Notional Defined Contribution Accounts

Neoliberal Ideology and the Political Economy of Pension Reform

By John B. Williamson and Matthew Williams*

Abstract. Notional defined contribution (NDC) accounts represent a new model for social security reform that so far has been adopted in seven countries. While NDC schemes remain public, they call for the individual accounts favored by neoliberal policy analysts. NDC schemes would address many of the demographic and fiscal problems threatening pension systems but, depending on the country, could do so in a way that puts low-paid workers and women at greater risk than do the schemes being replaced. NDC systems are often the result of a compromise between different interest groups, typically between neoliberal economic elites on the right and labor unions or pensioners’ organizations on the left.

I

Introduction

An increasing number of countries are facing crises in their pension systems due to both fiscal and demographic crises (or projected crises). Some aspects of these crises are due to the structure of the pension systems themselves, but others are due to that constellation of phenomena variously known as neoliberalism, globalization, or

*John B. Williamson is Professor of Sociology in the Department of Sociology at Boston College, Chestnut Hill, MA 02167; e-mail: jbw@bc.edu. He is the author or co-author of 15 books and more than 100 articles and book chapters, many of which deal with comparative social security policy and the related debate over privatization. Matthew Williams is a Ph.D. student in the Department of Sociology at Boston College, Chestnut Hill, MA 02167; e-mail: willibhi@bc.edu. He has been a research assistant at the Center for Retirement Research at Boston College and has an interest in political economy, social movements, and globalization. The authors wish to thank the following people for their assistance: Stephanie Howling, Giuseppina Chiri, Jenna Nobles, Shari Grove, Catherine Sigworth, and Laurence Moss.

free market reforms. Most countries have responded to such crises either by reforming their existing public pension system, by privatizing it, or by some combination of these strategies. A small number of countries—as of this writing, seven—have adopted a third approach to pension reform, creating notional defined contribution (NDC) accounts. Although an NDC scheme is still a public social insurance system, it nonetheless is consistent with neoliberalism’s ethic of individualizing costs and the curtailment of social welfare programs. Many have argued that privatization is the wave of the future. We ask whether NDC systems might eventually displace privatization as a pension reform strategy.

The policy analysis in this article draws on the political-economic perspective. We use the term political economy as it is commonly used in sociology, where the term has a different meaning than the one common in the field of economics. As used by sociologists, “political economy” refers to the examination of the intersection of state, economic, and ideological power, with a focus on class conflict and compromise; here, we consider how this affects pension policy. Gaining a sense of the balance of these forces will allow us not only to evaluate the impact of NDC systems on different segments of the population, but also how likely the model is to spread to other countries. Our political-economic analysis does not focus solely on domestic factors, but takes global forces into account as well.

In particular, we consider the effects of neoliberalism, which we here understand in a dual sense, as both an ideology (a term we use in a neutral, technical sense) and an emerging global economic structure, the two of which are dialectically related. The advocates of neoliberalism as an ideology emphasize economic deregulation, the curtailment of the welfare state, and market solutions to social problems; as a structure, neoliberalism involves the transformation of the global market in a way that increases the power of certain social actors, such as transnational corporations and investors, intergovernmental organizations such as the International Monetary Fund and World Bank, and the leading industrialized nation-states—the United States, Japan, and the countries of Western Europe. We recognize that most of those we refer to as “neoliberals” would most likely not call themselves such and that the term reflects a left-of-center normative
orientation. We feel, however, that alternative terms, such as “free market reformer,” are also normatively loaded and that the term “neoliberal” best reflects our own orientation. Further, “neoliberal” is a term commonly used by sociologists and, albeit much less frequently, by economists and political scientists.

II

The Structure of NDC and Other Pension Schemes

During the post-World War II era the most common old-age security model around the world has been the public, unfunded (or partially funded), pay-as-you-go defined benefit (PAYGO DB) model (Social Security Administration 1999), but privatized, funded defined contribution (FDC) individual account schemes have become increasingly common with the rise of neoliberalism. A PAYGO DB system (such as we have in the United States today) essentially works through paying for the pensions of today’s recipients with contributions of today’s workers, who will be recipients tomorrow. PAYGO DB schemes are funded through a payroll tax on workers’ earnings and on their employers. Workers’ future pensions will be calculated based on their contributions during their working life, sometimes the whole span, sometimes their final years or the years when they earned the most. Their eventual pensions are not directly proportional to their contributions, and there is typically some redistributive mechanism through which some of the contributions of higher-paid workers are redistributed in ways that favor lower-paid workers. Nor are the contributions saved for the workers; instead they are used to fund the pensions of those who have already retired. The pensions of current workers will, in turn, be funded by the contributions of those still working when the current workers themselves retire (World Bank 1994). The problems these schemes face are in part due to the retirement of the “baby boom” generation, which creates a situation in which the number of people receiving pensions is disproportionately high in comparison to those currently working and funding the pension system.

In the past, FDC retirement savings schemes fell into one of two categories: (1) provident funds and (2) voluntary, private, and
occupational pension plans. Provident funds are publicly managed FDC schemes with individual accounts, adopted by a number of former British colonies in Asia and Africa soon after independence (Gillion, Turner, Bailey, and LaTulippe 2000). The shift toward the neoliberal model of privatized FDC schemes began in 1981, when Chile became the first country to fully shift from a PAYGO DB scheme to a mandatory FDC scheme as part of the Pinochet regime's widespread implementation of neoliberal policies. During the 1990s, a number of other countries, primarily in Europe and Latin America, shifted from a PAYGO DB system to either a totally FDC system or, more often, to a mixed model that includes both an FDC element and a PAYGO DB element (Kritzer 2000; Social Security Administration 1999; Williamson 2001). The mechanics of privatized FDC schemes are fairly straightforward. A number of private pension funds are permitted and regulated by the government. Workers may choose between them, but by law they must invest a certain proportion of their earnings in one of them. The company managing the pension fund then invests the money in a variety of financial instruments, usually including private sector stocks and bonds. The company typically makes its profit by charging administrative fees. When workers retire, they use the assets accumulated in these accounts to purchase an annuity that pays a lifetime monthly pension based on how much is in the pension account at the time of retirement (Kay and Kritzer 2002; World Bank 1994).

Almost all countries that have mature PAYGO DB systems in place are or will be facing problems financing these schemes due to one or more of the following issues: program maturation, population aging, reductions in the rate of productivity growth, competitive pressures linked to globalization, or the transition from a command to a market economy. However, policy-making elites have a choice about how to address these problems. As neoliberalism has increasingly become the dominant ideology among the economic elite in many countries, these elites have more and more often called for greater emphasis on neoliberal economic policies (Hicks 1999; Huber and Stephens 2001). Many neoliberal public pension experts have been calling for a shift from an existing PAYGO DB scheme to either a FDC scheme or a mixed PAYGO DB and FDC system as the best solution
to the expected financing problems many pension systems face (Fox and Palmer 2001; Holzmann and Stiglitz 2001).

During the mid-1990s, however, pension policy experts in Sweden designed yet another model based on the concept of notional or virtual accounts—the notional defined contribution (NDC) model. Although the NDC scheme was first designed in Sweden, because of the lengthy political process needed to reach agreement on it, some other countries actually implemented it before Sweden (Gichon 1999). NDC schemes have been or are in the process of being introduced in Sweden, Italy, Poland, Latvia, Russia, Mongolia, and the Kyrgyz Republic.

The NDC model remains public and pay-as-you-go but, like an FDC scheme, it calls for individual accounts and is, in many ways, consistent with neoliberalism. The NDC model contains a number of provisions designed to create a much closer link between contributions and benefits (Gichon 1999). As with PAYGO DB schemes, funds from payroll taxes are used to finance pension benefits for those currently retired. Where the NDC model differs from a PAYGO DB scheme is that in the NDC model an individual notional (virtual or unfunded) account is set up for each worker. This NDC account is then credited (without any funds actually being deposited) for that portion of payroll taxes (including the contributions of both employee and employer) used to pay pension benefits to current retirees during the person’s working years. The worker’s own NDC retirement benefits will be directly linked to these payroll contributions. Unlike the PAYGO DB system, there is no explicit mechanism for redistribution in the payout formula.

Although an NDC scheme does not represent the full-scale privatization that neoliberals generally advocate, NDC schemes are nonetheless consistent with the ethos of neoliberalism in important ways (Esping-Andersen 1996a). Although the system remains public, redistribution is greatly reduced as benefits are tied more closely to contributions. Some of the risks associated with the funding of old-age pensions are shifted from the central government to individual workers (Myles and Pierson 2000). Thus an NDC model replicates in pay-as-you-go form the nonsolidaristic logic of individualism implicit in the FDC model favored by many neoliberals (Barr 2001).
While an analogous scheme based on the FDC model would earn a rate of return based on trends in capital markets, the notional accounts in an NDC system earn rates of return based on wage and productivity indicators, such as changes in wages, GDP growth, or the wage sum (the cumulative total of all wages in the country subject to the payroll tax) (Bender and MacArthur 2000; Brugiavini and Fornero 1998; Castel and Fox 2001; Chłoń-Domińczak 2002; Disney 1999). During retirement, NDC pensions are indexed in ways that take into account changes in the standard of living (wage increases) or, more frequently, inflation (price increases) (Castel and Fox 2001; Chłoń-Domińczak 2002; Hamann 1997; Palmer 2001).

In addition to the NDC system itself, there are other elements in most NDC schemes, such as a minimum pension, that must be taken into consideration in an analysis of the scheme’s overall policy impact and its role as part of a larger reform strategy. Although the NDC model does not by itself involve much, if any, redistribution, the need for at least some redistribution can be met by the inclusion of a minimum or flat pension, often financed in part or entirely from general government revenues rather than payroll taxes. The minimum pension acts as income insurance for workers who would not otherwise receive adequate NDC pension benefits due to low wages and/or irregular work histories. The minimum pension is typically means-tested for other sources of pension income and only available to workers when they reach a specific eligibility age. In many countries, this eligibility age is lower for women than for men. Many countries also require payroll tax contributions for a specified period of time, ranging from five to twenty years, in order for workers to be eligible for the minimum pension (Bender and MacArthur 2000; Cichon 1999; Fox and Palmer 1999; Sundén 2000). In Sweden, the minimum pension is quite generous, but in the other countries with NDC systems it tends to be very modest (Cichon 1999).

Another way in which most NDC schemes accommodate redistribution is through provisions that grant notional credit to certain categories of workers for time spent out of the paid labor force. For example, some nations grant credit to those individuals who are receiving unemployment insurance benefits or who are college students. During these periods, the government contributes to the
pension system out of general revenue on behalf of the worker, whose NDC account is in turn credited for those contributions. While not all governments cover every employment contingency, nearly all governments with NDC schemes grant some notional credit to parents, usually mothers, for time spent out of the labor force providing child care. The size of the credit each year and the number of years a worker can receive credit varies from country to country (Castel and Fox 2001; Disney 1999; Fox and Palmer 1999; Fultz 2002; Myles and Pierson 2000; Palmer 2000). Thus, despite their individualized character, NDC schemes are not devoid of all elements that socialize the costs of supporting elderly retirees.

III

The Political Economy of Pension Reform

Most countries that have implemented NDC schemes have done so as a response to a combination of factors, including fiscal and demographic crises (or projected crises), the rise of neoliberal ideology, structural constraints arising from globalization, and the resistance of labor unions and pensioners’ organizations to implementing an FDC system. In this section, we will engage in a political-economic analysis of how these factors interact with each other. Our analysis has been particularly influenced by the school of political economy known as world-systems theory.

Very briefly, in world-systems theory, the entire global economy (also known as the capitalist world-system) is taken as the basic unit of analysis. Nation-states are not seen as autonomous entities but as tied together in a single, unequal division of labor. States are divided into three categories—core, semi-peripheral, and peripheral. The most powerful states are the core states—the developed, industrialized, or “first-world” nations—that are able to exercise power within this system because their capitalist class is relatively unified and they have historically developed a strong state apparatus (administrative bureaucracy, military, etc.). Peripheral states—the developing or “third-world” states—are characterized by a capitalist class suffering from severe internal divisions and a weak state apparatus. This leaves the peripheral states open to exploitation by the core states, which
use their greater wealth and military power to exploit the labor and natural resources of the peripheral states for the advantage of the core-state capitalists (and often middle classes), albeit frequently in alliance with sectors of the peripheral elite, either capitalists or government officials. Semi-peripheral states fall somewhere in between, both exploited by core states and exploiting peripheral states in their turn (Wallerstein 2000).

Among those who are the chief advocates of neoliberal reforms are the top officials of transnational corporations (TNCs), usually citizens of core states; of intergovernmental organizations (IGOs) like the World Bank, where core state policymakers have disproportionate influence as a result of the voting structure, and the European Union (EU), until recently a federation solely of core states; and of national governments. In the last case, support for neoliberalism tends to be stronger among the officials of core states, while there are more divisions in peripheral states. People's beliefs are usually shaped by their location in the social structure in such a way that their material and ideal (or ideological) interests (Weber 1946) tend to coincide, although this is not a rigidly deterministic process. As Mills (1956) and Bourdieu (1984) have both implicitly argued, people's interests, both material and ideal, are shaped by the social networks within which people are embedded and through which they are socialized. Knowledge, whether in the form of a political ideology or a social scientific theory, is therefore never socially neutral but is shaped by the knower's location and experiences within such networks (Collins 2000; Smith 1987). Thus, neoliberal ideology tends to reflect the material interests of those who embrace it, for the simple reason that they are basing their political beliefs on their own experiences as members of the elite—or, at the very least, the very affluent—and the experiences of those they know, who also tend to be members of the elite. Like most people, advocates of neoliberalism assume their interests are universal, something that unfortunately is often not the case, as we will see with pension reform.

The World Bank, for instance, tends to take its lead in policy prescriptions from the International Monetary Fund, which has established close ties to the transnational finance corporations through the rotation of high-ranking personnel among them; thus, their policy
prescriptions reflect the material and ideal interests of transnational investors (Stiglitz 2002). World Bank pension reform experts are among those most supportive of FDC and NDC schemes as an alternative to PAYGO DB systems. Both FDC and NDC schemes reflect the ideal interests of transnational investors because the schemes are consistent with the neoliberal ethic of individualizing costs and limiting the redistribution of resources. FDC schemes fit in with transnational investors’ material interests quite straightforwardly: under such schemes, workers’ pension funds come under the control of financial corporations and are invested in the stock market, bonds, and so forth. This also contributes to the sort of “business-friendly” environment preferred by transnational investors and corporations. NDC schemes are a somewhat more complicated matter and are favored where conditions make it difficult to immediately implement a full-blown FDC scheme, as we discuss below.

In their efforts to implement neoliberal policy reforms, including FDC or NDC pensions systems, different social actors, both individual and collective, face two major types of structural constraints. The first relate to the institutions existing in the specific country where they are trying to enact reforms (although other neoliberal reforms may be implemented through international trade agreements, pension reform remains a country-specific task). The second type of structural constraints is the result of social actors’ location within both the world-system and the various organizations, such as TNCs, IGOs, and nation-states, that make up the world-system.

One of the principal constraints that existing institutions in a country create is the degree to which it is realistically possible to implement the FDC schemes usually favored by neoliberal pension policy experts. Many peripheral nations (including both those of the traditional “third world” and those of the former Soviet bloc) do not currently have the financial infrastructure to support a substantial FDC scheme. In this context, neoliberal reformers often see a mixed-model system, with a substantial NDC component and a modest FDC component, as a first step in the evolution of a pension system that could contain a substantial FDC element (James 1999a). An NDC system, combined with a smaller FDC system, could help ease the transition to a scheme that will eventually put the emphasis on the FDC system.
The initially modest FDC system would foster the development of the financial institutions and markets needed to support a major FDC system a few decades hence. This is, for instance, actually the stated goal behind the recent pension reforms in Mongolia (Bender and MacArthur 2000; Hulan 2000).

To turn to the structural constraints created by social actors’ location within the world-system, TNCs and IGOs have the most room to maneuver. TNCs, though usually based in a core state, can invest in those countries where they find conditions most favorable. In an effort to attract investment by these corporations, national governments are under enormous pressure to tailor their social policy to meet the needs and desires of these corporations, such as minimal taxes and nonrestrictive labor laws. In many cases, this means cutting social spending, including pensions (Scarbrough 2000). For example, as Swedish corporations have become increasingly oriented toward the global market, they have felt less need to compromise with the domestic labor movement and have grown less supportive of welfare state programs. By ending centralized bargaining with the Trades Union Confederation—the blue-collar union—corporate employers were able to undermine its political clout, setting the stage for the retrenchment of Sweden’s welfare system (Stephens 1996), one aspect of which was pension reform.

IGOs also have increasing power to define the structures of the world-system and to place constraints on national governments. In Western Europe, the EU has increasingly limited what is possible in the arena of domestic policy. Italy, for instance, adopted its NDC scheme as a result of the constraints created by the Maastricht Treaty, which required Italy to halt the growth of public debt as rapidly as possible—which essentially meant large cuts to the welfare system (Ferrera and Gualmini 2000). Even though it was not committed to becoming a member of the EU, Sweden also found itself bound by Maastricht to enact austerity measures (Huber and Stephens 2001).

Multilateral lending IGOs have played a large role in the neoliberal restructuring of the welfare states of those peripheral nations that had been part of the Soviet bloc (Standing 1996). The World Bank in particular has played an important role in promoting both NDC and
FDC schemes. Many of the countries in question are in debt to the World Bank, which puts it in a position to strongly influence social policy. Even in the case of countries that do not owe debt, the Bank’s approval or disapproval of policy can still be very important. It is very difficult for countries to get loans from private transnational banks if the World Bank does not consider their policies to be economically sound. The World Bank is also one of the few organizations willing to make advice on pension reform readily available to financially struggling peripheral governments. In the case of Poland, the World Bank actually funded their pension reform agency, which was headed by a World Bank official on temporary leave (Müller 1999, 2000a, 2000b; Orenstein 2000).

Neoliberal elites within national governments have less room to maneuver than do those in transnational corporations and IGOs. It is here that we can see most clearly the interaction between the constraints created by the world-system and local institutions and politics. Usually some faction of the national elite, such as the social democrats in the core states of Italy and Sweden or the ex-communist parties in former Soviet bloc countries, has an electoral base in groups such as labor unions or pensioners’ organizations that oppose anything other than reforms to the existing PAYGO DB scheme, while another faction is more aligned with those transnational actors supporting neoliberalism. In many such cases, for any reform at all to take place, some sort of compromise has to be devised in which labor unions and other grassroots interest groups feel that they have had input (Myles and Pierson 2000).

These negotiations took slightly different forms in Italy and Sweden than in the former Soviet bloc nations that have implemented NDC schemes. In Italy, the first Berlusconi government (in 1995) tried simply pushing pension reform through without negotiating with the labor unions. A massive strike resulted and the government was forced to back off. In contrast, its successor—the Dini government—negotiated directly with the labor unions and was able to enact legislation putting the NDC system into place (Ferrera and Gualmini 2000; Myles and Pierson 2000). In Sweden, the pension reform process was initiated by a four-party center-right governing coalition. Although they did not deal directly with the labor unions, the Social
Democratic Party, which has its electoral base in the Trades Union Confederation, was included in the committee that designed the new pension system (Myles and Pierson 2000; Palmer 2001; Sundén 2000).

The political situation in much of the former Soviet bloc is less clear-cut. Although in most of these countries there was initially strong support for a transition to a market economy, support for the preservation of existing welfare state programs was also strong. Disagreement with the more extreme forms of inequality engendered by neoliberal reforms is now widespread (Standing 1996). Political parties often represent conflicting social interests; both left-wing and right-wing parties may include populist factions opposing the privatization of the pension system and elite neoliberal factions supporting it (Orenstein 2000). In Poland, for instance, the left-wing parties included social groups like the ex-communist labor union that opposed privatization and a liberal leadership that favored partial privatization as a way to save the pension system; the right-wing parties included both pro-free-market factions supporting privatization and populist ones opposing it. The ex-communist union was persuaded to support the mixed NDC-FDC system in part by being given the right to set up some of the new private sector pension programs (Orenstein 2000; Müller 1999). Political parties in Mongolia represented a similar mix of contradictory interests. When one faction of the then governing Democratic Union Coalition put forward a proposal for total privatization that would simply wipe out current pension obligations, it was forced to withdraw the proposal in the face of popular opposition. The NDC scheme was eventually settled on as a compromise between those supporting neoliberal reforms and those preferring to emphasize the social welfare of workers (Hulan 2000). In both cases, the compromises had to be made not just between parties but within parties.

IV

The Potential Consequences of NDC Schemes

As noted above, because neoliberalism is rooted in the structural position and life experiences of members of the elite of the world-system,
it tends to reflect their interests. In this section, we will examine the likely consequences of NDC schemes for society’s most vulnerable members.

In most cases, a transition from a PAYGO DB system to an NDC or FDC system is only considered because the former is in crisis. The NDC model is better able than the PAYGO DB model to deal with demographic shifts, particularly the shift from larger to smaller age cohorts due to decreased fertility. The NDC model is also better suited to deal with macroeconomic fluctuations, such as declines in wages, productivity, and the rate of economic growth. The existing NDC schemes incorporate a variety of mechanisms to keep retirement benefits and payroll tax revenues in balance. In addition, by incorporating life expectancy into the pension annuity formula, most NDC schemes automatically adjust for this source of population aging (Williamson 2004).

Although a balance between payroll taxes coming in and benefits being paid out is important, the impact of pension reform on income redistribution is also important. Some critics of the NDC model (e.g., Müller 2000b) argue that it may undermine the social insurance aspects of existing pension systems in ways that go beyond the reduction in the amount of income redistribution. As described earlier, NDC schemes are often paired with FDC schemes with the intent to gradually shift the emphasis from the NDC scheme to the FDC scheme. A mixed-model system with such a structure could create future policy constraints that will eventually lead to near full privatization of the pension system. Partial privatization tends to undermine public pension systems both politically and financially as more and more money is diverted from the public to the private system (Müller 2000b). Although narrowly targeted forms of redistribution do remain with most NDC schemes, they tend to be more costly to administer and more politically vulnerable than more universalistic forms of redistribution (Esping-Andersen 1996b). With the exception of the Kyrgyz Republic, all countries that currently have NDC systems either have or are planning to create a system of FDC accounts, although in some countries it will be mandatory and in some optional. Even if the extreme of full privatization is not reached, the focus on financial stability and individual responsibility present in NDC schemes is
likely to lead to less focus on redistributive goals (Valdés-Prieto 2000). Over time, it is possible that we might see cuts in the redistributive mechanisms that generally accompany NDC schemes.

Another negative effect of the shift from a PAYGO DB scheme to an NDC scheme is that unless it includes a generous guaranteed minimum pension, there will typically be more income inequality among pensioners as a result of the shift. Low-wage workers, in particular, will tend to be worse off under an NDC scheme than under the prior PAYGO DB scheme, due to the lack of redistribution inherent in the NDC model. A low-income worker is likely to fare better even under reforms (such as increasing the payroll tax or the retirement age) of the prior PAYGO DB system in part because of the redistributive nature of most PAYGO DB schemes.

An NDC scheme will generally provide good income replacement (something in the range of 50 percent of pretax earnings) for workers who have contributed for at least 40 years (Fox and Palmer 1999). However, for many rural workers, women, irregular low-wage workers, and those who spend much of their working lives in the informal economy, the number of years of contribution will be far less than 40 years. Given the current economic climate, workers with low wages and irregular work histories or workers who have worked mostly in the informal sector are likely to grow more common (Cichon 1999). Many of these workers will depend upon the guaranteed minimum pension for all of their retirement income. Some, if not many, of these workers would have fared better under a reformed PAYGO DB scheme than under the new NDC scheme.

As a whole, women, particularly low-wage and single women, would typically fare better under a reformed PAYGO DB scheme than under an NDC scheme. Women, due in part to the dual responsibilities of child and elder care, often have irregular work histories, earn less, and have shorter employment histories than their male counterparts. As a result, women receive less in the form of pension annuities and can be more at risk for poverty in old age. In fact, in Sweden, which has a relatively generous minimum pension, most women will not earn enough to get more than the minimum pension (James 1999b).

Under the NDC model, women can also be disadvantaged by
provisions that discourage early retirement. Women in Latvia, for instance, who retire at 55 will receive pension benefits that are 25 percent lower than those received under the previous PAYGO DB system (Fox and Palmer 1999). Similarly, women in Poland who cannot afford to delay retirement until 60 will be penalized by a pension that is half of that afforded to individuals who do remain in the workforce until 60 (Fox 1997). Because women are often responsible for caring for young children as well as for ailing spouses and parents, it is difficult for many to match the typical length of a man’s work history, and they face greater pressures to retire early. Moreover, because they live longer than men on average, if women retire at an early age they will have to bear the burden of a lower pension benefit over a longer time period. Women who retire early thus potentially face many years of poverty (Fox and Palmer 1999; Castel and Fox 2001). In some former Soviet bloc countries, such as Latvia and the Kyrgyz Republic, early retirement is often a short-term survival strategy. By retiring early, women may be eligible for at least some pension income, which can be very attractive when their family is very near the economic margins and they are needed to care for parents, children, or other family members or when they are unable to find paid work (or do the work that is available). Many poor women in these countries are simply not in a situation to plan ahead for the time when they will no longer be able to find paid work (Castel and Fox 2001).

Despite these drawbacks from the perspective of low-wage workers and women, there are circumstances under which a shift from a PAYGO DB to an NDC scheme can be beneficial. The shift to an NDC scheme is typically part of a set of reforms that have the effect of reducing the level of public spending on pensions for the elderly. In nations in which public spending on old-age pensions is crowding out social spending for other vulnerable groups, the shift to the NDC model has benefits that offset much of any decrease in benefits to the elderly. In Poland, for instance, both the contribution rate under the old PAYGO DB system and the implicit pension debt were so high (31 percent of payroll and 220 percent of GDP, respectively) that they essentially precluded most other forms of social spending (Hausner 2001).
NDC schemes are likely to be a good deal less vulnerable to fluctuations in the financial markets than are FDC schemes. As described above, the rate of return in NDC schemes is generally linked to some relatively stable economic indicator, such as changes in wages or GDP growth. The rate of return in FDC schemes, on the other hand, is tied to wherever the money is invested, frequently the stock market, which is far more volatile, especially in peripheral countries. While the potential gains may be greater under an FDC system, so are the potential risks—and most people are risk averse (Orszag and Stiglitz 2001). Workers will be better able to predict the size of their pension under an NDC system than an FDC system and thus be better able to plan for their futures. They will also be less vulnerable to stock market crashes.

Because they are administered by the government rather than by a number of private companies that must make a profit, the administrative costs for NDC schemes are actually likely to be lower than in FDC schemes. This is partly a result of economies of scale. Under an NDC system, the administration of the accounts is centralized in the hands of the government. Under most FDC systems, the administration of the system would be dispersed among many competing firms, each dealing with many individual accounts. In the peripheral nations a substantial fraction of these accounts are likely to be quite small. In addition to the loss of economies of scale, administrative costs increase in an FDC scheme because of the need for advertising and other additional costs resulting from competition. Under an FDC system, administrative costs are deducted from workers' contributions; based on the experience of the United Kingdom and those Latin American nations with FDC accounts, these costs can amount to a substantial proportion of the worker's contribution in the case of small accounts, thus harming low-wage workers disproportionately (Kay and Kritzer 2002; Orszag and Stiglitz 2001).

No complex system is immune from corruption, but it seems as though FDC schemes are more vulnerable to it than NDC schemes. Many workers, particularly those from less affluent backgrounds, have a poor understanding of the mechanics and varieties of private investment (Orszag and Stiglitz 2001). This, combined with both the need of pension firms in a competitive market to attract as many clients
as possible and the payment of sales representatives by commission, resulted in a "miss-selling scandal" in the United Kingdom in the early 1990s. Seeking to sign up as many clients as possible, sales representatives misled workers about what pension plans were in their best interests, leading many to put their pension contributions into schemes that actually provided a much poorer rate of return than they could have obtained elsewhere. This sort of problem can be reme- died only by greater government regulation, which again results in higher administrative costs (Williamson 2002).

Given all these factors, from the perspective of the most vulnera- ble, it makes the most sense to reform a PAYGO DB system, assum- ing it is salvageable and is not eating away at other forms of social spending. If it is not salvageable, an NDC system with a generous guaranteed minimum benefit remains a better alternative than an FDC system. Labor unions, pensioners' organizations, and left-of-center political parties, therefore, have had good reason to oppose the implementation of FDC systems and push for either the reform of PAYGO DB systems or, at the very least, the creation of NDC systems as a compromise measure.

V

Conclusion

It is difficult to say how rapidly the NDC model will spread. It is one of several possible responses to the fiscal and demographic problems that many countries face. Since it has generally been imple- mented as a compromise measure between those social forces sup- porting and opposing neoliberalism, it may become more common when and where resistance to neoliberalism grows stronger. Although it is too soon to predict, it seems possible that FDC schemes may become less popular as time goes on. More countries may come to implement NDC schemes, either when their PAYGO DB schemes are no longer viable, or when they face external pressures from social actors like TNCs and the World Bank to enact neoliberal reforms while facing internal opposition from left-of-center political organizations.

The NDC model seems most likely to continue to spread in the
countries of the former Soviet bloc in Eastern Europe and Central Asia, as well as in other former command economies around the world. For example, a mixed model system that includes an NDC component and a FDC component is currently being introduced in Russia (Afanasiev 2003; Ivanov and Stroutchenewski 2003). China has also introduced a multicomponent scheme that includes what is formally an FDC element but actually turns out to be a quasi-NDC element, with the amount contributed recorded in individual accounts, but with the actual funds then being diverted to pay pensions to the currently retired (Williamson and Zheng 2003). These nations in transition from command to market economies face pressing problems with their pension programs. Many have mature PAYGO DB schemes that, at least on paper, promise pension benefits far more generous than their economies can support. In some countries in Central and Eastern Europe the number of workers contributing to pension schemes has been shrinking rather than increasing in recent years (Fultz and Ruck 2001; Orenstein 2000). The main cause is that many older workers have been forced into retirement because of the lack of jobs in the new market economy. In some of these nations, falling fertility rates are also part of the problem (Fultz and Ruck 2001). Both of these trends point to a dependency burden projected to worsen in the years ahead. In many of these nations, policymakers have had to make deep cuts in promised benefits (Orenstein 2000). NDC schemes offer a way to address these problems that is consistent with the neoliberal model advocated by the World Bank and other creditor organizations, while meeting some of the objections of labor and pensioners' organizations.

In the years ahead, NDC schemes may become common among other peripheral nations as well, especially those that currently have mature PAYGO DB systems. Many such nations face serious fiscal, demographic, and political pressures. Unlike FDC schemes, the NDC model does not require a well-developed infrastructure of financial markets and related institutions. Many of these nations are in debt to the World Bank, which uses this leverage to push for neoliberal reforms, while they also face a growing resistance to neoliberal policies from internal social movements. The NDC model could provide a middle path for peripheral nations under pressure from the World
Bank and TNCs to privatize, but without the financial markets or administrative infrastructure to do so. Thus we may see more of NDC schemes in the future.

References


