

INTRODUCTION

In 1981, under military government, Chile moved away from a badly-designed set of diverse defined-benefit plans (Soto 2007), and put in place a mandatory fully-funded defined-contribution plan in the formal sector, with a guaranteed minimum for workers with at least 20 years of contributions.

Moving to such a plan was widely touted by the Chilean authorities, by some analysts, and by the World Bank (e.g. World Bank, 1994). And many countries started partially down

to mandatory coverage for survivors. The 1981 system included a minimum pension guarantee for people with at least 20 years of pension coverage.

To handle the individual accounts, Chile organized a highly-

The Commission's assessment of the pension system

The Commission's assessment identified a range of problems (unless otherwise stated, all quotes are from the Executive Summary (2015a, English version)).

INADEQUATE PENSIONS. At the time of reform in 1981 people were led to expect a 70% replacement rate. In contrast with OECD member countries, whose average net replacement rates are 66% for men and 65% for women with histories of regular contributions, Chile is below that average by 18 percentage points for men and 28 percentage points for women (p. 14). Widespread discontent about low pensions raised the central question of how to raise replacement rates. Since the solidarity pension improved poverty relief for the elderly, a particular concern was replacement rates above the poverty line.

LOW COVERAGE. Many people do not contribute all the time, nor pay the full amount owed to their account; and many self-employed workers do not participate.

CONTINUED HIGH CHARGES. Administrative charges continued to be a concern, despite improvements from the auction mechanism, because many people do not move to AFPs with lower charges.

GENDER INEQUALITY. Women in Chile face a quadruple disadvantage: (a) on average their annual earnings are lower than those of men; (b) on average they have fewer years of contributions; (c) retirement age for women is lower than for men; and (d) single-sex life tables are permitted. As a result, replacement rates are systematically lower for women than for men. Though (a) and (b) are outside pensions policy, (c) and (d) are not.

HOSTILITY TOWARDS THE AFP SYSTEM. High percentage of the population believe that only a complete change in the AFP system would help improve pensions (72%) and believe that most of the responsibility for low pensions lies with the AFPs (66%) (p. 17), though with lack of clarity whether the discontent is with the system itself (including its origin under a dictatorship) or the fact that pensions fall short of people's expectations.

LOW FINANCIAL LITERACY. In this respect Chile is like other countries. Lack of financial literacy helps to explain at least in part why the AFP system is blamed for low pensions when for many people the underlying cause is an incomplete contributions record. It also helps to explain why people do not move to AFPs with lower charges.

The Commission's Report includes 58 specific recommendations concerned mainly with the structure of benefits, and three Global Proposals, each with different strategies for organising and financing them. Each specific proposal was supported by at least a simple majority of the 24 Commissioners; none of the Global Proposals reached that target.

Specific proposals

The proposals are wide-ranging: some are detailed (e.g. increasing the solidarity pension by 20%), others indicate a direction of change (e.g. increasing earliest pension age), others are more in the form of aspirations (e.g. establishing higher-quality jobs for older workers). Some could lead to legislation soon, some only in the medium term, some never. We therefore do not discuss the proposals in detail; instead, we draw out directions of travel for which there is support, illustrating the general theme that Chile has pursued a mostly sensible evolutionary approach to its pension design, though the reforms that introduced the Solidarity Pensions System could usefully have come earlier.

EXPANDING THE SOLIDARITY PENSION SYSTEM. There is near-universal support for the Solidarity Pension System. The main proposals are twofold: increasing the non-contributory benefit for people with little or no AFP pension by 20%; and tapering the benefit so that at least the bottom 80% of pensioners receive some benefit, compared with 60% at present.

INCREASING CONTRIBUTIONS. Proposals include:
€ Introducing a new 4% employer contribution, some of which would go into the Solidarity Fund which helps to finance the non-contributory pension.
€ Expanding the contributions base by (a) expanding the definition of covered earnings and (b) raising the contribution ceiling on covered earnings and indexing it to wages.

INCREASING COMPETITION WITHIN THE AFP SYSTEM. One approach is to extend the 2008 auction mechanism to a wider group than new entrants, using a mechanism to be defined.

In addition, the Report endorses parallel legislation that introduces a state-run AFP that might lower charges and might partly sidestep the unpopularity of private AFPs. On the last point, interestingly, despite the hostility to the AFP system, 70% of survey respondents agree with the creation of a State AFP and 69% would transfer their funds to it if it existed (p. 17).

CHANGING PENSION AGE. These proposals include:
€ Over time raising women's pension age to 65, the same as for men, and subsequently periodically reviewing earliest pension age.
€ Extending the period of compulsory contribution to the age of actual retirement.
€ Paying higher solidarity pensions to people who delay the start of benefit.

IMPROVING GENDER EQUITY. In addition to equalising pension age, the proposals include:
€ Requiring the use of unisex life tables.
€ Allowing judges to divide pension funds equally at divorce.
€ Establishing shared pension funds. In this arrangement, originally set out in Barr (2001, p. 150), 50% of the husband's annual pension contribution goes into his wife's pension accumulation and vice versa, and analogously for other recognised partnerships. An implication is that the costs of forgone pension accumulation while caring for young children is shared between parents.
€ Recognising caregiving in the pension system.

CHANGING ARRANGEMENTS FOR DECUMULATION. The proposals include:
€ Making it compulsory to annuitise, though further work is needed about whether the mandate should apply to all pension wealth or give people some choice.

€ Including a person's education level or average income in the pricing of annuities. Poorer people on average have shorter life expectancies than richer people, and the difference can be considerable.

€ Restructuring SCOMP to accommodate a group bidding process for annuities

REMOVING EXCEPTIONS. The 1981 system applied to civilian pensions; the military continued to have its own PAYG defined-benefit arrangements. The Bravo Commission's remit was to consider civilian pensions. Proposal 58 moves beyond that remit by addressing military pensions (tackling what up till now has been a taboo subject): [f] the Armed Forces, Carabineros, and similar bodies should, in general, receive the same treatment regarding affiliation and contributions as other workers.⁷

