Chile's Fully Funded System: An Analysis of its Impact

On the State and the Society

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Introduction

The question of social security privatization is at the core of the international discussion regarding the future of social security throughout the world. Since Chile was the first country in the world to fully privatize its social security system, important lessons can be obtained from the 20 year old Chilean experience. The purpose of this paper is to present an analysis of Chile's fully funded, defined contribution system. The paper will emphasize the impact of the reform on the state, the pension fund administrators and the insured.

The Financial Structure

The 1980 legislation introduced a number of substantial reforms which changed the very basis of the financial system, altered the principle of solidarity, and reinforced individualism. It involved the elimination of employer's contributions to the social security system, and the transformation of the common fund into individual funds.

The reduction of the employers contribution to the pension system had began in 1975 when contributions were reduced from 43.3 percent of the taxable wages to 20.3 percent in 1980.[1] The 1980 legislation maintained only a 1 percent contribution to the workmen's compensation fund, and a temporary, 2.85 percent tax to finance the family allowance and the unemployment insurance programs. By 1988 all the employers contributions had been eliminated. The purpose of these reductions was to lower the cost of labor and in turn reduce unemployment rates. Employees and workers contributions to the system were also reduced, but only for those workers who transferred their social security funds to the new system, providing a very strong incentive to do so. The insured pays a 10 percent contribution to the old age pension system. Additional contributions of 2.5 percent to 3.7 percent are required to finance the invalidity and survivors pensions. The insured can also make additional contributions of up to 10 percent to augment the old age pension fund and they have to deposit another 7 percent of the wages to obtain health and maternity benefits. Consequently, the total compulsory contribution in the private sector amounts to 19.5 percent to 20.7 percent, while the contribution in the public sector is of about 27 percent.[2]

The large reduction in the contributions to the pension plan resulted from the reduction in social security expenditures that was mandated by the D.L.2448. Specifically, the elimination of the pensions based on years of service; the increase in the retirement age to 60 years for women and 65 for men; and the elimination of the *desahucio* or cash benefit paid in relation to the years of service produced a sizable reduction of expenditures. Better fiscalization and compliance with the laws will also produced an increase in revenues.[3]

The common fund system, *sistema de reparto*, which had been under the attack of the neo-liberals since 1974 was replaced by the individual capitalization fund, or fully funded system. For Píñera the common fund had not only failed to achieve its fundamental purpose, social solidarity, but it had generated and encouraged the inequalities, inefficiencies, and insufficiencies that characterized the whole social security system.[4] The elimination of the common fund system, in fact, complemented the elimination of the social security tax and established a system that might be defined as compulsory private insurance system.

There is little doubt that the prime reason behind the replacement of the common fund by the individual fund was s the individualistic ideology sustained by the regime. What Piñera calls the collectivist philosophy of the past is what had served as the foundations for the prevailing social narrative: the notion that the state could be used to bring about a better society for all. Pinera's argument was that the old system failed to achieve its goal and instead of creating a better society for all, it created a better system for those with enough power to get the benefits from the politicians. For the others it created simply a hope and also a deception; a myriad formed by unattainable benefits.

Why was the military excluded from the system? Here the issues of modernity and self-reliance were conveniently abandoned. It appears that in this case the old system was not as bad as depicted by Piñera. It is quite obvious that the military would rather have the safety and security provided by state instead of the uncertainty of a system based on one's personal effort. That the military acted as an interest group within the regime it is also quite obvious.

The Administrative Reform

The principle of subsidiarity of the state; the need to enhance the role of the private sector; and the need to improve the administration led Píñera to argue that the social security funds should be put in the hands of the private sector. The administrative reform was expected to reduce the administrative costs and integrate the social security system into the national economy.

It is important to note that for the government economists one of the major obstacles to

Chile's economic development, and one that the market approach had proven unable to resolve was the low savings rate. The low savings rate resulted from the underdevelopment of the local capital markets. The social security reform was crucial both for the development of the capital markets and to achieve economic growth. As Martin Cóstabal argues.

> The growth of the capital markets produced by the new pension system will be oriented, by and large, to produce long term effects. The long term characteristics of the social security savings will be geared to develop long term credit instruments, which would contribute to structure a more integral capital market, something we have not had until now.
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> The development of these long term capital markets would bring stability and longer terms to the credit system, improving credit conditions for activities such as housing, and for medium and small entrepreneurs, who are intensive credit users.[5]

The transference of the administration of social security funds to the private sector involved the creation of a new type of enterprise: The Administadoras de Fondos de Pensiones, or A.F.P. (Pension Funds Managing Corporations). They are exclusively charged with the administration of the individual funds and the provision of the social security benefits established in the law.

In order to understand the nature and functions of these new private entities, one has to keep in mind that the D. L. 3500 contains both free market and regulatory principles. The free market principles encouraged the formation of a plurality of A.F.P. that would compete among themselves, offering the highest interests in the capital accounts, and charging the lowest commissions. The A.F.P. is a lucrative corporation, whose profits results from the commissions they charge for the administration of the funds. Originally, those commissions could be structured, either as a flat rate, as a percentage of the insured deposit, or as a combination of both. In order to insure efficiency and the lowest commissions, the insured was free to more from one A.F.P. to another.

Given the underdevelopment of the Chilean economy, and especially the underdevelopment of the capital markets, the state chose to regulate the investments of the newly created corporations. The law establishes that each A.F.P. has to maintain two separate funds: a minimum capital fund required to establish an A.F.P., and a second one formed by the individual deposits. The law also prescribes investment policies and the profitability of the latter fund.[6]

In regard to benefits, the 1980 legislation and the modifications to the law approved in August of 1987 established that once the basic requirements to obtain a pension has been fulfilled the pensioneer has three different options: a) to buy an immediate life annuity from an insurance company with the funds accumulated in the account, b) to obtain the pension directly from the A.F.P. However, in this case the capital fund has to be large enough to provide for a pension that is at least equal to 120 percent of the value of the minimum state pension and c) to combine a temporary annuity paid by the A.F.P. with a deferred life annuity bought from an insurance company. In the case of disability and survivors pensions caused during the active life of the insured, the pension received by the beneficiary is a proportion of the taxable income of the last 12 months, fluctuating between 50-100 percent of the taxable income. The benefit is paid by the A.F.P. directly.[7]

Finally, the D.L. 3500 created a system of minimum pensions for those affiliated to the new system to be applied in case of depletion of the individual capital account, or if the rent produced by the fund is smaller than the minimum pension. In order to qualify for this pension the insured must have at least 20 years of contributions. The original value of the pension was about U.S. $45 monthly.

Launching the Fully Funded System

Launching the new system involved the actions of both the private and the public sector: the former had to create the A.F.P. and the later had to make the affiliation to the new system compulsory for all those that became employed, for the first time, after December of 1982; and to ensure that all transference to the new system was permanent. The state also created two new agencies, the Superintendencia of A.F.P. and the Instituto de Normalización Previsiónal, or Institute for the Normalization of the Social Security System, charged with coordinating the transition from the old to the new system.

The launching of the reform on May 1, 1981, was followed by the massive adoption of the new system. In the first month, half a million people changed to the new system and by December of 1981 1,604,908 persons, out of an economically active population of 2,890,000, had moved to the new social security system. Neither the government nor the leadership of the A.F.P.'s had predicted such large move.[8] Four elements seem to have prompted people to abandon the old social security system: a) a very expensive and well orchestrated propaganda campaign; b) the net increase in income of those that moved to the new system; c) the desperate situation of the pensioneers, and d) the pressure applied by some employers.

Both the A.F.P. and the government launched, what was the most expensive publicity campaign in Chile's history.[9] This campaign stressed the issues of modernity and self-reliance involved in the new system, as opposed to the politicization, chaos, and crisis involved in the old one. Just during the months of May and June of 1981 all of the A.F.P. spent over US $8 million in advertising.[10]The acceptancé of the new system can be explained in terms of the skillful propaganda campaign, the changes in societal values stressed in the publicity, and the importance of propaganda in the context of a tyrannical regime in which the society is deprived of alternative views or ideas.

The net salary increase obtained by those workers that chose to move the new system also contributed to the decision to move. The salary increase ranged from 7.6 percent, for those that belonged to the Blue-Collar Workers Fund, to 17.1 percent for the Bank Employees. The salary increase was well publicized by both the government and the A.F.P. It is reasonable to believe that the desperate situation of the retirees might have also acted as an incentive for people to move to the new system. The combined effect of several years of high inflation, declining real wages, and the system used to compute the pensions, had withered away their pensions.

The beginning of the new system was preceded by the creation of several A.F.P. However, the large degree of concentration of the Chilean economy, thwarted the free market principles that inspired the reform. Of the 12 corporations that were originally created, 9 of them were owned by Chile's largest economic groups and they covered 91.99 percent of the affiliates that changed to the new system.[11] Furthermore, the two largest A.F.P., Provida and Santa María, owned by the two largest economic groups, captured 63 percent of the insured. By the end of 1987, Provida had 30 percent of the affiliates while Santa María had 20 percent. By the end of 1998 1/3 of the insured were using Provida while about of the insured had their funds in Habitat. Santa Maria ranked third with about 1/6 of the affiliates.[12]

The Role of the State

The social security reform did not eliminate the role of the state as one might be led to believe by the neo-liberal rhetoric, but simply transformed it. The new role of the state exhibits three important characteristics. Because of the compulsory nature of the fully funded system, the state had to enforce the system. The law established that all the new workers are obligated to join while the old workers are forced to remain in it once they have decided to change. In order to enforce the new rules and facilitate the transition from one system to the other two new bureaucracies were created: The Superintendecia de Administradoras de Fondos de Pensiones and the Instituto de Normalizaci6n Previsional. From a financial perspective the role of the state changed and the reform entails a massive budget deficit.

The establishment of a state enforced private insurance system is certainly unique. Its creation reflects some of the contradictions that the application of neo-liberal principles with extensive state involvement can exhibit, especially in the context of authoritarian politics.

From an institutional perspective, the new system involved the creation of two new social security bureaucracies: the Superintendencia de Administradoras de Fondos de Pensiones, and the Instituto de Normalizaci6n Previsi6nal. The Superintendencia de Seguridad Social was maintained to control the old system.

The Superintendencia of A.F.P. was created to supervise and control the newly established A.F.P's., authorize their constitution, supervise the structure of commissions, control the pension funds, regulate the agreements with the insurance companies, and dissolve the A.F.P. in case of violation of the law. Why did a government create this new supervisory agency? The question is particularly relevant since the regime had done the outmost to reduce the size of the civil bureaucracy and reduce government involvement in the economy. Behind the stated technical reasons seems to be a political motive: to create an institution responsive to the needs and ideas of the neo-liberal economists, and to put an end to the life of the old superintendencia.[13]

The Instituto de Normalizaci6n Previsional has financial functions. It was created to facilitate the transition from one system to another. Its fundamental function is to administer a social security fund formed with all the funds received by the different Cajas. The old Cajas had ceased to be autonomous and are under the financial control of this institute. The creation of the institute is the culmination of a process of fiscal centralization that had began in 1978 and that drastically reduced the power and functions of the Cajas. The Instituto also administers the Bono de Reconocimiento, or recognition bond. The bond represents the number of years that the insured contributed to the old system and is given to the A.F.P. at the time of retirement invalidity or death.[14]

The Impact of the Reform

As Píñera correctly argued,

> The social security reform has been one of the most important steps taken by the present regime. It constitutes a new and original scheme which will contribute decisively to change the economic, social and political culture of all Chileans.[15]

The impact of this reform has to be analyzed in at least two ways: From an economic perspective, regarding both the public and the private sector of the economy; and from a socio-political perspective. In order to assess the economic impact we will look at data from the late 1980's and the late 1990's.

The Economic Impact

It is useful to distinguish two levels of the reform's economic impact: the impact on the pensions and on the general economy. Regarding the first we will look at the reform's effects on coverage and the value of pensions, as well as, the impact on women. Regarding the second one, the analysis will focus on those areas identified as critical by the proponents of the reform such as the impact on the state, and on the capital and labor markets.

The question of coverage under the new system appears to be quite complex. While in the old system Chile had about 80 percent of the labor force covered in the new one the measurement of the coverage has been problematic. In 1996 the Superintendencia reported that 107 percent of the labor force was covered by the new system, and that figure did not take into account that 89 percent of the self-employed were not covered, that a small percentage remains in the old system, and that the armed forces have their own separate system. After a preliminary revision of the data the Superintendencia argued that the figures were marred by statistical deficiencies produced by the constant changes from one AFP to another one. The agency now estimates that about 80 percent of the labor force is covered and 90 percent of that is in the private system. However, this data is still being revised.[16] The data for 1998 indicates that the total number of people registered in the AFP system amounts to 5,966,143 while the active contributors to the system are 3,149,755. This means that only 62 percent of the insured was actually paying the monthly contribution, which entails a substantial reduction of the number of people actually covered by the private pension system.[17]

Since the basic statistics regarding coverage remain unclear it is impossible to analyze the impact of the reform in terms of coverage. Tentatively, one can conclude that the actual percentage of population covered has decreased due to the fact that only 62 percent of the insured is actually paying the monthly contributions. The self employed which, by and large, did not have coverage in the past remains outside the system.

The value of the pension received by the insured depends on the deposits made by the insured plus the interest accrued, less the commissions charged by the A.F.P. The pensions awarded under the new system are therefore the direct result of the level of wages and the real rate of capital return. Between 1981 and 1987 one observes at least two contradictory phenomena: the decrease in the real value of wages, which by 1985 were estimated to be 13 percent below their 1970 level, and the high real yield of the pension fund investments which in the average amounted to 13.8 percent per year. The situation changed dramatically in the 1990's. Between 1990 and 1998 the real value of wages increased by 35 percent.[18] On the other the real yield of the investments decreased. The performance of the pension funds has been quite unstable oscillating from a real yield of 28.6 percent in 1991 to -2.5 in 1995.There were moderate gains in 1996 and 1997 and the real yield was again negative in 1998 (-1.6 percent). The average yield since the inception of the system until December of 1998 has been 10.9 percent.[19]

A recent study indicates that the replacement ratio is 80 percent in the case of the old age pensions and 67.9 percent for those who opt for early retirement[20] On the other hand, the value of an average old age pension provided by the fully funded system is only slightly larger than the average pension provided by the old system. The old system pension equals 89 percent of the value of a pension in the fully funded system. In other words, the pension in the fully funded system is 12 percent higher than the value in the old system. However, in the case of disability, the pension provided by the old system is 23 percent higher than the pension provided by the fully funded system.[21]

The Superintendencia de Administradoras de Fondos de Pensiones, in 1987, estimated that the average value of a pension paid by the new system was 1.24 times higher than those paid by the old system, while the invalidity pensions are 2.23 times higher. However, it is important to note that by the time this estimate was done the A.F.Ps. had granted only 10,099 old age pensions and 12,383 invalidity pensions out of an insured population of almost 3 million people. By the end of 1998 the system was paying 290,000 pensions and the average value of a retirement pension was of about US$200, while the average value of an invalidity pension was about US $280.[22]

A very interesting issue raised by the reform is the question of gender inequities. The central issue here is that the reform reinforces the existing gender inequalities. To the extent that the value of the pension depends on the value of the wages, the years of contributions and the life expectancy after retirement, the situation of women is certainly worse than that of the male retirees. As Arenas de Mesa and Montecinos argue,

> "women should clearly understand that. .. every year in the labor market is considered in the calculation of their pensions. This means that women who take time off the labor market. . .will receive lower pensions than those who have worked without interruptions.
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> Women should also know that the actuarial factors used to calculate their pensions are different from the one's used for men's pensions. The pensions that women receive in the new system are lower than the pensions of men, because the average life expectancy of women is longer than men's life expectancy. Women should consider that although the system allows them to retire five years earlier than men, early retirement reduces even further the amount of their pensions."[23]

The government, the women, and those interested in women rights have entirely ignored this critical issue. The value of the pensions has a direct effect on the life of women and also on the state finances. One can expect that a very large number of women will not qualify for a retirement pension due to the fact that they earned less, took time off, or simply because they live longer than men and that they will have to obtain a minimum pension from the state. Consequently, women are being penalized and discriminated upon by the system and nothing has been done to remedy the problem.

The structure and size of the commissions charged by the A.F.P. for the administration of the fund also impinges directly on the pensions. Originally the law established that the A.F.P. could charge a flat rate, plus a percentage of the deposit to administer the fund, plus an additional commission geared to finance invalidity pensions which amounted to a percentage of the wages. Changes in the law introduced in January of 1988 eliminated the percentage over the deposit. Although this change makes it easier for the insured to know how much he or she is paying for the administration of the fund, it does not deal with the main problem in this area which is the regressive nature of the flat rate. For instance, at the beginning of 1988 Provida charged $954 to administer the fund when the taxable wage was $20,000 and $3,728 when the taxable wage was $100,000.[24] This regressive element affects not only the poorest sectors of the population, but it also has an impact on the fiscal deficit given the fact that the government has to subsidize those pensions that are smaller than the minimum pension.

1998 data indicates that the regressive effects and the high administrative costs continue. For instance for an insured with an income of about US $160 the administrative costs fluctuates between 25.6 percent and 37.9 percent, while the cost for an insured with an income of US $1,300 the cost fluctuates between 24.1 percent and 30.2 percent.[25] The data also indicates that in spite of the reforms and the freedom of the insured to move from one AFP to another one the administrative costs have not declined. "What has decreased is the premium for disability and survivor insurance which is managed by commercial insurance companies. . . the premium decreased from 1.22 percent to 0.62 percent from 1990 to 1998, but the commission rose from 1.73 percent to 2.34 percent from 1990 to 1995 and then declined to 2 percent (still higher than in 1990). Conversely, the commission for old-age insurance has oscillated but tended to increase in the long run. The net result has been rising or at best stagnant administrative costs, a strong indication that competition does not work properly."[26]

Strongly related to the question of commissions is the overall nature of the administrative system designed by the framers of the program. Essential to the reform was the notion that the private sector would create the pension fund managing companies and that the public will be free to choose among them, and to change from one to another one. Ideally this would create a system characterized by low administrative costs and high coverage and efficiency. In practice, the number of AFPs has not changed much. There are today thirteen AFPs (initially there were twelve) and the three largest concentrate 69 percent of the insured. The insured is permitted to change A.F.P.s as often as he or she wishes and the data indicates that people have massively changed from one A.F.P. to another one.

According to Mesa-Lago between 1984 and 1996 the proportion of insured changing from one A.F.P. to another one increased from 10 percent to 52 percent which amounts to a total of 1.3 million transfers. Since most of these changes are the result of the promotional activities of the A.F.P.s the key element in the change is the action and numbers of sales personnel involved in the process. The number of salespeople reached almost 19,000 by 1996 or one per 160 insured. The cost of this amounted to 37 percent of the total operating costs of the A.F.P.s and 60 percent of the commission charged by the A.F.P. to the insured.[27]

Perceptions about the efficiency of the A.F.P.'s have changed since the inception of the system. A survey conducted in 1987 indicates that the public image of these institutions is declining. For instance, over 50 percent of the interviewees indicated that they believed the state was more likely to pay a higher pension and an indexed pension than the A.F.P., while only 9 percent preferred to leave the administration of the pension programs to national private enterprises.[28]

It is interesting to note that during the 1980's the three largest A.F.P.s charged the highest commissions, however that has changed and currently they exhibit the lowest costs. During that same period the largest institutions had the lowest rate of return. Consequently, it appears that the selection was not made on the bases of performance or cost, but a s a result of the actions of the sellers and the publicity. It could also be the result of a generalized dissatisfaction with the performance of the AFPs

The economic effects of the reform have not been limited to the pensioneers; the reform has had also a large impact on the private sector at large, representing a huge transference of funds from the public to the private economy. By the end of 1985, the capital accumulated by the A.F.P.'s amounted to 9.73 percent of GDP and by the end of 1998 the capital accumulated in the hands of the A.F.P.'s was about US$30 billion which amounts to about 40 percent of the GDP.[29]

In order to protect the fund the law closely regulates the investment of the pension funds and establishes that the A.F.P.s has to distribute their investment among government instruments, fixed term deposits, mortgage bonds and stocks. By the end of 1985 42.6 percent of the funds were invested in government instrument, 35.3 percent in mortgage bonds and 20.5 in fixed term deposits.[30] In 1987, 1990 and in 1993 some of these regulations were modified in order to liberalize the investment opportunities, reducing the investment in government paper while increasing the investment in stocks and allowing investment in foreign stocks and bonds. By December of 1998 40.9 percent of the funds were invested in government bonds, 16.6 percent in mortgage bonds, 14.5 percent in stocks and 13.6 percent in fixed term deposits.[31]

The Chicago trained economists argued that the private pension system would be a critical element in the establishment of a local capital market. Although there is no question about the growth of the capital markets in Chile there is a strong debate about the role of the A.F.P.s in that process. Some analysts argue that the pension funds have had a critical role in that process, promoting foreign investment in the local market and reducing the foreign debt by transforming debt into a capital investment. Others argue that the growth of the Chilean capital market is not different from that of other Latin American markets during the same period and that the pension system did not make a strong contribution to that growth.[32] The most complete study to date has been made by Robert Holzmann. He suggests that the pension funds made the financial markets deeper and more liquid and that the pension fund activities enhanced efficiency and risk allocation. Holzmann's econometric studies also indicate that the overall impact of the pension fund on growth rates fluctuates between 1 and 2.9 percent.[33]

Finally, the expected positive impact on national savings is also a matter of intense debate and there is no conclusive evidence that the new system has had a positive impact on the rate of savings. In fact a recent study shows that the net effect on national savings has been negative since the fiscal cost was higher than the capital accumulation.[34]

Ministers Piñera and Kast argued that the elimination of the employers contribution would reduce the price of labor and that, in turn, would produce a drastic reduction of unemployment. The behavior of the unemployment rates between 1981 and 1985 show, that the social security reform did not produce this effect. Again, the neo-liberals seemed to have ignored the fact that the high unemployment rates were linked to the very nature of the economic model and its consequences. Unemployment was the result of the reduction in the size of the industrial sector due to the combined effect of the policy of trade liberalization, the reduction or elimination of subsidies to the industrial sector, and the reduction in the internal demand produced by the shock therapy. In fact, between 1975 and 1983 unemployment rates were at least 3 times higher than in the previous decade while the price of labor had dramatically decreased. Since unemployment was not the result of the price of labor, as Kast and others repeatedly argued, there was very little the reduction or elimination of the social security tax could accomplish. By the same token the growth of employment between 1986 and 1997 cannot be attributed to the social security reform, but to the modifications introduced in the model and the success of the export sector.

Unemployment has again increased since 1997 and in May of 1998 reached 10 percent is highest level in a decade. The main reason is the collapse of Asia's demand for copper, which accounts for about two-fifths of Chile's exports. Chile's exports of manufactures have also suffered due to the recession in Argentina and Brazil.[35]

The effects of the social security reform on the public sector are just as important as those it produced on the private sector. However, the financial impact of the reform on the fiscal finances was never estimated,[36] in fact, the social security reform is having and will continue to have a large budgetary impact, which will seriously affect the finances of the Chilean state.

The reform carries a budget deficit which is the result of the transference of the administration and payment of contributions to the private sector, while at the same time the state maintains a high level of expenditures. The transference of about 90 percent of the economically active population to the new system involved a net decrease of the government social security receipts which were previously received by the state. But this reduction in government receipts was not accompanied by a decrease in social security expenditures due to a number of reasons. First, in order to allow the A.F.P. to capitalize, the law established that they will not pay retirement pensions during the first five years. As a result, during those five years, the state was faced basically with the same social security expenditure, since workers close to retirement chose not to move to the new system.

After the first five years the state continues paying pensions to those who chose to remain in the old system and is has to pay also the *bono de reconocimiento* (or recognition bond) of those that begin to retire in the new system. This bond, which represents the number of years that the insured contributed in the old system becomes effective at the time of retirement, invalidity or death.[37]

The pattern of transfer to the new system added a new financial burden. Those affiliated to the civil servants fund, which required the largest state contribution, were reluctant to move to the new system, while those affiliated to the self-financed funds such as white collar workers and bank employees have moved in a very large proportion because of the increase in the take-home pay. In brief, "the state contributes to the private pension fund through two mechanisms: the recognition bond, that amounts to half to two thirds of the capital of those who are going to retire before the year 2000; and the difference needed to pay the minimum pension of those individual who at time of retirement do not have enough funds in the A.F.P.s. Furthermore, the state covers the deficit of the civil servant and armed forces funds, pays all the welfare pensions and the unemployment compensation; and the family allowances and the health benefits for the indigents."[38]

It is clear that built into the new system there is a large state subsidy and a large budgetary deficit. Estimates done by several social security analysts point to a deficit of about 4 or 5 percent of GDP. It is not clear either how the state is financing the deficit. According to Carmelo Mesa-Lago the state has three options taxes, public debt and combination of the above and up to 1994 the government has opted for the use of public debt, which in turn would increase the public debt to as much as 67 percent of GDP.[39]

In conclusion, the reform has not involved a reduction of government expenditures, but a very peculiar application of the principle of subsidiarity of the state, as the state maintains a secondary role only regarding the administration of the funds, but not regarding financial responsibility.

Social and Political Impact of the Reform

The unavoidable question from a social point of view is to what extent this reform altered the traditional social security principles. There is little doubt that, at the very least, the reform substantially transformed the principle of social solidarity since the new system is based on the notion of individual insurance combined with a social system of minimum pensions. In other words, providing for the old age is an individual responsibility, except in the case of the military personnel and the extremely poor. As the under-secretary of labor argued, the reform transforms the notion of solidarity both in its role and in its content. From now on, solidarity is not a fundamental notion, but a complementary notion and as such is not expressed in the entire system, but it is reserved for those cases in which the principle of individual responsibility cannot be applied as in the system of minimum pensions and the system of welfare pensions.

To a large extent, then, the reform has transformed the social security system into a private insurance system in which the state intervenes at two different stages, at the onset, by enforcing enrollment into the new system, and at the final stage by providing pensions to the military and to the lowest income groups.

From a political perspective, the reform has to be analyzed in the context of the other reforms enacted by the government between 1981 and 1982. It is clear that the neo-liberal economic model and the authoritarian regime converged in their need to disarticulate the entire society. It was especially important to disarticulate those groups perceived as having political power and the power to interfere with the free functioning of the market, such as organized labor, professional associations and the organizations representing white-collar workers and civil servants.

It is also clear that just like in the past there were groups favored by the system and others ignored by the system. However, due to the nature of the regime these interests groups acted from within the government. Very much favored by the reform are those who own or control the pension industry, as well as the major banking and publicity concerns involved in the reform. The real measure of their economic power is that they control more than 40 percent of the country's GDP. On the other hand, there are those with temporary, low-paying jobs, those that have to abandon the labor market either because of a downturn in the economy or for personal reasons, and those who are not even in the system. What is their freedom? I suppose they are free to choose between a state pension of about US$50 or no pension at all.

The real rate of return of the pension funds will also affect the size and impact of the budget deficit. Here a new study done by C.B. capitales estimates that the Superintendecy of AFPs has consistently overestimated the rate of growth of the pension funds since it has not considered the negative impact that the value of the commissions has on the funds. Since the average commission for 1998 was estimated to be 18 percent of the contribution, only 82 percent enters the fund. Consequently, the actual real rate of growth of the fund between 1982 and 1998 was 5.1 percent and not 11 percent which is the estimate of the Superintendency for the same period. According to the same study, if the affiliate would have invested in 90 days certificates of deposit.[41]

In August 1999, presidential candidate Ricardo Lagos declared that "during the next administration we are going to have to deal with the problem of the AFP... since the majority of the pensioneers will not be able to [save enough] obtain a pension that is equivalent to the minimum pension. Who is going to pay the difference? The state.[42]

CONCLUSION

The Chilean experience with a fully funded, defined contribution system indicates that this type of reform has profound effects on both the state and the society. The reform has entailed the elimination of the social security tax, the transference of the administration of the funds to private corporations and the creation of private medical insurance institutions. The state's role, on the other hand, has been transformed. The state pulled out from the direct management of the new funds, centralized the administration of the old ones, and it has continuously regulated the operations of both the old and the new systems. Most importantly this is a state enforced private insurance and the state has important supervisory and budgetary functions.

On the other hand, after 20 years of experience one can conclude that the pensions have not increased substantially, that women's pensions are much lower than the pensions of their male counterparts and that the role of the state has not been eliminated. The real winners have been the Pension Fund Administrators who control over 50 percent of the country's GDP.

Thus, as more and more countries face the dilemma of how best to provide for their ageing populations it will be very important to consider the costs and inequalities involved in the establishment of fully funded, defined contribution systems. As shown above, this type of system enhances social and economic inequalities, eliminates the notion of solidarity, does not reduce the fiscal cost, and has not increased substantially the value of pensions.

Endnotes

[1]José Pablo Arellano, "Elementos para el analisis de la reforma previsional chilena, Colección Estudios CIEPLAN, No. 6, Diciembre 1981, p. 11.

[2] Carmelo Mesa-Lago, La reforma de la seguridad social y las pensiones en America Latina: Importancia y evaluacion de las alternativas de privatizacion (Santiago: Naciones Unidas, Comision Economica para America Latina y el Caribe, 1994), p. 18

[3]José Pablo Arellano, Op. Cit., p. 15. The elimination of the Perseguidoras does not have a direct influence in the amount of the employer contributions since they were financed directly from General Revenues. Martín Cóstabal, "Efectos económicos de la reforma previsional," Gestión, Vol. VI, No. 64, 1981, p. x.

[4]Exposición del Ministro del Trabajo José Piñera en el "Saminario sobre Reforma Previsional y evaluación del Plan Laboral" Santiago, June 29, 1980, p. 2.

[5]Martin Cóstabal, Op. Cit., p. 64.

[6]For an analysis see, Ernesto Illanes, "Inversión de recursos del sistema de pensiones," Gestión, Vol. VI, No. 63, 1981, pp. 48-52; D.L. 3500, arts 37-45.

[7]See Texto Actualizado de las leyes que rigen la Previsión Social derivada de la Capitalización Individual, published in Superintendencia de Administradoras de Fondos de Pensiones, Boletin Estadistico, Noviembre 1987.

[8]Superintendencia de Administradora de Fondos de Pensiones, Boletin No. 12, p. 55. According to Minister Kast the speed of change was four times faster than that the one predicted by the government. El Mercurio, May 19, 1981, p. 26.

[9]Grafimatic reports that the cost os the publicity campaign in the first two months was around US $8 millions. Hoy, No. 213, August 19, 1981, p. 26.

[10] Hoy, No 213, August 19 1982. P. 26

[11]The remainder three belonged to the Copper Workers Association, the Teachers Association, and to the Chilean Builders Association.

[12]Carmelo Mesa-Lago, El desarrollo de la Seguridad Social en América Latina (Estudios e Informes de la Cepal, Naciones Unidas, Santiago, 1985), p. 114. Superintendencia de Fondos de Pensiones, Boletin Estadístico Mensual No. 74, Diciembre 1987, p. 17; Superintendencia de Administradoras de Fondos de Pensiones, Boletin Estadistico Mensual, No 148, Diciembre 1998, p. 57.

[13]José Piñera, Op. Cit., 1980, p. 12.

[14]La Segunda, March 10, 1981, p. 23.

[15]José Piñera, Op. Cit., 1980, p. 12.

[16]C. Mesa-Lago, 1998, Law Review, Brooklyn, p 782.

[17]SAFP, 1998, pp. 373 & 374.

[18]CEPAL, Balance Preliminar de las Economias de América Latina y del Caribe, Santiago, Diciembre, 1998.

[19]Superintendencia de Administradoras de Fondos de Pensiones, Boletín Estadístico Mensual, No. 77, Marzo 1988, p. 13 and No 148, December 1998, p. 340.

[20] Asociacion de AFP"Calidad de las pPensiones que entregan las AFP muestra ediciencia del sistema" Serie de Estudios, No 17, Sept 2001

[21] Superintendencia de Administradoras de Fondos de Pensiones, Boletin Estadistico Mensual, 2001, p 199

[22] Superintendencia de Administradoras de Fondos de Pensiones, Boletín Estadístico Mensual, No.74, pp. 42, 43 and 53 and No 148, December 1998, pp. 142 & 402. Data on the average value of a pension in the old system was not found.

[23] Alberto Arenas de Mesa and Verónica Montecinos, "The Privatization of Social Security and Women's Welfare: Gender Effects of the Chilean Reform" Unpublished Manuscript, University of Pittsburgh, 1996, p. 24.

[24] Superintendencia de Administradoras de Fondos de Pensiones, Boletin Estadístico Mensual, No 73, pp. 5, 6 and 11; Boletin Estadistico Mensual No 148, December 1998, p. 404.

[25] S A F. P. Boletín Estadístico Mensual, No 148, December 1998, pp. 28 & 32.

[26] Carmelo Mesa-Lago, "Pension Reform Around the World: Comparative Features and Performance of Structural Pension Reforms in Latin America" Brooklyn Law Review, Fall 1998, No 64, p. 786.

[27] C. Mesa-Lago, in Bonilla and Conte-Grand compiladores, 1998, p. 120.

[28] Centro de Estudios Públicos, Estudio social y de opinión pública en la población de Santiago, Dic 1986 - Enero 1987, Santiago, Documento de Trabajo No. 83, May 1987.

[29]A Iglesias, A Echeverría and P. Lóopez, "Proyección de los fondos de pensiones" in S. Baeza ed., Analisis de la Previsión en Chile (Santiago: Centro de Estudios Públicos, 1986) pp. 115-117.

[30]A Iglesias et. al., op. cit., pp. 117 and 118.

[31]Superintendencia de A.F.P., Boletín Estadístico Mensual, No 148, Diciembre,1998, p. 405.

[32]Alejandro Bonilla, "Informe de Misión Santiago de Chile," Ginebra, OIT, October 5-12; Carmelo Mesa-Lago, "Review of Chile, SAL III Condition: Pension System," Washington , D.C., World Bank, 1988; Colin Gillion and Alejandro Bonilla,"Analysis of a National Private Pension Scheme: The case of Chile," International Labour Review, 131:2, among others, argue that the pension program has not had the expected impact. For the opposite argument see Hernan Cheyre, La previsión en Chile ayer y hoy: Impacto de una reforma (Santiago, Centro de Estudios Publicos, 1991; Augusto Iglesias y Rodrigo Acuña, Chile: Experiencia con un regimen de capitalización 1981-1991 (Santiago: CEPAL/PNUD Sistemas de Pensiones en América Latina, 1991); Marco Santamaría, "Privatizing Social Security: The Chilean Case," Columbia Journal of World Business, No 27.

[33] Robert Holzmann, On Economic Benefits and fiscal requirements of moving from unfunded to funded pensions (Santiago, United Nations, Economic Commission for latin America and the Caribbean, 1997), pp. 41, 43 & 46.

[34] Alberto Arenas de Mesa, "Learning from the Privatization of the Social Security Pension System in Chile: Macroeconomic Effects, Lessons and challenges" Ph.D. dissertation, University of Pittsburgh, 1997, cited by C. Mesa-Lago, Brooklyn Law review, 1998, p. 787.

[35] The Economist, July 3rd 1999, p.30.

[36] Interviews with Professor Patricio Novoa, Ramón Covarrubias and Luis Orlandini. Also José Pablo Arellano, "Reformas al sistema de seguridad social chileno," Mensaje No. 291 (August 1980), pp. 412 and 413; For estimates on the deficit see, "Mas eficiencia en la Seguridad Social," Gestión Vol. VI No. 64, (1981), p. 19.

[37] José Pablo Arellano, "Evaluación de la reforma previsional" and Juan Alfredo García "Mercado de renta vitalicia y bono de reconocimiento in S. Baeza ed., Analísis de la reforma previsional, pp. 88, 89 and 176.

[38] Carmelo Mesa-Lago, La Reforma de la seguridad social y las pensiones en America Latina: Importancia y evaluación de las alternativas de privatización, (Santiago:Naciones Unidas,

Comisión Economica para América Latina y el Caribe, Serie de Reformas de Politca Publica, No 28, 1994), p.22.

[39]C. Mesa-Lago, Op. Cit., 1994, pp. 22 & 23.

[40]Interview with Mr. Patricio Mardones, Undersecretary of Labor, Santiago, August 1981.

[41] Que Pasa, Ibid, p. 63

[42] Que Pasa, Ibid, p. 62