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Literary Review of Canada

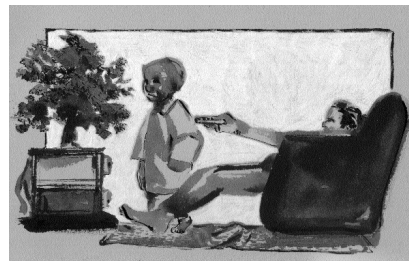
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**your pension?**

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## Drawings throughout the issue by Tom Pokinko.

Tom Pokinko is a graphic artist based in Montreal. His work has appeared in *The Progressive*, *Clamor* and *Fine Books & Collections* (formerly *OP Magazine*), as well as with the United Nations Association in Canada. His online portfolio can be seen at <www.tompokinko.com>.

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# Duelling Pension Manifestos

Should workers have a say in where their money goes?

KEITH AMBACHTSHEER

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## Pension Power: Unions, Pension Funds and Social Investment in Canada

Isla Carmichael

University of Toronto Press

225 pages, softcover

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Critics agree that when Marx and Engel finished penning their *Communist Manifesto* in January of 1848, they had written one of the greatest masterpieces of socio-political-economic writing of all time. The authors' success was based on carefully following a four-part formula for writing a good manifesto. First, they addressed a burning issue (the dreadful mid 19th-century working conditions of the proletariat). Second, they employed a highly dramatic writing style (starting line: "A spectre is haunting Europe—the spectre of communism" ... ending lines: "The proletariat have nothing to lose but their chains. Workers of the world unite!"). Third, they kept it short (only 40 pages); and fourth, they avoided empiricism (no statistics!).

Isla Carmichael's new *Pension Power: Unions, Pension Funds and Social Investment in Canada* is also a manifesto. Its burning issue is that pensions are deferred wages and, hence, the financial assets backing these deferred wages should be controlled by workers. This control should not be used to increase pension fund returns, but, in Carmichael's words, should be used "to rebuild neglected communities and increase productivity for the benefit of workers, communities, and our governments." How is this takeover to occur? Chapter 12, titled "Two Models for Union Control of Pension Funds," provides the answer:

- Get the structure of pension funds on collective bargaining agendas.
- Get control of pension fund governance processes.
- Get control of the investment decision processes.
- Devise and implement social investment programs.

However, these four steps cannot just come out of thin air, but will require an explicit social

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action strategy forged by the labour union movement:

- Develop and support union leaders who are passionate about the pension fund takeover idea.
- Identify sympathetic professional allies (business managers, fund managers, accountants, actuaries, etc.) to assist in the takeover processes.
- Devise and implement social investment education programs for union trustees and the broader union membership.
- Do more research into what is required to turn these ideas into practice on a large scale.

So Carmichael's book does indeed pass the first successful manifesto rule in the sense that it identifies a burning issue and offers a plan as to what should be done about it.

Unfortunately, the book scores less well against the other three manifesto rules. The book's prose is uninspiring, it is far too long at 225 pages and, by indulging in a little empiricism, Carmichael inadvertently shows the whole union takeover plan for Canada's pension funds to be an unambiguously bad idea.

### A Little Empiricism

Carmichael notes that we have had some experience with social investing in Canada and that, on the whole, it has been a good thing. Specifically, she writes: "These forms of investment are productive, socially useful, and far less speculative than much pension fund investment practice to date." Here is a listing of the major examples she provides:

- The Caisse de Dépôt et Placement du Québec has been a leader in supporting regional and industrial development in Quebec by investing billions of dollars in these areas through a number of wholly owned provincial development funds.
- Labour-sponsored investment funds provide much-needed capital from workers to small- and medium-sized businesses, creating jobs in the face of high unemployment. Ideally, such funds are directed by a labour body, meet established economic and social goals, provide an equitable rate of return through a diversified portfolio, have the participation of a broad base of working people and facilitate co-operation between business and labour.
- Manitoba's Crocus Fund is an especially good example of all these labour-sponsored fund

characteristics. It is proactive by taking seats on the boards of the companies it invests in. This is not schmoozing, but is instead a way of providing expertise to new companies or helping to renovate older ones. The Crocus Fund is also a leader in adopting a best-of-sector approach to selecting its investments. This approach, supported by social audits, should help raise the performance bar for other companies in the sector as well.

- British Columbia's Concert Properties was created 15 years ago by 26 pension funds with the goal of creating rental housing in Vancouver. From a \$30 million capital base at inception, it now has a \$450 million asset base and is the largest developer of rental housing in Western Canada. Concert Properties' goals are to create union jobs, develop communities and provide a reasonable rate of return to the investor pension funds.
- The 14,000-member Carpentry Workers' Pension Plan of British Columbia is an example of a union pension fund that believed in the Concert Properties concept. Indeed, CWPP took the idea of making investments that would directly create jobs for its members a great deal further. By 1999, it had cranked up its exposure to B.C. real estate in the form of mortgages and equity investments to almost 50 percent of the CWPP fund.

How have things worked out for these poster children of the union-led pension revolution that Carmichael advocates in her book? Predictably poorly. Why so predictably? Because there is a hard-wired "one-policy goal—one-policy instrument" rule in economics. Applied to pensions, the rule means that, at best, a pension plan can do only one thing well: produce a predictable stream of pension payments at a reasonable cost. If it tries to achieve other goals as well (for example, rebuild neglected communities, create jobs for union members), its primary goal will inevitably be compromised. All of Carmichael's poster children are cases in point:

- The 1990s saw an increasingly serious straying at the Caisse from its primary goal to make money for its depositors. This misdirection eventually led to a crisis in confidence in the board of directors and senior management. Henri-Paul Rousseau was recently installed as the new CEO. He has publicly promised to return the Caisse to its primary goal of earning a competitive rate of return on its depositors' assets.

- Labour-sponsored investment funds have developed a well-earned reputation among Canadian investors as a high-cost, low-return asset class, with net new sales drying up despite the generous tax breaks that these funds offer investors.
- A recent *Report on Business* headline read “Labour Funds Wither as Crocus Wilts.” Trading in the shares of Manitoba’s Crocus Fund was halted on December 10, 2004, to reassess the value of the portfolio, “leaving 34,000 Manitobans wondering about the future of their \$190 million invested in the fund,” according to Carrie Tait in the *National Post*. The Manitoba Securities Commission has stepped in, alleging that the Crocus board of directors knowingly sold shares at an inflated price. Disgruntled investors have commenced a class action law suit against current and past members of the Crocus board of directors, which reads like the Who’s Who of Manitoba’s organized labour movement.

Amidst a long, glowing story on the founding and growth of Concert Properties, Carmichael slips in the rather innocuous observation that “figures are not available for complete returns on investment in Concert.” Finding it hard to believe that a \$450 million real estate company would not have the return it earned for its shareholders readily available, I visited the Concert website. There indeed was no return on investment information to be found. The next step was to email

Concert senior management with a request for the information. The curt response was that this was proprietary information available only to shareholders. What should we make of this story? Should we infer that building rental housing with union labour is more important than earning a competitive return on pension assets?

The CWPP story has turned into an unmitigated disaster. As the real estate investments in the B.C. carpenters’ pension fund soured at the turn of the decade, liabilities ballooned at the same time because of falling interest rates and generous early retirement packages offered to older union members. Fiscal sanity had returned by 2003, but not without a major organizational shakeup and cuts in pension benefits as high as 45 percent. Carmichael observes that “these reductions were higher than anticipated and devastating to the membership of the CWPP.”

What are we to make of Carmichael’s empiricism? Are these five stories meant to convince us that, in her own words, union-directed social investing is “productive, socially useful, and far less speculative than much pension fund investment practice to date”? Surely not. Is the message, instead, that investment return does not matter in her framework? That pension assets are put on this earth for a higher purpose? And that she knows what that higher purpose is? On the face of it, this would seem to be the case.

### An Alternative Pension Manifesto

All this raises interesting questions. For example, if I were to write a pension manifesto, what would its message be? What arguments would I use to underpin my message? How would my

manifesto differ from Carmichael’s? Let me try to answer these questions.

Rather than plot a takeover of Canada’s workplace-based pension system to achieve some greater good, my pension manifesto would focus on the interests of the people the pension system was created to serve. So it would start from a premise that rational individuals want to maximize happiness and personal satisfaction from a lifetime income stream. For most people this means acquiring an education early in life (that is, building intellectual capital), accumulating a pool of financial capital during the mid-life working years and converting that pool of financial capital into a stream of pension payments during the retirement years. Unfortunately, there are three practical flies in this theoretical pension ointment.

First, people exhibit only bounded rationality, rather than full rationality, in their decision processes. In other words, people are generally quite rational in making decisions within the bounds of the familiar. However, when circumstances take them into uncharted territory, people stop being rational. Unfortunately, for most, making a series of complex savings and investment decisions over three or four decades is decidedly uncharted territory. So now people exhibit tendencies to construct inappropriate decision rules, to act impulsively or, more often, to avoid making any decisions at all.

## How have things worked out for the poster children of the union-led pension revolution that Carmichael advocates in her book? Predictably poorly.

The second fly in the ointment is that agency-related costs can create a serious wedge between investors and their money. Such costs arise in markets where sellers know more about what they are selling than buyers know about what they are buying. In the financial services marketplace this means that if the sellers of these services (such as financial advice, money management) have the opportunity to turn their informational advantage into profits, they will. In her manifesto, Carmichael—to the detriment of her own argument—makes the important point that for-profit financial services sellers are not the only constituency that can impose agency costs on retirement savers. Her five examples show that, given the opportunity, people with “greater good” aims can also impose material costs on people attempting to accumulate retirement savings.

The third fly is that individuals all face a serious risk of outliving their money. While an actuarial table might show that the life expectancy of a 65-year-old is 20 years, that doesn’t mean all 65-year-olds are going to live until age 85 and then obediently die. Some will die sooner, others later, a few much later. This reality creates a serious conundrum for people. How much of a retirement nest egg should we plan for? To last 20 years? 25 years? Longer? A serious conundrum indeed!

In the spirit of Marx and Engels, these three flies also deserve a ringing “workers of the world unite!” response. However, the goal of our pension revolution would not be to get control of pension assets to achieve some greater good. Instead, it would be to increase the efficiency and reliability with which streams of retirement sav-

ings are converted into streams of pension payments. To achieve this, I propose the following four-step pension program for Canada:

1. Make membership in a registered pension plan compulsory for all working Canadians.
2. Set the minimum required contribution rate at 10 percent of current compensation.
3. Foster the creation of well-governed, arm’s-length, not-for-profit pension co-ops with the sole mission of converting streams of retirement savings into streams of pension payments with maximum efficiency and reliability.
4. Require that the pension contracts managed by these pension co-ops are transparent and fair to all and that they explicitly deal with the noted three pension “flies” of bounded rationality, agency costs and longevity risk.

We conclude with arguments why such a program would shower material benefits on practically all Canadians.

### Pension Revolutions, Means and Ends

An important test of any proposition in welfare economics is the Pareto optimality rule, which requires that an unambiguously good policy makes at least some people better off and no one worse off. The policies set out in Carmichael’s manifesto fail this test. While parties deemed worthy in Carmichael’s eyes win through wealth transfers, parties that end up with the short end of the wealth-transfer stick lose. In contrast, the only people who would lose under the pension policies proposed in my manifesto are the financial services providers who are currently being paid too much for too little. Adam Smith would be pleased.

Meanwhile, under my manifesto, workplace-based pension coverage would more than double, from under 50 percent of the workforce today to 100 percent. The minimum 10 percent contribution rate would ensure that the workplace pension system would eventually produce material pension cash flows on top of promised payments to the Canada and Quebec pension plans. At the same time, it would take considerable pressure off future taxpayers to underwrite future burgeoning payments to the Old Age Security and Guaranteed Income Supplements owed to Canada’s aging baby boomers.

Furthermore, my manifesto places the control of the resulting very large accumulations of Canadian retirement savings in the hands of well-governed, arm’s-length pension co-ops charged with the sole task of turning retirement savings into pensions in a cost-effective, transparent, reliable manner. Thus, this approach keeps control of this money out of the hands of all power groups—not just organized labour, but organized business and government as well. This is the pension socialism that Peter Drucker hoped would evolve from the time he wrote his 1976 book *The Unseen Revolution: How Pension Fund Socialism Came to America*.

Carmichael and I do agree on one thing, Canada’s workplace-based pension system could use a good revolution. Where we differ is on what the means and ends of that revolution should be. □