



Punjab Pension Reform Plan

**FINANCE DEPARTMENT
GOVERNMENT OF THE PUNJAB**



Table of Contents

A. Executive Summary	2
B. Introduction	3
C. Overview of the Current Scheme	4
D. Actuarial Analysis of Pension Liabilities of Government of Punjab	5
E. Regional Comparison of Pension Schemes	6
F. Weakness of Current Pension Scheme	6
G. Longevity and Associated Fiscal Risks.....	7
H. Minimum Pension Increases	7
I. In-Service Death Benefits Policy through Financial Assistance Package	7
J. Proposed Pension Reforms.....	9



A. Executive Summary

The Government of Punjab currently offers a Defined-Benefit (DB) Pension Scheme for its permanent employees under section-18 of the Punjab Civil Servants Act, 1974 (the Act). The pension scheme is being managed on a ‘pay-as-you-go’ basis, i.e. pension payment during a year is made out of that year’s revenues regardless of the time of accrual of liability. Pension has become one of the largest expenditures of the Government of Punjab’s Current Revenue Expenditure. The exponential growth of pension expenditure has emerged as a key fiscal risk consequently.

2. The Provincial Cabinet, in its 45th meeting held on 14.06.2022, has already approved Fiscal Risk Policy Framework which appropriately recognizes pension payments as a major challenge to the provincial finances unless reform measures are undertaken. In addition, Public Financial Management (PFM) Reforms Strategy of the Government of Punjab, under its Pillar 3, stipulates establishment of a mechanism for identifying fiscal risks along with their proactive management and, *inter alia*, mandates development and implementation of an alternative pension scheme in this regard.

3. Punjab’s pension regime has gone through several changes, liberalizing the scheme, over the years which have gradually rendered the scheme fiscally unsustainable. Pension expenditure has risen rapidly over the last decade making it a key fiscal risk for the Government of Punjab. The ratio of pension expenditure to General Revenue Receipts has increased from 6.8% in FY10-11 to 14.9% in FY20-21. The continuous increase is likely to further restrict fiscal space for other essential expenditures essentially on service delivery and development. Unless addressed, the current pension regime along with its expenditure will become a steep challenge in the effective management of provincial finances.

4. It is in realization of this challenge that Punjab Civil Servants Act, 1974 has been amended (w.e.f. 29.10.2021) to fix the minimum retirement age at 55 years, subject to completion of 25 years of service. In continuation of this effort, Finance Department has undertaken a comprehensive review of the situation and prepared a comprehensive Pension Reform Plan which shall govern the transformation of pension regime of the province.



B. Introduction

5. Punjab's pension regime has gone through several major and minor amendments over the years impacting both the amount of entitlement, types of entitlement and number of entitled beneficiaries. These changes have gradually rendered the scheme fiscally unsustainable. A snapshot of major changes brought through gradual concession in the pension rules is as under:

- a. Dearness allowance was included in the definition of average emoluments (1977)
- b. Pension shall be calculated based on last pay drawn (1986)
- c. Rate of Gratuity increased from 1 to 1.5 for invalidation and in service death (1977)
- d. Family pension for the maximum 10 years at 50% of gross pension (1977)
- e. Family pension admissible to widow for life or until remarriage (1983)
- f. Gratuity being 25% of full pension is abolished and commutation is allowed instead (1986)
- g. Family pension to sons until they attain the age of 21 (1983) changed to 24 year of age (1989)
- h. Family pension to unmarried daughters until they married or attain the age of 21 (1983) age limit replaced with the attainment of regular source of income (1989)
- i. Family pension to physically/mentally disabled children will be admissible for life (1989)
- j. Restoration of commutation is allowed for family pension (1994)
- k. Family pension rate increased from 50% to 75% (2010)
- l. Widowed/divorced daughter made eligible for family pension for life or till re-marriage (2015)

6. Pension expenditure has risen rapidly over the last decade making it a key fiscal risk for the Government of Punjab. Pension expenditure has grown at a Compound Annual Growth Rate (CAGR) of 21.5% over the last ten years since FY10-11. General Revenue Receipts have grown by 12.3% during the same period. Resultantly, ratio of pension expenditure to General Revenue Receipts has increased from 6.8% in FY10-11 to 14.9% in FY20-21. If pension expenditure continues to grow at this rate, it is projected to reach about 18% of the revenues by 2030 and approximately 22% by 2040. If we analyze pension expenditure as percentage of current expenditure, the situation becomes more worrisome. The consistent increase is limiting and will continue to constrain fiscal space for other essential expenditures essentially on service delivery and development.

Pension Expenditure - Comparison with Current Expenditure & Revenue

PKR Billion

Year	Annual Pension	Current Expenditure	Pension Expense as % of Current Expenditure	General Revenue	Pension Expense as % of Revenue
FY10-11	36.4	370.0	9.8%	539.0	6.8%
FY11-12	50.1	444.0	11.3%	606.0	8.3%
FY12-13	67.4	534.0	12.6%	703.0	9.6%
FY13-14	76.4	569.0	13.4%	815.0	9.4%
FY14-15	88.8	670.0	13.3%	902.0	9.8%
FY15-16	113.8	730.0	15.6%	1,108.0	10.3%



FY16-17	141.0	900.0	15.7%	1,405.0	10.0%
FY17-18	172.9	961.0	18.0%	1,387.0	12.5%
FY18-19	205.2	1,129.0	18.2%	1,426.0	14.4%
FY19-20	233.1	1,258.0	18.5%	1,477.9	15.8%
FY20-21	255.7	1,314.9	19.4%	1712.7	14.9%

7. The sustainability of both basic salaries and pensions are also of considerable concern with the cost of pensions projected to soon overtake basic salaries as a proportion of public expenditures. Notably, basic salaries and pensions are projected to increase in Punjab to over 50% of provincial revenues by 2060. Accrued pension liability of the Government of Punjab is **Rs 6,558.509 billion** as of 30th June 2019. It was previously assessed as Rs 3,866.458 billion on 30th June 2015. Major reasons for such a huge jump in pension liabilities are (in order of financial impact):

- Large benefit increases in real terms each year, linked to pay (perpetual increases)
- Decision of providing retroactive restoration of commutation benefits
- Increase in family benefits / life expectancy
- Rapidly retiring workforce / early retirement is highly incentivized

8. The situation calls for a major reform of pension regime in the Punjab. Consequently, Finance Department has prepared a “Pension Reform Plan” after thorough deliberations. Finance Department has undertaken a comprehensive review of the matter, sought guidance from the Ministry of Finance along with deliberations being undertaken by the Pay and Pension Commission of the Federal Government and evaluated pension schemes of other provinces such as KP and Sindh. Finance Department has taken input from and held consultations with a diverse set of stakeholders to review the pension regime of the province of Punjab including, but not limited to, the following:

- Actuarial Evaluation of Punjab Pension Fund as at 30.06.2019 with reform options and new scheme options for new entrants (Annex-I)
- Consultations with the World Bank in the context of report on “Pakistan Assessment of Civil Services Pensions” by the World Bank dated December 6, 2019 (Annex-II)
- Pension Reform Options for the Government of Punjab under Sub-National Governance (SNG) Programme, FCDO (Annex-III)

In addition to the above, the Government of Punjab has obtained assistance of the World Bank, under the Punjab Resource Improvement & Digital Effectiveness Program (PRIDE) programme, to undertake various Public Financial Management reforms including pension reforms.

C. Overview of the Current Scheme

9. Service structure of the government employees entitled them to receive pension, gratuity, or both. Pakistan’s civil servants’ pension scheme is a non-contributory defined-benefit scheme. A worker is entitled to an annuitized benefit after required years of service. The starting pension is calculated based on the number of years of service, multiplied by the accrual factor times the pensionable wage base. In addition, retirees are entitled to post-retirement allowances which materially increase the individual replacement rate after retirement. Past period pension increases



along with the medical allowances added to post-retirement pensions have, in recent years increased the effective average accrual rate from 2.33% per year of basic salaries to more than 5.23% per year.

10. Pension increases from year to year are given on ad-hoc basis; that is to say, pension is not subject to automatic annual increase, nor are they linked with any benchmark like inflation or current wage rate. Up to 35% of the pension benefit can be received in a lump-sum commutation. A decision by the Supreme Court in 2015 provides that the full amount of commuted benefits have to be restored after completion of commuted years, implying that full pension is restored, along with benefit of past increases, once the 'commuted' period has ended.

11. Pension benefits are financed directly from the budget with no employee contribution. A provincial reserve fund has been established in 2008-2009 with the aim of pre-financing some of the future pension liabilities. Actual fiscal transfers to these funds have been substantial but not commensurate with growth in pension liabilities.

D. The Actuarial Analysis of Pension Liabilities of Government of Punjab

12. Actuarial valuations are carried out periodically to determine the implicit pension debt of the Government. The valuation also determines the cost expected to arise from an additional year of service which is termed as "current service cost" of the scheme. Current service cost is also described in terms of "Contribution Rate" which is determined as a percentage of the pensionable pay.

13. The Punjab Pension Fund has carried out actuarial analysis of pension liabilities of the Government of Punjab lately in 2019. Major findings of the actuary are as follows:

- i. Accrued pension liability of the Government of Punjab is **Rs 6,558.509 billion** as of 30th June 2019. It was previously assessed as **Rs 3,866.458 billion** as of 30th June 2015. There were 479,274 pensioners and 965,323 permanent employees as of 30th June 2019 as per AG records. Pensioners as of 30th June 2021 have reached **525,689**.
- ii. The annual growth in pension liabilities is **26%** since 2007.
- iii. About **50%** of active employees have not reached to minimum service length required for pension benefits i.e. 10 years of service.
- iv. Among pensioners, **36%** are retiring pensioners followed by **33%** of family pensioners.
- v. About **37%** of pensioners are in the age bracket of **55 to 65** indicating a relatively 'young pool' of retirees and also reflective of an increasing trend of early retirement.
- vi. Pensioners are about **50%** of total active employees indicating a relatively mature scheme.
- vii. There is a notable increase in the early retirement trend which increased from **22%** of total retirees in 2010 to **63%** of total retirees in 2019.
- viii. About **42%** of the current pensioners will be restoring their commutation in the next ten years. Pension bill for a single employee increases by about **60%** after the restoration of commutation. There is a huge surge in pension bill is expected in the next 10 years.
- ix. Leave encashment is also a sizeable annual expense of around **Rs 15 billion**.



E. Regional Comparison of Pension Schemes

14. Several countries in the region inherited non-contributory defined-benefit special schemes for civil servants from the British. India moved to a contributory defined contribution scheme for new entrants to the civil service in 2004 and later established a voluntary scheme for private-sector workers with the same design and using the same platform. The Maldives converted its defined-benefit scheme for civil servants and private-sector workers to a contributory defined benefit scheme in 2009.

15. Pakistan offers one of the most generous average civil pensions in the region when measured as the replacement rate for basic wages. However, if allowances are factored into total compensation, it suggests that many workers may enjoy far less generous replacement rates. In addition, the prevalence in the region of such allowances in the overall compensation package for civil servants makes it difficult to meaningfully compare replacement rates.

16. Pakistan's retirement age of 60, with most workers able to retire with 25 years of service, is similar to several countries in the region. There is a recent regional trend to enhance the retirement age which has been witnessed in Afghanistan and the Maldives which have increase it to 65.

17. All schemes in the region except for Afghanistan have or have had supplementary provident funds. The benefits from these supplementary schemes vary a great deal since substantial withdrawals may be made for health needs and housing.

F. Weakness of Current Pension Regime

18. A legal framework specifically for the pension regime does not exist in Punjab and it is regulated on the most part through notifications which are subject to legal challenges. It also leaves the door open for pressure / influence on the Government from various avenues.

19. Current civil servants' pension structure also suffers from weaknesses in equity between workers and predictability of benefits:

- Post-retirement benefit adjustments have not only substantially increased fiscal costs but their ad hoc nature expose workers and retirees to the risk that their benefits may lose purchasing power.
- Non-pensionable allowances vary substantially across grades of workers and even across workers in the same grade. As a result, an individual's total replacement rates vary widely at retirement even though many have similar work histories.
- Since benefits are computed based on workers' final salaries, pensions can be materially affected by promotions or wage adjustments before retirement. Generally, higher-wage workers receive a higher replacement of lifetime wages than low-income workers. Finally, workers who retire shortly after a wage hike can receive much higher benefits when compared with those who retire before one.
- There is no adjustment to the benefit based on the age of retirement. A worker can retire after 25 years of service at 55 years of age (after the recent amendment in the Punjab Civil Servants Act, 1974) and receive the same benefit (based on years of service) as a worker who retires at age 60.



G. Longevity and Associated Fiscal Risks

20. Life expectancy at the age of eligibility for retirement benefits has increased since the civil service pension system has been in place and is projected to increase further in the future. Pension benefit extends for a greater number of years than years served by the employees, as reflected in the following table:

Average Pension Duration of Superannuating Pensioner (life expectancy of 82 years)	22 Years
Average Pension Duration of Family Pension: Wife (estimated 5 years younger than husband; Life expectancy of 87 years)	10 Years
Minimum Pension Duration of Family Pension: Other (especially for widowed/ divorced daughter)	10 Years
Estimated Average Pension Duration	42 Years

21. In case of early retirement, benefits for family pension are extended further. Benefits for survivorship (Family Pension) have increased substantially from 2010-2018. In 2009, the family pension benefit was increased from 50% of the worker's pension benefit entitlement to 75%. Further, the Court judgements to allow additional beneficiaries have extended the pension payment life by multiple years.

H. Minimum Pension Increases

22. Lower cadre civil servants are protected against increasing cost of living through guaranteed minimum pension, which is in addition to the annual increase in pension. The Government periodically revises the threshold of minimum pension which has resulted in growth of minimum pension much higher than annual pension, as highlighted in the following table:

Increases in Minimum Pension (in Rs)

Date of Revision	Pensioners under the Age of 75 years		Pensioners who are 75 years or more	
	Self	Family	Self	Family
1st July, 2008	2,000	1,000	2,000	1,000
1st July, 2010	3,000	2,250	3,000	2,250
1st July, 2013	5,000	3,750	5,000	5,000
1st July, 2014	6,000	4,500	6,000	4,500
1st July, 2018	10,000	7,500	15,000	11,250
CAGR	17%	22%	22%	27%



I. In-Service Death Benefits Policy through Financial Assistance Package

23. Multiple benefits have also been allowed by the Government of Punjab to the family of a civil servant who dies while in service. Apart from provisions regarding accommodation, education, health etc. the notification provides that:

- a) Lump-sum grant ranging from Rs. 1.6 million (BPS 1-4) to Rs. 4.0 million (BPS 20 and above) whose entitlement has been increased by 100% to 300%
- b) Deceased family shall be allowed salary, along-with annual increases in the pay, the deceased officer was drawing till the date of superannuation of the deceased civil servant
- c) After the date of superannuation, family pension shall be allowed as allowed as per clause 4.10 of the Punjab Civil Services Pension Rules, 1967
- d) Appointment of one child or widow in BS-1 to BS-11 on contract or regular basis as per provisions of Rules 17-A of the PCS (A&CS) Rules, 1974



J. Proposed Pension Reform Actions

24. Given the nature and magnitude of challenge discussed in preceding sections and results of multiple reviews and analyses, it is understood that pension reforms which modify the benefit formula and qualifying conditions could moderate fiscal costs. Multifarious reform actions to address the growing challenge were assessed and analyzed based on their impact, practicality and applicability. In view of the burgeoning pension outlay, Finance Department has prepared a comprehensive pension reform plan, to be implemented over a span of around five years, while keeping the principles of equity and fairness in perspective. The following reform actions are hereby proposed:

1. Introducing a Defined Contribution Pension Scheme for New Entrants

25. The existing Defined Benefit Scheme may be discontinued no later than 1st July, 2023 for new entrants into Government service. Instead, a Defined Contribution Scheme may be offered to these employees. The major reason why the existing Defined Benefit Scheme is becoming fiscally unsustainable include the following:

- a. The existing scheme did not balance the interests of the employees with those of the government.
- b. The existing scheme offers many guaranteed benefits that entail a high cost. Retirement age has not increased in line with increases in life expectancy and the cost of providing the guaranteed benefits has increased further as a result. The Government lacks the expertise to properly ascertain those costs and also lacks the financial resources to bear those costs.

26. The Government may approve the following objectives and strategy for the future:

Objectives

- a. Introducing a scheme no later than 1st July, 2023 that contributes towards retirement security of the permanent employees (civil servants) hired/recruited subsequently;
- b. Striking a balance between the interests of the employees and those of the Government as an employer;
- c. Designing the retirement scheme in a manner that encourages and enables the employees to follow a savings discipline and plan for the post-retirement phase of their lives in accordance with their individual preferences;
- d. Designing the retirement scheme in a manner that is in line with the long-term objective of fiscal sustainability of the Government; and
- e. Avoid inclusion of guarantees implicit in Defined Benefit schemes or coverage of risks addressed in other benefit programs.

Strategy

- f. These objective shall be achieved by offering a Defined Contribution Retirement Scheme to new employees hired subsequent to roll-out of the scheme.
- g. Within three months, the detailed design and implementation strategy of the new scheme shall be prepared by Finance Department and submitted to the Government for approval.



2. Replacing Medical Allowance of Pensioners with Health Insurance Coverage

27. An amount of Rs. 19 billion is being provided to pensioners as Medical Allowance which is far more generous than that applicable to employees. Furthermore, the benefit of claiming medical reimbursement for indoor treatment and medicine for chronic disease is also available. This is in addition to the fact that such persons can avail medical treatment from government-run facilities in their capacity as citizens. Now that the Government of Punjab has rolled out ‘Sehat Sahulat’ health insurance coverage to all the citizens, which includes pensioners, there is a case for withdrawal of the Medical Allowance.

28. It may be noted that medical allowance admissible to the pensioner is linked to net pay. Consequently, an employee receives more medical allowance after a retirement than during service. It proposed that an insurance scheme, under the umbrella of ‘Sehat Sahulat’ universal coverage in Punjab, may be designed specifically for Government employees and pensioners as replacement. It is further suggested that before replacing it with health insurance, the linkage of medical allowance to the net pension should be removed and a fixed reasonable amount may be provided to pensioners.

3. Introduction of a Minimum Retirement Age

29. The trend of taking voluntary early retirement has increased substantially over the last few years, having touched 64% of the total retirements in the year ending 30th June 2020 and 63% of total retirements in the year ending 30th June 2019. While the long-term impact of this trend is a rise in the number of pensioners and their monthly recurring pension expenditure, a more immediate fiscal impact is that of payment of commutation amount.

30. In realization of this, an Act has been passed by the Provincial Assembly in October 2021 to effectuate a minimum retirement age of 55 years of age, subject to completion of 25 years of service. This shall result in annual deferment of Rs 15-18 billion under the cost of pension commutation. This advantage of deferment shall mainly be available for 3 to 4 years and gradually reduce thereafter.

4. Applying a Discount Factor for Early Retirement

31. A rational approach to discourage early retirement is the introduction of a ‘Discount Factor’ for each less year served than superannuation. This could act as a real deterrent for employees exiting the public workforce merely due to attractiveness of pension benefits. It shall also bring the real savings depending upon the ‘Discount Factor’. The World Bank has suggested the following reduction factor, however, an actuarially fair formula shall be framed:

Actuarially Fair Reduction Factors by Age
(Cumulative adjustment at each age)

Age at Retirement	53	54	55	56	57	58	59	60
Reduction Factor	21%	18%	16%	13%	10%	7%	4%	0%



5. Change in Rate of Commutation

32. Commutation of pension is payable at the time of retirement @ 35% of gross pension determined through a formula. In the past, it was 50% of the gross pension which was gradually brought down to 35%. A reduction to 25% would decrease the commutation expenditure by approximately 28%. For example, if the commutation rate had been reduced from 35% to 25% in the current financial year (with effect from 1st July, 2022), the budgetary allocation under the head for commutation would have been reduced significantly.

33. A considerably staggered deferment of around Rs 15-20 billion would ease the fiscal burden on the Government. This reform was proposed by the previous Pay & Pension Commission as well.

6. Implementing a Robust ‘Proof of Life’ Verification System

34. While the Direct Credit System (DCS) for payment of the monthly recurring pension amount directly into the bank account of the pensioners has been helpful in computerization of records, it was a one-time exercise. It is vital that a recurring biometric-based verification system is developed, which shall be more reliable than the present practice of pensioners required to submit a ‘life certificate’ periodically at the bank from where they draw pensions. For this purpose, the Federal Government has already made requisite legal amendments and is coordinating with NADRA and CGA for implementation. The subsequent changes for Punjab in this regard is the formulation and rollout of policy / legal framework to enable “Proof of Life” through biometric verification.

7. Indexation of Annual Pension & Salary Increases

35. Pension and salary increases have remained ad-hoc over the years. International best practices require indexation of pension and salary to inflation. Year-on-Year (YoY) Consumer Price Index (CPI) is the best benchmark to measure inflation in the country which may be used to benchmark annual pension and salary increases. On average, pension increase is higher by 2.9% than YoY CPI in the last 11 years.

36. The actuarial report for 2019 has determined that 1% decrease in pension reduces accrued pension liability by Rs. 613.707 billion. Hence, if the Government had allowed annual increase in pension equal to weighted average of three years’ YoY CPI, then it would have reduced accrued pension liability on 30th June 2019 by Rs. 1,780 billion and contribution rate by 19.34%.

37. Long term growth in salary through revision in BPS is 13.7%. International best practices suggest that increase in salary is allowed at 1% to 2% above inflation. Long-term inflation i.e. YoY CPI in the country is 7.3%. Thus, the Government has been giving annual salary increase which exceeds the best practices by 4.4% even when salary benchmark is taken at 2% above inflation. This has had a significant impact not only on salary expenditure but also on accrued pension liabilities.

38. It has also been determined that 1% decrease in salary reduces accrued pension liability by Rs. 281.138 billion. Hence, if the Government had allowed annual pay increase at 2% above weighted average of three years’ YoY CPI then it would have reduced accrued pension liability at 30th June, 2019 by Rs. 1,237 billion and contribution rate by 38.23%.

39. It is recommended that a long-term policy of introducing automatic indexation of pensions to a percentage of weighted average of three years’ YoY CPI be adopted to avoid pensions losing their



purchasing power. A policy of automatic increases may be perceived as introducing risk of undue burden arising for government in times of high inflation. This risk can be readily mitigated using a formula for indexation based on averaging or capping the increase. It is also recommended that a long-term policy of introducing automatic indexation of salary at a certain percentage above the weighted average of three years' YoY CPI be adopted.

8. Definition of Emoluments – Linking Pension to Basic Pay

40. Definition of emoluments needs to be revised wherein only basic pay is included and no other pay/allowance is reckonable towards pension.

9. Introducing a 'Pension Act' to Implement Changes

41. It has been observed that the legal framework for pension regulations is outdated and leaves room for interpretations which has resulted in undue favor to the pensioners. It is therefore thought expedient that a more refined legal structure may be brought forward through a 'Pension Act' which would provide cover to the pension scheme, along with paving the way for implementation of reform actions.