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AGEING HORIZONS
Issue No. 5, 3–11

Pension Reform and Age of Retirement Rules

Kenneth Howse, Oxford Institute of Ageing

Documents reviewed

- *Pensions systems: beyond mandatory retirement*. Edited by Elsa Fornero and Paolo Sestito (Cheltenham: Edward Elgar, 2005).
- *Active ageing and European pension systems: synthesis report*. By Karl Hinrichs and Paola Aleksandrowicz (University of Bremen Centre for Social Policy Research, 2005).
- *Live longer, work longer*. By OECD (Paris: Organisation for Economic Cooperation and Development, 2006).
- *Working beyond 60: key policy issues and recommendations*. By Geneviève Reday-Mulvey (Geneva Papers on Risk and Insurance: Issues and Practice, 2005, 30, pp. 604-619).
- *Do different welfare regimes engender different policy preferences? Opinions on pension reforms in Eastern and Western Europe*. By Katalin Velladics, Kène Henkens, and Hendrik P. Van Dalen (Ageing and Society, 2006, 26, pp. 475-495).

Abstract

Changes in age-of-retirement rules form an essential part of a larger set of policy reforms that are intended to discourage early retirement and encourage longer working lives. These reforms are in various stages of consideration and implementation in most of the wealthier ageing societies across the world. Although pension rules on the age of eligibility for benefits are by no means the sole – or even the main – determinant of the timing of retirement, they are clearly important factors in structuring the framework of incentives for continuing attachment to the labour force. This paper looks at how these rules are changing in different parts of the world, and at some of the tensions that exist between the different policy objectives that guide (or should guide) their reform.

Introduction

- In December 2005, in spite of a pair of one-day protest strikes in October, the Belgian parliament approved the so-called 'Generation Pact', a package of measures aimed at encouraging workers to stay longer in the labour force. Although the official state pension age will remain unchanged at 65 years, the age threshold for entitlement to an early retirement pension will be increased from 58 to 60 years.
- Also in December 2005, just two years after Denmark bucked the trend by *reducing* the normal retirement age from 67 years to 65 years, a Danish government commission recommended that this age be increased by one month a year from 2013 to reach 66 years in 2025.
- In March 2006, a bill was introduced in the US Senate to accelerate the transition timetable for raising the full retirement age (i.e. age of entitlement to full Social Security benefits) from 66 years to 67 years, and to introduce longevity indexing into the formula used to calculate benefit levels. Unlike the President's own proposals to 'fix' Social Security, this particular Senate bill (which should be seen mainly as a vehicle for promoting debate) would maintain the pay-as-you-go system in Social Security.
- In the autumn of 2005, and then again in February 2006, the threat of strike action from public sector unions forced the United Kingdom government to back down over proposals to increase the age of retirement for civil servants and local government workers from 60 to 65 years. Shortly afterwards, following the report of the Pensions Commission at the beginning of April 2006, the government published a set of proposals for pension reform, which incorporated the Commission's recommendation for a gradual increase in the state pension age – from 65 years to 67 years. The Trades Union Congress is one of several organizations that have already made it clear[1] that it would be opposed to such a measure.

Proposals such as these to raise the age of eligibility for retirement pensions have become commonplace in high-income countries in recent years. Sometimes, as in Belgium or the UK, the proposed changes target the right to retire earlier than the official or standard pensionable age. Sometimes, as in Denmark or the USA, they target the official or standard retirement age itself. Either way, as the strikes in Belgium and the threatened strikes in the United Kingdom have shown, proposals that require individuals to wait for longer – whether in work or out of it – before being entitled to receive their pension benefits may prove very unpopular and difficult to implement. National governments, international agencies, think-tanks and academic analysts are nonetheless virtually unanimous in the view that later retirement and longer working lives are an essential component in any sensible strategy to cope with the fiscal and economic challenges of population ageing. It is accepted that the institution of retirement has to be adjusted to fit the changing demographic circumstances, and the age at which people become eligible for their pensions defines one of its main parameters. What has given added urgency

and weight to the effort to delay retirement in ageing societies is the long-term trend, especially marked in Europe, towards *earlier* rather than later retirement. Not only do we live longer than we did 50 years ago, but the average working life is now much shorter. Although in some countries the trend towards earlier retirement has been accompanied by a lowering of the 'official' or 'standard' pensionable age, more usually it has been marked by a widening gap between the 'official' and the *effective* age of retirement. Unless governments *reverse* the trend towards earlier retirement they stand little chance of coping successfully with the challenges of population ageing.

The benefits of later retirement and longer working lives

Both the OECD and the EU make no bones about the fact that later retirement and longer working lives are an essential part of the solution, not only to the problem that declining 'system dependency ratios' pose for the finances of public pension schemes – but also to the wider economic challenges of population ageing. It is for this reason that changes in age-of-retirement rules for pension systems have come to be seen as part – though *only* part – of larger reform 'packages' that address these connected, but nonetheless distinct, problems. How should government reform pension systems so as to secure their long-term financial viability? How should government set about changing retirement behaviour so as to extend the period of economically active life in an ageing population?

Delaying the transition from work to retirement as (part of) the solution to the problem of the financial sustainability of public pensions

PAYGO pension schemes with Defined Benefits are vulnerable to population ageing because it increases the ratio of pensioners to contributors. In order to maintain the basic structure of the scheme and avoid an accumulating deficit, it is necessary to change the framework of rules that govern contributions and entitlements. An increase in the age of entitlement to a pension has the effect of decreasing the ratio of pensioners to contributors[2], and so offers a policy alternative to reduced benefits or higher contributions as a way of maintaining long-term financial viability under conditions of population ageing. There are, furthermore, good reasons for governments to prefer a strategy of delaying retirement to the other 'parametric' approaches to pension reform (i.e. reforms that look to keep the basic structure of the pension system unchanged). It is preferable both to a reduction in benefits, since it allows governments to deal with the fiscal problem without undermining individual pension adequacy; and also to an increase in contribution rates, certainly in those countries which already have relatively high unemployment and are looking to reduce rather than increase taxes on labour. An increase in contributions is also widely perceived as unfair to the future taxpayers who have to bear the costs of such a policy.

The actual size of the increase in the retirement age that would be required, without any other changes in contributions or entitlements, to maintain the financial viability of a PAYGO pension scheme varies considerably from country to country, very large in some, not so large in others. Even so, the judgement that it would be politically unacceptable to delay access to pensions by the number of years required for this purpose seems common to most governments that have enacted pension reforms over the last decade. The tightening of age-related restrictions on eligibility to public pensions has rarely, if ever, taken the entire burden of restoring sustainability to pension systems threatened by population ageing. Changes in age-of-retirement rules for public pensions have generally been implemented along with other reforms that are intended to lead to lower average replacement rates (in defined benefit schemes) and also to shift at least some of the costs of provision onto defined contribution schemes.

> As of 2004 only 3 out of 23 countries [in the OECD] have set the pensionable age to higher than it was in 1949, while life expectancy in 2035 is projected to be roughly 8 years higher than in 1949. Thus the [enacted] increases in pensionable age are not sufficient to offset the added soc1al security benefit payments due to longer life expectancy.
>
> Turner, 2005, p.19

Delaying the transition from work to retirement as (part of) the solution to the economic challenges of population ageing

Longer working lives have important benefits beyond their impact on the finances of PAYGO pensions, and since the late 1990s policy pronouncements on this matter have tended to highlight the wider benefits of delayed retirement for *both* the individual *and* the economy. As early as 1998 the OECD refocused debate on the implications of population ageing for pension reform away from a narrowly defined fiscal problem to a broader concern with individual pension adequacy. For people who are not reliant on a defined benefit PAYGO scheme for most of their retirement income an extended working life helps maintain economic wellbeing in later life. A longer working life enables people to accumulate greater 'pension wealth' *and* shortens the period of time over which they depend on this wealth for their income[3]. Pension reforms which ensure that a growing proportion of the retired populations of most OECD countries will be increasingly dependent on defined contribution schemes provide governments with a good reason to encourage later retirement and facilitate continued work.

And for ageing societies that are threatened with stagnation, or even decline, in their labour supply, increased economic activity among the older population will help to maintain general prosperity and provide the government with more revenue to pay for public goods and services. Increasing the labour participation of older workers is by no means the only

solution to the problems that population ageing poses for advanced economies with relatively large welfare systems[4], but it does seem to be an essential part of any workable solution. And this is why Scandinavian countries which already have relatively high employment rates for older workers are being urged to do more to increase their labour force participation even further (OECD 2005e).

Delaying the transition from work to retirement and 'active ageing'

In most advanced economies, exit from employment usually entails more than loss of income. Paid employment has become the dominant form of productive activity through which individuals acquire social status, self-esteem and a structure of daily time use. Exit from employment means loss of participation in a domain of social activity that for most people has a wide range of important non-economic benefits. If these benefits can be found elsewhere, all well and good. If they cannot, if individuals find themselves in a situation which "favors passive time use...underutilizes remaining productive capabilities and fosters disengagement" (Hinrichs and Alexandrowicz, 2005, p.3), then their well-being – perhaps their health - is likely to suffer. In short, delaying the transition from work to retirement helps promote 'active ageing', which is itself an important ingredient of 'successful ageing' (DWP, 2005).

Push and pull

There is a now a considerable body of research which emphasises the importance of pension and welfare arrangements in determining the balance of advantages that frame individual decisions about withdrawing from the labour force before the official retirement age. Individuals are 'pulled out' of the labour force by a combination of financial arrangements (favourable provisions for early retirement and/or easy access to 'pre-retirement' benefits) which make the choice of work over leisure look increasingly unattractive. This problem is most evident perhaps in the way in which pension schemes adjust (and fail to adjust) benefits to take account of the timing of retirement. Evidence from large comparative studies (Gruber and Wise, 2002; Duval, 2003) strongly suggests that the difference made by additional (or fewer) years of contributions to the total expected income from a pension has an effect on retirement behaviour[5].

> … Striking the right balance between guaranteeing an adequate income for older workers, while not undermining work incentives, is a challenge facing all OECD countries.
>
> OECD, 2004b, p.57

There is, however, another side to this story, and it has received increasing emphasis in both research and policy-making circles in the last few years (OECD, 2006). The continuing participation of older workers in the labour market depends not only on the choices they make about supplying their labour. It depends also on the choices that employers make about recruiting and retaining older workers – on the demand for their labour. Older workers may be 'pushed out' of the labour market if employers believe that their businesses would perform better without them – because they are seen to be more expensive than younger workers or more difficult to retrain or less productive or a more appropriate target for redundancy. 'Push' factors explain early retirement as an effect of exclusionary labour markets (Jensen, 2005); and there is plenty of reason to suppose that labour markets do indeed work in this way for older people – though it is quite a different matter to assert that early retirement is *first and foremost* an outcome of exclusionary labour markets, or that the appearance of worker choice in this matter is more illusory than real (Vickerstaff, 2006). Older workers may also of course be 'pushed out' of the labour market by deteriorating health or disability; and European data would seem in fact to suggest that a slightly higher proportion of permanent withdrawals from the labour force are to be explained by health problems than by dismissal or redundancy (EU, 2004).

A culture of early retirement?

According to a Eurobarometer survey conducted in 2003, the average *preferred* retirement age for men in the EU-12 was 58.1 years[6]. These men did not expect to see their preferences satisfied, however. They expected in fact to work for about four years beyond their preferred retirement age. Even their *expected* retirement (62.2 years), however, was considerably lower than the legislated 'standard retirement age' in nearly all the EU countries. A similar gap between preference and expectation was found with women, though in this case the expected retirement age (61.4 years) was often higher than the legislated retirement age[7]. More recent surveys conducted in Canada (PRI, 2005) as well as selected EU countries have produced almost identical results – a sizeable gap between preferred and expected retirement ages.

Where public opinion surveys have asked about policy preferences, the results suggest that most people (in Europe anyway) would prefer to pay for a longer retirement through increased contribution rates rather than longer working lives – though the strength of the aversion to an extended working life does vary quite considerably from country to country – being relatively strong, for example, in the set of countries surveyed as part of a recently completed 'active ageing' research programme (Hinrichs and Aleksandrowicz, 2005), and relatively weak in the countries that participated in the trans-national Population Policy Acceptance Study (BIB, 2005). There is, though, an important qualification to make here: what people find objectionable is the prospect of an increase in the *official* retirement age; they are more accepting of proposals to abolish or limit opportunities for retirement *earlier* than the official retirement age (Velladics *et al.* 2006). It is interesting furthermore to note that in

Germany, where the nature of the reform agenda has concentrated a lot of research attention on this particular question, it looks as though most older workers would actually prefer to see some reduction in their pension rather than work for longer (Jung, 2004).

Although the evidence from national labour force surveys makes it clear that the trend towards earlier retirement has been stopped – and even reversed in some countries – it would be rash to deny the persistence of an early retirement culture.

> Societal expectations settle very fast at a lowered retirement age, whereas it is a lengthy and troublesome political task to retirement preference into the opposite direction again – almost comparable to squeezing toothpaste back into the tube. Financial disincentives and, even more, the non-availability of public pensions as early as was possible until recently will drive individual expectations on retirement age upwards, but this course of policy is largely disliked.
>
> Hinrichs and Aleksandrowicz, 2005, p.50

The idea of *having to* work for longer in order to become eligible for a pension is not at all popular.

The rationales for early retirement and 'pre-retirement' schemes

The United Kingdom has no provision for early retirement in its public pension system. The rules do not allow individuals to receive public pension benefits earlier than the standard State Pension Age[8]. Nor are there any special arrangements for public 'pre-retirement' benefits of the kind that are still to be found in many of the high-income countries of the OECD[9]. Legislating increases in the standard retirement age may make very little difference to the effective age of retirement if early retirement pensions or special pre-retirement benefits allow individuals to withdraw from the workforce before the official age.

Early retirement schemes come in various shapes and sizes, and they do not all have the same policy rationale. Although they all (by definition) facilitate early retirement by allowing individuals to draw pension benefits before the standard or normal retirement age, they may justify departure from the age norm in different ways. US Social Security is a clear example of a scheme which combines flexibility in the choice of retirement age with actuarial neutrality in adjustments to benefits levels, i.e. regular benefit payments are decreased by an amount that is designed fully to offset both the reduced contribution period and the (expected) longer retirement period. There are two basic requirements for eligibility for early retirement in the US Social Security system – a minimum age and a minimum period of contribution. The fundamental rationale for designing a pension scheme so as to allow early retirement on these conditions, whilst preserving actuarial neutrality, is *choice*. The scheme opens up a 'retirement corridor' within which individuals can choose the age at which they will leave the workforce and start drawing their pension benefits; and it is thought better that individuals should have some freedom of choice over their age of retirement than none. The ability to exercise choice in this matter is seen as welfare-enhancing for the individual, even though the net lifetime value of the pension is not affected by the way in which this ability is exercised.

Choice is not the only rationale, however, for allowing early retirement, as is apparent in various schemes – either recently abolished or still in existence – which have *not* attempted to preserve actuarial neutrality in benefits, but have instead granted the right, under special conditions, to retire on a full (or only slightly reduced) pension before the official retirement age. The point is that a single fixed retirement age may seem unfair or unreasonable in its failure to take account of particular circumstances and contingencies beyond the control of the individual. It is these various circumstances and contingencies – conditions that apply over and above the bare fact of being a certain age – that have formed the rationales for the gradually extending right to early retirement.

Fatigue and reduced capacity to work

VERP, the main pathway to early retirement in Denmark, was established in the 1970s to allow "fatigued (but not disabled) older workers a way to leave the labour market before they became entitled to the old-age pension at the age of 67" (OECD, 2005b, p.61). Similar provision was made in the Austrian public pension system for early retirement on grounds of 'reduced capacity for work'. Both schemes identify a health status that is clearly intended to acknowledge a form of age-related loss of capacity that falls short of medically recognised disability; and it is not difficult to discern the rationale for such a policy. Granted that this age-related loss of capacity must make work more difficult for some individuals than for others – and that individuals are as variable in their susceptibility to this condition as they are to age-related disability – it may seem unfair to require everyone to delay their retirement until the same age. And why should individuals be expected to delay their retirement if they are already suffering from the kind of age-related loss of capacity that surely forms part of the justification of the very institution of retirement? In a country like Denmark, the fact that the official pension age is relatively high provides an additional rationale for the scheme[10].

By the end of the 1990s, 50% of Danish women and 43% of Danish men in the 60-66 year age group were retiring through VERP. What had been introduced as a special right had become transformed into a general right. Although VERP was reformed in 1999 with a view to delaying uptake from 60 to 62 – and the government now proposes to increase the earliest age of uptake from 60 to 63 – it is still going strong. The Austrian scheme, on the other hand, was

abolished in 2000, since which time, however, claims for disability pensions have increased considerably (OECD, 2005a).

Seniority pensions

In 1995 the Italian pension system was radically restructured as a result of the so-called 'Dini reforms', which legislated for the replacement of a complicated system of defined benefit schemes by a harmonised system based on 'Notional Defined Contributions'. The new system is to be phased in, however, at a gentle pace. Only workers entering the labour market after 1995 will have their entire pension based on the scheme. Workers with at least 18 years of contributions (in 1995) will have their pensions based entirely on the old system; and workers with less than 18 years of contributions (in 1995) will have a mixed pension. This means that even in 2050 "the stock of pensions calculated (fully or partially) according to the old defined benefit rules will remain around 45 per cent" (Marano and Sestito, 2005, p.149).

One of the distinguishing features of the old system is the availability of seniority pensions (*pensione di anzianità*). Although they are to be phased out under the new system – which will combine a flexible retirement age with full actuarial neutrality in the calculation of benefits – for the time being they remain important as a route to early exit from the workforce. Eligibility requirements have been progressively tightened by successive reforms since 1992 (when the official retirement age was raised by 5 years for both men and women to 65 and 60 respectively). The 2004 Berlusconi reforms – which were strongly resisted by the labour unions – will gradually increase the minimum age for a seniority pension, previously set at 57 years for someone with 35 years of contributions. By 2015 workers with 35 years of contributions will only be eligible for a seniority pension when they reach 62 (OECD, 2004a).

Although seniority pensions are in some respects a peculiar feature of the Italian system – illustrative of the way in which social policies were such an important currency in collective bargaining in the post-war period – they are not merely an extravagant relic of Italy's former addiction to deficit financing. Italy is not unique in having pension rules which base eligibility on the length of a working career rather than age. In France, for example, which has a relatively low official retirement age (60), it is possible for someone who started work very young (14-17 years) to take early retirement with a full pension if they have paid contributions for at least 40 years (OECD, 2005c). The rationale for such rules can readily be found in an appeal to social justice: they help 'level the playing field' between those who enter the labour market late (usually because of tertiary education) and those who enter it relatively early, since otherwise more contribution years would be required from workers with less earnings power.

Special rights for special jobs

Prior to the 1992 'Amato' reforms in Italy, public employees could retire with a seniority pension after a mere 25 years of contributions. Workers in the private sector had to accumulate an additional ten years of contribution. These so-called 'baby pensions' provide an extreme example of pension system rules that treat public sector workers more favourably than private sector workers. To rest the case for this kind of favourable treatment on the mere identity of the employer (state rather than private corporation) is not as acceptable as perhaps it once was. It is still quite common, however, for special rules to be applied to individuals undertaking work that is judged to be unusually arduous or hazardous. The rationale is that they have a shorter life expectancy that the average worker.

In Poland, for example, in 2005, the government reluctantly conceded that miners should have their right to early retirement prolonged indefinitely – instead of having to wait, like everyone else, until they are 65 – now the official retirement age. They will be able to retire after 25 years work underground. And in Austria, workers doing strenuous or heavy work have been excepted from the general age-of-retirement rules implemented as part of the 2005 pension reforms. The reforms establish a single retirement corridor (62 to 68) for most of the workforce, who will as a result be able to retire before (or after) the official pensionable age of 65 with appropriate reductions (or increases) in benefits. For workers engaged in strenuous or heavy work, however, every additional year of such work above a threshold of 15 years will reduce the pension eligibility age by three months.

In France, there are (still) various special pension schemes, which allow workers whose jobs are deemed to be unusually hazardous or tiring to retire before the relatively low standard pensionable age of 60. This includes everyone working in public services classified as "active". Police officers, fireman, nurses, prison guards and blue collar government workers can all retire between 50 and 55 years of age. The fact that police officers working in administrative positions have the same rights in this respect as field officers lends some colour to the OECD view on this matter, which is that the entitlement is "linked to a status rather than any real arduousness in the job itself" (OECD, 2005c, p.66).

Job loss and unemployment

When commentators criticise the provisions for early retirement that proliferated in Europe in the 1970s and 1980s, what they usually have in mind are schemes that were intended to relieve some of the pressures of rising unemployment by smoothing the path out of the labour force for older workers. By offering early retirement as an alternative to unemployment, these schemes not only relieved older workers who had lost their jobs of the necessity of trying to find work in a difficult labour market, they also made it easier for employers to shed older workers as part of the process of 'downsizing' and 'restructuring' their businesses. The pension system was to

be used as a way of cushioning older workers against the effects of unemployment, thus facilitating industrial restructuring and easing competition for jobs.

Germany is one of several countries in the EU which retains the elements of such a scheme (OECD, 2005d). It has high unemployment, especially in the eastern *Länder*, and long term unemployment still gives older workers the right to an early pension. If they have been unemployed for 12 months, they do not have to wait until they reach the standard retirement age (65 years) in order to become eligible for their retirement pensions - and generous unemployment benefits help to bridge the period between job loss and the receipt to an early pension[11]. Although recent reforms have retained the provision for an early ('unemployment') pension, the rules and conditions have been changed quite substantially. As from 2008, the earliest age at which it will be possible to receive the state retirement pension will be raised from 60 years to 63 years, and the period of entitlement to full unemployment benefits will be reduced from 32 months to 18 months, – which means that the age at which early exit becomes feasible through these pathways will be increased by more than 4 years, from 57 years and 4 months to 61 years and 6 months. Workers who exhaust their entitlement to unemployment benefits before they become entitled to an early retirement pension will presumably be referred to benefit schemes that are not designed to 'bridge' extended periods after an irrevocable termination of employment (i.e. are less generous).

The UK provides a useful contrast with Germany – and illustrates the point that private occupational pensions may be just as effective as public pensions in smoothing the path out of employment for older workers and thereby facilitating industrial restructuring. In the late 1980s and early 1990s, it was the availability of generous early retirement windows in defined benefit occupational pension schemes – funded by the large surpluses that the stock market boom had generated in the pension funds – that allowed many employers to "downsize and restructure" their workforces (Disney, 1999). In Germany employers and unions could happily agree to pass on (to taxpayers) the costs of a process of downsizing and restructuring which suited both their interests (Ebbinghaus, 2006). In the UK, the costs of the same process were born not by the employer or indeed taxpayers – but by the pension funds.

> If, for sound economic and financial reason, society expects workers to remain longer in the labour market, the need for a diversity of ends of careers must ... be accepted. The public debate on this issue and the policies to which it gives rise must therefore accommodate a limited number of exceptions to a later exit age...In other words, if major resistance to the new measures is to be avoided, employers and the public authorities must ensure that the new policies pave the way for a wide range of end-of-career options and modes of transition into retirement.
>
> Reday-Mulvey, 2005, p.610

Policy responses

Many countries with large PAYGO public pension schemes with defined benefits have enacted reforms that will reduce the generosity of public pensions at the same time as they have tried to expand alternative or supplementary provision for retirement income through funded schemes[12]. The effect of these twin measures is to sharpen the incentives for delaying retirement and continuing in employment. Changes to age-of-retirement rules, which all have the effect of "reducing the degree to which individuals can leave the workforce early without bearing at least some of the cost of doing so" (OECD, 2006), have often been embedded in these broad reforms and constitute an important part of the whole reform process.

Reforming early retirement schemes

Although some governments have succeeded in closing down particular early retirement schemes, they have by no means disappeared. In Austria, for example, long-term unemployment no longer confers a right to an early retirement pension; the provision was removed as part of a set of reforms enacted in 2004. In Germany, as we have seen, the situation is different. France, Denmark, Norway, Poland and Italy all provide further examples of countries which retain – albeit in modified form – 'special' provisions for early retirement in their public pension schemes. Abolition is clearly proving difficult in many places – and perhaps there are others where it is not even on the agenda. Where schemes are retained, however, conditions have as a general rule been tightened – i.e. earliest age at which it is possible to draw early retirement pension has been raised.

The point has already been made that there is no provision for early retirement in the UK public pension scheme. There is, however, ample opportunity for early retirement (i.e. before State Pension Age) in most of the private or occupational pension schemes which form an increasingly large proportion of the retirement income of the majority of pensioners. And even though the government recently decided to raise the age threshold for receipt of a non-state pension from 50 to 55 years (by 2010), this still leaves plenty of scope for early retirement[13]. It must indeed be a small minority of people who opt to draw on their occupational pension before they reach the age of 55.

Flexible retirement ages and the appropriate adjustment of benefits

The replacement of provisions for early retirement that attempt to take account of special circumstances and contingencies beyond the control of the individual with a simplified and unified scheme that allows for a flexible retirement age with *full* actuarial adjustment of benefits has been one of the most significant trends in pension reform within the OECD in recent years. In Italy and Sweden this policy shift is being effected by the introduction of Notional Defined Contribution pension schemes. In other countries such as

Spain and Austria the change is being made within the framework of a more Bismarckian-style defined benefit scheme. Either way, the change combines the promotion of choice and flexibility with a clear-sighted attempt to shift the costs of choice onto the individual (and so encourage later retirement).

There are many important questions to be asked about the design of these flexible age retirement schemes, and it should come as no surprise that different countries answer them differently. What should be the earliest age of retirement? And how long should the 'retirement corridor' be? Should there be an upper limit – not to the age at which individuals may choose to draw on their pension – but to the age at which pension benefits are readjusted to reflect additional contributions and/or fewer years of expected retirement[14]?

An increase in the earliest age of retirement generally has a different rationale from an increase in the standard or 'reference' age within this kind of scheme. The decision, for example, to phase in an increase in the so-called Normal Retirement Age for US Social Security pension benefits from 65 years to 67 years should help to maintain the long-term financial viability of the system – and this forms the basic rationale for the change in rules. The same point applies to the proposal (see above) to accelerate the introduction of the later retirement age. Proposals, on the other hand, for raising the Earliest Entitlement Age (EEA) for US Social Security have no real bearing on the financial sustainability of the system (Munnell, 2004). Since the formula which is used to calculate benefits for workers opting for early retirement at 62 years (the current EEA) is already set to be actuarially neutral, an increase in the EEA (e.g. to 63 years) would do nothing for the long-term solvency of the Social Security. The net value of the pension would be the same either way. In this case the main point of raising the EEA would be to protect the pension adequacy of people who might be myopic about the future consequences of accepting the lower level of benefits that go with early retirement[15].

It used to be common for defined benefit schemes – both public and private – (i) to offer no 'rewards' or bonuses for deferral of a pension beyond the standard age[16]; and (ii) to make adjustments (benefit reductions) for early retirement that fell short of what would be required to maintain actuarial fairness. Although this is beginning to change, it is arguable that the adjustments continue to fall short of *full* actuarial fairness in many schemes (OECD, 2006). As to bonuses for deferral, there are plenty of examples to be found, both inside and outside of Europe. The Berlusconi government in Italy, for example, introduced a so-called 'superbonus', paid as a salary increase rather than a pension benefit increase, for workers in the private sector who choose to stay in work even though they are eligible for a full pension. In Australia the Pension Bonus Scheme benefits anyone who defers the basic tax-financed pension for up to 5 years. In the UK, the government has removed a similar 5-year limit to the period over which people can 'earn' extra state pension, and the rules have also been changed to allow this additional pension to be taken as a lump sum. Nor is it necessary for older people to be in employment and paying contributions in order to benefit from these arrangements.

Legislating change in retirement age

Many of the recently legislated increases in standard retirement ages in OECD countries have raised (or will raise) official retirement ages for women to bring them in line with those for men. Arguments for gender equality have thus lent support to a course of action which helps contribute to the financial viability of PAYGO pension systems by delaying access to pensions for a substantial proportion of the working population. With some notable exceptions, most countries seem to have fixed on 65 as the standard retirement age for both men and women – and are not (yet) considering proposals to raise it any further. In Norway and Denmark, however, it is already higher than this; and in the USA legislation has been passed to raise the Normal Retirement Age for Social Security to 67. In France, on the other hand, it is proving difficult to move beyond 60. There are also a few Eastern European countries which stand apart from the common trend of gender alignment. Having previously had relatively low retirement ages for *both* men *and* women (usually 55 for women pre-1990), they have raised the threshold for both – often maintaining a substantial age differential between the sexes, as in Romania, Poland, Lithuania and Slovenia; and often also ending up with an official retirement age for men that is lower than the norm in western Europe.

Eastern Europe also offers examples of countries which have elected to tie retirement age to family size (Velladics *et al,* 2006). This is not just a matter of being credited contributions for periods of child-rearing (though this does happen) but of being rewarded for choosing to have children. In the Czech Republic the retirement age for women will be increased to 59- 63 years by 2013. The upper age applies only to women with no children. The more the children women have, the earlier they can retire. In Slovenia, where retirement ages for both sexes will be raised gradually over the next 15 years, a similar set of arrangements will apply to both men and women, and couples will be able to decide which of them is to retire early.

Longevity indexation

Both the Italian and the Swedish pension reforms have adopted systems which use Notional Defined Contributions as the basis for determining pension entitlements[17]. The level of pension benefits in both systems depends on population life expectancy. An increase in life expectancy after retirement will require an adjustment in the level of benefits if the individual's accrued 'pension wealth' has to be stretched over more years. The mechanisms of longevity indexation are, however, quite different in the two countries. The Italian

scheme provides for a decennial review of the 'transformation coefficient' that is used to calculate the benefit level; which means that the government and the social partners will 'argue it out'. The Swedish scheme, on the other hand, has lifted the issue out of the political arena by opting for an 'automatic' adjustment mechanism[18]. In the US, which has a defined benefit scheme, proposals for incorporating longevity indexation into the benefit formula have already been debated in Congress. There are other ways of indexing pensions to life expectancy besides reducing benefit levels, however. The Danish government, for example, has proposed indexing the standard retirement age to life expectancy; and the French are considering a similar device for tying the minimum contribution period to changing life expectancy.

A final word: choice and flexibility in the timing of retirement

Many of the difficult problems faced by policy makers in considering changes in age-of-retirement rules would seem to result from the pressure to reconcile objectives that can all too easily pull in quite different directions. There is broad consensus about the importance of raising the *effective* age of retirement in ageing societies, and broad consensus also about the desirability of enhancing individual choice and control over the timing of retirement. Part of the solution to the problem of achieving these objectives simultaneously lies with the rule that benefits should be adjusted in an actuarially fair (or neutral) way. Since this rule will shift the costs of the retirement decision onto the individual, fairness requires that its use should be accompanied by changes in the labour market – changes that will remove barriers to employment for older workers and help to make a reality of the ideal of individual choice. Another part of the proposed solution to reconciling the two objectives lies with changes in pension scheme rules that will facilitate gradual or phased retirement – by making it easier for people to draw on their pension while in employment, especially part-time employment (Reday-Mulvey, 2005). There is, however, a third objective in policy-making in this area – the attempt, namely, to secure fairness in age-of-retirement rules by taking account of special contingencies beyond the control of the individual – and this pursuit of social justice must inevitably limit the application

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Notes

[1] In written memoranda to the House of Commons Select Committee on Work and Pensions.

[2] If delayed access to retirement benefits is accompanied by a continuation of work and hence also by additional contributions, it has a 'double dividend' for the finances of the system since there are more contributors as well as fewer pensioners.

[3] Some increase in the length of a working life may be regarded as the 'natural solution' to the problem that the individual faces of apportioning increased life expectancy between work and leisure (Fornero and Sestito, 2005).

[4] Increases in immigration and female labour force participation are among the main alternatives.

[5] The suggestion, however, that recent improvements in the employment rate of older people are evidence of successful policy reforms – i.e. the effect of changes in pension-related work incentives – rather than a more general economic upturn is challenged by some commentators (see e.g. Disney 2005).

[6] The preferred retirement age of men in the UK was one of the lowest on the sample (56 years).

[7] A detailed analysis of these results can be found in Esser (2005).

[8] Though many people receive private or occupational pensions before reaching State Pension Age. According to Banks and Smith (2006) the median age at which men start to draw a pension in the UK is 61 years. The OECD estimate for the average 'age of effective retirement' in British men is higher – at 63 years.

[9] The OECD and most other analysts distinguish between disability benefits, which are formally age-independent, and various special 'pre-retirement' arrangements, which have been introduced *in order to* bridge the gap between early exit and the age of eligibility for a retirement pension.

[10] The AFP scheme in Norway operates on a similar basis, and has a similar rationale.

[11] With some reduction in benefit levels to offset early receipt.

[12] The UK has seen a parallel trend in non-state occupational pensions, where there has been a massive shift away from defined benefit schemes i.e. private sector DB schemes are being closed to new entrants.

[13] Which is not to say that private occupational schemes may not themselves raise the threshold age for DB benefits much higher than this in response to looming deficits. In September 2006 the management of British Airways proposed that the scheme's standard retirement age be increased from 60 to 65.

[14] Diamond (2005) is one of many commentators who argue that the absence of any upper limit would unfairly advantage high earners who enjoy their work.

[15] The proposals of the Pensions Commission in the UK to raise the age of eligibility for the basic state pension similarly have more to do with overall pension adequacy than with the financial sustainability of the state pension. The aim is not so much to 'rescue' a pension system threatened with insolvency as to finance a *more* generous state pension – one of a set of reforms intended to improve pension adequacy, which in the UK means more saving in private occupational pensions.

[16] i.e. the accrual rate would be negative beyond this age.

[17] Such schemes are able to dispense with a 'standard' retirement age. Defined benefit schemes, on the other hand, require, a 'reference' age in order to calculate the actuarial adjustment of benefits for a longer/shorter working life.

[18] The National Social Insurance Board has estimated that the cohort born in 1990 would have to work 2.5 years more than the 1940 cohort to achieve the same benefit levels (OECD, 2003).