

Redesigning pension systems

The institutional structure of pension systems should follow population developments

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ELEVATOR PITCH

For decades, pension systems were based on the rising revenue generated by an expanding population (the so-called demographic dividend). As changes in fertility and longevity created new population structures, however, the dividend disappeared, but pension systems failed to adapt. They are kept solvent by increasing redistributions from the shrinking working-age population to retirees. A simple and transparent structure and individualization of pension system participation are the key preconditions for an intergenerationally just old-age security system.

KEY FINDINGS

Pros

- + Pension reform can improve social equity by balancing the interests of workers and retirees.
- + By lowering labor costs, pension reform can reduce entry barriers to the labor market.
- + Pension reform can reduce tax distortions that discourage job creation.
- + By reducing subsidies to the pension system, reform can improve public finance.
- + More transparent institutions can lead to more rational decisions on savings, work, and family.

Cons

- Pension reform faces political obstacles from the opposition of those due to retire or recently retired.
- The strong tendency to make the same choices as in the past ignores condition changes.
- Pension system complexity makes it hard to see the need for reform, and to assess its merits.
- If reforms involve financial markets, positive as well as negative externalities may arise.
- Accounting applied to contributions flowing through pension systems misleads and tempts politicians to hide the real scale of indebtedness.

AUTHOR'S MAIN MESSAGE

Pension systems need to be redesigned to accommodate demographic changes. Postponing adjustment simply increases the economic and social costs. The interests of workers (deductions from wages) and retirees (receipt of benefits) differ. Governments need to make pension systems more transparent and make adjustments to reduce the burden on workers, returning the pension system to its social role, which is helping the very old without overburdening the young. Pension solidarity should not be confused with political discretion. Transparency and fairness are the key preconditions when adjusting pension systems for the 21st century.

