



# **INCENTIVES TO PROMOTE LONGER WORK LIVES**

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# 1 INTRODUCTION

This paper uses the existing literature to analyse the implications of the ageing process for the labour market. It also discusses policy measures that might be used to counter the negative effects of this process. Although we treat a broad range of possible measures, most attention will be paid to measures promoting longer work lives.

In the next 50 years the share of people aged over 65 will increase dramatically. This ageing process is a global phenomenon (ILO, 2002). However, in Europe populations are already relatively old and in this part of the world the implications of the ageing process will become noticeable earlier than elsewhere. Although, this is already known for quite some time, in most countries governments have become fully aware of the implications only recently. Therefore, the development of policies to deal with the ageing process is still at an early stage.

Obvious implications of the ageing process are that:

- a) the share of the inactive in the total population increases, leading to an upward pressure on public expenditure;
- b) the share of the 50 to 65 old in the working age population increases, which leads to a decline in the macro labour force participation rate under the assumption that the current low labour-market participation of this age category will remain the same.

Therefore, a smaller part of the population has to support an increasing number of inactive.

These are the implications of the ageing process that are usually stressed. However, an older workforce may also have negative effects on productivity and innovation. In fact, a relatively low productivity of older workers may be one of the causes for the low employment rate of this group. If the ageing process not only leads to a smaller employment- population ratio but also to a slow-down of productivity growth, the implications for income per capita could be very serious. Then, the logical question is: what can be done about the negative effects on the relative size of the labour force and on productivity?

A higher pension age is often proposed as the solution to the problem of declining participation rates. However, current employment rates among people aged between 50 and 65 are very low. Therefore, a higher pension age as such will not make a lot of difference, unless the conditions are created under which employers are more willing to employ older workers and the latter are more motivated to work longer. In the paper we will therefore pay a lot of attention to measures that increase the incentives for companies and older workers to prolong work lives. However, we also discuss measures in the field of human capital and productivity.

The paper is structured as follows. The first three sections deal with the impacts of the ageing process on: a) the relative size of the working population; b) the participation rate and c) productivity. Furthermore, the implications for the labour market and the economy are discussed. Then, the role of incentives for the employment rate of older workers is discussed. Next, we discuss possible policy responses with an emphasis on creating favourable incentives. The final section contains the conclusions.

## 2 IMPACT ON THE RELATIVE SIZE OF THE WORKING AGE POPULATION

Although demographic development is not completely autonomous, population forecasts give a pretty accurate picture of the future size and age composition of the population. The forecasts made, clearly show that the old-age dependency ratio (defined as the number of 65 plus aged divided by the working age population) will strongly increase between now and 2050 (table 1). For the OECD countries it will on average more than double from 23,8 per cent in 2000 to 49,9 per cent in 2050. Furthermore, the very old (80 plus) will take an increasing share in the 65 plus population (Casey et al, 2003). On average this share will increase from 22,4 per cent in 2000 to 35,1 per cent in 2050.

Among the EU countries that are also OECD member, Austria, the Czech Republic, Italy, Poland and Spain face the strongest increase in the old-age dependency rate (more than 30 percentage points), while the increase in this ratio is relatively low in Denmark, Sweden and the United Kingdom (less than 20 percentage points). From the two biggest OECD countries outside the EU, Japan and the United States, the figure for Japan is similar to the first group; the figure for the United States similar to the second group. The table contains data for only three new EU countries, but from other sources we know that most other new member states are also confronted with rapid ageing of their populations (Fortuny et al, 2003). Cyprus is one of the exceptions.

A declining share of younger people accompanies the increasing share of older people. If we define the overall dependency ratio as the sum total of the population aged under 15 and the old-age population divided by the working age population than for some countries the increase in the dependency ratio is less pronounced. This holds particularly for some of the new member states where fertility rates have sharply declined after the transition.<sup>1</sup>

A higher old-age dependency ratio entails higher expenses on pensions and health care. However, a declining number of young people reduces the expenses on education. In the paper by Casey at all projections are presented for age-related public spending. According to these figures total age-related expenses will – on average - increase from 21,2 per cent in 2000 to 27,0 per cent in 2050. Early retirement programmes only accounts for a small part of this increase. Most likely the figures already reflect the tendency to reduce access to such programmes.

An increase in the population share of older people does not necessarily cause a problem. If pensions are based on a funding system and most people are able to reach a sufficiently high pension level, the implications may not be that far-reaching. Even the increasing costs of health care and other services for older people could in that case perhaps partly be paid by the older people themselves. However, many countries still have a pay-as-you-go system, which implies that pensions have to be paid from the current income of the still active. Furthermore, the increasing expenditure on health care for older people will at least partly be paid for by the working population. As the paper by Casey et al shows, considerably higher tax rates for workers would be required to pay for the increasing age-related expenses. A negative side-effect of this might be that it reduces the incentives to work and could therefore reduce the participation rate and the number of hours worked with negative effects for the economy. This

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<sup>1</sup> Although this implies that the ageing of the *working age* population is an even more pressing problem for these countries.

would mean that even higher tax rates would be needed to account for the larger age-related expenses.

*Table 1 Old-age dependency ratios and shares of the very old in the total elderly population*

	Old-age dependency rate (65 plus population divided by the working age population)			Very-old persons ratio (80 plus population as a percentage of the 65 plus population)		
	2000	2050	Change in percentage points	2000	2050	Change in percentage points
Austria	20.4	47.0	26.6	23.3	34.0	10.7
Belgium	28.1	49.5	21.4	21.5	39.7	18.2
Czech Republic	21.9	57.5	35.6	17.0	29.0	12.0
Denmark	24.2	40.3	16.2	26.8	37.4	10.6
Finland	25.9	50.6	24.7	22.0	35.2	13.2
France	27.2	50.8	23.6	22.2	37.5	15.3
Germany	26.6	53.2	26.6	21.1	37.5	16.4
Hungary	23.7	47.2	23.5	16.9	26.6	9.7
Ireland	19.7	45.7	26.1	23.1	27.1	4.0
Italy	28.8	66.8	38.0	21.0	37.1	16.1
Netherlands	21.9	44.9	23.0	23.3	37.3	14.0
Poland	20.4	55.2	34.8	16.2	26.6	10.4
Portugal	26.7	50.9	24.2	19.1	30.7	11.6
Spain	27.1	65.7	38.5	21.8	33.2	11.4
Sweden	29.4	46.3	16.9	28.0	35.7	7.7
United Kingdom	26.6	45.3	18.7	25.0	37.3	12.3
Japan	27.7	64.6	36.9	21.9	42.2	20.3
United States	21.7	37.9	16.2	26.5	36.1	9.6
OECD average	23.8	49.9	26.1	22.4	35.1	12.7

*Source: Casey et al (2003).*

A second implication of higher dependency rates is that a larger share of the labour force has to be employed in health care and related activities. This may have a negative effect on macroeconomic development if it goes at the expense of high-productivity activities.

### **3 IMPACTS ON PARTICIPATION RATES**

Currently, participation rates among people aged over 50 are low. The EU average for this category is 57.7 per cent in 2002, while the average macro participation rate is 71.9. According to forecasts by Burniaux, Duval and Jaumotte (2004) the participation rate will drop with 10 per cent points between 2000 and 2050 if one purely takes the demographic effect into account and assumes that the current pattern in labour force participation will not change (table 2). Cohort are assumed to have a positive effect on participation, but on average this effect is small. If we

look at the total change between 2000 and 2050 the effects are particularly big for the countries in Central Europe. However, also for the other EU countries the effects are big.

*Table 2 Change in aggregate participation rates (base-line scenario)*

	Levels in 2000	Percentage point changes 2000-2025		Percentage point changes 2025-2050		Total percentage point changes 2000-2050
		Total change	Change owing to demographic effects	Total change	Change owing to demographic effects	
Austria	73.8	-6.5	-7.2	-5.1	-4.7	-11.6
Belgium	65.2	-2.2	-6.3	-3.1	-2.8	-5,3
Czech Republic	71.6	-7.5	-6.2	-11.1	-11.1	-18,6
Denmark	80.0	-7.0	-7.3	-1.7	-1.4	-8,7
Finland	74.3	-8.2	-10.7	-0.9	-1.4	-9,1
France	68.0	-6.7	-6.9	-2.7	-2.7	-9,4
Germany	72.2	-3.5	-6.4	-3.3	-3.1	-6,8
Hungary	60.2	-7.8	-3.9	-9.7	-8.8	-17,5
Ireland	67.4	5.1	-3.7	-5.0	-5.4	0.1
Italy	60.3	-1.0	-6.8	-5.8	-4.7	-6,8
Netherlands	74.6	-4.4	-9.7	-1.8	-1.8	-6,2
Poland	65.8	-7.8	-5.0	-9.3	-7.6	-17,1
Portugal	71.1	0.0	-2.3	-4.2	-4.6	-4,6
Spain	66.7	-0.8	-6.6	-5.7	-5.1	-6,5
Sweden	78.9	-9.1	-7.5	-1.0	-0.7	-10,1
United Kingdom	76.6	-4.5	-6.1	-2.0	-2.3	-6,5
Japan	72.5	-6.8	-6.9	-4.7	-4.6	-11,5
United States	77.2	-5.6	-7.1	-0.9	-0.4	-6,5
OECD average	70,7	-4.5	-6.1	-4.4	-4.1	-8,9

Source: Burniaux, Duval and Jaumotte (2004).

In reality the decrease in participation may be less than a mechanistic extrapolation suggests. With a given level of labour demand, a decrease in the size of the labour force will lead to a less than proportional drop in employment. This also implies that the unemployment rate will be lower, which may evoke new entrants to the labour market. Furthermore, the increasing demand for services in health care and related activities as a result of the ageing process may lead to an increase in labour demand.

In table A.1 in the annex the combined effect of a growing population share of the 65 plus and a lower participation rate of the active age population are shown. The figures are particularly worrisome for the new EU countries included in the table (Czech Republic, Hungary, Poland and Slovakia), Italy and Spain.

## 4 IMPACT ON PRODUCTIVITY AND INNOVATION

The impacts of ageing on the dependency rate and on labour market participation rates have received most attention. However, the effects on productivity and innovation could be equally important. If a person's productivity starts to decrease after a certain age, the ageing process could lead to a decline in macro economic productivity. There is evidence from various sources that a higher employment share of older workers goes together with a lower level of productivity (Gelderblom and De Koning (1992), Gelderblom, De Koning and Kroes (2003), Medoff and Abraham (1980), Mendes de Oliveira, Cohn and Kiker (1989), Crépon, Deniau en Pérez-Duarte (2002)). The pattern found by Gelderblom and De Koning and by Gelderblom, De Koning and Kroes is that the relationship between productivity and age has a parabolic shape: first productivity increases with age, but gradually the increase slows down and after a certain point (which roughly lies between 50 and 55 years of age) productivity declines. However, the literature is not unambiguous about the relationship between age and productivity (see Auer and Fortuny, 2000, for example). Furthermore, the total effect of the ageing process on macro productivity may be more limited as this process also implies that the share of young people diminishes. The latter also have – on average – a relative low productivity.

It is important to note that the ones from the 50-65 age group that have left employment are in most cases probably also the ones with the lowest productivity. This is most likely the case for the ones that became unemployed or disabled, but it will also hold for some that went into early retirement. This would mean that an increase in employment rates among the 50-65 years old could at the same time reduce productivity.

However, even if a negative correlation between age and productivity exists for the past, this does not mean that such a pattern is inevitable. There is evidence that the negative relationship between age and productivity depends at least too some extent on context factors and can thus be avoided by changing the conditions under which older workers have to work. Older workers have more difficulties than younger workers with some aspects of jobs such as a high work pressure, but on other aspects the difference are small or even to the advantage of older workers (social skills, management skills).<sup>2</sup> Therefore, if an older worker is not employable in his job anymore, he might still function in a satisfactory way in a different type of job. Sometimes such a change might involve a change of sector. For example, in the Netherlands a large cleaning company made an agreement with the security sector that older workers who had problems with the physical demands could move to the security sector if an assessment proved that they were suitable for that type of work. Often, training will be necessary to make the transition from one job to the other. There is also evidence that the level of investment in human capital during earlier stages of life is a crucial factor in ensuring employability at old age. The higher the level of initial education is, the lower the chance of a decline in employment rate at older age is. The same is true for training and mobility during one's career.

An older workforce could also have a negative effect on innovation and therefore on productivity growth. New technical knowledge is often embodied in young people who have been taught the latest developments in science and technology. Furthermore, on average young people are better educated than older people. What also plays a role is that during their career people tend to specialize and thus become more vulnerable for technical change at older age.

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<sup>2</sup> Older workers could, for instance, play a role in the transfer of knowledge (particularly of firm-specific and experienced –based knowledge) to younger workers.

Also from that point of view it would be important that initial education provides individuals with sufficient knowledge and competencies so that they will pick up new knowledge and develop new competencies during their working life.

It is difficult to say exactly how large the negative impact of ageing on the level and the growth rate of productivity is, but it is certainly not a problem that can be ignored. Higher investment in human capital is the answer, but how can workers and employers be stimulated to higher expenditure on and participation in training? In the next section we go more deeply into the role of incentives.

## 5 THE ROLE OF INCENTIVES

As was earlier said, employment rates in the 50 plus age category are low in many countries. In Austria, Belgium, Italy and Spain the figure lies below 50 per cent (table 3). In France, Germany, Ireland and the Netherlands the figure is only just above 50 per cent. Are companies unwilling to employ older workers? Do older workers prefer leisure to work? Or are older workers unable to work anymore. The fact that there is such diversity between countries that are similar in many respects (compare the Netherlands with Sweden, for example) suggests that preferences and disability are not the only factors behind the low employment rates of older workers. Differences in human capital intensity could partly explain the differences between the countries. The same is true for differences in legislation aimed at fighting age discrimination. However, we will concentrate on a different factor: incentives or rather the lack of incentives.

Table 3 Employment rates of people aged between 50 and 65

Austria	44.8
Belgium	41.0
Denmark	67.3
Finland	60.7
France	51.4
Germany	50.6
Ireland	55.4
Italy	40.7
Netherlands	56.0
Portugal	60.0
Spain	47.3
Sweden	74.1
United Kingdom	62.3

Source: Eurostat

### ***Productivity and wage***

The relationship between age and productivity has a parabolic shape. At young age productivity increases with age, but after a while productivity growth slows down. At some point a maximum is reached after which productivity declines. This turning point differs individually and depends both on the individual's physical constitution as well as on many context factors such as education, legislation, etc.. There is evidence that currently for most people the turning point is approximately at the age of 50-55.

Age-income profiles are different from age-productivity curves. Often, age-income profiles also follow a parabolic curve, but the peak in pay is hardly ever reached before retirement age. For higher educated people the curve remains almost linear until retirement age. According to contract theory this has to do with the fact that an expected rise in pay will motivate workers and therefore leads to a higher productivity. Often this has been institutionalised in pay systems.

The observed age patterns in pay and productivity imply that for many older workers productivity is considerably lower than their pay. One might argue that taken over the worker's whole career, costs and benefits are in balance for the employer. The fact that at older age wage costs exceed productivity is compensated by relatively low costs at young age. However, if employers can get rid of low-productivity workers, an implicit contract will not withhold them from it. This is particularly true if separation costs are low for the employer, because it is easy to have workers enrol in social security schemes or because both older workers and the government opt for early retirement. An unfavourable productivity-wage ration also implies that companies are reluctant to hire unemployed older workers. This is one of the reasons why expected unemployment duration for individuals aged over 50 is very long.

In principle, training can increase an unfavourable productivity-wage ratio. However, the pay-off period for employers is quite short in case of older workers. Groot and Maassen van den Brink (1997) argue that this is partly compensated by the fact that quit rates among older workers are relatively low. However, employers also face higher risks in terms of sickness and disability in case of older workers. Partly, the behaviour of employers will also be based on prejudice.

Our conclusion is that under the present conditions employers have an incentive to fire older workers rather than to employ them. There is also no sufficient incentive to offer training to older workers. In the coming years labour will become scarcer owing to the demographic developments. This may change the attitude of employers towards older workers. However, this may not offer a solution for low-skilled older workers with a productivity-below the minimum wage level.

### ***Incentives for workers***

So far, government policies have stimulated early retirement. In the Netherlands, for example, many pension funds developed pre-retirement schemes. Premiums from both employers and workers together with fiscal arrangements led to the situation where many workers could leave employment between the age of 55 and 60. For many the increase in free time outweighs the relative small decline in net income. The fact that at this age often the children have already left home and mortgages are paid, contributes to a choice for 'leisure'.

Following the same reasoning as for employers, older workers do not have a strong incentive to invest in human capital: the pay-off period is too short to get positive returns. However, this

arguments should be moderated somewhat in case of short types of training that are not that costly. The argument mainly applies to situations where older workers have to get retrained for

Box 1: What could be the reasons for high employment rates for older workers in Sweden?

The OECD report on ageing and employment policies in Sweden (OECD, 2003) does not give an explicit overview of factors explaining the good performance of Sweden in employment rates of older workers compared to other countries. However the description of the country situation gives some clues to answer this question.

First, employment rates for women have been relatively high for some time in Sweden. In the early seventies the fiscal system was individualised, leading to more incentives for women to work. Moreover, Sweden has developed good facilities for child care as well as care for old age people, making it easier for women to combine work with other obligations. These cohorts of females are used to work and building up a career and continue this pattern when becoming older.

Second, Sweden has not had generous early retirement schemes on a large scale. Both in the old system as well as in the recent new pension system, the public part of the system has offered possibilities to retire earlier, starting at 61. However, if workers made and make use of this, the pension level is lower the earlier the pension is taken. This reduction in pension level has a life-long consequence. This system has been less attractive than many systems of early retirement which have been running in for example Germany and the Netherlands, which offered early retirement until the official pension age at relative favourable benefit levels and without consequences for pension rights after 65. In the new Swedish system, the incentives have increased even more, for example because there is no maximum in years worked which is taken into account for determining the pension, so every additional year of work counts extra for the future pension level. There has been an “escape route” for companies by offering relatively high occupational pensions for older workers they want to lay off. However, in the new system, occupational pensions do not generate additional public pension rights, so the use of these schemes as a way of early retirement will probably diminish. Finally, social partners cannot make clauses in social agreements in which employees are forced to retire before the age of 67, which gives employees a certain freedom to work until this age.

Third, compared to many other countries the wage systems in Sweden are much less based on seniority rules. This leads to rather “flat” profiles comparing wages between age groups within the same type of functions. However, this rather flat profile is counterbalanced by certain systems of social premiums (especially for pensions!) which increase wage costs for older workers much more than for younger workers.

The situation for Sweden is not only a success story. The proportion of older age cohorts in longer sick leave and sickness compensation (formerly “disability pension”) is large and increasing. Already in 1993, during the recession benefits were lowered. Moreover, in 1995 the social insurance offices were given the possibility to reinvestigate the decision of disability. In 1997 the possibility of receiving a disability pension due to labour market reason was abolished. These measures helped to decrease the numbers, but later in the nineties, numbers have started to rise again. In January 2000, an attempt was made to lower the number of disability pensioners by offering all persons on disability pension the possibility to work for a maximum period of three years, without jeopardizing entitlements. After a year only less than 0.5% of all recipients accepted this possibility. A more recent measure is a temporary employment subsidy to make it easier to those on long-term sick leave to re-enter employment. Moreover, to strengthen employers’ responsibility for early and active rehabilitation, the sick period during which employers disburse pay to the employee has been extended from two to three weeks (Sweden’s action plan for Employment, 2003).

a new type of job. The fact that early retirement has become normal and to some extent the ‘norm’, may also have contributed to lower participation rates in training.

Easy access to social security benefits has also reduced the incentives for workers to continue working. The 50 plus category accounts for a high share of total expenditure on unemployment benefits. In some countries such as The Netherlands and Sweden also disability arrangements have attracted many older workers that under other socio-economic circumstances could have continued to work.

## **6 CHALLENGES AND POLICY RESPONSES**

### **6.1 CHALLENGES**

From the previous sections we conclude that the ageing process has the following effects:

- a) an increase in age-related expenditure, requiring a considerable increase in tax rates, which would in turn have a negative effect on the economy;
- b) a negative effect on productivity owing to the fact that a larger proportion of the workforce will be engaged in health care and related activities;
- c) a negative effect on labour market participation owing to the relatively low participation rate of people aged over 50;
- d) negative effects on the level and the growth rate of productivity owing to a larger share of older workers.

For countries with a good pension system based on a funding principle, the negative effects will perhaps partially be compensated by an increase in the demand for certain types of services in the field of travel etc. However, the conclusion is that the ageing process poses considerable challenges to society and that policy measures are needed to make sure that we can keep a moderate level of income growth per capita.

Policies should concentrate on two objectives: a) increasing labour force participation; and b) increasing productivity and productivity growth. Increasing pension age may seem as an obvious measure to deal with the problems. In the UK government is planning to increase the pension age for women from 60 to 65 (equal to men) as well as a certain type of pension benefit (pension credit). However, being part of the labour force does not guarantee that one will be employed. Therefore, if participation rates of age groups below the official pension age are low, then it is logical that much attention is paid on measures that increase the employment rate of these age groups. The fact that some countries such as Sweden have very high employment rates of older workers suggests that policy measures can make a difference (see box 1).

### **6.2 INCREASING THE INCENTIVES FOR OLDER WORKERS**

#### ***Making early retirement less attractive***

Early retirement schemes are widespread. During previous periods of high unemployment, early retirement was seen as a means to reduce unemployment and to improve the job entry chances of young people. One might argue that this was not based on sound economic reasoning, as

reducing labour supply also tends to reduce the level of employment. Therefore, the positive effects of early retirement are questionable anyhow. However, given the ageing of the population there is no doubt that early retirement should be made less attractive. This will not be an easy process because today early exit from working life is an important component for most employees in planning their future lives. It will not be easy to change these expectations. A first step, which was carried in the Netherlands at the end of the nineties, was to adjust early retirement schemes with fewer incentives to postpone retirement, into pre-pension schemes, which led to higher pension incomes if the decision to retire was postponed.

### ***Adjusting pension systems***

If productivity decreases from a certain age, people could still be employed if they would accept lower paid jobs. One of the reasons why older workers are often reluctant to accept lower paid jobs is that their pensions are based on their last salary. However, there is a tendency to adapt systems to benefit levels that are based on an average of the wage level over the whole career<sup>3</sup>. In such a regime, demotion has much less consequences for older workers. Continue working after the pension age is more attractive if a postponement of pensions is rewarded by higher pension incomes afterwards. Sometimes flexibility is also mentioned as a way to stimulate this. If people can work part-time in combination with a (“part-time”) pension, this could make this option more attractive. Flexibility by offering part-time options as a way of (early) retirement could also avoid that these people choose the full-time (early) retirement option because the workload is too heavy, or because they want to have more free time. However, experiences with part-time options are not very successful. In Germany part-time options of old age pensions are very rarely used. The workers tend to have a clear preference for full retirement in one step (Schmaehl, 2003). Also experiences in Sweden are not very encouraging (OECD, 2003). A partial pension system there was considered expensive afterwards, because in practice it sometimes functioned as a subsidy for switching from full-time to part-time work (instead of postponing full retirement). The conclusion is that there “there appears to be little evidence that subsidising part time work by a partial pension system would have positive effects on labour supply in terms of labour volume”.

### ***Blocking the road to social security***

Social security schemes like sickness and disability arrangements, as well as unemployment benefits can act as pre-retirement schemes. Policy options to prevent and counteract this, are: a) to cut in benefit levels, b) to periodically review the “state of” sickness and disability, c) to maintain the obligation to try to find a job, d) to interview and advice them regularly, e) to use “bonuses” for finding a job, f) to give them the opportunity to try to work in a new job without the risk of loosing their entitlements, if things do not work out, and g) to shorten the period of entitlement to a benefit. Germany is an example of a country where recently several reforms have been introduced in social security arrangement to improve the employment rate of older workers. Reduction of payment periods for older unemployed workers is one of them (Vogler-Ludwig, 2005). Also other countries used one or more of the policy options mentioned. However, these countries are all still struggling with high volumes of older age cohorts in social security arrangements

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<sup>3</sup> In Sweden in the past public pensions were based on the income in the “best” 15 years of the career. Now they are based on full life time income.

### *Making wage formation more flexible*

Wages are highly dependent on age. Typically, wage levels go up with age, which can make older workers less attractive, because productivity does not increase in the same way. A way out is to include more performance based elements in the pay system. This means that criteria must

#### Box 2: Policy instruments used in The Netherlands

Several specific **public policy** instruments and incentives have been developed to encourage the employment of older workers:

- To stimulate older workers to continue working, a specific tax deduction in the income tax has been introduced in 2002. This tax deduction is 241 Euro for those 57-59 and rises to 722 euro for those 62-64 (2004).
- In the middle of 2001 a taskforce *ouderen en arbeid* (elderly and employment) was established. A number of studies were carried out and a number of recommendations were presented in the final reporting of the task force in 2004. A change in culture both at employer and employee side is necessary to adapt to a situation of higher labour participation at older ages. Incentives and legislation can stimulate this process. These recommendations led to a number of new public initiatives.
- For the period of 2004-2007 the Ministry of Social Affairs & employment has put 21 millions euro available for experiments and projects which help to continue working of the elderly. Starting 1 December 2004 it is possible for companies and branches to submit their claim for projects and experiments.
- In November 2004, a national center for diversity-management has been established to support and advice employers with age-related human resource policies.
- A change of culture is necessary to increase the participation of elderly employers on the labour market. For that purpose a specific committee called *grijs werkt* (grey works) has been established at the end of 2004. The goal of this committee is to promote longer labour market participation of elderly under employers and employees. For the success of this group it is necessary to fight the stereotypes about elder employees. The committee wants to spread practical examples of 'best practices' under companies and institutions.
- The current ESF and EQUAL programs contain many projects that aim at reducing inequality and discrimination with respect to older workers. Often, the projects are carried out in close co-operation with the social partners.

Furthermore, in **collective agreements** several initiatives have been taken:

- In recent years, employers have been aiming to move away from seniority-based pay, basing wage increase more on performance. This has been reflected in collective labour agreements, which increasingly provide for the introduction of flexible pay (CPB, 2001, p.69). Data from the OSA-company panel also confirm the increasing role of performance-based pay elements. However, the seniority principle still plays an important role in Dutch pay systems (Van Opstal and others, 1997, Stegeman, 2000).
- Within many collective agreements, attention is paid to older workers. A review of collective agreements in 2001 (Spijkerman and Klaassen 2001) showed that about 40% expressed intentions to investigate the position of older workers and the (potential) role of HRM-policies for older workers. Many agreements also offer specific facilities to older workers, such as extra holidays or rights for days off for training, demotion (for example the guarantee that working in a lower function will have no or limited wage consequences), advise about one's future career, etc.
- Many collective agreements also certain agreements are made about sectoral levies to finance training activities. Often sectoral training institutes are partly financed out of those funds. Some of these training activities can specifically target to older workers, for example specific courses for older workers to deal with new technologies (ICT).

be found that are accepted as “just”. In many cases the criterion is a judgement by a manager. A positive side-effect is that in such cases the superiors are forced to regularly discuss the situation in detail with the (older) employee and also work on possible options for improvement. The criteria can also be linked to more collective scores, for example a profit of a certain department or the production of a work group.

#### ***Stimulate investment in training***

In the past most incentives for training were targeted towards employers. With the growing awareness that employees also have a self-responsibility for employability, instruments have been developed which target to individuals. Examples are instruments like the individual learning accounts and learning vouchers. The (limited) evaluations available for these types of instruments seem to indicate that they are quite successful (Brummelkamp and others, 2005).

### **6.3 INCREASING THE INCENTIVES FOR EMPLOYERS**

#### ***Experience rating in social security schemes;***

Employers tend to use social security schemes as an exit route for older workers. To avoid that, one could make the premiums employers have to pay dependent on the number of separations of this employer in the past. This measure increases separation costs and will therefore induce employers to find ways to improve the productivity of older workers. At the same time the legal barriers to firing worker could be reduced.

#### ***Reducing separation costs;***

A disadvantage of experience rating is that employers may become more reluctant to hire older workers. There are two ways to deal with this problem. First, it can be made more easy for employers to fire workers, which reduces separation costs. Furthermore, employers that hire older workers may be given a bonus to compensate for the risks.

#### ***Subsidizing wage-costs or reducing social premiums/taxes***

If for some older workers productivity is structurally too low to employ them, permanent wage subsidies for older workers might be considered. This could be done by reducing taxes and/or social premiums for employers. A negative aspect of such schemes is that the deadweight is considerable. The subsidy is provided for every older worker also for the ones that are perfectly employable. A way out of this could be to apply the scheme to specific categories of older workers. Perhaps the problem is most prominent among low-skilled workers.

#### ***Increasing mobility and participation in training (human capital)***

Companies are confronted with fluctuations in demand and the need for regular internal reorganisations. In these circumstances, situations occur in which these processes of adaption are partly carried out by the expulsion of older workers in all kind of arrangements. Representatives of companies admit that as long these routes are open without large cost consequences, there is less incentive to adapt to changed circumstances by investing in older workers (Schmaehl, 2003). Measures like experience rating might induce employers to invest more in their workers in order to avoid separations. However, training and mobility can also be stimulated in different ways. Examples of policy options for stimulating training investments by

companies are tax incentives, levies and subsidies. Overview evaluation experiences shows that tax incentives have a high deadweight, which to a somewhat lesser extent also applies for levies. Experiences with subsidies indicate better results, probably also because of a sharper targeting and formulating of conditions that is possible for this instrument (Brummelkamp and others, 2005). The employer training pilots in the UK, which also offer possibilities to subsidise lost

### Box 3: Policy instruments used in the United Kingdom

In recent years, the – complicated – pension system in the UK has been changed. The pension age for certain types of pensions will be increased. For women the official pension age will be gradually increased to 65 (instead of 60) in 2020, which is equal to the current situation for men. Moreover, a specific pension element which was available already from 60 years on, the pension credit, will also be available from 65 over the same period. This credit which was specifically initiated to support low-income groups, turned out to be an incentive to withdraw from the labour market for these groups. The age of retirement in the civil service is also proposed to increase to 65. Another measure related to the pension are an increase in the extra pension incomes which are the result of a deferral of pensioning.

There has also been ongoing reform of the UK's system of disability benefits. There is now stricter Personal Capability Assessment carried out by a doctor operating on behalf of the Department for Work and Pensions and the financial incentives associated with benefit receipt were reduced. Moreover, the importance of providing support the help people on disability benefits to move back to work has been recognised. Proposals include: a) Work focused interviews for new IB claimants, b) A return to work Credit for those moving off IB into employment, c): Access to a range of provisions to support a return to work.

Within the UK several initiatives have been taken to promote life long learning, which are open to all age groups. Some of these initiatives, like the *Union Learning Fund* managed to reach relatively many older workers. One regional initiative *Experience works* specifically targeted on workers over the age of 45. The principle aim is to enhance the training and skills of older workers. Help can also come in form of confidence building, practical advice, career guidance and support for becoming self-employed. The program also works together with partners to promote age diversity in the workplace.

A series of New Deal programs aimed at helping individuals back to work was introduced in the UK. The new Deal 50-plus, introduced in 2000, is specifically targeted at getting older unemployed or those receiving an incapacity benefit of disability allowance back into work. Entrants into the program have their own personal adviser at their local Jobcentre, supporting them with drawing individual action plans, preparing CVs and letters of application, job search and organizing training courses. Until recently, upon becoming gainfully employed, individuals were paid directly through their personal adviser an Employment Credit up to maximally a year. In April 1993 the Employment Credit was replaced and financial benefits will now fall under the broader umbrella of the Working Tax Credit. Individuals aged 50 and over and working at least 16 hours a week will now receive the “50 plus element” of the WTC for 52 weeks. Moreover a Training Grant is available upon taking up employment. Evaluations show that JobCentre Plus staff and participants are very positive about the program. Moreover Grierson (2002) found that more than three quarter of the participants had not returned to benefit. On the other hand Atkinson (2001) finds that more than half of Employment Credit recipients expected to return to work anyway, indicator a large deadweight.

The Prince Initiative for Mature Enterprise (PRIME) is a national organization dedicated to helping people aged 50 and over to set up a business. This is done by providing loans. However, future plans also involve other services like help for creating business plans.

Source: OECD (2004)

working hours because of training, are a relative successful example of a subsidy. The OECD-country report on ageing and employment for the UK, suggests targeting this subsidy more towards older workers (see also box 2 for initiatives in the UK).

## **6.4 OTHER MEASURES**

### ***Active labour market policies***

One of the current problems is that older workers that become unemployed are hardly able to find a new job. The average unemployment benefit duration among older workers is very long. We talked about the possibility to create incentives for both workers and employers in the social security system. However, active labour market policies can also help to improve job entry chances for older unemployed.

In a recent survey of the international evaluation literature, covering 130 studies, De Koning et al (2005) find that the evidence for a positive effect on job entry chances is strongest for incentives for jobseekers (sanctions, bonuses and job search monitoring), job counselling and placement subsidies from employers. A clear majority of evaluation studies report positive net effects for these measures. The case is worst for job creation schemes: most studies find that this type of scheme reduces the job entry chances in a non-subsidized job. Training holds an intermediary position. However, many training programs that proved ineffective are targeted to young people. For older workers training may be effective. In any case, particularly for older workers, active labour market policies may be more effective than is sometimes assumed.

### ***Education***

Participation rates tend to be lowest among the low educated. Moreover, the decline in participation with age is much stronger for the low-educated than for the high educated (see table A.2 in the annex). Furthermore, higher educated people tend to engage more in continuous training during their work life. Therefore, it is important to reduce the number of low-educated by improving initial education and by offering low-educated adults the opportunity to increase their educational level.

### ***Increasing the participation of other groups***

In many countries there is also room for increasing labour market participation among other groups than the elderly. Participation rates among, women and ethnic minorities in younger age categories are often still below average. It is beyond the scope of this paper to discuss policies to increase the participation rates for these groups, but clearly such policies exist.

### ***Older pension age***

The possibility to increase pension age is already discussed. In some countries it may appear to be inevitable. However, as long as employment rates for the 50 plus category are as low as they are, it is more logical to concentrate on measures that might help to increase

### ***Initiatives by the social partners***

Solutions for the problems posed by the ageing process can also come from the social partners in collective agreements. Box 3 gives a number of examples for the Netherlands.

## 7 CONCLUSIONS

It is almost certain that the ageing of the population will cause economic problems. Age-related expenses will increase relative to the size of the workforce. A larger share of the active population will be attracted to health care and related activities. Furthermore, the participation rate of the active age population will drop. And finally, the level and the growth rate of productivity will be affected negatively. However, most of these effects depend on behavioural reactions. Therefore the size of each of these effects is uncertain. But it is very unlikely that they will all prove negligible.

Several measures can be taken to deal with the problems caused by the ageing process. Increasing the currently low employment rates among older workers is an obvious solution. To that end early retirement and pre-pension schemes should no longer be subsidized by the state. Furthermore, unofficial routes to retirement through unemployment and disability benefits should be blocked. Shorter benefits will induce older workers to accept other jobs more easily. Job search monitoring and sanctions for inactive search behaviour in combination with job counselling appear to be effective in stimulating the transition from unemployment to work. Such specific active labour market policies are more effective than is sometimes thought.

However, this will only be effective if equally strong incentives are created for employers. Experience rating in social security will induce employers to develop human resources policies that keep workers employable longer and to make arrangements with other employers for job mobility of older workers. This could be accompanied by a bonus system for employers that hire older workers and by more flexible rules for firing workers.

Particularly for the lower educated a permanent wage subsidy may be necessary to bridge the gap between productivity and wage. More flexible pay systems and pension systems in which pension benefits are based on the average wage during one's career, could also make it easier for older workers to accept demotion. However, in that case one basically accepts a negative impact of the ageing process on productivity. It would be better if the productivity-wage gap could be bridged by increasing the productivity of older workers. The incentive schemes discussed above may induce employers and older workers to invest more in human capital. Training can also play an important role in active labour market policies for unemployed aged over 50.

However, education and training are even more important for preventing loss in employability at older age. Higher educated workers have considerably higher chances to remain employed at older age than the ones with lower education. Furthermore, frequent training and mobility during one's working life reduces the chances of unemployment and inactivity at older age. Therefore, a life-long learning strategy is certainly important.

So far, we mentioned several measures to increase the employment rate and the productivity of people aged between 50 and 65. Furthermore, policies promoting life-long learning and reducing the number of people with low education could have a general positive effect on productivity. However, this may still not be enough to deal with the consequences of the ageing process. Increasing the participation rates among women and ethnic minorities would be an additional measure. Finally, it may prove necessary to increase the pension age.

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## ANNEX

Table A.1 *Old-age dependency ratios relative to the labour force (65 plus population divided by the labour force)*

	2000	2050	Change in percentage points
Austria	23.0	54.3	42.0
Belgium	31.2	64.9	26.6
Czech Republic	26.2	86.9	60.7
Denmark	27.8	47.7	19.9
Finland	25.9	57.3	31.4
France	35.7	68.8	33.1
Germany	33.1	60.8	27.7
Hungary	33.3	116.2	82.9
Ireland	22.3	43.2	20.8
Italy	41.3	86.7	45.4
Netherlands	24.1	48.9	24.1
Poland	25.8	86.9	61.1
Portugal	24.1	42.0	17.8
Slovakia	23.4	93.2	69.6
Spain	36.1	72.3	36.2
Sweden	32.1	53.5	21.4
United Kingdom	28.4	46.5	18.2
Japan	24.9	65.0	40.1
United States	20.2	35.4	15.1
OECD average	26.5	59.6	33.1

Source: Burniaux, Duval and Jaumotte (2004).

*Table A.2 Activity rates by levels of educational attainment, age group and sex 2004 (first quarter)*

	Euro-zone			EU-25		
	15-24	25-54	55-64	15-24	25-54	55-64
<b>Men and women</b>						
Total	43.4	83.0	40.7	44.5	83.3	43.1
Less than upper secondary	34.4	73.7	33.1	30.1	72.3	33.8
Upper secondary level	54.2	85.7	43.0	58.6	85.2	47.3
Third level	63.9	91.9	61.6	69.8	92.1	64.4
<b>Men</b>						
Total	46.9	92.5	51.1	47.8	91.6	53.5
Less than upper secondary	39.7	89.8	45.8	35.1	87.7	45.5
Upper secondary level	57.6	92.8	49.5	62.5	91.9	53.7
Third level	62.0	95.9	67.3	69.1	95.8	69.2
<b>Women</b>						
Total;	39.8	73.5	30.7	41.1	75.0	33.3
Less than upper secondary	28.5	58.0	23.5	24.6	57.8	24.9
Upper secondary level	50.9	78.5	36.0	54.7	78.4	40.1
Third level	65.1	87.8	52.1	70.3	88.5	57.6