International Experience with Individual Accounts: An Update

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January 26, 2017

Today’s focus

- *The concept:*
  - Social insurance versus systems of *mandatory*, privately managed, individual savings accounts
- *Regions*:
  - Latin America (Chile, 1980)
  - Central and Eastern Europe (Hungary and Poland, 1997)
  - Western Europe (Sweden, 1999)
- *Time period*:
  - Post Bush Social Security privatization proposal (2005-6) and post Global Economic Crisis (fall 2007)

Quick flashback:

Individual Accounts and Demographic Aging

“Averting the Old Age Crisis”

World Bank, 1994

World Bank, 2001

"In the end, both (types of systems) require a subsequent generation to fulfill the generational contract, either in the form of current contributions (in pay-go systems) or through purchase of accumulated assets (in funded systems). Putting money aside for retirement alone does not change this fact …."

1. Hungary an Poland:
The shortfall in public pension finance due to individual accounts

	Year of partial privatization	Public pension contributions diverted to individual accounts	Resulting annual shortfall to public pension system	Duration of shortfall
Hungary	1998	20% (6% out of 28%)	0.8-1.4% of GDP	43 years
Poland	1999	20% (7.3% out of 36%)	1.5-2.2% of GDP	50+ years

Retrenchments of individual accounts

- Hungary – 2010 – ceased funding individual accounts and recouped most workers account balances, restoring their public pension rights

- Poland – 2011 – cut the diversion of pension revenues to individual accounts (7.3 to 2.3%) and subsequently –2014 -- transferred most accounts to the government, restoring most workers' public pension rights

2. Individual accounts in Chile

Year of privatization – 1980

Employee contribution rate – 10%

Competing private funds, “AFPs” – 21

Exclusions – Chilean military and police

More than 20 countries adopted similar models

Pensions in Chile today

- Average pension - $315
- Average replacement rate – 34%
  - 48% men, 24% women
- Minimum wage - $384
- Workers making regular contributions – 64%
- Average investment returns (since inception) – 8%
  - Investment return to worker after administrative charges – 3%

Chile – pension reforms proposed by President Michelle Bachelet, 2016

- To promote competition among AFPs, create government option
- To protect worker savings, restrict money management fees
- To increase benefits, require employer contribution (5%)
- To promote gender equality, use gender neutral life expectancy tables in computing private annuities

3. Sweden

- Year of partial privatization – 1999
- Individual accounts receive 2.5% of 18.5% contribution rate
  - Source of funds to cover missing revenues – Swedish pension buffer funds
- Separation of account record keeping (government) and investment (commercial funds)
- Regulation of private management fees to preserve worker savings
  (0.3% of contributions for administration, 0.4-0.8% money management)
- State-run default fund for those who don't choose a private fund
- At retirement, mandatory annuity purchase from single, public provider

Individual accounts in Sweden today

- Stable system, no retrenchment, but …

- 700 plus funds

  – 98% of new workforce entrants in default fund, 42% of all participants

  – Few people (6%) exercise the annual option to change funds

Final observations

- The policy rationale for individual accounts has been narrowed progressively.
- Effective systems require many forms of government involvement.
- Need for a source of funding for transition costs.
- In benefit design, devil is in the details.