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An Overview of the Turkish Pension System

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Social security in Turkey is a publicly managed system for both the public and private sectors established in 1940 and covering almost 86 per cent of the population (SSK, 2011). The public pension system is composed of three distinct branches which are based on defined benefit (DB) scheme and financed on a pay-as-you-go (PAYG) basis. Public and private pension schemes co-exist, but, the public pension system predominates.

The organisation of social security institutions and pension regimes are set by law: the public old-age pension provision including disability and survivor pensions are regulated by the Social Insurance Act of 1964 (Law No. 506), which was amended in 1999 (Law No. 4447). The system then underwent radical reforms with amendments in 2006 by virtue of which three different social security institutions were unified (Law No. 5502) and subsequently, other changes were implemented by the Social Security and General Health Insurance Law (No. 5510) of 2008. Despite the favourable demographic conditions, the generosity of the former system led to an increasing deficit in the social security budget, making the enactment of the October 2008 amendment essential.

The main pension schemes in Turkey are: public, mandatory occupational, voluntary occupational and private plans. The public pension system covers three branches, coded as 4a–c referring to the former three separate institutions which were merged into one as the "Social Security Institute" (SGK in Turkish). The branches are: (1) blue collar workers employed in the public sector, and blue and white-collar workers in the private sector (4a); (2) self-employed people (4b), (3) white-collar workers employed by local and central government (4c). Earning pension benefits requires compulsory participation in retirement plans for each branch. The mandatory occupational schemes for the employees of the armed forces and the state-owned coal mining enterprises allow both DB and defined contribution (DC) elements to operate under separate legislation. The voluntary occupational plans are offered by employers, operates as DB, DC or both in the framework of book reserve or saving funds. The private pension insurance, called the Individual Pension System ("Bireysel Emeklilik Sistemi" or BES), implemented in October 2003, is a voluntary DC system and designed to be a complementary scheme to the public pension. Administered by the pension companies, participants' contributions are invested in selected pension mutual funds which are managed by professional portfolio management companies. According to the new legislation, which was amended in 2012 to increase attractiveness, the tax deduction was replaced by a state match of 25 per cent for contributions made by BES members up to a certain limit. The match is capped at the annual gross minimum wage. In force since January 2012, this new incentive has already doubled the subscription rate. Moreover, caps for plan administration fees and fund management fees have been dramatically decreased.

The unification of three different public retirement structures in the Turkish public pension system also necessitated parametric changes as concerns the retirement age, the days of contribution, the replacement rate and the valorisation coefficient. There has been a transition process due to older laws in which pension parameters were different. Older laws used fewer years for averaging wages, had higher revalorisation and accrual rates, and offered higher minimum pensions. Therefore, depending on the enforcement date, three different terms apply with regard to pension valuation. These are: (1) prior to 8 September 1999, (2) between 8 September 1999–30 April 2008 and (3) after 1 May 2008. The parametric changes in the public pension system have been adopted into the system according to the branches 4a–c, producing more uncertainty in actuarial valuations. The retirement age,

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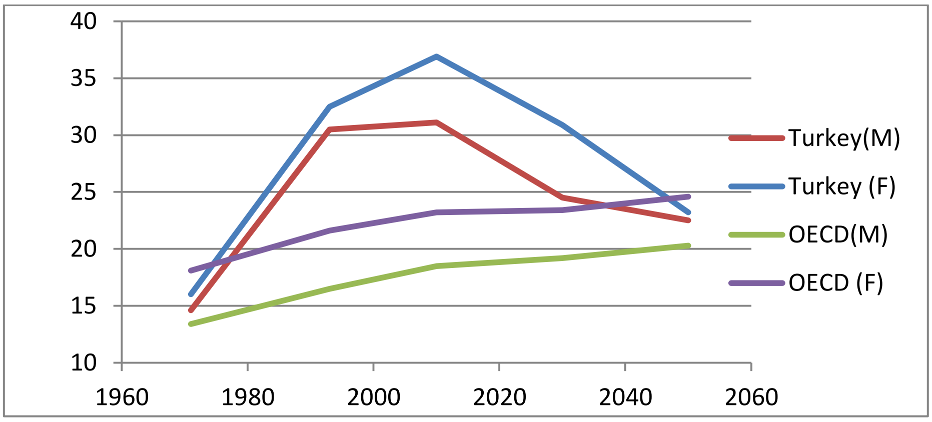
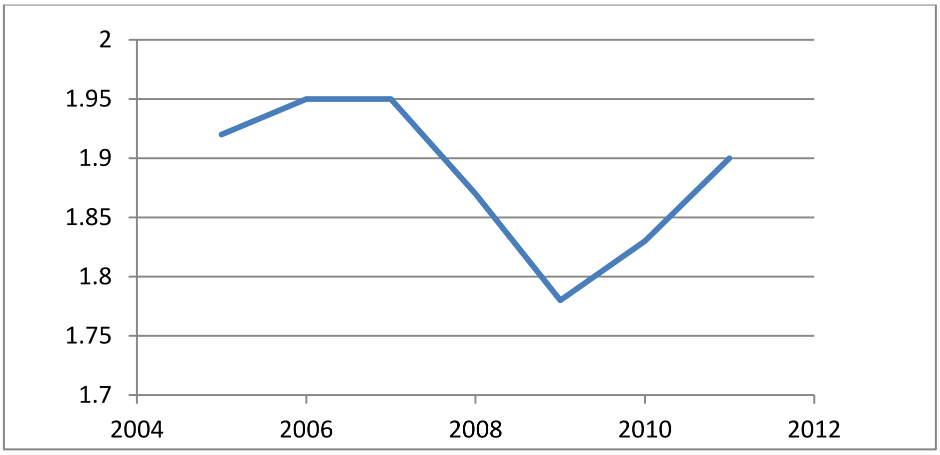
increased to 58/60 for females/males with the reforms, is planned to increase gradually by 2036 reaching 65 for both genders as of 2048. The requirement on days of contribution is increased from 5,000 to 7,200 or 9,000 days with respect to the branches conditioned by years of service. Workers in specific industries (e.g. mining) and people with disabilities can retire early, but other workers cannot claim pensions before the eligibility ages.

Figure 1. The life expectancy at retirement compared to OECD countries (F: female, M: male) (OECD, 2011)



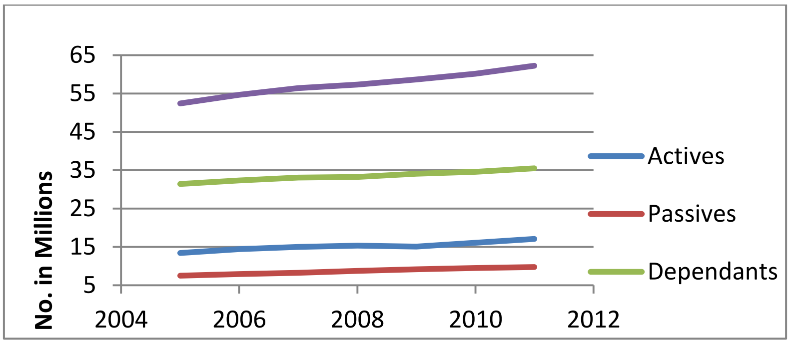
The premium rate of old-age, disability and survivorship insurances is 20 per cent, of which 11 per cent is employer-provided. The premium corresponds to the premium rate multiplied by pensionable earnings. It is bounded above by 6.5 times the minimum wage and below by the pensionable earnings. Components of benefits are determined as follows: (1) The averaging period for wages is the full career. (2) Revalorisation (RV) of wages is RV=1+CPI+30%GDP growth. (3) The accrual rate is linear with 2 per cent for every 360 days. (4) CPI is the post retirement index (5) The minimum pension is 35 per cent of minimum wage.

Figure 2. The active-passive ratio between years 2005-2011 (SGK, 2012)



Besides having a young population compared to most OECD countries, because of the lower retirement age, the life expectancy at retirement in Turkey is also higher than the OECD average (Figure 1), resulting in younger pensioners to be supported longer. Additionally, the early retirement policy of 1992, changing the minimum age condition to 38/43 for females/males, placed an enormous burden on funds, and its impact on the system is already recognisable. The active–passive ratio (Figure 2) and social security deficit (US$12,455m in 2012, [SGK, 2012]) illustrate the consequences of the entitlement ages and other components inherited from the old system, such as the high proportion of dependents (Figure 3) and the lower net pension replacement rate compared to other OECD countries, inappropriate management of pension funds, lack of premiums from informal labour, and the economic crises experienced through last decades.

Figure 3. The number of determinants in the pension system (2005-2011) (SGK, 2012)



The attempts to rehabilitate the pension system in Turkey definitely need time to bring the system into equilibrium because of the complexity in the pension requirements of the workers entitled under former laws. Non-uniformity in workers' profiles challenges the actuarial valuation and predictions on the future behaviour of the system's development. However, the demographic advantages and stability in economy in the last decade are opportunities for the pension system to recover and reduce the share of social security deficits as a percentage of GDP. State support to encourage private pension scheme (BES) is a sturdy step to establish the second pillar in pension system in Turkey.

References

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