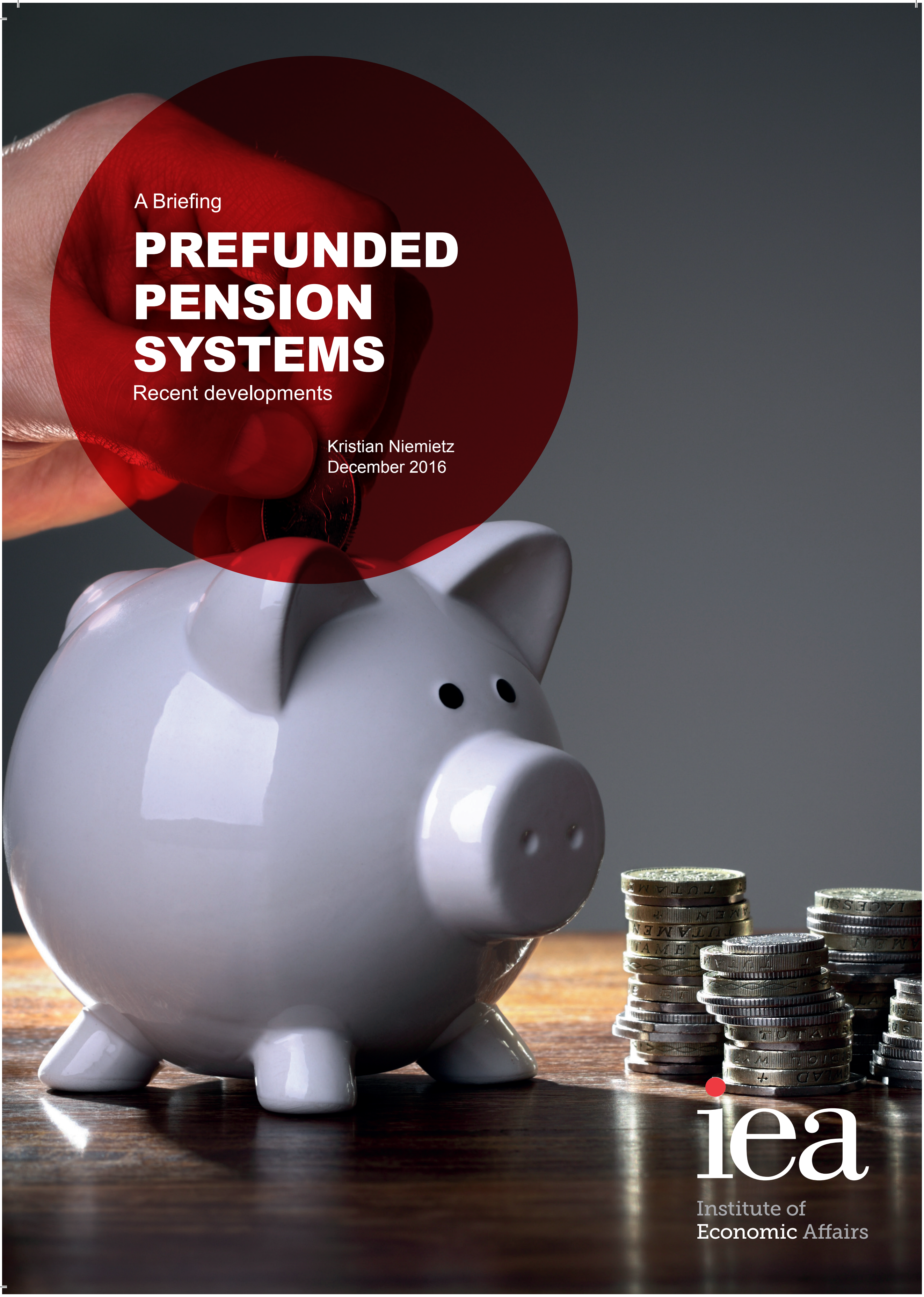

A Briefing

PREFUNDED PENSION SYSTEMS

Recent developments

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Contents

About the author

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Summary

- From the mid-1990s to the onset of the financial crisis, prefunded pension systems, based on individual retirement savings accounts, were spreading around the world. The UK was initially a world leader in this, due to the system of contracting out, which had allowed people to opt out of part of the state pension scheme and save for their own pension instead.
- Since 2008, there has been a global U-turn. Private pension systems are now in retreat and the old-fashioned paternalistic welfare state is reasserting itself. The UK is no exception. The contracting-out system, which worked so well for over half a century, has now been ended.
- Even in Chile, which has long been regarded as the 'Mecca' of private prefunded pensions, the mood has turned against that system. If even Chile has lost faith in privatisation and prefunding, what hope is there for an expansion of such systems elsewhere?
- It is therefore necessary for international observers to interpret the Chilean experience correctly. However unpopular it may be at the moment, it remains the case that Chile's private pension system has been a success story. It has provided consistently high rates of return and it has been an active ingredient in the country's rapid economic development.
- The reason why pensions in Chile have fallen behind expectations is insufficient savings, not any 'failures' of the system as such. Only one in three men, and one in four women, save regularly, and in addition, the contribution rate and the retirement age are set too low. The system offers decent pensions and excellent value for money to those who save regularly. But it cannot magically turn a record of sporadic savings into a comfortable old-age living standard – and nor could any other pension system.

- Whatever problems the Chilean prefunded system may have, these are highly country-specific, and not applicable to the UK. In order to defuse the ‘demographic time bomb’, the UK would do well to reanimate its successful system of contracting out, and promote private pension savings.

Introduction

In 1994, the World Bank published its seminal report *Averting the old-age crisis. Policies to protect the old* ***and*** *promote growth*, which made the case for a three-pillar pension system. The first pillar would be a publicly funded safety net, the second pillar would consist of mandatory long-term savings, and the third pillar of (more lightly regulated) voluntary savings. This combination, the authors argued, would generally offer people the best protection in old age, especially against the global backdrop of rising life expectancy and falling birth rates. The prefunded pillar(s) would also give rise to a host of beneficial economic side effects. As the authors explained:

> 'The advantages of a mandatory (defined contribution) saving scheme […] are that coverage can be broad and benefits are fully portable. […] [It] can be part of a national policy to develop new financial institutions, deepen capital markets, mobilize saving, and allocate it to the most productive uses […] It also allows workers to increase their returns and insure against political or other country-specific risks through international diversification of investments' (World Bank 1994: 244).

Comprehensive though that report was, its description of how that three-pillar system would work was necessarily somewhat theoretical, because the majority of the world's pension systems were a million miles away from what the World Bank authors had in mind. Pay-as-you-go (PAYGO) systems were the norm, and prefunded pillars that played more than a minor supplementary role were hard to find.

But there were a few exceptions, which could be broadly grouped into two categories. On the one hand, there was the Chilean system. In 1981, Chile had begun to phase out its state-run PAYGO system, and replace it with a prefunded system based on individual retirement savings accounts.

Chile had been the first country in the world to embark on such a reform, and around the time the World Bank report was published, Argentina, Colombia and Peru were launching their own ‘Chile light’ reforms.

On the other hand, there were a small number of developed countries that had managed to develop private prefunded and public PAYGO systems side by side. The Netherlands, Switzerland, Denmark, the US and also the UK fell into this category (ibid: 169-174).

The difference between these two groups of countries was that in the Chile-type systems, governments had deliberately created, or were about to create, prefunded pillars. In the second group, these pillars had developed spontaneously – nobody had ‘created’ them. Governments may have facilitated their operation, or given them a specific shape, but we could not trace them back to a specific start date, or a specific Act of Parliament. The UK system is a case in point. As Seldon (1996: 63-64) explains:

> ‘[V]oluntary saving originated in the decisions of individuals of all income-groups, including many with low earnings […] since the middle-late 19th century. […] [I]n the 1950s […] millions of people were saving […] and had accumulated private property, in both financial instruments like savings accounts, insurance policies and stocks and shares […] and in real estate like homes and other property […] There were […] some 14 million accounts with Industrial and Provident Societies, including Co-operative Societies, and over eight million accounts with Friendly Societies. […] Over 88 million industrial assurance policies and annuities […] were held with assurance companies and 33 million […] with Collecting Societies. A further nine million policies and annuities […] were held with life assurance companies. […] There had also been expansion, mainly since the 1930s, in […] ‘occupational’ pensions. In 1951 they covered […] nearly five million men and 1.3 million women.’

Nonetheless, there were gaps in coverage, and old-age poverty remained a problem, which the post-war welfare system aimed to resolve. Unlike in most other developed countries, however, the British government was aware that an expansion of state pensions would lead to a crowding out of the existing private system (if ‘system’ is the right word), and sought to minimise this side effect. The Macmillan government came up with a unique arrangement, which was developed further by subsequent governments: contracting out.

The post-war pension system consisted of a safety-net pillar and an earnings-related, contributory pillar. ‘Contracting out’ meant that people were allowed to opt out of the second pillar if they already had alternative occupational arrangements. Those who did so received a rebate in National Insurance contributions, broadly equivalent to the pension entitlement they forewent by opting out. They could then use that rebate in order to build up their own portfolio of old-age savings.

There were always some problems with the contracting-out system, especially because in a defined-benefit system, setting the rebates at the right level is not an exact science. But it broadly worked as intended: while in most developed countries, state pensions crowded out private pensions, in the UK, they grew side by side. Between the mid-1950s and the mid-1960s, the number of people in occupational pension schemes nearly doubled to around 7 million. The 1986 Social Security Act further facilitated contracting out, by broadening the scope of private pensions which people could contract into instead (Booth and Niemietz 2014: 13-20).

Around the time the World Bank report was published, British pension funds had accumulated assets worth 73 per cent of GDP (World Bank 1994: 173-174). In this respect, the UK was a world leader. Very few other countries came anywhere near achieving such levels. The value of the assets held by German and Japanese pension funds amounted to less than 10 per cent of these countries’ respective GDPs.

A lot has changed since then. In the fifteen years following the publication of the report, prefunded systems were in the ascendancy: more than two dozen countries that had not previously had prefunded pillars emulated aspects of the Chilean model. Some of the countries that already had such pillars – especially Australia – strengthened them further. Had the World Bank report been published in 2008, there would have been plenty of real-world examples, which came close enough to the suggested three-pillar system, to draw upon.

The UK, during that period, made little of its excellent starting position. Although the New Labour government initially seemed supportive of the contracting out system, it later began to erode the value of the rebates, increased the system’s complexity, and made contracting out harder (Booth and Niemietz 2014: 40-43). Still, the system continued to develop. The proportion of pensioners receiving a private pension on top of their state pension increased from 62 per cent to 70 per cent, and the average private pension increased by about 47 per cent in real terms (ibid.: 20-23).

The financial crisis marked a global U-turn. The spread of prefunded pension pillars came to an abrupt halt, and was in some cases reversed. In October 2008, in a bizarre move, the government of Argentina expropriated all retirement savings accounts, and forced savers back into the public PAYGO system (Niemietz 2009). In 2010, the government of Hungary took a similar if less extreme step, pressuring pension savers to swap their retirement assets for PAYGO entitlements. In Poland, the government reduced contributions to the system's private prefunded pillar and increased contributions towards the public PAYGO pillar accordingly (ibid: 35-37). And in the UK, the Liberal-Conservative coalition phased out the system of contracting out.

More recently, this political mood swing has even reached Chile, the pioneer of reform. Throughout the summer and autumn of 2016, the country witnessed mass protests against the pension system in the capital and other major cities, with hundreds of thousands of people taking to the streets. A dissolution of the system and a return to a state-run PAYGO system may not be immediately on the cards, but it is now seriously being discussed in Chile.

Although controversies about Chile's pension system are a domestic matter, they have attracted an unusually high level of international media coverage, including on BBC News[1], BBC World[2], in the *Guardian*[3], the *Economist*[4], the *Financial Times*[5], the *Daily Mail*[6], Reuters[7], the *New York Times*[8], the *Los Angeles Times*[9] and Bloomberg[10]. This is probably a reflection of the emblematic status of the Chilean system: it is quite unlikely

1 'Chileans protest against Pinochet-era private pension scheme', BBC News, 22 August 2016.
2 'Miles protestaron en Chile contra el sistema de pensiones privadas', BBC World, 22 August 2016.
3 'Thousands protest in Chile against state pension provisions', *Guardian*, 22 August 2016.
4 'The perils of not saving', *The Economist,* 27 August 2016.
5 'Chile pension reform comes under world spotlight', *Financial Times*, 12 September 2016.
6 'Thousands in Chile protest against state pension system', *Daily Mail*, 4 November 2016.
7 'Chile's Bachelet proposes pension reforms amid criticism', Reuters, 10 August 2016.
8 'With pensions like this ($315 a Month), Chileans Wonder How They'll Ever Retire', *New York Times*, 10 September 2016.
9 'Chile's privatized social security system, beloved by U.S. conservatives, is falling apart', *Los Angeles Times*, 12 August 2016.
10 'Chile Pension Protests Swell as Proposals Fail to Placate Public', Bloomberg, 22 August 2016.

that domestic disputes about, say, the Brazilian pension system would attract a lot of media interest in the UK. But if even Chile, the ‘Mecca’ of private prefunded pensions, is turning against that system – what hope is there for prefunded schemes elsewhere? Does this mean that this idea has run its course?

This is why it is important for international observers to interpret the current situation in Chile correctly. This briefing will show that the main reason why pension levels in Chile have fallen behind expectations is insufficient savings, *not* a failure of the pension system as such. The prefunded pillar does provide decent pensions for those who have contributed regularly throughout their working lives. But it cannot magically turn a record of sporadic savings into fifteen or twenty years of a comfortable living standard, and nor could any other pension system.[11]

When assessed against realistic counterfactuals, the Chilean system performs remarkably well. This briefing will show that whatever weaknesses it may have, these would still be present under the alternatives that are currently being discussed in Chile. There is scope for improvement, but attempts to dismantle or subvert it are dead ends. Effective reforms would remain in keeping with the spirit of the original 1981 reform, and build on the system’s strengths. The briefing will also discuss implications for the UK.

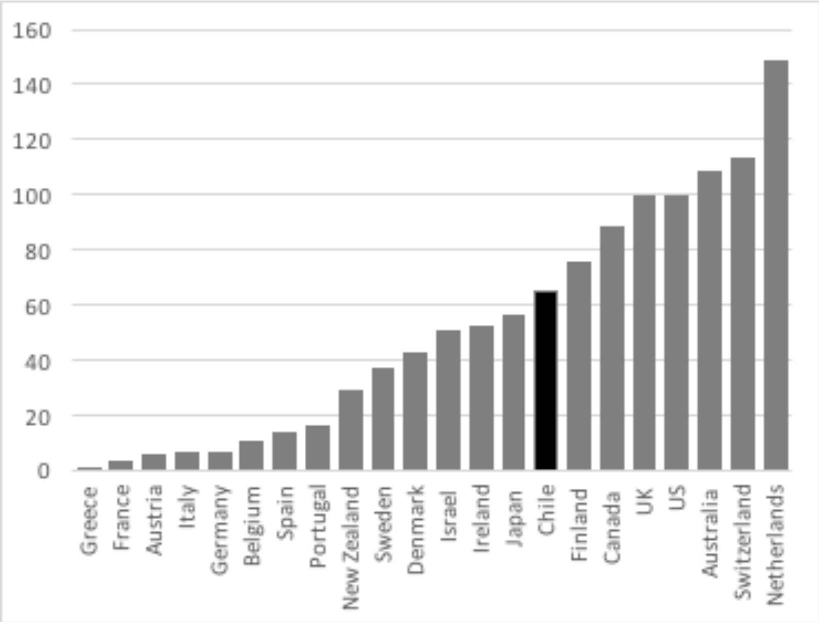
11 On average, Chilean men spend 15 years, and Chilean women spend just over 19 years in retirement (OECD 2015: 164-165). This is the difference between the average life expectancy and the effective (as opposed to the official) retirement age.

The Chilean system

The Chilean system is a system of mandatory old-age savings, underpinned by a tax-funded old-age safety net. Working-age people pay 10 per cent of their gross salary into a retirement savings account, managed by a pension fund provider – known as AFPs (*Administradoras de Fondos de Pensiones*) – of their choice. Since 2002, people have also been able to choose between five different risk levels.

Taken together, the value of the assets accumulated by Chilean pension funds is equivalent to about two thirds of the country's GDP (Figure 1). This places Chile in the same league as countries which have had private pensions for over a century, and miles ahead of countries with traditional Bismarckian systems (see below).

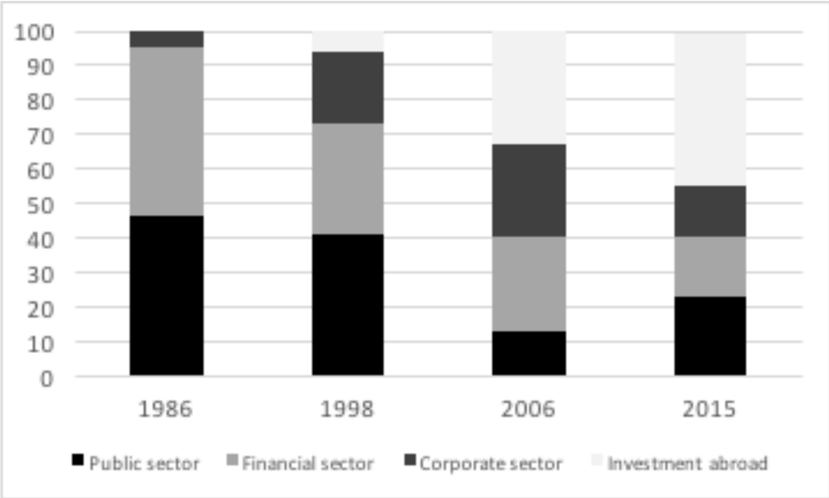
Figure 1: Assets held by pension funds as a percentage of GDP, 2013



Based on OECD (2015: 190-192)

Initially, AFPs invested mainly in government bonds, central bank titles and in the domestic banking sector. Over time, though, their investment portfolios became a lot more sophisticated and a lot more diversified – both by economic sector and by geography (Figure 2).

Figure 2: Investment portfolios of Chilean AFPs over time



Based on SP (2016)

The system has also always had a safety net component, which has been reformed and extended in recent years. Its main instrument is a means-tested, tax-funded minimum pension. People who have no pension income of their own receive the full amount. Support is gradually withdrawn with pension income, and tapers off at the 60th percentile of the income distribution. This solidarity pillar is therefore more than a safety net: even people with above-average incomes can still qualify for support.

The old system ceased to accept new entrants in 1981, but it did not suddenly disappear. A successor organisation, which administers the pensions of those who did not switch to the new system in 1981, is still in place. There are also parallel schemes for the police and the armed forces.

The 1981 reform gave rise to a transitional cash-flow deficit: pension entitlements that had been accrued under the old system still had to be honoured, but the number of contributors plummeted. In the early years, the fiscal cost of the old system's obligations amounted to just under 5 per cent of GDP each year (Comision Asesora Presidencial sobre el Sistema de Pensions 2015: 57-58). This has dropped to 1.6 per cent of GDP more recently, as the bulk of the transition cost has now been paid off.

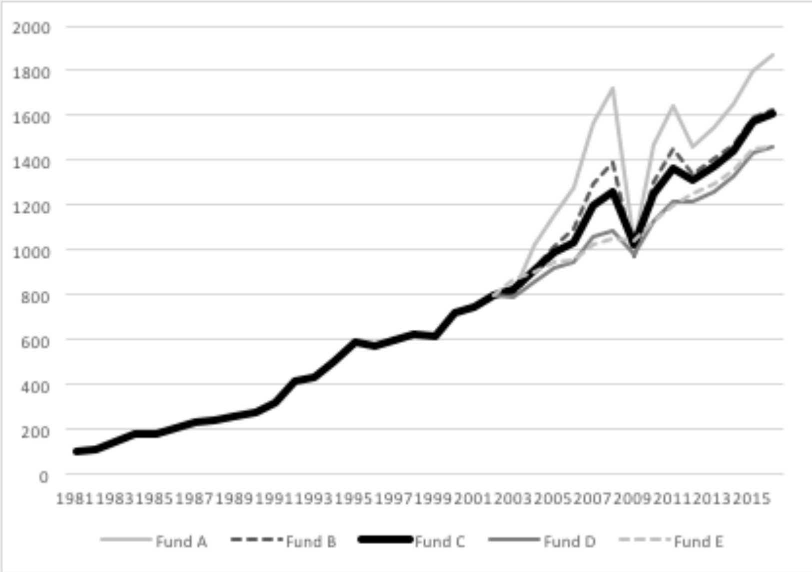
The poverty rate among the elderly is lower than that of the population as a whole – 3.9 per cent vs. 10.3 per cent, or 8.4 per cent vs. 14.4 per cent, depending on the poverty measure used (Comision Asesora Presidencial sobre el Sistema de Pensions 2015: 64-65).

Chile's 1981 pension reform has given rise to a number of positive economic spillover effects: the prefunded system has been an active ingredient in the accelerated economic development that the country has been experiencing since the mid-1980s. It has increased savings and investment, even after taking account of offsetting effects such as the transition deficit (Coronado 1997, Bennett et al. 2001, Corbo and Schmidt-Hebbel 2003). It has increased employment, especially in the formal sector (Edwards and Cox Edwards 2002, Corbo and Schmidt-Hebbel 2003). It has boosted the development and sophistication of Chile's capital markets, and thus raised Total Factor Productivity (Beck, Levine and Loayza 2000, Corbo and Schmidt-Hebbel 2003).

High returns, low pensions?

Critics of the Chilean system point out that the average AFP pension is lower than the salary of a minimum wage worker (No+ AFP 2016), and that replacement rates are among the lowest in the OECD (OECD 2015: 138-151). Supporters, in turn, point to the high rates of return earned by the pension funds. Both claims are, on the face of it, correct. The average annual rate of return since 1981 has been 8.4 per cent, after inflation (SP 2016). £100 invested in an average-performing Chilean pension fund in 1981 would be worth over £1,600 today (in constant prices). The financial crisis was no more than a dent in the system's overall performance. Even A-Funds, which represent the highest risk level, and which crashed spectacularly in 2008, bounced back relatively quickly (Figure 3).

Figure 3: Cumulative real rates of return of Chilean pension funds, 1981-2015 (1981 = 100)



Based on SP (2016)

So how can a system which consistently offers such high rates of return offer such low pensions? Where do all those returns go? The system's critics argue that they end up enriching the companies managing the funds. Luis Mesina, the spokesman of the movement 'No+ AFP' ('No More AFPs') which has emerged out of the recent protests, claims:

> 'We swear that we will not rest until we have made sure that our pension savings cease to serve those economic groups, and are put in the service of those who are their true owners: the workers'.[12]

This idea is echoed by David Blake, a professor of Pension Economics at London's Cass Business School:

> 'Initially the Chilean model appeared to be very successful, but the sting in the tail appears to be that charges extracted by the industry have resulted in pensions being much lower than otherwise would be the case.'[13]

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12 'Miles protestaron en Chile contra el sistema de pensiones privadas', BBC World, 22 August 2016.

13 'Chile pension reform comes under world spotlight', *Financial Times*, 12 September 2016.

This interpretation is factually wrong. AFPs finance themselves by charging an income-related monthly fee. That fee is *not* taken out of people's retirement savings account; instead, people pay it *on top* of the 10 per cent they deposit into their account. This means that the fee cannot diminish people's future pensions. It can only reduce their current consumption.

This is not to say that there is no scope for greater competition in the AFP industry, and for a reduction in commissions. AFPs have historically shown high profit margins, often exceeding 20 per cent (SP 2010: 102-104).[14] The industry is characterised by high levels of concentration (there are only six AFPs), customers show low levels of price sensitivity, and market entries and exits are not a frequent occurrence.

So there is scope for introducing greater dynamism and competitiveness into the industry, and this would be the kind of reform strategy that would improve the system rather than undermining it; the kind of reform strategy that would be in keeping with the spirit of the original 1981 reform. But desirable though that would be for other reasons, it would not, on its own, increase people's pensions.

14 Nonetheless, AFP commissions have shown a gradual downward trend over the years, falling from nearly 5% of people's salaries in the early 1980s to between 0.5 per cent and 1.5 per cent today (Comision Asesora Presidencial sobre el Sistema de Pensiones 2015: 54).

Contribution densities

Latin American welfare systems have long had a problem of narrow coverage (Rofman 2005). The main reason is that these economies contain large informal sectors, where people are employed without a contract, or work as unregistered sole traders, or run a company that is not listed in any commercial registry. People in these informal occupations are not covered by formal social protection mechanisms, be they private or public. In Chile, about a quarter of the labour force work in the informal sector (López García 2015: 2). By Latin American standards, this is a very low proportion (Gonzales 2015), probably the lowest in the region. But it is a high proportion by OECD standards.

Conventional measures of social security system coverage are binary: people are classified as ‘covered’ or ‘not covered’ (or as ‘insured’ or ‘uninsured’). This is not appropriate in the case of the Chilean AFP system. Unlike in many of the neighbour countries, in Chile, people will rarely spend their entire working lives in the informal sector, but many switch back and forth between formal and informal employment. This means that almost all of them have an AFP account (unless they are part of one of the parallel pension systems), and are, in this sense, ‘covered’. But having an account, and contributing actively, are two very different things.

Only about one in three men, and one in four women, contribute regularly, if we define ‘regularly’ as ‘for at least four years out of any five-year period’. At the other end of the spectrum, one in five men, and one in three women, only contribute very rarely, if we define ‘very rarely’ as ‘for less than a year out of any five-year period’ (Candia and Cifuentes 2014: 10).

This is why, in the Chilean case, ‘the average pension’ is not a meaningful concept. Suppose Chile had a more informal economy, like neighbouring Peru or Columbia, and many people had no AFP account at all. In calculating average pensions, we would then obviously not include people without an AFP account in the denominator; we would not divide the total sum paid out by all AFPs by the total number of retired people in the country. It would be clear even to the system's fiercest critics that if somebody never paid a peso into an AFP account, we cannot blame the AFPs for not providing them with a pension.

But if it is not appropriate to include non-accountholders, why is it appropriate to include 'passive accountholders', who have an account, but rarely use it?

Among people who have contributed for between 24 and 32 years, the median AFP pension replacement rate is 46 per cent (Comision Asesora Presidencial sobre el Sistema de Pensions 2015: 89). This is still not high by OECD standards, but then, the average pension contribution rate in OECD countries is just under 20 per cent, compared to a mere 10 per cent in Chile (ibid: 119). In addition, the assessment base – the definition of what counts as part of somebody's wage or salary, for pension contribution purposes – is a narrow one. According to one estimate, on average, the contribution rate is only applied to 91 per cent of people's remuneration (Candia and Cifuentes 2014: 13-15), which means that the *effective* contribution rate is not 10 per cent but 9.1 per cent. Meanwhile, in terms of life expectancy, Chile has virtually closed the gap with the developed world (Roser 2016). With this in mind, the Chilean AFP system offers excellent value for money.

Non-solutions

More moderate critics of the Chilean system want the state to become a more active player in the pension fund market, not least by setting up a state-owned AFP. During the last presidential election, this idea was endorsed by eight out of nine candidates (Libertad y Desarrollo 2013: 1). The more radical critics want to dismantle the AFP system entirely, and replace it with something closer to the pre-1981 PAYGO system. That is, in particular, the agenda of the citizen's movement 'No+ AFP' ('No More AFPs'), which has emerged out of the recent protests (No+ AFP 2016).

As for the former proposal, if people are not putting enough money into a privately managed retirement account, they are not suddenly going to put a lot more money into a publicly managed retirement account. The creation of a state-owned AFP would therefore not address the system's main problem. But it could create a host of new problems.

The government's expert commission on pensions has called for a public AFP that is strictly independent of the government, that operates under the same rules as the private AFPs, and that is fully self-funding (Comision Asesora Presidencial sobre el Sistema de Pensions 2015: 101). But if a public AFP truly fulfilled those conditions, it would not, in any meaningful way, differ from a private AFP.

The danger, of course, is that it would not remain genuinely independent for long. Politicians would be tempted to grant favours to 'their' AFP, and to pressurise it into investing in politically favoured industries, as well as, of course, in government bonds. In the worst case scenario, a public AFP would become a tool for channelling resources into the political pet projects *du jour* and/or a cash cow for the government. Apart from the economic damage, this would lower people's future pensions.

The more radical critics, meanwhile, do not specify what exact type of PAYGO system they want to replace the AFP system with. They merely claim that their PAYGO system would, magically, 'immediately double pensions at no fiscal cost' (No+ AFP 2016). But PAYGO systems essentially come in two varieties, namely 'Bismarck' and 'Beveridge' systems. Bismarck systems are contributory systems, characterised by a strong relationship between current contributions and future pension entitlements. Beveridge systems aim to provide a basic universal standard, which is not, or only loosely, connected to people's prior contribution record. Unlike in a Bismarck system, the state pension in a Beveridge system is meant to be more of a safety net than an earnings replacement.

A Beveridge system is clearly not what the No+ AFP movement has in mind. They promise more generous pensions across the board, not just a guaranteed minimum standard (which, in any case, is already provided by the solidarity pillar). A Bismarckian PAYGO system, however, would replicate the current system's main problem. Just as a record of low and patchy savings leads to low private pensions in the AFP system, a record of low and patchy contributions leads to low state pensions in a Bismarck system.

Chile could, in theory, afford a return to a PAYGO system, because the country's demographic conditions are still relatively favourable to PAYGO systems. With a median age of only 34 years (Roser 2016a), Chile is still a young society. Half of the country's current population hadn't even been born when the AFP system was created.

But the country is also ageing rapidly. Average life expectancy at birth has increased from 71 years in the mid-1980s to 79 years today, and in the same period, birth rates have fallen from 2.7 children per woman of childbearing age to 1.8 (Roser 2016a, Roser 2016b).

Accordingly, modelling shows that under certain restrictive assumptions, a return to a PAYGO system could produce some short-term gains (Titze 2015: 17-20). But the same models also show that these gains would dissipate over the next decade, and that from then on, the cost of a PAYGO system would rise rapidly (relative to the cost of the current system, and for a given old-age living standard).

Few developed countries would introduce PAYGO systems today, but now that they already have them, they shy away from the transition cost of moving to a prefunded system. Chile is, in this sense, in an admirable position. It started the transition when demographic conditions were still favourable and has now paid off the bulk of the transition cost. But if introducing a PAYGO system today would be nonsensical, *returning* to a PAYGO system *after* having borne the cost of the transition would be madness.

Conclusions

Despite the current backlash against it, Chile's pension system is a success story. The system has achieved consistently high rates of return. It offers excellent value for money and solid pensions for those who contribute regularly. It has also been an active ingredient in Chile's rapid economic development, boosting savings, investment, employment, the development of capital markets and productivity.

But it is not a magic money tree: it cannot turn sporadic contributions into 15 or 20 years of a high old-age living standard. The system's safety net pillar, however, does look after those who have not had the opportunity to save enough for their retirement. Chile's old-age poverty rate is well below the country's overall poverty rate.

The system can only be evaluated against a realistic counterfactual, with a Bismarckian PAYGO system probably being the most likely alternative. Patchy contribution records would be just as much of a problem in a Bismarckian system as they are in the current system, but a Bismarckian system would not produce the beneficial economic side effects that the current system produces. Under certain restrictive assumptions, moving to a PAYGO system could produce some short-term gains, but they would dissipate quickly, and then turn into net losses. This, it should be noted, is the result of theoretical modelling, which does take account of the tendency of state-run pension systems to become a political football.

But despite its impressive economic record, the system has failed to win people's hearts and minds. Most of the criticism directed against the system is not about economic arguments, but about the perceived *motives* of some of the system's actors, namely the companies running the pension funds. For proponents of free-market solutions, this is an all-too-familiar problem, which is by no means country-specific or sector-specific. An intuitive dislike of the profit motive is an ineradicable feature of human psychology, hardwired into us (Foster 2014), whether it is in Chile or the UK, whether it is in field of old-age provision, healthcare, education or elsewhere. It leads to a visceral rejection of solutions which give room to the profit motive, and economic evidence can only go so far in countering it.

There is room for improvement. But there is no need to 'think outside the box' – there are plenty of workable solutions within the box, and the solutions that lie outside of it turn out to be non-solutions upon closer examination.

Informal economic activity normally results when the cost of entering the formal sector is too high – when there are, for example, too many bureaucratic hurdles to clear for setting up a company legally (de Soto 2000). What this means in detail, in the Chilean case, is beyond the scope of this briefing, but suffice it to say that Chile has already become a much more formalised economy than it used to be, and has the potential to further increase opportunities for formal employment.

The issue of low market entry rates in the pension fund industry could be solved relatively easily by allowing banks, insurance companies and other financial intermediaries to also offer retirement savings accounts. At the moment, they can only do so by setting up a separate AFP company, entailing an increase in fixed costs.

Meanwhile, price sensitivity among customers could be increased by allowing group contracts. Trade unions, professional associations, employers and civil society organisations could be allowed to act as intermediaries between their members and the pension fund administrators, shopping around for the most lucrative offers on their behalf. It is not necessary for every individual customer to be superbly informed and highly sensitive to price differences. Having a critical mass of active, well-informed customers can be sufficient, and giving customer representatives greater freedoms could be one way of achieving this.

Greater competition would lower the commissions charged by pension fund administrators. As explained, this would not increase pensions, because in the current system, there is no link between commissions and pensions. But such a link could be established. Ultimately, the savings rate will have to be raised, not to the OECD average (which would imply a near-doubling) but to a level somewhat closer to it. Raising the rate will be easier if commissions fall at the same time.

The current retirement age of 65 years for men and 60 years for women is also no longer realistic, and the distinction between a male and a female retirement age is outdated anyway. Most OECD countries have given up that distinction (OECD 2015: 50-51). The official retirement age is not as important in Chile as it is in countries with state-run systems. By and large, in that system, people retire when they have accumulated enough savings, not when politicians think they should retire. In practice, most Chileans already work beyond the official retirement age (OECD 2015: 164-165). But that threshold still matters for the solidarity pillar. People who are close to retirement age, and who have not accumulated a huge amount of savings, have little incentive to continue working. The retirement age should be pegged to life expectancy, and the male-female gap should be closed.

Unemployment-related career breaks lower pension entitlement in most countries, and only a completely non-contributory system could prevent this. However, in Chile, the impact of such a break on future pensions is larger than in other OECD countries (OECD 2015: 96-98). This could be changed by integrating the pension system and the unemployment insurance system. As well as smoothing current consumption, unemployment insurance could also be used to smooth out pension contributions, at least to some degree. The integration of the self-employed, meanwhile, is already under way, even if implementation is lagging behind the official timetable.

Going back to the UK, the most important policy implication from Chile's recent experience is the *absence* of strong policy implications. The problems the Chilean system experiences are country-specific, or more precisely, specific to a country that has only relatively recently joined the club of high- and upper-middle income countries (World Bank 2016).

In the UK, the employment rate is at a historic high, and informal employment is, at best, a fringe issue. If the UK were to move to a fully prefunded system, universal coverage would be much easier to achieve than it is in Chile. Market concentration in the pension fund industry is an issue in Chile, but it would not be an issue for the UK. The UK's pension fund industry is among the world's most competitive, and fees are low by international standards (OECD 2015: 196-197).

In the UK, it would not be necessary to reinvent the wheel. The contracting-out system as worked well enough for half a century. Its foundations are still in places, and it could easily be reanimated with a few minor tweaks: Booth and Niemietz (2014: 44-51) outline a proposal for how this could be achieved in practice.

The idea of prefunded pensions may well have fallen out of fashion, but intellectual fads and fashions come and go. The economic case for prefunded pensions remains as strong as ever, and political mood swings will not be enough to defuse the demographic time bomb.

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