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Esat AKTAŞOĞLU
EU Expert, Ministry of Labour and Social Security, EU Coordination Department

Erdem CAM
Ph.D. Labour and Social Security Training Expert, Centre for Labour and Social Security Training and Research

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ABSTRACT

In recent years, in order to reduce growing pension spending, which is foreseen as unsustainable, social security and pension system reform has been applied in many countries. Within the scope of these reforms, the privatisation of pension funds has been one of the most important trends. However, the economic and financial crisis of 2008 brought into focus once again the problems of private pension systems, and the regulatory and supervisory role of the state in this area. In the light of the lessons learned from the crisis, this article attempts to examine whether the privatisation trend was flawed, and if its adoption can only be explained by the influence of organised business interests. Using cases from countries across the world, this article argues that the trend toward privatisation per se was not a mistake; that, in addition to capital's influence, there were many other factors involved in the crisis; that, even taking their potential benefits into account, privately funded pensions should only be used as a complement to public old-age security systems and not as substitutes; and that any type of pension funds require effective government.

Keywords: Social Security Reforms, private funded system, pension privatisation trend, influence of organised business interest, economic crisis

ÖZET

Son yıllarda giderek artan ve sürdürülemez olarak tahmin edilen emeklilik harcamalarının azaltılması amacıyla sosyal güvenlik ve emeklilik sistemlerinde birçok ülke reform uygulamıştır. Bu reformlar kapsamında emeklilik fonlarının özelleştirilmesi de önemli eğilimlerden biri olmuştur. Ancak özellikle son yaşanan ekonomik ve mali kriz özel emeklilik sistemlerinin aksaklıklarını ve devletin bu alandaki düzenleyici ve denetleyici rolünü tekrar gündeme getirmiştir. Bu makalede krizden çıkarılan dersler ışığında özelleştirme eğiliminin bir hata olup olmadığı ve bu eğilimin yalnızca organize sermaye çevrelerinin baskısı ve etkisiyle açıklanıp açıklanamayacağı genel hatlarıyla incelenmiştir. Sonuç olarak özelleştirmeye yönelik reformların kendi başlarına tamamen hatalı olmadığı; sermaye kesiminin etkisine ek olarak başka birçok etken olduğu; ikame yerine tamamlayıcı özel emeklilik sistemlerinin potansiyel katkıları ve her türden emeklilik fonunun etkin ve şeffaf bir yönetimi gerektirdiği örneklerle açıklanmaya çalışılmıştır.

Anahtar Sözcükler: Sosyal Güvenlik Reformları, özel emeklilik sistemi, emeklilikte özelleştirme süreci, sermaye kesiminin baskısı, ekonomik kriz

* *EU Expert, Ministry of Labour and Social Security, EU Coordination Department, esat.aktasoglu@ikg.gov.tr*
** *Ph.D. Labour and Social Security Training Expert, Centre for Labour and Social Security Training and Research, erdem.cam@csgb.gov.tr*

INTRODUCTION

In the past three decades, the problem of ageing populations and their economic burdens have forced many countries throughout the world to design or reform their social security and old-age pension systems (Arza and Kohli, 2008:5). As a potential solution, many western countries have sought ways to privatise their retirement systems (Ebbinghaus et al., 2012). Privatisation and individualisation, increasing the ties between contributions and benefits, and strengthening the prefunded elements in schemes were the main three trends in this process (Schelkle, 2013: 450). Pay-as-you-go (PAYG) schemes were fully or partially replaced by privately funded, defined-contribution systems based on individual accounts. But the dramatic results of the recent economic crisis raised significant questions about the neoliberal model of capitalism in general and the pension privatisation trends in particular. With the financial crisis of 2008, the value of pension assets decreased and assumptions about investment returns were not met; in response, many countries reduced the role of their privatised pensions. In this respect, it can be said that governments began to turn toward social policy measures.

In order to assess whether the movements toward pension privatisation were flawed, and if that trend can only be attributed to the influence of organised business interests, in the second and third parts of this paper which follow, an analysis of both the lessons learnt from the crisis and the arguments about capital's influence on the proliferation of private schemes is performed. The fourth part summarises the main arguments. These include, first, that despite the fact that private old-age pension plans have many serious flaws, the movement toward privatisation per se was not totally wrong, but lacked necessary regulation and good governance; and second, that as there are other factors worth studying, the impact of organised business cannot be regarded as the only explanation for this trend.

I- PENSION PRIVATISATION TRENDS

Most states have had 'pay-as-you-go' (PAYG) public retirement income schemes, under which the pensions of retirees are paid out of the income from the contributions of current workers. This means that there is no direct relationship between the amount of benefits received by a

retired person and the amount of contributions that he or she paid while working. On the other hand, under the 'fully-funded' system, the benefits of a retired person are paid out of his or her own accumulated contributions. Some situations, such as unemployment, early retirement and an ageing society, endanger the sustainability and adequacy of public PAYG pensions. These situations decrease the number of workers paying contributions, while they simultaneously increase both the number of pensioners and the 'age dependency ratio'.

In many European Union countries, the amount of old-age security spending is too high (Thomson et al., 2009) because the degree of economic development cannot maintain the current levels of social spending. In order to address budget constraint problems and demographic challenges, most European countries have reformed their pension systems and have created a three-pillar, multidimensional old-age security system comprising publicly, occupationally and privately funded pension aspects.

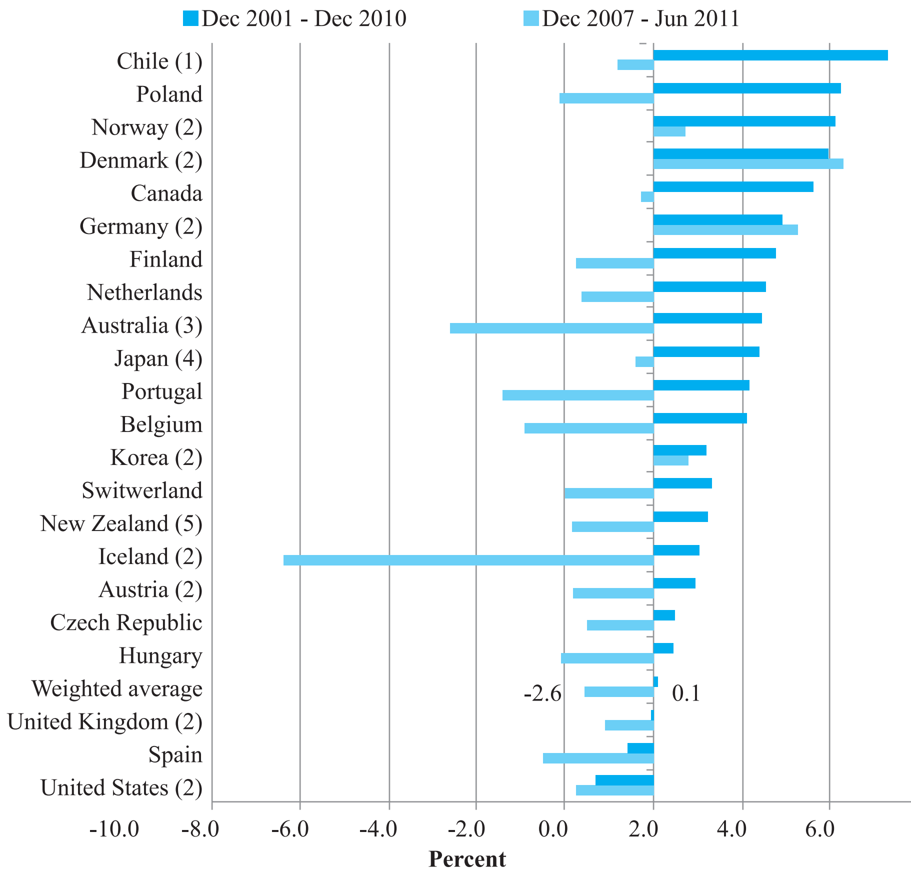
Under the framework of privately funded systems, contributions are invested in financial assets; thus, there is a strong correlation between the returns and financial asset prices, and pension funds rely on the volatilities of the financial market. Privately funded schemes based on individual accounts entail individualisation of the risks, and in most schemes being implemented, no minimum benefit is guaranteed. The privatising pension trend decreases shared risks and eliminates the possibility of intergenerational risk-sharing and distribution of income (Brooks, 2005; Barr, 2012). That is, the fluctuation risks are borne by insured individuals, not by the insurers. For example, in the US until 1999, in order to reduce the risks of maturity mismatch and interdependencies, five core financial sectors (insurance, retail banking, commercial finance, investment banking and trading on their own account) used to be legally segmented, but after deregulation, barriers were removed, and these financial assets have become useable as raw material in any part of the financial system for regulatory arbitrage in the absence of financial market segmentation (Schwartz, 2012). These characteristics mean that privatised systems have rendered individuals vulnerable to every possible uncertainty and common shocks, including inflation, and the risk of current and future income losses. Risks can even include poverty.

The 2008 financial crisis which soon gave rise to economic crisis not only signaled these negative aspects of privately funded pensions plans once again, but also made them painfully felt worldwide (Holzmann, 2012). According to the Organisation for Economic Co-operation and Development (OECD), the collapse in global stock markets had a serious impact on pension funds in 2008 (OECD, 2012). They report that 'Private pension funds lost 23% of their value in 2008, worth a heady US $5.4 trillion. Economic output is falling and unemployment is rising, putting pressure on the finances of public pension schemes as well' (OECD, 2009:1). Returns on pension assets fell dramatically due to the crisis; although many have recovered between 2008 and 2010, the real rate of return for the OECD average is negative by -1.4% in first half of 2011 (OECD, 2012: 20). The five-year weighted average (2007–2011) of real net investment returns on pension assets for OECD is -1.6% annually (OECD, 2012: 15, 20, see Figure 1).

With the crisis, it has become clear that the options and knowledge levels of individual savers is very important. Strong arguments related to the market failure approach have already warned us about behavioural problems such as bounded rationality and limited will power, and including issues such as inertia and procrastination (Barr, 2012).

It is rightly argued that people are living longer than they used to; changing work and life patterns and geographical dispersion of families make it difficult to sustain traditional social security mechanisms in which family members provide for each other (Thaler and Sunstein, 2008). But to understand these realities and act accordingly is not easy for individuals, since they have imperfect and limited rationality and mental accounting knowledge, which leads to cognitive fallacies. For example, as they are loss averse, people tend to perceive social security contributions as loss rather than an investment for their retirement savings. They also have limited will power and tend to procrastinate in doing things beneficial for them. Many also exhibit what is called present-biased or hyperbolic discounting behavioural tendencies, in which short-term instant gratification is more attractive than long-term investment (Congdon et al., 2009).

Figure 1. *Average Annual Real Net Investment Return of Pension Funds*



Source: OECD, Global Pension Statistics, StatLink: [http://dx.doi.org/10.1787/888932598113]

It is also argued that unethical practices (Gobby, 2005: 126) and asymmetric information are among the reasons for the recent crisis (Barr, 2012: 211). This suggests that under the varied and volatile conditions of financial markets, it is very hard for even well informed individuals to select a rational investment strategy, and workers with identical strategies who retire just a few years apart might get surprisingly unequal benefits (Burtless, 2010:1-25).

For these issues, the market failure approach offers a range of solutions, albeit some of which are partial. These include the economic arguments for state intervention in the form of regulatory provisions, for example creating default options (Barr, 2012); stricter financial consumer/saver

protection; increasing the capacity of related civil society organisations; etc. As the risk of losses is dependent on one's investment portfolio, in order to mitigate the exposure to risky investments like equities and hedge funds, regulation by the government creating standards requiring use of a certain portion of safer tools, such as public bonds, within portfolios can be useful. The crisis has also showed that countries where the pension funds were more regulated and better governed suffered fewer negative consequences from the crisis than other, less-regulated nations. For instance, Ireland experienced high losses because of its risky investments (Ebbinghaus, 2011a:8).

The crisis has undermined the credibility of funded pensions (Eich, 2009:13), which may also lead to decreases in private savings where the system is not mandatory. This illustrates one more example of another market failure argument: that making participation mandatory to reduce procrastination may cause a decrease in voluntary savings, which raises questions about the growth effect of private pensions (Barr, 2012). Compulsion is also important in terms of government responsibility and political salience. For these reasons, rather than a compulsory auto-enrolment system, allowing individuals the right to opt-out in a limited time can be more useful (Barr, 2012; OECD, 2012).

Whenever neoliberal policies are implemented, possible market problems such as crises, inflation and imperfect information should be taken into account, and additional policies must be designed as complement them. According to Schelkle (2012), social policies do not just compensate the failures of financial markets, but with their commodifying effect, they can also create and shape them. Her classification about social functions also shows different potential functions of social policies, and examples of which measures should be used in crisis management.

One of the main lessons learned from the crisis of 2008 is that individuals and households should not be left alone in financial planning matters, considering their lack of knowledge about today's complex financial markets. Under the framework of market correcting, or the shaping function of social policies, risk-bearing responsibilities can be distributed in favour of weaker parties at the point of contracting; consumer production measures such as prohibition of certain lending practices defined as

predatory, sound affordability assessment and fixed interest rates can be utilised (Schelkle, 2012).

The efficiency of correct social and economic policies has been proven by the experience during the financial crisis in which countries with complementary social policies were damaged less by the effects of the crisis. Schelkle examines and compares different combinations of welfare state interventions in the US, the UK and France, in response to their housing price bubbles. According to her findings, unlike France, the United States did not complement its policies with protection of the vulnerable consumer. When things went wrong, the US did not use effective insurance instruments, which was done by the United Kingdom, with success. To Schelkle, 'this combination of activism and complacency not only exposed individuals to unbearable risks but it endangered the financial system as well…' (2012:6-7).

Expenditure on financial products by households accounts for one of the biggest parts of their spending, and needs to be protected. Hence it can be claimed that if the governments had introduced sufficient protective regulations, and ensured good governance and privatised pensions, their countries would not have suffered so badly from the crisis. This, in turn, suggests that the privatisation trend per se cannot be regarded as totally flawed.

II-INFLUENCE OF ORGANISED BUSINESS INTERESTS

Obtaining pension entitlement can be regarded as the most important motive for individuals and families to save, so policies over pensions are, in general very sensitive, and efforts toward finding a scientific and technical solution to actual and objective problems of social security and retirement income systems have usually stayed under the shadow of ideological and political discussions. In this context, some people believe that, despite the risks and downsides of private pre-funded pension plans, the existence of the trend toward them can only be explained by the influence of organised business interests. However, the trend toward privatising pensions can be explained by many other factors, the influence of capital being only one of them.

It is true that, in general, interest groups representing capital are not in favour of the so-called welfare state. Particularly, proponents of neo-liberal thought point to sovereign debts as the main cause of crisis, and often use this in order to reduce social services and protection systems. In many countries, through the influence of these interest groups, social security deficits are often overstated and presented as one of the most important problems faced by the governments, while meanwhile, serious income inequalities go unnoticed. Right-wing policies, especially the New Right, believe that welfare programs and social expenditures produce passive dependants and curb their development.

Both the financial industry and employers' associations have a strong interest in reducing social security premiums going into statutory PAYG schemes[1]. This reduction not only provides cheaper labour for employers, but also stipulates more household savings and increases demand for private pension products for insurers. Under privately funded contribution systems, these savings are transferred into financial markets and converted into capital, which creates and increases significant profitable business opportunities for financial service firms. Since public PAYG pension plans constitute about 10 or 15% of the GDP of the wealthiest countries, and these figures are between 5 and 10% of the GDP for many emerging economies, privatising public pension funds results in a large impact on the economy, and insurance firms become the main winners, obtaining huge administrative charges (Orenstein, 2011).

Therefore, the influence of lobbyists representing pension funds, insurance companies and related interest groups over the policy makers is not difficult to understand. Some scholars claim the correlation between structural adjustment and stabilization policies, together with global capitalism, have made states more focused on labour market flexibilisation and casualisation. This has both increased the insecurities/inequities and created additional obstacles for poor countries, which already have low commodification, in their movement toward the organised and formal labour markets of post-industrial societies (Gough and Wood, 2004). Welfare regimes of industrialised societies are not static or immunised from global liberalisation process and are also influenced by transnational actors.

1 See: Naczyk, M. (2013)

By providing formal arguments together with anecdotal and descriptive evidence, Kemmerling and Neugart (2008) in their comparative study show how the movement toward pension privatisation occurred earlier and had stronger private elements in the UK, where financial markets were bigger and corresponding lobbies were better organised, than in Germany. Concerning the German case, Wehlau (2008) also provides empirical evidence showing the institutional investors' financial, formal and informal relations with political parties and their media power during the reform process. Scholars of transnational policy diffusion also point out transnational actors like World Bank, OECD and the International Monetary Fund (IMF), backed by multinational financial institutions, and think-tanks like the Geneva Association and the Cato Institute, are the main drivers which have spurred the recent pension reforms. These groups have been involved in mandatory funded schemes in many countries using a range of tools, such as providing technical expertise, software programs and conditional loans (Müller, 2003; Orenstein, 2011, Leimgruber, 2011 and 2008). Leimgruber (2008) says that the adoption of the three-pillar model (which he claims originated from Switzerland before the Chilean radical privatisation of 1981 and the famous World Bank report of 1994 and thus is far from being Anglo-American or imposed from abroad) was a 'victory' for private pension providers. He argues that since most of the top global insurance and reinsurance groups are members of Geneva Association, it is impossible to ignore its major role in shaping welfare state policies.

It must be noted that in the field of old-age security reforms, there may not be a consensus between business societies, particularly between employers and insurance providers. Naczyk (2012) explains how French and Belgian employers own and manage their own supplementary occupational schemes, as opposed to insurers' plans for privatisation, as they do not want to lose their rights and means to control these schemes. Moreover, after the crisis of 2008, many plans involving retrenchment of privately funded plans in the Central and Eastern European (CEEC) countries were favoured by the IMF (Orenstein, 2011).

The transnational campaign approach provides strong arguments about the influence of business interest, especially over the CEEC, Latin Amer-

ican and developing countries, where trade unions and left-wing parties were generally weak and political instability was common when the reforms were introduced. For example, except for Hungary, reforms toward privatisation in all CEEC nations were introduced by right-wing governments (Beblavý, 2011:7), but at the time, most of these countries adopted many other supply side policies (Scharpf, 2012) as well, in order to create a good environment for direct foreign investment. Scharpf (2012) argues that governments were constrained in their policy options by liberal international parameters. Particularly since monetary and exchange rate instruments are being used by the European Central Bank (ECB) within the framework of the Economic and Monetary Union (EMU), member countries can only use fiscal and income policies which are more salient in the electoral arena. He also points out how the Keynesian policies became difficult or impossible under international capital mobilisation and the absence of exchange rate instrumentation, so governments are forced to resort supply-side reforms; although the developments causing crisis originated in the US, Europe has highly been affected because its vulnerability was increased by the monetary union. These arguments somewhat explain why policies pursued by EU countries were supply-sided, in which wage reductions for competitiveness and measures for more flexible labour market were involved.

So pension privatising might be seen by the government as a tool for diminishing labour cost. Other economic and demographic factors, including the EU's political and economic requirements, should also be taken into account for the analysis of the pension privatisation trend in the CEEC. Furthermore, although many governments around the world adopted new reforms weakening some elements of fully funded plans, only few countries, like Hungary and Argentina, have eliminated their privatised systems. This also forces a look at other causes for the trend in addition to business interests, as any reform cannot be viable without compatibility with other policies, and a broad internal political and social support, especially from trade unions. For example, in France, despite strong protests, the retirement age was raised in 2012 by the government, which had not worked toward a consensus with the trade unions and thus lost the presidential election; the new government immediately changed the retirement age back to 60 for some workers.

Arguments about capital's impact on the proliferation of privately funded pensions in the western EU countries can be regarded as less convincing, given the importance of social governance, namely the self-administration and self-regulation in these countries. The stronger trade unions have a greater capacity for blocking any unilateral reform by the government and for preserving their vested rights through institutionalized and non-institutionalized veto power (Ebbinghaus, 2011b). The private supplementary occupational pensions are more common in Beveridge-type systems than in Bismarckian systems and provide social partners with more influence on policy making through self-regulatory responsibility for non-state pensions; so it is argued that the privatising trend can widen the scope also in a Bismarckian system (Ebbinghaus, 2011b:328).

Although business interest has undoubtedly played a major role in social security reforms, it is not the only explanation for the privatisation trend. Because other important factors, like ageing populations, early retirements, budget limitations, and changed work and family patterns, cannot be ignored, as they have endangered the sustainability and adequacy of public pension systems. The presence of the current huge fiscal burdens and other sustainability risks of the public PAYG pensions, together with the 2008 crisis, have driven unemployment rates up and should make it easier to look more into the possible benefits of private pensions. Demographic changes that create risks for the adequacy of future benefits, and the necessity of decreasing the pension gap to ensure decent living standards, makes pension privatisation more appealing. That is why most EU countries, sometimes at the expense of adequacy, have been trying to improve the sustainability of their privatised systems rather than totally eliminating them (Natali, 2011:27-28).

CONCLUSION

In the field of old-age insurance, there is no single, best, one-size-fits-all pension scheme. The optimal system will be different for different countries and at different times (Barr, 2012; EC, 2010). For instance, policies designed to lower the risks of funded schemes decrease their ability to offer higher benefits than public systems; while on the other hand, allowing more financial risks to increase this ability brings about more uncertainty for individuals about whether the risk of old-age income security can be

fully insured (Ebbinghaus, 2011a:9). These arguments suggest a proper balance between sustainability and adequacy elements is necessary in every system.

It should be noted that privatising pensions cannot be the main solution to the problems of pension finance, and as Barr (2012) rightly argues, the solutions for improving pension finance should be a combination of four strategies:

- ‘Lower monthly pensions’, which risks elderly poverty;
- ‘Higher contributions’, which reduces living standards of workers while contributions are already high;
- ‘Later retirement’; and
- ‘Increasing national output’.

So it is better to suggest voluntary privately funded schemes as a complement rather than a substitute to statutory public pensions. Effective and transparent government is crucial for all types of pension systems (Barr, 2012). Lessons from the 2008 economic crisis showed that the problems of state PAYG systems had been exaggerated and the bottlenecks of private funded plans ignored. This suggests a range of regulatory provisions such as a safety net for addressing issues of inadequate income at retirement, required safer investment portfolios, strengthening governance, monitoring, coordination and supervision (Antolin and Stewart, 2009).

In this article it has been argued that the economic crisis has not, per se, shown that the trend toward privatising pensions was flawed, but that it is necessary to improve regulatory framework and governance. Secondly, it has been argued that, although the major influence of organised business interests over pension plans should not be ignored, one cannot conclude that this influence is the only explanation of the privatisation trend in the presence of many other significant factors.

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