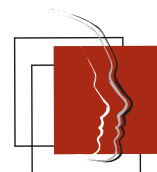


GURN

Global Union Research Network



International Labour Office
Bureau international du Travail
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Current Pension Debate for Trade Unionists: A Brief Canvass of the Issues

Bob Baldwin



The Global Union Research Network (GURN) is a cooperating project of the International Trade Union Confederation (ITUC), the Trade Union Advisory Committee to the OECD (TUAC), the ILO's International Institute for Labour Studies (IILS) and the Bureau for Workers' Activities (ACTRAV) of the ILO. The aim of the research network is to give union organizations better access to research carried out within trade unions and allied institutions.

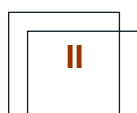


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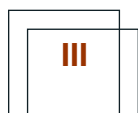
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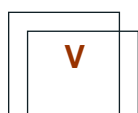
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1. INTRODUCTION

Nowadays pensions and retirement are freely associated with old age. But, their widespread nature is quite a modern development – largely a development of the period since World War II. Broad access to pensions and retirement reflects several modern economic and social developments: the spread of formal, market employment; the achievement of high levels of labour productivity; the tendency for extended families to give way to nuclear families; and the urbanization of populations.

While pensions and retirement are relatively recent developments in relation to the sweep of human history, they have fundamentally transformed the latter part of the life course. A centuries-old pattern, in which formal employment (and informal work) lasted until old age brought on physical and mental deterioration, has given way to a situation in which millions of working people worldwide can reasonably look forward to a period in later life in which material comfort can be provided without the need for employment, and good health can still be enjoyed. Modern pensions and retirement are key elements in the diffusion of the benefits of economic growth following World War II. (An excellent global overview of the evolution and operation of public pensions is provided by: Gillion et al, 2000.)

Trade unions have played an important role in the emergence of these institutions. Unions were in the forefront of calls for the creation of public pension programs. In cases where public pensions were not fully adequate to meet their members' needs, unions negotiated the creation and improvement of workplace pensions and, in many cases, accepted management responsibilities for them.

For much of the past decade, the positive achievement of the earlier period following World War II has been under attack and rolled back. An OECD publication in the year 2000 noted that 26 of the 29 member countries at that time had implemented pension reforms in the period since 1990 (OECD, 2000). The common reforms included: raising the age of eligibility for public pensions; lengthening the period over which wages and salaries are averaged for purposes of calculating benefits; changing the basis for adjusting retirement benefits in pay from a wage to a price index; reducing cross subsidies; and generally encouraging more private and pre-funded provision of retirement income.

Outside the OECD area, the World Bank and the various regional development banks have used a combination of persuasion and cajoling to restructure pension systems. The Bank has noted that between 1984 and 2004 it made loans to 68 countries with pension commitments attached to the loans (Holzmann and Hinz, 2005). A key element in the Bank's reform

agenda has been to replace publicly administered, earnings related, pay-go defined benefit (DB) pension plans with privately administered, mandatory individual defined contribution (DC) plans.¹

Trade union movements in countries where these recent reforms have occurred have generally not been supportive of them. In some cases the reforms have been accepted unenthusiastically; in other cases, the reforms have prompted unions to initiate strikes and demonstrations. National trade union movements have been engaged in pension reform debates to varying degrees.

The general purpose of this paper is to establish a basis for international trade union dialogue on pension reform. The paper reviews and comments on a number of common issues that trade union movements are forced to address in pension reform debates: demographic change, the role of publicly and privately administered pension, defined benefit (DB) versus defined contribution (DC) plans, and so on. It also notes some of the special issues that confront low income countries. In the final section of the paper, an attempt is made to articulate at a high level a general approach to pension reform for trade unionists.

Given the broad scope of issues covered in this paper and the hope of keeping its length manageable, none are covered to a fully satisfactory depth. Although an attempt has been made throughout the text to make it relevant to both high and low income countries, the paper reflects disproportionately the experience of the high income world. Some of the key issues that are distinct to low income countries are brought together at the end of the paper but more needs to be done on pension issues facing trade unionists in the low income world. It is also an unfortunate reality that much data is presented for OECD countries only due to a lack of comparable worldwide data.

Much of the debate on pensions and pension reform sinks quite quickly into unfamiliar technical detail as issues such as the relative merits of pre-funding versus pay-as-you-go, and defined benefits plans versus and defined contribution plans, are argued. These issues will be addressed below. First, however, it is worth taking stock of some of the values that might animate a trade union view, and the somewhat murky nature of recent public policy debates on pension reform.

¹ Many commentaries and critiques of the World Bank's efforts are now available. One important source of critical commentary is various editions of the International Social Security Review. Many of the issues and the intensity of the debate are captured in a collection of papers prepared by the Bank itself: World Bank, 2001 and World Bank, 2006. A self assessment of the Bank's work is provided by: Holzmann and Hinz, 2005. A trade union commentary on the Bank's approach was prepared by Peter Bakvis of the ICFTU (see: Bakvis, 2006).

2. TRADE UNION VALUES AND A MURKY DEBATE

Trade union views 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 will typically be judged by two criteria:

- 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?

The objective of maintaining living standards in retirement should be satisfied not only for people who spend their entire adult lives in paid employment. This objective should also be met for people who experience spells of unemployment as well as for people who leave the labour force temporarily to bear and raise young children.

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 length of the period of retirement (see: Table 2 below). Maintaining living standards over this lengthening period focuses attention on the question of how pensions in pay are adjusted. 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.² Concern for the maintenance of living standards also needs to extend to concern for the living standards of surviving spouses.

Concern for the maintenance of living standards is clearly significant for people whose adult life course includes substantial periods spent in formal, paid employment. It is desirable that people be able to leave paid employment at some age and live comfortably. In low income countries, the portion of the population for whom this condition is satisfied may be relatively small, but it remains a valid objective. In this context, concern might be greater than otherwise to make sure that earnings' related programs are not cross subsidized by the population at large.

² A discussion of indexing options and their relationship to economic and demographic variables is available in Musgrave, 1980.

The objective of protecting against poverty remains valid in all countries. In countries where poverty is pervasive, it is important to think through the appropriate forms of attention that might be given to the elderly versus other impoverished parts of the population.

While the primary concern of trade unionists is income adequacy, there are other considerations that will also be important.

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 unionists 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.³

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).

³ Some of the political science literature on pension reform refers to the 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 called for by, for example, Holzmann, MacKellar and Rutkowski, 2003.

It is true that the income situation of the elderly improved substantially in the latter part of the 20th century in the OECD area. Real incomes increased and so did incomes of the elderly in relation to the non-elderly (see: Yamada, 2002). The improved income situation of the elderly in the OECD area has given rise to a widespread unwarranted complacency on the issue of income adequacy. In many cases the data that has been relied on to generalize about pension and retirement issues is not appropriate.⁴ 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. More importantly, 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 some 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 have been 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. This kind of substitution might be justifiable if one could establish that a society has a different tolerance for private versus public expenditures. But this point is seldom (if ever) raised clearly.

⁴ Generalizations about the strength of the pension 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).

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.⁵ 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.

⁵ 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).

3. DEMOGRAPHIC CHANGE

Much of the dialogue on pension reform is cast in terms of what is required because of 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 65.⁶ 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 2050.⁷ Moreover, as we can see in Table 1, this development will occur in all continents, though there are clear differences among continents in both the starting and end points. Indeed, had the data been broken down by sub-groups of the elderly one would have noted more rapid increases in older subgroups (i.e. age 75 to 84, and 85+).

Europe and Northern America (Canada and the US) start out and end up with the oldest populations. But other regions of the world are projected to get older at a faster pace. Also, if Asia were broken down by country or sub-region it would be clear that it includes countries on quite different demographic trajectories. High and middle income East Asia (China, Japan, Korea and Taiwan) are ageing very rapidly. Much of South and West Asia is ageing much more slowly. India is on a much different demographic trajectory than China and will remain younger for a longer period, while also overtaking China in total population.

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. Moreover, among those that did, the age structure that will exist after the baby boom has died will not look like today’s age structure or that of the past. 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. Again, as can be seen in Tables 2 and 3, these trends are global and are evident in all continents.

⁶ 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.

⁷ All of the UN population estimates cited in this paper are mid-range projections.

Table 1. Percentage of the world population 65 and over, by region and year

Region	1950	2000	2050
World	5.2	6.9	16.1
Africa	3.2	3.3	6.7
Asia	4.1	5.9	17.5
Europe	8.2	14.7	27.6
Latin America and Caribbean	3.7	5.6	18.4
Northern America	8.2	12.4	21.1
Oceania	7.3	9.7	19.3
'More Developed' Regions	7.9	14.3	25.9
'Less Developed' Regions	3.9	5.1	14.6

Source: UN, World Population Prospects: The 2004 Revision.

Table 2 reveals that life expectancy at age 65 has been increasing in all continents for women and for men. The life expectancy of 65 year old women increased more over the last half of the 20th century than was the case for men: 4.5 years compared to 2.9 years. Female life expectancy at 65 increased by more than one month per year and male life expectancy by about seven tenths of a month per year. There is an intense debate about whether the increases in life expectancy that were experienced over the latter part of the 20th century will carry on into the new century.

There was also some convergence in life expectancy at 65. In Europe, life expectancy at 65 was greater than elsewhere in 1950, but Europe experienced the smallest increase of all continents. The life expectancy of European men increased by only eight tenths of a year over the fifty year period. At the other extreme the average life expectancy of 65 year old Asian women increased by 5.5 years. Overall, life expectancy at 65 increased more rapidly in less developed regions, albeit from a lower starting point, and was still lower by a material amount at the end of the period.

One important thing needs to be noted about Table 3. It includes whole continents with fertility rates below 2.1 in 2000-05 and 2045-50: 2.1 is the fertility rate required to reproduce a population of a given size. 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 to offset the decline to which the balance of births and deaths will otherwise give rise. Thus, as is illustrated in Table 4, population growth across the globe is expected to decelerate, and Europe faces the prospect of absolute population decline over the coming half century.

Table 2. Life expectancy at age 65, by gender, region and year

Region	1950 Female	2000 Female	1950 Male	2000 Male
World	12.5	17.0	11.3	14.2
Africa	10.5	13.7	9.7	12.4
Asia	10.6	16.1	10.2	13.7
Europe	15.9	18.0	13.6	14.4
Latin America and Caribbean	13.0	18.2	12.1	15.8
Northern America	15.6	19.8	12.1	16.3
Oceania	15.1	20.0	13.0	16.5
'More Developed' Regions	15.9	19.0	13.1	15.3
'Less Developed Regions	10.6	15.6	10.2	13.5

Source: UN, World Population Prospects: The 2004 Revision.

Table 3. Life total fertility rate, by region and year

Region	1950-55	2000-05	2045-50
World	5.02	2.65	2.05
Africa	6.72	4.97	2.52
Asia	5.89	2.47	1.91
Europe	2.66	1.40	1.83
Latin America and Caribbean	5.89	2.55	1.86
Northern America	3.47	1.99	1.85
Oceania	3.87	2.32	1.92
'More Developed' Regions	2.84	1.56	1.84
'Less Developed' Regions	6.17	2.90	2.07

Source: UN, World Population Prospects: The 2004 Revision.

Many a story of economic catastrophe is told around these demographic trends. Much of the OECD's 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. A minor theme in the OECD story is that the health and well being of older people requires more active engagement in employment and other activities, rather than passive TV watching. 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).

Table 4. Change in population size by size, region and period

Region	1950-00	2000-50
World	142%	49%
Africa	263%	138%
Asia	163%	42%
Europe	33%	- 10%
Latin America and Caribbean	213%	50%
Northern America	84%	39%
Oceania	142%	54%
'Most Developed' Regions	47%	4%
'Less Developed' Regions	187%	60%

Source: UN, World Population Prospects: The 2004 Revision.

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. 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. Bearing in mind that transfers to the young are more likely to take place inside private households whereas transfers to the elderly take place largely in the public sphere, shifting transfers from the young to the old can be politically difficult. But that is a different issue than the absolute burden on the working age population which is often the subject of discussion.

Moreover, in thinking about the impact of population ageing on today's youth cohorts and youth cohorts of the near future, it is important to reflect on the demands they will have to make on successor generations to maintain their well-being in retirement. If they give in to the urging to retrench in the face of the current ageing phenomenon, this may weaken their claim for support on the generations that come after them. In this context it is especially important to bear in mind that the ageing process that is currently underway is not a temporary process related to the ageing of a baby boom. It appears to be a more permanent process based on increasing longevity and low fertility.

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. 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.⁸

It may prove to be the case that working people will look at the prospective trend in earnings net of pension contributions and decide to trade off some period of retirement in favour of higher lifetime incomes. But that is a legitimate exercise of their choice. It is not something that is dictated by an iron law of demography. Furthermore, the tendency in much of recent history has been for people to want to capture productivity improvements in paid time off in retirement (Burtless and Quinn, 2002).

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. (The 'discovery' that public pensions induce retirement is a bit like discovering that they do what they are supposed to do.)

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. All of the factors underlying this trend are not clear. It does not seem to be a straightforward case of inadequate pension provision causing more late life work (Sundén, 2006).

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. 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

⁸ In focusing on the importance of productivity increases, it is assumed that average labour income will track productivity improvements as has been the case over long periods of history. However, in the recent past there have been many national contexts in which wage increases have lagged behind productivity improvements.

'career job') and these delays will have substantial effects on their future life course, including when they are likely to retire (see: Beaujot, 2004).

In both the near and long term there may be supply side pushes for later retirement that are accommodated on the demand side. But, as we look at the world right now, there are many countries in both the high and low income worlds where high unemployment has persisted for some years. In a context like this there is a real danger that promoting the employment of older workers will have a zero-sum aspect to it. Increased employment of older workers will be gained at the expenses of younger workers' employment. It will be important in national contexts of high unemployment to combine increased employment of older workers with an aggressive attempt to increase employment generally so that conflict between cohorts over available jobs does not result.

4. BALANCE BETWEEN PUBLICLY AND PRIVATELY ADMINISTERED PENSIONS

The respective roles of publicly and privately administered pension arrangements vary widely in the OECD area. Public and mandatory private pensions as presently designed are estimated to replace more than 70% of the pre-retirement earnings of men with median earnings in Austria, Finland, Greece, Hungary⁹, 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 earnings 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 that will never be fully resolved. 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 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.

The coverage issue is particularly important as coverage for a significant part of working life is a prerequisite of ending work with a decent pension. It is worth noting that private pension coverage well beyond 50% of the paid workforce occurs in only a few OECD countries. In these countries, coverage is effectively mandatory thanks to legislation that requires coverage, or by collective bargaining in countries with high degrees of collective bargaining coverage (Queisser and Whitehouse, 2006).

⁹ In this account, all mandatory programs including mandatory DC are treated as public. The Hungarian and Mexican regimes now include significant mandatory DC components.

In countries where employers can choose whether to put private pensions in place it is generally labour market pressures and collective bargaining that cause them to do so. As a consequence, there is a general tendency for workers who are vulnerable or disadvantaged in the labour market (e.g. women, immigrants and migrant workers) to be less likely to be covered. In recent years these longstanding concerns have been accentuated by the growth in non-standard forms of employment (part-time and temporary contract work). People who are engaged in these forms of employment are often left out of voluntary private pension plans. Another development of the recent past that is important in the English-speaking world in particular is a growing unwillingness of companies to sponsor DB pension arrangements. This tendency has become quite extreme in some cases and raises serious questions about the usefulness of individual companies as platforms for providing pension benefits.

Despite the 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. Some considerations that might lead in that direction are noted below with comment. In addition, it may be important to consider the options that are open for the design of publicly administered programs, and some pros and cons of each.

As a practical political matter, the fact that the balance between public and private provision is contested territory is always a consideration, as are prevailing values and beliefs. In countries dominated by liberal thought, including all of the English-speaking high income countries, it is difficult to escape the belief that some room needs to be left for market solutions to retirement income needs. Moreover, if there is an effective political limit on the ability to raise taxes, major public pension programs may be seen as a barrier to achieving other public policy objectives. The same problem can arise in countries where the tax collection capacity of governments is limited for practical reasons.

A variant on this 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.

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. Unfortunately, history has offered some support for this concern. 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.

There is also an important question whether retirement income needs are sufficiently homogeneous to allow them all to be substantially met through one or more public programs. This is an issue that is likely to be assessed differently in different countries, and may look different depending on what kinds of programs are currently in place and/or seem plausible in the foreseeable future.

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

1. Means or income tested programs - These 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.
2. Universal flat rate programs - These 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.
3. Compulsory earnings related programs - These 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. Career interruptions, changes in earnings, and differences in earnings do not affect benefits provided by flat rate plans.

Compulsory, earnings related programs are 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.¹⁰ 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 are financed by earnings related contributions, they can drive a substantial wedge between take home pay and total labour costs. Thus 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.

An important consideration with respect to the operation of each of these types of program is how, if at all, they deal with the pension rights of immigrants and migrant workers. Ideally, globally mobile workers would accumulate rights to retirement pensions as they move from country to country, and the country of residence at the age of retirement would pay benefits that reflect an accumulated lifetime of work. International social security agreements would provide compensation to the country of residence at the time of retirement from countries where retirees lived and worked at earlier stages of their lives. But making significant progress in this direction is by no means easy.

Global migration patterns are dominated by movement from low income to higher income countries. Many of the source countries still have rudimentary social security pensions so migrants may have had no pension coverage in their home countries. Moreover, because earnings in the source countries are very low compared to those in receiving countries, a benefit based in large part on a pension entitlement in the country of origin may not mean much in a host country. Compensating fully for the differences in earnings and the development of social security between countries of origin and host countries creates dilemmas of its own.

As was noted above, many of the World Bank client countries have been persuaded or cajoled into the adoption of mandatory individual retirement savings accounts as an alternative to publicly administered, earnings' related DB programs. It is important to come back to this point for three reasons. First, it is important to add that the old pension systems had come to have problems with coverage (i.e. the numbers of people contributing to/participating in them) and this problem has not been solved by the new

¹⁰ 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).

arrangements. Coverage has declined in a number of Latin American countries (Mesa-Lago, 2006, and Phang, 2006). Second, while the new arrangements are privately administered, they are also highly regulated in the public interest. Third, they provide a reminder that in many countries that were colonized for some period by the UK/England, public pension provision often amounted to a provident fund that might be mandatory for people in some or all areas of formal employment. The provident funds were mandatory, publicly run DC plans that had the distinctive feature that they paid their benefits in lump sums rather than annuities or annual withdrawal programs, and they were often designed to provide for withdrawals prior to retirement to cover other contingencies. Over the course of the past decade some provident funds in the Caribbean and Africa have been converted into DB plans (Gillion et al, 2000).

A number of typologies of pension systems and their components have been developed over the years and many of them are variations of the typologies used by the World Bank (World Bank, 1994 and Holzmann and Hinz, 2005). This paper employs the following typology:

- the first pillar is made of flat rate or means tested programs that are publicly administered and tax financed;
- the second pillar is either earnings related publicly administered DB or mandatory private savings schemes; and
- the third pillar is private pensions at individual or groups of workplaces that may be DB or DC, and individual retirement savings schemes.

Details on the typology used in this paper are set out in the Appendix.

5. DB VERSUS DC

Most but not all trade union movements have shown a clear preference for DB pensions versus DC pensions, and this widespread preference reflects the greater predictability 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 all 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. 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).

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 and, all other things being equal, thirty years of participation will be worth more than 1.5 times twenty years of participation.

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.

In recent years mandatory DC plans have become commonplace in World Bank client countries and in some OECD countries as well. It is worth noting

some of the things that mitigate the retirement income risks where these plans have been put in place.

In the World Bank client countries, mandatory DC schemes often play a large role in the retirement income system as a whole. They tend to dominate the second pillar and there is often little in the way of a third pillar that might mitigate the risk associated with a large DC dominated second pillar. In these situations, the DC risks noted above are substantial. Even here though, the risks are mitigated somewhat by the presence of first pillar plans which are quite common. The DC risks are much smaller in cases where the mandatory DC co-exists with other second and third pillar plans, as in Sweden or Italy.

In addition, there are 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 and take on the downside risk of doing so. In Chile and a number of Latin American countries a relative rate of return is guaranteed (i.e. the guarantee is linked to the average performance of all funds).

Finally, the risks faced by workers who are older at the time that mandatory DC schemes are introduced are frequently addressed directly. This protection most commonly takes the form of a choice between participation in the new DC plan or the old DB plan. This choice usually has to be made on a once and for all basis, but may be available throughout the remainder of working life.

The shift from DB to DC in both second and third pillar arrangements has given rise to important questions about the appropriate regulatory arrangements for DC plans and what needs to be done to provide plan members with the necessary knowledge to manage their DC accounts effectively. These issues are now in front of national authorities and are an important part of the work of the OECD's Working party on Private Pensions.

Third pillar pension plans have involved hybrids of DB and DC arrangements for many years, and new ones are emerging. But, in the second pillar, the DB and DC worlds have been quite distinct until recent reforms in Sweden, Italy, Poland and Latvia implemented 'notional DC' (NDC) plans that combine elements traditionally regarded as belonging to the two distinct types of plan. 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. When it is converted, the benefit payment is based on

the amount credited to a contributor's account, 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.

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 rather than investment returns 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. 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. 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.

A line of argument that accompanied the move to NDC was that the relationship between contributions and benefits needed to be more closely aligned. The implication was that cross subsidies in the old DB plans had become too great. There is nothing about NDC that makes them inherently more resistant to cross subsidies than are DB designs. In practice though, cross subsidies were reduced with the introduction of NDC plans and support for groups with interrupted and incomplete periods of employment was scaled back.

The support for DB plans by most trade union movements reflects a conviction that key sources of retirement income should be predictable. However, it is 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 second pillar 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. 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.

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). Historically, a major preoccupation of trade unionists and others concerned with the well being of older working people has been to make sure that they share appropriately in the well-being of society. 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, in the last analysis, 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 a period of prolonged deflation where downward adjustments to nominal benefits were not allowed).

6. PRE-FUNDING VERSUS PAY-GO

Historically, the chief concern of trade unions in the pension arena has been the provision of adequate benefits to retired people. Given this focus, the question whether pensions should be pre-funded or pay-go has been addressed largely in terms of which method would provide benefits more quickly and securely.

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 number of examples of large reserve funds being associated with second pillar DB plans, for example: Canada and Quebec, France, Norway, Portugal and Sweden. But based on some examples of poor management of public pension funds outside the OECD area, the World Bank has warned very strongly against the accumulation of large reserve funds under government control (World Bank, 1994). In practice, recent reforms have achieved higher degrees of funding primarily by implementing mandatory privately administered individual accounts rather than building up reserve funds under public programs.

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

As was suggested above, it is likely easier to phase-in benefits quickly under a pay-go DB plans and pre-funded DB plans, than under DC. 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 if funding targets are linked to the plan's 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. This source of upward pressure on required contributions may be accentuated by an increase in the portion of the population whose age makes them eligible

to receive benefits. If the need for these contribution increases is not widely understood and accepted, the plans may be vulnerable to political attack.¹¹

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 (or raise benefit levels). 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 instead of 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 (and GDP) 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.

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.

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

¹¹ 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.

1. 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.¹² 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.
2. Second, 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.¹³ What changes with pre-funding are the income streams that are tapped to pay for the pensions. But, even here, one could conceive of a pay-go tax base that includes non-wage income. Indeed, most first pillar programs rely on the general tax base of governments as a source of financing.
3. Finally, the shift from a public pay-go pension plan to a pre-funded, mandatory DC plan can create fiscal difficulties for governments that attempt this switch. The underlying problem arises from the fact that up to the date of the switch, contributions of active workers are used to pay benefits to existing retirees. On the date of the switch, the flow of contributions to existing retirees ends and new contributions are used to provide future benefits to active workers. If governments are going to honour the benefit promises made up to the date of the switch, as one would hope and expect would be the case, the question of how to finance the benefit commitments made up to the date of the switch has to be addressed.

The degree of difficulty that a government will have in addressing this overhang of pension liabilities from the old DB system will increase if: the old DB pension is mature, if the population is old, and if the government is in a weak fiscal situation at the time of conversion. Ironically, those governments

¹² To the extent that pre-funded pensions are invested in government bonds, the income stream that are paying for pensions are the income streams that make up the general tax base of the government. This will be predominantly labour income. In practice, many of the new mandatory DC schemes have been regulated so that they are invested largely in government bonds. Unless this changes in the years ahead, these plans will function very much like pay-go plans with somewhat different distributional characteristics than the old earnings related DB plans because of the different tax bases from which public debt is paid versus the tax base for an earnings related DB plan (World Bank, 2006).

¹³ If one comes to the conclusion that retirees/pensioners are claiming too great a share of national income, this 'problem' can only be addressed by reducing either their relative numbers or their relative incomes. This issue is not addressed by a change in funding arrangements, except in so far as foreign investing might tap income generated abroad.

that might have benefited most from introducing a mandatory DC plan at the outset are those for which a conversion might be most difficult. Further fiscal demands can arise from first pillar minimum income guarantees, guarantees built into the second pillar program and deficits carried over from the old system (Mesa-Lago, 2006).

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. 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).

Another argument that has been made in favour of pre-funding that has the appearance of a pension argument is that pre-funded systems are fairer between generations. But, as with so many pension debates, the key term has no precise meaning; indeed, there are many approaches to what constitutes intergenerational fairness (Wolfson and Rowe identify a number of them; see: Wolfson and Rowe, 2006).

Sometimes it is suggested that schemes are fair between generations when each generation pays its own way. But a strict adherence to this view is more of an argument against a rapid phasing in of benefits, no matter how they are financed, than it is an argument about pay-go versus advance funding. Sometimes it is suggested that if some generations have higher ratios of benefits to contributions (usually the first generations that draw pay-go benefits) this is evidence of intergenerational unfairness. But, thanks to both short and long term swings in the relationship of returns on financial assets and wages and salaries, even mature pre-funded DB and DC schemes will not provide constant ratios of benefits to contributions. In fact, it is doubtful that their benefit to contribution ratios will be as stable as in mature pay-go schemes.

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. As was suggested above, much of the argument about intergenerational fairness seems to be politically motivated to discredit pay-go public plans.¹⁴

The foregoing comments deal with pay-go and pre-funding in a very general way, which is most relevant to consideration of the first two pillars - pillar two in particular - or to a more general consideration of the pension system as a whole. But, before concluding this discussion, it is important to acknowledge that in many countries the pre-funding of third pillar DB programs is required to provide insurance to accrued benefits. While the details of financial requirements vary from country to country in important respects, generally speaking, they are designed to provide for the creation and operation of a pension fund at arm's length from sponsoring employer(s) so that the bankruptcy of the employer will not put the accrued pension benefits at risk. To achieve this objective, assets in the pension fund should equal the plan's liabilities and if there is a shortfall, special payments to cover the shortfall will be prescribed.

In recent years there have been very important debates about the proper method of valuing assets and liabilities in these plans, the consequences of different approaches to pension fund investment, and whether the insurance provided by the pension fund should be supplemented by a reinsurance program. These are extremely important debates. But they are not debates about whether to pre-fund. They are debates about how to manage pre-funding. These debates have been inspired in significant part by very serious financing problems in pre-funded DB plans in recent years. These problems have jeopardized the existence of third pillar DB plans in some countries where those plans have played an important role. In those countries this is a major problem for the trade union movement to try to address, even if the global scope of the problem is not great.

¹⁴ 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.

7. 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. It could take the form of recurring and unexpected financial problems. Administrative procedures may inhibit the timely processing of benefit applications and/or the payment of benefits. Administrative procedures may produce erroneous benefit calculations. Appeals procedures may not be timely or even-handed, or might be lacking altogether. In the extreme case, of course, officials responsible for administering the program may be corrupt.

Governance and management issues have been taken seriously, especially in a context where trade unions want to promote public pensions as a solution to retirement income problems. There will always be groups in society who will want to seize on every sign of weakness in public pension programs, and confidence in the programs will be eroded among potential beneficiaries if bad management persists. Even where programs are well run, they are vulnerable to political attack if they are poorly understood.

It is essential that public programs be able to deliver on the benefit promises and contribution levels they promise. This requires 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. Promoting an understanding of the plan and how it works should be an important aspect of plan administration.

Given the nature of the issues that revolve around public pension arrangements (e.g. adequacy of retirement income, age of retirement, required contributions), 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 to build broader public confidence in a plan. However, even if it is recognized that the social partners should have a role to play in plan oversight and management, the authority that should be vested in them can cover a wide range of possibilities. It is also an interesting question whether plan beneficiaries or others need to be represented separately from social partners. Moreover, if trade unions succeed in establishing a role for themselves in plan oversight and

management, how do they equip their representatives with the skills necessary to perform their role?

With respect to privately administered pensions, a great deal of attention has been given to issues of plan governance in recent years. Much of it 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. Concerns about increased expertise have 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 contract 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. 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.

Financing, investment and benefits policy should be treated as an integrated relationship so that mutual influences are clearly understood, and unhappy surprises are minimized. This is not a problem that is specifically related to investment expertise. Moreover, the proper means of balancing these considerations involves judgments, with respect to which there is a good deal at risk for the plan members.

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.

8. RESPONSIBLE INVESTING

Where trade unionists have had a role to play in pension fund investing, they have shown an interest in ways that pension fund investments might contribute to a good working life, as well as a good retirement income. Thus, one can find examples of investment initiatives involving pension funds in which trade unionists have governance responsibilities that: 'screen in' or 'screen out' investments based on the non-financial behaviours of companies; utilize various forms of corporate engagement that revolve around non-financial behaviours; and invest with a view to combining good financial returns with beneficial side effects such as job creation or filling gaps in housing markets.

Although these types of investment initiative (especially screening) have a long history in the retail investment market, they were, until recently, almost unique to union influenced investment in the pension world. But the world has been changing and continues to change rapidly in this respect.

In recent years there has been a significant increase in activity by pension funds in the area of corporate governance. Much of this activity focuses on agency problems where corporate management and directors pursue courses of action at odds with the interests of other shareholders, including pension fund shareholders. While funds in which trade unions play an active governance role have been involved in this type of activity, many others have as well.

In addition, there are a number of signs that a wide range of pension investors have become concerned about the financial risks that might arise from corporate behaviour that offends basic norms of good conduct in the social or environmental sphere. The UNEP - Finance Initiative has engaged the global financial sector in a number of initiatives designed to build support for sustainable development. Many of the world's largest pension funds and fund managers have endorsed its 'Principles of Responsible Investing', which commits signatories to take account of environmental, social and corporate governance (ESG) issues in their investment decision-making.

Another UN based initiative is the Global Reporting Initiative which was launched by the UN, business organizations and NGOs with an environmental mandate, and which now includes labour. Its purpose is to develop a standard approach for reporting on firms' conduct on environmental, social, and labour matters, as well as financial matters.

Governments in the UK and Australia require pension plan sponsors to report on how they take account of social and environmental considerations in their investment policy.

Many of these initiatives fall short of what trade unionists have been seeking, and trade unions are likely to have to keep pushing to keep things moving forward. But they are, at the same time, a far cry from the world of not long ago when pension fiduciaries were told that they were not allowed to consider anything but the financial behaviour of firms in making pension investment decisions.

But the new environment also creates challenges for labour. Given that the initiatives and institutions concerned with ESG issues are international in scope, it is important for the international trade union movement to engage in international dialogue on the challenges and opportunities in this area. By creating the Committee on Workers' Capital, the ICFTU has created a context for addressing ESG issues. Much of the work of the Committee is carried out by working groups on: trustee education, pension and financial market regulation, corporate engagement and economically targeted investments.

Work in this area opens up a new field in which to promote international instruments of good corporate behaviour such as the ILO's Declaration on Fundamental Principles and Rights at Work, and the OECD Guidelines on Multinational Enterprises. For fiduciaries, one of the important things about these instruments is that trustees can cite their adoption by governments and social partners as indicative that they represent broadly accepted, global community standards of good corporate behaviour, and not just the prejudices of a group of trustees.

It is also important for trade unionists who work on ESG and related issues to accept the challenge of articulating clearly how this area of activity relates to pension financing more generally, and to think through the regulatory requirements, if any, that flow from it.

9. SPECIAL CONSIDERATIONS IN LOW INCOME COUNTRIES

In low income countries, there are formal sector workers who have every reason to look forward to a financially secure retirement, just as in the high income countries there are people who never succeed in establishing a lasting attachment to paid employment and for whom pensions and retirement are not a meaningful concept. But the balance between the two groups can be quite different in high and low income countries and this can lead to somewhat different considerations in terms of how a pension system might be designed.

Where informal employment predominates, it goes without saying that earnings related pensions will be limited in their scope of operation. Coverage rates for employment related pensions outside the OECD area are seldom as high as 50%, even for mandatory second pillar regimes, and coverage rates are often less than 10% (Asher, 2006, Barrientos, 2006, Mesa-Lago, 2006 and Phang, 2006). Moreover, close attention needs to be paid to the question of whether financing earnings related pensions from payroll contributions is increasing the numbers of people engaged in informal employment by driving a wedge between labour costs and take home pay.

To provide pension benefits to people who have spent much of their working life in informal employment, a tax financed, first pillar program may be most appropriate. Bearing in mind that tax raising capacity can be a problem in low income countries, an income or means tested version of a first pillar program may be attractive because it will involve a lower level of government expenditure than a universal program that provides the same income guarantee. However, an income or means tested program may also involve much higher administrative costs and perverse interactions with programs that are in place for workers in the formal economy.

The tax back rate under the income or means tested program (i.e. the rate at which benefits are reduced in light of income from other sources) reduces the value of income from other sources for people who receive benefits from both the means or income tested programs and other sources as well. These perverse interactions can become extreme in cases where the income range to which the tax back applies overlaps with income to which a personal income tax applies, and/or the income range to which tax backs under social service programs like subsidized housing apply. In cases where a number of different income or means tested programs are available to the elderly, the moderate and low income elderly can face extremely high marginal tax rates.

While there are many important issues to resolve in designing first pillar programs, they can overcome the coverage problems of the second pillar programs that tend to be the predominant form of pension plan in low income countries. Moreover, first pillar programs are generally judged to make an effective contribution to poverty reduction (Barrientos, 2006 and ILO, 2006). They can also have a variety of positive side effects for households that include elderly recipients of first pillar benefits that range from improved health and education of children to access to credit. It remains true, however, that delivering first pillar benefits can be a challenge, especially in poor rural areas where automatic electronic deposits are still a long way off in the future (Asher, 2006).

It is a legitimate aspiration of formal sector workers in low income countries to have a decent retirement pension and it is reasonable for governments to support this aspiration. However, a question that is relevant in almost all contexts takes on particular significance in low income countries, and that is the question how much revenue should be sacrificed through tax support for third pillar pensions, given the possible uses of the revenue. Also, since formal employment in low income countries is heavily concentrated in the public sector, it is important that public employee pension costs be reasonable in a total compensation context.

In high income countries, the elderly who are poor are often treated more generously than the lower income non-elderly. This reflects the expectation that the non-elderly will fend for themselves in the labour market. It is not clear how this logic does or should apply in countries where low income and poverty are pervasive. Also, without pre-judging an answer to that question, it might be that in low income countries the balance in the overall provision for the elderly should focus more strongly on the provision of necessary services (health, housing and transportation) rather than on income provision. This could be particularly important where the elderly have been separated from other generations in their extended family and where HIV/AIDS has broken up networks of family support.

10. 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 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 circumstances 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 provide benefits that are reasonably predictable;
- Publicly administered pension plans have a positive role to play in any pension system, and universal flat rate programs can be useful in both high and low income countries;
- Pay-go financing of public programs has many desirable features and should not be readily abandoned; and
- Representatives of workers/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 is that they will eventually be the older population. 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. Experience of trade unions in recent years suggests that trade union views will have a greater impact in tripartite forums than in closed consultations with governments. 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 with other groups in society that are likely to share a common perspective on pensions issues.

ACRONYMS

DB	Defined benefit
DC	Defined contribution
ICFTU	International Confederation of Free Trade Unions
ILO	International Labour Organization
NDC	Notional defined contribution
OECD	Organization for Economic Cooperation and Development
UK	United Kingdom
UN	United Nations
UNEP	United Nations Environment Programme
US	United States of America

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APPENDIX: THREE PILLARS TYPOLOGY

First Pillar

- Publicly administered;
- Universal flat rate or means tested;
- Focused on age (and residence or citizenship) as a basis for payment; establishes a minimum income floor for the elderly. Universal flat rate plans also contribute to earnings replacement in a redistributive fashion;
- Financed from general tax revenues on a pay-go basis;
- Found in many but by no means all OECD countries; usually a relatively small component of the entire system.

Second Pillar

- Publicly administered or privately administered;
- Publicly administered:
 - mandatory earnings related DB plans;
 - focused on replacing pre-retirement earnings;
 - financed primarily from earnings related contributions on a pay-go basis; examples can be found of these schemes with significant reserve funds, and of general tax contributions to them; and,
 - found in almost all OECD countries and it dominates the pension system in many; historically, they have also been a dominant element in the pension systems of many non-OECD countries; pension reforms in the 1990s have also seen the emergence of DC plans that are pay-go (e.g. Italy and Sweden).
- Privately administered:
 - predominantly mandatory individual savings accounts; there are a few instances where collective bargaining or legal requirements make workplace DB pensions effectively mandatory (e.g. Netherlands, Sweden);
 - focused on earnings replacement;
 - pre-funded: i.e. financed by earnings based contributions and investment income; and
 - mandatory individual accounts have been promoted by the World Bank as an alternative to publicly administered earnings related DB plans; World Bank client countries in Latin America, Central and Eastern Europe and Central Asia have adopted individual accounts and they are a large part of the reformed pension system; some OECD countries have adopted a small tranche of mandatory individual accounts as a supplement to other arrangements (e.g. Italy and Sweden).

Third Pillar

- Voluntary workplace pensions and individual savings;
- Workplace pensions:
 - privately administered; established on the initiative of employers and/or unions; participation by more than half of the employed population is an exception;
 - focus on replacing pre-retirement earnings;
 - may be DB or DC;
 - usually pre-funded with pension assets separated from the assets of sponsoring employers; insurance provided by the pension fund is sometime supplemented by a scheme of pension insurance (e.g. US, UK, Ontario/Canada, Sweden); occasionally workplace pensions are insured by claims on the sponsor's balance sheet - examples of the latter approach are found in Germany and Austria;
 - financed by earnings related contributions of employers and employees and by investment income;
 - subject to public regulation and receive tax support.
- Individual Savings:
 - privately administered; established on the initiative of individuals who buy saving products from financial institutions;
 - focus on replacing pre-retirement earnings;
 - DC;
 - pre-funded;
 - financed by contributions and investment income;
 - subject to regulation that is generally looser than for workplace pensions, and receive tax support in all but one OECD country (New Zealand).

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