The Global Savings Gap

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June 2017

Executive Summary

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About this report

Many governments around the world are currently having to choose between reforming current pension systems to ensure their sustainability which is politically difficult, or maintaining the status quo which may ultimately risk bankrupting the state. But while reform might be necessary to ensure pension system sustainability, where does this leave individual pensioners? We certainly don't want to return to the past when older people were poor and destitute, unable to work and without security of income in later life. This would represent a dramatic reversal of decades of real progress. Instead, future pension systems will need to balance the need to be sustainable on the one hand, against the need to support adequate retirement incomes on the other. But pension systems must also support outcomes that are fair across generations. We need to be confident that our children and grandchildren will not face worse retirement outcomes than current generations of retirees.

In this context, this report explores the future of pension provision across high income countries and regions in light of demographic and economic change. Its principal aim is to identify how different pension systems compare with one another, both in terms of their future affordability, as well as their potential to promote and sustain a comfortable standard of living in later life. In addition, we seek to understand whether future generations of pensioners in different countries will be worse off in retirement than today's retirees.

Analytical approach

To illustrate these points, much of our analysis highlights and compares different countries' "savings gaps", which we have calculated to show how much individuals will need to save every year on top of what they are currently entitled to in order to secure adequate retirement incomes. We supplement this analysis with a small selection of detailed country and region profiles, each of which include findings from a bespoke survey of savings behaviours across more than 5,000 people in the USA, UK, France, Singapore and Hong Kong. Together, this comprehensive analysis enables us to draw conclusions about what features of different systems work well to support future sustainability and adequacy, and to develop solutions for measures that address common challenges facing pension systems worldwide.

The challenge: Pension systems and economies under pressure from ageing

- Longer lives are leading to longer periods of time in retirement, but governments may not be able to afford to pay pensioner benefits over extended periods, particularly with growth in the working age population stagnating or in some cases falling.
- While ageing may increase government expenditure, it will also have implications for economic activity. A slowdown or fall in the numbers of working age people will slow or reduce employment levels, curtailing economic potential.
- Increasing workforce productivity may help to compensate for a falling or stagnating labour force, but evidence suggests that a rising elderly share of the population is associated with lower productivity per person, reduced investment and lower inflation.
- Irrespective of the exact reasons for recent sluggish economic growth, we starkly illustrate what a new economic normal might mean. We calculate, based on IMF forecasts, that economic output per person across advanced economies may be as much as 44% lower in 2021 than we would have expected given pre-crisis trends.

The response: Personal savings as a solution to the sustainability challenge

- In the face of these fiscal and economic pressures, some high income countries are already reducing the generosity of state provision, while others have plans to do so in the near future. But unless individuals are able to supplement reduced public provision with income from their own pension savings or through other collective savings schemes, they are likely to face significant income shortfalls in later life.
- We estimate that a reliance on public provision plus any current mandatory pension schemes will only be sufficient to deliver adequate retirement incomes in 3 out of the 30 countries and regions we explored for this report. Of these, Singapore and Hong Kong are among the worst performers when looking at the shortfall as a proportion of average earnings. We estimate that individuals in these regions need to save an additional 12.5% and 15% of earnings respectively in order to close the adequacy gap. This is despite both countries already exhibiting high personal saving rates.
- In most OECD countries, private pension saving will be highly important for securing an adequate income in retirement. This is particularly relevant to those countries where state provision for retirement is not that generous such as the UK, USA and Canada.
- In the UK, USA and Canada, savers will need to put away between 11% and 18% of their earnings every year in order to afford a comfortable retirement. Each of these countries exhibit relatively widespread private pension coverage, but still a substantial proportion of the working age population do not save for retirement, while many of those that do save, fail to save enough. When we modelled the likely outcomes for typical private pension savers in each of these systems, the savings gaps shrunk considerably, showing how important such saving will be for future retirement prospects in these countries.
- There are a number of pension systems that do particularly well from having both a public pension component as well as a mandatory or quasi-mandatory pensions saving component. The Netherlands is an interesting exponent of this model - it is not projected to have any retirement income shortfall for average earners. Similarly, Denmark's pension system does well, supported by high contribution rates to mandatory occupational pension schemes, with strong employer contributions, as well as coverage through supplementary voluntary schemes.

Almost all developed countries face an intergenerational savings gap

- 28 of the 30 countries and regions we explored face an intergenerational savings gap. The average amount that someone entering the workforce today will have to save to enjoy the same retirement income adequacy as current retirees is around $5,080 or 12.6% of earnings.
- Unfortunately, current savings behaviours suggest this is unlikely. Even after accounting for expected saving into private pension schemes for those countries where such schemes are prevalent, today's twentysomethings are projected to do worse than current retirees. This is true for all OECD countries.
- By comparison to the OECD countries, Singapore and Hong Kong do not face an intergenerational gap, but this does not mean that future retirees in these regions will do well in retirement. Rather, they will do marginally better than current retirees who do particularly badly, suffering from low replacement rates and high levels of pensioner poverty.
- If people fail to save in the USA and UK, we calculate that they face an intergenerational gap in excess of $10,000 a year (over 20% of earnings). Anticipated savings behaviours in the US and UK reduce the gap but do not erase it altogether.
- France faces the biggest intergenerational savings gap of all countries explored in this report (26% of earnings). This is because current pensioners enjoy substantial income in retirement relative to their pre-retirement earnings, and we model anticipated reforms to reduce the generosity of state support over the coming decades.

Honing in on different pension systems

To better understand critical challenges facing pension systems in high income countries, we explored, in detail, the pension systems and savings behaviours across a number of different countries and regions: the USA, the UK, France, Singapore and Hong Kong. These were chosen because of interesting similarities as well as stark differences in systems, savings behaviours and retirement outcomes. Below we report our key findings.

The USA

- Public expenditure on old age social security in the USA is relatively low as a proportion of GDP which supports long run affordability.
- But this means it performs poorly on adequacy for those who fail to save privately, leading to relatively high pensioner poverty rates in the US.
- Increasing private pension coverage allied to raising pension contributions will be critical to deliver adequate retirement incomes for future US retirees.
- Our bespoke survey shows that US retirees are more likely to have a retirement savings target than in the UK and France, only a minority are actively contributing to a private pension - 28% of those earning above $75,000 a year save towards a private pension, while only 3% of those earning less than $25,000 make private pension savings.

The UK

- Public expenditure on old age social security in the UK is one of the lowest as a proportion of GDP across the OECD, supporting long run affordability.
- This means that individuals in the UK have to save a high proportion of their earnings in order to be confident of a comfortable retirement. Automatic enrolment in the UK has helped to support coverage, but even after this is taken into account in our modelling, the UK is only middle ranking on adequacy and intergenerational fairness.
- Supporting wider coverage amongst a growing cohort of non-standard workers, and raising private pension contributions more broadly are key challenges, as is supporting increased financial capability as the choices facing consumers become more complex.
- Our bespoke survey confirms the need to save more with only 12.4% of people in the UK saving more than 15% of their earnings despite the need to save in excess of 18% to secure an adequate retirement income. People in the UK are also far less likely to have a retirement savings target than in the US, Singapore or Hong Kong.

France

- Strong state provision combined with mandatory occupational pension scheme membership has supported very high levels of retirement income adequacy amongst the current generation of retirees, and very early exits from the labour market (average age of 59).
- However, with the state's offering likely to become less generous over the long run in order to support affordability, we estimate a significant intergenerational gap – current retirees are likely to do much better from the French system than future retirees.
- According to our survey results, outside of contributions being made into mandatory schemes, only 24% of the French population are currently saving above 6% of their earnings, and in most cases, such savings are for rainy-day reasons rather than specifically for retirement.
- Perhaps because of the paternalistic nature of the French system, only a small proportion (7%) of the unretired population have a specific retirement savings target.

Singapore

- There is no universal basic pension in the Singaporean system, and limited means tested social security for the poorest, which makes it highly affordable.
- The Singaporean pension system is excellent at generating a high level of personal savings due to the significant level of responsibility placed on individuals to fund their own retirement through the mandatory Central Provident Fund.
- However, despite savings rates in excess of 20% of earnings, the system performs poorly on adequacy since there is no basic pension or significant safety net.
- Perhaps unsurprisingly given such high levels of personal responsibility, a relatively high proportion of the Singaporean population have a specific saving target (33%) though this still means that the vast majority do not.

Hong Kong

- With a mandatory defined contribution scheme for all employees (Mandatory Provident Fund), Hong Kong has achieved widespread pension coverage and fostered a culture of independent saving as a means of securing retirement income.
- However, as with Singapore, because there is no universal state pension provision, coupled with weak means tested support for the poorest, there are high levels of current and anticipated pensioner poverty. It is therefore good on affordability but not on adequacy.
- By comparison to the other four countries, people in Hong Kong are more likely to plan for their retirement, with 59% having a specific target for the amount of money they want to save and how to use it when they retire. As with other countries, the rainy day savings motive dominates (57%), but having money for retirement (41%), and paying for social care (24%) are also highly prominent motivators.

Addressing some common challenges

In light of our cross country analysis we come to some broad conclusions about how to address some of the common challenges facing pension systems.

Raising private pension coverage and contributions

- Supporting widespread saving into occupational pension schemes is a critical pillar of any sustainable pension system. Two public policy options look to be particularly successful in this regard, one which compels people to save as per the Singaporean, Hong Kong and French systems and another which "nudges" people to save as per the UK's auto-enrolment system. Simply hoping that people will save is unlikely to be sufficient.
- Allied to the problem of getting people to save into an occupational pension, is the issue of supporting such saving amongst the growing number of people in non-standard work, such as temporary or self-employment.
- In Hong Kong, all eligible workers including the self-employed are forced to put something away for retirement, but the self-employed will not, by definition, be able to benefit from any additional employer contribution. This represents a significant and growing challenge facing most pension systems.

Raising financial capability with mass market advice and sensible defaults

- With increasing emphasis on personal responsibility for retirement planning, people will need to be able to understand the benefits of deferring consumption for a later date, the value of investing in assets other than cash, the importance of asset diversification, and the virtues of buying some form of longevity insurance at the point of retirement. Therefore, in the long run, raising the financial capability of individuals will be very important in determining good outcomes for consumers.

- Raising capability does not just happen overnight. This must be supported by a financial advice market that works for the many and not the few, in conjunction with new advice models that utilise technological advancements such as robo advice to make advice more accessible, understandable and cost effective. Finally, there will always be people who are inert and do nothing in the face of complex decisions. Good product defaults that avoid the worst outcomes will be important in this regard.

Facilitating longer working lives

- Retirement income shortfalls can be plugged by either saving more, retiring later or increasing the level of state support. Since raising state support is likely to be costly due to rapid population ageing, it follows that many individuals are likely to have to save more and/or retire later than is currently the case.
- While raising pensionable age might be the easiest and most effective incentive to support longer working lives in many pension systems, it can have unintended side effects, including increasing the number of people who leave the workforce before reaching this age. A big challenge facing advanced economies is how they cope with an increase in economic inactivity rates before retirement age as people leave the workforce for health reasons or because they are caring for other family members.
- Widespread adoption of flexible working practises might help to prevent the retirement “cliff edge”. But for those who do drop out early, there may also be a mixture of public and private sector solutions including forms of unemployment insurance, which would could be targeted specifically at this group and act as a bridging mechanism between leaving work early and pensionable age.

Reducing inequality of retirement outcomes

- Supporting pension saving, longer working lives and raising financial capability are all vitally important if we are to build sustainable pension systems over the long run. But none of these are able to eradicate the substantial challenge of inequality that inevitably arises if pension systems increasingly rely on the individual to save for the future.
- Some individuals may have extended periods of unemployment, inactivity or experience low earnings throughout their working lives. They may not, therefore, be able to save for a pension, or if they do, they may not be able to put much away for retirement.
- Clearly, any action to compensate the disadvantaged will need to be affordable in the long run, while also going with the grain of an overarching policy framework which incentivises saving. This largely rules out a hike in the value of universal pensioner benefits, but may be consistent with a system of more generous means tested support for those who faced low earnings during working life.

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