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Chile's Way

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Over the next two decades, 78 million Americans will quit working, quit paying into the Social Security system and start drawing benefits, straining the resources of our public pension system.

Is there a way to persuade them to stay in the labor force — continuing to contribute their skills and talent — and postpone their Social Security payments?

Yes, there is, and Chile is showing us how. Sixty-two percent of Chilean men ages 60 to 69 were still in the work force in 2004, compared with 46 percent of American men that age. Among men ages 70 to 74, 31 percent of Chileans were still working, but only 19 percent of Americans.

Why the difference? Chile has a public retirement system, but after retirement age — 65 for men, 60 for women — people who keep working are no longer required to contribute to a pension fund. This increases their net wages, strongly encouraging them to continue working. Since 1981, when Chile put the system in place, labor force participation rates for men ages 65 to 70 have risen 13 percentage points.

Chilean public pensions are set up differently from Social Security. Workers contribute 10 percent of their wages to an individual account and choose a fund in which to invest it, earning a market rate of return. In retirement, workers can receive inflation-protected annuities or withdraw the money gradually. Workers can receive payments early (and stop contributing), once their retirement accounts are large enough to provide a pension that is at least 70 percent of their average wages and 150 percent of the government-guaranteed minimum benefit. But a man under age 65, or a woman under 60, who has not reached this target replacement rate cannot receive benefits — and therefore must keep working.

In contrast, Americans can start receiving Social Security benefits at age 62, but if they keep working, they must keep contributing. And if they earn more than a minimum amount, they also see a reduction in their current monthly benefit. Both the early pension option and the earnings penalty discourage work.

Disabled Chilean pensioners, who, like disabled Americans, receive benefits before reaching retirement age, are likewise allowed to work and keep any wages earned, in addition to their disability benefits.

In a similar fashion, Chilean widows receive both their own pension benefits and their survivor's benefit — unlike American widows, who must choose one or the other. That means Chilean women get a higher expected return on their contributions to the pension system, which helps

explain why labor force participation rates for older women in Chile are growing even faster than those for men.

By postponing the age at which the pension can start, reducing the payroll tax on people over 65 and eliminating other penalties for work, the United States could also encourage older people to work. This would increase national income, expand the tax base, ease the financial burden on Social Security and help to finance pensions for our increasingly long lives.

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