A Personal Burden; Chile switched to a privatized pension system nearly 25 years ago, and millions of workers still fall through the cracks; [HOME EDITION]

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Abstract (Document Summary)

The U.S. faces the same demographic pressures that propelled Chile's bold move. The Andean nation, however, began its experiment with privatization at a very different point in its development. Chile was a military dictatorship saddled with a hodgepodge of rickety, disparate pension plans when leader Gen. Augusto Pinochet allowed U.S.-educated Chilean economist Jose Pinera to construct a single program centered on private accounts.

Although the U.S. can avoid some of the biggest pitfalls of Chile's privatization, it isn't likely to experience the same benefits. For example, privatization helped Chile develop its fledgling capital markets, but America's are already the most sophisticated in the world. In addition, Chilean investors profited from some uncanny market timing that brought them huge gains in both the bond and stock markets early on, a situation that appears unlikely to repeat itself in the U.S.

FINANCIAL PLANNING: People receive help at AFP Summa Bansander, a pension fund office in Santiago, Chile. In 1981, many workers began funneling 10% of their wages into private accounts.; PHOTOGRAPHER: Tomas Munita Associated Press; CARRYING HIS OWN LOAD: Luis Oyarze, 63, hauls a stack of boxes in Santiago, Chile. Oyarze has been self-employed for 34 years selling handicrafts to tourists. For those who are self-employed or work in Chile's underground economy, participation in the country's privatized pension system is voluntary.; PHOTOGRAPHER: Tomas Munita Associated Press; BACKUP PLAN: [Inelia Pardo Acevedo], 64, recently retired. But she plans to look for a part-time job to pad the nest egg in her personal account under Chile's privatized system.; PHOTOGRAPHER: Pablo Martinez For The Times

Full Text (1755 words)

Weary from decades of working nights and weekends at a public hospital, nursing assistant Inelia Pardo Acevedo recently retired.

But the 64-year-old plans to look for a part-time job to pad the nest egg in her personal retirement account. The $225 a month she draws under Chile's privatized system doesn't stretch far. And what galls her is that colleagues who stuck with traditional pension plans get three times as much, guaranteed for the rest of their lives.

The government "painted this wonderful picture of private accounts," Pardo said. "They fooled me. They fooled us all."

As the Social Security debate heats up in the United States, many are looking south to Chile, where nearly a quarter century of experience with privatization hasn't settled the question of how to best construct an old-age safety net.

In 1981, Chile scrapped a pay-as-you-go system similar to the one in the U.S., in which the contributions of active workers were used to pay pensions of existing retirees. Instead, many Chileans began funneling 10% of their wages into professionally managed private accounts that allowed them to invest in stocks and bonds.

Nearly two dozen nations, including Britain, Argentina, Sweden and Singapore, have since adopted some version of Chile's plan. President Bush has lauded it as "a great example" of why Americans should be allowed to divert a portion of their Social Security contributions to personal accounts.

By some measures, the switch has been a resounding success. Private retirement savings have fueled Chile's capital markets, boosted the nation's economic growth and restored fairness to a system that once doled out benefits based on workers' political clout.

Chileans have tucked away more than $60 billion into their own accounts, the equivalent of two-thirds of the nation's gross domestic product. Average returns on those investments have topped 10%.

But high management fees have trimmed retirees' payouts substantially, while big holes remain in Chile's safety net. An estimated half of the nation's workers aren't saving enough to qualify for even a minimum government pension of about $134 a month. The transition has been brutal for the first wave of retirees such as Pardo, many of whom made the change too late in their careers to reap the full benefits of compound interest.

And although many pension experts laud individual accounts as the only way to assure long-term solvency, opinion polls show that most Chileans are skeptical of their pioneering reform.

"Millions of Chileans would go back to the old system if they could," said Manuel Riesco, director of the National Center for Alternative Development Studies, a Santiago think tank critical of Chile's reform.

Even supporters of Chile's model say that proponents of U.S. privatization may be raising expectations too high. Economists doubt American workers would see such lofty investment returns, or that the economy would get the same lift, in part because the U.S. appears unwilling to swallow the tough fiscal medicine that Chile endured to make the transition.

Guillermo Larrain Rios, who heads the regulatory body that oversees Chile's pension system, marveled at a recent article by a U.S. newspaper columnist who predicted that privatization would reform democracy and even the character of the American electorate.

"It is irresponsible to ask a pension reform to do all that," Larrain said. "Our reform was a good one. But it has limits."

The U.S. faces the same demographic pressures that propelled Chile's bold move. The Andean nation, however, began its experiment with privatization at a very different point in its development. Chile was a military dictatorship saddled with a hodgepodge of rickety, disparate pension plans when leader Gen. Augusto Pinochet allowed U.S.-educated Chilean economist Jose Pinera to construct a single program centered on private accounts.

All salaried employees entering the labor force after the program's inception in 1981 were required to enroll in the new system. Meanwhile, the government enticed most workers in the old plans to switch. It did that by dangling carrots such as lower withholding taxes, by providing them with so-called recognition bonds to give them credit for their previous contributions, and by offering them a chance to earn fat returns in the stock and bond markets.

"They promised us gold and riches," said Maria Quintanilla Carvajal, 63, a government secretary who rued the day that she left her guaranteed-benefit plan to invest on her own behalf.

Quintanilla and hundreds of thousands of Chileans approaching retirement age are finding that they would have been better off remaining in the old system. The gap stems mainly from the way some workers' recognition bonds were calculated, resulting in lower benefits at retirement. Workers have formed an advocacy group that is pressuring the government to compensate them for their so-called pension damage.

While most everyone agrees that these workers were shortchanged, experts say the culprit is Pinochet-era policies that stiffed them on the conversion, rather than a problem with private accounts, which have delivered solid returns.

Some argue that the true performance of the reformed system can't be evaluated until after 2020, when the first generation of workers to have spent their entire careers contributing to their own accounts begins to retire. Still, a survey conducted last year showed that more than half of those Chileans polled had little or no confidence in the privatized system.

Nieves Stuardo Arevalo is among them. At first blush, the 48- year-old social worker would seem to have every reason for optimism. She entered the workforce the same year as pension reform was born and has contributed steadily ever since. The $52,000 she has saved is a small fortune in a nation with annual per capita income of about $4,500, and she is only half-way through her working life. But the lack of a fixed lifetime benefit spooks her.

"It's really not much" considering how long people live these days, she said of her nest egg. "It worries me."

Stuardo is one of the lucky ones. The Chilean government guarantees a so-called minimum pension to workers who have contributed to the system for at least 20 years in the event they outlive their savings. That figure ranges from $134 to $153 a month depending on the retiree's age.

The trouble, critics say, is that nearly half the workforce isn't saving enough to qualify for even that modest sum. Participation is purely voluntary for the self-employed and those toiling in Chile's sizable underground economy, so few bother. Many other workers move in and out of the formal economy on short-term contracts, and thus contribute to their investment accounts only sporadically. Nearly 60% of Chileans enrolled in the system have accumulated less than $3,500.

Millions of workers fell through the gaps of the old system as well. But some studies have concluded that the problem has worsened under privatization. That has some analysts concerned about a wave of elderly poor swamping Chile's welfare rolls down the road.

"There is going to be tremendous pressure ... to raise taxes," said Andras Uthoff, an economist at the United Nations Economic Commission for Latin America and the Caribbean in Santiago.

To be sure, the coverage gap bedeviling Chile's privatized system wouldn't be a major issue for the U.S., where the underground economy is smaller and the self-employed are already paying into Social Security.

And the U.S. would probably do better on costs. The Chilean pension market is controlled by just six management companies, whose fees and profits have been criticized as excessive. An average Chilean worker who retired in 2000 would have seen half of his contributions eaten up by fees, according to a recent World Bank study.

Pension experts believe Uncle Sam would be able to demand much better terms given its clout and the competitiveness of U.S. financial markets.

Although the U.S. can avoid some of the biggest pitfalls of Chile's privatization, it isn't likely to experience the same benefits. For example, privatization helped Chile develop its fledgling capital markets, but America's are already the most sophisticated in the world. In addition, Chilean investors profited from some uncanny market timing that brought them huge gains in both the bond and stock markets early on, a situation that appears unlikely to repeat itself in the U.S.

Those banking on a Chilean-style economic growth spurt are bound to be disappointed as well. Pension privatization helped Chile boost its national savings rate and freed up capital to fuel the private sector, but only because the nation ran big budget surpluses to help pay for the transition. Those and a slew of other changes to open Chile's economy have resulted in average GDP growth exceeding 5.5% annually since 1990.

In contrast, the U.S. is burdened with huge budget deficits. And the Bush administration has proposed borrowing even more to maintain existing Social Security promises to retirees if his plan is approved and younger workers begin channeling a portion of their contributions to their own personal accounts.

The end result, said Chilean economist Joseph Ramos, is that the U.S. will get no net increase in its national savings rate, "so you're not going to get the powerful growth effect we saw in Chile."

While privatization may have been good for Chile's economy, workers like Quintanilla say it hasn't done much for them.

"I'll probably have to work the rest of my life now," she said. "I'm angry."

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(BEGIN TEXT OF INFOBOX)

Social insecurity

In any given month, only about half of Chileans with personal retirement accounts contribute to them. And most participants had accumulated less than $3,500 as of September 2004.

Chilean workers' participation in private accounts

Not contributing: 51%

Contributing: 49%

Breakdown of private accounts by size

$3,481 or less: 59%

$3,482 to 8,702: 19%

$8,703 to $17,403: 11%

More than $17,404: 11%

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Source: Chile's Superintendent of Pension Fund Administrators

Los Angeles Times

[Illustration]
Caption: PHOTO: FINANCIAL PLANNING: People receive help at AFP Summa Bansander, a pension fund office in Santiago, Chile. In 1981, many workers began funneling 10% of their wages into private accounts.; PHOTOGRAPHER: Tomas Munita Associated Press; PHOTO: CARRYING HIS OWN LOAD: Luis Oyarze, 63, hauls a stack of boxes in Santiago, Chile. Oyarze has been self-employed for 34 years selling handicrafts to tourists. For those who are self-employed or work in Chile's underground economy, participation in the country's privatized pension system is voluntary.; PHOTOGRAPHER: Tomas Munita Associated Press; PHOTO: BACKUP PLAN: Inelia Pardo Acevedo, 64, recently retired. But she plans to look for a part-time job to pad the nest egg in her personal account under Chile's privatized system.; PHOTOGRAPHER: Pablo Martinez For The Times

Credit: Times Staff Writer