

## **Globalization and Pension Reform in Latin America**

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### **ABSTRACT**

The striking depth and pace of old age pension privatization across Latin America has raised important questions about the influence of common global economic forces in this movement. While some scholars point to the pressures of trade competition, others underscore the financial influence wielded by the international financial institutions over pension reform efforts in the region. This study offers an alternative view, which emphasizes the powerful but often-contradictory influence of international capital markets on the time horizon over which government actors make crucial decisions about whether and how much to privatize. While financial globalization has created powerful incentives for Latin American governments to privatize old age pension systems, reliance on footloose, short-term capital flows has also constrained the ability of cash-strapped governments to enact this reform. Analysis of the technocratic process of pension reform in Argentina and Brazil brings evidence to this claim. Rather than simply generating unidirectional pressures for structural pension reform, financial globalization created a double bind for Latin America's capital-scarce governments: at once fostering long-term incentives to privatize old age pension systems, while in the short term heightening the risk of punishment for some of the most cash-strapped governments.

Since 1980, more than 25 governments around the world have implemented some form of market-oriented pension reform, or ‘privatization.’ More than a third of these reforms have been in Latin America, with ten governments having implemented some form of pension privatization by 2005. Although the specific design of pension privatizations has varied considerably across the region, this trend is striking as much for its geographic and temporal clustering as it is for the deeply transformative implications of this measure, which fundamentally rewrites the basic social bargain of old age income protection in privatizing countries. Pension privatization, moreover, is costly to implement, both in financial and political terms. Not only must governments impose new risks and costs on beneficiaries of traditional social insurance pension systems while offering only long-term and uncertain benefits, but they also must continue to finance current benefits owed to retirees even as workers divert payroll contributions to their private pension accounts. Pension privatization is therefore far from a quick-fix for ailing state pension systems; instead, it is a costly and perilous measure for any government, and particularly for the young democracies in Latin America.

A rich body of scholarly research has emerged to address the puzzle of why and how so many Latin American governments have privatized their national pension systems. For some scholars, the answer rests heavily on international financial pressures that buffeted Latin American governments in the 1990s. This view holds first that global economic forces such as trade competition and capital mobility generate strong pressures on governments to lower domestic production costs and diminish inflation risks as a means to enhance trade competitiveness and attract foreign investment. It also

underscores the financial rewards and punishments wielded as critical power resources by international financial institutions (IFIs). On both dimensions, globalization emerges as a powerful force pushing inexorably toward the adoption of more market-oriented reform, especially in the most capital-scarce nations.

This paper affirms the importance of international economic forces in domestic political decisions about pension reform, but offers an alternative conceptualization of their role and ultimate impact on privatization decisions in Latin America. I argue that the most significant effects of global economic forces and IFIs have not been wielded through coercion, nor have they conduced strictly toward greater privatization in the most cash-poor nations. Rather, while global financial integration and IFI promotion of structural pension reform have combined most powerfully to enhance the attractiveness of private pension reform models, at the same time, exposure to increasingly volatile international capital markets has created powerful *obstacles* to the adoption of this costly structural reform in the most cash-strapped nations. Comparative analysis of the technocratic process of pension reform in Argentina and Brazil brings evidence to this argument. In both countries, government actors counted on extensive financial support from IFIs such as the World Bank, while also facing strong pressures to attract and maintain the confidence of owners of increasingly-footloose international capital. In both cases, however, it was the threat of punishment by private market actors that more powerfully influenced decisions over the final reform design. Paradoxically, by attending to the short-term concerns of global capital, reformers wound up *limiting* the extent of market orientation in proposed pension reform designs in both cases.

## **GLOBAL PRESSURES AND PENSION REFORM**

The profound social and economic crises of the 1980s provide an important backdrop for understanding the ascent of pension reform to the top of political agendas in the 1990s. After decades of post-war expansion in coverage and generosity, Latin American pension systems fell upon hard times following the 1980s debt crisis. Just as hyperinflation eroded any reserves that remained in ailing state pension funds, high unemployment, rising poverty and social dislocation narrowed the contributory base for these systems while sharply increasing demands for social services (Mesa-Lago 1989). At the same time, the ability of governments to respond to these needs was constrained by spending limits stipulated by orthodox stabilization plans. These plans, along with an array of market-based structural reforms such as privatization, trade and financial liberalization and deregulation, were prescribed by Washington-based international financial institutions as remedies to the macroeconomic problems gripping Latin America, catalyzing a region-wide shift toward integration with the global economy.

As liberalization proceeded, the once heavily-protected Latin American economies confronted powerful market forces demanding greater efficiency and competitiveness, including cuts to labor costs through social policy reform (Dion 2006: 53-54; Kay 2000: 186). The enhanced factor mobility that attended trade and capital account liberalization also created new incentives for governments to cut social spending in order to diminish the risk of inflation, and thus to attract foreign investment (Dion 2006; Kaufman and Segura 2001; Wibbels 2006). Indeed, the most radical pension privatizations in Latin America were enacted in precisely the countries that also adopted the deepest macroeconomic liberalization programs (Mesa-Lago 1997, 503). In light of these trends,

global economic forces came to be seen by many as an important catalyst behind the adoption of market-oriented pension reforms.

The financial leverage borne by international financial institutions also came to be viewed as a powerful catalyst of pension privatization in Latin America (Cruz-Saco and Mesa-Lago, 1998; Huber and Stephens, 2000, 19; Madrid 2005, 23-50). Chief among these was the World Bank, which provided financial, technical and political support for pension privatization throughout the world (Kay 2000; Müller 2001: 69). For Huber and Stephens (2000:19), IFIs, along with private business interests, “pushed and supported” capital-scarce governments to adopt pension privatization through the exercise of financial leverage – specifically, loan conditionality. Even where loans were not explicitly conditioned on pension privatization, scholars maintain that policy makers anticipated that IFI financial support depended on the adoption of a market-oriented pension reform (Kay 1999; Mesa-Lago and Müller 2002: 710). The ability to provide or withhold financial resources was said to have magnified the influence of IFIs in domestic policy debates over pension reform (Madrid 2005: 29). Huber and Stephens (2000: 19-20) sum up this view by stating, “It is essentially correct to argue, then, that globalization has been a major force behind the privatization of pension funds in Latin America.”

***Assessing International Pressures.*** There is good reason to take seriously the influence of economic integration and IFIs in the rapid ascent of pension privatization on reform agendas in Latin America. Not only did IFIs use policy-based conditions to advance the ‘first generation’ of macroeconomic reforms, but policy lending in Latin America also rose considerably during the late 1980s and 1990s, just as the issue of pension privatization came to the fore (Mesa-Lago and Müller 2002: 710). But can we

take this as evidence either that Latin American governments were pressured or coerced to privatize, or that globalization has conduced strictly toward privatization? There is reason to be unsatisfied with these claims. For one thing, closer examination of lending patterns by the World Bank casts doubt on the notion that resource power became the institution's most effective instrument for promoting privatization. Not only has the bank been more active – offering a greater number and more generous loans – to support pension reform in countries that did *not* privatize than in countries that did (Holzmann and Hinz 2005; World Bank 2005a), but in many cases loan conditions associated with pension reform related more directly to the creation of legal infrastructure and social assistance benefits than to the creation of private systems (Deacon and Hulse 1997: 53).

Even where World Bank loans were granted to support pension privatization, we cannot be sure that domestic politicians did not desire such a reform for independent reasons, whether ideological or instrumental. Indeed, there is evidence that domestic coalitions of financial elites and government technocrats – even broad public opinion in some cases – turned against state pension systems as declining performance in the late 1980s eroded confidence in state institutions and in the broader state-led development model (Arce 2001; Kay 1999; Margheritis 2002; Müller 1999). Whereas Mesa-Lago and Müller (2002: 708) identify the main sponsors of pension privatization as domestic actors - mainly neoliberal technocrats, rather than international actors – other scholars suggest policy conditions on IFI loans were at times *sought* by governments in order to gain leverage over domestic political opposition (Vreeland 2003 p. 321-343; Nelson 1996: 1551, 2004). Several Latin American governments, moreover, such as Argentina,

Mexico and Peru, embraced this reform well before the World Bank began to actively promote it in the mid-1990s (Nelson 2004; Queisser 2000).

Emphasis on the leverage exerted by the World Bank through its extension of loans and development assistance also may overstate the significance of these resources as a source of finance for Latin American governments. World Bank loans as a share of GDP in most Latin American countries are dwarfed by the vastly-greater size and significance of private capital flows in Latin America, as illustrated in Figures 1 and 2. If government actors were swayed by the resources or ideas proffered by powerful financial actors, then we must take seriously the punishing force of international financial markets in domestic politics. Indeed, the liberalization of capital markets in the 1990s vastly magnified this punishing capacity, generating an ever-present threat of swift and massive capital flight. This sanctioning capacity was demonstrated with devastating consequences in the 1995 Mexican peso crisis, which reverberated with capital flight throughout Latin America.

Close examination of capital market dynamics, however, suggests that financial integration has not been a source of strict pressure for market-oriented pension reform; it has also generated powerful constraints on pension privatization efforts. Such constraints relate to the heavy financial toll imposed by this reform, and the consequence of this cost for investor confidence in an economy. Indeed, pension privatization exacerbates, rather than alleviating, financial pressures created by deficitary pension systems in the short-to-medium term. This financial toll – the ‘transition cost’ of privatization – arises as workers begin to divert payroll contributions from the state social insurance system to private pension funds, forcing the government to surrender its principal source of revenue with which to finance ongoing state pension liabilities. In no case have social sector loans

from IFIs, moreover, come close to covering the annual cost of transition to a private pension system, which in Chile exceeded 4 percent of GDP in the first decade after the reform. For owners of highly-liquid assets whose investment decisions in an economy may be revised on a daily or even hourly basis, it is precisely the short-term effects of pension privatization – including the widening of fiscal deficits and/or swelling of government debt – to which they will respond most forcefully. Where the time horizon over which investors – and thus government actors – weigh the merits of policy change is short, therefore, privatization’s putative long-term benefits (such as raising domestic savings) may be heavily discounted.

Globalization thus entails much more than pressures for reform; it also carries the threat of swift punishment for governments that lose the confidence of external creditors. The critical question in regard to globalization’s effect on decisions to enact pension privatization, then, is to understand when this reform raises the risk of market punishment such that the near-term possibility of capital flight would outweigh the positive inducements associated with the measure’s purported long-term benefits.

### **Globalization’s Double Bind**

This section offers a theoretical alternative to the view of global capital as a strict source of pressure for pension privatization. First, I argue that IFIs were most influential in privatization processes through the exercise of ‘soft power’ or attraction (Keohane and Nye 1998). By packaging and disseminating pension privatization as a policy tool to raise domestic savings and deepen capital markets, the World Bank in particular helped to make this reform attractive to governments in capital-scarce nations, such as many Latin America, which suffered under the increasing cost of exposure to highly volatile capital

flows. Attraction alone, however, cannot explain the adoption of this reform. For economic integration also generated powerful constraints on the ability of cash-strapped governments to privatize old age pension systems, the force of which varies with the domestic financial conditions of the government, and with the impact of the pension reform on key indicators of sovereign creditworthiness such as debt and deficit levels.

### **Attraction to the Pension Privatization in Latin America**

*Narrowing Time Horizons.* To understand how a common policy innovation came to be enacted in some countries but not others, we must look closely at the domestic processes through which such policy models are taken up, evaluated and/or adopted. Technocratic processes serve as a critical gateway to structural reforms, where policy specialists play a pivotal role in shaping the political agenda. Before institutional reforms may be adopted, a new policy model must come to the attention of technocrats, and be perceived as an attractive option for reform. Once an attractive policy model is chosen for further consideration, issues of viability come to the fore. At this stage, short-term costs and constraints are weighed against the expected long-term gains of policy change.

The technocratic process is neither a one-shot decision nor simply a gradual winnowing of alternatives; rather, discrete choices are made within this realm, and often involve considerations weighed over very different time horizons. Whereas attraction to pension privatization rested heavily on the measure's expected *long-term* implications – such as lowering the government financial role in pension provision and possibly raising domestic savings – consideration of the viability of this reform often revolves more closely around concerns about the model's near-term political and economic feasibility, particularly when market feedback to these reforms may be immediate. And as Santiso

(2003) has demonstrated, as the time horizons governing investor decisions in the 1990s narrowed, they imposed a similarly constricted temporality on government decision-making. For Latin American technocrats weighing alternative policy models, this meant anticipating the near-term effect of reform on investor confidence in their economy.

*Attraction to Pension Privatization.* Two factors combined to make pension privatization highly attractive to many government technocrats in Latin America. The first was the embedding of this model in a coherent set of ideas – indeed, a new paradigm – that provided intellectual and economic justifications for the reform. These ideas rested on claims of inherent failure of the state-centric model, and associated privatization with macroeconomic ends such as increased savings, growth and capital market deepening. The packaging and dissemination of these ideas was spearheaded globally by the World Bank (Orenstein 2005), although other IFIs, along with Chilean economists and liberal think tanks, participated actively in its promotion. But the market-oriented paradigm in social protection did not hold the same allure for all governments. Rather, attraction was reinforced by the particular macroeconomic circumstances of many countries in the region, which combined chronically low growth and capital shortages with institutional crises that undermined the performance of, and political support for, traditional state pension systems. Indeed, in the late 1980s, low levels of domestic savings and heavy reliance on foreign capital came to be seen by government technocrats as powerful constraints on domestic investment, and hence on growth, as well as a major source of the region’s vulnerability to capital flight. Many Latin American technocrats thus embraced the goal of diminishing their country’s reliance on foreign savings as a means to achieve sustained growth (Soberón and Villagomez 1997: 107-126). As these ideas

began to gain ground, the 1981 pension privatization in Chile captured the international spotlight. That reform, decreed by the authoritarian regime of Augusto Pinochet, replaced the nation's traditional state-run pension system with a fully individualized, private savings scheme in which the state would provide only a minimum pension guarantee to 'top-up' the accounts of workers whose lifetime savings failed to reach a minimal level. For most workers, however, pensions would derive solely from individual savings accumulated in privately-managed retirement accounts.

International fanfare surrounded Chile's pension reform in the late 1980s as the nation's positive macroeconomic performance set it apart from its neighbors. As other Latin American economies endured prolonged contractions and outflows of savings, Chile's growth surged and domestic savings boomed. When prominent economists linked Chile's pension privatization to these positive macroeconomic outcomes, policy makers throughout the region took notice. Interest in Chile's pension reform therefore surged on the perceived links to the nation's strong macroeconomic performance, even though links between this reform and the nation's positive macroeconomic performance were questioned by academic research, while privatization was just one element of the country's broad move toward free-market reform (Kurtz 1999).

Nevertheless, when pension privatization was endorsed by the World Bank (1994) as a means to deepen local capital markets and increase private savings and growth, pension privatization secured a place within the new market-based 'orthodoxy' (LoVuolo 1996; Müller 1999). In this sense, IFIs such as the World Bank played a critical role in the process of pension reform by shifting the terms of debate toward macroeconomic concerns (Müller 2001; also see, Orenstein 2005). It did so, according to Müller, not

through coercion or by threatening to withhold financial support, but rather by offering “conceptual, technical and strategic know-how” (2001: 69) to supporters of privatization. Peer diffusion reinforced the attraction to this model in Latin America. For Weyland (2005), it was the more ‘available’ example provided by regional peers that accounts for the broad regional diffusion, superseding the influence of IFIs in this trend. Peer decisions also may have assured reformers that the very general set of ideas promoted by IFIs were both relevant and feasible in a country like their own (Brooks 2005).

In addition, attraction to private pension reform models was reinforced by the imperative of attracting and retaining inflows of savings to remonitize domestic financial sectors and spur growth. Indeed, while many economies of the region were long burdened by chronic capital shortages and low growth, the 1990s brought a new problem: the increasingly-costly exposure to volatile international capital markets. As investment flows to emerging markets became ever more unstable in the 1990s, vulnerability to capital flight led many Latin American governments to prioritize structural reforms that were expected to raise domestic savings, and thus diminish their exposure to precarious global capital flows (Brooks 2002; Madrid 2003; Mesa-Lago and Müller 2002). Sending policy signals to maintain the confidence of those investors thus became a crucial policy priority. And on this level, pension privatization had both positive and negative implications. On the positive side, this reform came to be seen as a costly and thus credible signal of the government’s commitment to playing by the market rules (Kay 2000). But privatization could also compromise government performance on key indicators of sovereign risk, such as debt and deficit ratios, and thus could also send negative signals to international markets, threatening punishment of reforming states.

## **Market-Based Constraints on Pension Privatization**

Indeed, as capital mobility increased in the 1990s, market actors' loss of confidence in an investment decision could evoke swift and massive capital flight from an economy. Such confidence in the creditworthiness of a capital-importing government could be lost, for example, if government debt (as a share of GDP) ratio rose above commonly-accepted levels, raising the perceived risk of default, or if the fiscal deficit ballooned, raising the specter of inflation, which would erode the value of an investment in the local currency. In such instances, a government's sovereign risk rating could be lowered, spurring concerns of default or devaluation and thus a sell-off of assets in the economy. In addition to raising the cost of access to international credit for the government, the loss of investor confidence held the potential to destabilize the entire financial sector of developing nations, dampening economic activity and causing deep and prolonged social dislocations. Thus while financial liberalization in the early 1990s brought the benefits of access to credit and higher growth, it also rendered Latin American countries vulnerable to the punishment of swift and massive capital flight. Coping with financial openness in the 1990s thus obliged governments in capital-importing nations to pay close attention to the signals of creditworthiness that even the smallest policy change would transmit.

Whether pension privatization is likely to invoke a market punishment in the near term depends upon a variety of factors, including 1) the potential cost of the reform; 2) the financial leeway that governments enjoy to finance the transition; and 3) the economy's vulnerability to capital flight. The cost of transition from a public pay-as-you-go pension system to a fully-funded private scheme has been widely acknowledged as a key obstacle to structural reform (Kay 1999; Brooks 2002; Madrid 2003; Müller 1999).

The magnitude of this financing gap varies with the inherited pension cost, the ‘implicit pension debt’ (IPD), and the explicit debt and deficit in the old pension system. Transition costs also depend on the extent of privatization that government actors propose. Where state pension liabilities are large, the financing gap created by a deep or radical privatization can be enormous. Governments may cover this financial breach in a variety of ways, although most use some combination of spending cuts, tax increases, or borrowing. However, since the imposition of a ‘double payment’ burden on working generations is often politically unpopular, the most common means of financing the transition to a private pension system are through the use of general budget revenue and by issuing new sovereign debt.

But the ability of a government to expand its budget deficit or debt burden is not unlimited, for these are key indicators of sovereign risk. And as mentioned above, a significant rise in debt and deficit ratios thus may threaten to spark a loss of investor confidence, and with it, capital flight. Critically, however, the likelihood that privatization would invoke such punishment varies across nations and over time. First, the importance of the signals that a government sends to international market actors varies with the extent to which a government relies on foreign investment to finance its balance of payments (Maxfield 1997). Not only are capital-importing governments vulnerable to the reversal of those flows, but in the particular circumstances of a persistent current account deficit (which is financed through foreign capital inflows) the loss of confidence and attendant reversal of capital inflows may spark a potentially devastating balance of payments crisis. Countries with large and persistent current account deficits thus become more vulnerable to the sentiments and confidence of

international capital markets, and enjoy less domestic policy autonomy (Mosley 2003).

Where international capital flows are in short supply, i.e., where international liquidity is low, moreover, such as when international interest rates are high, investors become more discriminating with regard to risk – rationing credit to developing countries and paying closer attention to signals of investment risk from state action (Maxfield 1997).

Taking on the fiscal cost of pension privatization depends further on the government's debt and deficit levels prior to the reform. If a government is in a tenuous financial position when considering privatization, the added cost of financing such a reform may push government debt or deficit beyond the levels that international markets will tolerate. Since governments carrying higher level of sovereign debt (relative to the country GDP) generally present a greater risk of default, and a large fiscal deficit is a signal of inflation risk (Eichengreen and Mody 1998), the ability to finance pension privatization through these means is tightly constrained where debt and deficit ratios are already high. By contrast, governments with access to strong cash flows (a fiscal surplus or revenue from the privatization of state-owned enterprises) or a low debt-to-GDP ratio enjoy greater leeway to finance this reform without the risk of losing investor confidence.

Critically, it is not the case that investors respond negatively to privatization *per se*, nor directly to its costs, for the 'cost' of transition is largely a relabeling of implicit pension liabilities as explicit debt, which are equivalent from an intertemporal budget perspective. Yet, to the extent that investors do not take the long view when evaluating investment decisions – as occurs with 'risky' emerging market nations – they may respond vertiginously to short-term changes in explicit government debt and deficit levels, rather than weighing the potential long-term consequences of a reform. Capital-importing

countries that carry high sovereign debt and deficit levels prior to initiating a pension privatization thus may be forced to trade-off some or all of their long-term privatization objectives to diminish the risk of short-term capital flight. Globalization thus generates a time inconsistency problem for capital-importing governments: to avoid punishment in the short term, they must divert from a longer-term strategy of expanding the market orientation of the economy, limiting the extent of pension privatization they propose.

The next section brings evidence to this claim by examining the technocratic process of pension reform in Argentina and Brazil. In the technocratic arena, state actors weigh the long-term goals of state action against short-term constraints on their proposed solutions. By focusing the analysis on just one component of the reform process, *viz.*, the technocratic arena, this study sets aside the broader social and political processes associated with institutional reform in order to isolate the arena in which global financial influences are likely to be most clearly-defined. The cases of Argentina and Brazil were selected in order to control for important factors shaping the influence of global economic forces, including country wealth and democratic status, while providing broad variation on the key factors expected to shape the intensity of global incentives and constraints on globalization. As illustrated in Figure 3, both governments recorded steep current account deficits at the time of their reforms, and thus were highly vulnerable to reversals in capital flows as they considered their options for reform. And as Figure 4 illustrates, both nations relied on volatile international capital inflows in the 1990s. However, there are also critical differences in their circumstances. Whereas international liquidity was high when Argentina's pension reform came to the top of the political agenda in the early 1990s, with U.S. interest rates having fallen from 10% in 1990 to 6%

in 1993, the supply of global capital was much more restrictive later in the decade when pension reform reached the top of the policy agenda in Brazil, as U.S. interest rates rose to 8.35% in 1998 (World Bank 2005b). The Argentine government also enjoyed a positive, although fragile, fiscal position at the time of its reform, while the Brazilian government struggled with fiscal deficits. Table 2 compares the primary balance for the two countries in the years in which structural pension reform was examined. Both the Argentine and Brazilian technocrats enjoyed considerable autonomy during the design phase of pension reforms, and the two governments received extensive support from the World Bank and International Monetary Fund, with multilateral debt service equaling 23.4% of public debt in Argentina and 16.7 % in Brazil at the time of each country's reform (World Bank 2005b). Yet, while Argentina enacted a deep pension privatization in 1993, Brazil did not privatize. The next section explores the role of global economic forces in these decisions.

## **GLOBAL CAPITAL AND TECHNOCRATIC DECISIONS**

### **Argentina**

In September, 1993 the Argentine National Congress sanctioned law 24,241, creating a 'mixed' public and private pension system. Under the new pension system all qualified workers would receive a flat public 'universal' pension and could choose whether to participate in a private pension system based on individual retirement accounts, or remain in the reformed public social insurance system for their earnings-related benefit. For workers choosing to participate in the new mixed (public and private) pension system, more than half of the average retirement benefit was expected to derive from individual

savings. The reform, which went into effect in 1994, brought a significant shift in the structure and logic of old age income provision in Argentina.

For President Menem, who oversaw the enactment of the reform, the privatization of Argentina's old age pension system was attractive mainly for the signal that it would send to international market actors – of his credibility and commitment to market-oriented reform. Government technocrats, for their part, were drawn to the private pension model by its putative long-term fiscal and macroeconomic ends, including the prospect for lowering state pension costs, raising domestic capital accumulation and deepening local capital markets. Privatization thus was expected to help end the cycle of Argentina's reliance on unstable foreign investment, while curtailing the rapid rise in pension costs since the late 1980s. Yet, while Argentina's vulnerability to capital flight enhanced the appeal of this model, the ever-more urgent need to signal the government's commitment to maintaining economic stability (i.e., the currency peg), shortened the time horizon over which key decisions relating to the design of the pension system were made. While key concessions in the proposed reform made democratic approval of the new pension system viable in the short term, they traded-off key long-term objectives that had originally drawn reformers to this reform model. In order to understand how these design choices were made, we must examine how the powerful pressures and opportunities emerging from short-term economic circumstances weighed upon technocratic decisions.

***Globalization and Attraction.*** President Carlos Saúl Menem came to office in July 1989, five months earlier than scheduled due to a grave economic crisis gripping Argentina. As an outsider in the Peronist party, and as one who had campaigned on a populist and protectionist platform, Menem enjoyed very little support or confidence of

market actors either within Argentina, or internationally (Palermo and Collins 1998). Upon taking office, Menem undertook a radical reversal of his campaign pledges by embracing an orthodox market-oriented stabilization and structural reform plan (Stokes 2001, 46-47). After several false starts and failed stabilization efforts, in 1991 Menem shifted to the extremes of neoliberalism in order to make himself credible to the international community (Palermo and Collins 1998, 45). He did so first by placing authority for economic policy in the hands of an insulated economic team under the leadership of his newly-appointed Economic Minister, Domingo Cavallo. Widely regarded as a close friend of the investment community in Argentina, Cavallo was “a man of *The City*,” the Argentine stock market, and was associated with the Argentine free-market think-tank Fundación Mediterranea (Torre 1997; Gerchunoff and Machinea 1995). Cavallo brought with him a group of free-market economists that designed and launched a series of deep, market-oriented structural reforms. The cornerstone of these measures was the inflation-quelling Convertibility Plan, which pegged the new currency, the peso, to the U.S. dollar at a rate of one-to-one (Gerchunoff and Machinea 1995, 43).

With price stability came an immediate surge in consumption and inflows of capital in the economy, stimulating a swift economic recovery. Although the Argentine government did not embrace market-oriented reforms universally across the social and economic policy spectrum (Murillo 2004), Cavallo turned his attention to the nation’s social security system. In 1991, he appointed Walter Schulthess, a macroeconomist, as the new Secretary of Social Security and charged him with the goal of crafting a structural pension reform. Schulthess assembled a highly-insulated team of technocrats that answered directly to Cavallo, rather than to the social security bureaucrats on whom

they were formally dependent. The group enjoyed financial support from a World Bank program administered by the United Nations (*Programa Nacional de Asistencia Técnica para la Administración de los Servicios Sociales*, PRONATASS), which financed a series of consultations by international pension experts, including economists from Chile and from Washington (Demarco 1998, 2004; Diaz 1998). Although the World Bank had been active in policy lending in Argentina and offered some early technical advice to reformers in the early 1990s, participants and close observers of the PRONATASS team argue that the bank did not define Argentina's pension reform objectives, nor contribute to the specific design of the country's pension reform proposal (Demarco 1998; Nelson 2004, 46; Rofman 1998; Schulthess 1998). Nor were domestic political interests influential in the early stages of the reform, as members of the reform team worked in what they describe as "laboratory conditions," tightly insulated from the pressure of traditional social security interests (Schulthess 1998). Argentine technocrats thus enjoyed considerable latitude to define the scope and objectives of their pension reform. Far from imposing privatization as a condition for the receipt of financial aid, the IFIs provided resources for Argentina's pension reform that allowed technocrats to seek advice from an array of international experts.

When the Argentine reform team began its work, the country's economy was in the midst of a boom in private consumption and growth that followed its successful stabilization. Consequently, strong inflows of capital and tax receipts created a situation of relative "fiscal plentitude" that temporarily slackened important financial constraints on government action (Torre and Gerchunoff 1998). Although this positive fiscal balance only thinly veiled the deep structural imbalances in government finances,

reformers took advantage of the broadened financial leeway to move forward with the structural pension reform. This decision was also catalyzed by a secondary and paradoxical effect of heavy inflows of capital: namely, the deepening of Argentina's vulnerability to capital flight. Such vulnerability heightened the urgency of passing the pension privatization in order to signal the government's resolve to maintain the stable currency while also diminishing the country's reliance on precarious foreign capital flows.

*Macroeconomic Context.* Although it quelled hyperinflation in Argentina, the Convertibility plan created a new problem, namely the enhanced vulnerability to capital flight. This condition arose from both the radical liberalization of the country's capital account, and the appreciation of the national currency that followed stabilization. The latter further aggravated this vulnerability by causing Argentina's trade surplus of \$3.7 billion in 1991 to become a deficit of \$5.9 billion by 1994 (Bustos 1995, 27). Given Argentina's low levels of domestic capital accumulation, this deficit was financed almost completely through foreign capital inflows, resulting in a wide current account deficit. Because capital could freely enter and exit the country, such foreign inflows became a highly precarious source of financing for the current account deficit, rendering it vulnerable to sudden shifts in market sentiment. This sense of vulnerability was unprecedented (Torre 1998) in Argentina, and lent urgency to technocrats' goal of enacting a private pension reform; indeed, it placed them in a 'race against time' to enact the reform before international sentiments or market conditions changed.

For Argentine politicians, gaining the confidence of market actors meant "playing by the market rules" (Santín 1998), specifically, adopting market-oriented structural reforms and sustaining low fiscal deficits and government debt levels (Diaz 1998). The goal of

reducing the cost of social security was of particular importance to these ends, as the old pension system in Argentina suffered grave financial and institutional troubles in the late 1980s and early 1990s. Not only was the system running a wide deficit, which in 1993 equaled 45 percent of its promised benefits, but after defaulting on its pension promises in the 1980s the government faced a proliferation of lawsuits from pensioners demanding payment of these arrears (Isuani et al. 1996, 95; Rofman 1997). Technocrats thus perceived that keeping the status quo public pension system would be simply “too expensive” given the precarious international economic context (Gaviola 1998; Rofman 1998; Etala 1998; Cetrángolo 1998; Schulthess 1998). As one analyst put it, the new pension system would have to be less costly because “the mobility of capital simply does not support high public deficits” (Facal 1998).

The sense of vulnerability to capital flight thus fueled the belief among technocrats that Argentina should adopt a deep structural pension reform, rather than simply adjusting existing public system, in order to send a credible signal of its commitment to macroeconomic stability (Rofman 1998; Schulthess 1998; Demarco 1998; Gaviola 1998; Etala 1998; Caro Figueroa 1998). In the longer term, they expected this system build more stable sources of domestic savings, and thus to provide a critical “buffer” for the domestic economy against exposure to volatile international capital flows (Bustos 1998; Gaviola 1998; Isuani et al. 1996, 94; Torre 1997; Torre and Gerchunoff 1998; Gerchunoff and Machinea 1995; Rofman 1998; Schulthess 1998).

Despite this strong attraction, Argentine technocrats perceived that wholesale replication of the Chilean archetype of pension privatization was neither politically or financially viable (Demarco 1998). Even partial privatization faced an up-hill political

battle, given Argentina's longer-term welfare state legacy. Lowering political obstacles to privatization would be costly, however, and would compromise important fiscal goals that originally animated the reform, such as reducing the long-term cost of social security. The Argentine government could make these compromises, however, on account of economic circumstances that broadened its short-term financial scope for maneuver. These included strong foreign capital inflows spurred by the high global liquidity and economic stability, which in turn, brought a surge in growth and tax revenues for the federal government. Argentina's fiscal situation was improved further by windfall revenue from extensive privatization efforts in the early 1990s. These factors temporarily opened a window of opportunity for the government to make key political compromises that lowered political obstacles to privatization (Cetrángolo 1998). Despite allowing the pension privatization to advance in the legislature while maintaining a positive fiscal position in the short term, these concessions compromised the longer-term fiscal and macroeconomic goals that had originally animated this reform.

*Short-Term Imperatives.* In early 1992, prior to sending the first structural pension reform proposal to the Congress, the technocratic reform team convoked a round table for "political dialogue" with the main social and political actors in the reform process. This dialogue was intended to offer technocrats a preview of the counter-arguments that the pension reform would encounter in Congress, and to establish consensus on the main provisions of the pension reform. Social and political actors made clear to members of the reform team that a private pension reform would not gain legitimacy in Argentina if it lacked substantial 'solidarity' pillar, i.e., a public and redistributive component (Demarco 1998). On the basis of this feedback, the reform team designed and sent the first pension

reform proposal to the National Congress in June 1992. The proposal envisioned a ‘mixed’ pension system with a small public universal basic pension and a mandatory private pension system for all new entrants in the labor market and all current workers under the age of 45. In order to limit the short-term transitional cost of the pension system, this proposal did not recognize or compensate workers for pension benefits earned from contributions to the old pension system.

The short-term political contexts in Argentina were highly favorable to the advance of a deep structural pension reform. The poor performance of the state pension system in Argentina in the 1980s, along with the striking success of the market-based Convertibility Plan in the early 1990s, provided fertile ground in which to justify the reform as a necessary and effective alternative to the old ‘failed’ model. Indeed, the state had been blamed for the country’s deep economic crisis in the late 1980s and had become the target of broad criticism. Powerful political and business leaders also backed Menem’s broad plans to remove the state from major allocative functions in the economy (Margheritis 2002: 889-890).

Nevertheless, the first draft of the pension reform met with strong resistance from members of the president’s own Peronist party, as well as from the legislative opposition. Politicians’ misgivings centered on failure to recognize contributions made to the old pension system, the lack of macroeconomic infrastructure to develop a private pension fund market and weak administrative capacity to support a private pension industry (Isuani and San Martino 1995). Given the force of legislators’ rebuff, government technocrats withdrew that first reform proposal before it was even discussed in committee. The message that government technocrats took from these discussions was that pension

privatization would not advance unless benefit rights acquired in the old system were recognized for the transitional generation.

At this point, the weight of long-term macroeconomic and fiscal goals diminished significantly in comparison to the more pressing short-term objective of quickly enacting the reform. This task, in turn, brought attention to the immediate concern for making privatization politically viable, revealing the narrowed the time horizon over which crucial reform decisions were made. The shift to short-term thinking was permitted by the slackening of fiscal constraints in the context of heavy foreign capital inflows, and by the rising sense of vulnerability to a cessation or reversal of capital flows (and thus a balance of payments crisis), which lent urgency to the enactment of the reform.

The critical task for reformers was thus to redesign their proposal in such a way that it would acknowledge acquired pension rights while still allowing the government to send positive short-term signals to international market actors – i.e., by passing some form of private pension reform. While fiscal constraints were loosened in the short term, allowing them to proceed with these costly compromises, they were not removed altogether. Indeed, Argentine technocrats were aware that acknowledging contributions to the old system in the way that the Chilean government had – through the issuance of a ‘recognition bond’ – would cause a sharp elevation of the government’s debt-to-GDP ratio, which would lower the country’s sovereign risk rating and threaten the loss of investor confidence.

Argentine technocrats thus devised an alternative method of recognizing pension contributions in the old system that would not compromise government debt ratios. They did so through the creation of a “compensatory pension.” Payable upon retirement, this

benefit acknowledged workers' contributions to the old public pension system as a function of income and years of contribution to the old system. Not only did this design fulfill a key political condition for the reform's advance, but it also allowed the Argentine government to spread the transition cost over a long time horizon, keeping most unfunded pension liabilities implicit, or out of sight of international investors – in the short term.

While sidestepping the market limits on Argentina's debt-to-GDP ratio, the new compensatory benefit expanded the government's medium-term fiscal obligations beyond what was originally anticipated by reformers. And while macroeconomic and fiscal circumstances were permissive of this added financial cost in the short term, not only were the medium to long-term goals of lowering the cost of pension provision compromised, but the government became even more vulnerable to shifts in the international and domestic economic conditions. In responding to short-term market constraints on the government's explicit debt ratios, therefore, the Argentine technocrats traded off the longer-term goal of reducing the fiscal impact of the pension system.

Paradoxically, analysts have noted that the principal cost-cutting goals of the reform were advanced primarily in the parametric reforms to the pay-as-you-go component of the pension system, such as the increase in the minimum retirement age and expansion of the number of years of contribution required to earn a pension, among other changes (Isuani et al. 1996, 95). What is more, Argentina's privatization did little to reduce the administrative burden on weak state institutions that was blamed for the failures of the old system. Instead, the new pension system *added* to the administrative demands on state social security institutions in Argentina by creating new responsibilities in the

collection of pension contributions and establishment, regulation and supervision of the new private pension industry (Kay 2003).

### **Brazil**

Between 1992 and 2003, the Brazilian government undertook nearly-unceasing efforts to reform the country's public and private pension systems. These efforts yielded two constitutional amendments (in 1998 and 2003) and a structural reform of the pay-as-you-go private sector pension system (in 1999) that was passed through ordinary law. The pension reforms in Brazil brought substantial changes in the design and generosity of old age pension provision, but did not privatize the system. This is not because Brazil did not rely on highly-mobile international capital flows; nor was it due to a lack of financial involvement from international financial institutions. Rather, in addition to facing powerful political obstacles to privatization, the absence of privatization may be understood in part as a result of Brazilian technocrats' weak attraction to the model, and in part as a function of the powerful short-term financial restrictions on the government. These mechanisms are evident in the technocratic processes surrounding Brazil's 1999 private sector pension reform. That measure brought a shift toward a system of individualized 'notional' (i.e., not private) pension accounts that transferred a greater share of income and demographic risks to individuals, while maintaining a pay-as-you-go financing structure. The new pension formula represents a balance between the long-term institutional and fiscal objectives of reform and the powerful short-term political and financial constraints facing the Brazilian government.

***Tenuous Attraction.*** Unlike in neighboring countries, technocrats in Brazil were not drawn powerfully to the Chilean archetype of private pension reform. This is not for the

absence of macroeconomic crisis, which has been viewed as a critical catalyst of the embrace of such models throughout the region. Indeed, Brazil endured severe bouts of hyperinflation and repeated failures of heterodox stabilization plans before finally achieving macroeconomic stability in 1994. Unlike in Argentina, however, the Brazilian government did not go to the extremes of neoliberal reform to quell inflation and liberalize the economy. Government consumption continued to claim a larger share of gross domestic product (GDP) in Brazil than in its peer countries, averaging 18.4 percent of GDP in the 1990s compared to the regional average of 10.5 percent (World Bank 2005b). At the same time, capital account liberalization in Brazil was undertaken with greater moderation than elsewhere in Latin America (Morley et al. 1999).

Nor was state intervention in the economy broadly discredited in Brazil to the extent that it was in Argentina. By contrast to the Convertibility Plan in Argentina, Brazil's inflation-ending Real Plan did not identify the state-led economic model as the root cause of hyperinflation; instead it diagnosed inflation as a remediable fiscal 'disorder' with many symptoms, including the lack of sufficient resources to finance development, distributional conflicts and excess indebtedness ("*Immediate Action Program*"). Unlike in Argentina, therefore, hyperinflationary crisis in Brazil did not cultivate a widespread view among political or technocratic elites that the state must be removed from its allocative role in the economy.

In addition to a greater political diffidence toward neoliberal economic models, Brazil enjoyed a privileged capacity to attract foreign capital without radical liberalization. Unlike in other emerging markets, where the dismantling of capital controls and financial regulations became a fundamental condition for the receipt of foreign investment, capital

flows to Brazil were not conditioned on radical neoliberal policy signals. Rather, strong capital inflows depended heavily on signals of Brazil's fiscal and macroeconomic performance. With market actors closely following the Brazilian government's debt and deficit ratios, technocrats came to evaluate policy changes according to their likely effects on these key sovereign risk indicators (Bier 1999). Pension privatization thus was not seen by technocrats in Brazil as an opportunity to signal credibility through market-oriented reform, but rather as a means to restore financial balance to the pension system, and thus to the state budget more broadly.

*Macroeconomic Conditions.* As in other countries that used an exchange rate-based stabilization, the quelling of inflation in Brazil brought an appreciation of the national currency, the real, and with it a widening current account deficit, which reached 4.7 percent of GDP by 1998 (Savitsky and Burki, 2003, 19). As in Argentina, this deficit heightened Brazil's vulnerability to sudden shifts in investor confidence, and thus to the risk of destabilizing capital flight. Because the success of Brazil's stabilization plan depended heavily on the government's ability to carry out a fiscal adjustment, market actors attended closely the evolution of policy reforms that were perceived to have a significant impact on the fiscal deficit. Chief among these was the pension reform. As Brazil's pension system deficit reached 4.6 percent of GDP by 1998, President Cardoso's effort to reform of the public and private pension systems attracted considerable attention from market actors (Edwards 2000, 3). Again, however, the signal that market actors sought from the Brazilian reform was fiscal, rather than institutional. That is, unlike in Argentina, where technocrats perceived that only a privatization would adequately signal the government's commitment to the currency peg, Brazilian technocrats felt pressure

simply to diminish the fiscal cost of the pension system, rather than to privatize it (Bier 1999; Oliveira 1999). Accordingly, Brazilian government priorities for reform centered on cost-cutting measures, rather than privatization, as a means to win investor confidence.

Brazil's macroeconomic landscape likewise dampened attraction to pension privatization. Whereas in much of Latin America, privatization appealed to technocrats as a long-term tool to develop national capital markets, local financial markets had been created in Brazil in the 1960s and deepened considerably between 1970 and late 1990s (Loureiro et al. 2003). Although domestic bond markets in Brazil were dominated by public debt instruments, and thus had considerable room for development, the near-term compulsion to use pension privatization as a means to cultivate a domestic source of financing for the public and private sector was far less pressing. Indeed, this deep local capital market allowed the Brazilian government to place the majority of its sovereign debt in domestic markets in the late 1990s (Bevilaqua et al. 2001). Brazil also had an established private pension industry. With over \$86 billion invested in private pension funds in 1998, the voluntary pension market in Brazil was twice the size of the Chilean industry (ABRAPP 1999). Government technocrats anticipated, moreover, that very little real savings could be gained through the creation of mandatory individual pension accounts, since approximately 80 percent of the labor force earned less than two times the minimum wage in the late 1990s, or less than \$200 per month (Bier 1999). Overall, therefore, the allure of pension privatization as a tool to build domestic capital markets and as a signal of the government's commitment to market reform were dampened considerably in Brazil by the combination of the predominantly fiscal benchmarks against which market actors gauged their confidence in the government, and by the

country's distinctive macroeconomic landscape, which offered less prospect for substantial long-term gains through privatization than in other Latin American countries.

Brazilian technocrats were actively engaged in consultations with IFIs such as the World Bank, from which received substantial financial support in the 1990s. Technocrats evaluated closely the ideas and models proffered by the World Bank as they began to design the private sector pension reform, including the bank's 1994 report, *Averting the Old Age Crisis* (Najberg 1998). Nevertheless, these ideas held little sway among technocrats designing Brazil's pension reform. Nor was the Chilean experience considered relevant to the Brazilian political and economic context (Beltrão 1999; Oliveira 1999). Rather, technocratic objectives remained centered on the goal of correcting long term financial imbalances in the state pension system.

Many of these problems were rooted in the 1988 Constitution, which brought a vast expansion of state social protection obligations and elevated the minutiae of pension benefit rules to the status of constitutional right (Weyland 1996). Although new progressive forms of redistribution were established, including the expansion of the rural pension system, the 1988 Constitution upheld a set of highly regressive benefit rules. These included a "time of service" pension that used only the last 36 months of contributions as the basis for calculating pension benefits, while requiring no minimum age for retirement (Pinheiro and Viera 2000, 9). More than half of the pension benefits offered in the private sector pension scheme (INSS) were time of service pensions, which were disproportionately claimed by higher-income workers, while low wage earners who could not establish a full labor history were obliged to work a longer number of years in order to receive the less-generous 'age' pension. Critically, the vast expansion of old age

benefits enshrined in the 1988 Constitution was not matched by the creation of equivalent sources of new revenue. While pension outlays more than doubled between 1988 and 1996, tax receipts rose by only one third, generating a wide gap in the system's finances (Ministério da Previdência Social 1997, 5). The objective of closing the financial imbalance in Brazil's social security system thus was the most urgent reform priority.

The first step in the reform process was a Constitutional Amendment Project (PEC-33) that President Cardoso launched in 1995. This proposal sought to remove from Brazil's constitution the detailed terms of pension provision for public and private sector workers, while adding provisions for a minimum retirement age. The amendment faced stiff opposition both in public opinion, where it was incorrectly tarred as a 'privatizing project,' and in the legislature, where the powerful civil servants lobbied forcefully against the measure, calling its supporters 'traitors.' After three arduous years of legislative struggle, the pension reform amendment was largely dismantled. Facing the possibility that his principal reform objectives were not likely to be fully achieved through that project, Cardoso began the 'second phase' of pension reform in early 1997, which focused on reforming the private sector pension system. He began by creating a special technocratic reform team under the leadership of André Lara Resende, the architect of the inflation-ending Real Plan. The group was tightly insulated from state actors that typically controlled the reform process, particularly the social security ministry, but also from the legislature and partisan pressures. Technocrats thus enjoyed considerable latitude to define the primary objectives of reform and new policy instruments to achieve them (Oliveira 1999).

However, reformers faced powerful political and economic constraints on their options for reform. The first of these arose from the defeat of a provision in the constitutional amendment project to create a minimum retirement age for private sector workers. Workers thus could retire at any age, as long as they fulfilled the rule of 35 years of contributions to the pension system (30 for women). With many workers joining the labor force in their teens, retirement at age fifty was not unusual under this system, resulting in a heavy financial burden on the government. A second constraint on the reform options emerged from the high payroll taxes in Brazil. Given the growing pressures of international trade competition, the option of raising employer or employee contributions to increase revenue to the pension system was foreclosed (Beltrão 1999; Oliveira 1999). There was also little public support for the concept of privatization. As one Senator put it, “the society here still is strongly of the belief that the state should play the primary role in the payment of pensions; that [social security] should be from the purse of the state, not the private sector.” (Madeira 1999). Reformers thus looked for ways to alter the long-term structure and financial balance of Brazil’s private sector pension system without privatizing or raising the retirement age or payroll taxes.

The group worked intensively throughout 1997 to design a reform that would restore financial balance to the system while conforming to their distinctive political and financial constraints. They chose a reform design that would alter the structure of risk-sharing within the pension system by separating the insurance and redistributive functions in the old age pension system. Similar to the market-oriented model, the proposed reform would link the expected value of old age benefits closely to each worker’s lifetime contributions while shifting the principal redistributive function to

means-tested programs (Oliveira et al. 1999). The proposal anticipated a considerable reduction in state pension liabilities. However, by lowering the ceiling on contributions and benefits, this proposal would create a short-term financing gap in the state pension system as higher-income workers would be encouraged to divert payroll contributions instead to a private pension fund. This gap in finances, they anticipated, could be covered through the issuance of new government debt. The prospective impact of this proposal on the government's debt-to-GDP ratio, however, would ultimately prove fatal for that proposal.

The basic outline of the technocrats' initial reform plan was approved by President Cardoso and his close financial advisors in late 1997 and presented to other Executive branch actors in early 1998. Among the first groups consulted were technocrats in the Central Bank and Finance Ministry, whose input in Brazil's reform process had been amplified in recent months by rising international financial pressure after the 1997 Asian financial crisis. Increasing risk aversion among international investors was magnified further by tightening international liquidity, which brought a restriction of credit to developing countries. Adding to this narrowing scope for maneuver was Brazil's fragile fiscal position, and in particular the government's rising debt burden, which reached 45 percent of GDP (net) in 1998. The consequence of these factors was to shorten policy makers' time horizons considerably, and to shift policy goals overwhelmingly toward that of avoiding any erosion of government debt or deficit ratios in the short term (Bier 1999).

The Lara Resende group's initial pension reform plan, however, would have caused a significant strain on government finances as a result of the proposed reduction in the contribution and benefit ceilings. Consequently, Central Bank officials vetoed the

measure on the argument that it would spur a loss of investor confidence and thus threaten capital flight (Beltrão 1999; also see, Melo 2004; Nassif and Caldas 1999). The financiers explained to them that “it would look bad internationally” if they did anything “that would require additional indebtedness of the public sector to finance it.” (Oliveira 1999). Due to the risks of market punishment, therefore, the first reform proposal was blocked by precisely the government ministries that are typically considered the most ardent supporters of pension privatization.

International financial pressures continued to worsen over the course of 1998. Following the Russian default in August, capital began to pour rapidly out of Brazil on fears that it would be next to default. To stem the tide of capital outflows, the Brazilian government signed a \$41.5 billion dollar loan from the International Monetary Fund, and agreed to a series of quarterly fiscal targets that required a sharp curtailment of government spending. After a series of political alterations in the government in mid-1998 that brought changes in the composition of the pension reform team, the group began anew to draft a private sector pension reform. With a grant from the World Bank, two members of the reform group attended a World Bank summer pension workshop held at Harvard University where they learned of a new model of structural pension reform based on systems of notional accounts that had recently been adopted in Sweden (Najberg 1998; Pinheiro 1998). This model incorporates key features of privatization such as the transfer of cost and risk of old age pension savings from the state to individuals through the creation of individual retirement accounts, but maintains the pay-as-you-go financing and public management of old age pensions. Most important for Brazilian technocrats, notional account reforms do not create significant medium-term

transition costs. This feature proved highly attractive to Brazil's reform team, given the narrow financial leeway within which the government could operate. Reformers thus drafted a second reform proposal in late 1998 that drew heavily upon the Swedish notional account model, although with important adjustments for the Brazilian context.

The first and most significant modification responded to the impracticality of attaching an explicit interest rate to workers' contributions to the notional accounts. Given Brazil's very high short-term interest rates, which ranged in 1999 from 45% on liquid bank deposits, to 21.12% real average return on certificates of deposit, any effort to match these rates would be financially untenable for the government, while using a lower interest rate would prove politically unpopular (Pinheiro and Viera 2000, 11). The government also had to adjust the proposed reform to account for the absence of a minimum retirement age for the private sector. It did so by lowering the pension benefits for individuals choosing to retire at a young age. As one member of the reform team explained, "The key is that the constitution gives people some rights. It does not say, however, what kind of price you are going to have to pay for those rights" (Oliveira 1999). The centerpiece of the proposal thus was a new pension formula, called the *Fator Previdenciário*, or social security factor, which incorporates each worker's life expectancy into the benefit formula so that workers who retire early would receive lower pensions, while late retirement was rewarded by a higher annual pension benefit.

This reform proposal was finalized shortly after the promulgation of the 1998 constitutional amendment; it was sent to the Brazilian Congress in mid-1999 and was sanctioned in December. Together, the 1988 constitutional amendment and 1999 private sector pension reform were projected to cut the long-term pension system deficit in half

(World Bank 2005c, 8). Although Brazil's 1999 pension reform brought a significant change in the structure of risk sharing old age pension provision and a reduction in pension costs, it did so without privatizing the system, and thus departed sharply from the broader Latin American trend.

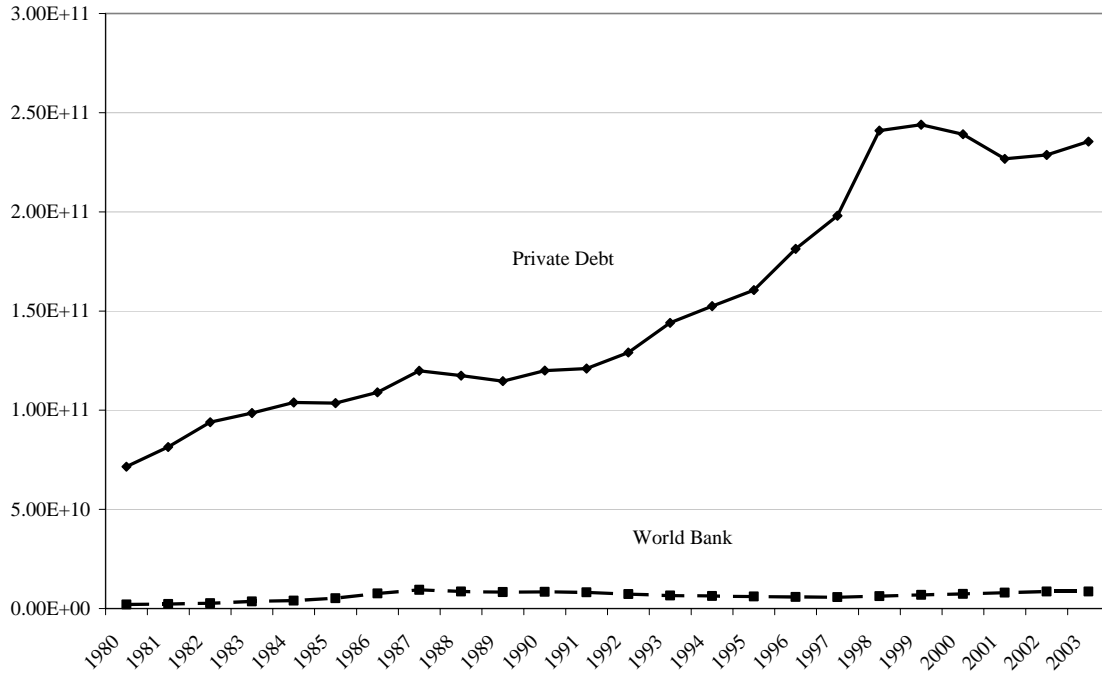
### **Conclusion**

Globalization has often been viewed as a principal source of pressure for market-oriented reform and social policy retrenchment in the developing world. Less often, however, is economic integration treated as a factor that may *limit* the extent to which governments – particularly in capital-scarce countries – expand the role of market forces in social protection. The principal thesis advanced in this study has been that rather than simply generating pressures on governments to enact more extensive market reform, globalization creates a double bind for capital-scarce governments: at once generating powerful incentives to privatize as a long-term means to raise domestic capital accumulation and as a signal to win or maintain the confidence of international investors, while also creating powerful short-term constraints on this reform. One of the main implications of this argument for the study of structural reform in Latin America arises from the view that capital mobility has exposed developing country governments to a virtual daily or even hourly referendum by capital market actors, shortening the time horizon over which they make critical, long-term reform decisions. Thus, while pension privatization is widely noted to have been embraced by Latin American governments on account of its putative long-term macroeconomic implications, we cannot assume that such ends were ultimately decisive in the process of designing and advancing structural pension reform. Rather, government technocrats faced a critical time inconsistency

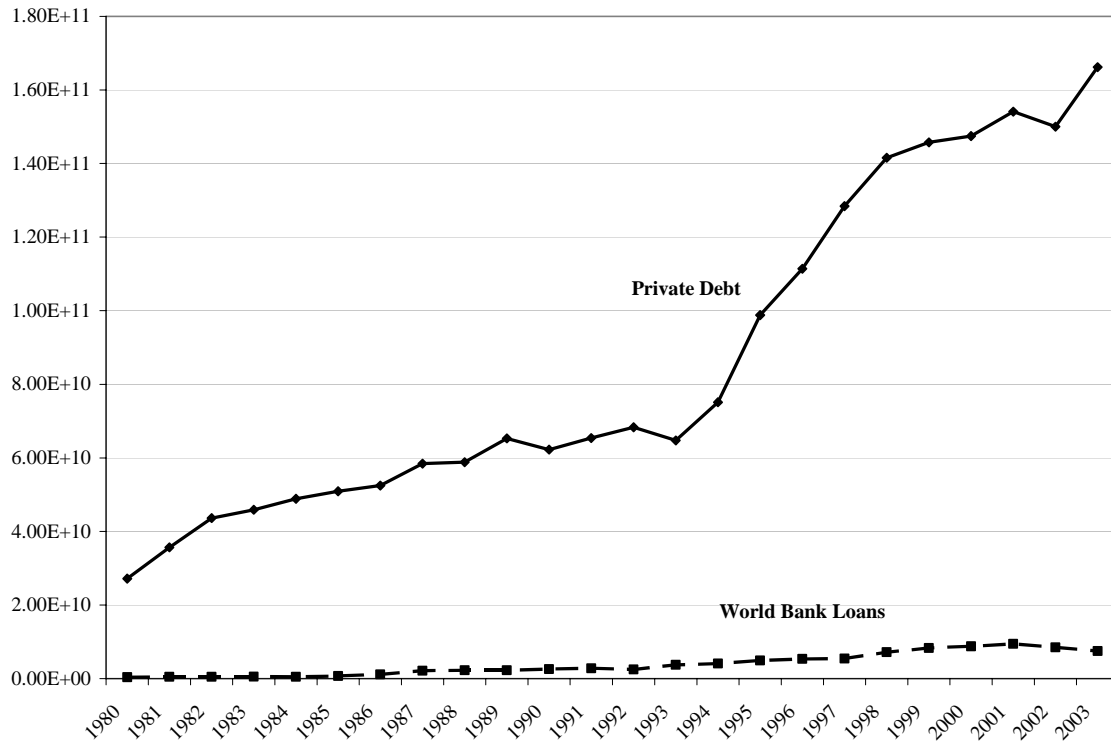
problem: they could be punished with capital flight in the short term for enacting a reform for which market actors would otherwise reward them in the long term.

How generalizable are the cases of Argentina and Brazil? While the two countries vary in the extent of their openness to international capital flows, they are among largest and thus most powerful Latin American economies. In one sense, this fact makes these countries more difficult cases in which to observe the punishing force of globalization's double bind in government decisions. Yet, as we have seen, both the Argentine and Brazilian governments were ultimately constrained in their reform goals by the threat of short-term capital flight. It could be the case that market actors paid less attention to smaller economies, however, given the more restricted investment opportunities in such nations. Other research, however, suggests that a similar dynamic obtained in Uruguay, where technocrats explicitly designed their pension reform in such a way that would avoid the use of a recognition bond – instead maintaining a larger public pension component in order to avoid any increase in the government debt ratio, and thus short-term market punishment (Brooks, forthcoming). In Nicaragua, moreover, the government approved a pension privatization in 2000, but did not implement it. As the Nicaraguan Finance Minister explained, privatization was unviable due to, “the fact of having a high public debt, a fiscal deficit among the largest in Latin America... [making] the cost of transition unsustainable” (“*Suspenden inicio de AFP*”). In large and small developing countries alike, global forces powerfully transformed the criteria and time horizons of policy making. By taking account of these temporal shifts, we might better understand how globalization has shaped the process and outcome of the dramatic renegotiation of the state and market balance in Latin America since the early 1990s.

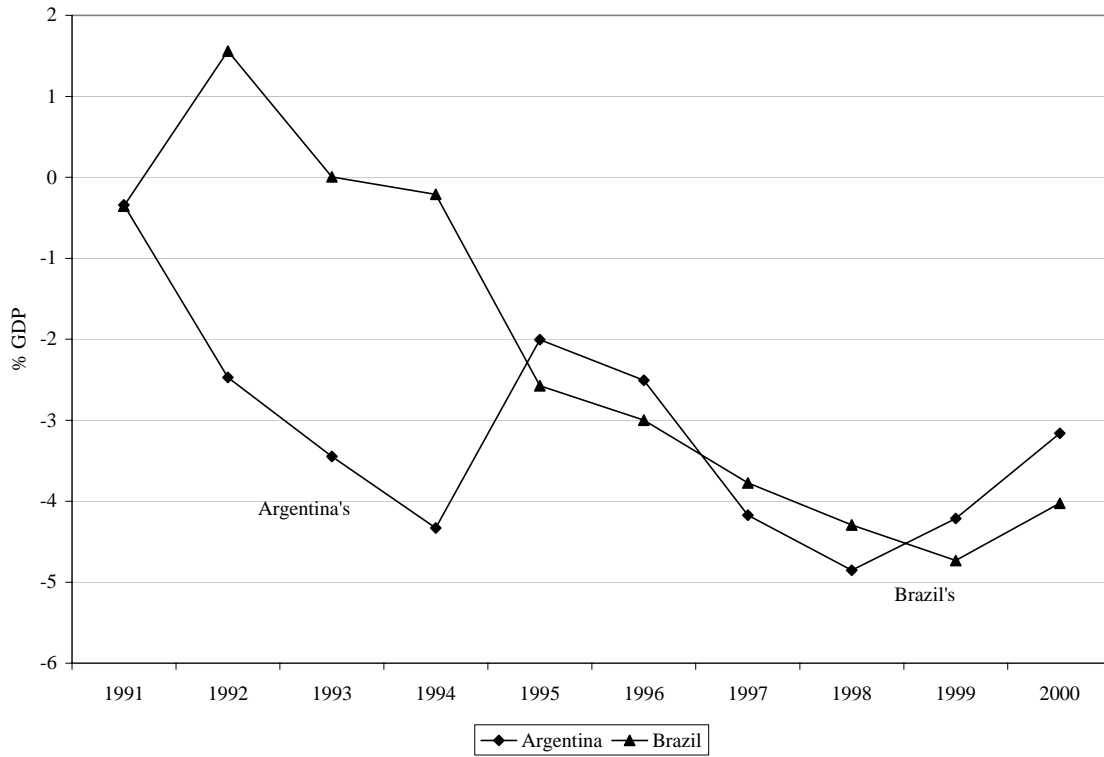
**Figure 1.**  
**Brazil: External Debt to Private Market and World Bank (Current US\$)**



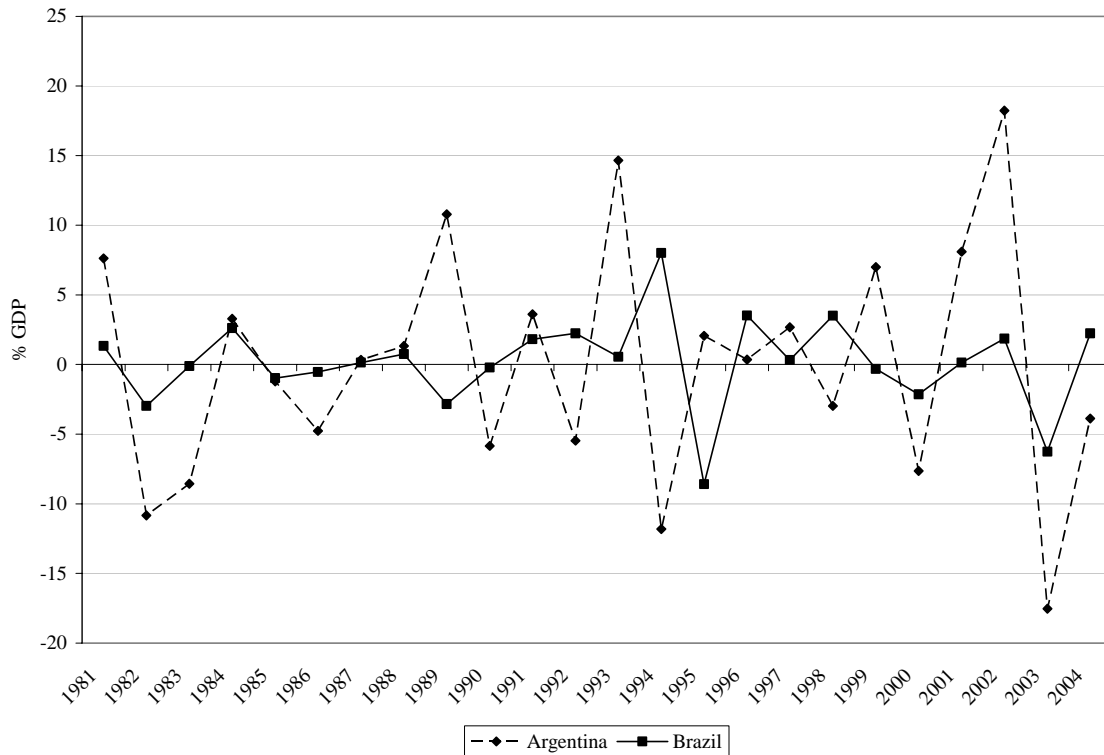
**Figure 2.**  
**Argentina: External Debt to Private Market and World Bank (Current US\$)**



**Figure 3. Current Account Balance in Argentina and Brazil**



**Figure 4. Annual Change in Gross Private Capital Flows: Argentina and Brazil**



**Table 1.**  
**Liquidity Positions of Privatizing and Non-Privatizing Countries**

	<b>Privatizers</b>	<b>Non-Privatizers</b>
<b>Budget Deficit (%GDP)</b>	-1.6	-3.7
<b>Debt (%GDP)</b>	42.5	59.6
<b>Reserves (months of imports)</b>	3.9	3.0

Source: World Bank (2005b) *World Development Indicators*.

**Table 2.**  
**Primary Fiscal Balance: Argentina and Brazil**

	<b>Year</b>	<b>Primary Budget Balance</b>
<b>Argentina</b>	1992	1.4
	1993	1.4
<b>Brazil</b>	1998	-0.01
	1999	-3.13

Sources: Argentina: International Monetary Fund 2004.

Brazil: Rocha and Pichetti 2003.

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