Pension Systems in Latin America: Trends and Challenges

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Outline

- Background: The Social Insurance schemes in Latin America
- The situation until the 1990s
- The reforms: Focus on Sustainability
- The situation in the mid 2000s
- Recent reforms: Focus on Coverage
- Pending challenges

Background

- Social Insurance schemes in Latin America originated in three waves:
  - “Pioneer” countries (Argentina, Brazil, Uruguay, Chile, Cuba)
  - “Intermediate” countries (Costa Rica, Ecuador Mexico, Colombia, Peru)
  - “Latecomers” countries (Bolivia, Ecuador, most Central American and Caribbean)

The pioneer countries

- Pension systems originated in the early twentieth century
- Fragmented schemes, responding to pressure groups (civil servants, unions)
- Legal coverage became wide, due to continuous expansion. Actual coverage high but not universal
- Generous benefits, high fiscal costs

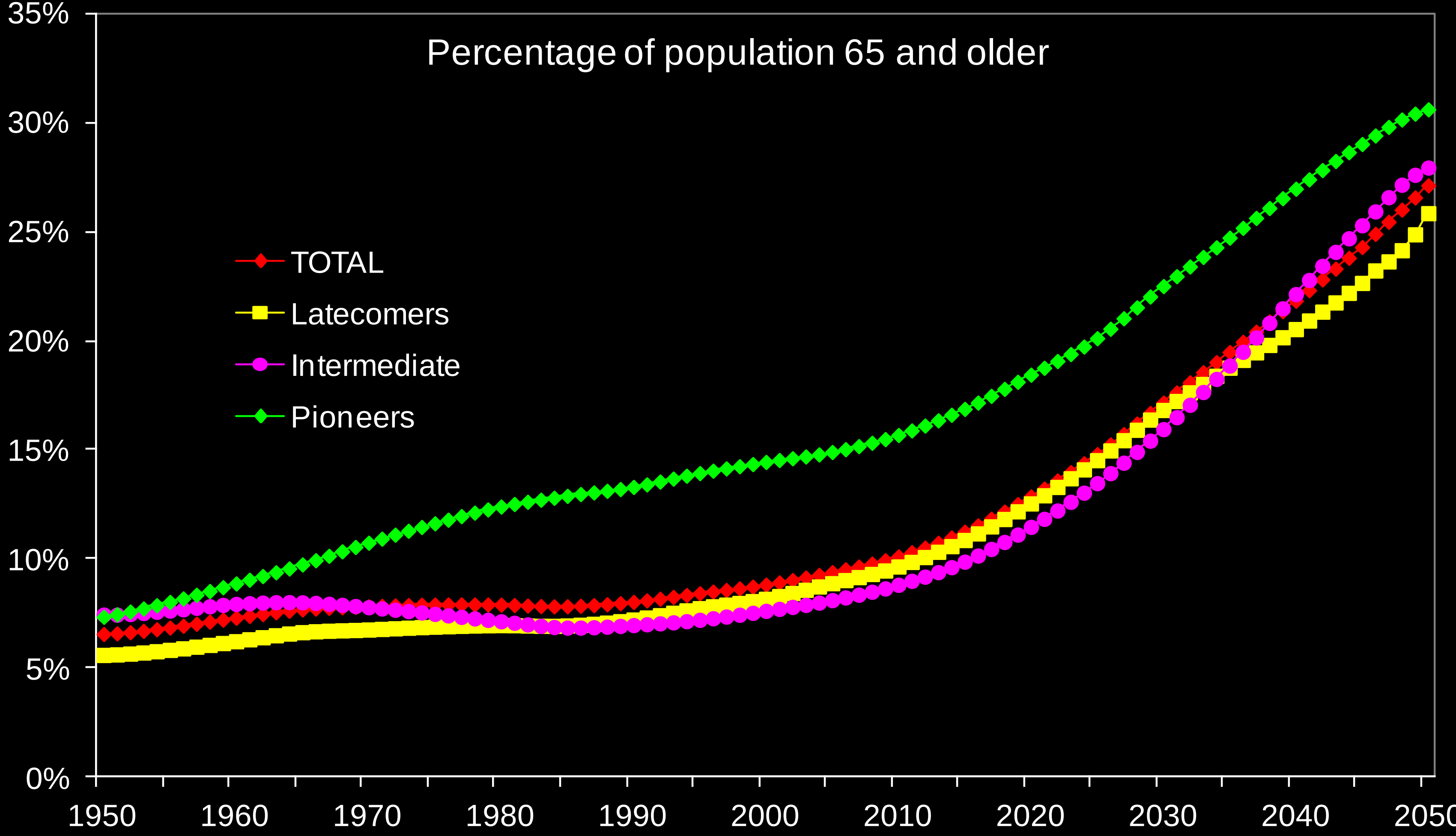
Intermediate countries

- Systems originated in the 1940s/50s (post WWII)
- Initiative from the State (Welfare State), resulting in less fragmentation
- Lower legal and actual coverage
- Less generous, less expensive

Latecomers

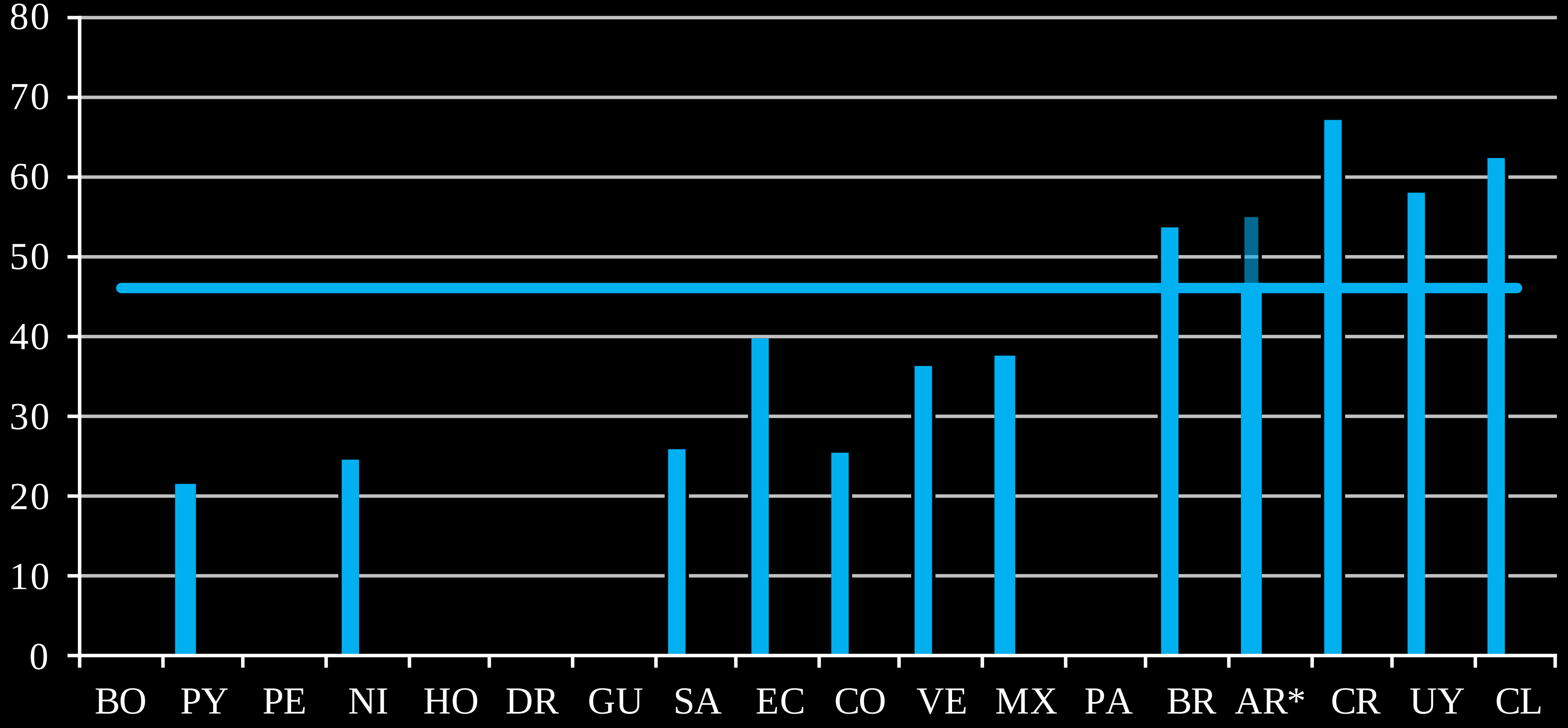
- System created in the 1960s/70s
- Highly centralized, organized from the State with welfare concerns
- Usually targeted and limited in benefits
- Fiscally sustainable, thanks to low coverage and benefits

Some common problems: Aging



Insufficient Coverage:

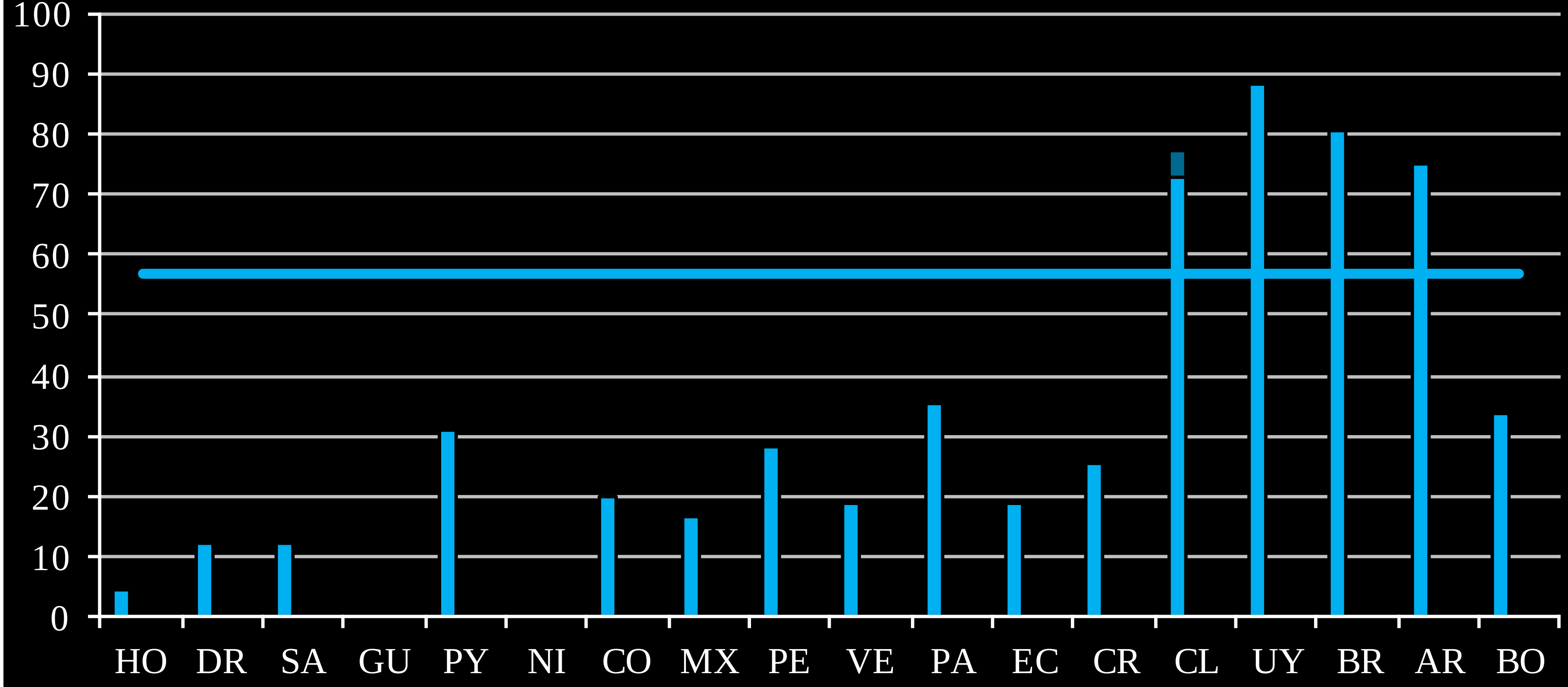
% of labor force contributing in early 1990s



Source: Rofman and Oliveri, 2011

Insufficient Coverage:

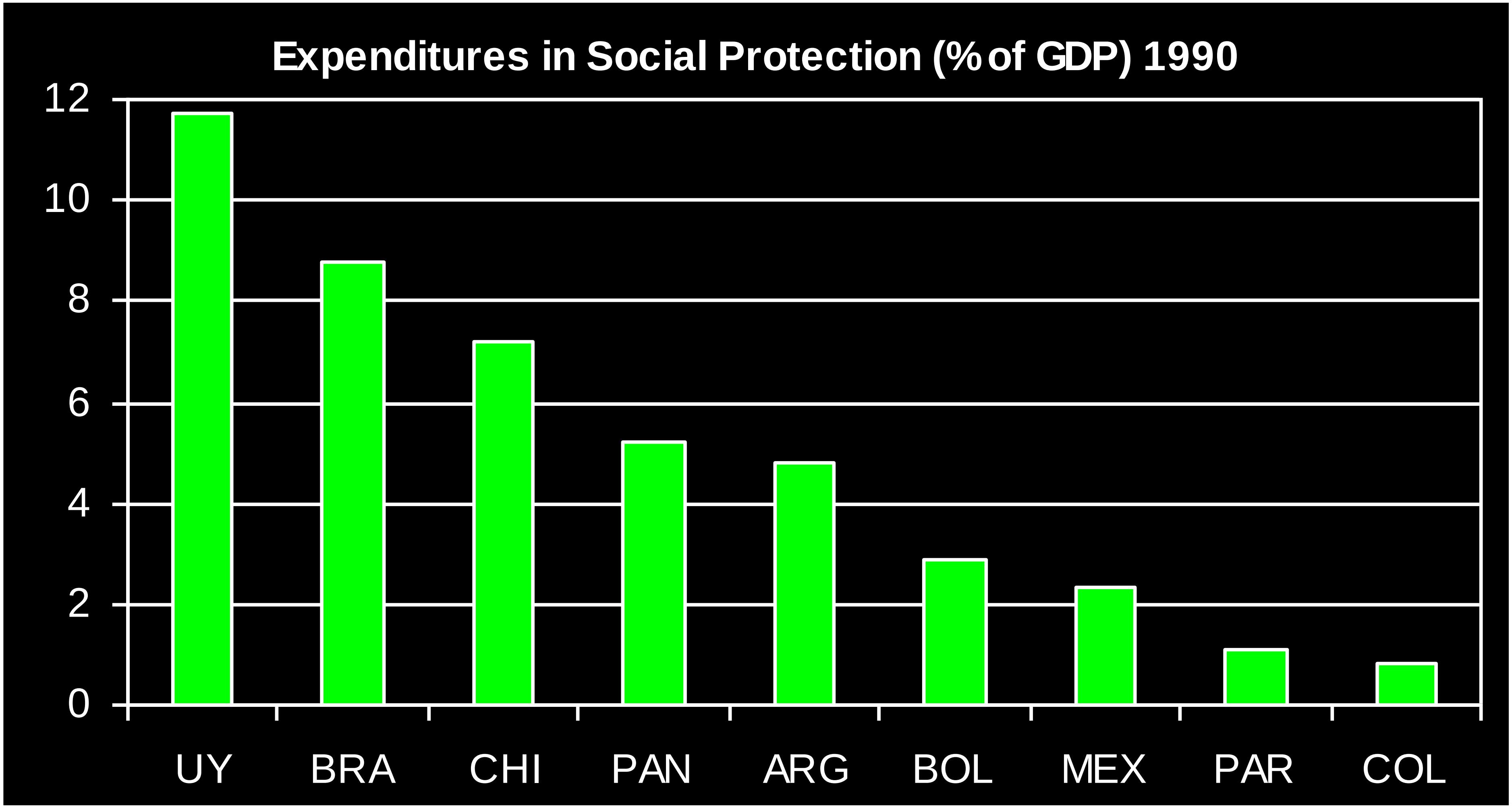
% of elderly receiving pension in early 1990s



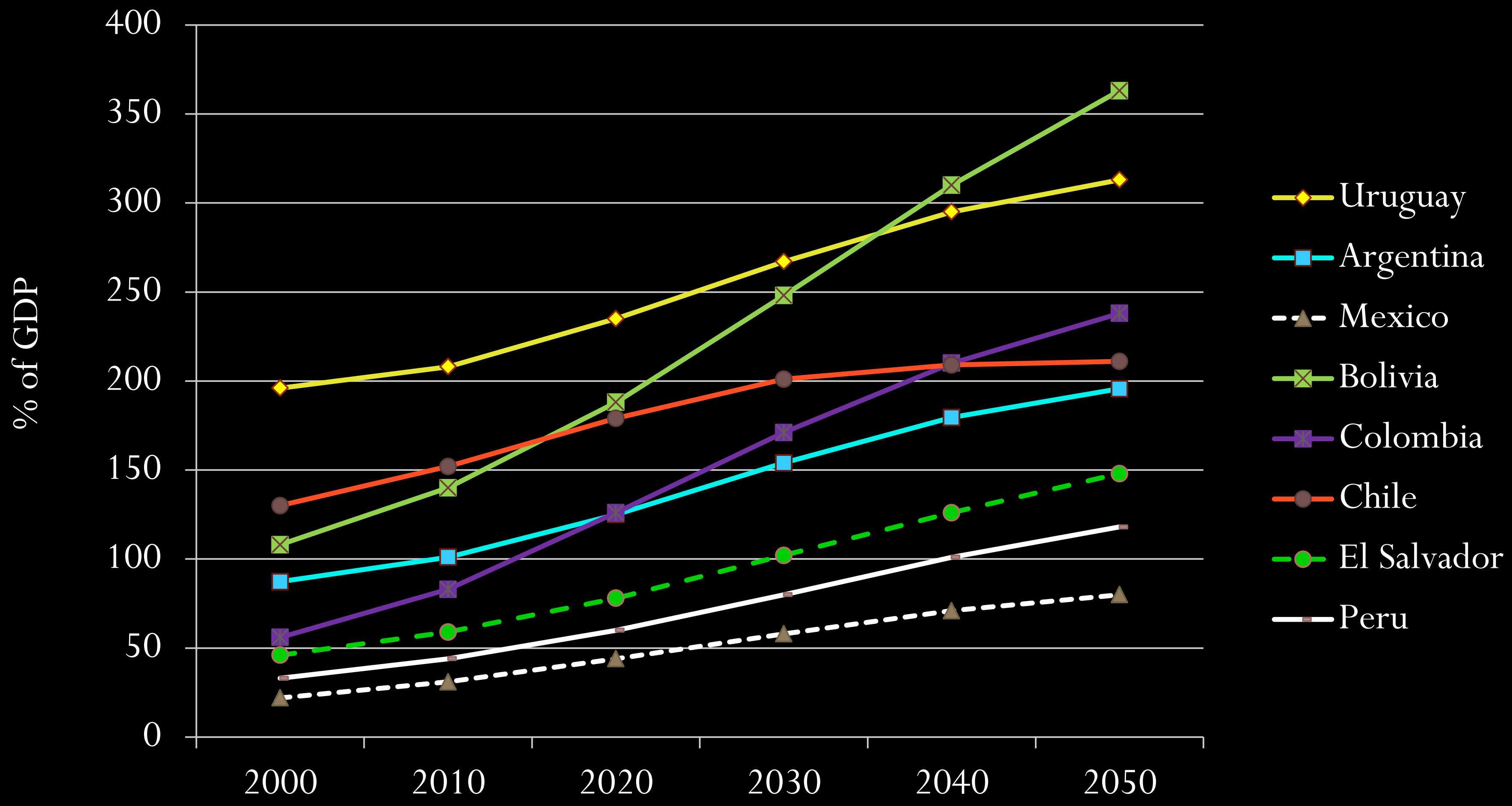
Generous Parameters

- Retirement ages around 50-60 yrs.
- Replacement rates 75% and higher
- Lax contribution requirements (as little as 5 years…)
- Special regimes even more generous

Increasing cost



Declining sustainability:
Implicit Pension Debt



Source : Zviniene & Packard, 2004

Consequences...

High costs

Subsidies

Fiscal Pressure

Low Coverage

Regressive Transfers

Inequities

Unsustainability

The reforms...

Main components:

1. Parametric reform
2. Introduction of DC schemes
3. Fully Funded schemes
4. Private management

Several countries stopped at (1) or (2)

Parameters…

- Increases in retirement age
  - Usually by 5 yrs, to 60 or 65
- Increases in vesting period
  - In UY, to 35 yrs, in AR, to 30 yrs
- Increases in contribution rates (not always…)
  - And shifting from employers to workers
- Reduction in expected replacement rates
  - From 60-80% to 40-60%

DC schemes...

- In some cases full shift, with no PAYG component (Chile, Peru, Mexico, Bolivia)
- In others, multipillar, with basic benefit financed through PAYG (Argentina, Uruguay, Costa Rica)
- Several countries kept full PAYG as an option

Funded schemes

- Workers contributions accumulated as financial assets
- In several cases, regulation pushed investment in government debt
- Also, regulation on minimum returns resulting in similar portfolios across managers

Private management…

- Funded scheme managed by private agencies, in a “competitive” model
- Systems not really privatized, more like a concession of a public utility
- State remained relevant in:
  - Financing part of the system
  - Collecting
  - Enforcing
  - Guaranteeing minimums

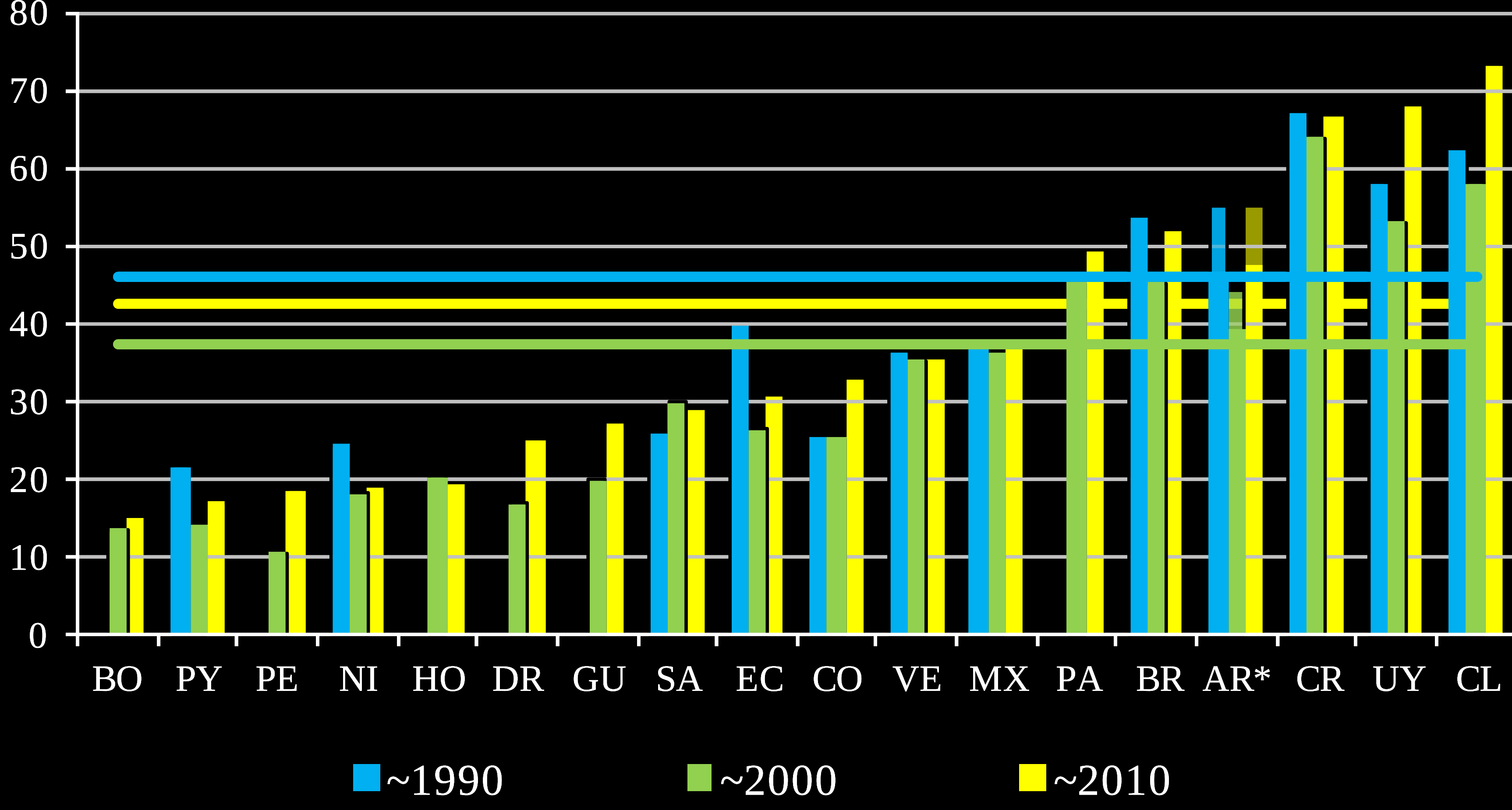
The politics behind the reforms

- Difficult processes:
  - In some cases (CL, PE) were approved by non democratic governments
  - In others, long negotiations and years of debate.
  - Two cases (NI, EC) where laws were approved but never implemented
- Results not always as planned, due to pressures of interest groups

The situation in the early 2000s

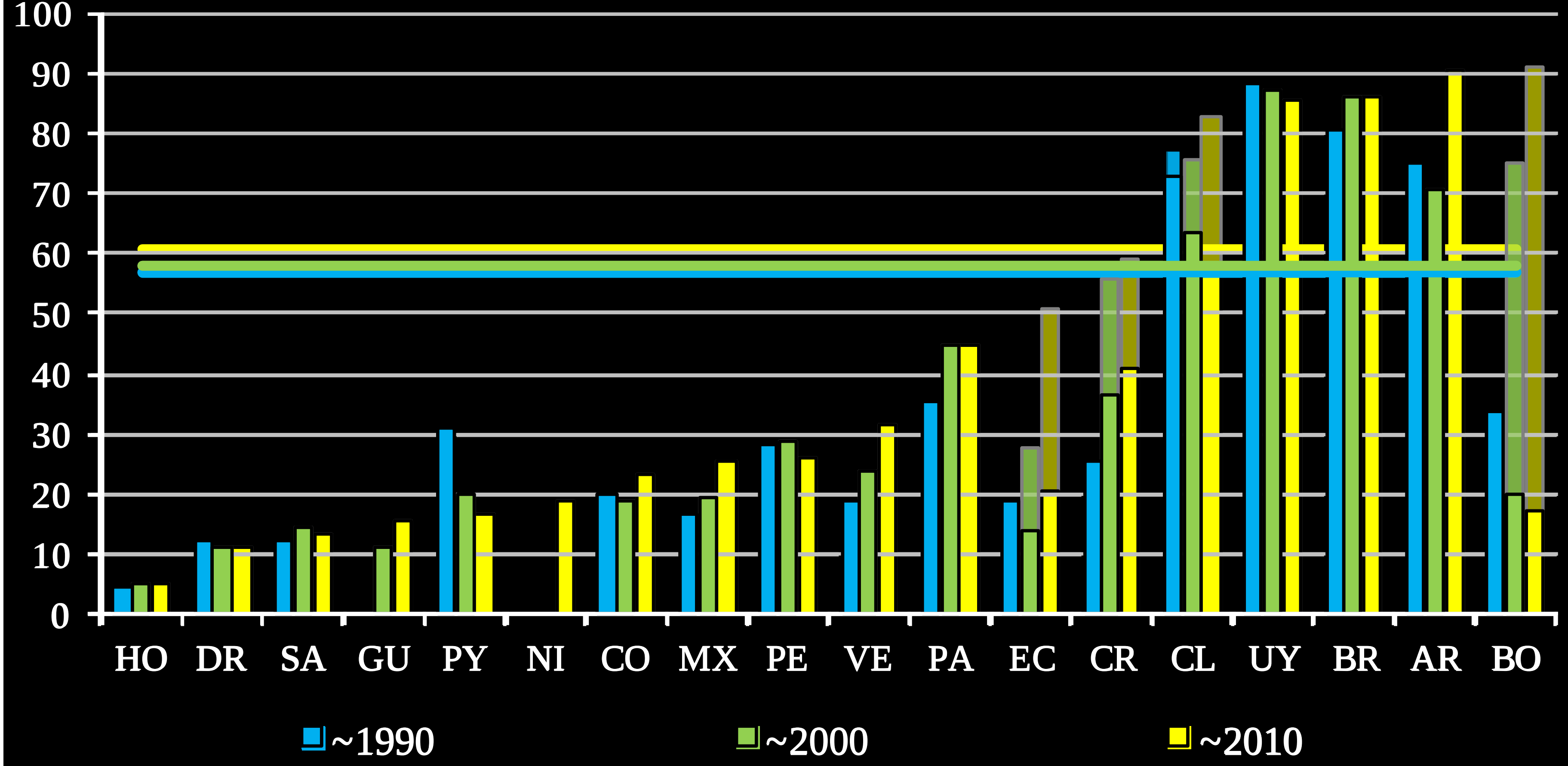
- Fiscally:
  - Medium and long term sustainability improved
  - Short term pressure important, may have contributed to fiscal crises in some cases
  - Overall outcome depends on institutions strength.

Coverage in the 2000s:
% of labor force contributing to pensions



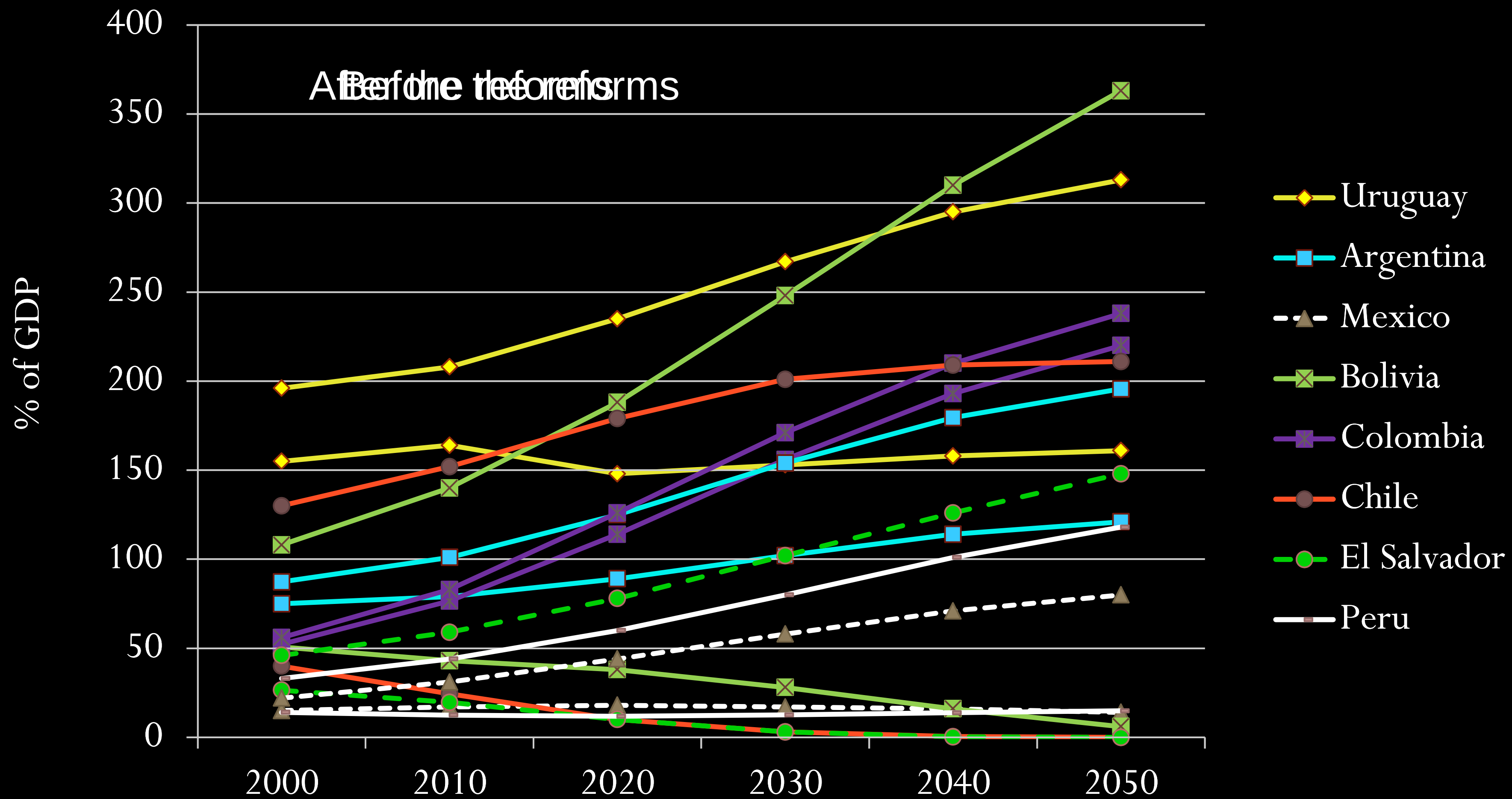
Fuente: Rofman & Oliveri (2011)

Coverage in the 2000s:
% of elderly receiving a benefit



Fuente: Rofman & Oliveri (2011)

Sustainability in the 2000s:
Implicit Pension Debt



Source : Zviniene & Packard, 2004

Recent reforms: Going back from funded model?

- Several countries have backed up on their 1990s reforms:
  - Argentina: Closed funded scheme in 2008
  - Bolivia: Closed AFPs in 2010 (but maintained funded scheme)
  - Uruguay: Allowed some workers to switch back to PAYG
  - El Salvador: Possible reforms in 2014?
- Impacts are still unclear

Recent reforms: Focus on Coverage

New initiatives to expand coverage of the elderly, through different approaches:

"Pure" Universal:

All citizen can apply,
provided some minimum
qualifications (age)

"Targeted towards universalization":

The program is targeted to those
who are not receiving contributory benefits

Targeted:

Focus on vulnerable or poor population
(using a proxy means-test)

Recent reforms: Focus on coverage

- Heterogeneous approaches:
  - Flexibilization of contributory scheme (AR, UY, BR): Gives all beneficiaries equal rights, puts more pressure on fiscal accounts
  - Targeted benefits: Replicates model of CCTs. Problems with targeting, lower benefits, less risky for fiscal accounts
  - Universal benefits: Challenge to coordinate with contributory program to reduce double coverage and limit negative labor market incentives

Conclusion– Pending Challenges (I)

- Coverage situation has improved in recent years, but still a key challenge in most countries
- Fiscal sustainability a problem in a few countries, could grow in coming years
- Equity concerns, due to public financing of pensions and lack of coordination of contributory with non contributory benefits

Conclusion– Pending Challenges (II)

- Multipillar still a reasonable response, if well calibrated, but it doesn't provide a magic solution to main issues
- Bottom line: Barr's centrality of output: If GDP grows fast enough, there should be enough resources, and pension design and aging become a distribution problem