Chapter 3

Alternative Late Career Employment Arrangements

As individuals age, they may wish to continue paid employment but with reduced hours or responsibilities. Employers that are interested in retaining older workers might offer a contract, either formal or informal, whereby select older workers continue their career employment but with reduced hours or in a new position. The employee might be offered lower compensation or reduced responsibilities but also more flexibility, different working conditions, and fewer work hours. This transition could entail a shift in job assignments, or the employee could continue doing the same tasks but only work a part of the day, fewer days per week, or full time for part of the year. Defined this way, phased retirement could be considered a form of job sharing, as employers use phased retirees to staff their labor force needs. Similarly, individuals might return to work after claiming a pension with a break in service. This chapter examines the conditions that influence employers’ ability and willingness to adopt policies that allow for alternative late-career employment arrangements beyond simply postponing retirement. Both employers and employees might benefit from a continuing employment arrangement, given a built-up stock of employer-specific human capital. However, programs such as phased retirement or return to work may prove difficult to implement because of pension regulations and concerns over age discrimination.

THE EMPLOYER PERSPECTIVE OF PHASED RETIREMENT

There are relatively few broad-based phased retirement programs in the private sector. Furthermore, many employers seem uninterested in including such a program as part of their future human resource policies (McGill et al. 2010).
Employers develop phased retirement plans to achieve certain human resource objectives. Of course, the success of these policies hinges on whether older workers will want to enroll in the phased retirement plan, given the employment terms, wage levels, and benefits that are offered. Employers can make these plans relatively cost neutral (half-time pay for half-time effort) or they can provide incentives to encourage older workers to move into phased retirement (three-quarters pay for half-time work). Phased retirement plans usually specify a predetermined departure date that ends the employer’s commitment to providing phased retirement to the individual employee. An important factor is whether retirees that are in phased retirement continue to receive benefits, especially health insurance.

Another major aspect of phased programs is how the nature of job assignments changes as older workers move into phased retirement. Phased retirement plans may be general in nature and cover all employees or can be used on an individual basis in an effort to retain certain employees. Hutchens and Papps (2004) and Rappaport (2001) both report that employers tend to favor informal phased retirement programs that allow employers to decide on a case-by-case basis whether older workers will be given the option of phased retirement.

The decision to adopt a phased retirement program is linked to many of the same issues discussed earlier regarding employer reactions to delayed retirement. In some cases, firms may want to retain older workers and the skills and experience they have acquired. Facing increased retirements associated with aging baby boomers, these employers may find that phased retirement encourages older workers to remain on the job and provides the level of institutional knowledge necessary for high levels of productivity for all workers. Other employers may believe that they have achieved the optimal age structure of their labor force and will be less willing to offer phased retirement for cost and productivity reasons. Thus, a key factor in the decision to adopt phased retirement plans is whether employers think it will encourage high-value workers to leave full-time employment sooner than they would without this option. Alternatively, eligible
employees could tack on additional years of phased retirement to the previously planned age of full retirement rather than simply retiring earlier than planned.

Gustman and Steinmeier (2008) develop a simulation model for workers choosing between full-time employment, phased retirement, and complete retirement. Their analysis indicates that if all employers adopted plans that allowed workers to enter phased retirement at their current hourly wages, there would be a substantial increase in phased retirement and a somewhat smaller reduction in full retirement. Employers must also consider whether phased retirement might appear to be a legal method to encourage less-productive workers to retire more quickly from full-time employment and enter phased retirement.

Hutchens and Grace-Martin (2006) consider three hypotheses for why firms differ in their preferences for phased retirement policies. They focus on minimum hours constraints, employee demand, and the presence of defined benefit pension plans. Building on the earlier work of Gustman and Steinmeier (1983), the authors develop a simple model of a profit-maximizing firm and posit that firms that impose a minimum hours constraint on all employees are less likely to have adopted phased retirement policies. The underlying theory behind this relationship is the production technology and the need for teamwork, whereby part-time employees or “substitute” workers might reduce the productivity of the team. They note that if employees have a preference for phased retirement and are willing to accept lower wages to have it, then firms are more likely to offer this benefit as part of the employment contract with a compensating differential of lower wages. Individuals who prefer having the option to phase into retirement might then cluster together in firms that offer this benefit.

Surveys of employers indicate that relatively few companies have adopted formal phased retirement programs. For example, Rapaport (2001) reports that a survey by William Mercer finds that less than one-quarter of employers surveyed had adopted formal phased retirement programs. Two surveys of older workers by Watson Wyatt
Clark and Morrill Worldwide (1999, 2004) indicate that there may be some increase in the incidence of phased retirement plans. The first survey finds that only 16 percent of large employers offered any type of phased retirement, while the latter survey reports that 40 percent of employers had policies allowing employees to phase into retirement on their current jobs. The 2004 report concludes that phasing will likely become increasingly prevalent as the baby boomers enter their retirement years. One should keep in mind that these surveys are small in scale and are not representative of the entire labor market.

REGULATORY FRICCTIONS

The lack of interest by employers in establishing phased retirement programs may be due to legal and regulatory policies associated with retirement plans, tax policies, and age discrimination laws. McGill et al. (2010, Chapter 8) provide a detailed account of federal policies that impact the payment of a retirement benefit from a defined benefit plan and how they have evolved over the past decade. Hutchens and Grace-Martin (2006) note that defined benefit pension plans may be an obstacle to phased retirement because of the relationship between final salary and retirement benefits. If phased retirees continue to be covered by a defined benefit plan, and phased years and the salary earned during these years are used to calculate retirement benefits, then annual benefits could be lowered by the individual’s having spent time in phased retirement. Obviously, this would make phased retirement less desirable. In contrast, participation in defined contribution plans can determine the date a worker initiates withdrawals and begins to draw down retirement wealth. Delaying the start of the draw-down from a defined contribution plan increases the potential annual annuity that ultimately can be paid.

IRS tax law prohibits individuals from working full time in a position covered by a defined benefit pension while also receiving a benefit from that same plan except under certain circumstances, as
modified by the Pension Protection Act. If a worker is incentivized to retire at a specific age because of the pension structure, it may be appealing to enter into a new type of employment contract with the career employer. For example, a worker could become a contractor. In this case, rather than a formal phased retirement program, there may be indirect channels of returning to work.

To investigate the role of minimum hours and pension policies in the adoption of phased retirement programs, Hutchens and Grace-Martin (2006) examine a sample of 950 establishments (not in agriculture or mining) with 20 or more employees. Their empirical results indicate that minimum hours constraints are important to consider and also suggest that the existence of defined benefit pension plans make phased retirement policies less likely. However, they find no evidence that employee preferences increase the likelihood of being covered by phased retirement policies. Significant differences in the incidence of phased retirement policies are found across occupations, and larger firms are more likely to have established phased retirement policies than smaller firms. Employer interviews also indicate that firms often have informal policies that allow some employees to shift to part-time employment at the end of their working careers.

**PHASED RETIREMENT IN HIGHER EDUCATION**

One sector of the economy that seems particularly well suited for phased retirement is higher education. Conley (2007) reports results from a survey conducted by the American Association of American University Presses that indicate 32 percent of universities had formal phased retirement programs. Allen (2005) describes the advantages to universities of offering phased retirement and reviews the incidence of these plans in higher education. He concludes that phased retirement can be a win-win in higher education. Workloads of career faculty are relatively easy to divide (e.g., teaching courses during one semester and then not working one semester). Universities gain from phased
retirement because career faculty members are typically required to give up tenure in exchange for a reduced workload. In many plans, the program is relatively cost neutral, as the cost of two phased retirees is similar to the cost of one full-time professor. Faculty gain from phased retirement since they are allowed to gradually disengage from the university. During phased retirement, faculty may actually have higher total income than when they worked full time, depending on their utilization of pension and Social Security income combined with their half-time salary from the university.

Allen, Clark, and Ghent (2004) examine the impact of a phased retirement system adopted by the University of North Carolina (UNC) system of 16 campuses. The UNC program required faculty to relinquish tenure and sign a three-year contract that provided 50 percent of preretirement pay for 50 percent effort, followed by complete retirement. Prior to the introduction of this program, the retirement rate of faculty 50 and older was 8.7 percent. After the plan was introduced, the total retirement rate (full plus phased retirement) increased to about 10.5 percent in the first three years of the program. About 30 percent of total retirements were faculty entering the phased retirement program. The authors conclude, “On balance, the introduction of phased retirement in the UNC system seems to have been beneficial from both employee and employer perspectives” (p. 124).

AGE DISCRIMINATION LAWS

To protect older workers from employer discrimination, federal and state laws prohibit the use of a worker’s age in making an employment decision (hiring, promotion, compensation, and retention). The 1968 Age Discrimination in Employment Act (ADEA) made discrimination against workers aged 40–65 illegal. Since the upper age was capped at 65, employers could continue to impose mandatory retirement at age 65 or above. In 1978, the ADEA was amended to
cover workers up to age 70. To comply, firms had to either eliminate
their mandatory retirement policies or raise the age to 70. The ADEA
was amended once again in 1986 to prohibit discrimination against
all workers aged 40 and over, thus effectively eliminating the use of
mandatory retirement and other age-based policies, except in certain
sectors of the economy and among certain highly paid employees.

Although ending mandatory retirement seems like a benefit for
older workers, it may have had unintended consequences. For exam-
ple, Lahey (2008) finds that employers reacted to age discrimination
policies by reducing older worker employment.

In addition to ending mandatory retirement, the ADEA requires
firms to modify other employment policies that might adversely affect
older workers. Thus, employers may worry about the legal implica-
tions associated with phased retirement policies that reduce hourly
wages and result in lower-status jobs. Furthermore, employers may
believe that they need to treat all workers equally when adjusting
wages or providing alternative end-of-career work arrangements (see
Neumark [2009] for a detailed discussion). They may be concerned
that any modifications in job titles, responsibilities, and compensation
that would make older workers more attractive to retain would be
considered age discriminatory. Thus, not all employers would con-
sider adopting some of the adjustments discussed in this review.

For the most part, research on age discrimination has focused on
the impact of laws that mandate that firms treat older workers equally
in hiring, training, and compensation. While most research indicates
that the opportunities of older workers have improved, some studies
suggest that firms are more reluctant to hire older workers because
of the stronger legal protections (e.g., Lahey [2008]; Neumark and
Button [2014]). It is possible that these laws restrict employers from
developing policies that accommodate the preferences of older work-
ers if it means giving up status and employee benefits.

More research is needed to evaluate whether government poli-
cies permit career employers to modify working conditions of older
workers without violating their rights or leaving them vulnerable to
discrimination. Phased retirement could become an important component of the retirement transition by allowing productive workers to remain with their career employers while compensation and working conditions are modified. Federal and state governments should examine whether age discrimination laws, tax policies, and pension regulations should be modified to remove restrictions that limit the use of phased retirement programs.

WILL PHASED RETIREMENT BE AN IMPORTANT RETIREMENT PATH IN THE FUTURE?

Economic studies and data analyses indicate that a large proportion of career employees would like the option of phasing into retirement on their current jobs. However, many of the studies of individual responses to the availability of phased retirement are dated, and most use survey responses from the Health and Retirement Study. Much has changed for older persons in the labor market in the past three decades. The trend toward early retirement has been reversed, and labor force participation rates of older workers have increased. Future research should address two key questions. First, how has delayed retirement from full-time career jobs affected the demand for phased retirement? Clark and Morrill (2015) find that individuals leaving career jobs in their fifties are more likely to enter phased retirement or bridge jobs than retirees in their sixties. Second, how has the continued decline in the coverage of defined benefit plans affected retirement transitions? Participants in defined contribution plans may find that phased retirement is less beneficial to them since they have greater control of the utilization of their retirement wealth.

The U.S. Department of Labor (2008) held hearings on the demand for phased retirement by employees and the barriers that inhibit employers from establishing phased retirement programs. Johnson (2011) discusses how age discrimination laws and pension regulations interact to restrict the adoption of phased retirement plans.
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(see also Fields and Hutchens [2002]). Recent changes in federal legislation to allow in-service distribution of pension benefits after employees have attained the normal retirement age have moderated a significant impediment to phased retirement. Limited evidence indicates that the incidence of phased retirement varies across employers and sectors of the economy, due in part to production techniques and the divisibility of job tasks. Hill (2010) discusses these legal barriers, as well as company-specific characteristics that restrict or limit employers’ ability to adopt phased retirement plans, such as the types of jobs, the organizational structure of the firm, and the characteristics of employees.

Interestingly, the federal government has recently adopted a phased retirement program for its own workforce and issued basic guidelines governing which federal workers are eligible and what terms of employment are acceptable. Employees who meet the eligibility requirements may continue working on a part-time basis with the agreement of their agencies. These phased retirees can receive a partial retirement benefit and will continue to accrue service credits that will be used in the determination of their ultimate retirement benefit. Office of Personnel Management (OPM) guidelines state that phased retirees must spend 20 percent of their time mentoring younger employees. OPM Director Katherine Archuleta states, “Phased retirement offers an innovative alternative to traditional retirement for the twenty-first century workforce. It provides a new tool that allows managers to better provide unique mentoring opportunities for employees, while increasing access to the decades of institutional knowledge and experience that retirees can provide” (McGuinness 2014).

RETURNING TO WORK AFTER RETIREMENT

An alternative to formal phased retirement programs is for older workers to return to their previous employers in a new role, often...
after a period of nonemployment. When an employee is covered by a defined benefit plan, in most cases she will find that continued employment past normal retirement age carries a large opportunity cost. However, perhaps she (and her employer) would prefer to continue the relationship. IRS rules stipulate that an individual must separate from employment for a period of time and may return to work only in a position not covered by the pension from which the individual is actively receiving a benefit. Pension benefits can be suspended and covered work resumed at any point. Uncovered employment can typically be structured as contract work, whereby a worker is either self-employed or employed by an agency that leases their services to the career employer. This work could be flexible and part time or could be full time, but it must not be in a position that is covered by the defined benefit pension plan. An employer might value this type of arrangement since these contract-type positions likely do not carry the same job protections and restrictions.

An alternative arrangement can be reached if a worker terminates employment and requests a lump sum distribution of the defined benefit pension. In the private sector, the Employee Retirement Income Security Act of 1974 guidelines stipulate that any plan that offers a lump sum option must calculate that amount using an actuarially equivalent formula. In the public sector, the lump sum option is generally calculated as the sum of employee contributions and is typically much lower than the present discounted value of the potential annuity for career workers (see the discussion in Clark, Morrill, and Vanderweide [2014]). In practice, it may be difficult for employers to navigate the complex tax rules associated with these work-after-retirement work-arounds. Maestas (2010, p. 726) writes, “Although the Pension Protection Act [2006] established the legality of in-service pension payments under certain circumstances, it is not yet clear to what extent employers will make this option available.”
EMPLOYER OPTIONS TO ACCOMMODATE DELAYED RETIREMENT

This chapter has highlighted several potential barriers to an employer accommodating workers’ desires to work longer. Age discrimination laws may hinder an employer’s ability to adjust compensation to reflect productivity changes as workers age. It might also be that conventions regarding wage growth inhibit an employer’s ability to adjust compensation downward. The typical structure of benefits may also be a problem. We speculate that employers may want to accommodate workers’ desires to work longer but might encounter legal or cultural obstacles along the way. This might explain why some workers transition to bridge jobs rather than enter phased retirement at a career employer.

As the workforce ages, we may see an increase in both phased retirement and return-to-work programs. This is particularly true among employers offering workers defined benefit plans, because these plans are designed to incentivize retirements at certain ages. If the employer seeks to retain talent at ages above their defined benefit plans’ normal retirement age, this can be achieved through the development of programs that allow for a continued relationship while not violating IRS and federal and state regulations of pension plans.

Notes

1. Most defined benefit pension plans have an earnings-based formula that is the multiple of a generosity parameter, total years of service (earned plus purchased), and a final average salary (FAS) value, which is often based on the average salary during the individual’s final few years of service. If phased years are included in calculating FAS, monthly retirement benefits will be lower. However, if phased retirees are not included in the retirement plan, then FAS would be based on prephased years (or the top few years of earnings, especially if the earnings were indexed) and the retirement benefit would be unaffected.

2. Allowing phased retirees to begin to receive their pension benefits while
in phased retirement would mean that the retiree would be receiving the full retirement benefit along with the salary for phased retirement.

3. Leslie and Janson (2005) also examine the value of phased retirement from the perspective of the university.

4. Switkes (2005) describes the introduction of a phased retirement plan in the University of California system.

5. Ghent, Allen, and Clark (2001) provide additional analysis of the introduction of this phased retirement plan. Interestingly, they find that faculty who are enrolled in the state defined benefit plan are more likely to enter phased retirement than those who elected to participate in a defined contribution plan. This reflects two parameters of the program: 1) the requirement that faculty retire before entering the plan, and 2) the stipulation that in phased retirement they will no longer accrue retirement benefits.