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It Is Better To Do No Reform Than a Bad One

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Reforms in the Czech Republic are poorly prepared and rarely fully completed and accomplished, said Stepan Jurajda, Director of CERGE-EI, which is devoted to economic research and doctoral studies. According to him, the country lacks an independent expert institution, where reform ideas as well as impacts would be thoroughly analyzed and evaluated.

LN: I suppose you have been watching the discussion about the tax pension reform. What's your opinion?

The whole agenda is not very persuasive. I'm not talking just about the dramatic changes in the level of the VAT increase. It is strange that a reform, which is critical for current, as well as future generations, is being prepared and presented in such a haphazard way. When the government is changing the fundamental structure of the proposal "live" in front of the audience, it can inspire confidence neither in the general public nor among experts. And what's even worse? That this pattern is constantly repeated with other reforms, which are quite often poorly prepared. It is quite simply a telling picture of how our public policy works.

LN: So you think the pension reform is fundamentally wrong?

The fundamental basis of the reform is correct. There is good reason for the reform. It is reasonable to make a small opt-out and to try to increase the level of savings. However, this potential can only be fulfilled when the opt-out is well designed. As with all other reforms, the details of the practical implementation are most important. If you do the details wrong, then it is better to not do any opt-out and to rather focus only on parametric adjustments of the first pension pillar.

LN: * What details do you have in mind?

For example, the anonymity of a saver, which could help reduce the cost of the whole system. Nowadays, Czech pension additional insurance works in such a way that a large portion of yields is lost because the individual pension funds are competing for their clients, and thus pay out big bonuses to agents who no longer increase the number of savers, but only reallocate savers from one similar fund to another and are rewarded for this largely useless activity.

These are unnecessary expenses. Similarly, there is no need to pay high fees for fund management. It is well known that active portfolio management has added value only (at best)

when you go into risky assets, while here it is clear that most people will choose a relatively passive investment strategy, which is natural. When you buy an ice cream you don't like, you will buy another one tomorrow. But if you chose a bad retirement scheme, it will fundamentally affect the rest of your life.

LN: What would you propose?

The state must ensure that savers will be offered a set of (default choice) index funds with well-adjusted passive strategies. When you invest in a relatively passive portfolio, and if the state chooses such funds well, so they attract enough savers and are big enough, you do not need to pay a manager high fees. If, on the other hand, we are talking about two percent annual fees levied on total assets in the system, there is no reasonable justification for that. When you save in this way for 35 years, you will lose up to one third of total savings for retirement. First, the state must ensure that the operating costs for a passive fund are low. We can employ a scheme, where savers' money will go into the funds through the Czech Social Security Administration anonymously in one package, thus the funds will not know the identity of their clients. There will not be any targeted marketing campaigns. You will save brokerage fees.

LN: The surest investment model is supposed to be an investment in the Czech government bonds. Do you think it's the opposite way, i.e. an uncertain way of saving? As it turns out, even the strongest economies may, in the crisis, fail.

If much of the private savings goes to Czech government bonds, one of the main goals of the opt-out will not be met, namely risk diversification. As a Czech saver, you should worry that the state may become unable to meet its obligations, either the promised pension benefits or government bonds. If such an unpleasant situation occurs, you would be better off to have part of the savings exposed to different risk. It is one of the reasons why we are creating more pillars. I would compare it to the collapse of Enron, when people lost both their jobs and their retirement savings, which were deposited in the shares of their employer. Moreover, if we invest private retirement savings into Czech government bonds, we create guaranteed demand for state debt. The whole decision process behind the reform is not based on careful analysis and this feature is quite symptomatic for Czech public policy.

LN: There is a broad discussion about the voluntariness of the transferring money out of the first pillar. What is your opinion on that issue?

I am personally a supporter of a compulsory participation in the opt-out. There is a serious risk that people, who need the second pillar the most, will not sufficiently participate in it or will make bad decisions. If people will not sufficiently prepare for future times, when the pension situation will be much worse, they may appear in the streets and complain that their situation is unbearable. This is the scenario, which should be actively prevented. So I think it is much better to have a compulsory transition.

LN: When you say that reforms in this country are not based on deep analysis, where do you see the problem?

I see two main reasons. First, it is the absence of the Civil Service code, and, second, the fact that at the end of communism, social sciences were in very poor condition. Social sciences

such as economics, sociology and political sciences are very important for the government performance. And this is tightly connected to the legitimacy of governance.

LN: In what way?

If the government does not have good independent economists, or if you have not set up independent institutes, which would evaluate the impact of government measures, you find yourselves in a vacuum. It seems that the only qualified and long-term expert team to have generated analytical documents was the Bezděk Commission. It was the first good case where the political parties asked for an independent expert evaluation of their own proposals.

LN: But our government has a well known NERV. It is true that the members of NERV are very enthusiastic from the proposed pension reform.

NERV is a great thing. I'm certainly glad that such an advisory body exists. However, what is NERV? It's a small group of people who do it voluntarily, pro bono, in addition to their primary job responsibilities. Our state lacks an independent state institution with strong analytical skills, which would advise politicians about reforms. Such a state institute works well in the Netherlands. Great Britain, on the other hand, has the Institute for Fiscal Studies, which is partially funded by government contracts, partially from other sources and it provides convincing and thorough analysis of the impact of government projects and reforms.

LN: I cannot well imagine that a similar proposal will be successful in the Czech Republic...

Politicians should get rid of the fear that if you create an independent analytic unit, it will be an obstacle. In short, it would have to be done in such a way political parties would not have to worry that such an office would be dominated by people from the camp of their political opponents. If you generate convincing empirical analysis, you finally move on from the typical current discussion "I think this program helps. I believe just the opposite." Lots of things in economics can be evaluated and, according to my opinion, this part of the economic profession is missing here.

LN: Do we have such independent experts, who could fit in such a body?

The number of such people available is growing and I would say that this in large part thanks to CERGE-EI, our joint work place of the Economics Institute of the Academy of Sciences and Charles University. For nearly twenty years, we've been educating doctoral students here and conducting research on par with European and global quality level. Our graduates now work in all international organizations that come to mind. Five percent of them work or have worked at the IMF, our people are in the CNB, in the research units and also on the bank board, but, in particular, they work at some of the world's top universities as professors. So the analytical manpower is available. It's just about the willingness to use it.

LN: You spoke about the social sciences were after the fall of communism in poor condition and that we failed to redress them. Generally, people do not speak about the Czech higher education in superlatives. Where is the problem? The aforementioned era of communism had passed twenty years ago...

This is a crucial question. Just look at the quality of scientific journals, where our researchers in social sciences publish. If the quality of scientific journals is divided into thirds, Czech social scientists publish almost exclusively in the bottom third – in contrast to social scientists in Austria, the Netherlands, Sweden and other small countries. According to a government database, we, at CERGE-EI, are producing a higher proportion of publication outputs in the upper two-thirds of top-quality journals than the rest of the Charles University or the rest of the Academy of Sciences in sociology, economics, psychology and political science combined.

LN: Why is the work of scientists of such a low quality?

Nobody is willing to reward scientists for high quality work. In the Czech Republic, Social Sciences are underfunded in comparison with other disciplines, as shown for example by the recent International Audit of Research, Development and Innovation. This is not the only problem, however. Money does not always go where it should go. This means to support scientific excellence. The ongoing reform of funding for research, development and innovation in the social sciences works exactly opposite to the way it should, as it encourages researchers to produce simple-to-do, low-quality output. The policy, established by the Government Council for Research, Development and Innovation, which will be effective for several more years, really works against quality research in the social sciences. So there is another example of poorly executed if much-needed reform.

LN: What should the state do at this point?

In the social sciences, the state should stop the implementation of what was started two years ago. A policy introducing wrong incentives is worse than no policy at all.

LN: In what way is CERGE-EI different from other scientific work places, since you manage to produce good results?

We operate much like American universities. Now, I am not talking about the level of support, but about the process that determines which researchers you hire or discharge, and who should receive rewards and for what type of results. We use a consultative body composed of some of the world's leading economists, including a Nobel Prize winner. This creates much the same internal competitive pressure to produce quality work that you'd feel at any American or Western European University.

LN: And how do you cope with the conditions of financing, which you speak of?

We have managed, in the last twenty years, with the significant contribution of the Academy of Sciences and Charles University, to create an environment that to some extent insulated our researchers from these external inefficient incentives and financial strains. If the current reform of science funding continues as currently planned, our situation will not be sustainable for long.