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## Why forcing people to save for retirement may backfire

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# WHY FORCING PEOPLE TO SAVE FOR RETIREMENT MAY BACKFIRE

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# WHY FORCING PEOPLE TO SAVE FOR RETIREMENT MAY BACKFIRE

## Abstract

If individuals are unable or unwilling to borrow, a higher than desired second pillar pension capital may induce people to retire earlier than they would have in the absence of such a scheme. Individuals thus leave the workforce as soon as the retirement income is deemed sufficient and the pension plan avails withdrawal of benefits. We provide evidence using individual data from a selection of Swiss pension funds, allowing us to perfectly control for pension scheme details. Our findings suggest that affordability is a key determinant in the retirement decisions. The higher the accumulated pension capital, the earlier individuals tend to leave the workforce.

JEL Code: D91, H31, J26.

Keywords: occupational pension, retirement decision, duration models.

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# 1 Introduction

The increase in early retirement is a widespread phenomenon throughout Europe causing financial distress to almost all public pension systems. In most countries the main reason for this effect seems clear: High replacement ratios and high implicit tax rates on working beyond a certain age induce workers to opt for an early exit out of the labor market. But early retirement is also prevalent — albeit to a lesser degree — in Switzerland, where implicit tax rates on working on in old age are virtually zero within the first pillar and zero to low in most second pillar schemes. Like in many other countries, the retirement age has fallen in the last decade despite the fact that institutional incentives (statutory retirement age, pension accrual rates, replacement rates and other factors) have stayed basically unchanged.

We argue that high pension replacement rates may trigger early retirement also in the absence of an implicit tax on working towards the end of individuals' working life. At first sight, this is not surprising. Time series evidence in OECD countries show that workers are more likely to withdraw from the labor market as soon as they have reached pensionable age if benefits are close to wages. However, the previous evidence may also be a consequence of replacement rates being much higher for low income individuals. Our data reveals that high replacement rates may have an equally strong or even stronger effect for high income workers. As a consequence the current policy of strengthening of the second pillar in old age insurance and thus the link between lifetime earnings and future pensions may lead to a decrease in the incidence of early retirement for low income individuals, but to an increase in early retirement among higher income earners, unless there is a cap on the level of income insured by the scheme.

Economic theory predicts that workers choose their intertemporal consumption and labor supply optimally according to a utility function and with respect to a lifetime budget constraint. If the adjustment for early retirement were the same for everybody and in the absence of (capital market) distortions, richer individuals should retire later due to their higher life expectancy (and a potentially lower disutility of labor). To get a more realistic picture of individuals' decisions at retirement, one has to take into account potential departures from rationality and perfect markets. A first is myopia of individuals. If individuals are forced to save for their retirement they may achieve a higher utility than without a pension system. But the replacement level could still be too low to reach a sufficient (subsistence) income level in old age, especially for low income workers. In that case, poorer individuals might be forced to work longer. A second distortion could be credit constraints or merely the reluctance of individuals to accumulate debt. A high replacement rate would then lead to an overaccumulation of capital compared to the desired level of pension assets. To offset this effect, people would retire earlier than desired. In both cases affordability plays a key role. We will argue in the paper that within the Swiss pension system, wealthier individuals are more likely to afford an exit from the labor market at a relatively low age.

To support this claim, we focus on the role of accumulated pension wealth on the retirement decision. We use a unique dataset of individual retirement decisions provided by a number of privately run (but publicly mandated) pension funds. This allows us to control for all company specific pension plan details. Due to the fact that the second pillar has been mandatory in Switzerland since 1985 (and had been offered by a majority of companies even before that year), differences in accumulated capital at retirement within the same cohort closely mirror differences in lifetime income. Moreover, due to the maturing of the second pillar the average pension capital, and thus the effective replacement rate has been steadily increasing over the years and now reaches high replacement rates for all income groups. Unlike in other countries, the structure of the scheme leads to replacement rates that are similar for lower to upper middle class incomes.

We find that the incidence of early retirement has increased considerably over the last decade despite the fact that there were no institutional changes throughout that period. Due to an increase in the effective replacement rate within Switzerland's second pillar, more people are now able to accumulate sufficient funds to pay for an early labor market exit than one or two decades ago. But even if we control for this apparent time trend, wealthier men tend to leave the work force earlier. Low income workers, on the other hand, often work up to the legal retirement age even in pension funds in which early retirement packages are generous. In these cases the need to generate income seems to be the only explanation for working up to the statutory retirement year. Due to differences in mortality rates across income groups, richer individuals thus tend to enjoy a much longer retirement spell than poorer people. For the pension funds, this means that adverse selection effects are unimportant.

Our empirical analysis delivers other interesting findings. Despite data limitations, we find that marital status is another key determinant for retirement decisions. Married women tend to retire earlier than both singles and widows, whereas single men tend to have a higher exit rate than non-singles. These findings suggest that the retirement decisions of husband and wife are interdependent. Financial needs and joint retirement problems seem to be the dominating forces.

Our analysis suggests that the reason for early retirement does not solely lie in the incentive structure implied by public pension plans. In the presence of sufficient funds the preference for leisure in old age seems to be a dominating driving force for leaving employment. Many poorer individuals only keep working because they cannot afford to retire.

## 2 Background

### 2.1 The Swiss social security system

Switzerland's pension system is composed of three pillars, of which the first and second are of approximately equal importance.<sup>1</sup> The first pillar is a predominantly pay-as-you-go (PAYG) system and aims at providing a basic subsistence level of income to all retired residents in Switzerland. The second pillar is a mandatory, employer-based, fully funded occupational pension scheme.<sup>2</sup> Gross replacement ratios in Switzerland increased from 28.4% in 1961 to 49.3 % in 1995. For workers with an uninterrupted working career who are covered by a second pillar scheme, the gross replacement rate is much higher, as Table 2 demonstrates. The statutory retirement age is 65 for men and currently 64 for women (has been 62 until 2002), the latter will be increased gradually to 65 in the next few years.<sup>3</sup>

In 2000, on average, approximately 50% and 40% of publicly provided retirement income were paid out by the first and second pillar, respectively. The second pillar's main goal is to maintain the pre-retirement living standard together with the benefits stemming from the first pillar. Upon attainment of retirement age, the accumulated capital can be withdrawn either as a monthly life-long annuity or as a lump sum (or a mix of the two) provided the pension fund allows for the lump sum option.

The second pillar is designed to be integrated with the first pillar. As the latter provides a basic level of income, the second pillar only insures income above a certain threshold level, which is equal to a yearly maximum single first pillar pension<sup>4</sup>. This lower threshold explains the much lower coverage for female workers, who often work part-time and have lower average wages than men. While there is in principle also a maximum insured income, most companies do not implement it.

The minimum contribution rates increase considerably with age (from 7% at age 25 to 18% from age 55 onwards) and the employer has to pay at least half. They are mandated by law, but the details are left to the individual pension providers. The contributions are accumulated as retirement assets and bear an interest rate. The minimum rate of return, which is determined by the Swiss Federal Council, remained at 4% for 17 years (from 1985 to the end of 2002), despite the fact that market returns showed considerable variability and exceeded this 4% level by a large margin most of the time.

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<sup>1</sup>A detailed description of all aspects of the Swiss social security system is, however, beyond the scope of this paper. The interested reader is referred to Queissar & Vittas (2000, especially concerning institutional details) and Bütler (2004, for the second pillar).

<sup>2</sup>The third pillar are earmarked and tax-favored private savings, but only few people use this opportunity.

<sup>3</sup>Note that retirement at 65/64 is not mandatory by law, but reaching age 65 for men or age 64 for women is rather an eligibility condition for claiming public pension benefits. Most labor contracts specify a retirement age that coincides with the eligibility age.

<sup>4</sup>In 2004, this threshold was: 25'320 CHF  $\approx$  17'000 EURO  $\approx$  18'500 USD.

The accrued capital is fully portable when the insured individual changes the employer.<sup>5</sup> The total amount at retirement has been accumulated over the entire work life and is, therefore, a good proxy for lifetime income. Old age pension benefits are strictly proportional to the accumulated retirement assets (plus accrued interest). The accumulated capital is translated into a yearly pension using a fixed conversion factor, which had been constant at 7.2% from 1985 to 2004. From 2005 it will be reduced in line with the increased life expectancy.<sup>6</sup>

The second pillar mandates joint annuities. Children under age 18 (or under age 25 if still dependent) of retired persons get an additional pension of 20% of the main claimant's benefit. When a retired man dies, his widow receives a benefit amounting to 60% of the previous pension, his dependent children a benefit of up to 20% each. As obvious from Table 1 this leads to sizeable differences in the money's worth ratios.

Most pension funds aim at a replacement rate of approximately 50% to 60% of the insured income. Together with the income from the first pillar and the fact that there are no social security deductions on pension benefits, the net replacement rate *before* taxes amounts to at least 70-80% even for high income groups. Due to the fact that federal and cantonal taxes in Switzerland are progressive, and due to the availability of additional children pension benefits, the effective net replacement rate can be well above 100% as Table 2 illustrates.

Early retirement options are now offered by most companies. For many this is simply an actuarially fair reduction of the conversion factor in the case of early withdrawals. For others more generous early retirement packages exist, including additional payments to make up for first pillar benefits up to the legal retirement age. Take up rates for early second pillar benefits are very high. On average, the observed retirement in occupational plans is substantially below the statutory age even in funds that do not subsidize early retirement explicitly.<sup>7</sup>

## 2.2 Related literature

A large part of the previous research has been devoted to analyze the role of the social security system in explaining the retirement decision of older workers. Kotlikoff (1979) shows that the provision of social security will not affect the retirement decision under the assumption of perfect capital markets, actuarial fairness and

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<sup>5</sup>By law, an employee changing the firm gets the accumulated total contributions accrued at the minimum interest rate. The total sum has to be paid into the new fund, with very few exceptions (self-employment under certain conditions, those who leave the country for good).

<sup>6</sup>The conversion factor does not vary with gender, family status or income. The 7.2% were constructed using a discount rate of 4% (the legal minimum requirement for 17 years) and somewhat optimistic — from the pension provider's perspective — mortality tables. This conversion factor delivers money's worth ratios clearly above 1 (see Table 1).

<sup>7</sup>The first pillar did not avail early retirement schemes until very recently. Since then the take-up rates of these early benefits have been small. Presumably this is due to the fact, that many second pillar pension plans allow an anticipation of benefits at actuarially fair rates (or better). This latter option is administratively more convenient for most beneficiaries.

| Sex    | Marital      | Ret.-age | $r = .04$<br>$g = 0$ | $r = .04$<br>$g = .01$ |
|--------|--------------|----------|----------------------|------------------------|
| male   | non-married  | 65       | 0.73                 | 0.79                   |
| male   | married (-3) | 65       | 1.01                 | 1.11                   |
| female | non-married  | 65       | 0.95                 | 1.04                   |
| female | married (no) | 65       | 0.98                 | 1.08                   |
| female | married (+3) | 65       | 1.02                 | 1.13                   |
| male   | non-married  | 62       | 0.80                 | 0.87                   |
| male   | married (-3) | 62       | 1.08                 | 1.20                   |
| female | non-married  | 62       | 1.02                 | 1.14                   |
| female | married (no) | 62       | 1.05                 | 1.17                   |
| female | married (+3) | 62       | 1.10                 | 1.23                   |

Table 1: *Money’s worth ratios of the Swiss second pillar system as a function of sex, marital status, the growth rates of benefits ( $g$ ) and the retirement age at which the full benefit level can be claimed. For married individuals the number in brackets is the assumed age difference to the spouse. The discounting interest rate  $r$  is the technical interest rate used by the pension funds.  $g$  approximately corresponds to the average Swiss inflation rate (to which most benefits are adjusted) since 1995.*

known lifespan, as pensions are equivalent to private savings. Crawford and Lilien (1981) relax each assumption in turn, and show that the effect on the date of retirement is in general ambiguous, but that a progressive system tends to advance retirement for low-income workers. Social security also has an impact upon the labor supply decision and on the allocation of labor and consumption over the life cycle. Craig and Batina (1991) simulate the strengths of such effects. Their results show how the introduction of a social security program acts as a disincentive to supply labor in the later stages of life, thus affecting also the level of output produced and the capital-labor ratio.

The quantitative effect of old age insurance on retirement has been measured using alternative approaches, like the “lifetime budget constraint” approach (Burtless and Hausman, 1978; Hausman and Wise, 1980; Burtless, 1986), the “option value” approach (Lazear and Moore, 1988; Stock and Wise, 1990), the “hazard model” approach (Diamond and Hausman, 1984; Hausman and Wise, 1985), or, more recently, the “structural dynamic programming” approach (Rust, 1995; Stern, 1997; Bingley and Lanot, 2004). Hazard model approaches in which the retirement decision is treated as a dynamic discrete choice have been used in Miniaci (1998) for Italy, Antolin & Scarpetta (1998) for Germany, Mastrogiamco, Alessie & Lindeboom (2002) for the Netherlands, Maestas (2004) for US.

A different perspective in understanding the retirement decision of older workers has been developed along a more behavioral context: timing of withdrawal from the labor force may be influenced by other factors, like one’s own health,

|                          |      |      |      |      |      |      |      |      |      |
|--------------------------|------|------|------|------|------|------|------|------|------|
| <i>Before retirement</i> |      |      |      |      |      |      |      |      |      |
| Gross income             | 50   |      |      | 100  |      |      | 200  |      |      |
| Marital status           | sing | marr | m+2  | sing | marr | m+2  | sing | marr | m+2  |
| Net income               | 41   | 42   | 44   | 73   | 77   | 80   | 135  | 143  | 147  |
| <i>After retirement</i>  |      |      |      |      |      |      |      |      |      |
| I = First pillar         | 20   | 30   | 36   | 25   | 38   | 46   | 25   | 38   | 46   |
| II = Second pillar       | 12   | 12   | 17   | 37   | 37   | 52   | 87   | 87   | 122  |
| Net (I + II - tax)       | 30   | 40   | 52   | 55   | 68   | 89   | 92   | 106  | 139  |
| <i>Replacement rates</i> |      |      |      |      |      |      |      |      |      |
| Gross                    | 0.65 | 0.85 | 1.07 | 0.63 | 0.75 | 0.98 | 0.56 | 0.63 | 0.84 |
| Net                      | 0.75 | 0.95 | 1.18 | 0.75 | 0.88 | 1.11 | 0.71 | 0.78 | 0.98 |

Table 2: *Pension benefits as a function of pre-retirement income (in 1000 Swiss Francs) and marital status (sing = single, marr = married with adult children, m+2 = married with two children under 18/25). The computations are based on the following (very realistic) assumptions: The spouse does not have any second pillar income, but qualifies for the same first pillar pension as the main bread winner (mainly through child care credits and part-time income) in the married with adult children case. For the married with two minor children case, it is assumed that the spouse (for obvious reasons the wife) is too young to claim her own benefits. The pension fund replaces 50% of coordinated income (= income - 25'300) with no upper income limit. Children benefits are 40% (first pillar) and 20% (second pillar) of the main claimant's benefits each. The tax base is the city of Zürich.*

the desire to pursue different activities, or, if married, a partner's work status. Poor health is consistently mentioned in the literature as a reason for retirement, particularly before recent trends toward early retirement resulting from corporate and pension/social security incentives (Howe and Manning 1987; Monette, 1996). Overall, poor health is associated to lower satisfaction in retirement (Encel and Studencki, 1996; Sharpley, Gordon and Jacobs, 1996). Retirement may also be affected by the willingness to increase social participation in later life, by having contact with friends and family which promote physical and psychological health (Teshuva, Stanislavsky and Kendig 1994). Moreover, the decision to retire may be jointly taken within a household, so that husbands and wives tend to retire at the same time, irrespective of their age. A number of studies for several countries (Gustman and Steinmeier, 1994; Blau, 1998; Jimenez-Martin et al., 1999; An et al., 2004 among others) find empirical evidence of the importance of coordination of retirement dates, and provide similarity of tastes, complementarity of leisure, sharing of household finances, health factors, correlation of unobserved tastes as possible explanations. Huang (1988) and Hurd (1990) report that both partners retire within the same month in 6-8 percent of their sample, within one year in 24-28 percent. Zweimüller et al. (1996) find a high and positive correlation of unobservable factors in the retirement process of both spouses. The increasing relevance of this phenomenon leads to the conclusion that aggregate effects of retirement or pension policy change should be assessed on the basis of joint retirement models. A number of studies (Encel and Studencki, 1996; Monette, 1996; Maestas, 2004) point out that for some people retirement may not mean total withdrawal from all paid employment, but only retirement from a specific work career. This turns out to be particularly true for those with higher education and professional or managerial skills.

There are relatively few contributions that explicitly model the exit from the labor market as a function of lifetime income. Using various sources of evidence, Costa (1998) argues that the decrease in the average retirement age in the US during the last century can be attributed to a great extent to a wealth/income effect. Bloom, Canning and Moore (2004) present a theoretical life-cycle approach in which a higher life-time income reduces the retirement age *ceteris paribus*, while better health and a longer life-span lead to a longer work period, albeit in a less than proportional way. What seems to emerge from a number of empirical country studies, to be found in Gruber and Wise (2004), is that a higher (life-time) income raises the retirement age (probably by a lower disutility of work), while higher pension benefits reduces it. Which of the two effects dominates when the retirement income is very strongly related to lifetime income, as in the Swiss case, is not clear, however.

### 2.3 Retirement and Life-time Income

According to economic theory workers should choose their intertemporal consumption and labor supply so as to maximize an intertemporal utility function with

respect to a lifetime budget constraint. If the adjustment for early retirement were the same for everybody and in the absence of (capital market) distortions, richer individuals should then retire later due to their higher life expectancy (and a potentially lower disutility of labor).

But people are neither fully rational, nor are markets complete. One of the rationales for introducing social security in the first place was the fear that people might not be able to accumulate sufficient funds for retirement. Forcing individuals to contribute to a pension scheme (in the form of taxes or earmarked savings) reduces this inefficiency and might lead to an ex post more efficient allocation of lifetime resources. Typically replacement rates of social security systems decrease with pre-retirement income to account for the fact that the level of retirement income deemed sufficient to cover the needs in old age increases less than proportionally with income (or may even be constant).

Assuming that targeted pension income increases less than proportionately with pre-retirement income, we expect the following: Richer individuals should save more for retirement, or — if they are partly myopic — work longer when the link between pre-retirement income and pension benefits is flat. On the other hand, when pension benefits are approximately proportional to pre-retirement income, it takes longer for the poor to reach a sufficient level of pension income leading to a higher retirement age. In the Swiss case, with net replacement rates nearly constant for low to medium income levels, we can thus expect a decrease in the effective retirement age with accumulated pension capital.

Now let us consider the impact of credit market restrictions: If people are constraint, or simply reluctant to borrow, a high replacement rate would lead to an over-accumulation of capital compared to the desired level of pension assets. To offset this effect, people could retire earlier than desired. If this effect was strong enough, people would want to retire at the earliest possible age, at which a withdrawal of benefits is possible.<sup>8</sup> It is not *a priori* clear, what would be the impact of life time income in this context. Again, if the minimum level of retirement benefits increases in a less than proportional way with pre-retirement income, people with higher income reach the target at a lower replacement rate, i.e., at an earlier age. Typically, individuals with higher lifetime income also have a steeper income profile. Thus the final replacement rate may underestimate the more relevant average replacement rate. Comparing individuals with similar final replacement rates (as is the case in the relevant income range), higher incomes can afford an earlier exit from the labor market even if the targeted level of pension income is proportional to life-time income. Note, however, that these people are also very unlikely to be credit constraint. This latter effect is only relevant if people are reluctant to borrow out of non-pension wealth.

But how likely is over-saving within the second pillar in Switzerland? Pretty likely, if one considers the large final net replacement rates even for very high

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<sup>8</sup>The fact that a majority of elderly workers retire as soon as benefits are available is still somewhat of a puzzle. See Gruber and Wise (2004) for more discussion and evidence.

income levels. Taking into account that expenditure needs may fall after retirement due to an increase in home production (as reported by Rohwedder and Hurd (2003)), pension benefits are very likely to be higher than the desired level.<sup>9</sup> Thus, a distortion of optimal individual allocations induced by the scheme at younger ages may lead to a socially suboptimal low retirement age. With both myopic individuals and borrowing constraints, affordability is likely to play a key role.

### 3 Data and empirical strategy

This section is devoted to the description of the database and the implemented empirical analysis.

#### 3.1 The data

In the empirical analysis we use data collected at the individual level from 15 Swiss companies, both public and private, active in several industrial branches. They include the national public railway company, civil servants in two cantons, several industry firms, as well as clothing and food firms. We use only observations with retirement year 1990 and later, due to lack of sufficient information for earlier years.

The dataset consists of 8452 observations<sup>10</sup>. We have information about date (or year) of birth, marital status, date (or year) of retirement, yearly pension payments (base level) and yearly additional pensions for children and for first pillar replacement packages. On the firm level, we are also provided with details of early retirement plans, in particular the adjustment in the conversion factor and the availability of first pillar replacement packages.

Some firms also provide us with information about the number of children under 18/25<sup>11</sup>, the amount withdrawn as a lump sum (if this option is available), the total capital accumulated at retirement, and an indicator whether the individual has chosen a non-standard retirement option.

As reported in Table 3, males and females represent 63.5 and 36.5 percent of the sample, respectively. The distribution of marital status is very different for men and women, the great majority of men is married (85.4%) at retirement, whereas almost half of the retiring women live alone (52.6% only are married). There are

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<sup>9</sup>Hurd and Rohwedder (2003) point out that the empirically observed drop in spending at retirement may theoretically be well within the spirit of the life cycle model and fully consistent with forward-looking behavior. Their empirical estimates suggest that the decline in consumption is mainly due to substitution of market-expenses for goods and services by home production.

<sup>10</sup>The cleaning and editing of the data has been a considerable task. Firstly, the data format provided varied widely across companies. Secondly, much of the relevant information for the project had to be imputed from other sources (regulation of pension fund) or from a combination of available data. In many cases the information could only be gathered from a personal interview with the responsible pension fund manager.

<sup>11</sup>Children under age 18 are always eligible for additional benefits. For those over 18, but under 25, a pension is available for disabled children and those still in school.

also large differences in annuity across gender and marital status, with women getting approximately half the amount of men on average. The only exception are singles, for which females fare better. This can be explained by the fact that single women are more likely to be well educated than average women, whereas the contrary is the case for men.

The sample consists of individuals whose age at retirement ranges from 55 to 70. We explicitly exclude all observations for which the path to retirement passes through a period of disability benefits. Despite a difference of 3 years between men and women in the statutory retirement age for individuals in the sample, the difference in the factual retirement age is less than half of this number. The median or average retirement age does not seem to vary very much across marital status either. There have been, however, important changes in retirement behavior over the last 15 years. Figure 1 depicts the distributions of the age at retirement for men and women for three different subperiods (1990-1994, 1995-1999, 2000-2003).

The distribution of age at retirement has a peak at the respective (current) statutory/eligibility retirement age of 65 (men) and 62 (women).<sup>12</sup> For the second time period the profile for men has another peak around age 62, which is the age at which some pension funds offer early retirement benefits — sometimes even full — even for men. This peak becomes the most prominent one in the third period. We also notice another peak at age 60. This is often the lowest age for which early retirement packages are offered at relatively good conditions. It is interesting to note that a sizeable fraction of women work beyond the statutory retirement age, though this number has clearly decreased over time. The most striking feature of these distributions is a clear shift of the retirement decision to lower ages for both men and women. This decrease is particularly strong from 1995-1999 to 2000-2003.<sup>13</sup>

It is important to mention that the fraction of people retiring early within the included pension plans far exceeds the corresponding fraction for the whole population. For the companies in our dataset 79% of men and 62% of women retire before the statutory retirement age in 2002-2003, whereas the corresponding numbers for the whole of Switzerland are 55% (men) and 44% (women) in 2002.<sup>14</sup>

## 3.2 The empirical strategy

We use the hazard model (or survival) approach for our empirical analysis. Survival-time data documents spans of time (duration) ending in an event, called “failure”. As the purpose of the paper is to understand the timing of retirement and retirement transitions, in particular, the failure event in our case is entering retirement.

<sup>12</sup>For all women in the sample, 62 was the relevant eligibility age for first pillar benefits.

<sup>13</sup>The median (mean) retirement age for men is 65 (63.2), 63 (62.7), and 62 (61.7) for the periods 1990-1994, 1995-1999, and 2000-2003, respectively. The corresponding numbers for women are 62 (61.5), 62 (61.3), and 60.1 (60.2), respectively.

<sup>14</sup>Recall that, in general, low income people (and to some extent self-employed) are not covered by second pillar pension plans. This might be a first indicator that individuals who retire early do so because they can afford it.

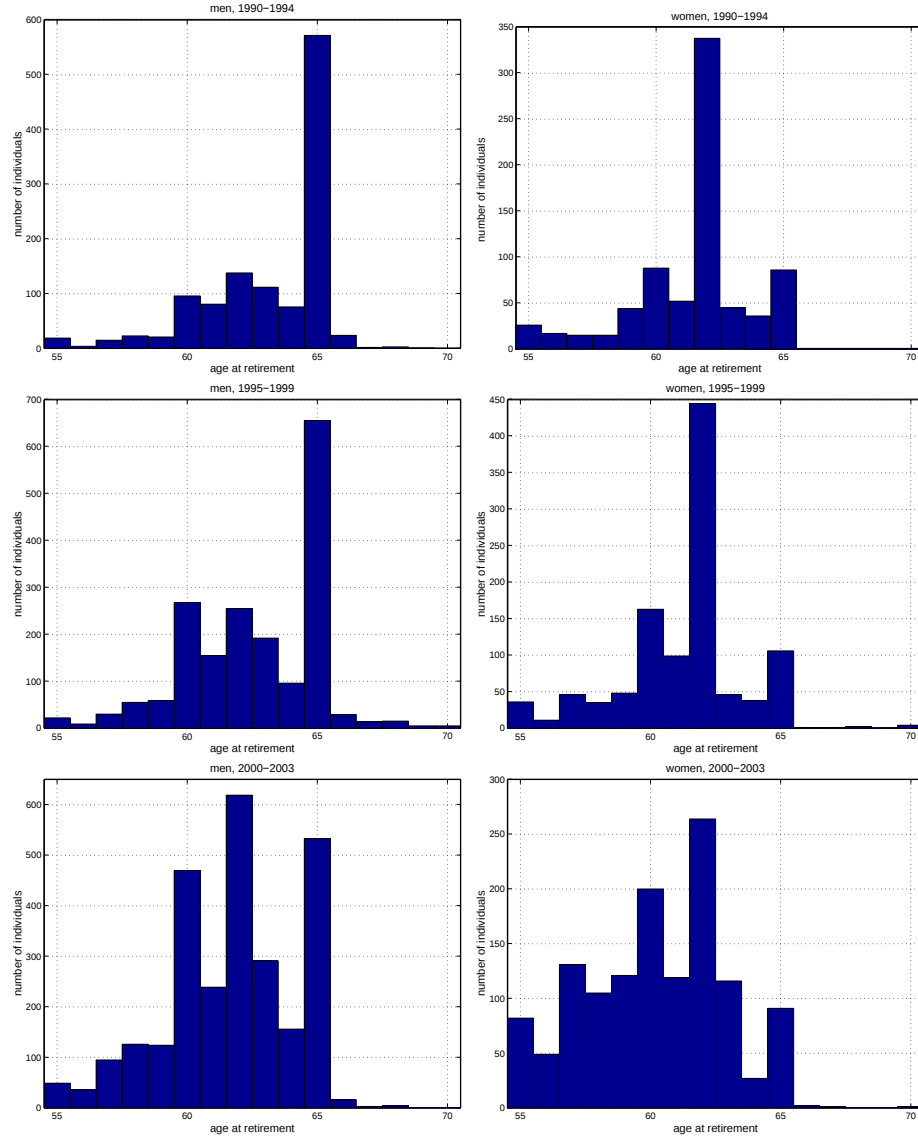


Figure 1: *Distributions of age at retirement for men (left-hand side) and for women (right-hand side)*

| <b>Variable</b>                | <b>Obs.</b> | <b>in %</b> | <b>Median</b> | <b>Mean</b> | <b>(Std.)</b> |
|--------------------------------|-------------|-------------|---------------|-------------|---------------|
| <i>Age at retirement</i>       | 8452        |             | 62.0          | 61.82       | (2.70)        |
| <u>female</u>                  | 3084        | 36.5        | 62.0          | 60.90       | (2.58)        |
| single                         | 500         | 16.2        | 61.1          | 60.66       |               |
| married                        | 1621        | 52.6        | 61.1          | 60.66       |               |
| widowed                        | 279         | 9.1         | 62.0          | 61.39       |               |
| divorced / separated           | 684         | 22.2        | 62.0          | 61.42       |               |
| <i>Age at retirement male</i>  | 5368        | 63.5        | 62.1          | 62.35       | (2.62)        |
| single                         | 293         | 5.5         | 62.2          | 61.55       |               |
| married                        | 4587        | 85.4        | 62.0          | 62.40       |               |
| widowed                        | 161         | 3.0         | 63.0          | 62.84       |               |
| divorced / separated           | 327         | 6.1         | 62.0          | 62.08       |               |
| <i>Statutory retir. age</i>    | 2665        | 31.5        |               |             |               |
| (female)                       | 1013        | 32.9        |               |             |               |
| (male)                         | 1652        | 30.8        |               |             |               |
| <i>Annuity deflated</i>        | 8452        |             | 35'422        | 41'016      | (32789)       |
| <u>female</u>                  | 3084        |             | 21'730        | 28'315      | (23378)       |
| single                         | 500         |             | 40'783        | 41'649      |               |
| married                        | 1621        |             | 17'610        | 26'155      |               |
| widowed                        | 279         |             | 14'246        | 21'650      |               |
| divorced / separated           | 684         |             | 21'498        | 26'404      |               |
| <i>Annuity deflated male</i>   | 5368        |             | 41'191        | 48'313      | (35115)       |
| single                         | 293         |             | 35'126        | 38'356      |               |
| married                        | 4587        |             | 42'594        | 49'613      |               |
| widowed                        | 161         |             | 33'077        | 43'001      |               |
| divorced / separated           | 327         |             | 35'518        | 41'613      |               |
| <i>Non-standard option</i>     | 576         | 6.8%        |               |             |               |
| (female)                       | 149         | 4.8%        |               |             |               |
| (male)                         | 427         | 8.0%        |               |             |               |
| <i>Lump-sum capital (in %)</i> | 649         | 7.7%        | 50.3%         | 60.0%       | (36.7%)       |
| (female)                       | 179         | 5.8%        | 100.0%        | 78.0%       | (29.7%)       |
| (male)                         | 470         | 8.8%        | 44.6%         | 53.2%       | (36.8%)       |

Table 3: *Summary statistics for some relevant variables*

The retirement hazard rate in  $t$  gives the hazard of retiring in  $t$  conditional on being in the labor force and not having retired yet until  $t$ . Similarly, the survival function gives the probability of continuing working in  $t$ . Note that the time axis  $t$  of the model corresponds to “age at retirement” and not to the calendar time axis. We will first use the survival function for a non-parametric analysis of the probability to retire for our data set as a whole and for different subsets of the data. We then turn to the analysis of the influence of covariates using the semi-parametric Cox proportional hazard model. For the latter we constructed a set of variables which is described in detail below.

As is obvious from Figure 1, retirement behavior is very different for men and women. For individuals retiring before 2004, the eligibility age for old age benefits as well as many conditions within company pension plans (notably early retirement conditions) are also very different across gender. We thus analyze men and women separately. Moreover, women are more likely than men to experience discontinuous work histories, be influenced by family responsibilities and family life cycle stages across the life span, be exposed to social roles beyond the work force, encounter financial instability, and live in retirement for a longer period of time.

An important task is to construct our proxy for the lifetime income, namely a measure of second pillar income that is equivalent across companies. This is basically equivalent to constructing a measure for accumulated capital at retirement plus adding the present value of additional benefits to be received by the pensioners. For this purpose, we use firm specific information on conversion factors, early retirement plans and other benefits.<sup>15</sup> The variable “annuity” corresponds to the yearly pension at *the regular retirement age* if all capital were fully annuitized, including the regular yearly pension plus any temporary payments, as well as the annuitized value of any lump sum payment upon retirement. To account for economic growth and inflation, these numbers are deflated by the nominal Swiss GDP (indexed, base year 2000). For our empirical analysis we use the log (variable “ln(annuity)”) as well as its square (variable “ln(annuity)<sup>2</sup>”) to capture potential nonlinear effects. Recall that, due to the legal requirement to transfer pension capital from a previous to the current employer, second pillar capital or income is a very good proxy for lifetime income. Nonetheless, individual data on retirement wealth cannot convey an exact picture of a person’s wealth position as the latter depends on additional income and wealth by the spouse, especially for women.

The variable “ln(annuity)” has an additional feature we might need to take into account: it increases during the relevant period. If we observe an individual from the age 55 on up to her age at retirement of, for example 64, then her retirement

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<sup>15</sup>To compute the increase in the retirement capital between the observed retirement age and the statutory retirement age, we need a measure of the relevant wage for that period. As we do not always know the wage prior to the (early) retirement decision, we had to impute it from the accumulated capital, using information on company specific contribution rates, the average wage growth and (if available) other benefits. We have experimented with different versions of imputation, but the results turned out to be very robust.

income increased during this period due to contributions and interests. We want to account for this fact by treating the two annuity variables as time-varying variables and interact them with a linear increasing function of the time axis of the model. Another justification for this step is that our test of the proportional hazard assumption turns out to be slightly violated for this variable.<sup>16</sup> The time variation is one way to correct for this violation. However, in order to prove the robustness of our results, we report results with and without time trend.

Time is bound to play another important role despite the fact that the proxy for average life-time income has been deflated. The effective replacement rate has increased due to a maturation of the system in most companies. This effect is captured by dummies for the retirement year. Alternatively, we have also worked with a linear retirement year trend, but, as the results are basically identical, we do not report the outcomes.

Differential behavior between cohorts might play a role in our analysis. In A set of dummy variables captures the marital status of the individuals in our data set. We include dummies for “married”, “widowed” and “divorced/separated” which we compare to the base “singles”.<sup>17</sup>

order to investigate this issue, we have included cohort dummies and experimented with a whole variety of different cohort definitions, including 3 or 4 birth years per cohort or following features of our data set as well as historical events. Including cohort dummies implies excluding retirement year dummies due to the high correlation between these. However, the cohort dummies are always highly significant regardless of the specification. We conclude that we cannot assign a change in the behavior to any cohort specificity. The results of the estimations with cohort dummies are very close to those with retirement year dummies, which implies that the latter already capture possible changes in the behavior. However, we report the results of the estimations with cohort dummies for the basic regressions<sup>18</sup>. (If cohort dummies are not reported, it means that they led to similar

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<sup>16</sup>The Cox proportional hazard model does not assume a specific probability distribution for the time until an event occurs. It assumes that the hazard functions of any two individuals are proportional over time, even if the values of one or more covariates are different. For example, if the hazard function of a married person is twice as high as the hazard function of a non-married person, this should be the case for all possible ages at retirement. We use a graphical test of the proportional hazard assumption (log-log plots).

<sup>17</sup>The test of the proportional hazard assumption turned out to not be violated for these variables, except at the statutory retirement age of 62 for women and 65 for men (this was also the case for the variables “ln(annuity)” and “ln(annuity)<sup>2</sup>”). As already mentioned, this effect is not surprising given the fact that contractual agreements often force people to retire at this age. Even if one considers retirement ages around the eligibility age as censored, the proportional hazard estimation is still often violated for data beyond the statutory retirement age. We believe, however, that these observations should still be included as they convey important information about retirement behavior. Estimations carried out with a truncated data set do barely differ from the complete data set.

<sup>18</sup>The reported cohort dummies follow historical events and hence are the same for the analysis of men and women. More precisely, the dummies mark the birth years: < 1933 (years of great depression), 1933-1938 (pre world war II period), 1939-1945 (world war II), > 1945 (post world

results when included.) We have also run estimations *by* cohort without having any significant differences in the results.

As pension plans differ considerably across pension funds and in order to also capture changes of company pension plans that may have influenced people’s decision to retire or not, we always include company fixed effects. For the largest companies in the sample, estimations are reported on the firm level as well.

It is very intuitive to think that macroeconomic variables have an effect on the retirement decision.<sup>19</sup> In order to account for this possible effect, we first included information about GDP growth and unemployment (using different alternative specifications, such as total unemployment rate, unemployment rate by gender, unemployment rate only for persons older than 55, as well as their lagged values.). We were, however, not able to identify a clear effect of these variables, especially because of ambiguous interaction effects between the macroeconomic variables and the dummy variables for retirement year or cohorts. Moreover, the fit of the model did not get any better by including macroeconomic variables and all other results remained entirely unaffected by them. We, therefore, do not report them in our final regressions.

At first sight, all retirement ages are observable, i.e., there is no obvious censoring in the data. However, although not required by law, many companies force people to retire by contractual agreements at the age eligible for first pillar benefits at the latest. A late or early retirement presumably is the result of the interaction of several reasons and options, whereas a retirement at the statutory age is rather an automatic act without further careful considerations. This means that we observe the eligibility age in such cases, although the person might have chosen to work longer had she been free to do so. A visual inspection of the histograms in Figure 1, with obvious peaks at 65 (men) and 62 (women) seems to support the incidence of an important bias at ages 65 and 62 for men and women, respectively. As a consequence, we choose to mark all observations with retirement ages around the eligibility age as censored, i.e., we treat them as if we did not know the reason why these individuals had retired at that age. We have experimented with various intervals around the eligibility age, finding very small differences in estimation outcomes. Results are reported for a censoring interval of “eligibility age  $\pm$  3 months”. As a robustness check, we also present estimations with all data points marked uncensored.

To classify the different estimations with respect to censoring and the impact of the retirement year, the following notation has been chosen:

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war II period).

<sup>19</sup>During the time we analyze, the total unemployment rate significantly rose from 0.5% in 1990 to 5.2% in 1997, then subsequently fell to 1.7% until 2001, and rose again afterwards. GDP growth increased from -0.8% in 1990 to 3.6% in 2001, and fell again afterwards.

|            |   |                                 |
|------------|---|---------------------------------|
| <b>I</b>   | = | no time trend, no censoring     |
| <b>II</b>  | = | with time trend, no censoring   |
| <b>III</b> | = | no time trend, with censoring   |
| <b>IV</b>  | = | with time trend, with censoring |

In parenthesis, we add the gender (m = men, f = women), as well as the number of the company or the retirement year if applicable.

## 4 Empirical results

The following sections report the results of the empirical duration analysis carried out with the described Swiss data set. Firstly, we present a non-parametric analysis using different subsets of the data in order to demonstrate the impact of several factors on the retirement decision. We then present the semi-parametric estimation results.

### 4.1 Non-parametric estimation results

We have computed Kaplan-Meier survival function estimates for different subsets of the data (always by gender). The empirical survival functions — only reported without censoring<sup>20</sup> — are shown in Figures 2-4. Kaplan-Meier survival estimates show the probability of not retiring up to a certain age.

Figure 2 depicts the corresponding estimates for the three time periods 1990-1994, 1995-1999, 2000-2003. In line with Figure 1, we observe a clear downward shift in the survival function for both women and men. The huge downward jumps at 62 for women and 65 for men, respectively, are replaced by many smaller jumps over all concerned ages. This reconfirms the observation of a more flexible entry into retirement. Another striking observation is that retirement ages are not equally spaced, but are rather concentrated at full years. This is not surprising given the fact that adjustment rates for early retirement are usually not adjusted in a continuous fashion, but rather in discrete intervals of one year.

To explore the impact of marital status we have split the data along that dimension. Figure 3 shows the results for individuals retiring between 2000 and 2003.<sup>21</sup> For both women and men, the probability of still working after age 55 is lowest for single individuals. Note, however, that single females are also the “richest” women in the sample, while single men have the lowest average annuity of all male retirees. So interpreting the figures without disentangling the effects of marital status and income is delicate. Married men tend to stay in the labor

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<sup>20</sup>The results do not differ very much if censoring is taken into account. The only difference is around the eligibility age of 62 and 65 years for women and men, respectively. As these observations are considered as censored, we do not observe a downward jump in the survival probability at this point, but rather at the end of the censoring interval.

<sup>21</sup>Estimates of other periods look similar (not reported here). It is important to do the analysis by period as different aspects, notably changes in the distribution of the marital status over time, may interact and influence the results.

force longer, while married women show an exit pattern similar to single women. Divorced or separated women as well as widows tend to work longer.

Figure 4 shows the estimated survival function by retirement income quartile, again for the period 2000 to 2003. For both men and women, the lowest retirement income quartile tends to stay longest in the work force, at least until the statutory retirement age.<sup>22</sup> The retirement behavior as a function of income is monotonic for women, but clearly not for men.<sup>23</sup> Men in the middle income range tend to retire earlier than both richer and poorer men. It seems as if income played a larger role for the retirement decision of women than for men. However, retirement income is also very much correlated with the family status for women, but far less for men. It is thus important to control for marital status to assess the impact of income.

## 4.2 Cox proportional hazard estimation results

Tables 4 to 13 summarize the estimation results for various specifications for women and men. The results are displayed as hazard ratios. A hazard ratio greater than 1 means that a marginal increase in the covariate increases the hazard to retire. If it is smaller than 1, a marginal increase in the covariate decreases the hazard to retire.<sup>24</sup> Estimated coefficients for retirement dummies are not reported in the tables, but are summarized in Figure 5. The number of stars (\*) for retirement year and cohort dummies in the tables indicate the level of significance for a majority of the estimated hazard coefficients: 10%, 5%, and 1% levels of significance for a majority of coefficients are marked with (\*), (\*\*), and (\*\*\*), respectively.

### 4.2.1 Results for women

Tables 4 to 8 present the results for women. Table 4 includes retirement year dummies, Table 5 cohort dummies. In Table 6 the variable “ln(annuity)” is replaced by dummy variables for the different quartiles of “ln(annuity)” (where quartile 1 denotes the lowest quartile). To assess the sensitivity of our results, we have also conducted regressions with various subsets of the data. Tables 7 reports some of these results on the firm level for the companies for which we had enough observations to carry out isolated estimations. Table 8 displays the coefficients for the three years with the highest number of observations in the dataset. The estimation results of the sensitivity tests do not differ greatly from the overall regressions.

<sup>22</sup>It is worth mentioning again, that second pillar retirement income is roughly proportional to lifetime income above a certain income level in Switzerland. The term “income” thus stands for both retirement income and average lifetime labor income.

<sup>23</sup>We therefore also include the square of “ln(annuity)” in all preliminary regressions, but only report it if its inclusion leads to a better fit of the model.

<sup>24</sup>In case of dummy variable the results have an even more precise interpretation: If the hazard ratio is bigger than 1, a unit increase in the covariate increases the hazard rate by  $(\text{hazard ratio} - 1) \times 100\%$ . If it is smaller than 1, a unit increase cuts the hazard rate to  $(1 - \text{hazard ratio}) \times 100\%$ .

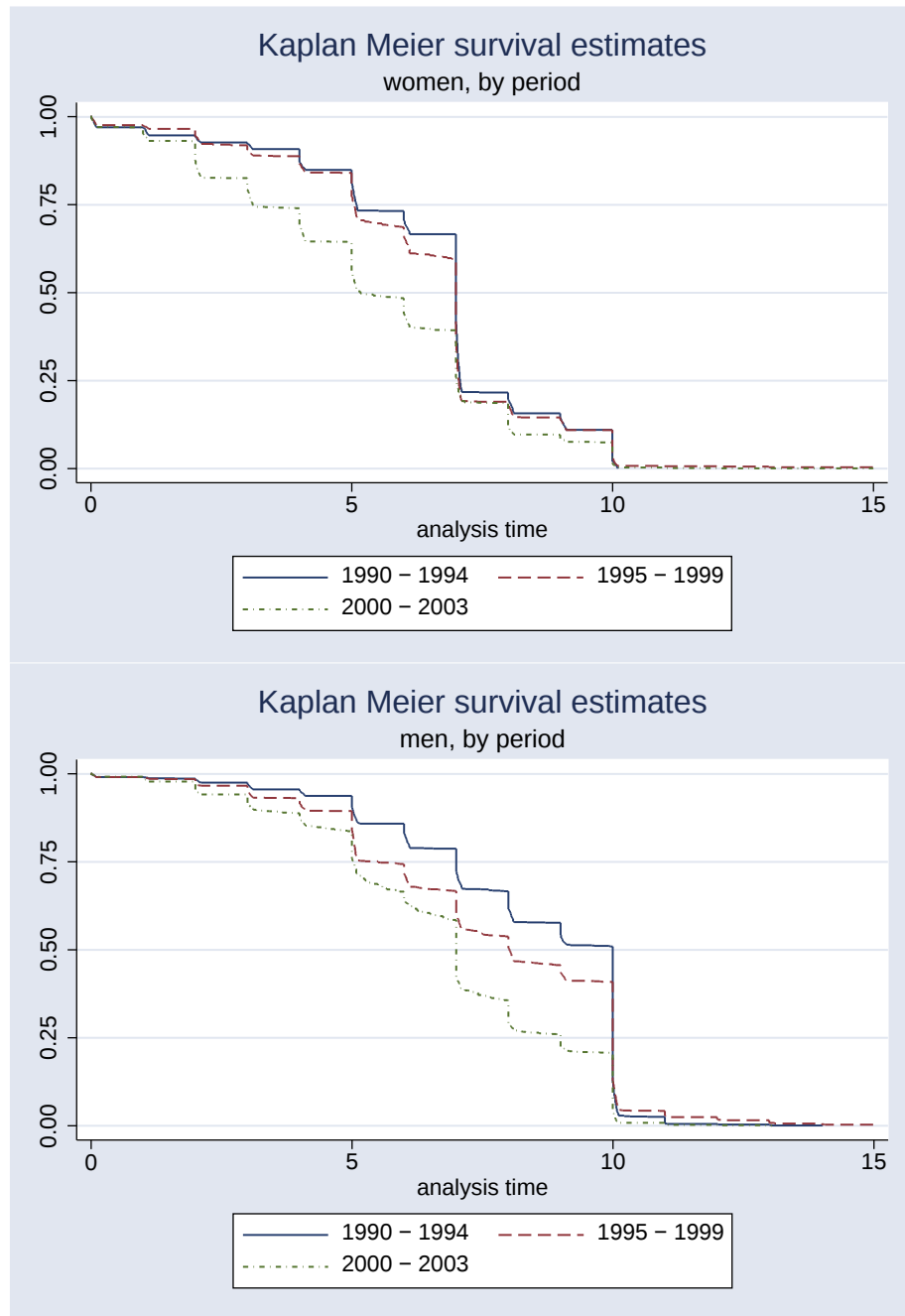


Figure 2: *Kaplan-Meier estimator without censoring by period for women (upper panel) and men (lower panel). The numbers on the horizontal axis denote the years after age 55.*

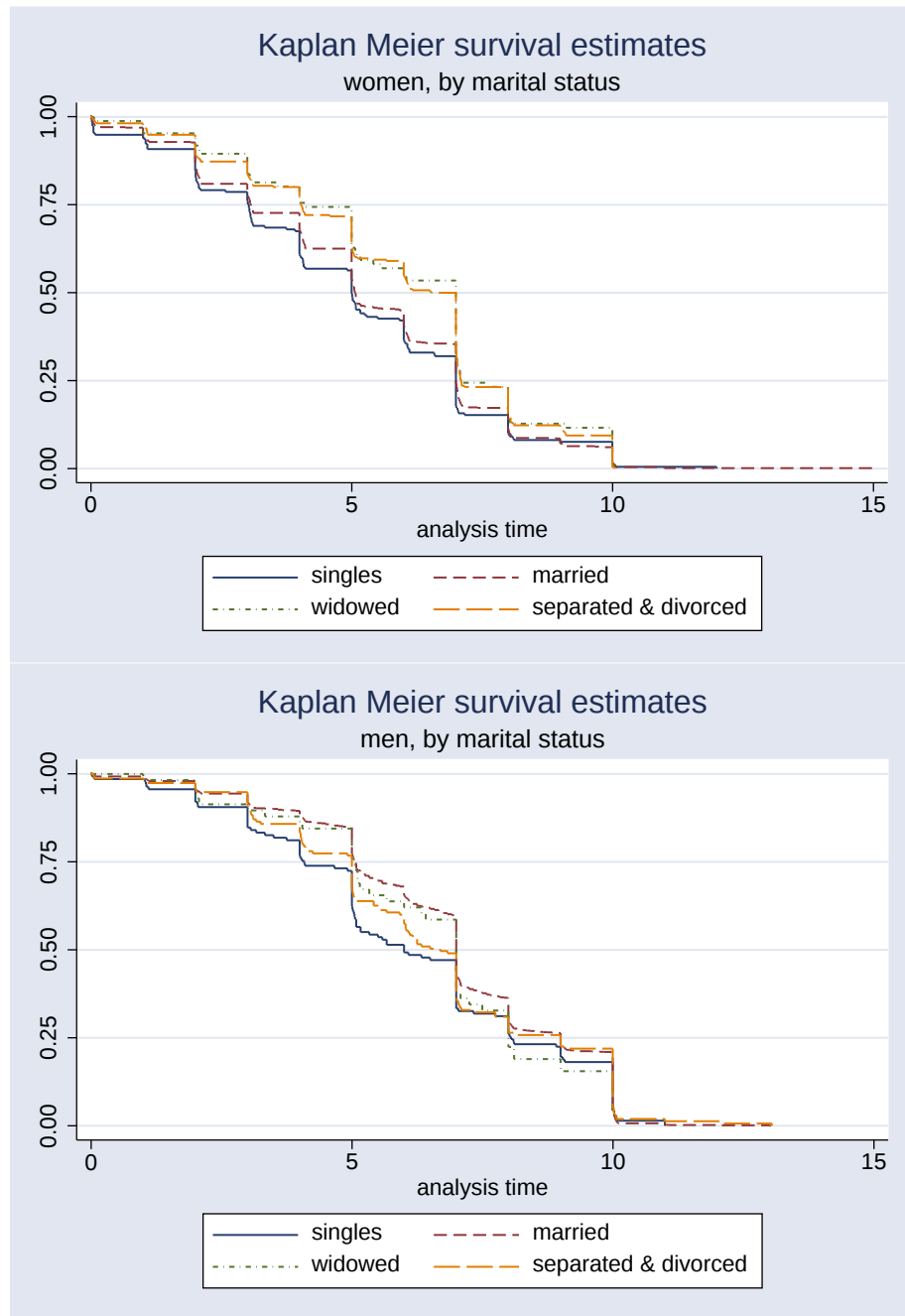


Figure 3: *Kaplan-Meier estimator without censoring for the period 2000-2003 by marital status for women (upper panel) and men (lower panel). The numbers on the horizontal axis denote the years after age 55.*

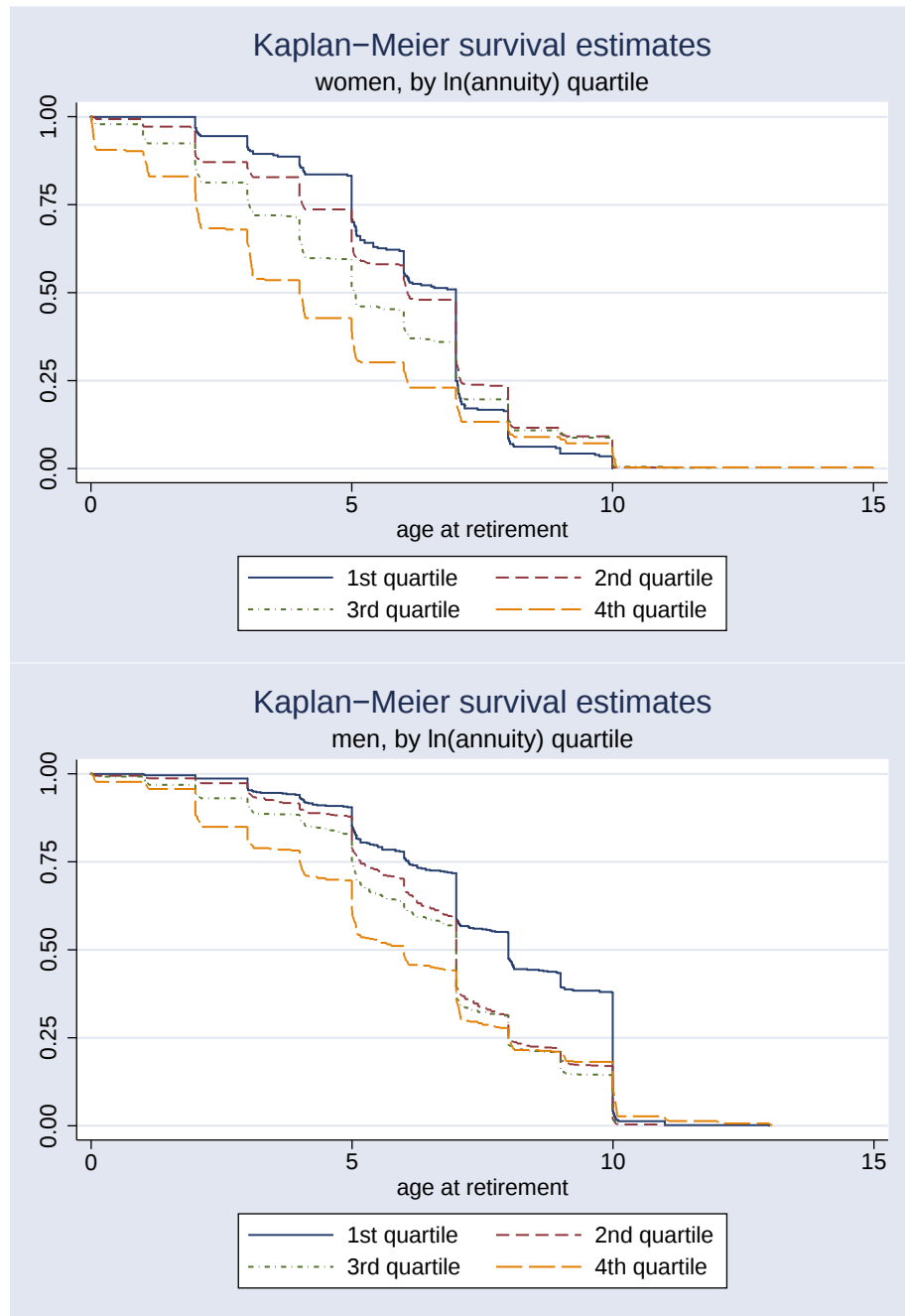


Figure 4: *Kaplan-Meier estimator without censoring for the period 2000-2003 by income quartiles for women (upper panel) and men (lower panel). The numbers on the horizontal axis denote the years after age 55.*

Due to the much smaller number of observations the significance levels are lower.

Including a time trend for the “ln(annuity)” and/or censoring alters the results only in a quantitative way. The time trend decreases the hazard ratio of the “ln(annuity)” variables (which is obvious, as capturing the trend should lower the net effect), but barely changes the hazard ratio of the other variables. Censoring the observations however increases the hazard ratio for “ln(annuity)”, as uncensored estimations ignore the fact that poorer women might have wanted to work longer, but were not allowed to do so. On the other hand, censoring slightly decreases the hazard ratios for the marital status variables. Which model we use for our estimations seems not to make a qualitative difference in the end. However, as we cannot rank the different models and identify the “best”, we keep and report all results.

The overall results for women are the following:

### **Retirement year**

The retirement year dummies are highly significant in all regressions. Also if included in a linear fashion (not included in the tables), retirement year is significant at 1% level in all regressions. This means that early retirement has become more prevalent over the last decade, which is also confirmed by the estimated coefficients on retirement year dummies in Figure 5. Earlier retirement may have been caused by an improved flexibility in occupational pension plans or the maturing of the system (enabling more women to withdraw earlier from the labor force). The cohort dummies, which are also highly significant (Table 5), capture a similar effect.

### **Marital status**

The results for marital status are the following. Married women tend to have a higher exit rate than both singles and widows. This result may be explained by two factors. The first is a joint retirement decision of married couples. As wives are younger on average than husbands,<sup>25</sup> they may also be willing to leave the workforce at an earlier age to coordinate the passage into retirement with their spouse. The second reason for the higher exit rate of married women is that the latter are “hedged” by their husbands’ income and may thus have lower financial needs than other women. In other words, marital status has a strong influence on a woman’s economic security after retirement. Not surprisingly, never-married women who are more likely to have enjoyed continuous careers tend to be the most financially prepared for retirement. In general, widows are well cared for by the Swiss social security system. Nonetheless there are some gaps in coverage, notably for widows of self-employed men. The fact that the employment rate of widows is somewhat higher than for married women indicates that some of

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<sup>25</sup>The age difference in Switzerland is approximately 3 years on average. This number is likely to understate the true age difference of a couple at retirement, as most second marriages display a larger age difference (the divorce rate in Switzerland is approximately 40%).

these women might be financially constrained. That widowed women stay in the labor market longer than married women is thus not surprising. Our findings also demonstrate that divorced women have a significantly lower retirement hazard even if one controls for income. Most of these women have suffered from a previous divorce law that was strongly biased in favor of the main (male) bread winner with respect to the allocation of retirement means accumulated during marriage.

### Lifetime income

We now turn to the main variable: the proxy for lifetime income “ln(annuity)”. The variable is significant (most of the times highly significant) in all estimations except one company regression. As the corresponding hazard ratio is greater than one, a higher lifetime income induces earlier retirement. Well paid women retire earlier than women with low labor incomes, even if one controls for marital status. This means that the attractiveness of the job does not seem to play a role, but rather the fact that a high pre- and after retirement income makes an earlier retirement age affordable. Table 6 shows the analysis by quartile of “ln(annuity)”. The hazard ratio is increasing from quartile 1 up to quartile 4 which confirms the linearity of the effect.

| <b>Covariate</b>    | <b>I(f)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>II(f)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>III(f)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(f)</b><br>Haz. Ratio<br>( <i>p-value</i> ) |
|---------------------|-------------------------------------------------|--------------------------------------------------|---------------------------------------------------|--------------------------------------------------|
| married             | 1.1783<br>(0.007)                               | 1.1640<br>(0.013)                                | 1.2316<br>(0.006)                                 | 1.2162<br>(0.010)                                |
| widowed             | 0.9957<br>(0.952)                               | 0.9835<br>(0.815)                                | 0.9781<br>(0.815)                                 | 0.9650<br>(0.707)                                |
| divorced/separated  | 0.9183<br>(0.153)                               | 0.9092<br>(0.111)                                | 0.8807<br>(0.090)                                 | 0.8713<br>(0.067)                                |
| ln(annuity)         | 1.1521<br>(0.000)                               | 1.0020<br>(0.000)                                | 1.2780<br>(0.000)                                 | 1.0040<br>(0.000)                                |
| ret. year dummies   | YES<br>(**)                                     | YES<br>(**)                                      | YES<br>(***)                                      | YES<br>(***)                                     |
| Time trend          | NO                                              | YES                                              | NO                                                | YES                                              |
| Censoring           | NO                                              | NO                                               | YES                                               | YES                                              |
| Comp. fixed effects | YES                                             | YES                                              | YES                                               | YES                                              |
| log p-lik.          | -21865.91                                       | -21871.70                                        | -14562.78                                         | -14569.80                                        |
| observations        | 3084                                            | 3084                                             | 3084                                              | 3084                                             |
| failures            | 3084                                            | 3084                                             | 2071                                              | 2071                                             |

Table 4: *Cox proportional hazard regression for women. The variable “ln(annuity)” has been interacted with a linear time trend (if time trend = YES). Data censored for age at retirement 61.75-62.25 (if censoring = YES).*

| <b>Covariate</b>    | <b>I(f)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>II(f)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>III(f)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(f)</b><br>Haz. Ratio<br>( <i>p-value</i> ) |
|---------------------|-------------------------------------------------|--------------------------------------------------|---------------------------------------------------|--------------------------------------------------|
| married             | 1.0523<br>(0.367)                               | 1.0415<br>(0.472)                                | 1.1033<br>(0.135)                                 | 1.0915<br>(0.183)                                |
| widowed             | 0.9917<br>(0.911)                               | 0.9814<br>(0.801)                                | 1.0128<br>(0.894)                                 | 1.0014<br>(0.988)                                |
| divorced/separated  | 0.8558<br>(0.009)                               | 0.8486<br>(0.006)                                | 0.8532<br>(0.026)                                 | 0.8454<br>(0.019)                                |
| ln(annuity)         | 1.0967<br>(0.000)                               | 1.0013<br>(0.000)                                | 1.1943<br>(0.000)                                 | 1.0027<br>(0.000)                                |
| cohort dummies      | YES<br>(***)                                    | YES<br>(***)                                     | YES<br>(***)                                      | YES<br>(***)                                     |
| Time trend          | NO                                              | YES                                              | NO                                                | YES                                              |
| Censoring           | NO                                              | NO                                               | YES                                               | YES                                              |
| Comp. fixed effects | YES                                             | YES                                              | YES                                               | YES                                              |
| log p-lik.          | -21130.15                                       | -21133.03                                        | -13753.88                                         | -13757.66                                        |
| observations        | 3084                                            | 3084                                             | 3084                                              | 3084                                             |
| failures            | 3084                                            | 3084                                             | 2071                                              | 2071                                             |

Table 5: *Cox proportional hazard regression for women. The variable "ln(annuity)" has been interacted with a linear time trend (if time trend = YES). Data censored for age at retirement 61.75-62.25 (if censoring = YES).*

| <b>Covariate</b>    | <b>IV(f; q1)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(f; q2)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(f; q3)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(f; q4)</b><br>Haz. Ratio<br>( <i>p-value</i> ) |
|---------------------|------------------------------------------------------|------------------------------------------------------|------------------------------------------------------|------------------------------------------------------|
| married             | 1.2230<br>(0.008)                                    | 1.2230<br>(0.008)                                    | 1.2230<br>(0.008)                                    | 1.2230<br>(0.008)                                    |
| widowed             | 0.9815<br>(0.845)                                    | 0.9815<br>(0.845)                                    | 0.9815<br>(0.845)                                    | 0.9815<br>(0.845)                                    |
| divorced/separated  | 0.9030<br>(0.180)                                    | 0.9030<br>(0.180)                                    | 0.9030<br>(0.180)                                    | 0.9030<br>(0.180)                                    |
| dummy quartile 1    | —                                                    | 0.9260<br>(0.215)                                    | 0.7819<br>(0.000)                                    | 0.5139<br>(0.000)                                    |
| dummy quartile 2    | 1.0799<br>(0.215)                                    | —                                                    | 0.8444<br>(0.003)                                    | 0.5549<br>(0.000)                                    |
| dummy quartile 3    | 1.2789<br>(0.000)                                    | 1.1843<br>(0.003)                                    | —                                                    | 0.6572<br>(0.000)                                    |
| dummy quartile 4    | 1.9460<br>(0.000)                                    | 1.8020<br>(0.000)                                    | 1.5217<br>(0.000)                                    | —                                                    |
| ret. year dummies   | YES<br>(***)                                         | YES<br>(***)                                         | YES<br>(***)                                         | YES<br>(***)                                         |
| Censoring           | YES                                                  | YES                                                  | YES                                                  | YES                                                  |
| Comp. fixed effects | YES                                                  | YES                                                  | YES                                                  | YES                                                  |
| log p-lik.          | -14548.73                                            | -14548.73                                            | -14548.73                                            | -14548.73                                            |
| observations        | 3084                                                 | 3084                                                 | 3084                                                 | 3084                                                 |
| failures            | 2071                                                 | 2071                                                 | 2071                                                 | 2071                                                 |

Table 6: *Cox proportional hazard regression for women - robustness tests with dummies for the quartiles of yearly annuity. Data censored for age at retirement 61.75-62.25 (if censoring = YES).*

| <b>Covariate</b>         | <b>IV(f; 1)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(f; 10)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(f; 11)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(f; 15)</b><br>Haz. Ratio<br>( <i>p-value</i> ) |
|--------------------------|-----------------------------------------------------|------------------------------------------------------|------------------------------------------------------|------------------------------------------------------|
| married                  | 5.0519<br>(0.014)                                   | 1.1398<br>(0.146)                                    | 1.5119<br>(0.090)                                    | 1.1528<br>(0.561)                                    |
| widowed                  | 2.1158<br>(0.343)                                   | 0.9035<br>(0.407)                                    | 1.3810<br>(0.226)                                    | 1.0529<br>(0.866)                                    |
| divorced/separated       | 3.0222<br>(0.105)                                   | 0.8370<br>(0.056)                                    | 0.9591<br>(0.844)                                    | 0.5815<br>(0.055)                                    |
| ln(annuity)              | 1.0023<br>(0.094)                                   | 1.0044<br>(0.000)                                    | 0.9991<br>(0.573)                                    | 1.0949<br>(0.015)                                    |
| ln(annuity) <sup>2</sup> | —                                                   | —                                                    | —                                                    | 0.9952<br>(0.020)                                    |
| ret. year (dummy)        | YES (99–00)<br>(*)                                  | YES (90–02)<br>(***)                                 | YES (90–03)<br>(**)                                  | YES (90–02)<br>(–)                                   |
| max hazard               | —                                                   | —                                                    | —                                                    | 11'300 Sfr                                           |
| Time trend               | YES                                                 | YES                                                  | YES                                                  | YES                                                  |
| Censoring                | YES                                                 | YES                                                  | YES                                                  | YES                                                  |
| Comp. fixed effects      | YES                                                 | YES                                                  | YES                                                  | YES                                                  |
| log p-lik.               | -529.43                                             | -8651.00                                             | -705.74                                              | -484.17                                              |
| observations             | 228                                                 | 1891                                                 | 192                                                  | 256                                                  |
| failures                 | 106                                                 | 1323                                                 | 163                                                  | 101                                                  |

Table 7: *Cox proportional hazard regression for women by company. The variables “ln(annuity)” and “ln(annuity)<sup>2</sup>” have been interacted with a linear time trend (if time trend = YES). Data censored for age at retirement 61.75-62.25 (if censoring = YES).*

| <b>Covariate</b>    | <b>IV(f; 2000)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(f; 2001)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(f; 2002)</b><br>Haz. Ratio<br>( <i>p-value</i> ) |
|---------------------|--------------------------------------------------------|--------------------------------------------------------|--------------------------------------------------------|
| married             | 1.1188<br>(0.576)                                      | 1.0671<br>(0.679)                                      | 0.8671<br>(0.321)                                      |
| widowed             | 0.7040<br>(0.238)                                      | 0.8041<br>(0.374)                                      | 0.6307<br>(0.020)                                      |
| divorced/separated  | 0.6109<br>(0.021)                                      | 0.7361<br>(0.079)                                      | 0.7458<br>(0.059)                                      |
| ln(annuity)         | 1.0053<br>(0.000)                                      | 1.0018<br>(0.078)                                      | 1.0015<br>(0.085)                                      |
| Time trend          | YES                                                    | YES                                                    | YES                                                    |
| Censoring           | YES                                                    | YES                                                    | YES                                                    |
| Comp. fixed effects | YES                                                    | YES                                                    | YES                                                    |
| log p-lik.          | -1344.13                                               | -1826.48                                               | -2083.07                                               |
| observations        | 409                                                    | 422                                                    | 441                                                    |
| failures            | 258                                                    | 354                                                    | 403                                                    |

Table 8: *Cox proportional hazard regression for women by retirement year. The variable “ln(annuity)” has been interacted with a linear time trend (if time trend = YES). Data censored for age at retirement 64.75-65.25 (if censoring = YES).*

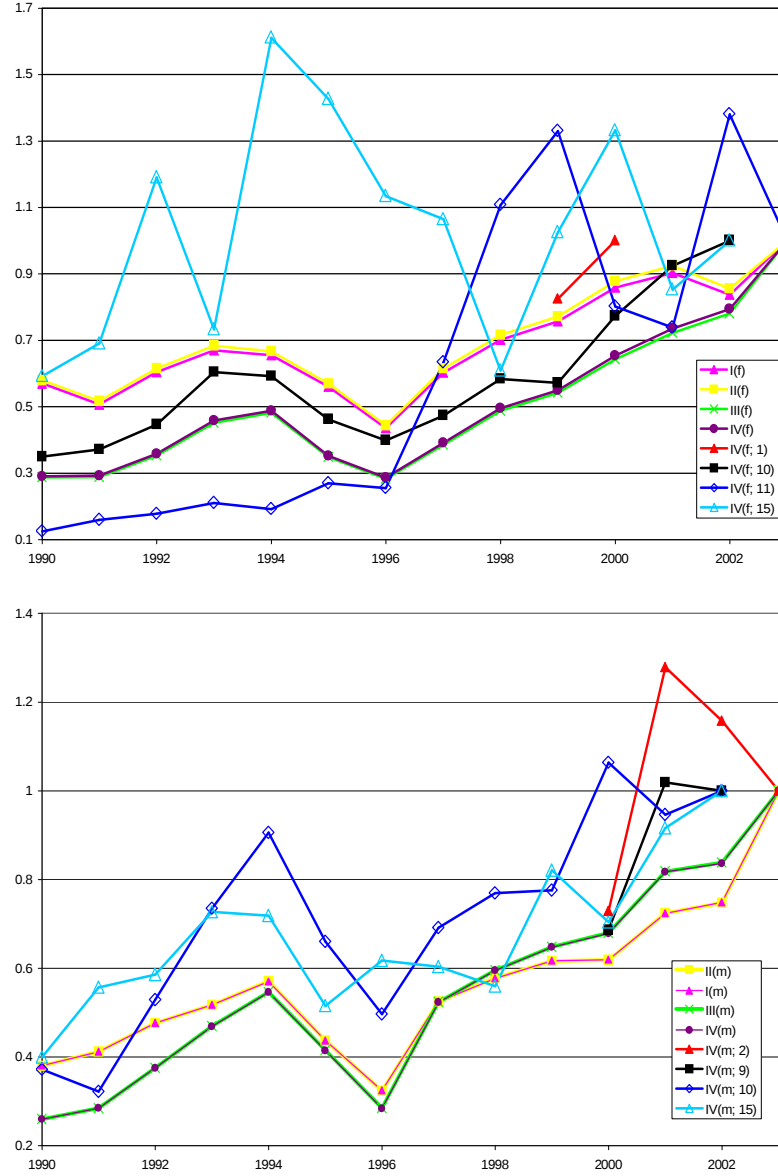


Figure 5: *Relative hazard rates for year of retirement (base year 2003). The upper and lower panels depict the relative hazards for women and men, respectively.*

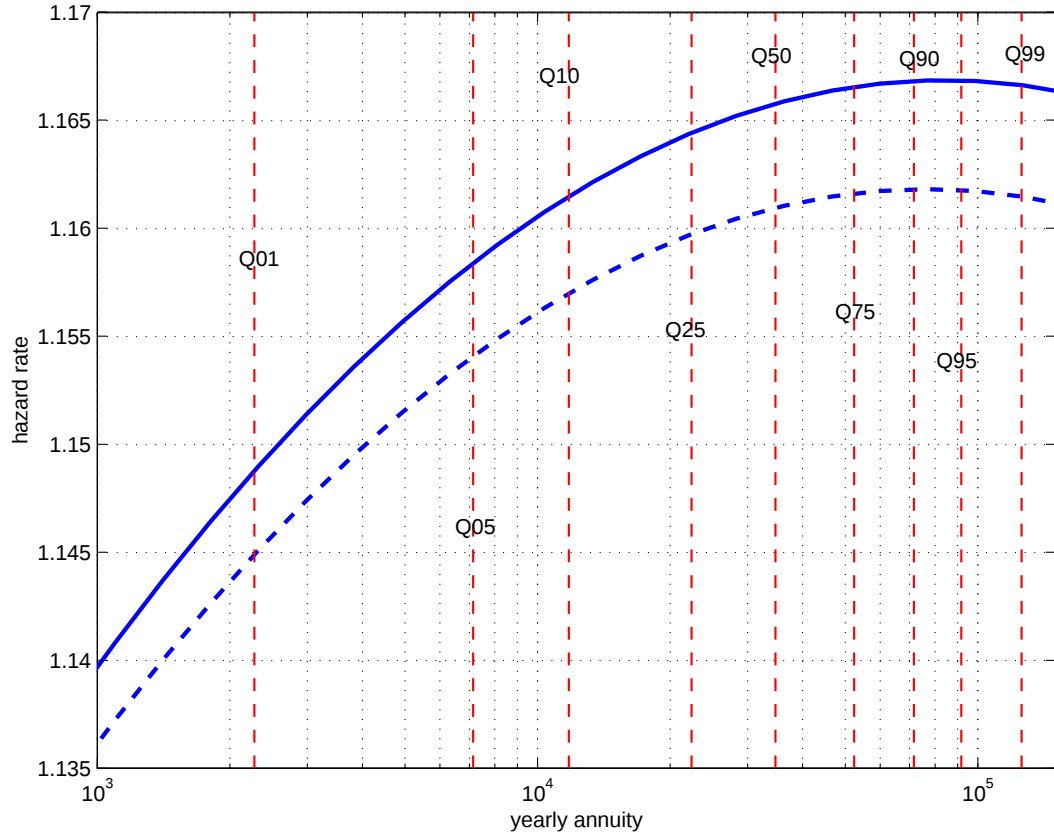


Figure 6: *Relative hazard rates for estimations  $II(m)$  (= dashed line) and  $IV(m)$  (= solid line) (with time trend) as a function of yearly deflated annuity (base = annuity of 1 SFR). ‘ $Q_x$ ’ denotes the  $x$ th quantile of the annuity distribution for men.*

#### 4.2.2 Results for men

The corresponding results for men are summarized in Tables 9 to 13. The structure and ordering of the tables correspond to those of women: Table 9 includes retirement year dummies, Table 10 cohort dummies. Table 11 looks at dummy variables for the different quantiles of “ $\ln(\text{annuity})$ ”. Tables 12 and 13 report the same sensitivity tests as for women: by company and per year respectively. The estimation results of the sensitivity tests again do not differ greatly from the overall regressions (except the somewhat lower significance levels).

As it was the case for women, including a time trend for the “ $\ln(\text{annuity})$ ” variables and/or censoring does not alter the results in a qualitative way. We are again not able to identify the optimal model and we keep and report all results.

The overall results for men are the following:

### Retirement year

The impact of the retirement year is exactly the same as for women: Retirement year dummies, cohort dummies and the retirement year trend (variable not reported) are highly significant and show the dramatic increase in the incidence of early retirement during the last 15 years. As reported in Figure 5, this trend is not monotonic. This is mainly driven by large fluctuations in exit rates across the participating pension funds (see company fixed effects below). The reasons for the latter are not entirely clear. It could well be that market conditions lead firms to advertise early retirement options more clearly, although the retirement decisions were not officially declared as down-sizing measures. But even if some of these fluctuations might have been driven by such measures, the quantitative impact of the increase in early retirement is strong and striking.

### Marital status

However, the role of the marital status is completely different. Married, widowed and divorced men tend to retire *later* than single men. There are no obvious (statistically significant) differences in retirement behavior between the former three groups when controlling for income. For men (and unlike women), the decisive factor in the retirement behavior seems to be the presence or absence of family ties.<sup>26</sup> There are several potential explanations for this finding paralleling the reasoning for women. The first is that a later labor market exit of married men is the result of a joint retirement decision. The second may be financial considerations. The overwhelming majority of today's elderly couples have followed a traditional role model in which the husband is the main (or even the only) bread-winner who has to care not only for himself, but also for his wife and children (who may still be at school). A third potential explanation is that there are large mortality differences between married and non-married men in favor of the former. If reductions to benefits for early retirement are actuarially fair, it is simply not optimal for married men to retire before the statutory age. This effect is reinforced by the joint annuity model in Switzerland (early retirement would entail that future benefits for the surviving wife are reduced at the same rate).

### Lifetime income

Retirement income has a clear, slightly non-monotonic impact on the retirement age. Up to a very high income level, a higher annuity (and thus a higher average lifetime income) leads to an earlier retirement, although lower life-expectancy for lower income workers should lead to the opposite outcome. For men, this affordability effect is much stronger at lower incomes than for women. It is important to stress that a median retirement income from the second pillar is clearly above the

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<sup>26</sup>The importance of family ties (particularly for men) seems to be important for another retirement decisions, the choice between an annuity and a lump sum upon retirement (see Bütler and Teppa (2004)). The absence of family ties induces men to opt the annuity option, probably because the annuity is the only form of insurance available to these men.

median income of *all* retirees, as low-income earners are not covered by the second pillar. The estimated peaks in the hazard ratio are at a second pillar income of 64'000 (56'500) Sfr for regressions without time trend (with time trend) and no censoring ( $\approx$  41'200 (36'400) EU or 53'300 (47'000) \$), and 183'100 (165'700) Sfr for estimations with censoring ( $\approx$  117'900 (106'700) EU or 152'300 (137'800) \$). This corresponds to a yearly pre-retirement income of at least 120'000 SFR ( $\approx$  80'000 EU or 100'000 \$). The dependency of the hazard ratio on income is also depicted in Figure 6 for the different regressions of Table 9. Table 11 assesses the non-linearity of the annuity variable by including quartile dummies instead. The results show that the hazard rate increases from quartile 1 to 3, but the hazard ratio of quartile 4 is again smaller and between the one of quartile 2 and 3.

Affordability thus seems to be a key determinant of male retirement behavior. There is a tendency to retire as soon as the financial situation permits (and as soon as early retirement plans are available). Another explanation may be that men have usually worked all their lives, in contrast to many women who had worked only part of their lives. Men may also suffer from worse health and thus retire as soon as the financial situation permits. Very rich individuals again retire somewhat later possibly due to the attractiveness of the job.

### Company fixed effects

One particularly interesting feature of company level estimations (Tables 7 and 12) is that they convey large fluctuations in the exit rate over the years (see Figure 5). The incidence of early retirement is higher when retirement schemes become more flexible, and lower in years following such changes. In most cases, however, no cause for a big fluctuation could be identified. It could well be that due to financial difficulty of a firm or higher returns on invested pension capital, more people were induced to take up early retirement, although this was not publicly admitted.

### Other variables

There are, of course, many other determinants for which an impact on the retirement decision can be anticipated, like health status, mortality differences or the number of dependent children at retirement. A bad health status is likely to induce early retirement regardless of the amount of annuity the person could get.<sup>27</sup> Mortality differences may have an impact on both the timing of retirement and the choice of the payout option. As differences in mortality are usually private knowledge,<sup>28</sup> the best we can do is to include proxies like life-time income (the rich live longer than the poor), and marital status (married men live longer than

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<sup>27</sup>Through the fact that health is usually negatively correlated with (lifetime) income, it is not completely absent from our analysis. It may be the case that less healthy individuals might prefer to retire early, but cannot afford to do so. It is hoped that more complete data sets may help to clarify this issue in the future.

<sup>28</sup>Even if differences in mortality were observable, they would most likely not be eligible as criteria for lower or higher pension benefits.

| <b>Covariate</b>         | <b>I(m)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>II(m)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>III(m)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(m)</b><br>Haz. Ratio<br>( <i>p-value</i> ) |
|--------------------------|-------------------------------------------------|--------------------------------------------------|---------------------------------------------------|--------------------------------------------------|
| married                  | 0.7696<br>(0.000)                               | 0.7726<br>(0.000)                                | 0.6789<br>(0.000)                                 | 0.6909<br>(0.000)                                |
| widowed                  | 0.7194<br>(0.001)                               | 0.7205<br>(0.001)                                | 0.6595<br>(0.001)                                 | 0.6598<br>(0.001)                                |
| divorced/separated       | 0.8453<br>(0.043)                               | 0.8458<br>(0.043)                                | 0.8211<br>(0.052)                                 | 0.8211<br>(0.052)                                |
| ln(annuity)              | 3.9188<br>(0.000)                               | 1.0224<br>(0.000)                                | 5.3140<br>(0.001)                                 | 1.0276<br>(0.001)                                |
| ln(annuity) <sup>2</sup> | 0.9402<br>(0.000)                               | 0.9989<br>(0.000)                                | 0.9334<br>(0.005)                                 | 0.9988<br>(0.004)                                |
| ret. year dummies        | YES<br>(***)                                    | YES<br>(***)                                     | YES<br>(***)                                      | YES<br>(***)                                     |
| max hazard               | 64'000 Sfr                                      | 56'500 Sfr                                       | 183'000 Sfr                                       | 165'600 Sfr                                      |
| Time trend               | NO                                              | YES                                              | NO                                                | YES                                              |
| Censoring                | NO                                              | NO                                               | YES                                               | YES                                              |
| Comp. fixed effects      | YES                                             | YES                                              | YES                                               | YES                                              |
| log p-lik.               | -41202.07                                       | -41205.21                                        | -29262.02                                         | -29266.27                                        |
| observations             | 5368                                            | 5368                                             | 5368                                              | 5368                                             |
| failures                 | 5368                                            | 5368                                             | 3716                                              | 3716                                             |

Table 9: *Cox proportional hazard regression for men. The variables “ln(annuity)” and “ln(annuity)<sup>2</sup>” have been interacted with a linear time trend (if time trend = YES). Data censored for age at retirement 64.75-65.25 (if censoring = YES).*

| <b>Covariate</b>         | <b>I(m)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>II(m)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>III(m)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(m)</b><br>Haz. Ratio<br>( <i>p-value</i> ) |
|--------------------------|-------------------------------------------------|--------------------------------------------------|---------------------------------------------------|--------------------------------------------------|
| married                  | 0.8023<br>(0.000)                               | 0.8048<br>(0.000)                                | 0.7163<br>(0.000)                                 | 0.7178<br>(0.000)                                |
| widowed                  | 0.7680<br>(0.010)                               | 0.7685<br>(0.010)                                | 0.7181<br>(0.013)                                 | 0.7176<br>(0.013)                                |
| divorced/separated       | 0.8495<br>(0.044)                               | 0.8496<br>(0.044)                                | 0.8294<br>(0.072)                                 | 0.8288<br>(0.070)                                |
| ln(annuity)              | 2.3161<br>(0.000)                               | 1.0142<br>(0.000)                                | 1.2397<br>(0.000)                                 | 1.0034<br>(0.000)                                |
| ln(annuity) <sup>2</sup> | 0.9630<br>(0.002)                               | 0.9994<br>(0.001)                                | —                                                 | —                                                |
| cohort dummies           | YES<br>(***)                                    | YES<br>(***)                                     | YES<br>(***)                                      | YES<br>(***)                                     |
| max hazard               | 69'500 Sfr                                      | 57'000 Sfr                                       | —                                                 | —                                                |
| Time trend               | NO                                              | YES                                              | NO                                                | YES                                              |
| Censoring                | NO                                              | NO                                               | YES                                               | YES                                              |
| Comp. fixed effects      | YES                                             | YES                                              | YES                                               | YES                                              |
| log p-lik.               | -39862.94                                       | -39864.37                                        | -27944.22                                         | -27947.11                                        |
| observations             | 5368                                            | 5368                                             | 5368                                              | 5368                                             |
| failures                 | 5368                                            | 5368                                             | 3716                                              | 3716                                             |

Table 10: *Cox proportional hazard regression for men. The variables “ln(annuity)”, “ln(annuity)<sup>2</sup>” have been interacted with a linear time trend (if time trend = YES). Data censored for age at retirement 64.75-65.25 (if censoring = YES).*

| <b>Covariate</b>    | <b>IV(m; q1)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(m; q2)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(m; q3)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(m; q4)</b><br>Haz. Ratio<br>( <i>p-value</i> ) |
|---------------------|------------------------------------------------------|------------------------------------------------------|------------------------------------------------------|------------------------------------------------------|
| married             | 0.6555<br>(0.000)                                    | 0.6555<br>(0.000)                                    | 0.6555<br>(0.000)                                    | 0.6555<br>(0.000)                                    |
| widowed             | 0.6463<br>(0.001)                                    | 0.6463<br>(0.001)                                    | 0.6463<br>(0.001)                                    | 0.6463<br>(0.001)                                    |
| divorced/separated  | 0.8041<br>(0.035)                                    | 0.8041<br>(0.035)                                    | 0.8041<br>(0.035)                                    | 0.8041<br>(0.035)                                    |
| dummy quartile 1    | —                                                    | 0.6171<br>(0.000)                                    | 0.5139<br>(0.000)                                    | 0.5271<br>(0.000)                                    |
| dummy quartile 2    | 1.6205<br>(0.000)                                    | —                                                    | 0.8328<br>(0.000)                                    | 0.8541<br>(0.002)                                    |
| dummy quartile 3    | 1.9459<br>(0.000)                                    | 1.2008<br>(0.000)                                    | —                                                    | 1.0256<br>(0.620)                                    |
| dummy quartile 4    | 1.8975<br>(0.000)                                    | 1.1709<br>(0.002)                                    | 0.9751<br>(0.620)                                    | —                                                    |
| ret. year dummies   | YES<br>(***)                                         | YES<br>(***)                                         | YES<br>(***)                                         | YES<br>(***)                                         |
| Censoring           | YES                                                  | YES                                                  | YES                                                  | YES                                                  |
| Comp. fixed effects | YES                                                  | YES                                                  | YES                                                  | YES                                                  |
| log p-lik.          | -29225.52                                            | -29225.52                                            | -29225.52                                            | -29225.52                                            |
| observations        | 5368                                                 | 5368                                                 | 5368                                                 | 5368                                                 |
| failures            | 3716                                                 | 3716                                                 | 3716                                                 | 3716                                                 |

Table 11: *Cox proportional hazard regression for men - robustness tests with dummies for the quartiles of yearly annuity. Data censored for age at retirement 64.75-65.25 (if censoring = YES).*

| <b>Covariate</b>         | <b>IV(m; 2)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(m; 9)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(m; 10)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(m; 15)</b><br>Haz. Ratio<br>( <i>p-value</i> ) |
|--------------------------|-----------------------------------------------------|-----------------------------------------------------|------------------------------------------------------|------------------------------------------------------|
| married                  | 0.5181<br>(0.000)                                   | 0.7148<br>(0.051)                                   | 0.7378<br>(0.023)                                    | 0.6110<br>(0.003)                                    |
| widowed                  | 0.6559<br>(0.167)                                   | 0.9270<br>(0.779)                                   | 0.6825<br>(0.099)                                    | 0.6696<br>(0.092)                                    |
| divorced/separated       | 0.6828<br>(0.186)                                   | 0.9969<br>(0.990)                                   | 0.8830<br>(0.467)                                    | 0.6798<br>(0.076)                                    |
| ln(annuity)              | 1.1403<br>(0.000)                                   | 1.0025<br>(0.054)                                   | 1.0801<br>(0.001)                                    | 1.0056<br>(0.000)                                    |
| ln(annuity) <sup>2</sup> | 0.9942<br>(0.001)                                   | —                                                   | 0.9965<br>(0.002)                                    | —                                                    |
| ret. year (dummy)        | YES (00–03)<br>(*)                                  | YES (00–02)<br>(*)                                  | YES (90–02)<br>(**)                                  | YES (90–03)<br>(**)                                  |
| max hazard               | 77'800 Sfr                                          | —                                                   | 62'200 Sfr                                           | —                                                    |
| Time trend               | YES                                                 | YES                                                 | YES                                                  | YES                                                  |
| Censoring                | YES                                                 | YES                                                 | YES                                                  | YES                                                  |
| Comp. fixed effects      | YES                                                 | YES                                                 | YES                                                  | YES                                                  |
| log p-lik.               | -4054.92                                            | -2926.48                                            | -9305.11                                             | -2893.79                                             |
| observations             | 762                                                 | 600                                                 | 2135                                                 | 937                                                  |
| failures                 | 695                                                 | 489                                                 | 1313                                                 | 460                                                  |

Table 12: *Cox proportional hazard regression for men by company (4 largest companies). The variables “ln(annuity)” and “ln(annuity)<sup>2</sup>” have been interacted with a linear time trend (if time trend = YES). Data censored for age at retirement 64.75-65.25 (if censoring = YES).*

| <b>Covariate</b>         | <b>IV(m; 2000)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(m; 2001)</b><br>Haz. Ratio<br>( <i>p-value</i> ) | <b>IV(m; 2002)</b><br>Haz. Ratio<br>( <i>p-value</i> ) |
|--------------------------|--------------------------------------------------------|--------------------------------------------------------|--------------------------------------------------------|
| married                  | 0.7660<br>(0.179)                                      | 0.6018<br>(0.001)                                      | 0.7990<br>(0.171)                                      |
| widowed                  | 1.0173<br>(0.954)                                      | 1.0991<br>(0.752)                                      | 0.7711<br>(0.344)                                      |
| divorced/separated       | 0.8804<br>(0.661)                                      | 0.6168<br>(0.037)                                      | 0.9953<br>(0.983)                                      |
| ln(annuity)              | 1.0731<br>(0.022)                                      | 1.0036<br>(0.001)                                      | 1.0036<br>(0.000)                                      |
| ln(annuity) <sup>2</sup> | 0.9969<br>(0.033)                                      | —                                                      | —                                                      |
| max hazard               | 72'800 Sfr                                             | —                                                      | —                                                      |
| Time trend               | YES                                                    | YES                                                    | YES                                                    |
| Censoring                | YES                                                    | YES                                                    | YES                                                    |
| Comp. fixed effects      | YES                                                    | YES                                                    | YES                                                    |
| log p-lik.               | -4030.24                                               | -4717.64                                               | -3562.61                                               |
| observations             | 884                                                    | 919                                                    | 749                                                    |
| failures                 | 663                                                    | 776                                                    | 598                                                    |

Table 13: *Cox proportional hazard regression for men by retirement year. The variables “ln(annuity)” and “ln(annuity)<sup>2</sup>” have been interacted with a linear time trend (if time trend = YES). Data censored for age at retirement 64.75-65.25 (if censoring = YES).*

singles). The impact of having dependent children on the retirement decision is unclear, *a priori*. People may want to keep on working to be able to finance their children’s expenses. But they also might want to benefit from the generous additional benefits for children (even if reduced due to early retirement) as long as they are still eligible. The overall effect will depend on the financial situation of a family as well as the age of the children. Unfortunately, our data do not allow us to control for any of these variables directly.<sup>29</sup> We cannot control for post-retirement employment either.

## 5 Conclusions

Reversing early retirement trends has become a major policy issue in most European countries. It is clear that incentives set by the social security system will be key in this exercise. But there might be other determinants of early retirement that are equally important. If the preference for leisure in old age is sufficiently strong, for example, even negative implicit tax rates on staying in the labor force might not induce people to work much longer if they have sufficient funds to live on when old. This paper has aimed to shed some light on determinants of the retirement decision other than the impact of social security incentives by analyzing individual data from a selection of Swiss pension funds.

The main findings from our exercise can be summarized as follows. Firstly, there is an increasing tendency to retire early in Switzerland even in the absence of legislative changes. The effect is more pronounced for men than for women, and was found to be especially strong in the last few years. Secondly, affordability seems to be a key determinant for the retirement decision, in particular for men. Richer men (as measured by life-time labor income) retire earlier than poorer men. For women, the effect of income on the likelihood to exit the labor force is also positive, but weaker than for men. This affordability interpretation may also partially explain the increase in early retirement over the last 15 years, as Switzerland’s second pillar has matured over this period, leading to higher effective replacement rates. The effective net replacement rates in Switzerland are so high now that the after retirement income is close to, or even higher than average pre-retirement income. If people are credit constraint or reluctant to offset this over-saving by accumulating debt, the rational response might be an earlier exit from the labor market. Thirdly, marital status plays an important role in an individual’s retirement decision. For men, the main difference is between singles, who retire earlier on average, and non-singles. This hints at the importance of family ties (and of potential financial liabilities for children and (ex-)wives) for men. Married women tend to retire earlier than other women, while divorced and separated women clearly work longer, probably due to financial constraints.

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<sup>29</sup>We have run the regressions with a small subsample of individuals in companies that reported the number and age of children. The results are inconclusive due to the small number of individuals with children.

We believe that our findings have important policy implications. High replacement rates may not only have strong effect on low income workers, but also on high income workers even when explicit early retirement incentives are unimportant. If pension reforms aim at an increase of the funded part, and thus at a strengthening of the link between life-time earnings and future pensions, reducing early retirement incentives for low income earners may come at the cost of a higher labor market exit rate for high income individuals, especially if effective replacement rates are high.

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