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'Chile Model' Revisited

Privatized pension system: the apple of London's eye

by Cynthia Rush

Whenever Chile's privatized pension system is mentioned, it sends shivers of delight up the backs of London and Wall Street bankers. Deemed a success inside Chile, the model has been set up in Peru and Argentina, and is now being considered for Mexico and other Third World nations. A Mexican delegation recently visited Chile to examine the system more closely. An article in the June 11 *Washington Post* suggests that the system might even work better in the United States than the existing social security system.

How does Chile's privatized system work? Today it consists of about $22 billion, which has been seized directly from workers' wages to prop up the Chilean monetary system. There are 18 private funds known as Administrators of Pension Funds (AFP in Spanish), which are managed by both private companies and the ubiquitous "financieras." The AFPs compete with each other in the "free market" for the Chileans who are active affiliates today. By law, workers must pay 13% of their annual salary to a fund, although they are "free" to choose the fund of their choice and they may also pay in more if they wish; 3% of their contribution is set aside to cover administrative and other costs.

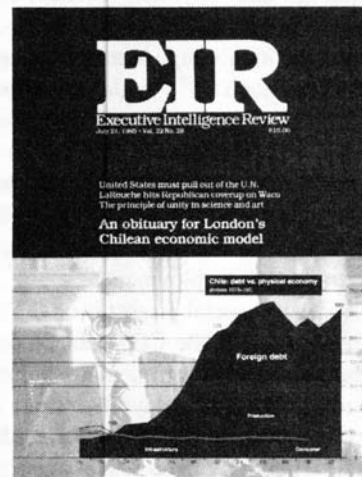
When the new system was created in 1981, it did not eliminate the old social security system at one stroke. Older workers were given a choice of staying with the old system or joining the new one. If they chose to join the new one, they were eligible to receive Recognition Bonds to compensate them for the benefits they had earned under the old system. Young workers just entering the labor force had to join the new system.

In the new system, a worker is allowed to "choose" which fund he wants his seized money to be placed in, based on different rates of return they claim to be making on the money. The pension he finally receives depends on the earnings his contribution makes over time. According to the June 11 *Washington Post*, from 1981 to 1990 the funds earned an average 13% per year (adjusted for inflation), with earnings ranging from 3.6% to 28.5%.

Where does the money get invested? Until now, a Risk Classification Commission has regulated the type of investment the AFPs could make, limiting investment abroad to 4% of a fund's holdings; however, a decree to be issued shortly will ease these restrictions, allowing the funds to "diversify" and invest 6% of their holdings abroad. According to the Superintendencia de Administradoras de Fondos de Pensiones in Santiago, Chile, as of March 31, 1995, a total of $138.5 million, or only 0.63%, were invested abroad—a figure that will grow once the law changes. Another 36.3%, or $8.0 billion, is invested in domestic private corporations, with two companies, Endesa and Enersis, receiving the lion's share of this investment. Both companies deal in energy and electricity generation. The remainder of the funds, almost two-thirds of the total, is invested in a variety of domestic treasury, central bank, and other financial instruments. In other words, a total of about $15 billion of workers' money has so far been pumped in to directly bolstering the Chilean financial system.

Those who extol the virtues of the Chilean pension system fail to mention that poverty rates and unemployment are increasing in the country, leaving unanswered the question of how the unemployed and poor are supposed to benefit from this system. Moreover, if the AFPs are now going to increase their investments abroad, they are buying into an international financial system in which the use of derivatives and other speculative investments have created a bubble which is about to burst. When that goes, so do the pension funds of Chilean workers.

Correction:



Last week's cover story (*EIR*, July 21, 1995) dissecting the failure of the "Chile model" was missing an important element of the package as originally designed, an article about the pension system, which appears on this page. Also, due to a translation error, several graphics, including the graph on the cover, used the terms "Production" where the correct term is "Producer Goods," and "Consumer" where it should have been "Consumer Goods," as indicated in the text.

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