Better **Pensions**, Better **Jobs**

Towards Universal Coverage in Latin America and the Caribbean

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World Bank Core Course on Pensions

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Better Pensions, Better Jobs. Towards Universal Coverage in Latin America and the Caribbean

- Diagnostic of pension coverage in LAC
- A conceptual framework
- Study recent policy innovations
- Offer guidance for policy reform
Low pension coverage in LAC: 4 out of 10 among Pop 65+ do not get a pension

(Pension Coverage in Latin America and the Caribbean, 2010)

Source: Bosch, Melguizo, and Pagés (2013).

(National Household Surveys data)
The labor market at the epicenter of the challenge and the solution

Only 44.7% of workers in LAC contribute to a pension system

Pension savings: Percentage of contributors over total employment in Latin America and the Caribbean, 2010

Source: Bosch, Melguizo, and Pagés (2013).

(National Household Surveys data)
Pension savings are low for non-wage earners, workers in small firms, or low-income workers ...
... but also for the emerging middle class

Pension savings: Contributors to the pension system in Latin America and the Caribbean by income decile, occupation and firm size, 2010

Source: Bosch, Melguizo, and Pagés (2013).
Pop 65+ will more than triple in four decades

Population projection for Latin America and the Caribbean, 2010–50

Pop 65+ (2010)
38 million
(6.8%)

Pop 65+ (2050)
144 million
(19.8%)

Source: Bosch, Melguizo, and Pagés (2013).

(United Nations and Celade projections)
Between 47% and 60% of adults 65+ (up to 83M) will not have an adequate pension

Pension coverage gap in 2050
(Percentage of adults over 65 without an adequate pension)

Source: Bosch, Melguizo and Pagés (2013)
This pension gap will have relevant consequences:

- **Social**: Families will need to devote greater effort to the care of the elderly.

- **Political**: Adults 65+ will make up between 20% and 30% of the potential voters.

- **Economic**: How coverage gaps are closed can have an impact on productivity growth.

- **Fiscal**: Lack of coverage represents (also) an implicit fiscal cost.
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A conceptual framework to understand informality

- Difficulties to long-term savings
- Problems to generate pension savings due to design and functioning
- Parallel social protection schemes, as a response to coverage gaps in traditional programmes

Low pension savings in LAC = High labor informality
High costs of formality (taxes and labor regulation) could be playing a role...

Cost of formality in selected economies in LAC
(Percentage of wages)

Source: Pagés (2010)
... especially when interacting with labor regulations

Share of workers contributing to pension schemes by income decile in Colombia, Honduras and Venezuela

Source: Bosch, Melguizo and Pagés (2013)
Procrastination and overconfidence matter

Have you thought about financing your retirement?

Source: Bosch, Melguizo and Pagés (2013)

No savings strategy. Many citizens even believe they can finance retirement with less than 10 years of contributions.
Informality is not an incurable disease

It is the outcome of:

- **Designs**: Systems exclude *(de jure or de facto)* non-wage earners.

- **Incentives**: Provided by the state in labor markets (including monitoring).

- **Value**: Placed by workers and firms on social security.

All this can be changed with **adequate policies**.
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Policy makers are faced with two objectives:

- **Increase coverage today**
  - Non-contributory Pensions

- **Secure coverage in the future**
  - Increasing contributions
Non-contributory pensions are one of the most widespread innovations

Public expenditure in non-contributory pensions
(Percentage of GDP)

With differences on generosity, elegility (age, income) and integration with the contributory schemes
They are proving to be extremely effective in increasing coverage

Source: Bosch, Melguizo and Pagés (2013)
However, institutions are not well established yet

The *slippery slope* of non-contributory pensions

Source: Bosch, Melguizo and Pagés (2013)
Pension gaps could also be considered (potential) implicit debt

Public expenditure in non-contributory pensions, 2010 and 2050
(Inflation vs. GDP indexation, percentage of GDP)
On the contributory side, interventions have focused on prices, benefiting particular groups...

Social contribution rate for independent workers in Costa Rica  
(Percentage of wages)

Source: Bosch, Melguizo and Pagés (2013)
... and on mandating and monitoring

Number of independent workers contributing to the pension system in Chile, 1986-2012

Source: Bosch, Melguizo and Pagés (2013)
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It’s possible to eradicate poverty in old age and to increase formal employment.

**Better Pensions**
- Social/universal pension
  - Anti-poverty
  - Sustainable
  - Efficient

**Better Jobs**
- Formal jobs subsidies
  - Subsidizing SS contributions
  - Innovating in channels
  - Enforcement, information and financial literacy
Better pensions: Anti-poverty pension

- **Universal**: With age and residence criteria

- **Anti poverty**: 10%-20% of PIB per capita
  (in line with national poverty lines; 2010 poverty 65+: 19.3%)

- **Sustainable**: Inflation adjusted, with sound fiscal institutions and funding sources

- **Integrated**: Compatible with a contributory pension
**Better jobs: Subsidizing formal employment**

Formality could increase from 45% to 63% (10 p.p. higher than the *status quo* scenario)

(State subsidy for all workers/firms equivalent to 50% of total social security contribution of one minimum wage)

Source: Bosch, Melguizo and Pagés (2013)
Better pensions and better jobs would cost annually on average for LAC 1.5% of GDP.

Source: Bosch, Melguizo, and Pagés (2013).
Financing choice would depend on current and future tax revenues

Consumption taxes and pension and health contributions in Latin America and the Caribbean, 2012 (Percentage of GDP)
The time is now: financial and political economy challenges can be overcome

- **Demography:** The region is still young but the window of opportunity will rapidly close.

- **Financing:** Pension reform requires an increase in resources allocated to these policies, preferably from alternative sources (VAT, commodities).

- **Improvement in formal employment and productivity:** Pension reform is central to achieve both.

- **Political economy:** Formal employment is a central aspiration of the middle classes.
Research open questions

• **Accounting** pension implicit debt:
  • IPD
  • Pension coverage gap and non-contributory pensions

• **Growth** and informality

• **Taxes** and informality: Level and composition (VAT, Commodities), other institutions

• **Savings**: prices vs. **channels**