

The Outlook for Pension Reform in Chile



© Olivia S. Mitchell
The Wharton School, University of Pennsylvania



Chile has a multi-pillar system for retirement support:

- Solidarity benefit
 - ✓ Safety net
 - ✓ 60% of poorest
 - ✓ Age 65+
 - ✓ Basic/Supplemental benefit
 - ✓ Survivor pension
 - ✓ Child bonus
 - ✓ Tax financed
- Mandatory pension
 - ✓ 10% contribution
 - ✓ Individual accounts (AFPs)
 - ✓ Until no, self-employed excluded
- Additional private saving: Voluntary accounts, home equity, etc.

Bravo Commission Analysis (2015)

- DC pension system replaced bankrupt PAYGO system in 1981;
- 70% of e'es pay into pension; highest participation in Latin America; \$205B (AUM 2017).
- Yet contribution rate low: 10% (OECD av. 19%);
- Also incomplete contribution histories:
 - Half of self-employed, 45% of wage workers don't contribute.
- Today: 90% of 65+ have some kind of pension incl. Solidarity & contributory pillars.
- Benefits lower than expected:
 - ✓ Current benefits: 34% RR from contributory, 45% incl. Solidarity pillar.
 - ✓ Projected benefits (2025-35): Solidarity pillar a major portion.

3

3 Commission Alternatives

A: Raise Solidarity benefits + Boost Private Saving Rate

- 2% ER Solidarity contrib + 2% ER AFP contrib. [ER vs EE]
- Equalize M/F Retirement ages
- Fiscal cost ~ 0.5 % PIB

12 supporters O. Attanasio, N. Barr, D. Bravo, M. Costabal, C. Díaz, C. Meghir, O. Mitchell, C. Mesa-Lago, R. Paredes, J.L. Ruiz, J. Tarziján and S. Urzúa.

B. Adopt Notional Accounts; Raise Solidarity benefits; Limit private accounts to top 50%

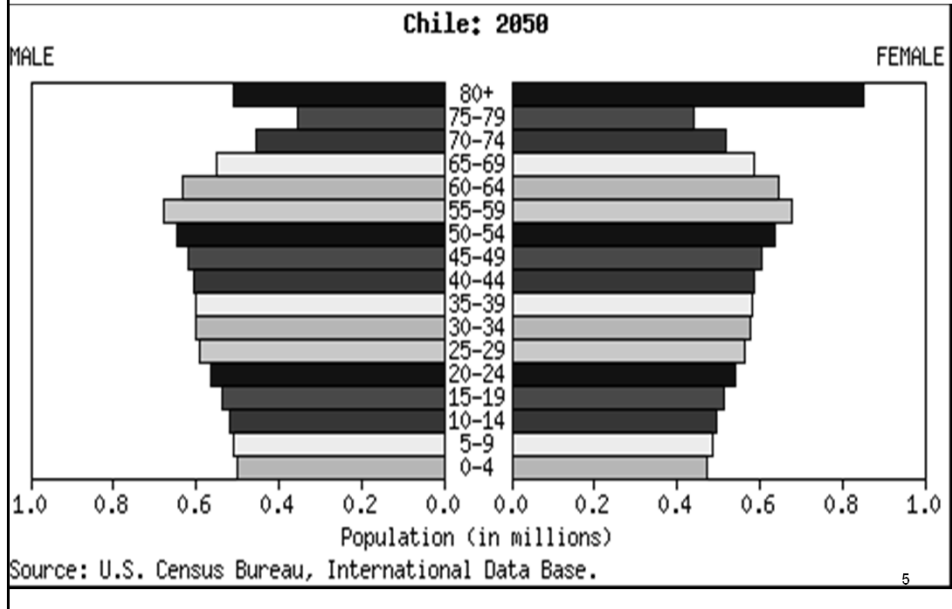
- Fiscal cost ~ 2.5 % PIB

11 supporters C. Albala, F. Bertranou, H. Cifuentes, R. Clark, C. Larrain, V. Montecinos, J. Palme, M. Rios, C. Robles, C. Sanhueza and A. Uthoff.

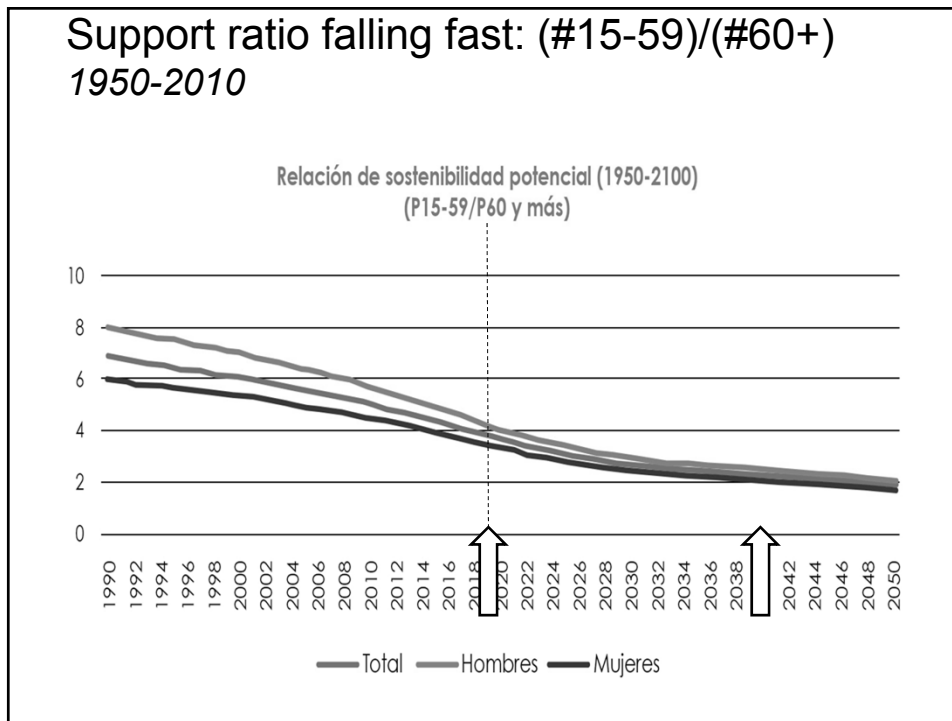
C. Revert to PAYGO immediately

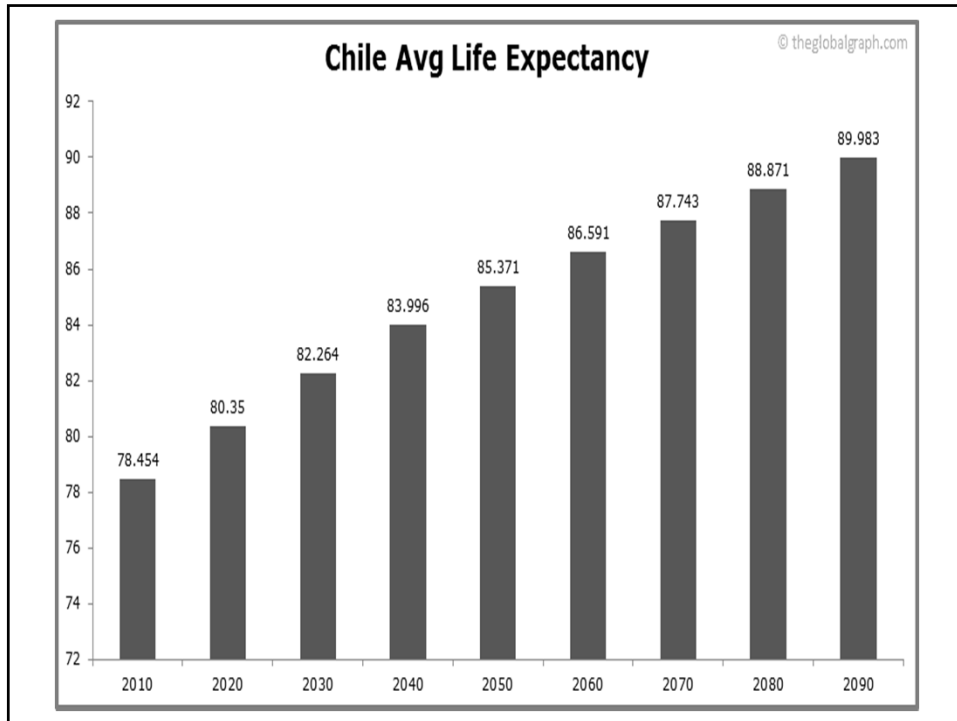
1: L. Orezia (approach rejected by the Commission)

Why reject PAYGO? Chile aging fastest in South America

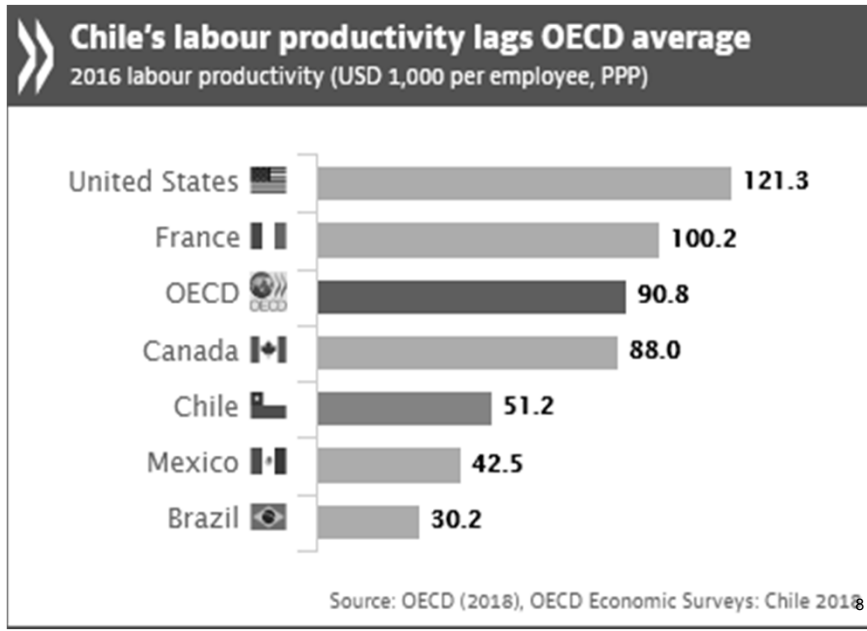


Support ratio falling fast: (#15-59)/(#60+) 1950-2010



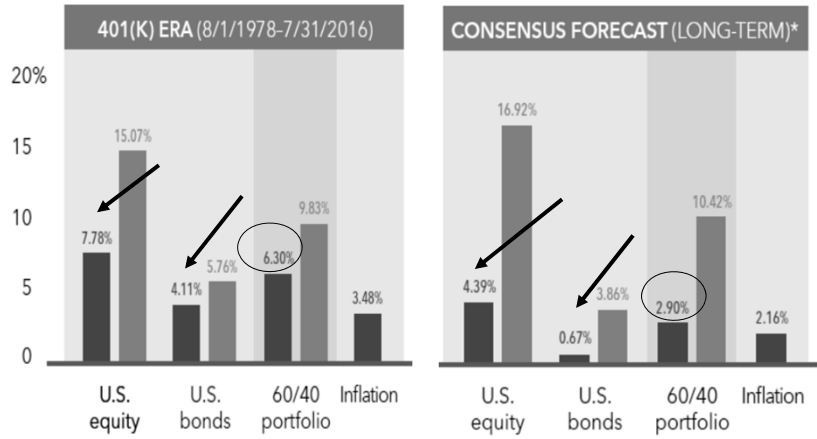


Low productivity makes things worse



Also outlook is for LOW future returns

■ Annualized average return (real) ■ Average annualized risk (real)



9

So we'll need to save far more:
To achieve a 50% RR

Save for:	$r=0.03$
20 years	27.5%
30 years	16.5
40 years	11.11

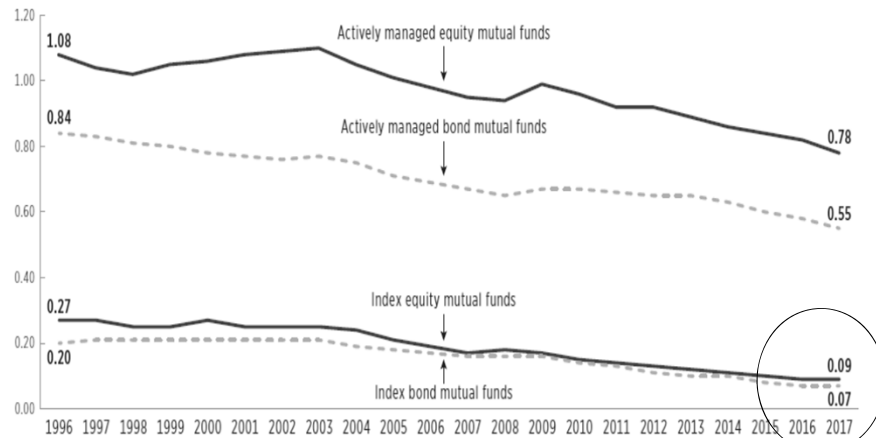
Pote

And fees must come down

Expense Ratios of Actively Managed and Index Mutual Funds Have Fallen

Percent, 1996-2017

EU 1.05?



11

Current Administration proposals:

- Strengthen Solidarity Pillar (10→50% by age) costing 15% more *[from where?]*;
- ERs to pay 4% of salary to indiv accounts *[incidence? AFP/new savings plans?]*;
- Provide partial lump-sum incentive to defer retirement, keep contributing;
- Encourage competition *[?]*;
- Establish disability subsidy/insurance system; Ers to pay 0.2% of salary *[low?]*;
- 0.25% of commissions to be used for financial literacy *[how?]*.

12

To better manage old-age risk:

Chile must reinvent retirement!

- Build human capital
- Work longer;
- Invest in financial literacy;
- Invest smarter, diversify better, reduce fees;
- Save MUCH more!
- Help protect against longevity.

In an aging world, generous PAYGO systems are doomed to fail.

Thank you!

- *For more information:*

Wharton's Pension Research Council:

- <http://www.pensionresearchcouncil.org/>

Books and working papers:

- <http://www.pensionresearchcouncil.org/publications/books.php>



 **Wharton**
UNIVERSITY OF PENNSYLVANIA