



► Issue Brief

July 2020

Considerations on social security, income security, pensions and the withdrawal of 10 per cent of workers' private pension fund savings during the COVID-19 pandemic in Chile¹

Key points

- The COVID-19 health crisis has severely affected households' economic security, requiring a timely, broad-based response by the social security system.
- The need to offset the devastating decline in the labour income of households has created tensions with the principles on which the different income security components operate and reveals the need to rethink the future of social security.

There are two considerations when discussing income and pension policies for workers in the context of the COVID-19 pandemic. First, that we are facing an economic crisis of epic proportions given its speed, scale and depth. Second, that for several years now, and especially since the social demonstrations of October 2019, there has been a debate on the legitimacy of the pension system based on individual capitalization complemented by a solidarity pillar with tax-financed benefits.

In this debate, in which the government, social actors, Congress and the Constitutional Court have participated, the principle of private property ("the funds belong to the workers") is at odds with the social security principle ("the funds should provide

adequate income security during old age") upon which the contributory component of the Chilean pension system is based.

The withdrawal of 10 per cent of the total balance of individual pension funds should be interpreted both from the need of households to guarantee income to mitigate the effects of the COVID-19 crisis and as part of the wider debate of the system and the future of pensions in Chile.

The 10 per cent withdrawal in the context of the debate on income security and Covid-19

Society security should be viewed as a set of benefit programmes to respond to different social risks. In

¹ This brief was prepared by Fabio Bertranou and Guillermo Montt, ILO Office for the Southern Cone of Latin America.

► ILO Issue Brief

Considerations on social security, income security, pensions and the 10 per cent of private pension fund savings of workers during the COVID-19 pandemic in Chile

the short term, the current Covid-19 crisis has had a major impact on the economic security of households due to the decline in labour income and the inability or limitations of unemployment or other non-contributory benefits to compensate for those effects. Consequently, policymakers have been debating, agreeing on and implementing other instruments, the most recent of which is the withdrawal of 10 per cent of workers' individual account savings.

In the context of a crisis limited in time and scope, labour institutions have developed unemployment benefits to support income security. Nevertheless, these have proven insufficient in systemic, wide-reaching crises, forcing other institutions to guarantee this security. For example, when unemployment rises sharply, and when unemployment insurance offers limited coverage, pension systems generally face increased claims for disability or other non-contributory or semi-contributory benefits, as well as the demand to use savings in pension funds.

In the current crisis, the loss of labour income should ideally be addressed through instruments that protect it, such as unemployment insurance and others that enable a response for both formal and informal workers, such as non-contributory transfers. However, as these instruments fall short due to coverage gaps or implementation delays, and given the nature of the individual savings system for old-age pensions, several actors have proposed the possibility of withdrawing 10 per cent of the funds managed by pension fund management companies (AFP).

Is this a “good” income security policy? Beyond the difficulties for defining what is a good or bad policy in this context, it should be stressed that the best policy in a health, economic and social crisis is the “possible” one to quickly and widely address the income needs of all affected Chilean households.



Is this a “good” income security policy? Beyond the difficulties for defining what is a good or bad policy in this context, it should be stressed that the best policy in a health, economic and social crisis is the “possible” one to quickly and widely address the income needs of all affected Chilean households.

Given that pension savings were established to address the risks of old age, during normal times they should ideally be used for the benefits workers will require in their old age.

Nevertheless, in response to the emergency, a modest share of individual pension savings could be used to address the economic security needs of households, especially of middle-income households not covered by targeted crisis mitigation policies.

Like in any social security system, these resources can play a countercyclical role and prevent the economy from slipping into a deeper, more prolonged recession, aiding in the recovery of activity and employment, and consequently limiting the possibilities for generating a contributory base to guarantee a future for the pension system.

Additionally, given that a considerable share of workers have few savings because of their low level of contributions, as well as their low density and limited contributory base, the amount that these workers, particularly younger ones, could withdraw will probably be insufficient to address the current situation. The example of the potential impact that some actors and institutions have used as a reference to “workers with average earnings,” make the same mistake made when the capitalization was

► ILO Issue Brief

Considerations on social security, income security, pensions and the 10 per cent of private pension fund savings of workers during the COVID-19 pandemic in Chile

introduced. That is, they predicted regular, uniform trajectories in working lives even though the labour market is extremely diverse, unstable and with high turnover, which has resulted in unequal distribution of remunerations and low contribution densities for a large share of the labour force.

The 10 per cent withdrawal in the context of the debate on the pension system in Chile

The contributory pillar of Chile's pension system was designed with individual savings accounts as a key component, based on the idea of ensuring that workers would be their savings' "owners". That premise runs counter to the social security principle, which assumes guaranteed income in old age through the social distribution of risk. As it is based on individual capitalization financed exclusively by workers for "old-age risk", the contributory component of the Chilean pension system lacks solidarity and inter- and intra-generational arrangements that distribute this social risk. The non-contributory component (solidarity pillar) partially compensates for these deficiencies through tax revenue, although with uncertain distributive effects.

In cases in which the social security principle is at odds with that of private property, the Constitutional Court has ruled in favour of the former: the main objective of pension funds is to provide benefits to compensate for the loss of income in old age. The possibility to withdraw 10 per cent recognizes that the right to ownership takes precedence, at least in emergency situations, and that the risks of old age and unemployment are covered by the individual rather than by collective solidarity. The impact of the withdrawal on the flow of future pensions appears insignificant since a large share of workers have few savings – more than 60 per cent of pensioners receive pension subsidies through the solidarity pillar – although the withdrawal could increase the future burden on the solidarity pillar.

From the standpoint of the pension system, ideally, the funds allocated to economic security in old age would be used for that social contingency rather

than to address other risks such as unemployment or health issues. Nevertheless, faced with the lack of coverage of these contingencies, social security should offer some type of response to these problems.

The Covid-19 crisis merits the injection of resources to maintain both household income and macroeconomic equilibrium for a more effective, sustainable recovery. Withdrawing 10 per cent is advisable from a countercyclical perspective although it is necessary to address the potential financial impact of the withdrawal. As the funds are invested, their rapid disinvestment could generate market volatility and consequently affect the value of the investment portfolios of all workers. The design and management of the fund disinvestment would need to be coordinated with other macroeconomic policies.

COVID-19 and the future of social security

We are faced with several political, economic and social crossroads because of the COVID-19 crisis. One is with respect to the path to follow for sustainable development and social cohesion, where pensions and income security are a crucial area representative of the type of collective decisions made. Since their creation in the late 19th century, social security systems have improved the wellbeing of societies. Most of these systems arose following severe economic crises such as the Great Depression or conflicts with enormous social consequences, such as the two World Wars.

If the proposal to use 10 per cent of the pension funds is adopted, and to the extent that it results from a political consensus, or as part of a social pact to mitigate the severe impact of the crisis, it would not significantly affect the future of the system's capitalization component given the percentage of the withdrawal. The legitimacy of capitalization depends on other variables, such as being part of a system with increased coverage, financing, adequate benefits and equality.

► ILO Issue Brief

Considerations on social security, income security, pensions and the 10 per cent of private pension fund savings of workers during the COVID-19 pandemic in Chile

From a perspective that more closely considers social security principles, the economic and social effects of the pandemic are an opportunity to redefine a social pact in which the visions and aspirations with respect to pensions converge. Including a social security component with tripartite financing, endorsed by employers and workers, with intra- and inter-generational solidarity, is an opportunity, and a need, that is more urgent than ever.² It implies building consensus to develop a system that shifts from one centred on “individual capitalization subsidized by fiscal resources” to a system of “social security complemented by individual capitalization,” which would take advantage of the benefits of both components in an authentic mixed system in which employers and workers fully participate in its management, together with the government. The interests of the system’s administrators, whether they are public, private or non-profit institutions, should not take precedence over the wishes of the actors who contribute to the system.



The economic and social effects of the pandemic are an opportunity to redefine a social pact in which the visions and aspirations with respect to pensions converge

The effects of the pandemic have also underscored the importance of income security for economic and social stability. The development of unemployment protection instruments such as the Employment Protection Law, the payment of Family Emergency Income and other measures can be expanded over time, establishing activation mechanisms in the event of economic, environmental or earthquake emergencies and thus avoiding delays in the design, processing and implementation of income security programmes. This would advance the establishment of a social protection floor to guarantee economic security for Chileans throughout the lifecycle, together with contributory components of social security.

Contact information

International Labour Organization
ILO, Southern Cone Office for Latin America
Santiago, Chile

Phone: (56-2) 2580-5500
E-mail: santiago@ilo.org
Website: ilo.org/santiago

© International Labour Organization 2020

² The principles governing a pension system in the framework of social security are protected in the international standards adopted by the International Labour Organization, including the *Social Security (Minimum Standards) Convention, 1952 (No.*

102) and the *Social Protection Floors Recommendation, 2012 (No. 202)*.