

Social Security and Labor Market in Chile: Strategies of Social Protection.

During the last 25 years, the Chilean economy has been object of a deep re-structuration. An import substitution model was replaced by an open-economic model, which has its core in exportations and in the action of the private sector. Such change occurred under an authoritarian regime (1973-1990), but it has been maintained after the transition to democracy in 1991. Overall, the new model has yielded healthy macroeconomic indicators, placing Chile as an exceptionally stable country in Latin America.

Two major pieces of economic re-structuration were the labor and the social security reforms. The former was built upon a legal change, which de-regulated labor in order to make the economy more competitive in an open scenario. The new setting brought a more complex labor structure, which reflected the declining importance of agriculture and the public sector and the increasing importance of the private, service sector, as well as the re-organization of labor and production inside the firms. The need of adaptation introduced more labor mobility among the different production sectors and was accomplished importantly via labor adjustments, which have produced more precarious employments (Titelman and Uthohff, 2003). Two indicators of this are the unemployment rate, which during the last five years has stayed relatively high (around 8%-10%¹) and the level of informal activity², which, even though it is one of the lowest in Latin America, reaches about 38% (ILO 2004). Women, who persistently augmented their participation in the labor force during the last twenty five years³, are overrepresented among the unemployed and the informal workers, constituting an especially vulnerable group.

The social security reform substituted a public, pay-as-you-go system, with a private, mandatory system based on individual accounts, managed by Pension Funds Administrators (AFP, Administradoras de Fondos de Pension). The reform created, probably, the most orthodox privatized social security system in Latin America. However, the state still plays an important role, regulating and supervising the system, paying pensions to the relatively small proportion of workers who did not switch to the new system when the reform was enacted,⁴ and providing security to the very poor. Internationally, the privatized system has been widely cited as a successful example for the solution of the social security problem facing other countries as well. Its returns are, on average, high, and it had helped to finance the growth of the economy. Despite these

¹ Since unemployment remains high, apparently, regardless the growth of the GDP, a fall in the employment-production elasticity has been discussed (Tietelman and Uthoff, 2003). As a consequence of the Asiatic crisis, the unemployment rate reached a peak of 9.7% in 1999, at the same time that the GDP turned to a negative 1.1. After that, the GDP started to grow, getting to 5.9 in 2004. The growth of the GDP absorbed part of the unemployment, but not to a large extent. The average unemployment rate in 2004 was 8.8%.

² Informality activity is here understood according to the ILO perspective, as the low productivity activities carried out by small firms, independent, non professional workers, domestic service and unpaid family workers.

³ Nonetheless, the female participation in the labor force was just 42% in 2000, while the corresponding male was 73% (Bernstein, 2005:3).

⁴ Workers entering the labor force after 1981 do not have the opportunity to choose between the new, private and the old, public system. They just can get into the private system, choosing the AFP where they prefer to send their contributions.

successes, the privatized system has serious failures. Particularly, it is unable to properly cover the labor force. Under the new system, social protection rests on the worker's contractual relationship and the contributions depends on the dynamics of the labor market (Titelman and Uthohff, 2003). The system adequately protects those with a stable participation of the labor market, but leaves unprotected those with precarious jobs and those who are affected by unemployment and labor mobility.

This study assumes that the reformed social security system was designed without considering changes in the labor market. In practice, it creates new forms of social exclusion, worsening the stark inequalities that already characterize Chilean society⁵. The focus of this project is the group that seems to be in the most vulnerable position in terms of social security, that is, those who are excluded from the private system and who are neither eligible for public protection. These are lower-middle income groups, who have surpassed poverty, but whose incomes, as their participation of the labor market, are still low and unstable. The study follows a quantitative-qualitative approach, the former oriented to set a proper diagnosis of the situation lower-middle income pensioners are facing and the latter oriented to explore the strategies of social protection they are deploying, both for the future and in the present.

A quantitative diagnosis of the problem.

The aim of this section is to clarify the failings in coverage of the current social security system. Its relative insensitivity to the main changes in the labor market is reflected in an inadequate or inexistent coverage of important groups of the population, "The characteristics the labor market has now are far away from the characteristics it had when the system was born, during the 80s. We cannot ignore the high rotation employment has today in Chile. The Unemployment Insurance Data indicate that about a third of workers is affected by labor rotation; these workers combine periods of employment and unemployment several times a year...we are talking about a significant portion of workers who are not able to accumulate pension's savings systematically, as people with a stable job"(Larrain, 2004: 148).

There are several ways to measure the coverage of the system. A first option is the so-called *statistical coverage*, which equals the number of affiliates (people who affiliates to the system) over the labor force. According to this indicator (Mesa Lago, 2004), Chile exhibits a coverage of 111% in 2002, which reflects the double counting of people who switch from one AFP to another⁶. A more accurate measure is the *effective coverage*, this is, the number of contributors over the labor force (see Table 1). Even though it has increased gradually since 1981, the year the reform was enacted, using this measure coverage was reduced to 58.4% in 2000. More recent data from the Superintendence of AFP indicate an effective coverage of nearly 55% in 2004, "From this point of view, the

⁵ Chile has the second highest in the region (its Gini index was .56-.58 during the 90s), being surpassed just by Brazil.

⁶ "Even further, this number excludes an additional 26% composed by the 3% enrolled in the Armed Forces social security system and the 23% estimated for the active population not covered, so the total would be 137"(Mesa Lago, 2004:53)

new system coverage is not substantially different from the one the old system had. Nonetheless, it seems that there is a problem with this interpretation, because the coverage levels of the old system apparently showed a more stable labor force than currently...the evidence shows high levels of labor rotation, probably higher than the ones the old system workers faced. This means that behind the apparently stable 55% a crowd coming in and out of the labor force is hidden” (Bernstein, 2004: 8).

Table 1: Effective Coverage (Contributors/Labor force) of the Social Security System, Chile, 1975-2000

Year	AFP	Public System	Total	Year	AFP	Public System	Total
1975	---	61.9	61.9	1988	46.6	9	55.6
1976	---	57.3	57.3	1989	47.2	8.1	55.3
1977	---	54.8	54.8	1990	46.8	7.5	54.4
1978	---	48.5	48.5	1991	49.9	7	56.9
1979	---	48.5	48.5	1992	51.8	6.5	58.3
1980	---	47.8	47.8	1993	51.1	5.7	56.8
1981	---	16.3	---	1994	51.8	5	56.9
1982	29	13.4	42.3	1995	53.5	5.1	58.6
1983	33.5	13	46.6	1996	55.7	4.6	60.4
1984	35	11.8	46.8	1997	58	4.1	62.1
1985	38.8	11.3	50.1	1998	53.8	3.9	57.7
1986	41.1	10.4	51.6	1999	55	3.9	58.9
1987	45.7	10	55.7	2000	54.5	3.9	58.4

Source: Arellano (1985); Arenas de Mesa (2000).

Not surprisingly, the un-covered workers are the ones with a precarious participation of the labor market (see Table 2). Informal workers have consistently lower levels of coverage than formal workers. Poor are less covered than non poor, even though the inequality of coverage between formal and informal workers exists regardless of their poverty condition.

Table 2: Coverage of the Social Security System, Chile, 1975-2000

	Poor		Non poor	Total
	Deprived	Non deprived		
1992				
Informal sector				
Domestic Service	21.5	22.6	42.8	37.5
Others	21.1	25.9	26.2	25.9
Formal sector	64.0	72	76.4	75.1
Total	43.3	52.1	55.6	54.5
2000				
Informal sector				
Domestic Service	7.4	18.2	40.6	36.6
Others	9.3	18.9	28.2	26.6
Formal sector	43.5	67.5	79.5	77.8
Total	25.9	45.3	59.7	54.5

Source: Tietelman and Uthoff, 2003, on basis of CASEN data.

The problem involves not only the extension of coverage, but also its quality -that is, the level of benefits the system is producing (Arenas de Mesa, 2002). Currently, an important portion of the retired population receives just the minimum pension (about \$US 200 a month), “In Chile, the beneficiated by the minimum pension, combining the public and private system in 2000, were 43% of the total of retired people in both systems; the minimum pension was 70% of the minimum wage and 24% of the average wage in the private sector. Both percentages decreased in the period 1990-2000. It is estimated that approximately half of the affiliated to the private system (35% of men and 60% of women) will receive a minimum pension” (Mesa Lago, 2004: 74). The level of benefits pensioners can expect, then, is quite low, which is a serious problem, considering the high costs of health at old ages and the general context of aging of the Chilean population⁷.

In the same direction, the Superintendence of AFP has developed two (unpublished) indicators. The first has to do with the concept of *contributions density* - the number of months the worker is contributing over the total number of months of potential contributions (Bernstein, 2004). The density distribution was calculated using a 24,000 social security history sample for which administrative data was available (from 1981 to 2003). The results are curiously bimodal, since about 18% of affiliates have densities near 100%, while another 10% have densities near 0%; the other affiliates are almost uniformly distributed between these two extremes. “This evidence suggests that there is a significant contributor’s rotation. Then, the 55% of the labor force that contributes to the pension system is not composed always for the same people. For individuals with low densities (i.e., less than 10% of their active life), is hard to think of any pension system giving them reasonable retirement benefits. These people will not even have right to a state guarantee, due to the little amounts of years they will contribute.”(Bernstein, 2004:12).

The second indicator is a projection of the flow of pensions current affiliates retiring over the next 30 years will receive⁸. Three categories are distinguished: 1) those who will get a pension equal or higher than the minimum guaranteed pension using their own funds, 2) those who will not get the minimum pension using just their funds, but who fulfill the requirements to use the guarantee and will receive a minimum pension, complementing their funds with the state subsidy, and 3) those who can not afford a minimum pension on their own, but either fulfill the requirements to ask the state guarantee, so they just will receive the money in their accounts in the modality they determine, until the money is over. This projection works with a wage growth of 2%, a growth of the minimum pension of the same amount, an 8% unemployment rate and a rate of return of 5%. These conditions are conservative, so the last two rates were changed (to 6% and 7%, respectively) to see what could happen in a more optimistic setting. The results indicate

⁷ The projection indicates that the population aged 60 years or more will duplicated between nowadays and 2050 (Larrain, 2004: 149). Life expectancy, according to the US Census Bureau, is set in 76.6 years for 2005 and 79.9 for 2025.

⁸This projection is made on basis of the contributable income profiles of affiliates who are not yet pensioned. The contribution rate is set at 10% of income, with a ceiling of 60 UF a month (about \$US 2000), which is the maximum level of income for which workers can contribute. Given the accumulated funds, a pension amount is computed by assuming that a life annuity is bought (other two retirement plans are not considered, namely, a programmed withdrawal schedule to guarantee income over the retiree’s expected life span, or a deferred annuity, which is a combination of the annuity and the programmed withdrawal option)

that “there are between 40% and 50% of affiliates that will not accumulate enough funds for a minimum pension and will not have the required number of contributions for the minimum pension guarantee...There are around 10% of the affiliates that might require a minimum pension guarantee and have the right to get it...the rest of the affiliates will get a pension that is above the minimum pension level and will not require the minimum pension guarantee...these results improve significantly if a larger rate of return on investments is assumed. Additionally, if wages grow faster or unemployment rate is lower, these results would improve as well” (Bernstein, 2004:15-20).

A qualitative approach to the problem of coverage.

The quantitative data shows the reformed system covers badly or does not cover all a substantial part of the population. It can be argued, however, that this is not a novelty, because, regardless the recent privatization of social security, welfare in Latin America has never depended entirely on “official providers” such as the market or the state. The family and the community have also played a fundamental role (Roberts, 1997). The current design of the social security system offers a privileged scenario to inquire about the role of the market, the state and the family in the provision of social security. We know from the quantitative projections discussed above that about 40% of the population will be able to afford a pension equal to the minimum (or higher) relying exclusively on their own funds. For these individuals, the market (this is, the privatized system) provides security, although for some, at the minimum level. This group must be formed by people with a more stable insertion in the labor market, but it is probably diverse enough, considering people with higher and lower income, who will, consequently, receive higher and lower pensions, so the market-provision of social security does not provide equal outcomes. Instead, it just reflects the inequalities in the labor market.

The state will have to supplement the minimum guaranteed pension of about 10% of the current affiliates. It should also provide an assistance pension⁹ at old ages to those with no other income sources, who are identified as poor using the government measures. Finally, there is an important proportion of between 40% and 50% of people who will not be able to afford a minimum pension on their own and who will not qualify for the state guarantee. In terms of social protection, these people are virtually in no-man’s land. They will receive the few funds they have accumulated during their labor histories, but there is no clarity about their future once those funds are over. They could apply for an assistance pension, but they will not qualify if they are not considered “poor” (and people who have acquired an asset, as a house, will not). Since these people contribute, regularly or irregularly, to the system, most of them will not be considered poor by government standards. Rather, they must be lower-middle income groups that have surpassed poverty, but who have a precarious and unstable insertion in the labor market.

These individuals are the focus of the present study. A qualitative approach is used to identify the strategies of social protection lower-middle income people are developing, both for the future and in the present. While the quantitative data tell us very much about *who* are the persons in the weakest positions under the current design of the social security

⁹ The assistance pension is currently about \$US 75 a month. In spite of its low amount, to qualify for an assistance pension is necessary to be deprived and, even qualifying, there is a waiting list to get one.

system, they do not tell us much about how is these people experiencing this problem, that is, how aware are they of it and *what are they doing*, if anything, in order to protect themselves. This is a question that has been less explored, and hence, we lack the categories to answer it. A qualitative approach is useful to generate such explorative information.

In order to examine these hypotheses, in-depth interviews were conducted with active head of households of lower-middle income groups. To facilitate a thoroughly fieldwork, this study limits itself to the capital city, Santiago, which concentrates a third of the country population.

The main hypotheses guiding this project are the following:

- The structure of the family determines the strategies of protection their members exercise. A mono-parental household has fewer resources to protect themselves than a bi-parental household. More specifically, a bi-parental household headed by a man is in a stronger position in comparison with a mono-parental household headed by a woman.
- The number of people working and the kind of job they have determines the strategies of protection the family develop. Families with people working in the formal sector have more resources in terms of social protection. Families with some members in the formal and others in the informal sector will try to get benefit of the formal insertion to protect the most of their members.
- The level of education affects the protection decisions people make. Families headed by more educated people develop more cautious protection strategies than families headed by less educated people.
- The age influences the protection decision people make. Older head of the household are more worried about social protection than younger people, so they use more consistent strategies.

Considering these hypotheses, the qualitative sample was designed using three variables: the structure of the family (bi-parental, mono-parental, unipersonal), the kind of labor insertion of the head of the household (formal, informal) and his/her level of education (secondary or less, more than secondary)¹⁰. The interviews were concentrated in Puente Alto, a municipality in the south of the capital city, which has the largest proportion of people in the second and third quintile of income (that is, lower middle income). Key informants were used to reach access to the interviewees. The interviews were conducted during July, 2005, reaching the number of thirty.

The conversations were focused on reconstructing the head of the household's labor history, in order to find out, at every stage, what are the roles the family and the community, the state, and the market play in the strategies of social protection lower-middle income people deploy. During the interviews, it became evident that the problem of social security is not an issue of concern for most working people, even when they are close to the age of retirement, unless it is related to health-care access. This is the issue

¹⁰ Age was not considered not to make the sample more complex. However, the final sample is diverse in age, including people in their early thirties as well in their early sixties.

they are concerned about in the present, regarding social protection. For that reason, the conversations also covered this topic. The analysis of these interviews is in progress. It will provide initial evidence about the strategies of social protection the most unprotected people is developing, generating information that is interesting both for the academic discussion and for the design of public policies.

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