Pension benefits in Chile: is it possible to improve adequacy and solidarity?

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Abstract

Chile revolutionized pension systems in 1981 by transforming its defined-benefit pay-as-you-go contributive system into a defined contribution privately managed fully-funded scheme. After 27 years, the fragmentation, low coverage and high costs of administering the private system led to a comprehensive reform to address these problems in 2008. The latter reform was a step forward in several ways: a social protection floor was established, the non-contributory and the contributory components were combined in an integrated system, and a significant increase in benefits coverage was reached. The reform, however, was insufficient: the system continues paying low benefits; coverage gaps have not been eliminated and significant benefit inequities remain. In 2014, only after six years after the last comprehensive reform, the government of President Bachelet convened a new advisory pension commission of national and international experts to recommend further changes to the system. The Commission delivered a report in 2015 that shows the challenges of returning to a path to improve the adequacy of benefits and rebuild social security solidarity mechanisms. Beyond some parametric reforms proposals to adjust the system to the demographic and labour context, major differences persist between two proposals: (a) keep the status quo of the current system with increases in tax financed benefits; and (b) transform it into a mixed system that includes a social insurance component. This article summarizes the trajectory, standing and challenges of Chile’s pension system together with the dilemmas posed by the expert’s commission reform proposals.

Key words: pension reform, coverage, benefit adequacy, solidarity, Chile.
Introduction

Chile revolutionized pension systems in 1980 by transforming its defined-benefit pay-as-you-go contributive system into a defined contribution privately managed fully-funded scheme based on individual accounts. After 27 years, fragmentation, lack of solidarity, low coverage and high costs of administering the private system led President Bachelet to conform a pension’s expert commission that delivered a reform proposal in 2006. New comprehensive legislation addressing many of the critical points was passed in Congress in 2008. The latter reform was a step forward in several ways: a social protection floor guarantee was established, the non-contributory and the contributory components were combined in an integrated system, and a significant increase in benefits coverage was reached. The commodities super cycle (copper price in the case of Chile) was crucial to generate enough fiscal space which allowed increasing simultaneously benefits and the extension of coverage; i.e. the vertical and horizontal dimensions of social protection coverage. This reform, however, was insufficient: the system continues paying relatively low benefits; coverage gaps have not been eliminated and significant benefit inequities remain.

In 2014, only after six years from the last comprehensive reform, President Bachelet second government convened a new advisory pension commission of national and international experts to recommend further changes to the system (http://www.comision-pensiones.cl/). The Commission delivered a report in 2015 which shows the challenges to return to a path which could allow improving the adequacy of benefits and rebuilding social security solidarity mechanisms. Beyond some parametric reforms proposals to adjust the system to the demographic and labour context, major differences persist between two global proposals: (a) keep the status quo of the current system with increases in tax financed benefits and some parametric changes (i.e. age of retirement and rate of wage contributions); and (b) transform the system into a mixed system that includes a social insurance component.

Contrary to what happened in the 2006 expert pension commission report where a unified reform proposal was presented to the president, the 2014 commission report provide two different proposals. The main issue of disagreement was the need to re-introduce into the system a component of social insurance allowing a mixed structure. This reflects not only the important conceptual differences among the experts in the commission, but also the divergence observed during the commission hearings where different stakeholders where invited to express their views (https://vimeo.com/channels/comisionpensiones). Moreover,

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1 Chile also pioneered the introduction of social security in Latin America and its privatization in 1980 influenced the World Bank policies and the adoption of similar reforms in eleven countries in Latin America and others in Central and Eastern Europe. As it will be discussed in this article, these reforms endured design problems and made many promises that were unfulfilled. (Mesa-Lago and Bertranou, 2016)

2 There were actually three proposals but a single commissioner only supported one of them. This commissioner proposed reversing privatization and a complete return to a defined benefit pay-as-you-go scheme. In this article I will mainly refer to the other two proposals that were dividedly supported by the other 23 commissioners.
both, the hearings and the meetings for citizen participation, showed that a significant majority expressed preferences for eliminating or limiting the private savings component of the pension system, and restoring a reformed system based on social security principles. On the other hand, pension management companies and conservative think tanks highlighted the need to maintain the status quo with some reforms in the volume of financing and parametric changes such as increasing the retirement age. Their arguments have usually been: (i) the country would not been able to afford a social insurance scheme because of its demographic transition; (ii) changing the fully-funded privately administered component of the system would represent a terrible negative signal to foreign investors; and (iii) national savings could be seriously harmed.

This article summarizes the trajectory, standing and challenges of Chile's pension system together with the dilemmas posed by the expert pension commission reform proposals. The main question that arises for the political economy of pension reform is whether there is going to be a chance to open some political space within the current context of economic slowdown to make a sort of structural reform, by reintroducing a social insurance component beyond the necessary parametric changes that are required in the short run, whatever the system is at the end adopted.

An important question here is whether the proposed parametric changes (increased in the retirement age, wage contributions and, probably, higher tax financing) would be socially accepted in the current democratic context without offering a structural change, that could rebalance individual and social risks.

The Chilean pension system in a nutshell

Barr and Diamond (2009) summarize the main characteristics of the individual accounts system put in place in 1981 which currently persists with some changes introduced in the 2008 reform. Workers are required to contribute 10% of covered earnings into the individual accounts and to make a market-determined additional payment for mandatory disability and survivors’ insurance which adds to an administration commission. The pension management companies (AFPs – Administradoras de Fondos de Pensiones) administer the individual account, collect contributions and manage the pension funds. At retirement, workers can buy inflation-indexed annuities purchased from insurance companies, or pull out their accumulation as phased withdrawals. In the second case, the pension funds remain with the AFPs.

The pension management companies were initially allowed to administer only one pension fund, later up to five fund portfolios each, varying in their mix of stocks and bonds. Entry into the business for administering pension funds is open, but capital requirements, managerial criteria and the nature of the economies of scale had made the number of
administrators reduce substantially since inception of the system. The range of choice for portfolio composition has been also limited because companies are required to have a guaranteed minimum return; which in practice incentive firms to hold similar portfolios.

On top of the mandatory individual pension savings accounts, there is a tax-incentivized voluntary component that allows workers to save beyond the compulsory 10% wage contribution. This voluntary component remains small relative to the mandatory one.

As it was mentioned before, in addition to the mandatory 10% wage contribution, a 1.15% wage contribution is currently required to finance the disability and survivorship insurance, while an administrative commission of 0.47% to 1.54%, depending on the administrator, is also deducted from wages. Until the 2008 reform, the worker paid the two commissions. Since 2008, the employer pays the disability and survivorship insurance.

Before the 2008 reform, the poverty relief components of the pension system were two. The first one, a tax financed subsidy to bring pension benefits up to a minimum benefit for those workers with low balances in their accounts and at least twenty years of contributions with savings. Eligible workers for this benefit were a very small fraction as it was a contributory minimum benefit. Projections in 2006, estimated that only five percent of the affiliates would be eligible to this benefit (Berstein, Larraín and Pino, 2006). The second poverty relief component was a very modest targeted non-contributory benefit financed out of tax revenues administered at the municipal level with quotas and a queuing mechanism.

The 1981 pension reform created a significant transition costs (estimated in 135% of the GDP) because workers contributions started accumulating in the funded component of individuals accounts, and the government had to finance both the pensions of existing pensioners and the cost of pensions earned under the old system by continuing workers. The transition was possible because the substantial and systematic fiscal surpluses from 1987 onward. Note that the generations that paid the transition costs for thirty years are the ones that currently lack of access to adequate benefits.

At the beginning of the 2000s, three major problems were evident:

1. Fragmentation and insufficient guarantees for basic economic security.

The system had a significant fragmentation in its structure. The core of the system was the contributory scheme based on individual accounts, while poverty alleviation components were peripheral and not systematically integrated. The minimum pension in the contributory scheme had strict access conditions (20 years of contributions); which contrasts with a precarious labor market. Workers in the pension system had very irregular labor trajectories due to economic crises in recent economic history. For example, the debt crisis in the early eighties brought unemployment to more than 20%. The labor market characterizes by high rotation, where a large proportion of workers alternate between either employment and unemployment; or wage employment and self-employment; or
formal and informal jobs. On the other hand, the non-contributory welfare/social assistance pension used to operate disjointed from the rest of the old age economic security programs. In other words, there was not only fragmentation but also that the state's role was mostly subsidiary in a context of low coverage.

2. Lack of solidarity, high inequalities and inequities.

Private pension systems normally lack of endogenous social solidarity because the individual pension savings accounts belong to each worker and there is no solidarity across generations, genders and income groups (Mesa-Lago and Bertranou, 2016). As it was mentioned before, the little (exogenous) solidarity was provided by the minimum pension arrangement and the modest welfare non-contributory pension. The natural outcome before both, the lack of mechanisms to embed solidarity within the system, and the very unequal labor performance in terms of earnings distribution, was an unequal access to pension benefits and an uneven distribution of benefits.

The clearest manifestation in terms of inequities was on the gender dimension. Women were not only penalized for unequal access to jobs, work histories and earnings, but also in terms of conditions of access to benefits. Private insurance logic applied in determining pension benefits (i.e., gender specific mortality tables applied to annuities) unjustifiably penalized women.

3. High costs of administering the private system.

Well known are the high costs of managing social security program in a decentralized and privately manner. There has also been studied the limits of having market competition among administrators in order to lower management fees. In the early 2000s this issue continued being a subject of debate and, despite some regulatory changes to improve AFPs market performance, administration costs were still very high, discrediting the industry and causing a very negative opinion by the insured. According to estimates from the OECD (2013), fee charged in the private pension system took a quarter of insured’s deposits placed in individual accounts.

The 2008 re-reform: reintroducing a state managed component and reinforcing its role

In 2006, under the leadership of President Bachelet, a presidential advisory expert pension commission was appointed to deliver a reform proposal addressing the main problems of the system. New comprehensive legislation tackling many of the critical points was passed by Congress in 2008. The economic context for Chile, product of the commodities super cycle, was quite favourable to face a major pension reform, though the core of the system (i.e. the individual saving accounts scheme) would remain practically unchanged in its consumption-smoothing role. This was crucial to allow the reform to transit smoothly
throughout the political economy process, as the AFPs would continue administering workers contributive resources.

According to the Superintendence of Pensions (2009, pag.11) the nine drivers of the 2008 re-reform were: (i) to increase the level of coverage through the poverty-prevention tier; (ii) to increase the level and quality of coverage through the mandatory contributory tier; (iii) to improve the quality of the coverage provided through the voluntary pillar; (iv) to bring gender fairness; (v) to increase competition and efficiency in the AFP industry; (vi) to optimise the risk-return ratio of the pension savings managed by the AFPs; (vii) to improve the quality of the benefits by solving issues of unfairness in the granting of old-age, disability and survivorship benefits; (viii) to improve population’s level of participation, information and education with regards to pensions; and (ix) to improve the pension system’s institutional structure.

As it was described in the introduction, this reform was a step forward in several ways: a social protection floor was established, the non-contributory and the contributory components were combined in an integrated system, and a significant increase in benefits (horizontal) coverage was reached. Some of main features of this reform were:

1. To increase coverage through the poverty alleviation tier, a “solidarity” component was created by transforming existing social assistance and minimum pension programs into (i) a social protection floor guarantee benefit (PBS – “pension básica solidaria”) to individuals without other pension benefits belonging to the poorest 60% of the population; and (ii) a top-up benefit (APS – “aporte previsional solidario”) to supplement self-financing pension benefit for those individuals with low pension savings and that belong to the poorest 60% of the population. (See Figure A.4.1 in Annex 4)

2. To increase coverage through the mandatory contribution tier, it was extended the mandate to self-employed workers in certain tax categories, throughout a transition period, via their annual income tax declaration. This measure, which was designed to reach the segment of self-employed workers with higher contributory capacity, was postponed until 2018.

3. To encourage gender fairness in the pension system, four measures were introduced: (i) a subsidy for women for each live birth (equivalent to 18 months contributions levied on the minimum wage, capitalized in the individual account until age of retirement 65); (ii) the disability and survivors insurance premium was equalized for both genders, but as women experience lower risks, the excess of premium paid by women is allocated to their individual accounts; (iii) redistribution of pension savings balances in case of divorce (justice may decide an up to 50-50 distribution of the pension savings accumulated by both spouses); and (iv) introduction of survivorship entitlements for male spouses.
4. To encourage competition and efficiency in the AFP industry, a new mechanism of auctioning of entrants to the pension system was established. Every two years, the Superintendence of Pensions organizes an auction process where the AFP that offers the lowest fee is automatically awarded those who join the labor market segment with mandatory social security contributions.

5. To improve participation, information and education, it was created a (i) User’s Committee for the AFP System; (ii) a Fund for Pension Education, financed from state transfers; and (iii) a Pension Advisor Board which offers independent advice to the government.

6. To improve the institutional structure, an array of new institutional innovations were introduced, where one of the most relevant was the set up of a Social Security Administration institution (IPS – Instituto de Previsión Social) as a continuation of the former residual Pension Normalization Institute (INP – Instituto de Normalización Previsional). This measure brings back the idea of having a public long-lasting institution, which administers public pension benefits (i.e., PBS, APS and benefits from the pre-1980 system).

This reform was definitely ground breaking, introducing several innovative solutions. It also allowed putting on front of the public policy debate the main problems, constraints and challenges that the highly internationally promoted model of private provision of economic old age security had and that were not completely acknowledged. Despite the numerous changes and its impacts, several weaknesses continue persisting: relatively low benefits; coverage gaps and significant benefit inequities remain. These are explained by both the labor market characteristics and performance, and the pension design itself.

Problems remaining and the need for a new reform

In 2014, only after six years after the pension re-reform, the second government of President Bachelet convened a new advisory commission of national and international experts to recommend further changes to the system. While the 2008 reform advanced substantially in expanding the poverty alleviation role by extending the social protection floor guarantee, improving pension benefits adequacy was still overdue.

The Commission delivered a report in 2015 with a shared view of the main deficits and challenges for the pension system, but a contrasting understanding of the needed policies to overcome such problems. The most important point of contrast was the role it should play the solidarity tier vis-à-vis the privately managed individual savings component. In other words, whether it should be a path to recover the adequacy of benefits by rebuilding a social security solidarity mechanism.
Beyond some parametric reforms proposals to adjust the system to the demographic and labour context, major differences persist between two general proposals: (i) preserve the status quo of the current system with increases in tax financed benefits and higher wage contributions into individual savings accounts (identified as proposal “A”); and (ii) transform it into a three tier mixed system that includes a social insurance component (identified as proposal “B”; see Annex 3).

Before discussing these two systemic proposals, it is important to highlight some of the problems identified in the shared view by the advisory experts commission:

- 50% of retirees, between years 2007 and 2014, receive monthly benefits that were equal or less than $ 82,650 (approximately US$ 150, or about 40% of the minimum wage, in 2014). These benefits already include the tax-financed additional solidarity benefit.
- In the same period, while half of women in age of retirement obtained monthly benefits that are equal or less than $ 42,561, men received benefits of $ 112,333 or less.
- 50% of retirees received benefits that, at most, were equal to 34% of their average last ten years wages. If only beneficiaries from the supplementary solidarity benefit (APS) were taken into account, the median benefits were $ 84,298 for women and $ 107,073 for men.
- 70% of the population surveyed considered that pension benefits provided by the system were not sufficient for an adequate standard of living.
- Of the total population employed, 69.3% made wage contributions, however, contribution densities were below 50% for the population affiliated to the pension system.
- The wage contribution rate for social security-pensions (10% of taxable income) was relatively low compared to countries with similar or higher development.
- For those receiving old age benefits, the risk borne by the insured depends on the modality of benefit chosen. Those that opt for the phased withdrawals have pensions benefits decreasing over time, which goes against the objective of consumption smoothing and exposes affiliates to two major risks, fund investment and longevity.
- The pension system includes rules that affect men and women differently, to the detriment of the latest. One of these is the mortality tables differentiated by sex.

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3 Annex 3 includes a brief discussion on the conceptual interpretation of a mixed system.
4 Proposal “A” was supported by 12 commissioners (all men, but one), while proposal “B” was supported by a more balanced number of 11 commissioners (6 women and 5 men). Proposal “C”, complete reversion of the privately managed fully funded component was supported by one commissioner.
5 This implies an exchange rate of about Chilean pesos $ 560 per dollar. Note that with the end of the super cycle of the commodities, during 2015, the Chilean pesos depreciated strongly reaching $700 at the end of that year.
used to calculate annuities which are separately built based on the life expectancy of men and women.

Adequacy of benefits is perhaps one of the most prioritized issues in the current pension policy debate. It is important to recall that the ILO (Convention 128) and the Organisation for Economic Co-operation and Development (OECD) advocate for a minimum replacement rate of 45 per cent applied to the average wage during the insured active life. The Advisory Pension Commission estimated an ample range of replacement rates and agreed to use median figures as this indicator is much more informative than the mean replacement rate given the biased shape of the pension benefit distribution. CAPSP (2015) estimated that the self-financed (individual pension savings) median replacement rate taking into account earnings from the last ten years before retirement was 34 per cent for all pensioners across 2007–2014 (Table 1). Pensioners with high contribution densities showed a median replacement rate reaching 46 per cent; while those with low density achieved only 4 per cent. There were also significant differences by gender. The median replacement rate for men was 48 per cent, while for women it was only 24 per cent. The subsidiary role of the state through the tax-financed supplementary pension benefit APS, significantly increased the median RR to 45 per cent for all pensioners; 60 per cent for men and 31 per cent for women; highlighting the important role of the state. (Mesa-Lago and Bertranou, 2016)

Table 1. Median replacement rates
Ten last salaries; 2007–2014 and projected 2025–2035; in percentages

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Men</th>
<th>Women</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual replacement rates (2007-2014)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Self-financed pension (*)</td>
<td>34</td>
<td>48</td>
<td>24</td>
</tr>
<tr>
<td>- Self-financed pension + public benefit (APS)</td>
<td>45</td>
<td>60</td>
<td>31</td>
</tr>
<tr>
<td>Projected replacement rates (2025-2035)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Self-financed pension (*)</td>
<td>15</td>
<td>24</td>
<td>8</td>
</tr>
<tr>
<td>- Self-financed pension + public benefit (APS)</td>
<td>37</td>
<td>41</td>
<td>34</td>
</tr>
</tbody>
</table>

(*) Obtained from the individual pension savings account.

CAPSP (2015) also projected the replacement rates for workers whose entire working lives would be under the reformed system. For this purpose, simulated future profiles of earnings and labour force participation were used to estimate the accumulated pension savings balances and benefits obtained under the parameters of the system under the 2008 re-
reform. The resulting median replacement rate was lower than the ones discussed before: for self-financed pensions, 15 per cent (25 per cent for men; 8 per cent for women). Adding the APS, the median replacement rate was higher: 37 per cent for all pensioners (41 per cent for men; 34 per cent for women).

These replacement rate results clearly explain both, why the system lacks of legitimacy, and the ample manifestations of concern regarding the old age economic security by the insured workers. The argument that replacement rates are reasonable given the low level of wage contributions (10%) hides the important subsidiary role played by the state, through the APS benefit, in supporting the improvement of replacement rates. This effort, though, seems to be insufficient to guarantee adequate replacement rates, particularly for women.

One of the proposals agreed by the Commission was the need of increasing the contributory effort by raising wage contributions. It was agreed that the increment in the contribution rate should reach an additional four percentage points, i.e. an increment from 10 to 14%, paid by employers. Despite this common vision, there were significant differences over the destination of these contributory resources. While proposal “A” (status quo) proposed to use those resources mostly for individual pension savings, proposal “B” recommended allocating them to fund a new social insurance scheme.

Proposal “B” would also be financed by the following sources: (i) all insured wage contributions, including the proposed increase from 10 to 14%, up to a limit of Chilean $ 350,000; which corresponds to the median earnings distribution; and (ii) general tax revenues that could take the form of matching contribution into a citizen social security account.⁶

This means that in the proposal “B” (mixed system), low-income workers only participate in the first (non-contributive basic benefit or PBS) and the second (social insurance) tiers. Those with incomes above certain level (i.e., those above the proposed median of the earnings distribution threshold) start contributing for those earnings to the fully-funded individual pension saving accounts scheme. Therefore, low-income workers are not subject to excessive risk, complicated options in terms of portfolio investment and fund administrators, and most importantly, they are going to be guaranteed a minimum of economic security.⁷

Last but not least, it is worth to mention that most of the commission members agreed some necessary changes which include a set of parametric reforms: (i) increase the coverage and the amount of the non-contributory benefit (PBS); (ii) maintain the contribution mandate for self-employed workers and accelerate their inclusion in the pension system; (iii) a gradual equalization of the legal retirement age for men and women.

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⁶ One alternative could be administering the citizen social security account as a notional account.
⁷ A preliminary calculation made by two commissioners (Christian Larrain and Andras Uthoff) showed that the first and second (social insurance) tiers could guarantee a 70% replacement rate of the minimum wage.
⁸ This is not the exhaustive list of proposals. For more information see CAPSP (2015).
and periodically review the age of retirement; (iv) the elimination of gender specific life tables for pension annuities; (v) the introduction of a state subsidized contribution mechanism for caregivers of children and seniors; and (vi) changes in pension fund investment and portfolio alternatives in order to reduce the excessive insured exposure to market risks.

Final comments (to be completed)

Is it possible to improve adequacy and solidarity in Chile’s pension system? It has been shown that 27 years were necessary to introduce the 2008 re-reform; which started reversing some of the shortcomings in terms of compliance with social security principles, particularly those related to coverage, solidarity, gender equity and efficient administration.

There is a call for further reforms in order to continue rebalancing the risk that is borne individually and socially by the insured population. Putting the system into a track to improve not only solidarity but also adequacy is crucial to allow socially acceptable parametric reforms, much needed in the short run. A structural reform seems to be necessary as maintaining the present structure of the system gives little room for tangible changes. It seems that within the current configuration, it would be difficult to pass legislation for a parametric reform to make the system financial and socially sustainable.

The lack of adequacy problem is partially explained by the insufficient resources devoted to old age economic security. Beyond the ample consensus for increasing the pension financing, a major policy debated issue is whether the additional contributory resources (higher wage contributions) and general tax revenue (mainly those “liberated” from the commitment to finance the 1981 structural reform transition) should be allocated to individual savings, or pooled in social security fund. The introduction of a new employer’s wage contribution and the pooling of these resources, could also allow to improve the pension benefits of existing retirees. They seem to have paid a high price in terms of the 1981 reform transition costs and their current relatively low benefits.

Another important issue refers to the sufficient consensus for a direct removal of the unequal treatment for women that represent the use of gender specific mortality tables. This could also provide both better benefit adequacy for women and solidarity across genders. The political will is crucial to materialize these needed changes in order to reinstate the practice of the universally accepted social security principles.
References


CAPSP. 2015. Informe Final. Santiago, Comisión Asesora Presidencial sobre el Sistema de Pensiones, September 15.


Annex 1: Chile’s pension reforms: summarized time-table

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>Pinochet’s military government unifies about 35 pension funds with aprox. 150 different schemes in terms of financing rules and entitlement conditions. These schemes operated under as pay-as-you-go defined benefit rules.</td>
</tr>
<tr>
<td>1980-1981</td>
<td>The military government enacted the Decree Law 3.500 (1980) privatizing the pension system by creating a fully funded individual account defined contribution scheme.</td>
</tr>
<tr>
<td>1990</td>
<td>Chile returns to a democracy.</td>
</tr>
<tr>
<td>2006</td>
<td>First President Bachelet advisory committee for pension reform, known as “Marcel Commission” (*).</td>
</tr>
<tr>
<td>2008</td>
<td>Comprehensive reform is passed. Law 20.255 is enacted in 2008 by ample consensus.</td>
</tr>
<tr>
<td>2014</td>
<td>Second President Bachelet advisory committee for pension reform, known as “Bravo Commission” (**). Report was delivered in 2015.</td>
</tr>
</tbody>
</table>

(*) Marcel Commission (15 national members): Mario Marcel (chair), Harald Beyer, David Bravo, Axel Christensen, Regina Clark, Alvaro Clarke, Rosanna Costa, Martín Costabal, María Margarita Errázuriz, Alejandro Ferreiro, Augusto Iglesias, Alejandra Mizala, Andra Repetto, Jaime Ruiz-Tagle and Andras Uthoff.

(**) Bravo Commission (15 national and 9 international members): David Bravo (chair), Cecilia Abdala, Hugo Cifuentes, Regina Clark, Martín Costabal, Carlos Díaz, Christian Larraín; Ricardo Paredes, Marcela Ríos, Claudia Robles, José Luis Ruiz, Claudia Sanhueza, Jorge Tarziján, Sergio Urzúa, Andras Uthoff; Orazio Attanasio, Nicholas Barr, Fabio Bertranou, Costas Meghir, Carmelo Mesa-Lago, Olivia Mitchell, Verónica Montesinos, Leokadia Oreziak, Joakim Palme.
Annex 2: Reform proposal towards a mixed system: schematic view

Table A.2.1. Structure of the current Chilean pension system

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Non-contributory</th>
<th>Contributory (only fully funded individual accounts)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No contributions required</td>
<td>PBS</td>
<td>-</td>
</tr>
<tr>
<td>Eligibility: poorest 60%</td>
<td>APS</td>
<td>PCI</td>
</tr>
<tr>
<td>Some contributions required</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Eligibility: Poorest 60%</td>
<td></td>
<td>PCI</td>
</tr>
<tr>
<td>Fully contributory</td>
<td>-</td>
<td>PCI</td>
</tr>
</tbody>
</table>

Financing
- General tax revenues
- Workers contributions according to taxable wage

Administration
- Social Security Administration (Instituto de Previsión Social)
- Pension management companies (AFPs) and insurance companies

PBS: basic non-contributory pension benefit (“pension básica solidaria”)

APS: tax financed supplementary or additional pension benefit (aporte provisional solidario)

PCI: pension benefit derived from individual pension savings or the so-called “self-financed pension benefit” (“pensión autofinanciada”)

A.2.2. Proposed structure for the Chilean pension system (Proposal “B” of the Advisory Pension Commission)

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Non-contributory</th>
<th>Contributory</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Social insurance</td>
<td>Fully funded individual accounts</td>
</tr>
<tr>
<td>No contributions required</td>
<td>PBS</td>
<td>-</td>
</tr>
<tr>
<td>Workers with wages up to the median earnings distribution ($350,000)</td>
<td>PBS</td>
<td>PSS</td>
</tr>
<tr>
<td>Workers with wages above the median earnings distribution (affluence test to exclude richest 20%)</td>
<td>PBS</td>
<td>PSS</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financing</th>
<th>General tax revenues</th>
<th>- Worker and employer contributions up to the median wage</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>- State contributions from general tax revenues</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Worker and employer contributions above to the median wage</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Administration</th>
<th>Social Security Administration (Instituto de Previsión Social)</th>
<th>Social Security Administration (Instituto de Previsión Social)</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Social security fund</td>
<td>Social Security Administration (Instituto de Previsión Social)</td>
</tr>
<tr>
<td></td>
<td>Pension management companies (AFPs) and insurance companies</td>
<td>Pension management companies (AFPs) and insurance companies</td>
</tr>
</tbody>
</table>

PSS: social insurance benefit
Annex 3. What is a mixed pension system?

The current debate on the possible pension reform in Chile presents a particular edge. Those who want a structural reform by reducing the size of the individual savings component and reintroducing a social insurance scheme, argue that the current system is not a mixed system. On the other hand, those that propose to maintain the current system argue that the current structure already has a mixed form. This is not a minor issue, in the sense that this is one of the main arguments in the debate for those who support the idea of maintaining the status quo and pursue blocking the proposal to reintroduce a social insurance component. Table A.3 sketches the differences in each view for the pension system structure where the second and third tier components display the major discrepancies.

Two countries in the Latin American region have advanced in structuring the pension system in a mixed manner: Costa Rica and Uruguay.

Table A.3

<table>
<thead>
<tr>
<th></th>
<th>Status quo</th>
<th>Mixed system</th>
</tr>
</thead>
<tbody>
<tr>
<td>First tier</td>
<td>Non-contributive component</td>
<td>Non-contributive component</td>
</tr>
<tr>
<td>Second tier</td>
<td>Mandatory contributions into individual pension savings accounts</td>
<td>Mandatory contributions into social insurance</td>
</tr>
<tr>
<td>Third tier</td>
<td>Voluntary contributions into individual pension savings accounts (*)</td>
<td>Mandatory and voluntary contributions into individual pension savings accounts</td>
</tr>
</tbody>
</table>

(*) The 2008 reform introduced collective savings accounts but this component has not developed yet.
Annex 4. Schematic figure of old age solidarity pensions in current Chilean pension system

Figure A.4.1

Source: Superintendence of Pension (2009, pag. 42)