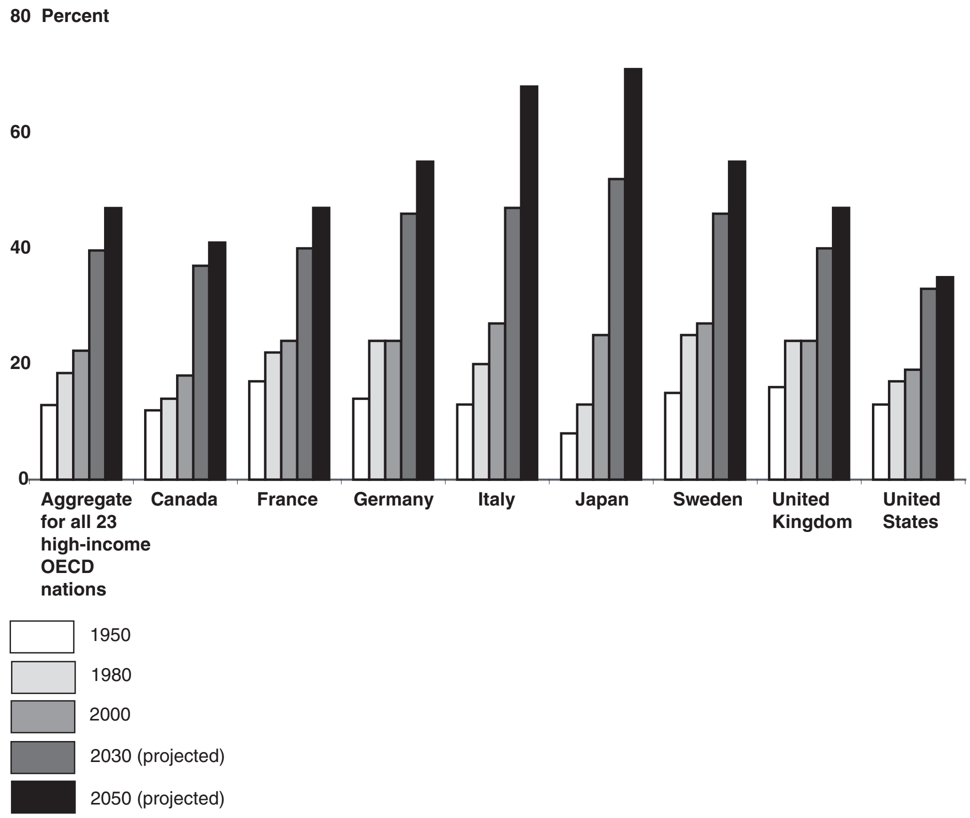
Figure 5: Median Age of the Population in High-Income Nations, 1980 to 2050



Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: 2000 Revision and World Urbanization Prospects: 2001 Revision.

The consequences of these demographic trends are most evident in the elderly dependency ratio. In most high-income nations, this ratio has been rising throughout the last 50 years and is projected to grow at a faster rate in the next half century (see fig. 6). The ratio in the United States is relatively low compared with other high-income nations. For every 100 people of working age (15 to 59) in the United States, approximately 19 people were in or nearing retirement age (60 or above) in 2000 compared with a ratio of 22 for the aggregate of 23 nations the World Bank has designated as high-income. This difference is projected to grow. By 2050, this ratio for other high-income countries is projected to be 47 in comparison with 35 for the United States. Even though the United States ratio will be smaller than that of other high-income nations in 2050, it represents an increase of over 75 percent from the 2000 ratio.

Figure 6: Elderly Dependency Ratio in High-Income Nations, 1950 to 2050



Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: 2000 Revision and World Urbanization Prospects: 2001 Revision.

Key Elements of Reforms in Other Nations Expected to Increase Labor Force Participation of Older Workers

The recently enacted retirement policy reforms in Japan, Sweden, and the United Kingdom are expected to lead to higher labor force participation of older workers. Reforms adjusting benefits in the national pension systems of each of these nations provide incentives for older workers to extend their working lives. National and employer-provided pension reforms that introduce defined contribution features that do not link benefits to a specific age are also expected to encourage greater labor force participation of older workers. Other reforms that seek to limit the use of disability benefits as a route to early retirement will also influence the older worker labor force participation. Acknowledging that improving the employment opportunities of older workers is an important consideration, each of these nations is studying or has enacted reforms that address the issues of older worker's employment more generally. Such reforms include loosening or eliminating mandatory retirement age standards, encouraging the elimination of age discrimination in employment, improving older worker training, providing employment earnings incentives, and exploring quality-of-work life issues such as the flexibility of work arrangements.

Benefit Adjustments to National Pension Systems May Increase Labor Force Participation of Older Workers

Reforms in the United Kingdom, Japan, and Sweden that increase the age at which workers are eligible for benefits or allow flexibility in when and how pension benefits can be taken are some of the policy changes that may encourage older workers to stay in the workforce. The United Kingdom will phase in an increase in the age at which women become eligible for national pension benefits, so that, beginning in 2020, men and women will no longer be able to draw benefits before age 65.[26] Japan has also enacted reforms that will gradually increase the full eligibility age for its earnings-based national pension system. In Japan, by 2025 for men and 2030 for women, the earliest age when this pension can be claimed will have risen from 60 to 65. Rather than increasing the age for benefit eligibility, pension reforms in Sweden allow older workers to take a full or partial national pension (i.e., one-fourth, one-half, or three-fourths of a full pension) at age 61 or later with no upper age limit and continue working.[27] This flexibility may make it easier to retire gradually with a mix of pension benefits and earnings.

Additional pension reforms that change benefit calculations so they reward continued work or discourage early retirement may also promote continued labor force participation by older workers. Sweden changed its benefit calculation to reward those who work longer. Under the new pension system in Sweden,[28] pensions are based on lifetime earnings,

[26]Means-tested benefits are available from age 60. See appendix IV.

[27]For example, if a worker "retires" from his/her full time job at age 61 and continues to work part time while drawing 50 percent of his/her national pension, these earnings will continue to add to the value of his or her pension account. When he or she retires completely, the pension will be recalculated to take into account these additional earnings. See appendix III.

[28]Sweden switched from a traditional pay-as-you-go defined benefit plan to system that combines a fully funded defined contribution plan and a pay-as-you-go "notional" defined contribution plan with automatic adjustments to preserve financial stability. The notional defined cotribution is the larger of the two plans, accounting for 86 percent of all national pension contributions. See appendix III.

instead of the highest 15 out of 30 years of earnings as they were under the old system. The United Kingdom adjusted its benefit calculation formula to increase the reward for those who defer drawing benefits from the national pension system. For example, by 2010, individuals who defer drawing their pension benefits will receive benefits that are 10.4 percent, rather than 7.5 percent, larger for each year deferred.[29] In Japan, reforms have changed how pensions are calculated, reducing the level of benefits for future retirees through lower accrual rates. The expected effect of these changes is a 20-percent reduction in lifetime benefits by 2020, thereby making early retirement less affordable.

Finally, reforms in Sweden and the United Kingdom, in changing how pension benefits are indexed, may discourage early retirement. The new pension system in Sweden indexes pension benefits to life expectancy.[30] With increasing life expectancy, different generations of individuals with similar work and earnings histories will have to work longer to maintain a comparable standard of living in retirement. This benefit adjustment provides incentives for increased labor force participation by requiring individuals to bear the cost of increased life expectancy, either through additional work or lower benefits. The United Kingdom also revised the index it used to adjust benefits in the portion of its pension that provides flat-rate benefits. Prior to the reform, the United Kingdom adjusted benefits using either the higher of increases in average prices or average wages as an index. Now the United Kingdom uses only average price

[29]Experts we spoke with disagreed about the effectiveness of this reform in increasing older worker labor force participation. However, the government has considered changes to this reform. For example, it is considering allowing people a choice between taking the benefit increase as a lump-sum payment or as increases in each benefit payment. It is also considering pushing up the implementation of the benefit increase so that it will take effect in 2006 rather than 2010. This could increase the incentive for older worker labor force participation.

[30]For example, a person's pension in the notional defined contribution plan is calculated by dividing their pension account (the value of their accumulated pension rights) by an annuity factor. Estimated cohort life expectancy is the key element in the determination of the annuity factor, which is also determined by the "norm" real rate of return (a 1.6-percent increase in average real wages) and age at retirement. A higher average life expectancy for a cohort will increase the size of the annuity factor for that cohort compared to preceding cohorts. Consequently, individuals in later cohorts retiring at the same age and with the same pension account as those in earlier cohorts will receive a lower pension. See appendix III.

increases.[31] Since prices tend to increase more slowly than wages, this reform has effectively reduced benefits relative to earnings.[32]

To Increase Work Incentives for Older Workers, National and Employer-Provided Pension Reforms Moved Systems Towards Defined Contribution Features While Other Reforms Addressed Disability Insurance

Each of the nations we studied implemented reforms that included defined contribution features in their national and employer-provided pension systems, although this shift was more pronounced in Sweden and the United Kingdom than in Japan. Defined contribution pensions are more retirement age neutral than traditional defined benefit pension plans. As part of its recent national pension reform, Sweden instituted a pay-as-you-go pension system with defined contribution features, including among other things a fixed contribution rate and notional individual accounts (the "notional defined contribution pension").[33] The new Swedish pension system also includes a smaller, funded defined contribution plan with an account for each individual worker (the premium pension). Reforms introduced in the United Kingdom in 1988 and 2001 permitted individuals to opt out of part of the national pension plan by participating either in employer-sponsored defined contribution plans or defined contribution individual pension plans called "personal pensions."[34] To participate in the individual plans, workers obtain an account from a financial institution and make contributions into their account or are provided access to a pension by their employer.[35] Japan implemented legislation permitting

[31]The United Kingdom government announced in December 2002 that it will increase flat-rate pension benefits in future years by at least 2.5% per year, even if this is larger than the increase in average prices.

[32]This change was introduced in 1980. Experts believe that the flat-rate basic portion of the U.K.'s national pension, which currently amounts to about 15 percent of average male earnings, will drop to 7 percent of average male earnings by 2050. However, means-tested benefits indexed to earnings growth are available to low-income individuals from age 60. See appendix IV.

[33]This plan is called a notional defined contribution plan because pension rights (i.e., claims on future pension income), not actual financial assets, are credited to the individual's notional accounts. In the U.S. context, this component of the Swedish national pension could be considered analogous to "cash balance" plan, a type of defined benefit plan.

[34]Prior to 1988, the United Kingdom's national pension system had allowed individuals to opt out of the earnings-related part of the national pension system for employer-provided defined benefit plans only. See appendix IV.

[35]Workers continue to pay contributions to the national pension system, but the government transfers a portion of contributions to individuals' personal or stakeholder pension account to compensate them for foregoing earnings-related national pension benefits. See appendix IV.

employer-provided and personal defined contribution pension plans in 2002.[36]

In Sweden and the United Kingdom, the inclusion of defined contribution features in the national pension system has prompted complementary changes among the employer-provided pensions. In Sweden, three of the four major employer-provided pension plans converted from defined benefit plans to pure defined contribution plans or plans with a mix of both features following the national pension reform.[37] In the United Kingdom, many employers have closed their defined benefit plans to new workers and replaced them with defined contribution plans. For Japan, where defined contribution pensions were only recently introduced, there is currently little data on the number of individual or employer-provided plans being formed or on the degree to which employers are substituting defined contribution plans for existing defined benefit plans.

The inclusion of defined contribution features in national and employer-provided pension systems is expected to encourage greater labor force participation of older workers. Because workers will have a greater responsibility for ensuring retirement through contributions and the returns they can earn on them, it will be in their best interest to make contributions for as long as they can. In addition, because defined contribution plans often have greater portability than defined benefit plans, older workers may have greater ability to shift to jobs that suit their leisure and health needs rather than retiring.[38]

[36]The law specifies the earliest age of withdrawal of pension funds from these defined contribution plans as 60 if enrolled for 10 or more years, or 65 if enrolled for less than 10 years. For a summary of Japan's national and employer-provided pension system, see appendix II.

[37]Employer-provided pensions, which are negotiated through collective bargaining, cover close to 90 percent of Swedish workers. See appendix III.

[38]Defined contribution plans likely increased the portability of benefits for many United Kingdom workers previously covered by defined benefit plans. In Sweden, workers' pension benefits were more portable under the old employer-provided pension plans than under the defined benefit plans in many other nations. However, some Swedish pension experts noted that because pension premiums are generally higher for older workers, and a workers' final employer has typically been responsible for paying their pension benefits, it has been difficult for older workers to change jobs later in their careers. These experts argued that with the recent negotiated pension plan changes the cost burden on the final employer is reduced.

Both Sweden and the United Kingdom, where disability insurance has traditionally been an avenue to early withdrawal from the labor force, have introduced reforms in recent years that will tighten eligibility of disability benefits.[39] In efforts to reduce the amount of early retirement financed through disability pensions, throughout the last decade Sweden has implemented successive reforms to tighten the eligibility requirements for disability insurance. This has included eliminating the ability of older workers to take a disability pension solely on the basis of long-term unemployment or a combination of unemployment and medical reasons. Medical reasons now provide the only valid criteria for granting a disability pension in Sweden. As part of its efforts, the United Kingdom, since the mid-1990s has tightened eligibility requirements, reduced paid benefits, and provided more support for returning to the workforce after an absence. For example, the government now reviews claims of incapacity to work every 3 years compared to the previous policy of not reviewing claims after the initial application, reduces or offsets disability benefits if the recipient also receives an employer-provided pension over a certain minimum level, provides services such as job search assistance to the disabled as a way to enable their return to work, and will test a policy allowing recipients to keep a portion of their wages if they return to work.[40]

Labor Market Policies May Reduce Barriers to Work at Older Ages

Each nation we studied has enacted, or is considering, policies that address barriers to older workers' continued employment such as mandatory retirement and age discrimination. In conjunction with its national pension reform, Sweden has already passed legislation giving employees the right to remain in employment until the age of 67, prohibiting the widespread practice of collective bargaining agreements prescribing mandatory retirement at age 65.[41] As members of the European Union, both Sweden and the United Kingdom must legislatively prohibit employment discrimination based on age by 2006. It is unknown how the European Union requirement will affect mandatory

[39]In contrast, statistics provided by a Japanese official indicate that workers have not used disability insurance as a major means of withdrawing early from the labor force.

[40]The policy that will allow disability recipients to keep a portion of their wages if they return to work is subject to means testing and a 1-year time limit.

[41]It should be noted that reaching an agreement on changing the mandatory retirement age in Sweden was difficult, and the legislation that implemented this change has been controversial.

retirement ages in specific industries or occupations in the United Kingdom.

In the absence of legislation, both the United Kingdom and Japan have encouraged employers to voluntarily end age discrimination. The United Kingdom, for example, has publicized the benefits of an age-diverse workforce, and issued best practices for eliminating age discrimination. Like the United Kingdom, Japan has also encouraged firms to voluntarily modify employment practices and retirement policies. The government has programs that subsidize the wages of workers who take jobs at reduced pay after mandatory retirement and subsidizes companies that modify their employment practices to accommodate older workers.

Each of the nations we studied has also made some efforts to provide older workers with access to training, job search assistance, and workplace flexibility. In the United Kingdom, for example, one government program provides job search assistance for people age 50 and older when they have been out of work 6 months or longer and also offers training opportunities and a wage enhancement.[42] As part of its efforts, Japan has employment job assistance centers (called “Silver Human Resource Centers”) that provide older workers temporary jobs or volunteer opportunities.[43] The Japanese government has also promoted a program to match older workers with suitable employers. In Sweden, efforts include the creation of a commission to explore policies to promote increased flexibility in working arrangements, such as granting older people a legal right to work part-time, and adjusting the public financing of education to promote skill development among older workers.

[42]All clients are eligible to receive services to help them find employment; clients are also eligible for up to £60 per week wage enhancement if they meet certain criteria. See appendix IV.

[43]See appendix II.

Experiences of Other Nations Suggest That the Nature of Reforms Plays a Key Role in Increasing Labor Force Participation of Older Workers

The experiences of other nations suggest that the scope and comprehensiveness of reforms, the transparency and availability of information, and the strength of the economy play important roles in encouraging labor force participation by older workers. According to government officials in Japan, Sweden, and the United Kingdom, reforms have a better chance of succeeding if they are comprehensive and complementary. In addition, they said that education and transparent information is important for helping workers understand what the reforms will mean for their retirement income. Officials also agreed that a strong economy was important for success.

Officials from each of the nations we studied said that the success of national pension reform, including those elements that influence older workers' labor force participation, depends, in part, on the scope and purpose of the reforms. Officials from all three nations noted that reforms are most successful when they are comprehensive in scope. Both Sweden and the United Kingdom, for example, in reforming their pension systems also made changes to both their disability insurance programs and labor market policies. Some officials also stressed that reforms should be designed so that the intent of a particular reform is not thwarted by countervailing policies in other areas. For example, Swedish pension experts and other officials have acknowledged that the continued presence of mandatory retirement ages in collective bargaining agreements and labor regulations can work at cross-purposes with features in the new national pension system that now relate benefit levels to retiree life expectancy and that essentially have no upper retirement age. They noted that to increase the effectiveness of the work incentives in their national pension reforms, these impediments will have to be resolved, as well as the need to establish complementary reform policies that foster alternative work arrangements and quality of work-life issues generally. Other nations also acknowledged the importance of complementary reforms. Japan has supplemented its national pension reforms with wage subsidies to encourage older employees to continue to work. Japan and the U.K. also support their national pension reforms by committing additional resources to organizations and services that provide job search assistance to older workers.

Officials in each nation that we studied emphasized that access to information and public education about how the reforms will affect retirement income would also be needed if the reforms were to have their intended effect. There is concern in these nations that many workers are currently unaware of the implications of the reforms. For example, surveys conducted by the Swedish government and advocates for senior citizens indicate that many individuals do not yet have a detailed understanding of the new pension system. U.K. government officials expressed concern that their citizens could have similar difficulties understanding the implemented reforms. To help their citizens understand that they may need to work longer or save more in order to ensure an adequate retirement income, each of the nations we studied has taken steps to educate workers. In Sweden, the government has launched several large information campaigns since the new pension system's implementation. In addition, participants receive annual statements of their account balances in both the notional defined contribution (NDC) and premium pensions. To help educate its workers, the U.K. government has created a pension forecast tool that will present workers with estimates of pension income from both government and nongovernment sources. In Japan, because defined contribution pensions are very new and offer both advantages and disadvantages to participants, employers are required to provide information to employees about defined contribution plan features and management.

In addition to the importance of information and education, government officials and pension experts agreed that a strong national economy is necessary for the success of pension and labor market reforms that may contribute to higher labor force participation by older workers. A strong economy eases the implementation of pension reform by offering increased employment opportunities for older workers. High unemployment and low economic growth will limit older workers' ability to remain employed, forcing them into complete retirement. Experts we spoke with believe that the low growth of the Japanese economy during the last decade has been a factor limiting the scope of pension and labor market reform, for example, in the area of mandatory retirement ages. Fiscal constraints also preclude more fundamental pension reform of system financing and structure. In contrast, the currently strong U.K. economy acts as an incentive for employers to retain their older workers and there will likely be an increased need for older workers in the long term, particularly as the workforce ages between now and 2020. The current tight labor market also makes it easier for job search assistance programs to find jobs for clients.

Concluding Observations

In many nations, despite their numerous differences, increasing the labor force participation of older workers is an element of the policies chosen to reform national pension systems. Officials from each of the three nations we studied emphasized this issue should be considered in their own nation's reform efforts. Encouraging workers to stay in the labor force longer can help alleviate the fiscal and budgetary stress induced by rising national pension expenditures and can potentially enhance economic growth. In those nations where national pension reform has included benefit reductions, working longer can also enable older persons to avoid serious reductions in their standard of living in retirement.

An important result from the experience of other nations is that to effectively foster greater labor force participation among older workers, individual reform components should be comprehensive in design so that employment incentives operate in a mutually reinforcing manner. Thus, in the nations we studied, changes in the national pension system were often matched by corresponding complementary initiatives affecting employer-provided pensions and the operation of the national labor market. Officials from each of the three nations we studied also identified other critical labor market policies that needed to be harmonized with these changes, particularly in the area of employment age discrimination and regarding mandatory retirement ages. Such comprehensive reforms can face formidable challenges to their design and implementation. In Sweden, for example, where prospects may be more favorable because the national pension system accounts for a large proportion of retirement income, comprehensive reform remains a work in progress with continuing discussion and debate. Nevertheless, the returns from a comprehensive approach could far outweigh the risks of failure.

The reform policies chosen by other nations should be evaluated within the context of their societies and institutions, however. For example, benefit payments from the national pension system in Sweden currently replaces a much larger percentage of pre-retirement income than in the United States. Therefore, benefit reductions in these nations will have significantly different effects on retirement income than similar actions taken in the United States. In addition, reforms that more closely link benefits to life expectancy, such as those implemented in Sweden could have significantly different distributional effects in the United States. For example, American subpopulations with lower average life expectancies, such as African Americans, would be more adversely affected by this policy change since they would collect benefits for shorter time periods relative to other racial groups. African American men have shorter life expectancies at birth and at age 65 compared to males of other ethnicities.

Finally, the focus on extending the labor force participation of older workers has also led to a reconsideration of the traditional definition of retirement where a person is either considered working or retired, to one that is more flexible or continuous in nature. The long-term trend of improved health and age longevity of older persons throughout the high-income nations now permits a range of options beyond the traditional career employment/out-of-the-workforce retirement tradeoff. Acknowledging this development, experts and officials from the nations we studied noted the importance of quality of work-life issues, including the wider use and availability of part- time employment and other alternative employment arrangements, and fostering "lifelong learning," as other key components in a long-term strategy to extend the labor force participation of older workers. In some ways, the United States has already forged ahead in this area, through its prohibition of age employment discrimination, broad elimination of mandatory retirement ages, and through its public discussion of bridge employment, phased retirement, and other alternative employment arrangements. However, opportunities exist to do more. In recent work, we found that few U.S. employers have focused on making such options available to their older employees on any widespread basis, and numerous economic and regulatory obstacles remain that can discourage the employment of older workers.[44] This led us to recommend to the Secretary of Labor that an interagency task force be established to develop legislative and regulatory proposals addressing the issues raised by the aging of the labor force. The challenge of how to extend the work-lives of older employees, given the new demographic realities of the 21st century, presents real opportunities, not only to bolster economic growth but to help secure retirement income adequacy for millions of working Americans and their families.

Agency Comments and Our Evaluation

We provided copies of this report to the Secretary of Labor and Commissioner of Social Security. They provided technical comments which have been incorporated where appropriate.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies of this report to appropriate congressional committees and other interested parties. Copies will also be made available to others upon request. In addition, the report will be available at no charge on GAO's Web site at http://www.gao.gov. Please

[44] For a discussion of these and related issues, see U.S. General Accounting Office, *Older Workers: Demographic Trends Pose Challenges for Employers and Workers*, GAO-02-85 (Washington, D.C.: Nov. 16, 2001).

contact me at (202) 512-7215, Charles Jeszeck at (202) 512-7036, or Jeff Petersen at (415) 904-2175, if you have any questions about this report. Other major contributors to this report are listed in appendix V.

Sincerely yours,

Barbara D. Bovbjerg
Director, Education, Workforce
and Income Security Issues

Appendix I: Scope and Methodology

Analyzed Statistical Data

To determine how the United States fares internationally regarding current and projected trends in key demographic and labor force characteristics, we compiled and analyzed data[1] from the United States and seven other high-income Organisation for Economic Cooperation and Development (OECD) nations.[2] In conducting this comparison, we examined the fertility rate, median age of the population, life expectancy at birth, old-age dependency ratio, population by sex and age group, labor force participation rate by sex and age group, and the unemployment rate by sex and age group for each of the eight nations. We also compared the United States to an aggregate for these characteristics that we constructed for a broader group of 23 OECD nations.[3]

Reviewed Literature and Conducted Interviews with Experts

In order to identify the dynamics of labor force participation rates of older workers, particularly with regard to the key incentives that influence work/retirement decisions, and to identify those nations that might be most appropriate to illustrate the role of extending the labor force participation in national pension system reform, we reviewed literature and interviewed experts. We conducted an extensive review of the international retirement literature, literature on the impact of aging societies, and previous analyses of conditions in other countries. Our review included research from organizations such as the OECD, International Labour Organization (ILO), the Center for Strategic and International Studies (CSIS), and the World Bank, as well as government agencies such as Japan's Ministry of Health, Labor, and Welfare; Sweden's Ministry of Industry, Employment and Communications; and the United Kingdom's Department for Work and Pensions. We also consulted with experts from many of these organizations, including the CSIS, the OECD, the World Bank, as well as the U.S. Departments of Labor and the Treasury, and the U.S. Social Security Administration. In addition, we

[1]These data include OECD summary statistics regarding labor force participation among older workers, United Nations Population Division data on demographics, and ILO data on actual and projected labor force participation based on population estimates from the United Nations Population Division.

[2]The group of high-income nations we analyzed are Canada, France, Germany, Italy, Japan, Sweden, and the United Kingdom.

[3]These nations are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, The Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, and the United States. We obtained demographic data on these nations from the United Nations Population Division and labor force statistics from the ILO.

conferred with individual experts affiliated with major retirement research institutes at universities or other research institutes such as the National Bureau of Economic Research, the Urban Institute, and the Brookings Institute both for background information on national pension policy as well as their recommendations on which countries to use as case studies.

On the basis of these interviews and our research review, we selected three nations for intensive study that had high rates of labor force participation for older workers and had enacted pension reforms within the last decade: Japan, Sweden, and the United Kingdom. We chose Japan for in-depth study for its extremely high labor force participation rates of older workers, because it already has a large aged population that will continue to grow significantly in the near future, and because it has taken steps over the last decade to address the consequences of an aged society through the reform of its pension system and labor market policies. We selected Sweden for its high rates of labor force participation of older workers, substantive reform to the national pension system, as well as its tradition of extensive labor market and social welfare policies. We selected the United Kingdom for its national and employer-provided pension reforms that reversed a previous trend of rising national pension expenditures (as a percent of gross domestic product) and for its active labor market policies regarding older workers.[4]

Conducted Site Visits in Three Foreign Countries

We performed a focused examination of these three nations' pension systems and labor market policies through site visits to each country. During our on-site study of each nation, we met with key government officials concerning pension and labor market policy, representatives from employer organizations and labor unions, advocacy groups, and well-known scholars whose research has direct relevance to understanding pension systems and older worker behaviors. In addition to speaking with us, many interviewees provided relevant written materials and statistics for our use.

[4]For additional details on key elements of each country's pension system, please see appendixes II to IV.

Appendix II: Japan

Japanese Pensions and Labor Market Policies

Old-Age and Disability Pensions

Retirement income for the majority of Japanese is mainly derived from the national pension system. Income from work constitutes the next largest share of retiree's income. Employer-provided pensions, or the earnings derived from lump-sum retirement benefits, are a small portion of this income. Disability pensions are used by a very small percentage of the working age population.

National Old-Age Pension System

The Japanese national old-age pension system consists of two tiers, both of which are financed on a pay-as-you-go basis. The first is the Old-Age Basic Pension, which covers all workers and their dependents. The premium for the basic pension is paid by the self-employed directly and by employees through their employers. The second tier is the Old-Age Employees Pension that covers salaried workers and their dependents, about 70 percent of the workforce. The premium for the employee's pension is paid equally by the employee and employer.

Old-Age Basic Pension

This is a relatively small pension financed primarily by a fixed premium paid either directly if self-employed or through one's employer. One-third of the financing comes from general revenues. Current premiums are about $111 per month.[1] Premiums are projected to almost double by 2020. Benefit amounts are determined based on the number of months of contributions, with 25 years of contributions required for full eligibility. The average monthly benefit in 2001 was about $417. Full pensions begin at age 65 and are not offset by other income. Pensions may be received as early as age 60 at a reduced rate.

Old-Age Employees Pension

This is an earnings-based pension financed by premiums paid equally by the employer and employee. The total premium rate is currently 17.35 percent of payroll and is projected to rise to 27.35 percent by 2020. Benefits are calculated based on the year of birth, the number of months in the system and average monthly earnings. There are two major

[1] All dollar figures are calculated using an exchange rate of 120 yen per dollar.

components of the employees pension. The first is the flat rate portion, which is based on the year of birth multiplied by the number of months of contributions. The second component is calculated using earnings and months of contributions. The growth rate of benefits for each additional year of work for this portion is determined by year of birth. The average monthly employees pension was about $1,467 in 2001. Full pensions can currently be received from age 61; eligibility ages are scheduled to gradually rise to age 65 by 2030. Benefits are reduced until age 70 if earnings while receiving this pension exceed a certain level.

Employer-Provided Pensions

Employer-provided pensions are primarily defined benefit in nature and may be received as (a) lump sums, (b) annuities, or (c) a combination of the two. The smaller the company, the more likely it is to use the lump-sum option. Benefits are available at mandatory retirement, usually age 60. About 90 percent of companies offer some type of retirement benefit, with about one-third of full-time employees receiving benefits through employee pension funds (EPF) and nearly the same level through what are known as tax-qualified pension plans (TQPP).[2] In 2001, two laws were enacted that affect employer-provided pensions. The first, the Defined Benefits Pension Law will impact EPF and TQPP. The second, the Defined Contribution Pension Plan Law will allow the creation of new pension plans for employees and individuals.

EPF are responsible not only for the occupational pension, but also a carve-out or “substitution” portion of the national old-age employees pension. EPF offer the remuneration portion of the old age employees’ pension and provide added benefits. According to the Pension Fund Association these benefits should be 30 percent or more of the substitution portion of the employees’ pension. About 43 percent of employees in EPF take their benefits in the form of a lump-sum payment.

TQPP participants receive pension benefits that are contracted between companies and financial institutions like banks or life insurance companies. This arrangement is more likely to be used by smaller

[2]The Employees’ Pension Fund is a public corporation made up of businesses and insured individuals. Management duties are performed by trust banks, insurance companies, and investment advisory companies and there must be an option to receive benefits as a lifetime annuity for those with over 20 years of service. TQPPs, while also managed by financial institutions, do not have a carve-out of national employees benefits and are not required to offer lifetime annuities.

companies, and benefits are likely to take the form of lump-sum payments or fixed term annuities. The Defined Benefits Pension Law requires that no new TQPP be created and all existing TQPP be transferred into new contract- or fund-type pension arrangements.

New defined contribution pensions were recently introduced in Japan for corporations and individuals. Contributions are managed by the beneficiaries themselves, and pension benefits are paid as old-age benefits, disability benefits, or lump-sum death benefits.

Disability Insurance Pensions

Disability insurance pensions are relatively rare in Japan. Like the two-tier Old-Age Pension System, there are two tiers of disability pension. Slightly more than 1 percent of the Japanese population receives one of these pensions. The Disability Basic Pension has benefits similar to that of the Old-Age Basic Pension with additional benefits for those with dependent children. Approximately one million disabled individuals aged 20-64 receive this pension. The Disability Employees Pension benefits, like the Old-Age Employees' Pension benefits, are based on earnings and months of contributions with additional benefits when a spouse is present. Less than 200,000 disabled employees aged 20-64 received this pension in 2001.

Reforms over the Past Decade

Concern about the balance between benefits, retirement ages, and contribution levels in the old-age pension system have been growing over the last two decades. Proposals to raise the normal retirement age first surfaced in 1980 and were finally agreed to for the flat-rate portion of the employees' old age pension in 1994 and the earnings-based portion in 1999. These eligibility age increases will be phased in over several decades. The pension system undergoes actuarial reevaluation at least every 5 years to balance premiums and benefits with existing socioeconomic conditions.

The Reform Process

The Japanese have used Pension Councils coordinated by the Ministry of Health and Welfare[3] to facilitate pension reforms. Pension Councils are composed of representatives of employers' groups and labor unions, as well as academic researchers and government officials. While the Ministry of Health and Welfare undertook the role of gathering and supplying information, employer organizations and labor unions were able to

[3]The Ministry of Health and Welfare is now the Ministry of Health, Labor and Welfare.

participate in the debate by means of participation in the Pension Council as official members and by publicizing their views concerning pension reform through editorials.

The changes that grew out of the Pension Councils can be summarized as follows:

Eligibility Ages

The normal retirement age for the flat-rate portion of employee pension will rise to 65 for men in 2013 and 2018 for women. Eligibility ages for the earnings-based portion of the employee pension will rise to 65 in 2025 for men and 2030 for women.

Contributions

The premiums for the basic (fixed) and employees' (earnings-based) systems are revised at least every 5 years based on the projected health of the systems. Current premiums on the earnings-related pension total 17.35 percent of payroll. Both premium rates are expected to grow in the future. The base of earnings covered by premiums to the employee pension was expanded to include income from bonuses, but the total percentage of earnings that will be needed to support the system has been reduced.

Calculated Benefits

Employee pension benefit levels for those born prior to April 1, 1941, are higher than for those born after that date. This is true for both the flat-rate and the earnings-related portions of the pension. Pension benefit levels were reduced by about 5 percent in 2000. It has been estimated that lifetime employee pension benefits will be reduced by about 20 percent by 2020.

Employer-Provided Pension Reforms

Outside of the Pension Council process, changes were made to employer-provided pensions through the passage of the Defined Benefits Pension Law and the Defined Contribution Pension Plan Law.

Enactment of the new Defined Benefits Corporate Pension Law requires that existing TQPP be abolished by 2012 and their funds must transfer either to the EPF or to new contract or fund-type corporate pensions. The primary purpose is to improve protection of beneficiaries' pensions.

The new Defined Contribution Pension Plan Law was designed to help those unable to participate in a defined benefit pension system through the creation of corporate and private defined contribution pensions. The target group for this pension is the self-employed and employees of small companies. Portability of pension benefits was also a factor in the creation of the Defined contribution Pension Plan Law.

Labor Market Policies

The Japanese labor market has a number of features and practices that affect the labor force participation of older workers. These practices may enhance labor force participation up to a certain age but decrease it after that point.

Lifetime Employment

During the period of high economic growth in the 1960s, companies instituted long-term or lifetime employment policies that effectively guaranteed employment until a worker reached mandatory retirement age. These policies offered companies a way to ensure that their investment in training achieved a positive return and provided workers job security. This policy is limited in that it applies only to full-time workers who are predominantly men.

The Seniority System

Promotions and wages are highly related to seniority in Japanese companies. Under such a system, wages rise as longevity with a firm increases. This is in part to reflect the greater knowledge and experience gained with greater tenure, but also to reflect the rise in cost of living as employees aged. Typically, the wage of a male employee rises until about age 50-55, after which it falls sharply. For many workers at large companies wages are 30-50 percent lower at age 65 than at age 55. This reduction makes older workers more attractive to employers by making them cost competitive with younger workers.

Employee Training

Training in Japanese companies usually takes the form of on-the-job training. The training is usually highly company-specific and is closely related to the seniority system. Training opportunities decrease once an employee reaches a high level of seniority.

Age Discrimination and Mandatory Retirement

There is no law in Japan that prohibits discrimination on the basis of age. However, recent legislation encourages employers to voluntarily not discriminate against older workers in the hiring process. Japanese law permits mandatory retirement, but the mandatory retirement age can be set no lower than age 60.

Recent Initiatives Directed at Older Workers

The Japanese government has enacted some initiatives to encourage the employment of older workers. Rather than legislate an increase in the mandatory retirement age in the current weak economy, the government has urged companies to extend the employment of older workers voluntarily and to offer some employment services and grants that are expressly targeted toward older workers.

The policies for accomplishing this are either employment extension programs whereby workers who have retired are rehired or the company may increase its mandatory retirement age. To date, the preferred course of employers has been to offer reemployment or extended employment where such action is beneficial to the company. Companies are provided subsidies—called Promotion Grants to Secure Continued Employment—for this purpose.

Japanese officials advised us that there are no job training programs geared specifically toward older workers. However, the Silver Human Resource Centers[4] offer skills training and job-matching services are offered. These centers also provide seniors with temporary or short-term community-related jobs. Other programs provide grants to employers to develop the skills of the middle-aged and older workers to improve their employability. There are also employment programs that focus on providing information to employers on the benefits older workers offer and how they can be accommodated.

Through the unemployment insurance system, subsidies are available directly to employees 60 to 64 years old who are working full-time and earning less than 85 percent of their former wage. This subsidy pays up to 25 percent of the employees' wage after age 60 until age 65. Utilization of this subsidy is low, however, due to the requirements placed on participation. For example, recipients must be working full-time and must be nominated by their employer. In addition, beneficiaries must have been paying into the unemployment insurance system for at least 5 years and the benefit period is reduced if they received unemployment payments following mandatory retirement. This program will become less generous and participation requirements will become more stringent in the future.

[4]Silver Human Resource Centers are community-based organizations designed to facilitate the continued involvement of people over age 60 in community life.

We were advised that participation in these programs, while small, is expected to grow as the retirement eligibility ages of the national pension system increases.

Appendix III: Sweden

Swedish Pensions and Labor Market Policies

Old-Age and Disability Pensions

Retirement income for the majority of Swedes is mainly derived from the public national pension system. Employer-provided pensions, on average, account for roughly 20 percent of total pension entitlements. These pensions, however, are relatively more important to higher income individuals (with incomes above the ceiling in the national old age pension).[1] Private (individual) pensions account for an even smaller amount, but have increased in importance over the last decade. Disability pensions have also been an important source of income for many who leave the labor force prior to becoming eligible for an old-age pension.

The major components of the Swedish old age and disability pension systems are undergoing important structural changes. With legislation passed in 1998, Sweden began implementing a fundamental reform of its national old-age pension system.[2] In addition, there have been changes to the structure of employer-provided pensions complementing the national pension reform. Changes in the eligibility criteria and administrative structure of disability pensions have also accompanied old-age pension reform.

National Old-Age Pension System—Old System

The old national pension system was a pay-as-you-go defined benefit plan, combining a flat rate universal benefit (the "basic pension") with an earnings-related supplement (the "ATP"). The basic pension, introduced in

[1]Most benefits within the Swedish social security system are linked to the "base amount," an amount of Swedish Krona (SEK) that is set each year by the government and appreciated by the Consumer Price Index. For 2002, the base amount was SEK 37,900 (roughly $4,341 at $1 = SEK 8.73). The ceiling for all social security transfers is 7.5 base amounts. Beginning in 2001, the ceiling for the national pension system has been indexed to the growth in average wages and not the price index, and the base amount for this system is somewhat higher (SEK 38 800, roughly $4,444).

[2]There will be a gradual transition from the "old" to "new" national pension systems for persons born between 1938 and 1953. Persons born in 1938, for example, will receive 20 percent of their retirement benefit from the new system and 80 percent from the old system. The share of benefits from the new system increases for each following birth year until persons born in1954 receive their entire benefit from the new system. Consequently, the structure of the old pension system will continue to influence old-age pensions for some time.

1913, was the first compulsory old age pension in the world to cover all citizens regardless of occupation. This flat rate pension was paid in full to everyone with at least 40 years of residence in Sweden between the ages 16 and 65, or with 30 years of work. ATP was introduced in 1960. Under ATP, a full earnings-related benefit could be obtained with 30 years of covered earnings at age 65, based on the average of the best 15 years. The normal (or statutory) eligibility age was 65 years for both the basic pension and the ATP, but both pensions could be drawn from the age of 61 (60 prior to 1998) with a life-long reduction or postponed to the age of 70 with a life-long increase.

The national pension reform was the result of discussions that began in the 1980s in response to concerns about demographic trends and accelerated in the early 1990s in response to a serious economic crisis and a change in the government.[3] The old national pension system was seen to be unfair in that it favored those who had short working careers or variable earnings. In addition, the old system faced severe problems with financial sustainability and was expected to require large increases in contribution rates in the future.

National Old-Age Pension System–New System

The new national old-age pension system consists of an earnings-related pension and a minimum guaranteed pension.

Earnings-Related Pension

The new earnings-related pension is a defined contribution scheme with two components: a pay-as-you-go “notional defined contribution” plan and a fully funded financial defined contribution plan (the “premium pension”). The total contribution rate for both plans is 18.5 percent of earnings, paid by both employers and employees.[4] Unlike the old system, the final pension in both plans is based on lifetime earnings. In addition, there is no normal eligibility age in either plan. Benefits may be drawn, in full or in part (i.e., one-fourth, one-half, or three-fourths of a full pension) at age 61 or later with no upper age limit. Earnings may be combined with a full or partial pension and will continue to generate pension

[3]In the early 1990s, unemployment reached historically high levels in Sweden, seriously eroding the contribution base for the national pension system. In addition, in the fall of 1991, the Social-Democratic government was replaced by a four-party, nonsocialist government.

[4]Employees only pay on earnings up to the pension ceiling, while employers pay on all earnings.

contributions. In both plans, individuals receive pension rights from earnings as well as income replacement transfers (i.e., disability and sickness benefits) and special credits (i.e., for time spent in child rearing, university studies, or compulsory military service). Pension credits from income replacement transfers and special credits are funded by general revenues.

Notional Defined Contribution Pension

The notional defined contribution (NDC) plan is the larger of the two earnings-related pensions, accounting for 86 percent of total contributions. The NDC plan is financed according to pay-as-you-go principles, but the system also includes pension reserve or "buffer" funds. The contribution rate for the NDC plan is 16 percent, with contributions credited to individual "notional" accounts.[5] These accounts are notional in that pension rights (i.e., claims to future pension income) and not financial assets, are credited to them.[6] During the accumulation period, the pension rights credited to the notional individual accounts are indexed by average wage growth. At retirement, the accumulated "notional capital" is converted to an annuity related to estimated life expectancy at the age of retirement and an assumed "norm" real rate of return (a 1.6-percent increase in real average wages). This means that with increasing life expectancy over time, other things being equal, individuals will have to work longer or accept lower pensions.[7] After retirement, benefits are indexed by average wage growth minus the assumed growth norm of 1.6 percent. Thus, if real wage growth falls below the norm, the real value of pensions will fall (and vice versa). An automatic balancing mechanism places a further "brake" on the upward indexation of pensions and pension rights if the balance in the pension reserve or buffer fund falls below a certain level.

[5]The adjustment mechanisms discussed in this paragraph, such as the indexation of benefits to life expectancy and growth of the contribution base, are expected to stabilize the system and keep the contribution rate constant indefinitely.

[6]The contributions credited to the notional accounts are for bookkeeping purposes only. The actual funds collected are comingled and used to pay current benefits.

[7]In a simplified form, the pension annuity under the NDC plan is calculated by dividing the notional capital balance at the chosen time of retirement by estimated average (unisex) life expectancy for men and women at the age of retirement: Annuity = Capital/ Life expectancy. As life expectancy increases, members of later generations retiring at the same age and with the same amount of notional capital as members of earlier generations would receive lower pensions.

Premium Pension

The new Swedish national pension also includes an earnings-related, funded defined contribution plan, the "premium pension," in which contributions are made to individual financial accounts. Participation in the premium pension is mandatory, but the contribution rate (2.5 percent) is low relative to that of the pay-as-you-go NDC plan. Individuals have a great deal of investment choice (currently about 600 funds), and a default fund is provided for those who decline to make investment fund choices for their accounts. At retirement, these individual accounts may be converted into either fixed or variable annuities.

Guaranteed Pension

In addition to the two earnings-related pensions, the new national pension system also includes a minimum "guaranteed" pension for those with no or low earnings. Unlike the universal basic pension of the old national pension system, the new guaranteed pension provides a means-tested benefit. The guaranteed pension is funded separately from the earnings-related pension; it comes completely out of general revenues. Unlike the earnings-related pensions, individuals may claim benefits under this plan no earlier than age 65. Benefits under this plan are indexed to the Consumer Price Index (CPI), not to average wage growth as in the earnings-related NDC plan.

Employer-Provided Old-Age Pensions

Roughly 90 percent of all workers in Sweden are covered by an employer-provided pension plan based on collective agreements between central employer and union organizations. There are four different collectively bargained, employer-provided pension plans: two separate plans for workers in the private sector — one for white-collar workers and one for blue-collar workers and two separate plans for public sector employees, one for central government workers and one for municipal (and county) workers. Traditionally, these pensions have been defined benefit plans, closely linked to and supplementing the national pension.[8] And, typically, benefits in these plans have been based on final salaries. During the 1990s, however, the plans for private sector blue-collar workers and municipal workers converted to defined contribution plans with contributions paid by the employers.[9] In 2003, central government workers will also have a new pension plan containing defined contribution

[8]It is interesting to note that even under the old systems, employer-provided pensions were highly portable across the four plans.

[9]Currently, the contribution rate for private sector blue-collar workers is 3.5 percent of gross pay; for municipal workers it is 4 percent.

features.[10] White-collar workers in the private sector, however, continue to have a largely defined benefit plan.

Private (Individual) Old-Age Pensions

Although private pensions remain a relatively small source of retirement income in Sweden, there has been an increase in individual retirement saving in recent years. Some analysts attribute this to the increased attention to retirement income associated with the pension reform discussion (and perhaps an increased awareness of financial markets associated with the introduction of the premium pension), and/or concerns about the impact of pension reform on future pensions (especially among women).

Disability Pensions

The most common way for Swedish workers to leave the labor force before the age of 65 has been with a disability pension. Prior to 1991, it was possible to be awarded a disability pension for three reasons: first, on medical grounds, for those aged 16-65; second, on medical and labor market grounds (i.e., due to long-term unemployment), for those aged 60-65; or third, on labor market grounds only, for those aged 60-65 who had exhausted their unemployment benefits. Disability pensions granted exclusively for labor market reasons were called "58.3 pensions": If a worker aged 58 years and 3 months were laid off, he or she could claim unemployment benefits up to age 60, and then claim a disability pension for labor market reasons (until claiming an old-age pension at age 65). Eligibility requirements for disability benefits have been tightened in successive reforms throughout the 1990s. The granting of disability pensions exclusively for labor market reasons, for example, was discontinued in 1991, and since 1997 medical reasons are the only valid criteria for granting a disability pension. In addition, as part of the national pension reform, disability insurance was separated administratively from the old age pension system.

Labor Market Policies

Active labor market programs for the unemployed play an important role in Sweden's labor market policy. These programs have, for the most part, always been open to workers of all ages. The Activity Guarantee program,

[10]The new pension plan for central government workers also includes the option of taking a partial pension beginning at age of 61. There is some concern among pension experts that this plan will encourage workers in this sector to choose part-time over full-time work after age 61.

for example, ensures the long-run unemployed placement in job training and re-employment programs. One-third of the participants are between the ages 55 and 64. Swedish experts and officials argue, however, that existing labor laws, workplace practices, and attitudes may create barriers to continued employment among older people. They also argue that reducing these barriers is increasingly important in Sweden in light of pension reforms that encourage increased labor force participation. Some policy changes have already been implemented in Sweden to reduce these barriers, such as increasing the mandatory retirement age from 65 to 67 years. In other areas of concern–such as seniority rules, age discrimination, employment and skills training, quality of work life and attitudes toward older workers—possible policy changes are currently under discussion.

Mandatory Retirement

Prior to the national pension reform, collective agreements in Sweden established a mandatory retirement age of 65. That is, seniority rules (see discussion below) were not applied to workers aged 65 and older, and employers were permitted to terminate employment at that age. In May 2001, the Swedish Parliament added a new compulsory rule to the Employment Protection Act, giving all employees the right, but not the obligation, to remain in employment until the age of 67.[11] Collective agreements prescribing a mandatory retirement age of 65 are now prohibited, although agreements covering the age at which employees have the right to leave employment and receive a pension are still allowed. Existing agreements prescribing mandatory retirement at age 65 were allowed to remain in place until they expired but no later than December 31, 2002.[12]

Seniority Rules

According to Swedish seniority rules, firms engaged in downsizing their work force must follow the “first-in-last-out” rule, giving priority for continued employment to those who have been employed the longest. Some analysts argue that this protection for older workers helps to explain

[11]Workers over the age of 65, however, continue to lack coverage by unemployment insurance or sick leave insurance.

[12]Reaching an agreement on changing the mandatory retirement age was difficult and required extensive negotiations. The passage of this legislation has also been controversial, with two of the three main trade union confederations arguing that it constituted unwarranted interference by the government in collective bargaining.

the relatively high rate of employment among the 50-64 year old age group. It is also argued, however, that this rule may promote early pensioning in times of downsizing and possibly limit the mobility of older workers. Ways to make seniority rules more flexible, while still offering employment protection, are currently under discussion in the context of policies to encourage older workers.

Age Discrimination

Advocates for older persons in Sweden view age discrimination as a serious impediment facing workers who wish to remain employed later in life. Sweden currently has no legislation against age discrimination in employment. As a member of the European Union, however, Sweden will be required to pass such legislation. In 2000, the European Union established a general framework for equal treatment in employment and requires all member countries to introduce legislation prohibiting discrimination at work on the grounds of age, sexual orientation, religion and belief, and disability. The directive gives member states until 2006 to implement the provisions on age and permits considerable latitude in how the directive is to be implemented in practice.

Training

Overall, the incidence of employment and skills training is relatively high in Sweden, and older workers receive nearly the same amount of training as younger workers. Some researchers and officials, however, believe that the skills of older workers need to be enhanced, particularly those skills necessary for adapting to changing work environments and pursuing second careers. They have concerns that older workers may be disadvantaged in acquiring such skills. It is difficult, for example, for people over 40 years of age to acquire public loans for university studies. There are various proposals to address these problems, including the establishment of special higher education savings accounts to enhance the financing of higher education for people of all age groups.

Quality of Work Life

Swedish researchers report that surveys of older employees in Sweden find many would like to work longer but would prefer different types of jobs and/or fewer hours of work. Thus, government officials and advocates for older workers see “working life” issues—such as the need for more flexible work time arrangements, the ability to switch to more appropriate types of work, and management practices that create a positive environment for older workers—to be critically important. Recommendations to provide older persons with a right to work part-time, to revise labor laws to allow for short-term contracts for older workers, and to devise systems to make it easier to change job duties while employed are under discussion. Negative attitudes toward older workers are also a concern and are seen to create barriers to the employment of older people. Surveys find that the majority of employers do not want to hire older workers. This attitude is attributed to prejudice and misinformation and/or work rules and practices that make older workers more expensive. Government officials and advocates argue that addressing these negative attitudes must be part of any comprehensive policy change to promote the labor force participation of older people and must be undertaken in the context of broader policies to promote the overall well-being of older people in Sweden.

Appendix IV: The United Kingdom

United Kingdom Pensions and Labor Market Policies

Old-Age and Disability Pensions

Retirement income in the United Kingdom is made up of both government and private sources. In the late 1990s, national pension benefits made up 38 percent of the national average wage. The government allows workers to substitute employer-provided pensions or individual pension accounts for the earnings-related portion of national pension benefits, and in the late 1990s, about 75 percent of workers did so. About 60 percent of current pensioners receive benefits from an employer-provided pension, typically defined benefit and providing them with two-thirds of their final salary after 40 years of service. With recent reforms, future pensioners are likely to have more of their retirement income derive from defined contribution employer-provided pensions or individual pension accounts. For low-income pensioners with little or no private pension income, the government provides a larger earnings-related benefit, as well as means-tested benefits. Disability pensions have also been an important source of income for many who leave the labor force prior to becoming eligible for an old-age pension.

The National Old-Age Pension System

The United Kingdom's national pension system consists of three tiers—the state basic pension, an earnings-related pension, and discretionary savings vehicles.

Basic State Pension

The Basic State Pension provides a flat-rate benefit of £75.50 per week for a single pensioner (about $120 per week or about $6,200 per year).[1] It is adjusted annually for price inflation. To qualify for the full benefit, male pensioners and female pensioners turning 65 after 2020 must have made 44 years of National Insurance Contributions. Female pensioners turning 60 before 2010 must have made 39 years of contributions.[2] Workers who are not paying contributions because they are unemployed, disabled, caring at home for a child or relative, on state maternity benefits, or are taking training courses may receive credits toward the Basic State

[1]Dollar figures are calculated using an exchange rate of 0.6 U.K. pounds to one U.S. dollar.

[2]From 2010 to 2020, the women's eligibility age for the national pension system is increasing to 65 to be equal with men's. Consequently, the number of years of contributions required for women to receive a full state basic pension will also gradually increase.

Pension. Workers with less than the required number of years of contributions have their state basic pension reduced proportionately, but workers must usually have made at least 10 years of contributions to receive any benefits. In practice, the Basic State Pension is near universal for men. It is becoming universal for women since the enactment of the Home Responsibilities Protection Act in 1978, which allowed those caring for children and people who are sick or disabled to earn credits toward the Basic State Pension so long as they have made 20 years of contributions.

Means-Tested Benefits

Low-income older individuals are eligible for means-tested benefits, one of which is the Minimum Income Guarantee (MIG). The MIG tops up incomes of those age 60 and over with income less than £98.15 per week for a single person (about $158 per week or about $8,200 per year) to those levels. MIG benefits are increased annually with average growth in wages. The MIG does have an earnings test. Each $1 of benefit is withdrawn for each $1 in earnings above the MIG level.

In October 2003, the government will replace the MIG with the Pension Credit, in part to reduce the MIG's earnings test. With the Pension Credit, each $1 of income will lead to a $0.40 decrease in benefits, increasing the worker's overall income by $0.60. The Pension Credit consists of two elements: (1) a guarantee credit which tops up the income of a single person to £102 per week (about $163 per week or about $8,500 per year) and (2) a savings credit which provides a benefit to those with modest savings, pension income, or earnings. The savings credit is designed to taper away as an individual's income rises and phases out for individuals with £134.80 of income per week or more (about $216 per week or about $11,200 per year). The eligibility age for the savings credit is currently 65. The eligibility age for the guarantee credit is currently 60 but will rise in line with the increase in women's eligibility age for national pension benefits, so that it will be 65 by 2020.

Aside from the MIG, other means-tested benefits include assistance with housing costs and local taxes. About 51 percent of U.K. households over age 60 are eligible for means-tested benefits, although in 2000-2001 only 64 percent to 78 percent of eligible households claimed these benefits.[3]

[3]Eligible households include single males, single females, and couples in which the oldest member is over the age of 60.

Earnings-Related Pension (State Second Pension)

The earnings-related pension, now called the State Second Pension, supplements the Basic State Pension but may be substituted by several types of private pensions. From its creation in 1978 until 1988, the earnings-related pension (then called the State Earnings Related Pension System) provided benefits of about 25 percent of workers' average annual earnings for the best 20 years. From 1988, benefits have been reduced to a target of 20 percent of average lifetime earnings. In 2000, a technical adjustment in computing benefits led to a further reduction. In April 2002, another reform was implemented which resulted in low- and moderate-income workers receiving higher benefits as a proportion of wages, while benefits for those with annual income above £24,600 (about $40,000) benefits remain about the same. In the late 1990s, about 75 percent of covered workers substituted private pensions for the state earnings-related pension. These private pension plans are either employer-provided pensions or individual pension accounts called personal pensions. Personal pensions may be provided through financial institutions or offered by employers. Employers with five or more employees who do not offer an employer-sponsored pension must give workers access to a type of personal pension called a stakeholder pension. Stakeholder pensions have additional legal requirements, such as a maximum administrative charge of 1 percent of the pension fund's value. In return for forgoing future State Second Pension benefits, individuals who opt out of the state earnings-related pension for private pensions pay lower National Insurance Contributions. Those who opt out for individual pension accounts pay full National Insurance Contributions but receive part of their contributions back as a rebate that is deposited into their individual account. Those who opt out of the State Second Pension for employer-provided pensions pay national insurance contributions at a reduced rate. Similar to the Basic State Pension, the State Second Pension allows individuals who are looking after a child under age 6 or an ill or disabled person to qualify for State Second Pension benefits.

The Discretionary Tier

The third tier consists of additional forms of voluntary savings. First, individuals can choose to make additional voluntary contributions into their employer-sponsored pension plan. Second, individuals can choose to make additional contributions into their personal pensions or stakeholder pensions. Individuals will receive tax relief for these contributions up to a certain ceiling. And finally, individuals can choose to make contributions to a variety of other tax-relieved instruments, such as annuities and life insurance.

Other Features of the National Old-Age Pension System

Eligibility Age: For the basic and earnings-related pensions, benefits may be drawn at age 65 for men and 60 for women. In response to a European

Union directive requiring gender equality in member countries' pensions policies, women's eligibility age will also become 65, with the change gradually taking place between 2010 and 2020. The U.K.'s national pension system does not have an early eligibility age.

Earnings Test: The U.K.'s national pension system does not have an earnings test, meaning that benefits are not offset by the wages earned by pensioners.

Deferral of Pension Benefits: If pension benefits are drawn past eligibility age, benefits are increased by an increment of 7.5 percent per year of deferral. In 2010, the increment will increase to 10.4 percent. The government is considering pushing up implementation of the increase to 2006. It is also considering allowing individuals a choice between taking the benefit increase as a lump-sum payment or as increases in each benefit payment.

Funding: The Basic State Pension and State Second Pension are funded on a pay-as-you-go basis by National Insurance Contributions shared by employers and employees. General revenues may also be used to fund pension benefits. Employers pay 11.8 percent of earnings above a threshold for employees in the State Second Pension and between 8.3 percent to 10.8 percent for employees who have opted out. Employees in the State Second Pension pay 10 percent of earnings above a threshold up to an earnings limit, while employees who have opted out pay 8.4 percent. From April 2003, National Insurance Contribution rates will increase by 1 percent for employers and employees on earnings above a threshold. Employees will also pay 1 percent of earnings above the earnings limit, and the earnings limit will be raised in line with inflation. National Insurance Contributions also fund other benefits, including disability, unemployment, and survivors' benefits.

Sustainability: Changes to the U.K. national pension system, including raising women's eligibility age, increasing Basic State Pension benefits in line with average price increases rather than the higher of increases in average prices or wages, and making survivors' benefits less generous, are helping to maintain the long-term fiscal sustainability of the system. In 1984, the U.K. government projected that the National Insurance Contribution rate needed to pay for national pension benefit payments would be 23 percent by the 2020s. Currently, the contribution rate needed to pay for benefits is estimated to be 18.2 percent by 2020. Pension costs as a percentage of gross domestic product are projected to remain about 5 percent through 2050.

Employer-Provided Old-Age Pensions

Almost half of U.K. workers are members of either defined benefit or defined contribution pensions provided by their employers. Employers who offer pensions to their workers may pay lower National Insurance Contributions by having their employees forego rights to benefits from the state earnings-related pension. Employees in these plans also pay lower National Insurance Contributions.

Until 1986, employers could only use defined benefit pension plans as a basis for their employees to opt out of the state earnings-related pension, and employers could require employees to join their defined benefit pension plan. The Social Security Act of 1986 allowed employees with either defined benefit or defined contribution employer-provided pensions to opt out and allowed workers to choose whether to join the pension plan provided by their employer. Since then, the U.K. has experienced a movement of employer-provided pensions from defined benefit to defined contribution. In 2000, about 81 percent of employees accruing benefits in employer-provided pension plans were in defined benefit plans provided primarily by large employers. However, of the plans open to new members, about 70 percent were defined contribution. On average, employers and employees make lower rates of contributions to defined contribution plans than defined benefit plans. In 2000, employers contributing to employees' defined benefit plans contributed 11.1 percent of earnings on average, while employers contributing to defined contribution plans contributed 5.1 percent of earnings on average. Employees contributed 5.0 percent of earnings on average to defined benefit plans, while they contributed 3.4 percent of earnings on average to defined contribution plans.

Employers who opt out of the State Second Pension by offering defined benefit pensions are required to provide benefits that are broadly equal to or better than the benefits employees would receive in the State Second Pension. There is no such requirement for defined contribution pensions. Typical defined benefit pensions offer benefits equal to one-eightieth or one-sixtieth of final salary per year of membership in the plan, or half or two-thirds of final salary for workers who have been in the plan for 40 years. Typical ages at which workers may draw full pension benefits are 60 and 65. The earliest age at which benefits may be drawn is 50.[4] All

[4]From the 1970s until the1990s when the U.K. was experiencing economic downturns, employers made use of their pension plans to shrink their workforces by providing generous benefits to encourage workers to retire early.

private sector defined benefit pensions are fully funded, while some public sector defined benefit pensions are financed on a pay-as-you-go basis.

The government has recently announced several proposals for encouraging employers to establish pension plans that encourage longer labor force participation. For example, the government plans to increase the earliest age when workers may begin drawing employer-provided pension benefits to 55 by 2010. The government has also specified some best practices for defined benefit employer-provided pension plans. These include allowing those who work past normal retirement age to continue earning pension rights and to receive a fair benefit increase. In addition, the government is encouraging employers to calculate benefits from the best year's salary out of the last few years of employment so as not to penalize people who change positions to reduce responsibilities at the end of their career.

Disability Insurance

Disability insurance in the U.K. pays a bi-weekly benefit to adults who cannot work. Currently, recipients age 50 and older number approximately 1,175,000 compared with approximately 160,000 recipients of unemployment insurance. During the 1970s and 1980s, the U.K. expanded and improved the coverage of benefits for disabled adults, then tightened them in accordance with the current government's overall "welfare to work" strategy. Prior to 1971, those unable to work due to disability received means-tested benefits. In 1971–2, the Invalidity Benefit (IVB) was introduced. For those who had a sufficient National Insurance contribution history, IVB provided an age-related income to those who were disabled and not working. Claimant's age and qualifications could be taken into account in the criteria determining incapacity for work. Cash benefits were not taxed and were indexed to earnings. Benefits generally expanded and improved during the 1970s. However, in 1980, IVB (and all other long-term benefits) indexation was changed to prices rather than earnings, which ultimately provided recipients with smaller benefits. In 1995, IVB was replaced by the Incapacity Benefit (IB), at least in part because these benefits were perceived to be subsidizing unemployment and early retirement. The National Insurance contribution element for IB requires contributions from work within the last 2 years, rather than in any previous year. IB also has stricter eligibility criteria, testing if there is any work the claimant could perform regardless of the likelihood of obtaining such a job or its suitability. The assessment of capacity to work can be ongoing rather than a once-only assessment. IB cash benefits, unlike IVB, are taxable. Finally, income over £85 per week from an occupational or personal pension, or certain types of health insurance payment will reduce by 50 percent the amount of IB paid to the claimant.

Labor Market Policies

The U.K. government has begun a series of reforms that are designed to increase employment opportunities and increase both incentives and abilities to take on paid work for older workers. These reforms address mandatory retirement and age discrimination, lack of training or skills, and inflexible work and retirement options.

Mandatory Retirement and Age Discrimination

Although the U.K. currently allows employers to set mandatory retirement ages for their employees, there have been efforts by the government to encourage employers to extend employment opportunities for older workers voluntarily. The government continues its campaign begun in 1993 to promote the benefits of an age-diverse workforce to employers. In 1999, the government issued a voluntary Code of Practice on Age Diversity, which sets good practice standards for employers on eliminating age discrimination in their business, in hopes that employers would retain and hire older workers voluntarily. In 2000, the Cabinet Office issued a report[5] describing the economic and social reasons for promoting active aging, a concept of improving people's opportunity to contribute to society and to the economy in their later working years, and laying out a plan of action to encourage active aging. In response, one public employer has raised and some private employers have eliminated their mandatory retirement ages. For example, civil servants in the U.K. were subject to a mandatory retirement age of 60, but now the majority of employees have the option of staying on until age 65. Finally, the U.K. is moving toward enacting legislation against age discrimination in employment, which is required by a recent European Union Council Directive by 2006. Although the government has proposed abolishing mandatory retirement ages, it is not yet known if the legislation will address current legal provisions permitting mandatory retirement policies.

Employment Assistance

The U.K. government offers several types of employment assistance for older workers, including assistance with job searching, training, and employment subsidies through the Department for Work and Pensions

[5]Cabinet Office and Performance and Innovation Unit, *Winning the Generation Game* (London, United Kingdom, April 2000).

(DWP). The DWP was created after the last election with the principal aim of implementing the government's welfare-to-work strategy. In 2002, the government units responsible, separately, for disability insurance and unemployment insurance were combined into the new government unit called Jobcentre Plus, effectively placing services for recipients of disability and unemployment benefits in a single office within the DWP. Jobcentre Plus provides services through local employment assistance centers where all unemployed clients go for assistance seeking jobs. For example, personal advisors assist clients to search for jobs.

The New Deal 50 Plus program is one government program specific to older people who want to work. Run through the Jobcentre Plus locations, it offers assistance with job searching, training, and through employment subsidies. This program was piloted in 1999 and went national in 2000. Since 1999, over 4,000 people ages 50-64 have received the training grant and over 80,000 have received the employment subsidy. Until April 2003, New Deal 50 Plus participants receive the employment subsidy as a cash wage supplement of up to £60 per week if their wages are under £15,000. In April 2003, the cash employment subsidy will become a tax credit for working individuals.

Quality of Work Life

Flexible working options for older workers is acknowledged as an important issue by government officials, representatives of union and employer organizations, and advocates. Despite the interest, employer organizations and government officials contend that a tax rule prohibits the receipt of employer-provided pension benefits while working for that employer. The government has recently proposed changes to this rule.

Appendix V: GAO Contacts and Staff Acknowledgments

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