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The Political Economy of Pension Reform: Latin America in Comparative Perspective

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In preparation for Geneva 2000, UNRISD is undertaking a wide-ranging inquiry into five areas of policy and institutional reform that are central to creating an enabling environment for social progress. These include initiatives related to financing social development; democratization and public sector reform; mainstreaming gender in public policy; strengthening the role of civil society; and promoting "people-centred" sustainable development. Selected papers from each thematic area are published in this series of Occasional Papers, and all papers are being synthesized in a special UNRISD report for Geneva 2000.

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Acronyms

AFP	Administradora de Fondos de Pensiones — pension fund management companies
ATP	Arbejdsmarkedets tillaegspension — Supplementary Labour Market Pensions
CEPAL	Comisión Económica para América Latina y el Caribe — Economic Commission for Latin America and the Caribbean
DB	defined benefit
DC	defined contribution
EUA	Estados Unidos de América — United States of America
FFI	private fully funded individual account
GDP	gross domestic product
GNP	gross national product
IDB	Inter-American Development Bank
IFI	international financial institution — institutions financières internationales — instituciones financieras internacionales
IMF	International Monetary Fund
IMSS	Instituto Mexicano del Seguro Social — Mexican Institute of Social Security
NBER	National Bureau of Economic Research
NDC	notional defined contribution
OECD	Organisation for Economic Co-operation and Development
PAYGO	pay-as-you-go
PLN	Partido de Liberación Nacional — National Liberation Party
PNB	produit national brut — producto nacional bruto — gross national product
PRI	Partido Revolucionario Institucional — Institutional Revolutionary Party
SSA	Social Security Administration
SSRC	Social Science Research Council
UNRISD	United Nations Research Institute for Social Development

Summary/Résumé/Resumen

Summary

Since pension schemes—along with health care and education—absorb the largest amount of social expenditure in all countries, their reform has a potentially major impact both on the fiscal situation of the state and on the life chances of citizens who stand to win or lose from new arrangements. This makes pension reform a highly controversial issue; and, except for the addition of new programmes and benefits, major restructuring of existing pension systems has been extremely rare in advanced industrial democracies. It was also rare in Latin America before the 1980s and 1990s. But there has been a great deal of experimentation within the region during the past decade. This paper examines the larger economic, social and political context of Latin American pension reform and compares experiences in different countries of the region with options available in Western European societies during the same period.

The authors argue that the type of pension reform undertaken in Latin America has been an integral part of the structural adjustment programmes pursued by Latin American governments, under the guidance of international financial institutions (IFIs). Although there was a range of possible remedies to the problems of pension systems in different Latin American countries, neo-liberal reformers and the international financial institutions preferred privatization over all others. They claimed that privatization would be superior to other kinds of reform in ensuring the financial viability of pension systems, making them more efficient, establishing a closer link between contributions and benefits and promoting the development of capital markets—thus increasing savings and investment. And they were able to push through some of their suggestions for reform in spite of considerable opposition from pensioners, trade unions and opposition political parties.

Interestingly enough, their pressure proved least effective in the more democratic countries of the region. In Costa Rica, for example, citizens preferred to reform the public system—eliminating the last pockets of privilege for public sector workers and ensuring that new levels of contribution would be adequate to provide minimum benefits for the aged and infirm. In Uruguay, citizens forced a public referendum, through which they rejected a proposal for privatization. At a later stage, they did permit the introduction of private investment accounts, but not at the cost of eliminating the public programme. In Argentina and Peru, after the legislature refused to authorize partial privatization, this was eventually pushed through by presidential decree. Only in Chile and Mexico has there been a complete shift to private pension funds—but, in both cases, influential sectors of the elite, including the military, have been allowed to keep their previous, publicly managed group funds.

Looking at the only privatized pension system in existence long enough to allow for some assessment of its consequences—that of Chile—the authors find that many of the claims made by supporters of privatization are not substantiated by the evidence.

The first discrepancy between neo-liberal predictions and the reality of Chilean pension reform has to do with *efficiency*. All previous claims to the contrary, private individual accounts have proven more expensive to manage than collective claims. In fact, according to the Inter-American Development Bank, by the mid-1990s administration of the Chilean system was the most expensive in Latin America.

The second disproved claim involves *yield*. When administrative costs are discounted, privately held and administered pension funds in Chile show an average annual real return of 5.1 per cent between 1982 and 1998. Furthermore high fees and commissions—charged at a flat rate on all accounts—have proven highly regressive. When levied against a relatively modest retirement account, for example, these standard fees reduced the amount available to the account holder by approximately 18 per cent. When applied to the deposit of an individual investing 10 times more, the reduction was slightly less than 1 per cent.

The third discrepancy involves *competition*. Although it was assumed that efficiency within the private pension fund industry would be associated with renewed competitiveness—while the public pension system represented monopoly—the private sector has in fact become highly concentrated. The three largest pension fund administrators in Chile handle 70 per cent of the insured. And to reduce advertising costs, public regulators are limiting the number of transfers among companies that any individual can make.

A fourth unfulfilled promise of privatization in Chile has to do with *expansion of coverage*. It was assumed that the existence of private accounts would increase incentives for people to take part in the pension scheme, but in fact this has not happened. Coverage and compliance rates have remained virtually constant.

A fifth major claim was that the conversion of the public pension system into privately held and administered accounts would *strengthen capital markets, savings and investment*. But a number of studies have recently concluded that, at best, this effect has been marginal.

And finally, the dimension of *gender equity* within a fully privatized pension scheme is being subjected to increasing scrutiny. Women typically earn less money and work fewer years than men. Therefore, since pension benefits in private systems are strictly determined by the overall amount of money contributed to them, women are likely to receive considerably lower benefits