

THE BOSTON GLOBE

Poor Chileans labor past retirement

Private pensions offer no safety net

By Indira A.R. Lakshmanan, Globe Staff | February 28, 2005

SANTIAGO, Chile -- Irma Moya Benech has worked 40 years in public hospitals caring for the sick and elderly, and now that she is both, she says the state is not taking care of her.

Already five years past the legal retirement age for women in Chile, Moya, 65, continues to toil as a medical technician for patients with AIDS, tuberculosis, and other infectious diseases, though her immune system is weak from radiation therapy for breast cancer. She desperately wants to retire but can't, she said, because her private pension would be less than 30 percent of her \$1,738 monthly salary. She would no longer be able to afford quality health insurance to cover chemotherapy and prescriptions.

Her 71-year-old husband, who has leukemia, is still working as an accountant at the University of Santiago, because his pension would be only 20 percent of his \$2,127 monthly salary.

"I think we have done our duty and should be allowed to rest after working for 40 years," Moya said, tears streaming down her face.

At a time when President Bush has made overhauling Social Security a central objective of his second administration, he and other proponents of privatization have held out Chile, the first in the world to privatize pensions in 1981, as a role model.

By transforming its system, this country of 16 million people fended off a looming pension debt owed its aging population and fueled domestic capital markets, contributing to high growth rates and a halving of poverty in what has become one of the most affluent nations in Latin America. For steadily employed Chileans who consistently channel 10 percent of their salaries into private retirement accounts, as required by law -- and preferably top it up with more, tax-free contributions -- pensions could reach 70 percent of salaries, providing a comfortable standard of living in retirement, according to estimates by the pension fund managers' association.

But what supporters of Chile's model have not advertised is that for poor, seasonal, and itinerant workers, and even for a great part of the middle-class and self-employed, the private system has proved inadequate, largely because those workers are unable to contribute enough to their private accounts. More than 17 percent of Chileans 65 and older keep working because their pensions are inadequate, according to a government-commissioned study.

Based on Chile's experience -- and that of more than 20 countries mostly in Latin America and Eastern Europe that followed its lead by privatizing part or all of their pension systems -- one conclusion from a new World Bank report is that the government will have to play a bigger role in any reformed pension system than proponents of privatization suggest. Private accounts can be one pillar of a Social Security system, but the state will have to provide a safety net. [Continued...](#)

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Page 2 of 3 -- "The 'Golden Years' don't exist for them," Yasmir Farina said of the association she leads of 157,000 retirement-age public employees who are lobbying the government to cover the shortfall between their private pensions and what they would have gotten under the old public system.

It will be another 20 years before the first generation of Chilean workers who spent their careers under the privatized system retires, and perhaps only then can privatization be truly judged. But since the late 1990s, a debate has raged over how to reform the system to better serve everyone.

Over two decades, Chile's privately managed pension funds, whose combined assets total \$60 billion, have yielded impressive annual returns. But recent government and independent studies found that about half of the 7 million current subscribers are not contributing for the 20 years necessary to qualify for the minimum pension: They will become burdens on the state or simply fall through the cracks.

Other apparent shortcomings of the Chilean experience, from money-management fees that critics say are too high, to a huge transition cost, offer lessons to anyone hoping to adapt the model to the United States. Critics note that the military government that imposed the privatized system on the advice of free-market economists -- and without the obstacle of political opposition -- kept members of the armed forces covered by the old, taxpayer-financed system, where they remain to this day. And far from being freed of its fiscal obligation, 24 years later the state is paying a staggering 30 percent of its annual budget toward pensions -- as much as it spends on health and education combined.

"It's a fiction to say there's no cost to financing a transition," said Ricardo Solari, Minister of Labor and Social Security.

Those taxpayer dollars go to retirees still covered by the old system, to compensation bonds for employees who left the old system, and to workers whose private accounts have not accumulated enough after 20 years to generate the "minimum pension" of \$150 a month, roughly two-thirds of Chile's minimum wage. Chile also pays "assistance pensions" of \$50 a month to indigent elderly. But many more who are middle-class, but whose employers erred in calculating their pension deductions -- such as Moya -- have been forced to work past their retirement age to maintain a decent life or skimp to survive.

Willy Contreras, an investment adviser at one of the large private pension funds, attributes low pensions to low wages. "If your salary is low, there is no system that can help you retire decently."

The challenge, Solari said, "is to design a real social security system that allows people who can finance their own retirement to do so, while dealing with those who cannot." [Continued...](#)

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Page 3 of 3 -- Bush's proposal would allow workers under age 55 to divert 4 percent of their payroll taxes from Social Security into individual accounts, but he has not suggested that private accounts replace the public system.

In contrast, even middle-aged Chilean workers who were vested in the old system in 1981 were strongly encouraged to join the new system. Workers were compensated with bonds based on their salaries in 1978, '79, and '80, three years when Chilean wages were severely depressed.

For salaried workers who joined the workforce in 1981 or later, 10 percent of their wages go by law into private pension funds and an additional 2.4 percent goes to fund managers for commissions and insurance. Employers contribute nothing. (In the United States, workers contribute 6.2 percent of wages to Social Security, which is matched by employers). Self-employed and informal workers -- from business owners to taxi drivers -- are not required to join Chile's system, and fewer than 3 percent do, either because they cannot reduce their monthly income or out of ignorance.

With one-third of Chilean workers self-employed, and many more moving in and out of short-term jobs, "over half of the workforce contributes less than four months a year" to their pensions, according to an analysis by Chile's Center for National Studies of Alternative Development.

Guillermo Arthur Errazuriz, president of the association of Pension Fund Administrators, contends that "those who aren't paying in must be taken care of by the state. That's not our responsibility. We can't criticize this system by asking why I don't pay poor people who don't contribute."

For those who contribute, private funds have yielded high rates of return, an average of 10.3 percent a year, said Arthur, the minister of Labor and Social Security under the military regime. Deducting fund

managers' commissions, the real profitability of net deposits was 6.3 percent, according to economist Manuel Riesco, author of the study by the Center for Alternative Development.

Chile's six pension funds, whose trustees include at least 17 Cabinet members of the former military regime that imposed the system, according to Riesco, have become one of the most profitable industries in Chile, reporting a higher return on equity than Chile's biggest utilities.

Arthur said critics who say the pension funds charge exorbitant fees are misinformed; commissions have been reduced, and now amount to 0.6 percent of total funds under management, less than most US money market funds, he said. Juan Yermo, a former World Bank pensions researcher, disputes the figure, saying fees amount to 1.2 percent of assets.

Arthur also asserts that one-third of the economic growth Chile enjoyed between 1985 and 1994 was a byproduct of the infusion of private pension funds into capital markets, an economic boom that boosted salaries.

That's little comfort to workers who contend that 20 percent of what is deducted from their wages every month goes to fees and insurance, not their accounts. Five of the six pension funds charge fixed monthly costs, said Solari, who wants to eliminate those fees.

One of Bush's arguments for privatizing pensions is to link rewards to contributions. Guillermo Larrian, the government regulator who oversees Chile's system, agrees that pay-as-you-go systems are unfair, because people do not reap more for working longer. But he suggests Sweden's hybrid system adopted in 2000 may be a better model for the United States than Chile's. Swedes pay 2.5 percent of their wages into private accounts, plus 16 percent into government accounts that link pensions to how much one contributes.

But for Rafael Tapia, a 49-year-old senior executive for a multinational corporation, Chile's system seems fair enough.

Tapia has taken advantage of the tax break for adding extra contributions to his account and has amassed

■ half a million dollars, about half of which is interest his money has earned, he estimated.

"I'd much rather stick with this system, which gives you a prize for your own work in life," he said, sitting by his pool. "It's always a problem of personal responsibility."

EL GLOBO DE BOSTON

Trabajo pobre de los chilenos más allá del retiro

Las pensiones privadas no ofrecen ninguna red de seguridad

Por Indira A.R. Lakshmanan, Personal Del Globo | De Febrero El 28, 2005

SANTIAGO, Chile -- Irma Moya Benech ha trabajado 40 años en los hospitales públicos que cuidaban para el enfermo y mayor, y ahora que ella es ambas, ella dice que el estado no está tomando el cuidado de ella.

Ya cinco años más allá de la edad del retiro legal para las mujeres

en Chile, Moya, 65. continúa trabajando como técnico médico para los pacientes con los SIDA, tuberculosis, y otras enfermedades infecciosas, aunque su sistema inmune es débil de la radioterapia para el cáncer

de pecho. Ella desea retirarse pero no puede desesperadamente, ella dijo, porque su pensión privada sería menos de 30 por ciento de su sueldo

mensual \$1.738. Ella podría no más de largo producir seguro médico de la calidad para cubrir la quimioterapia y prescripciones.

Su marido 71-year-old, quién tiene leucemia, es el sti