

Chicago Boys' Free-Market Pension Model Is Unraveling in Chile

Eduardo Thomson, *Bloomberg*, May 10, 2021

- ▶ Savers withdraw billions of dollars from pension accounts
- ▶ Some lawmakers want the whole system to be dismantled



Photographer: Cristobal Olivares/Bloomberg

Chile's privately run pension funds are in a battle for survival, reeling under the impact of billions of dollars of withdrawals as politicians and social movements attack a system once viewed as a model for the world.

Chileans have taken out more than \$30 billion from their retirement savings in the past year and congress has authorized a third wave of withdrawals that could drive the figure to more than \$50 billion. That would leave the pension funds with about \$180 billion of equities and fixed-income assets. Many lawmakers are now calling for the whole system to be dismantled.

"I'm not sure it's the end of the AFP system, but I think it's clear this round of withdrawals will change things," said Mario Castro, a fixed-income strategist at BBVA in New York. "Clearly we're going to have reforms to the pension system, which will most likely include a significant role for the government."

Created during the dictatorship of August Pinochet on the advice of free-market economists known as the Chicago Boys, the private pensions Chileans are required to fund are a bedrock of the country's system. The savings they have generated over the past four decades have given local credit markets and the peso a stability that is the envy of serial defaulters such as Argentina or Ecuador, and prompted countries including Peru and Colombia to adopt similar structures. Yet, many complain that the funds have failed to provide decent pensions.

Distrust in the system, and a need for cash, meant Chileans rushed to pull money out of their savings accounts as the pandemic forced the government to shutter much of the economy.

The quasi rebellion against Chile's long-standing institution is part of a wave of social upheaval sweeping through Latin America in the months after the arrival of the coronavirus, which hit the region harder than any other part of the world.

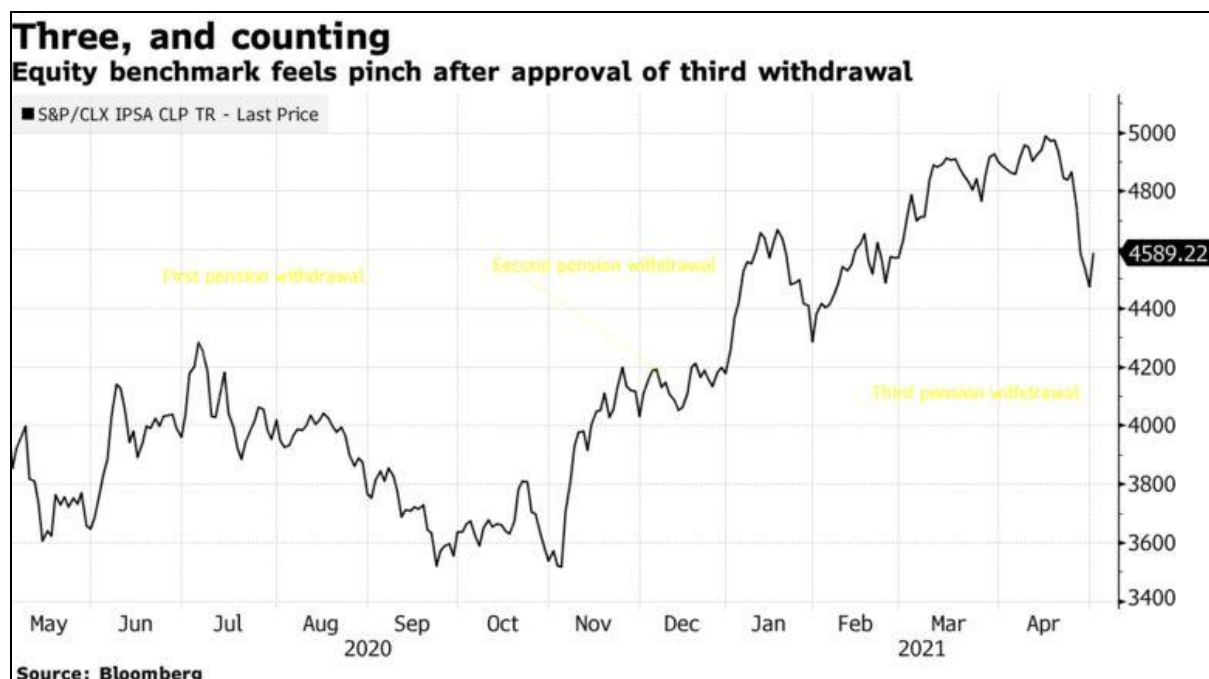
Protesters in Colombia, objecting to a broad tax increase for the middle class, staged bloody street demonstrations that last week resulted in the finance minister being fired as the government withdrew the plan. In Peru, the leading candidate in a presidential runoff scheduled for June is a Marxist. In Brazil, the disjointed response to the pandemic from Jair Bolsonaro's administration has spurred anti-government protests and counter protests.

Under Attack

Some Chilean lawmakers, with an eye on presidential and congressional elections in November, are now proposing rules that would allow a fourth pension withdrawal.

What's more, opposition lawmakers have demanded other changes to the system, including a royalty tax on Chile's giant copper industry and a levy on the super rich -- such as President Sebastian Pinera himself.

None of which is good news for markets. Chilean bond prices have fallen as pension funds sell the most liquid assets such as sovereign debt to meet demand. Broader concerns over the direction of economic policy have also led to a slump in share prices.



"It's a perfect storm," said Luis Felipe Alarcon, head economist at Euroamerica in Santiago. Amid concern the government may take over the pension system, "the rich will start to withdraw money, even though they don't need it."

To boost pensions and head off a more fundamental challenge to the system, the government has proposed a reform that would force employers to contribute to workers' savings accounts and increase competition via a state-owned pension fund.

The opposition is unimpressed though and the bill is languishing in congress. Alternatives include a state-managed savings system, a dual system or a return to tax funded state pensions.

Laying Blame

Kenneth Bunker, a political analyst and director at tresquintos.cl, lays at least part of the blame for the chaos at the door of Pinera.

"It's mostly Pinera's fault that the country finds itself in this mess," Bunker said. Bunker said. "His excessively obtuse and socially-disconnected vision led him not only to lose the support of the people, but also to lose the support of his own coalition."

The government has spent 8.2% of gross domestic product on measures to ease the economic impact of the pandemic, the second-highest rate in the region after Brazil, according to data from the International Monetary Fund. Yet, it has done little to bolster Pinera's support.

It is all feeding into a growing sense of malaise in a country that still has the highest credit rating in Latin America.

Chile was wracked by a wave of protests and riots in October 2019 that only ended with the imposition of a lockdown during the pandemic. The result of those demonstrations was a commitment to rewrite the constitution, drawn up during Pinochet's dictatorship.

That new charter will be decided on by a constitutional assembly to be elected later this month. Presidential elections are scheduled for November.

And in the middle of this battleground over economic and political reforms stands the pension system.

"The pressure will continue to move toward a different system in the new constitution, as this has been a constant demand and people are dissatisfied," said Alvaro Vivanco, head of emerging market strategy at Natwest Markets in Stamford.

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