

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

REGIONAL

**SUPPORT FOR PUBLIC POLICIES TO INCREASE COVERAGE, SUSTAINABILITY
AND ADEQUACY OF PENSION SYSTEMS IN THE REGION**

(RG-T3047)

TC DOCUMENT

This document was prepared by the Project team consisting of: Mariano Bosch (SCL/LMK), Team Leader; Waldo Tapia (LMK/CPN), Alternate Team Leader; Ethel Muhlstein (SCL/LMK); Maria Teresa Silva Porto Diaz (SCL/LMK), Lukas Keller (SCL/LMK); Tania Lucia Gaona (SCL/LMK); and Margie-Lys Jaime Ramirez (LEG/SGO).

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PENSION SYSTEMS IN THE REGION**

RG-T3047

CERTIFICATION

I hereby certify that this operation was approved for financing under the **Ordinary Capital Strategic Development Program for Social Development (SOC)** through a communication dated July 6, 2017 and signed by Mariana Mendoza (ORP/GCM). Also, I certify that resources from said fund are available for up to **US\$200,000** in order to finance the activities described and budgeted in this document. This certification reserves resource for the referenced project for a period of four (4) calendar months counted from the date of eligibility from the funding source. If the project is not approved by the IDB within that period, the reserve of resources will be cancelled, except in the case a new certification is granted. The commitment and disbursement of these resources shall be made only by the Bank in US dollars. The same currency shall be used to stipulate the remuneration and payments to consultants, except in the case of local consultants working in their own borrowing member country who shall have their remuneration defined and paid in the currency of such country. No resources of the Fund shall be made available to cover amounts greater than the amount certified herein above for the implementation of this operation. Amounts greater than the certified amount may arise from commitments on contracts denominated in a currency other than the Fund currency, resulting in currency exchange rate differences, represent a risk that will not be absorbed by the Fund.

CERTIFIED BY:

Sonia M. Rivera
Chief
Grants and Co-Financing Management Unit
ORP/GCM

Date

APPROVED BY:

Carmen Pages-Serra
Division Chief
Labor Markets Division
SCL/LMK

Date

Technical Cooperation (TC) Document

I. Basic Information for TC

▪ Country/Region:	Regional
▪ TC Name:	Support for public policies to increase coverage, sustainability and adequacy of pension systems in the region.
▪ TC Number:	RG-T3047
▪ Team Leader/Members:	Mariano Bosch Team Leader, SCL/LMK; Waldo Tapia, LMK/CPN, Alternate Team Leader; Ethel Muhlstein, SCL/LMK; Maria Teresa Silva Porto Diaz, SCL/LMK, Lukas Keller SCL/LMK; Tania Lucia Gaona, SCL/LMK; Margie-Lys Jaime Ramirez, LEG/SGO.
▪ Indicate if: Operational Support, Client Support, or Research & Dissemination	Research & Dissemination (RD)
▪ If Operational Support TC, give number and name of Operation Supported by the TC:	N/A
▪ Date of TC Abstract authorization:	June 27th, 2017
▪ Beneficiary (countries or entities which are the recipient of the technical assistance):	Borrowing member countries of the Bank. ¹
▪ Executing Agency and contact name (Organization or entity responsible for executing the TC Program)"	Inter-American Development Bank (IDB), Social Sector, Labor Markets Division (SCL/LMK), Mariano Bosch, mbosch@iadb.org
▪ Donors providing funding (amount and Fund's name):	Strategic Development Program for Social Development (SOC).
▪ IDB Funding Requested:	US\$200,000
▪ Local counterpart funding, if any:	0
▪ Disbursement and execution period:	36 months (disbursement period same as execution period)
▪ Required start date:	September 2017
▪ Types of consultants (firm or individual consultants):	Individual consultants and Consulting Firms
▪ Prepared by Unit:	Labor Markets Division (SCL/LMK)
▪ Unit of Disbursement Responsibility:	Labor Markets Division (SCL/LMK)
▪ TC Included in Country Strategy (y/n):	No
▪ TC included in CPD (y/n):	No
▪ Alignment to the Update to the Institutional Strategy 2010-2020:	Social inclusion and equality & strengthen institutional capacity

II. Objectives and Justification of the TC

- 2.1 Pension systems across Latin America and the Caribbean (LAC) are facing significant social and fiscal challenges, which are affecting the three dimensions generally considered as critical to the performance of these systems, namely coverage, adequacy, and sustainability. With regards to coverage, studies show that only 45% of workers of the region contribute to a pension scheme at any given time. A key

¹ The three beneficiary countries will be selected based on the criterion of whether they are actively considering proposals to reform their pension systems at the time of the execution of this TC. At the moment, the countries under consideration are Chile, Nicaragua, Panama, Peru, and Trinidad and Tobago. See paragraph 2.8 for further details.

determinant of low pension coverage is the type of a worker's employment. While on average, 64% of wage workers contribute to a pension scheme, just 17% of independent workers do.^{2,3}

- 2.2 Secondly, in terms of adequacy, which relates to the capacity of pension systems to provide sufficiently high levels of retirement income, low contribution densities mean that a large percentage of pensions are not adequate to smooth consumption for elderly adults. On the one hand, estimations for Chile, Colombia, Dominican Republic, Mexico and Uruguay indicate that the net pension replacement rates for high income workers range between 15% and 32% and for low income workers between 10% and 15%. On the other hand, in several countries, workers commonly fail to accumulate the minimum number of specified weeks of contributions necessary to claim a pension. These countries include, for example, Paraguay, Honduras, and El Salvador, where laws set this minimum at 25, 15, and 25 years, respectively.⁴
- 2.3 Finally, with regards to sustainability, although the region still enjoys the benefits of relatively low dependency ratios^{5,6}, some of the countries with defined benefit systems cannot cover the entire cost of pensions with current contributions of workers anymore, and, as a result, have to finance them with alternative resources. Such fiscal imbalances between contributions and payouts already absorb more than 1% of the GDP of Argentina and Brazil and continue to grow in Colombia, El Salvador and the Dominican Republic, among other countries.⁷
- 2.4 Policies that aim to prevent poverty in old age and a sudden drop in consumption upon reaching retirement age should consider these three performance dimensions of pension systems. For example, policy recommendations to increase pension coverage

² OECD; World Bank; IDB. 2014. *Pensions at a glance: Latin America and the Caribbean*. Pensions at a Glance. Washington, DC: World Bank Group. Available at: <http://documents.worldbank.org/curated/en/794051468016189496/Pensions-at-a-glance-Latin-America-and-the-Caribbean>

³ This average does not consider whether a given country has put in place laws that require independent workers to contribute to the pension system.

⁴ Bosch, Mariano, Ángel Melguizo, y Carmen Pagés. 2013. *Better Pensions, Better Jobs: Towards Universal Coverage in Latin America and the Caribbean*. Washington D.C.: Inter-American Development Bank. Available at: https://publications.iadb.org/bitstream/handle/11319/462/Better_Pensions_Better_Jobs.pdf?sequence=8&isAllowed=y

⁵ The dependency ratio is defined as the share of dependents, aged zero to 14 and over the age of 65, in the total population, aged 15 to 64. According to Cavallo et al. (2015) (see citation in footnote 6), who analyze United Nations Population data, the average dependency ratio of Latin America and the Caribbean is lower than that of Europe and Africa and only slightly higher than that of Asia, but will increase together with an ageing population of the next decades.

⁶ Cavallo, Eduardo, Gabriel Sánchez and Patricio Valenzuela. 2016. *Gone with the Wind: Demographic Transitions and Domestic Savings*. <https://publications.iadb.org/bitstream/handle/11319/7579/Gone-with-the-Wind-Demographic-Transitions-and-Domestic-Saving.pdf?sequence=1>

⁷ Cavallo, Eduardo, and Tomás Serebrisky. 2016. *Saving for Development: How Latin America and the Caribbean can Save More and Better*. Washington D.C.: Inter-American Development Bank. Available at: <https://publications.iadb.org/bitstream/handle/11319/7677/Saving-for-Development-How-Latin-America-and-the-Caribbean-Can-Save-More-and-Better.pdf?sequence=6>

should look at the complete system, integrally, aiming to get a balance between these three elements, which interact with each other.

- 2.5 Despite the many efforts and reforms made to the pension systems of the countries in the region, they have not been able to provide adequate protection to important sectors of the population. All policies present trade-offs, and there is no one-size-fits-all policy capable of addressing all challenges.⁸ However, understanding the type of policies implemented in other contexts could potentially provide direction to others. Efforts should be focused depending on the specific priorities and initial conditions of the country under study.
- 2.6 Pension reforms that strike a successful balance between these three performance dimensions require first a detailed diagnosis of how pension coverage, adequacy and sustainability interact with each other in any given context. Unfortunately, there are only few countries for which such diagnoses are available, raising the need for further research and dissemination in this regard. The dearth of knowledge on pension performance indicators is particularly severe in the case of Caribbean countries. A recent analysis by Nassar, Okwuokei, Li, Robinson and Thomas (2016)⁹ shows that fast-aging populations, combined with slow economic growth and high unemployment rates result in low contributions to the pensions schemes and significant pressures on public finances in many Caribbean countries. Additionally, in some of these countries, low contribution income is also due to inadequate coverage and weak compliance.
- 2.7 Against this background, the objective of this TC is to increase the knowledge of the beneficiary governments regarding the design and implementation of policies aiming to promote coverage, sustainability and adequacy in their countries. To this end, the TC seeks to elaborate diagnoses of the pension systems in three selected LAC countries in terms of the aforementioned dimensions and to evaluate policy recommendations for consideration in pension reforms that governments seek to design and/or implement in the short and long term.
- 2.8 The three beneficiary countries will be selected based on the criterion of whether they are actively considering proposals to reform their pension systems at the time of the execution of this TC. Besides, the selection of beneficiary countries will be based on an analysis of the urgency of these reforms. This urgency will be determined holistically, taking into account possible gaps in terms of coverage, adequacy and fiscal sustainability of the pension system in question. At the moment, the countries under consideration are Chile, Nicaragua, Panama, Peru, and Trinidad and Tobago.
- 2.9 The proposed TC is aligned with the Bank's Updated Institutional Strategy (UIS) 2010-2020 (AB-3008) and its accompanying Second Revised Version of the Corporate Results Framework (CRF, GN-2727-6) as it contributes to the strategic policy objective of furthering social inclusion and equality and to the cross-cutting objective of

⁸ Bosch et al., 2013.

⁹ Nassar, Koffie, Joel Okwuokei, Mike Li, Timothy Robinson, and Saji Thomas. 2016. National Insurance Scheme Reforms in the Caribbean. IMF Working Paper WP/16/206. Washington, D.C.: International Monetary Fund. Available at: <https://www.imf.org/external/pubs/ft/wp/2016/wp16206.pdf>

strengthening institutional capacity. Specifically, with regards to the former objective, the activities of the TC will assist countries' efforts in combating extreme poverty in old age and promoting the inclusion of all segments of the population in financial markets. Concerning the latter objective, the TC will improve the capacity of beneficiary governments to design and implement policies aimed at increasing the coverage, sustainability and adequacy of their countries' pension systems. Additionally, the TC is in line with the sectoral priorities of access to formal employment (section V, dimension 1, page 41) and access to adequate and sustainable social security systems (section V, dimension 3, page 44) of the Labor Sector Framework Document (GN-2741-7). The TC is also consistent with the objectives of the Ordinary Capital Strategic Development Programs for Social Development (GN-2819-1), in particular with its objectives iii (support IDB and clients to foster social inclusion, gender equality, and diversity through projects and programs), and iv (promote social inclusion, gender equality, and diversity in member countries).

- 2.10 The TC is in line with other activities that the Bank, through SCL/LMK, has been implementing in recent years to increase regional knowledge on ways to increase pension coverage, adequacy and sustainability, among them RG-M1277 "Inclusive Retirement Savings: From Access to Use in Chile, Colombia, Mexico and Peru".

III. Description of activities/components and budget

- 3.1 **Component 1: Country Diagnoses (US\$115,000).** The objective of this component is to generate knowledge that will help governments in Latin America and the Caribbean prepare pension reforms that strike a successful balance between coverage, adequacy and fiscal sustainability of pensions.¹⁰ This component will finance three technical notes (one per country), which will each include, at the least: (i) analysis of the main structural features of the country's national pension schemes, including qualitative description as well as quantitative estimates of pension benefit levels and coverage rate; (ii) diagnosis of the pension system, including recent reforms in terms of coverage, labor market and financial (and fiscal) implications; (iii) analysis of the institutions involved in pension administration; (iv) description of the socio-demographic and economic trends and their relation with the pension system; (v) comparison with benchmark countries; and (vi) policy recommendations that will lead to stronger and more efficient pension systems. The reform options and recommendations would also specify necessary changes to the regulatory, institutional and legal framework, as well as required institutional changes to ensure effective implementation of the reform and prudential enforcement.
- 3.2 **Component 2: Knowledge dissemination (US\$75,000).** The objective of this component is to disseminate the knowledge generated under Component 1 and raise

¹⁰ There is no single measure that indicates whether a successful balance between the three performance dimensions has been struck. However, the policy notes to be developed under this component will contain careful analyses of how different levels in coverage, adequacy and fiscal sustainability will influence each other in a given country context and how to approximate an equilibrium where all three dimensions are balanced out.

awareness and promote consensus among key stakeholders¹¹ about how to balance coverage, sustainability and adequacy of pension systems in the respective national contexts. Activities to be financed under this component include three events (one per country) allowing for knowledge exchange between experts and policy makers; travel of experts and attendees; and printing of knowledge materials.

Indicative Budget (US\$)

Component/Activity	Description	IDB/Fund (SOC)	Total Funding
C1: Country Diagnoses	Individual consultants, firms and travel	115,000	115,000
C2: Knowledge dissemination	Individual consultants, event logistics and services, travel, publications	75,000	75,000
Incidentals		10,000	10,000
Total		200,000	200,000

- 3.3 In terms of the supervision of this TC, Mariano Bosch (Economics Principal Specialist, Team Leader), Waldo Tapia (Labor Markets Economics - Sr Spec, alternate team leader), and Ethel Muhlstein (Operation Sr. Analyst) will be responsible for monitoring and facilitating the activities required to reach the expected results. The TC will be monitored and evaluated according to the requirements of the Bank and through the Results Matrix. Annual reports and a final report will be prepared in Convergence, according to the Grants Unit and the Donor instructions.

IV. Executing agency and execution structure

- 4.1 The Bank, through SCL/LMK, will execute this TC. This is justified given the regional scope of planned activities, outputs and outcomes and the Bank's experience in generating knowledge for the benefit of LAC countries. The implementation of this TC by the Bank will facilitate the exchange and application of knowledge generated by Bank specialists. SCL/LMK will be responsible for the procurement and supervision of the products included in this TC.
- 4.2 Letters from beneficiary countries are not required for R&D TCs. However, non-objection letters from the Bank's liaison offices in the beneficiary countries will be sought before activities in the beneficiary countries take place.

¹¹ Technical documents produced by SCL/LMK on the topic of pension policy in Latin America and the Caribbean highlight the important role that a diverse set of stakeholders play at all stages of countries' pension reform processes. These stakeholders include regulators, tax authorities, pension fund administrators and civil society organizations, among others. SCL/LMK is engaged in ongoing dialogues with many of these stakeholders, for example through the Network for Pensions in Latin America and the Caribbean (Red PLAC).

- 4.3 **Procurement.** The Bank, through SCL/LMK, will contract individual consultants, consulting firms and different consulting services in accordance with current Bank procurement policies and procedures. Specifically, Section AM-650 of the Administrative Manual “Complementary Workforce” will be applied in the case of individual consultants and the Policy for the Selection and Contracting of Consulting Firms for Bank-executed Operational Work (GN-2765-1) and its operational guidelines as well as the Corporate Procurement Policy (GN-2303-20) will be applied for different consulting services. The initial procurement plan provides information on the contracts foreseen and their applicable monitoring and contracting methods.

V. Major issues

- 5.1 The main risk associated with this TC is the low institutional capacity of some government agencies, mainly due to the shortage of personnel that is sufficiently qualified to apply the learnings generated through this TC. Another risk is related to the possibility that the policy options emerging from the technical notes will, mainly due to political factors, only slowly, or not at all, be translated into practice and that the expected impact of the TC will be muted as a result. This risk is particularly relevant given the multitude of stakeholders that stand to be affected by pension reforms. These stakeholders include citizens, businesses and civil society organizations, among others. Finally, the TC exposes the Bank to a reputational risk given the considerable political charge of pension reform proposals and projects in the countries considered to benefit from this TC.
- 5.2 These risks will be mitigated by the experiences that SCL/LMK has acquired through its efforts in implementing similar operations aimed at advising LAC governments on structural social security reforms. The aforementioned risks will also be mitigated by the proposed dissemination strategy, which will provide guidance to government representatives on how to implement the policy options arising from this TC. The proposed TC will moreover address the above risks by engaging in ongoing dialogues with decision makers at the upper levels of government so as to ensure that the learnings of this TC will be internalized by the officials in charge of implementing pension policy. Finally, the activities of the TC will also include regular consultations with key non-governmental stakeholders such as private sector and civil society actors in order to obtain broad support for the consultants’ findings and recommendations. The Bank’s efforts regarding consensus building and communicating with a broad set of stakeholders will also serve to mitigate the reputational risks that are mentioned in the previous paragraph.
- 5.3 Given failed efforts in the past to promote pension reform, it is critical that there is broad support and understanding of the need for decisions regarding pension reform by the government, as well as in the private sector and civil society. This risk is mitigated by regular consultations with key public-sector stakeholders and other stakeholders in the private sector, and a workshop to disseminate and socialize the consultants’ findings and recommendations.

VI. Environmental and Social Strategy

- 6.1 Based on the nature of this operation, there are no expected significant negative environmental or social impacts. Based on the Environment and Safeguard Compliance Policy (OP-703), the proposed technical assistance has been classified as category C. (See [Safeguard Policy Filter](#) and [Safeguard Screening Form](#)).

Required Annexes:

- Request from client (not applicable for R&D. See ¶4.2.)
- [Results Matrix](#)
- [Terms of Reference for activities/components to be procured](#)
- [Procurement Plan](#)