DESIGN AND PENSION REFORMS
ECONOMICS AND COVID-19

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COVID-19: a “tail effect” with supply-demand synchronized channels, uncertainty and persistent effects

- A global economic crisis of non-financial origins.

- Productive dislocation: although all productive activities were hit, key sectors where highly affected. This will make recovery complex all around the world.

- Multiple channels under siege: international financial markets, international trade, real sector

- Persistent uncertainty: Supply: should I invest? /Demand: should I consume?

- Supply - Demand loop effects

- COVID-19, second waves and non-linear effects
This story has not ended

Mobility towards workplace - Index

Covid-19 Daily Cases – Moving average, 1000 people

Source: BBVA Research / Google Mobility Reports.

Source: BBVA Research / John Hopkins University.
COVID-19 impact on jobs

In Q2, 2020, the equivalent of 400 million full-time jobs were lost

% of lost working hours in Q1 and Q2, 2020, compared to Q4 2019

Source: International Labor Organization
Fall and rebound 2020-2021.....

GDP Economic Forecast

... but what will happen next?

Source: World Economic Outlook, Octubre 2020 (FMI).
Breaking the piggy pot

Fiscal response to COVID-19 - % of GDP

Source: MAPFRE
And also, breaking the pension piggy pot (and beyond)

Early access to pension saving available for Covid-19

Peru and Chile: Two countries where early access to mandatory pension savings “is” not permitted but….

Source: Worlbank 2020, García Huitron and Ponds (2015), and recent news
Pension systems were being impacted before Covid-19

**Trends**

- Global Financial Crisis 2008-2009
- Demographic transition
- Third Industrial Revolution – Data Revolution
- Financial unsustainability of DB, PAYG or similar schemes
- Moving high responsibility to people under more relevant CD schemes

**Impacts observed**

- Long term impact on long-term assets
- A decade of low interest rates
- Accelerated downsizing of DB/PAYG schemes: tough parametric adjustments
- Increasing importance of DC mandatory/voluntary pillars
- Formal/Informal Labor Markets <-> Rigidities v Flexibilities
- Gig Economy
Trends before Covid-19

Size of assets in funded and private pension plans in reporting jurisdictions, 2018 or latest year available /(% of GDP)

Average accrual rates for new pensions over the period 2010-2060 (%): 2012 AR versus 2015 AR

Covid-19 has accelerated previous trends in pension systems

Covid-19 accelerates previous challenges

• A longer period of more depressed interest rates.

• Dragging effects on capital markets? How much and longer will be the effect?

• Covid-19 has accelerated labor market impacts: flexibility vs rigidity; neo-ludites? “Engel’s Pause?”

Pension system hardly hit

• DB, PAYG and similar systems will be under more pressure around the world

• More parametric adjustment in sight. Pensions based on strong promises become unsustainable without adjustments or more downsizing. More funding, more fiscal deficits.

• Change of risk preferences on DC and DB plans

• Impact on labour careers and savings pot

• Impact on those more vulnerable (women, less educated)

• Reduced pensions and early retirement

• Reduced pension and early access to pension
Pensions will be hardly hit by early access to pension savings: the Peruvian case

A. 3.5% real interest rate

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<th>Scenario</th>
<th>100%</th>
<th>50%</th>
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<td>Baseline scenario</td>
<td>18.6%</td>
<td>37.1%</td>
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<td>10% withdrawal at 55</td>
<td>15.1%</td>
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<td>10% withdrawal at 40</td>
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<td>25% withdrawal at 55</td>
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<tr>
<td>10% withdrawal at 40</td>
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B. 8% real interest rate

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<td>10% withdrawal at 40</td>
<td>24.3%</td>
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Source: BID (2020)
Designing reforms

• Covid 19 will spur pension “reforms” around the world:

• The degree/type of pension reform will depend on the intersection of four vectors:

  1. labor market institutions (formal/informal) - > An issue in Emerging Economies

  2. degree of financial desequilibrium (private/public funded)

  3. unstoppable global trends (technological, demographics, others)

  4. Cultural/idiosyncratic preferences/institutions
Designing reforms in Emerging economies: basic questions before starting

- Covid 19 makes social unprotection more evident
- A need for a pension reform but taking into consideration financial contraints
- How to match the empty consensus for a reform of a “Universal-Integrated-Multipilar” pension system:
  - What does it mean?:
  - Multipilar (non contributory / mandatory / voluntary): what is the weight of each pilar?
  - How to finance a non contributory pension?
- How to finance a pension promise?
  - How much it cost?
  - Can we afford it?
- How to incorporate solidarity in a contributory pilar?:
  - Intergenerational/intragnerational
  - Among participants / from the budgets- taxes
- Keeping a pension promise: does your country/government have the institutional development to enforce parametric adjustments or increase taxes?
- Does your country/government have the institutional development to import complex systems that works in developed economies?
- How to incentivize people to save voluntarility for retirement?
- Is retirement the most important shock from a life cycle perspective?: withdrawal; other mechanisms
- Are you avoiding the “tunnel vision”?
  - Does an increase in employer/employee contributions increases labor market informality?
  - Does the introduction of a non contributory pension incentivize informal labor markets?
  - Does a structural change from DC scheme to DB scheme (partial or total) will affect current institutional arrangement of property rights?
  - Does a structural change will impact capital market development, infrastructure financing, economic growth?
- The political- consensus stage: How are you designing your reform process from BEGINNING to END?
Multi-trillion dollar problem and opportunity

Pension Landscape

- **600M**
  - Salaried employees with pension benefits

- **1200M**
  - Self-employed workers without pension benefits. Can afford to save for old age

- **600M**
  - Below poverty line. Cannot afford to save

Problem

- **2 billion**
  - Elderly by 2050

80% of them will be living in Asia, Africa or the LAC. Majority will not get a pension and could face 20+ years of extreme poverty in old age.

A tax-funded social pension of $2/day to the excluded future elderly will cost $1 trillion a year.

Opportunity

By saving $1 a day, a 25 year old can enjoy an inflation-indexed monthly pension of $400 a month for 20 years starting age 60 (at 2020 prices)

If even 10% of the excluded informal workers save $1 a day for old age, they can generate $1 trillion in new long-term savings within the next 5 years.

Only sustainable option is to encourage and enable young, economically active informal workers to start saving for their old age.
Barriers to comprehensive pension inclusion

- **Fragmented ecosystem**
  The digital financial inclusion ecosystem is fragmented and does not readily serve the retirement needs of lower-income informal sector workers.

- **Low commercial incentives**
  Traditional, agent-led finance sales models and incentives make small-ticket pensions and insurance unviable at a disaggregated level — for both finance firms and distributors.

- **High friction and costs**
  Cumbersome KYC and paper-based account activation.
  Increases cost of financial literacy, on-boarding and servicing. Inhibits voluntary mass-adooption of pensions and insurance.

- **Affordability constraints**
  Most informal workers are not insured. Use past savings and loans pay the full cost of (insurable) lifecycle risks. Surplus income is used to repay expensive emergency loans. Leaves no room for retirement savings.

**PinBox Solution**

- **Use pensionTech as “glue” to integrate and leverage the existing digital finance ecosystem for pension inclusion.**

- **Aggregate demand by providing trusted channels easy, zero-cost, plug-and-play access to a digital micro-pension marketplace.**

- **Leverage open platforms like WhatsApp for micro-pensions. Simple, familiar user-interface. Optimizes access. Nullifies digital literacy efforts and costs.**

- **Integrate pension with liquid savings and insurance. Provides liquidity. Releases surplus income for savings. Makes pensions more affordable and attractive.**
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A global issue
Designing reforms from a global perspective: how to face multiple shocks? an issue that Covid-19 has accelerated

• Pension systems will gradually move from a three stage Life-cycle hypothesis ....
Designing reforms from a global perspective: how to face multiple shocks? an issue that Covid-19 has accelerated

- Pension systems will gradually move from a three stage Life-cycle hypothesis ....

- ... to a multistage Life-cycle hypothesis to tackle increasing multiple shocks:
  - More frequent natural disasters
  - Pandemics?
  - Up-skilling, re-skilling to face the risk of labor market transformation ...
  - ... digital effects
  - ...... Longevity effect

- Necessary to rethink the whole concept of pension savings

- Incentive to save for continuous and long-term shocks: behavioral economics and digital platforms
Market segmentation, INTEGRATED SOLUTIONS

**Micro-pension**
Simple and flexible long-term saving product with some liquidity benefits.

**Group Insurance**
Simple, low-cost insurance for Covid-19, airborne and vector diseases, death and disability.

**Digital payments**
UPI for direct transfer of periodic savings, premiums and benefits to and from product providers.

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**Flexible Solution**
Each subscriber is free to decide how much and when she wants to save as per her own savings capacity and income-flows.

100m: Domestic help
50m: Gig-economy workers
150m: Women micro-credit clients of NBFC MFIs
400m: Women SHG members, milk producers
300m: MSME employees and contract workers
Covid-19 has exposed the economic vulnerability of self-employed workers. Most workers ran out of savings within a few weeks of the lockdown. This added extreme social, economic and fiscal stress to the health crisis. But has led to stronger policy and public realization about the importance of social security and savings.
PinBox Solutions: one of the 10 most innovative fintech solutions globally

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THANK YOU!