Foreword

AT PRESENT, NATIONS AROUND THE WORLD (both large and small, rich and poor) are engaged in debate over how to reform their social security systems and care for the aged. For many countries this debate requires speculation on hypothetical scenarios, but in Latin America a rich body of experience on social security reform has been accumulating for more than a decade (for Chile, more than two decades). *Keeping the Promise of Social Security in Latin America* takes stock of those reforms, evaluates their successes and failures, and considers the lessons that can be drawn for the future of pension policy in the region. The authors draw on a series of background papers and surveys commissioned specifically for this inquiry, as well as existing research conducted by themselves and other pension experts. The report was also enriched by discussions with policymakers, pension fund industry managers, and academics at a regional conference held in Bogotá, Colombia, on June 22–23, 2004.

The task of assessing reforms that are still in progress must be undertaken with both caution and humility. But the stakes are high, and it would not be advisable to wait until the reforms have run their course. This study is intended to inform an ongoing debate, not to end it.

The authors find that structural reforms undertaken in Latin America in the last two decades mark a major improvement in many dimensions with respect to the earlier pay-as-you-go systems. In particular, reforms reduced fiscal liabilities, contributed to financial sector development, and improved the equity of pension systems, although there is still much to be done in these areas. Most importantly, the shift to individual accounts was a major structural improvement to the income-smoothing objective of pension systems for most current contributors. But there have also been significant disappointments, chief among them the failure to extend access to social security to a broader segment of society.

More than just an empirical assessment of reforms, this volume is also an attempt to rethink the priorities of social security systems in the region. The authors argue that the main priority of any publicly established pension system should be to prevent poverty in old age. If preventing poverty among old men and women is the most important policy priority, then the extent of coverage must be the most important criterion by which to judge any formal social insurance system. Detractors of social security reform in Latin America have rightly criticized the failure of reforms to increase coverage, despite any positive effects reforms may have had on fiscal balance sheets or financial sector development. This report meets the detractors in that arena, by analyzing why coverage has not adequately increased following reform and discussing the range of appropriate policy responses.

The authors argue, thus, for increased attention to the poverty prevention function of social security and a less prominent role for mandated savings. They claim that Latin America has not paid enough attention to pillars "zero" or "one"—those pillars whose main purpose is precisely to avoid the risk of falling into poverty in old age. They also argue that excessive attention has been paid to "pillar two" (mandated individual savings accounts) and not enough to the "third pillar" (voluntary savings). They do *not*, however, propose a "corner solution" composed of just pillars one (or zero) and three in all cases. The authors recognize the need to strike a balance between people's improvidence in planning for old age, on the one hand, and a government mandate to save, on the other—both of which can cause damage. Finding a suitable equilibrium between these tensions is a delicate task and one on which even experts can disagree. The appropriate final balance will depend, among other things, on the degree of development of financial systems, institutional capabilities, and past history of pension systems. The proper design of pillars "zero" and "one" is also difficult, as bad designs may encourage moral hazard and provide additional disincentives to participate in the formal labor market. Furthermore, the transition toward the desired system is not easy. Developing a strong zero or first pillar will be demanding in fiscal terms, requiring many countries to first finalize the "first generation" reforms in order to reduce the large fiscal liabilities that still exist today in favor of highly privileged middle- and high-income individuals. Meanwhile, developing a zero pillar must be weighted against the priorities of other poverty prevention programs.

Some of the ideas presented in this book may strike some readers as radical. However, in the debate on pension reform there is no orthodoxy, as reflected in major differences of opinion among leading experts in this area of policy. Despite more than a decade of experience with pension reform in Latin America, although undoubtedly a major step forward, reforms are still works in progress. No magic formula for success exists. We hope that this report will further enrich an already vibrant policy dialogue that is of crucial importance to the future of the region.

Guillermo Perry
Chief Economist, Latin America and the Caribbean Region
World Bank Group
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