SOCIAL SECURITY DEVELOPMENTS AROUND THE WORLD

By Tianhong Chen, David M. Rajnes, and John A. Turner

This article surveys social security developments around the world. We focus on China, Africa, countries with privatized individual accounts in South America and Central and Eastern Europe, and OECD countries. China, though the country with the largest population in the world, is often overlooked in international surveys.[i]

CHINA

Some degree of fragmentation in social security systems exists in many countries, with some groups of workers covered by different systems. For example, Canada has the Canada Pension Plan for most of the country and the Quebec Pension Plan for the province of Quebec. Tanzania has separate social security programs for Zanzibar and for mainland Tanzania, which is the former Tanganyika. Nevertheless, by expanding coverage of the main social security program, merging separate social security programs, or starting new programs that are nearly universal in coverage, some countries are reducing fragmentation of social security systems. China provides social security old-age benefits in a highly fragmented manner that is virtually unique among world social security systems, but it too is reducing fragmentation.

With respect to the social security benefits programs, China's population can be divided into seven groups. The two major groups in terms of number of participants are urban employed workers and workers in rural areas. Five smaller groups are urban unemployed workers, rural migrants to urban areas, farmers who have had their land appropriated by the government, government workers, and the military. Fragmentation also exists within the major programs, with regional and local variations in the national programs accounting for much of the fragmentation. China has more than 2,000 social security funds managed by different government entities.

China's social security program for urban workers provides a traditional defined benefit program plus mandatory individual accounts. The one for rural workers is voluntary, with voluntary individual account pensions. The mandatory individual accounts have been defunded to pay for benefits in the associated pay-as-you-go system, while the voluntary individual accounts are fully funded. The difference is not due to a greater ability to manage individual account plans in rural areas than urban areas, but primarily is due to differences in the amount of implicit pension debt for pay-as-you-go pensions in the two areas. The mandatory social security system for urban workers are supposed to be financed by a tax on employers of 20 percent of wages, but some employers understate wages or simply do not pay the tax because the rate is so high.

China has an innovative program that provides additional social security benefits at advanced ages, called the old-age allowance. This benefit starts at age 80 in some areas, but age 90 or even age 100 in other areas. Ireland is another country with a special social security benefit that starts at an advanced age.

AFRICA

The majority of workers around the world lack social security coverage. This is one of the key problems facing social security programs, particularly for middle- and lower-income countries. On average, social security programs in Africa only cover 10 percent of workers. For example, less than five percent of workers are covered in Uganda. Part of the reason is that many workers work in the informal sector and social security programs do not cover workers in that sector. Many private sector workers who are covered by law are not participating due to contribution evasion, which is the failure of employers to make mandatory social security contributions.

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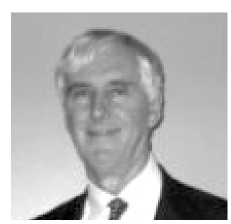

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Recognizing the problem of lack of coverage, many countries are attempting to extend coverage to more workers. Burundi has an innovative system where motorcycle taxi cab drivers are covered through contributions to their national association. To encourage coverage among agricultural workers, who are typically difficult to bring into the social security system, Tanzania has a public relations campaign to encourage more people to participate in the social security system. Tunisia charges agricultural workers a lower contribution rate than urban workers. Egypt allows self-employed workers to declare their level of income, with the minimum level varying by occupation.

Provident funds were established in many countries that were formerly British colonies or British protectorates, in part because of their simplicity. They are defined contribution plans that typically provide lump sum benefits and that have a single investment pool for all participants. Provident funds were established in most of the former British colonies or protectorates in Africa—Gambia, Ghana, Kenya, Nigeria, Seychelles, Swaziland, Tanzania, Uganda and Zambia. Outside of Africa, Singapore and Malaysia also have provident funds. However, many countries have ended those plans and have switched to social insurance types of plans. Those countries include Ghana, Nigeria, and Tanzania. Kenya and Uganda are considering converting their provident funds to defined contribution pensions, rather than to a defined benefit social insurance pension. Nigeria subsequently switched to a mandatory individual account system. In 2010, Egypt passed a law replacing its pay-as-you-go system with a system of mandatory individual accounts.

COUNTRIES WITH PRIVATIZED INDIVIDUAL ACCOUNTS

Most countries around the world provide social security benefits through traditional defined benefit pay-as-you-go systems based on principles of social insurance. However, a number of countries in Latin America, Central and Eastern Europe, and elsewhere, have added mandatory individual accounts as a component of their social security programs.

In 1981, Chile was the first country to privatize its social security program. Chile completely ended its pay-as-you-go system for private sector workers, replacing it with an individual account system, while most other countries that followed it cut back on the pay-as-you-go system and combined it with a mandatory individual account system. Since 1990, 10 other countries in Latin America have followed Chile. The first countries (with the year implemented) were Peru (1993), Colombia (1993), Argentina (1994), Uruguay (1996), and Mexico (1997). These were followed by two of the poorest countries in the region, Bolivia (1997) and El Salvador (1998). In 2008, Panama added mandatory individual accounts for new entrants into the social security system.

Beginning in the late 1990s, after the fall of the Soviet Union, a number of countries that were part of the Soviet Union or that were in Central and Eastern Europe added mandatory individual accounts as part of their social security systems. Kazakhstan (1997), Hungary (1998) and Poland (1999) were early leaders, followed by Bulgaria (2000), Latvia (2001), Croatia (2002) and Estonia (2002). Other countries include Bulgaria (2002), the Former Yugoslav Republic of Macedonia (2003), Slovakia (2005) and Romania (2008). In addition, Lithuania, the Czech Republic, Slovenia and Russia have enacted reforms.

Mandatory defined contribution plans have also been introduced in countries in other regions, either in addition to or in replacement of existing traditional social security programs. In 2011, Thailand introduced the National Pension Fund as a mandatory defined contribution plan to supplement its traditional social security plan. In 2010, Brunei added mandatory individual accounts to its existing mandatory social security system. Between 1988 and 2008, 29 countries followed Chile and established mandatory individual accounts.

Contribution rates have increased in some countries with mandatory individual accounts and mandatory pensions, such as Mexico, Singapore, Hong Kong, and Australia. Australia is raising its contribution rate for its mandatory pension system from nine percent to 12 percent.

Some countries that enacted reforms that privatized social security by adding individual accounts have later cut back on those reforms, reducing or eliminating the contributions to privatized individual accounts. Argentina ended its system of privatized individual accounts in 2008, while Bolivia nationalized its system of individual accounts in 2010. Retrenchment has been more common in Central and Eastern Europe than in South America, in part because of the financial crisis there and the subsequent economic downturn. In Central and Eastern Europe, Poland, Latvia, Lithuania, Estonia, Romania and Slovakia all retrenched their privatized systems in some way since 2010. Starting in 2010 Hungary ceased funding its mandatory individual accounts and returned most of the accumulated funds to the participants. In 2012, the Slovak Republic reduced the contributions to the mandatory individual accounts and transferred those contributions to the pay-as-you-go system. It also temporarily permitted workers to withdraw from the system. In 2013, Kazakhstan announced that it was nationalizing its system of mandatory pension funds.

Retrenchment has occurred in part because of the double payment problem, where payments are being made into the new individual accounts, while payments are still required into the traditional pay-as-you-go system to pay the benefits promised from that system. Some governments have found that it was too expensive to pay for the existing pay-as-you-go system and for the new individual accounts, particularly in circumstances of an economic downturn.

OECD

Though they have generally not been described this way, historically social security programs were designed as longevity insurance programs, meaning programs that provided benefits at advanced ages where roughly half of those entering the workforce had died. Over time, they have gradually shifted to being retirement benefit programs due to the increase in life expectancy and decreases in benefit eligibility ages. For example, while the United States Social Security is now a benefit that most people who enter the workforce survive to receive, it was originally structured like a longevity insurance benefit. In 1940, when benefits were first provided, the benefit eligibility age was

65. Taking into account that people entered the workforce at earlier ages than currently, from U.S. life tables for 1910 for the population age 18 that year, at age 65, 54 percent of the population would still be alive.

Because of rising old-age dependency ratios, a number of OECD countries have cut back on the generosity of their social security benefits, resulting in falling income replacement rates in old age. These countries include France, Japan, Sweden, Greece, South Korea and the United States. A number of countries have reduced benefits in traditional social insurance old-age benefits programs by increasing the years used in the earnings averaging period for calculating benefits. Spain has done so, resulting in more years of relatively low earnings being included, lowering average earnings in the benefit calculation. Finland, Austria, France, Italy, Greece and the United Kingdom have also increased the number of years used in benefit calculation. In Italy, the increase was from the worker's last five years of earnings to lifetime earnings.

Contribution rates have been increased in many OECD countries, including Denmark, Finland, France, and Sweden. Social security contributions also can be increased by raising the contribution base. Countries that have completely eliminated the ceiling on taxable earnings for social security financing include Finland and Norway. In 2001, Ireland eliminated the ceiling on taxable earnings for social security for employer contributions. The United Kingdom also requires employers to pay social security taxes on employee earnings without a ceiling on those earnings. In 2014, Japan increased its value added tax (VAT) from five to 10 percent, with the increased revenue being used to finance its social security program. Although all OECD countries use contributions from employers and employees to finance social security old-age benefits, nearly all those countries also use general revenue funding.

At least twelve countries have adopted automatic adjustment mechanisms as a way to maintain the solvency of their pay-as-you-go social security programs. Finland, Portugal, Norway and Sweden adjust the generosity of benefits received at retirement automatically for changes in life expectancy. Portugal passed legislation in 2007. A sustainability coefficient was introduced in the benefit formula for calculating pensions. This coefficient equals the ratio between life expectancy in 2006 and life expectancy in the year preceding retirement. The level of statutory pension is multiplied by the coefficient, reducing the benefit level as life expectancy increases.

CONCLUSIONS

This article provides a quick trip around the world, surveying selected developments in social security. In most countries, social security is a work in progress, with developments continuing as countries face the challenges of aging populations. ■

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ENDNOTES

[i] The material for this article is taken from the sources in the list of references, where a full list of references can be found.