



New Frontiers in Retirement in Industrialised Nations

The changing dynamics of
the pensions' funding crisis

Schlosshotel Kronberg,
October 30, 2003



Providing Old Age Security: Issues in Household Savings and Retirement

Joseph E. Stiglitz



Changing environment necessitates changing systems for providing old age security

- > Changes in financial markets
- > Changes in demographics
- > Changes in government policy
- > Changes interrelated
 - Slowdown in population growth makes pay as you go system more problematic
 - Changes in pace of technology (new economy?) may exacerbate problems posed by gaps in standards of living across generations posed by pure contributory system
 - Changes in financial markets should improve ability to manage risk better
 - Still a gap—lack of inflation insurance

Objectives

- > Providing for old age security
 - Recognizing that the amount required from private sources will depend on the amounts available from public pensions, which will be changing over time
 - And recognizing the special patterns of spending of the aged
 - With health care generally financed by the government
 - But costs of health care likely to rise
 - Life spans likely to rise
 - Family structures likely to change
 - So that there will be increasing expenditures on long term care
- > Maintaining social solidarity — avoiding income gaps
- > Promoting economic efficiency

Role of Government

- > Providing basic minimal standard
 - Impossibility of committing not to “bail-out”
- > Addressing market failures
 - Lack of insurance against inflation
 - High transactions costs
 - Lack of consumer information
 - Complexity of markets makes poses challenge
 - Perverse incentives
 - Individuals only find out about problems when it is too late

Interpreting anomalies in private savings and risk behavior

- > Life cycle model predicts
 - Less risk taking as one gets old
 - High dis-saving after retirement

Alternative Models

- > Bequest motive
- > Imperfect capital markets as a result of asymmetric information
 - Especially important for entrepreneurs
- > Comprehensive portfolio
 - Including housing
 - Ownership of housing insures partly against changes in costs of housing
 - Human Capital
 - Resolution of uncertainty over time
 - Both because of few working years remaining
 - And life prospects become clarified

Implication (I)

- > Not a single “package” for everyone
- > Government can provide minimum, but there is an important role for private supplements
- > Tailored to preferences and circumstances of different individuals
- > Complexity of problem means that Financial Institutions can help individuals design appropriate retirement packages

Implication (II)

- > Strategy entails identifying “typologies,” different kinds of representative individuals
 - While in principle should distinguish exogenous from endogenous variables
 - Endogenous variables may provide good basis for sorting
 - Overall wealth
 - Home ownership
 - Entrepreneurial status
 - Age
 - Children; marital status

Presenting Results

- > Use of scenario analysis
- > Identifying key contingencies
- > Focusing on key objectives
- > Based on historical analysis
- > And possible distinctive features of future evolution
 - The nature of government programs
 - Reduction of equity premium
 - Changes in systems for providing care in old age
 - And changes in life expectancy

PIONEER FONDS MARKETING GMBH

Hopfenstraße 4, 80335 München

Tel.: +49 (0)89.29 07 41-0

Fax: +49 (0)89.29 07 41-80 99

www.pioneerinvestments.de

