Are You Entitled to the Income of Others?

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Thinking like an economist can be terribly frustrating. Every day people insist that moving water to one side of a bathtub will raise the water level on that side. At least they argue the economic equivalent.

Because **economic** understanding is so closely tied to sociological beliefs, it's impossible to sway anyone from their views. Trying to explain the basics of economics is pointless if you started by discussing a topical issue.

It's best to just enjoy your bath and watch people get reality served to them. Economic law always trumps political policy and good intentions in the end.

The good news is that all this is predictable. And that means you can profit from it.

The bathtub analogy was illustrated nicely this week, this time on the topic of pensions. The Financial Times summarised a new study and an older survey which show how private pension money must actually come from somewhere. It's water being moved around the bathtub. It leaves someone, somewhere, out of pocket.

This is a deep shock to those who thought paying for promises is always someone else's problem, or not a problem at all. But now we're feeling the consequences of pension promises in all sorts of ways.

> *An average 10 per cent of the money that has been paid into defined-benefit schemes over the past 16 years has been funded by suppressing wages, according to new research. On average, workers are paid £200 a year, or 0.6 per cent, less than employees in similar companies which have not had to plug pension deficits, the Resolution Foundation said.*
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> *Dr Bell's findings are also consistent with survey evidence released at the end of last year which suggested that one in ten companies had dealt with increased pension costs since 2013 by restricting pay rises for staff. One in 20 companies said they had reduced staff numbers.*
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> *"With average earnings still £16 a week below their pre-crisis peak and prospects for a return to strong pay growth looking shaky, it's important that younger and low-paid workers don't take a hit to their pay because of deficit payments to pension schemes that they're not even entitled to," Mr Whittaker said.*

Yes, it turns out that money must come from somewhere. Just like water in a bathtub, you can't move it around without creating a void. The void is workers' pockets. And investors', as we'll see in a moment.

But first we'll double check if you're thinking like an economist yet.

Do people who are legally entitled to a company pension really have a claim on the income of workers?

If you're trying to answer that question based on ethics, legalities or some sort of social theory, you're not thinking like an economist. You're arguing about moving water around the bathtub. Good luck to you.

The correct answer is that company pensions only work as long as the people actually paying for them tolerate it. We do have a choice over where we work and how we spend our money, for now. And companies can fail.

Paying workers less and having to fire people certainly doesn't bode well for the future of a company, nor its pension plan. Raising prices on whatever the company sells is asking for the competition to show them the door.

Stuck between a rock and a hard place, companies will have to decide what's more important – their employees, their business' survival, their investors or their pension promises. Unless someone decides for them, as the FT reported last week:

The UK pensions regulator has warned it will take a tougher line on companies that prioritise shareholder dividends over reducing pension deficits. In a statement on Monday, the regulator said it would focus on "fair treatment" when it reviewed funding plans from schemes undergoing pension valuations this year. "We are likely to intervene where we believe schemes are not being treated fairly," it said.

In the UK, about 11m people are members of private sector "defined benefit" pensions schemes. In retirement, they will be dependent on their employer for income. But pressures on the 5,800 companies that have this type of scheme have increased as pension deficits have grown to £530bn, largely because low interest rates have inflated liabilities.

As always, it's the central bank that's to blame. At least partially.

The consultancy JLT did the maths and discovered that half of the FTSE 100 companies could clear their pension deficit if they hand over their annual dividends.

It's ironic to think of how pension funds' investments in companies are underperforming because the same pension funds are preventing those companies from doing well by imposing an enormous liability on their balance sheets. The lack of pensions' investment income will only get worse if companies aren't allowed to pay out dividends to the same pension funds that are preventing them from doing it.

This is how water in the bathtub refills the void. The money flows back.

But think about what's going on here. Are companies designed to serve their pension plans or their owners? What is "fair"? Do you think employees and investors like to hand over money to an underwater pension fund? Do you think they will do so?

The water level in this bathtub is getting low, no matter how you rearrange it.

Here in Japan they have the very same problems. Mighty corporations are struggling under their private pension plans and demographic change. Last year the Nikkei Asian Review put up the figures:

The value of listed Japanese companies' future obligations to retiring workers reached a record 91.21 trillion yen ($860 billion) at the end of fiscal 2015, with the unfunded chunk growing to nearly 26 trillion yen amid depressed interest rates.

Explaining all this to the potential Japanese in-laws probably won't go down well. The last of a long and illustrious line of Ishikawa Prefecture dentists is nearing retirement with no male dental heir. The three daughters don't plan to marry any aspiring dentists. And I probably wouldn't be suitable, even if I wanted to be one…

Polite inquiries as to my financial preparations for retirement have already been asked. Please purchase a newsletter to help me make the case.

Gagging the gig economy

The gig economy refers to people who get paid for the work they do rather than the hours they spend at work. This is a truly novel concept to British politicians who are of course looking to crack down on the concept.

Uber drivers, Deliveroo riders and freelancers are in the firing line.

Prime minister Theresa May says she wants to "properly protect" workers in the gig economy. Which completely ignores why people work there in the first place. They value the freedom of not being protected over the constraints of being protected. Should they be allowed to?

May says gig economy workers shouldn't take the UK's low unemployment rate for granted. But she has the cause and effect backwards. The economy is doing well because Britain allows more flexibility than other nations. She shouldn't take gig economy workers for granted.

Forcing protection on your own people is the job of the Mafia and the government should stay well away.

Until next time,

Nick Hubble
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