

Part II. Protecting the poor and vulnerable

Chapter 4. Reforming social safety nets and pensions

Iraq faces a choice between considerably broadening and strengthening its formal safety nets or continuing to rely on untargeted subsidy schemes and subsidized services. The choice is imminent because Iraq's social fabric remains very fragile, with large segments of the population facing unprecedented social and economic risks. The continuing conflict, high unemployment, widespread poverty, and so far limited economic response to reform are some of the problems that the society must confront. The incidence of absolute poverty is significant. Whether measured by monetary income or nonmonetary indicators such as health, nutrition, and life expectancy, poverty has worsened dramatically during the turbulent recent decades. Several population groups are especially vulnerable: unemployed youth; demobilized soldiers and militia; war victims with disabilities; and internally displaced persons, refugees, and returnees.

Iraq's volatile security is likely to have continuing consequences on poverty and vulnerability. The limited ability to manage these risks, coupled with the social exclusion of large vulnerable groups, threatens the nascent Iraqi democracy and the reconstruction process. Recent assessments confirm the importance of developing social protection programs that can help to mitigate the consequences of economic transition. The first priority would be to undertake comprehensive household expenditure surveys to identify the Iraqi poor. These surveys are starting. The next step would be to design formal safety nets and finance them in a sustainable fashion.

Poverty and vulnerability in Iraq

A systematic assessment of poverty has yet to be undertaken in Iraq, but available data suggest that the incidence of poverty is significant.¹ About 1 in 10 Iraqis lives in absolute poverty, and the same number are near the brink of the international poverty line of \$1 a day (table 4.1).

At the same time, surveys register relatively low inequality. The ratio of median incomes of the lowest and the highest quintiles was relatively low in 2003 at 3.7. In 2004 conflict and economic transition exacerbated inequality and pushed this ratio up to 5.3. Similarly, poverty indicators other than income also reveal relatively low inequality (e. g., in child malnutrition). These outcomes suggest the impact of the state-led redistributive development model that Iraq followed for decades and, more recently, the success of the Public Distribution System in securing the nutritional standards of the Iraqi people.

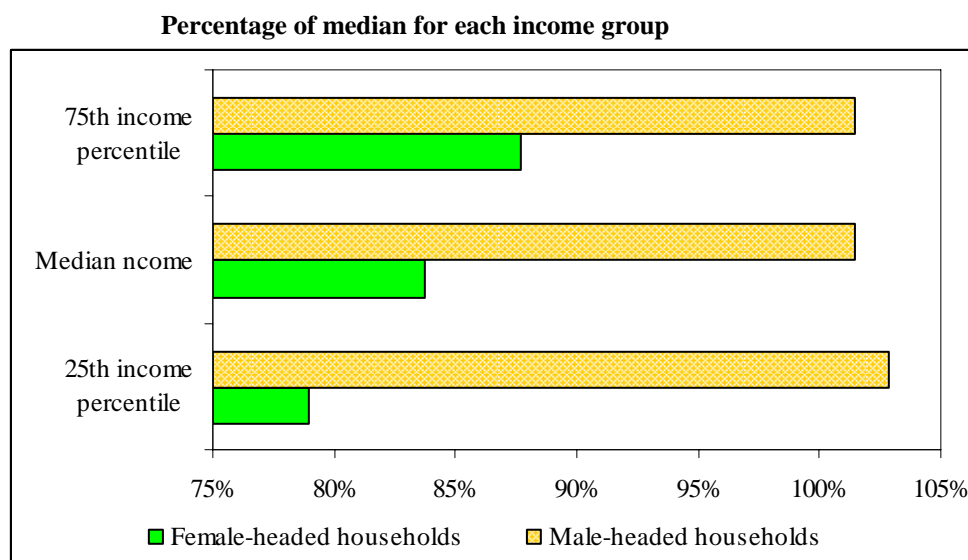
Table 4.1. Iraq's per capita household income by income quintiles, 2003 and 2004
(in U.S. dollars)

Year	Income quintile	25th percentile within quintile	Median for quintile	75th percentile within quintile
2003	Lowest income	427	585	780
	Low income	661	873	1,132
	Medium income	847	1,179	1,545
	High income	1,137	1,544	2,072
	Highest income	1,470	2,158	3,025
2004	Lowest income	555	809	1,104
	Low income	1,029	1,374	1,833
	Medium income	1,433	2,070	2,638
	High income	2,053	2,797	3,698
	Highest income	3,057	4,314	6,211

Source: Ministry of Planning and Development Cooperation/UNDP 2005.

An important aspect of Iraq's poverty is its concentration in female-headed households, whose median incomes are 15–25 percent below comparable male-headed households. The gender gap is particularly pronounced among the poorest (figure 4.1).

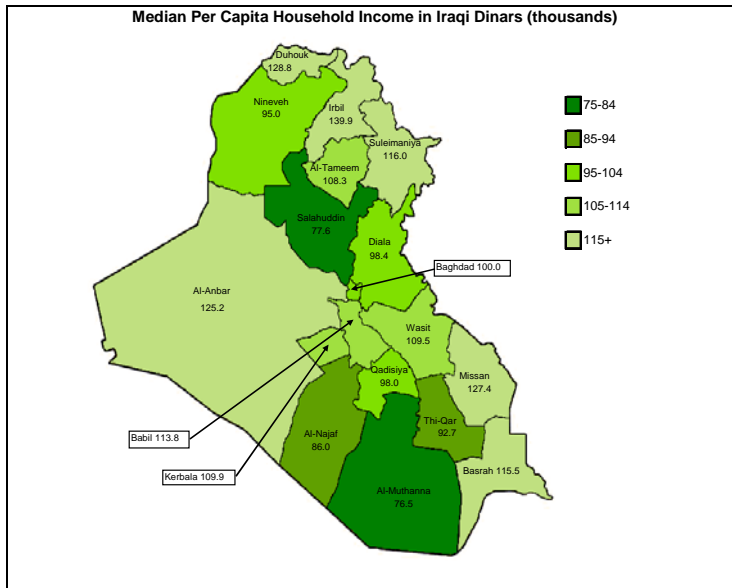
Figure 4.1. Gender and poverty by household income percentile, 2003



Source: Ministry of Planning and Development Cooperation/UNDP 2005.

Iraqi poverty has a distinct regional dimension (figure 4.2). The three Northern Kurdish governorates register consistently higher incomes than the rest of the country, while several Southern governorates, particularly Muthanna and centrally located Salah Al Din, report distinctly lower incomes. This poverty gap does not appear to be a rural-urban divide, at least not nationwide: the gap between median incomes of rural and urban households was less than 10 percent in 2003–04. Regional disparities are also pronounced in the nonmonetary poverty indicators, such as health and education conditions.

Figure 4.2. Regional patterns of poverty in Iraq



Source: Ministry of Planning and Development Cooperation/UNDP 2005.

Societies can have both chronic and transitory poor people. In Iraq, there are many groups that are especially vulnerable to poverty, social exclusion, and other social ills, given the current environment. These include, among others:

- *Unemployed youth.* The labor force participation rate among Iraqi youth is estimated at less than 30 percent, while for the economy as a whole it is over 40 percent (Ministry of Planning and Development Cooperation/UNDP 2005). Youth do not have the experience to compete in tight labor markets, and many also do not have the skills that employers need. Unemployment early in working life has been shown to increase the probability of future joblessness and lower future wages and can lead to alienation and social unrest (ILO 1998–99).
- *Former military, police, and ex-militia.* Many young people are among the former military and paramilitary forces that were disbanded following the fall of the old regime. While military forces are being reconstituted, it is expected that some 250,000 to 300,000 former members of the military, some with disabilities, and another 20,000 private militia members need civilian jobs. These large numbers make redeployment and reintegration a formidable challenge, particularly because many ex-soldiers are not oriented toward private-sector occupations. They are vulnerable to social and lifestyle adjustments; their alienation poses a risk to the formation of a stable Iraq. Already over 300,000 former military and militia and their families receive cash assistance under the government’s reintegration program.
- *War victims with disabilities.* Exact statistics for the number of civilians injured in the conflict are difficult to come by. A standard assumption is that the number of people injured in a war is at least three times the number of deaths. Estimates of

the injured in Iraq, including combatants, range from between 20,000 up to 135,000, depending on the source and the methodology.ⁱⁱ Children, too, often are affected long after a conflict stops. UNICEF has concluded that by July 2003 more than 1,000 children had been injured since the end of the war as a result of unexploded ordinance. That number continues to increase.

- *Internally displaced persons, refugees, and returnees.* These groups form a vulnerable population that has limited recourse to traditional risk-coping mechanisms, such as personal or family assets or faith-based support. Internally displaced persons include a prewar group displaced by the policies of the former regime (perhaps as many as 800,000 in the Northern governorates and up to 200,000 in the South, including Marsh Arabs and displaced Shi'a families).

Iraq's volatile security is likely to have continuing consequences on poverty and vulnerability. Lack of access to work and social services will cause temporary hardship for a large segment of the population. Long-term, chronic poverty will also result in households whose primary earners are killed or whose livelihood is destroyed, and for those whose education is cut short. Even in the optimistic scenario of a stable security and political situation, the Iraqi economy will be undergoing a major market-oriented transformation, which will create temporary unemployment as labor allocation moves to more productive areas. There will certainly be winners and losers in this transformation and changes in the distribution of income. The nature of these changes, however, is uncertain and, given the number of changes occurring simultaneously, the changes will be difficult to predict. In this context, efforts to monitor changes in the nature and extent of poverty and measures to provide reliable safety nets to the poor will be crucial.

Social protection

Social protection in Iraq consists of a collection of program interventions and providers, including direct support from families, assistance from private and charitable organizations, and programs administered by the government, as well as temporary interventions from donors and the international community. Altogether, the system is similar to other social protection arrangements in the Middle East and North Africa region and elsewhere. It has been profoundly weakened by the policies of the previous regime, coupled with the years of conflict and the resulting burden placed on the limited public assistance.

Subsidies

The Public Distribution System is the main publicly supported safety net available to the whole Iraqi population. Other subsidies are off budget and amount to transfers to households possibly in excess of 50 percent of GDP. These subsidies were analyzed in chapter 3.

Cash and in-kind assistance

For families without adequate support, including the blind and disabled, as well as single-parent families and the elderly, the Ministry of Labor and Social Affairs provides a monthly cash transfer. This flat benefit is modest (less than 10 percent of the median income of the lowest quintile) and reaches only about 112,000 families, whereas conservative estimates have put the number of needy families at more than 850,000.ⁱⁱⁱ Small cash transfers are also provided to demobilized military personnel covered under the government demobilization and reintegration program. The 2005 budget allocates ID 375 million for the 300,000 demobilized personnel, implying an average benefit of about 10 percent of the median income of the lowest income quintile, similar to the Family Allowance.

Neither of these transfers is based on a consistent definition of need, nor takes adequate account of family size in determining benefits. It is likely that some benefits are spilling over to those less needy and that better targeting methods, such as individual or proxy means testing, would improve the equity and efficiency of payments.

The ministry also provides limited institutional care for the blind and disabled. It maintains approximately 130 facilities, including kindergartens, orphanages, institutes for the disabled, elderly homes, and cooperative society workshops. Many of these have been severely damaged and have inadequate supplies. The number of beneficiaries is quite small, numbering only about 6,300 in 2004. The facilities and in-kind services offered are not designed to promote independent living or integration into society.

Private and informal safety nets

The extent of nongovernmental mechanisms for social protection is unknown. It is likely that family and personal networks account for the majority of social protection and that charity and faith-based institutions provide significant assistance to the most vulnerable. Recent surveys suggest that more than 90 percent of households had more than one source of income in 2003, with nearly a quarter reporting three or more sources. Households are relying on multiple jobs and job holders within the family and possibly in some cases contributions from outside the family to survive.

Nongovernmental organizations (NGOs) could have a significant role in the provision of social safety nets. Currently, there is not enough information at hand to determine the level of assistance actually provided by NGOs. Official estimates put the number of registered NGOs at more than 2,500 at the end of 2004, following the adoption of statutes designed to encourage the formation of NGOs and community groups.

As in many majority Muslim countries, *zakat* and *waqf* are common forms of assistance from individuals, typically given to community charitable organizations or to mosques, which then direct the use of funds. The government, through the official Awqaf Divans, helps to coordinate the distribution of some of these resources.

Pension reform

Pensions are another kind of formal social protection mechanism. All public-sector workers and employees of private firms with five or more employees are entitled in principle to social insurance, including pensions, medical insurance, disability, sickness, and maternity leave benefits.

Having an insurance mechanism in place to protect against poverty in old age is an important element of the social contract for workers in Iraq. Formal pensions have existed in various forms since 1922. Unfortunately, the pension system covers a minority of workers, given the large informal-sector workforce, and it is very expensive. The system now faces critical problems of financial sustainability, equity, and efficiency. These problems stem in part from the implementation of a series of emergency policies put in place after the war without proper assessment of the financial implications. To a large extent, however, the problems of the pension system are structural and would have had to be addressed in any circumstance.

The Iraqi mandatory public pension system is composed of two separate funds: (a) the State Pension System, which covers civil servants, the military and security forces, and employees of state-owned enterprises and (b) the Social Security System, which covers private-sector workers. Both are defined-benefit schemes financed on a pay-as-you-go basis.

Excluding the military, the two systems together cover roughly 15 percent of the labor force—mostly public sector workers. Indeed, from a total of 1.1 million workers accruing pension rights with either system, 1 million are civil servants or employees in state-owned enterprises (table 4.2). Only around 76,000 workers in the private sector currently are enrolled in the Social Security System—a mere 1 percent of the labor force.

Table 4.2. Contributors and beneficiaries in the Iraqi pension system, 2004

	<i>Military</i>		<i>Civil servants</i>		<i>Private sector</i>	<i>Total</i>
<i>Contributors</i>	n.a.		1,733,686		76,200	n.a.
Share labor force (percent)	n.a.		17		1	n.a.
	<i>Length of service</i>					
	<i>Less than 25 years</i>	<i>More than 25 years</i>	<i>Less than 25 years</i>	<i>More than 25 years</i>		
<i>Beneficiaries</i>	322,164	156,685	320,510	235,538	14,125	1,072,791
Old-age	105,120	116,205	181,968	169,209	6,108	620,825
Survivor (one)	91,151	15,709	84,092	41,827	8,017	231,049
Survivor (more than one)	125,893	24,771	54,450	24,502		220,917
Total expenditures (ID million)	407,526	286,259	472,185	595,971	11,683	1,405,987
Share of GDP (percent)	1.09	0.76	1.26	1.59	0.03	3.74
Average monthly benefit (ID)	105,414	152,247	122,769	210,855	68,929	109,216

n.a. is not applicable.

Note: GDP in 2004 was ID 37,556 billion. Data are as of December 2004. Data regarding the demographic structure and the finances of the pension system remain very limited.

Sources: Ministry of Finance, Ministry of Labor and Social Affairs.

Implementation of emergency policies

After the termination of major military operations in Iraq, the Coalition Provisional Authority replaced regular pensions with emergency “flat” payments, which amounted to about 3.7 percent of GDP in 2004. These payments have been increased continuously and now range between ID 80,000 per month (\$53) and ID 200,000 per month (\$133). The motivation was to compensate pensioners whose payments had been significantly eroded by inflation. General civil service salaries were also increased. Together, these measures imply a larger government debt with the pension system. Costs are likely to increase further, given the need to design compensation and reintegration programs for military, security forces, and ex-members of the militia.

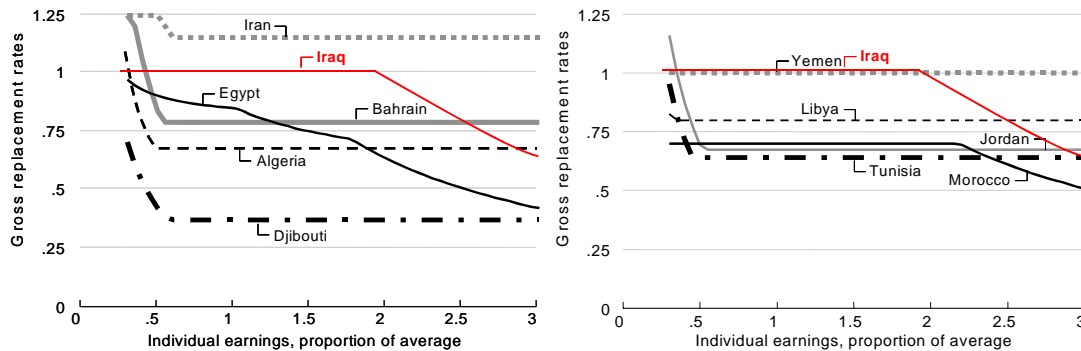
It is desirable to normalize pension payments as soon as possible, but going back to the previous pension formulas would be counterproductive. Indeed, as discussed in the next section, these formulas have several problems that compromise the financial sustainability of the pension system and are a source of inefficiencies and inequities. Current emergency “flat” pension payments could be preserved until the new pension system is ready. These payments would be financed out of the general budget, but they would be rationalized to control costs. Assuming that individuals continue to retire with emergency payments during the next 12 months, it is estimated that costs would peak at 7.6 percent of GDP in 2006 and then gradually decline.

Structural issues

The pension system in Iraq, as in other Middle East and North Africa countries, faces structural problems that compromise its financial sustainability, reduce economic efficiency, and create intra- and intergenerational inequalities:

- A first problem is the dual structure of the pension system, which is a source of inequalities. Provisions differ between schemes, with civil servants receiving more generous benefits. Dualism also increases administrative costs and, more important, can restrain the movement of the labor force, thus precluding efficient allocation of labor. As the role of the private sector expands, a dual pension system would be a drag on the Iraqi economy.
- The second problem is related to the mandate of the pension system, which is unaffordable. Both schemes offer very high gross replacement rates, close to 100 percent of the last salary for the average full-career worker. These are among the highest replacement rates observed in the region (figure 4.3). This reduces incentives to diversify the sources of savings for retirement, particularly among middle- and high-income workers and thus limits alternative means of managing financial and longevity risks.

Figure 4.3. Income replacement patterns of pension systems in the Middle East and North Africa



Source: World Bank staff calculations.

The Iraqi pension system is accumulating unsustainable pension liabilities as a result of the misalignment between the contribution rates, the targeted replacement rates, and the retirement age. Accrued-to-date pension liabilities with current contributors—that is, excluding the liabilities with current retirees—are estimated at over 60 percent of GDP. This is due, in part, to recent salary increases for civil servants. The contribution rate necessary to equilibrate the old-age pension component (i. e., without taking into account disability and survivorship pensions) would need to be set at over 30 percent of the covered wage. This level of taxation can cause a severe loss in competitiveness, a reduction in the demand for labor, and the possible expansion of the informal sector. Moreover, as the demand for public resources continues to increase, pension payments would crowd out the production of other public goods and services potentially of higher social value (e. g., health and education).

The low coverage rate of the scheme for private-sector workers is another cause of concern. Only about 2.5 percent of private-sector workers are enrolled in the pension scheme. Managers report high levels of evasion. Employers systematically underreport the number of employees to remain below the minimum at which pension enrollment becomes mandatory.

A final concern is the governance structure and administrative capacity of the pension system. The current staff will need additional skills to properly manage a reformed pension fund and to design and implement necessary reforms. Information technologies will need to be updated, including record keeping and payment systems.

Summary of recommendations

The social protection system in Iraq faces enormous challenges. Unemployment, poverty, and other vulnerabilities are prevalent under current conditions, and the resources and capacity to assist the needy and help them manage risks effectively are limited. Yet, the difficult transition that Iraq is enduring presents an opportunity for strategic development of effective social protection for the future. Several recommendations emerge from the initial review of the system:

Improve information for policy design. To design and implement effective social programs, it is critical to have timely and reliable information on the poor and vulnerable in society. Data and information will need to be collected at two levels: the national population level and the program level. Improving the information base includes implementing comprehensive household surveys on income, expenditure, and use of services as soon as conditions permit, together with reestablishing administrative data sources at the program level.

Enhance institutional capacity and coordination. The capacity of many ministries and agencies with social protection mandates has been weakened in recent years, even before the current conflict. The infrastructure to collect and process data, the institutional ability to analyze data, and the administrative and technical capabilities to effectively run, monitor, and evaluate programs need to be improved. Coordination between agencies with overlapping mandates or beneficiaries must be improved as well. Government safety-net interventions, NGOs, and Islamic charities largely operate independently of one another at present.

Rationalize existing social safety nets. There is considerable scope for improving the targeting and efficiency of existing programs to reach more needy families while containing costs. An important element is the design of the interventions, which can benefit from moving toward more individual needs-based targeting criteria. The performance of the Public Distribution System, for example, can be improved by altering the set of commodities or developing income or asset-based tests of need. Alternatively, the subsidy may gradually be replaced by a targeted cash transfer that would reach more disadvantaged families while reducing administrative costs. It is advisable to reexamine in-kind services to ensure that they are helping beneficiaries to become more productive and independent, especially with respect to institutional care.

Develop new interventions to preserve human capital and respond to the needs of vulnerable groups. Appropriate analysis will be needed before considering new interventions, including a conditional cash transfer program to improve education and health outcomes among youth and programs for former combatants and displaced families.

Utilize community-based, informal, and private social protection mechanisms. Community and faith-based assistance is a vital component of an effective strategy to alleviate poverty and mitigate social risks. Religious charities and foundations appear to be among the most active providers of safety-net assistance, and NGOs have emerged as potential contributors as well, after having been suppressed for many years. Incorporating local capacities and strengths in the provision of services is also consistent with the federalist thinking of the interim government.

Improve the design of the pension system. Iraq has the unique opportunity to fundamentally revise the design of its pension system. The current scheme is financially

unsustainable now and can be improved in terms of both equity and efficiency. The main components of a strategy may be summarized as follows:

- Within a period of one to two years, a new, integrated pension system would be designed and implemented. This new system would: (a) provide adequate and affordable pensions for plan members; (b) be financially self-sustainable; (c) allow for transparent and equitable redistribution; (d) minimize economic distortions; and (e) incorporate the best international practices in the scheme design and management.
- The current schemes would be closed to new entrants, and the current plan members along with the new entrants would start contributing and accruing rights in the new system.
- The rights accrued to date in the old system by current employees would be respected and the associated pension liabilities made explicit by the government. To improve transparency and the credibility of the fiscal framework, the implicit pension debt of the new system will be explicit. This can be done if all the surpluses of the pension fund are invested in government debt instruments.
- A new noncontributory scheme, financed out of general revenues, could be created to provide a basic pension to all individuals reaching a certain age (say, age 65). Individuals benefiting from the “flat” emergency payment scheme will not be eligible for this new basic pension.
- Any incentive package for military or ex-members of the militia who fall outside the rules of the new Pension Law, the new noncontributory scheme, or the “flat” pensions emergency payments, would require separate financing mechanisms and would not be managed by the new pension fund.
- It is very important that the fiscal impacts of any reform program are assessed. The key feature of the proposed design is that the surpluses of the new pension system would be reinvested in government debt, thus helping the government to finance the cost of the implicit pension debt.

Notes

ⁱ Income data should be interpreted with caution: recent income surveys may have been hampered by the security situation and a large role of informal sector (see box 1.1). Certain groups of the population were not covered, including recent returnees and internally displaced persons fleeing combat areas such as Falluja. More of these households are likely to fall into the lowest income category, and their exclusion could have artificially inflated income levels.

ⁱⁱ Various sources report a range between 20,000 and 135,000 deaths over 2003–04.

ⁱⁱⁱ Data are for 2004. The Ministry of Labor and Social Affairs has recently increased the Family Care Allowance for a single person from ID 30,000 to ID 40,000 (about \$28) and for families with more than one person to ID 50,000 (\$35). The ministry also intends to expand the number of families covered to 300,000 in 2005, resources permitting (Ministry of Labor and Social Affairs data; United Nations and World Bank 2003a).