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Reforming the Pension System: Is Privatization *a la Chile* the Best Route?

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The Philippine pension system is on the verge of a crisis, thus requiring immediate drastic reforms. The reform process has begun, with the recent signing of two new Republic Acts, which serve as the legal framework for institutional reforms in the Social Security System (SSS) and the Government Service Insurance System (GSIS). Notwithstanding this development, some quarters in government are pushing for a more radical approach, that is, the privatization of the pension system patterned after the much-vaunted (though often misunderstood) Chilean model. Although the Chilean model of a privatized pension system is controversial, it has attracted a lot of attention worldwide. A number of studies in Chile and elsewhere find basic weaknesses in the Chilean privatized pension system. Building on these studies, this article develops a critique of the standing proposal to make the Chilean model the guide for privatizing the Philippine pension system. The paper recommends structural reforms that will combine the roles of the public and private sectors in promoting two types of pension systems: the collective, defined benefit system (pay as you go) and the individualized, defined contribution system (the mixed, dual system).

Introduction

The government is preparing for the next wave of privatization—the privatization of the social sectors. This new wave includes the privatization of pension funds. In March 1996, the Department of Finance (DOF) outlined its bold proposal to reform the pension system via privatization. The DOF titled its presentation: "Learning from Chile: Empowering the Filipino Worker."

Chile is touted as *the* model of the privatization of the pension system. And to learn more about "what is really good" about the Chilean system, the Philippine government sent two delegations composed of legislative and executive officials to Chile (Ongkiko 1997: 2).

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In gist, Chile's pension system is based on individual accounts (defined contribution system) administered by private fund managers. In 1981, Chile shifted from the defined benefit system (also known as the pay-as-you-go system[1]) to the privatized defined contribution system. A respected Chilean academic specializing in pension reforms describes the Chilean model as "an extreme case of privatization." This system favors the individual, not the social group. Upon retirement, the individual gets back all his or her contributions and the investment income. The principle of solidarity is absent, for the gains or earnings from individual contributions are strictly for the individual.

On the other hand, the defined benefit system (pay as you go) is guided by the principle of social equity and solidarity. Benefits are shared by all although some contributors get fewer benefits than individuals belonging to the disadvantaged sectors. This is because individual contributions are also used to subsidize the poor, the sick, the disabled, and the old.

Despite the DOF's pitch for the Chilean model, it seems that the *total* privatization of the Philippine pension system may not materialize, at least for the moment. In President Fidel Ramos' speech on the occasion of the 39th anniversary (September 1996) of the Social Security System (SSS), he enumerated his vision of establishing "the four pillars of social security protection." As cited by Ongkiko (1997: 4-5):

> (1) Publicly managed social assistance to "address the needs of the less fortunate who do not have the wherewithal to insure, much less, take care of themselves." Tax revenues will finance this social assistance pillar.
>
> (2) Publicly managed defined benefit system to "provide some kind of safety net for our workers, especially the low income and the poor who, individually or together with the employer, can afford to pay social insurance premiums." The SSS and Government Service Insurance System (GSIS) are performing this role.
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> (3) Privately managed defined contribution or individual accounts to "cater to individuals who find the present benefit levels too low and are prepared to contribute more to be able to build a nest egg for the future."
>
> (4) Privately managed individual savings to "cater to the middle and high-income groups which want more protection and can afford the additional premiums."

President Ramos' "four pillars" of social security, combining both the public and private administration of funds, may not be as controversial as Chile's privatized system. Yet, the debate continues. Ramos' speech may have defined the parameters of social security reforms, but the major issue is the privatization of the management of the pension funds.

Moreover, the Chilean system has become the reference point to reform the Philippine social security system. As Ongkiko notes (1997: 6), there is "a determined and continuing campaign of some quarters in favor of the privately managed defined contribution system patterned after the Chilean model."

Social sector privatization, especially that of the pension system, is arguably the most controversial of the government's privatization schemes. Needless to say, it is a crucial public issue cutting across classes, sectors, and generations. Unfortunately, the protagonists in the debate are limited to a handful of officials in the Congress and the Cabinet, a couple of columnists, some social security administrators and a few economists. Further, the concerned government agencies have not begun broad public consultations on the issue.

In this light, the article hopes to contribute to the discourse and sustain the debate on the new wave of privatization. The paper will focus on the plan to privatize the management of pension funds patterned after the Chilean system. To see the broader perspective, the paper will likewise discuss the internal and external contexts of Philippine privatization.

The article is divided into the following sections: (1) the domestic context of Philippine privatization, (2) the international context, (3) the privatization stages, (4) the privatization of the social sectors as a paradigm, (5) the scope of social sector privatization, (6) the rationale for privatizing pension funds, (7) the example of Chile, (8) the political dynamics, and (9) the alternatives.

Domestic Context of Philippine Privatization

Privatization in the Philippines has gained legitimacy in light of two factors: (1) the inefficiencies and politicization of state-owned enterprises and (2) the perennial problem of low revenues and growing spending.

However, privatization is also being advanced as part of an ideological offensive to reduce the size and scope of government. Very indicative of this is the statement of basic principle regarding the privatization of the Metro Manila Waterworks and Sewerage System (MWSS). Dr. Angel L. Lazaro III, MWSS administrator, said: "Privatization is a recognition that the private sector is by its nature better than government at certain tasks and operating a water utility is one of these." Lazaro's statement would be less contentious if he did not raise it to the level of principle.

Lazaro's statement is not a personal belief. It echoes what the Ramos administration has been preaching all along—"a new paradigm of governance" that "allows the private sector a bigger role in national development." The

Ramos administration is pushing for a reengineering plan, with accompanying legislation, "that seeks to refocus the role and scope of government" (DBM undated). All this of course is the euphemistic way of saying: Reduce the size and scope of government, which should not compete with the private sector.[2]

With minimal government intervention and participation in the economy as the arch framework, the DOF is now saying that the privatization program has "evolved from a primarily revenue-driven program to a vision of governance and development." In other words, the privatization thrust is "a new paradigm"; privatization is seen "not only as a revenue generating tool but as a strategy of governance" (DOF 1996).

All these statements, unfortunately, obfuscate the merits (as well as demerits) of privatization as a policy instrument. It is important to make the distinction between privatization as an abstraction (a philosophy of governance), on the one hand, and privatization as a specific policy instrument, on the other hand.

It goes without saying that privatization as a policy tool can address contextual issues relating to efficiency, public revenue, and social welfare. But it is also a truism that privatization is not a panacea. Dogmatism—the view that the state and parastatals are inherently inefficient—does not contribute to an intelligent discourse.

Yet, it is difficult to deny the inefficiency of the Philippine state-owned enterprises known as government-owned or -controlled corporations (GOCCs).

Take the case of MWSS. The current MWSS rate is ₱8.78 per cubic meter. But the winning concessionaires in the privatization bid, Benpres plus joint venture partner Lyonnaise des Eaux and Ayala plus joint venture partner International Water, have offered rates of ₱4.97 per cubic meter (for the west zone) and ₱2.32 per cubic meter (for the east zone), respectively.[3] More to the point, under the operation of the government-owned MWSS, non-revenue water, or the system losses, is equivalent to 56 percent of total water distribution. Further, the MWSS coverage of service area for water and sewerage is 68 percent and seven percent, respectively (Lazaro 1997).

Or recall the GSIS financial irregularities uncovered by the Commission on Audit (COA) in 1995. Among other things, the COA said the GSIS lost US$1 million in offshore investments and overstated its net income by ₱265 million (Chikiamco 1995a).

As these two concrete examples show, it is unsurprising that GOCCs engaged in public goods are perceived as wasteful and inefficient and therefore deserving of being privatized.[4]

In a similar vein, the deficits or losses of GOCCs contributed heavily to the country's perennial fiscal crisis. This situation gave government a convenient justification to proceed with the privatization of GOCCs. From another angle, the fiscal constraints resulted in the government's abdication of its responsibility to provide the basic public goods, including infrastructure and social services. Again, the solution is to let the private sector deliver the public goods.

Simply put, concrete problems like the inefficiency and corruption plaguing government and its corporations and the lack of fiscal resources have made privatization attractive. Such attraction, in turn, has objectively resulted in cementing the ideological basis for privatization.

International Context of Philippine Privatization

In the global context, ideology also impinges on the arguments for privatization. Privatization as a global development is rightly or wrongly associated with the free market and liberalization. Haque (1996), for example, calls the neoliberal offensive a "worldwide movement for privatization."[5] In this regard, the World Bank (1996a: viii) makes a distinction between privatization in a "strict sense" and privatization in a "broader sense." The strict sense is "that of divestiture by the state of enterprises, land, or other assets." The broader sense is defined as "any action that moves an enterprise or an economy in the direction of private ownership or that tends to make the behavior of state enterprises more like that of private entities."

The world now looks at the adoption of the free-market economy and all things related to it as the only development path. The collapse of socialist economies and the stagnation of nation-states that previously embraced protectionism have of course bolstered the argument for open, outward, and liberalized economies. As *Newsweek* (23 June 1997) wrote in a confident tone: "Throughout the world, the primacy of markets and open trade, of fiscal austerity and stable currencies, has become settled wisdom."[6]

The case of the East Asian miracle may at first glance seem to be an exception. However, state intervention in the high performing Asian economies (the newly industrializing countries, NICs) has an important qualification. That is, intervention was subsumed into a "market friendly"—or shall we say "market-conscious"— framework and an outward orientation of aggressively pushing exports. In the World Bank (1993) jargon, the formula is "having a winning mix of fundamentals and interventions."

The other view contends, in the fashion of "state-assisted capitalism," that it is the state guiding or directing the market.[7] Be that as it may, the

possibility of replicating the East Asian NICs' formula at present is less likely, taking into consideration the unique characteristics of these NICs, and the new—and still unfolding—qualitative changes brought about by globalization. Further, even if we argue in favor of the position that the NIC states "guided" or "directed" the market, this does not imply a rejection of the market economy. In fact, "state-assisted capitalism," as the term itself suggests, is market-oriented.

At the very least, then, market-orientation is unchallenged in theory and practice. Privatization easily fits into this overriding framework. And for those countries determined to pursue the liberalization path, privatization has become a key component of stabilization and structural reform programs.

The Philippine case is a typical example (though not a positive one). The successive administrations (Marcos, Aquino, and Ramos) have committed the privatization process to economic agreements with the International Monetary Fund (IMF) and the World Bank (WB). Hence, some quarters criticize privatization as part and parcel of an orthodox structural adjustment package that aims to reduce the state's role in the economy.

In the particular situation of erstwhile central-planning economies in transition, privatization is a natural move to transfer state assets to the private sector. Nonetheless, the East European countries have avoided the US model of "casino capitalism" and have instead opted for the Western European paradigm of a socially regulated economy. In the social-democratic context of broadening ownership, privatization—for lack of a substitute term—is, in fact, democratization.[8] Trade unions, cooperatives and ordinary people are given the opportunity to own and manage the state firms. This is perhaps an example of how privatization in Eastern Europe is justified on the ground of drawing out political support.

With regard to the once import-substituting economies and once state-centered models in Latin America and Asia, privatization has become a hallmark of reinventing and retooling governments. Chile comes to mind as the best example of the latter. This is likewise the case in the Philippines, as clearly stated by the DOF's declaration that the privatization of the social sectors signifies a new "vision of governance and development."

The Organization for Economic Cooperation and Development (OECD) countries are not spared from the privatization trend. In the face of the compelling need to arrest growing public sector deficits and to restructure industry, the mature, developed economies have proceeded to privatize state assets and the delivery of social services. Even a social market economy like Germany—upon reaching a high level of state-owned industries especially on the heels of reunification—has used privatization "as an effective way to reduce

the level of government influence and involvement in commercial life" (Tichy 1996).

All told, a number of conditions—theoretical and practical—favor privatization even as some of the arguments against privatization remain valid. In the end, the national decisions whether to privatize or not take into account both economic efficiency and particular historical, political and social reasons.

In light of the above-mentioned domestic and international factors, the government's privatization program has occupied the high ground. But it will be a mistake to conclude that the Filipino public's reception of privatization has more to do with the belief in the superiority of the neo-liberal ideology and less with the concrete problems facing the Philippine public sector.[9]

To be sure, the advocates or ideologues of neo-liberalism have taken advantage of the opportunity to trumpet the victory of privatization as a principle. Opposition to privatization, especially coming from affected state workers and some Left organizations (opposing privatization also for ideological reasons) continues.[10] The opposition, however, is weak vis-à-vis the motley combination of pro-privatization forces: government, business, opinion makers, and academics. Privatization has gained momentum, and the whole process seems unstoppable at this point.

The Stages of Philippine Privatization

The privatization process was set in motion as part of the stabilization program to arrest the deep crisis triggered by Marcos' economic mismanagement and political isolation in the first half of the 1980s.[11] The state-owned enterprises, many of which were managed by Marcos cronies, incurred heavy financial losses at the same time that government assumed the liabilities of corporate borrowers that defaulted on their loans during the financial crisis. By 1984, the government owned 303 enterprises, a sharp increase from the 1975 figure of 120 state-owned enterprises.

The Marcos regime had to seek the support of the Bretton Woods institutions to stabilize the crisis. Hence, the economic program was subjected to the rigid scrutiny and supervision of the IMF and WB. The economic program had to conform to stringent conditionalities, including the selling of state assets as a means to sharply reduce the public sector deficit.

Just before his dictatorship was overthrown, Marcos issued a Letter of Instruction (No. 1520) and two presidential decrees (Nos. 2029 and 2030) that laid the legal framework for the privatization of state-owned enterprises.

The Aquino government followed through these Marcosian fiats with Proclamation No. 50 to speed up the privatization program. Since then, the privatization program has become irreversible, although some (for example, Diokno 1997) criticize the backsliding and the slow pace of implementation.

The privatization sales from 1987-95 amounted to ₱33.2 billion. This amount is modest, and government could have earned more if the assets were sold at a higher recovery ratio.

However, the objective of privatization has gone beyond the need of government to generate revenues. As said earlier, the Ramos administration, through the DOF, has defined the current stage of privatization as a "new paradigm," being "a strategy for governance."

The development of privatization in the Philippines since the Aquino administration is described by the DOF in terms of different waves. The DOF defines the first wave as "reprivatization," which was basically "revenue-driven."[12] The second wave is "infrastructure privatization." The distinguishing characteristic of the second wave is the underlying objective of catalyzing the private sector in providing infrastructure.[13] The third wave—the new wave, so to speak—is the privatization of the "social sectors," specifically education, health services and pension funds. By privatizing the "social sectors," the government sees itself as an "enabler."

Privatizing the Social Sectors as a Paradigm

For the third wave of privatization, the DOF contrasts the "old view" with the "new paradigm." The table below shows how the DOF differentiates the old view from the new paradigm.

Old View	*New Paradigm*
Government rows	Government steers
Government directly undertake (sic) production of public good	Government funds more efficient private sector producer
Government an inefficient monopoly producer, no market test for efficiency	Government sets rules, competition among private providers assures efficiency and prudent use of taxpayers' money
Opaque subsidies to producer—no direct accountability, many leakages	Transparent and well-targeted subsidies to consumers; private producers go out of business if not responsive to consumers

Source: DOF 1996.

The new paradigm—of which the application extends to a broad range of economic matters other than privatization—borrows the catchy principle popularized by Osborne and Gaebler in *Reinventing Government* (1993):[14] "Catalytic government: steering rather than rowing." Steering includes making "*more* policy decisions," putting "*more* social and economic institutions into motion," and doing "more regulating."[15] The principle of "steering rather than rowing" therefore does not advocate a minimal role for government in the economy.

Indeed, a new paradigm is called for. We cannot deny that government has been an inefficient monopoly producer (not in all cases though) and that subsidies have been non-transparent and have had many leaks. We also favor government setting rules and providing transparent and well-targeted subsidies.

The controversy lies in how the Ramos administration interprets and applies the principle of "steering rather than rowing." The contention is the administration misinterprets and misapplies the meaning of "steering and rowing," and it papers over the nuances and qualifications of key formulations that underpin the principle.[16]

For example, the government's new paradigm stresses "competition among private producers" but fails to take into account the position of Osborne and Gaebler that "government agencies remain as service providers in many cases—although they often have to compete with private producers for that privilege." In a similar vein, Osborne and Gaebler argue that not only can government compete with business, "it can win."

The decisive element is neither "the efficient private sector producer" nor the "competition among private producers." Competition is indeed a necessary condition. But because we are dealing with public goods, the competition is not exclusive to the private sector. It must be a type of competition that welcomes "public versus private competition" as well as "public versus public competition"[17] (Osborne and Gaebler 1993: 35, 84-92).

This set of arguments is recaptured later in the critique of the proposed privatization of the pension system.

Scope of Social Sector Privatization

The DOF states that education, social services, and pension funds are covered by the third wave of privatization.[18] To reiterate, privatizing the social sectors is arguably the most controversial phase of privatization.

The "reprivatization" stage was easier to implement in the sense that the reprivatized firms were, in the main, duplicating activities that the private sector does better. "Infrastructure privatization," while more challenging than "reprivatization," has the advantage of being guided by established "do's and don'ts" of running or regulating natural monopolies. The privatization of infrastructure, which has become *au courant* globally, is replete with lessons, especially in relation to pricing and regulatory policies.[19]

Infrastructure privatization becomes a lightweight upon comparison with privatizing the social sectors. The privatization of the social sectors is a far more complicated undertaking than the earlier privatization programs.

For one thing, the traditional view (having become a truism, in fact) is to regard education, health services and social security as public goods that government must always provide. For another thing, the social sectors have an immediate and direct impact on equity and poverty alleviation. And therefore, the criteria of having economic efficiency, promoting corporate governance, and generating public revenues cannot—and should not—dominate the criterion of reducing poverty and promoting equity.

Among the social sectors, the privatization of education and health services is relatively more politically optimal—or less politically controversial—than the privatization of pension funds.[20] How come?

Take the case of education. State colleges and universities (SCUs) are targeted for privatization. The SCUs have a generous but disproportionate share of the public education budget. The opportunity cost is having less resources for primary education.[21] Primary education is the priority. It has higher social returns than tertiary education. Thus, closing down or privatizing SCUs, which in many cases are political enclaves of traditional politicians, will free much-needed resources for elementary education.

It is also a fact that the overwhelming majority of the poor do not reach the tertiary level; hence the argument that SCUs cater to the poor is specious. Further, the academic performance of many SCUs is below standard. In short, there are sufficient arguments favoring the privatization of some SCUs.

There are likewise strong arguments on the grounds of efficiency and equity that support the privatization of specialized hospitals (e.g., Philippine Heart Center, Kidney Center, and Lung Center). The tertiary public hospitals—catering mainly to the urban middle and upper classes—receive a substantial proportion of the health budget. However, preventive health care has a greater impact on poverty reduction; it follows that more resources have to be shifted to primary health.

Solon (1997) favors the privatization of the specialized hospitals under a regulatory framework, arguing that the problems of externalities, incomplete information, and poverty alleviation can be effectively addressed through means other than an open and direct access delivery system.[22]

With regard to social security funds, the need for state intervention is a non-issue. Perhaps, it is best to cite the World Bank. Notwithstanding its market bias, the World Bank says: "State intervention is justified only where markets fail—in such areas as defense, primary education, rural roads, and some social insurance—and then only to the extent that it improves upon the market" (WB 1996a: 110).

Because the pension system is characterized by imperfect information, it is a kind of good that is vulnerable to market failure. Hence, the question of whether or not to intervene becomes academic. The more difficult questions are: What kind of state intervention is most appropriate—government ownership or government regulation or a hybrid of the two? Related to this, what are the specifications, mechanics and processes of the preferred type of intervention?

Government ownership or regulation? Given the Philippine context, this is difficult to answer. The move towards privatizing the pension funds is precisely a response to the poor performance of the government-owned GSIS and SSS. (See the following section.) On the other hand, government regulation in the Philippines is weak and wanting.[23] It thus seems the choice is between the devil and the deep blue sea.

Rationale for Privatizing the Pension Funds

Privatizing the management of pension funds is indeed tempting in light of the search for solutions to overhaul the pension system. Consider the following data.

(1) An actuarial assessment of the SSS and GSIS estimates that social benefits funds of the GSIS and SSS will become negative in 2008 and 2014, respectively and the funds will be depleted in 2016 and 2022, respectively (WB 1995: 57-59; also cited by Chikiamco 1995a). These are "best-estimate assumptions."[24]

(2) In 1992 and 1993, the benefit payments and operating expenses of SSS exceeded contribution income. Hence, the SSS had to use investment income to cover the current expenses (WB 1995: 45).

(3) Between 1989 and 1993, the average real rate of return for the SSS portfolio was 5.0 percent. The GSIS investments had a

negative real rate of return, a five-year average of -0.6 percent (WB 1995: 54-55; also cited by Chikiamco 1995b).

(4) Employer compliance with SSS contribution requirements is very low, with estimates ranging from 35 to 55 percent. Low compliance has two manifestations, namely the low number of members contributing and the low number of contributions during the year (WB 1995: 33, 60).

(5) The SSS coverage of 60 percent of the workers in the formal sector (WB 1996b: 49)—plus the fact that it does not provide protection to the large informal sector—suggests that the SSS is still far from attaining universal coverage. The Philippine social security system has not reached the absolute poor—those who need social security most.[25]

The World Bank, too, asserts that the pension benefits of the GSIS and SSS are "very expensive" and "very generous" (1995: 60, 62), thus contributing to rising social security costs (1995: 60, 62). Some quarters disagree, arguing that the monthly pension for retirees is low. For instance, General (1997) states that upon the signing of Republic Act No. 8282, the average pension is now ₱1,700 a month for SSS retirees, which however is less than half of the minimum wage.

On the other hand, an upward adjustment in pension benefits will result in further strain on the financial resources of the GSIS and SSS, unless contributions increase at a faster rate than the rise in costs. One critical finding of the World Bank report (1995: 61-62) is that the current level of contributions for both the GSIS and SSS "is not adequate to support the benefits being promised."

All of the above facts and figures clearly show that the Philippine social security system, without instituting radical reforms, is headed towards bankruptcy. In a simplistic way, the DOF paper says there are two options: "Do nothing" or "reform the system." The choice is obvious, but the DOF, instead of presenting a menu to reform the system, offers only one recipe—the Chilean recipe.

Learning from Chile

Before the privatization of Chile's pension system in 1981, the pay-as-you-go system was in place. The contributions of active members took care of the pension benefits of the retirees. The balance was used to subsidize housing to a select few, finance unsustainable infrastructure projects, and provide short-

term subsidized loans. The ever-increasing spending, further aggravated by the decreasing ratio of active contributors to pensioners, intensified the pressure on government financing. In short, the old system was in crisis (DOF 1996).

The old system was also criticized for being "highly dependent on State financing since, as time went by, the ratio of active to passive workers decreased; thus State support for financing the System was inevitable and growing" (Superintendence of Pension Funds Administrators 1995: 16).

In 1981, the Pinochet dictatorship legislated (or imposed) a new pension system based on individual funding, free choice of pension funds, and administration by private, for-profit groups. This new system is also called the "private fully funded pension system based on individual capitalization accounts" (Arenas de Mesa and Bertranou 1997: 329).

According to Arenas de Mesa and Bertranou (1997: 330), the introduction of a private fully funded pension system in Chile "is an attempt to eliminate (actuarial) imbalances, pension benefits from the ups and downs of political process and public finance, and induce positive effects on savings and capital accumulation."

The new system targeted the "workers employed by the civil society." The pay-as-you-go system was retained for members of the armed forces and the institutions of law and order. Up to now, those under the coverage of the pay-as-you-go system "have shown no interest in changing over to the funded scheme" (Ruiz-Tagle 1995).[26]

The law "obliged" all people entering the labor market to become members of the new system. (The individual capitalized account was made compulsory for all salaried workers but optional for the self-employed.) Meanwhile, the dictatorship gave an 11 percent increase in net pay to attract workers already covered by the pay-as-you-go system to transfer to the new system. As an added enticement, government provided inflation-adjusted, interest-earning "recognition bonuses" (*bonos de reconocimiento*).

On the other hand, the workers must set aside ten per cent of their taxable monthly salaries and earnings as their pension contributions. Note that the 10 percent contribution is a reduction from the 19.6 percent contribution in the old system. However, in the reformed system, the contribution of the employers has been withdrawn (Arenas de Mesa and Bertranou 1997: 333).

The privatized pension funds offer "guaranteed benefits," that is, a minimum pension and a minimum actual yield. In the event that a private pension fund could not provide the minimum yield, the Chilean state would compensate even as it would close down the private pension fund. Also in the

event of bankruptcy of the private pension fund, the state would release additional contributions.[27]

Aside from guaranteeing the funding of some benefits, the state assumes the role of setting and enforcing the rules and regulations of the entire pension system.[28]

Against this backdrop, the DOF is gung-ho about Chile's pension reforms. It claims that Chile's privatized pension system resulted in the following gains:

(1) The pension funds yielded an average real return of 13.3 percent from 1981-94.

(2) The system introduced competition and depoliticized the management of pension funds.

(3) The pension funds grew by leaps and bounds, from around US$250 million in 1981 to over US$25 billion in 1995.

(4) The pension funds boosted the equities market, which grew twelve-fold between 1986 and 1994.

(5) The pension funds contributed heavily to investments in the housing market; investments in mortgage bonds surged from about US$ 1.25 billion in 1988 to nearly US$ 3 billion in 1994.

(6) The pension funds augmented the insurance market, which grew more than four-fold between 1983 and 1994.

Ruiz-Tagle (1995 and 1996), however, paints a not-so-rosy picture. He describes the Chilean model an "extreme case of privatization," and he raises five major criticisms.

The first criticism is that the new system, already in place for more than 15 years, still has a limited coverage. As of February 1995, 54.4 percent of the workers were actual contributors, although the new system at that time covered 96 percent of the workforce. Hence, a huge number of the labor force was not making regular contributions. The set of data from the Superintendence of Pension Funds Administrators (*Superintendencia de Adminsitradoras de Fondos des Pensiones* or SAPF) does not contradict Ruiz-Tagle's claim: From 1982 to 1993, the contributors account for an annual average of 59.8 percent of the actively employed workforce (1995: 73).

Says Ruiz-Tagle: "By way of comparison (although unemployment was then much higher in real terms than it is today), contributors to the pay-as-you-

go scheme in 1980 accounted for 62.8 percent of the workforce. The truth of the matter is that after being in place for 14 years, the individual funding system has not been able to provide better *cover* for the working population. In fact, in February 1995, only 2.4 percent of working contributors were self-employed; this means that nearly all members of the new system are salaried workers, who are obliged to join anyway."[29]

The second criticism is that the Chilean government should not deceive the public that high profits (or interest rates) are an enduring characteristic of the privatized pension system. The high returns between 1981 and 1994 "were linked to certain circumstantial factors including the economic crisis of the 1980s and the steep rise in share prices during the period 1991-94." Ruiz-Tagle estimates that "in the long-run, real average profits are likely to be below five percent."[30] (Incidentally, the return was negative 3.5 percent in 1995.)

The third criticism is that the administrative costs of managing the funds are expensive. In fact, the administrative costs in the privatized system are higher than the costs in the so-called inefficient public system. Marketing costs are high to cover commissions, perks, and promotions to attract new members.[31] The fund bodies retain a minimum of 16.7 percent of contributions.[32] In the same vein, commercial expenses (e.g., increase in the number of salespersons and the rise in sales staff wages) went up by 139.1 percent from 1988 to 1994 (Superintendence of Pension Funds Administrators 1995: 121).

Yet, the fund bodies more or less have provided the same return for their members, indicating that the marketing and other administrative costs have had no impact on private fund managers to "beat the market." The different fund managers are like "birds going together." The SAPF calls this "a trend toward portfolio homogenization."

To avoid being out of pocket, the fund managers play safe by having the same portfolio. The law states that the return for the pension funds should not go below 50 percent of the average actual yield over the past year of all the funds.[33] If the yield falls below this minimum, the private fund manager is penalized and must pay from its own pocket to ensure that the return to its members is at least 50 percent of the average rate. Thus, if the average return in one year is 13 percent, each fund manager should post a return of at least 6.5 percent. Below that, the fund manager has to pay the amount needed to reach the minimum actual yield of 6.5 percent. To quote the Superintendence of Pension Funds Administrators (1995: 118): "Consequently, the AFPs are encouraged to adopt investment policies similar to the average as a way of minimizing the risk of recording yields below the minimum."

At this point, it is important to note that the 13.3 percent average return is not the actual yield for the individual accounts. To be deducted from this

average return is the cost of administering the funds, which is a minimum of 16.7 percent of contributions.[34]

In a similar vein, the competition in the Chilean (as well as the Argentine) model is circumscribed by the increasing concentration of membership in a few pension fund managers. Arenas de Mesa and Bertranou (1997: 335) state that the three pension fund administrators (AFPs) in Chile with the largest concentration of members do not give the highest rate of return on investments even as the commissions they charge are not low.

The fourth criticism is that contrary to the Chilean government boast, the 1981 pension system does not make a substantial contribution to national savings.[35] According to Ruiz-Tagle, the fresh money injected by the new pension system is US$900 million, equivalent to three percent of national savings. Much of the investments now in private hands were previously with the state ("transferring from one pocket to another").

Furthermore, the privatized pension system is not a main factor in productivity expansion, for the private managers have mainly invested the pension funds in the secondary market.

Ruiz-Tagle (1995) also deplores the one-sidedness of presenting the Chilean model of the pension system:

> Some writers claim that Chile's individual funding arrangements have been a great success because they have attracted large sums of money into the capital markets. However, what they do not say is that the down-side of this money accumulating in the Pension Fund is the shortfall in the level of provision that the Treasury has had to cover to pay out pensions under the old scheme, and to fund the minimum statutory pensions under the new scheme for workers who cannot build up sufficient funds against their name.

The fifth criticism is that the new system lacks "all notion of solidarity." Ruiz-Tagle (1995) explains:

> ... that, under the individual funding system, pensions are fixed at the point of retirement and do not vary much thereafter in real terms. This means that retirees will not be able to benefit from any economic progress that the country may enjoy in the coming years. To put it another way, this system will produce a *widening gap* between the incomes of employees (whose salaries will rise in line with the country's economic progress) and retirees' pensions (which will stand still).

Arenas de Mesa and Bertranou (1997: 332) offer a less critical view. That is, although the Chilean model lacks an "endogenous" mechanism for income redistribution (subsidies from high-earning workers to low-earning workers and from active workers to retired workers), it nevertheless relies on an "exogenous" factor (tax revenues) to guarantee a minimum pension for everyone.

Another weakness of the Chilean model is that the privatized, fully funded pension system causes gender inequality. To quote Arenas de Mesa and Bertranou (1997: 339):

> Unlike the public schemes that give the same benefits regardless of the sex of the affiliates, fully funded schemes pay benefits which explicitly include life expectancy factors by gender. Therefore, those who live longer (women) obtain on average lower benefits than those with shorter life expectancies....For instance, in Chile, assuming an equal record of wages and years of contributions by gender, women who retire at 60 would obtain 52% to 76% of the pension received by males.

That the privatized pension system in Chile is not the ideal model is borne out by the fact that no country in Latin America strictly followed the Chilean path. Indeed, Latin American countries were at first enamored with the Chilean model, but in the end, their pension reforms took different paths.

Argentina has adopted a mixed system, which is a combination of having collective and individualized capital accounts. Colombia has a dual system, in which the state-managed pay-as-you-go system co-exists with the privatized pension system. Costa Rica has opted to introduce reforms within the pay-as-you-go system.[36]

Political Dynamics

An objective of privatizing the pension system is to democratize corporate ownership. In the Philippines, however, privatization has only resulted in the concentration of power in the hands of the old and the new oligarchy and the foreign investors. To cite some examples, privatized firms or assets in the hands of the national elite or foreign investors include Meralco, Petron, MWSS, Manila Hotel, and the Fort Bonifacio property. In the case of Philippine Airlines, which is not yet fully privatized, government representatives cohabit with the tycoon Lucio Tan.

This highly inequitable pattern gives us a glimpse of the possible distribution outcome of privatizing the management of social security funds. It is thus unlikely that the privatization of the social security system would serve equity and fairness.

To be sure, the inequitable pattern of ownership is happening elsewhere. The particular example of Argentina is close to home. Consider the analysis of Canitrot and Sigal (1994: 135) with regard to the contradictions in Argentina's market economy: "The most important long-run decision—privatization of all state firms—has yielded a ring of monopolies around the state providing basic public services under conditions of high profits and secured demand. The

proximity of highly concentrated corporations to the government implies a future close relationship between political and economic decisions that contradicts the aseptic principles ruling a free-market economy."

Canitrot and Sigal (1994) then connect the above statement to Argentina's privatization of the pension system, adapted from the Chilean model.[37] They acknowledge this "will create long-run saving funds made up of compulsory employee contributions that will allow banks to overcome their present short-run biases and recover the capacity to provide investment credit." But the tradeoff is disturbing:

> When the compulsory source of long-run credit is combined with the monopolistic source of high profits represented by public service enterprises, a powerful mechanism of capital accumulation will be set in motion. Although such an arrangement could be efficient in terms of growth, the hierarchical and political model it implies is not too distant, except for private intervention, from the old Bismarckian growth project the military dreamt of in the postwar period[38] (Canitrot and Sigal 1994: 135-36).

In the Philippines, the privatization of the pension funds is not only an economic issue; it is likewise political. Chikiamco (1995a) has stressed that privatization of the pension system is also aimed at doing away with corruption and political interference. We need not elaborate, for example, on how different administrations have used the social security funds to fulfill political objectives. We need not further delve into the alleged financial irregularities in the GSIS, either.

Yet, privatization does not guarantee the end of political patronage and interference. In fact, Philippine privatization has induced a great deal of political interference,[39] with the elite factions having the political connection being able to bag the most-coveted prizes. In turn, the increased concentration of asset ownership among the elite has further solidified their political influence or power.

As emphasized by Gamarra (1994: 64), the redistribution of the privatization process does not depend solely on economic factors (e.g., profitability, pre-privatization and post-privatization price, use of privatization revenue). The political question of whether privatization produces greater concentration of wealth in the hands of a few is also crucial. To borrow Nelson's (1994: xx) proposition, the political trend—in this case, the problem of connection, privilege, and patronage—affects the credibility of the economic measure.

This time, let us contemplate a lesson drawn from Bolivia's privatization experience. The political character of Philippine privatization is similar to Bolivia's. Says Gamarra (1994: 64):

> If anything can be learned from the privatization process in Bolivia so far, it is [that] the patrimonial dynamics of the political process itself induce corruption. No matter who controls the state, a few well-connected individuals will have the upper hand in the privatization process....The Bolivian experience highlights how traditional political dynamics can blend very well with the 'modern-rational' logic of privatization.

Alternatives

The Chilean model, discussed at length in a previous section, has fundamental weaknesses. To be fair, this article acknowledges that we can learn some good lessons from Chile—the introduction of competition, depoliticization of the management of pension funds, and the maximization of investment yields. But learning these positive lessons does not mean embracing the whole model.

Furthermore, a model is not for photocopying. A model is useful as a guide, but the choice to nationalize or privatize, to quote Samuelson and Nordhaus (1989: 585), will "depend more on a nation's history and institutions."

In this regard, we have to point out two distinguishing characteristics—one positive and one negative—that significantly influenced the privatization program (and the whole economic reform process) in Chile.

Let us first state the negative characteristic. To quote Stallings (1990: 166): "Closer analysis suggests that Chile's model was viable only under an authoritarian state, although how far it will deviate under democracy remains to be seen." The privatization of the pension system was done under a brutal dictatorship. It was thus easy for the military regime to impose the reforms. The new pension system "obliged" workers to join the individual-funded arrangements.

Another view, though not contradicting the first, emphasizes the positive characteristic. That is, quoting Herrera and Graham (1994: 242), "yet many reforms of the social security, public health, and education systems and decentralization of municipal governments would not have been possible without the preexisting and relatively efficient public sector." Sadly, one cannot be confident in saying that the Philippines has a "relatively efficient public sector."

Note the paradox. The inefficiency of the public sector, according to the doctrinaire view, is enough reason to privatize. Yet, successful privatization depends on the institutionalization of an efficient public sector.

Still and all, reforms cry out to be done in the Philippine pension system. The need to overhaul the Philippine pension system is not only predicated on

the weaknesses and whatever wrongdoing of the GSIS and SSS. Consider that better quality and hence longer duration of life (because of economic and technological progress), increasing health and medical costs (because of modern technology), and a growing informal sector (because of globalization?) are all threatening the financial sustainability of the current pension system.

What then is the alternative to the status quo? If the Chilean pension model is wanting and controversial, what else can be done? This article's bias is to put in place a mixed, dual system. That is, make the pay-as-you-go system (defined benefit system) and the individualized fully funded (defined contribution) system co-exist and let both the private and public sectors participate in the pension schemes. This framework can thus accommodate the positive characteristics of the Chilean system at the same time that it defends the worthy features of the status quo.

But before elaborating on this, we need to be reminded of an obvious statement: Thorough economic reforms do enhance pension reforms. For instance, an economy that can sustain growth in output and investments will lead to an increase in the number of active workers contributing to social security funds as well as a decrease in the number of dependents. Tax reforms are likewise crucial to the success of reforming the pension system. Given that higher payroll taxes are politically unacceptable, administrative and legislative reforms resulting in better tax compliance will increase the funds for pension and social security.

Internally, the old system (i.e., the current one) can still accommodate crucial reforms. Some of the administrative reforms are, shall we say, no longer original. We have heard time and again the measures to professionalize the management and bureaucracy of the GSIS and SSS and increase efficiency through incentives based on merit and performance. We may also be tired of hearing the recommendations to free the government financial institutions from rigid, restrictive rules. Nevertheless, these "old-hat" reform proposals remain relevant simply because they have not been tried.

Moreover, much can still be done with regard to the financing of the pension system.[40] The GSIS and SSS should drastically cut social security costs. Anyhow, much of this spending is used to finance overgenerous benefits and even non-benefit programs. In particular, the GSIS and SSS should scrap programs that provide cheap, subsidized loans to its active members (e.g., housing loans, investment loans and salary loans).

I confess I am guilty of exploiting the generous benefits offered by SSS. I am probably much better off than many fixed-income earners, but I have been able to squeeze SSS benefits that the ordinary members may have not availed themselves of. Since I have better access to information and I am familiar with

esoteric concepts like arbitrage and equities market, I have profited from borrowing from the workers' funds managed by the SSS. In 1995, I borrowed ₱20,000 from the SSS at six percent interest per annum (which at that time was about three times less than the prevailing market rate) and a term of five years to invest in Meralco stocks. That six-percent interest loan has rewarded me an annual average of 40 percent in dividends!

The GSIS or SSS is not set up to provide subsidized loans to those who are not financially deprived. The defined benefit system is intended to provide extra benefits to the poor, not to the well-to-do contributors. Take a look at the prevailing subsidized interest rates for some loan programs of the SSS (1997: 91-105):

(1) Salary Loan: eight percent per annum

(2) Stock Investment Loans Program: ten percent per annum

(3) Privatization Fund Loan: six percent per annum.

The above criticism should not be interpreted as a rejection of providing adequate incentives for active contributors so they will continue giving contributions. By all means, the GSIS and SSS should continue their personal loans program even as their main objective is the provision of long-term social security. The basic qualification is that the loans should bear interest rates that reflect—or at least are close to—the market rates.

To be fair, the government has already set in motion some major reforms. Signaling the reform process is the recent signing of Republic Act No. 8291 and Republic Act No. 8282, which aim to institute reforms in the GSIS and SSS, respectively. The provisions in the two Republic Acts cover a lot of ground:

(1) Expanding and increasing the coverage and benefits (retirement, death and disability),

(2) Promoting voluntary compliance,

(3) Increasing the rate of contribution of members,

(4) Strengthening enforcement,

(5) Relaxing some restrictions,

(6) Maximizing yield, and

(7) Ensuring prudent management of funds.

Yet, some sections in the two laws are subject to misinterpretation and even abuse.

Take the case of the SSS. SSS administrator Renato C. Valencia announced the implementation by 1 July 1997 of a higher uniform interest rate of 16 percent on all housing loans (*The Manila Chronicle*, 26 June 1997). Valencia said this would align the SSS housing loan interest rate with current market rates. The higher interest rate conforms to Section 26 of Republic Act No. 8282, which states that the Social Security Commission "shall invest the funds to earn an annual income not less than the average rates of treasury bills or any other acceptable market yield indicator." The problem is that the SSS has fixed the rate at 16 percent which is only subject to review after five years. The wisdom of fixing the rate for five years is questionable. For instance, given the bias of the *Bangko Sentral ng Pilipinas* to increase interest rates to control inflation and stabilize the exchange rate, the fixed rate effective for five years may eventually mean the SSS subsidizing the cost of money at some time.

Section 26 of Republic Act No. 8282 creates the condition for the SSS to be more efficient in the allocation of resources. Hopefully, this section will be interpreted in a manner that will put an end to subsidized salary, educational, livelihood, and marital loans.

With respect to the GSIS, it is strange that Republic Act No. 8291, the new law instituting reforms in the GSIS, has no explicit provision about investing the reserve funds in a manner that will earn income comparable to, or exceeding, average rates of treasury bills. Section 41(o) and Section 43(e) of Republic Act No. 8291 merely state that the GSIS and its Board shall have the power "to fix and periodically review and adjust the rates of interest and other terms and conditions for loans and credits extended to members or other persons, whether natural or juridical."

A positive feature of Republic Act No. 8291 is that it has broadened the list of instruments in which the GSIS can invest its funds and has given its Board more flexibility in making investment decisions. In theory, this can help GSIS earn bigger yields. But without political and administrative reforms in place, this may only reinforce influence-peddling and political interference in the GSIS.

On the whole, the two laws provide the framework to rectify the problems arising from the ambiguous social security orientation of the past. The ambiguity refers to the manner of allocating resources intended for different purposes: immediate material benefits for active contributors, pension benefits for the retired, and safety nets for the poor.

Social security indeed has a broad coverage: from poverty alleviation to insurance. Social security—which can likewise be called social adequacy—is the

responsibility of the whole state. Within this framework, the role of the GSIS and SSS is principally in the realm of providing social insurance.

To protect the poor, the government must use general tax revenues and make budgetary allocations for special funds targeting poverty reduction. This is to say that the special funds for the poor are separate from the pension contributions.[41] The GSIS or SSS should have no role in the supervision or management of special funds for the poor so these two institutions can concentrate on the area of social insurance. The Social Reform Agenda's Poverty Alleviation Fund (PAF) is an example of the special poverty fund.[42]

With regard to medical care, it is high time government provided the financial and political boost to the national health insurance system.

What is clear from the foregoing discussion is that public policy is retaining the defined benefit system. To be precise, the new laws have refined the defined benefit system.

At the same time, Republic Act No. 8282, Section 4(a)(2), empowers the SSS to establish a provident fund. Similarly, Republic Act No. 8291, Section 41(s) enables the GSIS to maintain a provident fund though the coverage is limited to GSIS officials and employees. However, Section 41(x) states that the GSIS shall exercise the function of designing and implementing "programs that will promote and mobilize savings and provide additional resources for social security expansion and at the same time afford individual members appropriate returns on their savings/investments." This can only mean the setting up of individual accounts for GSIS members.

In short, the government has cemented the legal basis for the development of the defined contribution system. The question that follows is whether to privatize the management of the defined contribution system.

The laws already provide an opening to the privatization of the management of the provident funds. Section 26-A of Republic Act No. 8282 declares: "As part of its investment operations, the SSS may appoint local or, in the absence thereof, foreign fund managers to manage the Investment Reserve Fund,[43] as it may deem appropriate." In less categorical terms, Section 40(c) of Republic Act No. 8291 states that the GSIS shall exercise the power "to invest the funds of the GSIS, directly or indirectly, in accordance with the provisions of the Act."

Leaving the management of provident funds solely to the private sector is but one option, a narrow option at that. Consider two givens: (a) the lack of future information (and thus uncertainty) in the management of pension funds and (b) the domination of the Philippine political economy by oligopolistic interests (especially in the financial sector). In this light, we have a solid

argument not only for strong regulation of the management of pension funds but also for the participation of public sector enterprises in the provident fund market.

A superior alternative to full privatization then is to let the GSIS and SSS participate in the management of provident funds or individual accounts. At any rate, the two financial institutions are already tasked to make investments and maximize the yields for their contributing members.

Further "commercializing" the GSIS and SSS is an acceptable proposition.[44] "Commercialization" in this context does not mean transforming the GSIS and SSS into private corporations. Rather, the GSIS and SSS will remain public corporations, but their strategy, structure, and operation will be shaped in the manner of private enterprises.

In fact, following the principle of "public versus public competition," the SSS and GSIS should be made to compete with each other. Accordingly, the GSIS and SSS should have "overlapping domains," allowing members to leave one corporation and join the other.

We then combine "public versus public competition" with "public versus private competition." Let private institutions take part and compete in the management of the provident funds or individual accounts.

In the case of Argentina, its mixed system allows public enterprises to compete in the management of pension funds. More to the point, the public pension fund corporations "have performed very well in terms of number of workers affiliated and the rate of return of the pension fund. In general, the investment yield for these (public pension fund companies) has been close to the average of the system. For instance, the *Banco Nacion* (owned by the main state bank) had 9.9 percent of total affiliation at the end of 1995, while the real rate of return of its fund for that year was 14.5 percent" (Arenas de Mesa and Bertranou 1997: 335).

Moreover, we should welcome organizations associated with the popular sectors to take part in the defined contribution system. In Chile, as a reaction to the workers' losing control over their pension savings, some trade unions formed their own pension fund administrative bodies, although they remain marginalized (Ruiz-Tagle: 1995). In Argentina, too, non-profit organizations can form pension fund companies (Arenas de Mesa and Bertranou: 1997: 334).

To conclude, the shape of the alternative model for pension system reforms conforms to the framework of a mixed, dual system. The basic features of a desirable modernized social security system include the following:

(1) Retain the positive characteristics of solidarity and collective accounts found in the pay-as-you-go or defined benefit system.

(2) Strengthen administrative capability towards having universal coverage and ensuring compliance.

(3) Rationalize benefits, reduce current costs, and gradually increase contributions to sustain the collective funds.

(4) Promote competition among public enterprises, private corporations, and civil society organizations in the management of provident funds or individual accounts.

(5) Strengthen the supervision and regulation of the management of social security funds through an independent public body.

(6) Maximize yields on pension contributions.

(7) Complement the collective funding system with special funds (especially funds targeting the poor) and individualized capitalized accounts.

(8) Ensure complete transparency by giving a periodic public report regarding pension contributions, investments, yields, costs, and other arrangements.

In a manner, it is both propitious and fortuitous that the two new laws, Republic Act No. 8282 (SSS) and Republic Act No. 8291 (GSIS), have recognized the wisdom of a mixed, dual system.

In other words, reforming and modernizing the pension system cannot be simply done through another wave of privatization. We have gone through wave upon wave of privatization. We have survived the onslaught though it has battered many of us. We should not allow the gigantic wave of privatizing the pension system overwhelm us.

Endnotes

[1]The contributions of those who work finance the pensions of those who have retired.

[2]This is actually an underlying principle of the Medium-Term Philippine Development Plans of the Aquino (1987-92) and Ramos (1993-98) administrations.

[3]It is, of course, highly controversial that the bidding rules and the regulatory regime have failed to anticipate a wide disparity in the rates of the two concessionaires. This deserves a separate discussion.

[4]Perception mirrors reality. But not all state-owned enterprises in the Philippines are inefficient. Let us take the case of SSS, which is relevant to this paper. Despite its shortcomings, the SSS has won successive awards given by the Asian Institute of Management for prudent financial management, basic service delivery, and best use of information technology (Ongkiko 1997: 3).

[5]Haque refers to privatization not only in relation to denationalization or the transfer of public-owned corporation to the private sector but more in terms of an ideology that glorifies unencumbered markets and "selfish, atomised individuals seeking maximum utility."

[6]A qualification is necessary. One can interpret the recent electoral victories of left-of center parties in the United Kingdom, Canada, and France and the resurgence of Left groups previously linked with the old, discredited Communist parties in Eastern Europe as a popular reaction to the "savagery" of the free market and thus the need to tame the market forces. Clearly, however, this is a case of not abandoning the market but humanizing the market. On the intellectual front, Krugman (1994: 205, 282) asserts that as early as the mid-1980s, "conservative macroeconomic theory had run aground" in the US and that "by 1992, the cutting edge of serious economic thinking was arguably on the moderate left."

[7]See, for example, Bello and Rosenfeld (1990) and Nixson (1997).

[8]Przeworski *et al.*, however, warn of the pitfalls of the different large-scale privatization schemes in Eastern Europe. Relevant to our discussion, for example is this statement: "The potential efficiency and equity gains from the strategy of free distribution of vouchers is [*sic*] not significant enough to warrant the high risks of losing government revenue." They likewise argue: "If equity is our concern, why not distribute ownership of firms equally to all citizens, via vouchers, and then allow a fully liberalized stock market?...Granted, this would probably result, quite quickly, in the concentration of firm ownership in the hands of a small class of otherwise rich citizens." Przeworski *et al.* are very sensitive to the negative externalities arising from "the concentration of firm ownership in the portfolios of a small class." For an elaboration, see Przeworski *et al.* (1995: 91-106).

[9]Although government economic policies are heavily influenced by neo-liberal theory and likewise expressed in neo-liberal jargon, this does not mean the neo-liberal ideology reigns supreme. In fact, the intellectual cutting-edge, to use Krugman's word, belongs to the new Keynesians and structuralists. The Filipino Keynesians and structuralists (e.g., UP School of Economics faculty members and non-governmental policy analysis groups) have figured prominently in policy formulation and on many occasions, have set the terms of the policy debate. Further, the differences between the neo-liberals and the Keynesians may have been glossed over by their convergence in the conjuncture to press forward the liberalization thrust. This convergence springs from the failure of protectionism and populism, which straitjacketed the Philippine economy for many years.

[10]We also have to make a distinction between those who oppose privatization as a principle and those who are against the particular objectives, conduct and method (including timing and pacing) of privatization.

[11]For a better appreciation of the history of Philippine privatization, including the economic and institutional background, see Diokno (1997). This section, describing the privatization process during the Marcos and Aquino terms, draws substantially from the Diokno paper.

[12]Reprivatization covered different types of corporations and assets such as Paper Industries Corporation of the Philippines, PHILSECO, Occidental Petroleum, Nonoc Mining, Ortigas property, Meralco, Philippine Airlines, National Steel, Interbank, and Petron.

[13]For the second wave, the DOF lists the following entities: Manila International Container Port, National Power Corporation, Metropolitan Waterworks and Sewerage System, and the various build-operate-transfer (BOT) projects.

[14]See Sta. Ana (1996) for a review of Osborne and Gaebler's *Reinventing Government*.

[15]To quote Osborne and Gaebler (1993: 32): "After all, those who steer the boat have far more power over its destination than those who row it."

[16]For a critique of government's version of reinventing government (which also includes a proposed legislation of "reengineering the bureaucracy"), see Sta. Ana (1997).

[17]To appreciate the context of this argument, see Osborne and Gaebler (1993: 35, 84-92).

[18]To have a common language, we henceforth define the privatization of the social sectors, including the pension funds, the way the World Bank defines it in the "strict sense." That is, "divestiture by the state of enterprises or other assets."

[19]In spite of many rich experiences and lessons available to Philippine policymakers, Philippine infrastructure privatization has led to some dubious results (e.g. pricing policy with regard to water distribution and weak regulatory environment in telecommunications).

[20]This is not to suggest that privatizing education and health services can easily hurdle the political roadblocks. For instance, according to Diokno (1997: 14), government has thought of including the University of the Philippines (UP) in a future privatization plan. To be sure, this will stir up trouble in a very assertive and articulate UP community. With regard to privatizing tertiary hospitals, the debate between economic managers and public health administrators seems to have reached a deadlock (Solon 1997: 1).

[21]In terms of cost-sharing in public education, the share of government vis-à-vis households in funding tertiary education went up from 74 percent in 1986 to 78 percent in 1994. On the other hand, government's share in funding elementary education decreased significantly from 88 percent in 1986 to 31 percent in 1994 (WB 1996b: 36-37).

[22]Solon (1997: 13) concludes with three conditional statements: "First, if there is a positive net gain between the inefficiencies of public provision versus market imperfections, and that this net gain is increased with regulation (net of its costs), then the relevant facilities should be privatized and regulated. Second, even if the inefficiencies of public provision were less than losses to market failure, but if regulation (net of its costs) was able to overcome the difference, we still have a case for privatization and regulation. Finally, if the costs associated with regulation were expected to wipe out the net gain between public delivery inefficiencies versus market failure, we might still want to consider privatizing the relevant facilities but not consider regulation."

[23]We have cited the absence of a provision in the MWSS regulatory rules to address the wide differential between the rates of the two water supply concessionaires. Another example is the lack of a clear-cut provision in the oil deregulation law that empowers the Department of Energy to deal with overpricing. It thus creates the condition for the domestic oil companies to be insensitive to a corresponding downward adjustment in local prices despite the current drop in international oil prices (including the Singapore Posted Prices). A third example is the indication of regulatory capture in the telecommunication industry, as shown by the preliminary regression results of the event study done by Abrenica, Cook, and Kirkpatrick (1997).

[24]The actuarial assessment as of 1 January 1994 provided best-estimate assumptions, optimistic assumptions, and pessimistic assumptions. For the GSIS, the optimistic assumptions are social benefits funds becoming negative in 2010 and funds running out in 2019. The

pessimistic assumptions are GSIS social benefits funds becoming negative in 2007 and funds running out in 2014. For the SSS, the optimistic assumptions are social benefits funds becoming negative in 2017 and funds running out in 2026. The pessimistic assumptions are SSS social benefits funds becoming negative in 2013 and funds running out in 2020. See World Bank (1995: Table 5.1, 58).

[25]Section 9 and Section 9-A of the newly approved Republic Act No. 8282, an Act further strengthening the SSS, have broadened the compulsory coverage in the SSS. The problem is the administrative difficulty of reaching the people working in the informal sector (Ongkiko 1997: 7-8).

[26]I am greatly indebted to Ruiz-Tagle, a professor at the Universidad Academia de Humanismo Cristisano, Santiago de Chile, for granting me an interview and offering his insights into Chile's privatized pension system. This paper draws substantially from his analysis and criticisms of the Chilean model. See Ruiz-Tagle (1995 and 1996).

[27]For a comprehensive description of the characteristics of Chile's privatized pension system, see Superintendence of Pension Funds Administrators (1995: 20-55).

[28]Some writers thus contend that it is unfair to label the Chilean pension system as a fully privatized one. See, for example, the literature cited in Arenas de Mesa and Bertranou (1997: 332).

[29]The Superintendence of Pension Funds Administrators (1995: 73), however, has different figures and a different conclusion. It says that from 1976 to 1980, the old pay-as-you-go system covered on average 49 percent of the workforce, "in contrast, during the period since the beginning of the Individual Capitalization System, average annual coverage for contributors of both Systems in relation to the work force has been 54.5 percent." This nevertheless does not alter the fact that the privatized system has a low coverage of informal labor and that close to half of those covered by insurance are not remitting contributions.

[30]Ruiz-Tagle notes that the "interest rates for life pension schemes held by AFP (*Administradoras de Fondos de Pensiones* or Pension Administrative Fund Bodies) pensioners are currently around 4.7 percent in real terms." The International Labor Organization, in a forthcoming publication about Chile's development, shares the same projection of much lower interest rates.

[31]An effect of all the marketing hype to pull in new members is the rapid but unstable movement of contributors from one fund manager to another. The decision to shift from one to another has become more of a function of short-term benefits (like earning a free holiday package) rather than judicious, long-term considerations.

[32]By contrast, says Ruiz-Tagle, the cost of managing the old pay-as-you-go system in 1979 was equivalent to five percent of total contribution revenues.

[33]To quote the Superintendence of Pension Funds Administrators (1995: 58): "Every month, the AFPs are responsible for the actual yield over the last twelve months of the Fund that they administrate not being less than whichever of following two possibilities turns out to be lowest: i. The average actual yield over the last twelve months of all the Funds, minus two percentage points, and ii. Fifty percent of the average actual yield over the last twelve months of all the funds."

[34]Fixed commissions disadvantage the poorer contributors. In comparison with the high-income contributors, the poor have a bigger proportion of their contributions going to commissions.

[35]Arenas de Mesa and Bertranou (1997: 330) also cite other studies that say that there is no conclusive evidence that the Chilean private pension system has had an impact on the national savings rate.

[36]Arenas de Mesa and Bertranou (1997) say they do not know of any country that has fully replicated the Chilean model. Mexico's pension reforms may come closest to the Chilean model. Nevertheless, the authors argue that the dual pension system—or the integrated model—in Argentina may become the new reference point for countries still undertaking the structural reform of their pension systems.

[37]Argentina's pension system, however, does not copycat the Chilean model (interview with Jaime Ruiz-Tagle, 16 May 1997). Chile has an individual-capitalized funding arrangement. Argentina has a mixed system; a personal account complements a common fund basis wherein retirees' pensions are paid out of the contributions of active members. Also see Arenas de Mesa and Bertranou (1997: 330-34). Arenas de Mesa and Bertranou describe the Chilean pension system as "the private model" and the Argentine system as "the integrated model."

[38]Inspired by Otto von Bismarck's 19th century model, the military-initiated National Postwar Council adopted in 1945 an economic strategy that gave the leading role to "state-related monopolies in basic industries."

[39]The Supreme Court's "Filipino first" ruling that reversed a decision to sell the Manila Hotel to a Malaysian-led venture is perhaps the most blatant example.

[40]The problems of former socialist countries in Central and Eastern Europe with regard to financing pension systems are in some ways uncannily similar to Philippine problems. We can thus pick up some applicable lessons from the experience of these countries in Central and Eastern Europe. See Andrews and Rashid (1996).

[41]In Chile, a solidarity and social assistance fund was set up in 1990. Its objective is "to help groups of the poor who were not protected by the country's relatively well-functioning social safety net and system of financing of basic education and health care through local governments" (World Bank 1996b: 59).

[42]The effectiveness of the Poverty Alleviation Fund, which has been criticized especially by NGOs, is a different issue altogether.

[43]The Investment Reserve Fund consists of the portion of SSS revenues that is "not needed to meet the current benefit obligations."

[44]See World Bank (1996a: 57) regarding its concept of commercialization.

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