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Philippine Institute for Development Studies
Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas

Social Insurance in the Philippines: Responding to the Global Financial Crisis and Beyond

Rosario G. Manasan

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**SOCIAL INSURANCE IN THE PHILIPPINES:
RESPONDING TO THE GLOBAL FINANCIAL
CRISIS AND BEYOND**

ROSARIO G. MANASAN

July 2009

Abstract

This paper aims to review and assessed protection afforded by the Social Security System and the Government Service Insurance System, two out of the three agencies tasked with administering social insurance in the country. Like social security systems in other countries, the GSIS and SSS provides income support to government/ private sector employees and their families in times of contingencies like death, old age, sickness, and disability arising from work, and are financed out of the contribution of members and their employers. The GSIS and SSS are both mandatory, publicly managed, benefit-defined social insurance schemes with funding coming from members and their employers and investment income from reserves. Government guarantees the solvency of both systems and the levels of benefits prescribed.

The coverage of the SSS and GSIS combined (28% of the total number of employed persons and 22% of total population who are at least 65 years old) is lower than the social security systems of Thailand, Malaysia, Singapore, and South Korea but higher than that of Indonesia. However, the replacement rate (i.e., the value of the pension payment as a percentage of the earnings of members during their working life) is estimated to be about about 70% for the GSIS and 67% for the SSS in 2007, higher than those of Indonesia, Malaysia, Singapore and Thailand. The growth of contributions to the GSIS lagged behind that of benefits payments in 2000-2007. Thus, the ratio of contributions to benefit payments declined continuously from 2.1 in 2000 to 1.3 in 2007. On the other hand, total the contribution of members to the SSS exceeds total benefit payments by about 2% in 2007, lower than the corresponding figure for GSIS but is a marked improvement from the situation in 1994-1995 and in 1999-2004 when the SSS was operating in the red and when SSS's contribution-to-benefit ratios was less than unity. The turnaround in SSS's contribution-to-benefit ratio in 2005-2007 was due to the increase in the mandated contribution from 8.4% in 2002 to 9.4% in 2003 and 10.4% in 2007. However, the contribution rate required to maintain the system in steady state equilibrium (i.e., in balance over the next 40 years) is estimated to be about 20%, almost double the current level in 2007.

The global economic downturn will tend to reduce the stream of contributions to the social security system as a result of the increase in unemployment and the reduction in the level of earnings on which contributions are based. At the same time, there will be a temptation on the part of policy makers to use the pension funds to partially finance the fiscal stimulus package that has been drawn in response to the crisis. However, using the pension funds for the purpose of pump priming the domestic economy will likely not match the primary objective of the fund to protect old-age income of members.

Even without the global financial crisis, reforms aimed at improving the financial viability of and corporate governance in both the GSIS and the SSS have already been started. Some gains have already been achieved in various areas of concern but sustained effort is still needed. The needed reforms have already been articulated by various experts (e.g., Holzmann et al. 2000, Navarro 2004, OECD 2009, Asher 2008) and includes: (i)

the broadening of coverage and enhancement of compliance; (ii) greater emphasis on fiduciary responsibility of social security institutions and improve the management of their investment portfolio; and (iii) reduction in administrative cost; and (iv) institution of additional parametric measures to improve sustainability of the social security institutions and reduce the national government's contingent liability. Prospectively, there is a need to explore the feasibility of a non-contributory social pension for aged poor given the low coverage of the informal sector in the SSS.

Key words: defined-benefit social insurance, replacement rate, required contribution rate

SOCIAL INSURANCE IN THE PHILIPPINES: RESPONDING TO THE GLOBAL FINANCIAL CRISIS AND BEYOND*

*Rosario G. Manasan***

1. INTRODUCTION

Even before being buffeted by external shocks in 2008 and 2009, poverty has worsened with the overall poverty incidence going up from 24.4% from 2003 to 26.9% in 2007 after declining continuously for the most part between 1991 and 2003. The number of poor families rose correspondingly from 4.0 million in 2003 to 4.7 million in 2006. In like manner, the proportion of families who are food-poor climbed from 10.2% in 2003 to 11.0% in 2006. Thus, the number of food-poor families increased 1.7 million in 2003 to 1.9 million in 2006.

Table 1. Poverty incidence and number of poor families, 2000-2006

	Poverty Incidence			Number of poor families		
	2000	2003	2006	2000	2003	2006
Overall poverty	27.5	24.4	26.9	4,146,663	4,022,695	4,677,305
Subsistence poverty	12.3	10.2	11.0	1,849,876	1,675,179	1,913,667

Source: NSCB 2006

In 2008, inflation surged to 9.3% from 2.9% in 2007 largely due to the rapid rise in the price of food and fuel products (**Table 2**). Food prices dipped towards the end of the third quarter of 2008 (as indicated by the decline in the Consumer Price Index for food) but surged once again in January 2009. Thus, the increase in the price of food in the first quarter of 2009 is even higher than that in the first quarter of 2008 and continues to be high for most of the second quarter of 2009. On the other hand, while the CPI for fuel, light and water went down by 6% between October 2008 and February 2009, the price of oil in the world market remains volatile.

The country's overall economic growth is threatened by the adverse impact on exports and OFW deployment and remittances of the global financial and economic crisis that started with the implosion of the US housing market and the ensuing recession in key developed economies in the latter half of 2008. Thus, Philippine exports registered negative growth for the full year of 2008 and the first quarter of 2009 (**Table 2**). The growth of GDP decelerated from a high of 7.1% in 2007 to 3.8% in 2008 and 0.4% in the first quarter of 2009. While OFW remittances continued to post positive growth, the its growth waned from 16.2% in the first quarter of 2008 to 2.7% in the first quarter of 2009.

* Paper prepared for the Strategic Summit on Social Welfare and Protection held last July 6-7, 2009 at Sofitel Hotel, Manila.

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Unemployment rose from 7.4% in April 2007 to 8.0% in April 2008. And while the unemployment rate dipped to 7.5% in April 2009, the employment picture is not entirely rosy. First, the share of wage and salaried workers in the total number of employed persons went down from 52.9% in April 2008 to 51.9% in April 2009 while the share of the self-employed and unpaid family workers went up from 30.0% to 31.1% and from 12.5% to 13.1%, respectively. Second, while the underemployment rate declined from 19.8% in April 2008 to 18.9% in April 2009, the share of the visibly underemployed (i.e., those who worked less 40 hours a week) to the total number of underemployed persons swelled from 57.5% in April 2008 to 62.6% in April 2009.

The projected weakness in both domestic and foreign demand in 2009 is expected to take a toll on the lives of poor and vulnerable households not just in the near term but in the longer term as well. Export of Philippine labor is expected to be hit with retrenchment, pay cuts and lower demand due to the economic downturn in the host countries. At the domestic front, employment in export-oriented sectors is also expected to be similarly affected. This will tend to reduce the purchasing power of affected households.

Table 2. Growth rate of GDP and its components , 2004-2009

	GDP g.r.	PCE g.r.	GC g.r.	CF g.r.	X g.r.	M g.r.	Inflation *
2004	6.4	5.9	1.4	7.2	15.0	5.8	6.0
2005	5.0	4.8	2.3	-8.8	4.8	2.4	7.6
2006	5.3	5.5	10.4	5.1	13.4	1.8	6.2
2007	7.1	5.8	6.6	12.4	5.4	-4.1	2.8
Q1	6.9	5.9	12.1	18.1	10.5	-1.8	2.2
Q2	8.3	5.6	8.9	17.4	4.2	-10.2	2.3
Q3	6.8	5.7	-2.6	5.3	3.3	-4.7	2.7
Q4	6.3	6.2	8.0	7.1	4.5	0.7	3.9
2008	3.8	4.7	3.2	1.7	-1.9	2.4	9.3
Q1	3.9	5.1	-0.3	-1.7	-7.7	-2.6	6.4
Q2	4.2	4.1	0.0	13.6	6.1	0.0	11.4
Q3	4.6	4.4	11.8	9.4	3.3	6.7	11.2
Q4	2.9	5.0	2.5	-11.7	-11.5	5.0	8.0
2009							
Q1	0.4	0.8	3.8	-16.5	-18.2	-19.2	6.4

PCE - personal consumption expenditures; GC- government consumption,

CF - capital formation, X- exports, M- imports

* based on CPI

The problems facing households at present are similar to those they dealt with during the 1997/1998 Asian financial crisis. At that time, 90% of households were affected by price increases, 19% by loss of domestic jobs, 4.2% by loss of overseas jobs and 15% by reduced earnings (**Table 3**). Also, the country's experience during the Asian financial crisis indicates how households affected by the crisis responded - by reducing their food intake, taking their children out school, increasing their work hours, and migrating to other countries (**Table 4**).

Table 3. Impact of 1997/1998 Asian Financial Crisis and El Niño

Per Capita Expenditure Decile (1997 FIES)	Percent of Households Affected by:				
	Price Increase	Loss of domestic job	Loss of overseas job	Reduced earnings	El Niño
1 (Poorest)	93.5	17.0	3.8	15.4	78.6
2	91.5	16.6	3.2	13.9	72.7
3	90.9	18.3	2.9	15.5	68.6
4	91.7	18.5	4.1	17.1	64.5
5	90.0	21.5	4.5	17.1	61.7
6	90.2	20.5	3.8	16.8	55.0
7	89.7	20.7	4.7	17.1	51.4
8	89.6	19.4	4.8	15.2	45.2
9	88.3	18.3	5.1	14.2	43.5
10 (Richest)	84.7	14.7	4.8	11.2	37.8
Overall	90.0	18.5	4.2	15.3	57.9

Note: Calculation are based on panel data 23,150 households) constructed from the 1997 FIES and the 1998 APIS.

Source: World Bank. 2001. "Philippine Poverty Assessment, Volume II: Methodology."

Table 4: Household Responses to 1997/1998 Asian Financial Crisis

Income Decile (1997 FIES)	Total HHs Responding	Percent of HH Responding to Crisis by:					
		Changing eating pattern	Taking children out of school	Migrating to city of other countries	Receiving assistance from other households	Receiving assistance from government	Increasing working hours
1	2,256	56.7	12.4	7.8	16.5	10.7	37.5
2	2,223	52.3	9.3	5.4	17.1	8.8	36.8
3	2,211	50.7	7.3	5.4	16.3	8.4	33.6
4	2,206	51.0	8.7	5.2	17.0	6.8	33.1
5	2,180	47.8	7.1	4.5	17.2	5.9	29.4
6	2,155	48.3	5.6	3.8	16.4	5.7	27.0
7	2,138	47.0	5.0	3.7	15.0	4.5	26.1
8	2,125	44.1	3.5	3.4	12.5	2.9	22.3
9	2,097	41.4	3.2	3.1	13.8	3.9	23.1
10	2,011	33.3	1.2	3.5	12.0	2.6	18.2
All HHs	21,602	47.5	6.4	4.6	15.4	6.1	28.7

Note: Calculation are based on panel data 23,150 households) constructed from the 1997 FIES and the 1998 APIS.

Source: World Bank. 2001. "Philippine Poverty Assessment, Volume II: Methodology."

While the impact of the 2008/ 2009 global financial crisis in the Philippines appears to be milder than that of the 1997/ 1998 Asian financial crisis, the economic turnaround is expected to be protracted because the current global crisis is deeper and broader in its coverage. At the same time, it should be emphasized that even when there is no global or regional crisis, households are subjected to risks and shocks of various kinds. For example, in 2004 54% of households reported being made worst off because of the higher

price of food, 19% because of reduced income, 8% because of job lost, and 3% because of natural disasters (**Table 5**). Moreover, poorer households appear to have been more vulnerable to the said risks and shocks. Given this background, it cannot be denied that there is an urgent need for effective and well-targeted social protection programs.

Table 5. Distribution of Households Reporting Being Worse Off as to the Sources of Vulnerability, 2004 APIS
(in percent)

Income Decile	Reason for being worse off								Total Number of HH
	Lost Job/Work	Natural Disaster	Increased Food Price	Poor Health	Reduced Income	No Savings	Loss of Gov't Assist	Others	
Across deciles:									
1 (poorest)	10.3	28.5	10.7	8.4	16.2	12.8	8.0	10.0	12.2
2	10.5	15.4	10.3	10.8	14.8	12.3	5.9	9.9	11.4
3	10.5	12.6	10.6	12.2	12.4	13.5	11.5	8.9	11.1
4	10.4	8.7	10.6	11.5	11.1	9.1	2.9	9.8	10.5
5	13.6	10.1	10.4	12.9	10.0	10.6	13.5	8.4	10.6
6	12.0	7.3	10.0	10.2	8.9	9.0	12.6	9.6	9.8
7	12.0	4.9	10.4	8.2	8.2	11.7	9.3	10.3	9.8
8	8.9	4.7	10.0	9.3	8.0	8.6	11.7	11.6	9.4
9	7.2	5.3	9.3	9.6	6.0	7.3	12.6	10.9	8.4
10 (richest)	4.5	2.6	7.8	6.9	4.4	5.1	11.9	10.4	6.8
All deciles	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Across reasons for being worse off:									
All deciles	8.2	3.0	53.9	5.8	19.2	3.8	0.4	5.4	100.0

Objective of the study. This paper aims to review and assessed protection afforded by the Social Security System and the Government Service Insurance System, two out of the three agencies tasked with administering social insurance in the country.¹ The Government Service Insurance System (GSIS) administers the social security scheme for workers in the public sector while the Social Security System (SSS) administers that for workers in the private sector.

Like social security systems in other countries, the GSIS and SSS provides income support to government/ private sector employees and their families in times of contingencies like death, old age, sickness,² and disability arising from work, and are financed out of the contribution of members and their employers. The GSIS and SSS are both mandatory, publicly managed, defined-benefit social insurance schemes with funding coming from members and their employers and investment income from reserves. Government guarantees the solvency of both systems and the levels of benefits prescribed.

¹ The third agency is the Philippine Health Insurance Corporation.

² With the establishment of the PhilHealth, the health insurance function of the SSS and GSIS was transferred to the PhilHealth.

The present social security system in the Philippines does not provide generalized unemployment benefits. However, members of the GSIS facing unemployment are entitled to a payment equal to one-half of their average monthly compensation for a maximum of six months. In the case of separation, the payment is equal to 18 times the basic monthly pension.

In particular, this paper will assess the coverage, the benefits and financial sustainability of these social security institutions. At the same time, it will also look at the implications of the global financial and economic crisis on the GSIS and SSS.

It should be emphasized that social insurance is just one of the three major components of social protection. In Resolution No. 1 of 2007, the Social Development Committee (SDC) of the National Economic and Development Authority (NEDA) defines social protection as “policies and programs that seek to reduce poverty and vulnerability to risks and enhance the social status and rights of the marginalized by promoting and protecting livelihood and employment, protecting against hazards and sudden loss of income, and improving people’s capacity to manage risks.” This definition of social protection is consistent with the standard definition in the international literature. For instance, the World Bank (2001) defines social protection as interventions that are aimed at (i) assisting individuals, households, and communities to manage risks and shocks better and (ii) providing support to the critically poor.

Social protection programs may be classified under three main categories: (i) contributory social insurance programs, (ii) non-contributory social welfare programs and social safety nets programs, and (iii) active labor market programs. Social insurance programs refer to contributory programs that help households insure themselves against sudden reductions in income. They mitigate income risks by pooling resources and spreading risks across time and groups of individuals. They include publicly provided or mandated insurance against old age (pensions), disability and death of main provider, and sickness.

Social welfare programs and social safety nets refer to non-contributory transfer programs that are targeted to the poor or those vulnerable to poverty and shocks.³ They include school feeding programs, conditional cash transfers, provision of jobs in labor-intensive public works schemes (also called “workfare” programs), micro-finance programs, livelihood/ self-employment programs, social funds and social assistance to specific vulnerable groups. NEDA SDC Resolution No. 1 of 2007 defines social welfare programs as preventive and developmental interventions that are intended to support the minimum requirements of the poor, particular the poorest of the poor. These programs usually consist of direct assistance in the form of cash or in-kind transfers to the poorest and marginalized groups, as well as social services including family and community support, alternative care and referral services. On the other hand, it defines social safety nets as stop gap measures or urgent mechanisms that are designed to address the effects of economic shocks, disasters and calamities on specific vulnerable sectors. These are

³ NEDA-SDC Resolution No. 1 of 2007 differentiates between social welfare programs and social safety nets. Such a distinction is typically not made in the international literature.

measures that specifically target affected groups with the specific objective of providing relief and transition.

Finally, active labor market programs are programs aimed at increasing the skills, employment and long-run earning potential of beneficiaries through training, apprenticeships, job search assistance, subsidized job placements and the like.

2. GOVERNMENT SERVICE INSURANCE SYSTEM

The GSIS, created by Commonwealth Act No. 186 of 1936, is mandated to provide and administer the following social security benefits for government employees: compulsory life insurance, optional life insurance, retirement benefits, unemployment insurance, disability benefits for work-related contingencies and death benefits. The GSIS covers all government workers irrespective of their employment status, except employees who have separate retirement schemes under special laws, namely:;

- Members of the Judiciary and Constitutional Commissions
- Contractual employees who have no employee-employer relationship with their agencies
- Uniformed members of the Armed Forces of the Philippines and the Philippine National Police, including the Bureau of Jail Management and Penology and the Bureau of Fire Protection

Contribution rate. The GSIS contribution rate is equal to 21% of the member's monthly compensation and is shared by the employee (9%) and employer (12%). The employer's share includes the 4% premium for life insurance. In 2003, the PhP 16,000 ceiling on the monthly compensation on which the computation of both the contribution and the benefit rate is based was abolished.

Benefits. The principal benefit package of the GSIS consists of compulsory and optional life insurance, retirement, separation and employee's compensation benefits. Active GSIS members are also entitled to the following loan privileges: salary, policy, emergency and housing loans.

GSIS members are automatically provided a life insurance cover. In case of natural or accidental death of the member, the designated beneficiaries/ legal heirs of a member is paid the amount stated in the life insurance contract and an additional amount of PhP 20,000 for funeral expenses.

The value of the benefit for each type of benefit is anchored on the basic monthly pension (BMP) which is computed as follows:

- 37.5% of the average monthly compensation in the last three years plus
- 2.5% of the average monthly compensation in the last three years for each year of service in excess of 15 years.

However, in no case shall the BMP exceed 90% of the average monthly compensation.

A member who retires from the service is entitled to retirement benefits (i) if he/ she has rendered at least 15 years of services; (ii) he is at least 60 years of age at the time of retirement; and (iii) he is not receiving a monthly pension from permanent total disability. Retirement from government service is compulsory at age 65.

The retirement benefit is equal to either:

- a lump sum payment equivalent to 60 months of the basic monthly pension (BMP) payable at the time of retirement plus old age pension benefit equal to the BMP payable monthly for life starting upon the expiration of the five-year guaranteed period covered by the lump sum; or
- a cash payment equivalent to 18 months of the BMP plus a monthly pension for life payable immediately equivalent to the BMP.

On the other hand, members who have not reached retirement age but who have been separated from the service are entitled to separation benefits provided they have had at least 3 years of service. For members with at least 3 years but less than 15 years of service, the separation benefits consist of a cash payment equivalent to one hundred percent (100%) of his average monthly compensation for each year of service he paid contributions, but not less than PhP 12,000 payable upon reaching 60 years of age or upon separation, whichever comes later. For members with at least 15 years of service and who are less than 60 years of age upon separation, (i) a cash payment equivalent to 18 times the BMP payable at the time of resignation or separation and (ii) an old-age pension benefit equal to the BMP, payable monthly for life upon reaching the age of 60.

Meanwhile, when a member or pensioner dies, his or her beneficiaries are entitled to cash and/or pension benefits. Beneficiaries who qualify for survivorship pension are entitled to fifty percent (50%) of the basic monthly pension of the member or pensioner.

On the other hand, the unemployment benefit is paid when a permanent government employee who has paid premiums for at least 12 months is involuntarily separated from the service as a result of the abolition of his office or position usually resulting from reorganization. The benefit is in the form of monthly cash payments equivalent to 50% of the average monthly compensation and the duration of the benefit depends on the length of service, ranging from 2 months to a maximum of 6 months.

The employees' compensation benefit is a compensation package for public sector employees⁴ and their dependents in the event of work-related injury, sickness, disability or death. The EC is a purely employer-based contribution benefit. Thus, the employee does not contribute any amount to the program. The employee compensation benefits are in the form of: (i) cash income benefits for disability or death, (ii) medical and related services for injury or sickness, and (iii) rehabilitation services (in addition to monthly cash income benefit) for permanent disability.

Disability benefits are granted to a member due to the loss or reduction in earning capacity caused by a loss or impairment of the normal functions of the employee's

⁴ Private sector employees are likewise entitled to employees' compensation benefits.

physical and/or mental faculties as a result of an injury or disease. A member who has been disabled is given a waiver of the monthly premiums on the policy from the time the insured member was found to be disabled and while the disability lasts. Said member is also entitled to a basic monthly pension provided the member had paid at least 36 monthly contributions. In addition, the member is entitled to the payment of the total face value of the policy to the disabled member on maturity date or earlier contingency.

A member who becomes permanently and totally disabled is eligible for permanent total disability benefits in the form of a cash payment equivalent to 100% of the average monthly compensation for every year of service he paid contributions for but not less than PhP 12,000, provided that (i) he is in the service at the time of the disability; or (ii) if separated from service, he has paid 36 monthly contributions within the last 5 years immediately preceding the disability, or has paid a total of at least 180 monthly contributions, prior to his disability.

A permanent/ partially disabled member who has satisfied the conditions for entitlement shall receive disability benefits in the form of a cash payment equivalent to the BMP times the number of months specified in the schedule of disabilities or Table of Loss Percentage. On the other hand, the temporary total disability benefit is in the form of a daily benefit equivalent to 75% of his current daily compensation for the duration of the disability starting on the 4th day of disability but not to exceed 120 days. For more extensive cases, duration may be extended up to a maximum of 240 days. The minimum benefit is PhP 70.00 per day while the maximum is PhP 340.00 per day.

In addition to the benefits mentioned above, GSIS members may also avail of salary loans, policy loans, emergency loans, and housing loans.

3. SOCIAL SECURITY SYSTEM

Republic Act 1161, which created the Social Security System (SSS), was passed in 1954 but was implemented in 1957. The SSS is mandated to provide social security protection to private sector employees and informal sector workers like self-employed persons and their families. In 1997, Republic Act 8282 further strengthened the SSS and enabled it to give substantial increases in social security benefits, expanded its coverage, increased its flexibility with respect to investments, provided for stiffer penalties for violators of the law, and established a voluntary provident fund for members.

The SSS is mandated by law to cover on a compulsory basis the following persons who are not over 60 years old:

- all workers in the private sector, whether permanent, temporary or provisional,
- all self-employed persons regardless of trade, business and occupations, with a monthly net income of at least P1,000.00 including workers of the informal sector,
- all household helpers with a monthly income of at least P1,000.00,
- all Filipino seafarers, and

- all employees of a foreign government, international organization or their wholly owned instrumentality based on the Philippines.

On the other hand, the following are covered on a voluntary basis:

- the parent, spouse or child below 21 years old, of the owner of a single proprietorship business,
- members who have been separated from employment and who would like to continue paying his contributions,
- overseas worker who are employed in a country that has signed a bilateral agreement with Philippine government to include Filipinos and their nationals in the social security coverage of either country,
- Filipinos recruited by a foreign-based employer for employment abroad or Filipinos who legitimately entered a foreign country (e.g., as student, tourist) and are eventually employed,
- persons who have not yet been an SSS member (legally married to a currently employed and actively paying SSS member) and who devotes his time fully in the management of his household and family affairs.

Contribution rates. Effective January 1, 2007, the SSS contribution rate is equivalent to 10.4% of a worker's monthly salary credit (MSC),⁵ shared by the employer (7.07%) and the employee (3.33%). A self-employed or voluntary member shoulders the full amount. The rate is applied to 29 MSC brackets, from a minimum of PhP 1,000 to a maximum of PhP 15,000.⁶ Thus, the monthly contribution per member ranges from PhP 104 to PhP 1,560.

Benefits. A member who is 60 years old and unemployed and has paid at least 120 monthly contributions prior to the semester of retirement and/or a member who is 65 years old, whether employed or not, may avail of retirement benefits. The amount of the monthly pension is the highest of:

- PhP 300 plus 20 per cent of the average monthly salary credit plus 2 per cent of the average monthly salary credit for each credited year of service in excess of 10 year; or
- 40 per cent of the average monthly salary credit; or
- PhP 1,200 if the member's credited years of service is between 10 and 20 or PhP 2,400 if his credited years of service is 20 or more.

A retiree has the option to receive his first 18 monthly pension in lump sum discounted at a preferential rate of interest to be determined by the SSS. If a member takes this option, he will then receive a monthly pension on the 19th month and every month thereafter.

On the other hand, the amount of an employee's sickness benefit is 90 per cent of the average daily salary credit multiplied by the approved number of days. Maternity allowance

⁵ Prior to the 2007 increase in the SSS contribution rate, the mandatory contribution was 8.4% in 1979-2002 and 9.4% in 2003-2006. It is notable that the employee's share in SSS contribution has been maintained at 3.33% since 1979.

⁶ However, a minimum MSC of PhP 5,000 is applied to overseas contract workers.

is equivalent to 100 per cent of the member's average daily salary credit multiplied by 60 for normal delivery or miscarriage, and 78 days for Caesarean cases.

When a member has been disabled and can no longer render service for valid reasons, he/she will be given the amount of the monthly pension based on the member's number of paid contributions and his/her years of membership. The lowest monthly pension is PhP 1,000 for members with less than 10 calendar years of service (CYS); PhP 1,200 for those with at least 10 CYS and PhP 2,400 for those with at least 20 CYS. A lifetime monthly pension will be awarded to completely and permanently disabled members. However, the pension will be suspended if the pensioner recovers from his illness, resumes employment or fails to report for physical examination when notified by the SSS.

The SSS also offers the following loan windows to its members; salary loans, housing loans and business loans.

4. ASSESSMENT

Coverage. In 2007, the GSIS has 1.4 million members while the SSS has 8 million contributing members,⁷ accounting for 92% of the total number of civilian public sector employees and 29% of the total number of employed persons outside of the public sector (**Table 6**). Together the GSIS and the SSS covered 28% of total number of employed population and 22% of the total population who are at least 65 years old in 2007. Thus, the coverage of the social security system in Philippines (i.e., GSIS plus SSS) is one of the lowest in the region. To wit, the coverage rate of the GSIS and SSS is lower than the social security systems of Thailand, Malaysia, Singapore, and South Korea but higher than that of Indonesia (**Table 7**).

Financial sustainability. The GSIS and SSS both operate partially funded defined-benefit pension schemes, i.e., they pay pensions that are related to the earnings of their members during their working life. As such, the financial sustainability of the pension system is largely driven by the discrepancy between contributions and benefits.

At present, the replacement rate (i.e., the value of the pension payment as a percentage of the earnings of members during their working life) ranges from 37.5% to 90% for the GSIS. The average replacement rate in the 1990s of the GSIS was estimated to be equal to 70% from a sample of retirees (Asher 2000). In contrast, the mandatory contribution to the GSIS is equal to 17% of the monthly compensation of members, not including the 4% contribution for the life insurance premium.

⁷ The SSS has 27.2 million members in 2007, but less than 30% of this number (or 8 million) are contributing members.

Table 6. GSIS and SSS contribution and benefit payments, 2007
(in billion pesos)

	GSIS	SSS	TOTAL
Total contributions	43.0	61.9	104.9
Social insurance	40.8	60.8	101.6
EC	2.2	1.1	3.3
Total benefit payments	32.4	60.8	93.2
Social insurance	32.3	59.7	92.0
EC	0.1	1.1	1.2
Total contributions as % of GDP	0.6	0.9	1.6
Total benefits as % GDP	0.5	0.9	1.4
Ratio of contributions to benefit payments	1.33	1.02	1.13
No. of contributing members	1.4 mill	8.0 mill a/	9.4 mill
as % of no. of employed workers	91.9%	28.9%	32.1%
Total number of old age pensioners	152,463	584,638	737,101
as % of popn aged 65+			21.8%

a/ SSS reports 27.2 million members but only 8 million are contributing members

Table 7: Coverage Ratios of Social Security Schemes a/

	Active members ('000s)	Members as % of eligible popn	Members as % of labor force	Members as % popn aged 15+
Philippines	9,356	32.1 c/	25.8	16.6
Indonesia	14,000	42.7	14.0	6.6
Rep. of Korea	17,070	n.a.	73.0	37.1
Malaysia	5,070	n.a.	45.5	19.8
Thailand	10,351	72.0	29.0	16.8
Singapore	1,324	77.0	56.6	31.2

a/ Korea: National Pension Scheme only. Malaysia: Employees' Provident Fund only. Philippines: SSS+GSIS

b/ based on number of contributing members of GSIS and SSS

c/ as % of total number employed

Source: data for all other countries is from Ghosh (2006);

data for Philippines is for 2007 and is estimated based on SSS/ GSIS data and Labor Force Survey (LFS) of National Statistics Office (NSO) for April 2007

The growth of contributions to the GSIS lagged behind that of benefits payments in 2000-2007. In specific terms, total benefits payments made by GSIS grew by 10% annually from PhP 17 billion in 2000 to PhP 32.3 billion in 2007. On the other hand, member contributions rose from PhP 35 billion in 2000 to PhP 41 billion in 2007, reflecting a 2% yearly increase (**Table 8**). Thus, the ratio of contributions to benefit payments declined continuously from 2.1 in 2000 to 1.3 in 2007. This occurred despite the abolition of the ceiling on average monthly compensation in reckoning members' contributions to the GSIS in 2003, perhaps because only 5% of GSIS members are affected by this change.

Table 8. Total premium contributions and total benefits paid by the GSIS and SSS, 2000-2007 a/
(in billion pesos)

	2000	2001	2002	2003	2004	2005	2006	2007
GSIS								
Premium contributions	34.7	36.7	39.9	40.4	39.2	40.4	39.1	40.8
Benefit payments	16.9	21.3	24.5	25.9	30.9	29.9	30.6	32.3
Ratio of contributions to benefit payments	2.05	1.72	1.63	1.56	1.27	1.35	1.28	1.26
SSS								
Premium contributions	29.9	30.9	33.7	38.6	43.1	46.6	51.6	60.8
Benefit payments	32.7	37.8	39.6	41.6	43.7	45.2	51.1	59.7
Ratio of contributions to benefit payments	0.91	0.82	0.85	0.93	0.98	1.03	1.01	1.02

a/ refers to social insurance only

In recent years, the GSIS intensified the collection of premium arrears of various government agencies. At the same time, it was able to improve the yield on its investments. With the enactment of amendments of the GSIS law in 1997, the GSIS was authorized to invest part of its funds to the in foreign assets so as to enable it to diversify its portfolio and secure better returns given the lack of local investment instruments.⁸ In line with its global investment program, the GSIS obtained the services of a professional global fund manager. It has also adopted an absolute-return strategy for its international investments. Specifically, as part of this strategy the GSIS requires a minimum annual US dollar return of 8% and a maximum portfolio volatility of 7%. Thus, the actuarial life of the GSIS reserve fund is estimated to be good up to 2055 as of 2007, an improvement from the 1999 actuarial valuation when the GSIS reserve fund was estimated to run out in 2041.

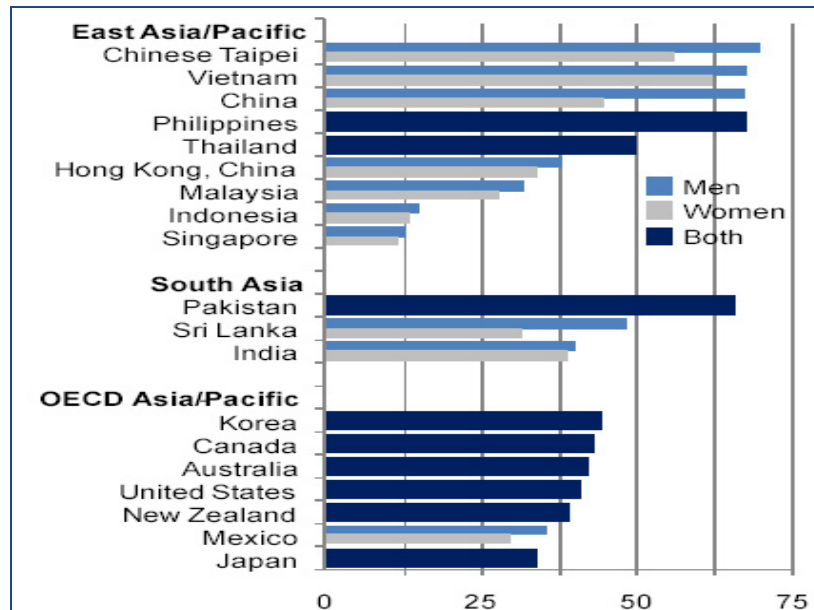
However, the continuous slide in the ratio of contributions to benefit payments made by the GSIS in 2000-2007 indicates the need for intensified efforts to improve its financial sustainability. The GSIS also embarked on the installation of a computerized information system to manage members' service records, contributions, payments and other data. This is much needed by GSIS management for the monitoring of its day-to-day operations, its actual actuarial situation and the performance of its investment portfolio, among others. This information system is also critical for the GSIS to actually operationalize the premium-based policy that was adopted recently (which calls for the proper matching of premium contributions with the amount of benefits to be received) and for it to be able to service its members' requirements efficiently and effectively. At present, the computerization effort has hit a snag and is still awaiting resolution.

With the exception of those who receive the minimum pension of PhP 1,200 for members with credited years of service between 10 and 20 and PhP 2,400 for members with credited years of service exceeding 20 years, the replacement rate for SSS pensioners varies from 20% to 40% depending on the number of credited years of service. However, the average replacement rate for the SSS is estimated to be 67% in 2007 (OECD 2009). This result is attributed to the large number of pensioners who receive the minimum

⁸ Similarly, the 1997 amendments to the SSS law also allowed the SSS to invest its funds in foreign assets.

pension. Thus, the replacement rate for the SSS is high relative to the pension systems of other countries in the region and even some of the OECD countries (**Figure 2**).

**Figure 2. Replacement Rates of Public Pension Systems in Selected Countries
In East Asia and the Pacific**



Source: OECD (2009)

Benefits of SSS members increased almost yearly in the 1990s by about 12% yearly on the average (higher than average inflation rate of 10%) but the contribution rate remained constant prior to the increase implemented in 2003. This resulted in the continuous deterioration in the financial sustainability of the SSS during the period. Thus, the estimated actuarial life of the fund plummeted from perpetuity based on the 1990 actuarial valuation report, to 2040 based on the 1995 actuarial valuation report to 2015 based on the 1999 actuarial valuation report.

Total contribution of members to the SSS exceeds total benefit payments by about 2% in 2007. This is much lower than the corresponding figure for GSIS but is a marked improvement from the situation in 1994-1995 and in 1999-2004 when the SSS was operating in the red and when SSS's contribution-to-benefit ratios was less than unity (**Table 8**).

The turnaround in SSS's contribution-to-benefit ratio in 2005-2007 was due to the increase in the mandated contribution from 8.4% in 2002 to 9.4% in 2003 and 10.4% in 2007. In addition, many reforms were instituted at the SSS since 2000 to strengthen financial sustainability of the system. These included both parametric measures (e.g. the increase in the maximum salary base from P12,000 to P15,000, and the redefinition of

credited years of service⁹) and administrative measures (e.g. Teller System, expansion of payment facilities, cost saving measures, improved investment portfolio and management, etc.).

As a result, the estimated actuarial life of the Social Security Fund (SSF) was extended from 2015 (based on the 1999 actuarial valuation) to 2036 (based on the 2007 actuarial valuation). This improvement already takes into account two rounds of 10% across-the-board increase in pensions that were granted first in September 2006 and the again in August 2007. However, the OECD (2009) estimates the contribution rate required to maintain the system in steady state equilibrium (i.e., in balance over the next 40 years) to be about 20%, almost double the current level. This is indicative of the extent of additional reforms that have to be implemented.

Impact of the global financial crisis. The global economic downturn will tend to reduce the stream of contributions to the social security system as a result of the increase in unemployment and the reduction in the level of earnings on which contributions are based. To date, this tendency has not yet become evident in the Philippines. However, if the domestic economy does slide into a recession as some analysts are predicting, then this might yet become a reality. If this happens, it will be an additional pressure point on the sustainability of the social security system, the SSS in particular.

Governments around the world are responding to the ensuing weakness in their own economies and those of their major trading partners with countercyclical fiscal spending. But precisely because tax revenues tends to be co-variant with the overall growth of the economy, the use the pension funds to partially finance the fiscal stimulus package may appeal to some policy makers. For instance, the GSIS and SSS are reportedly going to finance PhP 50 billion of large infrastructure projects under the Economic Resiliency Plan of the government. This situation is not unique to the Philippines. Malaysia did the same thing in the wake of the Asian financial crisis in 1998 (Holzmann et al. 2000). However, there is a need to resist the temptation to dip into the pension funds for the purpose of pump priming the domestic economy as this will likely not match the primary objective of the fund to protect old-age income of members.

Additional reforms beyond the crisis. Even without the global financial crisis, the need for reforms aimed at improving the financial viability of and corporate governance in both the GSIS and the SSS cannot be denied. These reforms have been articulated by various authors (e.g., Holzmann et al. 2000, Navarro 2004, OECD 2009, Asher 2008) and we re-iterate them here. It should be emphasized that some gains have already been achieved in various areas of concern but sustained effort is still needed.

- Strengthen the link between contributions and benefits

⁹ Up to 1984, the number of credited years of service is defined as the number of calendar years from year of coverage regardless of the actual number of contributions. In 1985-2001, it is defined as the number of calendar years in which six or more monthly contributions have been paid. From 2002 onwards, it is defined as number of months with contributions paid divided by 12.

Significant strides have already been taken by the SSS in instituting parametric measures to improve its sustainability. However, more are still needed including, among others: (i) the removal of the minimum pension guarantee, (ii) further increases in the contribution rate, (iii) further increases in the maximum salary credit, (iii) revisit of the use of the final salary as basis of pension benefit, and (iv) an increase in the vesting period.

- Improve the protection provided to pensioners

There is also a need to further improve the protection provided to pensioners. At present, pensions are adjusted in an ad hoc manner over time. The value of pensions may be better protected from erosion due to inflation if pensions are adjusted in a systematic manner through inflation indexation.

At the same time, both the GSIS and SSS allow pensioners to get their benefits as a lump sum at the time of retirement. The withdrawal of benefits in such a chunky manner rather than in the form of annuities tends to reduce the welfare of beneficiaries as they run the risk of outliving their retirement savings.

- Broaden coverage and promote compliance

It is recognized that poor compliance will persist if the incentives for evasion are engendered by the very design of pension benefits and contribution (Holzmann et al. 2000). For instance, both the OECD (2009) and Holzmann et al. (2000) argued that the minimum pension provision and the provision that pensions are computed on the basis of salaries in the last 5 years of service tend to result in the evasion of the payment of appropriate premiums. In other words, these two provisions create incentives workers and employers to collude by either (i) under-reporting earnings until the last 5 years of their working life and/ or (ii) artificially boosting pay that is reported to the pension system in the last 5 years of their working life.

On the other hand, the lack of sanctions on employers who either under-report or who do not remit the contributions they withhold from their employers obviously results in a reduction in the amount of contributions that actually reached the system. In addition, it also reduces the credibility of the system and discourages other workers from participating in the system.

- Put greater emphasis on fiduciary responsibility of social security institutions and improve the management of their investment portfolio

Holzman et al. (2000) and Asher (2008) emphasized the need to strengthen corporate governance and promote accountability in the social security institutions so as to help them perform more effectively their fiduciary responsibility (i) to preserve the value of the pension fund, and (ii) to maximize the returns on investment. They also pointed out the fiduciary role of pension funds is sometimes given less emphasis in favor of the pursuit of other domestic policy goals (like financing of infrastructure investment, foreign

exchange management, even outright political intervention) as these pension funds manage their investment portfolios.

There are many examples of the politicization of the SSS and GSIS in the past. Palmieri (2002) notes that “the government has influenced the use of public pension funds to attain a variety of public policy objectives. Given the large pool of funds, it is often tempting for government bodies to direct the investment of a portion of these assets for specific domestic political purposes such as low income housing, financing start-up businesses and development of the capital market, among others. While well-intended these economically targeted investments normally lead to less than market rates and thus deviate from the fiduciary principles.” For instance, at the behest of the Marcos government, the GSIS funded the construction of numerous hotels which later on became non-performing loans in the mid-1980s. At about the same time, it also took over the ownership of the Philippine Airlines (PAL). More recently, both the GSIS and SSS acquired substantial shares in a commercial bank at the behest of President Estrada in support of a crony’s take-over of the said bank.

At the same time, there is a need to strengthen the governance structure of SSS, particularly in terms of the selection of members of the Social Security Commission. Ghosh (2006) points out that the broad selection criteria used for selecting the members of the Commission has, in the past, resulted in the limited technical capacity of the Commission to “understand complex technical issues and take appropriate policy decisions. In contrast, this problem has been mitigated in the GSIS by the requirement in the GSIS Charter that 4 out of the 8 members of the GSIS Board come from the banking, finance, investment, or insurance sectors and that one be a recognized member of the legal profession.

On another note, there is also a need to revisit the percentage of the investment portfolio that is earmarked for housing and other loans to members of both the SSS (ceiling of 45%) and the GSIS (ceiling of 40%). It should be pointed out that this mandate clearly drags down the return on investment of these two entities since these loans are granted at below market rates.

- Reduce administrative cost

Holzmann et al. (2000) found that the administrative cost of running the SSS and GSIS is high relative to that of social security systems in other countries. For instance, the operating expense of the pension fund in Malaysia is 2% of total contributions while that of the pension fund in Singapore is 0.5% of total contributions. In comparison, the operating expense of the SSS is equal to 11% of contributions in 2007, marginally higher than the corresponding ratio (10.7%) in 1995. On the other hand, the operating expense of the GSIS is equal to 15% in 2007, even higher than corresponding ratio in 1996 (10.8%).

- Consider feasibility of non-contributory social pension for aged poor

Finally, the low coverage rate of social security system underscores the importance of social safety net not just for the aged but also the informal sector. The government

provided a one-time grant of PhP 500 to senior citizens aged 70 years and over who are not receiving any pension from the SSS/ GSIS, and the PNP/ AFP retirement system in response to the rapid rise in the price of rice and fuel in the middle part of 2008. The discussion below, however, shows that hurriedly designed programs like this are typically not very effective in reaching their desired beneficiaries. From this perspective, the feasibility of providing a non-contributory basic social pension for the aged poor should be explored. Needless to say, the fiscal cost of such a scheme will be enormous given the large informal sector and low coverage provided by social security system to this sector so that this proposal requires careful study.

- Unemployment insurance may not yet be appropriate for the Philippines

Recently, in the wake of the global financial and economic crisis and the ensuing rise in the unemployment rate, there is renewed interest on the introduction of unemployment insurance in the country. Earlier assessments on the desirability and prospects of doing so (e.g., Yoo 2001, Esguerra et al. 2002) are not encouraging. They argue that unemployment insurance is not feasible because (i) the share of the informal sector is high (roughly 50% of employed persons are in the informal sector), (ii) both unemployment and underemployment is high, ranging from 7% to 8% and 19% to 26%, respectively, in the last 5 years, (iii) the proportion of the poor among the unemployed is low in relative terms (e.g., in 1997 only 12% of the unemployed are poor but the overall poverty incidence is 25%), and (iii) administrative capacity to monitor the employment status and job search behavior is weak. Given these conditions, unemployment insurance will tend to create inefficiencies and dis-incentives. Esguerra et al. (2002) notes that by imposing contributions to be levied on wages, the costs of labor may increase, contributing to the further growth of the informal sector and the increase of the equilibrium level of unemployment. The increase in unemployment is further magnified by unemployment insurance because unemployment insurance tends to intensify job search, thereby prolonging unemployment spells.

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