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To what extent can partial retirement ensure retirement income adequacy?

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DESIGN PAPER 149

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Colophon
Netspar Design Paper 149, May 2020

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Acknowledgments
We wish to thank Erik ten Hove, Jan Maarten van Riemsdijk, and Joost van Valkengoed for supporting this research and providing helpful explanations of the institutional setting, and two anonymous reviewers for their insightful comments and suggestions. We thank PFZW for providing the data. This research is supported by the Network for Studies on Pensions, Aging and Retirement (Netspar) under grant number LMVP 2014.03. Its contents are the responsibility of the authors and do not necessarily represent the official views of Netspar.

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Summary

Policy makers are confronted with the challenge of making the pension income adequate for older individuals and the pension system sustainable at the same time. Partial retirement can be an instrument to achieve both goals. Combining wage and pension income can fund old-age consumption, and induce individuals to extend their working lives up to the legal retirement age or beyond. Partial retirement can facilitate employment especially among individuals with heavy occupations who struggle to work full-time until the legal retirement age. We analyze the implications of partial retirement for the financial well-being of older individuals, and to what extent this implies a self-reliant financial security in retirement. Using data on the pension entitlements of the clients of a large pension fund, we show that, on average, when individuals retire partially before the legal retirement age, they attain at least a minimum target replacement rate of 70 percent during partial retirement, and subsequently a higher replacement rate during full retirement. The replacement rates fall much below the minimum target replacement rate if individuals retire full-time. Furthermore, we show that when individuals retire part-time instead of full-time at a given age, they are much more likely to maintain an adequate pension income when pension funds do not index pension rights, or when pension income is smaller due to accruing pension rights for fewer years.

Samenvatting

Beleidsmakers staan voor de uitdaging om tegelijkertijd ouderen van een adequaat pensioeninkomen te voorzien en het pensioenstelsel houdbaar te houden. Deeltijdpensioen kan een instrument zijn om beide doelen te bereiken. De combinatie van loon- en pensioeninkomen kan consumptie op latere leeftijd financieren en individuen ertoe aanzetten hun werkende leven te verlengen tot de AOW-leeftijd of daarna. We analyseren de gevolgen van gedeeltelijke pensionering voor het financiële welzijn van ouderen en in hoeverre dit financiële zelfredzaamheid tijdens het pensioen inhoudt. We laten aan de hand van pensioenaansprakendata van klanten van een groot pensioenfonds zien dat individuen, gemiddeld genomen, wanneer zij met deeltijdpensioen gaan voor de AOW-leeftijd, de minimale streefvervangingsratio van 70% behalen tijdens het deeltijdpensioen en een nog hogere vervangingsratio tijdens voltijdpensioen. De vervangingsratio's liggen ver onder de minimale streefvervangingsratio wanneer zij voltijds met pensioen gaan. Verder laten we zien dat wanneer mensen op een bepaalde leeftijd deeltijds met pensioen gaan in plaats van voltijds, zij een hogere kans op een adequaat pensioeninkomen hebben wanneer pensioenfondsen pensioenrechten niet indexeren, of wanneer het pensioeninkomen lager is doordat zij minder jaren pensioenrechten op hebben opgebouwd.

1. Introduction

Recent policy measures in the Netherlands aim at tailoring individual retirement income to personal financial needs and at making the pension system financially sustainable. Employees bear increasing investment risk due to the indexation of their pension rights with respect to the returns on investment in the financial market. The accrual rate of occupational pension rights has been reduced in the past decade and may be reduced further in the coming years. The resulting reductions in accrued or paid pension rights are likely to make individuals more dependent on alternative sources of income during retirement or induce them to work longer to compensate for lost income. Furthermore, the pension law is expected to accelerate the shift from defined benefit to defined contribution schemes. Compared to a defined benefit scheme, in a defined contribution scheme the worker faces higher risks and greater personal responsibility to secure an adequate level of retirement income through decisions on contribution rates, asset allocation, or decumulation strategy. Such decisions require an adequate level of financial literacy (Poterba, 2014).

Partial retirement can help individuals to secure their financial well-being in retirement. For example, by working part-time at an otherwise early retirement age, individuals can rely on part-time labor earnings instead of only on an occupational pension that is actuarially penalized (Laczko, 1988; Kantarcı et al., 2013). While working part-time, they also continue to accrue pension rights for full retirement at a later age. Partial retirement can also be beneficial for public finances if it extends working lives. In fact, several studies have suggested that, in the United States and in Europe, supplementing retirement income with income from part-time work can ease the pressure on the pension system caused by population aging (Laczko, 1988; Chen, 1996; Cahill et al., 2006; Robinson and Clark, 2010). This is in line with the policy objective of the European Commission, which focuses on ensuring the adequacy of pensions in aging societies without straining public finances (European Commission, 2012).

Van Duijn et al. (2013) and Knoef et al. (2016) investigate retirement income adequacy, based on replacement rates when individuals retire full-time from their career job before or at the statutory retirement age. Kantarcı et al. (2013) compute replacement rates in full and partial retirement scenarios for a hypothetical worker with assumed job characteristics. These studies provide rich analyses on financial security in retirement as they compare actual and expected replacement rates, study the implications of partial retirement for replacement rates, or identify the vulnerable groups in the population that have replacement rates below a minimum target level or full replacement level. However, in these studies the calculation of the replacement

rate is not based on actual wages and pension rights at the time of retirement, but on projections of wages and pension rights from the time of observation until the day of retirement, based on strong assumptions about wage profiles, work histories, and accumulation of pension rights.

We analyze the retirement income of clients of a large pension fund in relation to their pre-retirement earnings to investigate their financial well-being in retirement. As information on their accrued pension rights up to the retirement age is available, we make weak assumptions when analyzing pension income adequacy. We start by analyzing cases of full retirement, where pension plan participants stop working and claim full occupational pension rights at ages from 60 to 70. We then analyze cases where individuals partially retire and claim a fraction of their accrued pension rights at those same ages. We account for the receipt of state pension rights and the applicable income tax rules and tax credits. Our main aim is to show, among clients of a large pension fund, to what extent retiring part-time instead of full-time reduces the risk of falling below a minimum target replacement rate of 70% both before and after the statutory retirement age.

We show that, both before and after the statutory retirement age, workers attain a much higher level of retirement income security when they retire part-time and combine part-time earnings with a partial pension, compared to when they retire full-time and claim the full amount of their accrued pension rights. For example, if the sample of workers retire full-time at age 63, about 22% fall below the minimum target replacement rate at age 70, while if they continue working part-time from that same age for a period of five years, about 4% fall below the minimum target replacement rate at age 70. Furthermore, we show that when individuals retire part-time instead of full-time at a given age, they are much more likely to maintain an adequate pension income when pension funds do not index pension rights, or when pension income is smaller due to accruing pension rights for fewer years.

The remainder of this paper is organized as follows. Section 2 describes the institutional setting. Section 3 presents the data. Section 4 describes the assumptions and calculation of the replacement rates. Section 5 presents the results. Section 6 discusses policy implications and contains conclusions.

2. The Dutch pension and income tax systems

The Dutch retirement income stands on three pillars. The first pillar is the state pension, the second pillar is the occupational pension, and the third pillar is the individual savings. All retirees who never lived abroad receive the full state pension, and the majority participate in a mandatory occupational pension scheme that is of the defined benefit type. The share of the third pillar in retirement income is much smaller, and its importance varies much across individuals (Alessie and Kapteyn, 2001; Knoef et al., 2016).[1] Therefore, the role of the third pillar is not considered in this study. This fairly homogeneous pension system allows a systematic analysis of retirement income across a large population of retirees with otherwise heterogeneous characteristics.

The state pension scheme

The General Old-Age Pensions Act (AOW) is the state pension scheme, paying flat-rate benefits to people above the statutory retirement age who have always lived in the Netherlands, independent of earnings, income or premiums paid (Sociale Verzekeringsbank, 2019).[2] It provides households with a subsistence level income in which the breadwinner attained the eligibility age or is older. The only thing that therefore matters for the benefit level is household composition: individuals who make up a couple receive less than single individuals, and there are special allowances for children younger than 21 and for single income couples in which only the breadwinner has reached the eligibility age.

The scheme is unfunded and based on the pay-as-you-go principle, meaning that current pensions are financed from the current premiums paid by workers. The premiums are paid as a percentage of work income through the personal income tax, and labeled as national insurance premiums. Every person who lives in the Netherlands is insured under the scheme. The maximum period of insurance is 50 years, from the age of 15 until the statutory retirement age. For those who do not live in the Netherlands during this entire time, the benefit is adjusted proportionally.

1 Knoef et al. (2016) show that, in 2010, among people who were 60 to 64 years old, the median net replacement rate was 82% when state and occupational pension benefits are considered in the calculation, increasing to 92% when, in addition, voluntary third pillar pensions and private wealth are taken into account.

2 The statutory retirement age is 66 years in 2018, and is being gradually increased to reach 67 in 2021. It will be partially linked to life expectancy as from 2022.

The state pension is paid as an annuity after the statutory retirement age, and calculated as the sum of the product of the accrual rate and pension base from each year over the period of insurance. The accrual rate is 2% per year. The pension base is determined by the government according to the net minimum wage. It depends on the domestic situation of the retiree: single without a child, single with a child under 18 years old, living with a partner who is older than 65 years, or living with a partner who is younger than 65 years, all with or without a supplementary allowance.

In the state pension scheme, it is not possible to claim all or part of one's accrued pension rights before or after the statutory retirement age. However, the government put forward proposals to introduce flexible retirement options into the state pension scheme in 2008 and more recently in 2019 (Ministerie van Sociale Zaken en Werkgelegenheid, 2008, 2019). The proposal put forward in 2008 presented a particularly detailed pension scheme that included actuarial rules for deferral of pension rights to a later retirement age. In this study we assume that this pension scheme is in operation and that, in hypothetical retirement scenarios, individuals who work beyond age 65 defer all or part of their state pension rights until retirement to smooth out their total income. The scheme allows an employee to defer all or part of his or her state pension rights for a maximum of five years. It is not possible to accrue additional rights during the deferral period. Deferred rights are actuarially increased at the time of claim. The increase is calculated as the product of the deferred pension rights at the statutory retirement age and an actuarial factor specific to the age at which the pension rights are ultimately claimed. The top panel of Table 1 shows the year-specific actuarial factors for possible ages of claiming state pension rights. The factor is calculated by dividing life expectancy at age 65 by life expectancy at age 65 less the number of years of delay. The life expectancy at age 65 is the average of the life expectancies of men and women at age 65. For example, the factor for claiming pension rights at age 70 is 1.354. It is calculated by applying the life expectancy at age 65 in 2007, which is equal to 19.14 years according to Statistics Netherlands, plus five years of delay due to deferral of the pension rights from age 65 until age 70.

An occupational pension scheme

In the Netherlands, employees are obliged to participate in an occupational old-age pension scheme. In most cases the scheme is of the defined benefit type. It is funded so that pensions are financed from the premiums paid by the participants in the past and from the returns on the invested premiums. It is an individual scheme, but for employees with a partner it incorporates a widow's pension and an orphan's pension for children up to an age threshold. We do not incorporate the widow's and orphan's

Table 1: Actuarial factors for earlier and later retirement than at age 65 for years from 2007 to 2013

	Retirement age	Actuarial factor						
		2007	2008	2009	2010	2011	2012	2013
State pension scheme	66	1.055	1.055	1.054	1.054	1.035	1.053	1.053
	67	1.117	1.116	1.114	1.114	1.112	1.113	1.112
	68	1.186	1.184	1.182	1.181	1.178	1.179	1.177
	69	1.264	1.262	1.258	1.257	1,253	1.253	1.251
	70	1.354	1.350	1.345	1.343	1.337	1.339	1.335
Occupational pension scheme	60	0.719	0.719	0.719	0.719	0.747	0.749	0.752
	61	0.765	0.765	0.765	0.765	0.789	0.792	0.794
	62	0.815	0.815	0.815	0.815	0.835	0.838	0.839
	63	0.871	0.871	0.871	0.871	0.885	0.887	0.889
	64	0.932	0.932	0.932	0.932	0.940	0.941	0.942
	65	1.000	1.000	1.000	1.000	1.000	1.000	1.000
	66	1.075	1.075	1.075	1.075	1.066	1.064	1.063
	67	1.159	1.159	1.159	1.159	1.138	1.134	1.132
	68	1.254	1.254	1.254	1.254	1.218	1.211	1.208
	69	1.360	1.360	1.360	1.360	1.306	1.296	1.292
	70	1.480	1.480	1.480	1.480	1.403	1.390	1.384

Notes: The actuarial factors of the occupational old-age pension scheme for 2007 are obtained from Stichting Pensioenfonds Zorg en Welzijn (2007). The figures of later years are obtained from the "Statuten en reglementen" of later years. The actuarial factors of the state pension scheme are the authors' calculations according to Ministerie van Sociale Zaken en Werkgelegenheid (2008) and year-specific average life expectancies for men and women available from Statistics Netherlands.

pensions in our calculations of pension benefits since they would involve another layer of complexity. Furthermore, in case of a divorce, the other spouse can be entitled to part of the accumulated pension, but we do not take this into account in our calculations. We base our analysis on the defined benefit scheme of Pensioenfonds Zorg en Welzijn (PFZW), the second largest pension fund in the Netherlands.

Employees pay premiums into their pension plan. These premiums are calculated as the product of the full-time equivalent, the contribution rate, and the premium base. The contribution rate is shared by the employee and the employer. The premium base is determined by the difference between the gross labor income and the state pension offset. Employees do not accrue pension over the state pension offset since they already pay premiums for the state pension. Table 2 shows the state pension offset amounts for the years 2007 to 2013.

The occupational pension is paid as an annuity after the statutory retirement age. It is calculated as the sum of the annual pension rights accrued over the years that employees accrue pension rights. In a given year, the accrued rights are calculated as

Table 2: Accrual rates and state pension offset amounts for years from 2007 to 2013

Year	Accrual rate (%)		State pension offset (€)	
	Born before 1950	Born in or after 1950	Born before 1950	Born in or after 1950
2007	1.75	2.05	11,872	9,819
2008	1.75	2.05	12,209	10,097
2009	1.75	2.05	12,466	10,309
2010	1.75	2.05	12,674	10,482
2011	1.75	1.95	12,898	10,667
2012	1.75	1.95	13,062	10,802
2013	1.75	1.95	13,227	10,940

Notes: Accrual rates may differ across pension funds. The figures are for PFZW. Accrual rates and state pension offset amounts are for the old-age pension scheme. State pension offset is also referred to as the "franchise". The accrual rate and state pension offset for 2007 are obtained from Stichting Pensioenfonds Zorg en Welzijn (2007). The figures of later years are obtained from the "Statuten en reglementen" of later years.

the product of the fulltime equivalent, the accrual rate, and the premium base. The accrual rate is the rate at which the pension rights build up. Table 2 shows the accrual rates for the years 2007 to 2013.

The scheme is an average salary scheme, with each year's salary contributing in the same way. Two specific issues regarding the calculation of the pension annuity need to be mentioned. First, the pension annuity depends on the domestic situation. If the participant is not single when claiming pension rights for the first time, the pension annuity applies and the participant's spouse is entitled to a survivor's pension when the participant dies. If the participant is single when claiming for the first time, the pension annuity is increased by a certain fraction. Second, pension funds aim to increase the pension annuities each year in line with wage inflation in the sectors in which they operate. The actual increase can be equal to, lower, or higher than the increase in the average wage, depending on the financial situation of the pension fund ('conditional indexation'). In our analysis we assume no increase in wages and no indexation. Our analysis can therefore be interpreted as an analysis of real wages under the assumption of full indexation and equality of wage and price inflation.

Claiming the pension annuity before or after the statutory retirement age has implications for the amount of the pension annuity. Deferring the claim of the pension annuity at the statutory retirement age affects the amount of the pension annuity when it is claimed in two respects. First, the annuity deferred at the statutory retirement age will increase due to the actuarial adjustment at the age the annuity is claimed. The increase is calculated as the product of the pension annuity at the

statutory retirement age and an actuarial factor specific to the age at which the annuity is claimed. The actuarial factor depends on mortality rates and an interest rate. The actuarial factors applied in case of retirement after the statutory retirement age are higher than 1, leading to a higher deferred pension. Second, the pension annuity at the time it is claimed will increase due to the additional rights accrued from the statutory retirement age until the time the rights are claimed, and due to the actuarial adjustment of these rights at the time these rights are claimed.

Claiming the pension annuity earlier than the statutory retirement age affects the pension annuity as follows. First, since pension rights are only accumulated until the early retirement age, the pension annuity will be lower than that if pension rights were accumulated until the statutory retirement age. Second, the pension annuity at the early retirement age will fall due to the actuarial adjustment at this earlier time. The actuarial adjustment factors for early retirement are lower than 1 so that early retirement is effectively penalized. Table 1 shows the full set of year-specific actuarial factors for all retirement ages.

Note that the actuarial increase due to deferral of pension rights beyond age 65 is lower in the state pension scheme than in the occupational pension scheme since the actuarial factors in the state pension scheme are lower. That is because the actuarial factors of the state pension scheme are driven by mortality rates only, whereas those of the occupational pension scheme are driven by mortality rates as well as by returns on invested pension premiums. It seems difficult for the government to increase the actuarial factors to the level of those of the occupational pension fund because the state pension system is unfunded, meaning that the government cannot generate returns on the premiums.

The tax system

Every person who lives in the Netherlands and has some source of income is subject to income tax. The income tax is applied per individual, with some specific allowances that depend on household composition and income of other household members. Aside from this, every person is required to buy basic health insurance from a private insurer at a premium that is independent of income. An income-dependent subsidy or tax compensates low income individuals for the regulated income-independent premium of the basic health insurance cover; this is integrated with income tax and national insurance premiums. Details of the calculation of income after tax and health insurance premiums are provided in the Appendix.

3. Data

We use administrative data from PFZW, which offers occupational pension plans for people working in the health care sector. Data are available for clients who accrue or claim pension rights during the period of observation from January 2007 to December 2014. The clients are cohorts of individuals aged 55 years or older at any given year of the observation period. The data include information on age, gender, marital status, number of years of pension accrual, accrued pension rights, claimed pension rights, full-time equivalent, and wage income earned during the period of pension accrual.

The initial sample consists of 1,657,978 individuals, where, for each individual, multiple observations are available across the months of the years for which data are available. We apply a number of restrictions to the initial sample. First, in the data, individuals who retire before the statutory retirement age often make use of an early retirement scheme that offers generous pension provisions. In the Netherlands, early retirement schemes (VUT) have gradually been phased out in the past twenty years. Therefore, individuals who participate in an early retirement scheme are not considered in this study. This restriction leads to a sample of 1,540,774 individuals. Second, we require that individuals work full-time in their last job and subsequently retire full-time. This further restriction leads to a sample of 8,666 individuals. The large decrease in the number of individuals is due to the fact that many pension fund clients have not yet reached the retirement age, so for them retirement is not yet relevant. Third, we require that individuals work full-time during the main part of their career before their part-time or full-time retirement. Therefore, we restrict our analysis to individuals who have accrued pension rights on full-time pensionable salary for at least 35 years by the time they turn 65. We require fewer years of pension accrual for younger workers and for those who retire earlier than at age 65. This restriction leads to a sample of 3,313 individuals who constitute the baseline study sample.

We do not use individual data for the state pension income but assume that all individuals receive the universal flat-rate amount. We thus also assume that all individuals are insured for the maximum period of insurance and receive the full state pension amount. The state pension income amounts we consider are those effective in the observation year when individuals become entitled to the state pension.

Table 3 presents descriptive statistics for a number of background and labor market characteristics. The majority of the sample is above age 60 and is married or living with a partner. About 65% of the sample consists of men. About half of the sample earns a gross annual wage close to the average of €47,422 in 2018 (OECD, 2019), and the other half earns a higher wage. Among the individuals who have accrued pension

Table 3: Background and labor market characteristics

Characteristic	Attribute	%
Age	55–60	21.92
	61–65	77.92
Gender	Male	64.70
Marital status	Married or living with partner	75.30
Annual gross income (in €)	< 35,000	8.05
	≥ 35,000–55,000	46.34
	≥ 55,000	45.16
Number of years of pension accrual	25–34	46.07
	35	53.93

Notes: The figures are based on 3,313 individuals. Annual gross income, expressed in euros, is the average wage earned in the last job in the sample. Totals may not add due to rounding.

rights for at least 25 years, about half have accrued pension rights for at least 35 years. The reason for the high fractions of older individuals, of men, and of high-income earners in the sample is that the sample is selected to consist of individuals with at least 25 years of pension accrual on full-time pensionable salary, whereas women often work part-time and earn lower wages and do not accrue (or accrue for fewer years) pension rights on full-time pensionable salary during their working career.

4. Method and assumptions

We analyze the financial well-being of older partially and fully retired workers in terms of their replacement rate, which we define as the ratio of retirement income over work income. Retirement income consists of the occupational pension income plus the state pension income if the individual has reached the statutory retirement age. In the case of partial retirement, retirement income consists of part-time work income plus part-time occupational pension income, but also of part-time state pension income if the individual has reached the statutory retirement age. Retirement income comes from pension savings and excludes any type of personal savings. In fact, in the Netherlands, many people make mortgage payments and therefore have less income available for consumption during their working years, whereas they finish their payments and thus have more income available for consumption during their retirement years. This means that personal savings may affect the amount of income available for consumption both before and after retirement and hence also the replacement rate.

When calculating the replacement rate, we define work income as the wage earned in the last job before age 60. Alternatively, we could define it as the average of lifetime wages earned. The two income amounts will differ from each other to the extent that the age profile of wages slopes upward. However, work income affects replacement rate through the pension income in the numerator of the replacement rate and the work income in the denominator. This means that an alternative work income profile specification could have different effects on the replacement rates and it is not a priori clear which effect dominates. Throughout our analysis we use work income from the last job when calculating a replacement rate. A main economic motivation is that retired individuals may evaluate their retirement income adequacy by comparing their pension income against what they earned during the final years of their working career instead of the average of what they earned throughout their entire career. We approximate the wages earned during the final years of the career with the wage earned in the last job. This approximation is likely to be good for at least two reasons. First, age-income profiles in the Netherlands are fairly flat as from age 60 (Knoef et al., 2013). Second, job mobility is particularly low at the end of the working life, and therefore one's wage is unlikely to show large variation during the final years of the career (Euwals et al., 2014). Therefore, using the wage amount from the last job in the calculation of replacement rates may lead to replacement rate predictions that are accurate approximations of how individuals evaluate their retirement income adequacy. Besides this economic reason, it is difficult to consider

average lifetime work income in the calculation of a replacement rate because, in the data, complete histories of wages earned are available only for a limited number of individuals.

We calculate both gross and net replacement rates. The gross replacement rate uses the gross pension and work income amounts (amounts before tax). To calculate the net replacement rate, we apply the income tax rules to the gross pension and work income amounts, as described in Section 2. Even though gross (work) income remains the same, net income may change with age in the final years before full retirement, due to the change in marginal tax rates at the statutory retirement age, or due to the employed person's tax credit. By taking full-time work income before age 60 as the reference amount, we do not incorporate these changes in the replacement rates. The age-dependent "work bonus" may also change net work income in the final years before full retirement. This tax credit applied from 2009 until 2018, with an amendment in 2013. We do not account for this tax credit in our calculations because it does not apply to all cohorts of older workers in our data, and because it has been abolished and has no policy relevance.

We conduct three types of analyses. First, we analyze the actual replacement rates. We calculate the actual replacement rates using observed wages earned in the last job, occupational pension annuities received from the age individuals are retired, and the universal state pension annuity received if individuals have reached the state pension age. In the data very few individuals are observed to retire full-time after the statutory retirement age or to retire part-time from a fulltime job at any given age (Section 3). Therefore, we calculate the actual replacement rates only for the individuals who retired full-time at the statutory retirement age, and for a smaller group of individuals who retired full-time before the statutory retirement age.

Given that a small number of individuals retire full-time after the statutory retirement age, or retire part-time at any given age, we predict, in a second analysis, replacement rates in scenarios of partial and abrupt full retirement at all ages from 60 to 70. We predict the replacement rates using observed wages earned in the last job, occupational pension annuities predicted on the basis of the observed accrued pension rights of individuals in the data, and the universal state pension annuity received if individuals retire at the state pension age, and otherwise the state pension annuities predicted on the basis of the universal state pension annuity if individuals defer claiming state pension rights.

Occupational pension annuities in alternative retirement scenarios are predicted as follows. We start with the observed accrued pension rights of individuals who retired at the statutory retirement age, but also with those of the smaller group of

individuals who retired before or after the statutory retirement age. Using the accrued pension rights observed, we predict pension annuities using the stylized pension rules described in Section 2 that apply to Stichting Pensioenfonds Zorg en Welzijn or to Stichting Pensioenfonds ABP, the two largest pension funds in the Netherlands. Note that, unlike earlier studies of retirement income adequacy, we do not make assumptions about wage rate, wage growth, and employment history of workers to forecast their pension annuities (cf., e.g., De Bresser and Knoef, 2015; Knoef et al., 2016). We observe accrued pension rights at the time of retirement, and use them to predict pension annuities in different retirement scenarios.

In an abrupt retirement scenario where a hypothetical individual works full-time until age 70, we predict the pension annuity at age 70 as follows. First, the pension rights accrued until age 65 and deferred at this age until age 70 increase due to the actuarial adjustment at age 70, when these rights are ultimately claimed. We calculate this actuarial adjustment by multiplying the accrued pension rights at age 65 with the actuarial factor specific to age 70, which is, for example, 1.480 in 2010 (Table 1). Second, due to deferring the claim of pension rights and working during the years from age 65 until age 70, additional pension rights are accrued during these years; these are, again, actuarially adjusted at age 70. Accrued pension rights are calculated by adding up the rights accrued in each year. In a given year, accrued rights are calculated as the product of the full-time equivalent, the accrual rate, and the premium base. The full-time equivalent is equal to 1 if the individual is assumed to be working full-time. The accrual rate is, for example, 2.05 in 2010 (Table 2). The premium base is determined by the difference between gross income and the state pension offset. We consider the observed gross wage income earned in the last job as the gross income. The state pension offset is equal to €10,482 in 2010. We then multiply the pension rights accrued from age 65 to 70 with the actuarial factor specific to age 70, which is 1.480. The sum of the pension rights deferred at age 65 and actuarially adjusted at age 70 and the additional pension rights accrued during the deferral years from age 65 until 70 and actuarially adjusted at age 70 determines the predicted pension annuity at age 70.

In a partial retirement scenario, where the hypothetical employee works full-time until, for example, age 65, and partially retires from age 65 to 70, we predict the pension annuity at age 70 in the same manner as in the abrupt retirement scenario, except that the full-time equivalent during the accrual of pension rights from age 65 to 70 is considered as 0.5.

The state pension annuity is given by the universal flat-rate state pension paid to all individuals at the state pension age. State pension annuity is predicted if state

pension rights are deferred at the state pension age. This prediction is done in the same manner as for the occupational pension annuity except that, according to the assumed state pension scheme that allows an employee to defer part or all of his or her state pension rights, suitable actuarial factors are used, and it is not possible to accrue additional pension rights during the deferral period (Section 2). For example, in an abrupt retirement scenario where a hypothetical individual works full-time until age 70, we predict the pension annuity at age 70 as follows. The pension rights accrued until age 65 and deferred at this age until age 70 increase due to the actuarial adjustment at age 70, when these rights are ultimately claimed. We calculate this actuarial adjustment by multiplying the accrued pension rights at age 65 with the actuarial factor specific to age 70, which is, for example, 1.343 in 2010 (Table 1).

Given the predicted replacement rates based on the actual earnings and accrued pension rights of individuals in the sample data, we study, in a third analysis, the distribution of the replacement rates and how partial retirement, compared to full retirement, affects the risk of falling below a minimum target replacement rate. In the Netherlands, social insurance schemes, including the unemployment and disability insurance schemes, pay benefits that replace 70% of the gross wage earned in the last job. We assume that the statutory replacement rate in social insurance schemes is also the target replacement rate in the pension domain, so that pension income from the state and occupational pension schemes replace at least 70% of the employee's final gross earnings. However, the net replacement rate is higher than the gross replacement rate. We abstract from the impact of income taxation and maintain that the minimum target replacement rate is also 70% in net terms. We present results based on a minimum target replacement rate of 80% as part of a sensitivity analysis.

5. Results

Observed replacement rates

Figure 1 presents the average of the gross replacement rates at age 65 when individuals retire full-time at age 60 to 65. The figure shows that individuals who retire at age 63 or 64 accumulate the most pension rights relative to their final full-time wage compared to other individuals, who retire at an earlier or later age. A possible reason for this is that those who retire at age 63 or 64 accumulate more pension rights to afford retirement at such age. This result suggests that individuals aim at achieving a level of retirement income that they consider adequate. As a result, it also suggests that when deciding on the retirement age, retirement income adequacy plays a greater role than institutional incentives or social norms, which call for retirement at the statutory retirement age. This finding might explain why the effective retirement age is lower than the statutory retirement age in the Netherlands, same as in many other Western countries.

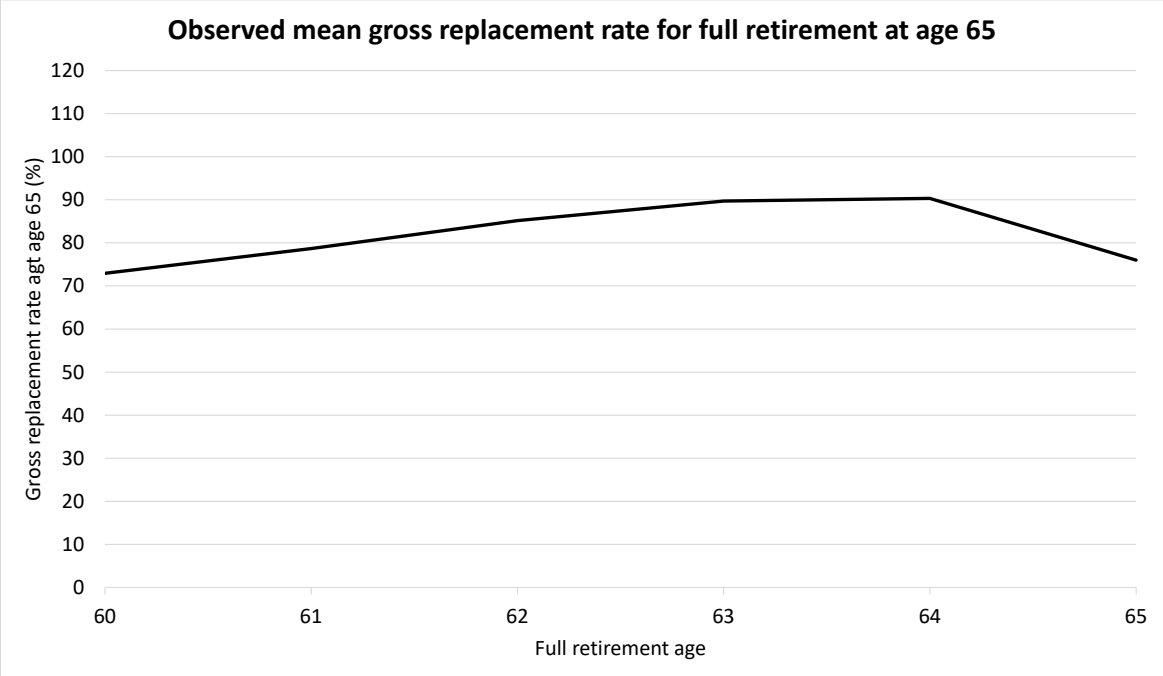

Figure 1: Observed mean gross replacement rate at age 65 when individuals retire fully from a full-time job at given ages from 60 to 65. Replacement rates are based on wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time of retirement at age 65. At least 30 years of pension accrual are required for workers who retire at age 60. The mean replacement rates at given ages from 60 to 65 are calculated based on data for 2,711 individuals.

Predicted replacement rates in scenarios of full and partial retirement

Figure 2 presents the gross and net replacement rate trajectories in scenarios of abrupt retirement at age 60 to 70. For example, in the left panel of the figure, in the scenario of abrupt retirement at age 60, the gross replacement rate is 33% from age 60 until 65, and 54% from age 65 and onwards. A replacement rate at a given age represents the average of the replacement rates predicted at that age, based on the actual wages earned in the last job, and the pension rights accrued by individuals who retired fully from a full-time job at age 54 to 65. Pension rights are accrued on full-time pensionable salary for at least 35 years by the time these individuals retire at age 65. At least 30 years of pension accrual are required for the individuals who retire at age 60.

A comparison of gross and net replacement rates shows that net replacement rates are higher than gross replacement rates. This is because pension income is lower than wage income, meaning that pension income is taxed in a lower tax bracket. The difference between gross and net replacement rates is higher after age 65 than before age 65. This is because the tax rate at age 65 is lower than that before age 65 (Section 2).

The gross replacement rate for abrupt retirement at age 65 is 77%. This is substantially below the gross replacement rate of 97% calculated by the OECD using the national parameters and rules applying in 2016 (OECD, 2017). The difference is mainly due to the fact that the OECD calculates the replacement rate based on a fictitious person who earns the median income during his entire career and accrues pension rights for 45 years on a full-time pensionable salary. In the sample data, however, very few people accrue pension rights for a total of 45 years on full-time pensionable salary. For example, among those observed who had worked full-time and retired the year after, the mean number of years of pension accrual on full-time pensionable salary is 26.6 years for men and 21.6 years for women. The replacement rates presented are calculated, however, based on the restriction of at least 35 years of pension accrual on fulltime pensionable salary. Indeed, Knoef et al. (2016) argue that, when evaluating the effectiveness of the Dutch pension system to replace pre-retirement earnings, attention should be given to the fact that career interruptions limit the amount of pension rights that individuals accrue. In the next section we analyze how different numbers of years of pension accrual affect retirement income adequacy when individuals retire part-time and full-time.

As to the gross replacement rates attained at the time of retirement, we see a large difference between when people retire before the statutory retirement age, and when they retire at or after the statutory retirement age. While the gross replacement rates range from 33% to 52% when people retire before the statutory retirement age, they

are much higher, ranging from 77% to 98%, when they retire at or after the statutory retirement age. This is due to the fact that, before reaching the statutory retirement age, individuals do not have access to the state pension income, while occupational pension income replaces their final wage only to a limited extent, especially because occupational pension rights are actuarially penalized when claimed earlier than the statutory retirement age.

As to the gross replacement rates attained at the age of 70, we see large differences across people who retire at different ages from 60 to 70. That is, at age 70, the gross replacement rates range from 54% to 72% across people who retire at the age of 60 to 64, while they range from 77% to 98% across people who retire at the age of 65 to 70. This shows that delaying retirement increases retirement income adequacy, and the increase after age 65 is higher than that before age 65. This is due to the fact that the actuarial increase in pension rights when delaying retirement is higher at older ages. Another finding is that pension income does not fully replace the final earnings before retirement even when retirement is delayed until age 70. For example, for the individual who retires at the standard retirement age of 65, pension income replaces about 77% of the final earnings, and it takes five additional years of full-time work to replace about 98% of the final earnings. A contributing factor is that gross replacement rates are capped at 100% by law, leading to mean replacement rates below 100%.

The differences across the net replacement rates are smaller compared to the differences across the gross replacement rates, especially after age 65. This is due to the progressive nature of the tax system. A person who retires later and accrues more pension rights is taxed at higher rates and will have a lower replacement rate. This demonstrates the redistributive role of the progressive tax system in pension provision.

Figure 3 presents the gross and net replacement rate trajectories in scenarios of partial retirement at given ages from 60 to 65. The duration of partial retirement is always considered to be five years.

Figure 4 reproduces the net replacement rates from Figures 2 and 3. In particular, the left panel shows the net replacement rates where individuals retire full-time from their full-time job between age 60 to 65, and the right panel shows the net replacement rates where individuals retire part-time from their full-time job at the same ages for a period of five years. A comparison of the replacement rates in the left and right panels of the figure leads to several findings.

First, considering the replacement rates attained before age 65, when individuals retire part-time, they attain replacement rates that are about 30 percentage points

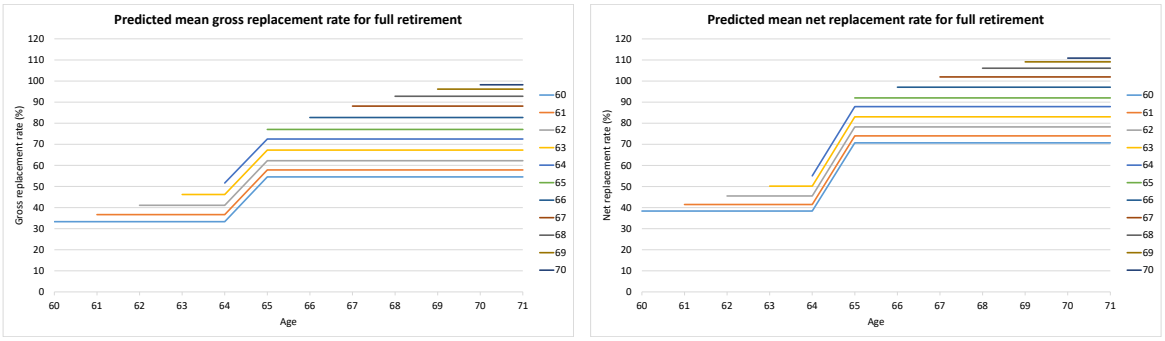

Figure 2: Predicted mean gross (left panel) and net (right panel) replacement rates in retirement scenarios where individuals retire fully at given ages from 60 to 70. Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time of retirement at age 65. At least 30 years of pension accrual are required for workers who retire at age 60. A mean replacement rate at a given age is predicted using data for 3,313 individuals who retired fully from a full-time job at given ages from 54 to 65.

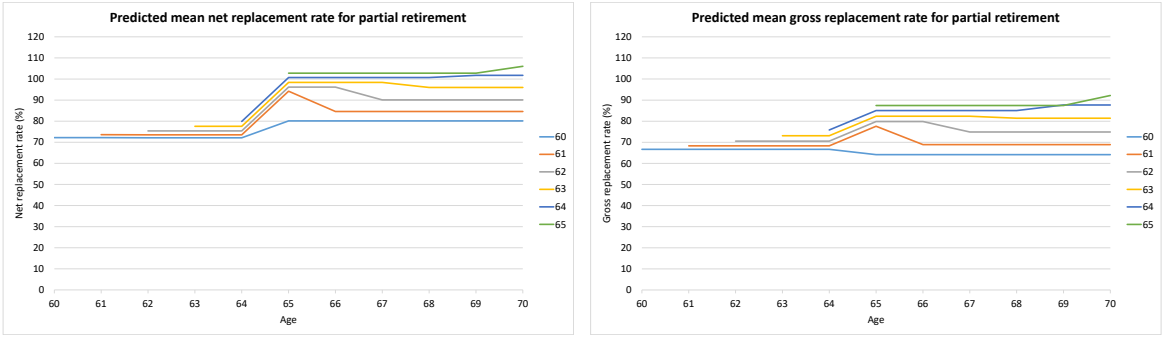

Figure 3: Predicted mean gross (left panel) and net (right panel) replacement rates in retirement scenarios where individuals retire part-time from their full-time job for a period of five years at given ages from 60 to 65. During partial retirement, individuals work 50% of the hours they worked in their full-time job and claim 50% of their accrued occupational and state pension rights. Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time of retirement at age 65. At least 30 years of pension accrual are required for workers who retire at age 60. A mean replacement rate at a given age is predicted using data for 3,313 individuals who retired fully from a full-time job at given ages from 54 to 65.

higher than when they retire full-time at the same ages. Considering the level of replacement rates, partial retirement allows individuals to attain at least the minimum target replacement rate of 70%, while full retirement at the same ages leads to replacement rates that are below 56%. This shows to what extent partial retirement helps workers to ensure their financial well-being against the large income shock they face if they retire before the statutory retirement age and have to rely on their occupational pension income.

Second, considering the replacement rates attained after age 65, retiring part-time instead of full-time before age 65 leads to replacement rates that are about 15

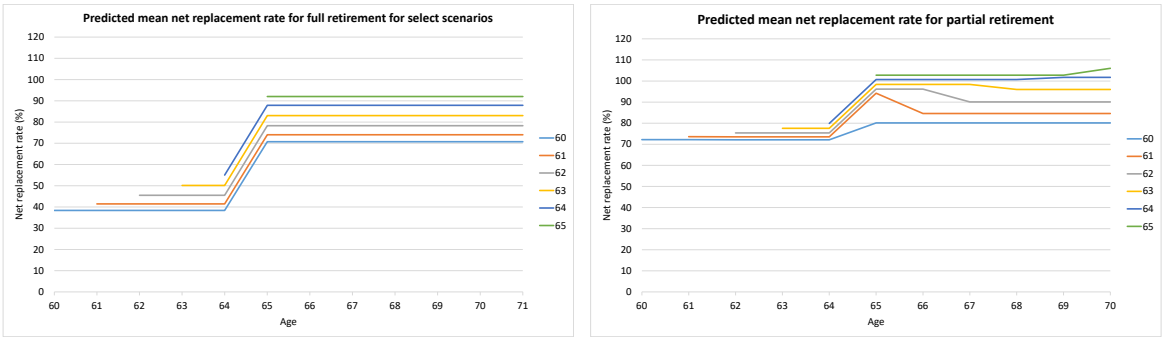

Figure 4: Income smoothing with partial retirement. Predicted mean net replacement rates in retirement scenarios where individuals retire from their full-time job fully (left panel reproducing the right panel of Figure 2 for select retirement scenarios) and partially (right panel reproducing the right panel of Figure 3) at given ages from 60 to 65.

percentage points higher. Compared to the much larger gap of 30 percentage points before age 65 presented above, the smaller gap after age 65 is due to the effect of the first pillar pension in the net replacement rate.

Overall, compared to full retirement, partial retirement results in a much smoother income path. For example, for someone who retires fully at age 63, the average net replacement rate moves from 50% at age 63 to 83% at age 70, while for someone who partially retires at age 63 for a period of five years, the average net replacement rate moves from 78% at age 63 to 96% at age 70. This demonstrates to what extent partial retirement helps individuals to smooth their income path over the course of their retirement when they stop working before the normal retirement age.

The risk of falling below the minimum target replacement rate

In Figures 2 and 3 we analyze replacement rates in scenarios of partial retirement and abrupt full retirement at ages from 60 to 70. In these scenarios, a given replacement rate represents the mean of the replacement rates predicted on the basis of the actual earnings and accrued pension rights of the individuals in the sample. Here we study the distribution of the predicted replacement rates, and in particular we analyze the fractions of individuals who fall below the minimum target replacement rate of 70% when they retire part-time compared to full-time. In this analysis we focus on retirement before the statutory retirement age since after that age the state pension largely enables workers to attain the minimum target replacement rate, as shown in the preceding subsection.

In Figure 5 we analyze the fractions of individuals with a net replacement rate below the minimum target replacement rate at the age (from 60 to 65) when they retire full-time and part-time (any number of years). The figure shows that almost all

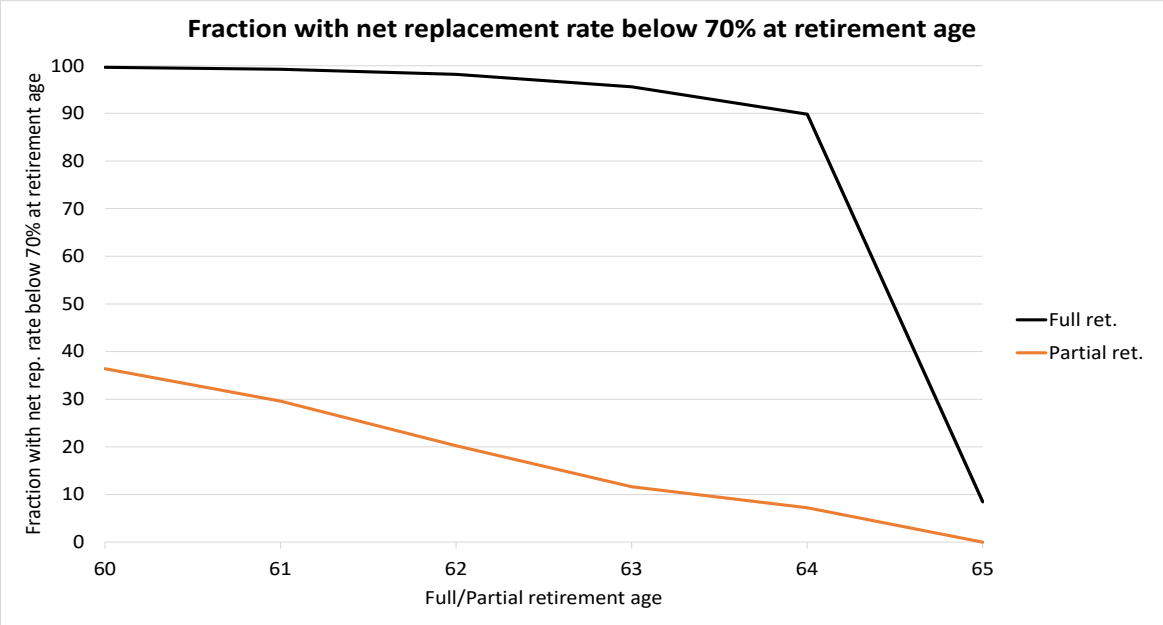

Figure 5: Fractions of individuals with a net replacement rate below the minimum target replacement rate at the age (from 60 to 65) when they retire full-time and part-time (any number of years). Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time of retirement at age 65. At least 30 years of pension accrual are required for workers who retire at age 60. Replacement rates at a given age are predicted using data for 3,313 individuals who retired fully from a full-time job at given ages from 54 to 65.

individuals who retire full-time before the age of 65 fall below the minimum target replacement rate. As demonstrated by Figure 2, this is due to the fact that, before the statutory retirement age, occupational pension income replaces the final wage to a limited extent, especially because occupational pension rights are actuarially penalized when claimed earlier than the statutory retirement age. The high risk of falling below the minimum target replacement rate before the statutory retirement age can explain why individuals often retire at the statutory retirement age, when they are entitled to the state pension benefit (Mastrobuoni, 2009; Atav et al., 2019). The figure shows to what extent partial retirement helps workers to insure their financial well-being against this high risk. That is, based on the replacement rates predicted among the individuals in the sample, partial instead of full retirement substantially decreases the fraction of individuals who fall below the minimum target replacement rate, for example from about 95% to only 12% at age 63.

In Figure 6 we analyze the fractions of people with a net replacement rate below the minimum target replacement rate at age 70 when they retire full-time and part-time at each age from 60 to 65. We distinguish among different partial retirement scenarios, where individuals spend different numbers of years in partial

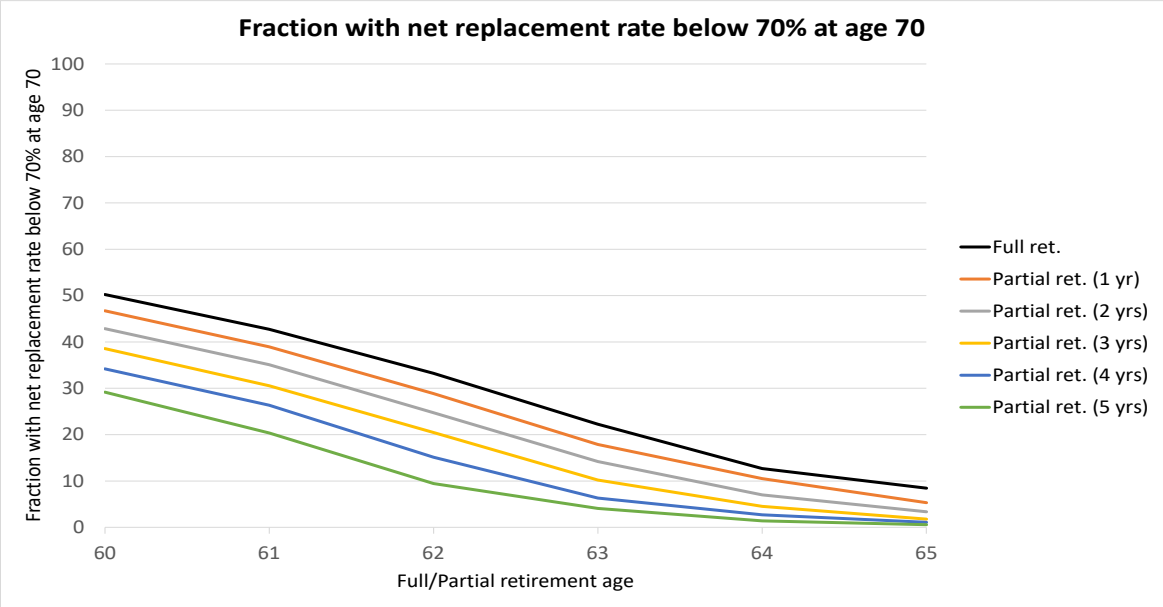

Figure 6: Fraction of individuals with a net replacement rate below the minimum target replacement rate at age 70 when individuals retire full-time and part-time – with different numbers of years spent in part-time work – at given ages from 60 to 65. Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time of retirement at age 65. At least 30 years of pension accrual are required for workers who retire at age 60. Replacement rates at a given age are predicted using data for 3,313 individuals who retired fully from a full-time job at given ages from 54 to 65.

retirement. We analyze the risk of falling below the minimum target replacement rate after the statutory retirement age, in particular at age 70. Thus, in all scenarios the state pension income is taken into account in the replacement rates. There are two main findings. First, the risk of falling below the minimum target replacement rate decreases as people retire full-time or part-time at later ages. This is because accrued pension rights are higher at later retirement ages, and because pension rights are less heavily penalized at later retirement ages. Second, partial rather than full retirement substantially decreases the risk of falling below the minimum target replacement rate. For example, at age 63, while this risk is about 22% when individuals retire full-time, it is about 14% when they instead remain employed part-time for two years and about 4% when they remain employed part-time for five years.

Vulnerable groups

In Figure 7 we analyze the risk of falling below the minimum target replacement rate at age 70 among the individuals who accumulated pension rights for at least 35 years (the same as those in Figure 6) and among those who accumulated pension rights for 25 to 34 years. Among the individuals who accumulated pension rights for fewer

years, the risk of falling below the minimum target replacement rate is substantially higher at any given age at which they retire full-time or part-time. However, the risk is substantially lower among the individuals who retire part-time than among those who retire full-time, at any given age. In fact, individuals who retire part-time for a period of five years and have 25 to 34 years of pension accrual appear to have a very similar risk profile as those who retire full-time and have at least 35 years of pension accrual.

In Figure 8 we analyze the impact of the earnings level on the risk of falling below the minimum target replacement rate. We consider two income groups with respect to the amount of wages earned in the last full-time job: €25,000-34,999 and €55,000-64,999. High-income earners appear to be much more likely to have a replacement rate that is below the minimum target level. The main reason is that, for a high-income earner, the state pension income is much lower relative to the wage income.

Figure 9 shows how the domestic situation affects the risk of falling below the minimum target replacement rate. Those living with a partner are much more likely to fall below the minimum target replacement rate. There are two main reasons for this. First, the state pension is lower for those living with a partner. Second, the gross wage earned in the last full-time job is lower for singles than for those living with a partner. In the sample, while singles earned €48,440 on average, those living with a partner earned €64,446 in the last job where they worked on a full-time basis.

Figure 10 shows how the risk of falling below the minimum target replacement rate differs between men and women. Compared to women, men are roughly twice more likely to fall below the minimum target replacement rate regardless of the age at which they retire full-time or part-time. Higher replacement rates for women reflect the fact that women earn less and that for them the state pension replaces a much higher share of their pre-retirement earnings. This result is remarkable because, despite the fact that we require that women, same as men, accrue occupational pension rights on a full-time pensionable salary for at least 30 years by the time they retire at age 60, or for more years if they retire later, their wage is low enough that it leads to replacement rates roughly twice as high as those of men. In the sample data, while women earned €48,860 on average in the last job where they worked on a full-time basis, men earned €65,551. The wage differential between women and men is due to the fact that, in the health care sector, men more often occupy higher paid medical professions.

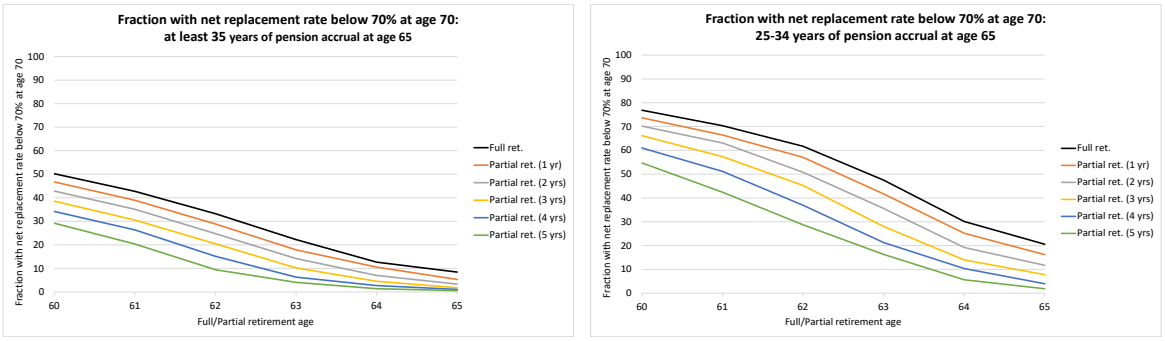

Figure 7: Fraction of individuals with a net replacement rate below the minimum target replacement rate at age 70 when individuals retire full-time and part-time – with different numbers of years spent in part-time work – at given ages from 60 to 65: for individuals who accrue pension rights for at least 35 years (left panel reproducing Figure 6) and for those who accrue pension rights for 25 to 34 years (right panel) by age 65. At least 30 years of pension accrual are required for workers who retire at age 60. Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for the studied cases of number of years of pension accrual. For individuals with pension accrual for at least 35 years, replacement rates at a given age are predicted using data for 3,313 individuals who retired fully from a full-time job at given ages from 54 to 65. For individuals with pension accrual for 25 to 34 years, replacement rates at a given age are predicted using data for 1,716 individuals who retired fully from a full-time job at ages from 54 to 64.

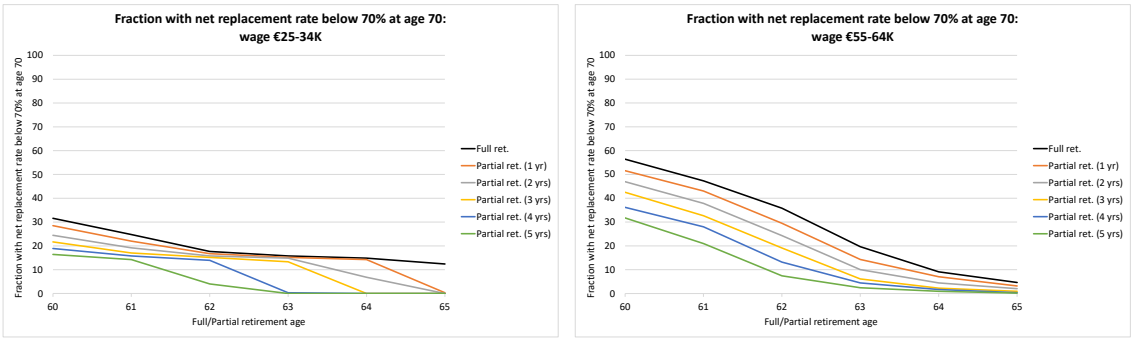

Figure 8: Fractions of individuals with a net replacement rate below the minimum target replacement rate at age 70 when individuals retire full-time and part-time – with different numbers of years spent in part-time work – at given ages from 60 to 65: for individuals with earnings of €25,000–€34,999 (left panel) and for those with earnings of €55,000–€64,999 (right panel). Earnings represent wage income in the last full-time job before (partial) retirement. Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time individuals retire at age 65. At least 30 years of pension accrual are required for workers who retire at age 60. For low income earners, replacement rates at a given age are predicted using data for 323 individuals who retired fully from a full-time job at ages from 54 to 64. For high-income earners, replacement rates at a given age are predicted using data for 539 individuals who retired fully from a full-time job at ages from 54 to 64.

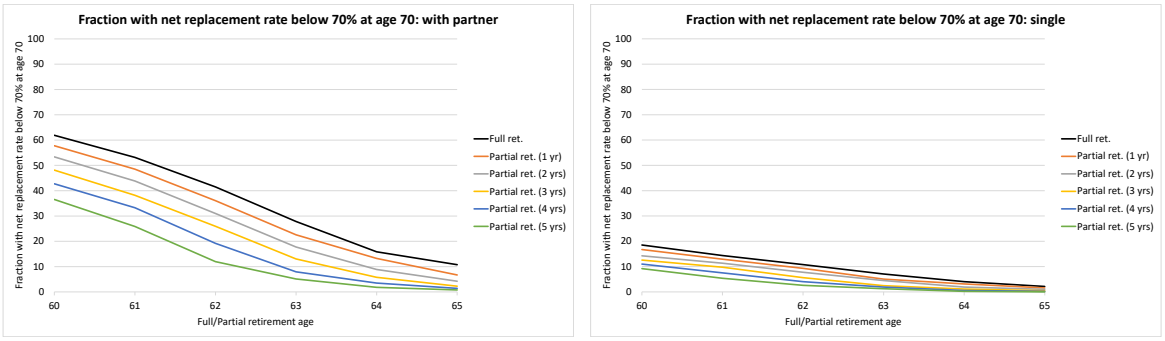

Figure 9: Fraction of individuals with a net replacement rate below the minimum target replacement rate at age 70 when individuals retire full-time and part-time – with different numbers of years spent in part-time work – at given ages from 60 to 65: for individuals with a partner (left panel) and for singles (right panel). Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time individuals retire at age 65. At least 30 years of pension accrual are required for workers who retire at age 60. For individuals with a partner, replacement rates at a given age are predicted using data for 2,422 individuals who retired fully from a full-time job at ages from 54 to 64. For singles, replacement rates at a given age are predicted using data for 891 individuals who retired fully from a full-time job at ages from 54 to 65.

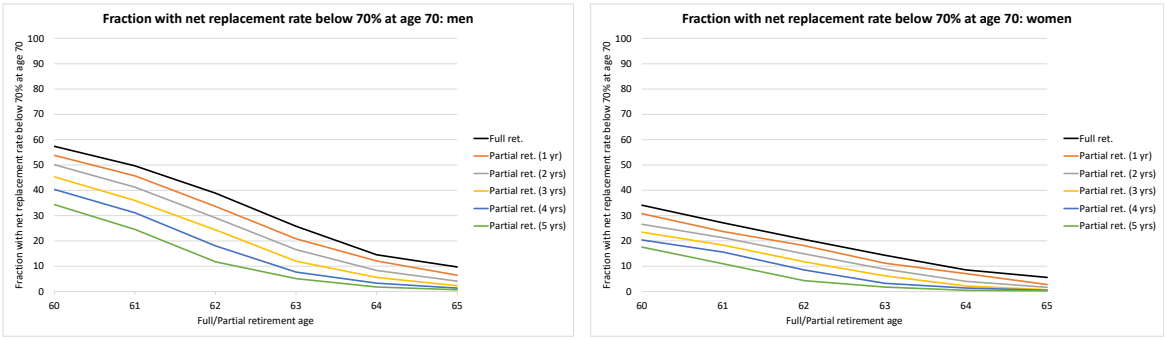

Figure 10: Fractions of individuals with a net replacement rate below the minimum target replacement rate at age 70 when individuals retire full-time and part-time – with different numbers of years spent in part-time work – at given ages from 60 to 65: for men (left panel) and women (right panel). Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time individuals retire at age 65. At least 30 years of pension accrual are required for workers who retire at age 60. For men, replacement rates are predicted using data for 2,293 individuals who retired fully from a full-time job at ages from 54 to 65. For women, replacement rates are predicted using data for 1,020 individuals who retired fully from a full-time job at ages from 54 to 64.

Policy simulations

Using the actual earnings and accrued pension rights of the individuals in the sample, we predicted replacement rates in alternative retirement scenarios. Using the distribution of the predicted replacement rates, we studied the fraction of individuals who fall below a minimum target replacement rate of 70% at age 70. In Figure 6 we showed how this fraction depends on an early retirement age and the type of

retirement (partial or full). Here we consider a higher minimum target replacement rate, and study the fraction of individuals who fall below the higher minimum target replacement rate, compared to the fraction of individuals who fall below the minimum target replacement rate of 70%. Figure 11 presents the risk of falling below the minimum target replacement rate when the minimum is defined as 70% and when it is defined as 80%. In the case of full retirement, the risk of falling below the minimum target replacement rate at age 70 increases substantially, by some 25 percentage points, when the threshold for the minimum target replacement rate is increased from 70% to 80%. In the case of partial retirement at given ages from 60 to 62, we obtain a similar increase. The increase is smaller at later ages of partial retirement. Another notable finding is that individuals who retire part-time for a period of five years and fall below the minimum target replacement rate of 80% have a similar risk profile as individuals who retire full-time and fall below the minimum target replacement rate of 70%. This shows that individuals who retire part-time instead of full-time before the statutory retirement age more often attain a retirement income that is deemed adequate from the point of view of the statutory gross replacement rate of 70% provided in social insurance schemes.

Throughout our analyses we assumed zero wage inflation, and therefore we did not consider indexation of occupational pension rights when making projections in hypothetical retirement scenarios. We also assumed zero price inflation. Here we retain our assumption of no wage inflation, and hence no indexation, since the largest pension funds did not index pension rights during the past five to ten years due to their low funding ratios. However, we allow for price inflation at an annual rate of 1%. That is, we deflate the pension rights paid during each year of retirement to obtain corresponding amounts in real terms. Figure 12 shows the risk of falling below the minimum target replacement rate at age 70 when paid pension rights are not adjusted, and when they are adjusted for price inflation. The figure shows that the risk of falling below the minimum target replacement rate is higher due to price inflation since deflated pension rights are smaller than nominal pension rights, relative to final earnings. For example, in the case of full retirement at age 60, the risk is about 10 percentage points higher when pension rights are adjusted for price inflation compared to when they are not adjusted. The large difference is due to the fact that individuals who retire full-time at age 60 are exposed to 1% price inflation and no indexation for ten years until retirement at age 70. The risk becomes smaller as individuals delay retirement since they accumulate more pension rights and defer their pension claims until retirement. The risk is substantially smaller in the case of partial

retirement. This shows that individuals who retire part-time instead of full-time are much less prone to changes in the general price level over the retirement period.

In 2014 the "Generation Pact" was introduced in the collective labor agreements of a number of municipalities. In subsequent years the scheme was expanded to other sectors. The Generation Pact is a partial retirement scheme that offers two types of financial incentives that make it more attractive than the partial retirement scheme already offered by most pension funds. First, it allows the employee to accrue pension rights based on the former wage instead of the part-time wage earned during partial retirement. Second, the wage rate during partial retirement is higher than that in the former job. It is assumed that the employer will finance the higher wage of the older worker by employing a younger worker, who will replace the hours released by the older worker but earn an hourly wage that is lower than that earned by the older worker. For example, in a widely used variant of the scheme, an employee works 80% of the hours he worked in his former full-time job, earns 90% of the wage he earned in his former full-time job, and accrues pension rights based on 100% of the wage he earned in his former full-time job. Alternative variants are possible, such as that the number of work hours is 60% of the hours worked in the former full-time job, the wage earned is 80% of the wage earned in the former full-time job, and pension rights are accrued based on 100% of the wage earned in the former full-time job. However, the employee must work at least 50% of his former number of work hours and start to participate in the scheme nor more than ten years before the statutory retirement age.

Here we analyze the replacement rates of workers when they participate in the Generation Pact scheme and earn wages and build pension rights on favorable terms, and when they participate in the default partial retirement scheme offered by their pension fund. Our particular aim is to show how much the final pension income is affected if employees participate in the Generation Pact and rely on a favorable wage income from their employer, compared to if they participate in the default partial retirement scheme and rely on their wage income as well as on their occupational pension income.

During participation in either scheme, we assume that individuals work 80% of the hours they worked in their former full-time jobs. We consider the widely used variant of the Generation Pact, where individuals are paid 90% of the wage they earned in their former full-time job, and accrue pension rights based on 100% of the wage they earned in their former full-time job. In the default partial retirement scheme, however, individuals are paid 80% of their former wage, claim occupational pension rights equal to 10% of their former wage, and accrue pension rights based

on the part-time wage they earn during partial retirement. This means that during participation in either scheme, the total income received is equal to 90% of the former wage earned, but this income is paid by the employer when participating in the Generation Pact scheme, while it is financed by labor income as well as by accrued pension rights when participating in the default partial retirement scheme.

Figure 13 presents the net replacement rates of the individuals when they participate in the Generation Pact and when they participate in the default partial retirement scheme. Considered are scenarios where individuals retire part-time from their full-time job at given ages from 60 to 64 until the statutory retirement age. During partial retirement, individuals attain a net replacement rate of about 96% when they participate in either of the two schemes. Considering the scenario of partial retirement at age 60, individuals attain, upon full retirement from age 65, a net replacement rate of about 85% if they participate in the default partial retirement scheme, while they attain a net replacement rate of about 92% if they participate in the Generation Pact. The difference is due to the fact that individuals accrue pension rights on a lower wage income when they participate in the default partial retirement scheme. The difference reduces to 1 percentage point when individuals partially retire at age 64. The reduction is caused by the fact that individuals accrue more pension rights if they partially retire at a later age. This shows that the gain in income replacement in retirement from participating in the Generation Pact is higher when employees partially retire earlier.

Figure 14 shows the risk of falling below the minimum target replacement rate of 70% at age 70 when individuals participate in the default partial retirement scheme and when they participate in the Generation Pact. Considering the scenario of partial retirement at age 60, the risk is about 19% if individuals participate in the default partial retirement scheme, while it is about 8% if they participate in the Generation Pact. The risk becomes smaller if individuals partially retire later in the default partial retirement scheme.

Section 2 described an alternative state pension scheme proposed by the Dutch government in 2008. The scheme allows full or partial deferral of state pension rights to a later retirement age. In our analyses, we assumed that the proposed pension scheme is in operation, and in hypothetical retirement scenarios individuals who work beyond age 65 defer all or part of their state pension rights until retirement to smooth their total income. Here we assume that the effective state pension scheme is in operation and that deferral of state pension receipt is thus not possible. However, we consider that individuals who delay retirement defer their occupational pension rights as the occupational pension scheme allows. Considering the net replacement

rates attained at age 70, we find small differences between the situation where individuals delay receipt of their state pension rights and where they claim their state pension rights at the statutory retirement age. For example, when an individual partially retires at age 63 and defers the state and occupational pension rights for five years until age 68, such person attains a net replacement rate of about 96% at age 70, whereas when partially retiring at age 63 for five years and deferring the occupational pension rights until age 68 but claiming state pension rights at the statutory retirement age, such person attains a net replacement rate of about 95% at age 70. As to the risk of falling below the minimum target replacement rate at age 70, this risk is 4.8% for the former group and 4.1% for the latter group.

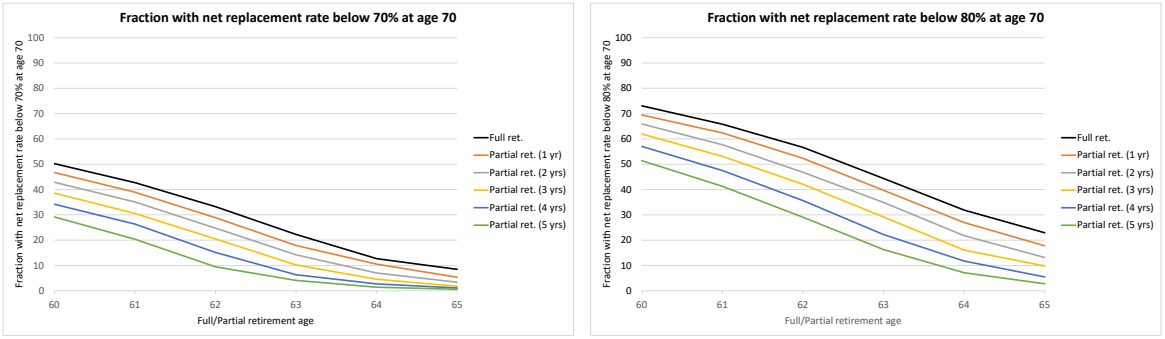

Figure 11: Fractions of individuals with a net replacement rate below 70% (left panel reproducing Figure 6) and 80% (right panel) at age 70 when individuals retire full-time and part-time – with different numbers of years spent in part-time work – at given ages from 60 to 65. Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time individuals retire at age 65. At least 30 years of pension accrual are required for workers who retire at age 60.

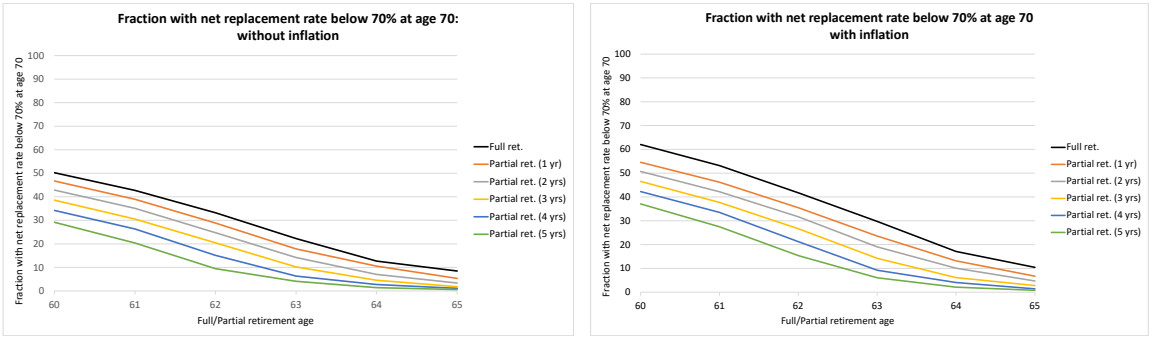

Figure 12: Fractions of individuals with a net replacement rate below the minimum target replacement rate at age 70 when individuals retire full-time and part-time – with different numbers of years spent in part-time work – at given ages from 60 to 65: when paid pension rights are not adjusted (left panel reproducing Figure 6) and when they are adjusted (right panel) for 1% annual price inflation. Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time individuals retire at age 65. At least 30 years of pension accrual are required for workers who retire at age 60.

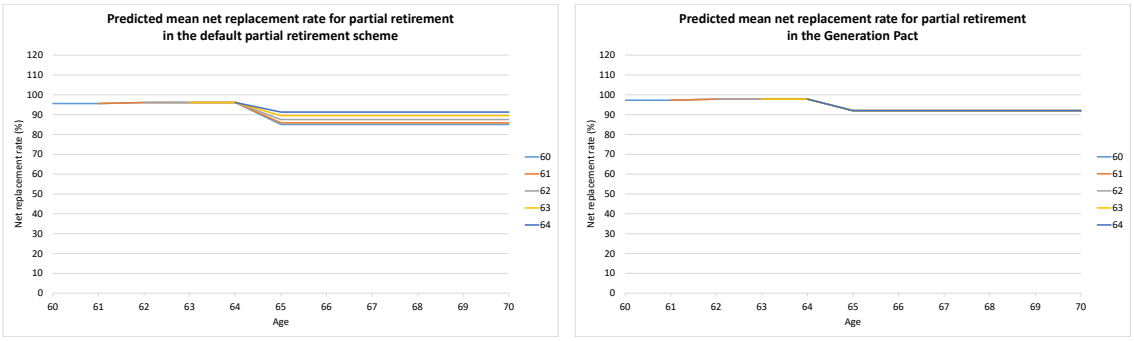

Figure 13: Predicted mean net replacement rates when individuals participate in the default partial retirement scheme (left panel) and when they participate in the Generation Pact scheme (right panel). Presented are partial retirement scenarios where individuals retire part-time from their full-time job at given ages from 60 to 64 until the statutory retirement age. When participating in the default partial retirement scheme, individuals work 80% of the hours they worked in their full-time job, earn 80% of their former full-time wage, claim occupational pension rights that amount to 10% of their former full-time wage, and accrue occupational pension rights based on their part-time wage. When participating in the Generation Pact scheme, individuals work 80% of the hours they worked in their full-time job, earn 90% of their former full-time wage, do not claim occupational pension rights, and accrue occupational pension rights based on their former full-time wage. Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time of retirement at age 65. At least 30 years of pension accrual are required for workers who retire at age 60.

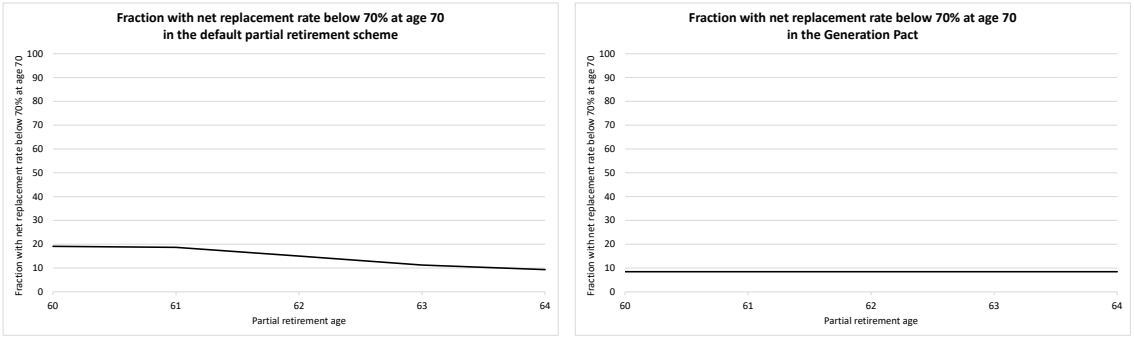

Figure 14: Fractions of individuals with a net replacement rate below 70% when they participate in the default partial retirement scheme (left panel) and when they participate in the Generation Pact scheme (right panel) at age 70, when they retire part-time at given ages from 60 to 64 until the statutory retirement age. Replacement rates are based on actual wages earned in the last job and on pension rights accrued on full-time pensionable salary for at least 35 years by the time of retirement at age 65. At least 30 years of pension accrual are required for workers who retire at age 60.

6. Conclusion

Policymakers are confronted with the challenge of ensuring an adequate retirement income for older persons, while keeping the pension system sustainable. Partial retirement can be an instrument to achieve both goals. Combining wage and pension income can fund old-age consumption, and it can induce individuals to extend their working lives up to the statutory retirement age or beyond. We have shown that, on average, older workers attain at least a minimum target replacement rate of 70% during partial retirement, and a higher replacement rate during full retirement, when they retire part-time and combine part-time earnings with part-time pension before the statutory retirement age. The replacement rates fall considerably below the minimum target replacement rate when workers retire full-time before the statutory retirement age. Furthermore, the distribution of replacement rates across individuals shows that those who retire part-time have a much smaller risk of falling below the minimum target replacement rate compared to those who retire full-time, both before and after the statutory retirement age. An important implication of this result is that, when individuals retire part-time instead of full-time at a given age, they are always less prone to shocks in pension entitlements due to, for example, zero indexation of occupational pension rights or a lower occupational pension income due to having accumulated pension rights for fewer years.

The relevance of partial retirement for pension income adequacy before the statutory retirement age is likely to increase in the coming years. Early retirement schemes have been phased out in the past ten years. This may increase the scope of partial retirement before the statutory retirement age as older workers now lack the possibility of early retirement from generous early retirement schemes (Bloemen et al., 2016; Muns, 2018). Furthermore, the statutory retirement age is being increased since 2013. Partial retirement can be expected to become prevalent among older workers, at least among those working in physically demanding occupations, who would therefore wish to retire earlier than the statutory retirement age (Vermeer et al., 2016; Kok et al., 2018). In fact, since 2014, a growing number of collective labor agreements allow older workers to participate in the "Generation Pact" scheme and retire partially, where they earn wages and build pension rights on favorable terms. From a public finances perspective, partial retirement can in fact be beneficial, as it increases the number of years of pension contributions and tax revenues during the years of otherwise early retirement. Indeed, it has been shown that partial retirement can increase total labor supply if it is offered to individuals who would otherwise fully retire in an abrupt manner before the statutory retirement age (Been et al., 2018).

We analyzed replacement rates in alternative retirement scenarios, based on the pension rights accrued and wages earned by individuals who work in the healthcare sector. Limiting our analysis to this specific labor market sector does not necessarily undermine the representative character of our analysis. Every retiree who never lived abroad receives the full state pension, and the majority of them participate in a mandatory occupational pension scheme of the defined benefit type. Furthermore, the occupational pension regulation described is very similar across pension funds. This means that our predictions of replacement rates would not have been different by any substantial amount if additional data, or data from other pension funds, were used. In fact, the mean gross and net replacement rates that we predict are comparable to those predicted by Knoef et al. (2016). Specifically, while we predict that the mean gross and net replacement rates are 77% and 87% (Figure 2), respectively, Knoef et al. predict that they are 71% and 84% (Tables 4 and 6). The analysis by Knoef et al. is based on occupational pension entitlements projected by Statistics Netherlands, using individual data from pension funds that are required to provide Statistics Netherlands with pension entitlement data on an annual basis.

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Appendix

Details of income taxation

After-tax income and health insurance premium payments are calculated according to the rules of the Dutch Tax and Customs Administration (Geppaart, 2010). First, the basis for wage tax and national insurance premiums is determined. Gross income is first determined as the sum of work income, occupational pension benefit, and state pension benefit, all on an annual basis, including holiday allowance and end-of-year bonus.[3] From this gross income, the premiums paid to the occupational pension scheme are deducted, since these premiums are tax-deductible.[4] That gives the basis for the employee insurance premiums. The deductions from and additions to the basis for the employee insurance premiums include the "lifecycle savings scheme" premiums and private car use.[5] This yields the basis for income-related health insurance premiums. Finally, the income-related health insurance premium is added to the basis for income-related health insurance premiums because the employer fully compensates the employee for this premium, which is therefore treated as taxable income. This gives the basis for income tax and national insurance contributions.

Given the basis for income tax and national insurance premiums, the amount of income tax and social premiums payable is determined according to the progressive tax rates. The tax rates in the first two tax brackets decrease by a certain number of percentage points after the statutory retirement age, because old-age pension insurance contributions no longer apply after this age. The average tax rate increases with income due to the increase in marginal income tax rates over the brackets. Hence, retirees with low income have the lowest income tax in terms of their income.

Finally, tax credits should be accounted for to determine the ultimate amount of tax payable. Some tax credits provide a flat-rate amount, while others are income-related or depend on the domestic situation. The amount of a tax credit can never exceed the amount of tax to be paid (before subtracting the credit) (Belastingdienst, 2019). The tax credits considered in this study are the general tax credit, employed person's tax credit, employed person's tax credit reduction, elderly person's tax credit, and the elderly single person's tax credit. We do not consider the

3 For income tax purposes there are three types of taxable income: income from employment (current or past) and home ownership, income from a substantial interest, and income from savings and investments. We consider only the first category.

4 Additions to and deductions from gross income include the tax-deductible company savings scheme premiums, wage payments in kind, and claims for future income. In our analysis these are assumed to be zero.

5 In our analysis these are assumed to be zero.

work bonus since it was abolished in 2018. We also do not consider the single parent's tax credit, single parent's supplementary tax credit, and the combination tax credit. These tax credits depend on whether people have children living in the household, but relevant data are not available for the subjects of our study.

Given the pension premiums, taxes, tax credits, health insurance premiums, and the health insurance premium compensation, net work income and retirement income can be calculated by adding the tax credits and health insurance premium compensation and subtracting pension premiums, taxes, and health insurance premiums from gross income.

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This is a publication of:
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www.netspar.nl

May 2020