Memorandum by *EIR* Staff

Looting of Nations by Pension Privatization

Ibero-America

Eleven countries in Ibero-America have privatized their social security systems, under pressure of the International Monetary Fund and their creditor banks. Chile was the model for the others, both in privatizing its system in 1981, and in its spectacular failure over the long term—so much so, that all forces in the country now agree it must be radically reformed. The Chilean government itself will be submitting a proposed reform to congress in early 2005.

Chile: The Chilean fiasco can be summarized in a few statistics:

- Only 20% of the labor force are covered with a pension greater than the government minimum standard of $110/month.
- About 25% of worker payments are skimmed off as "administrative fees" by the Pension Fund Administrators (AFPs).
- From 1997-2004, the AFP annual profit rate was a cool 50%. The AFPs are 94% controlled by foreign banking interests.
- From 1982-2004, the annual return on individual accounts with the AFPs has averaged only 5.1%.
- If two co-workers with the same salary in 1981 entered, one the old pay-as-you-go system, and the other the new privatized system, the co-worker in the privatized system today would receive less than half of the amount that the person who had remained in the old public system would be receiving.

In the other countries where social security has been privatized, it has followed the same trajectory of attaching billions of dollars in workers' pensions, and using it to bail out foreign banks. For example, in Peru, workers in the privatized system are forced to pay in 11.2% of their gross wage, the AFPs take an average 28.7% of the amount paid in as a "commission," and the AFP's average profit rate, as of May 2004, was 68%.

Mexico: Mexico attempted a privatization of its system of retirement assistance in 1992; when that "reform" fell apart, a more dramatic privatization was legislated in 1997. The old pay-as-you-go system, based in significant part on the employer's contribution, had generated surplus reserves for years, but these reserves had often been tapped by the government for expenses and public investments. The new private funds, called by the acronym AFORES, *are based very closely on the "Chile model."*

The AFORES manage $30-40 billion in funds of 12 million workers previously affiliated with the Mexican Social Security Institute (IMSS). These funds were created in 1997 with very large increases in retirement contributions by the Mexican government (from 0.425% of wage under the old system to 2.425% under the new) and employers (from 9.5% under the old system to 12.9% under the privatization scheme). As a result:

- Under the new scheme, the Mexican government is burdened with expenses estimated (by a CBO analysis in 1999) at 0.4% of GDP in 2006, and at 0.8% of GDP in 2025. As in Chile, the government is left guaranteeing a minimum pension to millions of workers who don't qualify for it under the privatization.
- That minimum is itself reduced, from 40% to 35% of the average wage.
- Foreign banks—The Banco Santander, Banamex, Bank of Nova Scotia, Banco Bilbao Vizcaya-Mexico—are now owners of the private pension funds of Mexico.
- The AFORES, from the outset, charged fees equal to at least 8-10% of the combined retirement contributions paid by employee, employer, and government. Now, it is estimated that the AFORES' fees are up to 30% of contributions paid—a swindle by any standard. The Social Security Commission of the Mexican Congress is demanding that the "fiscal cost" of the AFORES be investigated.
- As of Jan. 1, 2005, the AFORES may invest 20% of its funds in the stock market, and 15% in foreign markets, Chile-style. This was a demand of José Piñera of the Cato Institute (who was Chile's privatizer when he was Labor Minister in 1981) and other ideologues, who objected to the AFORES investment mainly in federal, state, and municipal debt paper.

Argentina: The partial privatization of Argentina's Social Security system in 1994 was a major contributing factor in the explosive debt crisis, default, and economic collapse of the country in December 2001.

- Aside from the looting represented by the large and illegitimate foreign debt, the 1994 privatization deprived the government of a significant amount of tax revenue which the privatization scheme diverted into private accounts, known as AFJPs. To make up the resulting deficit, the government was forced to borrow abroad—at very high interest rates—and accept the austerity conditionalities attached to IMF loans, in particular. By 2001, the deficit created by lost revenue was close to 3% of GDP, according to a 2002 study by the Center for Economic and Policy Research in Washington.
- The December 2001 default punctured the claims of lunatic analysts—just like those now coming out of the woodwork around the White House, and Congressional Republicans—that Argentina could take 75 years to pay off these "transition costs."

Partners in crime: Chilean architect of the "Pinochet Model" of privatizing pensions José Pinera (left) and U.S. Federal Reserve Chairman Alan Greenspan.

• In September 2001, three months before the debt default, the IMF forced the government to make a 13% cut in benefits in its old pay-as-you-go social security program—still functioning alongside the new private system—as a conditionality for a new agreement. The old program had been generous, offering a broad array of survivor and disability benefits, in addition to pensions.

• By the late 1990s, 48% of AFJP funds were invested in bonds, on which the government defaulted in late 2001.

The other Ibero-American countries that have privatized social security to date are: Peru (1993); Colombia, Costa Rica, Ecuador, Uruguay (1994); Bolivia (1997); El Salvador (1998); Panama (1999).

Canada

Canada's Old Age Security system was privatized in 1999 with the creation of the Canadian Pension Plan (CPP). In 1997, in preparation, the Paul Martin government drastically raised the contribution rate (payroll tax) from 5.8% of earnings to 9.9%—needless to say, creating since 1998 a substantial surplus of $74 billion, projected to keep growing through 2015. Under Law C-2 passed by Martin's government in 1999, this surplus was then turned over to a CPP Investment Board (CPPIB); the CPP's chief actuary charged that figures were being faked in this process, and the government fired him. The CPP Investment Board's self-description: "We are an investment corporation managed independently of the CPP by experienced investment professionals drawn from the private sector." The CEO for 1999-2004 has been John McNaughton, former president of Nesbitt-Burns Investment Advisors, an investment firm linked to the Bank of Montreal.

• In the CPPIB's five years under McNaughton's direction, it has already suffered one year—2002—in which it invested $18.4 billion of CPP funds and lost $3 billion, a negative 15.9% return. In 2004, its rate of return will apparently be only about 4%.

• McNaughton's Board has used the CPP as a fund to back favored start-ups, and energy companies like Talisman Energy, making dubious investments in Sudan. In a January 2000 speech he said: "We are long-term investors. We can be patient and can support companies during adverse periods if they have strong boards of directors. . . ." In 2003, the CPPIB put $50 million in a Canadian Venture Capital fund for "early-stage software companies," and so on.

• As of 2003, the CPP's mandatory 90-day benefits reserve fund was abolished, and 100% of its surplus fund is now in the account of the CPPIB.

Sweden

In 1998, the Swedish social security system was opened to "the markets." Of the Swedish worker's income, 2.5% (about one-seventh of the total retirement contribution) was diverted to private accounts managed by funds, for investment in the stock market, after a TV propaganda blitz to convince Swedes they would become millionaires thereby. Though most Swedes remained opposed to privatization, it was done anyway. An Oct. 29, 2004 Swedish investigative TV report exposed those 1998 claims as simple lies, including the patently false "warning" that Swedish pension funds invested in safe government Treasury bonds would soon be losing money.

Also in 1998, the four large public funds which manage the other 16% in "pay-as-you-go" retirement contributions, suddenly shifted from 30% equity investment of those public funds, to 70% equity investments. And the government began heavily to "borrow" the funds' surpluses for general expenses, Bush-style, in anticipation of their great near-future gains!

The IT bubble's collapse ensued. The losses by the public funds are likely to increase the retirement age from 65 to 69 in near-future legislation. The individual employees, on their own modest scale, are also losing: In 2003, some 87% of all the private investors of retirement funds, in 654 investment funds available, were losing money, with an average annual loss of 10%-20%. Now, Swedish employees and retirees dread opening the bright red envelopes which contain their checks and statements about "their" accounts.