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ON PUBLICLY FUNDED PENSION FUNDS: REPLY[1]

In the last issue of the *Economic Annals*, Nikola Altiparmakov (2013) commented on one of my books (Mijatovic, 2008) in a negative and inaccurate way. This is my response.

First, Altiparmakov argues that Mijatović "advocates" and "express[es] optimistic views" about publicly funded pension funds, which is not true. My book does not advertise these funds; it is rather an attempt to examine this model of pension insurance based on economic considerations and experiences of several countries. Therefore a very cautious attitude has been maintained, and this is very obvious in the conclusion of the book that I quote here entirety:
"The herein outlined proposal may contribute to alleviation of the pension crisis in the near and distant future, and could be beneficial for the population of Serbia and its budget. However, this idea makes sense only if Serbia is capable of successfully legislating a good model of publicly funded pension funds, and if this model is implemented exactly the way it is designed and legislated. Otherwise, it is better to refrain from engaging in this endeavor."

Altiparmakov also claims that I did not provide "economic analysis" that supports my claims and, even more, that I did not investigate whether Serbia's public funding would result in "economically efficient intergenerational transfer of wealth from current to future generations."

The claim that I did not provide economic analysis of this model of pension reform is not correct-- the book is discussesed analytically, which includes issues of savings, sources of capital funds, investments and investment policy, yields, equity, and management. This is obvious to anyone who even browesed the book.

The next claim -- that I did not research quantitavely the future effectiveness of intergenerational transfers -- is accurate.[2] But, there is a good reason for this: we do not know what the relevant economic processes in Serbia during the upcoming decades will look like quantitatively and for this reason it is not possible to talk seriously about the transfer efficiency in the Serbian case. Let's have a look at the three crucial variables: economic growth,

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[1] This reply was sent to *Economics Annals* but wasn't published there.
[2] Although I dealt with intergenerational issues in a section named *Enhancing Intergenerational Justice*.

investment returns and cost of Serbian public debt. Do we know the rate of growth for the Serbian economy during the next half of century or later? Can we even approximate what the returns on investments in 21st century Serbia will be? Do we know what the interest rate will be for the Serbian public debt during the next decades? Of course we do not know, and for this reason we cannot seriously discuss quantitavely whether the public fund transfer will be efficient or inefficient.

The procedure taken by Altiparmak clearly confirms my last statement. In order to show how to perform the efficiency analysis of these transfers, he compared a 4% return rate with a 4% rate of economic growth and, adding the present price of Serbian public debt of 5%, he concluded that this transfer would be ineffective. Where did Altiparmakovu get these figures from? He assumed the future 4% rate of return, without any argument. He has assumed the future 4% rate of economic growth without quoting the source -- probably from the "Crisis model ", which is certainly unreliable. The current 5% Serbian cost of debt does not predict figures for the next few decades, and should not be taken into consideration.

In other words, Altiparmakov has based his argument on one of his own unsubstantiated estimates, on one unreliable projection, and on one actaul value that he assumed would not change in the future. In this way, he attempts to provide a very important conclusion in a resolute way, i.e. that pension system based on current funding (PAYG) is more effective than the funding system. In my opinion, there is no doubt that this is inaccurate and a very unconvincing procedure.

Literature

N. Altiparmakov (2013): Is There an Alternative to the Pay-As-You-Go Pension System in Serbia?, *Economic Annals*, July – September 2013.

B. Mijatović (2008)*: Kapitalizacija penzijskog osiguranja* [Funding Pension Insurance], CLDS and Službeni glasnik.

So the public pension funds cling to the illusion of 8% annual returns even though returns over the past decade have proven that to be a flawed assumption. Many private pension funds are in better shape, as many have been operating with 5% annual return assumptions. Even the private sector has fallen short of the 5% assumption over the last decade, but at least not to a devastating extent. Where is Houdini when you really need him? A pension fund, also known as a superannuation fund in some countries, is any plan, fund, or scheme which provides retirement income. Pension funds typically have large amounts of money to invest and are the major investors in listed and private companies. They are especially important to the stock market where large institutional investors dominate. The largest 300 pension funds collectively hold about $6 trillion in assets. In January 2008, The Economist reported that Morgan Stanley estimates that Public Service Pension Fund (PSPF) is a creation under the Public...Â Public Service Pensions Fund (PSPF) Board Chairman Mr. Barnaby Mulenga thanked Government for releasing the Funds and acknowledged that the gesture would help reduce the outstanding arrears to pensioners under the Public Service Pensions Fund. He further applauded Governments commitment towards the plight of pensioners in line with PSPFâ€™ s mandate of ensuring that the lives of its members were secured after retirement.