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Pension funds: key issues after the global crisis

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Abstract

Pension funds have been playing and will play an outstanding role in the global saving and investment process. However, in spite of the pension funds' power to centralize huge amount of "savings from workers", workers do not seem to have a strong defense against the contemporary worldwide trends. By analyzing the impacts of the global scenario on the savings of workers and the future flows of workers' income, this paper aims to favor a reflection on the pension funds´ challenges after the 2008 global crisis. Unlike the main discussions on the dynamics of pension funds - that considers short-term market performance - our perspective privileges a long-run perspective. The cutting questions proposed are: How could the low interest rate and austerity policies affect the evolution of the workers´ savings? How could the pension funds´ allocation strategies give support to the new short-term business practices of private equity funds? How could the informal economy and youth unemployment affect the future pension funds´ inflows? The paper addresses that it is crucial not only to re-shape the pension funds´ regulation in terms of asset allocation but also to re-think public polices related to job creation. Besides, it is urgent to consider pension funds as a public good to create new conventions and institutional set ups that could cope with solutions focused on sustainable livelihoods.

Introduction

Throughout the last forty years, the huge growth of deregulated finance has been associated to great transformations in the pattern of asset management, economic growth, job creation and income distribution. Most governments in Western countries supported the long-run process of financial expansion that turned out to be characterized as the "financialization" of the capitalist economy (Foster, 2009). However, after the 2008 global crisis, there has been broad recognition that the current operation of the financial markets has not generated sustainable economic growth since the dynamic of the centralized finance capital became increasingly dependent on credit and financial bubbles (Foster, 2009).

Looking back, as Bello (2006) warned, in the 1990s, the Clinton administration embraced globalization as an American strategy. First, this strategy aimed to accelerate the integration of production and markets by transnational corporations. Secondly, it aimed to create a multilateral system of global governance centered on the World Trade Organization, the International Monetary Fund and the World Bank. As a result, global liquidity - that has been stimulated by the evolution of the American monetary policy since the early 1990s - favored the expansion of private capital flows and deepened the interconnections between national financial systems (Chesnais 1998). Accordingly Stockhammer (2009), the "finance dominated" accumulation regime has decisively shaped a pattern of accumulation where low economic growth rates and a high degree of financial fragility have been reinforced by the expansion of global banks and institutional investors. In this scenario, the centralized financial capital increasingly subordinated asset management of pension funds to short-term volatile commitments.

Within this historical setting, the expansion of pension funds' assets – as institutional investors - has been stimulated by the debt cycle and has included risk management practices (Saunders, 1994). By 2020**,** the largest pools of pension fund assets are projected to remain concentrated in the US and Europe. In North America, pension fund assets reached $19.3 trillion in 2012 and PwC estimates that by 2020, pension fund assets will rise by 5.7 percent a year to achieve over $30 trillion of the $56.5 trillion in total global assets, more than 50 percent of the global total.

Indeed, according to the PwC report, *Asset Management 2020: A Brave New World*, demographic changes, accelerating urbanization, technological innovations and shifts in economic power are reshaping the asset management environment where pension funds have been playing and will play an outstanding role in the global saving and investment process. Three key factors seem to stimulate the global growth in assets: i) changes in government-incentivized or government-mandated retirement plans that will turn out to increase the use of defined contribution (DC) individual plans; ii) faster growth of high-net-worth-individuals in South America, Asia, Africa and Middle East regions up to 2020; iii) the expansion of new sovereign wealth funds.

However, in spite of the pension funds' power to centralize huge amount of "savings from workers", workers do not seem to have a strong defense against the contemporary worldwide trends. By analyzing the impacts of the scenario on the *savings of workers and the future flows of workers' income*, this paper aims to favor a reflection on the pension funds´ challenges after the 2008 global crisis. Unlike the main discussions on the dynamics of pension funds - that considers short-term market performance - our perspective privileges a long-run perspective. The cutting questions proposed are: *How could the low interest rate and austerity policies affect the evolution of the workers´ savings? How could the pension funds´ allocation strategies give support to the new short-term business practices of private equity funds? How could the informal economy and youth unemployment affect the future pension funds´ inflows?*

Section 1 underlines the interrelations between financial deregulation and pension funds´ asset management strategies. Considering the financial scenario ten years after the 2008 crisis, Section 2 discusses the impacts of the low interest rate scenario and austerity programs on the asset management of pension funds. Section 3 discusses the relation between pension funds and private equity funds and the challenges to workers. Section 4 analyzes the interconnections between youth unemployment, the growth of the informal economy and pension funds. The final section suggests the need of a reassessment of the policy agenda.

1. Pension funds´ asset management in the context of deregulated finance

The 2008 global financial crisis revealed the inner economic, social and political tensions that have overwhelmed the outcomes of self-regulated markets. The process of financial deregulation has been overwhelmed by new investment and consumption patterns while the government social and infrastructure spending has become restricted by policy rules based on inflation targeting and surplus targets.

In this historical setting, changes in the distribution of income, wealth and power have affected labor and working conditions. As a matter of fact, the interconnections between deregulated credit and capital markets have fostered the growth of pension funds' assets. The other side of the "coin" has shown diminishing workers' savings, increasing household debt, youth unemployment and older people's challenges with retirement plans. Indeed, the current global financial scenario suggests a new articulation among liquidity, investment and labor beyond the reorganization of business and markets (Madi and Gonçalves, 2008).

From the Keynesian tradition, Minsky (1986) warned that financial liberalization brought about new patterns of government practices and business strategies that have affected the trends of investment and job creation.[1] During the last decades, important changes in investment decisions resulted from the increased pressure of shareholders. Managers and owners of firms have come to view their organizations in terms of their short-term financial performance and the firm turned out to be considered as a set of assets which operational divisions might be bought or sold in order to enhance further short-term profits. In spite of the specific growth pattern, the finance-led accumulation regime has presented some distinctive features. A redefinition of the role of the state justified privatization and deregulation in product, labor and financial markets. Changes in macroeconomic policies turned out to focus inflationary targets and undermined the ability of national governments

[1] Under his approach, the investment dynamics is based on the existence of a monetary economy based on credit relations, organized markets of financial assets, speculation and uncertainty. In this economy, there is a set of interrelated balance sheets and cash flows between the income-producing system and the financial structure that is crucial to affect the valuation of the stock of capital assets and the pace of investment.

to decide on budgets and planning in order to favor sustainable growth and employment goals.

In addition to the redefinition of labor and working conditions, changing labor organizing principles coped with the dictates of increasing capital mobility. The declining rate of real investment has been followed by a short-term boost in productivity associated with the extraction of more value with less working hours, besides the increasing reliance on outsourcing, casualization and precarious jobs (IUF, 2008). In addition to subcontracting, outsourcing, temporary jobs and supply chain restructuring have imposed heavy losses to workers, automatic production control, redefinition of tasks, job rotation and crowdsourcing put pressure on labor unions and reduced their strength to achieve collective demands (IUF, 2007). As a result, the workers' savings and pension fund inflows have been reduced. All these trends have affected the evolution of workers' incomes and savings because of the impacts on formal labor markets and retirement plans. Lower levels of formal employment have affected the evolution of pension funds´ inflows and, therefore, outflows of worker's savings.

In the context of deregulated finance, pension funds´ asset management has mainly supported the "status quo", that is to say, the expansion of private money and liquid capital markets (Guttmann, 1998). Considering this trend, the 2008 American financial crisis has been an example of how pension funds were affected by the overall scenario of the financial industry that encouraged speculative strategies dependent on future housing prices, the future price of securitized assets and the renewal of lending operations.

Indeed, housing prices increased steadily from 1991 to 2005. Lending requirements were liberalized and banks managed the capital requirements adjusted to risk management by means of enhancing further securitized assets. In other words, the financial institutions encouraged speculative and Ponzi strategies – also in pension funds´ asset management. Consequently, pension funds´ performance turned out to be mainly dependent on future prices of houses, future prices of securitized assets and renewals of lending operations. However, when the credit boom finished, the pension funds´ asset management turned out to be extremely vulnerable to changes in asset prices, credit strategies and monetary policies. This scenario affected the performance of these institutional investors and reduced the value of the stock of workers' savings in pension funds.

In a context of uncertainty, as Keynes (1936) warned, pension funds are part of a set of financial links where there are interrelated balance sheets and cash flows between the income-producing system and the financial structure. Consequently, pension funds' performance ultimately relies on the endogenous instability of the economic system as asset management is mainly based on precarious conventions.[2] In other words, the performance of pension funds might be affected by the evolution of financial fragility of domestic structures. However, the outcomes of financial instability and its effects on the workers' savings might be dampened by the Central Banks´ interventions as lender of last resort and the higher spending of governments to enhance effective demand and private profits (Madi and Gonçalves, 2008). In this scenario, the management of the "stability of the financial system" is critical to give support to the price of financial assets in pension funds and, therefore, the total value of the workers' savings.

2. Pension funds´ asset management in a context of low interest rates and austerity

As the 2008 global crisis has shown, Central Banks´ actions are not independent from private and public pressures. In this conjuncture, one relevant question relies on how Central Bank long liquidity-driven policies can last and influence the pension funds' strategies and decisions. After 10 years of the global crisis, some central banks continue to maintain monetary stimulus program, boosting asset prices and market currencies, and austerity programs.

[2] The role of expectations and private strategies is crucial in Keynes´ analysis. The principle of uncertainty is based on the idea that the past is irrevocable and the future is unknown. In the capitalist economy, money means the representation of wealth, the link between present and future. Money has a non-neutral nature, or yet, it affects spending and portfolio decisions.

As we already highlighted, the connection between pension funds and speculative finance is one of the contemporary features of the management of working savings. Continued low interest rates would impact the future profitability of pension funds, particularly in those portfolios where income-fixed assets predominate. As a result, the evolution of low income-fixed portfolio performance would stimulate riskier assets in order to improve profitability.

Among other challenges related to the asset management of pension funds is the evolution of austerity programs. Indeed, the aftermath of the 2008 crisis, in some countries of Europe and Latin America, for example, the increasing growth of sovereign-debts has been imposing the adoption of austerity programs that rely on increasing flexibility in labor markets and retirement plans. In this setting, the trends that involve the loss of retirement rights, job destruction, turnover, outsourcing, workforce displacement and longer working hours could also be part of the spectrum of features that reveals how the formal labor markets and the retirement plans have become a key variable in macroeconomic policies.

Considering the European experience, many countries have announced that they will need to make budget reductions in order reduce the public deficit. At this respect, Table 1 shows some of the austerity measures concerning retirement rights and pensions in European countries that include cuts in public sector wages, cuts in social welfare, investment projects reduction, expenditure cuts and tax increases, changes in retirement age and pension payments. These austerity measures might affect the evolution of the real incomes of older people and the retirement possibilities of future generations. Indeed, the future employability and the retirement perspectives seem to be conditioned to strategies that aim public budget reduction.

Table 1. European countries: austerity measures concerning retirement rights and pensions

Country	Measures concerning retirement rights and pensions
United	Raising the retirement age from 65 to 66 by 2020

Kingdom	
Spain	Automatic inflation-adjustments for pensions will be suspended
Poland	Tightening pension requirements (but not raising the retirement age)
Netherlands	Measures will include higher retirement age
Hungary	Measures implemented by the previous government in 2009, include a gradual three-year increase in the retirement age of 65
Belgium	Stalemate in domestic politics after deadlocked elections has paralyzed action on austerity measures. When a new government is formed, it will find proposals on the table for new taxes: on pensions.
Czech Republic	Taxes will be applied to pensions of workers who earn three times the national average wage. More reforms to pension and healthcare are expected to be announced.
France	The pay-as-you-go pension system is being raised by half a year to 41.5 years of required work for full pension; pension contributions from employees' pay will rise to 10.55 percent from 7.85 percent
Greece	The average retirement age is set to rise from 61.4 to 63.5 along with other expected pension cuts.
Lithuania	Pension reforms are expected to be adopted

Source: Pietras (2009)

In truth, many Western governments, under global investors' pressure, should meet budgetary targets and pursue further structural reforms - also related to age and amount of pension within retirement plans. Besides, fiscal policy actions might cut the levels of domestic demand and, therefore, the economic and social crisis might be intensified.

In short, fiscal austerity could become a risky social and political strategy as a tighter fiscal policy could result in even weaker economic growth, higher unemployment, the reduction in worker's real incomes. Indeed, the current era of austerity – and its impacts on retirement plans and job creation - is certainly affecting day-to-day life of older workers and the future of the asset management of pension funds.

3. Pension funds, private equity investments and workers

Accordingly the Uni Global Union survey that covered the large 116 pension funds in the UK, Continental Europe, Japan, Australia and South Africa, the pension funds´ participation in private equity could vary. As of the 2008 global crisis, almost half of the pension funds allocate less than 2% of their assets to private equity, another 35% allocate between 2% and 4%, 16% allocate more than 4% (Uni Global Union, 2008). The highest average allocations were found in the Netherlands, UK and Sweden. However, in all these markets the average allocations were well below the average exposure for US pension plans that achieve nearly 25% (Gonçalves and Madi, 2011).

As Gonçalves and Madi (2011) explained, a private equity fund obtains commitments from investors - also pension funds. In the second stage, the managers identify potential companies to acquire. In the third stage, after the buyout of the target company, the target is to increase its value. The aim is to sell the company at a profit up to 10 years in order to support the expectations of the investors. Under this business model, the private equity managers turn out to consider their companies in terms of their short-term financial performance and they are under pressure to produce results quickly. The *Workers´ Guide to Private Equity Buyouts* clearly explains the short-term investors´ perspective:

"The short-term, unsustainable system of dividend recaps perfectly illustrates the logic of private equity buyouts. Private equity firms buy a company as a financial asset with the potential to generate an instant cash flow to the new owners in the short term. Huge returns are generated through aggressive restructuring to cut costs and by financial reengineering based on large quantities of debt" (IUF, 2007:10)

As private equity managers are committed to short-term profits, the firms of the funds' portfolio turn out to be subordinated to efficiency targets that shape labor relations overwhelmed by longer working hours, job destruction, turnover, outsourcing, workforce displacement and lots of rights. Changes in corporate ownership, through waves of mergers and acquisitions, are part of this new business models where companies turn out to be bundles of assets and liabilities to be traded. As a result, the recent experience of workers has been negative as the asset management strategy of private equity funds is based on short-term financial performance and shareholder value. Indeed, the private equity business model threatens the long-run workers' savings because of job losses, reductions in pay conditions and retirement incomes (Tate, 2007). In this setting, labor turns out to be the main focus of cost saving measures, first through longer working hours, then the abolition of holiday pay and finally through the reduction in the workforce and worker displacement.

As Minsky warned, the financial conception of investment has increased in the context where financial innovations aimed to achieve fast growth with lower capital and labor requirements could be used by managers to favor short-term financial performance (Fligstein, 2001). Taking into this background, it is worth highlighting that the participation of pension funds in private equity investments has supported corporate decisions that have been increasingly subordinated to speculative financial commitments. Therefore, as pension fund managers give support to this kind of management practices in private equity funds, this will certainly affect the evolution of pension funds´ inflows and workers´ savings.

4. Youth unemployment, the informal economy and pension funds

The impact of the 2008 financial crisis was quickly felt in labor markets all around the world. The number of unemployed increased by 38 million in 2009 and the global unemployment rate surpassed 7 percent. Globally, youth unemployment is 3 times as likely as adult unemployment. In truth, youth employment challenges have been deepened by the management of the financial crisis (The Economist, 2011). Besides, in the aftermath of the crisis, the outcomes of austerity policies have also affected the access to work conditions among young people -between 15 and 24 years old. The level of employment and types of labor contracts have turned out to be subordinated to economic efficiency targets aimed at cost reduction (Gonçalves and Madi, 2011). This scenario, characterized by precarious jobs mainly based on short-term contracts, has enhanced the vulnerability of workers, mainly young people in informal labour markets (The Economist, 2011).

The conceptualization of the informal economy focuses on some features of the business dynamics and employment conditions. That is why the definition includes not only enterprises that are not legally regulated, but also employment relations that are unregulated and unprotected, that is to say, employment without any kind of social protection. According to Chen (2007: 236)Ç

"... economic relations – of production, distribution and employment- tend to fall to some point on a continuum between pure 'formal' relations (i.e., regulated and protected) at one pole and pure 'informal' relations (i.e., unregulated and unprotected) at the other, with many categories in between"

In most of the developing countries, the small businesses' challenges have contributed to the expansion of the informal economy. Small and micro-entrepreneurs are usually subject to complex regulatory barriers. Besides, the access to credit is restricted. As a result, micro and small enterprises reveal poor performance in competitive environments, a lower capacity for innovation and a weak international orientation. Among other obstacles to survival and expansion in the formal economy, the costs of starting up a formal enterprise are outstanding in developing countries. Among these transaction costs, we can highlight: i) the number of procedures that includes all necessary licenses and permits and completion of any notifications, verifications or registrations required by the relevant authorities; and ii) business legislation, specific regulations and fee schedules that are used as sources for start-up cost calculation. However, the global scenario reveals that the level of informality is also growing in advanced economies since various forms of informal working conditions have been included in the new global production networks.

Current global transformations in labor markets have also been characterized by the decline in the formalization rate of employment and an increase in the rate of self-employment. In many countries, the decreasing weight of industrial jobs promoted new relations and interactions between formal and informal economy. Today, informal unemployment includes self-employment in small unregistered enterprises, unpaid workers, own account operators and also unpaid work in family businesses. Actually, the total amount of informal workers include: employees of informal enterprises; casual or day workers, domestic workers, temporary or part-time workers; home workers and workers occupied in the context of outsourcing agreements.

In our times, in the developing world, the percent of informal employment was almost 50% of the total in Latin America, nearly 60% in Africa and more than 60% in Asia. These data, from WTO, is considered one of the alternative measures of informality and its evolution shows that there is substantial heterogeneity across the world regions. In African countries, the level of informal employment seemed to have slightly decreased, mainly in urban areas. However, it slightly increased in Latin American countries. Besides, in Asia, the level of informal unemployment rose after the Asian crisis.

In addition to this informal employment indicator, governments try to measure the incidence of informality in production in other ways. For instance, the percent of the informal economy in relation to the total gross domestic product gives an indication as to the low overall productivity in the informal economy. In accordance to the WTO data, the percent of the informal economy (excluding agriculture) in relation to the total gross domestic product, as of 2006, was 37.7% in South Saharan Africa, 30.4% in North Africa, 26.8% in Asia, 25.9% in Latin America, 21.2% in the Caribbean countries and 13.9% in the transition economies.

As a result, the evolution of the informal economy and youth unemployment might certainly affect the evolution of pension funds´ inflows and, therefore, the evolution of the workers´ saving to face the future commitments of pension funds in a context of improvement of life expectancy.

5. Final considerations: reshaping pension funds´ regulation and public polices

The financial crises observed in the last decades give strong reasons to think about systemic problems and the 2008 financial crisis has restated the menace of deep depressions among the current challenges (Foster, 2009). In this setting, the macroeconomic adjustments that privilege fiscal austerity and labor market flexibility can be costly, socially and politically, and will certainly affect the evolution of the assets of pension funds.

Mainly concerned in preventing deep depressions, Minsky (1986) emphasized the need of shaping a thorough agenda of institutional reform so as to control the working of a capitalist economy. Following Minsky, we can say *"finance- and pension funds - cannot be left to the free markets"*. As the organization of economic and social institutions helps to define policy goals and outcomes, his proposals stimulates a reflection on how to promote: a financial reform aimed to favor hedge financing- also in pension funds; an industrial and foreign trade policy that could enhance decent employment goals articulated to the investment decisions of the pension funds. The apprehension of this political and social reality is decisive to enhance alternative government responses that could privilege, for instance, youth issues in the formulation of investment and job creation policies. The attempt to re-focus the policy agenda toward sustainable pension funds' finance is decisive to support an inclusive growth for future generations.

Future research should privilege new perspectives in the analysis of the relationship between pension funds and sustainable growth that could favor a reflection on the outcomes of the financial transformations on economies and societies. Time and space could not be neglected as they shape the possibilities of observation, analysis and intervention to configure the economies and societies where older people and future generations could live. In this attempt, it is crucial to re-shape the pension funds´ regulation in terms of the asset allocation and re-think public polices related to job creation. It is urgent to consider pension funds as a public good in order to create new conventions and institutional set ups that could cope with solutions focused on sustainable livelihoods

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