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WHOSE MONEY IS IT ANYHOW?: GOVERNANCE AND SOCIAL INVESTMENT IN COLLECTIVE INVESTMENT FUNDS

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Over the past two decades, an aging population and budgetary stress have led to substantial changes in public pension systems throughout the world. Many countries initially responded to pension funding crises with incremental reforms, including retrenchment of existing pension commitments and by raising payroll taxes or increasing commitment of general tax revenues to pay pensions. A number of countries have also engaged in a more fundamental restructuring of their pension systems, both to deal with current problems in their public pension systems and to prepare for the coming demographic shock of the Baby Boom retirement. Several other countries have also made changes in their defined benefit pensions, moving away from traditional Pay-As-You-Go financing practices toward building up collective investment "reserve" or "buffer" funds. Finally, some countries have changed the governance of tax-privileged pension savings to provide increased incentives for private retirement savings, despite very mixed evidence about whether such incentives are effective in increasing overall savings rates.

These seemingly disparate responses to the pension funding crisis in fact raise a common set of issues about the public/private divide in governance of such funds. Should their purpose be solely to maximize returns for their (individual or collective) beneficiaries, or should they serve "public" ends as well? Should they, for example, stress domestic investment that may increase jobs within their home country, or should they spread investment risks across a range of global investments? Should they consider social and environmental criteria in investments—for example, by foregoing investments in companies that produce weapons or tobacco, or countries that have poor pollution or human rights records? And if they should pursue public objectives, what ends should they serve, and who should decide what those ends are? How should these investment funds be protected from the potential that groups within their societies will in fact use ostensibly "public" mandates to pursue their own political objectives or economic interests?

These questions have been posed in particular for collective investment funds in partially-funded defined benefit pension systems. A recent study suggests that publicly managed pension funds are likely to produce below-market returns on investment, and that these political risks are likely to be especially severe in countries with overall governance problems. But individual accounts have potential shortcomings of their own, such as potentially very high administrative costs, and uneven financial market and annuitization returns across cohorts, which raise concerns about them as well. And the costs of financing a transition to a fully-fund system of individual accounts are seen by politicians in most democratic countries as ranging between daunting and impossible. Broadening the range of investments and increasing the returns of collective buffer funds (especially where they are already in place), on the other hand, is seen by many politicians as the political equivalent of a free lunch—a way to meet existing expectations about future pension commitments without resorting to benefit and eligibility cuts or contribution increases.

This paper examines how several OECD countries have addressed the "public/private divide" in collective investment "buffer" funds, drawing on the experience of Canada, New Zealand and Sweden, as well as the Swedish experience with a "default fund" (for those who do not make an active fund choice) in the individual account defined contribution tier of its public system. While most of these programs are quite new, they nevertheless provide some interesting and useful lessons about the potentials and pitfalls of such funds

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