OECD

2015 Pension Policy Notes

COLOMBIA

- **Overhaul the pension system by eliminating the existence of mutually exclusive and parallel schemes, preferably through the creation of a three-pillar regime.**
- **Delink the minimum pension from the minimum wage.**

The pension system is very complex. Its structure is unusual as it comprises two parallel mandatory systems, a public PAYG defined-benefit scheme and a private defined-contribution scheme. Workers are allowed to switch between the two every five years up until ten years before retirement age. They contribute 4% of their wage and employers 12%. Since 2014 the retirement age is 62 years for men and 57 for women, with no possibility for late retirement in the public scheme. The monthly minimum pension is equal to the legal minimum wage. The minimum contribution period is 1,300 weeks in the public scheme. In the private scheme, people can retire as long as their account can finance an annuity of 110% the minimum pension. Workers, above the retirement age, who have contributed for at least 1,150 weeks in the private scheme, but whose account balance is insufficient, are entitled to the minimum pension. In both schemes, those who have contributed for less than the minimum contributory period receive a refund. The system tends not to benefit low-income workers as they are typically not covered. According to OECD projections, the long-term net replacement rate is 74% for males in the public scheme, a level that would be obtained if the future net real rate of return in the private scheme were equal to 6% per year on average.

Key indicators: Colombia and OECD average

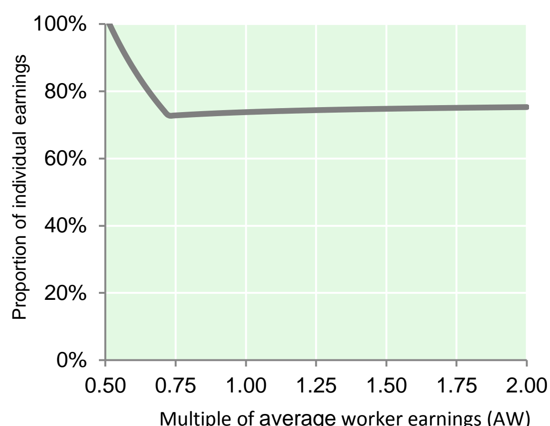
	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20			60.0 (55.0)	60.0 (55.0)		62.0 (57.0)	
Retirement age			60.0 (55.0)	60.0 (55.0)	62.9 (61.8)	62.0 (57.0)	64.6 (64.4)
Net replacement rate, avg earner						74.0 (67.0)	63.2 (62.7)
Total mandatory contribution rate			15.0	16.0	19.1		
Total pension spending, % of GDP				3.5	10.3		
Public pension spending, % of GDP					8.4		
Public debt, % of GDP					115		
Employment rate 55-64, %			74.0 (33.7)	79.6 (45.8)	66.1 (49.1)		
Labour-market exit age					64.6 (63.1)		
Old-age poverty rate, %					12.6		
Life expectancy at 65, years	14.0 (15.8)	15.0 (16.8)	16.0 (18.1)	16.9 (19.1)	18.4 (21.5)	20.5 (22.8)	22.9 (25.9)
Old-age dependency ratio	0.08	0.09	0.09	0.12	0.28	0.46	0.57
Fertility rate	3.2	2.5	2.1	1.8	1.7	1.7	1.8

Note. Numbers when different across gender appear in parenthesis for women.
Long-term: Around 2060 based on all legislated reforms up to mid-2015.

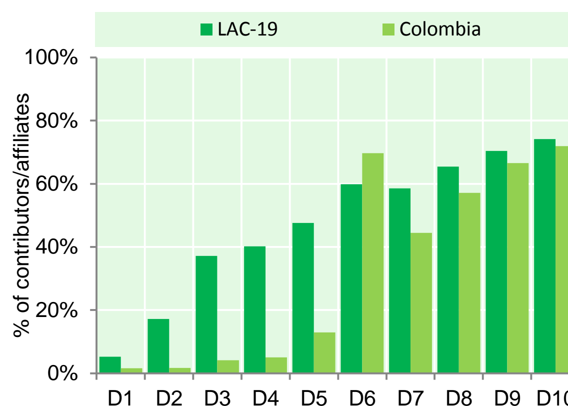
Recent reforms have aimed at reducing old-age poverty risks, but remain insufficient. A means-tested contributory scheme (*Beneficios Ecónomicos Periódicos*) has been introduced to provide retirement income support for informal and irregular workers. People can make voluntary contributions, with a 20% top-up by the government, but the benefit at retirement cannot exceed 85% of the minimum wage. To allow more people from the three lowest deciles to be covered by the public pension scheme, the Family pension (*Pension Familiar*) was created in 2012, allowing two individuals in a couple to add up their contributed years. Targeting the three lowest income deciles is tight though as coverage is low even for median income groups. The old-age assistance scheme was strengthened in 2010 through the creation of *Colombia Mayor*. It targets the two

lowest income deciles and covers about 40% of the 65+ population. However, the significant expansion of coverage generated financial pressure, which has resulted in the halving of the already low benefit. It is, relative to average earnings, below that of all OECD countries.

Long- term net replacement rates from the public scheme, by earnings level



Contributors as a share of total workers (aged 15-64), by income decile around 2010



Low coverage raises equity issues. The large size of the informal labour market, due in part to the high level of both the minimum wage and non-wage labour costs. explains the low coverage At about 85% of the median wage, the minimum wage is in relative terms far above the level in OECD countries. The constitutional rule imposing that the minimum pension be at least the minimum wage is also an important detrimental factor, increasing inequalities. Beyond the high amount of DC contributions required to meet the minimum pension requirement, this discourages private companies to participate in the annuity market. Indeed, unpredictable changes in the minimum wage, which represents a floor for all annuity payments, induce large risks for annuity providers. Only around 15% of benefits are paid through lifetime annuities, which increases poverty risks for those outliving their lump-sums. Moreover, the reference wage in the public scheme is based on the last 10 years of earnings, which benefits those with steep earnings profiles who also tend to have high incomes. While a contribution of 25 years is short to get a full pension by OECD standards, it is very long to get some pension entitlements. When the contribution period is below the minimum, the accumulated contributions are only price-indexed in the public scheme.

There is a need of a comprehensive systemic reform. The existence of parallel schemes cannot be easily understood by contributors and is therefore prone to fuelling inequalities, beyond serious parametric weaknesses. It also creates administrative inefficiencies given its complexity, and compared with other Latin American countries operating costs are high. A three-pillar system should be created based on the complementarity rather than the competition between its components. The safety net for the elderly should be further improved, and its financing facilitated by the taxation of pension benefits, currently largely exempt from taxation on top of the non-taxation of pension contributions and investment returns. The minimum pension should be delinked from the minimum wage, as such a tie creates huge inefficiencies. The minimum contributory period to get some pension entitlements should be reduced, and the reference wage computed based on more years. Finally, the retirement age should converge for men and women and its evolution linked to gains in life expectancy.

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