Flattening the Government Pensions Curve; Making them Sustainable

Mahmood Khalid & Naseem Faraz

Prime Minister Imran Khan while chairing a cabinet meeting on August 28 th , 2020 has said that the burden of pensions was fast becoming unsustainable and directed Finance Ministry to include eminent international experts in the Pay and Pension Committee to professionally evaluate the best available options[8].

Most of the countries around the world have pension systems which are intended to provide income support to those persons who have either lost earnings due to old age or become disabled due to some incident. Each pension scheme must result into adequate resource provision to meet the basic living standards and decreases difference in pre and post retirement earnings. This would help pensioners live a decent standard life post retirement as ability to earn reduces post superannuation. Funding these pension schemes can be through either forced savings or contribution by employers (including governments). Some argue it's the sole responsibility of the individual vis voluntary savings or the family vis family contributions or the State. However on thing is certain that changing demographics in terms of an ageing = population, weaker family support, increase health services and higher expected lives have created need for policy response to be dynamic.

PIDE Policy Viewpoint No 22.2020 ***"The Pension Bomb and Possible Solutions"*** critically evaluated the government existing Pension system for Pakistan and proposed some out of the box solutions to manage this crisis. Unlike other countries Pakistan has not reformed its public sector pension system and maintains a pay-as-u–go defined benefits type pension system, which has resulted in increase in unfunded liability for the government. Pakistan practices a legacy pension system where pensioners are paid directly from the revenues as part of the current expenditures. Government Pension expenditures are growing at around 25%, which cannot be provided from an economy growing at a much lower rate. The pension burden is therefore bound to grow, rather doubling every four-years. In the fiscal year 2018-19 federal superannuation and pension expenditures were almost 78% of the value for PSDP expenditures and it increased in FY 2019-20 to 87%(463,419 million Rupees and 533,220 million Rupees respectively). The share of pensions as a percentage of current expenditures is also increasing overtime (for FY 2019-20 it stood around 7.6%) and at the current pace it is estimated by 2050, pensions will account for 56% of current expenditure. The government will not have the funds for pension expenditure after 8-10 years.

9 Situation is worse in provinces and PSEs; pension outlay in Punjab Budget equals 95% of the revenues of the province and Railway pensions stand at 70% of its annual revenue.

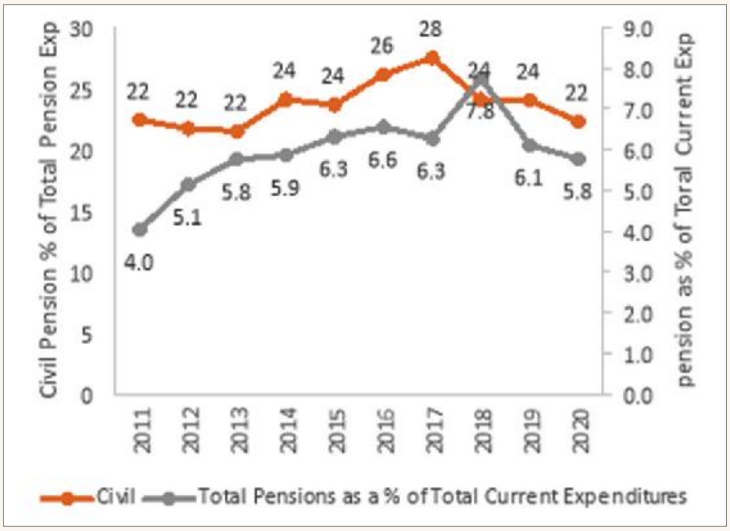
The PIDE Policy Viewpoint further states that the existing government pension system of Pakistan is fragmented, non-transparent, understudied, and without any underpinning asset base. Federal government, provincial governments, armed forces of Pakistan, autonomous bodies and other government agencies are throwing forward the pension liability without any plan on how to meet their growing burden. 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 reimbursement of retirement benefits. It results in significant long-term savings at the national level that are mostly invested in the assets which fuel economic growth.

For Civil services having a defined benefit (DB) system which is unfunded creates barriers for entry and exit into the civil services. Turnovers are not possible because of the unrealised pension benefits. If this system is converted into a defined contribution (DC) system then employees would have more leverage for switching across jobs and help attract qualified and talented individuals in various stages of service.

However an actuarial analysis has to be done for identifying the possible benefits which these funds can offer. World over these pension funds are operated by trusts, private funds managers and even governments themselves. These funds play a pivotal role in providing for the financing requirements of the economy as well. The role of Pension Funds in the economic growth can be assessed from the fact that around 76% of assets in the US Stock Exchange are owned by the Pension Funds[10].

PIDE Policy Viewpoint reports that converting the existing system to a DC system would make the pension payouts to be sustainable in the longrun. Pension Funds usually become operative after eight years once sufficient funds have accumulated and investments have started generating revenues. It is therefore of critical importance that pensions are transformed into Contributory Funded Pension System to allow time for these funds to become operational before the prevailing system runs out of the stream.

Ministry of Finance should urgently initiate Actuarial Study and identify the major issues with government pension schemes, EOBI, and VPS (Voluntary Pension System). Future policies should be aimed at broadening participation of the general public in Pension Funds as seen in western countries.



[8] Business Recorder, August 28 2020, Accessed at https://www.brecorder.com/news/40015014/pm-says-pension-burden-becoming-unsustainable

[9] Addressing the Pension Liability by Hasaan Khawar, April 18, 2018 https://tribune.com.pk/story/1681449/addressing-pension-liability

[10] *Research Journal of Finance and Accounting* www.iiste.org ISSN 2222-1697 (Paper) ISSN 2222-2847 (Online)Vol.7, No.16, 2016.