



The impact of retirement on psychological well-being in Canada

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ABSTRACT

The objective of this study is to investigate the effect of retirement on psychological wellbeing. The empirical part of this study uses seven longitudinal waves of the Canadian National Population Health Survey, spanning 1994 through 2006. To account for biases due to unobserved individual specific heterogeneity, this study deploys panel data methodologies such as fixed effect method, fixed effect logistic method, and instrumental variable fixed effect method. Using age specific retirement incentives provided by Canada's Income Security System as instruments for retirement behavior, the study finds that retirement has significant positive impact on subsequent psychological well-being. The findings of the study would substantiate the continuity theory notion that retirement may actually improve psychological well-being.

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1. Introduction

Like most other developed countries, Canada is experiencing a decrease in the age at retirement and simultaneously an increase in life expectancy. In the mid 1980s, the median retirement age in Canada was about 65 years, but it declined to 61 years by 2005. At the same time life expectancy has been on the rise in Canada: in 1921, life expectancy at age 65 was 13.3 more years, while it was 19.2 more years in 2003 (Statistics Canada, 2008). These trends imply that people are living longer in the retirement phase. This situation has implications for sustainability of the retirement system, as government will need to pay more in the form of pensions and other retirement benefits. These trends also have implications for health care expenditures. Here the question is whether retirement benefits or harms health. If retirement improves health, then early retirement may reduce health care expenditures. On the other hand, if retirement harms health, then policies that promote early retirement may actually increase health care expenditures. There are numerous studies on the impact of physical health on retirement. However, only a few studies have examined the impact of retirement on physical health, and the results are still inconclusive. A number of studies also focused on the impact of retirement on mental health and psychological well-being. However, these studies also had no conclusive result, as some studies suggest that retirement improved psychological well-being while other stud-

ies show that retirement actually has a negative impact. Studies produced conflicting results because most of the studies on retirement and psychological well-being used small samples and they also suffered from methodological problems such as endogeneity bias.

This paper uses large-scale Canadian longitudinal data to estimate the impact of retirement on psychological well-being. To address the endogeneity issue, the paper utilizes sophisticated econometric techniques. This study will have important policy implications. Studies using data from Canada and other Organization for Economic Co-operation and Development (OECD) countries suggest that the provisions of social security programs themselves often provide strong incentives to leave the labor force early (Baker et al., 2003, 2004). A finding that retirement positively impacts psychological well-being in Canada will mean early retirement may reduce mental health related expenditures. On the other hand, a finding that retirement harms psychological well-being will imply that early retirement incentives may actually increase mental health related expenditures and thus such a policy needs to be re-considered.

This study aims to contribute to the literature in the following ways: first, this will be the first Canadian study on the relationship between retirement and psychological well-being using large-scale longitudinal data; second, unlike other studies in retirement literature, this study takes into account endogeneity resulting from the presence of time-varying unobserved factors; and third, this paper conducts separate analyses to examine whether the impact of retirement on psychological well-being differs between males and females.

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This paper is structured as follows: Section 1, introduction; Section 2 reviews the literature; Section 3 deals with the conceptual framework; Section 4 discusses methodology; Section 5 presents results; and Section 6 is the concluding section.

2. Literature review

Palmore et al. (1985), using U.S. data on men and women, estimated the impact of retirement on well-being and did not find any conclusive result. Crowley (1986) explored both the psychological and physical quality of life of retired men, using U.S. longitudinal data and found that retirement appeared to have no adverse effect on well-being. Bossé et al. (1987) examined psychological symptoms of a sample of older men. After controlling for physical health, this study found that retirees reported more psychological symptoms than workers. Ekerdt et al. (1985) used a longitudinal sample from U.S. men aged 50–70 to examine the impact of retirement on life satisfaction and they found that retirement had a negative but nonlinear effect on life satisfaction. In their study, Reitzes et al. (1996) used U.S. longitudinal data on men and women aged 58–64 and they found that retirement had a small positive effect on individual well-being. Using U.S. longitudinal data, Kim and Moen (2002) examined the impact of retirement on men and women's psychological well-being. The study found positive effects on well-being for men, but no effect for women. Mein et al. (2003) used longitudinal data on British civil servants to determine whether retirement age at 60 is associated with improvement or deterioration in mental and physical health. This study found that retirement was associated with an improvement in mental health, particularly among high socioeconomic status groups.

A major problem of all the above reviewed studies is that these studies did not take into account the probable endogeneity of the retirement variable on the well-being. However, as will be discussed in detail in Section 4, the well-being equation may suffer from endogeneity bias, as there may be unobserved factors that are correlated with both the retirement variable and with psychological well-being. Regressions that do not control for endogeneity may not provide an unbiased estimate of the impact of retirement on well-being.

A few recent studies take into account the endogeneity issue using sophisticated econometric methods. Charles (2004) used an instrumental variable method on longitudinal data of U.S. mature men and women to estimate the impact of retirement on psychological well-being. The study found that retirement had a positive effect on psychological well-being once simultaneity between retirement and well-being was taken into account. Jaeger and Holm (2004) used a fixed effect estimator on a large-scale panel data set of elderly Danish respondents and they found that retirement did not have any significant negative effect on well-being. However, when estimating a separate model for men and women, they found that men experienced a decline in well-being as a consequence of retirement, while women were unaffected by retirement. In a most recent study, Johnston and Lee (2009) used Health Survey of England data to estimate the short-term effect of retirement on health. To control for endogeneity, this study used the Regression Discontinuity Design (RD) and found that retirement increased an individual's sense of well-being and mental health.

So far two studies have examined the impact of retirement on psychological well-being using Canadian data (Thériault, 1994; Gall et al., 1997). Thériault (1994) examined the work to retirement process to verify whether pre-, intra-, and post-retirement periods are different from one another. Findings from 17 experimental and 22 control subjects, aged 65, suggest that anxiety level steadily decreased with time in retirement. Gall et al. (1997) used a sample of 117 male retirees to evaluate the short-term impact of retire-

ment as well as to monitor the change in adjustment across time. The study concluded that there was no evidence that individuals experienced retirement as a stressful event.

These above-mentioned Canadian studies were based on small samples and the researchers also did not consider the endogeneity problem. This study will use large-scale Canadian longitudinal data and will take into account the endogeneity problem. To solve the endogeneity problem, this study will use both a fixed effect model and a fixed effect instrumental variable method.

3. Conceptual framework

There are two conflicting theoretical views on how retirement impacts psychological well-being: role theory and continuity theory. The role theory considers that work and employment, being a source of self respect and identity, play a central role in the life of a typical adult (Miller, 1965). According to this theory, retirement brings this work role to an end, and the retired individual will suffer psychologically since he/she is no longer able to view him/herself as a productive and contributing member of the society. This theory argues that leisure roles during retirement cannot replace work roles as a source of self respect. Atchley (1976, 1982, 1985, 1993) proposed a continuity theory that suggests that retirement may not necessarily have negative consequences on psychological well-being. According to this theory, individuals occupy multiple roles such as family roles and friendship roles and for most people the work role may not necessarily be their most central role. This theory suggests that retirement may actually offer an opportunity to spend more time in the important roles of friend and family member and the continuity of these roles into retirement would prevent an overall negative consequence of retirement. The continuity theory further argues that retirement may offer relief from job pressure and performance expectations that may actually improve psychological well-being.

Thus, these retirement theories failed to agree on a conclusion on the impact of retirement on psychological well-being.

4. Methodology

4.1. Empirical framework

It is assumed that when deciding whether to retire or continue working at any particular age, an individual compares expected utility from retirement (U^R) with expected utility received from continuing in the workforce (U^L). At any particular age, the individual will decide to retire if he/she finds that $U^R > U^L$ or $U^R - U^L > 0$. The individual's retirement behavior can be written in the following way:

$$R^* = \delta_1 Z + \varepsilon \quad (1)$$

$R = 1$ if $R^* > 0$ and $R = 0$ if $R^* \leq 0$. where Z is a vector of variables that determine retirement probability and ε represents mean zero error term.

It is also assumed that psychological well-being for an individual is determined by the following equation:

$$WB = \beta_1 R + \beta_2 X + \nu \quad (2)$$

where WB denotes individual's psychological well-being, and R is the indicator variable which equals 1 if the individual is retired, X is a vector of variables influencing psychological well-being, and ν is mean zero error representing unobserved factors that determine well-being.

The coefficient of retirement β_1 in Eq. (2) will provide an unbiased estimate only if the unobserved determinants of psychological well-being are completely uncorrelated to the unobserved deter-

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