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A Short History of Pensions in Paraguay

By Victor Molinas

To understand the pension system in Paraguay, we must first walk through its initial steps.

In 1909, the first pension scheme was established; it was designed to provide for the retirement and pension requirements of civil service staff, the military and the police force. Over the years, this scheme became La Caja Fiscal (the Government-run Pension Fund), and it is now managed as a unit of the Finance Ministry (Ministerio de Hacienda).

During this time, other pension schemes focusing on particular collectives were established: Instituto de Previsión Social, or IPS (private sector workers), in 1943; Caja Bancaria (banking employees) in 1951; Caja Administración Nacional de Electricidad (the state-run power company) in 1968; Caja Municipal (Asunción municipality staff) in 1978 and Caja Parlamentaria (members of Congress) in 1978. Today, IPS is the country's largest and most important scheme because it is the only one that also provides health care, but it covers only about 17 percent of the workforce. This low rate of coverage is due to a widespread informal economy, among other reasons.

All these "public schemes" share some primary characteristics: they target salaried workers and servants, they were established by specific laws and their statutes are established in these laws. All of them are mandatory for a specific collective and have a defined benefit (DB) system.

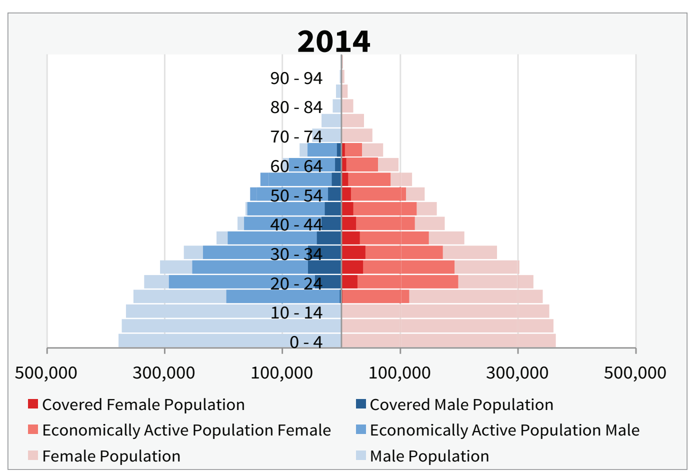
In light of the absence of coverage for independent workers, professionals and entrepreneurs, private sector initiatives were also developed. This initiative came in the form of nonprofit organizations set up under the principles of solidarity and mutual aid in which some people voluntarily organize themselves and set up these entities to gain access to services based on trust and reciprocity. They are known as *mutuales* (a different concept from the Anglo mutual fund) and are run by a specific law designed to manage them.

La Caja Médica (Physicians' Fund, set up in 1981) and La Caja Mutual de Cooperativistas del Paraguay (Cooperatives Associates' Mutual Fund, set up in 1985) focused at first on restricted collectives and had a DB system. This private sector initiative was prompted by the lack of coverage from public schemes and the urgency to have associates at least partially covered. In the 1990s, when the first actuarial deficits started to emerge and with a new school of thought in the region (Latin America Southern Cone countries in particular), the mutuals shifted from DB to DC (defined contribution) schemes, emulating the individual accounts from the Chilean Pension System. Actuarial liability became a concern and started to be addressed. The mutuals grew in affiliates and assets, but they did not achieve high coverage for independent workers/professionals and entrepreneurs.

Also in the 1990s, discussions arose among policymakers about a structural reform of the pension system and the possibility of shifting the public schemes from DB to DC systems. But this idea went no further than a draft.

The public in Paraguay strongly believes that public schemes with DB systems are the most appropriate, although new actuarial deficits are starting to emerge for different reasons: higher life expectancy at retirement age, lower contribution density, high substitution rates and lower interest rates on financial investments. Public opinion also holds that because of the pyramidal structure of the population—a very large young population, resulting in a healthy population bonus at least for the short and medium term—as shown in Figure 1, there won't be problems in the near future. That might hold true for the country's largest scheme (IPS), but the public schemes are starting to show actuarial deficits at different speeds, some at very high ones.

Figure 1
Paraguay's Pyramidal Population Structure

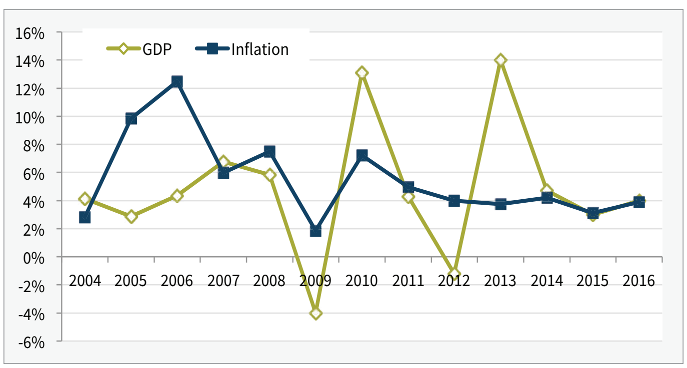


Source: *www.ips.gov.py*

In 1997, La Caja Bancaria already had a cash flow problem, primarily due to a financial system crisis that directly affected its revenue sources as well as its increased liabilities due to a substantial growth in retirees. Its law was amended in such a way that contribution rates by active members and employers increased, and retirees had to start contributing too. Furthermore, retirement benefits were cut up to 50 percent, creating not only serious economic problems for retirees but also social problems. Since 2016, retirees have again collected full pensions; however, the contribution rates by active members and employers have remained at the new level. Despite this troublesome period and its negative impact, there was no proposal for a structural change in the scheme.

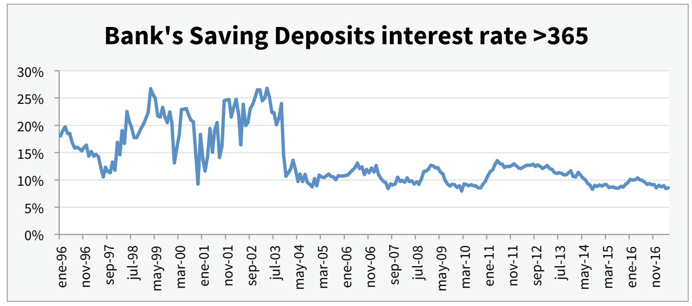
Paraguay has shown strong macroeconomic metrics for a few years: low inflation (3–5 percent per annum—as shown in Figure 2), a low fiscal deficit (1.5 percent of GDP), and a solid GDP growth (4 percent average—as shown in Figure 2) coupled with a substantial decrease in interest rates on banking liability papers (from 12–15 percent to 8–10 percent per annum). Considering that contribution rates were established several years ago based on a different economic scenario, the decrease in interest rates has become an issue as earnings derived from financial investments (as shown in Figure 3) are a crucial element in the health of the funds.

Figure 2
Paraguay's GDP and Inflation evolution



Source: *www.bcp.gov.py*

Figure 3
Paraguay's Banks Interest Rate for Deposits > 1.5 years term in local currency



Source: *www.bcp.gov.py*

Asset managers are not yet used to the new economic scenario, nor are they prepared to take higher risks to reach the profitability target on their financial investments. And with new benchmarks (lower interest rates), the actuarial deficits are growing.

The good news is that policymakers are now aware of this problem, and steps are being taken. The first of these was to submit a bill to Congress to create a superintendency of pension funds/mutuals. This structure should serve, provided it is passed by Congress and made into law by the executive branch, to supervise pension funds. The project and its key objectives have generally been welcomed by most sectors affected as it addresses a crucial need for both the long and the short term. However, as currently outlined, it is somewhat controversial in certain aspects and faces opposition from some sectors (particularly from workers' unions). Therefore, it appears that the bill will face lengthy and difficult negotiations before it is finally passed into law. Its approval should bring order, discipline, better overall administration and better protection for all interested parties. ■

Víctor Molinas, economist and actuary, is chief actuary of the IPS (Instituto de Previsión Social), a governmental organization overseeing social security and health care based in Asuncion, Paraguay. He can be reached at *victor.molinas@mgc.com.py*.