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The argentinean pension system: prior and after Reform*

ANGELIKA BUCERIUS**

I. INTRODUCTION

In July 1994, Argentina implemented a new pension system, which was legislated in October 1993. Argentina is the first Latin American developing country, which implemented a systemic pension reform¹ not by authoritarian rule - like in Chile 1981 - but through a democratic process (Vittas, 1997, p. 1). Argentina transformed its former pay-as-you-go (PAYG) pension scheme into a mixed public-private system comprising a PAYG uniform basic pension

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¹ According to Katharina Müller a "substantial paradigm shift in old age security" qualifies for the term "systemic pension reform". This was the case in Argentina when the government introduced a mandatory private old-age provision layer in order to downsize the public pension layer and to strengthen individual responsibility of the insured (Müller 2002b, p.1).

² Contrary to other sources, the notion "layer" is used instead of "pillar", as "layer" is more apt to describe the composition of the social security scheme. Social security schemes normally consist of different layers, some of them are fixed (compulsory), some of them are variable (voluntary). Pillars may have different heights (per cent of contributions going to the different layers), implying that the whole social security system is rather out of balance – even if this is actually not the case.

as its first layer² and the choice of either an additional private or an additional public second layer. The private alternative is based on individual fully funded (IFF) pension accounts managed mainly by private fund administrators. The public alternative is financed on a PAYG basis and organized by the state.

First, the new pension system will be portrayed (Section II). The next step is to describe the economic and political background of pension reform (Section III). This is an important basis for the reasons for reform. However, as Section 4 demonstrates, economic problems are not the only reason for reform in Argentina. Thus, there will be a brief summary of the most problematic features of the old pension scheme (Section IV.1.). It goes to show that structural deficits of the old pension system were one major cause for the financial disequilibrium of the old age security system. Secondly, the most crucial economic - and wherever necessary the political - framework prior to reform will be analyzed (Section IV.2.). The last part of this chapter contains demographic projections until 2050. As pension schemes are created to provide financial security for the retired, Section V gives attention to the situation of the pensioners before and after reform. Following this, the development and current condition of the public and the private pension schemes will be described (Section VI). Finally, I will sum up my findings (Section VII).

II. THE 1994 PENSION REFORM AND ITS MAIN FEATURES³

The new Argentine pension system SIJP (Sistema Integrado de Jubilaciones y Pensiones) was legislated in October 1993 and began operating in June 1994 (Law 24241). The new Argentine system is a mixture of the old government-administered PAYG-system and an individual funded or unfunded retirement account

³ This section is based on Hujo (2001), Queisser (1998) and Vittas (1997).

program. All public programs are organized and supervised by the National Social Security Administration (ANSES - Administración Nacional de Seguridad Social). Private pension funds are administered by private or public Retirement and Pension Fund Administrators (AFJPs - Administradoras de Fondos de Jubilaciones y Pensiones). The two layers are intertwined.

II.1. The first layer: The social security scheme

a. Universal Old-age Pensions (PBU)

The first layer remains purely public. It comprises several different parts for special purposes. First, there is the Universal Old-age Pensions (PBU - Prestación Básica Universal) which covers almost every employed persons⁴. It is financed on a pay-as-you-go basis. PBU is a defined benefit scheme and provides a basic pension for all insured who reach retirement age (60 years for females and 65 years for males) and who have contributed for at least 30 years to either the old system, the new system or a combination of the two.

These two factors are the main difference to the old system, which allowed women to retire with 55 years and men with 60 years. Prior to 1994, just 15 years of contribution were required for a full pension. By increasing this eligibility criteria, reformers intended to reduce evasion. Thus, people are required to contribute for at least 30 years to receive a public pension. However, if this prerequisite is strictly implemented, people who do not meet the requirements may fall into poverty. This criteria, conversely, might have the opposite effect of its very intention: namely, that people are discouraged to pay their contribution to the pension scheme at

⁴ Not included are employees of the Armed Forces, the Foreign Ministry, the Legislative Branch as well as the Judiciary Security personnel.

all, if the people doubt to be able to contribute for such a long period.

PBU is financed by a 16 per cent contribution rate on the worker's salary. It is exclusively levied on employers⁵. To cover negative differences between contributions to PBU and expenditures, the states transfers earmarked taxes and general revenues to the social security budget. The replacement rate offered by PBU is supposed to be around 30 per cent. Until 1997, PBU offered 2.5 times of AMPO (Aporte Medio Previsional Obligatorio)⁶. Yet, since 1997 the flat benefit amounts to 2.5 times of MOPRE (Modulo Previsional)⁷. By means of MOPRE, the government annually decides on the amount of retirement payments on the basis of the budgetary plans. For example, at the end of 1997 one MOPRE amounted to 80 US-Dollar. As this unit is multiplied by 2.5, pensioners could receive 200 US-Dollar monthly payment from PBU. Yet, by substituting AMPO with MOPRE, a discretionary element was introduced into the public pension scheme (Hujó, 2001).

b. Compensatory Payment (PC - Prestación Compensatoria)

Secondly, the state provides for a Compensatory Payment (PC) within the first layer. It obliges the government to provide benefits to people who contributed to the old scheme. The compensatory pension amounts to 1.5 per cent of the average indexed wage of the last ten years of employment before retirement. Eligible for a compensatory payment are those who are entitled for a basic pension (PBU). Compensatory Payments are financed out of current contributions and budgetary transfers. There are special

⁵ The employer's contribution rate is independent from the employee's decision whether he participates in the private or public scheme of the second layer.

⁶ AMPO related to the contributions assessed on employees and was set two times each year by dividing total contributions by the number of active contributors. Therefore, by means of AMPO, pension benefits were linked to average wage, however with a time lag of six month (Vittas, 1997, p. 44).

⁷ MOPRE was introduced in 1997 by decree 833/97 as a unit to calculate retirement benefits.

earmarked taxes to fund public transfers. From the governments's perspective the positive feature of this scheme is its "cashflow advantage" in comparison to Chile's recognition bonds (Vittas, 1997, p. 33⁸).

When a new economic crisis set in again in Argentina in the late 1990s, this design might have been rather fortunate for the government, as the state was already struggling to pay pensions. However, it is too early to make a final judgement on whether compensatory pensions or recognition bonds are better suited for both the financial situation of the state budget and the pensioners. The fiscal consequences of these alternative methods are up to future demographic trends⁹. For example, if longevity will rise considerably - as it is predicted in the case of Argentina - the costs of compensatory pensions are likely to increase. Another drawback of the Argentinean alternative is that there is no clear break with the past pension system, like in Chile. Hence, old pension claims have to be paid much longer after the reform in Argentina (Vittas, 1997, p. 34).

c. Old System Pensions (OSP)

Thirdly, the government provides Old System Pensions (OSP) to existing beneficiaries. The main problem of OSP is that it transfers the problems of the old system to the reformed system.

d. Advanced Age Pensions (PEA)

Additionally so-called Advanced Age Pensions (PEA - *Pres-tación por edad avanzada*) are granted to people over 70 years

⁸ In Chile, the total capital sum that workers had accumulated until reform is paid on retirement. By contrast, in Argentina the payment is distributed over time. Therefore, the compensation of earlier pension claims takes place gradually. To most observers this had been a sensible choice, as "[t]his mechanism reflects Argentina's limited capacity for additional debt" (Queisser, 1998, p. 16)

⁹ Additionally, it may well be that there is no first best option. Like social security systems in general, some designs may work very well in one country but may fail in another due to different economic, social and political circumstances.

who do not meet the eligibility criteria if they have contributed for at least 10 years to the pension scheme. PEA was created in order to prevent the very old people from becoming poor, if they cannot expect to receive a pension by right.

II.2. The second layer

Every worker is free to choose whether she wants to join the funded, privatized module or the unfunded public module of the second layer. All workers must contribute 11 per cent of their salary independently of their choice of either the funded or the unfunded system. The public alternative is financed on a pay-as-you-go basis. In the case of the individually fully funded (IFF) alternative, the contribution rate is split. 3.5 per cent of the salary is deducted to cover administration fees and also an insurance premiums for disability and survivorship. The remaining 7.5 per cent of contribution are capitalised on individual pension accounts¹⁰.

a. Public alternative: a Payment for Additional Permanence (PAP)

The state provides a Additional Payment for Permanence (PAP - *Prestación Adicional por Permanencia*) for workers who prefer to remain under the unfunded system. PAP is a defined benefit scheme financed on a pay-as-you-go basis. It offers 0.85 per cent of the average indexed salary of the last 10 years of employment for every service year under the new system. The maximum replacement rate can be attained after 35 service years and amounts to 29.75 per cent of average wage.

¹⁰ In Argentina, collections of all contributions are centralized and handled by the General Tax Service (DGI). The very intention of the centralization was to combat evasion and to contain costs of contribution collection. Yet, this goal has yet not been met, as the rate of evasion remains high (see Section VI).

b. Private alternative: Ordinary Pension (JO)

The funded alternative is the so-called Ordinary Pension (JO - Jubilación Ordinaria) which is administered by Pension Fund Administrators (AFJP - Administradoras de fondos de Jubilaciones y Pensiones). The main difference to the public second layer is that it is an individually fully-funded (IFF) defined-contribution scheme. As soon as an affiliate reaches retirement age, old-age pensions are calculated on a strict actuarial basis¹¹.

III. THE ECONOMIC AND POLITICAL BACKGROUND

Pension reform in Argentina was primarily motivated by short-term considerations. The fiscal deficit was alarmingly high due to macroeconomic turbulences and structural problems of the pension scheme. When the state failed to meet the pension claims in the 1980s, protests within the population popped up and forced the government to react. Because of these - largely temporary - necessities, the Argentinean government introduced a pension reform. Long-term problems like an ageing society because of declining fertility rates and increasing longevity had already been expected (see Section IV.3). However, long-term challenges were not the major motivation of pension reform in Argentina.

The 1994 pension reform has to be seen in the context of grave economic circumstances and subsequently in the context of overall economic transformation in the early 1990s. Vitas even saw Argentina as an example par excellence for the assumption that radical reforms of social security schemes do not become possible until the old system hits "rock bottom" in financial terms (Vittas, 1997, p. 41).

¹¹ The insured has to choose from three different pension modes. First, a person can obtain a life annuity from an insurance company; second, a person may opt for a scheduled monthly withdrawal; or third, a person can combine both modes.

III.1. The economic crisis in the late 1980s

The economic crisis in the late 1980s has its roots in unfortunate economic policies after World War II. State intervention, restrictions on trade, an exceedingly controlled financial market and growing political instability were decisive factors for the slowdown of investment and production. The Argentine industry became ineffective and unproductive. Furthermore, due to trade restrictions, exports decreased significantly and thus contributed to an escalating balance-of-payments crisis. The government tried to compensate the deficit with austerity policies, which worsened the situation even more. In the 1970s and 1980s, Argentina experienced an unprecedented crisis. Negative growth rates of the Gross Domestic Product (GDP) highlighted the bad shape of the Argentinean economy. In 1981, the economic output shrank by about 6 percent of GDP. In the following years, the situation even worsened. Four years later, there was a negative growth rate of 7.6 per cent (Table 1). Argentina experienced the worst post-war annual growth rate in 1989.

Table 1

Annual GDP growth (in % compared to the previous year) in Argentina (1981 to 1994) selected years

	1981	1985	1988	1989	1990	1991	1992	1993	1994
GDP growth	-5.7	-7.6	-2.6	-7.5	-2.4	12.7	11.9	5.9	5.8

Source: World Bank Development Indicators 2001.

Because of the economic crisis, unemployment rose. Still, in 1980 unemployment rates were relatively moderate. However, they soon rose to 5.9 per cent in 1988, 7.3 per cent one year later and even 9.3 per cent in 1990 (Table 2). In 1994, there was a two-digit unemployment rate (11.7 per cent), despite of the growth of GDP in the 1990's.

Table 2
Unemployment (in % of total labour force) in Argentina
(1980 to 1994); selected years

rates	1981	1985	1988	1989	1990	1991	1992	1993	1994
Unemployment	2.3	5.3	5.9	7.3	9.2	6.3	7.2	9.1	11.7

Source: World Bank Development Indicators 2001.

Taking a closer look at the reasons for this severe economic performance, two underlying causes can be discovered. Firstly, the chronic budget deficit, and secondly, high inflation rates.

Table 3
Overall budget deficit(-), superávit (+) including grants (in % of GDP) in Argentina
(1981 to 1994); selected years

	1981	1985	1988	1989	1990	1991	1992	1993	1994
Budget deficit(-)	-6.7	-7.9	-5.5	-2.9	-0.4	0.02	0.6	0.7	-0.2
Superavit (+)									

Source: World Bank Development Indicators 2001.

One major reason for the growing budget deficit were rising social expenses (Table 4). Rising social expenditures in turn shadow the economic crisis of the 1980s. Social spending in per cent of total fiscal spending jumped from 35.4 per cent in 1979 to 54.4 per cent in 1980. Since then, social spending swallows up more than half of public expenses.

Table 4
Public social expenditure by category (in % of total public expenditure) in Argentina
(1979-1993)

	1979	1980	1981	1985	1987	1988	1989	1990	1991	1992	1993
Social expenditures	35.4	54.4	56.2	57.7	59.5	56.9	56.9	65.2	66.5	68.5	71.6
of which for											
Social Security	16.7	21.0	21.8	19.6	21.7	20.4	18.1	25.5	26.4	31.0	33.1

Source: Own calculations based on OECD (1997b).

As Table 4 shows, the big increase of social expenditure in 1980 was not primarily due to rising expenses on social security¹². Rather, increases in the health budget and expenses for welfare, housing and employment were the major cause (OECD, 1997b). However, since then payments for social security in Argentina rose. In 1993, nearly half of the social budget was needed to cover social security expenses. At the same time, inflation rates in Argentina were extremely high for almost two decades. The persistent and increasing public deficits fuelled inflation even further. Since 1975, there was a three-digit inflation rate. When Argentina returned to constitutional democracy in 1983, people were free to speak up again. The people urged the government to control inflation. The government was forced to react and launched four successive stabilization programs. However, every single one of them failed to reduce inflation, because they did not succeed in diminishing the structural and the resulting financial deficit of the public sector. Rather, inflation increased even further. In 1988, the inflation rate mounted to an annual rate of 343 per cent. In 1989, the price rise peaked at 3079 per cent (Table 5). The two traumatic hyperinflations in 1989 and 1990 contributed to the awareness that overall economic reform was needed. This included reforms in the pension scheme as well.

Table 5

Annual inflation of consumer prices (in % of the previous year) in Argentina (1970-1994)

	1975	1980	1985	1988	1989	1990	1991	1992	1993	1994
Inflation	182.9	100.8	672.2	343	3,079	2,314	171.7	24.9	10.6	4.2

Source: World Bank Development Indicators 2001.

¹² Social security largely comprises all pension payments (i.e. old age, invalidity, survivorship).

III.2. Economic reforms under Menem since 1989

The Argentinean economy is facing negative growth rates, high rates of unemployment and accelerating inflation rates again. Yet, the prospects of the Argentinean political, economic and social system seemed to be quite favourable in the mid-1990s. This is largely due to the economic transformation policy initiated by the Menem government.

When Carlos Saul Menem of the Justicialist National Movement - also known as the Peronist Party - became President in 1989, he started to restructure the economy fundamentally. Privatisation, liberalisation and deregulation of the economy were on top of the government's agenda. In April 1991, the government launched the so-called Convertibility Plan, tying the Argentinean Peso to the US-Dollar at pari (i.e. 1:1). The very intention was to stop hyperinflation, reduce the public debt, promote economic growth and limit state domination of the economic system¹³. The government liberalized trade and restructured the economy in order to re-establish confidence, both in the government and in the economy (Hujo, 2001; OECD, 1997a; World Bank, 2000).

The new economic policy quickly took effect. Argentina experienced strong economic growth and low inflation rates in the 1990s (see Table 1 and 5). As soon as 1992, the annual inflation rate was down to 24.9 per cent - a historically low figure. Two years later, in 1994 prices rose by just 4.2 per cent. Thus, the government succeeded in ending hyperinflation. Consequently, to most Argentines as well as international creditors and advisers -especially of the World Bank and the International Monetary Fund-, the future looked promising in economic terms.

¹³ The plan goes back to the former minister of economy Domingo Cavallo. Cavallo re-scheduled internal and external debt and started to reform the fiscal and monetary system.

However, there was one major concern that remained, namely the chronic budget deficit. In the first years of his presidency, Menem actually succeeded in reducing the overall budget deficit. The Federal Government's fiscal deficit declined from an average of about 6 to 8 percent of GDP for most of the 1980s to a slight surplus of 0.6 per cent of GDP in 1992 (Table 3). However, as soon as 1994, the balance became negative again.

The negative development of the balance in the mid-1990s partly goes back to increasing popular pressures over pending pension claims, the government eventually was forced to yield to. As a result, the financial stability of the Social Security budget was shaken again. For example, in 1994, the government was obliged to spend 1.3 billion US-Dollars in subsidies to cover deficits flowing from retrospective pensions, ordered by judicial rulings, for 100,000 recipients (Sennholz, 2002).

III.3. The new Argentinean crisis since the late 1990s

The fiscal debt turned out to be the major problem of the Argentinean economy. Interest payments on the government debt rose while the government failed to repay its liabilities. Therefore, even though Argentina is one of the countries in Latin America with the highest per capita income during that time, and even though international institutions continuously praised the country for its economic policy since 1991, Argentina is now on the brink of ruin again since the late 1990s. There are various reasons for this bad economic performance. Some of them go back to external shocks, some of them are due to domestic policies.

a. External shocks

Just one year after the pension reform, the stability of the economic system was put to a test. Due to the devaluation of the Mexican peso in 1994 (Diciembre), the Argentinean economy shrank by 2.8 percent in the same year. However, this was just a temporary setback. The following year, Argentina's GDP growth

rates were positive once again. One year later, in 1997, real GDP growth rates amounted to 8.1 per cent. Therefore, the economic background on which the reformed pension system operated was quite favourable - at least in the first few years.

Yet, the next wave of successive economic shocks hit Argentina hard. Following the Russian crisis in 1998 and the subsequent turbulence in international financial markets, Argentina steered straight into a recession in the fourth quarter of 1998. In 1999, the economy experienced a contraction of 3.4 percent of GDP. One year later, annual growth rates plunged by another 0.6 per cent of GDP. The situation got worse in 2001 when annual growth rates dropped again at about 3.8 per cent of GDP. The devaluation of the Brazilian currency and unfavourable weather conditions accelerated the downward spiral of economic growth¹⁴. The situation turned from bad to worse. Eventually, Argentina fell back into economic crisis and returned to its history of rising inflation rates and unemployment, negative growth rates and mounting fiscal problems.

b. Domestic problems and politics

Domestic - especially political factors - contributed to the difficult economic state. In the second half of 1999, uncertainty over the presidential elections further complicated the situation. In October 1999 Fernando de la Rúa won the elections to Argentine presidency. In order to deal with the increasing economic problems the new president levied new taxes and reduced public spending (Sennholz, 2002). Yet, the economic prospects remained critical. Unemployment rose from 13.7 percent in October 1999 to 15.4 percent in May the following year (World Bank, 2000). When

¹⁴ As Brazil was Argentina's most important trading partner, exports from Argentina became relatively expensive. This was a major blow to the export industry. It is important to note that Argentina - besides Hong Kong - was the only country that did not devalue its currency since 1991 (Argentinisches Tageblatt, May 4, 2002).

international creditors and organisations called for fiscal consolidation, the population became alarmed because they feared further austerity-programs.

When the Minister of Economy José Luis Machinea resigned in March 2001, his successor Ricardo López Murphy revealed a rigid austerity program within the same month. Yet, just a couple of days after the presentation of his austerity program, he had to quit because of furious protest over his policies. Domingo Cavallo, who had been in office before from 1991 to 1996, became new Minister of Economy and quickly presented a new strategy in order to settle economic turbulences¹⁵. At the end of July 2001, the government passed its major austerity bills with the intention to end budget deficits. It implied cuts in state salaries and pension benefits by up to 13 per cent. Again, this policy met with fierce resistance of the people. Workers were afraid to fall into poverty and retirees saw their pensions diminish or even lost altogether. The situation escalated even further and nearly got out of control. When the unions called general strikes, millions of workers paralyzed the economy by blocking highways, disrupting transportation, closing schools, and damaging business property. Because the people did not trust the government or the financial market any longer, they withdraw huge amounts of money from their bank accounts that amounted to about 1.3 billion US-Dollars a day in November 2001. As a result, on the 1st of December the Minister of the Economy announces restrictions on the amount of money the public is allowed to withdraw. When the government froze all bank accounts to protect the banks from breakdown shortly before Christmas 2001, the situation escalated. Peaceful as well as violent protests spread all over the country. In addition, the 2002 budget plan that was presented by the government in mid-December implied spending cuts of nearly 20 per cent. On December 19th Argentina declared

¹⁵ One of his main targets was a zero-deficit policy to lower the mounting fiscal deficit, which already had piled up a sum of 2.5 billion US-Dollars in the second half of 2001 (Priess 2001a).

a state of emergency to stop opposition to its plans. When riots spread and more than 20 people died during demonstrations, President de la Rúa just after being two years in office and Minister of Economy Cavallo resigned on December 20 - 2001, leaving the economy in worse shape than ever. Adolfo Rodríguez Saa became president. However, Saa quit just after being eight days in office. Congress replaced him with Eduardo Duhalde of the Peronist party.

In 2002, price increases speeded up again. In April 2002 consumer prices rose (compared to April 2001) at a rate of 21.1 per cent¹⁶. At the same time, no emergency and austerity plan that was implemented by successive economic ministers took effect. Rather, these measures contributed to an already aggravated situation.

IV. THE REASONS FOR PENSION REFORM

IV.1. Structural deficits of the old pension scheme

The pre-1994 pension system had major structural drawbacks. First of all, it was highly fragmented and consisted of multiple funds. Every fund had different kinds of legislation and organisation, benefits, and contribution rates. The result was efficiency losses and high costs as well as problems of inequality between different groups of the insured. Secondly, entitlement conditions were quite permissive. People could receive full pensions after 15 years of contribution-payments. The official retirement age was comparatively low. The minimum retirement age for women was 55 years and 60 years for men. As the three highest salaries of the last ten years of employment were used as basis to calculate the resulting benefit, employers often granted profound salary increases

¹⁶ The main reason for this new inflationary pressure is the devaluation of the peso, to which the government resorted in January 2002. As the Argentinean Peso was closely tied to the US-Dollar since 1991, the turn to a more or less floating exchange rate hit the economy particularly hard. Within three months, the Peso was traded 3:1 to the US-Dollar (Argentinisches Tageblatt, May 11 2002).

at the end of working life. On the other hand, underreporting of income was usual. Altogether, it led to high losses in contribution revenues (Queisser, 1998).

In the 1980s, the Argentine pension system deteriorated, as the balance of the pension system worsened. In 1991, the deficit of the social security scheme already amounted to 0.72 per cent of GDP. The negative balance increased to 1.47 per cent of GDP in 1994 (Table 6).

Table 6
Financial Situation of the old pension system in Argentina in % of GDP (1991-1994)

	1991	1992	1993	1994
Contribution revenues	3.06	3.51	3.73	3.45
Expenditures	3.78	4.45	4.80	4.92
Balance	-0.72	-0.94	-1.07	-1.47

Source: Vittas, 1997, p. 15.

At the same time, social expenditures were high. Besides the low retirement ages and resulting longer periods of pension payment, replacement rates were generous. The government promised relatively high pension benefits and a replacement rate of 70 to 82 per cent of previous earnings¹⁷. Even the relatively high contribution rates of 27 per cent of gross wage were not sufficient to provide for a stable financial basis of the pension scheme¹⁸. In 1990, the average replacement rates fell to 40 per cent. As a result, people lost faith in the government and the pension system (Vittas, 1997, p. 3). When the contribution-benefit linkage turned weaker and weaker, a growing number of people evaded contribution payments. In 1990, the estimated rate of evasion amounted to 46 per cent of workers who were eligible for the pension system. It increased

¹⁷ Replacement rates were even higher for privileged groups like high rank civil servants (Hujo, 2001).

¹⁸ From 1985-1991 state subsidies amounted to 20 to 30 per cent of benefit payments (Hujo, 2001).

further and reached an estimated 57 per cent in 1995 (Cf. *ibid.*, p. 17). Thus, even during the expansion of employment during the economic upswing in the early 1990s, reported employment to the social security scheme lagged behind¹⁹. As a result of rising unemployment rates and increasing contribution evasion, the financial basis of the social security scheme is further weakened.

IV.2. The economic and political context

As already mentioned earlier, the pension reform was a logical result of the economic crisis in the 1980s and the restructuring of the Argentinean economy in the 1990s. The new policy under the Peronist prime minister Carlos Menem has been called a "neoliberal turn" as he favoured market solutions to state intervention and regulation (Hujo, 2001). The main implications are twofold. Firstly, because of the Convertibility Plan, the implicit debt of the pension system became explicit²⁰. Eventually it turned out that the pension system had piled up a negative balance of 12 billion US-Dollars (Hujo, 2001). As a first step to lessen the debt burden, the new Menem administration issued long-term pension bonds. Furthermore, the government spent 4.5 million US-Dollar of privatisation revenue of the national petroleum company to balance the deficit at least in parts (World Bank, 1996). This emergency measure however was a short-time reaction. A structural reform of the social security system that would address the underlying problems of the financial instability was considered as being necessary. Thus, secondly, the financial crisis in the 1980s paved the way for an agreement on fundamental reforms of the pension scheme.

¹⁹ For example, between October 1998 and October 1999 the number of employed people increased by about 1.7 per cent whereas the number of employees reported to the social security administration had been lower in the third quarter of 1999 than the year before. This is an indicator for a growing informal sector and thus contribution evasion (ECLAC, 2000, p. 144).

²⁰ The implicit pension debt in 1990 in Argentina was among the highest in Latin America and mounted to an estimated 305 per cent of GDP (Bravo/Uthoff, 1999, p. 11).

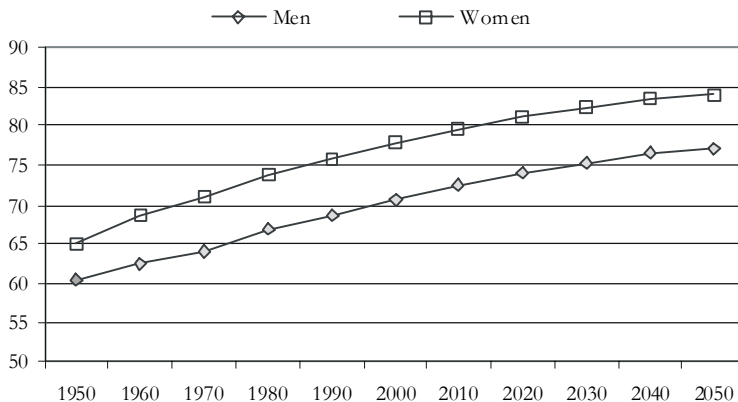
The Argentinean pension system was in dire need for reform, as it was "technically insolvent prior to its radical reform" (Vittas, 1997, p. 11). The pension system was expensive and increasingly dependent on state subsidies. In addition, the system was mature, as it operated since 1944 and gradually included almost the entire working population²¹ (Queisser, 1998).

IV.3. The long-term perspective: Demographic projections

While macroeconomic circumstances are crucial for the ability of the people to contribute to the pension scheme, the financial stability of a pension scheme is largely determined by demographic factors. The demographic situation was quite favourable in the 1990s. Still, rising life expectancy (Figure 1) and declining birth rates (Figure 2) were already observable.

Figure 1

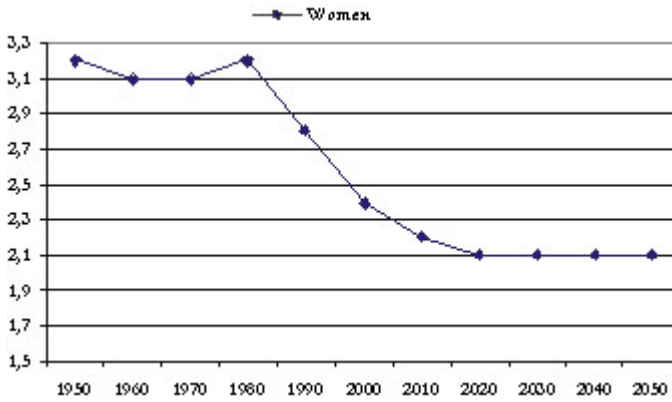
Development and projection of life expectancy at birth in Argentina (1950 to 2050) in years



Source: Own presentation based on ECLAC (2002a)

²¹ General Peron is largely responsible for universality of the Argentinean social security system. Until 1944, just seven percent of the population was covered by social protection. However, step-by-step Peron integrated all workers – including urban as well as agricultural workers, the self-employed and civil servants into the pension system (Hujo, 2001, p. 3).

Figure 2
Development and projection of the Total Fertility rates* in Argentina
(1950 to 2050)



Source: Own presentation based on ECLAC (2002a)

These two factors are the main long-term challenge for the pension system in particular and state finances in general. When fewer children are born and people live longer, this causes a rising old age dependency rate (OADR). OADR measures the ratio of the people aged 65 and above in relation to the working age population (people aged 15-64). This relation describes the age structure within a country and is especially important in respect to public social security expenditures (Table 7). Because of the rising old age dependency rate, more and more people have - and will have - pension claims.

Table 7
Projected Old Age Dependency Rate* in Argentina in % (selected years: 1950 to 2050)

1950	1960	1970	1980	1990	2000	2010	2020	2030	2040	2050	
OADR	6,4	8,6	11,0	13,2	14,7	15,5	15,9	17,6	19,9	22,9	28,5

* OADR (Old Age Dependency Ratio) = Population aged 65 and above in per cent of population aged 15-64
 Source: Own calculation based on ECLAC (2002a).

V. THE SITUATION OF THE PENSIONERS

V.1. During the economic crisis in the 1980s and prior to pension reform

Taking the above mentioned structural deficits of the old pension scheme as well as macroeconomic problems into account, it was inevitable that sooner or later the government would fail to pay pension benefits. As inflation increased, the government missed to adjust benefits to inflation because of budgetary pressures. As a result, real pensions continued to drop until their level reached "politically and socially unsustainable dimensions" (Hujo, 2001). Real pension benefits were not sufficient to protect the old from becoming poor. In 1986, the government announced a state of social security emergency. It levied new taxes on fuel, telephone services, and gas to finance the pension system. In the meantime, the government faced increasing pressure from the population. Argentinean pensioners took legal action against the government because pensions dropped to levels well below the statutory replacement rate. To ease the pressure from the population, the government re-negotiated the calculation base in order to pay outstanding pensions. Yet, the emergency measures just improved the situation temporarily. After lifting the state of emergency, problems popped up again. By the end of the 1980s, the Argentine pension system was insolvent (Cf. *ibid.*).

V.2. During the phase of economic recovery and after pension reform 1994-1999

From a welfare perspective, one undesirable tendency since the pension reform is the declining rate of effective coverage from 54 per cent of eligible workers in 1990 to 42 per cent five years later. Additionally, there is an increasing share of non-contributing affiliates to the overall pension scheme, i.e. both the first and the second layer. In 1990, 4.89 million people contributed to the pension scheme. Five years later - one year after the new pension scheme was implemented - there were only 4.18 million affiliates who paid contributions. Thus, the System Dependency Ratio (SDR)²² which measures the relation of beneficiaries to contributors declined from 64.0 per cent in 1990 to 49.4 per cent in 1995 (Vittas, 1997, p. 17). This is an alarming development - not only for the fiscal budget but especially for the pensioners. Queisser already warned in 1998 "[t]he increasing share of non-contributing affiliates jeopardises the effectiveness of the new pension system in providing old-age security" (Queisser, 1998, p. 21). As most of the non-contributing affiliates belong to the lower-income groups, they are likely to drop below the poverty line when they retire. Additionally, these figures indicate that many affiliates will not complete the necessary contribution period in order to receive a minimum pension.

Financial problems remained oppressive because contributions to the pension scheme became less (see Table 6). Shortly after the pension reform, the authorities decided to cut pensions by changing the benefit formula according to budgetary needs (Vittas, 1997, p. 3). In March 1995 the Argentinean government introduced the law on Pension Solidarity (Law, 24463), which implied that pension benefits are no longer automatically indexed but subject to ad-hoc decisions by the government. Two years later, the government

²² The System Dependency Rate (SDR) is a good indicator for the financial equilibrium of a pension system. When the number of contributors decreases – or even remains unchanged – while the number of beneficiaries increases, this relation will rise. In a PAYG-scheme it means that the burden on the employed increases as they have to finance the benefits of an increasing number of pensioners.

substituted AMPO with MOPRE to calculate retirement benefits (see Section II). Therefore, the effective replacement rates now depend on annual budgetary considerations. Furthermore, the 1995 Pension Solidarity Law provides for greater distribution in the public scheme, as it favours low level pensions over higher pension claims. The main intention of this measure was to limit costs of public pensions.

Vittas regarded the law as "a necessary measure for reducing the burden of past pensions". Yet, one problematic feature of the Pension Solidarity Law is that pension payments are subject to arbitrary decisions by the government.

V.3. During the new economic crisis since the late 1990s

In order to stop increases in social security expenditure the state resorted to further measures that entail arbitrary rulings depending on the financial situation of the state budget. When economic turbulences set in again in 1998, pensioners were affected along with the whole population. In July 2001, pension benefits were cut by 13 per cent when the government issued its austerity plan in order to reduce the budget deficit. On December 6 2001, Minister of Economy Cavallo launched an emergency measure to avoid the government's failure to pay 130 billion Dollar public debt. He transformed the country's pension funds into treasury bonds or government backed loans in order to service fiscal debts. This provoked protests of the already hostile electorate. In 2002, pension payments became chaotic. People were queuing outside banks, post offices, and police stations in order to get their pensions²³ (*Argentinisches Tageblatt*, April 27, 2002). This upheaval goes back to the severe situation of the pensioners. In April 2002, for more than half of all 3.2 million pensioners monthly benefits amounted to less than 300 pesos²⁴ (*El Cronista*, April 26, 2002).

²³ In Argentina, pensions are only paid in cash.

²⁴ Monthly pension payments are distributed (in per cent of all beneficiaries) as follows: Up to 150 pesos 17.4 per cent; 150 to 300 pesos: 50.6 per cent; 300 to 500 pesos: 15.3 per cent; 500 to 1000 pesos: 11.4 per cent; 1000 to 2000 pesos: 4.5 per cent; more than 2000 pesos: 0.7 per cent (*El Cronista*, 26 April 2002).

VI. THE ARGENTINEAN PENSION SYSTEM AFTER REFORM

Early experience with the new pension scheme indicate that the reformer's expectations were largely too optimistic. Some of the predicted advantages did not materialize. One practical explanation is the adverse economic situation since the late 1990s. Yet, there may be some problematic features in the structural design of the new pension scheme.

VI.1. The development of the Public Scheme

The very intention of the reform was to solve the problem of ever-increasing budget deficits in the retirement scheme. Yet, despite the pension reform, welfare costs remain a heavy financial burden for the state. Since the 1994-reform, the state is responsible for numerous different retirement benefits. This includes the payment of the Basic Universal Benefit (PBU), the Compensatory Benefits (PC), and the payment of non-contributory pensions²⁵. Yet, while the Old System Pension and the Compensatory Pensions are just transitory, they represent a profound financial obligation at least in the short run. Thus, from a fiscal perspective, the reform implies problematic transitory features. In addition, as parts of the old system remain in place the government is still financing the old, extremely expensive pension scheme. It is no wonder that the reform did not put an end to the increasing budget deficit. To the contrary, total pension spending grew steadily. As a result, the pre-reform dilemma remained after the reform: The government is forced to reduce the federal government deficit, while liabilities increase even further.

The prospects of the reformed system do not seem to be too glorious. Firstly, the benign economic circumstances of the mid-1990s did not last long. Secondly, fiscal costs will increase due to the transition from the old to the new pension scheme at least in

²⁵ These non-contributory pensions are special retirement regimes financed out of tax revenues. They are granted to employees of the Armed Forces, the Security personnel, the Foreign Ministry, the Legislative Branch and the Judiciary.

the first years of operation. Thirdly, long-term problems of an ageing society are already looming.

Because of the expected and already occurring transition costs of national pension reform, neither expenditures nor the budget deficit did decline as expected. Some authors even claim the pension reform itself contributed to the dilemma of ever-increasing budget deficits and increasing pension liabilities while contribution revenues decline. Critics like the economist Mark Weisbrot see the pension reform as one part of the economic problems that set in again at the end of the 1990s (Bussey, 2002). This is because the privatization of the social security system obliges the federal government to spend more than one percent of its budget each year²⁶. As parts of the contributions are channelled into the private pension plans instead of going into the PAYG scheme, the government has to pay pensions to recent pensioners out of a shrinking PAYG social security budget. Additionally, the Old System Pensions (OSP) transfers the problems of the past system to the new pension scheme. The most problematic inheritance was a very high system dependency ratio because of widespread evasion, low retirement ages, lax eligibility rules, and high targeted - however most of the time not achieved - replacement rates (Vittas, 1997, pp.14-16). The situation got worse because of the recession in Argentina since 1999. While the government has to find new sources of funding for pensions, contribution payment break away and thus increase the debt even further (Figure 5).

After the pension reform, benefit payments did not decrease but increased while at the same time contribution payments became less. Admittedly, reformers had expected this. Yet, the transformation costs had been projected under rather optimistic assumptions - for example an initial ratio between contributors and affiliates of 65 per cent was expected to rise to 95 per cent within the first years after pension reform. According to the projection of government economists, the public layer pillar would accumulate a

²⁶ Transitional fiscal costs of pension reform are more or less manageable depending on the inherited size of the debt, demographic and macroeconomic factors, the reform path and the transitional regulations.

deficit until 2013. After that time, they predicted a growing surplus the following years (Vittas 1997, p. 22). Thus, at least in the first years, the partial privatisation of pension insurance had adverse effects on fiscal balance. This might not have been too problematic, if Argentina had a safe financial background²⁷.

The relatively good shape of the Argentinean economy in the early 1990s was not good enough to finance the costs arising from the transition of the old to the new pension scheme. In addition, the Argentinean government did not succeed in creating sustainable financial space in the state budget in the second half of the 1990s. The Russian crisis in 1998 aggravated the unfortunate situation. Yet, the deathblow was the devaluation of the Brazilian currency in 1999. Eventually the government found itself with largely no sources left to finance the pension system. The country has practically run out of state companies to sell (Gill, 2002). Furthermore, tax receipts plunged at about 7.4 per cent from March 2001 to March 2002; VAT-revenues fell during that time at about 27.2 per cent and income tax fell at about 34.6 per cent (Birdsall, 2002; Priess, 2002). As unemployment increases, rises many people fell beneath the poverty line and therefore could not contribute to the social security scheme²⁸. Still, the government has to provide

²⁷ In 1997, Vittas was still optimistic that the transformation costs could be managed, as “the projected deficit of the public pillar appears financiable in the new environment of macrostability and growing fiscal markets” (Ibid., p. 23). Even in 1999, the French political scientist Alain Touraine stated that prospects for economic recovery and economic growth in Argentina were very good – especially in comparison to other Latin-American countries. To his mind, the country did succeed in passing all reforms necessary to be able to deal with future social challenges (Priess 1999). From what we know now, this was a complete misinterpretation of the situation. But they cannot be blamed for this optimistic judgement as during that time Argentina’s economic prospects did not look too bad.

²⁸ Additionally, the new pension scheme does not seem to be attractive to self-employed. According to recent studies, out of 4.8 million self-employed in Argentina 3.2 million are affiliated either to the public or to the private pension scheme. However, only 10 per cent of the self-employed affiliates contributed to one of the schemes of the second layer. This figure means a sharp decrease compared to previous years. Whereas in 1994, 1.3 million self-employed joined either the private or the public alternative of the second layer, in 1999 there were just 700,000 of them left. This relatively low figure may be caused by the relatively high contribution rate of 27 per cent for the self-employed (Hujo, 2001).

benefits. As a consequence there is an increasing discrepancy between contributions and benefits (Figure 3).

The irony of the situation according to critics is that the pension reform program was especially pushed forward by institutions - like the IMF and the World Bank - that now urge the government to cut the fiscal debt. This however might lead to further cuts in public pension benefits and resulting poverty among the elderly (Bussey, 2002).

Figure 3
Social Security Contributions and Benefits in Argentina in million Pesos (1993 to 2001)



Source: Own calculation based on Secretariat of the Treasury (Ministry of Economy)

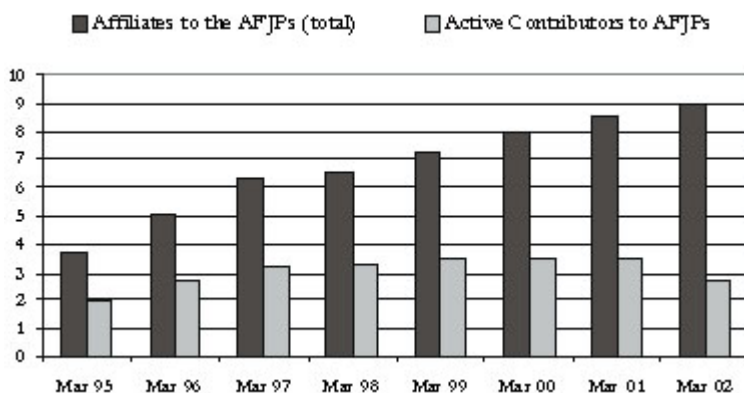
VI.2. The private layer (AFJP)

As expected prior to reform an increasing part of the working population would opt for the private pension scheme. Yet, in the early days of pension reform in July 1994, no more than 1.8 million workers were affiliated to one of the AFJPs. However, the pace of affiliation to the AFJPs speeded up within a short period of time. As soon as March 1995, around 3.7 million workers joined the private pension scheme. In the following years, the private

alternative attracted more and more people. Within three years, the figure of affiliates had almost doubled to 6.5 million in March 1998. In early 2001, the second layer - i.e. the private plus the public alternative - counted over eleven million affiliates. Most of them (78 per cent of all insured) were affiliated with the private alternative (Hujo, 2001). In March 2002, the number of affiliates had accelerated to more than 8.9 million.

However, this supposed story of success needs to be seen with one important qualification. Taking the numbers of active contributors to the AFJPs into account, there is another story to tell. Whereas the number of affiliates has increased steadily, the number of contributors firstly always lagged behind and secondly, decreased in absolute and relative terms since 1999 (Figure 4). The reasons for this might be found in the economic slowdown since the late 1990s but as well in an increasing rate of evasion. It had been largely expected that the privatisation of the pension system would mean higher compliance. This however might have been a fallacy.

Figure 4
Social Security Contributors and Affiliates in Argentina

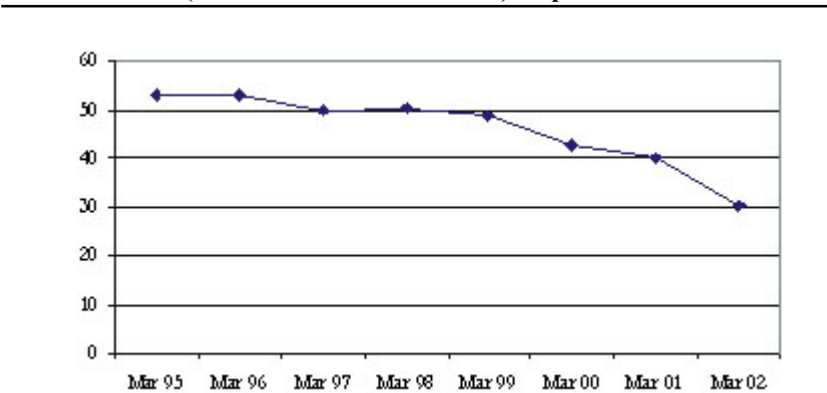


Source: Own calculation and presentation based on SAFJP

Therefore, the relation of affiliates to active contributors worsened (Figure 5). Therefore, high evasion rates are an important and escalating problem of the private alternative as well.

Figure 5

**Active contributors in relation to affiliates of the AFJP in Argentina
(March 1995- March 2002) in per cent**



Source: Own calculation and presentation based on SAFJP

VI.3. Development of the pension fund market

Since 1994, the pension fund market underwent a process of concentration. When the new pension scheme was implemented, 25 pension fund companies offered pension schemes. In March 2002, there were just 12 left. These 12 pension funds accumulated 24 billion pesos in March 2002, which is equivalent to 9 per cent of GDP. The four largest pension fund providers accounted for 76 per cent of all funds and affiliates in March 2002. The fluctuation between the pension fund companies has decreased slightly in 2002²⁹. From March 2001 to March 2002, 411,000 people swapped the company.

²⁹ Affiliates are allowed to switch the pension fund company twice a year. However, they have to contribute at least four times to the pension provider they are leaving.

Table 8
Performance of Fully Funded Scheme in Argentina 1996, 2001 and 2002

	June 1996	July 2001	March 2002
Affiliation			
- number of insured persons	5.4 Mio	8.7 Mio	8.9 Mio
- contributors	2.7 Mio	3.3 Mio	2,7 Mio
Effective rate of contributors	51%	38%	30%
Market structure			
- number of administrators	21	13	12
- concentration (affiliates in first 4 AFJP)	52%	73%	76%
administration costs (% salary)	2.6%	1.97%	2,26 %
insurance fee	0.7%	1.4%	0,53 %
Volume of funds	\$ 3.839 Mio	\$ 21.000 Mio	\$ 24,000 Mio
- accumulated funds/GDP	1.4%	7%	9%
Average real rate of return	22.8%	9.9%	9,3 %
	(1994-1996)	(1994-2001)	(1994-2002)

Sources: Hujó, 2001; SAFJP.

The accumulated annual rates of return varied profoundly. Between March 2001 and March 2002, there was a negative rate of return of -4.3 per cent. In the previous period there had been a slightly positive rate of 1 per cent, whereas between March 1999 and March 2000 the rate amounted to 22.4 per cent. The lowest rate yet had been achieved between March 1998 and March 1999 (-6.1 per cent). The highest rates were reached between March 1995 and March 1996 (25.6 per cent). However, these nominal rates or returns do not take commission rates and the inflation rate into account. Especially because of rising prices since early 2002, real rates of return are likely to become negative (Hujó, 2001; SAFJP; Vittas, 1997).

VII. CONCLUSION

It is not easy to judge the reformed pension system in Argentina, while the economy is caught in a recession. Any pension system - whether it is a well constructed one or not - will struggle in such harsh economic circumstances. Furthermore, the most crucial test, namely whether the system turns out to be viable and stable in the long-term, has not started yet. One key issue due to the special design of the new pension system is likely to become the payment of the compensatory pensions (PC) due to an expected increase in life expectancy. As demographic projections have demonstrated, the major challenge of an ageing society is about to come in the next decades. Therefore, even if expectations have not been met and the reformed pension system is in such a bad shape as 2002 it is too early to condemn it outright.

Accordingly, this paper firstly accounted for the reasons for pension reform and secondly described the development of the new pension scheme. However, some observations are quite interesting and thus offer lessons to learn from. It has been shown that the pension reform in Argentina was primarily motivated by short-term problems. Ironically, since the late 1990s the new pension scheme faces almost the same temporary problems as the old scheme. The disastrous shape of the Argentinean economy has negative effects on the social security system. These effects led to modifications of benefit calculation and benefit cuts. Moreover, economic problems are largely responsible for the fact that the Argentinean government does not manage to finance the transition period. As a consequence, financial short-term problems are more serious than anticipated.

The additional demographic burden will come along gradually but will hit the pension scheme especially hard if the economy does

not recover. So first of all, the economy needs to be consolidated. Until that time, the government will not be able to make any amendments of the pension scheme in order to improve compliance, to secure sufficient pension benefits or to reconsider some unfavourable elements. Structural deficits of the new pension system are the relatively low retirement age for women and the high minimum-contribution years. The retirement age for women should be increased because of the projected ageing of the society. On the other hand, the increased minimum-contribution years seem to lead to even less compliance instead of fighting evasion as actually intended. Furthermore, due to the tightening of this eligibility criterion, the formerly high coverage of the elderly dwindles and leaves more and more people without old age security. For that reason, the minimum-contribution rates ought to be reduced.

Considering everything, it becomes obvious that many of the reformer's expectations have not been met. Evasion has not decreased but increased, the pension scheme is not prone to state interventions and the financial burden exceeds the most negative expectations and seems to be greater than before. At the present, Argentina is not even able to cope with anticipated short-term problems like financing the transition period. Therefore, it remains to be seen whether the new pension system is capable of facing future problems.

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