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Current Pension Issues

Table of contents

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Trade Union Values and a Murky Debate

It may seem too obvious to be worth stating, but trade union views are likely to take as their point of departure, the view that a national pension system should be judged primarily on its ability to deliver adequate retirement incomes to as many people as possible. Income adequacy, in turn, will typically be judged in two dimensions: are incomes above some nationally recognized measure of poverty or low income; and, do they permit continuity in living standards both through the transition from work to retirement, and throughout the retirement period.

Maintaining the continuity of living standards over the entire period of retirement, rather than just at the moment of retirement, becomes increasingly important as life expectancy increases and, with it, the duration of the period of retirement. Conceptually, it is important to consider whether one is trying to maintain the purchasing power or real value of a pension, or whether one is trying to maintain the relationship between pensions in pay and the living standards that are generally enjoyed in a society. The former objective is typically met through price indexing, and the latter through wage indexing.[i]

Trade unionists have also shown a concern for making pension income predictable. Given the inherent uncertainties about future events that are relevant to providing a pension, this is an objective that can only be met if economic and demographic risks are pooled to some extent. Thus, trade unions have shown a widespread - though not universal – bias in favour of DB plans and publicly administered plans. Also, while it is seldom stated explicitly, there is also a tendency to want to protect established patterns of public pension provision, if only so that people can assess what needs to be done through individual or workplace initiatives to achieve retirement income goals. Continual restructuring of pension arrangements is inherently problematic.[ii]

While all of this may seem obvious, it is striking how little attention is given to these issues in official pension reform discourse. The policy reform prescription offered by the OECD focuses overwhelmingly on increasing the supply of older workers on the labour market and, to a lesser degree, on protecting public budgetary balances in the face of an increase in the demand for public spending that will be brought on by a growing share of the population being eligible for age related pensions. The World Bank reforms have also been designed to address the budget balance issue – an issue with respect to which the Bank has a particular self-interest – and the prospect that fully funded pension arrangements will encourage the emergence of innovative financial institutions and instruments, which will facilitate the process of economic growth. (Holzmann and Hinz, 2005).

One can debate the merits of these objectives. But the point that should not be missed is that these objectives have little to do with why pension plans exist in the first place. To the extent that the issue of income adequacy gets dealt with at all, it is often dealt with as a problem that has been solved for all time in the OECD area, and may only be relevant for particular parts of the older population (e.g. widows and immigrants). (See: OECD, 2001).

It is true that the income situation of the elderly improved substantially in the latter part of the 20th century in the OECD area. That has given rise to a widespread complacency on the issue of income adequacy that is not warranted. In many cases the data that has been relied on to generalize about pension and retirement issues is not appropriate.[iii] Moreover, in countries where there is a heavy reliance on pre-funded pensions, the growth in retirement incomes in the latter part of the 20th century was fuelled by a particular set of economic circumstances that included: high returns on financial assets; low inflation; and, low wage growth. The role played by economic circumstance in improving the real and relative incomes of the elderly, as opposed to the strength of the pension system, is seldom acknowledged, The same set of pension arrangements will not produce the same outcomes in alternative economic circumstances.

Not only does the object of the pension exercise get lost in much official discourse on pensions, but key terms in the debate are left in an obscure state, and fundamental considerations are ignored.

Frequently, the debate about the future of public pension programs is cast in terms of sustainability. But, the standard used to decide what is sustainable and what is not sustainable is seldom (if ever) made clear. Sometimes it is implicit that if tax increases are required by current arrangements, then they are unsustainable. If earlier generations had adopted this standard, most of what is presently in place would be unsustainable well before now.

But what may be most startling about the sustainability argument is that it seems never to apply to private arrangements. Thus proposals are made to cut public program benefits in the name of sustainability, and the hope is offered that private programs will replace them. But, if the private programs provide comparable benefits to a comparable number of people (and get their administrative costs down to public sector levels), then ‘the burden on society’ is no different than if the public arrangements were left in place.

Finally, much of the debate about pension reform is presented as if reform proposals are technically necessary. Yet the decisions that individuals and societies make about how employment and non-employment will be structured over the life course, and how income will flow over the life course, have substantial elements of pure preference in them, and so they should. For societies, there is a purely political element to these decisions and this is regularly ignored in much of the discourse. The importance of public preferences and particularly the preferences of working people, are largely ignored in the policy discourse.[iv]

<u>**Demographic Change**</u>

Much of the dialogue on pension reform is cast in terms of what is required by demographic change, and population ageing in particular. The most frequently cited indicator of population ageing is the growing portion of the population over some specified age that is a rough equivalent of retirement age – usually, age 60 or 65.[v] This phenomenon is often discussed in terms of the ageing of the post World War II ‘baby boom’.

There is a strong and undeniable element of truth in the point of departure for the demographically based discussion. Based on UN population projections, the portion of the world’s population over age 65 will increase from 6.9 % in 2000, to 16.1 % in 2050.[vi]

Europe and Northern America (Canada and the US) start out and end up as the oldest societies. But, other regions of the world are projected to get older at a faster pace, such as high and middle income East Asia (China, Japan, Korea and Taiwan) while South and West Asia, is ageing much more slowly.

It is worth noting too that while there is a popular interest in the role of the baby boom in causing this development, it is largely irrelevant (though it serves the politically useful purpose of creating an enemy). Most countries of the world did not experience a baby boom of any significance. The shift to older age structures is likely to last as far as one can see into the future. It is fuelled by increased life expectancy at older ages, and by lower fertility. These trends are global and are evident in all continents.

It is important to make note of developments regarding fertility. Some OECD countries have fertility rates as low as 1.2 (e.g. Italy, Korea, Spain). The clear consequence of a fertility rate below 2.1 is that the population will decline (unless there is a net inflow of immigrants). Worldwide fertility rates are declining toward 2.1 and population growth across the globe is expected to decelerate. Europe faces the prospect of absolute population decline over the coming half century.

Many stories of economic catastrophe are told around these demographic trends. Much of the OECDs policy story on ageing society revolves around the fear that population ageing and decelerating population growth will lead to slower economic growth, budgetary deficits and unsupportable public pension expenditures. Aggravating these demographic trends is a tendency to ever-earlier retirement. Thus, the OECD has promoted among other things, later age of eligibility for public pension benefits, more pre-funding of pensions and more private pension provision. (See: OECD, 1998).

It is undeniably true that if the relative incomes of the older population are maintained and their relative numbers increase in line with population projections, they will claim a larger share of national income. It is also likely that these forces will push up public expenditures on pensions, health care and other services for which the elderly are a disproportionately large clientele. However, in terms of its impact on the working age population, the increased transfers to the elderly will be offset in substantial measure by a decrease in public and private transfers to the young.

It is also important to note that while the income shares going to the elderly may be increasing in the years ahead (along with public budgets), these will likely be larger shares of larger incomes. What will happen to the earnings of the working age population net of pension contributions will depend on future productivity increases (provided that the benefits of the latter are distributed equitably). In most countries, productivity increases in the realm of between 1.0 % and 1.5 % per annum will keep generating increases in earnings net of pension contributions. These are modest but not trivial levels of improvement by historic standards and if demographic trends give rise to labour shortages as is commonly worried, then productivity improvements should be induced.

Much of the concern that has been expressed about demographic changes is interwoven with concerns about ever-earlier retirement. Moreover, analytic work done on the incentives to retirement in public pension plans has led to a conviction that the age of eligibility for public pensions needs to be increased[vii]. It is worth noting in context that the trend to earlier retirement has been over for as much as a decade in some OECD countries, and that employment rates are increasing for 55 to 64 year olds. In a number of high income countries people currently approaching retirement age have had greater educational opportunities than earlier age cohorts. They have entered the labour force at later ages, and smaller portions of them have worked in jobs where they have been exposed to heavy physical demands that break down the body. Thus, while it is important to resist the dogmatism that more work in late life is 'a necessity', it may not be safe to assume that earlier exit from employment will always be wanted[viii].

Balance Between Publicly and Privately Administered Pensions

The respective role of publicly and privately administered pension arrangements varies widely in the OECD area. Public and mandatory private pensions are estimated to replace more than 70 % of the pre-retirement earnings of men with median earnings in Austria, Finland, Greece, Hungary[ix], Italy, Luxembourg, Spain and Turkey. On the other hand, they are estimated to replace 40 % or less in: Australia, Ireland, Mexico, New Zealand, UK and US. Generally speaking public programs replace higher percentages of low earning than high earnings thanks to caps on earnings replacement in earnings related programs and the presence of universal flat rate programs and/or programs targeted on the low income elderly. (OECD, 2005).

The right balance between public and private arrangements is bound to be a political issue. On the one hand, the financial sector will always tend to look at publicly administered pensions as a market opportunity lost. On the other hand, trade unions and many social policy groups will have opening biases in favour of a strong role for publicly administered programs.

There are many good reasons for the bias in favour of publicly administered programs. They have the greatest possible risk pooling potential which is vital to operating DB programs and making retirement incomes predictable. They do not require pre-funding for purposes of insuring benefit promises as is typically required in privately administered arrangements. They can achieve administrative economies of scale and, if they are funded to some degree, they can capture efficiencies in the investment area as well. In addition, compared to an alternative of 'voluntary' workplace pensions, they have the advantage of solving chronic problems of limited coverage, portability and limited protection against inflation. With regard to coverage, generally public plans are more responsive to changes in the structure of labour market and the increasing casualisation of employment (i.e. replacement of a single lifelong job with a succession of short term jobs interspersed with unemployment).

Despite these clear advantages of publicly administered programs, there are both theoretical and practical reasons why a trade union movement might choose not to propose a pension system that is entirely publicly administered. One limitation is that publicly administered programs are subject to political risk. If a political system is prone to major swings in the outlook of those in power, it may not be appropriate to encourage people to rely too heavily on a major public pension program. It may be possible to develop decision-making structures that involve social partners that might mitigate this risk[x].

There is also an important question whether retirement income needs are sufficiently homogenous to allow them all to be substantially met through one or more public programs.

To this point, publicly administered pensions have been referred to as if they are an homogenous entity. Yet there are at least three generic types that are commonly found:

First: there are means or income tested programs that are commonly tax financed and operate on a pay-go basis. They are typically provided to all of the elderly who meet requirements based on a combination of: age; period of residence or citizenship; and, economic resources at their disposal.

Second: there are universal flat rate programs that are also commonly tax financed and operate on a pay-go basis. They are typically provided to all of the elderly who meet requirements based on a combination of age and period of residence or citizenship.

Third: there are compulsory earnings related programs that are typically financed by employer (and employee) contributions on a pay-go basis. Benefits are usually based on some measure of pre-retirement earnings and years of contributions to the plan. These plans may include minimum benefit provisions and benefits in pay typically receive some form of regular adjustment to reflect price or wage movements. There are some examples of plans of this generic sort having significant reserve funds that will use investment income to cover a portion of expenditures, and examples can also be found of some tax financing to supplement employer (and employee) contributions for these plans.

The first two types focus on age versus retirement as the basis for payments, and they focus more on minimum income protection than on earnings' replacement. They tend to play a relatively more prominent role in liberal societies, other than the US, than they do elsewhere in the OECD. They are also found in Nordic countries where, except for Denmark, they exist side by side with substantial publicly administered earnings related plans. However, it is worth adding that flat rate benefit plans also contribute to earnings replacement and do so in a redistributive manner.

The third type of plan is designed specifically to replace pre-retirement earnings. In continental Europe plans of this sort often form a substantial part of the entire pension system. This type of plan has substantial advantages over most alternatives as a way to provide retirement income to people retiring from long periods of formal employment.[xi] For others, they function less effectively. They may or may not include significant internal redistribution and the self-employed may or may not participate in them. Because plans of this sort that are financed by earnings related contributions they can drive a substantial wedge between take home pay and total labour costs, they can induce tax avoidance, particularly on the part of low wage workers and/or their employers. They are also vulnerable in periods of severe economic distress when their revenue base may contract, while their beneficiary base does not.

DB versus DC

Most, but not all trade union movements have shown a preference for DB pensions versus DC pensions, and this widespread preference reflects the greater certainty of the benefits that will be provided on retirement by DB plans. The general absence of risk pooling in DC plans means that individuals bear virtually of the risks entailed in the lack of certainty about: future wages and salaries; rates of return on investment during working life; annuity prices at the date of retirement; and so on. Where participation in a DC plan leads to the purchase of an annuity, there is pooling of longevity risk which is taken on by the vendor of the annuity. But, where participation leads to a 'phased withdrawal' of assets, the longevity risk is also born by the individual plan participant and there is a chance that retirement assets will be exhausted while the plan member is still alive.

In addition to the general risks to which DC plans give rise, there may be subtle (or not so subtle) differential impacts by gender. In the absence of direct subsidization of years spent bearing and raising children, it is likely that women whose working lives are interrupted by these events will end up with lower benefits than their male counterparts. It is 'easier' to address this type of situation through cross-subsidization within a DB plan than it is within a DC plan[xii].

Several other aspects of DC arrangements are worth noting.

In most earnings related DB plans, benefits are directly proportionate to years of participation in the plan. All other things being equal, thirty years of service will provide 1.5 times the benefit that will be provided based on twenty years of service. But, because DC benefits rely on compounding interest during the accumulation phase, benefits tend to grow exponentially over time. Thus, years of participation early in one's working life have a disproportionate value. All other things being equal, thirty years of participation will be worth more than 1.5 times twenty years of participation.[xiii]

Also, while it might be theoretically possible to phase in DC benefits quickly, in practice this is not done. Thus, these plans take a significant period of time to mature and to deliver benefits. DB plans, whether they are pay-go or pre-funded, are capable of delivering newly established benefits more quickly.

The risks of DC are much smaller in cases where DC co-exists with other second and third pillar plans as in Sweden or Italy. DC risks are also mitigated in cases where the downside risks on investment returns during the accumulation phase are limited by investment return guarantees. Examples of these are provided by mandatory DC schemes in Denmark and Switzerland. In both cases governments provide guarantees of minimum rates of return.

The DB and DC worlds have been quite distinct until recent reforms in Sweden, Italy, Poland and Latvia implemented 'notional DC' plans that combine elements traditionally regarded as belonging to the two distinct types of plan[xiv].The fact that a notional account is built up during working life and run down in retirement is akin to a DC plan. But, the fact that the account is credited with returns based on movements in average wages is a difference that is significant. The degree of volatility will be much lower than in a conventional DC plan, and the notional accounts should maintain a closer relationship to movements in the standard of living of working people[xv]. But, in other respects the notional DC schemes are very similar to DB schemes with a career average adjusted benefit formula, and actuarial adjustments for retirement ages other than the normal retirement age. The pay-go nature of the notional DC plans is also similar to second pillar DB plans.

The support for DB plans by most trade union movements reflects a conviction that key sources of retirement income should be predictable. It is, however, worth reflecting on certain aspects of DB arrangements. In particular, it is important to think about how post retirement adjustments affect living standards over the retirement period. Many pension plans have recently shifted from wage based adjustments to price based adjustments. These are capable of protecting the real income of retirees, but not income relative to prevailing living standards. With retirement periods commonly reaching 15 years in high income countries, 1.5 % annual real income growth will cause the relative incomes of retirees to decline by roughly 20% over a retired life of 15 years[xvi].

Generally speaking, DB benefit formulae will provide benefits linked to the work history of the individual while the post-retirement adjustments are linked to general economic developments (wage or price movements). Under normal economic circumstances, pensions that are based on individual work histories and are adjusted appropriately can establish appropriate relative incomes and income shares for the elderly. But all that can really be guaranteed to the elderly is a 'fair income share', and one can imagine economic circumstances under which it would be very difficult to honour widespread promises based on individual work histories (e.g. a period of general economic collapse, or period of prolonged deflation where downward adjustments to nominal benefits was not allowed).

Pre-funding versus Pay-Go

In the context of recent pension debates, the issue of pre-funding has taken on new significance as pre-funding has come to be equated in both policy discourse and actual pension reforms with a move to privately administered individual accounts. Yet, there is no reason in principle why the objective of a higher degree of funding could not be achieved by increasing the size of reserve funds under second pillar DB plans. There are, in fact, a few instances of very large reserve funds being associated with second pillar DB plans

From the point of view of achieving improvements in benefits, there are some aspects of pre-funding versus pay-go that are worth considering.

It is likely easier to phase-in benefits quickly under pay-go DB plans and pre-funded DB plans, than under DC plans. Moreover, while fully funded DB plans can achieve this objective, they require very high levels of contribution in the early years if any element of past service is recognized under the plan and funding targets are linked to the plans liabilities in whole or in part. The relative ease of phasing in benefits quickly under pay-go plans is one of its virtues. But, this strength of pay-go is accompanied by the common need to increase pay-go contributions with no increase in benefits as larger portions of the elderly population become eligible for the new benefits[xvii].

Levels of contributions required by the two funding methods may differ even after the plans reach their maturity (i.e. after some age cohorts have spent their entire working and retired lives participating in the plans). Generally, if aggregate wage growth exceeds rates of return on financial assets, pay-go contributions will be lower. Conversely, if returns on financial assets are higher, pre-funding will lower contribution rates. If labour force and employment trends follow the population trends noted above, aggregate wages will be at or below levels of individual wage growth. Rates of return on financial assets might be expected to exceed aggregate wage growth on average over the long term, but much more caution on this point is required than is found in much of the commentary supporting pre-funding.

Caution is required first of all because there will be feedback from demographic change into the operation of pre-funded systems. It has been recognized for some years that in so far as personal savings are targeted on the provision of retirement income, the ageing of society implies a growing number of sellers versus buyers of financial assets. Moreover, it is more common to try to match retired life liabilities in pre-funded schemes with bonds than with stocks, and the ageing of society implies a relative growth in retired life liabilities (i.e. a shift in asset allocation from stocks to bonds). As a result, societal ageing will likely decrease the extent to which pension funds try to capture the equity risk premium. Finally, if labour and capital shares of national income remain fairly constant, and demographic change induces a slowdown in aggregate wage growth, then the capital income that can be tapped through pre-funding will also be affected. In short, even if pre-funded contributions are lower, they will not be on a dramatically different trajectory than pay-go contributions[xviii].

It is important to note two additional things about a move to greater funding.

If increased funding lowers required contributions, it does so by supplementing contribution income with investment income. Investment income comes generally from the capital income stream in the economy which is much narrower and more volatile than labour income. Thus, if increased funding is associated with very precise DB funding targets, the targets are likely to be exceeded or missed on a regular basis. This reality can translate into volatility in pension contributions which may be more troublesome than higher but more stable contributions in a pay-go regime. For DC plans, the volatility of investment income translates directly into retirement income volatility[xix].

Much of the argument in favour of increased funding bears little relation to the adequacy of the retirement benefits that will be provided or to the best way of providing them. It focuses largely on the economic consequences of different funding systems.

In the mid 1970s, it was argued that the pay-go nature of the US social security system had reduced savings, investment and economic growth in the US by a significant amount. The analysis and debate on this issue has carried on ever since with very mixed results. As a result, while one still hears echoes of this original debate, it enjoys a less prominent place in the arguments in favour of pre-funding than it once did. In addition, it is now recognized that in extreme cases of societal ageing, pre-funded systems may have a negative impact on savings as benefit payments come to exceed contributions and investment income[xx].

Finally it is worth questioning how important it is to establish intergenerational equity within a pension system. Many of the early beneficiaries of net intergenerational transfers in second pillar DB plans are the currently elderly and the elderly of the recent past. In many societies it is accepted that these generations endured a great deal and left an important, positive economic and social legacy. The fact that they are on the receiving end of an intergenerational transfer through the pension system is an acceptable quid pro quo. Much of the argument about intergenerational fairness seems to be politically motivated to discredit pay-go public plans. The issue of intergenerational fairness is a serious one. But, while much of the commentary on the issue focuses on financial issues, the most important issues have non-financial definitions. It is important that each generation of young people inherit from their predecessors: a capital stock of sufficient size and quality to permit full employment at high incomes; an environment that is useful for both production and consumption; the skills and knowledge required for production, civic responsibility and personal enjoyment; and, social peace.

Governance in Public and Private Pensions

A great deal of good can come from the successful implementation of a well designed publicly administered pension plan. But, even a well designed plan can be seriously undermined if it is badly managed. Bad management can arise in many areas of a plan's operations.

Public programs require regular actuarial analysis, the results of which should be in the public domain. Estimates of future retirement incomes should also be prepared on a regular basis, but seldom are. Plan administration should be open, transparent, competent, efficient and easily accessible to plan members. There should be an easily understood and timely procedure for appealing administrative decisions. Given the nature of the issues that revolve around public pension arrangements (e.g. adequacy of retirement income, age of retirement, required contributions, and so on), public pensions are an area that invites very active involvement of labour market partners in plan oversight and management. Moreover, this may be one of the ways in which broader public confidence in a plan is built.

With respect to privately administered pensions, the OECD Working Party on Private Pensions has addressed a number of key governance issues in its Core Principles of Occupational Regulation[xxi] and in its Guidelines on Pension Fund Asset Management[xxii]. These initiatives mark important progress in international understanding of what is required to permit privately administered pensions to function effectively. But, a number of problems remain unresolved.

A great deal of attention has been given to issues of plan governance in recent years. Much of this has focused on the need for increased expertise required to manage pension fund investments as prescriptive regulation has given way to a 'prudent person' approach, access to international financial markets has opened up, and a large number of new synthetic derivative products has emerged. Concern with this focus has had the unfortunate side-effect of leading to support for expert Boards of Trustees as opposed to Boards that include member representatives. It has also resulted in the obscuring of other important governance issues.

It is important to accept that the investment function has become more complex and that trade union representatives who participate in governance roles need appropriate training to deal with the new investment environment. But the governance of private pensions is an area where agency and conflict of interest problems abound. Employers who sponsor private pensions often consider them tools for implementing human resource policy. But, where their role as employer ends, and their fiduciary duty to plan members begins, is often unclear. This is especially worrisome where there is no plan member involvement in plan governance.

The duties of professional service providers are unclear too. They are commonly contacted and act on contracts to a sponsoring employer, but have public interest functions to perform within the framework of regulatory law. The potential for conflict of interest is clear. In the case of actuarial work, some countries address this issue by requiring an auditing actuary who is a different person or company from a plan actuary. Others do not.

In addition, pension plan governance often suffers from a tendency to treat financing policy, investment policy and benefits policy as separate spheres each dominated by its own expert advisor. The implications of the decisions taken in one sphere on the others are not always sufficiently clear to plan governors[xxiii]. Financing, investment and benefits policy should be treated as an integrated relationship so that mutual influences are clearly understood, and unhappy surprises are minimized. Unfortunately, the prevailing concern with investment expertise has left many of these issues unexamined.

It is worth reflecting too on the relationship between plan member involvement in plan governance and what is required of the regulatory regime. Some jurisdictions that have not wanted to require plan member involvement in plan governance have very prescriptive regimes to protect plan member rights. One wonders whether plan member involvement in governance might obviate the need to be quite so prescriptive.

Conclusions

The past decade has been a difficult period for many trade union movements as far as pension policy is concerned. Pension reforms have been implemented that do not reflect trade union priorities. In many cases, unions have mounted substantial opposition to them. Moreover the debate on pension reform has been frustrating. It has often focused on issues that are not germane to either the purpose of pension plans, or the central concerns of trade unions. In addition, arguments in favour of recent reforms have often relied too on unreasonably pessimistic predictions about the demographic future and its consequences.

In considering a trade union response to the current situation, it is important to acknowledge the reality of a wide variation in national circumstance in all of the economic, political and demographic spheres. These national differences will (and should) have an impact on what trade unions recommend with respect to pensions systems, and to the likely outcome of future reform processes.

Despite national differences, there is likely to be common ground among trade union movements on a few basic points:

> Pension and retirement income systems should be judged primarily, if not exclusively, on their ability to deliver adequate retirement incomes, without imposing an inequitable burden on the working age population;
>
> Adequate retirement incomes should allow people to retire from extended periods of formal employment without a significant loss in living standards, and provide all older people with incomes above nationally recognized low income measures;

Pension systems should have core programs that provides benefits that are reasonably predictable;

Publicly administered pension plans have a positive role to play in any pension system;

Pay-go financing of public programs has many desirable features and should be strengthened and not be readily abandoned; and,

Representatives of worker, plan members should play an important role in the governance of second and third pillar programs.

Moving forward on pension issues creates some important challenges for trade unions. It will be difficult to stem the tide on undesirable pension reforms unless trade unions succeed in bringing the focus of pension discourse back to income adequacy. This is an issue that needs to be addressed in terms of the well being of the retired population overall. It also needs to be addressed with particular populations in mind, notably women and immigrants.

Trade unions also need to do general pension education work with all levels of their membership. Trade union leaders need to be knowledgeable and confident advocates of progressive change. More specialized training is required for those who take on governance roles. Not all of this training has to be provided within the trade union movement. But the trade union movement does have a responsibility to be sure that the training is available.

It is important too, to encourage a life course perspective on pension and retirement issues. These issues often get dealt with as if they are only relevant to the current elderly whose interests are sometimes pitted against those of currently younger age groups. But, one reality of the youth population at any point in time is that they will be older population at a later point in time. It is important to encourage among today's youth a sense of interest and concern for how they will be provided with income and cared for in old age.

Finally, it is important for trade union representatives to engage in dialogue on pension issues with employers and government representatives, as well as policy specialists. But, there are likely very few political contexts where a trade union movement on its own will be able to establish the political support required to implement a progressive pension agenda. Trade union movements need to identify and engage other groups in society that are likely to share a common perspective on pensions issues.

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[i] A discussion of indexing options and their relationship to economic and demographic variables is available in Musgrave, 1980.

[ii] Some of the political science literature on pension reform refers to phenomenon of ‘path dependency’ which suggests that the outcome of reform processes will be heavily shaped by the institutional arrangements in place at the beginning of the process. (See, for example: Pierson, 1997). The point made in the text suggests that

‘path dependency’ is not just an observed fact, it is a virtue. It also calls into question some of the forceful demands for a complete paradigm shift in pension provision as provided by, for example, Holzmann , MacKellar and Rutkowski, 2003).

[iii] Generalizations about the strength of the pensions and retirement income systems are commonly based on income data derived from all income sources of individuals and/or households 65 and over. Despite the low labour force participation of this age group, a surprising amount of the total income of this age group still derives from wages and salaries in many OECD countries. A study of the incomes of older households based on data from the end of the 1980s and early 1990s found that in nine of fourteen European and North American countries, earnings from employment accounted for 10 % or more of household income. (See: Hausser, 1997). If one wants to generalize about pensions and retirement income, one should focus on the incomes of the fully retired (i.e. people with no employment income).

[iv] There is no purely technical answer to the question whether everyone should work longer (assuming for the moment that this is an achievable option) in order to raise aggregate and per capita GDP, or whether people should be employed for a shorter time and enjoy longer periods of non-employment. An element in some economics writing on pensions that is quite disturbing is a tendency to dismiss expressions of group views on pensions as the views of entrenched groups. There is always the connotation that groups should not be heard from. But of course, economists should be heard from – some much more than others. (See for example: James and Brooks in World Bank, 2001).

[v] It will not be discussed, but it should be noted that the active labour force will also be increasing in age, and this also has some important implications.

[vi] All of the UN population estimates cited in this paper are mid-range projections.

[vii] The ‘discovery’ that public pensions induce retirement is a bit like discovering that they do what they are supposed to do

[viii] Moreover, if labour force entry ages and life courses generally become more heterogeneous in terms of periods spent in and out of paid employment, the role that chronological age should play in defining access to pension benefits is worthy of debate. In some countries, young workers have delayed key passages in the life course (e.g. age of leaving the parental home, age of marrying and having children, age at which they get a ‘career job’) and these delays will have substantial effects on their future life course, including when they are likely to retire. (See: Beaujot, 2004).

[ix] In this account, all mandatory programs including mandatory DC are treated as public. The Hungarian and Mexican regimes now include significant mandatory DC components.

[x] Sometimes, concern about political risk is embellished by concerns about corruption and/or incompetence of the politicians and public officials who are responsible for overseeing public pensions. On the other hand, private arrangements also require substantial regulation and tax support, and if public officials are too corrupt or incompetent to manage a public program, they probably cannot be counted on to regulate a private one effectively.

[xi] An important conceptual issue in the design of earnings related public pensions is the decision as to what is a normal duration of working life. This decision is often only implicit. The way it relates to particular portions of the population is always important (e.g. women, immigrants, people engaged in high risk occupations).

[xii] In addition, there is some evidence in the US that women are more cautious investors than men and may, as a result, end up with lower DC accumulations. (Turner, 2001)

[xiii] Comments in this paragraph ignore changes in rates of return financial assets through time. To make the outcome of participation in a DC plan predictable, it is not sufficient to anticipate the average rate of return on investments over working life. One actually has to anticipate correctly, rates of return at different stages of life. (See: Thompson, 1998). The re-investment risk of converting an accumulation of assets into a lifetime income cannot be underestimated. (Walker, 2006)

[xiv] Earnings related contributions are made to these plans and a notional account is created for each contributor. The accounts are credited with a return based on growth in average wages and salaries. A significant degree of flexibility is offered in terms of when the account can be converted to a stream of income, and when it is converted the amount of the benefit payment is based on the age of the individual at the time of conversion and the life expectancy of the age cohort of which the person is a member. Life expectancies are established on a gender neutral basis. These plans operate on a pay-go basis.

[xv] The direct linkage of benefit payments to life expectancy of one’s age cohort is novel, and more like traditional DC than DB. The annuities purchased from DC accounts reflect changes in life expectancy in amounts of benefits paid as in notional DC accounts, while DB plans have fixed retirement ages and absorb changes in life expectancy through changes in contributions..

[xvi] . Moreover, some third pillar DB plans provide no post-retirement adjustments which means there is very little that is clearly defined in the DB plan other than the replacement rate at the moment of retirement. Because of their longer life expectancy, the issue of post retirement adjustments is a little more acute for women than for men.

[xvii] The relative ease of phasing-in pay-go benefits is an important element in what leads conservative commentators to suggest that pay-go DB plans are prone to make 'unsustainable' benefit promises. Sometimes this concern about pay-go DB plans is expressed by describing them as Ponzi schemes. This caricature ignores the similarity of pay-go and pre-funded schemes in a mature state, and the reality that most Ponzi schemes rely on geometric growth in the participating population.

[xviii] Given what was illustrated above with respect to demographic change, it may be possible to fend off the implications of demographic change in some of the older societies by investing in younger, faster growing economies. Some smaller high income and older societies seem to be practicing this approach with some success. But the full retirement income claims in the older high income world are likely too great to be satisfied by the investment opportunities available in the younger countries.

[xix] In a closed economic context, pre-funding is no different than pay-go in terms of the share of national income that will be paid out by a pension scheme. The amount paid out is determined entirely on the benefit side of the program or more specifically by the ratio of the pensioner population to the non-pensioners, and the ratio of average pension income to average non-pension income. What changes with pre-funding is the income streams that are tapped to pay for the pensions. But, even here, one could conceive of a pay-go tax base that included non-wage income. Indeed, most first pillar programs rely on the general tax base of governments as a source of financing.

[xx] Thus, in recent years, the World Bank has shifted the emphasis in its arguments in favour of pre-funding to the likelihood that pre-funding will encourage innovation in financial institutions and instruments and this, in turn, will facilitate economic growth. (Holzmann and Hinz, 2005).

[xxi] The Recommendation includes six core principles touching upon: 1. effective regulation, 2. establishment of pension plans, funds, and managing companies, 3. liabilities, funding rules, winding up, and insurance, 4. asset management, 5. rights of members and beneficiaries and adequacy of benefits, and 6. supervisory bodies.

[xxii] 2006 OECD Guidelines on Pension Fund Asset Management, 2005 OECD Guidelines for Pension Fund Governance and 2004 OECD Guidelines for the Protection of Rights of Members and Beneficiaries in Occupational Pension Plans. Draft Guidelines on Funding and Benefit Security are currently under consideration.

[xxiii] For example, the plan actuary may choose a discount rate that implicitly assumes the capturing of a substantial risk premium. Yet, no direct connection may be made between the work of the actuary, who has clearly made a statement about investment policy, and the fund manager.