Too Many Grannies?

Private Pensions, Corporate Welfare and Growing Insecurity

THE CORNER HOUSE

"We're richer, busier, healthier and living longer"[1]

"Korean female life expectancy tops OECD average"[2]

"The elderly: healthy, wealthy – and still at work"[3]

Headlines such as these might suggest that the articles following them will celebrate greatly improved living and working conditions. Instead, they invariably dwell on the dire consequences, particularly in the North, of an ageing citizenry,[4] warn of a "demographic time-bomb" that does not refer to a population explosion in the South, or raise alarms about "longevity risks" and "generational conflict".

The main problem, we are told, is how to pay the pensions of so many older people. The World Bank has warned of state budget crises if countries have to pay an extra 9-16 per cent of GDP to meet their old-age benefit promises – an "unprecedented economic burden on working age people".[5]

One proposed solution is to raise the pension age, another to raise the retirement age or to abandon it entirely.[6] A third – and the topic of this briefing – is to persuade, even compel, people to save for their old age so that they rely less on the state. The savings in question would not be stuffed under a mattress or hoarded in a bank vault. Instead, people would be encouraged to put them in pension funds run by private financial institutions, which would invest the money, primarily in stock markets. These investments, it is said, would not only generate enough profits to pay pensions but would also stimulate economic growth – two activities that the private sector, it is argued, can carry out better than the public sector. The state would confine itself to regulating and guaranteeing these privately-run and privately-invested retirement savings plans.

But more than a decade since this idea was endorsed by the World Bank in its influential 1994 report, *Averting the Old Age Crisis*, the evidence that it will work remains unconvincing. Overall, the privatisation of pensions has led neither to better pensions for more people, nor to greater economic growth. The theory persists only because financial, commercial, political and labour interests, backed by the work of academics, support it for their own opportunistic reasons – to expand stock markets, "liberalise" financial markets or change the role of the state. Pension privatisation is not really about pensions at all, but about furthering these goals.

1. *Irish Independent*, 21 October 2005.
2. *Korea Times*, 21 December 2005.
3. *The Guardian* (UK), 27 December 2005.
4. "Ageing" means not just that people are on average living longer but also that the proportion of older people in any given population is increasing.
5. Peterson, P. G., "Gray Dawn: The Global Aging Crisis", *Foreign Affairs*, Vol. 78, No. 1, January/February 1999, p.44.
6. The pension age is the age at which someone can take an occupational (private) pension entitlement. The state pension age is the age at which someone can begin to draw their basic state pension, irrespective of whether they continue working or not. The retirement age is the age at which someone has to stop working if their employer does not wish to keep them on.

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Briefing 35: Private Pensions, Corporate Welfare and Growing Insecurity

This briefing outlines the different ways in which countries have financed both social security for older people and economic production. It describes the rise of the private model of pensions and the influence of pension funds on capital flows around the world. It then summarises and critiques the main justifications given for expanding private pension schemes, and analyses the motivations of the groups that perpetuate this model.

Types of Pension

Formal pension arrangements generally comprise a "basic" pension and a "supplementary" pension. The basic pension is usually associated with the state, while supplementary schemes are often linked to some form of private provision.

A basic pension can be "flat-rate" and financed solely or mainly from general public state revenues, or it can have "earnings-related" features based on contributions, or calculations related to lifetime earnings.

A supplementary pension is usually earnings-related in one way or another. It invariably features an insurance dimension (usually private) linked to contributions that are based on the ability and willingness to pay. It can be a group or universal system that is often compulsory, or it can be an individual, voluntary, private arrangement.

Anglo-American

Countries following the Anglo-American pensions approach tend to have a minimal, usually flat-rate, basic pension run by the state and financed out of its current revenue, whether drawn from social insurance contributions paid by current workers and employers or from general public revenue, such as taxation. This basic pension is increasingly referred to as a "safety net" to demonstrate its residual nature.

State expenditure on pensions in these countries tends to be low. The UK's total expenditure, at less than 10 per cent of the country's GDP (5 per cent from public pensions, 3 per cent from the private sector), is among the lowest in the European Union and the OECD, even though the proportions of the population aged over 60 and over 65 in 1990 were higher than the average for the EU and OECD. In the US, these proportions were lower than average, but pensions expenditure lower still, as was the case in Australia and Ireland.

To enhance the basic pension, and in some cases to minimise or even replace it, these countries tend to encourage significant supplementary schemes run by private financial institutions (banks, insurance companies, pension funds and other fund managers). They invest individuals' and employers' contributions, usually in stock markets, in the expectation that the investment returns will be sufficient to pay out pensions when those contributing to them retire.

Such a "funded" system can be organised on an occupational (company), industry-wide, or national and individual basis, and can be compulsory or voluntary. Individual self-reliance tends to be emphasised, and tax concessions on contributions to supplementary pensions and investment returns are common.

This model is promoted most avidly by the United States and the United Kingdom and also followed by The Netherlands, Ireland, Switzerland, Australia, Chile, South Africa, Canada and, arguably, Japan.

European

Many European countries have a large basic pension, frequently with an earnings-related component, run by the state. Pensions are paid out of current social insurance, taxation, and public expenditure – a "public pay-as-you-go" system.

Countries such as Germany and France emphasise solidarity between and within different generations as a reason for redistributing some current income to current pensioners.

Alongside the state-run system, there may be a supplementary scheme run by private financial institutions and invested in stock markets, as in Scandinavian countries; or an earnings-related pay-as-you-go system run by employers and employees, as in France; or a private "book reserve" or "direct commitment" system in which companies keep future pension commitments on their balance sheets and do not hand over the contributions to the capital markets or invest in physical assets, as in Germany and Luxembourg.

These supplementary pensions can cover a significant number of people, but are usually small or negligible in terms of assets.

The continental European model is pursued by Norway and most countries of the European Union, except the UK, The Netherlands, Ireland and the Eastern European countries that joined the EU in 2004.

Asian-Pacific

The Asian-Pacific model is dominated by state-run funded pensions schemes usually referred to as national or central provident funds. They tend to have extensive or universal coverage of a country's working people and invest heavily in government securities.

These schemes are dominant in Singapore, Malaysia and Fiji and are also important in Sri Lanka, Kenya, Barbados, India and Indonesia.

Welfare Blocs and Financial Systems

Social or welfare policies, financial systems, and mechanisms for promoting investment and economic development are today intricately intertwined. Whereas just two decades ago, welfare policies for the unemployed, sick, disabled and elderly were perceived as a counter to, or insurance against, "the market" and its failings, now many governments use such policies to support or bolster "the market" itself. Pensions are a prime example.

Broadly speaking, most countries follow one of three different ways of financing their economic production and their old age pensions: the "Anglo-American", "European" or "Asian" model (*see* Box: "Types of Pension").

The Anglo-American approach to finance emphasises, in general, the role of stock markets; the so-called free movement of capital in corporate takeovers, mergers and acquisitions; and shareholder expectation of dividends. A company gets a once-off injection of cash when it issues and sells shares in its company. The shares are bought and sold in the financial market: the stock exchange. Buyers expect to be paid regular dividends from the company out of its profits. They also aim to make money by buying shares low and selling them high.

In the Anglo-American model, the pension system and the financial system are two sides of the same coin.

The continental European approach, meanwhile, has relied far more on banks and interlocking corporate structures to finance production and far less on the stock market. The Asian model is similar, but adds strong state involvement to economic decision-making. These three models' choice between a capital-market or bank-oriented approach determines the relationship between the financial and industrial sectors.[7]

The three approaches to pensions also differ. In the Anglo-American model, the state provides a minimal, flat-rate "basic" pension, while private financial institutions (such as pension funds and insurance companies) run significant additional schemes. In such schemes, returns[8] from stock-market investments made by individuals or their employers accrue to a pension fund, which either uses them to pay out pensions or reinvests them via the stock market for individuals yet to retire.[9]

In the European approach, the state provides a substantial pension, frequently with an earnings-related component. The scheme is described as "unfunded", meaning that the money to pay out pensions has not been set aside and accumulated years in advance, but is paid for out of contemporary social insurance or taxation – a "pay-as-you-go" scheme.[10]

The Asian pensions model combines elements of both Anglo-American and European approaches. It is dominated by funded, investment schemes, as in the Anglo-American model, but these schemes are publicly- rather than privately-run. The model uses stock markets but does not depend on them.

All three approaches to social welfare for older people strive in their own ways for a balance between a basic pension and a supplementary one, between funded and non-funded, and between the state and the private sector. The clearest divide between the different systems, however, lies in whether they use private financial institutions and rely on the free movement of capital, or not.

7. For more information, *see* Rybczynski, T., "Financial Systems and Industrial Restructuring", *Nat West Bank Quarterly Review*, November 1988; Dore, R., Lazonick, W. and O'Sullivan, M., "Varieties of Capitalism in the Twentieth Century", *Oxford Review of Economic Policy*, Vol. 15, No. 4, Winter 1999.
8. The annual "rate of return" on an investment is the profit earned that year from the investment, expressed as a percentage of the total amount invested.
9. Some funded schemes are managed by the public sector, for instance, schemes run by individual states in the US. The largest portfolios of assets assembled in the 21st century – 90 billion euros since 2001 – have been in France, Ireland and Sweden as the public sector has set up buffer funds to help pay pension benefits in forthcoming decades.
10. A variant of the European model is one that has only a state, unfunded pension system, in which there are no "investments" and no private sector. It was followed mainly by the former Communist countries of Central and Eastern Europe and the Soviet Union, and is still prevalent in urban China.

From Supplementary to Fundamental

Most pension debates today focus on the Anglo-American model. Its supporters have been seeking for over a decade to make "supplementary" funded schemes the dominant form of pension provision around the world. They have been doing so in two ways: by freezing or reducing public pensions; and by encouraging private saving. The increased savings can, so it is argued, be put to more productive use by being privately managed and invested on stock markets, as these markets are the most efficient way of allocating the savings among different stocks (or companies).[11] The increased economic growth resulting from such investments, so the theory goes, will create greater resources to provide for people's retirement.

In the Anglo-American model, therefore, the pension system and the financial system emerge as two sides of the same coin. Pensions are not only dependent on the nature of the finance or production system, but are also a significant determinant of it. The whole economic and social system is united in a dynamic that prioritises the stock market as the arbiter of the control and pricing of companies *and* of the returns that can be obtained to pay pensions.

This model turns the intuitive logic of production, finance and social distribution on its head. Productive investment is usually thought of as creating profit, followed by state intervention through taxation or the regulation of employment conditions to finance social distribution and enhance social welfare. Instead, the Anglo-American model regards the pension system itself as an initiator of production.

Such "pension fund capitalism"[12] has been spreading in recent years from the US and UK to South America, Central and Eastern Europe, and the Pacific area. Amid escalating criticisms of public or state arrangements, the European model – which avoids using capital markets and privately-managed finance to fund economic growth or retirement – is increasingly on the defensive.[13]

11. Pension funds' main international assets are equities traded on stock exchanges, but they also invest in bonds, hedge funds, property, high-yield debt, emerging market debt, commodities, global small companies, private equity, currency and cash.
12. Clark, G.L. *Pension Fund Capitalism*, Oxford University Press, Oxford, 2000.
13. Pension systems that are not funded, but are not run by the state, are also criticised, because they do not involve investment (apart from cash balances). The French system run by employers and employee representatives is based on contributions and is earnings-related, but includes pay-as-you-go principles. In the German book reserve system, companies retain future pension commitments on their balance sheet but do not hand the contributions over to capital markets.

    The first state pension was introduced in 1889 in Germany by Chancellor Otto von Bismarck for workers over the age of 70. Bismarck's aim, together with accident and health insurance legislation, was to erode support for the socialists by improving the position of workers.

    After the First World War, the rise of fascism and bolshevism persuaded several other governments, especially those of the US and the UK, that social insurance was critical to reduce support for such movements.

    In recent decades, as social and labour movements have been increasingly on the defensive, many governments no longer feel a need to respond to social pressures, and thus leave pensions and other forms of welfare to the private sector.

Pension Organisations

Pension funds and their assets are largely controlled by international financial institutions, such as banks and insurance companies.

The trustees of a pension fund – for instance, a scheme run by a company for its employees – appoint a fund manager to invest the accumulated money, either an in-house employee or department or, most commonly, an "external" investment firm, such as a clearing bank, merchant bank, insurance company or an independent investment company, that charges management fees for this service.

These managers invest the funds in a range of investment "instruments", predominantly equities, government bonds and property, and retain a proportion in "cash", depending on rates and returns in the market. Returns from these investments accrue to the fund and are either reinvested or contribute towards pension payments.

These financial institutions not only manage pension fund (and other) capital, but also perform other financial functions, such as providing advice and management services to governments and companies, both nationally and internationally, on fund-raising, privatisation, mergers and acquisitions, and economic policy.

Companies within the financial sector have themselves been merging with or acquiring each other over the past two decades or so in a continuous process of corporate concentration. In 1999, one survey (by pensions consultancy William Mercer) estimated that just five groups of money-managers, encompassing mutual funds, insurance companies and banks, looked after assets equivalent to the combined GDP of the UK and France, while the top 35 managed $8.2 trillion, rivalling the size of the US GDP.

There are two consequences of such concentration. One is that companies and individuals have less choice over who should manage their pension savings. Another is that the financial institutions manage such large funds that they are in a stronger position to put pressure on the companies whose shares they own.

Financial Markets and Pension Funds

Because countries with funded pension systems managed by private financial institutions now encircle the globe, pension funds have become a crucial part of financial systems over the past two to three decades. They account for enormous flows of private funds, nationally and internationally, and are significant in terms of their size, proportion of Gross Domestic Product (GDP), and volume and concentration of control of financial markets.

Worldwide pension assets were estimated to be over US$12 trillion at the end of the 1990s. Given that total world GDP was US$28 trillion in 1998, global pension fund assets amounted to nearly 43 per cent of world GDP.[14] This proportion is still roughly the same today, despite stock market falls and financial crises.[15] The OECD estimates that pension funds comprise 28 per cent of all institutional finance within OECD countries.[16] Pension fund assets are over ten times the size of all the foreign currency reserves of the 15 largest industrialised economies (most of the EU plus the United States, Australia, Canada, Japan and Switzerland).

As the bulk of private pension funds have been invested in stocks and shares, they form a significant part of world financial markets. Moreover, countries with large pension funds tend to have large stock markets because of the significant overlap between the two. In the US and the UK, private pension funds are the largest institutional holders of company shares.[17] They own over 30 per cent of their respective stock markets (the market capitalisation of the companies quoted on the stock exchanges). The proportion is much higher if the pension-related holdings of US mutual funds[18] and UK insurance companies are included.

Elsewhere, the number and size of domestic stock markets are increasing rapidly as more and more countries have taken up the private pensions model. At the same time, "emerging markets" are increasing their share of world stock-market capitalisation (defined as total world share values).[19] Any expansion of pension funds boosts stock markets; the prices of company shares or securities rises as pension funds increase their demand for them (other things being equal).

International Pension Flows

The growing pension fund "stock" has an increasing, if not crucial, influence on the "flows" of world GDP. In total, over 12 per cent of all pension fund assets are invested outside their country of origin. In G-10 countries,[20] the figure is 17 per cent. Around 24 per cent of Australian pension funds is invested outside the country, while in the UK and The Netherlands, the proportion is 30 per cent.

This private capital is not for the most part "foreign direct investment" (FDI) – finance for new capital investment in infrastructure, production or services outside the domestic economy. Financial institutions use pension funds to buy (and sell) existing stocks, securities, shares and associated currencies – the "portfolio" markets – along with newly-issued stock, especially that of newly-privatised companies. To enable them to do so, they had pushed governments to end capital controls.[21]

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14. In 1997, total world stock-market capitalisation was US$23 trillion.
15. In 2003, world reported GDP had risen to $36.5 trillion, while pension fund assets of the world's top five pension markets had increased to £13 trillion. Total world stock-market capitalisation was $31 billion. By 2004, world GDP had gone up to $41 trillion, and by 2005, assets of the 11 major pension markets had risen to over $16.4 trillion. (GDP estimates from World Bank Quick Reference Tables, http://www.worldbank.org; pension asset estimates from pension consultants Watson Wyatt; stock market figure from IMF, *Global Financial Stability Report*, Washington DC, April 2005.)
16. OECD, "International Financial Market Implications of Ageing Populations", *Financial Market Trend*s, no. 71, OECD, Paris, 1998. These figures exclude the pension-related activity of insurance companies and other similar institutions. Their inclusion would increase pension-related investment assets to nearer US$10 trillion – over 40 per cent of the OECD total.
17. In the US, occupational pension funds often buy the shares of the company in which the pension contributor is working.
18. Instead of buying shares themselves, investors buy units in a pooled "mutual fund" run by a fund manager who uses the money to buy a diverse portfolio.
19. The term "emerging market" was coined in 1980 by the International Finance Corporation, the private-sector arm of the World Bank, for what used to be called "Third World". Comments *The Economist*, "For much of the time since, 'submerging' has been more apt: look at the succession of crises, from Latin America to East Asia and Russia, in the past decade or so". Emerging economies now have two-thirds of the world's foreign-exchange reserves, consume 47 per cent of the world's oil, but still account for just 14 per cent of global capitalisation ("Climbing back", *The Economist*, 21 January 2006, pp.71-2).
20. G-10 refers to the (now 11) countries (Belgium, Canada, France, Germany, Italy, Japan, The Netherlands, Sweden, Switzerland, United Kingdom and United States) that provide resources to the IMF's General Arrangements to Borrow (GAB), invoked if the IMF's resources are below members' needs.
21. Capital controls are taxes or national restrictions on the trade of financial assets (stocks, bonds, cash) across international borders. They can, for instance, limit the amount of a firm's shares that can be owned by foreigners or limit the investment of domestic firms and citizens outside the country (http://www.geocities.com/Eureka/Concourse/8751/edisi04/neely.htm).

Manias, Panics, Risks . . . and Pension Funds

Flows to the South . . .

Pension funds contribute to international financial crises. During the 1990s, they fed the mania for diversification into the "emerging markets" in Southern and Central and Eastern European countries.

Institutional investors had grown more and more interested in these markets over the ten years to 1998, especially as the number of stock markets increased throughout the world. The World Bank has calculated that, in 1997, US$256 billion of private capital flowed to "developing countries" (official publications often use the terms "developing countries" and "emerging markets" interchangeably) compared with just $33.3 billion in 1985. By 1997, private flows were nearly six times greater than official development finance (funding from government and intergovernmental bodies).

Between 1985 and 1997, foreign direct investment (FDI) still comprised the largest category of private capital flows (corporate investment in overseas subsidiaries, or new or purchased ventures and plants, including cross-border mergers and acquisitions).

But between 1990 and 1997, portfolio flows (investment mainly in equities and bonds) rose ten times, while FDI increased only five times. Moreover, total portfolio flows made up more than one-third of all private financial flows. By 1997, Southern countries received 30 per cent of global portfolio capital, compared to only 2 per cent before 1990. The share of world stock-market capitalisation represented by emerging markets (the market value of securities on their stock markets) increased to 9 per cent of world capitalisation by 1997, contrasted with just over 4 per cent in 1988.

Driving this growth in portfolio flows was the money pouring into pension funds – money that pension funds needed to invest in new places. Returns on investments in their domestic markets, primarily the UK and the US, were flattening as more private funds from more prospective pensioners flowed into a relatively fixed stock of tradable assets, pushing up domestic share prices. The institutions believed that buying low-priced assets in the high-growth economies of emerging markets would produce higher rates of return than at home.

By 1997, pension funds held $70 billion of investments in emerging markets, representing around one per cent of their total assets. In the US, pension funds held around two per cent of their total assets in emerging markets (3.75 per cent according to one source for 1996), while in the UK, the figure has hovered around one per cent, with the larger pension funds holding a larger percentage.

These are small figures given the substantial pension funds of the developed markets – and yet have enormous implications for the smaller markets of the developing world. When a large institutional investor adjusts its portfolio even slightly, it can have a major influence on an emerging market, especially if other large institutions, with their similarly small investments, follow suit.

. . . and Out Again

The major problems relate to "surges" in private capital flows. In the 1990s, the sudden large amounts of capital flowing to the South initially reflected the "strong economic performance" of Asian countries. But investors were also encouraged by "structural reforms" as the World Bank encouraged these countries to set up and develop their capital markets and to open their economies to financial "intermediation" by institutions holding savers' money and increased "financial integration" with stock markets and institutions elsewhere.

The amounts were extremely large in relation to the size of the economies affected by them, with possible inflationary consequences. The World Bank lists 10 developing countries that received annual inflows averaging more than four per cent of GDP during inflow episodes in the 1990s. Chile, Malaysia, Thailand and Mexico experienced the earliest and largest surges while South Asian and Eastern European countries experienced surges after 1992.

Even the World Bank, a major promoter of stock market development and private pensions, raised concerns about the threat of major reversals of these flows. Unlike foreign direct investors, "portfolio investors can divest themselves easily of their stocks of equities or bonds", it pointed out in 1997.

In the first part of 1997, for instance, prices in several developing country stock markets increased significantly – 14 per cent in Indonesia, 79 per cent in Brazil, 10 per cent in Chile and 129 per cent in Russia. But in the second half of that year, these figures turned around: Indonesia at minus 45 per cent, Brazil minus 22 per cent, Chile minus 16 per cent, and Russia minus 3 per cent.

Currency exchange rates fell at the same time as the stock markets did. Because external financial liberalisation leads to closer interaction between a country's stock market and its foreign exchange market, an economic shock to one "can lead to a negative feedback loop [in the other] and even greater instability".[1]

The surges and reversals are exacerbated by "herding". Professional fund managers who administer the assets of pension funds tend to follow the investment decisions of *other* fund managers to show their pension fund and other clients that they know what they are doing. If one fund pulls out of a country, the others tend to follow. If the decision proves to be the wrong one, the managers are likely to be judged as unlucky rather than incompetent, because others acted likewise. The *Financial Tim*es points out that "pension funds are well known for their lemming-like behaviour."[2]

The impact of a fund manager's sudden decision to sell up its portfolio is felt in an emerging market far beyond the stock market. In the countries affected by the East Asian financial crisis from 1997 onwards, for instance, some 13 million people lost their jobs.

Real wages collapsed (40–60 per cent in Indonesia). In Indonesia, 40 million people (20 per cent of the population) fell below the poverty line. In Korea and Thailand, an estimated 12 per cent of the population were similarly affected. The number of poor people in East Asia was estimated to rise over the two years to 2001 from 40 million to over 100 million.

The Chief Economist of the World Bank at the time, Joseph Stiglitz, drew attention to the social consequences of the global economic crisis of 1997–98 and the way in which financial-sector liberalisation can greatly increase the risk of a crisis. In just a few months, some countries went from robust growth to deep recession. He pointed to:

> "children dropping out of school, millions of people either falling back into poverty or coping with already desperate circumstances, and poorer health".[3]

Institutions' Inherent Risk

Another cause of financial instability is the financial institutions themselves.

Investment activity is concentrated in the hands of relatively few institutions. The IMF itself points out that further consolidation in the fund management business could lead to "a relatively small number of very large global companies each managing assets well in excess of $150 billion" with a number of smaller management companies surviving only in "regional niche markets".[4]

By 1998, a mere 20 financial institutions each individually managed assets well in excess of this $150 billion benchmark – with cumulative total assets amounting to $6 trillion – 25 per cent of all the attributed world financial portfolio assets for 1995.[5]

If financial institutions make a policy mistake within and among themselves, it has knock-on effects because of this enormous concentration of funds in conglomerates with a range of financial and banking functions and because of the financial integration of these institutions.

This process was illustrated starkly in 1998 when the Long-Term Capital Management (LTCM) "hedge fund" nearly collapsed. LTCM, the "Rolls-Royce" of hedge funds – private pools of capital that can invest, long or short-term, in whatever they please – had built up an investment exposure of around $900 billion, mostly in Northern capital markets. During one month in 1998, however, it suffered a 44 per cent fall in net asset value.

This triggered financial problems in other institutions, because many well-known and established financial institutions had invested in, or lent to, LTCM. These included:

- the Bank of Italy;
- Sumitomo Bank;
- Union Bank of Switzerland-UBS;
- Credit Suisse First Boston;
- Dresdner Bank of Germany;
- Merrill Lynch; and
- ING.

The knock-on effect of a collapsing pyramid of deals considerably reduced the share prices of banks and industrial companies and damaged their credit ratings. Profits, growth and jobs were all affected. To stop the cascade, other financial institutions stepped in to bail out LCTM.

The World Bank and IMF have issued warnings about financial institutions operating in Southern countries. Similar warnings should perhaps be given for those operating in the North. Alongside the risks of volatility, surges and reversals should be added the cumulative risks of: institutional concentration; the complexity of financial instruments and investment vehicles; the technical ability of investment institutions to amass enormous risk; and the lack of "transparency" of risk profiles.

In 1998, the OECD summarised the involvement of pensions funds in international financial crises as follows:

> "The globalisation of financial markets, driven in part by population ageing and other structural factors, is reflected in the quicker international transmission of short-term price movements in financial markets, as occurred in the Mexican crisis of 1994–95, the ongoing Asian crisis and the recent Russian turmoil and their impact on OECD financial markets. Financial integration has also increased the potential intensity and duration of the attacks. There is evidence that pension funds and other institutional investors have played a crucial role at times in determining asset prices in emerging financial markets, with shifts in institutional investor sentiment occasionally contributing to increased volatility in markets."[6]

Crisis Solutions?

The recipes proposed by official bodies to prevent financial crises vary, sometimes significantly:

- introducing capital controls (controlling a national currency's exchange rate by setting limits and prohibitions on trading the currency across national borders);
- introducing greater reserve funds to counter speculative attacks;
- developing and regulating financial securities (stocks, shares, currencies and bonds); and
- strengthening banking systems and accounting standards.

But none of these tackle a root cause of financial instability: the unrelenting growth of funded pension arrangements.

1. Singh, A. and Weisse, B.A., "Emerging Stock Markets, Portfolio Capital Flows and Long-term Economic Growth: Micro- and Macroeconomic Perspectives", *World Development*, Vol. 26, No. 4, April 1998, p.615.
2. Kat, H., "Hedge funds are no panacea", *Financial Times FTfm*, April 2005, p.28.
3. "Lessons of the Asia Crisis", *Financial Times*, 12 December 1998, p.20.
4. IMF, *International Capital Markets: Developments, Prospects and Key Policy Issues*, Washington, November 1997, p.121.
5. "America's largest overseas investors", *Institutional Investor*, July 1998.
6. OECD, "International Financial Market Implications of Ageing Populations", *Financial Market Trends*, No. 71, OECD, Paris, p.62.

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In the process, however, they have contributed to financial instability affecting "developed", "developing" and "in transition" countries alike. Because institutions can withdraw this mobile or "liquid" capital at short notice, they can potentially create financial shocks with enormous international knock-on effects on markets and asset values. This is particularly the case if the rush to get out of one area and invest in another builds into a panic, a characteristic of both capital markets and investors.

How much of this footloose capital that is not tied to specific investment projects is accounted for by pension funds? The World Bank put total pension fund assets in emerging markets at $70 billion for 1996–97, the height of the emerging market financial crises.[22] Emerging-market capitalisation at the time was 9 per cent of the world total, giving pension funds between 3.5 and 4 per cent of the total of emerging markets. If estimates for personal pensions run by insurance companies in the UK and their US equivalent, 401(k) pension plans run by mutual funds, are added in, foreign pension-related investment rises to around 6 per cent of emerging market stock markets (*see* Box: "Manias, Panics, Risks", pp.6-7).[23]

22. World Bank, *Private Capital Flows to Developing Countries: The Road to Financial Integration*, Oxford University Press, New York, 1997, p.21.
23. Official figures show that only 3–5 per cent of international capital-market activity from 1994–97 was equity investment, while 27–33 per cent took the form of bonds – tradable or "securitised" loans with interest. But these figures refer only to equity *issues* (new equity capital, especially privatisation programmes in developing economies) and do not encompass equities more generally, such as existing stocks and shares. Extrapolating from net investment flows, the international holdings of shares by pension funds are estimated to be up to three times the official figures for new equity issues alone. Therefore, pension funds are involved in international capital-market activity to a considerably larger extent than official figures suggest.

From Eurodollars to Petro-dollars to Pension Dollars

The 1944 Bretton Woods economic agreement established not only the World Bank and the IMF but also a monetary system, underpinned by the US dollar, that influenced the world economy for several decades. Within the system, currency adjustments, based on a country's balance of payments, were kept within limits and were supported by short-term credits from the IMF.

The Communist bloc was not part of the arrangements, however. In the 1950s, the governments of China and the Soviet Union instigated a trade in dollars outside the currency controls of the US, which led to the development of "Euromarkets".

These markets were boosted by a major expansion of US corporate capital into Europe in the 1950s and 1960s. This followed on from the Marshall Plan for European reconstruction after the Second World War, which had been prompted by the perceived Communist threat to Europe and elsewhere.

In the early 1970s, yet more dollars surged into Europe as a result of President Nixon's loosening US monetary policy in his 1971–72 re-election bid. At the same time, Germany's central bank, the Deutsche Bundesbank, was tightening interest rates to combat inflation. Dollars thus fled to Europe to earn higher rates of interest.

What had begun as an "off-shore" dollar market (a trade in dollar-denominated securities outside US controls), with London as its chief offshore centre, soon became a market in many other currencies. These Euromarkets were enhanced by the flows of "petrodollars" from corporate bodies, banks and the world's oil-producers resulting from the oil price increases of the mid-1970s.

Meanwhile, currency controls had started to weaken with speculation against the UK's sterling in the 1960s, leading to its devaluation in 1967. By the early 1970s, the international monetary system was already under considerable strain when the US, citing the cost of its war in Vietnam, withdrew from its key role within it.

As a result, governments abandoned exchange rates based on parities with the US dollar, and ultimately gold, in favour of floating rates in 1973. Subsequently, they also abandoned controls on capital movements, then a key part of the Bretton Woods system.

Despite attempts at international agreements and "accords" from the 1970s on-wards, exchange rates, interest rates, debt levels, inflation and public expenditure all became far more susceptible to the flows of finance in international financial markets – and thus began the enormous growth in "pension dollars".

These international financial markets dwarf the currency reserves of individual countries, with the IMF now providing rescue packages, or "bail-outs", to restore "confidence" to the financial markets.

The IMF's new role started with the Latin American debt crisis in the 1970s and 1980s (fuelled by Nixon's monetary policy, which pushed money into anything promising higher returns), extended to Russia and Eastern Europe after the collapse of the Communist bloc in 1989, and then to South-East Asia and Korea after the 1997 currency crises.

Pension Dollars

Global financial markets now rely substantially on private pension funds (and on public funds administered by private financial institutions). These "pension dollars" have, in turn, fuelled the expansion of financial markets. In addition, economic "reform" policies in many countries have relied on private pension funds to buy up shares in newly-privatised state assets – policies that thus depend on private pensions being expanded so as to yield yet more funds.

No longer does financial capital, or the financial sector, or the institutional investment system – however the accumulation and use of money is described – arise solely from conventional sources such as corporate or trade surpluses; companies switching their capital to more profitable uses; banks lending money and receiving returns and deposits; governments raising and lending money; or private individuals and corporations holding investments on stock markets or putting their private savings into banks and savings institutions for "a rainy day". "Social security capital" is now just as important, if not more so. Nothing of this nature, scale and geographical reach has ever happened before.[24] Whatever the history of financial empires, manias, investment and money markets,[25] something rather novel has occurred.

Financial markets now rely on "social security capital" – nothing of this nature, scale and geographical reach has ever happened before.

Global financial flows (and their unpredictable effects on countries' economies) may grow still further if more countries introduce pension systems along Anglo-American lines. They would also increase significantly if the US government privatised its Social Security system (*se*e Box, "Taking 'Social' and 'Security' out of US Social Security", pp.22-23) and if private solutions were extended still further in the UK, because these two countries already dominate the world's league tables in the size of pension funds and pension-related financial assets.

The Arguments for Private Pensions

Most advocates of the privately-run and -provided pensions model do not base their case on the need to expand capital markets, international financial flows or the financial services that go with them. Instead, they put forward other reasons as to why the public sector can no longer afford to pay pensions. They claim, for example, that:

1. The ratio of paid workers to pensioners is declining. There are more and more older people but fewer and fewer younger people, whose work has to pay for the non-earning older people. These demographic changes are undermining the ability of governments to maintain social security benefits.
2. The public sector doesn't have, or won't have in future, enough money to pay out the pensions of increasing numbers of old people. The present value of state pension benefits in most OECD countries scheduled to be paid between now and 2030 or 2150 (two of the dates often referred to in official forecasts) exceeds the present value of expected contributions to such pensions by two or three times the present value of GDP for most OECD countries. If the state is to pay out these promised pensions, it will have to increase general taxation or raise social insurance contributions (payroll taxes). The private sector, however, it is said, can invest in the stock market to finance pensions.

24. At least according to three criteria suggested to assess the contentious theme of globalisation: novelty (without parallel), magnitude (comparative size) and distribution (geographical extent). *See* Weiss, L., "Globalisation and the Myth of the Powerless State", *New Left Review*, No. 225, September/October 1997, pp.3-27.
25. For more information, *see* Arrighi, G., *The Long Twentieth Century: Money, Power and the Origins of Our Times*, Verso, London, 1994. For general information about financial manias, panics and crashes inherent in the current financial system, *see* Kindleberger, C.P., *Manias, Panics and Crashes: A History of Financial Crises*, Wiley, New York, 1996. For analysis of financial crises and crashes in the US, *see* Morris, C., *Money, Greed and Risk: Why Financial Crises and Crashes Happen*, John Wiley & Sons, Chichester, 1999.

Privatising pensions is about expanding stock markets, liberalising financial markets and changing the role of the state – not about pensions.

3. States are already spending too much on pensions. In the countries of the European Union, for example, pension expenditure runs at 12–15 per cent of GDP and makes up half or more of individual governments' social expenditure. In "transition" and "developing" economies, the levels of expenditure are so high that they are "bankrupting" their governments.
4. Public pensions are undermining economic production, competition and the expansion of financial markets by increasing state expenditure (considered to be a drain on the economy). Only the (relatively) unconstrained private sector can create and use savings to increase investment and thus economic growth through financial markets.
5. If the state provides a reasonable public pension, people won't save and invest some, or even any, of their earnings for their retirement, but simply spend them today.
6. The private sector liberates people from depending on the state, thereby increasing choice and self-reliance.

On close scrutiny, none of these arguments hold up.

Too Many Old People?

Predictions of what will happen in the future based on current statistics and trends are notoriously problematic, not least because they do not allow for any changes occurring between now and then. Population studies do provide indications for future economic development, economic growth, labour markets, national savings, age structures, health, fertility and mortality, functioning of markets, welfare programmes and inequality. But the results are simply projections rather than predictions and in many cases are inconclusive. According to one view:

> "The paradox of long-term demographic forecasting is that its methods combine superb technique with an almost complete lack of predictive theory."[26]

Nonetheless, the findings of demographic studies that the absolute numbers of older people and their proportion in any given population are rising have alarmed many.[27] In some countries, the figures are rising faster than in others. In Japan, the proportion of the population over 65 is the highest in the world at 19 per cent, even though half a century ago, it was around 5 per cent, well below that in the US, UK, France or Germany. In the UK, according to the government's actuaries, the proportion of the population over the age of 60 has been about the same for the past 20 years (21 per cent). But they believe that in ten years time, this figure will go up to 24 per cent, and by the year 2031 will be almost 30 per cent. Of OECD countries, Italy, Japan and South Korea are likely to be the "worst affected" by population ageing. By the year 2050, more than one-third of the populations in these countries may be over 65 compared to one-fifth in the US, Mexico and Turkey. Although warnings focus on a "crisis" in Northern countries, some 60 per cent of older people already live in the South, with the figure expected to rise to 80 per cent by mid-century.

26. "Mathematical demography is an elegant and sophisticated construct; supplied with the necessary assumptions, it can generate detailed and internally consistent population projections. Those assumptions, unfortunately, are precisely the sticking point" (Eberstadt, N., "Too Few People?", *Prospect*, London, December 1997, pp.50-55).
27. Definitions of "old" as applied to people are not consistent in the fields of biology, demography (the study of mortality, morbidity and fertility), sociology, or employment and retirement. But for statistical and public administrative purposes, "old" is usually defined as 60 or 65 years or above.

Living Longer – and Shorter

> "Once upon a time our biggest fear was dying too young. Now it is living too long."[1]

Life expectancy in many countries has been lengthening for the past 200 years. In the UK, it has increased an average of two and a half years each decade.

In the first half of the 20th century, lower death rates in early life accounted for much of this rise in longevity. But people now tend to be living longer because of changes that affect the rest of their lives: less smoking, less exhausting and dangerous jobs, better education, and medical advances in anaestheia and surgery.

Many projections of life expectancy assume that people's lives will simply carry on lengthening, just as predictions of future population are often based on extrapolating high birth rates way into the future.

But just as population growth and birth rates do not continue ever upwards, so, too, life expectancy will not increase *ad infinitum*.

Indeed, average life spans in several countries are already falling. According to US Census Projections, life expectancy in more than 40 countries is anticipated to be lower in 2010 than in 1990, largely because of health "setbacks" such as AIDS.

In Russia, life expectancy has dropped significantly since 1985, especially for men. A woman born in 1994 could expect to live to 71, compared with 74 a decade earlier, but a man in Russia can hope to get to just over 57, down from nearly 64 years old. The drop is attributed to alcohol-related diseases, accidents and violence. Demographers are now reversing their earlier projections of Russia's future population growth, based on their calculations of people dying younger and fewer women having fewer children.

In sub-Saharan Africa, life expectancy has dropped preciptiously by 10-20 years in the past two decades. This is largely because of AIDS, which is now the leading cause of death, far surpassing the more traditional killers of malaria, tuberculosis, pneumonia and diarrhoea. If there are proportionally more older people in many African countries, it is more because the young are dying than because the old are living longer.

In the meantime, as more and more people the world over become obese while others overuse alcohol and drugs, subsequent generations in several countries may not live, on average, markedly longer than previous generations. The World Health Organisation predicts a surge in deaths around the world from diabetes, heart disease and cancer. In the UK, it predicts five million deaths from these chronic diseases over the next 10 years.[2]

It should be noted that the increase in (healthy) life expectancy has not been spread evenly across social groups. The average unskilled manual worker in the UK is likely, at the age of 65, to live to 78, whereas the average professional can expect to live another five years to 83.

In the US, white people live on average about five years longer than African-Americans, who rely more on Social Security in their old age because they tend to have lower incomes throughout their lives. Some opponents of President George W. Bush's attempts to part-privatise Social Security have urged him to tackle inadequate healthcare, poor diet and high levels of violent crime rather than assume that African-Americans will continue to live shorter lives.

Indeed, as in other sectors of society, the gap is widening between the elderly rich and the elderly poor. Under many pension schemes, both public and private, the poor are worse off than the rich: because they die earlier, they draw their pensions for a much shorter period of time; because they earn less, their pensions are less. Concludes *The Economist* of industrialised countries:

> "The class divide matters more in old age than at any other time of life."[3]

The stock market model of social welfare widens this divide and exacerbates conflict within and between generations, classes and workers.

1. Matthews, T., "Fewer pension pots, more efficiency", *Financial Times*, 23 November 2005, p.19.
2. WHO, *Preventing Chronic Diseases: A Vital Inv*estment, WHO, Geneva, October 2005.
3. "A long, long life", *The Economist: A survey of retirement*, 27 March 2004, p.5.

What actions should be taken based on these projections, however, is open to question. Historical demographic statistics do not show that the proportion of older people in a population has risen constantly: just like birth rates, it rises and falls over time as circumstances change. Indeed, the increase in the number of older people is, to a certain extent, a temporary phenomenon, reflecting the advancing years of those born during the "baby boom" – the sudden leap in births that occurred in many industrialised countries after the Second World War between 1946 and 1964.[28]

Significant increases in longevity are, meanwhile, often cited as a cause of the pensions crisis (*see* Box: "Living Longer"). What is important for insurers and pension schemes is the life expectancy of those who reach 65 (or the age at which a pension starts being paid). Men

28. The "old age bulge" will work its way to the top of the age pyramid and deflate by about the middle of the 21st century as the baby boomers die. Rarely mentioned is that societies managed to find the money to feed, clothe, house and educate all these baby boomers for their first dependent 16 to 20 years before they started working; and that the US economy will be three to four times larger when the baby boomers retire than it was when they were young dependents. *See* Baker, D. and Weisbrot, M., *Social Security: The Phony Crisis*, University of Chicago Press, Chicago, 1999, p.31.

in Britain are now likely to live 19 years after reaching 65, while 65-year-old women can expect to live another 22 years. Yet it is hardly a surprise that people are living longer, notes *Financial Times* columnist Michael Skapinker:

> "Why did it take companies and their actuaries so long to wake up to it? People have been talking about it for a while. 'We are now entering and living in a period when the span on human life has been mercifully prolonged.' Who said that? George W. Bush? Tony Blair? No, Winston Churchill – in 1925."[29]

Governments and actuaries have had at least half a century's warning of any "crisis", given that pensioners were born 60 or more years ago.[30]

In addition, rather than "too many old people", the issue could be presented equally well as one of "too few babies". Fewer younger people, particularly those in paid work, is another cause of increased old-age dependency ratios – more older people relying on fewer younger people.[31] An October 2005 OECD study of the impact of an

29. Skapinker, M., "Final salary pensions will be a test of corporate character", *Financial Times*, 8 June 2005, p.12.
30. Clark, G.L. and Whiteside, N., *Pension Security in the 21st Century: Redrawing the Public-Private Debate*, Oxford University Press, Oxford, 2003.

Too Many Old People? Or Too Few Babies?

In the past 50 years, the world's average birth rate has tumbled from five children per woman to 2.65 children. Most of the 44 countries classified by the UN as "developed" have birth rates below the replacement level of 2.1 children per woman – not enough babies being born to replace people who die and thus keep the population constant. In some countries, the birth rate is far lower than 2.1.

Japan has one of the lowest birth rates of any developed nation at 1.5 children per woman (combined with negligible immigration and one of the longest-living populations). Japan's total population began declining in 2004 as deaths exceeded births for the first time.

In recent years, Italy has had the lowest birth rate in Europe, 1.3 children per woman, with Spain not far behind. A mayor in southern Italy recently initiated a "babies for cash" scheme, offering women 10,000 Euros for each child they bear.

But figures from the EU's statistics office for 2004 suggest that Germany now has the lowest: 8.5 births for every 1,000 inhabitants compared with 12.7 and 12 in France and Britain respectively. "Baby Shock: We Germans are Dying Out" headlined one newspaper article in March 2006. In response, some politicians have mooted that people (especially educated women) who do not have children should have their pensions reduced by half.

Russia's fertility rate has also dropped to about 1.3, attributed to young women having a child and then avoiding further births because of economic despair or ill-health. Clearly, economic calamity can depress fertility rates as much as affluence.

And it is not just in the developed world that fertility has fallen. In East Asia, Thailand, Burma, Sri Lanka, many Caribbean countries and most South American countries, fertility rates are below replacement level. Brazil, Iran and Turkey, it is claimed, will all be below replacement level within 15 years. In some countries where more boys than girls are being born and raised because of sex selection and son preference, the decline may be compounded.

Comments sociologist Ben Wattenberg:

> "Never in the last 650 years, since the time of the Plague, have birth and fertility rates fallen so far, so low, for so long, in so many places."[1]

China, one of the most rapidly ageing societies ever, is an extreme illustration of this process. "One mouth, six pockets" is how some Chinese now describe a typical family: a single precious offspring doted on by its two parents and four grandparents, the result of China's one-child policy strictly imposed over the past few generations to reduce its overall population growth rate.

At present, China has few pensioners and few children, but many working-age adults. When these adults become pensioners, however, there may be far fewer workers to replace them. The number of people working for every pensioner is expected to drop from 9 at present to 2.6 in 40 years time, according to UN projections. At that point, suggests *The Economist*:

> "it will be more like six mouths to feed and one pocket to pick up the bill."[2]

Ironically, the United States – the country that has led efforts the world over during the past 50 years to lower birth rates in order to reduce population growth – is one of the few countries not affected by a drop in birth rates or population decline. Its overall population is increasing; the birth rate is above the 2.1 replacement level; there will be far more young people in 20 years time than there are today, and the proportion of older people is lower and growing more slowly than that in Western Europe.

1. Wattenberg, B., *Fewer: How the New Demography of Depopulation Will Shape Our Future*, Ivan R Dee, Inc, Chicago, 2004.
2. "China's golden oldies", *The Economist*, 26 February 2005,

ageing workforce on labour markets in OECD countries projects that, by the year 2050, 10 active workers will be supporting, on average, more than seven older inactive people compared with just four in the year 2000. What is not explored, however, is whether those earning may be generating enough national income for some to be redistributed to non-earning pensioners, many of whom not only paid for a previous generation of retirees but also laid the foundations for economic growth through their own work and taxes.

"Raising the birth rate would resolve long-term problems" says the *Financial Times*, but dependency ratios – the ratio of those dependent on others for their survival –would only increase in the short-term "as youngsters would need to be educated and kept healthy before they could enter the labour force".[32]

Statistics, moreover, leave out the reasons why many people of all ages struggle to earn a reasonable living: a lack of skills, experience or aptitude; lack of educational opportunities; low wages; the outsourcing of manufacturing and, increasingly, service jobs to even lower waged countries. Raising the age at which people can retire and draw a pension as a way of reducing the cost of pensions assumes that there are jobs and training available and that older people do not suffer age discrimination. In the UK, some 40 per cent of the one million people aged between 50 and 65 who want to work are unable to find employment, according to a 2004 National Audit Office study.

"Old" is, moreover, a relative term, while attitudes towards "old age" are anything but unilinear and unambiguous. Nor are boundaries between "working age" and "old age" completely rigid. Many retired people are part of the "active" economy rather than a dependent expense or a passive burden. This is the case whether they are seen only in the narrow calculus of economics and accountancy or whether they are considered as part of a broader politics of welfare. In financial terms, they spend, save and invest, all of which helps an economy. They may not be net consumers of public money or national wealth, if the broader effects of their activities are taken into account. For instance, many perform social, voluntary, group and family activities, such as (grand)childcare,[33] community and charity work, all of which are not captured by quantitative measures such as GDP and are not off set against public expenditure.

Population ageing may well be "unprecedented" and "without parallel in the history of humanity",[34] but it does not follow that the challenges it creates are major, nor that proposed solutions are as obvious as they might appear.

Not Enough State Money?

Given that the numbers and proportions of older people are rising, it follows that future pensions paid at the same level as today would cost more in total. But whether a country has enough money to pay out such pensions or not is less of a number-crunching accounting issue than a political question related to public spending priorities,[35] and to the amount and source of public revenues.

In addition, claims that the private sector will have more money than the state from which to pay out pensions tend to be based on

31. The old-age dependency ratio is conventionally defined as the ratio of the population aged 65 years and over to the population aged 15-64. It is widely used because it is easy to calculate, but provides little information about the overall economics of an ageing population. Many of those aged between 15-64, for instance, may not be earning, while some of those over 65 will be earning, and some of those under 65 will already be drawing a pension.

    More useful indicators might be the ratio of pensioners to earners, or the overall dependency ratio. Those in paid work directly and indirectly support not only non-earning older people but also a range of non-workers, including carers of young children, students in school, college and university, and the disabled. Some estimates suggest that the composition of those not working may change in future (for instance, more older people), but that the total number may not, especially given lower birth rates.

    This would suggest that overall dependency ratios may change little. They have been more or less constant over time. Indeed, the ratio today is lower than it was at the end of the baby boom in the late 1960s and lower than at the end of the 19th century. This would in turn suggest that more generous public sector pensions could be provided without significant tax increases as less public support would be needed for fewer other non-working people.
32. Taylor, A., "Ageing populations threaten to overwhelm public finances", *Financial Times*, 11 October 2005, p.12.
33. The voluntary organisation, Age Concern, estimates that the childcare provided by grandparents in the UK would cost about £3.9 billion in childminding fees.
34. UN, *World Population Ageing: 1950-2050,* Department of Economic and Social Affairs: Population Division, New York, 2002, http://www.un.org/esa/population/publications/worldageing19502050/
35. The estimated direct costs to the US of its war in Iraq have been estimated, conservatively, at $750 billion – 10 times the world's net annual official development assistance to all developing countries. A more moderate estimate suggests the direct costs will be $1,184 billion. When wider and indirect costs on the US economy are added in, a conservative estimate suggests $1.026 billion and a more moderate total of $1,864 billion (Blimes, L. and Stiglitz, J., *The Economic Costs of the Iraq W*ar, January 2006, http://www2.gsb.columbia.edu/faculty/jstiglitz/Cost_of_War_in_Iraq.pdf, cited in Wolf, M., "America failed to calculate the enormous costs of war", *Financial Times*, 11 January 2006, p.19).

Profit and Prejudice

Dull, number-crunching arguments about life expectancies, birth and death rates, and the affordability or otherwise of both public and private pensions become emotionally-charged when they overlap with debates on immigration.

Indeed, fears of too many immigrants provide much of the subtext for the current debates on population ageing. In the process, both migrants and pensioners are being scapegoated, marginalised and impoverished.

Supporters of increased immigration, either on a permanent or temporary basis, argue that migrant workers provide much-needed skills and labour, given the declining ratio of younger people to older ones. They thereby boost economic growth and enable pensions to be paid.

UN secretary-general Kofi Annan is adamant:

> "There can be no doubt that European societies need immigrants [because] Europeans are living longer and having fewer children."

He points to Japan, Russia and South Korea as examples of other countries facing shrinking economies and stagnating societies.

> "Immigration alone will not solve these problems but it is an essential part of any solution". [1]

Opponents contend that immigrants take the jobs of "native workers", lower the wages of others, and thereby depress the economy for everyone.

While these arguments are ostenisbly about economic costs and benefits, racism and nationalism are never far from the surface, while other economic and historic realities are selectively left out of the picture.

The UK and the United States, for instance, have been countries of migrants for centuries, while their pre-eminence still relies on the legacy of slavery and colonialism. Columnist Gary Younge of the UK's *Guardian* newspaper points out that:

> "Economically, without the huge pool of cheap labour emanating from the developing world, documented or not, we simply could not function as we do."[2]

More and more migrants are going to OECD countries, at the request and approval of OECD governments, as highly-skilled workers to fill jobs in areas of shortage, such as nursing, teaching and information technology.

Without nurses and doctors from overseas, for instance, the UK's health service would collapse:

> "Over one third of registered doctors are not originally from the UK, and not far off half of newly registrant nurses are from overseas. The UK population relies for its standard of health care on health professionals trained elsewhere."[3]

Those coming to Britain in 2004 encompassed British nationals returning home, Indian software engineers, US investment bankers, Filipino nurses and Australian gap year students. The top overseas birthplace for new immigrants in 2001 was the Republic of Ireland. Many migrants are filling jobs that British people are unwilling or unable to do.

Far from depending on welfare, many migrants are supporting families and communities in the countries from where they came. In 2004, migrant workers formally tranferred US $150 billion in total, and informally twice that amount – in all, triple the value of official aid to Southern countries and not far behind foreign direct investment.[4]

An estimated 200 million people now live and work outside their own country, double the number of 25 years ago, but representing just three per cent of world population. Europeans migrated in vastly higher numbers in the 19th century to the Americas and Australasia.

Nonetheless, migrants are often held responsible for unemployment among old and young alike. Three academic economists point out how easy it is to create a "popular wisdom [that is] simply false":

> "Start by substantially overestimating the number of migrants, as the natives invariably do. They assume the number of jobs is fixed. Evidently any immigrant must be taking the job of a native, so unemployment can be cut only by stopping immigration."[5]

Often left out of discussions is "an international trade policy that allows capital to roam freely across borders in search of the low wages", destroying jobs and livelihoods as it does so, but that does not allow people to move in search of better ones.[6]

To date, such free market policies have been instrumental in causing the *forced* movement of people who are simply trying to survive or are fleeing from torture and oppression – and in causing the increased racism and hostility they encounter if they manage to do so. Many immigrants are left with the worst of all worlds:

> "economically exploited and socially demonised . . . vulnerable to unscrupulous employers, opportunistic politicians and racist hate-mongers . . . Business take the profit, the immigrants get the prejudice."[7]

In a similar and related process, pensioners are denigrated as burdens on the young even as footloose capital depends on their savings.

1. Annan, K., "Migrants can help rejuvenate an ageing Europe", *Financial Times*, 29 January 2004.
2. Younge, G., "Detox this racist culture", *The Guardian*, 16 May 2005.
3. Mensah, K., Mackintosh, M. and Henry, L., *The "Skills Drain" of Health Professionals from the Developing World: a Framework for Policy Formulation*, Medact, London, February 2005, p.7.
4. "The global workforce: How to realise the benefits of migration, and reduce its risks", *Financial Times* (editorial) 6 October 2005, p.18.
5. Boeri, T., Brucker, H. and Portes, R., "It makes economc sense to open borders", *Financial Times*, 10 June 2005, p.19.
6. Younge, G. op. cit. 2.,
7. Ibid.

assumptions that its stock-market pension system yields higher "rates of return" (the percentage profit earned from an investment) from individuals' savings put aside for their retirement than from the same amount paid by individuals as taxes to fund today's pensioners. Such claims assume that the stock-market system optimises national resources to pay future pensions, while the public payment of current pensions drains them and hinders economic growth.

When the rates of return on individual private accounts are compared to those of state pensions, the results are notoriously misleading while the assumptions underpinning them are unproven. They do not compare like with like, while "rates of return" that cannot be measured by narrow stock measures are ignored (*see* Box: "Rates of Return and Welfare", pp.16-17). Indeed, balance-sheet accounting standards of profit and loss often do not apply to issues of social welfare.

Critically, the comparisons overlook the fact that future pensioners, whether in funded schemes (the money put aside in advance) or pay-as-you-go ones (the money taken from current taxation), depend, like everyone else, on what the economy is capable of producing at the time when they are actually pensioners, and at what price – unless they store up 20 years' worth of tinned food, dried milk and a hip replacement or two beforehand. Funding a pension scheme does not isolate a part of current national income for future use by those who defer their consumption. Thus debates about whether to opt for funded schemes or pay-as-you-go schemes – a percentage of an individual's earnings put aside for the future or paid to today's pensioners – serve simply to hide a conflict about how to divide *current* national income and who should receive it.

Pensions result from what societies produce, not what they save.

All pensions have to be paid out of current resources – in effect, all pensions are pay-as-you-go.

State Expenditure Too High?

Related to the argument that the public sector doesn't have enough money to pay pensions is the assertion that state expenditure on pensions in some countries is already "too high". Drawing up a profit-and-loss balance sheet for the public sector that includes future payments at current prices but not future income to make such payments, some theorists draw the conclusion that the public welfare systems of many countries are going bankrupt. Yet to call future pension entitlements "liabilities"[36] is an amazing translation of complex social and political considerations and policies into a narrow financial accounting picture of a nation, its democratic processes and its social commitments. The implication that so many nations should be put into receivership (in practice, change their policies) demonstrates just how prevalent this narrow concept of welfare provision has become.

In fact, warnings of a looming pensions crisis tend to be "unrelated either to current or projected levels of expenditure on old age benefits". As pension policy experts John Myles and Paul Pierson point out:

> "The countries of Continental Europe face the highest levels of [public] spending, now and in the future, in part because of generous pension schemes but also because of their very high rates of early retirement and labor force withdrawal by those under 65. Nevertheless, one hears virtually the same rhetoric of 'crisis' whether one travels to high-spending Italy or to low-spending Australia."[37]

continued on page 18 . . .

36. In accounting terms, a financial liability is an outstanding debt owed to another, but more generally refers to a hindrance, or something that puts one at a disadvantage.
37. Myles, J. and Pierson, P., "The Comparative Political Economy of Pension Reform", paper presented at workshop on "The New Politics of the Welfare State", Cambridge, MA, October 1998, p.7. *See also* Myles, J. and Pierson, P., "The Comparative Political Economy of Pension Reform", *in* Pierson, P.(ed.), *The New Politics of the Welfare State*, Oxford University Press, Oxford, 2001, pp. 305-333.

Rates of Return and Welfare

Various definitions or understandings of "rates of return" underpin the logic of the Anglo-American pensions theory and its empirical evidence.

Returns on "Assets"

The stock-market pensions system aims to maximise financial returns on specific pieces of property or "assets". These returns not only provide the basic criterion for how capital is allocated – which company shares get bought and which not – but are also equated in the stock-market pensions theory with economic growth, as indicated by Gross Domestic Product (GDP).

But there is in fact no correlation between returns on share investments and GDP growth. For example, among the US, UK, Japan, Australia, Canada and Germany over the ten-year period 1984–93, the UK had the highest returns in its equity market, but the lowest increase in GDP. The same applies for the 25 years from 1966 to 1990 for the UK compared to Australia, Canada, Denmark, Germany, Japan, Netherlands and the US.

In Southern economies, the rates of return on specific assets are not necessarily the same as economic growth either. Instead, sales of public companies in privatisation programmes have driven stock-market development, and consumed domestic and foreign investment. In Chile, for example, holdings in privatised companies accounted for 90 per cent of all the equity holdings of pension funds in 1990.

Rather than providing new capital for productive investment in Southern countries, the equity market has simply functioned as a facilitator of ownership transfers.

Moreover, in the calculus of stock-market returns, the overall economic cost of unproductive takeovers and mergers, which make huge capital gains for investors but do little for economic growth, is likely to be substantial but rarely assessed.

During 1982–95, only about two per cent of all UK stock-market turnover went towards the provision of *new* capital to companies. Of that, a substantial amount was devoted to takeovers, repayment of debt and the financing of dividends. Only a tiny amount went towards "productive capital stock" such as business plant and equipment.

Between 1970 and 1985, in the UK and the US, new share issues actually made a *negative* contribution to investment – there were net redemptions of stocks due to takeovers and mergers and the consequent buying of stock by acquiring companies.

In the US, net savings transferred to the corporate sector through the equity market averaged less than one per cent of GDP over the decade to 1998, and were often negative. Between 1981 and 1997, US non-financial corporations paid back $813 billion more in stock than they issued because of takeovers and buybacks. Between 1970 and 1989, the contribution of equity markets to the investment requirements of the corporate sector in the US and the UK was negative.

It is therefore highly arguably whether pension funds have contributed to new investment and production through the equity markets.

Returns on "Pension Pyramids"

The stock-market theory implies something for nothing – that the stock market will create more value or "growth" through its self-expansion alone, thereby giving the owners of capital and workers greater ability to meet their future expectations.

But what happens when pensioners want to claim their pensions? What are their savings going to be worth if they have expanded without any equivalent expansion in the real economy, nationally or internationally?

Even before the stock-market crises of 1997–98, pension assets were valued at more than the worth of all the companies quoted on the world's three largest stock markets – the US, the UK and Japan – put together.

Buying higher-risk, higher-return investments overseas might initially stabilise or increase the domestic rate of return. Higher returns elsewhere based on cheaper production costs puts pressure on wages at home and thereby increases the share of wealth accruing to capital.

But international financial crises and all their knock-on effects illustrate that pension funds cannot in fact square the circle by "diversifying" their risks and investments into overseas stock markets.

If pension savings cannot be put to productive use because there are not enough investment opportunities, then stock-market investment rapidly hits diminishing returns.

And if stock-market returns have nothing to do with real economic growth, then security in retirement becomes an illusion. Pensioners can share only in what is produced when they are, in fact, pensioners. If production has fallen, their savings buy less in real terms.

Thus future pensioners may have a good rate of return in gross financial terms, but the production of local goods and services could well have declined; they may have to pay more tax; they may also have to support their unemployed children; their streets may be unsafe; and many local facilities may have closed.

The ultimate conundrum is this. When the current generation of savers retires, their savings schemes must attract *more* savers to keep the system going. The claims on the underlying assets – the shares in companies as well as property holdings and government securities – must be sold to *other* savers, such as younger workers, or these schemes will get into difficulty. These "pension pyramids" underpin the edifice of private pensions.

Returns on Pay-As-You-Go

When pension reformers apply balance sheet accountancy standards to pay-as-you-go schemes, they create further problems for macroeconomic and social welfare issues.

The predicted poor "returns" on state pay-as-you-go schemes are supposedly aggravated by demographic change. As the proportion of workers to pensioners falls – more pensioners, fewer workers – current workers have to pay relatively more than a previous generation did to provide the same pension in real terms – a falling rate of return. These workers don't get back what they paid in.

Whether this "return" amounts to a reasonable pension seems irrelevant in this personalised calculus of contributions, entitlements and percentages. Instead, it is argued, if pensioners had invested in stock markets, they would have received a *higher* percentage rate of return. Equity markets may produce no economic growth, but they supposedly produce a better rate of return than pay-as-you-go.

The different goals of pension schemes become clearer when considering "rates of return" in other insurance schemes. UK actuary and director of the consultancy Union Pension Services, Bryn Davies, has analysed whether pension systems are equitable between different generations:

> "It is possible, after the event, to show that people whose houses burn down get a better rate of return on their insurance premiums than those who are more lucky in this respect. This does not mean that it is sensible to suggest that the payment of the insurance premiums proved to be a bad decision. The point may be mathematically accurate, but it is irrelevant because it ignores the reason why the premiums were paid in the first place. They were not paid as an investment, they were paid to provide a feeling of security. In the same way the contributions paid to a pay-as-you-go pension system might be, at least in part, paid for reasons other than investment."

In many cases, concludes Davies, comparing rates of return in different pension systems:

> "will be unimportant, particularly where a system has been established explicitly on a basis of intergenerational solidarity, where arguments based on the rate of return simply do not apply."[1]

United Nations economist Larry Willmore, moreover, points out that:

> "Social security reform in itself is not likely to generate increased savings or growth; it is essentially a zero sum game in which some participants gain at the expense of others. Arguments for reform of social security masquerade as economics, while in reality they are political arguments for changing the distribution of costs and benefits."[2]

How the "rate of return" on public pay-as-you-go schemes are understood is essentially a matter of social policy, which should be separated from debates on the determinants of economic growth and financial returns.

Social Returns

Some pension-fund investors, including public authorities, invest in companies that do not conform with standard portfolio investment criteria but safeguard employment in a particular area.

A US Congressional Report claims that the potential of such investments "to harm the nation's economic growth is considerable".

> "By forcing pension funds to finance less productive investments, the economy will suffer. The long run slowdown of economic growth caused by . . . misallocation of capital will depress income growth and the standard of living."[3]

Such a view takes no account of the financial cost to the taxpayer of doing nothing for local investment and the consequences for local demand for labour, goods and services.

For instance, the public authority could obtain tax revenues from the company and employees in which its pension scheme had invested. The investment could enable many people to continue paying into their pension systems.

If the company closed due to lack of investment, on the other hand, the authority could be faced with lost consumer spending at local retailers, lost orders for suppliers and knock-on effects from bankruptcies or lay-offs, and lost taxation revenues.

1. Davies, B., 2000, "Equity Within and Between Generations", *in* Hughes, G. and Stewart, J., (eds.), *Pensions in the European Union; Adapting to Economic and Social Change*, Kluwer Academic Publishers, Amsterdam, 2000, pp.117-8.

2. Willmore, L., "Social Security and the Provision of Retirement Income", mimeograph, United Nations, New York, 1998.

3. Joint Economic Committee House Staff Report, 'The Economics of ETIs: Sacrificing Returns for Political Goals', September 1995, cited in Lips, C., "State and Local Government Retirement Programs: Lessons in Alternatives to Social Security", *Social Security Privatisation*, CATO Institute, SSP no. 16, 17 March 1999, pp.5–6.

. . . continued from page 15

This suggests that the "crisis" lies not in pensions or in the numbers and proportions of old people, but in aspirations for different political and economic systems. It is even harder to assume the pension schemes of "transitional" or "developing" economies are bankrupt when rapid and broad changes are taking place in investment, banking, production, exports, inflation and debt.

Expenditure on Public Pensions or Public Subsidy of Private Pensions?

Private pensions usually cost the state money in various ways. These include subsidies and guarantees to the private pensions sector, and lost tax revenue because of the tax breaks given to those who take out private pensions. These costs are usually neglected by those who maintain that the state must reduce its spending on pensions.

In the UK, for example, the present system of private pensions is estimated to cost the state £21 billion a year in lost revenue, because contributions to private pensions have been largely tax exempt. Over half this tax relief goes to top-rate taxpayers, who are mostly men.[38] In the US, the system of private pensions was estimated to cost the state $50 billion a year at the beginning of the 1990s through the tax relief granted to contributors. While tax relief usually confers an advantage on those who take out private pensions, everyone pays for the subsidy "including those who save and those who don't," points out pensions consultant Michael Littlewood.[39]

Government guarantees provide another subsidy for private pension schemes. The US government set up the Pension Benefit Guaranty Corporation (PBGC) in 1974 as an insurance scheme for company occupational pension schemes. In 2003, the Corporation was itself put on the list of institutions that might need a taxpayer bail-out because it was sinking under more than $60 billion worth of pension liabilities.[40]

In the UK, the government's Pension Protection Fund (PPF) is modelled on the US PBGC. The scheme, which will pick up some of the pensions bill if a company goes bankrupt with a shortfall in its pension fund, came into force in April 2005, largely as a result of protests by contributors to pension funds that have been wound up in recent years, paying out little or no benefits, after the sponsoring companies went bankrupt. Occupational pension schemes pay a levy set by the government to the PPF to prevent any liabilities falling onto the public sector. But the Confederation of British Industry is already calling for taxpayers to contribute to this pensions lifeboat and for the government to act as "banker of last resort" if the PPF has to pay out more than the pension schemes have paid in.[41] British taxpayers are already committed to paying out £400 million over the next 20 years to an interim Financial Assistance Scheme that provides some compensation to some of those in under-funded occupational pension schemes sponsored by companies that have already gone bust.[42] Given that at least 85,000 people have already lost some or all of their pensions because of corporate bankruptcies, a further £2.6 billion over 40 years could be needed.[43]

38. Altmann, R., "Use wasted billions to reform our ailing state pensions", *Financial Times*, 16 January 2006, p.19.
    Some 45 per cent of tax relief goes to 2.5 million higher rate taxpayers while 55 per cent goes to 13 million lower rate taxpayers. Some 9 million people receive nothing as they are not saving into a pension. Overall, pension tax relief benefits men, middle-classes and white people, while women, the low-paid, and ethnic minorities tend to lose out.
39. Littlewood, M., "How to Create a Competitive Market in Pensions: The International Lessons", *Choice in Welfare no. 45*, IEA Health and Welfare Unit, London, p.59.
40. The Corporation plunged from a $7.7 billion surplus in 2001 to a $23 billion deficit as of September 2004, because companies did not pay their insurance premiums, went bankrupt, or off-loaded their underfunded pension schemes onto the Corporation. The Corporation's liabilities could increase still further if automotive, airline and steel companies with large pension deficits go bankrupt. Twenty years ago, the Corporation insured 112,000 pension schemes, but fewer than 30,000 now remain. Only one-fifth of workers in the US are now covered by defined-benefit pensions (*Financial Times* editorial, "The oracle of Delphi", 11 October 2005, p.20).
41. The PPF will provide 90 per cent of benefits, with a maximum annual payout of £25,000, to someone who would have retired at 65 if the company had not gone bust. Some estimates suggest that after 10 years, the PPF itself will have built up a deficit – the excess of claims over its assets – of £3 billion in today's money and that the PPF needs two to four times the government's original estimate of £300 million a year.
42. The Financial Assistance Scheme, launched in May 2004, will pay 80 per cent of a lost pension (up to a maximum of £12,000 a year) to those retired, or within three years of retirement, who had contributed to an occupational pension scheme provided by a company that went bankrupt between 1997 and April 2005. An estimated 15,000 workers are eligible. The government will make the bulk of the money available only in 2008. To date, just 27 pensioners have received limited payouts.
43. In March 2006, an inquiry by the Parliamentary Ombudsman (a public official acting as an impartial intermediary between the public and government) concluded that the government had contributed to these financial losses by misleading workers about the safety of their company pensions and by relaxing pension funds' minimum funding requirement (*see* footnote 70).

In addition, the money put into a private pension does not all accrue to an individual's pension pot. A significant proportion of the contributions are taken up in administrative costs, which provide some of the profits for the institution managing the fund. Proponents of individual private pensions often assert that competition among pension providers will ensure low administrative costs. Not only is this claim unproven, but experience to date suggests the opposite.

Chile was the first country in the world to switch from a public pay-as-you-go pension scheme to a privatised defined-contribution approach based on individual or personal pensions, as part of President Pinochet's efforts to marketise the Chilean economy. In 1990, the operating costs of the Chilean private pension funds accounted for 15.4 per cent of annual contributions and represented 2.3 per cent of total assets. By 2000, half the contributions by Chilean workers who retired in 2000 went to management fees. The administrative costs of the Chilean privatised pension system are proportionally about 20 times those of the US public pension system, Social Security.[44]

In the UK, an estimated 40-45 per cent of the value of individual private pensions has been consumed by various fees and costs, explicit or implicit.[45] The chair of the UK's Pensions Commission,[46] Adair Turner, says that:

> "it is very difficult for the financial services industry to sell pensions to people of average earnings and below, at annual management charges sufficiently high for them to make a profit, but sufficiently low to represent good value for money for the person saving".[47]

Because "the financial services industry simply cannot service small accounts cost-effectively", Turner has proposed a public collective scheme as "the most sensible way to resolve this dilemma".[48] In Singapore, which has a public monopoly on pension provision, the operating costs are 0.53 per cent of annual contributions and 0.1 per cent of total assets.[49]

Switching from a pay-as-you-go (PAYG) public pension system to a funded one itself costs money. The generation making the switch has to pay twice: it has to pay the pensions of its parents' generation while at the same time setting aside savings to fund its own retirement.

44. *See* Queisser, M., *Pension Reform: Lessons from Latin America*, OECD Development Centre Policy Brief, no. 15, 1998.
45. Orszag, P. R. and Stiglitz, J. E., "Rethinking Pension Reform: Ten Myths about Social Security Systems", paper presented to the conference on "New Ideas about Social Security", World Bank, Washington DC, 14–15 September 1999.
46. The UK government appointed a Pensions Commission in December 2002 to assess the adequacy of private pension saving in the UK and to advise on appropriate policy changes.
47. Quoted in Timmins, N., "Call for lowering of pension scheme charges to attract the less well-off", *Financial Times*, 15 September 2005, p.4.
48. Wolf, M., "A challenge for the savings industry", *Financial Times*, 2 December 2005, p.19. Turner recommended in November 2005 that the UK introduce a national, defined-contribution scheme which would collect contributions as a payroll tax and put them into funds run by the government (or contracted out to private management). All workers would be enrolled, but could opt out.
49. World Bank, *Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth*, Oxford University Press, New York, 1994, p.224.
The pre-funded US$48 billion Central Provident Fund (CPF) in Singapore is managed by a state body, although the government has considered handing it over to private management to attract fund managers to the country and to expand the country's financial markets. In March 2005, plans to allow Singaporeans to withdraw their retirement savings from the CPF and invest them through privately-managed pension plans were shelved because the new schemes would be too small to offset high management fees.

Defined-Benefit versus Defined-Contribution

Most pension schemes, whether basic or supplementary, have been "defined-benefit" – the amount of the pension paid out each week or month is more or less known in advance and is often related to the number of years of employment, citizenship or final salary.

New supplementary, funded schemes, however, are increasingly "defined-contribution". The benefit (the amount actually paid to the pensioner) is not known in advance but depends on how much was contributed by the individual and/or employer and, crucially, investment returns. These are "money purchase" schemes (what you contribute plus investment returns are what you get) as opposed to "final salary" schemes.

Defined-contribution schemes are said to:

a) increase labour mobility (contributors carry their pension scheme and agreed contribution rate with them when changing employer);
b) lower employment costs (there is no "guarantee" from the employer);
c) increase choice (competition between pension providers); and
d) lower pension costs to the consumer (as a result of competition).

In practice, however, these schemes have substantially reduced contributors' rights, raised costs and increased the sums that contributors have to pay in if they hope to obtain the same level of pension as a defined-benefit scheme.

The longer a PAYG pension system has been going and the more generous its promised benefits, the larger the implicit debt in the system. Because of these transitional costs, no country with a substantial PAYG system can switch rapidly to a privatised system.

Draining or Boosting the Economy?

Those who claim that public expenditure on older people has little or no positive effect on economic demand and growth ignore two facts. First, pensioners spend much of their pensions, thus stimulating consumption. Second, that they save what they don't spend, thereby contributing to potential economic investment, according to the very economic theory that justifies stock market pensions.

And if, as proponents of funded pension schemes argue, investment in equities through private accounts has substantial economic

Pension Funds Change Markets and Assets

Pension funds may have recently reduced their investments in equities in general, and in the UK stock market in particular, but they still heavily influence the world economy.

Since the 2000-2003 fall in stock-market values, UK managers of pension funds have reduced their equity holdings to, on average, around 65 per cent of the fund's value (down from a high of 80 per cent in 1993).

They have also switched their equity holdings from those traded on the UK market to overseas stock exchanges. Overseas equities now account for about 45 per cent of the stocks and shares held by UK pension funds and insurance companies. Whereas UK pension funds and insurance companies used to own over half the UK stock market in the late 1990s, now their share is down to about one-third.

Pension fund sales of UK equities has helped to drive down UK share prices further, making UK companies more attractive to overseas investors, including US pension funds, insurers and other companies.

In 2005, overseas companies spent nearly £50 billion on UK organisations, the highest amount for five years. Spain's Telefónica bought up O_2; France's Pernod acquired Allied Domecq and its Saint-Gobain the plasterboard maker BPB; and Deutsche Post purchased Exel. In 2006, Dubai Ports World eventually managed to buy P&O; Linde of Germany scooped up gas company BOC; and Nippon Sheet Glass agreed to buy Pilkington. The UK government has not intervened in these deals, in contrast with the French, German, Italian, Polish and US governments, which do not always welcome "foreigners" buying "their" firms.

By 2005, overseas investors held over 32 per cent of the UK stock market, double their share of a decade earlier. Holdings in companies listed on the London Stock Exchange have now become so complex that almost half of listed UK firms don't understand who owns them.

The Name is Bond

While reducing their UK equity exposure, many pension funds have been buying up bonds – interest-bearing securities issued by governments, financial groups or industrial companies that mature in 30, even 50, years' time and that pay a regular level of guaranteed interest (yield) – in the belief that these can best assure regular payouts to pensioners.

The "lemming-like" shift into bonds, particularly long-dated ones, however, has triggered a vicious cycle: as pension funds have bought more and more bonds, so bond prices have gone up (particularly since there's a bond shortage) and yields have dropped to all-time lows.

Not only does this mean that funds may not have enough money to pay out pensions in future. It also means that their estimated deficits are increasing, because actuaries now calculate pension fund deficits according to bond yields, irrespective of whether the fund has invested in bonds or not. The lower the bond yield, the higher the calculated deficit. This drives pension funds to invest in yet more bonds.

Given the sheer weight of pension fund money trying to invest in bonds, both governments and companies might be tempted to issue those long-term bonds. The pensions industry is certainly urging the government to do.

From a government perspective, issuing long-term debt over 30 to 50 years in the form of bonds that give yields of less than one per cent looks like a once-in-a-century opportunity to lock in such low borrowing costs.

But for the government to borrow more than it needs when it is aiming to keep public spending low could, ironically, be described as the very "backdoor to nationalisation", at least of some of the long-term liabilities of private pension schemes, that the World Bank and others decry. The pension savings ultimately end up as public sector investments anyway.

and social benefits, then investment into similar assets through public trust funds should have the same advantages.[50] The World Bank has been concerned that such public investments can be a "backdoor to nationalisation".[51] Others charge that state involvement in investments is political "interference", for instance, when local government funds are used to promote the local economy and employment.[52] Both views suggest that what is at issue is national and international politics rather than individuals' welfare (*see* Box: "Rates of Return and Welfare", pp.16-17).

Private Pensions Increase Savings?

The linchpin of Anglo-American pension philosophy is that funded pensions (under private management) will increase net domestic savings – savings that will support productive investment and economic growth.[53] Even the pro-free market Adam Smith Institute concluded more than a decade ago that, if the argument about savings and investment falls, then so does the whole case for pension privatisation.[54] Martin Feldstein, Harvard economics professor and major advocate of privatisation for over 30 years, seems to agree, given his comment about the proposed privatisation of the US Social Security system:

> "Without extra savings and an increase in the nation's capital stock, nothing would be gained by shifting some of the existing trust fund [federal government Social Security] from government bonds to private stocks or bonds."[55]

If this is the case, private pension theory is in trouble. Several studies now suggest that the introduction or extension of private pensions do not lead to an increase in net domestic savings. After analysing an extensive range of data, articles and reports produced over the past 20 years, Irish economist Gerard Hughes concludes simply that:

> "The balance of the evidence . . . does not show that pay-as-you-go state pensions significantly reduce saving or that funded occupational or personal pensions significantly increase it."[56]

Similarly, US academics Selig Lesnoy and Dean Leimer have re-examined Feldstein's influential work, which concluded in 1974 that public social security depressed personal savings by 30 to 50 per cent and that it would also decrease the private "capital stock" in the long run by 38 per cent, implying a substantial reduction in GNP.[57] Lesnoy and Leimer found that these conclusions were "unwarranted", attributing them to a computer programming error. If anything, they decided, the evidence showed the opposite.[58] After examining further empirical evidence from time series, international comparisons and household surveys, they found that no conclusions could be drawn about the US private pensions system's effect on savings.[59]

One reason why private pensions don't boost net domestic savings is that some people are not able to save, even if they wished to. Below-average earners tend to have little or no spare money to put aside. The dismal uptake in the UK of "stakeholder pensions", introduced by the government in April 2001 to provide a low-cost, flexible, transferable money purchase pension for the less well-off, illustrates the point. Some 80 per cent of the schemes have no contributions going into them.[60]

50. Some funded systems run by the state or state institutions, such as local government schemes in the US and the UK, remain largely free from criticism, because they delegate control of investment, for the most part, to private financial institutions.
51. World Bank, op. cit. 49, p.214.
52. Davis, E. P., *Pension Funds: Retirement-Income, Security, and Capital Markets: An International Perspective*, Clarendon, Oxford, 1995.
53. For a summary of the historical debate concerning the role of savings in creating demand and in liberal and laissez-faire economics, *see* Fairmount, F. E., *The Rise and Fall of Economic Liberalism; The Making of the Economic Gulag*, Southbound and Third World Network, Penang, 1996.
54. Butler. E., Asher, M. and Borden, K., *Singapore versus Chile: Competing Models for Welfare Reform*, Adam Smith Institute, London, 1995, p.28.
55. Feldstein, M., "The Case for Privatisation", *Foreign Affairs*, Vol. 76, No. 4, July/August 1997, p.33.
56. Hughes, G., "Pension Financing, the Substitution Effect and National Savings" *in* Hughes, G. and Stewart, J., (eds.), *Pensions in the European Union: Adapting to Economic and Social Change*, Kluwer Academic Publishers, Amsterdam, 2000 (papers from a conference organised by the Gesellschaft für Versicherungswissenschaft und Gestaltung e V and the European Network for Research on Supplementary Pensions, June 1996, Münster) p.58.
57. Feldstein, M., "Social Security, Induced Retirement, and Aggregate Capital Formation", *Journal of Political Economy*, Vol. 82, No. 5, September/October 1974. Arguments advanced by academics in the US in particular seem to have played a major role in advancing the Anglo-American private pension investment theory.
58. Leimer, D. R. and Lesnoy, S., "Social Security and Private Saving: New Time Series Evidence", *Journal of Political Economy*, Vol. 90, No. 3, June 1982.
59. Lesnoy, S. and Leimer, D. R., "Social Security and Private Saving; Theory and Historical Evidence", *in* Meyer, C. W., (ed.), *Social Security: A Critique of Radical Reform Proposals*, Lexington Books, Lexington, Massachusetts, 1987, pp.74 and 98.
60. An estimated 9-12 million people in the UK are said to be saving too little, most of them in the low-to-middle income range. The finance industry is not interested in promoting products to these people because it cannot make enough profit out of the low amounts paid in or the mandated low fees.

Even the *Financial Times* concludes that "the most important lesson from the British experience" of individual personal pensions has been that they have not generated a surge in private saving, whether they are funded by individuals and employers or are a partial opt-out of the state system (as President George W. Bush proposed for US Social Security).[61]

61. Giles, C. and Balls, A., "Cheques and balances: America takes heed of the British pensions 'disaster'", *Financial Times*, 1 March 2005, p.17.

Taking "Social" and "Security"

"The view of demography as destiny is only a half-truth, and in some ways it's as damaging as a lie."

Paul Krugman

Although US-dominated institutions have been at the forefront of attempts to privatise state pension systems around the world, the United States has not privatised its own social security system, the OASDI, or Old-Age, Survivors, and Disability Insurance.

OASDI, introduced in 1935 and known as Social Security, is funded by a payroll tax and gives the average worker a retirement benefit equivalent to 42 per cent of wages. It is the primary source of income for two-thirds of retired households, and is the largest government programme of its kind in the world.

In anticipation of the babyboomers' retirement, this payroll tax was increased in 1983 to build up a trust fund, which is held in US Treasury bonds. Thus payroll taxes financing the public pension system account for about one-quarter of federal revenue, but its payments represent about one-fifth of all federal spending.

Nonetheless, it has been forecast since the 1990s that the system would be in "crisis" within 20-30 years, or earlier, because the current surplus would be exhausted; unless the "burden" can be reallocated, the system, it is said, will become "insolvent". President George W. Bush stated baldly in 2005 that "in 2042, the system goes broke".

Privatising Reform

President Bush outlined several proposals to "reform" Social Security as a priority for his second term in office:

- Linking pensions to price inflation rather than wage rises, meaning that in 40 years time, the system would pay about 22 per cent of an average worker's wages instead of the current 42 per cent;
- Allowing individuals to divert 4 per cent of their 12.4 per cent Social Security payroll tax into private accounts;
- Reducing future Social Security benefits because of the assumed benefits from private individual accounts.

Proponents of part-privatising Social Security were advised not to call the proposals "privatisation", however, because of the term's negative connotations, and instead to emphasise the words "personal" and "choice".

Crisis? What Crisis?

Economists Dean Baker and Mark Weisbrot argue that assertions that the system will be "flat broke" or "go bust" are just plain false.

Unusually for many government or state departments, Social Security has a planning horizon of 75 years, and has already taken steps to cope with an ageing population by building up a trust fund. Even if national economic growth is low and even if the babyboomers live longer than expected, the shortfall in the programme's finances would be only slight, suggesting minor tinkering at most. Viewed on its own terms, Social Security has been run responsibly and is sustainable.

If there were a deficit, however, diverting almost one-third of Social Security revenues into private accounts would only increase it – "hardly a promising start for restoring fiscal solvency," points out erstwhile World Bank Chief Economist, Joseph Stiglitz, who concludes that Bush's proposals:

> "simultaneously undermine the solvency of the Social Security system, worsen the fiscal deficit, diminish the security of the elderly and increase the incidence of poverty."

The problems don't end there. Someone would still have to pay Social Security to those already retired or soon to do so – workers whose own payroll taxes had supported a previous generation. If one-third of the payroll taxes of younger workers are no longer available for that purpose because they've been diverted to private accounts, another source of money must be found. "This problem is often summarized with the deceptively innocuous term 'transition costs'" says economist Paul Krugman, "but it's an enormous one."

President Bush ruled out tax increases to make up for lost revenue and instead proposed borrowing the money, increasing the government's long-term debt, which would peak at almost 24 per cent of GDP and not be reduced for 40-50 years. The proposals could add an extra US$2 trillion to public expenditure in the first 10 years, and a further $5 trillion in the second decade, while savings from cutting benefits during the first 20 years would amount to less than $1 trillion.

Financial markets would probably be made very nervous by borrowing on such as scale, with

One journalist observes that "it is simply impossible, without huge savings rates, for two-thirds of a life (childhood and education plus retirement) to be funded from the money earned during one third of it."[62] Some estimates suggest that, for the private sector to provide reasonable pensions, every adult in the UK would need to save 15 per cent of their income for 45 years of their working life. Such saving

62. Timmins, N., "No easy answer to age-old question", *Financial Times*, 7 November 2005, p.29.

out of US Social Security

the prospect of repayment so far in the future. Could such privatisation increase the risk that international investors would stop lending to the United States?

Finally, the financial sector itself may not be that interested in privatisation, because the accounts would mostly be too small to make any profit out of. Although acknowledging that someone will make money out of the process, some institutional money managers believe that privatising Social Security will not offer a lucrative windfall or bonanza for fund managers. A quarter of wage earners are on the minimum wage, which would mean $200 a year going into the private accounts – but the pension industry needs $1,000 a year for a plan to break even. Said one fund executive:

> "I for one won't be falling over myself to get at those accounts. It's not where the money is".

Bush proposed to keep fees low by centralising the administration of the new accounts – "personal" or "individual" accounts would in practice be simply an accounting device – and subcontracting management to big money managers. Nonetheless, this would still not constitute much of a bonus.

Social Security was always intended to be an insurance programme, not a savings plan – and that insurance is still needed for millions in the face of growing economic insecurity.

The Real Crisis

> "Because the demographic problem is perceived as being much bigger than it really is, the spotlight is off the gross irresponsibility of current fiscal policy . . . [R]ight now everyone is talking about Social Security, and nobody is talking about the stunning shift from budget surplus to budget deficit since Bush took office."
>
> *Paul Krugman*

The US does have a serious long-run fiscal problem, even if it doesn't lie with Social Security. The financial shortfall in the government health insurance plan for the elderly, Medicare, is estimated to be four times as large as that of Social Security.

If Medicare, Medicaid (another government health insurance scheme) and Social Security are all lumped together, their projected costs total more than 20 per cent of GDP by the year 2075, up from less than 8 per cent today. This rise is easily attributed to "too many grannies".

But US health care spending has been rising as a proportion of GDP in the past two decades largely because of innovation. The range of things that medicine can do keeps increasing. In the face of these rising costs, private health insurance is gradually unravelling. Federal and state budgets can't keep up.

The problem with health care, maintains Krugman, is not that the old are exploiting the young, but that medicine can do ever more things and "we haven't figured out how to pay for or ration that growing ability." The problem is made worse by the fact that current debates tend to blur the distinctions between the costs of an aging population and the costs of medical advances. Concludes Krugman:

> "The problem posed by rising medical costs would be there even if the population weren't aging – and misrepresenting the problem as one of demography gets in the way of confronting it."

A better approach would be to reorganise the US health care system – one of the most costly in the world for the least health benefits.

The Iraq war, meanwhile, has also increased public expenditure:

> "Mr Bush's own actions – above all, his insistence on cutting taxes while waging war – are largely responsible for the real problem, the huge deficit in the general fund."

Worsening financial problems won't be the result of the existence of more old people, but exaggerating the demographic challenge only makes that grim future more likely.

For now, Social Security seems safe because Congressional and public support for privatisation has waned. When presented with the "choice" of Social Security as is, or Social Security with higher risks and reduced benefits, most US citizens opted for the former.

Sources

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Baker, D. and Weisbrot, M., *Social Security: The Phony Crisis*, University of Chicago Press, Chicago, 1999.

Pensions cannot be paid for in advance.

"Successful" in stock market terms is not the same as "investment" or economic growth.

is beyond the capacity of most people, particularly if they also have to pay for student loans, mortgages, school fees, health care and credit card debt.[63]

Yet if private pensions do not "add materially to future GDP", in the words of economics professor Malcolm Crawford, "pensions, in the aggregate, cannot really be paid for in advance."

> "[F]unded and unfunded pensions alike have to be provided out of a total of contemporary real resources which pensions funding cannot alter. In that case, *effectively all pensions are pay-as-you-go*, in terms of their economic consequences. The difference is that state schemes do not have to be funded (which saves on running costs) while private ones have to be funded to ensure their solvency."[64]

Even if a country's net level of savings did increase under private pension schemes, moreover, the ability of the private sector to turn these savings into economic growth through equity markets would be highly dubious. New savings might well be invested in the most successful companies, thereby lowering the cost of capital for them. But "successful" in stock-market terms means being able to sustain dividends or capital gains, which is not always the same as promoting "investment" or overall growth. Moreover, a lower cost of capital does not necessarily lead to more investment if the economy is in slump or if there is no consumer demand because of unemployment or declining welfare benefits, a surfeit of savings or a government committed to cutting public expenditure.

"Savings in isolation do not matter: what matters is what happens to savings and investment rates".[65] The effects of pension savings have to be assessed along with other fundamental determinants of economic growth, such as corporate savings (companies' retained profits) and public sector investment. The UK's Pensions Commission pointed out that, in 2002, it was companies (excluding those in the financial sector) that contributed 65 per cent of gross national savings, and 90 per cent of net national savings.[66] Indeed, virtually all new funds required for corporate investment are derived from corporate profits that have not been spent or distributed to shareholders but retained.

But if people save more, could financial institutions find an investment home for their money? A supply of savings does not necessarily create a demand for such savings. The world is already awash with savings, particularly from Asia, one reason why interest rates are so low.[67] It could be difficult for real interest rates to fall still further so as to accommodate a huge increase from private pension funds. But if every country did increase its level of savings to more than its GDP, interest rates and equity returns could plummet further – and pension savers would be in for a shock.

State Liberation?

Far from "liberating" people from depending on the state, private funded pensions tend to create a band of dependent people who cannot take part in them because of their low pay or interrupted employment (particularly women). When profits and thus financial returns are

63. A reasonable private pension would also require stock market returns over the next generation to match those of the last generation; and companies to increase rather than reduce their contributions. From 1974 to 1999, shares went up on average 13 per cent a year, interest rates were high and inflation was falling. This is highly unlikely to be repeated. At present, companies are drastically reducing their pension contributions for their employees. Raising the pension age affects the calculations just fractionally.
64. Crawford, M., "The Big Pensions Lie", *New Economy*, Vol. 4, Issue 1, Spring 1997, p.39, emphasis added.
65. Magnus, G., "We can adapt to an ageing world", *Financial Times*, 30 May 2005, p.15.
66. Quoted in Wolf, M., op. cit. 48.
67. Since their last financial crisis in 1999, emerging markets have been saving more themselves. Between 1996 and 1998, two-thirds of the Asian emerging market economies' swung from current account deficits to huge surpluses.

dependent on employment cuts, the ability of those who lose their jobs to invest in the future is further reduced. But it is not just the cost of maintaining ageing populations or of people's inability to save because of low or interrupted employment – or no employment at all – that are the cause of the pensions "crisis". A key problem is the way portfolio investment and financial markets themselves reduce or interrupt employment – or do away with jobs altogether.

Defined-contribution, money purchase pensions that require continual contributions render their participants particularly vulnerable if they have to stop work through ill-health. Because the pensions that these schemes pay out depend only on the amount contributed plus stock-market returns on the contributions, one major survey concluded that drawing a good private pension from them depends on "pot luck".[68] All the unlucky will have to rely even more in their later years on support from the state, aggravating pressures to shift pension responsibility from the "bloated" state to the stock market.

Finally, the World Bank, among others, accuses public pension schemes of being "politically risky": the schemes may falter or reduce their benefits as a result of changes in political priorities. Such schemes are thus held to be "unreliable" for future pensioners – far better, the implication goes, to trust one's own efforts.[69]

Rarely mentioned, however, is how inherently risky the private sector has become. In the decade since the mid-1990s, when private pensions theory was at its height, these risks have turned into realities for many pensioners. In the UK, the private sector has produced the scandals of businessman Robert Maxwell stealing some £450 million from his companies' pension funds to shore up his ailing publishing empire;[70] the mis-selling of personal pensions, underpinned by state subsidies but inadequately regulated, to at least 1.5 million people who left better occupational schemes; and the collapse of the world's oldest life insurer, Equitable Life.[71] In addition, a spate of corporate bankruptcies have left between 85,000 and 125,000 people with depleted retirement incomes – or no pensions at all – despite a lifetime of saving. In the US, the public's confidence in the private financial sector has been similarly dented amid corporate governance scandals affecting bankrupt companies Enron and WorldCom, mutual insurance funds and US mortgage giants.

At the turn of the millennium, moreover, it became clear that private occupational pension schemes, both in the UK and the US, were grossly underfunded: their accumulated assets were assessed as insufficient to meet their forecast liabilities. Worldwide, pension funds are now estimated to be 20 per cent underfunded, representing US$1.5- 2 trillion. Some companies have holes in their pension plans larger than the value of the company itself. A November 2005 survey suggested that more than one-third of the UK's top 350 companies believed their businesses could be at financial risk because of company pension scheme deficits.[72]

For some years, companies have not been offering new employees "defined benefit" pension schemes (in which pensions are linked to final salary). Instead, many now offer "defined contribution" plans (in which pensions are dependent on the level of contributions and stock market returns) (*see* Box, p.19). When stock markets are

68. "Pension Payouts 'Depend on Pot Luck'", *Financial Times Money Supplement*, 16 June 2000, p.20.
69. In the UK, for instance, the government decided in 1981 to link the basic state pension to average price increases rather than average wage increases. Because the subsequent two decades have been an era of low inflation, the value of the basic pension has since plummeted.
70. The theft came to light after Maxwell's death in 1991. Much of the money was eventually recovered so that workers could receive full pension benefits. The scandal prompted the UK government to introduce legislation in 1995 to improve the security of occupational pension schemes. In 1997, it forbade companies from emptying their pensions pot below a minimum funding requirement to ensure that all pension benefits could be paid in full. Subsequent corporate collapses, however, indicate that a scheme's assets can meet this requirement (which the government later weakened in 1998 and 2002 under pressure from employers but against the advice of actuaries), but still be lower that its liabilities. The requirement took no account of bankruptcies, but assumed a company's continued existence. The requirement was scrapped in 2004, when new legislation gave pension trustees the responsibility to ensure that a pension scheme can meet its liabilities.

    Companies can still achieve the same result that Maxwell did without breaking the law by switching from defined-benefit plans to defined-contribution plans and by closing defined-benefit plans to any more contributions from existing members (Skapinker, M., "Pensions test corporate character", *Financial Times*, 7 June 2005).
71. Equitable Life had sold "guaranteed annuity rate" pension policies since the late 1950s. When interest rates began to drop in the 1990s, it changed the rules of policy entitlement and cut the rate. Some 800,000 policy holders lost 18 per cent of the value of their pension fund. In 2000, the company closed its doors to new business when it nearly collapsed, but legal proceedings have continued ever since.
72. Taylor, A., "Deficits in company schemes lead to fears of financial risk", *Financial Times*, 17 November 2005, p.3.

    Pension deficits have become an issue in corporate acquisitions, and several company takeovers have been abandoned because potential buyers are unwilling to take on what is increasingly regarded as a company debt. This upsets the whole *raison d'être* of the stock market and threatens the lucrative fees that financial institutions reap from takeover activity. Unsurprisingly, some companies will attempt to shed their liabilities.

falling in value, a "pray as you go" approach is of little comfort to future pensioners.[73]

Exhorting people to accumulate more private savings shifts the responsibility and the risk of providing for older people from being societal and collective to individual and personal. But as UK pensions consultant Ros Altmann points out:

> "Transferring pension risk away from the state does not make risk disappear. If the private sector does not deliver, the risk ultimately falls back on the state anyway."[74]

A commentator from a leading consumer organisation has described the private pensions industry as "the most dysfunctional consumer market."[75]

73. Altmann, R., "Pensions cannot solve the retirement crisis", *Financial Times*, 16 May 2005, p.15. Because of low interest rates, investment returns and annuity rates, these pension schemes provide 78 per cent less income than they did a decade ago, stated pension consultants Watson Wyatt in February 2006.
74. Ibid.
75. Vicary Smith, P., letter to *Financial Times*, 1 September 2005.

The Pension Penalties of Motherhood

> "Past, present, and future majorities of pensioners were, are, and will be female."[1]

There are more old women than old men – and far more old, old women – because women on average live longer than men. Two-thirds of all pensioners in the UK are women.

The old people most likely to be in poverty the world over are also women, especially if they are divorced or separated. Two-thirds of UK pensioners in poverty are women.

This is because pension provision, both public and private, tends to be based on prior income and formal employment, but women are far more likely than men to spend a large of their lives in unpaid work, caring for children, and sick and older relatives.

Over 50 per cent of women in Bolivia, Colombia, El Salavador, Argentina, Brazil and Chile will not receive pensions because they have spent their lives as homemakers without paid employment.

Even though more and more women are now in paid work – they comprise half the paid workforce in the UK – they often have to take intermittent, part-time, low-paid or informal or casual sector work that fits around their caring responsibilities.

Women's wages tend to be less than men's. In the UK, women receive on average 17 per cent less than men for full-time work, and 40 per cent less for part-time work, despite 30 years of legislation to counter sex discrimination.

The National Assembly of Women points out that:

> "Women would need to be financial magicians to produce decent pensions in these conditions."[2]

In Chile, rural women who are employed only during the planting or harvesting season (about three to five months a year) would have to work 80 years to accumulate a minimal pension. Notes Flavia Marco of the UN's Economic Commission for Latin America and the Caribbean:

> "Women subsidize a system that excludes them, contributing their unpaid labour to caring for the family while their husbands work outside the home."[3]

Most pension systems assume that women will rely on their husbands' pensions. Thus divorced, separated and widowed women tend to be worse off than never-married women. Only 16 per cent of women retiring today in the UK are entitled to a full basic state pension, compared with 92 per cent of men. Some 40 per cent of marriages in the UK now end in divorce, but the pension system has not adapted. As a result, women's income in retirement is about 57 per cent that of men's in the UK.

Any reforms promoting the private pensions sector will only exacerbate the gender and poverty gap in old age – invariably benefiting high-earning men over low-earning women.

In September 2004, a British government minister for trade, Patricia Hewitt, called upon women to have more babies: "We won't have a workforce if people do not have children."[4] Unless childcare and employment conditions, including pensions, improve, however, women are unlikely to pay attention.

Concludes gender and ageing expert Jay Ginn:

> "Despite women's increased participation in employment, most cannot rely on private pensions to provide an adequate personal income in later life. Only improved state pensions with protection of caring periods, or alternatively a universal citizen's pension, can ensure that women's unpaid family care work does not lead to poverty and dependency in later life."[5]

1. Ginn, J., "Poverty and Inequality among Older People in Post-War Britain: The Gender Dimension", *Revue Française de Civilisation Brittanique*, 11(1), 2001, pp.101-114, quoted in Clark, G.L. and Whiteside, N., *Pension Security in the 21st Century: Redrawing the Public-Private Debate*, Oxford University Press, Oxford, 2003, p.5.
2. National Assembly of Women, *Pensions Briefing,* February 2002, *http://www.sisters.org.uk/pen_brfg.pdf*
3. Quoted in Gonzalez, G., "Pension reforms hit women hard", *Third World Economics*, 16 December 2004-15 January 2005, p.24. *See also* Montano, S. and Marco, F., *Pension Systems in Latin America: A Gender Analysis*, ECLAC, Santiago, 2004.
4. Quoted in McKie, R., "Recognise this? We need a lot more of them", *The Guardian*, 15 October 2004.
5. Ginn, J., *Gender, Pensions and the Lifecourse*, Policy Press, Bristol, 2003. *See also* Ginn, J., *From Security to Risk: Pension privatisation and gender inequality*, Catalyst, London,

In sum, many of the main arguments for private pensions do not hold up, as is now acknowledged even by the World Bank and IMF, the institutions that originally espoused them in the mid-1990s.[76] On balance, the evidence suggests that introducing or extending private pension provision increases, rather than lessens, the risk of insecurity in old age, given the vulnerability of stock market investments. Indeed, the enormous expansion of financial market risk exposes pensioners to asset meltdown of a serious kind. The Anglo-American model functions essentially to distribute more income to the financial sector and to the most securely-employed individuals, exacerbating the gap between rich and poor. And although it seeks to minimise state pensions provision, the model still requires the public sector to support a large swathe of people whom the private sector cannot make profits out of and to subsidise the private investment infrastructure. After a decade and more of pension privatisation, it is private pensions rather than public ones that are showing signs of "creaking".

Private pensions increase, rather than lessen, the risk of insecurity and poverty in old age.

In Whose Interest?

It is private rather than public pensions that are in need of reform.

If the evidence to support Anglo-American pensions theory is inconclusive or invalid, why is the model still so popular? The short answer is that various formidable commercial, political and social interests believe they will benefit from private pensions, whether or not they improve the lot of the elderly. In the background has often been the World Bank, which argues that if "reform" is not producing better pensions, then at least it is expanding financial markets – a key component of economic growth, it claims. In the foreground are other financial institutions, governments, international government agencies, business corporations, labour and trade unions, supported by reform groups and academics.

• Financial Institutions

Financial institutions have a self-evident interest in promoting private financial capital investment and savings "products" rather than public saving and investment. Even if the theory that increased investment on the stock markets leads to the profitable expansion of the economy and more money for welfare is wrong or misleading, financial institutions can still make substantial profits out of promoting private pensions, managing funds, trading assets and charging fees.

Financial institutions' management fees alone – their percentage of the estimated US$10-12 trillion pension assets worldwide – are equivalent to at least 12 times the total public pensions bill in Greece, four times the bill in Belgium, more than the bill in France and more or less equivalent to that in Germany.

Pension-fund management groups – banks, insurance companies and others – also benefit considerably from the takeover and privatisation business. This is a critical part of the process of market liberalisation, the free movement of capital, and the expansion, extension and funding of capital markets – a process for which pension funds provide the money. In 1994, eight of the top ten "external" pension fund managers in the UK were part of financial groups that ranked among

76. The World Bank still favours mandatory, funded, individual private pensions, but now acknowledges that a single model of pension privatisation is not appropriate because the legal and financial infrastructure is not available in all countries to make this feasible. It states that pension reform must take account of workers in the informal economy and must cater for people who will be poor throughout their lives. Its 2005 report, *Old-Age Income Support in the 21st Century*, thus advocates states providing a non-contributory basic pension to provide a minimal level of protection against poverty in old age (Holzmann, R., Hinz, R., and Bank staff, *Old-Age Income Support in the 21st Century An International Perspective on Pension Systems and Reform*, World Bank, Washington DC, 2005; "Second thoughts on the third age", *The Economist*, 19 February 2005, p.77).

A 2004 World Bank study noted that in most Latin American countries that had privatised their pension systems, just 20 per cent of the labour force were covered by the new pension system, indicating that the majority of people will have no pension at all (Gill, I. Packard, T. and Yuermo, J., *Keeping the Promise of Social Security in Latin America,* Stanford University Press, 2004).

Exporting Financial Services – and Insecurity?

Pension funds and other financial institutions have been actively trying to influence bilateral, regional and global free trade agreements to expand the markets for their services.

The WTO's General Agreement on Trade in Services (GATS) already has detailed (and controversial) provisions aimed at liberalising investments and services provided by financial institutions that involve money and capital being traded across national borders.

Concerted lobbying by US and European financial service companies ensured that many requirements and commitments specific to financial services were tacked on to GATS after the Agreement itself was finalised in 1994.

GATS aims to liberalise international financial services, but its measures also affect a country's (de)regulation of its financial markets and large capital transactions, which are usually the responsibility of national authorities and are critical to a country's economy.

For instance, once a country has agreed to put (or "commit" in GATS-speak) one or more of its financial services within the remit of GATS, any national measure that aims to minimise capital flows destabilising an economy or to prevent a financial crisis, or any prudential measure a country might put in place to regulate its financial markets, could be challenged by another country as a barrier to international trade. Some of the wording of the Agreement is so unclear that a country might play safe and not introduce any such requirements so as to avoid a challenge.

GATS also affects national management of the financial industry as a whole.

Myriam Vander Stichele of the multinational research centre, SOMO, stresses that:

> "GATS is mainly about giving foreign service providers . . . more freedom to invest . . . This means that GATS is about more than trade in financial services . . . GATS is also an investment agreement."[1]

Current GATS re-negotiations, linked to other WTO renegotiations, aim to deregulate and open markets still further for financial and investment services. The US, Europe and Japan will be the main beneficiaries since they dominate the financial services industry.

Comments Christopher Roberts of the group, International Financial Services, London:

> "There is no other service sector, to my knowledge, where there are such well developed international contacts within the private sector focussed on the WTO negotiations."[2]

Leaked "requests" made by the EU in 2002 to other countries during these negotiations resemble "a wish list of the European banks and insurance companies", comments Vander Stichele. The requests indicate that "market opening" primarily means eliminating national laws and regulations that are perceived as barriers to trade – or simply hinder foreign financial institutions' attempts to maximise their profits.

That the EU made requests involving financial services to 94 out of 109 countries clearly indicates the priority it places on the financial sector in these GATS re-negotiations.[3]

For instance, the EU wants Chile to remove its requirement for incoming capital to be invested in the country for two years before it can be remitted abroad – a measure (in the form of a tax on early withdrawals) that was internationally praised after the late 1990s' Asian and Latin American financial crises as guarding against volatility and instability.

Similarly, the EU wants Malaysia to remove several measures it took after 1997 to tackle the causes of the Asian financial crisis.

In addition, the EU requested that many developing countries provide access to pension fund management.[4]

These proposals not only pose further major threats to the financial stability of many countries, but will do little to provide them with improved services or goods or access to capital.

Once dominant financial institutions have gained a foothold, they are likely to take over a substantial part of the (profitable) domestic financial industry, leading to further concentration within the sector. This could lead to an increase in firms that are "too big to fail", and thus require funding bailouts to limit financial crises.[5] Moreover, foreign banks tend not to lend to smaller, domestic enterprises or individuals in poorer countries, thereby stifling the local economy.

Southern countries did not respond to these requests as positively as the EU had wanted. Thus in February 2006, the European Commission joined several other countries to make collective or "plurilateral" requests to many emerging market countries to deregulate their financial services under GATS. The EU explicitly states its goal of helping the European financial industry expand:

> "For EU financial services companies, the fast-growing emerging economies will become a major source of activity that will help to offset slower growth in the more mature financial services markets."[6]

1. Vander Stichele, M., "GATS negotiations in financial services: The EU requests and their implications for developing countries", WEED, Berlin, 2 December 2005, p.1.
2. Roberts, C., "WTO Negotiations on Trade in Financial and Other Services: The Juggernaut Begins to Roll", *Investment Adviser,* 2002.
3. Lipke, I. and Vander Stichele, M., *Financial Services in the WTO: License to Cash In?* WEED, Berlin, 2003.
4. Vander Stichele, M., "Financial Services in GATS: EC Requests and Offer Endanger Financial Stability", SOMO/TNI, March 2003, http://www.tni.org/archives/stichele/eugats.htm.
5. Vander Stichele, M., "Trade in financial services: liberalisation in the GATS Agreement and insufficient assessment of the risks", Chapter 6, *Critical Issues in the Financial Industry*, SOMO, Amsterdam, April 2005. http://www.somo.nl/html/paginas/pdf/Financial_sector_report_05_EN.pdf.
6. "Collective requests in which the EU is participating under the DDA Trade in Services negotiations", 28 February 2006, http://www.ourworldisnotforsale.org/showarticle.asp?search=1318, accessed 3 April 2006.

the top 20 advisers to takeovers. In the first ten years of privatisations in the UK, starting with the Labour government in 1977, nearly US$40 billion was raised from privatisation by the UK government at a cost of over $700 million in fees paid. From 1977 to 1994, about $140 billion was raised from the privatisation programme, with commensurate fees for advisers. Eight banking groups advised on the first wave of privatisations up to 1994, and four of these were among the ten external pension-fund managers in that year. In turn, pension funds, or rather their managers, have played a major role in the investment decisions concerning takeovers and privatisations.

From 1993 to 1998, UK governments raised another $35 billion from privatisations, while in the European Union as a whole the figure approached $320 billion. Italy and France dominated privatisations in this period, with around 40 per cent of the total take, but the two countries' supposedly "bloated" state sectors have barely been dented.[77] These sell-offs provided more opportunities for pension funds to invest in and more fees for advisers to the governments and pension funds. All these countries have allegedly "creaking" or "bankrupt" pension systems in need of "reform" because of their costs.

Financial institutions can make substantial profits out of private pensions – even if the resulting pensions are poor.

As a result of the commercialisation of social security, pension "reformers" and private providers devise ever more savings "products" to distance themselves from the state and its mechanisms and policies. The Chief Executive of the UK Prudential Assurance Company, the largest private insurance provider in the UK, has stated that winning acceptance of the need to save more for retirement is partly a marketing issue. "It would be easier if people felt this was not a tax" as this "would make it much easier to sell".[78]

• Government Interests

Why are governments attracted to the private pensions model? First, the move gives governments an excuse for freezing or cutting public expenditure on old age: they can claim that they are being prudent, restrained, and respectful of individual responsibility and choice. They can also claim they are minimising unemployment – pension reformers often argue that employers make do with less staff when taxes to pay for public pensions contribute to higher wage costs.

Second, some governments and political parties see extending their national financial sectors as a way of competing for international banking, insurance and securities business. This, they hope, will result in increased revenue and employment at a time when public expenditure and investment in manufacturing are being minimised. Meanwhile, the increased savings that governments expect will flow into funded pensions will lower consumption, thereby reducing the balance of payments deficit.[79]

Third, some governments and commentators see the increase in pension funds as a way of funding the privatisation of state-owned industry. Encouraging savings for private pensions, and thus the demand for equities, ensures a supply of private capital that a government intent on privatisation can exchange for shares in previously state-owned companies. By encouraging people to pay for these assets a second time (first through taxation, second through savings schemes – or taxation by another name), governments can reduce the public side

77. "Forget Thatcher. Who'll Be the Biggest Privatiser of Them All?", *The Observer*, 7 March 1999, p.6.
78. *New Statesman*, "Interview with Peter Davis, Chief Executive of the Pru", 25 October 1996, pp.30–1.
79. This has been an important argument in Australia and Denmark, but less so in the UK, where any shift from consumer spending (albeit debt-financed) into savings could depress economic growth and increase unemployment.

of the national balance sheet. The Chair of the Warsaw Stock Exchange is reported to have stated that securing enough buyers for privatised assets is exactly the reason that pension funds are needed.[80] Indeed, the need for cash to buy privatised firms has been a major argument for pension reform in Central and Eastern Europe more generally.

Countries not in debt to the IMF managed to escape World Bank pressure to privatise their pensions.

• International Government Organisations

"International Government Organisations" include bodies such as the World Bank, the International Monetary Fund (IMF), the International Labour Office (ILO), the Organisation of Economic Cooperation and Development (OECD) and the European Union (EU). All are involved in different ways – and possibly for different reasons – in "policy transfer", a process including financial and technical assistance and structural adjustment programmes.[81] Many of these policy transfers promote privatisation of state-owned assets, development of capital markets – and privatised social security.

The World Bank has been key to disseminating the stock-market pension model around the world, notably through its 1994 report, *Averting the Old Age Crisis*.[82] The report, which has been widely quoted and referred to by academics, policy advisers, politicians and the press, analysed different pension systems, and recommended that most countries adopt a more thoroughly private structure of pension savings, particularly individual or personal accounts, and conduct investment through stock markets. Not only would this protect retirement provision; it would also, as emphasised in the subtitle to the report (*Policies to Protect the Old* and *Promote Growth* – the original emphasis on "and" is crucial in the Bank's theory), spur the economy – the key link again being the stock markets. The Bank now has experience of pension "reform" in more than 80 countries, particularly those of Eastern Europe and Latin America.[83] Whatever the different local and national arguments put forward for privatising pensions and reducing public provision, almost all of them can be traced back to the doomsday scenario of ageing populations, demographic timebombs, burdens of old people, crises of public expenditure, the end of the welfare state, and crises in governments themselves.

For example, Robert Holzmann of the World Bank writes that the countries of Central and Eastern Europe, at the outset of their transition to a market economy, were:

> "made aware by the IMF and the World Bank . . . of the unsustainability of the inherited pension scheme."[84]

In contrast, the ILO, the OECD and the European Commission all recommended a more cautious approach and much less drastic reductions in public expenditure.

At first, these countries were attracted to a European model of pensions. They knew the ILO well, as one of the few international institutions that had maintained a connection with them under Communism. They were neighbours to EU countries and wanted to join the EU themselves. In addition, they were promised technical and financial assistance from several EU countries if they adopted the European pension model.

80. Butler, R., "The Price of Pension Reform", *Institutional Investor*, April 1998, p.56.
81. For further discussion, *see* Dolowitz, D. and Marsh, D., "Who Learns What from Whom: A Review of the Policy Transfer Literature", *Political Studies*, Vol. XLIV, 1996.
An international class of executives – politicians and professionals from the private and public sectors – sent in by international government organisations to implement this process of policy transfer share to a large extent the ideology of the reform process. They have common business degree qualifications, worldviews, consumption requirements and interchangeable employment positions. They are, in effect, "social movements for global capitalism" (Sklair, L., "Social Movements for Globalisation: The Transnational Capitalist Class in Action", *Review of International Political Economy*, Vol. 4, No. 3, Autumn 1997).
82. World Bank, op. cit. 49.
83. Many South American countries have replaced a state-run, tax-funded pension system with a system of individual retirement plans administered by a private institution into which workers pay a fixed amount every month: Chile (1981), Peru (1993), Uruguay (1996), Colombia and Argentina (1994), Bolivia and Mexico (1997), El Salvador (1998), Venezuela and Costa Rica (1998-2000), Nicaragua (2004) and Dominican Republic (2003-6). Ecuador's attempt to initiate pension reform in 2004 was blocked by massive popular demonstrations, in which retirees played a leading role. Brazil approved a mixed system incorporating elements of both public and individual funding in 2003.
84. Holzmann, R., "Starting Over in Pensions: The Challenges Facing Central and Eastern Europe", *Journal of Public Policy*, Vol. 17, No. 3, 1997, p.203.

But in the end, many Central and Eastern European countries compromised. First, they were persuaded by the World Bank that privately-funded, contribution-related systems were better because the future benefit would "be dependent on the individual contribution effort and not on political distribution considerations."[85] Second, they took a positive view of Chile's experience with privatised pensions. Third, they were convinced that private systems would have positive effects on "saving and capital formation, financial market developments, and labour market –performance."[86] And fourth, they were persuaded that private, funded pension plans were needed to buy up privatised state assets.[87]

From the point of view of international government organisations, mandatory, private, funded pensions are attractive because they do not appear to be a form of taxation. Their regressive aspects can be concealed under a smokescreen of talk about "benefits for economic development". This helps further the politics of "reform" and expansion of capital markets required by the World Bank and the IMF.

Countries not substantially in debt to the IMF, however, have managed to escape World Bank pressures to privatise their pension systems.[88]

• Corporate Interests

Many individual companies favour private pension schemes because they think that if domestic capital markets expand, they will be able to secure access to cheaper capital for corporate investment. Western European companies became especially partial to this view following German unification in 1990, corporate expansion into Central and Eastern Europe since 1989 when the Berlin Wall was breached, and the expansion of the European Union to encompass the countries of Central and Eastern Europe in 2004.

Other corporations believe that the growth of their countries' domestic financial institutions will counter the international expansion of other countries' pension funds – mainly, but not solely, those of the United States – that have been buying shares in European companies and then trying to change their voting rules to give more power and rights to shareholders. France and Germany have been favourite target countries (*see* Box: "Pension Funds Transform Germany's Economy", p.32).

The leader in this field is CalPERS – the pension fund of the state of California – which has had a clear and publicly-declared strategy of identifying companies in the US and abroad that appear to "underperform" relative to the assets underlying their share price. CalPERS buys shares in these companies and then presses for greater shareholder rights in order to change how the company manages its assets, all with the goal of increasing the value of its shareholding. The French newspaper *Libération* dubbed the head of CalPERS "Darth Vader,"[89] the villain of the *Star Wars* movies.

In 1998, CalPERS joined forces with Hermes (the UK British Telecom pension-fund management institution) in a combined "corporate governance" strategy. The two funds are among the largest pension funds in the US and the UK respectively. Together, they control assets of some US$198 billion, and each fund holds around one per cent of their respective domestic equity markets, representing

85. Ibid., p.205.
86. Ibid., p.205.
87. A 2004 OECD report indicated that Hungary, Poland, Latvia, Estonia, Kazakhstan, Bulgaria, Croatia, Russia and Romania had undertaken radical reforms to enhance the role of the private sector and invested pensions. Since 2004 when ten Central and Eastern European countries became EU members, a majority of the EU's 25 countries have dominant or increasingly significant private stock market pensions. This could increase pressure on those EU states still pursuing "social models" of welfare.
   A new European Union directive on the activities of Institutions for Occupational Retirement Provision (IORP) came into effect in September 2005.The *Financial Times* cites the three "*raisons d'être*" of the directive as being: to deepen capital markets; to reduce public expenditure on old age benefits; and to bring pensions policy in line with the freedom of labour and services within the EU. But it will not cause an immediate rise in the EU in work-related savings, because it is optional (Maton, B., "Funds left waiting for pension party to begin", *Financial Times FTfm*, 31 October 2005, p.3).
88. The Czech Republic had a low level of external debt and did not opt for the "new pension orthodoxy".
   In Slovenia, trade unions threatened industrial action in 1997 because they believed the country's financial infrastructure and economic policies could not cope with privatised pensions savings nor preserve their value.
   Slovakia was advised by the World Bank and by ILO in 1993–94, and chose to modify but not privatise its social security system.
   Bulgaria's main concern in 1996 was to stabilise its public pensions system during a major banking and political crisis that led to street demonstrations, attacks on the Parliament, and the imposition by the IMF of a currency board to limit speculation, inflation and political instability. (Mueller, K., "The Political Economy of Pension Reform in Central and Eastern Europe" *in* OECD, *Reforming Public Pensions: Sharing the Experiences of Transition and OECD Countries*, OECD, Paris, 2004. *See also* Muller, K., *Privatising Old-Age Security: Latin America and Eastern Europe Compared*, Edward Elgar Publishing, Cheltenham, 2004.)
89. Maton, B., op. cit. 87.

Pension Funds Transform Germany's Economy

Germany first experienced the power of pension funds in 2000 when the UK company, Vodafone AirTouch, attempted to take over Mannesmann, both companies being active in the telecommunications/engineering/steel sectors. Pension funds played a key role in the takeover.

In the US, TIAA-CREF, one of the world's largest pension funds, supported the Vodafone takeover, pledging its one per cent of Mannesmann shares for the deal.

In contrast, the US AFL-CIO congress of trade unions – presumably in touch with German trade unions – warned about the commercial dangers of the potential deal and urged the managers of its benefit funds to oppose the takeover. AFL-CIO's investment department provided advice to a number of collectively-bargained benefit funds that in turn owned or controlled around 13 per cent of Mannesmann shares.

All this was possible only because non-German shareholders in Mannesmann had already begun to outnumber German ones. Pension funds and other UK and US investors with a European investment strategy were bound to have some stake in Mannesmann, given its importance in the large telecommunications and European engineering market.

During the takeover controversy, Mannesmann had also acquired Orange, a successful UK mobile telephone company, further increasing the number of non-German shareholders in Mannesmann itself.

Vodafone eventually prevailed over Mannesmann's fierce defence. At the time, its takeover of the Germany company was the largest ever recorded – and it was the first time a foreign company had successfully launched a hostile bid for a large German company. The sum paid, £119 billion, was equivalent to nearly three times the GDP of Chile and over 10 per cent of that of the UK. The fees generated for the banks and other advisers to the deal were estimated at nearly £600 million. The *Financial Times* remarked:

> "It is a deal that will . . . pave the way for a wave of cross-border mergers and acquisitions . . . It demonstrates that there are no longer any no-go areas as European business embarks on a widescale restructuring . . . One investment banking adviser to Vodafone said: 'Germany's hitherto unbreachable corporate world has finally been broken and many are going to be licking their lips.'"[1]

But more to the point:

> "the lack of a proper funded pensions system in Germany creates an ownership vacuum. While domestic shareholdings in large listed companies are often highly concentrated, it is not uncommon for more fragmented foreign shareholdings to account for 40 or 50 per cent of the outstanding equity. This leaves companies vulnerable to takeover once the principle of an active market in corporate control is accepted."[2]

The *Financial Times* had already emphasised that the state pension system in Germany was "creaking badly" and that smaller pensions had "hardly mitigated the burden on German finances". The introduction of pension funds, however, would hold opportunities for the German capital market, it stated:

> "A strong capital market, capable of providing the industries of the future quickly and efficiently with capital, is a key to prosperity and higher employment."[3]

Some five years on, and the network of cross-shareholdings and shared non-executive directorships that insulated corporate Germany from international capitalism since the Second World War is gradually unravelling. The *Financial Times* points out that:

> "German banks are [now] unwilling and unable to continue corporate lending that yields meagre returns, so German companies must turn to the capital markets for finance. Investors – German or foreign – cannot be ignored by the companies they invest in."[4]

As Germany's big banks, insurance groups and industrial blue-chips have liquidated their stakes in each other, making full use of a tax break introduced in 2001, foreign investment has multiplied.

The average Germany blue-chip has seen a sharp swing in its shareholder base – away from supportive German investors towards "foreigners", predominantly UK and US funds. As a result, there is an increasing clash between long and short-term visions: shareholding fund managers and hedge funds see opportunities to make quick gains and demand cash; company investment plans take second place.

Meanwhile, the demand for capital to acquire state-owned assets, particularly in the former East Germany, has suddenly outstripped domestic investors' ability to supply it, while lucrative opportunities to advise on state sell-offs are increasingly luring the world's big banking names to the German capital.

The end result is resentment at the increasing dominance of "foreign" money in corporate Germany, both by equity investors and lenders. The German services trade union, Verdi, said of Deutsche Bank's planned job cuts:

> "Increasing profits at any cost is unfair, anti-social and irresponsible. Such a cold corporate strategy is irreconcilable with the foundations of a social market economy".[5]

Yet at the same time, German investors are themselves buying up investments outside the country.

1. "Triumph for Vodafone as Mannesmann Gives In", *Financial Times*, 4 February 2000, p.1.
2. Plender, J., "Whirlwinds of Change", *Financial Times*, 4 February 2000, p.18.
3. "Survey of German Banking and Finance", *Financial Times*, 25 October 1999.
4. Editorial, "Germany's pay law", *Financial Times*, 20 May 2005.
5. Quoted in Jenkins, P. and Milne, R., "The coming powers: how German companies are being bound to the interests of foreign investors", *Financial Times*, 1 April 2005.

enormous market power. Another joint venture established in 1998 was Hermes Lens Asset Management, which, by the end of 1999, had accumulated ten pension-fund investors from the US, UK, Canada and Scandinavian countries. Its aim, like that of CalPERS, was to extend its investment activity in "underperforming equities" into continental Europe. In essence, these strategies and activities represent the institutionalisation of conflict over corporate surplus between shareholders and company management. At the same time, workers are pressured to work more for less money.

Some companies believe this threat, whether real or imagined,[90] can be countered by generating domestic shareholders through the domestic funding of private pensions. This has been a particular issue in France. By 1999, foreign investors held over 30 per cent of French quoted company shares. The *Wall Street Journal Europe* reported on:

> "the rising profile of buyout funds – those packs of private capital that prey on juicy assets that are prime for a quick makeover and a resale to the highest bidder. The fast-moving funds typically boast returns of 30% a year . . . What's driving all this? US pension funds and other big investors, encouraged by talk of widespread restructuring within Europe's sclerotic conglomerates, have been investing in private equity as never before."[91]

The president of the French bank, Crédit Lyonnais, was one executive who expressed fears of a pension-fund invasion:

> "The systematic search for the highest value possible for the shareholder is nothing other than the disguised expression of *rentier* interests, with a strong preference for the future over the present, a translation of the power of Anglo-Saxon pensioners (who are the only ones to save so strongly) over the whole of world society, in short, of old or ageing Americans and Britons to the detriment of young people of all other countries . . . Let us forget for a moment frontiers and nationalities: within each of us, to put it another way, old age is in charge of what we do . . . Indeed we find that today's workers have no say over how their savings are invested and the activities of the most powerful financial interests are legitimated."[92]

But would ensuring that investors and shareholders are domestic solve the problem by itself? The claim is questionable:

- It assumes that domestic shareholders will be more sympathetic to domestic managers. (But patriotism or national sentiment in the operations of finance and pension funds is probably not sustainable beyond the short-term.)
- It assumes that share prices will rise as more investors enter the market, thereby undermining the objective of the pension-fund raiders. (But domestic funds might experience a subsequent capital loss if prices then fall.)
- It assumes a solidarity between pension funds – "we will not sell our shares in your company if you do not sell your shares in ours". (But this scenario conjures up a "prisoner's dilemma" for domestic funds.[93])
- It assumes that employers will invest the bulk of "their" particular pension fund in the shares of their own company as a blocking tactic. (But this is an extremely controversial proposition politically, which

90. In 1999, seven of the ten top multinational companies, ranked by foreign assets, were from the Anglo-American bloc, namely from the US, the UK, The Netherlands and Switzerland. Yet of the 20 largest cross-border merger and acquisition deals announced in 1998 and up to June 1999, only one firm from an Anglo-American bloc country (the UK) was taking over a company of the European bloc (Sweden). In practice, deals have flown both ways between the US and the European bloc, between the UK and the US, and between European bloc members themselves (UNCTAD, *World Investment Report 1999: Foreign Direct Investment and the Challenge of Development*, United Nations, New York and Geneva, 1999, pp.78, 96. *See also* Box: "Pension Funds Change Markets and Assets", p.20).
91. *Wall Street Journal Europe*, September 1999, p.1.
92. Blackburn, R., "The New Collectivism: Pension Reform, Grey Capitalism and Complex Socialism", *New Left Review*, No. 233, January/February 1999, p.13. *See also* Blackburn, R., *Banking on Death or, Investing in Life: The History and Future of Pensions*, Verso, London, 2002.
    On 31 December 2005, before implementing EU regulations on the free movement of capital, the French government gave itself the right to veto or impose conditions on foreign takeovers in 11 "sensitive" or "strategic" industries, including casino gambling, biotechnology, defence, armaments, cryptology, security, vaccine production and secure information systems (Hollinger, P. and Parker, G., "France lists sectors to be protected from foreign bids", *Financial Times*, 1 September 2005, p.6). In March 2006, the French prime minister proposed using the state-owned Caisse des Dépôts, which manages pay-as-you go state pensions, to build up core shareholdings in French companies.
    The Italian government has blocked foreign takeover bids for Italian banks.
    Some US politicians want to enforce barriers against takeovers that they believe threaten national security, prompted by the Chinese state-run oil firm, CNOOC (China National Offshore Oil Company) attempting to buy US oil company, Unocal, in 2005, and by US opposition to Dubai Ports World operating the US ports that came with the company's February 2006 acquisition of the UK-based Peninsular and Oriental Steam Navigation Co (P&O).
93. If Company A does not know whether Company B will keep or sell A's shares, Company A would be better off selling B's shares first, irrespective of what Company B does (A's self-interest). It would be better for both companies, however, if neither sold each other's shares (A and B's shared interest) (http://plato.stanford.edu/entries/prisoner-dilemma).

would take some time to accomplish in practice. The US energy firm, Enron, put millions of dollars of employees' future pension provision into its own shares, which became worthless when the firm went bankrupt in 2001 after it emerged that the firm had hidden huge debts offshore.)

It is ultimately self-defeating for companies to promote domestic pension funds to encourage the domestic capital market as a way of avoiding being taken over by the stock markets/pension funds/corporations of other countries. Domestic markets, with their new pension-fund portfolio approach, would themselves put pressure on domestic corporate relationships – and might not be able to prevent the incursion of non-domestic investors into the domestic market. And as the *Financial Times* points out:

> "The single [European] market will increasingly make a nonsense of borders anyway. But it will enable countries to participate more fully in the takeover game. Hence the extra interest in channelling pension payments through the markets as long-term [sic] funds."[94]

Private pensions exacerbate conflict between generations, classes and workers in different countries.

• Labour

Funded pension schemes have long been seen by many workers and trade unions as "deferred wages". In the 1950s-1960s, many trade unions and workers agreed to limit their demands for wage-increases today in exchange for pension benefits tomorrow (particularly in the US, UK and Australia). This trade-off was a crucial element in the development of pension funds.[95]

In today's era of income restraint, many unions continue to argue for their members "deferring" current wage-increases in exchange for a share in capital ownership that will provide for members' retirement incomes. In March 2000, for instance, the historically powerful IG Metall trade union in Germany uncharacteristically agreed to a lower pay rise than it had initially demanded in return for employers extending an early retirement programme and increasing their payments to pension arrangements. By reducing their wage claims, such workers allow the owners of capital to retain a greater part of the surplus in exchange for a claim on that surplus to be redeemed when the workers retire. Yet this claim is only a paper claim. Pensions are paid out of what is produced at the time of payment, not out of what was produced at the time the contributions were made.[96]

Moreover, when workers have a perceived stake in shareholder returns, relationships between capital and the labour force change. A senior public adviser from the Bank of England says that pension funding may:

> "increase overall economic efficiency and flexibility by reducing the conflict between labour and capital, since with funding, workers do not focus on high wages and safe employment".[97]

The author of a 1997 IMF publication agrees that a private pension arrangement "sensitizes workers to financial issues and enterprise performance, reducing the dichotomy between capital and labour".[98]

But if some trade unions are unsure whether or not to trust the state with workers' pension contributions, the collapse of so many

94. "Pension Moves May Boost Equity Flows", *Financial Times*, 30 June 2000, p.37.
95. Minns, R., "The Social Ownership of Capital", *New Left Review*, No. 219, September/October 1996.
96. Friot, B., "Social Contributions, Earmarked Taxes and Wage Earner Savings in the Financing of Social Protection: A Comparison between the British and French Systems", paper presented at Conference of the European Network for Research on Supplementary Pensions, Dublin, September 1997.
97. Davis, E. P., *Can Pension Systems Cope? Population Ageing, and Retirement Income Provision in the European Union*, Royal Institute of International Affairs, London, 1997, p.37.
98. Holzmann, R., "Pension Reform, Financial Market Development and Economic Growth: Preliminary Evidence from Chile", *IMF Working Paper*, WP/96/94, 1997, p.1.

occupational pension schemes in recent years and the huge deficits in the majority of those that remain suggest that a promise from their employers can be reneged on as well. Far from being put to one side, "deferred wages" are anything but isolated from the vagaries of the market. They often wind up paying current wages and profits for financial institutions rather than deferred wages for contributors. Nevertheless, once private pension funds have been established, it is hard to make changes.[99]

• Academics, Media and Politicians

A wide range of other individuals and institutions also support private provision of old-age pensions through stock-market investment. Many senior academics from the US and the UK, for instance, agree that the role of the state in pensions provision should be restricted as way of decreasing "costly" public expenditure on welfare or social security, enhancing economic growth and making support for old-age pensions more sustainable.

The financial press, too, frequently echoes the gloomy warnings of the "bankruptcy" that is said to follow from public sector stewardship and from the proverbial ticking clock of a demographic time bomb. *Financial Times* articles on the subject, for example, are studded with terms such as "burdens", "shake-ups" and "liabilities", or are introduced by headlines such as "Time to rethink a bankrupt system",[100] "Pension crisis comes to the boil",[101] "Baby boomers who face going bust",[102] and "Ageing populations threaten to overwhelm public finances".[103] In the US, *The New York Times* and the *Wall Street Journal* have given interesting commentaries on changes in pension systems, but still advocate private systems over public ones, echoing the received wisdom.

Last, but certainly not least, come the politicians who advise the public that their savings for social protection and social security will be more effective in safeguarding both the economy and social welfare if they are placed in the hands of private money managers, insurance companies and stock markets rather than in public institutions that are directly accountable to, or owned by, the state. For many politicians, pension funds should be less active in funding government debt and more active in supporting private equities and bonds and in promoting the "new risk culture".

The critical issue is whether financial markets and institutions should play leading roles in social welfare or not.

The crisis is one of low wages, unemployment and poverty, not of demography.

Conclusion

The stock-market model of pensions fails by its own criteria of spurring savings, investment and economic growth and thereby improving the finances of old-age payments. Pension privatisation is not really about pensions at all, but about extending capital markets and the free movement of capital and changing the role of the state.

The philosophy of welfare has changed over the twentieth century because politics has changed, particularly after the collapse of the Soviet Union – not because the welfare philosophy that prevailed in the mid-twentieth century became unsustainable or because stock markets proved to be a superior road to economic growth.

The critical issue is not a choice between the state and the private

99. Private pension systems can also exacerbate conflict between workers in industrialised countries and those in Southern countries. Both are pressured to accept lower wages and poorer working conditions.
100. *FTfm*, 27 September 2004, p.6.
101. *Financial Times*, 26 July 2004, p.16.
102. *Financial Times, Money Supplement*, 23 January 1999, p.2.
103. *Financial Times*, 11 October 2005, p.12.

sector, nor the precise balance between a basic pension and a supplementary one, nor non-funding versus funding, nor general taxation versus contributions based on income. Instead, it is the question of whether financial institutions, financial markets and the "free movement of capital" should play leading roles in social welfare. Debates about pensions cannot ignore the effects pension schemes have on relationships between finance and industry, investment, and the broader social and economic implications of the stock-market approach to welfare or social security.

There are certainly problems with many public sector pensions, but relying on funded individual private schemes is likely only to make

"Scandal, Poverty and Privatization":

Britain's pension crisis is not one of too high public spending. By the year 2050, if current policies continue, the UK will be paying just five per cent of its GDP on state pensions (subsidies to the private sector excluded). Its public pension is one of the lowest in the OECD.

Its crisis, rather, is one of private pensions. UK companies are jettisoning the defined-benefit occupational schemes they have provided for decades, while partial opt-outs from the state system and the introduction of personal pensions have been mired in scandal, high costs and miserly returns. What's left of the state pension is so reduced in value that, all told, an estimated 70 per cent of pensioners will be in poverty by the year 2050.

Concludes the US *Fortune* business magazine:

> "One need only look to Britain, once held up as a model by pension reformers, to see how the lofty ideals behind privatization can easily go awry."[1]

Company Pensions

Just a decade ago, Britain seemed to have avoided high public costs by allowing employers to opt out of paying into the state system if they provided their own pension schemes for their employees.

When these defined-benefit pensions were first offered in the 1960s and 1970s, it seemed feasible to promise to pay someone two-thirds of their final salary in retirement if they worked for the company for 40 years. Those who made it to retirement were subsidised by those who left early (such as women), and many pensioners did not survive long after retirement anyway, particularly those who had had manual jobs.

Employees contributed between 4 and 8 per cent of their salary to the scheme, while employers put in on average 16 per cent.

During the 1980s and 1990s, when share prices soared, pension funds appeared to have more than enough to meet their promises. According to actuarial calculations, many schemes were in surplus, so companies took "contribution holidays".

Companies also raided these paper surpluses to fund major labour "restructuring" in the 1990s – early retirement and redundancies for workers who were themselves considered surplus.

From Boom to Bust

But when hi-tech speculation in the late 1990s led to the dot.com stock market bubble bursting in 2000, share prices crashed. A pension system in surplus went into major deficit.

The deficit of all the UK's final salary pension schemes – the gap between the current market value of a pension fund's assets and its total liabilities if it had to pay out its pension promises all at once – was estimated at around £134 billion in December 2005 (depending on assumptions about future investment returns, longevity and pay increases). This dwarves the country's national debt.

Only 5 per cent of UK company pensions are now considered to be fully-funded, compared with 20 per cent of US funds. The companies with the largest pension deficits are British Telecommunications (BT), BAE Systems, Lloyds TSB, Royal Bank of Scotland and Unilever.

In 2004, according to one actuarial report, the 100 biggest UK companies paid out four times as much in dividends to shareholders than in repairing holes in their pension schemes – paying to shareholders more than would have been required to wipe out the collective shortfall.

The UK government set up a Pensions Regulator in 2004, which can now require a company to shore up its deficit before using its spare cash for shareholder dividends or company investment. Accountants Pricewaterhouse Coopers has estimated that one in five affected companies would need to comit more than its entire free cash flow to meet a 10-year deadline required by the Regulator for deficits to be eliminated.

Pension and Pay Cuts

Many companies are now closing these pension schemes to new members, citing their huge deficits. Actuaries predict that most will not these problems worse. There are many clear alternatives to the Anglo-American model, and ways of adjusting the model itself in order to generate more wealth as well as generous and equitable pensions for all.[104]

If there is a crisis of too many old people, it is one of too many people in poverty in their old age, both now and in the future. Problems of pension financing derive less from demographic changes than from unemployment, low wages, and a shift in income distribution away from wages towards profits. Even if demography were the main problem, a private system based on financial markets would not be the solution, as it is more costly, less equitable and inherently less secure than public alternatives.

104. For example, Murphy, R., Hines, C. and Simpson, A., *People's Pensions: New Thinking for the 21st Century*, New Economics Foundation, London, 2003; Blackburn, R., *Plugging the gap: how employers can help to fill the pension deficit*, Catalyst, London, 2005.

The British Pensions Disaster

be accepting any contributions from existing members by the year 2010, if not sooner.

Instead, firms are offering their employees defined-contribution pension schemes, and cutting, even abolishing, employer contributions in the process.

For instance, telecoms giant BT was paying in an average of 11.6 per cent of each worker's salary to its final salary scheme before it was closed to new entrants in 2001. One year later, the company was paying an average of 4.7 per cent into its defined-contribution scheme, two-thirds less than before. BT has in effect put through a 7 per cent pay cut for new workers.

The National Association of Pension Funds estimates that the typical employer contribution into a defined-contribution pension is just 7 per cent of salary compared to about 16 per cent of a final salary pension.

Some occupational schemes have collapsed altogether when the sponsoring companies have gone bankrupt. An estimated 85,000 people have been left with a reduced pension or nothing at all, even if they had paid into a scheme all their lives.

Game Over – Who's To Blame?

What's behind the crisis and who's to blame?

Are company bosses to blame for taking "contribution holidays"?

Are actuaries to blame for getting their life expectancy sums wrong? (In 1981, men's life expectancy at the age of 65 by the year 2004 was predicted as being 14.8 years; it turned out to be 19 years.)

Is the government to blame for regulating too much? (Its 2001 accounting rule obliged firms to make an annual review of their pension scheme's assets and liabilities and thus made shortfalls obvious.)

Is the government to blame for regulating too little and too late? (It introduced minimum funding standards in 1997 only after publisher Robert Maxwell had stolen from his companies' pension schemes, but they were "recklessly inadequate".)

Is the government to blame for taxing too much? (In 1997, it started taxing the dividends paid out to pension funds from their equity holdings, reducing their annual income by about £5 billion.)

Are speculators to blame for causing the UK stock market to fall by one-third since its high in early 2000?

Are historically low interest rates around the world, the result in part of a savings glut, to blame?

Financial Times columnist Martin Wolf opts for none of these, saying simply that the crisis has exposed the occupational pension scheme for what it is: "A shameful confidence trick".[2]

Pension consultant Ros Altmann believes that the spectre of huge deficits and thousands of destitute pensioners merely illustrate how uncertain the "pray as you go" approach is.[3]

Given that most companies no longer offer final-salary pension schemes to new employees, it is public sector (largely unfunded) schemes based on final salaries that now seem generous, secure – and costly. Pressure is building to cut these in various ways, even though public sector pay has generally been far less than private sector pay.

Privatising State Pensions

Compounding the occupational pension scheme crisis is one of failed privatised state pensions.

As part of its goal to shrink the welfare state, Prime Minister Margaret Thatcher's government allowed workers to contract out of part of the state pension and put the money instead into a "personal pension" or individual account (the privatisation that George W. Bush proposed for Social Security in the US).

More than five million workers switched to new personal plans, often under high-pressure selling from financial advisers, an onslaught of advertising and marketing, and generous tax rebates worth more than the value of the state benefit given up.

But even before the stock market bubble burst in 2000, the privatised state system was generating a deafening chorus of complaints about deceptive advertising, bad financial

continued overleaf . . .

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advice, and high fees. The individual accounts hadn't generated better pensions. When the rebates were trimmed, older people lost an average of £4,000 from their pension pot. Thousands of people are now contracting back into the state system.

The Thatcher government also reduced the value of the state pension by linking it in 1981 to average price increases rather than average earnings increases. By the year 2050, it will be worth just 7.5 per cent of national average earnings.

Concludes pensions consultant Ros Altmann:

> "State pensions have been reduced too far and private pensions have not compensated for this, leaving half our pensioners needing means-tested pension credit to avoid poverty."[4]

Barely half the UK's adult population have private pension coverage.

The policy adviser on financial issues to the UK consumers association, Which?, concludes that:

> "the consequences of 'marketising' the provision of pensions in the UK is there for all to see in a collapse of confidence in pensions, serious underprovision for individual consumers, and value destruction."[5]

Back to the Future

To tackle the pensions crisis, the Labour government set up a Pensions Commission in 2002, headed by investment banker Adair Turner. The Commission recommended in November 2005 that the government should introduce a higher basic state pension linked to average earnings, not prices, that was not dependent on contributions throughout a working life.

It also said that the government should introduce a nationally-organised (but not nationalised), low-cost pensions savings scheme with annual management charges of just 0.3 per cent. All workers would be enrolled but could opt out if they wanted. Contributions would be collected centrally, but the government would contract out fund management to the private sector via competitive bidding. Workers could choose the type of assets in which their money could be invested, but not who managed it. The scheme would be, in effect, a "defined contribution or money purchase, occupational fund available nationally."[6]

Comments *Fortune* magazine on the Commission's proposals:

> "Britain's experience has been so bad that it's effectively dismantling a system strikingly similar to what the White House is proposing here".

The UK consumers association, *Which?*, points out the irony of the UK rediscovering "the wisdom of the collective approach" while "the failed UK retail model" of privatised pensions is still promoted throughout the world.[7]

The government has yet to accept the Commission's proposals, however. The private pensions industry is lobbying hard for them to be junked in favour of its own alternatives of individual accounts or "super trusts" at higher costs.

1. Despeignes, P., "Scandal, Poverty and Privatization: Tales from Britain", *Fortune*, 21 February 2005, p.16.
2. Wolf, M., "A shameful pensions confidence trick", *Financial Times*, 1 July 2005, p.19.
3. Altmann, R., "Pensions cannot solve the retirement crisis", *Financial Times*, 16 May 2005, p.15
4. Ibid.
5. McAteer, M., "UK liberalisation may be a lesson too far", *Financial Times FTfm*, 28 November 2005. p.8.
6. Timmins, N., "Seeking a fit to the pension puzzle", *Financial Times*, 18-19 February 2006, p.4.
7. Ibid.

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