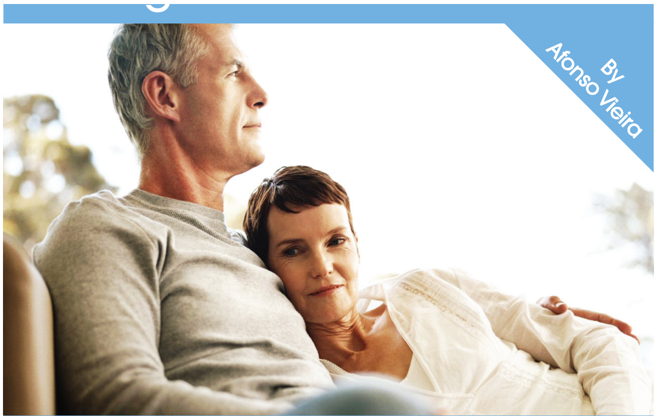
Retiring Poor



By Afonso Vieira

Traditionally, families have taken care of their own. But after WWII, governments became the main pension provider in rich countries. The old collectivist solution was the "pay-as-you-go" financing of pensions: today's workers pay for today's pensioners while keeping their fingers crossed that a future generation of employees will pay for their pensions. This works when there are many young and few old adults, but population aging and low fertility rates means more old people will need to be supported by young workers.

DEPENDENCY RATIO

The old-age dependency ratio is the ratio of the number of elderly persons at an age when they are generally economically inactive divided by the number of persons of working age. By 2030 this ratio will have increased to 31 in the US, 36 in Australia and the UK, 46 in Germany and 52 in Japan according to the United Nations. In Japan 2030 for instance, for every 52 pensioners there will only be 48 workers. This is clearly unsustainable.

	2010	2030
USA	19	31
Australia	21	36
UK	25	36
Germany	31	46
Japan	35	52

Before the financial crisis, the so-called pension time-bomb was a worry for rich countries. This is why governments have been devaluing their pension promises since the 1990s, by lowering pensions relative to earnings, by increasing pension age and by raising the contribution rates for workers. Now, because of the crisis, the IMF expects government debt in advanced G20 countries to jump from below 80 percent of GDP to over 100 percent within five years. Governments are struggling to keep pensions for the elderly from ripping gaping holes in future budgets.

PERSONAL PENSION

Young workers will be poor when they retire… unless they have a personal private pension scheme and save an adequate amount every year. The main difficulty to overcome is deferred gratification; until employees reach their 40s, retirement seems an awfully long way away. Spending cash straight away looks a lot more fun. This is a shame, in pension terms, because of the miracle of compound interest. Invest US$3,000 a year at age 45 (earning an annual return of 7 percent) and by age 65, you will have a pension fund of only US$123,000. But start at 25 and your pension fund will be worth almost US$600,000.

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