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Chile's Pension System: Background in Brief

Alison M. Shelton
Analyst in Income Security

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Summary

In 1980, Chile was the first country to replace its pay-as-you-go public pension system with a system of individual accounts. The "Chilean model" has been widely studied as one possible model for public pension restructuring.

Chile's public pension system consists of three tiers: a poverty prevention tier, an individual account tier, and a voluntary savings tier. The poverty prevention tier provides a minimum benefit to aged persons who did not participate in the public pension system and to retired workers whose monthly pensions financed by individual account assets (the second tier) do not reach certain thresholds. Workers contribute 10% of wage or salary income to an individual account in the second tier and choose a private-sector Administradora de Fondos de Pensiones (AFP) with which to invest their pension contributions. Employers are not required to contribute to employees' AFPs, although since 2008 employers have been required to pay the premiums for workers' survivor and disability insurance, which are provided by private insurance companies. Upon retirement, the worker may withdraw assets that have accumulated in the individual account as an immediate or deferred annuity or through programmed withdrawals. The third tier allows workers to supplement retirement income with voluntary, tax-favored savings.

In 2008, Chile approved major reforms intended, among other goals, to increase participation in the public pension system, improve competition among the private-sector individual account managers, and bolster the poverty prevention tier. There has been concern that, as a result of low participation rates and underreporting, many workers could reach retirement with individual account balances that are too small to provide an adequate pension annuity. The 2008 reforms helped address these concerns by expanding the poverty prevention tier, phasing in coverage for most self-employed workers, and providing incentives for additional voluntary saving through the system's third tier. Other provisions approved in 2008 are intended to reduce high investment management fees (administrative costs) by increasing competition among AFPs.

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Introduction

In 1980, Chile replaced its pay-as-you-go public pension system, under which benefits for current beneficiaries were paid with taxes from current workers, similar to Social Security in the United States, with a system of individual accounts that has become a possible model for public pension restructuring around the world. The preceding pay-as-you-go system had been foundering financially and was unable to pay full scheduled benefits. In addition, the previous system had been extremely complex, with more than 100 different combinations of contribution rates, retirement ages, and benefit amounts for different groups of employees.

Chile's system of private pension accounts has been widely studied as one model for public pension restructuring. The U.S. Congress has considered a number of proposals to include private accounts in the Social Security system, either by carving contributions to private accounts out of Social Security's current payroll tax revenue stream or by adding private accounts onto Social Security's traditional benefit system.

This report provides an overview of Chile's pension system, including a description of major reforms approved in 2008, the Chilean government's role, and challenges facing the system. The Chilean pension system consists of three tiers: a poverty prevention tier, an individual account tier, and a voluntary savings tier. The poverty prevention tier provides a basic benefit to aged persons who did not participate in the public pension system and to retired workers whose monthly pensions financed by individual account assets (the second tier) do not reach certain thresholds. Under the second tier, workers contribute 10% of wage or salary income to an individual account and choose a private-sector Administradora de Fondos de Pensiones (AFP) to manage the account. Upon retirement, the worker may withdraw the individual account's accumulated assets as an immediate or deferred annuity or through programmed withdrawals. A third, voluntary savings tier encourages workers to supplement pension income with additional savings. The 2008 reforms were designed, among other goals, to increase participation in the public pension system, reduce high investment management fees and administrative costs, and bolster the poverty prevention tier.[1]

Pension Structure: Three Tiers

First Tier: Poverty Prevention

The first tier of Chile's public pension system is a poverty prevention tier funded by general revenues. The poverty prevention tier is available to all citizens aged 65 and older who pass a means test and who have lived in Chile for at least 20 years, and for at least 3 of the past 5 years, whether or not they contributed to an individual account (the second tier).[2]

[1] Under Chile's social insurance system, retirees receive free health care.

[2] The means test, which applies to both the Basic Solidarity Pension and the Pension Solidarity Component, is measured at the household level and is designed to determine that a beneficiary does not belong to the top 40% of the population based on income from earnings and pensions, by age and disability status.

The Chilean government pays a Basic Solidarity Pension to individuals who have not contributed to individual accounts and pass the means test. The Basic Solidarity Pension is 75,000 Chilean pesos (about $154) per month, wage indexed starting from July 2008.[3]

A Pension Solidarity Complement is paid to individuals who contributed to individual accounts (the second tier) and pass the means test, but who would receive a monthly pension below a threshold amount of 255,000 Chilean pesos (about $523) in July 2011, wage indexed thereafter. In the case of retirees who have annuitized their individual account balances, the Pension Solidarity Complement is paid as the difference between the minimum benefit amount and the annuity financed by the individual account. In the case of pensions paid through programmed withdrawals from the individual account, the Pension Solidarity Component is paid once the member has used the balance in his or her individual account. Because the existence of a poverty prevention tier could discourage savings through the second tier (individual accounts), the state's contributions are designed so that every dollar saved always increases retirement income, but not by a full dollar.[4]

Second Tier: Mandatory Individual Accounts

Pension Contribution Rates

Employees are required to contribute 10% of wage and salary earnings to an individual account, up to a ceiling on monthly taxable earnings of 60 unidades de fomento (UF).[5] Since 2009, the earnings ceiling has been indexed to growth in average earnings and stood at 67.4 UF in early 2012.[6] Employers are required to withhold workers' contributions from their paychecks and to forward contributions to the AFP chosen by each worker. Employees' contributions are tax deferred: contributions do not count as income in the period they are made and interest earnings are exempt from taxation until withdrawal. Retirees pay regular income taxes on pension income when it is drawn as a retirement benefit.[7]

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[3] Superintendencia de Pensiones, "Pensión Básica Solidaria de Vejez," at http://www.spensiones.cl/573/article-5784.html.

[4] Starting mid-2011, the Pension Solidarity Complement is defined as the value of the Basic Solidarity Pension of 75,000 Chilean pesos minus 29.4% times the value of the pension from the worker's individual account, where the figure of 29.4% is derived as the ratio of the Basic Solidarity Pension to a threshold of 255,000 Chilean pesos. See OECD, *Pensions at a Glance 2011*, Paris, France, p. 2011, http://dx.doi.org/10.1787/pension_glance-2011-en, p. 209. See also Social Security Administration, *Social Security Programs Throughout the World: the Americas, 2011*, at http://www.socialsecurity.gov/policy/docs/progdesc/ssptw/2010-2011/americas/chile.html and The World Bank, Reforming *the Pension Reforms: The Recent Initiatives and Actions on Pensions in Argentina and Chile*, SP Discussion Paper No. 0831, May 2008.

[5] Unidades de fomento, or UF, are real, inflation-adjusted units that have been used for a variety of purposes in Chile since 1967, including pension contributions and guaranteed benefits under the pension system, private and public loans, housing values, construction costs, and other purposes. In 2008, 60 UF were equal to eight times the minimum wage and 291% of average earnings (OECD, *Pensions at a Glance 2011*, Paris, France, p. 2011, http://dx.doi.org/10.1787/pension_glance-2011-en, p. 208). At end-February 2012, one UF was equal to about $22.46, at http://www.uf.cl/.

[6] Superintendencia de Pensiones, *Informaçion Para Pago de Cotizaciones Previsionales*, at http://www.spensiones.cl/safpstats/stats/inf_estadistica/cotprev.html.

[7] Some groups of workers have their own pension systems and do not participate in the individual account system. These include employees of railroads, the public sector, military and police, and seamen and port workers.

Employers are not generally required to contribute to employees' accounts. Since 2008, employers have been required to pay premiums for survivor and disability insurance, which in Chile is provided by private insurance companies. Survivor and disability insurance premiums have recently totaled about 1.49% of employers' payroll, on average.[8] Tax incentives are available to employers who make matching contributions to employees' supplemental savings through the third, voluntary savings tier.

Structure of Individual Accounts

Workers choose one AFP with which to invest their 10% pension contributions. An AFP is a private company that is regulated by Chile's Superintendent of Pensions. An AFP exclusively manages a worker's pension investments and administers pension benefits, including collecting pension contributions, keeping records, managing pension investments, calculating retirement annuities (unless a worker chooses to contract with an insurance company), and paying retirement annuities.

Workers may choose any AFP and may switch AFPs at any time for a fee. In February 2012, there were six AFPs. Each AFP offers up to five government-approved funds, called Funds A to E, with different levels of risk. Fund A, with the highest proportion of equities, carries the highest risk and potentially the highest return. The five-fund portfolios operate within regulations established separately for each type of fund concerning the credit rating and liquidity of investments, diversification, and other factors.

Participants pay administrative charges to the AFPs for managing individual account assets. These charges are levied in addition to the 10% mandatory contribution. The AFPs are free to set fees and commissions, as long as these are standard for all members. In other words, it has been assumed that participants' freedom to choose their AFPs, combined with competition among AFPs, will result in an appropriate level of commissions. Administrative charges and AFP profits have historically been significant, however.[9]

Retirement Benefits from Individual Accounts

A worker's pension annuity is calculated based on the accumulated assets, plus returns, in his or her individual account. The annuity calculation is based on age and gender-specific life expectancy. If the pension annuity is below certain thresholds, the Chilean government provides additional payments to bring the total pension up to the monthly Solidarity Pension (first tier) amount.

Early retirement is possible at any time as long as the capital accumulated in the account is sufficient to finance a pension that (1) starting from August 2010, replaces 70% of the worker's average earnings in the 10 years prior to drawing the pension, and (2) starting from July 2012,

[8] Social Security Administration, *Social Security Programs Throughout the World: The Americas, 2011—Chile* at https://www.socialsecurity.gov/policy/docs/progdesc/ssptw/2010-2011/americas/chile.pdf.

[9] Superintendent of Pensions, *The Chilean Pension System, Fourth Edition*, p. 47, at http://www.safp.cl/573/article-3523.html. See also Mauricio Soto, *Chilean Pension Reform: The Good, the Bad, and the In Between*, Center for Retirement Research at Boston College, Number 31, Boston, MA, June 2005 and Barbara E. Kritzer, Stephen J. Kay, and Tapen Sinha, "Next Generation of Individual Account Pension Reforms in Latin America," *Social Security Bulletin*, vol. 71, no. 1 (2011).

equals 80% of the Pension Solidarity Complement. The normal retirement age (NRA) is reduced by one or two years for each five years of work in certain specified, arduous occupations, with a maximum reduction in the NRA of 10 years.

The assets accumulated in the individual account can be withdrawn in the following ways:

1. *Programmed Withdrawal*. The AFP calculates monthly annuity amounts, including an annual inflation adjustment, and manages the pension payments. The account balance is held in one of the three lower-risk funds, at the retiree's choice, to avoid risk-taking that might result in premature account exhaustion and trigger the government's minimum benefit guarantee. The account holder retains ownership of the account, and can leave any remaining balance to heirs, but assumes longevity and investment risk in the case of monthly withdrawals that exceed the minimum benefit guarantee.

2. *Life Annuity*. Members may choose a life insurance company to pay an inflation-adjusted monthly pension and a survivor pension to any beneficiaries. The account holder transfers ownership of the assets to the life insurance company, which assumes both financial and longevity risk. The decision to choose a life annuity is irrevocable once the ownership of the account assets has been transferred to the life insurance company.

3. *Temporary Income with Deferred Life Annuity*. The account holder contracts with an insurance company to provide temporary or programmed monthly payments until, at some point after retirement, the insurance company starts to pay a life annuity. In this way the account holder retains ownership of the part of the account that remains in the AFP until the life annuity begins.

4. *Immediate Annuity Plus Programmed Withdrawals*. In 2004, a new option was created, under which a portion of the account balance is used to purchase an immediate annuity and the remainder is paid out as programmed withdrawals.

From the account balance, 15 UFs are reserved to cover funeral expenses.

Disability and Survivor Benefits from Individual Accounts

In Chile, disability and survivor benefits are financed by a combination of the worker's individual account and private insurance. AFPs are required to purchase insurance policies to finance disability and survivorship benefits on behalf of participants and their surviving dependents through the age of 65.[10] Since 2009, employers have been required to pay the premiums to the AFPs on behalf of their employees. Survivor and disability insurance premiums have recently averaged about 1.49% of payroll contributions.[11] This insurance is used to pay the difference between an annuity financed from the accumulated assets in the worker's account and the

[10] Men and women pay the same fee for disability and survivorship insurance. But because men have higher risk rates than women, the cost of insurance differs by gender, and this difference is deposited in women's individual accounts. As a result, women's contributions to their pension funds will be slightly higher than the 10% prescribed by law. See The World Bank, *Reforming the Pension Reforms: The Recent Initiatives and Actions on Pensions in Argentina and Chile*, SP Discussion Paper No. 0831, May 2008.

[11] International Social Security Association, http://www.issa.int/Observatory/Country-Profiles/Regions/Americas/Chile/Scheme-Description/%28id%29/106103.

disability or survivor pension to which the disabled worker or the worker's survivor (spouse, children, or parents) is entitled.

The monthly disability pension is 70% of the worker's base salary (defined as his or her average monthly salary for the previous 10 years) for those entitled to a total disability pension and 50% of base salary for those who are entitled to a partial disability pension.[12] Eligible survivors may include a surviving widow(er)[13] and children younger than aged 18 or aged 24 if a student. There is no age limit for disabled surviving children.

Third Tier: Voluntary Additional Saving

Workers may make voluntary additional contributions to certain savings products authorized by the Chilean government, including voluntary savings accounts managed by the AFPs, mutual funds offered by banks, and savings products offered by insurance companies. Contributors may pay up to 50 UF per month (unindexed) to voluntary savings vehicles, over and above the mandatory 10% basic contribution to the AFP. Contributions may be made on a periodic basis or on a single occasion. Contributors may transfer funds from a voluntary savings account to the individual account (tier 2) to increase the amount of the monthly pension annuity.

Voluntary contributions receive tax preferences. At the worker's choice, contributions may be paid from pre-tax income with the assets and accumulated income subject to taxation upon withdrawal, or contributions may be made out of after-tax income and are tax-free at withdrawal. Because tax preferences provide little incentive to workers who have no income tax liability, the government subsidizes low-income workers' contributions to voluntary savings accounts.

Since 2008, the government has also offered tax incentives to promote employer-sponsored voluntary pension plans (Ahorro Previsional Voluntario Colectivo). The tax incentives are intended to encourage firms to establish voluntary savings accounts for their employees and to match a share of employees' contributions.[14]

[12] A worker receives a total disability pension if he or she has lost at least 2/3 of ability to work. A worker receives a partial disability pension if he or she has lost between half and two-thirds of ability to work.

[13] Widows are allowed to receive both a survivor pension and a pension from their own individual account.

[14] The employer-provided voluntary savings plans, which were part of the 2008 reform package, resemble 401(k) defined contribution plans in the United States. Chilean employers can contract with any financial institution (AFP, banks, mutual funds or insurance companies) to establish a plan. Conditions must be the same for all workers and employers cannot under any circumstance restrict participation to certain groups of employees. See The World Bank, *Reforming the Pension Reforms: The Recent Initiatives and Actions on Pensions in Argentina and Chile*, SP Discussion Paper No. 0831, May 2008.

Financial and Regulatory Role of the Chilean Government

Role of General Revenues

The second tier of individual accounts is generally fully funded by workers' contributions. In cases in which the Superintendent closes an AFP or an AFP becomes insolvent, the Chilean government assumes responsibility for contributions, guaranteeing pension benefits, disability pensions, and the death benefit.[15] Chile's government is also responsible for financing the first, poverty prevention tier, from general revenues, including the Basic Solidarity Pension for persons who did not contribute to individual accounts and the Pension Solidarity Complement for persons whose annuitized individual accounts provide pensions below the guaranteed minimum. The Chilean government also provides subsidies to low-income workers who contribute under the third, voluntary savings tier, and tax incentives to employees who save in the third tier as well as to employers who establish voluntary savings accounts and match employees' contributions to these accounts.

Transition costs have been financed from general revenues, particularly during the first years of Chile's move from a pay-as-you-go system to a system of individual accounts plus poverty prevention programs. Between the 1981 conversion to individual accounts and 1999, total transition costs averaged about 3.25% of gross domestic product (GDP) per year.[16] Transition costs include spending for current beneficiaries and those who remained in the pay-as-you-go system, plus "recognition bonds"[17] issued to those who transferred to the new individual account system. Although expenditures on recognition bonds are currently increasing as more former pay-as-you-go system participants reach retirement age, total transition costs have begun to decline as the number of participants under the pay-as-you-go system declines and are expected to be negligible by about 2050.

The 2008 reforms discussed below, which included substantial expansions of the government-financed poverty prevention tier, are expected to cost an additional 0.5% of GDP in the first few years, rising to about 1% of GDP after phase-in by 2025.[18] This estimate is qualified, however, by considerable uncertainty in the number of potential beneficiaries in the reformed poverty prevention tier, as well as uncertainty about future demographic and economic assumptions. It is "quite possible"[19] that the current 10% contribution rate may be insufficient to fund adequate

[15] If an AFP becomes insolvent, the Chilean government would provide a life annuity up to 100% of the minimum pension and 75% of the excess over and above that, up to a threshold.

[16] Superintendent of Pensions, Santiago, Chile, *The Chilean Pension System, Fourth Edition*, p. 47, at http://www.safp.cl/573/article-3523.html.

[17] Recognition bonds are issued to workers under the pay-as-you-go system who elected to switch to the individual account system starting in 1981. Recognition bonds are calculated as the capital needed to purchase a life annuity based on the worker's life expectancy and his or her contributions under the pay-as-you-go system, with some adjustments. Recognition bonds are financed out of general revenues and are redeemed when the worker reaches normal retirement age, becomes permanently disabled, or dies.

[18] The World Bank, *Reforming the Pension Reforms: The Recent Initiatives and Actions on Pensions in Argentina and Chile*, SP Discussion Paper No. 0831, May 2008, p. 45.

[19] The World Bank, *Reforming the Pension Reforms: The Recent Initiatives and Actions on Pensions in Argentina and Chile*, SP Discussion Paper No. 0831, May 2008, p. 48.

benefits from individual accounts, particularly if life expectancy increases, in which case payouts from the poverty prevention tier would increase.

Supervision

The Superintendent of Pensions is responsible for supervising and regulating the mandatory and voluntary individual account systems. The Superintendent approves new AFPs; sets capital requirements; oversees AFP accounting, advertising, investment, and legal practices; interprets laws; issues regulations; proposes new laws; imposes fines; and orders the dissolution of AFPs when necessary. For each of the five investment portfolios that AFPs are authorized to offer, the Chilean government sets certain per-instrument, per-issuer, and per-group-of-instrument limits to ensure that the five authorized portfolios are diversified, have appropriate balances of risk and return, and that a single AFP does not acquire a controlling interest in any single issuer of stocks or bonds.[20]

2008 Reforms

In 2008, Chile under President Michelle Bachelet introduced several major reforms to the pension system to address concerns, including low participation rates, high pension fund management fees, and inadequate benefits for low-wage and women workers.

Participation Rates

Before the 2008 reforms, only about 62% of the labor force, and about 68% of those employed, participated actively in the national pension system.[21] A large share of the workforce was then, and continues to be, self-employed in Chile's formal and large informal sectors. Prior to 2008, the law allowed self-employed workers to participate on a voluntary basis and only a small percentage of the self-employed chose to contribute. Other non-participants were temporarily out of the workforce due to caregiving or unemployment. Among those who did participate, many underreported their income to lower their contributions. As a result of low participation rates and underreporting, there was concern that many workers would reach retirement with individual account balances that were too small to provide an adequate pension annuity.

The 2008 reforms phased in a requirement that most self-employed workers contribute to the pension system.[22] In addition, the 2008 reform package, to increase participation among younger workers, established government subsidies to the accounts of low-income workers between the

[20] The 1980 pension reform wrote most of these investment limits into the law. The 2008 reform package maintained over-arching limitations but transferred most of the regulatory authority for specific limits to Chilean government agencies (Central Bank and Superintendent of Pensions).

[21] Mauricio Soto, *Chilean Pension Reform: the Good, the Bad, and the In Between*, Center for Retirement Research at Boston College, IB no. 31, 2005, p. 3, http://crr.bc.edu/images/stories/Briefs/ib_31.pdf. Participation is defined as contributing, in any month in 2003, to either an individual account, the pre-1980 pay-as-you-go system, or one of the separate pension programs for certain groups of employees, such as public-sector workers, the military, and police.

[22] The extended coverage applies to all self-employed workers with income subject to the income tax. The most informal sectors of the economy, such as agricultural workers and small-scale producers and retailers, will not be brought into the pension system by the 2008 reforms.

ages of 18 and 35. The 2008 reforms also tightened rules facing employers who fail to transfer workers' contributions.

Administrative Costs

Historically, fees and commissions charged by AFPs to manage individual accounts have been a concern attributed to high-cost marketing and increased concentration in the industry.[23] The number of AFPs was 12 in 1981, rose to 21 by 1994, and declined to 5 by 2008 due to mergers and closures. Administrative costs reduce investment returns to account holders, reducing a worker's account balance over time and resulting in a lower annuity at retirement.

The 2008 reform package included a number of measures intended to reduce administrative costs, including a simplified fee structure that facilitates workers' ability to compare administrative costs among the AFPs.[24] The 2008 package also included provisions intended to increase competition among the AFPs and reduce industry concentration. Insurance companies were allowed to create AFP subsidiaries. In addition, AFPs were allowed to contract out more services, such as record keeping and customer service, in order to lower barriers to entry for new AFPs. The 2008 reforms also created a competitive bidding process under which all new participants for two years are automatically enrolled in the AFP that offers the lowest management charges in the most recent round of bidding; it is hoped that this new bidding process, by guaranteeing a steady flow of participants for two years without having to incur marketing costs, will attract potential new AFPs.

It may be too early to tell if these reforms will increase competition. In February 2012, the number of AFPs was six. In January 2012, AFP Modelo won the competitive bidding process for new workers' accounts for the next two years with a low bid of 0.77% for administrative expenses, notably lower than current AFP administrative expenses, which range from 1.14% to 2.35% of covered (that is, taxable) earnings.[25]

Pension Benefit Adequacy

The adequacy of pension benefits has also been a source of concern. Individual accounts systems do not generally allow for the redistribution that occurs in public defined benefit systems; instead, a worker's pension is directly related to his or her own earnings and contribution history. In addition, low or negative returns between 1995 and 1998, combined with high management fees, caused many workers to lose money during this period. In 1998, the Chilean government asked workers to consider delaying retirement until the market recovered.[26]

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[23] In 2003, for example, administrative costs and premiums averaged about 2.26% per month, of which about 1.51% was for administrative costs and about 0.75% was for survivor and disability insurance premiums. See CRS Report RL34006, *Social Security: The Chilean Approach to Retirement*, by Christopher Tamborini.

[24] As a result of the 2008 reforms, AFPs can only charge a single commission, which is expressed as a percentage of individual account earnings.

[25] Superintendent of Pensions, Santiago, Chile, Comunicado de Prensa, January 30, 2012, at http://www.spensiones.cl/573/article-7895.html.

[26] Stephen J. Kay, *The Perils of Private Pensions*, Foreign Policy, winter 1999-2000.

As part of the 2008 reforms, the Chilean government restructured the poverty prevention tier to expand protection for low-income workers and workers who have contributed inconsistently, or not at all, to the individual account tier. In addition, to encourage participation in the third tier of voluntary savings, the 2008 reforms created bonuses for low-income workers and tax incentives for contributing employees and for employers who establish voluntary savings accounts and match employees' contributions to these accounts. Also in 2008, a subsidy was approved to encourage employers to hire workers between the ages of 18 and 35, on the principle that early contributions can have a significant impact on final pension amounts.

The 2008 reforms also contained several measures intended to improve the adequacy of women's benefits from their individual accounts, given that women often earn lower wages than men and many leave the workforce temporarily or permanently for caregiving. The Chilean government deposits a bonus in a woman's private account at age 65 for every live birth or adopted child. For women who have not contributed to the pension system, the Chilean government makes a corresponding increase in the amount of the Solidarity minimum benefit. The bonus is equivalent to 10% (i.e., the contribution rate) of the monthly minimum wage at the time of the child's birth, times 18 months, plus the average net rate of return on individual account pension plans in the C Fund from the child's birth until the pension is claimed. Women's contributions are boosted somewhat above the statutory 10% rate by a 2008 provision that charges both sexes the same premium for survivor and disability insurance, but deposits the difference between the higher premium that would have been charged to men into women's individual accounts. Finally, reforms passed in 2008 allow a judge to transfer up to 50% of funds from one spouse's account to the other spouse's account in cases of divorce or annulment.

Conclusion

Lessons from Chile's introduction of individual accounts may be helpful to other countries considering a similar transition, although not all of Chile's experiences are directly comparable to major Organisation for Economic Co-operation and Development (OECD) countries, such as the United States. For example, Chile's experience with high administrative costs may or may not be relevant to a second country, depending on whether the second country's public or private sector would manage account investments and the extent of financial-sector competition in the second country. Another difference between Chile and other countries may be the degree of public acceptance for the first, welfare tier of the system, which creates fiscal pressures similar to those of a pay-as-you-go system. Another political consideration is that Chile in the early 1980s, under General Pinochet, had considerable latitude to impose top-down reform of the pension system. Transition costs are another issue facing a country considering a move to a Chilean-type model. When Chile transitioned to a private account system in 1981, the earlier pay-as-you-go system was chaotic, insolvent, and unfair.[27] At the same time, Chile's non-pension budget in the early 1980s was in surplus and available for financing transition costs, and high growth rates of economic growth in Chile during the 1980s reduced the burden of transition on the economy.

[27] Mauricio Soto, *Chilean Pension Reform: The Good, the Bad, and the In Between*, Center for Retirement Research at Boston College, Number 31, June 2005, at http://crr.bc.edu/briefs/chilean-pension-reform-the-good-the-bad-and-the-in-between.

The 2008 reforms to the poverty prevention tier (the Solidarity tier) are generally acknowledged as the most important component of the 2008 reform package.[28] Chile's public pension system continues to face challenges after the 2008 reforms, however. Although the 2008 reforms will bring many self-employed workers into the public pension system, much of the informal sector remains outside the pension system. It remains to be seen whether reforms to AFPs will increase competition and lower costs.

Author Contact Information

Alison M. Shelton
Analyst in Income Security
ashelton@crs.loc.gov, 7-9558

[28] The World Bank, Reforming *the Pension Reforms: The Recent Initiatives and Actions on Pensions in Argentina and Chile*, SP Discussion Paper No. 0831, May 2008, p. 57.