Social Security Privatization Around the World

Introduction
While most countries of the world continue to rely on traditional social security systems, an increasing number, primarily in Latin America and Central and Eastern Europe, have privatized at least part of their social security systems. The term “privatization” is used here to mean replacing at least part of the publicly run social security system with a privately managed and funded one. Mandatory individual accounts are included within this definition.

The Issue Paper “Social Security Privatization Around the World,” by John Turner, surveys social security privatization in a number of countries. It presents a framework for understanding the ways that countries have privatized social security. It then surveys the countries that have done so. Based on the international experience, it discusses issues that have arisen as a result of privatization, including high administrative costs, delays in crediting accounts, and the lack of predictability of benefits due to financial market risks.

Principal Findings
1. **Types of privatized plans.** Social security privatization using individual accounts has occurred two ways. Voluntary carve out plans are used in the United Kingdom and Japan. Mandatory plans are used by a number of Latin American countries, such as Chile and Mexico, and by Sweden.
2. **Risk.** Defined contribution individual accounts are riskier for workers than defined benefit social security programs in most countries, and, as a result, the level of benefits they provide is unpredictable. A number of systems where the privatized plan provides a substantial part of retirement income have introduced rate of return guarantees in an attempt to control the financial market risk. These guarantees typically reduce the difference in rates of return received by workers at a point in time by restricting the portfolios of the pension providers, but they do not protect against prolonged periods of low rates of return.
3. **Administrative Expenses.** To reduce administrative expenses, Sweden uses a centralized collection agency that collects all contributions and maintains records of accounts. This system is considerably less expensive to administer than the voluntary carve out system of the United Kingdom. Still, administrative expenses in Sweden are considerably higher than those in a traditional pay-as-you-go social security system.
4. **Voluntary Carve outs.** The experience in the United Kingdom indicates that it is difficult to structure voluntary carve outs so that workers at all ages will be better off taking the voluntary carve out than remaining fully in the social security system. In the United Kingdom, the terms of the voluntary carve out vary by the age of the worker. Many workers in the United Kingdom have been made worse off by taking the voluntary carve out, and currently, some insurance companies are advising their clients to remain fully in the social security system.
5. **Transition Costs.** While the term “transition” suggests a short period, the transition period from a pay-as-you-go to a privatized system typically lasts 50 or 60 years. In Chile, the annual transition cost peaked at about 5 percent of gross domestic product (GDP) during the first decade of reform, but after more than 40 years, it is projected to still exceed 1 percent of GDP. Some countries have reduced transition costs by reducing the value of benefits in the pay-as-you-go social security system. For example, Argentina has raised the early retirement age at which those benefits could be received. This change is not an actuarial adjustment of benefits for postponed retirement, but rather raises the age at which benefits are received.

6. **Payout Choices.** It is difficult for individual account plans to replicate some of the payout features of social security defined benefit plans. For example, Chile does not provide gender-neutral annuitization or “free” spousal and survivor benefits.