Postponing Retirement

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Why Should We Postpone Retirement?

➤ Why is Postponing Retirement such a common Policy advice?

1. We Retire increasingly earlier, although we live longer
Higher Longevity & Longer Retirement
Past & Current Trends in Retirement

Età Media di Pensionamento nei paesi OCSE: Uomini 1985-2011

- paesi OCSE
- Italia
- Spagna
- Grecia
Why Should We Postpone Retirement?

- Why is Postponing Retirement such a common Policy advice?

1. We Retire increasingly earlier, although we live longer

2. A Policy Response to Aging & to the Problems of Financial Sustainability of PAYG Pension Systems
## Aging Process

### Age-Specific Contributions to the Increase of Record Life Expectancy among Women 1850 to 2009 in %

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<td>32</td>
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<td>8</td>
<td>11</td>
<td>24</td>
<td>41</td>
<td>37</td>
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</table>

Data Source: Calculations based on Human Mortality Database by Roland Rau and James Vaupel (unpublished)
Aging Process in Italy

Age

0 to 9
10 to 19
20 to 29
30 to 39
40 to 49
50 to 59
60 to 69
70 to 80
80 to 89
90 and more

year 2000
year 2050
Aging Process

Figure 2.1: Percentage of Elderly in the Total Population

- Germany
- Spain
- France
- Italy
- United Kingdom
- United States
Graph 51 - Change in the Public Pension/GDP over 2007-60 (in percentage points)

Source: Commission services, EPC.
Why is Postponing Retirement such a common Policy advice?

1. We Retire increasingly earlier, although we live longer

2. A Policy Response to Aging & to the Problems of Financial Sustainability of PAYG Pension Systems

3. A Policy Response to (Current &) Future Pension Adequacy
Old age poverty rate, people aged over 65

OECD average: 15%
Future Pension Adequacy?
Figure 1: Share of temporary workers by age
Italy: Future Pensions for Temporary Workers

Labor market prospects of current young

<table>
<thead>
<tr>
<th>Growth Rate (g)</th>
<th>Retirement Age</th>
<th>Transformation Coefficients (2009)</th>
<th>Monthly Pension</th>
<th>Replacement Rate</th>
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<tr>
<td>1.5%</td>
<td>67</td>
<td>0.06136</td>
<td>1155</td>
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<td>60</td>
<td>0.05163</td>
<td>697</td>
<td>54%</td>
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<td>1.0%</td>
<td>67</td>
<td>0.06136</td>
<td>1041</td>
<td>80%</td>
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<td></td>
<td>65</td>
<td>0.06136</td>
<td>976</td>
<td>75%</td>
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<tr>
<td></td>
<td>60</td>
<td>0.05163</td>
<td>675</td>
<td>53%</td>
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</tbody>
</table>

25-28 y.o.: Temporary Job (Co.co.pro.)
29: Unemployed
29-31: Fixed Term Job
32: Unemployed
33-35: Fixed Term Job
35-65: Permanent Job
### Italy: Future Pensions for Temporary Workers

#### Young B – with Labor Market Reform

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<td>87%</td>
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<td>60</td>
<td>0.05163</td>
<td>957</td>
<td>61%</td>
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<td>1.2%</td>
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<td>79%</td>
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<td>60</td>
<td>0.05163</td>
<td>881</td>
<td>56%</td>
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## Labor Market Impact on Future Pensions

### Italy: Future Pensions for Temporary Workers

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<th>Growth Rate (g)</th>
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<th>Transformation Coefficients (2009)</th>
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<td>Monthly Pension</td>
<td>Replacement Rate</td>
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What may Push for Postponing Retirement?

1. Adequacy of Future Pension Benefits - particularly due to current labor market situation

2. Political Push of Aging on Postponing Retirement.
   How to deal with the effect of Aging on Financial Sustainability of Pensions?
Conventional Wisdom: Aging - by changing the ratio between Workers and Retirees - may undermine the financial sustainability of PAYG systems

Problem: Systems will have to be Reformed. Possible measures - higher contribution rates, lower pension benefits, postponing retirement, partial funding - differ in how the costs of the reform are distributed across generations.

The political process will have to reconcile the opposite interests of subsequent generations.
Politico-Economic Effects of Aging

Aging induces (at least) two crucial effects:

**Economic**: An increase in the Dependency Ratio reduces the average long run return of the system → Since pensions represent a saving device, Portfolio Rebalancing: agents *reduce* the size of pension system.

**Political**: Aging Increases the Political Weight of the Elderly → Generates “political pressure” to *increase* the generosity of the system.
The existing Politico-Economic literature suggests that the

1. **Political aspect dominates:** Aging induces the contribution rates to increase everywhere although (generosity) replacement rates may decrease.

2. **Policy Implications:** Higher actual retirement ages are very effective in limiting the increase of the size while increasing the generosity of the system

Will voters be willing to support an increase in the effective retirement age?
How do individuals choose (vote)?

- Choosing (voting on) pension contributions for a given retirement age depends on age.
- Higher Retirement Age Induces Lower Pension Contributions

Choosing (voting on) retirement age for a given pension contribution rate depends on (i) Individual labor-leisure trade-off via retirement; (ii) Impact of retirement age on pension benefits via dependency ratio.

- Higher contributions (and pensions) create a substitution (lowering RA) and an income effect (increasing RA)
Issue-by-Issue Bidimensional Voting

![Graph showing the relationship between Tau and RA. The graph plots Tau as a function of RA and RA as a function of Tau.](image-url)
How does Aging affect individuals vote?

- Voting on pension contributions, given retirement age:
  - Economic Effect (lower IRR): lower contributions
  - Political Effect (older median voter): higher contributions
  - Overall result is ambiguous

Voting on retirement age, given pension contribution

- Negative Income effect: aging reduces returns from social security. Retirement Age increases
- Negative Substitution effect: for a given contribution rate, aging reduces pension benefit. Retirement Age increases
- Overall result: Retirement Age increases
Issue-by-Issue Bidimensional Voting
When voting over RA and SS contribution rates, the political economic equilibrium is associated with lower contribution and higher RA.

WHY? With aging and large social security systems, individuals will be “poorer” and will need to work longer years.

**Bidimensional Voting Simulation Results**

<table>
<thead>
<tr>
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<th>Age of the median voter over contribution rate</th>
<th>Effective retirement age</th>
<th>Social security contribution rate</th>
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<td>2050</td>
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<tr>
<td><strong>UK</strong></td>
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<td></td>
<td></td>
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<tr>
<td>2000</td>
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<td>63</td>
<td>14.5%</td>
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<td>2050</td>
<td>53</td>
<td>70</td>
<td>27.1%</td>
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<td><strong>US</strong></td>
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<td>2000</td>
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<td>9.7%</td>
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<td>2050</td>
<td>53</td>
<td>68</td>
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</tr>
<tr>
<td>2050</td>
<td>53</td>
<td>69</td>
<td>11.9%</td>
</tr>
</tbody>
</table>
1. Would keeping elderly workers in the labor force reduce economic productivity?
Axel Börsch-Supan and Matthias Weiss, (2011) on productivity by age for team workers in a Mercedes-Benz production plan in southern Germany.
Aging & Economic Productivity

Aging & Economic Productivity

Aging & Economic Productivity

Figure 4: Age-profiles of average test scores by employment status.

Source: F. Mazzonna and F. Peracchi, 2012. Dati SHARE.
Should We Postpone Retirement?

Yes, because:

1. Increased (and Increasing) Longevity

2. Later Retirement Mitigates the Financial Sustainability problems of PAYG Pension Systems

3. No Evidence that Elderly Workers have Large Drops in Economic Productivity

4. No Lump of Labor: No Negative effect on the Employment of the Young
Why & when will Retirement be Postponed?

- Why? To Achieve Pension Adequacy
  - Both Individual (Economic) & Aggregate (Political) decisions driven by “Negative Income Effects”.
  - Future Elderly “too poor” too retire early

- When? It will depend on
  - Initial retirement conditions
  - How long it will take to reduce pension benefits (reform transition)
  - Current labor market conditions.
Why & when will Retirement be Postponed?

Reference


European Union (2013), Combining the entry of young people in the labour market with the retention of older workers


