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MONEY WISE

RETIREMENT PENSIONS – ARE THEY A RIGHT OR A LUXURY?

Firstly there is good news and bad news. The good news is that improvements in healthcare and lifestyle are likely to extend our lives some 10 to 20 years beyond what we could expect 50 years ago. The bad news is that for many people in the world the extra years will be years of hardship or even abject poverty.

Hardship and poverty are no strangers to most people in the developing world. Some, however, will actually see life in old age improve over that of their parents. These are the lucky ones in countries that have moved rapidly forward and recognized the part social welfare can play in modernizing their societies.

What pensions will Indonesians enjoy?

Sadly, for the majority who work in the informal sector or who are unemployed, a pension will remain a dream. Retirement as such has no meaning. For decades government employees have enjoyed pensions but relatively small ones and subject to loss of value in face of inflation. In the private sector, when I first came to Indonesia in the 1980's, a 'pension' universally consisted of a single lump sum payment linked to salary and length of employment. This was paid on the last day of employment and in most cases, no matter how substantial the sum, there would be little or nothing left after a few weeks. I recall how one former oil company employee traced me years later begging for help as he was completely destitute. This unsatisfactory situation is slowly being replaced by more and more real pension schemes.

But many Westerners will find it harder going

Over 60 years ago the UK became the envy of the world when it provided free healthcare for all and pensions to men over 65 and women over 60. The model assumed adults would contribute throughout their working lives and that people would live just a few years into retirement. Much of Europe followed, some countries providing even more generous benefits. But as life expectation moved into the 70's and now the eighties the model is no longer sustainable.

Western governments are desperately trying to reduce the benefits but are meeting staunch opposition from social groups, unions and workers.

Corporate pensions under pressure too

One of the greatest benefits of working for a large company was the expectation of a pension based on final salary and years of service, further boosted by annual increments to match inflation. Companies could comfortably fund a pension scheme by making contributions of perhaps 5% to 10% of salaries. Here again the old model has been destroyed by changing demographics and made even worse by market factors. During the golden days of rising stock markets a large portion of funds would be invested in stocks. The growth was such that companies could often reduce or even suspend their contributions. But after a series of stock market crashes fund managers took fright and moved heavily into safer bonds.

The problem is that bonds now offer very low returns so that companies have to make much larger contributions to honor their commitments to retirees. For some large companies like General Motors and British Airways, their generous benefit packages of the past have come back to haunt them in the form of huge pension fund liabilities. In the UK it is estimated that over 80% of company pension schemes are underfunded. For many companies the burden is such that it affects their share price and competitiveness in the market.

But corporations have found a solution

For future retirees most companies have now abandoned the provision of ‘defined benefits’ which guaranteed pensions related to service and salary and replaced them with ‘defined contribution’ plans where the contribution is fixed but the value of the benefits is not. This means that investment risk is passed from the employer to the employee. At the end of the day the pensioner is not only likely to be worse off than under the old regime but it will also be more difficult to plan ahead since pensions will depend on the vagaries of the markets.

Private pensions have also taken a hit

Those who have made additional efforts to preserve a decent standard of living in retirement by way of investing in personal pension plans have also been disappointed by the performance of such schemes. In the past twelve years markets have moved very little and scheme charges, quite reasonable during the good years, have become more burdensome. Investors who gave up on their plans would have fared even worse through penalties. It can be strongly argued that making the effort to save is better than not saving at all but the end result can be below expectations.

Will things get better or worse?

On the face of it, things are going to get tougher as shrinking workforces struggle to support an ever-growing number of retirees. But if governments, corporations and especially individuals take the right steps all is not lost. What steps? We can look at these next time.

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