Pension Systems and Reform

Country Experiences and Research Issues

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Summary findings

Pension reform is spreading around the globe, from Latin America to the OECD countries, and major reform projects are being discussed in many other developing, transition, and OECD countries.

Arrau and Schmidt-Hebbel survey current research issues and country experiences related to old-age social security arrangements by introducing the papers selected for a special June 1994 issue of the Revista de Análisis Económico and presented at the July 1994 Conference on Pension Systems and Reforms sponsored by Fundação Getúlio Vargas.

They also present 15 research and policy design issues not addressed by the literature, including macroeconomic effects, conditions of political economy, government's role in easing or reducing old-age poverty, and design features of fully funded pension systems.

This paper — a product of the Macroeconomics and Growth Division, Policy Research Department — is part of a larger effort in the department to understand macroeconomic and financial aspects of pension systems. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Emily Khine, room N11-061, extension 37471 (27 pages). June 1995.
PENSION SYSTEMS AND REFORMS:
COUNTRY EXPERIENCES AND RESEARCH ISSUES*

by

Patricio Arrau and Klaus Schmidt-Hebbel**
1. INTRODUCTION

Pension reform is a major policy initiative offered by governments to aging populations fed up by failing old-age security arrangements. The spreading of pension reform around the globe is occurring at a growing speed. It ranges from Latin America (Chile 1981, Mexico 1991, Peru 1993, Argentina 1994 and Colombia 1994) to OECD countries (Switzerland 1985, Australia 1992), with current discussions of major reform projects in most other Latin American countries, some OECD economies, and many developing countries in Asia and Eastern Europe. The next few years will witness an exponential growth of pension reform. A conservative estimate is that 30 major country-wide pension reforms will have been started by the year 2000.

These pension reform programs -- although initiated in a large variety of countries -- have common ingredients. The new brand of mandatory pension proposals typically comprises two elements: a pillar of fully-funded saving based on individual pension accounts, with investments channeled to a variety of public and private long-term instruments often selected and managed by the private sector, and a complementary state-run distributive pillar in support of the old-age poor. They involve a radical departure from the still dominating conventional pension paradigm in three dimensions: (i) substitution of a pay-as-you-go scheme by a fully-funded arrangement for (at least part) of old-age saving, (ii) more explicit separation of the distributive component from the non-distributive pillar, and (iii) (frequently) private management of collection of contributions, investment of pension fund savings, and/or payment of pension benefits.

Mandatory old-age security systems are indeed among the most multi-dimensional and complex economic arrangements developed by modern societies. They involve macroeconomic and welfare issues resulting from how they affect saving and output by inducing intergenerational transfers, capital and labor market distortions, and public finance effects ranging from tax efficiency questions to deficit financing issues. Pension systems also affect intragenerational equity and old-age poverty -- in ways which often differ from those intended by the systems' stated distributive objectives. They also impinge on the role
of the private sector, the functioning of capital and insurance markets, and the need for government regulation and insurance. Finally, the political economy of pension systems and reforms is a complex outcome of actions by many interest groups, such as worker and employer organizations, pensioners, public pension institutions, private pension funds, and the government. It is hard to think of economic arrangements other than pension systems that involve simultaneously so many markets and people and such large financial resource flows.

This paper surveys current research issues and country experiences related to old-age security arrangements by introducing the papers refereed and selected for a special issue of Revista de Análisis Económico (vol. 9, No. 1, June 1994) and the July 1994 Conference on Pension Systems sponsored by Fundação Getúlio Vargas in Rio de Janeiro. In a policy field characterized by exponentially growing country experiences it should not surprise that many more analytical and policy questions are raised than answers are provided by researchers -- let alone agreements reached on many contentious issues. Hence we also pose in this paper some of the remaining research questions -- those which we face more often in policy discussions or think are addressed in a least satisfactory way by the literature known to us.

Section 2 reviews the papers. Section 3 poses questions for future research. The conclusions are left to the reader.

2. ANSWERS TO OPEN QUESTIONS AND REVIEWS OF COUNTRY EXPERIENCES

2.1 Macroeconomics and Intergenerational Welfare

The seminal contributions by Samuelson (1958) and Diamond (1965) have introduced the two-cohort overlapping-generations (OLG) model to analyze the main public finance, accumulation, and intergenerational welfare dimensions of public debt and old-age security arrangements. A major extension

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