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RENT-SEEKING IN PRIVATE PENSIONS

Concentration, Pricing
and Performance

**Mark Hyde and
Silvia Borzutzky**



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palgrave
macmillan

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ISBN 978-1-137-58034-4 ISBN 978-1-137-58035-1 (eBook)
DOI 10.1057/978-1-137-58035-1

Library of Congress Control Number: 2016949577

The Editor(s) (if applicable) and The Author(s) 2016

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Printed on acid-free paper

This Palgrave Macmillan imprint is published by Springer Nature
The registered company is Macmillan Publishers Ltd. London

FOREWORD

The 1980s marked the transition between two models of pension income protection. Since the 1920s and 1930s in Latin America and more so in the post-World War II period, the state took responsibility for reducing pensioners' income inequality and poverty through redistributive social welfare programmes, such as non-contributory pensions and transfers between generations, income groups, and genders. This paradigm was based on the social security principles shaped by ILO Conventions and Recommendations, such as universal coverage, social solidarity, equal treatment, gender equity, and so forth. Pension programmes in Latin America, however, did not always meet those principles as they often reproduced social stratification in society through multiple pension schemes with significant differences among them, granting privileged entitlements and benefits to the most powerful groups like civil servants, armed forces, and so on. Most of such schemes faced financial and actuarial disequilibrium and required substantive fiscal transfers. Furthermore, social security in developing countries was basically concentrated on salaried employment and left uncovered the poor and low-income groups (Mesa-Lago 1978).

The 1980s and particularly the 1990s witnessed a significant change in the design and delivery of pensions. The trend began in Latin America with the pioneering Chilean neoliberal structural pension reform, which eventually was quite influential in another ten countries of the region, as well as in Central and Eastern Europe, and also shaped the World Bank strategy of privatisation. The reforms totally or partially privatised pensions,

transforming the previous defined-benefit, PAYG, or partially funded collective funds that were publicly managed into defined-contribution, fully funded, and privately managed schemes of individual accounts. The previous collective responsibility of social security was transferred to the insured that was solely responsible for confronting a variety of social risks. These policies were premised on new principles such as individualism, ownership of the accounts, freedom of choice, equivalence between contributions and pension levels, competition, capital accumulation, higher economic growth, and employment creation. Finally, the structural reforms made a series of promises that were largely unfulfilled, e.g., expansion of coverage, better benefits, and lower administrative costs. Furthermore, the reforms did accomplish the elimination of social solidarity and a disregard for protecting the poor (Mesa-Lago 2008; Orenstein 2008; Borzutzky 2012; Hyde 2014).

Social policy scholars have been highly critical of this shift in pension design, documenting its negative consequences for the insured and pensioners. The neoliberal model was perhaps partially adequate for those in the formal sector but not for the informal labour force that predominates in most of the region, hence resulting in stagnant or even declining coverage (Mesa-Lago 2008; Esping-Andersen 1990; Van Parijs 1995). Gender discrimination was accentuated by the elimination of social solidarity, the fact that many women leave the labour market to raise their children and care for the sick and the elderly without any compensation, women's concentration in informal or precarious jobs, and the application of gender-differentiated mortality tables compounded by women's higher life expectancy, which results in smaller accumulation in their accounts and much lower pensions than men. Administrative costs, usually paid by the insured, have been high and stagnant in most countries, contributing to lower pensions.

In 2008–2010, pension re-reforms strengthened the role of the state and social solidarity in Chile, Argentina, and Bolivia: creating or expanding non-contributory pensions, increasing the levels of low pensions, compensating women for raising their children, infusing more competition or eliminating it, and trying to reduce high costs. In Argentina and Bolivia, the private system was closed and all the insured transferred to a public, PAYG system (in Bolivia, however, individual accounts are guaranteed by the state). In general, the re-reforms improved social aspects of the system, but, in Argentina and Bolivia, the financial-actuarial sustainability is in jeopardy (Mesa-Lago 2012). Other countries in the region are discussing re-reforms (e.g., El Salvador and Peru), whereas parametric reforms in Uruguay have increased the role of the state and improved pensions.

Given the already extensive literature on pension privatisation, what do Hyde and Borzutzky have to say that could be construed as a meaningful contribution to the discipline of social policy? This slim volume augments our understanding of pension reform in at least three significant ways:

- Social policy analysis deals with the adverse distributive consequences of privatisation—that is, growing inequalities in the *distribution* of retirement income. Focussing principally on Chile, but looking also at retirement systems in other nations, Hyde and Borzutzky take the reader on a tour of the pension fund management industry in a private pension system. This analysis includes its *structure*—patterns of ownership and concentration; *pricing*—the contingencies that shape the imposition of management fees; and *performance*—the capacity of pension fund managers to deliver satisfactory benefit entitlements. Although a feature of economics, business, and management studies, this focus has largely been neglected by social policy scholars.
- As I have demonstrated in my own analysis of social security privatisation in Latin America and Eastern Europe, Hyde and Borzutzky argue that there is a wide gap between the free market rhetoric and the regulatory approach that the state has adopted in Latin America and Eastern Europe (Mesa-Lago 2008, 2012; Hyde and Borzutzky 2015). Governmental action to shape and steer compulsory private pensions diminishes competition among pension fund managers curtailing consumer sovereignty. In countries with very small insured markets, such as Bolivia and El Salvador, there are only two pension managers, a virtual duopoly. In other countries, there are sufficient administrators but a high concentration in the largest two or three administrators, and the outcome has not been lower commissions or higher returns but huge profits for the pension managers. Additionally, the insured’s lack of financial knowledge has limited their capacity to select pension managers and the type of pension that is most beneficial to them.
- This brings us to their third contribution. Social policy scholars have developed a variety of conceptual schemes for classifying welfare states and typically associate defined-contribution pensions with the neoliberal model. Hyde and Borzutzky take issue with this characterisation too, arguing that such arrangements are intended to facilitate market privilege rent-seeking—the creation of institutional asymmetries that enable pension fund managers to siphon financial resources away from their members. When the rhetoric of enterprise

and competition is stripped away from public debate, it is clear that such arrangements are typically designed to buttress the wealth and power of a group of corporate actors and are best assigned to the *conservative* model.

While this monograph is firmly located within the field of social policy, Hyde and Borzutzky deploy themes and insights that are atypical of the social policy discipline. In these very important respects, their analysis of retirement income protection is genuine scholarship, and it makes an incisive contribution to our understanding of pensions in the early twenty-first century.

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CONTENTS

1	A Global Revolution in Retirement Provision? Mandatory Defined-Contribution Pensions	1
2	Structure: Concentration and Ownership in the Pension Fund Management Industry	29
3	Pricing: Management Charges in Mandatory DC Pensions	57
4	Performance: Investment Regulation and Returns in Mandatory DC Pensions	83
5	Conclusion	115
	Bibliography	141
	Index	143

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LIST OF ABBREVIATIONS

AFP	Administradoras de Fondos de Pensiones
C3	3-Firm concentration index
DB	Defined benefit
DC	Defined contribution
GDP	Gross domestic product
HHI	Herfindahl-Hirschman index
ILO	International Labour Organisation
MESIP	Market entry and sustainable industry participation
MPG	Minimum pension guarantee
MRG	Minimum return guarantee
ODC	Occupational defined contribution
OECD	Organisation for Economic Co-operation and Development
PAYG	Pay-as-you-go
PDC	Personal defined contribution
SAFP	Superintendencia de Fondos de Pensiones

LIST OF TABLES

Table 1.1	An overview of existing mandatory DC pension arrangements	3
Table 2.1	The beneficiaries of the state-run rent-seeking game: labour and finance ownership of the Chile's pension fund management industry	41
Table 3.1	Annual commissions for six of Chile's pension fund managers, 2005	66
Table 3.2	Pension fund management industry concentration and charges in Latin America, 2007	68
Table 3.3	Reasons for transferring to a new fund manager	71
Table 4.1	Plan participant knowledge of investment	96
Table 4.2	Regulation of performance in selected Latin American countries	101
Table 4.3	Investment returns in selected OECD defined-contribution pension arrangements	109
Table 5.1	The neoliberal model and existing compulsory fully funded pensions	119
Table 5.2	The discrepancy between the rhetoric of the public interest and the reality of market privilege rent-seeking	122
Table 5.3	Variation in the supply side of the mandatory DC pension fund management industry	126

A Global Revolution in Retirement Provision? Mandatory Defined-Contribution Pensions

Abstract Mainstream analysis of pension privatisation and compulsory fully funded retirement scheme defines these programmes as an extension of classical liberal political philosophy and emphasises consumer sovereignty, intensified competition, and market efficiency. We take issue with this widely shared characterisation of pension reform, highlighting its role in giving preferential treatment to the corporate actors responsible for managing private pensions. Chapter 1 conceptualises the perverse distributive impetus of privatisation, drawing on two traditions. Public choice theory has highlighted the prevalence of political rent-seeking—the pursuit of unearned income streams by lobbying government for market privileges. Simultaneously, the critique of state capitalism emphasises the government role in the protection of corporate interests. Political rent-seeking is illustrated with reference to Chile, the pioneer of compulsory fully funded pensions.

Keywords Defined contribution pensions • Privatisation • Neoliberalism • Rent-seeking • State capitalism • Chile