# Early Retirement Reform: Can it Work? Will it Work?

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Abstract

Early retirement from the labour force has become standard practice for most employees in the industrialised world. However, as a result of the rising costs of early retirement schemes, curbing the outflow of older workers from the labour force has become a central government policy objective. Early retirement reforms under which benefits are financed on a more actuarially neutral basis are currently being implemented in the Netherlands. At present it is not clear how older workers will react to these policy reforms. In this paper we examine the extent to which (Dutch) older workers are inclined to change their retirement intentions in response to new early retirement arrangements. On the basis of a labour market and a population survey we examine retirement intentions under alternative early retirement policies. The overall conclusion is that the retirement reform may lead to a substantial delay of the retirement date, but that in practice more forces than the financial incentives are at work. This is also reflected in the long-run early retirement trend. This trend presents demographers and economists with a puzzle because a break shows up in the time series but this break has set in before the actual early retirement reforms were put into practice.

# Table of Contents


Abstract ..... 3

1. Introduction ..... 7
2. Data ..... 10
3. Changing Social Norms on the Labour Market ..... 10
4. Changing Early Retirement Regimes ..... 12
5. Changing Regimes, Changing Intentions? ..... 15
6. Changing Long-Run Trends? ..... 19
7. Conclusions ..... 21

References ..... 24

## 1. Introduction

Early retirement has become standard practice for most employees in the industrialised world. The reasons for leaving the labour force are multifaceted. In the mid-1990s, formal early retirement schemes in virtually all OECD countries made it financially unattractive for people to continue working after the age of 55, and in most countries the incentive to withdraw from the labour market with the help of early retirement programmes has risen strongly since the 1960s (Blöndal and Scarpetta, 1998; Gruber and Wise, 1998). Furthermore, disincentives to continue working beyond the age of 55 have been strengthened by various de facto early retirement programmes, like unemployment and disability schemes (Kapteyn and De Vos, 1998; Kerkhofs et al., 1999). When unemployment became a widespread phenomenon in the 1970s and 1980s, early retirement schemes were designed to alleviate the financial implications of an ageing workforce: older workers, who receive relatively high wages, could be replaced by young workers. With one stroke of the pen, youth unemployment could be reduced, older workers were offered a ‘cushy’ exit route, and the financial position of firms could be improved as the expensive seniors were substituted by cheap youngsters and the bill for early retirement could be shifted to collectively financed early retirement schemes. In the 1990s, it became apparent that these early retirement schemes were no longer a blessing. As more and more older workers used this exit route from the labour force, it became the central policy issue for countries facing an ageing workforce (see Guillemar, 1999; OECD, 1995). The reason why early retirement programmes are considered a policy hazard is clear: social security and early retirement schemes in most European countries are financed on a pay-as-you-go (PAYG) basis, and large-scale early retirement exacerbates the already large and looming crisis in financing benefits for the retired in steadily ageing populations (Van Dalen, 1996; Börsch-Supan, 2000). Early withdrawal from the labour market not only decreases the number of workers, it simultaneously increases the number of inactive people. As shown in Table 1, the trend towards earlier retirement from the labour force is visible in all OECD countries over the period 1950-1995, with perhaps the exception of Japan, where a trend towards early retirement is present but it is so small that the retirement age for both men and women remains high. Early retirement is most pronounced in the Netherlands, Belgium and France with average retirement ages in the year 1995 well below 60. The negative changes in the number of years working in these countries are perhaps even more staggering as they range from 7 (for most men) to almost 11 years (for French women). As a consequence of this trend towards early retirement the financial sustainability of social security and early retirement schemes is at stake.

**Table 1: Average age of retirement in OECD countries**

| Country | 1950 | | 1995 | | Difference 1950-1995 (in years) | |
|---|---|---|---|---|---|---|
| | Men | Women | Men | Women | Men | Women |
| Netherlands | 66.4 | 64.1 | 58.8 | 55.3 | -7.6 | -8.8 |
| Belgium | 64.8 | 62.9 | 57.6 | 54.1 | -7.2 | -8.8 |
| France | 66.1 | 69.0 | 59.2 | 58.3 | -6.9 | -10.7 |
| Germany | 65.7 | 62.7 | 60.5 | 58.4 | -5.2 | -4.3 |
| United Kingdom | 67.2 | 63.9 | 62.7 | 59.7 | -4.5 | -4.2 |
| Sweden | 66.8 | 65.4 | 63.3 | 62.1 | -3.5 | -3.3 |
| United States | 67.2 | 64.2 | 63.6 | 61.6 | -3.6 | -2.6 |
| Japan | 66.7 | 65.5 | 66.5 | 63.7 | -0.2 | -1.8 |

Source: Blöndal and Scarpetta (1998).

Given these developments, governments are anxious to keep older workers employed (Taylor, 2001; Whitting et al., 1995). Most countries are trying to keep the looming problems at bay by extending the length of working lives with the aid of social security reforms and by promoting personnel policies which make working conditions for older workers more attractive (Ekamper, 1997; Taylor, 2001). There is, however, no denying that corporate personnel policies in actual practice still make little provision for older workers. This holds for the Netherlands (Remery et al., 2001), the UK (Taylor et al., 2000) as well as for most of the other European countries (Taylor and Walker, 1998; Taylor, 2001). In the end employers still seem to have preferences which clearly go against the interest of older workers (Van Beek et al., 1997).

With these developments in the back of our mind it would be of considerable interest to see how effective public policy actually is. The Netherlands presents us with an interesting case study, as it is a country with one of the lowest labour force participation rates among older workers in the OECD. The main focus of public policy in the Netherlands has been on reducing opportunities for early retirement. The Dutch government is currently radically reforming its own early retirement system, encouraging firms to switch from a PAYG-financed early retirement scheme to schemes on a more actuarially neutral basis. The intergenerational transfers implied by the old regime are effectively removed in the new regime.

The intergenerational solidarity between generations was clearly present in the design of the old early retirement programs. During the economic downturn in the seventies and eighties, older workers had to make room, willingly or unwillingly, for younger workers and they could make use of early retirement schemes which were de facto collectively financed ‘golden parachutes’ or buy-outs on an industry-wide scale. The willingness to pay for the increasing number of early retired workers was slowly but gradually eroding during the 1990s as the early retirement insurance premium also increased. The common opinion was that the changing tide on the Dutch labour market made a reversal of financing principles necessary if early retirement was to remain a viable option in a welfare state like the Dutch welfare state. At present it is far too early to evaluate the early retirement reform but we will take a shot at it by comparing retirement intentions of people in a survey under two hypothetical but realistic retirement regimes. But before doing so we will explore in some detail how early retirement institutions have changed over time.

An important impetus for this change can be traced to the evolution of norms and values about job opportunities and equity on the labour market. The first issue we address in this paper is therefore the question how public opinion evolved over the last two decades with respect to the employment opportunities of older workers and generational equity in general. Until recently only very few people worked after the statutory – often mandatory - retirement age of 65 and in gaining an insight into the publicly held view about older workers it is of some interest to know how the (Dutch) population feels about giving older workers, even beyond the age of 65, an equal chance on the labour market. The ulterior motive for first examining this question is that it offers a nice illustration of how opinions about the equal opportunities and individual responsibility can change in such a relatively short time. Furthermore this switch coincides with the switch from a PAYG system to a retirement system based on funding. Deep down it is a switch from intergenerational solidarity to no solidarity at all between generations, although it must be said that most early retirement programs still contain implicit intergenerational transfers.

The second issue concerns the question whether the early retirement reform will change individual retirement plans. We examine the extent to which (Dutch) older workers are changing their retirement intentions in response to early retirement reforms that currently take place in the Netherlands. On the basis of a survey held among the Dutch population we have examined retirement intentions under two early retirement policy systems: the old, PAYG-financed scheme versus the new, more actuarially neutral schemes. By focussing on the retirement intentions under the two different regimes we are in effect dealing with one of the most topical issues of personnel policy of the current labour market, viz. to what extent are older workers inclined to alter their retirement intentions when they are confronted with a more actuarially neutral early retirement scheme? Those familiar with (Dutch) retirement research will be particularly interested to see how this experiment will evolve as expectations concerning the effectiveness of financial incentives in delaying retirement are not that high (Henkens, 1999; Henkens & Tazelaar, 1997; Heyma, 2001). Besides answering this fundamental question we will also try to evaluate in this paper whether the new retirement scheme constitutes a structural break in the long-run early retirement trend.

The structure of this paper is therefore as follows: first we briefly discuss the survey data on which our findings are based (section 2). We will subsequently explore how attitudes towards age-equality on the labour market have changed over time (section 3).

The general nature of these changing attitudes is reflected in the changing finance principles on which early retirement systems are based. The switch from the old to the new early retirement regime and some background information about the Dutch labour market and its institutions are given in section 4. The acid test of the early retirement reform is presented in section 5 where retirement intentions are compared under the old and the new regime. Section 6 offers the reader a discussion whether the new early retirement regime will mark a structural break in the long-run retirement trend and in section 7 we summarise the general conclusions.

## 2. Data

The data are based upon a survey entitled "Opinions and attitudes on aspects of population and welfare" (denoted in the figures by the acronym MOAB). These cross-sectional surveys are carried out at certain intervals in time by the Netherlands Interdisciplinary Demographic Institute (NIDI). To be more precise, this survey was held six times during the last twenty years. For this paper we used survey data from the waves 1986, 1990 and 2000. Each survey comprises of a sample of about 1,500 Dutch respondents. Information was collected on opinions about population issues and related policy topics. In 1986 and 1990 data were collected by mail questionnaires (see Moors, 1995). The data for the wave in the year 2000 (see for details Esveldt et. al., 2001) were collected by the databank *CentERdata* of the University of Tilburg (see for more details: centerdata.kub.nl) which maintains a representative Internet-based panel of two thousand households in the Netherlands.

The waves of the NIDI-survey consist of a standard section with questions recurring every wave. This part contains questions regarding the attitudes about lifestyle, work of older people, and immigrants. Besides the standard section, in every wave some questions are added to poll the opinions surrounding hot topics. In the latest version of the NIDI-survey (2000) questions were added concerning opinions about early and flexible retirement (see section 4). For this particular section a sample of people of working-age were selected, so the old-aged were excluded as they no longer have a stake in questions concerning early retirement.

## 3. Changing Social Norms on the Labour Market

The norms which are relevant at this point are those concerning generational job equity and opportunities for different age groups on the labour market. The reason why these attitudes of the general population are relevant is that they generally reflect the same principles on which the sustainability of retirement schemes depend. When intergenerational solidarity is strong one can imagine that systems, like most public pension systems, in which the young support the old in a direct manner are strongly supported. However, when the population changes its mind and supports the view that everyone - no matter how old or young - should pull their own weight, one can imagine that systems that are in line with these principles, like funded pension systems, become the dominant mode.

Opinions which are relevant for assessing the changing labour market culture are related to questions concerning the position of the older worker vis-à-vis the younger worker. There is ample reason for suspecting that these attitudes have changed, as demographic and economic conditions have changed markedly over the past few decades. The older worker in the Netherlands is at the moment a rare species when it comes to working beyond the age of 65. Of course, there are sectors where self-employment is high and where 65 does not necessarily mark the end of a working career, but even for those self-employed working beyond the age of 65 were deemed anti-social as younger colleagues are hindered in their career mobility. Much has however changed in the past few decades: in 1960 still 20 percent of the men of 65 and older kept on working, in 1971 this was 11 percent and in 1997 a mere 3 percent of the men of 65 and older were working and of those active ‘senior citizens’ 75 percent was self-employed. With the labour shortages becoming more and more apparent the last few years employers are now more easily persuaded of the benefits of employing older workers, especially those of 65 and older as the social insurance premiums for these workers are far less than for regular workers younger than 65. The NIDI-survey as illustrated in Table 2 shows clearly how society at large is becoming more and more in favour of giving older workers, especially those of 65 and older equal opportunities on the labour market.

**Table 2: Changing social norms (opinions concerning equal opportunities for old and young on the Dutch labour market)**

| | | Age group | | | |
|---|---|---|---|---|---|
| Question in survey: | Year | 20-44 | 45-64 | 65+ | Total |
| | | % in agreement with the statement | | | |
| Because of their life-long experience, people of 65 and older can still be very productive employees | | | | | |
| | 1986 | 51 | 59 | 65 | 56 |
| | 1990 | 57 | 65 | 74 | 61 |
| | 2000 | 77 | 73 | 88 | 76 |
| A person of 65 year or older is just as much entitled to work as a young person | | | | | |
| | 1986 | 38 | 34 | 39 | 37 |
| | 1990 | 44 | 46 | 54 | 46 |
| | 2000 | 55 | 45 | 59 | 52 |
| Work done by workers of 65 and older deprives young people of work | | | | | |
| | 1986 | 49 | 52 | 51 | 50 |
| | 1990 | 36 | 43 | 43 | 39 |
| | 2000 | 35 | 35 | 30 | 35 |

Source: Esveldt et. al., 2001

In 1986 56 percent of the population thought that men and women of 65 and older were well equipped to participate on the labour market. With the changing status of the labour market the percentages steadily increased, with 61 percent in 1990 and in 2000 this percentage rose to a steady 76 percent. The same tendency can be seen in questions concerning the equal opportunities of different age groups on the labour market. In 1986 almost half the population felt that people who kept on working beyond the age of 65 deprived younger workers of labour market opportunities; in 2000 only one in three of the Dutch population felt that way. Furthermore, the majority of the population (52 percent) is of the opinion that people of 65 and older should have the same opportunities in obtaining gainful employment as younger workers. Of course, it stands to reason that the change in opinion is in part the result of the so-called ‘Dutch miracle’ in the 1990s which has led to a high rate of employment growth. And as labour supply did not keep up with the pace of labour demand, Dutch employers were also less inclined to use exit routes for older workers. The job opportunities for young workers were ample in the 1990s and the older worker was no longer seen as a nuisance factor for the upwardly mobile youngsters. This stance also shows up in another survey question: 75 percent of the population agrees with the survey statement “Under conditions of unemployment, the old have just as much right to a job as youngsters.” Unfortunately we cannot present a picture over time for this question as it was only surveyed in the year 2000.

Although the changes over time are remarkable, another aspect of Table 2 is noteworthy: the small, if not the absence of differences across age groups concerning the generational job equity and opportunities. Of course, the older respondents are far more positive in their outlook on the labour productivity of workers of 65 and older but then again they have the advantage of ‘inside information’, i.e. they are more knowledgeable about what someone of 65 and older can actually achieve.

## 4. Changing Early Retirement Regimes

The changing norms concerning generational equity and individual responsibility are clearly reflected in the change of design of early retirement arrangements in the Netherlands.

*Old early retirement regime*

In the Netherlands the first early retirement schemes were introduced in 1976, in a period of rising unemployment, particularly youth unemployment. It was a time when firms had to deal with the aftermath of the oil crisis of 1973 and the labour market was heavily influenced by the inflow of young workers born during the post-World War II baby boom. These newcomers could not be absorbed by the labour market. The Dutch government in cooperation with the employers’ organisations and trade unions designed a way out of this dismal situation: early retirement of older workers. The Dutch government financially supported early retirement experiments as it perceived the benefits for society to be significant: positive effects on youth employment and greater freedom of leisure choice for older workers. Early retirement benefits bridged the period between the cessation of work and the date of entitlement to a state and supplementary pension. Payment of pension contributions and other social insurance contributions was continued during the early retirement period, leaving the pension to which retirees were entitled at age 65 completely unaffected (OECD, 1995).

Although more than 300 different early retirement schemes exist in the Netherlands, which are the result of bargaining processes within industrial sectors, one can say that Dutch early retirement schemes were characterised by relatively favourable financial conditions and relatively little variation between companies and organisations, both in the public and in the private sector. Most Dutch firms and organisations use a fixed early retirement age, usually around 60 years, after which an employee is free to choose when he or she wishes to retire. The financial aspects are fairly generous, with replacement rates generally around 80 percent of the gross wage. This is much higher than in the US and most European countries (Grad, 1990; OECD, 1995), and may well explain why early retirement is such a widespread phenomenon among Dutch older workers. In the Netherlands, early retirement pensions have so far been financed largely on a PAYG basis, by a levy on the gross wage bill. Part of the costs are met by the employers. In return, the trade unions sometimes accepted smaller wage increases than they would otherwise have done. The premium paid by the employer varies between 0.5 percent and 8 percent of the gross wage bill, depending on the industrial sector (Ministry of Social Affairs and Employment, 1995).

*New early retirement regime*

The problem of the old early retirement system is rooted in the pay-as-you-go finance method, which allows individuals and companies to pass the financial burden of their decisions on to others. People who retire early are dependent on the solidarity of the employed who keep on working. They are the ones who pay the pension contributions necessary to finance the early retirement benefits. The new early retirement schemes - denoted here as flexible early retirement (FER) arrangements- are designed to be actuarially neutral and increase the individual responsibility. A system is actuarially neutral if the present discounted value of net retirement benefits is the same for all possible retirement ages (Börsch-Supan, 1992).[1] Such a system would not bias or distort the labour-leisure choice. In recent years, more FER arrangements have been introduced in several parts of the private sector as well as in the public sector in the Netherlands (see Van de Ven, 2001). Under the new plans, pensions are no longer financed on a PAYG basis but on the basis of the principle of funding and actuarial neutrality. The

[1] The concept of actuarial neutrality (or non-distorting) is not be mixed up with actuarially fairness as a system is actuarially fair if the present discounted value of net retirement benefits for all retirement ages is zero.

FER arrangement allows individual employees to retire early, provided they pay a price that is substantially higher than the price generally paid for early retirement. Contrary to the old early retirement schemes in the Netherlands, pension entitlements are accumulated on an individual base under the FER system. Under the new system, the early retirement benefit is related directly to the individual employee's employment history and the contributions paid. The shorter the employee has worked, the lower the pension benefit. The new plans do, however, offer employees more flexibility in choosing the age at which they wish to retire and – through additional savings – the level of the benefits they wish to receive. The FER scheme is based on a standard age at which workers are entitled to retire and the gross retirement benefit at this standard age tends to be between 70 and 80 percent of the employee's most recent salary in case of a complete pension history. Employees are entitled to stop working earlier or later, in which case the benefit is lower or higher, respectively. There are, however, some limits to the choice of the date of retirement: the minimum retirement age of the majority of workers who take part in FER schemes is 55 (see Table 3). This is substantially lower than the minimum age of 60 among those who retire early under the current system. However, most pension funds try to aim by adjusting replacement rates at the age of 62 as the standard early retirement rate, although for a transition period big pension funds aim at standard ages 60 or 61.

**Table 3: Minimum retirement age in new early retirement plans, The Netherlands 1998**

| Minimum early retirement age in FER plans: | Number of funds | Number of active participants | Total amount |
|---|---|---|---|
| Under 55 or no minimum | 9.6 | 2.2 | 7.1 |
| 55 years | 15.5 | 64.2 | 62.3 |
| 56-59 years | 5.9 | 1.2 | 0.9 |
| 60 years | 62.1 | 29.1 | 27.4 |
| 61-65 years | 6.8 | 3.3 | 2.4 |
| Total | 100 | 100 | 100 |
| **Total (absolute)** | **425** | **2.7 million** | **227.4 billion euro** |

Source: Verzekeringskamer (1999)

The conditions of early retirement have clearly deteriorated from the individual employee's perspective. Gross pension benefits under the new FER arrangements average 71.9 percent of final wages, compared with an average early retirement benefit of 79.4 percent under the same collective labour agreements (Dutch Labour Inspection, 1999). Some organizations offer their personnel an extra financial bonus if they keep on working till the age of 65. It will therefore not come as a surprise that older workers are more inclined to retire earlier under the generous old early retirement schemes than under the new arrangements. The question that still needs to be answered, however, is *how big* this difference is.

## 5. Changing Regimes, Changing Intentions?

It is, of course, far too early to examine the influence of the FER system on labour force participation since the full impact of retirement incentives will only manifest itself in the long term. What we can do, however, is to ask older workers at which age they would like to retire under the different schemes. We asked a sample of people of working-age in the annual population survey held by the NIDI in 2000 about their retirement preferences and intentions. Two of the questions posed in the survey are particularly pertinent when studying the extent to which the FER scheme acts as an incentive: (1) a question about the age at which respondents would like to retire if they could freely choose their own retirement date; and (2) a question about the age at which respondents would like to retire if they faced a flexible retirement scheme in which the pension received would range from 20 percent of net wages (at age 56) to 95 percent of net wages (at age 64). This scheme is quite similar to the recently introduced early retirement system for the public sector. Table 4 shows the results of a comparison between retirement intentions and the reality of a flexible retirement scheme.

**Table 4: Different systems, different retirement choices**

| Freely chosen retirement age* | Percentage | Pension age chosen under a flexible early retirement regime** | | Percentage |
|---|---|---|---|---|
| | | Age | With replacement rate | |
| 55 or younger | 32.4 | | | |
| 56 | 1.5 | 56 | 20% | 2.6 |
| 57 | 3.2 | 57 | 25% | 0.5 |
| 58 | 5.5 | 58 | 30% | 1.3 |
| 59 | 1.0 | 59 | 35% | 1.1 |
| 60 | 38.7 | 60 | 45% | 10.6 |
| 61 | 0.5 | 61 | 55% | 5.1 |
| 62 | 4.1 | 62 | 70% | 41.0 |
| 63 | 1.0 | 63 | 85% | 14.9 |
| 64 | 0.6 | 64 | 95% | 22.9 |
| 65 or older | 11.5 | | | |
| Total | 100.0 | | | 100.0 |
| N = | 785 | | | 785 |

* The question in the survey about the retirement date was phrased as follows: "If you could choose freely, at which age would you prefer to retire from the labour force?"

** Idem the question was: "Suppose you would work at a firm which has a flexible early retirement scheme which would make it possible to stop working before the age of 65. With that scheme someone could stop working at 64 and that person would get a higher pension than someone who would stop at say 58 (see the list with ages and replacement rates). Which retirement date would you choose?"

Source: NIDI-MOAB Survey, 2000.

To start with the discussion of the freely chosen retirement date, it is a striking fact that one third of the respondents would like to retire at 55 or even earlier. The average retirement age is 58.6 years. Furthermore, it is interesting to note that employees rarely plan to retire at ages 59 and 61 and instead choose to retire midway at 60. This could possibly be explained by the fact that 60 years is seen as a focal point among respondents surveyed, a fact that could be traced to the 'convention' that two-thirds of all people who retired early in the 1990s did so at the age of 60. The fact that relatively few respondents said they would like to retire at ages 59 and 61 could also be explained by a process known as age heaping: survey respondents appear to have a slight dislike for figures that end in 1 or 9 (Stockwell and Wicks, 1974). However, Table 4 makes one thing very clear: working up to the official retirement age of 65 years is not a popular option among older workers. A meagre 12 percent of the respondents would retire at 65 (and some even beyond 65).

Things change rather radically once the respondents were asked about their preferred retirement date in the case of the new FER schemes, where retiring before the age of 62 can be an expensive deal. Perhaps it may not come as surprise that most respondents choose for the retirement date which also seems like an affordable date: the average retirement date is 62.1 years. The new system therefore results in an average delay of retirement of 3.5 years. Of course, these aggregate results cover up the highly age dependent nature of retirement decisions and to determine the extent to which the FER plan really acts as an incentive to retire later, we disaggregated by retirement choices by the initially chosen retirement date. Table 5 presents some figures about the effects of this policy reform and as was to be expected the delaying of the retirement date is age-dependent.

**Table 5: To what extent do new early retirement schemes influence the intended retirement age?**

| Workers who initially chose the age | N = | ..who do not extend their planned retirement date, | ..or extend their planned retirement date | Average number of years extended of those who delay their retirement date |
|---|---|---|---|---|
| | | Percentage | | Years* |
| 55 or younger | 254 | - | 100.0 | 7.6 (3.3) |
| 56-59 | 88 | 6.8 | 93.2 | 4.2 (1.7) |
| 60 | 304 | 14.5 | 86.5 | 2.2 (1.4) |
| 61-64 | 49 | 61.2 | 38.8 | 0.4 (0.8) |

* Between brackets the standard deviation.
Source: NIDI-MOAB Survey, 2000.

Respondents planning to retire before the age of 62 appear to be particularly sensitive to the income effects of the FER scheme. Naturally the group with their initial retirement date of 55 or younger has to delay as the fictitious FER scheme in the survey does not allow retiring before 56, but for those respondents who initially chose 56 or older the age-dependence is clear: 93 percent of those initially retiring between 55-59 delay their retirement, whereas the group of 61 and older almost 40 percent delay their retirement. Of those who would like to retire at 55 or even younger the *percentage* of those delaying their retirement date may not be of interest, the actual number of years which are shifted is of some significance and this is mentioned in the last column: the number of years delayed amounts to almost 8 years. With an average working career for men of about 40 to 45 years (Liefbroer and Henkens, 1999) this extension can be termed 'substantial', but at the same time one should be cautious in interpreting this figure as this group might well have unrealistic beliefs about the (financial) feasibility of retiring at say 55 or even younger. In that respect the most interesting age group to study is the one applying to those who initially chose to retire between 56 and 59: 93 percent extend their working career under the new regime and, what is more important, with an average of 4.5 years. These numbers suggest that the early retirement reform really functions like a wake-up call for those workers who still think that the (Dutch) early retirement system is a free lunch. Retiring early under the new regime has its price and the most frequently chosen retirement date under the new system is the age of 62.

*Pension Carrots*

In order to stimulate older workers to keep on working till the statutory retirement age of 65, some pension funds have built in an extra bonus in their FER scheme if the worker makes an effort in reaching this age. This is a topical issue which has so far not received any attention in the pension literature although the question of using carrots versus sticks in motivating workers has received ample attention by psychologists. Especially the work by Tversky and Kahneman (1981) is best known for bringing this topic forward. They argue that the 'framing' or the way in which the issue is presented is of particular significance in the effectiveness of an incentive. The status quo is very important to the individual who has to make the choice. The pension and retirement world has ample examples of the terminology of carrots and sticks and usually the framing of early retirement is framed in the language of penalties or 'sticks'. Steverdink et al. (1998) suggest that older persons are relatively more loss averse than young adults. This would also imply that compared to young workers older workers may be relatively insensitive to bonuses in delaying their retirement date.

In order to discover the extent to which people are willing to delay their retirement date we posited a new question by explicitly presenting a lump-sum bonus and ask respondents about the willingness to work up to the age of 67. Given the fact that we know little about the income position of respondents we simply framed this bonus as a half year's wages (net of taxes). Five percent of the respondents would surely make use of this offer, eight percent would probably make use of the offer, 25 percent can be marked as a 'maybe' and 60 percent will not consider working till the age of 67. Of course, these percentages are quite different when one takes account of the differences in initial retirement ages and when the ‘sure’ decision makers are all people near the age of 67 the five percentage result is not that large. It would be astounding if the five percent ‘sure decision makers’ would come from those below the age of 60 years of age. A cross tabulation by intended age-groups is therefore necessary in order to understand these percentages better. Table 6 shows that the group with the intended retirement date before the age of 60 is quite sure about its initial choice as 72 percent of this group will stick to their choice and only 8 percent will consider working till 67. For the age group 60-64 this last percentage amounts to 9 percent, whereas only those with a preferred retirement age of 65 or 66 are easily triggered to delay their retirement date by accepting the bonus offer.

**Table 6: To what extent do big ‘pension carrots’ influence the intended retirement age?***

| Workers who initially chose to retire at | ..who will stick to their initial choice despite a bonus, | ..or who *maybe* consider working till age 67, | ..or who will consider working till age 67 | N = |
|---|---|---|---|---|
| | (1) | (2) | (3) | |
| 59 or younger | 71.6 | 20.2 | 8.2 | 342 |
| 60-64 | 56.9 | 34.0 | 9.1 | 353 |
| 65 or 66 | 19.7 | 42.4 | 37.9 | 66 |

* In this part of the survey respondents were asked the following: “Suppose that people who would work up and till the age of 67 would receive a half year’s wages, net of taxes. Would you consider working till the age of 67? (1) yes, sure; (2) yes, probably; (3) maybe; (4) no, probably not; (5) no, certainly not.” Column 1 is the sum of answers (4) and (5); column 2 corresponds to answer (3); and column 3 is the sum of answers (1) and (2)
Source: NIDI-MOAB Survey, 2000.

One reason why these groups can stick to their initial choice may be traced to the individual's private financial assets. The NIDI-survey offers some information on whether people are accumulating private savings for the purpose of retiring earlier than the statutory retirement age of 65.[2] E.g., the large majority of those who initially chose a retirement date below the age of 60 have private financial assets earmarked for the purpose of retiring early or are planning for early retirement. Most of the people who choose to retire at 64 have not accumulated any savings earmarked for early retirement. Although the survey question does not poll the respondents’ savings behaviour, the question does capture the intentions of people for taking responsibility for one's own old age pension and not relying too much on collectively financed retirement arrangements.

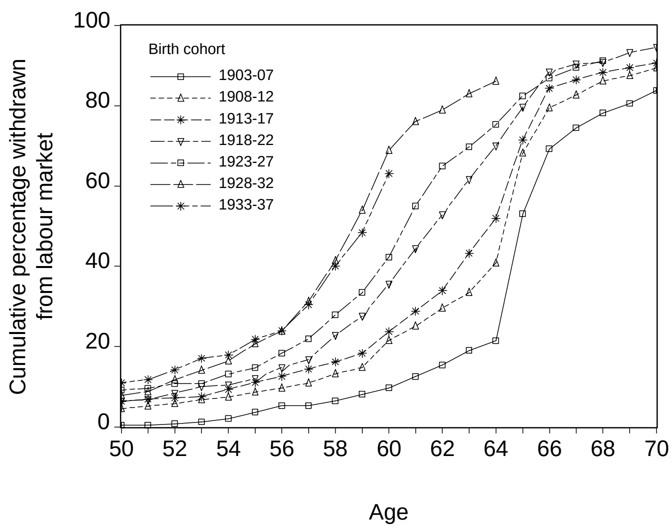
2 The material concerning the interaction between private savings and early retirement is for concerns of brevity not shown here but can be obtained upon request by one of the authors.

## 6. Changing Long-Run Trends?

It remains to be seen whether a trend that set in almost a century ago can be reversed by introducing pension and early retirement reforms. Obviously, if you remove 'the offer you cannot refuse' around the age of 59 which was built into the old early retirement regime (see for evidence of this Kapteyn and De Vos, 1998) and replace it by an actuarially neutral FER scheme the theoretical prediction will be that future labour fore participation of older workers (those between 59 and 64) will be somewhat higher and the transition from work to retirement will be far smoother than it is right now (see Bettendorf et al. 2000). However, this is a once-and-for-all shock and it does not imply that the long-run trend will be reversed.

In order to develop some insight into the long-run trend in retirement behaviour in the Netherlands we have constructed Figure 1 which shows the cumulative percentage of men from different birth cohorts who have withdrawn from the labour market. Figure 1 clearly depicts the urge to retire early as a structural phenomenon among different cohorts of employees in the Netherlands.[3] The data have been taken from a different survey (NESTOR-LSN) among 4,400 older Dutch men born between 1903 and 1937.

**Figure 1: Cumulative probability of retirement for various cohorts of men**




[3] A more extensive discussion of the long-run trend in the Netherlands is presented in Liefbroer and Henkens (1999).

Whereas a mere 20 percent of all men born before 1908 had left the labour force before reaching the age of 65, this percentage had risen to 90 percent for cohorts born in the years 1928-1932. Employees born at the beginning of the twentieth century spent 74 percent of their lives in the labour market, compared with 58 percent among the youngest cohort of pensioners.[4] As the life expectancy at birth is on the rise, the length of people's working lives would have to be extended as well in order to bring this downward trend to a halt. There are some signals that things are slightly but gradually changing. The latest born cohort in Figure 1 (viz. 1933-1937) shows this to some extent as the retirement behaviour is almost identical to that of cohort 1928-1932. In other words this suggests that the long-run trend has come to a halt and that this must have happened somewhere in the mid-1990s. Closer examination of the aggregate labour force participation statistics for the Netherlands shows that this is no accident as these statistics suggest a similar break during the years 1994-1995.[5]

What is remarkable about the early retirement reform in the Netherlands is that the downward trend of labour force participation has grinded to a halt in the mid-1990s, long before the early retirement system was actually reformed and put into practice. This suggests that other factors besides the retirement system are at work on the labour market. The earlier mentioned changing tide on the labour market, switching from a situation of large-scale unemployment to a situation of labour scarcity, could well be the most plausible explanation for this state of affairs. Employers no longer use the conventional exit routes for restructuring their organisation and as a consequence the involuntary outflow through early retirement schemes has dropped.

The introduction of the FER system will no doubt tempt older workers to delay retirement and represent an extra source of labour supply. It is questionable whether this would completely reverse a trend that set in a century ago. It will probably stop the trend, but it will generate a number of consequences, which at present are not well assessed. With the introduction of FER schemes there are three sources of uncertainty surrounding the consequences of FER packages to act as an incentive to continue working till the age of 65:

- *Interdependent exit routes*. The reason why one may have doubts about the question whether the trend will be reversed is the fact that the different exit routes from the (Dutch) labour market are closely interrelated. It is well acknowledged that the low labour force participation in the Netherlands is caused by three types of outflow: early retirement, disability and unemployment (De Vroome and Blomsma, 1991;

[4] The median duration of life in birth cohorts 1903-07 and 1933-37 has been estimated on the basis of the cohort life tables for the Netherlands for the years 1850-1990 (see for more information Van Poppel, Tabeau and Willekens, 1996). For the survival after 1990 the period life table for the year 1997 has been used. Values for the five-year cohorts have been calculated making use of the unweighted average for the individual cohorts.

[5] See http://www.cbs.nl/nl/statline/index.htm

Kerkhofs et al.,1999). These three types of outflow are not independent of one another: restrictions in one irrevocably result in an increase in another. Research has convincingly proven that restricting the early retirement outflow will lead to an increase in disability outflow and unemployment (Van Imhoff and Henkens, 1998). So far, early retirement benefits have generally been higher than disability and unemployment benefits. Exit from the labour market through disability or unemployment is therefore virtually never an attractive option for workers who are eligible for early retirement. This is likely to change when early retirement reforms lead to a decrease in the level of pension benefits. As soon as FER payments drop below the level of disability or unemployment benefits, the take-up of these latter provisions will increase strongly. This will, of course, have important implications for the labour force participation of older workers.

- *Lifetime wages and productivity*. A second reason why one should not have set one's hopes too high with respect to FER schemes in extending the length of working careers may be found in the condition that the base of (early retirement) savings, the lifetime wage structure, remains untouched. A central issue in personnel and labour economics is the divergence between productivity and wages. Wages increase generally much stronger with age than productivity, particularly in the Netherlands where salary scales with automatic annual increments are common. It may therefore not come as a surprise that Dutch employers perceive increasing labour costs as the most important consequence of an ageing workforce (Remery et al., 2001). Encouraging older workers to keep on working will not solve the workforce ageing problems of firms, it might even aggravate the financial problems as the average working age will merely increase by such an initiative.
- *Transitional dynamics*. Reforms do not take place overnight. The transition periods agreed upon in the (collectively negotiated) labour contracts for changing from the old early retirement system to FER schemes tend to be so long that many cohorts of older workers will still be able to benefit from the old early retirement schemes in the future, and this will be reflected in the labour force participation of these cohorts. It is interesting to note that it is the baby-boom generation that will continue to benefit from early retirement schemes whilst the bill for their 'free lunch' will be footed by the younger generations. To what extent future generations will compensate the deterioration of early retirement benefits by individual saving plans which enables them to retire early is at this moment difficult to say.

## 7. Conclusions

The long-run trend to retire early from the labour market is clearly visible in many countries. Attempts to curb this trend and to encourage later exit from the labour market are of fairly recent date. In the Netherlands much is expected by the government and firms of the transition of PAYG funded early retirement systems to individually based retirement systems. In these newly designed Flexible Early Retirement (FER) systems retirement benefits are less dependent on the intergenerational solidarity of workers with (early) retirees, but on the retirees' own contributions over their career. The reforms must enhance the position of older workers on the labour market and increase participation levels.

In this article we first examined the opinions within Dutch society concerning the implicit intergenerational contract on the labour market, which promoted the use of exit routes among older workers. The results for the Netherlands show that in relatively short time sentiments on the labour market about generational equity have switched. In the seventies and eighties the old were supposed to make room for the young on the labour market but in the 1990s the support for age-equality of job opportunities for both young and old workers on the labour market has become overwhelming. A majority of the population - young and old - hold the view that persons of 65 or older are just as much entitled to work as young persons. These results seem to contradict somewhat the evidence for Scotland where Loretto et al. (2000) concluded that a majority of young people agreed that tackling youth unemployment should be accorded greater priority than tackling unemployment of those workers over 50. There is however also a schism in attitudes in the Netherlands as the publicly held views about the equality of job opportunities across age groups does not seem to be reflected in privately held intentions to retire. Although there is increasing support for the opening of the labour market for those beyond the official retirement age of 65, still very few are inclined to work past that age themselves.

A second research finding is that the introduction of FER schemes can substantially increase the number of years worked compared to desired retirement date. The FER will affect retirement intentions quite strongly of those who desire to retire at the age of 60 or younger. The age groups 61-64 will hardly change their behaviour. The study also shows that retirement bonuses trying to trigger workers to work until the age of 67 seem to have an incentive effect on especially those workers who are already planning to retire near the age of 67. People who plan to retire at 60 or even younger are hardly affected by this bonus. Private savings will probably dampen the work extension effect of a switch from a PAYG to an actuarially neutral early retirement scheme as it enables those with substantial wealth to retire far before the age of 65 and at least stick to their preferred retirement date. Despite retirement reforms most workers still want to stop working long before they reach the official retirement age of 65. Of course, intentions regarding retirement may change with time progressing. Research into the relationship between these intentions and actual behaviour shows, however, that those most inclined to change their plans are people who initially said they do not intend to take early retirement but ended up doing so after all (cf Anderson, et al., 1986; Henkens and Tazelaar, 1997).

Our results suggest that, given the importance people attach to leisure time, the early retirement reform is just part of the solution and it remains to be seen whether the long-run trend towards early retirement will actually be reversed. The question whether or not we are witnessing a reversal of a trend has already led to a fierce debate in the US (*Wall Street Journal*, 1999) which so far remains unresolved. Quinn (1999) argued that the early retirement trend in the US is showing a significant break, a reversal, which he tracks to the mid-1980s. The puzzle is of course what has brought on this break and did this break also occur in Europe? Quinn points to significant institutional changes in the US like ending mandatory retirement practices, making work at older ages financially attractive and the shift from defined benefit to defined contribution pension plans. Costa (1998) on the other hand points out that pension plans and social security systems are not the primary force driving the long-run trend and in her opinion Quinn puts too much emphasis on the cyclical effect. Economic history points out that a slowdown in retirement trend is not unprecedented: older workers' participation in the US labour force rose between 1850 and 1870 and again between 1910 and 1920 before the long-run trend resumed. Costa receives some additional support from Ahituv and Zeira (2000) who show how labour supply of older workers in the US is negatively affected by technical progress. Technical progress could in principle lead to higher labour force participation as it raises real wages, but as the findings by Ahituv and Zeira show this positive effect is dominated by the negative effect on labour supply as technical progress erodes technology specific human capital.

What remains odd about the Dutch case is that labour force participation rates of older workers have picked up before the *actual* retirement reform had been carried out. Our interpretation of what is happening right now in the Netherlands is that favourable business cycle conditions reduce the outflow of older workers, but still few employers are inclined to recruit older workers. As some calculations by the OECD (1998: 144) show, the share of older workers in recent hires (across nine EU countries) is almost 13 percent lower than that of prime-age workers. Employer preferences for younger job candidates may explain why older workers have such a hard time on the labour market. The same harsh fact clearly shows up in the Dutch labour market. Van Beek et al. (1997) show that in case of hiring workers it is still the employer who decides and the employer generally prefers younger to older workers. Moreover, research among employers in the Netherlands (Remery et al., 2001) underline Taylor's (2001) remarks that recent attempts to encourage later exit often do not coincide with reforms aimed at improving working conditions for older workers and increasing their employment prospects. The early retirement reform probably exacerbates the disadvantages of those workers at risk who may, for example, be forced to continue working while in poor health, or still be forced to retire but this time on poorer terms. While the current retirement reforms dismantle 'pull' factors in an effort to increase participation rates among older workers, there are other reasons why older workers are exiting in addition to it being financially attractive to retire.

The real acid test for the early retirement reform will probably have to be an experiment in the real world under real adverse conditions because only then will the true effectiveness of the reform become visible.

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