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Book review

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Mesa Lago, Carmelo, 2020, *Evaluación de cuatro décadas de privatización de pensiones en América Latina (1980-2020): promesas y realidades*. Mexico City. Fundación Friedrich Ebert in Mexico.

Carmelo Mesa Lago is, without doubt, the best known expert on pension systems in Latin America. In this book, he provides incisive criticism of the promises made about the suitability, efficiency, and sufficiency of contributive pensions provided when private pension systems were created in the region. These promises were first made in 1980 when Chilean pension reform created a private pension system administered by the private pension administrators (PFA) industry and insurance companies, and closed the public pension system. Since then, public policymakers in many Latin American countries have commercialized the administration of contributive pensions through the creation of new institutions that in some cases replaced public pensions or else supplemented them in mixed or parallel arrangements. Nevertheless, at least in the Chilean case, a majority of the population opposes the private pension system—as illustrated by the frontal attack on the PFA that played an important role in the election of President Gabriel Boric and the establishment of a constitutional convention. on the matter.

In Peru, increasing frustration with the unfulfilled promises of the private pension system has not led to the same changes as in Chile. Instead, in 2016 retired account holders were allowed to withdraw 95.5% of the funds in their pension savings accounts, and then, in 2020 and 2021, four withdrawals per person were permitted in response to the COVID-19 pandemic. These measures left more than a third of the enrollees without any funds in their individual capitalization accounts, or with just minimal balances.

The methodology used in this monograph consists of a comparative analysis of the performance of the private pension system in those Latin American countries that established them, using five main criteria: (i) coverage of the EAP (active) and senior citizens (passive); (ii) social solidarity and gender equity; (iii) adequacy of benefits; (iv) efficient administration and reasonable costs; and (v) financial and actuarial sustainability. At the

end of the book, Mesa Lago offers a series of recommendations to improve pension systems in the region.

The sample used in the study includes (i) nine Latin American countries that adopted "substitutive" private pensions systems (Chile, 1981; Mexico, 1997; El Salvador, 1998; Dominican Republic, 2003), "parallel" systems (Peru, 1993; Colombia, 1994), and "mixed" systems (Uruguay, 1996; Costa Rica, 2001; Panama, 2008); (ii) three countries that adopted private systems and then introduced "re-reforms" (Chile and Argentina, 2008; Bolivia, 2010); (iii) proposals for reforms in Colombia and Peru (not implemented in Peru); and (iv) the redistribution system in Brazil.

A brief review of contributive pensions in the region allows for a detailed evaluation of Mesa Lago's offering. Traditional societies usually cover short-term and long-term personal contingencies through support and care provided by the family and the local community. This care is based on intergenerational relations that constitute the family pillar of informal ties based on solidarity, social cohesion, and reciprocity. Reimbursement for care services and subsequent coverage is provided directly, through monetary payment or compensation for caregivers within the family—generally, women. Currently, in some Latin American countries, such as Peru, the reduced coverage of seniors through contributive and social pensions implies that families continue to support this population group: half of Peru's senior citizens do not receive any kind of pension.

In modern societies, contingencies are covered through the transactional mechanism of insurance that distributes risks among collectives. The public pillar is composed of insurance or social security financed by the obligatory contributions of employees and employers, who generally use "distribution"—transfers by participants in the labor market to non-participants, including retired persons—and defined benefits. This pillar, in most countries, is based on conventions regarding the principles of social security and the fundamental rights of workers adopted by the member countries of the International Labour Organization (ILO).

The private pillar is made up of life insurance policies acquired voluntarily and private pension savings schemes that are obligatory for employees. In Latin America, the latter are administered by the PFA. They are based on individual capitalization, defined contributions, and the risk of savings investments obligatorily taken on by enrollees in the private system. When retiring, enrollees have the option of selling their savings to an insurance company in exchange for an annuity.

The public pillar was the primary system in existence from the beginning of the 20th century, established at different times across the region. In 1980,

the neoliberal model implemented in Chile ushered in the commercialization of certain social services, such as pensions, healthcare, and education. The structural reform of social security closed the public pension system and replaced it with a private pension system (regulated by a PFA superintendency). Such private pension systems were adopted starting in 1992/93 by nine countries in the region (Peru being the first). Mesa Lago provides a detailed analysis of the four decades following the creation of the private pension system, as well as important conclusions regarding what should be taken into consideration in efforts to reform these systems.

In the case of the first criteria—the coverage of pensions—Mesa Lago argues that private pension systems did not substantially increase coverage of the EAP in relation to previous systems. Nevertheless, he notes that household surveys between 2009 and 2018 show relative improvement in contributive coverage of the EAP, with significant differences between countries. Uruguay, Costa Rica, and Chile have the highest coverage, ranging between 71% and 65%. The coverage in Panama, the Dominican Republic, Mexico, Colombia, El Salvador, and Peru varies between 50% and 21% (p. 29). The coverage of retirees (passive coverage) is greater than active coverage due to social pensions. Thanks to these, at least 80% of retired people have coverage in Chile, Uruguay, and Panama. However, in countries such as the Dominican Republic and El Salvador, coverage of retirees is very low: between 19% and 14%, respectively. It is evident that one of the main reasons why coverage in these countries is not more extensive is the high level of unregistered or informal employment, which enables evasion of contributory obligations. In addition, there are also large numbers of independent workers who contribute on a voluntary basis.

When it comes to the second criterion, social solidarity and gender equity, Mesa Lago argues that the principal of social solidarity within the public pillar was replaced by the principle of equivalency, in which the pension is calculated based on the amount saved in the individual account of the person enrolled (p. 39). This principle implies the absence of intergenerational transfers or transfers between genders. The private pension system eliminated employers' contributions; enrollees were burdened with the industry's high administration and setup costs, while pension funds and other programs for special groups (such as the armed forces, teachers, diplomats, and other public servants in official agencies) were maintained. It was noted that the contribution rate in the private pension system went up when the salary of the enrolled worker increased (p. 42). Some solidarity mechanisms, such as minimum guaranteed pensions, are outside the private pension system and financed by government income.

In Latin America, gender inequity is highly evident in the labor market. Women's overall participation is lower but, on average, higher in less productive activities than more productive ones. A significant gender pay gap and more frequent labor-market entries and exits mean that women save less in their capitalization accounts during their work life than men. Thus, despite living longer, women tend to have lower pensions. Although there has been a small increase in the female EAP, it will take a long time for women to reach the same share as their male counterparts. And while gender inequity is common in both the public and private pension systems, inequalities are more apparent n the latter. For example, in some cases, there was an increase in the years required to obtain a minimum pension, which made it more difficult for women to obtain this benefit (p. 43). To ease gender inequity, in Chile the government provides a universal bonus for each live birth, which is deposited in the mother's individual account. In addition, in the case of divorce, the pension fund accumulated during the marriage can be divided between the spouses, which benefits the wife, who will generally have accumulated less. In Uruguay, the government provides one year of contributions to the individual account of the mother for each child.

Mesa Lago goes on to analyze benefit insufficiency, the third criterion. He notes that the InterAmerican Development Bank (IDB) calculated the average rate of replacement in public pension systems as equivalent to 64.7%, while the average rate of replacement in private systems is 39.8% (p. 47). The OECD confirmed this result. Using the ILO benchmark of 45%, the OECD demonstrated that eight public pension funds surpass the private rate, while only El Salvador's private system exceeds the benchmark by 1.6 percentage points (p. 47). Other researchers have validated that rates of replacement in the PPS do not reach the benchmark of 45%. In Chile, the average rate of replacement is 34% of the average salary over the last 10 years and is projected to decline to 25% between 2025 and 2035. In Mexico, the rate of replacement decreased from 71% in the public pension system to 29% in the private system for men, and from 67% in the public system to 30% in the private system for women (p. 49). In Peru, the average rate of replacement is 39% in the PPS, compared to the 60% promised when the system was first established. Nevertheless, it is also true that it would not necessarily be possible for the higher rates of replacement in the public pension systems to be maintained into the future.

When it comes to the fourth criterion—efficient administration and reasonable costs due to competition—Mesa Lago concludes that the principle of competition in the private pension system has not been fulfilled for

various reasons. These include the reduced number of PFAs, the enrollees' lack of knowledge about how to choose a PFA, the reduction of transfers due precisely to a lack of competition, and excessive administrative costs. In Costa Rica and Uruguay, with the establishment of a public PFA, administrative costs were reduced. In Peru, the share held by private PFAs increased, and there is no public PFA to contribute to reducing these costs. For each point charged in administrative costs, the pension is reduced by a significant proportion. Mesa Lago stresses the substantial earnings of the PFAs as well as the high salaries plus expenses of the executives, and how this leads to mistrust in a context when pensions are increasingly insufficient.

Finally, Mesa Lago argues that the fifth criterion—the financial and actuarial sustainability of private pension systems—is fundamental. However, he notes that there is a tendency toward the reduction of the contribution rate, and consequent reduction in the contributions of the enrollees. This situation is worsened by evasion, arrears, or the non-reporting of income by workers and employers. On the other hand, the total pension savings has increased substantially. In Chile, it is more than 80% of GDP and in Peru, it is around 20%. The investment portfolios of the new private systems continue to consist primarily of public debt and investment abroad. It was promised that local stocks would benefit the most from the private systems, but insufficiently developed markets constitute a barrier to this type of investment. As a result, funds invest abroad or in public debt. The initial promises made that the income from investments would be considerable did not take into account high administrative costs, international financial volatility, or internal economic and political shocks. The actuarial sustainability of the private pension system is fulfilled due the principle of equivalency. However, the most problematic aspect of this principle is that implicit investment risk is assumed in its totality by the enrollee. In Peru, the absence of a guaranteed minimum pension in the private system elevates this risk.

The main conclusions of the evaluation of the promises and realities of the PPS can be summarized as follows. First, it was promised that coverage would increase substantially. This did not happen. Increases in active coverage, when they occurred, have been minimal. Passive coverage increased due to social pensions. Second, social solidarity worked because of social policies and not due to the private system. In addition, gender inequity increased. Third, the promise of sufficient benefits was not fulfilled. On average, the rates of replacement are lower than the ILO's benchmark of 45%. Fourth, PPS administration is inefficient and administrative costs are excessive, reducing the size of pensions. Competition has not been achieved

or is very limited. The number of PFAs has decreased, transfers have greatly declined, and PFAs' earnings have been sustained even during international shocks. Fifth, the number of enrollees who pay into the system has decreased and evasion remains constant. While the proportion of total pension fund savings in proportion to GDP has increased, investments are concentrated in government debt and foreign investment rather than stocks on the domestic market. The net return on administrative costs is less than the PFAs claim and the investment risk is assumed by the enrollee.

The recommendations (17) arising from this study are precise and based on careful analysis of the evidence. They can be summarized as follows: (i) developing reforms or re-reforms in the framework of social dialogue and restoring social representation in the private system; (ii) increasing coverage, which in many cases means improving registered and productive employment, reinforcing compliance by reducing evasion or circumvention, and introducing special regimes or pension funds; (iii) expand social solidarity and gender equity; (iv) improving knowledge and information about the private system, reducing administrative costs, and increasing pension sufficiency; (v) diversifying investment portfolios and increasing net earnings; and (vi) limiting withdrawals from individual accounts and creating a more attractive climate for voluntary savings.

In order to be effective, most of these reforms require public policies that increase economic growth and strengthen institutionality so that pension savings increase. These interventions are particularly important because of the impact of the COVID-19 pandemic on the labor market, which in many cases encourages authorized withdrawals from individual capitalization accounts and a reduction in contribution rates. In Peru, where joint pension coverage through the public and private pension funds covers less than a third of the EAP, it is very important for pension reform proposals to consider the lessons and recommendations of this excellent new contribution by Carmelo Mesa Lago.

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