PENSIONS FOR ALL: Towards a Universal Pension System for Argentina
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Outline

1. Background
2. Diagnostics
   1. Informality
   2. Financial unsustainability
3. Pension system reform
   1. Pillar 1: What, why, how does it solve informality?
   2. Pillar 2: What, why, how does it help consumption smoothing?
4. Financing the transition
   1. Is the pension reform financially sustainable?
   2. Fiscal reform: Why and how does it solve sustainability?
A History of Deficits

Source: Cetrangolo et al. (2011)
Where are we now? PayGo-DB

Financially Unsustainable
(partially funded with taxes)
Where are we now? PayGo-DB

Financially Unsustainable
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Low Replacement Ratio
Where are we now? PayGo-DB

Financially Unsustainable (partially funded with taxes)

Wrong Incentives in the Labor Market (high payroll taxes)

Low Replacement Ratio
Where are we now? PayGo-DB

Financially Unsustainable (partially funded with taxes) → Low Replacement Ratio → Wrong Incentives in the Labor Market (high payroll taxes) → Labor Informality
Where are we now? PayGo-DB

Financially Unsustainable  
(partially funded with taxes)

Wrong Incentives in the Labor Market  
(high payroll taxes)

Low Replacement Ratio

Smaller taxable base

Labor Informality
Where are we now? PayGo-DB

- Financially Unsustainable (partially funded with taxes)
  - Low Replacement Ratio
  - Smaller taxable base
  - Structurally non-inclusive
- Wrong Incentives in the Labor Market (high payroll taxes)
- Labor Informality
Where are we now? PayGo-DB

Financially Unsustainable (partially funded with taxes)

Low Replacement Ratio

Wrong Incentives in the Labor Market (high payroll taxes)

Poverty Reduction and Inclusion

Smaller taxable base

Structurally non-inclusive

Labor Informality
Where are we now? PayGo-DB

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Sustainability: is it becoming better?

OLD DEPENDENCY RATIOS IN ARGENTINA

Source: Own elaboration based on CELADE (2014)
Sustainability: is it becoming better*?

*Source: Own elaboration
Universal Flat Pension – Non Contributory

**THE POLICY PACKAGE**

**Pension Reform**
- Pillar 1. Universal transfer for the elderly
- Pillar 2. Optional individual capitalization scheme
- Retirees and current workers: weighted average of their entitlement as per their contributions and Pillar 1.

**Fiscal Reform**
- Pension system is funded by general taxes and contributions are gradually reduced to zero
- Increase income tax revenues by 10% and reduce subsidies to historical levels (2% of GDP)
- Use FGS funds to ease the transition

*Source: Own elaboration*
Giving the right incentives

PROPOSED CONTRIBUTION RATES OF EMPLOYEES AND FIRMS

Source: Own elaboration
Is it inclusive?

Yes! By construction: the only condition to get a pension is to be old and the pension is exactly the amount needed to be above the poverty line $\rightarrow 0\%$ poverty rate among the elderly (by law!)

Does it provide the right incentives to labor?

Yes: Bosch et al. (2011) and Levy et al. (2010) among others showed that reducing labor contributions has a causal negative impact on informality.
Does it provide the right incentives to labor?

- Yes: Bosch et al. (2011) and Levy et al. (2010) among others showed that reducing labor contributions has a causal negative impact on informality. Quantities varies depending the country.
- Other authors (Cruces, 2014 for example) show that AUH increased informality, precisely because the benefits of formality are each time less... our proposal closes part of that gap!
Does it let workers smooth consumption*?
Is it structurally sustainable?

**THE NEW PENSION SYSTEM COST**

![Graph showing the cost of the new pension system and status quo over time, with a source note: Own elaboration.](image)
How do we finance the gap?

<table>
<thead>
<tr>
<th>Funding Alternatives</th>
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</thead>
<tbody>
<tr>
<td><strong>Option A</strong></td>
</tr>
<tr>
<td>Increase Income Tax Revenues by 20% (Today, 7% of GDP)</td>
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<tr>
<td><strong>Option B</strong></td>
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<tr>
<td>Increase Vat Revenues by 20% (Today, 9% of GDP)</td>
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<td><strong>Option C</strong></td>
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<tr>
<td>Reduce transportation and energy subsidies to 2% of GDP (Today, 4.5%)</td>
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<tr>
<td><strong>Option D</strong></td>
</tr>
<tr>
<td>Reduce transportation and energy subsidies to 2% of GDP (Today, 4.5%) and Increase Income Tax Revenues by 20%</td>
</tr>
</tbody>
</table>
How do we finance the gap?

**PROJECTED DEFICIT AFTER THE PENSION AND TAX REFORMS**

Source: Own elaboration using data from the Federal Budget Office (2014)
Is it feasible to raise taxes?

TAX BURDEN (FEDERAL) AFTER PENSION AND TAX REFORMS

Source: Own elaboration using data from the Federal Budget Office (2014)
To sum up....

• Today’s system is not inclusive, financially unsustainable, doesn’t smooth consumption, doesn’t encourage savings and encourages informality!

• Our system is 100% inclusive, much more sustainable (less dependant on demography), encourages formality, let workers smooth consumption and heavily reduces the fiscal burden on households and firms
Thank you!
A History of Labor Informality