It has sometimes been suggested that FERS induces more turnover among those in their mid- and late careers while at the same time inducing individuals, especially those in managerial positions, to retire at later ages. The purpose of our analysis was to examine whether the separation and retirement incentives embedded in FERS are consistent with these hypotheses. In the process of addressing these issues we also examined how FERS compares with CSRS in terms of providing greater expected lifetime wealth, whether FERS and CSRS embed different retirement incentives in general, and whether CSRS personnel have an incentive to switch to FERS.

When FERS was introduced, some civil service workers expressed concern that FERS would provide smaller benefits than CSRS for employees who planned to remain in the civil service until retirement (GAO, 1998). Our results suggest that this is generally not the case. We find FERS to be more generous than CSRS because expected lifetime wealth is predicted to be greater. The greater benefits under FERS might compensate civil service personnel for the risk they bear that their fund accumulations, or the returns on them, might fall because of a downturn in interest rates or in the stock market.

Our analysis of retirement incentives indicates that FERS will be more successful than CSRS at inducing individuals to retire at later ages in future years. We find that the age-YOS retirement incentives that are embedded in FERS and CSRS are the same, given our assumption that those covered by FERS face a minimum retirement age of 55. The MRA is 55 for those born before 1948 and rises gradually to 57 for those born after 1970. When the MRA is 57, we find that the age-YOS retirement incentives embedded in FERS and CSRS are not the same. In this case, we find that individuals who spend their careers in the civil service will retire later (at age 57 compared with age 55) if they are covered by FERS than if they are covered by CSRS. Since recent hires are more likely to be born after 1970, our analysis predicts that recent hires will retire at a later age under FERS than they would have retired had they been covered under CSRS. Therefore, we expect that the average retirement age will rise in the future as new hires age and eventually retire from the civil service.

Our analysis also suggests that FERS will create more variance in retirement ages, although the average retirement age is predicted to be the same, given an MRA of 55. We find that the penalty for deviating from the optimal retirement age is smaller under FERS. Those who retire earlier or who retire later than the optimal age will not
lose as much in net earnings and retirement wealth by failing to retire at the wealth-maximizing retirement age under FERS. While FERS is more likely than CSRS to encourage senior personnel to stay in the civil service rather than retire at age 55, it is also more likely to encourage them to leave earlier. This aspect of FERS is not consistent with earlier hypotheses regarding the retirement incentives embedded in FERS. If the goal is to retain more senior personnel, then the retirement system needs to be constructed such that the optimal retirement age shifts up for them.

We also find that the generosity of FERS gives junior and mid-career employees an incentive to stay that is stronger than it would have been had they been under CSRS. Separation incentives are weaker under FERS for those in their early and mid-careers because the cost of leaving is greater under FERS. In contrast, for those nearing retirement, we find that separation incentives are stronger under FERS than they are under CSRS. Whether the stronger separation incentives for these personnel are sufficient to offset the weaker separation incentive for those in their mid-careers is an open question. Since greater turnover in the more-senior ranks provides greater promotion opportunities for those in the junior ranks, whether FERS provides greater or fewer promotion opportunities overall is also unclear.

Empirically, we estimate that the separation rate of early- and mid-career civil service personnel under FERS is 45 percent lower than the rate for similar early- and mid-career personnel under CSRS. It is likely that this estimate overstates the difference in separation rates. The bias arises because of difficulties in disentangling empirically the effect of FERS on separation rates from the effect of changes in environment factors in general on separation rates. Nonetheless, our empirical analysis suggests that separation rates are not higher for early and mid-career under FERS, contrary to the initial intent of FERS, and appear to be substantially lower.

These results suggest that turnover targets for junior and mid-career personnel need to be pursued outside of the retirement benefits package since the current retirement systems are not producing the desired turnover results. Determining how effective other forms of compensation, such as separation pay, would be in meeting these targets should be an area for future research.

As for switching to FERS, we find that those who face the switch decision early in their careers are better off financially by switching, given our assumption of a 6 percent real return on the TSP. Those who face this decision later in their careers are not better off if they plan to stay in the civil service until they retire.

These results have implications for the switch window opened during the second half of 1998 for employees covered by CSRS. Since those covered by CSRS in 1998 would not be in their early or mid-careers but would have at least 14 YOS, our results suggest these individuals would generally be worse off by switching to FERS if they plan to stay in the civil service until retirement.

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1There were no data yet available for 1998 as of the writing of this report.
However, at higher assumed rates, such as a 15 percent real return on the TSP fund, we predict that they would be better off financially by having switched. Therefore, whether many more individuals than expected switched to FERS in 1998 depended crucially on what these individuals believed about the future real return on the TSP. Given the enormous growth in the stock market returns in recent years, individuals facing the switch decision may have believed that such returns could be earned over the rest of their careers. In that case, larger numbers than might otherwise have been expected may have chosen to switch to FERS. Since FERS costs more to the agencies that employ them (GAO, 1998), differences in the number of individuals who switched could have important cost implications for these agencies.