

The Peruvian Pension Reform: Ailing or Failing?

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Outline of the talk

- Basic info on the Peruvian reform
- What has been achieved?
- What do critics say?
- Pending issues
- The agenda of reforms



The Peruvian Reform

- Main elements:
 - Peru reform was in 1992, the second country to introduce a FF system in its pension reform. It was done under very precarious political economy conditions.
 - The old system was poorly managed by governments.
 - 3 separate systems: standard, privileged, police and armed forces. The reform didn't touch the last two.



The Peruvian Reform (2)

- The reformed system is a parallel system. The old public pension system is still an option along with the FF (mandatory) private system.
- The Congress approved last week the possibility of returning back to the public system.
- The Executive proposal is to allow withdrawals **only** at retirement age (as in Mexico).



Old vs New

(as of December 2004)

	Public DL 1990	Public DL 20530	Private
Affiliates (in thousands)	1,320	60	3,332
Contributors (%)	32	n.d.	39
Pensioners (in thousands)	411	262	19
Receive minimum pension (%)	57	n.a.	1.5
Annual contribution collection (million US\$)	179	n.d.	657
Pension Fund (million US\$)	3,091	n.d.	7,236



What has been achieved

1. The reform has not been reversed. For Peruvian standards that is a plus.
2. The reform was aimed to provide a better pension coverage. The average pension is US\$ 265 per month equal to the maximum pension benefit in the old public system.
3. The pre reform minimum pension in the SNP was 15 dollars per month. Today is 125 dollars.



More achievements

4. The FF system has sustained M&As, financial and political crises, and the constant pressure of Congress.
5. Today, the fund size is around 13% of GDP.
6. The average annual real return on pension funds is around 9.2%.



Achievements?

- What have we gained keeping both systems?
 - Constant political pressure to undo the reform.
 - No gains in coverage, or better pensions
 - Is the SNP a relevant competitor?



What do (other) critics say?

- AFPs high ROE are a consequence of extremely high commissions supported by a market structure rather non competitive.
- Unfortunately, too many of policy initiatives are geared toward reducing ROE instead of increasing pension or coverage.



**Table 6: Average Commissions in Latin American Private Pension Systems
(31.12.2004)**

Country	Fixed fee US\$	Variable Commission (% wage)	Variable Commission (% wage)		Variable commission (% pension fund)	Variable commission (% rentabilidad)
			AFP	Insurance company		
Argentina		2.53	1.12	1.41	-	-
Bolivia		2.21	0.5	1.71	(a)	-
Colombia		3	1.55	1.45	-	4.5
Costa Rica		-	-	-	-	7.25
Chile	0.95	2.26	1.27	0.99	-	-
El Salvador		2.98	1.78	1.2	-	-
México		1.38	1.38	-	0.33	-
Panamá		-	-	-	1.26	-
Perú		3.19	2.27	0.92	-	-
Dominican Rep.		1.5	0.5	1	-	28.75
Uruguay	0.43	2.9	1.94	0.96	0.002	-

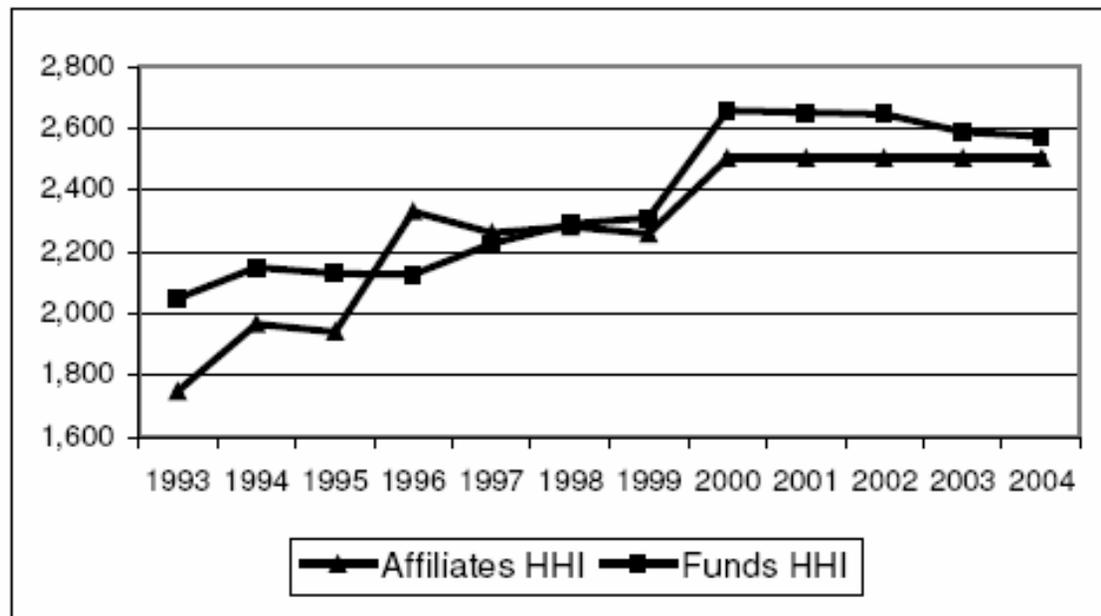
Source: FIAP (2005)

Notes: (a) 0.2285 if the pension fund is less than US\$ 1000 // 0.14 if the pension fund is more than > US\$ 1000 but less than US\$ 1200 // 0.067 if the pension fund is more than US\$ 1200 but less than US\$ 1500.



Highly concentrated: mirage or real?

Figure 3: Herfindhal-Hirschmann Concentration Indexes

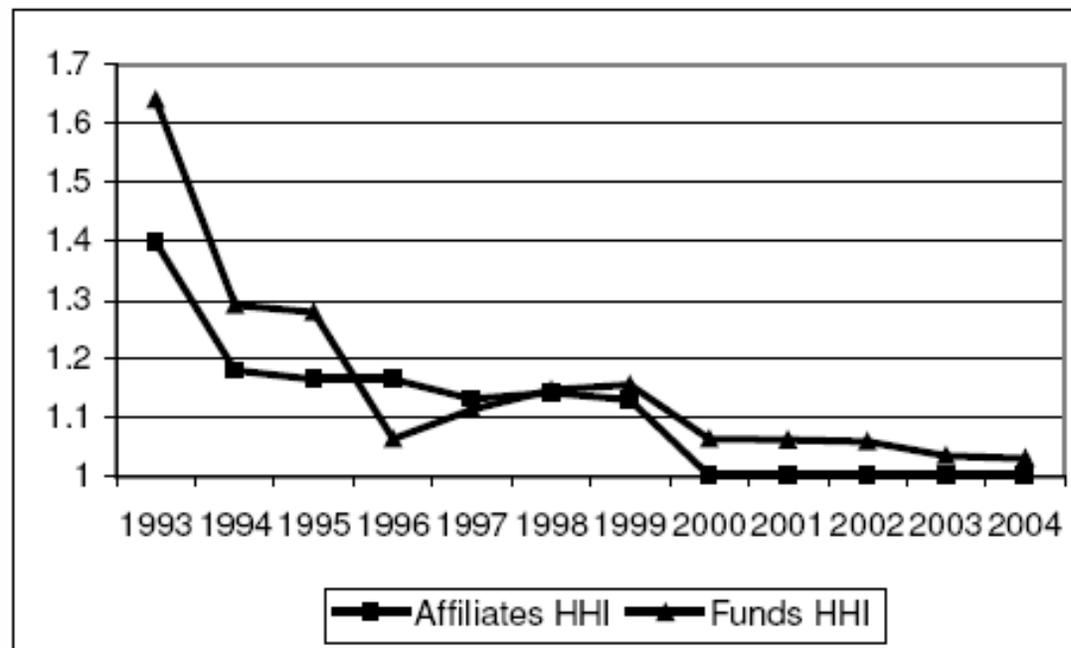


Source: SBS (2005)



Highly concentrated: mirage or real?

Figure 4: Herfindhal-Hirschmann Alternative Indexes



Source: SBS (2005)



Pending issues

- Coverage was low and is still low (~30% of wage-earners). No actions have been taken. The task seem impossible to handle as 2/3 of the workforce are in the informal sector.
- Very limited ability to enforce compliance from Ministry of Labor and industry regulators.



Agenda of reforms

- Refocus government intervention
 - Complements instead of substitutes
 - Objective: extend coverage
- Which is the best institutional design when informality is as large as 2/3 of the workforce?



Is the pension reform failing? ...ailing?

- We cannot say that the reform is failing and therefore there is no need to go back to the original design.
- But we do have to emphasize that there has been no efforts to increase coverage and that will always spark political trouble.
- It is true, that the far we go, the harder to mess around?, or the larger the temptation?

