LESSONS FOR CHINA'S PENSIONS OF PENSION PRIVATIZATION IN LATIN AMERICA

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Ciclo de Conferencias del Cechimex
Mexico City, September 7, 2022

OBJETIVE OF THE PRESENTATION

A) Evaluate the performance of ten pension systems with individual accounts in Latin America 1980-2020, based on five key ILO social security principles:

1. Coverage of the labor force and elderly population
2. Social solidarity and gender equity
3. Benefit sufficiency
4. Efficient administration and reasonable managerial costs (competition)
5. Financial and actuarial sustainability

B) China's dual pension system

Lessons for China derived from the L. A. experience (based in the 5 ILO principles)

An important question on priorities for China's future pension policy

PENSION STRUCTURAL REFORMS (PRIVATIZATION) IN LATIN AMERICA

In1980-2008, 11 countries shifted totally or partially from: defined benefit, pay-as-you-go (PAYG) and public administration (**"public"**) to defined contribution, fully-funded individual accounts and private administration (**"private"**):

Countries	Year of implementation	Models of structural reform	Re-reforms: Change to new model
Chile	1981	Substitutive	Substitutive (2008)
Peru	1993	Parallel	In process move to Mixed
Argentina	1994	Mixed	Public (2008)
Colombia	1994	Parallel	In process move to Mixed
Uruguay	1996	Mixed	Mixed
Bolivia	1997	Substitutive	Mixed (2008)
Mexico	1997	Substitutive	Mixed (2020)
El Salvador	1998	Substitutive	Mixed (2017)
Costa Rica	2001	Mixed	Mixed
Dominican R.	2003	Substitutive	Substitutive
Panama	2008	Mixed	Mixed

- Due to the **flaws of the private systems** (to be analyzed herein) **"re-reforms"** were implemented:

- **Argentina** closed its private system and transformed it into **public**
- **Bolivia, El Salvador** and **Mexico** moved to **mixed** systems
- **Chile** maintained the substitutive system but introduced a public, PAYG, state-financed component (**close to mixed**); **D. Republic** has not have a re-reform and maintain substitutive
- **Costa Rica, Panamá** and **Uruguay** maintained their mixed systems.
- **Colombia** and **Perú** are in the process of reforming their parallel systems and probably moving to mixed system

CHINA'S MIXED PENSION SYSTEM IS DUAL

China has a **mixed** pension system (like most Latin American countries now), combining basic social insurance and individual accounts, but with substantial differences between the two major schemes (dual system)

1) Urban employees (salaried): mandatory, five pillars: 1) basic social insurance, 2) individual accounts, 3) occupational plans in large corporations; 4) voluntary commercial insurance savings-individual accounts (only covers 3.5% of the labor force)

Financed: contributions (% of salaries) from employers (to basic social insurance) & employees (to individual accounts)

2) Urban and rural (non salaried) **residents**: voluntary, two pillars: 1) basic social insurance, and 2) individual accounts (this group lacks occupational plans and cannot afford voluntary commercial insurance

- Financed: flat contributions from central gov't (to basic social insurance) and residents (to individua accounts), plus local gov'ts subsidies
- Residents scheme has lower coverage (some groups largely excluded), lesser contributions, smaller accumulation in individual accounts, lower pensions, etc. than the urban employee scheme.
- **Comparisons with L.A are difficult** China's population is more than twice the entire population of Latin America and is the second world economy. Some Chinese cities and urban areas exceed the standards of the most developed L.A. countries whereas some Chinese rural areas are similar to L.A. less develop countries.
- Some L.A. countries were pioneers in social security (Uruguay, Chile) whereas China's modern social security appeared later than in most other L.A. countries.
- Still **some L.A. experiences may be useful to China**

Promises and Results of Pension Privatization in Latin America: 1980-2000

1) Coverage:

Promise: The contributive coverage of the labor force will increase; no mention of non-contributive pensions

Results:

- Coverage of the labor force decreased in all countries after the reform: average down from 38% to 26%.
- Later, coverage grew but in the 5 less developed countries it covers from 21% to 38% (less than ILO minimum of 50%) and very difficult to extend it (informal sector)
- Coverage of the elderly population: grew in all countries, mainly due to non-contributory pensions financed by the state.

2) Social solidarity and gender equity:

Promises: None

Results:

- Social solidarity improved in most systems but due to state policies such as non-contributory pensions, fiscal subsidies to low contributive pensions and inclusion policies.
- The private system accentuates gender inequalities in addition of those derived from the labor market (mortality tables differentiated by sex)

3) Benefit sufficiency

Promise: The pension level will be adequate (RR “70% of the last salary” José Piñera)

Results:

- IADB 2015: the average RR in the private system is 39.8% and in the public system 64.7% (ILO minimum RR 45%).
- The RR in 5 private systems is lower than the 45% and the majority of insured will only get the balance in the individual account

4) Efficient administration and reasonable administrative costs:

Promises: competition in the private system will reduce administrative costs

Results:

- Competition has not functioned in most private systems:
- The number of administrators has decreased significantly and concentration in the major two has grown
- The percentage of affiliates that annually changes administrators has shrunk sharply; in 5 systems is between 0 and 1%.
- The administrative cost is high and usually sustained; discounts take from 23% and 30% of the deposit in 5 countries thus reducing the future pension
- Profit as percentage of the net patrimony fluctuates from 20% and 48% in 4 systems and from 12% and 16% in other 4

5) Financial-actuarial sustainability:

Promises:

- Ownership of the individual account and private administration will motivate the insured to pay their contributions;
- the pension capital will increase significantly;
- the investment portfolio will diversify (away from govertment debt) and most investment will be in national stocks; and
- there will be high capital returns.

Results:

- The percentage of affiliates that contributes has drastically declined in 8 systems (as much as 42 p.p.)
- The accumulated capital in the pension fund has growth notably and also as a percentage of GDP (81% in Chile).
- The investment portfolio is heavily concentrated in government debt, bank deposits and foreign instruments; nothing or very little is in national stocks
- Gross real capital returns from the introduction of the private system to 1999 were high, during the 2007-08 crisis, did not recover the pre-crisis level in the majority in 2009-19, and decreased again in 2020-2021 (-17% in Chile)
- The insured bear all the financial risk and the administrators virtually none

SOME POTENTIAL LESSONS FOR CHINA

1) **Coverage of labor force** (contributory)**:** both pension schemes 42.5% ILO 50%); 5 L.A. countries have higher coverage and 6 have lower coverage

- **Urban employee scheme:** 68%; only Uruguay (pioneer in social welfare) has higher coverage in L.A.
- **Urban-rural residents scheme:** No estimates available, but much lower that urban employees. Reasons: voluntary, non-salaried workers, may be joined by migrant workers and flexible employees but most have not.
- Resident scheme faces similar obstacles that 6 less developed L.A. countries: the informal sector (groups in this sector as self-employed also have voluntary coverage in most L.A. countries)
- Coverage of the **elderly population** by contributory pensions; lacks non-contributory pensions, but social assistance available for poor and other disadvantage groups covers 70% of the elderly population (zero pillar)
- **Lessons:** Gradually make mandatory the resident scheme and reduce gaps with the urban employee scheme; higher state support needed to achieve those goals

2) Social solidarity and gender equity

- As in L.A., these principles don't apply to individual accounts, occupational plans and new commercial insurance; they do apply to basic social insurance but there is a significant gap between the two schemes.
- Gender inequities derived, as in L.A., from labor market and individual account system.
- **Lessons:** both principles have been improved in L.A. by implementing state-financed benefits (Argentina, Bolivia, Chile, Costa Rica, Mexico, Uruguay); virtually all countries provide non-contributory pensions either targeted on the poor or universal.

3) Benefit sufficiency

- **RR:** estimates vary significantly, the most plausible is 48.5% in the urban employee scheme (combining basic and individual accounts), above 45% ILO minimum. No RR estimate in the urban-rural resident scheme.
- Comparisons with L.A. are not feasible
- Average contributory monthly pension in the urban employee scheme meets essential needs, but 20 times the average pension of the urban-rural resident scheme (probably does not meet essential needs)
- **Lessons:** Several L.A. countries (Chile, Costa Rica, Mexico, Uruguay) have improved RR by state contributions to low contributory pensions.

4) Administrative competition, efficiency and low costs

- The pension system is fragmented; provincial and local government play a key role deciding contributions, public subsidies, setting reference salaries, which generates differences.
- Important positive steps are: gradual integration of previously separated pension schemes (civil servants), unification in the collection of taxes and contributions, some standardization in national norms, central adj't fund to reduce differences.
- There is a low enforcement of employers' compliance, particularly with migrant workers and flexible employees
- Lack of data on administrative costs in basic social insurance and individual accounts impede evaluation of efficiency.
- **Lessons**: In L.A. competition does not exist or is poor in the administration of individual accounts and costs are high; the state has strengthened supervision and imposed restrictions on administrative commissions. China should publish information on these issues.

5) Financial-actuarial sustainability

China urban employee pension scheme 2019	
Basic social insurance balance surplus/GDP (%)	6.4
Individual accounts/GDP (%)	2.5
Commercial insurance individual accounts/GDP (%)	0.02
Capital returns real (%, 2020)	15.8
Fund predicted year of exhaustion (actuarial study)	2035
Urban and rural resident scheme	
No data, no actuarial study	

Performance in China **urban employee** scheme **better** than in mixed systems 1st pilar in L.A: higher basic surplus, capital returns and year of exhaustion (similar to C. Rica); also better than in public systems of Colombia and Peru. But sum in individual accounts much lower (Chile 80% of GDP). China Commercial insurance lower than 3rd pillar voluntary savings in L.A.

No information available on urban-rural scheme

Aging major problem in China, which has an older population than in L.A. except for Cuba. China's policies giving incentives for more children but young couples not responding yet.

Lessons: Urban employees: implement 2022 5-year plan on aging recommendation to rise age 5 years for men and women (but no enough), need to rise contribution (preferably to enterprises). ILO could provide actuarial alternative scenarios to achieve longer equilibrium and carry on actuarial study on resident scheme. Some L.A. countries have an independent Superintendence and regulations to protect savings, that should be applied to China's commercial insurance to protect savings of insured

QUESTION FOR THE DEBATE ON CHINA PENSION POLICY

The evaluation of performance in L.A. ten private systems found that promises on coverage, sufficiency, social solidarity, gender equity, administrative efficiency/costs and financing were not fulfilled; only the growth of the pension fund was met.

In view of that negative performance, one important questions for debate in China pension policy for the future is:

What should be the priority on social security pensions: improving coverage and benefits in the resident scheme, as well as social solidarity and gender equity, and social assistance for the majority of the labor force and population or developing individual accounts further for a minority of the labor force?

Many developed countries (Finland, France, Germany, Portugal and Spain) rely primarily on reliable, generous, and sustainable public social security provision to ensure adequate and safe retirement to their populations.