Does the privatization of social security make sense for developing nations?

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We discuss the privatization schemes of Chile and Argentina following a review of three alternatives to privatization. Our major conclusions are as follows: (1) the Chilean scheme has performed very well during much of the past 15 years, but it is not yet clear what will happen during an extended period of economic stagnation and declining financial markets; (2) for many countries it would make more sense to reform existing public pension schemes than to replace them with privatized schemes, at least until one has a better idea how privatized schemes perform in adverse financial environments; (3) privatized schemes have important distributional effects that deserve more attention.

The issue of whether or not to privatize social security has become one of the hottest debates in recent years among those who analyse international trends in the social welfare policy world (Arenas de Mesa and Bertranou, 1997; Beattie and McGillivray, 1995; James, 1996, 1997b; Myers, 1992; Singh, 1996; World Bank, 1994). The Chilean model has already had a major impact in Latin America and it is even being mentioned in the debate over the future of social security policy in industrial nations such as the United States (Advisory Council on Social Security, 1997; US Senate, 1995). The question we will be addressing is whether or not the privatization of social security makes sense for developing nations and, if so, under what circumstances.

Worldwide population trends explain some of this interest. Owing to much higher mortality rates and higher fertility rates, older people make up a much smaller fraction of the population in developing nations than in industrial ones. However, despite having a smaller base of elderly persons, developing countries confront a faster rate of population ageing (Holden, 1996; Kinsella and Taeuber, 1993). Between 1960 and 1990, the percentage
of the world’s population over age 65 increased from 5.3 to 6.2 per cent, and it is projected to increase to 8.8 per cent by 2020 (Poortvliet and Laine, 1995). Between 1990 and 2030, the number of people over age 60 will almost triple, with most of the growth taking place in developing nations. This increase may pose a special economic burden to these nations because they have lower government revenues to support a dependent population and need to devote their limited resources to economic growth.

Of the 173 countries (and territories) considered in Social Security Programmes throughout the World — 1997 (US Social Security Administration, 1997), some 125 can be classified as developing nations.1 While six of these nations (all developing) have no public or publicly mandated form of old-age security support, all industrial nations and most developing nations offer at least minimal support for some of those employed in the modern sector of the economy. By far the most common form of old-age security provision is social insurance; such schemes are found in 100 developing nations (and 142 nations overall). The next most common are the provident fund schemes found in 18 nations (all developing). South Africa and Namibia illustrate another model. They have social-assistance-based national old-age pensions. These are non-contributory means-tested pensions. Several other countries include such pensions as a backup for at least some of those who are not eligible for benefits from an alternative scheme such as a social-insurance-based pension.

Seven nations, all but one being developing nations, have at least partially privatized their old-age security systems.2 The reference here is to the creation of individual fully funded accounts managed by private-sector organizations. In all seven of these countries, social-insurance-based schemes are also in place. In the case of Chile, there is a social-insurance-based scheme for older workers covered under the prior scheme who did not elect to make a shift to the privatized alternative introduced in 1981. In the case of Argentina, workers can choose either a public social insurance option or a privatized option for the earnings-related tier of their old-age security scheme. In the United Kingdom, employers may opt out of the public earnings-related plan and employees may in turn opt out of their employer’s plan setting up privatized individual accounts. A variant of

1. We use the term “developing nations” to refer to all nations listed in this source except those in Europe (including eastern Europe), Canada, United States, Australia, New Zealand, and Japan.

2. It has been estimated that for much of the transition period during which the prior scheme is being phased out, these recognition bonds will represent between 50 and 70 per cent of the capital accumulated by insured workers at the time of retirement (Arenas de Mesa and Bertranou, 1997).
this approach is the mandatory, employer-sponsored, fully funded occupational pension found in Switzerland.

Both provident funds and social insurance schemes have provided valuable government revenues that more than matched expenditures so long as both fertility and mortality rates stayed high. Since these rates have declined and many of these schemes have started to mature, the number of people eligible for benefits has increased, in some cases dramatically. The cost of paying provident fund benefits and old-age pensions has become a major drain on government revenues in many of these countries, and will likely get much worse in the years ahead owing to a rapid increase in the size of the elderly population. These trends have contributed to an interest in new ways to provide for older people, such as the privatization of social security.

We begin our analysis with a discussion of the three major alternatives for old-age security in the developing world today: private support from one’s family; national provident funds; and social-insurance-based public pension schemes. We follow this with a discussion of two alternative models of privatization as illustrated by schemes in Chile and Argentina. We conclude with a discussion of the pros and cons of privatization.

Alternatives to privatization

Family support

In most developing nations, the primary source of support in old age is one’s family; in a few it is the only source. Even in countries with social insurance or provident fund schemes, most of the elderly population depend on economic support from their adult children (Darkwa, 1997; Peil, 1991; Sanda, 1987).

Traditional support systems continue to work as well as they do in many developing nations because so few people live to an age when they can no longer work, and those who become incapacitated tend to die rather quickly (Tracy, 1991). When older persons do need help, children who have migrated to urban areas still feel obligated to provide economic support, and children who live nearby to provide personal services (Peil et al., 1989). In many countries, older people retain control of family assets, such as the family farm, and this control of property helps assure support (World Bank, 1994). Throughout history, family and extended-family support has been older people’s primary source of assistance, and this continues to be true for most of the population in most developing nations today.
In the future, the family must remain the primary source of old-age support. If governments tried to extend coverage to the entire elderly population, as opposed to the small fraction of the population employed in the modern sector of the economy, they would face an unsustainable drain on government revenues. In short, governments in many developing countries cannot now or in the foreseeable future afford the cost of taking on the responsibility of providing for the entire elderly population. Only the more affluent developing nations such as Brazil and South Africa have programmes in place that provide at least some coverage to most of the elderly population (Adamchak, 1995; Hochman and Williamson, 1995; Holden, 1996).

Despite the need for many poor countries to rely on the traditional support system, an increasing proportion of the elderly population are not being adequately cared for (Apt, 1996; Williamson and Pampel, 1993). The major problem with the traditional, informal mechanisms is that not all older people can rely on their children or extended family. Some people do not have children. For those who do, some children die and others migrate to distant cities (World Bank, 1994). While adult children who migrate to distant cities sometimes send money back to their elderly parents living in rural areas, many do not earn enough to do so (Apt and Grieco, 1994; Nyanguru et al., 1994). As a result, an increasing proportion of rural older people are economically worse off than in past generations.

**Provident funds**

A provident fund is a mandatory savings plan with contributions typically shared by the employee and the employer. Each worker has his or her own account that includes contributions made to it over the years as well as interest earned on those contributions. Provident funds differ from privatized social security plans in that the government manages them. Typically invested in government bonds rather than in the private sector, the funds often pay benefits as a lump sum at retirement but sometimes as an annuity yielding a pension for life.

The provident fund approach stems from occupational pensions established during the nineteenth century in Great Britain and other European countries. In the British colonies, expatriate employers set up similar schemes for their employees (Dixon, 1995). Many of these colonies introduced national provident fund schemes after independence. Such schemes might offer an important source of funds for development projects.

Unlike social-insurance-based old-age security plans, provident funds are not pay-as-you-go (PAYG) schemes; they are funded. However, gov-
Government control over how funds are invested has often led to poor returns; the focus has frequently been on meeting the government’s need for low-interest loans to finance development projects (or general government expenses) rather than ensuring fair market rates of return to workers. Interest rates are typically set at levels below the rate of inflation. As a result, deposits are often considerably eroded by inflation prior to retirement (Dei, 1997). For example, in Zambia between 1981 and 1988, money invested in the national provident fund lost on average 23 per cent each year (World Bank 1994); these negative returns have been more the rule than the exception, particularly among the African nations. However, there are important exceptions to this pattern: those in Singapore and Malaysia have consistently produced positive returns even after adjusting for inflation (McKinnon et al., 1997).

Provident funds have been criticized in many countries such as Zambia and India for inadequate regulation and poor administration. Owing to poor record-keeping, many workers, particularly those who have frequently changed jobs, find it very difficult to establish eligibility for their provident fund benefits (Iyer, 1993). Retirees sometimes die during the several years that it takes to get a claim approved (Aire, 1974). In addition, the size of the benefit is often too low because employers have skipped or delayed payments of provident fund contributions (Ijeh, 1977).

Even when adequately protected against inflation prior to disbursement, provident funds taken as a lump sum payment are very susceptible to inflation and are often spent within a few months or years (Darkwa, 1997). Singapore’s provident fund is often held up as a model, but it too leaves retirees vulnerable to inflation after funds are withdrawn (Asher and Yong, 1997). It is not at all clear how well retirees in Singapore and Malaysia will weather the recent turbulence in the Southeast Asian economies (Asher, 1998). Many provident fund schemes allow workers to withdraw a substantial fraction of their assets prior to retirement, for special purposes such as health emergencies or the purchase of a dwelling. While in some ways helpful, this flexibility often leaves workers with little to live on in old age (Dixon, 1993; Schulz, 1993).

A few countries such as Singapore devote only about 1 per cent of annual contributions to administration, but administrative costs are much higher in most countries. One extreme example, Zambia, recently spent 52 per cent of its annual contributions on administration (World Bank, 1994). Thus, while some might say that a poorly performing provident fund is better than no programme at all, such a conclusion is not obvious when the cost of administration is high and real rates of return are consistently negative.
On the positive side, when compared with no programme at all, provident funds contribute to capital formation and sometimes help promote economic growth (Dixon, 1993). Although the same benefit also comes from a partially funded social-insurance-based scheme, the provident fund calls for a simpler administrative infrastructure. While some experts argue that privatized schemes and private-sector investments generally make greater contributions to economic growth than do provident funds, others argue that provident funds, with their ability to target funds where they will contribute most, can make an even greater contribution to growth. In addition to the often modest direct contributions provident funds make to the welfare of older people during retirement, there are important indirect quality-of-life effects owing to the impact on economic growth (McKinnon et al., 1997).

Provident fund schemes may also be less vulnerable to certain forms of corruption than social insurance schemes. Favouritism with respect to certain individuals or categories of workers can significantly affect pension eligibility and size, and corruption among civil service employees plagues many developing nations, including those with provident funds (Hardgrave and Kochanek, 1986; Kirk-Greene, 1986; Lubeck, 1986; Sinha, 1980). Yet, with a provident fund, benefits relate directly to what workers put in rather than whom they know or their ethnicity. The transparent source of provident funds makes them particularly suitable for nations with deep ethnic cleavages (Williamson and Pampel, 1991).

Social insurance

During the 1950s and 1960s, social-insurance-based, defined-benefit PAYG old-age security programmes spread throughout the developing countries of the world. Most were partially funded (as opposed to being pure PAYG schemes) so as to provide a source of funds that could be used to foster economic development. These schemes are typically financed by payroll taxes split between the employer and the employee, and in some cases supplemented by general government revenues. Many of these countries obtained their independence in the aftermath of the Second World War and viewed the establishment of national social insurance schemes as an integral part of nation building. Efforts to protect workers from poverty during old age would contribute to national integration and foster regime legitimacy. Leaders of many nations were convinced by technical experts from international organizations such as the International Labour Office to adopt social-insurance-based social security systems modelled on those in the western industrial nations (McKinnon et al., 1997).
For the first few decades, these systems easily took in more contributions than they paid out as pension benefits. Government leaders soon realized that such programmes provided a valuable source of money to fund various development projects. They also realized that coverage of new groups and provision of higher pension benefits could help gain political support. Thus, social security schemes first covered civil servants and a few key industries in the modern sector of the economy with meagre benefits, but they were generally extended to cover a larger proportion of the labour force with more generous benefits. Such actions were tempting because most of the costs of such popular reforms could be postponed — as long as the number of contributors was rapidly expanding and relatively few were as yet eligible for pension benefits.

Even so, many of the poorest nations had after several decades covered only a quite limited proportion of the workforce. Today, a few developing countries such as Brazil cover most of the population, but much more typical even among the most affluent of the developing countries is coverage of approximately 50 per cent of the population. Low-income countries, such as those in sub-Saharan Africa, typically cover less than 10 per cent of the population, many of whom are government employees (Darkwa, 1997; Gruat, 1990).

Defined-benefit social insurance schemes can protect individual workers from a number of risks. Most protect workers against the risk of reduced earning power in old age and many include survivor and disability insurance as well. Such schemes call for a pooling of risks that provides greater protection than typically associated with either provident funds or privatized social security schemes. This is particularly true for workers who are younger, have been covered fewer years, and have lower incomes. This approach also reduces the risk that retirees will outlive their benefits or that inflation will substantially erode those benefits (Iyer, 1993).

Another characteristic of the social insurance approach is that it facilitates income redistribution. Most of the redistribution is horizontal; that is, across the life span. But such schemes sometimes include vertical distribution as well, providing a better return on contributions for low-wage workers, as in Brazil (Williamson and Hochman, 1995a). Additionally, social insurance schemes usually offer forms of protection for women (as spouses or as workers) that are absent from provident fund plans and privatized social security schemes: they make women eligible for full benefits at an earlier age than men, provide survivor and spouse benefits, allow full (or nearly full) benefits to workers who have been out of the labour force for several years owing to care-giving responsibilities, and do not reduce pension benefits to women owing to their greater longevity (Kay, 1997a; 1997b).
However, the redistribution involved in these schemes has not always favoured low-wage workers and vulnerable groups. In many countries, certain categories of more affluent workers have been awarded pension benefits based on a rate of return on prior contributions far more generous than that for the average worker (World Bank, 1994). Similarly, problems of corruption and favouritism allow already advantaged individuals, ethnic groups, or occupations to secure unusually generous pension benefits through bribes, ethnic ties to key persons in the bureaucracy administering the scheme, or membership in influential labour unions or professional associations (Kay, 1997b). High administration costs, payroll tax evasion, and inadequate record keeping contribute further to limited redistribution (Gruat, 1990; Iyer, 1993).

While defined-benefit plans in theory protect workers against the risk of inadequate pension benefits in old age, there have been serious problems in practice in many developing nations. Although nations adjust such pensions for inflation, these adjustments in many cases fall below actual inflation rates (McKinnon et al., 1997). As these schemes have matured in recent decades, it has become increasingly difficult to pay promised pension benefits based on current contributions. This problem also stems from demographic shifts, changes in the economy, and the common practice of attempting to curry favour with voters by granting pensions far in excess of what could be justified on actuarial grounds.

In many developing nations, the economic burden of these pension schemes has been a major source of political and economic instability. In some countries, this burden has been associated with much higher payroll taxes and a shift of jobs into the informal sector in an effort to evade these taxes (Kay, 1997b). This is one reason why policymakers in many developing nations are today looking for possible solutions to the financing burdens they face. The privatization of social security is the primary alternative being advanced today as a possible solution by many technical experts and by organizations such as the World Bank.

**Privatization: Alternative models**

One alternative to the political risks of the PAYG approach involves privately administered, compulsory savings plans (Diamond, 1994). The major political risk of PAYG schemes is that benefits will be cut, possibly quite substantially, as part of government attempts to deal with fiscal pressures such as those linked to population ageing. Privatized schemes are designed to deal with pressure on PAYG schemes to cut benefits and raise payroll taxes. Privatization also may contribute to the development of
capital markets, financial institutionalization, increases in after-tax wages, decreases in the cost of labour, increases in the savings rate, and increases in the rate of economic growth (Hansell, 1992; Santamaria, 1992; World Bank, 1994).

Beyond having these general goals, privatization takes a variety of different forms. In the discussion to follow, we consider two of the most important models for privatizing traditional PAYG public pension schemes: (1) the Chilean scheme, sometimes referred to as an example of full privatization, and (2) the Argentine scheme, an example of partial privatization that gives workers a choice between a mixed (public/private) plan and a fully public plan.

The Chilean model: Full privatization

In 1924 Chile became the first nation in the Western Hemisphere to introduce a national social security scheme (Mesa-Lago, 1978). At the outset, coverage was limited to a small fraction of the labour force, but it increased over the years to include more than three quarters of the labour force by the early 1970s (Mujica and Larrañaga, 1992). As with many other Latin American social insurance schemes, it became clear by the late 1970s that massive government subsidies would be needed to continue to pay benefits at the level originally intended (Edwards, 1996). Many factors contributed to the economic burden associated with the programme. Owing to demographic shifts and maturation of the system, the ratio of contributors to beneficiaries had fallen from 8:1 in 1960 to 2:1 in 1980 (Poortvliet and Laine, 1995; Santamaria, 1992).

There were also serious problems of non-compliance and manipulation of the system, due in part to the high payroll tax rates (Kay, 1997b). For example, wages would be underreported for many years and then sharply increased during the five years just prior to retirement, the years used by the scheme to compute retirement benefits (Myers, 1992; World Bank, 1994). Even so, the pension scheme was supposed to replace 70 per cent of a manual worker’s final wage but, owing to financing problems, by the late 1970s it was replacing closer to 20 per cent (Simone, 1983). In addition to these problems, the system suffered from inefficient administration and inequity. The inequity took the form of much more favourable benefit levels and eligibility criteria for certain occupational groups.

Chile’s privatization plan was introduced in 1981 as part of a more general effort by President Pinochet to reorganize the Chilean economy in the direction of privatization and greater economic liberalization (Williamson and Hochman, 1995b). The authoritarianism of the Pinochet regime made
it possible to enact a reform that many interest groups did not support (Edwards, 1996). But opposition to the change was muted, in part because 93 per cent of pensioners were receiving the minimum pension under the PAYG scheme and in part because workers who agreed to make the shift to the new scheme were promised an 18 per cent wage increase. Workers also received recognition bonds that gave them credit for contributions to the old system and could be cashed in at retirement (Kritzer, 1996). Current retirees and those close to retirement could retain the prior scheme, but new entrants into the labour force were required to enrol in the privatized scheme.

The privatized scheme is mandatory for employed workers, but optional for the self-employed. There is no employer contribution; the entire contribution comes from the employee. Each covered worker contributes 10 per cent of wages (up to a ceiling of about $1,860 a month) to one of 15 pension fund management organizations referred to as AFPs (Administradoras de Fondos de Pensiones). Investment decisions by the AFPs are based on an assessment of the economic interests of their investors. This contrasts with the provident funds that sometimes favour governments with low-interest investment capital. Much of the AFP money is invested in government bonds paying market rates of return (Edwards, 1996).

Covered workers must contribute another 3 to 4 per cent (the amount differs slightly from one AFP to another) for administrative costs, marketing costs, profit for the AFPs, and private disability insurance and survivor insurance. Some AFPs also charge an additional fixed amount for each contribution which reduces net returns for low-wage workers in relation to those for high-wage workers. The AFPs compete with one another and have considerable flexibility in how much money they invest in various asset classes. The government specifies the maximum amount allowed in each of several different categories of investments, including stocks, government bonds, private-sector bonds, mortgages, and international mutual funds.

To maximize their returns, workers can keep track of their account balances and shift their funds from one AFP to another several times a year. After 20 years of participation and reaching age 65 (60 for women), workers can take the money (contributions plus earnings on those assets) out of the account. They can retire early if they have accumulated sufficient funds to replace 50 per cent of their indexed average annual wage over the past ten years. At retirement, workers purchase an inflation-indexed annuity from a private insurance company or sign up for the periodic withdrawal plan (Castro-Gutiérrez, 1989).

Over the first 15 years since the plan’s introduction, investors did quite
well, and this has contributed to the popularity of the scheme with workers (Diamond, 1994; Poortvliet and Laine, 1995). While these AFPs have lost money in some years, returns over the long run have averaged close to 13 per cent. The highest gain equalled 29.7 per cent in 1991 and the lowest a loss of 2.5 per cent in 1995 (Kritzer, 1996). These generally high returns have not gone unnoticed in other developing (and industrial) nations around the world.

Despite the impressive results thus far, some projections of the inflation-adjusted average annual real rate of return for the future range from only 2 to 5 per cent (Gillion and Bonilla, 1992; Myers, 1992). Note also that these high reported returns do not subtract the 3 to 4 per cent of wages that go to the AFPs for administrative expenses. Counting these costs reduces the original investment to about 9 per cent (James, 1997a). Further, the very high returns experienced during the first 15 years may have been in part due to special circumstances, such as selling off a number of public enterprises and the high yields on government bonds during the 1980s due to the debt crisis, factors that are unlikely to help boost returns in the years ahead (Kay, 1997a). As a result, for half of the workers currently covered, retirement pensions may fall below 50 per cent of pre-retirement income and provide less than a subsistence income (Schulz, 1993).

Although many commentators view the new Chilean system as an example of a fully privatized social security scheme, it actually has substantial public involvement (Schulz, 1992). The government regulates the AFPs that manage the pension funds, guarantees the assets of any of these AFPs in the event of insolvency, and promises to ensure a minimum real rate of return in relation to the average for all AFPs. The government also guarantees a minimum income to workers who retire after 20 or more years of contributions and end up with a pension income based on AFP assets that falls below the specified minimum (Scarpaci and Miranda-Radic, 1991). Another form of government involvement is the payment of “recognition bonds” to retirees who had contributed to the old scheme prior to enrolling in the privatized one. At retirement, workers are awarded a sum based on the value of any accrued rights under the public pension scheme. The government has also taken on the responsibility of paying retirement pensions to present and future retirees who stayed with the PAYG scheme. In short, it has agreed to pay out of general revenues what some would describe as

3. It has been estimated that for much of the transition period during which the prior scheme is being phased out, these recognition bonds will represent between 50 and 70 per cent of the capital accumulated by insured workers at the time of retirement (Arenas de Mesa and Bertranou, 1997).
the staggering transition costs associated with the shift from a PAYG scheme to this privatized alternative, a burden that will continue for decades (Kay, 1997b).

Privatization has made the Chilean economy more attractive to foreign investors. Employers gain clear tax advantages when they do not have to help finance old-age pension schemes. Since Chile introduced its privatized social security scheme, the national savings rate has increased about 10 per cent a year. While some analysts conclude that the increase is primarily due to privatization, others argue that the net impact on the national savings rate is inconclusive (Mesa-Lago, 1994; Santamaria, 1992). One estimate is that about a fifth of the increase in the national savings rate can be attributed to privatization (Kritzer, 1996).

In recent years, the cost of managing these funds has begun to increase rapidly. One reason is that many of the AFPs are offering similar products with similar returns. To get workers to shift from one AFP to another offering essentially the same product, much money needs to be spent on marketing (Singh, 1996). The large number of very small accounts adds to administrative costs and lowers effective returns for the low-wage workers with small accounts (Diamond, 1996). Administrative costs run at approximately 15 per cent of annual contributions for Chile’s privatized scheme, while the corresponding figure is 2 per cent or under for the national provident funds in Malaysia and Singapore (Singh, 1996). Estimates for the PAYG Social Security system in the United States are in the 1 to 2 per cent range as well (Diamond, 1996; Williamson, 1997). Many experts argue that the cost of administering Chile’s privatized scheme is higher than it was with the old PAYG scheme (Diamond, 1994), but some disagree (Edwards, 1996).

Some critics argue that Chile’s privatized scheme represents a step backward with respect to coverage, which under the public scheme reached approximately 79 per cent of workers in 1973 (Mujica and Larrañaga, 1992). When comparing the coverage of the new scheme, a distinction must be made between affiliates (those who have enrolled in an AFP and have made contributions some time in the past) and current contributors. Between 1990 and 1994, approximately 88 per cent of workers were classified as affiliates, but only 55 per cent of those in the labour force were actually contributing to the scheme (Kritzer, 1996; Singh, 1996). By early 1996, the number of affiliates actively contributing had dropped to 47 per cent. Participation rates are very low for certain sectors of the economy: only 13 per cent of the self-employed are enrolled in an AFP and only 5 per cent contribute on a regular basis (El Espectador, 1996). Rates are also very low for agricultural workers, household workers, and those in the informal sector (Williamson and Hochman, 1995a).
Many low-wage workers are shifting out of the formal sector of the economy into the informal sector. They want to avoid paying the high payroll tax associated with the privatized scheme — about 20 per cent of income when including deductions for health insurance and the pension scheme. It makes more sense for many to take the government’s minimum pension than to pay in for more than the required minimum number of years (which includes years contributing to the PAYG scheme for many current workers) in an effort to get a larger pension based on their accumulated assets (Arenas de Mesa and Bertranou, 1997). In many cases, such a pension would only marginally improve on the guaranteed minimum pension. One estimate is that between 30 and 40 per cent of currently covered workers may end up taking the minimum pension, a pension that is currently about $120 month (Kritzer, 1996). According to a recent report in the Colombian newspaper *El Espectador* (1996), the number of Chilean workers making this decision is increasing; the resulting future burden could become a major problem.

Privatization shifts risk from the government to individuals. The Chilean scheme is structured in such a way as to minimize the risk due to poor investment decisions on the part of individual workers (the returns for the various AFPs tend to be very similar), but not to protect against the risks of long-term market stagnation or sharp market corrections just prior to retirement (Singh, 1996). While the economy has been rapidly expanding and financial markets have been booming, the risk aspect of this privatized scheme has not received much attention. When the Chilean financial markets experience a prolonged period of stagnation or worse, the popularity of the privatized scheme may decrease, particularly among those who end up with much lower than anticipated pension benefits.

The Argentine model: Partial privatization

The social security system in Argentina evolved gradually. By the late 1930s, national pension schemes were in place for many categories of employees in the railroad, civil service, utility, banking, insurance, and journalism industries. However, even as late as 1944, only about 7 per cent of the labour force were covered by one of these schemes (Rofman and Bertín, 1996). After the Second World War, coverage began to increase rapidly. This rapid expansion created a ratio of people contributing that was high in relation to the people drawing pensions, and allowed for pension benefits far in excess of prior contributions and interest. Civil servants and workers represented by influential unions and professional organizations received especially generous rates of return. Owing to these policies, the
gradual maturation of the system, and poor management, the system began to experience funding crises during the 1960s that became worse during the 1970s and 1980s (Arenas de Mesa and Bertranou, 1997).

During the 1980s and early 1990s, the old social insurance scheme was criticized on many grounds:

- Both employees and employers failed to make their mandatory social security contributions. In 1991 close to 70 per cent of the self-employed, 40 per cent of employees, and 46 per cent overall failed to make their contributions (Vittas, 1995).
- Contributions were not well managed. As a result, the pension funds found it increasingly difficult to pay promised benefits, particularly as the ratio of pensioners to workers began to increase. It became necessary to supplement pension fund revenues using general government revenues.
- Certain categories of workers were granted special treatment. Some received unusually high pensions in relation to the contributions they had made; others such as members of the judiciary were granted benefits after far fewer years of coverage and at an earlier age.
- Despite indexation, the real value of pension benefits fell (Rofman and Bertin, 1996).
- Conservative governments sometimes cut the level of employer contributions by reducing either the cap on the amount of salary subject to taxes or the actual payroll tax rates.

By the early 1990s, the old social security scheme was in a state of near collapse (World Bank, 1994). The number of workers contributing per pensioner fell to 1.8. A very substantial infusion of general revenues was required to pay even inflation-reduced pension benefits. The government started turning to one-time revenue sources to finance pensions, such as the sale of the national oil company (Hansell, 1992).

Despite these problems, the new scheme was opposed by retirees, unions, and social security experts. In contrast, the banking and insurance industries and others in the business community supported the change (Bobrovsky, 1996). Employers received a promise that as contributions to the privatized component grew over the years, their payroll taxes would be reduced. Banking and insurance industries expected more profits owing to an infusion of money into capital markets. Businesses more generally hoped for an increase in the level of savings, investment, and the rate of economic growth.

The pension reform legislation of 1993 (implemented in 1994) created a new social security system giving workers a choice between a reformed public PAYG regime and an alternative mixed regime based on both the public PAYG scheme and investments in individual fully capitalized ac-
counts. The private accounts go to one of several alternative pension fund management organizations called AFJPs (Administradoras de Fondos de Jubilaciones y Pensiones). AFJPs are private, public, or non-profit corporations (Arenas de Mesa and Bertranou, 1997). Most of these corporations have been established by financial institutions such as banks, but some have been set up by labour unions.

With few exceptions (e.g. the military, the police, provincial civil servants), all workers, including both employees and the self-employed, must join the new Integrated Pension System called the SIJP (Sistema Integrado de Jubilaciones y Pensiones). The new Argentine model embodied in the SIJP represents a conscious effort at partial as opposed to full privatization; it was intentionally constructed so as to combine elements of a public scheme with elements of a privatized scheme. Developments in Argentina are being closely watched by social security analysts in many other countries, particularly those considering shifting from PAYG public schemes to partially privatized alternatives. In most countries, the idea of shifting to a fully privatized Chilean-like scheme is viewed as too radical to be politically acceptable, but some countries may be ready seriously to consider partial privatization.

The new Argentine social security system has a two-tiered structure. The first tier is a flat benefit, the Universal Basic Pension, paid to all retirees who meet the age (65 for males, 60 for females) and time of contribution (30 years) conditions. It is financed from a payroll tax on employers and from government general tax revenues (Arenas de Mesa and Bertranou, 1997). For the second tier, workers may select either the government-run PAYG defined-benefit scheme (called the Additional Pension) or the defined-contribution alternative by enrolling in one of the 29 AFJPs. The AFJPs are in many ways similar to the Chilean AFPs. Workers can enrol with only one AFJP, but are free to select any AFJP and periodically to shift from one to another. As in Chile, limits exist on how much the AFJPs can invest in various asset classes. To encourage investment in the Argentine economy, the programme strictly limits how much can be invested outside the country (Ciampi 1997).

The second tier of the social security system is financed by an 11 per cent payroll tax paid by the employee (as opposed to the employer) and by 11 per cent of the 27 per cent tax on the self-employed. For workers who select the public scheme for the second tier, the money is used to pay pen-

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4. This pension comes to about 25 per cent of the average worker’s covered wage (World Bank, 1994). For workers covered for more than 30 years, the size of the pension is increased by 1 per cent for each additional year up to 45 years (Arenas de Mesa and Bertranou, 1997).
sions to those currently retired. For those who opt for the privatized second tier, 8 per cent of the 11 per cent goes to purchase shares in the fund; the other 3 per cent is used by the AFJP for administration, profits, and marketing, and to purchase disability and survivor insurance (Poortvliet and Laine, 1995).5

Given that the first tier of the Argentine social security system is the public, PAYG flat-benefit Universal Basic Pension, workers who select the PAYG second-tier alternative (the Additional Pension) have opted for an all-PAYG public alternative. Those who select as their second-tier scheme enrolment in one of the AFJPs have opted for a mixed alternative that includes a public PAYG component (the Universal Basic Pension) and a funded component (the AFJP). Those who select the privatized second tier, and who for any of a variety of reasons — such as low wages or poor investment returns — end up with a low asset base at retirement, qualify for an additional pension designed to bring the retired worker’s pension from the privatized component up to a specified minimum level. This pension is paid for by the government using part of the payroll tax on employers (Arenas de Mesa and Bertranou, 1997).

If all goes according to plan, the Argentine scheme will replace a larger share of pre-retirement income than does the Chilean scheme. After 20 years of contributions, the Chilean minimum pension is projected to be about 25 per cent of the wage of the average worker. In contrast, for Argentina the projected minimum after 30 years of contributions is at least 40 per cent of the average wage for both those who select the privatized second tier and those who select the public alternative (Vittas, 1995). If the government can keep its promises, this means a better pension for low-income Argentine workers. But it also places a greater burden and higher risk of failure on the government (Poortvliet and Laine, 1995).

Another important difference between the two schemes relates to the compensation for contributions to the prior public schemes. In Chile, a recognition bond is paid in full as a lump sum benefit at retirement. In Argentina, workers become eligible for a special compensatory pension paid for life. The size of this compensatory pension depends on the amount contributed to the prior scheme. The Argentine approach puts less fiscal burden on the government at the outset, as the debt repayment to an individual worker is spread out over that worker’s retirement years and is limited

5. Incapacitated workers receive a pension benefit that is paid in part by the capital accumulated in their AFJPs. If the level of accumulated assets does not yield a pension above a specified level, the disability insurance supplements it so as to bring it up to that level. The procedure is similar for survivor benefits.
to those who have contributed for at least 30 years as opposed to 20 for Chile (Arenas de Mesa and Bertranou, 1997). While the Chilean approach spreads the burden to some extent as workers do not all retire at the same time, the Argentine approach does so even more.

The second tier of the Argentine system has clear similarities to Chile’s privatized scheme:

- Argentina’s 29 AFJPs are heavily regulated by the government, including how much of the AFJP’s funds can be invested in each of several alternative asset classes.
- Investments in government bonds get market rates of return, not the low rates of return so common with public social insurance and provident fund schemes.
- The government guarantees funds invested in the AFJPs against returns that fall below a specified level in relation to rates of return for the AFJP industry as a whole and against the event that one of the AFJPs becomes insolvent.
- Argentine workers can retire early if they have accumulated a specified high amount in their AFJP accounts.
- Most of the Argentine pension fund management organizations are private companies that have been established by financial institutions, but some have been set up by non-profit organizations such as labour unions.
- High administrative costs emerge from additional sales staff and other marketing efforts of the AFJPs (Rofman and Bertín, 1996).

Neither the Chilean nor the Argentine scheme is gender-neutral. In both cases, women with earnings and contribution records that are identical to men’s will end up with lower pension benefits, but there are important differences between the schemes (Arenas de Mesa and Bertranou, 1997). In Chile, because retirement pension benefits take into account gender differences in life expectancy, benefits for women are reduced. Those who retire at age 65 receive between 86 and 90 per cent of the pension men receive with the same asset accumulation. In Argentina, similar gender differences exist in benefits paid to workers who opt for the privatized second-tier alternative. However, Argentine workers who opt for the public alternative with similar wage histories receive the same pension benefits independent of gender. The result is an implicit income transfer from men to women, as women become eligible for pension benefits at an earlier age and live longer (Kay, 1997b). However, women are less likely than men to be in the labour force for 30 years or more. Workers who are not in for this length of time are ineligible for the first-tier flat benefit, a provision that disproportionately harms women (James, 1997b).

It is too early to say much about how well the Argentine scheme will
work out in the long run. The hope is that it will increase the national savings rate (Rofman and Bertín, 1996) and stimulate the development of capital markets and related institutions. The new system is in better long-term actuarial balance than was the prior scheme, particularly during the years just before its replacement. This is due to the structure of the new PAYG scheme and to the shift from full to partial dependence on the defined-benefit model. The new system also reduces certain forms of inequity that were present in the old scheme. For example, it eliminates past preferential treatment of special categories of workers with considerable political influence. Finally, the competition among the AFJPs also seems to have improved the level of service to workers in comparison with the prior system (Rofman and Bertín, 1996).

While the new scheme in many ways improves on the serious problems facing the prior scheme, it does have its critics. For example, many cannot understand why the level of the payroll tax on employers varies so dramatically from one region to another. By executive order, the executive branch of the government can grant reductions in the payroll tax on employers in certain regions or in certain favoured industries. Employers in such industries as raw materials production, manufacturing, construction, tourism, and technology receive special treatment. Similarly, in 1996, the 11 per cent employer payroll tax rate in Buenos Aires far exceeded the tax rate of 4 per cent in the province of Formosa. The potential competitive advantage of employers in one region over those in another seems inefficient to many analysts (Bobrovsky, 1996).

Another problem concerns the transition costs to the new scheme. If money that would in the past have been used to pay pensions to those currently retired is redirected to personal pension fund accounts in AFJPs, then a way must be found to make up the difference. In Argentina, retirees currently bear the costs of this transition. While pensions have been indexed, the indexing has not kept up with inflation. These pensions have been losing real value and leaving many retired workers with less income than they need and less than they had anticipated receiving.

The transition costs are also borne by current taxpayers who fund the payment of pension benefits from general revenues (Rofman and Bertín, 1996). Besides paying higher payroll taxes now, workers risk lower replacement rates in the future. Part of the cost will also be borne by future taxpayers. The increase in the national debt due to the gap between government spending on pensions and payroll tax collections for the PAYG scheme will add to the tax bill of future taxpayers.

There has also been criticism with respect to the issue of coverage. For example, the prior scheme had no requirements for how recently a worker
had to contribute to become eligible for disability and survivor benefits. That has changed. With the new scheme, workers who have not contributed for at least six out of the past 12 months are not eligible for those benefits. Another problem is the very high tax rate of 27 per cent on the self-employed. This creates a strong incentive to underreport income. However, as participation is mandatory, coverage among the self-employed is greater than in Chile, where participation is optional (Arenas de Mesa and Bertranou, 1997). There is evidence of a problem of adverse selection in connection with the new scheme. Low-paid workers tend to opt for the public PAYG scheme and high-wage workers for the mixed system. Similarly, a higher proportion of women than men have opted for the public PAYG scheme (Arenas de Mesa and Bertranou, 1997).

Many Argentinean workers are not covered by the new social security scheme. About one third of affiliates (those who have made at least some contributions at some point in time to the SIJP) are covered by the PAYG scheme and about two thirds are covered by the privatized scheme (Rofman and Bertín, 1996). Each year the share in the privatized scheme increases. Yet any estimate of coverage depends on how we count. If we include all affiliated workers, then the upper limit with respect to coverage is close to 65 per cent. But many affiliates are no longer making contributions. If we count only those who are making contributions, the estimate of coverage falls to 35 per cent of workers. Worse, this low estimate does not include seasonal and other workers who are in and out of the labour force (Rofman and Bertín, 1996). In any case, however measured, current coverage is below that under the prior scheme during the 1970s.

Discussion

Many developing nations are having serious problems with their old-age security programmes, and conditions may worsen over the next few decades. Countries with PAYG social insurance schemes fear the projected fiscal burden due to declines in fertility and mortality rates, rapid population ageing, and a reduced ratio of contributors to retirees eligible for public pensions (World Bank, 1994). Most countries with provident fund schemes suffer from inadequate regulation, poor administration, and meagre benefits. Policy experts in both groups of nations have reasons to follow developments in those nations that have at least partially privatized their old-age security systems.

6. One source estimates the rate of affiliation at 70 per cent and the real rate of coverage at 54 per cent, slightly below the estimated real coverage rate for Chile (Arenas de Mesa and Bertranou, 1997).
In 1981 Chile introduced a privatized social security programme, and on balance the new scheme has performed well, much better than most provident funds and social insurance schemes have performed in other developing countries over the same period. Perhaps because of the infusion of private retirement money into capital markets, Chile during this period has had one of the fastest growing economies in the world (Santamaria, 1995). Certainly, privatization has in a number of ways contributed to the development and institutionalization of capital markets in Chile (Arenas de Mesa and Bertranou, 1997; Diamond and Valdés-Prieto, 1994). Argentina has borrowed elements from the Chilean model in an effort to come up with an alternative that combines the strengths of both public- and private-sector models.

Is something approaching full privatization as in Chile or partial privatization as in Argentina suitable for other developing nations? Although we still await the evidence that social security policymakers should ideally have prior to making major shifts in the structure of their old-age security programmes, this is not deterring policymakers in a number of Latin American nations. Influenced by the Chilean model, five Latin American countries have already made major changes in their social security systems (Argentina, Colombia, Mexico, Peru, and Uruguay) and several others plan to make such changes or are in the early stages of implementation (Bolivia, Costa Rica, Ecuador, Honduras, Paraguay, El Salvador) (James, 1997a; *Latin American Weekly Report*, 1997).

This rapid spread of a new approach to social security provision makes Latin America a pioneer region in social security policy that may soon have a major impact on policy in the rest of the world (Hall, 1997; Santamaria, 1995). Some countries are turning to privatization as a potential source of development capital. Others are turning to privatization to ease the projected fiscal burden of paying old-age pensions to an ageing population. Still others view it as a way to deal with their inability to pay promised pension benefits to those currently retired.

To evaluate the suitability of privatization of old-age social security for specific countries, however, we need more than a general review of strengths and limitations. The suitability may vary with country characteristics such as per capita national product, level of development of capital markets and related institutions such as banking, what type of scheme is currently in place, the average level of education in the general population, the education level among civil service employees, and the quality of the bureaucratic infrastructure more generally.

For many of the poorest nations in the world, including most of the sub-Saharan nations in Africa, most older people currently depend on their
children and extended family for support in old age. Some of these countries have national provident funds and some have social-insurance-based public pension schemes, but these programmes only reach a small fraction of the population, primarily those living in urban areas and employed in the modern sector of the economy. Whether based on a provident fund, social insurance, or privatization, old-age security schemes will make little difference to the bulk of the population in these countries. Most people will continue to depend primarily upon their families for support well into the future.

In most developing nations, the economic and social changes associated with modernization are putting a great deal of stress on traditional family support systems, and some are not holding up well. Many experts argue that something needs to be done to strengthen these family support systems (Darkwa, 1997; Nyanguru et al., 1994). One option that deserves more attention than it has received is the social-assistance-based old-age pension. Such pensions in South Africa and Namibia provide at least some support for the elderly poor population and they may indirectly reinforce extended family support systems (Adamchak, 1995; Holden, 1996). National social assistance schemes may not be feasible in the poorest nations, but they may work well in many middle-income developing nations.

Despite low coverage in poor nations, the introduction of a privatized pension scheme might increase the rate of economic growth and improve the standard of living for both the general and the elderly population. This would occur if privatized schemes contributed to the development of capital markets and the institutional infrastructure needed for a modern market economy (Hansell, 1992; Santamaria, 1995). Full or partial privatization could be justified by its impact on the overall economy, the standard of living, and the quality of life of older people (James, 1996). However, we cannot assume that most older people would realize an improved standard of living, as poverty and inequality sometimes increase during periods of sustained economic growth.

While the evidence does not allow a firm conclusion, it seems doubtful that privatized social security alone would have a substantial positive impact on the economy in the poorest nations of the world. While it might have such an effect if included as one component of an interrelated set of growth-enhancing policies, such a scheme by itself would most likely involve few workers and little capital in relation to the size of the economy as a whole. Even worse, the transition from a public to a private scheme might be financed in part by allowing the real value of pensions of those already retired to erode (Kay, 1997a).

In most of sub-Saharan Africa and in many other of the poorest nations...
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around the world, any formal approach to old-age security provision runs a high risk of being poorly managed. Programmes calling for a reduction in current wages in exchange for the promise of future benefits may not benefit most workers. The risk is high that new, privatized old-age security schemes would come to be associated with corruption, mismanagement, exorbitant administrative fees, and negative long-term returns, rather than with the stimulation of capital markets, the development of a banking industry, and higher returns on retirement account contributions. The best course in many of the poorest nations may be to continue to rely primarily on informal family support systems until capital markets are more developed and governments are better able to regulate an old-age security system, public or private (James, 1997a).

For these reasons, countries with adequately functioning provident funds or public pension systems currently in place should probably wait to make changes until there is more evidence how well the privatized schemes perform in prolonged stagnant or declining financial markets. Radical change involves transition costs, and it does not make sense to take on those costs until there is a better understanding of both the strengths and the weaknesses of the privatization approach. One also needs to know more about the risks involved in setting up privatized social security systems in nations with high levels of corruption and very little governmental capacity to regulate the organizations managing the pension fund money.

Our conclusions differ for the more affluent developing nations. These countries typically have PAYG social insurance or provident fund schemes in place, covering a substantial fraction of the population. There is less risk involved in basing policy decisions on the Chilean experience for higher-income developing nations than for the poorer ones (Queisser, 1995). They share a number of characteristics with Chile, such as the level of development of capital markets, size of the modern sector of the economy, age structure, quality of the civil service corps, level of education among covered workers, and degree of political stability. While there will also be important differences, such shared characteristics increase the relevance of the Chilean model.

The Chilean model looks attractive to policymakers in some, if not many, of the more affluent developing countries with PAYG public pension schemes. Were privatization introduced, workers covered under prior PAYG schemes would be given some credit for contributions to the old public pension scheme, but it is likely that compensation to workers would typically come to less than they had been promised in connection with the prior scheme. Given that the burdens they currently face will worsen in the near future, policymakers in many of these countries may wish they had
opted for privatized schemes years ago. Perhaps some will see privatization as a rationale for scrapping expensive public systems. An entirely new social security scheme can potentially be used to renege on some of the promises made in connection with current PAYG schemes, promises that are becoming increasingly difficult to keep. Such a radical change would also justify cuts in the sometimes large bureaucracies administering existing schemes and elimination of special and increasingly burdensome privileges for certain categories of workers (Kay, 1997b).

Despite some benefits of change, it is not yet known how well such schemes will do in the long run in Chile, to say nothing of how well they will work in countries that differ from Chile in their level of economic, political, and social development. There is already some experience dealing with the impact of prolonged stagnation and financial market decline on PAYG schemes, but there is no such experience with privatized schemes. Even in relatively affluent developing countries, then, it may make more sense to reform existing PAYG schemes than to make a radical shift to a privatized alternative. The transition costs of privatization would be high in most of these countries and even more unbearable than the burden associated with existing PAYG schemes.

Would it make sense for those nations in Africa and Asia with provident fund schemes in place to shift from their public schemes to privatized alternatives? As these schemes are funded, the transition should in general be easier than one from a public PAYG scheme to a privatized mandatory savings scheme as in the Chilean case. Further, these schemes have been providing very low — in many cases negative — rates of return and have had very high administrative expenses. If these funds would be more efficiently managed and more productively invested in the private sector, such a shift might make sense. Yet, without addressing issues of corruption, mismanagement, and lack of governmental capacity to provide adequate regulation, any new privatized social security scheme would soon be discredited by many of the same problems faced by the current provident fund schemes.

How about countries such as Singapore that are operating well-managed provident fund schemes with very low administrative costs and consistent positive real rates of return (McKinnon et al., 1997)? On one hand, privatization would very likely lead to a substantial increase in administrative costs. On the other hand, in a comparison of the past 15 years of experience in Singapore with that in Chile, the privatized alternative will probably show substantially higher real long-term returns even after subtracting the higher administrative costs (Financial Times, 1997). Workers in countries such as Singapore might be better served by privatized
schemes, but there is some evidence suggesting that they may do worse, not better, when investing pension assets on their own (Asher, 1998).

The provident fund of Singapore is very conservatively managed, with most of the funds invested in government bonds that have consistently protected assets and consistently provided positive real rates of return during both up and down financial markets (Financial Times, 1997). The Chilean scheme cannot yet make that claim. When Chile does enter a prolonged period of stagnant or declining financial markets, Chilean workers as well as policy analysts from around the world will begin to look at the privatization model more critically than they do today.

**Conclusions**

In recent years, privatization has become a social movement that is sweeping around the world. Policymakers in many spheres are making major structural changes as part of their efforts to push toward greater privatization and greater dependence on market mechanisms with respect to both economic and social welfare policy. Over the next couple of decades, then, many countries will seriously consider making major changes in the structure of their social security systems. Given the large number of people who are likely to be affected either positively or negatively by such changes, one needs to know as much as possible about the potential consequences of the proposed changes.

Chile provides a useful case study for the pros and cons of privatization in a relatively affluent developing country. The case will be of particular use once it has weathered a prolonged period of economic stagnation and decline. Evidence from other affluent developing countries such as Argentina and Mexico will likewise be useful after their schemes have been in place for a few more years. So will outcomes for poorer developing countries such as Peru or the first poor African nation to privatize its social security system. As a number of African countries are moving in the direction of more market-oriented economies, one of them may in the future partially privatize its social security system.

With the newly emerging information, there will be a need to explore the consequences of privatization in different types of developing countries.

The most obvious need here is to distinguish between poor developing nations and more affluent ones. Besides levels of national income, nations differ in the education level among workers, level of development of capital markets, quality and professionalism of the civil service corps, level of dependence on world trade, age structure, structure of the labour force,
degree of and trends in urbanization, and rate of economic growth. All of these characteristics may affect the success or failure of privatization. Perhaps it will work much better in Latin America than in sub-Saharan Africa. Perhaps it will work better when a shift is made from a PAYG public pension scheme to a privatized mandatory savings scheme than from a provident fund to a privatized mandatory savings scheme.

The evidence from Chile suggests that privatized social security schemes may provide higher returns than PAYG schemes over the long run — at least for average- and high-wage workers. But they may not equally benefit low-wage workers and vulnerable population subgroups. We need more analysis of who benefits and who is likely to be harmed as a result of privatization. For example, there is some evidence suggesting that privatized schemes in Chile and Argentina favour men over women (Arenas de Mesa and Bertranou, 1997; Kay, 1997a). Similarly we need to explore the consequences of privatization for those who spend most of their working lives in the informal sector of the economy.

While a privatized scheme may on average return higher benefits than a PAYG scheme over the long run, it does so at the cost of increased risk to covered workers. Benefits under a privatized scheme might be lower than under a PAYG alternative for cohorts of workers that retired when stock and bond markets were depressed. While affluent workers can afford to take some risk, workers closer to the economic margins cannot afford the risks implicit in the privatized scheme.

Overall, then, it is not yet clear that the privatization or partial privatization of social security is over the long run preferable to a well-structured and managed PAYG public scheme, even for Chile and Argentina. Even if one were to conclude that privatization is a good idea at least for some countries, the next step would be to determine those circumstances under which it is a good idea. It would be a mistake to assume that one approach to the provision of social security is the best for all developing countries. In some countries, privatization may make the most sense in some provident funds, in some social assistance schemes, and in some PAYG schemes. For countries best suited for privatization, the question remains of what form privatization should take — the full privatization of the Chilean model or the partial privatization model of Argentina.

Choices also will depend on demographic and economic trends, both in the nation and in the world more generally. The type of scheme best suited to a country in the context of today’s world economy may not fit the context of a very different world economy 50 years from today. Given the high economic and political costs associated with shifts from one type of scheme to another, attention needs to be given to what type of social
security system is likely to work best, given a variety of different scenarios with respect to short- and long-term trends in the national and world economy.

Considerable attention has been given to the possible positive indirect effects of privatization, such as fostering economic growth and the development of capital markets. More attention needs to be given to the reverse side of the coin, to possible negative indirect effects, such as increased exposure to market risk, decreased coverage for low-income groups, and adverse distributional effects for certain vulnerable groups such as women (Arenas de Mesa and Bertranou, 1997; Kay, 1997a).

As the shift away from government ownership of major industries and the drive to cut government spending on social programmes have picked up momentum in recent years, there is a risk that the PAYG public pension approach to the provision of old-age security is being unfairly blamed for other more general problems many nations are facing. As most nations have PAYG schemes in place and as most are finding it difficult to finance government expenditures, it is not surprising that many have concluded that their PAYG social security programmes are a big part of the problem. Attention needs to be given to the possibility that the focus should be on how these schemes are administered and structured. Public schemes can be well or poorly structured and managed, just as private schemes can be well or poorly structured and managed. It would be instructive to analyse the experience of a few of the best-managed PAYG schemes currently in place in developing countries. Studies are needed to compare their success over the long run with that of privatized schemes such as those in Chile and Argentina.

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