Classical Liberalism and Conservatism: How is Chile's "Private" Pension System Best Conceptualised?

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Abstract

In 1981, Chile's military dictatorship introduced a major reform of the retirement system, replacing a long-standing public pension arrangement with a multi-pillar approach, which included a substantial privately-administered second pillar. For a wide spectrum of scholarly opinion, this reform represented the institutional embodiment of *classical liberalism*, emphasising individualism, competition and economic efficiency. We reject this widely accepted characterisation of the Chilean pension reform. In particular, this article evaluates Chile's second pillar pension arrangement against pension design principles that would be suggested by classical liberalism, focussing on pricing and performance in the pension fund management industry. In reality, Chile's experiment in pensions' "privatisation" was deeply *conservative*, creating a state-organised system of market privilege rent-seeking that was biased in favour of big business. By insulating pension fund managers against market forces, the Chilean state facilitated economic predation through excessive pricing and sub-optimal performance.

Keywords: Chile; pensions; classical liberalism; rent-seeking; price; performance; conservatism

Introduction

At the start of the 1980s, the Chilean state replaced a long-standing publicly-administered pension arrangement with a multi-pillar retirement system.[1] Centrally, this new arrangement provided for a second pillar of privately-administered, defined contribution (DC) individual accounts. According to a wide spectrum of scholarly opinion, the new "private" pension arrangement was and continues to be the institutional embodiment of the classical liberal blueprint for the reform of retirement income protection. On the left of the ideological spectrum, the kinds of measures deployed by pension reform were integral to the "neoliberal" counter-revolution that (allegedly) dismantled the social democratic welfare state, violently in Chile’s case (Harvey, 2005; Crouch, 2011). Crucially for this article, classical liberal scholars of retirement have defended Chile’s “private” pension pillar on the grounds that its design corresponded in important ways to their core values and principles (Tanner, 2004; Shapiro, 2010). For much of the classical liberal mainstream, Chile’s “private” pension pillar plays a vital role in providing a practical illustration of the measures that are necessary to reform retirement income protection in other national jurisdictions.

We reject this characterisation of Chile’s “private” pension pillar, arguing that any resemblance between its design and the core principles of classical liberalism is superficial. When evaluated in detail against relevant criteria, it is clear that Chile’s “private” pension pillar falls far short of the classical liberal ideal of liberty. This argument is developed in two specific ways. First, we provide a brief contextual overview of the scholarly pensions literature which has maintained that Chile’s experiment in pensions privatisation has exemplified the classical liberal reform model. Second, we evaluate the Chilean second pillar pension arrangement against the requirements of pension design principles that would be suggested by the classical liberal corpus, focussing on the pension fund management industry—the state-licensed agents who have been responsible for running the “private” system. In particular, we appraise their role in managing worker’s savings in terms of classical liberal principles regarding *price* and *performance* during the period 1981 and 2008.

Our findings lead us to argue that Chile’s experiment in pensions “privatisation” during this period of analysis did not correspond substantially to any of the core principles of classical liberalism, contrary to what many believe. In characterising the “private” pension arrangement as *conservative*, we concur with classical liberal critics of state capitalism who regard today’s corporate economy as a state-organised system of market privilege rent-seeking that is systematically biased in favour of big business. Instead of pursuing a policy of *laissez faire* with regard to retirement income protection, the Chilean state has rigged the “private” pensions pillar in order give preferential treatment to the financial services industry incumbents who manage it. This has meant that rather than striving to satisfy the preferences of sovereign consumers, Chile’s pension fund managers have been insulated from market competition, and have thus been able to impose excessive charges for sub-optimal performance.

Classical liberal Chile?

Under the aegis of a brutal military dictatorship lead by Augusto Pinochet, Chile's publicly-administered pension arrangement was replaced by a system of privately-managed, defined-contribution (DC) individual accounts for all new labour market entrants, and existing workers who elected to transfer to the "private" pillar. This new arrangement gave the responsibility for managing worker's accounts to state-licensed and highly regulated pension fund management companies, the *Administradoras de Fondos de Pensiones* (AFPs). Covered workers were required by law to contribute 10 percent of their monthly earnings to their own account, and each was given a degree of choice around their AFP—the initial choice of AFP was unrestricted, while participants could transfer to a new AFP several times each year. In important ways then, the 1981 reform reinforced the principle of individual responsibility; the DC principle made affiliates fully responsible for their own retirement income futures; while the institutionalisation of consumer choice made them responsible for selecting their fund manager on the basis of relevant information, such as data regarding price or performance. Although significant, this particular emphasis on individualism was not to last in its original form. In 2008, the Chilean state introduced a second wave of reforms which modified the retirement system in substantial ways (Hyde, 2014). If the design of Chile's multi-pillar retirement system had ever been consistent with the core tenets of classical liberalism, it wasn't now. To be fair to those classical liberals who endorse Chile's multi-pillar retirement system on the grounds that its design is consistent with their principles then, we confine our analysis to the period 1981 to 2008—henceforth, our *period of analysis*.

It has been widely accepted in the scholarly social security literature that Chile's second pillar pension arrangement was influenced by the core tenets of classical liberal political philosophy, and should thus be regarded as the institutional embodiment of the classical liberal pensions reform model. On the left of the ideological spectrum, there has been a general consensus that the kinds of measures that were pursued under the auspices of Chile's 1981 reform have been integral to the "neoliberal" counter-revolution against the social democratic welfare state. Combined with the retrenchment of publicly-administered welfare programmes, "privatisation" and "deregulation" were intended to shift power and financial resources away from organised labour and civil society to corporate elites, particularly the financial services industry (Harvey, 2005;

Crouch, 2011). Most importantly for our analysis, it is clear that many classical liberal scholars of social security also accept that the provisions of the 1981 reform exemplified their own approach to the design and provision of retirement income protection. This is best illustrated by highlighting the core principles of classical liberalism regarding the respective role of markets and the state in economic affairs.

Classical liberals of various philosophical hues maintain that the reliance of the *free market model* on voluntary exchange to coordinate economic transactions is able to deliver three substantive benefits.

- *Individual sovereignty*. On natural rights grounds, the classical liberal corpus is clear that voluntary exchange gives all human agents the opportunity to exercise the choice that is essential to the pursuit of sovereign life-plans. An economic system that is unimpeded by state coercion, including a “purely voluntary pension system is most compatible with this classical liberal emphasis on liberty” (Shapiro, 2010, p. 49) because it respects people’s capacity for sovereign decision making and allows them to flourish.
- *Economic welfare*. On consequentialist grounds, classical liberals have argued that voluntary exchange facilitates substantial competition on the supply-side of the market as each firm strives to augment its market shares and power. An economic system that is unimpeded by state intrusion delivers important economic benefits to consumers, reflecting its responsiveness to their sovereign decisions, and its tendency towards efficient production and distribution (Friedman, 1962).
- *Proportional remuneration*. Reflecting both sets of concerns, some classical liberals have maintained that voluntary exchange minimises the possibility of economic predation by incentivising supply-side actors to prioritise their customers—if they don’t, others will seize the opportunity to bring better alternatives to the market. An economic system that is unhampered by statutory restrictions ensures that reward is proportional to performance (Carson, 2007).

The classical liberal case against governmental intrusion in the market is illustrated poignantly by its analysis of the *state capitalist model*, where social and political institutions are arranged in order to facilitate economic predation by corporate elites. *Rent-seeking* refers to the pursuit of income streams or other tangible assets by manipulating aspects of the economic environment in order to generate self-serving institutional biases; rather than taking action that adds value to the production and distribution of goods and services. If successful, rent-seeking results in the production of *economic rents*, which are represented by the excess of realised remuneration over the value of the beneficiaries' actual productive achievements. Crucially for our analysis, classical liberalism acknowledges the pivotal role of the state in shaping the distribution of economic rents, for rent-seeking typically involves the "manipulation of political and legal processes with the objective of creating a legal and institutional environment" which enables economic agents to "extract transfers of wealth outside the normal processes of voluntary market exchange, from other people in society" (Evans, 2010, p. 2). An early but enormously influential variant of this critique distinguished two modes of generating access to material resources; the "economic means", involving the production of goods and services that have value to consumers; and the "political means", essentially the use of force to appropriate other people's goods. For Nock (1983), the state is nothing more than the institutionalisation of the political means, facilitating and giving legitimacy to acts of theft and banditry. Under state capitalism institutionalised rent-seeking takes a particular form, involving the deployment of state power to facilitate economic predation through the *exchange process*. *Market privilege rent-seeing* is where the state takes action to circumscribe competition, insulating corporate actors from market forces and enabling them to appropriate economic rents, either by imposing excessive prices, or by delivering sub-optimal goods and services. This might include measures to facilitate industrial concentration such as the imposition of barriers to market entry; compulsory cartelisation, where the state forces industry incumbents to act in unison with regard to some aspect of production and distribution; or the imposition of captive markets, where people are forced to consume particular goods or services. *Redistribution rent-seeking* on the other hand is where the state distributes excessive remuneration to corporate elites directly by giving them tax-payer financed subsidises (Carson, 2007, 2008). The question is, which model best illuminates the nature of Chile's "private" pension arrangement during the period of our analysis, the *free market model* of classical liberalism, or the *state capitalist model*?

It would be fair to say that for much of the mainstream of classical liberal pensions analysis, the Chilean second pillar should be regarded as the institutional embodiment of the free market model (Tanner, 2004; Shapiro, 2010). This endorsement has been developed in two broad ways, reflecting its underlying intellectual traditions. The first equates loosely to the deontological emphasis on the importance of natural rights, arguing that the design of Chile's "private" pension arrangement corresponded to the core normative principles of classical liberalism. Most prominently perhaps, the recent work of Daniel Shapiro has illustrated this influence by contrasting the design attributes of Chile's second pillar (particularly its emphasis on *individual responsibility*) with those of publicly-administered social security, which has embraced *collective responsibility*—where everyone is required to share "responsibility not only for their own and their family's security, but also the security of everyone else, present and future" (Shapiro, 2010, p. 56). For example:

- Plan participants in the Chilean second pillar were given property rights around their accumulated assets, but members of social security are not;
- Affiliates in the private pension were fully responsible for their retirement income futures, whereas the entitlements of social security participants are often only partially related to their work or savings' effort;
- Chile's pension plan members were given the limited opportunity to direct the investment of their own savings, but there is no investment at all under social security, because benefits are financed by tax-payers; and
- The first pillar retirement income safety-net that coexisted with Chile's "private" second pillar was designed to be parsimonious, both in terms of eligibility and generosity, so-as-to avoid the creation of perverse incentives (which could diminish work or savings' effort).

The second and perhaps more prominent classical liberal endorsement of Chile's "private" pension arrangement has been developed in consequentialist terms, emphasising the economic benefits of free markets. Jose Piñera's defence of the 1981 reform (2004) has highlighted the wider economic advantages of the "private" pension arrangement including improved savings rates, flexible labour markets, the development of financial institutions and markets and, consequently, substantial economic development and growth. Most importantly, classical liberal pension scholars have highlighted a variety of means by which Chile's "free market" in retirement provision has served to augment the economic welfare of plan participants, now and in the future. For example;

- Investment returns from the private pension arrangement have been sustained and substantial, exceeding the notional returns of the social security arrangement it replaced substantially.
- Retirement benefits from individual accounts “have been significantly higher than under the old, state-administered system, which required a much higher payroll tax” (Piñera, 2004, p. 197).
- Unlike social insurance systems, the Chilean second pillar was financially sustainable because retirement benefits were “funded”—plan participants were required to save and pay for their own retirement benefits, so there could be no implicit pension debt.

For much of the classical liberal social security mainstream then, the design of Chile’s “private” pension arrangement that was in operation during our period of analysis was consistent with the normative and programmatic requirements of the free market model.

An evaluation of Chile’s “private” pension arrangement

In contrast, our analysis of the Chilean second pillar suggests that its design and implementation gave expression to the state capitalist model in a sustained and coherent way. We established this by evaluating its design characteristics against the requirements of the two models, particularly those features that have relevance to two salient dimensions of productive effort; *pricing*—the charges that are imposed by each AFP for managing its members’ retirement savings; and *performance*—the ability of each fund manager to generate investment returns on behalf of those who were forced to pay for this service.

Pricing

Although Chile’s pension fund managers were permitted to impose a variety of charges on affiliates during the period of our analysis, we confine our attention here to the principal management charge; that is the monthly management charge comprised of fixed and variable fees. Unlike mandatory DC pensions in several other national jurisdictions, Chile’s AFPs were permitted to exercise discretion around the level of charging, since no statutory limits were imposed. The question is, did this freedom suggest that Chiles’ approach to charging was consistent with the core principles of classical liberalism regarding pricing, as has been claimed (Rodriguez, 1999)? Before we can address this, we need to determine the nature of the pricing arrangements that should be expected of a pension arrangement that is reliably informed by the principles of classical liberalism. Following our discussion of the free market model in the previous section, the *voluntary determination of prices* (henceforth “voluntarism”) is the single most important characteristic of charging for goods and services, and for three reasons.

- *Individual sovereignty*. Voluntarism facilitates the pursuit of sovereign life-plans because prices in a free economy convey important information about *variation* in consumer preferences, telling supply-side actors where their efforts are most needed. Where prices are distorted by statutory controls and regulations, producers become less responsive to sovereign consumer preferences (Shapiro, 2010).
- *Economic welfare*. Voluntarism facilitates competitive effort on the supply-side of the market as producers strive to augment their market shares and power, and this drives the growing prevalence of low-cost goods and services that are characteristic of a free economy. State intrusion aimed at circumscribing market competition ultimately prevents consumers from realising this economic benefit. (Friedman, 1962).
- *Proportional remuneration*. Voluntarism minimises the prevalence of economic predation because price competition reduces the possibility of over-charging, ensuring that reward is proportional to productive effort. State intrusion to circumscribe competition insulates supply-side actors from market forces, enabling them to impose excessive prices (Carson, 2007).

This endorsement of voluntary exchange suggests that charging for pension fund management services in a retirement scheme that is consistent with the core tenets of classical liberalism would have three characteristics.

- *Differentiation*. The efforts of each firm to differentiate itself from others in order to augment its market shares and power is the essence of market competition, as understood by classical liberals. In a competitive pension fund management industry, we should anticipate evidence of visible differentials in management charges.
- *Transparency*. The model of consumer sovereignty that is endorsed by classical liberal economics puts consumers in the driving seat, because their purchasing decisions are informed by reliable comparisons of producers in terms of relevant criteria. In a competitive pension fund

management industry, we should expect to find evidence of price transparency, manifesting as arrangements to ensure that management charges are visible to consumers.

- *Flexibility*. For classical liberal economists, differentiation arises because firms have been able to take action adjust prices in order to gain advantages over competitors. In a competitive pension fund management industry, we should anticipate evidence that incumbent firms have such discretionary control over their own fees and commissions.

Classical liberal critics of state capitalism have highlighted a variety of ways that governmental action can be deployed to circumscribe voluntarism, most of which have considerable relevance to Chile’s pension fund management industry during the period of our analysis.

The first is *compulsory cartelisation*, where the state imposes regulations that require industry incumbents to act in unison with regard to some aspect of pricing, eliminating or substantially curtailing the possibility of price flexibility and differentiation. Evidence of significant variation in management fees and commissions throughout our period of analysis suggests that this method of circumscribing price competition on behalf of corporate elites was not deployed in the Chilean context. In 2005 for example, the combined fee (fixed and variable fees together) imposed by each of Chile’s fund managers ranged from US$182 per annum for AFP Santa Maria to US$234 for AFP Bansander, generating a difference of US$52, suggesting that the authorities did not impose “any controls on the level of fee or commission, relying on competition (and presumably the threat of future regulation) for putting a lid on them” (Tapia & Yermo, 2008, p. 71). But did the Chilean state really rely on market competition to regulate prices?

The second means of circumscribing voluntarism is the deployment of *statutory measures to facilitate industrial concentration*, insulating supply-side actors from market forces, and enabling them to impose excessive prices—individual firms in an oligopoly industry can “determine their price very much as would a single monopoly firm. The resulting price surcharge passed on to the consumer is [...] significant” (Carson, 2007, p. 228). The evidence of substantial concentration in Chile’s pension fund management industry is compelling (Hyde, 2014). At the start of our period of analysis there were 11 AFPs owned largely by domestic corporate elites, but with some labour union ownership (with the three largest accounting for 75 percent of assets under management); but by the end of our period of analysis in 2008, there were just 5 AFPs owned wholly by multi-national financial institutions (with the three largest accounting for 78 percent). For classical liberalism, the apparent dominance of large firms at any point in time is not in itself problematic, for freedom of entry to the market exposes incumbents to the possibility of competition (Friedman, 1962). It turns out that the most serious monopoly abuses are those that manifest through state monopoly, primarily because government has the power and authority to make competition illegal. Across a range of national jurisdictions, the most prevalent form of state monopoly is not *direct state monopoly*, but *state monopoly in private hands*—that is, private monopolies created or fostered by statutory ordinances or regulatory requirements which have eliminated or substantially curtailed market competition—such as Chile's restrictions around market entry, including state licensing and capitalisation requirements (Hyde, 2014).[2]

The evidence of cross-national comparative research supports the argument that state-imposed industrial concentration has curtailed price competition among Chile's pension fund managers. In Table 1 for example, we have ranked nine Latin American DC pension arrangements in terms of the level of management fee. This seems to suggest that the relationship between industrial concentration and charging can manifest in two distinctive ways—the juxtaposition of high concentration and high fees, as would be anticipated by classical liberal critics of state capitalism; or the juxtaposition of high concentration and low fees, reflecting perhaps the realisation of significant economies of scale. When we control for the presence of statutory limits on management fees (column 6) however, this second relationship becomes far less significant. Crucially, we should note that Chile's pension fund management industry has one of the highest levels of industrial concentration, and is ranked third in terms of the level of fee, giving a degree of credibility to the argument that excessive market power curtails price competition.

The third means by which the state can seek to diminish voluntariness is by imposing charging arrangements that permit, even encourage, *insufficient transparency*. For classical liberal scholars of economic affairs, consumer sovereignty rests pivotally on informed choice—the availability of accurate and sufficient information enables consumers to compare prices and choose the best deal, incentivising price competition (Friedman, 1962). But in the highly regulated market of Chile's pension fund management industry, the *means of imposing charges* has curtailed such transparency substantially. Because the fixed monthly charge has been deducted directly from the accumulated balance of each account, plan participants didn't have a clear perception of its value, or any associated losses or benefits. Moreover, we should acknowledge that the variable charge was deducted directly from monthly earnings by employers who transferred it directly to the relevant fund manager. Since "workers usually compare only net (after tax and social security contributions) wages, they do not see clearly the differences in prices between AFPs". Insufficient transparency has been accentuated by the high cost of acquiring information around charges "when compared with the seemingly immaterial differences in monthly charges" (Acuña & Iglesias, 2001, p. 45).

Table 1. Pension fund management industry concentration and charges in Latin America, 2007

Country	Year[1]	Percent of Contribution[2]	Percent of assets[3]	Number of providers[4]	Cap on fees?[4]
Argentina	1994	17.8	1.5	11	*
Peru	1991	15.3	1.0	4	
Chile	1981	14.6	0.7	6	
Uruguay	1996	12.8	0.9	4	
Columbia	1994	12.6	2.0	6	*
El Salvador	1998	12.3	1.4	2	*
Mexico	1992	12.0	1.6	21	
Costa Rica	2000	6.7	2.1	8	*
Bolivia	1997	4.8	0.5	2	*

[1] Year in which the scheme was introduced. See Hyde *et al*., 2006.
[2] Source: Kritzer, 2008.
[3] Source: Tapia & Yermo, 2008.
[4] Source: Hyde *et al*., 2006.

The argument that Chile's fund management charging structure has lacked sufficient transparency during the period of our analysis is given added impetus by attitudinal research which highlights two aspects of diminutive awareness among plan participants. First, it is clear that the complexity of charging in the second pillar has been poorly understood. According to one analysis of their retirement decision making, more than 96 percent of active contributors did not know that fund managers were able to impose fees as a percentage of earnings, even though this has been the principal management charge (Martinez & Sahm, 2005). Second and by extension, awareness of the level of charging has been diminutive. According to the findings of a longitudinal study (Arenas de Mesa *et al*., 2006), fewer than 2 percent of active contributors knew either the fixed or variable commissions that had been imposed on them in any year. This lack of transparency would in turn suggest that consumer sovereignty in Chile's second pillar pension arrangement has been negligible.

The fourth means by which the state can diminish voluntariness is by imposing measures that *impede flexibility* in the adjustment of prices to changing market conditions. For classical liberals, the absence of possibilities for such flexibility makes it impossible for supply-side actors to respond appropriately to variation in sovereign consumer preferences, and results in the imposition of a degree of uniformity. In Chile, the freedom of pension fund managers with regard to charging has been ambivalent. On the one hand, it has been argued that such liberty has been substantial (Rodriguez, 1999), since each AFP was given considerable discretion around the standard charge for its members. On the other hand, this freedom was circumscribed by the requirement for each fund manager to apply the management charge uniformly to its affiliates, diminishing the possibility of flexible responses to variation in sovereign consumer preferences, as well as resulting in excessive charging for particular affiliates. One way that such flexibility has manifested elsewhere for example is where consumers have been able to negotiate lower prices by agreeing to membership contracts with a minimum duration, giving a degree of security to producers and cost savings on the demand-side. In the Chilean context, this could also be regarded as a fairer approach to charging since the imposition of a uniform percentage charge means that higher income workers are forced to pay more for what is essentially the same service. Furthermore, the requirement for uniformity in charging gives each fund manager the incentive to pursue economic rents by targeting affluent workers, since those with the highest wages offer a greater contribution density, and a bigger potential financial margin (Acuña & Iglesias, 2001). Alternatively, such flexibility could manifest as the opportunity for plan participants to negotiate lower fees on the basis of maintaining a designated account balance. The imposition of a uniform charge during the period of our analysis eliminated the possibility of such flexibility, suggesting a lack of responsiveness to consumer preferences, and it should not be surprising to learn that pricing has not figured prominently among the concerns that have influenced consumer decision making around affiliation (Martinez & Sahm, 2005).

Rather than allowing management charges to be determined voluntarily by each AFP in response to market forces then, the Chilean state imposed measures that served to impede price completion.

Performance

Ultimately, plan participants in a DC pension arrangement pay fund managers to take action to augment their retirement assets during the accumulation phase by generating investment-driven increments in value. Although pension fund managers may be responsible for a variety of related administrative tasks, their core service is the investment strategies that they are able to deploy on behalf of their affiliates. Naturally, plan participants can have a legitimate expectation of performance, manifesting as a consistent record of positive realised investment returns.

Again, our consideration of the free market model in the previous section would suggest that voluntary decision making around the characteristics of goods and services is the single most important element of their production, where this is consistent with the principles of classical liberalism. In this respect, voluntarism can be expected to deliver at least three benefits.

- *Individual sovereignty*. Voluntarism facilitates the realisation of sovereign life-plans by giving people the opportunity to exercise meaningful choice regarding the characteristics of the goods and services that they depend on, particularly aspects of quality. The imposition of product standards and regulations by the state curtails such choice, and thus impedes sovereignty (Shapiro, 2010).
- *Economic welfare*. Voluntarism facilitates competitive effort on the supply-side of the market as producers take action to sustain their market shares, and this incentivises the production and distribution of better quality goods and services. Paradoxically, the imposition of statutory quality or safety standards eliminates or impairs the market competition that drives performance (Friedman, 1962).
- *Proportional remuneration*. Voluntarism minimises the possibility of

economic predation by reducing the prevalence of inferior goods and services, ensuring that performance is proportional to reward. State action to regulate product competition insulates supply-side actors from market forces, enabling economic predation through sub-optimal performance (Carson, 2007).

This endorsement of voluntary exchange would suggest that performance in a pension fund management industry that is consistent with the core principles of classical liberalism would have three salient characteristics.

- *Differentiation*. Again, differentiation is the essence of market competition, and we should anticipate evidence of variation in the investment strategies of pension fund managers in a competitive industry. At the very least, this should manifest as differentials in the investment portfolios of each fund manager.
- *Transparency*. The model of consumer sovereignty that is endorsed by classical liberal economics presumes that consumers are able to compare producers in terms of their performance, suggesting that we should expect to find evidence of sufficient transparency around investment strategies and returns in a competitive pension fund management industry.
- *Flexibility*. In a competitive pension fund management industry, we should anticipate evidence that incumbent firms are able to exercise considerable discretionary control around their own investment strategies.

In contrast, classical liberal critics of state capitalism have highlighted a variety of means that can be deployed by the state to limit voluntarism around performance, each of which has considerable relevance to Chile's pension fund management industry.

The first is *compulsory cartelisation*, where the state imposes a degree of uniformity around the characteristics of goods or services. If the state can get producers to act in unison with regard to aspects of quality, it will have succeeded in insulating them against market forces, facilitating the pursuit of economic predation through sub-optimal performance (Carson, 2007). The evidence around pension design suggests that this was approached in the Chilean context in two distinctive ways. Statutory restrictions around asset allocation imposed significant quantitative limits on investment in designated financial instruments, and issuers of instruments. At the start of the system, the AFPs were required to invest *all* assets in fixed income securities, giving plan participants a degree of security, but ensuring lower investment returns. As the system evolved and matured, these restrictions were relaxed to the extent that investment in a wide range of financial instruments became permissible; which means of course that the relevance of such restrictions to any explanation of diminutive market competition has become less salient.

Of much greater importance for our analysis here is the statutory imposition of minimum product specifications such as basic safety requirements or quality standards. While they permit diversity in the productive efforts of supply-side actors, classical liberals believe that such restrictions generate uniformity around the state-defined minimum, which becomes the *de facto* industry norm. Carson’s seminal work on compulsory cartelisation (2007, 2008) explains this reaction to state-imposed minima in terms of motivational contingencies such as the fear of competition, and peer pressure, for industry incumbents “take a harsh view of competitors that exceed regulatory safety or quality requirements[…]Exceeding government safety standards, it seems, unfairly implies that products which merely meet the ordinary[…]standard are less than adequate” (2008, p. 81). This approach was instantiated in Chile’s second pillar pension in the form of the Minimum Return Guarantee, which required fund managers to realise investment returns that were equivalent to the industry average. Under this arrangement, each AFP had to maintain designated financial reserves which could be deployed in the event of a shortfall of returns. The 1981 reform gave the statutory supervisory authority, the *Superintendencia de Administradoras de Fondos de Pensiones* (SAFP), the power to liquidate any fund manager failing to meet this obligation, and to transfer its assets to another AFP.

The empirical evidence around trading in financial markets suggests that these measures have helped to generate substantial uniformity in investment decision making, manifesting principally as correlated trading, or *herding*. A 1998 study of asset allocation in the industry found evidence of remarkable similarity in the investments of the nine existing AFPs; for example, a range of 36 to 45 percent (of all invested assets) for government bonds, 31 to 42 percent for corporate bonds, and 1 to 6 percent for foreign fixed income securities (Rodriguez, 1999). More recently, Olivares (2005) found convincing evidence of regulatory-induced herding in Chile’s pension fund management industry (between 1997 and 2001), manifesting in a variety of ways; for example, the three largest AFPs tended to mimic each other; investment by medium-sized and small AFPs tracked the largest fund managers; and 85 percent of investments were held in the thirty largest stocks. An SAFP survey suggests that herding even extends to the duration of investments; for example, a range of 4,320 to 4,700 days for general treasury bonds, 2,004 to 2,393 days for Central Bank of Chile securities, and 13 to 99 days for negotiable instruments (Júaregui, 2010).

Again, a second means of circumscribing voluntarism is the deployment of *statutory measures to facilitate industrial concentration*, conferring substantial market shares and power, and enabling supply-side actors to generate economic rents through sub-optimal performance. As we have suggested, the 1981 reform instituted a series of compelling barriers to market entry and sustainable industry participation, resulting in very substantial industrial concentration. In addition, we should note that the authority to execute the range of pension fund management responsibilities, including asset management and allocation, was further circumscribed by the “single corporate purpose” requirement—the AFPs can “only do what the pension law allows them to do and no one who is not an AFP is allowed to offer what the law assigns exclusively to these entities” (Acuna & Iglesias, 2001, p. 44), ruling out the possibility of achieving economies of scope through horizontal integration with other financial services industry actors.

If the intent of measures to facilitate pension fund management industry concentration was to circumscribe market competition around investment performance, the evidence of a range of empirical studies suggests that they have been enormously successful. We can better illustrate the negative impact of concentration for investment decision making by distinguishing three phases in the development of the industry; the *stability* phase (1981-1990), the period of the military dictatorship in which the number of fund manager was stable, oscillating between 12 and 14; the *expansion* phase (1990-1994), where the number of AFPs grew dramatically, peaking at 22; and the *consolidation* phase (1995-2008), a period of intense concentration with the number of fund managers eventually falling to 5.

The recent work of Chilean economists on the pension fund management industry has illustrated the negative impact of industrial concentration for competition around investment performance in a variety of ways. Olivares and Sepulveda (2007) for example have evaluated the significance of trends in asset allocation as Chile's pension fund management industry became more concentrated during the "consolidation" phase (Olivares & Sepúlveda, 2007). As well as giving AFP affiliates a degree of choice around the investment of their own assets, a core concern of the 2002 multi-fund arrangement (see below) was to generate greater portfolio differentiation across the fund managers by making it more difficult for them to mimic each other. Olivares and Sepúlveda (2007) sought to determine the impact of this initiative by comparing investment decision making before and after its introduction,[3] and found evidence that herding among Chile's fund managers became even more prevalent. While before "the change, 80 percent of asset allocation corresponded to herding among the PFAs [the fund managers], after the change it increased to 86 percent. Thus, the creation of more funds did not decrease herding but the contrary" (2007, p. 2), reflecting the powerful effect of growing concentration in Chile's pension fund management industry during the "consolidation" phase. It seems clear then that the concentration of Chile's pension fund management industry during the latter part of our period of analysis has induced sub-optimal investment performance.

A third means of circumscribing voluntarism involves the statutory imposition of *captive markets*, where people are forced to consume designated goods or services in ways that are not of their choosing, and which may prove to be disadvantageous. To the extent that the state can standardise the experience of consumption it will have succeeded in eliminating competition, and this will facilitate the pursuit of economic rents through sub-optimal performance (Carson, 2008). Of particular importance in the Chilean context has been the prohibition of plan participant-involvement in investment decision making, which always has the potential to generate portfolio diversification. Classical liberal scholars of economic affairs insist that this should be a matter for scheme members and any agents they contract to manage their savings; whereas the Chilean state gave itself the right to take these decisions on behalf of plan participants. For the first twenty-one years of Chile's second pillar pension arrangement, AFP affiliates were excluded entirely from investment decision making, which was executed by the fund managers in accordance with statutory requirements around asset allocation. Even after the multi-fund arrangement was introduced in 2002, affiliate involvement in investment decision making was tightly circumscribed, relative to mandatory DC pensions in other national jurisdictions. In Chile, plan participants were permitted only to select two out of a range of five investment options with different risk-return profiles, with further restrictions imposed on retirees and workers close to retirement, whose choices were limited to low-risk options. Plan participants in the Chilean second pillar were not permitted to divide their savings between different fund managers, as they would have been in a free market. This contrasts with mandated DC pensions elsewhere, such as the Swedish Premium Pension, or Australia's Superannuation scheme, which facilitate choice from a wide range of options.

Rather than allowing investment strategies and asset allocation to be determined voluntarily by each pension fund manager then, the Chilean state imposed measures that curtailed competition around performance.

Pension fund management as economic predation?

Returning to the principal concern of this article, it is clear that the design and operation of the Chilean second pillar during the period of our analysis have been shaped substantially by public action rather than market forces and, consequently, have not been consistent with the core principles of classical liberalism. This would come as little surprise to classical liberal critics of state capitalism, who maintain that the defining rationale of state intrusion in economic affairs is the elimination of competition, conferring market privileges on preferred corporate agents which enable them to pursue economic remuneration through rent-seeking, rather than productive effort. Our evaluation suggests that this has manifested in Chile in two specific ways.

Classical liberal critics of state capitalism have highlighted the role of the public authority in enabling business agents to generate economic rents by imposing monopoly prices, or prices that exceed the value of their contribution to the production of goods and services. It would be fair to say that there has been widespread concern about the level of charging for pension fund management in Chile since 1981, which has been fairly substantial. Although fees and commissions fell consistently across the period of our analysis to about 2.5 percent of earnings (Fajnzylber, 2010), this represented a quarter of all contributions to the system. But however large Chilean pension fund management fees might appear to be, can we think of them as *excessive* in the sense that would be implied by the classical liberal critique of state capitalism?

One way of addressing this is to compare management charges in Chile's second pillar with those of other financial services and institutions. As suggested earlier, Chile has had the third highest level of charging for pension fund management among the mandatory DC pension schemes of Latin America (see Table 1). Other scholars of Chilean social security have concurred with our analysis. Valdés (1995) for example compares management charges in ten DC pension arrangements, and concludes that Chile belongs to the group of "expensive" countries—like us, he finds that it has been the third most expensive. In a more recent analysis, Valdés and Bateman (1999) compare management charges in the mandated DC pensions of Australia and Chile, and find that the latter has been up to 60 percent higher. They estimate that Australian plan participants have paid 30 percent less in management charges over the entire accumulation period. Similar findings can be generated if we broaden our analysis to include other types of financial institution. According to a prominent authority on Chile's multi-pillar retirement system, AFP management charges have been up to two-thirds higher than the fees imposed by the country's banks for administering savings and on-time accounts (Borzutzky, 2006). For the period 1997 to 1998, Valdés and Bateman (1999) show that AFP charges were up to 67 percent higher than fees for the management of savings accounts, and professional asset management services elsewhere in the financial sector, which were less exposed to intrusive state regulation. This evidence gives some credibility to the belief that Chilean pension fund management charges during the period of our analysis were "excessive", and to wider arguments concerning the role of the state in facilitating the imposition of monopoly prices.

Similarly, classical liberal critics of state capitalism have highlighted the role of the state in imposing regulatory requirements that enable rent-seeking through sub-optimal performance in the production and distribution of goods and services (Carson, 2007). Even though they have been higher than fees in comparable financial services and institutions, Chile's second pillar management charges could have been deemed justifiable if it could be demonstrated that plan participants were able to benefit from superior investment returns by paying more. Scholars of Chilean social security who endorse the multi-pillar retirement system have not been slow to highlight the impressive investment returns that have been generated by AFP involvement in asset allocation. For one survey of Chile's fund managers, the average investment return for the period 1981 to 2000 was 11 percent, 3.8 percent higher than the average interest rate for bank deposits (Acuña & Iglesias, 2001). Nevertheless, there is substantial evidence to suggest that the investment performance of Chile’s fund managers has been sub-optimal, falling short of the returns that would be necessary to justify their considerable income streams. In this respect, we should recall that the ostensible purpose of management charges is to render payment for the service of generating investment-driven increments to the value of retirement assets, which means that it is returns to plan participants that ultimately count. Much of the evidence around net returns—which are a function of investment returns and management charges—suggests that the performance of the AFPs during the first two decades of the “private” system was rather less impressive. When returns are estimated in this way, they are “more than halved from what has been reported by the AFPs and conservative pundits” (Leiva, 2006, p. 7). According to one authoritative study (Acuña & Iglesias, 2001), the AFPs generated an average net return of 5.1 percent during the first two decades; while Kay (2003) estimates average net returns of 0.3 percent for the period 1982 to 1986, and 2.1 for 1991 to 1995. We should also note that the fixed element of the management charge has had a regressive impact, resulting in returns for low income workers that have been less than average. Even during the good times of the first two decades then, there is evidence that might lead us to question the assertion that high management charges were grounded in superior investment returns.

In large measure this reflects the substantial recomposition of Chile’s pension fund management industry during the latter part of our period of analysis. As reported earlier, its remarkable and sustained concentration has eroded market competition, accentuating the tendency towards correlated trading. Not surprisingly there is evidence to suggest that regulatory-induced herding has impacted negatively on performance, generating a downward trend in realised investment returns. Looking only at the six largest AFPs, the evidence highlights an inverse relationship between the degree of concentration in the pension fund management industry and its investment performance. During the “expansion” phase when the number of industry incumbents grew substantially, monthly investment returns for all six fund managers ranged between -1.8 and 8.6 percent, and negative returns were uncommon (thus a period marked by *more fund managers and better returns*); during the earlier part of the “consolidation” phase (1995-2000) when concentration was starting to become more salient, investment returns ranged between -6.4 and 6.6

percent and negative returns were common (*growing concentration, diminishing returns*); but during the latter part of the "consolidation" phase (2001-2004) when industry concentration was most prominent, investment returns ranged between -1.6 and 2.5 percent, and the incidence of negative returns was high (*high concentration, low returns*) (Fajnzylber, 2010). Our analysis here is echoed by the findings of Olivare's examination of the average monthly returns of all fund managers for the period 1997 to 2001 (2005).

The evidence of policy design and outcomes reviewed in this section suggests that the classical liberal critique of state capitalism has considerable relevance to an adequate understanding of Chile's mandatory DC pension arrangement, particularly its assertion that governmental intrusion in economic affairs is ultimately intended to facilitate a particular form of market privilege rent-seeking; that is, economic predation through the exchange process. This has been made possible by the distinctive nature of the exchange relationship in Chile's pension fund management industry, which differs fundamentally from exchange in the free market. In the latter, individuals are free to consume products of their choice in quantities and from suppliers of their choosing, and this compels responsiveness to consumer preferences, reducing the possibility of economic predation through exchange. But in Chile's pension fund management industry, individuals are forced to consume a designated and tightly defined product from a small number of state-appointed suppliers who were given both the incentive and power to prioritise the "political" over the "economic" means, by taking action to pursue economic rents.

Conclusion

In view of this evidence of policy design and outcomes then, the assertion that the architects of Chile's multi-pillar retirement system created a "private" pension arrangement that was compatible with the core principles of classical liberalism is looking highly questionable. In reality, there are many stark points of contrast between its design and these tenets, particularly the classical liberal emphasis on the *primacy of liberty*. But if Chile's "private" pension arrangement during our period of analysis cannot be regarded as a particular instantiation of classical liberal principles, how is it best described?

According to one authoritative historian of economic affairs, the deployment of state power to augment the wealth, power, and authority of corporate elites is not characteristic of *laissez faire*, neither did it emerge during the "neoliberal" era of the late 20th century. Rather, the growing prominence of *conservative* economic policy and regulation on behalf of corporate elites can be traced back to the very early 20th century when large business enterprises were confronted by smaller and more efficient firms in intensely competitive markets. Characteristically, corporate elites responded to this challenge not by rationalising productive effort in order become more competitive, but by seeking preferential treatment from the state in the form of market privileges and subsidies. These early statutory measures laid the foundations for the institutionalisation of a very distinctive but prevalent form of capitalism, as acknowledged by scholars at different points across the ideological spectrum. For Kolkos' "new left" critique of private wealth and power (1963), *political capitalism* involved the "utilisation of political outlets to attain conditions of stability, predictability and security—to attain rationalisation—in the economy" (p. 3). According to a prominent critic of capitalist globalisation (Klein, 2007), *corporatism* is given expression by the institutionalisation of an alliance between political and economic elites to augment and sustain their respective shares of national wealth (Klein, 2007). And for a prominent exponent of *laissez faire* (Carson, 2007), *state capitalism* manifests as the "movement of large-scale organised capital to obtain its profits through state intervention" (Carson, 2007, p. 208). The salient theme that links these diverse contributions is the notion that state action is purposively deployed on behalf of big business to facilitate economic predation. Although the literature around welfare reform and retrenchment sometimes conflates the two, conservatism and classical liberalism diverge in fundamental ways. A awareness of these differences helps us to understand the distinctiveness of the Chilean approach to "privatisation", as opposed to that of classical liberalism.

The conservative commitment to *liberty* is subordinate to its collectivist emphasis on maintaining a hierarchical social order in which the wealth, power and authority of ruling elites takes priority (Hayes, 1994). It is thus not surprising that the conservative critique of state coercion has been highly selective, emphasising those elements of public action that offer benefits to the least advantaged, such as social security benefits, public services, and health and safety regulations. This is clear from a close inspection of economic and social policy during the first decade of the

Pinochet dictatorship which retrenched social programmes substantially, while extending public support to groups favoured by the regime. While facilitating the freedom of business enterprises from coercively imposed obligations such as the requirement to contribute to their employees' retirement, for example, the Chilean state increased the obligations of tax-payers to finance corporate benefits such as a series of highly subsidised privatisations, and the market privileges of supply-side actors in the second pillar pension arrangement. It is highly symptomatic of this arbitrary approach to the pursuit of liberty that the Chilean state allowed those charged with the responsibility of physically upholding state capitalism, the police and the military, to retain their highly subsidised public pensions, while forcing all other workers to affiliate to a DC pension in the second pillar. Where the conservative approach to liberty is pragmatic, classical liberals insist that *laissez faire* should be applied consistently.

The conservative commitment to the *market* is also very distinctive, endorsing individualism and competition to the extent that both can be a source of the wealth, power and authority of corporate elites; and thus subordinating the market to the goal of sustaining a hierarchical social order. This means ultimately that conservatism adopts a “pragmatic attitude towards the economy, realising that compromise and concession may have to be made to maintain social order” (Hayes, 1994, p. 21). Perhaps reflecting such flexibility, a notable feature of conservative political engagement has been its willingness to countenance and pursue alliances with classical liberals where this has proved to be compatible with its core mission. Historians of Chile's military dictatorship have argued that its adoption of Friedmanite utilitarianism represented such a marriage of convenience. Intent on eliminating all vestiges of “socialism” from society, yet unwilling to return to democracy, Pinochet's military coup was a political project in search of an economic platform. This was supplied by the “Chicago boys”—economists of the Catholic University of Chile—and classical liberal luminaries such as Friedman and Hayek, who were in regular contact with the regime, offering moral support and policy guidance. For the first decade of the military dictatorship, Friedmanite utilitarianism performed a vital role in helping Pinochet to realise his conservative mission, providing a convenient explanation of the country's economic misfortunes, and furnishing a set of policy prescriptions that would bolster the wealth, power and authority of corporate elites. The Friedmanite influence waned after the early 1980s, but the conservative institutions that it had helped to create remained intact thereafter. Our point here then is that the mere presence of classical liberal ideas in policy discourses, and classical liberal ideologues in the policy process, are not sufficient to indicate a classical liberal reform project.

It should be clear then that conservatives and classical liberals differ fundamentally with regard the appropriate role of *the state*. For the latter, the public authority exists *only* to protect the liberty of all citizens, principally by exercising coercive powers that are sufficient to rectify violations of individual rights—by for example operating a criminal justice system and military defence.[4] In contrast, conservatives embrace a pragmatic approach to the scope of state action, which can include any and all measures it deems necessary to pursue its core mission—the maintenance of hierarchical social order (Hayes, 1994). It is clear from our own analysis, and that of other scholars in the field (Borzutzky, 2006), that state intrusion during the period of our analysis exceeded the night-watchman role envisaged by classical liberals substantially. Rather than embracing the classical liberal notions of autonomy and self-rule that are implicit in *laissez faire*, Pinochet endorsed the idea of autocratic rule by an authoritarian state, reflecting an obsession with power and strength, and driven by a vision of leading the country like it was a regiment. In practice, he gave himself and the regime he headed absolute political power, reflecting deeply entrenched conservative instincts regarding the importance of deference to authority. Although the return to democracy eliminated the more repressive attributes of the state, its conservative role in distributing privileges to corporate elites and other preferred groups continued unabated. In this regard, we should acknowledge that Chile's private pension reform has been compatible with the country's long-standing and deeply-entrenched conservative tradition of "patrimonial statism". Like "many other Latin American nations, the state has long used social programmes to extend political patronage and reward to loyal constituencies. Its continued involvement in social security in the context of marketisation reflects these traditions" (Midgley & Tang, 2001, p. 79).

Far from being a classical liberal reform project aimed at facilitating individual rights and sovereignty then, Chile's private pension reform aimed to distribute power, wealth and authority to its core constituents, corporate elites. It was, in all essentials, a conservative reform project.

Notes

[1] The Chilean retirement system during our period of analysis was comprised of two pillars, the privately-administered second pillar which is the subject of the present study; and the first pillar retirement income safety-net, administered by the state. The first pillar safety-net rested on two income transfer programmes: the means-tested social assistance safety-net for those not covered by the private pension arrangement; and the minimum pension guarantee, for plan participants in the private arrangement with benefits that fell below a state-defined poverty threshold.

[2] Such barriers manifested substantially in Chile's "private pension arrangement as a system of state licensing, restrictions relating to organizational scale such as a minimum "net worth" requirement, and of course, capitalization requirements.

[3] The two periods for which asset allocation was compared were 1997-2001, and 2002-2005.

[4] Indeed, many classical liberals reject the state entirely, arguing that it is a criminal enterprise engaged in acts of extortion, and insisting that "public" functions can be performed satisfactorily in the private sector (Rothbard, 2002; Carson, 2007).

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