

Policy Responses to an Aging Population

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Picture painted by Landis MacKellar is not a pretty one.

No simple solution to the problem.

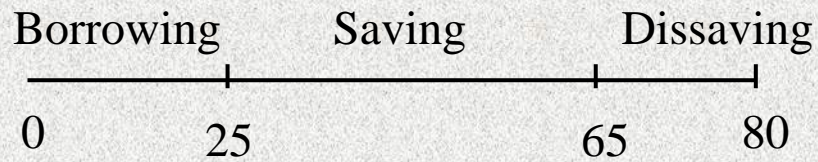
I discuss a few possibilities.

1. Change mentality.

Each person is responsible for funding his own retirement.

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Figure 1



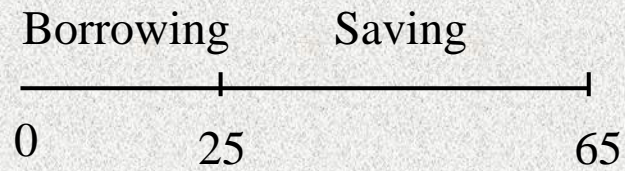
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On average if one lives 80 years and works 40 years, one's income during one's 40 working years must cover one's consumption in the 40 non-working years.

Last year's early retirements in Austria.

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Figure 2



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What happens to our consumption when we live longer?

Consume less.

What is optimal response to greater longevity?

Consume less.

Work more.

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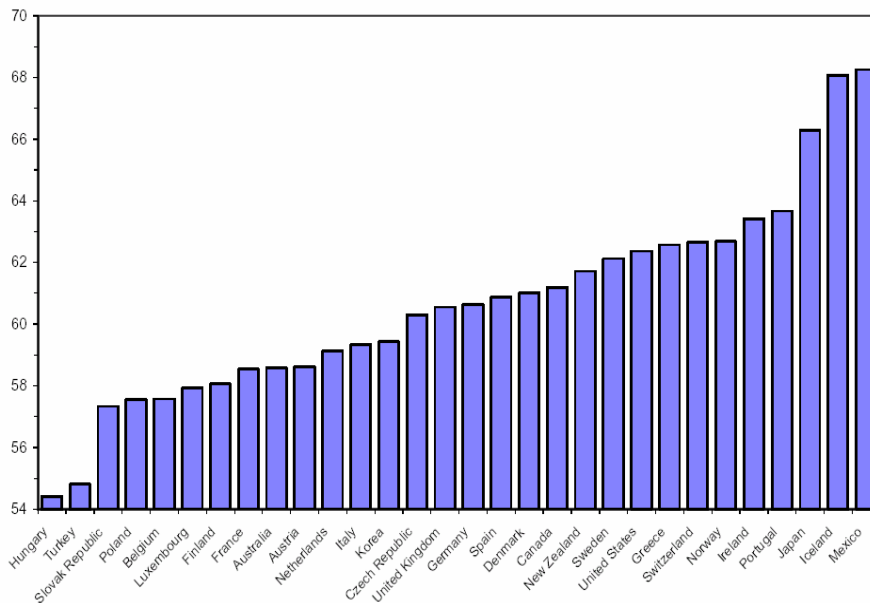
What has been the trend in the highly developed countries?

To work less.

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Figure 1. Retirement ages vary widely in the OECD

Estimated effective retirement age of older male workers in 2000

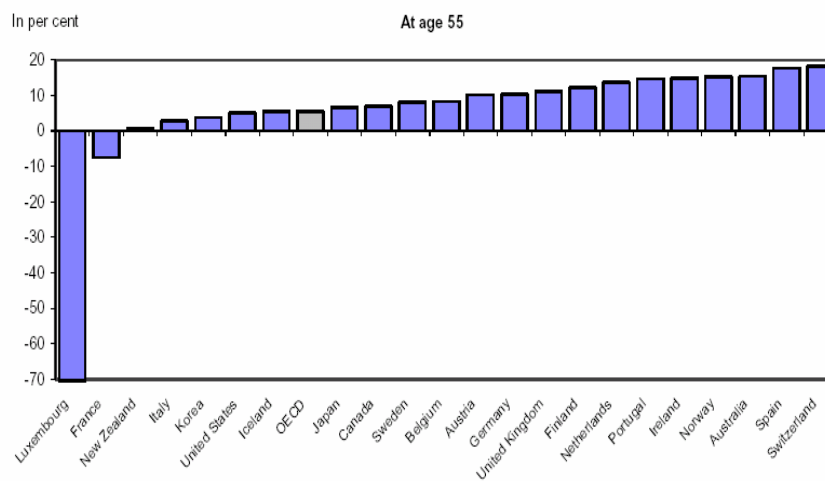


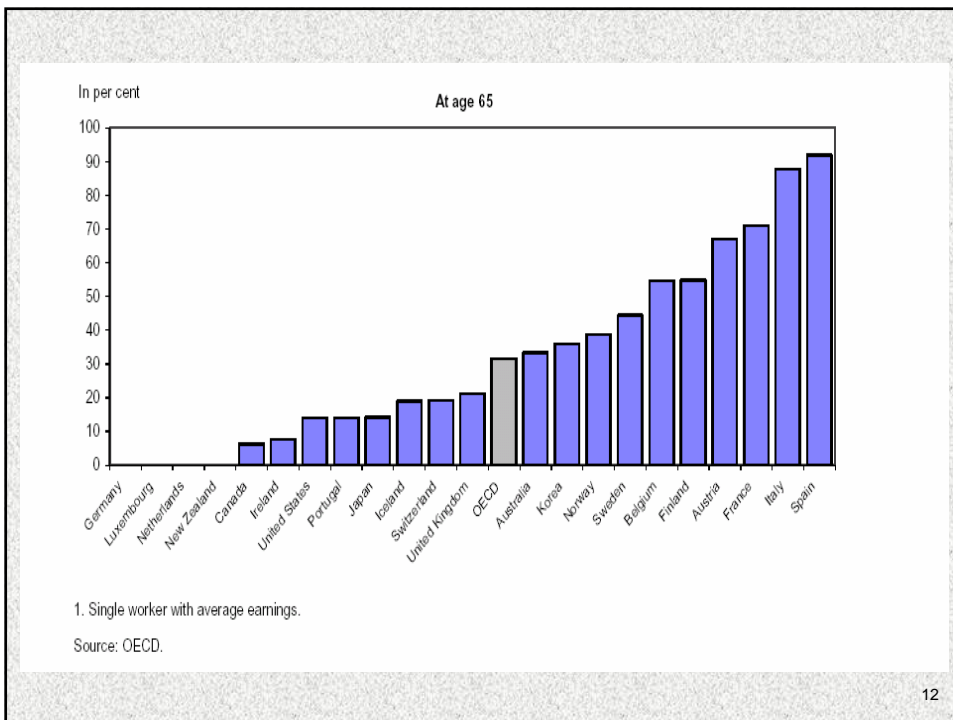
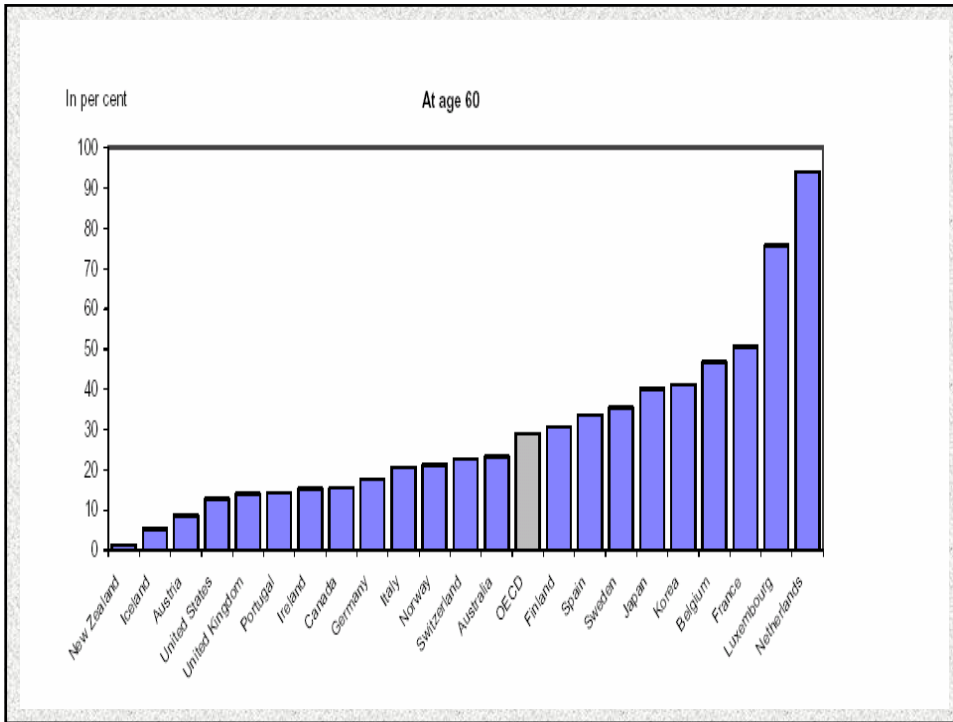
Must change the incentive to retire by reducing the implicit tax on continued work.

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Figure 3. Financial incentives to continue working decrease as individuals age

Implicit tax rates on continued work over next 5 years in current old-age pension systems¹





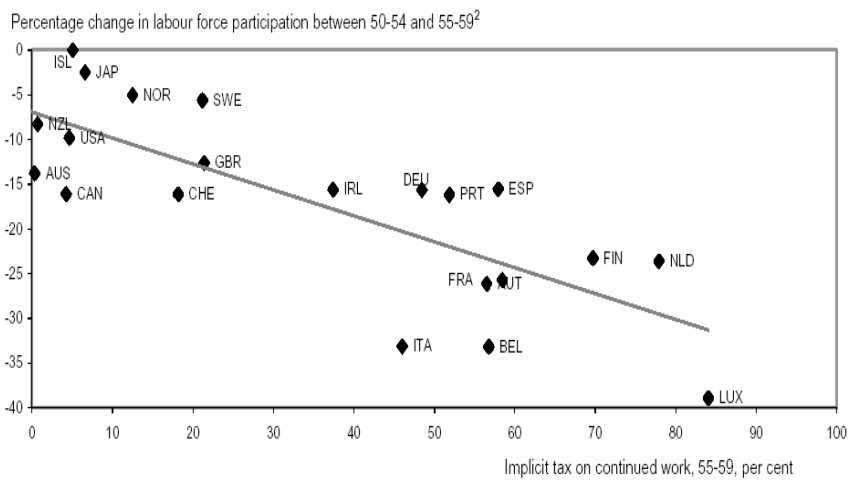
People respond to incentives. The higher the tax on continued work, the more people withdraw from the workforce.

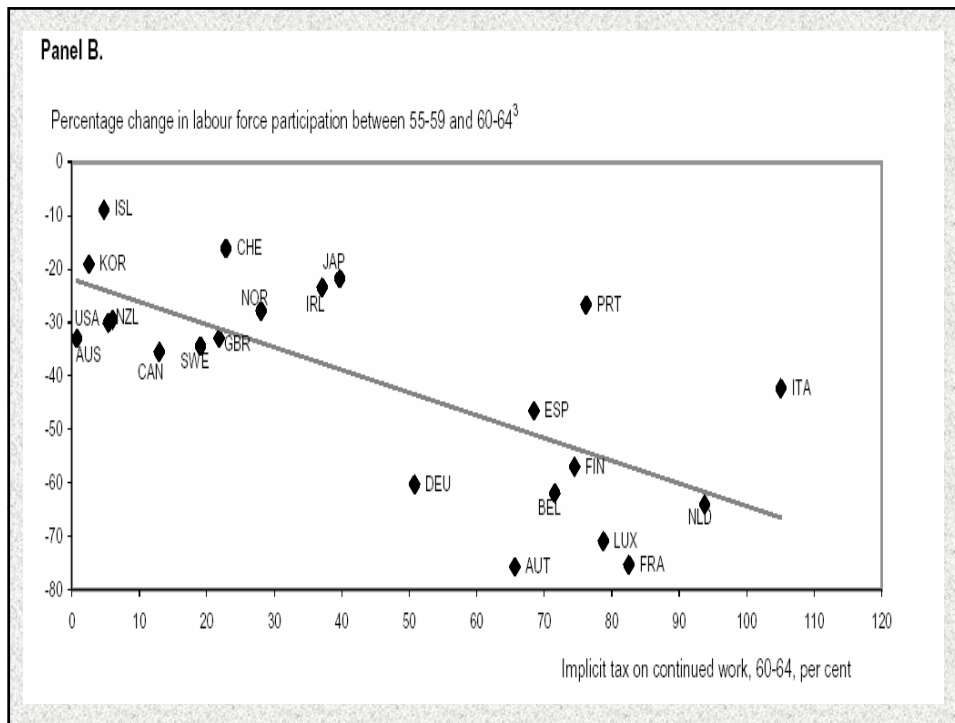
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Figure 5. High implicit taxes encourage labour market withdrawal

Fall in male labour participation between two consecutive age groups and implicit tax rates on continued work, 1999¹

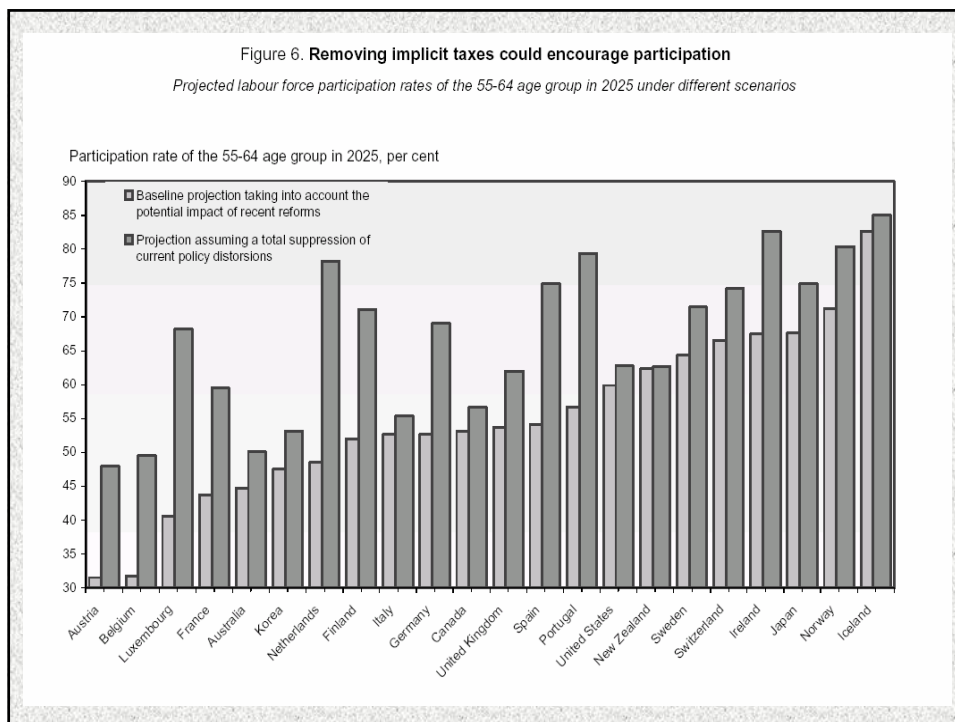
Panel A.





Implication

– remove disincentives to continue working.



The Leisure State.

The leisure state is unsustainable.

People should be free to choose between working more and consuming more, or enjoying considerable leisure and lower levels of consumption.

Role of the state should be to not distort these choices.

Policy options

1. Flexible labor markets for the old
2. Modest guaranteed state pensions plus self-financed private pensions
3. Eliminate compulsory retirement ages
4. Eliminate the tax on continued employment by the elderly