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THE BASICS OF PENSION FINANCE

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FOUR PILLARS OF RETIREMENT

(THE NETHERLANDS)

1. *public basic scheme* (35%)
 - *supplementary schemes* (45%)
 3. *individual insurance plans*
 4. *continue working*
- } (20%)

HIDDEN LIABILITIES

*in the 1990's much concern in Europe
about the hidden liabilities*



2 to 3 times government debt

- many other liabilities*
- no information on the sustainability of
basis
pension plans*

THE REAL ISSUE

future productive capacity

————→ *a larger pie gives bigger slices*

relative changes between age groups, but

more welfare for all

THE COSTS OF A PENSION PLAN

the resources forgone

*or: that part of total income used to support
the retired population*

FUNDING AND PAY-AS-YOU-GO

- (dis-)advantages (BOX 1)
- does funding make a real difference ?

MICRO - ↔ MACRO-LEVEL

- no redistribution over time
- fallacy of composition
- more investment → larger resource base

FALLACY OF COMPOSITION

“ To assume that because something is true for an individual, it is (necessarily) true on aggregate.”

DOES FUNDING MATTER ?

- the optimal level of savings and investments
 - overcapitalization → payg more emphasis
 - undercapitalization → funding more emphasis

CONDITIONS TO BE FILLED (1)

- pension savings → higher total national savings
(no crowding-out)
- savings → investments
- savings below their optimal value
|
- pension savings most efficient

CONDITIONS TO BE FULFILLED (2)

- how pensions affect personal and total savings
(BOX 2)
- need for more investment worldwide
- no serious doubt on efficiency

MACRO-CONSIDERATIONS IN PENSION FINANCE

funding as an instrument to

- save and invest more today
- produce and consume more tomorrow

MICRO-CONSIDERATIONS IN PENSION FINANCE

funding as a instrument

- to save today and to dissave or consume tomorrow
- for securing accrued pension rights

NO CONTROVERSY BETWEEN PENSIONERS AND WORKERS

- economic
- production function, $Y_t = K_t^\alpha \cdot L_t^{1-\alpha} \cdot e^{mt}$
- psychological / political

NOTE THAT

- accrued pension rights = claim on future output
- ownership of pension capital = resource base of the retired
- payg = the willingness and ability of the current labour force

SUMMARIZING, FUNDING IS

a mechanism of

- *pension finance*
- *increasing savings*
- *solving the distributional problem*

PENSION AS A CLAIM ON FUTURE PRODUCT

- funding : an economic claim; adequate returns on pension capital are guarantee
- payg : strength of the social contract between generations

NONETHELESS RISKS REMAIN

if total demand > total output,

*then, 1) price inflation of goods and services,
2) prices of securities may go down*

CONCLUDING

capital income arising from the (property of the) capital stock generally provides a better guarantee than promises made under a payg-system.