The diffusion of regulatory reforms in pension systems: Latin America in comparative perspective

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First Draft
Please, do not cite or circulate.

III ECPR General Conference, Budapest 8-10 September 2005
Panel 3.2: The Diffusion of Regulatory Reforms

1. Introduction

In Latin America, regulatory reforms have been widely introduced in recent decades. These reforms represent a major transformation of the role of the state in the region. In accordance with larger transformations in the world economy, the state restructuring pursued a different form of governance aimed to manage capitalism through detailed regulation, but avoiding both direct state intervention in the economy as much as undomesticated capitalism (Manzetti, 2000; Cook et. al. 2004; Jordana and Levi-Faur 2005; Levi-Faur 2005).

This paper is devoted to examine a particular case of regulatory reforms that gathered momentum worldwide in the last years: the reform of public pension systems. Until 2005, pension reforms were put in place in 14 Latin American countries, starting with the pioneering case of Chile in May 1981. In most cases, the reforms were oriented towards the introduction of private schemes (only reforms in Brazil and Venezuela were not open to privatization initiatives). However, the reforms show important national variation: they were based on different policy designs, complementing or substituting the previous public systems. Our goal is to investigate why countries decided to adopt a particular model of reform or another (full or partial privatization or parametric reforms) and, above all, to understand why this policy innovation has diffused. We also want to place Latin American pension reforms in context, considering the development of similar policy reforms in European countries, in order to discuss in a comparative perspective the diffusion of regulatory reforms in pensions systems in Latin America.

There are four basic characteristics of pensions systems: contributions, benefits, financial regime and management. Usually, pension reforms that transform public pay-as-you-go (PAYG) systems into private systems imply changes in all these four characteristics. Besides the introduction of private management of pension funds, reforms often shifted from non-defined contributions to well-defined ones, from known benefits to unknown ones, and they transformed the financial regime into individual schemes of capitalization (Mesa-Lago 2004). We observe a transfer of some responsibilities from the state to individuals, who should now take early personal decisions to assure their own retirement income.

Pensions are a case in which successful diffusion of policy reforms does not mean always successful reforms. During the nineties, pension privatizations were considered a symbol of modernity and were suggested by international organizations as necessary reforms. Now, the view about the pensions reform has changed: experts at the World Bank and the IDB are much more cautious (Gill, Packard, Yermo, 2005; Crabbe, Giral, 2004), and policy annalists suggest that its performance as to main social functions was regressive, increasing

old-age poverty (D'Haseleer and Berghman, 2004; Mesa-Lago, 2004a). Problems created by pension reforms in the nineties were visible several years after, but not immediately after. During this initial period, however, many governments had the "general wisdom" that pension privatizations were a success, and some countries took insights from experiences of other countries –Chile in especial (Madrid, 2003; Weyland, 2004).

Because of the long-term consequences for the population, public debates for reforming pension systems take place within the framework of social regulation and social policy reform. However, it is important to distinguish between social policies and social regulation. Social policies are mostly about welfare redistribution. In the case of pension system reforms, the social policy aspect refers to what extent non-contributive pensions are publicly provided; on the other hand, social regulation is basically about protecting social risks by means of regulation, and it refers to which extent life protection criteria should be considered. Finally, we need to distinguish social regulation from the widely extended regulation of markets or economic regulation, the latter oriented to promote competition among pension funds managers. In fact, we depict pension reforms as a particular type of policy events that occur at the interplay of social regulation, social policy and economic regulation. Social and economic oriented regulations coexist together in pension systems as far as policy reforms aimed to create competitive markets among managers of pension funds and simultaneously have to provide some protection against social risks and economic uncertainties for the retirement. Finally, some degree of social policy intervention offering non-contributive pensions should be activated after reforms because pension reforms marginalize- if not exclude - redistribution as one of the objectives of the private pension schemes.

In this study, our immediate reference is Brooks' recent analysis (2005) of the diffusion of pension reforms around the world. In her paper, the author finds strong peer dynamics causing the adoption of pension privatization in Latin America but not in advanced countries.[1] By peer dynamics, the author refers to the positive impact that the density of pension reformers in a particular region causes on the decision to privatize in other countries in that same region. Brooks controls the effect of peer dynamics for other possible mechanisms of policy diffusion, such as competition and coercion, and for domestic political and financial variables. She finds that domestic political and financial variables are responsible for the variance observed in the modality of pension reforms chosen and that coercion and competition pale in comparison to the strong effects of peer dynamics. Innovative and informative as her study is, she leaves unexplained what peer dynamics amounts to and, particularly, why peers dynamics have been relevant among Latin America

countries but not among advanced industrial countries.

Policy preferences for market-oriented reforms in social policies in Latin America during the nineties were much extended, probably more than other territories. However, policy changes did not occur in all social sectors; pensions were by large the most "successful" case. Its nature as a very centralized policy issue (that makes policy changes manageable for a reduced group of policy reformers) and the absence of large constituencies involved in the implementation of the policy (differently than health or education) may account for explaining such reforms. Different structural factors also influenced the policy changes. In addition, country interdependencies within the region play an important role, as Brooks research clearly states.

Taking these different explanatory focus as starting point, our aim is to put them together suggesting how a process of policy diffusion took place. We aim to apply an interpretative model to make sense of the existing interrelations. Using a utility model devised by Braun and Gilardi (2005) that offers a unified model of policy diffusion, we intend to explain Brooks' contrasting findings. By policy diffusion, we shall refer to the process by which policy choices in one country affect policy choices in another country causing policy choices to converge. Our argument is that whereas in Latin America, learning from the experience of others, competition and persuasion, together with a certain dose of symbolism played some role in the diffusion of pension privatization, in advanced industrial countries none of these mechanisms operated. In fact, the deterioration of the status quo as reflected in increasing state liabilities associated with demographic and economic changes appears as the most (if not unique) pressing reason to reform the pension systems in advanced countries. Thus, in the case of industrial countries, what we observe is governments responding to the same external pressures in an independent way rather than interdependent choices: some convergence towards pension system reform is observed, but diffusion (interdependent policy choices) is not the reason.

The paper proceeds as follow: section 2 present a theoretical model of policy change and policy diffusion based on expected utility theory. Section 3 uses the parameters and predictions of the model to give an account of privatization choices in Latin American and in advanced countries. Section 4 concludes.

2. A Theoretical Framework to Study the Diffusion of Social Regulation.

The goal of this section is to develop a theoretical framework for studying the

diffusion of regulatory reforms in social policy. The discussion is based on Braun and Gilardi (2005). The basic idea is that interdependencies among countries influence the parameters determining the choice of policymakers to change policy. The model of policy change put forward by Braun and Gilardi (2005) is based on the idea that a process of change is initiated if the expected utility of change is greater than that of the status quo. Expected utility of any policy depends on two factors, payoffs and effectiveness, and the expected utility of the policy change depends of the differences existing between new and old policies, considering also the uncertainty of the policy change itself, and the costs of finding a new policy.

First, to consider payoffs, we observe that some policies will be more attractive than others to policymakers and thus yield greater payoffs, either in terms of their policy preferences) - policy-makers may prefer private provision of social security on ideological grounds-, or in terms of votes (their electoral rewards) - policy makers may refrain from privatizing social security out of fear of electoral sanctions (Pierson 1994)-. Note that the relative importance of electoral and policy rewards may change across countries and over time. Second, a variable measures the degree to which some policies will be more effective than others in doing what they are supposed to do. Due to broad structural trends such as population ageing, the transformation of household structures and post-industrialization, existing welfare state arrangements are experiencing new challenges (Pierson 2001).

The basic idea of the model is that these two factors, policymakers' payoffs and their perceived effectiveness of policies, interact in determining the expected utility of policy alternatives. Policy-makers may attribute high payoffs to existing welfare state arrangements (either because they are in line with their policy preferences, or because they are electorally rewarding, or both), but nevertheless they may prefer reform because of the low effectiveness of the status quo (for example, excessive burden on public budgets). The exact outcome of the interplay between payoffs and effectiveness depends on the values of the different parameters and thus cannot be derived analytically; what is important is that high payoffs may be counterbalanced by low effectiveness and vice versa, that is, we can see ineffective policies perpetuated if they are considered to enjoy high popularity or are aligned with the (strong) preferences of politicians; alternatively, we can see highly effective policies that are not adopted if they are alien to the (again strong) preferences of politicians or perceived as highly unpopular.

Two additional parameters in the policy change model are the transaction costs –search costs - associated with finding an alternative policy (for example, how to reform social security?) and the uncertainty of the policy process, that is, the expectation that the reform will be passed. This fact is likely to be anticipated by policy-makers: a reform that is very unlikely

to succeed is not likely to be initiated in the first place. Note that this uncertainty is strongly related to the institutional features of the polity. A political system plagued with veto points is likely to pose important obstacles to the passing of reforms, whereas dictators and governments enjoying strong majorities in democratic systems face less uncertainty about reforms being passed. Formally, the model is presented below. In addition to the variables already introduced, we note that ***w*** is a weight, and ***m, n*** measure the effectiveness of policies ***i*** and ***j***, respectively:

$$U_i = wV_i + (1\text{-}w)P_i;\ 0 \leq w \leq 1 \quad (1)$$

$$U_j = wV_j + (1\text{-}w)P_j;\ 0 \leq w \leq 1 \quad (2)$$

$$EU(i) = mU_i;\ 0 \leq m \leq 1 \quad (3)$$

$$EU(j) = nU_j;\ 0 \leq n \leq 1 \quad (4)$$

$$EU(\text{change}) = EU_j > EU_i = pnU_j + (1\text{-}p)mU_i - C;\ 0 \leq p \leq 1,\ C > 0 \quad (5)$$

$$pnU_j + (1\text{-}p)mU_i - C > mU_i \quad (6)$$

$$nU_j - mU_i > C/p \quad (7)$$

where U represents payoffs, V votes, P policy, w is a weight, m and n represent effectiveness of policy i and j respectively, p is the uncertainty of the reform process, and C are transaction costs.

Suppose that i, the status quo, is the classical public provision of social security whereas j is the alternative policy, that is, introducing some private provision of social security. Equation (1) gives the utility of policy i as a function of both votes and the policy preferences of politicians. If governments are highly ideological, they will give more weight to policy *(P)* than to votes (V) ($w<0.5$); yet, facing the prospect of an election, they may give more importance to votes than to their preferred policy in case both conflict ($w>0.5$). Equation (2) gives the utility of alternative policy j. Equation (3) gives the expected utility of policy i as a function of the effectiveness of policy (m) and the utility (payoffs) of policy i. What this equation entails is that a policy may be very attractive in terms of both votes and policy preferences, which are the components of utility, and yet have a low expected utility because the policy is perceived not to be the best means to achieve a particular goal. Equation (4) reflects the same trade-offs for the alternative policy, j. Equations (5) to (7) give the conditions under which a change to policy j, that is, pension reform is most likely to occur. Not only are the perceived effectiveness and payoffs of alternative policies relevant for policy change but also the costs of finding an alternative policy (C); the probability that a new policy will be passed (p) also matters. Eventually, the adoption of policy j and the abandonment of

policy *i* is most likely the more effective policy *j* is perceived to be (*n*); the closest it is to the ideological preferences of politicians (*P*) and to the preferences of voters (*V*); the less costly to find and design that policy alternative is (*C*); and the more likely the passing of that policy alternative is (*p*).

It is important to distinguish among three ways to explain policy convergence: bottom-up, top-down and horizontal, because interdependent effects only appear in the latter. First, policies may converge because countries confronted to the same external shocks respond to them in the same way, but independently (bottom-up policy convergence). Second, policies may converge as the result of an external imposition: a powerful third party imposes the policies on other countries (top-down policy convergence). Finally, policies may converge because policy decisions in one country affect policy decisions in another country, that is, policy choices are interdependent. This horizontal convergence is what we refer to as *diffusion*. Note that we can observe policy convergence not caused by horizontal interdependences (diffusion) (Meseguer and Gilardi 2005). Yet, a model of policy change is not sufficient to explain why policies at times diffuse, that is, why policies change in a good number of countries, in a short span of time, and in the same direction causing policies to converge despite different domestic conditions. Diffusion enters the model with the idea that the main parameters of the model of policy choice and change (*V, P, m, n, p* and *C*) are influenced by the various kinds of interdependencies that exist among countries. In turn, several mechanisms defining how these parameters might be affected by interdependences can explain diffusion:

Learning is defined as a process whereby the experience of other countries supplies relevant information about the results of policies. Politicians deciding under uncertainty about the effects of policy may look around and evaluate how policies have performed elsewhere. Learning implies that decision makers obtain information from other countries that influences evaluations of the respective effectiveness of alternative policies (*m* and *n*). For example, policy-makers may update their beliefs on the effectiveness of pension privatization after observing that in several countries this has permitted to reduce social security deficits.

Competitive interdependence is a process where the choices of others create policy externalities. This alters the relative effectiveness of policies (*m* and *n*). For example, if several countries reduce the burden of social security contributions on salaries, this may push policy-makers to do the same to preserve the competitiveness of the economy, and this despite the fact that they may dislike this reform either on ideological or electoral grounds (or both). Here channels of information are indirect, because decision makers perceive in their own country the consequences of other's policy changes, not the reforms performance.

Common norms may emerge when policy-makers interact with professionals in their networks. These professional networks lead to the development of shared views on appropriate courses of action, which amounts to saying that shared beliefs on effectiveness may create a consensus around the idea that pension privatization is the "best" thing to do during a time period. Whether common norms are effective norms, professionals networks penalize those who are outside their loyalty, and politicians may be tempted to share them, either by concern to be penalized or because they are convinced of the norm's value. In any case, as a result, the policy preferences of politicians (*P*) may change in favour of the new policy. It is clear that international organizations are crucial actors in the production of common norms, but in fact they emerge as product of repeated interactions among experts and professionals located at different places and territories.

Persuasion is a process where pressures from powerful actors (international organizations or powerful countries) suggest orthodox policies to be pursued. Strictly speaking, persuasion is not a mechanism of horizontal diffusion but rather a top-down channel of diffusion (see above). However, is worth exploring because it may reinforce the common norms mechanism in our model. Although several authors have found no evidence of international organizations influencing domestic welfare state reforms (see Armingeon and Beyeler 2004 for the OECD, Brooks 2005 for the World Bank, and Weyland 2004 for the World Bank and the Inter-American Development Bank), it may be argued that if such organizations strongly advocate pension privatization, this may raise the policy payoffs by changing the policy preferences of politicians (*P*) associated to this reform, thus making policy change and diffusion more likely. Moreover, we argue that these organizations also played a crucial role in lowering the transaction costs *(C)* of searching for policy alternatives.

Taken-for-grantedness entails that some policies are considered as natural choices. As Contrary to common norms, here there is not penalization to non-believers, because this is just an interactive process of diffusion of believes about certain situation or policy option. This affects directly the beliefs on effectiveness (*n*) and eventually may alter the policy preferences of politicians (*P*). Over time, justifying private provision of social security because of demographic or economic problems may become so widespread that it is no longer questioned and it is taken for granted as *the* appropriate interpretation.

Symbolic imitation is an interdependent process whereby conformity to socially valued policies is rewarding, which alters directly the relative size of the payoffs of policy alternatives (Ui, Uj). Policy-makers may be uncertain about the effectiveness of pension privatization, but they may feel inclined to try this reform if this constitutes a means to show that they are acting in an appropriate way and gives them prestige. In other words, there are

policies that may increase status and credibility even if its effectiveness is controversial.[2]

What kind of hypotheses can be derived from the model to guide our empirical analysis? First, it is sensible to hypothesize that the relative importance of some parameters varies between innovators and followers. For innovators, a domestic version of the model could be useful. It is in special for the followers that the mechanisms of diffusion mentioned above will matter. Innovators, as opposed to followers, should be expected to have very strong policy preferences (P) or very high electoral expectations (V) in relation to social security reform since hard data about its effectiveness is lacking (n is unknown) and the transactions costs that innovators incur are high (C). In other words, for innovators the effectiveness of the innovation is uncertain and transaction costs are high. As shown in equation (7), this is not a favourable context for policy change, which can happen only if the new policy yields very high payoffs in terms of policy preferences or votes. Alternatively, policy change can occur if the status quo is so ineffective (m is very low) that politicians are willing to run experiments in order to escape a clearly bad situation. Also, innovators are likely to introduce reforms because either they do not face uncertainty about whether the policy will be passed (as in the case of dictatorships) or they enjoy strong majorities (in the case of democracies). Thus, strong policy preferences, an ineffective status quo, and a relatively uncertain policy process will encourage pioneers to innovate.

Second, and regarding patterns of policy diffusion, followers will face less uncertainty about the efficacy of the policy, both in terms of achieving the intended goals and also in terms of the popularity that the new policy may enjoy. The experience of innovators is information continuously available to followers, and this can be seen as an interactive process. That experience change the perception of effectiveness (m and n) and it updates crucial information to followers about the expected support that the policy will enjoy in their country should they choose to change policy. Also, a highly effective policy is likely to affect the policy preferences of politicians (P), especially if the mechanism of learning plays some role. And finally, in their condition of followers, the transaction costs (C) they face are lower, since followers do not have to innovate as much as they copy or adapt the policy to their specific conditions.

We hypothesize that, in social policy, electoral payoffs and the policy preferences of politicians are likely to matter a lot and not only for ideological reasons. Social policies provide politicians with a useful tool to differentiate their platforms and actual choices from those of their political rivals. This implies that all mechanisms that influence effectiveness may have a limited impact on policy change. Beliefs on the effectiveness of the status quo may evolve (because of learning, competition, or common norms) in a direction that favours

in the privatization of social security; but this may not lead to change because of the importance of electoral considerations. Things may be different if policy-makers give (much) more importance to policy preferences than to votes (w<0.5), and especially if they are ideologically inclined to privatization. In this case, the payoffs are so strong that beliefs on effectiveness may in fact be irrelevant (that is, EU(privatization)>EU(status quo) for almost any n).

Additional hypotheses are needed with respect to which mechanisms of diffusion are likely to be more relevant. *Taken-for-grantedness* is almost certainly not relevant: no one thinks that there is no alternative policy to privatizing social security. *Learning from* the results of others' pension privatization somewhere else may matter although the hard part is to pinpoint at the specific result that may have been crucial in spurring policy change somewhere else. However, the results of some early innovators may have a higher visibility. Taking into account that pension privatization has been mostly an economic strategy; *competitive interdependences* may have played a more important role than one would expect to find in social policies. We also hypothesize that *symbolic imitation* and *common norms* may have been relevant mechanisms to impact on decision-makers behaviour to reform the pension systems but the actual models adopted have been rarely the result of purely symbolic motivations. Finally, we hypothesize that the role of *international institutions* and *powerful countries* in paving the way towards privatization of pension systems both in the Organization for Economic Cooperation and Development (OECD) and in Latin America has taken the shape more of persuasion and dissemination of policy ideas than of outward imposition. It is with these expectations in mind that we proceed to analyze the adoption and diffusion of pension reforms in Latin America and the OECD using the abundant secondary literature on the topic.

3. The adoption and diffusion of the privatization of social security.

3. 1. Pension Reform in Latin America: the leader and the followers.

The purpose of this section is to give an account of the adoption and diffusion of pension privatization in Latin America using the model depicted above and consequently the parameters *m, n, V, P* and *C* as the analytical tools for the narrative. We shall distinguish between the decision to change policy focusing on the innovator (Chile) and the decision to subsequently adopt the innovation or some version of it in Argentina, Uruguay, Costa Rica, Mexico, and Peru that is, the diffusion of the policy innovation.

As table 1 reflects, many countries engaged in the reform of the pension systems but a

few others did not make any progress. Moreover, variation is important among those that chose to privatize the provision of their pension systems. Whereas some decided to follow closely the Chilean reform and put at the centre of pension provision a mandatory Fully Funded Individual (FFI) private second pillar and give to the first public pillar a marginal role, others chose to strengthen or reform the public pensions system and developing the second pillar, that is, the private FFI system complementing or competing in parallel with the first public pillar. In other cases, notably Brazil and Venezuela, the provision of public pensions was reformed but not privatized, with the emphasis put on improving the financial viability of the public PAYG system. Thus, we can rule out from the outset the mechanism of *taken-for-grantedness* as an explanation of the diffusion of pension privatization in the region. There was nothing taken-for-granted in the decision to privatize Latin American pensions systems.

Table 1. Pension Reforms in Latin America as of 2005

Full privatization; FFI accounts; PAYG system closed immediately or to be phased out gradually.	Bolivia, 1997 Chile,1981 El Salvador,1998 Mexico,1997 Dominican Republic,2003 Nicaragua, 2004
Parallel public PAYG and private individual accounts systems; both options available to choose from.	Colombia, 1994 Peru, 1993
Mixed systems; basic public PAYG and supplementary private individual accounts systems.	Argentina, 1994 Uruguay,1996 Mexico, 1992 Ecuador,2004 Costa Rica, 2001
Changes in public PAYG system to strengthen financial viability, parametric reforms recently launched or in progress	Brazil, 1999 Venezuela, 2005
No major reform proposals presented by government to legislature	Guatemala Honduras Cuba Haiti Panama Paraguay

Sources: Cruz-Saco and Mesa-Lago, 1998, Mesa-Lago, 2004

We shall argue that the diffusion of pension privatization in the region is not associated with countries' thorough evaluation of the performance of the reform along the parameters expected to be used to evaluate it. Pension privatization was considered successful only because it was part of a general economic strategy that was considered successful, but not because the reform delivered good results in terms of the criteria we shall mention. We shall also argue that International Financial Institutions (IFIs) have hardly coerced; however, they have been crucial as model disseminators. Their persuasive labour has consisted much more in reducing the transaction (*C*) for countries searching for policy alternatives than in changing politicians´ policy preferences dramatically. We shall argue that pension privatization was fundamentally conceived as an economic rather than a redistributive strategy and that the need to signal credibility to capital markets and reduce labour costs was crucial in the diffusion of pension privatization. However, our final argument will be that policy maker' preferences shifted in favour to reforms because of horizontal interdependencies: they were exposed to professionals' common norms sustaining privatization positions, and as symbolic imitators also they interact for gaining prestige from different countries. No doubt that the particular model of pension reform adopted in each country was clearly constrained by domestic politics and the expected electoral payoff of the reforms (*V*), but also we shall sustain that more audacious reforms depended on policy preferences and not on considerations about the effectiveness of the policy alternatives, the uncertainty of reform process or their transaction

costs.

Chile launched the privatization of its pensions system in 1981 under authoritarian rule. The core of this reform was individual pension accounts funded by workers´ compulsory contributions and the investment of those contributions to be managed by competitive private firms (Administradoras de Fondos de Pensiones (AFPs)). Employers do not contribute in this model and there is a (meagre) social assistance pension paid by the government. This system, also referred to as FFI system, completely substituted the previous PAYG system (Mesa-Lago and Arenas 1998, Mesa-Lago 2004).

The PAYG system was perceived to be in arrears (*m* was very low) already well before the privatization process was launched. It was costly and unequal; but the possibility of reform was thwarted by a highly politicized and fragmented labour movement, a highly competitive political system, and the economic crisis (low *p*). There was nothing Eduardo Frei could do under these circumstances. However, these were no obstacles under the highly repressive and autonomous Pinochet´s regime, which imposed pension privatization after emasculating labour and silencing public opinion. Unconcerned about the probability of passing the reform ($p=1$), Pinochet put in place a pension system consistent with his policy and ideological preferences (*P*). The private system substituted the principle of social solidarity for that of individual responsibility and it was in accordance with the spirit of his overall project of societal transformation. Moreover, pension privatization was in line with the regime's overall economic strategy aimed at giving the lead to the market as the way to boost savings, investments, and growth (Borzutzky 1998; Mesa-Lago 1998). Efficiency, not equity, was the main concern. Thus, a combination of a perceived ineffective status quo (low *m*), strong policy preferences (strong *P*) and an uncertain political process ($p=1$) explains the adoption of the radical Chilean model of pension privatization. This policy had a high expected utility (*EU*) despite the important transaction costs associated with pioneering and the uncertain outcome of the policy.

The perception that a reform was needed out of an ineffective *status quo* is also crucial to understand the subsequent wave of privatizations in the region (*m* was low). The economic crisis of the 80s and the growth of the informal economy together with the ageing of the population severely threatened the viability of the traditional PAYG system as the number of contributors per pensioner – dependency ratios – decreased dramatically (Brooks 2004). Countries were searching for alternatives to reform a system that was perceived to be economically and socially unsustainable and the Chilean model provided a valuable reference with which to agree of disagree; in any case, the Chilean model framed most debates on pension reform.

We have mentioned above that followers as opposed to policy innovators have more information about the effectiveness of the new policy (*n*), they have information about the anticipated popularity of the reform (*V*) and they face less transaction costs (*C*) since there is a model out there that followers can simply copy or adapt but they do not need to create or discover. Thus, the value of these parameters gets modified depending on the number of countries that already did the reform before. As Weyland (2004: 21) puts it, governments "let others make the mistakes and copy the successes."

The information about the effectiveness of the alternative policy (*n*) and the reaction to that information is crucial to evaluate whether the mechanism of *learning* played some role in the diffusion of pension privatization in the region. In the case of this mechanism, the complication is to pinpoint at the particular variable or parameter of performance that politicians may have used to assess the effectiveness of the Chilean pension reform. As Cruz-Saco and Mesa-Lago mention (1998: 14), there are several dimensions of pension reform one may use to evaluate its success. One could for instance assess whether the Chilean pension reform (1) increased compliance and therefore contribution and coverage (2) whether the reform reduced administrative costs (3) whether the reform has expanded capital markets and national savings have increased (4) whether the investment yields of pension fund portfolios are higher (5) whether real pensions are higher and finally (6) whether the private pension system improves equity.

Interestingly, a sober analysis of the Chilean pension reform suggests that the Chilean pension privatization has not fulfilled its promises in most of the dimensions mentioned above and where it has fulfilled it promises, it is doubtful whether pension privatization has been the reason. The Chilean pension reform has not increased coverage, it is very costly to administer, and it has put a strong pressure on the government accounts because the transition to the new model is very costly while the two systems co-exist. Finally, it has not redistributed income. However, all this information was available only many years after the reforms, not during the early nineties. At that moment, the Chilean pension privatization process *coincided* in time with a boost in savings (over 20% of GDP in comparison to less than 15% in other Latin American countries), investment and economic growth, though; but sober analysis is also showing that pension reform cannot be given responsibility for this boost. Apparently, the boost in savings and investment had much more to do with an increase in firms' and governments' savings rather than households' savings (Demarco 2004; Pinheiro 2004; Huber and Stephens 2000; Borzutzky 1998; Mesa-Lago and Arenas 1998).[3]

Why then was the Chilean pension privatization considered a success? Why the reform was considered to be effective (high *n*)? We argue that the reform was considered to be a

success only because it was part of a successful broader economic strategy and fully consistent with the spirit of that broader economic strategy. This was evidenced by the uncontroversial outstanding rates of growth of Chile at the same time that the rest of the region stagnated. Pension privatization was judged to be a success not on the basis of the parameters that should have served to judge it but on the basis of the broader objective to which pension reform was contributing, that is, promoting economic growth. Thus, what politicians in the region learned was that the overall Chilean economic strategy successfully promoted growth and that pension privatization was part of that economic strategy. It was irrelevant for them whether pension privatization was *the* cause of the economic dynamism (Madrid, 2003).

This does not mean that governments did not look at the parameters mentioned above to subsequently evaluate pension reform; but when they did, it was precisely to distance from the radical Chilean model. For instance, the high transition costs attached to the adoption of the FFI system posed an internal inconsistency, for a reform that was launched to reduce government deficits ended up increasing them.[4] This fact reduced the expected utility of pension privatization (*EU* was low) in countries where the transition burden was expected to be very high and in countries were inequality was a severe problem. Governments in Argentina, Uruguay, and Brazil modified their reform proposals with the evidence of these high transitions costs in mind - besides other political reasons we shall mention later – and opted for alternative models of pension privatization. Thus, whereas a bad *status quo* (low *m*) and the perception of overall success of the pension reform as part of a more general growth strategy (high *n*) motivated the adoption of pension reform, the evaluation of the particular dimensions of the Chilean model determined how much specific country choices distanced from the Chilean model. Overall, *learning* from the Chilean experience has had two different consequences: learning from the positive results of the Chilean growth strategy of which pension privatization was seen as part encouraged other countries to reform their pension systems; however, learning from particular dimensions of the Chilean pension reform – particularly, its high transition costs - led some countries to opt for less radical models of pension privatization.

In Latin America, there is no doubt that pension privatization was conceived mostly and fundamentally as an economic rather than a redistributive policy (Madrid 2002). With that in mind, it is not surprising to find that *competition* has been a more important mechanism of policy diffusion than one would expect taking into account that *a priori* we are dealing with a social policy. In the 90s, pension reform came to be seen as an indicator of the national commitment to free market principles that could boost investment ratings. Also, the privatization of pensions and the expected increase in savings were conceived as a remedy to

the high dependence of the region on footloose foreign capital that so much economic distress had caused to the region (Huber and Stephens 2000; Weyland 2004; Nelson 2004; Brooks 2004). Finally, governments could perceive that pension privatization would help to solve the labour market distortions associated with employers' high contributions, which in turn was considered to be an obstacle to improve international competitiveness. For instance, Mesa-Lago and Arena (1998) mention that trade liberalization measures made much more difficult for employers to pass on the costs of social security contributions to customers. And in Mexico, were the employers' contribution was kept, there was concerned about how this fact would affect Mexican integration into the world market in the face of the establishment of the North American Free Trade Agreement (NAFTA) (Bertranou 1998). Thus, the new competitive environment introduced a new perception of how effective the privatization of pensions might be from a strictly economic point of view (increased *n*). It is unclear, however, to what extent effective economic competitive pressures –investment, wages, employment…- contributed to update policymakers' perceived effectiveness of policy reforms[5].

In the secondary qualitative and quantitative literature, there is a widespread consensus regarding the advisory rather than the coercive role played by the different IFIs involved in model discussion and dissemination. In fact, several countries launched their reforms before the World Bank published its influential report, *Averting the Old Age Crisis*, in 1994. Thus, *overt coercion* has not been a fundamental mechanism in the diffusion of pension privatization in the region. Most countries initiated discussions on pension reforms with the IFIs playing a marginal role in those discussions if playing some role at all (Brooks 2004; Demarco 2004; Brooks 2005; Weyland, 2005). Actually, the internal competition among different IFIs which advocated rival models of pension privatization undermined the capacity of IFIs to impose any particular model (Weyland, 2004). Whereas the World Bank (WB) and the International Monetary Fund (IMF) advocated the creation of a compulsory second private FFI pillar in the framework of a multipillar system[6], the International Labour Organization (ILO) and the International Social Security Association (ISSA) emphasized the strengthening and reform of the public first pillar and to develop a voluntary complementary savings plans (Cruz-Saco and Mesa-Lago 1998; Weyland 2004; Pinheiro 2004). IFIs, however, exerted a very important function by providing policy alternatives, offering forums for debate and exchange of policy ideas and, eventually, providing financial resources for the transition to private models of pension provision of different sort. It is unlikely that Latin American governments had paid attention to pension reforms in New Zealand, Sweden, or Latvia had not the WB acted as an active promoter. Thus, although IFIs shaped politicians' policy preferences through debate, we argue that their most important function was to reduce the

high transactions costs involved in searching for policy alternatives and particular solutions for specific countries *(C).* As a matter of fact, in quite a few cases, notably Uruguay and Costa Rica, the advocacy role of the IFIs could not change the deeply ingrained preferences of these societies for which the radical Chilean model was not a serious alternative.

Pension privatization occurred in a context in which primacy was given to market principles and to a commitment with economic liberalization, and the views on the benefits of creating markets for pensions were converted in a set of common norms among a large epistemic community of finance professionals, policy advisers and neoclassical economists having governmental positions (Madrid, 2003). Pension privatization was seen as contributing to that broader principle. But it is also true that there was considerable debate and nothing similar to common norms regarding how pension privatization should address the other dimensions of pension policy, namely, the insurance and redistributive goals of it. This means that probably within the networks of social security professionals multiple views were presents. However, networks of economic reformers with such common norms reached to be highly influential and were able to place in policy agendas for many cases the issue of pension privatization (Madrid, 2003).

Finally, *symbolic imitation* played an important role. Although no country did engage in the reform of the pension systems without mediating the perception that something needed to be done to solve the financial crisis. Possible alternatives to the Chilean model were usually considered, but in most cases aiming a privatization strategy that may provide most prestige to policy makers. In some cases, notably Mexico in 1995, the choice made was especially radical and symbolic. As Huber and Stephen explain (2000), "the peso crisis of early 1995 made it particularly urgent to reassure international financial markets with a *symbolic act* (emphasis added), like pension reform." However, symbolic imitation together with common norms shaped decision makers policy preferences, acting as key mechanisms to explain the horizontal diffusion of pension reforms in Latin America.

As said, not all explanatory factors come from a horizontal diffusion perspective. It is impossible to understand the particular shape taken by pension privatization without taking electoral concerns into consideration (*V*). It is not by chance that countries only engaged in pension privatization after Patricio Alwyn's democratic government in Chile (1990) agreed to keep Pinochet's pension reform, thus removing the stigma that linked pension privatization with Pinochet's dictatorship. It is not either by chance that the countries that followed closely the Chilean model were the ones were the political power was highly concentrated (Madrid 2002). This is clear in Mexico, where the dominant and disciplined *Partido Revolucionario Institucional* (PRI) under Ernesto Zedillo (1994-2000) held control of the congress and the

union (Bertranou 1998; Huber and Stephens 2000). A somewhat deviant case is Alberto Fujimori in Peru (1990-2000), who despite concentrating all power in his hands after the 1992 *autogolpe* still chose to implement a parallel rather than radical pension reform, allowing the public first pillar to compete with the private second pillar. According to Cruz-Saco (1998), Fujimori's choice derived from the political need to legitimate himself during the presidential campaign previous to his re-election in 1995 ($w>0.5$).

In Argentina, Carlos Menem set out to reform the pension system but was convinced that privatization *á la* Chile was impossible by an act of congress. Concerned about the popular reaction to pension reform, the government conducted a poll to gauge public opinion on that matter. The poll revealed that Argentines were suspicious both about the extant public system and the privatization of pensions. The poll also revealed that they expected the pension system to exert a redistributive function. Unions, who were a powerful actor, had to be somehow appeased as much as the opposition within the Peronist party. Eventually, a mixed pension system was adopted that allowed non profit organizations, including unions, to participate as managers of private pension funds thus ending with unions' opposition to the reform. The state continues to play an important role in the administration of the system (Demarco 2004).

The number of veto players certainly affects politicians' expectations of passing the reforms and the kind of reform that is eventually passed. In Brazil, the privatization of the pension system required a constitutional amendment, which in turn required a 3/5 majority in Congress, making p very close to 0. An amendment was passed in 1995, but the government lacked a majority in the legislature and could not even count on the votes of its own coalition. Congress deliberated for three years, eventually passing a watered-down version of the reform in 1998 (Huber and Stephens 2000; Pihneiro 2004). In the same vein, in Uruguay, the institution of the referendum made possible to pass the reform of the pension system only after five trials (p was low) and after deep political debate had made clear that society supported the public provision of social security and would never back a full privatization of the pension system. It was also the strong preference of Julio Maria Sanguinetti's government to protect the redistributive function of social security (P) (Brooks 2004). Thus, neither was full privatization the preference of the government nor of the society, and therefore the utility (U) of privatizing pensions was low.

In sum, our cases range from the radical Chilean model in which both the utility (U) of pension privatization (V did not matter and P were strong) and the expected utility (EU) of pension privatization (n was believed to be high) were conducive to a radical choice. At the other end, in cases like Uruguay, both the utility *(U)* of pension privatization (V was low and

P was weak) and the expected utility *(EU)* of pensions privatization (*n* was low in the view of high transition costs) played against a radical choice.

Overall, we argue that the diffusion of pension privatization in the region resulted from the combination of a perceived need for reform (low *m*, increasingly shrinking, because of competitive interdependence), the perception that there was an effective alternative whose success was judged in the view of the growth results in Chile (high *n*, and growing because of 'holistic' learning during the early nineties). However, in this "favourable" context, the adoption of reforms by different countries was trigged by preference changes of policy makers. Such preference changes where caused by the perception that this policy alternative was precisely *the* most effective one in an open and integrated economic environment. IFIs persuaded and made governments' task of looking for policy alternatives much simpler (reduced *C*). The diffusion of strong common norms within economic and financial professional networks that reach close positions to decision makers, introduced the primacy of the markets and liberal economic policies pushed for preference shifts, displacing values of traditional Social Security professionals, most of them trained in law . Rarely did countries adopt pension privatization for purely symbolic reasons, but reinforced the preference shift and pushed for more radical reforms because policy makers competed for prestige. Finally, at the domestic level, the model eventually chosen was shaped by the probability that the proposed reform was passed (*p*), which in turn depended on societal preferences and above all on the possibility that political institutions offer to the society to express those preferences and thereby affect politicians' fate (*V*).

3. 2. Pension Reform in OECD countries: the leader and the followers.

The main trend in OECD pension reforms is the progressive shift from PAYG systems to capitalized systems (Palier and Bonoli 2000). As we have seen in the previous section, this trend is observed outside Europe (see also Brooks 2002). Table 2 summarizes the state of pension reforms in selected OECD countries.

Table 2. Reforms to pension systems in OECD countries: measures to establish/expand capitalization

	Capitalization already well established before the 1990s	Reforms in the 1990s

Australia	No	Mandated private pensions for all except young and lowest paid workers, but excluding self-employed.
Canada	Yes	
Finland	No	--
France	No	--
Germany	No	Granted subsidies for participation in new private pension schemes as individual accounts or as employment-based fund.
Hungary	No	
Italy	No	Encouraged establishment of private occupational pension schemes.
Japan	No	Proposal to establish framework for private individual accounts.
Korea	No	
Netherlands	Yes	
Norway	No	
Spain	No	Granted tax incentives for privately-managed occupational accounts and individual pension accounts
Sweden	Yes	Diverted 2.5 percent of 18.5 percent contribution to mandatory public pension to individual accounts with private, mutual funds.
Switzerland	Yes	
United Kingdom	Yes	Encouragement of private second-tier provision and reduction of attractiveness of public second tier for other than lowest earners – objective, to switch from 60:40 public-private mix to 40:60 mix.
United States	Yes	

Source: (Casey et al. 2003: 49)

As in Latin America, a clear leader can be identified, namely, the United Kingdom (UK). The UK introduced already in 1975 (implementation in 1978) a second pillar, the State Earnings Related Pension Scheme (SERPS), which is a public PAYG plan where benefits, unlike in the first pillar, are related to earnings (Disney, Emmerson, and Wakefield 2001: 71-72). In this system, opting out was possible, but only for employees who belonged to an employer-provided occupational pension scheme, in which case both the employer and the employee paid a reduced fee, although normally the employee had to pay an additional contribution for membership in the plan. Under this arrangement, responsibility for providing the second-pillar component of pensions fell on employers, who in exchange paid reduced contributions.

The second pillar was partly privatized in 1988, when employees were given the possibility to opt out to personal saving accounts operated by private insurers, while maintaining the public PAYG second pillar (the SERPS). Therefore, this reform introduced capitalization into the second pillar. In this option, there is no guaranteed pension; the benefits depend on contributions but also on the performance of the investments operated by the insurer. This reform was in fact a watered-down version of a proposal put forward by the Thatcher government, which intended to fully privatize the second pillar, but failed to do so because of the problem of financing current pensions when PAYG contributions disappeared;

in addition, the proposal was opposed by trade unions, the left opposition, and even part of the employers (Palier and Bonoli 2000: 220), the latter mainly because of the double-payment problem (Stephens, Huber, and Ray 1999: 183).

The British reform can be interpreted in the same way as that of Chile (see previous section): innovation was possible because of the combination of strong policy preferences (P) and comparatively little uncertainty about the outcome of the process (p). The Thatcher government was obviously keen on introducing more privatization in social security, and this was made easier by the fact that the British political system was characterized by a single veto player, namely the government. Veto players have been acknowledged for long as central institutional determinants of welfare state development and reform (see e.g. Bonoli 2001; Huber, Ragin, and Stephens 1993; Huber and Stephens 2001; Immergut 1992; Swank 2002). The more players have to agree for policy change, the more difficult it is to build universalistic welfare policies, and the more it is to roll them back if they have been established. Thus, it is not surprising that "leaders" in pension reform were countries where the uncertainty of the reform process was relatively low, namely Chile (a dictatorship at the time) and the United Kingdom (a single veto player).

In addition to veto players, another institutional characteristic made reform comparatively easier in the United Kingdom, namely, its electoral system. Of course, the electoral system is one of the determinants of the number of veto players (and therefore of p), but it also has a second, distinctive influence on pension reform. An important component of the resilience of welfare state arrangements is their fundamental popularity: "Welfare state expansion involved the enactment of *popular* policies in a relatively undeveloped interest-group environment. By contrast, welfare state retrenchment generally requires elected officials to pursue *unpopular* policies that must withstand the scrutiny of both voters and well-entrenched networks of interest groups" (Pierson 1996: 144, original emphasis). This is obviously related to the V component of the utility function, which can put off even governments that, on a policy perspective (P), would prefer pension reform.

While this is true for all countries, what changes is the relative importance of P and V for policy-makers (that is, w). Interestingly, w partly depends on the electoral system. In plurality systems, only a relative majority of votes is necessary for a party to win elections. In these cases, unpopular reforms will lead to less dramatic electoral sanctions, as was the case in the United Kingdom, and also in New Zealand (Huber and Stephens 2001: 307). New Zealand is an interesting case because of its radical pro-market reforms initiated by the left, which were also unpopular (low V) but feasible because of the specificities of the plurality system (Nagel 1998). The left lost two elections in a row (1978 and 1981) despite winning a majority

of votes, so that in 1984 it was willing to trade some votes in safe districts against votes in more conservative districts by putting forward neo-liberal reform, a strategy that turned out to be successful.

Plurality systems have thus the effect of reducing the relative importance of electoral support (*V*) in policy-makers' utility function, and conversely, increasing the importance of the policy component (*P*) ($w<0.5$). In addition to the electoral system, the strategic configuration of party systems can also influence the extent to which politicians are willing to pursue unpopular reforms (Kitschelt 1999; Kitschelt 2001). For example, social-democratic parties will be more willing to pursue retrenchment if they face no significant competition at their left from parties that could benefit from the votes of disappointed social–democrats (Kitschelt 2001: 276). This was the case in Sweden, where the introduction of a capitalized second pillar by left governments in the 1990s, along with other unpopular reforms, was possible because only a minority of voters disaffected with reforms turned to communist or protest parties, so that social-democratic electoral losses, while important, where not catastrophic (Kitschelt 2001: 291). The capacity to pursue unpopular policies may also follow a "Nixon-goes-to-China" logic (Ross 2000): left parties may be more trusted not to "exaggerate" in welfare state reforms because they may be perceived as doing it almost against their will, while right parties may inspire the fear of thorough retrenchment. In Britain, however, it was a conservative government that enacted pension reform without suffering much electoral losses. This was possible because of the economic crisis (low effectiveness of the status quo, *m*) in conjunction with the low credibility of the Labour party with respect to its capacity to improve the situation (Kitschelt 2001: 283).

The British reform was also made possible by the nature of the pension system. One of the major obstacles to pension reform is the "double-payment problem": "a shift from PAYG to capitalization (or pre-funding) requires current workers to continue financing the previous generation's retirement while simultaneously saving for their own" (Myles and Pierson 2001: 313). This problem affects the effectiveness of reform (*n*), and is not homogeneous across countries because it depends on the scope, maturation and design of the PAYG system, which vary across countries. Myles and Pierson (2001) thus draw a distinction between "latecomers", namely countries where significant PAYG programmes were not in place at the end of the 1970s (that is, when pressures for retrenchment began to materialize), and countries where such programmes were well developed at that time. Only in the former was a shift to capitalization possible (*n* relatively high), while in the latter the costs of transition made capitalization an ineffective alternative (low *n*). Consequently, the main reform strategy was a reduction and rationalization of PAYG transfers (Myles and Pierson 2001: 307). In Britain,

PAYG schemes existed in 1980, but their implementation was recent. This factor was crucial in making the transition to capitalization technically feasible (Myles and Pierson 2001: 314), even though the fact that PAYG programmes existed made it impossible to fully privatize the second pillar as Thatcher wished. By contrast, the presence of a comparatively well-developed PAYG system (low *n*) prevented an equally motivated government, the Reagan Administration, from privatizing social security (Myles and Pierson 2001: 314-315). It remains to be seen how far the Bush administration will succeed in its current attempts to achieve the same goal. What can be said is that privatization suffers from low effectiveness due to high transition costs (low *n*), but on the other hand what matters is not *n* per se, but rather in relation to *m*, and in this respect pressures on the status quo are more severe now than twenty years ago.

To sum up, then, several factors made the United Kingdom a forerunner in pension reform. Firstly, pension privatization yielded high payoffs to the Thatcher government: it was clearly attractive in policy terms (*P*) and not too damaging in electoral terms (*V*) because of the low credibility of the Labour opposition, which made it possible to neglect the unpopularity of the reform[7] ($w<0.5$). Capitalization was a reasonably effective alternative (*n* relatively high) because the PAYG system was relatively recent, which made the double-payment problem less severe than in other countries. Finally, the institutional context was favourable to reform because of the centralization of authority in the hands of the executive (*p* relatively high).

A note is due on Switzerland, where a capitalized second pillar existed before the British reform. Switzerland is however a different case because the introduction of a compulsory second pillar in 1982 (implemented in 1985) actually constituted an expansion of the welfare state, since before the reform occupational pensions existed but were not mandatory. Switzerland is thus an example of difficult expansion of the welfare state because of the many veto players rather than an example of difficult retrenchment. Despite this fundamental difference, both Switzerland and the United Kingdom, in addition to Chile, had an influence on reforms in other countries, since on the one hand they demonstrated the feasibility of capitalization (update of beliefs on *n*), and on the other hand they inspired influential reports such as that of the World Bank (Palier and Bonoli 2000: 213), but also the European Commission green paper (1997) and an OECD report (1998), which further encouraged the spread of pension reforms (lowering transaction costs, *C*).

These diffusion effects were however rather limited, and could not have led to change in other countries without a sharp deterioration of the effectiveness of PAYG systems (low *m*). Palier and Bonoli (2000: 236-237) argue that in Sweden, France, Germany and Italy no

attempts to reinforce capitalization would have been possible if the status quo had not been proven to be ineffective. According to Stephens et. al. (1999: 181), in Scandinavian countries "significant rollbacks were resisted until it appeared that it was impossible to return to the previous low levels of unemployment."[8] In Greece, reforms of the pension system were initiated in the 1990s because of its patent ineffectiveness, both in terms of fiscal burden, especially in the context of the European Monetary Union (EMU), and of equity (Featherstone, Kazamias, and Papadimitriou 2001: 463). At the beginning of the 1990s, it even appeared as a real danger that the state would soon be unable to pay pensions and salaries to the public employees (Featherstone, Kazamias, and Papadimitriou 2001: 468). Despite these strong pressures, reform has proven to be very difficult, mainly because of the opposition of powerful constituencies (low p). In Germany, the 2001 pension reform allowed a progressive introduction of capitalization in a path-breaking public-private mix that was due to the fact that, basically, the status quo was no longer tenable (very low m). As Lamping and Rüb (2004: 175) put it, "policy makers ran out of options for internal problem solving and were more or less pushed to a path-breaking strategy." Pension reforms in Italy, enacted by the Dini and Amato governments in the early 1990s, were also influenced by the very low effectiveness of the existing system, which was both financially unsustainable (in 1993, pension deficit was 47% of overall public deficit) and not equitable, since it discriminated sharply across occupational categories (Natali 2004).

All countries, therefore, are under the pressure of a low effectiveness of the status quo (low m). The factors leading to this loss of effectiveness can be linked either to globalization or to structural socio-economic changes of post-industrial societies. According to some accounts, globalization exerts downward pressures on the spending capacities of states. Since pensions (together with health care) account for a large part of welfare spending, which in turn accounts for a large part of public spending, they are a natural target for governments wishing to contain expenditures.

However, whether globalization limits the spending capacities of states is unclear, since many scholars have pointed to the fact that not only does globalization not reduce welfare state expenditures, but in some cases it even increases it (see e.g. Garrett 1998). In a similar vein, Pierson has argued that, whatever its precise impact, globalization is not the main factor driving welfare state reform in general, and pension reform in particular. Rather, "post-industrial pressures" at the domestic level should be held responsible, such as the rise of the service sector and the slower productivity growth associated to it, welfare state maturation, population ageing, and the transformation of household structures (Pierson 2001b). The effect of these pressures is that existing welfare state arrangements are no longer sustainable (low

m). The consequence of these trends is, following Pierson (Pierson 1996; Pierson 2001a), a "new politics of the welfare state." While welfare state development was strongly driven by party politics and in particular by the strength of the left (Huber and Stephens 2001), in the new context, partisan differences are eroded, since governments of all ideological leanings have no choice but to reform the welfare state. In terms of our theoretical model, this could mean two things: firstly, policy preferences (*P*) become more homogeneous across parties, with the left embracing pro-market policies (Ross 2000); or secondly, the left still prefers generous and universalistic pension systems (*P* varies as a function of the partisan composition of governments), but cannot avoid reform because of the ineffectiveness of the status quo (*m* is low). Thus, no matter what *P* is, the expected utility of the status quo is low because of the low *m*. This seems to be the view of Huber and Stephens (2001: 240).

To sum up, pension reform in advanced countries has been driven by a declining effectiveness of the status quo (*m*) under the pressure of a host of domestic and international pressures. Prominent examples of capitalization such as Switzerland and the United Kingdom have certainly influenced reforms by showing that capitalization can be an effective alternative (*n*). Of course, as our model shows, a relative change in *m* and *n* may not be sufficient for policy change. Transition costs may remain too high (*n* too low), electoral sanctions may be too strong (*V*, *w*), and the uncertainty of the reform process may be very high (*p*). In this respect, it should be mentioned that in addition to formal veto players, organized interests and opposition parties also influence *p*. Most successful reforms, in effect, implied the close association of social partners and/or opposition parties to the decision-making process (Natali and Rhodes 2004; Schludi 2003).

How does the European experience relate to Latin America? The same trend towards capitalization can be observed, which is however stronger in Latin America. This is due to several reasons. Firstly, on average *n* is higher in Latin America because of the lower (in comparison to Europe) implicit pension debt in that region (Madrid, 2002). Secondly, in Latin America, pension reform had the broader goal of signalling commitment to market reform to attract investment and enhance credibility, something that was not needed in advanced countries, at least not so desperately; the perceived positive performance of Chile in that respect updated beliefs on *n* in other countries. By contrast, in industrial countries, the goal of reform was essentially the improvement of the financial viability of the pension system.

Overall, changes in the perception of the effectiveness of the status quo *(m)* and of the alternative *(n)* can alone tell the story of partial pension reforms in advanced countries. What the narrative above shows is that neither *learning*, nor *competition*, or *symbolic imitation* have played the role that these mechanisms of policy diffusion have played in stimulating the

adoption of pension reforms in Latin America. At the most, the Maastricht criteria on budget deficits and debt ratios to GDP have exerted some *soft coercion* to privatize but the reforms adopted, again, have not been unique. The comparison with Latin America also reveals that the increasing turn to capitalization in advanced countries accords to a case of bottom-up convergence, that is, one observes that policy choices have somewhat converged in advanced countries; but the reason is not so much that policy decisions in one country affected policy decisions in another country as it is the fact that countries confronted with a similar problem (the bad finances of the pension systems given the new post-industrial context) have *independently* chosen to partly capitalize the provision of social security. This is why, we believe, the interdependent logic that Brooks tests in her quantitative study performs badly in the advanced countries despite observing some policy convergence also in that region.

4. Conclusions

There has been a worldwide trend towards the introduction of market reforms in social policies. In the case of pension provision, market reforms have entailed the substitution, complementation and/or competition of public systems with the creation of a private second pillar that ties benefits to contributions and the quantity of benefits to the yields of the investment of those contributions. Whereas this trend is general, there are important inter and intra regional differences regarding the particular form of pension reform adopted. This paper aimed to explain those differences.

We took Brooks' (2005) results on the diffusion of pension privatization as our point of departure. Despite observing a worldwide policy convergence towards privatization, the author finds that peer dynamics (peers influencing subsequent decisions to reform pension systems) have been relevant among Latin American countries but not among advanced countries. Using, in turn, an expected utility model of policy change and policy diffusion suggested by Braun and Gilardi (2005) we argued that policy convergence is observed among Latin American countries because different mechanisms of horizontal diffusion (interdependence) did play a role: learning from the experience of other countries, economic competition, common norms and symbolic imitation were relevant mechanisms spurring the diffusion of pension reform in the region. Learning from the experience of others had two opposing effects, though: it encouraged privatization in the view of the Chilean success but it discouraged the most radical option among those countries for which the transition costs to a fully private model were expected to be very high (like Argentina and Uruguay).

Interestingly, all advanced countries fell under the latter category. This is why we do not observe any case of radical privatization in the OECD, not even for the innovator (UK)

despite operating under quite unrestrained political conditions. One observes policy convergence among industrial countries only because they were confronted to the same problem of a low effectiveness of the status quo amidst a shared context of demographic and economic changes. But the decision to engage in pension reforms appears quite independent for each country. There is little evidence about learning from others or economic competition, and there does not exist in Europe a powerful network of economists with common norms able to shift politicians preferences on pension policy, and tendencies to imitation are strongly shortcut by domestic policy processes. For these reasons, these mechanisms did not play the prominent role that did play in Latin America, although more primary research will have to be done in this respect. Thus, pension reform in industrial countries would better accord to a process of bottom-up convergence rather than horizontal diffusion.

There is strong evidence that domestic politics was crucial in opting for one or another model of pension reform. Even in countries in which the status quo was ineffective and politicians initially proposed radical options, re-election concerns and the pressure of specific groups, notably unions, set a limit to how much to privatize pension systems. This narrative account accords with the result of statistical analysis that point to the important role of veto players in halting radical reform projects.

In sum, regarding inter-regional differences, we find that pension privatization was a more popular policy in Latin America because their pension systems were relatively recent and thus, the implicit debt governments were facing was relatively lower – consequently transition costs were also lower - than that of their OECD counterparts. Moreover, pension privatization was also more popular among Latin American countries because they were more pressed by their bad macroeconomic performance, more urged by competitive concerns and the need to signal credibility, and much more exposed to IFIs advice. Finally, intra-regional differences had also to do with expected transition costs, and, fundamentally, with the political space to push for reforms. However, in spite of all these factors, to explain pensions policy change in Latin America as an interdependent and horizontal phenomenon (and not only a as convergent process), we also should apply to shifts in policy preferences produced by the emergence of some new common norms and the dynamic of symbolic imitation. In addition, in spite of some excessive simplicity, to explain the variation in pension reforms within the horizontal diffusion framework, we might apply to perceptions about effectiveness of different policy proposals, produced by countries different ability to learn from others and to perceive the existing economic competition.

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Endnotes

[1] The strongest peer dynamics are found in Easter Europe/Central Asia region.
[2] We also could expect that in a interaction for obtaining prestige among symbolic imitators, those with more radical policy proposals could be seen as being more *heros* than moderate reformers, and then, gaining more prestige than the average reformers. See Maxfield (1997) concerning Central Bank Independence and the role of symbolism.
[3] Other unfulfilled promises of the Chilean reform have been the concentration of the market of private fund managers, thus halting competition in the sector, the introduction of a fixed commission, which is regressive, and the likely perverse consequences on poverty, since 37% of the affiliates to the private system will be unable to obtain a pension above the minimum pension (Mesa-Lago and Arenas, 1998; Cruz-Saco and Mesa-Lago, 1998).
[4] The overall financial burden of the reform has been massive – around 4 to 5% of GDP per year in the 80s-for the government had to pay pensions on the old system, where contributions had declined dramatically (Huber and Stephens, 2000: 8).
[5] Brooks (2005) finds a less clear role to trade liberalization in the hazard to adopt pension privatization. However, she finds that foreign direct investment has had a positive impact on the probability to privatize pension systems.
[6] This does imply that the World Bank subscribed all aspects of the Chilean privatization program. As a matter of fact, the World Bank financed the transition to different models of pension systems and advised to proceed slowly and cautiously in those cases in which countries lacked regulatory capacities (Nelson, 2004).
[7] This was not possible in other domains. Pierson stresses that pensions, along with housing, were an exception in an otherwise unsuccessful attempt to welfare state retrenchment (Pierson 1996: 159-164).
[8] Unemployment is a relevant parameter because "an increase in unemployment makes any given set of entitlements more expensive and reduces the number of people contributing to welfare state financing through payroll taxes, thus intensifying fiscal pressures" (Huber and Stephens 2001: 225-226).