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# HOW IMPORTANT IS MEDICARE ELIGIBILITY IN THE TIMING OF RETIREMENT?

BY NORMA B. COE, MASHFIQUR R. KHAN, AND MATTHEW S. RUTLEDGE\*

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## Introduction

Eligibility for Medicare at age 65 is widely viewed as an important factor in retirement decisions. However, it has been difficult to quantify the influence of Medicare because eligibility for Medicare came at the same age as Social Security's Full Retirement Age (FRA). The recent rise in the FRA, along with other changes, has decoupled the age-related incentives in the two programs, making it easier to estimate the effect of Medicare eligibility on the timing of retirement. This *brief*, based on a recent study, provides such estimates of the importance of Medicare on retirement decisions.<sup>1</sup>

The discussion proceeds as follows. The first section discusses the relationship between Medicare eligibility and the timing of retirement. The second section describes the metric used for assessing the timing of retirement and the effect of Medicare eligibility. The third section reports the findings. The fourth section concludes that Medicare eligibility is a significant factor in the retirement decision, but that changes in the availability of health insurance for retirees could alter its importance going forward.

## Medicare Eligibility and Retirement

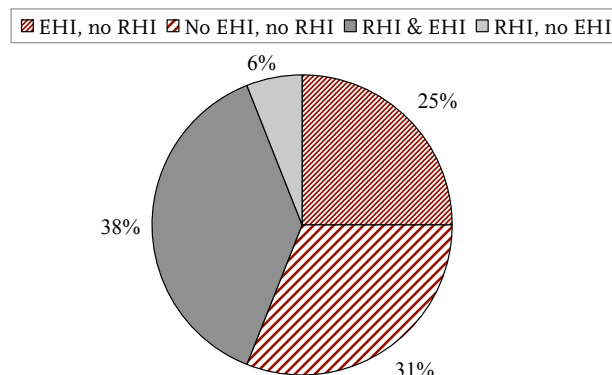
Researchers are virtually unanimous that health insurance availability generally, and Medicare eligibility at age 65 specifically, influences workers' retirement decisions.<sup>2</sup> However, not all workers will be equally sensitive to Medicare eligibility. It is not expected to affect the retirement decisions of the 44 percent of workers age 64 who have employer-provided retiree health insurance (RHI), as they have continuous health coverage regardless of employment.<sup>3</sup> But Medicare eligibility can be expected to affect the remaining 56 percent of workers age 64 without RHI (see Figure 1 on the next page). It should be especially important to the 25 percent of workers who have employer-provided health insurance (EHI) but not RHI: they would lose their health coverage if they retired prior to age 65.<sup>4</sup> It could also be important for the 31 percent of workers who lack EHI as well as RHI: Medicare coverage could free up resources otherwise spent on out-of-pocket medical costs, making retirement more affordable at age 65.<sup>5</sup>

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FIGURE 1. WORKERS AGE 64 BY HEALTH INSURANCE COVERAGE, 1996-2010

RHI = Retiree Health Insurance EHI = Employer Health Insurance

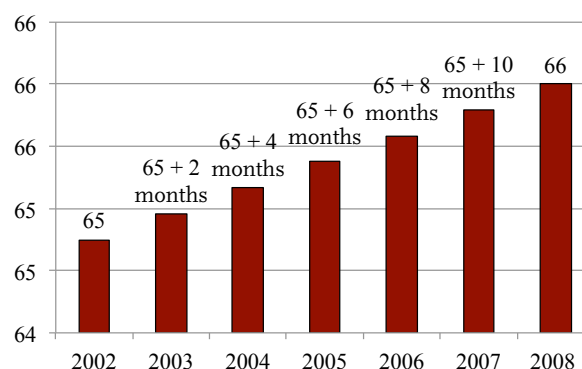


Source: Authors' calculations using University of Michigan, Health and Retirement Study (HRS), 1996-2010.

Although researchers agree that Medicare eligibility affects retirement decisions, its importance remained unclear because Social Security's Full Retirement Age (FRA), until 2003, was also 65. The FRA tends to be recognized as the government-designated "normal" retirement age, a norm the program had reinforced with financial incentives. A worker's monthly benefit was actuarially reduced 6.7 percent for each year the worker claimed prior to the FRA. Until recently, monthly benefits were also given a less than actuarially fair increase for each year a worker claimed after the FRA. Researchers assessing the role of Medicare eligibility in retirement decisions thus had to disentangle the effects of these Social Security incentives, which encouraged retirement at the same age. Their efforts produced varying assessments of the importance of Medicare eligibility on the timing of retirement.<sup>6</sup>

Recent changes in Social Security have decoupled the two program's age-specific retirement incentives. Most important is the increase in Social Security's FRA from 65 to 66 (see Figure 2). This change pushed back the government-designated normal retirement age. It also reduced monthly benefits claimed at 65 below their "full retirement" amount, which would encourage loss-averse individuals to work to their FRA to get their "full" benefit.

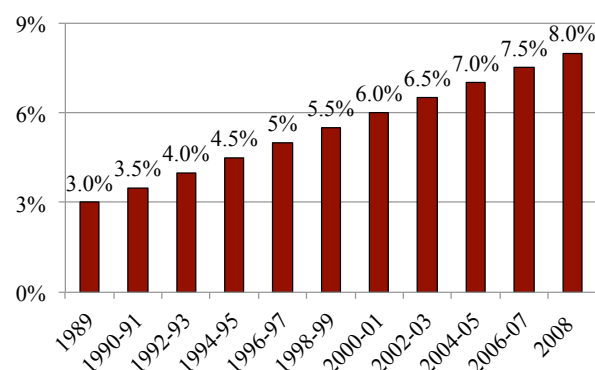
FIGURE 2. SOCIAL SECURITY FULL RETIREMENT AGE, BY YEAR WORKER TURNS AGE 65



Source: U.S. Social Security Administration (2012).

Two other changes in the Social Security program also increased incentives to work past the FRA, and thus past Medicare eligibility at age 65. The first was an increase in the Delayed Retirement Credit – the increment to monthly benefits awarded to workers who claim later than the FRA – from 5 percent a year for workers who turned 65 in 1996 to an actuarial increase of 8 percent a year for workers who have turned 65 since 2008 (see Figure 3). The second change was the elimination, in 2000, of the Retirement Earnings Test for workers older than the FRA. This change allowed workers to remain employed and still collect their full monthly benefit, no matter how much they earned.

FIGURE 3. SOCIAL SECURITY DELAYED RETIREMENT CREDIT, BY YEAR WORKER TURNS AGE 65



Source: U.S. Social Security Administration (2012).

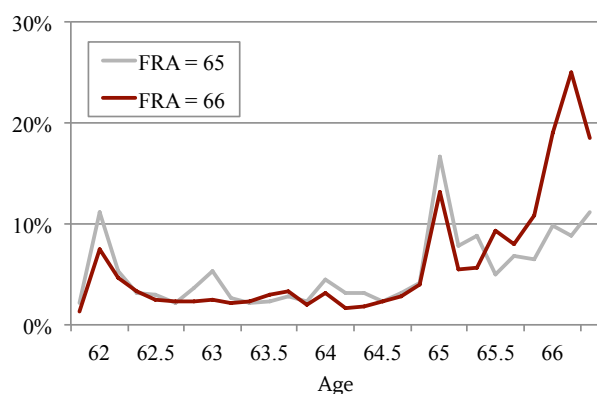
## Methodology and Data

This analysis makes use of the recent separation of the Medicare eligibility age and Social Security's FRA to assess the importance of Medicare in the timing of retirement. Following earlier studies, it uses the likelihood that workers still employed will retire at a given age as the metric for assessing the timing of retirements. The data come from the *Health and Retirement Study* (HRS), a biennial household panel survey of individuals over the age of 50, with retirement defined as the first month that HRS respondents report being completely retired.

If Social Security's FRA and corresponding changes in the benefit levels and accrual rates affect the timing of retirement, the likelihood that workers would retire at age 65 would fall, and the likelihood that they would retire later would rise, as the FRA increased. But if Medicare eligibility also affects the timing of retirement, a continuing spike in retirements will be evident at age 65.

Figure 4 shows that the increase in Social Security's FRA is clearly associated with workers pushing back their retirement age.<sup>7</sup> The gray line shows the monthly retirement rate for workers with an age-65 FRA; the red line is for workers with an age-66 FRA. Workers with the higher FRA indeed retire later. Interestingly, the figure also clearly shows a continuing spike in retirements at age 65. About 13 percent retired at 65, more than four times the rate for months before 65.

FIGURE 4. RETIREMENT RATE, BY SOCIAL SECURITY FULL RETIREMENT AGE



Notes: The age-65 line covers the 1931-1937 cohorts. The age-66 line covers the 1943-44 cohorts. The rates are for 2-month periods.

Source: Coe, Khan, and Rutledge (2013).

## Medicare's Effect on Retirement

A continuing spike in retirements at age 65 could be due to factors other than Medicare eligibility. For example, 65 remains a standard "reference" retirement age and the traditional retirement age at many employers. To assess the role of Medicare, the study estimated the effect of access to health insurance – specifically employer-provided health insurance (EHI) and employer-provided retiree health insurance (RHI) – on the likelihood of retirement at age 65.

The study focused on the retirement behavior of individuals still employed at age 64 with observable work histories to age 66.<sup>8</sup> It ran regressions identifying the effect of health insurance access and a broad range of worker characteristics on the likelihood of retirement. These characteristics included race and ethnicity, education, marital status, health, wealth, wages, pension coverage, cognitive functioning, financial planning horizon, risk aversion, and self-employment status. The regression includes interactions between an age-65 indicator variable and retiree health insurance coverage. This approach allowed the study to identify the effect of RHI on the likelihood of retirement at age 65, when a worker becomes eligible for Medicare.

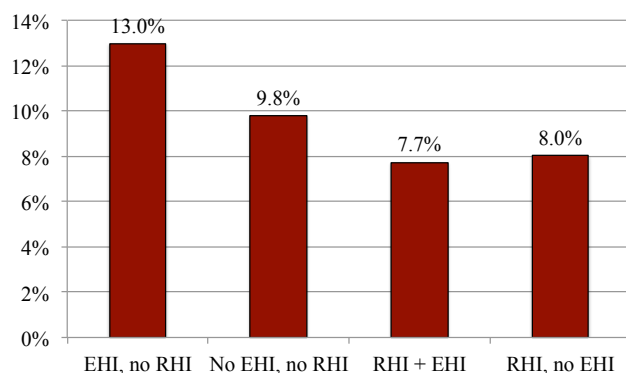
The regression results support the notion that Medicare eligibility is an important factor in the decisions of workers without retiree health insurance to retire at age 65. The coefficient for the interaction between RHI and the age-65 variable indicates that workers without retiree health insurance – who are expected to be more sensitive to Medicare eligibility – are 6.5 percentage points more likely to retire in the month they turn 65 than those who have RHI coverage.

The regression results also help to quantify the extent to which Medicare eligibility explains the spike in retirements among all workers at age 65. The retirement rate at age 65 is 8.7 percentage points higher than the rate at age 64½, the regression baseline (10.6 percent at age 65 vs. 1.9 percent at age 64½). Using the regression results, the study estimated the retirement rate at age 65 based on all worker characteristics, then on all characteristics *except* whether the worker had RHI. The difference between these two estimates was 2.6 percentage points, or 30 percent of the 8.7-percentage point spike at age 65. This finding suggests that Medicare eligibility explains 30 percent of the spike in retirements at age 65.

Figure 5 reports results that drill down further into how pre- and post-retirement health insurance coverage interact to influence the retirement decision. These results derive from a separate regression that includes the interactions of an age 65-indicator, RHI, and EHI, and then predicts the probability of retiring at 65 for four groups: workers with both RHI and EHI, workers with neither, or workers with just one or the other.

As expected, workers with EHI but not RHI – those who would lose coverage should they retire prior to age 65 – were especially sensitive to Medicare eligibility. The predicted retirement rate for workers in this group was 13.0 percent in the month they turned 65. The rate for workers who had neither RHI nor EHI, workers who lacked health insurance prior to becoming eligible for Medicare whether or not they retired, was 9.8 percent. The difference in the importance of Medicare was especially striking when comparing workers with EHI but no RHI (the first bar) to those who did have RHI benefits (the third and fourth bars). The predicted retirement rate for the month these workers turned 65 was 7.7 percent for workers with both RHI and EHI, and 8.0 percent for the smaller group with RHI and no EHI.

FIGURE 5. PREDICTED PROBABILITY OF RETIRING AT AGE 65, BY PRE- AND POST-RETIREMENT HEALTH INSURANCE COVERAGE



Source: Authors' calculations.

## Conclusion

The results of this study support the notion that eligibility for Medicare at age 65 is an important factor in retirement decisions. The study found workers without retiree health insurance – those most affected by the availability of Medicare benefits – are especially likely to retire in the month they turn 65. Their increased propensity to retire when they become eligible for Medicare in fact accounts for about 30 percent of the continuing spike in retirements at age 65, now that the Social Security FRA has increased to age 66.

Whether Medicare eligibility will remain important in the retirement decision going forward is hard to predict. Further declines in the prevalence and generosity of retiree health insurance benefits, and further increases in the cost of health care, should increase its importance. At the same time, various experts advocate increasing the Medicare eligibility age to 67; if so, workers may opt to work longer. But the health insurance exchanges created by the Affordable Care Act are projected to significantly expand access and reduce the premiums for non-employer provided insurance – especially for older workers. If coverage in the exchanges is comparable to Medicare coverage, then workers may be freed to retire on their own terms, and not have to wait for Medicare eligibility.

## Endnotes

- 1 Coe, Khan, and Rutledge (2013).
- 2 See Monk and Munnell (2009) for a review.
- 3 Medicaid beneficiaries and those who could obtain health insurance through their spouse would also be insensitive to Medicare eligibility. These factors are not included in Figure 1.
- 4 COBRA coverage is available to workers for 18 months after leaving their job, but premiums are 102 percent of the full premium (employer- and employee-paid shares combined).
- 5 Individuals age 64 who were still employed were much more likely to have health insurance coverage than all individuals that age. Among individuals age 64 still working, as noted above, 44 percent had RHI and 56 percent had EHI; among all individuals that age, only 33 percent had RHI and 37 percent had EHI.
- 6 See Rust and Phelan (1997); Blau and Gilleskie (2006, 2008); and French and Jones (2011).
- 7 Also see Song and Manchester (2007); Kopczuk and Song (2008); and Behaghel and Blau (2012).
- 8 The resulting sample included 3,717 individuals: 2,109 with an age-65 FRA and 1,608 with a higher FRA.

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The Center for Retirement Research at Boston College was established in 1998 through a grant from the Social Security Administration. The Center's mission is to produce first-class research and educational tools and forge a strong link between the academic community and decision-makers in the public and private sectors around an issue of critical importance to the nation's future. To achieve this mission, the Center sponsors a wide variety of research projects, transmits new findings to a broad audience, trains new scholars, and broadens access to valuable data sources. Since its inception, the Center has established a reputation as an authoritative source of information on all major aspects of the retirement income debate.

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