



# Reforming Pensions: Principles and Policy Choices

By Nicholas Barr, Peter Diamond

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**Reforming Pensions: Principles and Policy Choices** By Nicholas Barr, Peter Diamond

Mandatory pensions are a worldwide phenomenon. However, with fixed contribution rates, monthly benefits, and retirement ages, pension systems are not consistent with three long-run trends: declining mortality, declining fertility, and earlier retirement. Many systems need reform. This book gives an extensive nontechnical explanation of the economics of pension design. The theoretical arguments have three elements:

- \* Pension systems have multiple objectives--consumption smoothing, insurance, poverty relief, and redistribution. Good policy needs to bear them all in mind.
- \* Good analysis should be framed in a second-best context-- simple economic models are a bad guide to policy design in a world with imperfect information and decision-making, incomplete markets and taxation.
- \* Any choice of pension system has risk-sharing and distributional consequences, which the book recognizes explicitly.

Barr and Diamond's analysis includes labor markets, capital markets, risk sharing, and gender and family, with comparison of PAYG and funded systems, recognizing that the suitable level of funding differs by country.

Alongside the economic principles of good design, policy must also take account of a country's capacity to implement the system. Thus the theoretical analysis is complemented by discussion of implementation, and of experiences, both good and bad, in many countries, with particular attention to Chile and China.

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### Editorial Review

#### Review

"The book is a must-read for any student who wants to work in public administrationsince pensions affect virtually every sector of public policy, and increasingly so in developing countriesand not only for pension experts. It is extremely well written and clear, and it is an intellectual joy to separate the two voices in this masterpiece of economic music: the first and fundamental voice of scientific deduction, almost always intertwined with the second, lower key voice of a legitimate but not uncontroversial paternalistic view of a largely benevolent government."--*Economic Development and Cultural Change*

"Two of the finest minds in the economics profession lucidly explain the theory and practice of pensions. They uncover the various trade-offs in designing and reforming pension systems in an imperfect world. While difficult, good reforms appear to be possible. I wish that this book had been available when I became interested in pensions. It would have saved me a lot of time and energy."--Lans Bovenberg, Scientific Director, Netspar, Tilburg University

"This is a wonderful book. Two very smart economists, steeped in theory and exposure to real-life pension issues, lay out the principles for good pension reform. They emphasize that pensions have multiple purposes-consumption smoothing, poverty relief, insurance, and redistribution, that we live in a 'second best' world, and that, because countries vary significantly in their stage of development, fiscal capacities, and administrative capabilities, there is no single best pension design. Yet using a host of international examples, the authors demonstrate how sound economic principles lead to good pension systems, and how analytical errors lead to trouble. This sophisticated yet highly readable volume should serve as a road map for any country embarking on pension reform."--Alicia H. Munnell, Director, Center for Retirement Research at Boston College

"Nick Barr and Peter Diamond have each written some of the best pieces on social insurance and pensions. Here they combine their comparative advantages to offer us a path-breaking book on this more-than-ever hot topic. This book brings together the analytics of pensions with discussion of some country experiences. The relevancy and wisdom of their view of reform can be summarized by their statement that 'The answer lies less in the underlying economic and demographic realities than in the political difficulty of adapting pension and health care systems to those realities.' This is the message of realism that they convey throughout their book."--Pierre Pestieau, Professor of Economics, University of LIEGE

"Finally we have a nontechnical, widely accessible and insightful book that brings together the analytics of pension reforms with a discussion of some important country experience. The authors, leading experts, use deep concepts of modern economic theory, such as incentives, risk-sharing, and behavioral aspects of savings and labor supply. All major topics and controversies are covered, superbly explained, and succinctly

summarized. This book will become a standard reference on the subject."--Eytan Sheshinski, Professor of Economics, Hebrew University

"This is a splendid, comprehensive book that social policy participants will want to read.... Highly recommended."--*CHOICE*

## About the Author

**Nicholas Barr** is Professor of Public Economics at the London School of Economics, the author of numerous books and articles, and a Trustee of HelpAge International. He spent two periods at the World Bank working on income transfers in Central and Eastern Europe and has been a Visiting Scholar at the Fiscal Affairs Department at the IMF. He has been active in debates about pension reform and higher education finance, advising governments in the post-communist countries, and in the UK, Australia, Chile, China, Hungary, New Zealand and South Africa.

**Peter Diamond** is an Institute Professor and professor of economics at MIT where he has taught since 1966. He has been President of the American Economic Association, of the Econometric Society, and of the National Academy of Social Insurance. He first consulted to U.S. Congress about Social Security reform in 1974. He has consulted about social security to the World Bank and has written about social security in Chile, China, France, Germany, Italy, the Netherlands, Spain, Sweden and the UK as well as the US.

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**Tom Tucker:**

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