Brief for GSDR – 2016 Update

Social Security to strengthen pension systems in Latin America

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Introduction

Theoretically, there have been efforts to explain the type of existing welfare state in European countries. An approximation by Gøsta Esping-Andersen, incorporated variables related States' systems with opening or regulation of its markets and the distribution of goods.

If we take the concept of welfare capitalism of Gøsta Esping-Andersen[1], we have that this author categorized into three types of welfare regimes: 1) liberal, 2) conservative or corporatist and 3) institutional or social democrat (A.L.C., 2005).

The *liberal* model is based on a policy where the state has a minimal intervention, but it does ensure that the poorest sectors of society have a system of protection to reduce social inequalities. The *conservative* regime prioritizes the participation of the State and public institutions to be those that distribute the economic benefits among citizens. In the *institutional* model it is considered intergenerational solidarity within a system of mutual support, with comprehensive coverage of the citizen to risks relating to the social policy so that people have equal opportunities to develop as individuals and social becomes universal.

In Latin America, due to their particular form of development, the typology of Esping-Andersen cannot be applied[2]. Carlos Barba Solano explains the relationship between social security systems and social policy as a mechanism for distribution of power, being classified as: universalist[3], dual[4] and exclusionary[5]. Within social reforms, pension systems had to modify their systems to make them financially viable.

In 2000, according to the Millennium Declaration of the United Nations, a number of indicators to be evaluated during the period from 1990 to 2015, the Sustainable Development Goals (SDGs) that are: 8 goals, 21 targets and 60 selected indicators[6].

In the review, we can see that the objective 1.3. calls for the implementation of social protection systems and measures. The issue of pensions is related to the SDGs because pensions are part of the social benefits of the States and who receive the pension can use these financial resources to cover their needs when they conclude their working lives.

The reforms in the pension systems in Latin America

According to the International Labor Organization (ILO, 1984), social security "is the protection that society places against economic and social contingencies arising from the loss of income due to illness, maternity, work injury, disability, old age and death, including health care".

In Latin America, from the eighties of the twentieth century, countries began the process

[1] Theoretically, Esping-Andersen establishes the three ideal types, links with the commodification, stratification and employment (Esping-Andersen, 1990, p. 2 and 3). *Liberal:* low levels of commodification, means-tested policies; *Conservative:* average level of commodification, maintaining traditional hierarchies; and *social democratic:* high levels of commodification and universal policies.

[2] This difference is due to the system of European welfare has a logic of a political nature which seeks to maintain the status differences, while in the Latin American welfare services are transferred to the family, especially women, men being providers who work in the formal sector of the economy.

[3] Chile, Argentina, Uruguay and Costa Rica.

[4] Brasil, México, Colombia and Venezuela.

[5] Centroamérica, Ecuador, Perú, Bolivia and Paraguay.

[6] On this website you can consult the MDGs and their evolution: http://mdgs.un.org/unsd/mdg/Home.aspx

of reforming their pension systems moving from defined benefit schemes to defined contribution systems.

Most countries continue with a deficit: crisis in their pension systems. This is because the reform created a new regime, but continues to pay the pensions of the defined benefit systems.

In **defined benefit schemes** are those who commit to paying a pension according to certain variables such as contributions, age of the beneficiary, among others. Its financing scheme is linked to the contributions of active workers. The concept of *intergenerational solidarity* is assumed.

A **defined contribution** refers to one where each worker contributes to their pension through their individual account. At the end of its working life, the beneficiary will get what their have actually contributed to the system. In this regime are considered the risks from market forces on investments.

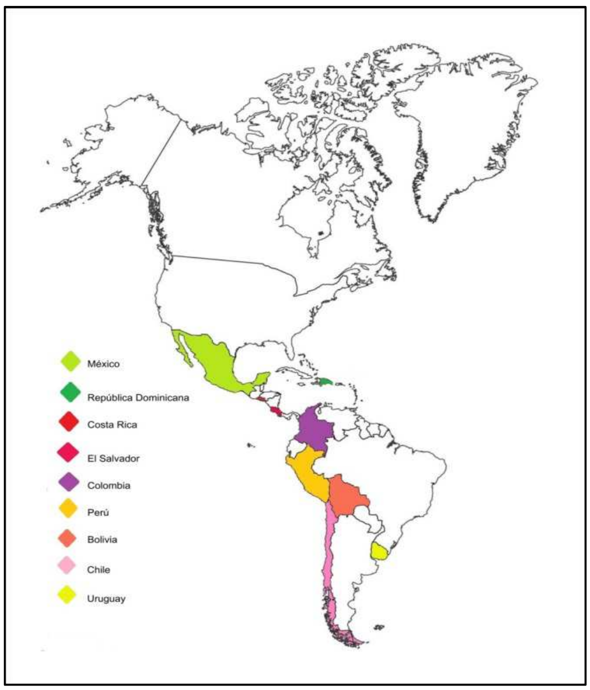

Figure 1: Countries with defined contribution systems.
Source: Prepared by the author.

In Latin America, most countries are part of the International Federation of Pension Fund Administrators (FIAP, for its acronym in spanish). According to FIAP, the year in which each country is reforming its pension system to institute a defined contribution scheme, we have: 1981, Chile; 1993, Peru; 1994, Colombia; 1996, Uruguay; 1997, for Mexico and Bolivia; 1998, El Salvador; 2000, Costa Rica; 2003, Dominican Republic.

In 2014, Chile's pension funds as a proportion of GDP were 68%; El Salvador, 32%; Uruguay, 21%; Colombia and Peru, 20%; Mexico, 16%; Costa Rica, 12%; Dominican Republic 11%[7].

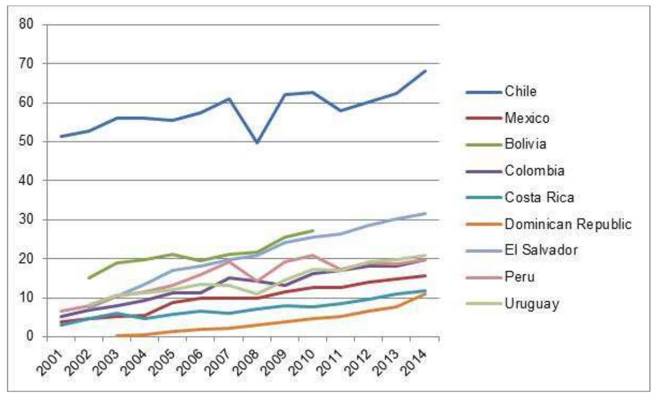

Figure 2: Funds pensioners as a percentage of GDP. 2014.
Source: Compiled by the author using data from the database of OCDE.

According to ILO data (2014), coverage of workers contributing to social security with respect to the PEA, is as follows:

Uruguay	66.8%
Costa Rica	66.5%
Chile	40.4%
Mexico	33.1%
Colombia	32.7%
El Salvador	28.6%
Dominican Republic	25.0%
Bolivia	20.0%
Peru	18.5%

These statistics are related to the labor market. In countries with greater incorporation of workers into the formal labor market, have a higher percentage of population economically

[7] In the OECD's database don't have information of Bolivia in 2014.

active contributing to the social security (OIT [ILO, for its acronym in English], 2014). Therefore, in the countries of Latin America it is important to establish strategies through programs that encourage work in the formal economy.

Proposal

In general, the contributions of workers are in accounts with low interest rates, therefore, their benefit is low. For this reason is why workers prefer to spend their income for immediate consumption and not savings. They don't take into account that in the future gets a pension that depends on what they have contributed to their individual account. In Latin America, the State allowed the entry of private pension fund administrators for individual accounts of workers. These entities are the ones who make profits, not the workers.

In this context, it is feasible to propose increase voluntary savings of the affiliate worker contributing to a social security system by implementing public policies to promote the social security culture.

One indicator of a decent pension is the *replacement rate*, which refers to the pension as a proportion of income received by the worker.

$$\text{Replacement Rate (RR):} \quad \frac{\text{Pension}}{\text{Wage}} * 100$$

ILO and OECD recognize a replacement rate of 50% as adequate, but recommended, according to the OECD is that the replacement rate is 70%. The replacement rate is determined primarily by voluntary savings: with higher voluntary savings, the replacement rate increases. To encourage voluntary savings, some of the mechanisms to be used would be through tax incentives and schemes pari passu (if workers perform voluntary contributions to a pension plan, the Government and/or the employer contributes a proportion of the savings).

These plans are designed for employees of medium and high income. Workers earning a grey salary (informal sector) are supported by the surplus from the investment of these pension's funds, so that they obtain a minimum pension to cover their main needs.

Within this scheme, the social security culture guarantee an improvement in the quality of life of workers, both active and next to retire, because they take into account what contribute voluntarily to future allowed to enjoy a higher pension.

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2. http://mdgs.un.org/unsd/mdg/Home.aspx [December 29, 2015].
3. http://stats.oecd.org/Index.aspx?DatasetCode=PNNI_NEW [December 29, 2015].