State Capacity and Pensions

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"In the present context of extreme scarcity of resources, efficient and politically beneficial use of resources for social expenditures becomes crucial. Accordingly, this moves to the center of political attention the question of state capacity to enforce the rule of law and to allocate resources efficiently." Huber (1995 p.163-164).

The shift to defined-contribution pension plans in Latin America was framed as a response to doubts about state capacity to deliver pensions in an efficient and equitable manner. In fact, improved economic efficiency is the primary objective of recent pension reforms in the region - according to its proponents, private sector management of pensions could deliver superior pensions at a lower cost than was the case with state-run PAYG systems.[1]

Whether or not the new systems of individual accounts can ultimately deliver upon these claims is an open question. Despite the increasing role of the private sector in the administration and financing of pensions, the role of the state remains critical to the success of the new systems. Therefore state capacity matters even as the administration and financing of pensions shifts to the private sector. This paper discusses a set of proposed indicators that can assess state capacity with respect to the policy goal of improved efficiency and equity in the provision of pensions.

In this paper I explore how state capacity may have changed after privatization of pension, while also considering indicators of how state-capacity may vary cross-nationally with respect to pensions (this is a first cut - a thorough exploration of this topic will clearly require further work). Specifically, I examine contribution rates, the composition of investment portfolios, the fiscal impact of reform, and other possible indicators of efficiency that might gauge the extent to which state capacity has changed under the new systems as well as allow cross-national comparisons. I devote particular attention to the Argentine case – which is in many respects a "worst case scenario" - in order to explore the extent to which a state might enforce (or violate) the rule of law with respect to pension reform policies. The paper concludes that based upon this preliminary analysis, state capacity is not necessarily enhanced under the new systems of individual accounts, and that states demonstrate a wide range of effectiveness in enforcing the rule of law.

The "Failure" of PAYG as a Justification for Privatization

Chile introduced the world's first social security privatization in Latin America in 1981. As in the rest of the Southern Cone and Brazil, the state played an expanding role throughout the 20th century in the financing and provision of social welfare policies as new segments of the population gained access to state benefits. Increases in social spending were accompanied by growing fiscal deficits that had reached 30 percent of GDP by 1973. The dictatorship (1973-1990) introduced reforms based on the concept of subsidiarity that prioritized the role of the market over that of the state in the provision of social services. The 1981 social security reform, which introduced private investment

[1] Esping-Andersen argued that with respect to Latin America, "The basic point that pensions are meant to secure incomes in old age seems to have been forgotten." (Esping-Andersen 2003 forthcoming).

accounts to replace public pay-as-you-go pension systems, has since become a model for pension privatization throughout the world.[2]

The old state-run pay-as-you-systems were beset with financial problems due to demographic trends, inequitable benefit schemes that favored key occupational groups, inefficient administration, and high levels of evasion. Deteriorating labor market conditions in the 1980s and stabilization policies of the 1990s led to an increase in pension fund deficits (Barrientos 1998 p. 24). Advocates of privatization argued that state-run pension systems pointed to the Chilean model as an example of how private defined-contribution savings accounts would reduce disincentives to work and save, flexibilize labor markets, lead to growth in capital markets, prevent political manipulation of pension funds, and provide higher benefits.

The state-run PAYG systems were also considered fundamentally flawed by advocates of defined-contribution accounts. The labor minister who oversaw Chile's privatization during the Pinochet dictatorship described the "original sin" of pay-as-you-go systems in the following way:

> The pay-as-you-go social security system created by Chancellor Otto Von Bismarck has a fundamental flaw, one rooted in a false conception of how human beings behave: it destroys, at the individual level, the essential link between effort and reward--in other words, between personal responsibilities and personal rights. Whenever that happens on a massive scale and for a long period of time, the result is disaster (Piñera 1998).

According to this logic, a structural reform rather than a parametric reform was necessary. The World Bank's 1994 report reflected this thinking and represented a fundamental departure from the post-war trend toward state-sponsored PAYG systems. The report also criticized the failure of public systems to fulfill their policy goals and stated that:

> "….public systems that have tried to do it all have too often produced costly labor and capital market distortions and perverse redistribution to high-income groups while failing to provide security for the old – outcomes that are neither efficient nor equitable nor sustainable." (World Bank, 1994, p.14).

[2] Under the new pension system, which was compulsory for new workers and optional for those already in the workforce, workers pay 10 percent of their monthly salary to a private pension fund administrator where the funds are invested in both domestic and international capital markets. An additional 2.3 percent goes toward a commission fee and disability and survivor's insurance. Those already in the workforce had a powerful incentive to join the new private system because they received an 11 percent net salary bonus for switching as well as a recognition bond representing accrued rights under the old system. Upon retirement, workers can use their accumulated funds to purchase an annuity or schedule programmed withdrawals (or a combination of the two). Workers who have contributed for at least 20 years that have not accumulated enough capital to purchase an annuity equivalent to a minimum pension will receive a government subsidy. The armed forces and police retained their state-sponsored programs.

The proposed solution to what the report describes as inefficiencies is to separate the saving and redistributive function of social security into separate "pillars" with redistribution publicly managed and tax-financed and savings privately managed and fully funded (p.15).

Is Privatization More Efficient? How Do You Measure Efficiency?

Under the new defined contribution pension plans government responsibility for administration and investment of pension funds is largely transferred to private agents (although in some cases, pension funds owned by state-owned financial institutions compete with private firms, as is the case in Argentina and Uruguay). However, government continues to play a fundamental role in the pension system through the supervision and regulation of pension funds, in enforcing labor market regulations requiring mandatory pension fund contributions, as the issuer of public debt (generally the largest category of pension fund investment), and through macroeconomic policies which greatly affect the performance of financial markets (see Kay 2003).

Measuring efficiency is problematic when it comes to pension reform. Until the first generation of workers retires under the new system, it will not be possible to evaluate pension benefits themselves since they will depend upon the performance of capital markets. The first generation of Chileans whose entire pensions will be generated from the new system (rather than resulting partly from recognition bonds granted to compensate for contributions to the old system) will not retire until the decade of the 2020s.

As proxies for evaluating state capacity this paper presents cross-national comparisons of compliance as well as a cross-national comparison of percentage of investment in government-issued paper. The Argentine case is also evaluated in discussion of the extent to which the state has been successful at enforcing the rule of law.

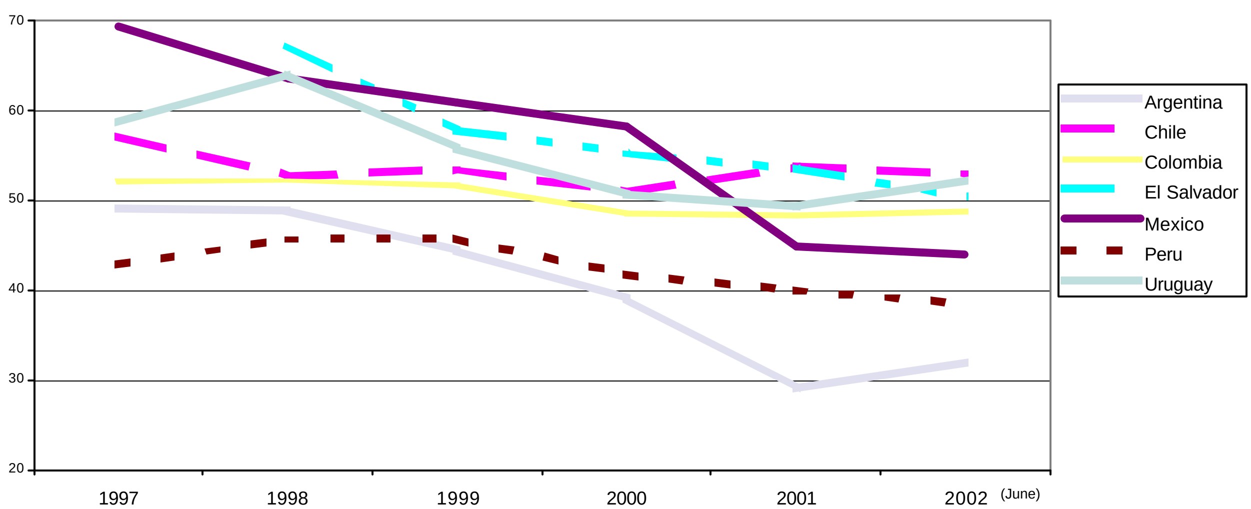
Compliance as an Indicator of Capacity

A basic indicator of state capacity is the extent to which the state is able to compel workers to contribute to mandatory social insurance programs. The main purpose of social security is to maintain income levels when individuals can no longer work. There is general agreement that compulsory social security is necessary to ensure income due to shortsightedness, inadequate savings mechanisms, or inability to save. The efficiency argument for compulsory social security is that uninsured losses would otherwise impose losses upon others (Barr 1987 p.191). Therefore one of the basic functions of government with respect to social security is to compel individuals to participate in the social security system.

As cited above, proponents of defined contribution accounts expect that workers will have an increased incentive to contribute to individual accounts. Yet, while contributing to social security may be in fact a legal requirement, states in the region have had difficulties enforcing compliance. By definition, workers in the informal sector are outside the system (approximately half of the labor force in Latin America is in the informal sector). However even in the formal sector, evasion rates are high and compliance varies.

Evasion can be caused by a variety of factors. Workers may conspire with employers to not report or underreport income. Workers may also drift in and out of the formal sector, and contribute only sporadically throughout their careers. Contribution rates will also fall during periods of high unemployment. The chart below demonstrates that compliance ranges dramatically in the region.

Chart 1: Percentage of Pension Fund Affiliates Making Regular Contributions

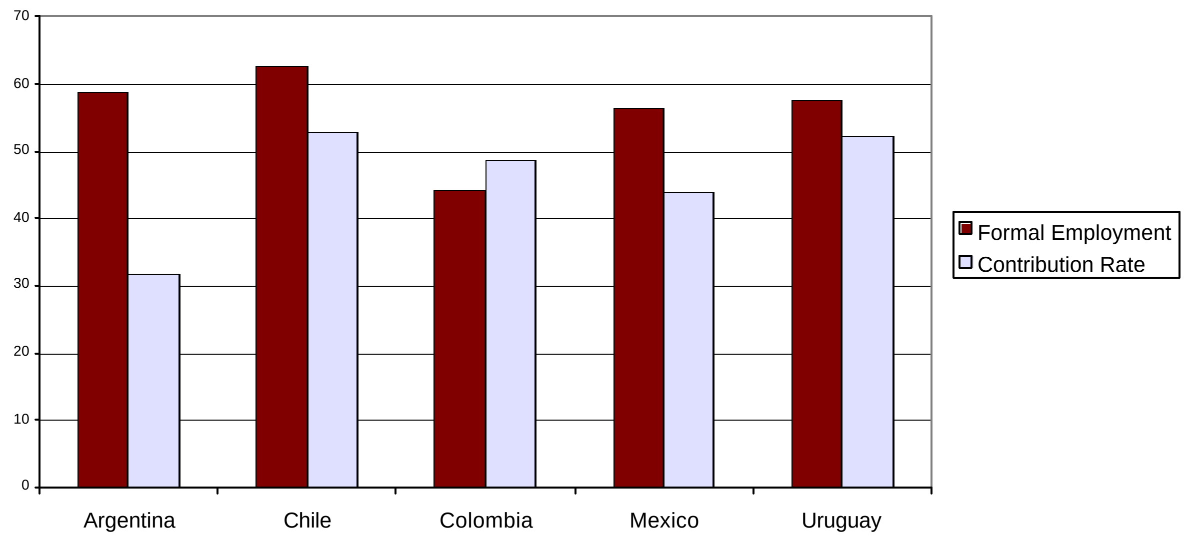


Source: FIAP web site (www.fiap.cl), author's calculations

This chart indicates the range of contribution rates in the region. In Chile, El Salvador, and Uruguay, just over half the affiliates of private pension funds make regular contributions. Mexico's contribution rate, which is still declining, has fallen from nearly 70% in since its debut in 1997 to 44% in June of 2002. Peru's contribution rate has fallen to 38.5 percent, while Argentina's contribution rate has hit 32% after averaging just 29% in 2001. In general, this chart demonstrates that contribution rates tended to decline in the late 1990s (except for Chile, all of the systems shown here were established in the 1990s).

The wide variation in compliance rates reflects the range of success that governments in the region have had in compelling workers to contribute to pension funds. Workers who are unemployed or have otherwise left the labor force will clearly stop contributing, yet all other workers who are employed in the formal labor force are required to make regular contributions. Many believed that the new private systems would provide workers with greater incentives to contribute (Piñera 1999); yet contribution rates have not appreciated substantially under the new systems of individual accounts. Informality is persistently high throughout the region, and workers drifting in and out of the formal and informal labor markets will have a sporadic contribution history. As the above chart suggests, workers who fail to contribute to their individual accounts will find it more difficult to accumulate sufficient assets to fund their retirement. These low rates of contribution and high rates of informality suggest that government capacity to enforce compliance with the new defined contribution plans has been limited.

Chart 2: Comparison of Rate of Formal Employment and Pension Fund Contribution Rate



Source: Cepal 2000, FIAP 2002 <www.fiap.cl>

In general, capacity to enforce compliance with pensions is likely to be closely linked to overall rates of informality in the workplace. Yet, as the chart above reflects, countries with similar rates of informality have had varying success in enforcing compliance. Argentina, Chile, Mexico, and Uruguay all had rates of employment in the formal sector ranging from 56 to 62 percent, yet rates of compliance varied drastically, from a low of 33 percent in Argentina, to a highs of around 53 percent in Chile and Uruguay. The contrast between Argentina and Uruguay, with its 52 percent compliance rate, is striking given the fact that both countries suffered from high unemployment rates of 20.4 and 18.6 percent (respectively) in 2002.

The range of compliance rates in the region reflects the varying success that states have had in compelling workers to contribute to the new pension funds. The extent to which this variation is caused by variation in state capacity or other variables requires further exploration.

Investment in Government-Issued Instruments as an Indicator of Capacity

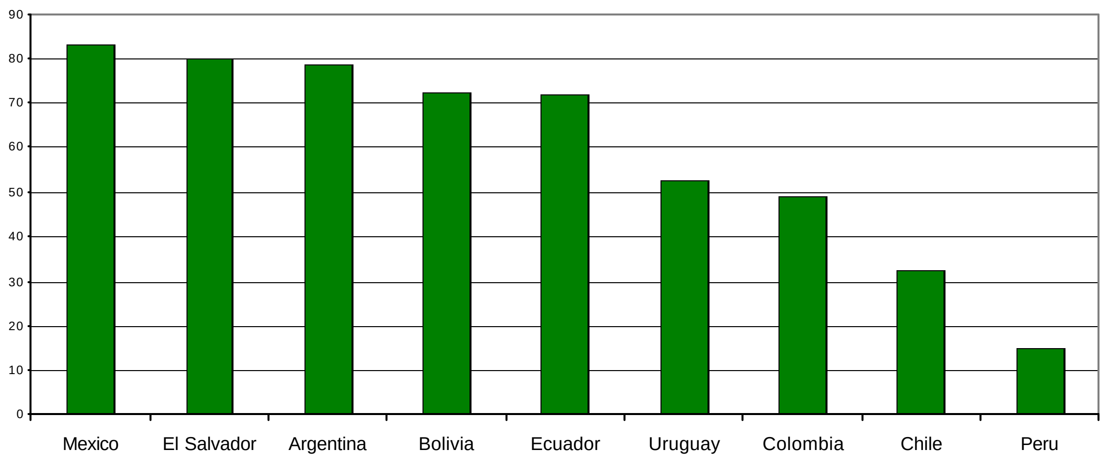
The new systems of defined-contribution individual accounts were expected to supply new investment capital that would spur the development of domestic capital markets. However, one of the biggest obstacles that the new pension funds have had to face is a limited array of potential investments in local capital markets. Pension fund investments are generally limited to investment-grade instruments, which are in short supply in emerging capital markets. During the 1990s firms with investment-grade status found it cheaper to borrow from banks, both at home and abroad, than to turn to the capital markets. Small and medium-sized firms that would have welcomed financing from capital markets generally did not meet investment grade requirements (interview with Riavitz 2003). In other words, those firms that could access capital markets didn't want to, and those that wanted such investments, didn't qualify as investment grade. Consequently, government-issued securities remained the investment of choice for pension funds (see Uthoff 1997). This lack of diversification and over-reliance on government issued paper leaves pension funds vulnerable to government default.

The development of new capital markets was intended to provide pension funds with a diverse array of investments. Diversification is fundamental to lowering investment risk, and the extent to which capital markets succeed at enabling pension funds to construct a diversified investment portfolio is a key measurement of their success. The extent to which local capital markets provide pension funds with sufficient investment options to achieve diversification can be viewed as another indicator of government capacity. If pension funds are over-reliant on investments in state-issued bonds, then as in any case where investments are concentrated rather than diversified, investment risk is higher. Concentration in government securities would mean that portfolios bear a high risk of government default.

The dangers of over-reliance on government debt were made apparent by the Argentine economic collapse in 2001 and 2002. By the time of the government's default and devaluation, approximately 70 percent of pension fund investment was in government-issued paper. The collapse of the Argentine debt market had a devastating impact on the value of pension fund investments that has net yet been fully priced into pension fund portfolios (interview with Riavitz 2003).

Foreign investment is also critical to diversification - without significant foreign investment, pension funds are unable to reduce country risk. In a worst-case scenario where a government defaulted on its debt (see the discussion of Argentina below), other local securities would perform poorly. Diversification abroad can ameliorate this risk. However, Chile is the only country in Latin America that allows significant foreign investment (it is scheduled to rise to 30% in 2004). In the wake of the Argentine crisis, Mexico recently allowed greater investment in corporate and foreign securities, and will also allow foreign investment, in an effort to reduce its high exposure to government debt (83% of investment).

Chart 3: Percent of Pension Fund Investment in Government Paper, June 2002



Source: Fiap web site (www.fiap.cl)

The above table demonstrates the heavy reliance on government-issued paper in all of the region's pension fund investment portfolios with the exception of Chile and Peru. Chile's pension fund investment in government paper peaked at 47% in 1986, while Peru's investments are by far the lowest, at 14.8%.[3] Even with its relatively "low" figure, Chilean pension funds still hold two-thirds of all public debt in Chile (Devesa-Carpio and Vidal-Meliá 2002 p.28). Colombia has just under half of its investments in government paper while five countries: Mexico, El Salvador, Argentina, Bolivia, and Ecuador have over 70% of pension fund investments in government-issued securities. These figures clearly indicate that most of the region's pension funds have not diversified their investment portfolios, and pension fund results are highly dependent upon government bonds.

In sum, if governments are successful at spurring the development of domestic capital markets, pension funds will be better able to diversify their investments. In cases where alternatives on the capital markets are scarce, investments will tend to be concentrated in government-issued bonds. Furthermore, pension funds will also be invested abroad in order to reduce country-risk. A more detailed cross-national assessment of pension fund investment portfolios would provide a better indication of pension fund portfolio investment risk.

The Fiscal Impact of the Transition Costs

Switching from a state-run pay-as-you-go (PAYG) defined benefit system to a funded, defined-contribution system entails large transition costs because the state ceases to collect the revenue that is diverted to the new individual accounts. Meanwhile, state

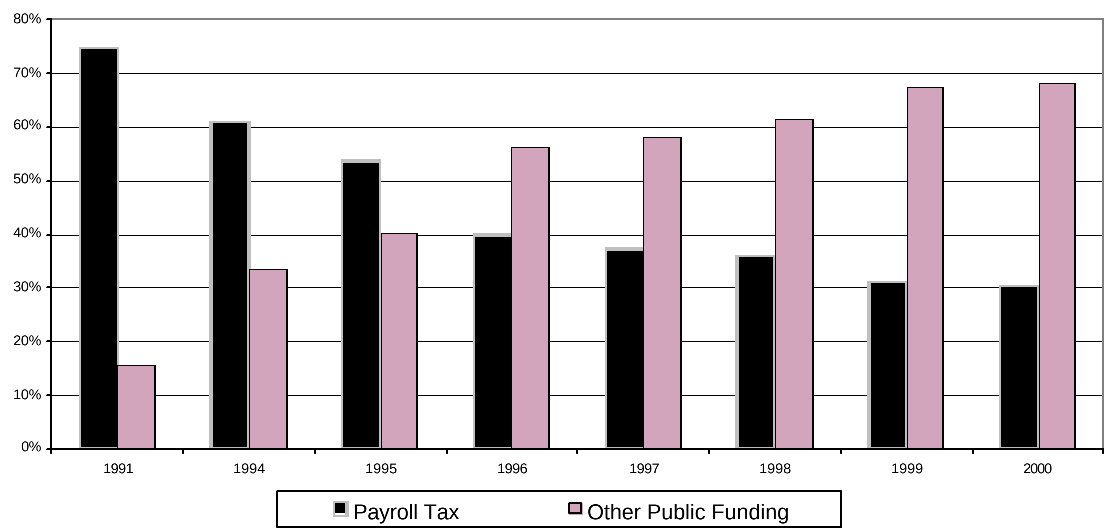
[3] Peru's status as an outlier can be explained by the fact that it has a far higher percentage of investments in local stock markets (around 25% of total investment) than is the case in other countries, with an additional third of total investment in short-term certificates of deposit. Peru's accumulated pension funds are also relatively small compared to both the size of the financial system and the overall economy.

pension obligations persist, leading to a severe revenue shortfall. Without prudent fiscal management, the burden of paying for these transition costs can undermine government finances.

Chile's transition costs averaged 6.1% of GDP in the 1980s, 4.8% of GDP in the 1990s, and are expected to average 4.3% from 1999 through 2037 (Devesa-Carpio and Vidal-Meliá 2002 p.28). This forecast is far higher than originally thought due to errors in projections about future obligations – originally it was believed that fiscal costs would eventually diminish under privatization (Ibid). Fiscal costs in Chile are elevated in part by the obligation to provide subsidies for workers failing to accumulate enough capital to earn a minimum pension. Acuña and Iglesias (2001 p.33) argue that this program represents the greatest fiscal uncertainty for Chile's social security system.

Proponents of defined-contribution systems argue that they will lead to an eventual reduction in government spending on social security, however this can only come about after the transition costs are paid. As the Chilean case demonstrates, this transition will take several decades (and will last longer than originally anticipated). Without fiscal discipline, short-run transition costs can be devastating. In the case of Argentina, the transition to the new private system contributed to undermining the country's fiscal balance and contributed to the economic collapse.

Chart 4: Changes in Sources of Finance for the Argentine PAYG System



Source: Inarss 2002

Chart 4 illustrates how the financing of the public social security system in Argentina was dramatically transformed by the implementation of the new defined-contribution system. In 1991 74.8% of social security revenue was funded by payroll taxes and only 15.6% came from other public sources. By the year 2000 the ratio had practically reversed itself as only 30.4% of revenue came from contributions and 68.2% came from other state resources. Payroll taxes dropped off dramatically after 1994 when Economy Minister Domingo Cavallo cut employer payroll taxes by a total of $5 billion per year as part of a plan to stimulate employment. At the same time, $4.2 billion per year was paid to the private pension funds rather than the state-run system. Furthermore the commissions paid to the private pension funds, that represented 30 percent of total contributions, were another source of revenue lost to the private pension funds. In total, between 1994 and 2001, $55 billion were directed to the new private system that otherwise would have gone to the public pension system (Muchnik 2001).

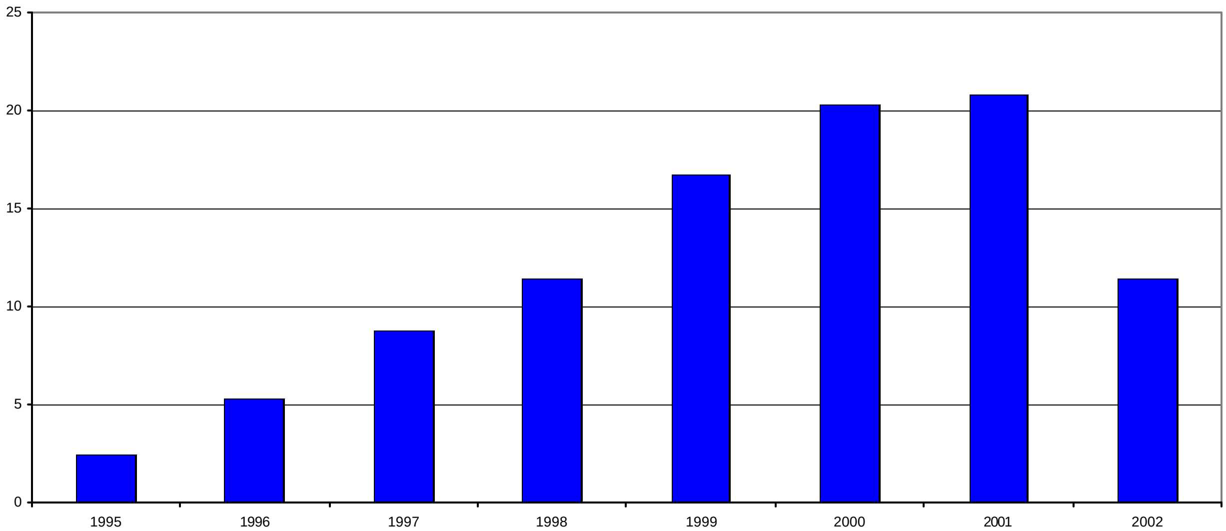
The fiscal impact of these transition costs cannot be overstated in the Argentine case. In January 2002 Argentina announced the largest sovereign default in history when it announced that it would not make payments on its $150 billion debt. The fiscal impact of the transition costs to the new private system clearly played a significant role in the accumulation of the debt – the $55 billion diverted to the public system comprised over a one-third of the total foreign debt. In this case, the transition costs in the absence of fiscal discipline were crippling and clearly did not represent the efficient allocation of resources. To the extent that the massive transition costs of privatization undermined other fiscal priorities, these costs weakened state capacity.

Pension Reform and the Rule of Law

In considering pensions as an indicator of "state capacity to enforce the rule of law and to allocate resources efficiently" (Huber 1995) it is apparent that states vary in the extent to which the "rule of law" is enforced. During the Argentine financial crisis the government took several short-term measures intended to shore up government finances that had a devastating impact on the finances of the reformed pension system. In doing so, it violated laws protecting deposits and shattered confidence in the pension system. The most egregious act took place when the government seized $3.1 billion in pension fund deposits and converted them into treasury bills in December 2001. It later defaulted on its debt obligations and devalued deposits at the below-market rate of 1.4 pesos to the dollar. These actions had a devastating impact on pension fund balance sheets.

The government seizure of pension fund deposits demonstrated that the privately held deposits were not immune from arbitrary state action (recall that advocates of individual accounts had argued that privatization would prevent political interference – see Kay 2003). The subsequent devaluation also violated Argentine law. In 2001 the government had decreed the "Law of the Intangibility of Deposits" which stated that the currency in which a deposit was made could not be altered. A Supreme Court ruling announced on March 5, 2003 ruled that the devaluation violated the 2001 law, which made it likely that banks will eventually be forced to redollarize pesified deposits (probably through the issuance of dollar-denominated bonds).

Chart 5: Argentine Pension Fund Assets (in US$ Billions)



Source: SAFJP <www.safjp.gov.ar>

The devaluation and default caused the value of pension funds to plummet. As the table above indicates, the value of pension funds plummeted from $20.8 billion in 2001 to $11.5 billion in 2002. The net value of pension funds in 2002 was equal to that of 1998, which meant that the economic collapse had wiped out 4 years of contributions and investment appreciation in dollar terms. The actual value of pension fund investments is uncertain since the government has yet to renegotiate its bond obligations and many pension fund investments are in illiquid securities (therefore the value of total investment may be less $11.5 billion).

Clearly the collapse will have a lasting impact on the pension funds, and ultimately, retirement pensions. Prior to the collapse, Salomon Smith Barney forecast that assets under management would reach $138.7 billion by 2015. However, that forecast has now been revised downward 62% to $52.5 billion (Salomon Smith Barney 2002). Without government compensation of some sort, the crisis will likely have a lasting impact on pension fund levels. The report cast doubt on the capacity of the new system to provide adequate pensions:

> …the gap between contributors and noncontributors has expanded exponentially while the system has produced extremely poor returns. If these two conditions remain, the Argentine private pension system may not be able to generate the needed future cash flow for the growing retirement population (Salomon Smith Barney 2002 p.33).

<u>Other Inefficiencies as Indicators of State Capacity</u>

Governments in the region are struggling with reducing inefficiencies associated with the recently reformed pension systems (see Kay and Kritzer 2002). Inefficiencies with respect to investment options and high rates of evasion were discussed earlier. High administrative fees and increased differentiation in benefits according to gender are other notable policy challenges.

The new private pension funds are expensive to run, and workers pay high commission costs. High costs are driven in part by the need to maintain a large sales force to persuade individuals to switch fund. Chile placed limits on fund transfers that has helped drive down total commission costs. Pension funds have generally not competed on price, although regulators in Chile now require greater disclosure of fees in order to encourage competition.

High commission charges have an impact on worker returns. The private pension funds generally assess fees on pension fund contributions rather than on pension fund balances (Bolivia and Mexico charge fees on both). Most analyses of the Chilean system tout the high commission returns after commissions are taken into account. However if total worker contributions are taken into account, including commission costs, returns for the Chilean system between 1981 and 1998 drop from 11 percent to 5.1 percent (CB Capitales 1999).

Table 1: Commission Fees as a Percentage of Wages

Argentina	2.2
Bolivia	0.5
Colombia	1.64
Chile	1.52
El Salvador	2.05
Mexico	1.49
Peru	2.39
Uruguay	1.97

Source: FIAP web site <www.fiap.cl>

Table 1 indicates that there is a wide range in commission charges in the region (this chart includes commissions only and not death and disability insurance premiums). Bolivia is an outlier because its fees were set by statute when licenses for the country's two pension plans were established. Mexico also charges a relatively low fee on contributions but recall that both Mexico and Bolivia assess fees on balances. The highest fees are charged by Peru and Argentina, which charge workers 2.39 and 2.2 percent of their salaries respectively. When Argentine authorities lowered pension contributions to 5 percent of salaries during the economic crisis in 2001, it meant that approximately 40 percent of a worker's total contribution went toward a commission fee (total pension fund contributions will return to 11 percent in 2004).

Whether or not the costs of the new system should be considered high is a matter of controversy as scholars have disagreed whether or not the costs of the new system are higher or lower than the systems that they replaced (see Devesa-Carpio and Vidal Melía 2002 p. 17 for a review of this debate). Clearly this is an important topic in measuring efficiency, however making such a comparison is problematic given the different services that each system provides, and the uncertainty of ultimate pension benefits and costs.

Gender Inequality

The impact of the region’s pension reform on gender inequalities has, with few exceptions, received little comment (see Arenas de Mesa and Montecinos 1999, Kay 1999). The fact that women are worse off relative to men is another inefficiency of the recent reforms. When compared to PAYG systems, the private social security systems in South America are less favorable for women because they strictly link benefits with earnings and place men and women in separate actuarial categories. Because they tend to earn less, spend more years of their lives in unpaid labor, and have greater longevity, women purchasing annuities upon retirement will systematically receive lower benefits than men.

Arenas de Mesa and Montecinos (1999) project the rates of return that women would need in order to achieve the same pensions as men. For example, assuming identical wages and years of contribution, a woman retiring at age 65 and purchasing an annuity would receive approximately 90% of what a man would receive. When we consider the actual disparities in income profiles and years of contribution, the differences are even more striking. A typical woman retiring at age 60 and purchasing an annuity after earning a 5% annual rate of return would receive a replacement rate of 57% of her former salary, while a man retiring at age 65 would receive 86%. Furthermore, women are more likely than men to wind up receiving the minimum pension subsidy that is granted to workers who contribute for at least 20 years but fail to accumulate enough funds to generate a minimum pension. Ordinary pensions are indexed for inflation, but minimum pensions are not (Ibid).

In considering efficiency indicators as a measurement of state capacity with respect to pensions, the issue of gender inequality should not be overlooked. Private pensions increase inequality by linking pensions directly to labor market earnings. The old PAYG systems contained provisions (such as placing men and women in a single actuarial category) that ameliorated inequalities, while the new private systems more directly reflect gender inequality in the labor force. In part this is a normative question - presumably advocates of individual accounts would argue that the proper role of the pension system is to directly link wages and pensions and not to compensate for inequity in earnings - Piñera (1998) seems to be making just such an argument in the quote cited earlier. However, if reducing gender inequality (rather than reproducing market inequality) is considered a goal of social security policies, then the new systems of individual accounts as they are presently organized are less efficient than the PAYG systems at achieving this goal.[4]

[4] One method to improve policy performance would be to combine men and women into a single actuarial category and to devise methods to compensate for years spent outside the paid labor force. These measures were included in Swedish reforms (see Fox and Palmer 2001 p.30).

Privileged Groups

In Latin America some occupational groups received particularly generous (and costly) pension benefits that remained untouched even after reform. In the region's first privatization, Chile's military and police were excluded from the new system (and remain so). This pattern has generally been repeated throughout the region – key constituencies such as the military and government workers have generally been exempt from the new systems (even if reform laws originally called for their eventual inclusion, as was the case in Argentina and Uruguay). In Uruguay, bank employees, notaries, and some white collar professionals belong to parastatal pension programs that have yet to be reformed despite language in the 1995 legislation that called for their incorporation into the new systems of defined-contribution accounts.

Throughout Latin America, Bolivia is the only country to not exempt groups of workers from the new reformed pension systems (Devesa-Carpio and Vidal Meliá 2002 p.37). Elsewhere certain privileged groups whose benefits are threatened by proposed pension reforms have managed to protect their benefits. Currently, Brazil's new administration is seeking to reduce privileges in the civil servants pension fund. President Lula proposed unifying the country's private sector and civil servant pension systems as part of a comprehensive civil service reform (the public sector system, while far smaller, is responsible for ¾ of the deficit). However political opposition from civil servants has already caused Lula to back down on the proposal to unify both systems (Cristino 2003). The extent to which governments permit privileged groups to keep their pension systems even after pension reform is another potential indicator of state capacity with respect to pensions.

Conclusions

States will vary with respect to enforcement of the rule of law and relative efficiency in achieving policy goals. Recent pension reforms in the region reflect these disparities. This paper has proposed a series of possible indicators that might be used to measure variations in state capacity with respect to pensions.

For advocates of privatization, the creation of individual defined-contribution accounts was a response to perceived shortcomings in state-run PAYG programs. Yet the newly reformed systems require continued state involvement with respect to supervision and regulation of pension funds and capital markets. Rates of affiliation, rates of formality vs. informality in labor markets, pension fund financing and investment, operating costs and gender bias are all measurements of state capacity with respect to the relative efficiency of these newly reformed systems. Furthermore, the Argentine case reflects state failure to enforce the rule of law and sets an unnerving precedent for the rest of the region's pension systems because it demonstrates that private pension funds are not immune from state intervention.

It is too soon to know whether or not pensions will be adequate under the new system since benefits will depend upon future investment returns. These returns are unknown and unknowable. In the Argentine case, the Salomon Smith Barney (2002) forecast for pension fund capital accumulation in 2015 dropped 62 percent due to the crisis. The catastrophic fall in the value of pension fund investments has clearly clouded the future for the Argentine system as it would in any country that suffered such a financial collapse. Comparing the old PAYG defined benefit and the new defined contribution plans is also problematic because the two types of systems offer different benefits and different types of services. There is significant disagreement in the literature on the relative efficiency of the reformed systems vs the PAYG systems. More research is necessary in this respect given the obvious policy implications as countries (like Brazil) continue to weigh the prospects of structural vs. parametric reform.

Cross-national comparisons can offer insight on relative state capacity with respect to pension reform. The fact that some countries manage to achieve greater compliance rates than others suggests a range in state capacity. Management of the transition costs (which Argentina failed to manage) and development of a strong capital market are other potential indicators of efficiency that were explored in this paper. The role of gender equity or inequity in the Chilean case was also explored. A cross-national survey on the impact (or potential impact) on the new system on gender equity, and the extent to which old privileged subsystems are preserved is another potential area for exploration. Establishing a basic set of indicators for measuring state capacity with respect to pensions is a first step toward exploring the causes of variation in state capacity.

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