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The Reversal of Pension Privatization in Venezuela

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Abstract

This paper documents the reversal of pension privatization and the reforms that took place in the 1990s and 2000s in Venezuela. The report analyses the political economy of different reform proposals, and the characteristics of the new pension system, including laws enacted, governance and social security administration, social dialogue, positive impacts and other key issues of the Venezuelan pension system.

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Contents

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Acronyms

ART	Occupational Risk Administrators
ATES	Tripartite Agreement on Employment and Wage Stability
ATSAM	Tripartite Agreement to Revise Minimum Wages
ATSSI	Tripartite Agreement on Comprehensive Social Security and Wage Policy
GDP	Gross Domestic Product
IDB	Inter-American Development Bank
ILO	International Labour Organization
IVSS	Venezuelan Welfare Institute
LOSSSI	Organic Law of the Comprehensive Social Security System
MTSS	Ministry of Labour and Social Security
PMV	Minimum Pension

Summary of Reforms related to Pension Privatization and its Reversal

1997	Creation of a Social Security Reform Executive Unit, responsible for leading the entire reform and negotiation of an Inter-American Development Bank (IDB) loan.
1997	Organic Law of the Comprehensive Social Security System (LOSSSI), or Framework Law: Sets a new system of individual saving accounts administered by public, private or mixed institutions, plus a government-run solidarity system to complement the payment of minimum pensions (PMV) to contributors who did not accumulate enough.
1998	Law Decree No. 2993, 1998: Specifies the individual accounts with public, private or mixed administration; substitutive model; government-guaranteed PMV. Individual accounts scheme was never implemented.
1999	New National Constitution stating that Social security is a non-lucrative public service with solidarity financing; pension benefit cannot be below the minimum wage; special coverage available for cultural workers, homemakers, the disabled, public employees and the armed forces.
2000	Appointment of a Presidential Commission for the preparation of re-reform laws. The draft legislation, submitted to the National Assembly, was rejected.
2002	New Social Security Framework Law: Average-premium public and solidarity programme. Defined benefit and public administration. Decision to standardize retirement programmes and establish new institutions.
2014	Law Decree No. 1440, 2014: First modification of the new Framework Law suspends the liquidation of the Social Security Treasury.

1. Introduction [1]

Venezuela's social security system was first established legally in 1940 and was put into effect by a series of decrees in 1944 when it also started its operation. The system provided coverage against the risks of sickness, maternity and occupational injuries. Subsequently, the *Worker-Employer Agreement* in the emerging democracy of 1958 and the *Fixed-Point Pact* between the leading political parties led to the *Agreement on Comprehensive Social Security and Wage Policy* (ATSSI), signed on 17 March 1997 at the Miraflores Palace [2].

The ATSSI created a social security system based on the principles of universal coverage and solidarity. A tripartite entity managed the system, which was composed of the subsystems dealing with pensions, health, layoffs, housing policy, vocational training and recreational benefits.

In the case of the pension subsystem, a mixed system was adopted with a solidarity component, which granted a pension in accordance with the contributions made and another based on individual accounts. Self-employed workers and farmers were to be covered by special programmes, but these were not defined.

A Social Security Reform Executive Unit was created, which negotiated a US$ 350 million loan with the Inter-American Development Bank (IDB) for reforms in health, vocational training and pensions, and another US$ 45 million for their implementation through an Executive Unit responsible for securing supporting contracts. The government also agreed, through ATSSI, to guarantee a minimum annuity (PMV) to workers who contributed to the pension system but did not meet all requirements, and to assist those who were already pensioners. This would recapitalize the pension fund, which would not be administered by the Venezuelan Welfare Institute (IVSS). The goal, although not expressly stated, was to liquidate it.

On 3 July 1997, the *Tripartite Agreement on Employment and Wage Stability* (ATES) was signed and the *Tripartite Agreement to Revise Minimum Wages* (ATSAM) was signed on 18 February 1998. The Tripartite Commission was created to prepare reports and draft bills on these subsystems. On 30 December 1997, the Commission persuaded Congress to approve the Organic Law of the Comprehensive Social Security System (LOSSSI), known as the Framework Law, which established the general regulations on administration, financing and benefits.

[1] This document has been translated into English from its original version in Spanish. We apologise for any discrepancy due to translation error and for any possible deterioration in the style of language.

[2] In representation of workers, the Workers Confederation of Venezuela (CTV), the Confederation of Autonomous Trade Unions (CODESA) and the General Workers' Confederation (CGT). On the part of the private sector, the Federation of Chambers of Manufacturing and Commerce, the National Council of Commerce and Services (CONSECOMERCIO), the Venezuelan Manufacturing Confederation (CONINDUSTRIA), the Farmers' Federation (FEDEAGRO) and the Federation of Craftsmen, Small and Medium-sized Businesses (FEDEINDUSTRIA), (ATSSI, 1997).

The Framework Law establishes ATSSI guidelines with respect to individual accounts and solidarity, the annuity and system management. It also incorporates changes made by Congress, such as standardizing the system by eliminating the many existing retirement programmes that were formerly based on public employment.

The Framework Law makes two fundamental changes to the ATSSI: the first is that the pension subsystem is not actually mixed, which refers to models where the worker pays into an individual account and a solidarity programme at the same time (Mesa-Lago, 1994). Rather, it is a model that allocates part of the contribution – as discussed later in this report – to a defined benefit (solidarity) fund for pensions to finance the PMV, while the other share is allocated to an individual account scheme.

The second modification is that the Tripartite Commission developed a series of norms for system oversight, for example, distribution of contributions, administration, expenses and supervision of pension funds. This was established through the Social Security Advisory Council; additionally, the Superintendent of Pensions was created for this purpose.

The differences between the ATSSI and the Framework Law reflect two issues: private-sector participation and IVSS liquidation.

2. The Privatization Reform

After the 1997 Framework Law was passed, the Tripartite Commission developed exhaustive regulations. The pension subsystem was created after the Congress granted President Rafael Caldera extraordinary legislative powers in November 1998.

Before the creation of the subsystem, the old-age pension was equal to a basic sum calculated based on inflation and the overall wage level, plus at least 30 per cent of the reference wage of the insured individuals, which could increase if workers made more than 750 weekly contributions and were at least 55 years old in the case of women and 60 years old in the case of men (Mandatory Social Security Law, 1967). However, due to the lack of financial and actuarial adjustments, the purchasing power of pensions deteriorated considerably until, following protests, it was matched to the minimum wage in 1995.

The pension sub-system

Public- and private-sector workers are obligated to enrol in this subsystem, regardless of whether they are dependent workers. Once again, as in the ATSSI, special programmes were designed, this time for temporary and part-time workers, domestic and rural workers. These special programmes were never implemented, however.

Individual savings accounts in the pension subsystem (Law Decree No. 2993, 1998) could be administered by companies with public, private or mixed capital. (At the time of the reform, only private companies associated with the banking sector were in a position to offer this service). The solidarity programme would be managed by an autonomous service of the Ministry of Labour and Social Security (MTSS) responsible for contracting, through public tender, the administration of the resources received.

Members who had turned 60 and who had made at least 240 monthly contributions were eligible to receive the PMV. The PMV was applicable when the amount accumulated in the individual account was insufficient to finance a pension equal to the PMV. The amount would be equal to 50 per cent of the average contribution earnings and could be increased to 60 per cent if the worker had made 300 contributions, and up to 70 per cent for 360 contributions.

Women's retirement age was raised by five years. The employer would finance 75 per cent of the contribution rate while the worker would cover the other 25 per cent. The contribution rate was set at 12 or 13 per cent of earnings, distributed as follows: 11 per cent for individual savings and, if workers earned four or more times the minimum wage, the rate would be 2 per cent for the solidarity programme and 1 per cent for remunerations below four times the minimum wage (Lo Vuolo, 1998).

Overall, the Law of Pension Sub-systems adhered to the regulatory framework that had been applied in other countries of the region and was specifically guided by the Chilean legislation. The IDB, through the executive unit of projects and monitoring of the negotiated loan, would serve as another reference. Like other regulatory frameworks in the region, the Venezuelan model respected the recognition of contributions to the previous system; provided information to users about their individual accounts; informed on the method for calculating fund profitability; and, created different entities associated with the stock and insurance market (Sousa, 1998). Given that the reforms in other countries also revealed that fund administrators charged excessive commissions, and at the request of the Tripartite Commission and with support from the ILO, the so-called «programmed retirement» pension programme was eliminated [3].

The political economy of reform

The process to prepare the Law of the Pension Subsystem was complex. This law was supported by the Tripartite Commission and the Congress, which passed the Framework Law. The Congress granted extraordinary powers to President Rafael Caldera to legislate and liquidate the IVSS. Transnational banking institutions and the IDB also intervened.

The Tripartite Commission was useful to the government as it legitimized its objectives. The government in power did not have significant representation in Congress. Different business sectors and three of the four trade union federations offered their support. The procedure for submitting reform projects to the Congress was shortened considerably as consensus between the social partners had been achieved, giving authority to its actions.

The government plan consisted of eliminating the political risks of providing pensions and advocated a transparent administration of pension funds. The main goals were management efficiency – which the IVSS was incapable of providing – as well as the reduction of administrative expenses of the public system and the generation of wealth through domestic savings in individual accounts.

In the reform process, trade unions advocated for guaranteeing the payment of current pensions and the purchasing power of the pensions. The chambers of insurance and banking believed that the Tripartite Commission was a suitable place to launch ventures in a virgin market such as the pension market. They knew that fund administrators, insurance companies and investment companies would employ business practices, together with other support services that could be commercialized, such as training courses, advisory services and publications.

[3] In *programmed retirement*, the amount of the pension is calculated annually based on the balance of the individual account, for which reason it was eventually exhausted if the person lived longer than expected. Thus, it did not guarantee a periodic annuity as established in ILO Convention No. 102, which was ratified by the country.

The IDB and the Congress were guided by the World Bank report *Averting the Old Age Crisis* (World Bank, 1994), determining that decision-making would be in the hands of the accountholder when choosing the pension fund administrator, the type of investment and type of pension. Further, the government would no longer exercise control or be held accountable. To strengthen the reform, the Congress modified the Framework Law and, in an innovative approach, incorporated Occupational Risk Administrators (ART) in the Law of the Pension Subsystem.

3. The Reversal of Pension Privatization

Following the passage of the Framework Law, the Episcopal Conference complained that the new law would not cover self-employed workers and the unemployed (*El Universal*, 1998). The Venezuelan Education-Action Human Rights Programme, a non-governmental organization, rejected the pension subsystem because it was based mainly on individual accounts judged insufficient (PROVEA, 1998). Some public companies feared that their retirement programmes would be eliminated and lobbied to keep them. Within the government, some sectors were against the liquidation of the IVSS and the political opposition that later rose to power claimed that the social security system had been privatized.

At the forefront of the change, the Tripartite Commission was viewed as a vehicle for reducing wages and a representative of capital interests. Consequently, the pension subsystem was rejected for the following reasons:

- The nominal cost of social security before the reform was 21 per cent of earnings; with the reform, it rose to 35.45 per cent.

- The fiscal cost was also high. According to an ILO study, which the Tripartite Commission commissioned, during the first 40 years of subsystem operation, the National Executive Unit would have to contribute an accumulated sum equivalent to 41 per cent of GDP of 1998 (the year of the reform), which together with the other subsystems such as health, layoffs, housing and occupational hazards, as well as the new institutions, would compromise the fiscal feasibility of the programme (ILO, 1998).

- The pension subsystem would not protect vulnerable groups: 45 per cent of employees (1.72 million) earned the minimum wage and 80 per cent did not earn three minimum wages. Neither was the informal sector covered, which accounted for 48 per cent of the workforce (Economic and Financial Advisory Office of the Congress, 1999).

- In the National Assembly (the former Congress), collective funding was considered more appropriate given the situation described. It was considered more advantageous than individual accounts because it guaranteed a defined pension and a lower rate of contribution and helped redistribute the contributions (National Assembly, 2001).

- Problems with application, which other countries with similar pension reforms had already experienced, suggested that the capacity to implement the changes would be fiscally and institutionally challenging. Mere legislative measures were insufficient given that the political risk would not disappear, and market risks would emerge.

- Finally, the pension subsystem did not prioritize poverty reduction, a concern that would intensify years later with the social protection floor (ILO, 2011) and the multi-pillar strategy (World Bank, 2013).

The re-reform and its actors

Following the 1998 elections, the Congress granted President Hugo Chávez extraordinary powers to legislate social security in 1999. The president decided not to liquidate the IVSS and deferred the effective date of the Framework Law and the Law on the Pension Subsystem. In the absence of a government proposal, the deferments continued. A Presidential Commission was appointed (Decree 925, 2000), with the participation of members of the business sector who had served on the defunct Tripartite Commission, and of experts of the IDB Executive Unit, as it was eliminated when the government suspended credit with the IDB. None of the trade union organizations that signed the ATSSI participated since they lost their bargaining power and were displaced after a referendum that same year, in violation of ILO Conventions Nos. 87 and 98.

The Presidential Commission had new guidelines for actions following the adoption of a new Constitution by referendum. The new Constitution stated that:

- Social security is a non-lucrative public service of solidarity financing;
- Pensions and retirement benefits for seniority in public employment cannot be below the minimum wage; and
- Special coverage is available for cultural workers, homemakers, the disabled, public employees and the armed forces.

Nevertheless, the draft bills prepared by the Presidential Commission did not have conceptual unity. Each sub-commission worked on its own and with opposing positions with respect to the possibility of allowing or disallowing private-sector participation. The set of laws was quickly rejected.The Congress, which had a large pro-government majority, assumed leadership of the re-reform.

The new Framework Law

In 1997, the National Assembly prepared a preliminary re-reform project with two pillars: one was based on solidarity and the other on individual savings exclusively for workers with medium-high earnings. This proposal was replaced by another definitive proposal in 2002. The new Framework Law established a defined-benefit pension under an average-premium financial system, with the option of government subsidies to the contributions of self-employed workers. Workers could on a voluntary basis adopt complementary old-age pension plans under a public, private or mixed administration.

In terms of governance, the new Framework Law created a Superintendent’s Office not only for pensions but for the entire social security system. The former subsystems were now known as systems, which covered one or more contingencies. New institutions were established, such as the Social Security Ombudsman, autonomous organizations such as that of Employment and of Pensions, and a rectorate of the system, with actuarial and information support units. None of these organizations were implemented, however. It was not until a decade later that the Superintendent’s Office and the Social Security Treasury, responsible for collecting and distributing contributions, finally began operations.

4. Measures adopted after the re-reform

The re-reform initiative stagnated between 2002 and 2007, when the transition deadlines and the liquidation of the retirement fund were cancelled with the modified new Framework Law. The IVSS was responsible for routine institutional activities. The tripartite administration was eliminated, and the law was modified to increase fines for non-compliance in 2008.

In 2012, the new Framework Law was modified for a second time (Presidency of the Republic, 2012) for the purpose of appointing and dismissing the social security national executive, the superintendent and the treasurer, who previously were supervised by the National Assembly (LOSSS, 2012). With that reform, the political consensus to designate key figures of the system ended.

A year later, the Superintendent's Office rules of procedure were established (Ministry of the People's Power for Finance, 2013) and the Social Security Treasury was charged with administering the retirement fund, whose liquidation had been suspended in the first modification of the new Framework Law (Decree 1440, 2014) after President Nicolás Maduro was granted extraordinary legislative powers.

Contrary to the new Framework Law mandate, IVSS pensions have not been increased to more than the minimum wage, except for certain groups of the public sector who receive higher benefits. The reform and re-reform as opposing projects had one thing in common: they both remained within the limits of mandatory social security.

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