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Reforming the pension reforms:

Argentina and Chile

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This article describes the most recent pension reforms in Argentina and Chile. The previous reforms, implemented in the 1980s and 1990s, aimed to improve long-term fiscal sustainability and institutional design of the systems, shifting part of the social and economic risks away from the State and on to participants. In recent years, the authorities in both countries identified the main problems facing current pension systems as inadequate coverage for older adults and the low level of benefits. The two countries have responded differently, however, owing to institutional and political divergences. In Chile, a lengthy participatory process resulted in a wide-ranging reform targeting medium-term effects through carefully calibrated adjustments. In contrast, the reforms in Argentina were made through a succession of corrections, with little public discussion of their implications or effects on coverage and fiscal needs.

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I
Introduction

Having pioneered pension reform in Latin America in the 1980s and 1990s, Argentina and Chile have recently undertaken a new round of revisions and adjustments to their retirement systems. This article describes key elements of the recent reforms, explains why and how they were implemented and discusses their potential effects and remaining challenges.

Chile was the first country in the region to make structural reforms to its retirement pension system in the early 1980s, based on a funded mechanism under private management. Wage-earners were required to participate in the system, while self-employed workers could join on a voluntary basis. In Argentina, the 1993 reform introduced a similar funded scheme, but without completely eliminating the defined-benefits/pay-as-you-go component. The Argentine reform was viewed at the time as more advanced than its Chilean counterpart; both the design process and political debate, as well as various technical aspects of the new system were considered sounder and more sustainable.[1]

While sharing certain design features, the Argentine and Chilean pension systems also suffered from a number of problems in common, such as low coverage rates, a structure of excessively high administrative costs, major uncertainty for participants and problems of equity. Some of these problems stemmed from macroeconomic and labour-market trends, whereas others were inherent in the system design itself.

Although many reports have been produced on the problems identified over the last 15 years —and several specific actions and small-scale reforms have been implemented— more fundamental reforms were postponed largely because of macroeconomic and political constraints. The more robust fiscal position prevailing in recent years, however, together with a political climate that was more amenable to reconsidering the role of the State, created conditions for proceeding with a new wave of reforms.

Although the reforms in Argentina and Chile over the last few years have a similar origin, the policy measures and processes sustaining them have been different, apparently reflecting institutional and political disparities between the two countries. Chile promoted public debate with widespread participation, to forge a broader consensus. In contrast, Argentina took a different course, in which the political process was limited, closed to debate and implemented through decrees or laws that were fast-tracked through the National Congress, thereby curtailing discussion on the aims, contents and effects of the proposed reforms.

This article has five sections. Sections II and III outline the workings of the Argentine and Chilean retirement pension schemes up to the middle of the current decade, and then go on to describe and analyse the recent reforms, their potential repercussions and outstanding challenges. Section IV discusses the implications of the political and institutional processes, analysing how and why the distinctive features of policy-making in the two countries have affected aspects of their recent retirement-pension policy. Lastly, section V puts forward a number of conclusions.

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[1] For example, Arenas de Mesa and Bertranou (1997) claim that the Argentine model displayed: (a) greater inter- and intra-generational solidarity; (b) relatively lower transition costs payable by the State; (c) higher coverage of self-employed workers; (d) a better defined regulatory framework; and (e) fewer gender inequities.

II
The reforms in Argentina

1. The Argentine retirement pension scenario up to 2005

The Argentine pension system is one of the oldest in the world, with origins dating back to the early years of the twentieth century. Following the creation of a number of occupational pension schemes, the system grew steadily until a major boost given by the Peronist government in the late 1940s triggered a rapid expansion of coverage. A few years later, practically all workers in Argentina (including wage-earners and the self-employed) were covered by a number of relatively generous partial capitalization schemes.

In the late 1960s a major reform integrated the various schemes into one, and the national government was given authority to run it. The new unified scheme was a pay-as-you-go mechanism with common parameters. Nonetheless, since the 1970s, the system has faced growing financial problems, and by the late 1980s further reform was clearly needed. Serious doubts regarding the fiscal sustainability of the system and debates on the role of the State in society resulted in a structural reform being introduced in 1993.

This section discusses the situation of the system up to the middle of the current decade, considering both design and operational aspects.

2. A brief overview of the system

Following the 1993 reform, the Argentine retirement pension system became a multi-pillar scheme featuring capitalization and pay-as-you-go components, public and private involvement in its management mechanisms, and a combination of the defined-benefits and defined-contribution models for calculating the pensions actually paid to retirees.

In no way can it be claimed that the changes introduced at that time constituted a "definitive" reform. Since the original law was passed in October 1993, some 850 new regulations on the retirement pension system have been approved, including 34 laws and 135 decrees. Although many of these were adopted to complement the original system design, the tendency was clearly to make short-term corrections and amendments.

The design of the Argentine retirement pension system in 1993 consisted of two basic pillars and a transition scheme.[2] In the second pillar, workers could choose between a fund capitalization scheme with individual accounts managed by private commercial companies, and a smaller pay-as-you-go scheme run by the State. The most important parametric reforms included a higher retirement age and a longer contribution history needed to receive a pension. The reforms also abolished special regimes which, for various reasons, set differential retirement conditions for certain occupations; and they promoted the integration of provincial schemes into the national framework. Lastly a complementary non-contributory system provided a basic income for older adults living in poverty.

3. Recent trends

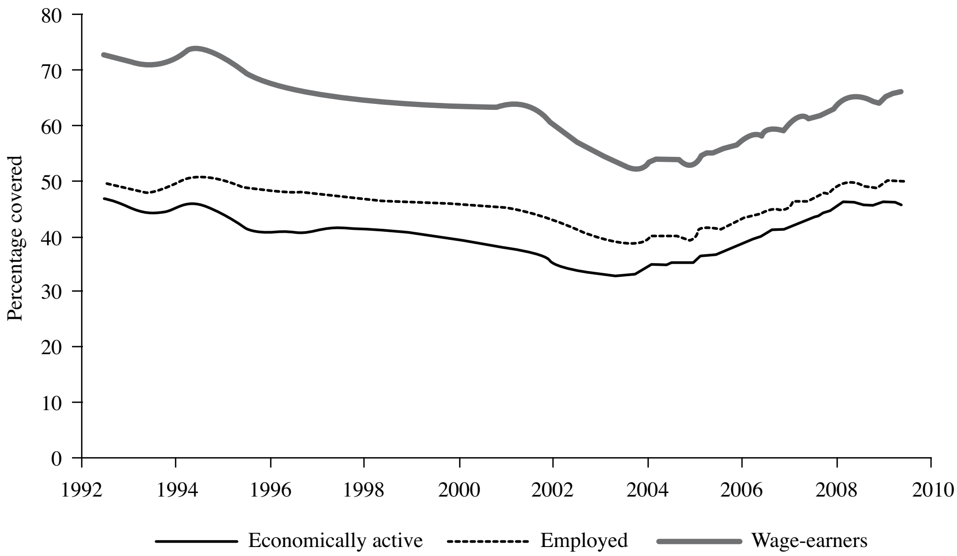
Following the 1993 reform, the Argentine pension system evolved closely in line with the macroeconomic trends prevailing in the country. The steady deterioration of labour-market conditions in the 1990s meant that fewer workers contributed to the system; the number of beneficiaries also shrank (although the older adult population was expanding rapidly); and the value of pension benefits remained broadly fixed. Pension assets collapsed in real terms in the 2001-2002 crisis, but have since been staging a recovery. The fiscal scenario was reflected in the trend of retirement pension benefits, because the average pension asset is the key determinant of the financial balance of the public system. Lastly, the financial situation of the capitalization scheme behaved extremely erratical, as a result of the economic and financial crisis in the first few years of the new century and various regulatory adjustments.

Argentina has maintained one of the region's highest levels of pension coverage throughout its history. Nonetheless, since the 1980s, as unemployment and informality began to spread, pension coverage started to retreat. Figure 1 shows that the proportion

[2] For a detailed discussion of its characteristics, see Rofman (2003).

FIGURE 1

Coverage of the economically active, employed, and wage-earning populations, 1992-2009
(Percentages)



Source: Rafael Rofman, Leonardo Lucchetti and Guzmán Ourens, "Pension systems in Latin America: concepts and measurements of coverage", *SP Discussion Paper*, No. 0616, Washington, D.C., World Bank, 2009; National Institute of Statistics and Censuses (INDEC), *Continuous Permanent Household Survey. First semester 2009*, Buenos Aires, 2009.

of employed workers covered by the system dropped from 50% in the early 1990s to under 40% by 2003.[3] Once the worst of the crisis had passed, coverage started to grow again, and by 2006 it was approaching late-1990s levels. Nonetheless, these coverage trends did not affect the various social groups equally. While the general deterioration in coverage in the 1990s did not affect the higher-income segment even at the height the crisis, it was catastrophic for the lowest income quintile, which suffered a drastic 40 percentage-point fall in coverage levels between 1992 and 2003. Since then it has regained just five percentage points.

While the coverage of active workers declined sharply in the 1990s, the impact on the coverage of older adults was slower. The relatively low contribution density of many workers (a study using 2002 data shows that most active workers in Argentina had fragmented and incomplete contribution histories, implying potential exclusion from future pension benefits), together with regulatory changes introduced in the 1990s, were the main determinants of this (Farall and others, 2003). A lengthening of the required contributions period to 30 years, in a clearly weakening labour market, affected many workers who were close to retirement. Consequently, the number of retirees under the national system fell from 2.1 million in late 1992 to 1.6 million in 2005.

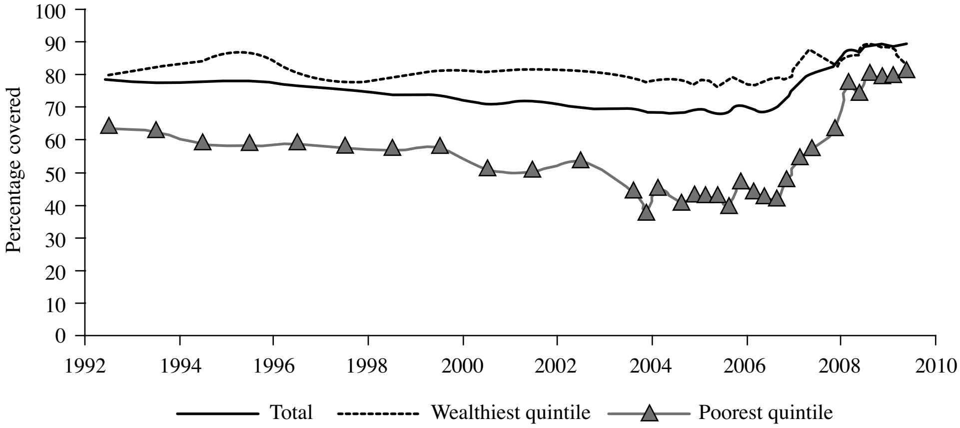
In Argentina, for every 100 individuals over 65 years of age, roughly 80 were receiving a pension in 1992; but this proportion declined slowly to reach 68% by 2003. Moreover, the reduction was not distributed evenly across income levels, but affected the poorest groups much more acutely. While older adults in the wealthiest sectors of the population did not suffer any significant change, the coverage of the poorest quintile fell from 63% in 1992 to a low of 38% in 2003 (see figure 2).

As figure 3 shows, the trend of pension fund assets was more stable in the 1990s. The average asset level rose slowly, but the minimum pension remained unchanged. After a sharp decline in the real value of pension benefits caused by the inflationary shock of 2002, the Government pursued an aggressive policy to raise the minimum pension. In 2003 this had already recovered its previous average values in real terms, and by the end of 2006 it was 65% above its level of five years earlier. In contrast, other assets

[3] Information on the coverage of pension fund assets in Argentina does not include the share pertaining to self-employed workers, so the coverage rates quoted for economically active and employed persons understate the true figures.

FIGURE 2

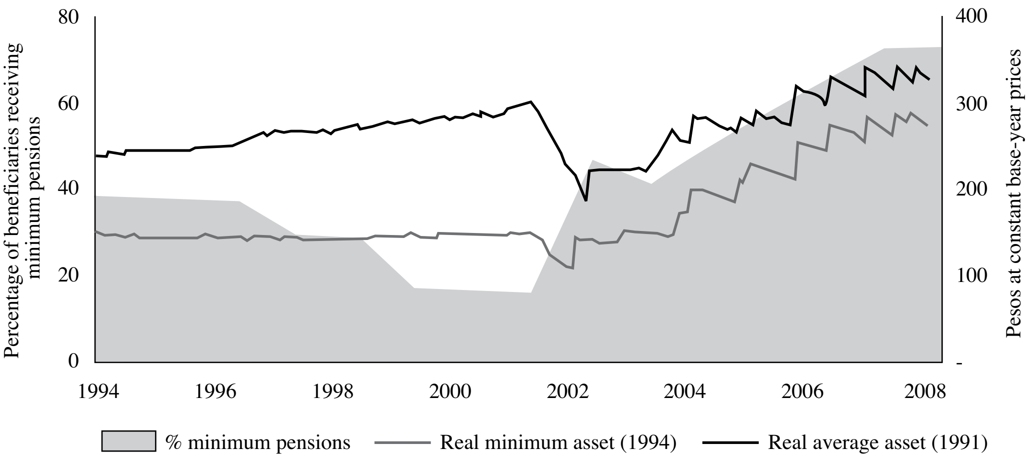
Coverage of the older adult population: total and by income quintile, 1992-2009



Source: Rafael Rofman, Leonardo Lucchetti and Guzmán Ourens, "Pension systems in Latin America: concepts and measurements of coverage", *SP Discussion Paper*, No. 0616, Washington, D.C., World Bank, 2009; National Institute of Statistics and Censuses (INDEC), *Continuous Permanent Household Survey. First semester 2009*, Buenos Aires, 2009.

FIGURE 3

Average and minimum benefits, and percentage of beneficiaries receiving minimum benefits, 1994-2008



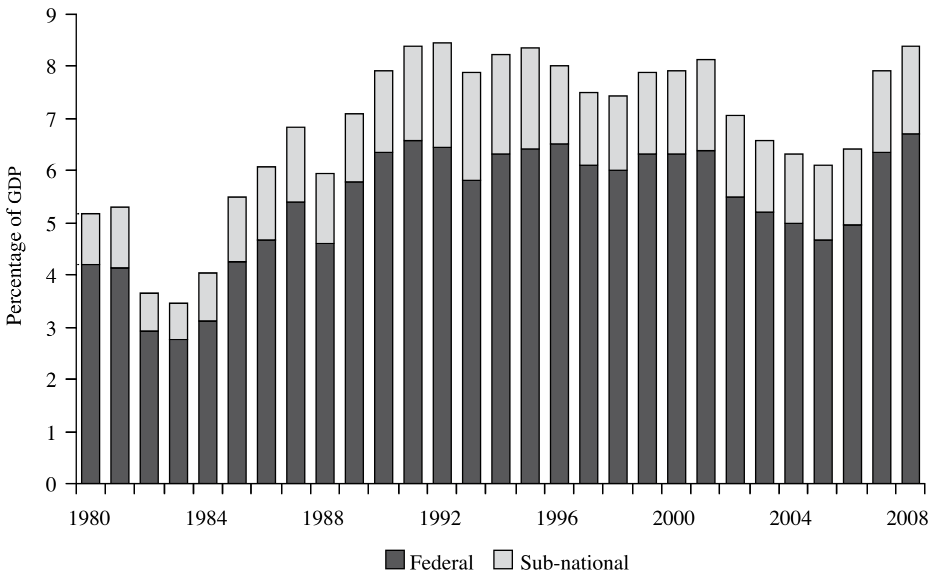
Source: Juan Martin Moreno, "Se acuerda, abuelo, cuando las jubilaciones en Argentina eran Bismarckianas?", paper presented at the IXth Argentine Seminar on Population Studies, 2007; Administración Nacional de la Seguridad Social (ANSES), *Social Security report. Fourth-quarter 2009*, Buenos Aires, 2009.

were only adjusted slightly, such that in late 2006 the value of the minimum asset was 83% of the average. Consequently, about 75% of system beneficiaries receive the minimum pension.

Figure 4 shows the trend of pension expenditure since the 1980s. The very sharp increase between the mid-1980s and early 1990s reflects government efforts to promote reform at that time. Once the new system was approved, total expenditure stopped growing and then dropped sharply in the wake of the 2001-2002 crisis and the freezing of assets until 2005. Since then, pension fund assets have recovered and coverage has expanded, and by 2008 expenditure was at levels close to the highs of the early 1990s.

FIGURE 4

Pension expenditure as a percentage of GDP, by jurisdiction 1980-2008



Source: Ministry of Economy and Public Finance (MECON), "Series de gasto público consolidado", Buenos Aires, 2009.

GDP: Gross domestic product.

4. Recent reforms and their potential impacts

Taken as a whole, the pension reforms recently implemented in Argentina aim to change the coverage and level of benefits provided by the system, along with its fiscal parameters, the roles played by the State and the private sector in managing the system, and also a number of regulatory aspects of the private scheme. The reforms were implemented through various legal instruments, including several decrees, laws and regulations. The main laws were Nos. 26222, passed on 27 February 2007; 26417, passed on 1 October 2008; and 26425, passed on 4 December 2008. In some cases, these regulations affect the provisions of earlier reforms. This section describes each of the changes in greater detail, and, where possible, estimates the expected short- and medium-term effects.

(a) *Coverage*

Affiliation reforms for active workers

Since the start of the decade, various amendments led to a progressive transfer of workers from the capitalization system to the pay-as-you-go scheme. The first sign of this trend was the restoration of special pension regimes for teachers, researchers, diplomats and justice officials — which had been abolished by decree in 1994, but had been a permanent source of litigation ever since. In 2001, the authorities restored the special scheme for diplomats and then did the same successively for the other regimes, so that by March 2005, the four programmes mentioned above were operating once again. In May 2007, it was decided that workers belonging to those regimes would have to pay their contributions into the public pay-as-you-go scheme, and roughly 174,000 contributors (1.5% of total affiliates in the capitalization system at that time) were transferred as a result of that ruling (SAFJP, 2007).

A second group of active workers who transferred to the pay-as-you-go system were individuals over 50 years of age (men) or 55 (women) who had less than $ 20,000 in their individual accounts. Law 26222 provided that those workers would be transferred to the pay-as-you-go system, unless they explicitly stated their desire to remain in the capitalization scheme. Between July 2007 and March 2008, about 1.1 million affiliates were transferred under this law, representing nearly 10% of all affiliates of the individual capitalization system (although no official information is available on how many of those affiliates actually made regular contributions to their accounts). The same law made it possible for workers to request transfer from one system to the other every five years, and provided that the first period in which that option could be exercised would last until December 2007. During those months, nearly 1.3 million affiliates chose to switch from the individual capitalization system to the public pay-as-you-go system.

These three measures jointly meant that about 2.5 million affiliates of the capitalization system (21% of total affiliates in late 2006) transferred to the pay-as-you-go system in early 2008. Many of them may have had highly fragmented contribution histories, but unfortunately no official information is available to verify this.

A final reform was introduced through Law 26425 in December 2008, which completely eliminated the capitalization scheme, transferring all contributors to a single public pay-as-you-go system. The transfer included beneficiaries of the private management system (unless they were receiving their pensions through a life annuity) and accumulated financial assets.

Reforms of coverage for older adults

Three major actions have been taken for this group of beneficiaries in recent years: (i) an easing of restrictions on access to non-contributory pension benefits; (ii) the pension moratorium programme, which enabled a huge number of older adults with insufficient or no contributions to the system to retire immediately; and (iii) an early retirement programme.

Argentina has had non-contributory pension benefits for many years, but access to these benefits has been restricted, both in terms of the effective conditions for obtaining those benefits (they were heavily rationed and those requesting them were put on a waiting list) and the low level of pensions they paid. Meanwhile, the coverage of the traditional retirement pension system among older adults steadily declined, and pressure grew to review the non-contributory scheme and make it more accessible.

In March 2003, the national government created the Senior Citizens Plan (*Plan Mayores*), a programme that sought to incorporate the over-70s into the Heads of Household Plan (*Plan Jefes y Jefas de Hogar*). A few months later, in August 2003, the restriction on the number of non-contributory pensions was eliminated, and this triggered a sustained increase in the total number of beneficiaries. Thus, in late 2006, the number of beneficiaries was more than twice that of three years earlier, while the real value of benefits had also doubled.

The second change, which introduced a massive pension moratorium programme, had greater repercussions. This programme enabled all individuals of minimum retirement age to apply for a retirement pension, by "paying" the contributions needed to satisfy the minimum system requirements. The key law in this reform was passed in December 2004, but the response was slow in terms of benefits granted until May 2007. Since then, application procedures and their processing has been speeded up, generating about 2.1 million new beneficiaries by mid-2009. Figure 5 shows how the number of pension beneficiaries grew until the mid-1990s, before stalling and then decreasing. Nonetheless, thanks to the moratorium, the total number of beneficiaries has grown rapidly since 2005.

Lastly, the third reform affecting coverage levels for older adults was based on the introduction of an early retirement scheme in December 2004. This enabled workers who had completed the minimum number of years of required contributions, but were up to five years younger than the established retirement age, to retire on a reduced pension. As of December 2008, roughly 46,000 workers had joined this programme.

(b) *Level of benefits*

In the case of pension payments, actions have been taken in three areas over the last few years. Firstly, minimum pensions have been increased significantly; secondly, the benefits expected by pay-as-you-go system affiliates have been altered; and thirdly, an automatic indexation mechanism has been reintroduced after 13 years for pay-as-you-go system benefits.

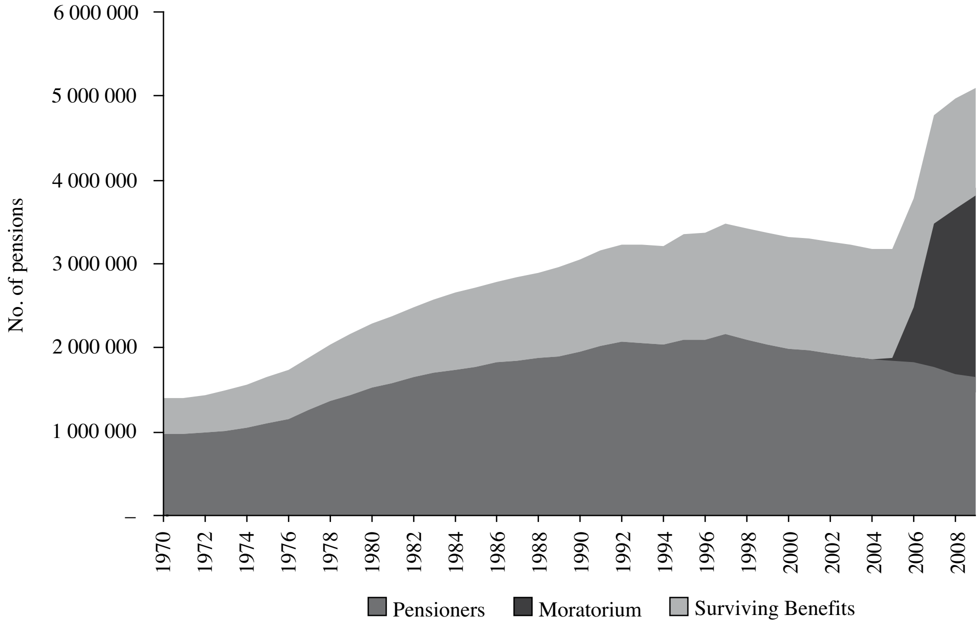
The key policy in relation to the level of benefits involved a sustained increase in the minimum asset level and, more recently, a discretionary adjustment in the other benefit scales. Figure 3 showed how minimum pension assets grew steadily in real terms between 2004 and 2007. By the end of that period, the real value of the minimum pension paid had doubled in relation to six years earlier. The other assets also grew, but at a slower rate, which caused a flattening of the benefits pyramid and weakened the contributory nature of the system.

The reforms made to the system in 2007 and 2008 also included increases in parameters corresponding to the additional benefit for permanency (paid to those who chose to remain in the PAYG scheme after the 1993 reform). Based on this amendment, the benefit corresponding to contributions made since 1994 increased by 76%.

Lastly, following years of political and legal controversy, the Government introduced an automatic

FIGURE 5

Pension benefits in the national system, by type of benefit, 1970-2009



Source: Administración Nacional de la Seguridad Social (ANSES), *Informe de la seguridad social. Cuarto trimestre 2009*, Buenos Aires, 2009.

pension asset indexation mechanism in 2008. This involved two annual adjustments in which all benefits of the pay-as-you-go system are increased in line with a composite index that takes account of wage increases and social security revenue. The law also provides that the same index will be used in future to raise benchmark wages for the purpose of calculating the initial benefit for workers taking retirement.

(c) *Investments of the assets of the public regime*

Thanks to an improvement of the financial performance of the public regime since 2003, the National Social Security Administration (ANSES) started to generate increasingly large surpluses. ANSES receives the contributions made by workers and their employers, together with other tax revenues that were assigned to it in the early 1990s to cover its deficit at that time. The surplus was generated by a rapid increase in pension contributions and tax revenues, while most benefits were increased by smaller amounts. In 2007, the Government created the Sustainability Guarantee Fund, to manage these surplus resources. When affiliates of the capitalization regime transferred to the pay-as-you-go scheme, the corresponding assets were deposited in this fund managed by ANSES. Law 26425 introduced additional regulations including the creation of a legislative supervision committee and a council with civil society representatives. The investment policies to be followed under the new reform were not regulated in detail in the law.

The Fund maintained a low profile until late 2008, when it received nearly 100 billion pesos, about 10% of GDP. Since then, the Government has made several announcements about the destination of these funds, including their investment in trust funds for consumer finance, automobile purchase, the financing of small and medium-sized enterprises, and others.

(d) *Potential fiscal effects of the reforms*

Owing to the political and institutional processes through which all of these reforms were adopted, there has been no formal and painstaking consideration of their potential short-or medium-term fiscal effects. None of the recent reforms was adopted in response to a fiscal need, nor was the topic aired through presentations or public debates. Until now, no agency or official organization has published a document or analysis on the short- and medium-term fiscal implications of the reforms; and official statements and references on the subject have been extremely vague.

Among the reforms implemented, transfers from the capitalization scheme to the pay-as-you-go regime and the moratorium seem to be the two most important elements from the fiscal standpoint. Naturally, the transfers had an immediate effect on the income of the public system. Firstly, the transfer of the balances of individual accounts to ANSES, between 2007 and 2009, meant an injection of assets valued at 100 billion pesos, equivalent to roughly two years of system outlays. Nonetheless, most of these assets are not liquid, so their short- and medium-term availability is limited. At the same time, the incorporation of some 5 million contributors to the pay-as-you-go regime, means an additional annual revenue for ANSES of 18 billion pesos (2% of GDP).

On the expenditure side, the cost of the moratorium programme was similar, so in the short term, the two measures would seem to offset each other. Nonetheless, the medium-and long-term effects are less clear, since they will depend on decisions made by future Governments on the possibility of keeping the moratorium scheme open quasi-permanently, or closing it (and consequently resuming a declining coverage trend).

The construction of a projections model that makes it possible to estimate medium- and long-term fiscal trends relative to the Argentine retirement pension system is a complicated task, but not impossible; and its preparation and dissemination should be one of the authority's priorities. A number of trends seem clear: the fiscal impact of the 2006-2008 moratorium will fade and eventually disappear in 15 or 20 years' time; whereas the positive fiscal effects caused by the closure of the capitalization regime should be offset as the number of retirees in the pay-as-you-go system increases.

III
The reforms in Chile

Twenty-eight years after the pioneering pension reform that replaced the traditional pay-as-you-go system with one based on individual accounts with a capitalization mechanism under private management, the Chilean National Congress passed a second comprehensive reform of the pension system in January 2008. This section will describe the political and social backdrop to this reform, analyse its main contents and preliminary results, and identify some of the outstanding challenges.

1. The Chilean pension system up to 2005

(a) *Overview of the system*

The current Chilean pension system can be divided into three main components: the poverty-prevention, contributory and voluntary pillars.

Prior to the 2008 reform, the poverty-prevention pillar was based on two programs: (i) the non-contributory assistance pension system (PASIS); and (ii) the State guaranteed minimum pensions system (PMG). The latter targeted individuals who, despite having contributed for at least 20 years to the individual capitalization scheme, had failed to accumulate the minimum amount needed to retire.

The contributory pillar was reformed drastically in 1980. The previous system was based on a series of pay-as-you-go schemes, with defined benefits calculated as a proportion of the wages received during the last period of employment. These schemes generated burgeoning deficits, reflecting major imbalances between the benefits promised and the contributions actually paid into the system. In 1980, the military government created a single national scheme based on individual accounts, in which each worker's savings were deposited and invested in financial instruments by specialized firms, known as pension fund managers (the AFP system).[4] These fund managers are free to set their commission for the various services provided (collection and recording of contributions, investments, calculation and payment of benefits, and assistance to the public); and individuals can opt to change their AFP at any time.[5]

Tax incentives are available for individuals who make additional voluntary contributions, through a special set of financial products, to supplement the

[4] Only military and security-force personnel remained in their previous pay-as-you-go systems.

[5] For a detailed description of the current AFP system see Berstein (2007), available at www.spensiones.cl. There is an extensive literature on the repercussions of the 1980 pension reform on coverage, financial development, national saving and economic performance. See, for example: Corbo and Schmidt-Hebbel (2003); World Bank (1994); Holzmann and Hinz (2005).

mandatory savings made in the contributory scheme. Funds can be withdrawn before retirement, but persons doing so are penalized through an addition to their income tax liability at the time of the withdrawal.

(b) *Recent trend in pension coverage*

As the Chilean pension system has been based essentially on the contributions paid into it by wage-earners in the formal sector, the contributory scheme is one of the key determinants of pension coverage. Since the early schemes in the 1930s, between 60% and 70% of the Chilean labour force has been affiliated to the pension system (Arenas de Mesa, 2000), although the indicator varies somewhat according to business cycles and conditions in the labour market. Following the 1981 reform, the available data have provided information on real contributions made and not just the number of workers affiliated. Figure 6 shows the proportion of contributors in the labour force, which has grown slowly over the last two decades.

Nonetheless, it has been claimed that the density of worker contributions, or the fraction of a person's working life for which he or she makes contributions to the social security system, is more important than contributory coverage. Figure 7 shows the distribution of this measure for Chilean men and women and highlights tremendous heterogeneity in contributory histories, which range from individuals who contributed throughout the entire period to those who hardly made any contribution at all. This heterogeneity is particularly notable among women, who display a clearly bimodal distribution, with a significant concentration at the two extremes (0% and 100%).[6]

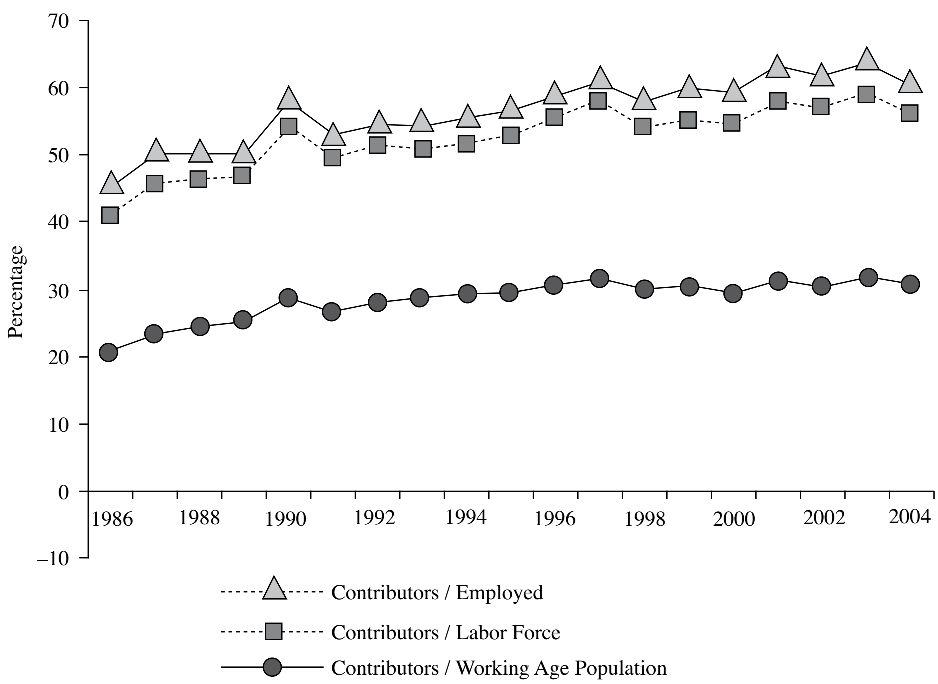
Lastly, figure 8 shows the distribution of coverage for older adults in the Chilean population. Half of all over-70s receive a pension from a contributory scheme (currently, most of this coverage is provided by pensions from pay-as-you-go regimes, but these will become less important as the new system gains maturity). The right-hand figure shows the different

[6] Contribution density was estimated on the basis of real data for 24,000 workers considered active while they were between 16 and 59 years of age.

FIGURE 6

Historical contributory coverage in Chile, 1986-2004

(Percentages)

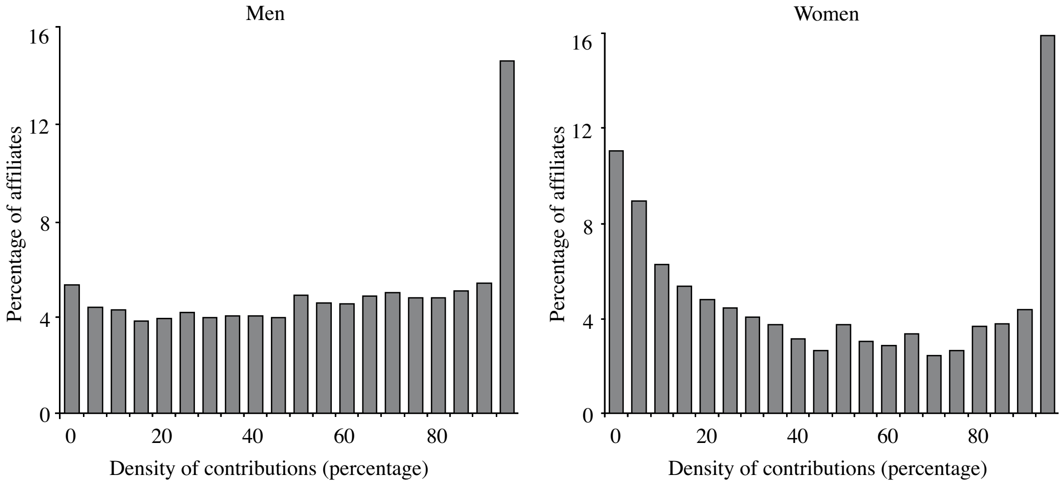


Source: Solange Berstein, Guillermo Larraín and Francisco Pino, "Chilean pension reform: coverage facts and policy alternatives", *Economía*, vol. 6, No. 2, Baltimore, Brookings Institution Press, 2006.

FIGURE 7

Density of contributions to the pension system

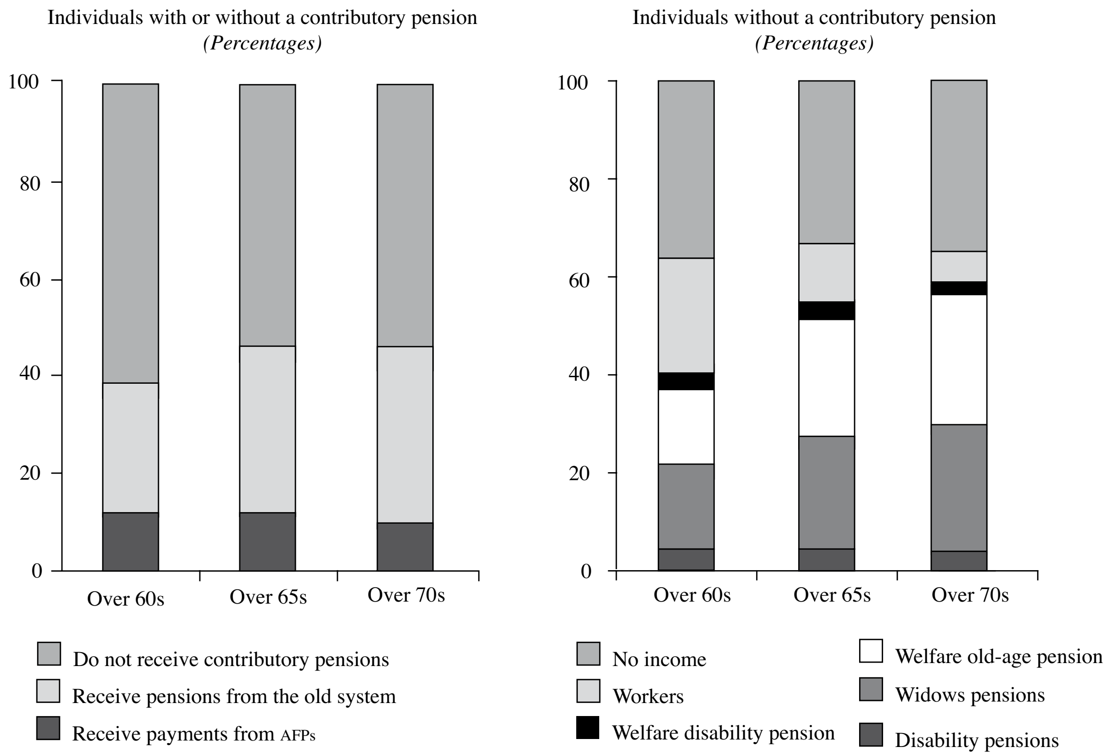
(Percentages)



Source: Solange Berstein, Guillermo Larraín and Francisco Pino, "Chilean pension reform: coverage facts and policy alternatives", *Economía*, vol. 6, No. 2, Baltimore, Brookings Institution Press, 2006.

FIGURE 8

Income sources in old age



Source: Solange Berstein, Guillermo Larraín and Francisco Pino, "Chilean pension reform: coverage facts and policy alternatives", *Economía*, vol. 6, N° 2, Baltimore, Brookings Institution Press, 2006.

AFP: Administradora de Fondos de Pensiones (Pension fund management firms).

income sources for individuals who do not receive direct pensions from the contributory scheme. As can be seen, assistance pensions, widows pensions and disability pensions provide some degree of coverage to around 60% of this group.

(c) *The political climate: Motives for the reform*

Several factors may have led the 2005 presidential candidate Michelle Bachelet to make pension reform one of her key campaign promises. Since the return to democracy, the centre-left coalition had won three consecutive elections promoting at least one important reform of the policies or institutions created during the 17 years of Pinochet government. Reform of the pension system, particularly its non-contributory component, was one of the outstanding debts of the coalition government. The demand for a reform to improve coverage was justified partly by studies on the subject published in 2005 and 2006, which suggested that a large sector of the population would be unable to finance a minimum pension and would not qualify for the minimum guaranteed pension.[7]

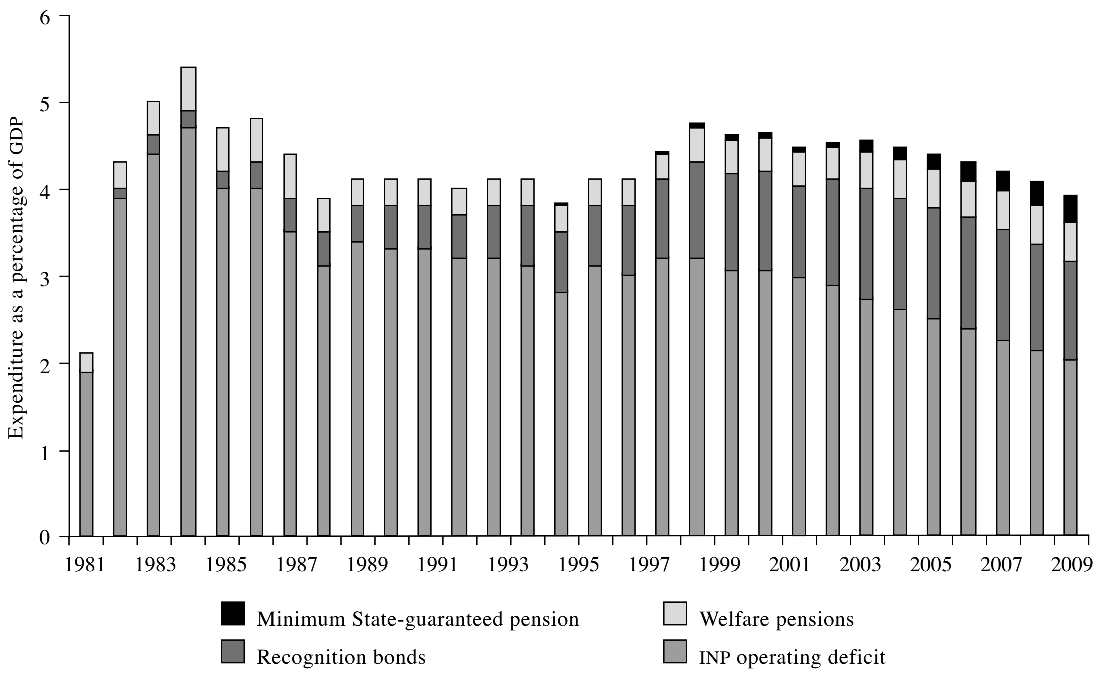
A second key factor in the decision to undertake a significant reform of the non-contributory component was the fiscal slack created by a gradual reduction in the transition costs generated by the original reform of 1980. As shown in figure 9, both the operating deficit arising from the gradual elimination of the pay-as-you-go system, and the liabilities contracted (through recognition bonds) with contributors to the old system who had transferred to the individual capitalization scheme, had already started to shrink by 2005. This provided an opportunity to introduce a broad social safety net for older adults.

Lastly, there was concern at the increasing concentration occurring in the AFP industry. Despite the extraordinary returns that participating firms were

[7] See Berstein, Larraín and Pino (2006) and Arenas de Mesa and others (2006).

FIGURE 9

Relation between pensions and fiscal expenditure in Chile



Source: Economic Commission for Latin America and the Caribbean (ECLAC), *La protección social de cara al futuro: acceso, financiamiento y solidaridad* (LC/G.2294(SES.31/3)), Santiago, Chile, February 2006.

earning on their assets, no new firm had entered the market for a long time, which suggested that price competition was not functioning adequately in this particular market. These were certainly some of the factors that influenced President Bachelet's decision to make reforming the system her main contribution to Chile's economic and social development.

2. The Chilean pension reform of 2008

In March 2006, the recently elected President Bachelet formed a presidential committee of 15 professional experts drawn from different areas related to the pension system, with a mission to produce a report making recommendations for reform.[8] Two years later, an exhaustive legislative bill was finally approved by Congress, which constituted the most substantial reorganization since the original 1980 reform creating the AFP system. The new reform maintained the original essence of the system, while introducing significant improvements to increase the coverage of the poverty-prevention pillar, improve gender equity, encourage greater competition in the AFP industry, and introduce a more flexible investment regime for the fund managers.

(a) *Description of the reforms*

— *Measures to improve the scope and quality of coverage of the pension system*

The individual nature of the AFP system creates a direct link between the frequency, timing and amount of the contributions made by an individual, and the benefits obtained. Benefits tend to be less when individuals fail to make contributions for long periods owing to occupational decisions or labour informality, if they enter the formal labour market late, or if they make contributions that are not proportional to their real income. Moreover, actuarial calculations suggest that longer life expectancy requires larger savings to allow for reasonable replacement rates. The additional savings needed could be generated by increasing voluntary saving, postponing retirement, or reducing the periods for which the pension is actually received. The 2008 reform addresses these problems through a series of measures, as described below.

— *The new solidarity pillar (NPS)*

The 2008 reform replaces the existing welfare pensions (PASIS) and minimum guaranteed pension (PMG) programmes, with a single scheme that guarantees all individuals over 65 years of age in the poorest 60% of the population access to a basic guaranteed pension irrespective of their contribution record.[9,10] This new programme pays old-age and disability subsidies financed by the State.

Individuals who have not made any contributions at all will be entitled to a basic old-age solidarity pension (PBS), if they are over 65 and satisfy the corresponding affluence and residency requirements.[11] Individuals whose contributions are sufficient to finance a pension below a given threshold, are entitled to receive a solidarity pension supplement (APS) subject to the same affluence and residency requirements.[12] The disability programme provides benefits under similar conditions, but its target population is individuals between 18 and 64 years of age. Once disabled persons reach 65 years of age, they are eligible for the old-age solidarity benefits.

Figure 10 illustrates the subsidy scheme, in which solidarity subsidies and total pensions are shown as a function of the contributory pension.

Two elements of this design need to be highlighted: integration of the contributory system with the new solidarity pillar, and concern for the contributory incentives that this integration generates. Integration ensures that all individuals in the first three quintiles will receive a pension equivalent to at least the PBS. If the benefit had been defined with a ceiling (as is the case with disability pensions), this would have created incentives for low-income individuals not to contribute, since their pension would not rise with the number or amount of contributions made. Under the chosen design, total old-age pensions rise monotonically with

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[8] See *Consejo Asesor Presidencial para la Reforma Previsional* (2006).

[9] For an analysis of the poverty-prevention pillar and alternative designs, see Fajnzylber (2006).

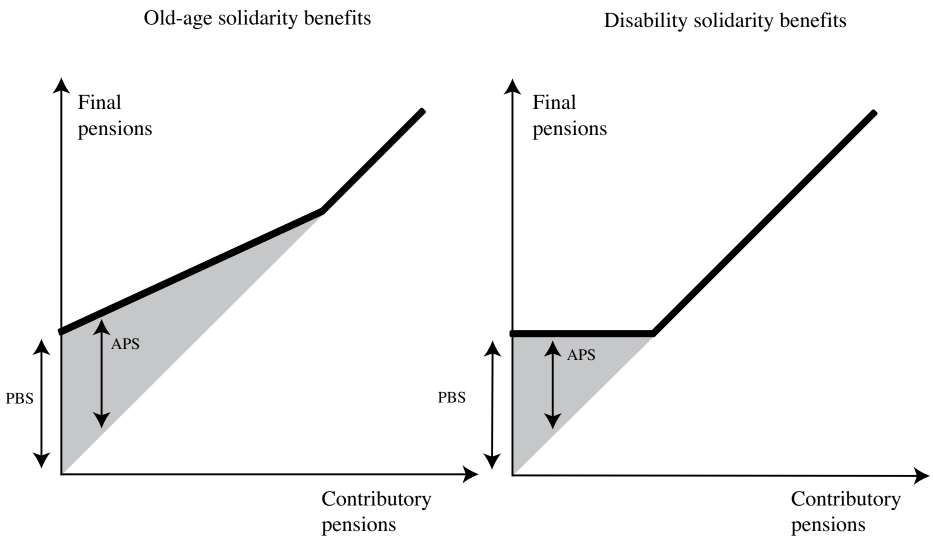
[10] The scheme will be applied gradually. In the first year, starting in July 2008, the basic solidarity pension will be equivalent to US$ 137, and will be limited to the poorest 40% of the population; it will then rise to roughly US$ 172 in July 2009, covering the lowest 45% income group. The final benefits scheme will enter into force on July 2012, covering the poorest 60% of the population.

[11] The affluence test is a means of verifying income to ensure that the person does not belong to the wealthiest 40% of the population (60% in the first year). Initial implementation (two years) will be based on the "Ficha de Protección Social". The residency test requires individuals to have lived in Chile for at least 20 years since their 20th birthday and for at least three of the five years prior to application for the benefit.

[12] The Solidarity Pension Supplement will be paid firstly to individuals whose contributory pensions are below US$ 161 and who were among the poorest 40% of the population in July 2008. The supplement will be steadily increased until 2012, when it will cover those who receive less than US$ 586 through their contributory pensions and belong to the 60% lowest-income group.

FIGURE 10

Final subsidies and pensions under the new solidarity pillar



Source: Prepared by the authors.

APS: Solidarity pension supplement
PBS: Basic solidarity pension

the savings financed by the individuals in question: every peso saved always increases the pension, although the relation is not one to one.

— *Compulsory contributions by self-employed workers*

To be consistent with the extension of coverage resulting from the introduction of the NPS, the reform requires all self-employed workers who receive taxable income to make social-security contributions based on their annual earnings. This requirement will be introduced gradually, starting with a three-year informative period, followed by another equal period in which contributions will be deducted from self-employed workers, unless they expressly choose otherwise (the default choice will be to participate in the system). During this transition period, the fraction of taxable income subject to this requirement will increase from 40% in the first year to 70% in the second, and then to 100% in the third year. From 2015 onwards, compulsory participation will be implemented in full.

— *Collective voluntary savings plans (APVCs) and incentives for middle- and lower- income workers.*

In Chile, as in many other countries, voluntary savings for old age can benefit from tax exemptions. This type of voluntary pension saving is known as *Ahorro Previsional Voluntario* (APV). APV plans can be implemented through a special account in an AFP, through special mutual funds offered by banks or other financial institutions, and through life insurance contracts with saving components. Given their design, this type of tax break mostly attracts voluntary savings from high-income individuals who are subject to the highest marginal income-tax rates. For most low- and middle-income workers, who are not liable for income tax, regular tax allowances do not provide incentives to participate in these plans.

The reform includes two mechanisms to increase the voluntary savings of dependent workers generally, and the savings of workers who do not benefit from regular tax exemptions in particular. Firstly, it creates the APVC scheme which provides tax incentives for firms to offer their workers saving plans in which the firm makes complementary contributions.[13] Secondly,

[13] APVC plans follow the same principle as private 401K pension plans in the United States, or other defined-contribution occupational plans implemented in other countries. Employers can set up saving contracts in an institution offering individual APV plans (AFPs, banks, mutual funds and insurance companies), supplement the contributions made by workers, and define a minimum number of years of contribution to benefit from the contributions made by the firm. The conditions need to be the same for all workers, and employers may in no circumstances restrict benefits to certain groups.

the reform contains two additional incentives for individual voluntary saving:

(i) workers can choose whether the tax exemption is applied at the time of making contributions or when they are withdrawn.

(ii) workers can benefit from a State-financed supplement worth 15% of the voluntary contributions (either individual or collective), which is added to the amount of the pension, subject to an annual ceiling, or else retire earlier.

— *Subsidies on the pension contributions of young workers*.

A specific feature of defined-contribution systems is that compound interest over a long period means that early contributions can have a significant effect on the pension eventually received. For this reason, and with a view to reducing youth unemployment, a special subsidy was created to partly pay for the pension obligations of employers hiring workers between 18 and 35 years of age. Specifically, employers will receive a subsidy equivalent to 50% of the pension cost (contribution plus commission) of a worker on the minimum wage, during the first 24 contributions made by young workers whose pay is no higher than 1.5 times the minimum monthly wage.

Those workers will also receive a State-financed supplement equivalent to the hiring subsidy, which will be deposited directly in their individual account. This supplement will be in effect for the first 24 contributions between 18 and 35 years of age, made on pay below 1.5 times the minimum wage.

(b) *Measures to improve the gender equity of the pension system*

The reform put special emphasis on measures to increase gender equity. In general, women tend to:

(i) Go long periods without making contributions while they look after their children or other dependent relatives.

(ii) Be employed in lower paying jobs (compared to men with similar education levels).

(iii) Retire before men.

(iv) Live longer than men.[14]

These elements create significant gender differences, when combined in a pension system that does not involve redistribution between the sexes during the retirement phase.

— *Introduction of the new solidarity pillar (NPS)*

To tackle these differences, the reform implements a number of measures, in particular introduction of the NPS. By design, the solidarity benefits will most often be paid to women, who are more likely not to have made any contributions ever, or to have done so less frequently than men. Moreover, the benefits are independent of a person's sex, which tends to benefit women more, since they usually live longer than men.

— *State-financed bonus for mothers for each live-born or adopted child*

The reform introduces a subsidy for each live-born or adopted child, equivalent to the contribution on a full-time minimum wage for 18 months. This is increased by an annual rate of return —equivalent to the net average return on type-C funds in the AFP system— from the date of birth until the mother is 65 years old. The benefit is subject to a residency requirement but not to the income test.

As Chile has one of the longest maternity leave periods (18 weeks) in the region, and also has one of the lowest female labour-force participation rates, the introduction of this benefit is important to obtain adequate retirement pensions, particularly for low-income female workers. Apart from the financial benefit, the measure is valued as a way of giving social recognition to the (unpaid) activities of giving birth and looking after children in their early years of life.

— *Economic compensation in the case of divorce or annulment of marriage*

The reform introduces the legal concept of pension compensation in the event of divorce or annulment of marriage, whereby, if necessary, a judge may order the transfer of pension funds between individual accounts, as a way of providing economic compensation to the party who loses out during marriage. This transfer may not exceed 50% of the funds accumulated during the marriage in the account held by the spouse that is required to compensate.

— *Separation of disability insurance contracts between men and women and transfer of the premium difference to the individual accounts of the lower-cost group*

Prior to the reform, the premium charged for the disability and survivor insurance (SIS) to participants in the AFP system was the same for men and women, even though women are less likely to become disabled

[14] The minimum retirement age is 60 for women and 65 for men. The report of the Presidential Advisory Committee on Pension Reform proposed raising the retirement age for women to 65, but this recommendation was not included in the legislation sent to Congress.

and do not generate survivor benefits for their spouses, unless the latter are disabled. To avoid this cross-subsidy, the reform requires an AFP to sign separate insurance contracts for men and women, charge affiliates the higher of the new premiums (probably corresponding to the contract for men) and deposit the difference with respect to the lower premium in the savings accounts of the lower-risk group (most likely women). As a result, women's final contribution to their pension funds will be slightly higher than the 10% indicated in the law. This can be viewed as a way to maintain a single-cost insurance for all participants, while increasing the amount of saving available for women at the time of retirement.

— *Pensions for widowers*

One of the main gender asymmetries prevailing in the pension system is the impossibility of generating survivor pensions for widowers, unless they are disabled. As part of the reform, both the requirement to reserve part of the accumulated pension funds to pay survivor pensions, and the low coverage of the survivor insurance are applicable to men and women alike. In the first case, the inclusion of widowers will actuarially reduce the retirement pension for women in return for the additional benefit. In the second case, the additional coverage will be financed by a single insurance premium corresponding to all women in the system, thus eliminating the current cross-subsidies from insured women to insured men.

The measures described here reflect the many steps that can be taken to improve pension equity between men and women by adjusting the design of the system. Nonetheless, pension inequality largely stems from cultural factors that govern the division of labour within households and labour-market distortions that operate through job or wage discrimination. Such factors cannot be adequately addressed through pension system reforms.

(c) *Measures to make the AFP industry more competitive*[15]

One of the main pillars of the 1980 reform was the introduction of competition between AFPs as a measure to discipline the fund managers and ensure good performance, high-quality service and low cost. The reality has shown that competition in an industry where the service is compulsory and extremely complex for the average consumer to understand, and in which the benefits are only perceived in the long term, does not always adopt the desired form. In recent years there has been a trend towards market concentration (five firms manage pension funds equivalent to 60% of GDP), high returns on assets earned by AFPs, and no new market entrants in the last nine years.[16]

— *Bidding for affiliates*

The reform addresses these problems by influencing both the demand and supply sides of the market.[17] On the demand side, elasticity is increased substantially by the introduction of an affiliate bidding process. All new participants in the pension system will automatically be assigned to the AFP offering the lowest commission during the most recent bidding process; and they must remain in that AFP for a minimum period.[18] The successful AFP will thus receive a constant flow of affiliates for a two-year period, without having to incur expenses on marketing or sales personnel. This measure also creates an attractive starting point for potential entrants, since incumbent firms are not allowed to charge a different commission for different groups of participants (current affiliates or new workers).

— *Commission structure*

Another explanation for the low sensitivity of demand, particularly in relation to the fees charged, is the complexity of comparing commissions between different fund managers, which may charge in different ways (partly through a fixed charge and partly as a set percentage of eligible income). In an attempt to facilitate price comparison between AFPs, the reform simplified the commission structure, with the result that the AFPs may only charge a single commission expressed as a fixed percentage of eligible income.

— *Requirement or facilities for subcontracting some AFP functions*.

On the supply side, a series of measures aim to facilitate the outsourcing of certain AFP functions, and the range of services that can be subcontracted has been significantly expanded. One of them, the SIS, must now be contracted by the AFP system as a whole, unlike the previous situation in which each

[15] For an exhaustive analysis of these measures, see Reyes and Castro (2008).

[16] For a detailed description of the returns on assets obtained by AFPs, see Valdés and Marinovic (2005).

[17] The legislative bill sent to Congress included a proposal to enable local banks to enter the AFP industry by creating subsidiary firms. Nonetheless, this was rejected by opposition parties partly to avoid creating a State AFP as a subsidiary of Banco Estado.

[18] The affiliate may switch to another fund manager if the winning bidder does not fulfill the regulation or underperforms other fund managers by more than can be explained by the difference in commission.

AFP had to take its own insurance, and contracts were designed so that most of the risk fell on the AFP itself.[19] This created a powerful incentive to compete on the ability to selectively attract low-risk individuals, to the detriment of good investment management, cost reduction, or better-quality service. The requirement to sign a systemic insurance contract means the risk effectively falls on the insurance companies, and the incentive to "hive-off" risky individuals is eliminated. The design of the SIS auction will be regulated in detail by the Pension and Securities and Insurance Supervising Authorities. By law, the insurance coverage must be tendered separately for men and women, although it is possible to form groups of affiliates chosen at random and assigned to different firms to avoid undue concentration of risks.

(d) *Greater flexibility for the AFP investment regime*

With the aim of limiting the absolute exposure of investment portfolios, the original regulation included a complex set of quantitative limits: per issuer, per issue, by type of asset (including limits on variable income), by fund origin (national or foreign), among others. Most of these limits were included in the law regulating the system, and there was little scope for interpretation or flexibility. The reform relegated most of these limits to secondary regulations, and a Technical Investment Board (*Consejo Técnico de Inversiones*) was set up to make recommendations on AFP investment and regulation policies.[20]

Greater flexibility will be matched by enhanced transparency requirements, in terms of explicit investment policies and the resolution of conflicts of interest. The reformed law includes the possibility of setting limits based on indicators of investment portfolio risk, instead of quantitative limits by type of asset.

e) *Expected effects and fiscal sustainability of the reform*

Given that the benefits of the new solidarity pillar were proposed as entitlements, the reform means a significant State commitment towards future pensioner generations. Although detailed information on the fiscal repercussions of the reform in the medium and long term is scarce, the available data suggest the cost could be significant. The draft reform bill was accompanied by a financial report containing estimates of fiscal cost between 2008 and 2025. Table 2 shows the expected effects of all the provisions included in the reformed law, including some that cannot be considered part of the pension reform, strictly speaking. Projections show that the fiscal cost of the reform should be less than 0.5% of GDP in the first few years, rising to roughly 1% of GDP by 2025.[21]

— *Preliminary results of the new solidarity pillar*

Pensions under the new solidarity system started to be paid on 1 July 2008 (Fajnzylber, 2010). Initially, only basic solidarity pensions (PBS) were paid, both for old age and disability, to beneficiaries mainly coming from the welfare and old-age and disability pension system.[22] As from October 2008, the solidarity pension supplements (APS) started to be paid, although these still represent a small fraction of total benefits.

As shown in table 1, a total of 623,296 solidarity subsidies were paid in September 2009, of which 95% corresponded to the PBS (62% old-age and 33% disability), with 64% of benefits being paid to women.

The small size of the APS compared to the PBS is thought to be transitory, stemming from the following phenomena:

(i) Most current PBS beneficiaries were originally recipients of welfare pensions, some of whom took their pension, used up their balance, and then applied for the welfare benefit. Once the system is operating, low-balance affiliates will be covered by an APS pension from the outset.
(ii) On a temporary basis, affiliates who were over 65 years of age and were already receiving a programmed retirement pension when the reform

[19] The insurance contracts included ex post adjustments equivalent to a risk transfer between the insurance company and the AFP, relegating the coverage provided by the insurance to extreme cases only.

[20] Only the main structural limits remained in the law, subject to an upper limit under which the Central Bank of Chile has authority to set the real limits: a variable income limit by type of fund; a total foreign investment limit (which could be as high as 80% of the funds) replaceable by specific limits by type of fund; specific limits by type of fund regarding the amount of investments not covered in foreign currencies; and lastly, a limit on investments in financial instruments issued by institutions that have been operating for less than three years.

[21] For further details, see *Dirección de Presupuesto* (2008).

[22] Between January and June 2008, an average of 228,065 old-age welfare pensions were paid, as well as 212,327 disability pensions (www.suseso.cl). Some of the disability pensions were paid to persons over 65 years of age, so the figures are not directly comparable with the basic solidarity old age and disability pensions for which payment began in July 2008.

TABLE 1

Number of PBS and APS paid per month, between July 2008 and September 2009

	Men				Women				Total			
	Old age PBS	Disability PBS	Old age APS	Disability APS	Old age PBS	Disability PBS	Old age APS	Disability APS	Old age PBS	Disability PBS	Old age APS	Disability APS
July 2008	101 418	84 277	-	-	189 152	108 433	-	-	290 570	192 710	-	-
August 2008	101 669	84 831	-	-	190 467	109 473	-	-	292 136	194304	-	-
September 2010	108 162	84 559	-	-	221 383	108 959	-	-	329 545	193 518	-	-
October 2008	110 075	84 437	955	229	230 808	108 604	2 444	217	340 883	193 041	3 399	446
November 2008	111 136	84 286	1 159	294	236 178	108 404	3 067	290	347 314	192 690	4 226	584
December 2013	113 630	84 823	1 234	348	244 815	109 628	3 251	352	358 445	194 451	4 485	700
January 2010	114 748	85 291	1 765	481	249 383	110 901	4 434	468	364 131	196 192	6 199	949
February 1995	115 183	85 481	2 132	584	251 808	111 775	5 048	596	366 991	197 256	7 180	1 180
March 2009	115 759	85 609	2 584	703	254 074	112 459	5 703	787	369 833	198 068	8 287	1 490
April 2009	116 177	85 787	3 131	922	255 795	113 104	6 499	1 119	371 972	198 891	9 630	2 041
May 2009	116 638	86 085	3 842	1 125	258 094	114 003	7 208	1 372	374 732	200 088	11 050	2 497
June 2009	116 982	86 441	4 373	1 346	260 086	114 983	7 817	1 674	377 068	201 424	12 190	3 020
July 2009	117 124	86 710	4 882	1 670	261 334	116 028	8 395	2 118	378 458	202 738	13 277	3 788
August 2009	117 348	87 229	5 603	1 969	261 917	117 514	9 052	2 469	379 265	204 743	14 655	4 438
September 2010	117 430	87 678	15 010	2 203	267 244	118 761	12 193	2 777	384 674	206 439	27 203	4 980

Source: Prepared on the basis of information available at www.spensiones.cl.

PBS: Basic solidarity pension.
APS: Solidarity pension supplement.

took effect can apply for the APS benefit when they wish, with the pension calculated on the basis of the balance at the time the request is filed. This means that many individuals with low account balances may prefer to stay with the minimum pension (currently around Ch$105,000) until they use up their balance, and then apply for the APS benefit (which will be equivalent to a PBS pension of Ch$75,000, because the individual would not have any asset balance remaining).[23] As this process will occur gradually, the number of APS beneficiaries should gradually rise.

In terms of the amount of benefits, the law provided that the PBS benefits would initially be Ch$60,000 per month. These were increased to Ch$75,000 per month as from July 2009. Table 2 shows the average amount of benefits paid each month, by type of benefit and the sex of the beneficiary.[24]

It should be noted that average APS benefits should always initially be less than those of the PBS. In table 2, this is not the case because of the initial payments, which can include more than one monthly payment and therefore tend to be higher. The situation should normalize itself through time.

— *Remaining challenges*

The most important aspect of the reform described above is that, instead of replacing the AFP system created in 1980, it improves it, by integrating a State-financed poverty-prevention pillar, extending the voluntary pillar to middle-income workers, and introducing a number of measures to extend coverage and enhance competition in the AFP market. This is the outcome of a lengthy two-year participatory process, preceded by exhaustive research and various evaluation efforts.

A number of challenges remain to be addressed in the coming years, relating both to implementation of the reform and to longer-term issues. In the

[23] As an example, persons whose pension calculated on a programmed retirement basis would be equivalent to Ch$ 30,000 could choose to apply for the APS pension, in which case they would receive Ch$ 96,000 for the rest of their life; or else they could opt to keep the minimum pension (Ch$ 105,000) until the balance is used up (which would occur in about four years five), and receive the PBS of Ch$ 75,000 from then on.

[24] The average amounts include payments made retroactively from the moment of filing the request. For example, if a person requested an APS benefit on 1 July 2008, and the first payment was made in October 2008, that payment would include the amount corresponding to four payments. This explains why the averages are higher than the maximum benefit (US$ 60,000 before July 2009 and US$ 70,000 thereafter) and in the initial APS payment months, average amounts are way above the maximum benefit.

TABLE 2

Average amount of PBS and APS per month

(Dollar equivalent) [a]

	Men				Women				Total			
	Old age PBS	Disability PBS	Old age APS	Disability APS	Old age PBS	Disability PBS	Old age APS	Disability APS	Old age PBS	Disability PBS	Old age APS	Disability APS
July 2008	120	120			120	120			120	120		
August 2008	120	120			120	120			120	120		
September 2010	120	120			120	120			120	120		
October 2008	126	121	401	314	132	120	316	326	130	121	340	320
November 2008	124	121	148	134	128	121	126	142	127	121	132	138
December 2013	129	125	175	116	132	129	122	120	131	127	137	118
January 2010	124	125	221	182	125	130	174	163	125	128	188	172
February 1995	123	124	147	150	124	129	118	158	124	127	126	154
March 2009	123	124	156	135	123	129	116	157	123	127	129	147
April 2009	122	125	180	173	122	129	146	195	122	127	157	185
May 2009	122	126	172	148	123	131	121	151	122	129	139	150
June 2009	122	127	140	140	123	133	113	147	123	130	122	144
July 2009	152	157	174	207	152	164	151	210	152	161	160	209
August 2009	154	159	207	183	152	168	163	187	153	164	180	185
September 2010	152	159	132	169	158	166	157	173	156	163	143	172

Source: Prepared on the basis of information available at www.spensiones.cl

PBS: Basic solidarity pension.
APS: Solidarity pension supplement.

[a] The equivalence calculation used an exchange rate of Ch$500 per dollar.

former category, the progressive application of the new solidarity pillar will probably face risks. Firstly, there is no clear knowledge of the real number of potential beneficiaries, since that depends on wage trends, compliance with the regulations, and the return earned by the pension funds. Moreover, organizing new institutions, creating conditions to fully integrate self-employed workers into the system, and implementing systems to identify the beneficiaries of the new solidarity benefits and make the corresponding payments, will require a major government commitment.

Among the longer-term challenges, not necessarily addressed by the recent reforms, the most important is a problem shared by most middle- and high-income countries: longer life expectancy and higher medical costs for older adults. The technological progress made in recent decades has meant longer life expectancy, based on increasingly sophisticated treatment and equipment. Although there is a reasonable idea of how long current pensioners are likely to live, little is known about the life expectancy of individuals who are entering the labour market today. The current contribution rate of 10% of taxable income will likely be insufficient to finance pensions in the future; and it is unclear whether generational differences will enable workers to remain in the labour market for long enough to compensate for this increase. Most of the burden will fall on the capacity of individuals to foresee these deficits and increase their voluntary savings. Given that pension systems were created to ease short-term tensions, is not obvious that this voluntary reaction will have the necessary timing and force. Greater effort is needed to improve knowledge on this uncertain future and, consequently, to adopt the (usually unpopular) measures of raising contribution rates or the minimum retirement age.

IV

Notes on the political processes behind the reforms

This article has thus far analysed the recent pension reforms in Argentina and Chile. Having reached this point, we will now briefly outline the relevance of the political processes underlying the retirement policy discussed above. The authors' interest in this aspect stems from the fact that several substantive elements that define the functioning of the Argentine and Chilean pension systems, seem to originate from the characteristics of the political institutions that design and manage them, rather than their inherent "technical" problems.

Issues relating to the relevance and consequences of political institutions and public policy-making processes clearly transcend pension policy. Much of the current public-policy literature concerns the idea that a degree of policy-making capacity is needed for policies to be effective; specifically that several significant aspects of public policies depend on the ability to consolidate inter-temporal policy agreements (Spiller, Stein and Tommasi, 2003). In the case of pension policy, this is aggravated by a number of distinguishing factors, since it is an explicitly distributive policy, with multiple objectives involving opportunity costs between them, and which unfold in a time sequence that makes the policy unique. Bearing in mind that the transfers involved are large, that the entire pension system is essentially founded on a type of promise, by organizing claims on future social production (Barr, 2002), and that the complete duration of the pension-policy cycle is quite exceptional, one can infer the decisive importance of the political dynamics surrounding it.

In very general terms it can be argued that institutional arrangements in Argentina have frequently been considered unfavourable and adverse for achieving and sustaining cooperative political behaviour, or they have been characterized by political actors facing short time horizons or inadequate incentives, or both (Spiller, Stein and Tommasi, 2003). In contrast, Chile seems to have displayed more solid policy-making processes since the restoration of democracy, in which changes have been incremental and have generally emerged out of a relatively intense and institutionalized process. In brief, Chile seems to have found policy-making dynamics that tend to facilitate cooperative responses in the political transaction game.

In terms of pension policy, it can be argued that the course of the recent reforms in Argentina and Chile is consistent with this differential diagnostic. The recent reforms in fact provide a range of circumstances where the capacity to articulate interests and inter-temporal political commitment seem to have been unequal. Returning to the structural reforms implemented in Chile (1980) and the Argentina (1993) as a similar starting point for analysing the most recent processes, both reforms were presented at the time as icons of broader reform processes. In Chile, pension reform was probably the most famous of the "modernizations" of the military dictatorship, whereas in Argentina, they were a cornerstone of the move to orthodoxy led by the first Menem government. Thus, as "icons" the reforms were surrounded by a major communication battle between promoters and opponents over what came to be called the privatization of retirement pensions.

But in Argentina, the 1993 reform did not completely replace the old system. Unlike the Chilean system and the one originally proposed by the Argentine Government, the law passed by the National Congress did not definitively close down the pay-as-you-go system, but founded a multi-pillar model. This fact seems not to have been trivial: from the very outset of the reform and until the present day, under the recent "revisionist" spirit that has surrounded it, the general debate on the pension system has (almost exclusively) been confined to a simplistic dichotomy of "private" versus "public". When that reform was introduced, the political authorities explicitly promoted the new individual accounts regime as "new" in terms of retirement pensions, and encouraged people to join it; but there was a glaring absence of a serious and objective information strategy targeting workers in different situations (Isuani and San Martino, 1995). In contrast, for several years, popular discourse has veered drastically towards the second of these positions; in fact, the key message transmitted by the authorities in relation to the recent reforms was the idea that workers would regain the chance to transfer from the "private" to the "public" system; and lastly, that reunification under a public pay-as-you-go scheme would generate improved benefits for retirees. In particular, neither then nor now do suitable political channels seem to exist, which —transcending the superficial and mechanistic debate over that false dichotomy— shape a deeper and systematic social dialogue that seeks to penetrate the (highly complex) dynamics of negotiation and inter-temporal cooperation required by any retirement system that aims to be efficient, inclusive and sustainable.

In Chile, meanwhile, once in power, the coalition governments chose continuity over radical change in this as in other public policy areas; and they decided to support the reformed pension system. Only minor reforms have been made to the system since 1990, mainly aimed at altering investment regulations. In recent years however, the issue of coverage emerged as a key element and has taken centre stage in policy debates. As noted above, in March 2006, the Government created the Advisory Council on Pension Reform, to analyse the evolution of the system, study its shortcomings and develop a public hearings process lasting 90 days. The Council, consisting of prestigious experts in this field, provided an in-depth diagnostic assessment and proposed a number of substantive reforms. The Government then set up a Ministerial Committee to evaluate the Council's recommendations, which finally produced a reform bill which was sent to Congress and passed in January 2008.

In contrast, the most recent reforms of the Argentine system, analysed in detail in section II, arose from a closed-door process involving a succession of steps (which were not always coordinated) from which key pensions stakeholders were excluded, where only a few political figures decided the course to be followed. As seen above, the moratorium for self-employed workers, which ultimately developed into an unprecedented mass transfer, proved to be one of the most significant reforms to the Argentine pension system in recent years. This was built on a combination of laws and decrees that led to a massive increase in the number of beneficiaries. The institutional process underlying this important reform was very unusual: for example, the legislative bill that led to the most recent amendment which triggered the mass of nature of the moratorium, originated in Congress and was passed without discussion —in other words without any debate by legislators, who voted for the bill as it emerged from the commissions. As a result, the new law did not attract the attention of the press or the political authorities; and, in particular, there was also no announcement or formal act to launch the initiative. One year later, the programme was made operational by a regulatory decree issued in November 2008. The subsequent abolition of the individual capitalization component under private management, and its replacement by a reunified public pay-as-you-go system, were announced as a surprise in late October 2008 and became law in December that year. The law abolished the capitalization scheme and provided that all taxpayers, beneficiaries and assets affiliated to it would be transferred to the public pay-as-you-go system. Once again, debate on the bill in Congress was extremely brief, since it received rapid support from all political sectors.

It is now possible to discern a reasonably clear pattern in recent pension policy in the two countries. In keeping with the characteristics of the systems described above, pension reforms have been seen to need not only scrupulous technical analysis but also a process for collecting and disseminating accurate information to gain support and build consensus (IDB, 2007). In the recent pension reforms, Chile seems to have come closer to those standards than Argentina, where changes were introduced in a disorderly sequence, with little mutual consistency. Many of the key announcements came as a complete surprise and were rapidly processed through Congress. Unlike the Chilean case, the Argentine reforms did not involve major efforts to promote broad debate and careful examination among the various pension-policy stakeholders (direct or indirect). Nor was there any consideration or detailed discussion of the present and future fiscal implications of the measures being implemented.

V
Conclusions

Argentina and Chile have traditionally been two of the region's social-policy pioneers. Both are among a small group of countries that introduced pension systems in the early twentieth century; since when they have moved forward by providing progressively broader coverage to a growing number of workers. In 1980, Chile once again took pioneering steps by introducing a structural reform which, among other important changes, set up a private pension-fund management system. A decade later, Argentina followed the Chilean model with a number of differences, when a traditional pay-as-you-go scheme was transformed into a multi-pillar scheme.

The progress made in adopting reforms has continued in recent years, with both countries again making significant changes to their systems. These clearly share several common objectives, such as the expansion of old-age coverage and redefinition of the role of the State in facilitating access to the benefits. Nonetheless, there are significant differences in other respects, including the institutional organization of the systems, partly owing to certain different political approaches towards the workings of the previous structures, and the implementation of different policy-making processes in the two countries.

The reforms in Argentina produced an immediate increase in coverage, sharply breaking with the previous trend. The total number of retirees rose by over 70% in two years, following the introduction of a moratorium that led to a massive inclusion programme. This made it possible for any individual over the established retirement age to apply for a pension, regardless of his or her past contributions record and irrespective of whether he or she was the beneficiary of some other type of pension currently in force.[25] The reforms also meant the annulment of a key part of the changes introduced in 1993, by abolishing individual capitalization accounts and returning to a unified form of operation managed by a public agency, in a system that reverted to a defined benefits framework. The existence of private pension-fund managers thus ended. Nonetheless, it is important to note that the changes did not represent a complete return to the pre-1993 situation, since most of the parameters of the system (including current contribution rates, retirement ages and replacement rates) were not reset to their previous levels. Moreover, the public agency responsible for managing the new reunified system will continue to receive a portion of general tax revenue (originally assigned to finance the transition cost). Consequently, this agency can be expected to manage a growing fund: in 2008 it amounted to over 10% of Argentine GDP. Lastly, to this day, there is no official estimate of the fiscal impact of the reforms, in either the short or medium terms.

In Chile, meanwhile, most of the reforms will produce their effects gradually through time. The beneficiaries of the new solidarity pillar will be few at first, but their number will gradually increase as the system is implemented. Clearly, this is the main novelty of the recent reforms, since they will lead to a universal coverage system in the near future. Another set of reforms affect operational aspects of the existing system and the institutional structure of government supervision and oversight agencies. Moreover, a number of changes aimed to eliminate systemic inequities, such as those relating to gender differences.

The process of designing and approving these reforms was very different in the two countries, reflecting different current institutional contexts. In Chile the process began when President Bachelet announced her intention to reform the system and appointed a Council of Experts. Two years later, following various debates, publications and analyses, the reform was approved. In Argentina, most of the decisions were made very quickly at the top government decision-making level, with a very brief and limited consultation and discussion process. These differences may help explain differences in the results and, therefore, deserve more detailed study and analysis in the future.

The more cautious and careful approach taken by the Chilean authorities in introducing pension reforms will probably help achieve more sustainable results through time. Nonetheless, the execution of a more rapid reform in Argentina managed to give an immediate response to the major problem of the massive

25 As the programme advanced, a restriction was introduced to avoid duplication of benefits, although this did not include limits on persons receiving a survivor pension.

decrease in coverage. Most older adults excluded from the system were receiving a pension within a year, thereby achieving an immediate improvement in relation to their previous situation. In Chile, by contrast, the process that means covering all registered beneficiaries will be slower and more gradual.

Clearly, neither of the two systems has attained a position or a design that could be seen as "definitive"; and policy challenges remain to be addressed by the authorities in the near future. New problems and difficulties will also inevitably arise. The ability of future Governments to respond adequately to these problems will be decisive for the well-being of future generations of Chilean and Argentine people.

(Original: Spanish)

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