Venturing retirement eggs in costly baskets: The impact and implications of pension transition costs in Eastern Europe

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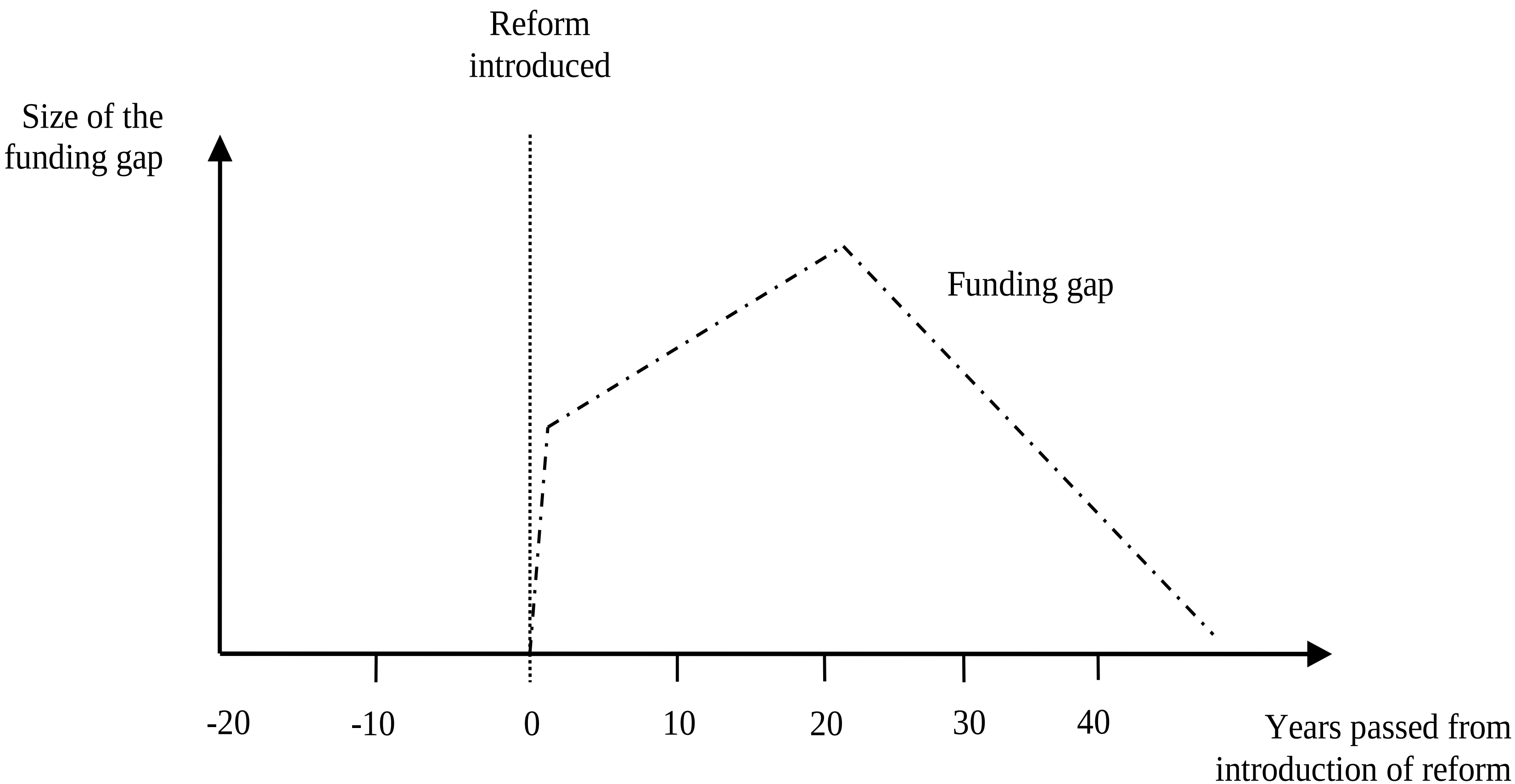
It is the part of a wise man to keep himself today for tomorrow, and not venture all his eggs in one basket

(Sancho Panza, cited e.g. in Whitehouse, D'Addio, and Reilly 2009, 10)

In the paper

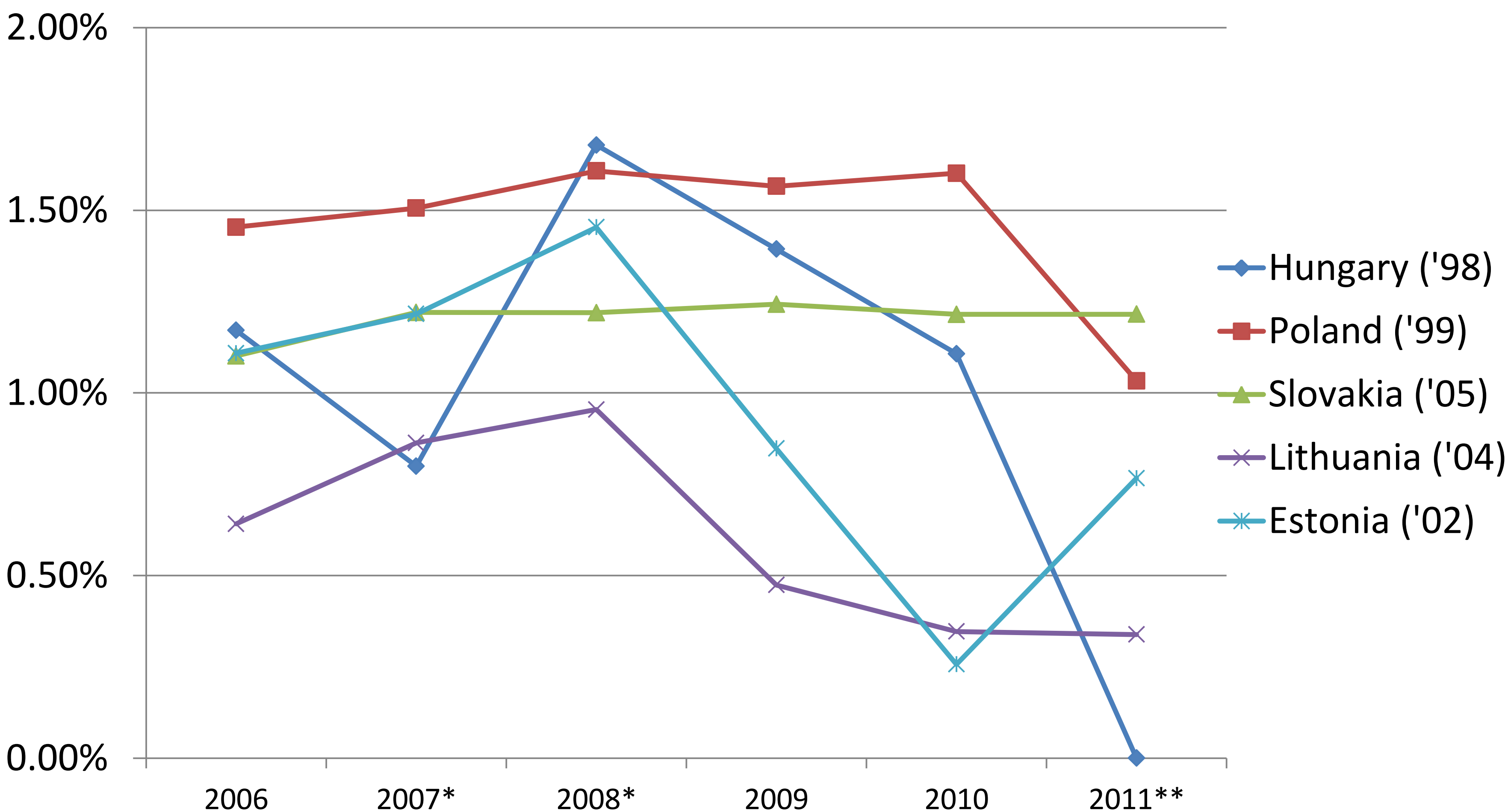
1. Two waves of reforms: Political economy and overview of reforms
2. **The funding gap: lessons from the first wave**
3. Actual solutions to financing the funding gap
4. **The diversification argument: lessons to be learned from the second wave**

The funding gap



Based on Simonovits (2003: 156)

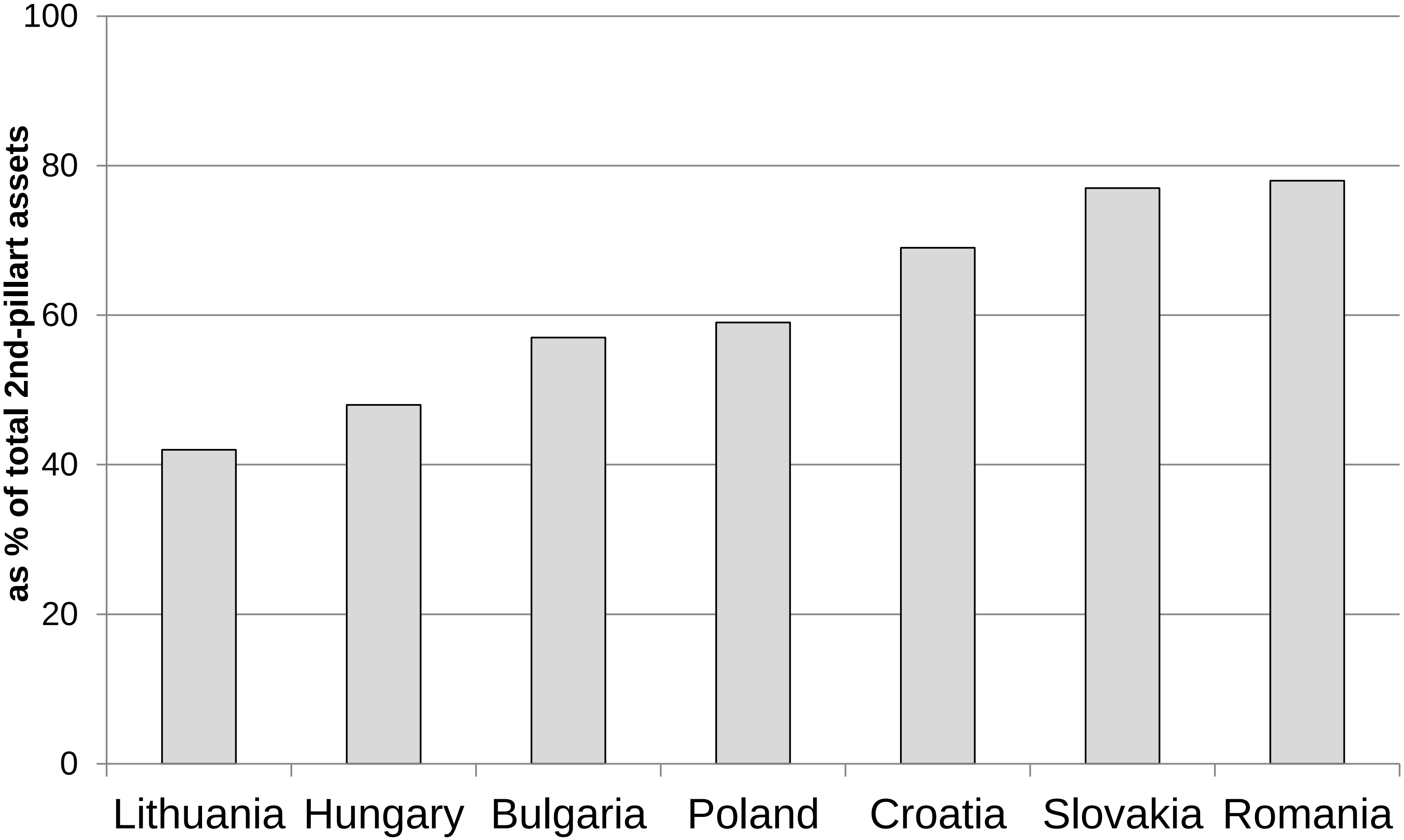
Funding gap: Actual developments



What behind the reversals? Lessons of the first wave

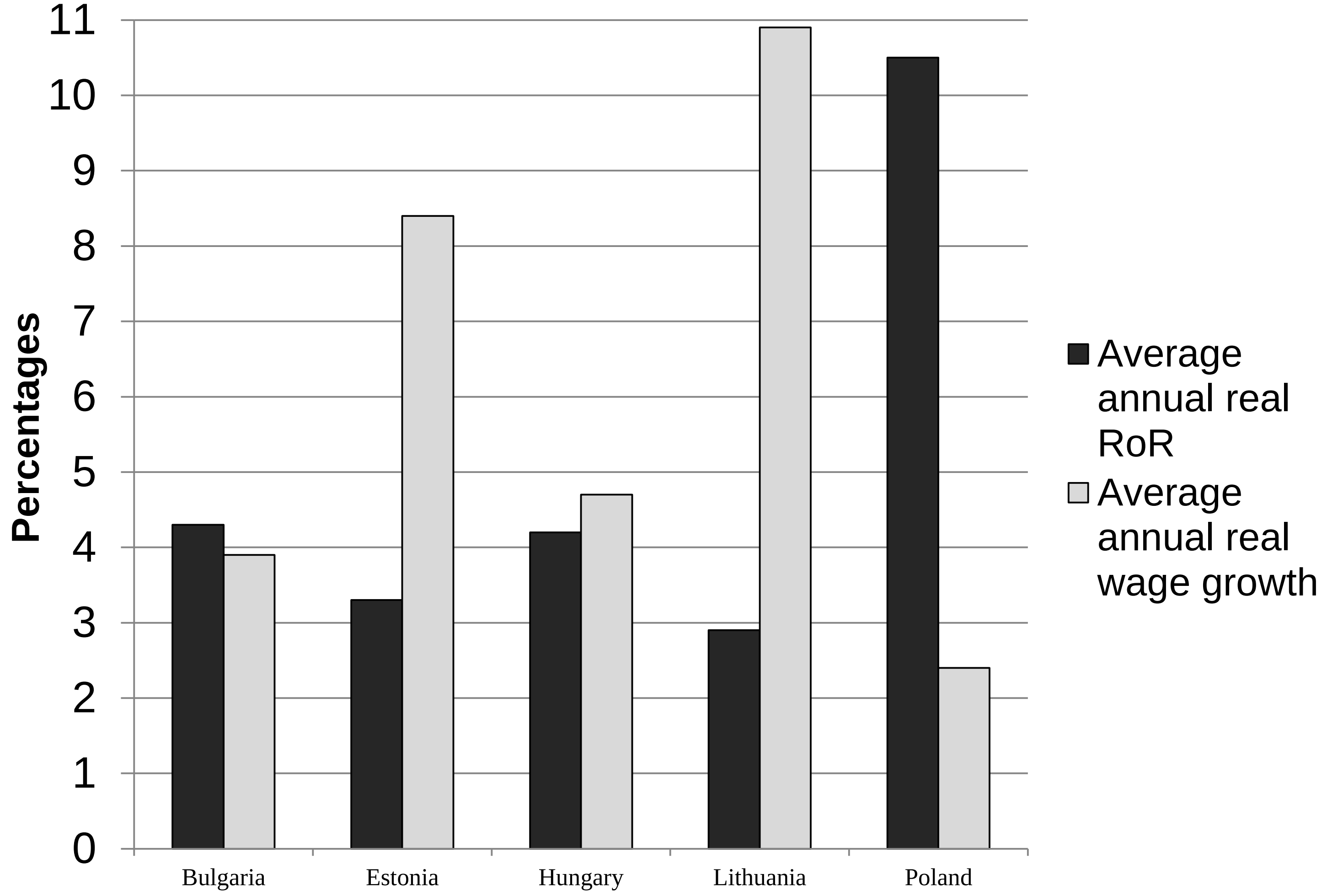
- Clarification of what transition costs actually pay for
  - Theoretical shock when no new generation
  - In practice: ‘only’ for transition to a mixed system
- Explicit and implicit debt equivalent only in the theoretical world of perfect information/rationality
  - Does not apply in the real world: transition costs generate new debt, explicit/implicit debt priced very differently by financial markets
  - Implicit debt theoretical: depends on future policy, not to be actually paid (implicit financing)
  - Explicit debt real: current and real liability, often against non-residents
- More realistic assessment of privatization benefits
  - Higher returns expectation were optimistic (and defeated by bond financing), transaction costs of individual accounts high
  - No evidence of pulling workers from shadow economy
  - Cannot hedge against aging: does not save anything, does not address future output

Share of government securities and bank deposits on total 2nd-pillar assets



Source: data provided by WB staff

Average real wage growth and real rate of returns in the 2nd pillar



Source: data provided by WB staff

The diversification argument: old wine in new bottles?

- Diversification: reducing *risks* by investing in a variety of uncorrelated assets (*micro-level*)
  - but pension system exposed to *macro-level shocks* (not about uncorrelated risks)
- Private pillars not immune to regulatory risks/shocks
  - inflation tax, tax on interest, other regulatory tools, default on bonds, a possibility of nationalization, …
- Actual arguments assume an inability of the state to pay pensions in the future
  - Because of the demographic shock – *back to the old myth of the first wave!*

Conclusions

- Many lessons have been learned
- But the major myth of the first wave still there
- What is left in the diversification argument?
  - A normative bias against collective insurance solutions and the state in general
  - Beyond the scope of positive economics
  - But also not honest

  the ideological quest → fiscal shocks → states apparently cannot deliver → confirmation of the ideological bias