The Latin American demographic dividend

A foundation for retirement savings

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The demographic dividend potential

Economic growth

Higher standards of living

Human capital development

Retirement readiness

EXECUTIVE SUMMARY

The demographic dividend, or the period when a country enjoys a relatively large population of working-age adults relative to the entire population, provides an attractive window to accelerate economic growth and enhance human capital development.

In particular, the dividend can create a foundation to increase retirement savings, as more workers are earning, saving, and investing their income in a more dynamic economy. Ideally, the ripple effect of this virtuous cycle leads to numerous societal benefits county-wide – including higher standards of living and improved retirement readiness. However, these benefits require a robust set of policies to come to fruition.

Increased savings rates are essential for achieving these benefits. Programs that target a variety of related economic and development goals – such as reducing poverty, increasing productivity, facilitating women's economic participation, widening access to education, and improving financial inclusion – can ultimately empower more individuals to enter the formal workforce and begin to save and invest for retirement. In turn, this surge in saving and investing can drive further macroeconomic and human development benefits – delivering on the promise of the dividend.

To accelerate these dynamics, Latin American (LA) countries can consider a variety of steps to significantly increase savings rates. These rates have remained relatively flat for decades, indicating a need to re-assess existing policies and programs in order to capitalize on the *remaining* dividend. They could follow the lead of many countries in more advanced demographic stages, who bolstered their retirement systems and savings rates in preparation for demographic aging.

A global perspective

The countries of emerging Asia have demonstrated that the demographic dividend can lift savings rates and contribute to Gross National Product (GDP) growth, *if* countries embrace a coordinated set of economic, social and financial incentives. And countries at a more advanced demographic stage, such as Japan, the UK, and the U.S., have demonstrated that even as populations age, economic growth can be sustained and extended – providing optimism for the long-term economic future of LA countries.

5 key levers to improve savings and investing rates in Latin America

LA countries can apply five key levers to help raise long-term savings and investing levels, leading to the potential for broader economic and human development benefits.

Earnings and savings of women

OPPORTUNITY

Increasing the women's economic participation can be a catalyst for LA countries to accelerate economic growth and raise the human capital contribution from an expanded portion of the population. Greater participation creates numerous benefits, from bolstering the number of women saving and investing for retirement to improving gender equality.

RECOMMENDATIONS

LA governments can designate a set share of their budgets for healthcare, education, training, and workforce participation programs focused on women, particularly those that help women access caregiving systems, enter the formal sector, and learn professional skills. In addition, expanding women's inclusion in pension systems and access to financial institutions and savings vehicles can help lead to higher female savings rates and overall GDP growth.

Consumption-to-savings shift

OPPORTUNITY

Currently, fewer than half of people in LA have accounts at financial institution and among them only 26 percent fully embrace savings accounts. Improving transparency and trust in financial institutions, enhancing competition within the financial system, and lowering costs for consumers are key steps towards encouraging greater savings and engagement with the financial system.

RECOMMENDATIONS

LA countries can introduce financial products and automatic savings programs designed to encourage customers to open and use bank accounts, including simpler, more transparent financial products, and products with "commitment devices" to encourage systematic savings behavior. Financial literacy programs starting with schoolchildren learning budgeting, banking, and investing at the secondary level, reinforce broader engagement programs.

Pension design

OPPORTUNITY

Underfunded defined benefit (DB) plans, low rates of pension coverage, and irregular contribution rates provide an opportunity for LA countries to improve their pension systems for long-term sustainability and higher savings rates. More efficient pension systems with broader coverage can play a vital role in a country's overall retirement system, as demonstrated by the success of many pension systems in Asian countries and other advanced economies.

RECOMMENDATIONS

LA countries can consider how pensions can promote long-term financial sustainability in light of changes in demographics, longevity, and fiscal realities. Improvements to both defined contribution (DC) and defined benefits (DB) programs could include revising labor market

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policies to encourage pension coverage and greater female economic participation, strengthening financial literacy and participant education programs, diversifying into global asset classes, and utilizing sole-purpose pension managers.

Capital markets

OPPORTUNITY

Capital markets have a positive correlation with savings and investing rates – but they require strong regulatory frameworks and protections for creditors and shareholders. LA countries can further improve capital markets by providing easier access to a broader set of potential market participants.

RECOMMENDATIONS

LA countries can increase the depth and breadth of capital markets with incentives for new issuers in stock and bond markets, easier capital market access or special market sections for smaller companies, and lowered administrative and tax barriers for foreign investors. Countries can also undertake regulatory improvements, such as strengthening market monitoring, enhancing corporate governance standards, augmenting investor protections, and improving the technology of trading platforms.

Investment products and solutions

OPPORTUNITY

Though there is variation in the region, many LA economies can realize significant benefits by overcoming a historical "home bias" in their investment allocation towards domestic markets and fixed income investments.

RECOMMENDATIONS

LA countries can remove regulatory limits on international allocations and prioritize a more balanced mix of investments. They can also develop investment solutions that allow for higher returns and better risk management, including expanding pension funds to include alternatives, developing voluntary savings products, and designing pension fund products and asset allocations to reflect risk preferences – such as age based "target date" solutions – as individuals invest for retirement.

Together, these opportunities and recommendations point a way forward for LA economies and societies, at every demographic stage, to improve their retirement savings and investing systems. If LA countries can realize this potential, they will enjoy a range of benefits, including more robust economic growth, stronger financial systems, maximized human capital, and higher levels of gender and income equality. Therefore, a variety of stakeholders in the region have strong incentives to undertake these recommendations to capitalize on the remaining demographic dividend and enjoy increased fiscal stability and standards of living.

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Introduction

This paper explores the interrelationship among savings and retirement systems, the capital markets, demographics, and public policy and its impact on long-term economic growth and fiscal stability for the largest national economies in Latin America.

Objectives

The paper's primary objectives are:

- **Introduce the demographic dividend** and explore the impact of demographics on economic activity and growth across the LA region — contrasting and drawing lessons from other regions and countries in varying stages of demographic transition
- Underline the **importance of savings and investments** as a means to maximize or extend the demographic dividend
- Raise the awareness of the importance and **benefits of maximizing human capital** and its potential impact on savings and retirement investment rates
- Clarify the key elements associated with **creating and maintaining a strong (retirement) savings system** for the major LA economies
- Consider the symbiotic relationship between the effective **functioning of pension systems and development of local capital markets**
- **Outline a set of key recommendations and levers** to raise long-term savings and investing levels

Background: What is the demographic dividend?

Demographics can have a meaningful impact on all aspects of a country's development, from changes in cultural norms, to long-term economic growth prospects, to the standard of living enjoyed by its citizens. All countries experience a change in demographics — albeit at different rates and impacts — with varying degrees of responses from governments, financial markets, and industries.

The demographic dividend is the result of a transition that occurs as a country's population matures and its age structure shifts, offering significant, long-term, potential economic benefits. At the beginning of this transition, improvements in healthcare, nutrition, and sanitation reduce rates of infant and child mortality. This is followed by a decline in fertility rates driven by women gaining access to family planning. A woman's choice to regulate fertility is often associated with better education, increased autonomy and empowerment, and a rising rate of women entering the workforce. As the long-term effect of lower fertility rates takes hold, a change in the age structure occurs, whereby a greater proportion of individuals are in their prime working years compared to children and the elderly.[1] This dynamic is commonly referred to as the demographic dividend.

1 *The State of World Population 2016*, United Nations Population Fund, 2016, p. 48, http://www.unfpa.org/sites/default/files/sowp/downloads/The_State_of_World_Population_2016_-_English.pdf

Economic growth and human development

During a demographic dividend, which can last decades, there are more working-age adults entering the labor force, earning income, and saving and investing country-wide. As a result, greater demand for goods and services and increased fiscal stability has the potential to create a virtuous cycle for accelerating economic growth.[2] A ripple effect of this dividend can include improvements in human capital development and poverty reduction.

However, these benefits do not occur automatically. They require a robust set of policies intentionally designed to realize the dividend's full potential for both economic and social progress. In short, the dividend provides a promising *potential*, not a naturally occurring remedy. Realizing this potential requires the proper policies and committed efforts from multiple stakeholders.

The economic lifecycle

The core of the dividend's potential is the close relationship between demographics and economic activity — rooted in the concept of the "economic lifecycle." This is the pattern of production and consumption that shifts as a society and individuals age.[3] In countries that are benefiting from a dividend, a greater proportion of the population is in the period of the economic lifecycle where their production outweighs consumption. As a result, the dividend can drive short- and long-term national economic growth, including:

- **Savings rates:** A greater proportion of the population are in their prime years to earn income, save, and invest
- **Investment returns:** Greater local capital and funding sources expand the breadth and depth of investment opportunities and can provide higher investment returns
- **Productivity:** A portion of investment opportunities can be allotted to infrastructure that enables firms and individuals to operate more efficiently and achieve a higher unit return

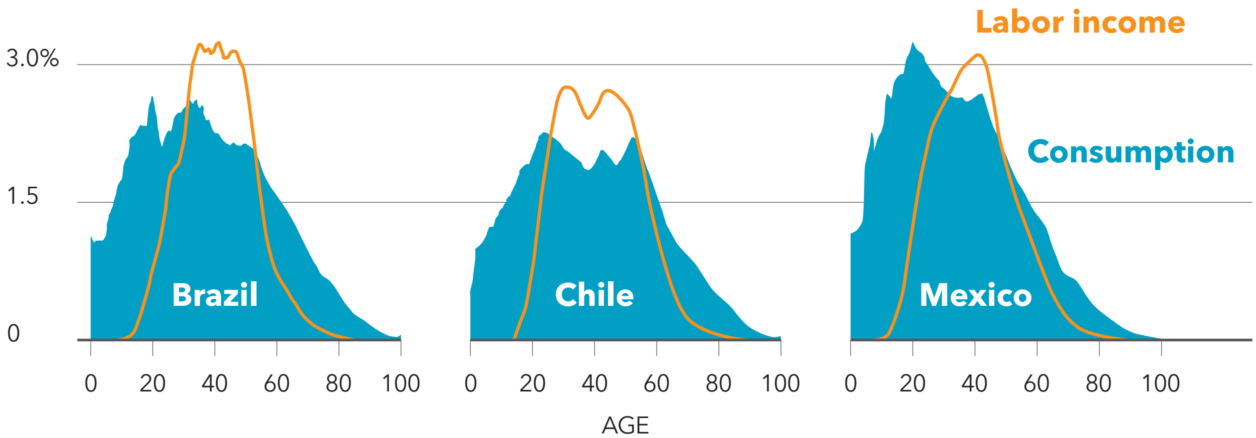
There are significant variations in the economic lifecycles among LA countries, as shown in Chart One. This results from multiple factors. For example, aggregate consumption is relatively high early in the lifecycle in countries with substantial in-flows of funds from individuals working abroad to help pay for the expenses of their dependents at home. In a similar vein, social welfare benefits that are contingent on a household's children attending school also increase early lifecycle consumption. In Mexico, these factors contribute to a peak aggregate consumption that is actually *higher* than peak labor income. However, in smaller countries like Argentina and Chile, the economic lifecycle resembles those in advanced economies, with labor income rising significantly above consumption throughout prime working years.

Benefits from the dividend are not automatic and depend on factors that vary among countries, such as proactive public policies, retirement system design, the inclusivity and competitiveness of the financial system, and macroeconomic trends. Therefore, the economic benefits associated with the dividend are not guaranteed, but only offer a "window of opportunity" for stakeholders.[4]

2 Eduardo Cavallo, Gabriel Sanchez, and Patricio Valenzuela, "Gone with the Wind: Demographic Transitions and Domestic Saving," Inter-American Development Bank, 2016, p. 5, https://publications.iadb.org/bitstream/handle/11319/7579/Gone-with-the-Wind-Demographic-Transitions-and-Domestic-Saving.pdf;sequence=1
3 "Economic Lifecycle," National Transfer Accounts, 2017, http://www.ntaccounts.org/web/nta/show/Methodology/2. Economic Lifecycle **4** "Gone with the Wind," p. 5.

CHART ONE

Labor income age and aggregate consumption
2016



Source: National Transfer Accounts, Interactive Data Explorer, Consumption and Labor Income Profiles, 2016, Selected Latin American countries, http://www.ntaccounts.org/web/nta/show/Interactive%20Data%20Explorer

Conversely, it's important to note that the technical tapering off of the dividend does not necessarily signal the end of a country's economic growth. For example, many European countries have sustained GDP growth rates for decades after their demographic peak.[5] Countries at any stage of population aging can increase or maintain strong economies if they adopt the right mix and timed set of policies, such as investing in education, promoting greater labor flexibility policies, and creating incentives for increased savings.

Investing in human development

Directly related to the dividend's potential economic benefits are opportunities to bolster sustainable human development. If countries implement and fund the right policies in this area, the dividend can provide tailwinds for efforts to reduce poverty, encourage formal employment, build gender equality, and lower rates of adolescent pregnancy and marriage. The result can be a mutually reinforcing cycle of economic and human development.

Consider informal employment. According to the United Nation's (UN) International Labour Organization, the defining features of informal employment are "lack of protection in the event of non-payment of wages, compulsory overtime or extra shifts, lay-offs without notice or compensation, unsafe working conditions and the absence of social benefits such as pensions, sick pay and health insurance." In LA, informal employment is a central challenge, accounting for 50 percent or more of non-agricultural employment in many countries (Chart Two).[6]

This constrains the benefits derived from the demographic dividend because workers in this area often do not have social and legal protections, which also exacerbates gender inequality, as a

5 World Bank DataBank, Population ages 15–64 (% of total), GDP growth (% annual), 1967–2016, France, Germany, United Kingdom, http://databank.worldbank.org/data/home.aspx **6** Statistical update on employment in the informal economy, International Labour Organization, 2012, p. 4–5, http://laborsta.ilo.org/applv8/data/INFORMAL_ECONOMY/2012-06-Statistical%20update%20-%20v2.pdf

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greater share of women workers are employed in the informal economy in most countries.[7] Informal employment also hampers the development of a savings and investment culture — a cornerstone to robust capital markets — as informal workers often do not contribute to pension systems. To address this barrier, countries and employers should institute policies to increase opportunities in the formal sector and formalize jobs in the informal sector.

A similar need exists for a wide set of programs to promote health, human development, and legal protection in LA. Socially, these programs are vital for promoting gender equality, empowering women, and enhancing human development. And economically, they are essential for maximizing the full potential of a country's burgeoning workforce.

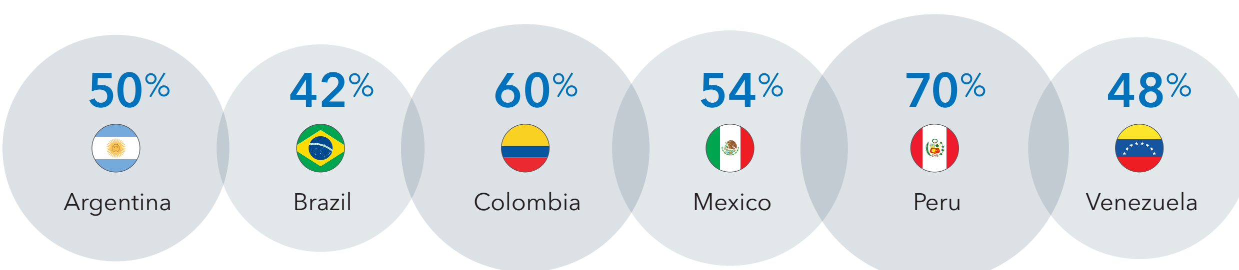
For example, LA had an adolescent birth rate of 66 per 1,000 for the period 2010–2015, second to sub-Saharan Africa,[8] which indicates that there are an estimated 2 million births by adolescent mothers each year. Part of this phenomenon is due to early marriage, which is common in the region. LA is the only region in which early marriage and unions of girls' younger than 18 have not declined in the last 30 years. If these rates persist, 45.5 million girls and adolescents will marry before the age of 18 in the next 20 years.

Programs that seek to address these challenges head on have demonstrated that ameliorating societal challenges can also pay economic dividends. Interventions targeting vaccinations, sexual and reproductive health, and maternal, infant, and adolescent health have been found to achieve a benefit-to-cost ratio as high as 10 by increasing GDP and removing the need for social services spending. Likewise, programs to reduce dropout rates and improve quality of secondary education have shown a benefit-to-cost ratio near 12.[9]

These are just a few — though very significant — examples of the need for strategies to convert on the economic, social, and development potential of the demographic dividend. Other factors and responses are discussed throughout this paper.

CHART TWO

Informal economy participants
% of non-agricultural employment



Source: Statistical update on employment in the informal economy, International Labour Organization, 2012, p. 4–5, http://laborsta.ilo.org/applv8/data/INFORMAL_ECONOMY/2012-06-Statistical%20update%20-%20v2.pdf

7 Statistical update, p. 6–7. **8** Niñas y adolescentes en América Latina y el Caribe. Deudas de Igualdad, CEPAL, 2016, http://repositorio.cepal.org/bitstream/handle/11362/40180/1/S1600427_es.pdf **9** Peter Sheehan et al., "Building the foundations for sustainable development: a case for global investment in the capabilities of adolescents," *The Lancet*, 2017, p. 1, http://www.sciencedirect.com/science/article/pii/S0140673617308723

Demographic dividend: a global perspective

This paper will focus on seven major LA economies: Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela. Chart Three illustrates their "dependency ratio" – the share of those in their "dependent years" (<15 or 64+) to adults in their prime working years (15–64) – for these countries. This important metric whereby a lower ratio should correspond to a demographic dividend for the economy is a good proxy for tracking and comparing countries.

Though each country is at a different stage in its demographic transition, these countries also represent a wide variation in population sizes and labor market structures. Therefore, as we assess opportunities for economic and human development, regional-, state-, and municipal-level strategies will be critical, particularly in countries like Mexico and Brazil with populations larger than 100 million.

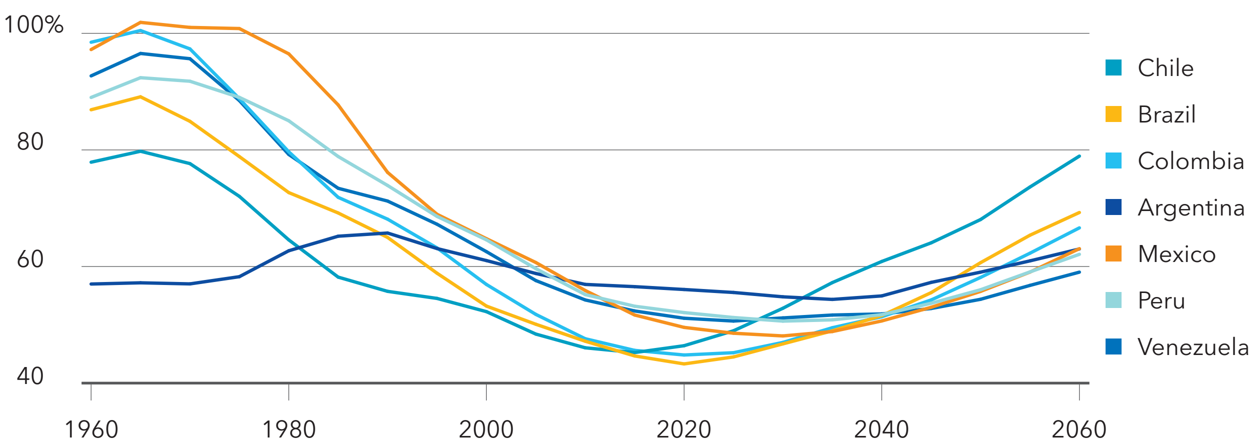
In comparison, countries and regions around the world are in more diverse stages of the demographic transition. Therefore, those in similar stages as LA, such as emerging Asia (defined as China, Hong Kong, India, Indonesia, South Korea, Malaysia, Singapore, and Thailand), or more advanced stages, such as Europe, the U.S., and Japan, can provide important lessons to leaders in the region.

As illustrated in Chart Four, the LA region overall will enjoy favorable dependency ratios compared to much of the world through mid-century. Though many countries in the region have already passed or will soon pass their demographic peaks, these national populations will still be relatively young compared to Europe, Japan, and North America.

CHART THREE

Dependency ratios

1960–2016

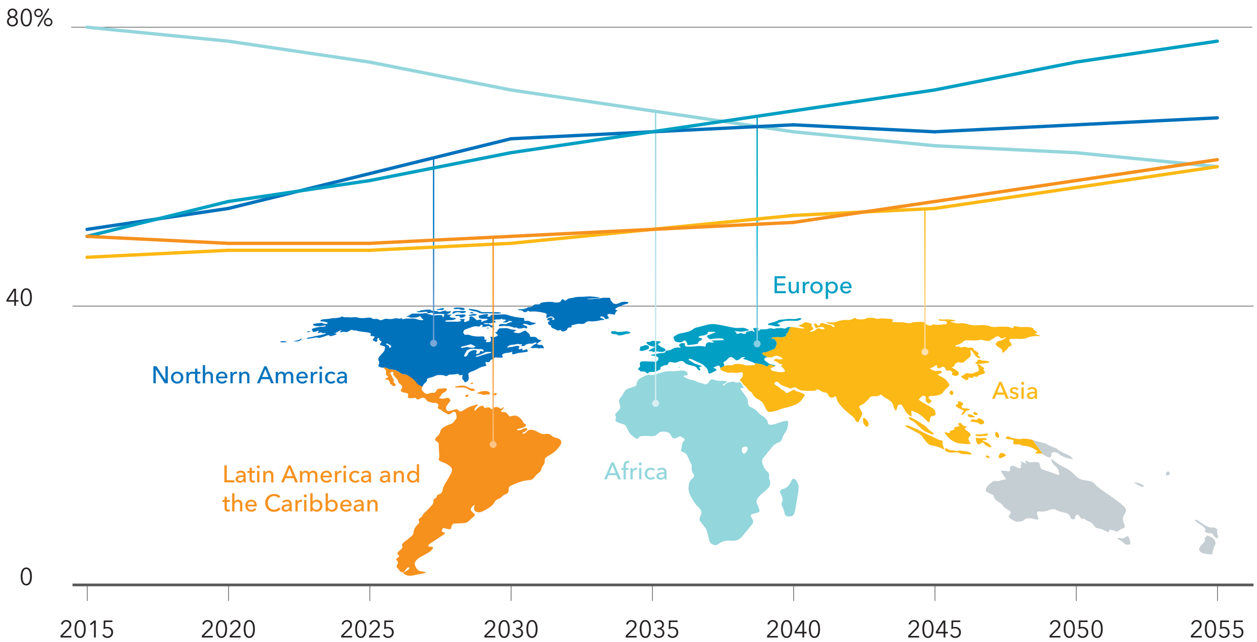


Source: Based on data from: 2015 Revision of World Population Prospects, UN Population Division, 2015, https://esa.un.org/unpd/wpp/Download/Probabilistic/Population/

CHART FOUR

Projected regional dependency ratios

2015–2055



Source: Based on data from: 2015 Revision of World Population Prospects, UN Population Division, 2015, https://esa.un.org/unpd/wpp/Download/Probabilistic/Population/

Key comparison: Latin America versus emerging Asia

The countries of emerging Asia provide an important comparison for LA, as these countries maintain a very similar demographic profile.[10] However, the economic impact in emerging Asia from their demographic dividend has been noticeably stronger compared to LA, particularly based on savings growth rates. In emerging Asia, the average savings rate grew from approximately 15 percent of GDP in the 1960s to above 35 percent in recent years – driven in part by the demographic dividend. However, the savings rate in LA has remained relatively flat – approximately 20 percent – during the same period.[11] Emerging Asia's higher savings rate corresponds to higher GDP growth for these markets over the past 50 years (Chart Five).

This is a critical area where LA has struggled to translate its demographic potential into economic benefits. In fact, if the region's savings levels responded to demographic factors to the same extent as their Asian counterparts, the savings rate as a percentage of GDP in LA would be roughly eight percentage points higher.[12]

10 2015 Revision of World Population Prospects, Indicators (Probabilistic Projections), United Nations Population Division, 2015, https://esa.un.org/unpd/wpp/Download/Probabilistic/Population/ **11** World Bank DataBank, Gross domestic savings (% of GDP), 1967 – 2016, Latin America & Caribbean, emerging Asia. Latin America & Caribbean includes: Antigua and Barbuda, Argentina, Aruba, The Bahamas, Barbados, Belize, Bolivia, Brazil, British Virgin Islands, Cayman Islands, Chile, Colombia, Costa Rica, Cuba, Curacao, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Puerto Rico, Sint Maarten (Dutch Part), St. Kitts and Nevis, St. Lucia, St. Martin (French Part), St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, Turks and Caicos Islands, Uruguay, Venezuela, U.S. Virgin Islands. **12** "Gone with the Wind," p. 4.

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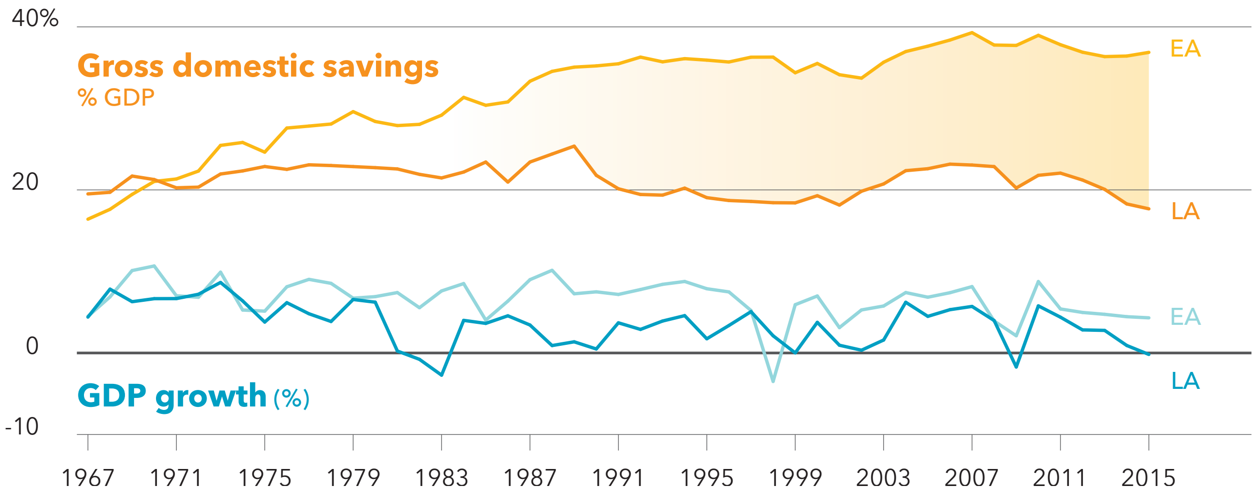
CHART FIVE Savings rate and GDP growth rate in Latin America (LA) and emerging Asia (EA)
1967–2015



Source: World Bank DataBank, Gross domestic savings (% of GDP), GDP growth (annual %), 1967–2015, Latin America & Caribbean, emerging Asia, http://databank.worldbank.org/data/home.aspx

Another critical difference between LA and East Asia is the issue of inequality. According to a comparative analysis of four LA countries (Argentina, Brazil, Chile, and Costa Rica) and four East Asian countries (South Korea, Taiwan, Indonesia, and Thailand), the LA countries experienced higher income inequality than the East Asian countries for the fifty-year period from 1960 to 2010.[13] In particular, the analysis attributes the lower levels of income inequality in East Asia to "policies in the same areas that led to East Asia's faster economic growth: land tenure, basic schooling, manufactured export promotion, and cautious macroeconomic management."[14] East Asia also demonstrates the benefits of increasing access to quality education, whereas LA countries have seen striking disparities between income brackets with regards to educational quality and accessibility.

What's preventing the dividend from boosting savings in Latin America?

A variety of factors may be limiting the dividend's potential to increase savings rates, deepen capital markets, and drive economic and human development in LA.

Industrialization and human capital investment

Early in the demographic shift, countries in emerging Asia implemented research to increase agricultural productivity, promoted policies to expand manufacturing infrastructure, and raised educational and healthcare spending to enhance human capital.[15] In contrast, most LA economies have not moved away from a heavy dependency on commodities, nor cultivated higher value-add industries and activities, especially compared to emerging Asia.

13 James W. McGuire, "The Politics Of Development In Latin America And East Asia," In Oxford Handbook of the Politics of Development, 2014, p. 21, http://jmcguire.faculty.wesleyan.edu/files/2014/10/McGuireOxfordHbkEAsiaLatAmDevel.pdf **14** "The Politics of Development In Latin America And East Asia," p. 4. **15** Andrew Mason, "Capitalizing on the Demographic Dividend," 2002, p. 8-9, http://www2.hawaii.edu/~amason/Research/UNFPA.PDF

Workforce participation rates of women is another underlying factor to spurring savings and investment rates. Despite progress, there is a significant variation in women's economic participation across LA and a significant gap compared to advanced economies (Chart Six).[16] The share of LA women participating in the labor force has grown significantly, from less than 30 percent in most of the profiled countries in 1980, to roughly 60 percent in Colombia and Peru, 50 percent in Argentina, Brazil, Chile, and Venezuela, and just over 40 percent in Mexico by 2010.[17] This is a clear improvement over the past 30 years – similar to the change in emerging Asian countries such as South Korea and Indonesia – but most are still below the 56 percent benchmark seen in advanced economies.

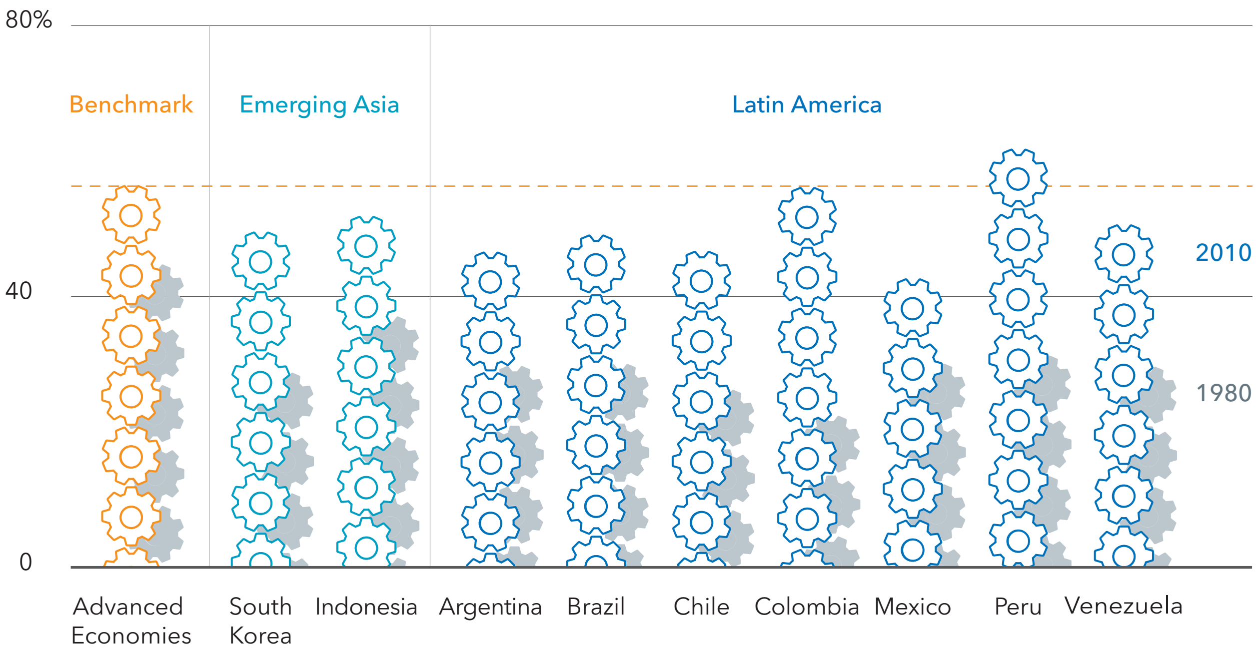
Capital markets

LA has also seen a lower degree of development of its capital markets when compared to those in East Asia. Most of LA has had a long history of macroeconomic instability given their dependency on commodities, endemic budget deficits, elevated inflation, and volatile business cycles. The macroeconomic instability in the region has often led to financial crises, characterized by: banking meltdowns, external debt defaults, and currency crashes. The combination of high inflation and fragile financial systems has caused many Latin Americans to favor spending today over saving for tomorrow, fearing a potential return to hyperinflation and bank runs.

CHART SIX

Female labor force participation[18]

1980–2010



Source: World Bank DataBank, Labor force participation rate, female (% of female population ages 15+) (national estimate), 1980, 2010, Seven profiled Latin American countries and advanced economies, http://databank.worldbank.org/data/home.aspx

16 Advanced economies defined as: France, Germany, Japan, United Kingdom, United States. **17** World Bank DataBank, Labor force participation rate, female (% of female population ages 15+) (national estimate), 1987–2016, Seven profiled Latin American countries. **18** Due to data for some countries being unavailable in selected years, Venezuela's rate from 1981 was used for 1980, and Peru's 1991 rate was used for 1990.

However, there is significant variation within the region. For the selected seven countries, the average market capitalization of listed domestic companies, as a percentage of GDP, from 2010–2015 ranges from 10 percent in Argentina to more than 100 percent in Chile. For this same time period, those countries with higher market capitalization have generally enjoyed higher savings rates with the exception of Mexico and Peru (Chart Seven).

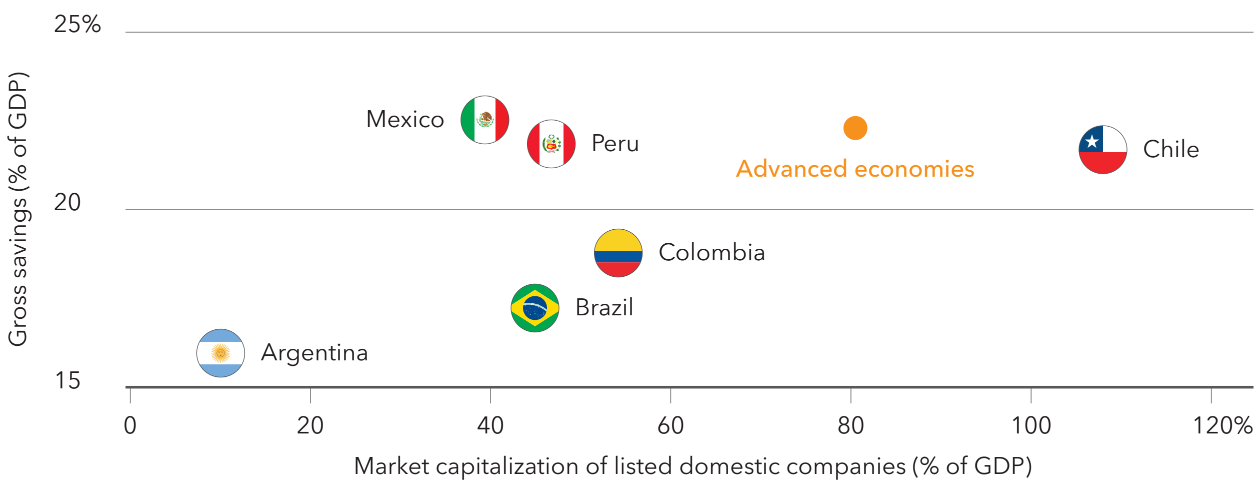
Another contributor has been the fragility of LA's financial market regulatory and legal frameworks, undermining the security of creditor claims and the rights of minority shareholders. According to several measures of investor and creditor protection, even Chile, the highest-ranked LA country, trails many of the countries of emerging Asia.[19] Another problem for capital markets has been the underdevelopment of clearing and settlement infrastructure. Trading platforms also suffer from similar deficiencies with limited transaction data available. Overall, despite recent progress to improve capital market infrastructure in Mexico, Brazil, and Chile, LA countries still lag their Asian counterparts and those of advanced economies.

Pension System Design

Pension design can be a key link between demographic factors and savings rates. For example, demographic shifts in conjunction with countries offering defined contribution (DC) pension systems show greater increases in savings rates than their defined benefit (DB) counterparts.[20] Further, many of LA's DB pension systems have contribution rates that are too low relative to promised replacement rates – undermining long-term sustainability. DC plans face the same problem, as contribution rates as low as 6.5 percent in Mexico or 11 percent in Chile are proving insufficient, particularly given projected increases in longevity and interest rates below historical norms.[21]

CHART SEVEN Market cap and savings rate

2010–2015 average



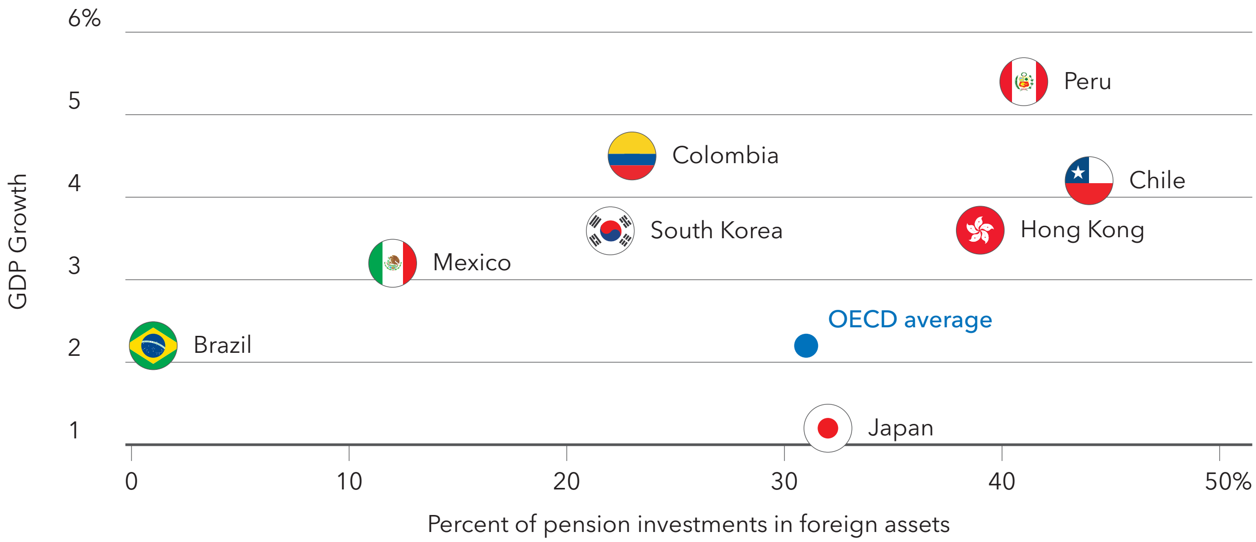
Source: World Bank DataBank, Market capitalization of listed domestic companies (% of GDP), Gross savings (% of GDP), Average of 2010–2015, Argentina, Mexico, Chile, Colombia, Mexico, Peru, http://databank.worldbank.org/data/home.aspx Advanced Economies: Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

19 Global Financial Stability Report: Fostering Stability in a Low-Growth, Low-Rate Era, International Monetary Fund, 2016, p. 90, http://www.imf.org/en/Publications/GFSR/Issues/2016/12/31/Fostering-Stability-in-a-Low-Growth-Low-Rate-Era **20** David Bloom et al., "Demographic Change, Social Security Systems, and Savings," National Bureau of Economic Research, 2006, p. 25, http://www.nber.org/papers/w12621.pdf **21** Santiago Acosta-Ormaechea, Marco Espinosa-Vega, and Diego Wachs, "Demographic Changes in Latin America – The Good, the Bad and …" International Monetary Fund, 2017, p. 42, https://www.imf.org/~/media/Files/Publications/WP/2017/wp1794.ashx

CHART EIGHT

Pension funds in foreign assets and GDP growth

2010–2015



Source: Beyond Their Borders: Evolution of foreign investment by pension funds, PwC and the Association of the Luxembourg Fund Industry, 2015, p. 15, Available here; World Bank DataBank, GDP Growth (annual %), Average of 2010–2015, Brazil, Mexico, Colombia, Chile, Peru, Japan, Hong Kong, South Korea, and OECD Members.

Investment Asset Allocation

Investment results within LA capital markets, however, have not always kept pace with improvements in demographics and savings rates. Specifically, investors in LA countries generally display pronounced "home bias" in their asset allocation decisions – suffering from a lack of diversification as a result.

Helping to explain why this "home bias" persists, many countries continue to set limits on international allocations. Brazil's pension invests *less than 1 percent* in foreign assets and Mexico just 12 percent, compared to an average of around 30 percent in emerging Asia and the entire group of profiled Organization for Economic Cooperation and Development (OECD) countries. In contrast, Chile and Peru with stronger savings rates both allocate more than 40 percent of pension funds to foreign assets.[22] This has driven strong returns for these countries: from 2004 to 2014, Peru had the highest real return in LA and Chile had the seventh highest in the OECD.[23] These two countries have also enjoyed relatively high GDP growth in recent years (Chart Eight).

The variation is, in part, a consequence of the size of countries' respective capital markets in relation to domestic savings pools. For example, Chilean pension funds have had no choice but to look abroad for investment opportunities. On the other hand, Brazil, with a relatively smaller savings base and larger supply of financial instruments can satisfy local and foreign investor demand. Brazilian fixed income assets in particular, frequently provide rates higher than international rates, as well as inflation-linked local bonds.

22 Beyond Their Borders: Evolution of foreign investment by pension funds, PwC and the Association of the Luxembourg Fund Industry, 2015, p. 15, http://www.alfi.lu/sites/alfi.lu/files/files/Publications_Statements/Surveys/Beyond-their-borders-Evolution-of-foreign-investment-by-pension-funds-final.pdf **23** Saving for Development: How Latin America and the Caribbean Can Save More and Better, Inter-American Development Bank, 2016, p. 171, http://www.iadb.org/en/research-and-data/dia-2016-saving-for-development-how-latin-america-and-the-caribbean-can-save-more-and-better,20527.html

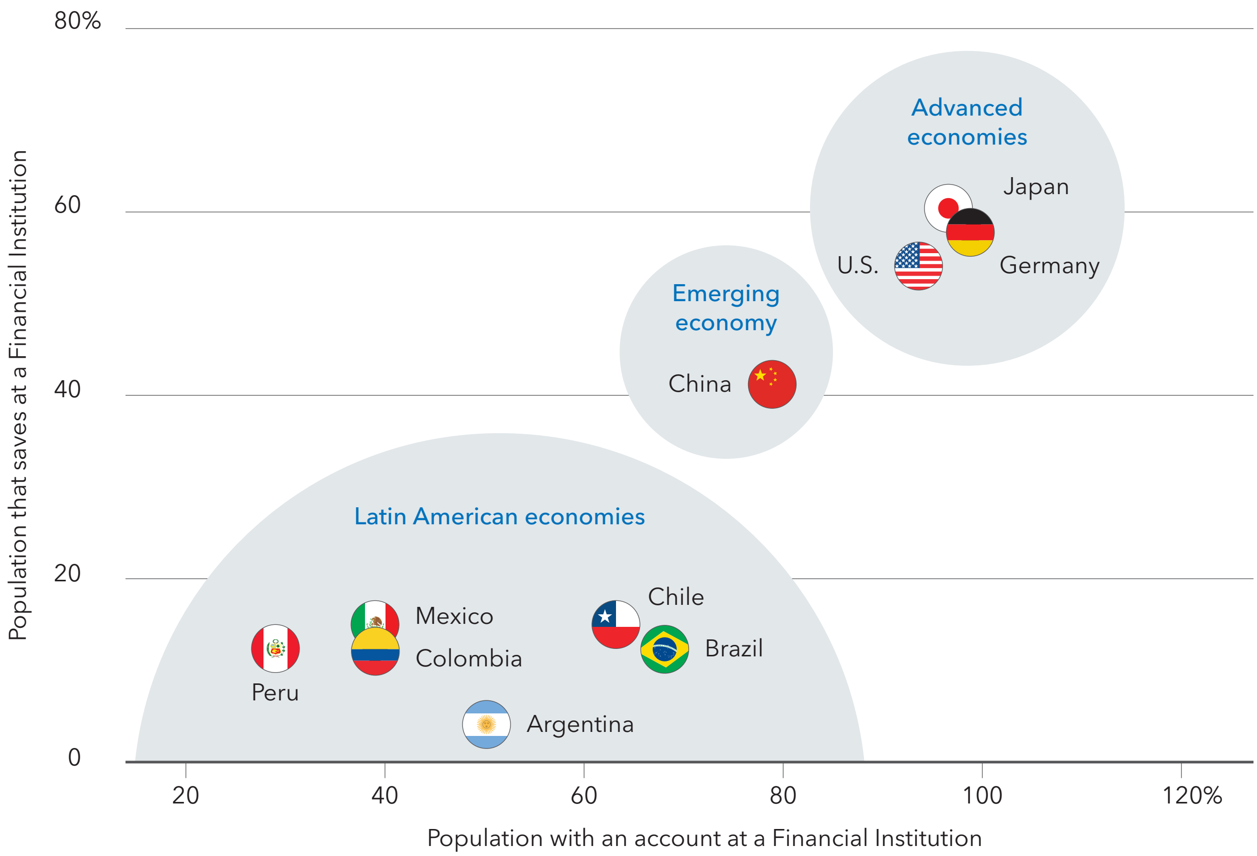
Financial inclusion

LA's long history of periods of high inflation has had a lasting effect on the relationship between consumers and financial institutions, especially consumer banks – the dominant distribution channel for savings and investment products in the region. Over 25 percent of Latin Americans who forgo a bank account list distrust of banks as a reason for this decision; the highest share of any region in the world and nearly twice that of East Asia and South Asia.[24] As expected, penetration of savings accounts within financial institutions is not only low compared to advanced economies, e.g., U.S., Japan, Germany, but also compared to other emerging economies like China (Chart Nine). Compounding this mistrust is a lack of competition within the banking industry leaving Latin Americans to pay higher fees than those in other regions. For example, a Brazilian investing in an equity mutual fund can expect to pay close to 3 times what a U.S. retail client would pay.[25]

CHART NINE

Financial development – accounts and savings

% of population with accounts vs. savings accounts at financial institutions, 2014



Source: Global Findex (Global Financial Inclusion Database), WorldBank, 2015, http://databank.worldbank.org/data/reports.aspx?source=1228#

24 Saving for Development, p. 219. **25** Dan Horch, "In Brazil, Investors Pay a Premium for Tradition," The New York Times, June 11, 2015, https://www.nytimes.com/2015/06/12/business/dealbook/in-brazil-investors-pay-a-premium-for-tradition.html?_r=1

CASE STUDY

Chilean retirement system

As a case study, the Chilean pension system provides instructive lessons about pension design, both in terms of elements to be followed and missteps to be avoided.

The reform of the Chilean pension system demonstrates the potential for pension design to provide a huge boost to savings and investment, driving GDP and employment growth. However, the system has had to address a few key limitations, illustrating the importance of continually re-evaluating and tailoring pension system design to demographic, investment-related, and other changes.

A record of success

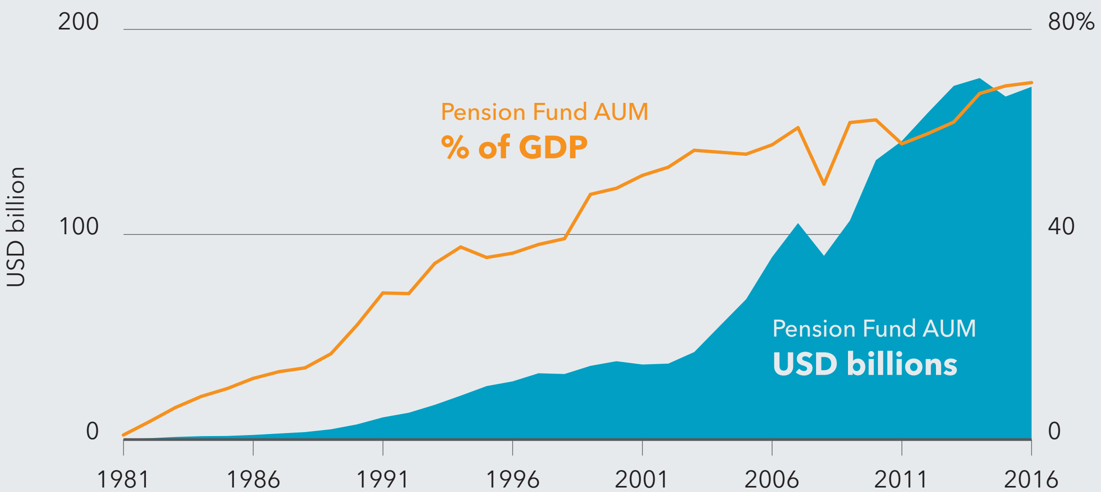
In 1981, Chile moved from a state-funded Pay-As-You-Go ("PAYGO") system to a fully-funded defined contribution scheme. Since then, employees have contributed a mandatory 10 percent of their income to an investment account that is managed by private sole-purpose entities.[26] The proceeds are then used to provide income during retirement.

This model has achieved wide-ranging benefits. Thirty-six years after the initial reform, the pension fund's assets under management (AUM) has grown to 70 percent of GDP (Chart Ten).

CHART TEN

Chilean pension funds AUM

1981–2016



Source: Chilean Pension Fund Regulator (Superintendencia de Pensiones, www.spensiones.cl), Central Bank of Chile, 2017, www.bcentral.cl

26 Waldo Tapia, Description of Private Pension Systems, Organisation for Economic Co-operation and Development, 2008, p. 14, http://www.oecd.org/finance/private-pensions/41408080.pdf

Chile has the highest average personal income in the region[27] and has reduced poverty from 45 percent in the 1980s to below 15 percent as of 2013.[28] Chilean capital markets lead the region, not only in terms of relative size to their economy (its stock market capitalization currently reaches 80 percent of GDP vs. 30 percent for LA as a whole), but also in the quality of corporate governance, as pension funds have pushed for minority shareholder rights. Most importantly, the investment performance achieved by the pension managers has been quite remarkable, posting an average 8.3 percent annualized real gross return since inception, though net returns and dollar-cost averaging returns are lower.

As a result, the World Bank has held up Chile as the role model for pension reform in developing economies. Its overall design framework and approach has been adopted by countries across Emerging Europe, East Asia, and LA.

Reforms: past and ongoing

Despite this success, the Chilean retirement system faced several significant limitations into the 2000s. The informality of the labor market, which led to inconsistent contributions, and high administrative costs proved to be significant headwinds. The system also struggled to achieve gender equality, as many women left the workforce to care for children, curtailing their contributions.

Thus, in 2008, the Chilean retirement system went through a major overhaul, following the recommendations of the Presidential Advisory Council on Pension Reform. The reform created a Basic Pension Income pillar — funded by general tax revenues — to provide a universal income for low-income retirees. The reform also included a subsidy for women for each birth, equivalent to 18 months of contributions based on the minimum wage and capitalized upon reaching retirement. Finally, to encourage competition and reduce administrative costs, an auctioning mechanism of new entrants to the pension system was established, where the contributions from these workers were automatically awarded to the manager with the lowest fees.

Though the 2008 reform addressed some of the core limitations of the pension system, certain key assumptions based on life expectancy were not updated, despite rapid increases in life expectancy in Chile. While reforms ushered in some poverty relief, challenges have persisted, with many middle-income workers continuing to struggle with low pensions and informal labor markets.

In response, the Chilean government has considered and enacted a variety of additional reforms in recent years. In 2014, the Chilean government called for a new Presidential Advisory Commission on Pensions, which produced close to 60 specific proposals. This led to a reform bill, being discussed in their Congress as of 2017, which would maintain the current mixed retirement system, but create an additional five percent, employer-funded provision. This would fund both a collective pool used to supplement low pensions and nominal individual accounts managed by a newly created state-managed entity, purportedly at a lower cost than current private managers.

Regarding investment options, the government has approved regulatory changes to allow for increased allocations to alternative investments, acknowledging the higher return expectations of private equity and debt, real estate, and infrastructure-related assets compared to traditional asset classes. These regulatory changes are currently being implemented. ■

27 Measured as GDP per capita at purchasing power parity (PP); World Economic Outlook Database, International Monetary Fund, 2017, http://www.imf.org/external/pubs/ft/weo/2017/01/weodata/index.aspx **28** World Bank DataBank, "Chile," 2017, http://data.worldbank.org/country/chile

Carpe dividend: an optimistic outlook for Latin America

According to some projections, LA will pass its demographic peak as soon as 2019.[29] Does this mean LA's demographic window is closing, savings rates will remain low or decrease, and an economic slowdown is imminent?

In fact, there are strong countervailing trends that indicate positive trajectories for aging countries around the world, which could bode well for LA countries and point towards a strong economic future. European countries that passed their technical demographic "peak" more than 30 years ago – such as Germany, France, and the United Kingdom – have maintained GDP growth around or above two percent in subsequent decades, even as their populations have aged.[30] And in Japan, older adults have accumulated wealth, assets, savings, and pension funds that should contribute to a "second dividend" after their demographic peak.[31]

Levers to counter aging and drive growth and savings

In these developed countries, a set of key policy levers have been shown to help sustain growth in a later demographic phase, providing critical lessons for aging LA countries.

First, extending working lives can drive the overall economy. A study in Japan found that adding five additional working years could raise per capita GDP 10 percent by 2025, and in the UK, it's estimated that increasing the number of workers over 65 by 2.6 percent per year could add nearly £1.7 trillion to the economy by 2037.[32]

To encourage later-life work, countries across Europe have raised the legal retirement age, and Japan has started to institute reforms to raise the pension-eligible age and reduce incentives for premature retirement.[33] The private sector has also played a role in the U.S., Germany, and other advanced economies by providing employees with flexible scheduling, implementing health and wellness programs, and redesigning facilities for older workers.[34,35]

Secondly, increasing women's economic participation is another imperative for countries faced with population aging. For example, increasing women's economic participation in Japan to the G7 country average is estimated to result in a *permanent 4 percent increase* in per capita GDP and increase annual growth by a ¼ percentage point.[36] Efforts to increase women's economic participation include

29 *Population Aging: Is Latin America Ready?* The World Bank, 2011, p. 58, https://openknowledge.worldbank.org/handle/10986/2542 **30** World Bank DataBank, Population ages 15–64 (% of total), GDP growth (% annual), 1967–2016, France, Germany, United Kingdom. **31** Naohiro Ogawa and Rikiya Matsukura, "Ageing in Japan: The Health and Wealth of Older Persons," The United Nations, 2005, p. 218, http://www.un.org/esa/population/meetings/Proceedings_EGM_Mex_2005/ogawa.pdf **32** Nicholas Eberstadt and Michael Hodin, "America needs to rethink 'retirement,'" American Enterprise Institute, 2014, http://www.aei.org/publication/america-needs-to-rethink-retirement/ **33** David Bloom et al., "Population Aging: Facts, Challenges, and Responses," *Program on the Global Demography of Aging*, 2011, p. 7, https://core.ac.uk/download/pdf/6494803.pdf?repositoryId=153 **34** Steven Greenhouse, "The Age Premium: Retaining Older Workers," *The New York Times*, 2014, https://www.nytimes.com/2014/05/15/business/retirementspecial/the-age-premium-retaining-older-workers.html **35** Christoph Loch et al., "The Globe: How BMW is Defusing the Demographic Time Bomb," *Harvard Business Review*, 2010, https://hbr.org/2010/03/the-globe-how-bmw-is-defusing-the-demographic-time-bomb **36** Yuko Kinoshita and Kalpana Kochhar, "She Is The Answer," *Finance & Development*, 2016, http://www.imf.org/external/pubs/ft/fandd/2016/03/kinoshita.htm addressing gender gaps in education and health and fostering shared responsibility for domestic non-remunerated labor, as well as improving caregiving systems, introducing flexible scheduling policies, formalizing employment arrangements, and extending greater legal and social protections.

Immigration can also help to moderate the impact of demographic aging. For example, in the U.S., it was projected in 2008 that immigrants and their children will account for 82 percent of the total increase in the population between 2005 and 2050.[37] In contrast, restrictive immigration and labor laws in Japan have discouraged foreign workers, exacerbating the aging of the workforce.[38]

Latin American tailwinds

Gradual aging: the new "sixty"

LA countries will age at a gradual rate for several decades and will maintain a large working-age population compared to regions like Asia and Europe, as well as by LA's own historical standards. This elongated transition creates opportunities and a longer "window" to take actions that can impact the economy. However, as the Chilean pension system illustrates, a large working-age population, alone, does not ensure high savings – this population must contribute to pensions or save through other means.

Later-life work

At the same time, LA adults are working, earning, and saving for longer. Today, roughly 40 percent of those over 60 years old continue to participate in the labor force, and these older individuals work nearly the same number of hours as younger counterparts.[39,40] The same dynamic applies to saving. In LA, savings rates reach their peak for individuals between 55 and 59 years old, and only gradually decrease after 60. In contrast, savings rates in the U.S. fall sharply after 45.[41] Many factors, such as smaller family size and increased longevity, will likely continue or accelerate these trends in the future,[42] and it will be important for LA countries to find ways to extend the number of healthy, productive years in individuals' lives.

Women entering the workforce

Bringing LA women into the workforce, particularly the formal sector, is an immense opportunity to build human capital and seed economic growth. For example, in Peru, Mexico, and Colombia, the value of unpaid domestic work is estimated at more than 20 percent of GDP.[43] If every LA country increased female labor force participation to match the best participation rate in the region, this would create an additional $1.1 trillion of GDP by 2025[44] or the second largest GDP "bump" of any region globally. Closing the gap would bolster the overall labor force and mitigate demographic aging effects, raise many families out of poverty, while creating a larger pool of potential savers and investors.

37 Jeffrey Passel and D'vera Cohn, "U.S. Population Projections: 2005–2050," Pew Research Center, 2008, http://www.pewhispanic.org/2008/02/11/us-population-projections-2005-2050/ **38** Hiroko Tabuchi, "Japan Keeps a High Wall for Foreign Labor," The New York Times, 2011, http://www.nytimes.com/2011/01/03/world/asia/03japan.html **39** *Is Latin America Ready?* p. 114. **40** *Is Latin America Ready?* p. 116. **41** *Saving for Development*, p. 35. **42** *Saving for Development*, p. 146. **43** *Cuenta Satélite Del Trabajo Doméstico No Remunerado*, Instituto Nacional de Estadistica e Informatica, 2016, p. 107, http://www.unfpa.org.pe/publicaciones/publicacionesperu/CUENTA%20SATELITE%20DEL%20TRABAJO%20NO%20REMUNERADO.pdf **44** Andres Cadena et al, "Where Will Latin America's Growth Come From?" McKinsey Global Institute, 2017, p. 18, Available here

How to improve saving and investing rates

Increase savings and investment

Globally, countries with robust savings and investments have strong economies and growth trajectories. Statistical analysis of countries around the world finds highly significant correlations between savings rates and economic growth and development.[45] In LA,for example, it's estimated that Chile's pension system created investments that were responsible for a half percentage point higher GDP growth from 1981 to 2001.[46]

In the reverse dynamic, failure to boost savings and investment can constrain economic growth. The Commission on Growth and Development estimates that a 25 percent level of investment of GDP is the minimum amount that can support long-term economic growth, but the average for LA countries is only 20 percent.[47]

We see several key levers to raising long-term savings and investing levels including:

- **Earnings and savings of women**
- **Consumption-to-savings shift**
- **Pension design**
- **Capital markets**
- **Investment products and solutions**

45 "Gone with the Wind," p. 10. **46** Vittorio Corbo and Klaus Schmidt-Hebbel, "Macroeconomic Effects of Pension Reform in Chile," In *Pension Reforms: Results and Challenges*, International Federation of Pension Fund Administrators, 2003, p. 299, https://fiapinternacional.org/wp-content/uploads/2016/01/pension_reforms.pdf **47** *Saving for Development*, p. 77.

Earnings and savings of women

Healthcare, education, and family planning resources can increase women's economic participation and create a larger, more educated formal workforce, which is more likely to save and invest.

Human development and workforce potential

THE UNFPA VIEWPOINT

> According to the United Nations Population Fund, investing in education, healthcare, and other development programs can help women enter the workforce, save, and drive GDP growth. A variety of programs have proven effective at improving girls' early educational achievement and enrollment,[48] and health information and services, leading to reduced rates of unintended pregnancy.[49] Overall, it's projected that investing 1.5 to 2 percent more of GDP in education, family planning, maternal mortality, and financial inclusion in LA would yield GDP benefits that are six to eight times that of the initial investment.[50]
>
> Although there have been strong strides over the past 30 years in women's economic participation rates, most LA countries still lag advanced economies, especially when accounting for participation in the informal economy. The United Nations Population Fund has found that a key aspect is access to sexual and reproductive health and rights, since this is a prerequisite for women to be able to lead more productive economic lives. This is particularly important for women in lower socio-economic strata who work in the informal sector, and who could better balance the demands of education, childcare, and work, if there was a more enabling environment with regards to their sexual and reproductive lives.

Savings, investment, and pension coverage

LA countries can also expand women's access to financial institutions, savings vehicles, and pension systems; an area that has seen significant progress in the past several years. As a hopeful sign, the share of women with an account at a financial institution grew by an average of 14 percentage points in just three years between 2011 and 2014.[51] In part, this increase is likely due to Cash Transfer Programs that increase the inclusivity of the financial

48 *The State of the World Population*, p. 49–50. **49** *The State of the World Population*, p. 50. **50** "Where Will Latin America's Growth Come From?" p. 19. **51** World Bank DataBank, Account at a financial institution, female (% age 15+), 2011, 2014, Seven profiled Latin American countries, advanced economies.

system by facilitating management of monetary transfers received through bank accounts. However, these rates could still move closer to full coverage, and holding an account does not necessarily mean that women are regularly saving their income.

Finally, increasing women's economic participation could also help to address gender-based disparities in LA pension coverage, though this will require programs to shift women from informal employment to the formal sector. For example, the average Chilean woman receives a pension that represents just 31 percent of her final salary, compared to 60 percent for men, mainly due to women leaving the workforce to care for children and family members.[52]

Recommendations

- Set country budgetary goals (as % of GDP) to invest in healthcare, education, skills training, and workforce programs targeting support for women
- Launch and enhance programs to shift women from informal employment to employment in the formal sector with resulting legal and social protections
- Design financial inclusion and outreach initiatives to encourage women to open bank accounts and save and invest regularly for retirement
- Institute educational and professional training programs for women
- Create programs to improve caregiving systems for children and the elderly
- Facilitate greater labor flexibility options, e.g., fund or incentivize technological improvements to enable telecommuting and working from home
- Introduce programs to mitigate adolescent pregnancies

52 "The perils of not saving," *The Economist*, 2016, https://www.economist.com/news/americas/21705850-pioneering-system-now-need-reform-perils-not-saving

Consumption-to-savings shift

LA countries need to address barriers that prevent their populations from pivoting from consumption towards savings and ultimately to investing.

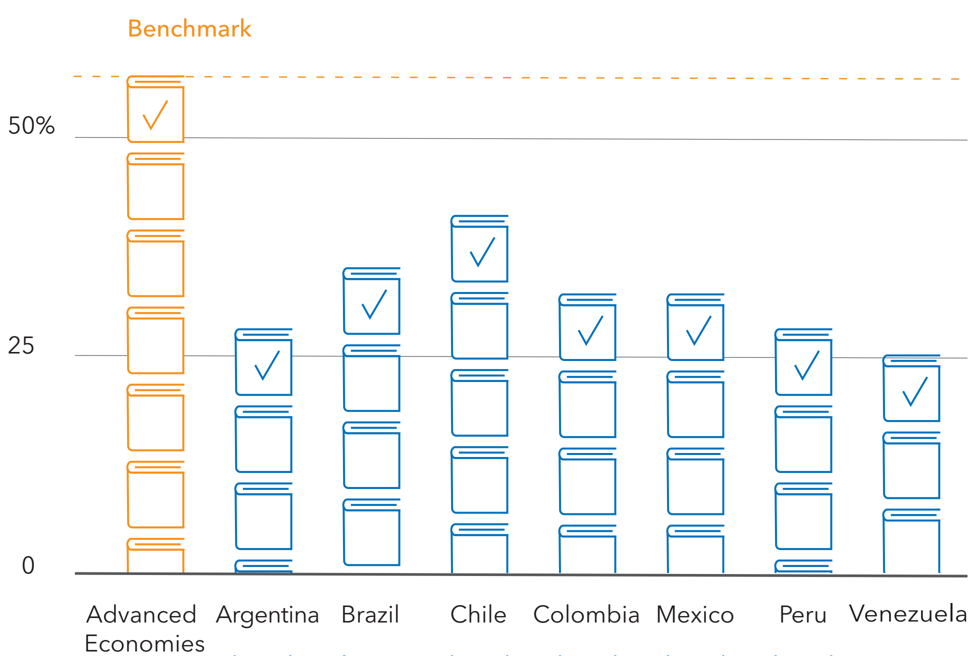
Accessing and using financial products

Less than 50 percent of people in LA have an account at a formal financial institution,[53] and among people who *do* have an account, only 26 percent use it to deposit all of their savings.[54] Opening and maintaining a financial account is relatively expensive in LA,[55] and distrust of banks is a larger barrier than anywhere else in the world.[56] In a global survey to assess financial literacy – defined as a basic knowledge of interest rates, interest compounding, inflation, and risk diversification – only 25 to 41 percent of adults across LA countries scored as "financially literate,"[57] compared to 57 percent in advanced economies (Chart Eleven).

CHART ELEVEN

Financially literate adults

% population



Source: Financial Literacy Around the World: Insights From The Standard & Poor's Ratings Services Global Financial Literacy Survey, The World Bank, p. 23–25, http://gflec.org/wp-content/uploads/2015/11/Finlit_paper_16_F2_singles.pdf Advanced Economies: Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

53 *Saving for Development*, p. 268. **54** *Saving for Development*, p. 268. **55** *Saving for Development*, p. 217–8. **56** *Saving for Development*, p. 218. **57** Leora Klapper, Annamaria Lusardi, and Peter van Oudheusden, "Financial Literacy Around the World: Insights From The Standard & Poor's Ratings Services Global Financial Literacy Survey," The World Bank, 2015, p. 23–25, http://gflec.org/wp-content/uploads/2015/11/Finlit_paper_16_F2_singles.pdf

Public and private stakeholders can adopt multiple approaches to these challenges. Research has found that reducing the initial transactional costs of formal savings products is the most effective way to encourage individuals to open accounts.[58] Other innovations include online and mobile banking, agent banking, and providing banks' saving products through the local, informal economy.[59] "Rule of thumb" educational programs have also shown promise for increasing levels of financial literacy and outcomes.[60]

Behavioral biases

Behavioral biases compound systemic barriers to regular, formal saving and investing. Time-inconsistent preferences and hyperbolic discounting — choosing smaller/sooner reward over larger/later — can lead individuals to prefer immediate consumption over long-term savings and investing behaviors. In Peru and Brazil, hyperbolic discounters are 14 and 8 percentage points less likely to save, respectively, and in Mexico, they are 10 percent more likely to be indebted.[61]

Well-designed financial products and education programs can help individuals to overcome these biases and save towards longer-term goals. For example, a bank in the Philippines increased savings balances by 300 percent when it offered consumers a commitment savings product, in which individuals could not withdraw their savings until they reached a time- or amount-based goal.[62] Additionally, financial education programs focused on children can instill budgeting and saving habits early in life, such as a Brazilian program that led high school students to be 12.5 percent more likely to save.[63]

Recommendations

- Incentivize mobile, online, and agent banking innovation and development with banks and technology firms
- Create incentives and minimize obstacles for a first-time customer to open a bank account
- Introduce "commitment devices" such as automatic savings programs to counter behavioral biases
- Simplify design and function of financial products and deliver greater transparency on fees and benefits to improve trust levels between banks and consumers
- Incorporate financial literacy programs and standards into childhood and secondary education including the value of budgeting, banking, and investing

58 *Saving for Development*, p. 220. **59** *Saving for Development*, p. 218, 236. **60** *Saving for Development*, p. 220. **61** *Saving for Development*, p. 224. **62** *Saving for Development*, p. 224. **63** *Saving for Development*, p. 228.

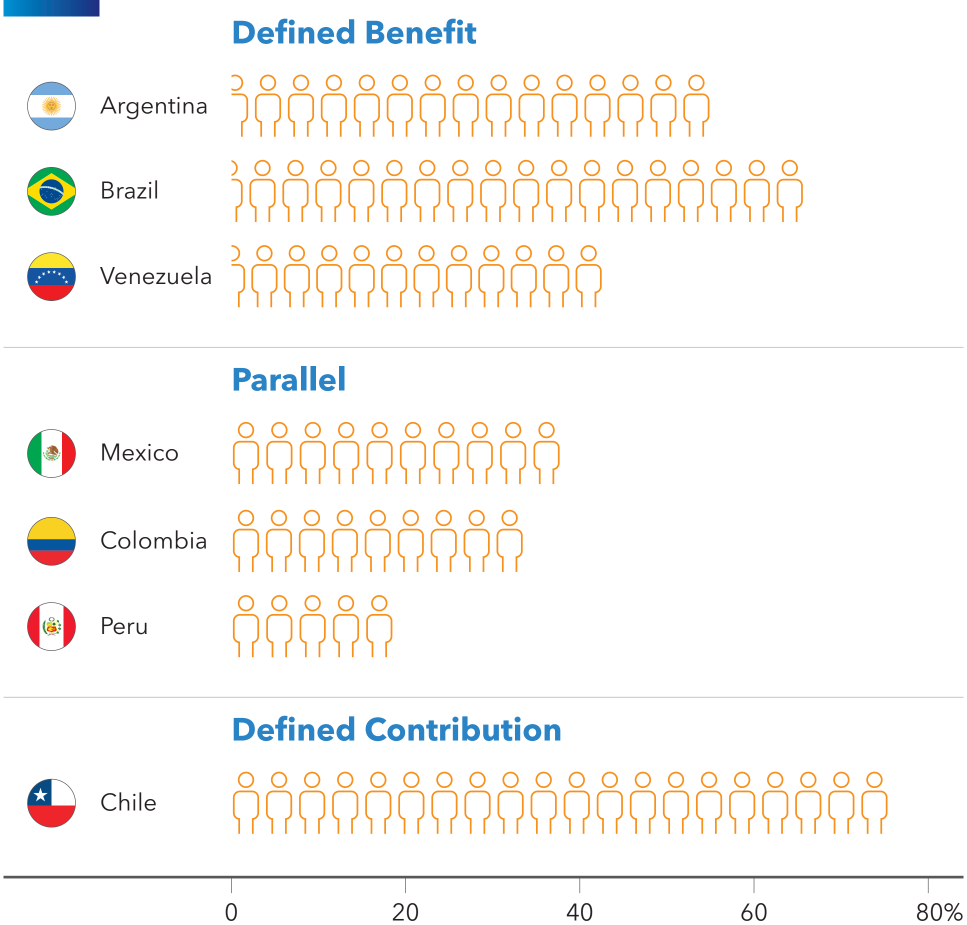
Pension design

Pension systems are crucial factors influencing how individuals in LA save for old age and manage their finances.

Pension coverage

As shown in Chart Twelve, pension design varies throughout the region. Argentina, Brazil, and Venezuela have a DB system, while Chile has a DC system. In Mexico*, Colombia and Peru, workers can choose between parallel DB and DC systems.[64]

CHART TWELVE Pension type and coverage



Source: *Pensions at a Glance: Latin America and the Caribbean*, OECD, p. 15, Available here; *Population Aging: Is Latin America Ready?* The World Bank, p. 241, https://openknowledge.worldbank.org/handle/10986/2542

* In Mexico, DB plans are generally closed to new contributions. **64** *Pensions at a Glance: Latin America and the Caribbean*, OECD, IDB, and The World Bank, 2014, http://www.oecd-ilibrary.org/docserver/download/8114181epdf?expires=1493044804&id=id&accname=guest&checksum=E6D4A6547F2C6CE78BB47D786E422652

Low rates of coverage and irregular contributions are a serious challenge for both types of systems. On average, only 45 percent of LA workers contribute to a pension system of any kind, and this rate has remained relatively flat for the past several decades, despite reforms.[65] Further, many of those who contribute do so unevenly, as a result of self-employment, the informal economy, caregiving, and lax enforcement. For example, though Chile has an overall coverage rate of 70 percent,[66] the average worker only contributes for 40 percent of their prime working years.[67]

Pension sustainability

The viability of these pension systems is another central concern. Though the DB systems regionally promised on average benefits equal to 67 percent of final salary, research finds that they can affordably finance only 37 percent of final salary, and only 15 percent by 2100.[68] Some studies find that shifting towards DC systems will successfully reduce these fiscal pressures,[69] and that DC systems are more effective at increasing savings rates.[70] However, other research points out that DC systems face high transition costs, low coverage rates, and inefficient returns and costs.[71]

Recommendations

- For DB plans, review current investment guidelines and consider expanding the range of asset classes available, including international assets and alternatives, that may increase diversification and better match pension liabilities, especially in the face of lower interest rates
- Ensure long-term pension sustainability by re-assessing pension systems and examining how DC structures can play a more central role in light of demographic changes, fiscal realities, and longevity expectations
- Review labor market policies as a means to improve pension coverage and women's economic participation rates
- Provide clear, systematic information and financial education to DC participants on the value of long-term savings for retirement. Re-visit investment offerings to ensure a diverse set of global offerings and strategies.
- Consider sole-purpose pension managers whose own assets are legally separated from the assets under management to avoid conflicts of interest

65 *Pensions at a Glance*, p. 9. **66** *Pensions at a Glance*, p. 15. **67** "The perils of not saving." **68** *Saving for Development*, p. 139. **69** *Is Latin America Ready?* p. 29–30. **70** David Bloom et al., "Demographic Change, Social Security Systems, and Savings," National Bureau of Economic Research, 2006, http://www.nber.org/papers/w12621.pdf **71** *Saving for Development*, p. 168.

Capital markets

Capital market development has a symbiotic relationship with the growth in savings. An important aspect of capital market development is increasing their breadth and depth, which allows for better price formation mechanisms and market liquidity.

Expanding breadth, understood as a wider range of assets available in the construction of portfolios targeted towards funding pensions, also allows for a better diversification of financial risks as well as access to higher expected returns.

Additionally, capital market development requires improvements in regulatory frameworks that allow increased protection to creditors and shareholders. This includes enhancement of minority shareholder rights, tougher sanctions on behaviors that prevent market fairness, such as insider trading, and encouraging a higher level of competition for capital.

Recommendations

- Develop incentives to increase the number of issuers in stock and bond markets, e.g., tax incentives, public listing of state-owned companies
- Reduce the current barriers to capital markets access for smaller companies and start-ups, e.g., create special market sections with less strict regulatory burdens or capital requirements
- Allow/Increase access of foreign investors to local capital markets by reducing administrative barriers and eliminating tax discrimination
- Enhance regulatory architecture to assure proper market monitoring and appropriate sanctions on improper market behavior
- Strengthen corporate governance standards
- Increase technological improvements to bond and stock trading platforms to improve competition among intermediaries and reduce transaction costs (fees and spreads)

Investment products and solutions

Pension systems in LA face increasing challenges such as the evolving demographics and increases in longevity but also the lower expected returns and yields from traditional asset classes. Addressing the latter challenge requires efforts to develop investment products and solutions that allow for higher returns and better diversification and risk management. Increasing pension fund asset allocation to foreign investments is an important step towards better outcomes, both in terms of investment performance, but mostly by reducing diversifiable risks.

Expanding eligible asset classes for pension funds to include alternatives is one avenue to enhance long-term expected returns. Pension funds would be able to capture the liquidity premium that many of these types of investments offer, which aligns with long-term investment horizons. In addition, directing a prudent allocation to fund local infrastructure or real estate projects would provide not only attractive returns, but also tangible evidence on how retirement-related savings pools benefit the national and local economies.

Another improvement would be to design pension fund products and asset allocations that accurately reflect risk preferences as investors move toward retirement. In particular, lifecycle fund structures have been successfully adopted in retirement programs around the world. Finally, the development of financial products that are supplementary to mandatory pension savings are an important area of development. Voluntary retirement savings products as well as insurance-bundled products allow for a higher probability of workers meeting their retirement goals.

Recommendations

- Increase incentives to improve voluntary savings rate; for example, provide tax incentives for employer matching and/or government-funded matches for young, and low-income workers

- Launch a nationwide personal finance program in the public school system, teaching a younger generation financial literacy and the importance of cultivating savings behavior

- Design and implement lifecycle fund structures to match changing needs and preferences of pension fund contributors

- Further develop financial instruments to address longevity risks. Single governments or multilaterals could issue very long-term bonds (50+ years) to allow pension funds and insurance companies to better match their liabilities

- Modify or remove regulatory limits on pension fund asset allocation to foreign investments and alternative investments, with a special emphasis on infrastructure and real estate, as a means to increase diversification

Conclusion

LA countries can design and implement retirement and savings strategies to translate the potential of the region's remaining demographic dividend into a solid foundation for a fiscally sustainable future and potentially raise the population's standard of living.

The benefits of the dividend are not automatic, and require proper policies and committed efforts. Doing so could overcome the region's historically low savings rate, help prepare for eventual population aging, and accelerate a virtuous cycle of economic growth, poverty reduction, and gender equality. Countries and regions around the world have demonstrated the possibility and benefits of seizing this demographic window, offering a set of proven strategies for LA countries to follow.

Though some LA countries are nearing their demographic peak, multiple trends could help to mitigate the economic drag traditionally associated with an aging population. In particular, gradual aging in the region, later-life working and saving, and women entering the workforce — combined with healthier, longer lives — can help to lift national economies. These trends provide reasons for optimism about the potential for LA countries to strengthen retirement systems and promote sustainable development in the long term, which will be essential for economic growth and the health and financial security of the growing population of older adults.

Efforts to achieve these goals will vary among LA countries, as population structures and economic factors vary significantly within the region. However, several broad recommendations apply for all profiled LA countries: investing in women's economic participation through programs to help women lower rates of early marriage and childbirth, and raise educational opportunities; encouraging the shift from consumption to savings; re-examining pension design to improve coverage and sustainability; developing and deepening capital markets; and improving access to a variety of global and diversified financial products.

These recommendations can lead to increased savings and investing — driving progress towards an economic profile in line with more advanced countries. The result would be a LA region that is increasing standards of living for all, has significantly strengthened its long-term fiscal situation, and is prepared to navigate a dawning era of population aging.

Definition of terms:

Alternatives: an asset that is not one of the conventional investment types—stocks, bonds and cash—such as real estate, private equity, commodities, hedge funds, etc.

Cash transfer program: are direct transfer payments of money to eligible people.

Defined Benefit (DB) plan: a type of pension plan in which an employer/sponsor promises a specified pension payment, lump-sum (or combination thereof) on retirement that is predetermined by a formula rather than depending directly on individual investment returns.

Defined Contribution (DC) plan: a type of retirement plan in which the employer, employee or both make contributions on a regular basis, such as a 401(K).

Dependency ratio: is a measure showing the number of dependents, aged zero to 14 and over the age of 65, to the total population, aged 15 to 64.

Inflation linked bonds: are securities designed to help protect investors from inflation.

Sole purpose pension manager: pension managers whose own assets are legally separated from the assets under management to avoid conflicts of interest.

Target date solutions: such as a target date fund (TDF), is a collective investment fund designed to provide a simple investment solution through a portfolio whose asset allocation mix becomes more conservative as the target date (usually retirement) approaches.

Voluntary savings products: savings in various accounts and institutions by individuals or organizations that they may be voluntarily deposited and withdraw from.

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ABOUT

BlackRock Retirement Institute

The BlackRock Retirement Institute (BRI) is BlackRock's global thought leadership platform on retirement and longevity established to enable our clients and broader community to make better decisions toward a financially secure and dignified retirement.

Lifespans have shot up over the last several decades but the way the world thinks and acts to address this new reality has yet to catch up. We at BlackRock recognize this emerging revolution – its challenges, its opportunities – and through BRI we join our voice with the voices of other experts to create and amplify some of the best thinking on retirement and longevity.

As the world's largest asset manager[72] – with two-thirds of the funds we manage related to retirement – BlackRock understands that our firm has a special responsibility to assist people all over the globe to live out their later years with dignity and security. An essential component of that is helping governments, institutions and individuals understand and take action in response to this new phase in mankind's history – that's what BRI is here to do.

The BlackRock Retirement Institute helps to enable our clients and broader communities to make better decisions towards a financially secure and dignified retirement.

72 Based on $5.69 trillion assets under management as of 6/30/17.

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Why BlackRock

BlackRock helps people around the world, as well as the world's largest institutions and governments, pursue their investing goals. We offer:

- **A comprehensive set of innovative solutions, including mutual funds, separately managed accounts, alternatives and iShares® ETFs**
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