



TURKISH INDUSTRIALISTS' AND BUSINESSMEN'S ASSOCIATION

RESTRUCTURING TURKISH SOCIAL SECURITY SYSTEM

Executive Summary



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Lebib Yalkın Yayınları ve Basım İşleri A.Ş.

FOREWORD

TÜSİAD (Turkish Industrialists' and Businessmen's Association), which was founded in 1971, according to the rules laid by the Constitution and in the Associations Act, is a non-governmental organisation working for the public interest. Committed to the universal principals of democracy and human rights, together with the freedoms of enterprise, belief and opinion, TÜSİAD tries to foster the development of a social structure which conforms to Atatürk's principals and reforms, and strives to fortify the concept of a democratic civil society and a secular state of law in Turkey, where the government primarily attends to its main functional duties.

TÜSİAD aims at establishing the legal and institutional framework of the market economy and ensuring the application of internationally accepted business ethics. TÜSİAD believes in and works for the idea of integration within the international economic system, by increasing the competitiveness of the Turkish industrial and services sectors, thereby assuring itself of a well-defined and permanent place in the economic arena.

TÜSİAD supports all the policies aimed at the establishment of a liberal economic system which uses human and natural resources more efficiently by means of latest technological innovations and which tries to create the proper conditions of for a permanent increase in productivity and quality, thus enhancing competitiveness.

TÜSİAD, in accordance with its mission and in the context of its activities, initiates public debate by communicating its position supported by scientific research on current issues.

The following is the executive summary of the report entitled "Restructuring Turkish Social Security System" that was prepared by Prof. Can Tuncay and Prof. Yusuf Alper for TÜSİAD on October 1997, in Turkish.

Prof. Can Tuncay

Prof. Can Tuncay was born in Ankara. Upon graduating from TED Ankara College, he received his bachelors degree from the Faculty of Law, Ankara University. He started working as a research assistant at the Faculty of Law, Ankara University in 1968. He has completed his PhD in 1975, he became an associate professor in 1980 and full professor in 1988.

He has participated in many research programs at various universities in Switzerland, Germany and US. He has presented papers in many national and international conferences. He has published ten books, more than a hundred articles and papers mostly in the fields of Labor Law and Social Security Law. He participates in the Preliminary Specialization Commission on the Seventh Year Development Plan and the preparation of the TOBB's report on Social Security and he is still working at the Department of Labor and Social Security, Istanbul University.

Prof. Yusuf Alper

Prof. Yusuf Alper was born in Konya in 1959 and was graduated from the Faculty of Economics and Social Sciences, Bursa University in 1981. He started working as a research assistant at the Department of Social Politics and completed his PhD in 1985. He became an associate professor in 1988 and full professor in 1995. He has specialised mostly on subjects such as social security and the impacts of privatization on social politics.

He has four books and many articles about social politics and especially social security. He is still working at the Faculty of Economics and Administrative Sciences, Department of Labor Economics and Industrial Relations, Uludağ University.

EXECUTIVE SUMMARY^(*)

Notwithstanding the noteworthy progress made during its short history of 50 years, the Turkish social security system is currently undergoing diverse hardships serious enough to almost incapacitate it for further movement.

Restructuring social security assumes a reform aiming to activate the fundamental principles and universal applicability of the social security concept for a sustainable social security system.

WHY A SOCIAL SECURITY REFORM?

Facing a crisis in the social security system is not unique for Turkey or for any other similar developing country; however, our system has some unique features such as the early retirement age which, in fact, worsens the situation. A social security reform is needed primarily because of the fact that the system has undergone a deterioration as a result of deviation from the fundamental principles of the social security concept. For example;

- The social security system in its current state is a matter of general dissatisfaction. Workers, as one of the directly involved parties, complain about low income and inadequate health services; the employers complain about the heavy burden of the premiums they have to pay; and the State expresses concern about the increasing financial deficit, already 3% of the national income.
- The basic indicators of our social security system has deteriorated sharply as a result of populist policies extravagantly applied for many years. The most notable deterioration is in the ratio of employed members to non-employed members (active/passive ratio). This ratio has dropped to 2

(*) In August 1999, the Government introduced a social security reform package, which included a gradual rise of minimum age of retirement from 38 to 58 for women and from 43 to 60 for men, in a ten-year period. This reform package increased the premium payment duration to 7000 days and also introduced unemployment insurance, which would start to operate as of June 2000 and set guidelines to avoid illicit employment, which is one of the major drawbacks of the social security system.

whereas it should have been retained at around 4. Running of a social security system with such a low ratio seems impossible. Working individuals can retire at the ages as early as 38-43. A social security system which includes only 44 percent of the working population is an inevitable outcome of unregistered economy which in turn leads to unfair competition.

- Financial deficits and the financial crisis that the system is facing have already reached a critical level to upset all macroeconomic balances. The Public Sector Borrowing Requirement is currently above 10% and nearly 1/3 of it originates from financing of the social security deficits. Actually, the financial crisis is only an outcome; the State having to finance the deficits is not the sole reason leading to the need for a social security reform.
- It is a bare fact that the level of income provided by the social security organizations to individuals is quite remote to the very purpose of the system which is supposed to be providing a life standard appropriate for the human dignity. Besides, the health services provided by the system are below any standard. Another deficiency of the system is the lack of an unemployment insurance.
- All the parties concerned unanimously admit that the system can no longer be run as it is today unless serious measures are taken. Public consciousness in this respect has been growing for the last one year period which calls for an extensive social reform be made urgently.

WHAT KIND OF A SOCIAL SECURITY SYSTEM?

Achieving solid improvement in the existing system through amendments of short-term nature and with limited scope seems very unlikely. For a sound, realistic and efficient social security system, a re-formation involving radical changes in the system as a whole, from its organizational structure to its financing methods is needed. Priorities and objectives must be clearly defined in any project for a new system.

- A dual-phase system (a system that is standing on more than one fundamental component) must be adopted.
- Possible political influences on the system and process must be minimized.
- A better and more secure future must be planned for the people.
- Individuals' personal responsibilities and initiatives must be emphasized.
- According to our Constitution, social security is under the custody of the State. Such responsibility of the State must be maintained in line with Turkey's socioeconomic realities and political counterpoises. On the other hand, however, the State's role and influence on the system must be re-defined.
- The State must contribute to the system by paying premiums and the public deficits from the system must be reduced to a tolerable level in the long run.
- The State's contribution to the premiums must be taken as a tool for encouraging registered employment, preventing unfair competition and providing social security to the additional 5 million workers resulting in a net increase in the public income.
- Relying on illegal or unregistered economic segments for establishing competitive and comparative superiorities would be a capital mistake with undesirable consequences in the long run.
- A second phase has to be incorporated into the system in which individual savings should be accumulated to form funds to help the development of capital and stock markets. Long-term fund markets should be initiated for prolongation of public debenture maturities, for facilitating the privatization process through the stock market and for creating easier manageability of the budget, the inflation and the interest rates.

THE PROPOSED MODEL

Basic features of the new social security system conforming with the above mentioned objectives are described as follows:

1. A DUAL-PHASE SOCIAL SECURITY SYSTEM SHOULD BE ESTABLISHED

The existing mono-phase system seems to be incapable of performing the functions of assurance, income distribution and savings properly. Thus, a dual-phase system established on obligatory basis is proposed as a model.

- The existing social security organizations (SSK, Bağ-Kur and Emekli Sandığı)¹ will constitute the First Phase.
- Workers in the agricultural sector as well as the voluntary members will be included in Bağ-Kur.
- SSK will take over the social security funds defined under Article 20 of SSK.
- The "Pay As You Go" method will remain as the basic philosophy of the First Phase.
- Health insurance shall be taken out of the First Phase's scope and shall be reviewed under the Health Reform. General Health Insurance will be realized and a Health Finance Organization will be established.
- Creation of the Second Phase organizations will be a real reform for Turkey. The obligatory payments by workers and employers will constitute funds to implement the function of individual savings. The individual savings account approach is becoming more and more popular in Latin America and Central European countries proving to be successful examples.
- The Second Phase which will be operated by funding through individual savings can be activated by transferring the existing individual savings

1 **SSK** - The Social Security Organization for Workers
Bağ-Kur - The Social Security Organization for the Self-employed
Emekli Sandığı - The Government Employees' Fund

which have already accumulated in the present obligatory savings accounts to the Second Phase accounts. The relevant burden on the State can be extended over a period of time through long-term public debentures and a gradual offer of privatization shares.

- Such funds will be managed by specially formed fund management organizations under strict supervision. Such fund management organizations will be established by banks, insurance companies or foreign management companies and they will be regulated by an exclusive supervisory body assisted by certain authorities such as the Treasury and the SPK (the Capital Market Board).
- The prime objective of the fund management organizations will be to provide a reasonable real yield on individual savings in the long run. The supervisory body will designate the placement areas for such funds. Inflation-indexed long-term government bonds (TÜFEKS) and shares related to the privatization projects would be appropriate financial instruments of priority for the purpose. The basic problem with the internal public debt is its short-term nature rather than its amount. The Second Phase savings will have an important role in extending internal public debt to much longer periods. Furthermore, domestic investment organizations which are essential prerequisites for upgrading our country's stock markets will be developed more easily by this means.
- Once the system starts to operate efficiently, investments in private sector bonds and shares as well as in banking instruments and in foreign markets could be allowed in time.

2. THE STATE WILL CONTRIBUTE TO THE FINANCING OF THE SYSTEM BY PARTICIPATING IN PREMIUM PAYMENTS

- The State will participate in the financing of the First Phase social security organizations as a premium paying party rather than a deficit financing body.
- With the State's contribution, the premium burden on the members and the employers would be reduced, thus entering the system could be encouraged.

- Improving the active/passive ratio (the ratio of employed or premium paying members to those who are not paying while receiving monthly retirement benefit), decreasing the system's deficits and also preventing all kinds of unfair competition would only be possible by having a considerable increase in the number of registered working members. To increase the number of working members registered in the system by 50% during the next 10 years, incentives are needed besides strict supervision, administrative and penal measures, adoption of the concept by the workers and workers' unions and the motivation of the public opinion.
- The State will more easily control its contribution to the system by paying premium and also it will gain a net benefit out of the increased number of registered members resulting in higher revenues.
- For better motivation, the State's contribution to the premium will be proportionate to the number of employed persons registered in the system. For the optimal formulation of such contribution, realistic statistical figures pertaining to registered employment and criteria such as the size of the enterprise will be used.
- The State's contribution could gradually be reduced once the problems such as unregistered economy and unregistered employment are reduced.
- Payments without a counterpart in the form of funds or premiums (such as the Social Aid Benefit) should be immediately stopped and salaries and wages should be readjusted accordingly. The system should not be allowed to provide any benefit which does not have a premium counterpart.

3. FINANCIAL STRUCTURE

- Income and monthly benefits provided by the social security organizations of the First Phase should be above the accepted poverty range.
- The lower limit of such income and monthly benefits to be provided should not fall below 50% of per capita income and such benefits should become as high as 70-75 % of it according to the length of the membership period.

- For determining the lower and upper limits of the premium basis, the minimum wage will be taken as the criterion whereby the premium basis will not be lower than the minimum wage and it will not be higher than two times the minimum wage. As reliable statistics become available in the long run, national wage averages will be taken as the criteria instead of the minimum wage concept for premium calculation.

Premium Rates of the First Phase

	<u>SSK</u>	<u>BAĀ-KUR</u>	<u>ES</u>
Member	7	6-10	7
Employer	2-6	–	2-6
State	5-9	8-12	5-9
Total	18	18	18

- No preliminary fixed upper limit will be in question for the monthly benefits to be provided by the Second Phase social security organizations. The Second Phase will operate on fund basis whereby the level of premium paid by the individual will vary upon the factors such as the period of membership and the real yield.
- In the Second Phase, a dual savings method will be applied whereby employer and the member will pay the premiums. The upper limit of the premium basis in this system will be 5 times the minimum wage. Member's contribution to the premium should be increased as his salary increases. The self-employed members will pay whole of the premium.

Premium Rates of the Second Phase

	<u>*MWx1</u>	<u>MWx2</u>	<u>MWx3</u>	<u>MWx4</u>	<u>MWx5</u>
Member	4	5	6	7	8
Employer	4	3	2	1	-
Total	8	8	8	8	8

* MW= Minimum Wage

- Category and indicator coefficients will be re-arranged so that the premium levels in Bağ-Kur (social security organization for the self-employed) be in accordance with the premium base levels of the employed members.
- Minimum wage concept is an important criterion of the system. We suggest that a realistic minimum wage figure is determined and adjusted on an annual basis which should take effect at the beginning of each calendar year.
- In the Unemployment Insurance which is planned for SSK members only, the premium basis will be upto two times the minimum wage. The member, the employer and the State will pay the premium, each one's share being 1.5 % of the premium basis defined above. Unemployment Insurance will be an important novelty for Turkey and it is regarded as a motivation factor for increasing the number of registered workers. A three-year adaptation period is suggested because of the current situation of the SSK. In other words, the system will start collecting premiums right from the start but first compensation payment will be due 3 years later. Employing a part of the savings accrued in the obligatory savings accounts for the start of the Unemployment Insurance would be a sound approach. On the other hand, while forming the Unemployment Insurance System, it is deemed necessary to rearrange the severance pay application (which has indeed developed due to the lack of an unemployment insurance upto now) and to amend the relevant tax laws simultaneously for restricting the benefit-deserving cases of severance pay and the number of days of payment for the same.
- The General Health Insurance System which is expected to be realized as part of the Health Reform calls for removing the health section from the scope of the First Phase thus it will no longer be a part of the retirement system but will be run on its own. A triple (the member-the employer-the State) financing method for the dependent employed members and a dual one (the member-the State) for the self-employed will be in place. Those members without any income will be financed by the State. The premium basis will be upto two times the minimum wage.

4. RETIREMENT AGE AND THE TRANSITION PERIOD

- The early retirement issue, one of the most unacceptable drawbacks in the existing system, must be solved as soon as possible in a realistic way. Early retirement availability is far from being an incentive for work on the contrary, it leads to considerable abusing of the system. Such a drawback must be eliminated immediately and retirement should not be made possible before the person actually reaches the age of reduced ability to work.
- In many countries, in order to improve deteriorated financial structures of their social security systems as well as to increase their active/passive ratios, retirement ages are raised upto 60 or 65, in line with the increased life expectancies and no age discrimination is made between male and female members any longer. Given this situation, it cannot be deemed acceptable to have a system enabling retirement at 38 or 43 in Turkey where life expectancies have already reached 70 for men and 74 for women.
- Actually, raising retirement ages through a new arrangement is a necessity so urgent that a transition period should normally be waived. On the other hand, it is not realistic to expect such a daring decision to be taken by the Parliament under the current political circumstances. Newletters, rights acquired by law should taken in to account as well. The compromise is raising the retirement age up to 55 for women and to 60 for men during a 5-year transition period. Applying a higher age of retirement to only new members cannot provide any improvement in the system which cannot last much longer under the current circumstances.

Proposed Transition Period

WOMEN		MEN	
Membership Period	Retirement Age	Membership Period	Retirement Age
16-19 years	41	20-24 years	44
12-15 "	44	15-19 "	48
9-11 "	47	10-14 "	52
5-8 "	51	5-9 "	55
less than 5 years	53	less than 5 years	58
new entries	55	new entries	60

- A compromised transition period as proposed above will lead to significant improvements in the system's actuarial outlook. While the social security system must be thoroughly reviewed with a reformative approach, the public must be made fully aware of all the new rules and concepts of the new system.
- Passive members will not be allowed to receive a retirement benefit and work at the same time. Furthermore, practices such as the so called "social security support premium" should be abandoned.
- Rewarding with undeserved rights, e.g. waiving of premiums and compensation of service should be abandoned so that neither the members nor the employers would have such expectations any longer.

5. POLITICAL INFLUENCES ON THE SYSTEM MUST BE MINIMIZED

One of the most important problems of the Turkish social security system is that while the social security organizations are defined by law to be autonomous administratively and financially, they are subject to intensive pressure from the political authority in practice.

- Political authority's intervention in the system, in the First Phase organizations in particular, must be minimized.
- The management of the First Phase organizations will be based on representation of the three contributing parties and will be truly autonomous. The State's social responsibilities as well as its involvement as a contributor to the system somewhat blur the concept of autonomy. In fact, achieving true autonomy in management is not only having to do with the system itself but also depends on the political authority's care and attention in this matter as well as on the effectiveness of the public opinion.
- The system's independency should be assured by individual savings accounts, on which the supervision, rather than the management, of state would be rendered effective.
- The First Phase organizations will be managed by professionals appointed and monitored by the parties to the system. The general manager of the organization will be elected by the General Assembly the Board of Directors. The Ministry's authority over the organization will be restricted to supervision and auditing.
- Decisions on the organizations' financial structure will be taken by their autonomous management bodies without government intervention. Determining and collecting premiums, management of funds and fixing the monthly benefits and income to be provided will all be handled by the management.
- The infrastructure necessary for more efficient and effective operation of the organizations will be provided. Administrative reorganization, separation of pension and health service functions, technological investments, providing a social security ID number for every citizen, faster premium collection, increased sanctions against employers' failure in premium payments, better fund management and public relations are topics to be emphasized.

6. THE MODEL'S RESULTS

For the purposes of this report, an econometric study has been made in which the system was tested to see the possible long-term results of the proposed model.

Herebelow is a summary of the findings which are presented in the main report to cover the period 1997-2050.

- The deficits of the social security organizations of the First Phase will be eroded by the year 2050.
- The financial burden that the State bears through paying premiums and financing the deficit will be around 1.02 % of GNP in 2007 whereas it was 3 % in 1997. Decreasing this deficit from 3 % down to 1 % in a 10-year period is quite promising.
- According to the Maastricht Agreement, the maximum acceptable ratio of budget deficit to GNP for the EU countries is 3 %. Assuming that the same will be an acceptable deficit ratio for Turkey in the long run, 1 % of such deficit emanating from the social security system would be a bearable situation which can further be improved in the following years according to the model.
- On the active/passive ratio issue, however, even in the long run such ratio will barely reach 3, far below the ideal ratio of 4-plus. Assuming that life expectancy in Turkey will increase and that the retirement ages will be raised to 60-65 resulting in an increased number of registered working members may push such ratio further up more quickly in reality than what is foreseen according to the model.
- The findings of the model about the Second Phase are very promising, particularly about the size of the accumulated funds that would be reached. Assuming that an accumulated obligatory savings of TL 500.000 billion is excluded from the system and that the premiums paid are calculated over an average of 2 times the minimum wage, the system will start creating funds equivalent to 3-4 % of GNP as of the year 2003, i.e. shortly after it is

started to operate. Such accumulations would further increase at a greater pace in the following years which would allow for reducing the premium rates and/or the real yield expectations.

- On a cumulative basis, the ratio of individual savings to GNP may be expected to reach 40 % over a ten-year period. Long-term individual savings reaching such a level would play an important role in financing Turkey's economic growth and in the development of capital markets.
- The model shows that in the long run, the monthly benefits from the Second Phase will considerably surpass that from the First Phase, reaching a proportion of 3 times in the 2010s and 2020s, which is an indication that individual preferences and initiatives will become more important factors in social security system and that the individual savings will be the system's center of gravity whereas the State's influence will gradually decrease.

Existing System Premiums

		SSK	ES	BAĚ-KUR
Disability/ Old Age/ Death				
	Employee	9	15	20
	Employer	11	20	-
Disease				
	Employee	5	-	12
	Employer	6	-	-
Motherhood				
	Employer	1	-	-
Work accident/ Diseases related to work				
	Employer	1.5-7	-	-
	Employee	14	15	32
	Employer	19.5-25	20	-
Sub-total		33.5-39	35	32
Obligatory saving				
	Employee	2	2	-
	Employer	3	3	-
		5	5	-
	Employee	16	17	-
	Employer	22.5-28	23	-
Total		38.5-44	40	32

New System Premiums

	SSK	ES	BAĞ-KUR
First Phase: (Disability, Old age, Death, Permanent Work Accident/Diseases related to work)			
Employee	7	7	10-6
Employer	6-2	6-2	-
State	5-9	5-9	8-12
(Temporary disability)			
Employee	1	-	-
Employer	1	-	-
TOTAL	20	18	18
Second Phase:			
Employee	4-8	4-8	4-8
Employer	4-0	4-0	-
TOTAL	8	8	4-8
General health insurance:			
Employee	3	3	6
Employer	3	3	-
State	2	2	2
TOTAL	8	8	8
Unemployment insurance:			
Employee	1.5	-	-
Employer	1.5	-	-
State	1.5	-	-
TOTAL	4.5	-	-
GENERAL PICTURE:			
Employee	16.5-20.5	14-18	16-24
Employer	15.5-8.5	13-6	-
State	8.5-12.5	7-11	10-14
TOTAL	40.5	34	30-34