Privatized Retirement
And how the Current Crisis has Worsen Worker's Losses

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ABSTRACT

The debate around retrenchment of pension systems became really popular in the 1990's, after the pioneering experience of Chile in 1981. The disastrous outcomes of the Chilean reform were widely known by the 2000's, although no relevant steps backwards were taken. This paper analyses the consequences of pension privatization, and focuses on Chile's recent data to demonstrate how the current international crisis has been making matters worse.

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Introduction

The debate surrounding social policies in general and pension systems in particular has been present since their inception. In Latin America, the debate around pension privatization has raged since Pinochet began deconstructing Chile's public pension system, inaugurating a new era for the systems once based in solidarity principles.

This paper starts by presenting some ideas that were part of the structuring process of the post-war Welfare State. The first part of the text is an attempt to examine the principles behind the construction of the Welfare State and of the PAYG (*pay as you go*) public pension systems built on the strength of the Golden Years of capitalism.

The entire postwar period had favored social protection structures built under the developed capitalist states that insured public coverage of social risks. The general spirit of those times allowed the construction of a system that would later be deeply criticized when the Keynesian years entered a period of crisis.

The crisis of the postwar construction was also the crisis of the Welfare State, which lead to a period of restructuring and retrenchment actions. Privatization was the most drastic part of pension system reforms that quickly became a dominating trend after Chile's pioneer experience, counting on the support of international organizations. Workers were lead to believe that private pension schemes would compensate for the diminishing state pensions, and that higher pensions at retirement could be expected from the fully funded private options. While the promised advantages of the private pension systems may have actually occurred amongst select highly paid workers, the great majority of workers have suffered severe losses since they have left the public PAYG systems.

After analyzing the deconstruction of the Welfare State, the ideologies and mechanisms used to deliver PAYG systems, this paper will critically examine the practice of pension privatization. It will become clear that privatization has disproportionately benefited employers while increasing costs and risks exposure for workers. Furthermore, the decrease in expenses and responsibilities of employers and of the State has worked hand in hand, explaining the eagerness of these actors to push for privatization.

After examining the general trends, the paper will review the classic example of Chile and its widely known disastrous outcomes.

Finally, the paper will analyze the pension fund losses during the current economic crisis as an additional factor to the problems of the private funded systems. As recent events have now shown, exposing workers to the financial oscillations of the market by gambling with pension savings is a practice in need of retirement.

v Background of the Study

1. The Consolidation of the Welfare State

The beginning of public initiative attempting to deal with social matters had emerged under the domain of the liberal ideology, but the history of Welfare as we know it has materialized in a distinct scenario of 20th century. Pressured by increasingly popular radicalism after the Second World War and by the very real existence of an alternative to capitalism (the "socialist threat" present during the Cold War), policy makers of the developed western world promoted the consolidation of the Welfare State, at that moment, the least controversial solution to social problems.

The influential Keynesian theories and the 'Beveridge Report' (Beveridge, 1942)[1], helped lead many developed countries to affirm a public commitment of intervention in the economy for the maintenance of full employment (contradicting all the traditions of the liberal orthodox thought). Beyond the governmental search for the full employment, the Welfare State consolidated in the postwar period, was based on two important characteristics: *universalism* and *'decommodification'*.

Universalism, seen in its purest form of universal social programs funded by governments, guarantees access for those in need, with no verification of eligibility criteria. Beyond the wide scope of universal programs, they usually have advantageous cost-efficiency relations and reduced transaction costs. Also, where these programs are present, individuals and trade unions do not need to spend time

[1] The Beveridge report made for the Churchill government was not the first to outline this kind of social policies, yet it is widely considered a groundbreaking document for its ability to synthesize concrete proposals and methods that governments took to intervene in the market. Many current welfare state structures in various countries were inspired in this early report.

and efforts negotiating basic provision of social protection. Furthermore, universal programs offer full portability of the social protection right.

The '*decommodification*' process has reduced the dependence of the individual in relationship to the market, in their search for well-being. This concept considers social protection as a right and not as a service to be bought; abandoning the idea that the market should select users of social services by their capacity to pay for them.

Building the Welfare State involved the creation of a technocratic administration, to assure that decisions would be made in more rational and scientific ways. The professional administration was made possible by the unprecedented growth in the public employment, making the maintenance of the governmental commitment to full employment possible. Additionally, the postwar scenario delivered huge economic growth and opportunities. These economic gains were then redistributed through Keynesian style "managed capitalism", minimizing social conflict and allowing for years of peaceful economic growth.

The Welfare State construction in this period was an attempt to protect families from possible fluctuations in their employment income (for example due to: unemployment, illnesses, disability or maternity). The same idea became the basis for the 'Universal Declaration of Human Rights and Social Security' by the ILO (International Labor Organization). By viewing such income interruptions as social risks, it not only became morally plausible, but pragmatically possible for the state to insure them collectively.

In many Western European countries, the Welfare State also represented a successful strategy to fight poverty and social inequalities. All social protection structures aim for some kind of redistribution, either vertical (from the rich to the poor, through progressive taxation) or horizontal (through the life cycle of individuals). The vertical redistribution, according to Palme (2005), made the Welfare State a civilizing project, as through the state, the poor would also have access to the social and material advances of society. The horizontal redistribution occurs in pension systems[2],

[2] Classic studies on poverty identified childhood and old age as especially vulnerable phases of the life cycle, where there is an unfavorable balance between work capacity and consumption needs. Thus, families with children or elderly members would be in a more vulnerable position. Results of a study carried out by Kangas and Palme (2000), showed that indeed poverty indexes were higher amongst

assuring individuals a decent living throughout their life cycles, thus guaranteeing income for those who have fallen out of the labour market. This redistribution can also be considered vertical, as risks related to unemployment and illnesses often place the lower income population in more vulnerable positions.

2. The Welfare State under Attack

The end of the 1970s and beginning of the 1980s represented a significant change in the political debate of most developed capitalist economies. As the social pact of the Golden Age entered in crisis during the 1970s, so did the Keynesian Welfare State.

The document "*The Welfare State in Crisis*" published by the OECD in 1981, gave legitimacy to the change in the *mainstream* ideology, by beginning to emphasize individualized and privatized solutions to social risks. From the end of the 70s, and throughout the 80s and 90s, the social policy debate was focused on what should be responsibility of the State, and what should be left to families/individuals. These questions appeared in various European countries, not only in Thatcher's neoliberalism in the UK, but even breaching the Scandinavian Social Democracy in the 70s (Kuhnle,1998). During the 80s, social movements, governments, politicians and thinkers on diverse ends of the political spectrum, all were advocating more market, less state, and more responsibilities to families and individuals.

Many critics blamed the social protection systems for the growing public deficits, the rising inflation ratios, unrealistic wage demands harming competitiveness, and the general deceleration of the economic growth. While authors with a liberal vision blamed the Welfare institutions for the economic deceleration, others viewed the problem from the opposite perspective, pointing to the economic crisis as the cause of the Welfare crisis.[3]

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families with children or elderly in the 1970s. In the 1990s, poverty in these groups had disappeared in the Nordic countries examined in the study (Finland and Sweden). The combination of a public structure of day-care centers, money transfers for families with small children and a universal system of retirement lead to these successful results.

[3] Different interpretations on the crisis of the Welfare State and its political consequences are well described by Barbosa de Oliveira (1989).

The causal relation might be ambiguous, however, it is undeniable that the economic deceleration had reduced the social policies budget, with less taxes being paid and more expenses being demanded. With the persistence of the crisis many of the conditions that had supported the expansion of the Welfare State began to disappear. In a scenario of increasing unemployment and demographic change, embedded social rights implied a commitment of the public revenue to the social protection needs. So at the same time that the debate had been changed to favor retrenchments, the reality was of increasing social expenses.

The retrenchment of the social policies actually meant a stop or even a step back in the trend of extending them. This meant less investments in the social programs structure, more rigid eligibility criteria for money transfer programs, more focused policies,[4] readjustment of benefits below the inflation rates, an increase of emergency programs and an increasing role of the private sector as a co-actor or even as a substitute for the public sector.

Despite the gravity of the reforms, Barr and Coulter (1991) as well as Pierson (1994), affirm that the implemented reforms in fact were actually smaller than what had been promised in speech, especially in the neoliberal discourse of Margaret Thatcher and Ronald Reagan.[5]

At the same time of these changes, criticisms against the intrinsic characteristics of the Welfare State gained strength. Many thinkers pointed out the necessity of differentiating policies and benefits, the extreme bureaucratization of the administration and other generalized inefficiencies of the system. The Welfare State was also accused of being pernicious as it supposedly encourages individuals to be dependent on the state. Regardless of the merit of these very subjective questions,

[4] In the social service area there was a huge trend to prioritize focused programs. According to Sinfield (1994), the percentage of resources used by focused programs in the United Kingdom doubled between 1978/79 and 1993/4, moving from 17% to 34% of the total social expense.

[5] In fact, the two clearly neoliberal governments of Reagan in the United States and Thatcher in the UK created expectations of radical reforms in the Welfare of these countries. The fact that the reforms had not occurred as drastically as many believed or still believe they did, is explained by Pierson (1994) with use of his path-dependence hypothesis. According to the author, in all countries some programs are much less vulnerable than others, as the more structured and consolidated the programs are, the greater the popular support they receive against retrenching changes.

another less disputably problem has also arisen – population aging.[6] The combination of decreasing fertility rates and increasing longevity brought distinct needs for social expenditures.

For the PAYG (pay as you go) pension systems, the demographic change is considered a heavier burden on the economically active population. However, it is worth noting that most of the analyses that have drawn this conclusion have not considered immigration as a possible solution due to other social and political complications related to it. Beyond the demographic issue, other aspects must be taken into consideration when projects of modernizing the Welfare State are analyzed: immigration, changing work structures, unemployment, lower economic growth, financialization of the economies, changes in the ideological mainstream, and changing family structures[7] amongst others.

Globalization and financialization have been threatening national social protection structures, and very often they are used as excuses for the retrenchment of social policies. The need to promote international competitiveness created in a globalized world gave many an impression that there is no alternative but deregulation of the economy and flexibilization of rights.

As neoliberal ideas became more and more dominant, the ideological criticisms of the Welfare State became stronger. The "offensive right" (as called by Przeworski & Wallerstein, 1988) considered state intervention damaging to the self-regulating market and trade unions a cause of distortions in the labour market. These kinds of interpretations nurtured anti-collectivism ideas, claiming that collective solutions to social problems would intervene in individual decisions, restrict free-choice, and create inefficiencies and corruption within bureaucratic structures.

[6] The "baby-boom" generation constituted smaller families than those where they had been born, and was followed by the so called "baby-bust" (Townson, 2000). This change was more evident in developed countries and only recently has become true for most of the developing world.

[7] As discussed by Esping-Andersen (1999), household structures include each day more: women as the bread-winner, single parent families, post-divorce marriage, same-sex unions, etc.

3. The Pension System Reforms

The public pension systems have always been a central issue whenever reforms of the Welfare State are being debated, as everywhere in the world pension expenses represent a significant share of the total social expenditures.

When most pension systems were being built, higher rates of fertility and the growth of the labor force in the 1950s and 1960s had endorsed the creation of "pay as you go" (PAYG) systems.[8] This option held strong support in European countries where the war and depression had ruined pension funds, leading to a great disbelief in fully funded systems. Another advantage of the PAYG systems was that the inexistence of pensioners collecting benefits at the moment of its construction allowed a combination of low contributions with the promise of generous future benefits. But the economic conditions that favored the implementation of the PAYG regimes changed and the taxation on wages became suspect of harming the employment level.

It is important to emphasize, that the decrease in the dependency ratio (number of contributors / number of pensioners) of the PAYG systems cannot be merely analyzed as a consequence of decreasing fertility rates and increasing longevity, as the unsatisfactory performance of the labour market must also be taken into account. Recent changes in the employment structure such as increased informality, structural unemployment, and generalized precariousness have all had a generally negative impact on social contribution revenues. All these transformations compose the background of pension systems entering into a period of crisis and initiating their retrenchment trajectory in the 1980s.

Many countries had carried through 'paradigmatic' reforms, introducing a mandatory private component to their pension systems.[9] Mesa-Lago and Muller (2002) have classified the paradigmatic reforms in three types: those where the public system is

[8] The PAYG systems count on an inter-generational solidarity. In these systems, current taxpayers finance the old age pensions of retired workers, implicitly assuming that the following generation will finance theirs when their time to retire comes.

[9] A 'paradigmatic' reform is one that imposes significant changes in the fundamentals of a system, very often introducing a private pillar. A 'parametric' reform usually changes the parameters of an existing public or private system.

substituted by a private system; those where the public system starts to compete with a private system; and those that create a mixed system where the PAYG public system offers basic pensions and the private system complementary pensions.[10]

The pioneering Chilean case, emphasized in this article, is very emblematic of the first type of paradigmatic reform, as its pension system went through a complete privatization process in 1981. From then on, other countries in Europe and Latin America followed similar tracks, implementing total or partially privatized pension systems.

In Europe, the United Kingdom also carried through a significant reform of its pension system in the 1980s, when pension reforms had not yet gained the popularity they would later achieve in the 1990s. These two experiences became icons of the cases of total privatization (Chile) and partial privatization (UK), carried through under the neoliberal governments of Augusto Pinochet and Margaret Thatcher.

The option of total privatization as performed in Chile, has now been removed from the debate by all but the most extreme neoliberal ideologues, given the recognition of fundamental problems linked to this choice. But the hybrid systems (public and private pensions coexisting) as in the case of the United Kingdom and several Latin American countries, still have strong popularity. Through a number of incentives and tax breaks, the United Kingdom has facilitated the growth of private pensions following their reform in 1986 (though the public system was kept). Many Latin American countries repeated this model during the 1990s, but just as in Chile, these reforms have been far from being a successful example to be emulated. The following table demonstrates the varying degree of pension reforms in Latin America, as well as in other parts of the world.

[10] Countries like Brazil and Venezuela carried through 'parametric' reforms that adjusted the rules of the existing PAYG model (Matijascic, Kay and Ribeiro, 2008).

Table 1: Pension Systems Reforms with Privatization

Country	Year of Reform	Pension Systems		
		Private	Private and Public coexisting	Private and Public competing
Latin America				
Chile	1981	X		
Peru	1993			X
Argentina	1994		X	X
Colombia	1994			X
Uruguay	1995		X	
Bolivia	1997	X		
Mexico	1997	X		
El Salvador	1998	X		
Costa Rica	2000		X	
Panama*	2002			
Dominican Republic	2003	X		
Central and East Europe				
Hungary	1998		X	
Poland	1999		X	
Sweden	1999		X	
Bulgaria	2002		X	
Croatia	2002		X	
Estonia	2002		X	
Kosovo	2002	X		
Russia	2003		X	
Lithuania	2004		X	
Slovakia	2005		X	
Macedonian	2006		X	
Asia				
Hong Kong	2000	X		
Kazakhstan	1998	X		
Africa				
Nigeria	2005	X		

*Reform of the civil servants pension system
Source: FIAP

4. Path-Dependency in Pension Systems Reforms

The different inherited complexities of the pension systems consolidated in the postwar period were, and continue to be, important determinants of their reforms. As studied much deeper by Pierson (2001), pensions systems' particular characteristics make it very difficult to reproduce certain reforms in different national realities. Policy makers necessarily face legal constraints and have to deal with the programs as they were drawn. Moreover, as already said, pension expenditures present great rigidity to adjust in the short period, given their contractual nature.

The Welfare reforms experiences are usually very unique not only due to particular characteristics of the institutions in different countries, but also because reforms

usually mean retrenchment. Being so, reforms involve decisions and actions that decision makers do not want to be remembered for ('blame avoidance'), as very often losses are more explicit than gains. Due to these characteristics, reforms are rarely done by unilateral imposition of new legislation, but, in general, negotiations between parties and organizations have to be made. According to Pierson (2001), this happens as governments avoid solely assuming the negative image of having cut social benefits, as unilateral reduction of rights previously acquired can shake the their legitimacy. Therefore the reforms tend to be implemented in a manner that intentionally allows for low visibility of the social costs, so that less political opposition has to be faced.

Thus retrenchment strategies involve an effort to transform programmatic changes into electorally viable options, as social programs also develop stakeholders' coalitions willing to protect the *status quo.*[11] Not only do the beneficiaries of the systems oppose the privatization of the regimes, but also the bureaucrats working for their administration. Usually, the strongest pro-reform lobby is the financial institutions that will profit from the new schemes. The usual reasons trumpeted for the reforms include efficiency, savings generation, stock market stimulation, no political interference, and no vulnerability to demographic changes.

Pierson (2001) classifies countries into two groups, according to their initial possibilities of pension reforms, taking into account the degree of maturity and coverage of their systems. The first group's is made up of the "late countries" that, until the 1980s, had not yet consolidated PAYG regimes. Four advanced economies fit into this classification: Australia, Ireland, Netherlands and New Zealand. Another two countries, Denmark and Switzerland, had implemented systems of modest replacement rates, unsatisfactory to workers of average and high incomes. The UK had already instituted its public PAYG system, however it was still quite recent and immature (it was far from accumulating the capital of a complete life cycle).[12] It was

[11] During the government of Jupee in France and in the first mandate of Berlusconi in Italy, the pension reforms proposed without consultation of interested civil organizations faced massive protests. Practically identical reforms were approved later in the governments of Amato and Dini in Italy, as both negotiated with trade unions and other organizations. In Uruguay, the pensioners lobby joined the left wing and blocked the total privatization of the pension system (Esping-Andersen, 2003).

[12] A pension system is generally considered "mature" when it has existed long enough to have had the same contributors enter the system (as young workers), and retire as pensioners.

amongst these countries that the privately funded systems had greater appeal. In 1990, Australia, Denmark, Switzerland and the Netherlands had already created universal or semi-universal fully funded regimes. The UK restricted its PAYG model and strongly encouraged adhesion to the privately funded pillar in 1986. Ireland never had a traditional PAYG system, and counts on a public system of basic pensions considered low (pension benefits represent 27% of the average industrial wage) and occupational private plans cover only about 50% of the work force.

The second group described by Pierson (2001) is composed by countries that already had mature or near-mature PAYG systems by the end of the 70s, such as many Western European countries and the Nordic countries (with the exception of Denmark), as well as the U.S. and Canada. In these countries the pension reforms recommended by the World Bank had few supporters. In some cases, there was a slight emphasizing of funded regimes and complementary pensions (Canada, Sweden and United States). However, in contrast to the radical reforms, the strategy of this group of countries has been to control the increase of pension expenses through partial and gradual reforms.

In continental Europe and in the Nordic countries (where structured PAYG systems exist), the consensus of workers organizations regarding the reforms has been a necessary condition for their implementation. Consequently, reforms in these countries have been less detrimental to the working population.

5. Consequences of Pension Privatization

The OECD published in 2005 and 2007, studies called *"*Pensions at a Glance*"* where they examined the varying and diverse pension systems of the different member countries.[13] The studies analyzed all mandatory pension plans of public or private administration (defined contribution or defined benefit).

The analyses below are based on these reports by the OECD (OECD, 2005 and OECD, 2007) as well as ILO data (Annycke, 2006). Both institutions make similar

[13] The OECD report "Pensions at a Glance" was first published in 2005 with the goal of becoming a biennial publication.

analyses, but the ILO covers a larger number of countries and asserts a more critical position regarding the privatization of pension systems. The ILO analysis considers the main pension system of each one of the 116 countries it looked at, while the OECD studies take into consideration all the mandatory systems.[14]

It can be concluded from the data of both institutions that privatization brought forth a general trend of reducing employer contributions (as an attempt to stimulate job creation), and increases in contributions of employees (maintaining or raising social revenues). It can also be noticed that governments spend huge amounts on tax incentives to encourage the use of private pensions. These trends certainly deepen the already fragile position of workers in the current economic scenario, not only because their participation in the contributions has increased, but also due to more restrictive eligibility conditions to retire, reduction in the real value of benefits, individualization of risks and high administrative costs of the privatized systems.

All the trends reviewed below had already become clear in the early part of the 2000s. In other words, by the time the current global economic crises hit the pension funds, these mentioned problems already existed. The crisis is only exasperating pre-existing vulnerabilities, deepening fundamental problems that can be described as follows:

A) Employee Contributions:

According to the ILO data (Annycke, 2006), it can be verified that from 1989 to 2003 despite the maximum contribution of employees decreasing by approximately 9%, the average contribution increased by 32,5%.

Table 2: Employee Contributions (% of Gross Wages)

	1989	1999	2002/2003
Average	4,15%	4,98%	5,50%
SD*	4,19	4,07	4,07
Maximum	24%	20%	21,75%

*Standard Deviation
Source: Annycke/ILO (2006)

[14] Both institutions base their studies on complete contributive periods, meaning the minimum number of contributive years that a participant needs to be entitled to a full pension.

Additional data showed that employee contributions have increased in all regions, but were particularly significant in Eastern Europe (with an average increase of 164%) and less significant in Asian countries (11% in average). The contribution increases in Eastern Europe are a result of the construction of new social security systems, following the dismantling of the former Soviet Union. The new systems included employee contributions, while in the previous Soviet system, only employers and the government had to contribute.

Also worth noting, is that in mandatory privately managed systems, the employee contributions increased significantly more than in programs managed by the public sector.

B) Employer Contributions:

According to the same research, the average contribution of employers in the 116 countries studied increased 26% between 1989 and 1999, less than the increase in the employee contributions (32,5%). Between 1999 and 2002/2003 there was a reduction of 3,6% in the average contribution of employers. Also, the highest employer contribution has decreased by 26%.

Table 3: Employer Contributions (% Gross Wages)

	1989	1999	2002/2003
Average	8,32%	10,89%	10,48%
SD	8,77	9,27	8,29
Maximum	50%	38%	37%

Source: Annycke/ILO (2006)

According to the database 'Social Security Programs Throughout the World', SSPTW (2006), the only cases of average employee contributions exceeding that of average employer contributions are in regimes of mandatory private pensions systems. In general, countries that have instituted private mandatory regimes have raised the contributions of employees while decreasing the contributions of employers. In countries like Chile, Peru and Bolivia, employers became completely exempted from contributing to the mandatory private systems.

The exemption of employer contributions goes against the ILO convention 102, article 71, which states: *"The total of the insurance contributions borne by the*

employees protected shall not exceed 50 per cent of the total of the financial resources allocated to the protection of employees and their wives and children."

The current highest employer contributions are found in East Europe and in the former communist countries. The lowest are found in Latin America and Africa.

Table 4: Average Contributions Post Paradigmatic Reforms[15]

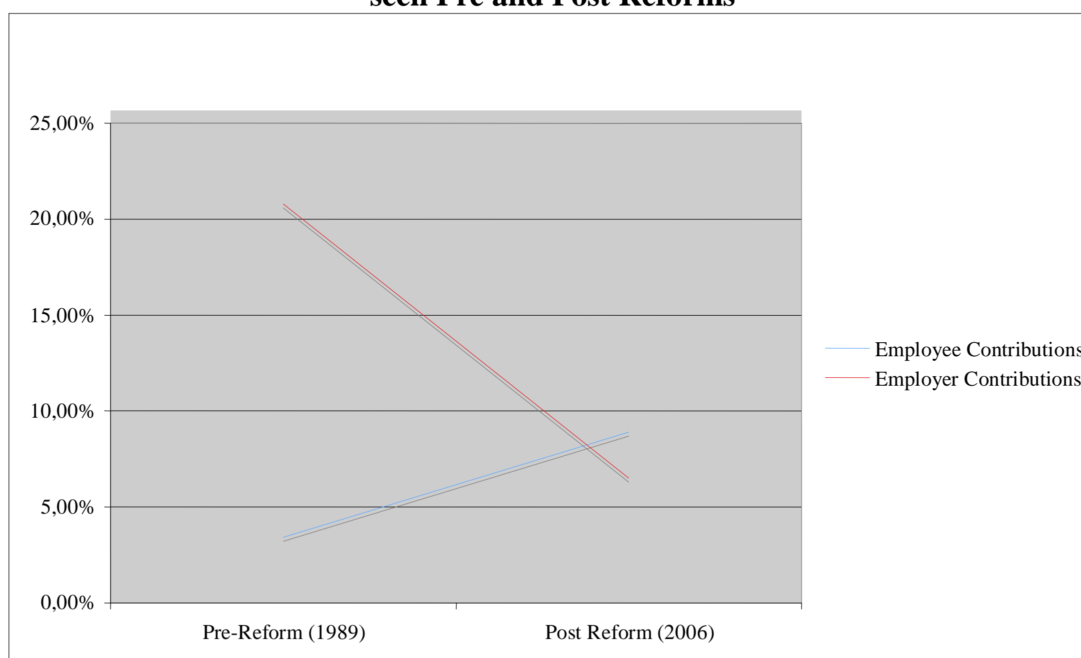
Country	Employee Contributions Pre-Reforms (1989)	Employee Contributions Post-Reforms (2006)	Employer Contributions Pre-Reforms (1989)	Employer Contributions Post-Reforms (2006)
Bolivia	5%	10%	3,5%	0%
Mexico	1,5%	1,125%	4,2%	5,15%
Peru	3%	13%	6%	0%
Kazakhstan	1%	10%	30%	0%
Hungary	10%	9,5%	43%	24%
Poland	0%	9,7%	38%	9,76%
Average	3,42%	8,89%	20,78%	6,49%

Source: ILO and SSW (2006)

Prior to the reforms in these countries, the average employee contribution represented 3,42% of the total contribution. After the reforms, this average raised to 8,89%. During the same time period, employer contributions dropped from 20,78% to less than the employee contribution, reaching 6,49%.

[15] The total contributions can also finance other insured contingencies such as spousal benefits, sick leave, maternity leave, disability pensions, etc.

Graph 1: Average Employer and Employee Contributions seen Pre and Post Reforms



Source: ILO and SSW (2006)

C) Eligibility Requirements

There is also a general trend of increasing the minimum retirement age for both men and women, and most countries have been setting the ages at the same amount.[16] The positive discrimination granted to women is being questioned more and more each day, especially because women have a longer life expectancy. Countries like Portugal, Japan and Bolivia have equalized the minimum age in recent years, while the great majority of the European countries have had equal minimum ages since the 1990s (OECD, 2005).

Most countries in the OECD use a minimum age of 65 years, but Denmark, Germany, Iceland, Norway, the United Kingdom and the United States have either already changed this to 67, or have plans to do so in the near future. By contrast, France, Hungary, the Czech Republic and Slovakia all intend to keep the minimum age below 65 years.

The positive discrimination can also be expressed in the demanded years of contribution. These differentiations were created considering that women usually have more interruptions in their professional/contributive lives due to family

[16] The minimum age here refers to the minimum age for a full pension benefit.

responsibilities (maternity and care of dependents). This differentiation for the minimum required years of contribution however, has also been decreased.

D) Benefits

The commonly used indicator to evaluate benefits is the replacement rate. As different regimes use different periods of contributions to calculate the value of their benefits, the data here considers the maximum share of the previous income that the pension benefit can represent. According to Annycke (2006), replacement rates increased until 1999 later falling until 2002/2003. In the OECD countries, higher replacement rates can be verified, but there was also a decrease in the average, minimum and maximum rates between the years of 2003 and 2004. The average rate in the period of one year (2003 to 2004) has decreased by 10%.

Table 5: Replacement Rates (Benefits as % of the Previous Income)

	1989 (ILO)	1999 (ILO)	2002/03 (ILO)	2003 (OECD)	2004 (OECD)
Average	64,65%	66,40%	65,29%	68,7%	58,7%
Minimum	25%	20%	20%	36,6%	31%
Maximum	100%	100%	100%	109,8%	96%

Source: Annycke/ILO (2006) and OCDE

However, it is important to notice that plans with defined benefits have become less and less frequent while there has been an increase in the number of plans based on defined contribution. This change has occurred especially in Latin America (Chile, Argentina, Uruguay, Mexico, Peru, Bolivia, Dominican Republic, Costa Rica and El Salvador) and former communist countries (Hungary, Poland, Kazakhstan, Latvia, Bulgaria, Croatia and Estonia). The defined contributions (DC) in private systems are invested in funds and the future benefits will depend on the interest rates (profitability of the funds), the volume of contributions and the administrative fees levied by the funds administrators.

According to the OECD (2007),[17] Greece has the highest replacement rate (96%) and the United Kingdom has the lowest (31%), with an overall average rate for the OECD economies of 58,7%. According to the 2005 report (OECD, 2005) the lowest

[17] The OECD research published in 2007 refers to data of 2004, and the research published in 2005 refers to the year of 2003.

replacement rate was verfied in Ireland (36,6%), and the highest was in Luxemburg (109,8%). It is also noted by the report itself that all the primary English speaking countries (Canada, Australia, Ireland, United Kingdom, New Zealand and United States) are below the OECD replacement rate average.

Table 6: Gross Replacement Rates before and after the Reforms

Countries	Pre-Reform	Post-Reform*
Austria	90,0%	80,1%
France	64,7%	51,2%
Germany	48,7%	39,9%
Hungary	57,7%	76,9%
Italy	90,0%	67,9%
Mexico	72,5%	35,8%
Portugal	90,1%	54,1%
Sweden	78,9%	62,1%

Source: OECD (2007) *In the year of 2004

Another trend can be noted: changing benefit calculations by increasing the contributive period considered. The readjustment of benefits according to price levels instead of wage levels has also become more commonplace. Additionally, countries like Germany, Portugal and Finland have even created formulas to reduce the level of benefits according to life expectancy increases.

- **Latin America & Chile**

6. The World Bank Influence on Latin American Pension Reforms

The World Bank lent its approval stamp to pension privatizations in 1994, when the document, "Averting the Old-Age Crisis: Policies to Protect the Old and Promote Growth" was published. Alleging that public systems were unsustainable and difficult to remodel, the World Bank (inspired by the Chilean reform) recommended reforms creating 3-pillar systems. The 3 pillars would be: a mandatory public system of basic benefits (with the objective of fighting poverty); a privately funded system of individual accounts (also mandatory); and a voluntary private system of complementary savings. The recommendations treated old-age pension problems as homogeneous, failing to distinguish between the developmental stages or social conditions of different countries.

The advantages of the 3 pillar system would be, according to the World Bank: the focusing of public transfers preventing the richest from benefiting from them; decreasing evasion and labor market distortions; the local stock market and economic growth would be stimulated; and the mixed system would diversify the involved risks in the public and private administration.

The World Bank went beyond carrying out studies advocating pension privatizations, as it also approved loans to privatize or remodel existing systems in countries like Peru, Mexico, Bolivia, Argentina, Uruguay and Brazil.[18]

Table 7: World Bank Loans to Pension Reforms
(1994-2001, in USD millions)[19]

	Structural adjustment[20]	Technical Assistance[21]
Brazil	1.262,63	5,05
Mexico	800	6
Argentina	300	22,4
Peru	1.100	0
Bolivia	0	28
Uruguay	100	0
Total	3.624,08	

Source: World Bank IEG (*Independent Evaluation Group*)

Although the World Bank loans for Structural Adjustment are conditional to local reforms in different sectors of the economy (agriculture, financial regulation, international trade, tax policies, etc.), many countries have submitted their economies to these conditions.

In the years before the World Bank loans of 1992 and 1993, many local groups had used consulting services from the Chilean pension fund administrators who delivered studies used to pressure local governments. To put this in some context, Chile's

[18] Not all Latin America countries received loans from the World Bank for their reforms. Among those that didn't are Chile, Colombia, Costa Rica and El Salvador (Valdés-Prieto, 2007).

[19] The data does not include loans from other international organizations, for instance the IDB (Inter-American Development Bank) that made significant loans to Uruguay. Also, WB loans prior to 1993, significant in Uruguay and Bolivia, are not included in this table.

[20] Loans for structural adjustments can be conditioned or not, depending on the macroeconomic indicators of the countries. The use of these loans is not restricted.

[21] These loans are restricted to specific objectives such as economic studies or consulting services.

privatization had gained great prestige and legitimacy when the elected government in 1990, that had initially opposed Pinochet's reform, announced that there would be no step backwards in the reform process.

A few years later, as the disastrous results of the privatizations were beginning to appear, researchers from the World Bank began to revise their positions. Joseph Stiglitz, back then chief-economist of the World Bank, stated that privatization recommendations had not achieved results positive enough to justify them and were part of a set of social security myths (Orszag and Stiglitz, 1999). Anrig and Wasow (2004) verified that in Chile, pension investment accounts had performed far worse than originally foreseen, forcing 41% of pensioners to keep working after their retirement. At the time, this situation was attributed to workers' difficulties to make contributions on a regular basis, and to the exorbitant commissions and administrative costs charged by pension administrators. Also, the transition costs to a privatized system had been excessively high.

By 2001, the World Bank had formally recognized that its advice had failed, and that poverty amongst the elderly population had increased significantly after the changes. As many had expected, the reforms had harmed self-employed workers (whose contribution to private systems is usually not mandatory) and those who spend significant part of their lives in the informal economy. Although there was recognition of the failure, the World Bank has never formally suggested revisions (Valdés-Prieto, 2007).

The report 'Keeping the Social Security Promise in Latin America' published by the World Bank and authored by Gill, Packard and Yermo (2005), also had a critical view of the reforms, but focused on the need to fix the problems of the privatized systems and assure that the funds were managed efficiently. Despite recognizing the importance of the public systems, the World Bank continued recommending that it should be limited to an assistance role, while income related pensions are managed privately.[22]

[22] The OECD however, recognizes that the systems after-reforms have reduced workers rights, placed them in more vulnerable positions and have increased poverty risks amongst aged. The average pension promise in the OECD countries has reduced 22% during the 90's (OECD, 2007b).

Both the World Bank and the OECD (OECD, 2007a) have been supporting voluntary private systems as an essential complement to the mandatory pensions. It is necessary to notice however, that the voluntary systems coverage is extremely different amongst different cohorts and social classes. In general, young workers, and workers of average and low income do not have regular voluntary savings.

The percentage of the population that contributes to voluntary systems in different countries is not known for sure, moreover, this information usually reflects the data for a specific moment in time. But the discontinuity of voluntary contributions is undoubtedly high. The World Bank usually recommends tax breaks to stimulate voluntary savings, but they have significant costs to fiscal revenues and there is strong evidence of their inefficiency.[23]

7. The Privatization in Chile

Chile was the first country in the world to privatize its PAYG pension system in 1981, in the midst of a privatization wave promoted by Augusto Pinochet's neoliberal dictatorship. Pinochet's government changed the prevailing paradigm and carried out a process of privatization in several different areas, reversing the universalization process of the previous Allende years,[24] and much of the social protection structure the country had counted on since the 1920s.

The first social security institutions created in Chile in 1925 were once considered one with the best social protection systems of Latin America (Lizana, 2004). In this country of late industrialization these achievements were only possible due to great struggles of the social movements and the mine workers organizations.[25]

This system was replaced as part of the economic plan called '*El Ladrillo*', greatly influenced by the Chicago School and its neoliberal views. These ideas guided Chile through one of the most profound state reforms in recent history, preceding the

[23] In general, those who can voluntarily save would do so with or without tax incentives, which are usually only advantageous for high income workers.

[24] The economic crisis of the early 80's interrupted and even reversed some privatizations. But when the crisis finished in 1984 and 1985, the privatization process was restarted.

[25] Mine workers included mainly those involved with copper and saltpeter exploitation (Lizana, 2004).

governments of Reagan and Thatcher. The 'Chicago Boys' influence made Chile's experience very distinct from other Latin American dictatorships, as it was fully in favor of free-market principles highlighting the promotion of an anti-statist culture. Opening of the economy (both commercially and financially), deregulating the labor law and decreasing expenditures on social policies, were all part of this processes.

In May of 1981, a radical and unique reform of the pension system was put into practice. Without a doubt, the previous pension system had several deficiencies that had made it expensive and difficult to administrate, in addition, the adjustment of benefits would regularly fail to keep up with inflation. The economic crisis of the mid 1970s certainly exasperated many of the inefficiencies and contradictions of the old system. An increasing unemployment rate, decreasing real wages and the consequently decreasing contributions, all helped deteriorate the pension budget. Although problems of previous pension system became more evident, its coverage was considered very high and in 1973, during its peak, it represented 79% of the working force.

The Chilean reformed pension system, introduced in 1981, was structured very differently. The main characteristics of the new system were based on the same 3 pillar system that the World Bank would later use as a base for their pension system recommendations (as discussed in section 6):

i) The first pillar would be composed of minimum basic benefits and would be financed through general taxes. It was meant to assist low income workers according to established eligibility criteria (*Pensión Básica Solidaria de Vejez* and *Aporte Previsional Solidario de Vejez*).

ii) The second and major pillar would be mandatory and have its contributions administered by private fund administrators (AFPs - *Administradoras de Fondos de Pensiones).* Workers would have to contribute 10% of their gross wages, which employers would be required to deposit into their individual accounts held with an AFP of their choice. The AFPs charge administration fees, and an additional 3,2% of wages for unemployment and disability insurance.

iii) The third pillar would be composed of voluntary contributions administered by private insurance companies and AFPs. Contributions and yields for this pillar were set up to have significant tax incentives.

The new Chilean system eliminated employer contributions, hoping that this labor cost reduction would lead to massive job creation (an expected result never proved to be true). The system was made compulsory for all workers in the formal sector and civil servants, while the self-employed could affiliate voluntarily.[26] As the new system was mandatory only for those entering the labour market, a complete transition was expected to take some time as people had to cycle out of the old system.

A separate institute, the INP (*Instituto de Normatización Previsional*) was created to assume the responsibility for pensioners and contributors that back then chose to remain on the old PAYG public system. Soares (2000) has estimated that barring any changes, it should take until 2038 before the INP no longer has contributors, forecasting pension obligations until around 2050. Today 792.000 pensions are paid from the INP, which still has approximately 103,000 contributors, according to the SAFP (*Superintendencia de Fondos de Pensiones*).

At the time of creation of the new system, the old system's debt was covered by fiscal resources. The fiscal burden also had to bear new tax incentives to stimulate migration to the new system as well as the payment of the "*Bonus de Reconocimiento*". These were lump sum bonus payments to workers retiring at the moment of transition in order to cancel the system debt with them, but these payments also increased the old pension system deficit.

The private system is regulated by the state, which sets up operational rules for the AFPs. Among them, minimum profitability rules tried to decrease investment risks (the profitability of each AFP cannot be lower than 2% less than the average). In case an AFP bankrupts, the state also insures the minimum profitability, guaranteeing

[26] Interestingly, the military and the civil police kept their old public systems. Was the risk too great for these functionaries of the dictatorship? Instead the risk was relegated only to working people who had little choice in the matter.

100% of the minimum pension and 75% of the accumulated capital up to a certain limit.

When the system first began to operate, there were 13 AFPs; today that number has been reduced to 5. Concentration is evident as the two largest AFPs (Provida and Habitat) have a market share of 66% of the contributors. The market concentration is partly justified by the economy of scale in the sector, since as the number of contributors increase the operational costs decrease. But of course the pulling power of an AFP also depends on the economic power of the financial groups behind it (like Provida, now owned by the BBVA group). The market concentration allows AFPs to increase their commissions and charges, making the system, in general, more expensive to contributors.[27]

Table 8: Number of Affiliated and Market Share of the AFPs – Sep. 2008

AFP	Affiliated	Market Share
CAPITAL	2.066.845	22%
CUPRUM	643.165	7%
HABITAT	2.238.604	24%
PLANVITAL	462.636	5%
PROVIDA	3.935.308	42%
TOTAL	9.346.558	100%

Source: SAFP

The AFPs are free to decide on their administrative fees, usually set very high. As this is their financing source and workers can choose and later change their AFPs, companies end up spending a lot on their marketing strategies. The AFPs usually charge a monthly commission (based on the contribution), a fixed administration fee and a percentage on programmed withdraws and transfers between different account holders. Additional commissions are charged on voluntary contributions (SAFP, 2009). According to CENDA (*Centro de Estudos Nacionales de Desarollo Alternativo*), one out of every three Pesos contributed to AFPs between 1981 and 2006, was kept by them.[28]

[27] The Swedish system of funds administration is seen by some researchers as a role model for Chile. In Sweden over 600 administrators (including a public company) compete and end up bringing prices down (CENDA, 2008).
[28] CENDA (2008) also criticizes the government for letting the AFPs increase their commissions twice during the current financial crisis.

Another serious problem of the system comes from a practice by employers who end up holding debts together with the AFPs. In these cases, employers simply retain their workers' contributions that are actually deducted from their salaries but never deposited into their AFP accounts. As the problem had worsened in the 1990s when several companies went through financial difficulties, a law was approved in 1999 (Bustos-Seguel Law) stipulating that a worker cannot be laid-off if the company owes contributions to his/her account. Even authors, who agree with the overall characteristics of the system, think that the operational rules need to be reviewed and the deposits should not be left to the employers (CENDA, 2008)

In addition to employer debt, the economic cycle certainly has influenced the performance of the system. The percentage of the population contributing has decreased with the increase of informality and self-employment. Many workers expelled from the formal sector ended up not contributing for long enough to grant themselves a minimum pension benefit. Another often discussed characteristic is that women have lost rights in the privatized system, as in the past they could retire at the age of 60 with the same rights as men at 65. In the AFPs, due to women's longer longevity, their pensions turn out to be approximately one third lower than a man's equivalent accumulated fund. What was supposed to be a virtue has instead become a problem.

The private pension system still exists today with essentially the same structure it had at the time of its creation, although some operational changes have been made. In 2002, a system of Multiple Funds (*Multi-Fondos*) was created (discussed further below), and during Bachelet's government new solidarity plans have been set up to assist those who otherwise would retire with a pension below the legal minimum. But the government has been criticized by several left wing lawmakers and academic leaders in the field, for not promoting a deeper reform.

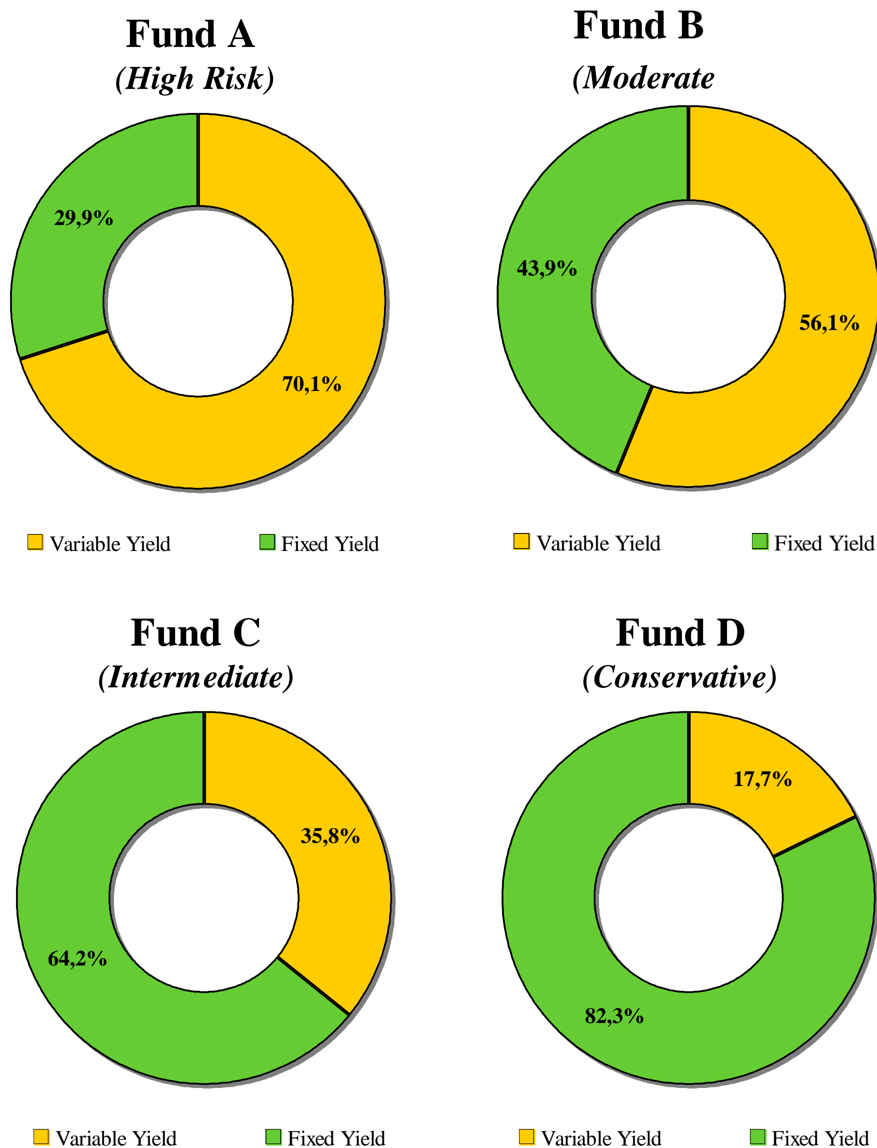
8. Pensions Funds and the Current Crisis

As already mentioned, under the new privatized system, workers' contributions are deposited into AFP's that administer their investments. Since August of 2002 both voluntary and mandatory contributions have been administered under a system of

Multiple Funds. The funds are divided in 5 groups (A, B, C, D and E) according to their maximum and minimum limit to make variable yield investments. The main objective of this change introduced in 2002 was to raise the expected value of pensions. It was also thought that the contributors would be able to choose better according to their risk preferences. It is mandatory that all AFPs offer the funds B, C, D and E.

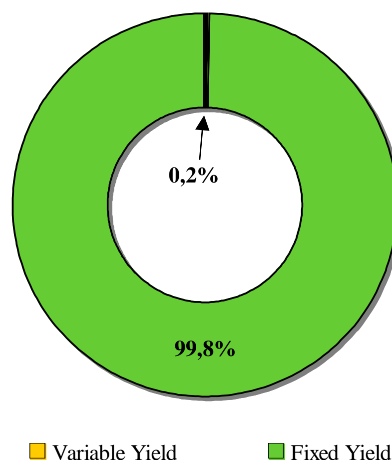
The graphs on the following page show the breakdown of investment between fixed and variable yields according to the five different funds.

Graph 2: Composition of Chilean Pension Funds



Fund E

(Very Conservative)



Contributors are free to select funds with their mandatory savings until they reach a certain age (55 for men and 50 for women), after which they can no longer choose the A fund. Once they begin to draw their pension, they can no longer select the A or B fund[29] though voluntary savings have no such regulations. Pensioners and contributors who do not make a choice are automatically allocated according to their age.

Table 9: Automatic Investment Options

	Men up to 35 Women up to 30	36 to 50 Men 36 to 55 Women	Men older than 51 Women older than 56
Fund A			
Fund B			
Fund C			
Fund D			
Fund E			

Source: SAFP

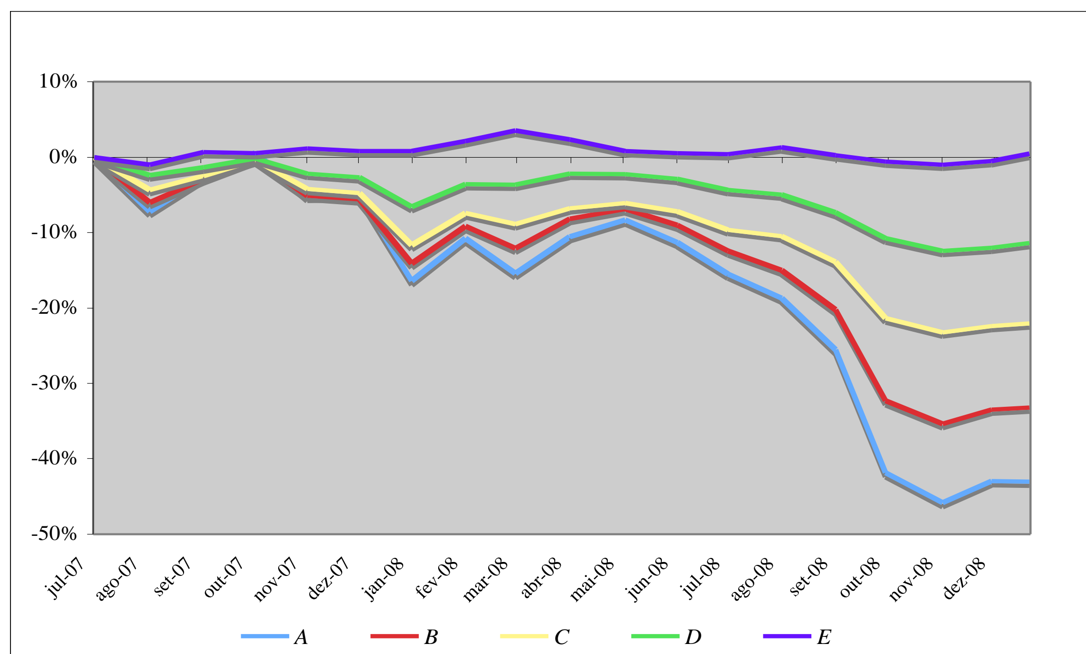
With the international financial crisis, any hope that the new Multiple Funds rule would generate higher pension promises, seems now further from reach than ever.

The failures of the AFP system have been worsened by the massive pension funds losses since the beginning of the current crisis. The funds with riskier portfolios have faced losses of over 30% (and over 40% in the case of the A fund). The C fund losses exceeded 20% and the D fund suffered losses of around 10%. The most conservative

[29] The migration between funds is charged when it happens more than twice a year (SAFP).

fund, E, has remained basically flat. The cumulative total lost in all funds is now over 27 billion USD (as of the 23rd of Jan. 2009).

Graph 3: Pension Funds Profitability since July 2007 (by Trimester)



Source: CENDA

To put these figures in perspective, one should also consider the percentage of contributors in each of the funds (investing through the various AFPs). The funds B and C, where the losses reached over 30% and 20% respectively, concentrate a significant majority of the contributors, representing over 7 million people. The fund with the lowest losses, the E fund, has only 1% of the contributors.

Table 10: Contributors per Fund at 20/09/2008

Fund	Contributors	Percentage
A	1.289.703	14%
B	3.694.770	40%
C	3.492.114	37%
D	786.770	8%
E	83.201	1%
Total	9.346.558	100%

Source: SAFP

Table 11: AFPs Financial Results in 2006, 2007 and 2008
(in Millions of Pesos as of Sep 2007)

	Sep 2006	Sep 2007	Variation	Sep 2008	Variation
BANSANDER	14.053.574	19.756.821	41%	-	-
CAPITAL[30]	-	-	-	648.601	-
CUPRUM	17.710.792	27.461.463	55%	7.097.383	-74,16%
HABITAT	23.737.652	34.204.377	44%	8.504.044	-75,14%
PLANVITAL	-1.594.870	1.637.962	103%	-2.491.697	-252,12%
PROVIDA	30.157.791	38.938.971	29%	-816.302	-102,1%
SANTA MARIA	7.525.715	11.783.268	57%	-	-
SISTEMA	91.590.654	133.604.797	46%	12.881.423	-90,36%

Source: SAFP

As it can be seen from the table above, the financial results of the AFPs have had very positive variations from 2006 to 2007. However, from 2007 to 2008, all the results variations were negative.

It is expected that only people who made significant voluntary contributions will retire with better conditions than they would have under the INP, even though the losses of the voluntary investments have also been significant. As it can be seen from the table below, the number of accounts with a balance over zero decreased slightly (2%), and the number of balances equal to zero have increased (3%). The total capital of these accounts by November 30th had decreased 34% (from 2007 to 2008) with liquid deposits also decreasing for the month of November (withdraws have not increased, but deposits decreased significantly). Also, the voluntary funds have suffered significant losses as most of this money was concentrated in the A fund.

[30] The ING Group bought Santa Maria and Bansander creating Capital in 2007.

Table 12: Voluntary Contributions to AFPs (2007 and 2008)

Funds	Balance=0 (Number of Accounts)	Balance >0 (Number of Contributors)	Total invested	Month Liquid Deposits
November 30th 2008				
A	77.390	162.639	133.951.421	-199.225
B	119.204	144.972	63.313.713	-702.679
C	385.889	392.691	131.569.195	-1.572.946
D	133.832	112.319	49.192.373	-1.165.931
E	13.086	40.302	84.610.350	-3.124.294
Total	729.401	852.923	462.637.052	-6.765.075
November 30th 2007				
A	63.969	196.630	332.722.400	-579.118
B	145.531	167.253	123.254.566	270.091
C	357.097	391.610	188.392.327	977.885
D	136.667	104.552	48.198.632	-6.528
E	5.470	10.987	17.150.041	-87.603
Total	708.734	871.032	709.717.966	574.727
Year Variation 2007-2008				
	2,92	-2,08	-34,81	-63,11

Source: SAFP

It is expected, due to the losses provoked by the crisis, that the number of contributors who will require the first pillar in order to retire (as contributions will not be sufficient to generate a minimum pension) should increase significantly in 2009. In other words, although the system was privatized, it is still the government who must bear the costs of failure.

In Chile, the elderly who do not fit neatly into the eligibility criteria for the government's first pillar are left to the social security programs aimed at those in extreme poverty conditions. The problem is that many of the nations' poor are caught in between the first pillar and the social security; they did not contribute enough to receive a state pension nor are they miserable enough to qualify for social security. To add insult to injury, social security eligibility is dependent upon ones' ability to verify and maintain their misfortune: several goods cannot be present in the household, such as TV sets or water heaters, goods generally common in houses of even poor families. According to Lizana's research (Lizana, 2004) if the option of moving back to the old system existed, approximately 90% of contributors would choose it, as it has now become clear that the majority of the pensions in the private system are not higher than those of the INP.

The individual account system created in Chile was meant to reduce the public deficits associated with the old system. However, the state has had to finance the transition, assist those who could not retire on the private system, and now, find a solution to the mounting losses provoked by the international financial crisis.

According to the recommendations made by CENDA to Bachelet's government, public measures should be taken to deal with the crisis, such as: requirements on all the funds to invest in safe areas until the end of the crisis, precise calculus of the real losses, a solution for those who have lost significantly and are on the verge of retiring as well as an authorization for contributors to migrate to the INP if they wish to. Also, according to CENDA, it would be important to evaluate the real liquidity of these funds and determine how solvent the AFPs truly are (CENDA, 2009).

v Conclusion

The Chilean model has inspired several countries, but 27 years after its implementation relevant deficiencies still persist. The mentioned problems of the private system were already evident before the financial crisis, as all the suppositions of the system have been proved wrong.

Besides the disappointing results in terms of coverage and costs, the idea of a privatized and individualized system goes against social cohesion and favors a fragmented society, as it gives people a sense of individual responsibility and risk. Aging, though, is not an individual risk but a natural process that needs to be treated collectively.

During the transformation of the post-war period, it was claimed that the state pensions based on generational solidarity of PAYG systems would place an unfair burden on younger generations, due to society aging. Private funded pensions, it was argued, would avoid this and should therefore be promoted while state pensions were being reduced. But the shift in the balance of provision towards the private sector has brought serious undesirable results. Private pensions could be a useful supplement to pensions if the state were providing reasonably adequate pension income, as it does happen in some developed countries (such as Sweden and the Netherlands). But the

privatizations the way they were carried out, have stepped over the principles behind the construction of the Welfare State, such as universalism and 'decommodification'.

The privatization trend of the 80's, 90's and even of the early 2000 years represented a reversion of the post-war construction, confronting its most rooted ideas of guaranteeing minimally decent life conditions through the state intervention in the economy.

The widespread and central reliance on private pensions has not only undermined solidarity between generations but it has also exposed workers to financial risks of the market. That is, pension systems that had always been vulnerable to economic oscillations are now unprecedentedly exposed to the risks of the economy financialization.

At this very moment, during the financial crisis, neoliberalism finds itself in a hecatomb only comparable to the crisis that in 1929 had buried classic liberalism. Governments have been intervening in the economy everywhere, now that it seems absolutely clear that capitalist markets are constructions in which the state plays a fundamental role.

Although the current scenario shows the public sphere stepping in to avoid even higher losses, solutions for worker's pension losses are yet to be seen. In Argentina, Kirshner's government has nationalized pension funds, hoping that the public administration of them would minimize contributors' exposure to the crisis. In addition to the pension losses, the labor market structural problems are deepened by the crisis, affecting the coverage of the pension systems and worker's capacity to contribute. As one worker, interviewed by Lizana (2004) in Chile, said: *"If you do not have a stable work or job, how can you think about retirement or make sure your monthly contributions are being made, when you don't even have something to eat?"*[31]

[31] The original quote has been translated from Spanish: *"Si uno no tiene trabajo o empleo estable cómo puede pensar en una pensión o tratar de pagar mensualmente o hacer su cotización, cuando ni siquiera tiene para comer?"* (Lizana, 2004).

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