Reflections on Impact of Averting after 20 years

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For the Global Pension and Saving Conference, World Bank, 2014

Basic Message of Averting—pre-fund saving part of old age system and make redistribution more transparent

- Old age programs have 2 objectives:
  - Saving--getting people to save when young so they have enough money to live on when old
  - Redistribution--to prevent poverty and help those with low lifetime incomes to live with dignity
- In most systems, these 2 objectives were mixed in a DB pension and financed by a payroll tax on a PAYG basis. PAYG required increasingly high tax rates as old age dependency rates rose. High costs hurt public treasury, worker take-home pay, saving, work incentives & economic growth. DB often intro. non-transparent undesired redistributions.

Costs would be lower, old age income & economic growth higher if part of the system were DC, pre-funded & invested

- Redistribution can't be DC & requires tax-finance but
- Saving component can be financed by workers thru mandatory pre-funded DC with no hidden redistrib.
- Therefore Averting recommended multi-pillar system
  - A redistributive tax-financed pillar +
  - A mandatory saving pillar, usually DC +
  - Additional voluntary saving (tax incentives?)
- Since 1994 over 40 countries have adopted this model
- While Averting influenced this development by articulating its rationale, it was largely a response to underlying economic & demographic forces

Many variations on this basic model

- Redistributive pillar takes many forms: flat or means-tested benefit to increase coverage & prevent poverty among non-contributors + DB that may favor low earning contributors (Chile, Estonia, Netherlands)
- Averting rec. individual control over funds to avoid political manipulation but a few countries have successfully used central control of records (Sweden) or investments (Norway)
- New techniques like auto-enrollment with opt-outs to nudge workers toward saving based on inertia, without mandate (UK, NZ)
- Large differences in size of PAYG Pillar 1 vs. FF Pillar 2 (PAYG > 50% in Sweden but FFDC > 50% in Mexico)

Over 40 countries with funded DC component in their old age systems (1)

- **High income OECD countries**

Australia
Denmark
Germany (subs. Reister Plan)
Iceland
Netherlands
New Zeal. (auto-enroll, opt-out, subs)
Norway
Sweden
Switzerland
UK (auto enroll, opt-out, subs)

Eastern & central Europe

Bulgaria
Croatia
Czech Republic (starting)
Estonia
Kazakhstan
Kosovo
Latvia
Lithuania
Macedonia
Poland
Romania, Russia, Slovakia

Over 40 countries with funded DC component in their old age systems (2)

- **Latin America**

Chile
Colombia
Costa Rica
Dominican Rep.
El Salvador
Nicaragua
Mexico
Peru
Uruguay

Civil servants' schemes

Nigeria
India
Botswana
S. Africa (FF DB)
Thailand
U.S.A.

Other

Ghana
Hong Kong
Taiwan
Malawi (legis., not yet implem.)

2d. major legacy of Averting was to spur new research lines and new policy ideas on old age security

- New issues arise once funding, defined contribution and transparent redistributions are part of the old age package. For example:
- How should pension funds be regulated & admin. fees minimized (central collection & records?)
- What investment options should workers be allowed and what are the defaults? (diversification, life cycle?)
- How should various risks (longevity, investment, inflation) be measured, controlled and shared?

New research lines (Cont’d)

- How to increase financial literacy & guide investments of workers with little financial experience?
- Can behavioral econ. get workers to save without mandates (defaults, auto-enrollmt with opt-out)?
- How should payouts be regulated (& how to set up annuity markets)?
- What is best way to expand coverage & provide an income floor to those who haven’t contributed (flat or means-tested benefit? which tax?)—espec. Important in developing world?

Averting raised these issued but one study can't consider them fully

- They have been the backbone of research in the pension field for last 20 years and the subject of this conference. Ex:
  - Work by Bank's anchor, financial sector &ECA on regulation & redistribution; IDB on coverage;
  - James et al on admin costs, annuities, disability;
  - journal articles on risk mgt, financial lit, behav. econ
- I regard this on-going work as the major legacy of Averting.

Do recent reversals & reductions in Argentina, Hungary and Poland mean Averting's message is rejected?

- Vast majority of countries that adopted multi-pillar model still have it.
- Countries that reversed were ideologically very divided from the start and had huge explicit and implicit debt that they didn't reduce during transition; taking money from the funds proved irresistible in financial crises.
- Countries with greater political maturity, fiscal restraint and vested interest in the system (from employers, workers, fin. institutions) kept funded pillar while cutting back on PAYG pillar (RA, index.)

In sum:

- Movement toward greater pre-funding and defined contributions and targeted redistributions continues to be inevitable, not because of Averting but because of underlying economic forces--population aging, slow & unequal wage growth, global investment opportunities, need for pro-saving & pro-work incentives--that Averting highlighted.
- But will take many different forms in different countries, and will be improved as new ideas develop through research and practice.