

Pension systems and growth

How to account for low growth risks and achieve sustainability?

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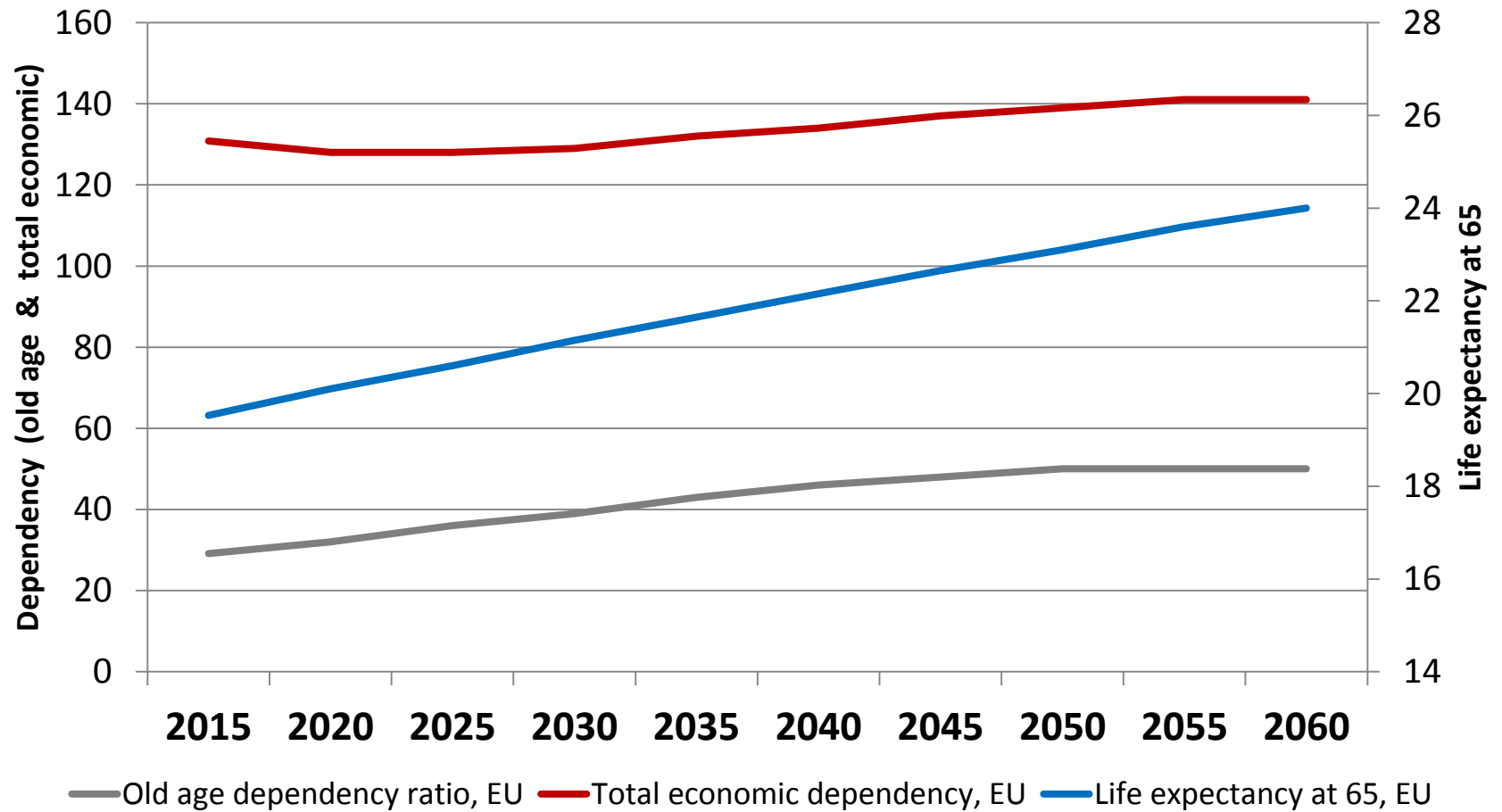
Issues

- Pension funding \Rightarrow investment \Rightarrow growth
- Risk sharing and the social contract

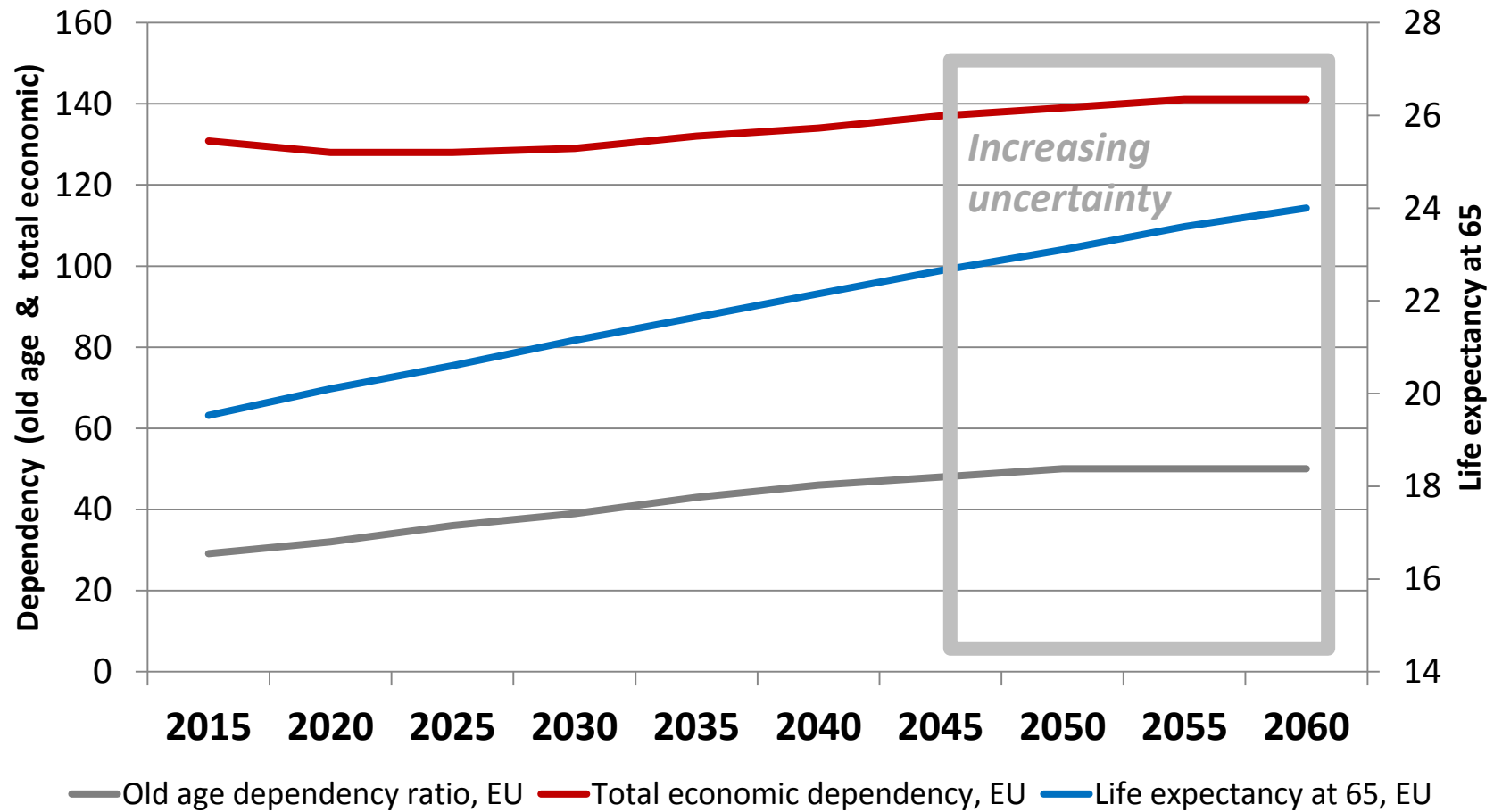
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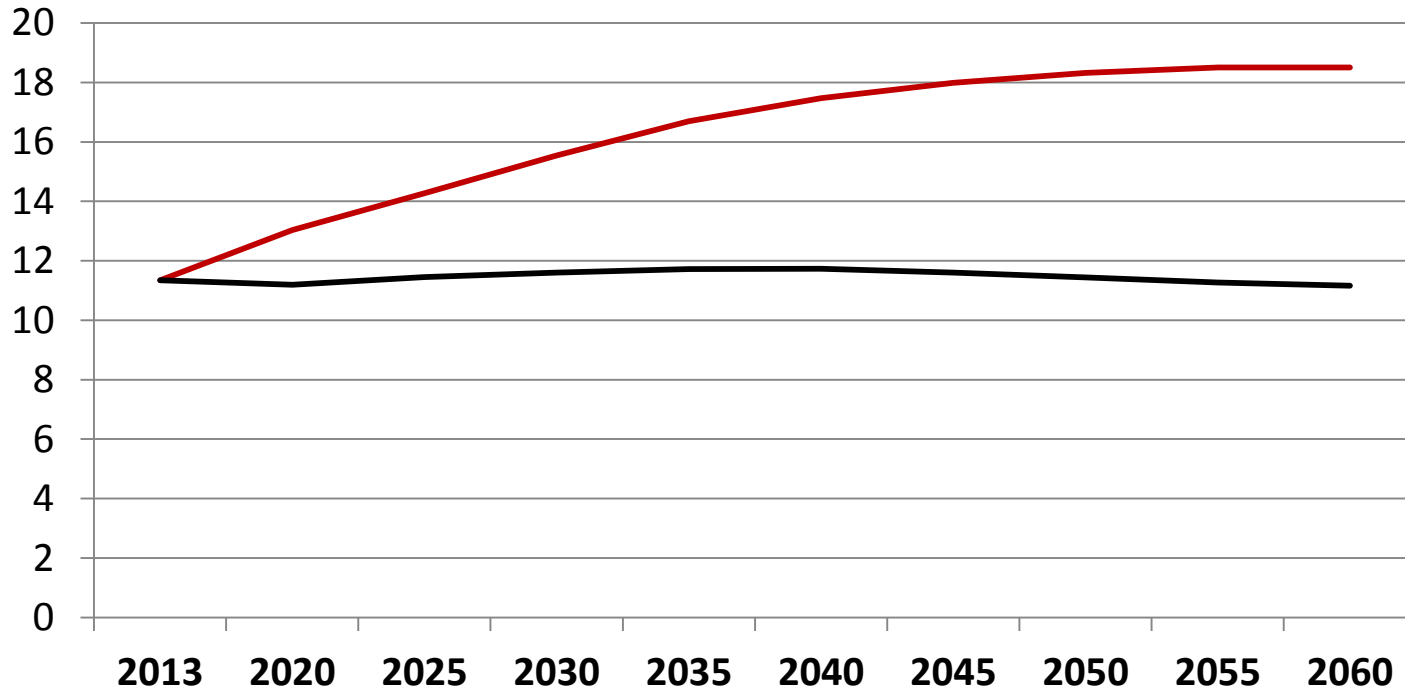
Dependency and demographic change in the EU



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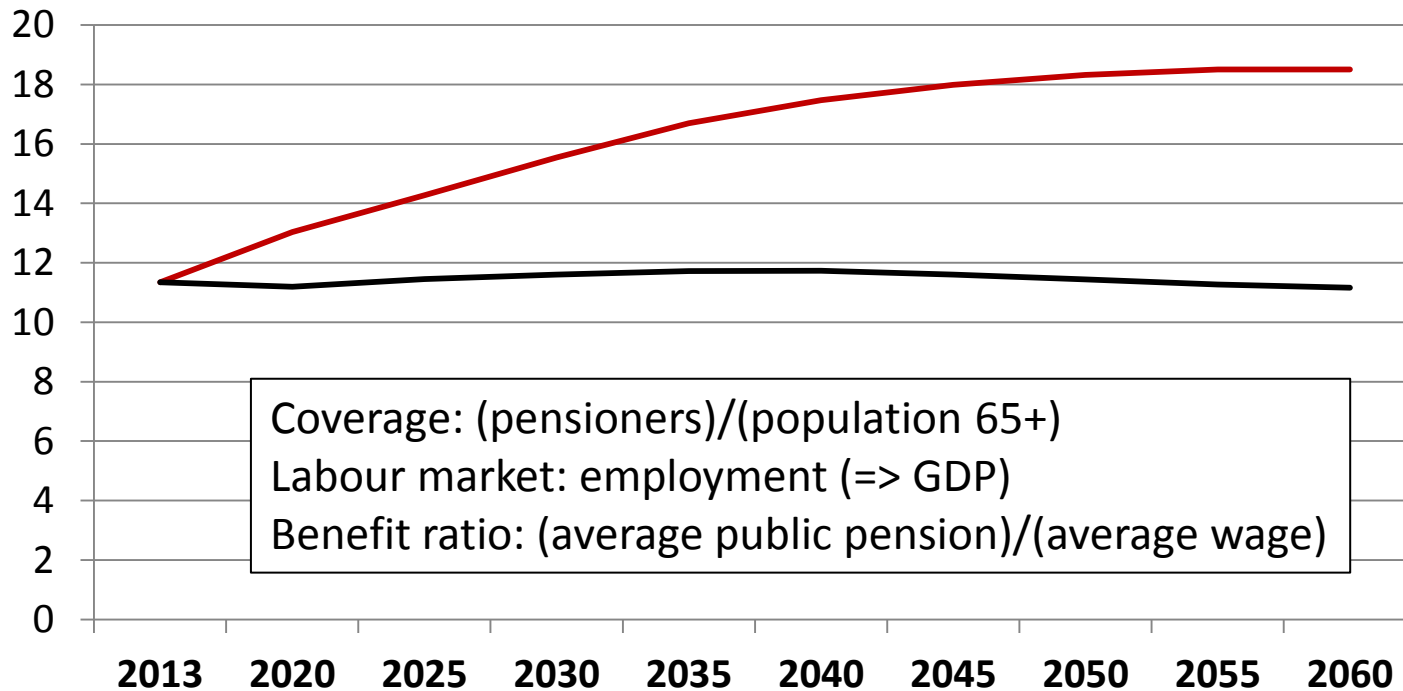


Public pension spending, % GDP, EU



- Impact of dependency (no change in coverage, benefit ratio, labour market ratio)
- actual forecast (incl. interaction)

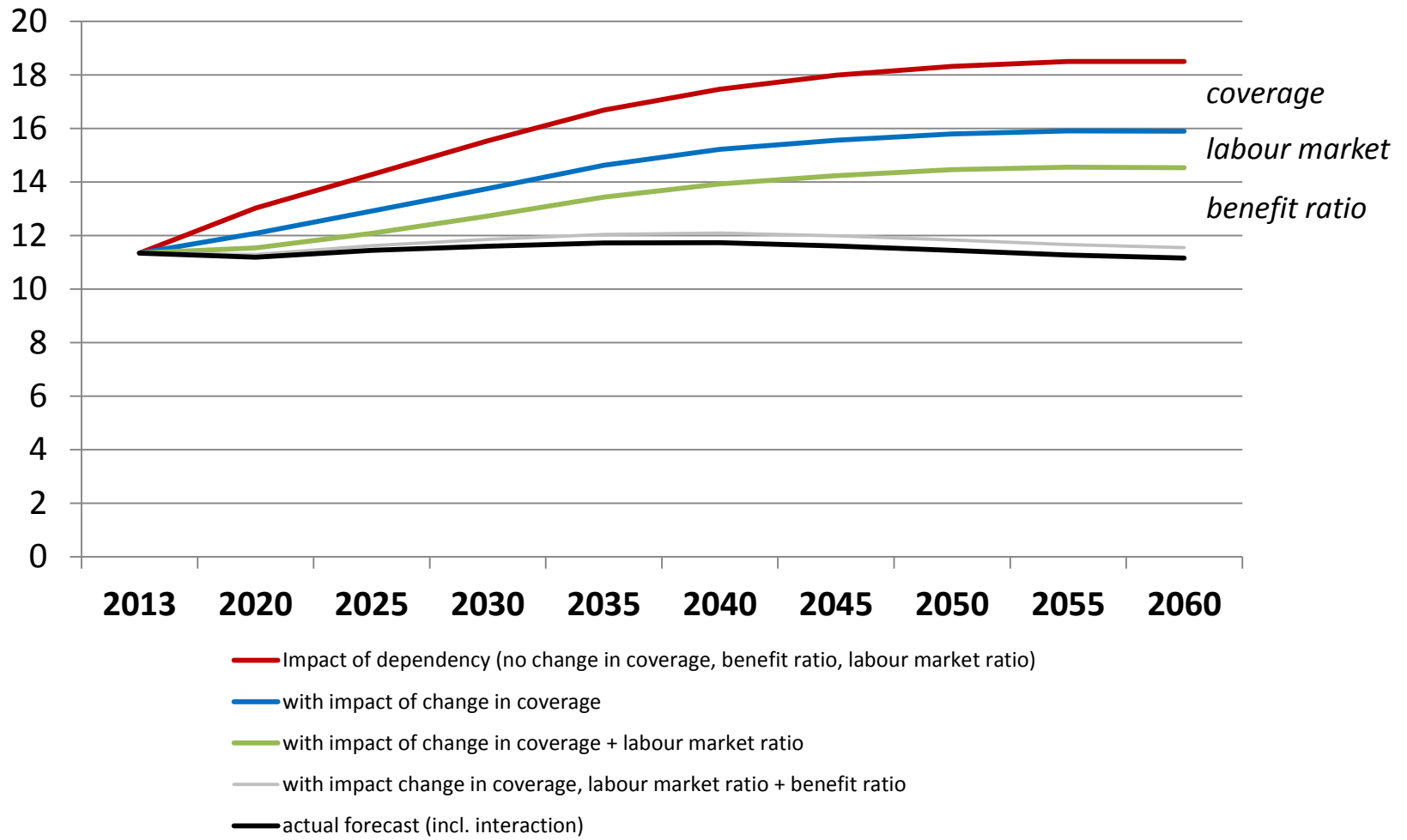
Public pension spending, % GDP, EU



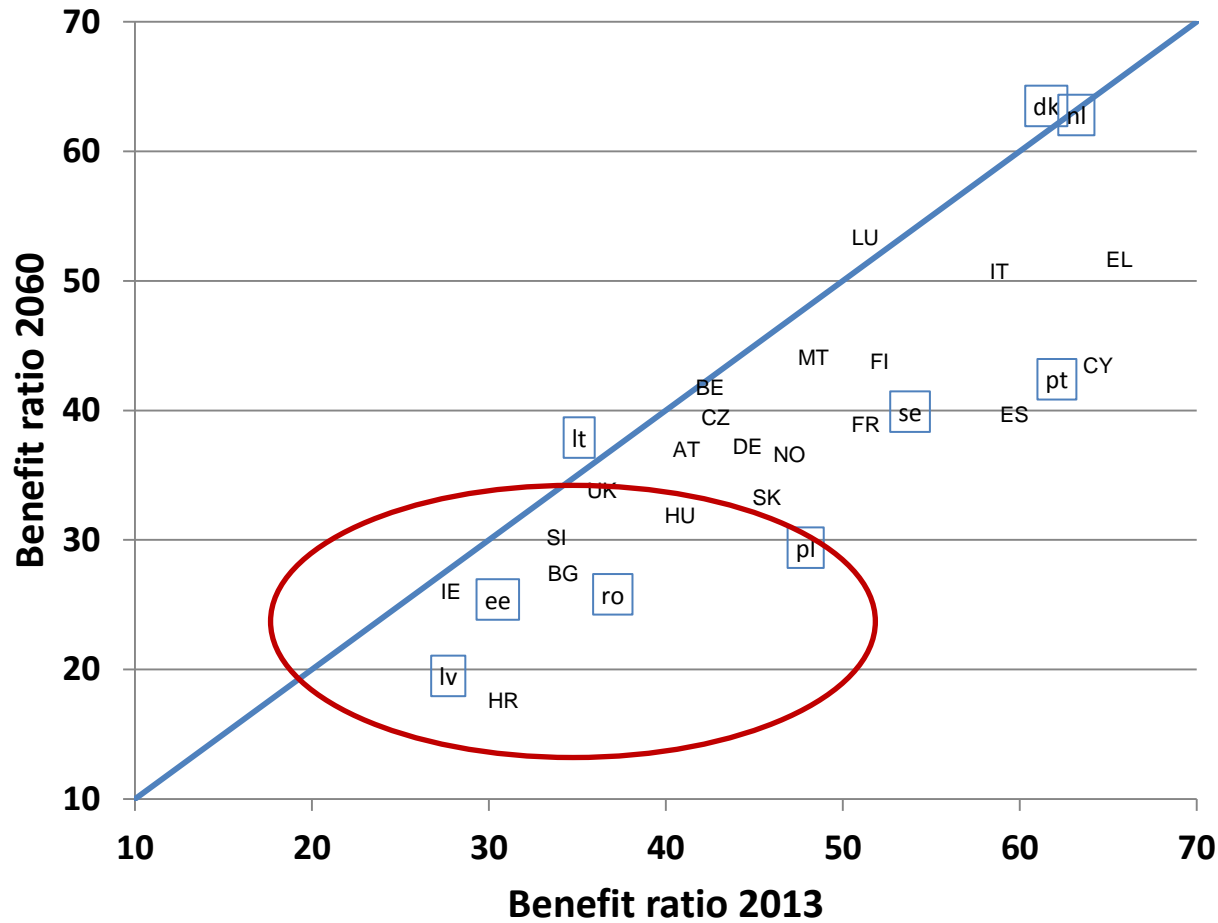
Coverage: (pensioners)/(population 65+)
Labour market: employment (\Rightarrow GDP)
Benefit ratio: (average public pension)/(average wage)

- Impact of dependency (no change in coverage, benefit ratio, labour market ratio)
- actual forecast (incl. interaction)

Public pensions spending, % GDP, EU - decomposed



Change in pension benefit ratios, incl. private pensions (□)



$$\text{Pension benefit ratio} = \frac{\text{average pension}}{\text{average wage}}$$

— No change (Musgrave rule) Benefit ratio all pensions

Intergenerational risk sharing: the social contract

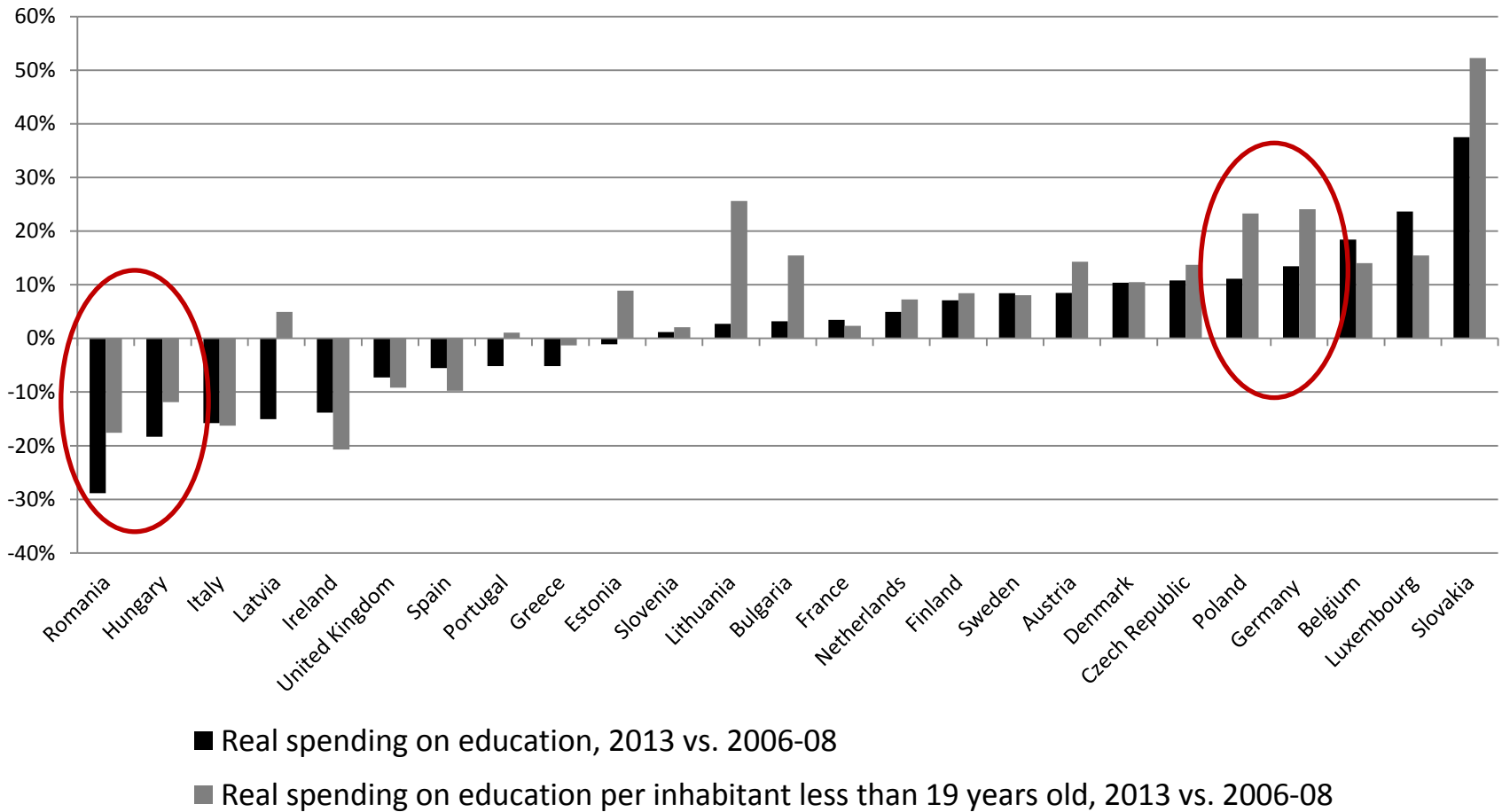
- Pensions = managing uncertainty
 - by integrating adjustment mechanisms in the pension system
 - EU Commission: by indexing parameters of pension systems to longevity (e.g. career requirements & retirement age)
- Options for risk sharing

	Defined benefit	Defined contribution	Musgrave rule
Fix...	Pension	Contribution rate	(net) pension benefit ratio
Economic risk	Risk for workers	Shared risk	Shared risk
Demographic risk	Risk for workers	Risk for retirees	Shared risk

Implementing risk sharing *à la* 'Musgrave rule' implies further normative questions

- Pension benefit ratio (*relative* level of pensions/wages): what is the optimal allocation of consumption over the life cycle?
- *Absolute* level of wages & pensions (given labour productivity): what is the optimal choice of leisure over a whole life?
- 'Growth risk' can be eliminated in pension contract *per se*, but trade-offs depend on broader context:
 - impact of unemployment in case of low growth
 - impact of labour productivity
 - human capital:
 - ⇒ long term development of productivity depends on human capital, i.e. requires sufficient efforts in education
 - ⇒ working longer requires a type of skills & life-long-learning

Pension policy begins with education: worrying signs of divergence across the EU



Conclusions

- Social sustainability requires fair intergenerational risk sharing.
- Long-term outlook is not reassuring in a number of EU Member States.
- It is both feasible and desirable to neutralize growth risk and demographic risk in a fair pension contract *per se*.
- But trade-offs are easier if 'growth in well-being'.

Resources

- Pension forecasts: see European Commission, *The 2015 Ageing Report*, European Economy 3/2015
- Musgrave rule: see Myles, 'A New Contract for the Elderly', in Esping-Andersen, *Why we need a New Welfare State*, OUP, 2002.
- Application to Belgium: see Belgian Commission on Pension Reform 2020-2040
 - www.pensioen2040.belgie.be
 - www.pension2040.belgique.be
- Need for a social investment perspective, see: Vandenbroucke, *The Case for a European Social Union. From muddling through to a sense of common purpose*, Euroforum Policy Paper, 2014

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