

# Discussion of three papers on: “Pension Design and Pension Reform”

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# Pension Systems—Goals and Constraints

## Goals:

- Consumption smoothing (**adequacy**)
- Prevention of **old-age poverty**

## Constraints:

- Fiscal **sustainability**
- **Efficiency** (minimizing distortion for saving and labor supply)
- **Fairness** (general acceptance as an equitable system)

# Pension Systems—Major Issues

## Major Issues:

- Many **trade-offs**:
  - Bismarck vs. Beveridge (contributiveness vs. redistribution)
  - Flexibility vs. moral hazard (or myopia)
  - Interaction with other issues (inequality, labor markets, gender,...)
- How to choose the **design**? (best practice, broad consensus,...)
- When to **reform**? (crisis-driven, window of opportunity,... )

# Pension Systems—A Plethora of Possibilities

- (a) Funded vs. Unfunded
- (b) Public vs. Private
- (c) Defined Benefits vs. Defined Contributions
- (d) Mandatory vs. Voluntary
- (e) Universal vs. Means-tested
- (f) Annuitized benefits vs. lump-sum
- (g) Redistributive vs. non-redistributive

## Pay-As-You-Go (PAYG) Pillar—Budget

- Balanced Budget Condition:

$$\underbrace{\tau_t}_{\text{Contr. Rate}} = \underbrace{\frac{\bar{P}_t^m}{\bar{W}_t}}_{\text{Ave. Rep. Rate}} \times \underbrace{\frac{P_t}{L_t}}_{\text{Dep. Ratio}} \quad \left( \text{or: } \frac{\tau_t}{1 - b_t} = \frac{\bar{P}_t^m}{\bar{W}_t} \times \frac{P_t}{L_t} \right)$$

- Design Issues:

- Size of  $\tau_t$ ?
- $P_t^i$  proportional to  $\bar{W}_t^i$ ?
- Automatic reaction to changes in  $\frac{P_t}{L_t}$ ?
- Which variable should react? Contribution rate, replacement rate, retirement age, all of the above, ...?

# PAYG Pillar—Important Questions

## Important Questions:

- Which reaction do **people prefer**?

▶ Survey

- An **increase in the average retirement age** is often regarded as the optimal/logical/only reaction to an increase in average life expectancy. Will it work?

▶ Arnberg et al.

- When is the best/typical time for a **pension reform**?

▶ Beetsma et al.

- What is a **fair system**?

▶ Devesa/Doménech

## Conclusion

- A sustainable and accepted system needs a **solid frame** as well as carefully **fine-tuned detail**.
- It should be the **(consensual) outcome** of a thorough, general debate.
- **Dynamic (self-adjusting) elements** seem advantageous, even if only as a “default path”.

## Survey Answers (2,000 respondents, Austria, 2014)

**Question:** “Life expectancy has increased over the last decades. How much would you approve/disapprove the following measures to stabilize the pension system?”

Policy Measure	(Strongly) Approve	(Strongly) Disapprove	Don't Know
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Increase Retirement Age	33%	58%	9%
Increase Contribution Rate	41%	51%	8%
Increase Government Subsidy	76%	11%	13%

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## Paper by Arnberg et al.—Comments

- Large effect of the increase in ERA? Are there other **pathways to retirement**? (the reduction in ER is rather “mechanical”)
- **Strong assumptions**:
  - Optimizing behavior
  - Age-related preferences for retirement (ability vs. willingness to work etc.)
- **Alternative** to structural model: asking people [◀ Example](#)

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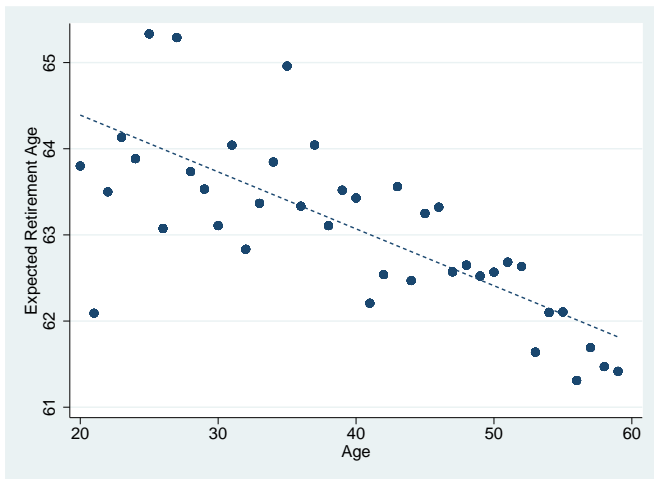
## Paper by Beetsma et al.—Comments

- The broad demographic trend is fairly constant and quite well-known. Maybe  $\Delta OAD$  not so important. Upswings in business cycle give a “window of opportunity”.
- Distinction between upswings and (strong) downswings?
- Pension reform discussions often last very long (e.g. Sweden). Difficult to find the correct lag structure.
- Would be nice to move beyond the 1/0 measures and capture the strength of the reform. Maybe also the success of a reform.

## Paper by Devesa and Doménech—Comments

- It would be nice to have **more specific proposals**.
  - Optimal mix between funded and unfunded? 10%, 50%, 90%?
  - Optimal mix of contributiveness and redistribution (e.g. size of minimum pension)
- **Intragenerational fairness**:
  - Should the pension design take into account that **life expectancy** is correlated with various **socio-economic factors** (income, education etc.)?
  - Useful to base the concept of fairness on “**first principles**” (welfare economics, political philosophy)
- **Intergenerational fairness**:
  - “What has the future ever done for us?”
  - Holding the **economic dependency ratio constant** sounds reasonable? What if life expectancy increases faster than the ability to work or availability of jobs?

# Expectations of Own Retirement (Austria, 2014)



Source: Knell/Segalla/Weber, "Expected retirement age and pension benefits in Austria: Evidence from survey data", *Monetary Policy & the Economy*, 2015