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Closing the Global Retirement Savings Gap: A Tale of Two Numbers

By Han Yik

Retirement systems play a critical role in society and affect virtually every major stakeholder group, but the challenges facing them are large and continue to grow. At the World Economic Forum, we have been working on a project on Retirement Investment Systems Reform as part of our initiative on Shaping the Future of Long-Term Investing, Infrastructure, and Development. In May 2017, we released a white paper entitled "We'll Live to 100 – How Can We Afford It?" The numbers are staggering – the current retirement savings gap on a global basis was valued at US$70 trillion and projected to increase to approximately US$400 trillion by 2050. The US alone represents 40% of the current gap, at $28 trillion.

How do we close the gap? It is important to recognize that when we talk about the "gap," we are talking about the difference between two numbers: the liabilities and the underlying assets. This is crucial because to close the gap, we cannot simply tackle either number in isolation; we must make sure that the growth rate of the assets exceeds that of the liabilities. Increasing asset returns from 5% to 8% is not helpful if the underlying liabilities are growing at 12% (using purely illustrative/hypothetical numbers), because this means the gap will continue to grow.

How do we define these assets and the liabilities? From a mathematical standpoint, the liability is easy to define – we have a start date (retirement age), an end date (mortality), and a dollar amount (pension). The assets come from a combination of three major stakeholders: the government (Social Security), employers (benefits), and the individuals themselves (savings). The assets can grow in one of two ways: as additional contributions or investment returns on existing assets.

Using this framework, we can start looking for solutions. The longevity issue we addressed in our white paper relates to the end date in the liabilities. People are living longer (so the end date is extended). Absent any other changes, the liabilities increase, and the gap continues to grow. The two adjustments that can be made from the liability side are easy to define, but politically and/or logistically difficult to accomplish: deferring the start date (increasing retirement age) and reducing the pension amount.

On the asset side, a large contributor is the fact that many workers in developed and developing countries simply do not have access to pension plans or savings products,

and even among those who do, many are not saving. According to the US Government Accountability Office (GAO), 60 percent of all households and 44 percent of working households in the US today lack any retirement account savings (defined contribution; DC). In addition, one-half of families close to retirement age (i.e., age 55 and older) have no DC savings and one-third have neither a DC nor a defined benefit plan, making Social Security an important, if not essential, part of retirement income. That is why one of the major focuses in our project this year has been how to expand access — the impact on closing the gap will be more significant than improving returns for people who already have access to pension plans or are currently saving.

To that end, we have been holding a series of workshops where we bring together stakeholders from both the public sector and the private sector to work on potential solutions. At one such workshop (hosted by Mercer), in San Francisco last year, we convened a select group of representatives from five states and experts from around the world, including those who have expertise in implementing and managing well-established national DC systems.

The states represented at the workshop — California, Illinois, Maryland, Oregon, and Washington — are at various stages of designing and implementing new state-based retirement systems. Members of our Expert Committee came from GeorgetownCRI, EBRI, etc. Regulators from countries that have already implemented significant pension reform (Australia, Canada, the UK, and New Zealand) also participated.

The workshop setting enabled frank discussion of not only successes but also challenges in enacting those reforms. We held similar sessions this year in Davos, Switzerland, and Sao Paulo, Brazil, to address this issue of expanding access for all workers.

Regional differences are important and can be quite significant in terms of implementation – for example, issues around government mandates versus individual choice – but by and large, the problems are universal, because a) not very many factors are at play, given the framework of retirement systems, and b) increased life expectancy, while good for us overall, is putting strain on retirement systems globally, even among countries that have enacted significant reforms. The following are just some of the challenges:

One issue that is magnified in terms of pensions is the gender gap. Given that the income gap between men and women has been measured at 10–20% and adding the fact that women on average live longer than men, the gap on the pension side is estimated to be as high as 30–40%.

Portability of assets is a recurring theme. Countries with savings accounts tied to employers have found individuals possessing multiple accounts that are fragmented among different employers at differing times in their careers. In the European Union,

although employment is open across borders, pension programs remain very much tied to specific countries.

Incentivizing savings is an issue even if there is access to retirement savings accounts. Other than mandatory contributions, we must find ways to encourage individuals to save for their own futures.

Decumulation is an area of concern even among countries that have made significant progress on the accumulation end of their retirement systems. As people continue to live longer, we must address who can and should be responsible for ensuring that their accumulated assets last.

We will release our findings and proposals in May 2018 in a white paper that will explore these issues in greater detail and look at lessons that can be applied from best practices around the world.

Going back to the framework, it is imperative to address this issue comprehensively, on both the asset and liability side, because anything less will only allow the gap to continue to grow. All of us — policymakers, the private sector, and individuals — must be bolder and think long term to make an impact on tackling this issue.

Han Yik is the Head of Institutional Investors at the World Economic Forum.

Additional Resources:

World Economic Forum, Retirement Investment Systems Reform Project Homepage.

World Economic Forum, We'll Live to 100 – How Can We Afford It?, May 2017.

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