

**Health, retirement and inequality:
can Germany and the UK learn
from each other?**

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HEALTH, RETIREMENT AND INEQUALITY

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Introduction

This study attempts to understand the effect of health on the decision of older workers to leave the labour market – a decision which is made within the context of the pension and benefit systems of the UK and Germany. We use comparable national panel data sets and innovative analytic methods in order to identify a true causal effect rather than just an association between poor health and early retirement. We also compare the results for Germany and the UK to see what each country can learn from the other.

We find that health is an extremely important factor in the retirement decision for both men and women in the UK and Germany. The effects of poor health seem to be greater in the UK than Germany. The size of the health effect is larger than that of pension entitlement and income in both countries. Our results also suggest that it is health shocks rather than a continual level of poor health that are important in the retirement decision.

Background

Germany and the UK share concerns about the sustainability of the public pension system and potential labour shortages arising from the aging of the population. Debates in both countries have centred on encouraging people to work for longer and on changing incentives to encourage greater retention of employees. This has neglected the important role of the health of older workers as a primary determinant of whether or not they remain in the labour market as they approach retirement age.

It is reasonable to expect that health will be an important factor in the decision to retire and a number of existing studies confirm this view. Because most people aged over 50 live as a couple, we also consider the joint decision making of older couples by including spouse health and spouse labour market status as factors in our analysis. As well as health, we also look at a broad set of socio-economic characteristics such as education, pension entitlement, housing tenure and income, which might also be expected to affect the decision to retire.

The data come mainly from two nationally representative data sets, the British Household Panel Survey (BHPS) and the German Socioeconomic Panel (GSOEP). The time period considered is 1991–2002, and our samples consist of people who were aged 50 or over, had a full interview and were in the labour force in 1991. The samples have been reduced over time by attrition, which largely arises through refusal, non-contact and because people become ineligible to participate. For both the BHPS and the GSOEP, we start with just over 1,100 people and this is reduced by over one-third by the end of the period. At this time, almost half of the original sample is retired.

One of the problems with work in this area is that it depends on subjective measures of health – in other words, health status as reported by the respondent themselves, with no objective validation by a health care professional. These types of measures may be appropriate because only the individual can give a true indication of how they feel. However, they can cause problems when attempting to uncover how health affects labour market status because the way in which an individual chooses to rate their own health (on a scale ranging from very poor to excellent) may be related to their choice of early retirement, even if there is no direct causal link between the two factors. In this study, we have attempted to overcome these problems by taking advantage of the rich data sets available to us and by using appropriate analytical techniques. Therefore, we are confident that our results reflect a real causal effect of health on the retirement decision.

Main findings

The effects of health on early retirement

- Measuring health in two different ways for each country, it is found to be a key determinant of the retirement decision for both men and women in the UK and Germany.
- The poorer an individual's health, the more likely they are to retire early, even after we have taken account of differences in age, education, marital status, pension entitlement, other household income and housing tenure.
- The effects of health on early retirement are larger in the UK than Germany.
- The size of the health effect is large compared to the other variables and, in particular, is larger than the pension entitlement and other income effects in both countries.
- It seems to be health shocks, rather than a continual level of poor health, which are important in determining retirement.
- The effects of spouse health do not appear to be important, but there is some evidence of an effect from having a working spouse.

Why is the effect of health larger in the UK than Germany?

- It may reflect increased incentives to utilise the disability route into retirement in the UK.
- This in turn may be due to an increased reliance on private sector pensions where people cannot access sufficient pension benefits before statutory retirement age and therefore rely on other sources of income including disability insurance.
- However, it may also reflect the fact that it is easier for older workers with health problems to continue working in Germany, and potentially this may be a reflection of less discrimination against older workers on the part of employers in Germany.

Inequality in health shocks and early retirement

Previous work has revealed that both health and income inequalities are much greater in the UK than in Germany. One of the main reasons seems to be the difference in the relative position of the retired, who are much more concentrated in the lower income groups in the UK. However, an earlier report for the Anglo-German Foundation (Naegele and Walker, 2002)¹ suggests that inequality and poverty among older people in Germany is expected to increase as a result of pressures on the pension system.

¹ Naegele, G. and Walker, A. (2002) *Ageing and social policy: Towards an agenda for policy learning between Britain and Germany*. London: The Anglo-German Foundation.

Policy implications

- Designing financial incentives to encourage people to work for longer may not be sufficient as a policy tool if people are leaving the labour market involuntarily due to health problems.
- Even raising the statutory retirement age may have no effect if poor health is the underlying reason for inactivity.
- There is a need to improve the health of the workforce and facilitate continued work for people with health problems and disabilities.
- An integrated approach between primary health care providers and employers is necessary, and this is not easily facilitated within the current systems of either the UK or Germany.
- Some hope is provided by the UK Pathways to Work scheme (and the Want2work schemes in Wales), designed to help people on Incapacity Benefit to return to work. These schemes provide specific health advice and might be usefully extended more generally to help older workers with health problems.
- Currently schemes tend to target only those workers who have already left the labour force, whereas it may be more effective to design policy that helps older workers to remain economically active.
- Once individuals leave the labour market, their skills start to deteriorate so it is better to retain some level of labour market activity by, say, allowing more flexible working arrangements to cope with health problems.
- The recent 'New Quality of Work' initiative in Germany, and its 2003 aim to promote employment for older workers, may be a way forward in terms of an integrated approach. However, thus far it is not at all specific in its policy tools. This initiative could learn from the initial successes of the UK Pathways scheme in combining health and work advice.
- Overall, our findings add strong support to the policy recommendations made by an earlier report to the Anglo-German Foundation (Frerichs and Taylor, 2005)²; in particular, the importance of health suggests the need for:
 - close co-ordination of policies between the government and the workplace
 - a greater emphasis on preventing people from leaving the labour market, rather than targeting all resources on those who have already left
 - increased use of measures to prevent a deterioration in health, such as provision of occupational health care and improved work-related knowledge among primary care providers.

The full methods and results of this study are provided in the final report available at http://www.shef.ac.uk/economics/research/areas/health_and_wellbeing.html.

² Frerichs, F. and Taylor, P. (2005) *The greying of the labour market: What can Britain and Germany learn from each other?* London: The Anglo-German Foundation.

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Notes to the editor:

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You may download the policy brief free of charge from the Foundation's website at www.agf.org.uk.

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