2015 Pension Policy Notes

UNITED STATES

- **Improve Social Security retirement benefits through higher contribution rates and increase old-age safety net levels while reducing withdrawal rates**
- **Expand the pension coverage of low-income workers through automatic enrolment in 401k systems**

The mandatory pension system provides low benefit levels. The pension system consists of an earnings-related component, with a social assistance benefit for the most vulnerable. Full-career average-wage workers would receive a benefit equivalent to 45% of previous net earnings, low earners 54% and high earners 39%, which puts benefits for all three earnings levels in the lowest quartile of OECD countries. In addition, voluntary pension systems are available for some workers, which employers may offer through several mechanisms. The most common forms are private pension funds, which can be defined benefit (DB), defined contribution (DC) or hybrid. In addition, there are many employee retirement funds sponsored by state and local governments, which are often large and mostly DB. Historically, DB plans have been the main type of pension plans, but these have been overtaken by DC plans, including 401(k) plans. Assuming a full-career contribution, at a rate of 9%, to a voluntary DC scheme, the net replacement rate would increase by about 37 percentage points across all earnings levels, resulting in the 10th highest in the OECD. Retirees with very low incomes can claim a means-tested safety-net. Overall, the relative average income of people aged 66 to 75 (versus that of the whole population) is currently well above the OECD average, but it falls below the average for the 76+ age group. The old-age poverty rate, however, is the sixth highest in the OECD and is 4 percentage points above that for the total population.

Key indicators: United States and OECD average

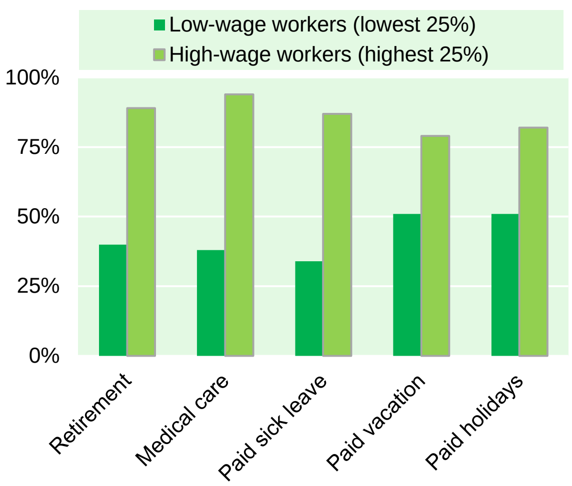
	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20	65.0 (60.0)	65.0 (60.0)	65.0 (60.0)	65.0 (60.0)		65.0	
Retirement age	65.0 (60.0)	65.0 (60.0)	65.0 (60.0)	65.0 (60.0)	62.9 (61.8)	65.0	64.6 (64.4)
Net replacement rate, avg earner						44.8	63.2 (62.7)
Total mandatory contribution rate		12.4	12.4	12.4	19.1		
Total pension spending, % of GDP	8.4	9.1	9.3	11.2	10.3		
Public pension spending, % of GDP	6.0	6.1	5.7	6.7	8.4		
Public debt, % of GDP	55	68	67	111	115		
Employment rate 55-64, %	65.0 (40.2)	63.6 (47.5)	67.0 (55.1)	66.8 (56.3)	66.1 (49.1)		
Labour-market exit age	65.8 (65.1)	64.2 (63.6)	64.6 (63.2)	65.9 (64.7)	64.6 (63.1)		
Old-age poverty rate, %	22.4	21.1	23.8	21.5	12.6		
Life expectancy at 65, years	14.7 (18.7)	15.8 (19.1)	17.4 (20.1)	18.5 (21.0)	18.4 (21.5)	22.4 (24.4)	22.9 (25.9)
Old-age dependency ratio	0.21	0.21	0.21	0.25	0.28	0.44	0.57
Fertility rate	1.9	2.0	2.1	1.9	1.7	1.9	1.8

Note: The figures for women appear in parenthesis where they differ from those for men.
Long-term: Around 2060 based on all legislated reforms up to mid-2015.

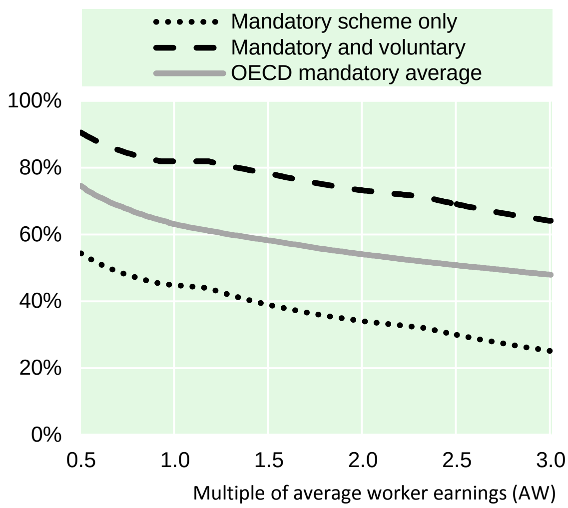
Limited reforms have taken place since the 1980s. The United States was one of the first countries to legislate an increase of the pension age to 67 in 1983 which will be phased in by 2027. Beyond this the pension system has remained unchanged for the last 30 years. The United States has favourable demographics in comparison to virtually all other OECD countries, yet further steps will be needed down the road to ensure sustainability of the pension system. Retirement ages will have to be increased either by new long-term legislation to a set age, as happened in the 1980s, or via a direct link to projected gains in life expectancy.

Private pension coverage among low-income earners is low, which translates into high levels of income poverty. Overall 47% of those aged 15 to 64 are covered by a voluntary pension, whether occupational or personal or in many cases both, but coverage varies with earnings. In the United States low-wage workers often have lower access than high-wage workers to private health insurance, pensions, and other leave entitlements. These factors imply insufficient savings, can increase stress and harm health but also increase poverty risks at retirement, especially given the low level of old-age safety nets. Relative income poverty rates for the 66 to 75 age group match the figure for the overall population figure, which is itself high compared with other countries, and the group aged 76+ has a 10 percentage points higher poverty risk. For those without direct access to employer plans, the new myRA (my retirement account) should increase coverage further. As the initial capital is guaranteed with no fees it is hoped to encourage lower earners to contribute.

Percentage of workers eligible for private benefits by income



Long-term net replacement rates (%), by earnings level



Sources: OECD Economic Survey the United States 2014; OECD pension models

Both Social Security contributions and coverage of voluntary pensions will need to increase if the US pension system is to deliver decent retirement incomes at an affordable cost. Currently employees and employers both pay 6.2% of earnings to finance the earnings-related component of the social security scheme, much lower than the OECD average total contribution of 19.1%. With reserves likely to be depleted by 2035, additional contributions are needed to ensure sustainability, and if possible increase the level of benefit. Although many States provide additional supplements to the safety-net benefit (the Supplemental Security Income), the base level is low in comparison to the majority of OECD countries, at 17% of average earnings compared to the OECD average of 22%. When taking into account the level of GDP per capita, the United States is an outlier with a very low benefit level. Reducing the safety net withdrawal rate against other income, from its current 100% level, would provide higher benefits to low-income workers upon retirement and help encourage even low income people to take some responsibility for their own retirement incomes. In addition, the coverage level for voluntary pensions needs to be increased. Consideration should be given to establishing an auto-enrolment mechanism at the federal level in, for example, 401(k) systems. New Zealand and the United Kingdom have introduced such schemes.

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