SOCIAL SECURITY PRIVATIZATION IN LATIN AMERICA

Until the 1981 pension reform in Chile, no country had completely replaced a publicly administered social security program with a privately administered one. After observing the Chilean social security reform for more than a decade, a number of other Latin American countries have followed suit and introduced individual accounts as part of their social security system.

**Background**

**Countries That Have Privatized.** The first countries to do so were Peru (1992), Colombia (1993), Argentina (1994), Uruguay (1996), and Mexico (1997). These were followed by two of the poorest countries in the region, El Salvador (1997) and Bolivia (1998). Since then, these countries have been joined by Costa Rica (2000), Nicaragua (2000), Ecuador (2001), and the Dominican Republic (2003), representing in total about half the population of Latin America (Gill, Packard, and Yermo 2005).

**Three Approaches.** The Latin American countries adopting individual account plans have taken three approaches (Mesa-Lago 1997).

**Full Replacement of Social Security.** First, directly following Chile, the countries of Bolivia, El Salvador, and Mexico have closed their social security system to new entrants and substituted a defined contribution individual account system (mandatory replacement). All of the other Latin America countries that have adopted social security reforms have retained their traditional social security system in some form.

**Mixed Systems.** Second, Argentina and Uruguay, the two countries with the oldest populations, have introduced a mixed system. All workers participate in both a mandatory social security program, which was reduced in the reform but is still dominant, and a mandatory individual account program. Argentina’s social security program provides a flat-rate benefit that increases with years of contributions but not earnings, while Uruguay’s program provides an earnings-related benefit. Low-income Uruguayan workers only participate in the traditional social security program, not in the privatized individual accounts.

**Competing Systems.** Third, Colombia and Peru have two competing programs, with workers choosing to participate in one of them. These two countries have a form of contracting out, where workers have a choice of whether to participate in the government-run system or in a substitute privately managed plan.

**Problems**

**Low Coverage Rates.** The mandatory individual account plans in Latin America have generally failed to cover more than half of the labor force, and because the half not covered is the half with lower income, these plans have failed to address problems of poverty in old age (Gill, Packard, and Yermo 2005). It was originally thought that mandatory individual account plans would be attractive to workers, leading to an increase in coverage rates (World Bank 1994), but that has not happened. Coverage rates have ranged from roughly 10 percent to 60 percent of the
economically active population (Gill, Packard, and Yermo 2005).

**High Fees.** Fees have been high in all countries. For example, in Chile, which has the longest experience, 28 percent to 33 percent of the cumulated contributions of workers retiring in 2000 went to pay fees (Gill, Packard, and Yermo 2005).

**Inequities across Generations.** The variability in financial markets has caused large differences in rates of return and benefits for different birth cohorts. For example, an outcome of the financial market risk in the Chilean pension system is that, because of differences over time in the rates of return in financial markets, different cohorts have experienced large differences in rates of return, with the cumulative average rates of return ranging from 4 percent to 11 percent (Gill, Packard, and Yermo 2005).

**References**

