BOLIVIA

Privatization: from promises to failure

The experience of the new social security system, based on the 'advantages' of private investment over a state-run system, has been a complete failure. Far from guaranteeing workers a dignified pension, privatization has established a system in which the saver has less control over his or her destiny. The new prevailing reality has failed to achieve the reform's objectives of greater coverage, more transparency and the promised increase in retirement income.

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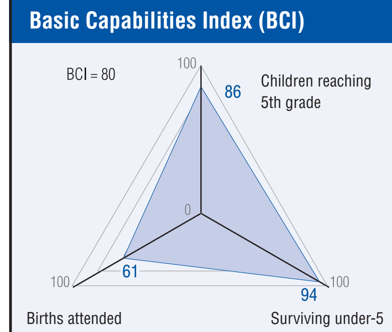

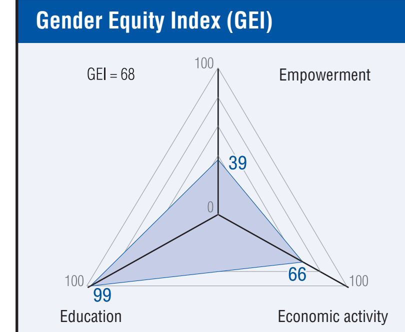

The underlying orientation of neoliberal policies is the promotion of market pre-eminence, idealizing it as the best mechanism for economic resource distribution. The role of the state is thus limited to that of a mere overseer of private companies' activities, and social objectives, such as citizens' well-being, become subordinate to capitalist investment profitability. However, a retrospective evaluation of the implementation of such policies reveals results far removed from the theoretical outcome: the state has lost its jurisdiction in the productive area but maintained a high profile in private investment bailouts, and was unable to meet the challenges of a free-market economy. This is the framework of social security system reforms in Bolivia and other countries of the region.

In the case of Bolivia, pension system reform was presented as a social necessity – an argument that was supported by the clearly dysfunctional state of the existing pension system in force for several decades – but was in fact designed as a potential source of profit for private investment.

According to one of the main promoters of the reform (Peña Rueda, 1996), the replacement of the 'pay as you go' (PAYG) social security system was justified by data suggesting its virtually bankrupt state:

- The proportion of active workers to pensioners was three to one, which is insufficient to financially support the system and much less than what is considered to be the ideal proportion (ten to one).
- The coverage of the system was very limited with only 314,437 regular contributors in an economically active population of 2.6 million.
- The system was discriminatory in its lack of coverage for the substantial number of non-salaried workers.
- The system was vulnerable to inflation and employment fluctuations and mobility.

Promised benefits

Consequently, a new system had to be implemented that would allow the state to reduce, and ultimately eliminate, its financial burden from the old bankrupt system and would provide adequate benefits to guarantee the population a dignified retirement from active working life. The intention was for this new system to have the following characteristics: a broadened reach including segments of the population not previously covered, in particular non-salaried workers; capacity for self-financing; investment management transparency; potential for strengthening the stock market; capacity for continuity in times of economic crisis; capacity to create mechanisms for maintaining the value of pensions; capacity to increase the incomes of Bolivians over the age of retirement.

More than five years after the implementation of pension system reforms it is possible to assess and compare objectives, results and prospects.

The mirage of greater coverage

One of the favourite arguments of government officials and Pension Fund Administrators (PFA) in defence of the reform is that the new system has resulted in an enormous increase in coverage. However, enthusiasm about the unprecedented growth in the number of affiliates, more than double when compared with the previous system, ignores the fact that at present the number of workers actually contributing to PFA-administered funds is substantially less than the number of affiliates.

A comparison of both social security systems' coverage, taking into account their relative size as a proportion of the economically active population, reveals that the situation has not changed significantly since the reform. Although in the year before privatization the previous system's coverage was less than that of the new system now, according to the National Employment Survey, in 1996 the economically active population figures were higher than in the 2001 Census and the projection for 2002.

Even worse, if we take the data used by government officials in charge of implementing the reform (an economically active population of 2.6 million in 1996), the previous system would have a much greater coverage than the current one, with the number of contributing workers amounting to 12% of the active population.

To the discomfort of the reform's designers and implementers, disaggregated data on the number of affiliates per type of worker also fail to indicate any clear superiority of the new system in extending coverage to non-salaried or independent worker categories. According to PFA information, by June 2003 the number of independent workers affiliated to the pension funds was only 4.3% of the total number of affiliates.

The cause of this state of affairs can be found, on the one hand, with the private fund administration entities who, in their search for income maximization, tend to avoid the administration of 'small-scale' contributions, and on the other, in the extremely low incomes of independent workers, mostly operating in the informal sector, that do not allow for the possibility of financing some type of saving for retirement. This second issue is further illustrated by the following data: according to the International Association of Latin American Pension Fund Supervisors (AIOS), the average insurable salary in Bolivia's individually funded system was USD 282 in 2003, while the average income of workers in the self-employed and small enterprise sectors for the same year was only USD 127, according to the National Statistics Institute.

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The system's unsustainability

As already mentioned, the promoters of social security reform in the country promised that the new individually funded system, unlike the previous one, would have the virtue of being self-financing (it would not require government assistance), supporting itself with the profits from investment in the stock market.

Available information refutes the theoretical assumption that the new system's operations would be subject to market efficiency. It is not free-market forces that determine investment decisions in PFA fund management. Current regulations require such bodies to maintain a certain structure in their investment portfolio with a predominance of state-issued securities. While the regulations limit investment in foreign-issued securities to 10%, investment in public securities, either of the National Treasury (TGN) or the Central Bank of Bolivia, has no limit. As much as 90% may consist of this type of investment, which explains the unusual concentrations in PFA portfolios.

In the case of the PFA Prévision, investment in TGN bonds (obligatory) amounts to USD 458 million, comprising 69% of its portfolio, and in the case of the PFA Futuro, USD 365 million, or 61% of its portfolio. This total of USD 823 million invested in TGN bonds represents 65% of the total funds in the Individual Capitalization Fund (FCI).

However, according to AIOS information, by December 2002, over 69% of the FCI portfolio was in the form of fiscal securities. That is to say, apart from the 65% invested in TGN bonds, 4% was invested in other state securities. This state-determined investment structure arises from a deterioration in the state of public finances, due to privatization policies, that does not allow the state to finance public expenditure in a normal way and explains its consequent repeated need to resort to the expedient of incurring public debt. It should be emphasized that a significant part of public expenditure is allocated to the cost of the social security system reform itself: the payment of pensions to the beneficiaries of the previous PAYG system.

Moreover, it must not be forgotten that in the framework of an economy as small and poor as Bolivia's, with a weak stock market and an inefficient financial system, a fiscal deficit financed with FCI resources becomes a more attractive option for the state than what the private finance system can offer. At the same time, an excessive dependence on public securities generates a high risk for PFAs, making them vulnerable to sudden changes in government policy.

It can consequently be inferred that the objective of efficient administration based on transparency in decision-making and investment has not been achieved, as the affiliates who contribute to the system, the true owners of the accumulated funds, have no influence in decision-making over the destiny and profitability of their savings, but rather it is public officials and political authorities whose interests are met through authoritarian imposition on PFAs.

Additionally, the expected potential of the new system for strengthening the stock market did not materialize. The extreme submission of pension fund management to government decisions, together with the particular characteristics of the national economy, prevented the emergence, and therefore consolidation, of a true stock market.

It is also clear that the absence of appropriate regulations to ensure an optimum operation of the long-term social security system, together with the marked weakness of the regulatory system for enforcing compliance with the rules of operation, have generated a high level of employer debt with PFAs.

It is a mistake to artificially separate the situation of the individually funded system from the situation prevailing in the residual PAYG pension system that, according to reform design, should tend to disappear, thus eliminating the fiscal expenditure that it involves. In relation to this, it can be said that the way in which the reform was implemented has resulted in alarming costs for the public treasury in the form of pension payments to pensioners from the old PAYG system, which represented more than 90% of the annual public sector deficit over the last five years.

The most worrying aspects of this situation are that such costs have to be regularly covered by taking on public debt, which incurs high interest, and that the obligations assumed by the state for paying such pensions have been steadily growing up to the present, and will continue doing so, due to commitments entered into by successive governments.

To summarize, this entire state of affairs has arisen because the reform's cost to the state – for payment of pensions to the beneficiaries of the previous system – has exceeded initial predictions calculated as USD 616 million over the first five years of the new system.

The aforementioned characteristics reveal the evident unsustainability of a system operating with a logic opposite to the one that the reform was originally based on and with an inherent dramatic contradiction that has created a kind of return to the old system. In other words, the accumulated savings in the new system provide, at a high cost, the necessary liquidity for paying pensioners from the old system.

Frustrated hopes for a dignified pension

The promise of dignified pensions that would improve on the social results of the previous PAYG system became the main justification put forward by reformers.

However, an evaluation of results indicates a worse situation and reinforces the hypothesis that the true objectives of the reform bore little relation to the endeavour to create better living conditions for the working population.

In the first place, transforming the system has not generated a significant increase in the number of beneficiaries, so it cannot be said that it has contributed to a reduction in the widespread phenomenon of large social groups being excluded from social security benefits.

Secondly, the promise of increased incomes has met with similar disappointment. The new scheme was designed in such a way that access to a pension is linked to a substantially longer working life and in addition it does not guarantee access to a dignified pension for all workers. There is a special category provision in the Law of Pensions called 'minimum retirement' that is applicable to a worker who has not paid enough contributions to finance a pension equivalent to at least 70% of the minimum national salary but who has reached 65 years of age. He or she will receive a pension or annual income equivalent to this percentage "until the accumulated funds are exhausted," irrespective of whether or not this pension covers all the remaining years of life after retirement. In short, there will be workers who only have access to a very small pension – the current minimum salary is no more than USD 58 a month – for a time that will not necessarily coincide with their remaining life span.

It is clear that the two systems are guided by different perspectives: the previous PAYG system regarded the provision of security to workers after their active working life as an inescapable obligation of the state, while the new system abandons this state responsibility, delegating the provision of security for the economically inactive population to the 'efficient' workings of the market. ■

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