



SOCIAL SECURITY REFORM

(VE-0100)

EXECUTIVE SUMMARY

BORROWER AND

GUARANTOR:

Republic of Venezuela

EXECUTING AGENCY:

Sector subprogram: Ministry of Finance

Technical-cooperation subprogram: Ministry of Labor

AMOUNT AND SOURCE:

Technical cooperation (IDB) US\$ 45 million

Local contribution US\$ 30 million

Subtotal, technical cooperation US\$ 75 million

Sector loan (IDB) US\$350 million

Total US\$425 million

FINANCIAL

TERMS AND

CONDITIONS:

Amortization period: 15 years

Disbursement period

Technical-cooperation funding: 36 months

Sector loan: 36 months

Interest rate: variable

Inspection and supervision: 1%

Credit fee: 0.75%

Currency: United States dollars from the Single Currency Facility

OBJECTIVES:

The objective of this operation is to support the Government of Venezuela's efforts to reform the social security system in order to transform it into a comprehensive system resting on a solid financial foundation, within an appropriate regulatory framework and with increased private-sector participation. The new comprehensive social security system will comprise three administratively and financially independent subsystems (pensions, unemployment and health). Policy reforms will focus on attaining the objectives detailed below.

First, a new pension subsystem compulsory for all workers and employers will be established based on a combination of the principles of intergenerational transfers and individually-funded accounts; the system will strive for greater equity and will be administered by properly regulated and supervised public, private and semipublic entities. The vested rights of current retirees will be protected under a trust guaranteeing a minimum pension. Supervisory functions will be discharged by a new autonomous superintendency fully equipped to carry out its responsibilities.

Secondly, a new unemployment subsystem financed by contributions will be established, incorporating the same principles of solidarity and funding as the pension subsystem and supervised by a superintendency. The subsystem will offer monetary compensation, contributions to the health subsystem and job training to help workers rejoin the work force. As a parallel measure, the severance benefits system (which had based benefits on length of service) has been modified, existing obligations will be paid off and a new system with sufficient funding and ceilings on benefits created.

Thirdly, a new health subsystem will be established with separate regulatory, financial, insurance and service delivery functions, and a balance will be maintained between benefits and available resources.

This subsystem will comprise three plans: compulsory, voluntary and public-assistance-based. The compulsory plan will be self-financed with contributions from workers and employers and participants will be able to select their service providers. The voluntary plan will cover additional services. Lastly, the assistance-based plan, which will be funded from general tax revenues, will provide coverage for noncontributing participants. All three plans will be subject to the technical rules of the Ministry of Health and Social Welfare (MSAS) and will be under the supervision of an autonomous health superintendency.

Fourthly, the subsystems described above will be integrated into a unified auditing and billing system, thereby curtailing evasion and reducing administrative and collection costs.

DESCRIPTION:

The loan comprises two subprograms: a fast-disbursing sector loan of US\$350 million and a parallel technical-cooperation component of US\$45 million, for a total of US\$395 million. The sector component will be disbursed in three tranches of US\$150 million, US\$100 million and US\$100 million, respectively, over a three-year period. The disbursement of each tranche will be contingent upon fulfillment of the conditions stipulated and on the maintenance of a macroeconomic environment consistent with program objectives.

Prior to submission to the Board of Executive Directors, and as a condition precedent to disbursement, the government enacted the Comprehensive Social Security System Act [Ley Orgánica del Sistema de la Seguridad Social Integral] (LOSSSI) and the Labor Act [Ley Orgánica del Trabajo] (LOT), and the Interministerial Committee [Comité Interministerial] (CI) approved draft legislation relating to the pension, unemployment and health subsystems. The accounts of the three subsystems were also segregated by establishing temporary trusts. These steps are helping to make the social security reform process irreversible.

Second tranche. Prior to the disbursement of the second tranche, the technical design of each subsystem will be prepared, special legislation will be enacted and the relevant regulations will be approved.

Third tranche. The comprehensive social security system must be operational, its various funds and its supervisory and inspection agencies must be functioning smoothly and at least 62% of formal sector workers must be system participants.

Furthermore, the parallel technical-cooperation component of US\$45 million will be used to fund policy and institutional reform efforts. The purpose of the subprogram is to finance the technical preparatory work required to design the system, supply any legal assistance needed to prepare the legal and regulatory framework, ensure the institutional strengthening of the new entities (including superintendencies and solidarity funds) and conduct a public information campaign to help the population understand the system's features, operation and advantages.

ENVIRONMENTAL

CLASSIFICATION:

The Environment Committee, at its meeting of June 11, 1996, classified this as a Category II operation.

IMPACT ON POVERTY:

Not applicable.

EXCEPTIONS TO BANK

POLICY:

The counterpart for the technical-cooperation operations will hire the United Nations Development Programme (UNDP) to handle the financial administration of the program, inasmuch as this agency possesses the technical and institutional capacity to perform the work stipulated in the terms of reference as indicated in Annex III (see paragraph 4.19).

CONDITIONS

PRECEDENT TO THE

FIRST DISBURSEMENT

OF TECHNICAL-

COOPERATION

FUNDING:

The borrower will: (i) demonstrate that the policy requirements for the first tranche of the loan have been fulfilled; (ii) supply evidence to the Bank that the Program Coordinating Unit (PCU) is functioning; (iii) provide the Bank with the terms of reference for the procurement of consulting and advisory services during the first year of operation; and (iv) submit the first annual operating plan for the subprogram to the Bank.

BENEFITS:

By providing adequate incentives to reduce the risk of abuses, the program will yield the benefits described below. First, it will result in the improved delivery of health services, in particular with respect

to their efficiency and effectiveness, through a regulated system of insurance coverage and prepaid medical care plans. Secondly, the program will have a positive social impact since low-income formal sector workers with inadequate savings will be guaranteed a minimum pension under the system's solidarity pillar. Thirdly, the program will increase domestic savings and promote their more efficient distribution through increased financial intermediation, a variety of available financial instruments and integration into international markets. Lastly, economic productivity will rise as the work force becomes more flexible, thereby avoiding the contractual distortions characteristic of the earlier severance benefits system.

RISKS:

The principal risks are: (i) the slow pace of reform of the other structures in the social security area; (ii) delays in the development of long-term financial instruments with positive real interest rates; (iii) the weakness of the banking sector; and (iv) the lack of fiscal discipline needed to ensure a stable macroeconomic environment.

Nevertheless, the following activities should reduce these risks. First, the LOSSSI sets a maximum of two years from enactment of the IVSS liquidation legislation. Second, the special legislation being drafted by the Venezuelan authorities and covering each subsystem includes specific provisions on the transition from the old to the new system; in the case of health, these include placing health centers in a temporary trust and giving the trust a specific mandate to transfer the centers to other operators, thereby in practice substantially reducing the role of the IVSS. Third, in order to minimize the risks set out under (ii) and (iii) above, the Government of Venezuela, with the assistance of the Bank, the World Bank and the International Monetary Fund (IMF), is consolidating the legal and regulatory framework of the financial sector under the technical-cooperation operation for the strengthening of the financial sector (893/OC-VE). Moreover, under this program, the new pension subsystem cannot begin operations until positive real rates of return have been registered. Fourth, the authorities are negotiating with the IMF to secure a new financing facility, and the Congress is debating draft legislation on the establishment of a stabilization fund; both of these measures will contribute to prudent fiscal management.

THE BANK'S

COUNTRY AND

SECTOR STRATEGY:

The Bank's strategy is guided by three key objectives: (i) maintain macroeconomic stability; (ii) reduce inequality and alleviate poverty; and (iii) stimulate the productivity of nonoil resources by developing the private sector. The common denominator of these objectives is the desire to support policy and public sector reform, which is a primary objective of the Bank's operations strategy.

Social security reform will help to attain these objectives and also presents opportunities for policy and

public sector reforms. Unless reforms are implemented, the current social security system will destabilize public finances, which will have serious consequences for macroeconomic stability. The old system, particularly the severance benefits component, places a heavy burden on the formal private sector by raising the cost of labor contracts and impeding increased productivity. Lastly, because it has been inefficient, ineffective and inequitable, the current system has not had a significant impact on poverty alleviation.

SPECIAL

CONTRACTUAL

CONDITIONS:

The program will be implemented under two contracts, a fast-disbursing loan and a technical-cooperation loan. Sector program disbursements will be subject to the provisions set out in Annex I to this document. The loan contracts also will include standard clauses pertaining to audits, inspections, disbursements, evaluations and procurement, as stipulated in the same annex.