

SOCIAL PROTECTION AND JOBS

2019 CORE COURSES

OCT. 28–NOV. 8 | WASHINGTON DC



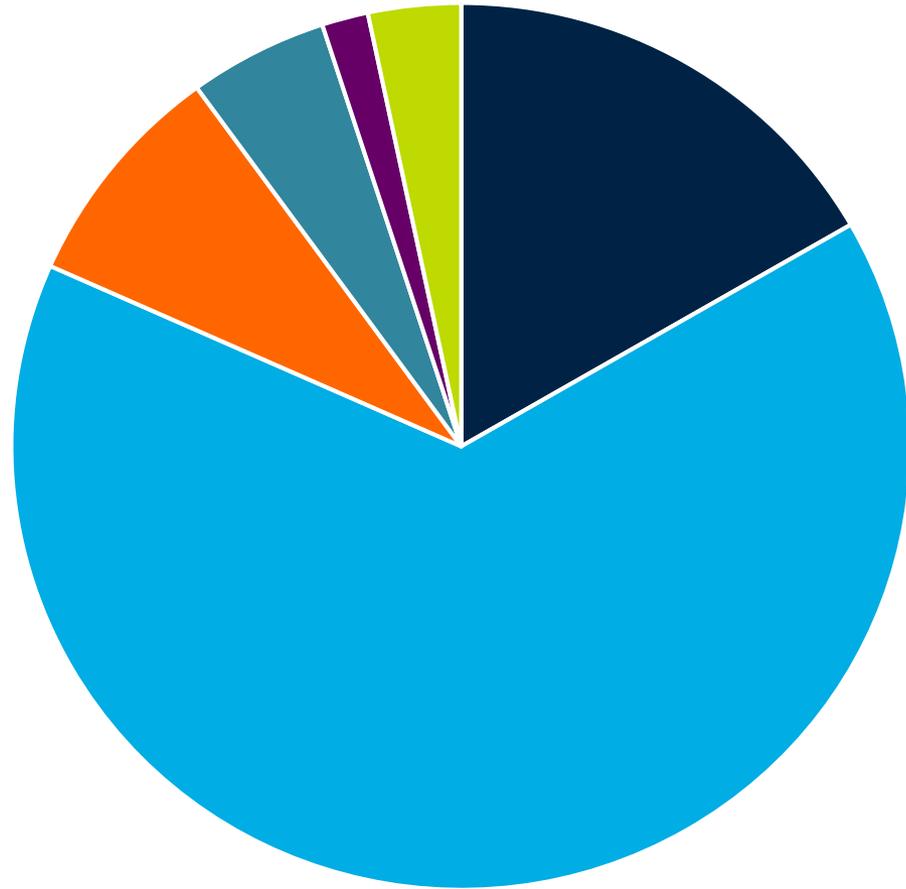
Pension Problems in Youthful Africa

Session 1: November 6, 2019

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Pensions Core Course

As anywhere else, pension schemes come in all shapes and sizes



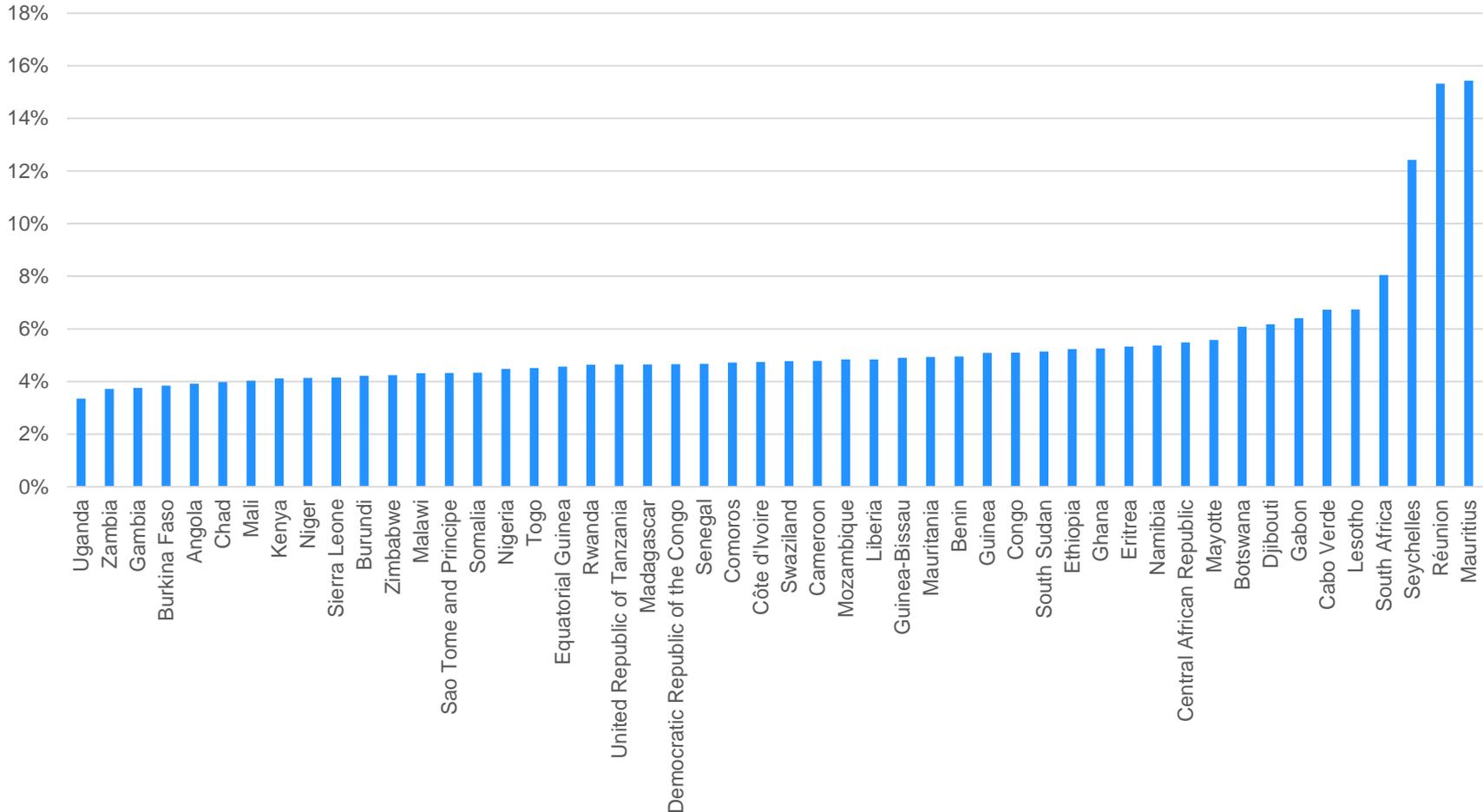
■ Social Pension ■ PAYG DB ■ FDC ■ FF DB ■ Hybrid DB-DC ■ Point Systems

Most countries in Sub-Saharan Africa have separate civil service systems

- **11 countries have an integrated pension system:** *Cape Verde, Central African Republic, Chad, Ghana, Liberia, Nigeria, Rwanda, Sao Tome e Principe, Seychelles, Sierra Leone, and Zambia.*
- **34 countries have a separate pension system** for public sector workers.
- In some countries public sector workers are also covered by some type of social pension in addition to their civil service pension: *Botswana, Lesotho, Mauritius, Namibia, Seychelles, Swaziland.*

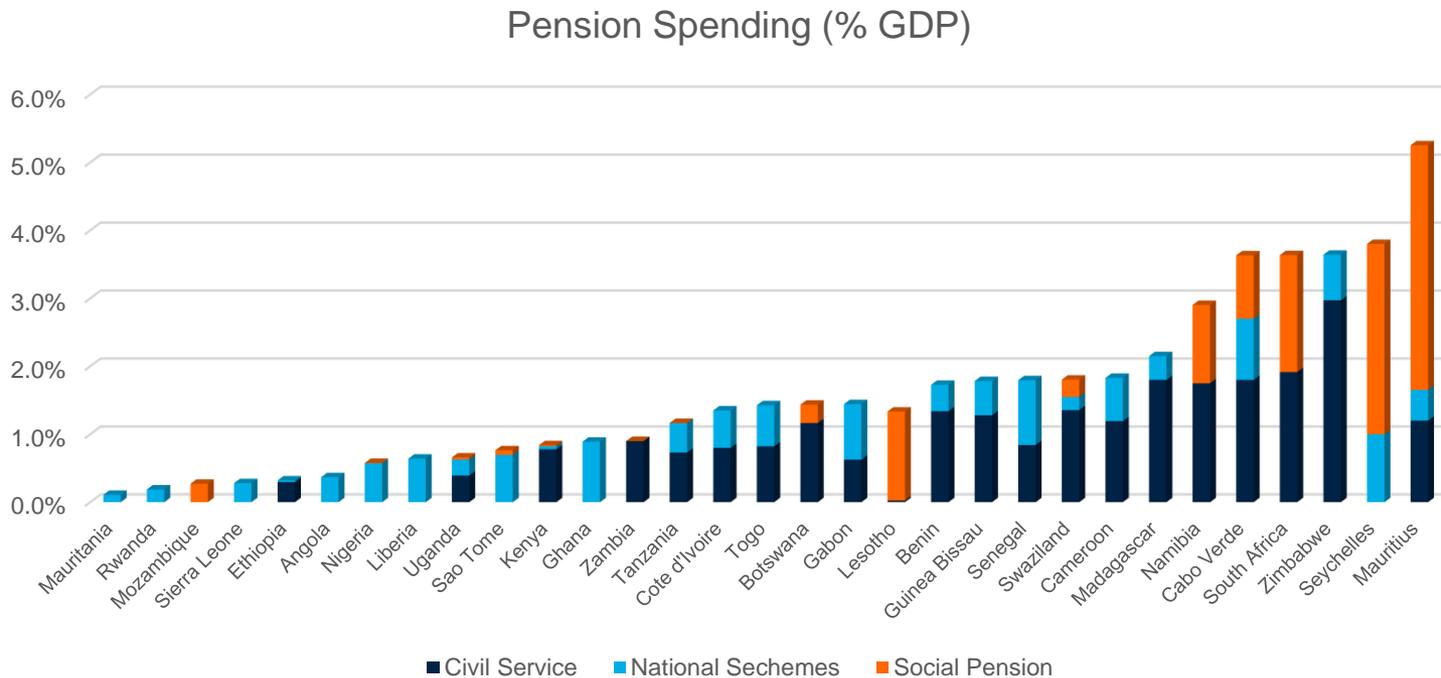
On the surface, African pension systems look to be in good shape

Africa is a young continent



Rosy Picture

- ❑ Spending levels as a percentage of GDP are relatively low
- ❑ Almost all national pension schemes are running surpluses

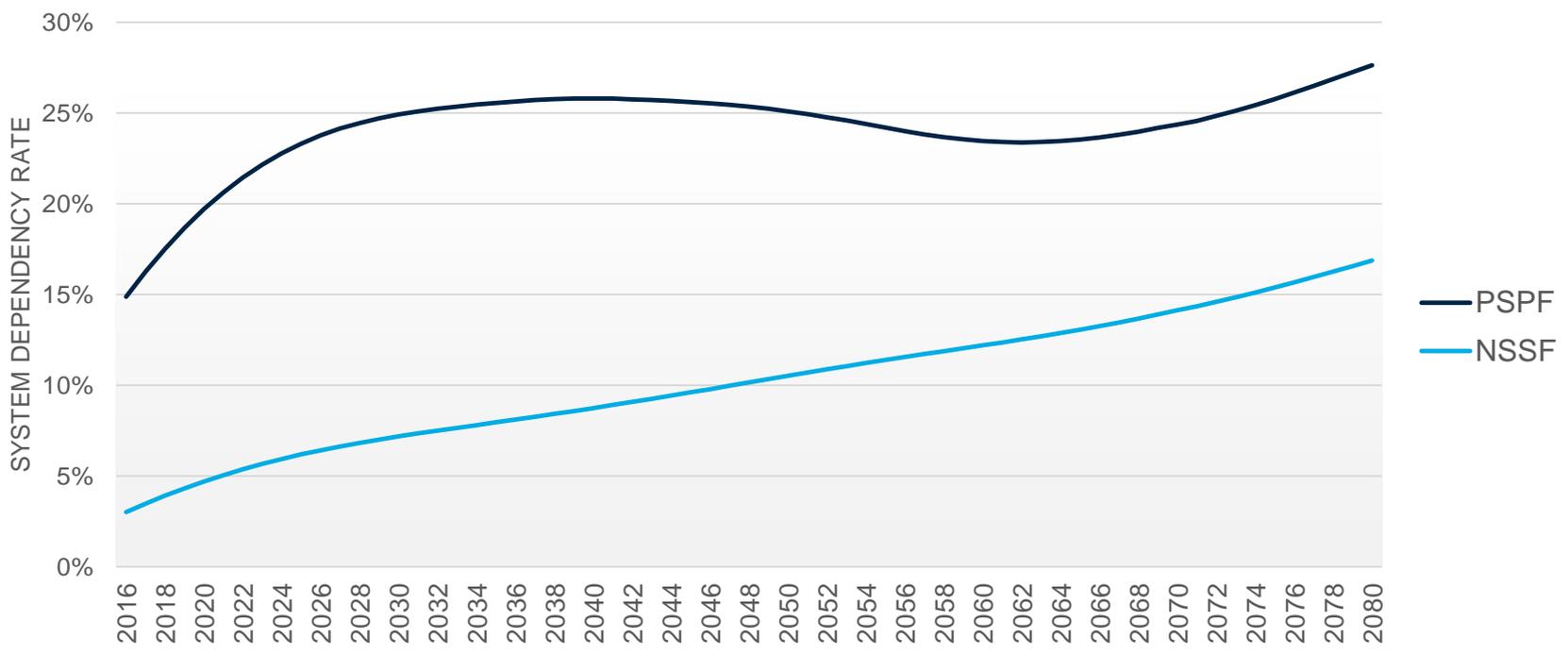


Reality is more complex

- ❑ For countries with separate civil servant schemes or separate schemes for public enterprise workers
 - Demographics of these schemes are far different from general population
 - Not only are these schemes older, but life expectancy of participants is much longer

System dependency rates are relatively higher for civil service schemes

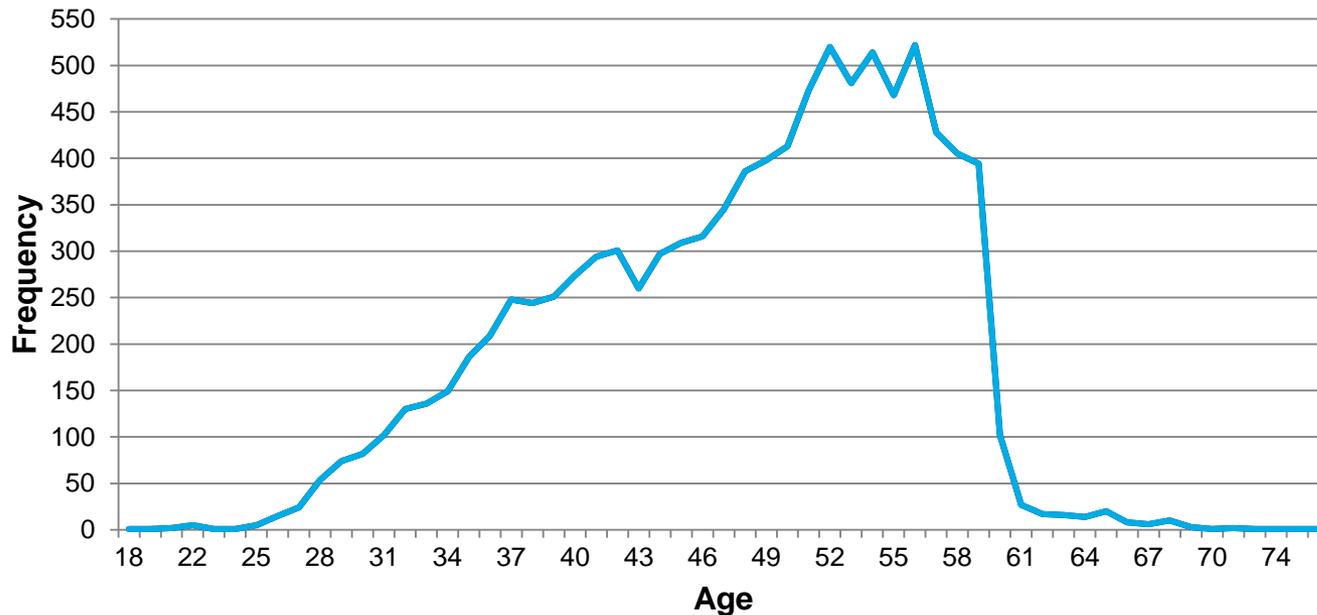
Demographic structure of national and civil service pension schemes in an African country



Many public employees are expected to retire soon to further worsen system dependency rate

- Age distribution of existing public employees is skewed

Age Distribution of public sector employees in an African Country



Even private sector systems have longer-run issues

❑ Systems are immature

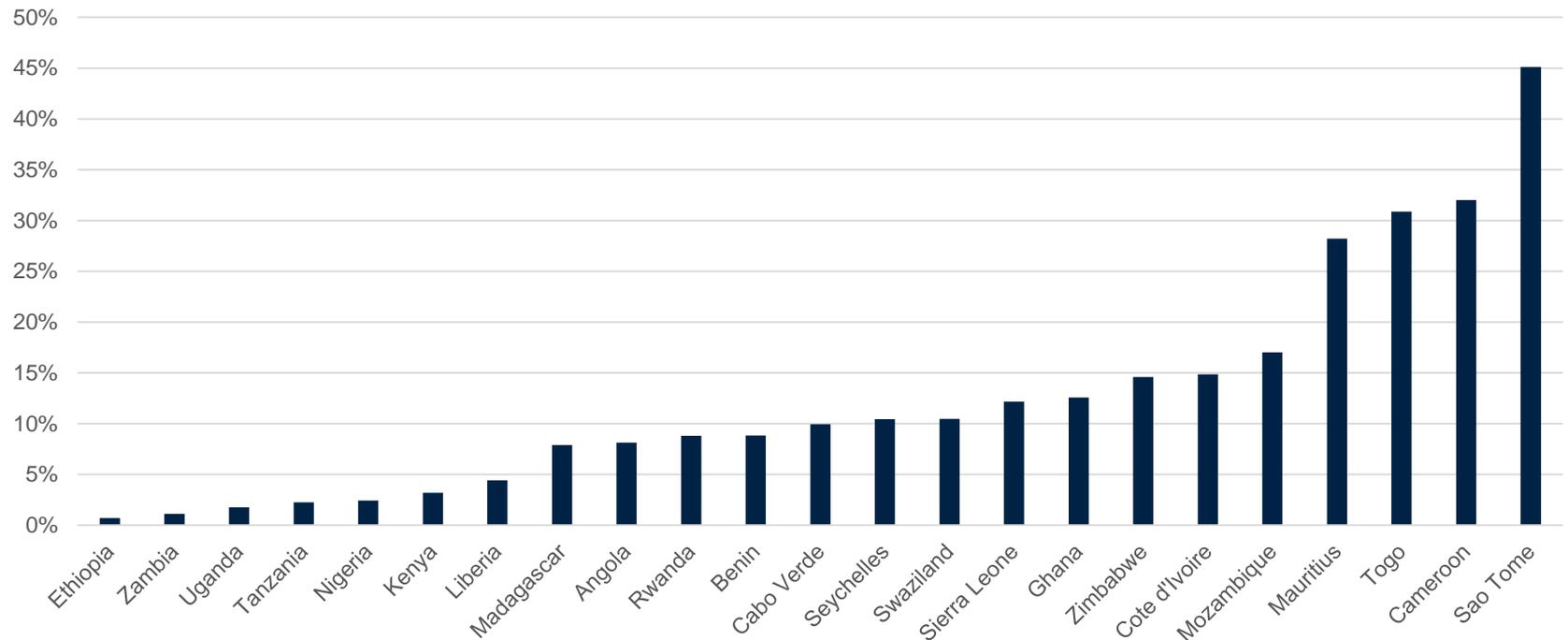
- Initially systems take in contributions, but pay few benefits because people reaching retirement do not have enough contribution years to qualify for a pension
- Maturity will take place when individuals with full working career of contributions spend their full retirement period with pensions

❑ Coverage is low

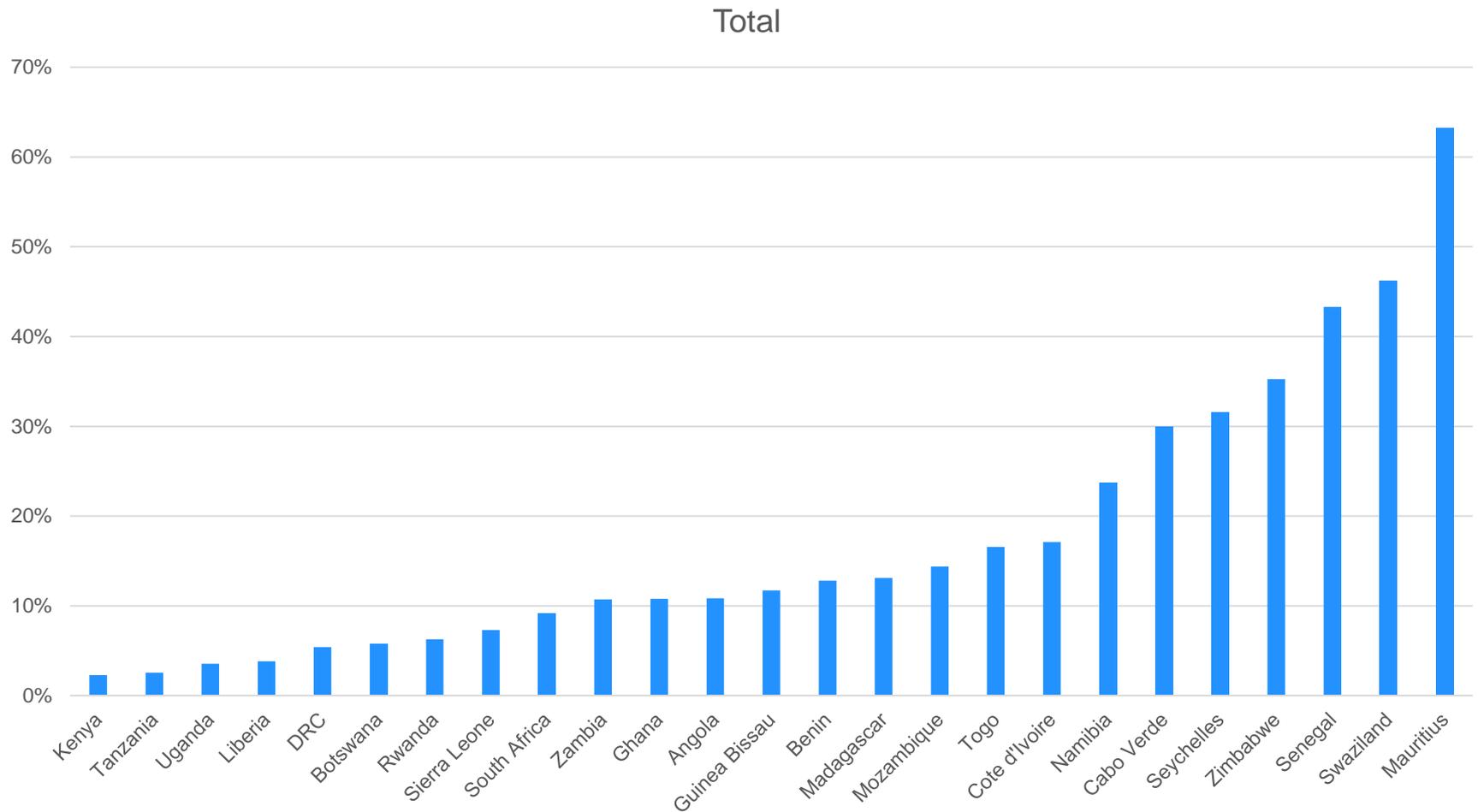
National Pension Schemes are immature

□ Fewer beneficiaries per contributor

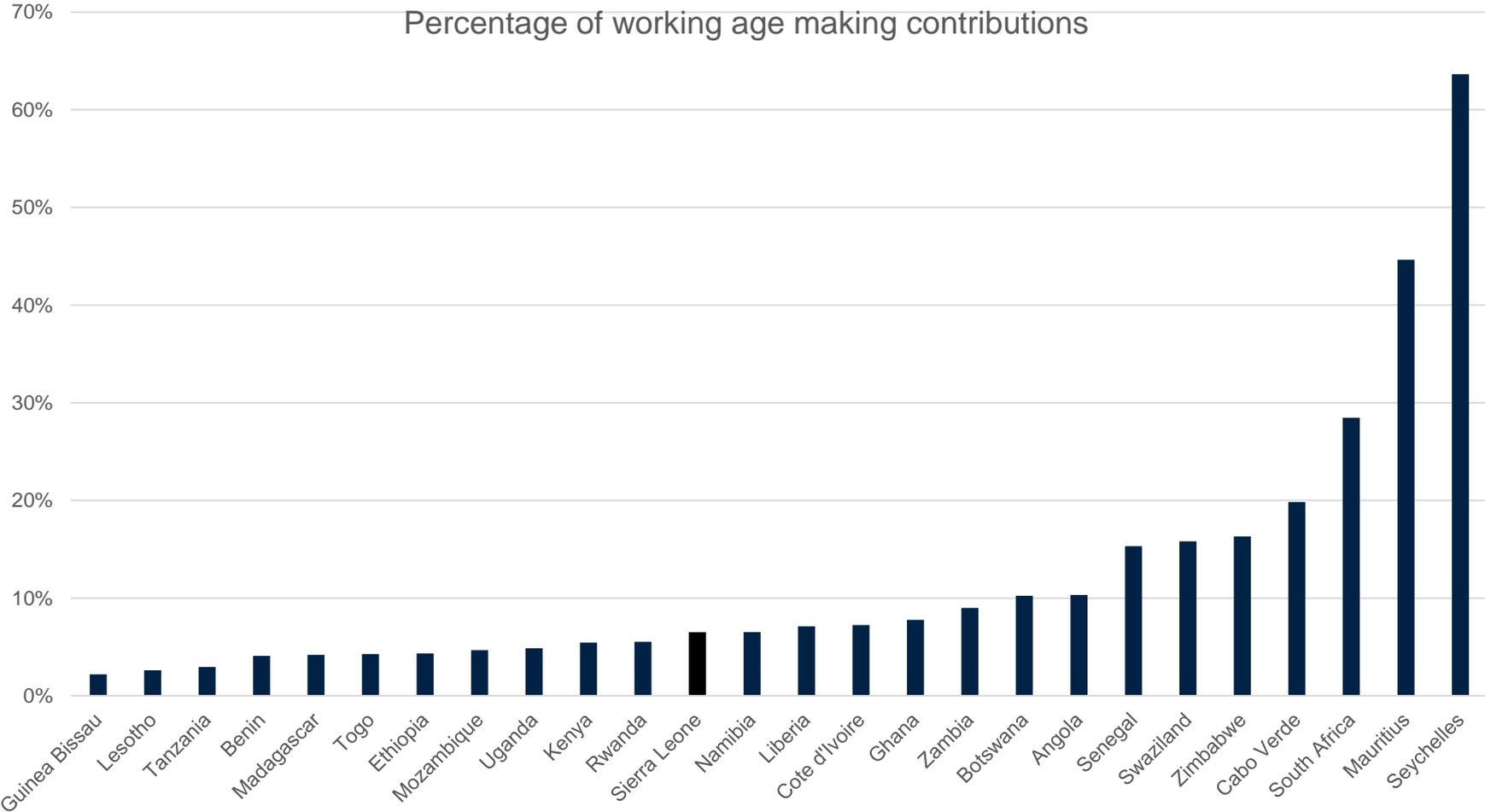
Number of Beneficiaries per Contributor



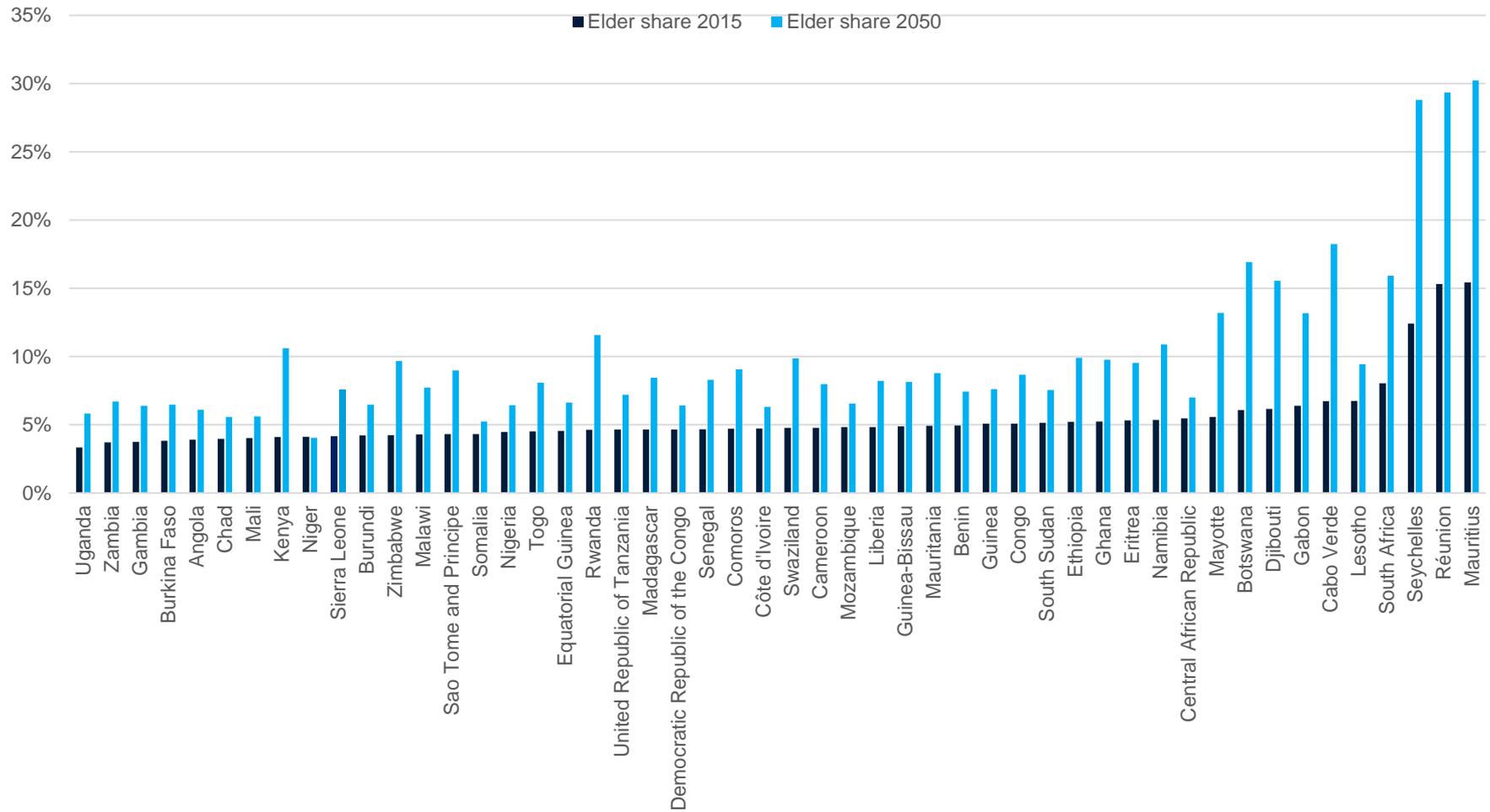
Few of the elderly are receiving pensions



And relatively few workers are making contributions



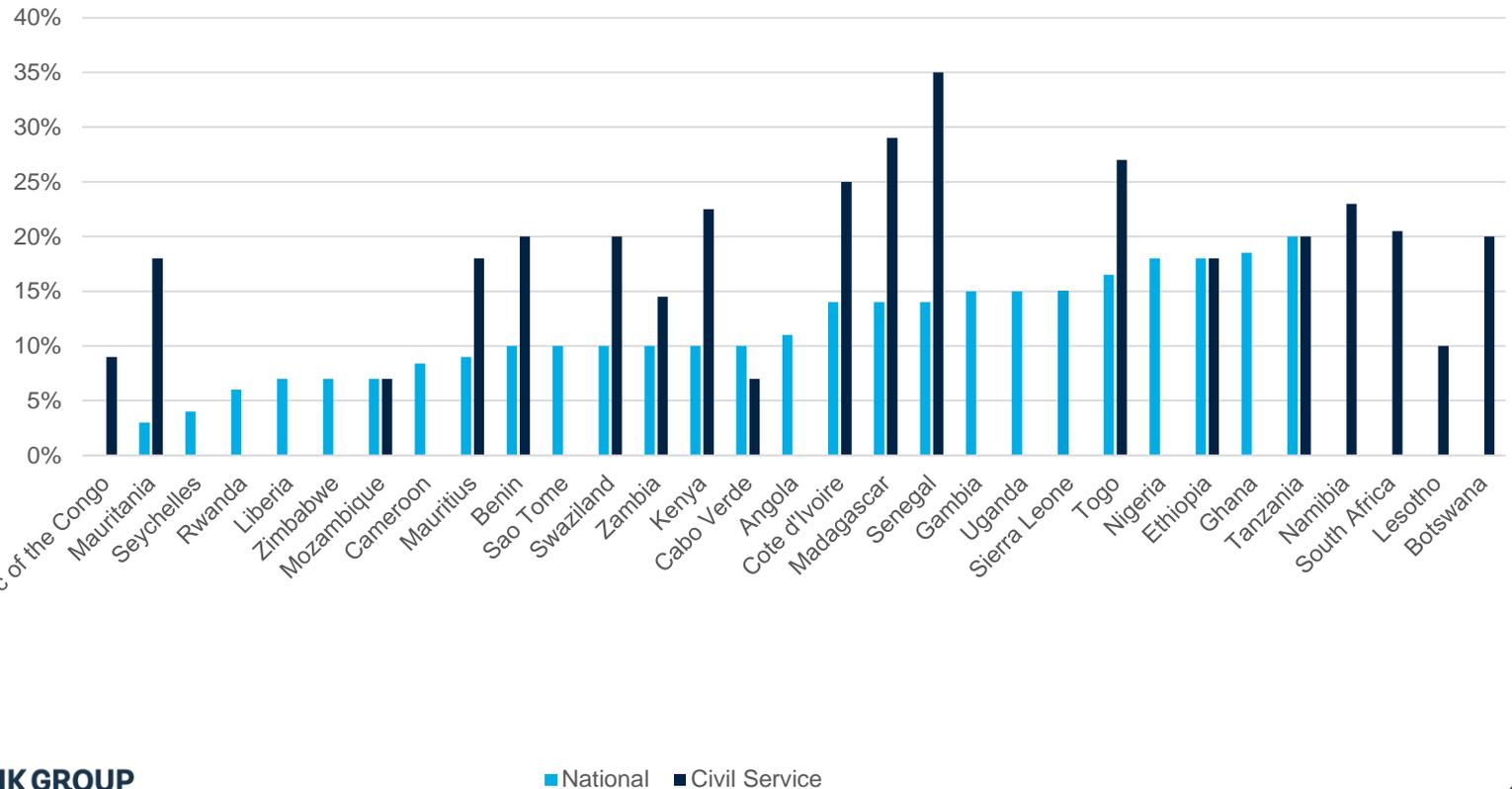
Share of elderly population will double on average between 2015 and 2050



Very high contribution rates

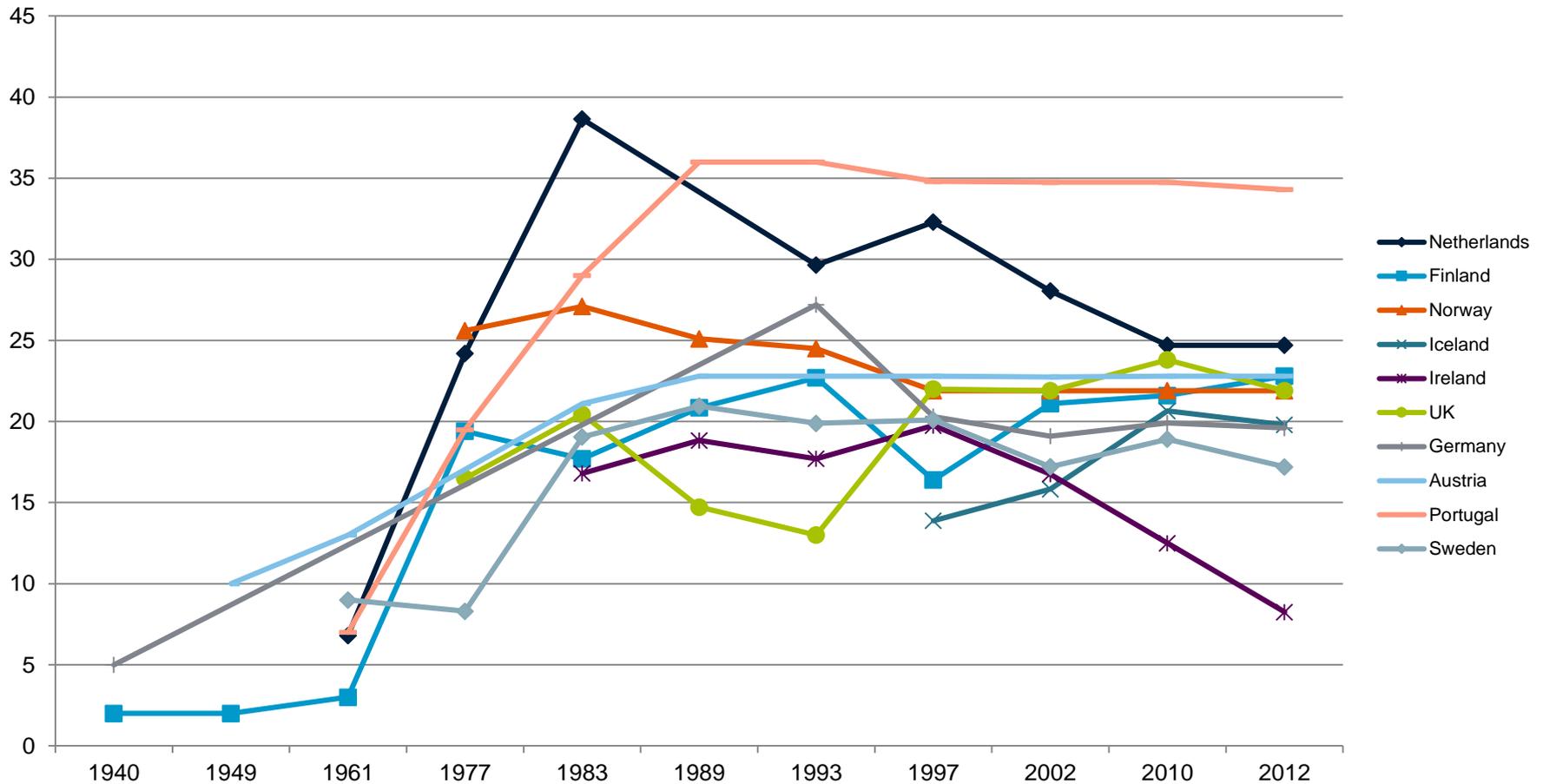
- Desire for actuarial balance has led to higher contribution rates than desirable given young demography

Contribution Rates as % of Wage



In European countries contribution rates grew as population aged

High Income Moderate Spenders



High contribution rates are problematic

❑ Disadvantages of high contribution rates

- Limit growth of formal sector
- Discourage labor-intensive growth
- Lower global competitiveness

Combination of high contribution rates and youthful population leads to large surpluses or reserves

- ❑ Pension fund becomes the largest financier in the country – politically powerful
- ❑ Symbiotic relationship with government
 - Governments use pension fund to advance projects for which they otherwise do not have financing
 - Governments frequently do not pay their required contributions to the pension fund
 - Governments of course rely on pension funds to buy their securities
 - Government loses ability to enforce governance and accountability

Many earn negative real rates of return on their investments

- ❑ Lack of marketable securities leads to investments in real estate and non-liquid investments
- ❑ Reluctance to invest abroad
- ❑ Pressure to invest in “socially targeted” projects

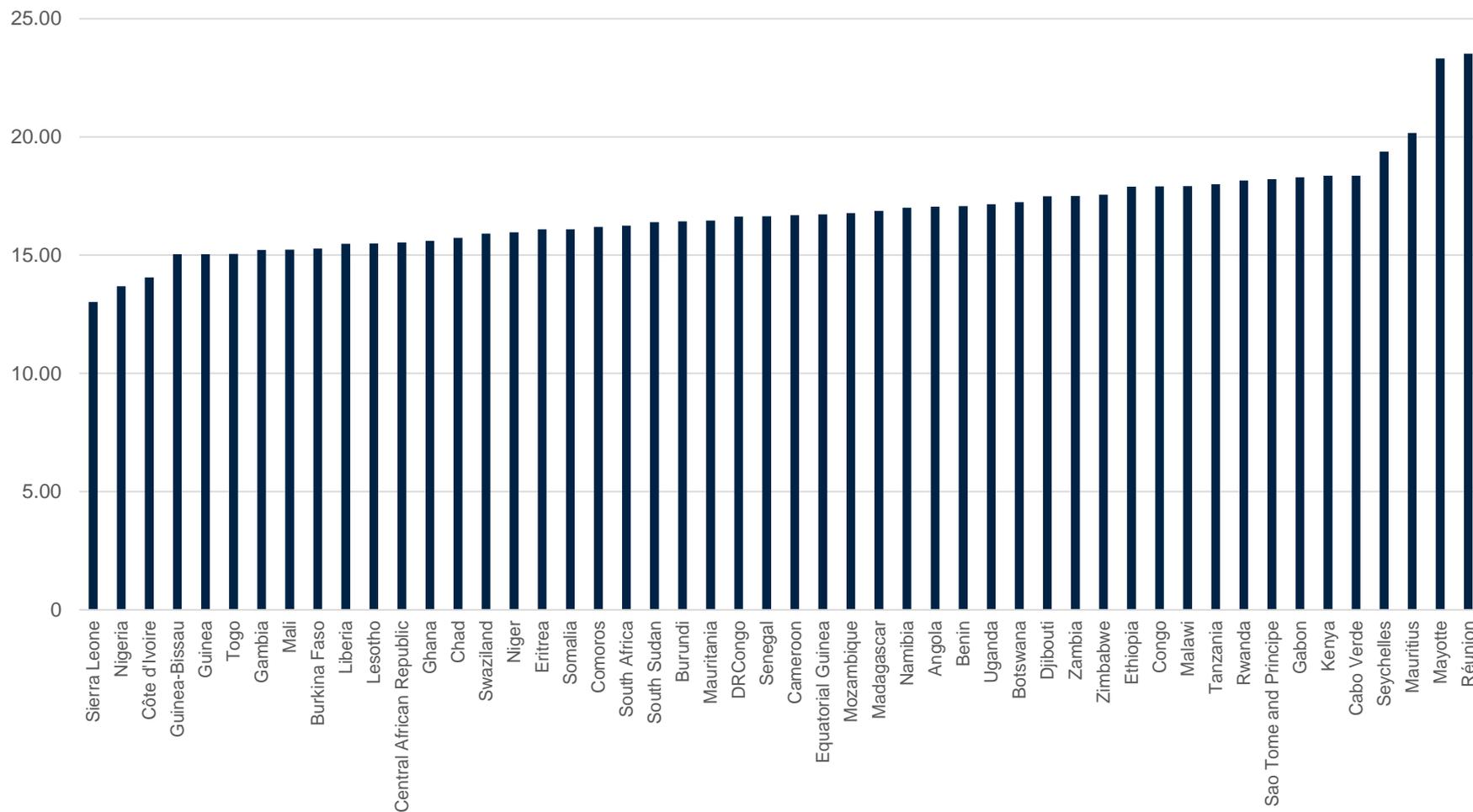
Pension funds spend an enormous amount on administrative costs

- ❑ Typical developed country system spends no more than 1-2% of contribution revenue on administrative costs or 1% of wage
- ❑ Recognize that there are far fewer economies of scale and potentially higher costs
 - Could justify administrative costs 3 or 4 times higher than in developed countries
- ❑ In reality, range from between 14% of contribution revenue to as high as 70%
- ❑ Lack of accountability

Benefits are also more generous than is sustainable

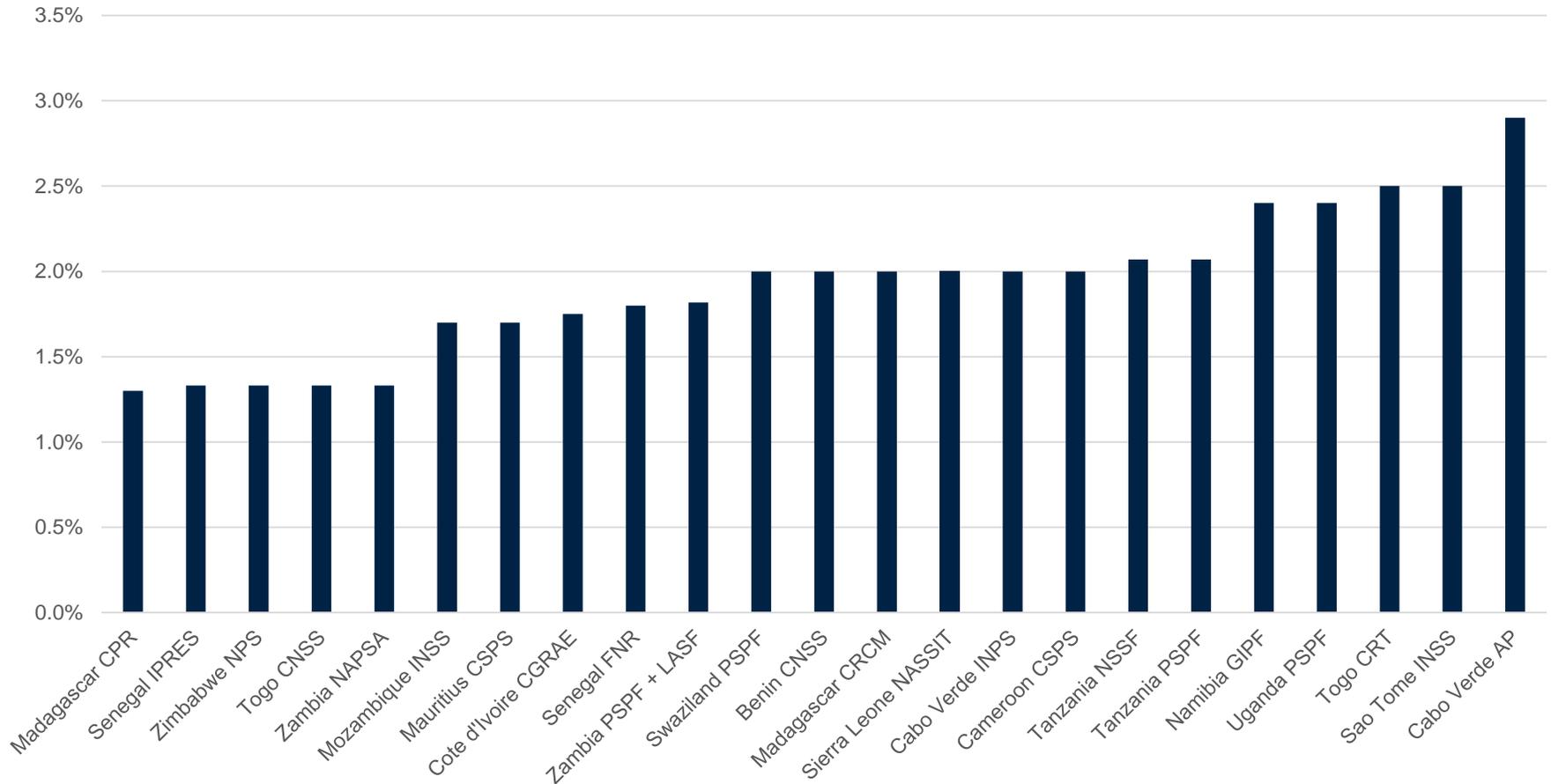
- ❑ Hard to resist demands for higher benefits when the pension fund is flush with reserves
- ❑ Often long duration of benefits due to early retirement
 - People should expect to spend no longer than 15 years in retirement
 - Civil servants actually do not want to retire
- ❑ Higher accrual rates than will be affordable in the long run
- ❑ Benefits not related to lifetime earnings, but focused on earnings of last few years – incentive to underreport earnings in early years and over-report in last years

Life expectancy at age 60 on basis of national statistics

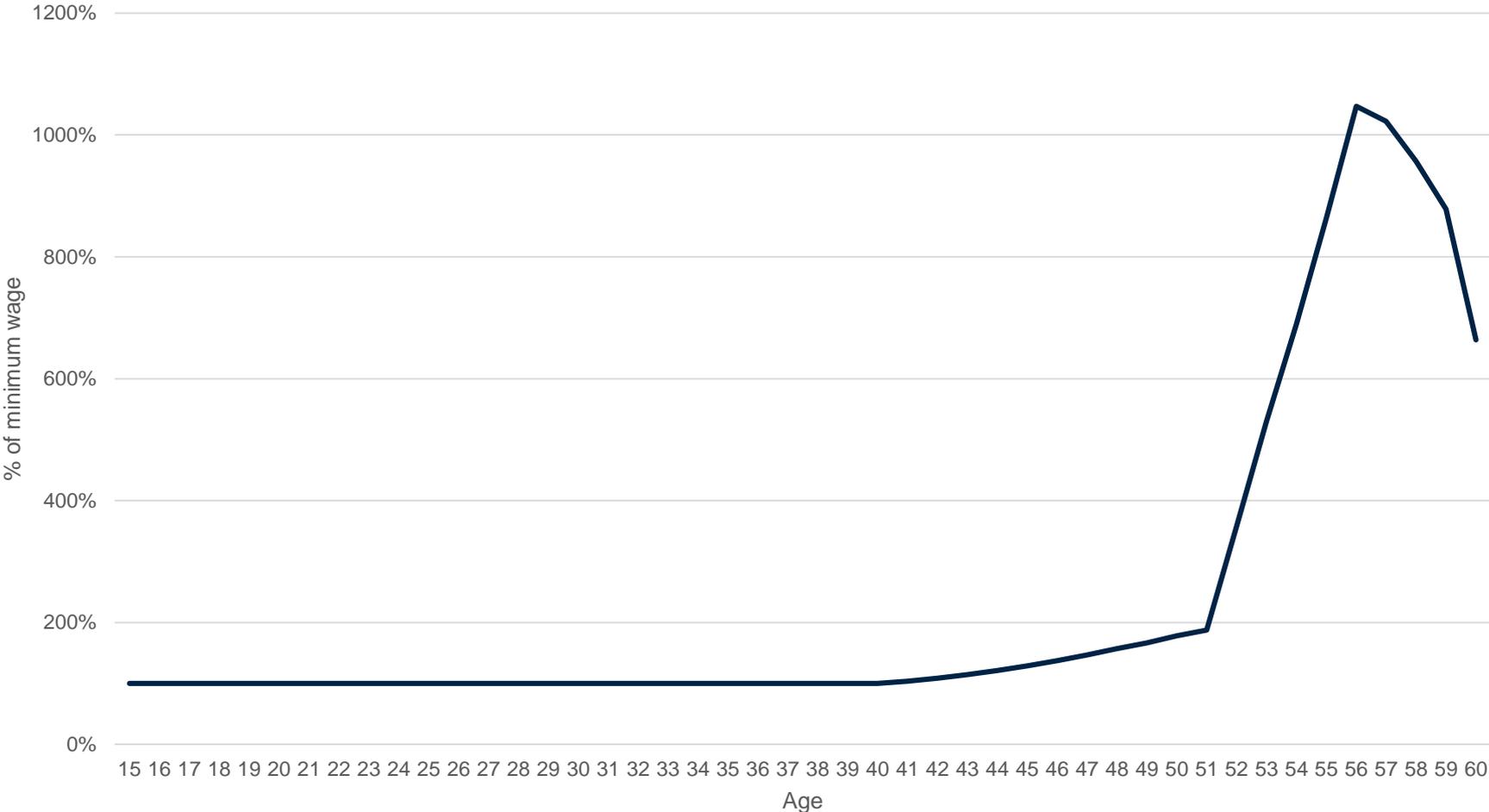


Current accrual rates will not be affordable in the long run

Accrual rates



Wage patterns when only last few years covered



Other issues with benefits

- ❑ Lack of legislated indexation leaves retiree with uncertainty
- ❑ Often include step accrual rates, with higher benefits given for first 15 years than for subsequent years
 - Or high minimum pensions
- ❑ Commutations result in low benefits over retirement life
- ❑ Civil service benefits sometimes based on base salary, rather than salary plus allowances, resulting in very low pensions compared to working age income
- ❑ Benefits for survivors not always designed to protect surviving family members
- ❑ Use of gratuities fairly common in addition to pension

Reform challenges for African countries (generic)

- ❑ Universal pension schemes
 - Identifying eligible beneficiaries and removing them upon death
 - Maintaining sustainable benefits
- ❑ Defined contribution schemes
 - Improving governance
 - Increasing investment instruments for funds to invest in
 - Enhancing supervisory capacity to ensure that funds are safe
- ❑ Defined benefit schemes
 - Maintain contribution rates at levels needed to pay current benefits until there are investment instruments which can reliably earn positive rates of return
 - Keep benefit design simple
 - Provide benefits of 1-1.5% of average lifetime salary per year of contribution
 - Inflation index benefits after retirement
 - Adjust retirement ages targeting life expectancy of 15 years after retirement for covered group
- ❑ Consider integration of multiple schemes for better labor market mobility

Increasing number of countries are looking at ways to extend pension coverage to informal sector

- ❑ Coverage of contributory pension systems remain limited to the formal sector
- ❑ Several high-middle income countries extended coverage through social pensions but at a high cost
- ❑ Informal sector is large in Africa
 - ❑ Informal jobs comprise more than 90% of total employment in some countries
- ❑ Most countries in Africa are likely to have large informal sectors for many years to come

Areas that need particular attention (1)

- ❑ Important to look at existing financial inclusion landscape (microfinance sector, mobile money, etc)
- ❑ Voluntary, DC scheme- individual accounts
- ❑ Identify main target groups
 - ❑ Household survey data analysis to get an indication of target groups
Additional surveys, focus group analysis
- ❑ Use technology to reach geographically dispersed informal sector
 - ❑ Mobile money could be considered
- ❑ Link long term old age savings with short term products; flexible product design
 - ❑ Health, microfinance
 - ❑ Short term savings account along with long- term savings for old-age

Areas that need particular attention (2)

- ❑ Professional management of savings
 - ❑ Maximize returns
 - ❑ Minimize asset management costs
 - ❑ Regulation
- ❑ Appropriate administration platform
 - ❑ Link with ID
 - ❑ Budget for start up costs, staffing
- ❑ Design the pay-out phase from the start
- ❑ Effective communications strategy and an implementation plan
 - ❑ Work with existing partners to build trust
 - ❑ Be clear on what benefit is being promised at eligibility age
- ❑ Important to pilot test various approaches