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Social Expenditure, Pension Systems, and Neoliberalism

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The neo-liberal tide of privatisation targeted public pension schemes quite some time ago. While decreasing the role of the State as such is part and parcel of this ideology, another aspect of privatising basic needs does not seem to have received appropriate attention. Government intervention and trade union strife for higher income have created high levels of relatively wide-spread wealth, which could profitably be tapped by private business. This is similar to state property such as railways whose privatisation offers golden business opportunities. The necessity to provide for old age and outright fear of misery during this stage of one's life are powerful incentives to provide financially, even if fees and charges for doing so are relatively high – elasticity of demand will be low.

Naturally, private pension schemes are likely to remain a comparatively marginal factor - of interest mainly to a relatively small layer of the well heeled - if and as long as public schemes offer relatively good levels of income for most people. By contrast, if public schemes were abolished altogether, a huge market would be opened to private business. Reducing or abolishing public systems allow private firms to tap this promising market more profitably. Re-channelling parts of mandatory contributions into private funds could strike a bonanza at little or no risk. Such funds only administer accumulated money for a fee. Huge losses may occur when stock prices fall dramatically - as has happened recently - but the risk is fully borne by pensioners or governments.

Insecurity created by pension reforms dictated by the determination to reduce benefits and lower pensions tends to fuel business. Somewhat one-sided propaganda - more politely called "myths about social security systems" by Stiglitz and Orszag (1999) - have prepared the ground. Routinely, public money in the form of tax privileges or outright subsidies has been used to reinforce incentives. Sometimes other agenda, such as diminishing financial burdens of employers by shifting financing more onto employees, may also be discerned. Euphoric praise, even though premature, has been helpful in selling the concept. So are stock market booms and temporarily high returns - as during the years when the discussion of switching to more private provisions took of in Western Europe. Privately funded pension schemes have been propagated by pointing at demographic changes, and with the assertion that public schemes would no longer be able to cope. Thus a perception of urgency was created. State minimalism demands cutting down public expenditures. Substituting non-private PAYG systems by private companies both reduces state intervention and opens business opportunities.

Astonishingly, the simple micro-economic fact that privatisation means huge profits for the financial service industry, which from a micro-economic point of view is a strong incentive, has not received much attention so far. The question of administrative costs has been raised in the past - Diamond (1993) is an early example. Large fees charged by private providers have been criticised. The historical record of Latin American pioneers shows how lucrative this market can be. Nevertheless, the issue of the profitability of privatising pensions and the profit motive as a potential microeconomic trigger behind reforms has not yet received sufficient attention.

The importance of charges is even played down. Whitehouse (2000, p.60) tried to put the discussion on charges into what he thought to be the proper perspective:

> It is easy to lose sight of the important issues in pensions policy in the detail of the analysis of administrative charges, which is necessarily complex and involved. The most important issues in pension reform relate to financial markets. How large is the equity premium? How volatile are long-term equity investments? Are stock-markets currently over-valued? Compared with these questions, administrative charges are a second-order, purely operational issue.

In plain English rather than discussing real losses by high charges one should discuss potential losses, which - as it turned out after 2000 - can become enormous as well.

High fees and their effects should be discussed openly. Recent evolutions of pension systems and the calls for reform should be seen with the economic perspective of high and riskless profits and the externalisation of risks in mind. The general logic of neo-liberalism, redistributing in favour of the rich, privatising profits and socialising losses, seems to apply to private pension systems as well (cf. Raffer 2003). This paper draws attention to this aspect, in the hope that it may stimulate discussion on a very central issue of economics - the effects of the profit motive.

Chile - the "Lab" of Privatisation

Due to the debt crisis and the dependence on International Financial Institutions (IFIs) so-called developing countries were forced to reform according to the tenets of neoliberal creed well ahead of many OECD countries. In a way structural adjustment policies in the South may be seen as test runs helping to make these policies more easily acceptable. Rodrik (1996, p.17) saw the debt crisis as an opportunity seized by orthodox economists for a "wholesale reform of prevailing policies" offering the chance "to wipe the slate clean and mount a frontal attack on the entire range of policies in use." A crisis brought about by overspending and overlending and the sudden change of economic policy in the North, which sent interest rates sky-rocketting was simply declared to stem from domestic policies disliked by orthodoxy.

Chile's decision to privatise its pension system is an excellent illustration of Rodrik's thesis. Strongly defending the decision by the military junta Acuña and Iglesias (2001, p.21) clearly state:

> … the new pension system was conceived as part of a package of economic and social reforms and was designed on the basis of the same principles as those used in the construction of the economic and social development model which began to be implemented from the very start of the military government.

The authors make it clear that it was a systemic issue. Since the " problems in social security were yet another manifestation of the failure of a model of economic and social development that needed to be replaced" (*ibid*., p.23) parametric reforms were not indicated. Acuña and Iglesias (2001, p.23) approvingly quote a former minister, E. José Piñera, who saw the basic mistake of the old system in a "collectivistic concept of man and society", which arose from a false ideological notion of the nature and conduct of the human being that had predominated and influenced many public decisions adopted in Chile. Thus, the problems in social security were yet another manifestation of the failure of a model of economic and social development that had to be replaced.

Transition resulted in enormous costs: "the total social security deficit rose from 4.1% in 1981 to a maximum of 8.4% of GDP in 1982. Since that date it has decreased steadily, reaching 3.9% of the GDP in 1998" (*ibid*., p. 35). Acuña and Iglesias (2001, p.36) wonder

> Despite its magnitude, it is a striking fact that the fiscal impact does not seem to have been an important obstacle to the pension reform effort in Chile. In fact, former minister Piñera comments on the ease with which the Minister of Finance and the Director of the Budget of that period accepted the pension reform project. ... In our opinion, the economic authorities at that time did share this view and shared Piñera's view that pension system reform was part of a set of economic reforms that were not independent of one another. This, combined with the fact that the government of the time had both sufficient will and political power to carry out the adjustments to the fiscal budget that were necessary in order to confront the social security deficit, were important in advancing the reform.

In the years immediately following the reform, the shortfall was financed mainly with public saving. Other expenditures were cut, a temporary tax was imposed. Apparently, no data on the costs to the budget were considered necessary. The authors argue that one way of estimating the "impact of all these changes would be to measure the difference, year to year, between the social security deficit without the reform and the actual social security deficit after the reform. Unfortunately there are no estimations of the deficit 'without the reform' that could make it possible to carry out this exercise" (*ibid.*, p.33). On the other hand, can one really put a price tag on saving a country - if not the world - from collectivism and communism?

Chile also illustrates Rodrik's (1996, p.33) interesting point very well that reform is seen as needing "a strong and autonomous executive, unhindered by the search for consensus and compromise". Doubtlessly, Chile's military dictatorship qualified. Due to lack of faith in people - who are assumed rational by orthodoxy - and democratic institutions "a lot of economists feel deep down but find [it] politically incorrect to articulate" (*ibid.*) that autocratic reforms are preferable to democracy, "especially in new democracies". Acuña and Iglesias have apparently no qualms of political correctness, giving the junta their due.

To make things absolutely clear, they state (emph. mine): "*The crisis of the old Chilean pension system was due mainly to a combination of bad management and political manipulation of social security programs, and not so much to demographic trends ('population aging')*"(*ibid*., p.54). The armed forces had, by the way, not joined the new privatised pension system compulsory for workers but retained the PAYG-variety, which would be difficult to understand if this reform had actually been in the very interest of people.

In Chile "40 percent of workers in the poorest income decile do not participate in the pension system" (IBRD 2001, p.154). Contending that "Even a well-structured pension system will not initially reach the poor" - which is surprising, considering when Chile introduced its new

system - the Bank concludes that coverage is lowest among the poor. It points out that mandatory contributions to a public system might be difficult for the poor, failing to argue why monthly payments to private institutions should be any easier. The IBRD argues that “social assistance or social pensions should cover the poorest …and those without family support”. This begs the question whether the Bank finally suggests re-introducing the principle that one has to depend on one’s family in old age.

The set of policies, which form one unity with pension reforms according to Acuña and Iglesias deserve commenting. After the putsch of 1973 the military dictatorship provided an ideal precondition to realise neoliberal ideas. Price controls were eliminated, public expenditure was reduced (also necessary to meet increased costs of financing the transition towards private pensions), state enterprises privatised, and the economy opened up. As the market knows best banking supervision was cut down in this process. After bailing-out the Banco Osorno authorities realised that "practically no inspection or supervision of bank portfolios existed." (Diaz-Alejando 1985, p.8) Reserve requirements had been steadily reduced, and "apparently little effort was spent on investigating the banking credentials of new entrants" when banks were privatised (*ibid.*) Moral backing came from the Bretton Woods Institutions. Voluntary financial transactions between private agents were believed to be their own business only, and presumably Pareto-optimal. The IMF's Director of the Western Hemisphere, E. Walter Robichek, e.g. had assured Chileans that private borrowers - as opposed to governments - were very unlikely to overborrow, even with official guarantees (*ibid.*, p.9). This view is sometimes called the Robichek doctrine. The "Chilean economic miracle " was proclaimed, even though per capita GNP "was less than 3 percent higher" than ten years before, and basic indicators of the standard of living of the poor, such as per capita consumption of calories, were all below the 1972 level (Fortin 1985, p.141). The bulk of booming credit expansion went into speculation, the trade deficit in 1982 was 70 per cent of export revenues (*ibid.*,

p.142). The "miracle" of 1981 turned into a catastrophe in 1982, when GDP fell by more than 14 percent. In 1983 Chilean pension funds had to be bailed out by government money. The costs of this bail-out are estimated by Roddy McKinnon at approximately 2.1 percent of GDP (cf. Raffer & Singer 2001, p.62). In line with general policies, the Mandatory Reserve ("Encaje") which belongs to the shareholders of the fund-management company and has to be held as a guarantee for minimum returns was reduced from 5 to 1 per cent of pension funds in 1983.

Chile was no single case. At the beginning of the 1980s liberalisation led to crisis in Latin America's Southern Cone. Naturally, Chile's government picked up the bill, including retroactive guarantees for private debts that were contracted without any government interference, and indeed while the government kept explicitly stating that it would not bail-out banks or financial intermediaries. This socialisation of private debts increased the country's debt stock considerably, crowding out other uses of public money, such as for decent pension systems. Suddenly, the showcase "miracle" was conveniently forgotten. Once the crisis was no longer remembered, it was re-used again.

Success was claimed in the case of the widely touted Chilean example well before the real test - the day when payments to pensioners are due on a normal scale. In the case of Chile this is expected around 2030, when workers having contributed exclusively to the new system will begin to retire (Key 2003, p.237) Acuña and Iglesias (2001, p.24) point out that a period of 20 years is still insufficient to evaluate long term performance. Pension payments in 2001 were still "financed to a larger extent with the Recognition Bond and not with contributions paid to personal accounts; some of the workers who receive pensions were already pensioners under the old scheme and contributed to the AFP system for a very short time, with the result that their pension level in the latter system is low; etc". So far, no proof of success exists.

This is no reason not to demand worldwide application. Arguing in favour of privatised systems Disney (1999, p.27) refers to the "most well known full scale privatisation of a public pension programme is that which took place in Chile in November 1980 ... which has been copied in a number of Latin American countries and elsewhere. Some influential commentators are advocating reforms of this kind in OECD countries". He mentions Börsch-Supan and Feldstein.

Privatising Profits

While long term performance can still not be evaluated, ample proof of high returns for private firms exist. Again, Latin America leads the way. Fees of private pension funds are sometimes quite high, which is understandable, as the main aim is making profit, not providing security. This should not be misunderstood as a misplaced demand that private enterprise should assume the role of a charity dispenser or a solidarity fund - the aim of private business rightfully is making profits. This qualifies it to do certain things extremely well, but one should not expect this to be so in all cases.

Latin America, which has been used as some kind of lab for neoliberal politicies by IFIs since 1982, provides first assessments of the business opportunities offered by privatising pension schemes. Commissions to administrators peaked in 1984 at 8.69% of taxable salary. They were brought done to 2.96% in 1997, which however was 18% of a worker's total contribution (Kay 2003, p.236). Expensive sales campaigns absorbed between 30 and 40% of operating costs, although regulations keep divergence between the returns of different funds small. Fixed commissions have a regressive effect. "The high cost of pension fund accounts for poor people led World Bank to suggest that poor people might be better served by saving for retirement in bank savings accounts." (*ibid.*, p.238)

Administrative costs in Latin American countries were generally substantial, as Ferranti, Leipziger & Srinivas (2002) document:

Table 1: Administrative Costs in Latin America (1999)

	Total fees (as % of wages)	Fees net of insurance premium (% of contributions)
Argentina	3.3	23.0
Bolivia	4.6	5.5
Chile	2.5	15.6
El Salvador	3.2	17.6
Mexico	4.4	22.1
Peru	3.7	19.0
Uruguay	2.7	14.3

With the exception of Bolivia, a very poor country, one dollar out of every four or six went to administrators. Presenting these figures under the title "Getting off to a good start" the authors draw attention to high "real annual returns before subtracting fees", admitting then that "accumulating adequate savings requires good returns and low fees" (*ibid.*). Apparently, high returns - which may be less likely at present - are to a large extent flowing into the pockets of administrators. Total administrative costs of 1.9 per cent of all receipts in the case of the Austrian PAYG system in 2000 according to the Federal Minsitry of Social Affairs pale in comparison, a sad example of disregarding profit opportunities.

Whitehouse (2000, p.28) gives slightly differing figures, which he calculated on data for December 1999 published by the Federación Internacional de Administradoras de Fondos de Pensiones in 2000:

Table 2: Pension Charges in Latin America
(per cent)

	Number of funds	Unweighted mean charge: Reduction in yield	Unweighted mean charge: Charge ratio	Weighted mean charge: by assets	Weighted mean charge: by members	Range of charges: Lowest	Range of charges: Highest
Colombia	8	0.65	13.5	14.0	14.1	11.9	16.7
Uruguay	6	0.72	14.7	14.4	14.6	13.2	15.8
El Salvador	5	0.85	17.1	17.0	17.0	16.1	18.4
Chile	8	0.88	17.7	16.2	16.1	14.5	20.4
Peru	5	0.96	19.1	19.0	19.1	18.6	20.0
Argentina	13	1.20	23.1	24.4	24.6	17.4	27.9
Mexico	13	1.39	26.0	24.5	26.2	19.3	35.4

Table 2 is much more informative that Table 1, which hides perceptible variations in fees:

> The relatively small number of funds in Peru, El Salvador and Uruguay levy very similar fees. In Mexico and Argentina, in contrast, there is much greater variation. In the former, for example, three funds charge the equivalent of 19 per cent of contributions while four funds levy 30 per cent or more.

Whitehouse points out that there exists a "considerable variation in the mean level of charges, ranging from a charge ratio of 13.5 per cent in Colombia to 26 per cent in Mexico. These are equivalent to reductions in yield of 0.65 and 1.4 per cent respectively." One should note that this means a charge load higher by 17.65 per cent than the fees presented by Ferranti, Leipziger & Srinivas (see Table 1).

The problem that total fees are difficult to calculate is often raised by literature. Whitehouse (2000, p.28) explains: "In Argentina, for example, the compulsory contribution is also 10 per cent of earnings, but a charge averaging 2.3 per cent is deducted from this, giving a net inflow to pension funds of 7.7 per cent of pay." However, "all of these systems also include mandatory private disability insurance. The insurance premia are collected as part of the charge, even though pension managers usually pass this straight on to separate insurance companies. The disability premium has been deducted from charges." In Australia, Whitehouse (2000, p.32) reports: "Neither the structure nor the level of charges is regulated. More-

over, although fees must be set out in a ‘key-features’ statement before purchase, it is often difficult to work out how much has been paid until an annual benefits statement arrives. The superannuation mandate encompasses a wide range of different funds." The structures of fees in Britain are frequently called “Byzantine”. Briefly put, consumers cannot choose, as they do not have the necessary information. Disney (1999, p.21) rightly concludes: "Such choice-based systems require a high degree of transparency and individual knowledge of pension accrual structures (net of transactions costs) if the risk of people choosing unwisely is to be avoided, as the personal pension ‘mis-selling’ scandal [in the UK] has illustrated."

Australia also provides a vivid example of differences in charges. There exist industry funds and so-called "master trusts", the former being collective schemes, the latter individual pension accounts. The respective charge ratios - the charge measured as a proportion of contributions (the reduction in premium) - are 11.2 and 35.5 per cent. Or, investment in an industry fund reduces returns by 0.5 per cent a year, compared with 1.9 per cent a year for master trusts. (*ibid*., p.32) Industry funds were established as part of a national industrial-relations agreement. Whitehouse explains this difference convincingly. Trade unions pushed for a low-cost form of pension provision. These funds have a mutual structure, with trustees drawn from participating employers and employees. They have essentially a captive membership, so there is little need for marketing and no need for a sales network. Master trusts are offered by traditional (generally profit-making) financial-services companies, often sold as part of a complete package of financial services by financial conglomerates. Whether the purported better service levels of master trusts, such as offering tailored insurance options that are not available from industry schemes, are worth this difference (Whitehouse 2000, p.33) is, of course, subject to individual preferences. Considering the lack of transparency in fees really paid, does not support the assumption of free and informed consumer choice. Industry funds, e.g., are not required to disclose asset-management fees (usually paid to a subcontractor).

According to James and Vittas (2000, p.18) the Thrift Savings Plan for federal employees and schemes for academic personnel in the US also offer superior money's worth ratios to those available to individuals through the retail market. They think reduced marketing and other transactions costs one possible explanation, as well as gains from increased information and bargaining power of group negotiators.

Acuña and Iglesias (2001, p.30) cite a study comparing Australia's and Chile's systems in detail, which found a price difference between Australia and Chile of 60 per cent in 1997. They remark, though, that "when charges are projected over the whole active life of the worker, the price in Australia comes to 30% less than that charged by the Chilean AFPs." As the quoted publication was not available to me these projections cannot be checked in detail. 30 per cent is certainly also a difference worth noting, in particular under the aspect of efficiency. The reason for this difference mentioned first is that it is "explained mainly by the fact that employers are authorized to create 'closed AFPs'" (*ibid*., pp.30f) - which seems to refer to industry funds.

Highlighting the "surprisingly high" costs of decentralised, privately managed accounts at the example of Chile and the UK, Orszag and Stiglitz (1999, pp.29f) present estimates for the US by the Advisory Council according to which the difference in total costs over a 40 years working life is exactly 1:10. For the would be pensioner it matters little whether this difference is pure profits or - as the authors believe - largely reflecting underlying costs. In both cases people pay ten times as much. Administering numerous indivdual accounts is certainly not cheap.

In Australia, low income workers are specifically excluded from the superannuation-guarantee system on the grounds that fees would eat up their contributions. The United Kingdom, too, excludes many lower-paid workers from the system. While regressive cost struc-

tures are one good reason, the fact that the working poor are no rewarding target group for private investors would be an equally good reason.

Besides administrative fees or all kinds, the consumer wanting what PAYG-systems automatically provide, namely life annuities, faces new fees and commissions. Such annuities have to be purchased. Again, Chile provides the example. Intermediation costs of life annuities rose during the 1990s. In 1989 the average fee paid to life annuity intermediaries was 1.56 per cent of premia, in 2000 this figure had risen to 5.9 per cent. Acuña and Iglesias (2001, p.52) explain this by a combination of two, independent factors. For most pensioners information costs about the characteristics of each pension modality are significant and so a high proportion of consumers do not have good-quality information when the moment comes to buy a pension. Also, "due to regulatory restrictions, information regarding those who are about to retire is not public knowledge, and this has given rise to a 'black market' for such information." The mentioned regulatory restrictions are, of course, no real problem - changing regulations would be easy.

There is, however, a more fundamental problem. "Markets for voluntary individual annuities are not well developed even in the most advanced OECD countries, let alone in developing countries" as James and Vittas (2000, p.11) observe. Moral hazard is one main problem. people knowing that their life expectancy is below average are not going to buy annuities, thus driving prices up. Ignorance and myopia by individuals who may not understand these complex contracts and fail to appreciate the benefit of insuring against the risk of outliving their assets is also mentioned. This is interesting because defenders of privatised systems routinely argue that these offer individuals more choice when this is opportune. One should recall that both problems do not exist in most public pension systems on the European continent, where payments are made as annuities and there is no need to convert, paying substantial fees. Uncertainty about the future, and mistrust of companies that might fail to honour

their obligations are mentioned. The main point, however, appears to be: "Public policies such as the offer of social security pensions and the encouragement of occupational pension schemes that tend to crowd out the use of individual annuities" (*ibid*., p.13). In other words, as long as public systems remain able to provide decent pensions - one should note that the word "compulsory" is not used - private profit opportunities remain limited. As one can see in Europe, most governments are about to do something about this "problem".

Finally, there is one further opportunity to make money. In a paper published by the IBRD's Social Protection Unit Pennachi (1998, p.5) points out that governments "usually retain an insurance obligation following a pension privatization". Thus an implicit subsidy is associated with such pension reforms. He proposes accounting for the cost of pension guarantees in government budget statistics in order to obtain an improved, market value-based measure of fiscal spending. "In addition, these cost estimates could make feasible a system of risk-based insurance premiums that would reduce or eliminate the subsidies from providing guarantees." (*ibid.*) Riskier pension funds and - their members - could then be required to pay higher insurance premia. Such insurance, one is tempted to add, could be offered and managed by private firms.

Socialising Risk and Losses

Unlike profits, all risks are externalised for private managers. The risk of capital losses and decreasing returns are carried by pensioners - and in most cases at least to same extent by governments. So is the risk of default by the managing entity.

Britain’s "mis-selling" scandal illustrates another risk. In 1988, new regulations allowed contracting out of the public pension system. Orszag and Stiglitz (1999, p.33) report: "At that time, few analysts thought that these individual accounts would present regulatory difficulties. After all, the U.K. financial services industry was a reasonably safe place to invest". Huge pressure sales tactics, however, were used to persuade people to switch into un-

suitable personal pension schemes. Orszag and Stiglitz (*ibid.*, p.34) quote a review by UK regulators in the early 1990s according to which "a large fraction had been given inappropriate advice". People with relatively generous occupational pensions were the main targets of sales agents. Firms did not even "keep adequate records to defend themselves against subsequent mis-selling claims." One may assume that records proving any misappropriateness were thus also not available. Apparently, the British government had operated on some kind of Robichek doctrine - like Chile when it liberalised its capital markets. Using simple microeconomic tools - such as externalised costs and profit maximisation - might have been more advisable and might have made this disaster foreseeable.

Orszag and Stiglitz (1999, p.17) illustrate the risks embodied in stocks by quoting a study by Gary Burtless, showing that replacement rates can be extremely volatile. If would be pensioners had invested two percent of their earnings in stock index retirement funds each year over 40 years and converted the accumulated balance into a retirement annuity at the age of 62, they would have received as little as 17 per cent of their previous wages in 1974. In 1968 the replacement rate would have been 39 per cent. The authors conclude that public defined benefits systems involve less financial risks, because they can spread risk across generations.

Succinct and excellent papers on the myths of private pension systems have been written by Orszag and Stiglitz (1999) and by Barr (2001), who also qualifies arguments against PAYG systems them as myths. Barr shows convincingly that demographic change has "more subtle but equally inescapable" adverse effects on funds, too. Excess supply of financial assets by pensioners due to reduced demand by the smaller younger generation leads to falling equity prices and hence pensions. As most pensioners are unlikely to have accumulated so much that this has no perceptible effect on their actual consumption, this is a risk worth discussing - possibly another reason for a public bail-out. The more wide-spread private funding becomes,

the more reason there is to safe "little guy investors". The risk that big funds would go bankrupt and their investors thus lose their pensions is practically non existent, as one may safely assume government bail-outs. The basis of those interested in preserving neoliberal policies is widened. Government bail-outs apart, the risk remains with the pensioners.

Acuña and Igelsias (2001, p.26) identify "a greater preference for life annuities" in Chile, "explained by the experience of pensioners under the scheduled withdrawal mode, who have seen the amount of their pensions fall in years when the investment results of the pension funds have been unsatisfactory, and which are more aware of the impact of longevity over their pensions." In other words, once the accumulated money is gone the government or the family has to feed the pensioner - very similar to 19th century Europe. Victor Hugo describes the fate of the unlucky M. Mabeuf , who had no family and - after his private fund manager lost all his wealth - no more money. Unlike the French government of Hugo's book governments nowadays intervene. In Chile the state assumes responsibility for the payment of pensions once the funds in the personal accounts are exhausted. Naturally, women are more likely to outlive their financial welcome.

James and Vittas (2000) warn that the decumulation phase must also be well organised and efficient, which is not yet the case. Many annuity and insurance market problems have still to be solved, and policies must be formulated to make these markets work properly. In plain English: transition was started on a global scale without knowing precisely how and whether the system would work in the end, like a parachuter jumping from a plane hoping to pick up a parachute on his way down. The risk of this strategy is also borne by pensioners and governments.

One should read the following critical assessment of public systems with these newly created risks in mind:

> Extensive research revealed the widespread failure of public, defined benefit schemes to protect the old. Politicians made pension promises

> that could not be kept so that “defined benefits” often turned out to be quite the opposite.
>
> (Holzman nyi, p.1)

Both systems have to be funded by those (still) working, including employers and self-employed, although in different ways. The viability of both depend on productivity increases. Bütler & Kirchsteiger (1999) show that with moderate technical progress standards of living can be maintained. Naturally, the increasing redistribution necessary might pose political problems. PAYG is based on deductions from gross wages, sometimes also implying some form of employer's contribution. Resources paid into pension funds also come from gross wages. For those receiving pensions they are the reward for investments made in the past, be it in the form of entitlements accumulated by years of contribution or by accumulating capital privately. Politically it is seen differently if people operate under the illusion of seeing only accumulated capital as investments, but not contributions. Calling systems revolvingly funded on a PAYG basis "unfunded schemes" corroborates this error - one cannot know whether willingly so or not.

As pension funds invest the money they administer, productivity might be increased, growth boosted - thus the "cake" itself might grow. Barr (2001, p.7) warns that while this point "might have some validity, it should not be seen as automatically or always true." Looking at present capital markets it seems obvious that there is no scarcity of capital. Quite on the contrary, overliquidity in international financial markets has led to scarcity of real investment opportunities and to what is sometimes dubbed "Casino capitalism". Due to the relative scarcity of productive investment outlets other acceptable uses for liquidity have to found, and created if necessary. In such a situation increases in investible funds seem quite unlikely to be beneficial to further growth. Suggestions that pension funds should invest in overindebted developing countries result from this problem. The surge in pension fund and private re-

sources in Latin America during the 1990s has brought about a perceptible shift of risk away from other creditor groups, especially commercial banks. It was encouraged and made possible by OECD governments and IFIs.

Institutional investors tend to emphasise shareholder value on a very short run basis, apparently for two reasons. First, presenting quarterly results is customary in the US, and a trend towards adapting the US way of doing business can be discerned globally. Second, most (would be) pensioners have relatively small investments, thus even small decreases in returns have strong effects on their pensions. As present evolutions in share prices show, a certain amount of volatility cannot be avoided. In concrete cases this may lead to substantial reductions in actual payments. High returns can easily be achieved during the years of booming share prices, but this is not always so. Fluctuations in returns can become a critical problem for those with low entitlements, even though stabilising effects can be achieved by some form of buffering: earmarking parts of "excess" income in good years for reserves to be dissolved in years with below average yields. But all in all pension funds have a built-in incentive to maximise short run results. This is described by the joke that a person's pension fund demanding wage bill cuts to increase shareholder values may finally be the reason why its investor is fired - another risk absent in public systems.

Investing in government bonds may also be less safe than PAYG-systems, as the example of Argentina illustrates forcefully. However, even in the US default by the government on its bonds accumulated by pension funds (worth over $1 trillion) was suggested by the President's Social Security Commission (Baker 2001). In PAYG-systems such funds do not exist - in this sense they are fortunately unfunded.

Concluding Remarks

Neoliberal patterns of redistribution in favour of the rich, and of socialising risk and losses while privatising profits can be most clearly discerned in the case of pension reforms.

The shift towards private pensions has opened enormous profit opportunities to private business, re-distributing risk to pensioners and governments. While using money in support of PAYG systems is loudly criticised, financing huge transition costs, subsidising transition to private systems or picking up the pieces of these systems by guaranteeing a humane minimum to pensioners having lost (part of) their wealth is benevolently declared to be economically effcient. Focusing research on whether and to what extent the profit motive might be an engine of reform would be extremely interesting.

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