UNITED STATES

United States: pension system in 2006

The publicly provided pension benefit, known as social security, has a progressive benefit formula. There is also a means-tested top-up payment available for low-income pensioners.

Key indicators

		United States	OECD
Average earnings	USD	39 400	35 800
	USD	39 400	35 800
Public pension spending	% of GDP	6.0	7.2
Life expectancy	at birth	77.8	78.9
	at age 65	83.6	83.4
Population over age 65	% of working-age population	20.8	23.8

Qualifying conditions

The pension age (called normal retirement age, or NRA) is 66 in 2006, and will later be increasing to 67 in steps. Eligibility for retirement benefits depends on the number of years in which contributions are made with a minimum requirement of ten years' contributions. Early retirement is possible from 62 with reduced benefits.

Benefit calculation

Earnings-related

The benefit formula is progressive. The first USD 656 a month of relevant earnings attracts a 90% replacement rate. The band of earnings between USD 656 and USD 3 955 a month is replaced at 32%. These thresholds are 20 and 121% of average earnings, respectively. A replacement rate of 15% applies between the latter threshold and the earnings ceiling. A 50% dependants' addition is available to married couples where secondary earners have built up a smaller entitlement and for a qualifying dependent child.

Earlier years' earnings are revalued up to the year in which the recipient reaches age 60 in line with growth in economy-wide average earnings. There is no adjustment of earnings for years after age 60. The basic benefit is computed for payment at age 62. Thereafter, the basic benefit is adjusted in line with prices. The benefit is based on the career average earnings for the 35 highest years of earnings (after revaluing) including years with zero earnings if needed to total 35 years.

The earnings ceiling for both contributions and benefits is USD 94 200 a year, corresponding to 239% of average earnings uprated annually in line with growth in economy-wide earnings.

Pensions in payment are adjusted in line with price increases.

Minimum

There is a minimum pension under social security. People earning less than a special minimum primary insurance amount are given a minimum pension that depends on their lifetime total years of coverage, varying between USD 33 for 11 years' coverage and USD 683 for 30 years'. The threshold for this minimum pension was USD 10 485 in 2006, or 27% of average earnings. (The threshold is defined formally as 15% of the "old law" contribution and benefit base.) The minimum pension does not affect the modelling results because the earnings range affected is below that presented.

Targeted

The United States provide a means-tested benefit for the elderly, known as supplemental security income.[1] Individuals without an eligible spouse over the age of 65 can be eligible for up to USD 7 236 a year depending on assets and other income. The benefit rate for cases where both members of a couple are eligible is USD 10 848 (33% higher than the rate for singles). These benefit rates are equivalent to around 18% and 28% of the national average wage, respectively. The benefit is indexed to price increases.

The asset tests are strict: individuals without an eligible spouse are limited to USD 2 000 worth of assets and eligible couples to USD 3 000, excluding personal belongings, a home, a car, funeral insurance and life insurance (the last two up to USD 1 500 in value). There is a small (USD 20 a month) "disregard" in calculating the entitlement. The benefit is then withdrawn at a 100% rate against income above this level.

The analysis is complicated by the fact that states can supplement the federally determined minimum. While 8 states pay only the federal minimum, 29 administer their own system, nine offer supplements that are operated solely by the federal Social Security Administration (SSA), and six offer supplements administered by both the state and SSA. The average supplemental payment in the 15 states with SSA administration is 29% of the maximum federal benefit for single pensioners and 50% for couples.[2] Note that the modelling does not include these additional payments.

Voluntary private pensions

Some 46% of employees are members of an occupational pension scheme and around 35% have personal plans. Because some people have both plan types, overall coverage of voluntary private pensions is 58%. Defined-contribution arrangements have become much more common. Evidence suggests that average contribution rates (employee plus employer) are around 9% of earnings.

A minority of workers continue to have defined-benefit occupational plans. Based on evidence from a national survey of such schemes, the modelling assumes an accrual rate of 1% of earnings for each year of service.

Variant careers

Early retirement

Early retirement is possible from 62, subject to an actuarial reduction. For each year of retirement before the normal age, the benefit is reduced by $6^2/_3$%. However, after three years, the reduction falls to 5%. This applies to retirees with a normal retirement age (NRA) of over 65. For retirees becoming eligible at age 62 in 2006, the normal retirement age is 66 years. This will increase gradually to reach 67 for people becoming eligible for retirement in 2022.

1. Supplemental Security Income benefits are also payable to eligible blind or disabled individuals.

2. Excludes those classified as blind or disabled.

Late retirement

Initial receipt of the pension may be deferred until after NRA, and credit is given for deferment up to age 70. The actuarial increment for 2006 is 7.5% for each year deferred. It will increase to 8% in 2008.

It is also possible to combine work and pension receipt subject to an earnings test. For beneficiaries of age under their NRA, the pension is reduced by 50% of earnings in excess of USD 12 480. For workers who have reached their NRA, there is no benefit reduction based on earnings.

Childcare

There are no provisions for credits during periods of childcare (except for workers who become disabled at younger ages, who may drop years of child care from their benefit computation).

Unemployment

There are no provisions for credits during periods of unemployment. However, periods of unemployment may be omitted from the calculation of earnings for benefit purposes in many cases as only the highest 35 years of earnings are considered. Periods of disability are omitted from the 35 years of earnings considered.

Personal income tax and social security contributions

Taxation of pensioners

Older people are entitled to an additional standard deduction in the Federal income tax. For single people of working age, the deduction is USD 5 150 compared with USD 6 400 for the over 65s. A married couple in which both partners are over 65 is entitled to a deduction of USD 12 300, compared with a standard deduction of USD 10 300 for working-age couples. There is also a tax credit targeted on poorer pensioners and the disabled. The maximum credit is USD 750 for an individual (single head of household and widows and widowers), but this is withdrawn against income and is exhausted once total income exceeds USD 17 500 or non-taxable public pension benefits exceed USD 5 000.

Taxation of pension income

A portion of social security (public pension) benefits may be taxable. The amount that is included in income is the lesser of one-half of the benefits or one-half of the excess of the pensioner's income (including one-half of the benefits) over a base amount equal to USD 25 000 for a single individual (USD32 000 for a married couple). However, up to 85% of social security benefits may be included in income if the pensioner's income (including one-half of the benefits) exceeds a higher adjusted base amount equal to USD 34 000 for a single individual (USD 44 000 for a married couple). Pensioners with income (including one-half of the social security benefits) that exceeds the adjusted base amount must include in income the lesser of (A) the sum of (1) 85 percent of the excess of income (including one-half of the benefits) over the adjusted base amount, plus (2) the lesser of the amount that would otherwise be includable if the 85% rule did not apply, or USD 4 500 (USD 6 000 for a married couple), or (B) 85 percent of social security benefits.

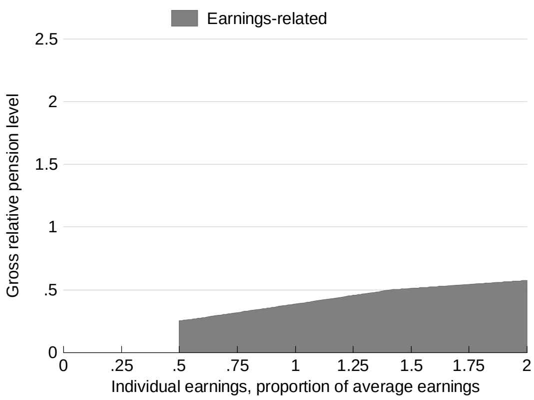
Differences in personal-income-tax structures between states complicate analysis of the United States. For the main empirical results, the OECD standard methodology, which assumes that the **example** individual lives in Detroit, Michigan, has been applied. The state income tax system for Michigan gives an extra tax-free allowance of USD 2 100 for people over age 65 (USD 4 200 for a married couple filing jointly). Public pensions are entirely exempt from the state income tax, as is the first USD 40 920 of income from a private pension. However, if the individual receives both public and private pensions, the amount of income from the public pension is used to offset the USD 40 920 exemption amount. All income from pensions is exempt from the Detroit income tax.

Social security contributions paid by pensioners

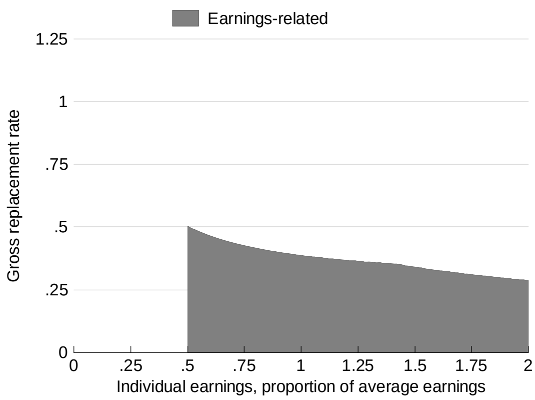
No social security contributions are levied on pension income.

Pension modelling results: United States

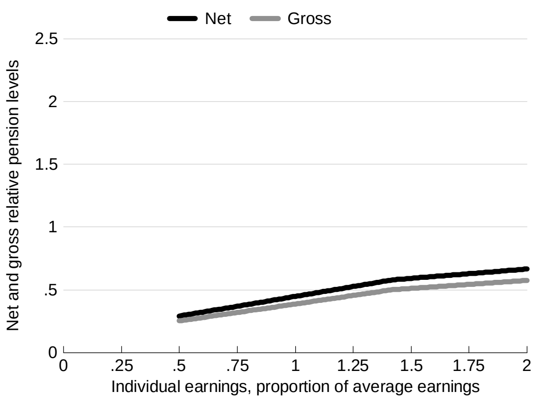
Gross relative pension level



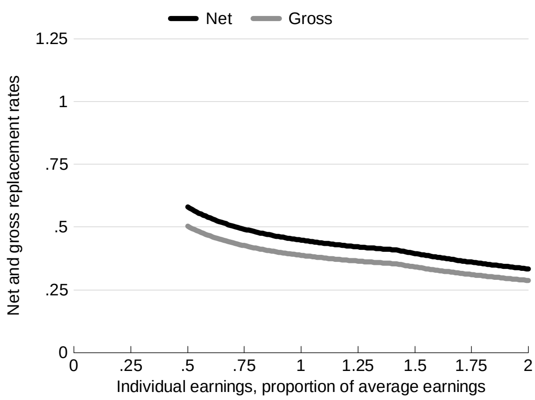
Gross replacement rate



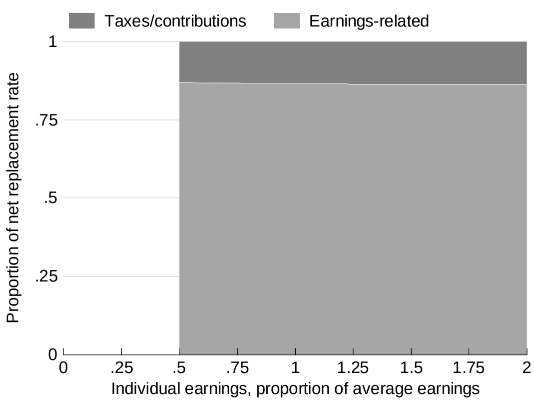
Net and gross relative pension levels



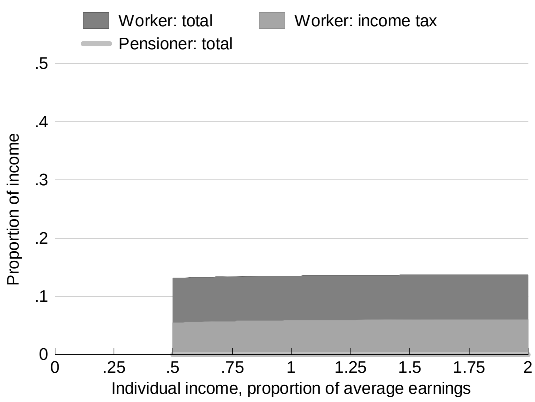
Net and gross replacement rates



Sources of net replacement rate



Taxes paid by pensioners and workers



Men *Women* (where different)	*Median earner*	*Individual earnings, multiple of average*				
		0.5	*0.75*	*1*	*1.5*	*2*
Gross relative pension level (% average gross earnings)	34.7	25.2	31.9	38.7	51.2	57.5
Net relative pension level (% net average earnings)	40.1	29.1	36.9	44.8	59.2	66.5
Gross replacement rate (% individual gross earnings)	40.8	50.3	42.6	38.7	34.1	28.8
Net replacement rate (% individual net earnings)	47.1	57.9	49.2	44.8	39.5	33.3
Gross pension wealth (multiple of average gross earnings)	5.8 *6.8*	7.2 *8.3*	6.1 *7.1*	5.5 *6.4*	4.9 *5.7*	4.1 *4.8*
Net pension wealth (multiple of average net earnings)	5.8 *6.8*	7.2 *8.3*	6.1 *7.1*	5.5 *6.4*	4.9 *5.7*	4.1 *4.8*