

CHAPTER II

THE OLD SYSTEM⁹

A. General Characteristics

As was mentioned in the previous chapter, the first manifestations of Social Security in Chile came into being in the early 1920s.

The various Social Security programmes were gradually modified over the course of time, with different social security schemes emerging for different groups of workers. As a result, there were different requirements for receiving a pension (in terms of age, years of service or sex), different contribution rates and different benefits, which did not necessarily bear any relation to them.

Although initially the System covered only social benefits, as time went by the benefits provided gradually increased. At the same time new Social Security Institutions (Cajas de Previsión) were created, and by 1979 there were 32 of these institutions in existence, with 2,291,183 workers paying into them. This gave rise to over a hundred different social security schemes, with considerable inequality between the benefits of the various institutions providing the service.

There was no general Social Security policy behind these various social security schemes, with the result that the system was unfair as far as the benefits that it provided were concerned.

From the 1950s onwards, different governments researched and analysed the Social Security System. During the government of Carlos Ibáñez (1952-1958) the Klein-Sacks mission issued a report containing the main criticisms of the Social Security System then in force in Chile. In the

⁹ For purposes of this book, the Old System is defined as that made up of the former "Cajas de Previsión" (Social Security Institutions). The main features of the Old System were obtained from four sources:

- Bustamente J., "Funcionamiento del Nuevo Sistema de Pensiones" ICARE, May 1988.
- Cheyre H. "Análisis Comparativo del Antiguo Sistema de Pensiones y del Nuevo Sistema Previsional" in "Sistema Privado de Pensiones en Chile" CEP, November 1988.
- Iglesias A. and Acuña R. "Chile, Experiencia con un Régimen de Capitalización 1981-1991" in "Sistema de Pensiones en América Latina" Regional Project of Financial Policies for Development, CEPAL – PNUD, October 1991.
- Godoy O. and Valdés S., "Democracia y Previsión en Chile: Experiencia con dos Sistemas" in Cuadernos de Economía N° 93, August 1994. Catholic University of Chile.

government of Jorge Alessandri (1958-1964) a Study Commission was set up to look into the Chilean Social Security System, chaired by Jorge Prat. Its diagnosis was not very different from that of the Klein-Sacks mission. Between 1964 and 1970, during the government of Eduardo Frei Montalva, even more searching analyses of the Social Security System were carried out.

In general terms, the main conclusions of these studies were the following: the Social Security System was very expensive for both workers and employers; the existence of numerous “Cajas” meant costly and inefficient administration; the pensions suffered significant devaluations; there was no pre-established order as regards the funding of the services and benefits provided; the System was unfair, given the differing membership requirements, contribution rates, criteria for determining disability, services provided and mechanisms for readjusting pensions. Moreover, it did not cover all workers and the resources were insufficient.

1. Contribution Rates

This section provides an analysis of how contribution rates developed in the three main social security institutions: the Servicio de Seguro Social (SSS), the Caja de Previsión de Empleados Particulares (EMPART) and the Caja Nacional de Empleados Públicos y Periodistas (CANAEMPU). In 1980, these three institutions together covered 94% of all contributors.

The contribution rates on wages and salaries gradually increased over time and by 1974 they represented over 50%¹⁰ of a worker’s monthly remuneration. Later these rates began to fall little by little, which increased the difficulties involved in funding the System. Even when contribution rates fell, they were still very high, which meant a real tax on hiring labour and a disincentive to do so. This in turn resulted in a lower level of formal employment in the economy.

It is worth pointing out that this global contribution rate financed pensions, health benefits and industrial accidents, among other things. Nevertheless, the development of this variable is more important than that of the contribution rate for pensions, since all the resources collected were used for the different programmes without distinction. As a result, the development of this latter rate does not reflect its real need for funding.

¹⁰ This rate includes the contributions charged for pensions, health, industrial accidents and others.

Table II.1
GLOBAL CONTRIBUTION RATES (1)
(In % on taxable wage)

Year	SSS			EMPART			CANAEMPU		
	Cont.(2)	Empl.(3)	Total	Cont.	Empl.	Total	Cont.	Empl.	Total
1968-1972	8.75	39.15	47.90	13.75	43.98	57.73	18.75	7.00	25.75
1973	9.50	40.40	49.90	14.64	44.36	59.00	18.75	7.00	25.75
1974 (Jan)	7.50	40.10	47.60	12.64	42.86	55.50	18.75	27.00	45.75
1974 (Mar)	7.50	53.10	60.60	12.64	55.86	68.50	18.75	40.00	58.75
1974 (May)	7.50	49.10	56.60	12.64	51.86	64.50	18.75	36.00	54.75
1975 (Jan)	7.25	45.10	52.35	12.34	47.87	60.21	18.50	32.00	50.50
1975 (Mar)	7.25	43.95	51.20	12.34	46.73	59.07	18.50	32.00	50.50
1977	7.25	39.95	47.20	12.34	42.73	55.07	18.50	28.00	46.50
1978 (Jan)	7.25	35.95	43.20	12.33	38.72	51.05	18.50	24.00	42.50
1978 (Apr)	7.25	31.95	39.20	12.33	34.71	47.04	18.50	20.00	38.50
1978 (Jul)	7.25	28.95	36.20	12.33	31.71	44.04	18.50	17.00	35.50
1980	7.25	25.95	33.20	12.33	28.71	41.04	18.50	14.00	32.50

Source: Cheyre (1991)

(1) The months used each year indicate changes in the contribution rates.

(2) Contributor

(3) Employer

TABLE II.2
CONTRIBUTION RATES FOR PENSIONS
(In% on taxable wage)

Year	SSS (1)			EMPART (2)			CANAEMPU (1)		
	Cont.	Empl.	Total	Cont.	Empl.	Total	Cont.	Empl.	Total
1968-1973	7.25	14.25	21.50	9.00	17.00	26.00	11.00	5.00	16.00
1974-1977	7.25	15.95	23.20	9.00	17.00	26.00	11.00	5.00	16.00
1978	7.25	15.95	23.20	10.16	15.00	25.16	11.00	5.00	16.00
1979-1980	7.25	15.70	22.95	10.16	14.75	24.91	11.00	4.75	15.75

Source: Cheyre (1991)

(1) Includes the contributions under the heading of pensions and those paid into the Pension Revaluation Fund.

(2) Includes the contributions under the heading of pensions, those paid into the Retirement Fund and those paid into the Pension Revaluation Fund.

2. Coverage

Until 1980, the first three institutions to be set up were the most important in terms of the quantity of contributors and pensioners.

Table II.3
ACTIVE CONTRIBUTORS PER CAJA DE PREVISIÓN
(In thousands of persons, as of December each year)

Year	SSS	EMPART	CANAEMPU	OTHERS	TOTAL
1961	1,264	189	-	78	1,531
1965	1,375	230	167	116	1,888
1970	1,476	275	261	129	2,141
1971	1,513	287	276	137	2,213
1972	1,540	310	269	144	2,263
1973	1,561	340	284	206	2,391
1974	1,594	361	292	140	2,387
1975	1,537	345	284	133	2,299
1976	1,550	350	273	132	2,305
1977	1,490	370	273	134	2,267
1978	1,447	378	275	135	2,235
1979	1,486	403	266	136	2,291
1980	1,394	430	264	139	2,227

Source: Cheyre (1991)

This group of institutions covered a high percentage of the workforce, varying between 60% and 79% in the period 1960-1980. The maximum coverage was reached in 1973, with 79%. This subsequently fell, little by little, until by 1980 it had reached 64%. The reduction is explained by evasion of the obligation to pay contributions, an increase in unemployment and a slight increase in the proportion of the population working independently. It is likely that the high contribution rates played a part in encouraging people to evade payment of social security contributions. Although these had fallen by more than 20 percentage points between 1974 and 1980, when the reform came in they were still oscillating at between 32% and 41% in the main "Cajas" of the Old System.

Table II.4
COVERAGE OF THE OLD SYSTEM

Year	Active Contributors/ Work Force (Percentages)	Active Contributors/ People in Work (Percentages)
1960	69	75
1961	60	65
1965	69	74
1970	73	77
1971	74	79
1972	75	78
1973	79	83
1974	78	83
1975	74	86
1976	74	83
1977	73	79
1978	68	76
1979	68	75
1980	64	71

Source: Cheyre (1991)

At the same time, the unemployment rate had risen from 3.3% in 1972 to 14.9% in 1975 and in 1980 it was still 10.4%. Finally, there was a rise in the self-employed sector of the population from 19.9% of the total in 1974 to 21.1% in 1980.

3. Benefits¹¹

The benefits granted by each of these social security institutions differed significantly, so each institution is analysed separately, considering the three most important ones in the Old System: the Servicio de Seguro Social, the Caja de Previsión de Empleados Particulares and the Caja Nacional de Empleados Públicos y Periodistas, Public Employees Section. A table is given below comparing the benefits granted by each of these three "Cajas" as regards the eligibility requirements for the various types of pension and the amounts given.

¹¹ Prepared from Cheyre (1991).

Table II.5
BENEFITS OF THE THREE MAIN INSTITUTIONS IN THE OLD SYSTEM

INSTITUTION	RETIREMENT		SENIORITY	
	Requirement	Amount	Requirement	Amount
SSS	- Man: 65 years - Woman: 55 years - 800 weeks' contributions - Contribution density of 0.5	-50% BS (1) + 1% BS (1) for each 50 weeks in excess of the first 500 - Not exceeding 70% BS(1)	No pensions awarded on basis of seniority	
CANAEMPU	- Men and women: 65 years - 10 years contributions	- BS (2)*N° of years of service/30 - Not exceeding BS(2)	30 years of contributions	- BS (2)
EMPART	- Men: 65 years - Women: 65 years minus 1 year for each 5 years' service with a maximum of 5	- BS (3)*N° of years' contributions/35 - Not exceeding BS (3)	-35 years' service for men -30 years' service for women with 25 years actually worked or 20 and 55 years of age	Equal to old-age pension

- (1) Basic Monthly Salary (BS): Sum of taxable wages and other income in the last five years divided by sixty, the last three years being readjusted according to the increase in the average subsidized wage.
- (2) Basic Monthly Salary (BS): Average of the wages of the last 36 months.
- (3) Basic Monthly Salary (BS): Average of the wages of the last 60 months prior to the moment of receiving the benefit, the last 24 months being readjusted according to the increase in the living wage.

Table II.5 (cont.)

INSTITUTION	TOTAL DISABILITY		PARTIAL DISABILITY		SURVIVORSHIP	
	Requirement	Amount	Requirement	Amount	Requirement	Amount
SSS	- Disability of 70% - Contribution density of 0.4 in the last 5 years and 0.5 in the membership period	- Equal to retirement pension	- Disability between 40% and 70%	- 50% of retirement pension	- Widows and Orphans: - 50 weeks' contributions - Contribution density of 0.4 in the last 5 years and 0.5 in the membership period	- 50% of pension of originator, or what he/she would have received in case of total disability - 20% of average salary for each child
CANAEMPU	- Complete disability - 10 years' contributions and under 65 years of age	- Equal to retirement pension	- No pensions awarded for partial disability		- Widows and Orphans - 10 years' contributions Also entitled: legitimate mother, natural offspring and unmarried legitimate sisters	- 20% of basic wage or pension and 1% extra for each year of service over and above the first 10 years, not to exceed 50% of BS (2)
EMPART	- 2/3 disability - 3 years' contributions and under 65 years of age	- 70% BS(3) + 2% BS(3) for each year over and above the first 20	- No pensions awarded for partial disability		- Widows - Orphans	- Widows: 50% BS(3) - Orphans: 15% BS(3) for each beneficiary

Source: Cheyre H.

As may be seen, the types of pension, their requirements and amounts varied from one institution to another, meaning that the System was unfair. At the same time, each of these "Cajas" gave their members other benefits, such as death benefit, loans, house sales under special conditions, compensation for years of service, mortgage loans, reimbursement of sums accumulated in the Retirement Fund, and others.

B. The Crisis of the Pay-as-you-go System

From the middle of the 1950s, the Pension System had been showing signs of crisis. A proof of this is the fact that all successive governments from that time onwards tried reforms, or indeed implemented them, in an attempt to improve it. The most complete studies of the system made with a view to reforming it were those carried out by the Klein-Sacks mission and the Prat Report. The crisis was characterized by financial imbalance, inequality in access to benefits and faults in administration.

1. Financial Imbalance

One of the main characteristics of the Social Security System then in force was that it originally functioned as a Partial Capitalization System. In other words, the active contributors financed the pensions of the passive, but at the same time a reserve fund was created with part of the resources collected. Although in the early stages it was possible to capitalize part of the resources collected, this became increasingly difficult, and it turned into a simple Pay-as-you-go System. In other words, no reserves were accumulated.

At the end of the 1960s the Old Social Security System, including pensions, family allowances, sickness and industrial accident benefits and unemployment benefits, was financed largely by the contributions paid into the System by workers and employers. In fact the collection of contributions represented approximately 65% of the total income of the "Cajas de Previsión". The second major source of income for financing the benefits came from the State, representing about 30% of the total income. Thus the contribution produced by yield on investments and other items was minimal.

Over the course of the years, the collections became insufficient to finance the benefits granted by the various "Cajas", with the result that the contribution rates continued to rise. When these also proved insufficient, it became necessary to increase contributions from the State.

From 1974 onwards, given the steep increases in contribution rates, collection was able to play a more important part in financing the benefits

This made it possible to achieve a moderate reduction in the State contributions, even though these continued to represent about 30% of all income to the Social Security System. However, it was impossible to sustain such high contribution rates over a long period of time, so at the end of the 1970s they were reduced to more reasonable levels, around 30% to 40%, necessitating an increase in the share of government funding to finance the benefits. It should also be pointed out that the "Cajas" generated other income, amounting to about 5% of the total, which played an increasing part in their own financing.

As far as pensions are concerned, Table II.6 shows the composition of the income of the "Cajas de Previsión" in the six years immediately preceding the Reform. The State contribution to the Old System for financing pensions represented a considerable part of government income. It remained at about 40% of the Pension System's income on average, which meant about 3% of the GDP between 1975 and 1980. At the same time, contribution rates for both employers and workers remained quite high, so there seemed to be no viable alternatives for financing the System. This was particularly relevant in view of the demographic aspects, where, as will be seen in the following sections, the ratio of actives to passives was showing a clear downward trend. In other words, every year there were fewer contributors to each pensioner.

Table II.6
COMPOSITION OF PENSION SYSTEM INCOME
(In% of the total)

Years	Contributions	Yield on Investments	Others (1)	State Contributions	Total
1975	53.94	3.00	0.65	42.41	100
1976	56.29	5.01	1.25	37.45	100
1977	53.82	4.68	1.43	40.06	100
1978	54.93	3.61	1.87	39.59	100
1979	56.45	2.82	1.23	39.51	100
1980	55.01	2.52	3.03	39.44	100

Source: Prepared internally on the basis of statistics from the Superintendency of Social Security.

(1) This item includes income in the categories of penalty interest, sale of assets, sports fields, camp sites, etc.

Table II.7
PENSION SYSTEM INCOME
(In % of GDP)

Years	Contributions	Yield on Investments	Others (1)	State Contributions	Total
1975	3.64	0.20	0.04	2.86	6.75
1976	3.72	0.33	0.08	2.47	6.60
1977	4.09	0.36	0.11	3.05	7.60
1978	4.09	0.27	0.14	2.95	7.45
1979	4.11	0.20	0.09	2.87	7.28
1980	4.34	0.20	0.24	3.11	7.88

Source: Prepared internally on the basis of statistics from the Superintendency of Social Security.

(1) This item includes income in the categories of penalty interest, sale of assets, sports fields, camp sites, etc.

For purposes of analysis, the causes of financial imbalance may be divided into demographic and socio-economic ones.

a. The Demographic Situation of the System

The whole decade of the 60s and the beginning of the 70s were characterized by a steep increase in social security coverage and also in the number of pensioners. Between 1961 and 1973 the membership of the System grew 56.17%, while the number of pensioners increased 209.02%. As a result of this disparity in the growth of the active and passive membership, the ratio of contributors to pensioners fell rapidly from 10.8 to 1 in 1960 to 3.5 to 1 in 1973.

Later, from 1974 to 1980, the situation described for the previous period was repeated, though to a lesser extent, with the number of pensioners increasing by 42.7% whilst the number of contributors fell by 6.7%. As a result of this situation, the ratio of contributors to pensioners fell from 3.2 to 2.2 between 1974 and 1980.

This performance of the contributors-pensioners ratio is attributable to the demographic changes observable in the country and to the generous provision of benefits to active members.

Table II.8
DEVELOPMENT OF THE CONTRIBUTORS-PENSIONERS RATIO

Years	Contributors-Pensioners Ratio
1960	10.8
1968	4.5
1969	4.3
1970	4.4
1971	4.3
1972	3.7
1973	3.5
1974	3.2
1975	3.2
1976	2.8
1977	2.6
1978	2.4
1979	2.3
1980	2.2

Source: Cheyre H.

b. The Socio-Economic Situation

Although the whole period 1965-1980 was characterized by a high level of direct State participation in financing benefits, it is possible to appreciate two distinct stages:

- Between 1965 and 1972 there was a significant increase both in the amount of pensions paid and in other related benefits¹². Between 1965 and 1971¹³ the average amount of pensions increased 86.5% in real terms, while the number of pensioners grew by 47.5%. This made it necessary to increase social security income. Factors which made a positive contribution towards attaining this objective were an increase of 128.9% in real wages between 1965 and 1972 and a reduction in the rate of unemployment from 5.4% to 3% in the same period. However, the increase in benefits was so significant that the resources provided by the State increased their share of the total funding from 34.1% in 1965 to 38.2% in 1972.

¹² Pension Scheme, family allowance, sickness scheme, industrial accidents, unemployment and other subsidies. Arellano "Políticas Sociales y Desarrollo: Chile 1924-1984" CIEPLAN, 2nd Edition, May 1988.

¹³ No information is available for 1972.

- Later, from 1973 onwards, the macroeconomic situation took a downturn with a sharp fall in real salaries and a significant increase in unemployment. Added to this was the increased evasion of social security contributions¹⁴, related basically with the high contribution rates. This led to a significant reduction in pensions which reached 69% in real terms between 1970 and 1974, and even in 1980 they were 21.24% lower than they had been in 1970. These drastic reductions in benefit amounts happened, partially at least, because of the lack of explicit mechanisms for indexing pensions in the context of high inflation rates.

2. Inequality in Access to Benefits

A common criticism of the Old Pension System refers to the fact that it is regressive. However, detailed calculations on contributions paid to the System and benefits received from it by different socio-economic groups show that the Pension System produced a re-distributive effect which was positive for the population with least financial resources¹⁵. Despite this, there were numerous examples of unequal treatment for workers in the same situation.

The causes of this may be found in the following:

- Lack of uniformity:* As has already been mentioned, towards the end of 1979 there were 32 social security institutions operating in the country, offering over a hundred different social security schemes, which grouped workers according to specific economic sectors.

The social security institutions ("Cajas") differed in:

- Contribution rates.
- Pensions to be obtained in relation to income.
- Conditions for entitlement to benefits.
- System for readjusting pensions to cope with inflation.

All this led to inequality in the benefits provided by the different social security institutions.

¹⁴ Arellano, Op.Cit. This document shows the fall in contributions from active members of the SSS, which decreased as a percentage of the work force from 61% in 1974 to 47% in 1980.

¹⁵ Arellano, Op. Cit.

- b. *Different benefits corresponding to identical contributions and identical needs:* In the former Pension System, people who had made contributions of the basis of increasing wages could obtain higher benefits than those with constant income, even though their total contributions during the whole of their working life were identical, because the pension calculation took only the last few working years into consideration.

3. Faults in Administration

In the operational area there were also notorious faults in the administration of the System, such as:

- a. Inefficient handling of the resources: The reserves accumulated by the “Cajas de Previsión” in the early years after they were set up were invested in public and private financial instruments which did not include readjustment for inflation. In addition, even though these institutions did not always have the technical capacity to evaluate credit risk and execute collection in case of default, they granted their members loans for a variety of purposes. These situations gradually reduced the real value of the reserves, transforming the financial regime of the “Cajas” from one of partial capitalization to a simple pay-as-you-go system which, as was mentioned, reached the end of the 1970s with a huge financial imbalance.
- b. The incorporation of new beneficiaries to the existing institutions and the creation of new schemes for particular groups of workers was not always supported by the corresponding actuarial studies, and this was one of the reasons why contribution rates had to be increased very rapidly when the System reached maturity and the financial imbalance became evident.

