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The Social Security Reforms in Chile: Can a Privatized System Work?

Daniel Altman

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Senior Thesis

Dr. Klooster, Dr. Wasielewski, and Dr. Wuhs¹

¹ I have finally seen the light at the end of the tunnel. However, I doubt I would have reached this point without incredible help from three different yet equally important professors. Each helped me in finding my threshold to work in order to achieve success, supported me when I struggled the most, and encouraged me to think outside the box. Thank you for all your support, allowing me to write this paper while abroad. Somebody once said, "let Chile change you." Thank you to all faculty members at the University of Redlands. I consider myself incredibly fortunate to have a degree from the University of Redlands. I hope my paper is reflective of the work that is sought at the University of Redlands.

The Social Security Reforms in Chile: Can a Privatized System Work?

Chile implemented a privatized Social Security system in 1924. The system was designed to provide benefits to all individuals within the state. However, inefficiency and lack of contribution, hindered the state-run program from the beginning? In 1952, politicians implemented a 'Pay as you go System' (PAYGO) which encouraged individuals to put their savings into a government run savings account. Once again, a lack of contributions combined with government deficits and benefits received by non-contributors, hindered the system. In 1973, Augusto Pinochet, overthrew the Allende government, and began to implement neoliberal policies advocated by the "Chicago Boys."³ These individuals studied in the United States, and supported Milton Friedman's idea of a completely open economy and the privatization of all industries.⁴ Continued state debt, and poor economic growth motivated Augusto Pinochet to implement their suggested privatization policies. In 1980, Chile privatized Social Security industry, and required all individuals who entered the workforce after 1980 to use Administradora de Fondo de Pensiones (AFPs). These were designed to encourage more individual savings and less reliance on the government.⁵

However, after close to 30 years of AFPs, problems have emerged. First, evidence shows that individuals from the highest economic brackets receive the most benefits.⁶ Secondly, the introduction of private pensions has not significantly increased individual overall savings or

² Peter Diamond and Salvador Valdes, "Social Security Reforms in Chile," Documento de *Trabajo*, 161 (1993): 13.

³ Silvia Borzutzky, "From Chicago to Santiago: Neoliberalism and Social Security Privatization in Chile," 4 (2005): 659.

⁴ Borzutzky, "From Chicago to Santiago:" 659.

⁵ Borzutzky, "From Chicago to Santiago:" 663.

⁶ Carmelo Mesa-Lago, "Social Protection in Chile: Reforms to Improve Equity," 147 (2008): 377.

reduced reliance on government.⁷ Consequently, criticism has emerged focusing on the current system. Chile is unlikely to return to a fully state-run system and as a result, the system must be changed in order to increase benefits for individuals. The public needs to have easier access to information about the AFP system. A more informed public, will save more effectively, and therefore be more prepared for retirement.⁸ Secondly, a more informed population, means that those who lack sufficient salaries to put in AFP's, know how to access government benefits that can supplement an individual's pension.⁹

Even with these suggested changes, the Chilean pension system remains contradictory. While it encourages individuals to save for retirement thereby reducing reliance on the government, many individuals who use the system do not receive sufficient benefits which will allow them to retire in the future.¹⁰ As a result, they have increasingly become dependent on government aid which has resulted in reforms targeting those in the lowest economic income groups.¹¹ However, these changes remain contradictory because neoliberalism advocated an economy dominated by business that could address social needs, but this has not occurred. As a result, the government has re-entered the social sphere in order to address economic inequalities. Neoliberals who once claimed that privatization would minimize government expenditure failed to fulfill their promises.¹² The neoliberal reforms implemented in Chile, resulted in inequality and government need to address this in order to improve overall standards of living.

Roadmap

⁷ Alberto Arenas de Mesa et al, "The Chilean Pension Reform Turns 25: Lessons from the Social Protection Survey," *National Bureau of Economic Research*, (2006): 23

⁸ Alberto Arenas de Mesa et al, "The Chilean Pension Reform Turns 25," 23.

⁹ Alberto Arenas de Mesa et al, "The Chilean Pension Reform Turns 25," 23.

¹⁰ Borzutzky, "From Chicago to Santiago:" 672.

¹¹ Carmela Mesa Lago, "Social Protección in Chile:" 394.

¹² Silvia Borzutzky, "From Chicago to Santiago:" 672.

This paper is broken down into 12 sections. *Section I* examines the implementation of the first Chilean Social Security system, and focuses on the reasons that debt was accumulated. *It looks at the modifications of the old public pension system, and examines the problems with the implementation of the PAYGO system implemented in Chile in 1952.*¹³ *Section II* focuses on the factors that led to the privatized Social Security system under the Pinochet regime, and, the paper examines the political ramifications, which encourage Pinochet to implement a privatized security system. *Section III* briefly discusses the functions of a "Pay-As-You-Go System" (PAYGO) by looking at its benefits, as well as its flaws, and shows that a fully public pension lacks significant advantages for the state and its population. *Section IV* outlines the foundation for the current privatized system in Chile and looks at the basic components of the system. *Section V* briefly highlights the positive economic effects that have been generated by AFPs. *Section VI* addresses the major problems with a fully privatized pension system. *Section VII* examines responses to the people I interviewed about their overall perceptions of the pension system. *Section VIII*, will lead to the conclusion using individual's analysis of their own system leading to specific changes that can be made in the system that could give individuals more incentives to put money into their retirement funds. *Section IX* provides closing remarks and conclusions. *Section X* provides the reader with the questions I asked and respondents' answers to my questions. My annotated bibliography is in section XI. The works cited page is found in section XII.

The Old Social Security System

Chile implemented its first Social Security system in 1924, which required both individuals and corporations to contribute to a Social Security system that provided benefits the

¹³ Peter Diamond and Salvador Valdes, "Social Security Reforms in Chile," 13.

public. Corporations that had provided private Social Security policies to their employees prior to 1924 were allowed to continue their programs. Individuals who did not use companies Social Security benefits placed their wages in social security institutions (SSIs). Overall contribution to the SSIs varied based on economic income blue-collar workers contributed 5% of their salary while white-collar workers contributed 10%. Nevertheless, the initial system failed to remain self-sustaining because of poor investment practices by the government. While Diamond and Valdes note, that total contributions rose from 1937 onwards, they state "[while] substantial surplus accumulated and was invested in government bonds... investment performance was dismal... prices doubled and the real value of government bond portfolio held by SSIs fell to half [of their real value]."¹⁴ The overall contributions that individuals made lost significant value and acted as a deterrent to individuals placing money in the individual SSIs. In 1952, Chile implemented a 'Pay as you Go' (PAYGO) system that was supposed to give individuals a greater opportunity to earn pension savings yields through more state aid.¹⁵

Diamond and Valdes note, "if pensions were going to be paid [by the state] a financial crunch was unavoidable ... reforms required a massive increase in contribution rates, spread out over three years."¹⁶ The creation of a separate Social Security fund independent from a health-care fund meant that individuals had to contribute a higher percentage of their overall income under the new system. Diamond and Valdes note, that the implementation of the new system increased "the tax on formal labor... from 9% to 32% of [their] taxable salary."¹⁷ Thus, workers were paying approximately 113 of their overall salary to the government sponsored PAYGO system that was designed to help them have enough finances for retirement. Arguably, a high

¹⁴ Diamond and Valdes, 12.

¹⁵ Diamond and Valdes, 14.

¹⁶ Diamond and Valdes, 13.

¹⁷ Diamond and Valdes., 13.

percentage of workers' salaries detected them from contributing to the PAYGO pension system. "The [PAYGO] reform failed to create political incentives to make sure that all benefit increases were financed... new groups with full benefits were added, even though they had not completed their contributions, these expenditures were first charged to the SSI, without legislating any tax increase or explicit revenue source to finance them."¹⁸ Clearly, individuals were receiving retirement benefits from the government without contributing to the system. This drained government resources because it contributed to retirement funds without being reimbursed for its expenditures. Furthermore, overall profits the government received from funding the system for public pensions were minimal. Diamond and Valdes note, "1950-1977 shows that the real value of assets held by private SSIs increased by 804% and only 57% for large public SSIs." The overall benefits that individuals received from the public PAYGO system were minimal.

As Solange Bernstein et al. note, "The collections became insufficient to finance the benefits granted to various worker groups with the result that the contribution rates continued to rise."¹⁹ Higher contribution rates, diminished individual's incentives to contribute to the system. Solange Bernstein et al note, "When these [funds from people] also proved insufficient, it became necessary to increase contributions from the state."²⁰ The state was forced to implement more resources in order to ensure that its population received the continuous health and retirement benefits that had been established in the 1924 social security reforms. This continued to drain government resources needed to address other problems within the Chilean economy. As Bernstein et al note, "The state contribution to the old system for financing pensions represented a considerable part of government income. It remained about [35%] of the pensions

¹⁸ Diamond and Valdes 14.

¹⁹ Solange Bernstein et al, "The Old System" in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pensions," (2008): 34.

²⁰ Solange Bernstein et al, "The Old System," (2008): 34.

systems income on average which meant about 3% of GDP between 1975 and 1980."²¹ Reducing government expenses was unfathomable because the contribution rates for both employers and workers remained relatively high which meant that their ability to continuously contribute to the system was diminishing.²² Thus, the government accepted a greater role.

Table 2: Pre-1980 Old-Age System Revenues and Expenditures: 1974-1980

Year	Revenues (millions of Chilean pesos)	Expenditures	Deficit	Revenues (% of GDP)	Expenditures (% of GDP)	Deficit (% of GDP)
1974	3445.23	698.866	-354.342	3	6.2	-3.1
1975	310.985	422.261	-111.276	3.4	4.6	-1.2
1976	360.509	662.877	-302.369	1.4	6.2	-2.8
1977	454.651	831.933	-377.282	3.6	6.7	-3
1978	556.642	1027.681	-471.039	4.1	6.3	-3.1
1979	970.61	1241.874	-304.811	5.2	6.9	-1.7
1980	1017.36	1336.172	-318.81	5.5	7.2	-1.7

Sources: Reyes and Nenas de Mesa (1992) Cent.-a Bank of Chile (BCCH),

Presidential leaders in Chile had recognized the problems with the provisional pension system. Peter Diamond and Salvador Valdes, note that several presidential administrations commissioned reports on the successes of the old public pension system, and each stated that Chile was incurring increasing amounts of debt. Diamond and Valdes note, "[attempts to modify the pension system through the] 1952 reform failed to create political incentives that would make sure that all benefit increases were financed."²³ The lack of public financing forced the government to pay for social services it could not afford. "Although the pension system fell far short from performing its insurance purpose adequately, this does not mean that its finances were

²¹ Solange Bernstein et al, "The Old System," 35.

²² Solange Bernstein et al, "The Old System," 35.

²³ Diamond and Valdes, 14.

out of control, because the level of benefits was quite low.²⁴ Even though Valdez and Diamond suggest that, the government was not over exerting its resources and, the low level of services that individuals received shows that the government was unable to provide sufficient services to its public. Bernstein et al show fiscal inequality was occurring by noting "contributions to the system represented approximately 65% of the total income [from businesses and individuals] the second major source of income for financing the benefits came from the state representing about 30% of the total income."²⁵ Businesses were paying more to provide Social Security to their employees than the government. Since the public pension system was financed by the people, a reduction in their contributions indicates that the system was paying for services it could not afford.

Governments attempted to prevent this from occurring, but political cleavages and the population's unwillingness to accept change prevented reform. Silvia Borzutzky notes that prior to the implementation of the private pension system, there were over 160 different Social Security funds run by the government, which were designed to address workers needs. Because of the different "Cajas" (different industrial groups), workers received different benefits from the state pension system based on the arrangements they had with their employers. Nevertheless, Borzutzky notes that attempts to create a more equitable system where workers receive the same benefits regardless of their overall skill or expertise failed. Ex- Chilean President Eduardo Frei noted, "In matters related to social security, all agree in considering unjust and inconvenient the present rules, but when the moment arrives for people to lose their privileges they rebel violently and bring all sorts of pressure to bear."²⁶ The lack of popular support for changing the Social Security system in Chile was a major hindrance. As Borzutzky states, "The crisis of social

²⁴ Diamond and Valdes, 14.

²⁵ Bernstein et al, "The Old System," 34,

²⁶ Borzutzky, "From Chicago to Santiago:" 657.

security was a by-product of Chile's unique democratic system: the expansion of political participation, the power of labor and entrepreneurs over the state... and the unwillingness of politicians to carry out the political reforms that would [establish a] more efficient and equitable social security system."²⁷ Thus, the political cleavages created by the labor sectors, through their political influence prevented the government from implementing a more efficient pension system.

Augusto Pinochet and the Implementation of Open Market Policies in Chile

The implementation of neoliberalism was linked to the implementation of a privatized Social Security system. Leaders' attempts to privatize certain sectors of the economy while allowing other sectors to remain public failed; as a result, economic leaders favored the complete privatization of all industries including Social Security. After gaining power in the 1973 coup, Pinochet implemented policies that strengthened his power. One of his first initiatives was the overhaul of the public Social Security program. Facing large amounts of government debt, Pinochet abandoned the old public system, and implemented a private one?⁸ Silvia Borzutzky notes, "the crisis of Social Security was a byproduct of Chile's unique democratic system: the expansion of political participation, the power of labor, and entrepreneurs over the state... and the unwillingness of politicians to carry out the political reforms that would [establish] a more efficient and equitable Social Security system."²⁹ Inefficiencies within the system required changes in order to reduce government debt, and provide efficient services to the population. This led to the implementation of neoliberal policies advocated by the Chicago boys who argued that through the implementation of neoliberalism which privatize all industries, could improve

²⁷ Borzutzky, 657.

²⁸ Borzutzky, 652.,

²⁹ Borzutzky, 657.

the inefficiency in Chilean Social Security. Borzutzky notes, "Following von Hayek's [economic principles] his Chilean disciples argue that the market [was] the only social arrangement capable of regulating human interaction without coercion ... the goal was to have the marketplaces act as a central regulator of economic activity guaranteeing efficiency and growth."³⁰

Two groups competed against each other in Pinochet's administration as each attempted to implement its favored Social Security proposals. Initially, the National Planning Office (ODEPLAN) advocated more moderate economic policies than neoliberals. After the military took over the organization, it started a recruitment process that attracted more conservative economic analysts who emphasized privatizing the economy. Members of ODEPLAN proposed a privately owned and administered Social Security system.³¹ Conversely, the Superintendence led by the corporatists advocated for a Social Security pension program that was controlled by the government. The Pinochet regime attempted to combine the two divergent policy measures in order to implement a new Social Security system, called the Ante proyecto del Estado Fundamental de Principios y Bases del Sistema de Seguridad Social. Papadopoulos notes, "[critics] blamed the project for having financial rather than social concerns. Criticisms were also centered around the nature and management of the corporations, the nature of the individual capital accounts, and the elimination of pensions based on years of service."³² Clearly, individuals feared that with the implementation of the new system those who had saved their money in the government-funded system would lose retirement savings. The attempts to create a new Social Security system based on differing ideologies between the ODEPLAN organization

³⁰ Borzutzky, 659.

³¹ Jorge Papadopoulos, "Politics and Ideas in Policymaking: Reforming Pension Systems in Comparative Perspective. The Case of Uruguay and Chile," 36.

³² Jorge Papadopoulos, "Politics and Ideas in Policymaking," 37.

and the Superintendence created criticism, and showed that the government's attempt to implement a new Social Security form was not supported by Chileans.

The Superintendence believed that the implementation of the neoliberal reforms was harmful to the economic growth and political power individuals held in Chile. Those in power who favored a more moderate economic stance "argued against the individual pension accounts because the envisaged system would not benefit the workers but the financial institutions... the system of individual insurance would only serve to create a new center of economic power and [furthermore]... a different economic and financial situations would yield negative interest rates."³³ Viewed from this context, the implementation of a privatized security system meant that corporations seeking to maximize profit were in charge of crucial Social Security benefits. However, Superintendents feared that individuals would lose part of their pension savings with the implementation of privatized social security because corporations would not be worried about losing pension savings since individuals were required to put their money in a private pension fund. Furthermore, they argued that the privatized system would hurt Chileans and the economy more because a transition to a privatized economy would increase the overall costs that Chile would incur because it would have to fund the creation of the Social Security system.³⁴ Thus, these factors prevented a joint presentation amongst the members of ODEPLAN and Superintendence from proposing a mutually beneficial social security system.

After Augusto Pinochet gained power in the 1973 coup, neoliberals within his administration argued for the implementation of a privatized social security system, which would create unity within the state. They argued individuals pursued their own benefits and the current

³³ Papadopoulos, 37.

³⁴ Papadopoulos, 37

government policies that sent different amounts of funds to different sectors meant that the government chose winners and losers thereby creating different factions. Jose Pinera, the architect of the current privatized Social Security system, claimed a market system allowed individuals to pursue their own goals without being limited by governments. Prior to the Social Security reforms, Pinera noted, "Freedom was a blasphemy. Nobody had the right to choose where to save. Nobody could establish, not even in his dreams, a pension fund managing institution. Competition was systematically prohibited."³⁵ Thus, the creation of a new Social Security system was highly linked to the ideals of the neoliberal philosophy, which emphasized minimal government interference and individual priorities.³⁶ The individual priorities favored industry by allowing it to pursue beneficial economic policies. As Eduardo Silva notes, "radical internationalists pushed harder for more draconian market liberalization because they saw it as an opportunity to increase their economic empires [that were hindered by the previous government.]"³⁷ Liberalization of the economy did not truly adhere to the idea of more individual freedom; instead it was based on giving corporations the ability to create another source of revenue.³⁸

According to Jorge Papadopoulos, the Social Security system implemented under the Pinochet regime was heavily insulated from outside interests. After the regime came to power there was a heavy emphasis on reversing the policies implemented under the Allende regime. Papadopoulos notes, that after Pinochet's rise to power, two political factions emerged. The Superintendencia simply wanted to minimize the power within the executive branch and reverse

³⁵ Jose Pinera, cited in Borzutzky, "From Chicago to Santiago," 662

³⁶ Borzutzky, 662.

³⁷ Eduardo Silva, "Capitalist Coalitions, the State, and Neoliberal Economic Restructuring: Chile, 1977-88," *World Politics*, 45 (1993): 545.

³⁸ Eduardo Silva, "Capitalist Coalitions, the State, and Neoliberal Economic Restructuring," 545.

the nationalization policies that were implemented under the Allende administration.³⁹ However, as economic problems continued Pinochet relied on more conservative neoliberal economic thought. This thought differed from the Superintendencia, because it emphasized the privatization of all sectors, while the Superintendencia maintained that government should continue to play a role in the economic market. Pinochet followed neoliberal economic principles in an attempt to strengthen the economy thereby strengthening his government. As Papadopoulos, notes, "since [the] economic policy measures did not change the expected results [by] 1975 corporatists began to be displaced and neoliberal started to consolidate their position inside government... Pinochet based his power on the ideological claims of the neoliberal groups inside and outside government urging for deeper reforms."⁴⁰ Pinochet and the implementation of neoliberal reforms were symbiotic: the neoliberals needed Pinochet to implement more drastic open-market principles and Pinochet needed the neoliberals to implement economic policies, which would strengthen the economy thereby strengthening his regime.

Neoliberal advocates were gradually gaining power within the Pinochet regime, allowing them to implement their favored Social Security policies. Nowhere was this more evident than in the increasing number of neoliberals who were given positions in ODEPLAN because they supported its neoliberal policies. Papadopoulos notes, "Changes at the level of the structure of economic decision-making started with the replacement of Fernando Leniz by Sergio de Castro in the Ministry of economy and later by the designation of de Castro as Ministry of finances and his own replacement in the Ministry of economy by Pedro Barona."⁴¹ Clearly, the changes in the economic policymaking sphere indicated that the radical economy proposed by neoliberal

³⁹ Papadopoulos "Politics and Ideas in Policymaking," 21.

⁴⁰ Papadopoulos 22.

⁴¹ Papadopoulos, 38.

advocates was becoming harder to ignore. Thus the Pinochet regime had decided to implement a system advocated by the neoliberals, and avoid and more state-funded government advocated by the Superintendence.

As Kurtz notes, the Pinochet regime made strong attempts to develop a corporatist relationship with all sectors of society. However, it was initially unable to control all aspects of it, because it lacked a strong foundational base that would support the government in its attempts to implement market-oriented reforms. The Pinochet regime dismantled "... the remaining social and political organizations that had been the bedrock of the previous democratic regime..."⁴² The implementation of new economic reforms under the Pinochet regime tried to weaken political institutions that threatened his power. As Kurtz notes, "as pressures for political opening mounted, the overarching goal of political stabilization was pursued by creating new patterns of social organization that would be, by their very structure inhospitable to statist or Marxist policy proposals. Crucially this centered on an individualized, highly targeted, and market mediated form of state society interaction..."⁴³ Thus, the implementation of privatized Social Security, was not only designed to weaken links between politicians and labor organizations, it was also an attempt to weaken support for opposition parties by breaking the link between political reelection in the distribution of incentives. As Kurtz concludes, "no longer were legal/institutional barriers alone to prevent the reemergence of leftist political tendencies... market led social transformation would also play this role."⁴⁴ Thus, Pinochet used neoliberal economic policies to strengthen his own power within the state.

⁴² Marcus Kurtz, "Chile's Neoliberal Revolution: Incremental Decisions and Structural Transformation. 1973-1989," *Journal of Latin American studies* 34(1999): 412, 413.

⁴³ Marcus Kurtz, "Chile's Neoliberal Revolution:", 415.

⁴⁴ Marcus Kurtz, "Chile's Neoliberal Revolution:", 415.

Clearly, diminished support for the Pinochet regime, forced Augusto Pinochet, to implement an economic policy that would stabilize his government. Papadopoulos notes, "As minister of labor, Jose Pinera undertook the most enduring social transformations... [he had to]: a) coordinate the labor and economic sectors of the government; b) to institutionalize a new system of labor relations creating a free depoliticized labor organization; and c) to reform the Social Security system."⁴⁵ The implementation of the new Social Security system was designed to weaken workers power; their power over businesses through strikes weakened economic productivity and forced government to implement labor friendly laws. The new Social Security system depoliticized labor, by forcing it to become less reliant on government aid. Weakening the link between laborers and government, made it more difficult for future governments to implement policies, which hurt businesses. Furthermore, the implementation of the system benefited the economic prospects for Chile because with a weaker labor union, economic growth would not be hindered by individual's desires for more benefits. Neoliberals supported this policy by arguing that an open market created more business and industrialization, and with different labor laws, foreign businesses would invest in Chile because its laws favored business profitability.

Individuals entering the workforce after 1981 were forced to deposit a portion of their pension into AFPs. Borzutzky notes that there were three components to the privatize Social Security system. First, the state subsidized the implementation of the new Social Security system; secondly, it reduced the amount of funds that the government would use to continue with the older system. Finally, it reduced the reliance that employees could place on corporations in

⁴⁵ Papadopoulos, "Politics and Ideas in Policymaking," 39.

order to receive retirement benefits.⁴⁶ The new system emphasized the need to place a higher reliance on the overall individual to take care of his social needs, and less reliance on government and businesses to protect workers. Jose Pinera defended the transition to a privatized Social Security system by noting, "The new system "establishes a clear relationship between the personal effort and the reward" and "gives the individual the freedom of choosing and deciding."⁴⁷ Thus, employees could no longer blame the government or their employers for their poor living standards or their inability to retire in part because they were now in control of their own retirement savings.

The initial, privatization of pensions required all workers to pay a onetime 10% tax in order to finance the creation of the system. Additionally the individual had to pay between 2.5% and 3.7% of their income to finance disability protection. Borzutzky notes that currently individuals who use the privatized Social Security system pay approximately 19.5 to 20.7% of their wages in the privatized Social Security sector. While some can argue that money is saved for retirement purposes, arguably this reduces the overall amount of money workers can use to achieve higher living standards, because they are deferring their overall wage payments until retirement. While this may seem fiscally responsible Borzutzky notes, that individual's retirement savings are invested in government debt, as well as mutual funds in the stock market in order to help pensions achieve higher growth rate.⁴⁸ The heavy amount of investment can create a bubble; if the debt is not paid, investors will lose a large percentage of their retirement savings. Since, private pension funds are only required to hold a minimum of 1% of the total amount of funds value they manage workers savings are not guaranteed. Thus, individuals would ask government to reimburse them for lost money in their private pension accounts.

⁴⁶ Borzutzky, "From Chicago to Santiago:" 663.

⁴⁷ Borzutzky, 663.

⁴⁸ Borzutzky, 665

Workers are asked to invest their overall pensions in order to retire, but the notion that private savings should help individuals in retirement is questionable.

The 1980 Chilean elections were crucial to the implementation of neoliberal policies regarding Social Security. As Papadopoulos notes, "1980 was a key year for the military. The Chilean government felt most of the policy initiatives had to be stopped in order to concentrate in the political goal of winning the 1980 referendum in order to achieve legitimacy."⁴⁹ As a result,, the Pinochet regime suspended its attempts to implement a more privatized Social Security because without legitimizing its own government, it could not legitimize the policies it wanted to implement. On September 11, 1980, a referendum was held and Pinochet received 65.71 of the popular vote. Papadopoulos notes, "Both the armed forces and the neoliberal economists that work inside the government felt that the victory implied support for the institutionalization of that regime and for its neoliberal policies and technocrats."⁵⁰ Thus, the established "legitimacy" of the Pinochet regime allowed the neoliberal technocrats to continue their plans for privatizing Social Security. Furthermore, their plans for the creation of a new Social Security system would remain protected since the regime had minimized opposition to neoliberal policies. As long as Pinochet remained in power, neoliberal advocates received support to privatize Social Security.

During the 1980s, the neoliberal policies implemented under the Pinochet regime returned state growth to its previous economic levels prior to the coup and international analysts hailed this as the Chilean economic miracle. According to Jorge Nef, the Pinochet regime reversed the government's highly influential position in the economic sector, and allowed private institutions to control economic production in the state. Policies advocated by the economics department at the University of Chicago led to hiring, "the Chicago Boys" who were crucial in

⁴⁹ Papadopoulos "Policies and Ideas in Policy Making", 40

⁵⁰ Papadopoulos, "Policies and Ideas in Policymaking," 40.

the implementation of neoliberal reforms.⁵¹ Even though these reforms have been widely praised and statistics have shown that Chile's economy continues to grow, evidence shows that with the implementation of neoliberal reforms, economic growth has only returned to its previous levels prior to the 1970s. As Patricio Silva notes, "[the implementation of neoliberal reforms] led to the acquisition by the middle and upper classes of very sophisticated patterns of consumption... The majority of the Chilean population however did not participate in the benefits of this process of modernization because of the in-egalitarian nature of the economic model and the unwillingness of the economic team to implement redistributive models."⁵² While individuals in the upper middle and upper economic classes benefited from the privatization of Social Security, neoliberal reform did not improve social security conditions for people in lower economic classes.

However, overall living conditions for lower class individuals remains poor. According to Marcus Kurtz, "fiscal caution" was the primary economic message used after the Pinochet dictatorship. Consequently, governments avoided spending high amounts of public revenue in order to improve Chileans living standards. Kurtz notes, "Government transfer payments as a proportion of income dropped for all income quartiles [between 1987 and 1996] a decline of over 50% for the very poorest... Even under the center left governments, the relative importance of public assistance has not been maintained across time... [Even with the economic miracle] the poor in Chile have only reestablished the living standards they had in 1970, while overall inequality has increased dramatically."⁵³ Thus, even with the implementation of neoliberal

⁵¹ Jorge Nef, "The Chilean Model Fact and Fiction: Chile since 1990 The Contradictions of Neoliberal Democratization," *Latin American Perspectives*, 30 (2003): 18

⁵² Patricio Silva, "In the Name of Reason: Technocrats and Politics in Chile" Pennsylvania State University Press, (2008): 151

⁵³ Marcus Kurtz. "Understanding the Third World Welfare State after Neoliberalism: The Politics of Social Provision in Chile and Mexico." 302.

reforms inequality remains and hinders the services that lower and middle-income Chileans can access.

Chilean governments after the Pinochet regime have maintained his system of privatized Social Security. Patricio Alwyin, the first democratically elected president after Pinochet, continued Pinochet's plans for privatized Social Security.⁵⁴ This process continued because economic policies have created growth in Chile during and after the Pinochet regime. As a result, politicians hesitated to change his economic policies.⁵⁵ Kurt Weyland notes, "Chile's highly skewed income distribution, and crucial policy outcome has not improved since the transition to democracy. The government's cautious approach and its reluctance to initiate conflicts with socioeconomic elites, especially private businesses... impeded more determined redistribution, which might have come about through additional tax... and a revamping of Chile's inequitable private health and social security systems."⁵⁶ Politicians remain fearful of alienating businesses which profit from the open market, and as result, congressional leaders as well as Presidents have been unwilling to significantly alter the current Social Security system. The largest reforms were implemented under Michele Bachelet, in 2008, but even these reforms barely altered the current system. She increased the number of individuals who were covered by government aid from 45 to 60% of those in the lowest economic classes. However, her system modified the original system, but did not attempt to return to a public system.⁵⁷ Thus, Chilean politicians have merely attempted to modify the system in order to improve it, but have not attempted to reverse its policies, because emphasis has remained on retaining business.

⁵⁴ Marcus Kurtz, 302. *Ibid.*

⁵⁵ Kurtz, 302. ,

⁵⁶ Kurt Weyland, "Economic Policy in Chile's New Democracy," *Journal of International Studies in World Affairs*, 3 (1999): 68.

⁵⁷ "Nigeria; Unending Misery of Pensioners" *Africa News*. July 22, 2010.

Problems: Pay as you go Systems and Private pension systems

There are currently two implemented social security systems in the world today, the first is known 'as a Pay-as-You-Go System' (PAYGO) and the second, which is currently implemented in Chile is known as a private security pension fund. While PAYGO is used internationally, Chile uses a private pension system.⁵⁸ The difference between a private pension system and the PAYGO pension system are that under a Pay as You go System, individuals pay a certain percentage of taxes to the government each year, and receive retirement and Social Security benefits. In contrast, privatized pension systems *should* allow the government to take a lesser role in the overall scheme of paying individual's pensions.⁵⁹ In Chile, an individual places a percentage of his income into a privatized Social Security fund which is managed by a private AFP which attempts to maximize the overall profitability of the money in the pension system.⁶⁰ In theory, this system should allow individuals to become less reliant on the government, and allow the government to use funds in order to address state needs.

One of the major benefits in a PAYGO system is that retirees are able to receive government assistance when they retire if they do not have enough money to live at the median income. Governments rely on workers to fund the system because the government uses revenue from the working population to aid retirees.⁶¹ One of the benefits that workers can receive from using a pay-as-you-go system is the fact that they do not have to worry about losing their money in retirement. Rather than investing their money, in potentially risky ventures, retirement savings is guaranteed by the government.⁶² Individuals who use PAYGO, especially retirees, are

⁵⁸ David Blake, "Does it Matter what type of Pension Fund you Have?" *The Economic Journal* (2000):F54. ⁵⁹ Raul Madrid, "Economic Pressures and Pension Privatization" *Latin American Politics and Society*, 47 (2002): 25.

⁶⁰ Marcus Porter and Arturo Condor, "AFP Provida," *Harvard Business School*, (2008):4

⁶¹ David Blake, "Does it Matter what type of Pension Fund you Have?" F51

⁶² David Blake, F52.

able to access benefits, something that is more difficult in a private pension system.⁶³

Essentially, a public pay-as-you-go pension system ensures a much greater chance of having equality among all members of society rather than ensuring that only small groups of people are able to retire and live lifestyles above the median income.

One of the problems with PAYGO is that a lack of contributions from the public sector forces the government to fund a greater percentage of the system. According to David Blake, "high labor requires high capital per worker, but net investment... has been inadequate: it has typically been considerably less than gross investment, and indeed, that investment by public sector corporations has frequently been negative."⁶⁴ If workers and companies are not funding the PAYGO system, the government has to spend more money in order to ensure that workers have enough money to retire. According to David Blake, "there has been a steady increase in unemployment in Europe over the last 40 years...[The Organization for Economic Co-operation and Development] OECD's explanation for this is that the service sector has failed to take up the workers released by the client manufacturing industry... indeed within the European [economy] the net growth of employment has been entirely confined to the public sector, with no net additional private sector jobs created since 1973."⁶⁵ The lack of employment in Europe after 1973 essentially means that fewer people have the ability to contribute to the 'PAYGO' system. Furthermore, a key pillar to the system is weakened because the government is unable to draw funds from a key segment of the population in order to continue to provide public Social Security. This forced the government to spend more of its own resources in order to make sure that the system continued to function.

⁶³ David Blake, F52.

⁶⁴ David Blake, "Does It Matter What Type of Pension You Have," F48.

⁶⁵ Blake, F48.

Furthermore, critics argue that with a PAYGO system individuals save less because they know that the government will help them if they had not saved for retirement. According to the OECD, Chile's decision to switch from a public pension system to a privately funded one was successful because "it restored public confidence in pensions savings."⁶⁶ Palau notes, "Domestic savings rate for the period 1981-2001 rose from 0.67% of GDP to 4.6% of GDP... savings for higher income individuals increased. Medium and low income individuals had an aggregate savings amount of 2.5% of GDP."⁶⁷ Overall increased savings from individuals contributed to greater economic growth. Those who argue that individuals in the lower economic sectors still struggle to find employment thereby contributing to AFPs were challenged by findings which stated, "pension reform in Chile did result in a modest reduction in unemployment and... because of pension reform, and total employment grew between 1.3 and 3.7% in the formal sector."⁶⁸ While the implementation of that private Social Security system created more jobs, it also created the opportunity for individuals to find jobs that allowed them to contribute to their privatized Social Security system.

One of the biggest incentives with a privatized pension system such as Chile's, is that it allows workers to save their own money; this means that they can play a heavier emphasis in their own retirement. According to Jose Pinera, "The [Pension Savings Account] PSA system solves the typical problems of pay as you go systems with respect to labor demographics: an aging population and the number of workers per retiree decreases. Under the PSA system, the working population does not pay for the retired population."⁶⁹ Individuals are able to save more of their own money for retirement. More importantly, with an individualized pension system,

⁶⁶ Augusto Iglesias-Palau, "Pension Reform in Chile Revisited: What Has Been Learned?" *OECD Social, Employment and Migration Working Papers*, 86 (2009): 43.

⁶⁷ Augusto Iglesias-Palau, "Pension reform in Chile Revisited : "43

⁶⁸ Iglesias- Palau, 43

⁶⁹ Jose Pifl.era, "Empowering Workers: The Privatization of Social Security in Chile," *Cato's Letters* 10 (1 996): 9.

workers have the ability to determine how much they want to risk with their pensions system. Individuals have the opportunity to invest in high-risk pensions that return high amounts of money, or to invest in lower risk pensions that guarantee greater overall savings.⁷⁰ The ability to determine which pension an individual chose also allowed him to determine and have more control over his retirement funds.

The Private Pension

The current pension plan in Chile has three main components. The first is the mandatory savings funds, which requires workers to put a minimum of 10% of their overall salary into an AFP. Individuals are allowed to change their pension provider every 6 months.⁷¹ The second pillar is a government subsidy designed to help those who earn low wages and who may not be able to save enough in order to retire. This was previously known as PASIS, but in 2008 was renamed the "Solidarity Fund" and was designed to provide more benefits to individuals in the lower economic classes.⁷² Finally, the third pillar is made up of voluntary pension contributions. Voluntary pensions allow individuals to place more than the required 10% of their income into pension accounts, thereby allowing them to receive tax benefits.⁷³

Mandatory Savings

"The underlying aim of the pensions scheme laid down in DL 3.500 (1980) is to ensure that workers who have finished their working life receive a stable income ... which bears a close

⁷⁰ Arturo Condor and Marcus Porter, "AFP Provida," 4.

⁷¹ Condor and Porter, 2

⁷² Solange Bernstein et al., "The Old System" in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pension, 18.

⁷³ Solange Bernstein et al., "The Old System" in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pension, 30

relation to that received during their active life."⁷⁴ The objective of the pension system is to allow workers to enjoy the same standard of living they held prior to retirement. Individuals place a portion of their income into individual and privately based pension funds. The mandatory voluntary saving system involves a system of administrators whose function is to ensure that individuals who put their savings in the pension funds, receive their funds when they retire, and more importantly such administrators have the obligation to ensure that savings increases over time. "Each member has an individual account in which his/her Social Security contributions are deposited. These are capitalized and earn the yield on investments made by the administrators with the resources of the funds..."⁷⁵ While AFP's can increase an individual's overall savings, the system is not free; administrators in charge of monitoring the personal pension funds charge pension holders for managing their accounts.

Even though the AFP industry is privatized, a state run regulatory board ensures that all pension holders receive the maximum benefits and acts as the last safety net for individuals who put money into AFP's. The regulatory body is composed by members of the Undersecretary of Social Security's office. Rather than allowing industry to regulate itself, the government plays a regulatory role ensuring that AFP's continue to function, properly while encouraging them to maximize profits for retirees.⁷⁶ Furthermore, the state plays an important role in ensuring that private pension companies have enough capital to pay retirees. The state has to check the amount of capital in AFP corporations in order to ensure that they have the ability to give retirees their savings, without defaulting. "If an administrator [of an AFP] fails to meet the minimum yield, once all other possibilities established in the law have been exhausted, the state will pay

⁷⁴ Solange Bernstein et al, "A Description of the Current Pension System" in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pension, 53.

⁷⁵ Solange Bernstein et al, "A Description of the Current Pension System," 53.

⁷⁶ Bernstein et al, 54.

the missing compensation..."⁷⁷ Thus, even though Chile has switched to a fully privatized system, there is still a large amount of involvement from the state, designed to ensure individual savings remain protected.

Currently self-employed individuals are not required to use AFPs. As a result, the self-employed, often "save" their retirement funds, but are unable to access retirement benefit from AFPs. While approximately 1.7 million Chileans, report being self-employed, and do not contribute to the AFPs, evidence indicates that this population often works in the informal labor, and often receives the lowest amount of salary.⁷⁸ Starting in 2012 a transition will occur in which the self-employed will gradually be incorporated into the private pension system. By 2015, all self-employed individuals will be required to contribute to a private pension fund. Mesa-Lago notes, "[the self-employed] will initially contribute 10% of 40% of their annual taxable income, increasing [to 10% of their entire income] by 2014."⁷⁹ This process occurs gradually, and does not immediately force them to contribute all of their earnings at once to an AFP. Instead of taxing 10% of a person's total income, the overall amount of contributions they put into the AFP *should* gradually increase with both time and income ?, allowing lower income earners to use their incomes for other important factors.

The government has to educate individuals in the informal sector about the AFP system. According to Mesa-Lago, "on average, self-employed members have less schooling, are older and have less social protection than workers in wage employment; those who have always been self-employed display much lower contribution density."⁸⁰ This segment needs to be targeted heavily because they are the most unfamiliar with the current privatized pension system, but

⁷⁷ Solange Bernstein et al, "A Description of the Current Pension System, 54.

⁷⁸ Carmelo Mesa Lago, "Social Protección in Chile:" 380,389

⁷⁹ Carmelo Mesa Lago, "Social Protección in Chile:" 394.

⁸⁰ Mesa-Lago, 389.

most reliant on state aid. Mesa-Lagos notes, "The vast majority [of self-employed] hoped to receive state or family aid and had not thought about the future."⁸¹ Evidently, these individuals know the least about the current pension system, and perceived failures may cause them to contribute less to it. A population that was heavily reliant on government aid will be critical of the system that fails to provide them with equal benefits that they receive from government. Nevertheless, the 2008 reforms are designed to motivate individuals to contribute. As Mesa-Lago notes, individuals who use the private funds and are self-employed will be eligible for increased government aid based on the overall income and contributions a family makes to the system. As Mesa-Lago notes, individuals will be eligible for the "solidarity based top-up benefit... this consists of state financial assistance to supplement the contribution pensions of persons [over 65]." Thus, individuals need to be more informed about the possible benefits they can receive under the new programs.⁸²

The military is currently the only organization that does not have privatized pensions. Its influence, allowed it to stop the privatization of pensions for its members.⁸³ Even though Mesa Lago believes that it will be difficult for the military to retain its current pension system, because of declining in influence in the state, government expenses on military retirement packages was 2 billion dollars in 2005. Military members have little incentive to accept a privatized system, because their benefits will be diminished.⁸⁴ As Mesa-Lagos notes, "the armed forces which implemented [private pensions] excluded themselves from it, and have a separate scheme with

⁸¹ Mesa-Lago, 389

⁸² Mesa-Lago: 394.

⁸³ Mesa-Lago: 400.

⁸⁴ Borzutzky, "From Chicago to Santiago," 669.

better pensions, mostly financed by the public purse."⁸⁵ The lack of a mandatory requirement to fund retirement, serves as a major incentive to remain dependent on the government.

Social Assistance Pension (PASIS)

The Social Assistance Pension (PASIS) was the second pillar in the privatized pension system it; targeted individuals in the lowest economic classes who did not have enough money to contribute to AFPs.⁸⁶ "Prior to the reform, the risk of poverty in old age was covered by two basic programs: Pension Minima Garantizada par el Estado (PMGE), which provided the floor for the pensions of those individuals with at least 20 years of contributions and PASIS for individuals without entitlement to pension from any pension system."⁸⁷ Viewed in this context, PMGE merely ensured that individuals had the minimum pension required, thereby minimizing the amount of aid the government needed to give. The Pension Superintendence noted, "Once granted, PASIS could be received until the person died, provided that the requirements continue to be met. The PASIS benefit was close to 50% of the minimum pension."⁸⁸ However, PASIS only targeted individuals who had the lowest amounts of income, but failed to aid individuals in the lower middle economic class, who had AFPs. "An individual who had accumulated funds in his/her individual pension savings account and was not entitled to a PMGE would in principle have to deplete his/her funds before applying for a PASIS."⁸⁹ The government offered aid only when individuals depleted the funds in their AFPs. Thus, those who were at the lowest levels of the economic classes continued to remain marginalized.

⁸⁵ Mesa-Lago, "Social Protection in Chile," 387.

⁸⁶ Solange Bernstein et al, "The Old System," 18.

⁸⁷ Solange Bernstein et al, "Pension System Coverage," in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pension 38.

⁸⁸ Solange Bernstein et al, "The Old System," 18.

⁸⁹ Solange Bernstein et al, "Pension System Coverage," in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pension, 38

In 2008, both the PMGE and PASIS combined to form the Solidarity Fund. The Solidarity Fund guaranteed, "All individuals in the least affluent 60% of the population [would] have access to a basic pension, regardless of their contributory record."⁹⁰ The new system aimed to help individuals who had contributed to the private pension system, but who were excluded from government aid due to their use of AFPs. Even though this group received aid from the government, the system provided minimal help for those who earned below median incomes. This group will only receive benefits once an individual turns 65. Individuals still have to use their own money for other requirements such as health minimizing their overall ability to contribute more to the pension fund. The authors of the Superintendencia de Pensiones (SAFP) note, "to avoid the high cost of a universal scheme, the benefits are focused on the poorest 60% of the population ... the amount of the benefit is withdrawn gradually, so that the final pension increases uniformly with the savings of each person."⁹¹ Those who contribute more will receive more benefits than those who contribute less.⁹² Thus, the overall goal remains to minimize the expenses that the government incurs.

Voluntary Savings Account (AVPs)

In 1987, a voluntary component was added to encourage individuals to contribute more than the required 10% to retirement funds.⁹³ Similar to the mandatory system in the private pension fund, individuals can choose how much they put into the voluntary savings fund. "[Individuals] can make deposits, either regularly or not, and these are freely available, though

⁹⁰Bernstein et al, "Pension System Coverage,"39.

⁹¹ Bernstein et al, 38.

⁹² Bernstein et al, 39.

⁹³ Bernstein et al, "A Description of the Current Pension System," in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pension, 62.

there is a limit of four withdrawals a year.¹¹⁹⁴ Unlike the mandatory portion of the system, individuals have the ability to use their money in a more flexible manner allowing them to withdraw savings for other expenses. Nevertheless, the voluntary system is constrictive because individuals can only withdraw money from the account four times a year. This limitation means individuals who have lower salaries one month and who have used the allotted withdrawal opportunities are forced to use their salary to pay for important expenses. Furthermore, individuals are charged a fee when they withdraw money from their voluntary savings account.⁹⁵ Fees are determined by "the real profit or loss in relation to the balance of existence at the date of the operation."¹¹⁹⁶ The greater earnings an individual achieves, the more he is penalized and thus, is deterred from using the account for other purposes. As Corripio notes, "The increase of benefits [in AVPs] increases participation in the system. However, when these benefits mean greater costs, the final effect will depend on relative effects [for example income.]"¹¹⁹⁷ High growth rates in AVPs combined with high cost of withdrawing from AVPs may deter individuals from contributing to the system.

However they are beneficial because they produce additional pension savings without promoting high-risk opportunities.⁹⁸ Unlike AFP's, APVs have consistently returned high amounts of investment for individuals using the system. Business News America reported, "[the APV industry] reported 4.63 billion dollar revenues and assets... up 36% to 2008..."⁹⁹ After 2002, APVs have grown consistently, and have not been subject to high rates of fluctuation.

⁹⁴ Bernstein et al, 62

⁹⁵ Bernstein et al, 62.

⁹⁶ Bernstein et al, 63

⁹⁷ Eduardo Corripio, "Creating Incentives for Voluntary Contributions to Pension Funds by Independent Workers: an Informal Evaluation Based on the Case of Chile" *Economic Research Development* 10 (2009): 73.

⁹⁸ Eduardo Corripio, ""Creating Incentives for Voluntary Contributions to Pension Funds by Independent Workers," 73.

⁹⁹ *Voluntary Pension Assets Jumped 36% in 2009-Chile*, Business News Americas: April 7, 2010.

Gonzalo Lira notes, in October 2008, during the financial crisis high risk AFPs lost 45% of their value and moderate risks AFPs lost 14.25 percent of their value.¹⁰⁰ APVs were safer places to put savings in part because for the same period of time, and during the same year, they did not exhibit the same fluctuation or other required mandatory risks resulting in pension loss.

Individuals as well as corporations, share the cost of contributing to a voluntary pension fund. "The payment of the corresponding contributions is obligatory for persons employing domestic workers. An amount equivalent to 4.11% of the monthly taxable wage must be paid by employers to the administrator at their own expense for a period of 11 years, this sum to be earmarked to finance compensation which will be payable in any event leading to the termination of the work contract..."¹⁰¹ This requirement forces companies to contribute to the voluntary pension system and *should* give companies an extra incentive to keep their workers since they are paying for the employees benefits in the future. Corporations benefit because their contributions are tax-deductible.¹⁰² This encourages corporations as well as individuals to contribute to the AVPs. Furthermore, in households where only one parent works, the contributions made by the company act as a supplement to the individual's own mandatory pension savings account in the event that the person cannot work. The Organization for Economic Co-operation and Development (OECD) notes, "in the event of the worker's death [or firing], these contributions provide his/her family with a certain measure of Social Security cover..."¹⁰³ This means that family members can reduce their reliance on government aid. Thus, the voluntary pension system can be seen as a supplement to additional income for Chilean employees.

¹⁰⁰ Gonzalo Lira, "Social Security and the Chilean AFP System," *Before its News*, August 17, 2010

¹⁰¹ Bernstein et al, "A Description of the Current Pension System," 64

¹⁰² Bernstein et al, "A Description of the Current Pension System," 64.

¹⁰³ *Bernstein et al.*, 64.

Nevertheless, individuals in higher economic classes, tend to contribute more to the voluntary fund, and as a result receive more benefits. Table 2 .8 shows that individuals who earned 100,000 pesos per year [approximately \$829] contributed the least to the pension system, while individuals who earned at least 1 million pesos or\$ 2074.33 per year contributed more. Clearly, this is an insufficient amount of money for a family of four when considering other expenses. In this sense, it makes sense that a family earning this amount each year, would struggle to save for retirement.¹⁰⁴ Conversely, only a small minority, 120,000 people benefit from the current APV system. "35% of APV savers have less than 10 million [pesos, approximately \$20743.30 in their mandatory pension savings account, when considering the number of members in this category, only 1% of the group have a positive balance."¹⁰⁵ Clearly, the level of benefits is insufficient to the number of people who are using the program. The lack of money combined with negative balances indicate that those with high incomes will have the ability to contribute more in order to minimize debts and thus will not be deterred by negative budgets, while those with less financial security, will be deterred because of negative account earnings. This shows that those who are most likely to use AVPs are in the higher economic classes, and thus, AVPs fail to draw individuals from the middle class.

Economic effects of AFPs

The overall impact that AFPs had on Chile's economy, should not be ignored. First, the creation of AFPs created a new industry that was unique to Chile, and therefore allowed it to profit from the industry's growth as it expanded into other countries. Furthermore, the implementation of a private pension system made investing in Chile more appealing in part because corporations did

¹⁰⁴ Mesa-Lago, "Social Protection in Chile," 387.

¹⁰⁵ Solange Bernstein et al, "Pension System Coverage," in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pension, 30.

not have to account for large expenses due to strict labor laws in Chile. Subsequently, they were able to save due to lack of requirements requiring them to contribute to pension systems. Finally, the overall ability to create an industry such as AFPs, allows the industry to expand and bring more revenue to Chile.

The AFP pension system benefits companies because it reduces their overall costs. Borzutzky notes, "The 1980 legislation reformed both the financial and the administrative structures by eliminating the employer's portion of the [retirement fund] could be as high as 52% of the taxable wages."¹⁰⁶ Companies forced to pay close to half of their employees salary in overall Social Security benefits were forced to account for large amounts of costs in their own budgets, thereby hindering their growth. However, the elimination of a Social Security fund where companies paid for the Social Security benefits of their employees can be viewed positively. Reduced company expenditures allowed businesses to save money and allowed them to develop further. Furthermore, the minimization of additional costs for corporations in Chile made it more attractive to businesses. Blake shows how the problem of individualized or company funded retirement programs affected economies globally. He notes, "European unit labor costs are the highest in the world: they average \$20 per hour (of which eight US dollars per hour covers the provision of social benefits). In China, unit labor costs are one dollar per hour while in Africa they are one dollar per day. Workers... [are] pricing themselves out of the formal labor market."¹⁰⁷ Markets are less attractive to companies because of the high expense costs, yet with an individualized pension system in states such as Chile; its market is more appealing, because it benefits businesses, which in turn creates more jobs.

¹⁰⁶ Borzutzky, "From Chicago to Santiago:" 664.

¹⁰⁷ David Blake. "Does it matter what type of pension funds you have?" F49.

Furthermore, companies also have the ability to develop in a state such as Chile, because private pension funds have created a new industry, in a state that was traditionally reliant on the production of raw materials. According to Marcus Porter and Arturo Condo, AFP Provida, one of the largest private pension funds in Chile, attempted to expand its business. They note, "The firm participated in foreign markets both as an investor and as a supplier of technology. Technology transfer took two forms: hardware and software technology related to industry operations and managerial know-how." ¹⁰⁸ Chile's ability to develop a service industry that had a comparative advantage within the region, allowed it to export its own technological services and profit in South America. Instead of relying only on commodities like copper, the diversified economy benefited Chile because it allowed it to develop an industry that was not established in other parts of the world and thus allow Chile to profit from its expansion. Furthermore, the authors note, then through the creation of private pension funds, AFP programs such as Provida "sought to grow rapidly and to seek new business that would increase the average income level of its members." ¹⁰⁹ Provida's expansion benefited its investors and pension holders who received positive yields from the company's success outside the state. The ability to expand its own operations outside of Chile allowed corporations to obtain a higher profit, and Chileans profited as Provida expanded and invested in other areas.

Furthermore, the development of a service sector in Chile, reduced the reliance on foreign investments, and allowed Chileans to receive significant profits from other countries developments. According to Tom Azzopardi, "advocates of the Chilean model note that one of its most remarkable effects has been its impact on the economy ... One study has estimated that

¹⁰⁸ Condo and Porter, "AFP Provida" 7.

¹⁰⁹ *Condo and Porter*, 6.

a quarter of Chile's economic growth since 1981 [is based on which are in privatized pension accounts] The assets managed by the industry, which today reach just over US\$60 billion, or close to two-thirds of GDP, created a new source of long-term finance."¹¹⁰ Clearly, the development of the private pension fund has been a strong factor in Chile's economic growth. Furthermore, as economic growth continues, and AFPs in Chile are able to increase their overall value, they have the ability to reinvest and finance government debt. While Silvia Borzutzky notes that private pension funds have fluctuated, and therefore are unstable in terms of funding the government she notes, "27.7% of AFP funds were invested in public debt securities... and 28.17% was invested in the financial sector, 22.62% in shares and investment funds, and 21.83% was invested abroad."¹¹¹ While a small portion of savings did not contribute to Chile's economic development, a large portion has helped the Chilean economy because it has reinvested in it.

While private pensions have failed to address the overall needs of people in the lower economic sectors, they have created more incentives for foreign businesses to enter Chile thereby creating jobs for the population. Even though corporations do not pay 52% of a worker's benefits they are required to pay a minimum of 4.11% of a worker's salary in order to contribute to the workers retirement fund. As a result, workers accept the majority of responsibility for retirement, but businesses are still held accountable. Furthermore, the implementation of the privatized social security sector, indirectly led to the growth of an industry in Chile. In this sense, while Chile was reliant on the production of raw materials such as copper to fuel its economy, the decision to implement a privatized social security sector allowed Chile to diversify its economy. This has led to increased economic growth and has allowed Chile to export its

¹¹⁰ Tom Azzopardi. "A Quarter Century on Private Pensions" *Business Chile Magazine*,

¹¹¹ Borzutzky, "From Chicago to Santiago," 665.

systems to other countries. While the system may have diminished workers rights, it has strengthened the overall economy in Chile. *Nevertheless, the system needs to be modified to address the economic needs of individuals in the lower economic classes.*

Doubts about the AFP system in Chile

Even though Chile's implementation of Ahorros Fondos de Previsionales (AFPs) has been supported by international institutions such as the World Bank and International Monetary Fund (IMF), Raul Madrid notes that individuals who use AFPs are unlikely to receive better benefits than they received under the previous system known as the Fondos Previsionales. Raul Madrid notes, "pension privatization schemes are costly in the medium term because they allow (or oblige) members of the Social Security system to transfer some portion of their Social Security contributions to private pension funds."¹¹² Individuals who were forced to shift their savings from the public system to a private system had to pay 10% tax in order to help fund the newly formed privatized pension companies.¹¹³ As Madrid states, "Where as the transition costs of pension privatization are quite large for countries with high current public pension expenditures; they are considerably smaller for countries with low public pension expenditures."¹¹⁴ Since Chile had a highly funded social welfare system, the transition was costly. The initial workers did not benefit from the implementation of a private pension system, because they were taxed to create a fully privatized one.¹¹⁵

Nevertheless, AFP supporters, argue that a privatized system, allows the state to maintain a fiscally balanced budget. They argue this allows the government to use resources in a way to develop the economy. Supporting the argument that private pension funds are an effective way

¹¹² Raul Madrid, "Economic Pressures, and Pension Privatization," 28.

¹¹³ Borzutzky, "From Chicago to Santiago," 664.

¹¹⁴ Madrid, "Economic Pressures, and Pension Privatization," 42.

¹¹⁵ Madrid, 43.

to allow individuals to control their own social healthcare costs is that "between 1982 and 2000, the pension funds generated returns averaging 10.9% annually above inflation."¹¹⁶ While this statistic indicates that Chileans are being rewarded with the implementation of AFPs, and therefore higher returns on pension should encourage Chileans to invest more of their money, studies have shown that even with high return rates Chileans are generally unwilling to put large amounts of money in their pension fund. According to authors Marcus Madrid, and Alberto Arenas de Mesa, David Bravo, Jere Bherman, Olivia Mitchell, and Petra Todd, "overall, self-reported contribution months exceed the administrative data count by 20%, no doubt in part due to recall error."¹¹⁷ The tendency to over report the amount of months and earnings placed into pensions challenges previous thoughts, which claimed the amount of money put into their pensions, would increase with a privatized system. This shows that Chileans are using more money on other issues rather than retirement. Thus, it will be difficult for the state to maintain a balanced budget, if individuals are not contributing sufficient amount of money to privatized pension systems.

The transition to a private pension fund increased Chilean government debt. According to Raul Madrid, transition costs to a private pension system," are particularly large for [some] countries because they tend to have a greater number of retirees whose pensions must continue to come from the state after the pension system is privatized."¹¹⁸ As the number of Chilean retirees increased, they collected their pensions from the state. However, as they withdrew their savings, and individuals switched to the private system, the state continued to lose funds necessary to

¹¹⁶ Madrid 31.

¹¹⁷ Mesa et al, "The Chilean Pension Reform Turns 25:" 13.

¹¹⁸ Madrid,. "Economic Pressures, and Pension Privatization," 42

fund retirees.¹¹⁹ Chile compounded this problem by encouraging workers who had held jobs prior to 1981 to switch their funds from the public system to a private one. Individuals were employed for the first time after 1981 had to enroll in the private pension system.¹²⁰ In essence, by encouraging individuals to adopt the privatized system, the Chilean government was minimizing the number of people who were necessary to contribute to retiree funds. As David Blake notes, "the introduction of a funded system creates what is known as a transition deficit this has to be financed by extra taxation or by the issue of recognition bonds by the government."¹¹

¹²¹ Proponents who claimed that the implementation of a privatized pension system reduced costs, especially in the short to medium term, failed to admit the government would incur greater costs with the implementation of a privatized system.

Neoliberals believed the transition to a private Social Security sector reduced government waste, while allowing the free market to determine prices of AFPs ensuring that the individual received the highest benefits from AFPs. As Marcus Porter and Arturo Condor note, "intense competition and modifications and regulations ... forced AFP's to continuously improve and extend their services at ever lower fees... the regulations designed to ensure sales force integrity and reduce account churning, resulted in... a sharp reduction in account transfers."¹²² While Porter and Condor stressed increased competition and reduced costs of AFP's, Borzutzky shows that, in the old system, the CF, individuals entitled to disability payments received \$231,720. Conversely, under a fully funded private pension system individuals received \$143,966. Overall coverage for the disability sector, an area that the private pension system was supposed to help did not provide individuals with significant benefits. As Porter and Condor note, "the four

¹¹⁹ Borzutzky, "From Chicago to Santiago," 669.

¹²⁰ Borzutzky, 663.

¹²¹ David Blake, "Does it Matter What type of Pension System you have?" F52.

¹²² Marcus Porter and Arturo Condo "AFP Provida," 4

largest AFP's contend for about 80% of funds under management and 90% of industry profits in 1999."¹²³ Clearly, a majority of AFP providers vie to get services from the population, which is not disabled. Minimal competition in some areas of the private pension sector show a fully privatized system, has not provided competition and benefits for all Chileans, this is a major reason why the government continues to fund disability services.

While pension funds reduced business costs, workers had to save for their own retirement, but contributed less to privatized systems. According to Silvia Borzutzky, in the 1980s, the overall value of wages decreased and by 1985, the true value of wages was 13% below the true value of wages in 1970. During this time private pension, funds returned an approximate increase of 13.8% of the overall pension fund per year. "Between 1990 and 1998 the real value of wages increased by 35% but the average investment yield decreased to 10.3%. The yield has been quite unstable oscillating from 28.6% in 1991 to 11.6% in 1998."¹²⁴ The fluctuation of wages in the early 1980s made corporations more profitable because they were not paying a large share of workers social costs. While wages increased in the 1990s allowing workers to put more income into their AFPs Borzutzky notes, the fluctuating pension returns deterred Chileans from saving more of their retirement money and thus they missed the opportunity to increase their savings. When salaries decreased, Chileans saved less of their earnings and when salaries increased, pension returns decreased. Thus, Chileans were unable to increase their savings.

Those with less money in their AFP accounts workers are more reliant on the government for financial aid. As Mesa et al note, the current Chilean pension system has "a noncontributory public system that provides welfare-based pensions [Solidarity Fund] for the indigent. The

¹²³ Porter and Condo, "AFP Provida," 4.

¹²⁴ Borzutzky, "From Chicago to Santiago," 667.

system is means tested and is operated centrally [and determines Solidarity Fund] benefits."¹²⁵ Remaining government-funded programs indicate that the Chilean government continues to use taxpayer dollars in order to fund the system. The state has not been able to allow the private sector to administer social welfare for its entire population; as a result the government has not been completely free to use funds in another manner to help Chile's economy. Critics of poor government spending must recognize that the current benefits that individuals receive from the Solidarity Fund are not substantial. Borzutzky notes, that individuals who have low pensions and low salaries remained reliant on government aid, but did not receive adequate services to address their needs. She notes, "The effects of the high costs of the commissions are not limited to the retiree. They also have a sizable effect on the fiscal budget because the state provides minimum pensions when the accumulated funds are not sufficient to provide a pension."¹²⁶ Contrary to the neoliberal thought, the government remains an important player in the distribution of funds to individuals in lower economic sectors.

Perceptions of AFPs

Even though Chile implemented mandatory private savings in the 1980s, the overall perception of the system will determine its future success. One of the biggest challenges it faces is the lack of knowledge Chileans have about it. Alberto Mesas et al note, "we posit that those better informed about their pensions are more likely to make sensible provisions for old age, possibly by contributing more and paying more attention to plan investments and making appropriate payout options."¹²⁷ A more informed population, should be able to maximize its overall returns in their private pensions, Nevertheless, the authors note that "as AFP participants pay little attention to investment costs, it is likely that AFP's will not need to compete amongst

¹²⁵ Mesa et al. "The Chilean Pension Reform Turns 25," 7.

¹²⁶ Borzutzky "From Chicago to Santiago," 668.

¹²⁷ Alberto Mesa et al, "The Chilean Pension Reform turns 25," 17

themselves to drive down prices and enhance service... fewer than 2% of the respondents knew either the fixed or variable commissions in either year."¹²⁸ Borzutzky noted that the lack of competition between pension organizations, forced the government to intervene and act as a regulator in order to ensure that individuals receive the most amount of benefits from their AFP. The lack of knowledge that individuals have about the system, suggests that they simply put their money into the retirement fund, but do not monitor their funds. This is problematic because individuals lack knowledge to adequately plan for retirement.¹²⁹ The attempts to implement a privatized Social Security system designed to increase overall individual involvement, has not lead to more responsible individual retirement planning.

Survey

While studies by Arenas de Mesa, show that a majority of Chileans are uninformed about the pension system, the current retirement system remains.¹³⁰ Many Chileans continue to support the current system indicating that they see as the most viable solution to their current Social Security issues. Increased support for the system with minimal knowledge about it suggests that if pensions do not return the same amount of value that they had been returning, many Chileans will question the overall benefits the system provides. Nevertheless, the evidence conducted in the reviews here suggests that Chileans in the middle and lower economic sectors, continue to support the process in part because it is the only system today are familiar with. By understanding Chileans perceptions of the system and understanding their disappointment with the system, it seems more likely that policymakers would likely alter the system in order to make it more appealing to more individuals. Chileans opinions about the system have the ability to

¹²⁸ Mesa et al, 18.

¹²⁹ Mesa et al, 18. *Ibid.*

¹³⁰ Alberto Arenas de Mesa et al, "The Chilean Pension Reform Turns 25,"

help policy makers alter policy in order to gain more support from the public, thereby reducing the chances that the public demands a complete overhaul of the current system.

In order to understand Chilean's perspective towards their private pension system, I interviewed employed Chileans whose ages ranged from 18 to 60. This age range was important because the Chilean population has the ability to retire at the age of 65 for males, and 60 for females.¹³¹ By using this age demographic, my goal was to determine the perceptions of savings held by individuals in a younger age demographic compared to an older demographic. Below are the questions I asked my respondents.

- 1) Tienes un Ahorro de Fondos Previsionales (AFP)?Cuál es el nombre de la empresa de su AFP? *Do you have an Ahorro de Fondos Previsional (AFP)? what company do you use?*
- 2) Aproximamamiento cuanto ganas en tu trabajo, cada mes, y ano? *[approximately how much does your job pay you each month? Year?*
- 3) Que porcentaje de su sueldo pones en tu AFP? *What percentage of your salary do you put into your AFP?*
- 4) ¿Guardas, mucho de tu dinero en su AFP? *Do you save a lot of your salary and put it into your AFP?*
- 5) Cual son los incentivos para ti para poner tu dinero en una AFP? *What are the incentives for putting your salary into an AFP*

¹³¹Bemstein et al., "Pension System Coverage," in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pension, 30.

- 6) Hay razones que preferirías poner menos de su sueldo en una AFP? Puedes explicar si o no? *What are the reasons that you would prefer to put less of your salary into an AFP? Could you please explain your reasons?*
- 7) Cuantos meses has puesto dinero en tu fondo previsional? Has puesto más dinero en tu AFP antes o después de las tenias 30 anos Porque hay una diferencia en la cuenta? *How many months have you contributed to your AFP? did you put more money in your AFP before or after you turned 30.*
- 8) Antes de las AFP's, usaste el sistema publica para obtener beneficios y jubilar? Que prefieres mas el sistema de antes de 1980 o los AFP's? Porque? (Depende en la edad de la trabajador) *Before the implementation of AFPs did you use the old provisional system (PAYGO)? do you prefer the AFP system over the old system? [note this is age dependent and also dependent on when the individual started working]*
- 9) Puedes explicar el tipo de AFP tienes. Por ejemplo hay muchos riesgos con su AFP, por ejemplo muchas inversiones que podrían darte beneficios o también problemas? O prefieres los AFP que no tienen muchas inversiones, pero también producen menos riesgos y beneficios? Porque escogiste tu tipo de AFP? *Could you please explain the type of AFP you have? For example are you required to take a lot of risks with your AFP in order to receive a lot of benefits? Or do you have a more moderate AFP system, which allows you to take fewer risks but also allows you to receive fewer benefits?*
- 10) Has perdido un trabajo? Durante el tiempo que no tenía trabajo ponías dinero en tu fondo previsional? Usaste dinero en su fondo previsional durante el tiempo que no

tenia trabajo? *Have you lost a job? During this time did you put money into your retirement fund? Did you use any money in your retirement fund to help you when you did not have a job?*

11) Que información tiene sobre su AFP?

what do you know about the AFP plan you have?

In Chile, all workers except self-employed individuals are forced to have AFPs. Questions 1 and 2 were important because they allowed me to learn which income group used certain AFP providers. One of the most important determining factors which will help determine whether private pension systems are viable in Chile is the amount of money individuals save. Question 5 is important because similarly to question four individuals who do not have an incentive to save for retirement, will rely on the government for financial aid. Similarly, questions six and seven, attempts to understand why individuals may have saved more after the age of 30. Rationale suggests that after the age of 25, incomes rise, but age can also determine a person's willingness to save. Therefore, simply claiming that jobs lead to overall savings may not be sufficient to explain increased savings. Question 8 is important because before 1980 there was a government-funded Social Security program. This question shows the overall likeliness that individuals save for retirement with government aid. Since there are various type of AFP pensions in Chile, individuals have the ability to determine the overall amount of risk they want to encounter when investing into an AFP. In addition, age as well as

Income should play an important role in determining the overall risks individuals are willing to take. If individuals accept high risks, with little money in their AFP's, and encounter heavy losses they will have to make up their losses. Similar to the survey conducted by Mesa et al, I also attempted to determine and learn how much individuals knew about their AFPs.¹³²

The first person I interviewed regarding their experience with the AFPs, was a 20-year-old female, who was a single mother and who lived with her parents. In order to continue her education, she had used loans, and worked during the day. This respondent represented the second-generation AFP users who have begun to use the system in their early 20s. Respondent number one noted that she selected Habitat to invest her savings because of its low price and low management costs. She noted she only saved the required 10% of her income, because "putting in more than the minimal amount was unnecessary."¹³³ This indicates that she wanted to use her money in other manners besides saving. While she noted that she would put more than the required 10% of her salary into the AFP if her overall job paid her more, her initial response challenges private pension supporters claims that private investment encourages individuals to save more for retirement. Respondent one indicates that with her current salary, she is be unlikely to put more of her salary into the overall retirement fund because it would reduce her ability to spend money on other necessities. In this sense, respondent one is the prototypical response to the implementation of a privatized system, but also gives supporters of the system the opportunity to note that individuals have the ability to determine how much of their overall incomes they save. Nevertheless, her saving habits indicate that retirement may be much easier for individuals who are able to save more and put more into their AFPs at an earlier age.

¹³² Mesa et al, "The Chilean Pension Reform turns 25," 2.

¹³³ Respondent I.

One of the major factors that will determine the overall success for the continued private pension system is the overall amount of support it receives from second-generation users. At this current point in time, while the second-generation seems to support the system, their inability to contribute indicates that if their wages do not increase, they will have less incentive to contribute to the AFPs. While respondent two noted that he puts the mandatory 10% into the savings account, when asked why he did not put in more, he noted "No Ponia mas en mi AFP, porque juntaba dinero para pagar el ultirpo semester de mi carrera en mi Universidad. [I didn't put more money into my AFP because I was collecting money to pay for my final semester of college.]"¹³⁴ This comment relates to the overall tangible feeling that pension users have towards the overall system. Education is more highly valued consideration than putting money into a pension plan. However, spending towards education may t hurt the overall individual in part because the system is set up to encourage continuous retiring savings, and thus, when this does not occur individuals become more reliant on higher salaries or working longer hours in order to make up for the lack of contributions to the system they missed in the early years.¹³⁵

The second respondent's overall lack of knowledge about his current pension system, indicated that he was not consistently tracking the overall gains his company reported. Respondent two noted, " es que escogi6 mi AFP fue el contador de la empresa donde yo comencé a trabajar, estoy totalmente desinformado de los riesgos y beneficios de cotizar en mi AFP." ¹³⁶[My employer chose my current AFP for me, I am completely uninformed about the risks and benefits that I can collect in my AFP.] The lack of knowledge he had about his AFP provider indicated that he was not constantly monitoring the benefits and risks that his company

¹³⁴ Respondent 2

¹³⁵ Eduardo Corripio, "Creating Incentives for Voluntary Contributions to Pension Funds by Independent Workers,"³

¹³⁶ Respondent 2

used in order to increase his pension. His lack of knowledge about the risks meant, that if his pension holder lost part of his savings, he would have to work longer in order to recover the savings. Furthermore, he may not be putting appropriate amounts of investment into his AFP in order to increase his earnings.¹³⁷ Employers who choose pension plans for their employees, must be forced to explain all the benefits and risks that employees receive with the company provided plan. A more informed investor is likely to save more effectively and be better prepared for retirement.¹³⁸ This respondent noted that in the future, the next time he changes his pension plan he is more likely to research all pension plan opportunities. Nevertheless, based on his results, this will be heavily reliant on the overall amount of time he has to determine which pension fund is best, and thus, his selection will play an important role in his overall ability to retire.¹³⁹

The third respondent differed from the first two because he was in his early 50s, and had put money into his AFP for over five years. While the authors of the SAFP noted individuals from 35 to 50, were more likely to put more funds into AFP's, as well as AVPs, respondent 3 challenges these findings.¹⁴⁰ He noted, "Ahorra estoy pusiendo el mínimo en mi AFP. No estoy como un empleado. Ahorra, estoy como un trabajador independiente. Es muy difícil para mí a poner mas que 10% de mi sueldo en un AFP porque mi sueldo es fijo."¹⁴¹ [Note independent workers do not have to put money into AFPs]. *[Right now I am putting the minimum in my AFP. I am not an employed worker, right now I am like an independent worker. It is very difficult for me to put more than 10% of my salary into an AFP, because it is fixed [and it is low]*¹⁴² The small amount of salary that he is earning at this current point in time is barely enough to

¹³⁷ Mesa et al, "The Chilean Pension Reform turns 25," 17

¹³⁸ Mesa et al, 17.

¹³⁹ Mesa et al, 17..

¹⁴⁰ Bernstein et al, "The Old System," in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pension, 30

¹⁴¹ Respondent 3

¹⁴² Respondent 3.

contribute to the pension fund. He noted that the amount he puts into his AFP prevents them from contributing any money to an AVP. This supports the findings of the SAFP, which found that individuals who put in more of their savings into APVs tended to have higher incomes.¹⁴³ The overall system fails to benefit many middle-income workers and as a result should be seen as a precursor to second-generation users in the sense that individuals who become self-employed and are not making large amounts of money, may struggle to contribute to the AFP and thus, may not have sufficient funds to contribute to AVPs.¹⁴⁴

Nevertheless, Chileans like the current AFP system this is ironic because many of the respondents were receiving minimal salaries, and the benefits they received remain small. This would suggest that Chileans would find the system inequitable. However, individuals believe that even the risks that they are required to take, their pension accounts have high growth rates and remain relatively stable. Respondent 3 noted, "Mira, tenía que poner mi sueldo en una AFP. Me gustan los AFPs...Cuando comiencen los AFP fueron regulados. El control es bueno de los AFPs, nose como otras seria funciona."¹⁴⁵ [Look, I had to put my salary in an AFP. I like the AFPs...When they began the AFPs were regulated. The regulation of AFPs is good. I don't know how another system would work other than with AFPs.] Chileans see the system as relatively stable, and furthermore, as respondent three notes, many do not see an alternative to the current system. While the respondent noted, "Mi papa me dijo que el recibí6 mas beneficios del sistema antigua que los trabajadores reciben de los trabajadores hoy. [My father told me he received more benefits from the old system, than the workers receive from the system today.

¹⁴³ Bernstein et al, "The Old System," in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pension, SAFP 30 .

¹⁴⁴ Bernstein et al, 30. .

¹⁴⁵ Respondent 3

]"¹⁴⁶ Even though, this suggests that the overall benefits individuals receive need to be improved to provide services equivalent to the older system, evidence clearly indicates that with the older system, large amounts of government inefficiency led to overall state debt.¹⁴⁷ Thus, it seems unlikely that politicians will support a return to the previous form of Social Security pension systems. It is more likely to implement reforms designed to help individuals and lower classes save more effectively for retirement.

Clearly, respondent number four differed from the initial ones in part because of his ambivalence towards the current privatized system. Unlike the other respondents, respondent number four was retired, but he highlighted the difficulty in obtaining a high pension in order to retire for individuals who were not professionals. He noted, individuals such as lawyers, doctors, other professionals, benefited from the system, but the overall population did not benefit. He noted:

"Es imposible obtener la cantidad porque tienes que ser un profesional. Tienes que ser, un doctor, abogado etc. Y también no me gusta el sistema porque tengo que pagar una administrador guardar mi dinero. No es justo, y tambien, si hay una crisis como que ocurri6 en 2008, muchas personas perdieron su dinero para jubilar, pero los AFPs no dieron dinero. En mi opinion hay demasiados riesgos. No, no me gusta el sistema."¹⁴⁸ [It is impossible to obtain the necessary amount in order to retire, you have to be a professional. You have to be a doctor, lawyer, etc. In addition, I don't like the system because I have to pay an administrator to watch my money. It's not fair, and if there is a crisis occurs like the one that occurred in 2008 many people lost their retirement funds,

¹⁴⁶ Respondent 3

¹⁴⁷ Borzutzky, "From Chicago to Santiago," 653.

¹⁴⁸ Respondent 4

but the AFPs did not give them back all their retirement savings. In my opinion, there are too many risks. I DON'T LIKE THE SYSTEM (emphasized)].

Unlike the previous respondents, who were un-concerned about losing their savings, this respondent, showed a lack of knowledge that the previous respondents had about the current system. While all noted that they were happy with the service and benefits, they receive from the system, none noted that they were worried about losing pension savings, and as respondent four shows, individuals should be worried about the overall accountability that AFPs have in part because they are not required to return peoples' lost savings. Clearly, the individuals who have the most to lose from the system, are nonprofessionals, who put in the required 10%, but do not have significant funds in AFPs.¹⁴⁹ In this sense, these individuals pay the highest prices for AFP's, in part because of their administrative charges and because of the lack of accountability their companies have in terms of overall savings.

While it is easy to argue for a return to the prior system, it is important to note that the overall amount of government inefficiency was the main point, which led to the transformation to a privatized system.¹⁵⁰ While the transition to a privatized system, has forced individuals to become more self-sufficient and less reliant on government aid, reducing government expenditure, inequality still exists. In order to rectify the current system, respondent 4 noted:

"me gusta la idea que personas tienen que guardar su dinero, pero ahorra no es justo porque muchas personas quien estan trabajando, estan recibiendo el sueldo mínimo.

Entonces, es muy difícil para jubilar. Ahora aquí el sueldo bajo es dos mil y quinientos pesos. No es suficiente para guardar los en los AFPs y también usar dinero pero otras

¹⁴⁹ Respondent 4

¹⁵⁰ Borzutzky "From Chicago to Santiago,"657

casas. Silos trabajadores reciban mas sueldo sería diferente porque tenía mas oportunidades para poner sus sueldos en AFPs." ¹⁵¹

[I like the idea that people have to save their earnings but right now it is not fair because people are receiving the minimum wage. Thus, it is very difficult for them to put portions of their salary in order to retire in part because they need to use it for other things. If workers received higher salaries, it would be different because they would have more opportunities to put their savings into AFPs]

Respondent four provides a reasonable solution to the current system in Chile. It would be more difficult, to completely revamp the system, but if individuals have higher salaries, they would have more money to contribute to the AFPs. All previous respondents noted that if they had greater salaries, they would be willing to contribute more in order to save for retirement. Nevertheless, one of the reasons that individuals at this current point in time lack the ability to do so is the overall fact that low salaries combined with high prices for other products, diminish their ability to contribute. ¹⁵² Government intervention is necessary in order to increase overall working salaries for individuals in the middle class giving them a greater opportunity to contribute to voluntary pension funds. This may be the most legitimate solution to the current problem in Chile, but this also will be dependent on businesses willingness to pay workers higher salary wages, and politicians willingness to alienate businesses in the state.

Searching for Solutions

Privately funded pension do not provide the greatest amount of benefits to Chileans. The Chilean government has implemented a hybrid system, where it helps individuals with lower

¹⁵¹ Respondent 4

¹⁵² Respondent 4

pensions, receive adequate standards of living in retirement. Ex-president, Michele Bachelet implemented the most aggressive reforms, in 2008, when she signed legislation that gave individuals in lower income brackets, more aid from the government. Eduardo Gallardo notes, "The new \$2 billion-a-year program will expand public pensions to groups left out by private pensions - the poor and self-employed, homewives, street vendors and farmers who saved little for retirement- granting about a quarter of the nation's work force public pensions by 2012."¹⁵³ This decision to implement increased government aid, diverges from the previous trends implemented under Pinochet and following presidents who placed a large burden of savings on individual workers. Individuals have struggled to contribute to the retirement plan, but increased government aid combined with the private system allows individuals who saved to receive increased aid from the government, if their personal savings is minimal. Estelle James noted, "Public pensions alone won't do, because governments are not able to finance them, while private accounts can leave people out."¹⁵⁴ Furthermore, individuals who save will be rewarded with government support and thus will have an extra incentive to save because they know that the government is representing their interests.

While the current pension system only provides aid to individuals once they have AFPs, individuals would be more likely to save if they knew that the government would provide them with aid for social costs. Carmela Mesa-Lago notes, "If the household's income does not reach the ceiling per capita, each adult member may receive a basic, non-contributory pension, so that two adults in the family unit may receive the benefit even though the household might not be amongst the poorest."¹⁵⁵ Government subsidies act as an additional support pillar for those individuals who have to spend money on other expenses such as health thereby reducing their

¹⁵³ Eduardo Gallardo, *Chile's Private Pension System adds Public Payouts for Poor*. New York Times.

¹⁵⁴ Estelle James cited in. *Chile's Private Pension System adds Public Payouts for Poor*. New York Times

¹⁵⁵ Mesa-Lago "Social Protection in Chile," 392.

ability to contribute to the overall pension fund.¹⁵⁶ Thus, individuals in these situations, are not punished for their lack of contributions at the minimal level. Mesa-Lago notes, "There will be incentives... [individuals who do not contribute] will not receive the certificate of documents needed for certain legal procedures and will not qualify for tax exemptions on credits."¹⁵⁷ The system encourages individuals to first fund their own policies, but willingly gives aid to those who attempt to save, but may not be able to contribute enough to savings.

Conclusion

Clearly, individuals are deterred from putting money into savings accounts because they fear they are losing it for other necessary purposes, such as health costs. "Individuals responding to the importance of needs ranked health as the most important, receiving 39% of the votes, housing as the second most important, receiving 27% of the votes, and education as the third most important, receiving 26%."¹⁵⁸ Individuals clearly place a higher emphasis on the potential need to pay for health costs than saving for retirement. The costs of health encourage individuals to save their money in order to receive its benefits. Retirement must be seen as a medium-term prospect rather than a long-term one. In order to do this, governments must understand individual's priorities. At this current point in time individuals pay for health expenses independent from their current pension funds.¹⁵⁹ However, Corripio notes that 35% of the respondents in his survey noted, "health benefits would be an incentive to additional contribution."¹⁶⁰ He stated only 4% of individuals claimed tax incentives were a motivating

¹⁵⁶ Mesa Lago, "Social Protection in Chile," 394.

¹⁵⁷ Mesa-Lago, "Social Protection in Chile," 394.

¹⁵⁸ Corripio Creating Incentives for Voluntary Contributions to Pension Funds by Independent Workers 43.

¹⁵⁹ Corripio, Creating Incentives for Voluntary Contributions to Pension Funds by Independent Workers 49

¹⁶⁰ Corripio, 49.

factor that encouraged them to contribute more to AVPs.¹⁶¹ Individuals are unlikely to feel the tax effect immediately when they contribute more money to the system, because it happens annually.¹⁶² Conversely, health is more relevant because individuals feel significantly affected by the costs each time they use it, because it reduces their salary.¹⁶³ In order to encourage individuals to contribute more money to the voluntary Social Security savings program, there need to be more tangible rewards.¹⁶⁴

Finally, if the government is going to reduce reliance on government aid, it must implement laws that increase workers' salaries. In 2007, one year before Michele Bachelet implemented her Social Security reforms, minimum wage was US \$288 per month.¹⁶⁵ Currently, minimum wage is US \$310 per month. The current amount that workers receive is significantly low and hinders their ability to put large portions of their salary into private pensions.¹⁶⁶ In 2007, workers wanted a wage increase in part because of their inability to purchase food. Evelyn Mathei noted, "If one considers the high inflation, one can understand that the increase [in wages) could not have been any lower. Chileans have lost a lot of purchasing power."¹⁶⁷ If Chileans are unable to purchase the current necessary goods in order to survive, they are even less likely to contribute to pension funds. In Chile, "a very nice, fully furnished studio apartment in a good neighborhood can be found for as little as \$400 per month."¹⁶⁸ Individuals who want to live in safe neighborhoods, have to make a decision: do they contribute less to pensions in order to have higher standards of living, or do they save for retirement and sacrifice living standards. Workers receiving minimum salary, and by contributing 10% of their salary to AFPs

¹⁶¹ Corripio, 49.

¹⁶² "The Chilean Income Tax System" http://www.sii.cl/aprenda_sobre_impuestos/estudios/sistemrenta_ingles.htm

¹⁶³ Corripio, 51.

¹⁶⁴ Corripio, 51.

¹⁶⁵ Matt Malinowski, *Minimum Wage Hike Planned in Chile*, The Patagonia Times, June 18, 2008

¹⁶⁶ Sebastian Leon, *Chile's Minimum Wage Change Still in Limbo*. The Santiago Times. June 11, 2010.

¹⁶⁷, Evelyn Mathei cited in Matt Malinowski.

¹⁶⁸ Expat Chile

would lack sufficient funds to live in a safe neighborhood and contribute to AFPs. Chileans want both of these and those statistics show, housing is ranked very important.¹⁶⁹ The government must increase overall wages in order to allow individuals to live in safe neighborhoods and contribute to pensions. Thus, an appropriate salary is crucial if the current privatized system is going to succeed.

Arguably, the government must support business interests and allow minimum wage practices or, it must intervene and increase overall salaries allowing more individuals to contribute to AFP's reducing reliance on government funding but possibly risk losing foreign investment. At this current point in time, the government's evidence response suggests that emphasis continues to be placed on attracting business rather than on helping workers save for retirement.¹⁷⁰ By reducing corporations responsibilities, the state government has placed a majority of the responsibility on workers who have insufficient funds. Lacking in sufficient funds, workers will continue to rely on government aid in order to retire.¹⁷¹ Thus, the neoliberal philosophy has not reduced government dependence and has not created a system that allows individuals to save their money and retire. In this sense, the system is contradictory because it requires large amounts of income in order for it to succeed. Conclusively the system requires individuals to rely on government aid in a similar manner that occurred under PAYGO systems.¹⁷²

The shift to a neoliberal advocated economic policy was supposed to reduce overall government influence in the social sphere allowing it to spend money more efficiently in other

¹⁶⁹ Corripio, "(Creating Incentives for Voluntary Contributions to Pension Funds by Independent Workers," 49

¹⁷⁰ Borzutzky, "From Chicago to Santiago," 664.

¹⁷¹ Mesa-Lago "Social Protection in Chile," 387.

¹⁷² Bernstein et al, "The Old System," in *Chile 2008: A Second Generation Pension Reform*, Superintendence of Pensions, 30

areas thereby developing the Chilean economy. However, this has not occurred. While neoliberalism claims that businesses have the ability to make economies more efficient, thereby strengthening economic growth and minimizing government expenditures, Michelle Bachelet's reform plan shows the inherent problems in a purely neoliberal market oriented policy. Rather than reducing government aid in the overall public sphere, and leaving it to the "efficiency" of corporations, strong evidence shows that neoliberalism continues to force governments to accept heavy burdens **to satisfy** public needs. The \$2 billion Social Security program that Michele Bachelet implemented in 2008, shows that the transition to a privately funded system, still requires heavy assistance from the federal government in order to achieve success.¹⁷³ Furthermore, the overall efficiency that neoliberalism promised in terms of improving standards of living must also be questioned.¹⁷⁴ If the government has to use its own resources in order to address the needs of individuals in the lowest socioeconomic sectors, then the promises that neoliberalism has advocated must merely be seen as promises given to a minority of the population but which fail to address the needs of the entire population. In this sense, the implementation of the neoliberal reforms in the shift to a neoliberal policy, did not benefit the Chilean government or its population.

Clearly, the interviews indicate that the attempts to encourage Chileans to save more money have been ineffective. Respondent one's answers to my questions could highlight many young Chileans perceptions of mandatory savings. In this sense, they saved because it is required, but show little ability or desire to increase their savings.¹⁷⁵ If individuals are not focused on retirement, but rather on other expenses such as providing food for their families, or

¹⁷³ Eduardo Gallardo, *Chile's Private Pension System adds Public Payouts for Poor*. New York Times.

¹⁷⁴ Jose Pinera, cited in Borzutzky, "From Chicago to Santiago," 662

¹⁷⁵ Respondent 1

continuing their education evidence clearly shows Chileans will continue to contribute minimum amounts of their salary in order to pay for other expenses which they believe are necessary in order to improve their standards of living.¹⁷⁶ In the interview process, it is important to highlight the overall personal feelings individuals have towards the current system. While many respondents looked at the system as boring, and uninteresting to discuss, only respondent three took a different attitude in favor of the system. However, even he noted that it was difficult for him to contribute more than the minimum requirement to his retirement fund indicating that in terms of his retirement income plays a heavy role.¹⁷⁷ If individuals lack attachment to the system and lack income to contribute to it, suggestively, the system will continue to have problems and the government will have to continue to fund it.

Even the most vocal critics of the current system such as Silvia Borzutzky admit that the public funded government system was inefficient.¹⁷⁸ Clearly, a dictatorship and the rise of neoliberals under Pinochet successfully implemented a market oriented Social Security program. While it was intended to minimize government spending, history has shown that it has not achieved its objective. Nevertheless, governments after the Pinochet dictatorship have continued to support the system, because they realize that returning to a fully public system would alienate the AFP industry. Thus Chilean governments are forced to decide between the economy or social conditions. Based on previous presidential administrations it seems unlikely that Chile will return to a fully funded public system. However, reforms under governments such as Michelle Bachelet in 2008 indicate that the system can be modified allowing the government to take a larger role in social security. Arguably, at this current point in time this appears to be the case as

¹⁷⁶ Corripio, Creating Incentives for Voluntary Contributions to Pension Funds by Independent Workers 49

¹⁷⁷ Respondent 3

¹⁷⁸ Borzutzky, "From Chicago to Santiago," 657.

a government has gradually taken on increased responsibility to ensure that a majority of the population receives Social Security benefits. Chile may be seen as a country that is in a transition phase, as the government increasingly takes a more active role in Social Security. Nevertheless, its involvement indicates that the overall model for Social Security provided by corporations has not been efficient as its advocates once claimed and thus the Chilean government once again finds itself funding the system in order to ensure that all individuals have access to Social Security benefits.

Theoretically a Social Security system that requires minimal government expenditure has the ability to allow government to focus its attention on other important aspects in society. Theoretically, companies would compete with each other in order to gain the most customers and such competition would increase overall benefits individuals received in the state. Realistically, competition has not resulted in increased benefits for individuals who use the service, and more importantly the state continues to use its resources in order to help individuals who are unable to receive benefits from the current privatized Social Security system. Therefore, Chile can be seen as a country that shows the inherent flaws in a fully privatized Social Security system.

Appendix I Interview Questions

- 12) ¿Tienes un Ahorro de Fondos Previsionales (AFP)?Cuál es el nombre de la empresa de su AFP? *Do you have an Ahorro de Fondos Previsional (AFP)? what company do you use?*
- 13) ¿Aproximadamente cuanto ganas en tu trabajo, cada mes, y año? *[approximately how much does your job pay you each month? Year?*
- 14) ¿Que porcentaje de su sueldo pones en tu AFP? *What percentage of your salary do you put into your AFP?*
- 15) ¿Guardas, mucho de tu dinero en su AFP? *Do you save a lot of your salary and put it into your AFP?*
- 16) ¿Cuales son los incentivos para ti para poner tu dinero en una AFP? *What are the incentives for putting your salary into an AFP*
- 17) ¿Hay razones que preferirías poner menos de su sueldo en una AFP? Puedes explicar si o no? *What are the reasons that you would prefer to put less of your salary into an AFP? Could you please explain your reasons?*
- 18) ¿Cuantos meses has puesto dinero en tu fondo previsional? Has puesto más dinero en tu AFP antes o después de las tenias 30 años Porque hay una diferencia en la cuenta? *How many months have you contributed to your AFP? did you put more money in your AFP before or after you turned 30.*
- 19) Antes de las AFP's, usaste el sistema publica para obtener beneficios y jubilar? Qué prefieres mas el sistema de antes de 1980 o los AFP's? Porque? (Depende en la edad de la trabajador) *Before the implementation of AFPs did you use the old provisional*

system (PAYGO)? do you prefer the AFP system over the old system? [note this is age dependent and also dependent on when the individual started working]

20)(,Puedes explicar el tipo de AFP tienes. Por ejemplo hay muchos riesgos con su AFP, por ejemplo muchas inversiones que podrían darte beneficios o también problemas? O prefieres los AFP que no tienen muchas inversiones, pero también producen menos riesgos y beneficios? Porque escogiste tu tipo de AFP? *Could you please explain the type of AFP you have? For example are you required to take a lot of risks with your AFP in order to receive a lot of benefits? Or do you have a more moderate AFP system, which allows you to take fewer risks but also allows you to receive fewer benefits?*

21)(,Has perdido un trabajo? Durante el tiempo que no tenía trabajo ponías dinero en tu fondo previsional? Usaste dinero en su fondo previsional durante el tiempo que no tenía trabajo? *Have you lost a job? During this time did you put money into your retirement fund? Did you use any money in your retirement fund to help you when you did not have a job?*

22)(,Que información tiene sobre su AFP?

what do you know about the AFP plan you have?

The following five respondents were selected because they currently use the AFP system. The interviews attempted to learn their perceptions about the current system, and gain information about each individual's overall comprehension of the current system. While the first three individuals tend to favor the system because it helps them retire, the last two, are more skeptical of the system, and have found other ways to increase their pension savings.

Respondent 1)

- a) Female 20 years old
- b) College Student
- c) Single Mother
- d) Living with Family

1)Tienes un Ahorros de Fondos Previsionales (AFP)?Cuál es el nombre de la empresa de su AFP

Hábitat. Lo escogí porque es muy barato y lo use para mi primer trabajo. Lo escogí porque una persona me había dicho que la empresa era buena.

2)Aproximamiento como ganas en tu trabajo, cada mes, y año?

Nose.

3) Qué porcentaje de su sueldo pones en su AFP?

Pongo 10porciento de mi sueldo en la AFP. Si recibo más dinero yo pondría más dinero en mi AFP. Cuando tengo trabajo, pongo mi sueldo en la AFP, cuando no tengo trabajo no recibo ayuda del gobierno, y no puedo poner dinero en mi AFP.

4) Guardas, mucho de su dinero en su AFP?

5) Como son los incentivos para ti para poner dinero en un AFP?

La {mica razón es para jubilar.

6) Hay razones que preferirías poner menos de su sueldo en un AFP? Puedes explicar si o no?

No tengo desincentivos para usar el sistema. Pero también, me gustaría poder usar mi sueldo para otras cosas por ejemplo para comprar cosas que me gusta.

7) En su opinion, no tienes problemas que la cantidad que tiene que pagar su AFP para guardar su dinero?

Podría ser que la inversión es alta.

8) Cuantos meses has puesto dinero en su fondo previsionales? Has puesto mas dinero en su AFP

antes o después 30. Porque hay una diferencia en la cuenta?

9) Antes de AFP's, usaste al sistema publica para obtener beneficios y jubilar? Qué prefieres mas al sistema antes de 1980 o los AFP's? Porque? (Depende en la edad de la trabajador)[Did not

ask, respondent entered work force after 1980}

10) Has perdido un trabajo? Durante el tiempo que no tenía trabajo ponías dinero en su fondo previsional? Usaste dinero en su fondo previsional durante el tiempo que no tenía trabajo?

Si, pero cuando no tengo trabajo mis padres me ayudan. Ponen dinero en mi AFP.

Respondent 2) Male, 25, Lives with family, student

1) Tienes Abonos de Fondos Previsionales (AFP)?

Si tengo JNG Capital

2) (,Cuanto ganas en tu trabajo, cada mes, y rulo?

En mi último año ganaba mensual\$ 205.512 restándole a esto los descuentos legales, no puedo !weber estimación anual que no he trabajado en un año completo.

3)(.Que porcentaje de su sueldo pone en su AFP? Guardas, más que el 10porcentaje en su AFP?

EL 10 % va a mi AFP.

4)(. Cuáles son los incentivos para ti para poner dinero en un AFP?

El tener una jubilación..

5)Hay razones que preferirías poner menos de su sueldo en un AFP (,Puedes explicar si o no?

Tener más dinero en el presente. pero claramente seria irresponsable de mi parte para mifutura vejez.

6) (,Cuantos meses has puesto dinero en su fondo previsional? Si has puesto mas dinero en su AFP puedes explicar las razones que decidiste a poner mas dinero en su AFP

Nose cuantos meses he puesto dinero en mi modo provisional. he tenido trabajos e. portadiscos, que difícil a calcular. . Nunca has puesto mas dinero [mas que 10%.} Nunca he puesto más dinero en mi AFP, quizás en el futuro con un mejor sueldo.

7)Puedes explicar el tipo de AFP tienes. Por ejemplo hay muchos riesgos con su AFP, por ejemplo muchas inversiones que podrían dar beneficios o también problemas?

O prefieres los AFP que no tienen muchas inversiones, pero también producen menos riesgos y

beneficios? Porque escogiste su tipo de AFP?

-El que escogió mi AFP. Fue el contador de la empresa donde yo comencé a trabajar. [No tengo información sobre] los riesgos y beneficios de cotizar en mi AFP

8). Usas el sistema voluntario para guardar para jubilar? (Usas una APV)

No ocupo este sistema de Ahorro Previsional Voluntario.

9) Hay varias opciones para escoger su AFP? Si puedes explicar porque escogiste este tipo. Si no leíste sobre su AFP antes pusiste dinero en la AFP? Si no leíste puedes explicar porque no leíste sobre la AFP

No leí sobre el AFP El contador de mi primer empleo determino cual sería mi AFP, fue

una despreocupación de mi parte.

10) El gobierno te dio ayuda con financiar tu AFP mientras no tenias trabajo? Par ejemplo el gobierno puso dinero en su cuenta para suplementar su dinero necesario para jubilar? Si n, Crees que esta sistema es justa? El gobierno debe hacer que para ayudarte cuando no tienes trabajo para incrementar su Dinero?

-No el gobierno no me ayudo cuando no tenía trabajo. El gobierno debe ayudar a las personas sin trabajo pagando.

11) Si podrías cambiar cosas en el sistema que cambiarías? En tu opinion porque es necesario para cambiar el sistema?

Cada AFP debe entregar mayor información a los personas para que tomen una buena decisión a la hora de afiliarse a una AFP y no pase como a mí que otro tomo la decisión por mí.

Respondent 3) Male, 50, Independent worker

1) En que ano empezaste a trabajar?

1987.

2) Tienes un Ahorros de Fondos Previsionales (AFP)? Cuál es el nombre de la empresa de su AFP?

Si tengo una AFP, mi primera AFP fue Santa Maria, pero ahorra uso CUPRUM

3) Aproximamiento como ganas en tu trabajo, cada mes, y ano?

[Did not ask respondent]

4) Qué porcentaje de su sueldo pones en su AFP? Aproximamiento como cantidad de su sueldo pones en su AFP?

10%. Ahora estoy poniendo la mínima en mi AFP. No estoy como un empleado.

Ahorra, estoy como un trabajador independiente. [Note independent workers do

not have to put money into AFPs} Es muy difícil para mí a poner mas que 10% de mi sueldo en un AFP porque mi sueldo es fijo. Pongo la mínima porque tengo que usar la otro parte de mi sueldo en otras casas.

- 5) Guardas, mucho de su dinero en su AFP?

[this question was unnecessary since respondent answered it in previous question)

- 6) Cuáles son los incentivos para ti para poner dinero en un AFP?

Para jubilar.

- 7) Hay razones que preferirías poner menos de su sueldo en un AFP? Puedes explicar si o no?

Si prefiero poder usar mas para otras casas, pero en realidad tengo que poner la mínima cuando soy un empleado.

- 8) Cuantos meses has puesto dinero en su fondo previsionales? Has puesto más dinero en su AFP antes o después 30. Porque hay una diferencia en la cuenta?

No he tenido trabajo, con un contrato, entonces no he tenido la oportunidad para poner más en mi AFP.

- 9) Antes de AFP's, usaste al sistema publica para obtener beneficios y jubilar? Qué prefieres mas el sistema antes de 1980 o los AFP's? Porque? (Depende en la edad de la trabajador)

Mira, tenía que poner mi sueldo en una AFP. Me gustan las AFPs ... Cuando comenzaron las AFP fueron reguladas. El control es buena para las AFP 's, no sé como de otra forma funcionaria. Mi papa me dijo que el recibí mas beneficios desde el sistema antiguo que los trabajadores reciben de los trabajadores hoy.

- 10) Puedes explicar el tipo de AFP tienes. Por ejemplo hay muchos riesgos con su AFP, por ejemplo muchas inversiones que podrían darte beneficios o también problemas? O prefieres los AFP que no tienen muchas inversiones, pero también producen menos riesgos y beneficios? Porque escogiste su tipo de AFP?

Riesgos no son grandes. CUPRUM ha hecho buenos casas en contabilidad.

- 11) Has perdido un trabajo? Durante el tiempo que no tenía trabajo ponías dinero en su fondo previsional? Usaste dinero en su fondo previsional durante el tiempo que no tenía trabajo?

Cuando no tenía trabajo, el gobierno no puso dinero en mi AFP. Solamente cuando tengo trabajo puedo poner dinero en mi AFP.

- 12) Que información sobre su AFP?

Veo mis resultados cada dos o tres meses.

Respondent 4) Retired, Male, 55, Single

This interview differs from the ones above because it was conducted informally. In this sense, the interview occurred over a meal, and I felt that it was better for me to listen rather than attempt to take notes. Even though the questions are limited, the respondent's perceptions in regards to the AFP system should not be devalued.

- 1) Tienes un AFP

Tuve BBUVA Provida

- 2) Cuáles son sus opiniones sobre las AFPs

Mira no creo en las AFPs, y porque, porque es imposible juntar suficiente dinero para jubilar. Par ejemplo sabes que básicamente, para jubilar y vivir necesitas como 72 millones [72,000,000 pesos is approximately \$144,000] para jubilar, yes

imposible, para obtener. Es imposible obtener la cantidad porque tienes que ser un profesional. Tienes que ser, un doctor, abogado etc. Y también no me gusta el sistema porque tengo que pagar una administrador guardar mi dinero. No es Justo, y también, si hay una crisis como la que ocurri6 en 2008, muchas persona s perdieron su dinero para Jubilar, pero las AFPs no dieron dinero. En mi opinion hay demasiados riesgos. No, no me gusta el sistema.

2) Pero sabes que hay un sistema que se llama PASIS y también da ayuda al público?

Si, pero también recuerda que, muchas personas tienen que trabajar, para jubilar . Y con ayuda del gobierno muchas personas van a recibir beneficios pero también muchas personas no van a recibirlos. Vivo con unos egipcios, y nunca han recibido ayuda del gobierno, y sabes porque, porque, estando colectando suficiente dinero, y el gobierno ha decidido, no es necesario para ayudarlos. Entonces, no han recibido ayuda.

3) Si puedes cambiar el sistema como cambiarías

-Mira, me gusta la idea que personas ahorren su dinero, pero ahora no es justo porque muchas personas quienes estan trabajando, estan recibiendo el sueldo mínima. Entonces, es muy difícil para Jubilar. Ahora aquí el sueldo mínima es de dos mil y quinientos pesos al día. No es suficiente para guardar en los AFPs y también usar dinero pero otras casas. Si los trabajadores reciban mas sueldo sería diferente porque tendrían más oportunidades para poner sus sueldos en AFPs.

Respondent 5) Female, Single, Teacher

- 1) Tienes un Ahorros de Fondos Previsionales (AFP)?Cuál es el nombre de la empresa de su AFP

BBVA Próvida. He usado BBVA par siete anos. Pero lo cuesta mucho para mantener, y también, hubo los beneficios no son suficiente. Ahora, tengo ambos un AFP, también A VP. Tengo ambos para aumentar mi sueldo.

- 2) Aproximamiento como ganas en tu trabajo, cada mes, y ano?

Un millon [pesos]

- 3) Qué porcentaje de su sueldo pones en su AFP? Aproximamiento como cantidad de su sueldo pones en su AFP?

Pongo 10% de mi sueldo.

- 4) Cuáles son los incentivos para ti para poner dinero en un AFP?

Los incentivos son !a de unidad para jubilar

- 5) Hay razones que preferirías poner menos de su sueldo en un AFP? Puedes explicar si o no?

No me gusta el sistema porque tengo que tomar más riesgos para recibir más beneficios. No puedo bajar mis riesgos porque el sistema quiere que los trabajadores accedan más riesgos para obtener más beneficios.

- 6) Cuantos meses has puesto dinero en su fonda previsionales? Has puesto mi dinero en su AFP antes o después 30. Porque hay una diferencia en la cuenta?

Did not ask age

- 7) Puedes explicar el tipo de AFP tienes. Por ejemplo hay muchos riesgos con su AFP, por ejemplo muchas inversiones que podrían darte beneficios o también problemas? O prefieres los AFP que no tienen muchas inversiones, pero también producen menos riesgos y beneficios? Porque escogiste su tipo de AFP?

Es como te dije, tengo que aceptar riesgos, los trabajadores D6venes} tienen que aceptar mas riesgos, que las personas que han trabajado par mucho tiempo.

- 8) ¿Tienes un APV?

- a. *Si tengo un APV. Usa para aumentar mi AFP. Pero no uso mi dinero en mi APV para cosas como enfermedades. Me gusta este sistema más porque es más fácil, y también tiene menos riesgos en este sistema en relación al sistema de AFPs.*

Independent Workers. The following two respondents were selected because they did not have AFPs. Both, earns low amounts of income, but the difference between the two was that the car washer, did not have to enter into the AFP system because he was already in the old social security system. Conversely, the second respondent knew that she had to enter into the AFP system, but knew little about the system. Based on the second individual's responses, she has a high probability of simply selecting an AFP, without much knowledge about it. Thus, this respondent is unlikely to understand the benefits and drawbacks associated with AFPs.

Respondent 6: Male, 57, Car Washer

- 1) Eres un trabajador independiente?

Si.

- 2) Tienes una AFP

No, no tengo una AFP. Tengo seguro social, el sistema antiguo que era antes de las AFPs.

3) Cuanto ganas por dia?

Recibo 7 o 8 mil cada dia. [7 or 8000 each day. This is equivalent to approximately 16 dollars per day]

4) Puedes decirme cuanto usa de su sueldo por sus cosas? Por ejemplo cuantas pagas para comprar comida? Electricidad Otras cosas?

Pago 1 mil para mi piso. Pago aproximado 1500 pesos por almuerzo, y 1500 pesos para cigarros y bebida.

5) Sabes que todas las personas tendran que tener una AFP para el 2015

[Note worker in old system doesn't have to change to privatized one]

6) Tienes que poner 10% de su sueldo en una AFP. Crees que tendrás, el sueldo suficiente para hacerlo?

question not applicable

7) ;_, Cual es su opinion, quieres tener un AFP?

Trabaje antes del sistema ahora. Cuando Pinochet [implemento] el nueva sistema, mi papa me dijo que me quedara en el sistema social seguro. Me dijo que el nuevo sistema no era buena, y si ponga dinero en el honor de sistema, lo perdería.

9) Recibes ayuda del gobierno

a. Tengo 14 millones de pesos en seguridad social. El gobierno aumento mi sueldo, recibo un 2% de mi sueldo en seguridad social, del gobierno.

Respondent 7)

1) Eres un trabajador independiente?

Si.

2) Tienes una AFP?

No.

3) Sabes que tienes que usarlo por 2015?

Si.

4) Quieres usar el sistema de las AFPs?

Si quiero usarlo. Si tengo una AFP no tendría que preocuparme sobre la jubilación.

5) Tienes que poner 10% de su sueldo en una AFP. Crees que tendrás, un sueldo suficiente para hacerlo? Hay programas que ayudan personas que no tienen suficiente sueldo para poner en una AFP. Piensas que va a usar esta parte del sistema?

Si. Si. [Response to 2nd question]

6) Sabes mucho sobre las AFPs? Como recibes información sobre los AFPs (Lees o ves la televisión para obtener información?)

no. no veo mucho tele. No estoy muy informado sobre el nuevo sistema.

7) Como te vas a informar sobre el sistema? Tienes mucho tiempo para ser informado si lo haces?

Puedo ir a cada AFP para [obtener] información. No tengo mucho tiempo para los verlos.

8) Si tuvieras mas dinero guardarias mas?

Si.

9) Porque no has puesto dinero en AFP

No he tenido mucho tiempo para hacerlo.

10) Cuanto ganas cada mes?

\$180.000

11) Puedes decirme cuanto usas de tu sueldo para tus cosas? Por ejemplo cuantas pagas para comprar comida? Electricidad? Comida? Otras cosas?

[Respondent could only give estimate about electricity} mas o menos 12 mil cada mes.

13) Hay alguna razón por la que no quieres una AFP?

No.

Annotated Bibliography

Ideas, Economic Pressures, and Pension Privatization Author(s): Raul L. Madrid

Source: *Latin American Politics and Society*, Vol. 47, No. 2 (Summer, 2005), pp. 23-50
Published by: Distributed by Blackwell Publishing on behalf of the Center for Latin American Studies at the University of Miami.

Raul Madrid, author of *Ideas, Economic Pressures, and Pension Privatization* argues that the implementation of the privatized system in Chile has been counterproductive because economic growth is not occurring at the privatization of pensions. While politicians have argued that privatization of pensions has the ability to reduce the amount of government spending for Social Security, such claims are misrepresented. Madrid notes, "economic crisis has undermined support for the existing state led development models in many countries, which paved the way for market oriented reforms such as pension privatization."¹⁷⁹ Economic crises allowed politicians to claim that inefficiencies in government have hindered social living conditions for Chileans and claimed that a privatized pension is necessary because individual funds will not be mismanaged and the overall standard of living will increase. However, strong evidence suggests that the implementation of privatization of pension funds will not increase overall economic growth or standards of living in Chile. Madrid notes, "pension privatization schemes are costly in the medium term because they allow (or oblige) members of the Social Security system to transfer some portion of their Social Security conjugations to private pension fund." The switch to a privatized system has forced the state to continue to pay for Social Security benefits for the

¹⁷⁹ Madrid 24.

older population as it attempts to transition to the privatized system.¹⁸⁰ Arguably, the high amount of transfer rates combined with the state's need to pay pension funds indicates there are fewer government resources because the state continues to pay for retirees pensions as well as the transition to a fully privatized pension system. Contrary to politicians, evidence shows that the state has become less discretionary in terms of spending.

Furthermore, Madrid challenges critics who argue that the implementation of private pension funds encourage individuals save more money thereby reducing reliance on government aid. While Madrid notes that "between 1982 and 2000, the pension funds generated returns averaging 10.9% annually above inflation. As a result of the strong returns, pensions have so far been substantially higher in the Chilean private system than in the public's system in spite of the lower level of contributions and the relatively high administrative costs in the private system."¹⁸¹ While the pension system can be seen as a success in states such as Chile, arguably, the high levels of administrative costs as well as the low levels of individual investment indicate that people are generally hesitant to put money into the pension system even though there are high levels of returns. Furthermore, the high costs that administrative burdens require show the private pension system is not perfect; overall costs remain high proving that attempts to reduce inefficient spending remain unsuccessful. As Madrid concludes, "any countries have opted to privatize their pension systems in the belief that such measures would boost their sagging domestic savings rates and solve long-term financial problems of their public pension systems. There is no clear-cut evidence, however the pension privatization will resolve either of these

¹⁸⁰ Madrid 28 .

¹⁸¹ Madrid 31.

economic problems." ¹⁸² clearly, this article highlights the problems associated with the private pension plan.

This article is helpful in several aspects first; it challenges the assumption that privatized pensions have the ability to help states become financially solvent. As debate emerges over the implementation of pensions, Madrid shows that the overall cost of the implementation of the new system are equally costly to older public pension systems, and do not lead to higher savings rates within Chile. Evidence would suggest that the overall growth of pension rates might be temporary; however, the lack of overall investment indicates that many Chileans are hesitant to invest in a fully privatized system that explains the overall low savings rates in such systems. Arguably, this poses a problem that will face the Chilean government in the long run; if individuals are generally unwilling to invest large amounts of money in private pensions, there is a heavier risk that an economic crisis will cause them to become more reliant on the government for work financial aid. Arguably, the pension system was supposed to reduce reliance on government spending, but in reality government spending continued because of high costs of the new system as well as poor saving rates by Chileans.

Alberto Arenas de Mesa, Bravo David; Jere Behrman; Olivia Mitchell; and Petra Todd. *The Chilean pension reform turns 25: lessons from the social protection survey*. July 2006.

The authors of this article give a brief history of the previous pension systems, known as provisional systems, which were implemented in Chile. After being replaced by, Administradora

¹⁸² Madrid 44.

de Fondos de Pensiones-Provida (AFP's) systems in the 1980s, individuals have been more likely to put money into their savings accounts in order to save for retirement. Nevertheless, the development of private pension systems is also important in part because they contribute to economic growth in Chile. The authors note that the private pension funds have played an increasingly growing role in the Chilean economy since 1980 and have increased their total market share of gross medic product to approximately 60% of the GDP in Chile's economy.¹⁸³ Viewed from this perspective, the government has an increased incentive to continue the (AFP's) because they are necessary for the continuous economic growth within the state. As the authors note, "initially all AFP monies were invested in government bonds, more recently pension fund managers have been permitted to offer a broader so regulated array of investment choices."¹⁸⁴ This article is important because it shows that the AFP's play significant role in overall economic growth in Chile, while also intriguing to retirement funds for pension holders. Nevertheless, the emphasis on AFP's shows that privatized pension system is incredibly important for the continuous economic growth in Chile.

The authors of this article study the overall demographic trends of Chileans and their use of pension plans. According to the authors, the new pension plan in Chile was implemented because many Chileans did not invest in the public pension system run by the government. Nevertheless, the study finds that overall growth in the Chilean pension system remains minimal and challenges prior assumptions that suggested Chileans would be more satisfied with private pension funds. Furthermore, the study finds that most Chileans are uninformed about their pension plans. According to the authors, "only half of one percent of all respondents claims to know both the fixed and variable commissions. The fact that workers and savers know virtually

¹⁸³ Alberto Arenas de Mesa, David Bravo, Jere Bherman, Olivia Mitchell, Petra Todd, 9

¹⁸⁴ *Ibid.*, 8.

nothing about the costs of investing their funds suggests that there is much work to be done to educate Chileans about this key aspect of their retirement system."¹⁸⁵ Clearly, the lack of education that Chileans know about the pension problems is problematic there are three different types of pension systems which vary from conservative investment practices to very risky investment practices. If Chileans are uninformed about their overall investments, this suggests that they may be heavily reliant on a system which is supposed to provide them with financial returns, but in the long run may not do so in part because of their lack of knowledge about the financial incentives that they receive from their pension plans. As a result, when retirement becomes evident, many Chileans may not have enough money in their pension plans to retire, and thus may be forced to work more years.

This article is important because it provides historical analysis about the previous pension systems implemented in Chile prior to 1980 as well as the current private pension systems. Arguably, this article's importance can be found in its samples of the Chilean population and its discoveries about Chileans perspectives on their own pension fund. This article has been useful in helping me develop questions I will ask Chileans. This article also provides helpful statistical tables measuring overall perceptions of the private pension fund in Chile examining demographic and social views towards the overall pension fund. I can use the tables in this article to compare my own results, which will allow me to highlight the similarities and differences between my own findings and those found in the statistical tables. I believe that this will allow me to find contrasting opinions about the overall pension funds. I believe the surveys and education about the pension funds in Chile conducted through my own questions will allow

¹⁸⁵ Alberto Arenas de Mesa, David Bravo, Jere Bherman, Olivia Mitchell, Petra Todd, 18.

me to use more acute the statistical evidence found in this article, which will allow me to emphasize the overall knowledge, Chileans have about their pension system.

Arturo Conde Marcus Porter. Harvard business school: AFP Provida

This article focuses on the positive aspects that have occurred with the implementation of the private pension system in Chile. As the authors note, Chile was one of the earliest Latin American countries to implement a private pension system that encouraged competition amongst various firms in order to encourage Chileans to invest in pension funds. Although the authors note that, the private pension system was implemented under an authoritarian regime they note, "Since the transition to democratic governments, privatization and deregulation efforts have deepened. Real gross domestic product (GDP) has averaged 7.3% between 1990 and 1998. After a sharp recession in 1999, the economy was growing again, albeit with a much higher unemployment rate."¹⁸⁶ While the authors like to show that private pension systems have contributed to strong economic growth, their support for private pension funds is an effective counter example to the flaws found in private pensions. While authors argue that private pension system hurt Chileans, the authors note "... During the first eight years that private pensions were implemented, pensioner's profitability was significantly higher because of strong AFP competition in Chile. Nevertheless, the authors note, "... After a consolidation period characterized by mergers, disillusioned, and bankruptcies, the number of AFP's stood at eight."¹⁸⁷ Arguably, with reduced competition between AFP firms in Chile, as the industry in Chile has become more concentrated and less competition has emerged, consequently Chileans are receiving fewer benefits from the system because companies offer similar services to all

¹⁸⁶ Marcus Porter, and Arturo Condo. 1

¹⁸⁷ *Ibid.*, 4.

individuals without having to worry about overall share of market competition. In this sense, the overall benefits that individuals receive from the private pension system need to be questioned.

While the authors argue that, the implementation of the private pension system has reduced reliance on government ample evidence challenges their claims. Arguably, while they support private pensions, their own statistics contradict their support for the system in Chile. One of the issues that the authors fail to address is the disparity of income levels found in Chile.

"Large pension firms such as AFP habitat attempt to attract individuals whose pensions are in the high to upper middle classes...AFP habitat focused on the middle to high income segment of the Chilean workforce, with the most appealing commission structure for this segment, a high fixed commission combined with the second lowest variable fee."¹⁸⁸ Clearly, the current pension system is beneficial for high middle classes families and excludes lower classes in part because of the high pension fees individuals must pay. Supporting this argument, the authors note that AFP Santa Maria "target low to middle-income individuals and charge the highest fixed fee in the market."¹⁸⁹ The high fixed rate costs compared to a much more upscale pension private firm targeted at middle to high middle income Chileans indicates that even pension funds designed to attract the lower income Chileans family's shows that Chileans who lack high monetary resources pay the same amount of money as upper-class families in the private pension system. In this sense, arguably, middle and lower class Chileans are paying much more of their overall salary in order to receive similar benefits that are found in upper middle to high-class pension families in Chile.

¹⁸⁸ *Ibid.*, B.

¹⁸⁹ *Ibid.*, 7.

This article is important because it provides a counter representation to the dominant theory that pension privatization in Chile has not benefited the population. While it provides statistics showing overall economic growth and overall benefits that individuals have gained from the implementation of privatized pension system it fails to address the economic disparities between wealthy and lower class individuals who are forced to use the private pension system. While the private pension system encourages individuals to save more money in order to retire, the high pension service costs and programs that are targeted towards middle and lower classes indicate that many families are paying large amounts of their overall salary in order to receive benefits the same benefits that upper middle class and high income Chileans receive. Arguably, pension plans should be geared towards the individual and the fact that pension plans are unable to deliver similar benefits to all Chileans indicates that the beneficiaries from the privatized pension plan remain high middle class Chileans. I will use this article to refute a growing perception that privatized pension plans are beneficial to Chileans as well as other people in the world. Furthermore, this article will be used to show the benefits of pension plans which were not addressed in other articles.

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