**Growing pension bill and economy**

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Like many other nations, Pakistan also struggles to manage ever-escalating pension bills. The existing pension scheme, designed as a non-contributory, defined benefit (DB)/pay-as-you-go (PAYG) system for providing financial security to retired public sector employees, is currently burdening the national exchequer. Therefore, growing pension costs necessitate transitioning from a non-contributory DB/PAYG pension scheme to a defined-contributory (DC) pension scheme. Such a scheme has long-term benefits, including slashing the government’s pension expenditure, expanding pension coverage to the non-regular workforce and growing the financial market.

For the past decade or so, the growing cost of the government, particularly the pension bill, has become an unwieldy constraint on our federal and provincial finances. State Bank of Pakistan (SBP), in its 2021 report, commented that the Federal Government’s pension expenditure is increasingly becoming unsustainable. When we look at the Federal pension bill, there has been a significant rise. Pension bills grew at a compound annual Growth Rate (CAGR) of almost 14 percent during 2012-23. The relative share of budgetary spending on pensions has risen from 4.81 percent to 5.53 percent during the previous decade (2012-2023). Meanwhile, the pension bill accounted for around 8.5 percent of the total revenues collected during the same period. As regards provinces, there is quite a different story. In its 2020 report, the World Bank stated that pension bills grew from 6.7 percent and 4.5 percent of the provincial revenues in Punjab and Sindh to about 12 percent of the local revenues during 2012-19 (Bank 2020). Likewise, official reports of the Khyber Pakhtunkhwa (KP) government reveal that pension payments grew from PKR 11 billion in 2010-11 to PKR. 84 billion in 2020-21, showing a 7.64 times increase in nominal terms (F. D. GoKP 2018, F. D. GoKP 2021). In his recent article, Mr TaimurJhagra notes that Pakistan’s cumulative pensions bill grew 50 times in two decades, doubling roughly every four years (Jhagra, 2023). Likewise, in its 2020 report, the World Bank made actuarial projections to suggest that salary and pension costs will persistently grow, crowding out other public expenditures in the coming years (Bank 2020).

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Factors responsible for the growing pension bill include the increasing size of the government, a disproportionally high share of non-gazetted employees, i.e. 95.3 percent of total Federal Government (FG) employees (SBP 2021), unfunded nature of pension, high replacement rate due to early retirements, improving life expectancy and increasing headcount of pensioners, retrospective increases in pensions, commutation and restoration facilities offered to pensioners and generous survivorship benefits.

One implication of ballooning pension bills is the squeezing development budget because all other heads, such as debt servicing, defence expenditure, etc., are more flexible. Besides this, excessive public borrowing reduces the private sector’s ability to borrow from the financial industry, and a growing fiscal deficit leads to currency depreciation, rising inflation, growing interest rates and eroding household purchasing power. Furthermore, pension bills as a percentage of total expenditure (both at the Federal and Provincial levels) exceeded spending on health and education in 2020 (SBP 2021).

Recent developments also anticipate the future scenario. KP government has introduced a contributory pension scheme for its employees since 1st July 2022. Likewise, former Federal Finance Minister Mr.Ishaq Dar, on 24th June 2023, announced pension reforms (Dar 2023), which bar retired officers (BS-17 & above) from drawing multiple pensions. Retired officers who get re-employed must opt for either the pension or the salary of a new job. Dependents of a pensioner are eligible to receive a family pension for a maximum period of 10 years after the death of a pensioner and his spouse.

Accelerated public sector spending on non-development segments is worrisome. The same is true for the pension bill. Alternatively, improvements in the pension framework can help create necessary fiscal space for development needs and manageable future pension payments. However, this would require resolute pension reforms such as gradually phasing out the existing revenue-funded DB/PAYG system and introducing the DC pension scheme. This will accrue certain benefits, such as the transition from a DB pension system to a DC pension system, which will gradually reduce the fiscal liability of the government. The defined-contributory (DC) pension system will expand the country’s capital markets by instituting pension fund holdings. Workforces not covered by public-funded pension schemes would also have the choice to opt for voluntary pension schemes managed by third-party fund managers. Pension funds may be used to buy stakes in state-owned and private business enterprises, helping them grow further.

The way forward includes long-term and short-term reforms. Short-term reforms include that early retirements may be discouraged and late retirements incentivised. Superannuation age may be increased. Retrospective pension increases may be stalled to avoid exponential increases in pension obligations. To prevent early retirements, commutation and restoration benefits may be streamlined by reducing variance in the commutation factor and rationalising the age profile. To finance the pension bill for the existing DC scheme, the government may consider levying a progressively increasing pension contributory tax on its employees (Jhagra, 2023). The survivorship benefits may be rationalised to allow entitlement only to the widow, parents and minor children of a deceased employee/pensioner.

The long-term reforms include the existing non-contributory DB/PAYG pension scheme, which needs to be progressively phased out and substituted with a DC pension structure wherein retirement benefits are systematically linked with pre-retirement contributions. The government may introduce transition pathways for switching to the DC pension scheme for early career employees. New employees must be covered under the DC scheme. An enabling environment should be created before switching to a DC pension system. In this regard, a regulatory framework would be needed to protect pension-fund contributors from market risks/fraudulent practices. Public sector employees may be educated about the strengths and weaknesses of both existing and proposed pension schemes. Capacity building and incentivisation of the private sector to establish pension holdings besides diversification of the financial market by allowing international fund managers/pension holdings to accrue the desired dividends.

A concerted effort towards comprehensive pension reforms is imperative to confront the substantial burden of Pakistan’s pension bill effectively. These reforms should meticulously balance the need for reliable retirement security for public employees with the broader goal of sustaining the nation’s fiscal health and economic progress. Through such strategic measures, Pakistan can navigate the complex dynamics of its pension system, ensuring both immediate relief and long-term sustainability.

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