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Pensions Outside U.S.: Lessons For Social Security

By Paul Whitfield

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In a way, a good chunk of Social Security's problems can be summed up in one question: Why didn't you have more children 40 years ago? While that might sound like a lame joke, the punch line carries wallop. Five years after Social Security was launched in 1935, there were 159 workers paying into the fund for every retiree getting a check, according to the Social Security Administration. Today the ratio is roughly 3 to 1.

Free market advocates say one way to solve the problem is to go to a 1 to 1 ratio: Personal retirement accounts that the worker owns and builds up over his or her career.

According to Michael Tanner of the libertarian Cato Institute, 32 countries have turned to partial or full privatization of their Social Security-like systems. The U.S. isn't one of them.

After his re-election in 2004, President Bush pushed for changes that would've let workers put part of their Social Security taxes into a personal retirement account. However, the effort stalled out. Polls showed the public did not favor the ownership plan.

Other nations have proven more open to change. Here's a look at several countries and their systems:

• Chile: Capitalists point to Chile as perhaps the best model for change. In 1924, Chile became the first country in the Western Hemisphere to introduce a retirement program, but the government program began to have funding problems in the late 1970s.

In 1981, Chile became the first country to replace its pay-as-you-go system with a mandatory private—savings system.

"It has been extremely successful," Tanner said in an interview with IBD.

Tanner noted that while many countries do partial privatization, Chile has "gone the full route."

There's little interest in undoing the change, Tanner said. Chile has "had a number of center left governments that tweaked the system, but the consensus view favors the program."

Workers must deposit 10% of their pay into the retirement account, which is then managed by an asset management firm.

Tanner said the program isn't perfect. "There are some problems with it," he said.

Such as?

"So much of the economy is underground," Tanner said. People work off-the-books, don't contribute to the accounts and then have nothing for retirement.

"This was a problem with the old system too," Tanner said.

Another problem is that the system inadvertently favors men over women. Divorce wasn't legal in Chile until the late 1980s. The accounts belonged to the wage earner, which usually was a man. Some divorced women were left with nothing.

"This is being tweaked now," Tanner said.

Converting to a private system can have challenges. Chile helped pay for the conversion partly by privatizing its copper industry.

• Sweden: The country has a leftist image in America, but Sweden has gone to "a much more partial privatization" than Chile, with a small portion of the payroll tax in personal accounts, said Tanner.

Mandatory private accounts, as part of Sweden's retirement system, were introduced in 2000.

Necessity rather than ideology was the driver. "All these countries in Europe are facing demographic pressures," Tanner said.

• Peru: Youthful Peru has a favorable age ratio.

Almost half the population is 24 years old and younger and only about 7% are 65 and older, according to the CIA World Factbook. (In the U.S., only a third of the population is 24 and younger, while 14% of the population is 65 and older.)

Peru kept its pay-as-you-go retirement system while adding a personal contribution option in the 1990s. "People have a choice between the two systems," Tanner said.

Peru also has underground economy problems.

• Australia: In America, privatization is often seen as a right wing idea. But in Australia, the leftist Labor government launched a private savings alternative in 1986.

"There is still a public system," in Australia, Tanner said.

• El Salvador: The Central American country created a private pension program in 1998 after dismantling the public system. But about two-thirds of the working population are in the underground economy, according to an Inter Press Service report. Only 1 of every 4 workers participates in the private pension plan.

Government has restricted investing choices to the El Salvador stock market and state bonds. The first is too small to be optimal, and the second delivers low returns.

What the experiments in private pension systems suggest is that free markets can't work if they are not truly free. If laws, regulations and the lack of property rights divert the poor to what economist Hernando de Soto calls "the grubby basement of the pre-capitalist world", then failure is likely.

A few countries have shunned the ownership path and have even seized private retirement accounts.

Argentina's government took over the $30 billion private pension system in 2008. Hungary appropriated pension funds in 2011 and burned through most of the money in less than three years via government spending or servicing government debt. In 2013, Poland nationalized about half of the private pension funds.

Could the same happen here?

"That's not going to happen in the U.S.," Tanner said.