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Integration and complementation between different social security programs and incentives and disincentives to contribute to the contributory pension system in Latin American countries

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Summary, conclusions, and best practice proposals

The first step for improving Latin American pension systems is to define the coverage objectives, pension amounts, replacement, and redistribution rates that society seeks to obtain through the operation of their different pillars. Those objectives should be related to wages and the poverty line and are different for each pillar. Their joint operation must also be consistent with the objectives set. There is technical consensus in that Latin American countries must gradually increase contribution rates and retirement ages in the mandatory contributory pillar to finance better benefits. Pension program design and operation must also be reformed to increase savings volumes, incorporate groups of workers who are not currently covered, address ongoing changes in the labor markets (creation of new types of work) and deal with population aging (lower birth rates and longer life expectancy at retirement).

That said, this pension note focuses on analyzing the relationship between social programs and their incentives and disincentives for making contributions to contributory pension programs, and the main causes of the low levels of savings and contribution density in mandatory contributory programs, apart from insufficient contribution rates. The following causes were identified as the most relevant, based on different specialized publications: labor market characteristics; low productivity and income levels and the low savings capacity of many workers; the shortcomings of the different public policies to address social contingencies; the lack of integration and complementation between the different social security programs and the different pillars of the pension system; the shortcomings of non-contributory social protection programs that do not encourage formalization and benefit informal sectors; poor supervision of the fulfillment of social security obligations by employers and the evasion and circumvention this entails; the long-term characteristics of pension savings; the lack of social security education of members; and poor assessment by members of the social security benefits that the systems can grant.

The close relationship between the labor market and the pension system highlights the importance of improving and promoting the proper functioning of this market, where high informality, the frequent rotation of workers between different types of formal and informal work, unemployment and inactivity affect the regularity and density of contributions to pension programs.

High firing and hiring costs are decisive factors in explaining informality, enrollment, and contribution to contributory pension program behavior. The experience of Latin American countries also shows that oversight must be strengthened, as evidence indicates that poor monitoring by supervisory bodies is another element that explains the persistence of high levels of non-compliance with labor regulations and the evasion and avoidance of social security contributions.

On the other hand, the inadequacy of coverage and benefits of social security programs to protect workers against the financial risks involved in the occurrence of several social contingencies (such as unemployment and/or drops in income), generate serious consequences for people when such situations materialize. If they affect a large number of workers, as occurred during the Covid-19 pandemic, political and citizen pressure is brought to bear to solve them through programs that were not designed for such purposes, as in the case of mass early withdrawals of mandatory pension savings. While these measures may alleviate the financial situation of some workers and their families in the short term, they harm them in the mid and long term. These experiences highlight the importance of planning reforms that gradually seek to increase the coverage of social programs, depending on the financial/fiscal conditions of countries, designed to adequately integrate all public social security policies.

Different studies by countries in the region have shown the lack of integration and complementation between social programs due to the existence of disincentives to the declaration of true income, because the perceived benefits are reduced or lost when formal income increases. Furthermore, these studies also show that measures must be included in these programs that encourage participation in contributory pension programs. Based on the above, social programs have to be properly interrelated, without rewarding informality over formality; must have means-testing tools that ensure that benefits reach beneficiaries with the lowest administration costs; must avoid unnecessarily discouraging participation in contributory programs, and incorporate, as far as possible, rewards for participating in these programs and education on the benefits they provide to workers. Although means testing instruments inevitably consider individual and family income, it is recommended that the criteria for accessing, reduction or elimination of benefits be gradual, based on income, without any abrupt changes. Efforts must also be made to provide the best possible information on the income received, integrating the information from the different public agencies. It is also important to consider all income when calculating the amounts of benefits to be received, and not only pension amounts, as in the case of the calculation of the Universal Guaranteed Pension amount in Chile, which depends directly and exclusively on the amount of the self-financed pension in the AFP system.

The existence of multiple social protection programs aimed at lower income sectors, with means-testing deficiencies and high administrative costs, has led to more radical reforms to social policies, eliminating programs that are inefficient and redundant, and replacing them with direct transfers to sectors that receive lower formal income (or none at all) through a “negative income tax” (collection of taxes from people who exceed a certain income threshold, and the provision of subsidies to those below that threshold), and the collection of progressive taxes from mid and high-income people. This type of reform could contribute to increasing pension savings if it promotes a greater formalization of the labor market and eliminates programs that grant benefits aimed especially at informal workers. Nonetheless, this would require improving the instruments that better gauge the formal and informal income people obtain, preventing them from remaining informal in order to maximize the perception of direct transfers from the State.

Non-contributory pensions are necessary and important in a multi-pillar pension scheme, because they enable achieving redistribution and solidarity objectives and contribute to the solution of current low pensions and the lack of pension rights of many people on retirement. But at the same time, the evidence suggests that the granting of these pensions is discouraging contributions to pension contributory programs in several of the countries in the region. This is because their design generates an implicit tax, since the increase in pension savings and the obtainment of a higher self-financed contributory pension cause the amount of non-contributory pensions to be lost or reduced. On the other hand, obtaining a non-contributory lifetime income generates an income effect on people, gives them greater security in retirement, and given a certain pension objective, reduces the required individual savings. To the extent that the necessary financial resources are available, the amount of the benefit should be close to the poverty line, to provide a safe base for pensioners and prevent them from falling into this condition, and it should cover all elderly people at a certain age, excluding higher-income workers. The experience described above shows that higher non-contributory pension amounts will discourage contributions to contributory programs and would also be extensive, putting the sustainability of benefits at risk over time. The design of non-contributory pensions should include the possibility of the beneficiary postponing the receipt of the pension, receiving as a trade-off a greater amount when requested at a more advanced age. This must be actuarially designed and calculated. This non-contributory pillar should be financed with general taxes.

Other factors that explain low coverage and contribution densities are the lack of education regarding the characteristics and benefits of pension programs, the distrust of workers in the system, which is often fed by myths that some political sectors build and spread regarding the origin of the low average pensions being provided, and the possibility of obtaining benefits without contributing, all of which affects the assessment that workers have of the benefits of formal vs. informal employment. Hence the importance of improving the information and education provided to workers regarding the benefits of the social protection system, and specifically pension programs, and implementing initiatives that stimulate and facilitate their participation in the system and generate a savings culture. Given the existence of other short-term priorities and the low savings capacity of many workers, the creation of voluntary savings plans with fiscal incentives that favor all workers (and not only those who pay income tax) should be evaluated. There should be different savings objectives (for example, education, housing and pensions) to generate greater interest and participation and contribute to strengthening the savings culture, provide greater flexibility and simplicity to make contributions, take advantage of technological advances, and evaluate the lessons of behavioral economics.

Finally, other factors that affect savings levels are the perception of the possibility of continuing to work at advanced ages to supplement pension income and the confidence of some workers (increasingly fewer) that they will be able to count on family support in that stage.

Introduction

This Pensions Note reviews different specialized publications to identify the reasons behind the low levels of pension savings in contributory pension programs and puts forward some proposals for best practices that arise from the experiences and lessons presented in these documents.

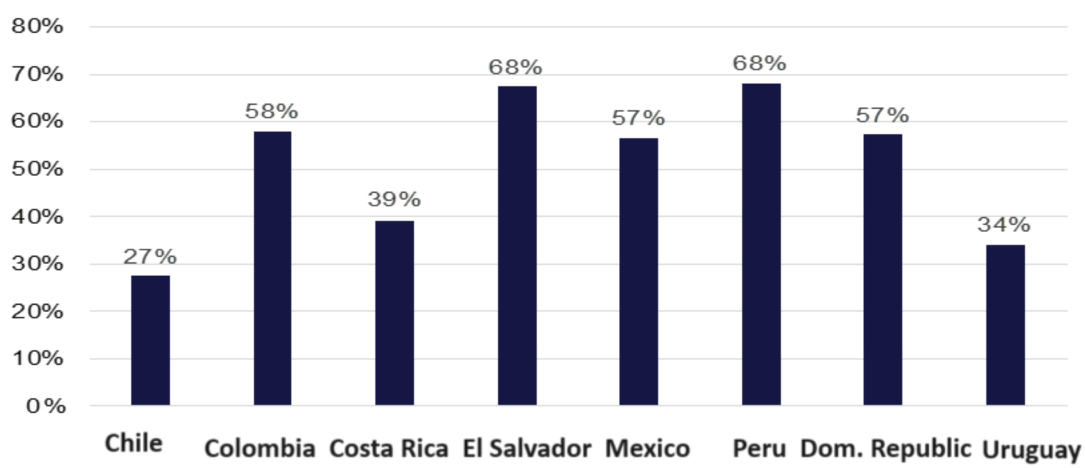
It is known that one of the main causes of the difficulties in increasing pension savings volumes is the functioning of the labor market, but there are other relevant causes that explain this issue and that have to do with public policies to address social contingencies, the design and relationship between the different social protection programs and between the different pillars of the pension systems, the incentives and disincentives they introduce and the effect they generate in the valuation of working in the formal and informal sector. This note addresses this topic, for the purpose of extracting lessons and proposals.

It is worth mentioning that the existing evidence enables reaching preliminary conclusions, lacking greater experience, deepening and updating of the studies to reinforce these conclusions, especially if we consider the broad changes that labor markets, technology, demographics, financial markets and pension systems are experiencing.

Why are the savings and contribution density levels in Latin American pension programs low?

In addition to the low contribution rates, the causes of the low levels of savings and contribution densities in the contributory pension programs are multiple and originate mainly from the characteristics of the labor market; the low productivity, income level, and low savings capacity of many workers; the insufficiency of public policies for addressing social contingencies; the lack of integration and complementation between the different social security programs; the creation of non-contributory social protection programs aimed at workers in the informal sector; the design of pension programs; poor monitoring of compliance with social security obligations by employers and the evasion and avoidance that this entails; the characteristics of pension savings; the lack of social security education and people's assessment of the social security benefits granted.

Graph 1
Proportion of the self-employed vs. full employment for some selected countries (year 2022)



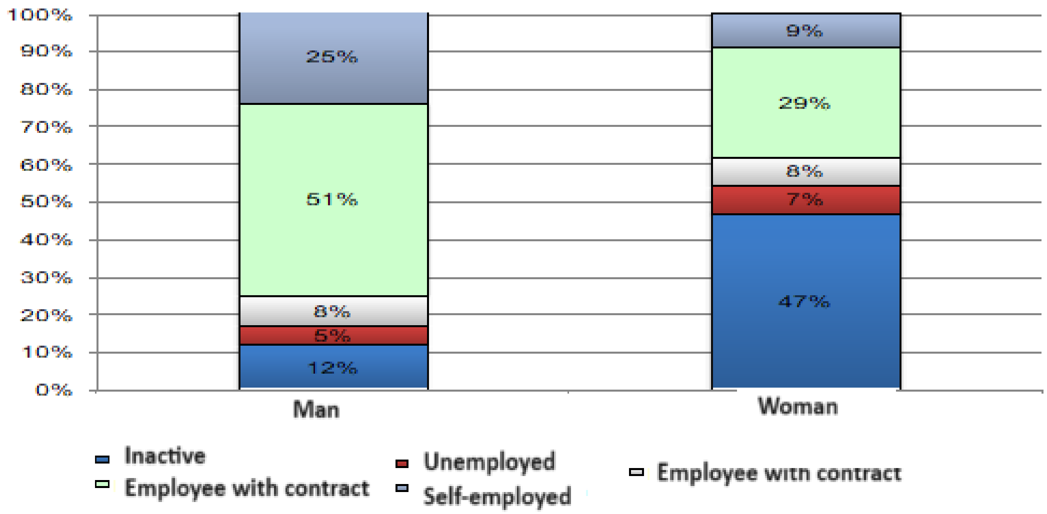
Source: ILOSTAT explorer.

High informality and the frequent rotation of workers between formality and informality, between dependent and self-employed status, between occupation and unemployment, and between activity and inactivity, affect the regularity and density of contribution payments to pension programs. Latin America and the Caribbean is one of the regions with the highest labor informality rate in the world. Before the start of the pandemic, between 50% and 60% of workers in the region were in informal employment (IDB, March 2021). More recent ILO statistics (2022) for selected Latin American countries show that the share of informal employment in total employment varies between 27% in Chile and 68% in El Salvador and Peru (see Graph 1). This situation affects low-income workers and women more intensely.

On the other hand, a study of the Chilean case by the Deputy Secretary of Social Security (2013) concluded that 50% of men and 71% of women are inactive, unemployed, employed without a contract, or work as freelancers at some stage of their active lives (Graph 2). Another study by Pinbox (2023) showed that, on average, approximately 24% of public and private salaried workers leave formality every year and switch to inactivity, unemployment, or informality.

Graph 2

Chile: Labor market by type of employment



Source: Deputy Secretary of Social Security estimates; based on EPS work history 2002, 2004, 2006 and 2009. Deputy Secretary of Social Security

One of the most significant causes of high informality in our countries is the high cost of hiring and firing, especially among lower-income workers. According to the IDB (2013), non-wage costs of formality can amount to 50% of salary. More recently, Pinbox (2023) pointed out that minimum wages plus pension, health, and unemployment insurance contributions amount to 36% of GDP per worker, compared to 22% of GDP in OECD countries. Furthermore, dismissal costs are also high in most countries in the region and generate uncertainty, which discourages formal employment, especially among small and mid-sized companies. On the other hand, experience shows that the reduction of labor costs has had favorable effects on formality, as in Colombia, where the implementation of the tax reform in 2012 and the consequent reduction in the wage tax by almost 50%, managed to increase formal employment by 18% (IDB, 2021). This shows how tax policy, together with labor and social policies, can affect the formalization of the labor market and the payment of workers' contributions, since they entail a high cost for formality. Hence the importance of not overburdening work taxes.

High minimum wages compared to average wages in some countries is another factor that hinders formal hiring, since the productivity of many workers is not sufficient to pay said wages and all the formal hiring costs. Low wage levels also imply low savings capacity and, together with the existence of minimum contribution wages, affect the regularity of contributions to pension programs.

The design and access requirements to social programs in the region are additional elements that disincentivize the declaration of income and contribution to contributory pension plans, since means-testing reduces or eliminates the benefits received in many cases, if an individual has a formal income. For example, in the Chilean case, CIEDESS (2019) concludes that the eligibility criteria for accessing the benefits of some social programs generate incentives and disincentives to formalization and enrolment in pension funds. Furthermore, many programs do not actively seek to promote formalization and participation in pension plans.

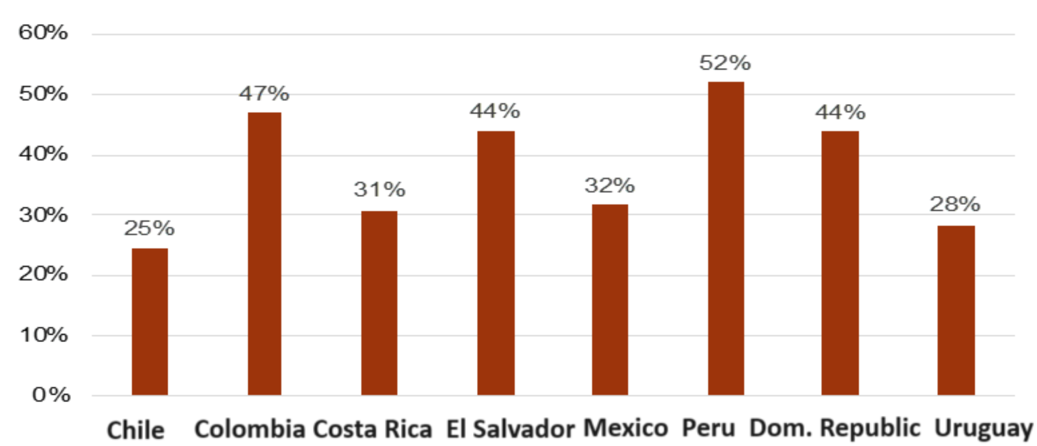
In other cases, programs are aimed at the informal sectors, thereby affecting people’s opinions regarding participation in the formal or informal labor sectors. The fact that beneficiaries are excluded from benefits if they enter formal employment reinforces the evidence that these programs often generate incentives for informality. Recent studies in Latin American and Caribbean countries show that non-contributory programs affect employment not so much in the decision to work or not to work, but in the decision to work formally or informally (IDB, 2021). Other studies show significant differences between the costs of formality and subsidies to informality. For example, the IDB (2013) notes that this difference exceeds 70% for workers in the first income decile.

In Latin America, the difficulties involved in expanding coverage and increasing contribution density are greater, because pension systems were not originally designed for universal coverage, but rather to cover dependent workers who contribute to the programs through the retention of contributions made by employers. Pension systems have also had limited capacity to adapt to changes in labor markets and new types of work, and to enroll the segments of workers that are more difficult to incorporate. Many workers also work in jobs in which they are not legally required to contribute, as in the case of the self-employed in many countries. They account for one third of the workforce in the region, and even as much as 70% in some countries (IDB, 2016). Updated ILO statistics for 2022 show that non-salaried workers fluctuated between 25% and 52% of total employment (Graph 3). The design of some pension systems, on the other hand, and the characteristics of their different programs, do not sufficiently incentivize people to contribute, or directly disincentivize them. In Peru, for example, people obtaining a contributory pension lose the non-contributory Pension 65 benefit, whereas in Chile the right to a Universal Guaranteed Pension diminishes or is lost when the self-financed pension surpasses a certain level.

Another reason that explains the low coverage and contribution density is the ongoing high level of evasion in compliance with labor regulations and the payment of social security contributions, and the poor supervision by supervisory bodies. Empirical evidence shows that auditing in our countries is focused on large companies that are already formal, and not on small companies that have less incentive to contribute, because they perceive a low cost for non-compliance (IDB, 2013).

Added to these factors is the lack of education on the characteristics and benefits of pension programs and the distrust of workers in the system, often fueled by myths that political sectors build and spread regarding the origin of the low average pensions that pension systems are providing. These factors are enhanced by the low savings capacity of many workers, the long-term and intangible characteristic of old age pension savings, the preference for present consumption and the existence of short-term priorities, in order not to duly value retirement contributions and try to avoid, reduce, or withdraw them. It is therefore essential for workers and employers to see contributions less as a tax and increase their valuation, because this will increase formality and the payment of contributions. The introduction of individual savings systems in our region since the 1980s has contributed to this goal. The early withdrawals of mandatory savings from these systems that have been massively authorized in Chile and Peru as a result of the Covid-19 pandemic, have been highly negative for the pension benefits of members, the only positive factor being the fact that the percentage of members who know that the savings are their property, that they exist and that they are used for their benefit or that of their survivors or heirs, has increased significantly.

Graph 3
Proportion of self-employed vs. full employment, 2022



Source: ILOSTAT explorer.

Finally, other factors that affect savings levels are the perception of the possibility of continuing to work at an advanced old age to supplement pension income and the confidence of some workers (increasingly fewer) that they will be able to count on family support in that stage.

It is necessary to improve public policies to prevent different social contingencies from increasing the risk of misuse of social security savings

The inadequacy of social security programs with wide coverage among the different segments of workers, to protect them against the financial risks involved in the occurrence of several social contingencies, generate serious consequences for people when such situations materialize, because they suffer the reduction of their income and their standard of living, and the increase in poverty levels. Moreover, when these problems affect a large number of workers, as occurred during the Covid-19 pandemic, political and citizen pressures are generated to implement programs that can alleviate the financial situation of some workers and their families in the short term, although they were not designed to protect them from the resulting consequences. These measures also have significant costs, as they undermine the achievement of the objectives defined for these programs, as occurred with the massive authorization of early withdrawals of mandatory pension savings in Chile and Peru.

The creation, implementation and development of the different public policies and social security programs must be comprehensive, ensuring the protection of people, workers and their families against different social contingencies. The design of benefits and access requirements must tend to the harmonious development of the set of programs, avoiding or minimizing the existence of disincentives to participate in some of them as a result of the characteristics and eligibility requirements for obtaining the benefits of other programs. For example, this occurs when the financial coverage of health benefits depends on the income that people declare, which leads to evading or avoiding the recognition of these incomes in formal pension systems, especially when the loss of rights is abrupt when exceeding a certain level of income.

The financial austerity of the countries of our region limits the possibility of making rapid progress in the broad coverage of the different social programs, which require the financing of workers, employers and the State. However, this does not prevent the planning of reforms that gradually seek to increase coverage, depending on the financial/fiscal conditions of countries, designed to adequately integrate all public social security policies. To this end, it is crucial to understand how the different social security programs work and interrelate and adopt appropriate measures that are consistent and sustainable in the mid and long term, encouraging formalization and protection against different social contingencies.

In most Latin American countries, social security is structured to preferentially cover the specific risks faced by formal dependent workers. This is clearly insufficient, especially with the current trends in labor markets, where workers switch between different types of work more often. Whether or not you are employed in a specific type of work should not cause you to lose social security protection. New policies aimed at overall protection must be adopted, incorporating new independent, informal workers who work in sporadic jobs. To this end, full understanding of the functioning of the labor markets of these different types of workers is required, so that programs that recognize their realities and contain incentives for them to participate, must be designed. In this design, the experiences and lessons offered by the study of behavioral economics and the possibilities offered by currently existing technology, should acquire a primary role. Special attention must also be paid to program design and incentives, so that workers increasingly know and value the benefits of formality and enjoy the benefits of social protection as their income increases.

Experiences with the relationship between different social programs, and the incentive to formalize and contribute to pension programs

Different studies by countries in the region have historically shown disincentives to formalization and the declaration of true income, so as not to lose the benefits of social protection programs. They also highlight the lack of consideration by those programs of measures that encourage participation in contributory pension programs, such as awarding points to those who participate in such programs and contribute to pensions.

The IDB (2013) points out that the design of certain social programs, whose beneficiaries are mainly low-income workers, can reduce incentives to formalization. This publication adds that some programs are only available to informal workers, which is equivalent to providing a subsidy for informality. In the case of non-contributory health programs and some conditional transfer programs, firm evidence in the region shows that they are causing negative effects on the creation of formal employment and, indirectly, on the generation of pension savings.

For example, in Colombia, people with zero savings capacity may enroll in the mandatory subsidized health plan (POS-S), whereas people who are currently employed, or who receive sufficient income to enroll in the contributory regime, cannot do so. Free health care in the Capital District, on the other hand, is aimed at the poorest and most vulnerable population classified in the Sisbén survey at level 2 (level 1 is already exempt nationwide). Sisben is a survey that rates the socioeconomic conditions of households and classifies them by their ability to generate income and quality of life. Membership of State health services in Uruguay depends on the integration and socio-economic situation of the family unit. Family members can freely enroll if their income does not exceed 62 Adjustable Units.[1] (U/R), to which 2.5 R.U. is added for each member of the family unit. In order to access the Family Housing Bond of the Social Interest Housing (VIS) program in Peru, the net monthly family income must fall below a certain income ceiling, among other general conditions. In Mexico, access to social housing programs is based on socio-economic studies of applicants.

1 The Adjustable Unit is adjusted monthly based on the Average Salary Index published by the National Institute of Statistics.

A study prepared for the Chilean Ministry of Labor and Social Security in 2012 was based on the hypothesis that there are often multiple social programs and public policies that can affect the willingness of beneficiaries to contribute to the pension system and to formalize their employment status. This situation has enormous implications for the proper functioning of mandatory individual savings programs. The study analyzed twenty-three programs and public policies, reaching numerous conclusions, including:

(i) There are protection programs that have no incentives for participating in the pension system. It was found that only three of the twenty-three social protection programs analyzed have incentives for social security coverage.

(ii) Given the beneficiary selection systems and access to benefits associated with the income received, there are clear incentives to declare less than actual income, which has an impact on contribution levels.

(iii) More relevant programs have disincentives for coverage, level, and density of contributions.

(iv) It is crucial to review the means-testing tools most used in social programs with a protection logic, as part of the existing mechanisms that can influence pension behavior.

(v) All programs in which certain income brackets are excluded from the provision of benefits, have an indirect incentive for lower income declaration, severely affecting contribution levels.

(vi) Gradual obtainment and loss of benefits can influence participation in a given program.

The increase in health and pension non-contributory programs and the obtainment of better benefits when lower incomes are received in housing programs, influences people's decisions on whether to look for formal jobs or not and generates net taxes (balance between costs and benefits) for those who join the formal sector. The next section will look specifically at what happens to non-contributory pension programs.

Contributory pension programs and integration and complementation with non-contributory pension programs

The number of countries with non-contributory pensions and the coverage of these pensions increased significantly in Latin America in the last two decades, although there is still a significant coverage gap, since 41% of the population over 65 years of age does not receive any type of contributory or non-contributory pension (FIAP, 2022).

The introduction of non-contributory pensions is a way to address coverage problems and low levels of savings and pensions in contributory programs in the short term, and to prevent people from falling into poverty in old age. They also contribute to solving the pension system design problems by being able to focus on all people, and not only on workers (IDB, 2013). The essential purpose of these programs is precisely the reduction of poverty levels in old age, ensuring all citizens a minimum level of income when they reach a certain age and have lost their ability to work

The analysis of the relationship between the amounts received from non-contributory pensions and the contributory pensions to which members of pension systems are entitled is important, because it can influence employment formality and incentives to contribute to contributory programs. According to IDB (2013), the absence of an integral design between both types of programs may negatively affect the participation of individuals in contributory pension systems, and a vicious circle of low coverage may form in them, leading to the creation of non-contributory mechanisms that, in turn, make contribution very unlikely, and therefore make it necessary to continue creating and financing alternative parallel instruments.

Three more relevant effects regarding the incentives to contribute are identified when granting non-contributory pensions. First, an income effect, produced by the increase in the pension (retirement income) caused by the reception of the non-contributory benefit. Given certain pension objectives of individuals, this effect can lead to a reduction in contributions to contributory programs, because the tax subsidy contributes to the achievement of this objective. Secondly, obtaining a generous non-contributory pension gives people greater certainty that they will be able to count on a lifetime income without the need to contribute to contributory programs. On the other hand, if obtaining a contributory pension means not being entitled to receive the non-contributory pension, or that its amount decreases, a contribution disincentive is introduced.

Studies analyzing these effects are still limited, preventing conclusions with broad empirical support from being drawn from them. The impacts on workers may also differ according to age, income, gender and other variables, which makes the analysis particularly complex. Below are some references from studies that reviewed these impacts.

According to the IDB (2013), the result with the greatest documented and expected support is that access to a subsidized pension has a significant impact on job offers to beneficiaries. Non-contributory pensions significantly reduce the job offers of those eligible and those approaching the eligibility age. This is indicated by the impact evaluations carried out in several non-contributory programs in the region. However, little is known about the long-term effect on pension savings of workers who are far from retirement age. The theory suggests that there is a potential contribution reduction effect, although it has not yet been conclusively and empirically proven. Another IDB publication (2016) notes that household decisions begin to change with the advent of non-contributory pensions, and that these benefits decrease the participation rates of recipients in contributory systems, while also reducing the transfers that beneficiary households receive from other household members.

Joubert et al. (2011) studied the effects of the 2008 pension reform in Chile that created the Solidarity Pension System, replaced in 2022 by the PGU, concluding that, among other effects, said reform will generate some negative behavioral responses in the form of a lower participation in the labor force at more advanced ages and lower participation in the labor market of the sectors covered by the benefits, generating a decrease in contribution density. They add that as people approach retirement, incentives to contribute to contributory programs decrease in relation to the situation prior to the reform, especially among women, due to higher income expectations in retirement. In any case, these authors warn that the magnitude of the effects must be validated with more up-to-date data that captures the full impact of the reform.

Attanasio et al. (2011) also studied the 2008 Chilean reform, noting that the changes in final pension equity at retirement age have slightly reduced participation in the formal labor market, and that the likelihood of contributing to the pension system has diminished due to the reform. According to them, the drop in participation in the formal labor market was close to 4.1% for workers over 40. The results differ by sex and age, as the reform reduces the probability of formal employment by 3.2% and 2.8%, for women and men between 56 and 65, respectively.

Pfutze et al. (2015) show that one of the effects of the Colombia Mayor program has been to increase participation in the labor force of male beneficiaries who are relatively younger. This increase occurs in occupations that require some investment, since receiving the non-contributory benefit enables beneficiaries to overcome liquidity restrictions and keep their jobs. However, this effect does not occur among women and older beneficiaries. Another study by Hessel et al. (2018) finds similar results.

A report by the Pension Advisory Council (2021) analyzed the effects of the bill of law that creates the Universal Guaranteed Pension (PGU) in Chile (a law that was subsequently passed). Some of the main conclusions that emerge from this report are the following:

- The incentives resulting from these measures will not affect all people equally, since they differ by income, gender, age, degree of vulnerability, awareness of the existence of the PGU and the number of years left to retirement.
- The fact that the implicit tax of the PGU is zero (i.e., increases in the contributory pension do not imply a reduction in tax benefits) for some pensioners, may make some people in this group, who are in the informal sector, decide to move to the formal sector, increasing their pension savings.
- Among the beneficiaries of the Solidarity Pension System (SPS), the increase in the state benefit could reduce the labor supply and social security contributions, since to reach a certain final pension, it is no longer necessary to work and save more in the social security system to achieve that objective.
- In the group of people who did not receive tax benefits with the SPS, and who will now receive the total amount of the PGU, an income effect will be generated, possibly reducing the labor supply and social security contributions.
- An additional effect is produced for those members who are close to the threshold that makes them decrease or lose benefits in the SPS, and who could have disincentives to contribute and work in the formal market so as not to lose them.

Relationship between contributory and non-contributory pensions in some countries studied

After reviewing the social pension programs in some selected countries in Latin America, FIAP (2022) points out that obtaining a contributory pension in Peru entails losing the right to receive the non-contributory pension, and that in Bolivia, El Salvador and Chile, there is an implicit tax, because receiving a contributory pension implies the reduction of non-contributory benefits for all or some groups of pensioners (Table 1).

In the case of Chile, it should be clarified that the current design of the Universal Guaranteed Pension (PGU) is substantially superior to the previous situation, since it generates an implicit tax lower than that previously produced with the Solidarity Pension Contribution (APS) and the Basic Solidarity Pension (PBS) [both were replaced by the PGU as of February 1, 2022]. On the one hand, the value of the APS decreased as the contributory pension increased (greater savings in the AFP reduced the amount of the APS), and on the other hand, the PBS was delivered only to those who did not contribute and if the worker had any contributions, he/she lost the right to the non-contributory benefit. This situation improved with the PGU and the amount of the non-contributory benefit no longer decreases if there are contributions, but is received in full, decreasing only if the contributory pension is greater than USD 684 and less than USD 1,085 (for a contributory pension equal to or greater at this threshold, the PGU is zero).

In three other countries (Colombia, Costa Rica and the Dominican Republic), obtaining a contributory pension could also affect the right to access a non-contributory pension if the eligibility conditions are no longer met, i.e., the person has sufficient resources to subsist, has a more favorable economic situation, is not vulnerable, or is no longer living in extreme poverty, according to the existing tools for assessing these qualifications. In Uruguay, earning personal income reduces non-contributory pension, and caps are applied to the personal and family income required to receive the benefit.

It was concluded that the design of non-contributory pensions discourages contributions to contributory pension programs in several of the countries studied, since it generates an implicit tax, i.e., non-contributory tax subsidies are lost or reduced when pension savings increase and individuals obtain a contributory pension. It was also pointed out that, given the importance that non-contributory pillars will acquire, a more extensive study of the effects they can produce on incentives to work in the formal market and to contribute to contributory programs will be required. As noted above, the studies conducted to date are limited.

Table 1: Relationship between non-contributory pensions and contributory pensions (1)

Country	Relationship
Bolivia	The Renta Dignidad amount dropped from Bs. 4,550 (USD 658) to Bs. 3,900 (USD 564) annually, if an individual receives a pension from the Comprehensive Pension System
Chile	The monthly amount of the PGU decreases if the value of the contributory pension is greater than Ch$660,366 (USD 684) and is no longer received if said value is equal to or greater than Ch$1,048,200 (USD 1,085)
Colombia	-
Costa Rica	The amount of the non-contributory pension, multiplied by 1.5, must not be greater than the value of the minimum pension of the Disability, Old Age and Death Insurance Scheme; the basic pension amount of those living in extreme poverty must not be less than 50% of said minimum pension
El Salvador	The monthly non-contributory pension is equal to USD 50; a subsidy is given to those who obtain a pension of less than USD 50 per month, allowing them to reach that amount
Mexico	-
Peru	To receive the benefit, one cannot receive a pension from the public and private sector
Dominican Republic	-
Uruguay	The personal income amount cannot exceed the value of the non-contributory pension; if an individual receives a lower income, the benefit is the difference between the amount of the non-contributory pension and the declared income

(1) Only cases in which the regulations directly indicate that the non-contributory pension is not received or is reduced when the person obtains a contributory pension, are included. The amount of the non-contributory pension may the indirectly annulled or reduced if individuals have income, including a contributory pension, which puts them in a category other than that required to obtain it, such as, for example, no longer living in extreme poverty.

Source: FIAP based on existing rules and regulations in different countries.

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