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Are Government-Sponsored Pension Privatization Efforts Leading to Better Beneficiary Outcomes?

Dylan Iadanza
University at Albany, State University of New York

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Research Advisor: Professor Bret Benjamin, PhD.

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Abstract

This paper seeks to inform readers on the history and the performance of tying state-sponsored retirement plans to the market. In the late 1970's and 1980's, many Latin American university students participated in an exchange program affiliated with the University of Chicago. After completing their studies under notable free-market economists such as Milton Friedman and Arnold Harberger, these students returned home and took prominent positions in governments- mainly in Chile, Argentina, and Brazil. In Chile, the students developed a plan known as *el ladrillo* ("the brick"). In 1981, their retirement system was completely privatized. Mutual funds, called *Administradoras de Fondos de Pensiones* (AFPs), were set up to collect Chilean worker contributions, invest the savings, and gradually pay out benefits once workers reached retirement age. Over the past thirty-five years, the AFPs have averaged high returns, and the establishment of a minimum mandatory contribution has eliminated unfunded government liabilities. The successes and failures of the Chilean pension system has been studied by both neoliberal and alter-globalist scholars alike. Over 25 countries have implemented market-based or mixed-source state retirement plans since Chile's experiment in 1981. Recently, Chile has experienced difficulties with its retirement system, as large rates of noncompliance have reduced contributions into the AFPs. After analyzing the problem from a socioeconomic lens, I have concluded that the private retirement system is sustainable in Chile, albeit with modest reforms. Furthermore, pension privatization can and has been replicated in other nations; with moderate financial cost that was largely achieved through the privatization of public firms in CEE countries. In historically capitalist countries with relatively small amounts of publicly-held firms (U.S. and Europe), a large source of capital isn't always readily available. Through modest budgetary reform, though, privatization should be examined in the Global North as policymakers attempt to address future Social Security deficits.

Keywords: Individual Retirement Account (IRA), social insurance, retirement, AFPs

The Studebaker Corporation, after years of strong sales, entered lean times during the Great Depression. Studebaker family chauffeurs, including my great-grandfather Wilhelm Zachman, were fortunate enough to regain their jobs in 1935 as the company reemerged from receivership. Declining profitability and financial difficulties finally caught up to Studebaker, though, and the company went bankrupt in 1963. Besides the loss of an iconic manufacturer, government auditors uncovered a massive fraud- money hadn't been set aside by Studebaker to cover worker pensions, as stipulated by prior contracts with the UAW. Pension liabilities totaling $15,000,000 --about $116,000,000 in 2015 dollars--wouldn't be paid out to beneficiaries *(Lowenstein, 2005)*. The Federal Government stepped in to fix the problem, and sought to design a more permanent solution to prevent another system collapse from happening again. On Labor Day 1974, President Gerald R. Ford signed the Employee Retirement Income Security Act into law. Among other provisions, which included the establishment of the Pension Benefit Guarantee Corporation, the Act provided for the implementation of the Individual Retirement Account.[1] As time went on, the IRA has become quite popular, as companies recognized defined contribution plans as advantageous to meeting future obligations. In the United States, market-based retirement plans have been used to supplement Social Security payouts to retirees. Other countries, though, were earlier adopters of market-based retirement plans, taking the first step to tie their entire Social Security systems (and not just individual accounts) to the economy and its performance. In 1981, under then-Secretary of Labor and Social Security Jose Pinera, Chile took this first step in dismantling the crutch of the

[1] The following paper refers to *OA (Old-Age)* Insurance as "Social Security", and not the *SD (Survivor and Disability Benefits)* component. Survivors Benefits and Disabled Insurance are provided through an administrative fee charged to AFP contributors in Chile, and has historically hovered around 3%. Only OA insurance will be discussed in the following paper.

post-war welfare state.[2] Private sector mutual funds called AFPs were set up to collect worker contributions and invest them in domestic stock securities.[3] From the mid-1980s until the late 1990s, Chile's economy grew at a spectacular rate of 7.2%, leading to high returns for retirees who have AFP accounts *(Edwards & NBER, 2000)*. The "Chilean Miracle" has served as a model for governments ranging from Poland to Mexico to experiment in setting up IRAs for their workers, with varying degrees of success. Recently though, Chile has experienced difficulties with its retirement system, as large rates of noncompliance have reduced contributions into the AFPs. This problem has been amplified by low economic growth, which averaged 4.1% between 2001 and 2013. With structural reforms to both the economy and the Chilean Social Security system, the integrity of the system can remain intact. Furthermore, it can also serve as a model for retirement reform in developed countries, like the United States- as policymakers begin to address future Social Security deficits.

After the 1871 defeat of the French in the Franco-Prussian War, Prussian Chancellor Otto Von Bismarck sought to preserve unification and maintain industrial progress by providing a safety net for old-age workers. In Germany, social insurance programs were introduced mainly to strengthen the conservative hold on power *(Scambler, 2005).* This helped to slow the rise of the liberals and socialists, whom many believed to be responsible for the 1848 European Revolutions and the destruction brought on by the 1871 Paris Commune. In the early 20th

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[2] Great Britain and United States greatly increased the size of their respective social safety nets following World War II (Truman's Fair Deal, followed by Johnson's Great Society). In the U.S., this included Medicaid, Medicare, Social Security, unemployment benefits, etc. In Europe, this model also included universal healthcare. Early on, Prime Minister Margaret Thatcher's administration focused on industrial inefficiency and labor relations, and not entitlement reform. The Chilean AFPs were the first direct attempt to break apart the Keynesian-based, post-war entitlement scheme.

[3] this requirement was later liberalized

century, though, Social Security became less about nationalization. Instead, it was made to be an important building block for the modern “welfare state”. Through modest transfer payments, industrialized nations sought to reduce elderly poverty rates and raise standards of living. Upon signing the 1935 Social Security Act, which established the system still in place today, President Franklin Delano Roosevelt maintained that “There is no tragedy in growing old, but there is tragedy in growing old without means of support” *(Office of the Historian, President Roosevelt).* The system was designed to cover the void in the nation’s post-work social insurance system, as not every American had access to large company pension plans, such as the one at Studebaker Corporation. Since 1935, about 453 million Social Security numbers have been issued to Americans, and over $11 trillion in contributions have been paid out to beneficiaries *(Office of the Historian, FAQs)*. Historically speaking, the United States Social Security system has led a surplus, collecting about $13 trillion to its $11 trillion total payout over the years *(Office of the Chief Actuary)*. Numerous amendments, legislative “fixes”, and an increasingly older demographic present challenges to its future operational success.

The U.S. Social Security system has largely been structured in the same way since its establishment in 1935: employers and employees both contribute a percentage of the employee’s taxable income to the Trust Fund. In 1935, each party was responsible for 1% in FICA taxes; by 2016, this figure had increased to 6.2% of taxable income, up to the taxable minimum of $106,800 per worker *(Office of the Chief Actuary, Tax Rates).* At retirement age, a monthly check is issued up until death. The Trust Fund is made up of a mixture of U.S. government short and long-term bills, which are considered the safest form of debt. Originally, President Roosevelt called for the Social Security to be fully funded under law. Of course, this isn't how any insurance program works. Much as with traditional life insurance plans, incoming contributions are used to pay current beneficiaries. This system is known as pay-as-you go, or PAYGO. A fully-funded system wouldn't be practical, because it would lead to an astronomical accumulation of reserves in the Treasury. The first Social Security Commissioner, Arthur Altmeyer, wanted reserve excesses to be used to buy government bonds or corporate securities. Possible efforts to fund government infrastructure projects or to spur investment in corporate capital was derided by opponents, though, with Senator Arthur Vandenberg (R-MI), even going as far to call the proposed scheme "socialism with a vengeance" *(Altmeyer, Interview 2).* Economist John Attarian points out, though, that the Social Security Administration has no *direct control* over the Trust Fund, as it "is a Treasury account, nothing more" (*Attarian, 2001).* It was set up as an accounting device to prevent the accumulation of a larger than necessary reserve in 1939, according to Altmeyer. The "Trust Fund" simply functions as a transfer endpoint, as worker contributions are deposited into the Treasury General Fund, an equal amount in Treasury securities is appropriated into the "Fund" itself. In an individual retirement account, though, no mixing of funds occurs, and full control over assets are retained by the accountholder.[4] In an important legal ruling, the Supreme Court wrote that "to engraft upon the Social Security system a concept of "accrued property rights" would deprive it of the flexibility and boldness in adjustment to ever-changing conditions which it demands" *(Flemming v. Nestor, 1960)*. Another structural issue with Social Security is that the current benefit calculation creates a disincentive for older workers to remain in the workforce. Since older workers are more financially secure, well-established, and generally have lower amounts

[4] This is not the case under the current United States Social Security system

of outstanding liabilities, the natural incentive to work longer is lessened. Social Security, though, takes this further - by determining post-retirement benefits on the highest 35 years of earnings, "so that work years beyond 35 add little or nothing to final benefits" *(Reznik, Weaver, & Biggs, 2001).* In addition, benefits received while working are taxed, adding to a dip in the old-age labor participation rate. Furthermore: even with administrative costs and risk minimization factored in, interest rates on private securities have been higher over the last 75 years than government backed ones, evident by the historic rate of return on the stock market of 11% *(Damodaran, 2016)*. The combined lack of individual property rights, old-age disincentive to work, and historically low interest rates on government securities makes a compelling argument for a shift towards a private sector-based, state-sponsored retirement system.

In his 1970 Presidential victory speech, Salvador Allende rallied his Popular Unity (UP) supporters around a call to "end the power of imperialism in Chile" through the nationalization of both copper production and foreign capital *(UPI, p. 1)*. Between 1971 and 1972, Allende's administration made large investments in infrastructure designed to improve the country's human capital- which included facilities that supported primary education, healthcare, and land reform. Historically speaking, land reforms in other countries[5] have been successful in reducing unemployment, increasing aggregate demand, and raising government tax revenues. Increased demand, though, was not met by an increased supply of goods and services. This was because of President Allende's hostility to free enterprise, according to then-U.S. Ambassador to the U.N. George H.W. Bush *(Harmer, 195).* Allende's reforms failed to spark a jump in overall

[5] South Korea and India

productivity, though. Instead, aggregate supply decreased, and price controls and consumer subsidies were instituted to hide inflationary pressures (over 500% by 1973) in the closed-off Chilean economy *(Inflation)*. The prices of household goods in the Chilean market rose drastically, and to balance the increasing government deficit and maintain an increasing rate of growth, the UP government devalued the Chilean *escudo* by almost 10% monthly. The fall in foreign direct investment (FDI) and a shortage of foreign exchange (fx*)* reserves used by the Finance Ministry to fund large-scale nationalization programs led to the eventual collapse of Chile's capital system. On September 11th, 1973, Chile's military executed a bloody coup, which removed Allende from power and eventually instilled General Augusto Pinochet as the country's leader. The junta had "succeeded in its basic goal, getting rid of Allende" *(Time 46)*, but the economy was thrown into further depression. The time between 1973 and 1975 was devoid of any cohesive economic policy, and marked the beginning of the numerous human rights abuses perpetrated by Pinochet's regime. In 1975, with the country at yet another turning point, General Pinochet began to quickly adopt the policies of free-market economists; most notably, Milton Friedman and Arnold Harberger. The distinguished professors and their University of Chicago students, advocated for a "shock doctrine" - the aptly-named title of activist Naomi Klein's 2007 book that critiqued neoliberal policies and institutions in developing countries. The policy changes included sharp cuts in money creation, taxes, government spending, and the privatization of publicly-held firms. Investments in health and childcare infrastructure were slashed- as according to Harvard-trained political economist Dani Rodrik *(2008)*, "Economic growth *is* the most powerful instrument for reducing poverty" *(p. 2)*. It took until the mid-1980s for the newly-structured Chilean economy to take off, and it has been the fastest-growing economy in Latin America from the late 20th century onwards. Upon closer examination, it is safe to conclude that the economic growth Chile experienced in the late 20th century was largely responsible for the high returns of the Chilean AFPs.

After leaving office, Jose Pinera commented that "the transformation of those unfunded systems into systems in which wealth is accumulated in individual accounts can bring about a new paradigm, a world of worker-capitalist[s]" *(Pinera, 2001)*. He, along with other policy officials in the Pinochet regime, concluded that the high rates of inflation and noncompliance hindered the existing unfunded system's ability to pay benefits out to future retirees. By using Rostow's economic stages of growth model, it is safe to say that at this time, the United States was in the final stage of high mass consumption. Using the same framework, Chile and other Latin American countries[6] were undergoing the conditions deemed necessary as pre-conditions to take-off. Since the median age of the population in Chile, like most of Latin America, was quite young (21.8 years, compared to almost 28.5 years in the United States), a shift in plan structure could be implemented without significant disruption to beneficiaries. In order to minimize the potential for disruption, the Chilean government allowed current beneficiaries and people who planned on retiring within 5 years to remain on the unfunded system, slowly winding down its operations. After 1981, all workers entering the workforce had to enroll in one of the AFPs, and begin the mandatory minimum wage contribution of 10%. Current workforce participants (in 1981) were given the option to switch over to the AFPs, and were given an 18% gross wage increase by the government for doing so. This pay bump reflects the higher mandatory minimum contribution borne solely by the employee, as the employer no

[6] Who would later privatize their pension systems after years of military rule

longer paid any old-age tax. In addition, these workers also received a security from the federal government signifying the amount of their past contributions to the old system. This "recognition bond" was also automatically marked to inflation- which is interesting, considering the political battle going on today concerning Social Security COLAs (cost of living allowances) in the United States. Once eligible workers reach retirement age (65 for men, 60 for women), they have either two options: purchase an annuity, or make programmed withdrawals from their individual account. Of course, annuities have been made more attractive by the lack of an administrative fee and by strong economic performance *(Callund, 2010, p. 46)*.

In the *Shock Doctrine*, activist Naomi Klein claimed that large corporations and the Pinochet regime "joined forces to wage an all-out war on the third power sector- the workers- thereby drastically increasing the alliance's share of the national wealth" *(Klein, 2007, p. 105)*. During the peak of Pinochet's power in the 1980s, though, this simply wasn't the case. Despite a plunge in copper prices in the 1980s--along with a severe economic recession in 1982--Chile rebounded quicker than neighboring countries dependent on primary sector exports. This was in large part due to its higher total factor productivity and prior reductions in government expenditures. Chilean workers were spared massive layoffs and a prolonged high unemployment rate, as the government had shifted much of the copper burden from state-owned Codelco to foreign firms (despite retaining a majority share). Today, Venezuela and Brazil are experiencing sharp economic downturns and shortages as a result of their overdependence on another natural resource, oil, for large subsidy programs *(Vyas 2015)* *(Jelmayer 2005)*. As Chile lowered their exposure to copper price volatility, and limited industry was introduced in the economy, the AFP rules on portfolio risk were loosened. In 1990, AFPs were allowed to invest in foreign securities. This small limit was increased gradually to 45% by 2008. The goal of these measures, according to Social Security Administration researcher Barbara E. Kritzer, was to “allow the AFPs to diversify their portfolios and gradually reduce the concentration in domestic instruments to lessen the impact on the domestic financial market.” *(Kritzer SSA)* Other instruments that AFPs were later allowed to invest in included: bank deposits, corporate bonds, foreign banks, and asset-backed securities- such as mortgage bonds. It is hard to tell if the liberalization of AFP portfolio requirements has led to higher returns or not- there are too many macroeconomic indicators to consider, given a certain time frame.[7] It is safe to say, though, that performance has been stable relative to past performance- when AFPs were mainly invested in domestic treasuries and very limited amounts of corporate bonds. Today there are six AFPs offered to workers. Each AFP offers 5 types of funds- lettered A-E according to riskiness (with Letter A funds being invested in equities, and Letter E funds consisting of mostly fixed rate instruments). According to the researchers, the funds have averaged a 12% nominal rate of return since the program’s inception in 1981 *(Mittelstaedt & Olsen, 2003)*. Government intervention did exist early on, in order to mitigate the effects of the 1982 foreign exchange crisis, but “most of the return in the second half of the eighties and the nineties has been genuine and is based on effective market returns of portfolio investments in Chile during the period” *(Vial Ruiz-Tagle & Castro, 1997, p.12)*. Though returns have fallen to more sustainable numbers, they are still averaging around 7% in real terms, peaking above 20% nominally in 1982, 1983, and 1991. For comparative purposes, the United States Treasury has

[7] Exs. inflation, performance of instruments relative to domestic conditions, fluctuations in portfolio weight given instrument purchases, etc.

measured that the “average real interest rate for the 134 years [between] 1870 to 2003 is near 3 percent” *(Girola, 2005, p.2)* on government-backed securities. The AFPs also function as an investment vehicle for the Chilean economy, much as public employee pension plans do in the United States (examples include FERS, CalPERS, and NYSLRS). According to AFP architect Jose Pinera, “the pension funds have now accumulated resources equivalent to 70 percent of gross domestic product [in 2004], a pool of savings that has helped finance economic growth and spurred the development of liquid long-term domestic capital” *(Pinera, 2004, p.1)*. He also added that, through the acquisition of individual accounts, that “since they [AFP contributors] have a personal stake in the economy, workers cheer the stock market's surges rather than resent them, and know that bad economic policies will harm retirement benefits” *(p. 2)*. Through AFP investment, workers attain a sense (both literally and figuratively) of ownership in individual companies. Between 1981 and today, the private savings rate has jumped significantly in Chile, increasing by 11% in the period between 1985 and 2012 (*Certa et al, 2015)*. Furthermore, economic growth through both foreign and domestic investment has grown considerably. Chile’s high growth rate accounted for spectacular economic prosperity in the late 20th century, relative to other Latin American countries. Mexico, Brazil, and Argentina were being bailed out by large IMF loans at the time, after taking on large debt loads to finance ambitious infrastructure programs *(Bertola & Ocampo, 2012*). Above-average returns in times of normal growth, due to the diversification and privatization of risk, present a unique opportunity to solve anticipated future deficits in the Global North.

As Latin American countries faced unfunded liabilities and high inflation in their social insurance programs, many turned to the Chilean model for assistance. Bolivia (1997), Mexico

(1997), and El Salvador (1998) implemented programs with mandatory private individual accounts; while Uruguay, Argentina, Colombia, and Peru reformed their PAYGO systems along with introducing voluntary supplementary accounts. As a group, these reforms have been quite successful. Though the rate of evasion is stubbornly high (though not as high as in Chile), economic growth has been strong. In Europe, though, the change has been quite different. Most of the countries that underwent pension system changes were former communist states. The collapse of the Soviet Union in 1991 and the subsequent switch to a market-based economy led to PAYGO systems requiring both employer and employee contributions. These times were marked with economic instability and hyperinflation. The standard of living guaranteed under communist rule had collapsed, and new governments "relaxed qualifications for early retirement and disability and used them as welfare and unemployment programs for the unemployed" *(Cerda et al. 2015)*. By the mid-1990s, the CEE PAYGO systems were near total collapse. By implementing market-based mixed systems, these countries also dealt with a population skewed older more appropriately. The advantage of a mixed system is that older contributors will be guaranteed a sufficient benefit for retirement, and the system will not bear a high upfront cost on a country's already overextended budget. Many of the CEE countries (Estonia, Latvia, Hungary, and Poland) were interested in joining the European Union down the road, and "requirements for doing so include total explicit debt not to exceed 60 percent of the country's gross domestic product" *(Kritzer, 2001/2002, SSA)*. Recognition bonds were extremely expensive in Chile, and only made possible through extensive privatization of publicly-owned enterprises. This debate was notable in Poland, where it was eventually decided that the sale of state enterprises through *powszechne uwłaszczenie* "general propertisation" would serve as the funding mechanism for the transition. The money through “general propertisation” would cover the future deficit of the current program *ZUS*, while the private account system would be fully funded by mandatory contributions. This process was repeated in other countries undergoing a pension shift, with varying degrees of success. Of course, the United States has a strong history of free enterprise and has veered away from the nationalization of large firms or entire industries. To undergo such a drastic shift in pension system makeup, where would the money come from?

The full privatization of any Social Security system presents many challenges, each of which may be insurmountable for any country to overcome. First and foremost, there are significant costs associated with a national pension transition, which limits the plan as a potential fix to future pension woes. Why is this the case? Under such transition, “not only do current pensions to be paid out: future pension claims of the middle-aged have to be honoured as well” *(Gesell et al. 1998)*. In Poland and Chile, this was largely financed through the sale of state-owned enterprises to domestic investors and foreign firms. In a sense, the privatization of firms helped to privatize social insurance. Now, most developed countries don’t have very many firms still in public hands, nor would their removal from state control be particularly easy or lucrative. A debt issue would have to be considered in order to fully finance any transition, and investors would not respond favorably to any large increase in any country’s deficit, particularly one with no immediate impact on the economy. In order for such a system to be replicated in developed countries, any combination of the following must occur: a cut in current benefits, significantly raising/establishing a minimum contribution (10% in Chile, and higher in almost every other Latin American country), and/or slashing current expenditures on nonentitlement programs from the federal budget. Notable free-market economists, including Chris Edwards of the Cato Institute, have long made clear that Social Security privatization efforts must include a sizable cut in any developed countries budget. Otherwise, a large transition cost would incur. Sensible spending cuts could be achieved through eliminating entitlement, healthcare, and defense budget excesses. In addition, revenues could be increased through effective tax reform- through the elimination of top-heavy deductions and an overall simplification of the tax code. The AFPs may be unique to Chile, and full privatization outside of Latin America is nearly non-existent (besides in Kazakhstan). Due to their reduced costs, mixed plans that consist of both a mandatory PAYGO and mandatory private account[8] may be easier to implement. The main sticking point in private pension plans with many Americans, though, concerns the slow growth of portfolios in a time of poor market performance. It is true that those retiring in the midst of a recession would take a hit on their retirement savings, as many Americans did in their IRAs and 401k plans in 2008. Historically, though, *market-tied securities have had a higher rate of return than government-backed securities!* Taking a long-term approach to investing, with appropriate diversification in a given portfolio, means that significant damage can be avoided. A plan with multiple stages of risk, with different asset allocations in each stage (as the A-E plans have in Chile), could help to mitigate concerns. History has shown that prolonged times of economic growth more than make up for the occasional bust – evident by the high recurring annual rate of return (RARR) on market-based securities. It is important to note that the current Social Security system in place isn't immune from poor market performance either. The weakening and tightening of the dollar by the

[8] These plan structures are found across CEE countries and Great Britain

Federal Reserve (or any central bank) alters the nominal value of any benefit. A common problem found in private national pension systems not found in public ones, though, is the rate of noncompliance. Sebastian Pinera (Jose Pinera's brother), in his unsuccessful run to become President, noted that "Chile's social security system requires deep reforms in all sectors, because half of Chileans have no pension coverage, and of those who do, 40 percent are going to find it hard to reach the minimum level" *(Rohter, 2006)*. Noncompliance has become a large problem in private systems worldwide. Since many of these countries are considered developing, a rather large informal sector still exists. It is known that evasion is much higher in Latin America than in CEE nations, but in Hungary, the size of the underground economy is as high as 30% of GDP. A high informal sector also contributes to gender inequality, since women are more likely than men to be employed informally. If people are "off the books", they don't have to contribute to the system, and thereby add to the noncompliance rate. The same logic also applies to the self -employed (who, in Chile, weren't mandated to contribute until 2012) and those who have underreported their income to avoid paying more in contributions. A high noncompliance rate will be particularly troublesome in the future, when guaranteed minimum pensions for non-contributors come due. Government has, and should continue to, play a role in the development of the economy; by cracking down on underreporters, increasing educational opportunities, and providing for additional unemployment benefits. This would aid in the breakdown of the informal sector and allow for upward mobility, while also shrinking the gender gap. Mandating contributions, while also assisting in economic growth, are appropriate roles for government in a private system.

Former Senator Alan Simpson (R-WY), half of the bipartisan Simpson-Bowles Debt Commission[9] assailed the AARP as “38 million people bound together by love of airline discounts” *(Grim, 2009)*. As an advocate for the elderly, the AARP was instrumental in backing negative advertising surrounding President Bush’s unsuccessful plan to partially privatize Social Security in his second term. George W. Bush had a longtime interest in reforming social insurance programs: in 1997, Jose Pinera and Bush had dinner at the Governor’s Mansion in Austin, where they discussed the Chilean retirement reforms *(Hook, 2005)*. Comparatively speaking, the President’s proposal was much less invasive than the AFP system was in Chile. It sought to divert a small portion of FICA taxes paid to private IRA-like accounts for each individual contributor. In its final report, the three plans that the *Commission to Strengthen Social Security* laid out called for diverting between one and four percent of FICA taxes to private accounts.[10] While public opinion was initially receptive to reform efforts, it quickly soured. Baby boomers, the biggest supporters of Bush’s reelection campaign, united together and rebelled against any effort to cut or redistribute benefits. For many retirees, Social Security is their only source of income. Edward F. Coyle, Executive Director of the Alliance for Retired Americans, claimed that “privatizing Social Security would let Wall Street firms profit while gambling workers’ Social Security savings on the roulette wheel of the stock market” *(Coyle, 2012)*. His statement couldn’t be further from the truth. While exposure to the stock market would be present (yet minimal), the stock market’s historical real rate of return is almost 10% annually. This renders equity as an essential component of any investment strategy. Across all

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[9] Created by President Barack Obama, and was charged with proposing fiscally responsible solutions for reducing the Federal Deficit

[10] The third proposal also called for the possibility of contributing up to 2.5% of taxable wages to the accounts

plans in Chile, the vast majority of contributions have been invested in public and corporate debt. This is much safer and less risky than equity, since rates are largely fixed and bondholders have the first claim on assets if an investment turns south. It is important to note that private IRA-like accounts would be much safer than throwing money at private equity and hedge funds, which public retirement systems have done for quite some time (and discovered that, contrary to prior belief, doesn't **guarantee** higher returns for a given portfolio). This is, in large part, due to high administrative fees and poor performance of such funds, relative to mutual funds and index-tracking investments. Journalists such as Matt Taibbi of *Rolling Stone* have pointed this out in their investigative pieces *(Taibbi, 2013)*. Of course, public employee pension reform is a different issue in itself to tackle, but it is almost certain that volatile hedge funds and private equity would be extremely limited in any IRA-type proposal. Even with such a small percentage of the Commission's recommendations going towards "Wall Street" (1-4% of FICA taxes, followed by less than half of that to investments in equity), it has been rendered a non-starter in today's political climate. This is unfortunate, because the Commission also sought to reform the program by reducing the inequalities found in today's Social Security system. By raising the taxable income limit to $200,000[11], due to the fact that wages above the tax limit are rising faster than the average American's wage, the redistributive impact of the program could be restored. But can the redistributive aspect of the program remain, while switching to a private system? It is certainly possible. A minimum guaranteed pension, like the one installed in Chile (recently reformed to expand coverage), would be helpful in guaranteeing an appropriate standard of living for the poorest, while retaining property rights for AFP contributors. Of

[11] Chile has no such taxable limit.

course, what has happened in Latin American and Eastern Europe isn't a cookie-cutter fit for the United States. Due to obvious age differences between reform countries, political obstacles, and a mature growth rate- privatization efforts should be carefully designed by policymakers with equity in mind. Taken with a long-term approach, while making a minimal impact on today's contributors and retirees, privatization should be studied extensively in any retirement reform efforts undertaken.

General Augusto Pinochet was a repressive dictator who imposed much violence and economic hardship on the country during his sixteen year rule. Free-market policies and institutions that were enacted during his time in power, though, were highly successful in cutting extreme poverty and attracting capital to the country. An overhaul of Chile's ineffective pension system is one of these successes, and the "Chilean Model" has been studied and implemented by many other countries across the globe. Many variations of liberalized pension systems have been developed- from the fully privatized systems prevalent in Latin America, to the mixed systems found in Central and Eastern Europe. The high returns of these systems largely coincided with strong economic growth in the 1990s and 2000s in non-industrialized countries. For developed countries with mature growth rates, like the United States, a private pension system retains the potential to outpace state-sponsored plans, while ensuring property rights and an equal field for all system participants. With structural reforms to both the economy and the Chilean AFPs, the integrity of the privatized system can remain intact. Furthermore, their system can continue to serve as a model for retirement reform in developed countries, like the United States- as policymakers begin to address future liabilities and deficits.

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