Symposium

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Vienna, May 5, 2011

Analytical principles

- Pension systems have multiple objectives
  - Consumption smoothing
  - Insurance
  - Poverty relief
  - Redistribution within and across generations
- Analysis should consider pension systems as a whole
- Implementation matters

Supplementing notional defined-contribution (NDC) accounts

1. Citizen's pension
2. Defined-contribution (DC) pensions

1. Citizen’s pension

- Definition: a public pension paid at a flat rate, on the basis of age and residence rather than contributions
- Financed out of general revenue or an earmarked source

Why noncontributory?

- Changing nature of work
    - More diverse patterns of work, with more fluid labour markets (‘post-industrialisation’)
    - Thus there are problems for coverage of contributory benefits tied to employment
- Changing nature of the family
    - More fluid family structures
    - Rising labour-market activity by women
    - Thus there are problems basing women’s benefits on husbands’ contributions
- UK illustrates problems of coverage
    - Hence reduced contribution from 40+ to 30 years
    - Talk of de facto universal pension from 2015

Matching costs with resources

Three instruments

- The size of the monthly pension
- The age at which the pension is first paid
  - Benefit should provide significant poverty relief
  - That may be possible only from a high age
- Whether the pension is universal or tested

Universal or tested

- Benefits may be reduced in respect of
  - Any income the person has (income test)
  - Any income or wealth the person has (means test)
  - Any income the person receives from the mandatory pension system (pensions test)
- Any of these tests can apply
  - At low levels of income, wealth or pension, thus excluding all but the poor
  - At high levels, thus excluding only the best off (affluence test)

Adjustment over time

- Index benefits in payment with a proper weighted average of prices and wages
- Adjusting to risk
    - Demographic change: automatic adjustment of eligibility age to life expectancy
    - Macroeconomic shock: with a large shock, the growth of benefits may need to be adjusted to slower growth of GDP, but with recognition of Keynesian needs

Arguments for non-contributory basic pensions

- Strengthen poverty relief in terms of coverage, adequacy and gender balance
- Likely to improve incentives relative to income-tested poverty relief
- Provide good targeting (age is a useful indicator of poverty)
- Assists international labour mobility through pro-rata arrangements
- Robust in face of shocks because shares risk widely
    - Across current taxpayers
    - Through government borrowing, also with future taxpayers

Examples of Non-contributory Pensions

Country	Eligibility for full pension	Pro-rating	Size of full benefit[1]	Above poverty line	Testing	Taxable
Australia	10 years	No	Benchmarked to 25% of Male Total Average Weekly Earnings: $670.90	No	Two tests: total income, assets	No
Canada	40 years after age 18	Yes	$526.85 CPI indexed	No	Total income	Yes
Chile	20 years including 4 of the last 5 prior to applying	No	75,000 pesos until 2012	Yes	Two tests: Individual mandatory pension income, family total income.	Yes
Netherlands	50 years after age 15	Yes	70% of minimum wage	Yes	No	Yes
New Zealand	10 years after age 20 and at least 5 years after age 50	No	$389.14 weekly	Yes	No	Yes
Sweden	40 years after age 25	Yes	SEK 7,597 for those born 1938 and later, and 7,780 for those born 1937 and earlier.	No	Against mandatory pension benefit[2]	Yes

[1] Except as noted, the column reports monthly benefits for a single person in 2011. Some countries have benefits that vary with marital status or living arrangement.

[2] 18/16.5 times Inkomstpension.

2. Defined Contribution Pensions

- Mandatory and/or Voluntary
- Tax treatment
- Benefit rules
- Organizing principles

Examples of Funded Individual Accounts

Country	Mandatory	Organization	Default	Benefit type
Australia	Yes	Multiple: public sector, corporate, industry, retail	Set by firms Reform under discussion	No restrictions
Chile	Yes	Private mutual fund firms. 5 funds per firm plus life-cycle Tightly regulated	Lifecycle.	Annuity or phased withdrawal
New Zealand	No Auto-enrolment (Opt-out)	Private mutual fund firms	Set by government, managed by firms	No restrictions
Sweden	Yes	Government organized. Wholesale investment in over 700 private funds, price regulated	Government-provided default[1]	Government-provided annuity
United States IRA, Roth IRA, 401(k)	No	Private financial firms for individuals Employer organized	 Set by employer	No restrictions other than minimal required withdrawal for tax deferred accounts
United States Thrift Savings Plan for federal employees	No	Government organized Wholesale investment in 5 funds, plus life-cycle	Life-cycle	No restrictions other than minimal required withdrawal for tax deferred accounts

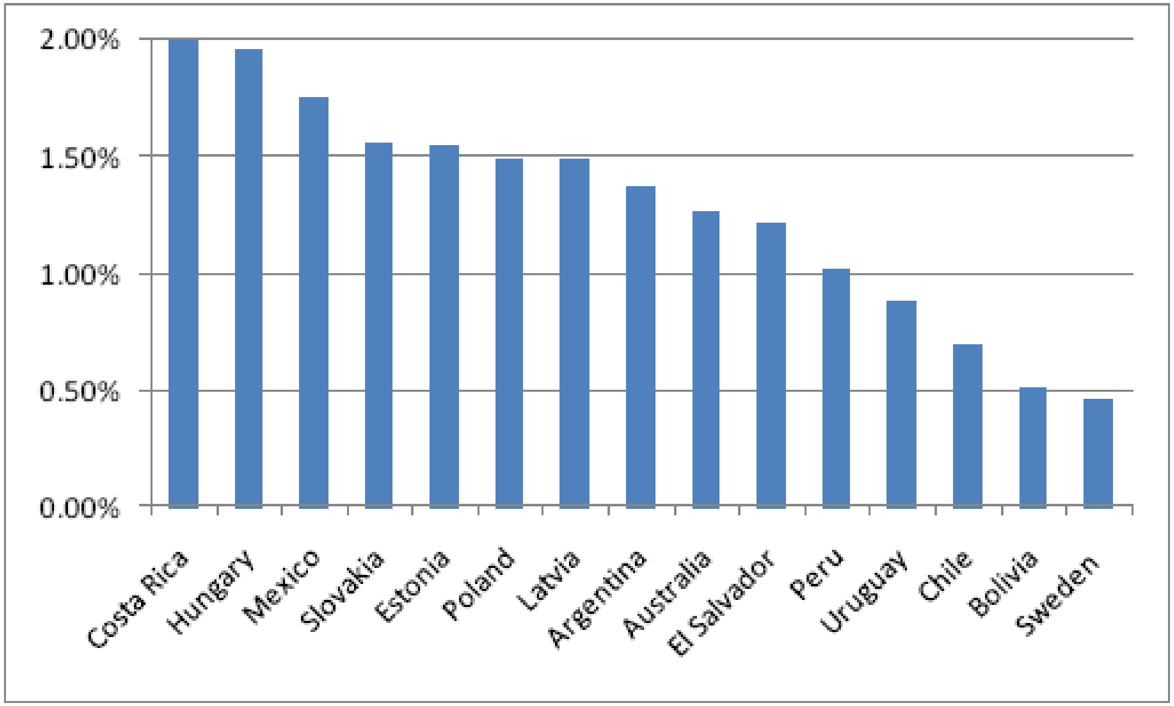
[1

Share of first-time choosers investing in the Swedish default fund (Premiesparfonden)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Percent Investing in Default Fund	**33**	**82**	**86**	**91.6**	**90.6**	**92**	**92.6**	**98.4**	**98.4**	**98.4**

Source: Sweden Ministry of Finance (2009, p. 47).

Administrative Charges as Percentage of Total Assets, 2007



Sources: Latin American countries: AIOS, 2007; Poland: Insurance and Pensions Supervisory Authority, 2007 and authors' calculations; Hungary: HFSA, 2007 and authors' calculations, Sweden: Premium Pension Authority, 2007.

Note: Australia, Hungary, and Poland are 2006 Figures.

Source: Tapia, W. and J. Yermo (2008) "Fees in Individual Account Pension Systems: A Cross-Country Comparison", *OECD Working Papers on Insurance and Private Pensions*, No. 27, page 11, OECD Publishing, ©OECD. Doi: 10.1787/236114516708

Australia

"Australia is in a mid-position with an average overall fee of 1.26% of total assets. However, fees in the Australian Superannuation system vary greatly according to the fund type. Public sector and corporate funds have the lowest overall fee at around 0.78% and 0.70% respectively. Industry funds are close to the industry average at around 1.13%, whilst [non-corporate] retail funds … are the most expensive at around 2.30% of total assets."

Source: Tapia and Yermo, page 11

Decline in Value of Accounts Due to Fees After a 40-Year Work Career [a]

Type and Level of Fees	Percentage Decline in Account Value Due to Fees
Front-load fees (% of new contributions) of:	
1 percent	1 %
10 percent	10 %
20 percent	20 %
Annual management fees (% of account balance) of:	
0.1 percent	2.2 %
0.5 percent	10.5 %
1.0 percent	19.6 %

a. Assuming real wage growth of 2.1 percent and a real annual return on investments of 4 percent. With a larger difference between the rate of return and the wage growth rate, the charge ratio with annual management fees is slightly larger, and conversely.

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