Early Retirement Incentives Involve Risks

By Michael Belarmino

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One constant for state and local governments is the never-ending search for ways to cut costs. In areas like service provision, that search sometimes leads to innovative solutions (e.g., technology). Areas such as payroll and benefits, however, are trickier, and solutions are even harder to find. Governments sometimes use early retirement incentives, but they are not without problems. In 2004, GFOA first issued an advisory urging governments that were considering early retirement incentives to exercise extreme caution.

Historically, early retirement incentives have had a low success rate, with governments underestimating the full costs of offering the incentive. GFOA's Executive Board therefore felt that the early retirement incentive advisory warranted review and a stronger stance, so over the past two years, GFOA's Committee on Retirement and Benefits Administration (CORBA) engaged in an extensive review. The updated advisory was recently approved by the Executive Board and now recommends that state and local governments not offer early retirement incentives. The lengthy review process did, however, produce a fortunate byproduct: a supplemental resource intended to help governments think about early retirement incentives from a risk perspective.

What are Early Retirement Incentives? Early retirement incentives are a strategy that governments employ to reduce payroll costs or stimulate short-term turnover among staff. Early retirement incentives are intended to be temporary and are generally offered over a specified time period. They may be offered in different forms, such as a one-time payment (that doesn't affect an ongoing defined benefit or defined contribution retirement benefit) or as some other financial incentive to encourage employees to retire before they had planned to do so.

Approaching Early Retirement Incentives from a Risk Analysis Perspective. In developing the supplemental resource, "Common Risks Associated with Early Retirement Incentives," GFOA did not intend to create any sort of checklist for offering early retirement incentives. Rather, the intent was to highlight a cross-section of the risks that are commonly associated with early retirement incentives, yet often overlooked. The resource sets out some of the common risks across the four key areas of goal setting, cost-benefit analysis, budget, and implementation. The risks listed are not exhaustive, but they are fairly demonstrative of where challenges can arise in offering early retirement incentives.

Goal Setting. When pursuing significant actions, we should ensure that we are pursuing clear, well-defined goals. This is where some of the ini-

tial pitfalls arise with early retirement incentives. For example, key decision makers sometimes lack clarity about the intended objective for offering an early retirement incentive. And even if everyone involved has a clear goal in mind, the short-term nature of early retirement incentives may potentially conflict with other retirement plan goals (e.g., increasing retention). Or the government may not have adequate quantitative or qualitative metrics in place to assess the effectiveness of the incentive.

Cost-Benefit Analysis. Another challenge arises when the potential costs and benefits involved in offering an early retirement incentive aren't adequately quantified or properly assessed. For example, a government may not fully consider all the costs of external resources that may be needed, such as hiring an outside consultant to study, set up, or implement the offering. In addition, governments often fail to assess all of the costs (e.g., recruitment, training, interim coverage) in replacing the personnel who accept the incentive. A compounding risk arises if the cost-benefit analysis is not linked to the incentive's goal (or goals; there may be more than one) and does not seek to recoup the cost over an appropriate period. As a result, a government may fail to fully considering the direct and indirect effects an early retirement incentive might have (e.g., employee morale and productivity, customer service, the loss of institutional knowledge, organizational efficiency). Conversely, linking the goal and risk analysis ensures that a government is more likely to consider these issues.

Quantifying Budgetary Impact. The resource also discusses risks that may be uncovered if a comprehensive budgetary analysis were conducted. Developing estimates for the potential budgetary impact of the early retirement incentive offering requires a comprehensive analysis. What are some flags that a budgetary analysis is incomplete? For starters, not including such elements as the effect the early retirement incentive would have on providing retiree health care. Another would be not including multiple scenarios and rates of adoption, since the levels of employee participation might vary. Other significant omissions would be not including market conditions for hiring replacements, which could lead to an inaccurate budgetary impact, or failing to compare multiple scenarios (e.g., not offering the early retirement incentive versus the incremental costs of the early retirement incentive over an extended period), factoring in other budgetary pressures like increased pension contributions or service demand.

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EARLY RETIREMENT INCENTIVE IMPLEMENTATION

Governments also need to consider risks that may not be fully addressed before or during implementation — not having a fully developed or adequately executed communication plan would be one example. Some of the things an organization may fail to include in the plan are: a properly identified point person who is authorized to comment on early retirement incentives; sufficiently detailed key messages and an outline of the topics the point person can and cannot comment on; and enough information to create awareness and understanding of the incentive, particularly for those who are critical of public pensions. From an internal standpoint, implementation risks may also be caused by failing to educate employees so they understand and can make decisions about early retirement as it relates to their own retirement planning, or not seeking input from collective bargaining units or applicable pension system administrators.

CONCLUSIONS

Early retirement incentives may seem like a reasonable option at first, but governments need to consider a wide array of risks. These incentives are complex offerings with many variables in play, and they can generate a significant amount of unintended consequences that will result in higher costs than what was originally anticipated. GFOA has therefore decided to take a stronger stance in recommending that governments not offer early retirement incentives.

Read GFOA's early retirement incentives risk analysis resource at gfoa.org/RiskAnalysisResource.pdf.

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