COMMENTS ON

"The Pension System of Cuba: The Current Situation and Implications of International Pension Reform Experiences for Addressing Cuba's Problems" by Pérez

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Based on my work for four decades on both Cuba and social security pensions, I can say that Lorenzo Pérez' paper on pension reform in Cuba is very good and that I agree with almost all it says. Especially interesting for me is his comparison of the Cuban pension system with that of nations that were part of the former Soviet Union. His recommendations for pension reform are balanced and very careful as such difficult issue demands. In fact, a recurrent nightmare of mine is that the Castro regime has fallen and I am called to design a new pension reform in the island! The following comments address some minor points in Pérez' paper and provide comparisons with pension reform in eight countries in Latin America.

1. Comparison of Cuba with former Soviet Republics. Cuba's pension system faces a worse financial and actuarial deficit than those of the nine new independent states, because its revenue is proportionally lower and its expenditures higher. On the revenue side, the employer's wage contribution in those countries is 32%, more than twice that of Cuba (14% after 1994), and the employee contribution is 1% compared to zero in Cuba (the 1994 tax law mandated such contribution, but it was postponed at that time and, again, by the V Party Congress in 1997). The total contribution in the former Soviet Republics, therefore, is 33% versus 14% in Cuba. But in Cuba, it had been actuarially estimated in 1995 that the total contribution had to be 36%, which means, that the employer contribution had to be raised to 18% and a similar percentage charged to the workers. (A few days after our session was held, Cuba's monopoly State Insurance Enterprise offered citizens and residents, between 17 and 65 years of age, disability and survivors insurance—not for old age—for a rather high premium based on their wages; the maximum lump sum to be paid will be 50,000 pesos or less than $4,000. See Raúl Rivero, "Proletarios de Cuba, !aseguráos!" *El Nuevo Herald*, August 21, 1998, p. 17A). On the expenditures side, retirement ages are the same in Cuba and in those nine countries (55 for women and 60 for men), but the longevity of Cuban pensioners is the highest among them (at least until 1989); furthermore, under the Rectification Process (1986-90) there was a relaxation in entitlement conditions, which led to a jump in the number of pensioners. The longer it takes to raise/establish the proper level of contributions, the higher they will have to be (more than 36% combined in 1998, if current entitlement conditions are maintained).

2. Erosion of Pensioners' Living Standards in Cuba. Pérez deals with this issue in his paper but I want to add a couple of things. Based on the inflation index estimated for Cuba, the average *real* pension decreased 42% in 1989-97. Rationing currently covers less than half the minimum food needs monthly. With the dollar equivalent of such average pension (about $5 monthly) it is impossible to buy food for the remaining half of the month. Transportation is a major problem for retired people because the immense majority of them can not ride bikes, and they suffer most from the deterioration of the health care system.

3. Regressiveness of the Pension System in Developing Countries. In most of Latin America, the pension system is even more regressive than in industrialized countries, due to two reasons: in half of those countries less than 25% of the labor force (mostly low income) is covered by pensions, but contribute to the system of those covered (middle income) through state taxes partly used to subsidize it, as well as through transfer of the employers' contribution to prices.

4. Investment Deficiencies. Investment of the pension fund in public securities was not the only reason for negative real yields in the 1980s. In Latin America, a significant part of pension fund investment was of the "social" type (housing, social insurance hospitals and equipment, mortgage and personal loans) which also had negative real yields, thus provoking a drastic reduction in the reserves. Because of the latter, often the first generation of pensioners got a good pension and a cheap (almost free) house due to inflation, but the second or third generations neither received a fair pension nor a house.

5. Multipillar Approaches. Before the World Bank published its famous report on pensions (1994) that included the multipillar model, the International Labor Office had published its own version (1993) but with a second (core) pilar completely different from that of the Bank (both models have almost equal first and third pillars). In my opinion, universal unique models are unfeasible due to the enormous divergence of economic, demographic, social security, labor market and political variables among close to 200 countries in the world. Each one has to adapt the pension reform to its own peculiarities, needs and resources.

6. Pension Privatization Boosts Capital Accumulation and Financial Market Development. Pérez properly questions this assumption in his paper. Let me add that in estimating *net* capital accumulation, one must take into account not only the positive accumulation generated in the new fully-funded pension system, but the triple fiscal cost of the transition too: (I) pension deficit in the old system; (ii) transfer of contributions (adjusted by inflation) from the old to the new system; and (iii) minimum pension guaranteed in the new system (for those who do not accumulate sufficient funds in their individual account). Studies conducted by Robert Holzmann and Alberto Arenas de Mesa prove that pension "privatization" in Chile has had a negative impact on net capital accumulation (at least in the first 14 years of operation), and the first expert has also shown that it has not played a role in the development of the financial market either.

7. Lessons for Cuba from Pension Reforms in Latin America. Eight countries in the region have already implemented a pension reform: Chile (the pioneer, in 1981), and Argentina, Bolivia, Colombia, El Salvador, Mexico, Peru and Uruguay (all since 1993). My own work shows that all the reforms are different, a result of the variety of conditions in those countries. The only country among the eight that has had some type of socialism is Chile (but it did not go too far); the other country in the region that tried socialism was Nicaragua (although far from the level achieved in Cuba), but it has not undertaken a pension reform yet. In Chile, the Allende government was overthrown by the military and pensions did not have enough time to be badly affected by the "Revolution" (as in Cuba and Nicaragua), while the authoritarian government faced no political obstacles to implement a radical pension reform ("privatization"). Conversely, in Nicaragua the economic policies of the Sandinistas led to record-high inflation which liquidated the reserves of the pension system; instead of an authoritarian government, a democracy was installed in Nicaragua, and the pension reform has been obstructed by political and economic obstacles. Cuba is in a worse situation than Nicaragua (there has not been a pension "fund" under the Revolution, because the employers' contributions go to the state and the pension system is financed out of the state budget). The type of pension reform that the island will adopt (e.g., full privatization Chilean style, mixed as in Argentina and Uruguay, or parallel as in Colombia and Peru), will depend on how authoritarian or democratic the transition is.

8. Inclusion of the Armed Forces. They were and are excluded from Cuba's general pension system, something true all over Latin America with the exception of Costa Rica that fortunately lacks armed forces. In Chile, the military government designed and implemented the pension reform, which has been successful so far and a model for the rest of the region and elsewhere, but the reform excluded the armed forces and the police, which kept their separate privileged program. I do agree with Pérez on the need to include the armed forces in an overall pension reform in Cuba, but the feasibility of that action will largely depend on how the transition occurs: if the armed forces take over power and lead the process, it would be extremely difficult that they accept incorporation into a general pension system.