

# **Pension Reform and the Development of Pension Systems: An Evaluation of World Bank Assistance**

## ***Background Paper*** **Uruguay Country Study**

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This paper is available upon request from IEG.

2007  
The World Bank  
Washington, D.C.



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## Abbreviations

AFAP	Administradora de Fondos de Ahorro Previsional
BPS	Bank of Social Protection
CAS	Country Assistance Strategy
CSSAL	Contractual Savings Structural Adjustment Loan
GDP	Gross domestic product
IADB	Inter-American Development Bank
IEG	Independent Evaluation Group (formerly OED)
IMF	International Monetary Fund
INE	National Statistics Institution
IVS	Retirement and Pensions Program (part of BPS)
NMS	National minimum salary
OED	Operations Evaluation Department (changed its name to IEG in December 2005)
ONAJPU	National Organization of Retirees and Pensioners from Uruguay
OPP	Office of Planning and Budget
PAYG	Pay-as-you-go
PIT-CNT	Plenario Intersindical de Trabajadores – Convención Nacional de Trabajadores
SAL	Structural Adjustment Loan
TAL	Technical Assistance Loan
VAT	Value-added tax



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## **Preface**

This paper belongs to series of 19 country and regional case studies commissioned as background research for the World Bank's Independent Evaluation Group (IEG) report "Pension Reform and the Development of Pension Systems." The findings are based on consultant missions to the country or region, interviews with government, Bank, donor, and private sector representatives involved in the pension reform, and analysis of relevant Bank and external documents.

This case study was authored by Jorge San Martino in 2003 and elaborated with the assistance of Lic. Natalia Capellari.





## 1. Background

### The Structure of the Pension System

1.1. The historical origins of Uruguay's pension system include early pension plans introduced in the 19<sup>th</sup> century. The first general law to cover all private employees was approved in 1919, and the country developed an extended welfare system during the 20<sup>th</sup> century. The welfare system was run by many independent funds until 1967, when the Bank of Social Protection (BPS) was created, a central administrative body to manage the national pension system along with unemployment, health insurance, family allowances, and other benefit plans. The BPS is one of the most powerful institutions in the country.

1.2. In 1979 the military government in power enacted a reform, which included some important administrative and benefit changes. The independently run BPS was replaced by the General Directorate of Social Security, under the Ministry of Labor and Social Security. The directorate was responsible for health and family allowance programs, maternity benefits, unemployment benefits, and the retirement fund that covered civil servants, teachers, and manufacturing and trade workers, centralizing many of the nearly 50 individual funds in a unique social security fund. This reform did not affect the acquired rights of pensioners because the effects were not expected until 2020.

1.3. On the benefits side, the minimum ages for retirement were increased to 60 years for men and 55 for women; an increase of 10 years from the previous requirements, and the years of service was increased to a minimum of 30 years. Some special and retirement benefits (maternity and layoffs) were eliminated and the indexation of benefits was changed from the cost of living to wages, with important discretionary power retained by the government to determine which index to apply.

1.4. The pension adjustment mechanism would occur annually, based on the change in the Average Salary Index from the past year, with a different factor applied to the lowest pensions that should receive greater adjustments, conditional upon the state's financial situation. It imposed a pension's ceiling at 15 times the minimum salaries for pensioners who received benefits from more than one source.

1.5. In 1984, a democratic political system was reinstalled in the country by Institutional Act No. 19 and the 1967 Constitution was restored, with the exception of Article 195, which referred to the creation of the BPS, thus leaving reform of the social security system to the new government democratically elected in November 1984. In subsequent years, the National Conciliatory Program (established to conduct the transition from the authoritarian regime) set up a working group on social security that agreed to (i) reinstate the BPS; (ii) raise all pensions to the level of the national minimum salary (NMS); and (iii) support the use of different factors to adjust pensions for inflation. These policies were proposed as part an economic agreement among presidential candidates to increase domestic demand by increasing real salaries and pensions.

1.6. During the 1982 debt crisis, Uruguay suffered a virtual cessation of capital inflows. Severely burdened by external debt, the country's economy entered a deep recession. In the

second half of the 1980s most policy discussions about pensions were linked to indexation, as the government tried to avoid using the official technical indexing mechanism (a variation of the average salary of the last year) and, instead, adjusted pensions by decree, using other indexes in an attempt to reduce total expenditures. These attempts, however, were, contested by political parties and interest groups.

1.7. President Julio Maria Sanguinetti's administration attempted to introduce a different system of indexation in April 1985. The administration negotiated and agreed to a savings of 0.5 percent of GDP during the first year of the International Monetary Fund's (IMF) program with the country. The government sought to favor poor and older retirees to reduce pension expenditures at the expense of other beneficiaries. The highest pensions were virtually frozen, affecting approximately 97,000 "high-income" pensioners, many of whom brought legal action against the government.<sup>1</sup> Despite the administration's efforts, however, average pensions increased 59 percent.

1.8. It is noteworthy that the Sanguinetti administration's main goals were to reverse the difficult fiscal situation—as part of the agreement reached with the IMF—through inflation-reducing policies and cutbacks in spending. Social security policies were consequently seen as a fiscal-deficit adjustment tool.

1.9. In 1986, Uruguay's Congress reversed the government's policy of indexation, declaring that it was illegal to adjust pensions at a rate below the rate of change in the average wage index. Congress increased indexation from the administration's proposed 85 percent to 107 percent, as proposed by the Social Security Commission. Although the administration initially vetoed the opposition's draft legislation, it approved a new decree that included the opposition's demands a short time later, in response to political and public pressures.

1.10. Uruguay's government during this period suffered from political gridlock because every attempt by the government to limit expenditures was strongly resisted. After a highly politicized and distressing process for both the government and the opposition, the Senate passed Law No. 15.000 in October 1987 dealing with reforms, thanks to an agreement between the ruling Colorado Party and the Broad Front (center-left political party). The reform project addressed the indexation issue, providing partial indexation that ranged from 85 percent for pensioners receiving the minimum, to 50 percent for those receiving more than four minimum salaries (Kay, 1995). Future annual adjustments would be based on the change in the average wage index, and the executive branch lost its discretionary power to adjust pensions. The special-privilege pensions of politicians and politically appointed officials were also cut.

1.11. The new legislation established a ceiling on the maximum pensions at 15 NMS in all cases (the government's original proposal was to keep it down to a maximum of 10 NMS) and a floor of one NMS starting in 1990. Both issues contributed to the

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<sup>1</sup> Three hundred and eighty cases were brought before the court and 60 received outcomes favorable to the pensioners, thus establishing the illegality of the executive branch's pension revaluation (Papadópulos 1992).

mobilization and organization of middle-class retirees. In addition, a tax on salaries was levied for the construction of homes for retirees. The financing of the reform was to be achieved by an increase of one percentage point in the value-added tax (VAT) and a 20 percent rise in the tax paid on new vehicles. The government was defeated in its efforts to raise the retirement age from 55/60 for women/men to 60/65. In 1988, the payroll tax increased to 37.5 percent (16 percent for employees; 21.5 percent for employers).<sup>2</sup>

1.12. Dissatisfied with Law No. 15.000, the pensioners' movement placed a referendum on the ballot to reform Article 67 of the Constitution, which would index pensions to the median salary index. This meant that the value of benefits would be adjusted four times a year and each time the salaries of federal government officials increased. There would be no delays between the annual adjustments, advance payments, and benefit increases. These steps were critical to maintaining the real values of pensions, given the rampant inflation rate, which in 1989 reached 100 percent. The referendum passed with 82 percent of the vote in November 1989, meeting with initial opposition by the central trade union, the Plenario Intersindical de Trabajadores – Convención Nacional de Trabajadores (PIT-CNT), on the grounds that the proposal raised benefits to the highest-paid beneficiaries, while draining resources from other social programs (such as family allowances, unemployment insurance, and health benefits). The Broad Front also opposed the referendum initially because it eliminated the ceiling imposed on pensions, but after their own proposal was defeated in Congress, and amid electoral pressures, it finally supported the measure.

1.13. Apart from the BPS's hegemonic position, five other groups provided social security benefits for the (i) military, (ii) police, (iii) bank employees, (iv) professionals (university graduates), and (v) public notaries. Each of these groups has its own pension system, still managed by an independent institution. By 1996, 87 percent of retirees were covered by the BPS, 10 percent by military and police funds, and the remaining three percent by one of the other three funds. The last two groups (13 percent of retirees) accounted for 35 percent of total pension expenditures.

1.14. Under the pension system in place until 1996, all workers not covered by one of the five independent funds had to register under the BPS. Employees had to contribute 13 percent of their gross salary and employers contributed 14.5 percent (from the private sector) or between 19.5 percent and 24.5 percent (from the public sector). The system, operating as an unfunded pay-as-you-go (PAYG) scheme, offered five basic types of retirement benefits: regular retirement, complete disability, early retirement, old age, and survivors benefits. In all these cases, the *benefits formula* was defined as a percentage of a "basic retirement wage"—an indexed average of the beneficiary's last three years of earnings. The benefit ceiling corresponded to a salary of UR\$ 5,000 (which represented approximately US\$ 800) and a ceiling of 15 minimum salaries for pensioners receiving benefits from multiple sources, independent of the number of jobs they had held.

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<sup>2</sup> According to Mitchell (1996), the measure generated further evasion of taxes.

1.15. The replacement rate was established at 70 percent of the average final salary, and early-retirement benefits were worth 60 percent of the pay for men with less than 35 years of service (30 years in the case of women). Survivors benefits were calculated at between 66 and 75 percent of the deceased retiree's benefit amount, and special benefits were also available for divorcees and parents of the deceased pensioners. The old-age benefit was granted to individuals 70 years or older, with a minimum of 10 years of service, at 85 percent of the minimum wage (the cutoff for old age benefits was subsequently dropped to 65 years). Special groups, such as teachers and workers in risky occupations, were entitled to additional credit for service years.

1.16. The non-contributory type of welfare benefits provided by the BPS (aid to families with dependent children, maternity allowances, unemployment benefits, old-age pensions, and health benefits) accounted for half of the BPS's total deficit and several attempts to earmark taxes or include user fees were unsuccessfully promoted.

### **Performance**

1.17. During the 1980s and early 1990s, the system was becoming increasingly unsustainable. The combination of the aging population (almost one-fifth was age 60 or older), increased longevity (life expectancy at retirement age was close to 17 additional years for men and 26 additional years for women), and a very old and outdated system created serious financial difficulties. Even though the real values of the pensions had been permanently decreasing over the past decades—by more than a 30 percent between 1962 and 1991—social security expenditures kept growing because of the increase in the number of benefits paid out (Saldain 1993, p. 74).

1.18. In addition, other factors contributed to the progressive deficit in the existing social security system, including (i) the reduced period on which to calculate the base salary for regular benefits (the last three years of earnings) and (ii) the flexibility in certifying years of service. The absence of appropriate registration enabled many people to receive benefits without ever having contributed to the system. A calculated 23 percent of BPS's expenditures corresponded to benefits for which no contributions were made (Noya 1999).

### *The Relationship between Contributors and Beneficiaries*

1.19. As of 1980, there were 1.4 contributors for every beneficiary in the system. By 1995, that figure had declined to less than 1.1 contributors (Papadópulos 1992 puts the figure at 0.76).

1.20. In March 1985, there were 705,000 pensioners depending on the system, with benefits paid in nearly 90 percent of the cases (630,937) by the General Directorate of Social Security. The remaining 125,000 pensions were paid by independent funds not affected by the 1979 reforms. From these funds, 36 percent of retirement pensions and 4.5 percent of the non-contribution pensions for indigents were equal to or above the NMS (US\$ 75).

1.21. The pension system contained a number of inequalities in coverage between the various insured groups. Taking as the base the average pension of rural and domestic workers in 1982 (12.177, in current thousand *pesos*), the ratios varied from 1.2 in the case of manufacturing and trade to 5.9 in the military.

1.22. In addition, the PAYG system included elements that generated negative incentives for workers to contribute: the typical male worker that followed the rules received a poor financial return on his pension contributions because the worker was taxed at about 4 percent of his wage relative to the long-term interest rate (World Bank 1996, p.13). Because women live longer and retire at an earlier age, their results were slightly better.

**Table 1.1: Average Pensions by Sector**

<i>Insured groups</i>	<i>Average pension<sup>a</sup> (in thousand pesos)</i>	<i>Ratio<sup>b</sup></i>
Domestic and rural	12.177	1.0
Manufacturing and trade	14.612	1.2
Teachers and public employees	29.896	2.5
Military	72.175	5.9
Public notaries	53.111	4.4
Professionals	50.148	4.1
Bank employees	68.638	5.6

Source: Mesa-Lago 1985.

a. An average of all pensions in each grouping, as of 1982, in thousands of *pesos*.

b. The average rural and domestic worker's pension is taken as the base.

1.23. The number of pensioners represented a high percentage of the population, estimated in 1995 at close to three million people. The population aged 60 or older in 1963 represented 19.3 percent of the working-age population (age 15–59) but grew to 27.2 percent in 1985 and was about 29 percent in 1995 (World Bank, 1996).<sup>3</sup>

1.24. During the entire period under consideration, payroll taxes decreased. For instance, for manufacturing and trade, the payroll tax was 36.7 percent in 1969, but was subsequently lowered to 25 percent by 1985 (Mitchell, 1996). In addition, in 1979 the government eliminated earmarked taxes to cover family allowances and unemployment insurance; despite this, payroll tax evasion did not improve, reaching 27 percent in the mid-1980s. Furthermore, in the 1979 reform, many older workers were allowed to choose early retirement during an extensive transition period, thus avoiding the higher retirement hurdles required under the new rules (Mitchell, 1996).

<sup>3</sup> Papadópulos (1992) estimated that in 1995, the number of individuals aged 60 or older would represent 19.63 percent of the labor force.

1.25. Because the reduced payroll tax revenues were insufficient to pay benefits, revenues transfers from the value-added tax (VAT) became increasingly necessary. The VAT was increased several times, growing from a minimum rate of seven percent in 1979 to 12 percent in 1984 (the basic rate increase was from 18 percent to 20 percent in the same period) (Mitchell, 1996). Taxes, including social security contributions increased from 20 to 25 percent of GDP between 1989 and 1993 (World Bank, 1996), making it infeasible to promote further increases as a way of reducing the deficit gap. The privileged group's funds often generated a deficit, while manufacturing and trade's funds showed surpluses in most years, highlighting the inequities of the system.

1.26. By the end of the 1980s, coverage declined to about 75 percent of the labor force, partly because of increased payroll tax evasion—which was calculated at three percent of GDP (while VAT evasion was 1.8 percent of GDP)—and to high labor costs (Uruguay's was the highest among the Mercosur nations). The aggregated estimates of evasion indicate that 27.3 percent of expected contributions did not materialize. Cheating was also widespread, with actual contributions paid in at a much lower level than they should have been. Pensions were effectively paid out at a much higher level than warranted by corresponding contributions, with actual benefits exceeding expected benefits by 45 percent (World Bank, 1996). The decline in the coverage rate was also affected by an increase in the unemployment rate, which rose from 7 to 12 percent between 1970 and 1996.

#### *The Evolution of the Financial Situation of the System*

1.27. By the mid-1980s, the social security burden represented close to 10 percent of GDP, in a deficit-ridden system where outlays exceeded revenues by 60 percent (3 percent of GDP). Overall, social security expenditures grew from 8.3 percent of GDP in 1985 to almost 15 percent of GDP 10 years later. IVS—the retirement and pension portion of the program under the BPS—accounted for 10 percent of GDP in 1995. Although contribution rates were high, financial problems were accumulating and the system's deficit was as much as 5.6 percent of GDP in 1995. However, predicted pension expenditures for Uruguay were slightly below 10 percent of GDP, while observed expenditures were 50 percent higher. In addition Mitchell (1996) argues that the system's shortfall contributed to the overall government deficit and that the social security burden was blamed for slowing national economic growth and causing macroeconomic problems, including inflation.

1.28. Uruguay's pension expenditures were extremely high, the highest share of GDP in Latin America by far, even exceeding OECD countries with the exception of Italy.<sup>4</sup> While this deficit was very large and difficult to finance, projections indicated that it would continue to grow in the medium and long term. In 1995, BPS pension expenditures were estimated to remain at about 12 percent of GDP until 2000 and increase steadily to 15.5

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<sup>4</sup> While Uruguay has a relatively unfavorable old age structure, the size of the pension system seems far higher than it should be based on the analysis by Palacios and Pallares (2000), which found a strong relationship between the old-age dependency ratio and pension expenditures around the world.

percent by 2030 and almost 20 percent by 2050, while revenues remained almost constant.

1.29. The situation was particularly serious for the military and police funds because these two had combined expenditures of 1.8 percent of GDP. The other three funds (for bank employees, professionals, and notaries) had aggregate expenditures of 1.7 percent of GDP, but they had revenues of 2.1 percent, resulting in a financial surplus.

1.30. Two different effects explain the high revenues of these last three funds. The largest fund is the one for bank employees, with contributions at 43.75 percent of wages. Contributions were lower for professionals and notaries; in this case almost 50 percent of revenue came from sources other than contributions (such as taxes, investment returns, and other compulsory contributions paid by third parties).

1.31. According Carmelo Mesa-Lago, the BPS itself accounted for more than 80 percent of the expenditures of the whole system, making its financial balance critical (the difference between BPS revenue and expenditures was -41.73 percent of revenue in 1984). The whole system's expenditures consumed about 15 percent of GDP (Mesa-Lago 1994, p. 158). Furthermore, Nelson Noya (1999) indicates that the central government's transfers to cover the current deficit of the social security system in 1995 accounted for 5.3 percent of GDP, which is equal to 50 percent of pension payments (3.8 percent for the BPS and 1.5 percent for the rest of the state's institutions).<sup>5</sup>

1.32. In the past, Uruguay's high inflation offset the system deficit, reducing benefits in real terms until 1989, when indexation mechanisms established that benefits should be indexed to actual salaries, which increased average benefits by more than 40 percent in real terms, over a period of four years.

1.33. Part of the crisis could be explained by poor investment management, which primarily placed funds in government bonds (compulsory) and personal home loans, which each yielded highly negative real interest rates, depleting the pension funds. BPS's inefficient administration forced repeated increases in its expenditures (75 percent, in real terms, between 1990 and 1993) leading to administrative costs of 5.5 percent of the pension assets (World Bank, 1996).

### **Earlier Attempts at Pension Reform**

1.34. Uruguay's attempts at pension reform have historically followed changing societal views of social security. During the transition to democracy and the initial restoration period, social security was seen as a means of income redistribution and economic stimulus (Papadópulos 1992). Since the time of the Sanguinetti administration the debate has centered on general macroeconomic policy, with various interest groups advancing the social security system.

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<sup>5</sup> According to the 1996 Country Economic Memorandum, in 1990, the central government's transfers to the system accounted for 2.6 percent of GDP.

1.35. Uruguay's dual voting system of open lists—in which voters select from lists of candidates from each party, and seats in the legislature are divided proportionally among the competing lists for each party (Kay 1995)—contributed to slowing down the reform process. Under this system, reform was more difficult because legislators had few incentives to maintain coalitions.

1.36. Even if the country's 1967 Constitution had established that pension legislation could only be initiated by the executive branch leaving political parties to interpret and reform proposals, citizen referendums could be an obstacle to reform. With 10 percent of the signatures of all registered voters, a proposal can be submitted to the General Assembly, and with agreement from two-fifths of the legislature, it can be submitted to a vote, providing interest groups a crucial opportunity to block policy initiatives.

#### *Fiscal and Other Motivations for Reform*

1.37. Since the 1970s, Uruguay's government has known that the pension system has been in difficulty. The situation worsened with the reform introduced by a constitutional amendment in 1989 that modified the indexation rule, resulting in a rapid increase in pension expenditures. Old-age, disability, and survivor benefits increased from 7.7 percent of GDP in 1989 to 10.4 percent in 1992 (Noya and Laens 2000). This increase forced the government to start planning for deep reforms. The first priority of the reform-minded government was to reduce the fiscal deficit, which had reached 2.8 percent of GDP in 1994, despite strong economic growth of 7.1 percent. Except for the fiscal deficit, no other explicit changes associated with pension policy goals were identified.

1.38. Uruguay's major reform efforts are listed below:

- **1990–95: Lacalle administration.** The government made several attempts to reform the pension system. In 1990, it presented a plan that considered several parametric reforms, including increases in retirement ages and vesting periods, and lowering replacement rates, but the plan did not gain parliamentary support. A year later, a multiparty commission was appointed to study four possible solutions: (i) parametric reform; (ii) full privatization (“Chilean style”); (iii) state-managed, defined-contribution PAYG scheme; and (iv) a mixed scheme, which combined a PAYG pillar with a funded one. The government selected the third option, a scheme similar to what would later be known as “notional accounts,” and submitted a plan to Congress in 1992, but it was rejected by both opposition parties.
- **1992: BPS modernization.** Under Rodolfo Saldain's presidency, the BPS tried to modernize the institution but encountered the firm opposition of the “social” directors (*directores sociales*) for what they considered to be a step toward privatization. Following this attempt, the BPS's Board of Directors became a highly politicized forum.



- **Late 1992: Small parametric reform (Law No. 16.320 is reversed in 1994).** Small parametric reforms were approved as part of the annual budget law despite the fact that Article No. 216 of the Constitution prohibits the inclusion of measures in budgetary laws that exceed the mandate of the current government or that do not directly concern the budget. In 1993, early 1994, and late 1994, the government tried to gain approval for several reform proposals (which included extending the retirement age, establishing personal accounts, and gradually extending the number of years needed to establish benefits), but was defeated in all cases.
- **November 27, 1994: Plebiscite.** With 74 percent of the vote, a plebiscite annulled many of the reforms directed at improving the finances of the pension system, arguing that the reforms were unconstitutional. The plebiscite was cosponsored by the PIT-CNT and the pensioners' associations, as well as the offices of the PIT-CNT representative on the Board of Directors of the BPS (Labor Social Director Ernesto Murro). Manufacturing, trade, and finance representatives did not play an active role in the negotiations. Uruguay's Supreme Court declared all of the regulations related to social security included in the budgetary laws to be unconstitutional. As a result, the BPS had to adjust benefits paid out as of January 1993.
- **March 1995.** After a general election resulted in a vote that was almost evenly divided among the three largest parties (the Colorados won the election with 32.3 percent of the votes, and the Blancos and the Broad Front each received 31 percent of the votes), a coalition was formed among the Colorado Party, the Blanco Party, and the Nuevo Espacio, a smaller, left-of-center party. They agreed to establish a mixed public-private system.
- **September 1995.** During the second Sanguinetti administration (1995–2000), a technical commission, financed by an Inter-American Development Bank (IADB) loan, prepared a new reform proposal, which was approved, thus finally creating a new pension system for Uruguay.

## Changes in Design and Parameters

### *Pension System Reform—Law No. 16.713*

1.39. The new system adopted in 1995 is a multi-pillar scheme. The first pillar, called the “inter-generational solidarity pillar,” is a PAYG scheme administered by the BPS. The second, or “individual-savings pillar,” is administered by private pension management companies called *administradoras de fondos de ahorro previsional* (AFAPs). The BPS was required to create an AFAP, which they did in association with the Banco República (the largest state-owned commercial bank) and the Banco de Seguros del Estado (the state-owned insurance provider).

1.40. Uruguay’s Ministry of Labor and Social Security is responsible for guiding sector policy, while the BPS is in charge of coordinating the state’s pension services and managing social security.<sup>6</sup> The ministry’s board of directors is composed of representatives from the pensioners’ movements, business and labor sectors, as well as four directors appointed directly by the president.

1.41. The first pillar of the plan includes workers with salaries up to UR\$5,000 and is funded with employers’ contributions on payroll wages up to UR\$15,000, as well as contributions from employees with salaries up to UR\$5,000 per month. In addition, the first pillar receives specifically allocated taxes and can count on general financial assistance from the government, whenever needed.

1.42. The second pillar includes all active contributors younger than 40 years of age at the time of the law’s enactment, with salaries between UR\$ 5,000 and UR\$15,000, as well as all new entrants to the labor market. As a transitional provision, workers older than 40 years at the time the law went into effect were not required to join the second pillar if they earned less than UR\$5,000 at the time of the reform (approximately US\$ 800). Those earning more were required to join the second pillar but only for the amount higher than UR\$5,000. To promote participation in the funded scheme by those earning less than UR\$5,000, a provision established that they could voluntarily join the second pillar, putting half of their contributions to this pillar and receiving a bonus of 50 percent of the base salary considered in the first pillar.

1.43. The third pillar includes workers with salaries above UR\$15,000, who can chose to contribute additional sums to their individual accounts. When workers retire, the insurance companies must provide first- and second-pillar annuities to them, as well as supplementary benefits to those who are completely disabled, very old, or survivors, while the government maintains direct responsibility for paying partial-disability benefits. Circular No. 26 of November 1997 regulated the insurance scheme, determining that the total amount of accumulated funds in the personal account of a worker should be transferred from the AFAP to the insurance company that the worker chooses when retiring. The minimum amount of the annuity is established based on age and gender. The

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<sup>6</sup> The ministry collects contributions and transfers the corresponding amounts to the AFAPs; it also controls and supervises compliance of the payments and issues certifications.

insurance company can pay annuities above that threshold, with the due justification and approval of the supervising body (Superintendencia de Seguros y Reaseguros). The insurance company must provide information to the beneficiaries or to their survivors annually, with an updated statement of their account.

1.44. An active worker's benefits include the following:<sup>7</sup>

- (i) maternity benefits—granted to working female employees or during unemployment coverage;
- (ii) health insurance—to cover dependent workers of private enterprises and a portion of public sector workers, including medical aid (healthcare and other complementary benefits like vision care) and health benefits equal to 70 percent of the base salary with a ceiling of 3 NMS;
- (iii) unemployment benefits—a monthly cash benefit for six months;
- (iv) family allowances—granted to private sector workers with children, unemployed workers, domestic workers, small rural producers, private sector pensioners, and retirees from private banks; and
- (v) special services for construction and household workers—such as vacation time and complementary annual salary payments.

There are three kinds of retirement benefits:

- (i) old-age retirement pensions,
- (ii) complete-disability retirement pensions, and
- (iii) very-old-age retirement pensions.

Other pension benefits include:

- (i) survivors' pensions granted to widow/ers, single children younger than 21, single children between 18 and 21 with parents who are completely disabled, and divorced people under certain circumstances;
- (ii) a temporary, partial-disability subsidy (regardless of the cause);
- (iii) funerary grants; and
- (iv) non-contributory pensions for the very old and disabled, provided to low-income people older than 70 or to those who are permanently disabled.

1.45. In addition, the BPS carries out social services for the elderly, such as support to senior citizens associations, recreational activities, special programs for the handicapped, and a housing program for pensioners who receive a maximum income of two NMS). Furthermore, BPS provides health services, including prevention programs in labor

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<sup>7</sup> As of 2000, the number of claims paid by the BPS included 416,000 for family allowances and 560,000 for health and unemployment benefits.

medicine, health care for pregnant mothers and children under six years of age, and dental care, among others.

1.46. Total contributions were maintained at 27.5 percent for private-sector workers in manufacturing and trade, but the share of employees was increased from 13 percent to 15 percent, while employer contributions were reduced from 14.5 percent to 12.5 percent. Employer contributions act like payroll taxes financing current pensions in the first pillar; they are not linked to the corresponding worker's pension.

1.47. At retirement, workers will receive a benefit from each pillar. In the first one, the amount results from applying a percentage to a base retirement wage, based on the average salary over the past 20 years. The percentage varies from 50 percent to 82.5 percent, depending on one's age and years of service, with minimum and maximum benefit limits. Benefits are indexed to the average wage. Although this accrual rate may seem extremely high for the first pillar, especially after reform, Uruguay's political and social traditions and legacy made it infeasible at the time to push for greater benefit cuts. To do so would have risked jeopardizing the process through a popular vote. Although no sound actuarial studies are available, it is expected that general ceilings will not be enough to contain expenditures, and with benefits indexed by wages, the system will continue to depend on general revenues to finance the transition costs.

1.48. The new system increased some requirements such as the minimum age, which was changed to 60 years for both men and women, and the years of service needed, which was increased from 30 to 35 years. An old-age benefit was also made more difficult to obtain, with the minimum age set at 70 for all workers with at least 15 years of service, while its replacement rate decreased from 55 percent to 50 percent, plus one percent per additional year, up to a maximum of 64 percent (the previous requirement had been 10 years of service and 65 years of age for women, and the replacement limit had been 70 percent). The disability-benefit requirements were also changed, with the new law requiring two years of service, as well as, at least, six months of work directly prior to the disability claim. Survivors' benefits were no longer granted until the end of life. Instead, the length of time was determined based on the widow/widowers' age at the time of the spouse's death: two years of benefits for survivors younger than 30 years of age; 5 years for those who were 30–39 years; and for those older than 39, until the end of their lives. The replacement rate for total disability was decreased from 70 percent to 65 percent.

1.49. The reform did not affect any of the five "special" systems for the military, police, bank employees, professionals, and notaries. The government was required to present plans for reforming these before January 1997, but there is little information as to the extent to which these reforms have been successfully implemented.

1.50. The replacement rate for regular full-career benefits was set at 50 percent, and increased according to a formula providing incentives for workers to extend their working lives after retirement age. For example, the replacement rate for workers aged 65 and with 40 years of service is 65 percent, while under the previous regime, it had been 80 percent for women and 75 percent for men, and could go as high as 82.5 percent for someone 70 years of age with 50 years of service. This limited the benefits received

before reform, because legislation set the replacement rate at 60 percent for regular retirement (60 years of age and 30 years of service). In the case of women, the change in the rates is more significant because, under the previous system, the replacement rate ranged from 65 percent to 80 percent, based on age and years of service, with a maximum of 7 NMS.

1.51. The AFAPs' efficiency has been largely determined by the law that mandated that no more than 30-60 percent of assets pension fund assets be invested in government securities. However, a temporary provision established that during the first year of operation, investments in government securities could be up to 80-100 percent of assets, as a transition to the permanent rate.

*Reactions from the Public, Trade Unions, and Politicians*

1.52. The state of the pension system has been largely determined by the political wrangling of the parties in office and the opposition, with success possible only when a political coalition was formed with sufficient majorities in Congress to pass the needed laws. The pensioners' associations (*asociaciones de jubilados*), which emerged as a powerful social movement between 1985 and 1990, quickly became important actors in blocking the alternative policies proposed by political parties. In 1990, they founded a broader organization, the National Organization of Retirees and Pensioners from Uruguay (ONAJPU), with 53 member organizations from across the country and almost 100,000 affiliated pensioners. ONAJPU became very active, raising their profile by meeting with politicians and top state officials, radio announcements, bulletins, newspaper columns, and open meetings before Congress and BPS.

1.53. The labor and professional associations also opposed reform, because it decreased their control over the pension funds and, consequently, their political power. But given that their demands focused on the improvement of salaries and working conditions, they did not present firm demands with regard to pensions. By contrast, manufacturing, finance, and trade favored reform in the belief that it reduced the costs of labor and introduced new sources of capital. The crisis inherited from the past (the pension system's deficit, external debt burden, and weak financial situation) was deepened by pensioner demands to increase pensions and worker demands to increase salaries, during the democratic transition that triggered expectations from almost every group in society. In addition, uncertainties regarding the feasibility of the new private system contributed to the initial general skepticism related to the reform.

*Preliminary Results of the Reform*

1.54. The new pension system started operating in April 1996 (although it was not fully operational until 1997), and the number of workers choosing to join the funded scheme rapidly exceeded expectations. By the end of 1997, the AFAPs had 457,000 members, slightly less than half of the total number of contributors to the national system. One year later, the number had surpassed 500,000 and, by the end of 2001, there were almost 600,000 members. As of December 2000, the AFAPs had received transfers of more than US\$ 845 million.

1.55. At the start of the new system there were six AFAPs competing for the market (Capital, Comercial, Integración, República, Santander, and Unión). Six years later, after some acquisitions, there were only four AFAPs left. Three of these had almost 40 percent of the members and 56 percent of the assets. The average administrative fee for the year 2000 was calculated to be 1.919 percent and the average insurance premium fee was 0.879 percent.

1.56. Because the old system had a benefit ceiling corresponding to a salary of UR\$5,000, the reform did not affect expected benefits for most workers, but it created additional benefits for those with wages above that threshold. Estimates from the World Bank at the time of the reform indicate that 87–90 percent of workers were below the UR\$5,000 limit.

1.57. Showing a slow tendency toward decline,<sup>8</sup> as of 2000, the number of benefits paid out by the BPS rose to roughly 722,000 (380,000 for retirement; 277,000 for pensions; and 65,000 for old-age pensions). The number of retirees in the system, which was growing by approximately one percent a year before the reform, underwent rapid growth in 1997, when the reform was enacted. This might have been stimulated by retirement of many individuals who met requirements under the previous system and were frightened by the possibility that their benefit qualification might not be upheld in the future. After 1997, the retirement rate began to decline and, since 1999 the number of retirees has fallen by 0.5 percent per year. The number of registered workers in 2000 was roughly one million (more than 70 percent in the private sector and close to 30 percent in the public sector). Not every member contributed regularly (a problem common in most Latin American systems), and the actual number of active contributors, by the end of 2001, was about 927,000. The coverage rate<sup>9</sup> was also affected by changes in the labor market (the rate of unemployment decreased in 1997–98 to 10.25 percent but started increasing again thereafter reaching 17.08 percent in 2002).<sup>10</sup>

1.58. Even if extending the vesting period was seen as anti-poor because most poor people tend to work in uninsured and informal jobs most of their lives and face greater difficulty in meeting the years of service requirement for retirement, the noncontributory schemes were expected to improve the situation for poor workers.<sup>11</sup>

1.59. While the old system's fiscal weaknesses have been fully discussed, it is important to recognize the system's efficacy in reducing poverty among the aged. In 1998, Uruguay had one of the lowest poverty rates among individuals older than 65 years, an estimated 2.8 percent were poor, while the national average of those living below the poverty line was 22 percent (World Bank 2001). The low incidence of poverty

<sup>8</sup> For instance, in 1998, the BPS paid 731,000 benefit claims.

<sup>9</sup> According to Ernesto Murro, a labor representative at the BPS, 41 percent of the population was not covered by the Social Security system as of July 2001.

<sup>10</sup> Data is from the National Statistics Institution (INE) and is available only for the city of Montevideo, Uruguay.

<sup>11</sup> For instance, according to a World Bank 2000 Country Assessment Strategy, only two-thirds of the population has health care coverage.

among the elderly was related to the high coverage rate of the pension system, which paid benefits to more than 75 percent of the elderly.

1.60. The new PAYG system is quite profitable for workers that follow the rules, suggesting good incentives for compliance (returns on full-career contributions are estimated at five percent versus an estimated long-term interest rate of 3.5 percent). However, the structure of replacement rates does not reward those who work longer. Therefore, the new law does not seem to encourage deferred retirement although this was one of its objectives, and, perhaps, this is an aspect of the law that should be reconsidered.

1.61. Replacement rates will be drastically reduced in the future, but this will only affect total pension outlays in the PAYG system to a slight degree (World Bank, 1996).

1.62. Pension expenditures, which continued to grow as a result of indexation, stabilized at about 15 percent of GDP since 1995 (the IVS component of the system accounted for roughly 11 percent of the GDP in 2000). General social security and public welfare expenditures kept on rising, from 10.7 percent of GDP in 1970–75, to 12.05 percent in 1980–85, and more than 20 percent by the end of the 1990s; in 1993–98, they accounted for 20.5 percent of GDP.

1.63. Overall, assets continued to be highly concentrated in government securities, which accounted for almost 70 percent of total assets. Cash accounts (15 percent) and bank deposits (14 percent) made up the majority of other investments, resulting in an inefficient, short-term portfolio as the returns of pensions depended mostly on government securities. Since 1996, returns have been between 10 percent and 18 percent in real terms. Based on these returns, the Central Bank calculates a projected net real return of approximately 10 percent for a period of 35 years. Of course, this projection is extremely sensitive to the assumptions, in particular, that high returns on government bonds will continue in the future, although this does not seem sustainable in the long term.

1.64. There is always a risk that inflation and poor investment returns from the capitalized pillar will deplete the value of the funds accumulated in the individual accounts, forcing the government into huge disbursements because of the state's guarantee of minimum profit. Fortunately, following the recession period, inflationary pressures diminished, falling to 8.6 percent by end-1998 and remaining moderate thereafter. Uruguay's underdeveloped capital market, which has a market capitalization rate of less than 3 percent of GDP, compared with an average of almost 10 percent in other emerging markets, does not help portfolio diversification. The contractual savings sector, including pension funds, mutual funds, and insurance is very underdeveloped. Pension funds accumulated by fund administrators amounted to about 1.3 percent of GDP in 1998, while total assets of the pension funds rose to 3.84 percent of GDP by 2000.

1.65. Without high rates of formal employment, private pension plans will be insufficient in providing universal social security coverage. In the early 1990s, unemployment averaged about 8–9 percent; over the past few years unemployment has shifted up to the 10–12 percent range. Those who are unemployed or underemployed and

those who work in the informal sector do not contribute to the social security system and would need to be subsidized in old age. Evasion in PAYG contributions continues to be a persistent problem, especially among those who expect to work for more than 20 years (the threshold considered in the base pension salary calculation), because workers will try to make full contributions only for the minimum period needed to secure a pension, and make token deposits in earlier years.

1.66. The transition costs of converting from a PAYG to a private capitalized system were covered by more fiscal deficits (in the short and medium term, it was calculated that the primary spending would increase between 1.6 percent and 1.8 percent of the GDP). The government's overall deficit of -1.3 percent in 1987 rose to -1.6 percent in 1997, and then decreased to -1.2 percent in 1998.

1.67. Even if some of the most important incentives incorporated by the reform are aimed at benefiting the less-advantaged workers (those earning less than UR\$ 5,000), the pension impact on income distribution does not seem significant: if subsidized pensions to the old and poor are excluded, the Gini coefficient for pensions is 0.36, moderately lower than the 0.41 national coefficient number (World Bank 1996, p.49). However, because there is still a need to use general revenues and VAT resources to finance the system, it could be argued that the whole situation is unfair and regressive for the low-income workers, who not only contribute, but for whom the VAT tax represents a relatively heavier burden.

1.68. In Uruguay, the debate over a public versus private approach has represented a false dichotomy, because the government still plays a crucial role as an active actor (by means of the public AFAP, for instance) and as regulator of the private system. Independence from politics, to prevent the mismanagement of pension funds through politically motivated investments or expansion of benefits, has not been fully achieved, owing to the tight investment limitations imposed on the AFAPs.

1.69. Despite the past achievements of the social security system (almost universal coverage and aggregate neutrality in income distribution), the financial situation became unsustainable. Traditionally, the social security crisis was tackled from a short-term perspective, with repeated attempts to curtail expenditures, and reduce benefits, while maintaining the system by implementing very unpopular measures that were resisted by constitutional plebiscites. The magnitude of the crisis demanded a deeper, structural solution. Uruguay was able to initiate a reform that tackled most of the problems that plagued the previous regime by decreasing negative incentives and reducing the system's inequalities. However, Uruguay's underdeveloped financial sector, characterized by the preponderant role of the state, weak regulations, weak supervisory mechanisms, and limited developmental impact, constitutes a serious obstacle to the enhancement of the second capitalization pillar and its potential to diminish the fiscal impact of social security in the coming years. After seven years of operation, the new pension system is now developed and its institutions are strong and growing, though some adjustments to improve coverage and address transition costs still need to be incorporated.



## 2. Bank Assistance in the 1990s

### Bank Involvement, Diagnosis, and Strategy

2.1 Assessing the Bank's strategy regarding the pension system in Uruguay is not a simple task because it has been neither explicit nor consistent over the years. Since the late 1980s, the Bank has produced a number of relevant documents related to the pension system in Uruguay, including background note and, working papers. Three specific loans—approved in 1987, 1989, and 1998—reflect some aspects of the Bank's strategic approach. Table 2.1 lists selected documents that were reviewed for this report, with a short note on the main findings and recommendations. Documents directly linked to the loans are not included in this list.

2.2 In general terms, the Bank's assistance was supply driven because Uruguay's government eventually assumed full ownership of the reform program with the support of the IADB. The 1994 World Bank study, *Averting the Old Age Crisis*, is not explicitly mentioned in the reviewed documents, but the recommendations contained in that study must have had an influence the policy discussions surrounding the pension reform measures adopted by the government, for example, that governments should explore a combination of systems or pillars: (i) a publicly managed system with mandatory participation and the limited goal of reducing poverty among the old; (ii) a privately managed mandatory savings system, and (iii) a voluntary savings system. Nonetheless, the Uruguay reforms did not completely accord with Bank recommendations.

2.3 It is remarkable how the Bank's documents are silent about institution's local counterparts, their level of technical sophistication, or willingness to engage in dialogue. Many documents refer to Uruguay's low-implementation capacity, but the role of policy makers in negotiations is not explored at all. Issues related to political and institutional effectiveness are not assessed either.

#### *1996 Country Economic Memorandum*

2.4 In October/November 1994, a Bank mission led by Jorge Garcia-Mujica visited Uruguay and reported on the serious fiscal burden that the social security system imposed on the national treasury. The 1996 country economic memorandum is based on those findings. The document recommended addressing long-term issues, specifically mentioning the social security system as a "critical" problem that could not be solved by parametric reforms but, instead, one that needed deep changes. Emphasis was placed on the need to maintain macroeconomic stability—a situation that could be jeopardized by labor market distortions and financial troubles stemming from the social security system. The perverse incentives provided by the system and the resulting abuses were identified as the main problems. For example, pervasive fraud meant contributions evasion was at 38 percent of collections, and individual pensions were 45 percent higher than the expected.

2.5 The new law was considered an important first step toward addressing problems of evasion and inflated pensions. Further reforms were recommended to address the negative incentives existing in the PAYG pillar. The Country Economic Memorandum calls attention to issues under the new law that still needed to be addressed: (i) a new large bureaucracy could endanger competition and efficiency, (ii) the transition to the capitalization system should be better specified, (iii) the system is still too complex, and (iv) government guarantees on the capitalization pillar may be too broad.

2.6 A tax increase was not recommended to reduce the deficit, because tax rates were already too high and such a measure could have led to further evasion. The Memorandum partly blamed the social security system for the country's low level of investment and productivity (together with the heavy tax burden and other structural difficulties) and for the expansion of the informal economy and the low level of national savings (about 15 percent of GDP in 1993). The incentive scheme under the new law was evaluated quite positively; the PAYG scheme was expected to perform poorly and might continue to face continuing shortfalls owing to the transfer of funds to the capitalization system, evasion, and commitments to present workers. The Memorandum proposed reducing further the scope of the PAYG. Bank loans were not specifically discussed.

2.7 With the IADB as the largest external financier, the Bank assumed a secondary role in financing Uruguay's reform program. The Bank proposed a base loan of US\$180–\$225 million to fund investments in key sectors, with the aim of promoting the benefits of Uruguay's integration with the Mercosur trade bloc, increasing private sector participation, and funding public expenditures in infrastructure and in education and health. In another proposal, a US\$300 million loan would allow adjustment operations to support financial sector development and deepen social security reform by strengthening the private pillar. The reform is considered a successful first stage, although it is acknowledged that much remains to be done to deepen the adopted initiatives (for example, extend reforms to the military and the police, appropriately develop the financial and capital-market sectors). In the late 1990s, the high cost of labor and low level of savings and investment was partly blamed on taxes and the structure of social security contributions. It was recognized that the system's deficit would improve gradually if the private pillar continued to flourish.

2.8 The Bank's 2000 strategy proposed greater selectivity through a gradually scaling down of its programs and monitoring the country's progress to realize development objectives. The Bank's program would be adjusted to Uruguay's evolving circumstances, focus on a limited number of areas with critical social and environmental dimensions, promote sustainable development, and increase the capacity of the poor to participate in that process. The Bank recognized the "positive impact" of the social security reform and praised Uruguay's political consensus-building approach as well as the equitable distribution of income attributable to a generous social security system that protected the elderly. The Bank supported key incremental steps in structural reforms with a single-tranche Contractual Savings Structural Adjustment Loan (CSSAL), without describing it or assessing the scope, quality, or impact of the social security system reform.

2.9 Reflecting the change in the relationship between the Bank and the government, the Bank expected an active policy dialogue to be maintained to be able to flexibly adapt to the policy and institutional stance of the government. The conclusion was that, by and large, the Bank's support in Uruguay had been successful, albeit slow to implement, generally agreeing with the Country Assistance Evaluation (IEG 2000), without much reference to the social security issue.

### *2000 Financial Sector Review*

2.10 The November 2000 Financial Sector Review is the most recent Bank document commenting on Uruguay's pension system. After a short description of the funded scheme's performance, it presents a few proposals for improving the system:

- (i) Increase portability and coverage—the existence of five special systems is discussed and the merging of them into the national scheme is proposed.
- (ii) Improve property rights—contributions to the pension funds were not fully vested because workers could not recover their funds if they didn't have enough years of service to retire. This limitation also applied to voluntary contributions. The existence of a stabilization reserve is also criticized.
- (iii) Improve risk management—the report proposes to allow workers to have more than one account in more than one fund, as a way to diversify risks and attain optimal portfolios, among other reasons.
- (iv) Improve competition—it is proposed that AFAPs should pay for collection as well as custody and settlement services; and the special guarantee of República AFAP should be eliminated.
- (v) Improve efficiency—it is recommended that AFAP fees should be based on assets managed, instead of on contributions.
- (vi) Strengthen supervision of AFAPs—done by a division of the central bank, by means of giving it a higher status or eventually make it an independent organization. (The report also indicates that there is no supervision of the collection process and that potential conflict of interests between AFAPs and commercial banks are not properly supervised.)
- (vii) Liberalize the investment regime by reducing investment restrictions and allowing international diversification.

2.11 While some of the proposals would certainly improve the performance of AFAPs, they are not considered within the broader context of the social security system, including the fiscal, social, and political implications of the recommendations.

**Table 2.1: Main Documents Issued by the Bank**

<i>Document</i>	<i>Main Findings</i>	<i>Main Proposals</i>
An Inquiry into Social Security (World Bank 1988)	Review of system history, identifying main determinants. Strongly critical of 1979 reforms.	Parametric reforms (increase retirement age, reduce replacement rate), eliminate special regimes. Apply price indexation and improve administration.
Back to office report (Kane, 1995a)	Informal memorandum, critical of the reform (PAYG remains too high and expensive, poor investment regulations).	Promote strong regulation of funded scheme.
Uruguay: Options for Pension Reform (Kane, 1995)	The report, prepared before the reform, considers that the old PAYG is unsustainable in the medium term.	Implement a funded scheme, either pure capitalization or a multi-pillar model.
Fiscal Impact of Switching from a Pay-as-You-Go to a Capitalization System (Garcia-Mujica, 1996)	The document reports large unintended transfers, cross-subsidies, and abuse in the old PAYG system. The reform is good, but insufficient.	Implement a fully funded system, creating recognition bonds to replace the new PAYG scheme.
Country Economic Memorandum (World Bank 1996)	Old system had serious fiscal problems, with high evasion, poor incentives, and abuse. Positive view of the new system.	Reduce role of public entities (in reference to the creation of República AFAP), improve transitional benefits, and reduce complexities.
Country Assistance Strategy (World Bank 2000a)	Minor reference to the pension reform as a “major achievement” and to its “significant” impact in reducing future government liability.	No proposals.
Financial Sector Review (World Bank 2000b)	Detailed description of funded-scheme operation.	Extend the system to the special groups (military, police, bank employees, etc.). Detailed agenda to improve AFAP operations.

## **A Description of Bank Assistance**

2.12 The seven documents mentioned in the Table 2.1 reflect the evolution of the Bank’s position on this issue. There have been three distinct phases of Bank involvement during the past 15 years.

### *The First Phase*

2.13 With the restoration of democracy, Uruguay’s government sought to support the stabilization effort by means of an IMF Stand-by Loan and an agreement with the private banks. In addition, it requested financial support and technical assistance from the Bank to deepen the structural and fiscal reforms. Beginning in the late 1980s, the Bank’s interest in the social security system in Uruguay was clearly driven by concerns about medium- and long-term fiscal stability and the administrative problems of the system, as clearly reflected in the 1988 report and the policy matrix included in the 1987 and 1989 Structural Adjustment Loans (SALs). After the second SAL was completed, the relationship between Uruguay and the Bank entered a new phase on pension policy.

### *The Second Phase*

2.14 In the early and mid-1990s, the Bank took a strong position against pension reform projects that were approved by Uruguay's Congress in 1995 and implemented in 1996. The main controversies arose from the Bank's evaluation that the new system was insufficient to reverse the growing fiscal burden on the system.<sup>12</sup>

2.15 The Bank continued to push hard for unpopular measures to curtail benefits. The government sought a way to preserve the system's benefits while rationalizing finances. The Uruguayan model was a semi-privatize the system – an alternative that, had not been backed by the Bank. From a purely technical perspective, the Bank team judged the proposed reforms inadequate to address the fundamental weaknesses of Uruguay's bankrupt social security system. Due to political difficulties the government was unable and unwilling to pursue deeper reforms, and the Bank chose not to lend financial support to the new system established in 1996. The Bank's analysis of the reform proposal in 1995 failed to predict the popularity of the AFAP regime, however, and considerably overestimated the importance that the restructured PAYG pillar would retain after the reform. The government went ahead and implemented its new public-private program, which the Bank perceived would merely cause system finances to deteriorate even further.

2.16 During this phase, there was no pension assistance from the Bank. The Bank did not participate in the political and institutional process that led to the agreement that finally enabled reforming the system under Sanguinetti's administration, neither through formal instruments (such as loans) nor through technical assistance, and the Bank was not part of the process until after the reform was implemented, when its position was reviewed. Initially, the reform was considered "an important first step," while the social security system almost disappeared from the Bank's agenda. The Bank had little to say about pension reform in 1997 except to mention that it would be good to integrate the military and police into the new system (with no references to banking employees, professionals, or notaries) and that appropriate implementation of a fully-funded private pillar would need to be supported by financial sector and capital market development to expand investment options.

2.17 While discussions between the Bank and Uruguay's government were not fully documented, information obtained in personal interviews, from memoranda, and indirect references made in other documents indicates that the Bank emphasized three major points:

- (i) The Bank estimated that the reform was insufficient to solve medium- to long-term fiscal problems, mainly because it maintained a large first pillar. The 1996 Country Economic Memorandum estimated that "... while the

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<sup>12</sup> An informal report, Kane (1995) clearly states the view that, "...after an initial fall, the contribution rate needed to balance the system will rise in the future..."

situation is an improvement, unless it produces a change in behavior, the PAYG system will still experience shortfalls” (World Bank 1996, p. 15).

- (ii) The Bank considered the implicit rate of return in the first pillar would tend to decline as population aging made the financial situation of this pillar more difficult.<sup>13</sup>
- (iii) The Bank misinterpreted the incentive formula for attracting workers earning less than UR\$ 5,000 to the funded scheme, believing that the new scheme would not be adopted by most workers.

2.18 This misinterpretation focused on one of its provisions that allowed lower-income workers to receive a 50 percent subsidy on a 50 percent private contribution if they switched to the new system. In other words, the Bank misinterpreted the incentive formula for attracting private-pillar contributors, which strained the Bank-Uruguay dialogue as the Bank feared that the private pillar would begin to mimic the public pillar, forcing the system into financial insolvency. The government was confident that it had taken an appropriate first step toward a long-term solution of the problem of social security financing and was distressed by the incorrect analysis of its program.

### *The Third Phase*

2.19 This stage was characterized by a return to dialogue with Uruguay by the Bank and an emphasis on the need for a strong financial sector to support the development of the private pillar established by the reform. The Bank’s view started to change once the new system was implemented. A 1996 Economic Note on the fiscal impact of the reform, prepared in 1996 by García-Mujica, was very critical of the old PAYG system, indicating that abuse was the most significant cause of problems. The view of the reform is that “...abuse is a main problem under the [old] system, and although reduced, it is likely to remain significant in the modified PAYG ... and the subsidy that the government grants to pay promised pensions, though reduced, remains high...”

2.20 Only after the system started operating did the Bank begin to support it more openly, and the 1996 Country Economic Memorandum considered that “... the new social security law is an important first step toward the solution of the country’s financial problems of its social security system. Most changes proposed are needed but much more importantly, the law will create conditions to widen political support for further reform leading to a long-term solution...” (World Bank 1996). The memorandum recognized that incentives were set in such a way that “almost all workers will be willing to join the capitalization system” and that this switch would likely represent an increase in shortfalls of at least 1 percent of GDP.

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<sup>13</sup> Even if Kane (1995) argues that the Bank objected to the 1996 reform for being regressive—given that low-income workers would, in principle, depend exclusively on this pillar; they would be disproportionately affected; and a regressive distribution effect would occur—this did not mean a direct negative impact on the low-income workers because the government continued to cover BPS’s deficits with general tax revenues.

2.21 In January 1998 a CSSAL for \$100 million was approved. This loan promoted three main goals: (i) liberalize the investment regime of the pension funds to allow greater investment in private securities, (ii) increase the availability of such private securities, and (iii) create incentives to improve cost consciousness among AFAPs and transparency in reporting. The CSSAL had highly satisfactory outcomes for the Bank. This positive view of the situation can be confirmed by the May 2000CAS, in which there are no major references to the pension system, except to point out that "... in terms of rationalizing public expenditures, one of the major achievements of the last administration was the reform of the social security system [...] The Bank supported these efforts with the single-tranche Contractual Savings Structural Adjustment Loan..." (World Bank 2000, p. 25).

## **Instruments, Outcomes, and Results**

### *Structural Adjustment Loan I*

2.22 The first Structural Adjustment Loan (SAL I) was an \$80 million loan, approved in 1987, aimed at supporting public finances (partly through social security reform), improving public investment programming, improving commercial bank and corporate finances, and promoting export growth through incentives. According to the SAL I documents, the Bank considered the system to be generous and complex, with serious problems owing to low retirement ages, high life expectancies, a low ratio of contributors to beneficiaries, and insufficient contribution rates (reduced in 1979 to promote employment but not replaced by other sources) The measures proposed targeting the parameters of the system for improvement, with no references to structural reforms in the pension system.

2.23 The explicit target defined in SAL I was to reduce the social security deficit from 3.8 percent of GDP, estimated for 1985, to 2 percent by 1990, and to zero by 2000. To achieve this goal, the government needed to get approval from Congress and then implement a reform that included: (i) increasing normal retirement ages to 65 for men and 60 for women; (ii) reducing benefit dispersion; (iii) eliminating regimes based on quality of service, and (iv) limiting the benefits of working-age dependents or those with adequate economic means.

2.24 If these changes were implemented, the Bank estimated that, by 2000 there would be 1.5 active workers per beneficiary and that the system would be in equilibrium with payroll contributions of 27 percent. In the short term, the government was planning to work on limiting indexation of the higher benefits, improving collection, and developing better administrative procedures.

### *Structural Adjustment Loan II*

2.25 SAL II was approved in 1989 and initiated in mid-1989, after SAL I was fully disbursed. This loan was for \$140 million and aimed to promote the general macroeconomic environment, reduce public-sector expenditures, improve public investment programs, strengthen prudential regulations and central bank supervision,

restructure commercial banks, rationalize the role of Banco República, and improve the legal and judiciary framework of commercial and corporate activities. The social security system had a minor role in the program. While maintaining the basic diagnosis presented under SAL I (that is, an excessively expensive system owing to large payouts and poor control), the goals under SAL II were mostly related to improvements in the administration of the system,<sup>14</sup> and not on parametric or structural reforms. Anyway, it proposed reducing the BPS deficit from about two percent of GDP to zero in the early 1990s (a significant advance from the zero target of year 2000 under SAL I). This was supposed to be achieved by administrative improvements and better controls and additional revenue sources for the BPS's non-contributory welfare programs, which accounted for about half of its deficit. Under the loan, it was acknowledged that introducing the issue of benefit reductions (such as reductions in the wage replacement ratio, gradual retirement programs after reaching retirement age, among other proposals) could be counterproductive in 1989, given the potential for unwanted changes in an election year. Instead, the government compromised by agreeing to prepare steps to strengthen the retirement and pensions program (IVS) and to present its proposal to the Parliament at the start of the new administration.

### *Contractual Savings Structural Adjustment Loan*

2.26 The 1998 CSSAL was a one-tranche loan, with a policy matrix that included five elements: (i) a general macroeconomic stability requirement; (ii) an investment regime for AFAPs; (iii) capital market laws and regulations; (iv) a public debt regime, and (v) regulation of AFAPs. The investment regime for AFAPs aimed to reduce the required minimum investment of pension fund assets in government securities to 55 percent by April 1999. The rates established at the time the system was created were fixed at 75 percent and 95 percent for 1997, but the CSSAL policy matrix was prepared before the 1998 Decree was issued. On March 4, 1998, the government issued a decree establishing the limits at 65 percent and 85 percent for 1998, and then at 55 percent and 75 percent for 1999, satisfying the condition set in the policy matrix, and reflecting the government's goodwill in maintaining open dialogue with the Bank.

2.27 The third activity, related to capital market laws and regulations, had as principal actions the establishment of at least one risk-rating agency in Uruguay and the development of a legal framework to draft a trust law. The rating agency was needed for independent assessments of the quality of assets, such as corporate bonds; while the trust law was needed to promote asset securitization. Both requirements were satisfied. The fourth activity was to promote the development of a secondary market for pension bonds, a special type of government securities with a long-term maturity and adjusted to wages. The law was passed, but the market developed slowly. By the end of 2001, the pension funds had approximately five percent of their assets in these bonds. Finally, the fifth activity promoted greater transparency in the AFAP regime. To achieve this, the Bank expected that requiring the AFAPs to report a projected net return on contributions would

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<sup>14</sup> The proposals included individual accounts for contributors, inspections, and cross-checking of statements through computerized systems (eventually financed by Technical Assistance Loan II) among other initiatives.



make the system clearer and improve competition. Accordingly, the government issued a decree and AFAPs started using a methodology to project returns and report them. The activity also required better regulations on investments in related companies, which were issued in early 1998.

2.28 In the mid-1990's, the completion report for SAL I found that the goal of reducing fiscal pressure from social security was satisfied by the measures implemented in 1988–89. However, the 1989 constitutional reform increased government expenditures by 2–3 percent of GDP. SAL I had an accompanying Technical Assistance Loan (TAL), which financed one consultant to evaluate the social security system and propose reforms, and another to help purchase of computer equipment to improve collection procedures at BPS. The completion report for the CSSAL's was highly complementary, rating the Bank and the Borrower's performance, as well as the general outcome of the program, highly satisfactory in every respect. Nevertheless, it acknowledged the inherent risk that opposition parties that could reverse some of the measures supported by the loan, indicating that sustainability was uncertain.

## **Ratings**

2.29 This evaluation of SAL I and SAL II programs is more critical than that of the Bank because it only assesses the social security component, whereas the Bank evaluated the entire loan.

### *SAL I Outcome*

2.30 The general objective of reducing the system's deficit by parametric reforms was consistent with the country's priorities (commitment to deficit improvements with the IMF and emergence from a deep recession), as well as with the Bank's country and sectoral assistance strategies. In addition, the specific goals mentioned in the loan were in line with the government's own internal negotiations to curtail social security expenditures. Both the general and specific goals were highly relevant, and we consider the overall relevance high. In terms of efficacy, the general achievement of the objectives expressed in SAL I was negligible because only modest advances were made regarding the privileged regimes. Political and social interventions made the goals infeasible, however, and the modest advances were reversed a couple of years later.<sup>15</sup> Both the government and the Bank were defeated in their attempt to raise retirement ages. In addition, the main goal to reduce the fiscal deficit by reducing social security expenditures was not fully met, and an increase of one percentage point in the VAT and other taxes was necessary to finance the system.

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<sup>15</sup> 1987 Law 15.000 was passed with modest results in terms of partial indexation and the establishment of floors and ceilings on the benefits, while some privilege pensions were cut. The reform was reversed in November 1989 by a plebiscite.

2.31 The fiscal goals presented were highly relevant, thus overall relevance was high, but the efficacy in reaching the goals was negligible. Therefore, the overall SAL I outcome rating (only related to social security) is moderately unsatisfactory.

#### *SAL II Outcome*

2.32 The specific social security objective of SAL II—improvements in the administration of the system—had modest relevance to the government’s and the Bank’s priorities, which centered on reducing expenditures. The efficacy in meeting that goal was also modest, because the institutional development achieved in the BPS was not substantial. During the following years, there would be several attempts to modernize its structure. Therefore, we consider the general outcome of SAL II to be moderately satisfactory, given the overall modest relevance of the loan on pension policy. The conclusion is that SAL II ought to have better addressed the social security situation, exploring many reform alternatives instead of just acknowledging that an election year was unfavorable for reform, perhaps working with the candidates to place the issue on their agendas and proposing feasible policy alternatives. The problem is, therefore, not the loan itself but, rather, the Bank’s general social security strategy.

#### *SAL I and SAL II Sustainability*

2.33 SAL I recommended cutting benefits and was not expected to receive popular or institutional support. A hot and highly politicized debate took place, centered on the maintenance of benefits through indexation, as discussed above. Continuity of the proposed measures was unlikely (in fact, the reforms were reversed some time later) because overall sustainability was considered unlikely. On the contrary, SAL II’s administrative improvements, although they faced initial administrative resistance, were likely to continue. In subsequent years, further improvements in the administration and in the procedures were incorporated into the system.

#### *SAL I and SAL II Institutional Development Impact*

2.34 The proposed pension reforms were in line with local views of the problem. As discussed, the process to change social security was quite complex and slow in Uruguay. Broadly speaking, the institutional development impact is substantial, even though the Bank’s project objectives under these two loans produced mixed short-term results -- on the one hand, improvements in BPS performance and on the other hand, short-lived, expenditure-reducing parametric reforms. But the Bank also predicted major steps toward structural reform in terms of Uruguay’s ability to effectively produce social security reforms, which only occurred years later.

#### *SAL I and SAL II Borrower Performance*

2.35 Despite demonstrating substantial commitment to the reform program in the two loans and the adoption of steps toward implementation (which were either reversed or had only modest impact), the government failed to assess political constraints during the preparation phase and, consequently, could not effectively implement the planned

reforms or attain program goals. Consequently overall Borrower performance was unsatisfactory under both loans.

**Table 2.2: Performance Ratings: SAL I and TAL I Programs**

<i>Ratings</i>	<i>IEG</i>	<i>This report*</i>	<i>Reasons for differences</i>
Outcome	Satisfactory	Moderately unsatisfactory	IEG evaluated the whole loan, this report assesses only the social security components. The main goal of SAL I to reduce fiscal stress was not achieved.
Sustainability	Likely	Unlikely	Political and institutional situations are resistant to proposed reforms.
Institutional development	Substantial	Substantial	Refers to its value as a key incremental step toward structural reforms.
Borrower performance	Satisfactory	Unsatisfactory	The failure of major fiscal goals can be attributed to poor preparation when evaluating political constraints and an inability to implement the planned reform.
Bank performance	Satisfactory	Satisfactory	Consistent with the Bank's and the country's priorities; evidence of good quality-at-entry.

\* Only refers to the social security component of the Bank's operations.

### *Bank Performance*

2.36 For SAL I, the Bank's performance is considered satisfactory. Quality-at-entry was satisfactory because the Bank had a reasonable diagnosis of the main problems in the system and a defined strategy for addressing them, which was consistent with the Bank's general pension strategy and with the country's priorities. The development objectives proved to be overly ambitious and were not realistic, with too much expected from the government. The project rationale was modest in terms of appropriate design. The Bank succeeded in ensuring high commitment and government ownership of the social security reform, although it failed to promote stakeholder participation, particularly among political party representatives and pensioners' associations. Supervision was reasonable, as the government prepared the program and implemented it.

2.37 The performance of the Bank in the case of SAL II is unsatisfactory. The main difference in the evaluation with respect to SAL I is that, by the time the SAL II was prepared, the Bank should have been aware of the political resistance that benefit-reducing reforms would face. In fact, political efforts to introduce a constitutional reform that guaranteed wage indexation for pensions were already under way. This reform, approved in November 1989, was supported by 82 percent of the voters. The political obstacles were a significant problem and seriously reduced the quality-at-entry, thus affecting the overall performance evaluation.

**Table 2.3: Performance Ratings: SAL II and TAL II Programs**

<i>Ratings</i>	<i>IEG</i>	<i>This report*</i>	<i>Reasons for differences</i>
Outcome	Satisfactory	Moderately satisfactory	The social security–specific component of the administrative improvements was achieved, although it was not, in itself, highly relevant.
Sustainability	Likely	Likely	Refers only to the successful technical support given to BPS.
Institutional development	Substantial	Substantial	Refers only to its value as a key incremental step toward structural reform.
Borrower performance	Satisfactory	Unsatisfactory	The failure of major fiscal goals can be attributed to poor preparation when evaluating political constraints and the inability to fully implement the planned reform.
Bank performance	Satisfactory	Unsatisfactory	The Bank was not able to draw timely lessons from the SAL I experience, indicating that the approach taken to reduce deficits would fail again.

\* Only refers to the social security component of the Bank’s operations.

### *CSSAL Rating*

2.38 Our evaluation of the CSSAL program is very close to that of IEG. The single point of disagreement is with the rating assigned to the outcome. While the Bank rated it highly satisfactory, we downgraded it to satisfactory. The reason is that, while the goals set in the program are reasonable and would certainly improve the performance of the funded scheme, their relevance cannot be considered a top priority for the social security system as a whole. For example, the change in minimum investment by AFAPs in government securities was important, but the reduction was already planned, but according to those interviewed, the Bank’s intervention accelerated the pace of the reduction.

**Table 2.4: Performance Ratings--CSSAL Program**

<i>Ratings</i>	<i>IEG review</i>	<i>This report*</i>	<i>Reasons for differences</i>
Outcome	Highly satisfactory	Satisfactory	The divergence is in the relevancy of the objectives. While the activities proposed would certainly improve the efficiency of the funded scheme, they cannot be considered highly relevant to the country’s development priorities.
Sustainability	Uncertain	Uncertain	No differences.
Institutional development	Substantial	Substantial	No differences.
Borrower performance	Highly satisfactory	Highly satisfactory	No differences.
Bank performance	Highly satisfactory	Highly satisfactory	No differences.

\* Only refers to the social security component of the Bank’s operations.

### 3. An Assessment of Development Impact

3.1 The following section on the assessment of development impact will consider the Bank's assistance for social security as a whole, rather than for individual projects, as described in the previous section.

#### Outcomes

3.2 As discussed earlier, the Bank has changed its strategic approach to pensions in Uruguay at least twice over the past 15 years. While this is not a problem in and of itself, a review of available documents and personal interviews led us to conclude that the Bank tended to apply an *ad hoc* approach, reacting to events in Uruguay instead of having a clear, long-term, conceptually sound and feasible agenda. The Bank's position has ranged from advocating Chilean-style privatization of the system;<sup>16</sup> to proposing parametric reforms when it was obvious that a structural reform was infeasible; to standing on the sidelines when momentum gathered for reform and the government proceeded on its own; to resuming dialogue with the government and proposing measures to improve the functioning of the new system. The shifts in pension politics in Uruguay since the early 1990s and the development of a positive attitude toward pension reform within the Bank has moved the discussion away from fiscal issues to the introduction of a funded scheme and its performance.

3.3 The various phases discussed in the previous section were reflected in the loans the Bank granted to Uruguay. During the first phase, two loans were approved to promote fiscal austerity in the pension system—SAL I and SAL II. Following this phase, there were no loans for nine years, while the Bank opposed reforms implemented by the government; this was the second phase. It was not until 1998 that a new loan, CSSAL, which was restricted to the financial and operation aspects of the funded pillar, was approved during the third phase.

3.4 The relevance of these strategies needs to be understood because they affect the fiscal stability of the system—a concern shared by both the Bank and Uruguay's government. Fiscal stability was very much a concern in the late 1980s, when the pension system's expenditures were approaching 10 percent of GDP and rapidly growing, and the country's macroeconomic conditions were seriously affected by the general crisis. Within that context, the Bank seems to have taken the right position in trying to place the fiscal problem at the top of the policy agenda, because the system would soon become unsustainable for the national economy. Therefore, it seems that the adopted approach was correct: to seek a sensible solution to a serious long-term problem, even though the adopted strategy did not generate the expected results. Consequently, the goal can be considered *highly relevant*.

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<sup>16</sup> There is no explicit reference to this in the available documents, but officials and consultants who were interviewed referred many times to the fact that full privatization of the system was being informally proposed by the Bank during the 1980s as a long-term solution to the fiscal problem.

## **Efficacy**

3.5 Uruguay's government was primarily responsible for the reform, and was unwilling to take the Bank's advice because it was not in line with the government's own aims. The merits and demerits of the reform are, therefore, attributable mainly to the country. As for the Bank, it was tied to an ideological approach, which caused it to overlook the country's specific conditions and limitations, thus leading to generally low efficacy in achieving the goals of the various loans and the country assistance strategies. In fact, early attempts to reduce expenditures through parametric reforms failed when, as a response to the Bank-supported policy developed by the government, the political opposition managed to reverse all expenditure reductions and even generate higher expenditures when the 1989 constitutional amendment was approved. Similarly, the policy in the early 1990s, when the Bank opposed the reforms promoted by the government, had negligible efficacy because the government went ahead with its reforms anyway.

3.6 The Bank's latest approach to pension reform in Uruguay is the exception to the rule. With the Bank supporting the reform and promoting improvements in the funded pillar, CSSAL had substantial efficacy because all of its goals were satisfied. One reason for this success was that the Bank adopted a lower profile, focusing the discussion on practical matters and refraining from including basic design issues in the loan policy matrix.

3.7 The overall efficacy of the Bank's pension policy can be considered negligible because measures that the Bank proposed, even when adopted by the government, were later reversed; or the government adopted reforms that was not supported by the Bank; or Bank proposals that were adopted were not major social security objectives.

## **Overall Outcome**

3.8 The Bank appears not to have had a clear strategy on pension policy for Uruguay. It has generally been reactive instead of proactive, and it did not seem to have a medium-term view of the role of social security in Uruguay. Fiscal problems were not directly addressed after the reform even though the system still spends more than one-seventh of total GDP on its pension program. Although the country's fiscal situation is not the Bank's responsibility or fault, because of the large magnitude of the problem, the Bank should have participated more.

3.9 Bank assistance in the social security area was not designed well because it did not fully take into consideration the political, institutional, and cultural background of Uruguay. The Bank underestimated how easily reforms could be stymied by political gridlock. Uruguay's constitutionally instituted plebiscite, political party system, tradition of social-welfare legislation as part of the local culture, and political influence of the pensioners' associations constituted a powerful legacy that could bring progress to a halt.

3.10 A change of attitude in the Bank in the late 1990s resulted in a new policy stance—interest was centered more on promoting small changes in the funded scheme. While some of these adjustments were improvements, their relevance to the larger goal

was not clear. The CSSAL and other analyses (such as the Financial Sector Review of 2000)<sup>17</sup> appear to be focused on financial issues alone, which may result in only minor improvements in the social security system as a whole.

3.11 Uruguay's pension system can be considered reasonable and moderately satisfactory. Given the country's circumstances and its slow implementation capacity, it was able to provide incentives to contribute and tended to solve the long-run fiscal problem, despite remaining weaknesses in transition financing. However, the Bank did not make a significant contribution to outcome because its ideology in the initial phases of reform resulted in loan programs that were either infeasible (SAL I and SAL II) or only marginally effective (CSSAL).

3.12 For the reasons stated, the overall outcome of the Bank's policy toward pensions in Uruguay can be considered to be moderately unsatisfactory. This conclusion is based on the fact that even though the highly relevant policy goals in the late 1980s and early 1990s failed (reducing the fiscal burden of social security and creating a new funded scheme), the Bank's interventions can be viewed as key incremental accelerators toward the structural reform that was finally adopted. Moreover, the policy goals of the late 1990s (improve some aspects of the funded pillar) were not substantially relevant to the pension system as a whole, and had overall negligible efficacy,

### **Institutional Development Impact**

3.13 Two types of institutional development objectives were included by the Bank in the background documents or as part of specific loans. In some instances, the objectives were indirectly included as part of general recommendations, and in other instances, they were more explicit, such as part of the conditions for the lending operations. These objectives were (i) regulatory frameworks to improve the transparency and efficiency of the administration, in order to promote better functioning of the pension system as a whole and to clarify the "rules of the game" for both the PAYG and the fully-funded pillar and (ii) specific provisions to improve administrative procedures, in order to enhance BPS capacities and AFAP operations.

3.14 Taken individually, the results of the first objectives were considered substantial, and the results of the second were modest (because it did not represent a relevant contribution to the institutional build-up capacity in this area.) However, the Bank's assistance concentrated on policy design and regulations, and did not fully consider other important aspects of development, such as training or technological transfers to develop local institutions and human capital.<sup>18</sup>

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<sup>17</sup> The review offered policy recommendations and treated AFAPs as standard financial sector institutions that provided services to highly sophisticated clients, but did not consider the social and political implications of its recommendations, for example, eliminating the *República* AFAP special guarantee.

<sup>18</sup> For instance, the BPS received computer equipment under TAL I for use in tax and collection advisory services. The amount of support for this specific purpose is not clear from the loan documents, but total computer equipment support under TAL I was US\$ 452,000 (divided among seven different projects). SAL

3.15 One of the main problems that affected the institutional development impact was that the Bank's counterparts were almost invariably officials of the Office of Planning and Budget (OPP) and the Ministry of the Economy. There were no significant contact with BPS staff (responsible for administering the PAYG scheme and all collections), the Central Bank of Uruguay (responsible for supervising the funded scheme), or the Ministry of Labor and Social Security (officially responsible of designing long-term social security policy). This lack of contact with technical staff significantly reduced the ability of the Bank to have a long-term influence on the institutions that managed the social security system in Uruguay.

3.16 The specific institutional development impact ratings for SAL I, SAL II, and CSSAL were substantial as based on improvements in BPS performance, including new computerized systems and equipment, regulations enforced to allow better development of the private pillar and associated markets, and improvements in the quality of the available information, among other recommended and adopted measures. However, our overall evaluation of the institutional development impact of the Bank's assistance is modest because the implemented interventions did not increase comprehensively the country's institutional capacity in the pension area.

## **Sustainability**

### *Social Security Reform Sustainability*

3.17 General support of social security reform since its uncertain start seven years ago has improved—institutions are functioning and many regulations are being implemented. The second pillar is operating better than initially expected but there remain many aspects still to improve. For example, the control and supervision mechanisms in place are far from efficient and the incentive structures still present some unsolved technical problems (the incentive to delay retirement does not seem to be showing the expected results). More important to the whole system is the fact that financing for the transition remains in doubt, and there are no sound actuarial studies on which to base projections. There are also no major proposals, in terms of debt and tax management strategies to solve the problem.

### *Bank's Pension Policy Sustainability*

3.18 In the last phase, the Bank promoted several policies that aimed at increasing risk diversification, operational efficiency, and market transparency in the funded scheme. While these proposals have been implemented, their sustainability is unlikely for the following reasons.

- i. Political uncertainty in Uruguay regarding the funded pillar—opposition to it remains strong almost seven years after its creation.

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II had a small technical assistance program to improve the computers at BPS. CSSAL had no technical assistance at all.



- ii. Political and other stakeholders (mainly pensioners' associations and trade unions) can activate the institutional mechanisms to reverse the reform (as in past reform attempts).
- iii. The government has taken full ownership (among the positive factors to consider) of the proposed measures and has, of late, advanced slowly in the desired direction, toward high sustainability of government ownership.
- iv. There is moderately solid institutional support, such as in the regulatory framework, and modest institutional development.
- v. The financial sustainability of the system—this is the most worrisome aspect.

3.19 Many questions related to transition financing remain unanswered, given the absence of actuarial studies and sound analysis of short- and middle-term funding mechanisms and their social implications. This is an area where the Bank should offer technical support to the Uruguayan government.

3.20 Moreover, the ability to translate the financial savings generated by the reform into real investments has been complicated by the slow development of the local capital markets, existing regulations that severely limit investment opportunities, and the lack of risk diversification from international investments. In addition, the financial crisis of 2002 in neighboring Argentina raised further questions about the long-term stability of the pension system.

3.21 The debate about whether the current funded scheme should be maintained or replaced by another PAYG or funded scheme, with a different structure, is far from over. Consequently, we consider overall sustainability as unlikely.

## 4. Results

### Bank Performance

#### *Quality-at-Entry*

4.1 The Bank's pension policy strategy in Uruguay was generally inconsistent. While most Bank documents correctly identified and diagnosed the shortfalls of the social security system, the Bank did not act accordingly. Moreover, it avoided participating in the policy dialogue at a crucial juncture. Further, the outcome of the economic and sector work conducted by the Bank was modest because it concentrated on fiscal issues and did not take into account either the economic impact of introducing a second pillar or the political context, in which pensions are an integral part of the social protection system.

4.2 The stated development objectives were not realistic in the period prior to the reform's implementation. The Bank expected too much too soon from the government and misjudged existing political constraints. The failure of the parametric reforms to restructure the package benefit, as proposed by the Bank and implemented by the government, is illustrative of this point. After the Bank's position was revisited, its objectives became more realistic and the Bank's analysis gradually came to grips with the realities of the new system and the government's implementation capacities.

#### *Approach and Design Appropriateness*

4.3 Even acknowledging that politically difficult choices and actions were required to keep the pension reform program on-track, the risk assessment made by the Bank was poor and seriously affected its ability to influence pension policy for most of the period. The instruments chosen to support the reform, SAL I and SAL II, needed stronger technical assistance components and proved to be too inflexible to adapt to the evolving circumstances. CSSAL proved to be a more satisfactory instrument, with compromise embedded in the medium-term strategy and realistic goals for a single-tranche operation (although its scope was limited).

#### *Government Ownership*

4.4 Although Uruguay's government initially had shown full commitment to Bank proposals (it was involved in project preparation), it eventually chose to another path and ignored the Bank's advice. After the reform's implementation, Uruguay worked with the Bank once again (for example in the CSSAL preparation process). The fact that the reform did take place—exceeding both the government's and the Bank's expectations—without formal intervention by the Bank, suggested that the “Uruguayan way of doing things” may have constituted a better approach than the one proposed by the Bank.

#### *Involvement of Stakeholders and Beneficiaries*

4.5 The Bank did not make significant efforts to convince different groups that reform was unavoidable. The message was probably a difficult one at the time, however, and

difficult for the Borrower, who was responsible for enacting and implementing the reforms. Actions to increase awareness among the pensioners' associations<sup>19</sup> and political parties could have created a more favorable atmosphere for the reform and would have supported political and civil society representatives in developing alternatives.

### *Technical Aspects*

4.6 The technical aspects of the reform were overlooked by the Bank. While the Bank was not responsible for the reform enacted, once it implicitly endorsed it, the Bank should have intervened in specific areas. The Bank did not fully assess the fiscal transition associated with the reform and did not provide any actuarial analysis—a technical failure, given the strong assumptions since the 1996 Country Economic Memorandum of increasing systemic imbalances. (After 2000, the Bank used the Pension Reform Options Simulation Toolkit (PROST) to make actuarial simulations.)

### *Institutional Analysis*

4.7 The Bank's institutional analysis was flawed because it failed to incorporate institutions or agencies that could have facilitated the project's implementation. The Bank likely failed to contact the relevant technical institutions and social sectors because it did not properly understand the political process in Uruguay. It complicated that situation by exclusively discussing policy with officials from the Ministry of the Economy and the OPP. While the Bank, the OPP and Ministry of the Economy may have been able to agree with each other on some basic policy goals, the agencies responsible for applying and enforcing these policies had little commitment to them and, in some cases, strong opposition. This was the case with the BPS, which systematically felt excluded from the discussions.

4.8 The possibility of complementing an active role of the IADB in Uruguay was never fully explored. The IADB was the major partner in the reform process—financing preliminary studies, supporting the Committee of Assessment of the Program of Social Security Reform, and funding the creation of the supervisory division at the Central Bank. In contrast with the Bank, the IADB's role is generally perceived as positive within Uruguay and is praised for its support and involvement. Consequently, the Bank's overall quality-at-entry is considered unsatisfactory.

### *Supervision*

4.9 The Bank had better performance during the supervision than at design. The first two loans (SAL I and SAL II) were adequately supervised and problems were identified early. The third loan (CSSAL) was executed on time and all conditions were met. However, because the Uruguayan management unit had been decentralized to Buenos Aires, Argentina (only one hour away from Montevideo), the absence of a specific "Uruguayan" team weakened supervision; the Bank's local representatives were not an

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<sup>19</sup> This is especially relevant, given that retirees account for approximately 30 percent of the electorate.

active presence in the negotiations. Therefore, the Bank's overall supervision is rated as satisfactory.

4.10 It is very difficult to assess the Bank's performance in the pension sector in Uruguay over the past 20 years as it has been characterized by alternating phases of cooperation and distance. Cross-accusations of blame and divergent views about why the Bank withdrew during the most important time in the reform process mean that the only certainty is that the reform was conceived, enacted, and initially implemented without the Bank's participation. Had the Bank remained more tolerant of the "Uruguayan style," it is likely that it could have recommended some improvements to the reform's design. For these reasons, the Bank's overall performance with regard to the pension system in Uruguay since the late 1980s is rated unsatisfactory. The Bank should have had a better understanding of the local interests involved in pension policy, adopted a more tolerant approach, and collaborated with the IADB to improve aspects of the reform model.

### **Borrower Performance**

4.11 As recognized in other Bank documents, Uruguay has traditionally been a steady, if somewhat slow, executor of the Bank's projects.

4.12 In the initial phase of the pension reform, the government did not take into account fully all of the factors involved (the political, economic, and institutional variables already discussed in earlier sections) and, most important, it was incapable of winning the support of the critical groups, which ended up reversing the reforms. We, therefore, consider the Borrower's preparation to be unsatisfactory.

4.13 The program's approach and design in the "third stage"—primarily the provisions of CSSAL, were much better prepared. In this case, the Borrower's performance was highly satisfactory. So, in the broad perspective, we have to acknowledge that the Uruguayan government managed to advance through numerous obstacles during the preparatory stage, to explore alternatives, and to adapt to the changing circumstances imposed by the political and social situation. Therefore, the Borrower's overall preparation was satisfactory.

### *Implementation and Compliance*

4.14 The government was not able to comply with the commitments it made under SAL I, and with many made under SAL II, with the exception of some administrative procedural improvements. After the reform was implemented, however the government was able to comply with all of its commitments on time (for the CSSAL, for instance). Nonetheless, there still appeared to be a problem with the participation of major stakeholders in developing the policy agenda. In fact, the implementation of these commitments was made by decree, and the BPS had no significant involvement in developing or implementing the ideas. Beneficiaries were not considered in the negotiations during the entire process. Consequently, implementation and compliance are rated to be unsatisfactory.

4.15 Even though the Borrower evidenced satisfactory preparation and implemented some of the Bank's proposals, we rated overall Borrower performance unsatisfactory because it failed to sustain reforms over time and did not effectively reach the established goals of the programs. Nonetheless, at the end of the day, Uruguay exceeded the performance targets set by the Bank due to the flexibility of the government and its ability to take control of its own social security system.

### **Other Contributors to Outcomes**

4.16 The IADB was a key player in the reform process and adopted a less structured approach than the Bank in terms of policy design. Unlike the Bank, the IADB did not publicly adopt a pension reform model, giving it more freedom to support policy alternatives. This fact limited cooperation between the two institutions because the Bank had taken an inflexible position regarding pension reform, while the IADB adopted a more pragmatic approach. If the Bank had joined in IADB's effort, it is possible that some aspects of the legislation would have been improved, and more financial resources would have been available to support the reform.

4.17 The IADB was the primary external financier and was active in virtually all sectors (for example, it financed a US\$ 950 million lending program between 1996 and 1998). In terms of pension policy, it financed the technical commission that prepared the approved reform proposal. It financed preliminary studies, supported the Committee of Assessment of the Program of Social Security Reform, and provided funds for the creation of the supervising division at the central bank. In March 1996, it approved a loan (No. 921/OC-UR) for US\$ 150 million to support effective implementation of the social security reform law, to promote institutional framework strengthening, and to develop the capital market in Uruguay. The IADB interventions resulted in positive reactions from most groups.

4.18 During the period, the IMF was very interested in supporting measures to tackle the severe fiscal problems of the social security system as part of the general stabilization effort that the Uruguayan government was encouraging. Sanguinetti's administration received support through an IMF Stand-by Loan and had to negotiate goals related to fiscal constraints. The agreed goals were a reduction in fiscal expenditures of 0.5 percent of GDP during the first year of the program, plus policies to limit inflation and contain spending. In this sense, the social security policies were seen as a fiscal-deficit adjustment tool.

### **Counterfactual**

4.19 While the results of the various instruments may not have been the desired ones, we need to consider what might have happened if the Bank had not been active.

4.20 Noya and Laens (2000)<sup>20</sup> estimated that the overall fiscal result of the social security reform in Uruguay—including interest paid for financing the deficit—under most of the projected scenarios would reduce the long-term deficit by between 0.5 percent and 2 percent of GDP. In the short and medium-term they calculated that primary pension spending would increase between 1.6 percent and 1.8 percent of GDP owing to the reduction in PAYG system contributions and the rise in benefits. Without reform, the BPS's deficit was projected to be close to 4.5 percent of GDP by the year 2040, pushing the system close to bankruptcy.

4.21 During the late 1980s the Bank strongly promoted reforms to reduce pension expenditures. While several parametric reforms were discussed, the most important one was to limit pension indexation. Of course, it is always difficult to assess a counterfactual confidently because we cannot know for sure what would have happened. Expenditures were growing and the Bank's proposals were aimed at stopping that process and pushing reforms that Uruguayan society was not ready to adopt. In the 1990s, the Bank was supporting regional pension reforms based on the multi-pillar model of *Averting the Old Age Crisis* (World Bank 1994). It is likely that had the Bank not intervened in the first stages of the reform process, Uruguay would have developed its own model anyway, at its own pace, determined by the local circumstances.

4.22 After the reform, when voluntary worker affiliation with the AFAP raised transition costs above government estimates, the authorities in Uruguay decided to approach the Bank for assistance. The Bank renewed presence in Uruguay with the 1998 CSSAL program, which contained numerous provisions to liberalize the investment regime of the pension funds lower costs, and improve system transparency. Had the Bank not participated in the implementation stage, the development of the funded pillar would have been slower. Most of the requirements set out in the policy matrix were satisfied and the institutional development introduced by it—in terms of the creation of investment opportunities and a regulatory framework—helped develop a modern financial sector in Uruguay.

4.23 To consider a counterfactual in which the Bank did not support Uruguay's multi-pillar reform is more difficult because we need to consider what would have happened if the Bank *had been* involved. Previous Bank analysis acknowledged that “The government of Uruguay was successful in the long run—perhaps even more so than if it had followed the advice of the Bank to the letter” (World Bank 1996). If the Bank had remained more tolerant of the “Uruguayan style,” the Bank may have been able to incorporate some improvements in the reform design. For example, the Bank could have provided technical advice and actuarial studies to evaluate the impact of the 50 percent bonus for low-income workers and, based on results obtained in terms of fiscal costs, have analyzed its inclusion in the law better or evaluated other alternative incentives to attract contributors to the funded pillar.

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<sup>20</sup> Noya and Laens, 2000, contains projections of revenues and expenditures for the period 1996–2050, under a simulation model that takes into consideration different economic growth and interest rate scenarios.

4.24 Given the role the IADB had in those years, however, there could have been no other major changes because the reform had both financial and political support from an international organization. If the Bank had joined this effort, some aspects of the legislation could have been improved, and also more financial resources could have been available to support the reform. In view of the earlier experience, the active presence of the Bank could also have backfired and created even greater political opposition.

4.25 It is clearly too soon to assess the long-term viability of the system, but at least no major problems have occurred since its creation. A detailed study evaluating the recent evolution and considering possible projections into the future would be important in designing the Bank's strategy on pensions for the coming years.

**Table 4.1: Performance Ratings--World Bank Assistance to Uruguay for Pension Reform**

<i>Category</i>	<i>Rating</i>	<i>Main reasons for assessment</i>
Outcome	Moderately unsatisfactory	Economic and sector work was insufficient, resulting in lack of an overall strategic view. Policy positions changed in response to local politics and rarely achieved significant goals but had some impact accelerating the slow local reform process.
Sustainability	Unlikely	Policies to promote efficiency and transparency in AFAPs were implemented, but their effect is long term, and it is too soon to assess if they will continue.
Institutional development	Modest	A concentration of counterparts in the Ministry of the Economy and OPP limited the effect of other institutions, such as BPS, BCU, or AFAPs. No links to non-governmental organizations or other institutions. Technical support to BPS was satisfactory, but limited.
Borrower performance	Unsatisfactory	Uruguay's government failed to implement the reforms agreed to with the Bank on two loans. Failure can be attributed to political pressures, which the government could not address.
Bank performance	Unsatisfactory	In not understanding the local political process, the Bank failed to develop good quality-at-entry. Attempts to impose reform resulted in a breakdown in the policy dialogue with the Government. The reestablishment of a relationship was a result of a more limited approach to pension reform.

## **5. Lessons Learned and an Agenda for Future Action**

5.1 The Bank misjudged the political and institutional environment in Uruguay and pushed hard for unpopular measures to curtail benefits that were contextually inappropriate. When society was ready and momentum for the reform had gathered, the Bank did not propose structural reforms because it thought the option was not feasible, again demonstrating a lack of understanding of the situation. The government went ahead and semi-privatized the system in 1995. Once the reforms were in place, the Bank misunderstood the incentives designed to attract low-income workers into the second pillar. But the Bank was convinced that under the circumstances, the best alternative was to continue its dialogue with government recognizing that further steps would have to be adopted for long-term solutions.

5.2 There are a number of lessons to be taken from the Bank's experience in Uruguay with the pension system. For the past 15 years, the Bank tried to influence pension policy, without much success. Although different strategies and tools were used, the results were poor in all cases. Of course, the Bank is not directly responsible for this failure, but it was indeed shortsighted in several respects.

5.3 One lesson from this experience is that pensions are an extremely sensitive topic in many countries, and, as such, should be handled very carefully. Attempts to push reforms beyond the limits set by the social and political climate may backfire (as was the case with the parametric reforms of the late 1980s) or end up stalling dialogue between the Bank and the Borrower (as was the case in the early to mid-1990s). The attempts were important in themselves, in the sense that the Bank and Borrower collaborated to push forward certain issues, generated debate, and, to a certain extent, put some pressure on the otherwise excessively slow Uruguayan implementation capacity in what could be called counterproductive efficacy of increasing opposition to the pension reform, triggering the approval of the 1989 Constitutional amendment, and thus accelerating the reform process.

5.4 Proposals should be weighed against the feasibility of local implementation. Therefore, when assessing a pension system, the Bank should do a thorough analysis of all dimensions, not just fiscal and financial, but also social, actuarial, and political. A pension system may have several pillars, different administrators, combined schemes, and so on, but it still should be a single system designed to provide income security to the elderly. As such, the Bank's approach to the system must be an integrated one.

5.5 A second systematic problem we found in the evaluation is that the Bank did not try to contact or to build relationships with the technical staff of the responsible agencies. Almost all policy discussions were held with the OPP and the Ministry of the Economy. These two offices are very influential in the policy-design process in Uruguay (both are part of the Committee of Assessment of the Program of Social Security Reform, which is presided over by the director of the OPP), but they have no involvement in implementing these policies. Contacts with officials at the BPS or the Central Bank were rare and, in most cases, were initiated to collect data and not to discuss policy.

5.6 A significant effort should be made to reach officials at the technical level. This strategy would be beneficial in two ways. First, while top-level officials must be the main counterparts



for political reasons (and, as in the case of Uruguay, because they are technically very competent), the staff at the specific agencies are usually closer to the real problems and could offer more detailed insights into the immediate and medium-term needs of the system. Also, because these lower-level officials are the ones who must implement whatever policy the Bank agrees to with the government, having direct contact with them would improve the dialogue and allow the Bank to influence some practical decisions, which is critical for the success of long-term policies.

5.7 In order to influence pension policy, it is necessary to work not only with the “formal” or “official” counterparts (that is, the Ministry of the Economy and the OPP) but also, most importantly, with the political and social sectors that will be affected. A proactive policy to reach out and contact other agencies, academics, and social constituencies is necessary. The Bank (and the government) must take an active role in educating the general public and explaining why the reforms are needed and what are the best available options. This approach is absolutely critical in the case of a country with a long tradition of participatory democracy, such as Uruguay.

5.8 Long-term stability is necessary to the success of pension systems, and to guarantee success, a broad social consensus must be built around the system. Explaining the need for reform, educating the public and reaching out to build large coalitions to support the reform are central to the success of any social security policy.

5.9 Future action on pensions should begin by preparing a detailed diagnosis of the whole system, evaluating whether it is able to satisfy the basic goals of a pension system (that is, provide replacement income for (nearly) the whole population, at a low fiscal and social cost, minimizing negative incentives and promoting responsible participation). Policy recommendations should be prepared based on this diagnosis and should consider fiscal, financial, social, and political restrictions. Partial approaches (such as the one presented at the Financial Sector Review of 2000) are useful for building an integrated analysis, but it is important to avoid presenting partial recommendations independently. A consistent, technically sound approach to pensions in Uruguay is the goal.



## Appendix: Basic Pension System Indicators

Uruguay	1990	1995	2000
<b>Coverage and Maturity of Pension System</b>			
1. Population: <sup>a</sup>	3,105,552	3,218,189	3,337,060
Ages 0–14	808,819 (26%)	806,176 (25.05%)	827,334 (24.80%)
Ages 15–64	1,939,209 (62.4%)	2,016,756 (62.65%)	2,079,536 (62.30%)
Ages 65+	357,524 (11.6%)	395,257 (12.30%)	430,190 (12.90%)
2. Labor force activity rate <sup>a</sup>	59.56	62.10	61.35
3. Employment rate <sup>a</sup>	54.02	55.42	52.85
4. Affiliates (registered workers)	n.a.	n.a.	1,059,298 <sup>b</sup>
5. Active contributors <sup>c</sup>	832,439	926,809	927,742
6. Beneficiaries: <sup>c</sup>	687,236	700,017	723,263
Old age <sup>d</sup>	349,912	363,943	381,124
Disability <sup>e</sup>	63,830	60,254	65,206
Survivors <sup>f</sup>	273,494	275,820	276,933
7. Key indicators: <sup>a,g</sup>			
Old age dependency ratio (60+/15–60)	18.60%	19.63%	20.71%
System dependency ratio: Beneficiaries/contributors	0.83	0.76	0.78
Coverage of contributors: Contributors/labor force	0.69	0.69	0.75
Coverage of contributors: Contributors/employment	0.75	0.77	0.87
Coverage of old-age population: Beneficiaries/population age 60+	1.35	1.70	1.26
<b>Basic Parameters</b>			
8. Contribution rates (1 <sup>st</sup> and 2nd pillars as applicable): <sup>c</sup>			
Employer	16.5 + 4% <sup>h</sup>	14.5 + 5%	12.5 + 5%
Employee	13 + 3%	13 + 3%	15 + 3%
9. Retirement age <sup>c</sup>	men: 60 women: 55	men: 60 women: 55	Both men and women: 60
10. Minimum years of service/Contribution <sup>c</sup>	30	30	35
11. Target replacement ratios for full career workers <sup>c,1</sup>			
Entry-level old-age pension/average wage by income class			
Retirement I and C / mean salary I and C, March 1997		0.59	

<b>Uruguay</b>	<b>1990</b>	<b>1995</b>	<b>2000</b>
Civil retirement / civil mean salary, March 1997		0.76	
Domestic work. Retirement / domestic work, mean salary, 1 April 1997		1.97	
Rural retirement / Rural mean salary, March 1997		1.04	
<b>Finance of PAYG</b>			
13. Contribution revenues (percentage of GDP) for contributions and IRP <sup>c, j, k</sup>	8.67	9.13	8.38
14. Pension Expenditures (percentage of GDP) IVS <sup>c, j</sup>	7.78	10.46	11.16
Old age			
Disability			
Survivors			
Other <sup>l</sup>	1.92	2.62	3.06
15. Balance (percentage of GDP) <sup>m</sup>	0.89	-1.33	-2.78
<b>Capital Market Indicators</b>			
17. Consolidated Assets of the Financial Sector <sup>c, j</sup> (percentage of GDP)		21.1% (1997)	23.74%
18. Assets of pension funds <sup>o</sup> (percentage of GDP) <sup>c, n</sup>		0.88%	3.84%
19. Composition of pension fund portfolios <sup>n, o</sup>			
Transitory availability			4.75%
State securities			61.44%
B.H.U. securities			9.75%
Literal C			17.31%
Literal D			4.99%
Literal F			1.76%
21. Administrative costs of pension funds <sup>n</sup>			2.798 <sup>p</sup>

Sources: National Statistics Institution (INE); Banco de Previsión Social (BPS); PEA ; AEA ; BCU

a. Data is from INE.

b. As of January 1999, from BPS database.

c. Data is from BPS.

d. Regular and advanced-age retirement; annual average.

e. Includes disability and old age pensions.

f. Total pensions.

g. PEA : 1990: 1,212,010 PEA 1995: 1,343,500 PEA 2000: 1,235,300

Employed 1990: 1,110,322 1995: 1,206,000 2000: 1,067,600

Population 60+ 1990: 509,336 1995: 546,668 2000: 572,367

h. Corresponds to sickness insurance percentage.

i. Data corresponds to average retirement according to classes and average revenues as of March–April 1997, stated in the labor history record.

Dollars as of March 1997: 9.08 – April 1997: 9.24.

j. Data is from AEA.

k. Corresponds to disability, old age, and survivor.

l. Corresponds to sickness insurance, family allowances, maternity and unemployment insurance, and special funds.

m. -13 to -14 (only IVS).

n. GDP 2000: 242,636,150 (in thousands of current *pesos*)

GDP 1997: 240,925,566 (in thousand current *pesos*).

Accumulated Previsional Funds (current *pesos*) December 1997: 2,119,707,693

December 2000: 9,323,547,331.

o. The AFAPs will invest in the stock market according to Article 123 of Law 16.713, which establishes that “The Administrators are entitled to invest the resources of the Previsional Savings Fund in: (1) securities issued by the Uruguayan State, up to 60 percent of the total asset; (2) securities issued by the National Mortgage Bank (*Banco Hipotecario del Uruguay*) up to 30 percent; (3) Term deposits in national or foreign currency to be invested in financial intermediary institutions established in the country, authorized to receive deposits, up to 30 percent; (4) Securities issued by public or private Uruguayan enterprises that are valued in the formal market, authorized by the Central Bank of Uruguay, up to 25 percent; (5) Representative values of investments in real-state, industry, forestry or other productive sectors, guaranteed by financial authorized institutions, by means of issuing deposit certificates, up to 20 percent; (6) Allocations in public or private institutions, in order to provide personal loans to affiliated and beneficiaries of the social security system.”

p. Corresponds to mean administrative fee (1.919 percent) and average insurance prime (0.879 percent).



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