

**Public versus private administration: would privately managed pension systems contribute towards increasing “capabilities” of pensioners as a measure of sustainable economic development?
The Case for Turkey**

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Abstract

This paper compares and contrasts the implications of privately managed pension provision vis a vis publicly managed pension provision on the capabilities of individuals in Turkey. This evaluation aims to measure the wellbeing of retirees as a result. The pension reform in Turkey has been widely researched and documented by national and international institutions, such as the World Bank and International Labour Organisation as well as academics. However, micro level approaches where individuals’ capabilities are targeted under privatised pension system have not been specifically examined. This inattention given to individual capabilities as a measure of wellbeing can also be observed in the economic development literature on Turkey. The aggregate approach focusing in general on economic growth assumes that inequalities that exist within the countries’ institutional framework will be overcome in achieving sustainable economic development. This neo-liberal approach to economic development which also guides the underlying policy context of privatised pension reform is short of identifying the wellbeing of individuals in terms of their capabilities. In other words differences in individuals’ doings and beings in any given circumstance. This paper aims to draw attention to vulnerabilities and capabilities of groups of people in Turkey and undertakes an evaluative analysis to seek if such groups can improve their well being under the private pension provision.

Key Words: private pensions, capabilities, wellbeing, economic development, Turkey.

1. Introduction: Background policy review of pension provision schemes

Publicly managed pension system, operating on the basis of pay-as-you-go (PAYG) principle in Turkey, has become one of the most costly programmes since the beginning of the 1990s. The treasury has supported the system with increasing rates (TUSIAD 1997, 2004). These deficits are almost equal to the investment expenditures undertaken by the government. But in spite of these growing pension deficits, pension benefits are also inadequately low. Furthermore, the number of people receiving this benefit represents only a small proportion of the elderly population. In other words, high proportion of the workforce is uninsured leading to increases in the informal sector. Thus, the current situation of the Turkish pension system has negative implications both at the macro and micro levels. On the one hand it has negative implications on the public budget and on the other hand, further diminishes the capability of individuals during their retirement years.

It is usually inevitable that pension schemes financed by the State are normally also administered by the State. However, since the pioneering pension reform of Chile in 1980, privatised management of pension provision has become one of the main issues that have been raised by researchers (Orszag and Stiglitz 1999). Hence, shift to private management of individual accounts based on defined contribution is claimed by its proponents to be beneficial both at micro and macro level. Advocators of pension reform (World Bank 1994) prefer private management, claiming that under private management both efficiency and equity are enhanced. On the other hand, critiques of this approach perceive public provision to be relatively advantageous in terms of predictability, safety and solidarity (Turner 1997, ILO 1999, Gillion, Turner and Latulippe 2000). But advocators of privatization argue that potential disadvantage of publicly managed pension systems is the threat of fiscal imbalance (Orszag and Stiglitz 1999). It is perceived inevitable that public management would lead to overexpansion of the system and hence to unsustainability (Browning 1979). Advocators of private pensions claim that, pension systems in developing countries in one way or another have been used as a political tool, which has contributed towards the deterioration of the expenditure – revenue balances of these pension systems (World Bank 1994, Holzmann 1999). Thus, this “failure” of publicly run PAYG systems has led to recommendations of replacement of publicly run PAYG systems with privately managed and individually funded pension provision systems.

An individualistic approach which is at the heart of the neo-liberal framework, also guides the World Bank’s pension reform policies. It is claimed that, individuals should be responsible for their own welfare. They should be “free” to choose and guided by their “rationality” they would be able to choose the best possible alternative. Increasing individual choice is perceived as an end in itself. It is argued that governments are unable to design economic policies in a way that would be able to reflect the preferences of individuals properly. The interests of individuals may not be properly represented by decision- makers, because the concerned bureaucrats may be motivated by factors such as maximisation of budgets, power considerations or self interest (Tullock 1970 and Niskanen 1971). Also, it is claimed by the proponents, that individual choice acts as an instrument for attaining efficiency. Thus, introduction of market elements in this context should bring about improvements in quality and reductions in costs, which are claimed, would inevitably have positive implications on individuals’ welfare. Based on these market-oriented assumptions, it is believed that each individual is able to compare and rank in order of importance the economic states of themselves and of other individuals, and choose the best option for them. In this sense, individuals are able to find the best outcome for themselves regardless of the “constraints” they may face. A basic and general requirement for individual choice is that people understand what their options are

and what the consequences of alternative choices are likely to be. This means that the individual must have access to information that is both comprehensive and comprehensible (Queissier 1997).

On the other hand social policy advocates such as ILO claim that, the State should ensure that the right environment for effective service provision. And furthermore, it is being stressed that, it is important to be focused on the ultimate objective, which is to increase the well-being of the individuals during their retirement. In other words, it is claimed that the system inducing the individuals to save more by exposing them to risk, may not mean improvements in their welfare. The main motivation towards privatization is claimed to be also political. Inefficient and corrupt governments are the driving force in moving away from public systems to private ones. However, some authors object to this, pointing out that, even under private system, there is a prerequisite for government regulation against risky investments (James 1997). Thus, implying that; why should an inefficient and corrupt government change in their regulation of private ones? This raises the paradox how private are the private pension provision. Coupled with this dilemma, is that in developing countries the financial markets and also the regulatory infrastructure required for proper functioning of individual accounts are not sufficiently developed.

According to social policy approach, there is no uniform policy that can be applied to specific countries. Different economies have very different characteristics and these characteristics are subject to change. Given this, pension systems should be flexible and pluralistic (Turner 1997, ILO 1999). Different models and designs may be more appropriate for different places and at different times. However, the pension model should be able to achieve the objectives of pension systems, particularly alleviating poverty and providing low-risk retirement benefits. Also, there is no concrete answer as to whether the provision should be privately or publicly managed. The choice will depend on 'political philosophies towards individual and private sector responsibilities versus the role of government and views as to the relative governance capabilities of the private and public sectors' (ILO 1999 p.16).

Examination of the Turkish labour market illustrates that a large proportion of workers are low paid and in precarious employment (Bulutay 1995). This implies that those workers with insufficient years of employment and savings will not have entitlement to be in the pension system. From a social policy perspective, individuals will be unlikely to obtain the capabilities required for human development, given the inadequate earnings during their lifetimes. It is questionable as to whether these categories of workers would be able to save enough even if they can contribute. Accumulation of funds between high wage earners and low earners will imply divergences in resultant retirement income levels. Furthermore, this 'disadvantaged' workforce has lower levels of educational attainments, hence it would be difficult for them to be properly informed and receive the same level of benefits as others from a private provision of pensions. This is a further hindrance to achievement of equitable retirement incomes. This phenomenon can increase the degree of inequality among the elderly as many will be forced to rely on the 'safety net' of the reformed system, whose adequacy in preventing poverty is questionable.

Hence, this paper aims to evaluate sustainable economic development in terms of capabilities of individuals. Based on Nussbaum's and Sen's conception of economic development as a multi-dimensional process, the paper will analyse implications of privately managed pension system on the welfare of retirees in Turkey. In other words, the paper will investigate how the individuals would function in enlarging their capabilities, under privately managed pension reform. In order for private pension system to work efficiently it should be built on a supportive infrastructure. However, Turkey has deficiencies in supportive infrastructures for private pension reform to meet the principles of social security provision. For example the government in Turkey has to

pass full legislation requiring insurance companies to have their accounts audited by qualified accounting firms. Thus, proper accounting and actuarial standards determine the proper operation of private schemes. Turkey pace by pace is moving towards privatisation of the system, currently observed intensely in the health provision services.

The emphasis of the paper is that, the institutional framework of Turkey is not uniform and hence needs in detail analysis and localised solutions to problems. Thus, this may imply that given this "improper" institutional framework of the country, privatized pension system may lead to further deprivation of capabilities, leading to increases in inequality gaps. Evaluation of individual capabilities under privatised pension reform, it is necessary to assess the 'pre-existing' individual capability. As briefly mentioned above, individual's status within the labour market is his/her pre-existing capability that will determine the resultant capability capacity under a private pension system as a retiree. At the same time, individuals' educational attainments are their pre-existing capability that would guide their choice of pension company, which is an important determining factor on their resultant pension benefit.

Evaluation of retirees' capabilities under privately managed pension reform requires examination of their pre-existing capability capacities within a given situation. Therefore, the paper will undertake an empirical analysis of the labour market. Disaggregated approach to labour market variables is necessary to reveal the extent of the institutional framework determining individuals' capabilities. Based on this socio-economic context in estimating the resultant well-being of retirees in terms of their retirement benefits is the main driving force of the paper. Examination of inequalities between the different socio-economic groups would provide a solution as to the applicability and suitability of privatised pension reform for Turkey within this context.

The structure of the paper is as follows; section 2 explains the evolution and features of the private pension system in Turkey. Section 3 evaluates the policy approaches that guide private pension provision. Section 4 develops an empirical approach in examining individuals' capabilities under DC (private) and DB (public) provision of pensions. Section 5 provides conclusions and suggestions as to the implications of private pension provisions on the well being of retirees in Turkey evaluated as a contribution towards economic development.

2. Evolvement and structure of the private pension system in Turkey

In order to be able to make comparative analysis, it is important to understand the private pension system in Turkey. Hence, this section examines the structure and operational characteristics of the private pension system in Turkey. The Turkish private pension law was drafted in 1999 legalised and institutionalised in 2002. It is believed that, by implementation of the private pension system would be a major contributor towards improving the public social security system's financial "crisis". Whilst this may be the main driving force towards promotion of private pension system's development, it is also promoted to be advantageous at the micro level, claiming to improve the benefits for retirees. Thus both at macro and micro levels, the purpose of implementing private pension system in Turkey can be summarised under three headings; (1) to shift the financial burden of the public social security system; (2) be a vehicle for diversifying pension risks and also to increase the level of retirement income, which are inadequately low; (3) and thirdly it can be said that, through increased individual pension savings it would have implications on the development of capital markets by generating long-term resources in the financial system. Whilst, under the recent social security reform, the Turkish private pension system is fully funded DC type, voluntary and based on individual retirement accounts, there is strong encouragement at the level of government policy. Implicitly, private system is perceived as a complementary scheme to the compulsory unfunded defined-benefit PAYG social security scheme.

Thus, the most advantageous feature of the private system is perceived to be its accumulated funds created by the contributions of the members, which finances the pensions of its members. The basic characteristics of the defined- contribution (DC) plan is its retirement fund which is accumulated and invested in each participant's account. Thus, a regular contribution of the participant which is a fixed proportion of the salary is an important part of the system. This implies that, under DC plan, pensions received at retirement depend on the level of contributions and the returns on investment. The economic policy of the government guided by the neo-liberal framework is to shift the financial burden of the public sector, where it is believed that the development of the monetary policy is adversely affected.

Choice of pension company is an important factor, as the return on accumulated savings to a large extent determined by the performance of the company. Portfolio management companies will manage the savings in the individual saving (retirement) account. The performance of the investment can be monitored by the contributors daily. Voluntary participation in the private pension system depends on individuals' demand, which depends on the investors' expectations of real returns in comparison to other financial instruments as well as growth per capita GDP, demographic structure of the country as well as government's economic policy. Here, it becomes important to highlight that, in order for individuals to be able to demand the most beneficial pension company for them; number of significant factors should be present. Transparency of the pension companies together with the knowledge of the investors are necessary factors to incur the intended benefits for the pensioners.

In Chile, where participation in the private system is mandatory, pension funds have reached an important proportion of country's GDP (almost equal to 40% Delloitte). It is claimed that, growth rate with private pension system has almost doubled. Hence, advocates of private pension system in Turkey also support this claim that such increases in economic growth would be achieved, together with having positive implications on the labour market performance.

Every individual who have civil rights in Turkey is eligible to participate in the individual pension account. Under the Private Pension System Regulation, contract is

drawn up between the participating individuals and the pension company. The retirement plan is covered by the contract guides the issues between the two parties. The entitlements and obligations of the participating individuals, terms of contributions and retirement benefit calculations plus the incurred fees drawn in this contract. Thus, it is important for participants to be knowledgeable and also to understand the cost and benefits of being under a private pension scheme. The contracts issued by the pension companies are determined by the Undersecretary of the Treasury (UT) with guide of the Capital Market Board (Pricewaterhouse Cooper Report- 2003). Thus as a consequence any changes intended to be implemented by the company to the pension contract must first be approved by the UT. The main duty of the UT is to protect the participants' rights, thus it holds the right to request certain changed in the schemes accordingly. Individuals make contributions to the individual pension accounts in accordance to the pension contract of the chosen pension company.

Under the provision of the pension company, the participants can diversify their investment to different funds up to four times a year. Another feature is that participants can make changes in the pension scheme upon written requests after a year being in the scheme. Also, under the regulations of private pension provision, the pension company is obliged to inform the participants 3 years prior to retirement that their savings would be transferred to lower risk funds. This regulation is to protect the participant from risky financial instruments. But, here it is important that this must be included in the signed pension contract. Again we can claim that in order for the participant to take full benefit from the private pension scheme, it is important to have some level educational attainment as well as the transparency of the companies.

The participants have the opportunity to observe daily the investment activities of the pension company. For example failure to invest the contributions at the latest by the second working day after receiving the contributions entails delay penalty regulations, which must be added to the pension account of the participant. The basic eligibility conditions for retirement are firstly at least 10 years of contribution period, plus one must reach the age of 56.

3. Policy Approach of the Privatised Pension Provision

A policy shift from public to private pension schemes are being promoted by many countries' governments as a significant source of retirement income. Also in Turkey, the financial stability of the system has been the main goal. Thus, pension reforms often entail radical measures, including reductions in replacement rates of public PAYG systems, indexing benefits to wages instead of prices, strengthening the correlations between benefits and contributions. It can be observed that the recent social security reform in Turkey, the pension formula has been changed from defined benefits to defined contributions type. Together with this the efforts have been undertaken to encourage individuals towards obtaining private provision of retirement income. The role of private pensions is perceived to be an important supplement to the public pension provision. However, it is important to stress that for whatever type of pension system, it implies some prerequisites. It can be said that, pension systems are the result of cultural and economic forces, reflecting political ideologies and philosophies of the governments, employees and the individuals in providing retirement income. Some countries may perceive solidarity of the society as priority, thus governments become the main actors in providing retirement income. On the other hand, we can observe policy approaches where high value is placed on individual responsibility and freedom of choice. Under such market oriented policy approach, both employers and workers have the major role in determining their retirement income. Developments of private/market provision of pensions are also influenced by the inflation history and the performance of capital markets.

The infrastructure of a country determines how successful the chosen policy will be. The significant frameworks are institutional and economic, where enough employment at a adequate levels of earnings are provided. Unless this condition is met by the economic infrastructure, which can refer to as "pre - existing capabilities" it is inescapable to find poverty in old-age, whatever pension system is in operation (Castellino and Fornero 2006). As a matter of fact, pension provision policy cannot be separated from an overall policy approach to economic growth and development. Therefore, even though a good pension design is of paramount importance, the institutional framework of the, such as the level of development of educational attainment, employment opportunities and activity rates and the like can not be ignored in evaluating the implications on the well-being of retirees within the policy of private pension schemes. However, even in high income countries, where the provision of private pensions has become widespread, eradication of poverty in old age had not been achieved (Castellino and Fornero 2006). The policy approach towards private pension provision also assumes that, individuals would act rational. But even when income levels allow individuals to save for old age, it is shown that workers are not always conscious of this.

Governments in fact have conflicting challenges to meet. On the one hand, as population ages the political power of the elderly must be taken into account as well as the growing financial burden on the public budget. Usually, scheme's public burden measured as a percentage of GDP shapes the policy approach towards provision of private pensions. Although, in many OECD countries, the policy shift from public to private provision of pensions has stemmed from demographic pressure on the public budget, Turkey's story is different. Factors other than the natural aging of the population have created financial unsustainability of the social security pension system.

As mentioned earlier, employment opportunities with adequate earnings are prerequisites for well-being of the retired population under any pension system. In Turkey, because this supportive framework has not been established, it is possible to observe wide-spread poverty in old-age. The labour market structure must be as such that, for individuals emerging from different sectors should be able to have a working life

as continuous as possible at adequate levels of earning that will yield acceptable levels of income for pensioners.

4. Comparative empirical evaluation of retirees' capabilities under private pension system

Before moving to undertaking empirical evaluation, it is important briefly examine capability approach as a concept. Application of Amartya Sen's Capability Approach (CA) to development issues, particularly in understanding poverty, inequality and human development emerged as an alternative to the standard economic frameworks over the last decade. CA has been directly concerned with 'human capability' and 'freedom'. The starting premise of CA is critical to the traditional/standard welfare economics. From the traditional approach, well-being is evaluated by income/command of commodities or utility. However, CA perceives commodities as a vehicle for capability to function, which should turn into functionings providing individuals with 'adequate' living standards. This quality of life is considered in terms of what people are able to achieve with the commodities at his/her command. As a consequence, it becomes necessary to evaluate the individuals'/societies' capacities in converting income/commodities into 'valuable' achievements. This capacity is the capabilities of individuals'/societies' to function.

Therefore, for retirees to have valuable achievement can be said to be, being healthy, to be able to live within the expected life span as well as being able to maintaining the standard of living during working life. This means that, with the entitlements individuals acquire during their retirement, is significant in being able to accessing health services, to be able to acquire the necessary nourishments for old age, to be able to participate recreational activities and so on. In evaluating the well-being of retirees, it is not sufficient only to look at the commodities they can command, but to look at how well they are able to function with the commodities they possess. This implies that, it is not possible to judge how well people will function with the income at their disposal. Unlike the assumptions of utility/welfare approach (or choice based approach), Sen's capability approach claims that, individuals are not always able to choose according to their own wishes or interests.

Functioning is what an individual manages to do or be. Thus, for a retiree it is important to be able to access a health service. Perhaps its can be asked that; what 'use' a person is able to make with the commodities at his/her command? But a person must have the "ability" to be able to achieve the necessary functionings. Hence, the person's 'capability' is the reflection of his/her ability in this sense.

However, in terms of empirical evaluation the most basic capability for a retiree is his/her income at their possession. Hence, it becomes important to investigate how private pension system would affect this basic capability capacity of retirees emerging from different socio-economic groups.

Therefore, this assessment is done by evaluating the private pension parameters for Turkey with special reference to the adequacy of future retirement benefits. The impact of inequality of lifetime earnings is assessed on the distribution of retirement income. Employment status and earnings are the main variables determining the worker's position in old age. In order to obtain greater understanding on the trend of lifetime earnings inequality, historical data is analysed. A trend towards greater wage inequality will obviously affect the distribution of future retirement incomes. Hence, adequacy of retirement benefit is measured by comparing the benefit outcomes for workers belonging to differing employment sectors distinguished by wage differences, DC (funded) formula for private pension system and DB (PAYG) formula for public system. Within this analytical framework the empirical investigation aims to compare and contrast the pros and cons of these alternative pension options for Turkey. Income levels distributed to retirees emerging from different employment sectors under each pension proposal will be evaluated theoretically to answer the question: How would private pension system change the capabilities of retirees in Turkey?

The underlying neo-liberal framework of the World Bank's pension reform policy links income increases to economic growth. In other words improvements in income occur as a consequence of economic growth. The ILO's pension option focuses on the capabilities of individuals as an indication of economic development. The level of the retirement benefits workers will receive upon their retirement is determined by two factors within the framework of these policies: the amount of savings that would be accumulated to encourage economic growth, and the adequacy and equality of pension benefits among workers. The analytical framework aims to analyse the claims of social policy and neo-liberal approaches to economic development.

Models

Actuarial balance

The actuarial balance of a pension system plays an important role in determining the viability of the PAYG system with defined-benefit principles. In defined-benefit plans, participants' entitlements to pension are predetermined on the basis of years worked and the level of wages earned, especially towards the end of a working life. The actuarial balance of the system is a prerequisite for honouring the promised pension benefits. In other words a sustainable PAYG pension system is possible if at every time period,

(1) Revenue (contributions collected) = Expenditure (pension benefits paid),
where

(2) Revenue = $(TxWxL)_t$ in which,

T = Contribution (tax) rate

W = Wages

L = Workers (insured), and

(3) Expenditure = $BxWxP$ where

B = Benefits

P = Pensioners

W = Wages, hence

actuarial balance requires that,

(4) $TWL = BWP$.

For simplification purposes, the pension scheme is assumed to be in financial balance, and on both sides of the equation wages are equal. On the revenue side wages generally refer to average lifetime wages, whereas on the expenditure side, calculation of benefits are based on wages towards the end of working life, usually based on the average of the last five years' wages prior to retirement.

Rearranging the equation for benefits will give:

$$(5) \frac{B}{P} = \frac{TW}{W}$$

Wage and fund accumulation

Under a private pension system, the actuarial balance of the system is guaranteed by the relationship between contributions and benefits. The pensions received depend on the accumulated funds, which basically depend on wages, contribution rate, length of working life and length of retirement life. The wage level of the worker's whole working lifetime is significant in making up the fund. This is contrary to the PAYG system where the worker's wages some years prior to retirement are important. The relation between wage and fund accumulation can be expressed in a simple mathematical equation. This introductory model begins with certain basic assumptions and later introduces more realistic ones to explain the financial structure of a defined-contribution model. The first assumption allows the comparison of flows of contribution payments and pension payments at different points in time without a need for compounding and discounting. At this stage it is assumed that the growth rate of real wages is zero, and making inflation immaterial (the inflation rate is assumed to be zero also). Under these simplifying assumptions, the defined-contribution pension plan collects contributions over the working life of the worker into a fund and then spreads the payment of pension over the retirement life. Another implicit assumption made at this stage is that the cost of

management of the pension plan is zero per cent, but the model can easily be modified to include management costs, which are included in the actual simulations.

Under the above assumptions, if t stands for the contribution rate, and W represents the gross real wage, and p is the gross pension rate or the replacement rate (ratio of the pension to the gross real wages) and n is the length of the working life, and if m is the life expectancy at retirement, then the relationship between contribution rate and the gross pension rate can be expressed as:

denoting pension fund as pf then,

$$pf = tWn$$

and if pension benefit denoted as pb and expressed as

$$pb = pf / m$$

$pb = pt = tWn / m$ hence pension benefit is calculated as

$$pb = tn / m$$

The above equation shows that the greater the contribution rate and the greater the ratio of working life over retirement, the greater will be the gross pension rate

However, to make the analysis more realistic, initial assumptions should be relaxed. Hence, wages and contributions grow at the rate of $1 + g$ each year, and the capital accumulated grows at the rate of $1 + r$ each year, g is the growth rate of wages and r is the rate of return on the accumulated fund. Capital accumulation for the worker at the time of retirement therefore is:

$$[kW_0 (1 + g)^t] (1 + r)^{R-i}$$

$$t = 1, 2, 3, \dots, R \text{ years.}$$

At the time of retirement the benefit rate of p is discounted over m years of retirement, thus

$$pb = pf_R / m.$$

m/n gives the passivity ratio; the greater this ratio the lower will be the rate of pension benefits, other factors remaining the same. In other words, the number of years in work is an important determinant of the level of pension benefits for the individual.

Data gathering and analysis

The main source of income data is the State Institute of Statistics Prime Ministry Republic of Turkey (DIE for short). Also some unpublished data has been obtained from the Directorate of Women's Studies, Ankara. DIE publishes series of statistics regarding the economy. The published data used for this research are from DIE Labour Statistics 1996–1999; DIE Household Labour Force Survey 1996, 1997; DIE Statistical Yearbook of Turkey 1997 and 1998. Statistics have also been obtained from the three social security institutions: BK 1994, 1995 and 1997; ES 1994 and 1997 and SSK 1994, 1995 and 1997. Statistics on demographic development have been obtained from publications of the United Nations. The variables required for the simulation analysis are extracted from these publications. In order to make sense, the data have been disaggregated into various ratios of the structures of demography and labour market structures.

Wages and earnings

The most important piece of statistical information for simulation analysis for this thesis is the range of wages. Data on wages and earnings form the basis of constructing the model, and the development of a theoretical framework as the underlying approach for the research. Wages form the basis for comparison. The distribution of wages between employment sectors is simulated under the parameters of DC and PAYG DB

pension models to find the retirement income outcomes for these workers. Wages are classified into four categories; wages of workers belonging to private sector, civil service, agriculture sector and the minimum-waged workers.

Simulations

The two sets of simulations undertaken here capture the parametric changes that the pension options propose. Four types of wages with varying lengths of working lifetime are used, together with varying lengths of retirement lifetime with possible rates of returns on accumulated funds. For both options the range of wages used to simulate the resulting pension benefits are given in Tables 1 and 2. Expressing the benefits as a percentage of the national average wage assesses the adequacy of the pension benefit. Other factors that have played a part in analysis are the growth of wages, growth of employment, and interest rate changes. These forecasted economic variables are given below, which refer to the estimations done by the ILO for Turkey.

Results

Table 4.6: Retirement benefits under the DB PAYG system, expressed as % ratio of national average wage

	Number of years in work						
	15	20	25	30	35	40	45
% of NAW for Civil Servants (A) workers	44	42	41	40	38	37	36
% of NAW for Private-Sector (B) workers	34	33	32	31	30	29	28
% of NAW for Agriculture workers (minus self-employed)	29	28	27	26	25	24	23
% of NAW for minimum waged A+B workers	28	27	26	25	24	23	22
% of NAW for minimum waged B (agricultural) workers	23	22	22	21	20	19	19

NAW: National Average Wage.

Table 2: Retirement benefits under DC-Funded pension scheme with differing wages expressed as percentage of national average wage

Number of years in work	Rate of return	Percentage of the national average wage			
		Civil Servants	Benefits for Private Sector workers	Agriculture	Minimum waged
20	1%	42	33	33	26
	2%	45	36	36	29
	3%	50	39	39	31
	4%	55	43	43	35
25	1%	50	39	39	31
	2%	56	44	44	35
	3%	63	49	49	40
	4%	71	55	55	45
30	1%	58	52	52	36
	2%	66	59	59	41
	3%	75	68	68	48
	4%	87	51	51	55
35	1%	65	51	51	41
	2%	76	60	60	48
	3%	90	70	70	57
	4%	106	83	83	67
40	1%	73	58	58	46
	2%	87	68	68	55
	3%	105	82	82	66
	4%	123	100	100	81

Interpretation

The evaluation of the pension results is assessed and evaluated, comparing the neo-liberal and social policy perspectives. The first striking observation that can be made between the benefit outcomes of the two pension options is that the level of pensions under the DC-funded system, even with the envisaged low rate of interest, is higher than that of the DB-PAYG system. The differences in pension benefit outcome for workers with differing number of working years and levels of wages are greater under the reformed system. This means that the inequality gap between pension benefits under DC is greater than DB. As the schemes become more earnings-related in character under both options,

the benefits would become more unequally distributed among different sectors, reflecting the greater degree of unequal distribution of earnings.

The fact that those with lower earnings and lower periods of insured employment would receive a lower percentage is a reflection of two features that underlie the SSK scheme: the predominantly flat-rate character of the benefits provided, and a strong bias in the benefit accrual rate in favour of workers with relatively short periods of service. In a sense the restructured system does not encourage workers to remain in the workforce, as this will not contribute to increases in pension benefits.

In comparison to the DB system, the benefit levels under the DC pension system seem to be higher. However, the simulations undertaken do not take into consideration the precarious employment patterns usual for low-earning workers. This is especially the case for the agricultural workers, for unlike under DC, they will be subject to the same procedures. This phenomenon in fact increases the degree of income inequality among the elderly.

Other factors would also tend to create greater inequality under DC. The most obvious one would be that the rates of returns on savings would tend to vary from one fund to another. This implies that for individuals to be able to choose the right option, choice is of paramount importance. However, as mentioned earlier, Turkey is one of the developing countries, still with a relatively insufficient degree of information flow and transparency, with a high proportion of the population being either illiterate or having very low levels of education. This implies that these individuals are highly unlikely to be able to make the right choices. At the same time there would be no minimum pension except for workers with at least 30 years' contributory service, which would provide little protection to the low paid since it would guarantee 40 per cent only of their previous low earnings. This implies that elderly will be forced to rely on social assistance.

In short, it can be said that under a private DC pension system pension benefits are sensitive to the number of years in work and the rate of return, neither of which are stable in Turkey. Furthermore improvements in replacement rates for the retired mean lower working lifetime standards of living, given that the level of wages would remain the same. This may act as a disincentive for workers, especially with increases in retirement ages, as individuals have been protesting against an increase in retirement ages (T.C. Calisma ve Sosyal Guvenlik Bakanligi 1997, TUSIAD 1997).

5. Conclusion

The task for the Turkish authorities in replacing the existing PAYG social security system is not a trivial one. The trade-off between efficiency and equity is not easy to establish given the complex institutional framework together with volatile stock market, which may still be under the influence of the political system.

Both women and the low paid groups, who are also subject to shorter and precarious careers, are likely to be hit the hardest. The people who are most likely to benefit are those who are already well-off, further widening the gap. This inequality gap implies greater social exclusion of these groups. The greater this exclusion the greater would be the extent of poverty among the elderly.

Finally, it must be stressed that improvements in the capabilities of retirees in Turkey require both efficiency and equity. Under the DB pension system, the benefits are more equitably distributed in comparison to the DC system. The DB system in this sense is better in targeting the workers in disadvantaged positions. We can deduce from the analysis that it is not possible to achieve all the objectives by picking either one policy option or the other, as Turkey needs such instruments that will facilitate improvements in savings, redistribution in a more equitable manner and insurance as a safety mechanism. However, if meeting all the objectives is not possible, it is important for Turkey to choose a pension model that would meet the needs of the majority rather than the few. For example, increases in contribution rates together with improvements in compliance rates can bring only temporary relief, since in due course they will be matched by higher benefit pay-outs, which may lead to overexpansion and hence a vicious circle.

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