Privatised pension systems lose their attraction

by Andrew Thompson

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What happened?

On 22 July the Chilean Senate voted to allow citizens to withdraw up to 10% of their savings from the AFPs – privatised pension funds. On the same day Mexican president Andrés Manuel López Obrador (AMLO) announced plans to boost pensions paid out by the Afores pension funds by 40%.

The details

One of the big ideas of the 1980s and the 1990s, championed by 'Chicago Boys' economists was to privatise pensions. As populations got older so-called state-run 'defined benefit' pension schemes were getting more and more costly. Instead the idea was to switch to privately run 'defined contribution' systems where workers' contributions would be invested in the stock market. The switch would save public money and deepen capital markets. Almost four decades later private pensions look less attractive. Private pensions paid out are seen as insufficient (on average, less than the minimum wage in Chile). The administrators don't really compete among themselves while charging high commissions. Workers have long obligatory paying-in periods before they can actually qualify for a pension.

In Chile, anger over privatised pensions has led President Sebastian Piñera to try and top them up with government funds. He has unsuccessfully opposed Congressional legislation to allow contributors to withdraw up to 10% of their pension capital as an emergency response to the COVID-19 pandemic. Piñera argues this will further reduce the eventual pension pay-out. The centre-left opposition says the money belongs to the contributors so they should be allowed to do what they want with it (Peru has passed legislation allowing withdrawals of up to 25%). Significantly, some members of Piñera's right wing coalition voted against the government. This may politically cripple the administration and end what could be called Chile's "free market consensus" on pension provision.

In Mexico AMLO is not a fan of the free market at all, but has nevertheless decided to reform rather than to destroy the Afores system. The main change in his proposal (likely to be approved by Congress where he has a big majority) is to almost triple contributions, from 6.5% of salary to 15%, with the employers contributing the biggest increase. He has also sharply reduced the minimum qualifying period. It is calculated that the change will increase average pensions for around 20mn Mexicans by 40%. Business leaders, who disagree with AMLO on a range of other issues have nevertheless welcomed the change which they see as helping a post-pandemic economic recovery next year. The promise of higher pensions will help boost AMLO's popularity ahead of congressional elections next year.

What does it mean?

No-one knows exactly what Latin America's post-pandemic "economic model" will look like, but political realities suggest the political attractiveness of "pure" privatised pension system will be much diminished. State-run, or hybrid state and private systems which try and improve coverage for the poor may be the shape of the future.

About the Author

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As well as being a Canning House Associate Fellow, Andrew is a former foreign correspondent (Buenos Aires, Mexico City, Rio de Janeiro) and a broadcaster for the BBC's Latin American Service. Working through La Rambla Research Ltd., he writes about economics, political risk, and business in Latin America.

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