Argentina’s Pension System*

The economic crisis in Argentina is affecting the country’s pension system. The International Monetary Fund (IMF) withheld a US$1.3 billion loan in December 2001 because it was dissatisfied with the government’s progress toward fiscal reform. As the Argentine government struggled to avert default on its foreign debt, it undertook a series of emergency measures, including delaying public pension payments and asking the pension funds to swap higher-yielding government bonds for lower-paying longer-term bonds. With deficits rising, tax receipts plummeting, and the recession worsening, Argentina borrowed $2.4 billion in pension fund assets that were held in bank accounts and used those funds to pay public pensions and salaries. Finally, the government imposed capital controls, defaulted on its foreign debt, and in January 2002, devalued its currency.

The peso had been pegged to the dollar for more than 10 years. The shift to a floating-rate peso could cause investors and savers to lose a significant amount of money depending on the value of the peso. Although it is too soon to calculate the costs of all of these measures, it is clear that they will impose a burden on the country’s pension system.

A brief description of the retirement system and some of its problems are needed to better understand the pension funds’ current situation. A 1994 reform replaced the ailing pay-as-you-go (PAYGO) system with a mixed public/private one. Participation is mandatory for most employed and self-employed workers. The military and police are covered by separate programs; provincial workers are gradually being incorporated into the national system.

The new system has three tiers. The first two are PAYGO: a non-earnings-related basic universal benefit (prestación básica universal, or PBU) based on years of service, and an earnings-related compensation benefit (prestación compensatoria, or PC) for service rendered before July 1994. The third tier offers a choice between a public defined contribution plan and a private individual retirement account. The public alternative benefit (prestación adicional por permanencia, or PAP) is based on earnings after July 1994. The private one is based on individual contributions to a pension fund management company (administradora de fondo de jubilaciones y pensiones, or AFJP) plus accrued interest minus administrative fees. Workers who do not choose between the public and private tiers are automatically placed in the private one.

Employers, employees, and the government finance the program. Employers contribute to the public system regardless of which program the employee chooses. The contribution of workers who choose the private tier funds an individual account, minus an administrative fee. The self-employed’s contribution is split between the individual account (minus an administrative fee) and the public system. The government contributes to the public program through general revenues, investments, and certain earmarked taxes.

A retirement benefit is payable at age 65 for men and 60 for women. The first-tier benefit, or PBU, requires 30 years of contributions and is the equivalent of a guaranteed minimum benefit. The second-tier benefit is for those with years of service prior to July 1994. The third-tier, privatized benefit has no specific years-of-service requirement; it offers the choice of an annuity, programmed withdrawals, or a combination of the two. Early retirement is permitted if the pension will equal 50 percent of the insured’s average salary in the 5 years before retirement. A lump-sum withdrawal is also permitted before retirement as long as the account retains funds that will yield a pension equal to 70 percent of monthly earnings in the 5 years before retirement. After retirement, a pensioner may continue working with full benefits, although the retirement benefit will not be

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recalculated to reflect postretirement benefits (Kritzer 2000).

AFJPs, or pension fund management companies, manage the individual account of workers who select the third-tier private plan. Each AFJP may operate only one pension fund. Requirements include minimum capital in order to begin operation and two types of reserves that the AFJP may use when its performance goes below the minimum rate of return. The minimum return is based on the average performance of all the AFJPs in a 12-month period.

Argentina required its National Bank, Banco de la Nación, to set up an AFJP that must provide a guaranteed minimum rate of return equal to the interest rates earned in savings accounts. The other AFJPs do not offer this kind of minimum guarantee; rather, they are expected to compete with the state-owned fund and provide returns that are equal or higher. Banco de la Nación must have 20 percent of its assets in local economies (Arenas and Bertranou 1997; Kay and Kritzer 2001).

The Superintendent of Pension Fund Management Companies (SAFJP) oversees the operation of the private system. Funded by the AFJPs, it authorizes their establishment or liquidation and makes sure the laws are followed. The SAFJP also limits and tightly regulates the types of investment the AFJPs can make (CBO 1999).

As the economic crisis was heating up during 2001, the government temporarily reduced a worker’s mandatory contribution to an individual account or the PAYGO system from 11 percent of earnings to 5 percent in order to boost take-home pay (IBIS, December 2001; Pensions International, January 2002). Although the reduction appears to be a short-term solution, in the long run the worker’s individual account will have a smaller balance, resulting in a lower retirement benefit. In late January, there was talk of restoring the contribution rate to the 11 percent level, in part to help fund public pensions (La Nación, 25 January 2002).

With a lower contribution rate, fees accounted for an even larger percentage of a worker’s contribution. Up until late 2001, AFJPs were permitted to charge both fixed fees and fees as a percentage of earnings. Many AFJPs lowered their variable rates and raised the fixed ones. Then in December 2001, the government abolished flat fees (IBIS, December 2001).

AFJPs also cut their variable administrative fee by about one-third, from an average of 3.4 percent of earnings to 2.25 percent. To make up for the AFJP income loss resulting from lower administrative fees and elimination of flat fees, when the AFJP’s annual rate of return exceeds a real rate of 5 percent (but no more than 1.5 percent of the fund’s assets), the AFJP is permitted to charge an additional 20 percent of the returns over 5 percent (IBIS, December 2001; Pensions International, January 2002).

In November 2001, when the government asked the AFJPs to swap the higher-yielding bonds for lower-paying ones, AFJPs had a total of about $14 billion in bonds (about 70 percent of total assets) that paid up to 25 percent interest. The yield on the new bonds will be 7 percent in 2001 and 10 percent in 2002. The AFJPs are estimated to have lost about $800 million in the process (Pensions International, November 2001, January 2002; IBIS, November 2001).

As the crisis deepened, the government took about $2.4 billion from the AFJPs’ accounts held in banks and replaced them with treasury bonds. The funds were to be used to pay pensions and public-sector wages (Reuters Business Briefing, 8 December 2001). By the end of 2001, 70 percent of the pension funds were in government bonds.

Another key issue for the privatized system is the low number of regular contributors to the system. At its peak, in 1994, about 66 percent of those enrolled in the system actively contributed to their accounts. In early 2001, that figure was down to about 40 percent, and with the severe economic crisis it had fallen to 28 percent in December. Of the self-employed, only about 10 percent are regularly contributing (SAFJP 2001; La Nación, 5 February 2001).

Workers who do not contribute for extended periods of time will have lower benefits.

Notes

1 In 2001, the government reduced the PBU for pensioners with benefits up to 800 pesos and eliminated it for those receiving more than that amount. The PC serves as a benefit that represents accrued rights under the old public system. This arrangement differs from the Chilean model, which replaced the public PAYGO system for mandatory individual accounts and provides a “recognition bond” that pays 4 percent interest as soon as a worker sets up an individual account. The transition costs for Argentina are much less than those for Chile because in Argentina the benefit is paid after retirement, earns no interest, and is not indexed for inflation (Mueller 2001).

2 In 2001, public pensions over 500 pesos were cut 13 percent as part of the government’s “zero-deficit” policies, which sought to immediately halt fiscal deficits.

3 Less than half of the self-employed’s contribution funds the individual account. According to Arenas and Bertranou (1997), that is a powerful incentive for them either to not contribute or to underreport earnings.

4 The compliance rate is about the same for the public system.
References


