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Chile's privatized social security system, beloved by U.S. conservatives, is falling apart

Michael Hiltzik

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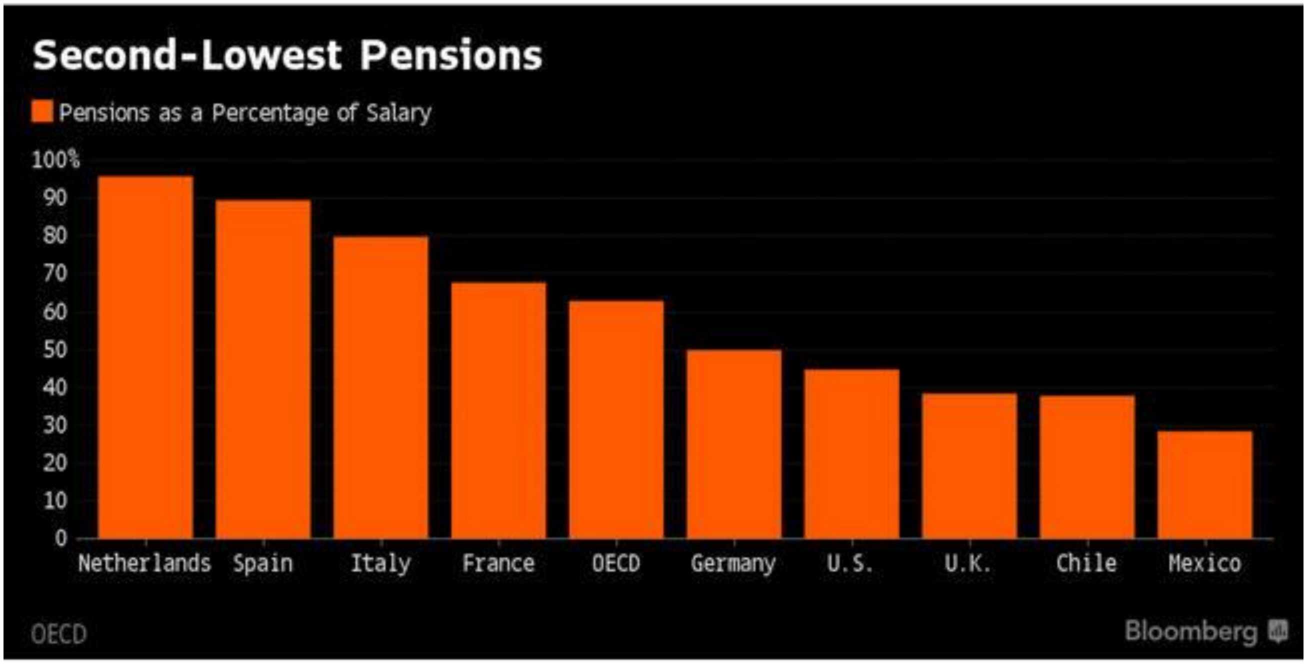
Promoters of privatizing the U.S. Social Security system have never tired of holding up Chile's privatized program as an example of how this can make workers rich. The trick is that they never ask ordinary Chilean workers and retirees how they feel about it.

That may be because they know what the answer would be. It was visible last month in the streets of the capital, Santiago, where crowds estimated at 100,000 to 200,000 marched to demand reform.

President Michelle Bachelet responded promptly in a televised speech this week, ordering up changes that include requiring employers to contributed to the system for the first time. As Bloomberg reported, Bachelet acknowledged workers' rage that pension benefits have fallen well below what was initially promised when the system was created in 1981, under dictator Augusto Pinochet. That promise was that pensions would provide 70% of a worker's final wages at work; the real figure is 38%, the lowest rate among developed countries other than Mexico.

"We need to build a solidarity system that doesn't leave all responsibilities to the individual and that abandons them when they're left behind," Bachelet said.

The Chilean program was promoted relentlessly by its creator, Jose Pinera, who got himself a sinecure at the Cato Institute out of the deal. From there he fed American conservatives' fantasies of "an obvious free market solution that works," he wrote for a Cato audience in 1997. (In that same article he declared that "America's Social Security system will go bust in 2010." Umm, no.) He boasted of how he single-handedly "decided to undertake a structural reform [of Chile's bankrupt retirement system] that would solve the problem once and for all."



Chilean government pensions lag those of most other developed countries as a percentage of working income. (OECD data, via Bloomberg)

Republicans lapped it up. Chile's supposed success gave impetus to President George W. Bush's misbegotten privatization scheme in 2005. During the last election, Herman Cain called for replacing Social Security with the Chilean model. The dream of privatized accounts still stalks American politics, with Chile still held up as a paragon.

Pinera and his fans talked up the Chilean workers' apparent gains during the system's early years, when it seemed to be delivering double-digit returns and lavish pensions to its lucky beneficiaries. What the promoters never much emphasized was how the program actually had been made to work. As I explained in a 2005 book, everyone entering formal employment after 1981 was required to deposit 10% of earned wages into individual accounts managed by a handful of investment companies appointed by the Pinochet regime. Workers enrolled in the old system were goaded into abandoning it by cuts in existing benefits. Chile financed the transition by draining its large government surplus. An unprecedented bull market in Chilean stocks did the rest.

But the seams soon showed. The World Bank determined that fees charged by those favored investment firms consumed fully half the pension contributions of the average worker retiring in 2000. The government surplus disappeared, and those outsized stock market gains faded away.

A series of reforms of the reform followed. But not enough. Many workers can't afford to pay the 10% minimum contribution, and others have been moved out of the system by a shift toward contract labor. The average pension for retirees is about $400 a month, Bloomberg reports, but 40% of retirees are getting less than $260.

Remarkably, some supposed experts in America still argue that the system works just fine. Wharton economist Olivia Mitchell, who served on a Chilean reform commission in 2014-15, attributed some of the problems to Chilean workers' "widespread ignorance of how the system actually works" and the citizenry's "financial illiteracy." (Of course, as we demonstrated recently, despite her lofty academic perch, Mitchell's grasp of her own country's Social Security program isn't all that impressive.)

Chilean workers undoubtedly know the most important fact about their program: It's not delivering the retirement security they were promised. The program now stands exposed as a simple-minded device to get the government out of paying for pensions by slathering risk onto the workers. "The system was imposed during the dictatorship," economist Claudia Sanhueza, an advisor to President Bachelet, observed to Bloomberg. "Given its origins and the results, the system has no legitimacy."

Pinera is still talking as though the system he created works just fine. The evidence on the ground is all to the contrary, and the Chilean administration knows the facts are inescapable. Will the privatization lobby in the U.S. take the hint?