COMMENT TO
"BETTER PENSIONS BETTER JOBS: STATUS AND ALTERNATIVES TOWARD UNIVERSAL PENSION COVERAGE IN LATIN AMERICA AND THE CARIBBEAN" BY MARIANO BOSCH, ÁNGEL MELGUIZO AND CARMEN PAGES

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1 Introduction

I would like to thank the organisers for the invitation to the workshop and the opportunity to comment on this interesting paper. Although pension policy in New Zealand is quite different to that in many Latin America and Caribbean (LAC) countries, New Zealand also faces challenges related to pensions, in particular, the growing cost of pensions arising from an ageing population, and so pension reform is an area of interest.

2 Main messages of the paper

The focus of the paper is on options for future pension reform in Latin America and the Caribbean (LAC). This includes options that can not only eliminate poverty in old age, but can contribute to boosting formal employment.

During the 1980s and 1990s, pension reform in many Latin American countries involved shifting from state-run, pay as you go social security systems to privately managed individual accounts. These reforms were in response to a range of problems including an uneven distribution of benefits, low coverage, and difficulty financing the benefits.

These reforms have been widely studied. This paper focuses on coverage. It summarises the current state of pension coverage in many LAC countries, which shows that low coverage remains a problem even after recent expansions of many non-contributory pensions. Only 6 out of 10 older adults receive a pension. In addition, low pension levels raise concerns about both old age poverty and inability to maintain an adequate standard of living for workers once they stop working. These policy issues are likely to become more of a problem in the future. Although the population in many countries in the region is relatively young, it will experience an ageing population, in common with many advanced economies.

The paper also summarises participation in contributory schemes, which is also low, particularly among low and middle income earners. The paper argues that this low participation is due to the large informal job sector and the focus of contributory pension systems on formal jobs.

The paper argues that coverage is not expected to increase significantly in the absence of further reform, particularly for women and low and middle income earners.

Therefore the paper outlines two main ways to increase pension coverage:

1) Grant pensions to those reaching retirement age who do not have social insurance coverage, through increasing non-contributory pensions. This would help to reduce old-age poverty.

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2) Increasing formal jobs to increase the numbers of workers in the labour market who are saving for their future i.e. increasing contributions to contributory pensions. This would help workers to maintain their standard of living in retirement.

There are some tensions and trade-offs between these two objectives, which the paper explains. For example, expanding non-contributory pensions:

- Could reduce incentives to participate in the labour market – for example, if these are funded by a social security tax, and
- Could reduce incentives to contribute to contributory systems.

3 Some evidence from New Zealand

Although the context in New Zealand is very different, some of our experience would tend to support some of these risks that can arise with a non-contributory pension. New Zealand has a public non-contributory system – known as New Zealand Superannuation – which is a universal, flat-rate benefit paid from age 65 subject to a residency requirement. Not surprisingly, this is generally considered effective in preventing old age poverty. However, the costs of such a scheme are expected to increase as the population ages – from around 4.5 per cent of GDP now to around 8 per cent of GDP in 2050.

What lessons from NZ are relevant for these proposals?

- First, on labour market participation. The New Zealand system has strong incentives for older people to stay working: no legal retirement age, no income or work tests. However, there is evidence that labour market participation falls sharply at the age of eligibility (although New Zealand's labour market participation is relatively high in lower age groups). It would be useful if the paper could distinguish between concerns about labour force participation at retirement vs. earlier ages.
- Second, on contributions to private pensions. Workplace-based private pensions declined in New Zealand from 23 per cent of workers in 1990 to 14 per cent of workers in 2006, as without any tax incentives and with a large non-contributory pension, there was little incentive to contribute to individual accounts. This does not mean, however, that people weren't saving for their retirement in other ways. But it does suggest a need to carefully consider how the introduction of a non-contributory scheme would affect incentives to contribute to a contributory scheme.

On the second option of increasing contributions to contributory pensions, the paper notes two main pathways to achieve this:

- increasing formal employment, and
- using innovations in how the state or private schemes communicate with citizens, such as text message reminders, to increase savings.

On the first, increasing formal sector jobs is a bigger challenge for the region than can be solved by pension policy alone. The paper notes some of the policy options in this area, such as tax reform to reduce formal labour costs. It also points to the need to ensure that any expansion of non-contributory pensions does not lead to higher costs on formal labour which could reduce formal jobs. I agree that increasing formal jobs is important in its own right and would also help to increase coverage. However, given the scope of the challenge, for the purpose of pension policy it would seem more pragmatic to take as given the presence of informal labour markets and consider how pension schemes can be designed to best work in these circumstances.

In terms of mechanisms to increase participation in private pensions, again I'd like to share some experience from New Zealand. In 2007, New Zealand introduced a new scheme with privately-managed individual accounts (KiwiSaver). The scheme is voluntary, employees are automatically enrolled when they start a new job but can opt out. It is open to all citizens under age 65. Workers who contribute will also receive a contribution from their employer, and there are some government subsidies tied to individual contributions (including for those of working age who are not currently working).

Enrolment in KiwiSaver has grown by an average of 20 per cent per annum over the last six years – around half of the total population have enrolled to date, with around 60 per cent of members opting in and around 40 per cent who were automatically enrolled when they started a new job. Many of the design features have aimed to make it as simple as possible for non-informed citizens to begin saving and encourage this to become a habit. It is too early to know how much this will increase retirement income over the long term, particularly because contribution levels are relatively low, but research suggests around one third of private contributions to KiwiSaver represent savings that would not otherwise have been made.

4 Suggestions for the paper

In terms of suggested improvements to the paper, I have four suggestions. First, it would be nice to see more discussion about the estimates of fiscal costs and the risks to the estimates of fiscal cost of expanding non-contributory pensions. The paper argues that moving toward universal coverage under certain conditions is affordable and can be achieved at a cost of around 1 percentage point of GDP, a level which would provide a pension of 10 per cent of per capita GDP. However, there are likely to be risks to this estimate. For example, a higher proportion of elderly in the population may lead to pressures to increase the level of the pension, which would increase the future cost by more than the estimates in the paper.

Second, there is little discussion around the choices between expanding non-contributory schemes for the current generation of retirees, compared with future generations. While it is possible to fund an expansion of non-contributory pensions for future retirees through a save as you go mechanism, this isn't possible for the current generation of retirees. The choice between SAYGO and PAYGO funding has implications for long run tax rates, intergenerational equity, capital accumulation, saving and risk sharing that it would be interesting to see considered further.

Third, in terms of non-financial instruments, the paper talks about examples such as providing information and financial education. While these mechanisms are important, decisions around pensions are complex and better information on its own may not be sufficient. The behavioural economics literature has much to say about non-financial mechanisms to increase saving, such as automatic enrolment, and it would be good to see some examples from countries that have tried some of these approaches and discussion about how these could be made to work in LAC countries, in the context of large informal labour markets.

Finally, the LAC region consists of a range of countries that have differing circumstances, and there is no one policy that will be suitable for all. Although the paper acknowledged this, overall I found that the paper was not clear about what specific policies could achieve the ambitious aims set out in the paper.

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