Social Security Reform in Latin America: Policy Challenges

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Mandatory Private Accounts: The Chilean Model

- 1981 old PAYGO system closed to new entrants
- Individual accounts set up
- Mandatory for employees hired after January 1983
- Voluntary for self-employed
- Police and armed forces have separate systems
Transition

- Recognition bond provides value of accrued rights under PAYGO
- Sale of privatized industries and budget surplus help fund transition
Financing

• **Monthly payments**
  – Workers contribute 10% of earnings
  – Survivors and Disability Insurance, 0.78% of earnings
  – Administrative fees, 1.35% of earnings and flat fees

• **One-time payment**
  – Annuity fees, 5.5% value of annuity
Benefits

• Retirement at age 65 (men) and 60 (women)

• Choice of:
  – Annuity
  – Programmed withdrawals
  – Combination of two

• Early retirement

• Guaranteed minimum pension
Administration

• Heavily regulated as to type of investment
  – 35% in government bonds
  – 10% in stocks
  – 5% in bonds
  – 34% in financial sector
  – 13% in international

• Guaranteed minimum rate of return
Performance (Chile)

Average real rate of return for selected periods of time (does not include administrative fees)

- July 1981-June 2001: 10.90%
- May 1995-April 2001: 5.25%
- January-June 2001: 5.10%
Chilean Model

- Bolivia
- Mexico
- El Salvador
Mixed Systems

- Argentina
- Uruguay
- Colombia
- Peru
Supplementary Accounts

- Costa Rica
- Brazil
- Pre-reform AFPs
  - Ecuador
  - Dominican Republic
Policy Challenges

- Administrative fees
- Investment rules
- Evasion
- Gender
- Incorporating new sets of workers
### Administrative Fees as a Percentage of Contributions

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>24.0%</td>
</tr>
<tr>
<td>Chile</td>
<td>15.0%</td>
</tr>
<tr>
<td>El Salvador</td>
<td>31.3%</td>
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<tr>
<td>Peru</td>
<td>22.8%</td>
</tr>
<tr>
<td>Uruguay</td>
<td>21.2%</td>
</tr>
</tbody>
</table>
Additional Flat Fees

• Only in Chile and Argentina
• Lower-income workers pay higher percentage of salaries than higher-income workers
• In Argentina, workers earning $240 month pay 3.99% of salary while workers earning $2400 pay 3.19%
Net Rate of Return in Chile

- Gross rate of return for July 1981 to April 2000, 11.1%
- Net rate of return for same period for low-income earners, 7.34% and for high-income earners, 7.69% (government figures)
- Private consulting firm estimates that from 1981 through 1998 worker earning average wage would receive 5.1%
## Limited Competition

<table>
<thead>
<tr>
<th>Country</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chile</td>
<td>3 out of 8 control, about 66%</td>
</tr>
<tr>
<td>Colombia</td>
<td>2 out of 8 control, about 50%</td>
</tr>
<tr>
<td>Uruguay</td>
<td>1 out of 6 controls, about 55%</td>
</tr>
</tbody>
</table>
Investment Rules

• Limited allowable investments

• Minimum rate of return and “herd effect”

• AFP limited to one or two types of funds it can offer
<table>
<thead>
<tr>
<th>Country</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>44%</td>
</tr>
<tr>
<td>Chile</td>
<td>44%</td>
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<tr>
<td>Colombia</td>
<td>40%</td>
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<tr>
<td>Mexico</td>
<td>61%</td>
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<tr>
<td>Peru</td>
<td>44%</td>
</tr>
<tr>
<td>Uruguay</td>
<td>56%</td>
</tr>
</tbody>
</table>
Gender

- Women have lower benefits than men
- No credit for child-rearing years
- Lower earnings than men
- Lower annuities because gender-specific mortality tables are used and women live longer than men
Incorporating New Sets of Workers

- Workers in special privileged pension plans not included in reforms
- Military and police usually not included
- Argentina and Uruguay include self-employed