Discussion of

“Voting over Type and Size of a Pension System when some Individuals are Myopic”

by Helmuth Cremer, Philippe De Donder, Dario Maldonado and Pierre Pestieau

Dirk Krueger

University of Frankfurt, CEPR, and NBER

TAPES Conference on Public Policy in Uppsala
June 12, 2006
The Question

- What is the voting outcome on social security in an economy with some myopic households.

- Two dimensions of the social security system:
  - Size of the system.
  - Degree of redistribution from the system.
The Structure of the Problem

\[ \alpha = 0 \text{ Beveridge} \]
\[ \alpha = 1 \text{ Bismarck} \]

\[ \tau_p = \tau E(wl) \]

- \( \lambda \) have \( \beta = 0 \), 1 - \( \lambda \) have \( \beta = 1 \)
- \( w \sim G(w) \), independent of \( \lambda \)
- \[ \text{Max} \log(c^\gamma - l^2/2) + \beta \log(c^o) \]
- \[ c^\gamma + s = (1-\tau)wl \]
- \[ c^o = s+p \]
- \( c^\gamma, c^o, s \) non-negative

\[ p = \tau wl \]
The Effects of Social Security

• Forced saving for retirement, beneficial for myopic households.

• Redistribution in case of the Beveridgian system.

• But: potential labor supply distortions and savings distortions: for the myopics in both systems, for the far-sighted in the Beveridgian system, in the Bismarckian system if \( s = 0 \).

• Note: no implicit tax on capital income from social security since \( n = r = 0 \).
Main Results

- Suppose that
  \[ \lambda + (1 - \lambda) \Pr \ w^2 \leq \frac{2}{3}E(w^2) \geq 0.5 \]  
  (Condition 1)
  Then \( \tau(\alpha = 0) = \tau(\alpha = 1) = \frac{1}{4} \).

- All myopics with \( w^2 \leq E(w^2) \) prefer a Beveridgian system. All far-sighted with \( w^2 \leq \frac{6}{7}E(w^2) \) prefer a Beveridgian system.

- If \( \lambda = 0 \) or \( \lambda = 1 \), a Beveridgian system is implemented. For many \( \lambda \) close to 0 or 1, too.
Main Results

- But: Bismarckian system may be implemented, e.g. if $\lambda = 0.5$ and sufficient mass in the right tail of the wage distribution.

- Note: Bismarckian system has support from high wage individuals of both groups, because of dislike for redistribution, and lower labor supply distortions for part of the far-sighted.

- Note: If Condition 1 is not satisfied, a change in $\lambda$ also affects $\tau(\alpha = 0)$. 
Some Comments: Robustness

- Suppose households have preferences

\[ \log(c^y) + \log(1 - l) + \log(c^0) \]

Qualitatively similar results, even though labor supply for myopics, for far-sighted non-savers not distorted by social security system.

- Here: one-shot game, one generation. No intergenerational (but intra-generational) conflict. Question: will the system and size be maintained if there is repeated voting? Some exciting recent work: Boldrin and Rustichini (2000, RED), Cooley and Soares (1999, JPE), Hassler et al. (2005, JME), Krusell et al. (1997, JEDC), Song (2006, mimeo).
Some Comments: Interpretation

- Are agents really myopic? Don’t think so! They suffer from a self-control problem (cannot save), but are perfectly aware of this when making voting decisions. Important for the calibration of $\lambda$. Note: $s = 0$ may be optimal for the far-sighted, so hard to identify $\lambda$ from savings behavior in the data.

- Optimal social security system when some agents are myopic? Similar exercise to Feldstein (1985).

$$\max_{\alpha \in \{0,1\}, \tau \in [0,1]} \lambda V^M(\alpha, \tau) + (1 - \lambda)V^F(\alpha, \tau)$$

Allows to analyze the welfare losses induced by the political process.