CHILEAN PENSION SYSTEM

[S]OCIAL SECURITY REFORM

CIEDESS

CORPORACION DE INVESTIGACION, ESTUDIO Y DESARROLLO DE LA SEGURIDAD SOCIAL

C I E D E S S

CHILEAN PENSION SYSTEM

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PRESENTATION

This document is a translation of the essay "The Chilean Proposal" presented, in spanish, by Mr. Nicolás Starck at the december 1993 meeting of the Social Securtiy Interamerican Conference -CISS- in Mexico City.[(1)] [(2)]

After a brief description of different prevision programs operating in Chile -specially those which emerge from the prevision reforms set off in 1980 and which were included in an structural adjustement program- it then analyses the framework and characteristics of the current system of Pension Funds in that country.

The chilean Pension Funds System is based in three key-elements:

- individual capitalization (each worker having a personal account in the fund of his choice, that increases in value in accordance with the average yield of the investment portfolio of the fund)

- private administration of the Pension Funds under government regulation

- workers's freedom to choose from several of the former and ability to change from one to another under certain conditions

The purpose of CIEDESS in issuing this document is to share information regarding a social security system that has proven to be efficient and succesful, contributing, besides, to the development and welfare of the population.

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(1) Mr. Starck is a CIEDESS (Corporation for the Investigation, Study and Development of Social Security - Chile) consultant. His paper was based on the book "12 Years of Modernization of Social Security in Chile", written by CIEDESS.

(2) The present edition in english was translated by the General Direction Oficce of International Benefits and Foreign Affairs, Income Security Programs, Human Resources, Developments - Canada.

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1. INTRODUCTION

Chile is a country situated in the extreme southwest of South America. Its population totals 13,500,000 people, 5,000,000 of whom are in the work force; the unemployment rate has remained steady at about 5% in recent years. For its part, the Gross National Product amounts to slightly more than US$ 35,000 million, which means a per capita product of slightly more than US$ 3,000; however, if this latter parameter is adjusted according to the observed parity of purchasing power, based on World Bank calculations, it reaches a figure of US$ 7,600. The growth rate of the product in the last year was 10.4% and it is expected that in 1993, it will exceed 6%.

In the area of social security, Chile was one of the first Latin American countries to introduce a general compulsory social security system, structured according to the principles and concepts prevalent at the turn of the century. This fact also made it the first to feel the effects of the imbalances caused by an artificial, costly structure of institutions and benefits, the result of a model which favoured the social rights of individuals over their obligations.

A backward glance at the ideas which gradually gave shape to the social services and their managing institutions enables us to distinguish well-defined periods in the evolution of chilean systems of social protection: the first, characterized by assistance programs supported by public charity, especially in the case of medical and hospital care for the very poor and which, by extension, included rudimentary forms of social assistance with some Staten participation. Later - as the country began industrializing -we see a second period emerge, with the introduction of social security systems conceived in more advanced countries, in a process characterized by the superposition of institutional and legal structures which were alien to national economic reality. Subsequently, as a result of the crisis experienced by the social security system, there began a period of appraisal and debate on the causes of same, with reformulation of programs and rationalization of their management. Finally, we arrive at the stage in which the country adopted its own model based on freedom of choice and individual savings, the administration of which was entrusted to private enterprise.

With an advanced social security system which had developed since the turn of the century, by the end of the decade of the 70s, social security coverage took in 2.45 million active workers and 800 thousand pensioners who, with their dependants, totalled 7.45 million people. Thus, 70% of the country's population enjoyed protection.

Appraisal of the state of social security prior to modernization.

In 1960, by special order of Jorge Alessandri Rodríguez, the President of the time, the Commission for Social Security Studies was set up, and, under the direction of Jorge Prat Echaurren, it proceeded to prepare an assessment of the different plans and institutions. The findings of this appraisal, which was completed in 1964, are conclusive in pointing out that the social security system of the time was "doomed to collapse because it is unfair, oligarchic, discriminatory and ineffectively onerous, both for wage or salary earners and for national producers". Despite this dark prediction, the system managed to survive until the end of the decade of the 70s, through the expedient of increasing State participation in its financing - which came to represent more than one third of annual social security spending - and also increasing rates of contribution.

The right to retirement, for example, varied according to the trade sector to which the worker belonged. The blue collar workers affiliated with the Social Security Service had to be 65 years of age and show a minimum number of contributions during the last years prior to retirement. On the other hand, office employees only required years of service, of which the number depended on how much pressure they could exert or on how powerful their union was. Thus, while private sector office workers could retire after 35 years of service, public servants could retire after 30 years, and there were other sectors where only 25 years were needed, such as bank employees, or 15 years in the case of parliamentarians.

The administration of social benefits was, in addition, spread among more than 30 Social Security Funds, seven Family Allowance Funds, three Industrial Accident Mutual Benefit Societies and various Health Services, a fact which, while not a defect in itself, appears unjustified, when one considers the population protected by each of these agencies. In effect, overall, 90% of the total population affiliated with social security institutions belonged to the Social Security Service, the Private Sector Employees Fund and the Public Servants Fund.

In terms of regulation, the diversity of plans resulted in a complex hierarchy, where the formulation of social security policy came under the Ministry of Labour and Social Security and seven other ministries: Health, Defense, Finance, Public Works, Interior, Education and Justice.

As regards social contingencies, the system managed to cover all those which are recognized by doctrine and by international bodies, granting benefits for illness, maternity, disability, old age, years of service, death, survivors, unemployment, industrial accidents and occupational diseases, as well as family benefits, welfare pensions and funding of housing programs. Although the range of benefits was quite broad, the system in general and the services in particular included a plurality of plans established by a prolific and complex legislation, which provided for differential treatment of contingencies to the detriment of the neediest social strata, a situation which was particularly notorious in the case of pensions.

Lastly, as regards financing, it should be pointed out that social security revenues came not just from contributions by members, employers and the State, but also from the community itself through specific taxes. This situation - because of the multiplicity of plans - resulted in more than 50 combinations of rates and taxable limits which in no way contributed to a equitable distribution of the tax burden.

One aspect of the system which best illustrates the critical state which it had reached from a financial standpoint, is the level of contribution rates which had to be born by workers and employers. Overall, they amounted to 50% of earnings, directly impacting on the cost of labour. This is even more evident if we consider that in the ten-year period 1956-1966, the real rate of growth of collections in the system amounted to 170%, while the domestic product increased only 66% in the same period. These same figures were 79% and 23%, respectively, for the period 1968-1972.

Despite the reforms proposed by the report of the Prat Commission, which was the commission appointed by President Alessandri in 1960, it was only in 1974 that a process began, aimed, in its first phase, at rationalizing some plans, standardizing services and looking for types of financing which could reduce negative social and economic effects to a minimun.

2. MODERNIZATION OF SOCIAL SECURITY IN CHILE

In the year 1974, as already indicated, a process of modernization of Social Security began in Chile aimed, in its initial phase, at rationalizing some plans, standardizing services and looking for types of financing that could reduce negative social and economic effects to a minimun. Standing out among the actions taken in this regard were the creation of a Combined Fund to administer family allowances, with the amount of this benefit made equal for all workers; the establishment of a common system of unemployment benefits; the introduction of a general mechanism of pension adjustment; the application of uniform age requirements for retirement; and the extension of the welfare pension system to the poorest population, favouring persons over 65 years of age who were without means and disabled persons over 18 years of age. As regards rates of contribution, these began to be reduced gradually beginning in 1975, with a view to raising employment indices by reducing hiring costs.

This modernization process began with the dissemination among the labour and management sectors of a revised social security model in the form of a document called "Basic Statute of Principles and Bases for the New Social Security System." This document outlines a system which reconciles the State's obligation to offer comprehensive social security to its inhabitants with the need to achieve high rates of economic growth and adequate employment levels.

The Statute describes the contingencies covered by the system, establishing as basic plans social medicine, pensions, family allowances, benefits for temporary unemployment, severance pay, social credit, welfare, social services and voluntary benefits. Although the proposals contained in this Statute did not become law, they did serve to raise awareness of the need for changes which were subsequently implemented.

During this same period, substantial reforms were introduced aimed at fostering the development of a competitive, efficient financial market compatible with a market economy, which later would prove essential for the investment of resources generated by the Pension Funds.

In this regard, it should be mentioned at the outset that the vast majority of our countries have been undergoing a process of adjustment of which the distinguishing feature has been the transformation of economies that were once excessively government-controlled, now being replaced by economic structures with more active private sector participation and where the market plays a key role in the allocation of resources.

To bring about this transformation, it was necessary, in our country, to meet two basic challenges:

a) First of all, reorganizing State finances in order to stem inflation processes; and

b) Subsequently, strengthening the competitiveness of society as a whole, in order to confront markets, both domestic and foreign, under more favourable conditions.

Among specialists, there was a consensus that to achieve these objectives, it was necessary to proceed simultaneously by at least six routes, namely:

- Monetary reform, in order to slow inflationary processes, and thus give the economic system the liquidity and price stability needed to properly transact goods and services;

- Fiscal reform to reduce fiscal deficits, which brought with it a rationalization of public spending and increased tax revenues where possible;

- Deregulation of prices and wages, to permit better competitiveness in goods and services.

- Transfer of public corporations to the private sector, in order to give them back the impetus of that sector and increase State revenues and assign the funds thus obtained to social investment rather than public spending;

- Establishment of an exchange and customs policy aimed at strengthening trade with other economies; and,

- Promoting the establishment of a broad social network, able to moderate the negative effects which these reforms would have on the majority of the population on the short term.

The country's development, in the last two decades, may be described as a three-phase process, with the first phase extending from 1974 to 1978 and aimed at "economic reactivation"; the second extending from 1978 to 1985 and corresponding to "modernization of the economy" and the third, which began in 1986, representing a "projection towards the future". Modernization of the country focused on the following areas:

- The labour plan;
- Social security reform;
- Educational reform;
- Health reform;
- Justice reform;
- Agricultural reform;
- Administrative reform.

The State, for its part, redirected its social action, concentrating its efforts on the most vulnerable sectors and delegating to the private sector those activities which could be efficiently carried out by that sector. Social security stopped being seen as an instrument for redistributing income, a goal which began being pursued through a tax system which favoured investment over consumption and which taxed higher incomes more heavily. The productive apparatus began to make decisions as a function of an emerging market in which decision-making was more and more concentrated in the hands of individuals.

Reform of the pension system

Within the general context described above, reforms to the pension and health plans were introduced in 1980, including changes which would profoundly alter the traditional role assigned to social security.

Thus, in November 1980, through publication of Decree-Law No. 3.500, a new pension system based on individual funding was born, under which private companies could participate in the administration of the Pension Funds in open competition. The funds had to be invested in the institutions and capital market instruments specifically indicated by law.

In May 1981, on the other hand, decree No. 3 was published with force of law, setting standards for the administration of the system of preventive and treatment medicine by the private sector.

Key elements in these reforms are the freedom of workers to opt for those alternatives which maximize their level of satisfaction, along with participation by the private sector in the administration of pension and health plans on a competitive basis.

2.1 Basic principles

An aspect considered in this modernization was that the model had to take into account the development strategy for which the country had to adhere to the principles of a market economy; that is to say, private administration, freedom of choice, decentralization of programs and a secondary role by the State.

2.1.1 Private administration

In the new model, an important part of social security administration was delegated to the private sector, creating conditions of competitiveness and responsibility for improving the quality of services and broadening the coverage of benefits.

2.1.2 Freedom of choice

The new model recognizes the knowledge gained by the workers of their social security rights and obligations, and allows them to decide on the best options for them in terms of institutions and types of benefits. This approach, besides the benefits to the worker in terms of personal satisfaction, also improves the efficiency of programs through the competiton which this freedom of choice brings about among supplier institutions.

2.1.3 Decentralization of programs

In the social security systems in which programs of a different type are administered by the same institution, in most cases, problems arise which make it difficult to evaluate the effectiveness of each of them. Among these, we would mention possible masking of deficits through transfer of funds between programs; difficulties of control and auditing and the pressures of a political or sectoral type which may be exerted to channel funds to given interest groups.

The new model has tended towards specialization by programs, where necessary creating institutional structures for each of them, in order to avoid the negative aspects mentioned. Thus, within the system, there are both limited companies and private non-profit corporations administering the different benefit plans.

2.1.4 Secondary role of the State

This role implies that the State only assumes those functions which private agencies are unable to perform and which are necessary from a social standpoint, and it is responsible for regulation and auditing of the social security system.

The financing of the system on the basis of compulsory contributions and the social impact of this on the population obliges the authority to be specially concerned about its operation. The secondary role of the State is played out, in this sense, through different auditing agencies which have as their aim to ensure compliance with existing laws and regulations.

3. STRUCTURE OF SOCIAL SECURITY

The modernization of Chilean social security, which began in the decade of the 70s, involved a substantial change in the approach to social security and gave rise to a number of benefits and institutions which are described in the paragraphs which follow. The last paragraph of this section describes the sources of funding of each of the benefits with the respective expenditures for the year 1991.

3.1 Services and Benefits

The current social security system considers social security programs for all persons whose salary or income level is sufficient to accede to same, and welfare programs for those whose level of poverty is such that they cannot afford the former. In turn, each of these programs is contingency-based or development-oriented in character, depending on whether the corresponding benefits are intended to cover certain facts or events related to health, termination or temporary loss of working capacity and family responsibilities, or are aimed at the training and advancement of individuals.

Table No. 1 shows the overall structure of the system, identifyng as programs designed to cover social contigencies: disability, old age and survivors benefits, health services, including preventive medicine and treatment, industrial accidents and occupational diseases and benefits for persons unable to work, family benefits, which take in family allowances, maternity and other benefits aimed at the family; unemployment benefits; and others of the welfare type such as food programs and care of minors in irregular situations. In turn, the development programs include, generally speaking, education, training, credit, housing, sports and recreation.

As regards the type of coverage, this same table identifies social security programs and welfare programs. The former are aimed at persons receiving a regular salary, and hence in a position to take out insurance against illness, disability, old age, death and other contingencies; and the latter at the poorest sectors, and having the purpose of providing them with minimum levels of income, education, health, food and housing, which is achieved mainly through welfare cheques, unemployment benefits, job training, free preschool and basic primary education, free health care, school meals and subsidized housing and care of minors in an irregular situation.

Table No. 1

PROGRAMS	SERVICES AND BENEFITS	TYPE OF COVERAGE
CONTINGENCY-BASED		
PENSIONS	- DISABILITY - OLD AGE - SURVIVORS	SOCIAL SECURITY AND WELFARE BENEFITS
HEALTH	- PREVENTION AND TREATMENT	
	- INDUSTRIAL ACCIDENTS	SOCIAL SECURITY
FAMILY BENEFITS	- FAMILY ALLOWANCE - MOTHER'S ALLOWANCE - MATERNITY BENEFITS	WELFARE BENEFITS
	- OTHER BENEFITS	SOCIAL SECURITY
UNEMPLOYMENT	- UNEMPLOYMENT BENEFITS	WELFARE BENEFITS
OTHER WELFARE BENEFITS	- FOOD PROGRAMS - MINORS IN IRREGULAR SITUATION	
DEVELOPMENT-ORIENTED		
EDUCATION	- BASIC - INTERMEDIATE - SPECIAL - ADULTS	SOCIAL SECURITY AND WELFARE BENEFITS
CREDIT	- SOCIAL CREDIT	SOCIAL SECURITY
TRAINING	- COMPANY PROGRAM	
	- SCHOLARSHIP PROGRAMS - SPECIFIC PROGRAMS	WELFARE BENEFITS
HOUSING	- SUBSIDIZED HOUSING	
SPORTS AND RECREATION	- SCHOOL - POPULAR	

Source: 12 years of social security modernization in Chile, CIEDESS, 1992.

3.2. Administrators

As was pointed out previously, the new model envisages participation by the private sector in the administration of programs covering pensions, preventive and treatment medicine, industrial accidents and occupational diseases and family benefits. Thus, the pension plan is managed by Administradoras de Fondos de Pensiones (Pension Fund Administrators)(AFPs) and life insurance companies, incorporated as limited companies; that of preventive and treatment medicine is administered by Instituciones de Salud Previsional (Social Security Health Institutions)(ISAPRE), which may be either limited companies or private non-profit organizations; and, lastly, the industrial accident and occupational disease and family allowance plans, which have the participation of the Mutualidades de Empleadores (Employers Mutual Benefit Societies) and Compensation Funds, respectively, both as non-profit corporations under private law.

State participation in the pension plans represents a temporary situation, since it is aimed at providing for workers affiliated with the old system who opted to remain in same and pensioners who are owed old-age, disability and survivors benefits from the old Social Security Funds. The corresponding functions are performed by the Social Security Standardization Institute, of which the beneficiary population will be gradually reduced since it is forbidden by law to accept new members. On the other hand, the National Health Fund serves the population whose income level is too low for them to be able to accede to the health plans of private institutions.

The welfare programs are administered by the Health Services, the National Kindergarten Board, the National School Assistance and Scholarship Board and the National Youth Service, the Municipalities and the Housing and Urban Planning Service, among others.

The list of the agencies which intervene in social security administration is shown in Table No. 2, broken down according to the programs in which they participate and the public or private nature of the corresponding institution.

Table N° 2.

SERVICES AND BENEFITS		MANAGING AGENCIES	
		PRIVATE	PUBLIC
PENSIONS	- DISABILITY - OLD AGE - SURVIVORS	- AFP[1] - LIFE INSURANCE COMPANIES	- INP[2]
HEALTH	- PREVENTION AND TREATMENT	- ISAPRE[3]	- HEALTH SERVICES - FONASA[4]
	- INABILITY TO WORK-BENEFITS	- ISAPRE[3] - CCAF[5]	- HEALTH SERVICES
	- INDUSTRIAL ACCIDENTS	- MUTUAL BENEFIT SOCIETIES	- INP
FAMILY BENEFITS	- FAMILY ALLOWANCE	- CCAF	
	- MOTHER'S ALLOWANCE - MATERNITY BENEFITS	- ISAPRE - CCAF	- HEALTH SERVICES
	- OTHER BENEFITS	- CCAF	
UNEMPLOYMENT	- UNEMPLOYMENT BENEFITS		- INP
OTHER WELFARE BENEFITS	- FOOD PROGRAMS		- JUNJI[6] - JUNAEB[7]
	MINORS IN IRREGULAR SITUATION		- SENAME[8]
EDUCATION	- BASIC - INTERMEDIATE - SPECIAL - ADULTS	SUBSIDEZED TEACHING ESTABLISHMENTS	MUNICIPAL TEACHING ESTABLISHMENTS
TRAINING	- COMPANY PROGRAM	- OTE[9] - OTIR[10]	- SENCE[11]
	- SCHOLARSHIPS - SPECIFIC PROGRAMS		
CREDIT	- SOCIAL CREDIT	- CCAF	
HOUSING	- SUBSIDIZED HOUSING	- PRIVATE CORPORATIONS	- SERVIU[12]
SPORT AND RECREATION	- SCHOOL - POPULAR		- DIGEDER[13]

1. Pension Fund Administrators
2. Social Security Standardization Institute
3. Social Security Health Institutions
4. National Health Allowance Funds
5. Family Allowance Funds
6. National Kindergarten Board
7. National School Assistance and Scholarship Board
8. National Youth Service
9. Technical Training Agencies
10. Intermediary Technical Training Agencies
11. National Training and Employment Service
12. Housing and Urban Planning Service
13. Directorate General of Sports and Recreation

Source: 12 years of social security modernization in Chile, CIEDESS, 1992.

4. PENSION SYSTEM

4.1 Welfare pension program

In an economic system organized on the basis of open competition, inequalities of aptitudes and opportunities of individuals naturally give rise to differences in income distribution. This, accompanied by a relatively low level of income in the country, means that there are individuals who cannot achieve that minimum level of well-being defined as the poverty line.

Chilean social security has, for this reason, developed a variety of welfare programs to make up for deficiencies in, among other things, the diet, education, health and income of the most underprivileged and vulnerable population. These programs are financed with funds from the taxation system in which the revenue of high income earners is more heavily taxed.

In addition, if social spending is focused on the most needy individuals, we shall achieve basic solidarity, a principle on which more and more emphasis is being placed by the reformed social security systems.

The funds budgeted for these programs in the year 1992 amounted to US$ 340 million, or 1.18% of the GNP, as indicated in Table No. 2.8.1.

Graph No. 2.8.1. shows the progression of fund allocation to welfare programs in the budget for each year during the period 1980-1991.

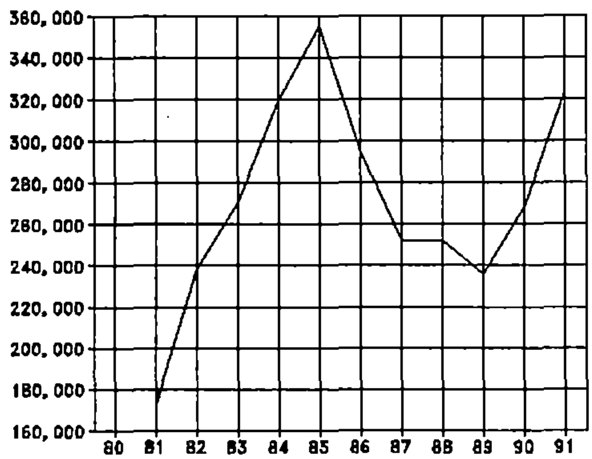
Table No. 2.8.1
Welfare Benefits

Program	Amount US$	GNP %
Diet Supplements	64.000.000	0,22
Preschool Care	12.000.000	0,04
School Meals	81.000.000	0,28
Care of Minors in an Irregular Situation	29.000.000	0,10
Lump-sum Family Subsidy[1]	34.000.000	0,12
Welfare Pensions	120.000.000	0,42
Total	340.000.000	1,18

(1) Implementation 1991 budget

Sources:
Public Sector Budget Act 1992.
Tentative data, Social Security Superintendency.
Monthly bulletins, Central Bank of Chile.
Prepared by CIEDESS

Graph No. 2.8.1
Funds for welfare benefits
(in thousands of dollars)



The efficient application of a focused social spending policy requires mechanisms for identifying the poorest sectors towards which assistance programs must be directed.

For this purpose, the Social Information System was set up, which also provides information on variations in poverty levels and the new needs of individuals.

4.1.1 Social Information System

To set up such a system, it is essential to define the concept of poverty, since this is the only way that indicators can be established to measure its level.

It is generally accepted that a family may be considered poor when it is unable to cover its basic needs for food, clothing, health, housing and education. From this standpoint, the best indicator of poverty level is the ratio between the disposable income of a family and the cost of covering said basic needs.

Although this indicator is adequate, it is necessary to add others in order to more precisely define the areas of need of the poorest sectors. Thus, methodologies and instruments are defined to stratify and prioritize the needs of these sectors, identifying the degree and area of poverty, as well as to analyze and oversee the effectiveness of social programs.

To achieve the foregoing, three instruments have been designed and used: the Map of Extreme Poverty, the File of Social Assistance Committees (CAS) and the National Socio-Economic Survey.

a) Map of Extreme Poverty

Has as its main purpose to identify the population settlements with the largest proportion of families below the poverty line and their characteristics. It is prepared with information taken from the Population and Housing Censuses conducted by the National Statistics Institute. The maps were prepared using data from the 1970 and 1982 censuses, and the next one with be prepared with the results of the 1992 census.

b) File of Social Assistance Committees

This instrument (CAS), also known as the social stratification file, consists of a questionnaire for the socio-economic characterization of families in extreme poverty, in order to concentrate the benefits of assistance programs on the most needy population.

c) National Socio-Economic Survey

This survey (CASEN) is used to assess the redistributive impact of policies which direct social spending towards the poorest population sectors and towards their reintegration into the labour market.

The survey is obtained through systematic data collection, based on stratified population samples from the areas identified as poor in the Map of Extreme Poverty, using methods borrowed from psychology, anthropology, sociology, statistics and others, through interviews, measurement techniques and data analysis.

4.1.2 Description of the welfare pension program

The welfare pension program (PASIS) was set up in 1975 by Decree Law No. 869 and has as its purpose to award pensions to persons over 65 years of age and disabled persons over 18 years of age lacking means of support, understanding as such those who have no income from any source or whose income is less than 50% of the minimum pension.

It should be mentioned that the minimum pension is equal to US$ 79.52 for persons under 70 years of age and US$ 83.90 for those over said age.

4.1.3 Requirements

Recipients are selected through the case histories provided by the CAS file, and the pension is renewed every three years if the conditions which gave rise to it remain unchanged.

4.1.4 Financing

Welfare pensions come under the National Welfare Pension Fund which is financed with resources allocated by the Social Security Standardization Institute (INP), the National Defense Social Security Fund, the Excise Officers Social Security Directorate and with tax revenues.

The fund is administered by the INP, an expenditure of US$ 120 million budgeted for 1992, equal to 0.42% of the GNP.

4.1.5 Administering and auditing agencies

The administration of the program comes under the Regional Intendancies and it is funded by the Social Security Standardization Institute.

The Social Security Superintendency is responsible for overseeing the proper administration of this program and the Regional Development Undersecretaries, through the municipalities, are responsible for coordinating and overseeing the granting of benefits in each commune. The Auditor General of the Republic, in turn, is responsible for auditing the amounts involved.

4.1.6 Evaluation and projections

The program benefits 300 thousand people, a figure which has not changed substantially in recent years. On the other hand, the uncovered demand for this benefit is limited, since at the end of 1991, only 21 thousand people were on the waiting list.

The results of the 1987 CASEN survey indicated that this program covered about 10% of individuals over the age of 65 years. In addition, 82% of the recipients were not part of any social security system, with the remaining percentage representing persons below retirement age.

This program has, in general, been well focused, since 62% of total spending has been concentrated on the poorest 30% and it is pointed out that, as in the case of the Lump-Sum Family Subsidy, there is more concern with improving the amounts of the benefit in real terms than with increasing coverage.

4.2 The old pension system

4.2.1 Description

In the seven years prior to the introduction of the AFP model, from 1974-1980, the social security system was the object of a series of reforms which aimed at simplifying and standardizing the Social Security plans; attenuating the most discriminatory differences and inequities within the system; separating the financing of certain benefits which do not constitute pensions from social security contributions; and paving the way for the change in social security which came about in 1980.

Among the principal changes, one might mention the following: in 1974, the minimum pensions of the different Social Security Funds were standardized; between 1973 and 1975, the majority of the institutions in the old system began to reduce rates of contribution; in 1979, Decree Law No. 2.448 standardized the age and years of service requirements for pensions which are based on age and years of service. In addition, 65 years for men and 60 years for women was set as the minimum age of eligibility for this benefit. However, those workers who had contributed for a considerable time could retire at a younger age; the same decree law established a mechanism of automatic pension adjustment to recover the buying power lost through inflation; in 1981, the contributions became the full responsibility of the worker, although to offset this, gross wages and salaries were increased; and finally, beginning in March 1988, with the passage of Law No. 18.689, the different Social Security Funds, except those of the Excise Officers and the Armed Forces, were combined under the Social Security Standardization Institute (INP).

Despite these changes, certain basic characteristics of the old system were not corrected, such as affiliation by type of work and financing on an "immediate" basis, better known as the allocation system, and some differences remained between the different Social Security Funds amalgamated into the Social Security Standardization Institute, since this amalgamation did not mean standardization of the corresponding benefits.

With time, the system of Social Security Funds will gradually reduce its contribution to pension benefits, since, as was pointed out earlier, newly employed workers are obliged to join the AFPs. However, on December 1991, this system still had 340 thousand members and more than a million pensioners. Given the diversity of plans coexisting in the INP, it is impossible to cite every one of them. However, further on, we offer a general description of the three main ones: The Social Security Service, the Private Sector Employees Fund and the Public Servants Fund, which together take in more than 90% of the total contributors under the old system.

4.2.2 Financing

The Social Security Funds operate, as indicated previously, on the basis of "immediate" financing, that is to say, pension benefits are paid with contributions made by active workers. However, since these contributions are not sufficient to pay pensions, State supplements are required to make up the shortfall.

4.3. The new pension system

With the passage of Decree Law No. 3.500 of November 1980, a compulsory pension system came into effect in Chile, based on individual funding of defined contributions, with private administration by competing agencies and freedom of choice for the member. This system- the first among social security systems known to have these characteristics - replaces the old pension system characterized by financing through allocation, administration by the State and defined benefits.

The workers affiliated with the old system and those who began working up to December 1982 could opt for either pension system, while the rest of the workers are obliged to join the system established by the aforesaid Decree-Law. Therefore, in the area of pensions, for some time yet there will be a coexistence of the two systems, of which the benefits, financing and administering institutions are described in the paragraphs which follow.

4.3.1 Description

The system of individual funding obliges salaried workers to place savings in an open personal account with a Pension Fund Administrator of their choice, for the purpose of financing their old age and disability pensions, as well as the survivor pensions of their beneficiaries. Self-employed workers, for their part, may join the system voluntarily.

The State, in its secondary role, guarantees a minimum pension level for those workers who, while meeting the requirements which will be mentioned further on, do not have sufficient funds accumulated to achieve said level. The minimum pension amounts are indicated in Table No. 2.1.1.

Table No. 2.1.1
Amount of minimum pensions

Benefit	Monthly amount US$
Old age and disability	
Pensioners under 70 years of age	73
Pensioners over 70 years of age	77
Survivors	
Pensioners under 70 years of age	
-Widow without children	44
-Widow with children, widowed mother or disabled father	37
-Orphans and other survivors	11
Pensioners over 70 years of age	
-Widow without children	55
-Widow with children	47

Prepared by CIEDESS on the basis of existing. legislation.

The old age, disability and survivor pensions paid under the system each has its own financing modality and may be paid in the form of scheduled withdrawals, an immediate life annuity or temporary income with a deferred life annuity.

Old age pensions are intended to maintain continuity in the income of those workers who, due to age, have lost their capacity to generate same. The law sets 65 years for men and 60 years for women as the ages for entitlement to this benefit. However, there are some legal provisions which permit retirement before these ages.

Disability pensions are aimed at replacing the salaries of workers who, during their working life, are victims of an ordinary disease or accident which leaves them disabled.

Disability, for this purpose, may be total or partial. It is total when the loss of working capacity is at least two thirds, and partial when said loss is greater than 50% and less than two thirds. Disability resulting from industrial accidentes or occupational diseases give rise to benefits under Law No. 16.744.

Survivor benefits are generated by the death of the active member or pensioner and are awarded to the wife, disabled husband and children who meet the requirements defined by law. In certain cases, the mother of illegitimate childrean of the deceased and the parents of the contributor may be entitled to benefits.

4.3.2 Requirements

To be entitled to benefits under the system, one must be affiliated with a Pension Fur Administrator (AFP). This affiliation is compulsory for all salaried workers who began workir after 31 December 1982; voluntary for self-employed workers and those who began workir prior to 1 January 1983, including members of the old pension system; and permanent, sinc it remains throughout the life of the worker, whether or not he or she continues to work.

The specific requirements for entitlement to old age, disability and survivor benefits establishe under the new system are described in the paragraphs which follow.

Old age pension

Entitled to this benefit are contributors who reach 65 years of age, in the case of men, and 6 years of age, in the case of women.

However, if the accrued balance in the individual account enables them to finance a pensic equal to or greater than 50% of their updated pensionable earnings in the last 10 years, ar equal to or greater than 110% of the minimum pension, they may opt for early retirement.

If the accrued balance in the individual account is insufficient to finance a pension equal to th minimum, the member's funds will be supplemented with a state contribution, provided that th individual meets the following requirements: is 65 years of age or older, if a man, and 60 yea of age or older, if a women; shows at least 20 years of contributions or calculable service in ar of the social security systems, including the periods in which the member receive unemployment benefits, limited to a maximum of three years; and does not have income equ to or greated than the minimum old age pension.

Disability pension

Entitled to a disability pension are those non-pensioned members under 65 years of age in th case of men and 60 years in the case of women who, as a result of an ordinary accident c disease, suffer a permanent reduction in working capacity.

The eligibility requirements for this benefit are: if a salaried worker with a current work contrac be a contributor to a AFP; if a self-employed worker, have contributed to an AFP in the calenda month prior to the finding of disability; and, if a salaried worker unemployed for a period of n more than 12 months, show at least six months of contributions in the previous year, countir from the last day of the month in which he or she stopped working. In the case of newly hire workers - if the accident occurred prior to joining a AFP - they are deemed to be members c the AFP in which the employer, on the date of the accident, had the largest number of affiliate workers.

Survivor's pension

The eligibility requirements which must be met by the beneficiaries of a deceased worker in order to obtain a survivor's pension are the same as those indicated for disability pensions as regards the conditions which must be met by the member at the time of the accident. These requirements are: if a salaried worker with a current work contract, have been contributing to a AFP; if a selfemployed worker, have contributed to a AFP in the calendar month prior to death; and, if a salaried worker unemployed for a period of no more than 12 months, show at least six months of contributions in the previous year, counting from the last day of the month in which he or she stopped working. In the case of newly hired workers - if the death occurs prior to their registration - they are deemed to belong to the AFP in which their employer, on the date of their death, has the largest number of affiliated workers.

4.3.3 Financing

The pensions established by Decree Law No. 3.500 are financed from the accrued balance in each member's individual account. However, if this balance is insufficient to finance a pension equal to the minimum, the member's funds are supplemented with a state contribution, provided that the worker meets certain legal requirements. This State contribution is made once the funds in the individual account are depleted or when the amount of the life annuity falls below the minimum pension.

The accrued balance in each member's individual account consists of the capital accumulated over the life of this account, plus the Accrued Benefit Bond, plus the additional contribution which the Administrator must make in the case of disability and survivor benefits, plus the transfers made by the member from his or her voluntary savings account.

Capital accrued by the member

This capital is made up of the compulsory and voluntary contributions of the worker and the return on investment of the fund, deducting from these amounts the commissions charged by the Administrators as payment for their services.

The compulsory contributions are the responsability of the member and represent a percentage of his or her monthly earnings or pensionable income, with a maximum limit on this latter of 60 Development Units, equal to US$ 1,308. The contributions consist of a basic rate of 10% and an additional percentage which varies depending on the Administrator that will be financing it and contracting disability and survivor's insurance.

The voluntary contributions consist of deposits which the member - without limits on the amount - freely decides to make to the investment account, in order to increase his or her balance and thus increase the amount of the future pension or take early retirement. Up to a limit of 60 Development Units, these contributions are not considered as income for tax purposes.

The return on the individual investment accounts consists of the capital gains produced by investment in the financial market of the funds accrued in the Pension Fund. The legislation establishes differents protective mechanisms for these funds, in order to limit risks, encourage transparency in operations and facilitate auditing of the investment process. In addition, the law protects the worker from risks deriving from inefficient performance by the Administrator in the investment of the fund, requiring a minimum return with respect to the mean of the total funds managed by all the AFPs.

Accrued Benefit Bond

The Accrued Benefit Bond is an instrument issued by the Social Security Standardization Institute, and represents the estimated value of the capital needed to pay the benefits to which the member would theoretically be entitled under the old system at the time of transfer to the Administrator. This Bond - which is issued in the worker's name- is expressed in currency and its value is adjusted for the variation in the Consumer Price Index, plus a real annual interest rate of 4%, up to the date on which the member reaches pensionable age, becomes disables or dies. At that time, the value of the Bond is transferred to the worker's investment account, to be included in the accrued balance used to finance his or her pension. The law authorizes assignment of the rights inherent in said Bond through simple endorsement so that, when this instrument in negotiated on the formal secondary market, its price and liquidity improve, thus facilitating the option of an early pension.

Additional contribution

The additional contribution is incorporated into the system as a source of financing of disability and survivor benefits and its amount is equal to the difference between the capital needed to pay these benefits and the funds accrued by the member in his or her personal account, on the date when this latter dies or is declared disabled.

The Administrator is responsible for making this contribution, and must - in order to guarantee its payment - take out insurance with a life insurance company, and the premiun is paid by the AFP from its own funds.

Understood as needed capital is the sum required to pay a pension to the member during his or her lifetime and, upon his or her death, to entitled beneficiaries. The needed capital depends, therefore, on the life expectancy of the family unit and on a discount rate determined by the Administrators on the basis of the return on the Pension Fund and the interest rate implicit in the life annuities awarded in accordance with Decree Law No. 3.500.

Voluntary savings account

The worker may voluntarily deposit any desired amounts with the Administrator with whom he or she is affiliated, as often as desired, with these amounts being paid into a personal account called voluntary savings account, which is separate from the individual investment account.

These deposits are not considered social security contribution for the purpose of income tax law and the Administrators are authorized to collect fixed commissions from holders of these accounts for any withdrawals, for purposes of financing the management of same.

Members may tranfer all or part of the funds in their voluntary savings accounts to their individual investment account for purposes of increasing the amount of their pensions or accumulating the capital needed for early retirement.

4.3.4 Pension modalities

Members who meet the requirements for entitlement to an old age pension and those declared disabled, once the ruling has become final, may dispose of the balance in their individual investment account for the purpose of receiving a pension.

To activate the pension, each member must freely choose among the following modalities: Scheduled Withdrawals, Immediate Life Annuity and Temporary Income with Deferred Life Annuity.

Scheduled withdrawals

In this modality, the worker, on retiring, leaves his or her individual account with the Administrator with whom he or she is affiliated an withdraws - in monthly instalments - an annual amount arrived at by dividing the accrued balance by the capital needed to pay one pension unit to the member and, upon his or her death, to the beneficiaries entitled to a pension. This annual amount is expressed in Development Units, is recalculated every 12 months and the agency responsible for its payment is the Administrator.

The worker, upon choosing this modality, retains ownership of his or her funds, so that if he or she dies, they form part of the deceased's estate if there are no beneficiaries entitled to a pension.

The member may at any time revoke the decision to take scheduled withdrawals and choose the option of an immediate life annuity or temporary income with a deferred life annuity.

Immediate life annuity

Members are entitled to contract payment of the pension with the life insurance company of their choice, which undertakes to pay a monthly income - expressed in Development Units - to said members up to their death and survivor's pensions to their beneficiaries thereafter. In this pension modality, the worker forfeits ownership of the funds accrued in his or her personal account, which are transferred to the insurance company.

Temporary income with deferred life annuity

In this modality, the worker contracts with a life insurance company for payment of a monthly lifetime income - expressed in Development Units - beginning on a future date subsequent to the date of retirement. In the period between the date on which this option is chosen and the date on which payment of said income begins, every month the member receives from the Administrator temporary income calculated in the same way as scheduled withdrawals, and financed with the funds retained for this purpose in the individual investment account.

4.3.5 Administrators

The pension system is administered by private institutions, called Pension Fund Administrators (AFPs), which must be set up as limited companies having as their sole purpose to administer Pension Funds and pay the benefits established in Decree Law No. 3.500.

Life insurance companies also participate in the administration of this new system through the sale of life annuities, payment of the agreed-upon pensions, and financing of the difference which - in the event of death or permanent disability - is found the member in his or her individual investment account.

4.3.6 Supervisory bodies

To facilitate inspection and supervision of the system and prevent conflict of interests, it was stipulated that the Pension Fund Administrators must be companies with a single line of business and a specialized auditing agency was created, called the AFP Superintendency, an independent agency which is linked to the Government through the Ministery of Labour and Social Security. It is responsible for inspection and supervision of the Administrators in their role as social security institutions, ensuring their efficient, transparent operation and protecting the wealth accumulated by the workers.

Table No. 2.1.6
Estimated amounts of old age pension[1]
(percentage of pensionable income)[2]

Pensionable Income US$	5% Real Annual Return[3]		6% Real Annual Return[3]	
	Male %	Female %	Male %	Female %
Alternative A: 7% non-contributory period				
66	81,8	53,7	115,4	73,3
105	83,5	54,8	117,8	74,8
263	85,2	55,9	120,3	76,4
526	85,8	56,3	121,1	76,9
947	86,0	56,5	121,5	77,1
Alternative B: 10% non-contributory period				
66	80,7	52,6	114,2	71,9
105	82,4	53,7	116,6	73,4
263	84,1	54,8	119,0	74,9
526	84,6	55,1	119,8	75,5
947	84,9	55,3	120,2	75,7

(1) Assumptions used:
- a) Fixed commission in the system: US$ 0,44;
- b) Growth of pensionable earnings; 2% real annual increase up to age 50;
- c) Age began working: 22 years;
- d) Male member assumes a 60-year old epouse, and
- e) Female member assumes no beneficiares.

(2) Mean of the last 10 years

(3) Return on Pension Fund

Prepared by CIEDESS

Table No. 2.1.7
Pension amounts paid under the old system
and under Decree Law No. 3.500

	Old system			New system		
Years	Old Age US$	Disability US$	Survivors US$	Old Age US$	Disability US$	Survivors US$
1981	68	92	49	-	n.a.	n.a.
1982	63	94	47	-	290	107
1983	64	98	47	64	257	100
1984	69	103	49	70	213	86
1985	64	97	47	68	197	83
1986	66	100	49	80	195	83
1987	62	94	47	83	193	81
1988	68	99	51	101	202	85
1989	68	99	52	116	202	88
1990	73	92	56	122	198	86
1991	84	106	66	149	206	92

n.a. not available

Sources:
Yearly bulletins, Social Security Superintendency.
10 years of history of the AFP system, 1981-82, published by AFP Habitat, 1991.
Statistical Bulletin, Superintendency of Pension Fund Administrators, No. 102 and No. 108.

Prepared by CIEDESS

Table No. 2.1.8
Population covered by the Chilean pension system

Year	Labour force	Old System[1] Subject to Deductions	Old System[1] Labour force %	AFP System Contributors	AFP System Labour force %
1980	3.636.000	2.227.000	61,2	0	0,0
1981	3.688.000	1.013.000	27,5	n.a.	n.a.
1982	3.661.000	648.000	17,7	907.000	24,8
1983	3.768.000	602.000	16,0	1.055.000	28,0
1984	3.891.000	557.000	14,3	1.139.000	29,3
1985	4.019.000	454.000	11,3	1.322.000	32,9
1986	4.270.000	442.000	10,4	1.494.000	35,0
1987	4.354.000	435.000	10,0	1.676.000	38,5
1988	4.552.000	423.000	9,3	1.772.000	38,9
1989	4.675.000	348.000	7,4	1.918.000	41,0
1990	4.729.000	330.000	7,0	1.962.000	41,5
1991	4.794.000	320.000	6,7	2.118.000	44,2

n.a. not available

(1) The population subject to deductions under the old system for the years 1990 and 1991 was estimated on the basis of historical figures.

Sources:
Population 15 years and older by employment situation, by periods, INE.
Annual bulletins, Social Security Superintendency.
Statistical bulletin, Superintendency of Pension Fund Administrators, No. 108.

Prepared by CIEDESS

5. PENSION FUND ADMINISTRATORS

5.1. Legal status

The Pension Fund Administrators (AFPs) are limited companies which have as their sole purpose the administration of a Pension Fund and payment of the benefits established in Decree Law No. 3.500 of 1980.

To become an Administrator, a minimum capital of five thousand Development Units is required, which must be subscribed and paid up at the time the respective charter is granted. In addition, these agencies must permanently maintain assets equal to the minimum required capital, which increases in relation to the number of members, as illustrated in Table No. 3.1.1.

Table No. 3.1.1
Minimum Assets required of AFPs

Number of members		Minimum net worth	
from	up to	D Units	US$
0	4.999	5.000	109.030
5.000	7.499	10.000	218.060
7.500	9.999	15.000	327.090
10.000	or more	20.000	436.120

Prepared by CIEDESS based on existing legislation

The Superintendency of Pension Fund Administrators is the agency responsible for issuing the resolutions which authorize the operation of the AFPs and for approving their bylaws. The AFPs are obliged - once they begin operating - to maintain at least one agency or office of national scope and to provide the public with information on its address, board of directors, Pension Fund, investments, value of shares, commissions, offices and branches, in accordance with the general standards set by the Superintendency.

The sole and exclusive activity of the AFPs on the one hand permits more direct and effective auditing of the system and, on the other, permits the decisions taken by the worker in choosing an Administrator to be based on the typical considerations for a pension fund - return, safety and quality of services - and not on aspects which favour "other benefits" which are alien to the system, to their detriment.

The Administrators are subject to strict mechanisms of regulation and control to ensure that they adhere to their objectives, which is justified by the fact that pensions represent a basic social need and their financing comes from compulsory savings by individuals. In this regard, the law and a series of regulatory provisions govern the operation and define working features, procedures for affiliation, range of benefits, requirements for acceding to same, the manner in which they are paid and obligations to provide information to the public. In addition, to protect workers's savings, there are standards on the evaluation and composition of the investment portfolio, the separation of the Pension Fund with respect to the AFP which administers it, the purchase of securities issued by companies connected with the Administrator and the transaction of investments through formal secondary markets.

5.2 Role in social security modernization

12 years after the AFP system began operating in Chile, its results unquestionably represent an enormous step forward in the modernization of social security and a significant contribution to national development. The reforms involved in the new model not only have meant greater benefits and fewer costs for members, but they have also helped the economy as a whole through the accumulation of social security savings originated in the system of individual funding.

In the pension area, the benefits being received by the members through the Administrators, in the majority of cases exceed those which could have been obtained under the old system, an aspect which reinforces one of the key features of the new model: the amount of benefits is determined by the member through his or her savings.

In effect, under the new social security system, pension amounts are directly related to the funds accrued in the members' accounts, which represents a clear individual incentive to increase these funds. Therefore, the personal effort involved in the regular payment of contributions is directly compensated through the amount of the future pension, as opposed to the allocation system of the old Social Security Funds which were characterized by the absence of any such relationship, since the contributions went into a common fund. In addition, the new system recognizes the individual ownership of the existing accumulated funds, so that there is greater interest in efficient utilization of these funds.

The automatic adjustment of pensions, which is expressed in Development Units, constitutes another advantage of the new system. Under the old system, the value of same could only vary following a discretionary decision by the authorities, which for many years meant a decrease in pension values in real terms.

In addition, the system envisages a minimum amount for old age, disability and survivor's pensions, which is generally and uniformly applied, with financing coming from the country's general tax revenues. This guarantee comes into play when individual savings are insufficient to achieve that minimum level, with the State providing the necessary supplement, which also has an effect of promoting solidarity and a basic safety net. The old social security system also considered a minimum pension; however, under the current system, the situation is more transparent, since the State only contributes the difference between the required amount and that accumulated by the member.

The new system grants the worker a wide margin of election, as reflected in the multiple decisions which must be taken in different areas. Thus, the member has the freedom to choose his or her AFP and to change to another at any time; to make additional contributions and deposit money in the voluntary savings account; to take early retirement; to decide on the type of pension and its amount; and to select the life insurance company, when he or she opts for a life annuity, or the AFP, when the scheduled withdrawal modality is chosen.

This freedom enables the worker to have some say in how his or her funds are being administered, in terms both of the returns on the investments and the costs involved in making contributions to the Administrator. In addition, freedom of choice has introduced an element of competition in the AFP market, which has improved the efficiency, stability and safety of the new system, leading the Administrators to make a constant effort to reduce the social security costs represented by fixed and variable commissions. Table No. 3.1.2 shows the sharp drop in these commissions since 1984.

Table No. 3.1.2
Cost for the member in the AFP system

Year	Mean monthly cost[1] US$	Porcentage variation %
1981	8,3	-
1982	9,2	10,8
1983	12,3	33,7
1984	11,9	(3,3)
1985	11,5	(3,4)
1986	11,1	(3,5)
1987	10,7	(3,6)
1988	10,3	(3,7)
1989	9,4	(8,7)
1990	9,1	(3,2)
1991	9,0	(1,1)

(1) Cost for a contributor with earnings of US$262, similar to the average of the system. Includes fixed commissions, percentage of the balance and percentage of pensionable earnings.

Prepared by CIEDESS on the basis of information from the Superintendency of Pension Administrators.

Economically speaking, the funds accumulated in the individual accounts have contributed significantly to financing national development, further permitting broad participation by the labour force in the ownership of the means of production. Likewise, the investment of social security savings in sectors and activities which are productive and profitable for the country has had a favourable impact, by increasing the growth rate of the economy and improving employment levels and real earnings.

On the other hand, the money in the Pension Funds has had a significant impact on the development of the financial brokerage market. The growth of the demand for financial instruments, the introduction of new investment opportunities on the market, plus the strict control and maximum information required by the administration of social security funds, are some of the factors which have impacted on the modernization of the financial sector, along with the vertiginous growth of leading edge technology.

Lastly, in the institutional and administrative context, the new system has benefitted from the advantages offered by private enterprise, which, when acting under competitive conditions, must constantly make every effort to reduce costs and improve services, through the incorporation of new technologies, innovation of working procedures and efficiency in the use of resources. On the other hand, as state agencies are replaced by private companies concerned with financial returns and subject to market competition, independent decision-making centres have proliferated, minimizing the risk that - due to political, union and sectoral pressures - the social security funds may be used for a purpose different from the one for which the system was designed.

The efficient operation of the Administrators is reflected in the different services which the members and pensioners are receiving from them. Thus, for example, service and information to the public is provided through more than 400 branches across the country, including certain services which are provided in the member's workplace; advance or temporary pensions are awarded, meaning that the benefit can be obtained within ten days of submitting an application to the respective institution; pensioners are offered different payment options for scheduled withdrawals and temporary income, such as deposits in a current account, use of automatic tellers, payments to the recipient's home address or direct pick-up at the offices of the Administrator; services and information are provided by telephone and by mail; and every four months, a standard report, showing the contributions made, the commissions charged, the return for the period and the balance in the individual account is sent to the home address.

Table No. 3.1.6
Development of the AFP Pension Fund System

Year	Pension Fund Annual Growth MUS$	Pension Fund Cumulative MUS$	Cumulative Growth %	GNP Thousands US$	Accumulated Fund GNP %
1981	210.000	210.000		21.688.000	1,0
1982	540.000	660.000	214	18.630.000	3,5
1983	540.000	1.200.000	471	18.499.000	6,5
1984	364.000	1.564.000	645	19.672.000	8,0
1985	621.000	2.185.000	941	20.153.000	10,8
1986	678.000	2.883.000	1.263	21.294.000	13,4
1987	644.000	3.507.000	1.570	22.516.000	15,6
1988	769.000	4.276.000	1.936	24.172.000	17,7
1989	1.009.000	5.285.000	2.417	26.587.000	19,9
1990	1.723.000	7.008.000	3.237	27.157.000	25,8
1991	2.911.000	9.919.000	4.623	28.787.000	34,5

Sources:
Annual bulletins, Central Bank of Chile.
Statistical Bulletin, Superintendency of Pension Fund Administrators, No. 108.
Prepared by CIEDESS

Table No. 3.1.7 shows the composition of fund investments, during the period 1981-1991, of which the certificates - at least 90% of them - must remain in the custody of the Central Bank, for which purpose this institution has developed and implemented a specially designed system for these funds, in which all the information on incoming and outgoing certificates is handled by computer.

It is important to emphasize that the assets of the Pension Funds are independent of the assets of the Administrators. Consequently, the eventual bankruptcy of one of these companies does no result in a loss of assets for members, who must, in this case, transfer their funds to another Administrator.

According to law, the Administrators must ensure that the real return on their Pension Funds in the last 12 months is at least equal to the lesser of the average real return of the last 12 months on all pension funds, less two percentage points, and 50% of the average real return of the last 12 months on these same funds.

This minimum return is guaranteed through the cash reserve, which - as indicated previously - represents an asset of the Administrator plus a reserve for fluctuation in returns, which is set up with the amounts which exceed the mean return of all the funds by more than two points or more than 50% of same.

5.3. Supervisory agencies

The supervision and inspection of the system comes under the Superintendency of Pension Fund Administrators, an independent agency legally incorporated with its own assets, which is governed by a special constitution and is linked to the Goverment through the Ministry of Labour and Social Security.

The Central Bank of Chile, which has the power to set maximum limits for investment in the instruments making up the portfolio of the Pension Funds and which assumes custody of the certificates representing the investments,participates through these mechanisms in the supervision of the system. Likewise, the Securities and Insurance Commission exercises supervisory functions over the Administrators only insofar as these are issuers of securities offered to the public.

Finally, the Risk Classification Commission, an independent agency, is responsible for designing the methodology of compulsory classification for Pension Fund investment instruments and approving the respective projects which the Administrators submit to it on a monthly basis.

Table No. 3.1.7
Investments of the AFP system pension fund

Year	Deposits and bank bonds		Mortgage bonds		Central Bank		Treasury		Corporate bonds		Shares	
	MUS$	%(1)	MUS$	%	MUS$	%	MUS$	%	MUS$	%	MUS$	%
1981	130.000	62	20.000	10	58.000	28	1.000	0	1.000	0	0	0
1982	178.000	27	312.000	47	29.000	4	145.000	22	4.000	0	0	0
1983	33.000	3	605.000	51	168.000	14	363.000	30	26.000	2	0	0
1984	205.000	13	682.000	43	262.000	17	408.000	26	29.000	1	0	0
1985	457.000	21	771.000	35	444.000	20	485.000	22	24.000	1	1.000	1
1986	665.000	23	732.000	25	746.000	25	593.000	20	24.000	1	175.000	6
1987	882.000	27	744.000	21	1.038.000	29	406.000	11	91.000	3	353.000	9
1988	1.278.000	27	894.000	19	1.302.000	28	233.000	5	278.000	6	702.000	15
1989	1.153.000	20	948.000	17	2.042.000	36	186.000	3	487.000	9	807.000	15
1990	1.206.000	17	1.120.000	16	2.961.000	43	107.000	2	776.000	11	787.000	11
1991	1.321.000	13	1.329.000	13	3.717.000	37	88.000	1	1.107.000	11	2.387.000	25

(1) Share of total Pension Fund Investments in the respective year.

Sources:
10 years of history of the AFP system, 1981-1990, published by AFP Habitat, 1991.
Monthly statistical bulletins, Superintendency of Pension Fund Administrators, No. 102 and 108.

Prepared by CIEDESS

Translator's note = MUS$ = Thousands of US$

6. MODERNIZATION OF SOCIAL SECURITY AND DEVELOPMENT

In the search for well-being, people, financially speaking, aspire to have the largest possible quantity of goods and services, engaging in actions which provide them with the necessary funds to acquire them. The result of this search is measured, for the overall population, through the Gross National Product (GNP).

Goods and services are produced through the use of production factors and the application of technology, of which the quantity and quality will determine a country's capacity for achieving a given GNP level.

With an optimum combination of factors, economic efficiency is achieved, at which point the possibilities of continued growth through better allocation of resources are exhausted. In this case, growth is only feasible through an increase in the number of factors, improvements in the quality of same and/or more advanced technology.

These three possibilities of growth imply the need to increase investment in capital goods - which requires that part of the available resources go into saving - and to step up investment in human capital through education and training.

Development, on the other hand, is achieved as a result of continuous, sustained long-term growth, based on efficiency and creativity in the use of production factors and technology. In turn, the benefits produced by economic growth should be reflected in an increase in the well-being of the members of the community as a result of their own efforts, and for this to happen, it is essential to have an economic and social framework which favours equality of opportunities as opposed to equality of individual well-being.

In this sense, modernization of social security in the direction of freedom of choice by individuals and participation by the private sector has had a significant impact on the country's development. In effect, both in its design and in the administration of funds, it has impacted on the efficient use of factors in different areas of the economy, especially in the labour and capital markets and in the health and education sectors, as well as on spending for social security benefits.

6.1. The labour market

Social security contributions, being compulsory, represent for the worker a "tax" equal to the difference between what he would have been willing to contribute voluntarily as a function of expected benefits and what is actually imposed in compulsory fashion.

If to the foregoing, we add that the contributions are calculated on the basis of earnings, it may be concluded that the financing of social security implies a tax on labour which, by increasing the cost of labour, translates into lower employment levels.

Recognition of the worker's ownership of social security contributions - a key aspect in modernization - brought about a changed perception of the nature of same, as they came to be seen as a resource with restricted availability more than as a tax.

The clearest example is the pension system, which is financed on the basis of individual funding, where the worker retains ownership of his or her money, which will be reimbursed when he or she becomes eligible for a pension.

Under the new system, the amount of the pension is related to the accrued balance in the individual account, which means a direct relationship between the member's contributions and the benefits received, something which does not occur under the old system where the amount of the pension was independent of the amount of contributions.

It is in this latter case that the tax-like nature of contributions is most evident, in that the worker does not receive a benefit directly related to the funds contributed.

Thus, the change of focus in the funding of the social security system meant eliminating the tax on labour, with the resulting positive effects on employment levels. In this regard, Table No. 4.1.1 shows the constant reduction in unemployment rates beginning in 1982, along with the variables GNP and inflation and contribution rates.

On the other hand, the retirement decisions taken by older people affect the employment offer and their impact depends on the conditions and requirements established for retirement. Facilitating early retirement, in an allocation system, implies a subsidy for early retirement, while in an individual funding system, it is the worker who must finance this option. This fact, by causing a reduction in the amount of the pension, leads the worker to remain in the labour force, which will be positive insofar as there is full employment.

Table No. 4.1.1
Unemployment rates and other variables

Year	Labour Force	Unemployment Rate %	Contribution rate pensions and health(1) %	Gross National Product MUS$	Annual Inflation Rate %
1980	3.257.000	10,4	25,2	20.549.000	31,2
1981	3.271.000	11,3	18,6	21.686.000	9,5
1982	2.943.000	19,6	17,7	18.630.000	20,7
1983	3.216.000	14,6	19,0	18.499.000	23,1
1984	3.349.000	13,9	20,0	19.672.000	23,0
1985	3.537.000	12,0	19,9	20.153.000	26,4
1986	3.896.000	8,8	20,6	21.294.000	17,4
1987	4.011.000	7,9	20,7	22.516.000	21,5
1988	4.268.000	6,3	20,8	24.172.000	12,7
1989	4.425.000	5,3	20,7	26.587.000	21,4
1990	4.460.000	5,7	20,6	27.157.000	27,3
1991	4.540.000	5,3	20,5	28.787.000	18,7

(1) CIEDESS estimate, based on the weighted average of the contribution rates of the old and new systems.

Sources:
Population 15 of age and over by employment situation, INE.
Monthly bulletins, Central Bank of Chile.
Prepared by CIEDESS
Translator's note: MUS$ = thousands of US$

6.2. Spending on social security services and benefits

The economic- financial aspects of social security have great significance for the functioning of the economy. Its importance derives from the quantity and destination of the funds which it manages and from its dependence on certain relationships and/or decisions of an economic type such as the national budget, savings and investment, the decision to retire or continue working and even the decision to work or not to work, among others.

Quantifying the value of benefits paid by the different programs thus becomes relevant for measuring their impact on the economy. In this regard, Table No. 4.1.2 shows the value of contingency-based and development-oriented benefits, with indication of the sources of financing of each and the amount of outgoings, according to whether they come under the public or private sector.

Based on the figures in this table, the total amount spent in 1991 by the different programs amounted to US$ 3,165 million, of which US$ 2,208 million or 69.8% corresponded to expenditures by public institutions and US$ 957 million or 30.2% to private agencies. Of this last figure, US$ 68 million correspond to benefits which, despite being paid by private institutions, were financed with state funds.

Table No. 4.1.2
Spending on services and benefits by Chilean social security in 1991
(in thousands of dollars)

SERVICES AND BENEFITS	FINANCED BY	EXPENDITURES			GNP %
		PUBLIC	PRIVATE	TOTAL	
-CONTINGENCY-BASED					
PENSIONS(1)					
-DISABILITY	WORKER	167.897	38.754	206.651	0,72
-OLD AGE	WORKER	256.222	82.041	338.263	1,18
-SURVIVORS	WORKER	132.236	33.063	165.299	0,57
HEALTH					
-PREVENTION & TREATMENT(1)	WORKER	623.000	476.000	1.099.000	3,82
-INDUSTRIAL ACCIDENTS(1)	EMPLOYER	19.882	114.000	133.882	0,47
-SUBSIDIES FOR INABILITY TO WORK(2)	WORKER	19.605	118.580	138.185	0,48
FAMILY BENEFITS					
-FAMILY ALLOWANCE	STATE	53.497	64.103	117.600	0,41
-OTHER BENEFITS	AGENCIES		3.810	3.810	0,01
UNEMPLOYMENT					
-UNEMPLOYMENT BENEFITS	STATE	2.000	4.000	6.000	0,02
WELFARE					
-FOOD SUPPLEMENTS(3)	STATE	66.000		66.000	0,23
-PRESCHCOOL CARE	STATE	12.000		12.000	0,04
-SCHOOL MEALS	STATE	63.000		63.000	0,22
-MINORS IN AN IRREGULAR SITUATION	STATE	30.000		30.000	0,10
-FAMILY SUBSIDY	STATE	34.000		34.000	0,12
-WELFARE PENSIONS	STATE	118.000		118.000	0,41
DEVELOPMENT					
EDUCATION	STATE	528.000		528.000	1,83
TRAINING	STATE	843	22.999	23.842	0,08
HOUSING	STATE	71.758		71.758	0,25
SPORTS AND RECREATION(3)	STATE	10.000		10.000	0,03
TOTAL		2.207.940	957.350	3.165.290	11,00

(1) Public spending includes state financing.
(2) Includes subsidies for maternity leave and illness of children under one year.
(3) Figures budgeted for the year 1991.

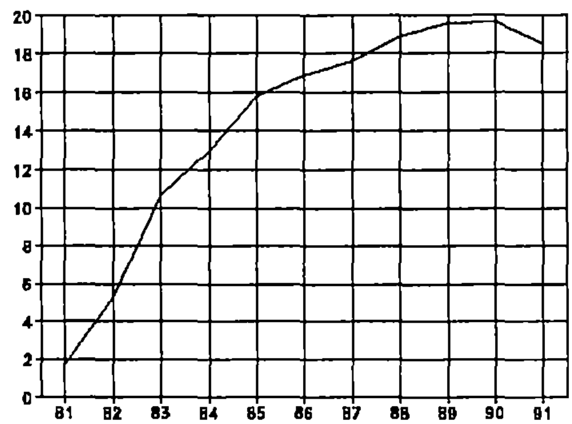
Prepared by CIEDESS

For its part, spending on contingency-based benefits, including social security and welfare benefits, amounted to US$ 2,532 million, or 80% of the total, while that corresponding to development represents US$ 634 million or 20% of the total shown.

6.3. Capital Market

An efficient capital market favours economic development by facilitating the flow of resources from persons who are willing to save to those who need them to invest. The change from a system of allocation to one of individual funding has had a significant impact on this market, and one notes a sustained increase in the offer of investment funds from 1981 to date. The impact of the funds supplied by the pension system to the capital market may be seen in Graph No. 4.1.2.

Graph No. 4.1.2
Participation of Pension Funds in the Capital Market
(In percentages)



This impact on the financial market was reflected in a significant demand for investment instruments, making it necessary to set standards to ensure that the management of funds was sufficiently transparent for Administrators and beneficiaries, especially since this was a new system which needed to earn credibility and gain the trust of the actors involved. This transparency is achieved by limiting the investment options of Pension Funds to instruments offered to the public, which prevented favouring the interests of agents connected with the Administrators.

This situation led with time to gradually reducing restrictions on the instruments which could be purchased by the Pension Funds - increasing the existing possibilities on the market - and to the setting of standards aimed at refining given instruments and introducing new ones, which had to be homogenous and with readily comparable characteristics, in order to have a broad, transparent secondary market which could favour their liquidity. These changes contributed to improving economic efficiency, thus increasing the country's growth rate.

Table No. 4.1.3.
Amounts invested in company bonds and shares by the Pensions Funds and their participation in the market

Year	Investments in:		Participation in the Market	
	Bonds MUS$	Shares MUS$	Bonds %	Shares %
1981	1.239	0	1,9	0,0
1982	4.035	0	1,3	0,0
1983	25.870	0	9,3	0,0
1984	28.699	0	10,2	0,0
1985	24.031	743	7,7	0,0
1986	24.029	174.764	11,1	3,2
1987	90.664	353.348	27,1	5,3
1988	277.935	702.420	48,1	8,4
1989	486.918	906.699	47,8	8,0
1990	776.187	787.178	59,3	5,5
1991	1.106.882	2.367.189	62,7	8,6

Sources:
10 years of history of the AFP system, 1981-1991, published by AFP Habitat, 1991.
Monthly Bulletin, Central Bank of Chile, No. 769.

Prepared by CIEDESS

Translator's note: MUS$ = thousands of US$

Among the diversification measures, one might mention the authorization to invest in shares of limited companies belonging to the real estate sector - which will have great impact on the development of this market - and in commercial bills representing short-term debt of companies.

The investments of the Pension Funds in company bonds and in shares, with their respective market share, are shown in the foregoing Table No. 4.1.3.

It is also interesting to note the progression of investment in mortgages because of its importance in the financing of housing. As of December 1991, the Pension Funds had acquired 58.6% of said instruments, as is shown in Graph No. 4.1.3.

Graph No. 4.1.3
Pension Fund participation in the mortgage market
(in percentage)

7. CONCLUSIONS

The background information provided here enables us to conclude that the adoption of a new approach to pension administration based on individual funding, by promoting higher growth rates and better employment levels, has proven more advantageous to society as a whole, with the members of the new system in turn receiving more attractive benefits than those granted under the old one.

This debate over a system of individual funding as opposed to one of allocation is not new to Chile, since back in 1927, in the particular case of the National Fund for Public Servants and Journalists, the austrian actuaries Karl Mumelter and Hans Volgsang recommended the former approach as the most appropriate "to create a Fund which is scientifically organized and well funded, a sure guarantee that at all times, personnel will be granted benefits in the manner promised and an absolute guarantee for the state that in the future it will not be asked to provide new subsidies."

The reasoning of the aforesaid actuaries was based on the fact that the existing Fund was not really a mutual benefit fund, since benefits were proportional to the last salary, from which it followed that an employee who worked for the same salary or with few increases during the entire time that he or she was deducted, contributed a much greater amount than employees who rose more quickly in their government career.

This demostrates the truth of the statement of Kant, who in one of his prolegomena maintains "because, since the human mind, over many centuries, has conceived of any number of things, it is not unlikely that, for every new thing, we can find another old one which bears some resemblace to it."

In the light of the foregoing and since more than eleven years have passed since the pension plan reforms were implemented, the analysis of their social impact confirms the contribution which they have made to the country´s greater stability and economic progress, factors which, in the last analysis, benefit the entire population.

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