A brief comment on Franco, Marino, and Zorreri's paper

by Takashi Oshio, Kobe University

Franco, Marino, and Zorreri focus on pension liabilities, which largely determine the sustainability of public pensions and affect long-term fiscal positions. They discuss this issue with special reference to the fiscal consolidation among EU countries under the Stability and Growth Pact (SGP). After examining the pension expenditure projections available in EU countries and their use in the assessment of fiscal sustainability, they discuss the different definitions of pension liabilities and their potential role in the EU fiscal framework. They argue that the level of pension liabilities cannot provide any indication about the sustainability of pension schemes, but that estimates of pension liabilities can complement the deficit and debt indicators currently used. They also point out some technical and organizational issues concerning projections.

This paper gives us a clear understanding of how we should consider pension liabilities in the context of public pension reforms. Although the analysis of the paper is much oriented to the EU fiscal policy discussions, it contains various policy implications to other industrialized countries including Japan. First of all, their examination about the three definitions of pension liabilities – (1) accrued-to-date liabilities, (2) current workers and pensioner's net liabilities, and (3) open-system net liabilities – is of great help in understanding pension liabilities and avoiding any confusion.

Regarding their assessment of pension liabilities, let me make two comments. First is on their argument that the level of pension liabilities is not a good indicator of the sustainability. It makes sense. To compare the levels across countries is irrelevant in many cases, and it seems to be a crucial point for assessing EU fiscal consolidation under the SGP. However, we can analyze pension liabilities in a dynamic framework; for example, growing net pension liabilities over time can be interpreted as a warning signal of rising unsustainability of the system. As mentioned in section 6, regular monitoring of the time-series evolution should be useful in gauging the sustainability.

The second comment is on the implications of pension liabilities to the overall fiscal policy and intergenerational equity. Among their three definitions, open-system net liabilities, which are the most comprehensive one, give important information in this respect. For example, positive open-system net liabilities would mean that the pension scheme is "incomplete," in that benefits must be financed from outside the system, requiring additional subsidies from the government and eventually tax increases. In addition, open-system net liabilities provide a clear picture of "generational accounting", which can help assess burden sharing between the present and future generations.

Discussions about pension liabilities remind us of a very simple strategy to improve the sustainability: "Do not promise people too much benefit to be financed." Theoretically, there are two candidates to achieve this goal: one is a shift to a funded-DC system and the other is a shift to a pure PAYG system. In a funded-DC system, gross pension liabilities and contributions are always balanced for each generation, and so there are effectively no net pension liabilities at all. In a pure PAYG system, the total amount of pension benefits paid out is given by the total amount of contributions. The government thus commits no future pension rights, so no liabilities exist. In both methods, however, the government has to finance the existing net pension liabilities. A funded-DC system needs additional taxes on the current and future generations, leading to no net benefit from the reform. A pure PAYG system has to reduce promised pension benefits, a solution which is not easy to be politically accepted. The concept of pension liabilities clearly points to this kind of policy dilemma.

Finally, this paper stimulates further research concerning pension liabilities. As mentioned above, the dynamic analysis seems to be of great importance in examining the sustainability of the system. Pension liabilities can also be a useful concept to analyze the intergenerational equity and intertemporal social welfare. In addition, discussions about pension liabilities emphasize the institutional aspects such as accountability and transparency, which are at the same time key concepts for a decision-making process of social security reforms.