Comments on Report on Pension Indicators for Latin America, 30 December 2017

Nicholas Barr

London School of Economics

http://econ.lse.ac.uk/staff/nb

IDB, Washington DC

20 March 2018

LSE

Comments on Report on Pension Indicators for Latin America , 30 December 2017

1 Work to be completed

2 Points to bring out in opening chapter

3 Writing

Caveat

- I am not a heavy-duty quantitative person, hence my comments are about principles and clarity, with little on quantitative technique

1 Work to be completed

- The current version is a solid interim document, but not yet a draft of the whole report
- An archetypal write up comprises
    1. Context
    2. Data
    3. Method
    4. Results
    5. Caveats and future research
- The current draft covers (2) and (3), with (4) only partly written and (5) to be addressed

Work to be completed, cont'd

- Important that the write up of (4) brings out the key results from the data in the spreadsheets

- Put another way, the report should summarise the main results in a form that is easily readable and easily-digested by the reader

- The Mercer Report is a good example

2 Points to bring out in opening chapter

- Important to set the scene for the following chapters

Note to finance minister

- Add early text explaining to grumpy finance minister why pensions are so important
- In economic terms
    - Getting it wrong has adverse micro (incentive) and macro (deficit) effects
    - Getting it right can contribute to saving and growth
- In political terms: inadequate pensions create political pressures to increase public pension spending
- In social policy terms: old-age security is a major element in individual welfare

Uses and limitations of indexes

- Important that the report should explain the uses and limitations of indexes

- In particular there should be explanation that
    - Converting a vector of characteristics (e.g. the elements of Performance) into a single number involves a vector of weights, and that
    - The choice of weights is arbitrary, hence no index can claim to be 'right' and any other index 'wrong'

- The point is important so that the results in the report are interpreted thoughtfully

Variance, not just the mean

- Many studies look only at idealised types, e.g. workers with a full contributions record

- The opening chapter should explain that a key advance of the report is that it considers diversity of outcomes (mentioned on p. 61 (1st para. of 13.3) – should come much earlier)

Reality, not just theory

- Many studies focus on what the pensions legislation says, ignoring that facts on the ground may be very different

- The opening chapter should explain that the report looks at both
  - What the law says (Pension design) and
  - What happens in practice (Performance): workers may not pay the contributions the law prescribes; governments may not pay in full and on time the pensions specified by law

- Remind readers of the point at the start of Ch. 12, saying that the report discusses reality in Ch. 13

The importance of administrative costs and charges

- The report does not mention the topic till 11.4 (capital market indicators)

    - The report should make it clear at the start that keeping administrative charges low is fundamental if individual DC accounts are to fulfil their purpose effectively, e.g. the auction mechanism in Chile

    - An annual management charge of 1% over a full career reduces a person's accumulation (and hence his/her pension) by 20%.

    - The point should be re-emphasised on p. 49

Gender

- The report could bring out more explicitly why women on average have lower pensions than men
  - The gender pay gap has three roots: on average, women have
    - Lower wages than men
    - A greater likelihood of part-time work, and
    - More career breaks
  - The effect of the gender pay gap (a snapshot at a point in time) is compounded by bad pension design if
    - Earliest pension age for women is lower than for men
    - Annuities use separate life tables for men and women, and
    - Benefits for a surviving spouse or upon divorce are inadequate

A key strength of the report

- Bring out the point that the report uses data sources that allow regular updating (one of the strengths of Mercer)

3 Writing

Pruning

- Discussion of the other studies is too detailed; that level of detail has insufficient value added

- Could shorten the description of the other studies, perhaps with details in an Appendix

- Or could include a very brief summary at the start, and say that readers who wish can proceed directly to Ch. 8 (Summary of pension indicators) or directly to Part II

- More generally, the draft has repetition that could usefully be cut

Target readership

- Report should seek to educate electorates in the region

- Perhaps useful to organise round three questions

  - What is happening – and what will happen?

  - What does it mean?

  - [Outside scope of project] What policy directions follow?

Key variable: Number of contributions

- The issue should be given considerable prominence
- Financial literacy worse than could possibly be imagined (Lusardi and Mitchell's (2014) study of OECD countries)
- Thus people do not understand how damaging incomplete records are
- Important to get this point across to electorates
- This aspect is part of explanation of the recent political unrest in Chile over pensions

Key variable: Pension age

- Include a graph showing relation between pension deficit and pension age
- This is what Finland (Table 5.1) is getting at

What other countries do: Proposed retirement ages in 2050

See http://www.etk.fi/en/the-pension-system-2/the-pension-system/international-comparison/retirement-ages/

Under 65   Sweden, Norway

65-66   Estonia, Bulgaria, Austria, Latvia, Lithuania, Luxembourg, Malta, Romania, Slovenia, Hungary, Switzerland, Poland

66-67   Belgium, Spain, Croatia, France, Germany, Slovakia

67-68   Finland, Czech Republic

68-69   Cyprus, Ireland, Great Britain, Portugal

69-70   Italy

70-71   Greece, Iceland

71-72   Netherlands

72-   Denmark

Key activity: Projections

- Important to have regular, credible (repeat, credible) projections, not least because of increasing age dependency rates
- Some countries (e.g. Canada, Sweden) link projected deficits to specific actions on contributions, accrual rates and benefits in payment

References

Barr, Nicholas (2012), *The Economics of the Welfare State*, OUP, Ch. 7

Barr, Nicholas and Diamond, Peter (2009), 'Reforming pensions: Principles, analytical errors and policy directions', *International Social Security Review*, Vol. 62, No. 2, 2009, pp. 5-29 (also in French, German and Spanish)

Barr, Nicholas and Diamond, Peter (2010*a*), *Pension reform: A Short Guide*, New York and Oxford: OUP

In Spanish: *La reforma necessaria: El futuro las pensiones*, Madrid: El Hombre del Tres, 2012, http://www.elhombredeltres.es/index.php/la-reforma-necesaria-2

Barr, Nicholas and Diamond, Peter (2016), 'Reforming pensions in Chile', *Polityka Społeczna*, No. 1, 2016, pp. 4-9, http://econ.lse.ac.uk/staff/nb/Barr_and_Diamond_2016_Chile.pdf

Barr, Nicholas and Diamond, Peter (2017), 'Designing a default structure: Submission to the Inquiry into Superannuation: Assessing Efficiency and Competitiveness', Australia Productivity Commission, September 2017, http://www.pc.gov.au/__data/assets/pdf_file/0015/221703/sub074-superannuation-assessment.pdf

Lusardi, Annamaria and Olivia S. Mitchell. 2014. "The Economic Importance of Financial Literacy: Theory and Evidence." *Journal of Economic Literature*. 52(1): 5-44