2-11-2005

Chile's Privatized Social Security

LADB Staff

Follow this and additional works at: https://digitalrepository.unm.edu/notisur

Recommended Citation
Chile's system of partially privatized social-security accounts is leaving some workers and retirees scraping for other income sources while it does little to alleviate the federal government's fiscal burden. Even after almost a quarter century of private accounts, the advertised gains that administrators boasted would come have yet to materialize, and the Chilean government still pays more than a quarter of its budget to fund pension programs.

The poor performance of Chile's and other nations' under-regulated private-account systems has led the World Bank, long a proponent of privatized social-security programs, to recommend a reduction in the use of private accounts there, although the bank has not backed off the idea entirely.

The system of privatized pensions that former dictator Gen. Augusto Pinochet (1973-1990) put in place in Chile in 1981 has gained international attention since US President George W. Bush announced that introducing private accounts to the US Social Security system would be a top second-term priority for him. He pointed to Chile's system as a success worth emulating. Bush's proposal has yet to be described in detail, but the US president did go on a five-city campaign-style tour to promote the yet-to-be-assembled program.

**World Bank backs off unregulated privatization**

A dozen Latin American countries have taken up the World Bank's pension-privatization advice in one form or another (see SourceMex, 1997-02-05, and NotiSur, 1997-05-30) hoping to relieve the burden of tax-financed pension schemes on their national budgets. In a report released ten years ago, the bank laid out a three-pillar pension-reform scheme that called, first, for a tax-financed public safety net; second, for compulsory saving by workers, generally into individual pension accounts; and third, for voluntary saving for retirement.

Chile, under Pinochet, was the first country to try the reforms, forcing its citizens to become savers after 1981. The government handcuffed the domestic spending of future administrations since it then needed as much as 7% of its GDP annually to pay off the old system. The figure is now down to about 3%.

Now a new study from the World Bank, Keeping the Promise of Social Security in Latin America, does a partial about-face on its advocacy for privatized pensions in sections like "The Benefits of Hindsight." One major problem for the Chilean and other privatized systems is the excessive fees charged by private companies handling the investment accounts. The result has been that those with hindsight are saying the gains of the reform were oversold and are not delivering the benefits for individuals that the reformers promised.

Opponents of the reforms may not regard such outcomes as hindsight but as fulfilled predictions. The World Bank report calls for greater regulation of companies managing the accounts, some of which have charged rates as high as 20% to run pension investments. The bank also wants more attention to its first pillar, a comprehensive safety net.

In Chile, about half the labor force is covered, but in most countries that have privatized the rate is typically about 20%. If coverage remains that low, the reforms may not have lasting political support, since they are not creating a comprehensive system of income security for older citizens. In some countries, pension funds have been directed to invest heavily in government bonds, and tight restrictions have been put on investments in foreign securities. Workers in Argentina experienced large pension losses when the government defaulted on its debts (see NotiSur, 2005-02-04).

### Chilean system covers only half of population

Government officials, financial analysts, and the World Bank point to the Chilean program's success in economic terms, with high returns on invested accounts. But the government continues to allot billions of dollars to a safety net for those whose contributions were not large enough to ensure even a minimum pension approaching US$140 a month.

The self-employed, seasonal workers, and workers who gained most of their income in the informal economy remain outside the system altogether. Together, those groups constitute roughly half the Chilean labor force, meaning only half of workers are captured by the system. Even many middle-class workers who contributed regularly are finding that their private accounts burdened with hidden fees that may have soaked up as much as a third of their original investment are failing to deliver as much in benefits as they would have received if they had stayed in the old system.

One of the people with that problem is Dagoberto Saez, a 66-year-old laboratory technician who plans to retire in March because of a recent heart attack. Saez earns just under US$950 a month; his pension fund has told him that his nearly 24 years of contributions will finance a 20-year annuity paying only US$315 a month. "Colleagues and friends with the same pay grade who stayed in the old system, people who worked right alongside me," says Saez, "are retiring with pensions of almost US$700 a month good until they die. I have a salary that allows me to live with dignity, and all of a sudden I am going to be plunged into poverty, all because I made the mistake of believing the promises they made to us back in 1981."

Workers in the work force in 1981 could choose to stay in the old system; those entering the work force after that had to opt for the private accounts. "What we have is a system that is good for Chile but bad for most Chileans," said a government official who specializes in pension issues and
who spoke on condition of anonymity to The New York Times, fearing retaliation from corporate interests. "If people really had freedom of choice, 90% of them would opt to go back to the old system."

**ECLAC: Pension reforms work against women**

Researchers from the Economic Commission for Latin America and the Caribbean (ECLAC) say changes to Latin American pension systems have heightened gender-based discrimination and will lead to greater poverty and vulnerability among women if corrective measures are not adopted. Sonia Montano, head of the ECLAC Women and Development Unit, and Flavia Marco coordinated studies in six regional nations, concluding that new privatized systems work against women because they face higher levels of unemployment, earn lower salaries, and are often employed in the informal sector, for example, as domestic workers.

Several authors laid out this thesis in the book Pension Systems in Latin America: A Gender Analysis, published by the Santiago-based UN agency. Since women earn less than men, their pension-fund contributions are also lower, as are their pension payouts once they retire. Another form of discrimination is that pension payments are determined in accordance with life expectancy at the time of retirement. Because women tend to live longer, their monthly payouts are calculated over a longer period, resulting in a lower monthly income.

The ECLAC studies also say that more than 50% of women in these countries will not receive pensions because they have spent their lives as homemakers, without paid employment. They will only be eligible for widow's benefits. "In this way, women subsidize a system that excludes them, contributing their unpaid labor to caring for the family while their husbands work outside the home," Marco says. The research also finds that the situation is particularly difficult for women who live in rural areas and who tend to be poor.

Maria Ester Feres, former director of the Chilean Department of Labor, says that rural women who are only employed during the planting or harvesting season would have to work 80 years to accumulate a minimal pension. Most of these women work only three to five months a year and are often the heads of single-parent families. Not surprisingly, they comprise one of the poorest sectors of society.

**Bush versus Pinochet, voluntary versus mandatory**

One difference between the Chilean system and the currently proposed US system is that President Bush claims that entry into the private accounts will continue to be voluntary rather than mandatory. Critics say this will still divert large sums away from the US Social Security system and be very expensive for taxpayers, just as the Chilean system has been. Presumably all of the cost would be borrowed, vastly increasing a swollen budget deficit.

A senior Bush administration official put the cost from 2009-2015 at US$754 billion, with US$664 billion to pay benefits and US$90 billion for interest on the money borrowed. Peter R. Orszag, a Social Security expert who served in the Clinton administration, calculated that the program would
cost the government more than US$1 trillion in the first 10 years the accounts were in place and more than US$3.5 trillion in the second 10 years. The administration also has left many details of the proposal unaddressed, perhaps fearing that opposition would increase if it did clarify them. The president has not said what benefit reductions he favors.

An official who briefed reporters Feb. 2 spoke only of unspecified "benefit offsets" and did not say what the cuts would entail or how large they would be. The president has not addressed the cost to the government of paying full benefits to retirees for decades while tax money was being diverted into private accounts. Nor has he said how much this would increase the annual budget deficit.

There has been no mention of what would happen to workers who become disabled, currently 16% of Social Security beneficiaries, or the minor children of workers who die, now 7% of beneficiaries. No one in the administration has yet mentioned how workers who retired when the market was in a slump would be protected financially. Bush faces overwhelming public opposition at this point.

A CNN poll found that 93% of the population disapproves of handing Social Security services over to the private sector. A Wall Street Journal and NBC News survey said that half of those asked thought Bush's plan was "a bad idea." A coalition of corporations has been formed to boost the Bush plan. Companies like Boeing, Pfizer, and Fidelity Investments say they will spend "much more" than US$5 million to promote it.

-- End --