Retirement savings in an aging society: A case for innovative government debt management.

Henning Bohn (University of California, Santa Barbara)

Abstract. Aging societies will have to rely increasingly on private savings to finance retirement. The natural savings vehicles, stocks and bonds, are unfortunately lacking key risk-sharing features that are built into public retirement. Innovative government debt management can address this problem. The optimal policy supplies retirees with securities that share the financial risks of aggregate productivity, asset valuation, and demographic shocks across generations. As the population ages, state-contingent government bonds are a better risk sharing tools than pensions, which become too costly, or taxation, which raises time-consistency problems. Wage-indexed and longevity-indexed bonds in particular yield unambiguous efficiency improvements. To the extent that public pensions remain important, plans with wage-indexed defined benefits seem preferable to defined contributions or price-indexed plans. Capital income taxes and pension trust funds can play a supporting role for risk sharing.