

How The Turkish Cypriot Community Pension Scheme Will Convergence With EU Applications?

Kıbrıs Türk Toplumunu Emeklilik Planı İle Avrupa Birliği Uygulamaları Nasıl Uyum Sağlayacak?

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ABSTRACT

Since the second half of the last decade, political priorities for the Northern Cyprus economy have been defined as follows: social security system should be reformed, public financial sector needs to be strengthened and public policies should aim convergence with EU. At this point, pension schemes have a crucial role for public reforms and convergence with EU. In this article, we concentrate on basic features of the pension schemes which are implemented in developed countries first. These schemes are explained on three bases: earned income tax credit, state earnings related pension scheme and earnings-based pension schemes. Meanwhile, we try to compose theoretical background with which can be compared TRNC pension schemes.

Keywords: Social Security - Pension Schemes in EU - T.R.N.C. Pension plan

ÖZET

Son on yılın ikinci yarısından itibaren, Kuzey Kıbrıs ekonomisi'nin politika önceliği şu şekilde belirtilebilir: sosyal güvenlik sistemi reformu, kamu finans sektörü'nün güçlendirilmesi ve kamusal politikaların Avrupa Birliğiyle uyumlaştırılması. Bu noktada, emeklilik planı, kamu reformu ve uyum politikalarında hayati öneme sahiptir. Bu çalışma, ilk olarak gelişmiş ülkelerin uyguladıkları planların temel unsurları üzerine yoğunlaşmıştır. Bu planlar üç temel üzerinde açıklanmaktadır: kazanılan gelir vergisi kredi uygulaması, devlet gelirleri ile ilgili emeklilik planı ve gelir esaslı emeklilik planı. Bu anlamda Kuzey Kıbrıs emeklilik planı ile karşılaştırma yapacak teorik altyapıyı oluşturmaya çalışmaktayız.

Anahtar Kelimeler: Sosyal Güvenlik – Avrupa Birliği Emeklilik Planları – K.K.T.C. Emeklilik Planı

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1. Introduction

Public pension systems represent the largest expenditure item in almost all developed countries.

“Many influential studies have shown that the currently legislated contribution rates of many national pension plans are too low to cover the pension benefits promised to future retirees. These plans are insolvent, in the sense that they depend on their sponsor (the state) making large net transfers towards them in present value terms. In Europe, three shocks have contributed most to insolvency: the growth in the pension indexation and in effective pension ages up to the mid-1990s, the drop in fertility and the increase in longevity” (Prieto, 2005, p.217).

Countries of the European Union spend on average 10,6% of their GDP on public pensions. Indeed, Austria, Poland, and Italy spend as much as 13–14% of their GDPs on public pension schemes. Moreover, pension expenditures are expected to grow fast, as European nations are aging quickly.

“The European Union estimates that Portugal may spend 20% of its GDP in 2050 only on pensions. Several countries (Hungary, Belgium, Luxembourg, and Spain) do not lag far behind. Pension systems thus represent an threat to public finance stability and their financing may undermine economic growth and competitiveness across the continent. The European governments are not ignorant of these trends. Indeed, they regularly introduce “pension reforms.” These reforms diverge widely in their consistency and efficiency. In many countries, reforms have been enacted only to be scrapped or substantially revised after an few years. Indeed, the very term “pension reform” has been compromised, as no clear definition is available and widely accepted” (Schneider, 2009, p.292).

In this article, we analyze pension plans within the context of these arguments. Indeed, Turkish Cypriot community has been affected also, because EU legal framework and southern part of Cyprus attempt might be constrain on fiscal and political structure. That’s why; in Part I could be given theoretical framework through with two basic plans. The State Earnings Related Pension Scheme (SERPS) and Earnings-based (EB) pension schemes. This part also has been maintained some compared between countries. And Part II also analyze Turkish Republic of Northern Cyprus (TRNC) pension schemes. This part aimed not only provide basic instrument to the subject but also worked with numerical values related with pension schemes. At the end of the analysis, we should some arguments for design new pension plans in northern part for compete or cooperation with partners in near future.

PART ONE

1. State Earnings Related Pension Scheme (SERPS)

The State Earnings Related Pension Scheme (SERPS) is a UK Government pension arrangement. The scheme manages from 6 April 1978 to 5 April 2002.

Everybody who paid full class 1 National Insurance (NI) at some point between 1978 and 2002 earned a pension entitlement. If an individual was a member of an occupational pension scheme, they could pay a reduced NI sum ("Contracting Out"), and their entitlement to SERPS was very much reduced. The main aim of the scheme was to provide a pension related to earnings in addition to the Basic state pension.

The original principle of the scheme was that the retiree would receive a pension of 25% of his earnings (above a minimum level or earnings) as a pension when he retired provided that he completed a minimum number of years within the scheme. The required minimum years to obtain the full pension depended on the individual's age when the scheme started (younger people had to complete a greater number of years). This ensured that older people at the start of the scheme, who had comparatively few years before retirement, could build up a reasonable pension. However, younger people had to work for a longer period to achieve the same pension, which controlled the overall cost of the scheme.

“Amongst other things, we argue that: □ Individuals as well as governments and actuaries underestimate the extent of increasing life expectancy which could have severe implications for private savings. Targeting of state benefits and increased importance of individual provision mean that there will be a much greater role for private pensions and savings in retirement for future generations of retirees. Because the basic state pension is so low and the majority of those with private pensions will have relinquished many of their rights to the SERPS, the implications of the shift from defined benefit (DB) to defined contribution (DC) pension arrangements in the UK are particularly important. In the USA, the fallback position is a public pension. In the UK for those with private plans and who are not entitled to means-tested benefits, it is just the flat rate basic pension – around 10 per cent of average earnings by 2025. For today's older workers, there are relatively large differences in individuals' expected chances of being in work at age 60 across groups with different types of pension arrangements. If future generations follow the same patterns and the reliance on DC schemes were to expand heavily with the pressure on final-salary DB schemes, then working lives may well be prolonged” (Banks and Blundell, 2005, p.36).

When the scheme was established, final salary pension schemes could choose to opt-out of SERPS, provided that, they gave the scheme members a Guaranteed Minimum

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Pension. In return for opting out of SERPS the employer would pay a lower rate of National Insurance Tax.

Many pension schemes already provided generous benefits and the introduction of SERPS would have provided members with a larger pension benefit. Therefore the option of paying less National Insurance and providing the member with their existing pension arrangement proved attractive and many schemes chose to opt-out despite the administrative burden.

In 1988 the rules for opting out were changed and money purchase pension schemes were allowed to opt-out for the first time. Instead of providing a Guaranteed Minimum Pension these schemes had to pay the difference between the full rate of national insurance and the lower rate of national insurance into the pension arrangement. To encourage the take up of this arrangement the Government paid an extra incentive payment into each pension scheme where somebody contracted out using this route.

In April 2002 SERPS ended and was replaced by the State Second Pension. The main reason for the change was to provide a larger pension to people of low earnings.

The UK's public pension program contains a mixture of 'insurance' benefits, entitlements to which depend on past contributions, and income related benefits, eligibility for which depends in part on income in retirement, mainly derived from accumulated pension rights (both state and private). Incomes in retirement therefore depend partly on past decisions, such as work histories and individuals' retirement saving decisions, and partly on outcomes in retirement. How generously the government treats accrued 'rights', and what other sources of income will be available to pensioners, are certainly not fully revealed before retirement – and in fact have often changed during retirement.

Disney and Emerson estimates suggest that,;

“Taking an individual with a large part of their working-age life spent in paid employment on male average earnings, the UK pension system is at its most generous to those who have reached state pension age in recent years. But entitlements have changed as a result of pension reforms, and the pattern of returns by generation across other types of individuals is very different. In particular, the shift towards greater reliance on income-tested retirement benefits means that the system is not set to be less generous to those on lower incomes, while reforms to the 'insurance' part of the public pension regime mean that support for those who have spent periods out of the formal labor market due to certain caring responsibilities will be relatively more generous in the future” (Disney and Emerson, 2005, p.56).

For example; the United Kingdom faces what is generally described as a ‘pensions crises’. The Interim Report of the Pensions Commission has drawn attention to the fact that because the population is ageing and life expectancy is increasing, the proportion of GDP devoted to providing pensions needs to rise by over 5 per cent of GDP if current commitments are to be maintained. This assumes, however, that payments to pensioners are held constant in real terms at today’s levels and does not make any additional provision for pensions to increase in line with the likely increase in wages. There is a general consensus that saving is unlikely to raise enough to be able to provide this through funded pensions and it is therefore likely that there will be an additional pay-as-you-go component introduced.

Furthermore, Sefton and others might be supplied valuable compared between UK and Denmark in their article;

“Sample one means of exploring the effects of greater reliance on pay-as-you-go pensions would be to see how the UK might look if it adopted the policy regime of one of its neighbors. Denmark is perhaps the most interesting standard for comparison because it manages to combine a seemingly generous social security system with a high level of labor force participation. The participation rate in the UK in the 55–59 age groups is 67 per cent as compared with 80 per cent in Denmark. In contrast, 39 per cent of 60- to 64-year-olds in the UK participate in the labor market as compared with 35 per cent in Denmark. Does the Danish scheme offer a practical solution to the UK pension’s crisis or would its introduction lead to a further increase in early retirement in this country? How would people of different ages be affected? There are a number of ways in which the different aspects of these questions can be assessed. Econometric methods can be used to fit reduced form models of labor supply / retirement decisions either to a panel of cross-country aggregated data or more satisfactorily to information on individuals in the age bracket of interest, explaining their decisions to work or retire in the light of their individual pension arrangements” (Sefton et al., 2005, p.84).

Also Sefton’s article mentioned that, we will reach valuable information about econometric methods on labor supply/retirement decision from Stock and Wise (1990) and Gruber and Wise (1999) specifically.

The rapid ageing of populations around the world has made it crucial to design a welfare system that will encourage those who can to provide for their own retirement while helping those who reach the end of their working lives with insufficient wealth to sustain an acceptable standard of living. Needless to say, these objectives frequently - and perhaps inherently - conflict. In dealing as best they can with the inevitable trade-offs, policymakers need to have three (3) important sustainability questions in mind (Banks and Blundell, 2005, p.35).

First, is the financial support offered to pensioners by the state in retirement sustainable in terms of the burden it places on the working population, who pick up most of the bill in the form of taxation? Second, are the mechanisms by which the private financial sector helps people save for retirement sustainable in their apportionment of risk between employers and employees? Third, is the way in which the state and private systems interact sustainable in the sense that the combination promises people a reasonable degree of financial security without creating unduly powerful disincentives for them to work and save?

One of these decisions, as to when to retire, is the topic of a companion paper by Banks and Blundell (this issue), so this paper ignores the retirement issue (or, more strictly, considers only what replacement rate an individual would have if he or she were in paid employment right up to a set age, such as the state pension age). Essentially, we assume that individuals are indifferent between staying in the public program and buying a private pension, such as a personal pension, with the contracted-out rebate. This is a major simplification (especially in so far as different types of pensions carry different kinds of risks), but it describes how the contracting-out procedure is supposed to work and allows us to focus on a different retirement saving issue: how the 'return' on additional private retirement saving is affected by changes to the public pension program (Disney and Emerson, 2005, p.57-58).

2. Earnings-based (EB) pension schemes

However, often redistribution operated in a perverse way, as highlighted in Forni and Giordano's article.

"The system is gradually moving to a contribution-based scheme with no direct redistributive aim. According to the 1995 reform, after the (long) transition towards the new regime, the pension benefit will be based on the contributions paid during the entire working life, notionally capitalized at the GDP nominal growth rate and converted into an actuarially fair annuity. The main objective of this paper is to study the distributive implications deriving from the determination of the benefit on the basis of the entire working history of the individual as opposed to an earnings-related scheme in which the benefit is computed on the basis of the last few years of earnings" (Forni and Giordano, 2001, p.490-495).

Meanwhile, Borella put another comment to the reform on retirees;

"The possible impact of the reform on retirees' welfare, taking into account the level of the resulting benefits as well as their distribution, is also considered. However, for individuals with relatively flat earnings careers and high ages of retirement, the contribution-based benefit has been found to be higher than the earnings-based one. From a distributional point of view, it could be expected that a formula that takes

into account the whole working history - as opposed to a formula based only on the last few years - reduces variability in the benefit. The redistributive ceilings present in the earnings-based formula, however, also tend to reduce inequality in the benefits, so that the overall effect on the dispersion of benefits is difficult to predict” (Borella, 2004, p. 416-417).

3. Pension Reforms in the EU-10

In this section we briefly present the main characteristics of the pension reforms undertaken in the ten Central and Eastern European countries that became EU members in 2004 and 2007 (the EU-10).

In the mid-1990s, most Central European countries modernized their pension systems, separated them from the central government budget, increased the retirement age and made pension benefits more dependent on pension contributions. The Czech Republic implemented such a reform in 1994, complemented by the creation of voluntary private pension funds. The Czech Republic was actually a frontrunner when it launched (voluntary) private pension funds in 1994 and reformed its pension system in 1996 (the retirement age was increased and pensions were linked to lifetime labor income).

However, these “first-wave” pension reforms proved to be insufficient very quickly, as Central European societies faced the phenomena of aging, whereby mortality dropped due to better health care and improved eating (and drinking) habits. At the same time, fertility rates collapsed as women faced both greater opportunities in labor markets and greater uncertainty. The fertility rate fell as low as 1.17 children born per woman in some Central European countries and old-age pension expenditures are expected to rise rapidly in all countries in the region.

“In the late 1990s, Poland and Latvia followed the Swedish example and reformed their pension systems to “notionally defined contributions” (NDC) systems, where contributions are spent as in a classical pay-as-you-go system, but contributors are credited with a national account where their contributions are indexed by a government-set rule. As Disney and Whitehouse shows, significant differences in indexation and revaluation procedures, transition strategies, and accumulation of special credits unrelated to contributions to notional accounts make NDC systems less transparent” (Disney and Whitehouse, 1999, p.14-18).

We should be viewed some corner stone from Beattie book review articles that, several Central European countries implemented “radical” pension reforms inspired by reforms in Latin America, particularly in Chile and further boosted by an influential 1994 World Bank report on pension reform. That study lent support to an “multi-pillar” model of

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pension reform combining an public redistributive pension scheme with an private funded pension scheme based on individual accounts (Beattie, 2004, p.715–719).

Therefore, structural pension reforms, i.e. reforms introducing private pension savings, were embraced in several countries. Hungary adopted such a “three-pillar” pension system in 1998. Poland followed suit (with an even more comprehensive reform) in 1999 and Estonia and Latvia then implemented reforms in 2001 and 2002, respectively. Croatia and Bulgaria also reformed their pension systems in 2002. The most recent reforms were adopted in Ukraine (2003), Lithuania (2004), and Slovakia (2005). Hungary reformed its system yet again in 2006 – Illustrated by Table 1.

In total, seven of the EU–10 has implemented pension reforms based on partial privatization. Thus the region has become the second hotbed of the so-called “structural” pension reforms (Latin America being the first). Nevertheless, as the pension system operates in the very long term, the effects of these changes are not apparent yet (Schneider, 2009, p.296–297).

After the necessary explanations about basic pension plans in EU, the new EU countries pension reforms also discussed above. Now constitute the second part of our article about TRNC pension schemes.

Table 1. Pension Reforms in CEE Countries

Country	Reform started	Total Pension contribution (% of wages)	Contribution to funded pillar (% of Wages)	Pension fund assets (% of GDP in 2007)
Bulgaria	2002	27	5	5
Czech Rep.		2821.5+6.5	0	5.1
Estonia	2002	22 (20+2)	6 (4+2)	5.0
Hungary	1998,2006	26.5 (18+8.5)	8	11.2
Latvia	2001, FF increasing until 2010	25.51 (only 20 included in Calculation of NDC)	2–10 (2006–2010)	3.0
Lithuania	2004	26 (23.5+2.5)	5.5	1.5 (2006)
Romania	2008	27.5	2–6 (2008–2016)	0
Poland	1999	32.52	7.3	12.4
Slovenia		24.35 (8.85+15.5)	0	2.7 (2006)
Slovakia	2005	24 (17+7)	9	4.2

Source: Schneider, 2009.

PART TWO

1. Turkish Republic of Northern Cyprus (TRNC) Pension Schemes

The pension system of the northern part of Cyprus serves a population of some 216 thousand persons. There are an estimated 54 thousand (2007 February estimated approximately 70 thousand) contributors which classifies it among the smallest pension system in the world. Nevertheless, it exhibits all the features of a self standing and fully operating system which regularly provides pensions to about 30 thousand pensioners. Beginning in the mid 1970s, the Turkish Cypriot community established their own pension system which assumed liabilities of paying pensions for Turkish Cypriots regardless of their residence prior to 1974. It also recognized all service years accrued in Cyprus regardless of origin of the contribution payer (employer). The Turkish Cypriot social insurance administration was established in June 1977.

The pension system of the northern part of Cyprus consists of two main parallel schemes. The general public schemes rest on two pillars and covers employers, private sector workers, public non-civil sector workers, civil servants during the two-year probation period and self-employed. The civil servants scheme, separated from the general public scheme, covers civil servants beyond their first two probation years. Total number of contributors to the general public scheme was around 52 thousand in 2008 including a number of temporary workers from Turkey (who since 2004 are required to register for at least 3 months), and to the civil servants scheme 10 thousand. The systems provided benefits to 22 thousand and 8 thousand beneficiaries, respectively.

1.1. The Current Pension System in the Cyprus

Turkish Republic of Northern Cyprus (TRNC) has own rather developed social security system compared with similar countries. However, TRNC's social insurance system has experienced deficits since the beginning of the 1990's. Among the reasons of deficits in the social insurance system, early retirement implementations, pensions that are not equivalent to contributions, undeclared working, low collection rates of contributions, deficiency of institutional capability of social security institutions are accepted as the most important ones. On the other hand medical expenses and abroad treatment expenditures of insured persons have reached significant extents. There have occurred significant differences between civil servants and private sectors employees in accessing to health services and in their funding. Contributions that have been collected for work accidents, occupation diseases, sickness, maternity and unemployment spending have been exploited so as to finance the deficits in pension insurance system.

“A viable and equitable pension system can ensure old-age income security for current and future generations without compromising economic stability. The current pension system of the northern part of Cyprus underperforms in all these respects. At a time when the Turkish Cypriot community is striving to modernize its economy and align itself

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with the European Union, the high fiscal deficit currently arising from the pension system as well as its lack of long term financial sustainability are important obstacles. To illustrate the magnitude of the problem, total budget deficits in the EU average 2,6 percent of GDP while in the northern part of Cyprus, the public pension system alone generates a deficit of 6,3 percent of GDP, and the civil servants' pension system an additional 8,4 percent, totaling 14,7 percent of GDP. Meanwhile, how about other part of Cyprus social insurance legislation. The Department of Social Insurance Services in southern part of Cyprus is responsible for the administration of the following legislation; social insurance, annual holidays with pay, termination of employment, provident fund, social pension, compensation of victims of violent crimes, protection of employees rights in the event of insolvency of the employer, equal treatment between men and women in occupational social security schemes" (Sarica, 2005, p.17-18).

The Department is also responsible for the collection of the human resource development levy and the contribution of social cohesion as well as for the examination of the implementation of the employers' liability (compulsory insurance) law.

Due to the absence of a recent population census, calculating the overall coverage of the pension system is complicated. Assuming a population structure similar to Turkey's, the working age population in the northern part of Cyprus would stand at 130 thousand, and the coverage (measured as share of contributors in labor force) would be 42 percent. This level is identical to Turkey but below countries with similar GDP per capita, which confirms the high degree of informality in the economy.

The current pension system in the northern part of Cyprus is costly (Illustrated via Table-2) Meanwhile, the first Social Insurance Scheme in southern part of Cyprus was introduced in 1957 and was characterized by flat-rate contributions and benefits with no connection between contributions and benefits to the income from work. On the 6th of October 1980 a new earnings-related Social Insurance Scheme was introduced incorporating the previous flat-rate scheme in a modified structure providing supplementary earnings related benefits. The scheme is divided into two parts: the basic part, corresponding to the repealed flat rate scheme and the earnings – related part. The main characteristic of this legislation is the provision for the adjustment of the insurable earnings and the benefits provided under the Social Insurance Scheme according to the increase of earnings and the cost of living index.

Table 2. Overall Pension Expenditures as Share of GDP, 2001-02

Country	Share of GDP (in percent)
Northern part	12,2
Southern part	8

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New EU Member States	
Czech Republic	7,8
Estonia	6,9
Hungary	6
Latvia	9,8
Lithuania	5,3
Malta	5,4
Poland	10,8
Slovak Republic	7,9
Slovenia	13,2
Average for EU-9/1	8,1
EU Member States (Pre-2004) Average	10,4
Source: http://www.oecd.org/dataoecd	

1. EU-9 refers to the new member states excluding Cyprus.

The Scheme covers compulsorily every person gainfully occupied in Cyprus either as an employed or as a self-employed person. Persons working abroad in the service of Cypriot employers and persons, who interrupt their compulsory insurance, are allowed to be insured voluntarily. The insured persons are classified in three categories; employed persons, self-employed persons and voluntary contributors.

The total number of active contributors of the Scheme in 2003 was 333.546 as compared with 319.038 in 2002. In particular, the numbers of employed persons were 298.074, as compared with 285.283, the self-employed persons were 34.351, as compared with 32.695 and the voluntary insured persons were 1.121 as compared with 1.060.

For the self-employed persons, the contributions are calculated on their “notional” income, which is determined according to occupation and place of employment. The self-employed person is obliged to pay contribution on the notional income of his occupational category. However, he has the right to pay contributions on his real income, if he proves that this is lower than the notional income. Moreover, the self-employed person has the right to pay contributions on income higher than the notional up to the maximum amount of insurable earnings. The contribution is payable by the self-employed person and the State in the proportion of 11, 6% and 4%.

Retirement age and contributing ratios for 2005 are shown by Table-3 and Table-4 respectively.

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Table 3. Retirement Age Pensions

	Men	Women
Germany	65	65
Norway	67	67
Finland	65	65
Luxembourg	65	65
France	60	60
UK	65	60
South Cyprus	60	60
North Cyprus	60	55

Source : Jenkins , 2005.

Table 4. Ratio of People Contributing to

	Contributors	Pensions	Ratio
UK	28,640,000	11,502,700	2.49
Germany	39,100,000	14,860,000	2.63
Norway	2,276,000	1,463,004	1.56
Finland	3,365,000	1,329,988	1.78
North Cyprus	34,181	30,065	1.14

Source : Jenkins , 2005.

“Total retired is 30 thousand, total employed is 59,1 thousand (informal sector is taken as 25 thousand). So the ratio of total employed to total retired is 1.14 without informal sector, 1.97 with informal sector. When we compare this with other countries we could see that this ratio is 2,49 in UK, 2,63 in Germany. This is one of the indicators that give information about the sustainability of the system. The retirement age was very low in the past and although it increased recently it is still low in north Cyprus. Retirement age for men is 60 and 55 for women while it is 65 for both in the south, Germany and Finland”(Jenkins, 2005,p.17).

The rate of contribution for the voluntary contributors is 13,5% on the insurable earnings they opt to pay contributions, 10% is payable by the voluntary contributor and 3,5% by the State. The contribution of the voluntary contributors who work abroad in the service of Cypriot employers is 16,6%, 12,6% is payable by the voluntary contributor and 4% by the State. The contributions collected are paid into the Social Insurance Fund, out of which all social Insurance benefits and administrative expenses for the operation of the Scheme are paid.

“On the other hand, Jenkins also calculated the replacement rate by using two different methods, for social security system for age over 40 to assess the degree to which pension benefits replace income earned during employment. According to the first model, the weighted average replacement rate in the North is 72%. It means that retired people, over 40s, are getting 72 % of their last incomes as

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pension benefits. Second model found out that replacement rate is %62. Replacement rate for public sector pension he used the formula that Ministry of finance is using and resulted as Replacement rate %52.53 of gross salary. Since the pensions are not taxed, the replacement rate of net income will be much higher. At the comparison of this rate with other OECD countries, we could find out that there are different replacement incomes and the OECD average is 65%” (Jenkins, 2005, p.18).

On the other hand, World Bank report (2006) gives some information retirement age and life expectancy via tables-5; New EU members lower retirement age, except Poland in male. But life expectancy is highly low in these countries. That’s why; average years in retirement still high in both sides of Cyprus.

Table 5. Mandatory Retirement Age and Life Expectancy for Men and Women

Country	Retirement		Life Expectations		Average Years in Retirement	
	Male	Female	Male	Female	Male	Female
Cyprus						
Northern part	55	55	71	75	16	20
Southern part	65	65	76	81	11	16
New EU Members State						
Estonia	63	63	65	77	2	14
Hungary	62	62	69	77	7	15
Lithuania	63	60	66	78	4	18
Poland	65	60	71	79	6	19
Slovak Republic	60	55	69	78	9	23
Slovenia	63	61	72	80	9	19
Acceding and Candidate Countries						
Croita	65	60	70	78	5	18
Macedonia	64	62	71	76	7	14
Romania	65	60	66	74	1	14
Turkey/1	60	58	66	71	6	13
EU Memb. States (Pre-2004) Average/2	65	63	76	81	11	18

Source: World Bank Report, 2006, p.38

1. To be reached gradually by 2034.

2. Selected EU member states excluded Belgium, Luxembourg, and the Netherland.

1.2. The Civil Service Pension System in Northern Part of Cyprus

Parallel to the general system, a separate pension system exist for civil servants. Current civil servants pensions are paid out of the central budget. For the civil servants presently working and employed before 1987 the contribution rate of 2,5 percent finances only a small part of the expenditures and results in a deficit of 4,4 percent of GDP. The civil servants employed after 1987 contribute 9 percent (5 percent for single men and women) of their gross salaries to the Civil Servants Pension Fund (CSPF), “legally” established as a defined benefit fully funded system. For both categories, the eligibility requirements include minimum 25 years of service and 55 years of age.

“On the average the system provides replacement rates of 45 – 50 percent. In addition, every civil servant retiree is entitled to a “gratuity lump sum” equal to last wage multiplied by the years of service, which emulates the lump-sum payments from the Provident Fund. Civil servant retirees with more than 25 years of service should receive a 25 percent cut in pension after having been paid the gratuity. However, this legal provision was never enforced. If a civil servant has less than 25 years of service s/he would receive only the “gratuity lump sum” and would not be entitled to a pension. This gratuity lump sum is significantly lower than the regular pension one would get from the system, which reduces incentives for individuals to leave the civil service. In addition to a higher wage level in the civil service in comparison to the private sector, the benefit system thus distorts labor incentives in favor of civil service and imposes a serious burden on the private sector. However in southern part of Cyprus, the Scheme provides cash benefits for marriage, maternity, sickness, unemployment, widowhood, invalidity, orphanhood, old age, death and employment injury. The Scheme provides also free medical treatment for persons receiving invalidity pension and for employed persons who sustain injuries as a result of an employment accident or an occupational disease. Employed persons are entitled to all the above benefits whereas self-employed persons are not entitled to unemployment benefit and benefits for employment accidents and occupational diseases. Voluntary insured persons are entitled only to marriage, maternity and funeral grants and to old age and survivor’s benefit. Voluntary insured persons working abroad for Cypriot employers are entitled to all benefits except benefits for employment injuries”. (<http://www.mlsi.gov.cy/mlsi/sws/sws.nsf>)

All periodical benefits are composed of the basic and the supplementary part. The basic part, which includes increases for dependants, is assessed on the basic amount of insurable earnings, which for 2003 was £70,83 per week. The supplementary part is assessed on earnings above the basic insurable earnings up to a maximum amount of

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insurable earnings. The payment of benefits, provided under the Scheme, except from benefits for employment accidents and orphanhood, depends on certain contribution conditions. During 2000, Social Welfare Services provided technical assistance to non-governmental organizations and Community Welfare Councils/Committees which operated programs and services meeting social needs on a local level.

According to the Social Insurance (Amendment) Law of 2002, which was entered into force on 1/1/2003, credits for insurable earnings are provided for the period the insured person is absent from work with parental leave. These days are not considered as days of incapacity for work or days of unemployment for the purpose of payment of sickness and unemployment benefits. In January 2003, Amendment Regulations entered into force. According to these Regulations all the benefits provided to insured persons were improved by the increase of the amount of pensions and other benefits provided by the Scheme. The main improvements are the following:

- As from 1/1/2003 the basic pensions payable out of the Social Insurance Fund increased by 3,04% and the supplementary pensions by 3,13%.
- As from 1/1/2003, marriage, maternity and funeral grants increased to £292, £215 and £292.
- As from 1/1/2003 the maximum amount of insurable earnings for weekly paid employees increased from £412 to £425 and for monthly paid employees from £1.785 to £1.842.
- As from 6/1/2003 the minimum amount of insurable earnings of all occupational categories of self-employed persons have increased by 3,04%.

“In December of 2003, Amendment Regulations were enacted in order to further improve the benefits provided to insured persons. These Regulations, which enter into force in January 2004, provide for: 1. An increase, as from 1/1/2004, at the rate of 3,73% of the basic pensions payable out of the Social Insurance Fund and at the rate of 3,42% of the supplementary pensions. 2. An increase, as from 1/1/2004, of marriage, maternity and funeral grants to £303, £223 and £303, respectively”. (World Bank Report, 2006, p.39-40).

The Social Welfare Services, under the Ministry of Labour and Social Insurance, is the official agency for the provision and promotion of social welfare services. It aims to address social risks and to advance social cohesion within the general framework of the state policies for social and economic development. Services focus on individuals, families, social groups as well as communities. The main goals of the Social Welfare Services are: 1-) to safeguard the right to a decent standard of living for all persons legally residing in Cyprus, 2-) to secure the welfare and best interests of children and of other vulnerable groups such as older persons and persons with disabilities, 3) to

support families in order for them to cope effectively in their multiple roles and 4) to identify, prevent and deal with social problems and concerns.

There has been an increase of 4,2%, in public assistance allowance, since July 2007. The recipient's current annual rate of allowance for basic needs is €379.31, for every dependant aged 14 and above is €189.65 and for every dependant aged below 14 is €118.79. (<http://www.mlsi.gov.cy/mlsi/sws/sws.nsf>)

1.3. Main Issues of The Pension System

Despite its multi-pillar-alike infrastructure, the pension system of the northern part of Cyprus is currently fiscally and socially unsustainable. The system currently exhibits two overriding problems:

a. Inadequate Incentive Structure: The current civil servants system with its generous wage policy and pension systems creates an incentive to leave the private sector and queue up for civil service jobs. The civil servants pension system further exacerbates the public sector bias by creating an incentive to remain in the civil service as long as possible. Such a system distorts the labor markets and prevents easy transfers of workers from private to public sectors and back and discourages part-time and short-term employment. The public sector has recognized this problem, particularly in the light of large fiscal deficit, and announced in 2004 intentions for a future program of integration and consolidation of general and civil servants pension schemes. On the other hand, the general system for private system employees with its high contribution rate, minimum pension and non-linear benefit formula creates incentives to minimize or evade contributions, and contribute at lower contribution bases which due to the formula applied provide higher replacement rates.

b. Lack of fiscal sustainability: By any standard, the pension system of the northern part of Cyprus provides too much and too early to its beneficiaries. Due to a generous pension formula, a low retirement age and a short calculation period, the PAYGO SIF cannot be self-financed with the current contribution rate of 18 percent. The Provident Fund, on the other hand, paying out saved amounts as a lump sum, has the characteristics of a forced savings and deferred wage payment vehicle rather than a pension program (which should ensure consumption smoothing over time).

“Due to already high replacement rates in the SIF PAYGO pillar, the Provident Fund beneficiaries commonly channel the lump-sum proceeds to private consumption and investment in houses and cars. As a result, with a contribution rate of 35 percent, the overall social insurance share in labor cost is among the highest in the region and is negatively affecting the international competitiveness of the workforce in the northern part of Cyprus. The fiscal un-sustainability of the civil servants pension system is self-evident: it combines a

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generous formula, early retirement age, short calculation period, and yet a symbolic contribution rate, which ultimately creates a very large fiscal burden for the taxpayers” (World Bank Report, 2006, p.46).

As a fiscal remedy, tightening of the PAYGO SIF parameters for new entrants should be accompanied by a below-price indexation for current pensioners and, if needed, increase in contribution rate. On the other hand, introduction of mandatory annuitization for the savings in the Provident Fund would spread the retirement funds over lifetime and reduce the need for a higher contribution rate. Measures in the civil servants system would have to be even tougher. In addition to less generous parameters and higher contribution rate, both pillars of the system have to be restructured to allow for integration of the civil servants system into the general scheme.

Finally, issues of concern in the PAYGO SIF pillar of the general system include: fiscal sustainability; statutory retirement age; benefit determination; indexation; calculation period of four best out of last seven years; eligibility period and minimum pension.

Conclusions

A basis reform regulation known as the “Unified Social Security System” is done by government in the Northern part of Cyprus. These regulations also including has some improvements compared to the old system. For example; increased coverage and retirement age and changed in health insurance coverage and contributions.

The old pension system of Northern Cyprus has been criticized by EU authority. it has been created a heavy burden on public finance. This burden has been created by the public sector employment directly. After regulations, the pension system would continue less the budget deficit as well.

In this article, we just defined some problems related with old system defaults. On the other hand, bring some comments about “what we should do” in EU applications in near future. As a result of this, we should determined some highlighted positive results from regulations that; improving organizational structure, high quality services, introducing new technologies and provide various institutions which are gained more services to the people in Northern part of Cyprus.

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