LAC: Are Pensions Low, is Pension Populism high, or both?

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Summary

The main challenges that pension systems are facing in the LAC region today:

• Sustainability is under threat
  – The remains of the recent *fiscal* bonanza fueled and still fuel populist demands for higher formal pensions
  – New *fiscal* challenges have led some governments to propose radical reforms that reduce the degree of funding of contributory pensions

• The policy responses are confused by an inadequate focus on formal pension amounts and on average coverage, rather than on the standard of living of the old.
Phase 1 of any diagnosis: measure the standard of living in old age

The “pension amount and coverage” approach suffers from a weakness: formal pensions can be low, and at the same time the old may have sufficient consumption.

Concept: “Sufficiency of Consumption of the Old”, relative to consumption by active workers at the same date

This is an alternative to the focus on “coverage of formal pension benefits” (whether pensions are low or not)

Data on Sufficiency: from Household Expenditure Survey taken every 10 years to calibrate the CPI’s weights. Most of LAC can do it.

Uses the most reliable field processes. Self-reports are checked. Expenditure is a better proxy of permanent income than the self-reported income used by poverty lines and headcounts.
Measuring sufficiency of consumption of the old in the case of Chile (EPF 2013)

<table>
<thead>
<tr>
<th>expenditure, per capita equivalent</th>
<th>Old age (65 and more years of age)</th>
<th>Ages 35 to 59 (only hholds without old)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Median (50th percentile)</strong></td>
<td>CLP 271.748/mo.</td>
<td>CLP 265.301 /mo.</td>
</tr>
<tr>
<td><strong>Vulnerable (25th percentile)</strong></td>
<td>CLP 175.296/mo.</td>
<td>CLP 163.039/mo.</td>
</tr>
</tbody>
</table>


=> Limited coverage and low pension amounts have not prevented the old from holding a better standard of living
Sufficiency of consumption of the old

Expenditure baskets differ by age. Health is a priority. Education too. Solution: measure expenditure excluding health and education:

Sufficiency of Consumption w/o H&E: percentiles 1-70. Chile 2013


Confirms previous result => The priority for social policy should be the young, and to raise consumption of the poorest decile of the old ¿take-up issues?
Are formal pensions low? Measurement challenges

Chilean law set a floor for “protected” pensions, and implements it through Non-contributory pensions (Basic and APS).

• Challenge: The law also establishes pensions not protected by this floor. Cases where the law withdraws protection:
  1. Beneficiaries of a Widow’s and widower’s pension, which added to their self-financed pension, exceed an amount called PMAS (CLP 300.000/mo.)
  2. Those received by the most affluent 40% of the population;
  3. Received by those with less than 4 years of residence in Chile in the 5 years before the pension is claimed;
  4. Received by those with less than 20 years of residence in Chile.

Thus, to be useful, pension statistics need to report separately the size distribution of “protected” and “non protected” pensions.

The recent Pensions Commission’s Report (sept. 2015) failed to do this. It mingled all pensions, protected or not. This created wrong information, which deteriorated the policy debate. See next...
Chile: The pension amounts reported by the Pensions Commission (Table 12)

Table 12’s numbers are incompatible with the “protection floor” set by the law for each pension. For 2014, this floor was CLP 85.964/mo.

<table>
<thead>
<tr>
<th>Frequency of contribution (% of time in active phase)</th>
<th>Median of the self-financed contributory pension + complement WOMEN (CLP/mo.)</th>
<th>¿Violates protection provided by floor on EACH protected pension?</th>
<th>Median of the self-financed contributory pension + complement MEN (CLP/mo.)</th>
<th>¿Violates protection provided by floor on EACH protected pension?</th>
</tr>
</thead>
<tbody>
<tr>
<td>zero - 25%</td>
<td>5.013</td>
<td>Violated</td>
<td>67.128</td>
<td>Violated</td>
</tr>
<tr>
<td>26% - 50%</td>
<td>15.054</td>
<td>Violated</td>
<td>86.896</td>
<td>Violated</td>
</tr>
<tr>
<td>51% - 75%</td>
<td>50.919</td>
<td>Violated</td>
<td>118.661</td>
<td></td>
</tr>
<tr>
<td>75% and +</td>
<td>222.941</td>
<td></td>
<td>244.357</td>
<td></td>
</tr>
</tbody>
</table>

More amazing: failed to add income from widow’s and widower’s pensions, directly contradicting the law, and failed to report this omission.

Source: Valdés (2015) Evaluación del Informe de la Comisión de Pensiones, ClapesUC.
Is it appropriate for LAC countries to focus on formal pension amounts alone?

“Non-pension resources” ≡ Expenditure – Mandatory and non-contributory pensions, reported in the same survey

Most of LAC can do it

Accounting identity implies that NPR is the sum of (Lee and Mason, 2011):

- Deccumulation of stocks different from pension rights (sell home, sell plot of land, sell share in local business)
- Capital income: imputed rent from home ownership minus expenditure in maintenance; other
- Intrahousehold transfers (including those from spouses), transfers from children in different hholds
- Labor income
- Transfers from other Gvt. programs for the old
- Economies of scale in the household.

If NPR are comparable, or larger, than formal pensions, then a focus on formal pension amounts alone would be inadequate.
Is it appropriate to focus on pension amounts alone?

Non-pension resources are highly significant for Old Age in LAC. Pension size alone tells little about where should policy focus. The basic pension seems to face a take-up challenge in the lowest decile. Low coverage of contributions in the active phase in LAC may show up in old age as higher stocks that can be dissaved, which may sustain consumption.

Pensions Populism and fiscal populism

Sustainability of pension schemes under threat

– The recent fiscal bonanza fueled populist demands for higher pensions, and still fuels them. Many countries in LAC faced this and some still do.

– Recent drop in commodity prices reversed the fiscal situation. Some governments may respond with radical reforms that reduce the degree of funding of pensions, i.e. by extracting resources from participants in pension schemes.
Populism operates in good times too:

• raise the generosity of parameters to win the next election.


• Example: Hungary and Romania raised (Pension Exp./GDP) over 2000-07.

Unsatisfied Pensions Populism in LAC: Chile

• The copper price bonanza started in 2004. In the 2005 presidential campaign, a candidate promised a large increase in non-contributory pensions. She won and started a reform in March 2006. Approved Jan. 2008.
  – New design raised the basic pension and extended it.

• But, other changes *clawed back* a lot of the promised expansion:
  – Non-contrib. pension indexation was reduced from wages to prices.
  – About half of all pensioners were excluded from the benefit expansion.
  – New non-contributory pensions are (lightly) targeted to the poorest 60%.

• Is this a case of responsibility and non-populist policy? No
• Pension “ambitions” were fueled. By 2014 they boiled over.
• Dissatisfaction has led important groups to propose a radical reform to *double Non-Contr. pensions for the next 20 years and to extend them to all.* Pensions populism lingers on.
• But now copper revenue for the government has fallen...
Measurement of unsatisfied pension ambitions: a new approach

The pension “ambition” is measured in a survey, by asking working-age persons “What is the pension amount you estimate as sufficient to cover your needs when you reach the legal pension age?” The answer is called the “ambition”. Not to be confused with their best estimate of their future replacement rate. The question should avoid mix up with sum of NON Pension Resources + Formal pensions.

<table>
<thead>
<tr>
<th>Ambitioned Pension (CLP/mo.) (Statcom survey, 2014)</th>
<th>Range of labor earnings declared in the same survey (CLP/mo.)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>180.000 to 250.000</td>
<td>250.001 to 400.000</td>
<td>400.001 to 800.000</td>
</tr>
<tr>
<td>313.000</td>
<td>383.000</td>
<td>475.000</td>
</tr>
<tr>
<td>145%</td>
<td>118%</td>
<td>79%</td>
</tr>
<tr>
<td>132%</td>
<td>108%</td>
<td>72%</td>
</tr>
</tbody>
</table>

Conclusion: Chile faces a serious populist challenge in 2017 election.
Responses to the current *fiscal* unsustainability challenge

The standard advice for managing fiscal deficits:

- Fiscal consolidation (raise taxes, cut expenditures), issue long-term public debt as long as it is cheap, and sell assets.
- To preserve citizen and investor confidence, take measures to improve the transparency of fiscal accounts. Also adopt a fiscal rule, and create an independent Fiscal Council to settle technical issues and decide projection assumptions.

Is it adequate to respond by extracting resources from pension schemes (i.e. from participants)?

- If the cause of fiscal stress is outside the pension system, the main response should also be outside the pension system.
Responses to the current *fiscal* unsustainability challenge

Pension systems in LAC have made substantial advances in many areas. For example, the Melbourne Mercer Index (2015) ranks the quality of pension systems of 25 countries, and provided the following results:

<table>
<thead>
<tr>
<th>Latin American Country</th>
<th>Grade for its Pension System</th>
<th>Other countries with the same grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chile</td>
<td>B</td>
<td>Sweden, Switzerland, Finland, Canada, UK</td>
</tr>
<tr>
<td>Brazil, Mexico</td>
<td>C</td>
<td>France, USA, Poland, South Africa, Austria, Italy</td>
</tr>
</tbody>
</table>

My view: If the pension systems in Uruguay and Costa Rica had been rated, they would have done as well as Chile’s. If the pension systems of Argentina and Colombia had been rated, they would have done at least as well as Brazil’s and Mexico’s.

Lesson: the existing schemes provided many valuable services. They should be defended from the current fiscal threat. Eastern Europe lost many advances.
Up to what degree should the pension system help absorb fiscal shocks?

• The uncontroversial help:
  – In a FF scheme, raise the % of the pension fund invested in long-term public debt, if CPI-indexed and at market interest.

• Radical measures with permanent effects
  – Reduce worker contribution flows to FF scheme and divert the difference towards a contributory PAYG scheme. Ex. Poland, Lithuania, Slovakia. Uruguay is already there. El Salvador is proposing it.
  – If the cash flow surplus of the first few decades is used to shore up the budget, this is equivalent to a program of issuing additional public debt for a few decades, to be serviced thereafter with a hidden tax on formal salaries.
  – This is not a transparent fiscal policy. Hiding. It can be highly inequitable across generations, and against the poor.
Thanks for your attention

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