

Research Article

Effects of an Eventual Upcoming Withdrawal of Pension Funds

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Abstract

The three withdrawals from pension funds injected almost US\$ 50.000 billion into the market bringing with them inflationary pressures in the short and medium term, a decision that was harmful to people and companies. On the economic side, more than half of domestic inflation is due to the three withdrawals, decreasing the value of people's money and increase the interest rates. On the pension side, eleven million people managed to withdraw their money and almost four million people were left without their funds. For women a drop of 33% in the amount of the future pension and for men a 24% on average. And on the financial side, a destruction of the capital market causing a significant drop in assets prices and companies to stop investing in big projects in Chile. During 2023, a new project was carried out on a new withdrawal of pension funds but in the form of a self-loan, a benefit that would have between one million and ten million Chilean pesos saved in their accounts to withdraw up to one million Chilean pesos. The purpose of this work is to see the effects of a possible fourth withdrawal from pension funds. And we conclude that an upcoming retirement has three consequences. In the economic sense, it would bring with another increase in the monetary base, which in turn translates into an increase in inflation. In the sense of pensions, more than three million people would again run out of funds and would cause a potential additional 16% drop in the amounts of future pension affecting the current saving of contributors. Finally, in the financial sense, the capital markets would be destroyed, causing a significant drop in assets prices and companies to stop investing in big projects in Chile.

Keywords

Inflation, Pensions, Injected Money, Capital Market, Economy

1. Introduction

High inflation imposes significant cost on economic growth and people's well-being, since is a factor that generates uncertainty, reduces efficiency and investment, and is regressive. How it will be examined later, in the long term, inflation is always related to behavior of monetary policy, and in the short term, inflation occurs through supply or demand shocks. The demand shock is what has caused the high inflation that Chile had in 2021-2022.

The three withdrawals from the pension funds injected almost US\$ 50.000 billion into the markets bringing with them inflationary pressures in the short and medium term, a decision that was harmful to people and companies. On the economics side, more than half of domestic inflation was due to the three withdrawals, decreasing the value of people's money and increasing interest rates. On the pension side, eleven million people managed to withdraw their money and almost four

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million were left without a balance in their funds. Likewise, women will have a 33% drop in the amount of the future pension and for the men a 24% on average. And for the financial side, a destruction of the capital market.

In 2023, the Chilean congress projected a new withdrawal of pension funds but in the form of a self-loan, a benefit that would enable people who have between one and ten million Chilean pesos saved in their accounts to withdraw up to one million Chilean pesos. If it is less, they can request the total amount. They may request it as many times as necessary as long as the withdrawal that was requested is returned.

In this essay I will try to explain the effects that an eventual withdrawal from pension funds would have on the Chilean economy and on people. The essay presented below is structured in four segments. The first part refers to the definition and measurement of inflation. The second part explains what the cost of inflation are. The third part presents what are the determinants of inflation in the short and long term. And finally, the fourth part describes the effects of an eventual upcoming withdrawal from pension funds.

2. Definition and Measurement of Inflation

At a conceptual level, inflation is defined as the sustained increase over time in the general level of the price of goods and services of an economy. To measure the general level of price and services in an economy, the traditional method is to use price indices¹. A widely used indicator worldwide is the consumer basket, which in the case of Chile is represented by the consumer price index² (CPI), which is prepared by the National Statistics Institute (INE). For example, the CPI of December 2022 had a monthly variation of 0,3% and an accumulated in the twelve months of the year of 12,8% [11] the highest since 1991.

Like any measurement tool, the CPI has limitations. First, the preferences of her home's changes, which makes the consumption basket change over the time. Secondly, in the short and long term, the consumption basket changes significantly among households in the country, which in turn causes effective inflation to be different for households of different socioeconomic level, although in the long term it is similar for all. Finally, the CPI in the short term may be more influenced by more volatile price, specific price subject to seasonal factors or by relative price adjustments.

It is good to have these limitations when analyzing this measurement points, the CPI is probably still the measure that best combines reliability, representativeness, and ease of communication as a measure of the relevant inflationary process [1].

3. What Are the Cost of Inflation

The price system is fundamental in the economy, delivers a metric of the relative shortage of goods and services allowing

a more efficient allocation of resources to those uses where they are most valued. When the inflation is high and volatile, it is difficult to distinguish changes in relative prices versus absolute prices, which keep relative prices constant and that also do not generate a change in efficient allocation. This weakens the informative function of the price system and makes it difficult for households and companies to make decisions [9, 14, 15]³. Also, high, and unstable inflation introduces uncertainty about the prices of goods and services, as well as the behavior of financial assets affecting investment and the developments of financial markets [8, 12].⁴

All this suggests that high inflation has a negative impact on the growth of the economy in the long term by reducing efficiency [4]. In addition, these effects will be increased if high inflation is combined with a high volatility [5].

If we speak in terms of equity, inflation is regressive, that is, hits people with lower income more strongly, who consume a higher percentage of their income and have less access to financial market, so they keep their money in cash or in bank account whose value is eroded by inflation [6, 7].⁵

For these reasons, high and volatile inflation decrease the well-being of the population because of its negative effect on growth, investment of the companies and household income.

4. Determinants of Inflation in the Short and Long Term

In the short term, inflation deviates from its long-term value by movement in aggregate supply and demand. When there is a positive (negative) shock on aggregate demand, it deflects the product over its power—for example, due to an expansive monetary or fiscal policy, or a depreciation of the exchange rate, or an improvement in the perceptions of the private sector that leads it to consume or invest more—there is an increase (decrease) in the product and inflation. Another factor that influences the short term is external shocks, that is, commodity and oil price, dynamism of the world economy and international interest rates. To control inflation in these cases, an adjustment of monetary policy must be made.⁶

In the long term, movements in the amount of money correlate positively with inflation [10]⁷, that is, inflation in the long term is a monetary phenomenon. This correlation is strong in periods of high inflation, which are associated with periods in which the growth of the amount of money is particularly high.

As the growth of money accelerates, the price of money related to good falls, that is, inflation occurs, spending grows faster than production, which puts pressure on the general level of rising prices. Another important cause of inflation in the long term arises from the existing institutional arrangements in the economy. In other words, the authorities may be tempted to generate inflationary surprises to create transient expansion of the product or to reduce payments for public debt. The latter explains, to a large extent, the high inflation up to the middle of 1970.

Although there is no fiscal demand or institutional weaknesses, inflation may be the result of the way economic policy is carried out. It is possible that policies generate inertia in inflationary shocks and, therefore, are unable to anchor inflation in the medium term.⁸

5. Effects of an Upcoming Retirement

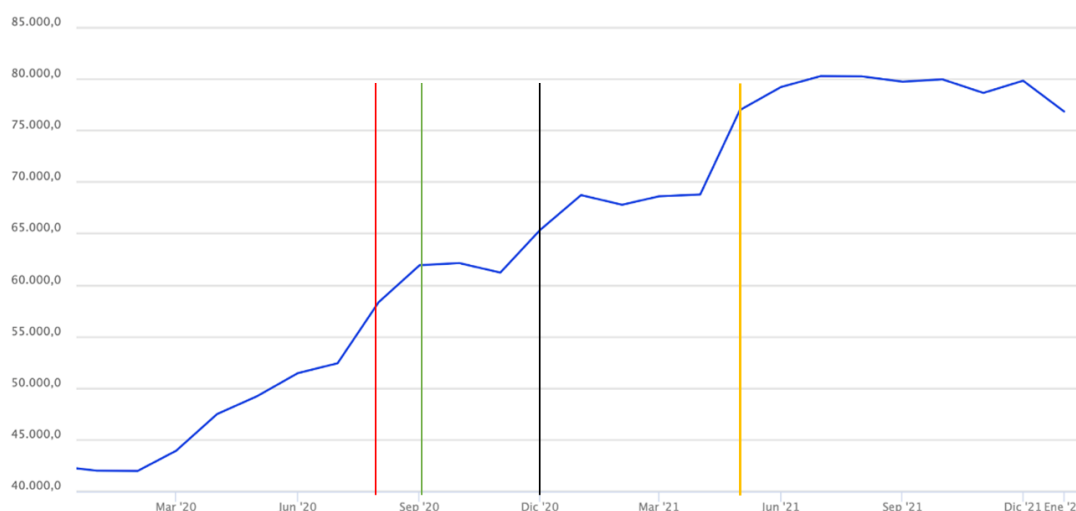
How the three withdrawals from pension funds affected our economy and the possible effects that a new withdrawal from pension fund administration is the following issue.

As of July 30, 2021, three withdrawals from pension funds were made, of which more than 11 million people requested this benefit. Of this total, almost 4 million people were left without a balance in their accounts [13]. Now one wonders ¿What effects did the three withdrawals have? As of August 13, 2021, the Superintendence of Pensions reports three effects. First, Chileans who withdrew 25% of their saving will take almost 6

years to recover the savings that were withdrawn.

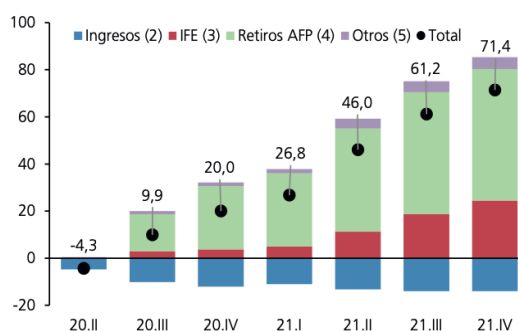
Secondly, the pensions that have are low and with the three withdrawals, the amounts on average will fall by 28,3%. The above further widens the gender gap on a provisional matter. For example, for women the drop in the amount of the pension will be 33% and for men 24% on average.

Finally, among the three withdrawals, almost US\$ 50.000 billion has been paid. This can be seen in figure 1 that shows the M1 monetary aggregate from January 2020 to December 2021 in billions of Chilean pesos. As you can see, from the first payment of the withdrawal of pension funds, that is, in August (red line) and September (green line), circulating money began to increase significantly until the third withdrawal (yellow line), where it almost reaches US\$ 80.000 billions in liquidity⁹. In addition, domestic demand was 21,6% of GDP in 2021, in other words, people allocated a large part of pension fund withdrawals to personal purchases increasing demand versus supply.



Source: Central Bank of Chile.

Figure 1. Monetary Aggregate M1 from January 2020 to December 2022 (In Billions of Chilean Pesos).



Source: Banco Central de Chile (2021) [2].

Figure 2. Accumulation of income and injections of liquidity to households (In Billions of Dollars).

Figure 2 shows the accumulation of income and liquidity injections that households had until the fourth quarter of 2021 in billions of dollars. As you can see, the abundant liquidity that households had for the fourth quarter of 2021 was the three withdrawals from pension funds, and to a lesser extent the emergency family income. All this contributed to the end of 2021 that domestic demand brought with it a high economic growth not seen since by the government of Eduardo Frei Ruiz Tagle. Central Bank of Chile pointed out that the main cause of the largest increase in price economy have been factors of a local nature and that is reflected in figure 2.

In the context of the economic slowdown of 2022, the idea of creating a self-loan mechanism for pension fund administrators arose, which leads us to ask ourselves ¿what does this self-loan consist of? This mechanism consists of the with-

drawal of up to 15% of the pension funds, with the obligation to return the money without interest and in 60 installments. The amount requested will be converted to the promotion unit on the day of delivery of the money and must be returned to the applicant's individual account readjustment according to the variations experienced by the development unit.

The amount of the self-loan is one million Chilean pesos and those who have between one and ten million Chilean pesos saved can apply for it. If it is less than a million Chilean pesos, you can ask for the total amount. You can request as many times as necessary as you do not have a pending withdrawal, that is, if the money you requested once has not been refunded, you will not be able to make another. In parallel, another self-loan project was processed in the congress that differs from this one because it allows a withdrawal of 100% of the funds.

In the presentation made by the Superintendent of Pensions, Osvaldo Macías, to the constitution commission of the lower chamber on January 11, 2023, it is estimated that the two motions of the self-loan of 100% of the funds would mean an injection of US\$ 168.000 billions to the economy, while the 15% project would imply an injection of US\$ 22.000 billions.¹⁰

If the self-loan project is approved, either 100% or 15%, the most likely effects would be: i) It would generate an illiquidity in the financial market, that is, the number of sellers is above the number of buyers, which would cause a free fall in the prices of assets; ii) the REPO operations of the Central Bank of Chile would be limited; iii) There would be an increase in the monetary base causing high inflation to persist; iv) The interest rate would increase even more; v) More than three millions people would run out of funds, and vi) it would cause a potential drop of 16% in pension amounts (the previous fall does not count).

6. Conclusions

Inflation has been a persistent and recurring phenomenon for much of the last century in Chile. Characterized by high rates, in some cases very high double-digit indices and because of the subordination of monetary policy as a form of tax financing in some periods. But as we have seen in this essay, the current inflation is not due to the subordination of monetary policy, it is because of the increase in the monetary base.

By March 2022, the Central Bank of Chile has indicated that the highest effective inflation took place in a context in which domestic spending has remained high, which has been intensified by the significant cost pressures faced by companies, thus raising product prices [3].

In summary, the significant increase in inflation in Chile from 2020 to mid 2023 is influenced by domestic demand and, to a lesser extent, by supply factors (outside the country).

The three withdrawals have meant a strong impact on the economy, given that they involved strong volumes of liquidity for people of almost US\$ 50.000 billions.

If the self-loan of 15% or 100% is approved, it would have another impact on the economy, it would be injected US\$ 22.400 or US\$ 168.000 billions respectively. So, we would have three effects:

In the economic sense, it would bring with another increase in the monetary base, which in turn translates into an increase in inflation. It would also bring with it a new increase in interest rates, because one of the errands that the Central Bank of Chile has is to ensure the stability of the currency. In practice, this translates into achieving low and stable inflation, and to control inflation, the Central Banks of Chile increase interest rates to reduce consumption. Therefore, introducing liquidity to the economy can delay the process of decreasing inflation.

In the sense of pensions, more than three million people would again run out of funds and would cause a potential additional 16% drop in the amounts of future pension affecting the current saving of contributors.

Finally, in the financial sense, the capital markets would be destroyed, causing a significant drop in assets prices and companies to stop investing in big projects in Chile.

Author Contributions

Hernán Bustos Martínez is the sole author. The author read and approved the final manuscript.

Conflicts of Interest

The author declares no conflicts of interest.

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*The author is responsible for what is stated in this document.

1 These indicators capture process of a wide range of Good and services weighted based on different criteria.

2 The CPI measures, month by month, the prices of a basket of Goods and services representative of household consumption.

3 See the articles of Fischer (1993), Tommasi (1994), and White (2006).

4 See the articles of Fischer (2016), and Pindyck y Solimano (1993).

5 See the articles of De Gregorio (1998), and Easterly y Fischer (2001).

6 If the demand shock is positive, the inflationary consequences are combated with a restrictive monetary policy. This policy also serves to stabilize the product in the long term.

7 See Friedman and Schwartz (1963).

8 An example of this is that a fully indexed economy, where the authority adjusts its objectives on the basis of past inflation, such as the exchange rate and wages, and for the same reason the general public ends up doing it, can perpetuate an increase in price, where, for example, a transient shock to the price of oil could generate periods of prolonged deviations of inflation from its medium term goal.

9 The Figure includes the amounts of the universal IFE that were in total US\$ 25.000 billion.

10 La Tercera, January 11, 2023. Available in <https://www.latercera.com/pulso/noticia/superintendente-de-pensiones-asegura-que-autoprestamo-del-100-de-las-afp-practicamente-implica-terminar-con-el-pilar-contributivo/EJ4IE4TMC5DUJKPDGEB54VAROQ/>.