KISS: Knowledge and Information on Social Security

First KISS Café on pension systems

27/10/2020, 48 participants

Agenda

1. Introduction by Shahra Razavi: *4 minutes*
2. Pensions situation in Chile: *15 minutes*
3. Comments from field specialists/experts on the Chilean case based on the experience of other countries (Thailand, South Africa, Egypt, Lebanon): *20 minutes*
4. Q&A: *15 minutes*
5. Update on the round table on pensions: *5 minutes*
6. What is next? *2 minutes*

Guillermo Montt

- Chile has a defined contribution system with a solidarity component. In the 1980s, a reform replaced the DB pension scheme by an individual savings account. Due to the individual savings account, pensions have been traditionally unpredictable and low. In 2006, a first expert commission was set up to evaluate the pension system and come up with recommendations for reform, including the introduction of the solidarity system, which was implemented in 2008. The savings account has a replacement rate of 20%, which is increased by the solidarity pillar to 40%. Even though pension coverage is high, benefit levels are low. There is no solidarity within the contributory scheme. In addition, the current system suffers from inequalities that are exacerbated by labour market inequalities (between men and women and across different socio-economic groups).
- Current debate: In 2016, a second expert commission was set up. There were two proposals: (1) to adjust the current system and (2) create a mixed system, with the latter being supported by the ILO. On the one hand, there was consensus for the need to increase the contribution rates, on the other hand, there was a need to strengthen the non-contributory component. The benefits provided under the non-contributory part were increased last year. Now the debate focuses on "what to do" with the contributory component. The contribution rate is currently at 10% and the idea would be to increase it to 16% but the question is what to do with the additional 6% of contribution. One option is to put all the 16% in the individual account. Others defend that 3% points would go to the individual savings account, and the other 3% points to a defined benefit scheme. Another idea is to allocate 2% points to the individual account, 2% to points for a defined benefit scheme and 2% points for a longevity insurance scheme. Opposition in Congress suggest to allocate the 6% into a new Notional Defined Contribution component that would provide some level of solidarity. Workers' organizations push for the elimination of the individual savings account, creation of a reserve fund and move to a defined benefit scheme.
- Although there is consensus around the idea that low benefits are the result of low levels of solidarity, there seems to be lack of clarity/agreement on the notions and understandings of solidarity. People want solidarity but there is no agreement on what it means in reality: intergenerational solidarity, solidarity between the rich and the poor, solidarity between formal/informal economy workers etc. In addition, clarity seems also

lacking as regards the proposal of a mixed system, as some interpret that the current system is already a mixed one given that it is composed by a defined contribution scheme and a non-contributory scheme.

- Since the concept of solidarity is blurred, the way forward is unclear. Moreover, the role of expert commissions has been weakened. Since the observations made by the expert commission installed in 2016 did not result in tangible reforms/improvements, there is an issue around the committee's credibility.
- There is also a constitutional process ongoing. Pensions have been part of a movement of protest and the process to reform the constitution will include a discussion on pensions.
- Uruguay is undergoing a similar reform process as Chile; however, in the Uruguayan case, the concerns are not around the adequacy of benefits but on the system's sustainability. An expert commission was installed and will start the system's diagnostic in early November.

Questions for discussion:

1. In Chile, pensions are perceived as individual property/self-effort rather than social security. How can we push for a change of language and concepts to reinforce the importance of collective financing and solidarity and move away from an understanding of social security as a purely individual issue?
2. Informality remains a big issue: What has been your experience in pushing for the contributory component of pensions in a context where you know that most people do not have the contributory capacity to participate in contributory arrangements?
3. What has been your experience in promoting the solidarity concept and "mixed" system?
4. Little discussion today on the improvements of the administration and governance of privately managed pension systems.

<u>Nuno Cunha</u>

- Issue of value and solidarity: The challenge of arguing for implementing a system based on solidarity principles is even more problematic when the population does not have the experience of receiving a pension. In this context, it is difficult for people to understand and trust a system that is a black box, and trusting that in 30 to 40 years, they will receive something. There are cultural issues in play that require more time for yielding changes in mind-sets.
- With the exception of Japan, countries are only starting the public policy debate in Asia. The reliance on markets is not so strong as it is the case in Chile, but more so on the family. The region is ageing very fast, with evolving family structures where the older people will no longer be able to rely on their family members. However, in many countries, populations are ageing extremely fast, leading to "sandwich populations" that need to take care of their older parents and their children.
- The answers to the challenges and the debates in the region focus mostly on sustainability rather than adequacy, although adequacy is still a key issue in most countries. Even countries with low expenditure on social protection seem to have the idea that spending is too high. This can be partially explained by a lack of understanding on the cost of aging. The narrative around maintaining the systems' sustainability is largely built by the World Bank and IMF.

- In some countries of the region that are influenced by the British colonial heritage, provident funds are in place, and people are used to immediate return benefits such as lump sums. Politically, even when governments want to change, workers are often against the reform as the overall mind-set prioritizes short-term gains over security in the longer term.
- Good news: Mongolia will keep the DB, despite discussions to move to NDC scheme.

Simon Brimblecombe

- Context in Thailand: The pension system is relatively young, as it started in 1999.
- Accrual rate of pensions: 15% with 15 years of contributions, afterwards 1.5% accrual rate for each additional year of contribution. Therefore, workers need a significant number of contribution years to get a reasonable pension. The system provides lump sum benefits for those with less than 15 years of contributions.
- Main issues: 1) Lack of understanding of how the system works. Workers prefer receiving a relatively high lump sum today than a smaller but periodic benefit in the future. 2) Low investment returns
- Given the attractiveness of lump-sum benefits, which has been aggravated by the COVID-19 crisis, certain segments of the Government are pushing for the introduction of a DC scheme.
- At the ILO, we can (1) push to improve the benefit structure (perhaps a reduced pension can be introduced for those with lower years of contributions); (2) Increase the salary cap, which currently limits the contribution base/resources available to the system; (3) strengthen the communication with members but also to Minister of Labour, (4) increase and improve financing with adequate contributions, (5) reinforce the idea that short-term solutions will not resolve long-term problems.
- Valérie's comment: Another important point is to increase the minimum wage, otherwise it will be difficult to increase contribution rates

Pascal Annycke

- Context in Egypt: What we have seen is that there is a weakening of the workers unions over the years.
- From 2007 onwards, there was a discussion between MoF and the World Bank to change the system to a system similar to the Chilean model. A law was adopted in 2010 to move towards a defined contribution scheme. But the revolution one year later completely changed the political scene and the law was never implemented.
- Before the revolution, the supervision of the pension system was entrusted to the Ministry of Finance. Currently, it's under the Ministry of Social Solidarity.
- This was a good opportunity for the ILO. A parametric reform instead of a structural reform was proposed. In 2019, the new Law was adopted modifying the contribution rates, benefit formula, benefit levels, etc. This has avoided a move towards DC scheme while providing an opportunity to strengthen the system.
- The 2019 law also allowed reducing segmentation. Previously there were many schemes and benefit levels, which have been consolidated under one law.
- Coverage: Over 40% of the labour force is contributing.

André Picard

- Context in South Africa: The pension system consists of a private DC scheme for those in the private sector and a DB scheme for civil servants. There is also a universal but means-

tested old-age grant. In 2017/18, 11.1 million workers were part of pension arrangements (out of 27 million workers in the labour market), 72% of people above 70 years of age receive the old age grant. However, many people are still falling between the cracks (Around 1 million people are excluded from the non-contributory scheme)
- In 2017-18, the ILO had discussions with NEDLAC to do a reform, focusing on putting in place a multi pillar system, establishing a social security oversight department and also a new NSSF to manage the new pension fund and setting up an administrative platform.

The multi-pillar system envisaged will have: a first pillar providing universal benefits, a second pillar based on collective financing (national social security fund) with a low salary cap so earnings above a defined threshold will only be considered for private pension insurance; and a third pillar administered by private institutions.

Luca Pellerano

- Context in Lebanon: Lebanon is the only country in the Middle East without annuities for workers in the private sector. There was a big push for an annuity also in the private system. With the crisis this has changed as workers were much more interested to cash out their lump sums, especially in case of lack of an unemployment insurance.
- ILO has made the point of adopting a model that has a strong DB component with 2 main arguments: (1) adequacy, as DC schemes do not provide predictable benefits that are sufficient to live in dignity (2) intergenerational solidarity. A bigger challenge is how to push for horizontal solidarity between groups within society. Consideration has to be given to the current low-interest rates and the vulnerability of DC to volatility.
- Need to think about the risk of DB schemes: How can we respond to the concerns vis-a-vis DB schemes? (e.g., inertia, unsustainability). Lebanon's experience is interesting in this regard: measures include among others automatic adjustment for life expectancy, indexation to ensure sustainability of the DB model without too much political interference.
- The question of trust: We need to reassure everybody that the national social protection system can be trusted and is accountable. In Lebanon, there is a perceived risk that certain groups (religious/sectarian groups in power) could capture the system's resources which make trust-building and solidarity issues challenging.
- Issue of Informality: Role of multi-tier pension system should be discussed to address different workers compliant with international labour standards and ensuring an incremental approach to providing pension benefits

Q&A

- Ariel Pino: the ILO should place the same efforts in fighting DC schemes than in showing/proving that the DB benefits are the best approach, if that is the case. Strong evidence may help to convince policy makers.

- Thein Than Htay: Myanmar is also undertaking pension reform, but in a wrong direction. Trying to change a DB to a DC scheme. The reason given by the government is high expenditure on pension benefit which is amounted to 10% of Total Government Expenditure and 1/6 of Total Tax Revenue.

- Simon Brimblecombe: The ILO should be working to illustrate to policy makers that DC schemes cost more than the DB equivalent. Nuno Cunha referred to the exercise in

Cambodia where the ILO was able to convince the Ministry of Finance that the DC option they were advised by ADB and EY was not a good option. They used very concrete calculations to show the risk of DC scheme but also to show them the transition costs. This is the same element that led the WB to advise Mongolia not to move into fully funded individual solutions.

- While this is important, many (e.g. Ariel and Nuno) agreed that the administration of schemes matters a lot. There are plenty of DB schemes that due to parametric options and bad design are not providing proper pensions.

- The need to work more on educating young generations on the importance of social security was emphasized by Ariel.

Resources that were mentioned during the discussion:

- Reversing Pension Privatization: Rebuilding public pension systems in Eastern European and Latin American countries (2000-18)
- ILO. 2019. Extending Social Security to Workers in the Informal Economy.