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Social Security: Challenges and Issues

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About Social Security Research Centre

The Social Security Research Centre (SSRC) was established in March 2011 at the Faculty of Economics and Administration (FEA), University of Malaya to initiate and carry out research, teaching and dissemination of evidence-based knowledge in the area of social security, including old age financial protection in order to enhance the understanding of this critical topic to promote economic development and social cohesion in Malaysia.

To support the research in social security in general and old-age financial protection in particular the Employee Provident Fund (EPF) of Malaysia has graciously provided an endowment fund to create the nation's first endowed Chair in Old Age Financial Protection (OAFPC) at University of Malaya. OAFPC has the over-riding objectives to help formulate policies to promote better social security and improve old age financial protection, and to help formulate policies to promote economic growth in an aging society for consideration by the Government of Malaysia.

The interest in social security and old-age financial protection is ever growing in view of an ageing population. Malaysia is also subjected to rising life expectancy and falling fertility rates, the perceived inadequacy of current social security provisions, coupled with the added fear that simply more expenditure may not be conducive to the development and growth objectives of the society. This calls for innovative policy solutions that may be inspired by international experience based on an empirical grounding in national data and analysis.

Social Security: Challenges and Issues

1. Introduction

The plight and hardships faced by elderly citizens living in poverty due to insufficient savings or inadequate financial support have been highlighted in recent articles in the mass media. According to the Employees Provident Fund, many of its contributors do not have sufficient savings when they reach their retirement age. In an effort to alleviate the potential problem of poverty in old age, the Government has approved eight Private Retirement Schemes. These schemes which are regulated by the Securities Commission are designed to provide supplementary financial protection for the elderly. In addition, the Government has introduced various measures which include cash transfer programmes, raising the retirement age for private sector workers and adoption of minimum wages to ensure that the rakyat live above the social floor.

In highlighting the plight of the poor and the elderly, the mass media has published numerous articles on poverty and old age financial protection, using terms such as safety net, social welfare, social protection, pensions and social security to describe various programmes that address the needs of the poor and the elderly. Some of these programmes, such as the EPF's contributions scheme and SOCSO's (Social Security Organisation) employment injury insurance and invalidity pensions require mandatory contributions from workers and employers while others are financed through the Government's budgetary allocations.

A wide range of differing perceptions, have been expressed by advocates as well as opponents on such schemes. Mandatory contributions were perceived as unfair and were even labelled as Ponzi schemes. It is imperative that everyone, especially contributors to mandatory schemes understand and have the right perspective on the issues. This article seeks to discuss the underlying issues in an attempt to provide an understanding and perspective of the challenges of social security.

2. Addressing Poverty and Standard of Living

It is evident from the primitive days when man and tribes hunted with spears, bows and arrows to the present times where nations are prepared to wage wars to gain control and ownership of economic interests that possession of economic resources and access to supplies and markets are critical for a nation's economic security. Similarly, at the micro level, individuals seek economic security for themselves and their families. In this process, there are two principal objectives:

a) To acquire economic and financial assets that could ensure that we do not suffer from deprivation and poverty; and,

b) To sustain a desired standard of living and to be protected against contingencies or risks that can potentially push us back into poverty or below the desired standard of living.

Modern societies have formulated various mechanisms to ensure that at least a basic level of economic security is available for every member of society. This entails the basic needs of food, clothing and shelter at an acceptable level of comfort. Hence, there is a need to determine a minimum level of economic subsistence. An assurance of adequate amount of food, shelter and clothing which constitutes part of the standard of living is the core of government economic and social development programmes. Naturally, a basic standard of living would entail minimum levels of food, clothing and shelter that can be supported by a minimum income in absolute terms. This standard in monetary terms would differ among countries and regions according to local conditions.

However, people realized that the capacity to attain a minimum or higher standard of living, not only changes over time, but may be eroded due to contingencies and changes in circumstances including the definitive process of ageing. We need an assurance that the standard of living could be protected and preserved from cradle to grave against such risks.

In addition, we also realize that life is more than food, clothing and shelter. As our life span increases as a result of expanding economic wealth and advancement in medical science and technology, we do not want a long life of pain and misery. As we increase the number of years to our life, we also desire to add life to years, to be able to consider life as meaningful and worth living. Obviously, this is a rather subjective and value-laden perspective. Hence, economists advocate achieving not just a minimum wage but a living wage and more recently a decent wage. Recent articles in the literature indicate a growing interest on measuring happiness. Organizations such as the New Economics Foundation and the Earth Institute are focused on developing a Happiness Index. The global trend towards an ageing population has also shifted the emphasis on the importance of wellness and wellbeing particularly for the disabled and the aged. Some governments have managed to achieve these objectives to a satisfactory extent while others are either still struggling or lacking in resources to provide such care.

Human development has often been measured in terms of the standard of living and the quality of life of individuals and their communities. Economists hold the view that the standard of living is objectively measurable and are invariably connected to the individual's income and his or her capacity to earn. Hence, when the income or the capacity to earn is affected, the standard of living of the individual and his or her dependents is jeopardized, potentially plunging into a state of deprivation. Socio-economic development efforts have focused on social policies and programmes to specifically address this fundamental issue of poverty and human development.

These efforts not only generated a range of methodologies but the extent to which the people's standard of living is assured differs. On the other hand, quality of life and happiness involves an element of subjectivity. It includes aspects of personal liberties and social-psychological desires that the individual deems to add happiness to life. These aspects are difficult to measure and comparisons across cultures are indeed impossible.

In an effort to achieve the twin objectives of a minimum standard of living above the poverty line and a decent life for every member of society, we need to overcome the classic economic problem of unequal distribution of resources. In any society, there are those who lack the means to overcome squalor and deprivation while at the same time, there are others who have much more than they require. Hence, redistribution of resources emerge as a critical component in the design of poverty eradication programmes.

3. Concepts and Perspectives - A Babel of Terms

The literature on economic and social policies on alleviating poverty and raising living standards is littered with a babel of terms. The terms that are most often cited are social welfare, social safety net, social protection and social security. These terms have been used interchangeably by many people, often referring to the same programmes. This has not only created confusion but negative perceptions especially on programmes that are not dependent upon government grants.

Although the terms may differ but the users of these terms often allude to similar underlying intentions. All of them have the stated objectives of:

a) Attainment of a minimum standard of living that is above the poverty line or social protection floor (a concept advocated by the International Labour Organization); and,

b) Protection against risks that could negatively impact on the standard of living that has been achieved prior to the loss of capacity to work such as disability or invalidity caused by accidents, terminal sickness or other crippling medical conditions, old age and death of the family's primary or sole income earner.

In addition, the funding mechanisms may be similar, that is, either as social assistance financed by tax revenue; forced savings schemes like provident funds with individual accounts; or social insurance schemes which mandate pooling of contributions from relevant parties.

To the layman, such similarities give rise to perceptions that all these terms are the same and could be used inter-changeably. It is difficult to differentiate the use of these terms and any attempt to identify the terms according to programmes may compound the confusion.

Different social and cultural traditions and political context could give rise to differing definitions and terminologies that are used to refer to programmes targeted at alleviating poverty and providing protection against risks that can impact our economic security. Nevertheless, the extant literature, particularly publications of international organizations such as the World Bank, International Labour Organization and the Asian Development Bank, do provide some strands of commonality in approaching this subject.

The United Nations Economic and Social Council refers to social protection as *"a set of public and private policies and programmes undertaken by societies in response to various contingencies to offset the absence or substantial reduction of income from work; to provide assistance for families with children as well as to provide people with health care and housing."* (UN ECOSOC, 2000) On a similar note, the World Bank proposed a definition which views social protection as "*public interventions to (i) assist individuals, households, and communities to better manage risk, and (ii) provide support to the critically poor."* (Holzmann and Jorgensen, 2001).

These two definitions are consistent with the International Labour Organisation (ILO) Social Security (Minimum Standards) Convention No. 102, which established minimum social security standards involving nine areas, namely:

a) Medical care;
b) Sickness benefit;
c) Unemployment benefit;
d) Old-age benefit;
e) Employment injury benefit;
f) Family benefit;
g) Maternity benefit;
h) Invalidity benefit; and
i) Survivors benefit.

Social protection and social security are often used inter-changeably by international agencies. Social security systems are based on the notion of solidarity and collective responsibility of society to provide economic security to its members. Solidarity means that every member of society must share with each other, for better or for worse. Those who have should share with those who do not have so that they could be assured of care and live above the social protection floor. No one is to be excluded. It is a shared and mutual collective responsibility with contributions from every individual. This is an inclusive concept of human development. It encompasses the elements of welfare and safety net which provides individuals with some security of income when faced with the contingencies of old age, survivorship, incapacity, disability, unemployment or to deal with financial difficulties in raising children, including access to preventive and curative health care.

As defined by the International Social Security Association, social security refers to *"the protection which society provides for its members, through a series of public measures, against the economic and social distress that otherwise would be caused by the stoppage or substantial reduction of earnings resulting from sickness, maternity, employment injury, unemployment, invalidity, old age and death; the provision of medical care; and the provision of subsidies for families with children."*

Social security usually refers to schemes that require the potential beneficiaries to bear a portion of the responsibility towards the financing of his future stream of benefits such as contributions from workers and employers. The terms 'welfare' and 'safety net' takes on the connotation that the responsibility lies with the state and social protection refers to a much wider scope. In this respect, the term social security excludes cash transfer programmes that are funded by the Government budget while social welfare and safety net programmes involve cash and non-cash social transfers which are financed through government tax revenue or third party donors. Social security schemes are designed to protect the real consumption of individuals and their families against a sudden drop in living standards due to old age or contingencies such as unemployment, disability, sickness, incapacitation, death or retirement. Therefore, social security schemes involve both short run occurrences such as unemployment or minor sickness, as well as long-term phenomena such as death, retirement or incapacitation as a result of accidents or sickness and disease. ILO's Convention No. 102 does not specify the modality for achieving the minimum standards for social security but proposed three approaches , that is: i) universal schemes which involve means-testing targeted at assisting the poor; ii) social insurance schemes which require mandatory contributions; and iii) social assistance schemes which are financed by tax revenue through government budgets.

Social security schemes which do not involve direct cash transfers include:

a) Pension Schemes;
b) Provident Funds (savings for retirement);
c) Employment Injury Protection Schemes;
d) Invalidity and Survivor's Pension Schemes;
e) Company Retirement / Pension Plans;
f) Private Retirement Plans;
g) Unemployment Assistance Plans; and
h) Social Health Insurance Schemes.

4. Social Security- A Noble Vision

Social security schemes provide financial assistance and services for the purpose of:

a) Alleviating poverty;

b) Ensuring that people feel secure not only against poverty, but also hardships caused by sudden change of circumstances such as sickness, invalidity, unemployment and death of the primary or sole income earner and a safe working environment;

c) Achieve equity by redistributing or reallocating incomes from those who have to those who lack; and

d) Social pooling or solidarity such that benefit payments are not simply viewed as charity but as a form of mutual co-operation, support and self-help.

The inherent diversities of human societies have resulted in unequal distribution of abilities and opportunities, both physical and intellectual, which have contributed to disproportionate socio-economic levels among individuals and societies. . Human history has taken cognizance of such inequalities and has accepted the notion that there is a need to provide assistance to the under-privileged, both on a short term as well as long term basis. Thus, the strong should take care of the weak and the able must undertake the responsibility for the less able or disabled. Our journey from cradle to grave is also a minefield of risks which could potentially lead to economic impoverishment and social marginalization. The need to address social exclusion (Estivil, 2003; Silver, 1994) caused by old age and contingencies forms the bedrock of social security schemes. It is about protection against risks that could result in impoverishment. The foundation of social security is premised on the principle of social pooling for an inclusive society.

5. The Social Protection Floor and Social Security

In the report 'Social Protection for a Fair and Inclusive Globalisation' (ILO, 2011), Bachelet, quoting from various sources, stressed that, despite decades of economic growth, access to adequate social security remains a privilege and that:

a) About 5.1 billion people or 75 percent of the world population are not protected by adequate social security;

b) 1.4 billion people survive on less than US$1.25 a day;

c) Thirty-eight percent of the global population or 2.6 billion people, do not have access to adequate sanitation;

d) 884 million people lack access to adequate sources of drinking water;

e) 925 million suffer from chronic hunger;

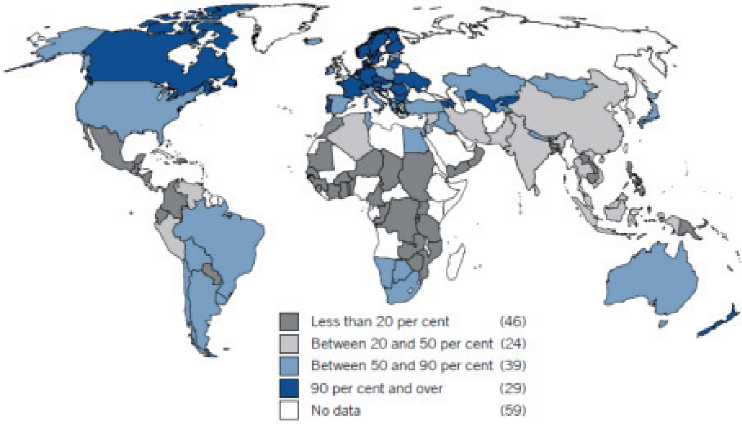
f) Nearly 9 million children under the age of five, die every year from largely preventable diseases;

g) 150 million people suffer financial catastrophe annually; and

h) 100 million people are pushed below the poverty line when compelled to pay for health care.

The percentage of people protected by old age pensions are still low in most parts of the world (see chart below).

Old-age Pension Beneficiaries as a Percentage of the Population above Retirement Age, Latest Available Year



Source: Bachelet (2011)

The international community upholds and recognizes that more efforts are required to expand access to social security. Towards this end, the ILO formulated the concept of a social protection floor and a policy framework for implementation at national levels. On 30 May 2012, members of the ILO adopted a new international labour standard, the "Recommendation Concerning National Floors of Social Protection" which defined social protection floors as *"…nationally defined sets of basic social security guarantees, aimed at ensuring basic income security and access to essential health care and other social services for all. They should secure protection aimed at preventing or alleviating poverty, vulnerability and social exclusion, and allowing a life in dignity."(ILO, 2012).*

Towards this end, social security guarantees may be achieved through a variety of modalities based on the contextual conditions of each country. These modalities include both contributory and non-contributory social transfers financed through fiscal measures. Social security guarantees could be secured through schemes that protect against old-age, injury and disabilities, unemployment and services for the unemployed and working poor, income support for family and children as well as access to essential health care. The system should also facilitate the provision of amenities such as health, water and sanitation, education, food security, housing and other areas which could prevent people from living below the social floor.

6. Social Security Systems and the Need for Reforms

Modern social security thoughts were greatly influenced by two men, Chancellor Otto Von Bismarck of Germany and Sir William Beveridge of Great Britain. Under Bismarck's vision, Germany had by the year 1889, established a comprehensive social security system based on social insurance that provides protection against old age, disability, accident and health. Beveridge presented his recommendations for a British welfare state based on social insurance in 1942. The principles and thinking on social justice and social inclusion by both men became the foundation of modern social security systems. Nevertheless, since then, we have witnessed many socio-economic changes which necessitated reforms to be made to the social security systems. Even though social security systems underwent evolutionary modifications, the social policies remain guided by the thoughts of Bismarck and Beveridge and the role of the state. It is noteworthy that in the case of privatized pension systems such as that in Chile, the government assumes the role of the regulator and guarantor for pension scheme contributors.

Policy-makers and social security administrators face challenges such as:

a) Changing demographic characteristics which display a distinct trend towards ageing societies throughout the world;

b) The need to generate dignifying jobs;

c) The threat of unemployment due to a highly globalized labour market and increasingly volatile economic environment;

d) The need to extend coverage within an affordable and financially sustainable system; and the debate regarding the public versus private management of such systems.

These challenges are formidable obstacles to efforts to expand coverage and provide adequate income above the social floor particularly in times of economic and financial distress. The debate on the financing of social security revolves around not only on the need to widen coverage and improve benefits, but also to the efficacy of response to demands, within the framework of prevailing economic conditions. In response to these challenges, existing methods of financing social security schemes have centered on the following:

a) Funding through general tax revenue or ear-marked taxes;

b) Social pooling through social insurance, that is, mandatory contributions from the target group(s);

c) Private insurance schemes and pension plans through voluntary participation;

d) Savings schemes with individual accounts; and

e) Social assistance programmes financed by government budget. These include a variety of social transfers which could be cash or non-cash transfers. Conditional transfers are among the latest being experimented particularly in South America and some Asian countries.

All countries adopt a mixture of the above financing approaches to provide protection against the various contingencies and to address social needs. These schemes either constitute a **defined contribution (DC) or defined benefits (DB)**[1] approach within a pay-as-you-go system. Many developed countries have comprehensive social security systems and generous defined benefit pension schemes for old age financial protection. However, in the last decade, the financial sustainability of old age or retirement pension schemes have been seriously challenged resulting in a shift of focus from DB to DC schemes. A flurry of reforms was initiated primarily to address the issue of sustainability and the capacity of the scheme to meet pension liabilities which are long-term in nature.

[1] Defined Benefit plans promise to pay participants an amount determined under a formula specified in the plan while Defined Contribution plans pay participants according to the amount of contributions paid into the participants' individual account plus net investment gains.

In addition, the dole mentality of some recipients of the benefits and the unsustainability of generous defined benefit retirement pension plans have led to calls for individuals to be responsible for their own socio-economic wellbeing. In response to this, some countries have incorporated the element of individual accounts via reforms to its old age pension schemes. This is a departure from the notion of social pooling and solidarity. This could give rise to questions pertaining to the adequacy of savings in the individual accounts of low income earners. At this stage, the inclination towards individual accounts and defined contributions may be driven by the emphasis on individual responsibility and government fiscal pressures rather than the principle of adequate income and wealth redistribution in a welfare state. However, taking cognizance of the need for redistribution, some countries such as Australia has implemented multi-pillar systems for old age financial protection. Multi-pillar systems for old age financial protection usually consist of a basic means-tested universal social pension which is financed by tax revenue and augmented by a defined contribution pillar with individual accounts which could be mandatory or voluntary.

Social security reform is a continuous process, often responding to prevailing demographic and economic conditions. Countries could learn from each other and share experiences but should refrain from replicating alien and probably unsuitable systems from another socio-economic context. Social cohesion supported by a political will and economic capacity are necessary in order for social security schemes to overcome social exclusion.

7. Challenges to Social Security

Although all countries have some form of social security schemes covering some or most of the components of Convention 102, not all countries especially the developing countries, have comprehensive social security systems. The ILO estimated that only 20% of the world's population has adequate social security coverage. Achieving the noble vision of social security for all members of society is often beset with challenging obstacles which are briefly discussed below:

a. **Access and Coverage** – Access to social security is recognised and accepted by the international community of nations as a basic human right, enshrined in several international declarations and conventions and agreed to by the community of nation states. These declarations include the United Nations' Universal Declaration of Human Rights (Articles 22 and 25) and Conventions of the International Labour Organisation. The development of social security has also been supported by the vision and programmes of the United Nations and its operational agencies such as the World Bank. However, large sections of the population are without coverage and have no access to social security schemes. Significant groups that are not covered include:

    i. Migrant workers - Most social security schemes including pensions are not portable across countries. When workers move to work overseas, they stop contributing into their pension schemes. Such interruptions have significant impact on the adequacy of earnings-related pension benefits. Migrant workers may even be excluded from pension schemes in their host countries.

    ii. Informal sector workers and the self-employed - Pensions and other schemes which require contributions are designed for people in formal employment. Workers and their families in the informal sector have to opt for coverage on a voluntary basis. Hence, in countries where the informal sector is large, the extent of coverage is low. In addition, the extensive practice of business outsourcing and externalization of work processes has changed the character of the informal sector. Currently, the self-employed include highly skilled professionals with high income, particularly those engaged in e-commerce.

    Besides low coverage in terms of the number of people protected by the social security schemes, there could be gaps, as not all the nine areas (ILO's convention No. 102, 1952) of social security are covered by the system. For example, in many countries, there is no coverage against unemployment or provisions for child benefits.

b. **Sustainability** – Beginning from the 1980s, many countries encountered the problem of sustainability of its old age retirement pension schemes which was the result of the combination of over-generous defined benefits and the impact of demographic changes which witnessed a trend towards an ageing population. Old age retirement pension schemes involve long term liabilities which could last twenty years or more. Pension schemes based on social insurance and a pay-as-you-go (PAYG) system becomes unsustainable when rapidly declining mortality and fertility rates result in an increasingly smaller working population supporting an increasingly larger older group of pension recipients. Research has also shown that longevity has been consistently underestimated.

c. **Adequacy** – One of the principal objectives of social security is to ensure that members of society have an adequate income that could allow individuals and their families to live above the poverty line. However, low income countries may not be able to afford a minimum pension that is adequate for a decent standard of living. In many countries, the retirees receive pensions that are equal to a replacement rate of 25% to 35%. In some cases, old age pension benefits are not even pegged against inflation or changes to the cost-of-living. Under such situations, the adequacy of pensions is eroded over time.

Underpinning the issue of inadequacy are labour market factors related to wage levels, productivity and labour market policies on retirement age, worker employability and opportunities for training. Many countries do not have a stipulated minimum wage and amendments to labour rules such as retirement age often lagged behind changes in labour market conditions.

The adequacy of benefits is dependent upon the definition of wages as specified in the social security schemes. The worker's monthly salary comprises a fixed basic component and fixed or variable allowances. If the rate of contribution and benefits are based on a basic fixed wage or net wage less allowances, the resulting retirement benefits may be insufficient for a decent standard of living.

d. **Equitable – Redistribution and social pooling** – The notion of social equity and redistribution of income between the rich and the poor was incorporated into the design of social security schemes based on social insurance which pools society's resources for the benefit of every member of society. However, increasing pressures on Defined Benefits schemes and changing social attitudes in some countries have resulted in an increasing preference for Defined Contribution schemes based on individual accounts. Systems which are based on individual accounts do not involve redistribution and social pooling. However, in order to provide assistance to the poor, many countries have a separate means-tested social pension which is financed by tax revenue.

As a result of all these challenges, many governments have undertaken reforms to its social security systems. These reforms include the adoption of:

a. Multi-pillar systems for old age financial protection with a mix of social pensions;

b. Financial and non-financial Defined Contribution schemes with individual accounts;

c. Supplementary Private Retirement Schemes within a multi-pillar old age financial protection system;

d. Increasing the labour force retirement age in the context of declining mortality and fertility rates;

e. Adjusting parameters of social security schemes including benefits; and

f. Labour market reforms including productivity-linked and performance-linked wage systems.

In conclusion, social security is an internationally accepted instrument of the state for achieving inclusive growth, social justice and human development, as enshrined in the declarations of the United Nations and its agencies such as the World Bank and the International Labour Organization. Its noble vision of adding life to years is a challenge to humanity to serve its fellow members. Nevertheless, it would be naive to ignore the fact that there are also objections and arguments raised by opponents against the various forms of social security schemes and the need for social pooling. The existence of such resistance has contributed to the slow progress of extending coverage and protection. There is an enormous extant literature on this continuing debate which would be the subject for future discourse.

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Mr. Soh has served for more than 30 years in the Administrative and Diplomatic Service of the Government of Malaysia. Over a period of more than 30 years of distinguished public service, he has served in various positions of responsibility in charge of formulating and administering public policies and management of development projects in various ministries and agencies such as the Ministry of Human Resources, Ministry of Agriculture, Ministry of Trade and Industry, National Institute of Public Administration, and the Malaysian Administrative Modernisation and Management Planning Unit (MAMPU) of the Prime Minister's Department.

His responsibilities also involve interaction at the senior level with international organisations such as the ILO, APEC, IMF and the World Bank. He has represented the Government of Malaysia at the international level such as the ILO's Social Dialogue sessions, the APEC-HRD Ministerial and Working Group meetings and ASEAN Senior Labour Officials Meetings and as Board members of the International Social Security Association (ISSA) and the ASEAN Social Security Association (ASSA). Prior to his retirement from the government, Mr. Soh was a Director in the Secretariat to the Economic Council, Economic Planning Unit, Prime Minister's Department, Malaysia.

From 2004-2008, Mr. Soh served as the Chief Executive Officer of the Social Security Organisation (SOCSO), a RM16 billion social security fund. SOCSO administers the Employment Injury Protection Scheme and the Invalidity Pension Scheme for Malaysian private sector workers. These two schemes provide various types of pension, monetary and medical benefits to injured workers and their dependents as a result of employment injury, occupational diseases, invalidity and death. During his term of tenure, SOCSO launched the "Return-to Work" programme to rehabilitate injured workers so that they can re-enter the labour market to seek gainful employment.

Mr. Soh holds a PhD in Industrial and Business Studies from the University of Warwick, United Kingdom and an MBA in International Business and Finance from the Wharton Business School of the University of Pennsylvania, U.S.A. He is currently a member of the Education Service Commission.

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