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The role of retiree health insurance in the early retirement of public sector employees[☆]

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ABSTRACT

Most government employees have access to retiree health coverage, which provides them with group health coverage even if they retire before Medicare eligibility. We study the impact of retiree health coverage on the labor supply of public sector workers between the ages of 55 and 64. We find that retiree health coverage raises the probability of stopping full time work by 4.3 percentage points (around 38 percent) over two years among public sector workers aged 55–59, and by 6.7 percentage points (around 26 percent) over two years among public sector workers aged 60–64. In the younger age group, retiree health insurance mostly seems to facilitate transitions to part-time work rather than full retirement. However, in the older age group, it increases the probability of stopping work entirely by 4.3 percentage points (around 22 percent).

1. Introduction

Individuals' decisions about entering or exiting the labor force, and about switching employers, can be strongly influenced by non-monetary employer-provided benefits. For example, employer-provided group health insurance has been documented to create "job lock," a phenomenon in which individuals remain in jobs that come with this benefit longer than they would otherwise (see, e.g., Madrian, 1994). One form of job lock occurs among older workers, who often have an incentive to delay retirement until Medicare eligibility – at age 65 – in order to maintain group health coverage.[2] But one important subset of workers – consisting of those whose employers extend group health coverage to retirees in addition to current employees – does not face this incentive. However, retiree health plans are rare in the private sector. According to the Kaiser Family Foundation (2013), among large firms providing employer-sponsored coverage, just over a quarter also provide retiree coverage, and that fraction has fallen sharply over time. In contrast, most public sector employers offer retiree health plans, allowing former employees who meet certain age and service requirements to participate in a group health plan before Medicare eligibility.

In this paper, we examine the impact of retiree health coverage on the retirement decisions of public sector employees.[3] While a large literature has examined the impact of retiree health

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2 In principle, the Consolidated Omnibus Budget Reconciliation Act (COBRA) allows workers to retire at age 63½ by giving them the right to them to buy into their former employer's group health plan. However, while COBRA gives workers access to group rates, it typically does not include an employer contribution.

3 Retiree health coverage may also reduce the need to save for retirement. A related paper (Clark and Mitchell, 2013) examines the impact of retiree health coverage on the saving decisions of public sector workers.

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plans in general, most previous studies focus on the private sector. Studying the public sector is important for several reasons. First, the public sector is large, accounting for around 16 percent of total nonfarm employment.[4] Second, both public sector pensions and retiree health plans are severely underfunded. As public sector employers consider making changes to these plans, it is important for them to understand how these changes might affect work incentives. Finally, public sector workers might respond differently to retirement incentives than private sector workers. For example, individuals who select into public sector employment might be more risk averse than average, indicated by their willingness to accept a lower salary in exchange for more job security. Additionally, public sector employers typically offer very generous defined benefit pension plans, which also contain strong early retirement incentives. Public sector employees are also more likely to be unionized than their private sector counterparts.

Because retirement is difficult to measure directly, in our empirical analysis, we use stopping full time work as a proxy. That is, we study whether generous retiree health insurance is associated with an increased pre-Medicare full time work exit rate among public sector employees with 5 or more years of job tenure. We model the probability of shifting out of full time work at ages 55–64 as a function of the generosity of retiree health coverage, as well as controls for demographics, health, job characteristics, work history, wealth, and pension plan retirement incentives. We focus on the decision to stop work before the age of 65 because retiree health coverage is most valuable for retirees in this group. Typically, a public sector retiree health plan is the primary payer for pre-Medicare eligible retirees. When a retiree becomes eligible for Medicare, however, he or she is required to enroll in Medicare, relying on the retiree health plan only as a secondary payer (Clark and Morrill, 2010).

To preview our results, we find that retiree health coverage raises the probability of stopping full time work by 4.3 percentage points (around 38 percent) over two years among public sector workers aged 55–59 and by 6.7 percentage points (around 26 percent) over two years among public sector workers aged 60–64. These effects are somewhat larger than the corresponding point estimates for private sector employees; however the differences are not statistically significant. Among 55–59 year old public sector workers, retiree health insurance appears to facilitate transitions to part time work, roughly doubling the probability of shifting from full time to part time work over a two year period. However, it does not appear to have a statistically significant impact on the probability of stopping work entirely. On the other hand, among 60–64 year old public sector workers, retiree health insurance increases the probability of stopping work entirely by 4.3 percentage points (around 22 percent) over two years among public sector workers aged 60–64.

As mentioned earlier, one motivation for studying the retirement incentives in public sector retiree health plans is that public sector employers are likely to consider changes to these plans in the near future. These changes will occur against the backdrop of the Affordable Care Act (ACA). As of this year, the ACA allows all individuals to purchase health insurance on state-run exchanges. In addition, many individuals are eligible to receive subsidies toward their health insurance purchases. Because the exchanges make subsidized health insurance widely available outside of employment, the ACA effectively provides all individuals with retiree health insurance. Thus, both public and private employers offering retiree health coverage may find that retiree health insurance is less attractive to workers than it was in the past. In response, we might expect to see employers dropping retiree health coverage, resulting in a smaller compensating differential in monetary wages between public and private sector employment.[5] This option might be particularly attractive to public sector employers facing financial distress from both pension and retiree health obligations. Indeed, there have already been reports of public sector employers taking steps to shift retirees onto the ACA's exchanges (Niquette and Wayne, 2013).

The remainder of this paper is organized as follows. Section 2 provides a summary of the prior research on retiree health insurance and retirement and an overview of public sector retiree health plans. Section 3 describes our data and methodology. Section 4 presents our results. Section 5 discusses the policy implications of our results in light of the ACA. Section 6 concludes.

2. Prior research on health insurance and retirement

The vast majority of public sector workers are covered by retiree health plans, which allow them to purchase group health insurance after retirement. Federal employees continue to participate in the Federal Employees Health Benefits (FEHB) program when they retire (US Office of Personnel Management, 2013), and retirees receive the same employer contribution as current employees. The FEHB program provides access to a range of different health plans, and in most cases, the federal government contributes either 72 percent of the overall weighted average premium, or 75 percent of premium of the chosen plan, whichever is smaller. At the state and local levels, the provisions of public sector retiree health plans – for example, employer contributions, co-pays, and deductibles – vary considerably (see, e.g., Clark and Morrill, 2010; GAO, 2007; Clark et al., 2011). Within each public sector health plan, deductibles, co-pays, and the employer contribution rate are often adjusted from year to year depending on health care costs and the plan's finances. In recent years, many plans have become less generous along these dimensions (see e.g., Franzel and Brown, 2012).

In principle, the availability of retiree health coverage makes it easier for workers to retire prior to Medicare eligibility. Thus, we would expect to observe higher job exit rates or lower labor force participation among retiree-health eligible workers in their late 50s and early 60s. Indeed, prior studies of retiree health coverage have found such a relationship. These studies typically take one of three approaches. The first approach is to use a structural life cycle model to simulate retirement behavior both with and without retiree health coverage. Studies taking this approach include Blau and Gilleskie (2006, 2008), Gustman and Steinmeier (1994), Lumsdaine et al. (1996), and French and Jones (2011). A second approach is to use micro-data to directly estimate the impact of retiree health coverage on retirement. This is the approach taken by Blau and Gilleskie (2001), Kapur and Rogowski (2011), Marton and Woodbury (2007), Karoly and Rogowski (1994), Robinson and Clark (2010), Strumpf (2010), Madrian (1994), Mulvey and Nyce (2004), Marton and Woodbury (2013), Leiserson (2013), Fitzpatrick (2013), and Nyce et al. (2013). These studies typically find larger effects than those based on structural models. Finally, Gruber and Madrian (1995) adopt a third approach based on aggregate state-level data. During the 1970s and 1980s, a number of states, as well as the federal government, adopted "continuation of coverage" requirements that allowed workers to continue to participate in their employers' group health plans after leaving employment. Using variation in

[4] See the Bureau of Labor Statistics figures available at http://www.bls.gov/news.release/empsit.t17.htm.

[5] The change in the wage differential would likely be smaller than the cost savings from dropping retiree health insurance as workers may not fully value this distant future benefit.