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Strategy Flash – Uruguay

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Uruguay Strategy Flash

Yesterday, the PIT-CNT resolved in a split decision to start a campaign to support a referendum against the newly instated pension reform, and the pension system.

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The PIT-CNT is preparing to challenge the pension system reform

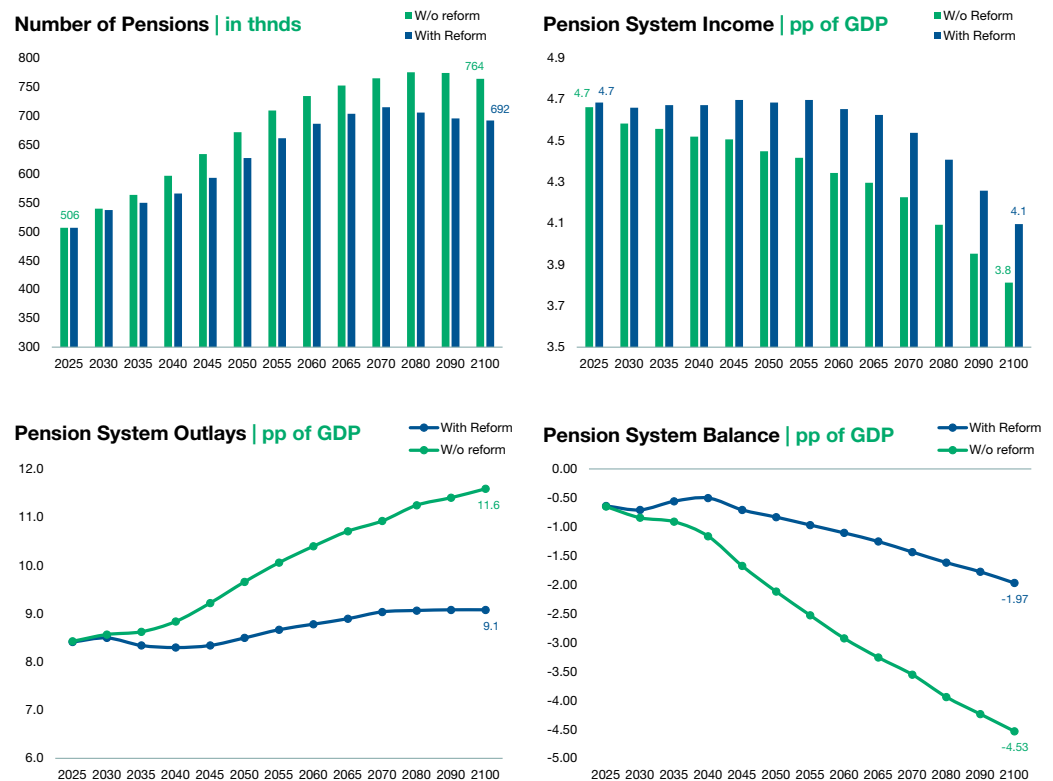
Yesterday, the PIT-CNT resolved in a split decision to start a campaign to support a referendum against the newly instated pension reform, and the pension system. Yesterday, key representatives of the PIT-CNT approved by a simple majority the decision to start campaigning in favor of a referendum that will try to overturn some of the changes to be implemented by the new pension reform. However, the initiative is even more ambitious, as it is expected to also campaign against the existence of the AFAP's, Uruguay's pension funds. In particular, the key points to be hammered in the referendum are an increase in minimum pensions to an amount above the poverty line, the maintenance of the retirement age at 60 years old, and the elimination of any profit-seeking firms inside the social security system, which is a direct threat to the AFAPs. In this context, the alternative that finally prevailed in the council of the PIT-CNT was the most extreme, as other, more moderate proposals which were limited to overrule the last pension system reform were discarded. However, the split vote left a significant part of the organization unhappy. In particular, representatives from the Communist Party, and the MPP (Popular Participation Movement), which are very significant inside the Frente Amplio, did not find this resolution to their liking, which will probably affect the amount of support they inject into the campaign, both from political mobilization and financing.

From a legal standpoint, the constitution offers two ways of promoting a referendum, both of which need to gather a significant amount of support before a year has passed since the promulgation of the law. The last time around, when trying to overturn the LUC, the PIT-CNT opted for the more direct route, which requires the presentation of the signatures of at least 25% of the registered voters in the country (roughly 675.000) within the year of the implementation of the challenged law. A less direct approach requires fewer signatures (only 2% of the registered voters, aka 54.000) within 150 days of the law being promulgated, which triggers a pre-referendum, in which, if the option to derogate the law reaches 25% of votes, then a full referendum is organized to define the matter. For the LUC referendum, the PIT-CNT managed to muster nearly 800.000 signatures, comfortably complying with the threshold contemplated in the first alternative route. In addition to the requirements mentioned above, the constitution also prevents referendums to challenge laws that have constitutional force, are incumbent to the Executive Power, or refer to any tributary matters. Therefore, from a legal perspective, it is clear that the PIT-CNT's idea of challenging the new pension system reform is possible, however, challenging the existence of the AFAP's and updating minimum pensions will require some creative wording, as it is difficult to envisage how these matters comply with the conditions to be challenged by the referendum, especially in the case of the AFAP's, which have been an integral part of the Uruguayan pension system for quite some time now. What the PIT-CNT could try to challenge more easily is the bill which grants more flexibility to the AFAP's in their portfolio allocation, allowing them to invest a greater part of their assets in external securities. This change was expected to pass with the Budget Law bill and can still be challenged by the PIT-CNT.

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In our view, these developments are credit negative, as they threaten a key public policy, even as the very nature of the repeal undermines its chances of being successful. As we argued when the Pension Reform was approved, a key problem with its implementation (mostly unsurmountable, granted), was that most of the key savings in the pension system were very gradual and very far off in the future. While from a stability perspective, this was desirable, it allowed the more extreme sectors of the Frente Amplio to challenge the law via referendum, or, given a strong enough change in political color, a favorable Congress to amend the law to their liking or revoke it. Now, the pension system reform must endure its first test. The importance of this law to stabilize public finances in the medium run is significant, as it would stabilize pension system outlays at 9% of GDP, instead of seeing them increase to 11.5% of GDP by 2100. Furthermore, it prevents the deficit of the system from reaching the 4.5% of GDP mark, keeping it at a reasonable 2%. Regarding the probability of success of the referendum challenge, initially, we are somewhat skeptical of its chances. Even if the topic is a controversial one, and should wind up with some support, the approved law is mostly beneficial for the citizenry. The most unpopular point of discussion could be the increase of the retirement age to 65. However, data shows that Uruguayans, on average, already retire at an older age than what was established in the previous law (62.5 years vs. 60), which could curb the support for the proposal to reduce it back to 60 years. However, we do believe that the main threat to the approval of a possible referendum is the challenge itself. It is not a moderate proposition, and we believe that threatening the AFAP's existence could be a mistake. The project has already generated controversy inside the FA, with the more moderate segments not supporting such an extensive challenge. This should translate to, a less fierce campaign in those sectors, and to the general public, where some of the proposals will struggle to find footing. Still, the result of any referendum will also be tied to the popularity of the FA and the current administration at the time, as was exhibited in the LUC challenge. If the FA manages to get enough traction, then the social security system could find itself under some serious threat.

Figure 1: Estimated impact of the pension system reform



Source: TPCG Research based on BPS

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