IMPACT OF PENSION REFORM ON THE LIVING ARRANGEMENTS OF OLDER PERSONS IN LATIN AMERICA

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INTRODUCTION

Social security systems have become major elements of social development in the twentieth century, with particularly important effects on the well-being of the older groups of society. The past 25 years alone have witnessed dramatic improvements in living standards among the elderly in Europe and the United States of America, combined with similar shifts in pension payments and the maturing of pension plans. In fact, in those countries, there has been a substantial decline in the proportion of those covered by social assistance who are elderly (Laczco, 1990). Although less markedly than in the more developed countries, social security has also played an important role in the development process of many Latin American countries (Nitsch and Schwarzer, 1995).

More recently however, Governments in developed as well as developing countries have come to view changes to the regulation and laws of their social security systems as key factors in the reform of the State. In truth, the social security crisis, which includes the reform of the pension system, has become one of the world's most debated social policy issues at the end of the twentieth century.

The reasons for the crisis seem to differ between the more developed and the less developed regions. With respect to developed economies, the rising affluence of the elderly has prompted a debate over what constitutes an equitable distribution of income and wealth between age cohorts (Duncan and Smith, 1989). Among the member countries of the Organization for Economic Cooperation and Development, benefit obligations for which funding does not yet exist are on the order of US$30 trillion (Quin and Burkhauser, 1994). Despite this observation, most industrialized countries have instituted retirement policies that discourage the elderly from working. Between the 1960s and the 1980s, the average retirement age in developed countries decreased by five years (Médici, 1997). During this same period, spending on retirement and pension payments increased threefold, resulting from the increase in the number of senior citizens, the expectation of longer lives after retiring, and the average amount paid out in benefits.

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In the past decade, however, these policies have begun to change in several countries. Recent legislation in the United States, for instance, has outlawed mandatory retirement, banned the cessation of service year credits in pension calculations after a particular age, and increased the social security credit for delayed retirement after the age of 65 (Quin and Burkhauser, 1994). Several other countries have also already implemented changes in their primary retirement pension systems, designed to raise the normal retirement age within the next few years (Morrison, 1986).

In Latin America, on the other hand, the recent past has been characterized by persistent external imbalances, declining levels of income per capita, growing unemployment, an expanding informal sector, and an ever-increasing number of people living below the poverty line (Durán, 1996). Within this framework of increasingly severe socio-economic problems, countries have been forced to adopt structural adjustment programmes and to question their own retirement and pension systems, particularly in the light of unfavourable economic conditions, rapidly moving demographic transformations and their own errors and limitations.

Several countries of the region have already experienced structural reforms in their pension systems, following the pioneer experience in Chile at the beginning of the 1980s. In general, these reform movements have cast doubt on all aspects of the previous regimes, and given rise to a confrontation between the polarized positions of collective versus individual, immediate versus lasting, public versus private, and financial techniques versus actuarial techniques (Mesa-Lago, 1997). The major difference between the initial and the reform movements, however, is the existence among the latter of a contingent of beneficiaries with legally acquired rights who demand the creation of acceptable and viable transition alternatives.

Since pension reforms in Latin America have represented the imposition of a new paradigm—the complementation or even substitution of the public allocation system by a private system of individual funds—we can expect not only an important impact in the macroeconomy of the region, but also important effects on the population's living conditions, especially in the case of the elderly, who are the main beneficiaries of the system.

The purpose of this study is to present a brief analysis of the pension reforms conducted in Latin American countries, emphasizing those aspects that could, at least in theory, influence the living arrangements of the elderly. It is not an easy task to measure the success of pension reform—whose effects are felt only in the long run—especially when it involves changes in the objectives that gave rise to the institution itself, and where previous experience is practically non-existent.

Therefore, rather than present a conclusive analysis of the consequences of pension reforms on the household structure of the elderly in Latin America, the intention is to provide insights for future research concerned with the relationships between transformations in the pension systems and the well-being of the Latin American elderly population.

INFLUENCE OF PENSION REFORMS ON THE LIVING ARRANGEMENTS OF THE ELDERLY

Determinants of living arrangements of the elderly

Multivariate analyses of the living arrangements of the elderly have emphasized benefits and costs associated with different arrangements (Da Vanzo and Chan, 1994; Knodel and others, 1991; Martin, 1989), pointing out "the apparent interplay of constraints and preferences" (Casterline and others, 1991). In these analyses, the living arrangement of an elderly individual is assumed to be the outcome of a series of decisions taken by a number of people over a considerable period of time, which is heavily influenced by factors such as changes in marital status, employment history, savings and investment, migration, housing, and health-related behaviour. At a given moment in time, an individual is subject to various constraints with respect to the range of living arrangements available; she or he will have a set of preferences as to which arrangements are better than others, and these, in turn, will be juxtaposed with the constraints, resources and preferences of the members of the elderly person's family network.

Preferences for different living arrangements result from the balance between costs and benefits of cohabitation, and may be influenced by cultural standards and values. The benefits of cohabitation for both the elderly and the other household members may vary from companionship and emotional support to physical and financial support. Among the costs, the literature emphasizes the loss of privacy, the decline in social status of the elderly after losing control of financial resources, and the burden that physically or mentally impaired seniors would represent for live-in caregivers—typically a daughter.

The primary constraint on the choice of living arrangements refers to the size and composition of one's kinship network. A second set of factors that constrain living arrangements are those related to financial and physical feasibility. Many studies have found a positive relationship between economic resources and independent living, suggesting that, whenever feasible, elderly people prefer to purchase goods and services that otherwise live-in children may provide. At the same time, research has shown that disability, illness and advanced age are often associated with a reduced likelihood of living on one's own. In any case, some basic conditions are clearly required for the elderly to live independently.

How pension reforms can influence the living arrangements of the elderly

The most direct effect of pension reform on the household structure of the elderly refers to the influence it may exert on their financial autonomy. Should the benefits increase in value, and if the proportion of the older population who are covered increases, a greater share of elderly individuals would have better conditions for exerting their preferences in terms of household structure, which would probably increase the tendency for independent arrangements (living alone or with a spouse only) among the elderly. On the contrary, if the benefits situation does not significantly improve, the majority of the elderly will remain financially dependent on their family, and living arrangements in which they cohabit with relatives will persist or even become more prevalent.

When considering the effects of pension reform on the living arrangements of the elderly, however, it is important to analyse the elderly's situation vis-à-vis the situation of the remaining population groups. There are cases in which the possibilities of the elderly who are financially independent to opt for independent living arrangements are constrained by the less favourable situation of their immediate family.

Saad (1996, 1998), for instance, found that while higher income of the elderly in the most affluent region of Brazil splits generations into different households, it stimulates co-residence between generations in the poorest region. According to the author, the exercise by the elderly of their preference for independent living arrangements is overridden, in the latter region, by the needs of their adult children. In this case, the modifications brought about by the 1988 Brazilian Constitution, which included the rural population in the retirement pension system and increased the pension value from one half to one minimum wage, has transformed the income of the elderly into an important family asset in that region, particularly if compared with the poorer conditions of the younger generations (Souza, 1998).

THE LATIN AMERICAN PENSION SYSTEMS CRISIS

In Latin America, the first retirement and pension systems began at the turn of the century in Brazil, Argentina, Cuba, Chile and Uruguay, and were implemented gradually in the remaining countries over a 50-year period. The majority of them were originally based on European models, relying on hypothetical full employment and continued economic growth. Overall, the region's systems expanded within national development contexts characterized by protectionist economic models, high demographic growth rates and increasing employment opportunities.

Since their inception, these systems have been organized primarily under pay-as-you-go schemes. These are in fact social contracts calling for the unrestricted, mandatory transfer of funds from the active workforce to retirees and pensioners. This transfer has been backed by an implicit commitment by the Government that on reaching retirement age, today's workers would benefit from the contributions of future generations of workers.

From a financial standpoint, these plans are fine as long as benefit payments are matched by contributions. While these payments initially represent a surplus of capital, they are subsequently subject to actuarial adjustments. This capital must be invested in the form of reserve funds to be deployed for benefit payments when the system reaches maturity. Increases in the beneficiary/contributor ratio lead to losses in the system, forcing corrections to the value of both variables (Uthoff, 1997).

As put forward by Lo Vuolo (1996), those in favour of reform in the Latin American case argue that traditional systems have been economically inefficient and socially unfair, leading to:

(a) Inequitable impacts such as reduced benefit payments, separation between the level of contributions paid and benefits received, exclusion of the poorest members of society, and unequal protection between the various age cohorts;

(b) Poor management evidenced by high administrative costs and negative revenues from funds managed by public agencies;

(c) Economic distortions such as increased use of capital-intensive technologies and tax evasion, a result of the growing tax load placed on labour, and the lack of long-term financial sustainability owing to the greying of the population.

The worsening ratio between active contributors and inactive beneficiaries, which at first glance seems due to an increasingly ageing population base structure, also owes something to the adverse economic situations that predominate in the region. These economic woes impact negatively on the system's contribution base, reflected in declining job creation and salary mass. The social security dependency ratio in Brazil, for example, went from 31 contributors per beneficiary in 1940 to the current 1.7, a figure even lower than that in countries such as Germany, the United States of America, Uruguay and Japan, which have much more mature systems (Oliveira Beltrão and Ferreira, 1997). Explanations for this decline include the inarguable prevalence of very early retirement, the high unemployment rate and the size of the informal economy, which robs the Government of about 25 per cent of its potential tax revenues.

The informal economy and its related labour market is one of the most important Latin American phenomena of the 1990s. The region seems to have lost its vitality for creation of jobs in the formal sector, and this has led to an increase in the level of informal work. Between 1980 and 1990, the numbers of Latin American workers active in the informal sector grew from 25.6 per cent to 30.8 per cent, meaning that practically one in every three workers in the region is employed in an informal capacity (Durán, 1996).

It is estimated that in the next 30 years the population of Latin America will increase by approximately 221 million inhabitants. In addition, the current number of senior citizens (65 years and older) will grow by 40 million to 55 million people. Under existing conditions, which vary considerably among the region's countries, at least one third of these senior citizens will not be entitled to formal pension benefits, meaning that after 2025, nearly 18 million senior citizens will find themselves without any form of guaranteed income replacement (Durán, 1996).

In addition to declining income levels and the lack of social coverage faced by workers, one of the informal labour market's worst consequences is tax evasion, as very few of these workers contribute voluntarily to social security (Pinheiro, 1999). As this aspect is vital to the reform of the region's social welfare institutions, the first comprehensive effort conducted by the Governments should be a full-scale drive to incorporate the informal sector into the formal economy.

Another factor responsible for Latin America's social security crisis is the existence of an anomalous set of benefits that translates into undeserved special retirement packages, characterized by lower contribution values, higher benefit payments and an early legal retirement age.

PENSION REFORMS IN LATIN AMERICA

The position of international organizations

Social security reform has long occupied centre stage in debates over social policy. However, it was not until the release of position papers by both the International Labour Organization (ILO) and the World Bank, published in 1993 and 1994, respectively, that international financial and technical agencies finally tabled detailed proposals on dealing with the issue (Mesa-Lago, 1996).

The two documents presented similar diagnoses of the problems associated with traditional pension systems, namely, contributions well in excess of salary levels; high incidences of tax evasion and contribution payments in arrears; inadequate application of tax funds and poorly performing investments. There was also common ground over their recommendations, with each set based on three distinct elements. In both cases, the first element consisted of a minimum benefit guaranteed through a mandatory and universal allocation plan financed by taxes and managed by the public sector. There was also agreement over the third element, which offered supplementary pensions based on defined contributions and non-defined benefits, and state-regulated, privately managed individual funds.

Where the two proposals differed, however, was in their treatment of the second element. Here, strategies for reforming the system disagree over a number of variables, including the legal nature of the proposed reform, the financial plan, contributions, benefits and how the assets are to be managed. Although the importance of this second element is not in question, the ILO position is based on a system of partially harmonized funds, with defined benefits financed through contributions from workers and employers, to be managed by social security. Conversely, the World Bank favours an individual savings plan, with non-defined benefits being managed by the private sector, subject to state regulation.

The ILO proposal, whose views are also shared by the International Association of Social Security, seeks to improve the current systems by adopting such non-structural measures as increasing the legal retirement age, eliminating special privilege plans, administrative cost-cutting and better control over tax evasion and contributions in arrears. While the World Bank agrees with the need for these measures, it considers them insufficient to resolve longer-term problems, and instead proposes radical structural reform based on an overhaul of the political system.

Pension reforms in Latin American countries

With the exception of Chile, whose social welfare reform pre-dates the publication of these two proposals, many Latin American countries brought about reforms to their retirement systems that were either too flexible or at odds with the World Bank and ILO recommendations. While the reforms in the majority of these countries have been structural—meaning the incorporation of a privately managed, individually funded system—there are important differences between their approaches. In Mexico, Bolivia and El Salvador, whose reforms were conducted between 1995 and 1996, the public system was totally abolished. In Argentina (1993) and in Uruguay (1995), mixed systems were adopted that incorporated a reworked public component. In Peru (1992) and in Colombia (1993), parallel alternative systems were implemented, combining private management with a reorganized public mandate (Mesa-Lago, 1997).

The Chilean reforms, conducted from 1979 to 1981, represent a model of transferring government control to private management, which has had a strong influence on other reforms in the region. However, the drastic Chilean reforms were only possible owing to a powerful authoritarian Government that dissolved Congress, banned political parties and trade unions, controlled the media, and eliminated and/or weakened any type of opposition to the reforms (Mesa-Lago, 1997). Given this unique set of conditions, a "pure" duplication of the Chilean reforms could not be implemented elsewhere in the region. With the re-emergence of democracy throughout the region, the chances of an occurrence similar to what transpired in Chile have also become much less likely. In countries that are still discussing social security reform, the proposals most similar to the ILO recommendations are those most likely to be adopted.

PRELIMINARY RESULTS OF THE CHILEAN REFORM

Even though the Chilean reforms are the oldest in Latin America, it is still too early to evaluate their impact definitively, as the effects they generated will continue to be felt for a long time to come. However, considerable efforts have been made by social welfare specialists to analyse the partial results of the Chilean reforms vis-à-vis their initial intents and expectations.

In 1996, 15 years after reforms to the social welfare system were implemented in Chile, 15 private companies were managing the accounts of 5.5 million Chileans, or approximately 99 per cent of the economically active population. The assets managed by these companies were on the order of $28 billion, or about 40 per cent of Chile's gross national product (Nitsch and Schwarzer, 1998). Despite these impressive figures, the overall evaluation has been a negative one, particularly in terms of the social impact.

One reform originally sought to enhance the level of social coverage, while at the same time reducing tax evasion and increasing the amount of benefit payments. Data from 1997, however, point to a reduction in the scope of the new system in relation to the previous one, as only about 45 per cent of the workforce were contributing regularly (Nitsch and Schwarzer, 1998). In addition, this disparity was even more apparent among the management companies representing low-income workers, meaning that the poorest members of the workforce, who most need assistance, were being left unprotected by the system.

With respect to tax evasion, no significant improvement was noted. Among self-employed workers, about 95 per cent still do not contribute regularly. For regular employees, most pay only the minimum required amounts (Azeredo, 1994). Regarding benefit payments, the situation appears no better. A study assuming 45 years of uninterrupted contributions being made in individual accounts, at profits of 3 per cent a year, would mean the contributor would receive back only 44 per cent of his or her contribution salary over this same period (Ruiz-Tagle, 1994).

Other attempts were made to bring more transparency and efficiency to the system by allowing the public to choose among the management companies. In theory, these institutions would then be forced to continue improving their service to maintain their market share. Studies have shown, however, that administrative costs for the privatized system are even higher than those of the previous system. About half of the contributors are unable to understand their account statements, while the three largest management companies—representing about two thirds of qualified contributors and 55 per cent of the assets under administration—feature neither the best levels of profitability nor charge the lowest commission rates, and in fact have the highest advertising budgets (Nitsch and Schwarzer, 1998).

One of the main objectives in privatizing the social security system was to remove the expenses of retirement payments and pensions from the public treasury. But contrary to that expectation, one of the consequences was a marked loss of income for the public sector. While the State took on the financial onus of privatization, remaining as manager for the old system, it lost immediate revenue sources from the new social security contributions now being made to the pension funds.

Consequently, the difficulties faced by the extant public system—which continues to address the majority of retirees and pensioners—have grown considerably, resulting in a dramatic drop in the amount of benefit payments. In addition to this, the regulations of the private fund managers stipulate that widows cannot receive any pension following the death of the retired beneficiary. The flaws in the private system can already be seen on the streets, where it has become more common to see an elderly person begging than a child (Alves, 1997). If the situation has reached such dramatic proportions in the urban areas, it tends to be even worse for rural workers, the majority of whom do not contribute to the private social security system.

FINAL REMARKS

Living arrangements constitute one of the most important dimensions of the well-being of the elderly. As previously stated, they depend on a set of strongly interacting factors, among which the financial autonomy of the elderly plays a crucial role. Thus, by affecting the income conditions of the elderly through the payment of retirement benefits under new regulations, pension reforms in Latin America are expected to have an important impact on the household structure of the elderly population, either by increasing or decreasing their decision power for choosing living arrangements of their preference.

Pension reforms in the region are still too recent for a better evaluation regarding their consequences. Only after a relatively long period of time will it be possible to know the real impact of these reforms on the living conditions of the elderly, and particularly on their living arrangements. Up to now, however, the results seem not to favour an increase in the financial autonomy of the elderly in the future, especially if pension reforms are not accompanied by a broader set of other socio-economic reforms.

In fact, there has been a long-held belief that structural reforms resulting from a social security crisis could somehow solve all the problems of previous systems. This would hold even when someone's work history included several periods of unemployment or informal employment, and salary levels continued to be precarious, such as in Latin America. The effectiveness of the private system, however, is based on regular contributions of sufficient levels of funds over the worker's professional life. This means the system will only function satisfactorily for those whose income already affords the ability to save. For lower-income workers, who typically have a less stable presence in the formal economy, chances are low they might set aside enough money in a fund to allow them to survive periods of unemployment or inactivity.

The issue, therefore, does not boil down to defining ways of extracting compulsory savings from workers, but rather is a fundamental matter of creating conditions for workers to generate those savings. Such an environment, though, can only be derived through higher levels of work-related revenue or other forms of remuneration. Thus, the need to link reform of the social security system to a set of more encompassing reforms, including those of the health and employment systems, becomes more apparent.

In a way similar to what happened with the previous systems, the reformed systems seem to place emphasis on vertical growth to the detriment of horizontal expansion, which would allow a sustainable development phase. Until now, efforts targeting transfers from contributors have been much more significant than those focused on increasing the actual numbers of contributors. In reality, certain groups such as agricultural workers, the informal sector, the self-employed and so on, who have little political representation and who have traditionally been excluded from the pension and retirement systems, remain practically marginalized by the reformed systems, depending almost exclusively on the minimum pension guaranteed by the State (Lo Vuolo, 1996).

Accordingly, the mere substitution of a public system by a private one would not be enough to solve today's major social welfare problems. In fact, such a transfer of administration might even further aggravate the problems of segmentation and social exclusion in Latin America, and lead to an even more severe impact on the public purse. The region's social heterogeneity and the narrowness of the formal economy make it difficult to solve the problem of guaranteeing income for retirees and the unemployed through a privately operated, individually funded investment model. In other words, the majority of the population cannot manage without a social welfare programme, or a public vehicle designed for the redistribution of income and wealth.

If it is true that pension reforms in Latin America have been primarily motivated by the desire to improve benefits and augment the national treasury, the success of such reforms will depend on the ability of the region's policy makers to harmonize their strategies in terms of social security. Thus, they are expected to continually modernize and adapt the pension systems to current socio-economic conditions, to achieve a suitable and sustainable equilibrium between social and economic objectives.

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