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PENSION REFORM: THE PHILIPPINE EXPERIENCE

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Abstract

As signs of a social security crisis manifest, pension reforms begin to be considered in the Philippines. The paper provides the recent economic, demographic, and labor trends and explains extensively the present comprehensive but fragmented social security program.

While caution is being advised on possible negative impacts to the disadvantaged of pension reforms, the paper boldly recommends increasing the contribution rate and the merger of the country's two major institutions. It also advocates the adoption of a social protection model of four layers and the creation of a national provident fund.

I. *Introduction*

The threat of the impending crisis in social security is now constantly heralded, and the opportunities that can arise by reforming it are promoted. The clamor for the re-evaluation of policy and the immediate implementation of reforms has become louder and louder. The effectiveness of social security mechanisms to meet the growing demands of the elderly and other members of society, and even the basic social insurance principle of income redistribution are being challenged. Traditional social security institutions are being required to justify their programs. While there is a growing imposition that these schemes effectively support national economic development plans, there are also fears that many existing schemes are expensive, not viable in the long term, and simply financially unsustainable. Indeed, the impacts of economic globalization, demographic shifts, and financial turmoil are too serious and staggering not to merit the rationalization of existing systems. They require, at the least, the review of present structural arrangements.

As a consequence, many social security institutions in both developed and developing countries are responding with a high sense of urgency and openness. Some have started their pension reform and are about to introduce bold measures that affect millions of lives. Others still hesitate to adopt what have been tried and tested in other parts of the world, and they have their own reasons for their hesitation. They are still debating on what appropriate course of action to take.

In the case of the Philippines, the alarm has likewise been sounded, and general reforms have started to be discussed publicly, but specific ones have yet to be identified and initiated.

A. Economic Performance

The Philippines' economic performance during the last three decades largely influenced its population income patterns and development of pension system.

Since the 1980s, the Philippines experienced a boom-bust pattern of growth where periods of relatively moderate economic growth were followed by either recessions or sharp slowdown in real output growth. It experienced four major political and economic crises, namely: (a) a balance of payments crisis in the early 1980s similar to Mexico and some Latin American countries which led to the restructuring of its foreign debt obligations; (b) an electric power crisis aggravated by the US recession in the early 90s; (c) the Asian crisis in 1997; and (d) the political crisis in January 2001 which saw the change in political leadership to the present President. As a result of these events, the Philippines posted one of the lowest growth rates among the five original ASEAN member countries and the lowest per capita income, surpassing only Indonesia.

The structure of the Philippine economy has also seen significant changes during the last three decades, which affected the structure of employment in the country. In the 1970s, the bulk of the country's output was accounted for by the agriculture sector. As a result of major reforms initiated, the industry sector became the dominant sector in the 1980s, contributing about 40 percent to total output. However, in the 1990s, the liberalization policy of the government affecting the banking and communication sectors, among others, led to the vigorous growth of the services sector, which accounted for 46 percent of total GDP. The consistently high growth of the services sector led to employment opportunities, with the sector accounting for the bulk of employment starting in 1997.

The boom-bust pattern of economic growth of the Philippines had negative repercussions on income security. The crises brought about by economic or political factors, or by natural disasters reduced employment and income sources of the ordinary worker, and consequently caused a deterioration in the country's poverty situation. Thus, the latest Family Income and Expenditure survey shows that the poverty incidence in the Philippines worsened from 32.8 percent in 1997 to 36.8 percent by 2000.

Crises periods were oftentimes accompanied by accelerating inflation, eroding the real value of incomes and pensions. Between 1990 and 2000, the consumer price index in the Philippines rose by 227 percent compared to 155.6 percent increase in Thailand and 142.6 percent in Malaysia. The higher inflation rate of the Philippines is due to changing weather patterns, higher dependence on imported oil, and tariff protection for rice, which remains the basic staple food of the population.

Ironically, accelerating inflation triggers the demand for higher minimum wages. While wage adjustments generally favor those already employed, they aggravate the situation of the unemployed, who in turn, raise the demand for social safety nets. Unfortunately, government budgets to finance meaningful safety nets are usually constrained due to lower revenue intake. In the case of the Philippines, the budget deficit as a result of the Asian crisis rose to over 4.0 percent of GDP by 2000. While social sector expenditures for health and education were protected from budgetary cuts, the needed increase in the budget to maintain the real value of social sector services could not be given.

The high central government budget deficit also has its positive benefits for the investor. Deficit financing and the high inflation led to higher yields for government securities relative to the equities market. Starting in 1997, 91-day T-bill rates fetched higher earnings compared to investments in stocks, which saw the Phisix[1] losing 41 percent of its value as a result of the Asian crisis. The same story was repeated in the last two years, which was mired by a political crisis that saw the Phisix plummeting by 45.5 percent from the 1999 year-end level. In contrast, the 91-day T-bill rates averaged 9.8 percent during the last two years.

The gross domestic savings rate of the Philippines has been going down from 26.6 percent in 1980 to 16.5 percent by 2000 due partly to the unsustainable pattern of economic growth in the Philippines. It can also be traced to the low level of income, the low rate of return on savings, and to demographic factors, such as the tendency of the young population of the Philippines to dissave.

The low savings rate has been mitigated, somehow, by the extended family system in the country that serves as a form of safety net during crisis periods. In the Annual Poverty Indicator Survey undertaken by the National Statistics Office in 1998 to assess the impact of the crisis, it was noted that the poorest 40 percent of the population were able to get financial assistance from their relatives during the Asian crisis.

B. Demographic Trends

The population in the Philippines as of May 1, 2000 stood at 76.5 million, 7.9 million higher than the 1995 census count of 68.6 million. The population grew at an average rate of 2.36 percent during the second half of the 90s, slightly higher than the 1990-1995 growth of 2.32 percent.

The population growth rate in the country has been declining from 3.08 percent in the 1960s to 2.35 percent in the 1980s. Since then, however, the expansion in the population has somewhat stabilized at around 2.3 percent. At this pace, the population of the Philippines is expected to double in 29.7 years.

The Philippines at present has an expansive population where the larger number of the population is in the younger ages. However, the population composition is moving towards a constrictive population with the proportion of those in the younger ages getting smaller.

Based on the 1995 census, the median age in the Philippines is 20.4 years. About 38.4 percent of the population is below 14 years of age. Consequently the youth dependency ratio is high at about 65.9 percent, but this has been declining from the 75.7 percent youth dependency ratio recorded in 1980. This ratio[2] will reach 30.5 percent by 2050.

Meanwhile, the old-age dependency ratio of the Philippines based on the 1995 census was 5.9 percent. The number of people above age 65 increased from 1.3 million in 1980 to 2.3 million by 1995. The old-age dependency ratio[3] will increase to 21.6 percent by 2050, implying that the number of those 65 years and over is projected to reach 18.6 million people by that time.

The Philippine population has an improving life expectancy. A person born in 1980 can expect to live 59.9 years on the average with the females expected to live longer at 61.5 years compared to 58.3 years for males. Life expectancy further improved to 66.3 years in 1995, and

[1] The Philippine Stock Exchange index

[2] Based on the medium series population projections prepared by the Population Division of the United Nations in 1998

[3] Based on the medium series population projection for the Philippines prepared by the United Nations

is projected to reach 78 years by 2050.

C. Labor Market Trends

On the labor front, the labor market situation in the Philippines follows closely the developments in the real sector of the economy. As expected, lower labor force participation rates and high unemployment rates were observed during periods of economic crises. For instance, the unemployment rate as a result of the Asian crisis hit double-digit rates at 10.1 percent in 1998. Again, the events leading to the political crisis in early 2001 that eroded consumer and investor confidence caused the unemployment rate to hit an average of 11.1 percent in 2001.

The labor force participation rate is about 67 percent in 2001. As of the latest Labor Force Survey conducted in October 2001, the male labor force participation rate was estimated at 82.3 percent compared to a much lower 52.3 percent for females. However, from about 46 percent in 1980, there has been a notable increase in the female labor force participation rate particularly in export-related industries such as electronics and semiconductors in recent years. The employment rate remains slightly higher for males at 90.6 percent while the corresponding rate for females is 89.6 percent.

The employment structure of the Philippines essentially follows the output structure in the real sector of the economy. Services account for 46.7 percent of those employed while agriculture's share is about 37 percent. In 1996, the latter contributed 42.8 percent of total employment. The increasing share of the services sector compared to the agriculture sector implies increasing formalization of the labor force. At the same time, subcontracting arrangements which seem to prevail in the export sector have proliferated. The latter was partly responsible for the growing informal sector in the economy, which is estimated to account for about 40 percent of total output. Increasingly, the government is slowly recognizing the importance of extending social protection to this sector as part of its poverty program.

II. *The Current Philippine Pension System*

The social security system of the Philippine has been described by some experts as comprehensive but fragmented the way it is being implemented by various government agencies and private institutions. It consists of benefits for old age, disability, death, maternity, sickness, medical care and workmen's compensation that are awarded in the form of short-term or long-term regular cash payments, or in kind as in the case of medical care. While family and unemployment benefits[4] are not regularly granted, equivalent benefits are being given by some companies on a voluntary basis.

[4] These two branches of social security are the only ones lacking in the Philippines to complete the nine branches of social security as provided for in International Labor Organization Convention 102.

A. First Pillar[5]

1. **The SSS and the GSIS.** The Social Security System (SSS) and the Government Service Insurance System (GSIS) play a major role in the implementation of the country's pension scheme. The SSS carries out the program for those in the private sector while the GSIS provides the pension benefits for employees of the public sector. Both institutions administer a mandatory publicly-managed, defined-benefit system, with primary funding coming from workers and employers in the form of contributions.

Both institutions follow a financing method based on the actuarial formula of:

$$\text{CONTS} + \text{INV INCOME} = \text{BENEFITS} + \text{OPER EXPENSES}$$

where CONTS is for contributions, INV INCOME is for investment earnings, BENEFITS is for benefits, and OPER EXPENSES is for operating expenses.

The length of time when the accumulated value of the left side exceeds or equals the right side is referred to as the actuarial life of the fund. Presently, the actuarial life of the SSS is less than 40 years, and therefore only partially funded. The GSIS, on the other hand, has a perpetual actuarial life and is fully funded. The SSS requires the eventual increase in its contribution rate, which at 8.4 per cent is very low compared to other similar institutions, in order to remain viable in the long term and avoid a crisis.

a. Coverage and Contributions. For the SSS, the worker contributes 3.33 per cent and the employer 5.07 per cent of pay. For the GSIS, the employee contributes 9 per cent and the employer, 12 per cent. The SSS by mid-2001 has 23 million active covered workers, and 820,000 regular monthly pensioners while the GSIS has 1.4 million members and 201,000 pensioners. In 2000, the SSS paid out total benefits of P33.8 billion[6] versus a contribution collection of P30.2 billion and investment income of P12.3 billion. The GSIS, on the other hand, paid out in benefits P18.2 billion versus a P42.3 billion in gross revenues.

   Both institutions have accumulated surplus contributions in the past that have been invested, and now earn tax-exempt incomes that form part of the funding system. As of the end of 2000, the SSS and the GSIS have almost the same total assets at P182 billion and P 181 billion, respectively. The offices of both institutions keep individual accounts of contributions made in the form of salary credits for every member, and receive contribution payments and pay pensions directly or through accredited banks.

b. Pension Formula. The pension formulas of both institutions depend on the length of contribution period and on the average salary credit (in a way, contributions) in the most recent period. For the SSS, the years needed to qualify for pension is 10 years, and for the GSIS, 15 years.

   For the SSS, the monthly pension formula is:

$$300 + 20 \text{ per cent} \times \text{AMSC} + 2 \text{ per cent} \times (\text{CYS} - 10) \times \text{AMSC}$$

   where AMSC is the average of the last 60 monthly salary credits, and CYS is the number of credited years of service.

[5] Pillars 1, 2 and 3 are by the definition of Fox and Palmer, as per the Author's evaluation.

[6] The Philippine Peso has an exchange rate with the US Dollar of 51.6:1.

For the GSIS, the monthly pension formula is:

$$37.5 \text{ per cent} \times \text{RAMC} + 2.5 \text{ per cent} \times (\text{YOS} - 15) \times \text{RAMC}$$

where RAMC is the revalued average monthly compensation of the last three years, and YOS is the number of years of service.

Both formulas are subject to minimum amounts that are increased from time to time. Pension amounts for all are adjusted regularly, and depend on the assessment of the two institutions, usually independent of each other, based on inflation and surplus income. Pension increases are not mandated by law.

c. Fund Management. Both the SSS and the GSIS have their own internal investment units. Their separate charters and regulations have set allocations for salary and housing loans to members, in traded and publicly listed stocks and in government securities. Loans have also been extended to private sector companies.

In the case of the SSS, its records show that since 1957, the investments have earned P185.7 billion as compared to the total contributions collected of P220.6 billion and total benefits paid of P209.8 billion. In other words, the investment income has truly been an important component of the financing system of the SSS, without which the contribution rate would have required an increase much earlier.

d. Operating Expenses. Total operating expenses of the SSS are subject to a statutory limit, equivalent to 12 per cent of contributions and 3 per cent of investment income. It had to operate within this limit lately. The GSIS, on the other hand, spent only 6.34 per cent of gross revenues in 2001.

2. **The ECC**. The Employees' Compensation Commission (ECC) is another institution that provides pension benefits for work-related contingencies (or workmen's compensation). The EC pension benefits are wage-related and are awarded additionally to the SSS and the GSIS beneficiaries who suffer death and disability. The contributions, which the employer fully pays by himself at 1 per cent of his worker's pay, are remitted together with those for the regular programs of the SSS and the GSIS. The pension amount is based on the formula used by the SSS or the GSIS plus 15 per cent, and paid out by either system.

The collection of contributions, record keeping, and benefit administration of EC benefits are carried out by the SSS and the GSIS. The ECC promulgates the policy and regulations, and settles disputes, appeals and legal issues regarding the award or non-award of benefits.

3. **The PVAO**. The Philippine Veterans Administration Office (PVAO) is a specialized government agency that administers the pension needs of retired military personnel. The PVAO pension benefits are based on the last pay and are funded from the national budget on a year-to-year basis. No tax is being deducted.

4. **The PHIC**. Medical care is a national contributory scheme that includes almost all as beneficiaries — the workers of both public and private companies, the self-employed and the indigents and their dependents. Pensioners of the SSS and the GSIS are entitled to the benefits without need of contributions as mandated by law. The scheme is being administered by the Philippine Health Insurance Corporation (PHIC), and integrates into its delivery system — i.e., public and private hospitals, pharmacies, doctors and other medical professionals on a fee-for-service basis.

B. Second Pillar

The other public institutions that provide pension benefits are the Home Development Mutual Fund[7] (HDMF or Pag-IBIG) and the Retirement and Separation Benefits System (RSBS).

The HDMF covers the members of both the SSS and GSIS, and are funded by the employee and the employer, each contributing at 2 per cent of salary. The RSBS is for members of the armed forces who contribute 6 per cent of salary. The employer, which is the government, does not contribute any.

The HDMF collects the contributions from the employers who may remit directly to the HDMF or through the banks.

Both funds employ their own internal investment personnel who invest in home mortgages, member loans, and in government and private securities. They maintain individual accounts of the members and credit to them earnings from investments.

Both programs are defined-contribution provident funds, the accumulated contributions and interest income of which are paid as a lump sum at the end of the contributory period. The incomes from the operations of the two institutions are subject to income tax, and the members at the time they receive their benefits do not pay any tax.

C. Third Pillar

Retirement schemes administered by public and private companies also exist, oftentimes under trust arrangements with banks, private insurance and pre-need companies. The benefits of employees of private companies are mostly defined-benefit, and the extent of the amount and vesting rights vary according to company and industry. The features of these schemes are usually the result of collective bargaining agreements. Some companies pay for the entire funding, others, especially those of public corporations, require workers to contribute. Those in the public corporations usually are defined-contribution schemes, the benefits of which are determined by the contributions and accumulated earnings.

The incomes of a company-sponsored scheme may be tax-exempt, if the scheme plan is approved by the Bureau of Internal Revenue, which examines the funding adequacy. Contribution rates for defined-benefit plans start at 10 per cent, and may go up as high as 40 per cent for defined-contribution schemes.

A law[8] requires companies to pay separation benefits to employees of certain sectors with a 5-year minimum length of employment period, inclusive of any company-sponsored retirement plan. The amount of benefit is equivalent to ½ month's pay for every year the worker was with the company. Prior funding is not required, however, and companies may not set aside funds until contingency takes place. Compliance is not well-monitored by the Labor Department, the government agency tasked for the law's implementation.

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[7] The HDMF is primarily a housing fund for all workers of both public and private the mandate of which is to raise funds that are lent out to members for housing mortgages.

[8] Republic Act 7641 of 1992

III. *Evaluation of the Current Pension System*

Redistribution and risk sharing functions — The pension formulas of the SSS and the GSIS may not seem at first glance to incorporate any redistribution from the high-income to the low-income members. They seem to provide benefits that are directly proportional to the length of contribution period and the amount of contributions paid.

Yet, when the SSS formula is examined, the constant factor of P300 in the formula is intended to provide a higher replacement for those with lower income. Only when this amount is regularly adjusted up, however, will this bias for the low-income remain meaningful.

In the case of the GSIS, redistribution and subsidy appear in its contribution system which requires the high-income members and the government to contribute beyond the salary cap used for benefit computation. In other words, contributions are being made for part of compensation that will not be used for benefit computation. In addition, there is a cap on the pension amount.

The grant of minimum amounts is the real feature of both schemes that contribute redistribution of income. Many pensioners will receive from a direct pension formula computation an amount that is small, which will result in the receipt of the minimum pension. Many do not realize that when one receives the minimum pension, he is being upgraded from a lower amount. When one, on the other hand, receives an amount based on the pension computation, then he is not upgraded.

In the case of the SSS formula, it has been shown that at 8.4 per cent total contributions, almost all do not accumulate enough contributions for their own pension benefits, whether through the pension formula or the minimum pension provision. This is under scenarios involving conservative demographic and investment trends, i.e., with investment assuming modest returns henceforth. Everyone is being subsidized by future contributors.

In the case of the GSIS formula, at 21 per cent of pay as contribution, it appears, on the other hand, that the present cohort is paying more contributions than they are required to finance their individual pensions. Everyone, it seems, is subsidizing past and future beneficiaries.

The absence of strict health examinations, disregard of the actual high claims incidence in particular industries, the uniform application of the pension formula regardless of sex, age and marital status — all of these are sharing of risks that is inherent in the social insurance nature of the benefit systems of both institutions.

Universality of coverage — The social security program for the general population, which is implemented through the SSS, has been extended to almost all Filipinos, whether they are formally employed or not.

Despite concerted efforts to extend actual coverage, still it has not been as exhaustive as intended. Much is to be desired on the participation of the informal sector, whose membership is effectively voluntary. More and more of the formal sector workers are forced into joining the underground economy, and have become indifferent to their obligation to contribute even for the sake of protecting their pension privilege.

A large segment of the population with their meager and irregular income cannot afford even the minimum contribution for social protection.

Fiscal Sustainability of the Pension System — The SSS scheme, with its low rate and salary cap for contributions, is observed to be heading toward a serious financing problem. Adding to this problematic situation is the widespread evasion on contribution payment, and the subsidy needed to contribution evaders who just pay enough to qualify for pension. Despite its high labor force affiliation, the number of members who actually contribute has always been less than half the number of registered members.

In the case of the GSIS, there are enough contributions to support its programs, and only a modest investment performance is required to guarantee its long-term sustainability.

The Employees' Compensation program for the private sector has accumulated enough reserves so that the deficit of current contributions to pay benefits is easily made up by investment income. This is not the case, however, for the EC fund of the public sector where the deficit is mounting and the only remedy is to increase the contribution rate.

The SSS and the GSIS benefits are guaranteed by government. At present, there is no funding allocation for the SSS pensions of the very poor. Accelerating their coverage will only worsen the fiscal situation of the SSS. It seems that the government is not ready to subsidize their pension needs.

Effects on the savings rate — The SSS pension benefits have been designed to be modest, with the minimum pension not even adjusted automatically for inflation.

At the introduction of the SSS scheme in the 1950s, there have been arguments and appeals to leave something for the insurance industry to sell as second tier benefits. The insurance industry felt threatened and feared that nobody will buy anymore insurance products if the social security scheme provided adequate benefits.

No important study has established any negative impact of the SSS pension scheme with the purchase of private insurance plans nor with the national savings rate. On the contrary, the private life insurance industry has consistently grown over the years. Likewise, no outstanding increase in the national savings rate has been observed whenever there were clamors for pension increases because pensions have been eroded by inflation.

Government banking and finance leaders have argued lately that the way to increase the national savings rate is to impose a contractual saving system via the conversion to the provident fund type of existing social security arrangements.

There is still consensus, however, that the easier way to increase income in old age is not through increased personal savings but through the more direct increase in public pension amounts. As a result, legislators have repeatedly sponsored bills for the grant of generous benefit increases, even going beyond the fund's capacity. This has led to the deterioration of the once funded scheme into a partially-funded one, with actuarial projections pointing to an eventual pay-as-you-go, and finally, bankruptcy unless corrective measures are introduced.

Effects on labor supply — On various occasions in the past, the Secretary of Labor, who sits as a regular member of the policy-making body of the SSS, proposed the reduction of the mandatory and early retirement ages from the present 65 and 60 to 60 and 55, respectively. This was made in the expectation that more jobs would be freed, as if workers cling to their jobs only because of the SSS retirement age requirement.

Records of the SSS show, however, that there is no rush to retire at age 60, the first time workers become eligible for retirement pensions. The age distribution is still smooth for actively contributing members who are aged 60 and above. Also, the female participation in the SSS remains at 1:2 compared to the males, a ratio that has remained steady over the years.

It seems that the labor supply is not at all affected by the social security program of the

SSS. The high unemployment rate is indicative of the desire of workers to stay in the labor force.

Administrative efficiency — The present system exists with little formal linkages among agencies and corporations involved in the provision of social security operations. They act independently of each other, resulting in the operations, administration, development and policies being fragmented, conflicting, and at times, redundant.

It is a credit to the framers of the social security programs that operating expenses have been capped, and thus prevent the different agencies from spending beyond a certain level. This, however, has resulted in less areas of coverage and less effectiveness in fully attaining the objectives of the programs.

IV. *Pension Reform: Responses and Initiatives*

The social security system of the Philippines, which started with the GSIS in 1937, has undergone many structural changes since then. These changes were not yet referred to as reforms, but they addressed weaknesses in the program and resulted in extending coverage, liberalizing benefits, opening up investments, and increasing contributions. Additional administrative procedures, controls, and penalties were also incorporated to improve operations. These changes have been espoused by the administrators of the institutions and went through public consultations and the legislative process. Most were with public support.

It is only recently starting at the time of release of the book *Averting the Old-Age Crisis* by Prof. Estelle James when a proposal to amend the pension scheme was referred to as a reform. Thus, in this section of the paper, previous major changes are being included as if they were part of a conscious effort to reform although they were not referred to as such when they were first discussed and introduced.

A. History of Pension Reforms

Creation of the Social Protection Coordinating Committee (SPCC) — Proposals for reform have proliferated since the early 1990s, and government officials ended up contradicting one another. Thus, to achieve unity of government position before going public, President Fidel V. Ramos created the Social Protection Coordinating Committee (SPCC) in 1996. Composed of government agencies and worker representatives, the committee was tasked to conduct a comprehensive study of the various social protection programs in the Philippines, and recommend reforms that will take into account the needs of the people and the prevailing socioeconomic conditions. The SPCC has since then been replaced by the Presidential Retirement Income Commission (PRIC), which continued the work of the SPCC.

Lately, the reform of the Philippine social security system has been advocated by the International Labor Office (ILO) and the World Bank (WB). It can be summarized that the two have similarities and differences in their priority reform recommendations. The ILO advocated universal coverage, adequacy of benefits and compliance. The WB argued for improving and even privatizing fund management and emphasized the need to raise contribution rates in view of projected fund deficit in the future.

Transfer of Medicare stewardship — Medical care used to be implemented since its inception in 1972 by the SSS and the GSIS to their members and their dependents. Using the need for universal coverage as main justification, the Medicare law was radically amended in 1995. The Philippine Health Insurance Corporation (PHIC) was created, a new independent implementing body, thereby separating health care insurance from other social security benefit administration. The PHIC is to implement the National Health Insurance Program (NHIP) for both the SSS and the GSIS members and for all Filipinos within the next 15 years. It was likewise directed to cover within five years the poorest 25 percent of the population via the NHIP Indigent Program.

The political appeal of extending medical care to the entire population, the poor, in particular, was simply irresistible. Many are still unaware of the developments in Medicare administration, and now, seven years into the NHIP implementation, the PHIC is regaining whatever was the level of efficiency delivered by the SSS and the GSIS to their members, and improving on many other areas of operations. The coverage of the poor has proceeded continuously. Unfortunately, the warnings on the additional and expensive operating expenditures are turning out to be correct. The PHIC has to collect, process benefits, record individual contributions and claims, invest, and replicate whatever the SSS and the GSIS were doing. The ratio of operating expenses to benefits is mounting.

Amendments to the SSS and GSIS laws — Being the pivotal vehicles of Philippine social security, the SSS and the GSIS have often been the targets of initiatives to reform. In response to the clamors of members, pressures from legislators and proposals of international experts, new provisions and substantial amendments to the respective charters of the SSS and the GSIS have been made in 1997.

Coverage was expanded in both systems, to include self-employed persons (agricultural workers, farmers, and fishermen), household helpers, overseas contract workers, non-working spouses, parents employed by children, and minors employed by parents. The benefits were enhanced to protect members, especially pensioners, against the high cost of living. The salary ceilings subject to contribution were raised, and the contribution rate can now be increased to improve financial capability without the need for Congress approval. Stiffer penalties on contribution payments and registration accountabilities were imposed to ensure strict compliance and fraud containment. Investment policies were restructured, broadening investment alternatives to maximize earnings and achieve an annual rate of return not less than the average of treasury bill rates; new ceilings were also prescribed (including offshore investments) to guarantee appropriate allocation of investments, effectively spreading risks.

While many of these changes appease popular causes, the financial viability of the programs has not been compromised, if the results of their actuarial studies are to be accepted. In any case, there is enough flexibility in the charters of the two Systems to resolve impending financing threats to the fund.

In the case of the SSS, the enhancements that were effected by the amendment of its charter triggered in subsequent years new pension adjustments that relied on a contribution rate increase. Unfortunately, the increase in the contribution rate has not been implemented yet.

B. Recent (and Ongoing) Pension Reform

Increase in SSS contribution rate — The SSS contribution collection has been exceeded by benefit payments in the last decade. As part of its long-term solution, the SSS has announced the need to increase gradually the rate of contributions from 8.4 per cent to about 14 per cent. Unfortunately, the announcement was made at the height of the public controversy regarding certain investments that have performed badly. The public was made to believe that the increase was necessitated by such poor investments. As a result, the SSS received negative reactions from both workers and employers, and prompted it to hesitate in implementing this much-needed reform.

To address immediate funding imbalance, the salary cap for contributions is now being considered for increase. This move will, however, only temporarily provide additional contribution relief, but will exert later an even higher pressure on pension obligations if the pension formula is not reduced for the high-income members. For now, the existing pensioners cannot expect any pension adjustment.

Individual retirement accounts — A bill has been recently filed in Congress that will establish individual retirement accounts, to be called Personal Equity Retirement Account (PERA[9]) thus allowing individuals to add a layer to their mandatory pension benefits without having to subsidize other individuals. The PERA is an individual's initiative and may not be used as a substitute for any of the existing mandated pension provision. Similar products are available from banks and insurance companies but they are taxed at 20 percent of income. This new retirement account will be tax-exempt.

The bill has been criticized for setting a very low cap on the amount that one can contribute to his account annually, which renders the scheme meaningless. What is of important concern is the opposition being expressed by the Department of Finance (DoF) because of the potential loss in income tax collection. In other areas of pension reform, the DoF has been a main proponent and supporter.

Private fund managers — It had been argued that public sector professionals are not as effective as their private sector counterparts in the investment of public funds. Many reasons have been cited, the political factor being the most common. In reaction, the charters of both the SSS and the GSIS have been amended to enable this arrangement, and private fund manager selection has been conducted. Implementation has been delayed, however, when fears of privatization of the entire scheme were raised.

The SSS and the GSIS charters have also allowed investments abroad using foreign fund managers. This has proceeded slowly in the case of the GSIS, but the SSS has yet to firm up its decision.

C. Evaluation of Pension Reforms

The success of a pension reform is usually determined by evaluating the objectives that justified its undertaking and introduction. However, unexpected events take place, and determination of success becomes more difficult.

1. For example, the dominant objective in the expansion of the SSS and medical care coverage was the achievement of universality in the program — to include as many new members as possible. Making the program accessible geographically to the workers in far-flung areas was also a dominant objective. These have been achieved. Unfortunately, the financial efficiency

[9] "Pera" in the local language literally means money.

had been sacrificed in the process. The expansion of membership has brought the need to reform the contribution system through an increase in the rate, otherwise the scheme will be unsustainable.

2. The expansion of the investment areas to give higher allocation to equity investment, from 10 percent to 30 percent of total reserves, was supposed to be part of the financial reform. Investing long-term funds is better if placed in stocks than in fixed-income securities, they said. However, this reform also brought with it the dangers inherent of the stock market. The public does not appreciate nor even comprehend the financial cycle that constantly happens. There is constant apprehension that an investment mistake, no matter how much was involved, can be exaggerated to create distrust toward the fund administrators. With the financial crisis continuing since late 1997, and investments not performing as good as in previous years, it looks like reform is needed to reduce exposure to stock, properties, and other variable investments.

In implementing the reforms, it was not clear how the final outcome will turn out to be. However, if measured in terms of extending the program to the rest of the population, the reforms enabled everybody to become part of a national program. The financial aspect will have to be addressed separately.

It was also important to determine the role that the general economy played. The outcome would have been better if the economy steadily took off as was being optimistically projected in the mid-1990s, and resulted in higher rates of employment and lower inflation.

D. Remaining problems and other options

Four Layers of Social Security Protection — On several occasions, government leaders have articulated the vision for social security protection in the country. In time, the Philippines should be able to develop and perfect an equitable, viable and effective social security protection system, which will assure Filipinos a better quality of life.

To achieve this vision, the government, with the full support of social security institutions, should establish four layers of social protection.

First layer — The first layer is a general welfare program that is broad-based, means-tested, and financed from general tax revenues. It is a basic pension program that will answer the clamors of the underprivileged, the disadvantaged, and the indigents for social security protection. In this layer, all individuals who cannot afford to contribute or pay premiums will be covered. The Department of Social Welfare and Development (DSWD) and the Department of Health (DoH) will be the lead agencies responsible for program administration.

This layer calls for budgetary allowance, and may start on a modest scale, and expand when government is able to afford it. The supply of funds being limited, pensions in this category must be means-tested to ensure that they will be awarded only to the most deserving.

Second layer — The second layer is a mandatory, publicly-managed defined-benefit social security system that is tax-exempt. It will be managed based on the principles of income redistribution between generations and cross-subsidies between those who can help and those who need help. It will be the scheme that will provide the basic protection and safety net for the working class, who can afford to pay premiums. Coverage will come from workers in the public and private sectors including the self-employed. The SSS, GSIS, and RSBS will spearhead the administration of this layer of protection.

Third layer — The third layer is a private sector led individual account scheme that is mandatory and defined-contribution system. It will address the need of the employed populace for a more meaningful protection, with benefits to provide a supplement to the second layer. This provident-fund type of scheme, which will be privately managed, will also be exempted from taxes to encourage participation.

Fourth layer — The fourth layer is the personal voluntary, privately managed, supplementary, pension scheme. This layer, which is a combination of insurance and individual savings plan, caters to the more financially capable members of society who are willing to pay more than what is required by law in exchange for a more comprehensive layer of social protection. Operation and management of this scheme will be personal and through his chosen occupational pension plan, insurance and pre-need companies.

Discussions regarding the adequacy of pension must recognize the means available to the individual through the four layers of protection in achieving the desired level of security in old age. It should not focus on what can be obtained from one single institution but on the consolidated benefits of the four layers of social security protection.

E. Proposals for Change

Establishment of the National Provident Fund System — Toward the development of a mechanism for the third layer of social protection, the SSS has proposed to introduce a mandatory provident fund, based on individual capitalization and patterned after Singapore's Central Provident Fund. Eventually, with the development of pension fund administrators (PFA) in the country, the SSS will privatize its participation in this layer with the worker selecting his own PFA, in the manner as practiced in Chile.

As the administrator of the National Provident Fund System (NPFS), the SSS will formulate policies, handle contribution collection, and exercise corporate powers to carryout the mandate. It will also accredit and supervise pension fund administrators; their appointment in managing the provident fund or its existing reserve fund is to be associated with the emergence of the industry.

The NPFS contribution rate will be five percent, shared equally by the employer and employee, and will be applied to the entire monthly salary in excess of ₱5,000 up to four times the ceiling of the regular SSS program. Participation by the employer will be considered as compliance to R.A. 7641 (a law providing for the mandatory retirement pay to qualified private sector employees), effectively putting in place a regulatory framework that will address the funding inadequacy of existing plans.

The NPFS is expected to provide the following benefits: (1) supplement existing pensions; (2) cap the effective contribution rates to existing schemes; (3) promote individual savings; (4) develop capital markets; (5) promote the local insurance industry; (6) allay fears that the present defined-benefit systems may deteriorate into pay-as-you-go; (7) answer the clamor of employees who want to contribute more to get additional benefits; and (8) serve as the most effective, cost-efficient replacement to R.A. 7641.

Merger of the SSS and the GSIS — The SSS and GSIS should be merged, the same proposal at one time by the WB, which was contrary to what was recommended by the ILO. The move is deemed as a critical phase in the development of an overall national strategy for social protection.

It is envisioned that the merger of the two social security institutions would lead to the removal of the artificial dichotomy between public and private employees and improve efficiency in asset management. As it aims to unify the programs, and standardize the benefits of the second layer of social security protection, the merger is projected to set the pace of the structural reform process.

Both systems have indicated their willingness and cooperation in crafting a collective approach to the plan. However, the SSS, on its part, has identified issues to be settled on the merger, citing that the studies conducted so far were limited to theoretical assumptions and justifications under drawn-up, best-case scenarios. To concretize the proposed reform, the first step is to undertake an actuarial study that will outline expected developments in the short-term and certify financial efficiency in the long-term.

Increase in the SSS Contribution Rate — The contribution rate of the SSS should be increased already, but announced prior to its implementation, in order for the scheme to survive. The solution to the problem of underfunding must now be addressed by all, which will be in keeping with the funding principle of the social security scheme. This generation of contributors must pay a higher rate, as it is also expected that future generations of contributors will have to pay a higher rate until such a time that an actuarial balance is achieved. The 8.4 percent of salary contribution rate is simply not enough, and served only as a transition rate. In any case, the increase is not unique for the Philippines. Almost all countries went through the process, and are now in the range of 20 percent and higher contribution level.

V. *Conclusion*

The Philippine social security system, though striving by its implementing agencies to attune to the new global orders and disciplines, will continue to be subjected to reform recommendations from many sectors, from within and even from outside the country. Nonetheless, however diverse the interests of these sectors are, the process of consensus taking will be followed in seeking a resolution to its reform requirements.

In the pursuit of pension reforms, be it as major as introducing individual account provident funds to replace defined-benefits or pay-as-you-go schemes or as minor as changing age-eligibility requirements, what is important is that the resulting social security scheme should pay attention to the needs and limitations of the beneficiaries, contributors and other stakeholders. The technological constraints, political climate, and incentive structures prevailing in the country must also be considered.

All individuals want some form of social security protection that they can rely on for contingent events. Those in formal employment are fortunate that they can depend partly on their employers to secure the future of their families when contingencies arise. A great majority of the population, however, can only depend on themselves and the government for a better social security coverage.

It is to be emphasized that programs may be successful in a particular country but they may not be as successful when implemented in another, despite similarities in the economic and demographic experiences. To some extent, this has been experienced in the Philippines when certain financial reforms were partly introduced. The public has not accepted and supported them.

It is hoped that as financial sustainability of the program is pursued, which is the main subject of most reform proposals, Philippine society's commitment to providing protection to all sectors in society, especially the disadvantaged and vulnerable groups, will be maintained.

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