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Costa Rica's Pension Reform: A Decade of Negotiated Incremental Change

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Chapter 12

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During the past two decades, Costa Rica has transformed its pension system and turned it into a 'mixed model' that combines collective and individual savings (Mesa-Lago 2004).[1] This chapter focuses on the structural reform approved in 2000 and in effect since May 2001 and the parametric reform approved in May 2005. The 2000 reform created a multipillar system, which included the Régimen de Invalidez, Vejez y Muerte (RIVM, or the Disability, Old-Age, and Survivorship Regime). The RIVM was created in 1943 and currently reaches nine out of every ten insured workers in the country. The 2005 parametric reform modified requirements and benefits of the RIVM and created new benefits while seeking to strengthen the collective capitalization system. Both reforms strengthened the administrative effectiveness of the RIVM.

This chapter discusses the main historical characteristics of the pension system, focusing on the RIVM; describes the political context for the design and adoption of the main reforms of the past five years; and explains both reforms in detail. It also examines the strengths and weaknesses of the implementation process and concludes with an exploration of tensions within the Costa Rican pension reform.

A Brief History of the Pension System in the Pre-reform Period

In the early 1990s, 64.5 percent of salaried and 5 percent of non-salaried workers were covered by all public pension systems compared to

A technical report commissioned by the Estado de la Nación (State of the Nation Project) provided me with the opportunity to organize the information regarding the 2005 reform process (Martínez Franzoni 2005*a*). I also thank Ana Catalina Ramírez for her meticulous support in completing information and bibliographic references, and Juan José Matamoros at SUPEN for his kind support in accessing and updating data. Stephen J. Kay and Tapen Sinha provided very helpful comments, and Stephen J. Kay patiently helped to edit a much longer version of this chapter. Flaws remain my own.

56.8 percent of salaried and 21.7 percent of nonsalaried workers in 2004 (Estado de la Nación 2005). Of those covered in the early 1990s, the RIVM paid benefits for 75.9 percent of retirees and 94.7 percent of contributors (Sauma 2004), and provided 3 types of pensions: (*a*) old age, for those who made the required number of contributions; (*b*) disability, for those who were forced to stop working; and (*c*) survivorship, for dependent family members of deceased-insured workers [Law 17 (Article 19); (CCSS 1994)].

Nineteen special regimes were operating alongside the RIVM, which operated in the public sector from the 1980s to the mid-1990s and covered groups such as teachers, legislators, and workers in the judicial branch. These programs offered privileged benefits, had enormous actuarial disequilibria, and were financed by the national budget. They received fiscal subsidies and had a regressive distributive impact that stood in stark contrast to the general lack of protection for the low-income sectors (Martínez Franzoni and Mesa-Lago 2003).

As the 1990s progressed, things began to change. In 1992 the pension law passed; in 1995 the teachers' pension system was restructured; and in 1996 Law 7605 abolished the special regime for legislators, making them part of the RIVM system. In fact, these reforms incorporated all public workers, except teachers and workers in the judicial branch, into the RIVM.[2] For that reason, current RIVM coverage is much higher among insured workers than pensioners. However, the financial weight of the regimes financed by the national budget (including teachers and the judicial branch) continued to grow because it has had to honor obligations previously contracted by the government. As Figure 12-1 shows, while the relative weight of the RIVM decreased from 9.2 percent of social expenditures in 1990 to 8.1 percent in 2003, special regimes went from 10 to 15 percent of overall social expenditures in that same period, corresponding to 40 percent of total pension expenditures in 1990 and 52.8 percent in 2003.

In contrast to most Latin-American pension systems and the Costa Rican special regimes, the RIVM was created as a partially funded DB system (called Capitalización Parcial Colectiva (CPC)) and has never operated as a pure PAYGO system. It has functioned on a scaled-premium system with considerable reserves, which if invested well could fund the system's costs along with worker's contributions. However, in 1998 it became apparent that in the medium term the system would face an actuarial disequilibrium, primarily due to an imbalance between benefits and contributions.

Several factors led to the RIVM's disequilibrium, including demographic, labor, design, and administrative problems (Martínez Franzoni 2005*a*). In demographic terms, the country had completed its transition. In other words, life expectancy increased while infant mortality has decreased,

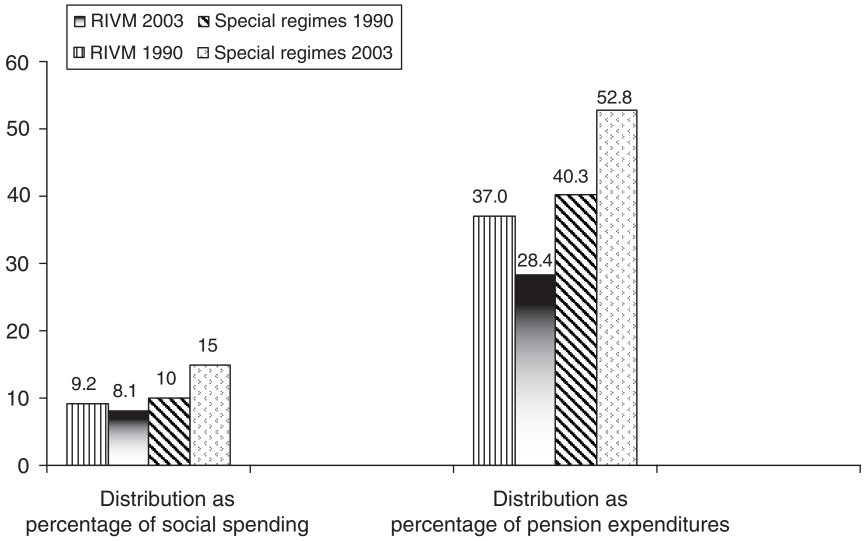

Figure 12-1. Structure and evolution of public social investments in contributive pensions (1990, 2003).

and, since 2001, population growth has been below the replacement rate (Estado de la Nación 2005). Today, there are 55 economically dependent people for every 100 paid workers. Toward 2018 the rate will be 44 per 100, and toward 2045 the composition of the dependent population will no longer be predominantly younger than 15 years but rather 65 years or older (Estado de la Nación 2003). This change will affect the labor market as well as pensions: while in 1970 there were thirty-two contributors per pensioner, in 2000 there were seven, and in 2040 there will be only three (CCSS 2004*a*, 2004*b*).

Regarding labor, the growth of the informal sector, which by definition does not contribute to social security, weakened the system's finances. In 2003 five out of every ten new jobs were informal, three were formal, and two were agricultural (formal or informal) (Sauma 2003). Between 1990 and 2002, an average of 25,000 formal jobs and 20,000 informal jobs were created every year (Estado de la Nación 2003). Although informal sector employment is not necessarily low-wage work, a significant proportion of workers has not contributed to social security—not because they earn subsistence wages but rather because they lack information, do not see the point, or try to get a 'free ride'. In fact, 45 percent of all informal workers who have not contributed to social security (of which 7 of 10 are salaried) are fully capable of contributing, while the remaining 55 percent (of which

7 of 10 are self-employed) are partially capable (Trejos 2003). (Evasion among those workers with full contributory capacity was also indicative of the RIVM's administrative inefficiency.) The limited number of workers making regular contributions increased the demand for noncontributory pensions. Those below the poverty line could request noncontributory pensions from the Régimen No Contributivo (RNC, or Non-Contributory Pension Regime)—benefits equivalent to a basic food basket, insufficient for covering basic needs like housing, clothing, and transportation (CCSS 1995). In 2002, the RNC covered less than half of the target population (44.5%) and had an 11,000-person waiting list, primarily because the Ministerio de Hacienda (Ministry of the Treasury) cut resources due to the fiscal deficit (Castillo, Uzaga, and Carmona 2002; Durán 2002). Thus, the Caja Costarricense del Seguro Social (CCSS, or Social Security Agency) was granting one pension for every two retirement or survivorship applications, and it frequently takes years for an application to be processed (Martínez Franzoni and Mesa-Lago 2003).

Among the design issues that led to disequilibrium is the replacement rate, which remained at 60 percent nominal since the RIVM's creation. The rate was based on the highest 48 monthly salaries out of the last 60, with an additional 1 percent for every additional year of contributions over 240 contributions and a floor and ceiling fixed periodically by the CCSS board of directors. This formula encouraged underreporting of income during most of a person's working life (especially in the private sector) and overreporting (public as well as private) during the 5 years prior to retirement. The general contribution from its creation through 2005 was 7.5 percent, divided among workers, employers, and the government and distributed according to whether workers were salaried or self-employed and according to the degree of qualification of the self-employed (see Table 12-1).

Administrative weaknesses are apparent not only in the high levels of evasion but also in the way the system handled increased longevity of the population combined with stagnant rates of contributions.[3] The system is regressive to the extent that the higher the income level, the higher the amount of resources required from the collective fund. Because workers making fewer than 240 contributions were ineligible for old-age pensions, even at a reduced rate, they had an incentive to seek disability pensions. This situation resulted in more people receiving disability than old-age pensions, reaching a proportion comparable to a country at war (CCSS 2005*a*). It also reflected political clientelism and influence-trafficking; workers had to know the right people to access disability pensions.

The following reforms were designed to correct many of these problems.

TABLE 12-1 Contributions by Contributors, Pillars, and Type of Insurance as Percentage of Total Salary (2003)

Contributor	*Salaried*			*Independent*	*Insured without Remuneration*
	First Pillar IVM	*Second Pillar*	*Total*	*First Pillar IVM*	*Second Pillar*
Employers	4.75	1.75	6.50	n/a	n/a
Workers	2.50	2.50	5.00	7.25 (State 0–2.5)[a]	5.5–7.25 (State 0–1.75)
State	0.25	0.00	0.25	0.25	0.25
Global	7.50	4.50	12.00	7.50	7.50

Source: Law 17, Article 33.
[a] Proportions established according to CCSS 2000.

Political Scenarios That Motivated the Reforms

Both the 2000 and 2005 reforms—as well as the creation of social security—took place under Social-Christian governments, now grouped under the Partido Unidad Social Cristiano (PUSC, or the Social-Christian Unity Party). The reforms can be considered consecutive since the second one facilitated changes the first one had not been able to make. Both reforms were planned by both government authorities and civil organizations, and they began after a failed reform effort, for which the Partido Liberación Nacional (PLN, or the National Liberation Party), under the José Figueres Olsen Administration (1998–2002), failed to get the approval of unions. In addition, unions supported both reforms, even though they had historically opposed adjustments to RIVM requirements and benefits and were ideologically opposed to the creation of a system of individual capitalization.

The 2000 Structural Reform: Creation of the Multipillar System

The prelude to the 2000 reform was the conflict that took place under the social-democratic Figueres administration (1994–8). Figueres opposed the Chilean-style reform promoted by the World Bank and proposed instead a modification to RIVM benefits and requirements, combined with the creation of a complementary individual savings pillar (Rodríguez and Durán 1998). However, the proposal did not get very far. In 1996, union demonstrators took over CCSS headquarters to show their opposition, particularly to the increase in the retirement age and the reduction in the replacement rate. They demanded that the government should improve the collection of social security fees and the financial management of RIVM investments before undertaking such drastic measures.

In 1998 Miguel Ángel Rodríguez won the presidential election by a narrow majority. His agenda included an ambitious set of economic reforms that would liberalize the telecommunication and electricity markets and incorporate private administrators in the management of mandatory complementary pensions. To that end, Rodríguez convened the Foro de Concertación Nacional (FCN, or the National Bargaining Forum) to begin negotiations about these issues. Government, business, and labor representatives whose organizations were represented in the CCSS board of directors participated, as did women's organizations and other groups representing new social movements. Although the government expected the FCN to strengthen support for its reform proposals, the alliance of organizations opposed to the reform actually grew stronger. To handle the opposition, the government changed the rules of the game, going from requiring a consensus to requiring a majority vote (Castro Méndez 2000). Still, in that volatile political environment, the pension reform unexpectedly survived, unlike all the other issues debated.

In September 1998 the pension agreement was the only one of the 96 agreements in the FCN's final report supported by all its members (Mesa-Lago 1998). Nevertheless, the law drafted in the legislature was far different from the one agreed on by the FCN, so revisions and intense deliberations in the Legislative Assembly went on for more than a year (Castro Méndez 2000). Finally, February 2000 saw the passage of the Ley de Protección al Trabajador (LPT, or Worker's Protection Law), which incorporated virtually all the agreements of the FCN (Law 7983).

The reformed pension system took effect in May 2001. Most notably from the government's perspective, the LPT omitted changes that the government had sought, including an increase in the retirement age and number of required contributions, and a replacement rate reduction. These parametric changes had been opposed by unions, cooperatives, women's organizations, and even the *solidaristas*,[4] which instead demanded, and achieved, long-expected measures to improve the administrative efficiency of the CCSS. Among measures aimed at collecting social security revenues were nonjudicial mechanisms, such as denying government contracts or shutting down firms not honoring social security contributions. Unions also agreed to create the capitalization pillar proposed by the government and the business sector, while the government agreed that pension fund administrators could be from either the public or private sectors (Jiménez 2000).

The 2005 Parametric Reform: Strengthening the RIVM

On February 18, 2004, the CCSS released its report on RIVM finances, forecasting that in 2005 contributions would be insufficient to finance pensions, interest from the reserves would be insufficient to pay pensions in 2015, and the fund itself would collapse in 2022. The ILO later confirmed this projection but forecasts that the collapse would hit instead in 2027. To address this financial problem, pension officials at the CCSS proposed creating a round of bilateral talks with interested civil society organizations largely representing businesses and workers. Cooperatives and unions persuaded that the CCSS board of directors to create instead an advisory commission to identify proposals for re-establishing the financial sustainability of the RIVM. The brand-new Social Commission, also referred to as the Comisión Técnica Institucional (or the Institutional Technical Commission), would provide input to the CCSS board of directors ahead of any decision (Comisión Técnica Institucional 2004). This commission was made up of representatives from public institutions, chambers of commerce, and labor. Women's organizations and two public institutions, the Defensoría de los Habitantes and the Superintendencia de Pensiones (SUPEN, or Superintendency of Pensions), also participated as nonvoting members.

During the first four months after the commission's creation, external advisers and the CCSS assessed different aspects of the actuarial equilibrium. The ILO played a key role as an independent arbiter concerning the actual financial situation of the RIVM in order to reduce the initial distrust among some of the parties. Although projections varied by five years, the ILO validated key assumptions of the CCSS projections and, more importantly, helped civil society representatives understand why a parametric reform was much needed.

As mentioned above, longevity had increased—17 years since the 1960s—while the overall contribution to the RIVM had remained fixed at 7.5 percent since 1943. To compensate for this disparity, all parties agreed to increase contribution rates. They also agreed to discuss pension benefits for individuals retiring with more contributions than required. Based on these initial agreements, each sector defined what was or was not negotiable.[5] The main disagreements were over replacement rates.[6] The ILO's representative proposed an alternative, eventually supported by all parties, that would scale pension replacement rates according to workers' earnings; that is, the higher the income, the lower the replacement rate, and vice versa.[7]

The ILO's advisers created a working group, the Grupo Técnico para la Reforma de IVM (or the Technical Group) that worked with representatives from public institutions and civil organizations (but not the business sector or the *solidaristas*) to consolidate all of the measures that had been proposed up to that point (Grupo Técnico para la Reforma de IVM 2005). In 1995, after several meetings, the CCSS board of directors approved the proposal developed by the Grupo Técnico and supported by the Social Commission, with minor modifications. Table 12-2 compares the proposals in detail. The CCSS Pensions Management and Actuarial departments (not the government or the board of directors) had to retreat from a more severe adjustment in replacement rates and ended up maintaining different retirement ages for men and women.

Main Characteristics of the Adopted Reforms

The sections below explain the structural reform of 2000, address changes in requirements and benefits of the 2005 reform, and summarize measures adopted to improve administrative efficiency in both 2000 and 2005.

The 2000 Structural Reform [8]

After 2000, the LPT reform reorganized pensions around three complementary pillars, each based on five main parameters: (*a*) retirement age, (*b*) percentage of contribution, (*c*) number of contributions, (*d*) reference salary, and (*e*) pension replacement rates (FCN 1998). The percentage of contribution is distributed only among insured (third pillar), between employers and workers (second pillar), or among employers, workers, and the government (first pillar). The pillars are combined according to whom they cover: salaried population (first, second, and third pillars), self-employed (first and third pillars), or population in poverty (RNC) (see Figure 12-2).

The first pillar is DB and mandatory for salaried workers. With the passage of the LPT, it was set to become mandatory for self-employed workers as well. The second pillar is complementary, with mandatory DCs for salaried workers. The third pillar is complementary and voluntary, available to any person, employed or not. The RNC, targeted at people living below the poverty line, universalizes the first pillar for those aged 65 years and older who do not receive a contributive pension.

The first pillar is administered by the CCSS, the judicial branch, the Junta de Pensiones y Jubilaciones del Magisterio Nacional (National Teachers Assembly for Pensions and Retirement), the Instituto Nacional de Seguros (INS, or the National Insurance Institute), and, in the case of the transition system, the ministries of Labor and the Treasury. The second and third pillars are administered by corporations created by public (such as the

TABLE 12-2 Proposed and Adopted Measures for IVM Parametric Reform

Measures	*Pre-reform*	*Measures Proposed by the Business Sector*	*Measures Proposed by Labor Organizations*	*Approved*
(a) Normal retirement				
Retirement age	65	65	65	65
Number of monthly contributions	240	300	300	300
Contribution (distributed in a tripartite form)	7.50%	10.5% in 30 years; adjusted 0.5% for every 5 years	10.5% in 30 years; adjusted 0.5% for every 5 years	10.5% in 30 years; adjusted 0.5% for every 5 years
Reference salary	Best 48 out of last 60	Last 240	Last 240	Last 240
Real replacement rate (with 25 years)	56.55%	46.05%	Scaled, 58.70–46.50%	Scaled, 58.70–46.50%
Real additional amt after 240 installments	0.87%	1.30%	1.30%	1%
(b) Early retirement				
B.1 With more contributions	MRA differentiated by sex; 60 years for women and 62 years for men	Same requirements for men and women	MRA differentiated by sex; women make six fewer monthly contributions than men for all early retirement	MRA differentiated by sex; women make six fewer monthly contributions than men for all early retirement
B.2 With lower total pension	None	Only table for men and women	Differentiated table with 0.5% in favor of women	Differentiated table with 0.5% in favor of women

TABLE 12-2 (*Continued*)

Measures	*Pre-reform*	*Measures Proposed by the Business Sector*	*Measures Proposed by Labor Organizations*	*Approved*
(c) Reduced pension				
Reduced pension for those who contributed but did not reach required contributions for normal retirement	None	Yes, proportional to effective pension floor after 75% with 180 installments	Yes, proportional to effective pension floor after 75% with 180 installments	Yes, proportional to effective pension floor after 75% with 180 installments
(d) Measures for high-income sectors				
Incentives to make high-income sectors contribute	None	Eliminating pension ceiling	Establishing contribution ceiling	Pension management developed specific incentive plans

Sources: CCSS (2004*b*), CCSS (2005*a*), *Diario Oficial La Gaceta* (2005), and Grupo Técnico para la Reforma de IVM (2005).
Note: MRA = minimum retirement age.

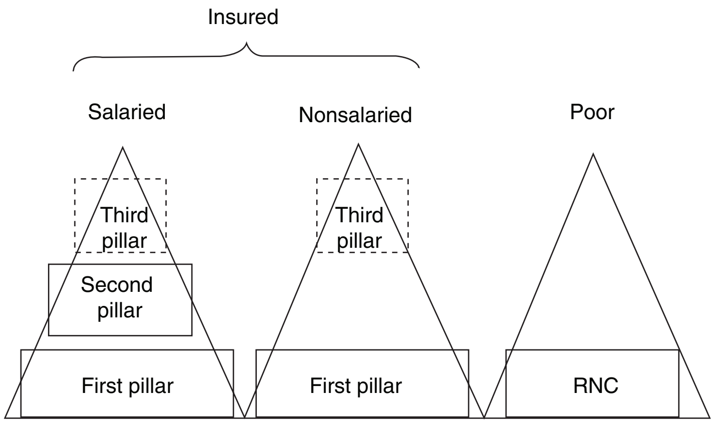

Figure 12-2. Multipillar system.

CCSS, Bancredito and Banco Popular) and private institutions. All are regulated by the state (Law 7983).

The First Pillar

Besides the RIVM, only four regimes provide first-pillar pensions: the judicial branch, the Régimen del Magisterio Nacional (teachers regime), the INS, and the transitional regime, financed by the national budget and closed to new contributors. Having relatively few special first-pillar regimes is a positive step, especially by Latin-American standards, toward achieving equal universal benefits because standard rules apply to as many people as possible. The two special regimes for judges and teachers have contribution and benefit rates higher than those in the RIVM.[9]

Formally, the RIVM promotes universalization and, along with the LPT, mandates insurance for self-employed workers (Law 7983). To that end, it offers both individual and collective insurance[10] and provides voluntary insurance to the non-EAP such as housewives and students.

The Second Pillar

The second pillar was created by the LPT as a mandatory complement to the first pillar for the salaried population. It is an individual capitalization regime—Fondo Obligatorio de Pensión Complementaria (FOPC, or Mandatory Complementary Pension Fund)—funded by 4.25 percent of a worker's total salary, with 3.25 percent coming from employers and 1 percent from workers (Article 9). Funding did not increase payroll taxes since contributions already made for other purposes were reallocated (Article 48). According to estimates, the FOPC will allow a replacement rate between 15 percent (for workers averaging less than 9 years of contributions) and 20 percent (for workers averaging 9 years or more of contribution) (SUPEN 2004).

The second pillar's funds are tax-exempt and belong to the insured, as is the case with third-pillar funds (see below). Workers can receive benefits as a life annuity or permanent annuity (Articles 68 and 73). The life annuity constitutes a monthly pension, from the day of the worker's retirement until his or her death (Articles 22–5 and Transitorio XIII). When the pensioner dies, the heirs do not receive any pension. The permanent annuity provides a pension during a period previously established with the insured—once it expires, the pension stops—along with an optional complementary disability and survivorship regime (Articles 27–9). If the pensioner dies before the end of this period, the total accumulated balance would be given to the beneficiaries (Article 29).

The LPT gives workers freedom of choice among administrators according to the limits and regulations determined by the SUPEN (Articles 2, 9, and 11). The administrators can be either privately or publicly owned firms and must be authorized by the SUPEN to operate.[11] They can be public institutions, public banks, social organizations, private banks, or occupational funds. The occupational funds created by state institutions or private companies can also become administrators (Article 75).

Since 2003 commissions have been assessed on both contributions and returns. Commissions range between 2 and 4 percent of a worker's contributions and between 6 and 8 percent of returns (SUPEN 2006).

In December 2006 there were eight administrators, six utilities to public banks and two to private banks (two of the original private administrators had merged). Workers who do not choose a fund are assigned to a designated public-sector administrator. Of the 1,542,151 affiliates in December 2006, 88 percent were with the state-owned public funds, Popular Pensiones and BN Vital (54.3 and 20.6%, respectively). Among privately held administrators, Interfin-Banex had the most affiliates, with less than 10 percent of the total (see Table 12-3).

Investments are mostly directed toward the public sector (85%). The law requires administrators to invest at least 15 percent in institutions belonging to the National Housing Financial System, which offers returns equivalent to the average return of other investments (Article 61).

If an administrator declares bankruptcy, an affiliate selects another administrator or is automatically assigned to one if he or she makes no selection (Article 44). If the administrator's assets are not enough to honor its obligations, the government must cover the remaining contributions

TABLE 12-3 Second Pillar Affiliation by Administrator: Absolute and Percentages (December 2006)

Administrators	*Affiliates*	*Percentage*
BN Vital	317,973	20.6
INS Pensiones	15,935	1.0
Popular Pensiones	837,882	54.3
Vida Plena	59,417	3.9
Interfin-Banex	127,552	8.3
BAC San José Pensiones	57,498	3.7
BCR Pensiones	106,369	6.9
CCSS OPC	19,525	1.3
Total	1,542,151	100.0

Source: SUPEN (2006).

and liquidate the administrator.[12] The government's guarantee is only partial since it does not include interest, and after 15 or 20 years of contributions, these will constitute the majority of the fund rather than the contributions.[13]

The Third Pillar

The third pillar has existed since 1995 (Law 7523), but the LPT brought it into the new multipillar system (Article 14 and following). It stimulates voluntary saving programs through fiscal benefits (Articles 69–73) and favors the creation of pension administrators, as was agreed in the FCN (1998, Agreements 63 and 87, described in Mesa-Lago 1998).

The 2005 Parametric Reform

The 2005 reform improved the equilibrium between the RIVM's contributions and expenses. The normal retirement age was kept at 65 years, but the number of required contributions increased from 240 to 300. Over a 30-year period, payroll contributions will increase from 7.5 to 10.5 percent, rising 0.5 percent every 5 years. Furthermore, workers now have an incentive to declare their wages because their benefits depend on their last 240 monthly real wages rather than the best 48 of the last 60 monthly nominal wages.

The primary innovation, however, concerns replacement rates. Before the reform, workers received a flat 52.2 percent of their real salary,

TABLE 12-4 IVM Contributors: Distribution and Shares of Total Income (2004)

Salary Group	*Workers*[a] *(%)*	*Total Salary (%)*
From 0 to < 2 minimum salaries	76	44
From 2 to < 4 minimum salaries	16	24
From 4 to < 6 minimum salaries	4	12
6 or more minimum salaries	3	20

Source: CCSS (2005*a*).
[a] The total is less than 100% due to rounding.

regardless of income levels. The reform scaled the benefits inversely to income levels—the lower the income, the higher the replacement rate—thereby making the system more progressive. The first salary group (zero to two minimum wages) includes almost 80 percent of CCSS contributors (who account for 44% of the CCSS income); 87 percent of all insured earn less than 3 minimum wages. On the other end, the top salary group (more than 6 minimum wages) includes 3 percent of the contributors (who account for 20% of total salaries). This very uneven distribution of income makes it possible to improve replacement rates among lower earners (see Table 12-4).

Table 12-5 presents the approved reform, distinguishing between the basic replacement rate with 240 contributions and the additional

TABLE 12-5 Benefit Levels According to Salary Scale in Adopted Parametric Reform (in %) (2005)

Salary Level, According to Number of Minimum Salaries	*Actual Real Basic Amount*		*Adopted Total Amount*	
	With 240 Contributions (20 Years) (a)	*With 300 Contributions (25 Years) (b)*	*Maximum Amount with 240 Contributions (20 Years) (c)*	*Maximum Amount. with Additional 1% (d)*
0 to <2	52.2	56.5	52.5	57.5
2 to <3	52.2	56.5	51.0	56.0
3 to <4	52.2	56.5	49.4	54.4
4 to <5	52.2	56.5	47.8	52.8
5 to <6	52.2	56.5	46.2	51.2
6 to <8	52.2	56.5	44.6	49.6
8 and more	52.2	56.5	43.0	48.0
Average amount	52.2	56.5	47.8	52.8

Source: CCSS (2004*b*).

replacement rate that includes an additional percentage for every 12 contributions beyond 240 (1% until 65 years of age and 1.6% afterward). A comparison of current and adopted replacement rates for people with 25 years of contributions shows that those who earn up to three minimum wages will have improved pensions. Columns (b) and (d) show an increase in pensions for up to 87 percent of the insured population, especially for the 78 percent with fewer than two minimum salaries. In these income brackets, the reform brings an average monthly increase of US$10 per insured person. The majority of workers with high incomes contribute for an average of 35 years. Therefore, their replacement rate effective loss will be less than that of those contributing for 30 years. Through a higher additional replacement rate, the reform provides an incentive for workers to contribute longer.

Early retirees get a full replacement rate if they make just under twice as many contributions as those required at age 65. This early retirement is useful for formal sector workers who start contributing very early in their careers, with high-average annual contributions, and who reach at age 60 or 62 years with many more contributions than required at age 65 years. The reform maintained early retirement but improved differential tables for men and women: at every age, women are required to make 6 fewer monthly contributions than men, therefore acknowledging, even if minimally, women's unpaid work.

Prior to the reform, individuals who did not make 240 contributions lost the right to a contributive pension, unless they could prove disability, which explains the high proportion of disability pensions, as discussed above. The new reduced pension recognizes contributions below the 300 contributions required for normal retirement, if the worker has made 180 contributions or spent 15 years contributing. The reduced pension is calculated as a proportion of the current minimum pension, and it begins after 75 percent of the minimum pension with 180 contributions and complies with ILO Agreement no. 102, which Costa Rica ratified. Finally, high-income workers are required to make contributions based on their full wages. However, when they retire, their pensions have a ceiling, which creates an incentive to underdeclare wages.

The reforms took effect in November 2006, 18 months after being approved by the CCSS. The transition rules vary by age group. For those older than 54 years, contributions and benefits did not change. For people between aged 45 and 54 years, changes take place gradually. For those younger than 45 years, all changes apply (*Diario Oficial La Gaceta* 2005). These age groups are equivalent to 7, 17.5, and 75 percent of the contributive population, respectively (Estado de la Nación 2005).

TABLE 12-6 Overall Costs as a Percentage of Salaries, without Estimating Effects of Administrative Efficiency Improvements

Year	*Pre-reform Situation* (*a*)	*With Proposal Supported by the Business Sector*[a] (*b*)	*With Proposal Supported by Labor* (*c*)	*With Adopted Reform (with Adjusted Assumptions)* (*d*)
2005	7.4	7.1	7.4	7.4
2010	7.5	7.1	7.4	7.4
2015	8.2	7.6	8.0	8.0
2020	9.6	8.6	9.0	8.8
2025	11.4	9.7	10.4	9.9
2030	13.1	10.4	11.8	11.0
2035	14.7	11.1	13.2	12.4
2040	16.2	11.9	14.4	13.7
2045	18.5	13.2	16.3	15.6

Source: CCSS (2005*a*).
[a] Column (b) underestimates the costs of proposal because it considers that pensions are adjusted according to a rate lower than inflation and that pension upgrading corresponds to 80% of living expenses, while others consider such revaluation to be 100%.

Contribution rates are expected to rise gradually over time. The gradual rise will help keep the funds reserve from being depleted. Table 12-6 shows projected contribution rates according to different proposals presented at the negotiation table as well as the one approved by the CCSS. The only estimate that took into consideration increasing administrative efficiency is the one formulated with the assistance of the ILO, according to which in 2035 increased administrative efficiency would lead contributions to decrease from 13.2 to 12.6 percent of wages.

Table 12-7 shows how the reforms averted potential financial crises. The first critical moment is postponed by 30 years; the second by 24 years; and the third by 26 years. Because the increase in contributions is gradual over 30 years, there are several years in which contributions are insufficient yet balance out during the following years. The reform achieves actuarial equilibrium of the RIVM during the next four decades, without considering the result of improving administrative efficiency, through nonparametric measures (primarily through increasing revenue collection and coverage), investment returns, and better administrative controls.

Improvements in Administrative Efficiency, 2000 and 2005

The LPT introduced a set of measures to improve revenue collection. First, it established a set of mechanisms to reduce evasion and income

TABLE 12-7 Financial Sustainability Projections without Considering Increase in Administrative Efficiency

Critical Moments	*Prereform Situation*	*Proposal of Pensions Management, Businessmen, and solidaristas*	*Proposal of INAMU, Unions, and Cooperatives*	*Adopted Reform*
Contributions insufficient to finance expenditures	2011	2047	2036	2041
Total inflows insufficient to cover total expenditures; reserves start to decline	2022	2053	2041	2046
IVM funds reserves running out	2028	2060	2049	2054

Source: Grupo Técnico para la Reforma de IVM (2005).
Notes: Base scenario estimated by ILO based on CCSS Actuarial Department's. It was not possible for the Actuarial Department to replicate estimates under an efficient administration scenario as developed by ILO for one of the scenarios.

underreporting. These measures introduced or strengthened rewards and punishments and complement existing judicial measures. They include: (*a*) requiring firms to be in full compliance with social security obligations before receiving government contracts, being eligible for tax cuts, or accessing public records; (*b*) strengthening CCSS supervision; (*c*) creating the Sistema Centralizado de Recaudación (SICERE, or Centralized Collection System); and (*d*) allowing the CCSS to crosscheck information with other public databases (Castro Méndez 2000).

Second, the LPT established new parameters and regulations for investments, which eliminated for the CCSS the investment ceilings defined by the Ministry of Treasury and allowed them to invest up to 15 percent in the national mortgage system.

Third, the LPT established a five-year deadline to complete coverage of self-employed workers and an August 2000 deadline to complete the master plan to broaden coverage, which was 6 months after the LPT took effect. Although the master plan to broaden coverage was not yet designed, the law still mandated that total coverage had to be achieved by August 2005.

Fourth, the LPT required that up to 15 percent of public institutions' profits go to finance the expansion of coverage for self-employed workers.

When the Social Commission began negotiations, there were no estimates regarding how well the goals of these measures were being fulfilled. Existing evidence showed that progress was uneven, much more so with the implementation of the SICERE (which was especially necessary to begin the second pillar's operation). There was also little evidence that coverage was increasing among the self-employed. This situation began to change only in 2004, when negotiations to modify the requirements and benefits of the RIVM had already begun. This lack of evidence of progress generated distrust among Costa Ricans concerning the new reforms discussed in 2004 and adopted in 2005, especially for the unions, which had been their main advocates.

The Grupo Técnico reached a compromise agreement that would increase coverage, reduce evasion, improve investment management, control disability pension expenditures, and collect complementary public funding (of up to 15% of profits from public enterprises). It forecasts an increase in contributions in 2010 based on an increase in coverage (at least 50% of the annual increase of the economically active population over 5 years). The CCSS board of directors approved these changes, which was noted in the official record of the meeting. However, these policies are not reflected in RIVM regulations, which could weaken compliance (CCSS 2005*b*).

Considerations about Implementation

The 2000 reform was highly effective in its structural component. The 2005 reform, which addressed nonparametric issues that had already been passed in 2000 but had not been implemented, is too new to be assessed. The CCSS is supposed to lead accountability meetings every 6 months; the first was held only in July 2006.

The participation of Instituto Nacional de la Mujer (INAMU) in the 2005 reform reflected the greater attention to gender issues than took place during the 2000 reform. Although not all of INAMU's proposals were adopted, it raised issues that had not been previously considered, such as the economic dependency of women,[14] and it argued in favor of women having the option for early retirement.

The role of civil society organizations was very intense during the design and adoption phases but was diluted during implementation. The technical staff of the CCSS had to make significant compromises during the first two phases. However, they regained control of the process during the implementation of adopted measures. It is too early to assess the gap between policy design and implementation.

Possible Directions for Future Reform

Because of the 2000 and 2005 reforms, the Costa Rican pension system is a hybrid of the original pension system created during the 1940s and a Chilean-style system adapted by successive reforms in countries like Argentina and Uruguay. Costa Ricans took the experience of other countries with their reforms and combined this information with innovations based on their country's own institutional legacy. An example of this innovation is the financing of the second pillar in conjunction with the reform of severance payments, as it is the link between parametric and nonparametric measures. Beyond specific policy measures, however, it is the involvement of social, business, and, more recently, gender-sensitive actors in policy reform that makes the Costa Rican pension system highly distinctive.

Under the current model, Costa Rica could move further toward achieving the principles of universality, fairness, and solidarity established in its political constitution. However, doing so would require additional adjustments in requirements and benefits based on scaled replacement rates. Among these changes, it would be necessary to improve incentives so that high-income workers would contribute to the first pillar, rather than evade or underreport income. It would also be necessary to draw on collective insurance programs already available to expand contributory coverage and family insurance, especially for women in the informal sector.

Whether Costa Rica will follow this path or not is not clear. So far, Costa Rica's pension reforms have taken place at critical junctures, when societal projects conflict (Seligson and Martínez 2005). Some policymakers would want to increase the importance of individual savings; others would like to eliminate or reduce the role of individual savings. For instance, the business and financial sectors are not fully satisfied with the minor role of individual savings. Unions are not happy with noncompliance with measures legally established to strengthen collective accounts. The reforms represented a compromise approved only after lengthy and arduous negotiation among key stakeholders that could have potentially vetoed the reform.

Notes

[1] Argentina and Uruguay are the other two countries in the region with mixed systems. Ecuador designed a system of this kind but at the publication of this book had not yet implemented it (Mesa-Lago 2004). The mixed system exists in at least

twelve European countries, making it the most widespread system outside Latin America (Mesa-Lago and Hohnerlein in Mesa-Lago 2002).

[2] See Rodríguez and Durán (1998) for a detailed discussion of the introduced reforms.

[3] In 1940, life expectancy at birth was 46.93 years compared to 78.7 in 2004 (Central American Population Program, discussed in Méndez and Araya 2001; Estado de la Nación 2005).

[4] The *solidaristas* are worker–employer mutual support organizations. Unlike unions, they cannot negotiate collectively (Law 6970).

[5] Employers established 1% as the largest increase in contribution fees that they could afford without losing competitiveness. Unions opposed a general reduction in pensions, while the INAMU, the agency promoting women's rights, stressed the need to maintain different requirements for men and women.

[6] One proposal—defended by management at the CCSS Pension Division, the CCSS Actuarial Department, the business sector, and the *solidaristas*—consisted of reducing the old-age pension replacement rate from 52.2 to 46.5%, reducing the disability pension replacement rates, and eliminating the difference in the requirements for early retirement for men and women (Comisión Técnica Institucional 2004).

[7] This measure was supported by one government representative (from INAMU), unions, and cooperatives. They discarded the reduction in disability pensions and proposed maintaining early retirement differences for men and women. Because measures already established in the LPT to run the CCSS more effectively had so far not been fully implemented, these organizations demanded that parametric changes be conditioned to the implementation of nonparametric changes (ANEP 2004; INAMU 2004).

[8] In this section, all law references correspond to the LPT unless otherwise indicated.

[9] For teachers, the replacement rate is 80% and the contributions are 8% (workers), 6.75% (employers), and 0.25% (government) (Law 7531 1995, which reformed Law 2248). In the judicial branch, the contributions are 9% (workers), 11.75% (pensioners), 11.75% (employers), and 0.25% (government). They retire at age 62, after 30 years of service, with pensions equal to the average of the best 12 out of the last 24 salaries, or with the required years of service and/or under 62 years (Law 7333).

[10] Through 150 ongoing agreements, collective insurance only covers about 32,000 people, comprising 2% of the working population (Martínez Franzoni 2005*b*).

[11] LPT, Articles 30–8, 41, 42, 44, 45, 46, 54, 55, and 58–66.

[12] The law established the shared responsibility of the administrators and authorized social organizations for harm and damages that result from fraud committed by the members of its board of directors, employees, or promoters (LPT Articles 40 and 41).

[13] For example, after its ninth year, 38.47% of the funds are contributions and 61.53% are interest. It is projected that in its 30th year, 4.4% will be contributions and 95.6% interest (Castro Méndez 2000).

[14] Regardless of the growing number of women in the economically active population, women largely continue to access the pension system as economic dependents.

The RIVM discourages contributions from women because declaring a remunerated job, even if it is marginal, results in losing insurance as a dependent. Furthermore, it is likely that most women lack sufficient information to calculate the difference between the total pension for widowhood and their own contributive pensions. Among other proposals, the INAMU insisted on exploring the combination of contributive insurance (in pensions) and family insurance (in health).

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