Privatising Pensions in the Context of Stabilisation and Structural Adjustment:
The Case of Argentina

ABSTRACT

The Argentinean economy experienced a radical neoliberal transformation during the ten-year Peronist Menem administration in the 90s. In was in this context that Argentina resorted to a partial privatisation of its old-age security scheme. My paper will deal with the relationship between pension reform and economic policy in Argentina, analysing the political economy of the reform process as well as the possible economic impact of the pension reform on state finances, the labour market, the financial sector and monetary policy.

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I. Introduction

The Argentinean economy experienced a radical transformation during the ten-year Peronist Menem government in the 1990s. Neo-Peronism impressed the international community by successfully ending hyperinflation and boosting economic growth through the introduction of a currency board and the strict implementation of orthodox policies like privatisation, liberalisation and deregulation, allowing the resumption of access to international credit markets.

It was in this context that Argentina resorted to a partial privatisation of its old-age security scheme. In 1994, a new mixed pension system was implemented, combining a Pay-as-you-go-financed (PAYG) uniform basic pension with individual fully funded (IFF) pension accounts managed mainly by private fund administrators. The Argentinean pension reform was clearly supported by the neoliberal turn politics took under Menem, favouring market solutions and radical reforms to recover credibility.

My paper will deal with the relationship between social security reform and economic policy in Argentina. Following a brief outline of the historical context, I will turn to the reform process in the 1990s and analyse the political and economic reform context and the eventual outcome after a two-year discussion process. I will then comment on the possible economic impact of the pension reform on public finances, financial sector and capital market development, labour markets and finally, monetary policy and the compatibility with the currency board arrangement.

I will show that economic objectives played a major role in the design of the Argentinean pension reform, although the democratic reform context introduced several modifications to former proposals of the government and pension experts, which resembled more the Chilean private model. Yet, evaluating the Argentinean growth perspectives for the future, the convertibility plan – successful in stabilising the inflation rate – seems to act rather as a straightjacket concerning the development of productive investment and employment possibilities, whereas a privatisation of old-age insurance implies a considerable fiscal burden in the short run, individualisation of risks, and rather insecure future growth effects in the medium and long term.

II. Social Security and Economic Policy in Argentina: Evolution and Problems

The renewed interest of economists1 in social policy issues and specifically pension systems can be seen as helpful and harmful at a time: on the one hand, light is shed on the close relationship between welfare state development and its economic context as well as the influence of dominant economic paradigms on social policy formulation. On the other hand, the complexity of this relationship has often been reduced in favour of oversimplified or even false interpretations concerning the problems of public PAYG pension systems or the virtues of their paradigmatic counterpart – private fully funded ones. Additionally, economic objectives seem to have gained priority within the reform debate, neglecting the social and political dimension of mandatory insurance schemes.

The following analysis tries to focus on the specific constraints, which the economic sphere imposes on the social policy sphere. This refers to economic resources available for social insurance and programmes as well as to policy design and reform options regarding social security systems, which in turn are strongly influenced by the development strategy chosen by local governments. In Latin America, the rupture with inward-oriented policies and the growing dependence on capital inflows in the context of neoliberal stabilisation policies has given leverage to recommendations of international credit organisations and increased the need to demonstrate market-friendly reforms.2 Although guiding principles in the area of

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1 There was an intensive debate about the economic effects of social security systems starting in the 1960s in the U.S., see Samuelson (1958), Aaron (1966), Feldstein (1974), for an overview Thompson (1983).
social policy are not always totally coherent with the chosen economic model in a specific period due to institutional inertia (or path dependency), there are strong trends towards harmonising the logic of the different policy areas as will be shown in the following paragraphs on the development of the Argentine welfare regime.³

As in other Latin American pioneer countries in social security development, the evolution of the Argentinean pension system has been pushed forward by influence of powerful pressure groups and populist-corporatist state action, based on the Bismarckian social security model of contribution-financed pension benefits for employees and their families (Mesa-Lago 1978).

State employees and the well organised labour aristocracy (railway transport, energy, banking, communications, merchant marine etc.) were the first to be covered by social insurance schemes from the beginning of the last century on. Nevertheless, in 1944 only 7% of the economically active population were covered by different old-age insurance schemes. Only during the two-term government of General Perón legal coverage of social security reached universality by integrating weaker groups of urban workers as well as agricultural workers, self-employed workers and domestic servants into the public pension schemes (Mesa-Lago 1991: 6). The young demographic age structure as well as the progressive integration of new contribution groups into the pension schemes provided a comfortable financial basis during the first decades. The horizontal (groups of insured) and vertical (benefits) expansion of the Argentinean Welfare State was consistent with the dominant economic development model of the post-war era, characterised by growing state intervention, protectionism and deficit spending. The development strategy of import-substituting industrialisation was financed via a soft budget constraint for state finances and social expenditures and growing external indebtedness.

However, inflation and investment of social security funds in public bonds with negative real interest rates led to a decapitalisation of pension reserves, whereas the growth-cum-debt model failed to provide the resources for honouring the accumulated social debt of the state (Nitsch 1996).⁴ At the same time, pension programmes in the pioneer countries became mature and reached the limits of coverage expansion.

One consequence of the erosion of pension funds and growing maturity of the system was a de facto change of the financing method: Argentina moved from its original collective capitalisation scheme to PAYG-financing in 1954, underlining the solidarity and redistribution function of social security and stimulating effective demand within the full-employment model of the populist Perón government.⁵

The specific evolution of social security programmes in Argentina gave rise to a number of problems:

Due to the coverage extension following occupational sectors the system was highly fragmented and consisted of multiple funds, each with different legislation and management, benefits and contribution rates. This meant not only efficiency losses and high costs, but also raised problems of inequality between different groups of the insured. Entitlement conditions (such as service years, age of retirement, benefit calculation formula) were lax, with a weak contribution-benefit linkage, whereas replacement rates - even for early retirement and invalidity benefits - were generous, especially in privileged systems, for such people as high rank civil servants.⁶ Contribution rates as well as state subsidies were elevated, at the same time the evasion and underreporting of income increased, resulting in worsening system dependency ratios (ratio of active contributors to pensioners), high payroll taxes and rising public transfers. Growing financing problems and inequities had a negative impact on the

³ See also Isuani 1998 and Lo Vuolo 1991.
⁴ Public debt vis-à-vis social security reached 4 Bio. New Pesos as soon as 1966, see Mesa-Lago 1978: 192.
⁵ An extensive analysis of this populist-Keynesian policy can be found in Lo Vuolo 1991 and Isuani 1998.
⁶ For a detailed analysis of the former pension system in Argentina see Schulthess/Demarco 1993, see also table 2
economy and worked as an incentive for evasion, especially when pensions were not properly adjusted to inflation. Finally, the advanced age of the programmes and demographic changes (e.g. increasing life expectancy, sinking fertility rates)\(^7\) contributed to the financial and actuarial disequilibria of the pioneer pension systems in Latin America.

The first serious attempt to unify and standardise the fragmented and stratified Argentinean pension system in 1967, aiming at more cost efficiency and equity, did not get very far. Neither did the orthodox modernisation project of the military government in 1976 change the basic rules in social policy, as full employment and public social benefits were seen as indispensable for legitimising authoritarian rule.

Financial problems in the pension scheme aggravated severely when the 1980s economic and financial crisis and subsequent stabilisation and adjustment plans diminished public resources for social policy, just when the need for compensatory state measures in the context of economic recession and growing social costs had become urgent (Mesa-Lago 1995).

Although the almost universal coverage of social security in Argentina helped to alleviate some of the consequences of the debt crisis (Mesa-Lago 1994), erosion of real pensions reached politically and socially unsustainable dimensions. Since the mid-eighties, Argentinean pensioners successfully sued the government in the courts against the downsizing of pension benefits due to insufficient inflation adjustment. The erosion of real pension benefits happened in spite of growing state subsidies\(^8\), earmarked taxes and several emergency laws, and average replacement rates fell to a minimum of 40% instead of legal rates from 70-82% (1990). It was only within the comprehensive debt restructuring in the context of the convertible plan that accumulated pension debt of more than 12 Bio. US$ was recognised. Between 1991-92, the new Menem administration issued long-term pension bonds and dedicated 4.5 Mio US$ of the privatisation revenue of the national petroleum company to the purpose (World Bank 1996), while at the same time urging for a structural reform of the social security system.

III. The Reform Context: New Pension Orthodoxy and Neo-Peronist Transformation

Recent studies about the political economy of pension reform (Mesa-Lago/Müller 2001, Madrid 2001, Brooks/James 1999, Müller 1999, Kay 1998) contributed a great deal to the understanding of a dynamic that, not so long ago, was thought to be highly improbable and little attractive to policymakers due to the extensive fiscal and political costs involved (Pierson/Weaver 1993, Pierson 1996). Despite the emergency state in various Latin American pension programmes, social scientists were surprised by the wave of systemic reforms in the region, meaning total or partial replacing of the public PAYG system by private, fully funded pension funds (IFF).\(^9\) This profound paradigmatic change, which involves a shift from the intergenerational-contract of PAYG financing to individual capital accumulation for retirement as well as market provision of pensions substituting for the state as the main supplier of old-age income (Müller 2001) has been explained by a combination of external and internal factors that helped to overcome the difficulties of previous attempts to restore financial viability and to increase equity via parametric reforms.\(^10\)

The strongest argument within this line of thinking, capturing the global trend in social security reform, seems to be the influence of dominant economic paradigms promoted by international finance institutions (IFIs) like the World Bank, the IMF or the IADB, and the

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7 World Bank 2001: The old-age dependency ratio (population aged 20-59/aged over 60) was 3.7 in 1995 and will be 2.4 in 2040, the percentage of population aged over 60 will increase form 13.2% 1995 to 21.3% in 2040.
8From 1985-91 they reached 20-30% of benefit payments, Isuani/San Martino 1995: 47
10 See Müller 2001 for a good survey of the political economy explanations of radical pension reform, also Huber 1999,
transfer of this neoliberal logic to the social policy sphere. The World Bank has actively promoted structural pension reform based on a multipillar model with a strong capitalisation component for several years. Nevertheless, international role models like World Bank model (based on the Chilean privatisation experience) are not simply copied or imposed on countries without modifications. International pension reform blueprints are modified and adapted to the local reform context due to institutional legacies, specific actor constellations and internal power balances, the degree of economic and institutional crisis and last but not least, the economic development context and the role, international investors and IFIs play within this context.

In the following sections I will outline the context of the Argentinean pension reform referring to international factors as the Chilean reform experience and the World Bank model, the economic context as well as the political background of the reform process.

III.1. The New Pension Orthodoxy: Learning from the Chilean Experience

Under dictator Pinochet's rule Chile was the first country world-wide to radically reform its public pension system introducing privately administered pension funds, operating on the basis of individual fully funding (IFF). Although the system was privatised before the country was hit by the debt crisis of the 1980s, its structural problems had already become urgent during the early 1970s: more than a hundred independent pension programmes operated without any effective co-ordination, privileges and inequities were widespread and payroll taxes for total expenditures reached 17% of GDP in 1971 (Mesa-Lago/Arenas de Mesa 1997: 406).

Based on a strong market-oriented ideology and extraordinary powers vis-à-vis civil society Pinochet managed to surpass the reform blockade created by influential pressure groups that had impeded numerous reform attempts during the past. The Chilean pension reform under authoritarian rule consisted of two stages: During a first step in 1979, important measures to eliminate privileges, uniform and standardise entitlement conditions were taken, and the retirement age was raised to 60/65 for females/males.

In May 1981, the military government eventually introduced the radical reform of its former pension system, closing down the old public system by prohibiting new entries and substituting it with the private IFF scheme. Pensions within the new system are paid out of the accumulated funds on a strictly actuarial basis. The state, however, continues to play an important role in the compulsory private scheme in terms of regulation and supervision, transition cost financing and extensive guarantees to the insured and pensioners (Mesa-Lago/Müller 2001: 4).

Despite its good performance during the 1980s and in a context of high growth rates, it was only after endorsement of the pension reform by the newly elected Chilean government at the beginning of the 1990s that the Chilean pension system could evolve as an international reform model for democratic policymakers elsewhere.

Equally or even more important for the wave of systemic pension reforms following the Chilean model during the 1990s, however, was the promotion of multi-pillar pension systems by the World Bank. This happened in a context of rising global concerns about the viability of traditional public pension schemes due to demographic changes and the erosion of formal full-time employment, while at the same time the neoliberal paradigm had become the dominant economic model of the 1980s and 90s.

In Latin America, increasingly unsustainable financial disequilibriums of public pension systems demanding rising payroll taxes and state subsidies threatened the efforts of fiscal consolidation within Washington Consensus-type stabilisation and adjustment programmes, which had been imposed on borrowing countries in the context of the 1980s debt crisis. During the second-stage adjustment process starting in the late 1980s and early 1990s,
multilateral finance agencies focused increasingly on social sector reform, with priority in social security systems (Nelson 2000).

In 1994, the World Bank published its influential policy report *Averting the old age crisis: policies to protect the old and promote growth*, in which the development bank promotes a three pillar model for old-age security, which is strongly based on the Chilean reform type: The recommended structure of a pension system consists of a first, public and tax-financed pillar with the objective of poverty alleviation, a second pillar of private, fully funded pension funds based on a strong contribution-benefit link, and finally of a third pillar of voluntary savings (World Bank 1994: 16). The World Bank argues that only a strict separation of redistribution and insurance functions within social security systems allows the achievement of social policy goals while minimising negative incentives (contribution evasion, early retirement, under-reporting of income, political manipulation) and market distortions, which they characterise as inherent to public PAYG schemes.\(^\text{12}\)

The advantages of the multi-tier approach for the Bank are clear: First pillar benefits are targeted towards the most needy, risk diversification takes place due to the combination of public tax-financing or PAYG-financing and the private capitalisation pillar, possibilities for political manipulation are diminished, efficiency and equity rise because of the strong contribution-benefit link and competition between pension funds, and long-term growth is enhanced by the positive effect of funding on national saving and capital market development.

The last argument has been especially attractive for Latin American policy-makers, as James and Brooks put it:

"However, it is the potential secondary effects on the broader macro-economy that have been the more compelling motives for adopting structural reforms. The perception by the ruling political party of the potential for favourable macroeconomic changes such as greater national saving and improved labour market incentives creates the 'pull' for structural reform..." (James/Brooks 1999: 3).

This has been especially true in a context of growing external indebtedness since the 1980s and volatile international capital flows as experienced during the 1990s. Madrid (2001) also argues that pension reforms in Latin America were largely driven by macroeconomic factors, although the link between pension privatisation, higher savings and higher growth are controversial on theoretical grounds and empirically ambiguous.\(^\text{13}\) Nevertheless, he and others state that policymakers seem to have believed that pension systems on a individual capitalisation basis would have a positive effect on the national saving's and growth rate (Madrid 2001; James/Brooks 1999: 4).

I would like to add that it was of less importance to Latin American politicians whether this belief was theoretically well-founded or not: What really mattered was the fact, that the proposal of multilateral aid organisations reflected the dominant neoliberal paradigm and the preferences of national and international investors. In order to attract international capital from private and multilateral sources, structural pension reform therefore became part of a political and economic strategy aimed at strengthening credibility.

The World Bank promoted the new pension orthodoxy (Lo Vuolo 1996) through different transmission channels such as publications, conferences, seminars and loans for technical studies or transition cost financing, and soon dominated the international pension debate,

\(^{12}\)In this way, the World Bank model reflects the institution's orientation towards the regulatory-subsidiary state model, a preference for individual old-age provision and free market economy and a general distrust towards the European Welfare State model (Queisser 2000: 40).

\(^{13}\)From a Keynesian perspective, no consumption sacrifice is needed as a precondition for investment, but the willingness to enter in long-term creditor-debtor relationships on the basis of stability and positive profitability expectations. High savings have to match the economy's liabilities in order to prevent inflationary pressures. Neoclassical critics point to the financing of transition costs as determinating the impact of pension reform on saving. See Corsetti/Schmidt-Hebbel in Valdés-Prieto 1997, James 1998, Orszag/Stiglitz 1999, Haindl 1997, Holzmann in...
replacing traditional social policy organisations like the International Labour Organisation (ILO) or the International Social Security Association (ISSA) as the principal agenda setters in this field. Nevertheless, the model also provoked a great deal of criticism not only from defenders of the traditional welfare state paradigm like the ILO (Beatty/McGillivray 1995) but also from its own staff (Stiglitz/Orszag 1999). However, the private alternative was clearly successful as reflected in the numerous pension reforms introducing IFF pillars world-wide as well as the fact that to the present even the ILO promotes a multi-pillar system (Gillion 2000).

In Argentina, the technical reform team carefully studied the Chilean model, and pension experts from Chile were invited during different stages of the reform process. The good economic performance of the neighbour country during the 1980s in terms of growth, saving's and investment rates were taken as an evidence of the positive economic effects of pension privatisation.

III.2. The macroeconomic context: Stabilisation via the convertibility plan

Since the Peronist Menem government assumed power in 1989 following two hyperinflation episodes and a severe economic crisis, the Argentinean economy has experienced a radical transformation in terms of trade and capital account liberalisation, deregulation, privatisation, internal and external debt rescheduling as well as fiscal and monetary reforms. The cornerstone of the Argentinean stabilisation model is the so-called convertibility plan, former and actual economy minister Domingo Cavallo introduced in April 1991. The Plan Cavallo fixes the Argentinean Peso 1:1 to the US-Dollar and guarantees full reserve backing of the monetary base, transforming the central bank (BCRA) into a currency board. This monetary arrangement has its origins in colonial times and mimics the specie-flow-mechanism of the gold standard in order to guarantee an automatic adjustment of the balance of payments. Monetary demand is supposed to be stable and monetary supply is determined by the amount of foreign exchange constituting the board’s reserves. The fixed exchange-rate in combination with unlimited convertibility, the automatic adjustment mechanism and the expected lowering of price levels and interest rates towards the anchor country, the elimination of discretionary monetary policy and the positive disciplining of economic policy in terms of fiscal consolidation and liberalisation, was aimed at augmenting credibility in order to attract foreign capital with low financing costs. Whereas textbook theory supposes that currency boards earn foreign exchange via a positive trade balance, the Argentinean board evades the contractive adjustment process produced by trade deficits through net capital inflows (Schweickert 1998, Hujo 2001)

Although inflation lagged behind during the first two years after introducing the currency board, resulting in a 40% overvaluation of the Peso, until the end of 1994 Argentina lived a

14 Queisser 2000 summarises the criticism on the World Bank proposal. On the one hand critics pointed to the fact that World Bank economists exaggerated the difficulties of PAYG schemes (regarding demographic changes, political manipulation, adverse incentives and market effects) and the advantages of IFF schemes (especially regarding its secondary economic effects), and on the other hand promoters of pension orthodoxy did not point out towards the problems of Chilean-style systems, as there are insecurity about future benefits, individualization of risks, problems of transition financing, potential future burden of state guarantees and minimum pensions, high administration costs of decentralized systems, the permanence of high evasion rates and problems of coverage.

15 As to the actual implementation policy, the World Bank seems to be less dogmatic than the model appears (Queisser 2000: 43, Holzmann 1997): specific conditions and preferences of client countries are recognised and Chilean-style reforms as well as a gradual introduction of fully-funded pillars (taking into account the macroeconomic and institutional context, administration and regulation capacities and the financing of transition costs) is supported.

16 For an evaluation of the economic policy under Menem see e.g. Heymann 2000 and Hujo 2001.

17 This arrangement neglects the fact that monetary demand is not stable and a fixed money supply does not necessarily correspond to the demand of liquidity by wealth owners (see also Schelkle 2000). Consequently, the inflexible monetary supply and the lack of a Lender of Last Resort inclines the system towards liquidity crisis and banking panics, similar to the events following the introduction of the Bank Act Peel II based on the currency principle in England 1844. The lesson the Bank of England learned quickly that stability could only be achieved by permanently
consumption-led boom and managed to bring down inflation rates close to US-levels. Nevertheless, the stabilisation success was overshadowed by growing external debt figures, historically high unemployment rates, rising trade balance deficits and difficulties in the productive sector (compare table 3 annex). Furthermore, the liquidity crisis shaking the Argentinean financial sector after the devaluation of the Mexican Peso in 1995 revealed the fragility of a development model based on net capital inflows. The currency board in combination with a dollarisation strategy lacks a Lender of Last Resort and results in a severe credit squeeze and bank panic when wealth owners take out their deposits. Currency board rules had to be suspended and heavy intervention of the BCRA as well as an international aid package was necessary in order to overcome the crisis. (see Fernández 1996, Pou 2000)

Although a range of measures have been taken to reform the financial sector, the inherent weakness and the need of financial institutions to hold large and costly reserves remains. Interest rates - although showing a downward trend - could not be brought down to international levels and dollarisation has increased considerably.

From 1996 to 1998 Argentina experienced a second expansive circle, until the difficulties of the Brazilian neighbour - Argentina's main trading partner - following the Russian crisis in 1998 and resulting in the devaluation of the Brazilian Real in 1999, forced Argentina into a recession, which could not be ended up to the present.18

The specific macroeconomic context in post 1991 Argentina had a crucial effect on the pension reform of 1994. After numerous failed stabilisation programmes and in the context of hyperinflation and social and economic chaos, the elimination of autonomous monetary policy via the currency board, a fixed exchange-rate as a nominal anchor and far-reaching liberalisation and privatisation policies seemed to be the only alternative to regain the lost credibility of wealth owners and foreign investors. The new rules of the game demanded profound changes in the Argentinean economy which had been shaped by the semi-closed statist development model of the post-war period: Pressures on fiscal policy and on wages were especially pronounced, as other policy variables like monetary, exchange-rate, trade or industrial policy were de facto eliminated and competitiveness of Argentine producers seriously hampered in a context of overvaluation and trade liberalisation.

The bankrupt public social security system and the accumulated pension debt were the first issues within social sector policies to be tackled. By radically reforming the Argentine pension system in a Chilean-style manner, policymakers could achieve two objectives:
Firstly, a successful pension privatisation would enhance credibility and underline the market-oriented development strategy of the Peronist government. Dismantling welfare state institutions by the same political movement, which had institutionalised the Argentinean welfare state model during the post-war era, was a strong signal towards the neoliberal commitment of the Peronist government.
Secondly, a pension system based on individual capitalisation should boost economic growth and stabilise the Argentinean currency board model in different ways:

? As the proper functioning of the currency board demands a budget surplus or at least fiscal equilibrium, social expenditures (the biggest single share within government expenditures)19 had to be lowered as soon as possible;

? As currency boards are vulnerable to liquidity crisis and banking runs in case of shrinking central bank reserves, declining capital inflows or loss of depositors’ confidence, channelling long-term forced savings of pension funds to the financial sector was supposed to work as a stabilising factor;

18 It is beyond the scope of this paper to criticize the development implications of a currency board. An appropriate monetary policy should try to undervalue the real exchange rate in order to reduce external indebtedness allowing for lower interest rates in the long run. Currency Boards need currency stability as a precondition, otherwise they work as a destabilizing factor in the monetary economy (see for example Schelkle 2000 or Hujo 2001).
19 Slodky 1997: in 1994, public social expenditures in % of total expenditures were 67% and 18.4% of GDP; pension expenditures
Additionally, pension funds could work as a sterilisation instrument offsetting adverse effects of high capital inflows in the context of reduced central bank powers and a fixed exchange-rate;

Instead of correcting the exchange-rate via nominal devaluation, a fiscal devaluation was supposed to increase competitiveness of the productive sector: in the long run, gradual reductions and final elimination of the employer's contribution was foreseen in order to reduce labour costs and encourage the creation of employment (if systems revenues or the federal budget allowed for such a reduction),

-To spur economic growth without recurring to volatile foreign capital, the low Argentinean saving's rate was to be raised and capital markets to be deepened by introducing a Chilean-style pension system, offering stable long-term financing for national investors.

Although not all of these arguments were part of the political discourse or can be found in external recommendations, the pressure to equilibrate state finances and to stabilise the financial sector as well as the desire to raise investment levels while lowering dependence upon foreign capital in the context of the Argentinean convertibility plan are obvious. If consensus about the reform necessity exists, why not introduce a new pension system that has a positive impact on the vital relationship with external investors and IFIs while promoting growth through higher savings, development of capital markets, positive incentives for the labour market and lower costs for the state?

However, various authors reject economic determinism for explaining structural pension reforms in Latin America. Kay (1998:19) states for example that:

"...social security privatisation in Latin America should not be seen as economically determined by structural adjustment or international economic pressures to lower wage costs, because privatisation is only one of several possible policy responses (which include various types of PAYG reform which are less costly to finance). If privatisation is the policy of choice in the region and PAYG is out of fashion, it is because privatisation has greater political appeal, not because it is economically determined."

Interestingly, he remarks further on (Kay 1998: 84):

"However, IFI support for privatisation made a purely PAYG reform in Argentina and Uruguay problematic. Since PAYG-only reform would have broken with IFI-financed advice and support, PAYG-only reform was never on the policy agenda."

One of the architects of the Argentinean reform considers pension privatisation as part of a profound redefinition of the state and not as a subordinated product of fiscal adjustment (Demarco 1997: 13). He says (2000: 8) that:

"It was clear for the 'policy makers' that the macroeconomic effects ('by-products') were desirable but by no means the principal target."

He concludes elsewhere (in IRELA 1997) that pension reform should not be considered a macroeconomic policy instrument, however well integrated it might be with the whole set of economic policy objectives.

As regards the influence of economic factors in pension reform design, confusion arouses within the debate about the definition of economic determinism or economic rationality:20 Most economist would agree that a strong contribution-benefit link, high coverage and financial viability are desirable features of a pension system. Nevertheless, pension

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20 A similar confusion arouses regarding the expression “successful reform”, as Lo Vuolo (1996:62) points out, it is common to mix up successful reform as solution to a perceived problem with the successful imposing of a new model. See also Brooks 1998: 10, who considers the structure of the Argentinean pension model to be a compromise between
privatisation is not necessarily a rational strategy from a theoretical point of view, especially within non-orthodox thinking.

On the other hand, in the context of the neoliberal economic framework of Argentinean politics, a welfare state model based on full-employment and a soft-budget constraint, emphasising the principles of redistribution and universalism, was clearly irrational. Consequently, speaking of economic determinism only seems to make sense regarding the complex role dominant international development paradigms play in debtor countries. Whether recommendations based on the international pension orthodoxy are appropriate solutions or not is of minor importance, or to play with Nicholas Barr words – it is not a question of myths or truths (Barr 2000). The greater political appeal of pension privatisation is linked to the economic development model chosen in most of Latin American countries during the 1990s and the need to make market-oriented commitment of governments credible to foreign investors. A second advantage that privatisation offers in the context of growing fiscal pressures and the erosion of formal employment is the possibility to adjust public social expenditure discretionary, as universal social benefits are substituted for targeted programmes complementing market provision of retirement benefits. These are the relevant economic dimensions of pension reform.

III.3. The political context: Bargaining for the mixed model

Several authors have analysed the political process of the Argentinean pension reform (see Madrid 1999, Brooks 1998, Lo Vuolo 1997, Kay 1998, Isuani/San Martino 1995, Alonso 2000, Torre/Gerchunoff 1999, Mesa-Lago/Müller 2001, Demarco 2000). The mixed structure of the Argentine pension model is described as the result of pension orthodoxy confronting democratic reality (Lo Vuolo 1996). Various authors emphasize the fact that the process and outcome of the pension reform reflects a proper working democratic system in Argentina and cannot be compared to the emergency measures taken in the economic sphere during the first years of the Menem administration (Gerchunoff/Torre 1999). However, the successful economic restructuring and the extraordinary powers Menem disposed of during the reform process in combination with relatively weak and non-co-ordinated opposition groups facilitated the reform, although modifications to the original government proposal, resembling more the Chilean pension system, had to be accepted.\(^\text{21}\)

The severe problems of the Argentinean social security system called for a profound restructuring with the objectives of guaranteeing financial viability, enhanced equity and extension of coverage. Nevertheless, the option of introducing parametric reforms within the public PAYG system was rejected on the grounds of two main arguments: Firstly, the economic dimension outlined in the previous sections and secondly, the high costs in terms of political opposition which visible cut-backs of benefits and privileges would create.\(^\text{22}\)

After introducing the convertibility plan, economy minister Domingo Cavallo appointed a prestigious economist and international pension consultant as Secretary of Social Security. Under the guidance of Walter Schulthess, a highly qualified team of economists and lawyers from outside the political network of the traditional social security bureaucracy elaborated 40 technical studies under isolated laboratory conditions with financing from the UNDP. (James/Brooks 1999; Mesa-Lago/Müller 2001: 8)

From the beginning of 1992 on, the phase of coalition building began by initiating a dialogue with political parties, business and labour representatives.\(^\text{23}\) Opposers of a Chilean-style reform criticized a first reform draft presented to Congress in June 1992. This draft law proposed a mixed scheme, consisting of a public basic pension and a fully funded tier similar to the Chilean pension funds.

\(^{21}\)Some authors speak of "minor modifications" (Demarco 2000: 28); others (Isuani/San Martino 1998, Torre/Gerchunoff 1999) emphasize the effects of the democratic process on the final reform version.

\(^{22}\)Demarco 2000:22 states that "the government concluded that, given the dimension of the crisis and the extension of its consequences, it needed a radical solution". This is comparable to the general strategy pursued in economic policy.
In order to attain approval within the democratic process, numerous modifications were introduced into successive versions of the legal draft, raising the fiscal costs of the reform while maintaining the hard core of the project - the introduction of an IFF pillar.\(^\text{24}\) The amount of the basic pension was raised, insured would be free to choose between a reformed public and the mixed scheme, insured in the public system would be offered an additional pension benefit, a compensatory pension would be paid to those who contributed to the old system, trade unions, mutual funds, co-operatives and public entities apart from financial institutions were authorised to manage pension funds and members of the National Bank's pension fund would be granted a special minimum return guarantee.

In spite of the strong position of the Peronist Menem government due to majorities in congress and relevant parliamentary commissions, extraordinary decree powers granted to the executive by the parliament during the hyperinflation 1989/90, support of business groups and international IFIs for the economic and social restructuring and last but not least, considerable popularity of the Peronist administration among Argentinean people in a context of successful economic stabilisation and reactivation, strategic use of reform bundling, sequencing and compensation measures had to be made in order to overcome opposition of trade unions, opposition parties, several Peronist congressmen and pensioners' associations.\(^\text{25}\) Compensation measures and expansion of public benefits were possible due to increased resources via capital imports and privatisation revenues.

The introduction of a mixed system combined with the option to remain in a purely public scheme has also been interpreted as a "hidden agenda" (Mesa-Lago/Müller 2001) or as tactical sequencing in order to achieve a more Chilean-style pension system in the long-term: If contributions are increasingly drained away from the public tier, the latter becomes even less financially viable, leading to subsequent downsizing of public benefits, which undermines the attractiveness and legitimisation of the public scheme (see also Lo Vuolo 1997: 12).\(^\text{26}\)

Fiscally motivated retrenchment of public benefits following the implementation of the Argentinean reform up to the present as well as official statements about the transitory nature of the alternative public tier point into this direction (Demarco/Cottani 1998: 189).\(^\text{27}\) However, Demarco (2000:15) repeatedly states that

"...it is a fallacy to consider that the mixed pension system was part of a negotiation to implement a 'Chilean-like' reform."

He emphasizes that the decision to implement a basic pension was a conscious deviation from the neighbour country's pension model (which has a minimum pension guarantee as a first pillar benefit) in order to guarantee a redistributive benefit within the pension system.

The political and economic context of the Argentinean pension reform shows that a variety of factors have to be taken into account in order to interpret the complex process of social security reform in a democratic context. Defenders of pension privatisation benefitted from the profound crisis of the former public system, the neoliberal transformation of the Argentinean

\(^{24}\)James/Brooks 1999:18 state with view to compensation strategies: "The trick here is to compromise just enough to mute the opposition without sacrificing the basic nature of the reform".

\(^{25}\)Pension reform and the honouring of accumulated pension debt via privatisation revenues was linked to the privatisation of the public oil enterprise YPF; compensation was offered towards trade unions (management of pension funds, postponing of health insurance system managed by trade unions), towards pensioners (privatisation revenues YPF), through exemption from the reform of privileged groups of insured (military, police) and via political compensation; sequencing refers to the gradual implementation of the private model.

\(^{26}\)Anita M. Schwarz in Feldstein 1998: 211 comments "...we should regard the Argentine reform as a second-best solution that serves as a conduit to the first-best solution rather than evaluating it strictly as a final solution in its own right."

\(^{27}\)Recently a member of the economy ministry stated „La creación de la PBU fue un error. No debería existir como una prestación universal. Es más conveniente que funcione como un seguro para atender casos puntuales, pero no como
economy, the support from national and international business groups and credit institutions, the strength of the executive vis-à-vis legislature and trade unions, and the relative weakness of opposition groups due to lacking of resources and co-ordination. Total privatisation was not on the agenda, as it proved to be politically difficult and economically problematic regarding the high implicit pension debt of the former Argentine social security system. Additionally, Argentine policymakers stress the fact that a mixed model with a flat basic pension was chosen in order to obtain a stronger redistributive tier within the pension system than in Chile.

Although pension experts hold the view that macroeconomic effects of pension privatisation and the influence of IFIs were of minor importance for the reform design, it was the economic context which a) gave special powers to the Menem administration while weakening traditional defenders of the welfare state model as national and international labour organisations, b) made market-oriented reforms credible to Argentinean people, and c) turned support of IFIs into a crucial element for the sustainability of the Argentinean currency board.28

IV. The Argentinean Pension Reform of 1994

IV.1. Structure and Operating Principles

The new Argentinean pension system SIJP (Sistema Integrado de Jubilaciones y Pensiones) began operating in June 1994. Similar to the Chilean reform, a first step before implementing the actual pension reform consisted in measures to uniform the social security administration29 and to aggravate entitlement conditions in the former system: Minimum contribution years were raised from 15 to 20 years30 and employees’ contribution rate from 10 to 11%. With the introduction of the SIJP in 1994, eligibility criteria have been further restricted regarding retirement age, contribution years and pension calculation formulas.

The new system has a multi-tier structure with the following characteristics (see Figure 1): As a first pillar, the Argentine pension system provides a universal basic pension (PBU Prestación Básica Universal), a defined benefit financed on PAYG basis and payable for every insured person reaching the retirement age of 60/65 (females/males) and at least 30 contribution years. The basic pension is financed by a 16% contribution rate, levied on employers, as well as by earmarked taxes and general revenues, and represents a flat benefit of 2.5 times MOPRE, which amounts to approximately 28% of average wages (since 1997 US$ 200).31

The second pillar offers the choice between a public defined benefit and a mainly private defined-contribution component: the insured who want to stay in a purely public, PAYG-financed system, can opt for the additional public pension (PAP Prestación Addicional por Permanencia), which offers 0.85% of the average indexed salary of the last 10 years of employment for every service year under the new system (maximum replacement rate for 35 service years: 29.75%). The defined-contribution component, the so-called ordinary pension (JO Jubilación Ordinaria) is based on individual fully funded capital accounts, which can be managed by private or public pension fund administrators named AFJP (Administradoras de fondos de Jubilaciones y Pensiones). Both alternatives are financed by an 11% contribution

28 The direct influence of the World Bank, however, is described as minimal (see Nelson 2000, Demarco 2001); the Bank financed technical studies as well as conferences and supported the transition process with loans (e.g. for integration of provincial systems). The IMF, however, committed the Argentine government to early pension reform in 1992, although some authors remark, that the Menem administration deliberately asked for the inclusion of pension reform into the Fund’s conditionality, possibly within a blame avoidance strategy.
29 Creation of a centralized Social Security Administration ANSES (Administración Nacional de Seguridad Social) and introduction of a centralized contribution unit CUSS (Contribución Unica de Seguridad Social) for pension, health care and unemployment contributions.
31 SAFJP (1998: 25): The provisional calculation unit MOPRE (Módulo Previsional) has been created by Decree 833/97,
rate, assessed according to employees. In the case of the IFF alternative, the insured person has to deduct the administration fee and the insurance premium for disability and survivorship of about 3.5%; the remaining 7.5% are capitalised on the individual pension account.

The Argentinean pension fund market functions with operating principles similar to the Chilean AFP market.\(^{32}\)

The pension fund administrator invests the fund capital according to specific investment rules (authorised groups of investment instruments with maximum limits per group, see Table 1) set by the state, and credits the respective profitability gains to the individual account. Voluntary contributions of the insured or third parties like employers are possible within a third pillar. All contributions (voluntary savings up to a maximum limit) and interest gains are tax deductible, whereas benefits are subject to income tax.

After reaching the retirement age, old-age pensions are financed through the individually accumulated capital, and the insured can opt for three different pension modes, each one calculated on a strict actuarial basis without redistributive elements: 1. A life annuity from an insurance company, 2. Scheduled monthly withdrawals, or 3. A combination of the two.

To guarantee the safety of the compulsory, but private AFJP-system, a new supervision agency was created (SAFJP- Superintendencia de AFJP), investment policy and information disclosure for the public are strictly regulated, the administrators have to keep the capital of the insured legally and financially separated from the AFJP, they have to hold an investment reserve of 2% of total assets (encaje), and guarantee a minimum profitability in relation to the average performance of all pension funds over a 12-month period, and excess returns have to be placed in a profitability reserve. In case of bankruptcy of AFJPs or insurance companies, the state guarantees the minimum profitability as well as pension benefits up to a maximum limit.

Contributions to the former pension system are not paid as a recognition bond as in Chile, but in form of a further defined benefit: the compensatory pension (PC Prestación Compensatoria), paid to workers eligible for the basic pension PBU and representing 1.5% of the average indexed wage of the last ten years of employment before retirement (maximum replacement rate for 35 contribution years under the old system: 52.5%).

Participation in the new integrated pension system is compulsory for salaried (civil servants included) and self-employed workers. The insured always have the possibility to join the IFF component, whereas a change back to the public system was only possible up to July 1996.

The role of the state in the partially privatised pension system is considerable and has gained in complexity due to new regulatory tasks, the administration of the public pillar and the financing of the transition period.

According to the classification of Mesa-Lago, the SIJP is at the same time a parallel and a mixed pension system\(^{33}\), as it offers two possibilities: PBU+PAP is the reformed public alternative offering a universal flat benefit and a defined benefit according to the average income level of the insured, while PBU+JO is the mixed alternative, combining the basic pension with a defined-contribution pillar.

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\(^{32}\) Minor deviations from the Chilean AFP-system are: The supervision agency SAFJP is financed by the administrators, minimum profitability refers to 70% of average returns (or 2 %) in nominal terms, changes of affiliates between AFJPs are limited to two per year, investment rules are not identical. Demarco 2000: 18 states that in the second pillar design Argentine policymakers mostly benefited from the Chilean experience.

\(^{33}\) Mesa-Lago 1995 classifies newly reformed pension systems into three groups: the private system replaces the public one (substitutive model), the introduction of an IFF pillar as alternative to the public system (parallel model), the
Figure 1: Financing and Benefits of Integrated Pension System SIJP

**Revenues**

System’s Revenues
- 16% employer’s contribution (reductions possible)
- 16% contribution self-employees opting for public scheme
- 11% personal contribution of employees affiliated to public alternative total contributions of monotributo scheme

General and Specific Taxes
- Value Added Tax
- Income Tax
- Wealth Tax
- Gas Tax
- Others

Others
- 30% Privatizations

**Benefits**

Old System Benefits
- Universal Flat Benefit PBU
- Compensatory Benefit PC
- Permanence Benefit PAP
- Survivors Benefit
- Disability Benefit
- Advanced Age Benefit

**System’s Revenues**

- 11% Personal contribution of employees affiliated to FF
- 11% personal contributions of self-employees affiliated FF

**Integrated Pension System SIJP**

**Capitalization Regime**

AFJP

- Commission to AFJP
- Accumulation in individual accounts
- Ordinary pension
- AFJP expenses
- Life and disability insurance

**Pay-as-you-go Regime (ANSES)**

Source: Modified after Isuani, Rofman, San Martino 1996.
IV.2. The Performance of the SIJP

In order to evaluate the performance of the new Argentine social security system after seven years in operation, in the following I will briefly analyse the evolution of coverage, the market structure and cost efficiency of the AFJPs and finally turn towards the volume of funds, the investment portfolio and rates of return. As we will see, the main problems of the capitalisation pillar are related to persistent high evasion rates and consequently insufficient coverage, increasing market concentration, high operating costs and volatile rates of return.34

a) Coverage

Seven years after the implementation of the new pension system the SIJP counts over 11 million affiliates, of which 8.7 million are affiliated with the capitalisation scheme representing 78% of all insured and approximately 2 million with the public PAYG scheme. However, the rate of contributors has diminished constantly and reaches currently 38% (3.3 million) in the funded option versus 40% (0.8 million) in the PAYG option. Coverage of the total labour force (about 15 million people) is even lower and was estimated by Rofman (2000) at 34%. Since the introduction of the new system, the total amount of contributors has increased only slightly from 4.1 to 4.4 million.

During the years following the implementation of the new system, the principal growth factor of affiliates in the AFJP system (apart from the inclusion of several provincial pension systems) has been the distribution of undecided insured (those who did not opt for either of the two schemes, about 70%) to equal parts between the pension funds.35

If high unemployment rates and the increasing informality in the labour market (about 40-50% of labour force) remain, the traditional high coverage of older persons with pension benefits will decrease36, as requirements to obtain a public pension benefit have been considerably tightened: Non-compliance with the thirty minimum contribution years or missing contributions in the last 18 months leaves insured without disability and survivor coverage and no regular public benefits for old age. Benefits for advanced age (age 70) require at least 10 contribution years and non-contributory pensions are limited (1992: 200.000, Isuani/San Martino 1995).

The mandatory insurance of self-employed has not increased coverage in this sector: 95% of contributors to the funded scheme are salaried workers, whereas the corresponding figure in the public scheme was 79% in June 2000. Additionally, 0.4 million insured in the simplified scheme of small contributors (monotributo) contribute to the public pillar.37 Between 1994 and 1999 the participation of self-employed in the SIJP dropped from 1.3 million to about 700.000.38

b) Pension fund market structure and cost efficiency

The AFJP market has augmented its concentration since 1994 following 12 mergers: The number of pension fund companies has diminished from 25 to 13, and the largest four AFJPs account for 73% of funds and affiliates in July 2001 versus 53.3% in June 1995. Another problem of extensive debate are the operating costs in decentralised pension system, which are high due to extensive marketing activities: In Argentina, total commissions diminished slightly from 3.5% to 3.4% (30% of contributions) of taxable income, but administration costs as a percentage of total commissions increased, as insurance fees for disability and

34 Figures are taken from SAFJP 2001 if not cited differently, see also table 1, p. 17.
35 The distribution process of undecided insured was modified via resolution SSS 4/98, before it was proportional to the number of affiliates of each AFJP. The change diminished concentration of affiliates considerably. SAFJP 2000: 28.
36 In 1995 about 70% of the Argentine population over 65 had some form of pension benefit, Rofmann 2000
37 Small contributors can opt between the AFJP or the public scheme, since March 2000, however, their contributions finance the public scheme (SAFJP 2000:13).
38 The main problem is the high contribution rate of 27% and inequities between different categories of self-employed
survivorship decreased from 46% of total commissions to 30% in 2000 (although showing an upward trend again in 2001, SAFJP 2000, 2001). Nine AFJPs offer reduced commissions for compliance and permanence (bonificaciones). Efficiency and welfare increases resulting from competition, transparency and information as well as increased choice within the private system might compensate for these costs, however, the highly regulated AFJP market is neither perfectly competitive nor take individuals rational decisions concerning the options offered within the SIJP. Besides the choice between the reformed public scheme and the capitalisation scheme (which 70% of insured do not exert), insured within the mixed scheme can choose between competing pension fund administrators. Affiliates are allowed to make up to two transfers per year, with a minimum of four contributions to the fund they are leaving. From 1995 on, the rate of transfers increased and reached a maximum in 1997 (835,163, about 9.5% affiliates); from then on, the number of transfers reduced considerably due to a change in regulations and an implicit agreement among the largest AFJPs (Rofman 2000), reaching 415,000 in the seventh year. Several studies have shown that transfers are particularly induced by publicity and activities of sales agents (SAFJP 2000), although the latter has diminished its influence after a regulation change. Nevertheless, rational choice of insured towards pension administrators with low costs and high profitability, or the distribution of undecided towards these AFJPs would contribute to a lowering of average costs in the market (Rofman 2000).

c) Volume of funds, investment portfolio and rates of return

At the end of July 2001, pension funds administered assets valued at US$ 21 billion, representing 7% of GDP. The accumulated nominal annual returns for the first seven years of operation were approximately 9.9%, although showing a significant degree of volatility on a rolling 12-month period: The maximum level was reached between August 1996-August 1997 (28.8%) and the minimum between September 1997-September 1998 (-13.1%, Rofman 2000). During the last 12-month period from July 2000-July 2001 returns were again negative (-4.6%) due to a sharp fall in the value of public bonds in the context of the recent economic crisis. High nominal returns are somewhat misleading, as commissions as well as the inflation rate have to be considered, although the latter exerted no significant role since the introduction of the convertibility plan.

AFJPs invest the insured’s capital according to investment limits set by law in order to reduce the overall risk for the affiliates. During the first years of operation, government bonds have absorbed about 50% of the funds, a figure that has recently increased due to the financing shortages of the Argentine state. Fixed term deposits started at 27% and went down to 17% in July 2001, mutual investment funds have increased their participation in recent years (17% 2001), equities represent about 10% in July 2001 after having reached a maximum limit of 23% during the Asian crisis, and finally, investment in foreign assets increased slightly over time reaching 3% in July 2001.
Table 1: Performance of Fully Funded Scheme: Argentina 2001 and 1996

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Argentina (July 2001)</th>
<th>Argentina (June 1996)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Affiliation to IFF Scheme</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-number of insured persons</td>
<td>78.4%</td>
<td>67.1%</td>
</tr>
<tr>
<td>-contributors</td>
<td>8.7 Mio</td>
<td>5.4 Mio</td>
</tr>
<tr>
<td>-average insured per administrator</td>
<td>3.3 Mio</td>
<td>2.7 Mio</td>
</tr>
<tr>
<td>-% of dependent workers</td>
<td>669.230</td>
<td>257,143</td>
</tr>
<tr>
<td>-% of self-employed</td>
<td>95%</td>
<td>83.3%</td>
</tr>
<tr>
<td>-% of self-employed</td>
<td>5%</td>
<td>14.5</td>
</tr>
<tr>
<td>Effective rate of contributors</td>
<td>38%</td>
<td>51%</td>
</tr>
<tr>
<td>Market structure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-number of administrators</td>
<td>13</td>
<td>21</td>
</tr>
<tr>
<td>-concentration</td>
<td>&gt;73% affiliates in first 4 AFJP</td>
<td>&gt;52% affiliates in first 4</td>
</tr>
<tr>
<td>-administration costs (% salary)</td>
<td>1.97%</td>
<td>2.6%</td>
</tr>
<tr>
<td>-insurance fee</td>
<td>1.4%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Volume of funds</td>
<td>$ 21,000 Mio</td>
<td>$ 3,839 Mio</td>
</tr>
<tr>
<td>-accumulated funds/GDP</td>
<td>7%</td>
<td>1.4%</td>
</tr>
<tr>
<td>Average real rate of return</td>
<td>9.9% (1994-01)</td>
<td>22.8% (June 1996)</td>
</tr>
<tr>
<td>Investment portfolio</td>
<td>Portfolio (maximum limit)</td>
<td>Portfolio (max. limit)</td>
</tr>
<tr>
<td>-public securities</td>
<td>55% (50%)</td>
<td>51.8% (50%)</td>
</tr>
<tr>
<td>-fixed term deposits</td>
<td>17% (28%)</td>
<td>17.6% (28%)</td>
</tr>
<tr>
<td>-investment funds</td>
<td>11% (14%)</td>
<td>1.5% (14%)</td>
</tr>
<tr>
<td>-stocks</td>
<td>10% (50%)</td>
<td>13.5% (35%)</td>
</tr>
<tr>
<td>-foreign stocks + securities</td>
<td>3 (17%)</td>
<td>0.5% (17%)</td>
</tr>
</tbody>
</table>

Sources: modified after Hujo 1999.

V. Social Security and Economic Policy in Argentina

In order to assess the impact partial pension privatisation in Argentina exerted on the macroeconomic sphere, in the following the effects on public finance, the labour market, the financial sector and capital market development as well as potential effects on the monetary system are analysed. Two factors make this analysis tentative and preliminary: Firstly, the new system is still far from entering a state of maturity and simulations about long-term effects have to be constantly adapted to changing rules and economic parameters; secondly, a strict separation of the impact of social security on economic variables from the general economic performance is difficult, as overall economic performance has a crucial impact on state finances and social expenditures, investment returns, saving’s rates, growth figures and labour market performance.

V.1. Impact on Public Finance

The shift from a mature public PAYG system to a decentralised fully funded scheme implies considerable transition costs. There are basically three strategies for financing the pension deficit, which arouses, when part of the contributions are transferred to individual accounts and cannot be used for the payment of current pensions. Additionally, government has to honour contributions paid to the old PAYG system for those who switch to a funded tier (cf. Queisser 1998: 41-44, Holzmann 1997: 8-18, James 1998).39

39 The relevant variable here is defined as the implicit pension debt, that is the stock of government’s liabilities towards
A first strategy consists in downsizing of the implicit pension debt of the former pension system by reducing benefits and tightening of eligibility conditions like retirement age, contribution years, conditions for early retirement and invalidity benefits as well as changing from wage to price indexation of public benefits.

A second strategy concerns the speed of transition and therefore the annual financing requirements: A slower phase-in period of the funded component can be achieved by setting age-limits for participation in the fully-funded pillars - the extreme choices are between allowing only new labour market entrants to join the new system versus forcing all workers to change immediately.

A third option to facilitate transition financing is a partial shift to a funded system, maintaining a public PAYG pillar of offering a funded pillar only as an alternative to the existing public scheme.

The choice how to compensate workers for past contributions to the former pension system has also important cash-flow effects: the most costly alternative would be a lump-sum payment at the moment of the reform, followed by the alternative of issuing recognition bonds which mature at retirement of the insured, whereas a compensatory pension presents the most favourable option in terms of cash-flow considerations.

Once the fiscal requirements for financing the transition from PAYG to fully funded pension systems are estimated, potential revenue sources have to be identified: Governments can try to reduce expenditures in other areas, sell off public assets, raise taxes or use general borrowing. Cutting expenditures and raising taxes puts the transition burden on the current generation and the reduced consumption is supposed to have a positive effect on savings and growth. Nevertheless, usually a mix of financing instruments is used to distribute the transition burden over time.

In Argentina, the implicit pension debt was considerably high due to the maturity, high coverage and generous benefits of the former pension system. Consequently, the first strategy to cope with transition costs was to downsize public benefits before and as a part of the pension reform. Secondly, making the funded pillar optional for everybody, although originally mandatory insurance in the private pillar for insured under age 45 was planned, reduced the speed of transition. Additionally, special groups have been exempted from the reform like the military, security and police forces as well as several provincial pension funds and thirdly, only a partial shift to funding has been undertaken due to the mixed nature of the system, so that a large part of contributions still go to the public pillars of the new pension system.

Regarding the resources used for transition financing, the Argentinean government implemented a mix of financing instruments, as there are privatisation revenues, earmarked taxes and debt issue, which is mainly held within the portfolio of the AFJPs and last but not least, the employer's contribution.

A number of studies have calculated the transition costs of the Argentinean pension reform taking into account different scenarios (cf. Posadas 1994, ASAP/FIEL 1998, for an overview Schultthess/Bertranou/Grushka 2000).

Schultthess/Betranou/Grushka 2000 distinguish three alternative scenarios: a base scenario (BS), an alternative scenario (AS1) which projects the evolution of the former pension system.


40Empirically, it proves difficult to identify revenue sources after pension reforms have been implemented, as pension expenditure cannot always be separated form general fiscal policy, see Queisser 1998: 51 for the Chilean case.

41The argument is taken from neoclassical theory, but lower consumption could also produce negative short-term effects on the business cycle and long-term growth effects due to higher savings are, as repeatedly stated here, not clear from a Keynesian point of view.

42It is important to note, that tax financing of formal pension systems without universal coverage have regressive effects, as fiscal revenues in Latin America are based primarily on indirect taxes See also discussion in Schultthess 1998.

43Cf. Schultthess/Betranou/Grushka 2000: 26. The base scenario defines the relevant simulation parameters as follows: rules as established by law 24241, activity ratio 50% of population, unemployment rate 7% of economically active population (EAP), number of contributors increases gradually from 39% to 70% in 2050, rate of dependant workers
system without reform as a counterfactual exercise, thirdly, a scenario (AS2), which takes a less optimistic view towards the evolution of active contributors (50% of insured) than the base scenario (70%) and fourthly, a scenario simulating the evolution of a reformed public system (AS3, 100% choose the public alternative of the SJIJ) in order to evaluate the effect of the parametric reform measures (increase of contribution years, retirement age) without considering the effects of the IFF pillar.

The authors conclude, that while the base scenario implies a major fiscal pressure in the short run (1995 deficit 2.74% GDP), the deficit diminishes in the medium term and a surplus is generated from 2020 on, (reaching its peak in 2035 1.03% GDP and decreasing afterwards) and supposing a effective rate of contributors of 50% (AS2)- ten years later. The scenario without reform (AS1) shows an inverse evolution: here the deficit decreases in the short run, but reappears in the medium term and becomes unsustainable in the long run (generating a deficit of almost 6% of GDP in 2050).

Interestingly, the most favourable evolution from a fiscal point of view can be observed under the scenario based on a pure parametric reform (AS3): Already in 2001 the system would have generated a surplus of 0.77% of GDP, reaching 2% of GDP in 2035 and equilibrium in 2050.

Within a comparative analysis of the fiscal costs of structural pension reforms in Latin America, Mesa-Lago (2000) estimates the transition costs of the Argentine reform as high, although lower than in the case of Chile. The relatively high fiscal costs in Argentina are explained by the maturity of the pension system, the high implicit pension debt (estimated by Bravo/Uthoff 1998 at 305.4% of GDP, Mesa-Lago 2000: 49), the demographic structure of its population, the compensatory and additional pension, social assistance pensions and guarantees and the high percentage of insured which changed to the capitalisation pillar in the first years of the reform. On the contrary, the tightening of eligibility criteria like contribution years, retirement age, as well as the cash flow advantages of the CP and the downsizing of the PBU lower costs.

Transition costs occurring in the context of structural pension reforms are tolerated, because the future financial viability of the reformed systems based on a strict contribution-benefit link and incentives against evasion as well as higher internal rate of returns of contributions should compensate for these costs. Another argument to consider is that parametric reform without the introduction of an IFF pillar -although fiscally superior as shown in the Argentinian case - would not have been politically feasible, as ownership of individual accounts and expectations to receive higher pensions through the market mechanism compensated for cut-backs of public benefits. It is also doubtful, if without a sweeping reform elimination of privilege systems could have been achieved.

However, as Schulthess, Betranou and Grushka (2000: 39) emphasize, all former projections about the fiscal costs of the Argentine pension reform have overestimated the effect of the reform in terms of reducing contribution evasion. Due to the difficult labour market situation in

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44Mesa-Lago 2000: 28 (Tab. 8) analyses twelve factors which contribute to the fiscal cost of a structural pension reform: age and coverage of former systems, number of insured changing to IFF pillar, fiscal responsibilities of the state (old pension deficits, recognition bonds, minimum pension, social assistance, other guarantees) and entitlement conditions like retirement age, contribution years, pension formula and retirement options.
45Another important part of the fiscal dimension associated with the Argentine pension reform is the evolution of non-contributory pension schemes and pensions for advanced age (Schulthess/Betranou/Grushka 2000: 36), which show an increasing trend since 1991 and could exert considerable financial pressure in the future. If low compliance rates persist, an important part of old Argentineans could be left without coverage. Non-contributory pensions amounted to 0.17% of GDP on average between 1994-97, Schulthess/Betranou/Grushka 2000: 37.
46This is also reflected in the position of the IMF, who treats fiscal deficits and debt associated with pension reform differently from normal public debt. See also Queisser 2000.
47The expected by-products in terms of economic growth and employment as well as immunity against political intervention are difficult to estimate, but surely were included into this kind of cost-benefit analysis.
Argentina, coverage within the new system could not be expanded. Another critical aspect was the government's fiscal devaluation policy: employer's contribution rates have been lowered to an average of 12% instead of 16% until June 2001, which aggravated the financial disequilibria of the public system.

Consequently, since the original law was passed in 1994, different steps have been taken in order to lower the fiscal costs of the pension system:

1) The Pension Solidarity Law 1995 (No. 24,463) restricts costs by eliminating the minimum pension guarantee (of 3.6 AMPOs) and the automatic indexation of pensions, linking public benefits to resources approved by annual budget laws.

2) The introduction of MOPRE 1997: The retirement calculation unit MOPRE (modulo previsional) has been created by decree 833/97 and the executive determines its value annually (end 1997: US$ 80). MOPRE substitutes for the former calculation unit AMPO, the average compulsory pension contribution (and therefore a wage indexation instrument), introducing a further discretionary element into the public pension scheme (SAFJP 1998: 25).

3) The Reform proposal of December 2000: The Radical government of president De La Rua presented an extensive reform proposal for the SIJP in December 2000 in the context of IMF negotiations about a bail-out package of 40 billion US$ to prevent default on the Argentinean public debt. Although the implementation of the emergency decree has been stopped by the Argentinean justice, a profound reform of the public component of the SIJP is still pending. The decree established a higher retirement age for women (65) and substituted the universal flat pension PBU and the pension for advanced age by three benefits:
   A universal non-contributory benefit of $ 100 (Prestación Universal) plus health insurance for insured aged 75 (descending to 70 in 2007), a proportional benefit (Prestación Proporcional) of at least $150 or (0.125)MOPRE per service year requiring at least 10 contribution years plus health insurance, and a supplementary pension (Prestación Suplementaria) after 30 contribution years, eligible for insured with total benefits below $800, with a maximum limit of $200 (formula: 10*MOPRE-(PC+PAP+JO)/3.5).\(^{49}\)

4) 13% cut-back of pensions for public employees as a emergency measure within the zero-budget initiative.

5) Reestablishment of the 16% contribution rate for employers (Decree 814 of 20.06.01) and increase to 20% for employers in the service sector. (Clarín, 21.07.01).

Although the economic recession exerts substantial pressures on the new pension system, frequent manipulations of the newly established rules undermine credibility with negative effects on compliance.

**V.2. Effects on Labour Markets**

Social security contributions with a low contribution-benefit link are supposed to create distortions in the labour market, if part of contributions is interpreted as a tax.\(^{50}\) This can be an incentive for evasion, lower labour supply, increased household work or flight to the

\(^{49}\) See Decree 1306/2000: Additional modifications concerned the introduction of more than one fund per administrator to offer different risk structures within one AFJP, the elimination of the fluctuation fund in order to increase profitability, uniform life expectancy tables for women and men, distribution of undecided towards pension administrators with lowest commissions and measures to improve transparency, information and competition.
informal sector. Although there are no theoretical reasons proving that PAYG systems cannot be based on the insurance principle\textsuperscript{51}, the international pension orthodoxy is convinced, that only a strict separation of the redistribution and saving's function of social security can minimise distortions and create positive incentives for formal labour market participation.\textsuperscript{52}

A further argument is based on the hypothesis, that IFF pension system can achieve the same retirement benefits with lower costs (or higher benefits with the same contribution rate) due to their higher profitability.\textsuperscript{53} If payroll taxes can be lowered, competitiveness should be enhanced and employment increase.\textsuperscript{54}

In Argentina, increasing formal labour market participation and a reduction of evasion was expected due to the correct actuarial calculation of future pensions based on individual fully funding in combination with the increased retirement age and contribution years. ASAP/FIEL 1998: 161 put forward the increasing employment activity rates for all ages (and especially for aged 50-64) and especially for women in Buenos Aires 1993-95 as evidence for increasing labour supply. Nevertheless, the Argentinean labour market development after the introduction of the convertibility plan seems too complex to separate a potential effect of the pension reform.

Certainly incentives to contribute to the social security system have improved as the system is more equitable, transparent and credible, but rising unemployment rates and growth of informality as well as the creation of temporary employment programmes without social security coverage undermined compliance with social security obligations. The mandatory coverage of self-employed as well as different mechanisms to increase coverage should work against informality and evasion\textsuperscript{55}, but this requires sufficient employment opportunities and adequate income levels.

Referring to the latter, the high level of contribution rates (27% for pensions only) constitutes a strong incentive for evasion for low-income self-employed as well as for small and medium size enterprises and additionally, elevates labour costs and therefore reduces labour demand and competitiveness. The reduction and final elimination of the employer's rate of 16% (to an average of 12%, differentiated between regions and sectors) was supposed to be achieved by sinking transition costs and higher returns of pension funds in comparison with the public system. Nevertheless, although the lowering of labour costs in the context of the convertibility plan was deemed necessary due to sinking competitiveness of local producers, it proved to be conflictive with regard to fiscal policy objectives and high transition costs and did not result in higher employment. As mentioned in the previous section, employers' contribution rates have been raised substantially in the context of the present fiscal crisis, although reactivation measures to overcome the three year recession are more needed than ever.

Social security systems should not incentive informality and evasion, as the former Argentina pension system certainly did. Nevertheless, the anti-accumulation bias of the Argentine currency board model cannot be overcome by lowering of wage costs, “getting incentives

\textsuperscript{51}A strict contribution-benefit link and increased transparency within PAYG systems can be achieved through a Notional Defined Contribution system (cf. Holzmann 1997a: 6 or Müller 1999: 14), although capital accumulation is only virtual. Contributions are recorded in an individual account and bear interest in form of a notional rate of return. A strong contribution-benefit link is also obtained within the German defined-benefit pension system; redistributive elements are financed via general taxes.

\textsuperscript{52}Holzmann (1997a: 4) points out that also IFF pension systems can be interpreted as an implicit tax on labour in case of high administrative costs or bad asset management. Orszag/Stiglitz 1999: 23 point towards the difficulty of separating already existing distortions from social security contributions and emphasize, that first pillar benefits and social assistance as well as part of transition costs or future debt service have to be financed by general taxes.

\textsuperscript{53}This refers to the interpretation of the famous Aaron’s rule (1966) in case of ageing populations; public PAYG pension systems reduce welfare if \( n + w - i \) (with \( n \) population growth rate, \( w \) wage growth rate and \( i \) interest rate).

\textsuperscript{54}High payroll taxes normally reduce wages, reduced competitiveness occurs in a context of labour market rigidities, see Thompson 1999. In Argentina, efforts are made to flexibilise labour markets, although pressure on real wages in a deflationary context is already considerable.

\textsuperscript{55}Definition of regularity for invalidity/survivorship pensions, benefits for advanced age with requirement of reduced contribution years, simplified contribution system for small contributors, unemployment benefits count as periods of
right” and flexibilisation of the labour market: Unfavourable macroeconomic development puts pressure on wages, increases un- and sub employment and makes compliance with the new eligibility requirements difficult.

V.3. Effects on Savings, the Financial Sector and Monetary Policy

It is beyond the scope of this paper to outline the extensive debate about the impact of a transition from a public PAYG system to individual capitalisation on the aggregate saving’s rate and resulting growth effects.\(^56\) As already mentioned, there are important theoretical doubts about the validity of the loanable funds theory as well as contradictory results found in different empirical studies about the growth effect of the Chilean pension reform.\(^57\)

Additionally, the aggregate saving’s effect is difficult to estimate considering the complex process of transition financing and the problem to separate the effects of pension reform from other policy variables and the general economic performance. Generally, higher savings rates are expected, if the change in the financing method is accompanied by cut-backs in benefits or higher contribution rates/vesting periods, or if transition costs are financed by taxes and decreasing state expenditures in other areas (consumption sacrifice is the key variable). The existence of credit constraints and extension of coverage should also add to higher aggregate savings.\(^58\)

A less controversial issue is the positive qualitative and quantitative effect of Chilean-style pension systems on financial sector and capital market development (Barrientos 2000). Savings are redirected from the public to the private sector, enlarging capital markets and leading to economies of scale. Following the creation of new institutional investors like pension fund administrators and insurance companies, the institutional framework of capital markets is modernised and efficiency enhanced. Deepening of the financial sector takes place due to securitisation and development of new financing instruments: Pension funds create a significant demand for stable, long-term and indexed instruments. Furthermore, foreign investors can be attracted to participate in the pension fund market.

In the Argentinean case, projections on the evolution of the national saving’s rate are based on simulations regarding the public deficit associated with the reform (see V.1.) as well as possible effects on private household and enterprise saving, the latter depending on the financing of the transition deficit and the level of employer’s contribution rate as well as effects on credit conditions for the business sector. ASAP/FIEL 1998 estimate an gradual increase in aggregate savings of more than 3% reaching 2040.\(^59\) Demarco/Cottani 1998 find a positive contribution to the national saving’s rate from 1999 on, reaching 2.5% of GDP in 2020. Nevertheless, underlying assumptions have to be carefully studied and the profound change in the macroeconomic context after 1991 certainly influenced private as well as public saving’s behaviour to a greater degree than the pension reform. The effects to consider are changes in the financial and monetary sector (price and exchange rate stability, return of flight capital, increase in consumer lending, increase in deposits) and in public finances (elimination of inflation tax versus soft budget constraint through capital inflows and privatisation revenues), changes in the income level and credit supply of individuals and business.

Regarding the development of the financial sector and the capital market, pension reform has definitely contributed to an increase in size and depth and supported institutional

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\(^{56}\) For the more recent debate see for example Feldstein 1997, Grosse 1997, IRELA 1997, Valdés-Prieto 1997.


\(^{58}\) Corsetti/Schmidt-Hebbel in Valdés-Prieto 1997, Reisen/Baillu 2000. If forced savings are too high, poor credit-constraint individuals might also experience welfare losses; credit constraint should be linked to short-sightedness in order to be welfare increasing, Barrientos 2000.

\(^{59}\) AFAP/FIEL 1998: 3.27% in 2040 if transition costs are financed by taxes (p. 134/5 Tab. 4, and in case of debt financing of 3.45% 2040 with 50% Ricardian equivalence, 50% Keynesian case; in case of maintaining financing via
modernisation.\textsuperscript{60} Supervision and regulation of the financial sector has been improved. Pension fund companies hold increasing shares of market stocks of investment instruments like government bonds, mortgage bonds, commercial papers, fixed-term deposits, mutual funds and equities. Increased capitalisation levels as well as a rise in the traded volume of stocks reflect the macroeconomic development in the 1990s as well as the effects of pension reform.

ASAP/FIEL 1998 underline the fact that during the 1995 Tequila crisis institutional investors substituted for foreign investors and contributed to the stability of the financial sector. In spite of the fact that private pension systems positively influence capital market development, a certain level of development and depth is also a precondition for their proper functioning.\textsuperscript{61} SAFJP (1999: 18) point out that the high volume of funds administered by the private pension system in relation to a relative small financial market in Argentina reduced the possibility of quick portfolio changes in the context of the international financial crisis in 1997 and 1998.

Regarding monetary policy and the stability of the currency board arrangement, there are mainly two arguments in favour of fully funded pension systems: the first one refers to the stabilising effect of long-term savings held by pension funds in a banking sector, which is especially vulnerable to banking panics and liquidity crises as well as the greater independence from volatile foreign capital. The second refers to the problem of exchange rate appreciation in the context of high capital inflows and the possibility of pension funds to a) absorb public bonds issued for sterilisation purposes or b) to export capital by investing funds in foreign instruments. Chile is quoted as an example for this argument (Fontaine in Valdés-Prieto 1997), as the absorption of sterilisation bonds did not generate an upward pressure on domestic interest rates because pension administrators were willing to hold these bonds (see also Reisen 2000: 69).

In the Argentine case evidence regarding these topics is mixed and the specific role of pension funds cannot easily be isolated. ASAP/FIEL 1998 emphasize the stabilising function of AFJPs during the Tequila crisis, but it is clear, that the final elimination of the threat of liquidity crises demands a permanent Lender of Last Resort (an open discount window), which is not possible in the context of a currency board and dollarisation. Support of IFs, pension funds, internationalisation of the banking system and high reserve requirements are no sufficient condition to guarantee stability of the Argentinean financial sector. Concerning the problem of exchange rate overvaluation, the absorption of public bonds and capital exports by pension funds might have some positive effects, but as the Argentine case shows, are certainly not apt to reduce overvaluation significantly.

As we have seen, there are a range of arguments that support the introduction of a private pension system in the context of a development model based on a currency board. (III.2.) However, some kind of positive cross-fertilisation can only take place in a positive macroeconomic context combining productive development and increasing employment with a budget surplus and a stable financial sector. In Argentina, the economic context is characterised by unsustainable levels of fiscal deficits and external debt, high unemployment and stagnation in the productive sector, increasing pressures on the overvalued exchange rate and a crisis-prone financial sector. Under these circumstances, institutional investor’s portfolios are likely to be negatively affected by volatile stock markets, default on the public debt or even worse, the effects of devaluation and its inflationary consequences. During the boom-phase of the Argentine economic miracle, pension reform was a positive signal towards foreign investors – at present, the high transition costs, the need to increase

\textsuperscript{60} Institutional modifications since 1992 include: (ASAP/FIEL 1998: 157ff) A new regime for mutual investment funds, risk qualification of public bonds, emission of negotiable obligations of small and medium enterprises, securitisation of mortgage bond, new insolvency law. Introduction of market makers: primary emission and negotiation in secondary markets for public bonds, leasing contracts.

\textsuperscript{61} Similar to the debate what comes first – savings or growth? Financial sector development is either meant to be an engine for growth or the result of economic development, see Patrick (1966), McKinnon/Shaw 1973 or Fry 1988 and
contribution rates and to cut-back public pensions (which have been lowered 13% within the recent zero-budget initiative) aggravate the economic crisis and raise doubts about the possibility to return to a stable growth path in the near future.

VI. Final Remarks

Argentina has been successful in implementing two radical reforms: a new accumulation model based on the currency board regime and a new pension system based on privatisation and decentralisation. Both reforms helped to overcome serious reform blockades of the past and changed the basic rules governing economic and social policies in the country. The underlying assumption of the Washington consensus-based development strategy is a successful transformation in three stages, passing from stabilisation over structural adjustment to a period of stable growth. Social security reform was considered one of the cornerstones during the second stage of structural adjustment, although high short term costs in terms of transition financing were acknowledged. The gains obtained through structural pension reform in terms of macroeconomic side-effects and political attractiveness were considered to outweigh these costs.

Nevertheless, the negative side of the coin is a new debt crisis, high unemployment, a breakdown of the productive sector and a severe fiscal crisis, leading once again to cut-backs in public pension benefits, whereas pension funds are negatively affected by volatile stock markets, increasing risk on government bonds, a potential collapse of the financial sector and the threat of devaluation, the latter implying severe consequences for the dollarised private and public sector.

International FIs supported the reforms and policymakers seemed to have had no alternative in order to increase credibility and attract sufficient capital inflows to support the new economic regime. The believe, however, that pension privatisation in developing countries leads to a virtuous circle of higher savings, investment and growth and therefore allows for higher pensions financed through lower contribution rates is as erroneous as the believe that a currency board paves the path for a stable accumulation process.

To the present, credibility is as low as ever and even “magic” economy minister Cavallo seems to play on time to prevent a major economic and social crisis in Argentina.

Macroeconomic crises are not new to Argentineans – but more than ever the workers’ and retirees’ welfare depends on the solvency of the state and the stability of the monetary and financial system as public benefits depend on fiscal possibilities and no indexation or adjustment mechanisms are planned. As Isuani/San Martino (1998 144) put it:

“Evidently, the investment system implies a strong bet on a future world of stability, peace, and progress.”

62 Important measures to regain investors’ confidence and to prevent the breakdown of the currency board are the introduction of multiple exchange rates with a devaluated rate for foreign trade, the voluntary rescheduling of short-term foreign debt and the negotiation of fresh money from multilateral lenders, a programme to increase
### Table 2. Reform of Social Security System in Argentina

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Argentina pre-reform (SNPS)</th>
<th>Argentina post-reform (SIJP 1994)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Insurance character</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- dependent workers</td>
<td>-mandatory</td>
<td>-mandatory</td>
</tr>
<tr>
<td>- self-employed</td>
<td>-mandatory</td>
<td>-mandatory</td>
</tr>
<tr>
<td><strong>Financing</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- contributions</td>
<td>PAYG 27%</td>
<td>PAYG/IFF 27%</td>
</tr>
<tr>
<td>(payroll tax, reference income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>self-employed)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>--- employer / insured</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- general/specific tax revenues</td>
<td>16% / 11%</td>
<td>16% / 11%</td>
</tr>
<tr>
<td>--- yes (15-35% of total resources)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Entitlement conditions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- contribution years</td>
<td>15-20 (30 affiliation)</td>
<td></td>
</tr>
<tr>
<td>- retirement age (female/male)</td>
<td>55/60</td>
<td></td>
</tr>
<tr>
<td>--- dependent workers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>--- self-employed</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Maximum taxable income</strong></td>
<td>60 MOPREs$ ^1 $ ($4,800)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(1 MOPRE = $80)</td>
<td></td>
</tr>
<tr>
<td><strong>Replacement rates</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- PBU 30-45 service years</td>
<td>70-82%</td>
<td>PBU: flat benefit ($200)</td>
</tr>
<tr>
<td>- PAP, PC 35 service years (max)</td>
<td></td>
<td>PAP: 29.8%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>PC: 52.5%</td>
</tr>
<tr>
<td><strong>Benefit calculation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- maximum benefit</td>
<td>-average of best 3 years</td>
<td>PBU: 2.5 MOPREs + 1%</td>
</tr>
<tr>
<td></td>
<td>within last 10 contribution years</td>
<td>for every add. year 31-45</td>
</tr>
<tr>
<td></td>
<td>PC/PAP = 1 MOPRE per service year</td>
<td>PAP: 0.85% of average indexed wage of last 10 years for every service year.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>PC: 1.5%, same calculation as PAP.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>JO: individual funds + investment yield</td>
</tr>
<tr>
<td><strong>Non-contributive pension</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- financing</td>
<td>-yes, means-tested</td>
<td>-yes, means-tested</td>
</tr>
<tr>
<td></td>
<td>-general tax revenues</td>
<td>-general tax revenues</td>
</tr>
<tr>
<td><strong>Early retirement</strong></td>
<td>-common in privileged retirement schemes</td>
<td>-only in mixed-scheme, no eligibility for PBU/PC/PAP</td>
</tr>
<tr>
<td><strong>Special old age regime</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(advanced age)</strong></td>
<td>-salaried workers age 65/70</td>
<td></td>
</tr>
<tr>
<td></td>
<td>independent age 70, 10 service years, 70% of normal benefit</td>
<td>-for pensioners at age 70. 10 service years, 30% reduction of PBU</td>
</tr>
<tr>
<td><strong>Further benefits</strong></td>
<td>-invalidity/survivor insurance</td>
<td>-invalidity/survivors = 70% average wage last 5 years/70% of pension</td>
</tr>
<tr>
<td><strong>Special pension regimes</strong></td>
<td>-multiple</td>
<td>-police, military</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-professional funds</td>
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<tr>
<td></td>
<td></td>
<td>-provincial systems</td>
</tr>
</tbody>
</table>

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$ ^1 $ Value of MOPRE determined annually by the Executive ($80 end of 1997)

Sources: Hujo 1999
<table>
<thead>
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</thead>
<tbody>
<tr>
<td>GDP growth rates %</td>
<td>-7.0</td>
<td>-1.3</td>
<td>10.5</td>
<td>10.3</td>
<td>6.3</td>
<td>8.5</td>
<td>-4.0</td>
<td>4.8</td>
<td>8.2</td>
<td>3.9</td>
<td>-3.5</td>
</tr>
<tr>
<td>National Savings Rate in % GDP</td>
<td>18.7</td>
<td>18.0</td>
<td>15.8</td>
<td>13.8</td>
<td>13.7</td>
<td>15.2</td>
<td>16.8</td>
<td>16.2</td>
<td>16.5</td>
<td>15.2</td>
<td>-</td>
</tr>
<tr>
<td>Gross fixed investment in % GDP</td>
<td>15.5</td>
<td>13.2</td>
<td>15.5</td>
<td>18.7</td>
<td>20.4</td>
<td>22.8</td>
<td>19.9</td>
<td>20.7</td>
<td>24.1</td>
<td>25.2</td>
<td>-</td>
</tr>
<tr>
<td>Capital Account Balance Mrd. US$</td>
<td>-0.04</td>
<td>-1.2</td>
<td>1.5</td>
<td>8.96</td>
<td>13.5</td>
<td>12.5</td>
<td>6.5</td>
<td>12.0</td>
<td>16.6</td>
<td>17.3*</td>
<td>13.9</td>
</tr>
<tr>
<td>External Debt Mio. US$</td>
<td>65.027</td>
<td>60.973</td>
<td>64.033</td>
<td>61.551</td>
<td>78.447</td>
<td>90.094</td>
<td>103.926</td>
<td>115.045</td>
<td>119.405</td>
<td>131.200</td>
<td>146.100</td>
</tr>
<tr>
<td>Public Sector Balance % BIP</td>
<td>-</td>
<td>-2.7</td>
<td>-1.3</td>
<td>0.4</td>
<td>2.2</td>
<td>1.0</td>
<td>1.0</td>
<td>-0.2</td>
<td>-1.3</td>
<td>-1.4</td>
<td>-2.6</td>
</tr>
<tr>
<td>Prices CPI</td>
<td>4.923</td>
<td>1.344</td>
<td>84</td>
<td>17.5</td>
<td>7.4</td>
<td>3.9</td>
<td>1.6</td>
<td>0.1</td>
<td>0.3</td>
<td>0.7</td>
<td>-1.8</td>
</tr>
<tr>
<td>Unemployment in % labour force</td>
<td>7.6</td>
<td>6.3</td>
<td>6</td>
<td>7</td>
<td>9.3</td>
<td>12.2</td>
<td>16.6</td>
<td>17.3</td>
<td>13.7</td>
<td>12.4</td>
<td>13.8</td>
</tr>
<tr>
<td>Sub-employment in % labour force</td>
<td>8.6</td>
<td>8.9</td>
<td>7.9</td>
<td>8.1</td>
<td>9.3</td>
<td>10.4</td>
<td>12.5</td>
<td>13.6</td>
<td>13.1</td>
<td>13.6</td>
<td>14.3</td>
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List of Abbreviations:
AFJP: Pension Fund Administration Company (Administradora de Fondos de Jubilaciones y Pensiones)
AMPO: Average Compulsory Pension Contribution (Aporte Medio Previsional Obligatorio), Argentine calculation unit
BCRA: Banco Central de la República Argentina
IADB: Inter-American Development Bank
IFF: Individual Fully Funded
IFIs: International Finance Institutions
ILO: International Labour Organisation
IMF: International Monetary Fund
ISSA: International Social Security Organisation
JO: Ordinary Pension (Jubilación Ordinaria), IFF pension in Argentina
MOPRE: Argentine calculation unit (Módulo Previsional) since Dec. 1997
PAYG: Pay-as-you-go
PAP: Additional Pension (Prestación Adicional por Permanencia)
PBU: Universal Basic Pension (Prestación Básica Universal)
PC: Compensatory Pension (Prestación Compensatoria)
SIJP: Integrated Pension System (Sistema Integrado de Jubilaciones y Pensiones), Argentina after 1994
SNPS: National Pension System (Sistema Nacional de Previsión Social), Argentina before 1994
UNDP: United Nations Development Programme