Title: The effects of privatized pension funds on Latin American workers

Author: Camila Gripp

Institution: Unicamp – State University of Campinas
Institute of Economics

Contacts: cgripp01@yahoo.com
+55 19 92577626

Address: Instituto de Economia - UNICAMP
CESIT – A/C Ms. Camila Gripp
Caixa Postal: 6135 - CEP 13083-857 - Campinas/SP - Brazil

The effects of privatized pension funds on Latin American workers

1. Introduction

After 27 years of Chile's pioneer experience of privatizing its old-age pension system, researchers, policy-makers and international institutions that supported the privatization of social security in the past, seem to be more careful now that its impacts on workers have been clearly evidenced.

The defendants of private individual accounts, which replaced the solidarity between generations, had claimed this would be the best solution for the crisis of the public pension systems. Behind this claim laid the interests of large capital institutions and corporations expecting their share out of the administration of huge funds.

Following in the footsteps of Chile, many Latin American countries reformed their pension systems in the 1990s, turning them into a fully or partially funded system of mandatory individual accounts. But the reformed systems were being implemented on weak labor markets with growing informal sectors, decreasing employment stability, and an overall descending participation of wages on the general output. These problems in the labor market resulted in insufficient coverage (even when membership is high, discontinuous contributions are common), low contributions (very often insufficient to provide even the minimum pension entitlements), and inexistent income redistribution.

The privatization of old-age pensions, considered a decade ago as a panacea to fiscal and social problems of the public pension systems, has not lived up to the promises of its proponents and supporters. The idea that it would improve coverage and benefits to workers and that the generation of savings would stimulate the financial market has proved to be a failure. When even the World Bank, who once was the ideological and financial supporter of countries willing to follow the privatization path in the 90's[1], revised its position, the outward signs of the unsuccessful choice became clearer[2].

In the new social and economic scenario, countries that had made reforms are now working on "reforming the reforms". Under Michelle Bachelet's government, Chile has recently created a basic

[1] The study 'Averting the old age crisis : policies to protect the old and promote growth' published by the World Bank in 1994, suggested that the financial security for the old would be better served if governments relied on a system of 3 pillars: a first public mandatory pillar of basic benefits that would reduce poverty amongst the old, a second mandatory private pillar of individual saving accounts, a third voluntary private pillar of individual accounts to cover old-age and other uncovered risks.

[2] The IEG (Independent Evaluation Group from the World Bank) published in the last few years several country studies evaluating the reforms and the World Bank's assistance. A 2004 study by Gill, Packard and Yermo, "Keeping the promise of social security in Latin America", was published by the World Bank, pointing out the shortcomings of the reforms and refers to them as "unfinished challenges" (despite its moderate criticism).

pension for low-income over-65 citizens who couldn't retire in the private system. This failure was due to insufficient accumulated funds, or simply because individuals could never contribute as many had to survive on low incomes in the informal economy. In Argentina, President Cristina Kirchner has just announced the government's intention of nationalizing nearly 30 billion USD of private pension funds to protect retirees from falling stocks and bonds as a result of the current international financial crisis[3].

This crisis has clearly made matters worse, though the systems were never capable of coping with the problems of low coverage and low wages. Now, countries with funded pension systems will have to manage the losses caused by the ongoing turmoil. Already saddled with high administrative and operational costs levied by the private administrators, the challenge of profitability seems even worse.

2. Objective

The objective of this paper is to contribute to the growing consensus that the indiscriminate promotion of the privatization of pensions has been a failed economic experiment. Not enough attention has been paid to the interdependence of labor markets and the performance of contributions, benefits and coverage. Based on the research, it will become evident that the ultimate beneficiaries of the pension reforms in Latin America were the pension fund administration companies themselves.

3. Methodology

This research shall make use of both qualitative and quantitative approaches. Qualitative data will be used to describe the major changes promoted by the reforms in Latin America countries through a brief literature review. While the research will examine various countries in Latin America, the Chilean case will be focused on, not only because it became a reference model, but also because its early reform provides more consolidated results.

A quantitative approach will be used to analyze the labor market performance in the region during the recent decades as well as the performance and costs of the private pension funds. Due to the variety of methods used by national governments in tracking this kind of data, information regarding the labor market shall be taken from international organizations' databases to ensure homogeneity.

Pension fund data is usually available through national organs of supervision (*Superintendencias Nationales de Fondos de Pensiones*) and by the International Federation of Pension Funds Administrators (*Federación International de Administradoras de Fondos de Pensiones*). Additionally, the latest data

[3] Analysts have been publishing on what they think is the real reason for the government's move, questioning whether the government is attempting to get a hold of the funds in order to help finance their national debt. The development of all this, however, is yet to be seen.

available will be used in an attempt to consider the impacts of the current financial crisis on the profitability of the funds.