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PRESS RELEASE

Voting on pensions: a survey
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This article is intended to state the latest position on the theoretical literature concerning the political economy of the pensions systems. The "new political economy" is becoming increasingly important in public economics. This line of thinking is concerned with the way in which a particular economic policy is adopted, rather than considering the policy as an exogenous factor. The economic agents can in fact influence economic policy via the electoral system, or more generally via politics. The simple hypothesis adopted in this article is that the existence and size of the redistributive pensions system are decided by majority voting. The article is theoretical in character.

The analysis is based on a very simple model with two overlapping generations and fixed remuneration for the production factors. The population is divided into "young" active people and “old” pensioners. If the population is growing, the latter are in the minority and the payment of any pension depends on the goodwill of the "young". The latter will not be interested in paying pensions unless (i) they are confident that the next generation will do the same for them, and (ii) the pensions system yields a higher return than private savings. The question of instilling confidence is examined using the tools of non-cooperative game theory. At a constant contribution rate, the yield on the pensions system exceeds the return on private savings if the economic growth rate is higher than the interest rate. Although the empirical debate on this subject is not over yet, many people think that this is an unrealistic hypothesis.

However, that criticism can be easily set aside by enhancing the analysis framework. For example, we can make the remuneration of the production factors endogenous. We can also take account of the diversity of the group of voters active on the labour market. This differentiation operates in two directions: the introduction of multiple age bands for workers, and allowance for the fact that workers do not all have the same productive capacity.

If the remuneration of the production factors is endogenous, the adjustment of the stock of productive capital to the introduction of the pensions system will produce opposing effects on the agents’ wealth, because funding the pensions entails a reduction in the productive capital and hence a reduction in wages and an increase in the remuneration of savings. In the event this combination proves advantageous for the first generations to contribute, the advantage turns rapidly into a disadvantage for subsequent generations.

Given an increase in the number of age groups for agents active on the labour market, the decision on pensions rests with voters of median age. If those in that age group are not right at the start of their working life, their opinion on this decision is biased since it does not relate to their entire life cycle. In that context, support for a pensions system will be greater the longer the life expectancy, the lower the retirement age or the lower the birth rate. If we now consider that workers do not have the same productive capacity and acknowledge that redistributive pensions systems do not merely redistribute wealth between generations but also within the same generation, the coalitions game will be greatly influenced by the equalising character of pensions. The more this dimension is present, the greater the benefits for the least well-endowed workers in supporting a generous pensions system which provides them with a much higher return than private savings.

For each of the hypotheses described above, a static comparative exercise reveals how a change in the basic parameters influences the decision of the median voter. The conclusions of this type of exercise obviously differ according to the hypotheses adopted, demonstrating the importance of taking account of the various dimensions examined as regards the pensions question. This type of study produces rather different conclusions from traditional normative analysis, and illustrates the problems of implementing an optimal economic policy, even if one were identified.

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