Phased Retirement and Workplace Flexibility for Older Adults: Opportunities and Challenges

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Introduction

Older adults are emerging as a major untapped labor source that could expand the pool of available workers and offset the slow growth in the number of adults age 25 to 54 who have traditionally made up the bulk of the nation's workforce. As the U.S. population ages and the number of Americans reaching traditional retirement ages increases, employers may need to attract and retain more older workers, many of whom are highly experienced, knowledgeable, and skilled. Several indicators suggest that many older adults are willing and able to work longer. Survey respondents often report that they wish to remain working after traditional retirement ages, health status at older ages is generally better today than in the past, physically strenuous jobs are now less common than they once were, and the current generation of Americans age 50 and older are better educated than any previous generation. Indeed, labor force participation rates at age 62 and older have soared over the past decade and a half. Nonetheless, older men's participation rates remain lower today than they were 40 years ago.

Employers may need to rethink traditional workplace practices to attract older workers. Because many older people who wish to remain employed do not want traditional full-time work schedules, some employers are experimenting with flexible work arrangements, including part-time employment, flexible schedules, telework, contract work, and job sharing. Some employers are formalizing these initiatives into phased retirement programs, which allow older, seasoned workers to move gradually from full-time employment to full retirement by reducing their hours and responsibilities.

This paper describes the opportunities and challenges of phased retirement. By allowing older employees to move to part-time work with fewer responsibilities, it appeals to those who no longer wish to work traditional full-time schedules, either because of additional personal obligations, worsening health, declining physical energy, or a growing preference for leisure. It also offers important benefits to employers, potentially enabling them to retain the skills, experience, and accumulated knowledge of veteran workers and managers who might otherwise leave the organization and would be difficult to replace. Nonetheless, formal phased retirement programs are difficult to

implement. They complicate the provision of fringe benefits, especially pensions, and could raise age discrimination concerns. Policy reforms could mitigate these problems, but they would necessarily reduce some protections for older workers.

Benefits and Challenges to Engaging Older Workers

The aging population threatens the nation's economic security. The growth of the older population will increase the number of older Americans who qualify for publicly financed retirement and health benefits in coming years, relative to the number of younger adults who typically work and pay taxes. Between 2000 and 2020, the number of working adults for every nonworking adult age 65 or older will fall from 4.5 to 3.3, if current employment patterns continue (Johnson and Steuerle, 2004). The shrinking labor pool threatens American economic growth, living standards, Social Security and Medicare financing, and funding for all other government programs. If current employment patterns and benefit levels persist, workers will have to pay higher taxes to support more retirees, employers will face tighter labor markets (particularly in certain industries), retirement benefits will likely be cut, and the growth in per capita economic output will slow.

But demographic change tells only part of the story. Future outcomes depend largely on individual employment decisions by workers and employers. Although labor force participation rates for older women have been rising over the past half-century as paid employment increased for women of all ages, participation rates for older men are lower now than they were decades ago, when health problems were more prevalent and jobs were generally more physically demanding. In 2009, for example, only 22 percent of men age 65 or older participated in the labor force, down from 47 percent in 1948 (Bureau of Labor Statistics, 2010). If people work longer, the economy can produce more goods and services, boosting living standards for both workers and nonworkers and generating additional tax revenue to fund all kinds of government services. For example, if men age 55 or older in 2020 worked at the same rate as they did in 1950 instead of the rate that prevailed in 2000, the ratio of working adults to nonworking older adults in 2020 would be 4.1 instead of 3.3 (Johnson and Steuerle, 2004). Restoring the 1950 labor force participation behavior of older men would eliminate about two-thirds of the expected drop in the old-age dependency ratio between 2000 and 2020. Alternatively, if every worker delayed retirement by five years, relative to retirement plans based on current work patterns, the additional income and payroll taxes they would pay would more than cover the Social Security trust fund deficit for the foreseeable future (Butrica, Smith, and Steuerle, 2007).

In addition to improving the economic outlook, working longer can enhance individual well-being. Those who delay retirement can raise their own retirement incomes by avoiding early retirement reductions to their Social Security and defined benefit (DB) pension benefits, accumulating more Social Security and pension credits and other savings, and reducing the number of retirement years that they must fund. By working until age 67 instead of retiring at age 62, for example, a typical worker could gain about $10,000 in annual income at age 75, net of federal income taxes and health insurance premiums (Butrica et al., 2004).[1] Delaying retirement may also promote physical and emotional health by keeping older adults active and engaged and imbuing their lives with meaning (Calvo, 2006).

[1] Most people can increase lifetime Social Security benefits by delaying benefit take-up, even if they do not work any additional years (Coile et al. 2002). The system increases monthly payments for those who wait to collect benefits to offset the reduction in the number of payments they receive over their lifetime. But, as life expectancy has increased, these bonuses now exceed the actuarially fair amount, overcompensating beneficiaries who delay claiming.

The Changing Retirement Landscape

The crucial question, then, is whether coming demographic changes will lead to higher employment rates and later retirements for older adults. A number of factors suggest that employment rates for older Americans will rise in the coming years. Improved health and declines in physical job demands leave older people better able to work today than in the past (National Center for Health Statistics, 2010; Johnson, Mermin, and Resseger, forthcoming; Steuerle, Spiro, and Johnson, 1999).[2] Recent Social Security changes increase work incentives at older ages. The normal retirement age for full Social Security benefits recently increased from 65 to 66 and will reach 67 for those born after 1959. Delayed retirement credits have been raised to better compensate retirees who take up benefits after the normal retirement age. And Congress repealed the earnings test—which reduces Social Security benefits for employed recipients who earn more than a limited amount—for beneficiaries past the normal retirement age.

Changes in employer-provided pension and retiree health benefits also encourage boomers to remain at work. Traditional DB pensions, which provide workers with lifetime retirement annuities usually based on years of service and earnings near the end of the career, discourage work at older ages (Stock and Wise, 1990). They often provide substantial subsidies for early retirement and penalize workers who remain on the job past the plan's normal retirement age, because workers who delay retirement by a month forfeit a month of benefits.

Over the past 30 years, however, employers have been shifting from traditional DB pensions to defined contribution (DC) plans (Bureau of Labor Statistics [BLS], 2009; Pension and Welfare Benefits Administration, 2001–2002), which do not encourage early retirement.[3] Employers typically make specified contributions into individual DC accounts that workers access at retirement, generally as lump-sum payments. Because contributions continue as long as plan participants remain employed and workers with a given account balance can receive the same lifetime benefit regardless of when they chose to begin collecting, DC plans do not generally penalize work at older ages. As a result, people in DC plans tend to work about two years longer than DB participants (Friedberg and Webb, 2005). The continued shift to DC plans, then, should increase older Americans' labor supply.

The erosion in employer-provided retiree health benefits is also likely to limit early retirement. Retiree health insurance, which pays health expenses for early retirees who have not reached the Medicare eligibility age of 65, discourages work by reducing retirement costs that arise from the loss of employer health benefits. Workers offered retiree health benefits by their employers retire earlier than workers who lose their health benefits (Johnson, Davidoff, and Perese, 2003; Rogowski and Karoly, 2000). Rising health care costs and the introduction of an accounting rule in 1993 that requires employers to recognize on their balance sheets the full liability of future retiree health costs have led many employers to terminate their retiree health plans. In 2009, only 29 percent of employers with more than 200 employees offered retiree health benefits, down from 66 percent in 1988 (Kaiser Family Foundation and Health Research and Educational Trust, 2009). Additionally, the retiree health benefits that employers provide have generally become less generous over time and now shift more costs to retirees (Johnson, 2007; Laschober, 2004). However, the 2010 health reform legislation (the Patient Protection and Affordable Care Act) will likely reduce the impact of employer-provided health insurance on retirement decisions. The creation of health insurance exchanges in 2014 is

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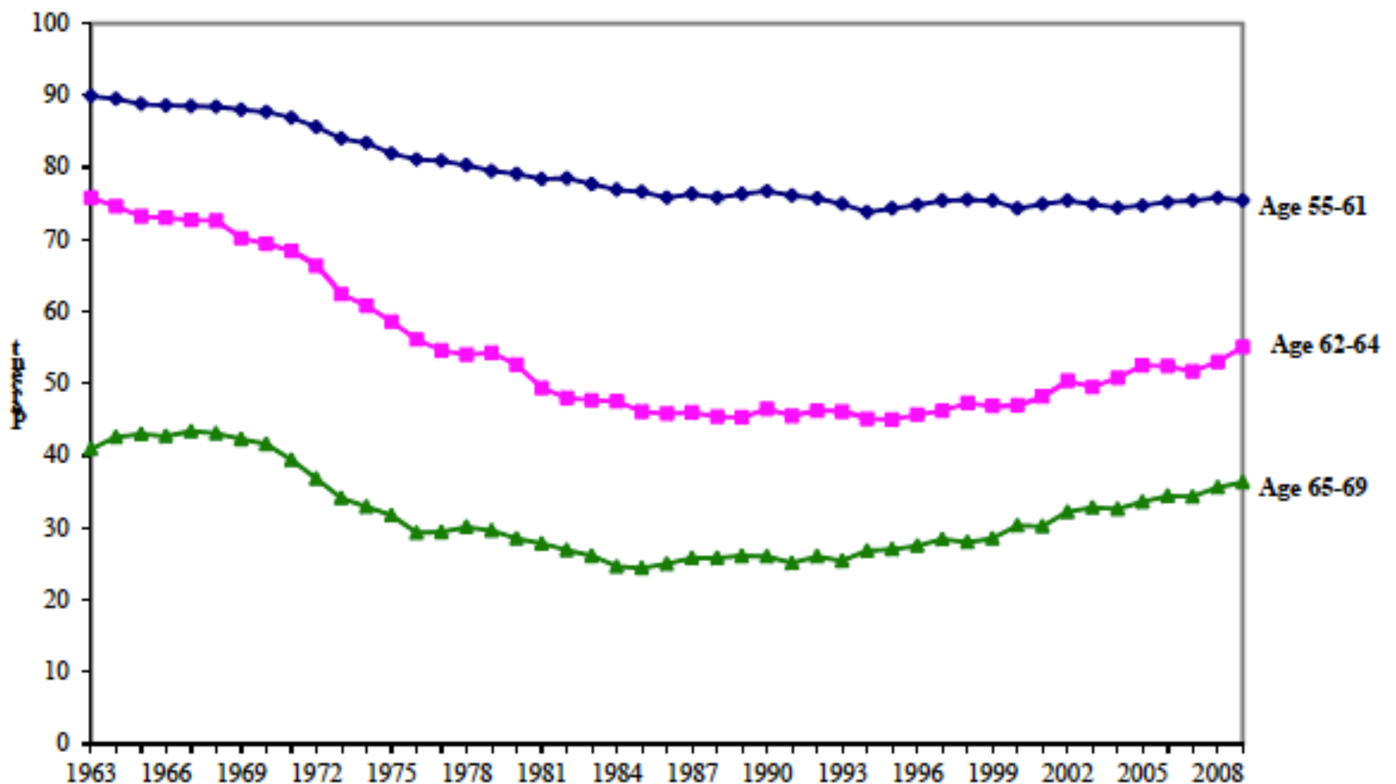
[2] There is some evidence, however, that the trend toward better health in late midlife has ended and perhaps reversed. For example, the share of surveyed adults age 51 to 56 reporting health problems increased between 1992 and 2004 (Soldo et al. 2006), and disability rates at age 40 to 49 increased between 1984 and 2000 (Lakdawalla, Bhattacharya, and Goldman 2004).

[3] DB plans continue to dominate in the public sector, however. In 2009, 79 percent of state and local government employers participated in DB pension plans (BLS 2009), and the federal government offers a DB plan to nearly its entire workforce.

expected to reduce substantially the cost of nongroup health insurance, limiting the incentive for workers without access to retiree health benefits to remain with their employer until they qualify for Medicare.

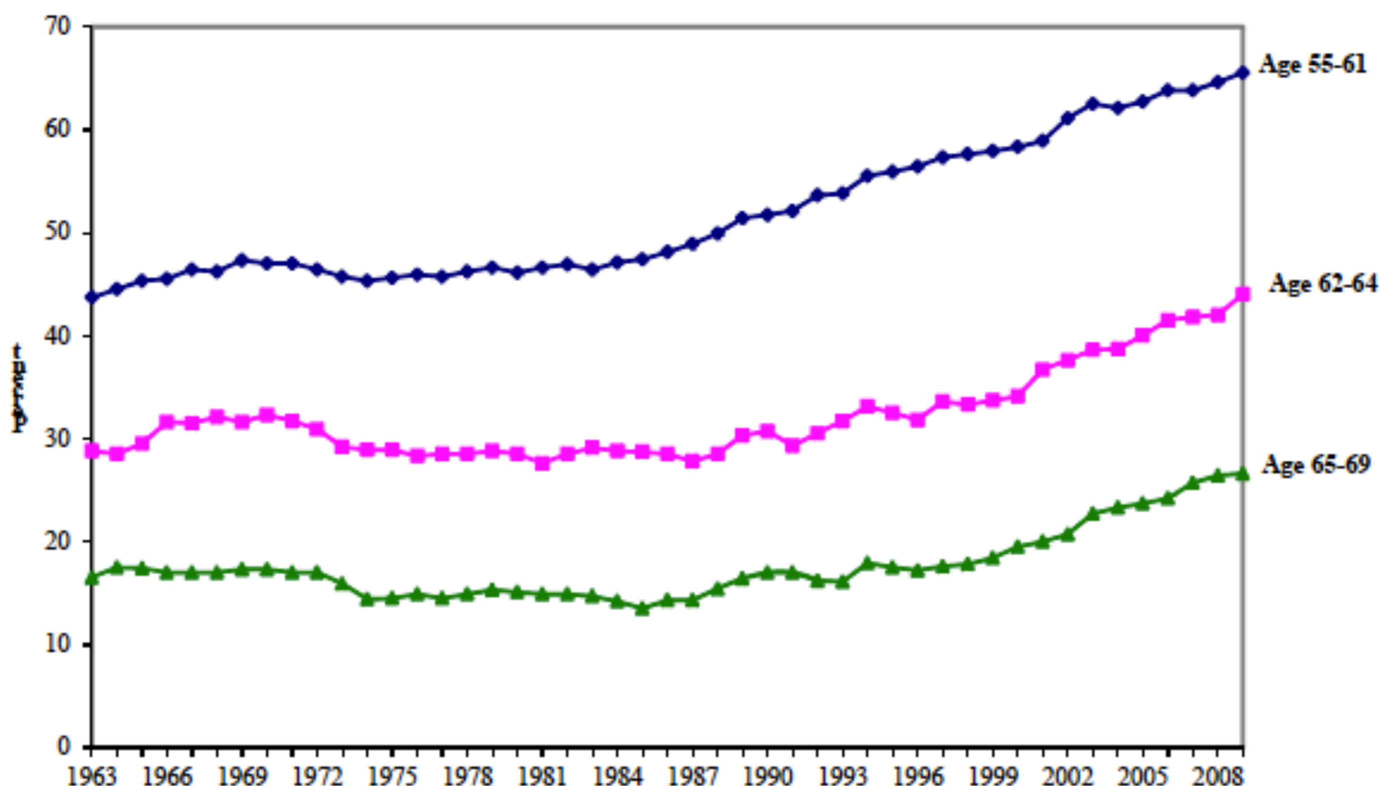
It is not surprising, then, that older adults are now working longer than they did 20 years ago. The share of older men participating in the labor force declined steadily until about 1990, but then began increasing among those age 62 and older. Between 1994 and 2009, male labor force participation rates increased from 45 to 55 percent at age 62 to 64 and from 27 to 36 percent at age 65 to 69 (figure 1). The increase among men older than 65, when Medicare eligibility begins, suggests that the desire for health insurance coverage is not the sole factor boosting participation rates. Over the same period, female labor force participation rates rose from 33 to 44 percent at age 62 to 64 and from 18 to 27 percent at age 65 to 69 (figure 2), reflecting the aging of a cohort of women with higher participation rates at younger ages than earlier cohorts.

Figure 1. Older Men's Labor Force Participation Rates, by Age, 1963-2009 (%)



Source: Federal Interagency Forum on Aging-Related Statistics (2008) and authors' calculations from BLS (2010).

Figure 2. Older Women's Labor Force Participation Rates, by Age, 1963-2009 (%)



Source: Federal Interagency Forum on Aging-Related Statistics (2008) and authors' calculations from BLS (2010).

Several surveys also suggest that boomers intend to work into old age. For example, 68 percent of older workers in one poll said they intended to work in retirement (AARP, 2003). The mean self-reported probability of working full-time past age 65 among workers age 51 to 56 participating in the Health and Retirement Study increased from 27 percent in 1992 to 33 percent in 2004 (Mermin, Johnson, and Murphy, 2007). A MetLife survey found that boomers are increasingly concerned about their ability to afford an early retirement (MetLife Mature Market Institute, 2005).

Challenges Confronting Older Workers and Employers

Despite these encouraging signs, a number of obstacles remain to lengthening work lives, discouraging both employees from working longer and employers from hiring and retaining them. On the labor supply side, Social Security payroll taxes create disincentives to work at older ages for people who have spent most of their adult lives in the labor force. Social Security benefits are based on average indexed monthly earnings, computed over the 35 years with the highest indexed earnings. For workers with fewer than 35 years of employment, an additional year of work and contributions eliminates a year of zero earnings from the benefit computation, often raising future benefits substantially. But for those with longer employment histories, an additional year of work will raise future Social Security benefits only if current earnings exceed adjusted earnings in the least remunerative of the top 35 years already used in the computation. This gain in benefits is not typically large enough to compensate for the additional payroll taxes that workers must pay (Butrica et al., 2004).

Even for older workers who have not completed 35 years of qualified work the net increase in Social Security benefits is often small because the benefit formula favors people with low lifetime earnings over those with high lifetime earnings. In addition, workers married to higher-earning spouses often receive no additional Social Security benefits in return for the payroll taxes they pay, because many end up collecting benefits based on their spouse's earnings history.[4]

Social Security's retirement earnings test remains in effect for those who have not yet reached the full retirement age, currently 66. The earnings test reduces current benefits for people who have not reached the full retirement age by $1 for every $2 of earnings above a specified annual threshold, set at $14,160 in 2010 (and adjusted each year by the average change in earnings). Many of those whose benefits are taxed away would eventually recover or more than recover them (depending on how long they live) through higher benefits in the future, but many people are unaware of (or do not respond to) this feature of the law. In addition, the earnings test may signal older people that they should not work, discouraging employment more than the financial incentives alone imply.

Certain fringe benefits also discourage work at older ages. As noted earlier, workers in DB pension plans often lose pension wealth if they work beyond the plan's normal retirement age. Although these plans are much less common now than they once were, they continue to cover about one in five workers in the private sector (particularly those in large, unionized firms) and nearly all workers in the public sector (Bureau of Labor Statistics, 2009). Retiree health benefits also encourage retirement before age 65 by providing affordable health insurance before Medicare eligibility for people who choose to stop working. Many people without retiree health benefits are forced to work until they qualify for Medicare at age 65 because private nongroup insurance is expensive at older ages, especially for people with health problems. Although these benefits are also disappearing, nearly all public-sector workers and about one in six private-sector workers had access to retiree health benefits from their employers in 2003 (Buchmueller, Johnson, and Lo Sasso, 2006).

On the demand side, the perceived high costs of older workers may deter employers from hiring and retaining them. For example, wages usually rise with age. If this relationship reflects only age-related productivity gains, then it should not pose employment barriers for older workers. But it may also reflect the workings of internal labor markets that tie pay to seniority regardless of individual productivity. Average health care costs also rise with age, raising the cost of employing older people and often making total compensation rise with age more quickly than productivity. Medicare secondary payer rules, which designate employer-sponsored health benefits as the primary payer of health care costs for Medicare-covered workers, further raise the cost of workers age 65 and older. DB pension plans raise the cost of hiring and retaining older workers because pension benefits in traditional plans that pay benefits based on highest earning years accrue rapidly in the years immediately before the plan's retirement age.

Older workers may also face age discrimination in the workplace. In a 2005 survey of 800 adults working or looking for work, 36 percent said that employers treated older workers less fairly than younger workers, and 71 percent said that older workers were more likely to be laid off (Reynolds, Ridley, and Van Horn, 2005). Fully 60 percent of workers age 45 to 74 responding to a 2002 survey said they felt older workers were the first to go when employers cut back their workforces (AARP, 2002). Two-thirds of the same group of respondents said they believed workers face age discrimination in the workplace, based on what they had experienced or seen.

[4] As married women's average lifetime earnings increase relative to men's, however, more married women are receiving benefits based on their own earning histories.

Quasi-experimental evidence provides additional evidence that some employers may favor younger workers over older workers. One study examining how managers reacted to hypothetical workplace situations found that they generally perceived older workers as less flexible and more resistant to change than younger workers and that they were reluctant to promote older workers to jobs requiring flexibility, creativity, and high motivation (Rosen and Jerdee, 1995). Another study found that employers were less likely to call back older job applicants than otherwise identical younger applicants (Lahey, 2008). And it takes laid-off workers age 50 and older much longer than younger workers to become reemployed, even though older unemployed workers appear to search just as intensively as their younger counterparts (Johnson and Mommaerts, 2010).

There is also evidence that some employers are reluctant to invest in training older workers (Frazis, Gittleman, and Joyce, 1998). Without adequate training, older workers run the risk of having their skills become obsolete, particularly in industries undergoing rapid technological change. Employers may fear that they will be unable to recoup their training costs before older workers retire.

Using Phased Retirement to Promote Workplace Flexibility

Flexible work arrangements are a potential tool that employers can use to retain older workers. They generally appeal to older adults who no longer wish to work traditional full-time schedules, either because of additional personal obligations (such as the need to care for aging parents or spouses or help with grandchildren), worsening health, declining physical energy or stamina, or simply a preference to sacrifice some income for more control over their time without giving up paid employment entirely. Older workers may have accumulated enough savings or gained full or partial access to pension benefits and employer-sponsored health benefits so they can maintain their living standards with lower earnings but still need some labor income. An AARP poll found that 38 percent of older workers want to phase into retirement gradually instead of leave the labor force altogether (AARP, 2005b). These arrangements typically include part-time employment and flexible schedules. They often require changes in work assignments to accommodate new work schedules.

Many younger workers also value flexible work arrangements, which can help maintain work-life balance throughout the lifecourse. Some employers, however, offer these arrangements only to older workers who are transitioning into retirement. These opportunities for phased retirement, which combine flexible work schedules and reduced hours with reduced job responsibilities, can enable employees to extend their careers with the same employer (or at least the same occupation or industry) instead of moving to self-employment or to different occupations or sectors where part-time work schedules are more common (such as retailing). By enabling older workers to stay in the same firm or occupation, these arrangements benefit both workers and their employers. Employees can continue to use the human capital and experience that they have accumulated over a lifetime of work, allowing them to earn more with their existing employers than with different employers. Employers are able to retain the specialized skills and knowledge that their seasoned workers have developed, and avoid the search, hiring, and training costs that result when employees separate.

Phased retirement programs are often difficult to administer, however. They complicate the provision of fringe benefits, especially for employees in DB pension plans. Most older workers cannot afford to reduce their work hours and earnings, particularly before they begin collecting Social Security, unless they can receive employer-sponsored

pension benefits. As Sheaks, Pitt-Catsouphes, and Smyer (undated) point out, access to benefits depends on whether phased retirees move directly from full-time work to part-time work or return to the employer after a temporary absence, and whether they are classified as employees or independent contractors or consultants. Uncertainty surrounding legal, regulatory, and tax issues involving employee benefits plans and anti-discrimination protections create additional challenges for employers.

Complications for Pension Plans

Federal law and regulations limit in-service distributions from retirement plans (or retirement payments to employees who are still working for the plan provider). DC retirement plan participants are not allowed to collect plan payments based on their own contributions before leaving the employer, unless they are at least age 59 and one-half. Until recently federal law forbade DB pension plans from paying benefits to employees before separation unless they had reached the plan's normal retirement age (which varies across plans but is typically 65). The Pension Protection Act of 2006 (PPA) facilitated in-service distributions by allowing plans to pay benefits to active employees beginning at age 62. The Internal Revenue Service issued final phased retirement regulations in May 2007 that effectively ruled out in-service distributions before age 62 for DB plan participants. Because few workers can afford to partially retire unless they receive retirement benefits, these regulations effectively rule out phased retirement before age 59 for DC plan participants and before age 62 for DB plan participants.

Phased retirees in DB pension plans who are not collecting benefits often lose significant pension wealth when they move to part-time employment. Most DB plan benefit formulas tie payments to earnings received near the end of the career, typically average earnings over the last three or five years on the job. DB plan participants would receive retirement benefits based on relatively low earnings if they back on their work hours in the last years of their career.

Instead of phasing from full-time employment to part-time work, retirees could leave the employer and then return part-time. If they return as employees (instead of consultants, say), any DB pension payments they are receiving may be suspended if they work too many hours (such as more than 40 hours in a calendar month). If they return as independent contractors or consultants, they may have to wait several months before returning to their original employer, because tax laws are unclear as to what qualifies as a termination of employment for purposes of receiving pension or retirement benefits. Several large employers, including MITRE and the Aerospace Corporation, rehire retirees who continue to collect pension benefits (Eyster, Johnson, and Toder, 2008).

Deferred Retirement Option Plans (DROPs). Deferred retirement option plans (DROPs) are one way of getting around the work disincentive effects of DB plan formulas. Under a DROP, workers who reach retirement age can continue working and receive contributions to a retirement fund equal to the pension benefit they would have received if retired. Workers do not receive cash pension benefits, but the amount contributed to the DROP account accrues interest until they actually retire. Upon retirement, employees start collecting the same annual pension benefit they would have received if they had terminated employment at the retirement age, plus they can withdraw the DROP account funds either as a lump sum or as an actuarially equivalent retirement annuity. In effect, the addition of a DROP makes the DB plan age neutral because the present value of the employee's lifetime retirement benefit does not depend on the retirement date. Additionally, the employee does not receive any cash pension benefits until retirement.

Under some plan designs, DROPs can be used to force out employees, especially if the plan is available only between the earliest retirement age specified in the plan and the normal retirement age (Calhoun and Tepfer, 1998).

Further, private-sector employers considering DROPs must deal with a host of complex legal issues under the tax law and the Employee Retirement Income Security Act (ERISA) relating to rules against back-loading pension benefits and against discrimination favoring highly compensated employees. These legal complications have limited the use of DROPs in the private sector.

However, several states and municipalities have adopted DROPs, particularly to deal with public school teacher shortages. Arkansas, California, Louisiana, and Ohio offer them to at least some of their teachers (U.S. General Accounting Office, 2001). In Arkansas, teachers who continue working in "critical need" areas such as math, science, foreign languages, and special education receive more benefits than teachers in noncritical subjects who remain at work. California offers bonuses to teachers who stay on the job once they qualify for retirement. Ohio uses the DROP program to recruit 10 percent of its teachers from its retirees. The City of Philadelphia also offers a DROP to its employees. The city's plan allows employees with 10 years of credited pension service who have reached their normal retirement age to accumulate their monthly service retirement benefit in an interest-bearing account for up to four years and to remain employed by the city (City of Philadelphia Personnel Department, 2007). The program has led municipal employees to delay retirement by 1.25 years, on average, but has also substantially increased the city's pension costs (Alva, Coe, and Webb, 2010).

An alternative approach to reducing the work disincentives created by DB pension plans and making phased retirement more appealing to workers in those plans is to modify the plan design. Employers could switch from a traditional DB plan to a cash balance or other hybrid plan that is essentially age neutral. In cash balance plans, employers set aside a given percentage of salary for each employee and credit interest on these contributions. Interest credit rates are generally tied to some benchmark, such as the U.S. Treasury bill rate. Benefits are expressed as an account balance, as in DC plans, but these balances are only bookkeeping devices. Plans pay benefits from commingled funds invested in a pension trust on behalf of all participants. As with DC plans, cash balance plans do not create strong retirement incentives because they express benefits as account balances that can continue to grow throughout the worker's career (Johnson and Uccello, 2004).

Complications for Other Benefits

Phased retirement also complicates health benefits. Retirees eligible for retiree health benefits can generally receive those benefits if they phase into retirement from full-time employment or return to part-time work. However, questions could arise about how these benefits wrap around Medicare coverage for phased retirees age 65 or older. Medicare's secondary payer rules identify Medicare as the primary payer for retirees with employer-provided health insurance, but as the secondary payer for active workers with employer coverage. Thus, employers could experience unusually high health care costs for phased retirees age 65 and older receiving health benefits.

Phased retirees younger than 65 at employers that do not offer retiree health benefits may have trouble obtaining health insurance coverage (at least until health insurance exchanges are established in 2014). Many employers do not provide health benefits to part-time employees, and making an exception for older workers could violate anti-discrimination rules. Most employers are required to offer continuation coverage to former employers for up to 18 months after separation (or 36 months for disabled former employees), with the health plan participant covering the full premium (plus 2 percent to cover administrative expenses). This coverage, however, might not last until the retiree qualifies for Medicare at age 65. Those rehired as independent contractors or consultants would also be ineligible for health benefits.

Other types of benefits might also be eliminated or reduced for older workers who phase into retirement and move to part-time employment. For example, some employers provide life insurance and long-term disability coverage only to full-time employees. Even when phased retirees are able to maintain coverage, benefits usually decline because they are typically tied to earnings. Life insurance and long-term disability benefits, for instance, are usually computed as multiples of current salary.

The Role of Anti-Discrimination Rules

Another challenge in the implementation of phased retirement programs is that they could conflict with the anti-discrimination provisions of benefit law and the Age Discrimination in Employment Act (ADEA). Employer benefit programs are governed by ERISA and the tax code. ERISA, enacted in 1974 and amended many times since then, sets minimum standards for most private-sector pension and health plans to protect plan participants. The tax code also has authority because many fringe benefits enjoy special tax advantages. The value of employer-provided health benefits, for example, is not generally subject to the federal income tax, and income taxes on pension and retirement cash benefits are generally deferred until beneficiaries receive their payments, as long as they are provided through what are known as qualified plans. In return for these tax advantages, the federal government requires employers to distribute tax-qualified fringe benefits equitably across the workforce. The tax code includes several nondiscrimination tests to verify that employer benefits do not unduly favor highly compensated employees at the expense of lower-paid employees, preventing employers from using fringe benefits simply as a way to avoid taxes. However, these tests can make it difficult for employers to implement phased retirement programs.

One of the tax code's most relevant nondiscrimination rules for phased retirement plans is the benefits, rights, and features test. It stipulates that all the benefits, rights, and features of a plan must be available to all participants. A particular component of a qualified plan meets this test if the share of nonhighly compensated employees benefiting from this component equals at least 70 percent of the share of highly compensated employees benefiting. In other words, a phased retirement program must not attract a much larger share of highly compensated employees than lower-paid employees.

Many formal phased programs may have difficulty meeting this test, because employers may gear phased retirement to highly compensated workers. Employers typically use phased retirement programs to retain highly skilled and experienced workers and managers who may be difficult to replace. These employees are usually well compensated. Employers may be more reluctant to offer phased retirement to less-skilled, lower-paid workers who may not be worth the expense of retaining. Moreover, low-paid employees may be unwilling to participate in a phased retirement program that does not allow for in-service distributions from pension and retirement plans because they may be unable to live on a part-time salary alone.

Congress could ease the benefits, rights, and features nondiscrimination test for formal phased retirement programs to promote flexible, part-time employment by older workers (Workplace Flexibility 2010, undated a). It could exempt phased retirement programs from the test, for example, since the original intent of the standard was to deter tax avoidance, not promote equal access to part-time employment. Or, Congress could reduce the 70 percent rule, making it easier for employers to meet the benefits, rights, and features test. Weakening the nondiscrimination test, however, could reduce low-paid workers' access to phased retirement.

Age discrimination law further complicates phased retirement. The ADEA protects workers age 40 and older from employment discrimination by employers with 20 or more employees. It outlaws discrimination on the basis of age with respect to any term, condition, or privilege of employment, including hiring, firing, promotion, layoff, compensation, benefits, job assignments, and training. Because many employers may choose to offer phased retirement only to certain employees deemed to possess essential skills, the establishment of formal phased retirement programs could expose the employer to ADEA claims, especially if it denies enrollment to relatively old employees (Workplace Flexibility 2010, undated b).

ADEA lawsuits may claim disparate treatment (i.e., employees were treated differently and with discriminatory intent because of their age) or disparate impact (i.e., certain actions led to worse outcomes for older workers, even if the employer did not intend to discriminate). Recent case law suggests that both types of claims would be difficult to prove with regard to phased retirement programs (Workplace Flexibility 2010, undated b). Under the disparate treatment argument, workers denied phased retirement would have to demonstrate that they qualified for the program (presumably because of their skills and experience) and that their denied requests to transition from full-time work to part-time work constitutes an "adverse employment action." Employers could argue that phased retirement is merely a request for a change in schedule, and that decisions on these matters do not qualify as adverse employment actions. Even if workers prevail on these counts employers can refute ADEA claims by simply showing legitimate, non-discriminatory reasons for denying enrollment in phased retirement programs. For example, the employer could argue that the employees in question lack the essential skills it needs in phased retirees.

Instead of pursuing a disparate treatment claim, plaintiffs could allege that a phased retirement program violates the ADEA because it harms older workers, even if the program was not designed to discriminate against them. However, employers could successfully refute such disparate impact claims by presenting "reasonable factors other than age" that guided their enrollment decisions. For example, employers could point to employees' performance, skills, technical background, seniority, and other factors.

Another potential ADEA complication for phased retirement is that ADEA protects workers age 40 and older, yet most employers offer phased retirement only to workers in their fifties and sixties. As a result, workers in their forties could have claimed that a phased retirement program illegally discriminated against them on the basis of age. However, in response to a recent Supreme Court ruling, the U.S. Equal Employment Opportunity Commission issued new regulations in July 2007 clarifying that the ADEA does not prohibit employers from favoring older workers over younger workers (even when the younger workers are age 40 or older).

It would generally be difficult for employees to prove that formal phased retirement programs violated the ADEA, under either a disparate treatment argument or disparate impact argument. However, the legal uncertainties that continue to surround these types of age discrimination claims may be enough to discourage employers from establishing formal phased retirement programs (Penner, Perun, and Steuerle, 2002). Legal costs make lawsuits expensive, even when the defendant prevails, and many employers may choose to forego phased retirement to limit their legal exposure, no matter how small the risk.

Employer Efforts to Promote Phased Retirement

Several surveys have examined the extent to which employers are taking steps to retain older workers. Many firms report that they are concerned about losing talent when baby boomers retire. In a series of AARP state surveys of about

400 to 700 employers, between 55 and 73 percent reported that they were likely to experience a shortfall of qualified workers in the subsequent five years (AARP, 2005a, 2006, 2007a, b, c, d). Similarly, an Ernst & Young survey of 151 Fortune 1000 companies found that 62 percent of employers believe that future retirements will lead to labor or skill shortages. However, fewer employers (between 19 and 37 percent) are taking active steps to prepare for boomer retirements, according to the same AARP surveys and a nationally representative survey of 400 employers by the Center on Aging and Work at Boston College (Pitt-Catsouphes et al., 2007).

Many employers report a willingness to allow phased retirement, but few actually do so. According to a nationally representative survey of 950 employers conducted by the School of Industrial and Labor Relations at Cornell University, 73 percent of employers indicated that "something could be worked out" if a full-time white-collar worker age 55 or older asked to switch to part-time work (Hutchens, 2003). Employers were less likely to allow phased retirement if they were part of large parent organizations, highly unionized, in the public sector (excluding education or social services), less dependent on part-time employees, or more dependent on older workers. Only 36 percent of employers reporting that they would allow white-collar workers to reduce their hours, however, had any phased retirees in the past three years. Other surveys suggest employers may be less likely to offer phased retirement to blue-collar than white-collar employees. The AARP and Center on Aging and Work surveys, which did not specifically ask about white-collar workers, found that 23 to 42 percent of employers offer phased retirement.

While many employers are willing to offer older workers the opportunity to reduce their hours, fewer are willing to offer additional inducements such as full health benefits or in-service pension benefits. For example, in the Cornell survey only 26 percent of employers allowing phased retirement would provide the same health benefits to workers after they reduced their hours. About two-fifths of employers allowing phased retirement in the Cornell survey, but only 9 percent of employers in the Ernst & Young survey, would allow in-service pension benefits.

Currently, most phased retirement opportunities are informal arrangements, not formal programs. Seventy-six percent of employers reporting they would allow phased retirement in the Cornell survey said these arrangements would be informal, as did 83 percent of such employers in the AARP Boston survey and 94 percent of those in the AARP Oregon and New York surveys.

Conclusions

Providing older employees with flexible work options could encourage them to work longer and delay retirement. As workers approach traditional retirement ages, they often prefer to reduce their hours, shift into less demanding positions, and work flexible schedules, especially if they have accumulated substantial savings or can access retirement benefits so they can afford the pay reductions that usually accompany downshifting. The inclination toward workplace flexibility is often driven by emerging personal obligations, such as the need to care for frail parents, disabled spouses, or young grandchildren, worsening health, declining physical energy, or a growing preference for more leisure after a lifetime of work.

Retaining older workers provides important benefits to employers. The organization loses valuable skills, experience, and accumulated knowledge when seasoned workers and managers retire, attributes that are often difficult to replace from within and sometimes impossible to bring in from the outside. The retention of senior talent is becoming increasingly critical as the population ages. Unless older adults work more, the slow growth in the size of the

younger population will lead to a stagnant labor force, making it increasingly difficult for employers to meet their staffing needs and limiting economic growth.

Phased retirement programs that allow older workers to reduce their hours and responsibilities and pursue more flexible work schedules could satisfy both the employee's desire for flexibility and the employer's need to maintain an experienced workforce. However, employers face several obstacles in setting up formal programs. Some of the most difficult issues involve benefit plans, especially DB pension plans. Employers may not provide in-service distributions to workers younger than 62, yet relatively few workers can afford to reduce their work schedules without access to retirement benefits. Also, DB plan participants usually lose substantial pension wealth if they reduce their earnings in the years immediately before retirement, because pension benefits are generally tied to earnings near the end of the career. Phased retirement complicates the provision of other types of benefits as well, including health insurance, life insurance, and disability. Many employers do not provide benefits to part-time workers, and anti-discrimination rules make it difficult to provide exceptions for older workers.

Anti-discrimination rules designed to protect low-income employees and older workers further complicate phased retirement. Federal law requires that benefits provided through tax-qualified plans are fairly evenly distributed between highly compensated and lower-paid employees. It would generally be difficult for formal phased retirement programs to meet these standards because most employers gear them toward well-paid workers, who tend to have the specialized skills and knowledge that employers value and who can generally afford to reduce their work schedules. Federal law also prohibits employment discrimination against workers age 40 and older. Employers tend to be selective about which employees they offer phased retirement, and those denied enrollment in the program may sue on grounds of age discrimination. Even if these claims would be difficult to prove, the threat of expensive litigation may discourage many employers from implementing phased retirement programs.

Several policy reforms could promote phased retirement, but many of these changes would conflict with other policy objectives. For example, pension law could be changed to allow employers to grant in-service DB plan distributions to employees younger than 62, but that would undermine the notion that pension benefits go only to retirees. Such a change could also encourage some workers to collect benefits early, permanently reducing their annual benefits for the rest of their lives. Congress could weaken or eliminate the so-called benefits, rights, and features test for phased retirement plans mandating that enrollees include both highly compensated and nonhighly compensated employees. This change, however, could leave relatively few lower-paid older workers with access to flexible work arrangements. Congress could state that the ADEA does not apply to phased retirement programs, but that would weaken employment protections and could expose some older workers to discriminatory behavior.

Additional research is needed to better understand older adults' demand for workplace flexibility and employer's apparent reluctance to establish formal phased retirement programs. For example, how will the aging of the workforce affect employers? How many older workers would work longer if they were offered flexible work schedules, and how many are unable to obtain flexible schedules? What employee traits do employers looks for when deciding which workers to offer phased retirement? How does phased retirement vary by industry and occupation? And what factors drive employer reluctance to offer phased retirement? Answers to these questions could help guide policy choices and ensure that employers get the most out of their aging workforces.

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