FIAP DECLARATION

EARLY WITHDRAWALS OF FUNDS REDUCE PENSION AMOUNTS

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1. Beginning in the 1980s and 1990s, most Latin American countries began replacing the PAYGO pension systems that were demographically unsustainable, unfair and regressive, because they were subject to political pressure. They were replaced by individually-funded pension systems, in which workers finance their pensions with their own savings.

2. The high return rates obtained by the fund managers by investing the workers' funds (7.2% real return per year, on average), have even tripled contributions. As concluded by the Commission for the Reform of the Chilean Pension System in 2008, chaired by the current Chairman of the Chilean Central Bank, this would allow all those who contributed regularly to obtain pensions similar to their last salary. Unfortunately, this has not been possible, to a great extent, due to high rates of informality, which run at 54% in Latin America. Nonetheless, the robust nature of the system has created the necessary leeway for financing a first non-contributory pillar to pay the pensions of the neediest sectors.

3. The system has also contributed significantly to the development of capital markets in the countries where it is in place. An academic study for Chile, Colombia, Mexico and Peru[1], shows that 7 to 12% of the GDP growth rate can be explained by the process of saving and investing workers' funds.

4. But the strong increase in life expectancy, aggravated by high informality rates that reduce contribution periods and the drop in interest rates, called for an additional effort to increase savings.

5. Except in the case of Mexico, where the contribution rate was increased, the debate has focused on weakening the foundations of the system, private management and investment in capital markets, to return to failed mechanisms such as the PAYGO systems, which have not been able to fulfill their promise of granting "defined benefits," since 79 countries have raised the contribution rate and 62 have raised the retirement age or reduced pension amounts, in the last 25 years. On the contrary, the pension systems rated the best in the world, according to the Mercer Index (Holland, Denmark and Israel) have adopted individually-funded mechanisms and are financing a significant part of their pensions with them.

[1] Source: "Contribution of the private pension system to the economic development of Latin America: Experiences from Colombia, Mexico, Chile and Peru," SURA Asset Management, August 2013.

6. Nonetheless, not only have we not increased the savings that are essential for improving pensions, but in response to a tidal wave of irresponsible populism affecting the region, Chile and Peru, in successive legal initiatives, have authorized the early withdrawal of the pension funds that workers had saved to finance their old age.

7. In Chile, the three withdrawals to date (for up to 10% of the funds) have entailed the outflow of USD 50 billion, equivalent to 25% of the existing funds. Furthermore, a total of 5 million people have been left without any funds in their accounts, and pension amounts will drop by almost 30%, equivalent to about 6 years of contributions.

8. In Peru, the different withdrawal mechanisms that have been approved would entail the withdrawal of more than USD 28 billion in total (equivalent to 64% of existing funds); as a result, almost 6 million fund members would be left with zero balance in their individual accounts, and pension amounts could drop by up to 25%.

9. In other words, not only have savings not increased, but have rather been withdrawn, to the extent that it will take many more years of contributions and/or a significant increase in the contribution rate to recover the level of savings that existed prior to the withdrawals.

10. Pension systems of any kind are mandatory precisely because people are unforeseeable and prefer present consumption. If they were not mandatory, no one would save, which is the same behavior that can be observed when, defeating the purpose of social security, they are allowed to make early withdrawals on what they have saved.

11. It is distressing to see the people who promote these measures boasting about being the great benefactors of affiliates, while depriving them of the funds they have saved, with great effort, for old age, under the protection of the law that they did not hesitate to violate.

Since the early withdrawals of funds have left a high percentage of workers without sufficient savings to finance their pensions, the government will have to contribute to their financing, which would provide them with a new pretext to demand that future contributions should be paid into, and managed by, the government. This paves the way for those who want to reestablish the PAYGO systems and eliminate private management, despite the evidence of their failure worldwide.

Thus, bills of law have already appeared in Chile and Peru, proposing the possibility of withdrawing 100% of the remaining funds. Although policies of this kind are irrational, since they cause irreparable damage to the pensions of future generations, they are supported by citizens who want to prevent their existing funds and future contributions from being used to finance a PAYGO pension system, which would otherwise be unable to pay pensions.

FIAP is thoroughly convinced that the discussion of a pension reform must the based on options that are viable and sustainable. It makes no sense to maintain or return to PAYGO pension systems in the face of great demographic challenges. Savings-based pension systems need to be strengthened. This process must be supported by strong institutions and committed governments, which prevent fiscal pressures and short-term political advantages from encouraging the implementation of populist reforms that destroy savings, deteriorating the pension system and affecting the well-being of the population in the future.

Signed: Board of Directors of the International Federation of Pension Fund Administrators, FIAP.

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