Nonfinancial Defined Contribution Schemes in a Changing Pension World: An Overview

EcoAustria – European Center – IHS Workshop on “Beitragskonten auf Umlagebasis” Industriellenvereinigung, September 24, 2012
Road Map

- What is NDC?
- Book overview
- Key Policy Lessons
- Policy Research Agenda
What is NDC?
The Beauty of Simplicity …

- **Fixed contribution rate** for all generations.
- Individual contributions (by employee, employer, and government) noted on personal accounts
- **Rate of return** paid consistent with PAYG scheme (using proxies such as nominal covered per capita wage & covered labor force growth)
- **Life annuity** based on individual’s account balance and cohort (unisex) life expectancy at retirement + rate of return
- **Minimum pension age** – but can work & contribute after this age – part or full time.
Distinguishing and promising micro features of NDC

- **Individual accounts give transparency**
  - They state clearly the individual’s claim on future consumption

- **Intra-generational fairness**
  - Present value of a unit of contributions gives the same pension increment for all – i.e., no tax wedge

- **Intergenerational fairness**
  - All generations pay the same % of GDP into pensions

- **Transparent social policy through non-contributory rights**
  - e.g., for early years of childcare, periods with sickness, disability, unemployment (financed with general revenues)

- **Accounts can be shared between spouses/legal partners**
  - e.g. acquiring the accumulation period and/or joint annuities can be created at retirement

- **Accounts can be combined with other insurance accounts**
  - e.g. severance pay, unemployment
Distinguishing and promising macro features of NDC

- **Financial sustainability**
  - achieved through the internal rate of return, and
  - integration of longevity changes into the pension formula

- **Labor supply incentives**
  - Direct link between contributions and benefits
  - no tax wedge → neutral for labor supply decisions
  - encourages labor force formality
  - annuity construction provides an incentive to postpone retirement with improving longevity
Book overview

- 2 volumes

Volume 1: Progress, Lessons, and Implementation

Volume 2: Gender, Politics, and Financial Stability

- 5 Parts

- 24 Chapters

- 58 authors/commentators

- 900 pages
Volume 1: Progress, Lessons, and Implementation

I. Taking Stock of Lessons and Issues

1 NDC in the Teens: Lessons and Issues
   Robert Holzmann and Edward Palmer

2 The First Wave of NDC Reforms: The Experiences of Italy, Latvia, Poland, and Sweden
   Agnieszka Chloń-Domińczak Daniele Franco, Edward Palmer,

3 Parallel Lines: NDC Pensions and the Direction of Pension Reform in Developed Countries
   Edward Whitehouse

II. Reforms under Implementation, Consideration, Contemplation

4 Pension Reform in Norway: Combining an NDC Approach and Distributional Goals
   Arne-Magnus Christensen, Dennis Fredriksen, Ole Christian Lien, and Nils Martin Stølen,
   COMMENT: Tarmo Valkonen

5 Egypt’s New Social Insurance System: An NDC Reform in an Emerging Economy
   Mohamed Maait and Gustavo Demarco
   COMMENT: Jorge Miguel Bravo

6 China: An Innovative Hybrid NDC Design Proposal
   Zheng Bingwen
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Harry Flam

Reflections on Introducing NDC in the Arab Republic of Egypt and Other Emerging Economies

Mohamed Ahmed Maait
Key Policy Lessons

- NDC schemes work well, as shown by the experiences of Italy, Latvia, Poland, and Sweden, but there is room to make them work even better.
- Go for an immediate transition, to avoid future problems.
- Identify and finance the transition costs in an explicit manner as they emerge—you will have to face them sooner or later.
- Adopt an explicit stabilizing mechanism to guarantee solvency.
- Establish a reserve fund to guarantee liquidity.
- Develop an explicit mechanism for sharing systemic longevity risk.
- Identify, analyze, and address the gender implications of NDC schemes.
Policy Research Agenda

- Assessing the outcomes of NDC schemes in view of the primary goals of pension systems and in comparison with alternative scheme designs
- Developing better measurement(s) of pension assets and liabilities to guide the introduction, adjustment, and sustainability of NDC schemes
- Clarifying the interaction of NDC (as a central consumption-smoothing pillar) with other pillars and benefits
- Addressing the design and implementation issues of NDC schemes in low- and middle-income countries