

Reforming pensions: Tales from China, Chile and elsewhere

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Reforming pensions: Tales from China, Chile and elsewhere

- 1 The simple economics of pensions
- 2 The China story
- 3 The Chile story
- 4 What about Europe?
- 5 Conclusion

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1 The simple economics of pensions

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The objectives of pension systems

- Individual objectives
 - Consumption smoothing
 - Insurance
- Additional public policy objectives
 - Poverty relief
 - Redistribution

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Ways of organising pensions

- Pay-As-You-Go (PAYG): pensions are paid out of current income
- Funded pensions: pensions are paid out of a fund built over a period of years from its members' contributions

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Controversies

- What is not controversial
 - State pensions, for poverty relief, and in many countries also earning-related state pensions for consumption smoothing
 - Voluntary pension arrangements for consumption smoothing and to allow for differences in

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The relation between contributions and benefits

- Defined contribution (DC) pensions
- Defined benefit (DB) pensions
 - Final salary
 - Longer period of measurement
- Notional defined contribution (NDC) pensions

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2 The China story

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2.1 Description

	Number of retired workers (millions)	Number of active workers per retired worker
1980	8.2	12.8
1985	16.4	7.5
1990	23.0	6.1
1995	30.9	4.8
2002	36.1	3.08

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The system for urban workers

- Basic pension
- Individual funded accounts
- Voluntary pensions
- Other forms of poverty relief

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2.2 Problem areas

- Fragmentation
- System deficits
- Problems with individual accounts
- Lack of nationwide administration

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2.3 Reform directions

- Obvious reform directions
 - Extending coverage
 - Improving compliance
 - Raising retirement age
 - Ensuring accurate actuarial calculations
- Fundamental questions
 - Are fully funded individual accounts *desirable* given current and projected economic conditions in China
 - Are they *feasible* given current regulatory capacity and the current state of financial markets?

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Are funded pensions desirable?

- Is a move toward funding optimal?
 - Does it increase output by

3.1 Description

- The system for formal-sector employed workers
 - Individual accounts
 - Poverty relief
 - Voluntary pensions
- Mistaken views about the 1981 reforms
 - Reduce public spending
 - Offer high rates of return
 - Get government out of the pensions business

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3.2 Problem areas

- Pensioner poverty
- Incomplete coverage
- Gender inequality
- High administrative charges
- Fiscal cost
- As a result:
 - 'the system of individual accounts created by the 1981 reform is not capable of meeting the pension needs of all Chileans' (Chile Presidential Advisory Council 2006)

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Primary lessons

- Funded individual accounts can be part of a good reform, but such a reform is not easy
- Private supply plus competition are not on their own sufficient to keep down transactions costs or charges
- Unless accompanied by a robust system of poverty relief, individual accounts are not a pension system, but only a part of a pension system

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3.3 Reform proposals

The strategy:

The Council proposes 'to move from a system dominated by individual accounts to a pension system capable of balancing and integrating its various components Instead of giving preference to one pension scheme over another or developing parallel systems, the proposed system [will] be structured on three pillars: a solidarity pillar, a contributory pillar and a voluntary pillar. These pillars must be capable of complementing and integrating with one another to ensure that older people have a decent life in old age'.

- The key strategic reform is the proposal to introduce a solidarity pillar

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The solidarity pillar

- Above the poverty line, phased in to reach 75,000 pesos/month by the end of the Presidential term
- Payable to lowest 2/3 of population
- Husband and wife in poor families each gets full basic pension
- Tax financed
- Replaces the minimum pension guarantee and welfare pension

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Individual accounts: Recommendations include

- Extending the mandatory system to self-employed workers
- Assisting low-income workers in accumulating funds
- Addressing gender disparities
- Improving the operation of individual accounts
- The dog that did not bark: a state-run fund

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Comparator countries

- The old system in Chile has much in common with Singapore, based heavily on individual saving
- The reforms bring Chile much closer to
 - Australia: tax financed pension for all but the best off, plus mandatory individual accounts
 - New Zealand: tax financed pension for all, plus voluntary individual accounts
 - Netherlands: tax financed citizen's pension plus de facto mandatory private, funded pensions

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4 What about Europe?

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4.1 The problem

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Public pension spending, % GDP

	2000	2030	2050
Denmark	10.5	14.5	13.3
France	12.1	16.0	n.a.
Germany	11.8	15.5	16.9
Greece	12.6	19.6	24.8
Netherlands	7.9	13.1	13.6
Sweden	9.0	11.4	10.7
UK	5.5	5.2	4.4

Source: UK Pensions Commission (2004, Table D2)

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Roots of the problem

- The ratio of pensioners to workers is increasing
 - More pensioners
 - More people live to retirement age
 - People retire earlier
 - Life expectancy at retirement is higher
 - Fewer workers
 - Declining birth rates
 - Working life starts later because of longer education
- Finance is constrained
 - Medical advances and the need for more education and training increase demands on tax revenues
 - Global economic pressures make it harder to increase taxation

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4.2 The range of options

- The UK Pensions Commission (2004, 2005) rightly argues that there are four and only four ways to improve the finance of a pension system
 - Lower pensions
 - Higher public spending
 - Higher saving
 - Longer working lives

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China and Chile revisited

- Lower pensions: rejected
- Higher public spending
 - China: mainly through expanding coverage and de facto recognition that individual accounts are not funded
 - Chile: an explicit element in reforms that introduce a tax-financed solidarity pension
- Higher saving
 - In China via voluntary pensions
 - In Chile by extending mandatory savings to self-employed workers and by making current savings instruments more attractive
- Later working lives
 - An explicit recommendation in China
 - Chile: through gradual equalisation of retirement ages

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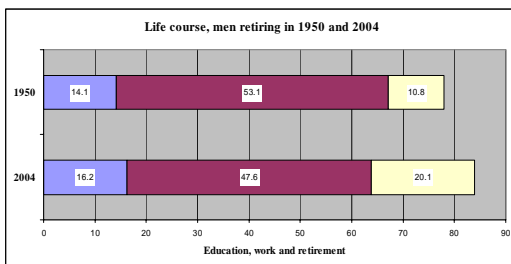
4.3 A central policy direction in Europe: Later and more flexible retirement

- There is neither an 'ageing problem', nor a 'pensions crisis'
- People are living longer – the great untold good news story
- Not a problem but a triumph
- However, creates problems of pension finance
- The solution: pensionable age should rise in a rational way as life expectancy increases

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The life course in the UK



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