United States

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.

Qualifying conditions

The current pension age (called normal retirement age, or NRA) is between 65 and 66, 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 592 a month of relevant earnings attracts a 90% replacement rate. The band of earnings between USD 592 and USD 3 567 a month is replaced at 32%. These thresholds are 22 and 133% 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 all previous earnings between ages 60 and 62. Thereafter, previous earnings are adjusted in line with prices up to the age of 67. 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. On the baseline assumptions for price and earnings growth this results in a benefit 14% lower than if all earnings were fully revalued in line with earnings.

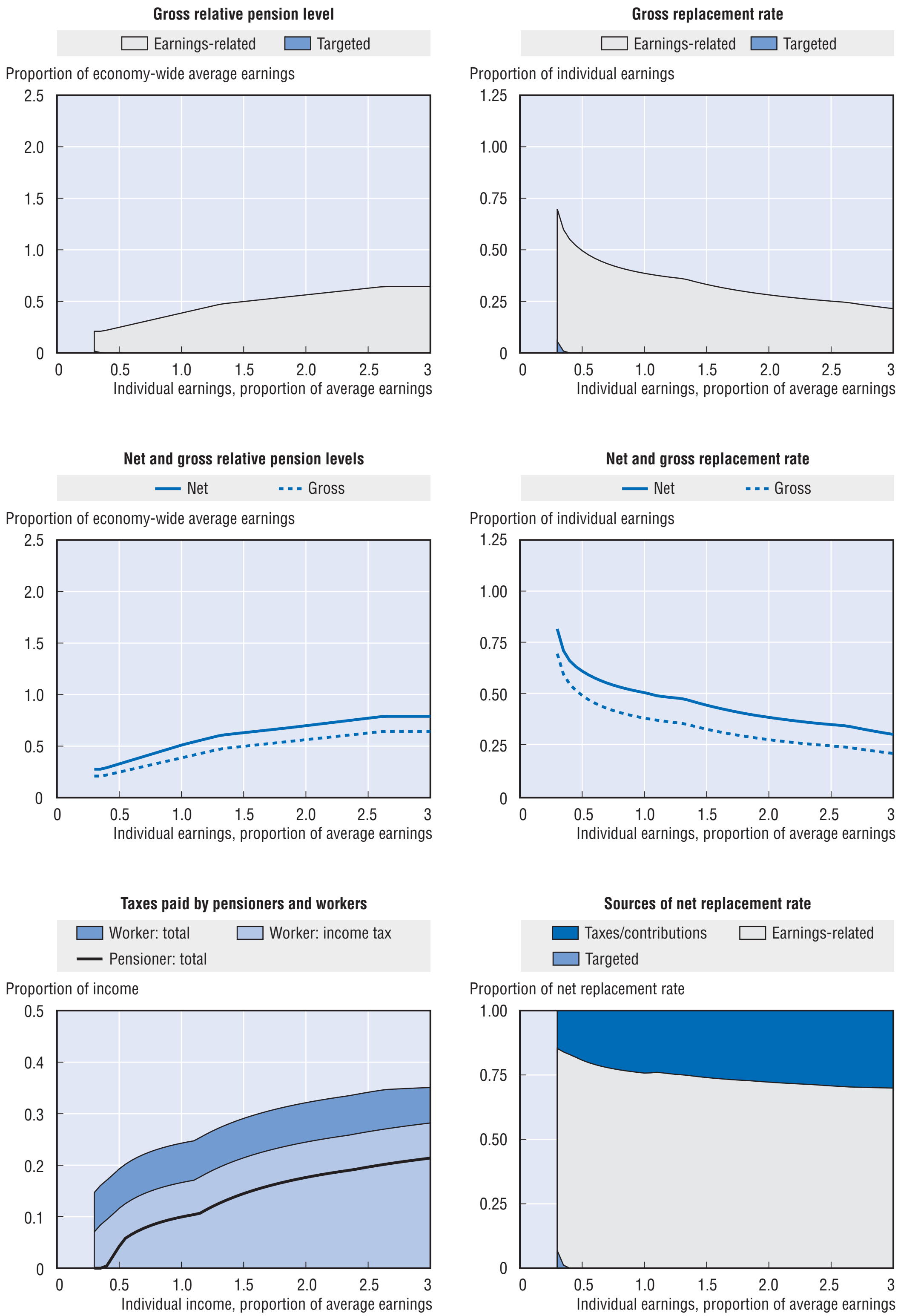
The earnings ceiling for both contributions and benefits is USD 84 900 a year – 2½ times average earnings – uprated annually in line with growth in economy-wide earnings.

Pensions in payment are adjusted in line with prices.

Minimum

There is a minimum pension under social security. People earnings 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 30 for 11 years' coverage and USD 626 for 30 years' coverage. The threshold for this minimum pension was USD 9 450 in 2002, or just under 30% 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.

Pension modelling results: United States



Source: OECD, based on information provided by the countries.

Targeted

The United States provide a means-tested benefit for the elderly, known as supplemental security income. Single people over the age of 65 can be eligible for up to USD 6 540 a year depending on assets and other income. The benefit rate for couples is USD 9 804 (50% higher than the rate for singles). These benefit rates are equivalent to around 20 and 29% of the national average wage, respectively. The benefit is indexed to prices.

The asset tests are strict: single people are limited to USD 2 000 worth of assets and 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 12 states pay only the federal minimum, some 28 administer their own system and 12 offer supplements that are operated by the federal Social Security Administration. The average additional payment in these 12 states is 13% for single pensioners and 18% for couples. Note that the modelling does not include these additional payments.

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 4 700 compared with USD 5 850 for the over 65s. A married couple in which both partners are over 65 is entitled to a deduction of USD 9 650, compared with a standard deduction of USD 7 850 for working-age couples. There is also a tax credit targeted on poorer pensioners and the disabled. The maximum credit is USD 1 125 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

Up to one-half of social security (public-pension) benefits is taxable if income, including one half of the pension, exceeds USD 25 000. This proportion can increase to a maximum of 85% for higher-income pensioners if half of social security benefits plus other income exceeds USD 34 000.

Differences in personal-income-tax structures between states complicate analysis of the United States. For the main empirical results, we have followed the OECD standard methodology, which assumes that the example individual lives in Detroit, Michigan. The state income tax system for Michigan gives an extra tax-free allowance of USD 900 for people over age 65 (USD 1 800 for a married couple filing jointly). Public pensions are entirely exempt from the state income tax, as is the first USD 33 810 of income from a private pension. All income from pensions is exempt from the Detroit income tax. (Note that the chart for average effective tax rates does not show the negative figure for low-income workers' personal income tax due to the earned income credit although this is calculated and used in the modelling.)

Social security contributions paid by pensioners

No social security contributions are levied on pension income.

Pension modelling results: United States

Men	Individual earnings, multiple of average					
Women (where different)	0.5	0.75	1	1.5	2	2.5
Gross pension level	24.8	31.7	38.6	49.8	56.3	62.7
(% of average earnings)						
Net pension level	32.7	41.9	51.0	63.0	69.8	77.1
(% of average net earnings)						
Gross replacement rate	49.6	42.3	38.6	33.2	28.1	25.1
(% of individual earnings)						
Net replacement rate	61.4	54.6	51.0	44.9	39.0	35.5
(% of individual net earnings)						
Gross pension wealth	3.5	4.5	5.5	7.1	8.0	8.9
(multiple of average earnings)	*4.1*	*5.3*	*6.4*	*8.3*	*9.3*	*10.4*
Net pension wealth	4.7	6.0	7.3	9.0	9.9	11.0
(multiple of average net earnings)	*5.4*	*6.9*	*8.5*	*10.5*	*11.6*	*12.8*

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Pensions at a Glance
Public Policies across OECD Countries

VOLUNTARY, OCCUPATIONAL PENSIONS

Occupational pension schemes, voluntarily provided by employers, are common in many OECD countries. This section shows detailed results on the value of these pension entitlements for four countries: Canada, Denmark, the United Kingdom and the United States. These four countries were chosen for three reasons. First, coverage of occupational pensions is broad: around one third of employees in Canada, a little under half in the United Kingdom and the United States and around 80% in Denmark.[1] Secondly, occupational pensions play an important role in providing retirement incomes. Thirdly, data are available on the rules and parameters of different employers' plans for these countries.[2, 3]

The analysis of the four countries that follows is presented in the same format as the country studies that discuss mandatory pension systems. These provide detailed descriptions of the rules and parameters chosen for the representative pension plan and the justification for that choice. The table below offers a cross-country summary of these provisions for the three countries where defined-benefit pension systems have been modelled. In Denmark, occupational pensions are of the defined-contribution type.

It is also important to note that defined-benefit occupational plans often have more generous rules for age of retirement than do national programmes. For comparison with other countries and with the results of mandatory pensions only, it is again assumed that people retire at the normal pension age of the public scheme. In practice, earlier retirement will result in lower benefits because of the smaller number of years over which pension accrues.

Parameters and rules for defined-benefit occupational pensions

	Canada	United Kingdom	United States
Earnings measure	Final salary (70%)	Final salary (95%)	Final salary (55%)
Vesting	5 years' service	2 years' service	5 years' service
Pension age	65	65	65 (47%)
Accrual rate	2% a year (70%)	1.25% a year (65%)	1.5% a year
Integration method	1.3% accrual up to public ceiling	–	–
Pre-retirement preservation	None	Price inflation	None
Post-retirement benefit adjustment	Half price inflation	Price inflation	None

Notes

1. See OECD (2001), Table 6.2 and Johnson (1998), Table 3.3.
2. The data for Canada come from OECD (1995). For the United Kingdom, data are drawn principally from the National Association of Pension Funds annual survey. The Government Actuary's survey is published with a huge delay, with 1995 data only available in 2001. Disney and Whitehouse (1994, 1996) provide simulations of pension entitlements for a range of different scheme rules and parameters. Data for the United States come mainly from Mitchell and Dykes (2000), which is based on a survey of schemes by the Department of Labor; see also Department of Labor (1999).
3. In other countries with broad coverage of occupational pensions – such as Germany, Japan and Switzerland – there have been no surveys of employer pension plans. It is impossible, therefore, to model with any degree of certainty the rules of a "typical" scheme.

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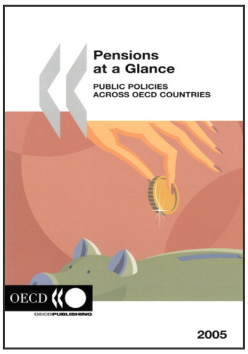

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