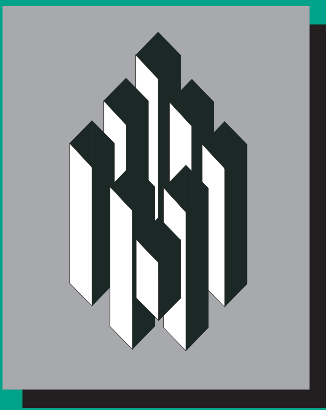

C.D. Howe Institute

Backgrounder

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Banning Mandatory Retirement:

Throwing Out the Baby With the Bathwater

Morley Gunderson

The Backgrounder in Brief

Mandatory retirement should not be regarded as blanket age discrimination, but rather as part of a mutually agreed company personnel policy, or collective agreement, generally negotiated by individuals with reasonable bargaining power. It should only be banned if there are explicit reasons for governments to override such private contractual arrangements.

About the Author

Morley Gunderson holds the CIBC Chair of Youth Employment at the University of Toronto where he is a Professor at the Centre for Industrial Relations and the Department of Economics.

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The debate over whether to ban mandatory retirement is one of the most misunderstood discussions in the area of labour and social policy. The Ontario government's recent proposal to remove the age cap in its human rights code and ban mandatory retirement intensified the discussion. Mandatory retirement is often misconstrued as some government law or regulation that requires people to retire at an age such as 65.

Mandatory retirement, however, is not a law or regulation imposed by governments. Rather, it is part of a company personnel practice or collective agreement that requires an employee to retire from that organisation at some fixed age, typically 65, usually as a stipulation of the firm’s pension plan. The employee can seek employment elsewhere and sometimes can continue with the original organisation, usually under a new contractual arrangement. The law allows the implementation of the practice (as is typically the case in Canada) or bans it (as in Quebec and Manitoba).

In that vein, the debate over mandatory retirement should be cast in terms of the conditions under which governments should prohibit private contracting between employers and employees — mandatory retirement being a form of such private contracting. The relevant question is not: Are you for or against mandatory retirement? Rather, it is: Are you for or against allowing private parties to enter into arrangements such as mandatory retirement, presumably as part of a broader employment contract involving such components as pensions. It is distinctly possible to be against mandatory retirement at your particular workplace, but to be in favour of allowing private parties to enter into such arrangements in general, including at your workplace. This is analogous to being against a particular dental plan in your company policy or collective agreement, but to be in favour of allowing it if that is the decision of the contracting parties.

Even though mandatory retirement restricts your choices when the constraint applies, it is the pro-choice option because organisations and individuals are allowed to enter into such arrangements. Banning mandatory retirement, in contrast, prohibits such market-based agreements. As such, the debate over banning should centre on the conditions under which governments should prohibit such private contracting.

Private contracting has been abolished in the case of indentured service, for example, when individuals agreed to work for an employer for a fixed number of years in return for having their passage paid to come to their new country. It is also generally abolished in the case of the market-based transaction of prostitution, even if consensual, although in some countries it is legal. In other areas, the state sanctions private contracting even though it can restrict flexibility and freedom at times. This is the case with marriage contracts, non-disclosure undertakings, collective agreements and requirements to repay loans. The issue is where does mandatory retirement fit in that spectrum? Should the private parties be prohibited from entering into such an arrangement?

Some light can be shed on the situation by answers to the following questions that are the focus of the remainder of this *Backgrounder*. How prevalent is mandatory retirement, and in what situations is it prominent? How constraining is it — that is, how many people would likely continue working if mandatory retirement were banned? Why does mandatory retirement exist? What will be the impact of banning mandatory retirement? What is the legal status of mandatory retirement in Canada? And, ultimately — in light of answers to these questions, what is the appropriate policy response?

How Broad is its Reach, How Tight its Constraints?

Approximately half of the Canadian workforce is engaged in jobs that have mandatory retirement provisions (Pesando and Gunderson, 1988, p. 33). This does not mean that half of the Canadian workforce will retire because of the policy — only that they work in jobs that are subject to mandatory retirement. Many may leave their job before their retirement date, whether they quit, are fired, retire early or die. Others may continue with the same employer under a different contractual arrangement, work for another employer, or become self-employed.

Of those who are retired, the proportion reporting that they did so because it was mandated was 12 percent, based on the General Social Survey of 1994 (Gomez, Luchak and Gunderson 2002, p. 412), and 21 percent of men and 13 percent of women, according to the 1991 Survey of Aging and Independence (Schellenberg 1994, Shannon and Grierson 2003).

Retiring because of mandatory policies does not imply that the company forced a person to leave involuntarily. The limited evidence that exists in that area indicates the numbers who are involuntarily constrained by mandatory retirement and who would like to continue working are relatively small. Based on different data sources, Gomez, Luchak and Gunderson (2002, p. 412) indicate that "about 6 percent who plan to retire at the mandatory retirement age would like to continue working," and "18 percent of men and 3 percent of women covered by mandatory retirement would like to continue working." Overall, research indicates that about half of the Canadian workforce is employed in jobs that involve mandatory retirement, about 12-to-20 percent of retirees did so because of mandatory policies, and about 6-to-20 percent of those covered by mandatory retirement would like to continue working. Whether that number would increase if the practice is banned is an open question.

Asking those who retired because of mandatory retirement whether they would like to continue working, may be asking the question to the wrong group. If mandatory retirement is part of a long-term contractual arrangement required in return for other quid pro quos, then individuals who are constrained when their part of the bargain becomes operative are very likely to respond that they would prefer not to retire.

Mandatory for Whom?

Mandatory retirement policies tend to cover advantaged workers who earn relatively high incomes in long-term employment positions, are male, covered by an employer-sponsored pension plan, and under the protection of a collective agreement or formal personnel policy (Gunderson and Pesando 1988, p. 33). Mandatory retirement is also associated with subsidized early retirement provisions that are common in employer-sponsored pension plans (Pesando and Gunderson 1988).

This association of mandatory retirement with advantaged workers and good jobs adds credence to the notion that the system is generally not an arbitrary practice foisted on disadvantaged employees by a discriminating employer. Rather, it is part of a private contracting arrangement between consenting parties — employers and employees or their unions.

Why Does Mandatory Retirement Exist?

The fact that mandatory retirement tends to exist for advantaged individuals who have reasonable individual or collective bargaining power, and that unions tend to support their right to negotiate such provisions for their members, generally as part of a pension plan, strongly indicates that mandatory retirement is part of an overall package that mutually benefits both parties. What are the possible benefits or rationales for mandatory retirement?[1]

Mandatory retirement may open job and promotion opportunities for younger workers. It may aid in succession planning and the costing of pensions, disability and health plans on the part of employers, as well as retirement planning and saving on the part of employees. It may facilitate retiring with dignity and reduce the need for more constant monitoring and evaluation and possibly ultimate dismissal of older employees. And it may also facilitate the prevalence of private and public pension systems as an integral part of mandatory retirement.

It may also enable deferred compensation in long-term contractual relations with organisations, under which individuals are underpaid when younger in return for being overpaid when older (Lazear 1979). Mandatory retirement may facilitate such arrangements by providing the termination date that limits the overpayment period, enabling an equilibrium compensation arrangement where the expected present value of the overpayment period is equal to the underpayment time. Such deferred compensation, in turn, can serve a wide range of other purposes, such as reducing unwanted turnover and shirking, enabling retrospective and periodic monitoring, and encouraging worker commitment, loyalty and bonding to the company.

Whatever the rationales for mandatory retirement — and there are many — it is clearly an intricate part of the employment relationship mutually agreed to by employers and employees who generally have considerable individual or collective bargaining power. This perspective places mandatory retirement in a different light from that which labels it as age discrimination. It also suggests that banning mandatory retirement can have a wide range of effects on the employment relationship.

What Happens if We Ban It?

Banning mandatory retirement is often regarded as not likely to have an impact because the trend is already towards earlier retirement. As well, a number of studies based on U.S. data found legislative bans on mandatory retirement in that country did not have a significant impact on the retirement decisions of older workers (Neumark and Stock 1999) and other studies (reviewed in Gunderson 2003, p. 326), in part because the financial incentives of public and private pension plans discouraged delayed retirement. Similarly, Reid (1988) and Shannon and Grierson (2003) found that legislative bans in Manitoba and Quebec generally had no significant impact on the employment of older workers.

However, the impact on the retirement decision could be more substantial. The move to earlier retirement could well change as a result of longer life expectancy and the shift towards a knowledge-based economy. As well, the retirement-inducing effects of public and private pension plans may become less attractive

1 These rationales for mandatory retirement are outlined in more detail in Gunderson and Pesando (1980, 1988).

because the wealth effects from the windfall gains of the earlier stock market boom are over, as may be the generous early-retirement packages. Also, the shift from defined-benefit (DB) to defined-contribution (DC) pensions reduces the importance of the financial incentives of defined-benefit plans that encouraged early retirement and discouraged postponed retirement.

Evidence on the employment effect of banning mandatory retirement is also inconclusive. Both Ashenfelter and Card (2003) and Clark *et. al.* (2001) found that banning mandatory retirement did have a major effect on postponing the retirement of university professors in the U.S., perhaps reflecting the characteristics of knowledge work or the predominance of DC pension plans that do not have retirement-inducing incentive effects. Gomez, Gunderson and Luchak (2003) also document that the labour force participation patterns of workers age 65 and older followed a similar decline in Canada and the U.S. from 1976 to 1986, the year the U.S. banned mandatory retirement. Afterwards, they diverged sharply, continuing to fall in Canada, but rising in the U.S.

Although there is no direct evidence, banning mandatory retirement could be expected to have an impact on a wide range of personnel and human resource practices (discussed in Gunderson 1983). In essence, if mandatory retirement is an integral part of the employment contract, serving various purposes, removing that one part could be expected to have an effect on other aspects. Dismissals, lateral promotions and possible demotions of older workers will be more prominent because of lack of clarity about how long older workers will remain with the organisation. Monitoring and evaluating older workers also will become more prominent, partly to protect against unjust dismissal and age discrimination cases. Deferred compensation will be less prominent — as will its associated benefits — with the decline or slower growth of wages of older workers likely bringing more age discrimination charges. Until the deferred compensation profiles adjust, older workers will receive windfall gains associated with the fact that any wages in excess of their productivity will continue until they retire. Retirement buyouts should become more prominent, possibly leading to perverse incentives for employees to reduce their productivity and performance to enhance the buyout if its size were to be equal to their expected future wages minus their expected productivity. As an alternative, employers may purposely assign older workers to more onerous tasks to encourage them to leave. Both public and private pensions may become less generous if employees can potentially continue working.[2]

Banning mandatory retirement should have less of an effect on women because they are less likely to be in jobs where retirement is mandatory. However, women may lose from a ban if they had benefited from any increased job or promotion opportunities that may have opened up because of the mandatory retirement of men. Women may gain from a ban, however, if it enables them to work longer and accumulate the service credits and wage increases — interrupted by periods out of the labour force for childraising — that could enhance their pension benefits, and especially make them eligible for early retirement provisions.[3]

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2 One of the concerns of the trade union movement is that banning mandatory retirement is simply the first step in a slippery slope of reducing public and private pension benefits.

3 Pesando, Gunderson and McLaren (1991), for example, provide evidence that women are not only less likely to be covered by occupational pension plans, but when they are, they do not accumulate the service credits and seniority-based wage increases that augment benefits, especially through generous early retirement provisions.

Is It Legal?

In contrast to the U.S., where mandatory retirement was banned in 1986, its legal status in Canada is quite complex, partly because much of it falls under provincial human-rights codes.[4] Those codes ban discrimination for a variety of reasons, including age. By itself, this would effectively make mandatory retirement illegal by defining it as age discrimination. However, the practice is generally allowed in Canada through two main mechanisms.

First, four provinces — British Columbia, Saskatchewan, Ontario and Newfoundland — maintain an age cap of 65 in their human rights codes to accommodate mandatory retirement. That does mean, however, that people over 65 do not receive the normal protection of the human rights codes against age discrimination in employment (Ontario Human Rights Commission 2000, 2001).

Second, six jurisdictions — federal, Alberta, Quebec, New Brunswick, Nova Scotia and Prince Edward Island — removed their age caps, while exempting bone fide retirement or pension plans, a policy that effectively allows mandatory retirement as long as they are part of such arrangements, which is usually the case. However, the removal of the cap does mean that older workers in these jurisdictions have normal protection against age discrimination.

Only two provinces — Quebec since 1982, and Manitoba since 1983 — effectively ban mandatory retirement under any circumstances. Quebec does so under its employment standards legislation, although a court decision allowed a collective agreement to terminate people at age 65 on the grounds that this was a fair policy in the face of layoffs. The federal government made mandatory retirement voluntary for the civil service, although it was not mandated by law, an option available to any employer.

In all jurisdictions, including those where mandatory retirement is banned, it can be allowed if it is a bona fide occupational requirement. Such a situation is difficult to prove, however, and the practice is generally restricted to situations where public safety is involved, such as with airline pilots, police and firefighters; even in these jobs, the requirement is often contested in the courts.

The legality of mandatory retirement itself has also been contested in the courts. In 1990, three Supreme Court of Canada Charter decisions basically upheld mandatory retirement by claiming that although it is discriminatory under the equality provisions of the Charter, it is "demonstrably justified in a free and democratic society", largely because the social benefits exceed the social costs. This effectively put the decision back in the hands of the provinces, which had to amend human rights codes to get rid of mandatory retirement. Other court decisions, notably in British Columbia, overturned mandatory retirement for specific reasons, such as the fact that an employee was not properly informed of the policy, or where the benefit did not exceed the cost in a particular situation. As well, in 2002, the B.C. Court of Appeal recommended that the Supreme Court of Canada reconsider its 1990 rulings allowing mandatory retirement.

Ontario recently proposed to remove the age cap in its human rights code and ban mandatory retirement. Initially, it appeared that the proposal would make an

4 The summary of the legislation presented here is based on Gunderson (2003) and references cited there.

exemption for legitimate pension plans (Ontario PC Party, 2003, p.2), which effectively would allow mandatory retirement in most cases because it is usually a part of such arrangements. The proposed legislation, however, did not contain that exemption. The only exception was for existing collective agreements negotiated before May 29, 2003, but not for those extended or negotiated after that period. This would effectively place Ontario with Quebec and Manitoba as provinces that prohibit mandatory retirement under any circumstances, except when it is a bona fide occupational requirement.

Conclusion

Is the Ontario proposal the appropriate policy response? The argument presented in this paper is: Close, but no cigar. Mandatory retirement should not be regarded as blanket age discrimination, but as part of a mutually agreed company personnel policy or collective agreement, generally negotiated by individuals with reasonable individual or collective bargaining power. It should only be banned if there are explicit reasons for governments overriding otherwise agreed arrangements. In my view, this case has not been made.

There may well be reasons for private parties wanting to change the arrangement themselves. Employers may find mandatory retirement increasingly anachronistic because of the looming labour shortages associated with the retiring baby-boom population and the need for institutional memory and mentoring. They may also find that abolishing it would save on pension costs if it enables them to provide less generous payments, or to save on wages if employees require a compensating salary in return for what may be regarded as a negative employment practice.

Employees may find mandatory retirement increasingly constraining because of their enhanced longevity and the possibility that work is less onerous in the knowledge economy. In such circumstances, private parties may abolish mandatory retirement on their own, or make it more flexible to ease transitions into retirement, with the practice surviving only where it is extremely important to employers or employees.[5] Private parties currently have the flexibility to change their retirement policies — as do governments for their own employees, following the federal government's example. The fact that mandatory retirement does not exist for about half of the workforce indicates that this is a viable option. In such circumstances, the role of governments should be restricted to removing any barriers that discourage flexible retirement practices.[6]

5 Evidence provided in Gomez, Gunderson and Luchak (2003) indicates that about half of employed or retired Canadians over 50 say that mandatory retirement is a good idea, with the proportion being substantially higher for those who retired because of the policy. The average preferred age of retirement was 61. People who are better educated, in better health and in industries other than manufacturing, however, are more likely to disapprove of mandatory retirement, indicating that the pressure on employers to abolish it or make it more flexible will increase because these groups are likely to grow in importance.

6 Such barriers include the claw-backs that exist in public pensions, disability payments and income tax systems, as well as those in private occupational pension plans (Gunderson 1998; Gunderson, Hyatt and Pesando 2000).

Nevertheless, the current practice in Ontario, British Columbia, Saskatchewan and Newfoundland of allowing mandatory retirement by having an age cap in human rights codes does mean that workers age 65 do not have the normal protection against age discrimination in employment.

This is an unfortunate loophole created by the desire to accommodate mandatory retirement through an age cap. The appropriate policy would be to remove the cap in human rights codes (thereby providing people 65 and older with the normal protection against age discrimination, while exempting legitimate pension plans and possibly collective agreements). This process would allow mandatory retirement in most situations where it exists, thereby allowing it only if it was part of such explicit protections, ensuring that it is a private contractual arrangement between parties of reasonable individual or collective bargaining power.

This is currently the policy in six Canadian jurisdictions. It is also the policy that was initially proposed in the Ontario Conservative Party document, although it called for exempting only legitimate pension plans that involved mandatory retirement. It did not take a position on whether a collective agreement with a mandatory retirement policy would also be exempt. It is certainly debatable whether mandatory retirement as part of a collective agreement should be exempt in the rare case that it did not involve a pension plan, or if there were concerns that unions would not adequately represent the interests of certain elements of their membership.

Overall, the policy recommendation that flows from this analysis is straightforward: Remove the age cap in human rights codes to ensure that people 65 and over have the normal protection against age discrimination, while exempting legitimate pension plans and possibly collective agreements. This process would allow mandatory retirement in most jurisdictions where it exists, thereby permitting it only if it was part of such explicit protections, ensuring that it is a private contractual arrangement between parties of reasonable individual or collective bargaining power. This would strike the best balance between combating age discrimination, while permitting mutually beneficial work arrangements between private parties with reasonable bargaining power. Simply banning mandatory retirement outright may be a well-intended policy appearing to combat age discrimination, but it also throws out the baby — mutually agreed private contracts — with the bathwater — age discrimination. Such a drastic approach is unwarranted.

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