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Pensions Systems in Central America: 1999 Report

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Pensions Systems in Central America: 1999 Report

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Abstract

This paper describes the current state of social security systems in five countries in Central America: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. Particular attention is given to efficiency aspects of the systems, like the way systems collect contributions, the degree of evasion and coverage, and what kind of services they provide to the contributors. The paper also summarizes information related to the financial status of the systems, as well as other indicators of performance like average pension, expenses and revenues, etc. Even though there are significant differences among these countries' social security systems in terms of maturity, coverage, and efficiency, most programs would benefit from adopting simple measures like computerization of records (to reduce time required to process claims), and the separation of health from old age insurance. Some information is also provided regarding both voluntary and mandatory private pension funds, which have been introduced recently in Costa Rica and El Salvador respectively.

Keywords: Central America, old age insurance, pensions, retirement, social security

JEL code: H55

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1. INTRODUCTION

Social security systems that provide income for retirement have traditionally been financed under a pay-as-you-go (PAYG) scheme. The main feature of PAYG schemes is that current workers pay for current retirees. This makes PAYG plans vulnerable to demographic shocks and may result in solvency problems in the long term. The increase in life expectancy and the general decrease in fertility rates over the last several decades have reduced the dependency ratio, meaning that the number of current workers that sustain each current retiree has gone down. As this ratio becomes lower, the revenues of the system decrease with respect to the expenses. Adjustments to either contributions or benefits are then needed to restore a balance to the social security accounts. This type of dynamics is inherent to pay-as-you-go plans, irrespective of the degree of development of a country.¹

Central America has not escaped this problem. In Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua, social security systems are, with some exceptions, a relatively recent phenomenon. The first retirement program in the region was established in Guatemala in 1932, for public sector employees. Universal Old Age, Survivors, and Disability programs (OASDI) were created in 1941 in Costa Rica, 1969 in El Salvador, 1971 in Guatemala, 1972 in Honduras, and 1957 in Nicaragua.² Some systems are close to maturity, while others are relatively young, as documented in Cifuentes and Larraín (1997).³ Even in young systems, performance has been rather disappointing in terms of assuring long-term solvency, allocating resources efficiently, and guaranteeing coverage to a significant proportion of the elderly population.

¹ One could argue that less developed countries have a lower life expectancy and a higher fertility rate, and in a sense are not subject to the dynamics mentioned in the text. This is true to a certain extent, but over time the phenomenon has been observed in developing countries too.

² The term universal is a misnomer. No system in Central America is universal (except maybe Costa Rica), because rural workers, which represent an important percent of the working population, are not covered in most of these countries. The same applies to the high percentage of the population working in the informal sector of the economy.

³ Maturity is achieved when the first cohort of full time contributors starts retiring. At that moment the ratio of contributors to pensioners gets close to the dependency ratio, i.e., the ratio of labor force to elderly (population over 65).

Many factors contribute to the inefficient provision of income for retirement in developing economies. Most of these can be observed in some Central American countries. First, computerization of records was delayed for a long time, and is still not enacted in some countries. This greatly delays the processing of claims, and results in a deficient service. Second, the social security administrations in these countries usually provide more than OASDI benefits. The administrations are also in charge of health insurance, and do not, in many cases, maintain these two accounts separately. Often, the deficit in one account, usually health, is covered by funds from the other. Third, some governments have appropriated part of the social security funds for other purposes. Fourth, there is conflict of interest between the traditional and original role for which these institutions were created and the service they actually provide (e.g. provision of mortgage loans or subsidized housing for the contributors in some groups). Finally, very lax policies have resulted in negative or low return investment policies, in some cases depleting completely a trust fund that could have sustained retirement benefits for years.

During the last two decades, a number of developing and developed countries have implemented different measures to cope with social security's solvency problems. The solutions adopted can be placed into one of two groups. The first consists of a conservative approach which calls for changing some features of the benefit formula so that the system breaks even again. This involves increasing the retirement age, the cap to wages subject to contributions, and the contribution rate. It also involves a decrease in the replacement ratio, or a combination of these.⁴

A second, more radical approach that has been adopted mainly in developing economies consists of implementing structural reforms, and replacing an entire social security system with a new one. As in the case of Chile in 1980, and other Latin American countries afterward, the PAYG system was replaced totally or partially by a defined contribution retirement plan that uses individual accounts. In this type of system a worker contributes a percentage of his salary every month, which is deposited in a personal account administered by a pension fund manager. The proceeds from investing these funds together with the principal are used at the time of retirement to buy an annuity or to schedule a program of funds withdrawals from the individual's account..

⁴ The replacement ratio is the ratio of the retirement benefit to the last period's earnings.

As for solving the other set of problems, some countries have moved towards improving efficiency. This is difficult to do. Yet, in some cases a structural reform also provides a perfect scenario for improvements in efficiency. This is so because a radical change offers the opportunity for reforming other aspects of the social insurance institutions, such as computerization of accounts, improvements in record-keeping, creation of monitoring agencies, etc.

This paper describes the current state of social security systems in five countries in Central America: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua with a focus on the efficiency aspect of the systems, i.e. how systems collect contributions, and what kind of service they provide to the contributors. The paper also summarizes information related to financial status of the system as well as other indicators of performance, like contributors, average pension, etc. Sections 2 to 6 contain information for each Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua separately. Section 7 concludes and section 8 contains the bibliography.

2. COSTA RICA

A. Current State of the System

Costa Rica has many different pension programs operating by independent rules and with varying degrees of efficiency. The most important one is the *Caja Costarricense del Seguro Social* (CCSS) followed by the *magisterio* (teachers) program. The latter used to be a standard pay-as-you-go, defined benefit plan. In 1995 this system closed and a defined contribution plan with individual accounts replaced it.

Costa Rica has very good social security coverage for its working population. The coverage is the highest in Central America and is similar to that of much richer countries. Coverage increased during the 1990s to more than 50 percent of the working population. In 1997, however, it fell. (See Table 1.) If matched against labor force instead of the working population, coverage is slightly less than 50 percent.

In every social security system coverage increases significantly during the first years of operation and often become stagnant afterwards. Usually the system becomes more

“universal” over time first by incorporating public sector workers, then private sector workers and finally other groups like state workers or the military.

Three factors help to explain why coverage in the Costa Rican systems has, conversely, decreased. They also suggest how coverage can be extended in the future. First, the system does not cover a significant number of self-employed workers and does nothing to foster their participation. Table 2 shows that while the CCSS covers 70 percent of salaried workers, it covers less than 10 percent of the self-employed. Coverage for the self-employed is not mandatory and there is no enforcement mechanism to encourage this group to participate. Information about the evolution of social security coverage by type of work is not available. It is possible that self-employed coverage has decreased over time.

Second, the rural population constitutes a significant portion of the labor force and coverage is lower in rural areas, according to Rodríguez Herrera and Durán (1997) even though it is mandatory for rural workers to contribute to social security in Costa Rica. (It is not mandatory in most other Central American countries.)

Third, coverage depends on the percentage of informal workers in the economy. The informal sector is closely related to the rural sector and does not participate in social security programs. As the size of the informal sector is correlated with the performance of the economy, coverage could decrease if the economy is doing poorly and more workers move to the informal sector. Attempts to incorporate more workers into the social security system have had mixed results.

Evasion constitutes a significant source of loss in revenues for the CCSS. There are two main types of evasion. Underreporting of earnings constitutes one main source of evasion.⁵ The other arises from non-affiliation, which results greatly from the last two reasons for declining participation, discussed above. The CCSS show that the loss in revenues amounts to 22% from non-affiliation, while 9% is due to underreporting of earnings (Rodríguez Herrera and Durán, 1997).

⁵ Since the benefit is calculated using the last years of earnings history, there is a tendency to underreport the first years of earnings and over-report the last years of earnings.

TABLE 1
COVERAGE OF THE CCSS, COSTA RICA, 1996 AND 1997

Year	Total Population	Labor force	Employed	Contributors	Contributors/ Employed
1996		1,220,914	1,145,021	621,975	0.54
1997	3,270,000	1,301,625	1,227,333	634,092	0.51

Source: Ministerio de Economía, Cifuentes & Larraín (1997), Rodríguez Herrera & Durán (1997).

TABLE 2
PERCENTAGE OF WORKERS AND SELF-EMPLOYED COVERED BY THE CCSS, 1997

1997	Workers	Self employed
Total	858,094	331,312
Contributors	600,854	29,998
Contrib./total	0.7	0.09

Source: Rodríguez Herrera & Durán.

The teachers pension plan is a significant fiscal burden on Costa Rica, despite the relatively small number of teachers enrolled in the now closed program. 1997 estimates suggest that pension expenditures charged to government accounts were about 3% of GDP and 11% of total government expenditure.

As the time the research was performed, it was not possible to collect more information about the pay-as-you-go portion of the teachers fund.

TABLE 3
CONTRIBUTORS AND PENSIONERS BY TYPE OF RISK, CCSS, 1996 AND 1997

Year	Contributors	Pensioners			Cont./Pensioners
		Old Age	Survivors	Disability	
1996	626,686	33,279	31,889	31,508	6.48
1997	675,525	34,494	33,972	32,681	6.67

Source: CCSS, Depto. Actuarial y Estadístico.

B. Private Pension Funds

Private pension funds in Costa Rica are completely voluntary. Begun in the 1980s, the private pension funds industry remains relatively small. The Superintendencia of Pensions (*Superintendencia de Pensiones*) first regulated the industry in 1995, and full supervisory operations by the central bank and the ministry of finance began in 1996.

The regulatory structure for pension funds in Costa Rica is very strict for a voluntary system. In Costa Rica, pension funds constitute the “third pillar” in the provision of retirement income. All aspects of the operation of pension funds, except the length of the contract and the amount of contributions, which are set by an agreement between the management company and the worker, are subject to regulation. In many cases, these regulations are as strict as those of mandatory systems. This may be intended to create confidence in individuals, or may be an intermediate step to the further development of pension funds. The current proposal for reform to social security considers using private pension funds as a second, mandatory pillar.

When the *Superintendencia* started to gather and maintain data on pension funds in late 1996 there were operating pension funds. By the end of 1997 there were nine pension fund management companies, as well as the teachers fund, which is also supervised by this regulatory agency, as Table 4 shows. Many of these funds operated as part of banks, which were obligated to administer these funds separately from the bank operations.

The evolution of contributors is striking. Between 1997 and 1998 contributors decreased by 15 percent. This difference, however, is only due to the reordering of accounts. The management companies had until the end of 1997 to separate the pension funds operations from their bank operations (most pension funds originated as a financial instrument in banks) and some previous operations were excluded from the funds. If all the contributors are included, the number of contributors remains more constant; in October of 1997 there were 104,355 individuals participating in some kind of pension fund, while in December 1997 there were 108,894 participating. The regulation did not include updated measures regarding the administration of pension funds by management companies.

TABLE 4
TOTAL ASSETS, RENTABILITY AND CONTRIBUTORS TO PENSION FUNDS

	1997		1998	
	Total Pension funds	Teachers fund	Total Pension Funds	Teachers Fund
Portfolio in Colones (thousands)	12,781,954	5,554,590	11,157,876	9,203,122
Portfolio in dollars	68,805	--	102,843	--
Annual Average Rentability in Dollars (nominal)	0.19	N/A.	N/A.	N/A.
Number of Funds	9	1	8	1
Number of Affiliates	93,328	15,566	79,240	15,770

Source: Superintendencia de Pensiones (1998).

The number of affiliates in the teachers' fund increased slightly, from 15,566 in December 1997 to 15,770 in June 1998. The fund's assets increased from 5.5 billion Colones (US \$ 22.5 million) at the end of 1997 to 9.2 billion (US \$ 34.5 million) in 1998. This is negligible as a percentage of GDP.

During 1998 two pension funds merged bringing the total number of funds, including the public fund, to its current level of eight. The market, however, is highly concentrated in one or two management companies. One company has 65 percent of the total holdings in Colones, and approximately 63 percent of the total number of contributors. Despite regulations and rules that aim to diversity the portfolio, investments are not highly diversified. The percentage of funds invested in the public sector ranges between 75 and 95 for the funds in Colones. Four management companies operate funds in dollars. These funds invest between 49 and 100 percent in the public sector.

C. Collection of Contributions and Quality of Service

Even though the teachers fund is significantly smaller than the CCSS, the latter grants benefits to its affiliates much more efficiently. The CCSS has done a very good job during the last few years of computerizing its accounts and setting individual

accounts for each worker in order to keep track of participants' contributions. Individual workers who want to check the amount of their contributions can easily access these accounts. CCSS branch offices immediately answers inquiries. Employers pay their contribution at one bank and at the 72 branches of the CCSS across Costa Rica.

The state administers the PAYG portion of the teachers fund. The system is not computerized but maintains records in microfiche. This contributes to an extremely inefficient process of checking contributions and granting benefits. In order to check contributions made by teachers, it is necessary to look into the government payroll for those periods the teacher claimed to have worked, and find his/her name in the payroll. This process takes an extremely long time, and is delayed even more because of the lack of a unique identifier. Part of the records have been ordered alphabetically and another part through an ID number. As a result, it takes from six months to one year for teachers enrolled in this PAYG plan to get a retirement benefit. In comparison, it takes no more than a month for workers in the CCSS.⁶

The law that regulates retirement procedures both for teachers and other workers has been subject to numerous changes. Many teachers are not well informed of changes in the law and requirements causing an estimated 40% of applicants to have their application for retirement benefits be rejected.

⁶ The 'survivors' pension in the CCSS is immediate.

TABLE 5
REVENUES AND EXPENSES, CCSS, 1996 AND 1997
(Millions of Colones (1996) except last two rows)

	1996	1997
Revenues	60,808.8	61,127
Contributions	43,428.6	45,990
Interest	16,670.3	13,436
Other	710	1,698
Expenses	40,837.5	42,266
Pensions	32,869.8	35,021
Services	3,719.3	3,959
Administrative	1,210.6	2,016
Other	3,037.8	1,268
Surplus	19,971.3	18,861
Avg. Wage	N/A.	65,491
Avg. old age pension	37,855	38,494

Source: CCSS, Departamento Actuarial y Estadístico.

As shown in Table 5, the CCSS is running a surplus. The figures in 1997, however, are worse than in 1996. Revenues increased by less than 1 percent, expenses increased by about 3 percent and administrative expenses rose by 66 percent. The Costa Rican government is worried about the long term solvency of the system, given the generous benefits they offer. Social security reform is now being discussed in Congress that includes a multi-pillar system to replace the CCSS.

3. EL SALVADOR

A. Current State of Social Security

El Salvador implemented structural reforms to its social security system in 1997. It is still too early to evaluate the full effects of the reform. Certainly, however, some elements of the old system, which still functions but is closed to new workers, seem to have spilled-over into the new. There are two main public social security systems in El

Salvador: the ISSS, Instituto Salvadoreño del Seguro social, and the INPEP, Instituto Nacional de Pensiones de los Empleados Públicos, for public sector employees.

The new social security system is a defined contribution system based on individual retirement accounts. Pension fund administrators administer the funds accumulated in the accounts. The *Superintendencia de Pensiones* regulates these funds and administrators. This new regulatory agency not only monitors private pension funds, but is also in charge of the retirement sections of both the INPEP and the ISSS. A private system was created at the same time. The requirements for a retirement benefit were homogenized with those for workers who remained under the old systems.

The old system did not extend high coverage. It remained almost constant in 1997, at 22 percent of the labor force. (The new law enabling contribution to a private system took effect in 1998.) The ISSS only covers urban workers. Self-employed were incorporated in 1988, on a voluntary basis. Rural workers are outside the system, even if they work in the formal sector of the economy.

TABLE 6
LABOR FORCE AND COVERAGE OF SOCIAL SECURITY IN EL SALVADOR
1996 AND 1997, ISSS

Year	Labor Force	Contributors INPEP	Contributors OASDI ISSS	Total Contr./Labor Force
1996	2,275,425	139,812	371,961	0.224
1997	2,346,553	146,382	380,127	0.225

Source: ISSS, Estadísticas Anuales 1997; INPEP Memoria Anual.

The ratio of contributors to pensioners is a good prediction of a system's long-term solvency and how soon it might encounter problems. A very low ratio means that very few active workers support each retiree, a situation that may not be sustainable in the long run if the system gives very generous benefits. Tables 7 and 8 show that the ratio of contributors to pensioners in both the ISSS and INPEP is extremely low in 1996 and 1997. The ISSS saw this ration decline from 11.3 to 10.6. The INPEP has an even lower ratio. When the INPEP was created, it absorbed a number of different pension plans that

already existed. In this sense, INPEP is an older program than the ISSS even though it was created at a later date. This largely explains why the ratio is much lower for INPEP than for the ISSS.

As of June 1998, the number of workers affiliated with the new system was 278,858, which is more than 95 percent of the estimated potential affiliation. Yet, this does not mean that coverage is high, because affiliation still excludes rural and self-employed workers. Provisions to incorporate these two groups remain to be established.

TABLE 7
PENSIONS BY TYPE OF RISK, INPEP, 1997

Year	Total pensions	Old Age	Survivors	Disability	Contribution/ Pensioners
1997	46,276	30,325	14,973	978	3.1

Source: INPEP, Memoria de Labores 1997. Superintendencia de Pensiones, Boletines Estadísticos 1997.

Table 9 shows the average value of ISSS pensions and taxable wages for 1996 and 1997 when the average old age pension increased from 55 percent of taxable wages to 62 percent of taxable wages. This seems to be an historically high level, which had only been seen previously during the final years of the 1980s (see Cifuentes and Larraín, 1998). Most of the increase comes from a higher absolute value of pensions, since the real wage is almost the same as in the previous period.

TABLE 8
PENSIONS BY TYPE OF RISK, ISSS, 1996 AND 1997

Year	Total pensions	Old Age	Disability	Survivors	Contribution/ Pensioners
1996	32,855	20,862	824	11,169	11.3
1997	35,716	23,158	879	11679	10.6

Source: ISSS, Estadísticas 1997.

TABLE 9
AVERAGE PENSION AND TAXABLE WAGE, ISSS (1996 COLONES)

Year	Average wage	Average Pension	Avg. pension/Avg. wage
1996	2,300.8	1,265.04	0.55
1997	2,291	1,429	0.62

Source: ISSS, Estadísticas 1997.

TABLE 10
ISSS, EXPENSES AND REVENUES

	Colones 1997	Percentage of GDP
Total Revenues	501,608,408	0.5%
Workers contributions	120,089,431	
Employers contributions	240,539,491	
Government transfers	5,922,008	
Investments	127,991,300	
Other	7,066,178	
Total Expenses	570,148,000	0.56%
Old age	419,086,649	
Disability	12,796,134	
Survivors	89,413,647	
Administrative cost	39,188,100	0.039%
Other	9,663,470	
Net Surplus	(68,539,592)	0.056%

Source: ISSS, Estadísticas 1997.

Table 10 shows revenues and expenses of the ISSS during 1997. The values are similar to previous years with a downward trend in revenues and an upward trend in expenses. As a percentage of GDP, revenues are at the lowest level since 1991, while expenses are the highest since the 1981 record. Even though these trends have resulted in a deficit for the first time, the size of the deficit as a percentage of GDP is negligible. As people move to the private system, revenues collected by the ISSS will continue to

decline and the deficit will increase. This will imply a transition deficit that the government has to cover.

B. Private Pension Funds

El Salvador passed a social security reform law in December 1996 but the system only began to operate in 1998. The supervisory agency, *Superintendencia de Pensiones*, published the first set of statistics on the pension funds performance in July 1998. It is still too early, however, to evaluate the effectiveness of the system.

Affiliation is only mandatory for salaried workers who were below 36 years of age at the time the law was passed. It is voluntary for male workers between 36 and 55 years of age and women between 36 and 50. Those older than these respective upper bounds must remain in the public sector. Self employed and agricultural workers may participate on a voluntary basis. Employers are required to contribute 6.75 percent of payroll, while employees contribute 6.25 percent of their wage. Three percent of this finances the disability and survivor insurance as well as administrative costs.

The *Superintendencia* estimates that about 95 percent of the potential affiliates have already signed up for one of the 5 private fund management companies. By June 1998 there were 278,858 affiliates in the new system. With five management companies, the market does not seem to be highly concentrated. The largest management company serves 33 percent of the affiliates, while the smallest serves 3 percent.

Table 11 shows the total size of funds and its composition. As can be seen, almost 73 percent is invested in the public sector because there are not enough instruments available for the funds to invest in the domestic financial market. This has generated the first challenge of the new system. The lack of adequate instruments and private investment opportunities has caused most management companies to violate law that mandates portfolio diversification and limits investments.

TABLE 11
COMPOSITION OF PENSION FUNDS, EL SALVADOR, JUNE 1998

	Amount (in Colones)	Percentage
Fixed Income		
Government	11,953,300	0.72
Bank deposits	4,490,000	0.27
Variable Income		
Stocks	70,239	0.0043

Source: Superintendencia de Pensiones (1998)

According to the *Superintendencia*, the system is now also encountering large problems with advertising. By law, the *Superintendencia* has to screen and to authorize advertisements released by the management companies in order to prevent distribution of misinformation to affiliates. Yet, even before the system began to function there was heavy advertisement and this continues. The management companies have complained and started to use third parties, often related companies, to advertise in their name. Since the *Superintendencia* does not have authority to screen these ads, there is concern that the ads provide false or misleading information. The *Superintendencia* must determine how to limit this type of advertisement.

C. Collection and Quality of Service

The remaining public social security system is also aiming to become more efficient within the larger structural reforms to the system. One of the main accomplishments claimed by the reformers has to do with workers earnings histories. The ISSS used to record the exact time worked and employer's ID number (in the case of INPEP it is only time worked) for each participant. At the time of retirement, employer's records needed to be checked manually in order to find out the worker's earnings and contributions to social security. Now the ISSS together with the *Superintendencia de Pensiones* are putting this information, including earnings history as far back as 1974, into individual computerized records. Since late 1997 workers have been able to check their own records and to inquire about their contributions with an immediate response by ISSS.

Benefit claims are also filed in a new way. Now, the worker initiates the retirement benefit process by completing an application. Once submitted, the entire process takes an average of 3 to 6 months before dispersal of benefit. In the near future, once the earnings history records are complete, the ISSS will notify *ex officio* the workers about six months prior to their mandatory retirement age, providing them with a summary of contributions and earnings history. It is expected that the average time needed to process a claim will be reduced to 15 days.

In El Salvador both ISSS and INPEP use banks to collect contributions. How particular banks are selected for this role, however, is not very clear. INPEP uses two banks, which offer the service for free because INPEP holds part of its trust fund in those banks. ISSS uses only one bank in addition to its own agencies.

The new private system also relies on banks for collection of contributions. Each pension fund (AFP) chooses which and the number of banks with which it will work. The *Superintendencia* must approve this choice.

4. GUATEMALA

A. Current State of Social Security

The Guatemalan social security system is highly fragmented. Although the *Instituto Guatemalteco del Seguro Social* (IGSS) covers the majority of the workers, there are 17 different pension programs in the country. The second largest plan covers public employees and the third the military. The other 14 plans complement the IGSS; workers contribute to both the IGSS and their respective complementary plan.

Despite the large number of plans, social security coverage in Guatemala is low and has not recently increased. 29 percent of the labor force was covered in 1993 and by 1997 only 25 percent of the labor force contributed to social security. The rural population is large—nearly 45 percent in 1997. Many rural residents likely participate in the informal labor sector, which helps to explain low coverage rates.

The number of beneficiaries has increased for every type of risk and most heavily in the old age category. Between 1993 and 1997, the number of retirees increased 22 percent, while survivors increased 19 percent and disability 17 percent.

The Guatemalan system is balanced and does not face immediate solvency problems. The most significant change in 1997 was a sharp decrease in the return to investments compared to the previous year. (See Table 14.) (1996 appears to have been an exceptionally good year in terms of investment returns.) Even with the decline, the system had significant surpluses in both years, and during the period 1993-1997 the growth of revenues was higher than that of expenses.

The main problem facing the IGSS is the joint administration of OASDI and the health insurance component that is facing financing problems. In 1996 health contributed 55% of revenues and consumed 70% of expenses. The situation improved slightly in 1997, to form 61% of revenues and 70% of expenses respectively.

TABLE 12
COVERAGE BY IGSS IN GUATEMALA, 1995-1997

Year	Population	Labor Force	Contributors to IGSS	Contribution/ Labor Force
1995	10621226	3095058	855596	0.27
1996	10923607	3200975	852243	0.26
1997	11234597	3310517	851292	0.25

Source: IGSS, Depto. Actuarial y Estadístico.

TABLE 13
CONTRIBUTORS AND PENSIONERS BY TYPE OF RISK IN GUATEMALA, 1993-1997 (IGSS)

Year	Contributors	Pensioners			
		Total	Disability	Old Age	Survivors
1993	823,239	85,531	9,103	30,698	45,730
1994	830,324	92,826	9,783	33,616	49,427
1995	855,596	98,893	10,463	35,727	52,703
1996	852,243	102,667	10,693	37,331	54,643
1997	851,292	103,107	10716	37546	54848

Source: IGSS, Depto. Actuarial y Estadístico.

TABLE 14
REVENUES AND EXPENSES TO THE IGSS, GUATEMALA, 1993-1996 (1993 QUETZALES)

	1993	1994	1995	1996	1997	1997 (% of GDP)
Revenues	313,577,297	417,715,684	442,811,326	588,489,328	455,596,101	0.63%
Employers cont.	154,975,614	163,716,396	183,233,402	188,968,514	185,783,958	
Workers cont.	80,656,812	81,825,976	91,541,481	96,743,654	96,579,500	
Return to Investments	77,220,059	170,145,308	167,553,829	302,012,606	172,566,982	
Expenses		200,786,284	222,692,308	248,411,889	249,492,504	0.35%
Old Age Benefit	87,391,599	96,468,217	106,417,717	123,979,694	130,431,302	
Disability	14,788,866	17,938,571	20,322,619	22,015,020	21,652,591	
Survivor Benefit	40,612,335	46,572,221	51,954,693	58,012,117	58,638,682	
Administrative Costs	37,348,286	39,807,275	43,997,279	44,405,058	38,769,928	
Surplus	133,233,439	216,929,400	220,119,018	340,077,438	206,103,597	0.28%

Source: IGSS, Informe Anual de Labores, 1997.

B. Collection and Efficiency

Even though the OASDI program at the IGSS does not face short term financial problems, the performance of the system is poor and urgently requires change. Calculation of benefits is still performed manually, creating significant delays in the granting of pensions. Individual records are kept on employer accounts instead of worker accounts, which means that workers cannot check if employers have made required contributions and how much has been contributed on their behalf. Guatemala also has the poorest performance record in Central America on the processing of claims. A worker cannot work while the claim for a retirement benefit is processed, which takes on average more than a year.

The IGSS collects the benefits itself. While it has many branches in Guatemala City it does not in the rest of the country. This is unusual given the well-developed banking system in Guatemala but may be a result of the authorities' greater concern with the health insurance system. While the health system consumes most of the IGSS resources,

it provides very poor service. Perhaps because of this concern, most changes to the IGSS have occurred in the health care sector, including permitting the private sector to participate in the provision of health care, rather than in retirement areas.

In 1997 the Government attempted to push forward social security reform. The plan was very similar to the Chilean system and authorized the creation of private pension funds to administer individual accounts. Congress rejected the reform proposal. As a reaction to this, or in anticipation of a new attempt to implement a structural social security reform, a number of private pension plans have already started to operate, creating an additional problem due to the lack of a regulatory framework for their operation.

5. HONDURAS

A. Current State of Social Security

Honduras has a relatively young social security system, which is reflected in the high ratio of contributors to pensioners. There are three main plans providing income for retirement. The *Instituto Hondureño del Seguro Social* (IHSS) covers private workers and some public employees. Most public employees, however, belong to the *Instituto Nacional de Jubilaciones y Pensiones de los Empleados y Funcionarios del Poder Ejecutivo* (INJUPEMP). Teachers have their own system *Instituto Nacional de Previsión del Magisterio* (INPREMA). The IHSS also covers health insurance for workers affiliated to the other plans.

Coverage has increased during the 1990s. Table 15 shows that about 22 percent of the labor force contribute to the OASDI program in IHSS. Including coverage by INPREMA and INJUPEMP, about 25 percent of the labor force is covered by a retirement plan, up from about 20 percent at the beginning of the 1990s. Coverage decreased in 1997, but it is not possible to make inferences about the transitory or permanent trend from that one year of change.

Table 16 contains the ratio of contributors to pensioners for the IHSS and Tables 17 and 18 show the same for INJUPEMP and INPREMA, respectively. The ratio is high in the IHSS, at around 34 contributors per pensioner, and somewhat lower for INJUPEMP

at 17 contributors per pensioner. The ratio is lowest in INPREMA, with less than 5. As expected, the lowest ratio belongs to the oldest program. The INPREMA was created in 1971, IHSS in 1972 and INJUPEMP in 1976. While the ratio of contributors over pensioners has increased over time for the IHSS, it has remained constant in INJUPEMP and decreased slightly for INPREMA. This last institution aimed to increase the base of contributors by incorporating some previously excluded groups. There are still a few groups not covered by INPREMA, such as teachers in localities. This group is not very significant, however, since most of the schools are funded by the national government.

TABLE 15
LABOR FORCE AND CONTRIBUTORS TO IHSS, 1992-1997

Year	Labor Force	Contributors to IHSS	Contributors to OASDI IHSS	Cont./Labor force
1992	1,728,599	389,728	305,437	0.18
1993	1,772,899	437,130	345,182	0.19
1994	1,825,438	475,502	377,826	0.21
1995	1,865,368	518,389	415,317	0.22
1996	1,988,204	535,496	426,882	0.22
1997	2,157,833	553,167	438,086	0.2

Source: IHSS, Depto. Estadístico.

TABLE 16
CONTRIBUTORS AND PENSIONERS BY TYPE OF RISK, IHSS, 1992-1997

Year	Contributors	Pensioner				Cont./pensioners
		Total	Old age	Disability	Survivors	
1992	305,437	11,122	4,800	1,324	4,998	27
1993	345,182	11,601	5,208	1,459	4,934	30
1994	377,826	11,584	5,453	1,490	4,641	32
1995	415,317	12,728	5,571	1,675	5,482	32
1996	426,882	12,855	5,594	1,703	5,558	33
1997	438,086	12,775	5,918	1,647	5,210	34

Source: IHSS, Depto. Estadístico.

TABLE 17
CONTRIBUTORS AND PENSIONERS BY TYPE OF RISK, INJUPEMP, 1993-1997

Year	Contributors	Cot/Pensioners	Pensioners		
			Old Age	Disability	Survivor
1993	54,785	17.8	2,150	483	450
1994	58,841	18.3	2,269	544	395
1995	63,403	18.2	2,434	588	461
1996	67,930	18	2,574	654	527
1997	72,075	17.7	2,763	730	559

Source: INJUPEMP, Memoria Anual 1997.

In spite of a relatively high ratio of contributors to pensioners, the system is performing poorly mainly due to low contribution rates of 1% for workers and 2% for employers. The ceilings for taxable wages are also extremely low.

Attempts to modify social security have been unsuccessful, largely due to strong opposition from specific groups, particularly when groups advocate structural changes and then oppose minor ones, or vice-versa. Opposition barred IHSS authorities from increasing ceilings. According to government officials, a structural reform is not going to happen in the short run since the government is now focused on other sectors of the economy.

Another problem in IHSS is the integration of health and retirement accounts and the overrun in costs of the health aspect. The system has young revenues from the OASDI program are much larger than expenses. This has generated large surpluses over the years. Table 20 shows revenues and expenses from both health and retirement programs for 1992-1996. While the retirement program has been accumulating surpluses, the health program has always been in deficit. Funds from retirement contributions have been used to cover the deficits of the health program. A separation of both should be a first step toward guaranteeing transparency and solvency of the OASDI programs.

TABLE 18
CONTRIBUTORS AND PENSIONERS, INPREMA, 1993-1997

Year	Contributors	Contr./pensioners	Pensioners		
			Old Age	Disability	Survivors
1993	37,163	7.1	4,256	507	443
1994	38,835	6.8	4,657	459	594
1995	39,669	6.5	4,896	489	686
1996	40,684	6.1	5,395	541	681
1997	43,006	5.7	6,136	585	738

Source: INPREMA, Depto. Estadístico.

TABLE 19
REVENUES AND EXPENSES OF IHSS, 1992-1996
(Million 1996 Lempiras)

	1992		1993		1994		1995		1996	
	IVM	EMA	IVM	EMA	IVM	EMA	IVM	EMA	IVM	EMA
Revenues	199,923	242,938	205,130	283,951	208,018	267,530	248,708	226,411	302,047	226,582
Expenses	59,927	297,705	60,594	306,692	64,109	264,612	48,536	230,741	46,336	223,298
Surplus	139,995	(54,767)	144,535	(22,741)	143,908	2,917	200,171	(4,330)	255,711	3,284

Source: IHSS, Depto. Estadístico.

The size of the IHSS revenues reaches nearly 1.5 percent of GDP. The surplus of the system in 1997 was almost 1 percent of GDP. This indicates that the ceiling for taxable wages is not yet a significant problem, at least in terms of IHSS accounts. The ceiling, however, may be affecting the generosity of the program if the calculation of benefits is based on the taxable wage.

Table 21 shows the 1996 and 1997 balance for INJUPEMP, which also carries a sizable surplus. The size of the system is practically negligible, however, compared to the IHSS.

TABLE 20
REVENUES AND EXPENSES, IHSS, 1997

	1997	% GDP
Revenues	722,896,610.73	1.5%
Contributions to OASDI	99,832,271	0.2%
Contributions to Health Insurance	265,707,229	0.5%
Other Contributions	23,029,911.89	
Investments	330,038,563.78	
Other Revenues	4,288,635.94	
Expenses	290,345,735.69	0.6%
OASDI	34,582,605	
Health Insurance	26,332,936	
Administrative	54,610,989	
Services in Kind (health only)	174,819,205	
Surplus	432,550,875.04	0.9%

Source: IHSS, Depto. Estadístico.

A third problem in INJUPEMP and INPREMA is the deviation of these institutions from their original mandate to provide for adequate retirement benefits. They are now engaged in providing mortgages and loans to their members, and also in building subsidized housing, projects that have generated somewhat mixed results and that may compromise the future retirement income of their members.

TABLE 21
REVENUES AND EXPENSES, INJUPEMP, HONDURAS, 1996-1997
(Thousand of 1996 Lempiras)

	1996	1997
Revenues	376,345.6	437,494
Contributions	210,828.7	259,419
Investments	160,361.5	161,938
Other revenues	5,155.4	16,137
Expenses	102,436.6	104,206
OASDI	77,242.2	78,762
Administrative	21,341.1	21,113
Other	3,853.3	4,330
Surplus	273,909	333,288

Source: INJUPEMP (1996, 1997)

B. Collection and Efficiency

All three social security funds in Honduras work relatively well, but INPREMA is the most efficient in providing retirement benefits. The state collects contributions for public sector teachers and a bank does so for private teachers. There is no clear procedure for choosing this bank. At present only one bank executes this function and it is the bank where INPREMA holds most of its saving deposits. INJUPEMP collects funds in a similar way, while many different banks collect for the IHSS. Workers can access individual records at all three institutions, although only about 60 percent of workers at INPREMA can currently do so because the procedure was only recently introduced.

The INJUPEMP offers two different types of benefits: a separation benefit that can be claimed at any time, in which the worker claims a lump sum equivalent to the amount accumulated in his account (somewhat corrected by result of investments), or a standard defined retirement benefit. Under these circumstances it is absolutely necessary to keep track of individuals contributions. Most retirees, however, opt for the retirement benefit.

The few that choose a separation benefit can re-incorporate themselves to the program by returning their original contributions.

Benefit claims are processed quickly, taking the most time at the IHSS where the procedure is performed manually. According to IHSS officials, the IHSS takes on average three months to process a claim.

6. NICARAGUA

A. Current State of Social Security

Nicaragua has made a commitment towards holistic social security reform. A structural reform is under way, where the old PAYG defined benefit system is going to be replaced in part or as a whole by a defined contribution plan with individual accounts administered privately. In preparation for that reform the *Instituto Nicaragüense de Seguridad Social* (INSS) has undergone a major reorganization of its accounts. The INSS was virtually broke in 1995, after the relaxation in requirements for retirement during the 1980s and the enormous increase in special programs that benefited war victims during the early 1990s imposed a heavy burden on the INSS accounts (as discussed in Cifuentes and Larraín).

In order to correct the situation, the following steps were taken:

- separation of health and other expenses from the OASDI program;
- separation of special programs, like war victims and non-contributing programs from INSS;
- computerization of accounts;
- reduction in administrative costs and in government transfers;
- creation of computerized individual records containing earnings and contribution histories.

As a result, records are now more transparent and service somewhat more efficient. The earnings history project began last year, and now workers can check the state of their accounts immediately for contributions made during 1997 and 1998. (INSS is working to recover entire earnings histories and enter them in the individual records.) Before these changes workers were not allowed to check the state of their contributions before

retirement. Moreover, such was virtually impossible because it meant revising manual records of contributions in employers' accounts, not more accessible workers' records. Computerization reduced the average time it takes to process a retirement benefit request to about two months. This process is likely to become even faster once the entire earnings histories are entered into the computer system.

TABLE 22
LABOR FORCE AND CONTRIBUTORS TO INSS, NICARAGUA, 1996-1997.

Year	Labor Force	Contributors	Contributors/Labor
1996	1,534,100	226,914	0.15
1997	1,580,300	242,642	0.15

Source: INSS and Banco Central.

Note: This refers to non-rural programs.

Coverage remains very low, with 15 percent of the labor force contributing to the INSS. This rate is slightly higher than the 13 percent registered in much of the 1990s. Table 23 shows that the ratio of contributors to pensioners is very low, about 6, but better than the 1993-1995 rates.

TABLE 23
CONTRIBUTORS AND PENSIONERS BY TYPE OF RISK, INSS, 1996 AND 1997

Year	Contributors	Cont./Pensioner	Pensioners			
			Total	Old Age	Disability	Survivors
1996	226,914	5.9	38,127	21,691	9,064	7,372
1997	242,642	6	40,449	23,055	9,541	7,853

Source: INSS.

Table 24 shows revenues and expenses of the INSS for 1996 and 1997. An increase in contributions from both workers and employers, proportionally more from the latter, raised revenues. At the same time, the Government decreased its participation

significantly in terms of contributions, 14 percent, while government transfers increased 17 percent. Revenues from investments also increased almost by 30 percent.

Regarding expenditures, an improvement in the INSS accounts can be noticed in the decrease in administrative and other expenses, which in turn diminished the INSS deficit. Administrative expenses were 15 percent lower in 1997 than in 1996, while other expenses declined by more than 60 percent.

TABLE 24
INCOME AND EXPENDITURES OF INSS, FOR OASDI, 1996 & 1997

	1996	1997	1997 % of GDP
Total Revenues	285,974.15	313,888	1.8
Workers contributions	71,615.3	77,088	
Employers contributions	122,731.57	136,492	
Government contributions	20,169.11	17,197	
Investments	63,101.1	81,136	
Government Transfers	1,386	1,625	
Other	6,791.16	347	
Total Expenses	343,415.08	355,069	2
Old Age pensions	168,119.18	184,173	
Disability	62,807.69	64,834	
Survivors	40,401.97	41,399	
Other benefits	21,238.32	22,940	
Administrative expenses	47,681.56	40,475	
Other expenses	3,166.36	1,245	
Fund's Surplus	(57,440.93)	(41,180)	0.24

Source: INSS.

That revenues and expenses are not as high of a percentage of GDP as in previous years reflects the sharp increase in GDP growth during the last few years. The deficit of the INSS is now about a quarter of a percent of GDP, down from 0.34 percent in 1996, and the average pension is now 42 percent of the average taxable wage, up from 40 percent in 1996.

The collection of contributions, which is centralized and performed by the INSS, could be improved. There are only 29 INSS branches in Nicaragua and employers must deposit contributions there. It is not clear why the INSS does not allow banks to participate in the process.

7. CONCLUSION

This paper has updated the 1997 assessment and revised parameters in the quality of services provided by pension systems in the region. Despite the differences across countries, there are a few general recommendations that could improve the health of the systems significantly:

- Separate health and retirement accounts.
- Increase coverage by incorporating rural workers, self-employed, and workers in the informal sector.
- Design mechanisms that will reduce evasion. Setting up individual accounts and reporting periodically to the affiliates the status of their accounts will reduce possibilities of employers under reporting or evading contributions.
- Restore the original goal of social security institutions to provide retirement income and not to engage in other types of activities such as mortgage loans.
- Reduce the time it takes to process claims. The replacement of manual record keeping by computers will facilitate this goal.
- Restore balance to financial accounts. Depending on the case, this will require a change in benefits structure, a change in contributions rate, an increase in the cap to taxable wages, or a structural reform.

Table 25 summarizes some basic features of the social security systems in each of the five countries studied. These provide an indication of how efficiently each system is run. The most urgent needs are the creation of individual accounts in the systems that do not have them and the switch from manual records to electronic record keeping.

TABLE 25
SUMMARY TABLE, SELECTED CHARACTERISTICS OF SOCIAL SECURITY SYSTEMS IN CENTRAL AMERICA, SOME EFFICIENCY PARAMETERS

	Costa Rica		El Salvador		Guatemala	Honduras		Nicaragua
	CCSS	Others	ISSS	INPEP		IHSS	INJUPEMP INPREMA	
Collecting Agency	CCSS	Government	ISSS	Banks	IGSS	IHSS	Government	INSS
Banks can collect contributions	One bank and CCSS agencies	No	Yes	Only 2 banks	No	Yes	Private sector employees (only one bank)	No
Employer has an account	No	No	Yes	No	Yes	Yes	Yes	Yes
Worker has an individual account to keep track of contributions	Yes	No	For recent years	Only register time worked. No way to know if employer evades	No	Yes	Yes (recently). Only 60% of affiliates has personal account	Yes
Worker can access account at any time	Yes	No	Only for selected years	Yes. Only 60% of workers so far have account	No	Yes	Yes	Yes
Time to process a retirement benefit request	1 month (survivors is immediate)	6 months	3-6 months	30 days	1.5 years	3 months	2-3 months	60 days
Worker can work during this period	Yes	Yes	Yes	Yes	No	No	Yes	Yes
Worker can request recalculation of the retirement benefit	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
Time appeal process takes	22 days	6 months-1 year	6 months			--	1 month	1 month
% of times appeal results in correction of benefit	Less than 3%	See section 2	Very few cases go to appeal			--	10%	

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