Lesson from Pension Reforms in the Americas

The Outliers

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

Two Subsequent Reforms

- In 2000 the Structural Reform created a Multipillar System
- In 2005 the Parametric Reform improved finances and progressiveness of the main 1st pillar

Why an Outlier?

The Policy Making Process

- Gradual (for all actors involved)
- Participatory (involved civil society)
- Negotiated (within non-institutional channels)

Why an Outlier?

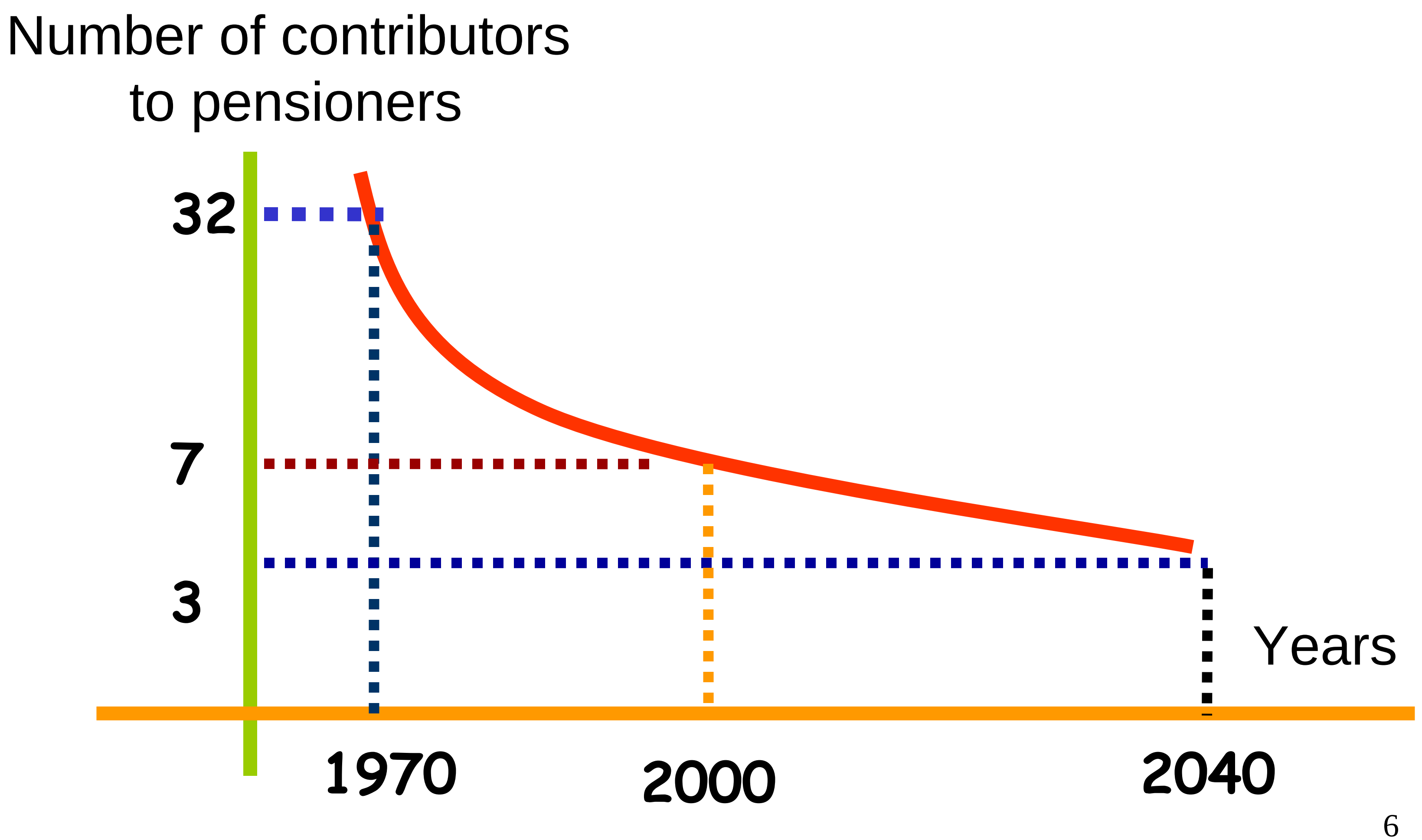
The Outcome

- Expanded benefits
- Strengthened collective capitalization
- Maintained affirmative action for women
- While incorporating individual savings

Main Features

- IVM: 9 out of every 10 insured
- Half the Economically Active Population are Uninsured
- Provides Old-age, Disability and Survivorship
- Partially funded defined benefit system
- Targets everybody but teachers and workers in the Judicial Branch
- If unreformed actuarial disequilibria due to demographic, labor, design, and administrative factors

Ratio of contributors to pensioners



2000 Structural Reform

Creation of the Second Pillar:

- Fully individual capitalization regime
- Funded with 4.25% of the total salary that employers report to the IVM, distributed
  - ✓ between employers (3.25%)
  - ✓ workers (1%)
- It did not involve an increase in the payroll tax
- It drew from a reallocation of contributions already made for other purposes
- Administrators are both private and public (public institutions, public and private banks, social organizations, occupational funds)

Cont. 2000 Structural Reform

The Second Pillar was Bundled with:

- Creation of a Labor Capitalization Fund (LCF)
- Reform of Severance Pay
  - ✓ Before 8.33%
  - ✓ Reform divided it: 5.33% only when being fired; 3% employer deposits in an individual account (LCF)
  - ✓ After 1 year half of it goes to the 2nd pillar
  - ✓ Employees withdraw resources every 5 years or when fired
- Strengthening of the RIVM
  - ✓ Insurance for Self-Employed Became Mandatory
  - ✓ Measures to fight evasion; expand coverage; improve the administration

2005 Parametric Reform

	Before	Reform
Retirement Age (regular)	65	65
Overall contribution	7.5%	10.5% in 20 yrs; adjusted 0.5% every 5 yrs; split in 3
Number of contributions	240	300
Additional amount	.87%	1%
Minimum pension *(new benefit)*	None	After 180 months contributions
Reference salary	Highest 48 months	Prior 240 months (inflation indexed)
Replacemen rate	52.2%	Scaled, between 58.70 and 46.50%

Years of contribution

Nr of Minimum Wages	*25*	*30*	*35*	*40*
0 to 2	57.50%	62.50%	67.50%	72.50%
2 to 3	56.00%	61.00%	66.00%	71.00%
3 to 4	54.40%	59.40%	64.40%	69.40%
4 to 5	52.80%	57.80%	62.80%	67.80%
5 to 6	51.20%	56.20%	61.20%	66.20%
6 to 8	49.60%	54.60%	59.60%	64.60%
8 and higher	48.00%	53.00%	58.00%	63.00%
Average	54.59%	59.59%	64.59%	69.59%

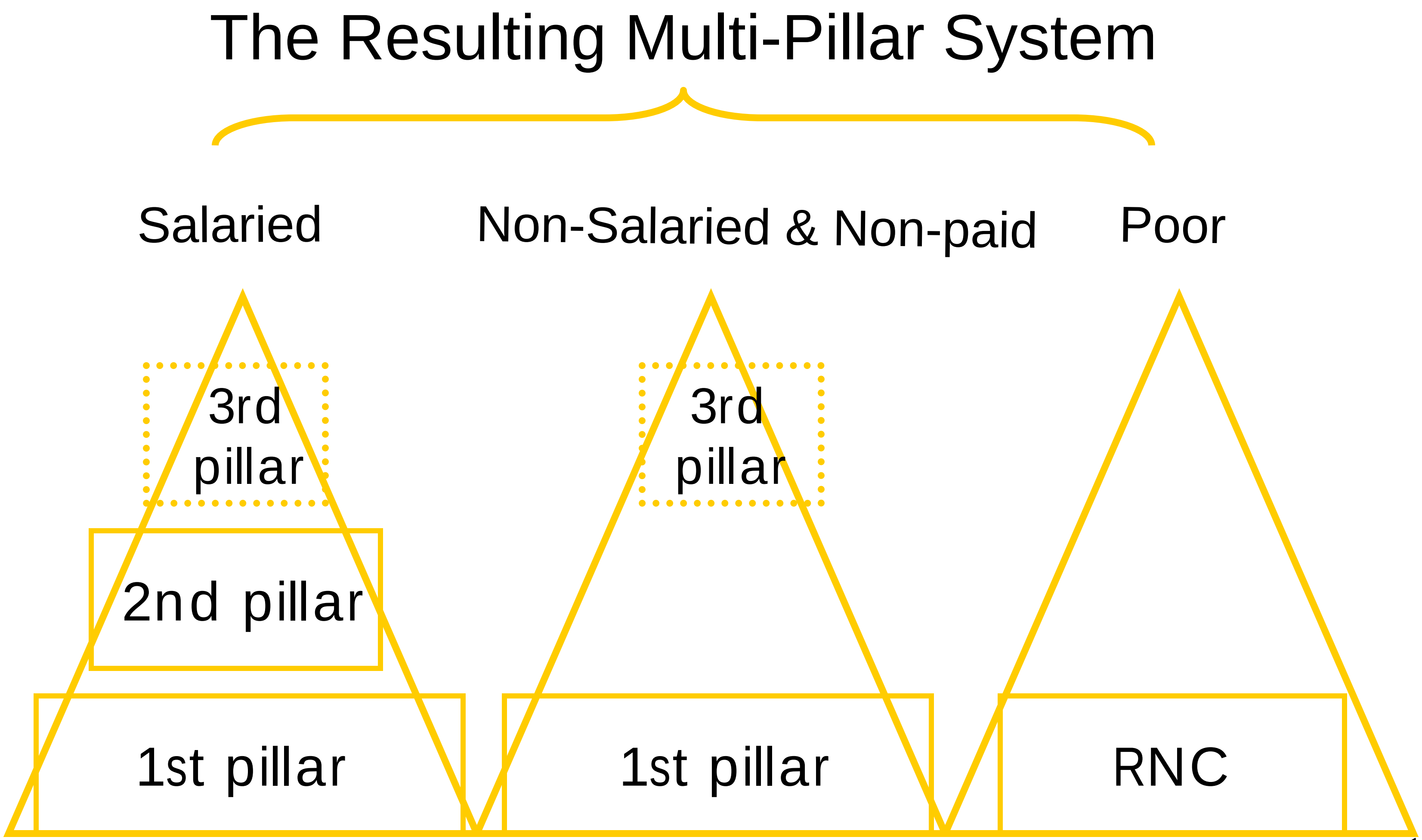
- 8,7 out of every 10 will see her pension improved
- Considers that the higher the income, the more years people remain in the labor market

Cont. 2005 Parametric Reform

Early retirement

	Current	Reform
Scenario A	More contributions; replacement rate similar to age 65	Same but two tables for women and men (6 months)
Scenario b (new benefit)		300 contributions; reduced replacement rate; two tables for men and women (0.5%)

Cont. 2000 Structural Reform



Cont. 2000 Structural Reform

Second Pillar:

- Initially nine (2001) and later 8 (2003)
- Five public and three private
- 80% of insured in Public Administrators

Managerial Effectiveness

2000

- Mechanisms for fighting and reducing evasion, delinquency, and under-declaration of income
- Introduce rewards and punishments and complement existing judicial measures
- Examples: being up to date with social security in order to become a State's vendor; obtain certifications of public records, and opt for fiscal incentives

2005

- Plans to improve financial investment, increase coverage, reduce disability pensions
- Contributions will increase upon expansion of coverage

Financial Projections

Projections with Reform and Increased Administrative Efficiency			
Critical Moments	Pre-Reform Situation	Adopted Reform with Current Management	Adopted Reform with Improved Management
Contributions are insufficient to finance pensions and other expenditures	2011	2041	2046
Total inflows are insufficient to cover total expenditures, and reserves start to decline	2022	2046	2051
IVM Fund's Reserves run out	2028	2054	2054