

Abstract

This paper investigates scale economies and the optimal scale of pension funds, estimating different cost functions with varying assumptions about the shape of the underlying average cost function: Ushaped versus monotonically declining. Using unique data for Dutch pension funds over 1992-2009, we find that unused scale economies for both administrative and investment activities are indeed large and concave, that is, huge for small pension funds and decreasing with pension fund size. For administrative activities, we observe a clear optimal scale of around 40 thousand participants during 1992-2000 (pointing to a U shaped average cost function), which increases sharply in subsequent years to size above the largest pension fund, pointing to monotonically decreasing average costs. As regards investment costs we observe an optimal scale for total assets of around € 690 million and larger, without a clear shift over time and without diseconomies of scale for larger funds. The results are very sensitive to the correct functional form of the cost model. Consolidation among especially smaller and medium-sized pension funds would increase cost efficiency.