



# Does retiree health insurance encourage early retirement? <sup>☆</sup>



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## ABSTRACT

The strong link between health insurance and employment in the United States may cause workers to delay retirement until they become eligible for Medicare at age 65. However, some employers extend health insurance benefits to their retirees, and individuals who are eligible for such retiree health benefits need not wait until age 65 to retire with group health coverage. We investigate the impact of retiree health insurance on early retirement using employee-level data from 54 diverse firms that are clients of Towers Watson, a leading benefits consulting firm. We find that retiree health coverage has its strongest effects at ages 62 through 64. Coverage that includes an employer contribution is associated with a 6.3 percentage point (36.2%) increase in the probability of turnover at age 62, a 7.7 percentage point (48.8%) increase in the probability of turnover at age 63, and a 5.5 percentage point (38.0%) increase in the probability of turnover at age 64. Conditional on working at age 57, such coverage reduces the expected retirement age by almost three months and reduces the total number of person-years worked between ages 58 and 64 by 5.6%.

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## 1. Introduction

In the United States, there is currently a strong link between health insurance and employment. Most individuals can only purchase health insurance at favorable group rates through their employer, and there are significant tax advantages to employer-based coverage. Employment-based health insurance can make it more difficult for individuals to retire before they become eligible for health insurance through Medicare at age 65. While some employers extend

health insurance coverage to their pre-65 retirees, most do not. According to the Kaiser Family Foundation (2012), only 25% of large firms (with 200 or more employees) and 4% of small firms that offer employee health coverage also extend benefits to retirees. A worker whose employer does not offer retiree health coverage has limited options for obtaining health insurance if he or she retires before becoming eligible for Medicare. Buying an individual health insurance policy can be difficult, particularly for those with preexisting conditions. The Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985 allows workers who leave their jobs to continue to participate in their former employer's health plan at group rates for up to 18 months. This law makes it possible for workers to retire at age 63½ without losing group coverage, although they would forego any employer contribution toward their premiums.

In this paper, through the lens of a new data source, we revisit the impact of the availability of group health insurance on the decision to retire. Our dataset consists of employee records from a large and diverse group of firms, drawn from among the clients of Towers Watson, a leading benefits consulting firm. These employee records are matched to detailed information about the firms' benefit provisions. Some of Towers Watson's clients offer health insurance to their retirees, while others do not. Moreover, the retiree health benefits that are offered vary in their generosity and eligibility criteria. Another advantage of our dataset is that we can control for a number

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of firm-level characteristics that influence retirement, including specific features of defined benefit and defined contribution pension plans. If access to health insurance does in fact influence retirement decisions, then we would expect to find a relationship between retiree health coverage and retirement for persons age 64 or younger.

This question is particularly important in light of the recently passed Patient Protection and Affordable Care Act (PPACA) of 2010, which will considerably weaken the link between employment and health insurance by making group coverage available to all individuals regardless of employment. Many individuals will also receive explicit subsidies to purchase group coverage, and older individuals will also likely receive substantial implicit subsidies through a legal limit on their premiums relative to those paid by younger individuals. One possible consequence of this reform is that it may encourage earlier retirements, as all older workers will be able to maintain group coverage – often with generous subsidies – even if they retire before Medicare eligibility. Studying the link between employer-provided health insurance and retirement can help us to understand the potential impact of PPACA on the labor market participation of older pre-Medicare workers.

To preview our results: We find that after controlling for individual and firm characteristics and pension plan features, being eligible for subsidized retiree health coverage (i.e., coverage in which the employer contributes towards the premium) raises the probability of turnover (leaving the firm) by 6.3 percentage points at age 62, representing a 36.2% increase relative to the turnover rate for individuals with no coverage. It raises the probability of turnover by 7.7 percentage points (48.8%) at age 63 and by 5.5 percentage points (38.0%) at age 64. We find no such effects for individuals who work for firms that offer retiree health insurance but do not meet the eligibility criteria for coverage. The effects of retiree health coverage are fairly consistent for men and women, and for high-salary and low-salary workers. We find little evidence that “access only” (i.e., coverage in which the retiree gets a group rate but the employer does not contribute towards the premium) influences retirement decisions in this age range. Subsidized retiree health coverage reduces the total years of employment between ages 58 and 64 by 5.6%. These results are consistent with the hypothesis that Medicare eligibility influences workers' retirement decisions, specifically among individuals who are younger than age 65 and do not have access to subsidized retiree health coverage.

The remainder of the paper is organized as follows. Section 2 summarizes the previous literature on the relationship between health insurance and retirement, and describes the contribution of this paper. Section 3 describes our dataset. Section 4 presents our methodology, and Section 5 discusses our results. Section 6 concludes.

## 2. Prior research on health insurance and retirement

Prior studies have used a variety of approaches to estimate the effect of health insurance on retirement. A number of studies use a reduced form approach to examine the retirement rates or labor force participation rates of those with and without retiree health coverage, controlling for other factors and, in some cases, for selection into retiree health coverage based on unobservable characteristics. In general, these studies find that retiree health coverage substantially increases the probability of early retirement among pre-Medicare eligible workers. Blau and Gilleskie (2001) estimate that subsidized retiree health coverage increases the rate of retirement (labor market exit) by about 2 percentage points per year among male workers aged 51–61, with an increase of 7.5 percentage points among 61-year-olds. They find that the effect on retirement is positive starting at age 54 and increases with age. Kapur and Rogowski (2011) estimate that retiree health insurance raises retirement rates by between 3 and 5 percentage points (depending on gender and marital status) for workers under the age of 65. Marton and Woodbury (2006) find

effects of a similar magnitude, in the range of 3–4 percentage points for males aged 51–61. Karoly and Rogowski (1994) estimate that retiree health coverage roughly doubles (from 12% to 24%) the probability of retirement over a 2-year period for men aged 55–62. Robinson and Clark (2010) use a proportional hazard model to show that individuals aged 50–60 with retiree health insurance are 21.2% more likely to leave their job. Strumpf (2010) finds that retiree health coverage raises the probability of being retired by 8 percentage points, on average, for individuals under the age of 65. Madrian (1994) finds that retiree health coverage reduces the age of retirement by 5–16 months. Mulvey and Nyce (2004) use matched employer–employee administrative data to demonstrate that retiree health coverage is associated with a reduction in retirement ages of 9.3 months for men and 1.6 years for women. Marton and Woodbury (2012) find that retiree health coverage reduces retirement among workers in their early 50s (when they are generally ineligible for benefits) but raises among workers in their early 60s (when they are generally eligible).

An alternative approach followed by a number of authors is to estimate a structural model of retirement, and to use the estimated model to simulate the impact of retiree health coverage. These studies tend to find smaller effects than those that use the reduced form approach. Blau and Gilleskie (2008) estimate that retiree health coverage reduces the labor force participation rate of older men by 3.6 percentage points. Studying the behavior of married couples, Blau and Gilleskie (2006) predict an increase in retirement probability of less than half a percentage point for men and 1.6 percentage points for women. Gustman and Steinmeier (1994) find that retiree health coverage increases the probability of leaving full-time employment at age 62 by 2.1 percentage points, a 16% increase over the baseline exit rate. Lumsdaine et al. (1996) find that retiree health insurance raises retirement rates between ages 60 and 64 by about 2 percentage points per year. French and Jones (2011) estimate that retiree health coverage raises the retirement rate at age 62 by 8.5 percentage points.

A third approach is to estimate the impact of retiree health coverage using aggregate state-level data, and variation in state and federal policy. Gruber and Madrian (1995) examine the state and federal “continuation of coverage” requirements that were adopted during the 1970s and 1980s. They find that these mandates encouraged earlier retirement. In particular, they find that the availability of COBRA coverage reduced the labor force participation rate of 55–64 year-olds by 3.3 percentage points.

We have access to a unique dataset that contains much more detailed information about firm-level benefits than has previously been available to researchers. In particular, our dataset is derived from the employee records of 54 firms, matched to a firm-level survey of benefit provisions. These firms are quite diverse in terms of their industry, size, location, and other characteristics. Our paper contributes to the existing literature in several ways. First, compared with the HRS and other public data sources, we have more detailed information on the size of the employer contribution towards retiree health coverage. Thus, we are able to separate out the effects of subsidized coverage (i.e., retiree health coverage that includes an employer contribution) and access only coverage (i.e., coverage that does not include an employer contribution but provides the benefit of a group plan). Second, our data on retiree health provisions are subject to less measurement error than the self-reported information in the HRS. It is generally difficult to get access to such firm-level data. (Blau and Gilleskie's (2008) study is one exception – they are able to supplement the HRS data with detailed employer-provided data on retiree health coverage and pensions.) Finally, we have detailed information on each firm's age and service eligibility criteria for retiree health coverage. Hence, we are able to compare the behavior of eligible and ineligible individuals within the subset of individuals whose employers offer retiree health coverage. This allows us to control for the possibility that individuals may select into such jobs based on

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