ON PENSION REFORM & OUR APPROACH TAKEN

.... "DB Plans Nationwide in Dire Straits" ...."Retirement Assets Wiped Out in Market Meltdown"..............."Pensions – Confusion and Uncertainty for Workers"..................."ABC Airline Files for Chapter 11" ...."Three in Four Feel Retirement Dreams Out of Reach"............"Pension Time Bomb in Developed Nations"................ "DC Accounts in Peril"....

Even though these headlines are fictitious, you have probably seen similar ones in the media. Without doubt, the objective of providing the lifestyle maintenance function is in the forefront of political debates and seems to matter. Throughout history, pensions were offered in ancient Greece, in the height of the Roman Empire, during Medieval times, pre- and post Industrial Revolution, reaching their zenith at the turn of the century in Germany and the United States. Be it through stockpiling agricultural goods, offering land, charity, affiliation to guilds or fraternal organizations (forerunners of trade unions), these were some of the collective responses to this common problem. Pooling health and retirement risk has persisted to this day and serves as the underlying principal in any social welfare program.

Today, different types of pension arrangements are established at the national, occupational or private level. Under the umbrella of this industry, transactions, savings and expenditure figures have grown to prodigious levels, only comprehensible in GDP scales. These arrangements are not negligible on an individual basis either as they provide a fair share of income in retirement.

Although this desire for security is a primordial human trait and methods of securing it date back to early civil societies (as we know of), remarkably enough we are still confronted with very basic – yet crucial – questions. Do I get a pension when I retire? Will pension schemes still be around or go extinct? How much will that pension payment be? Will my benefits be worth anything in times of high inflation? And so on.....

A plethora of reform activities supported by findings of academia and pressed ahead by an armada of consultants are working towards answering these questions. At its core, our efforts are aimed at reviewing and evaluating reform measures transparently and creating a platform to initiate and lead the transition process. Before getting started though, we would like to make a few comments about our process.

Even though we rely on quantitative analysis to corroborate our propositions, we consider most of our work to be of qualitative nature. For the most part, the chosen timeframe for analysis spans a century from 1950 to 2050. Historically, the majority of current running systems were initiated in the latter half of the 20th century. On the other end, current circumstances and trends are extrapolated symbolically up to 2050, knowing that validity of projections – with fairly reasonable assumptions – diminishes as we look further and further into the future.

Pension matters and in particular reform aspects thereof have to be regarded with a grain of realism. Admittedly, in times of a financial crisis, high unemployment, slumps in the housing market or even natural disasters it is difficult – if not impossible – to gather the required resources to sustain the system, particularly if already in distress. Even in cases where this critical barrier is passed, it shall not be forgotten that decisions of this magnitude are not made overnight in democratic societies where proposals devised by experts need to go through an approval process before being implemented. Conversely, reforms in non-democratic societies are susceptible to failure due to potential misuse by political agendas.

We do not intend to stoke fear despite alarming signals. Although not disclosed in standard fiscal accounts, implicit pension debt is often much larger than explicit government debt. Adding both components would in most cases exceed prescribed debt to GDP ratios by multiple factors. In light of challenges facing EU member

states with adherence to the Maastricht eligibility criterion of limiting “explicit” government debt to 60% of GDP, one would wonder about consequences of including implicit debt to this criterion. In today’s global economy, governments with high pension liabilities are prone to be downgraded by rating agencies through risk metrics such as Moody’s sovereign credit risk rating as is the case with corporations. Although deemed incapable of servicing their overall debt, governments have not been downgraded based on this circumstance. As a key explanation serves the fact that almost all industrialized nations have partially defaulted on their pension commitments by violating original contracts while at the same time none of them has done so on their explicit debt since World War II. If debt levels are not disconcerting enough, the existing demographical trends are providing only a limited time window to act. Despite the spectre of downfall, we do see a resolution in sight if an effective, holistic, and timely response is followed.

Finally, our reform process aims to demystify this often enormous effort by recognizing a pension plan’s current standing as well as spelling out its next reform steps in the pipeline, hence leaving no room for inertia, paralysis or least of all a standstill. That being said, pension plans that follow this process might reach the “zenith” of being acknowledged as an effective pension provider. With the benefit of hindsight, however, this only represents a second-best solution and there is always a next step in this typical optimization process…

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