# Time to grow up

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**Pension systems in rich countries are not working properly. They need a radical overhaul, argues Paul Wallace**

IMAGINE a world where you had no direct property right to your most important financial asset, probably worth more than your house; where the value of that asset bore no direct relationship to what you had put into it; and where that asset, and the return on it, was often assigned to you arbitrarily and unfairly.

In fact you don't have to do much imagining at all: the peculiar world of pensions is all around us. To take one example, in America the value of future public-pension payments for a typical household headed by a 65-year-old man is $180,000; but this is not a legally enforceable claim to ownership, as a Supreme Court ruling made clear in 1960. Not that the post-war generations of pensioners in the developed world have been much bothered by such legal niceties. After all, many of them have seen a spectacular return on their contributions, receiving far more in benefits than their due.

One way of thinking about public pensions is as a form of insurance for which you pay premiums while you are working, against the predictable risk of a period without earnings later in life. Such a system of insurance, you would expect, would convert your contributions, together with the interest they earn, into pension benefits in an actuarially fair way. When you retired, your pension would reflect the contributions you had made, plus interest, and the length of time you were likely to spend in retirement, except that a small amount would be deducted to provide a minimum-income guarantee for those who, through illness or misfortune, had been unable to build up enough contributions of their own.

Again, real-life pensions fail to pass this test. Public pension systems do not achieve a reasonable trade-off between actuarial fairness and protection against poverty in old age. What they mainly do is redistribute income from the young (who may be poor) to the old (who may be rich), often in an inequitable way.

Nor do pensions provided by companies come off much better. "Final-salary" schemes, until recently the most common form of private pension, are often just as actuarially unfair as public pensions. Early leavers lose out, whereas time-servers and top managers do disproportionately well.

Pension systems that work so capriciously make little sense at the best of times, and even less in an ageing world. Populations in the West and Japan are no longer pyramid-shaped as they used to be, with a big base of younger people and few pensioners at the top. Instead they are becoming top-heavy, with many more older people both in the workforce and in retirement. Ill-designed pension systems magnify the effect of population ageing by creating incentives for people to retire ever earlier. Unaffordable public-pension commitments threaten the fiscal solvency of many countries in the European Union.

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