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Chapter 14

Uruguay: A Mixed Reform

Rodolfo Saldain

Introduction

Toward the late nineteenth century and the beginning of the twentieth, Uruguay was among the first countries in the hemisphere to introduce pensions. However, during the latter half of the past century, social insurance went through an extensive period of retrenchment as the maintenance of generous social security benefits became incompatible with chronic economic stagnation.

Although international organizations like the ILO urgently recommended reform as early as 1964, it was not until 1979—during the military dictatorship—that some parametric changes were introduced. By then, the relatively generous benefits combined with an aging population had resulted in the actuarial bankruptcy of the pension system. An insolvent social security system, covered by government transfers, represented around 2 percent of GDP during the 1970s, equivalent to a little more than 20 percent of central government expenditures (see Table 14-1).

In the beginning, the strategies for confronting the crisis included raising worker and employer contribution levels, which came to represent about 8 percent of GDP by the end of the 1970s. Funding was insufficient, however, and the purchasing power of pensions declined systematically. This ended in 1989 with a constitutional reform that increased the budget for pensions to approximately 15 percent of GDP.

In 1995 the third elected government after democracy was restored in 1985 approved a new structural reform. The new model is innovative in that it maintained continuity with the Uruguayan statist tradition yet still followed the regional trend toward privatization. The new system is mixed. The main component, or first pillar, is pure PAYGO with respect to contributions, benefits, and administration. The primacy of the first pillar will be maintained even after the mixed system reaches maturity, around the year 2020.

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TABLE 14-1 Central Government Expenditures on Social Security (1,000s of Nominal Pesos)

Year	*Central Government Outlays on SS*	*Central Government Total Indexed Outlays*[a]	*Weight of SS Expenditures on Central Government Nominal Outlay Structure (%)*
1974	103,594.35	438,426.11	23.63
1975	113,533.83	457,518.80	24.82
1976	115,718.16	505,420.05	22.90
1977	128,118.39	590,697.67	21.69
1978	157,635.47	667,816.09	23.60
1979	210,318.47	928,152.87	22.66
1980	506,923.08	1,439,252.75	35.22
1981	634,288.35	1,740,397.41	36.45
1982	870,237.24	1,977,217.83	44.01
1983	389,548.35	960,026.06	40.58
1984	298,485.12	901,067.55	33.13
1985	261,358.04	824,007.10	31.72
1986	276,970.14	965,530.85	28.69
1987	347,568.02	1,155,166.03	30.09
1988	396,553.07	1,254,071.50	31.62
1989	414,926.26	1,327,575.10	31.25
1990	378,246.02	1,322,066.52	28.61
1991	512,216.11	1,628,395.94	31.46
1992	709,677.27	1,987,605.18	35.71
1993	943,049.01	2,392,113.32	39.42
1994	1,238,793.63	2,934,836.78	42.21
1995	1,441,247.43	3,334,299.68	43.22
1996	1,712,481.27	3,681,136.15	46.52
1997	1,894,431.05	4,018,069.40	47.15
1998	1,972,784.57	4,132,022.44	47.74
1999	2,090,238.10	4,353,561.82	48.01
2000	2,056,682.64	4,269,617.13	48.17
2001	1,989,804.10	4,176,206.71	47.65
2002	1,439,320.12	3,169,018.31	45.42
2003	1,109,256.44	2,759,290.02	40.20
2004	1,154,658.82	2,992,841.55	38.58

Source: Author's computations, based on projections from the Instituto Nacional de Estadistica (National Statistics Institute).

[a] Does not include investment outlays.

Although the pension system survived the largest financial crisis in the country's history in 2002, it faced a political challenge when the left Frente Amplio coalition came to power in 2004. The Frente Amplio had systematically opposed the pension reform since its inception, and some sectors of the coalition demanded the abolition of certain structural components, such as the participation of *administradora de fondos de ahorro provisional* (AFAPs, or private retirement saving fund administrators). Thus far, there has apparently been no political attempt to alter the reform, as the government has focused on developing a hospitable environment for foreign and local investment.

Historical Evolution of the Pension System

In Uruguay's coverage of old-age, survivorship, and disability risks (Sistema de Invalidez, Vejez y Sobrevivencia, or IVS) started soon after independence in 1829. In 1896 the first protection system based on the Bismarckian model was created; it covered retirement for teachers, who were considered an essential human resource in the creation of the new nation-state.

After a series of armed conflicts ended in 1904, Uruguay went through an extensive period of democratic political stability—albeit with two limited episodes of instability in 1933 and 1942—distinguished by a multiclass and bipartisan political system.[1] In this context, a vast network of social security institutions developed that recognized workers' rights. All workers were gradually incorporated into this network. In 1943 rural workers were incorporated, representing the last large and significant sector of the labor force, and in 1954 coverage for old-age, survivorship, and disability was extended to all primary wage-earning employment.

After the foundation and development periods of the Uruguayan social security system, a long period of decline began in the mid-1940s, provoking a crisis in the system. The state apparatus became an arena of political conflict among the two traditional 'catch-all political parties', especially with respect to the social security system. During this period, several special pension systems were developed as a result of negotiations and bargaining processes, and political clientelism in the social security institutions covering IVS risks became common practice.

The Crisis

These circumstances, along with inefficient investment policies of the initial reserves, tax evasion, poor administration, and a demography characterized by low-birth rates and high life expectancy combined with economic stagnation and slow growth, led to the financial and social crisis of the system.

In 1963 an ILO report stated that 'it is no longer enough to apply palliative remedies to improve the situation. Instead there should be a radical change in the direction and implementation of social policy in order to avoid the total social, administrative, and financial collapse of the Uruguayan social security system' (OIT 1964: 64–71).

For at least three decades, the predominant policy was to maintain the formal–legal parameters of the social security system that promised access to generous benefits, while in practice the value of those benefits fell due to insufficient cost of living adjustments in an environment of high inflation. The political leadership typically denied the problem in order to avoid actions that would carry political or electoral costs. The government coped with the financial disequilibria of the pension system by (*a*) cutting the value of pensions in real terms,[2] (*b*) not paying all legally owed benefits, and (*c*) generating fiscal deficits in order to cover financial obligations.

During the military dictatorship that ruled from 1973 to 1984, there was a clear concentration of power. Although an important parametric reform in 1979 corrected some of the system's main shortcomings, there was no structural reform as in Chile. The regime that resulted from the 1979 reform (which endured through 1995) was pure PAYGO, with no accumulation of reserves. It was centralized in the executive branch and financed through worker, employer, and government contributions. The results of this reform still resonate among the retired population, and the worker/beneficiary ratio is likely to rise slightly through 2010, after which the ratio is expected to deteriorate at a constant rate, according to all projections.

The 1989 Constitutional Reform

In the early years following the return to democracy (1985–9), there were strong demands for benefits, in particular for pension increases. During that time, pensioner organizations emerged as a new social movement (see Papadopulos 1992: 158–77). These groups formed alliances with other political actors and demanded higher benefits, while at the same time radically defending the public PAYGO system.

In 1989 pension organizations and their allies successfully sponsored a plebiscite that amended Article 67 of the Constitution. Eighty percent of the electorate supported the initiative, which is still in effect today.[3] This article determined that pensions would be adjusted according to the variation in the median salary index and would go into effect concurrently with salary increases for employees of the central government. Fiscal balance was maintained only because of insufficient adjustment in a context of high inflation (which of course reduced the buying power of benefits). The new regulation altered one of the variables essential to the pension system's financial equilibrium: the ratio of the average benefit over the average contribution base salary.[4] In 1989 the average benefit was 58 percent of the average contribution base salary; this figure jumped to 77.5 percent in 1991, the first full year of reform. That rapid jump meant that additional resources equivalent to a 10-percent increase in the salary contribution rate were necessary. Consequently, the annual Banco de Previsión Social del Uruguay (BPS) pension budget rose from 7.7 percent of GDP in 1989 to 9.7 percent in 1991, and to more than 11 percent in 1994. (The BPS is Uruguay's Social Security Bank.)

There were only two administrative options to ease the excessive increase in the pension budget: (*a*) reduce the value of the national minimum wage, which was the measurement unit used to express pension ceilings and other social security benefits, or (*b*) moderate salary increases, especially for state workers, because of their direct impact on both the national budget and the median wage index, on which pension increases were based. To generate more income, the government declared a crackdown on evasion. Results were positive, though limited by the fact that structural conditions for evasion persisted.

Toward the 1995 Structural Reform

One virtue of the constitutional amendment of Article 67 was that it brought national attention to the challenges of social security reform. It was impossible to continue postponing difficult reform decisions by allowing inflation to limit benefits. The magnitude of the problem demanded that the government find the political will to implement difficult measures in the face of powerful interest groups opposed to reform. Various proposals were suggested based on foreseeable demographic trends and pension system indicators. By all accounts, the system appeared to be moving rapidly toward a financial crisis in the first decade of the next century.

After two failed attempts to introduce some parametric reforms in 1990, the Lacalle administration summoned political leaders and representatives of social sectors to discuss the magnitude of the problem, even though its major impact would largely fall on future governments. The administration proposed four objectives for the social security reform: (*a*) improve social equity and individual fairness, (*b*) establish total financial transparency, (*c*) achieve adequate financing of the programs administered by the BPS, and (*d*) improve the adequacy of the financial structure. They added four alternative proposals for analysis:

1. Maintain the current system, but modify the procedure used to calculate the base reference salary and the replacement rates;[5]

2. Create a new regime financed through individual capitalization. In this case, it would be necessary to define ways to finance transition costs[6] and the legal nature of the new pension fund administrators;
3. Create a new pension system based on individual accounts but financed via PAYGO;[7] and
4. Create a new two-tiered pension system that would include a state-managed PAYGO system with benefits clearly lower than those of the current regime,[8] and a second tier based on individual capitalization, with pension fund administrators operating in a competitive market.

In 1992 there was substantial progress toward reaching a political accord. However, the left-wing Frente Amplio systematically opposed all social security reform initiatives. Ultimately, the Chamber of Deputies did not approve the project. That same year, the legislature (without the support of the left-wing parties) agreed to modify the procedure to calculate pensions, but a 1994 plebiscite later reversed that modest reform and the Supreme Court found it unconstitutional.[9]

The 1995 Reform

Negotiations over social security reform began in January 1995, after Julio María Sanguinetti began his second term. An agreement soon resulted, though it again did not have the support of the Frente Amplio.[10] Political agreement was hastened by the fact that the technical and political teams working on the reform had worked together in prior years.

The Design of the 1995 Reform

The reform, centered on the idea of a mixed system, consisted of a traditional state-managed PAYGO pillar and a mandatory, private, individual saving accounts pillar under private management, with old-age, disability, and survivor's insurance financed out of savings.[11] In the new multipillar system, workers contribute to each fund according to where their income falls within a salary-level band. Additionally, the public sector participates by providing a basic safety net pension (PAYGO system) to complement the mandatory system of individual capitalization, administered by AFAPs and insurance companies.[12]

Studies conducted in 1991 and 1992, which analyzed the financial feasibility of the new mixed system, suggested the need to reduce the fiscal impact of the transition. As a result, the reform was oriented toward (*a*) the mandatory incorporation into the new mixed model of only the younger population (younger than 40 years), and (*b*) a PAYGO component large enough not to affect benefits for workers still acquiring rights—that is, those workers who had paid into the old system but had not yet qualified for benefits.[13] The ceiling proposed at the first level (PAYGO) was very similar to the one in the old system, but with more stringent conditions with respect to age and years of services. It was not necessary to acknowledge previous contributions because older workers and those who had contributed for a longer time could not be affiliated in the new system, unless they wanted to contribute to a voluntary supplemental account. In addition, the size of the first level—with relevant parametric changes—covered practically the entire sum of benefits owed under the previous regime, leaving unaffected the benefits that current workers were still acquiring.[14]

According to Caristo and Forteza (2003), the 1995 reform and later adjustments to the social security policy first increased and later decreased the financing that the BPS required.[15] In the first few years, the deficit increased by more than half a point of GDP, mainly as a consequence of decreasing the contributions withheld by the BPS. This situation changed in later years, since financial obligations decreased as outlays decreased. The improvement of the BPS financial results in the medium and long term is mainly a result of decreasing payouts to people who had obtained benefits without ever having contributed. According to the projections, from the second decade of this century on, central government debt will be less than if the reform had not taken place.

Multilateral credit organizations had a limited role in the conception and design of the reform initiatives. Even at the World Bank there was opposition to the proposed system at the beginning. On the other hand, at the end of 1994, a consultant group from the Inter-American Development Bank led by Francisco E. Barreto de Oliveira provided an important study of policy alternatives, including an analysis of the feasibility of a mixed system.

General Characteristics

The 1995 reform exclusively applies to BPS affiliates and provides for the existence of three regimes: the previous, transition, and mixed:

- For those affiliates with acquired rights in the old regime as of December 31, 1996, the old system was maintained with no risk of having the new regime applied to them, unless it would be more favorable;
- For affiliates aged 40 years or older by April 1, 1996, special transition rules were established through a parametric reform of the PAYGO system; and

- For affiliates younger than 40 years by April 1, 1996, for those entering the labor force for the first time, or for those (mentioned above) who voluntarily opted for it, the mixed model applies. The option for the mixed model is irreversible.

Regardless of the applicable regime, only work history registered after April 1, 1996 would be recognized. The BPS keeps this history—which includes time of service, remunerations, contributions, and other required information—and updates it monthly. According to the institutional organization of the 1995 reform, the Ministerio de Trabajo y Seguridad Social (MTSS, or Ministry of Labor and Social Security) is responsible for social security policy. The BPS is in charge of the previous system, transition system, and the first pillar of the mixed system. It is also responsible for collections, including contributions to the second pillar destined for individual accounts of the AFAPs' affiliates. The Banco Central del Uruguay (BCU, or Uruguayan Central Bank)—an autonomous organization with public resources—supervises the new social security participants (AFAPs and insurance companies) based on the creation of the mandatory individual savings pillar. For special services provided to specific groups, there are three parastatal pension funds (*cajas*),[16] as well as military and police pension funds.

The effective implementation of the reform was coordinated by the Planning and Budget Office through two ad hoc committees: the Evaluation and Follow-Up Committee and the Social Security Reform Program.

The Transition Regime

The transition pension system—for those not already retired under the old system or part of the new mixed system—includes a parametric reform. It is a modified version of the old system, and its regulations are similar to those of the first pillar in the mixed system. The new system (*a*) is based on a PAYGO system; (*b*) gradually increases the retirement age for women by 5 years until it is equal to that of men (60 years); (*c*) increases by 5 years the minimum number of years of service necessary to have pension rights (to 35 years); (*d*) increases to 20 years the period used to calculate the base reference salary;[17] (*e*) reduces the replacement rate; (*f*) increases by up to 120 percent the pension floor; and (*g*) progressively increases the pension ceiling by about 60 percent. This system, exclusively PAYGO, will apply to the great majority of new pensioners until about the year 2020.

The Mixed System

The first pillar includes, without exception, all affiliates in the mixed system for the first UY$5,000 of monthly earnings in May 1995 values

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TABLE 14-2 General Regime

Remunerations	*Contributions*	
	BPS	*AFAP*
UY$12.525 US$521	Yes	Optional
UY$12.525–$37.573 US$522–US$1,565	No	Yes
UY$37.573 US$1,566	No	Voluntary

(equivalent to about US$520 monthly in 2005). The second pillar includes BPS affiliates for the band of salary UY$5,000 and UY$15,000 (equivalent to about US$1,560 monthly in 2005 see Table 14-2). It also includes affiliates with income lower than UY$5,000 who voluntarily opt to affiliate with the second pillar, depositing half of their contribution to each pillar (the decision is irrevocable).[18] There is also a third pillar for voluntary savings open to BPS affiliates for the band of salary over UY$15,000 per month. (All values are expressed in pesos, adjusted automatically according to the median salary index every time public salaries and pensions increase.)

Financing is based on the following:

- Employee contribution of 15 percent of salary up to the pension ceiling, with earnings up to UY$5,000 to the public pillar and earnings between UY$5,000 and UY$15,000 to an individual account.[19]
- Employer contribution of 12.5 percent—or 14.5 percent for public sector employers—up to UY$15,000 maximum earning deposited to the BPS (PAYGO system, first pillar).
- Central government contribution, if needed to supplement the finances of the BPS.

Current pensions and those to be paid in the future by the old rules, transition, and first pillar of the mixed system are paid by BPS.

The second pillar of the mixed system entitles only authorized insurance companies to issue life annuities. This component of the mixed system is fully integrated with the first pillar, since to have access to these benefits it is necessary to receive first pillar benefits. The only exception is for people older than 65 years, who can collect their second pillar benefits without contributing, while continuing their employment. If a worker dies without naming a survivorship beneficiary, the personal account balance can be inherited.

Benefits under the second pillar are the same as in the first pillar with two different procedures:

- Defined contributions, or individual savings, covering the risk of old age (ordinary retirement and extreme old age). In this case, the amount of the benefit is not legally defined, neither in absolute nor relative terms. It is calculated based on individual savings account balances to the date funds are transferred from the AFAP to the insurance company chosen by the affiliate, life expectancy according to general official tables, and life annuities' acquisition terms with the insurance company.

- Defined benefit, or group insurance, for disability and death-at-work coverage. In this case, the amount of the installment is legally defined in relative terms: a determined percentage from a determined calculation base. For the disability pension and the transitory subsidy for partial disability, benefits equal 45 percent of monthly base salary (on which contributions to an AFAP savings account were based on the past ten years of activity, or real time of contribution if less than ten years). For survivorship pensions, the same pension allotment percentages from the first pillar apply. This insurance is contracted by AFAPs with an authorized insurance company.

The BPS is responsible for paying all benefits in the first pillar, while insurance companies pay second pillar benefits, either those covered by collective insurance or the life annuities to be contracted by affiliates.

Retirement Saving Fund Administrators

As is discussed above, the AFAPs—single-purpose corporations authorized by the executive branch and the BCU—administer the private savings.[20] Each AFAP administers only one retirement savings fund. AFAPs are regulated by the superintendency of the BCU. They compete for affiliates, who can transfer their accounts from one administrator to other after contributing for at least six months. The AFAPs invest available pension fund savings and maintain updated individual savings accounts data. One hundred percent of fund investment returns are credited to the affiliates' accounts.[21] The investment funds are regulated as an administration trust. They are the property of the affiliates and are not part of the AFAPs' assets (and thus cannot be legally attached).

Collections are centralized under the BPS, which transfers affiliate contributions to the AFAPs. This method of organizing the collection process is considered one of the elements of cost rationalization, since it prevents duplication of effort for administrators and employers. In 2005 the BPS began to charge AFAPs for this service. AFAPs receive a commission for their work as the only payment from their affiliates for their services. Commissions are set freely according to the following rules:

- All affiliates are charged the same commission, except for bonuses for staying with an AFAP, as explained later;
- Commissions are charged only on mandatory contributions and voluntary deposits.
- Commission charges are not imposed on transfers from one AFAP to another, nor are they charged on account returns;
- Commissions can be a fixed amount, a percentage of the worker contribution, or a combination of these two; and
- AFAPs can provide bonuses for customer loyalty.

The law requires investment guidelines aimed at security, profitability, diversification, and term compatibility criteria based on objectives and investment limits found in the legislation (Table 14-3).

Implementation of the 1995 Reform

The 1995 reform implementation had to resolve several critical issues, some derived from the peculiarities of its own design, others from its partial introduction into the financial markets, and others due to its political and social acceptance.

Design Challenges: Central Role of Public Institutions

From an operational perspective, there were two especially relevant characteristics. The first—and most important—was the capacity of the BPS to administer the new mixed system. The BPS had six months to undertake a process in which it needed to account for the labor history of all active workers, establish adequate processes for collecting revenue, and create a process whereby contributions from affiliates in the mixed regime would be distributed to AFAPs according to individual choices. Unlike most reforms introduced in the region in the 1980s, which stressed the role of the private sector, the 1995 Uruguayan reform gave to the BPS, the central public pension administrative institution, the central role in the implementation and administration of the reform.

The second characteristic was the creation of a publicly owned AFAP, though it was fully governed by private law. This AFAP had to be fully operational when the reform took effect and could not repeat the classic inefficiencies of the public administration. From the start, workers flocked to the publicly owned República AFAP, making it the market leader. This leading role for a publicly owned AFAP has been one of the most notable developments of the reform implementation process.

TABLE 14-3 Social Security Savings Fund Assets Consolidated and by AFAP

	System		*Afinidad*		*Integración*		*República*		*Unión Capital*	
	Thousands of Pesos	*% s/total*	*Thousands of Pesos*	*% s/total*	*Thousands of Pesos*	*% s/total*	*Thousands of Pesos*	*% s/total*	*Thousands of Pesos*	*% s/total*
Resources available	4,705,871	9.98	589,794	7.01	322,912	8.12	2,887,196	10.87	905,969	11.1
National currency	820,278	1.74	51,622	0.61	91,751	2.31	610,110	2.30	66,795	0.82
Foreign currency	3,885,593	8.24	538,172	6.40	231,161	5.81	2,277,086	8.57	839,174	10.28
Investments	42,429,893	90.02	7,823,148	92.99	3,654,353	91.88	23,692,747	89.14	7,259,645	88.9
National currency	24,202,523	51.35	4,578,017	54.42	2,039,376	51.28	13,633,499	51.29	3,951,631	48.39
Uruguayan pesos	1,941,654	4.12	86,388	1.03	56,922	1.66	1,738,113	6.54	51,231	0.63
Ind. for Inflation	22,260,869	47.23	4,491,629	53.39	1,973,454	49.62	11,895,386	44.75	3,900,400	47.77
Foreign currency	18,227,370	38.67	3,245,131	38.57	1,614,977	40.61	10,059,248	37.85	3,308,014	40.51
Fund's total assets	47,135,767	100	8,412,942	100	3,977,264	100	26,579,946	100	8,165,614	100
Special reserve	240,911	0.51	43,059	0.51	19,913	0.5	136,160	0.51	41,779	0.51
FAP [a]	46,894,856	99.49	8,369,883	99.49	3,957,351	99.5	26,443,786	99.49	8,123,836	99.49

Source: Author's computations, based on BCU quarterly bulletins (*Memoria Trimestral del Régimen de Jubilación por Ahorro Individual Obligatorio*, various issues).

Note: Values to June 2005.

[a] FAP = *fondos de ahorro provisional*, or pension fund.

Introduction into the Financial Markets

The new capitalized pillars now required a complete introduction into the financial system. The system provided for a competitive market in which AFAPs would compete for affiliates, as in other countries in the region. When the reform took effect in April 1996, five AFAPs began operations; shortly after, a sixth firm entered the market. Since that time, only mergers have taken place; with severe barriers to entry in a small market with low new enrollment and few transfers, no other firms have entered the market. Today, there are four AFAPs: República, Afinidad, Unión-Capital, and Integración (see Table 14-4).

By June 2005, AFAPs administered US$1.678 billion, equal to 11.7 percent of GDP (see Table 14-5). República AFAP, which is owned by 3 state-owned firms, managed 56.5 percent of these funds, a share that was relatively constant during the 10 years after the reform. Fifty-three percent of the assets were in Uruguayan pesos and 47 percent in US dollars, while 81 percent of assets were invested in Uruguayan public debt titles. Since the system came into effect, the profitability of the funds in US dollars has been 9.59 percent annually and 12 percent in indexed Uruguayan pesos. Returns vary little among AFAPs due to legal regulations that led to the homogenization of investment policies and the lack of appropriate investment instruments, which in turn has contributed to a concentration of investment in instruments issued by the public sector.

For the 10 years after the reform, the 672,080 AFAP affiliates (as of June 2005) were distributed among the 4 AFAPs in a relatively stable pattern. República AFAP consolidated its lead, with slightly more than 37 percent of the affiliates. In looking at affiliate salary levels, República AFAP has been the leader among affiliates with higher salary levels. During the first four years of the reform, the AFAPs competed intensely to encourage affiliates to transfer to their firms. Firms employed large sales forces at very high costs and ended with essentially null results, as market shares remained stable. Toward the end of 2000, the six operating AFAPs agreed to end this strategy. Transfers came to a halt, making it clear that affiliation or transfer decisions are not sensitive to product differences. For example, there are differences in commission fees, but they do not seem to have an impact on an individual's decision to change or stay in the same AFAP.

AFAPs charge an administration commission, which since the beginning of the system has averaged from 1.58 to 2.25 percent of a worker's salary.[22] Since 1996, the group insurance for death and disability, which AFAPs contract for their affiliates, has ranged from a minimum value of 0.553 percent in 1998 to a maximum value of 1.165 percent in 2003. Charges from the second pillar of the mixed system do not have a regulated fixed ceiling. In

TABLE 14-4 Affiliate Distribution by AFAP: Market Concentration (through December of Each Year)

	1996	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*[a]
Tot. affiliates	300,798	442,903	499,865	531,190	565,324	593,736	613,432	632,330	655,204	672,080
Share by AFAPs										
Capital (%)	8.75	11.78	12.47	12.76	13.42	—	—	—	—	—
Comercial (%)	16.87	16.25	17.34	17.27	17.92	—	—	—	—	—
Integración (%)	15.93	15.02	14.29	13.61	13.29	13.22	13.27	13.59	13.98	14.16
República (%)	39.49	36.81	37.29	37.93	37.64	37.74	38.14	37.98	37.77	37.66
Santander (%)	13.49	14.48	12.85	12.64	11.93	—	—	—	—	—
Unión (%)	5.47	5.65	5.76	5.79	5.80	—	—	—	—	—
Afinidad (%)	—	—	—	—	—	29.72	29.51	29.41	28.89	28.65
Unión Capital (%)	—	—	—	—	—	19.32	19.08	19.02	19.36	19.53
Total (%)	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Avg. HHI	0.239	0.223	0.225	0.228	0.227	0.286	0.287	0.285	0.283	0.282

Source: Author's computations, based on BCU Quarterly Bulletins.
[a] Values to June 2005.

Table 14-5 Social Security Savings Fund (FAP[a])

	1996	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*
FAP[a] by AFAP in Thousands of Dollars									
Capital	3,146	13,011	25,420	40,320	70,356	n/a	n/a	n/a	n/a
Comercial	5,311	18,769	40,343	65,292	81,983	n/a	n/a	n/a	n/a
Integración	4,508	19,000	39,994	56,984	68,917	87,181	75,488	102,529	140,572
República	29,880	109,501	206,157	331,463	454,491	590,195	508,058	700,479	948,815
Santander	6,865	24,035	40,961	54,557	69,973	n/a	n/a	n/a	n/a
Unión	644	6,185	21,472	42,545	65,306	n/a	n/a	n/a	n/a
Afinidad	n/a	n/a	n/a	n/a	n/a	190,598	159,225	218,232	299,309
Uni. Capital	n/a	n/a	n/a	n/a	n/a	177,428	150,593	210,838	289,564
System	50,355	190,501	374,347	591,161	811,026	1,045,402	893,364	1,232,079	1,678,261
FAP as % of GDP	0.3	0.9	1.7	2.9	4.2	5.9	9.3	10.4	11.7
AFAP Market Share in Percentages									
Capital (%)	6.2	6.8	6.8	6.8	8.7	n/a	n/a	n/a	n/a
Comercial (%)	10.5	9.9	10.8	11.0	10.1	n/a	n/a	n/a	n/a
Integración (%)	9.0	10.0	10.7	9.6	8.5	8.3	8.4	8.3	8.4
República (%)	59.3	57.5	55.1	56.1	56.0	56.5	56.9	56.9	56.5
Santander (%)	13.6	12.6	10.9	9.2	8.6	n/a	n/a	n/a	n/a
Unión (%)	1.3	3.2	5.7	7.2	8.1	n/a	n/a	n/a	n/a
Afinidad (%)	n/a	n/a	n/a	n/a	n/a	18.2	17.8	17.7	17.8
Uni. Capital (%)	n/a	n/a	n/a	n/a	n/a	17.0	16.9	17.1	17.3
Sistema (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Author's computations, based on BCU Quarterly Bulletins.

Note: Values are through December of each year. n/a=not applicable, because either the FAP has not been created or it has merged with another.

[a] FAP= *fondos de ahorro provisional*, or pension fund.

a small market such as Uruguay's—with only four participants—it is reasonable to think that price agreements or other anticompetitive practices are likely to occur.

Given the recent implementation of the system, benefits to be paid from the second pillar are still rare. Through June 2005, there were 4,002 cases, mainly survivorship pensions.

In 2002, six years after the reform, the second pillar successfully faced the deepest financial crisis in the history of the country. The crisis, which had two phases, could have severely damaged the reform. The first phase was based on criminal actions involving the management of two banks that owned AFAPs—100 percent of an AFAP in one case. The second was the result of the bank run that led to the closure of three of the largest banks, the public banks' failure to meet depositors' demands for withdrawals, and the fiscal crisis that forced a restructuring of long-term public debt as an alternative to default. The institutional structure of the second pillar meant that the criminal actions of the two private banks owning AFAPs had no impact whatsoever on pension funds. At the same time, the Batlle administration's solution to the 2002 fiscal crisis, which had the strong support of the US government and multilateral credit agencies, prevented damage to pension fund assets that were largely invested in Uruguayan public debt.

Political Opposition

From a political perspective, the reform had to overcome the strong opposition generated by the unions, pensioner organizations, and, especially, the Frente Amplio. These social and political organizations developed a campaign against the reform, but opponents fell just short in their campaign to collect enough signatures to turn the issue into a popular referendum.

Possible Future Trends

In March 2005 the leftist candidate, Tabaré Vázquez, assumed the presidency, and the Frente Amplio coalition won a legislative majority in both houses. This party has been highly critical of the 1995 reform. With a wide legislative majority, President Vázquez's administration could redirect policy. Questioning the social security reform was part of its political strategy, as it focused on restoring the classic characteristics of the Uruguayan welfare state, which has a strong hold on the Uruguayan collective imagination. During its ten years of opposition to the 1995 reform, the left did not provide an alternative project. During the 2004 electoral campaign some sectors of the leftist coalition—including their own candidate and the current president of the Republic—admitted that they would not abrogate the 1995 reform but would instead introduce some adjustments. This position was rejected by some members of the coalition, who continue to call for the reform's demise.

In its first two years in office, the Vázquez administration focused on improving the business climate. Maintaining the basic characteristics of the 1995 reform is an important step toward reaching that goal. Introducing adjustments to its design to improve the reform's efficiency is perfectly compatible with this goal. Among the options it could consider are (*a*) allowing for the administration of more than one investment fund, with different degrees of risk; (*b*) redefining voluntary savings regulations; (*c*) modifying insurance companies' regulations regarding life annuity calculations, including separating technical reserves into trusts separate from other insured risks; and (*d*) making the BCU superintendency of pension funds autonomous to avoid potential interference from other BCU sectors that have competing policy interests.

At the same time, AFAPs could be permitted to invest between 10 and 15 percent of funds outside the country. This measure, which is strongly supported by the AFAPs, has encountered stiff political opposition and does not currently seem viable.

A new administration considering socially oriented reforms could take two actions: make access to old-age pensions more flexible by allowing retirement after less than 35 years of service—for example, at age 65 years—and re-examine the income-tested noncontributory pension program, also administered by the BPS, and adapt it to the new context of contributive benefits, in which it will no longer be possible to easily obtain a pension without having contributed. With this perspective, it is necessary to guard against two risks: first, the temptation to direct the funds toward social spending at the expense of profitability and security and, second, to favor a greater market concentration, which would benefit República AFAP.

Indeed, if the new administration gives in to forces favoring the rollback of the 1995 reform, the most powerful tool to carry that out would be to promote market concentration, which would work to the detriment of the private administrators. Because it is better able than its competitors to reduce commissions, República AFAP could withstand this change. If competition among administrators disappears because of market rules, the model would lose part of its mixed character. Pension fund administration would be concentrated in the hands of public agencies, which would probably increase the political and financial risks inherent to the system.

If the political and legislative will were there, the relative weights of PAYGO versus savings components could be modified, giving PAYGO greater weight. In the short and medium term, this alternative could have a positive fiscal impact because BPS collections would immediately increase.

The design of the 1995 reform is flexible enough to adapt to changes in the relative weights of its two pillars, to either adjust exposure to different risks or to incorporate changes in the way the national community perceives the role of individuals, society, and the state. However, in the long term, with the current parameters of the PAYGO component, fiscal obligations would increase.

The risk of market concentration exists independently of an express policy in this regard. To avoid such concentration, it is necessary to decrease barriers to entry for new competitors. In fact, if the role of fiduciary administration is maintained (to ensure the inviolability of social security funds), the single-purpose requirement for administrators could be ended, thereby opening up competition to firms in related industries, always under an independent superintendency. Certainly, a measure of this kind would also reduce administrative costs considerably.

If an increase in population coverage is sought, it should not be oriented toward the second pillar but rather toward the first, since this is where mandatory coverage is accessed. The main limitations to be surpassed are exogenous to the pension system in that they are based on the labor market structure. Nevertheless, some endogenous actions—which are not exempt from fiscal impact—could influence the achievement of this objective. These include revising eligibility conditions of noncontributive pensions for the aged and reducing formal labor contracting costs, within the context of a tax reform.

The future of the 1995 reform depends especially on the balance between trends inside President Vázquez's own administration, which has expressed concern over preserving the investment and business climate. This goal, along with the lack of a viable alternative to the 1995 reform, suggests that the policy path with respect to pensions will be maintained, without precluding the introduction of advisable and necessary adjustments. In the coming years, social security will continue to be prominent on the national agenda, but without the urgency and dramatic tone of years past. This will foster improvement of the mixed system, which has already been consolidated. There is no doubt that a healthy, balanced social security system, which adequately integrates social solidarity and individual fairness, will continue to be one of the main instruments for the personal well-being and social development of Uruguay.

Notes

[1] According to Hobsbawn (1995: 188), 'the list of solid constitutional states in the Western Hemisphere was small: Canada, Colombia, Costa Rica, and the United States and now the forgotten "South American Switzerland" with its only real democracy, Uruguay' (translated from Spanish).

[2] The real pension re-evaluation index, July 1962 = 100, was 34.29 in December 1973, reaching its lowest value in December 1985: 20.34. This index results from comparing pension increases with the Consumer Price Index.

[3] Only presidential candidate Jorge Batlle and the far-left Tupamaros National Liberation Movement opposed the initiative, for different reasons. In a second show of force, these organizations gathered enough signatures for another plebiscite initiative for constitutional amendment, this time to block the parametric reforms approved by the parliament in 1992. A new plebiscite was held during the national elections in 1994, and an ample majority approved the initiative, which declared unconstitutional the reforms previously introduced as part of the budgetary laws.

[4] After the amendment took effect and as a result of applying the constitutional reform, the real pension revaluation index went from 24.90 in December 1989 up to its highest value in 1999—41.64. Since then, that index has declined in line with the average salary decline.

[5] This parametric reform alternative was approved by the parliament in 1992. The Supreme Court later found it to be unconstitutional, based on the results of the November 1994 plebiscite.

[6] The team appointed by the Lacalle administration analyzed the financial feasibility of adopting a Chilean-style individual capitalization system and concluded that the transition costs would be prohibitive.

[7] This notional defined contribution alternative was the one developed for the project that the executive branch sent to the parliament in 1991. The project was given priority status but not approved.

[8] This was the selected alternative for the reform finally approved in 1995.

[9] It was sponsored by the Frente Amplio, the union and pensioner organizations, and also—strangely—by the political sector of ex-President Sanguinetti, who had originally approved the law.

[10] This coalition of political parties formed the main opposition force to those governments that approved and implemented the 1995 reform. It assumed the presidency in March 2005 with the support of more than 50% of the population and with an outright legislative majority.

[11] The design did not have the support of international credit organizations, and even the World Bank opposed it initially. However, after the operation began, the World Bank participated in the reform implementation process.

[12] The shares of one of the AFAPs are owned by three public institutions.

[13] Otherwise, social security benefit obligations accrued in the old system about to be repealed would have to be acknowledged (known as 'recognition bonds' in Chilean law).

[14] This total, based on the minimum wage and administered price levels, had already lost value in order to limit the system's financial obligations after the 1989 constitutional reform.

[15] Using a different methodology, Noya and Laens (2000) affirm that, in the long run, reductions of more than 2.1% of GDP are obtained in all cases. The reductions result from reducing social security expenditures in the PAYGO first pillar by 5.7% of GDP. The reductions are counteracted in part by diverting contributions equivalent to about 3.5% of GDP toward the capitalization pillar. In contrast, in the

short and medium term, the primary deficit increases, oscillating between 1.6 and 1.8% of GDP, the result of reducing PAYGO contributions as well as the expansion on social security expenditures introduced by the same reform.

[16] Caja Bancaria de Jubilaciones y Pensiones (Bank Employee Pension Fund), Caja Jubilaciones y Pensiones de Profesionales Universitarios (University Professional Pension Fund), and Caja Notarial de Seguridad Social (Notary Pension Fund).

[17] The previous system-based pensions on a reference salary covering the past three years in the labor force.

[18] These workers earning less than UY$5,000 retain the right to 75% of the benefit that they would have received in the public PAYGO pillar (even though half of their contributions go to an individual account).

[19] The contribution ceiling does not apply to those in the previous and transition systems.

[20] Policymakers stipulated that one AFAP was to be property of the BPS, by itself or jointly with the state-owned Banco de la República Oriental del Uruguay (BROU), Banco Hipotecario del Uruguay (BHU), and Banco de Seguros del Estado (BSE). República AFAP, the administrator with the largest number of affiliates and the highest total of administered funds, is owned by the BROU, BPS, and BSE.

[21] There is a minimum return requirement that if not met will eventually result in the liquidation of the AFAP.

[22] Today, República AFAP charges the lowest administration fees (fixed and variable commissions).

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