

SUMMARY COMMENTS BY RAPPORTEUR

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I. INTRODUCTION

1. The Joint ILO-OECD Workshop on Development and Reform of Pension Schemes was held at the Chateau de la Muette (the OECD building), Paris, between Monday 15 and Wednesday 17 December 1997. Papers by pension experts from ILO, OECD and World Bank, together with those papers by invited experts from the academic circle and the research institutions, were presented. About 150 persons of distinguished figures in administrations of social security pensions from OECD countries, employer representatives, and trade unions, participated in the workshop.
2. Such a joint meeting had hardly been arranged so far, in spite of its importance. Debates between the international institutions concerned, had been badly expected to take place. They should have been done in a practical way based on the past experience together with taking into account the most probable prospects in the future.
3. The Joint ILO-OECD Workshop on Development and Reform of Pension Schemes held at Paris in December 1997 was the first that was arranged for debates between the international institutions with so many participants from the academic circle, research institutions, administrations, employer and employee representatives.
4. The workshop was a titanic challenge. Presented papers were all so excellent, very informative and well-balanced. Thanks to an outstanding chairmanship by Mr. Norman Glass (from HM Treasury, the UK), with so many active participants, the workshop won very lively, substantial and fruitful discussions. Every participant would have had a great deal from the reports and through discussions.

Needless to say, the achieved success of the workshop was mainly due to careful preparations by the OECD secretariat team headed by Mr. Peter Scherer.

II. NORMATIVE ISSUES

5. Mr. Gruat's opening presentation was clear in exposing the normative basis of pensions¹⁾. It set up one of the main themes that dominated the subsequent discussion—flexibility and multiple pillars. His thought was taken up in the discussion that the basic principles, while central, can be respected by a range of quite different practical arrangements.
6. The ILO approach is a normative one. There are mainly three normative issues; design, coverage and governance. The Paris workshop largely focused on designs in the developed countries. Few discussions were made on coverage or governance issues which are paramount for developing countries.
7. There still remains a coverage issue even in some developed countries. Ireland and Japan, for example, have a drop-out problem for non-employees where the social security contributions are basically required to get pensions (nearly 40% of non-employees other than dependent spouses of employees are currently not paying in contributions of social security pensions in Japan).
8. The universal coverage could be neatly attained not by a social insurance system, but by a system financed by general revenue. It remains an open question whether the universal coverage of pensions is to be assured or not. A minimum income for the elderly can be available through a welfare system other than social security pensions, with means-testing financed directly from general revenue.
9. The ILO has been providing a benchmark of replacement rates for public pensions up to the minimum 40% after 30 years service. This guideline was severely criticized as a misleading indicator by the paper presented by Prof. Axel Borsch-Supan, who asserted that "virtually all OECD countries have a retirement income package consisting of public retirement income plus income from other sources." The ILO benchmark was set up 45 years ago. The economic status of elderly has changed drastically during the past 45 years in the OECD countries. The benchmark for the developed countries is to be reconsidered, taking current,

changed economic conditions of the elderly into account.

10. Some participants pointed out that the benchmark is to be clarified whether it is in terms of gross income or net income, whether in terms of final salaries or lifetime real average income, and whether it relates to income for single individuals or couples. It may be the level of survivors pensions and not the level of old-age pensions that is currently relevant in preventing old-age poverty. 30 years service is also to be looked through, since by and large employees are currently working much longer than 30 years in developed countries.
11. There are several social and economic objectives other than income security after retirement. Among others, higher economic growth and reduced unemployment are still of imminent importance in the OECD countries. Providing proper long-term care is urgent in some countries, too. Almost all participants seemed to agree that old-age income security is just one of several important objectives; it is competing with other objectives. Cost effectiveness and adverse effects of social security pensions should be considered together in setting up the minimum level of pension benefits.

III. CURRENT ECONOMIC STATUS OF THE ELDERLY AND RECENT REFORMS IN THE INSTITUTIONAL ARRANGEMENTS OF THE PENSION SYSTEM

12. Professor Hauser's presentation provided basic information about the fundamental objective of pensions; adequate and appropriate income in retirement. The pension income of retirees depends on the particular administrative arrangements in each country which vary widely. There is nevertheless similarity in the overall income situation of older people. As one discussant said, the replacement rates of pensions were relatively flat on average among the different countries. This is one of the important fact-findings in Hauser's paper. We can have more if the pension income is classified in more details; mandatory or non-mandatory, state, occupational, and individual.
13. Professor Hauser's paper also demonstrated that retirees are, on average, doing reasonably well economically. This provided an important context for the later review, led by Mr. Kalisch, of the actual pension reforms in OECD countries which were fundamentally addressed to fiscal goals, including reducing generosity of

pension benefits.

14. It is not enough to look at averages, however. The Hauser's paper indicated that there is a wide diversity in the positions of older people and the gap between the richest and poorest older people varies considerably from country to country. There still remain some developed countries with relatively high poverty-ratios for elderly pensioners.
15. This may be mainly due to lower levels of widow's pensions, inflation-indexing (and not wage-indexing) of old-age pensions or non take-up of means-tested support. Housing income is another concern since inclusion of income from owner-occupied housing or housing benefits will give quite a different picture of poverty after retirement for some countries.
16. It is still quite evident that critically important is collecting new data about pensions, retirement, and relative positions of older and younger people. One needs both real data on the retired population and data on the institutional arrangements of pension schemes. The need for better data was eloquently demonstrated by the following presentation by Professor Borsch-Supan, too.
17. The paper by Professor Borsch-Supan greatly enriched the discussions on all precedent themes. His discussion of the breadth of resources available to people on retirement and their substitutability made us recognize the necessity of taking account of multiple pillars in addition to those that are labeled "pensions."
18. As well, the Borsch-Supan paper introduced what might be thought of as the next theme of the workshop, i.e., the importance of considering risks inherent in various elements of the retirement income system. The particular risks associated with annuities came up in discussions and carried on over the three days. The annuities issue along with the development of financial market instruments was another theme that we came back to many times.
19. Participants from Hungary and other countries pointed out another risk in the current pay-as-you-go system, which was not mentioned in the Borsch-Supan paper. It is refusal of paying-in by non-payment of contributions particularly for younger generations. There is an increasing concern of this incentive

compatibility problem for most OECD countries.

20. The Borsch-Supan paper, by treating earnings as a part of the retirement income system, re-enforced conversations begun earlier about the critical importance of working later in life as a central theme of the pension debate on "active aging," which had been emphasized in OECD(1996). This was also a theme that grew in importance over the course of the workshop.
21. By the end of the first day, with Mr. David Kalisch's presentation, the discussion was in full swing. We had established a common vocabulary that was enriched by each succeeding presentation. People clearly found the practical description of actual reforms to be most helpful. Many participants gave supplementary explanations to the OECD description of the system for their own countries, which deepened understanding of the detailed context in actual reforms.
22. Recent reforms include 1) an increase in the normal pensionable age, 2) greater flexibility in the retirement age with promoting gradual retirement, 3) encouraging a longer contribution period and freedom to combine a pension with income from work, 4) curtailing early retirement, 5) reducing the level of benefits, 6) a funding shift to less on contributions and a little more on taxes, 7) responding to changes in family circumstances, and 8) promoting private pension arrangements. An increase in the contribution rate of social security pensions seems to be currently rare in developed countries except for Canada.
23. Some more immediate issues began to be identified, such as the high administrative cost of individual funded accounts. The high administrative cost is also inevitable in implementing social insurance pensions for non-employee people if their contributions are not collected together with income taxes by inland revenue. This is the case in Japan.²⁾

IV. SUBSTANTIVE AND TECHNICAL ISSUES

24. On Tuesday, Mr. Larry Thompson's paper on risks and predictability consolidated many of themes of Monday and the importance of multiple pillars to diversity risk. One could sense that this paper had succeeded in putting in words what many had felt, but had never heard so well expresses—in particular, its enlightening

discussion of economic risk.

25. The Thompson's paper was criticized for its modesty in assessing the best mixes of program elements. He brought us back to the reality of the earlier themes, however, by reminding us that there were no single right answers; reforms would have to vary depending on country circumstances.
26. The session on modeling by Mr. Michael Cichon provided a change of pace that allowed an examination of much the same set of issues from a more quantitative perspective. As well, it opened another important theme that the only thing that ultimately counted was the share of GDP that went to workers and to retirees (the number of retirees and the average benefits received by each).
27. Professor Martin Feldstein then created a lively discussion by providing an alternative view of the macro issue. He argued that the real issue was not shares of GDP going to pensioners, or economic growth rates, but that it was primarily a matter of higher return from advance-funded systems³⁾. There were problems in shifting to advance-funding; transitional costs, economic risk, distributional issues and administrative costs, but all had solutions, including more work in developing better financial instruments.
28. Many participants would have liked to have heard more from Professor Feldstein about the relation of higher rates of return to pensions and higher GDP, i.e., the issue of how higher rate of return in the pension world might unfold in the broader macro economy. How will higher rates hold up in light of changing demography and huge pension assets already built up and still rapidly increasing? More particularly how would advance funding actually effect national savings and investment given what seems to be inconclusive literature on the subject. Also questioned was a possible decline in shares of income for labour, which would be theoretically induced from a higher rate of return from capital. This outcome might be another political problem.
29. The paper by Mr. Bernard Casey was well received and it added greatly to the issues of earnings as a source of income among older people and of flexibility in the work-retirement decision. Early retirement decision were emerging as one of central themes of the workshop. It was confirmed that the macro economic

environment is crucially important for promoting later retirement, and that employment-neutral systems before the normal retirement age is at least to be set up for the same purpose.

30. The other dominant theme, i.e., the importance of multiple pillars that are tailored to the individual circumstances of countries, was highlighted in the paper by Mr. John Turner. Most of the discussions of his paper centered on the undesirability of using advance-funding for low income people. There was little discussion of his main points, namely, that there is no one right system and that success depends on diversifying risks through multiple pillars that would vary depending on the country circumstances. He thought that these would prove to be controversial conclusions. Yet they seemed to be accepted by most in the room. This reflects a new maturity in discussions on pensions of the OECD world.

V. CONVERGENCE AND DIVERGENCE

31. On Wednesday morning, papers by Mr. Colin Gillion (ILO), Mr. Robert Holzmann (World Bank) and Mr. Peter Hicks (OECD) were presented. While different were approaches and principal emphases by each international institution, there seemed to be common understandings in so many points for the proper design of the pension system of the developed countries. They are as follows.

A) The Past Experiences in the Pay-As-You-Go Defined Benefit System

32. Almost all OECD countries have a PAYG DB system for public pensions. We have once had a successful story of this system when the economy enjoyed a relatively high speed of growth with relatively young populations. As Beattie-McGillivray (1995) pointed out, we have many examples of this system which have been effective in reducing poverty among the elderly and also in providing people with a stable living standard after retirement. Further, administrative costs of this system have been quite low, showing quite an efficient system-operation.

33. For the past 20 years, however, the PAYG DB plan for public pensions have been facing severe and growing criticisms in these countries. Criticism are so many. Among others, financial stresses are becoming so severe under a declining rate of economic growth with the population aging⁴⁾. The system is now quite unpopular

among younger people.

34. It becomes quite difficult for these countries to increase the contribution rate for social security pensions. Hikes in the contribution rate have bitterly damaged domestic companies which have been facing the "mega-competition" on a global scale, thereby exerting adverse effects on the economy, with a higher unemployment rate, lower economic growth, lower saving rates and so on.
35. Hikes in the contribution rate will induce an incentive compatibility problem, too. The internal rate of return in this system will be quite low or will become negative for the younger cohorts, and younger generations will find that their participation in the public pension system does not pay.
36. There is another criticism on the current PAYG DB plan. It exerts perverse redistributions. Through a massive transfer of income by public pensions, the rich elderly are becoming richer, while other elderly people still are suffering from low income.
37. Political resistances to cutting the benefits level or to increasing the normal pensionable age have been so strong, and so many countries have experienced the difficulty in doing so. Many people are feeling that the government are breaking its promise with them. There has been a growing concern on incredibility problem. Namely, distrust against the government commitment is growing ⁵⁾.
38. With a better understanding of the PAYG DB system, however, some of the criticisms will disappear. Moreover, we can rectify some of deficiencies and inequities in the existing system. I know well that the governments of the OECD countries have been making great efforts to do so by increasing the normal retirement age, introducing net indexation and so on.
39. The most difficult problem for us to tackle seems to be the incentive compatibility problem, since the internal rate of return in PAYG DB plans of OECD countries is getting lower and lower than the rate of return in a funded DC plan.
40. Consequently in developed countries there will be little room for a further increase in the contribution rate for the PAYG DB plan. Unless we succeed in cutting

pension benefits, financial difficulties will continue in the future.

B) Some Lessons

41. We can draw some lessons from the experiences for the past 20 years. We have had so painstaking reforms of public pensions in the OECD countries. The lessons are also so many. Here I touch on a few, important ones.

42. First, the PAYG DB system has been working not as a pure insurance system but rather as a tax-and-transfer system involving huge amounts of income transfers between generations. It is possibly a problem between managers and trade unions, but mainly is a problem between generations.

43. We have a political difficulty in this sense. Seniors are strong voters while the younger people and future generations currently have so weak or no political powers. The interest of future generations are likely to be neglected. The problem will be the same in a sense as that of preserving global environment.

44. Second, the nature of the intergenerational contract is difficult for many people to understand. Maintaining a fixed rate of replacement in gross income terms is by no means "a contract." It is found to be quite risky, pushing its costs entirely to actively working generations or future generations.

45. In a PAYG system, pension benefits don't come from the heaven. Pension benefits for the aged parents are financed mainly by contributions of their children and grandchildren. It is a socialized system of intergenerational transfers between parents and their children. Without a socialized system, ordinary parents and their children would have responded quite flexibly to a changing circumstance. The retired parents are expected to maintain their dignity, while actively working children should be adequately rewarded for their labours. There should be little difference in the design of a PAYG DB public pension plan and the privately-based income transfers between aged parents and their children. The PAYG DB system should prescribe the rules for satisfying two needs for the aged parents and their children, just stated.

46. The benefits and contributions in PAYG DB plan should be changed flexibly to

respond to changing circumstances. As Diamond(1996) explained, it partly comes from the incompleteness of planning for different possible outcomes in the future. Consequently we have found that the replacement rate embedded in the law is not a “promise” in a strict sense⁶⁾, but it is just the “starting place” of an ongoing process of adaptation to a changing and predictable world. Everlasting reforms are required to keep the system viable, while they can be viewed as “political risks.”

47. The third lesson is that continued economic growth is definitely in need to maintain the PAYG finance healthy. Were the economy to fail to expand when the share of senior citizens in the population increased, the real after-tax pay of workers would decline. Younger people would despair of achieving a higher standard of living than their parents, and the present level of intergenerational transfers from workers to the retired would become hard to maintain.

48. In this light, we need to approach the question of funding from the perspective of circumventing constraints on economic growth. We must ask which revenue sources will slow down growth the least. The answer is not a wage tax nor an income tax, but a consumption-based tax. The consumption tax does not function as a direct levy on the saving and investment that powers the economy. In this respect, social security contributions are highly problematic. It will make sense in some countries to fund part of the increased costs of our greying society by raising the rate of consumption-based tax. Current reforms in Spain, Portugal and Germany followed this approach by reducing the contribution rate for public pensions, with increasing the rate of VAT, instead⁷⁾. Through these reforms, as well, pension burdens will be shared more evenly over the whole life-cycle of each person.

C) Advantages and Disadvantages of the Funded Defined Contribution Plan

49. Due to a reduction of benefits in a PAYG DB plan, there has been a move, passive or active, toward a funded scheme of pensions in many OECD countries. A funded DC scheme has a potential advantage over the PAYG DB plan, as Professors Feldstein, Borsch-Supan and others asserted. It is mainly because the rate of return from the financial market could now become much higher than the internal rate of return in PAYG systems, on average.

50. We should not ignore or make light of the current move toward a funded scheme. Partial prefunding by mandating or encouraging private pensions is inevitable. It has due reasons. We have to accept it as a matter of fact.
51. Obviously the funded DC scheme has some other advantages such as possible increase in the saving rate, possible higher rates of economic growth, understandability or transparency, and flexible response to increasing diversity of a life-course of ours (increasing heterogeneity, increasing freedom to choose a working place, working hours, and working periods, widening choices of no-kids, divorce, and remarriage, etc.) . It also encourages people to make responsible for themselves and to support themselves on self-reliance, not allowing to behave irresponsibly to impose cost on others, especially on future generations who have no political influence today.
52. As many participants have pointed out, however, the funded DC plan will have several difficulties. First, the market rate of return is quite volatile in the short-term, as is known as "the NIKKEI effect." Its differentials are quite large. The rate of return from the financial market will decline with an ongoing population aging, and with ample supply of funded money. It is not inflation-proof.
53. Consequently the insured people will face the investment risk. The income disparity after retirement will get widened, and the increasing proportion of the elderly will suffer from low income. Some of the current retirees, namely, asset-holders will also have some damages from a possible decline in the market rate of return on their assets.
54. Second, we have to have relevant regulations on the funded scheme. We can learn something from experiences of the Anglo-Saxon countries. But, so far we have had insufficient knowledge about them. Missing are institutions against investment risks.
55. Third, there exists an administrative cost problem. This problem will be quite serious especially for the low-income earners. They are forced to have a relatively low rate of return.
56. We have other problems here in shifting from a PAYG to a funded system. Among

others, a “twice-burden” problem should not be ignored. Professors Feldstein and Borsch-Supan showed, however, that the burden in the US or Germany can be much less twice, if we have a gradual, step-by-step shift⁸⁾. Their contributions are obviously quite valuable in deepening our knowledge. Nevertheless, it is still an open question whether people can politically accept the heavier burdens on the middle aged generations at the start-up of the transitional period.

57. We have also had an important intellectual innovation from recent reforms in Sweden. The “notional” rate of return is to be introduced in shifting to a PAYG DC plan from a PAYG DB plan⁹⁾. With this shift, we can entirely escape from the “twice-burden” problem. As James(1996) observed, unfunded DC schemes can produce a close transparent relationship between contributions and benefits, thereby deterring evasion and other distortionary behavior, as well. They can eliminate some undesirable redistributions within the same cohort of individuals, too.

D) Synthesis: No Single Solutions

58. Mr. Gillion emphasized advantages of the PAYG DB plan more than its disadvantages, alerting risks involved in the funded DC plan, while Mr. Holzmann did the opposite, referring to a “paradigm shift” to a funded scheme. Mr. Hicks was most careful in assessing the two systems, with separating urgent and long-term reforms. Nonetheless, they all seemed to agree that a diversified multi-pillar system is most advisable. Differences would be in the magnitude of reforms and in the speed of adjustments.

59. For the developed countries, increased costs are still required to prevent poverty with securing stable income after retirement. We have no painless solutions for the future. No reforms without tears.

60. As far as the increased “costs” required are concerned, there seems to be virtually little differences between reducing benefits of the PAYG DB system together with encouraging private pensions and mandating private pensions with a partial and gradual fade-away of the PAYG DB plan.

61. Partial prefunding, mandatory or voluntary, is inevitable. Missing are better

instruments to minimize risks involved on the funded system. Missing as well are better understandings in the induced individual behaviors, the macro economic impacts, and the distributional outcomes from increased prefunding.

62. It should be born in mind that voluntary opting-out from the state scheme induces a cream-skimming problem, as known in the UK and in Japan. Losers are those contracted in the state scheme¹⁰.

63. Different objectives are often competing. Promoting later retirement may induce higher unemployment for younger people. Encouraging occupational and individual pensions can lead to early retirement. Tax smoothing or advance increases in the contribution rate for the long-term sound financing will cause higher unemployment in the short-term. Solutions will be different depending on which objective is more important.

64. What we want to have is not a society with so small a cradle with so many graves. We are moving to a society of compassion with a harder edge. Time is now not to deliver generous benefits, but rather to manage to share the increased costs. Who shares them and when? How are they shared? These are the imminent questions before us. More specifically, are the costs to be shared by increasing social security contributions? By increasing taxes? By increased individual savings? By later retirement? Or by reducing benefits? Who is to bear basic living costs arising from longer life expectancy? Are there any differences in responding to this question when longer life expectancy is expected in well advance to take place and when unexpected? How much is increased freedom to choose accompanied by self-reliance in old-age? How much is the exchange of income resources between generations allowed through a public program? Is there any room for a universal or differential cut of benefits for the elderly? Can it be accepted at once or gradually? What devices (other than cutting benefits) can we have in making part of increased costs shared by current pensioners? What economic differences will come from all of the alternative solutions? The answers will be different country to country.

65. The type of pains that we are forced to bear will be different country to country. It depends on potentials of economic growth, a balance between solidarity and self-reliance, perceptions about income disparity after retirement, understanding of

intergenerational equity, credibility of the government commitment, regulatory competence against investment risks, development of the capital market, taste of “surgical” operations, and so on.

66. In the end, life is still risky. We have to realize that we cannot eliminate all of risks in our long life completely. But we have been making great efforts to control these risks at a minimum level. I eagerly hope that we are wise enough to manage them.

NOTES

- 1) The author is greatly indebted to a hand-out written by Mr. Peter Hicks in summarizing themes from the first two days of the workshop.
- 2) The administrative cost of the basic flat-rate pension for non-employees in Japan is currently equivalent to about 10% of their aggregate amount of contributions.
- 3) Professor Feldstein asserted that in the US, the real after-tax market rate of return will be 5.5% per annum in the long run, while the implicit internal rate of return in the PAYG system will be only 2.5%. A participant from the UK mentioned that the market rate of return (after deducting administrative costs) will be 4% in the UK case.
- 4) Exceptional is the UK, where financial problems of social security pensions have been already solved. The UK will face increasing dependence on welfare benefits, instead.
- 5) The governments are found to often fail, as a market does. Promising for the government is not to be a direct supplier of benefits or a player of the game, but to be an organizer, a planner, and an incentive-builder, or an umpire.
- 6) The Japan case may be typical, since Japanese succeeded twice in reducing a part of “earned entitlements” to nil. See Takayama (1992, 1996).
- 7) The generalized social security contribution (the so-called “CSG”) introduced in France can be viewed as the same line of this argument.
- 8) The required increase in pension burdens estimated by Professor Feldstein and Borsch-Supan was 3 to 4 percentage points of earnings in Germany and the US at the start-up of the transitional period. See Feldstein (1997) and Borsch-Supan (1997), for example.
- 9) Italy recently followed this approach.
- 10) According to the estimates made by National Audit Agency in the UK, the loss of

the state scheme caused by opting out through individual pensions would be 5.9 billion sterling pounds. The loss in Japan by voluntary contracting-out through occupational pensions would be around 2 trillion yen. See Murakami(1997).

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