Lebanon's Pension System

BLOMINVEST BANK

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For many workers in the Lebanese private sector, reaching retirement age entails confronting an ambiguous future with inadequate access to social protection. This yields a large section of the population with meager income in old age, susceptible to falling into poverty.

According to the IMF report "Sustainability and Equity Challenges: Some Arithmetic on Lebanon's Pension System", Lebanon is the sole country in the MENA that does not offer social security for retirees in the private sector. Despite the fact that several reform proposals have been formulated since the early 2000s, none has been implemented to date. Costs escalate with every year of delay, so action is required soon to address these challenges.

Lebanon's pension system is based on separate schemes for public- and private-sector employees, which were established in the 1960s. The public sector schemes cover civil service and military personnel, while the private sector scheme only covers private sector and contractual government employees.

Current Public Pension Scheme

Public pension expenditure for Lebanon presently stands at 3% of GDP, half the average 6% of GDP level in other emerging markets. Public pensions have traditional defined-benefit that present an assured pension income based on a pay-as-you-go system.

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Public Sector

<table>
<tr><th></th><th>Civil Servants</th><th>Military</th></tr>
<tr><td>Retirement Age</td><td>No requirement.
Maximum retirement age 64.
Female teachers can generally retire after 20 years of service; male teachers after 25 years.</td><td>No requirement.
Maximum Retirement age 58-64 depending on the rank.</td></tr>
<tr><td rowspan="4">Benefit Rate</td><td>Less than 20 years of service: end-of-service compensation.
At least 20 years of service: choice between lifetime pension or end-of-service lump-sum.
More than 40 years of service: a combination of lifetime pension and end-of-service compensation.</td><td>Credited years of service up to 3 years per effective year depending on the security alert level.</td></tr>
<tr><td colspan="2">End-of-service compensation: 85% of last monthly basic salary times 1 month for each year of service for the first 10 years; 2 months for each year of service in excess of 10 years but less than 20 years; and 3 months for each year of service in excess of 20 years.</td></tr>
<tr><td colspan="2">Lifetime pension: accrual factor of 2 1/8th% of the last monthly basic salary for each year of service and fractions thereof up to a maximum of 85%.</td></tr>
<tr><td colspan="2">Combined lifetime pension and end-of-service compensation (for more than 40 years of service):
85% of the last monthly basic salary as a life-pension and an end-of-service compensation at 85% of last monthly basic salary times 3 months for each year of service that exceeds 40 years.</td></tr>
<tr><td>Contribution Rate</td><td colspan="2">6% of basic salary; retirees do not contribute.</td></tr>
<tr><td>Pension Indexation</td><td colspan="2">Ad hoc basis. The last pension increase was granted in 2012 based on the 2008 salary categories.</td></tr>
<tr><td>Other Benefits</td><td colspan="2">Survivor benefits for employees who die during service; disability pension for employees who qualify.</td></tr>
</table>

Source: World Bank, IMF

The above table shows that public schemes are lavish. The system does not impose a minimum retirement age, making the accumulation rate high with respect to the retirement age and the contribution rate. Moreover, ad hoc and costly supplementary benefits, such as an extra lump-sum payment for retirees who complete 40 years of service, and the crediting of additional years of service for the military, distort the schemes. Finally, the pension payments are linked to changes in public sector salaries, making the system potentially exposed to large salary adjustments.

Benefits are exceptionally substantial to surviving heirs of retirees, as they retain the full pension of the deceased employee. Unmarried, divorced and widowed daughters of retirees keep the pension benefits for life. This means that pensions are drawn for an average of 30 years after a particular public servant's retirement, compared to an average lifetime career of 40 years.

Although significant, end-of-service-indemnity (EOSI) lump-sum distributions in the public sector have traditionally been less than pension payments. EOSI payments are compulsory for forced termination and for teachers who served less than 25 years. For the military, terminated employees and officers who serve less than 20 years are only eligible for a lump-sum indemnity. Most men choose pension payments while women, whose husbands are also public sector employees, choose lump-sum payments they would inherit their husband's pension for life.

Current Private Pension Scheme

The private sector pension scheme is a defined-contribution scheme, administered by the National Social Security Fund (NSSF), an independent institution established in 1963 under the Ministry of Labour. An end-of-service-indemnity offers a lump-sum cash benefit upon retirement—equivalent to the accumulated contributions associated with past employers, and one month of earnings for each year of service with final employer.

Private Sector

Retirement age	Maximum age 64. Beyond that no accruals to the EOSI despite continued coverage under other benefits.
Benefit Rate	Share of entitlements if the employee completed at least 20 years of service, reached age 60 or older; in case of marriage (during the first year and for females only), death (prior to retirement with at least six months of service), and disability (subject to a minimum of 20 times the monthly earnings). The monthly earnings used to determine the EOSI is equal to one-twelfth of the taxable earnings in the year preceding the date of entitlement. If the individual resumes work subsequent to the pre-age 60 liquidation, he or she can only liquidate subsequent accrual upon reaching age 60, death, or disability.
Contribution Rate	None from the employee. Employers contribute on behalf of each employee at the rate of 8.5 percent of the individual's taxable income (of which 0.5 percentage points to the NSSF administration). However, effective employer contribution rates are higher since the last employer pays the shortfall between the employee's entitlement with the last employer and the accumulated contributions with interest corresponding to the same employment period.
Coverage	Private sector employees, contractual government employees, taxi drivers, newspaper and magazine vendors, local councillors and voluntary self-employed subscribers.
Investment	Contributions are collected in individual accounts and accrue an interest rate determined by NSSF investments----usually the rate on government bonds as most of NSSF investments are in treasury paper.
Other Benefits	Upon claim of indemnity, employers add one month of salary for every year the employee has spent with them (up to 20 years), and 1.5 months for every year after that. Accumulated contributions are managed by the NSSF.

Source: World Bank, IMF

Pensioners from the private sector lose all benefits, after retirement, when they need them the most. They only receive one lump-sum payment at retirement and have no health coverage benefits thereafter.

Other than the scheme managed by the NSSF, other schemes exist for universities, syndicates and private sector teachers, presented in the table below.

Universities' Teachers	Require contributions ranging between 5-11% of the employee's earnings to finance their pension schemes. The schemes offer mostly defined benefits that depend on the last earned salary and the number of years of service. The investment of the fund is delegated to private insurance companies. Many universities offer health insurance, life insurance, and disability benefits and pay funeral expenses for their members, as well as education allowances.
Private Syndicates	Provide regular pension payments upon retirement as well as health coverage. These defined contribution schemes are optional and extend to family members.
Private Schools' Teachers	Offer an indemnity that can be converted into a regular pension as well as health insurance coverage. The indemnity is a lump sum worth 1 month salary for each of the first 10 years, 2 months for each of the following 20 years, and 3 months' salary for each year beyond 30 years. The pension schemes provide regular pension payments worth 85% of the last salary for members who serve at least 30 years. The plan is financed by a contribution of 6% of the member's salary topped by a similar amount by the school.

Source: IMF

Main Challenges

Lebanon faces key challenges that impede it from ensuring a sustainable pension system and providing social protection. The primary setback is the underlying demographics.

According to the United Nations, Lebanon had the highest life expectancy of 80 years among the MENA region in 2012. This level is forecasted to increase to more than 86 years by 2050.

Concomitantly, Lebanon has the lowest fertility rate of around 1.5 children/female in the MENA region, as of 2012. This rate is expected to advance in line with the MENA average of 2.7 children/female.

Given the high and increasing life expectancy and the low fertility rate, Lebanon's dependency ratio, the population above 65 years relative to the working age population, is expected to, be the highest in the MENA region, surpassing 30% by 2050, given that the MENA average is around 20%.

Under these demographic dynamics, public pension expenditure is expected to skyrocket from 3% of GDP in 2014 to 5.2% in 2030, and expedites considerably after that to stand at around 9% of GDP by 2050. The aggregate cost of the increase in payments over 2014-2050, measured by their discounted present value is substantial, projected at 77% of 2015 GDP. This is also much greater than the estimated 25% of 2015's GDP of emerging markets.

With no reforms implemented, projected pension spending will weaken fiscal sustainability. Specifically, the projected 77% increase basically entails taking in, and financing, 77% of additional debt, on top of an already-very high debt burden. The accrued pension liability, which stands at 109.7% of GDP in 2050, also suggests significant fiscal risks.

Even though the forecasted spending for the private scheme would grow consistently with the increase in that for the public sector, its impact is trivial. Considering the same demographic trends, private sector pension expenditure is projected to increase from 0.5% of GDP in 2014 to around 1% in 2030, and 1.5% of GDP in 2050. The projected discounted present value of the growth in pensions over the period 2014-2050 is 12.8% of GDP, denoting its small impact on expenditure over the long term. Accrued pension liability, during the same period, is estimated to be 18.3% of GDP.

Compared to the public schemes, the rise in private-sector pensions does not pressurise fiscal sustainability. The forecasted surge could be counterbalanced by fiscal alteration and/or running down NSSF reserves. However, if the revenues were kept constant as a percentage of GDP, and expenditure grew in harmony with demographic dynamics, the overall NSSF would decline to null by 2050. Moreover, the opacity that exists between subscriber contribution and benefits might lead to additional liabilities.

Coverage of the pension system is inadequate, with a big disparity between the public and private schemes. The average employee would earn a pension equivalent to almost 85% of his income before retirement, bearing no income tax, and remain covered by healthcare insurance. On the other hand, the private sector schemes grant a lump-sum payment that is a smaller equivalent of pre-retirement income with retirees losing access to health care coverage.

This triggers a divergence in financial and longevity risks under the two schemes. Under the private sector, employers confront financial risk because the final employer is supposed to pay the difference between the dues to the employee and the actual amount of money in his/her account. Moreover, employers face longevity risk as the increased life expectancy can result in disbursements higher than initially predicted. This is diverges severely from the public pension schemes where both financial and longevity risk are born by the government.

Other than coverage, Lebanon is the only country in the MENA that does not grant social security for retirees in the private sector. Hence the more vulnerable elderly are left without any formal lifetime pension coverage. Furthermore, Lebanon has the highest percentage of older adults who continue to work beyond the age 60, signifying that most of these labours would be self-employed or employed in the informal sector without any old age pension.

Suggested Reforms

Several possibilities could be adopted to tackle sustainability and equality issues. These possibilities include fractional reforms and a transition to an integrated pension system.

Suggested Reforms for the Public Sector

Partial reforms to the public sector schemes include adopting a higher retirement age, limiting benefits and increasing social contribution.

A greater retirement age is assured due to the high life expectancy Lebanon has. If retirement age is pushed up by 4 years by 2030, pension expenditure is predicted to decline by 1.1% in 2030 and 1.8% in 2050.

A second option is to decrease benefits. This can be done by delinking pensions from public sector wages and, as a substitute, indexing them to inflation. This would decrease pension spending by 0.7% in 2030 and 1.6% by 2050, as pensions would be concealed from possibly high and unanticipated wage adjustments.

Moreover, allowances and end-of-year-indemnity lump-sums for retirees who choose pensions would result in almost a 4.6% decrease in the discounted present value of expenditure over the period of 2014-2050.

Finally, social contributions could be increased from their current 6% level. If the contributions are increased to 10%, pension expenditures would drop by 1% of GDP by 2050.

Suggested Reforms for the Private Sector

Other than increasing the retirement age and increasing social contributions, the private sector schemes necessitate also replacing the lump-sum payments by annuities.

A 5 year rise in the retirement age for private sector employees would lead in a 0.2% of GDP decrease in pension expenditure by 2030 and 0.4% of GDP by 2050.

Assuming annuitization is implemented, private sector employees could become subject to a 10% contribution rate. Hence, pension expenditures would be reduced by 2.5% of GDP 2050, producing surpluses.

The latest and most thorough suggestion, which is still being examined by the parliament, recommends offering lifetime health insurance, pension allowance, and other vital benefits.

To be able to provide both, sustainability and equality, the public and private sector schemes should undergo a transition to a unified pension system. Many reforms proposals have been formulated, however none has been successful. Two of these suggestions are the 2004 proposal and the 2011 proposal.

The 2004 proposal targeted at unifying the public and private pension schemes into one modern fully-funded defined contribution scheme. This scheme was intended to comprise a minimum pension guarantee to those who had contributed adequately, a flat indemnity to those who had not made enough contributions and preservation of the attained rights under the existing system. Contributors to the current civil and military schemes could choose to move to the new system on a voluntary basis. Coverage under the new system would be expanded to the informal sector, the self-employed and casual workers with limited saving capacity by allowing optional enrolment and providing better enrolment incentives.

The 2011 proposal necessitated the implementation of a "National Defined Contribution", in which individuals would contribute from their salaries to finance benefits paid to the retirees. This scheme would offer a 2% annual rate of return in real terms, and would ensure a minimum 40% of the last salary for a retiree with 30 years of contribution, with a reduced pension available after 15 years of contribution. Like 2004's proposal, this scheme also recommends extending medical insurance after retirement, providing a contributory minimum wage, and a non-contributory pension scheme to all citizens to be funded by taxes.

Conclusion

Finally, among countries in the MENA, Lebanon has the highest life expectancy and the lowest fertility rate, bringing about the highest current and expected dependency ratio. Moreover, since the longer the adjustment to the pension system, the costlier it becomes, making early reforms to the Lebanese pension system crucial. Although reforms have been proposed since the 2000s, none has been implemented. Steered by these suggestions, partial reforms should be implemented, as a minimum, to limit fiscal sustainability risks, such as increasing the retirement age and social contributions.

In addition to fiscal sustainability, reforms should also reduce inequality by offering lifetime health insurance and pension allowance.

To fix sustainability and equity issues would call for an integrated pension system that includes minimum pension guarantee, flat indemnity, wider coverage, extension of medical insurance after retirement, the provision of a contributory minimum wage, and a tax-funded non-contributory pension scheme for all citizens. However, these reforms are problematic since they require political agreement.

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