Lessons from Pension Reform in the Americas

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Chapter 15

The Pension System in Argentina

Rafael Rofman

Introduction

Founded more than a century ago, Argentina's pension system is one of the oldest in the world. Natural maturation and legislative changes progressively converted what was initially a highly fragmented contributive scheme into a mostly integrated model (see the discussion on system fragmentation later in this chapter). The current pension system enjoys growing fiscal support but declining coverage.

The 2001–2 fiscal and financial crises in Argentina created special interest in its pension system as many wondered about the resilience of the new funded schemes. Looking back a few years, to the worst of the crisis, it is clear that while the system and its beneficiaries suffered from the institutional confusion and financial turmoil, there are no lasting concerns arising from the crisis. The main challenges of the pension system continue to be around coverage, institutional design, pension fund managers' efficiency, and fragmentation—the same problems that a paper written in the late 1990s would have listed.

The Prehistory of Pensions in Argentina

The pension system in Argentina originated at the onset of the twentieth century, when in 1904 the government created a regime to cover civil servants. In 1915, with the creation of a program to benefit rail workers, the system began to expand to other sectors. By 1944 six autonomous national pension funds existed, covering approximately 7 percent of the labor force. Workers were able to retire as young as 47 years and could receive benefits close to 90 percent of their pre-retirement salaries. Not surprisingly, several of these funds had serious financial problems.

The legal and actual coverage of the pension systems expanded rapidly from 1945 to 1955, a period that saw a large number of social reforms. By 1956 almost every sector of the economy was covered by a pension scheme, and the proportion of the labor force effectively enrolled in the pension system was close to 30 percent. That same year, the number of beneficiaries was still relatively low, at around 500,000, or 25 percent of the population aged 55 years or older.

While the early programs had been designed as funded DC schemes, increasing financial problems and government interventions forced a conversion into PAYGO schemes. By the late 1960s most national programs were integrated into three centralized schemes: for civil servants, private employees, and the self-employed. To increase the financial sustainability of the schemes, the government adjusted the regulations. This reform was relatively successful; the system operated under reasonable conditions during most of the 1970s and early 1980s. However, by the mid-1980s, because of the continued aging of system participants and increasing informality in the economy, the system began to experience deficits. The government adopted a risky strategy that eventually backfired; to maintain financial stability, administrators ignored or 'reinterpreted' benefit indexation rules, which linked benefits to active workers' salaries. These actions resulted in a decline of the real value of benefits and the replacement rates. Beneficiaries' lawsuits against this practice rapidly multiplied, overwhelming the legal system and forcing the government to declare a state of emergency.

By the early 1990s the system was unsustainable, so the government proposed a structural reform. The debate about the proposed reform was difficult, as differences in ideologies and interests were large. However, after two years of debate, legislators approved a new law in October 1993 introducing a deep structural reform to the national pension system.

The Reforms

The 1993 pension reform was approved as the country was emerging from its most serious macroeconomic crisis in decades, having experienced two episodes of hyperinflation in 3 years; growing unemployment, informality, and poverty; and a sharp 15 percent decline in per capita GDP. The reform was partly inspired by Chile, where a funded scheme had replaced the old PAYGO system in the early 1980s.[1] The new design (SIJP, for Sistema Integrado de Jubilaciones y Pensiones, or Integrated Pension System) is a mixed model, with participation from the government and the private sector in its management, a combination of DB and DC components in the benefit formula, and financial arrangements that include PAYGO, funding, and tax financing elements.

The new model requires all workers in the private and the national public sectors (including the self-employed) to contribute 11 percent of their salaries; employers contribute 16 percent.[2] All workers must participate in the Regimen Previsional Público (the public pension scheme). They can also enroll in a funded, privately managed scheme. As a result, benefits have several components (see Figure 15-1).

	Public scheme	Private scheme	
Pillar II	Additional benefit ('PAP')	Annuity	Scheduled withdrawal
Pillar I	Basic universal benefit ('PBU')		

Figure 15-1. The integrated pension system (SIJP): benefit structure.

A worker retiring from the national system will receive a basic benefit (PBU, for *prestación básica universal*, or 'universal basic benefit'), equivalent to approximately 27 percent of the average wage at the time of the reform, as well as a benefit from the newer, smaller, publicly run PAYGO scheme (PAP, for *prestación adicional por permanencia*, or 'additional benefit'), or a benefit financed by his or her accumulated contributions paid in the form of an annuity or as a scheduled withdrawal.

The reform changed many aspects of the system, including its institutional setting, participation rules, risks distribution, and financing. These changes comprise four basic dimensions, which can be considered independently, although their implementations are deeply connected and sometimes mutually necessary due to political economy considerations.

The first dimension is a *parametric reform*. Most parameters in the system were modified, including:

- contribution rates, which changed from 10 to 11 percent of wages for workers' contributions;
- retirement age, which increased by 5 years for both sexes, to 60/65 years for female/male workers;
- required number of years with contributions to retire, which increased from 20 to 30;
- the benefit formula, which went from 70 percent of average of best 3 years for those retiring at the minimum age to an estimated 60–65 percent; and
- the indexation formula, which continued to be based on salaries but had stronger links to collection.

These changes, which increased revenue or reduced expenditures, were intended to improve the system's finances. Their implementation reduced both the expected number of beneficiaries and their average benefits, limiting coverage of the system.

The second dimension is a *benefit formula reform*. For many workers, the new system introduced a new level of uncertainty by switching part of the benefits from the traditional DB model to a DC scheme, or, more appropriately, an 'undefined benefit' model.[3] With the introduction of individual accounts, the state transferred to workers some risks, including those related to financial volatility and population aging. While these changes clearly improved the medium-term prospects for the state, transferring risks to workers was a change that could be considered problematic, as the pension system was also supposed to protect workers from those risks. Three characteristics of the new scheme were aimed at limiting the impact of these changes in workers: (*a*) the requirement to annuitize benefits at retirement (or to choose a schedule withdrawal calculated as an annuity), (*b*) the basic protection received by all workers from the PBU benefit, and (*c*) the minimum return regulation that reduces financial volatility in the system.

The third dimension affected the *financial scheme*. Since the mid-1960s, benefits had been financed by current contributions and treasury transfers, either through earmarked taxes or direct transfers. The new scheme, implemented in July 1994, reintroduced a funded scheme, with part of workers' contributions accumulating in individual accounts and used to pay benefits in the future. By diverting part of the contributions to the new pension funds, the reform further increased the system's dependency on transfers from the central government, at least in the short and medium term.

The fourth and final dimension of the reform introduced new actors in the system from the *private sector*. The newly created private companies would manage the pension funds for a fee. These managers are specialized companies, responsible for administering the individual accounts, investing funds, and paying benefits. They are also required to cover the cost of disability and survivor's benefits, for which they must get insurance from an outside provider.

Each of the four dimensions described above could have been implemented independently. The government could have addressed fiscal problems by simply adjusting the parameters of the system. It could have reduced its exposure to financial risks by introducing a variable benefit formula, as in the notional defined contribution schemes adopted in Sweden and other European countries. Similarly, it could have created funding to improve long-term financial sustainability without switching management or using individual accounts. The private management of these accounts was not a technical prerequisite for any of the other reforms.

Acknowledging that the pension reform in Argentina was in fact several reforms implemented at once allows for a clearer analysis of each of them and their outcomes, as well as the links between them. Several analysts (Kay 2001; Brooks 2002) have studied Argentina and other countries in the region, considering the pension reform processes from a political science viewpoint, and many public statements by those involved in the process are available. While the debate is far from being settled, it seems clear that the parametric reform would have had a small chance of being approved if proposed as an independent piece of legislation. However, because it was bundled with other reforms that involved potential benefits to capital markets and provided better alignment of interests for workers (due to the individual accounts) and managers (due to the participation of the private sector), it responded to the prevailing political climate in the early 1990s and received sufficient support to be approved.

The Impact of Reforms and the System in the Past Decade

Assessing the impact of the pension reform is a difficult task. Differences of opinion arise from the relatively short time that has elapsed since its 1994 implementation (given that it covers a lifecycle of 60 or more years), the lack of consensus regarding the actual goals of the reform, differences in relevance assigned to short- and long-term effects (which are in some cases contradictory), and a myriad of changes in the economic and social context as well as in the postreform legislation. Most debates about the reform and its impacts in Argentina rapidly evolve into a discussion on whether some particular trend can be attributed to the reform or to other social processes that have taken place in the same period, or whether the current system design is actually the result of the 1993 reform or the accumulated adjustments applied since that date.

In that context, this chapter considers the evolution and current state of the pension system in three separate dimensions, discussing the possible determinants of the observed changes, including the reforms of 1993 as a contributing factor. The dimensions are:

- fiscal, where changes in current and expected fiscal impacts of the pension system in the last decade are analyzed;
- coverage, where the role of the pension system as a provider of social protection is considered; and
- other indirect impacts, through institutions or markets.

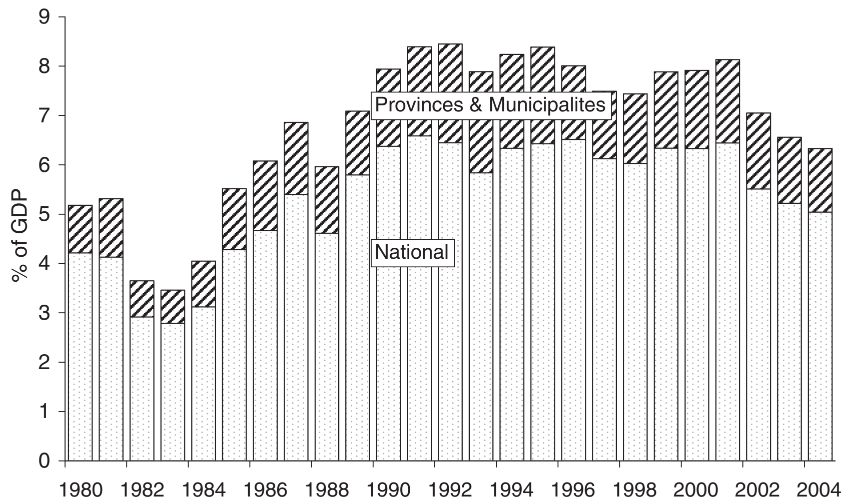

Figure 15-2. Pension spending by government level (1980–2004). (*Source*: Ministry of Economy 2005.)

The Fiscal Dimension

As discussed earlier, growing fiscal pressures were among the main triggers that initiated the pension reform process in the early 1990s. Pension expenditures at the national level had risen from less than 3.5 percent of GDP in the early 1980s to almost twice that number 10 years later. Aggregated expenditures (including provincial and municipal schemes) showed a similar trend, reaching almost 8.5 percent of GDP in 1992. Figure 15-2 shows that, with some volatility, expenditures after the reform stabilized at around 6.2 percent at the national level and 7.5–8 percent at the aggregate level. In addition, most projections show that expenditures should start to decline, as old retirees die and new beneficiaries receive benefits under the reformed legislation. As a result, expenditures should decline in the medium term, reaching 2–2.5 percent of GDP by 2025.[4]

While the reform appears to have already slowed down expenditures, the overall fiscal impact must be assessed considering the availability of funds to finance them. As in any country that replaces a PAYGO with a funded scheme, Argentina had a short-term cash flow problem that had to be solved. Because benefits of workers who were already retired continued to be paid and those retiring soon after the reform received a transitional benefit, the decline in expenditures has been a slow process. Moreover, when the funded scheme was introduced in 1994 the public system immediately lost revenues as individual contributions began to be directed towards the pension funds.

This 'transition cost' had to be financed until the system reached a new equilibrium. Some analysts (e.g. Baker and Weisbrot 2002) have argued that this cost was the main cause of the fiscal and financial crisis of late 2001 in Argentina. They estimated that if no reform had been enacted, the country's fiscal situation would have been much more solid, with small fiscal surpluses in most of the years between 1993 and 2001. These estimates, published soon after the crisis, received wide media attention and had significant political impact, yet they have some important flaws that cannot be ignored.

Baker and Weisbrot (2002) assumed for their calculations that the transition cost was stable at 1 percent of GDP during the whole period. They did not derive this figure themselves. Rather, they took it from an IMF (1998) report that introduced it without any discussion of how it was derived. An appropriate measurement of transition costs should consider the losses in revenue, which slowly grew as active workers switched from the PAYGO to the funded scheme, reaching 1.4 percent of GDP by 1999–2001. The measurement should also consider the savings produced by the parametric reform and the introduction of the funded scheme, which started paying some benefits soon after 1994. While this last figure is difficult to estimate, since no definitive counterfactual is available, there is no reason to assume it is negligible, especially considering the sudden stop in spending growth observed after the reform. Table 15-1 shows an estimate of these values. Column (ii) shows the difference between actual spending and a projection based on the growth of the elderly population and the growth of average benefits. (The negative values for 1994 and 1995 are the result of an increase in retirements immediately after the reform.) It is apparent that the transition costs between 1994 and 2001 went from a maximum of 0.9 percent of GDP in 1995 to 0.1 percent by 2001.

The transition cost in Argentina was actually manageable, and lower than in other countries in the region. However, the general fiscal pressures, increased by political conflicts and inflexible monetary policies, resulted in a major crisis in late 2001. In this context, the experience of Argentina indicates that a pension reform, as any other policy that requires important financial resources for several years, should only be implemented if this financing is guaranteed, or at least feasible.

The Coverage Dimension

The heated debates during the early 1990s about the fiscal implications of the pension system, or whether a funded scheme would operate more or

TABLE 15-1 Transition Costs and Other Related Policies in % of GDP (1993–2001)

	Transition Cost		
	Revenue Loss (i)	*Spending Reduction (ii)*	*'Pure' Transition Cost (iii) = (i) + (ii)*
1993	0.0	0.0	0.0
1994	0.3	−0.6	0.9
1995	0.8	−0.1	1.0
1996	1.0	0.2	0.8
1997	1.2	0.4	0.7
1998	1.3	0.6	0.7
1999	1.4	0.8	0.6
2000	1.4	0.9	0.5
2001	1.4	1.3	0.1

Source: Rofman (2006).

less efficiently than a PAYGO model, or whether the private sector would be more or less efficient than government, overlooked the topic of coverage, which should always have been in the center of the debate. Pension systems are social schemes designed to provide income protection to the elderly, under the assumption that if the task were left to them, most individuals would not be able to save enough during their active years. The problem of providing goods and services to the elderly has been present for most of mankind's history and was solved, with many instances of individual failure, through family or community support networks. It was only after the combined effect of the demographic transition (which resulted in smaller families) and the definition of labor as a marketable ability that could be exchanged for money that the traditional arrangements began to lose effectiveness. Social security systems were created to replace those schemes, due to the initiative of unions, employers, and lawmakers. In any case, and with many variations in design and implementation, the systems created during the last century were developed to provide income security to the elderly.

Due to its origins and a conceptual approach based on the Bismarckian model, the pension system in Argentina has been mostly contributive. The rationale is quite simple: pensions are payments designed to replace earnings when workers are forced to retire. Thus, the best way to assign these payments is by identifying those who were receiving payments for their work, and then replace these payments in a reasonable proportion.

While the early system designers focused on specific groups of workers, the system rapidly evolved into a national scheme. By the late 1940s it was clear that access to social security was considered a basic right of any citizen. In fact, a constitutional amendment approved in 1949 established the 'right to social security'. With this goal, new laws were approved to extend social security coverage to all workers, assuming that all workers would participate and the system would become universal. Logically, legal coverage extended much faster than effective coverage.[5] The number of workers contributing to the pension system expanded for several decades but as the system matured and labor market problems became more prevalent, the increase lost momentum. In the Buenos Aires metropolitan area, the percentage of salaried workers with contributions to social security was close to 80 percent in 1980 but declined to around 75 percent in 1985, 70 percent in 1990, and 66 percent in 1993—the time of the reform. This effect was compounded by the increase in unemployment.

Analysts have argued that the introduction of funded individual accounts in a pension system should result in higher participation, as a response to the incentives created for workers (Piñera 1991). However, opposing effects appear to have been much stronger, as the trend on coverage since the reform has continued to be negative. Figure 15-3 shows the proportion of the labor force contributing to a pension system in Argentina from 1992 to 2004.[6] The declining trend discussed earlier continued after the reform, as the percentage of the labor force paying monthly contributions to social security decreased from more than 45 percent in the early 1990s to less than 35 percent in the early 2000s. This decline was caused partly by growing unemployment, but the trend among occupied workers and even wage earners was similar.

The decline in participation since the early 1990s has been important, but the composition of this decline has become a serious problem, as Figure 15-4 shows. In the early 1990s participation by income among occupied workers was homogeneous, as the rates varied from 40 percent for the poorest to 60 percent for the fourth quintile. As the overall rate declined, the composition of the contributors changed dramatically. The two richest quintiles improved their participation rates, by 7 percentage points in the case of the fourth quintile and 17 points for the richest quintile. On the other extreme, the poorest workers saw their participation decline rapidly, as the second quintile reduced its participation from almost 60 percent to less than 20 percent, and the poorest went from 40 percent to under 2 percent.

Because the pension system in Argentina is mostly contributive, the proportion and composition of workers participating is important, since these factors determine workers' future right to receive benefits. However, the most relevant variable to assess the performance of a pension system is the percentage of the elderly receiving benefits, because the goal of the system is precisely to provide these benefits.

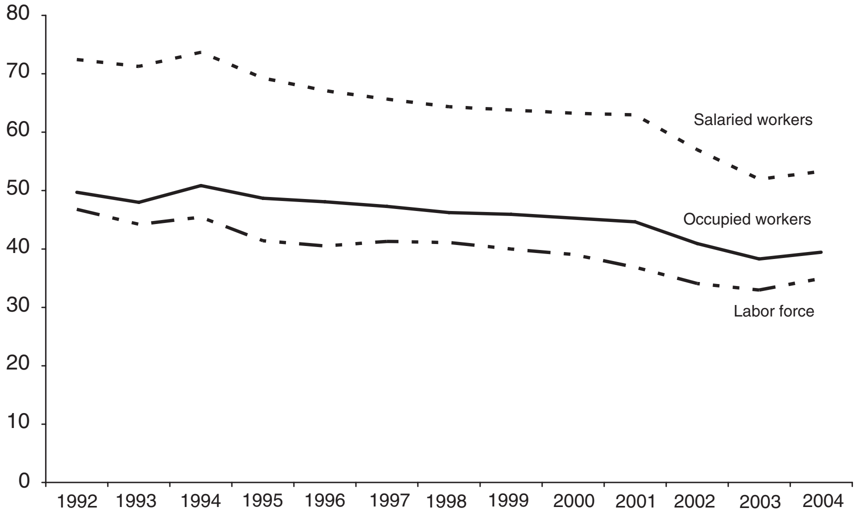

Figure 15-3. Rate of contribution of labor force, total and by income (1992–2004). (*Source*: Rofman and Lucchetti 2006.)

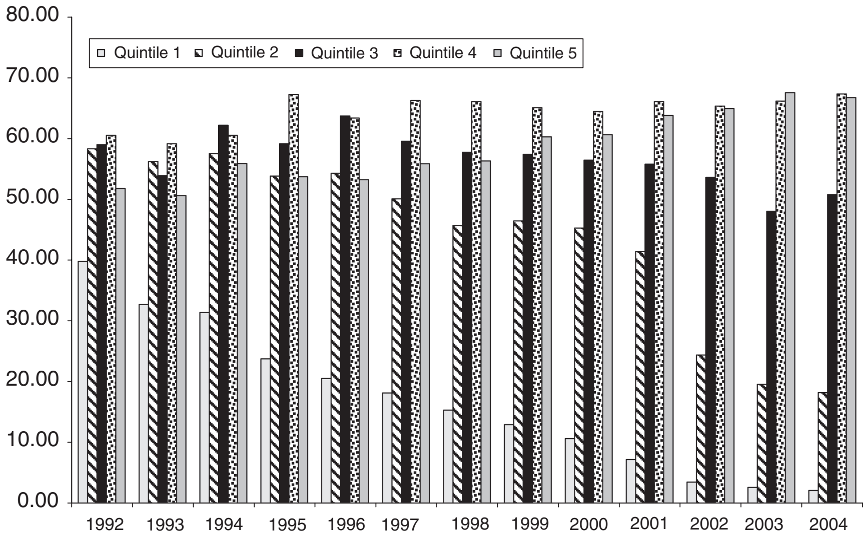

Figure 15-4. Participation of occupied workers by income decile (1992–2004). (*Source*: Rofman and Lucchetti 2006.)

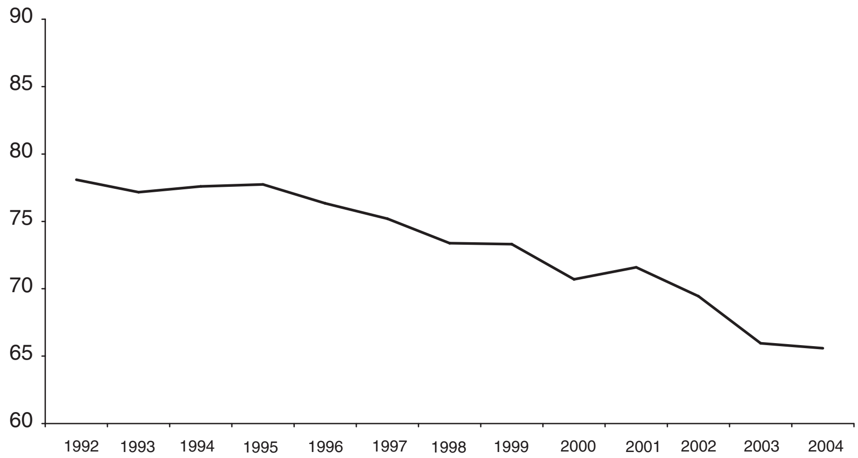

Figure 15-5. Coverage of the pension system among the elderly (1992–2004). (*Source*: Rofman and Lucchetti 2006.)

Data obtained from urban household surveys since the early 1990s show that coverage among the elderly reached a maximum by 1993–5, when 77 percent of the elderly were receiving a pension benefit, and then began to decline, by almost 1 percentage point per year, to 65 percent by 2004. This reduction was caused by the long-term negative trend in labor force participation and the introduction of stricter requirements in the system with the 1993 reform. It is important to mention that this data is not limited to the SIJP but considers as covered all individuals receiving benefits from other national or subnational schemes, including the noncontributory program (see Figure 15-5).

Other Impacts: Institutions and Markets

The creation of the funded scheme in the national pension system introduced several new areas of concern for analysts and regulators. Among the most relevant problems that deserve careful attention are (*a*) the role and performance of the institutions at the policy design, supervision, and operational levels; (*b*) the development of market conditions, competition, and costs; and (*c*) the investment policies, including regulations, managers' strategies, impacts on capital markets, and response to the financial crisis of 2001.

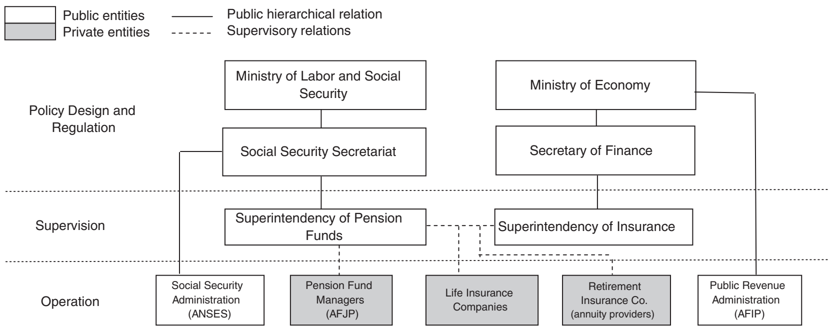

Figure 15-6. Institutional framework of Argentina's national social security system. (*Source*: author's own.)

The New Institutional Setting

When the new system was created in 1994, several institutions had to be organized or adapted to cover three functional levels (see Figure 15-6).

1. Policy design and regulations became the responsibility of the Ministerio de Trabajo (MT, or Ministry of Labor), through the Secretaría de Seguridad Social (SSS, or Social Security Secretariat), and, in some aspects, the Ministerio de Economía (ME, or Ministry of Economy), through the Secretaría de Finanzas (SF, or Finance Secretary).
2. Two public institutions, the newly created Superintendencia de Administradoras de Fondos de Jubilaciones y Pensiones (SAFJP, or Superintendency of Pension Funds) and the existing Superintendencia de Seguros de la Nacion (SSN, or Superintendency of Insurance), became responsible for overseeing activities of the private agencies and issuing lower-level regulations.
3. Finally, four groups of institutions took operational responsibility:
   a The Administración Nacional de la Seguridad Social (ANSES, or National Social Security Administration), an autonomous agency under the SSS, continued to manage the residual PAYGO scheme, including paying benefits to retirees under the old system, paying PAYGO benefits to those that chose the public scheme for the second pillar, providing basic pensions for all new retirees, and paying transitional benefits to those with contributions before the reform.
   b Specialized companies, Administradoras de Fondos de Jubilaciones y Pensiones (AFJP, or pension fund management companies), became responsible for managing the new pension funds. Directly supervised by the SAFJP, they manage individual accounts, invest assets, and process and pay benefit requests.

c Existing or newly created insurance companies, under the direct supervision of the SSN and, for some tasks, the SAFJP, became responsible for managing insurance schemes, including disability and survivor's policies for the AFJPs and annuities for beneficiaries.
d Finally, the Administración Federal de Ingresos Públicos (AFIP, or Federal Public Revenue Administration) continued to collect all contributions and distribute them to ANSES and the pension funds.

The performance of these institutions since 1994 has varied. At the policy design level, the role of the Ministry of Labor and the Social Security Secretariat was weaker than originally expected. Many policy initiatives came exclusively from the Ministry of Economy, and the political space of the SSS slowly declined, as they lost staff and budget. The 'emergency mode' that defined most policy decisions in the late 1990s and early 2000s in Argentina reduced the relevance of analytical areas in the government, a trend that was particularly damaging for the social security system. Hierarchical lines were rarely respected, and in many cases the Ministry of Economy or the president appointed authorities to ANSES and the Superintendency of Pension Funds without consulting the Ministry of Labor.

While the supervisory agencies have an autonomous status that should preserve their independence from political pressures, the experience during the first 10 years of the new pension system shows that this independence is limited when pressures are strong enough. The role of the SAFJP has been different from that of SSN, as the former has made important efforts to be proactive and focus its attention on protecting the workers' interests while the latter has had a more traditional approach, preserving 'system integrity' even if that means affecting beneficiaries' rights.

At the operational level, since the mid-1990 ANSES has had a strong record of implementing institutional improvements and simplifying processes. They have increased transparency and reduced delays in granting benefits, and taken some steps to reduce fraud. However, ANSES still has much to do in terms of achieving efficiency, transparency, and political independence. The agency manages a huge budget—nearly 40 percent of the total national budget—which unavoidably makes it the focus of many political interests.

Much controversy surrounds the role of AFIP, as the sole institution responsible for collecting and enforcing contributions to the social security system. Supporters of this arrangement have argued that, because AFIP manages all contribution databases for national taxes and social security, it has the advantage of being able to crosscheck information and enforce payment. Opponents, on the other hand, have argued that social security is too low in the AFIP's priorities, as most salaried workers are employed by relatively small firms or are independent workers. Meanwhile, AFIP efforts are focused on a small group of high contributors who are responsible for as much as 80 percent of revenues from income and value-added taxes. However, because they are not labor-intensive companies, their share in social security contributions is much smaller. There have been many proposals to separate the collection of taxes from social security contributions, including plans that would transfer this function to ANSES or to a new independent agency. The government implemented this last proposal in 2001, with the creation of the Instituto Nacional de Recaudación de los Recursos de la Seguridad Social (INARSS, or National Institute for Collection of Social Security Revenue), but this institute was never fully functional and closed a couple of years later.

Market Development: Competition and Costs

When the government instituted the new private system in 1994, 24 managing companies started operations. These AFJPs were owned by a diverse group of stockholders, including banks, insurance companies, government-owned agencies, health services providers, individuals, and even a soccer club. Almost 85 percent were from financial institutions, and 69 percent were domestic. The evolution of the market composition has been rapid. By the end of 2005 there were only 11 AFJPs. Of stockholders, 76 percent were from financial institutions, and only 58 percent were domestic. Concentration has also evolved. In 1995 nearly 50 percent of affiliates were enrolled in the four largest funds. By late 2001, this percentage had grown to 75 percent, falling to 61.5 percent by early 2007 (SAFJP 2007).

Although the new funded scheme was optional—workers could choose between it and the second pillar—whenever a worker did not make an explicit choice, administrators would assign the worker to an AFJP. During the first year of the new system, nearly 50 percent of workers registered in the SIJP had chosen an AFJP, 41 percent had chosen the PAYGO scheme, and 9 percent had been randomly assigned to an AFJP. Over the next 9 years, the proportion of assigned workers steadily grew; by mid-2005, 4 out of every 10 workers affiliated with an SIJP had entered the system through this channel.

As in other Latin-American countries, market competition has been a serious concern for regulators. Demand has shown low price elasticity, and the managing companies' returns became extremely high, particularly in the late 1990s. From the introduction of the system to late 2001, average fees were stable, at around 3.5 percent of wages. Meanwhile, operational costs declined as early investments were amortized and economies of scale realized. Consequently, returns in the industry grew rapidly: by 1999 and

2000 returns on equity were over 20 percent. However, these rates declined and became negative in 2002 and later, mostly because of poor financial management.

The history of competition among the AFJPs has been strongly defined by changes in regulations. We can identify 4 different periods, with different determinants and outcomes. The first period goes from mid-1994, when the AFJPs began enrolling workers, until the end of that year, when efforts to attract individuals to the funded scheme ended. During this period, the managers focused on capturing the largest possible share of the new market, developing large networks of branch offices and sales forces and making large marketing expenditures. The tight link between commercial expenditures and the number of affiliates each AFJP obtained shaped the future distribution of the market. Regulatory decisions reinforced this trend by randomly assigning workers who did not explicitly choose a company in proportion to the market share of each fund.

By early 1995 AFJPs entered a second phase when they were authorized to transfer affiliates. Consequently, the number of salespeople declined by nearly 75 percent, and a new period of relative calm but growing competition began. The ratio of annual transfers went from 19 percent in 1995 to 26 percent in 1996 and 32 percent in 1997. As the trend was accelerating (the annualized rate for the second semester of 1997 reached 38 percent), expenditures in sales force rapidly increased and concerns about the 'inefficient spending' of the industry became widespread. After many discussions, the Superintendency of the AFJP issued new regulations complicating transfers. Most AFJPs responded by rapidly reducing their marketing efforts.

From early 1998 to late 2001 the market was very calm, with few efforts to expand the overall contributor base and even fewer efforts to attract affiliates from other AFJPs. Only one AFJP showed significant net gains in affiliates, increasing its market share by an annual rate of 10–15 percent. The overall ratio of transfers to contributors sharply declined to one-third of its previous value. Marketing costs, which in 1997 had accounted for more than 50 percent of operational costs, also declined, by nearly 40 percent in 3 years.

The most recent period began when the fiscal and financial crisis of 2001 directly affected the AFJP industry. The economic turmoil created confusion, and two important reforms enacted in November of that year altered market conditions: (*a*) workers' contribution rates went from 11 to 5 percent of gross wages, and (*b*) a change in insurance policies brought these costs to nearly zero in the short term. Reacting to these changes, AFJPs sharply reduced their fees, which resulted in little change in competition or transfers. Other changes, such as the creation of a new AFJP in 2001 and the differential impact of the financial crisis, had some minor effects, though by mid-2005, transfers were still very low.

The insurance industry has had a different history. Insurers that provide death and disability protection do not compete to attract workers. Rather, they sell their policies to the AFJPs, usually within the same economic group. While analysts, policymakers, and industry experts have discussed the determinants and evolution of AFJP costs, the analysis of the life insurance market has been less intense, probably because the supervisory agency has a less proactive attitude. Regulations state that AFJPs must select their insurer through a competitive process, whereby they publicly request bids every year. However, with very few exceptions, AFJPs hire insurance companies within their economic group at rates that are not transparent.

Designers of the funded scheme expected the cost of death and disability insurance to be around 1 percent of taxable wages. In the early years of the system, mortality was much lower than expected, and market analysts disagreed on whether these numbers were in line with the long-term expected rates or whether there was a delay in claims processing that would eventually catch up. As claims increased over the next few years, so did rates. These rates in part reflected the higher actual payments but, given the observed delay, they were also affected by concerns about future increases in claims. By 2001 the average insurance costs had grown by 60 percent compared to the 1995 rates. Most analysts agreed that these costs would continue to grow.

In late 2001 the government enacted a new regulation allowing insurance companies to disregard expected payments. Consequently, costs rapidly declined to less than 0.5 percent of salaries but then began to grow again. By early 2007 they had reached their highest level ever, at 1.41 percent of salaries (SAFJP 2007). Although some analysts have argued that the growing costs are because the medical boards responsible for assessing disability claims are overly lenient, a report from the Superintendency of Pension Funds shows that these boards have been very consistent over the years, with an approval rate of around 60 percent of claims (SAFJP 2004). Furthermore, the data show that the absolute number of claims has been stable since the comparable data was collected in 2000.

The Investment Policies: Regulations, Strategies, Crises, and Responses

Asset management under the new funded scheme has also been the target of controversy. The law and regulations were restrictive regarding diversification—setting maximum investment limits by type of instrument and issuer—and required minimum risk ratings to increase security. Regulations also limited international diversification, as in other countries in the region. Following Chile, the Argentine system also includes a guaranteed minimum return, defined as either 70 percent of the market average or the average minus 2 percentage points, whichever is lower.

Portfolios have been highly concentrated in domestic government securities, nearly always at the established limit of 50 percent, or even higher because of valuation changes and short-term regulation adjustments. The high incidence of public debt during most of the period can be explained by the high returns generated by these instruments. However, during the 2001–2 crisis, when authorities actively promoted and sometimes required that the AFJPs increase their exposure, this percentage went well beyond the limit (see Table 15-2).

Regulations on diversification have not been binding, except in a few particular cases. This is also true for investments in foreign assets, as the maximum limit has been 17 percent of the funds' value and actual investments never exceeded 10 percent. On the other hand, the minimum return guarantee has had an important effect both directly—several AFJPs have had to compensate their affiliates for low returns—and indirectly—pension fund managers tend to replicate their investment strategies to avoid falling below the minimum return.

Despite the controversies over the impact of the 2001–2 crisis on the financial status of the pension funds, real returns in the system have been reasonable over time. Analysts and fund managers predicted in early 2002 that the government default would result in a catastrophic loss for the pension funds, by as much as 45 percent.[7] These assessments were exaggerated, the result of comparing nominal dollar values of assets before and after the default and negotiations. The actual evolution of pension funds' real returns should be measured in local currency. The pension funds have produced an average real return of nearly 10 percent per year since 1995. While volatility has been important, in some cases it can be attributed to a delay in adjusting valuation to the actual conditions of the market (see Figure 15-7).

What Is Next?

The pension system in Argentina appears to have survived the worst of the 2001–2 crisis in relatively good condition, but several problems that preexisted it were somewhat worsened and require urgent attention. Public debate about the pension system has been focused on topics that appear to be relevant in the short term but have little if any importance in terms of long-term strategy. Meanwhile, some of the most important structural problems—such as declining coverage, dysfunctional institutional design, weak competition, high costs in the funded scheme, and residual fragmentation—have been neglected.

TABLE 15-2 Portfolio Composition of Pension Funds (in %)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*
Cash	2.3	2.2	1.4	1.4	1.9	1.1	0.7	2.3	0.9	2.5	1.5
Government bonds	51.5	51.8	49.3	44.6	51.3	53.0	53.3	77.8	75.2	67.4	59.6
Bank deposits	27.1	17.6	16.4	23.0	18.1	15.2	15.4	2.1	3.2	4.2	7.4
Equity	2.0	13.5	21.8	20.9	17.3	16.6	11.5	8.3	8.2	10.4	13.0
Corporate bonds	6.8	10.7	4.8	2.3	2.3	2.4	2.3	1.3	1.3	2.1	2.1
Mutual funds	4.2	1.5	4.1	5.5	6.5	5.5	11.6	1.0	1.1	2.7	4.7
Foreign assets	2.8	0.4	0.4	0.4	0.2	4.4	3.4	5.6	8.3	9.4	9.9
Other	3.4	2.4	1.8	1.9	2.3	1.8	1.7	1.6	1.8	1.4	1.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: SAFJP (2005).

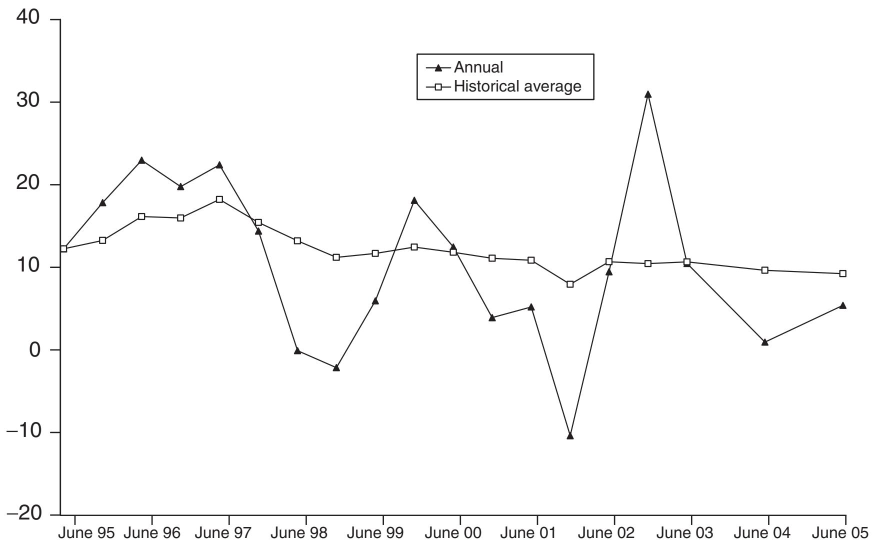

Figure 15-7. Pension fund real annual returns. (*Source*: SAFJP 2005.)

Coverage

As discussed earlier, workers' participation in the pension system has steadily declined in the past two decades, a process that reflects deep changes in the economic structure and the labor market at the national level. This decline cannot be fully explained, nor can it be fixed with reforms. However, to continue performing its role as a provider of income security to the elderly, the system must adapt to the new reality.

There are several areas where policymakers might have an impact, and each of them should be carefully considered. First and foremost, at the national level, Argentina has a fragmented model that could be better integrated to improve coverage and reduce gaps. The 3 schemes of basic benefits—the PBU, or basic benefit for those retiring under the standard system, received at age 60 or 65 years with a minimum of 30 years of contributions; an 'old-age' benefit, received at age 70 years with a minimum of 10 years of contributions; and a noncontributory benefit—are sometimes inconsistent and exclude many potential beneficiaries. Several measures in recent years have attempted to repair these inconsistencies, including reforms in the noncontributory pension scheme and a simplification of rules for back payments for the self-employed (a de facto reduction in the requirement of 30 years with contributions). However, these changes are not part of a clear strategy to expand coverage, especially for the poorest.

As of 2005, nearly 60 percent of expenditures were being financed with taxes or transfers, and this proportion is likely to decline in the future. Given that the public system has clearly moved away from a purely contributive financing scheme, the division between contributive and noncontributive schemes has become somewhat artificial, and a serious discussion of the reasonability of continuing to discriminate among beneficiaries on this basis is necessary. While sharp changes in the benefit structure are not possible or desirable for political, social, and legal reasons, authorities could try to focus the debate in the system design for the medium and long term, and discuss the transition mechanisms to reach that model later.

Institutional Design

The institutional design of the pension system at the national level in Argentina is good, with clear separation of policymaking, supervisory, and operational roles among institutions. However, these roles are not always respected, and the limits between these three levels are often blurred.

Correcting this problem is not simple, as political forces tend to override normative structures, yet it might be possible to improve it by reinforcing the existing model and by prohibiting officials and institutions from going beyond their assigned functions. Legislation could be made clearer regarding the definition of ANSES as an operational agency with no policymaking responsibilities, or authorities could reinforce the independence of the Superintendency of AFJP. However, taking these steps would certainly require strong political commitment from current and future authorities.

Alternatively, the government could redesign the institutional structure, reducing the number of agencies and abandoning specialization as the main organizing principle. Thus, ANSES could take on both policy design and operational functions, which would give it a much higher status in the government structure, perhaps at the level of a ministry. Other countries have taken this approach, which has some advantages, as it eliminates the source of institutional conflicts, but also carries risks, as it concentrates too much unsupervised power in one institution.

Competition in the Funded System

By bringing in multiple private providers to manage the pension funds, the system designers had hoped that market competition would bring about improved services and declining costs. However, the providers have focused most of their competitive efforts on marketing, with only a few cases where differences in costs, services, or returns had a relevant role.

Inadequate incentives for participants are the primary cause for this lack of competition. Affiliates have shown little interest in switching to the least expensive or more profitable pension fund, and system regulations have done little to reverse this situation. The original legislation made switching pension funds difficult, and regulations made the task even more so.

Because the government creates the rules to assign workers who did not choose an AFJP, it has a powerful tool for promoting competition. However, until 2001 the criterion used to assign workers was not pro-competitive. Originally, they were distributed in proportion to the number of workers enrolled in each AFJP. Nearly 3.7 million workers were assigned following these criteria. In 2001 legislators implemented a new criterion whereby 'undefined' workers were enrolled in the least expensive pension funds, at a time when the flow of new affiliates was much smaller—only 1.1 million workers were assigned with this criterion between 2001 and 2005.

Experiences in other countries show that enhancing demand awareness is difficult but some actions, such as public information campaigns, can increase it. Others, such as simplifying switching procedures, can facilitate switching. Peru recently changed its regulations to permit switches through the Internet and enabled managers to sign workers to long-term contracts. This change was immediately followed by the entrance of a new provider in the market and a sharp reduction of fees by all participants. In Chile some have proposed allowing group and long-term contracting. Other countries have implemented more ineffectual changes. In Colombia, for example, policymakers tried to set up a maximum fee, but all managing companies adjusted to the maximum fee without any competition.

System Fragmentation

The pension system in Argentina was born as a fragmented model, with many institutions and schemes operating in parallel. For most of the twentieth century, each government, knowing that fragmentation had led to inequities and sustainability problems, tried to integrate these pension schemes. In this context, the reform of 1994 and the transfer of provincial civil servants to the national system was aimed at unifying the social insurance system at the national level.

The integration trend lost momentum in the late 1990s, and more than 100 independent schemes that cover provincial level civil servants or professional groups still exist, with insufficient supervision and coordination. Many of these programs are very small, with their own rules and financial schemes. While many are well managed and requirements are stricter than in the national system, workers usually suffer due to problems of portability, and the medium- and long-term sustainability of the programs is not clear. Recent legislation appears to be intensifying fragmentation, with the creation of several new civil servant and professional funds at the provincial level and the reinstatement of special schemes within the national system for occupational groups.

As in any social insurance scheme, integration of systems appears to be a desirable strategy. Larger pools are better able to distribute risks, and multiple systems unavoidably generate inequities across the population. Policymakers should renew the drive towards integration, either institutionally—that is, progressively integrating all systems into the national SIJP—or by developing a better coordinated supervision system, ensuring access, sustainability, and equity across the system.

Recent Changes

In late 2005 Argentina's government began to refocus its interest in the pension system. Several reforms approved since then have had and will have a significant impact on the system's operation and performance. In 2005, under a generous financial agreement, the government approved a program that would allow individuals who had been self-employed before 1994 but had failed to make contributions to pay off their debt. This program originally seemed like a minor collection measure but turned out to be a de facto universalization of the system. Lower-level regulations established that all these workers could apply for retirement benefits immediately after making the first installment of their payment plan, and that they would receive benefits as long as they continue to pay their monthly obligation. Though no official data is available, it has been estimated that by December 2006, 1.5–2 million new beneficiaries had been added to the system, nearly doubling the number of beneficiaries.

In early 2007 the government announced a legislative reform expanding the role of the public system by automatically assigning unaffiliated new workers to the public system, raising its replacement rate, and allowing workers in the private system to switch back to the state-managed system. Other changes proposed in this reform include the elimination of disability and survivors insurance, as these benefits would be financed directly by the pension funds, and the introduction of a maximum fee for AFJPs to reduce costs.

While it is still too soon to assess the impact of these proposals on the pension system in Argentina, they will probably result in a much smaller private pillar, with a role limited to providing complementary benefits to a relatively small proportion of middle- and high-income workers.

Notes

[1] The Argentine reform also included elements from the Peruvian system. For a full discussion of that system and the Chilean system, refer to Carranza and Morón (this volume) and Arenas de Mesa et al. (this volume).
[2] The system includes more than 80% of the labor force; the only workers not covered under the national scheme are the police, the military, civil servants at the provincial level in 14 of the 24 provinces, and independent professional workers (lawyers, engineers, medics, etc.) working at the provincial level.
[3] This concept was proposed in an international workshop by Elsa Rodriguez Romero, an Argentine expert on pension law, who noted that the new schemes are characterized not by the fact that the contribution is known, but rather by an unknown future benefit.
[4] Rofman, Stirparo, and Lattes (1997) estimate that, by 2025, the national system would be spending 2% of GDP; Grushka (2002) estimates expenditures of 2.4%; and the SSS (2005) estimates expenditures of 2.15%.
[5] Measuring coverage in pension schemes is a complex issue. Problems in definitions, availability and quality of data, and interpretation of indicators have produced controversy and confusion. This chapter considers that workers who contribute to a pension system are covered by it during their active years, and coverage among the elderly is estimated by comparing the number of individuals aged 65 years and older with retirement benefits with the total population of that age. For a discussion of problems, limitations, and caveats in definitions and data, see Rofman (2006).
[6] The household surveys in Argentina do not ask about contributions of the self-employed. Data shown in this chapter assumes that all self-employed are uncovered, an assumption that underestimates coverage but not significantly. According to registration data, the proportion of the self-employed contributing to social security has been around 10%, which would increase the overall coverage by approximately 3 percentage points.
[7] This figure was included in a press release issued by the UAFJP in March 2002, as reported by Cronista (2002).

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