

The impact of demographic shocks on the political arrangement of pay-as-you-go pension systems

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Summary

- Financial Shock: a decrease in the return on capital
- Demographic Shock: a lower mean or a higher variance in the population growth rate
- Pay-as-you-go (PAYG) pension system:
 - A financial shock increases contributions and benefits
 - A decrease in the population growth rate increases contributions, but lowers benefits
 - A demographic shock shrinks the pension system

Contribution

- In a political setting of public voting, a demographic shock decreases the return of pension due to the 'Strategic effect'
 - During Great Recession, governments did not expand PAYG pension systems
 - Countries in Latin America and Central and Eastern Europe transform the PAYG system into a fully-funded system
- The combination of financial and demographic shocks accounts for the development of the PAYG pension system

Politician VS Ramsey planner

- Following financial and demographic shocks, the Ramsey planner changes contributions and benefits in the same direction as the politician
- In the absence of 'strategic effect', facing a demographic shock, the Ramsey planner sustain a higher size of the pension system

Comment

- Can financial shocks explain the emergence of PAYG pension system?
 - Some countries introduce it after WWII, after higher inflation or massive destruction of capital stock
 - Some countries transformed from a fully-funded system
- Economic downturn: a trigger or a cause?

Comment

- A lower mean or a higher variance of population growth causes the pension system to shrink, how about the skewness?
- The generosity of governments during Great Recession is explained by the perception of a lower or more uncertain population growth. But the decrease of population growth starts from 1980s?

Comment

- A decrease in the population growth rate increases contributions but decreases benefits
- The average contribution to the PAYG pension system is smaller if the mean population growth rate is lower