CSA.QXD:Layout 1 11/26/09 1:02 PM Page 1

ADVANTAGES OF THE SYSTEM

The vast social, legal and economic diversities between countries mean that there is no "right" answer to the design of a country's pension system. However, the three-pillar model may be the most effective way of balancing pension objectives, each with its own source of funding. The first pillar provides social safety net support to everyone; the second pillar emphasizes savings and promotion of growth, and the third pillar encourages discretionary savings and capital development. Upon reaching the age of retirement, the member benefits of such a system as follows: a salary of mandatory retirement, calculated according to the base salary (first pillar); income from pillars two and three added to the base pension salary entered individually on the personal account of the participant. The member has the right, after reaching retirement, to withdraw and collect a certain amount of the sums accrued from pillars two and three. The remaining capital is distributed as monthly wages, added to the base salary as determined in pillar one.

For pensioners as well as employers, the new regime will certainly be more advantageous financially. The current pension is fixed and represents a little more than 20 per cent of the salary on average while the proposed system provides a life pension of approximately 60 per cent of salary. Also, in the case that the contribution of 8.5 per cent made throughout the career of the private sector employee is not sufficient to pay his/her pension, the employer has to reimburse the difference (Sayed and Robalino, 2009). In the three-pillar system, employers will pay perhaps slightly more overall, but will in any case be free from surprises that require them to pay considerable sums upon the retirement of their employees.

Additionally, the current schemes for civil servants and the military and security personnel are a major liability for the budget. These schemes offer to the full-career worker a pension equivalent to 85 per cent of pre-retirement income – among the most generous in the world. This high level of income replacement is not only unaffordable, but also reduces incentives to diversify sources of savings for retirement outside the public system, particularly among middle- and high-income workers.

The success of the three-pillar system depends on the financial performance of these funds and hence on the efficiency of the capital markets. The creation of these pension funds will absorb national savings and contribute to boosting the economy (Draft of the Law approved by the Joint Parliamentary Committees on October 27, 2008).

Regular social pension income:
Enables older people's access to health care and medicines
Increases older people's standing in their families
Means greater autonomy in their decisions
Contributes to their dignity, confidence and empowerment
Promotes equity
Can have a significant impact on poverty alleviation and contribute to economic growth
Is affordable within existing resources, if properly managed

Source: HelpAge International, 2008; HelpAge India, 2009

CONCLUSION

Older people, and in particular older women, are often disproportionately affected by poverty. Regular income in old age is an essential component of the rights to social security and adequate standard of living. This was recognized in the Universal Declaration of Human Rights (1948), and reiterated in the Madrid Plan of Action on Ageing (MIPAA 2002). Demographic realities and cultural expectations render pension system reform an undoubtedly economically and politically challenging task. Nevertheless, obstacles to change can be overcome. Research, data and roundtable debates are urgently needed to portray the various stakeholders' views on the different visions for the future of pensions and the means to combat old-age poverty and inequity.

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CSA

About the CSA

The CSA was established in 2008 by a group of professionals committed to the promotion of evidence-based policy and practice in support of the older population. The mission of the CSA is to create a hub for research, education, policy formulation, and training on aging in lebanon and the Arab region. Its motto is "Translating Research into Policy and Practice" (TRIPP).

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CSA

CENTER FOR STUDIES ON AGING

TRANSLATING RESEARCH INTO POLICY & PRACTICE

POLICY BRIEF

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PENSIONS:

A RIGHT LONG OVERDUE FOR THE OLDER CITIZENS

UNFPA

United Nations Population Fund

CSA.QXD:Layout 1 11/26/09 1:02 PM Page 4

POLICY BRIEF

PENSIONS: A RIGHT LONG OVERDUE FOR THE OLDER CITIZENS

This Policy Brief sets out some of the issues with pension systems in the Arab region with a focus on Lebanon, as a case-study. It discusses options for reforms for sustainable pension systems that would help older people to live in retirement with dignity, security and a good quality of life.

INTRODUCTION

With the consistent increase in life expectancy and the concomitant rise in unemployment rates and stagnating wages in most countries of the Arab region, pension reforms have become a central policy priority for governments and the most pressing development challenge. Social insurance systems in Arab countries were established across a wide range of years, from as early as 1949-50 in Algeria and Iraq to as late as 1991 in Oman (Yount and Sibai, 2009; Turner and Lichtenstein, 2002). Pension schemes were primarily designed for public sector employees and security forces and have been partially or fully financed from the national budget providing benefits with little linkage to the contributions paid. They are invariably defined-benefit (DB), pay-as-you-go (PAYG) schemes with high public expenditure. Separate systems of social insurance exist for employees in the formal private sector to which they have contributed a number of years; however, the actual benefit is often quite low. Those who work in the informal sector, representing the vast majority of Arab women, frequently do not qualify for an old-age pension, thus raising an issue of gender inequity.

Benefits for retirees in countries of the region range between 12 and 45 per cent of the economy wide average earnings and remains generally low (Sayed and Robalino, 2009). One expected result of the pervasively small old-age pensions in Arab countries is that a large percentage of older adults continue to work into their later years. According to the recent PAPFAM survey conducted in Lebanon in 2004, around 26 per cent of older men aged 65 years and over continue to work after the legal age of retirement, and over 11 per cent continue to work beyond age 80 years (PAPFAM, 2004). These workers are often engaged in informal and physically demanding low-paid jobs, with no income security or legal protection for their rights.

Social security systems affect the country's entire economy. It influences the incentive for people to continue to work, especially near retirement. It also affects the willingness of employers to hire labor, as well as, the labor distribution and allocation between formal-informal sectors. Pensions also affect the level of national saving and the development of financial market and the fiscal position of Governments.

Financing Social Security Programs

Retirement plans are, in general, classified as defined benefit or defined contribution according to how the benefits are determined:

- The benefit in a defined benefit (DB) pension plan is determined by a formula that incorporates the employee's pay, years of employment, age at retirement and other factors. DB arrangements in most countries of the world are unfunded, with benefits paid to retirees being contributed directly by current workers' contributions and taxes. This method of financing is known as pay-as-you-go (PAYG). Many countries have problems with their PAYG systems as it is highly vulnerable to changes in demographics: relatively more people are retiring and drawing benefits and fewer workers are paying into the system.

- Defined-contribution schemes are based on contributions paid from employee salary or from employer contributions into an individual account with the contributions being invested, for example, in the stock market. Returns on investment are credited to the individual's account.

Source: Auerbach and Lee, 2006; PRB, 2009

Estimates of the percentage of older adults who continue to work beyond age 60 years in selected Arab countries

Country	Egypt	Jordan	Lebanon	Yemen
Year	2000	1990	1996	1991
60-69 yrs	43.9	47.9	60.2	65.7
70-79 yrs	23.6	28.7	33.2	47.0
> 80 yrs	12.2	11.4	13.6	20.9

Source: Yount and Sibai, 2009

DEMOGRAPHIC TRENDS AND PENSIONS IN THE ARAB REGION

Compared to other countries in the West, populations of the Arab region are relatively young; and except for Tunisia and Lebanon, the Arab region currently enjoys one of the lowest old age dependency ratio (estimated at 5 per cent) (Sibai and Kronfol, 2007). Low dependency ratios coupled with a rapidly expanding labor force offer a number of countries a "demographic dividend". This will potentially increase the growth rate of the contributory working base of pension systems and boost their fiscal sustainability. However, this will work only if employment and job creation becomes a policy priority in order for the pension systems to be able to "cash in" the demographic dividend (Rutkowsky, 2006).

While nearly all social security programs in the Arab countries are traditional defined benefit programs, differences exist in terms of coverage, benefits provision and funding patterns (Turner and Lichtenstein, 2002). Most schemes are government owned and managed, with the pension promises well exceeding the contributions paid. The pension systems in the region tend to be highly fragmented, providing coverage only to a limited portion of the population (on average, around 32 per cent of the labor force is covered) (Muhanna, 2009). In addition to financial and fiscal sustainability, there are concerns regarding equity, efficiency of its administration, governance patterns and administration capacity of the various social security schemes.

Despite the fact that populations are relatively young, pension reform remains a priority in the Arab region. On the short to medium term, the pension systems need to overcome hurdles to their performance that do not come from current or projected demographic trends. Reforms are needed in pension design, in improving the link between contributions and benefits, and in strengthening their administration and regulation. Also, countries with more than one social security scheme need to converge to a unique pension system (Muhanna, 2009).

THE CASE OF LEBANON

The Mounting Burden of Supporting Older People

Over the last three decades, fertility rate in Lebanon has fallen substantially and is now considerably one of the lowest in the region (1.9 children per woman in 2007) (PAPFAM, 2004). With increasing life expectancy, the age structure has also been undergoing dramatic changes. Estimates indicate that the burden of supporting the elderly in Lebanon, expressed as the number of old-age pensioners in relation to the active population, is expected to grow at a sustained pace such that it would nearly triple from just 10.8 per cent in 2000 to over 27 per cent in 2050 (Saxena, 2008). Many households reach retirement age with financial assets too small to maintain their standard of living. In Lebanon, around 50 per cent and 68 per cent of retired older men and women, respectively, report being financially dependent on others, mainly on children (75 per cent) (PAPFAM, 2004).

Pension Schemes in Lebanon

Current pension scheme in Lebanon classifies beneficiaries into three groups: 1) civil servants; 2) military and security personnel; and 3) private sector employees. The first two groups are covered by the Government run defined benefit scheme (DB). This is calculated as a certain percentage of the last wage, the benefits are overall generous with expenditures imposing a great fiscal burden on the Government. In contrast, employees in the private sector have access to end-of-service indemnity (EOSI), where retirees who have completed at least 20 years of work are eligible for a lump sum payment calculated according to the length of employment (on average a one-month salary per year of service) and contributions and interests accumulated from previous employment. This is currently applied through the National Social Security Fund (NSSF) and covers the vast majority of beneficiaries in the country (around 75 per cent).

The EOSI program has not been an adequate program to provide income support in old age. The lump sum given to retired workers is, most of the time, rapidly consumed. This happens at the same time that retirees lose access to health insurance. Also, the EOSI is an employer-based program that cannot be expanded to the entire labor force – hence workers in the informal sector and the self-employed are excluded. Furthermore, the majority of older women are particularly vulnerable given their involvement mainly in the informal sector, with no access to any form of formal social security.

The three schemes cover only 38 per cent of the labor force at a cost of 3.5 per cent of the Gross Domestic Product (GDP), among the highest levels of spending on pensions in the region, where the average is close to 2 per cent of GDP. All three schemes are fraught with serious problems in terms of financial sustainability, efficiency and equity which compromise the credibility of the fiscal framework, the recovery of the economy and the welfare of the old and future generations.

Retirement provision for beneficiaries in Lebanon – 2008

Beneficiaries	Scheme	N	%
Civil servants	Defined benefit - Government run	40,000	2.35
Military personnel	Defined benefit - Government run	70,000	4.12
Engineers, doctors, lawyers and others	Defined benefit - Privately run	60,000	3.54
Private sector (NSSF)	End-of-service indemnity	480,000	28.24
Subtotal with retirement provision		650,000	38.24
Subtotal with no retirement provision		1,050,000	61.76
Total work force		1,700,000	100.00

Source: Muhanna, 2009

THE THREE PILLARS

Countries adopting social security reforms are increasingly oriented to the 'three-pillar' pension system. This system has proven its ability to ensure financial stability, to provide basic social needs, health insurance and protection in case of unemployment.

FIRST PILLAR: this is an anti-poverty pillar that provides a basic minimum income in old age; it is compulsory, unfunded and guaranteed by the State. It is based on the real basic wage that must not be inferior to the official base salary. Contributions are paid by employers and employees, preferably, based on a ratio of 1:6. In Lebanon, these are set at 1.7 per cent and 8.5 per cent, respectively. The ceiling of contributions is fixed according to the precise coefficient of the base salary. The rule applied in different societies around the world is based on the coefficient of 3-6 times of the base salary.

SECOND PILLAR: this is also compulsory and guaranteed by the State, but funded. Hence, the two compulsory pillars differ only in whether benefits are flat, or related in some way to contributions. Employers and employees make contributions in the proportions defined in the first pillar (1:6) that includes salary increments above the levels defined in this first factor.

The rule generally applied in different societies around the world is multiples of 3 to 6 of the base salary, provided that the portions subject to pillars 1 and 2 do not exceed 6 to 12 times the base salary.

THIRD PILLAR: this is an optional voluntary funded component. It covers the portion of wages above the level specified in the preceding two paragraphs. The employee concerned may deduct from his wages a certain sum, provided it does not exceed a specified average and a defined ceiling. The experiences in different societies around the world demonstrate that these ratios do not exceed 10 per cent of salary. They are the sole responsibility of the salaried contributor.

Reforms are needed

In most countries, the growth of pension expenditure for the public sector has become a fiscal threat, and pension reform has become a priority. Reforms are needed in pension design, in improving the link between contributions and benefits, and in strengthening administration. Institutions need better accounting, more rigorous management and financial controls, extensive computerization and staff skills upgrading.