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The Political Economy of Pension Reform: Latin America in Comparative Perspective

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United Nations Research Institute for Social Development

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Acronyms

AFP	Administradora de Fondos de Pensiones — pension fund management companies
ATP	Arbejdsmarkedets tillaegspension — Supplementary Labour Market Pensions
CEPAL	Comisión Económica para América Latina y el Caribe — Economic Commission for Latin America and the Caribbean
DB	defined benefit
DC	defined contribution
EUA	Estados Unidos de América — United States of America
FFI	private fully funded individual account
GDP	gross domestic product
GNP	gross national product
IDB	Inter-American Development Bank
IFI	international financial institution — institutions financières internationales — instituciones financieras internacionales
IMF	International Monetary Fund
IMSS	Instituto Mexicano del Seguro Social — Mexican Institute of Social Security
NBER	National Bureau of Economic Research
NDC	notional defined contribution
OECD	Organisation for Economic Co-operation and Development
PAYGO	pay-as-you-go
PLN	Partido de Liberación Nacional — National Liberation Party
PNB	produit national brut — producto nacional bruto — gross national product
PRI	Partido Revolucionario Institucional — Institutional Revolutionary Party
SSA	Social Security Administration
SSRC	Social Science Research Council
UNRISD	United Nations Research Institute for Social Development

Summary/Résumé/Resumen

Summary

Since pension schemes—along with health care and education—absorb the largest amount of social expenditure in all countries, their reform has a potentially major impact both on the fiscal situation of the state and on the life chances of citizens who stand to win or lose from new arrangements. This makes pension reform a highly controversial issue; and, except for the addition of new programmes and benefits, major restructuring of existing pension systems has been extremely rare in advanced industrial democracies. It was also rare in Latin America before the 1980s and 1990s. But there has been a great deal of experimentation within the region during the past decade. This paper examines the larger economic, social and political context of Latin American pension reform and compares experiences in different countries of the region with options available in Western European societies during the same period.

The authors argue that the type of pension reform undertaken in Latin America has been an integral part of the structural adjustment programmes pursued by Latin American governments, under the guidance of international financial institutions (IFIs). Although there was a range of possible remedies to the problems of pension systems in different Latin American countries, neo-liberal reformers and the international financial institutions preferred privatization over all others. They claimed that privatization would be superior to other kinds of reform in ensuring the financial viability of pension systems, making them more efficient, establishing a closer link between contributions and benefits and promoting the development of capital markets—thus increasing savings and investment. And they were able to push through some of their suggestions for reform in spite of considerable opposition from pensioners, trade unions and opposition political parties.

Interestingly enough, their pressure proved least effective in the more democratic countries of the region. In Costa Rica, for example, citizens preferred to reform the public system—eliminating the last pockets of privilege for public sector workers and ensuring that new levels of contribution would be adequate to provide minimum benefits for the aged and infirm. In Uruguay, citizens forced a public referendum, through which they rejected a proposal for privatization. At a later stage, they did permit the introduction of private investment accounts, but not at the cost of eliminating the public programme. In Argentina and Peru, after the legislature refused to authorize partial privatization, this was eventually pushed through by presidential decree. Only in Chile and Mexico has there been a complete shift to private pension funds—but, in both cases, influential sectors of the elite, including the military, have been allowed to keep their previous, publicly managed group funds.

Looking at the only privatized pension system in existence long enough to allow for some assessment of its consequences—that of Chile—the authors find that many of the claims made by supporters of privatization are not substantiated by the evidence.

The first discrepancy between neo-liberal predictions and the reality of Chilean pension reform has to do with *efficiency*. All previous claims to the contrary, private individual accounts have proven more expensive to manage than collective claims. In fact, according to the Inter-American Development Bank, by the mid-1990s administration of the Chilean system was the most expensive in Latin America.

The second disproved claim involves *yield*. When administrative costs are discounted, privately held and administered pension funds in Chile show an average annual real return of 5.1 per cent between 1982 and 1998. Furthermore high fees and commissions—charged at a flat rate on all accounts—have proven highly regressive. When levied against a relatively modest retirement account, for example, these standard fees reduced the amount available to the account holder by approximately 18 per cent. When applied to the deposit of an individual investing 10 times more, the reduction was slightly less than 1 per cent.

The third discrepancy involves *competition*. Although it was assumed that efficiency within the private pension fund industry would be associated with renewed competitiveness—while the public pension system represented monopoly—the private sector has in fact become highly concentrated. The three largest pension fund administrators in Chile handle 70 per cent of the insured. And to reduce advertising costs, public regulators are limiting the number of transfers among companies that any individual can make.

A fourth unfulfilled promise of privatization in Chile has to do with *expansion of coverage*. It was assumed that the existence of private accounts would increase incentives for people to take part in the pension scheme, but in fact this has not happened. Coverage and compliance rates have remained virtually constant.

A fifth major claim was that the conversion of the public pension system into privately held and administered accounts would *strengthen capital markets, savings and investment*. But a number of studies have recently concluded that, at best, this effect has been marginal.

And finally, the dimension of *gender equity* within a fully privatized pension scheme is being subjected to increasing scrutiny. Women typically earn less money and work fewer years than men. Therefore, since pension benefits in private systems are strictly determined by the overall amount of money contributed to them, women are likely to receive considerably lower benefits. Public pension systems, in contrast, have the possibility of introducing credits for childcare that reduce this disadvantage. Sweden is an example of countries that have embarked on this course.

In the latter part of the paper, Huber and Stephens widen their comparative framework to include recent pension reforms in advanced industrial countries. There, where economic crisis was not as severe and where pressure from international financial institutions was not significant, much broader options for reform were available. In fact, although long-established systems were under stress, no developed country opted for complete privatization. Complex measures were taken to strengthen the funding base of national pension systems, including changes in investment procedures and changes in rules for

calculating pension benefits. Reforms also increased retirement age, as well as the number of years required to qualify for a full pension. But even the most thoroughgoing reforms retained a central role for public schemes in ensuring old-age benefits.

In conclusion, the authors consider steps that can be taken to craft pension reforms with more desirable results than those obtained to date in Latin America. They recommend measures that address the problem of an aging population by increasing the ability of each generation to pay for its own pensions—rather than relying primarily on the contributions of preceding generations of insured workers. Pension payments should be invested in a variety of financial instruments and benefits must ultimately be related to the yields obtained. Such a strategy does not require introduction of privately managed, individually held, investment funds. On the contrary, risk is lessened by relying instead on collectively managed funds, in which accounts can either be identified with individuals or—more equitably—with generations of contributors.

Reformed public pension systems should also contain minimum "citizenship pensions" that guarantee subsistence income in old age to all individuals as a matter of right. Such a measure, financed from general tax revenue rather than from personal contributions, is not beyond the means of medium income countries in Latin America and the Caribbean. In fact, some Nordic countries introduced citizenship pensions when their GNP per capita was lower than that of most Latin American countries today.

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Résumé

Dans tous les pays, les régimes de pension absorbent, avec la santé et l'éducation, le plus gros des dépenses sociales. Leur réforme peut donc avoir d'énormes répercussions à la fois sur la situation budgétaire de l'Etat et sur les conditions d'existence des citoyens qui peuvent pâtir ou bénéficier des nouvelles dispositions. Aussi la réforme des pensions est-elle une question extrêmement controversée. D'ailleurs, les refontes des systèmes de pension existants, si l'on excepte l'adjonction de nouveaux programmes et prestations, ont été extrêmement rares dans les démocraties industrielles avancées. Elles ont été rares aussi en Amérique latine avant les années 80 et 90 mais, depuis 10 ans, l'expérimentation va bon train. Cet essai porte sur le contexte économique, social et politique de la réforme des pensions en Amérique latine et compare les expériences de différents pays de la région avec les options qui s'offraient dans les sociétés d'Europe occidentale pendant la même période.

Les auteurs démontrent que les réformes des pensions entreprises en Amérique latine font partie intégrante des programmes d'ajustement structurel appliqués par les gouvernements d'Amérique latine sur les conseils des institutions financières internationales (IFI). Bien qu'il existe toutes sortes de remèdes possibles aux problèmes de régime de pension qui se posent dans différents

pays d'Amérique latine, les réformateurs néolibéraux et les institutions financières internationales ont préféré la privatisation à toutes les autres. Selon eux, la privatisation devait, mieux que d'autres types de réforme, parvenir à assurer la viabilité financière des systèmes de retraite, à les rentabiliser, établir un lien plus étroit entre les cotisations et les prestations et favoriser l'essor des marchés des capitaux, ce qui devait accroître l'épargne et l'investissement. Ils ont réussi à faire adopter certaines de leurs suggestions de réforme malgré une opposition considérable des retraités, des syndicats et des partis politiques d'opposition.

Il est intéressant de constater que c'est dans les pays les plus démocratiques de la région que l'on a le moins résisté à leurs pressions. Au Costa Rica par exemple, les citoyens ont préféré réformer le régime public, éliminer les derniers privilèges dont jouissaient encore les employés du secteur public et veiller à ce que le niveau des cotisations soit suffisant pour garantir des prestations minimum aux personnes âgées et aux handicapés. En Uruguay, les citoyens ont obligé le gouvernement à soumettre à référendum une proposition de privatisation qu'ils ont ensuite rejetée. Par la suite, ils ont autorisé l'introduction de comptes de placement privés, mais sans que soit supprimé le régime public. En Argentine et au Pérou, après le refus des parlements d'autoriser une privatisation partielle, celle-ci a fini par être imposée par décret présidentiel. Seuls le Chili et le Mexique se sont totalement convertis aux fonds de pension privés encore que, dans les deux cas, des secteurs influents de l'élite, dont l'armée, aient été autorisés à conserver leurs caisses corporatives, gérées par le système public.

A l'examen du seul régime de pension privatisé assez ancien pour qu'on puisse en évaluer dans une certaine mesure les conséquences—celui du Chili—les auteurs constatent que beaucoup d'arguments avancés par les tenants de la privatisation n'ont pas été confirmés par les faits.

Le premier point sur lequel la réalité de la réforme chilienne s'écarte des prédictions néolibérales est celui de l'*efficacité*. Contrairement à tout ce qui avait été prétendu, la gestion de comptes individuels privés s'est révélée plus coûteuse que celle de créances collectives. En fait, selon la Banque interaméricaine de développement, l'administration du système chilien était vers 1995 la plus coûteuse d'Amérique latine.

Le deuxième argument invalidé par les faits est celui du *rendement*. Une fois déduits les frais administratifs, les fonds de pension détenus et gérés par le secteur privé ont eu en moyenne un rendement réel annuel de 5,1 pour cent entre 1982 et 1998. De plus, les honoraires et commissions élevés perçus au même taux sur tous les comptes se sont révélés d'un effet extrêmement régressif. Prélevés sur un compte de retraite relativement modeste par exemple, ces frais, identiques pour tous, réduisent d'environ 18 pour cent le montant dont dispose le titulaire du compte alors que, lorsqu'il s'agit d'un placement 10 fois supérieur, le prélèvement est légèrement inférieur à 1 pour cent.

Le troisième point sur lequel la réalité vient démentir les prédictions touche à la *concurrence*. On supposait qu'une compétitivité renouvelée—le régime de pension public étant un monopole—contribuerait à l'efficacité des fonds de pension privés mais c'était compter sans la forte concentration du secteur privé.

Les trois principaux administrateurs de fonds de pension au Chili regroupent 70 pour cent des assurés. De plus, pour réduire les frais de publicité, le législateur n'autorise, par personne, qu'un nombre limité de passages d'une société à l'autre.

Quatrième promesse non tenue : la privatisation au Chili n'a pas *augmenté la couverture* des assurés. On supposait que l'existence de comptes privés inciterait davantage de gens à cotiser au régime de pension mais il n'en a rien été. La couverture des assurés et le taux de conformité aux réglementations sont restés pratiquement constants.

Selon le cinquième argument majeur, la conversion du régime de pension public en comptes détenus et administrés par le privé devait *renforcer les marchés de capitaux, l'épargne et l'investissement*. Or, un certain nombre d'études ont conclu récemment que, dans le meilleur de cas, cet effet avait été marginal.

Enfin, les conséquences sur l'*égalité entre les femmes et les hommes* d'un régime de pension totalement privatisé font actuellement l'objet d'un examen de plus en plus serré. Les femmes, typiquement, gagnent moins d'argent et travaillent moins d'années que les hommes. Comme les prestations de retraite dans les régimes privés sont strictement déterminées par le total des cotisations versées, les femmes vont sans doute percevoir des prestations considérablement inférieures à celles des hommes. Les régimes de pension publics, en revanche, ont la possibilité d'introduire des crédits pour les enfants élevés—ce qui réduit ce désavantage. La Suède est le pays qui s'est engagé dans cette voie.

Dans la dernière partie de leur essai, Huber et Stephens élargissent le cadre de leurs comparaisons pour y inclure des réformes récentes introduites dans des pays industrialisés. Là, où la crise économique n'a pas été aussi grave ni les pressions des institutions financières internationales aussi lourdes, l'éventail des options de réforme a été beaucoup plus large. En fait, malgré les pressions pesant sur les régimes établis de longue date, aucun pays développé n'a opté pour la privatisation complète. Des mesures complexes ont été prises pour renforcer la base de financement des régimes de pension nationaux : les procédures de placement et les règles régissant le calcul des prestations de retraite notamment ont été modifiées. Les réformes ont consisté aussi à relever l'âge de la retraite et à augmenter le nombre d'années requis pour avoir droit à une pension complète. Mais même les réformes les plus poussées conservent aux régimes publics un rôle central dans l'assurance des prestations de vieillesse.

En conclusion, les auteurs étudient les mesures qui peuvent être prises pour concevoir des réformes dont les résultats soient plus favorables que ceux obtenus jusqu'à présent en Amérique latine. Pour s'attaquer au problème du vieillissement de la population, ils recommandent d'augmenter la capacité de chaque génération de payer pour sa propre retraite au lieu de compter surtout sur les contributions des générations précédentes de travailleurs assurés. Les cotisations de retraite devraient être investies dans divers instruments financiers et les prestations, liées en dernière analyse aux rendements obtenus. Une telle stratégie ne nécessite pas l'introduction de fonds de placement détenus individuellement et gérés par le secteur privé. Au contraire, des fonds gérés

collectivement, avec des comptes individuels ou, ce qui est plus équitable, correspondant à des générations de cotisants permettent de réduire les risques.

Les régimes publics de pension, une fois réformés, devraient aussi compter un volet "pensions de citoyenneté", garantissant de droit un revenu minimum à toutes les personnes âgées. Une telle mesure n'est pas hors de portée des pays à revenu moyen d'Amérique latine et des Caraïbes s'ils la financent par les contributions publiques plutôt que par des cotisations personnelles. En fait, certains pays nordiques ont introduit ce type de pensions alors que leur PNB par habitant était inférieur à celui de la plupart des pays d'Amérique latine aujourd'hui.

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Resumen

Puesto que en todos los países los esquemas de pensión (junto con la atención a la salud y a la educación) absorben la mayor parte del gasto social, reformarlos tiene consecuencias importantes tanto para la situación fiscal del estado como para las posibilidades de vida de los ciudadanos que pueden beneficiarse o perjudicarse con los nuevos ajustes. Esto hace que la reforma al sistema de pensiones sea un tema sumamente controvertido; y en las democracias industriales avanzadas las reestructuraciones fundamentales del sistema de pensiones existente han sido muy escasas, excepto por lo que se refiere a nuevos programas y beneficios adicionales. En América Latina también era muy escaso ese tipo de reformas antes de los decenios 80 y 90, pero en el decenio pasado se ha experimentado mucho sobre ese tema. En este ensayo se examina el contexto más amplio, económico, social y político de América Latina en el que se ha hecho la reforma al sistema de pensiones, y se comparan las experiencias de los diversos países de la región con las opciones que han tenido las sociedades de Europa Occidental en ese mismo período.

Los autores consideran que el tipo de reforma a las pensiones que se ha efectuado en América Latina ha constituido una parte integral de los programas de ajuste estructural que han tratado de aplicar los gobiernos latinoamericanos, guiados por las instituciones financieras internacionales (IFIs). No obstante que ya había una gama de soluciones factibles a los problemas de los sistemas de pensiones de los diferentes países latinoamericanos, los reformistas neoliberales y las instituciones financieras internacionales prefirieron aplicar la privatización por encima de cualquier otra solución. Alegaban que la privatización sería superior a cualquier otro tipo de reformas para asegurar la viabilidad financiera del sistema de pensiones, haciéndolo más eficiente, estableciendo conexiones más firmes entre las aportaciones y los beneficios, y promoviendo el desarrollo de mercados de capital, elevando así los ahorros y la inversión. Fueron capaces de impulsar a fondo algunas de sus sugerencias de reforma a pesar de la oposición considerable por parte de los pensionistas, los sindicatos y de los partidos políticos de oposición.

Es interesante advertir que su insistencia tuvo menos éxito en los países más democráticos de la región. En Costa Rica, por ejemplo, la ciudadanía prefirió reformar el sistema público, eliminando los últimos conjuntos de privilegios de los trabajadores del sector público, asegurándose de que los nuevos niveles de contribuciones fueran adecuados para proporcionar beneficios mínimos a los ancianos y a los desamparados. En Uruguay, los ciudadanos exigieron que se aplicara un referéndum público, por el cual rechazaron una propuesta de privatización de los fondos de pensión. Posteriormente, permitieron la introducción de cuentas de inversión privadas, pero no a costa de eliminar el programa público. En Argentina y en Perú, después de que la legislatura rehusó autorizar la privatización parcial de las pensiones, en un momento dado se hizo que se aceptara por decreto presidencial. Sólo en Chile y en México se ha girado completamente hacia los fondos de pensión privados, pero en ambos casos, a sectores influyentes de la élite, incluidos los militares, se les ha permitido conservar sus fondos colectivos previos, manejados públicamente.

Al analizar el único sistema privado de pensiones que ha tenido una duración suficiente para poder evaluar algunas de sus consecuencias, como es el caso de Chile, los autores descubren que muchas de las justificaciones hechas por los partidarios de la privatización no concuerdan con la realidad.

La primera discrepancia entre las predicciones neoliberales y la realidad en la reforma al sistema chileno de pensiones, tiene que ver con la *eficiencia*. A pesar de todos los alegatos previos en favor de la reforma, se ha demostrado que las cuentas individuales en el sector privado resultan más caras de manejar que las que se cubren de manera colectiva. De hecho, según el Banco Interamericano de Desarrollo, a mediados del decenio de los 90, la administración del sistema chileno de pensiones era la más cara de América Latina.

El segundo alegato desaprobado se refiere al *rendimiento*. Una vez descontados los costos administrativos, los fondos chilenos de pensión controlados y administrados por el sector privado, muestran una tasa anual de retorno del 5.1 por ciento entre 1982 y 1998. Más aún, se ha demostrado que lo elevado de los cargos y comisiones (hechos a una tasa fija para todas las cuentas) es sumamente regresivo. Por ejemplo, cuando se imponen estos cargos fijos a una cuenta de pensión relativamente moderada, le reducen al pensionista su monto de dinero disponible en aproximadamente un 18 por ciento. Cuando se aplica al depósito de un individuo que haya invertido diez veces más, la reducción es poco menos del 1 por ciento.

La tercera discrepancia se refiere a la *competencia*. No obstante haberse considerado que la eficiencia en el negocio privado de los fondos de pensión estaría relacionada con una renovación de la competitividad—en tanto que el sistema público de pensiones implicaba un monopolio—de hecho el sector privado se ha vuelto sumamente concentrado. Las tres administraciones más grandes de los fondos chilenos de pensión, manejan el 70 por ciento de los asegurados. Y para reducir los costos de publicidad, la normatividad estatal acota el número de transferencias que un individuo pueda hacer entre las diversas compañías.

Una cuarta promesa de la privatización en Chile que no se ha cumplido tiene que ver con la *expansión de la cobertura*. Se suponía que la existencia de cuentas

privadas aumentaría los incentivos para que la gente participara en el esquema de pensiones, pero de hecho, eso no ha sucedido. Las tasas de cobertura y de acatamiento en realidad se han mantenido constantes.

Un quinto supuesto importante fue que la conversión del sistema público de pensiones al sistema controlado y administrado por el sector privado, *fortalecería los mercados de capitales, de ahorros y de inversiones*. Pero, recientemente, en varios estudios al respecto se ha llegado a la conclusión de que, en el mejor de los casos, dicho efecto ha sido marginal.

Y finalmente, la dimensión de la *equidad en la distinción por género* en un esquema de pensiones completamente privatizado, está siendo sometida a un mayor escrutinio. Normalmente las mujeres ganan menos dinero y trabajan menos años que los hombres. Por lo tanto, puesto que los beneficios de las pensiones en un sistema privado están estrictamente determinados por la cantidad global de dinero que se aporta a las pensiones, es muy probable que las mujeres reciban beneficios considerablemente menores que los hombres. Los sistemas públicos de pensión, por el contrario, tienen la posibilidad de introducir créditos para el cuidado de los hijos, con lo que se reduce esa desventaja. Suecia es uno de los países que ha implantado este sistema.

En la última parte del documento, Huber y Stephens amplían su marco de comparación, a fin de incluir las reformas recientes al sistema de pensiones que se han hecho en los países industriales avanzados. En estos últimos, donde la crisis económica no ha sido tan grave y donde las presiones de las instituciones financieras internacionales no han sido significativas, se dispone de un número mayor de opciones de reforma. De hecho, aunque en los países desarrollados los sistemas de pensión, que fueron establecidos desde hace mucho tiempo, han estado sometidos a ciertas tiranteces, en ninguno de ellos se ha optado por una privatización completa. Se adoptaron medidas complejas para fortalecer la base de financiamiento de los sistemas nacionales de pensiones, incluyéndose cambios en los procedimientos de inversión y en las normas para calcular los beneficios de las pensiones. Las reformas permitieron también aumentar la edad de jubilación, así como el número de años requerido para poder calificar en la obtención de una pensión completa. Pero aún las reformas más amplias no impidieron retener el papel central de los esquemas públicos en el sistema de pensiones para asegurar que a edad avanzada se reciban beneficios adecuados.

En su conclusión, los autores plantean los pasos que hay que dar para elaborar reformas al sistema de pensiones con resultados mejores que los obtenidos hasta la fecha en América Latina. Recomiendan que se adopten medidas con las que se atienda el problema de una población en proceso de envejecimiento, aumentando la capacidad de cada generación para pagar sus propias pensiones en vez de apoyarse primordialmente en las aportaciones de las generaciones de trabajadores asegurados que las preceden. Los pagos de pensiones deberían ser invertidos en una gama de instrumentos financieros y en última instancia, los beneficios deben provenir de los rendimientos obtenidos. Ese tipo de estrategia no requiere que se introduzcan fondos de inversión controlados individualmente y administrados por el sector privado. Al contrario, el riesgo se reduce al apoyarse en los fondos administrados colectivamente, en los cuales

las cuentas pueden referirse a individuos o, en forma más equitativa, a generaciones de contribuyentes.

Los sistemas públicos de pensiones, reformados, deberían contener también la posibilidad de otorgar una "pensión ciudadana" que garantice un ingreso de subsistencia a todos y cada uno de los individuos ancianos por derecho propio, adquirido en razón de su ciudadanía. Una medida de este tipo, financiada con el ingreso procedente de los impuestos generales y no de las aportaciones personales, no está más allá de las posibilidades económicas de los países de ingreso medio de América Latina y el Caribe. De hecho, algunos países nórdicos introdujeron la pensión ciudadana cuando su PNB per cápita era más bajo que el de la mayoría de los países latinoamericanos de la actualidad.

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I. Introduction

In the past two decades, established pension systems all over the world have come under pressure and in many countries they have undergone significant reform. These changes have been particularly profound in Latin America, where all aspects of social protection schemes have come under close scrutiny and most of them have been reformed to coincide with visions of more open and market-driven economies. The big unanswered question is what happened to social protection in the course of all these reforms.

The traditional purpose of social protection schemes is to protect the population from economic hardship associated with social risks such as old age, sickness, accident, death of the breadwinner and/or unemployment, or more broadly to prevent or alleviate poverty resulting from these and other causes. While there is wide variation in the degree to which social protection schemes effect redistribution across generations and social classes, the very idea underlying them is that the state has the responsibility to provide a social safety net and that the structure of this net should embody at least some degree of social solidarity. Thus the question is whether reforms have strengthened or weakened the social safety net, in the sense of providing protection for a larger or smaller proportion of the population and covering more or fewer risks, providing higher or lower benefits, doing it more or less efficiently and assuming a more or less permanent and widely supported role.

This paper analyses the reforms of one particular safety net—pension schemes. Pension schemes are important because they are the largest social transfer schemes and, along with health care and education, absorb the largest amount of social expenditures. They are particularly salient because, unlike other social risks, old age affects the entire population—or at least the entire population perceives it as most likely and desirable to reach old age. Thus pension schemes, at least where they have matured, channel a large amount of resources and are essential to a very large part of the population. Accordingly, their reform has a potentially major impact on the fiscal situation of the state and the political behaviour of winners and losers. This makes pension reform a highly controversial issue; and major restructuring of existing pension systems—except for the addition of new programmes and benefits—has been extremely rare in advanced industrial democracies. It was also rare in Latin America before the 1980s and 1990s. To understand, then, why pension reform has become so widespread in Latin America in the 1990s, it is important to understand the reforms in the larger economic, social and political context.

To present our argument in a nutshell, we see the reasons for pension reforms in a combination of changing demographics, a decline in the growth of real wages, an increase in returns to capital and—in the Latin American cases—structural problems of the established systems, aggravated by the economic crisis of the 1980s.[1] The type of pension reform undertaken in Latin America has to be seen as an integral part of the structural adjustment programmes pursued by Latin American governments, in the wake of the debt crisis, under the guidance of international financial institutions (IFIs). In the advanced

[1] For more on the implications for pension reform of changing demographics, declining real wage growth and increases in real returns to capital, see Myles (1997) and Thompson (1998:14).

industrial countries, on the other hand, the pressures for reform were less intense and the influence of the IFIs insignificant, which meant that they chose very different types of reforms.

The old pension systems in Latin America did have very serious problems. Although there was a range of possible remedies, neo-liberal reformers and the international financial institutions preferred privatization over all others. They claimed that privatization would be superior to other kinds of reform in ensuring the financial viability of pension systems, making them more efficient, establishing a closer link between contributions and benefits and promoting the development of capital markets—thus increasing savings and investment. But looking at the Chilean example, the only privatized pension system in existence long enough to allow for some assessment of its consequences, we find that for the most part these claims are not supported. Moreover, we would like to call attention to a number of considerations that are not mentioned by neo-liberal reformers but that are important from the point of view of the strength of a social safety net, such as the gender-specific impact of reforms and the degree of inter-generational and cross-class solidarity.

Of course, neo-liberal reformers were not strong enough to impose their preferred type of pension reform in all Latin American countries. Rather, the nature of the reforms was shaped by the balance of power between the neo-liberal reform coalition, on the one hand, and its opponents (mainly unions, pensioners and opposition parties), on the other. Political institutions, and specifically the degree of concentration of political power, were also important in determining the outcome.

In the course of the paper, we widen our comparative framework to include recent pension reforms in advanced industrial countries. There, much broader options for reform were available, options that were not even considered in Latin America. Advanced industrial countries had the latitude to choose the most appropriate model for themselves, while Latin American countries responded heavily to pressures from the IFIs for the introduction of mandatory, fully funded, privately managed, individual account pension systems—as recommended in a World Bank (1994) report.

We conclude by offering some suggestions for alternative pension reforms with more desirable results than those obtained in Latin America to date.

II. Crisis of the Old Pension Systems in Latin America

By the end of the 1970s, pension systems in the more advanced Latin American countries already faced a number of serious problems and these problems reached unmanageable proportions with the economic crisis of the 1980s.[2] The maturing of pension systems led to a deterioration of the active/passive ratio. Surpluses in these systems had not been invested properly

[2] Mesa-Lago (1989; 1994) provides extensive discussions both of these older problems and of their aggravation in the 1980s.

to create growing reserves. In fact, they had often been used to finance other social programmes. Evasion of contributions by both employers and employees was a constant problem; and it was much more severe for the self-employed—even where their affiliation to a pension system was mandatory. All of the pension systems also had privileged programmes for certain categories of employees, whose benefits were significantly higher. Most notorious among these special programmes—aside from those for the military—were those for higher civil servants, with time-of-service pensions that made it possible to retire with a full pension after a certain number of years on the job, mostly far below the general pension age. Of course, these programmes required costly subsidies and thus weighed heavily on the social expenditure budget.

States were required to make contributions to pension systems for public employees in general and for the most part to other pension programmes involving the private sector. But they often ran up considerable debts to the pension system. Such debts, along with delays in contributions from private employers, were particularly damaging for the financial health of pension systems in periods of high inflation. In addition, administrative costs were high, as the agencies in charge—like other parts of the bureaucracy—were frequently used for patronage employment.

The debt crisis and ensuing deep recession then greatly aggravated these problems. With the shrinking of formal sector employment, in both public and private sectors, the number of people contributing to pension systems declined rather drastically. Moreover, with the decline in real wages, the real value of contributions declined also. Inflation played havoc with established pension formulas and with the real value of benefits. Austerity-bound states let their debt to the pension systems increase. In addition, the trade liberalization measures so central to structural adjustment programmes made it much more difficult for employers to pass on the costs of social security contributions to customers and political pressure from employers effected reductions of employer obligations. All of these factors, when combined, created a perception of crisis in pension systems.

III. The Privatization Alternative

There was a general consensus, then, that the old systems were bankrupt or in danger of becoming so, that they were inequitable and that they were inefficient. Nevertheless there was no corresponding consensus on a desirable reform model. With the support of the IFIs—most importantly the World Bank, the International Monetary Fund and the Inter-American Development Bank—and of domestic neo-liberal reformers, privatization and individualization emerged as the dominant model. In its influential report, the World Bank (1994) recommended reforms that would combine three tiers:

- a small, public, basic pension system, financed from general revenue and providing a basic means-tested welfare benefit and a basic pension benefit for those contributing to the mandatory funded system;

Box 1—The structure of pension systems: A brief review of terminology

Before proceeding, a brief introduction to different kinds of pension systems is in order. We shall confine this discussion to mandatory pension systems—that is, systems established by law and compelling at least some categories of the economically active population to participate. A first basic distinction is between pay-as-you-go (PAYGO) and advance funded systems. The former involves intergenerational transfers: contributions from the current working population are used to pay the pensions of current retirees. In the latter, there is no such transfer: contributions from each generation are invested; and the accumulated funds are used to finance the retirement of that generation. In practice, there are no pure pay-as-you-go systems, since contribution rates in systems are set with a view to the maturing of the system. Before the system is fully matured, it generates a surplus; and that surplus is usually invested in secure instruments, such as government bonds. Still, those funds are not earmarked for the specific generation that made the original contributions and thus do not constitute advance funding in the strict sense. Several countries have introduced partial advance funding into PAYGO systems, channelling a small part of current contributions into funds to be invested and earmarked to pay in part for the current generation's retirement.

Among the advance funded systems, a fundamental distinction exists between individual and collective accounts. In the former, each individual owns and manages his or her retirement account, investing contributions with a company dedicated to administering pension funds and choosing an annuity or a phased withdrawal at the time of retirement. In the latter, collective actors such as employers, unions or the government manage the pension funds. It is important to note, however, that even if funds are managed collectively they can be held individually. In theory, the corporations that administer individually owned or collective pension funds can be either public non-profit or private for-profit corporations. In practice, individual accounts tend to be administered more frequently by private institutions and collective funds by public institutions.

A further basic distinction concerns the bases for entitlements to pension benefits. The three main types are universalistic flat rate, defined benefits (DB) and defined contribution (DC) pension systems. Under universalistic flat rate systems, each individual is entitled to a fixed monthly amount of pension support, regardless of any previous pension contributions. In some countries, these benefits are income-tested; in others, they go to every citizen (as a citizenship pension) or to every aged person with a certain length of residence in the country. Under DB rules, pension benefits are calculated as a function of some combination of previous earnings levels and years of contributions to the pension system. A crucial issue here is whether the benefits calculated under this formula for a new retiree will be automatically adjusted over the course of retirement, or whether they will be allowed to deteriorate in real value. If they are adjusted, the question is whether they are adjusted to the consumer price index, in order to keep their real value constant, or whether they are adjusted to real wages, in order to increase their real value and let retirees benefit from a general increase in the income of the working population. Under DC rules, pension benefits are calculated as a function of contributions made, plus the return on invested contributions. In general, DB rules govern pensions under PAYGO systems and DC rules govern those under advance funded systems. A new hybrid—a notional defined contribution (NDC) system associated with PAYGO systems—calculates pension benefits as a function of total lifetime contributions, the rate of wage growth and average life expectancy.

Most mature pension systems in advanced industrial countries consist of a combination of the types just outlined. They often have a first tier of universalistic or means-tested public pensions and a second tier of DB PAYGO pensions. In addition, several have introduced partial advance funding in the form of collective or individual accounts with DC rules. Several countries have a third tier of non-mandatory collectively negotiated schemes, typically advance funded. In Latin America, the first tier has typically been very weak, consisting of means-tested social assistance pensions with very low benefits. The second tier has usually consisted of fragmented PAYGO systems, with different schemes for different occupational categories. The recent wave of reforms has favoured advance funded, individual account, DC systems and introduced important advance funded, individual account, DC schemes.

- a large, mandatory, privately administered and fully funded pension system, based upon individual accounts and financed through contributions from individuals and perhaps employers;
- voluntary, supplementary, fully funded private pension savings schemes for individuals.

Though the entire set of recommendations was more complex, their essence was fully compatible with the reforms that had been introduced in Chile in 1980 under the Pinochet dictatorship; and the Chilean model became the shining example held up by the IFIs. For a considerable time, the prevailing opinion was that such reforms could only be implemented under a dictatorship willing to suppress any opposition. However, the strong advocacy of these reforms by the IFIs, along with the acceptance by the democratic government in Chile of the new system and the excellent economic performance of Chile in the late 1980s and early 1990s, conferred both greater legitimacy on the privatization model and greater credibility on the claim that such reforms would promote capital markets, investment and economic growth.

The advocates of this model argued that a transition from the public pay-as-you-go (PAYGO) to a private, fully funded, individual account system would ensure the future financial viability of the new pension system and make it more efficient. It would establish closer links between contributions and benefits and thus strengthen the incentive to contribute; and it would promote the growth of capital markets, savings and investment. The transition to privatization would support the growth of capital markets both directly (by creating new financial instruments and providing resources for investment) and indirectly (by sending the appropriate signals about governments' commitment to financial reforms to international financial markets). Opponents of the privatizing reforms, preeminently unions, pensioners and opposition parties of the centre and left, argued that privatization amounted to an abdication of responsibility for adequate pensions on the part of the state and would eliminate an essential element of social solidarity. They noted that it would greatly reduce the benefits of those receiving pensions from the old system, that it would expose future pensioners to undue individual risk from market fluctuation and that pension systems should be constructed to maximize the goals of social protection, not to support the overall neo-liberal reform project. Opponents of the privatizing reforms were joined by members of special pension programmes who objected to any steps that would eliminate their privileges. The balance of power between neo-liberal reformers and their opponents, combined with the degree of power concentrated in certain political institutions, shaped the outcome of struggles over pension reforms.

IV. Pension Reform in Latin America

In virtually every Latin American country, the privatization model was put on the agenda of pension reforms at some point. In many countries, initial legislative proposals envisioned a transition to a private, fully funded, individual accounts system. Yet such proposals were implemented only in Chile and Mexico. In Peru, such a system exists parallel to the reformed public system,

but there is some doubt as to the permanence of the public system. In Colombia, a new private system was also established parallel to the public system; but the public system was thoroughly reformed, so that a real choice exists and the public system is supposed to persist. Both Bolivia and El Salvador passed legislation to introduce mandatory private pension systems—in Bolivia supplemented with a collective capitalization fund—but implementation in both cases has been problematic (Cruz-Saco, 1998a:23). In Argentina and Uruguay, proposals for privatization were modified to create mixed systems with a basic public component and an additional private component. In Costa Rica, the public system, which was already more unified than the systems in other countries, was reformed to gradually absorb the privileged programmes and to strengthen its financial base. Finally, various attempts at pension reform in Brazil, most prominently the curbing of benefits in privileged systems, failed and left the drain of pensions on the overall social expenditure budget unmitigated.

Table 1: Pension reforms in Latin America as of 1999

	Successful	Stalled
Full privatization; fully funded individual accounts; public PAYGO system closed immediately or to be phased out gradually.	Bolivia Chile El Salvador Mexico	Ecuador
Parallel public PAYGO and private individual accounts systems; both options available to choose from.	Colombia Peru	
Mixed systems; basic public PAYGO and supplementary private individual accounts systems.	Argentina Uruguay	
Changes in public PAYGO system to strengthen financial viability.	Costa Rica	Brazil
No major reform proposals presented by government to legislature.	Guatemala Honduras Nicaragua Panama Paraguay Venezuela	

Sources: US SSA, 1999; Cruz-Saco and Mesa-Lago, 1998.

Table 1 summarizes the major characteristics of pension reforms in Latin American countries. A brief review of struggles over reform in some of the countries where serious reform was on the political agenda, but in which the outcome of reform attempts was quite different, follows below. This will lay the groundwork for generalizations about the factors shaping these reforms and for an analysis of the latter's consequences.

Chile

In Chile, policy making under the military regime was closed and pension reform was simply imposed by the government. This reform was a part of a very radical neo-liberal reform project begun in the mid-1970s, aimed at

shrinking the state sector and the state's regulatory role in the economy. The overall project rested upon a political as well as an economic logic.[3] The economic logic prescribed maximum play for market forces to compel Chilean industry to modernize and to open access to international financial markets. The political logic prescribed the withdrawal of the state from important redistributive functions, which would make the government less interesting as a target for collective action. At the same time, the declining welfare role of the state would weaken solidarity among popular groups and make them less likely to engage in such action. Physical repression combined with restrictive labour legislation to create an atomized society (Garretón, 1989) and individualization of social insurance fit perfectly into this logic.

During the transition to democracy, following the Pinochet regime, the newly elected government committed itself to respect the institutions set up by the dictatorship—the political institutions that ensure a strong military role in politics and overrepresent the right, as well as the economic institutions that shape markets for goods, capital and labour. Although the new government did raise taxes to increase social expenditures considerably, it did not undertake any institutional changes in social policy.

The 1980 pension reform law, promulgated during the Pinochet era, transformed the public PAYGO systems into a private, fully individualized, funded system, administered by pension fund management companies (AFPs). Employer contributions were eliminated entirely, so that workers now bear the full responsibility for all deposits. Affiliation is mandatory for all employees and voluntary for the self-employed. At the time of retirement, people have the option of phased withdrawals of their funds from the AFPs or of purchasing an annuity from an insurance company.

Employees with previous contributions to the old system had five years to choose whether to remain with the old or move to the new system, but all new contributors were forced to join the new system. (Significantly, the pension system of the armed forces was exempt from this reform.) Massive advertising campaigns, the incentive of lower contributions, the promise of recognition of contributions to the old system in the calculation of pensions in the new one and the experience of falling benefits in the old system induced most people to switch to the new system. By 1991, 90 per cent of those insured were in the new system. Those who stayed in the old system were mainly people close to retirement.

The government regulates the AFPs with regard to their investment strategies and required minimum returns, but not as regards fees and commissions. The government also guarantees a minimum pension for those with 20 years of contributions, issues recognition bonds for contributions to the old system that become effective at the time of retirement and guarantees annuities in case of the bankruptcy of an insurance company. In addition, those without insurance and those whose accumulated contributions would yield less than a minimum

[3] The literature on the politics and economic policies of the Pinochet government is voluminous. The following discussion draws particularly on Foxley (1986), Garretón (1986; 1989; 1994) and Valenzuela and Valenzuela (1986). The development of social policy is analysed by Borzutsky (1983; 1998), Raczynski (1994; forthcoming) and Vergara (1986).

pension are entitled to a public assistance pension. Given that the government also has to pay pensions in the old system, where contributions have declined drastically, the overall financial burden from the reform has been massive—around 4 to 5 per cent of GDP per year in the 1980s and early 1990s (Diamond and Valdés-Prieto, 1994:279-280).[4]

Pension benefits at the time of retirement are determined by the contributions made by the individual, plus the returns on this investment, minus the fees and commissions charged by the companies. Despite several reforms in the structure of fees and commissions, the existence of flat rate fees continues and they obviously have a regressive impact on pension fund accumulations (Borzutsky, 1998:42). Competition among AFPs is apparently not sufficient to bring about a significant lowering of charges on deposits. In fact, the pension fund industry in Chile has become highly concentrated rather rapidly: by 1991, three AFPs controlled 68 per cent of all deposits.

Costa Rica

In terms of design, the polar opposite to the Chilean reform is found in Costa Rica. The Costa Rican pension system was traditionally more universalistic than those of other Latin American countries, with 80 per cent of those affiliated belonging to the general pension scheme. Still, even there, special programmes for privileged civil servants absorbed 42 per cent of total pension expenditures in 1987 (Mesa-Lago, 1994:98-99). Reforms eventually closed new entries into schemes other than the general pension scheme, so that all civil servants would be integrated under standard conditions into the latter. They also strengthened the financial basis of the public scheme by increasing retirement ages to 60.5 years for women and 62.5 years for men and by increasing the government's contributions. Privatization of the pension system was never even a serious political proposal.

This type of response is congruent with the general approach of Costa Ricans to neo-liberal reform. Various governments in the 1980s and 1990s were forced to implement some stabilization and structural adjustment measures, but they generally attempted to protect the lowest income groups from the impact of these reforms. This was particularly true for governments of the National Liberation Party, which had historically close ties to the labour movement and co-operatives. They were comparatively fortunate in the 1980s to have more room for maneuver than governments in other small countries, because Costa Rica occupied a crucial geo-political position next to Nicaragua and thus had considerable bargaining power vis-à-vis the United States. That Costa Rican governments were successful in their overall efforts can be seen from the fact that inequality in income distribution was reduced slightly, or at least held constant, between 1980 and the mid-1990s, whereas neo-liberal reforms in

[4] This 4-5 per cent of GDP constitutes the "double payment" made by one generation in the transition from a mature PAYGO system to an advance funded system. The problem of "double payment" is the key political barrier to effecting such a transition. Though the benefits of advance funding are now widely recognized, it is politically difficult in a democracy to convince the current working generation to contribute to their own retirement while also paying for the present retirees' pensions, whether through reductions in other public spending, as in Chile, or through increases in taxes.

other Latin American countries during this period were generally associated with sharply rising inequality (Berry, 1998:28).

Mexico

Most other cases of pension reform in Latin America fall between these polar opposites. In Argentina, Colombia, Peru and Uruguay, full privatization was on the table, but opposition from civil society and/or parliament resulted in modifications that produced mixed systems in Argentina and Uruguay and parallel systems—at least for the time being—in Colombia and Peru. Only Mexico emulated the Chilean model. This is not surprising given the legacy of authoritarian politics in Mexico that persisted despite increased electoral competition.

Mexico attempted to reform its pension system in 1992, introducing a new supplementary individual savings scheme, administered by the private sector and financed by contributions from employers amounting to 2 per cent of the individual's earnings. Three years later the government decided on privatizing the old pension system while retaining the new supplementary individual savings scheme. During preparation of the first reform, the central labour federation close to the governing Institutional Revolutionary Party (PRI) strongly opposed privatization of pensions; but through a combination of incentives and threats from the government, it was convinced to support the reform in 1995 (Bertranou, 1998). Major business representatives also supported privatization of the pension system.

Despite an increase in electoral competition in Mexico from the 1980s onwards, the recovery of the PRI in the 1991 and 1994 elections allowed the government to ignore the opinions of independent unions and the political opposition and to push through legislation privatizing the old system in late 1995. The new system began operating in mid-1997 (although the pension schemes for the armed forces, federal employees and oil workers remained exempt from this reform). All other employees have to transfer within four years to the new system, as the old one will be shut down. Coverage for the self-employed is voluntary. One important difference with the Chilean system is that the employers' contribution was not changed and that the government's contribution to the pension system increased. While in Chile only the employee makes contributions, in the amount of 13.2 per cent of salary, in Mexico employers contribute the lion's share with 7.95 per cent of salary, followed by the state with 2.375 per cent and the employee with 2.125 per cent (Cruz-Saco and Mesa-Lago, 1998:391).

Bertranou (1998:104-106) lists a number of additional differences between the Mexican and the Chilean systems. In Mexico, pension funds can be administered by private or public or mixed corporations, all operating under the same rules—including the Mexican Institute of Social Security (IMSS), which administered the old pension scheme and continues to administer disability and survivors' pensions. Still, the new pension funds administered by the IMSS are individual, privately owned accounts that the IMSS has to invest. At the time of retirement, the insured can choose a pension calculated according to the old entitlement conditions, in which case the individual's accumulated pension funds go to the Treasury, or a pension simply based on

the accumulated individual funds. In the latter case, the options are the same as in Chile—phased withdrawal or purchase of an annuity from an insurance company. In both cases, individuals receive the funds from the supplementary individual retirement savings scheme.

As in Chile, the Mexican government guarantees a minimum pension for those who have participated in a programme, but there is no social assistance pension for those without any other retirement plan. The minimum pension is the equivalent of one minimum salary in the Federal District, annually adjusted to the consumer price index, whereas in Chile there is no automatic indexing mechanism. Finally, the government is responsible for all current pensions and for the future pensions of individuals who opt for the old entitlement conditions. For the first six or seven years, reserves from the old pension system are estimated to cover these obligations, but afterwards they will have to come out of general revenue.

Again, the pension privatization in Mexico fits well with the overall neo-liberal reform project.[5] In fact, the initial plans for reform in the period 1990-1992 were linked to the re-privatization of banks (earlier nationalized by the government) and to efforts to promote the growth of the domestic capital market. The private financial sector and the monetary authorities played an important role in putting privatization on the agenda, while the Mexican Social Security Institute and the Ministry of Labour and Social Security were more and more marginalized from the process of reform. The government's basic plan was to set up a supplementary private pension system and then gradually to incorporate the existing system into it. For various reasons, the government decided to implement the first step of the reform only in 1992, setting up the supplementary private system. Given the opposition of pensioners and unions to privatization and the PRI's need to recoup support after the highly tarnished 1988 elections, it is reasonable to assume that electoral considerations played an important role in this decision.

By 1995, political conditions had changed; and Zedillo used the window early in his presidency to push the reform through. The peso crisis of early 1995 made it particularly urgent to reassure international financial markets with a symbolic act, like pension reform. The government used its still rather formidable control of unions to overcome their opposition with minimal concessions and the PRI's majority in congress and strong party discipline enabled the government to prevail despite total opposition from non-PRI legislators and discontent within its own ranks (Madrid, 1999:ch. 4).

Peru

The case closest to the Mexican—involving policy making largely unconstrained by the legislature but still influenced by considerations of popular support, as well as pension privatization as an important part of an aggressive neo-liberal economic agenda—is the Peruvian. Shortly after Fujimori came to power in 1990, he abandoned his campaign promises and embarked on an ambitious stabilization and structural adjustment programme. With the tacit support of the military, he closed congress on 5 April 1992, arguing that

[5] The discussion of the political process of pension reform in Mexico relies heavily on Bertranou (1998)—except for the discussion of electoral considerations, which he does not mention.

partisan bickering hindered his efficient pursuit of economic reform and impeded efforts to fight the Shining Path insurgency. Significantly, the reform of the pension system was effected by presidential decree in December 1992 and the new system began operations half a year later.

As in other countries, there were strong pressures from the private financial sector, the IFIs and upper income groups for privatization of the pension system (Cruz-Saco, 1998b). In addition, the fact that the government made great efforts to attract foreign capital converted pension privatization into a high priority issue. Nevertheless, given the strong international pressures on Fujimori to restore democratic procedures, he remained concerned about popular support; and as a concession to strong opposition from lower-, middle- and working-class groups, he established a parallel pension system, in which the old programme would be kept alive to operate alongside the new private scheme. Important or historically well organized groups, such as the armed forces, civil servants, fishermen, chauffeurs and artists, were allowed to keep their own programmes; but individual members could join the new private system if they preferred. Coverage for the self-employed is voluntary.

Initially, the old public system was not reformed. This meant that there was a great difference in required contributions from employees. In the old system, employers continued to pay 6 per cent and employees 3 per cent of their earnings, whereas in the new system employees had to pay 15.5 per cent and employers nothing. Employees who switched to the new system were supposed to receive a 13.54 per cent net salary increase to compensate for the higher pension contributions (Cruz-Saco, 1998b:172). Similarly, pension age and required years of contributions remained more favourable in the old system. On the other hand, benefits had radically deteriorated and been leveled by the hyperinflation of the late 1980s; so there was a strong incentive for upper income earners to switch to the new system.

The new private system resembles the Chilean one in all important aspects of its administration and options for retirement. A minimum pension was established in 1995 for those who form part of a retirement scheme but, as in Mexico, there is no social assistance pension. Recognition of contributions to the old system (if made for a minimum of four years) is to be given, but subject to an inflation-adjusted ceiling (Cruz-Saco and Mesa-Lago, 1998:405). Until 1995, individuals could switch back and forth between the old and new systems; after that, switching back became no longer possible. By July 1995, only 13 per cent of the labour force and less than half of the insured had joined the new private system (Cruz-Saco, 1998b:172).

Under the combined impact of pressures from the financial sector (particularly the pension fund administrators) and the deteriorating financial situation of the old pension system, a new reform was adopted in 1995 by a congress dominated by Fujimori's supporters. Essentially, it was aimed at equalizing contributions and retirement age in the public and the private pension systems. Accordingly, employer contributions to the old system were abolished also and employee contributions were set at 11 per cent in both systems. The 1995 reform also eliminated salary increases for workers who switched to the new system. Retirement age was set at 65 in both systems and a minimum pension was introduced in the new system, though regulations concerning the minimum

pension were not passed. Proposals to close the old system to new entrants were not adopted by the government, but returning to the old system in fact became impossible. Moreover, employee contributions in the old system were raised again in 1997, to 13 per cent, thus increasing the relative attractiveness of the new system. After these reforms, enrolment in the private system increased to some 58 per cent of those insured (Cruz-Saco and Mesa-Lago, 1998:404).

Colombia

A second reform establishing parallel public and private pension schemes is the one passed in Colombia in late 1993. The government had also pursued a plan of full privatization, linked to its overall structural adjustment programme. Actually, several proposals were being hotly debated inside the government; but in 1992 President Samper sided with the Finance Ministry and its allies in support of a Chilean-type reform (Mesa-Lago, 1994:136-149). However, the proposal encountered strong opposition in congress and President Samper was forced to withdraw it. The government then submitted a second proposal that responded to some criticisms but maintained the essential features of the Chilean model. This proposal was again heavily criticized and modified in congress, so that the final compromise left the public system to exist parallel to and in competition with the new private one (Mesa-Lago, 1994:136-149). As in other cases, the armed forces and groups like public teachers, oil workers and members of provincial and municipal pension funds are exempt from the reform and affiliation of the self-employed is voluntary (Cruz-Saco and Mesa-Lago, 1998:404).

The old system was reformed to strengthen its financial base, with increases in contribution rates equal to those in the private system. Employers pay 10.1 per cent of an individual's earnings and employees pay 4.4 per cent in both systems and the state covers the deficit in the old system. The retirement age in the old system was raised and the requirement as to years of contribution was extended, as was the base for calculating pension entitlements (Cruz-Saco and Mesa-Lago, 1998:406). An issue looming very large in the Colombian debate was the very restricted coverage of the old pension system, which could not be expected to be expanded with privatization. In the early 1990s, only 21 per cent of the total population was affiliated to a pension scheme (Mesa-Lago, 1994:136). In 1995, coverage for the age group 18-65 was 33 per cent (Cárdenas, 1998:194). A pension solidarity fund was introduced to provide subsidized pensions, but in 1995 it covered only 2.7 per cent of the 18-65 age group (Cárdenas, 1998:196). Still, in contrast to Chile and to Peru (after the 1995 reform), both the old and new systems collect a solidarity contribution from employees above a certain income level, which is equivalent to 1 per cent of their earnings. Also, there is both a minimum and a social assistance pension. In sum, under congressional pressure the original attempt to emulate the Chilean model failed; and the Colombian reform provided real alternatives by strengthening the old public programme and introducing a new private scheme. The reformed system also contains some element of social solidarity.

Argentina

Similar modifications of original reform proposals took place in Argentina and Uruguay, where the results were mixed systems, with preservation of some public component for everyone. Pension reform became a highly politicized

issue in Argentina in the 1980s. By 1988, high inflation and the general fiscal crisis of the state had reduced the real value of pension payments to only 64 per cent of their level at the beginning of the decade (Schulthess, 1990:26; cited in Madrid, 1999). Pensioners sued the government for failing to live up to its obligations; and for the most part they won their cases, which created a staggering public debt within the pension system. In co-operation with members of unions and oppositon parties, pensioners also organized and demonstrated. As in other cases, the private financial sector urged privatization of the pension system (Isuani and San Martino, 1998).

After taking office in 1989, Menem moved quickly to implement stabilization and neo-liberal structural adjustment policies; and pension reform was made an integral part of the strategy to increase domestic savings and attract foreign capital. The World Bank financed studies to lay the groundwork for reform and pension privatization was part of Argentina's reform commitment to the IMF in exchange for an Extended Fund Facility (Kay, 1998:141-142; Madrid, 1999). Nevertheless, Menem never presented a proposal for full privatization, Chilean style. Instead, he opted for maintaining a public first tier. Madrid (1999) explains this as an outgrowth of the prohibitive costs of full privatization, though he recognizes political constraints as well. Certainly, the government strongly emphasized that the public tier would safeguard the solidaristic and redistributive functions of the pension system. Still, political constraints in the form of opposition from unions and from Peronist members of congress close to the unions, along with pensioners' associations, forced further modifications in the original proposal of a mixed system.

In 1991, the Ministry of Economy took control of the Secretariat for Social Security and a new Secretary was appointed in the latter who had close ties to Domingo Cavallo, the architect of neo-liberal reforms in Argentina (Madrid, 1999). The following year, Menem presented a proposal to congress that created a new pension system, consisting of a public PAYGO first tier and a private, fully funded, individual account second tier. To assuage opposition among its own supporters in the labour movement and in congress, the government was eventually forced to accept recognition of contributions to the old system from workers under 45 years of age; to provide an option for non-profit organizations, including unions, to administer private pension funds; and—most importantly—to permit people to make a choice between the new private second tier and a reformed public one. Even after these concessions, however, opposition remained strong; and the government, lacking a majority in the Chamber of Deputies, resorted to some parliamentary maneuvering of rather questionable legality to push the bill through (Madrid, 1999). The legislation was finally passed in September 1993 and the new system began operation in July 1994. Once again, the armed forces, as well as employees of provinces and municipalities, retained their own systems, with an option to join the new system later through special agreements. In contrast to all the other cases discussed so far, affiliation for the self-employed is mandatory in Argentina—as it was before the reform; and these people are required to pay the equivalent of the full employer and employee contribution, amounting to 27 per cent of earnings.

Under the new system, all insured citizens belong to the public first tier, which is financed by employer contributions of 16 per cent of earnings. This plan

provides a universal basic benefit after a minimum of 30 years of contributions, with a retirement age of 60 for women and 65 for men. In 1994, the corresponding benefit amounted to 2.5 times the average obligatory social security contribution and reached $157.50[6] per month (Isuani and San Martino, 1998:138-142). For the second tier, individuals can choose to remain in or join the old reformed system, where their contributions of 11 per cent of earnings go to the reformed PAYGO system, or they can join the new private system of individual, fully capitalized, accounts. The public system pays a supplementary defined benefit of up to 53 per cent of average earnings over the final 20 years of work (Cruz-Saco and Mesa-Lago, 1998:401). In the private system, the individual has the same choice as in Chile, to opt for phased withdrawal of the accumulated funds or buy an annuity from an insurance company. The insured can switch to the private system, but not back to the public one. If they opt for the private second tier, they receive a compensatory pension benefit based on previous contributions to the public system, in addition to the basic pension and the supplementary pension from the private scheme. For the insured whose total pension income from all sources is less than three and two-thirds the average obligatory social security contribution (the level set as a minimum pension), the government will provide the difference (Isuani and San Martino, 1998:142). For the uninsured destitute, there is a social assistance pension. The state is responsible for the social assistance pension and for any deficits in the public system. It also guarantees a minimum return on invested funds and pension payments in case of bankruptcy of an insurance company.

Uruguay

In Uruguay, pension policy has been equally politicized. The real value of pensions was falling consistently before the military regime took over and it continued to deteriorate precipitously under the military. Before the return to democracy in 1985, an agreement was reached among social and political actors to improve the value of pensions, particularly for those with lower incomes. Social security reform, then, loomed high on the agenda of democratic governments. Initial raises were granted, but they were still below levels expected under the agreement (Filgueira and Filgueira, 1999). In this situation, pensioners led by former union leaders organized a movement and, with support from unions and opposition parties, were able to demand a referendum in 1989. This referendum provided for a constitutional amendment indexing pensions to the mean wage and linking the timing of the adjustments to raises for state officials. An overwhelming majority of voters (82 per cent) approved the amendment. But their victory made reform all the more urgent, since it raised social security expenditures to new heights—from 9.6 per cent of GDP in 1986 to 16.1 per cent in 1992 (Papadópulos, 1998:155-156).

Though major business interests endorsed a Chilean-style privatization and IFI pressures also worked in this direction, full privatization never became a serious political proposal in Uruguay (Kay, 1998:141, 203). Between 1990 and 1994, three reform proposals failed—two because they were rejected by congress and one because it was reversed in 1994 in another referendum demanded by pensioners' associations. In 1994, then, the Inter-American Development Bank (IDB) financed an in-depth study to lay the groundwork

[6] All references to dollars are to US dollars.

for reform, which suggested a mixed system. Between the election of the new government and its inauguration in March 1995, a commission composed of representatives of all parties with parliamentary representation worked out a reform proposal based on this study. The commission did modify several features, but the basic thrust of the mixed system remained. Representatives of the leftist coalition abandoned the commission and their parliamentary representatives opposed the legislation, as did unions and pensioners' associations. But the legislation passed in September 1995 with the support of the two traditional parties, the *Colorados* and the *Blancos* (Papadópulos, 1998:158-159). It is certainly reasonable to assume that the financing of transition costs by IDB contributed to this support.

In the new system, which began operating in April 1996, all employer contributions (12.5 per cent of earnings) plus all employee contributions (15 per cent of earnings up to $800) go to the reformed public PAYGO system. Employees who are over 40 years old and are earning *above* this limit have the option of making contributions on their additional earnings either to the public or to the new private, individual, fully funded account system. Entitlement conditions for those who decide to stay with the old system remained unchanged. Employees in this higher income category who are under 40 years old, as well as all new entrants, have to make contributions to the private system. It is significant that state institutions such as the Bank of the Republic and the Housing Bank are allowed to administer individual, privately owned pension funds; and that these institutions have in fact managed to gain a large market share (Filgueira and Filgueira, 1999). Moreover, 80 per cent of the privately administered pension funds have to be invested for a certain amount of time in treasury bonds (Filgueira and Filgueira, 1999)

The public first tier pays a basic pension with an upper and lower limit to those who are 60 years of age or more and have made contributions for at least 35 years. In addition, the public second tier pays 50 per cent of the average of the last 20 years of earnings (within a 35-year contribution period) and more for additional years of contributions. The private second tier has no defined benefit, but rather operates along Chilean lines. There is no recognition bond for previous contributions to the old system, since those over 40 years of age had the option of remaining in the old system. The state regulates private pension funds and guarantees a minimum return and it also guarantees pension payments from the publicly administered individual capitalized accounts. There is a minimum pension for those with 15 years of contributions and over 70 years of age and a social assistance pension for indigents over 70 or those who are unable to work (Papadópulos, 1998:161). Finally, the armed forces retained their own system, as did four other groups who may eventually be incorporated by a decision of the executive (Cruz-Saco and Mesa-Lago, 1998:399).

Brazil

Brazil constitutes an example of failed pension reform. As in other countries, some financial sector interests pushed for privatization, some reformers inside the government supported it and the World Bank suggested partial privatization (Madrid, 1999:chapter 6). Nevertheless successive Brazilian governments, characterized by a slower and more selective approach to neo-liberal reforms, did not pursue privatization of the pension system. Rather

they—and particularly the Cardoso administration—attempted to reform the public PAYGO system in a way that would eliminate the most generous provisions and strengthen the financial viability of the system. A key reform provision was to set a minimum age of 60 years (55 for women) for retirement for private and public sector workers, thus ending the practice through which employees could retire after 35 years of service (30 for women), regardless of their age. Another was to set an upper limit on replacement rates, which would have had a particularly significant effect on highly paid civil servants. In the event, opposition from pensioners groups and from unions was intense. The reform required a three-fifths majority, because it entailed a constitutional change. But the government lacked a majority in the legislature and—given the weakness of party discipline—could not even count on the votes of its own coalition. All of this led to a significant watering down of the reform proposal that was ultimately passed at the end of 1998 (Madrid, 1999:chapter 6).

V. The Consequences of Pension Reform

Most of the new pension systems in Latin America have only been in operation for a few years, which makes it difficult to arrive at an assessment of their medium and long range effects. Thus we have to concentrate on the Chilean case in order to gauge to what extent the claims of the advocates of privatization have been met there and are likely to be met elsewhere. Perhaps the biggest discrepancy between claims and reality lies in the area of administrative efficiency. Neo-liberal reformers attacked public pension systems in Latin America for their high administrative costs and argued that the private sector would be forced by competition to lower these costs. In reality, it was precisely competition—requiring large numbers of sales personnel working on commission and large advertising budgets—that helped drive administrative costs upward. Moreover, as we shall point out in the comparative discussion below, experience in other countries over decades has shown that private individual account systems are simply more expensive to manage than collective accounts. Thus, Diamond and Valdés-Prieto (1994:309) concluded that administrative expenses associated with the new Chilean system probably exceeded those of the old system. And none other than the Inter-American Development Bank (IDB, 1996), an ardent advocate of privatization, stated that as of the mid-1990s the administration of the Chilean system was the most expensive in Latin America.

Administrative costs have serious consequences for those insured through private, fully funded individual accounts. They lower overall returns significantly and their structure has a potentially highly regressive effect. One estimate suggested that in 1987 total fees and commissions caused an 18 per cent reduction in the deposit of an insured individual in the 10,000 pesos-per-month bracket, but only an 0.9 per cent reduction in the deposit of an individual with 10 times that income (Mesa-Lago, 1994:123-124). It is interesting that the agency in charge of supervising the AFPs in Chile provides figures on returns from invested pension funds that do not take administrative costs into account. The average annual return calculated in this way is 11 per cent between 1982 and 1998. This is a simple average, which does not weigh the accumulation of capital in the funds. Since annual returns were significantly

lower in the 1990s (when more capital had accumulated) than in the 1980s (when the private funds were only beginning), the simple average overestimates real returns. In contrast, calculations done by CB Capitales (1999)—which look at the total amount of money contributed by individuals, including the share going to fees and commissions, and which take a compounded weighted average—suggest an average annual real return of only 5.1 per cent for this same period.

One obvious way to reduce the regressive effects of administrative costs is to regulate the structure of fees that private pension fund administrators can levy. Regulation is less effective, however, in stimulating competition. In most countries, the pension fund industry has become highly concentrated, with the proportion of the insured population belonging to the three largest pension fund companies ranging from a low of 40 per cent in Argentina and 60 per cent in Colombia, to 70 per cent in Chile, Peru and Uruguay (Cruz-Saco and Mesa-Lago, 1998:417). Also, given the sophisticated ways in which financial reports can be presented, it is difficult for the average insured person to make rational decisions when choosing companies. The main way for pension fund administrator companies to acquire and defend market share is through massive publicity (Barrientos, 1998:103). Ironically, one of the ways in which regulators have attempted to reduce costs is by reducing competition—that is to say, by limiting the number of transfers between companies that an individual is allowed to make.

The second major unfulfilled promise of privatization has been that it will expand coverage. While it is clear that coverage by any contributory pension scheme is limited by the structure of the labour market and specifically the size of the informal sector, advocates of privatization have claimed that a system of individual accounts should reduce non-compliance with social insurance laws and thus expand effective coverage. Presumably, the link between contributions and benefits becomes simpler and more transparent and thus provides incentives to make regular contributions. However, as just discussed, this link is by no means simple and transparent, since it differs for people in different income classes and fluctuates with financial markets. Given these fluctuations, the timing of one's contribution and retirement periods heavily affects the real returns derived from contributions (see the discussion below).

Therefore, in reality, coverage and compliance rates under the new systems have not improved. The rate of affiliation as a percentage of the labour force has remained around 80 per cent in Argentina, Chile and Uruguay—and only 32-38 per cent in Peru, Colombia and Mexico.[7] However, even in the countries with comparatively high coverage, only roughly half of those affiliated to pension schemes are active contributors and an unknown number underreport their earnings. The ratio of active contributors to insured affiliates is 45 per cent in Peru, between 50 and 54 per cent in Argentina, Chile and Colombia, and 67 per cent in Uruguay (Cruz-Saco and Mesa-Lago, 1998:389-408). This leaves a large proportion of the aged population without the necessary contribution record even to receive a minimum pension and many others will

[7] These coverage figures are from Cruz-Saco and Mesa-Lago (1998:389-408). Mesa-Lago's (1989; 1994) coverage figures have tended to be higher than those from other sources (see Huber, 1996:183), so we can interpret them as an upper limit.

qualify for a minimum pension only. The self-employed simply do not affiliate, as their contribution rates tend to be excessively high. Thus, the adequacy of the social assistance pension is crucial in shaping poverty rates among the elderly.

The third major promise of privatization—its supposed contribution to strengthening capital markets, savings, investment and economic growth—has also been largely unfulfilled, although there is considerable controversy on this issue. Part of the controversy stems from theoretical disputes about the relation between savings rates and growth,[8] and part of it stems from difficulties in finding empirical evidence that links increases in savings to pension reforms, rather than to potential competing causes. There is fairly general agreement that pension privatization in Latin America has contributed to a deepening of capital markets by creating new financial instruments and channelling large amounts of new resources through the financial sector (Grosse, 1999). In the Chilean case, however, two other factors have been crucial to the rapid development of capital markets since the mid-1980s. The first was the privatization of a large number of firms, including public utilities, and the second was the very significant legal and regulatory reforms of the financial sector (Barrientos, 1998:155). Moreover, while there certainly was an impressive increase in the savings rate in Chile (from 7.8 per cent of GDP in 1985 to 25.4 per cent in 1994), the major contributors to this increase were government savings and corporate savings—not household savings, where the impact of pension fund savings was relevant (Arrau, 1996:21). Barrientos (1998:155) concludes that "the net saving effect of pension reform [in Chile] is, at best, marginal". Cruz-Saco and Mesa-Lago (1998:418) go even further, arguing that "in 1981-1995 the FFI [private fully funded individual account] system did not influence net savings and the reform as a whole had a negative impact on savings". Finally, the argument that pension privatization attracted large amounts of foreign capital is difficult to assess, because it is based mainly on assumptions about the symbolic effect of pension privatization on investor confidence. Even if we assume such an effect, it would be difficult to disentangle the effect of pension privatization from that of the larger programme of neo-liberal structural reforms. Moreover, macro-economic and political stability certainly made Chile an attractive place for foreign investors.

One area that advocates of privatization have simply omitted from discussion is the impact of private fully funded individual account systems on equity between genders. Since pension benefits in such systems are strictly determined by the overall amount of money contributed by the insured—aside from investment performance and commissions and fees, of course—and since women typically earn less money and work for fewer years than men, women receive considerably lower benefits. If we add to this the generally higher life expectancy of women, which is taken into consideration in the structuring of phased withdrawal programmes and of annuities, then women's benefits become still lower in comparison to men's. In public systems with defined benefits, there are generally some gender differences also, stemming from the

[8] See for example Gavin et al. (1997:166) for a critique of the conventional view that Latin American savings rates have to be raised in order stimulate growth. Rather, they argue that higher growth precedes higher saving and that Latin America's low savings rate is primarily a consequence, and not a cause, of low and volatile economic growth.

calculation of benefits on the basis of some record of earnings; but they typically are mitigated by generous minimum pensions, by the fact that life expectancy does not affect benefit levels and, more recently in some cases, by credits for years spent caring for children. Some reforms in advanced industrial countries have introduced overall life expectancy in the population as a factor in determining defined benefit levels, but these are not gender-specific. On the contrary, developments in public systems have tended towards more gender equity, in clear contrast to privatizing reforms.

Finally, advocates of privatization of social security schemes simply skirt considerations of underlying values in social policy, such as solidarity and redistribution. Upper income earners can always make provisions for their own support in old age. The very reason for the state to intervene and build up pension systems has been to provide a safety net for those unable to provide for their own future. Gradually, under the influence of strong labour movements and affiliated parties, the idea of the safety net has been expanded from providing bare subsistence to providing as close to the customary standard of living in retirement as possible. For those whose contributions would not have been sufficient to achieve subsistence earlier and this more generous level later, the commitment to solidarity has implied that the collectivity of contributors would provide additional resources, thus effectively redistributing income. The values of solidarity and redistribution have no place in private fully funded individual account systems. Theoretically, a commitment to generous minimum pensions could reintroduce them, but in reality governments that are promoting neo-liberal reforms and pension privatization are reluctant to invoke such values. They justify the need to provide minimum pensions by referring to the fight against poverty and to the usefulness of providing incentives for people to build up a record of contributions.

VI. Determinants of Privatization

In all cases of significant pension fund reform examined above, with the exception of Costa Rica, executives committed to neo-liberal economic restructuring put privatization of the pension system on the agenda. In the vast majority of cases, full privatization was the essential starting point. Executives were pushed and supported in the drive for privatization of pension systems by large and internationally well connected business interests, particularly from the financial sectors, and by the IFIs. The World Bank's (1994) report of pension systems became the reference point for privatizing reforms, but pressures in this direction emanated from international financial institutions long before the its publication. The IFIs played a particularly important role through consultancies, direct financing of studies and of the reforms themselves, and insistence that pension reform be implemented as an essential part of adjustment programmes. These institutions, in turn, were implicitly backed by international financial markets, in so far as these markets take IFI approval of a country's reform programme as a signal for assessing market risk.

It is essentially correct to argue, then, that globalization has been a major force behind the privatization of pension funds in Latin America. However, this is a special form of globalization, involving pressures from IFIs and international

capital markets to privatize in order to demonstrate a general commitment to liberalization and thus to the free flow of goods and capital. This type of reform was not required to allow countries to become, or stay, integrated and competitive in the world economy. It is possible to be integrated and competitive without such measures. In reality, different types of reforms would have been possible and compatible with having an open economy; and, as our discussion below will demonstrate, these other reforms would arguably have had more advantageous effects on efficiency and equity, both between genders and among income classes. The very fact that different types of reforms were chosen in advanced industrial democracies, where governments were not exposed to IFI pressures for privatization and the establishment of individual accounts, underlines the importance of IFI pressures for the resulting reforms in Latin America.

Of course, reforms in Latin America were not uniform. External pressures were mediated by domestic institutions and by the distribution of power between internal advocates of privatization and their opponents. External pressures were more effective where the economic crisis was very deep—with high debt service pressures, steep economic decline and high inflation rates—and where consequently the need for financial assistance from the IFIs was very urgent. These pressures were translated into policies most effectively when executives were engaged in a sweeping neo-liberal adjustment programme of the economy and where political institutions concentrated power in the hands of the executive. Structural adjustment programmes strengthened the internationally oriented sectors of business and particularly private financial interests—forces that favoured privatization of pension schemes. Political power concentration was highest where congress was simply closed, as in Chile and Peru when the reforms were introduced. It was also high where the president's party had a majority in congress and party discipline was traditionally high, as in Mexico and to a lesser extent in Argentina (Kay, 1998; Madrid, 1999). In Mexico in 1995, the PRI still had a congressional majority and PRI party discipline was always high. In Argentina, Menem's party had a majority in the senate but not in the chamber of deputies and party discipline alone could not sway the labour representatives in the party to support the reforms without significant concessions. In Uruguay, party discipline was historically very problematic and the institution of the referendum constituted a veto point where opponents of privatization could successfully mobilize.[9] Party discipline has been equally problematic in Colombia, where the two traditionally dominant parties are highly fragmented. This has led to a general blocking by congress of major reform proposals from the executive (Archer, 1995:177-188).

The main opponents of pension privatization were unions, associations of pensioners and opposition parties, the latter partly for ideological and partly for simple partisan political reasons. More generally, members of privileged pension schemes were militantly opposed to privatization and any other reforms that would have curtailed their benefits. A clear demarcation of

[9] See Huber et al. (1993) and Huber and Stephens (forthcoming) for a quantitative analysis of the relation between constitutional structures and welfare policies. Structures that disperse power have slowed development of the welfare state, during its expansionary phase; but they have also inhibited retrenchment in the 1980s and 1990s.

reforms, making it obvious early on that the potentially most powerful groups would be allowed to keep their own schemes, was effective in neutralizing such opposition. The armed forces were universally excluded from the reforms and the second most often excluded groups were public employees. Among other excluded groups were the powerful oil workers in Mexico, judicial employees in Uruguay, the historically well organized chauffeurs and fishermen (employees of the large public fishing company) in Peru, and public teachers and oil workers in Colombia.

At the time when the reforms were introduced in Chile, Mexico and Peru, unions had been greatly weakened—in Chile by a combination of heavy repression and deep economic reforms, in Mexico and Peru mainly as an outgrowth of economic reforms. The weakness of labour, combined with the extreme concentration of power in Pinochet's hands, made a full pension privatization possible in Chile. In Peru, Fujimori could have imposed full privatization, but he decided to respond to union protests and keep the old system alive as an option parallel to the new private one. However, the financial future of the public system remains questionable. The 1995 reforms strengthened its financial base somewhat, but renewed fiscal crises may well lead to a closure of access to the old system in the future, thus driving the pension system closer to the Chilean model. In Mexico, there was a long tradition of co-operation and co-optation between the PRI and the main union confederation, which ultimately prevailed and generated official union support for the pension reform that established a parallel private and public system. The Colombian labour movement was among the weakest in Latin America around 1990, comparable to the Chilean movement (McGuire, 1996); but it is reasonable to assume that labour opposition to privatization strengthened the resolve of congressional opponents to some extent.

In Argentina and Uruguay, labour was still much more militant than in Chile, Mexico and Peru, though unions had also been weakened by the economic crisis. Unions co-operated with pensioners' associations and opposition parties to thwart privatization or at least to modify the original proposals. The results in both cases were mixed systems, with the preservation of a strong basic public first tier. In Argentina, contributors have a choice between the public and the private second tier. In Uruguay, membership in the private tier for those under 40 years of age at the time of the reform and for all new entrants is mandatory, but the public system can still be regarded as the main tier and the private one more like a supplementary tier for middle and upper income earners. In Argentina, the long-standing relationship between labour and the Peronist party made bargaining possible and considerable concessions ultimately generated support from the labour confederation close to the government.

Costa Rica is a special case, differing in the structure of social policy before the 1980s, in the severity of external pressures and in the internal balance of social and economic forces. Because it has had an uninterrupted democratic history since 1948, Costa Rica has developed a comparatively strong civil society, including unions, a co-operative movement and a party, the National Liberation Party (PLN), with moderate social democratic leanings, which has been in power for extended periods. Accordingly, Costa Rica built a comparatively unified pension system, with only civil servants having a separate

system. In the 1980s, financial pressures on the system were less intense than in other countries, in part due to the fact that Costa Rica could resist radical neo-liberal economic policies. Though the country was hit early and hard by the debt crisis and did have to impose a stabilization programme from mid-1982 on (Nelson, 1989:144-145), the newly elected president from the PLN, Monge, successfully resisted orthodox economic prescriptions. His motives for doing so were his social democratic commitments and his ties to organized labour. His ability to do so stemmed from the strategic location of Costa Rica in the Central American conflict.

The Reagan administration's policy towards Nicaragua had the beneficial side effect for Costa Rica of encouraging significant US aid and a certain degree of insulation from IFI pressures for radical neo-liberal reforms. Accordingly, Monge was able to adopt a gradual approach to stabilization and a combination of orthodox with clearly non-orthodox policies, the latter aimed at protecting the poorer sectors from bearing disproportionate costs of austerity and adjustment. He maintained this same approach in the subsequent structural adjustment programme (Valverde et al., 1992). In his approach to the pension system, he attempted to strengthen and further unify the existing programme, rather than privatize it. Benefit conditions were tightened to improve the resource base and new civil servants were integrated into the general—rather than their own special—scheme. In the 1990s, Costa Rica lost its advantageous position, as far as the United States was concerned, because the Central American conflict was resolved; and it was forced to adopt further structural adjustment measures, including contraction of public sector employment, restrictions on wage and salary levels and other measures to reduce domestic consumption and increase exports. Popular protests tempered some of the government's measures and efforts to soften the impact of these measures on the poor continued. In this context, it is easy to understand that privatization of the pension system was never seriously put on the political agenda.

VII. Pension Reform in Advanced Industrial Societies

Given the weaknesses of the privately managed, fully funded individual account systems, one might ask if there are alternatives that accomplish the same goals of these systems without the drawbacks that they appear to have.[10] We can turn to the recent experience of advanced industrial democracies, where the defined benefit (DB) PAYGO systems, which formed the mainstay for most of these pension systems, have come under stress in the past 20 years and where reform either has already occurred or is currently under study. Adding these countries greatly extends the range of variation in our dependent variable, pension system reform. Not only did no advanced industrial country replace its DB PAYGO system with a private, fully funded individual account system, but even the most thoroughgoing reforms retained a central role for public systems.

[10] For Australia, Austria, Germany, the Netherlands, New Zealand and the Nordic countries, our discussion is based on Huber and Stephens (forthcoming). For Belgium, France, Ireland, Italy, North America and the United Kingdom, we rely on Myles and Pierson (forthcoming), Myles (1999), Fox and Palmer (1999) and Scharpf and Schmidt (forthcoming).

Furthermore, adding the advanced industrial countries to the analysis also extends the range of variation in factors, which we found to influence the pace and direction of reform. Above all, it allows us to evaluate the influence of international financial institutions and other international actors on pension reforms.

Some of the sources of the pension system crisis experienced by advanced industrial societies are similar to those experienced by Latin American countries: demographic change, slowed wage growth, increased national indebtedness, increased competitive pressures in an internationalizing economy and the spread of neo-liberal ideology. However, the depth of the economic crisis was not nearly as severe as in Latin America and nowhere did the indebtedness force countries to turn to international financial institutions and submit to IFI programmes for structural readjustment of their economies. Moreover, only in Australia and New Zealand—where, as in Latin America, import substitution industrialization behind high tariff walls, financed by primary product exports, became unviable—did developments in the world economy force industrialized countries to make dramatic shifts in their economic development models. The rest of these countries had very low tariffs by Latin American and antipodal standards and the generous welfare states of northern and central Europe were particularly open and dependent on competitive manufacturing exports. The social policy regimes in these countries were developed to be compatible with competitive export economies. Thus economic internationalization did not force a fundamental reorientation of policy.[11]

As we show elsewhere, by far the most important immediate cause of welfare state retrenchment in advanced industrial countries has been large and apparently permanent increases in unemployment.[12] Pension reform is, however, a special case; and, as Myles and Pierson (forthcoming) point out, the difficulties faced by the DB PAYGO systems have a widely recognized demographic component and a less recognized wage component, which are both linked. Citing a 1958 article by Paul Samuelson, Orszag and Stiglitz (1999:12) point out that the real rate of return in a mature PAYGO system is equal to the sum of the rate of growth in the labour force and the rate of growth in productivity. In the long run, real wage growth is primarily a product of productivity growth. In the past three decades, not only has the birth rate declined and longevity increased—thereby increasing the ratio of the aged to those of working age (the demographic component)—but real wage growth has also declined.

[11] This is not to say that economic internationalization has had no impact on social policy. Financial liberalization has reduced the policy options of governments in a number of ways and thus has reduced governments' capacities to stimulate growth and combat unemployment (see Huber and Stephens, 1998; forthcoming).

[12] See Huber and Stephens (1998; forthcoming) and Stephens et al. (1999). In a small number of countries, notably New Zealand and the United Kingdom, conservative governments have introduced social policy cutbacks for ideological reasons, rather than out of economic necessity.

Thus optimal conditions for DB PAYGO systems have disappeared, while the increased return on capital has made funded systems more attractive.[13] Yet in no advanced industrial country was the PAYGO system replaced by a privately managed, fully funded individual account system as favoured by the World Bank (1994) and implemented in Chile. The United Kingdom came closest, as one could opt out of the public system and into an individual account or a collective corporate plan. Moreover, it is telling that the United Kingdom experienced some of the same problems that the privately managed system has, such as high administrative costs and misrepresentation of products by private pension management firms. On the other hand, a large number of countries have significantly transformed their pension schemes in ways that partially or fully address the problems associated with the previous system, PAYGO or otherwise. Some countries have introduced or expanded fully or partially funded earnings related tiers; some have transformed their DB PAYGO systems into defined contribution systems; some have raised the number of years to qualify for a full pension; some have raised the pension age. Sweden, for example, has done all of these.

What this makes very clear is that the 1994 World Bank report on pensions makes a serious mistake when it conflates a number of other characteristics with privatization. In a recent paper for a World Bank conference on pension reform, Peter Orszag and World Bank Chief Economist Joseph Stiglitz explode 10 "myths" created by the earlier World Bank report and subsequent articles on pension reform influenced by that report (Orszag and Stiglitz, 1999). Orszag and Stiglitz (1999:5; see also Geankopolos et al., 1998:139ff) contend that these myths emanate from the conflation of privatization, prefunding, diversification and the distinction between defined benefit and defined contribution systems. While it might be true, for example, that privately managed systems are directly funded by each insured beneficiary, it is not true that publicly managed schemes are necessarily unfunded by these beneficiaries. Table 2—from Myles and Pierson's (forthcoming) analysis of pension reform—lists all advanced industrial countries with capitalized earnings-related pension schemes. Of these seven countries, only the United Kingdom's scheme contained the option of a privately managed individual account system and, even there, other options existed. Note that Myles and Pierson exclude systems like that of the United States, which are partially funded, but in which all of the funds are invested in government debt. Thus, one can see that public schemes are compatible with diversification of investments into stock markets.

[13] Note that some of the drawbacks of DB PAYGO plans would apply to the unfunded, partially or wholly tax-financed, flat rate or income-tested systems of Australia, Denmark, Ireland, the Netherlands and New Zealand. On the other hand, many of the basically PAYGO systems did provide for some advanced funding, at least in government debt.

Table 2: OECD countries with capitalized earnings-related pension schemes, 1998

	Defined contribution	Defined benefit
Fully capitalized	Australia Denmark* Switzerland	Netherlands* United Kingdom
Partially capitalized	Sweden	Canada

Notes: Does not include funds invested in government debt.
Classification of DB and DC identifies the predominant pattern.
* = non-mandated but quasi-universal due to high levels of union contract coverage.
Source: Myles and Pierson (forthcoming).

From the above table one can also see that advanced funding (applying the contributions of any given generation to the retirement accounts of that same generation) is compatible with either a defined benefit or a defined contribution scheme. The typical PAYGO plan is a defined benefit scheme, in which the benefits are guaranteed to the retiree conditional on his or her work history. Thus the government or other sponsor (e.g. the employer) bears the risk. The typical privately managed plan is a defined contribution scheme in which the contributions to the plan by the individual worker (or employer or government) are invested and the worker's pension depends on the total contribution and the financial management of the investments. Thus the worker assumes the risk. However, in many funded plans, such as those in Denmark and Switzerland, there are no individual accounts. They are collective and thus spread the risk over a whole cohort of retirees. It is also possible to structure funded plans in ways that spread risk across cohorts of retirees, so that a given cohort's pensions are not entirely dependent on how well or badly the stock market is doing when they retire. Both the Swiss mandated second tier and the Danish ATP and labour market schemes do this.[14]

It is beyond the scope of this paper to survey all the reforms introduced in advanced industrial democracies in order to remedy the deficiencies of their PAYGO systems. Here it is sufficient to outline the experiences of several countries, to give an idea of the range of possibilities available to developing countries considering pension reform. Australia's new pension plan was introduced as a result of the Labour government's "accord" with organized labour. The earnings-related superannuation plan was initially based on an agreement between organized labour and employers. It emerged from a 1986 decision of the arbitration system, which was subsequently expanded and codified into legislation by the government and, like other legislation associated with the accord, was in part a *quid pro quo* for wage restraint. When fully matured in 2031, it would have provided benefits equal to 60 per cent of pre-

[14] The variability of cohorts' replacement rates can also be reduced in individual account systems by various provisions, such as the purchase of variable annuities rather than real annuities. See Alier and Vittas (1999) for a discussion of such provisions.

retirement income.[15] It was funded by employers' contributions, which were scheduled to rise to 12 per cent of payroll, and employee and government contributions of 3 per cent each. The money is invested in funds chosen by employers from a list of government-approved "complying" funds. Currently, the selected funds are industry-based and have conservative asset allocation, but it is expected that the allocations will become more balanced as the funds mature (Bateman and Piggott, 1997:327).

The Australian plan is a mix of industry funds and individual accounts, with the current balance heavily weighted to the latter. As in the Chilean plan, the Australian individual accounts are charged a flat fee, which weighs more heavily on small accounts. However, total administrative costs do not appear to be as high as in Chile. Ingles observes that Diamond's (1998) estimate of average administrative costs of a decentralized individual account system is consistent with his own estimate that administrative costs in Australia in 1996/97 were 1.56 per cent of total invested funds. While it is possible that these costs are declining, he feels that they are unlikely ever to go below 1 per cent.[16] This can be compared with an estimated cost of 2.36 per cent in Chile (Barrientos, 1998:116).[17] The difference is probably due to the existence of industry-wide funds, as well as to lower advertising and marketing expenses in the individual account system in Australia, since it is the employer, rather than the individual, who chooses the fund. More limited possibilities for switching funds may also lower costs in Australia. Nonetheless, these costs are significant. Ingles estimates that a 1 per cent cost will lower a pension by 22 per cent, which is consistent with Orszag and Stiglitz's (1999) estimate that administrative costs of privatized decentralized systems consume about 20 per cent of the value of the account due to "significantly higher advertising expenses, the loss of economies of scale, competitive returns on financial company capital and various additional costs".[18] By contrast, the US Advisory Council on Social Security estimated that the administrative costs in a centralized management system with restricted investment options would reduce the pension by only 2 per cent (Orszag and Stiglitz, 1999:29).

We can look to Denmark as an example of a funded system with centralized management and collective funds. There are two funded systems: the ATP, which was introduced in 1964 and in which the benefits are dependent on the years of contribution but not income level; and the negotiated earnings-related schemes introduced between 1985 and 1993, which cover almost all the working population, given high employment levels and the very high level of union density and union contract coverage in Denmark. The ATP plan was passed by a Social Democratic government to compensate wage earners for

[15] We say "would have" because the Liberal government elected in 1996 cut the employer contribution to 7 per cent and, since it is a defined contribution system, this will necessarily lower the replacement rate.

[16] David Ingles, e-mail message, 14 October 1999.

[17] There is some ambiguity with regard to this figure; Barrientos does not specify that it refers to a percentage of total capital administered, so it could refer to a percentage of average contributions, which would make it non-comparable with the figure for Australia. At any rate, the consensus of analysts is that the Chilean system is comparatively expensive.

[18] Costs in the United Kingdom are even higher, rivaling the Chilean system. Murthi et al. (1999) estimate that 40 to 45 per cent of the value of individual accounts is consumed by various fees and costs.

two years of wage restraint (Salminen, 1993:247). Unions obviously played a central role in the negotiated plans, so—as in Australia—labour politics were central to the development of the pension systems. The ATP is managed as a single fund, while the labour market programmes are administered in around 50 different collective schemes. Given that there are no advertising costs or individual accounting costs and that the large size of the funds allows economies of scale, it is not surprising that administrative costs are extremely low, averaging only 0.1 per cent of the total value of funds for ATP and 0.3 per cent for the labour market schemes.

Sweden handled the future difficulties of its DB PAYGO system in a novel fashion and its new system has already become a model for other countries with well developed DB PAYGO systems. As we have seen, fully funded DC systems solve the problems faced by demography and variations in wage growth by having each individual, age cohort or generation (depending on the system) pay for their own pensions. Since, in PAYGO systems, the working population pays for the retired population's pensions, replacing a PAYGO system with a fully funded DC system makes the current generation pay for its own future pensions as well as for the pensions of current retirees. In countries with well developed PAYGO systems and high earnings replacement rates, this is a very expensive proposition. As we saw in our discussion of Chile, the government there paid for the transition mainly by cutting other parts of the budget. Therefore a generation of Chileans paid for the transition in reduced consumption. The alternative is to pay for it by increasing government debt; but that just shifts the double payment to the future and creates other problems, as we shall see. Thus it is not surprising that none of the advanced industrial countries with well developed PAYGO systems and high income replacement rates has chosen to replace them with fully funded systems.

Sweden's old system combined a flat rate citizenship pension, a partially funded earnings-related DB PAYGO plan and a supplement for those who had accumulated few pension rights in the earnings-related plan. The fund in the earnings-related DB PAYGO plan was larger than the reserve funds typical of PAYGO plans, such as the US Social Security reserve fund, and it was intended to offset an anticipated decline in private savings and provide the government with an instrument to steer investment. In practice, it was initially heavily invested in the housing market and later also in the stock market. The income of retirees in the system was not affected by the performance of the investments.

The new system expands the funded component by introducing fully funded individual accounts. It combines an earnings-related PAYGO plan based on the concept of a "notional" defined contribution, or NDC; a DC fully funded individual account system with centralized administration; and a supplement for retirees with few pension rights in the earnings-related plans. The NDC PAYGO component is the biggest innovation in the new system. A retiree's pension from this system is calculated on the basis of total lifetime contributions, the rate of wage growth and average life expectancy in the population at the time of retirement of the individual. The whole system is expected to yield approximately the same replacement rate as the old system, at present forecast levels of wage growth and life expectancy—although, of

course, the benefits deriving from the funded portion will depend on the performance of the investment.

The Swedish pension accounts are "notional" because there is no account actually accumulating funds, as is otherwise typical of DC systems. This is a PAYGO system in which payroll taxes go to pay for present pensions. It is more resilient to demographic changes or modification in the rate of wage growth than a DB system because it is automatically adjusted to changes in life expectancy and wage growth. In other words, the formula for calculating pensions is similar to those used in traditional DB PAYGO systems, but this formula is adjusted for wage growth and average life expectancy of the population. Note, however, that, unlike a fully funded DC plan, the NDC structure does not insulate the system from changes in the ratio of the working population to the retired population that might arise from declining fertility and/or declining labour force participation of the working age population. But neither does it expose retirees to individual or cohort risk stemming from the performance of investment portfolios.

In order not to penalize those undertaking long periods of higher education, caring for small children or suffering bouts of unemployment, the Swedish system gives pension credits for time spent in education, childcare and unemployment. Otherwise lifetime contributions and retirement income are fairly tightly linked. Retirement age is flexible and the worker bears the cost of early retirement or reaps the benefits of later retirement. Since later retirement lowers life expectancy at retirement, an extra year of work has a very large effect on the replacement rate. Cichon (1999:100) estimates that an extra year of work will increase the replacement rate by 6 per cent. The advantages of NDC plans for countries with large DB PAYGO plans have already been widely recognized: Italy, Latvia and Poland have transformed their systems into NDC PAYGO plans, following the Swedish model.

The structure of the second component in the Swedish system—the fully funded individual account system—promises to minimize administrative costs. Contributors are allowed to select the funds in which their money will be invested, but contributions are aggregated and invested by a government agency, which will allow it to capture economies of scale and to exercise bargaining power. The agency will also maintain all records and carry out all negotiations with the private funds. Individuals who decide to switch fund placement must pay the cost themselves. Finally, the fact that funds will not have information identifying their members should discourage sales commissions. While the Swedish individual account system does appear to address the problem of administrative cost, individuals bear the risk involved in cyclical swings in the stock markets. However, since only 2.5 per cent of payroll goes to fund this system, compared to 16 per cent for the NDC PAYGO plan, the new Swedish system should deliver a reasonable level of income security in old age.

As to the politics of pension reform, Myles and Pierson (forthcoming) note the centrality of organized labour and its political representatives in almost every case. In countries with underdeveloped earnings-related plans, it was the demands of labour for such a plan that led to its introduction; and in countries with well developed earnings-related PAYGO plans, the consent of labour was

necessary to transform the plan. In contrast to Latin America, international institutions, and particularly the IFIs, played little role in pension reform. The European Union has had some influence, as its rules do not allow for benefits to be awarded on the basis of citizenship and require that pension rights be portable. The lack of influence of international financial institutions goes far towards explaining why the World Bank's 1994 model has not played a significant role in advanced industrial societies.

VIII. Options for Pension Reform in Developing Countries: Key Issues

With the experience of advanced industrial societies in mind, we can now outline some of the key issues facing governments in developing countries that may be considering reform of existing public pensions, initiating new systems, or adding new tiers to existing systems. While our remarks are primarily aimed at countries at medium levels of development, where some pension system already exists, most of the following comments also apply to countries at lower levels of development. We consider three issues: economic growth, risk and equity.

One reason why IFIs have touted the privately managed, fully funded system is its supposed effect on savings and growth. It is argued that PAYGO systems discourage private savings, because people will save less for old age where these systems are in place. In contrast, fully funded systems create compulsory savings, thus necessarily raising them above previous levels. But, as pointed out above, private management and advanced funding (or ensuring that a generation provides for its own retirement) are separate issues; and it is funding that is related to savings, not private management. Doubts about whether the Chilean reform had much of an impact on domestic savings and growth have also been noted. At a general level, evidence concerning the relationship between pension systems and savings rates is not as clear as the critics of PAYGO systems have argued. In a study associated with an International Social Security Association project, Thompson (1998:61) concludes that there is little evidence that PAYGO systems lower savings. He also finds that "advance funded plans can lead to an increase in personal savings, though by less than the gross amount of the assets accumulated in these plans" (Thompson, 1998:61). The effects of advance funded plans on savings, investment and growth are contingent on other policies, such as fiscal, tax and credit policies. For instance, as Orszag and Stiglitz (1999) correctly argue, if the transition from a PAYGO system to a funded system is debt financed, it will not result in a net increase in savings.

Nonetheless, there is enough evidence that advance funding (when accompanied by appropriate tax, fiscal and credit policies) increases savings to recommend that policy makers seriously consider introducing at least partial funding in unfunded systems, increasing funding in partially funded systems or adding a funded tier to existing systems. The fact that funding addresses the problem of demographic change, by making each generation pay for its own pensions (to the extent that the system is funded), further increases the

desirability of increasing the level of funding. The introduction of partial funding requires that a government channel part of all mandatory pension contributions into pension funds that are invested in a variety of financial instruments. The returns from these investments are then reinvested to accumulate for the pensions of future retirees. If there is a surplus in the pension system, it is painless to introduce partial funding. If revenues in the system just cover current expenditures, then the government has to pay the equivalent of the mandatory contributions going into the funded part of the system out of general revenue (assuming greater general savings are the goal).

In introducing partial or full funding, the risk factor along with administrative costs argues strongly against the privately managed individual account model along Chilean lines. We have already seen that it may be possible to address the cost issue by centralized administration of the individual accounts systems. Nonetheless, as we pointed out in our discussion of the Swedish individual account tier, individuals do bear the risk involved in management of their accounts and the cyclical swings in the equity markets. This is a serious consideration. A central, if not *the* central, purpose of publicly mandated pension systems is to provide income *security* in old age. But individual accounts subject retirees to both individual and cohort risk. By individual risk, we mean the risk an individual bears for his or her investment decisions. By cohort risk, we mean the risk borne by a group of people, retiring in a given year, because of swings in the equity markets. Individual risk can be eliminated and cohort risk can be greatly reduced by relying upon collectively managed funds, such as industry-wide funds managed by employers and unions (such as the Danish labour market pensions or the Swiss mandated second tier), or funds managed by public pension authorities (like the Danish ATP). The fact that these systems have been proven to have very low administrative costs is yet another reason for favouring such an approach.

Additional reasons sometimes given for preferring a privately managed pension system in developing countries are lack of state capacity, public sector inefficiency and corruption. If these systems are to function well, however and not to expose contributors to the risks of fraud and business failure, they need to be closely regulated. If the state apparatus lacks basic regulatory capacity and bureaucrats are deeply corrupt, a private system will be plagued by high risk, unethical business practices and bribes extracted by regulators. To run a pension system with integrity and efficiency, be it public or private, building state capacity and accountability is a prime requirement. Trying to bypass the state by privatizing the pension system is not a solution.

The final issue is equity. Almost all advanced industrial societies have some redistribution built into their DB systems, or they complement a DC system with a basic citizenship pension or a means-, income- or pension-tested system for those with little or no pensions or retirement income. In developing countries with DC systems, this is most often not the case; and the aged poor often have to fall back on public assistance, which is invariably woefully inadequate even by the countries' own standards. Moreover, this is a much more serious problem in developing countries than it is in advanced industrial countries because so many people either never work in the formal sector or do not work in it enough years to be assured of a minimally adequate pension in old age.

Citizenship pensions were introduced in the Scandinavian countries at a time when a large portion of the population still comprised farmers and thus not formal sector employees. These pensions were a basic safety net, no more; and they were justified on the grounds that the community, represented by the state, had the obligation to guarantee subsistence to all citizens as a matter of right, not a matter of charity. Later, earnings-related contributory PAYGO public pension systems were introduced in addition to citizenship pensions, in order to provide a higher level of income in retirement. More recently, due to rules under European integration that prohibit any discrimination on the basis of citizenship, these pensions were changed to reflect not a right of citizens, but a right of residents with a certain number of years in the country. Also, testing for other pension income has become more prevalent. But the principle remains that every resident in Scandinavia has the right to a subsistence income.

It might be objected that developing countries do not have the resources to provide minimally adequate pensions for all aged people. While this may well be true of the low income developing countries, the medium income countries of Latin America and the Caribbean do have sufficient resources. These societies are wealthy enough. For instance, current per capita income in Chile is roughly equivalent to per capita income in Finland in 1956, when Finland instituted its flat rate citizenship pensions. In constant dollars adjusted for purchasing power parity, Finland's GDP per capita in 1956 was $4,600; in Chile in 1992 it was $4,890 (Penn World Tables—www.nber.org/pwt56.html). There may, of course, be a political problem associated with resistance to the increase in taxation that would be necessary to fund such citizenship or means-tested pensions. The fact that Barbados, Guyana, Jamaica and Suriname have current government revenues of over 30 per cent of GDP, Trinidad and Tobago 28 per cent, Chile 26 per cent, Nicaragua 21 per cent and the rest of the Latin American countries less than 20 per cent (some considerably less; figures for 1995 from IDB, 1997:232) demonstrates that this is a problem of political will and power, and not a problem of inadequate societal wealth or of technical capacity to tax economies at this level of development. The difference in tax burdens between the English-speaking Caribbean and the bulk of the Latin American countries has persisted for more than a decade, which suggests that globalization does not exert inexorable pressures for a race to the bottom of the tax scales. It is clear that internationalization of production and the concomitant increased mobility of capital—along with the internationalization of capital markets—do impose limits on governments' capacity to tax. However, tax rates are only one of many factors that influence investment decisions. Macro-economic and political stability, as well as market access, can certainly outweigh tax considerations, provided tax rates are not way out of line with those of comparable countries.

Two additional arguments have to be considered regarding the introduction of non-contributory, flat rate, basic pensions that guarantee subsistence. The first is that if these pensions are provided on the basis of citizenship or residency, the money is wasted on middle and upper income earners. This problem can be handled through the tax system, by reclaiming part of it through regular progressive taxation. The advantage of such universalistic pensions is political, as they command large-scale popular support because everybody benefits. The

alternative is an income-tested basic pension, which makes it more difficult to garner political support for the scheme among middle and upper income earners, but avoids the problem of first giving the money and then reclaiming it from those who have significant other sources of income in retirement. In either case, an effective tax system to extract resources and to redistribute them according to people's income level is essential.

The second argument concerns the introduction of incentives or disincentives to participate in the formal economy, as these are related to the establishment of a non-contributory basic pension scheme. Some might argue that the introduction of such a scheme would remove any incentive for people to participate in the formal economy and thus to pay taxes and contributions to a pension programme. One can counter this with several considerations. The Chilean scheme, which is supposed to provide the closest linkage between contributions and benefits, is not very successful either in getting people to make pension contributions. Only somewhat over half of those affiliated to the pension system make regular contributions. Evasion is certainly widespread among formal and informal sector employees alike. However, given the wage differential between the formal and the informal sector and, in many cases, the additional benefits—such as union representation—accruing from work in the formal sector, it is not very plausible that a worker would choose an informal sector job over a formal sector one in order to avoid pension contributions. Moreover, the basic flat rate pension would do no more than guarantee subsistence, so it should not affect the behaviour of all those who aspire to an income level above subsistence in retirement. For the latter, participation in the formal economy and in mandatory pension schemes above and beyond the basic flat rate pension can be made more attractive by retaining employer contributions to the schemes and encouraging strong elements of risk sharing.

IX. Conclusion

Our analysis has demonstrated that IFI pressure for the adoption of individual account, fully funded, privately administered pension systems, as an integral part of neo-liberal reforms, led to full or partial adherence to this model in many Latin American countries. The Pinochet dictatorship in Chile was the first government to fully embrace the idea and subsequently the Chilean model became the one to be emulated. The degree to which this model was implemented in different countries depended largely on the power balance between the proponents of neo-liberal reforms and their opponents, as well as on the concentration of power in the hands of the executive. The previous discussion has also shown that the Chilean model did not live up to expectations that it would ensure lower administrative costs, higher compliance with contribution requirements, and thus wider coverage and an important contribution to national savings and investments. Moreover, this approach contains no elements of cross-class, cross-generation or cross-gender solidarity; and the level of risk for individuals and for cohorts is very high.

Our discussion of reforms in advanced industrial countries suggests that there are good reasons to opt for advance funding of pension systems and for defined contribution systems, but that IFI prescriptions mistakenly conflated a

number of issues with funding, most prominently the need for individual accounts and private management. Collective funds and public management entail significantly lower administrative costs and they can also build in risk sharing and some degree of solidarity. In terms of coverage, the most effective means to achieve universal protection, even in a context with a large informal sector, is through a basic flat rate, tax-financed pension, granted either as a citizenship right or as a right of all retirees living on an income below subsistence. In addition, mandatory partially or fully funded pension schemes, with collective funds and public management, based on financing from employee and employer contributions and incorporating risk-sharing components can provide supplementary pension incomes.

What stands in the way of such reforms in developing countries, and specifically in Latin American countries, is political resistance from a formidable array of privileged and powerful actors, including groups who have enjoyed privileged treatment under the old pension systems; groups who have benefited or stand to benefit from private administration of individual pension accounts, mainly corporate interests in the financial sector; and groups who benefit from low taxes. These opponents of effective social protection find common cause with domestic neo-liberal reformers and international interests pursuing the expansion of global markets and the shrinking of states.

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