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Why People Don't Choose Private Pensions: The Impact of 'Contagion'

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Abstract

Pension privatisation requires that people exercise choice. They might have to choose whether to opt out of a public scheme into a private scheme, or whether to supplement public pension contributions with private pension contributions. If they do choose to participate in a private scheme, they are likely to have to choose how their savings are to be invested. This paper looks at whether people are happy to opt for private solutions, and particularly, how well disposed they are to saving for old age in private, equity-based, funds. It suggests that the experience of poor stock market performance, provider failure, counter-intuitive decisions by regulators and the working of means-testing rules frighten people off voluntary participation in private pension schemes. Whether justified or not, negative experiences can be contagious. Evidence from the USA, Germany, Sweden and the UK is offered to support this assertion.

1. Introduction

Most governments, both in the industrialised world and beyond, and many commentators and analysts, argue that the only way of ensuring that people have an adequate level of income in retirement is to get them to make more provision for themselves whilst they are working. If the state can no longer levy the taxes required to finance adequate pensions on a 'pay-as-you-go' basis, 'funding' is the appropriate response. In most cases, 'funding' is synonymous with 'private funding', either via collective funds sponsored by an employer or group of employers or, increasingly, via individual accounts. Whether collective or individual, funding implies choice in ways that state systems do not. Participation in schemes is often voluntary; the level of participation, and the form it takes, is also voluntary. However, making the appropriate choices is widely considered to make substantial demands upon individuals. Products are said to be too complex, whilst the information supplied about them is said to be opaque. Over and above this, the level of financial literacy is widely accepted to be too low to enable people to analyse the requisite data, even if these data were presented more transparently. Lastly, there is plenty of evidence that people are myopic, and have very high discount rates, so that pension saving is given low priority. For all these reasons, individuals, left to choose on their own, are likely to under-save or to save inappropriately. This leads to proposals for choice to be curtailed, and even the advocates of choice to suggest that 'libertarian paternalism is

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not an oxymoron' (Sunstein and Thaler, 2003).[1]

This paper is concerned not with whether people should have their choice constrained by a benevolent state, nor with whether, and if so how, they can be educated to make better choices. Rather, it is concerned with whether people wish to participate in private pension schemes based upon funding. In particular, it is concerned with whether people find this way of financing retirement too risky for them to contemplate with equanimity. Accordingly, it looks at the extent to which people are happy to choose funded pensions, both those where they are required to be active managers of their savings and those where their savings are managed by another and their role is largely passive. In doing so, its principal interest is with the factors that discourage people from choosing private, funded pensions, and with the way changes in the environment in which private pensions operate impact upon people's willingness to embrace the funded approach. The 'environment' in question includes the economic environment, which is taken to include the way in which investments are performing, the extent to which companies and institutions in which savings might be invested and, more specifically, the extent to which pension providers themselves are considered as deserving of trust. It also includes the political environment, especially the extent to which safeguards offered by governments to people participating in private pension systems are seen as satisfying popular expectations.

The ways in which changes in the environment make people less willing either to favour private pensions at all, or, where these exist, to participate in private pension schemes, are the subject of this paper. Adverse changes in that environment can have a greater impact than, *prima facie*, appears justified. A particular event might undermine the confidence of a particular group of people, but it might have far wider consequences in that it provokes a wider lack of confidence. In this respect, its impact is 'contagious'. The term 'contagion' has been much used by international financial economists to describe the domino effects resulting from failures in individual economies or sub-systems of these economies. Other economies, or sub-systems of an economy, contiguous with, or perceived as sharing some of the characteristics of the initial economy or sub-system, are treated in the same way as that initial economy or sub-system. Confidence in them falls; investors desert them. This happens whether or not the lack of confidence is deserved, or is deserved in full. The concept of 'contagion' provided the basis for analysing the South-Asia financial crisis of 1997. Analysis of this and succeeding 'crises' was couched in terms of 'spillover' and 'flight to quality' (IMF, 1999). It was also much used in the period following the collapse of the energy trader Enron, where commentators were concerned with 'fallout' and 'guilt by association' (Gleckman, 2001). Insofar as stock market falls, accounting scandals, provider failures, or perceived shortcomings of regulators or government policy can provoke a loss of confidence in private pension provision, they, too, can have 'contagion effect'. They can engender scepticism and taint the credibility of such an approach to the financing of old age, either because they call into question some of the precepts upon which it is based, or because they reveal weaknesses of key actors or institutions. Linkages are made, whether or not they are entirely applicable, and conclusions are drawn, whether or not they are entirely valid.

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1. The argument here is that, whilst choice should be available, it should be constrained. In the case of pension provision, people might be able to opt out of the public scheme, but the latter should be the default. Equally, within a private scheme, less risky portfolios should be the automatic recipients of contributions, unless the worker explicitly chooses an alternative.

The paper draws from experiences in the USA, the UK, Germany and Sweden. With respect to the first country, opinion poll data on public attitudes to privatisation over the last five or so years are examined. With respect to the other countries, the extent to which, and the ways in which, people have participated in the private pension schemes that have been introduced in recent years is reported and discussed.

2. The impact of 'contagion' in the USA

Instances of individuals having a direct choice between private provision and public pension provision are relatively rare. In most cases, private pensions are taken out on a voluntary basis, in addition to a public pension in which participation is mandatory. In the UK, where, since 1988, it has been possible for workers to choose how they make contributions to the mandatory supplementary pension system, attempts can be made to influence that choice – substantial incentives were offered to encourage people to choose a 'personal pension' rather than stay in the 'state earnings-related pension scheme' (SERPS).[2]

Rather than considering actual outcomes in cases where playing fields are not level, it is more useful to look at hypothetical outcomes where people are asked their preferences concerning how pension systems might best be organised. There is considerable evidence about how very different approaches are rated by the population when the case of the USA is considered. By the second half of the 1990s, there was much discussion of the desirability of legislating to allow, or to oblige, American workers to switch all, or part, of their mandatory pension ('social security') contributions into a pension system based upon funding.[3] Whilst this discussion sometimes referred to collective funding (allowing the social security 'trust fund' to invest in equities), in many cases it referred to individual funding – in other words, to the construction of something like a 'Chilean' system. In the run-up to the 2000 presidential election, the Republican candidate and subsequent President, George W Bush, acting under the advice of Martin Feldstein (see, for example, Feldstein, 1998) who has long advocated such a reform, included proposals for the establishment of individual, funded accounts in his manifesto.

2.1. An analysis of opinion polls

People's attitudes to this kind of privatisation were measured in opinion polls on numerous occasions. Whilst the results of such surveys showed that Americans had doubts about the ability of the public pension system to meet its obligations, they also showed that concerns about the risks attached to equity investments meant that they were less than fully convinced of the merits of a system based on private accounts (for examples, see Zogby *et al.*, 2003 especially Table 2). Moreover, perceptions were not constant over time (see, for example, the tables in Association of British Insurers, 2003). Sometimes people were more doubtful about the sustainability of the public system; sometimes they were more doubtful of the ability of a privatised system to

2. In the early years, the contribution rate for those choosing the personal pension option remained at 5.8 per cent, but a mixture of subsidy and tax relief meant that, effectively, nearly 8.5 per cent was contributed to their savings accounts (see Disney and Whitehouse. 1992).
3. Advocates pointed to the superior rates of return available on equity investment, relative to the notional rate of return available under the public pension system in a period when the working population was growing slowly.

deliver an adequate pension. There is little doubt that differences in perception were influenced by the intensity of political debate, and the extent to which one approach – usually privatisation – was being advocated. It is also probable that the external environment, and in particular, the extent to which one or the other system was assessed as capable of performing, influenced attitudes. Thus, the publication of projections for the Social Security budget, showing the date by which the Trust Fund would be exhausted, might well have produced greater uncertainty about the public system's sustainability. Equally, precipitous falls in the stock exchange were likely to reduce confidence in the privatisation option. In practice, the stock exchange is a more visible indicator.[4] Social Security projections are made relatively infrequently, and they are seldom widely read. Rather, they are absorbed into the political debate and influence the language used there. Moreover, such projections are normally used to illustrate the precariousness of the public system, rather than to underline its strength.

The extent to which Americans' attitudes to the privatisation of pensions depended on the economic environment can be shown using responses to questions of the form:

> 'Do you favour or oppose allowing individuals to invest a portion of their Social Security taxes in the U.S. stock market?'

This question is 'neutral' in so far as it neither refers to the risks attached to funding nor comments upon the sustainability of the public social security system. It has been posed, with minor variations, by pollsters at irregular intervals over the period from February 1998 to January 2003. The findings from these surveys were regressed on a measure of stock market performance – the Standard & Poor's 500 index – and on an additional variable that was specially constructed to see if there was any change in behaviour after the collapse of Enron in October 2001.[5]

A cursory examination of the data showed that, over time, people became both less favourable to privatisation and more opposed to privatisation.

DIAGRAM 1 HERE

The results of the preferred regression model investigating the impact of the stock market index and of the Enron collapse on opposition to privatisation is given in Table 1.[6] The model explains nearly half of the changes in opposition to privatisation.[7]

TABLE 1 HERE

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4. According to Association of British Insurers (2003), some 60-70 per cent of American adults pay 'some' or 'a lot' of attention to what happens in the stock market.
5. Details of the data are given in Annex 1.
6. Modelling was done with respect to opposition to funding. This was because an expression of opposition is a stronger response than an expression of support. Surveys can suffer from what is termed 'acquiescence response bias' – the tendency to agree with any assertion, regardless of its content. One reason for such acquiescence is that, often, respondents think only superficially about an offered statement and do so with a confirmatory bias – i.e., there is an inclination toward agreeing (see Krosnick, 1999).
7. A graph showing the actual level of opposition and the level of opposition predicted by the model is included in Annex 2.

The Table shows, first, that there is a significant, negative relationship between the level of the stock market and opposition to privatisation. In short, as the stock market index fell – as it was doing from late 2000 until early 2003 – opposition increased. On the basis of the model, it seems as if every ten per cent fall in the S&P index led to rather less than five per cent rise – or a 1.7 percentage point rise in the level of opposition.[8] Between September 2000 and January 2003 the S&P index fell by about 40 per cent.

Second, the Table shows that, in the 'post-Enron' period, this reaction was more pronounced. The coefficient on the S&P index is the sum of the two coefficients – i.e., it went from 0.687 to 0.737. The impact of a fall in the stock exchange on opposition was exaggerated by about seven per cent.[9]

Last, the Table confirms that there was a steady rise in opposition across time. The positive coefficient on the time variable is also strongly significant. Over the five years under investigation, even if there had been no change in the value of the S&P index, and no Enron collapse, opposition would have increased by nearly 19 percentage points from its initial 29 per cent.

3. Examples of 'contagion' in Europe

Within those European countries where private pension systems have been introduced on a voluntary basis, there has been concern about low levels of take-up. In the case of Germany, take-up of the 'Riester pension' fell well below aspirations. This pension, which became available at the start of 2002, offered workers the opportunity to compensate for the step-by-step cuts in the public pension that had also been legislated. Subsidies were offered to those who chose to participate in the scheme. Initially, the government had expected that between two thirds and three quarters of those eligible would open a private pension account within the first year (Mesa-Lago and Hohnerlein, 2003). In fact, it appears as if no more than one in ten have done so – sufficient to prompt not only the government, but also representatives of the insurance industry, to suggest that compulsion might be necessary.

Equally disappointing has been the take-up of 'stakeholder pensions' in the UK. These became available in spring 2001 and were a component of the government's efforts to encourage lower paid people to make some supplementary provision for their old age. However, not only has the target group been missed, in that only some 40 per cent of the stakeholder plans opened were opened by such people, the absolute number of plans started has been much smaller than hoped. The number of individual

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8. This finding is in stark contrast to the assertion of the Cato Institute – a 'liberal' think tank that is an advocate of privatisation. This argued that:
9. There is no correlation between support for individual accounts and stock market performance. The growing support for individual accounts in the late 1990s was not a result of the bull market. Recent declines in stock prices have not significantly diminished support for individual accounts. (Zogby et al, 2003, p1)
10. This finding contradicts the assertion of another liberal think tank – the American Enterprise Institute. There, the argument was advanced that:
11. Neither the stock market's ups and downs nor Enron's collapse appears to have changed attitudes about privatization. (Bowman 2002)

plans opened fell off almost continually after the first few months, and a substantial share of these were not plans opened by new savers but plans opened by people seeking to transfer their pension savings from a 'personal pension' scheme they had opened earlier. Moreover, at least 80 per cent of the collective stakeholder plans – those 'designated' by employers – have yet to receive any members (Association of British Insurers, 2003).

3.1. The impact of stock market declines

In addition to product complexity and consumer myopia, one reason frequently put forward for the low take-up of private pensions in Germany and the UK has been the falls in equity markets that occurred in the post-2000 period. In the case of Germany, between early 2000 – when the Riester pension was being heavily debated in the media – and the end of 2002 – by which time people had had to register a policy to obtain the subsidies available for that year – the DAX stock market index fell by about 40 per cent. This was even more profound than the fall in the S&P 500 index (of about 20 per cent) over the same period.

In the UK, a number of consumer surveys have shown concern about scheme performance, or the state of the financial markets, acting to discourage participation in pension plans. Since these surveys have been 'one-off', and have posed different questions to different people, results are not comparable across time. Nevertheless, one conducted in spring 2003 found over half of 'financially active' adults claiming to be less confident about pension and equity-based products than they were two or three years previously, and over half of these cited falling stock markets as a reason for their loss of confidence (Consumers Association, 2003, p.16).[10]

Some indication of how market performance can influence actual behaviour can be seen in Sweden. The Swedish pension reform of the late 1990s established individual, funded accounts on a mandatory basis – the 'PPM' scheme. Workers have to place 2.5 percentage points of the 18.5 pension insurance contribution into an individual account. They can allocate their contributions across as many as five funds from the initial 450 or so to the present 700 or so that were available. Those who do not wish to be 'active' participants, or do not know how to choose, allow their contributions to go into a 'default' fund under the social security system – the 'AP7' fund. The AP7 fund managers are required to meet a performance target – over a five year period, the return on monies invested must both at least equal the average for all the funds in the 'PPM' system and be less volatile.

Those people who were already in the labour market had to make their investment decisions in late 2000. In the previous months, world stock market indices had been climbing rapidly. Some two thirds of workers opted to invest actively, and only one third chose the 'default' fund. However, almost immediately after the decision had been made, markets started to decline. By late 2000, the loss of value across all active funds was of the order of 40 per cent. For funds that had invested in new technology stocks, it was yet greater. In subsequent years, new entrants to the social security system shied away from active investment. Table 2 shows this.

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12. 'Financially active' adults were those who owned one or more of the following products – a current account, a savings account, a pension or shares or bonds. They made up about 86 per cent of the adult population.

TABLE 2 HERE

3.2. The impact of 'scandals' and ' provider failures'

In Germany, one reason that has been adduced for the low take-up of the Riester pension was that consumers had begun to question the viability of the life insurance companies that were selling the relevant policies. In late 2002, a survey of holders of life assurance policies found more than two thirds doubting that their assurer would survive the next ten years (Dünn and Fasshauer, 2003). These fears soon came to be realised. In spring 2003, the solvency of one major life insurer came under the spotlight.[11] It proved not to be a single case. According to the 'stress tests' set by the financial regulator (BaFin), at that time, nearly two thirds of the life assurance sector risked insolvency if capital market weakness persisted. Recognition of the contagious effect of this is to be found in the comments of two analysts (see Financial Times, 2003a). Thus, one remarked:

> 'It is difficult to persuade people to buy a private pension from a life assurer if half a dozen of its peers have just gone into bankruptcy.'

The other, commenting on the low take-up of the Riester pension said:

> It's already total chaos. More bad news is the last thing we need.

Such contagion might apply to the UK, too. Concern has been expressed about the 'with profits' funds that underpin most endowments and pension savings plans in that country. Not only were such funds regarded as singularly 'opaque'. In a world where equity markets had ceased to deliver the exuberant growth rates promised to investors, such funds had, for some years, been failing to deliver the capital repayments for housing mortgages. This had led to providers coming under investigation for 'mis-selling'. Now, it became clear that stock market falls were threatening pension promises. Private pension providers were closing for new business.[12] By summer 2003, some two thirds of life companies with 'with profits' funds, together responsible for one third of all money so invested, had closed to new business (Financial Times, 2003b). In a consumer survey of spring 2003, one in three of those who admitted to having lost confidence in investing cited 'mis-selling' and/or lack of trust in pension providers as one of the reasons for their having done so (Consumers Association, 2003 16).

In the UK, contagion related to provider behaviour has taken several other forms. In the two years to spring 2003, up to 60 per cent (weighted by membership) of final salary, 'occupational' pension schemes had been closed to new members and a further 10 per cent had been closed completely. Whilst most of the employers concerned did not cease pension sponsorship completely, they replaced their defined-benefit schemes with defined-contribution ones. Awareness of demographic developments was one factor prompting this behaviour. So, too, was a wish by employers to have certainty in the costs of pension provision. New accounting rules, which required

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13. This was the Mannheimer Leben, which finally closed for new business in June 2003
14. A recent case is NPI, one of the subsidiaries of the troubled Australian AMP. Closed funds are obliged to move out of equities to secure their liabilities with bonds, but this reduction in equity holdings lowers the profits that might be made in the longer term, so reducing the attractiveness of the fund to current investors and, possibly, and despite exit penalties, precipitating their withdrawal.

pension funds to 'mark to market' and declare their fund liabilities directly in their balance sheets rather than in annexes, have also been cited as an explanatory factor. However, in a country where it is not unusual for 'occupational' schemes to maintain some 70 per cent of their assets in equities, many employers were motivated by the severe fall in equity markets. Companies were required to make good major shortfalls from current profits – a situation sharply different from that of the late 1980s and 1990s, when many schemes were in surplus and the sponsor was able to take a contributions 'holiday' and, thereby, boost profits.

Whilst most of the reports on scheme closures appeared in the quality and specialist press, awareness of them 'drip fed' into the public consciousness. Occupational pensions had, traditionally, been viewed as much more secure than personal pensions, particularly since they had had strong government support and an implicit guarantee. The 'Maxwell affair' of the early 1990s might have dented confidence, but it had involved malfeasance and had provoked legislation intended to prevent repetition. The causes of scheme closure in the last two years have been of a different order. They underline how vulnerable pension savings are to stock market performance. Scheme closure is likely to have been contagious. It reduced faith not only in occupational pensions but also, more generally, in pension savings. According to the spring 2003 consumer survey, some one in ten of those who admitted loosing confidence cited occupational scheme closures as contributing to their having done so (*ibid*).

3.3 The impact of 'government' failure

In the UK it was not only scheme closures that were reducing confidence in the security of occupational pensions, company bankruptcies were revealing that defined-benefit schemes might offer almost nothing to members who were not yet retired. Legally, these schemes are required to protect the pensions of retirees, but this means that if the scheme is under-funded, and the sponsoring company is insolvent, the accrued savings of active members – including any assets they might have transferred in from a previous pensionable employment – can be called upon for this purpose. The number of people who, as a consequence of such bankruptcies, have lost all or much of their retirement savings is relatively small, but the repercussions of such events have been, potentially, much larger.[13] Successive governments have encouraged participation in occupational pension schemes – indeed, until 1988 membership of a scheme, where it existed, was obligatory as a condition of employment – and have claimed to regulate them to protect members' rights. Failure to do the latter, plus reports of affected workers marching in protest over their 'stolen pensions', is likely to have an impact upon people's attitudes.

The contagious affect of a perceived failure of regulation has been heightened by the publication of the latest judgment with respect to the role of the supervisory authority (the Financial Services Authority) in handling the case of the implosion of a major

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15. Some 40,000 people – up to 0.2 per cent of active members of defined-benefit schemes – are said to be so affected.

provider of personal pensions.[14] The losers in this 'affair' argued that the regulator, in the knowledge of the provider's questionable status, had allowed it to continue to take on new business. Those who had entered under such circumstances maintained that they were entitled to compensation from the regulator. Yet in this they had no success. The supervisory authority pleaded *caveat emptor*, and its argument was upheld by the ombudsman. The latter, in its report, highlighted what it describe as 'the apparent mismatch between public expectations of the role of the prudential regulator and what the regulator could reasonably be expected to deliver'. It continued:

> It was never envisaged by those who framed the legislation establishing the regulatory regime that it would provide complete protection for all policyholders. The emphasis was on a 'light touch' approach to regulation and the avoidance of over-interference in a company's affairs. (Parliamentary Commissioner for Administration, 2003, Part 1, para 10)

Whatever the legal validity of such an argument, it is hardly likely to inspire consumer confidence.[15] Not only was any trust in pension providers dealt a blow. So, too, was trust that, where people followed government exhortations to take responsibility for their retirement, they would receive support when things, through no fault of their own, went wrong.

Whilst cases of 'failed' (as opposed to merely 'closed') pension schemes, and of 'counter-intuitive' decisions by bodies established to investigate maladministration, are instances not so much of market failure but of government failure, they are at least as deleterious. Just as likely to discourage pension savings as a lack of faith in regulators is people's concern about whether, even if they have successfully saved, the government will reward them for having done so. In the UK, retired people on low incomes are eligible to claim social assistance.[16] Those who have a small private pension often gain no advantage, since the existence of this income merely reduces the amount of social assistance to which they are entitled or, if their private pension is substantial enough, disqualifies them from receiving social assistance altogether. Those who have built up financial assets are likewise disadvantaged. Beyond a certain level, these assets are assumed to yield a nominal (and high) rate of interest, and the hypothetical income from assets reduces their entitlement to social assistance. In short, those who can only save a small amount for retirement are strongly discouraged from doing so. Admittedly, a new 'pension credit', operative from autumn 2003, will allow a small amount of supplementary income to be ignored, but

16. The specific case was that of Equitable Life. This company had sold annuities and guaranteed an annuity rate that, in current markets, was extremely costly to honour. Its attempts to withdraw from its obligations had ultimately been disallowed as breach of contract, but as a 'mutual' (i.e., owned by its policy holders), the only means it had to meet its promises was the accounts of those without guaranteed policies, leading the latter to suffer severe reductions in the value of their savings.
17. The regulator, itself, has repeated this argument in a number of documents it subsequently produced (see, for example, Financial Services Authority, 2003 and Sergeant, 2003).
18. For pensioners, this is the so-called 'minimum income guarantee'. Until 1999, low income pensioners, were covered by the same means-tested income support scheme as all other residents.

at best it will reduce the marginal tax rate on income from savings from 100 per cent to 40 per cent, and for some, it will remain as high as 91 per cent.[17]

There is every indication that, even if people are not aware of the details of means-testing, they are aware of its underlying principles. Older people compare their situation with those of friends and neighbours. They see who has received what, and how those who have tried to save come out little or no better off than those who have been profligate. Such experience is contagious. In the UK, it is one more explanation for the failure of many with lower incomes to take out stakeholder pensions. Pension providers in that country are also conscious of the impact of means-testing. Like private individuals, they know that the relevant rules can be changed at quite short notice. They are increasingly wary of doing business with lower income people for fear that, later, they might be open to accusations of 'mis-selling'.[18]

4. Conclusions

This paper has found evidence to suggest that, over and above any sense of inability to cope with making decisions about pensions, many people simply do not want to participate in a pension system where they are obliged to accept a high degree of risk. It might be that people do not expect full protection – the same consumer survey that testified to a 'contagion effect' also showed a degree of ambivalence in this respect.[19] However, it is equally clear that people can be frightened off making pension savings, or making an adequate level of such savings, by their perception of the risks involved and of the extent to which governments are able, or willing, to protect them from these risks in a way they consider adequate.

If this is the case, campaigns to educate people so that they are better prepared to shoulder the 'responsibility' to make their own retirement provision that governments are placing upon them might well be irrelevant. Indeed, they could even have a perverse effect, since the more people learn, the better they can see the impact of financial market volatility upon their retirement incomes. Equally, initiatives undertaken or planned by governments to encourage people to save by regularly informing them of the pension entitlements they have accumulated to date and, thus, of their likely retirement incomes, might be misplaced.[20] Not only do these initiatives fail to recognise that people place little value on rather abstract projections of a rather distant future, they also fail to recognise that confronting people with failures – as

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19. The 91 per cent rate obtains for those who are also eligible for assistance with housing costs and the payment of local property taxes (House of Commons, 2003, paras 47ff). Moreover, those who have failed to accrue a full basic pension – as have many women currently of, or approaching, pension age – will still face a rate of 100 per cent, since income bringing them to that basic level will not count towards the 'credit' (Altmann, 2003).
20. In addition, providers are critical of the value of the rebate offered to those who 'contract out' of the supplementary state pension into a stakeholder pension. They argue that, under current assumptions about annuity rates, earnings growth and account management charges, the likely pension will be considerably lower – perhaps 14 per cent lower – than that which the state supplementary pension would offer (AXA, 2003).
21. Thus, whilst some eight out of ten of the 'financially active' feel people should be able to claim compensation if they have been given wrong advice, nearly seven out of ten think that it is up to the individual to make sure that the financial product they purchase is appropriate for them (Consumers Association, 2003, p.29).
22. The best-known example is the Swedish 'orange envelope', but similar 'statements' are to be found elsewhere, including Germany (from 2004) and, in a more limited fashion, the UK.

would a ‘statement’ showing that accrued assets this year, despite the contributions that have been paid over the last twelve months, are lower than accrued assets were last year – might well act to discourage them further. Such ‘statements’ could have a contagion effect in their own right.

Lastly, the whole discussion of choice is predicated upon a misguided assumption that privatisation can somehow solve the projected pensions ‘crisis’. As has been eloquently argued by others (for example, Barr, 2002), the proponents of such a strategy ignore the aggregation problem and fail to recognise that, *ceteris paribus*, funding merely changes the way in which transfers are made; it does not reduce the level of transfers occurring. ‘Demographic time bombs’ can better be defused not by introducing choice into systems of retirement provision but by increasing the propensity of older people to work. The kind of ‘choices’ that need discussion in this context are those that people make with respect to when and whether to leave employment. They are affected by the level of income people can access if they cease work, but they are also affected by the attractiveness of work to them, by the availability of flexible forms of retirement and by whether their effort, skills or experience is being sought by those who employ labour. Policy makers and policy analysts might better concern themselves with the challenge of improving opportunities for older people to choose work rather than retirement and with improving their abilities to choose how to pay for their retirement.

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Tables and Diagrams

Diagram 1. Opinion about privatisation of social security via individual accounts (% favouring and opposing) and US stock market performance (S&P500)

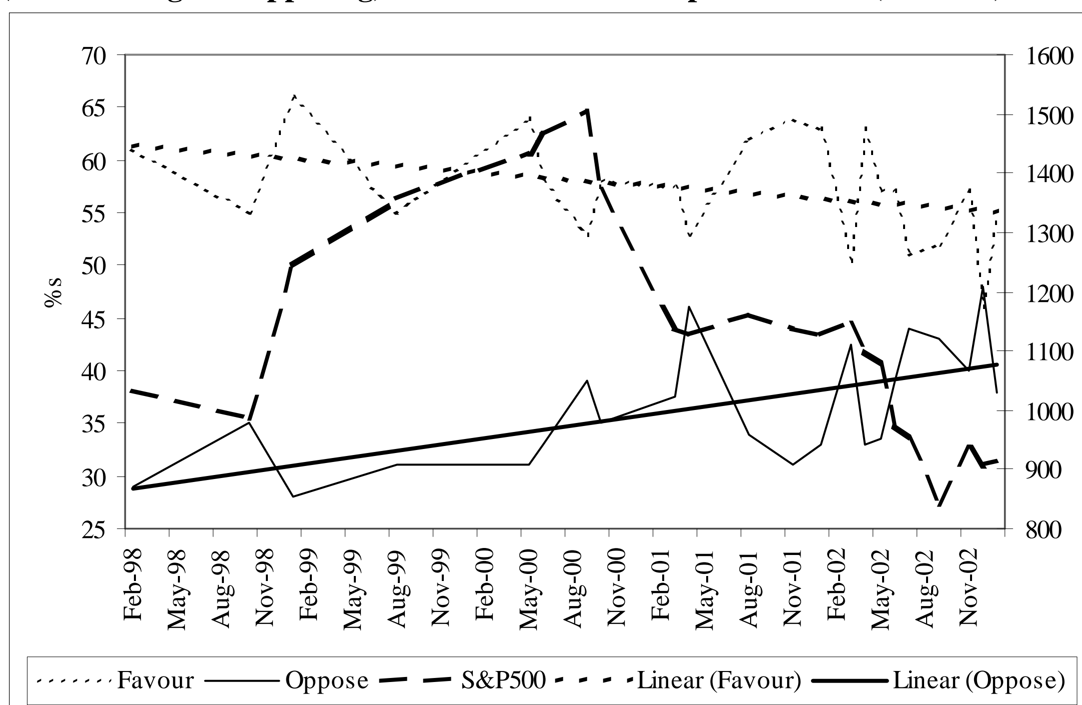


Table 1: Results of preferred regression

odds of being opposed (logged)	coefficient	standard error	t statistic	probability
time	0.0137862	0.0037757	3.65	0.002
S&P500 (logged)	-0.6869134	0.2989288	-2.30	0.034
S&P500 and Enron	-0.0495208	0.0210460	-2.35	0.030
constant	3.8912820	2.1249330	1.83	0.084

adjusted R-squared = 0.4932
Durbin-Watson statistic (4,22) = 1.294499 (lower and upper critical values for acceptance of null hypothesis: 0.96 and 1.80)

Table 2: Extent of 'active' participation in the Swedish PPM system and selected performance indicators				
time	**share choosing to be 'active'**	**characteristics of people making any choice**	**index of all PPM 'active' funds, end previous December**	**% change in S&P500 in 3 months to end Dec.**
initial decision – for start of 2001	approx. 67%	all ages (current workers) but approx same % for young people	100	
starting spring 2001	approx. 18%	mainly young people (new entrants)		-10.0
starting spring 2002	approx. 14%	ditto	88	-8.6
starting spring 2003	approx. 8%	ditto	63	-17.4

Note: 'Active' means not relying upon the 'default' fund but picking funds one's self.
Source: personal communications from PPM, PPM, DAX and S&P websites

Annex 1: Data used

The opinion poll data used referred to broadly neutral questions of the form:

> Do you favor or oppose allowing individuals to invest a portion of their Social Security taxes in the U.S. stock market?

The questions and data were reported in a Cato Institute publication (Zogby *et al.*, 2003) and by the American Enterprise Institute (Bowman, 2003). Additional opinion polls were collected by a web-search, and these were used to bring the latest observation to January 2003 rather than July 2002.

In some cases, there were considerable gaps between one poll and another; in others, the polls took place within days of one another or within the same month. In the latter cases, the results were averaged. In total, there were 22 used observations. Surveys had a margin of error (at 95% confidence) of about three percentage points or fewer.

The polls were not all taken by the same organisation, and different pollsters used slightly different questions. This means that, at least at the margin, responses are not directly comparable one with another. In the Cato Institute's initial data set, the results of one poll where the question asked was sufficiently different from the others – it could be described as a 'leading' question – the observation was dropped for the purpose of the analysis undertaken in this paper.[21]

The stock market index chosen was the Standard & Poor's 500 index. The closing price chosen was that of about five days before the first day on which the opinion poll was carried out. The idea was to allow any one stock market value time to settle in. Day to day fluctuations are normally sufficiently small that measurement error cannot

[21] The relevant question, and that in the two polls carried out almost simultaneously, is shown in the table below.

poll details	question	privatisation	
		supported	opposed
July 10–11, 2002; 1,003 adults, CNN/Time Poll	Do you favor or oppose allowing individuals to invest a portion of their Social Security taxes in the U.S. stock market?	50	43
July 11–15, 2002; 1,512 adults, ABC News/Washington Post	Would you support or oppose a plan in which people who chose to could invest some of their Social Security contributions in the stock market?	52	45
July 9–15, 2002; 1109 adults, Zogby International	There are some in Government who advocate changing the Social Security system to give younger workers the choice to invest a portion of their Social Security taxes through individual accounts similar to IRAs or 401(k) plans. Would you strongly support, somewhat support, somewhat oppose or strongly oppose this plan?	68	29

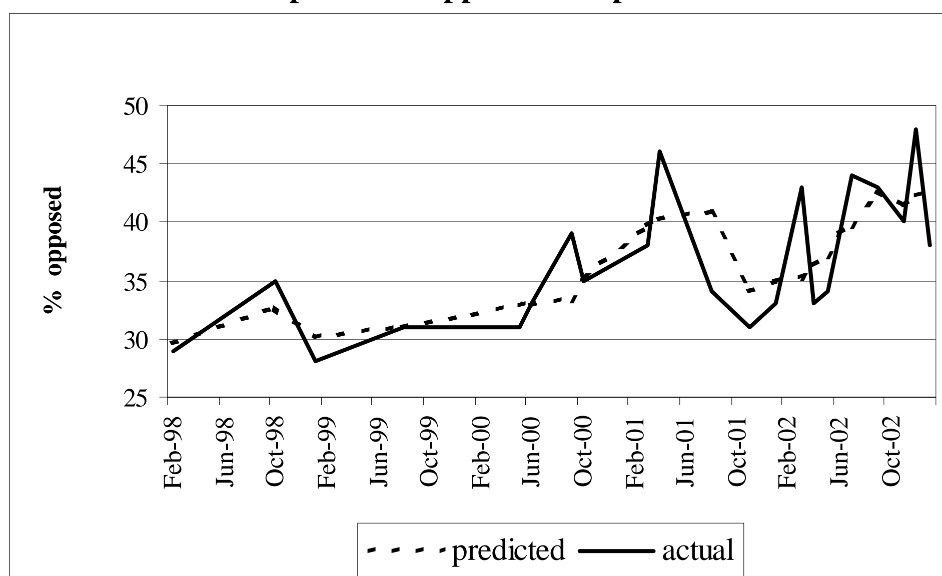
The last poll asks only about privatisation for younger workers, not for all. These are longer-term savers, who might be able better to withstand short-term fluctuations in the stock market than older workers, who are close to retirement. It mentions forms of privatisation already existing and, thus, familiar to respondents, and so could be considered to encourage a favourable response. It is the only poll that graded responses rather than offering a simple alternative.

be regarded as a problem. The substantial rises and falls occurred between polling periods, not within polling periods.

To test whether people were less disposed to privatisation after Enron collapsed in October 2001, a further variable was added. The variable took the value of zero for all observations before that date and one after.

Because both opposition and support were measured by a percentage, and so bounded by zero and one hundred, for modelling purposes it was necessary to transform the dependent variable to the natural log of the odds of opposition. The explanatory variable, the S&P500 index, was also logged, so that the coefficients obtained in the regression show the percentage effect of a one percentage fall in that index on the log of odds of opposition.[22]

Annex 2: Actual and predicted opposition to privatisation



[22] A semi-log model, with the S&P index entered directly, was also tried. It gave similar, but slightly less robust results to the fully logged model.