

# Elders In the Workforce: Advantage and Disadvantages of Staying on the Job

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# Elders in the Workforce: Advantages and Disadvantages Of Staying on the Job

*Is it wise to encourage older employees to delay retirement? Some statistics say yes. While there are benefits to continuing to work, however, there are also financial consequences. This article discusses the advantages and drawbacks of staying in the workforce beyond the age of sixty-five.*

**By Monica Pikoske**

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**A**t the end of the day, most Americans are left with feelings of accomplishment, self-satisfaction, and integrity. This stems from the ability to achieve and maintain gainful employment. At the end of many days and years, however, people feel entitled to reap the benefits of their hard-earned retirements. The current Social Security system, tax structures, and pension plans allow people to do this. However, the workforce is changing—and so are the considerations for remaining in or reentering the workplace.

Take, for example, my own parents: My father, aged sixty-one, retired early from engineering at the age of fifty-six to spend more time working on his hobbies. However, he has recently embarked on a second career in the postal carrier service. Similarly, my mother, aged sixty-six, left full-time teaching thirty years ago in order to raise three children. She has recently returned to teaching as a substitute. When asked their reasons, both my mother and my father cite minor financial rewards, but much of their motivation is linked to sociological benefits: They truly appreciate being physically and mentally able to contribute to the needs of their small community.

While I first thought my parents were unique in their post-retirement careers, I now realize that there is a growing need to encourage older employees to remain in or reenter the workforce, and my parents are unknowingly trendsetters in their time. However, there are also significant barriers that need to be addressed before the fifty-plus employee decides that continued employment is much

more attractive than a retirement full of leisure activities.

The workforce is getting older as the Baby Boomers reach retirement age, the younger generations are not replenishing these numbers, and Social Security is scheduled to run out of funds somewhere around the year 2035.<sup>1</sup> So while statistics indicate that it would be wise to encourage older employees to delay retirement, there remain financial consequences to those who do; but there are also financial benefits for older employees who continue to work.

### **Why It Is Necessary To Rethink Our Workforce**

Recently policymakers, employers, and academics alike have been debating how to address the problems of a shrinking labor force and a decreasing Social Security trust fund. Because it accounts for five percent of the Gross National Product, and that figure is expected to rise in the next few years, Social Security is the primary target for reform.<sup>2</sup> In addition, the present structure of Social Security is in jeopardy of going bankrupt.

In order to appreciate the necessity for reform, one must first understand the rapid rate at which the labor force is aging. The gradual shift in the demographics of the labor force is increasing the strain on the Social Security system. Since the birth of the Baby Boomers, the pool of employees supporting retirees has diminished.

In 1950, the ratio of workers to retirees was 16.5 to 1. This means the taxes of 16.5 workers were paying the Social Security benefits of one retiree. Currently, about 3.4 workers support each retiree. By 2030, just 2 workers will have to support each retiree.<sup>3</sup>

This trend indicates that with a reduction in the number of employees available to support each retiree, some changes are required. Social Security benefits will either need to be decreased, or the amount of income taxes that go to supporting current levels of Social Security will have to increase to around fifty percent of wages.<sup>4</sup> In addition, the disparity among the populations of each generation is worsening.

Between now and the year 2030 the percentage of people over age sixty-five in our population will double to a quarter of the population, equal to the number of people ages twenty to thirty-five. Older Americans will live longer. In 1900 the life expectancy of a child at birth was forty-nine; it is now seventy-six, a bigger spurt than in the prior 5,000 years. Our youthful population, on the other hand, is not even reproducing itself. We are fast becoming a middle-aged society.<sup>5</sup>

Not only is the large population concentrated in the Baby Boomers demanding to our current system, there appears to be little hope for the subsequent generations to alleviate the problem by producing a larger pool of laborers. These demographics warn that our current system will be overloaded too quickly unless we start to address the growing need.

Next, one must understand the nature of the Social Security redistribution system and how, under current laws, the system will go bankrupt in a few decades. The pay-as-you-go system takes withholdings from one generation of employees and redistributes it to the retirees of the preceding generation.<sup>6</sup> The amount of benefits a retired worker is entitled to depend directly on the amount of contributions he or she has made over the years.<sup>7</sup> A mathematical formula is used to help determine the benefit for each retiree.

For a typical retired worker, the process of computing the AIME (average indexed monthly earnings) starts by identifying all of the years in which that worker had covered earnings and determining the amount of earnings in those years. Indexing for inflation is used to make earnings from early in the worker's career comparable to earnings in later years. Up to five years of low earnings are excluded. Then the highest thirty-five years of indexed earnings are selected and totaled. This total indexed earnings figure is then divided by thirty-five years to get an average indexed annual earnings figure.<sup>8</sup>

Because these benefits are paid by the current

contributions of younger workers, however, as the number of retirees multiplies and their life expectancies grow, a reduced labor force will be increasingly taxed to maintain the promised levels of benefits. Eventually, the smaller labor force will be unable to support this current system.

### **Incentives to Remain in the Workforce**

The Social Security system currently contains incentives that encourage elderly employees to remain in the workforce. These are intended to help alleviate some of the pending shortages in the system.

The first incentive is inherent in the calculation of AIME.<sup>9</sup> Second, there is a delayed retirement credit for employees who continue to work after the age of sixty-five.<sup>10</sup> In addition, there are particular tax provisions that exclude Social Security benefits from taxable income.<sup>11</sup> These combined features provide a modest incentive to an older worker to remain in his or her current employment, provided that he or she is willing and able.

Currently, Social Security benefits are paid out based on the amount of contributions made during years of employment. It would follow that employees would want to maximize those contributions while they are still employed, enabling each retiree to achieve the highest possible payout upon retirement.<sup>12</sup> Because the AIME excludes lower earning years, an older worker who has a greater likelihood of earning higher wages would thus be able to earn higher benefits upon retirement by staying in the workforce at that higher rate of pay.<sup>13</sup>

Similarly, the Social Security system encourages delayed retirement in two ways: It allows for early collection of benefits but at a lower rate,<sup>14</sup> and it provides a credit if the employee delays retirement and application for benefits.<sup>15</sup> Older employees can opt to retire at the age of sixty-two and start collecting Social Security benefits under the Earliest Eligibility Age provision.<sup>16</sup> However, just as benefits are indexed in accordance with inflation, benefits collected before the age of sixty-five are actuarially reduced to around eighty percent of the regular monthly payment.<sup>17</sup> This reduction is appropriate, considering that the amount of benefit is essentially fixed upon retirement.

Someone who wishes to draw on those benefits

early must be prepared to receive a smaller payment each month than someone who retires at age sixty-five.<sup>18</sup> In terms of motivating workers to stay in the labor market, some studies suggest that greater benefits under Social Security play only a minor role in a person's decision to leave the workforce.<sup>19</sup>

On the other hand, it appears that the delayed retirement credit, under 42 U.S.C. § 402(w), is a more persuasive provision because it awards a flat percentage increase to people who put off retiring.

The delayed retirement credit increases the monthly benefit to be paid to a worker who delays receipt of benefits until after normal retirement age because that worker has not filed an application for benefits or was working. The delayed retirement credit [was] five percent per year for workers aged sixty-five in 1997 and 1998 and will increase by one-half of one percent in 1999 and every other year thereafter until it reaches an actuarially fair eight percent in 2008.<sup>20</sup>

This is a nice option for workers who have already made the decision not to retire early, and gives an added encouragement to stay past the age of sixty-five. The delayed retirement credit is most appropriate in cases where the older employee has the desire and physical capability to remain at his or her job; however, it needs to be emphasized once again that financial rewards are only part of the decision to stay in the workforce.<sup>21</sup>

The final incentive for continuing employment after the age of sixty-five involves federal tax structures that reward this choice. Specifically, a certain percentage of Social Security benefits are not taxed as income.

Most of the Social Security benefits received by elderly individuals are excluded from gross income because of a special tax provision. The actual amount of a beneficiary's Social Security benefits to be included in gross income is determined by applying a complicated two-tier formula. Basically, single taxpayers with incomes over \$25,000, and married couples with incomes over \$32,000, must include as much as half of their Social Security

benefits in income.<sup>22</sup>

This amounts to significant portions of a retired person's income being tax-free. A related provision allows employees to remain in the workforce and receive income and also receive Social Security benefits as long as they do not earn over a certain dollar amount each year. For 2000, the amount was \$25,000 per year that would not affect the Social Security benefit.<sup>23</sup> In addition, there is a standard deduction for persons over the age of sixty-five regardless of the person's employment status.<sup>24</sup> This, combined with other general tax provisions that directly and indirectly benefit the elderly, help support their decision to continue working past the age of sixty-five.

### **Disincentives for Remaining In the Workforce**

Although there are some financial incentives to delaying retirement, there appear to be more disincentives to postponing that decision. We have lived in a society that assumed age sixty-five is the appropriate age for retirement for far too long without considering changing it.<sup>25</sup> Now this age is entrenched in many government programs to the extent that if people want to remain active in employment after that, they are subjected to Social Security penalties, tax consequences, and even pension restrictions.

Even though Social Security appears to encourage working until sixty-five and beyond, there are some provisions that can actually penalize people for deciding to do so. For instance, the retirement earnings test provides that an older employee can lose benefits if he or she decides to continue working after starting to receive Social Security benefits.<sup>26</sup>

In 1998, the retirement earnings test allowed workers under age sixty-five to earn up to \$9,120 a year in wages or self-employment income without affecting their benefits. For earnings beyond that amount, one dollar of benefits was lost for every two dollars of earnings.<sup>27</sup>

Although this is not a critical amount of money lost over time, the income amount stipu-

lated in the statute is minimal, and most employees, even part-time, would easily exceed it.

Similar to the incentives to working past the age of sixty-five, the AIME calculation formula can also serve as a deterrent to delaying retirement.

Because no more than thirty-five years of earnings are used to compute average indexed monthly earnings, working another year often pushes out a prior year for which the worker had previously made Social Security tax "contributions."<sup>28</sup>

In other words, someone who has worked more than the required thirty years would have little or no reason to continue to work because the employee's contributions of that extra year would not directly increase his or her own benefit. This is typical of the Social Security system that takes money from one generation to pay the retirement of another. Plus, there is a strong sentiment of feeling entitled to those hard-earned benefits.<sup>29</sup>

Another incentive that can serve as a limitation is the delayed retirement credit. Although this allows for an increased benefit, it is merely five percent.<sup>30</sup> This amount of reward is too low.

For many workers, this inadequately compensates for a year of foregone benefits. The delayed retirement credit will increase gradually to an actuarially fair eight percent in 2008. Until then, Social Security discourages work after age sixty-five. Not surprisingly, more than half of new beneficiaries claim their benefits as soon as they can—at age sixty-two—and fully seventy-two percent of new beneficiaries claim them before age sixty-five.<sup>31</sup>

These numbers represent how strong these provisions actually work against retaining elderly employees.

These Social Security provisions, combined with certain tax consequences, urge retirement at the "normal" age. As stated earlier, a large portion of Social Security benefits are free from taxes. However, for single persons earning over \$34,000 in 1995, federal tax laws required tax on eighty-five percent of Social Security benefits

as income.<sup>32</sup> Although the salary requirement is considerable for those who remain in high-paying jobs or have the same job for years, this salary requirement is easily satisfied. For those who continue to work, under certain requirements, they could pay on numerous levels for that decision. First of all, the income is taxed if the employee receives Social Security benefits. Second, portions of those Social Security benefits are taxed.

Further, the employee must continue to contribute to the Social Security system. These layers of taxes become too burdensome, and the subsequent income is not worth the effort for many elderly employees.<sup>33</sup>

Finally, some employers are punishing elderly employees for remaining in or reentering the workforce by placing restrictions on pension plans. For example, Kansas has recently implemented a program for its public employees called the Kansas Public Employee Retirement System.<sup>34</sup> This program applies to public employees, school employees, peace officers, firefighters, and judges.<sup>35</sup>

[R]etirees who reemploy with an employer in the same subsystem may keep full pension benefits while earning their new salary, unless the post-retirement employer is the same employer from which the member retired. When returning to employment with the same employer that the employee worked for in the final two years before retirement, the retiree faces earnings limitations.<sup>36</sup>

The system is based on the premise that every state has some form of pension limitation for certain retirees who remain in or reenter the workforce.<sup>37</sup> Although public-sector workers typically have generous benefits, this pension restriction, combined with the Social Security penalties and tax consequences, does not leave public employees over the age of sixty-five with much of an incentive to continue working.

### **Possible Solutions**

Although the shrinking labor force and the growing number of expected retirees threatens to deplete our Social Security program entirely, the

benefit should not be eliminated. Social Security is widely recognized for protecting our retirees from impoverishment and statistics support this. For example,

[t]hirty years ago, almost 30% of the elderly were in poverty, a poverty rate that was more than twice as high as the rate for the population as a whole. Today, in contrast, only about 12% of the elderly are subject to poverty, a rate that is about the same as the rest of the adult population.<sup>38</sup>

This change is significant because of the broad scope of the Social Security system. It currently covers over ninety-five percent of the labor pool, and no other government program is as extensive.<sup>39</sup> Because of this, a large portion of the retiring workforce relies solely on Social Security benefits for retirement. As one scholar noted, "six out of ten private-sector workers of retirement age have no private pensions to fall back on, and less than half of all private workers are currently earning pension credits."<sup>40</sup> Therefore, it is imperative that this system be reformed so that it can continue to provide for our growing number of retirees, and one way to do this is to encourage older workers to remain employed.

Some policymakers suggest reforms to the existing Social Security program, while others maintain privatizing or partially privatizing Social Security is an even better approach. Regardless, Senator Nickles suggests some very significant policy considerations to be addressed when implementing reforms: "Allow for the change to be voluntary, ...provide for the highest possible return for workers, ...make the system self-sustaining, ...[and] require no increase in taxes in order to fund the change."<sup>41</sup> The debate over reforming Social Security is bound to be an endless political foray, but remaining focused on those who have the most to lose in these reforms might help develop the best solution.

Those who recommend reforming the existing Social Security program suggest a myriad of reforms including raising the retirement ages, extending the benefit computation period, changing tax consequences, eliminating the retirement earnings test, raising the delayed retirement cred-

it, and even converting Social Security into individual retirement accounts.<sup>42</sup> The most controversial of these suggestions is raising the retirement age. Although it is not disputed that the age of sixty-five was arbitrarily chosen as the appropriate age to retire, this was done at a time when life expectancies were much shorter and age-related infirmities were much more prevalent.<sup>43</sup> No adjustment to this age has been considered even though people are living longer, they are in better health, and they are physically and mentally able to continue working.<sup>44</sup> The best argument for raising the retirement age is that it would require employees to remain in the workforce. The earliest eligibility age would necessarily need to be increased as well, or the incentive would be lost.<sup>45</sup>

Other proposed Social Security reforms provide less rigid motivations. If the benefit computation period were extended, the AIME would naturally rise. Because employees could still exclude the lowest-earning five years, they would have greater incentive to stay at the higher-paying jobs many of them hold in their later years.<sup>46</sup> By capping the period at thirty-five years, there is little motivation to go past the required number of years. This deterrent could be offset by providing a direct benefit of an increased monthly payment. Likewise, eliminating the restriction under the retirement earnings test would also inspire more elderly employees to stay employed.<sup>47</sup> Increasing the amount offered in the delayed retirement credit would have a similar effect.<sup>48</sup> Finally, removing some of the tax consequences such as increasing the amount of benefits that are tax-free would provide additional enticements.<sup>49</sup> All these reforms are relatively minor and require little in terms of legislative effort, but represent some major relief to the overloaded system.

A rather creative solution involves converting Social Security benefits into individual retirement savings accounts. Jonathan Barry Forman states:

[p]roponents of complete or partial privatization of Social Security typically call for replacing all or a portion of the current system with a system of individual retirement savings accounts that would invest in the stock market. All or a portion of the Social

Security taxes that workers now pay to the federal government would go instead into IRSA's which would operate much like today's Individual Retirement Accounts.<sup>50</sup>

Although Forman agrees with this approach, he suggests that the individual retirement accounts be handled and invested by the government.<sup>51</sup> This reduces some of the risk involved in transitioning over to a completely privatized industry, and transforms the redistribution system to a direct benefit system where an employee's tax contributions go directly to him or her upon retirement. It also allows for a greater return on an employee's contributions.

Others recommend privatizing the retirement benefit program based on the success of similar programs in other areas of the world.<sup>52</sup> Some of the benefits of privatization include: higher rates of return, reduced government liability, creation of a self-sustaining system, disconnection of benefits from length of life, and better benefits for lower-income workers.<sup>53</sup> An indirect benefit is greater economic growth due to the larger amounts of private investment.<sup>54</sup> In addition, keeping elderly employees in the workforce would help alleviate the demographic problems with the redistribution scheme of Social Security.

## Conclusion

Unfortunately, each of the solutions being offered comes with a downside and considerable risks. However, these risks do not justify ignoring this problem.

There are currently incentives to those who want to remain in the workforce, but they have shortcomings, and the financial consequences far outweigh the incentives. Also, financial considerations are not the only reasons for deciding to retire. Many people do weigh the financial costs and benefits, but the decision to retire encompasses many other non-fiscal issues. Therefore, financial rewards alone are not sufficient to change the collective minds of the Baby Boomers.

Retirees want change. They want more freedom and less accountability. They have been contributing to the Social Security Trust Fund for years, and want and deserve their fair share.

Stronger financial incentives are a step in the right direction, but the true solution will embrace the proper balance of monetary rewards and sociological benefits.

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### Endnotes

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15. *See* 42 U.S.C. § 402(w).
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17. Forman, *supra* note 8, at 292.
18. *Id.*
19. Moore, *supra* note 1, at 571.
20. Forman, *supra* note 8, at 291.
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22. Forman, *supra* note 11, at 601-02.
23. Forman, *supra* note 8, at 291.
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25. Moore, *supra* note 1, at 547.
26. 42 U.S.C. § 403(f).
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