Pensions at a Glance 2019

How does THE UNITED STATES compare?

27 November 2019

Key findings

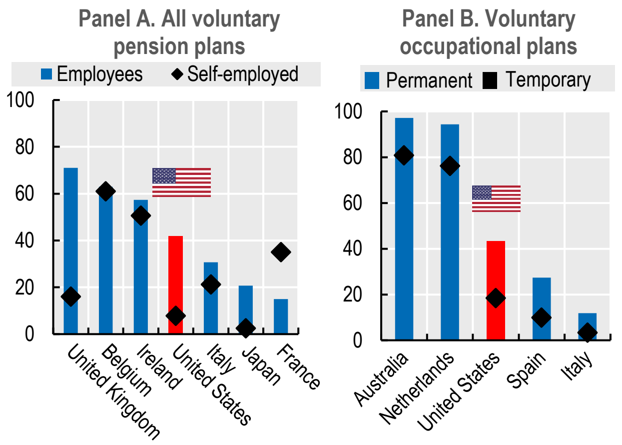
- The mandatory public pension scheme in the United States covers self-employed workers in a similar way as employees. A self-employed and an employee with the same net income from work during a full career will receive the same pension from the mandatory scheme against a 20%-lower level for the self-employed on average in the OECD.
- The private pension coverage of the self-employed remains much below that for employees. Some occupational schemes exclude employees with low earnings including those from part-time work and set long vesting periods before temporary workers get access to the pension scheme, which also leads to low coverage.
- The United States is one of only six OECD countries that calculates mandatory pensions based on only part of total career earnings. This cushions the pension impact of short career breaks and might limit incentives to contribute after reaching 35 contribution years.
- The employment rate of older workers (aged 55-64) has grown by five percentage points since 2000 in the United States against 18 percentage points on average in the OECD, and both are now at 60-65%.
- Relative old-age poverty rates and old-age income inequality are very high in the United States.
- The future net pension replacement rate from mandatory schemes for a full-career average-wage worker equals 49% against an OECD average of 59%. Contributing to voluntary private pensions throughout their career or only from age 45 would increase it to 84% or 62%, respectively.

Workers in non-standard jobs are not well covered by voluntary pensions

The mandatory public pension scheme in the United States covers self-employed workers in a similar way as employees. The old-age benefit from mandatory pensions is the same between the self-employed and dependent workers for individuals with a full career from age 22 in 2018 with the same net income from work. This compares to a 20%-lower level for the self-employed on average in the OECD. However, underreporting may reduce the effective coverage. One-third of the self-employed admittedly underreport earnings for tax purposes according to a 2018 survey. Moreover, the self-employed are much less often covered by voluntary private pensions than employees, and do not benefit of course from employer's matching contributions, which in turn significantly reduces incentives to participate in such schemes. Temporary workers face a long vesting period of three years before getting access to private Simplified Employee Pension schemes, which also leads to a low coverage rate of only 18% compared with 43% for permanent employees. The accelerating digital transformation may create more non-standard jobs like platform workers, compounding problems raised by insufficient coverage. In addition, occupational schemes are allowed to exclude employees with earnings below a certain threshold (e.g. 8% of average earnings in Savings Incentive Match Plans for Employees), hence particularly affecting part-time workers.

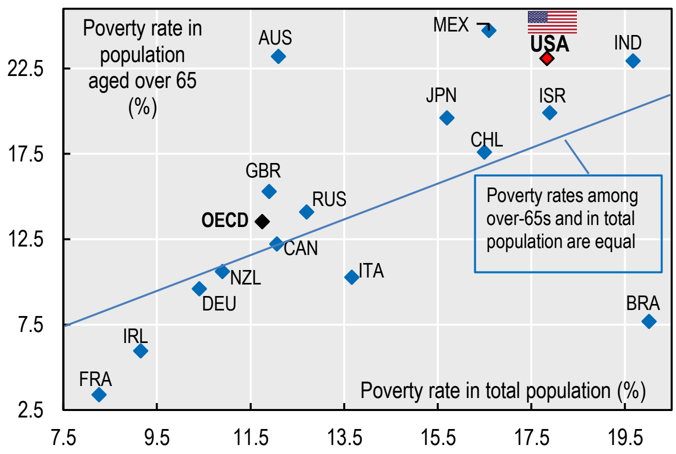
Relative income poverty (below half the median equivalised household income) is high in the United States in general, and among the elderly in particular. It affects 20% of the 66-75 year olds and 28% of those aged 76 and over - rates that are close to those in India and Mexico - compared to the OECD averages of 12% and 16%, respectively. As in most OECD countries, older women face much higher poverty risks than men. Yet, people older than 65 years have an average income equal to 94% of that of the total population, against 87% in the OECD, reflecting a high level of old age inequality in the United States.

Participation in funded pensions by employment status (%)



Source: Figures 3.5 and 3.6.

Relative old-age poverty rate is especially high in the USA



Source: Figure 7.2.

The future net pension replacement rate from mandatory schemes for a full-career average-wage worker equals 49% against an OECD average of 59%.It is higher at 61% for low-income earners, but still below the OECD average of 68%. Additional income from personal or occupational pensions is therefore critical to reach more adequate pension income.

Private pensions play an important role in providing old-age income in the United States. The country has one of the longest traditions of complementing public pensions with voluntary private pensions. About half of the working-age population (15-64 years) is covered by voluntary private pension schemes: 44% participate in occupational pension schemes and 19% in personal plans, with some having both. While this exceeds the coverage in many other OECD countries, in Germany and New Zealand voluntary private pensions cover more than 70%.

The future net replacement rate of an average-wage earner increases to 84% if voluntary contributions at 9% of gross wages are made throughout the whole career. However, accounting for contributions from age 45 only leads to a projected replacement rate of about 62%. Moreover, these numbers are based on annuitising accumulated pension assets at retirement age, which currently rarely happens: low annuitisation exposes older people to large risks of outliving their assets.

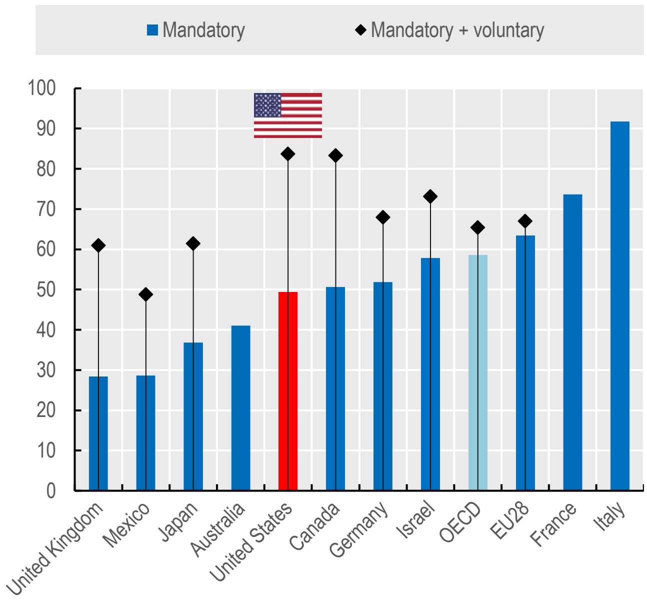
The populations of all OECD countries are ageing. However, this process is less pronounced in the United States, which will be among the OECD countries with the lowest old-age to working-age ratio by the middle of this century. The working-age population based on fixed age boundaries (20-64) is even expected to grow by 9% until 2050 compared to a 10% drop on average in the OECD.

Working longer could partly offset the still considerable projected increase in the old-age to working-age ratio and would improve both the financial sustainability of the pension system and retirement-income adequacy. Employment rates of older workers aged 55-64 have grown in almost all OECD countries since the turn of the century and on average by 18 percentage points, reaching a level of about 60% in 2018, similar to the United States. The employment rate of the 55-64 increased by five percentage points in the United States over the same time span.

The United States is one of only six OECD countries that calculates mandatory pensions based on only a part of all career earnings. Therefore, accumulating additional public pension entitlements from continued work after reaching 35 contribution years is limited. There is no additional accrual and earnings below the 35 best career years does not generate additional pension entitlements. This limits the incentives to continue contributing to the system, in particular on a part-time basis. However, it also cushions the impact on pensions of some periods of part-time work or career breaks due to childcare or unemployment. Therefore and although the pension system in the United States does not grant any special credits for unemployment or – as the only OECD country - childcare breaks a 5-year later labour market entry and a 10-year unemployment spell lead to a drop in the gross replacement rate of an average earner of only 10% compared to 25% on average in the OECD.

Private pensions are potentially important in the United States

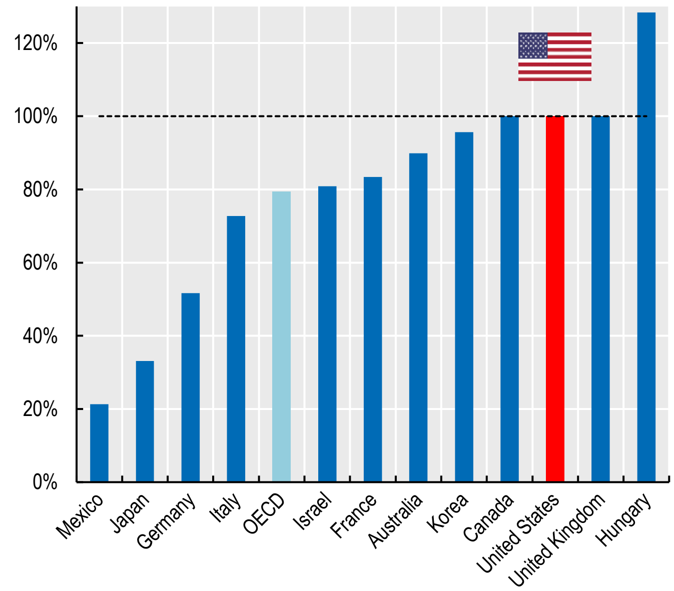
Net replacement rates (%) from mandatory and voluntary schemes, average-wage earner contributing during a full career



Note: Voluntary contribution equals 9%. Source: Table 5.6.

Mandatory pension of a self-employed in % of that of an employee with comparable career earnings

Based on a full career from age 22 in 2018



Note: Based on the same taxable income from work for the self-employed and the employee, equal to the average net wage before taxes, for individuals with a full career from age 22 in 2018 and contributing only the amount that is mandatory to pensions. Source: Figure 2.13.

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