The Political Economy of Social Security Reform: The Case of Jordan

Omar Razzaz
Outline

• Why is Social Security so Hard to Reform?
• Group Exercise
• The Jordan Case
• Options to Explore if you Want to Take the Plunge
Why Is Social Security So Hard to Reform?

The Environment Analogy:

- What problem? Deterioration is often slow and unobservable to the eye
- Reform means sacrificing now in the hope of benefiting in the future
- Who is missing at the negotiating table?
Why is Social Security so Hard to Reform?

Major difference bet. Env. And SS:

Environmental Awareness

Vs.

Social Security Blame Game

Postponement is still a politically appealing option
Jordan Social Security Reform
Group Exercise

• Why is SS reform necessary in your country (or is it)?
• What factors make SS reform most difficult in your country?
• Who are the typical stakeholders in the debate on reform? Can that group be expanded? Is that desirable in your case?
• What are options for reform? How would they be received by various stakeholders?
• What other benefits might be included in the reform package going forward?
• Who would be the ultimate winners and losers? What would be your strategy to deal with both groups?
The Jordan Case

- Defined Benefits, Partially Funded/ PAYG System
- Coverage Under the Old Law
  
  - Old Age
    - Compulsory (Male 60, Female 55)
      - Vesting (15 yrs)
      - Accrual rate 2.5%
      - Reference wage (Average of last 2 yrs)
    - Early retirement (45 years) for both genders
      - Vesting (15 yrs Male, 18 yrs Female)
  
  - Disability
  - Death
  - Work-Injuries
- Coverage extended to
  - All firms hiring more than 4 employees
  - Civil Servants (Since 1995)
  - Military (Since 2003)
Sixth Actuarial Study
Drivers of Future Debt

- Generosity

- Adverse Incentives
  - The scheme encourages
    - Gaming and Evasion
    - Early Retirement
Taking the case to Policy Makers

Adverse Incentives …..

I. The Scheme Encourages Gaming

- NPV = 14800 JDs
- IRR = 13.5%

- Contributions
  - Steady Growth in Income
  - Doubling Income 6 yrs before Retirement
  - Exploiting the Ceiling on Income Growth during the last 5 yrs before Retirement

- Retirement Salaries
Adverse Incentives: Some Recent Evidences

The Ratio of Early and Normal Retirees to Total Retirees

Average Age of Retirement

- Normal Retirement
- Early Retirement
### Poor Labor Force Participation Rate

<table>
<thead>
<tr>
<th>Region</th>
<th>Employed</th>
<th>Unemployed</th>
<th>Not in the labor force</th>
</tr>
</thead>
<tbody>
<tr>
<td>EAP</td>
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<tr>
<td>Paraguay</td>
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<td>Philippines</td>
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<td>LAC</td>
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<tr>
<td>Jamaica</td>
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<tr>
<td>ECA</td>
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<tr>
<td>Syria</td>
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<tr>
<td>SAP</td>
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<tr>
<td>Sri Lanka</td>
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<tr>
<td>Guatemala</td>
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<tr>
<td>Morocco</td>
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<tr>
<td>MENA</td>
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<tr>
<td>El Salvador</td>
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<tr>
<td>Egypt</td>
<td></td>
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</tr>
<tr>
<td>Jordan</td>
<td>31%</td>
<td></td>
<td>6%</td>
</tr>
</tbody>
</table>

*Note: The chart represents the labor force participation rate in various regions. The color codes indicate employed in the labor force, unemployed in the labor force, and not in the labor force.*
Consequently... the scheme is quickly maturing.
Taking the Case to the Public

– What is an Actuarial Study? Budget estimate over 40-70 years! Why?

– Why should we care about financial sustainability?
  Image building: Social Security as “Olive Tree”

– What is the risk of doing nothing? Animation to help explain how funded scheme work and risks involved.

– What can be done?
Study shows grim future for SSC's finances

By Khalid Neimat

AMMAN - The Social Security Corporation (SSC) will face difficulties in paying its benefit obligations unless it prevents further early retirements and adopts a new "benefit formula", according to its Sixth Actuarial Valuation, published on Wednesday. The study lends new urgency to the corporation's push for the House t
Framing:
The Olive Tree Metaphor
Explaining how financing works

unemployment fund that protects the jobless while they are looking for a job
...And How it can fail!

not only for today's generation but also for future generations
وثيقة الحوار الوطني
 حول مشروع قانون الضمان الاجتماعي
 ٢٠٠٩ - ٢٠٠٩

إعداد وتحرير
إدارة الإعلام وعلاقات المشتركين
أيلول/سبتمبر ٢٠٠٩
Not Retrenchment... but a Total Reform Package

• Extending Coverage
  – Firms with less than 5 employees
  – Employers and Self Employed
  – Non-employed housewives

• Indexation
  – Starting at Age 60
  – Progressive (through a ceiling on annual increase)
  – Indexation to Inflation or Av. Wage Growth Rate

• Insuring Additional Employment Related Risks
  – Unemployment
  – Maternity Insurance
  – Health Insurance

• Governance Reform on the asset and liability side
Political Economy Lessons Learned

1. **Awareness first:** Build awareness of current challenges facing the sustainability of social security systems ... And build that awareness of the problem *before* you jump into formulas for fixing it.

2. **Constituency:** Broaden Public Participation in the Debate to new economy participants. Get “Prospect Theory” working for you.
Public Opinion
Political Economy Lessons Learned

3. **Beyond Retrenchment**: Expand the Terms of the Debate to real risks people face.

4. **From Vice to Virtue**: show lack of sustainability, regressive distribution, discrimination, disincentives to work... suggest virtuous alternatives.

5. **Multiple Scenarios**: Explore the reform options scenarios openly with stakeholders. Show implications of each.

6. **A Package Deal**: Develop a broadly appealing package of proposed reforms... not a one dimensional cost cutting/retrenchment reform

7. **Governance**: In partially funded or fully funded systems, address the important issue of Governance of funds and investments, and introduce stop-gap measures on the liability side.
Exploring the Option of Increasing Contributions
Political Economy Lessons Learned

8. **Limit Casualties**: Limit Impact on those close to retirement (the importance of expectations)

9. **Technical vs. Political tradeoffs**: Don’t get too wedded to “your” plan and distinguish between financial sustainability of the system (Technical), and implicit and explicit social contract (Political).

10. **Winners and losers**: Identify early on the potential winners and losers of the proposed reforms: Provide platform for the winners, explore compensating the losers, or even better, changing their incentives. But don’t try to appease everyone.
Who Gained and Who Lost in the Jordan Case?

- **Who Gained?**
  - The previously uncovered (micro enterprises, self employed, voluntary, etc.)
  - The youth
  - The pensioners
  - Those who will retire at 60 or later
  - Everyone benefiting from maternity, unemployment, and other small reforms
Who Gained and Who Lost?

• **Who Lost?**
  – Those who would want to retire early and can no longer do that.
  – Those with salaries above twice the average wage on an increasing schedule.

• **Who got partially compensated?**
  – DC systems for those with higher wages
  – Those with many years in the system
  – Hazardous jobs category for organized unions
Conclusion

The three most important lessons

• Don’t take political support from leadership for granted—Make sure you win the awareness battle.

• Forget first best, design reforms with political economy in mind: Make sure there are clear winners, and that losers can be compensated!

• Engage, engage, engage
Thank You
• Annex

Main Reforms in the New Social Security Law, April, 2010
<table>
<thead>
<tr>
<th>Provision</th>
<th>Parameter</th>
<th>Old Law</th>
<th>New Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>General</td>
<td>Eligibility</td>
<td>Definition of Insured Person as salaried worker</td>
<td>Amending the definition of insured person to cover also the non-employed, self employed (compulsory basis)</td>
</tr>
<tr>
<td></td>
<td>Health Insurance</td>
<td>Not Applicable</td>
<td>Wording a separate paragraph allowing SSC to apply health insurance</td>
</tr>
<tr>
<td></td>
<td>Unemployment Insurance</td>
<td>Not Applicable</td>
<td>Introducing new UI scheme based on Individual Saving Accounts</td>
</tr>
<tr>
<td></td>
<td>Maternity Insurance</td>
<td>Not Applicable</td>
<td>• Introducing Maternity Insurance for private sector employees</td>
</tr>
<tr>
<td></td>
<td>Deductible Wage</td>
<td>No Wage Ceiling</td>
<td>• Setting a ceiling on deductible wage at a maximum of (JD5000) for current contributors</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• five times the average insured wages for new entrants</td>
</tr>
<tr>
<td></td>
<td>Contribution Rate</td>
<td>14.5%</td>
<td>• for military servants: Increases gradually to reach 25.5% by 2021</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• TBD for insured engaged in hazardous occupations</td>
</tr>
<tr>
<td>Provision</td>
<td>Parameter</td>
<td>Old Law</td>
<td>New Law</td>
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</tbody>
</table>
| Old-age, Disability, and Death | Age of Compulsory Retirement (Old-age) | ✓ (60) for males  
✓ (55) for females | ✓ 60 for males, with having the right to continue until age of (65).  
✓ 55 for females with having the right to continue until age of (60).  |
|                           | Age of Early Retirement             | (45) for males and females                                             | ✓ Same for those who complete minimum vesting period for early and normal retirement before 2011 (exempted) and workers engaged in Hazardous occupations  
✓ non-exempted current contributors : a gradual increase to age 50  
✓ closing early retirement window for the new contributors |
<table>
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<th>New Law</th>
</tr>
</thead>
</table>
| Old-age, Disability, and Death  | Minimum vesting period for early retirement | (18) For males, (15) For females             | ✓ Same for exempted groups and workers in hazardous occupations  
✓ Gradually increased to 25 yrs for male and 22 for female for non exempted contributors |
|                                 | Accrual Rate                           | (2.5%)                                       | ✓ progressive accrual rate based on age and wage layer  
✓ 2.5% at the normal age of retirement for the 1st wage layer, and 2% for the second layer  
✓ higher discount rate on early retirement accrual rates and specially for the first wage-layer  
✓ increases above 2.5% after the normal age of retirement to reach 3% at 65 (male) and 60 (female) for the 1st wage layer and 2.5% for the 2nd layer |
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</tr>
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</table>
| Old-age, Disability, and  | Family Allow | (10%) for first dependent and (5%) for each of the second and third dependents                                                                 | ✓ (10%) for first dependent at a minimum of (JD20) and a maximum of (JD50).  
✓ (5%) for each of second and third dependents at a minimum of (JD5) and a maximum of (JD25) for each |
<p>| Death                     | Indexation   | Not Applicable                                                                                                                                   | ✓ Annual indexation of pension to inflation after age of (60) for male and (55) for female with an absolute ceiling on the annual increase (20 JD). |
|                           | Replacement  | At a maximum of (75%) of average wage used in calculation.                                                                                     | ✓ the entitled pension should not exceed the average reference wage used to calculate pension                                                                                                         |</p>
<table>
<thead>
<tr>
<th>Provision</th>
<th>Parameters</th>
<th>Old Law</th>
<th>New Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Old-age, Disability, and Death</td>
<td>Reduction Coefficient for early retirement</td>
<td>Age- Based Reduction Rate</td>
<td>Replacing reduction rate by variable age- based accrual rate</td>
</tr>
<tr>
<td></td>
<td>Wage growth prior to retirement</td>
<td>Excluding specific categories from the limitation on growth rate</td>
<td>Removing all exclusions</td>
</tr>
<tr>
<td></td>
<td>Reference wage for calculating pension</td>
<td>Average wage of last (24) months prior to retirement</td>
<td>✅ Same for the exempted contributors</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>✅ Average of last 36 months for those who retire at the normal age of retirement</td>
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<tr>
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<td></td>
<td>✅ 60 months for early retirement</td>
</tr>
<tr>
<td>Provision</td>
<td>Parameters</td>
<td>Old Law</td>
<td>New Law</td>
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</tr>
<tr>
<td>Old-age, Disability, and Death</td>
<td>Coverage after fulfilling the normal retirement eligibility conditions</td>
<td>Compulsory retirement when fulfilling normal retirement conditions</td>
<td>Allow insured person to continue after normal retirement age to increase pension.</td>
</tr>
<tr>
<td></td>
<td>Cost: Inclusion of Previous Periods of employment</td>
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<td>Costly</td>
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<td>Less costly and limited only for fulfilling the minimum vesting period for normal retirement (Max 8 yrs)</td>
</tr>
<tr>
<td>Provision</td>
<td>Parameters</td>
<td>Former Law</td>
<td>New Law</td>
</tr>
<tr>
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</tr>
<tr>
<td>Insurance against Work Injuries</td>
<td>Contribution Rate: depends on compliance with rules of occupational health and safety</td>
<td>No Distinction</td>
<td>Empowering SSC according to a bylaw to raise contribution rate of insurance against work injuries at a maximum of (4%) based on rates and frequency of work injury occurrence when compared with sectoral benchmarks.</td>
</tr>
<tr>
<td>Daily Allowances</td>
<td>Employer bears payment of first day wage</td>
<td>Employer shall bear payment of wages for first three days from date of accident occurrence.</td>
<td></td>
</tr>
</tbody>
</table>