Allianz International Pensions

What’s **happening** in…

November 2014

Turkey may be a young country today but it must monitor its **rapid aging process**.

Pension reforms since the turn of the century have transformed an opaque and generous system into a more modern one. However, work still needs to be done to tackle poverty, an informal workforce and contribution evasion.

Although Turkey has improved its **employment situation**, the level of informal work is still high at 36 % in 2013.

Turkey is actively working on improving things and has implemented **various social security contribution reduction plans** to stimulate labor market participation. Other programs aim to help vulnerable groups. ▸

…Turkey?

Making social protection more employment friendly

Introduction

Turkey recently amended its private pension plan, with two somewhat different aims: while many countries aim at improving the financial situation of people in retirement, Turkey is combining this measure with economic development goals – fostering private savings, thus broadening capital basis for investment.

This is a key issue for the country’s economic situation. After a phase of strong growth, Turkey has recently suffered due to severe political woes. Tackling massive economic and financial imbalances makes it more difficult to devise a comprehensive and sustainable formal old-age provisioning system. But this has become increasingly necessary: industrial evolution is challenging the social security network, which places a strong emphasis on the extended family. Nevertheless Turkey is still considered an emerging economy, with traditional agriculture a large employment sector, a large part of low-productivity business, strong domestic demand and low and decreasing private savings.

This report describes the condition of the Turkish pension landscape after recent reforms. In an earlier report we discussed in detail the former old-age provisioning system and the reform waves in the first decade of this century.[1] It mentions the issue of high informal employment, which was the main challenge in the past and is still an important policy issue in Turkey today.

Demographics still favorable

In many Western countries, demographic developments and the accompanying effects on public finances have acted as the driving forces behind pension reform. This is not the case in Turkey as it has only recently become an ‘aging’ country – when 7% of the population is 65 years of age or older.[2] When this portion of the population exceeds 14%, the country is seen as ‘aged.’ France and the UK (both 18%) belong to the latter category, while Germany (21%), Italy (22%) and Japan (26%) are already being referred to as ‘super-aged’ as they have reached the next 7% threshold.

However, despite its relative youth, aging in Turkey will occur at a much faster rate. Whereas Germany and the UK took approximately 40 years to become an aged country, in Turkey it will only take 25, with just another 15 years required for it to become super-aged. In Germany, this development took another 40 years. Further evidence of this rapid aging process can be found in the old-age dependency ratio, which is expected to triple in the next ▸

1 Allianz Global Investors (2011), Pensions in Turkey – A Race against Informality and Low Retirement Ages, International Pension Papers 3/2011

2 Allianz (2014), Security – Trust – Solidarity, Perception of retirement: a cross-country comparison, Allianz International Pension Papers 2/2014

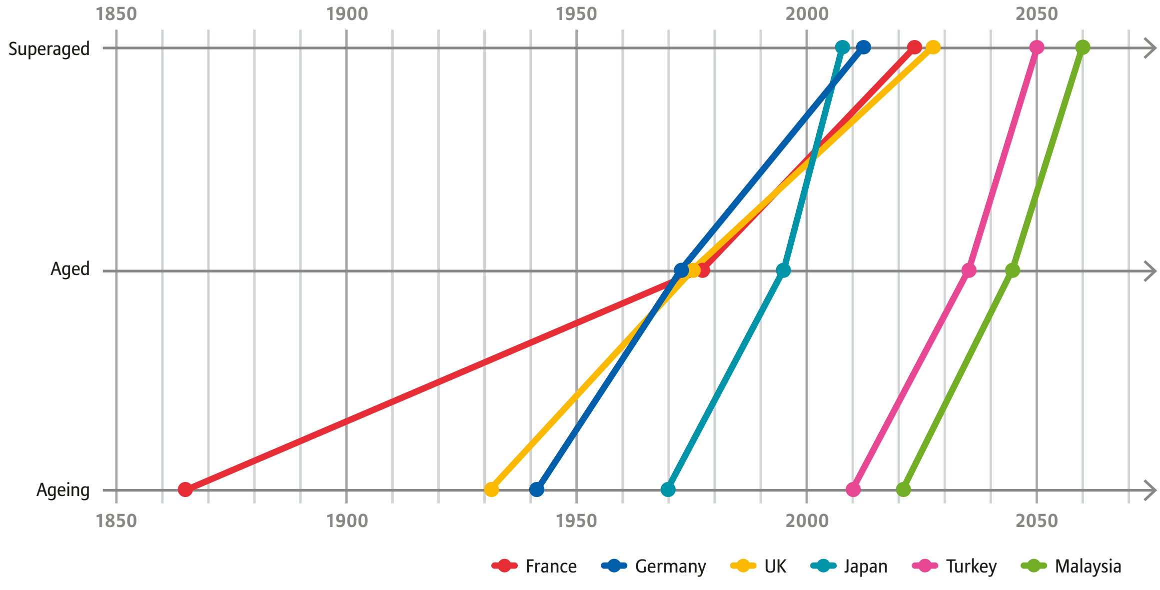
Allianz

Fighting poverty is high on the political agenda. The Ministry of Family and Social Policy, established in 2011, is implementing an action plan on aging and measures for social integration of the elderly.

According to a survey conducted by Allianz, the majority of older people in Turkey think they will find themselves in a tight financial situation when they retire. This is probably why they think that they will have to rely on **family support**.

After **amendments to the private pension law** at the beginning of 2013 (first introduced in 2003), the number of participants increased by more than 30% to reach 4.1 million at the end of 2013.

Figure 1: Speed of aging



Sources: United Nations Population Division, US Census Bureau, Statistisches Reichsamt, Kisella and Gist, Mirkin and Weinberger, Allianz, International Pensions

40 years. This change is the result of the contrasting effects of falling fertility rates and increasing life expectancy. Currently, the average fertility rate in Turkey is above 2 (2.1),[3] whereas in the OECD it averages around 1.7. In contrast, the average life expectancy of men in Turkey (71.7) is substantially below the OECD average (77.2).[4] The impact of these trends should not be underestimated. Although still young today, emerging economies with such fast aging processes face a variety of policy issues, besides building a comprehensive and sustainable pension system.

Pension system reforms

The driving force behind Turkey's reform efforts in the late 1990s was its generous and opaque retirement system, not demographics. Very low retirement ages and high replacement rates made the system costly, while the size of Turkey's informal economy and low contributions presented huge financing problems. The first wave of reform (1999 to 2001) included an increase in retirement entry age to 60 for men and 58 for women, as well as a closer alignment of employee's contributions and benefit entitlements: the average income of all working years was taken for the pension calculation instead of only the last 10 years. In addition, private pension savings plans were introduced to complement the state pension schemes.

A second wave of reforms (2006 to 2008) addressed the complex institutional setup as well as the introduction of regulations and parameters for the Social Security Institution (SSI) and universal health care. The contribution rate was set to 20% across the board, while benefit rates were decreased by lowering the accrual rates and changing the adjustment mechanism from the productivity to inflation index. Measures were also taken to further gradually increase the normal retirement age for males and females to 65, although this new rule only applies to new entrants to the workforce to ensure long transition phases.

The reforms carried out have helped improve Turkey's position in the Allianz Pension Sustainability Index[5] (PSI) compared to 2011, particularly the increase in retirement age. However, the long-term nature of these reforms makes this improvement a minor one. Because of the differing qualifying conditions to draw a pension and changes in the calculation method, it is often better for workers who started their career before 1999 to leave the workforce much earlier than legal retirement age, meaning effective retirement age remains very low. In addition, the net replacement rate of more than 90% is very high compared to other countries. As coverage is low, the government has to step in to prevent poverty, increasing the burden on public finances. As a result, Turkey only ranks at the top of the last third of countries ►

3 Note that developing countries generally have higher fertility rates; however, this is expected to decrease in the future.

4 UN population projection 2012; OECD (2013), Pensions at a Glance 2013

5 The Allianz PSI combines various characteristics of pension systems with the factors that influence them to help track and evaluate policy changes made in different countries around the world. It uses a range of sub-indicators – such as demographic developments, public finances and pension system designs – to measure systematically the long-term sustainability of a pension system. See Allianz (2014), 2014 Pension Sustainability Index, International Pension Papers 1/2014.

BOX 1: THE TURKISH PENSION SYSTEM

The Turkish pension system consists of a means-tested pension and an earnings-related social security system. The first is tax-financed and provides a minimum pension for poor and elderly people above the age of 65. The latter is financed on a PAYG basis where employees (9%) and employers (11%, of which 5 % is paid by the state) contribute to the system. Pensions are paid out according to different qualifying conditions depending on the date of workforce entry.

Date of workforce entry	Retirement age for men (women)	Contribution period
Before Sept. 1999	No explicit retirement age; contribution period is the only condition	23 years (men) 18 years (women)
Between Sept. 1999 and Oct. 2008	Age 60 (58)	7,000 days or 25 years with 4,500 days
After Oct. 2008	Age 60 (58) To be raised to 65 (65) by 2048	7,200 days or age 65 with 5,400 days

The achievable replacement rate is high compared to the majority of OECD countries.[6] In addition, there is a voluntary private DC pension scheme which is supported by the state *(see Box 3)*.

in the PSI. A large informal workforce and labor market regulations that can lead to contribution evasion are challenges still to be overcome.

Informality – an ongoing policy task

The informality rate in Turkey was around 50%[7] in the late 1990s, when the first wave of reforms was introduced to address the sustainability of its retirement system. Although Turkey has been able to improve its employment situation, informality is still high at 36% in 2013. Compared to other OECD countries the formal employment rate of workers aged 25 to 54 is still much lower than in other countries or compared to the OECD average.[8]

A recent analysis of Turkish economic progress by the OECD[9] points at successful broad-based business sector development with fast job creation coupled with productivity gains. Nevertheless, there still seem to be large inequalities due to uneven labor market conditions. The share of workers in small businesses is very high, as is the level of informal employment within these businesses. According to the OECD analysis there is almost 60% unregistered employment in non-agriculture firms with up to 10 workers, leaving a large percentage of workers in informality and thus without social security plans.

Although the social contribution reductions introduced in 2008 have helped stimulate job creation according to the OECD country report,[10] the regulatory framework still hampers formal employment with social security contributions and regular tax payments,[11] particularly for small businesses.

Turkey is actively working on improving its large informal sector and the evasion of contributions as they pose the greatest risk to its old-age provisioning. The government has implemented various social security contribution reduction plans to stimulate labor market participation. A 25% reduction of employer social security contributions is widely used[12] to increase registered employment and regular contribution payments. Other programs are aimed at improving the financial situation of vulnerable groups such as the young unemployed, women and older workers.

Although Turkey has succeeded in increasing employment levels for women and older citizens, to some extent the programs need to be expanded. Further social security improvements are included in the 10th Development Plan for 2014 to 2018 and a new National Employment Strategy published early in 2014 aims to tackle the biggest labor market problems; one part expressively aims at "making social protection more employment-friendly."[13] ▶

6 OECD (2013), Pensions at a Glance 2013

7 World Bank, 2010: Turkey. Country Economic Memorandum: Informality. Causes, Consequences, Policies

8 OECD (2014), Employment database.

9 Gönenç, R. et al. (2014), Fostering Inclusive Growth in Turkey by Promoting Structural Change in the BusinessSector, OECD Economics Department Working Papers, No. 1161

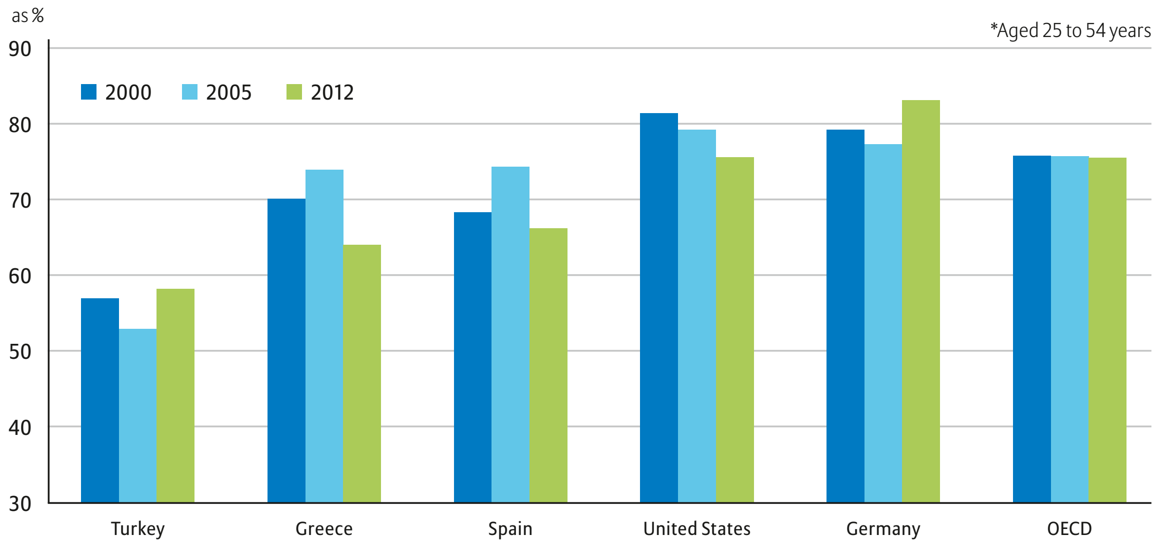
10 OECD (2014), OECD Economic Surveys: Turkey 2014

11 There are stricter rules for companies once they pass certain thresholds for numbers of employees.

12 Karadeniz, Oguz (2013), Pensions, health and long-term care, Turkey Country Document 2013, asisp on behalf of the European Commission

13 Gönenç, R. et al. (2014), Fostering Inclusive Growth in Turkey by Promoting Structural Change in the Business Sector, OECD Economics Department Working Papers, No. 1161

Figure 2: Employment rates of prime workers* in selected OECD countries



Sources: OECD(2014), Allianz Asset Management

Addressing poverty

As Turkey has evolved industrially, it has become increasingly necessary to provide a comprehensive, sustainable formal old-age provisioning system with adequate benefits as the social security network, with a strong emphasis on the extended family, is challenged.

In response, the topic of aging entered the political agenda[14] roughly eight years ago. The National Committee on Aging prepared an 'Action Plan on Aging,' which is being implemented by the Ministry of Family and Social Policy, established in 2011. Measures focus on social integration of the elderly, health and long-term care issues. ►

BOX 2: ONGOING PENSION REFORMS

Recent reforms* in the public pension system:

- Alignment of the calculation periods for different groups of retirees who retired at different points in time (as part of the 10th Development Plan)
- Extension of invalidity coverage
- Increase of minimum pension threshold

Social assistance:

A new law allows workers to stay in employment and receive social assistance at the same time.

Reforms on the agenda according to the 10th Development Plan (2014-2018)

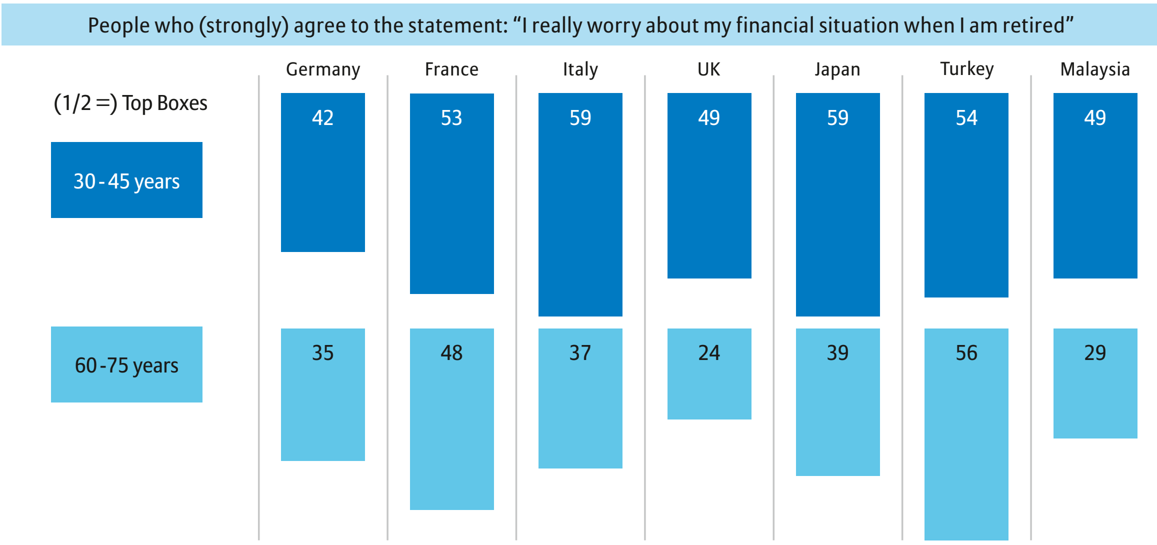
- Improve administration in order to cope with unregistered employment and contribution evasion (inspection mechanisms, coordination, IT)
- Reduction of bureaucracy
- Increase awareness of social security obligations and rights

*For earlier reforms, see Allianz Global Investors (2011), Pensions in Turkey – A Race against Informality and Low Retirement Ages, International Pension Papers 3/2011

14 Republic of Turkey (2012); Second Review and Appraisal of the Madrid International Plan of Action on Ageing, October 2012.

Figure 3: Financial situation

Figures are in %



Question: We are interested in your view about the time in retirement and your preparation for it.
Please indicate how strongly you agree or disagree with each statement below; Scale: (1) strongly agree – (5) strongly disagree

Source: Allianz (2014), Security – Trust – Solidarity, Perception of retirement: a cross-country comparison, Allianz International Pension Papers 2/2014

Fighting poverty has a high priority for the government in order to get the elderly integrated in social life. Although Turkey is on the right track, poverty rates are still high. In fact, older Turks are among the poorest in OECD countries, with poverty rates at 17.6%, versus a 12.8% OECD average.[15] And it isn't just the number of people living in poverty which must be tackled; the amount they can receive is much lower than in many OECD countries. Indeed, almost 40% of elderly citizens with an income below 60% of the country's median income do not receive any state benefits at all.[16] Hidden within these statistics is the even more problematic situation of women in Turkey, as the pension system is based on a male breadwinner approach.[17]

With this in mind, it is not surprising that people in Turkey think they are or will find themselves in a tight financial situation when they retire, as shown in a survey conducted by Allianz[18] in seven countries across two age groups. In almost all countries, young people are worried about their financial situation in retirement due to the unknown impact of changes in retirement systems and difficulties in planning across a long-term horizon. By contrast, the older people surveyed are not quite as pessimistic, with the exception of those in Turkey, where 56% of the elderly are worried about their financial future.

Family support remains important in Turkey and the majority of older people still think that they will have to rely on their families according to the survey. This is in stark contrast to other countries surveyed – even Malaysia, where there is still a strong family support system today *(Figure 4)*.

The situation will probably improve in the future as the government drastically increased the threshold for the means-tested old-age pension by almost 100% in 2013. For women the financial situation should also improve as Turkey has launched a new program for widows without a pension.

Private pension plans for all

Private pensions were introduced in 2003 with the aim of supporting economic development by providing the necessary capital and opening up the opportunity for employees to save for old-age provision. While the number of participants was in line with the expectations of the Pension Monitoring Center in 2011, assets under management lagged behind the expected amount[19] and didn't really take off[20] until the recent improvements.

After the introduction of certain amendments to the private pension law in 2013, particularly the matching contributions paid by the state, the number of participants increased considerably. While at the end of 2012 there were 3.1 million participants contributing to private ►

15 OECD(2013), Pensions at a Glance 2013.

16 Karadeniz, Oguz (2013), Pensions, health and long-term care, Turkey Country Document 2013, asisp on behalf of the European Commission

17 This is not only a problem in Turkey; in many countries, older women are more at risk of poverty than males. See Allianz (2013), The young wife's curse, Project M special edition 2013

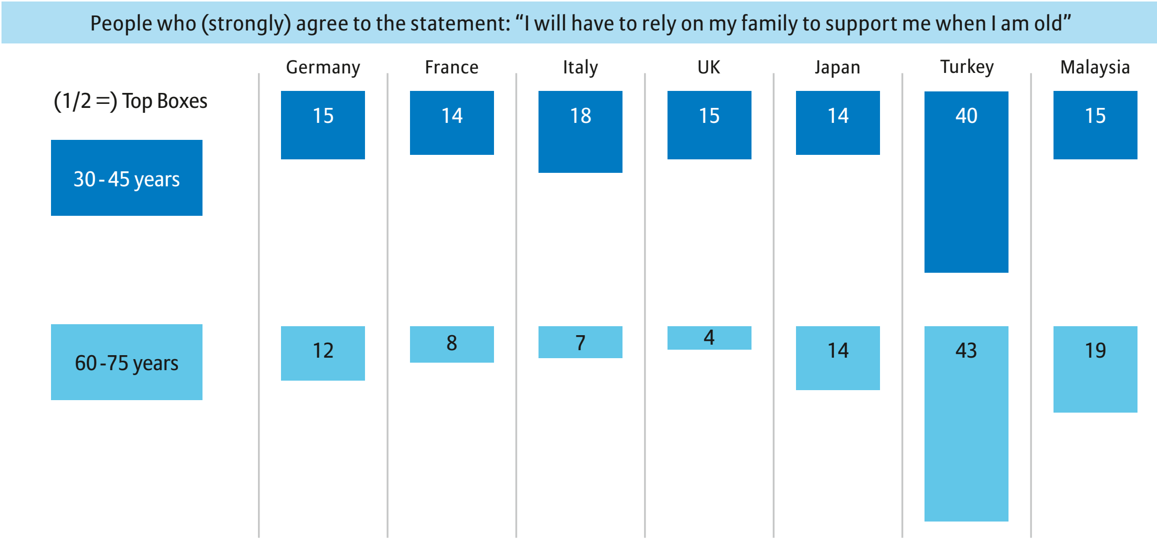
18 The survey was conducted in seven countries and for two cohorts to compare regional and age differences in retirement preparation. See Allianz (2014), Security – Trust – Solidarity, Perception of retirement: a cross-country comparison, Allianz International Pension Papers 2/2014

19 Quoted in TCMB, in 2011 the expected participants were 4 million and the amount TRY 48 billion for 2015

20 Pension monitoring center (2014), Individual pension system 2013 progress report, 2014

Figure 4: Family support

Figures are in %



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Please indicate how strongly you agree or disagree with each statement below; Scale: (1) strongly agree – (5) strongly disagree

Source: Allianz (2014), Security – Trust – Solidarity, Perception of retirement: a cross-country comparison, Allianz International Pension Papers 2/2014

pension schemes, the number increased by more than 30% to reach 4.1 million at the end of 2013. A similarly positive development can be seen in the increase of contributions and assets under management. By October 2014, the number of participants reached 4.9 million, with assets under management climbing to 31.3 billion Turkish lira (€11.1 billion). However, the ratio of private pension funds to GDP is low (roughly 2%) compared to other countries, probably due to a short history, the voluntary set-up and a sluggishly increasing awareness of necessary additional private saving for old age. Turkish (future) retirees are still relying principally on PAYG benefits from the public pension system.

With improving labor market conditions, employment opportunities and the young structure of the country (see paragraph on demographics), as well as financial support, pension schemes and funds should further grow at a considerable pace in the future. ►

BOX 3: PRIVATE PENSIONS[21]

Key characteristics:

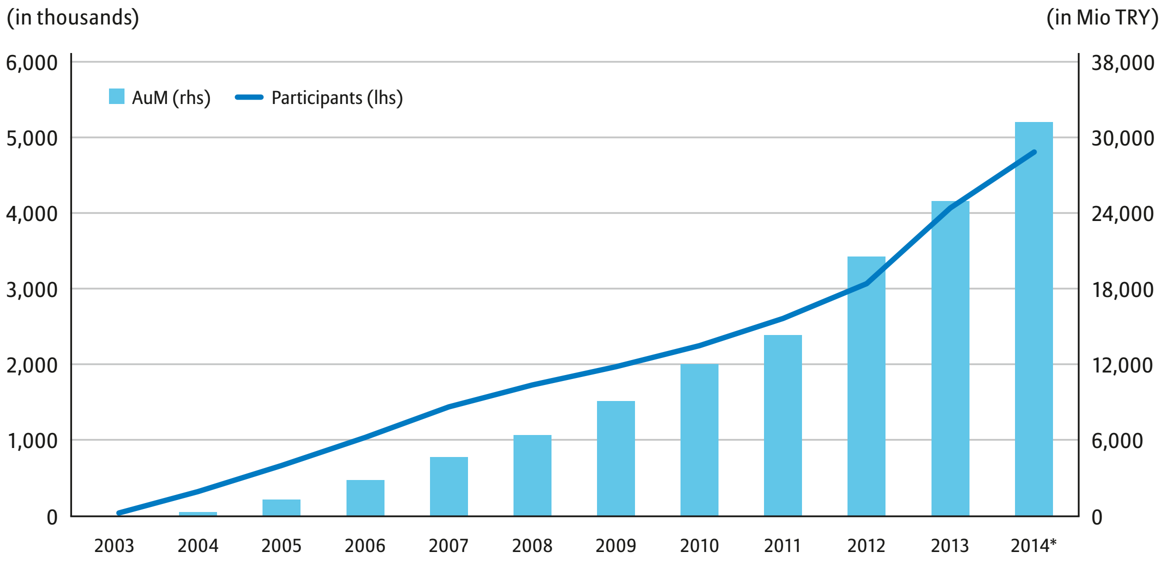
- Voluntary participation
- Defined contribution schemes
- Minimum contribution period of 10 years, earliest withdrawal at age 56
- Funds with different risk/yield structure must be provided
- Pension companies increased from 6 at the beginning to 18 in 2014
- Tax incentives offered

Reform effective as of January 2013 aims at raising the amount of funds and number of contributors via:

- the introduction of matching contributions of 25% by the government
- a reduction of fees
- tax exemption on contributions, even in the case of early withdrawal
- improvements for employers who contribute, such as greater tax deductions

21 See TCMB Financial Stability report, Nov 2011 and ASISP

Figure 5: Private Pensions in Turkey – Number of participants and volume of funds



*October 2014

Sources: Pension Monitoring Center Turkey, Allianz Asset Management

Outlook

Turkey finds itself in a difficult situation as it attempts to foster economic development on the one hand and prepare for a rapidly aging society on the other. The country has already taken action on both fronts and is on the way to improving labor market conditions to alter what still remains a largely informal workforce. It is addressing the issues of social security contribution evasion and poverty, while the new Ministry of Family and Social Policy is implementing an Action Plan on Aging and the 10th Development plan 2014-2018 is tackling the employment problem. These changes will take time, however, as pension reforms in particular have long transition phases. It will take a while until these measures have the necessary impact on the sustainability of the pension system.

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