

The Rise and Fall of Privatized Pension System in Chile. An International Perspective.

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THE RISE AND FALL OF THE PRIVATIZED PENSION SYSTEM IN CHILE

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Background

- Chile was a **pioneer**, under Pinochet, **to privatize its pension system**.
- The new system was approved in 1980 in a **secret session** of the military junta.
- The **pay-as-you go system** was replaced by **individual accounts** (civilian population).
- Pension funds managed by **for-profits companies (AFPs)**.
- Affiliates to the system must pay a **management fee**.
- Aimed to promote **choice**, create a **domestic capital market** and boost domestic savings, investment and growth. Reduce **fiscal burden** of pay as you go.
- Four-tier system: (1)basic pensions, (2)privatized tier, (3)remanent old-system (*cajas*), (4)armed forces pension pillar, CAPREDENA-DIPRECA.

Features and results of the Chilean system (after 40 years of application)

- No *systemic* choice: only one private system managing the pension system of the civilian population. 11.5 million accounts managed by the AFP. Population 19.5 million.
- **Low pensions**, average USD 300 per month, 2019 (lower for women).
- Management fees may have reduced pensions by 30 percent (for 30-35 years contribution).
- **Fiscal costs** (3-4 percent of GDP for near 30 years).
- Use of pension funds to **finance domestic economic conglomerates**.
- Currently **55 percent of the stocks of accumulated funds is invested outside the country**. Exports of pension (domestic) savings.

Features and results (after 40 years of application), cont.

- Large **differences in benefits** between pension system for the armed forces and the civilian population (ratio of 4 to 1 in the level of pensions).
- The state finances a basic universal pension and subsidizes low pension of the private tier.
- **Savings pool** generated by the pension system: **near 65 percent of GDP**. It started at 5 percent, ever growing. Is it optimal?
- **Average rate of profit of the AFP system**(23 percent of capital, 2010-2020). A highly profitable business niche.
- **GDP growth** has been probably supported by the savings from the private pension system but at the cost of low pensions and other problems.

Cycle of Privatization and de-privatization in Latin America and Eastern Europe.

- Most of the **privatization** of pension systems took place in the 1990s and 2000s. Chile started in the 1980s.
- Focused mainly on Latin America and Central Europe.
- Inspired in the **Chilean case and promoted by the Washington Consensus.**
- **De-Privatization phase** (reversion) led by fiscal problems, low pensions, high management fees:
- More notorious cases: Argentina (2008, N. Kirchner), Hungary (2010, Orban), Poland (2013-14)
- Return to dominant public systems. No economic crisis in the reversion.

International Context: Cycle of Privatization and Deprivatization of Pension Systems.

Source: Solimano, 2021. *The*

Rise and Fall of the Privatized Pension System in Chile, Anthem Press.

Latin America and the Caribbean		Eastern and Central Europe	
Privatization	Reversion	Privatization	Reversion
Chile (1981)		Hungary (1998)	2010
Peru (1993)		Poland (1999)	2013-14
Argentina (1994)	2008	Latvia (2001)	
Colombia (1994)		Bulgary (2002)	
Uruguay (1996)		Croatia (2002)	
Bolivia (1997)	2009	Estonia (2002)	
Mexico (1997)		Lithuania (2004)	
El Salvador (1998)		Slovakia (2005)	2012
Nicaragua (2000)	2005	Macedonia (2006)	
Ecuador (2001)	2002	Romania (2008)	2017
Dominican Republic (2003)		Czech Republic (2013)	2016
Panama (2008)		Russia (2002)	2012

Lessons from the Chilean and Global Experience with Privatized Pension Systems

- **Insufficient savings capacity** of the working population.
- **Over-complex system** for the affiliated. Choice risk-return far from simple.
- **High management costs** (sales labor force, marketing expenses, high return on capital).
- **Labor market** affected by precarious jobs, informality and low wages. Affects continuity of contributions and pension levels.
- **Financial risks and longevity risks** fall on the pensioners/ affiliated.
- **Fiscal costs** of the transition to privatized system is significant.
- Mechanism of **savings redistribution from wage earners to capital owners**. Contribution to wealth concentration.
- **The political economy dimension**. The pension funds management industry became too large: capture of the political system, very hard to reform in Chile.