

Introduction to The Economic Theory of Annuities

In: *The Economic Theory of Annuities*

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Abstract

Annuities are financial products that guarantee the holder a fixed return so long as the holder remains alive, thereby providing insurance against lifetime uncertainty. The terms of these contracts depend on the information available to insurance firms. Unlike age and gender, information about individual survival probabilities cannot be readily ascertained. This asymmetric information causes market inefficiencies, such as adverse selection. Groundbreaking in its scope, *The Economic Theory of Annuities* offers readers a theoretical analysis of the functioning of private annuity markets. Starting with a general analysis of survival functions, stochastic dominance, and characterization of changes in longevity, Eytan Sheshinski derives the demand for annuities using a model of individuals who jointly choose their lifetime consumption and retirement age. The relation between life insurance and annuities that have a bequest option is examined and "annuity options" are proposed as a response to the lack of secondary markets. This book also investigates the

macroeconomic policy implications of annuities and changes in longevity on aggregate savings. Sheshinski utilizes statistical population theory to shed light on the debate of whether the surge in savings and growth in Asia and other countries can be attributed to higher longevity of the population and whether this surge is durable. This book shows how understanding annuities becomes essential as governments that grapple with insolvency of public social security systems place greater emphasis on individual savings accounts.

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