Reforming Pensions for Civil and Military Servants.

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Journal of Pension Economics and Finance / Volume 12 / Issue 04 / October 2013, pp 466 - 468
DOI: 10.1017/S1474747213000164, Published online: 29 August 2013

Link to this article: http://journals.cambridge.org/abstract_S1474747213000164

How to cite this article:

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The book could have made an even better contribution if they used data for the current financial crisis directly. However, at the time of writing that kind of data may not have been available and there is no point in arriving after the party has ended – even if you have the nicest dress.

Since the current economic downturn is far deeper than anything we have seen in the last decades it is quite a stretch to assume that parameters estimated in less turbulent times should remain the same during a crisis. I believe this aspect should have been discussed in greater detail as it may turn out to be important. Readers skimming the book are easily misled by the chapter titles (‘Impact of the stock/housing/labor market crash’) to believe that it is the current crisis that is being studied; it is not.

Briefly summed up, their findings are as follows. The housing market played little or no role explaining retirement behavior. The stock market made relatively well-off workers work longer as these workers lost a substantial fraction of their private pensions. Less well-off workers were however unaffected because they had no such private pensions anyhow. The labor market crash also made people retire, particularly workers over 62 years with little or no education.

The analyses are topped off by a synthesis of their partial estimations where the total impact for different groups of workers is calculated. They find that the economic downturn expedited retirement for workers in the bottom third of the income distribution with as good as no private pensions savings. Early retirement as a result of job-loss made this group much worse off since their social security pensions is spread over more years. The authors find that the income reduction in their retirement period may be as large as 30 percent. However, the downturn also caused some workers to delay their retirement. As their private pensions partly vanished they chose to work longer to compensate their loss. Still, they will also face reduced retirement income, but on another scale – at least in relative terms. The authors find their loss to be in the ballpark of a few percent. Finally, they find that the first is larger than the latter; still it has until now received little public attention.

Shedding light on the financial crisis’ cruel consequences for relatively poor Americans is in my view the most important contribution of this book. All in all their analysis is convincing and their results are important. The book is easy to read and should be read by many, not least outside the field of Pension Economics.

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This book summarises an international seminar held in January 2011 where academic experts discussed the arrangements for public sector employees’ pensions in a range of countries. The editor, Noriyuki Takayama, is the director and CEO of the project on intergenerational equity at the Research Institute for Policies on Pensions in Tokyo. The Institute produces a range of international studies on public policy issues, and has produced here another valuable resource on an aspect of pensions that is somewhat neglected in the literature.

In some countries, as the collected papers outline, public sector pensions are paid in addition to other basic state pensions or social insurance pensions. In others, there is some degree of integration and comparability with private sector schemes. Critically, in most countries, there has been a tradition of favoured treatment for pensions for civil servants. The book asks whether this dualism makes sense any more. As the Global Financial Crisis continues to affect sovereign states, and as Defined Benefit (DB) plans in the private sector have struggled, the favoured situation of civil servants has been put under increased scrutiny.
The collection highlights both the fiscal and intergenerational equity implications for states with expensive unfunded promises to civil servants. It also explores the way in which such schemes lack transparency and accountability, often being designed and governed by the very civil servants who are the beneficiaries. Actuarial assessments are rarely made public, or independently assessed, and the implicit costs of such schemes are higher because civil servants often have a different demographic profile than the population as a whole.

In a world of growing inequality, and demographic ageing, state pensions are being reformed. As in Ireland (not unfortunately included in this study), even private pensions in payment may be renegotiated in light of solvency dilemmas. Public sector schemes can no longer expect to be immune, especially not in countries affected by the current Eurozone problems or facing fiscal dilemmas such as in Asia and the U.S.

Detailed examinations of the arrangements in Australia, China, India, Indonesia Malaysia, Singapore, Japan, Korea, the U.K. and U.S. are outlined by respective authors in nine chapters, with a helpful overview of OECD countries by Edward Whitehouse to begin.

For Australia, authors Bateman and Piggott describe an atypical situation where the switch from DB to DC plans for new public sector employees began 20 years ago. Legacy costs are still large but at least will eventually fall to zero as pensioners die off. Other countries, such as China, still face the need for reforms to contain cost and fiscal risks, and countries such as Korea and India have had reforms but still face challenges.

One of the advantages that public servants typically have enjoyed over their private sector counterparts is not only longevity protection, but usually, generous inflation adjustments. In Japan, favourable treatment for civil servants has sparked a ‘pension jealousy debate’ and there have been progressive reforms to reduce the difference.

Concern over both the generosity of final salary plans and the fiscal consequences has driven pension reform discussions in the U.K. Rather than the Australian approach of a shift from DB to DC schemes in which the public sector employee bears more of the risk and in which some prefunding (if not full funding) is feasible, a reduction in the DB formula is the preferred reform approach. A recommendation, for example, has been made for the use of ‘average’ not ‘final’ salaries, and the linking of the age of retirement to the state pension age. By way of contrast, the U.S. public sector schemes are considered to be in a state of evolution rather than in need of radical reform to meet the 21st century’s changed conditions.

Little discussed is that these special schemes once provided a useful human resource management tool. For example, by allowing retirement with a generous pension to be mandatory for employees over a certain age, those who otherwise might have held on to jobs past the point at which they were productive could be satisfactorily ‘put out to pasture’. On the other hand, final salary pensions may reduce mobility for those civil servants late in their careers in order for them to maximize their pension advantage. Such ‘holding on’ for pensions might be seen as ‘bad’ for the individual, for taxpayers, and for an efficiently functioning economy. Some quantifications of these effects would have been welcome.

In a modern world where older people are healthy and can contribute in a meaningful way for longer, and where there is a skills shortage, the use of pensions as a human resources tool may not be appropriate any longer. Another missing dimension is any gender or a human rights analysis. Old fashioned public sector schemes treat those with dependents, such as spouses, differently. In the modern world women are more likely to have pensions from working in their own right. Moreover when those with ‘spouses’ receive implicitly more than those without, deciding who is a spouse with today’s fluid and multiple relationships poses some real equity issues.

Some may believe that pension promises can be completely relied on only if a sufficient pool of assets is set aside to meet the promises accrued while each employee is working. Whitehouse reflects the dilemma that governments face: if they contribute directly to the pension pot the government is ‘simply paying money to itself’. While this might reduce the deficit in its pension plans, it does not have an overall effect on the economic position of the government. It is as Whitehouse correctly says ‘an exercise in relabeling’.
It is a pity then that we did not have a more critical analysis of the Future Fund in Australia, set up to fund the unfunded liabilities of civil servants’ pensions legacy costs. Beside the ‘fiscal illusion’ aspect of the fund, there may be inherent risks in funding, especially if investments turn out badly.

Unanswered is the question of why state employers should offer subsidised pension schemes of any kind over and above what other employees get? The equivalent cost of such schemes could be treated as part of salary and employees allowed to decide whether (and how) to save that amount for retirement. Shifting all current employees to a ‘total remuneration’ approach to pay would stop the accrual of further problems and would make current compensation arrangements fairer, more transparent and flexible.

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