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The Reversal of Pension Privatization in Ecuador

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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 Ecuador. The report analyses the political economy of different reform proposals, and the characteristics of the new pension system, including laws enacted, coverage, benefit adequacy, financing and contribution rates, governance and social security administration, social dialogue, positive impacts and other key issues of Ecuador's pension system.

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Acknowledgements

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Acronyms

AFJP	Pension fund administrator
CONAM	The National Government Modernization Council
IDB	Inter-American Development Bank
IESS	Ecuadorian Social Security Institute
ISSFA	Armed Forces Social Security Institute
ISSPOL	National Police Social Security Institute
PROST	World Bank's Pension Reform Options Simulation Toolkit
USAID	US Agency for International Development

Summary of Reforms related to Pension Privatization and its Reversal

1993	Law of Government Modernization, Privatizations and Public Service Delivery, promoting increased efficiency, flexibility and productivity and calling for decentralization of administrative functions and resources of the public sector, including the privatization of public services.
1994	The President established a Social Security Commission of the National Council for State Modernization (CONAM).
Jan 1995	Social Security Council adopted the proposal for Social Security Reform for Pensions and Health, prepared in collaboration with CONAM officials and international advisors (IDB, USAID). The CONAM study recommended a mixed – three pillar – system. 1. Basic pension provided through the Ecuadorian Pension Institute 2. Mandatory defined-contribution, individual-account pension system, administered by pension fund administrators (AFJP). 3. Complementary voluntary individual-account, old-age pension, administered by AFJP. The proposal further included a retirement age increase from 55 to 65.
Nov 1995	In a referendum, Ecuadorians voted against the proposal and thus rejected the privatization and overall reform of the pension system.
2001	The National Congress drafted Social Security Law 2001-55. The law established a mixed pension system like the Uruguayan pension system. The system was never applied, however.
2002	The Constitutional Tribunal declared sub-sections of the Social Security Law unconstitutional, two of which referred to the fund or social security savings administrator. The Tribunal also ruled that the article that defined the financing of the mixed system was unconstitutional.
2008	The new Constitution that went into effect in October 2008, declared that the social security system is public and universal, and cannot be privatized.

The Reversal of Pension Privatization in Ecuador [1]

The law on the Ecuadorian social security system dates back to 1928, formally covering workers of the public sector, teachers and the banking sector, and since 1935, private-sector workers.

Since its establishment, the Ecuadorian defined-benefit pension system has had tripartite participation with contributions from workers, employers and the government. The Mandatory Social Security Law of 1942 established that the government would contribute 40 per cent of the pensions paid, while workers and employers would finance the remaining 60 per cent.

Ecuador was not immune to the economic crises affecting the region in the 1980s. In response to the crisis and in light of the difficult fiscal conditions, Ecuador considered the application of neoliberal policies and a radical social security reform, which included its privatization and the implementation of the system of individual accounts, which had been applied in Chile since 1980.

The legal framework of the structural reforms proposed by the pro-business, conservative government (in power from 1992 to 1996) was supported by the Law of Government Modernization, Privatizations and Public Service Delivery, published in *Official Registry* 349 on 31 December 1993. The law sought to increase the efficiency, flexibility and productivity of the public administration and to promote, facilitate and strengthen the participation of the private and community sectors and simplify the public administration and economic structures. Furthermore, it called for the decentralization and de-concentration of administrative functions and resources of the public sector. This included the breakup of monopolistic structures and the privatization of public services and other economic activities assumed by the government or other public sector agencies.

The National Government Modernization Council (CONAM), an administrative agency of the executive branch, was created to implement the modernization process.

This was how the privatization of social security and the de-monopolization of the Ecuadorian Social Security Institute (IESS) began. According to the Constitution of 15 January 1978 and the Mandatory Social Security Law, autonomous institutions were responsible for providing social security in Ecuador as an inalienable right of workers to protection in the event of illness, maternity, unemployment, disability, old age and death, financed with equal contributions from government, employers and workers.

In May 1994, the President signed an executive decree to establish a Social Security Commission of the National Council for State Modernization, which in January 1995 formally adopted the Proposal for Social Security Reform in Pensions and Health, prepared with the participation of CONAM officials and national and international advisors. The Inter-American Development Bank (IDB) and the US Agency for International Development (USAID) also contributed to this proposal.

[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.

The CONAM study «Ecuador, Proposal for Social Security Reform,» argued that the pension system in Ecuador had become unsustainable due to the administrative, technical and financial crisis. The social security system struggled with limited coverage, high evasion rates (in 1993, estimated coverage was just 18.37 per cent of the total population and 38 per cent of the economically active population), underreporting of earnings (the contribution wage represented between 50 and 60 per cent of total earnings), delays in employer and government contributions, inefficient management of investments, high administrative costs, unequal government subsidies to insured pensioners and the depletion of financial reserves. The collective capitalization system, it was argued, reduced the capacity for savings of the country's economy, affecting investments and their multiplier effects, such as growth and development. For this reason, there were calls to design a new pension system. Several alternatives were analysed, such as the possibility of reforming the existing system, generating a parallel system that would compete with the IESS or creating a mixed system.

The CONAM study recommended a mixed pension system for Ecuador, structured around three pillars:

One: Assign responsibility for the basic pension and the Social Security System for Rural Workers to the Ecuadorian Pension Institute, a decentralized government agency.

Two: Establish a mandatory defined-contribution system for the old-age pension, with individual accounts and with a decentralized, competitive administration, under the responsibility of retirement and pension fund administrators (AFJP).

Three: Establish a complementary old-age pension, voluntary for individual accounts, also under the responsibility of the AFJP, which offers accountholders the possibility of early retirement or higher pensions of Pillar 2.

This proposal changed the retirement age from 55 to 65; redistributed contribution percentages; regulated the contribution on total earnings; called for the independent administration of funds; and, mandated insurance companies to transfer pension payments under the annuity plans.

While the CONAM proposal was supported by the financial and business sector, especially that of Guayaquil region, several groups, including trade unions, public servants, members of the Social Security System for Rural Workers and social security workers, rejected the proposal with protests, strikes and roadblocks. Members of Congress even voiced complaints and offered counterproposals.

As the executive branch did not have majority congressional support for its initiatives, the modernization and privatization process promoted by the executive branch would have been obstructed, even more so in the case of privatization, which would require a Constitutional reform. In response, the government organized a public referendum containing 11 questions associated with decentralization; the equitable distribution of resources; the cessation of public services; the constitutional dissolution of Congress; changes to the electoral, judicial and constitutional oversight systems; and, elimination of public-sector privileges, the second of which was:

> «2. The right to choose a social security system. Should the Constitution incorporate a provision that reads: 'All individuals have the right to freely and voluntarily choose the social security system as well as their benefits and services under the responsibility of the Ecuadorian Social Security Institute or other public or private institution? The social security system shall be founded on the principles of solidarity and free competition.' YES-NO.»

After the government and the economic powers launched an excessive, impersonal campaign for «yes», the referendum was held on 26 November 1995. Citizens voted against the referendum. In the case of Question 2, the results were:

Yes: 31.11 per cent

No: 47.29 per cent

Blank: 10.33 per cent

Invalid: 11.24 per cent

Academics and politicians who analysed the results attributed the «No» victory to a rejection of the government, resistance to change, the excessive, overwhelming propaganda for «Yes,» and to the poorly designed, ambiguous referendum texts. In some cases, such as the social security question, initial acceptance was 80 per cent, which then fell to 56 per cent and in the days before the referendum, from 40 per cent to 31.11 per cent, according to survey data.

Following these results, the campaign for privatization stopped until the idea re-emerged during the discussions of the 1998 constitutional reform. Despite the 1995 referendum against privatization of social security, it was argued that the new Constitution should call for the direct participation of the private sector in the social security administration, a view that was partially accepted by the majority of members of the National Constituent Assembly that prepared the Political Constitution of the Republic of Ecuador, published in the *Official Registry* on 11 August 1998, as evidenced in the articles cited below:

> «Art. 55.- Social security shall be a duty of the government and an inalienable right of all inhabitants. It shall be delivered with the participation of the public and private sectors, in accordance with the law.»
>
> «Art. 58.- The provision of mandatory general insurance shall be the responsibility of the Ecuadorian Social Security Institute, an autonomous agency led by a tripartite administrative-technical body with an equal number of representatives of the insured, employers and the government, who shall be appointed in accordance with the law…».
>
> «Art. 61.- Complementary insurance shall focus on covering social security contingencies not covered by the mandatory general insurance or to improve their benefits and shall be optional. They shall be financed with the contribution of the insured, and employers may make voluntary contributions. They shall be administered by public, private or mixed entities regulated by law.»

As demonstrated, the Constitution reflected the majority will of Ecuadorians expressed in the 1995 referendum to establish the Ecuadorian Social Security Institute as an autonomous body exclusively responsible for the provision of mandatory general social security. The administration of optional insurance is the responsibility of public, private or mixed entities, as defined by law.

This Constitution also called for an urgent reform of the IESS, led by a tripartite Supervisory Commission made up of one representative each of the insured, employers and the executive branch, appointed by the President of the Republic. The commission was given the task of preparing a draft bill of the reform of the Social Security Law.

To comply with this mandate, the commission hired several national and international experts to carry out consultancies to support the social security reform proposed in the new law. World Bank experts also disseminated and provided training on the application of the World Bank's pension reform options simulation toolkit (PROST) in the financial projections of a mixed system.

Based on the Supervisory Commission's project, the National Congress drafted Social Security Law 2001-55, which was published in *Official Registry* 465 of 30 November 2001. It maintained the former pension system for pensioners receiving pensions and members aged 50 and over on the date the law went into effect. The law established a mixed pension system like the Uruguayan system for members below age 40. Those between ages 40 and 49 could also choose between the new (mixed) and the old system. The new mixed system included an inter-generational solidarity retirement system under the responsibility of IESS and a mandatory individual-savings retirement system administered by social security savings entities accredited by the Superintendent of Banking and Insurance.

However, the mixed system was not applied in Ecuador because in the first month after the Social Security Law went into effect, several legislators, leaders of the Social Security System for Rural Workers and representatives of leftist political parties filed a motion with the Constitutional Tribunal claiming that several of the articles of the law were unconstitutional. In May 2002, the Constitutional Tribunal declared sub-sections of six articles unconstitutional, two of which referred to the fund or social security savings administrator. The Tribunal also ruled that the article that defined the financing of the mixed system was unconstitutional. That decision was challenged, an action that delayed the effective date of the resolutions of the Constitutional Tribunal until 16 February 2005, when they were published in the supplement of *Official Registry* 525.

The Constitution that went into effect in October 2008 eliminated the possibility of privatizing the social security system in Ecuador by declaring in Article 367 that the social security system is public and universal, cannot be privatized and that it should attend to the contingent needs of the population. It named the Ecuadorian Social Security Institute as the autonomous agency responsible for providing for the contingencies of the mandatory general insurance. Like the previous Constitution, it also allowed for the existence of special social security programmes for the National Police and the Armed Forces, which have been administered by the Armed Forces Social Security Institute (ISSFA) since 1992, and by the National Police Social Security Institute (ISSPOL) since 1995.

The Constitutional provision does not expressly call for the tripartite participation of the government, employers and workers in the social security administration. Instead, it mandates the government to legislate, regulate and oversee social security activities. Through the Organic Law for Labour Justice and Recognition of Domestic Work, published in Supplement Three of *Official Registry* 483 of 20 April 2015, the government exercised this power to eliminate the 40 per cent contribution of the government to IESS pensions, which had been applied since 1942.

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