

Pioneer Global
Asset Management
Research Unit

Providing Old Age
Security: Issues in
Household Savings
and Retirement

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June 17, 2002
Rome

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1. 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

2. 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

3. 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

4. Interpreting anomalies in private savings and risk behavior

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

5. 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

6. 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

7. 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

8. 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