COMMENTS ON SESSION 2
PENSION REFORM AND CAPITAL MARKETS

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1 Comments on "Pension Systems in EMES: Implications for Capital Flows and Financial Markets" by Ramón Moreno and Marjorie Santos

The first paper, "Pension System in Emerging Economies: Implications for Capital Flows and Financial Markets", written by Mr. Moreno and Mr. Majorie Santos, explores the effects of the pension system on capital flows, saving and investment, and the deepening of financial markets.

The authors analyze three relevant aspects: the stage in the demographic transition, the pension system design and the pension fund asset accumulation and financial deepening. One of the most important conclusions of the paper is that the implications of demographic changes for saving and investment would depend on the stage in demographic transitions. However, according to the ambiguity of some results, the authors conclude that other factors than demographic can play an important role in influencing national saving and investment.

As a second conclusion, it is not clear the expected effects with a funded pension scheme. One of the statement used to justify the introduction of a funded pension system is that could increase the incentive to save and reduce the evasion. The authors list several factors that may have limited the impact of pension reforms on national saving: the lack of financial literacy, the reduction of precautionary saving, the transitional costs, the declining pension coverage of workers and the high administrative costs.

Finally, the authors analyze the assets accumulation and the financial deepening and conclude that in spite of the growth of accumulated assets in emerging economies, the levels in terms of GDP are still lower than in develop economies. At the same time, the portfolio composition of the managed funds in emerging economies is limited, with an important participation of public debt. According to the authors, as pension fund assets have grown, emerging securities markets have deepened in recent years. However, financial markets in emerging economies are still not as deep as in developed countries.

The paper explores in an interested way the effects of the pension reforms on national saving and investment and on domestic capital markets. Most of the explanations provided by the authors help to understand the developments after the 1994 pension reform in Argentina.

In spite of the authors' mention of the relevance of the informal labor sector to explain the declining in pension coverage of workers, it is important to emphasize this effect, taking in account that the informal labor sector has an important participation in the majority of emerging economies.

In addition, the lack of the institutional framework in some emerging economies is important to understand the portfolio composition of the pension managed funds. In this sense, for example, the fiscal cost of the transition has covered in part through the pension funds, explaining the high composition of government debt on the total pension managed funds.

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2 Comments on "Reforming the Pension Reforms: The Recent Initiatives and Actions on Pension in Argentina and Chile" by Rafael Rofman, Eduardo Fajnzylber and German Herrera

The paper "Reforming the Pension Reforms: the recent initiatives and actions on pension in Argentina and Chile", written by Rofman, Fajnzylber and Herrera, is a very complete description of the recent pension measures that have been adopted in Argentina and Chile and a compared analysis of the institutional and political framework in both countries. The paper describes the most relevant components of the recent reforms, explaining why and how they were introduced, discussing their impacts and the remaining challenges.

According to the authors, the introduced reforms during the recent years in Argentina and Chile recognize similar origin: the concerns about coverage, equity and efficiency of the systems, as well as a renew interest in defining the role of the state in the system. However, the measures and the process were very different in both cases. While in Chile there was a wide public debate, in Argentina the reforms were adopted through decrees or through laws whit little discussions about the contents and the goals. This difference reflects the disparity in political and institutional framework of the countries. Therefore, the expected results of recent reforms are also different.

The authors provide an incredible summary of the pension measures introduced in Argentina during the recent years. Since 2002, the minimum benefit has been increased to compensate for inflation and also increase the real value. The government has introduced increases in other benefits than the minimum up to the year 2006. The minimum pension benefit rose more than 70 per cent in real terms from 2002 to 2008, meanwhile the average pension benefit lost real value of around 4 per cent during the same period. As a result, the benefit pyramid has been reduced.

The constitution of Argentina obligates the authorities to adjust the pension benefit according to the evolution of the market wages. However, the government, up to the year 2008, had adjusted the pension benefit using discretionary decisions due to the historical tightening fiscal position. However, in August 2006 the supreme court ruling for a specific beneficiary (called "Badaro case") ordered that the pension benefit of that beneficiary be adjusted for the period between January, 2002 and December, 2006 on the basis of the annual changes in the level of the wage index (formal and informal wages) published by the national official statistics institution (INDEC). A class action ordering the extension of the benefit adjustments to all beneficiaries was approved in June 2008.

In this context, the government introduced a mobile adjusted rule on the basis of the minimum result of the simple average between the six-monthly increase in wages for the registered workers and the year over year evolution of tax revenue for the National Social Security Institution (ANSES) and the year over year rate of the total resources of ANSES. As it was indicated in the paper, originally the index had some technical mistakes because it was estimated using a semiannual rate together with an inter-annual rate.

After the decision of introducing the mobile index of pension's adjustments, the government changed the annual for a semi-annual rate to estimation. Nevertheless some details of the index's estimation have not been provided yet by the government. At the present, there are some doubts regarding the calculation. For example, the updated number of beneficiaries of the pension system is unknown and it is key information to estimate the mobile index.

The anticipated retirement and the moratorium plans are two of the most important measures that have been taken during recent years. The plans were closed at the beginning of 2007, however according to the administrative steps; some new beneficiaries were registered into the pay-as-you-go system during 2008. According to the official information, as of March 2008 more than 1.8 billion people entered to the pay-as-you-go system through these plans.

In 2007, the government introduced a pension system reform. According to the government, the main goals of that reform were to: increase the pension coverage rates, increase the replacement rates, allow contributors to choose between the two schemes, reduce the commission of the funded system and improve the portfolio composition of the managed funds by the pension administrators. However, the voluntary transfers to the pay-as-you-go system were limited and the composition of the pension funds has not registered significant changes.

In spite of the lower rate of voluntary transfers from the funded scheme to the pay-as-you-go scheme, in 2008 the congress approved the nationalization of the funded pension scheme proposed by the executive branch, introducing marginal changes to the original plan. The recent pension measures have had fiscal impacts in the short-term but also in the medium and long-term. As the paper describes, there are not enough official information of the total fiscal impacts.

The anticipated retirement and the moratorium plans generated a net fiscal cost in 2007 (when the majority of people were registered) of 0.7 per cent of GDP. Under the design of the plans, after five years, people will receive the total pension benefit, so the estimated net fiscal cost of these measures will increase during the next years with an important impact on the year 2012 of around 1.3 per cent of GDP.

The 2007 pension system reform included non-voluntary transfers from the funded scheme to the unfunded scheme for some professionals and old-age people that had low levels of accumulated assets in their individual capital accounts. The transfer of the accumulated assets generated extraordinary resources for the government by around 1.0 per cent of GDP during 2007. As of the end of the year 2008 the managed funds by the pension fund administrators were transferred to the National Social Security Institution (ANSES), but this transfer was not accounted as fiscal revenues such as was the case in 2007. The managed funds represent around 8 per cent of GDP. At the same time, during 2009 the government will receive in net terms 4 billion dollars (more than 1 per cent of GDP) of additional cash funds from the nationalization of the pension system.

It is important to explain the fiscal framework in which these measures were implemented. The authors cite that the improvement in the fiscal position in Argentina and Chile during the recent years has permitted to the governments adopt the described pension measures. However, the introduction of a briefly analysis of the fiscal framework could be provide a most complete description of the context in which pension reforms were adopted.

In Argentina, tax collection has increased at unprecedented rate during the last six years (2003-2009) helped by the economic expansion, the increase in exports volumes, the high commodities prices and the local inflation. Tax resources represented 25.9 per cent of GDP in 2008, the highest level during the last fifteen years. At the same time, the primary fiscal expenditures of the Non-financial National Public Sector have been increased too, but at a lower rate, and represented in 2008 24.5 per cent of GDP.

According to the evolution of tax collection, the transfers to the provinces, that include the tax share, have accounted for the highest increase during the last few years. At the same time, the current transfers to the private sector have risen 1.6 percentage points of GDP from 2002 boosted by the subsidies to some key sectors (such as energy and public transport) to reduce the impact of the high commodity prices on local inflation.

The third primary expenditure item that has registered the highest increase has been the pension benefits, increasing from 2.8 per cent of GDP in 2002 to 4.4 per cent in 2008. As a result, of the evolution of the fiscal revenues and expenditures, the primary fiscal balance and the overall fiscal balance of the Non-financial National Public Sector have reached a historical surplus, representing 3.1 and 1.4 per cent of GDP, respectively, in 2008.

During the last few years, the National Social Security Institution (ANSES) has increased their composition of the total primary surplus of Non-financial National Public Sector from 0.1 per cent of GPD in 2002 to 0.7 per cent of GDP in 2008. This increase has been helped by the evolution of tax collection. In particular, by the increases in vat and income taxes, both of which are shared with the pension public system. However, considering only the resources of the pay as you go system (that is the pension contributions) and the pension benefit expenditures, the chronic pension system deficit has not eliminated. The participation of the resources other than contribution to the pension system has increased during the last few years.

Regarding the pending challenges, all the challenges described by the authors are very important and constitute part of the core. However, Argentina has been characterized by a pro-cyclical fiscal policy. The recent pension measures are reflecting the pro-cyclical behavior of the fiscal policy. Therefore, one additional challenge is the reduction of the pro-cyclical behavior of the policy makers. For the short-term, the challenge is the management of the pension system in a less favorable fiscal environment. Additionally, the government has had limited access to the capital market, responding to some local factors, such as the absence of a final solution of part of the defaulted public debt, and the external financial crisis.

In this context, the national treasury has financed their gap through other public entities such as the National Social Security Institution (ANSES). Therefore, the intra public sector debt has increased during the last few years. At the same time, the nationalization of the private pension scheme increased the composition of the intra public sector debt. As of October 2008, more than 50 per cent of total managed funds by the private scheme was allocated to public debt corresponding to the national treasury. As a result, the composition of the pension funds are concentrated in national treasury's debt. In this sense, the fiscal solvency and the improvements in public debt management are important challenges to preserve the real value of the pension contributions and to guarantee the sustainability of the system.

Finally, the enhancement of the institutions and the independency of the social security institutions are the most important long-term challenges. Legal framework to guarantee the transparency, efficiency and predictability of the pension fund administration are other pending issues.