Pensions at a Glance 2015

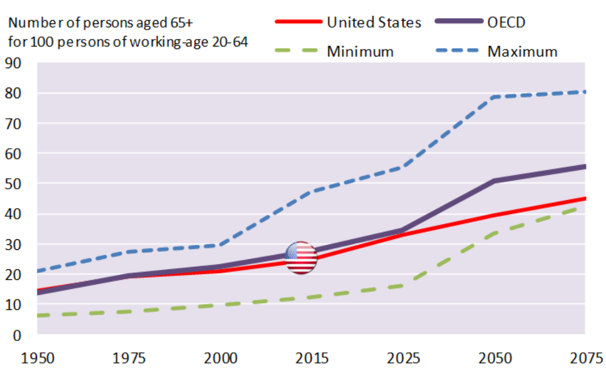
UNITED STATES

1 December 2015

Key findings

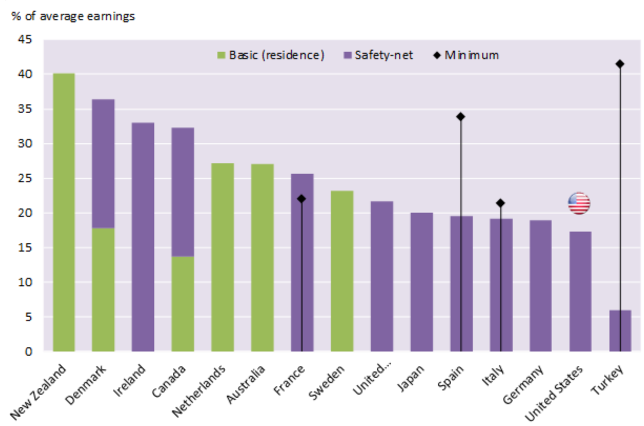
- **Poverty rates for older people are high when compared to the whole population and to other OECD countries.** Currently, 21.5% of people over 65 live in income poverty in the United States relative to 17.6% for the whole population. This compares to 12.6% and 11.4% for the OECD average, respectively.
- **The value of the safety net is low.** Elderly individuals who meet the means-test are topped up to an income level of 17% of the average earnings against 22% on average in the OECD. Safety benefits have been falling in relative terms since they only follow changes in prices, resulting in a decline of the safety-net benefit by about 7% relative to wages between 2002 and 2014.
- **The future net pension replacement rate from mandatory schemes for a full-career average-wage worker equals 45% against an OECD average of 63%.** In the United States, low income earners see a larger part of their incomes replaced than higher earners. Yet, workers on half the average wage who retire after a full career may expect a net replacement rate of 54% relative to 75% on average across the OECD.
- **Private pensions play an important role in providing incomes for old age in the United States.** In the United States the net replacement rates of an average earner from public schemes alone is 45%, compared with 63% across OECD countries. Assuming that workers contribute to voluntary private pensions throughout their career at a rate of 9% the average-earner replacement rate would increase to 82% .
- **Population ageing is less pronounced in the United States, which will become one of the OECD countries with the lowest old-age dependency ratios.** This is mostly due to inward migration of workers and relatively high fertility rates. The United States currently has 25 people aged over 65 per 100 of working age; the figure is projected to increase to 40 in 2050. The OECD average is 28 and 49, respectively.
- **The employment rate of older works has been growing slowly in the United States.** Working longer would improve both the financial sustainability of the pension system and retirement-income adequacy. Employment rates of people aged between 55 and 64 have increased by 8 percentage points on average in the OECD, from 48% in 2004 to 56% in 2014. In the United States, however, the rate only increased from 60% to 61%.

Figure 1: Demographic dependency ratio



[PAG2015 Table 7.5]

Figure 2: Value of first–tier pensions



[PAG2015 Figure 2.6]

Why is it important for the United States?

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. The net replacement rates of an average earner increases from 45% with public schemes only to 82% when full-career voluntary pension contributions at 9% are taken into account.

The coverage of the working-age population (15-64 years) in private pension schemes is equal to 47%: 42% participate in voluntary occupational pension schemes and 22% in voluntary personal plans, with some having both. While this is around the OECD average, in Germany and New Zealand voluntary private pensions cover more than 70%.

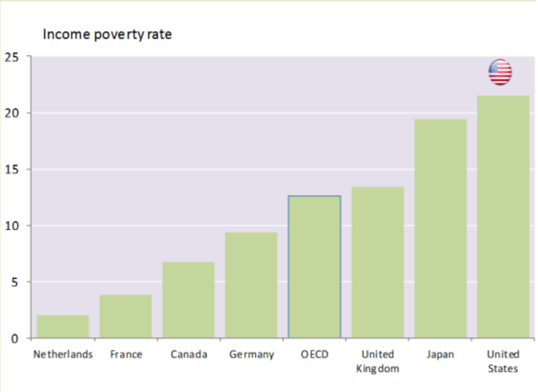
Income poverty (at half the median equivalised household income) is high in the United States, in general and among the elderly in particular. Poverty among the "younger old" (aged 66-75) stands at 17.5% and is lower than among the "older old" (aged 75 and over) who have a poverty risk of 27% , compared to the OECD averages of 11.2% and 14.7%, respectively. There is a large gender gap in old age poverty with 26% of women aged 65 and above at risk of poverty compared to 16.5% of men in the same age group. The OECD average poverty rate for people aged over 65 equals 9% for men and 13% for women. On average, people aged 65 and above have incomes equal to 92% of those of the total population, against 87% on average in the OECD. Work is a more important income source in the United States than in most other countries: it accounts for more than 30% of older people's income.

The United States is a country with relatively high elderly poverty rates and low safety-net benefits. At 17% of average earnings, the level of the safety-net benefit is well below that of countries with similar GDP per capita levels. For example, the safety-net is 23% of average earnings in Sweden, 27% in Australia and 36% in Denmark which all have GDP per capita levels within 5% of that of the United States.

There is no paid maternity leave in the United States, contrary to all other OECD countries, and no credits are given for child care. However, an implicit mechanism exists to neutralise the impact of childcare breaks on pension entitlements: to earn the maximum level of public pension only 35 years of contributions are required. A person entering the labour market at age 20 and working until age 67 can have career breaks for up to 12 years without any impact on the public pension.

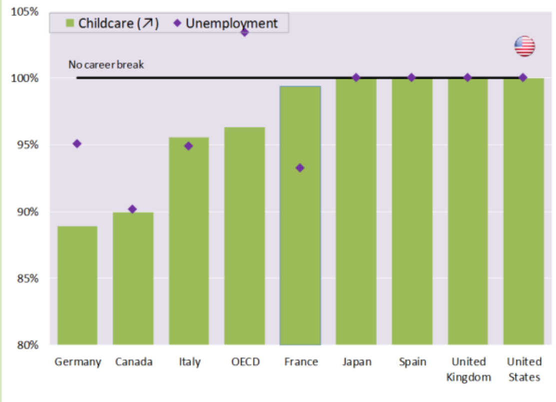
While the employment rate of older workers has remained basically flat over the last decade the average effective age of labour market exit is high at 65.9 years for men and 64.7 for women and just slightly below the normal retirement age of 66 years.

Figure 3: Income poverty rates for people aged 65 and above



[PAG2015 Table 8.3]

Figure 4: Effect of a 5 year break for childcare or unemployment on pension from mandatory schemes



[PAG2015 Figure 3.13]

Contacts

OECD Social Policy Division

Kristoffer Lundberg

☎ +33-1-4524 -1488

kristoffer.lundberg@oecd.org

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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

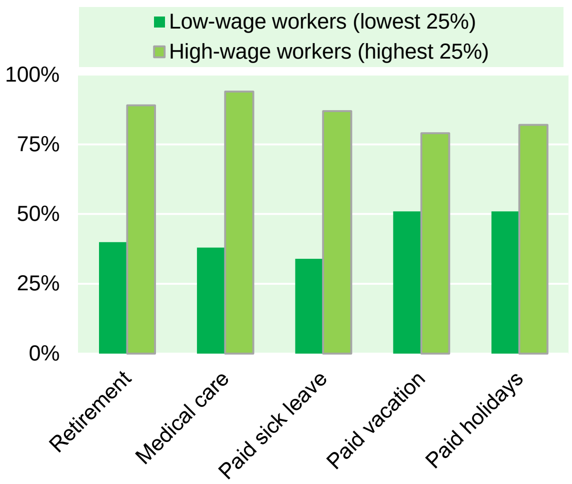
	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20	65.0	65.0	65.0	66.0		67.0	
Retirement age	65.0	65.0	65.0	66.0	62.9 (61.8)	67.0	64.6 (64.4)
Net replacement rate, avg earner						44.8	63.0 (62.6)
Total 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	20.5	21.5	20.5	24.7	27.9	44.1	57.2
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.

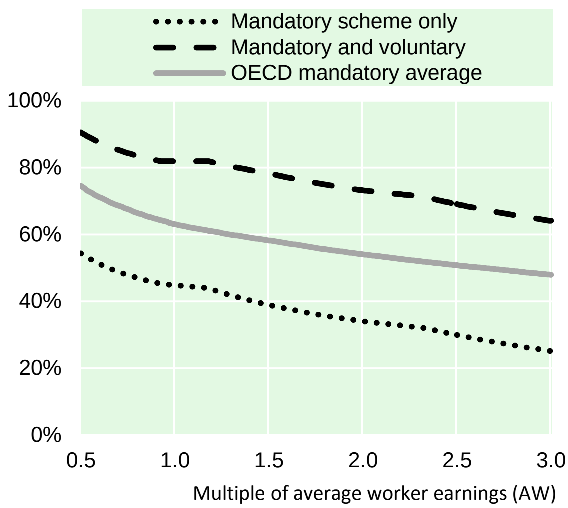
Limited reforms have taken place since the 1980s. The United States was one of the first countries to legislate an increase of the pension age to 67 in 1983 which will be phased in by 2027. Beyond this the pension system has remained unchanged for the last 30 years. The United States has favourable demographics 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.

For more information, please contact:

Andrew Reilly, andrew.reilly@oecd.org
+33 1 45 24 82 04

Hervé Boulhol, herve.boulhol@oecd.org
+33 1 45 24 84 58

Anna Cristina d'Addio, anna.daddio@oecd.org
+33 1 45 24 87 09

Kristoffer Lundberg, kristoffer.lundberg@oecd.org
+33 1 45 24 14 88

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