Insights for Change

Deferred Dreams: Global Perspectives on Pension Reforms

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Seeking Inspiration Beyond Borders

Any meaningful pension reforms are bound to affect the interests of pensioners and public sector employees and that is why such reforms are considered extremely difficult to implement - especially in a context like ours, with polarized politics and a charged atmosphere teetering on the brink of political instability. But while our context may be somewhat unique, the potential resistance by pensioners and government employees is not. Pension reforms entail similar challenges everywhere, yet notwithstanding such challenges, several countries have drastically transformed their unsustainable PAYG (pay as you go) pension models into financially sustainable contributory schemes, driving economic growth through the investments they make, rather than creating a drain on taxpayers' resources. How did these countries manage the political resistance and other bottlenecks to pension reforms and what can we learn from them?

This is the second piece in a series of articles on pension reforms. In the first piece, we delved into Pakistan's prevalent pension crisis, which has escalated to a near-breaking point. The analysis revealed an unsustainable growth trajectory in pension expenses, outpacing both revenue growth and the operational expenses of the government. In recent years, the pension bill has swelled enormously, rising from Rs. 248 billion in 2018 to Rs. 1+ trillion in 2024-25, with projections showing that it could potentially double every four years. This fiscal strain is not confined to the federal level but is mirrored across provincial governments and state-owned enterprises, with a systemic burden that stretches across all tiers of the government.

This ballooning crisis calls for urgent and decisive reform measures. It's therefore imperative to explore and understand how other nations have navigated similar pension crises, ultimately reforming their systems. In particular, it would be interesting to take a close look at the pioneering model of Chile as well as some of the best ranked pension systems in the world. It would also be instructive to review our next-door neighbor India's experience with pension reforms.

This article aims to dissect international pension reforms, extract key lessons, and propose broad contours for Pakistan to overhaul its pension framework.

Chile's Pension Overhaul: Ahead of Its Time

In 1981, under the authoritarian regime of Augusto Pinochet, Chile embarked on a groundbreaking pension reform program, championed by José Piñera[1], the then Minister of Labor and Social Security. The 33-year-old Piñera was a dynamic economist who had earned his PhD from Harvard and was known for advocating free market reforms. Piñera convinced Pinochet to replace the decades old Defined Benefit (DB) scheme with a mandatory individual Defined Contribution (DC) system, wherein contributions would be invested in the market, taking the load off the budget[2]. This reform marked a significant departure from the traditional public PAYG system to a fully funded, privately managed system, based on individual retirement accounts - the first of its kind, eventually becoming a model for subsequent pension reforms around the world. It's worthwhile to note that at the same time, the public sector in US was still having a defined-benefit non-contributory system, while the 401(k) plan was just taking birth. The Chilean approach was therefore novel and ahead of its time.

The authoritarian nature of the Chilean regime meant that the government could implement sweeping reforms with little or no opposition from political parties, unions, or the public, thus enabling a rapid rollout of the new system. (This should not mean however, that autocracy is a pre-requisite for reforms. The real problem is to manage political resistance, ideally through building consensus and negotiations, which should lead to a much more sustainable political settlement.)

Moreover, the pension reforms were introduced in the backdrop of an economic crisis and widespread dissatisfaction with the existing pension system, which was perceived as inefficient, inequitable, and financially unsustainable. This situation contributed to a consensus on the immediate need to overhaul the system, even among those who would have typically opposed such changes. The new system was pitched as an alternative with higher investment returns and better benefits for the pensioners, thus appealing to pensioners' self-interest.

The Chilean pension reform fundamentally changed the pension landscape by shifting the responsibility of savings from the state to the individual. Managed by private pension fund administrators known as Administradoras de Fondos de Pensiones (AFPs), these entities competed for workers' contributions while being subjected to strict governmental oversight to ensure responsible fund management.

One of the notable features in the new system was its flexibility and portability, allowing workers to maintain their pension accounts without disruption, even when changing jobs. To address equity concerns, provisions were made for a minimum pension guarantee, aimed particularly at those with low contribution densities[3] or who had not contributed sufficiently throughout their careers. The government also provided a supplementary pension for low-income

[1]José Piñera was the brother of two-time Chilean president Sebastian Pinera (one of Chile's richest businessmen), who died in a helicopter crash on 6th Feb 2024.

[2]The pension reforms were part of a broader social security reform agenda.

[3]Defined as "the share of earnings in the active phase of life on which the individual contributes to some contributory pension system for old age" Ribe H., Robalino D. and Walker I. (2012), "From right to reality: incentives, labor market and the challenge of universal social protection in Latin America and Caribbean", The World Bank

retirees, ensuring a basic standard of living for all seniors[4].

The reform was not an overnight exercise but was gradually implemented. Existing workers were given the option to stay in the old system or opt for the new one, while new entrants to the workforce were automatically enrolled in the new DC scheme. This choice reduced potential resistance from those who were already close to retirement and concerned about changes to their expected benefits.

The World Bank supported the Chilean government in these reforms as part of a broader structural adjustment program, providing additional legitimacy to the reform efforts. With World Bank partnership, the government and the newly established AFPs undertook extensive communication campaigns to educate the public about the benefits of the new system, which alleviated fears and misunderstandings about the reforms.

After the return to democracy, subsequent governments made various adjustments to the pension system, addressing some of its shortcomings, such as introducing a safety net for the poorest retirees and improving coverage. These reforms helped to mitigate some of the criticism from political parties that had emerged over time.

Chile's model provided a pioneering example of market-based pension reforms, and this blueprint proved invaluable for countries around the world.

Neighborly Wisdom: Pension Reforms in South Asia

Pension reforms also made their way into South Asia at the turn of this century, with India becoming the first in the region to go in this direction. Until then, India's pension system was primarily a defined benefit system, financed on PAYG basis. This system became increasingly unsustainable due to growing pension liabilities. The fiscal burden was particularly acute given India's large public sector workforce, and the generous pension benefits they were promised. The 2001 Old Age Social and Income Security (OASIS) Report highlighted the deficiencies of the existing pension system and recommended a shift towards a defined contribution system.

The economic reforms of the 1990s, which liberalized the Indian economy, had already set the stage for pension reforms, with a focus on modernizing various aspects of the financial system. The New Pension System (NPS) was launched in 2004 for new government recruits (excluding the armed forces) but was gradually opened to all citizens by 2009, marking a complete shift from a DB to a DC system. The establishment of the Pension Fund Regulatory and Development Authority (PFRDA) helped in providing a regulatory framework to build trust in the new scheme.

Similar to the Chilean model, government servants who were already part of the DB scheme were given the option to remain in their existing system, while the new scheme was made mandatory for new entrants. This dual-track approach helped mitigate resistance from existing employees and unions. Although there were initial apprehensions and opposition from unions, the absence of large-scale protests indicated a relatively smooth transition.

[4]Recent discussions and reforms in Chile have focused on further enhancing the model to address emerging challenges such as the adequacy of benefits and inclusivity of the pension system. These ongoing reforms aim to adapt the system to current economic and demographic realities, ensuring it remains robust and sustainable for future generations.

Bhutan and Maldives soon followed India's example. Since the early 2000s, Bhutan has developed a well-structured pension system through the National Pension and Provident Fund, and the Maldives introduced the Retirement Pension Scheme in 2009, a mandatory contributory pension scheme designed to provide lifetime pensions to Maldivians. Other South Asian countries like Bangladesh, Sri Lanka and Nepal still maintain defined-benefit pension schemes for their government employees.

Solving the Political Jigsaw

The key to Chile's political economy challenges lay in an authoritarian regime, a crisis necessitating action, promises of high returns making the reform palatable, gradual implementation, extensive communication, and a continually evolving reform process.

India on the other hand managed to reform its pension structure on the back of the momentum of economic reforms, with a carefully crafted strategy and a transparent system with robust regulatory structures. Like Chile, India also followed a gradual approach to pension reforms implementation.

Similar lessons can be drawn from other countries. For example, France's pension reform journey spans over three decades, beginning with the 1995 under President Chirac, with subsequent reform efforts under Nicolas Sarkozy in 2010 and Emmanuel Macron in 2020[5]. The United States' Social Security Amendments of 1983 were made possible due to bipartisan support. Greece's pension reforms, much like those in Chile, were necessitated by a broader economic and debt crisis, whereas Brazil's 2019 pension reform can be attributed to President Bolsonaro's political capital and coalition-building in the legislature to overcome entrenched interests and historical resistance.

Best in Class: Insights from the World's Best Pension Systems

The Global Pension Index, officially known as the Mercer CFA Institute Global Pension Index (MCGPI), first released in 2009, serves as a crucial benchmark for evaluating the efficacy and robustness of pension systems worldwide. This annual report assesses pension systems of 47 countries, based on more than 40 indicators which are grouped into three main sub-indices: adequacy, sustainability, and integrity – a report card of sorts ranking pension systems around the world.

Based on the overall index score, the countries are given a grade ranging from a maximum of grade A for index value greater than 80 to a minimum of grade E, for index values below 35. The table below highlights the 7 top-ranked countries on MCGPI that scored a grade of B+ or higher.

[5]Emmanuel Macron's attempt to reform the pension system in 2020 aimed to create a universal points-based system. The reforms were met with widespread protests and were eventually disrupted by the COVID-19 pandemic.

TABLE: BEST RATED PENSION SYSTEMS ON GLOBAL PENSION INDEX	
Country	**System Structure**
Grade A (Index Value > 80): A first-class and robust retirement income system that delivers good benefits, is sustainable and has a high level of integrity	
Netherlands	The Dutch pension system consists of three pillars: a flat-rate public pension (AOW), occupational pensions (collectively agreed upon and often mandatory for sectors), and private savings (voluntary).
Iceland	Iceland's pension system also has three main components: a tax-financed public pension, mandatory occupational pensions (which are collectively bargained), and voluntary private pension savings.
Denmark	Denmark features a three-pillar system including a state-funded basic pension scheme, occupational pensions which are compulsory and private, and voluntary personal savings. The system is known for its "flexicurity" model that combines labour market flexibility with social security.
Israel	Israel's pension system includes a basic state pension provided by the government, supplemented by mandatory pension funds and private pension plans. Contributions are required from all employed persons.
Grade B+ (Index Value 75-80): A system that has a sound structure, with many good features but has some areas for improvement that differentiate it from an A-grade system.	
Australia	Known for its "Superannuation" guarantee system, where employers are required to make contributions to pension funds. It also includes a means-tested government pension and voluntary private savings.
Finland	Finland operates a residence-based national pension scheme supplemented by earnings-related pensions, which are compulsory and managed by private companies or public sector institutions. There's also an option for voluntary supplementary pension insurance.

Singapore	The Singaporean pension system is centered around the Central Provident Fund (CPF), a comprehensive savings plan where contributions are mandated for employed citizens and permanent residents. It covers retirement, health care, home ownership, and family protection.

While each system has its own distinguishing characteristics, all these top-rated pension structures share a common feature: the use of a multi-pillar structure, combining public pensions, occupational pensions, and private savings. This multi-pronged approach ensures distribution of risks, comprehensive coverage, financial sustainability and pensioners' adequacy. These examples provide a broad strategic direction for countries seeking to reform their pension systems.

Blueprint for Change: Crafting Pakistan's Future Pension System

Drawing insights from a range of pension systems around the world, Pakistan can learn several important lessons to avoid common pitfalls and build on successes elsewhere:

- Most sound and sustainable pension systems are based on a multi-pillar pension structure, rather than a single pension stream. Such a multi-pillar structure – with mandatory public pension contributions, voluntary private savings, and occupational pensions - distributes financial risks and provides a more reliable safety net for retirees.

- Financial sustainability may be a critically important objective to pursue (especially from a fiscal standpoint), but ensuring adequacy is an equally important if not more important goal from a social standpoint. Both these objectives therefore must go hand-in-hand to have a long-term viable pension structure.

- Periods of economic or fiscal crisis (like the one Pakistan is undergoing currently) can be a blessing in disguise and can provide the broader understanding and momentum needed to push meaningful reforms.

- The only path to successful pension reform goes through building consensus and trust, which in turn can be built with utmost transparency, pursuing the twin objective of adequacy alongside financial sustainability, and focusing on active engagement and clear communication with stakeholders.

- To effectively manage a contributory pension system, a strong regulatory framework is a must, to protect pensioners' savings and thereby foster trust in the system.

- Successful pension reforms are mostly based on a flexible approach, with the new systems constantly evolving and adjusting to the contextual changes and needs through periodic reforms.

- Most successful pension reforms in developing countries happened through collaboration with international development partners, which provided the technical expertise and financial support needed for reforms.

- Increasing the financial literacy of the public is highly important, enabling the individuals to take charge of their investment plans and make informed choices.

- The real success of a contributory pension system would lie in its investment approach, as only a minor difference in returns over the years can lead to significant differences in financial outcomes. A successful pension system should therefore craft a careful approach for life cycle fund management, ensuring adequate returns for pensioners while optimally managing the risks.

These lessons can provide the broad contours for a new pension system in Pakistan. However, designing and implementing such a system would require careful planning, wider stakeholder buy-in, and a capable team to lead the process. In the third and last piece in this series of pension articles, I would lay out the structure of a new pension system in Pakistan that can cater to the needs of our rapidly growing public sector workforce

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