The political economy of pensions and pension reform

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A little background

• The Chile 2008 pension reform
• Contents:
  • Creation of a “solidarity pillar”
  • More competition in the market of fund administrators
• Process
  • Expert commission
  • Ministers’ committee
  • Long congressional discussion
A few useful lessons (and principles)

1. Pensions get all the attention
2. A battle of ideas (or ideologies?)
3. Pension contributions do not come easy
4. Simplicity is king (and queen)
5. There is such a thing as too much choice
6. Legitimacy matters (a great deal)
7. When it comes to pension reform, process is content
Pensions get all the attention

- Polls: pensions must urgent issue
- Paradox: poverty among
  - Elderly: 8%
  - Children: 20%
- Explanations
  - We will all be old one day
  - Retirees vote
A battle of ideas (or ideologies?)

• 2008: the role of banks
  • Should they own AFPs?
  • Provide pension services?

• Hugely controversial
  • Split both coalitions down the middle
  • Occupied much press attention
  • Nearly exhausted congressional demand for conflict
  • Eased passage of other (more difficult, more complex) items
Contributions don’t come easy

Density of contributions
(by percentile)

<table>
<thead>
<tr>
<th>Percentile</th>
<th>Density</th>
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<tbody>
<tr>
<td>p10</td>
<td>0.0%</td>
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<tr>
<td>p25</td>
<td>11.5%</td>
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<tr>
<td>p50</td>
<td>39.8%</td>
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<tr>
<td>p75</td>
<td>69.2%</td>
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<td>p90</td>
<td>86.6%</td>
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- Most systems built for a labor market that does not exist: with formal, steady, high-paying jobs
- Many people are liquidity constrained, and will not contribute voluntarily
- How to obtain contributions from the self-employed?
Simplicity is king (and queen)

- Most people do not like current pension arrangements
- But few people understand how the system works
- Paradox: policymakers have made it more complicated, not less
There is such a thing as too much choice

- Chile: Multifondos
- Problem: excessive exposure to risk
- Problem: thinking you can beat the market
- Problem: manipulation by outside parties
Legitimacy and trust matter

- Pensions systems are about handing over money today in exchange for getting money back in 30 or 40 years
- To work well, system requires a great deal of trust
- Most systems enjoy very little trust & legitimacy
- Consequence: recent fund withdrawals in Peru and Chile
Process is content

- The surfing theory of reform
- Expert committees help
- Tradeoff: expediency versus legitimacy
- Key: experts have to listen
- Key: they help set the bounds of the discussion
- Key: they improve terms of Congressional discussion
Issues for the future

1. Economic: can we do something about the labor market? Pandemic offers an opportunity

2. Political: can capitalization systems regain legitimacy? Change model of fund administration

3. Fiscal: how will governments pay for pensions? Risk sharing with other contributors or with all taxpayers?
Thank you!