Bush's Chile Model: Take Their Pensions and Run!

by Cynthia R. Rush

Almost 25 years ago, in 1981, the free-market ideologues directing the economic policy of Gen. Augusto Pinochet's military junta in Chile—most of them trained at the University of Chicago in the fascist quackery preached by Milton Friedman and Friedrich von Hayek—privatized that country's Social Security system. Today, Chile is George W. Bush's model for Social Security privatization. Chile took $22 billion deposited in the government-run Social Security fund and handed it over to 18 private investment funds, known as AFPs (Pension Fund Administrators).

The chief architect of Chile's privatization scheme was Harvard-trained economist José Piñera, a longtime member of the Cato Institute's Project for Social Security Privatization, who is cited frequently by President Bush. Piñera has travelled the world to convince, especially, developing sector and Eastern European nations of the benevolence of Chile's pension and free-trade model.

Through a splashy multimillion-dollar propaganda campaign, Piñera and Gen. Pinochet's "Chicago Boys" told Chilean workers the same thing that Bush is telling Americans today. The large number of funds (run by banks, insurance companies, and other financial vultures) would offer workers an array of "choices" on how and where to invest their money, without government looking over their shoulders. They promised workers a high rate of return and a secure future.

Those who agreed to leave the old U.S.-style "pay as you go" Social Security system and join the new privatized one would experience nothing short of earthly paradise, the privateers vowed. All they would have to do is allow a mandatory 12.5% of their monthly paycheck to be deducted and deposited into the AFP of their choice, from which it would be "wisely" invested. Unlike the old system, employers would make no contribution at all.

One million Chilean workers did switch to the new system in 1981. They were offered incentives and rewards, including an initial wage increase.

It Doesn't Work

Earthly paradise? In a Dec. 9 conversation with *EIR,* Manuel Riesco, a board member of the private Center for Alternative National Economic Studies (CENDA), put it this way: This has been a quarter-century experiment and the results are uncontestable. *"The system doesn't work!"*

Reiterating what CENDA stated in its January 2004 report, "Chile: Basis for a Reform of the Pension System," Riesco said there is a *consensus* today among "everyone"—the government, AFP administrators, trade union leaders, think-tanks, and even the World Bank (which recently published a report on the subject)—that the system is a complete failure. More than half of the people belonging to the system today *will not qualify for even the minimum pension* of $110, which the state guarantees. That's 3.3 million people out of a labor force of 6 million. One government study concluded that the number not qualifying for the minimum pension is as high as two-thirds of all affiliates. This has been the case even in years when the rate of return on the AFP investments was 10%, a rate no fund is likely to see again anytime soon.

As CENDA documents, this is because contributors have not been able to make the required 240 monthly payments into a private fund over a 20-year period. Many low-wage earners registered with the private system evade the mandatory monthly payments by underreporting their income, assuming that the minimum pension will yield *more* than whatever their retirement accounts offer. A majority of participants only make an average of two to three monthly payments a year.

In 1973, 77.7% of the labor force was covered by the government's Social Security system. Today, the old system and the privatized system *combined* cover only 60% of the labor force; 40% have no coverage at all. Only a tiny fraction of those who contribute to the private system will get pensions that allow them to live decently.

Those who don't qualify for the minimum pension may withdraw whatever meager funds have accumulated in their individual accounts, and must apply for the state's special *welfare* pension, about $50 a month. But not all of the country's poorest citizens can be assured even of those small grants, as only 300,000 are available. Chile's unemployment is 10%; and the 26% of the labor force employed in the "informal economy"—off the books—can hardly make voluntary contributions to any pension fund.

Stealing by Any Other Name. . .

The truth is that Chile's private pension system is a gigantic Enron-style swindle. The financial sharks who set it up never intended it to be anything other than a mechanism to loot the workforce and the economy, while they and their allied financial predators reaped huge profits. This is true in every country where the Chile pension model has been imposed—Argentina, Peru, and Bolivia, to name a few. The same foreign banks that have bought up 42% of Ibero-America's banking sector—chief among them Spain's Banco Santander, Banco Bilbao Vizcaya Argentaria (BBVA), and the U.S. Citibank—control a whopping 59% of its pension funds today.

Piñera is explicit in stating that his pension model has nothing to do with the principle of the general welfare, embedded in the U.S. Social Security system founded by Franklin

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Roosevelt. In an article in the Dec. 1 *New York Times,* Piñera insisted that the crucial issue is the link between "personal effort and reward": Who wants "risky government promises" when they can have "property rights"? What better for workers than cheering "stock market surges, rather than resenting them"?

Property rights? It was the AFPs that "took almost all the money and left the state to pay almost all the pensions, which resulted in a gigantic expenditure," CENDA states in its January 2004 report. Today, the Chilean state is left with the responsibility of covering the private system's unfunded liabilities, to the tune of 7% of Gross Domestic Product—$5.5 billion—more than it spends on health and education combined. In 2000, the government spent 41.5% of all of its social expenditures to cover the private pension system's deficit.

The government must also cover the cost of the old system, to which the Armed Forces and the police still belong, together with half of public-sector employees. Workers who switched to the new system were granted interest-bearing "recognition bonds" corresponding to what they had accrued in the old system. When those workers retire, they are entitled to cash in those bonds, on which the government is also obligated to pay.

But the AFPs are feeling no pain. They charge gigantic commissions for their services, making the system unbelievably costly. A May 2002 report by the United Nations Development Fund (UNDP) in conjunction with Chilean experts, found that the AFPs charge commissions on the order of $500 million annually. Between 1981 and December 2000, commissions totalled $6.2 billion. The Superintendent of Pension Fund Administrators (SAFP) estimated that as of March 2002, some 25-32% of each mandatory deduction went to payment of commissions!

According to the same report, AFPs had an average profit rate of 33.8% in 2001; and in 2002, under conditions of economic recession, that rate reached 50.1%—with one of the largest funds attaining a profit of 209.8%! Chilean law professor Juan Gumucio aptly remarked that AFP managers "make more money than drug traffickers selling white powder."

CENDA concludes that the country's privatized pension system is the "most protected industry in Chile's history, created by those who criticized our earlier protection of industry." The Chicago Boys weren't averse to protectionism if they were the beneficiaries.

Predators, Inc.

In "An Obituary for London's Chilean Economic Model," published in its July 21, 1995 edition, *EIR* demonstrated that the much-vaunted Chilean "economic miracle" was based on a barbaric gutting of the physical economy and a six-fold growth of a speculative debt bubble over a 20-year period. The radical free-marketeers who took over the direction of economic policy in 1976, carried out a stunning dismantling of anything in the country remotely connected to sovereign state control of economic processes or real production, at the same time imposing draconian austerity.

The looting intensified after the 1982 financial crisis and banking blowout, with an accelerated deregulation of the economy—privatization of state-sector companies, firings of public sector workers, and 70% wage cuts for those who remained. Funds for health and education were dramatically cut. Tariffs were lowered to encourage "competition," depriving industry of any protection. As a prelude to the pension privatization, the reforms which Piñera imposed as Labor Minister from 1978-81, including abolishing the minimum wage, smashed Chile's once-strong organized labor movement.

It was this brutal austerity, enforced by a military dictatorship, which produced the "high savings rate" which supposedly proves the success of the Chilean "miracle." The $22 billion appropriated by the financial buzzards in 1981, became a general slush fund to keep the debt bubble afloat, or prop up any other part of the "miracle" that needed backup.

Where did the money go? By 1994, according to The Century Foundation, more than half of the AFPs were incurring losses. In 1995, about two-thirds of what was then a $25 billion pension fund was invested in highly speculative paper linked to the international derivatives bubble. In September 1995, the funds lost $1.5 billion of their total value, and had negative real returns of 2.5% for that year. A study by a Chilean brokerage firm, CB Capitales, found that the real rate of return in the individual accounts has averaged only 5.1% since 1982.

Today, 33% of AFP funds, which total $36 billion, are invested in government debt which, under current conditions of a dollar collapse and global financial upheaval, can hardly be called stable. At least 12% of the funds may be invested overseas, likely to end up in shaky derivatives markets. The rest goes into unstable mortgage securities, bank deposits, or corporate debt.

The Enron-style thievery and corruption embedded in the Chilean pension model is reflected in the fact that at least two dozen former members of Pinochet's cabinet have at one time or another ended up as directors of AFPs. Instead of 18 AFPs, today there are only 7, constituting a virtual cartel that wields enormous financial and political power.

The above-cited UNDP report points out, for example, that the AFPs exercise significant political control over the companies whose stock they purchase. Exemplary are the state-owned energy companies which the Chicago crowd privatized. Having purchased those companies' stock, the AFPs were often able to select their directors, who then went on "to create a true empire in the [energy] sector, which extended to Argentina, Brazil, and Colombia, allowing them to control a significant portion of electricity generation and distribution in Latin America."