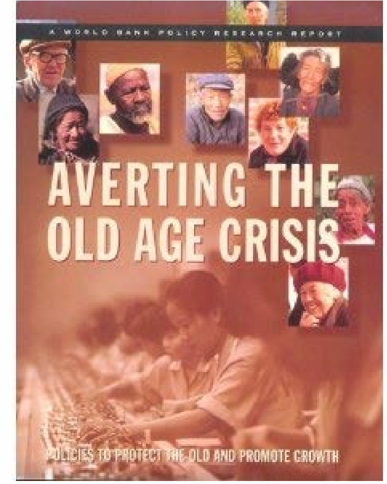

Reflections on Impact of Averting after 20 years

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Today I’m going to talk about 2 kinds of impacts that Averting has had:

- 1) Impact on kinds of old age security policies that countries have adopted
- 2) Impact on research agenda about old age security

Old age security policies

- Old age security programs have two 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 live with dignity
- Prior to Averting, 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 intro. non-transparent undesired redistrib.

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

- Saving component can be financed by workers thru mandatory pre-funded DC (no hidden redistrib.)
- Redistribution can’t be DC & requires tax-finance
- Therefore Averting recommended multi-pillar system
  - A transparent 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—population aging, slowing wage growth, need for pro-work, pro-saving incentives

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 (Kosovo, 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 issues 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 a 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 and had huge explicit and implicit debt that they didn’t reduce during transition; taking money from the funds proved irresistible in financial crises.
- Most countries that temporarily reduced DC contributions have now resumed
- Countries with greater political maturity, fiscal restraint and vested interest in the system kept funded pillar & cut back on PAYG pillar (RA, index.)

In sum:

- Movement toward greater pre-funding, DC & targeted redistributions continues to be inevitable, not because of Averting but because of underlying economic forces--population aging, slow 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.