

Comments

Eduardo Morón: This paper discusses a topic that for many critics offers a clear-cut example of how neoliberal reforms in Latin America have not solved real problems. The performance of Chile's reformed pension system has thus become a hot issue in many countries in the region that followed the Chilean model. The paper addresses the main problems of the Chilean pension system and proposes a set of further reforms to improve the current situation. The first lesson of the paper is that Chile has a severe problem of low coverage: only 30 percent of the economically active population is covered. Although Chile certainly does not have the worst coverage indicators in the world, it seems surprising that even the first reformer has this problem.

Measuring coverage is tricky, as just being an affiliate of one of the pension fund administrators (AFPs) does not guarantee an adequate pension in the future. Therefore, any evaluation of the performance of a particular pension system must include the projected pension benefits that the system will render to its affiliates. Most of the previous studies approximate these projections by assuming a lot of homogeneity across the underlying population of affiliates, because individual-level data have not been available. In contrast, Berstein, Larraín, and Pino combine a rich administrative database with a social security survey, which allows them to compute at the individual level both the probability that affiliates will contribute to their personal accounts and the profile of wages across the life cycle. They also project the size of the capital gains from AFP investment management. Here they use a rather conservative assumption for their baseline scenario, setting the benchmark real rate of return for the pension fund at 5.8 percent.¹ With these three inputs—that is, the probability of contributing, the wage profile, and the projected rate of return—the authors compute the expected pension benefits for different types of individuals.

1. This is the average of the last ten years, although the twenty-year average is twice as large. It would be interesting to see how much the results change under a slightly less conservative assumption.

The results present a worrisome picture. Fully 45 percent of affiliates will receive a pension below the state's minimum pension guarantee (MPG), yet an almost negligible group will receive the MPG, which reveals that the requirements for this government-sponsored benefit are too strict. The paper downplays the critics of the reformed pension system, however, by showing that these apparently dreadful results are largely the direct consequence of the characteristics of the labor market and rules that provide too many incentives for early retirement. The authors show that the projected replacement rate, taking into account the traits of the Chilean labor market, is more than 100 percent for affiliates that manage to contribute to the system for at least ten years. The paper thus provides evidence that many of the criticisms aimed at the private pension system are misguided. For example, arguments focusing on the administrative costs charged by AFPs seem to be overstated.

The second lesson of the paper is that the reformed system works for those that work (that is, for workers who are able to contribute during their whole active employment period). This is remarkable, considering that in the old pay-as-you-go systems in many countries, even workers who contributed regularly to the system received very low pension benefits on retiring. Administrative problems were common in many of the region's pay-as-you-go systems. This point is often forgotten in the current policy debate. Government-run pay-as-you-go systems used the pension funds at their discretion, and inflation was a tool for reducing fiscal obligations.

The paper provides a very good starting point for those willing to reform Chile's reformed pension system. Before changing the rules of the system blindly, reformers must define some priorities. For instance, where should the government invest its first marginal peso? Should it be in a noncontributory pension scheme or a less strict MPG? A system that only offers good pensions to half of the affiliates clearly is not politically sustainable, and urgent measures must be taken. Reforming the real culprit, the labor market, will not be easy, although the authors' proposals are a first step in that direction. Another policy option that merits further discussion is funding means-tested noncontributory pensions for low-income individuals.

Pension reform has allowed the state to save a huge fiscal tab. It is now time for the governments in the region to reconsider their role in the provision of pension benefits. The design of new reforms requires careful assessment of the government's role in each of the pillars of the reformed pension system. To do that accurately and properly, analysts require better data, such as the database used effectively in this paper. Otherwise, we will simply keep adding items to our list of working assumptions.

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