Rethinking the Economics of Pensions

KTN-University of Warwick Conference
Royal Statistical Society, London 21-22 March 2013

From pension funds to piggy banks: (perverse) consequences of the Stability and Growth Pact since the crisis

Bernard H Casey
Institute for Employment Research
University of Warwick, UK

Knowledge Transfer Network
Financial Services

GUSTO
www.gusto-project.eu

WARWICK IER

From pension funds to piggy banks

Outline of presentation

The SGP and the new fiscal orthodoxy

Four approaches to meeting fiscal targets

- reducing “transition costs”
- nationalising/sequestering funds
- drawing on “demographic reserve funds”
- influencing fund investment behaviour

Conclusions and issues arising

From pension funds to piggy banks

The SGP and new fiscal orthodoxy

- Initial responses to the crisis
  - Fiscal expansion in W. Europe and USA
  - “Internal devaluation” in many CEE countries
- Subsequent responses
  - New orthodoxy: “expansionary fiscal contraction”
  - “Six pack” and “Fiscal Compact”
  - Increased monitoring and sanctioning powers
- Pension re-reform and un-reform as solution
  - But not about scheme performance/efficiency
  - Releasing resources, meeting targets

From pension funds to piggy banks

Reducing transition costs

- Pension reforms in CEE post independence
  - Funded second-pillar “carved out” of first pillar
  - “Transition costs” underestimated?
  - 2005 revision of SGP allowing temporary relief
- New fiscal orthodoxy
  - Size of “transition costs” relative to deficit
  - Letter of “nine” reformers
  - “Six pack” relief more conditional
- Responses of re-reform and un-reform
  - (Temporary) switching back of contributions to first pillar
  - Closure of second pillar (Hungary)

From pension funds to piggy banks

Nationalising/sequestering pension funds

- Second stage of Hungarian un-reform
  - Argentina as precedent
  - “Unorthodox” fiscal policy and high deficit and debt
  - Government with “supermajority”
- Nationalisation of Irish universities pension fund
  - Preceded Hungary
- Nationalisation of sector funds in Portugal
  - Telecom and bank funds
- Nationalisation of Royal Mail fund in UK
  - component of privatisation plan
- “Loans” from sector funds in Cyprus
  - “Until bailout agreed”

From pension funds to piggy banks

Drawing on “demographic reserve” funds

The “Fillon” pension reform in France

- Retirement age to 62
- Accelerated rundown of Retirement Reserve Fund

Accessing funds from Polish “demographic reserve”

- Self-imposed fiscal debt limit

Dipping into Spanish social security reserve fund

- Transfers to general account for unspecified expenditures

Stop on payments into Irish Reserve Fund

- And fundamental reorientation of tasks

From pension funds to piggy banks

Influencing fund investment behaviour

Reorientation of Irish National Pension Reserve Fund

- Assisting with bank recapitalisation
- Financing government’s “growth enhancing” projects
- Taking responsibility for nationalised pension funds
- (“directed” rather than “discretionary” investments)

Switching portfolio of Spanish reserve fund

- Move into Spanish government bonds

“UK pension funds to invest in infrastructure”

- Growth enhancing without public expenditure

From pension funds to piggy banks

Conclusions and issues arising

- Not about pensions
  - About meeting targets
  - Sometimes secondary pension-specific justification
  - Sometimes secondary macro-economic justification
- Consequences unclear
  - Future pension levels of people switched out of funds
  - Private pensions not free of political risk
  - Costs moved from present to future
- Excessive concentration on short-term?
  - “Funding makes costs explicit”
  - Unfunded future costs not taken into account
  - Encourages treating funds as “piggy banks”