How To Make Pensions Sustainable?

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Prime Minister Imran Khan while chairing a cabinet meeting on August 28th, 2020 said that the burden of pensions was fast becoming unsustainable and directed the Finance Ministry to evaluate alternate best possible options.

PIDE Policy Viewpoint "*The Pension Bomb and Possible Solutions*" critically evaluates the existing pension system and proposes some out of the box solutions to manage the crisis. The Viewpoint also mentions that unlike other countries Pakistan has not reformed its public sector pension system and maintains a pay-as-you–go (PAYG) defined benefits pension system. Pakistan practices a legacy pension system where pensioners are paid directly from the current revenues of the government. The pensions paid are treated as current expenditures of the government.

Federal government's pension expenditures are growing at around 25 pc annually, which cannot be funded by an economy growing at a much lower rate. The pension burden is therefore bound to grow, rather double every four years. In the fiscal year '19 federal superannuation and pension expenditures were almost 78 pc of the federal development expenditures (through the PSDP) and these increased to 87 pc in FY'20 The share of pensions as a percentage of current expenditures is also increasing overtime (for FY' 20 it stood around 7.6 pc).

Our estimates suggest that at the current pace of growth, pension expenditures will account for 56 pc of current expenditure by 2050. With this growth rate, the government will not have the funds for pension expenditure after 8-10 years. The situation is even worse in provinces and public sector enterprises; pension outlay in the Punjab budget equals 95 pc of provincial own revenues and pensions of Railways stand at 70 pc of its annual revenue.

The existing pension system of Pakistan is fragmented, non-transparent, understudied, and without any underpinning asset base. Federal government, provincial governments, armed forces, autonomous bodies and other government agencies are throwing forward the pension liability without any plan on how to meet their growing burden.

The present Defined Benefit pension system whereby the pensions are paid out the current revenues of the government is clearly unsustainable. The country should move to a Defined Contribution system whereby the employees themselves contribute towards their pension, the contributions are invested by a Pension Fund and the retirees are paid out of the accumulated assets of the fund.

An actuarial analysis is required to work out possible benefits/amount which the funds may offer to the retirees upon retirement. The world over pension funds are operated by trusts, private funds managers and even governments themselves. The employee contributions received by the pension funds are invested through stock exchanges and banks in equity and fixed income securities.

Thus the pension funds, besides paying pensions to retirees also play a pivotal role in providing for the financing requirements of the economy as well. Around 76 pc of assets in the US Stock Exchange are owned by the Pension Funds – this speaks of their role in providing for financing requirements in the economy.

Converting the existing Defined Benefit system to a Defined Contribution system would make the pension payouts sustainable in the long run. Pension Funds usually become operative after eight years once sufficient funds have been accumulated and investments have started generating revenues. It is therefore crucial that pensions are transformed into Contributory Funded Pension System sooner to allow time for these funds to become operational before the prevailing system runs out of the steam.

Ministry of Finance should urgently initiate an actuarial study to figure out the monthly contributions required to receive a handsome pension upon retirement. Future policies should be aimed at broadening participation of the general public in Pension Funds as seen in western countries.

In case of armed services all other countries facilitate soldiers for their second careers. This, on one hand, increases the contributions towards the pension fund, and the other hand delays payment of retirement benefits. This results in significant long-term savings at the national level that are mostly invested in the assets which fuel economic growth.

Under the present defined benefit (DB) pension system the pension is paid at the time of retirement. This restricts mobility across jobs because an employee who has served for certain length of time refrains from switching job to avoid losing pension benefits. If we adopt the defined contribution (DC) system then the employee can collect back his contributions with some return thereon while leaving well before the retirement age. This will allow people to move into jobs which satisfy their aspirations most and will also help attract qualified and talented individuals in public service at senior levels.

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