



Fiscally Sustainable Pensions in Pakistan

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Abstract: Public sector employment remains attractive for important reasons such as job security and a guaranteed pension. Evaluating alternate pension systems has gained importance among policymakers concerned about the aging population and rising poverty levels. Pakistan has a Pay-As-You-Go type pension system, financed by taxpayers’ money, and has resulted in the building up of unfunded liability for the government. The expenditures on superannuation are gradually coming into mainstream discussions on fiscal sustainability and public finance management. These additional expenditure liabilities require an increase in future taxes to be solvent. We use scenario-based projections to highlight how the existing pension system is fiscally unsustainable and what approaches are needed to make it sustainable.

Keywords: Fiscal policy, public economics, public finance, tax-induced, pensions.

JEL Classification: H3, E620.

Fiscally Sustainable Pensions in Pakistan

1. Introduction

Public sector employment remains attractive for several reasons, particularly job security and a guaranteed pension (Dixit, 2002). Most countries worldwide have established pension systems to support individuals who lose their income due to aging or disability. These pension schemes aim to provide adequate resources to meet basic living standards and minimize the gap between pre- and post-retirement earnings. They allow pensioners to maintain a decent quality of life, especially as earning potential significantly declines with age. However, the responsibility for mandatory savings or contributions by employers (including civil governments) differs depending on the type of pension scheme. Some argue that individuals are responsible for saving through voluntary savings or family income, while others believe the state should create institutions based on resource needs and sustainability.

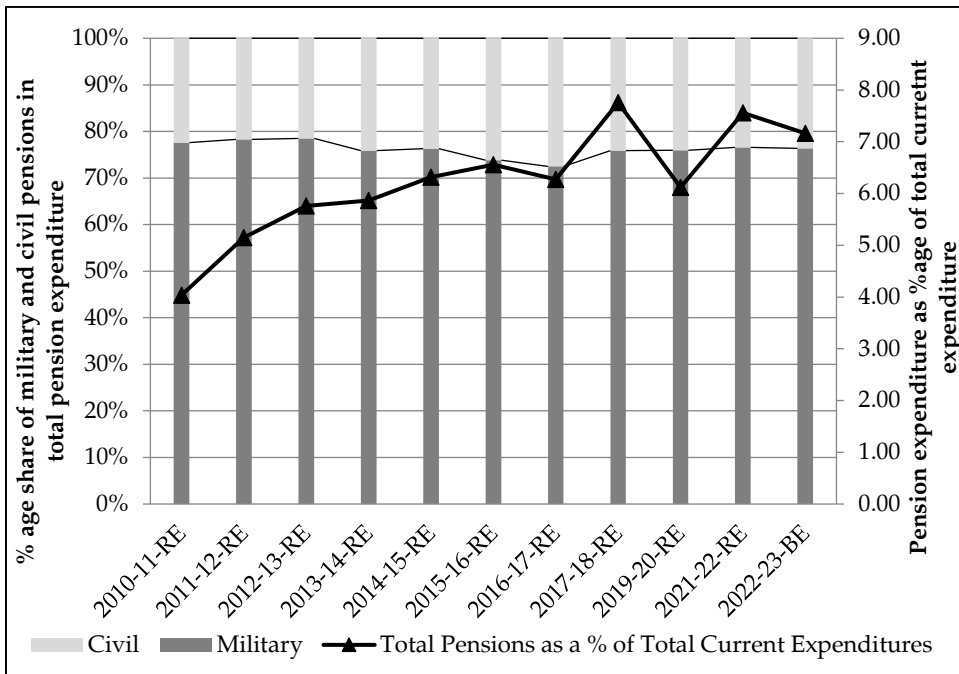
Nevertheless, changing demographics, characterized by an aging population, reduced family support, increased healthcare needs, and longer life expectancy, have intensified the need for a dynamic policy response. Evaluating alternative pension systems has become increasingly crucial for policymakers concerned about the aging population and rising poverty levels. Countries like Pakistan are experiencing tight fiscal conditions due to substantial pension liabilities. Article 38 of the Constitution of the Islamic Republic of Pakistan, enacted in 1973, addresses the "Promotion of Social and Economic Well-being of the People." This article consists of seven sub-clauses, each stating that the state shall take measures to secure the well-being of its citizens, provide opportunities for work, ensure adequate livelihood with reasonable rest and leisure, and offer necessities such as food, clothing, housing, education, and medical relief for all citizens. Sub-article (C) states explicitly: "Provide for all persons employed in the service of Pakistan or otherwise, social security by compulsory social insurance or other means."

The same notion has been reiterated in various Civil Service Reform Commissions. For example, the NCGR-2015 included one of the broad principles for reforms: "Grant a living wage and compensation package, including decent retirement benefits, to all civil servants." However, providing such a post-retirement facility necessitates a system based on sound financial appraisals that consider fiscal sustainability. Any

weakness in such a program may lead to undesirable outcomes. For instance, increasing the pension bill was cited as one reason why governments shifted toward contractual appointments (as stated by the Chief Secretary of Punjab and reported in NCGR Vol-II).

Pakistan's current Pay-As-You-Go pension system, funded by taxpayer money, has accumulated unfunded liabilities. The increasing pension bill is coming under scrutiny for its impact on fiscal sustainability and public finance management. This necessitates future tax increases to maintain solvency, as pensions have historically been excluded from total employee costs due to their non-contributory nature. Essentially, addressing the sustainability of the pension system requires a comprehensive approach that balances the needs of retirees with the government's fiscal constraints, highlighting the importance of informed policymaking and prudent financial management.

Figure 1: Percentage Share of Pensions in Total Current Expenditure



Source: Government of Pakistan.

The stacked bar chart in Figure 1 illustrates that military pensions account for over 76% of total federal pension expenditure, compared to civil pension expenditure, which is around 24%. Conversely, the grey line shows

that the percentage of pensions relative to current expenditures has been increasing over time (for FY 2019-20, it was approximately 6%, and for 2022-23, it exceeded 7%). However, these costs are becoming substantial and are diverting resources from other important objectives, such as promoting economic growth. For instance, in fiscal year 2018-19, federal superannuation and pension expenditures made up nearly 78% of PSDP expenditures (392,870 and 502,065 million Rupees, respectively). With the economy facing persistent fiscal deficits, the opportunity cost of these pensions is significant and increasing. Therefore, a careful analysis is necessary to propose reforms that protect employees' rights while ensuring fiscal sustainability. Additionally, pension financing costs are rising due to increased longevity, rising health expenses, and reforms.

The current pension system in Pakistan is overseen by the federal government, provincial governments, the armed forces, autonomous bodies, and EOBI, with limited involvement from the private sector. Ideally, a thorough examination of the entire pension system is required, and suitable proposals should be made. However, this study will concentrate exclusively on federal civil pensions to initiate discussion on the necessity and potential strategies for addressing reform in this area.

2. Structure of the Pension System in Pakistan

For the first time in Pakistan's history, a pension was introduced through an act titled "The Governor-General's Pension Act of 1954." This Act was established to provide pensions to individuals who have held the office of Governor General of Pakistan. Over time, the original scheme was amended, and the current pension system is outlined in the revised edition of 2006 of "A Manual of Pension Procedures," which was first published in 1999.

2.1. Classification of Pension

- **Compensation Pension:** This is provided in the event of the abolition of a permanent post.
- **Invalid Pension:** This pension is awarded if a civil servant is permanently incapacitated for public service due to a physical or mental infirmity.
- **Family Pension:** A family pension is granted to the relatives of a government employee who dies before retirement.

- **Superannuation Pension:** A superannuation pension is awarded to a government servant who is entitled or required by regulation to retire at a specific age.
- **Retiring Pension:** This pension is granted to a government servant who is allowed to retire after completing 25 years of qualifying service.

2.2. Rate and Scale of Pension

Sections 13 and 19 of the Civil Servant Act of 1973 include clauses concerning pensions and gratuities for civil servants. They specify that a civil servant becomes eligible for a pension after completing 20 years of service (the minimum vesting period) and must retire by the superannuation age of 60. Pensions are calculated at a rate of 70% (Replacement Ratio) of the last pay received. Additionally, there are distinct rules for invalid pensions and pensions payable upon death; whether before or after retirement, the family is entitled to receive the specified pension, gratuity, or both. Civil servants who opt to retire before completing 20 years but have more than 10 years of service are eligible for one-fourth of the gross pension or a gratuity amount. Those retiring before completing 10 years but with over 5 years of service qualify for gratuity only. In the case of pensions of invalid persons, the minimum requirement of ten years of qualifying service is waived. In the case of a family pension, 75% of the gross pension is provided for life to the widow.

2.3. Commutation of Pensions

Pensioners can commute up to 35% of the employee's gross pension using the provided commutation tables at the time of issuance. Furthermore, this commutation will be restored once the commutation period concludes for all types of pensioners.

2.4. Other Pension-Related Benefits to Civil Servant

2.4.1 Benevolent Fund and Group Insurance

The Federal Government established a fund and procured group insurance for its employees. This Act is known as the "[Federal] Employees Benevolent Fund and Group Insurance Act, 1969 (Act No. II of 1969) (Amended up to December 2010)." This Act creates a Benevolent Fund for the common benefit of federal government employees and certain autonomous bodies, providing for their group insurance. It applies throughout Pakistan to every employee, regardless of their location.

2.4.2 *Benevolent Fund*

The Benevolent Fund receives contributions from employee subscriptions, grants from the federal government, autonomous bodies, organizations, institutions, and other authorities, donations from private individuals or institutions, and all income, profits, or interest generated from the Fund's assets or investments. Additionally, it includes loans raised by the Board with prior approval from the federal government.

2.4.1.2 *Benevolent Grants to be Paid from the Benevolent Fund*

It includes an allowance for disabled and family pensioners in the event of death during service or if a pensioner passes away before age sixty-five. The Board may, if deemed appropriate and considering the availability of funds after meeting its obligations under this Act, set up schemes to distribute any funds for the benefit of employees, including retired employees and their families. This encompasses grants for weddings, educational stipends for dependent children, farewell grants at retirement, and burial expenses.

1.4.1.3.1 *Group Insurance*

In the event of an employee's death, regardless of the cause, during their employment, the Board shall pay the deceased employee's family a sum as prescribed through arrangements with the Insurance Company. Currently, the minimum assured sum ranges from PKR 350,000 to PKR 1,000,000. A separate Federal Employees Insurance Fund has been established to credit premiums from current employees. Any remaining amount after payment to the insurance company may be used for the benefit of employees, including retired employees and their families, as directed by the Board.

2.4.2 *Health Facilities at Government Expense*

Retired government employees are entitled to medical treatment at government expense, equivalent to the facilities provided to current government employees. They can also reimburse approved medical expenses, specifically costs associated with about 15 chronic illnesses. The list of covered diseases includes those typically avoided by insurance companies or those that are costly, such as all expenses related to dental issues. Additionally, medical reimbursement of grants @31.25% and @25% of the net commutation pension is available for pensioners in BPS 1-15 and

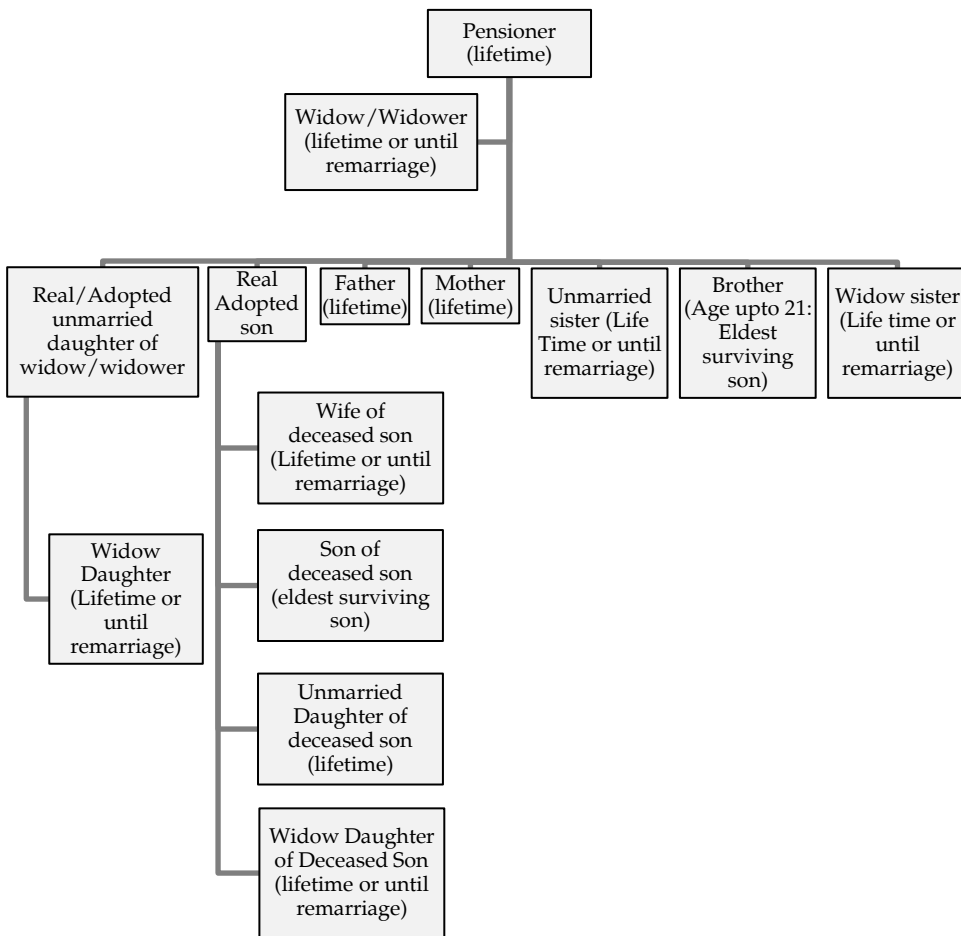
16-22, respectively. The minimum allowance is set at Rs.1200 per month for all grades.

2.4.3 General Provident Fund Scheme

Government employees must contribute to the General Provident Fund at prescribed rates (i.e., BPS 1 at 3%, BPS 2-11 at 5%, BPS 8-22 at 8% of basic pay). The trust fund pays an annual return based on the government borrowing rates for that year. Employees can take an advance from this Fund, which is repaid in installments from their salary. A non-refundable advance of up to 80% of their balance in the Fund is available upon reaching age 45, and 100% is accessible upon reaching ages 50 and 55. At retirement, the remaining balance and any interest accrued are paid to the employees. However, government employees can choose whether they want to receive interest on their contributions. They may also take interest-free housing or conveyance advances if they choose not to receive interest.

2.5. Hierarchy of Family Members Eligible for Pensions

The significant challenge contributing to the substantial burden of pensions on the government treasury stems from the complex multi-level hierarchy of eligible family members across generations. This complexity intensifies the administrative burden in terms of time, cost, and effort required to scrutinize, document, and verify multiple relationships, from the retiree to various family members and among family members themselves. Documentation involves submitting various documents, such as marriage certificates, medical records, and affidavits. Despite implementing digital checks, this hierarchical structure exposes pension schemes to a higher risk of misuse and fraudulent practices that are difficult to detect. Furthermore, the thirteen layers of the hierarchy unnecessarily prolong the duration of pension disbursement.



3. Best Practices/Lessons of Reforms from the Rest of the World

This section discusses best practices from various countries. The following sections provide insights into different methods and pension schemes.

3.1 United States: the Blended Retirement System

The term "blending" in the Blended Retirement System refers to the integration of two significant sources of retirement income: an existing annuity provision for individuals who retire after 20 years or more of service, as well as the returns from a Thrift Savings Plan (TSP). All members are automatically enrolled in the TSP after 60 days of service and receive a monthly government contribution of 1% of their basic pay into their account. This 1% contribution is automatic; members do not need to

provide their own funds. Additionally, they are automatically enrolled to contribute 3% of their basic monthly pay to the TSP, which they can change or stop at any time. If a member contributes just 3% of their basic pay to the TSP, the government will match that contribution. Even if a member chooses to contribute a higher percentage of their basic pay to the TSP, such as 10%, the government will match only up to a maximum of 5% of the member's basic pay. The significant advantage of making a TSP contribution is that it supports individuals who do not serve in the military long enough to qualify for a pension. According to government statistics, 83 percent of people who join the military do not serve long enough to be eligible for retirement benefits. Therefore, when they leave after 5 or 10 years of service, they receive no assistance toward their future retirement. Military members contributing to the TSP can depart at any time and take their retirement savings with them. Even if they leave before completing 20 years, the money in their TSP fund will remain theirs. Members can leave the funds in the TSP, withdraw them, or transfer them to another retirement account to save on taxes. As an additional incentive for service members to remain until they reach the 20-year mark and qualify for monthly military retirement pay, the BRS offers mid-career continuation pay around the 12-year mark of service. The Blended Retirement System consists of four specific components:

3.1.1 Defined Benefit

If military personnel retire after 20 years of service, they will receive 40% of their final basic pay. Similarly, retiring after 30 years of service yields 60% of their final basic pay. This means the benefit is based on twice the number of years served. Military personnel can choose to receive their full retirement pension when eligible or opt for a lump-sum benefit at retirement. If they select the lump sum, their monthly retirement check will be reduced until they reach age 67.

3.1.2 Defined Contribution

The military will contribute 1% of military personnel's base pay to their TSP, even if they do not contribute any of their own money. They will be automatically enrolled with a 3% base pay contribution to their TSP (this can be adjusted at any time). The military will match contributions up to 5% after two years of service. Personnel can always choose to stop contributing to the TSP, take a loan against their TSP balance, or withdraw funds from their TSP account.

3.1.3 Continuation Pay

When military personnel reach 12 years of service and commit to an additional four years, they will qualify for a cash incentive ranging from 2.5 to 13 times their regular monthly basic pay if on active duty, and from 0.5 to 6 times their monthly basic pay if they are in the reserves.

3.1.4 Choice of Lump Sum Payment

If an individual accepts a lump sum payment, it will be discounted to account for inflation. Additionally, if they choose the lump sum payment, their monthly retirement benefits (including survivor benefits) will be reduced.

3.2 Turkey: Ordu Yardimlařma Kurumu (Oyak)

OYAK is a legal entity governed by civil law regulations. It includes members of the Turkish Armed Forces, the General Command of the Gendarmerie, the Coast Guard Command, and workers who voluntarily choose to enroll, including civilians as defined by law. OYAK offers its members "supplementary retirement benefits." In addition to providing pension benefits, pensions, and death and disability benefits as mandated by law, OYAK also offers housing, loans, the Donation-Based Retirement Income System (BDEGS), and the Housing Savings Fund (KBF). With the largest membership and contributions, along with extensive services for its members, OYAK serves as a model for the establishment of other supplemental occupational pension funds in Turkey and provides additional benefits to its members independent of the Social Security Institution.

OYAK is a key player across various industries, including iron, steel, and cement manufacturing; automobile production, construction; mining; energy; finance; chemicals; logistics services; and port management. The cement factories owned by the Fund also significantly contribute to the national economy. With 60 enterprises operating in 21 countries, OYAK employs over 32,000 individuals. In 2015, OYAK's total economic value was estimated at \$25 billion, with exports reaching \$4.7 billion in 2018. According to the 2020 consolidated results, OYAK's total income hit 73 billion TL, and its total assets increased to 157 billion TL. It accounted for 2.5 percent of Turkey's total exports, with an export value of 4.3 billion USD. This data demonstrates that OYAK is more than just a credit union for Turkish military personnel; it is also a significant, influential, and profitable corporation within the Turkish economy.

3.3 Malaysia: Lembaga Tabung Angkatan Tentera (LTAT)

The Malaysian pension system consists of five broad categories of distinct institutions that primarily serve various constituencies: a tax-funded defined benefit (DB) pension scheme for public servants, a defined contribution (DC) scheme for armed forces personnel, a publicly run (DC) retirement scheme for private sector employees, and a privately run DC scheme open to all (Hussein, 2019).

LTAT has two primary goals. The first goal is to provide retirement and other benefits to enlisted members of the armed forces (compulsory contributors) and to allow officers and mobilized members of the Volunteer Forces to participate in a savings program. Contributors to the LTAT plan are expected to contribute 10% of their monthly wage, while the government, as the employer, contributes 15%. Contributions from volunteer participants start at RM25 and may increase to RM2000 monthly. Officers' participation in the Fund is optional, and no payments are made to their accounts by the Malaysian government. Other ranks in the armed services (compulsory contributors) are required to contribute a portion of their monthly wage to LTAT, with the government also contributing as the employer. When a mandatory non-pensionable contributor dies, retires, is released from duty, or reaches the age of 50, they receive their retirement benefit as a lump sum payment. A compulsory pensionable contributor also receives a lump sum payment of their contributions upon death, retirement, or reaching the age of 50.

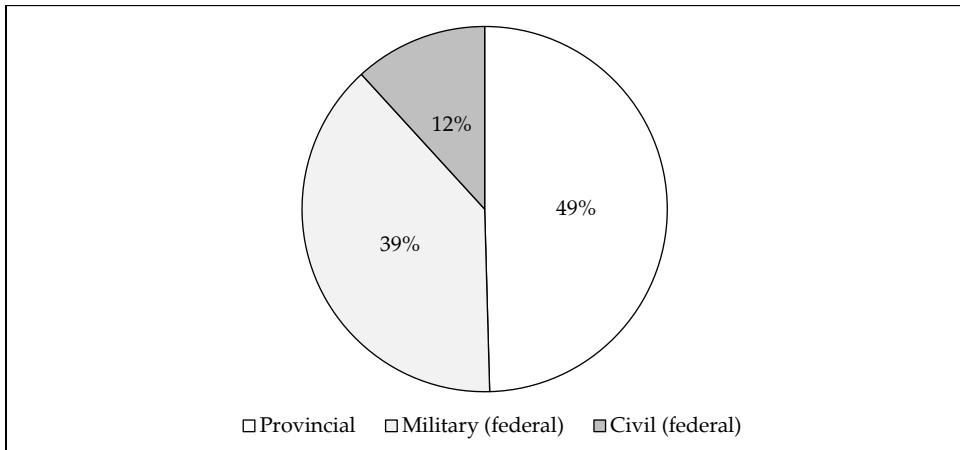
Meanwhile, the government's portion is transferred to the Retirement Fund, which then administers monthly pension payments. Voluntary members have the right to withdraw their contributions at any time. As of the end of 2017, the Fund managed RM10 billion in assets.

4. Pension Landscape in Pakistan

Pension expenditures at the federal (including civil and military) and provincial levels are spiraling out of control and remain underfunded. They have increased from PKR 164 billion in 2011 to PKR 988 billion in 2021. Federal pension expenditures (including military pensions) have more than quintupled over the last ten years, while provincial pension expenditures have surged more than sevenfold. Meanwhile, tax revenues have only grown by 2.7 times during the same period.

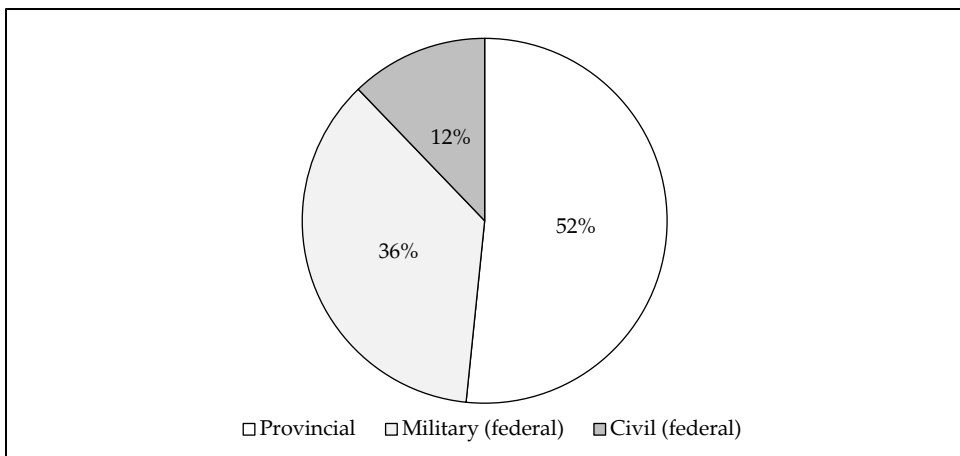
The pie charts in Figures 2 and 3 compare the shares of provincial, federal (civil), and federal (military) pension expenditures as a percentage of total pension expenditures for the fiscal years 2019-20 and 2021-22. The share of military pension expenditures decreased from 39% to 36%, while provincial expenditures rose from 49% to 52% during these years. The share of military pension expenditures remained unchanged in both years.

Figure 2: Pension Shares in Total Pension Expenditures (916 billion PKR), 2019-20



Source: Federal Budget in Brief, 2019-20 and Provincial Budget Documents.

Figure 3: Pension Shares in Total Pension Expenditures (1116 billion PKR), 2021-22

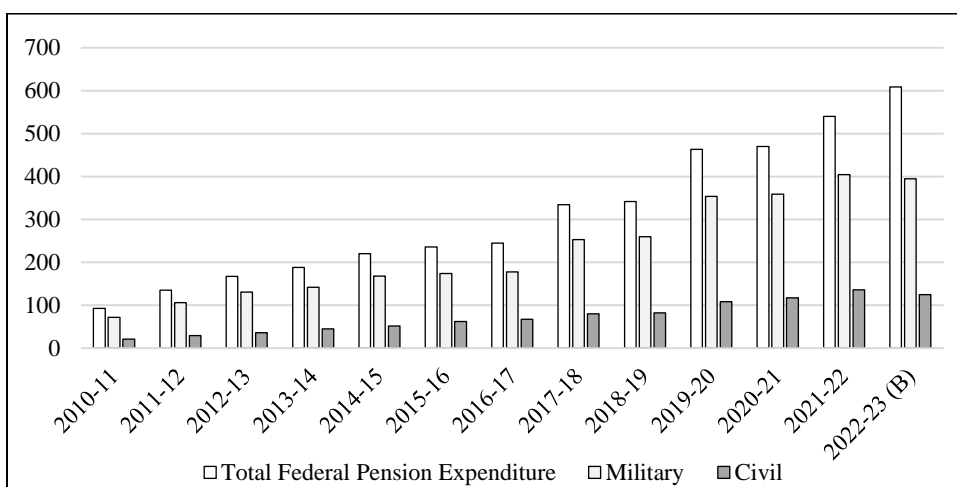


Source: Federal Budget in Brief, 2021-22 and Provincial Budget Documents.

4.1 Pension Scenario of Federal Government (Civil and Military)

The federal government announced a 6.3 percent increase in the defense budget for the fiscal year 2021-22, reflecting the nation's various domestic and foreign challenges, including strained relations with India and the potential negative impacts of the U.S. military withdrawal from Afghanistan. According to the 2022-23 budget, defense spending will total 1.6 trillion rupees for current expenditures, which represents approximately 16% of the overall budget expenditure.

Figure 4: Shares in Federal Pension Expenditure (in billion Rupees)



Source: Budget in Brief (revised estimates).

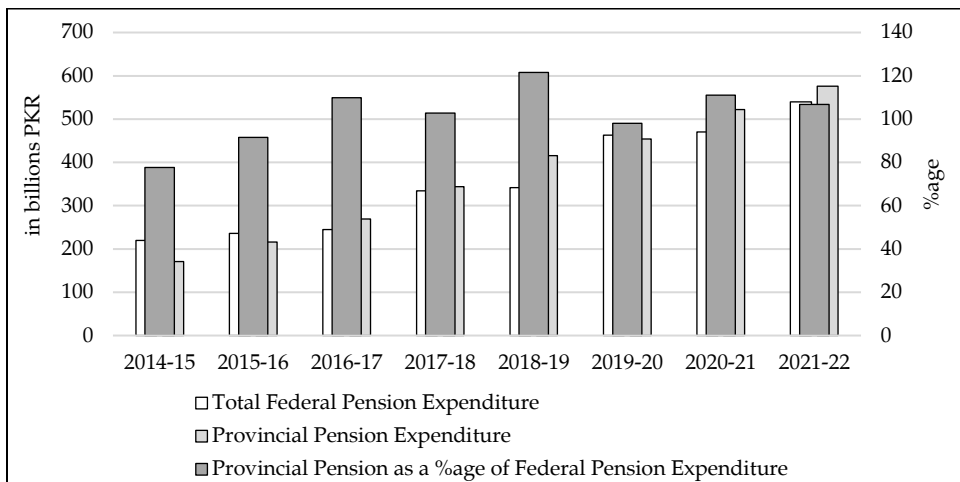
A deeper examination reveals that the figure of 1.6 trillion rupees excludes 395 billion rupees designated for the pensions of retired military personnel and 340 billion rupees allocated to the Armed Forces Development Program. Regarding pension expenditures for the previous year (2022), public pensions for the military account for over 75% of the federal government's total pension outlays. Furthermore, military pension spending has been rising at an average annual rate exceeding 16% since 2014. Expenditure on pensions for retired military personnel is more than three times greater than what is spent on pensions for retired federal government employees. The most concerning aspect is that these pensions are not adequately financed. Suppose both the federal budget and pension expenditure continue to grow at the current rate by 2050. In that case, pensions will consume 56% of the federal budget, leaving minimal funds available for defense, development, and other vital areas (Khawar, 2018).

It is, however, important to explore how this crisis can be averted. The state is currently making no plans to address future pension obligations. Typically, pensions are paid from a fund to which both the employee and employer contribute during their employment. The Fund invests these contributions in various capital market instruments to generate profits. These earnings are intended to support the employee once they retire.

4.2 Provincial Pensions

Provincial pension expenditures have consistently represented a significant portion of overall pension spending in Pakistan; however, the exact percentage compared to federal pension expenditures fluctuates over time. It peaked in FY19 at around 121 percent but declined to 107 percent in FY22.

Figure 5: Provincial Pension Expenditure as a % age of Federal Pension Expenditure



Source: Revised Estimates from Provincial and Federal Finance Divisions.

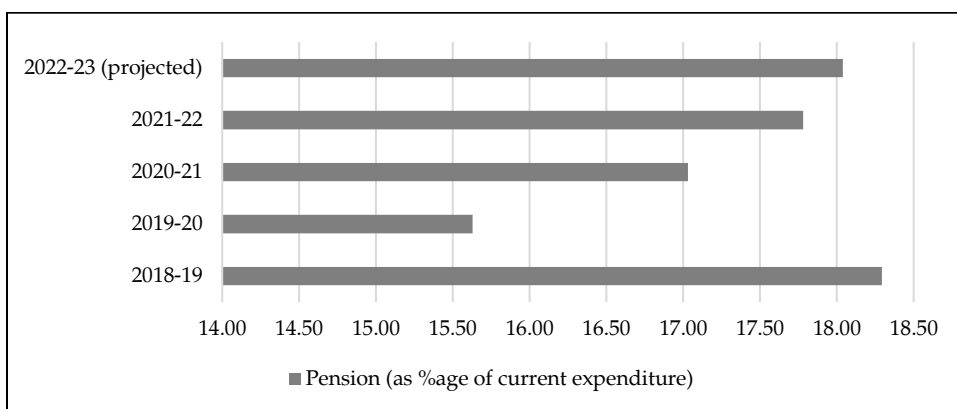
4.2.1 Pension Scenario in Khyber Pakhtunkhwa

Even prior to the COVID-19 outbreak, the fiscal situation of the Khyber Pakhtunkhwa government was precarious. Federal transfers to the province constituted 90% of total provincial receipts in 2019-20. While recent revenue increases—especially from the Sales Tax on Services—have been notable, Khyber Pakhtunkhwa's dependence on federal payments has not significantly diminished. The onset of COVID-19 has further constrained budgetary space, mirroring a global trend. The pandemic has

impacted the financial health of defined-benefit pension plans around the world. In 2019-20, federal allocations to the Khyber Pakhtunkhwa government totaled Rs. 670.9 billion, but in 2020-21, they fell to Rs. 609 billion. As shown in the table below, provincial taxes were insufficient to make up for the shortfall in federal transfers. Implementing new taxes or raising current tax rates could be detrimental during the pandemic while broadening the revenue base through administrative reforms will yield only medium- to long-term effects.

Every year, pension costs increase. These expenditures are projected to rise by 48.8% from 2019-20 to 2022-23. Pension expenses as a percentage of current expenditures are also climbing, moving from 15.63 percent of total current expenditures in 2019-20 to 18.04 percent in 2022-23. The significant salary and pension costs will continue to take up budgetary space available for health, education, and other welfare-related goals in Khyber Pakhtunkhwa. This will have significant consequences for a vulnerable provincial economy.

Figure 6: Pension Expenditure in Khyber Pakhtunkhwa



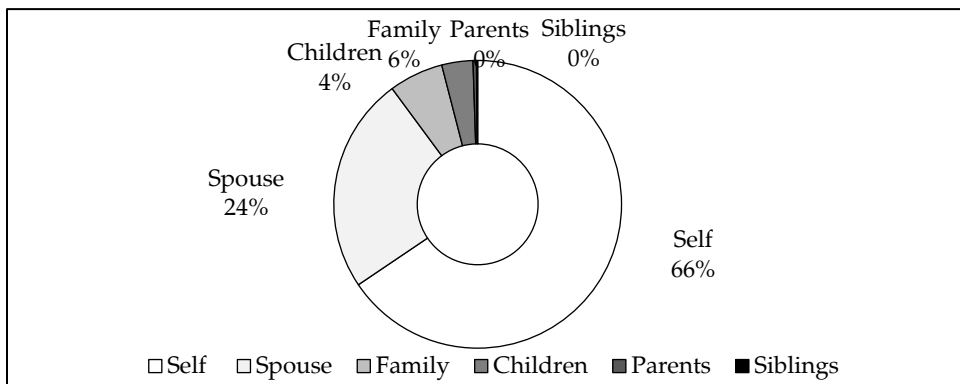
Source: Actual Revenue Expenditure, Finance Department, Government of KP.

Annual public pension expenditures in Khyber Pakhtunkhwa have increased from 15.6% of the provincial budget for current expenses in 2019-20 to over 18% in 2022-23. Pension costs have surged nearly tenfold, rising from Rs. 7.2 billion in 2009-10 to Rs. 94.6 billion in 2021-22, outpacing the growth of wages, federal payments, and even the overall budget size. Financing such a significant increase in pension costs will now pose a challenge. If debt is used to fund pensions, it will create a gap in the government's financial accounts, leading to high refinancing costs for these liabilities. In response to COVID-19, the government has had to allocate

even more resources for family pensions, medical allowances for retirees, and regular pension expenses.

Since 2008-09, the number of retired civil officials in Khyber Pakhtunkhwa's public sector has increased at an average annual rate of 7%. Consequently, the total number of pensioners reached 169,358 by the end of the 2019-20 fiscal year, contributing to a significant rise in the government's fiscal burden during that period. Most active retirees come from the lower ranks, specifically grades 1 to 4. In terms of receiving the most significant pension amounts, grades 15-17 rank among the top three. In both scenarios, public pressure on the government to regularize ad-hoc or part-time personnel often arises, which would further escalate the government's growing post-retirement obligations.

Figure 7: Hierarchy of Pension Eligible Family Members in KP

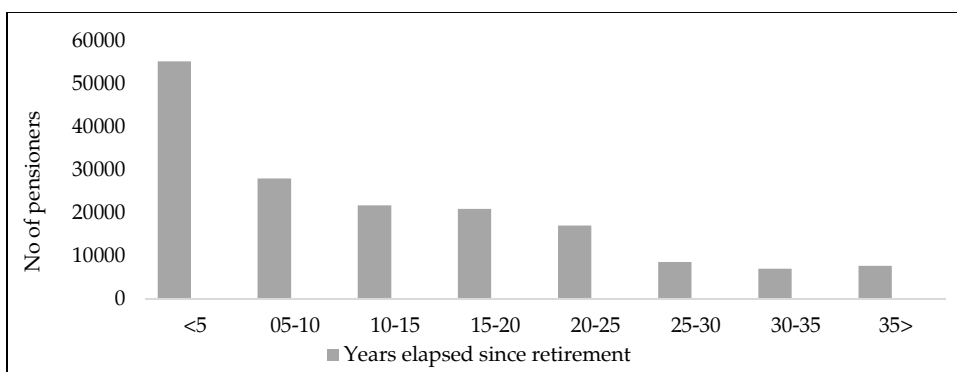


Source: Figure based on data from the report titled "Government Pension and Fiscal Sustainability in KP."

The multi-level hierarchy of eligible family members, spanning three generations, remains the most significant issue. This increases the administrative burden of inspections regarding the time, cost, and effort involved in tracing, documenting, and confirming the various connections between the retiree and family members and among family members. Required paperwork includes marriage certificates, medical records, affidavits, and other documents. Despite the implementation of computerized checks, this structure jeopardizes pensions due to mismanagement and fraudulent activities that are difficult to track. Furthermore, the thirteen layers significantly extend the lifespan of the pension. Over 1,300 pension claims dating back more than 50 years are still active in the system. This number is likely an understatement, as pensions

can be reopened even after termination if the qualifying criteria for family members change. Besides the retirees themselves, a substantial portion (34%) is collected by family members, including spouses, children, parents/guardians, and siblings, as illustrated in the graph below.

Figure 8: Number of Pensioners' Age Curve in KP



Source: Figure based on data from the report titled "Government Pension and Fiscal Sustainability in KP."

The duration of pensions has already increased due to rising life expectancy, and this trend is expected to continue. The report on pensions in Khyber Pukhtunkhwa outlines thirteen layers of pension life, indicating that more than 1,300 pension claims, some dating back over 50 years, remain active in the system. This figure likely underrepresents the reality since pensions can be reopened even after termination if family members' qualifying criteria change. Additionally, many layers create a situation in which the influx of new pensioners entering the system far exceeds the rate at which old pensions are terminated. Over three years, from 2015-16 to 2017-18, over 11,000 workers retired and became eligible for pensions. During the same period, however, only an average of 100 pensions were terminated per year, resulting in an entry-exit ratio of 110:1.

From 2015-16 to 2019-20, the number of new pensioners added to the system grew at an annual rate of 8.1 percent, while pension costs escalated at an annual rate of 18.7 percent. The following graph illustrates how many years retirees have been receiving their pensions. Approximately 21,736 individuals have been receiving pensions for the past 10-15 years, while the government covers the costs for 1,377 individuals who have been receiving pensions for over 50 years. This aligns with the national pattern. Pension expenditures are projected to rise to 3.5 percent of national GDP in the medium term due to increased life expectancy and demographic changes.

The provincial Cabinet of Khyber Pakhtunkhwa has approved amendments to the Civil Servants Pension Rules & Orders 2006, aimed at rationalizing pension beneficiaries to direct dependents and parents. This restructuring reduces the hierarchy of family pensions from 13 levels to 6, resulting in shorter durations and reduced costs for pensions. However, these amendments will only apply prospectively.

Furthermore, the revised rules will exclude dual pensioners, including retirees who receive both their own pension and that of a retired family member. The Finance Department of the Government of Khyber Pakhtunkhwa has identified 1,935 dual pensioners within the pension system. Additionally, active employees will no longer be eligible to receive family pensions, with 738 active employees reported to be collecting pensions for retirees in 2021. Once implemented, these amendments are expected to generate total savings of Rs. 12 billion in the coming years.

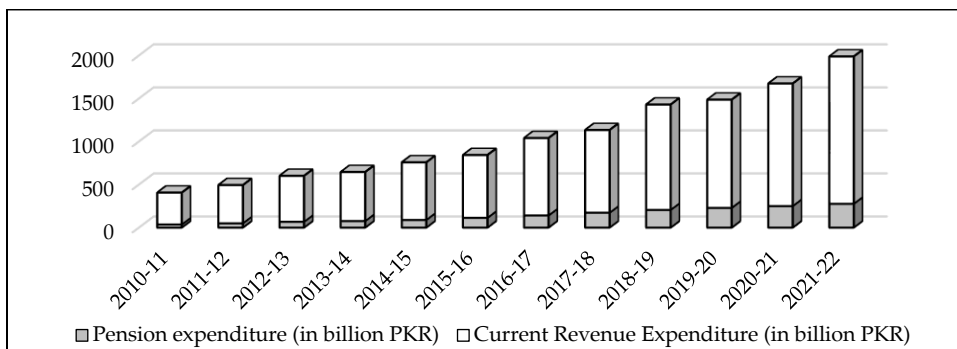
4.2.2 *Pension Scenario in Punjab*

Punjab has a population of around 110 million people, accounting for approximately 54% of the nation's annual production of goods and services. As a result, the health of the national economy is closely linked to the performance of Punjab's economy.

After salaries, pensions represent the second highest current revenue expenditure for the Punjab government. The rapid increase in this expense is concerning. The government has a Defined Benefit (DB) Pension Scheme for its permanent employees. The pension program operates on a "pay-as-you-go" basis, meaning that pension payments come from that year's income, regardless of when the liability arises. Given the growing burden of pension expenditures, the government has adopted a more systematic approach to valuing, reporting, and funding pension liabilities in recent years.

The Punjab government performed actuarial valuations of its pension liabilities in 2007-2009, 2010, 2015, and 2019. Actuarial valuation depends on specific economic and demographic assumptions when estimating future pension obligations. This valuation is a critical process that offers essential insights into the long-term sustainability of a pension system. The table below shows the trend in Punjab pension expenditure from 2010 to 2018.

Figure 9: Share of Punjab Pension Expenditure in Current Revenue Expenditure (in billion PKR)

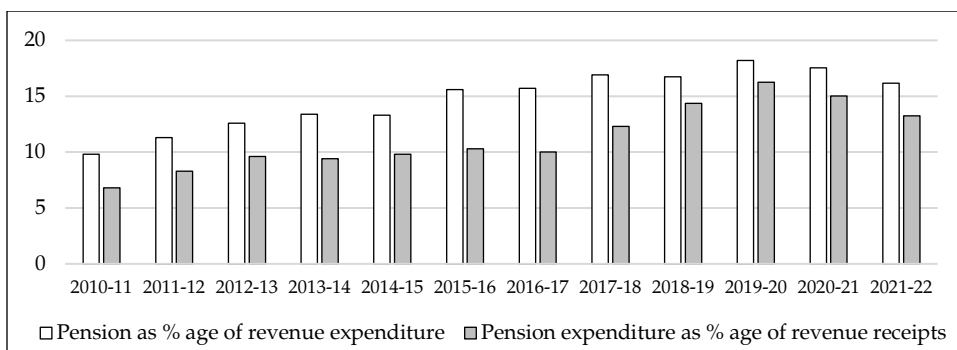


Source: White Paper (various issues), Finance Department, Government of Punjab.

Pension spending as a percentage of current revenue expenditure has risen from 9.8 percent in the fiscal year 2010-11 to 16.2 percent in the fiscal year 2022-23. Similarly, the ratio of pension expenditure to general revenue receipts has increased from 6.8 percent in the fiscal year 2010-11 to 13.3 percent in the fiscal year 2021-22. If pension spending continues to grow at this pace, the government's budgetary flexibility for other current and future expenditures will decrease. Below is a graphical illustration of projected pension payouts over the next 30 years.

The Punjab government follows the Federal Government by permitting annual salary and pension increases. Below is a comparison of inflation with the salary and pension increases provided by the Punjab Government since FY 2010-11.

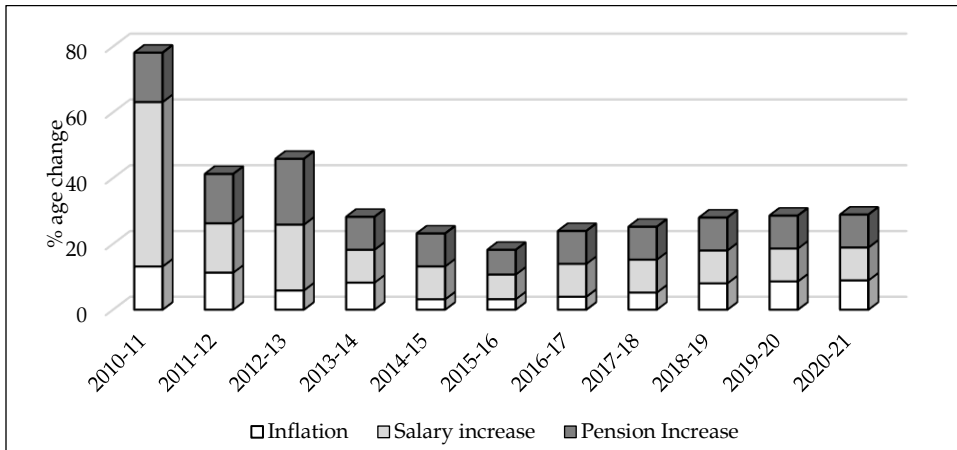
Figure 10: Punjab Pensions as %age of Current Revenue Expenditure and Revenue Receipts



Source: White Paper (various issues), Finance Department, Government of Punjab.

Annual salary and pension increases that do not account for inflation can lead to excessive pension expenses and liabilities. As observed in developed economies, these increases should be linked to inflation.

Figure 11: Punjab Pension/Salary vs Inflation

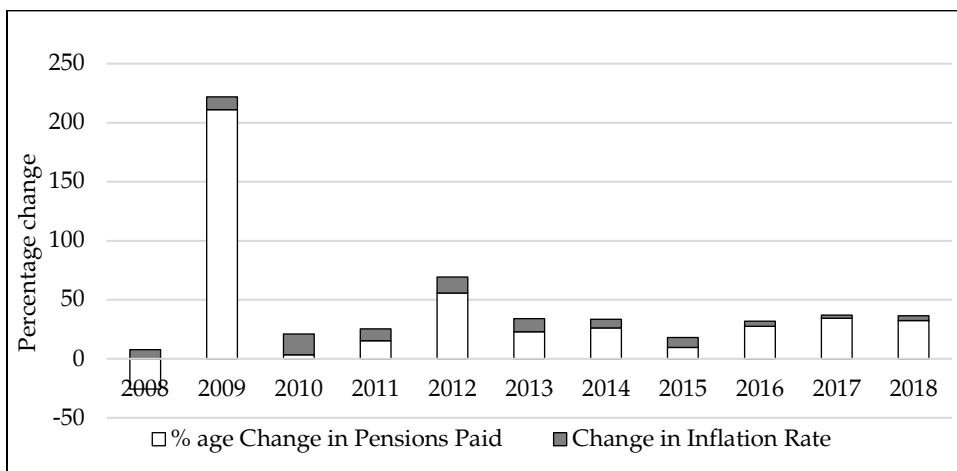


Source: White Paper (various issues), Finance Department, Government of Punjab.

The compound annual growth rates (CAGR) reported in the White Paper for 2021-22 for Punjab indicate that current expenditure has increased by 13.06 percent over the past eleven years. Meanwhile, pension expenditure alone has soared by 20.25 percent during the same period. In contrast, the revenue collection increase for that period is only 14 percent.

4.2.3 Pension Scenario in Sindh

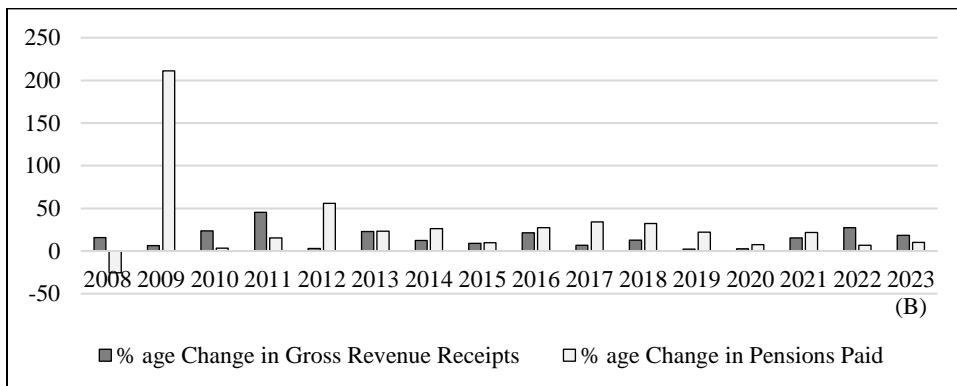
Sindh is Pakistan's second-largest province, with a population of 47.886 million (2017), accounting for 23% of the total population and 17.7% of the land area. As Pakistan's industrial, economic, and financial hub, Sindh plays a critical role in the country's economy and development. Several key characteristics position the province as an essential center for economic activity in Pakistan. Its primary advantage is its proximity to the open sea, which enables a diverse economy encompassing heavy industries, manufacturing, the services sector, and agriculture. The services sector and industry have made the most significant contributions to the province's economic growth. Sindh is home to two seaports that manage most of the country's exports and imports, a thriving stock market, and a robust corporate sector, all of which drive the nation's economic activity.

Figure 12: Pension/Inflation Scenario in Sindh

Source: Budget Strategy Paper (Various Issues), Finance Department, Government of Sindh.

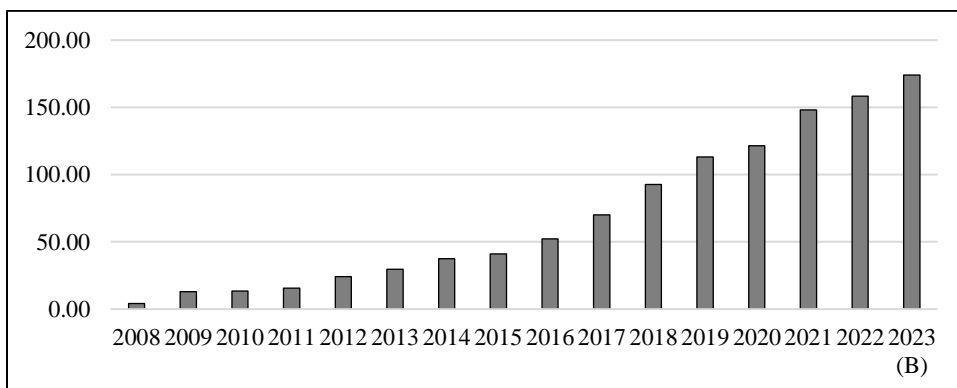
As the second largest province, it has a significant population of retirees, which exposes it to challenges arising from pension increases over time. Employee Retirement Benefits, which include pension and gratuity payments provided to retired workers, represent a government liability that is rapidly growing due to new retirements and increases in pension benefits. According to the Sindh Budget Strategy Paper for 2022-24, spending on employee retirement benefits accounts for approximately 16 percent of total current revenue expenditure during these fiscal years. Meanwhile, the share of employee retirement benefits during the fiscal year 2019-20 and through the next three years is anticipated to remain at an average of 14 to 15 percent. Following the revision of pension benefits and the restoration of the commutation amount in July 2018, allocations for employee retirement benefits have been adjusted upward by 14.7 percent, rising from Rs. 99.3 billion to Rs. 114.0 billion in the current fiscal year. This reflects a 23 percent increase compared to actual expenditure in the previous fiscal year. Spending on employee retirement benefits is projected to grow at a cumulative annual rate of 10 percent over the next three years (2019-20 to 2021-22).

Figure 13: Percentage Change in Pension Expenditure in Sindh



Source: Budget Strategy Paper (Various Issues), Finance Department, Government of Sindh.

Figure 14: Total Expenditure on Pensions in Sindh (in billion PKR)



Source: Budget Strategy Paper (Various Issues), Finance Department, Government of Sindh.

4.2.4 Pension Scenario in Balochistan

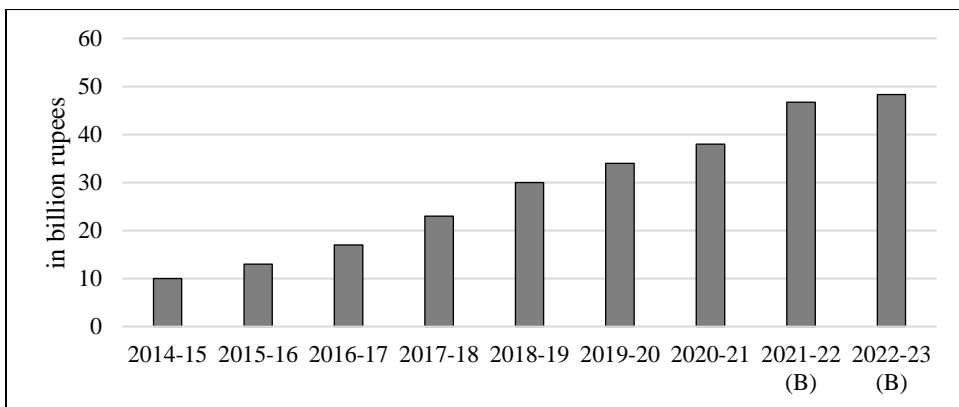
Balochistan is Pakistan's largest province, covering 347,190 square kilometers and representing 43.6 percent of the country's total land area. However, it is also the least populous province, with merely 9.3 million people (5% of the total population) living there. Aside from the major hubs of Quetta and Khuzdar, the rest of the population is dispersed across a vast landscape of arid and hilly terrain. These distinctive geographical features, combined with low population density and the province's governing system, pose significant challenges for public service delivery. As a result, Balochistan exhibits relatively weaker macroeconomic and social indicators.

Despite its strategic location and abundant natural resources, Balochistan contributes only 8% to the national GDP. The economy of Balochistan largely depends on agriculture, transportation, wholesaling, and manufacturing. Over the last decade, these sectors have represented an average of 77 percent of the region's economy. In contrast, the mining sector accounted for an average of 5.5 percent during the same period.

Pension expenses have risen dramatically in recent years, raising significant concerns for the government. Estimates of pension expenditures in previous fiscal years failed to account for actual spending patterns, leading to estimation issues and undermining the credibility of budgets in this area. Pension spending was projected at \$33.785 billion for FY 2019-20, while revised estimates for that year were adjusted down to \$33.616 billion, closely aligning with budget expectations. Pension expenditures have surged rapidly in recent years, showing a growth rate of 37% over the last five years, with the lowest growth rate at 12%.

Consequently, when generating budget estimates for pensions for FY 2022-23, Rs. 48.3 billion has been allocated, marking a 30% increase in expenditure over the revised estimates for 2019-20. This amount represents 51 percent of the total proposed expenditure under "General Public Service." The graph illustrates the trend of pension expenditure over the past several years, highlighting significant growth that requires the government's immediate attention to address the issue.

Figure 15: Balochistan Pension Expenditure (in billion PKR)



Source: White Paper on Budgets (various issues), Government of Balochistan.

5. Federal and Provincial Pension Systems –Sustainability Challenge

Pensions and other forms of social protection pose significant challenges for authorities in nearly every country. However, establishing sustainable pension and social protection systems is even more urgent in developing nations, where the fiscal framework is either too rudimentary or too unstable to support a comprehensive system. While this remains a complicated political issue worldwide, the challenges in Pakistan arise from various structural and procedural factors. It has been observed in previous sections that pension programs for government officials in Pakistan are increasing in cost, posing a threat to other development goals if left uncontrolled. Since 2012, these expenses have risen from approximately 4.5 percent of Sindh's and Punjab's provincial fiscal revenues to nearly 12 percent in 2019. According to actuarial forecasts, these costs, combined with rising salary expenses, are expected to continue increasing significantly in the future, thereby squeezing out other limited public development spending. The government can manage the growth of these expenditures by limiting benefit indexation and reducing benefits for individuals who retire early while still ensuring equity and predictability in benefits. This section focuses on highlighting the inconsistencies within the civil pension system and how they contribute to the fiscal burden, making the system unsustainable. The pension schemes for the Punjab and Sindh Civil Service incur significant financial costs. Pension expenditures are projected to almost double as a percentage of fiscal revenues by 2060 if benefits increase along with wage growth. However, these costs could be stabilized at around 15% of fiscal revenues if benefit increases are limited to consumer price inflation. The long-term sustainability of both basic salaries and pensions presents a serious challenge, with pension costs expected soon to surpass basic salaries as a percentage of government spending.

Basic wages and pensions are projected to increase from around 25% of provincial revenues in 2020 to over 50% by 2060 in Punjab, and from about 32% of revenues in 2020 to nearly 42% by 2060 in Sindh. As a result, civil service pay and pension benefits will take up a larger share of government spending. Moreover, pensions are expected to surpass salaries in Punjab by 2023 and in Sindh by 2028.

Let us consider the example of Punjab. In June 2013, the total number of retirees receiving pensions was 440,000, with pension expenditures at 55 billion rupees. By 2020, the number of pensioners had risen by 25%, reaching 550,000, while pension expenses soared more than fourfold to 238 billion rupees. A special section detailing the need for

pension reforms in Pakistan, published by the State Bank of Pakistan, outlines five reasons for this substantial increase.

- The primary reason is the retrospective increases in pension payments. When the federal government raised pension pay in 2009-10, a clause was added stating that this increase would apply to future retirees. This meant that any public employee retiring after 2010 would be eligible for all prior increases in pension pay. The provinces also adhere to this. This provision was included in all subsequent pension increase circulars. For instance, if an employee retires in 2020, they will be entitled to all increases from 2010 to 2020. Pensions increased by 15 percent in 2010, 20 percent in 2012 (this increment did not apply to retirees after 2017), 7.5 percent in 2015, and 10 percent each year in 2017, 2018, and 2019. An employee retiring in 2020 will receive all these increments in their monthly pension payment. Those who retired before 2010 do not enjoy the same benefits benefit.
- Secondly, the growing number of pensioners using commutation facilities contributes to the rise in public pension costs.
- Third, more employees are opting for early retirement retirement.
- Fourth, there is an increase in the number of survivorship benefits that eligible family members receive in the event of the death of the current employee retiree.
- Lastly, the highest replacement rate in Pakistan is 70% of the retiree's final salary.

Box 1: How Pension Coverage Becomes Unsustainable

In order to fully understand and absorb the severity of the consequences, let's see how a 2% pension coverage results in an unsustainable situation.

After completing his 30 years of service, a grade-17 government officer retired in 2020. His last drawn salary was 64,870 rupees after deducting all the allowances. His pension was fixed at 70% of his last drawn basic pay, which was 47,109 rupees. However, he is entitled to all previous raises dating back to 2010. The pension is calculated based on the previous six increments and now stands at 85,104 rupees. In 2010, a medical allowance of 20% of the base pension was added, which is also available to today's pensioners. The medical allowance was further increased by 25% later on. His/her regular monthly pension becomes 96,859 rupees, adding to the medical allowance and its growth. This is more than his last drawn basic and gross pay of 92,305 rupees, assuming that the retiree has not taken a commutation.

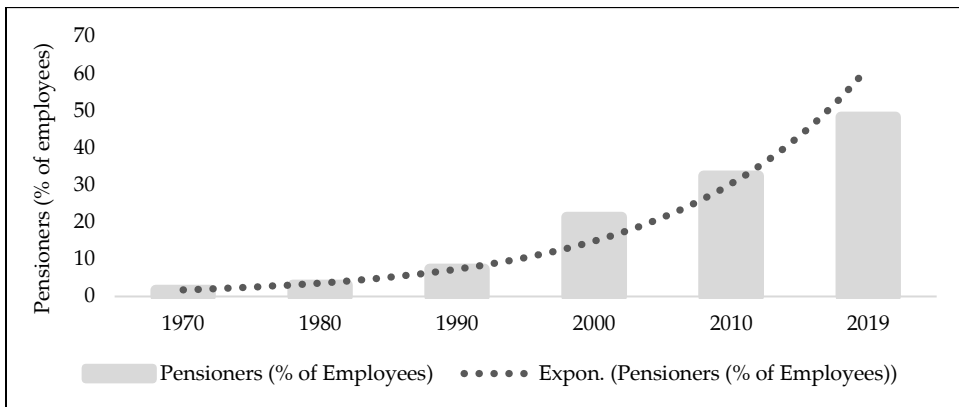
In this way, the employees retiring before 2010 are getting relatively less of what the retirees are getting today. So, they put pressure on the government to increase annual pensions as they are deprived of what the retirees of 2020 are getting.

It is surprising to consider that if a government official retires today, he will take home more money than his last drawn basic pay. This suggests that he has a financial incentive to retire early. He may either enjoy his retirement or seek employment in the private sector. Early retirement is advantageous for him. The data supports this assertion. In Punjab, early retirement accounted for 22% of total retirees from 2006 to 2010. By 2011-2015, that number increased to 26%; by 2019, it had surged to an astonishing 63 percent.

This illustrates how pension costs have skyrocketed over the past decade. Another way to analyze the rising pension costs is by examining the proportion of retirees relative to the total number of employees. In Punjab, pensioners comprised approximately 1.7 percent of the workforce in 1970, but this figure has surged to 48.3 percent in 2019. With more individuals choosing early retirement, this percentage is expected to rise further. In our scenario, a grade 17 officer who retires at age 60 and opts for commutation receives a lump sum payment of 2.5 million rupees, while their monthly pension decreases to 62,958 rupees from 96,859 rupees without it. The lump sum payout would have increased to 3.7 million rupees if they had retired at age 50. Additionally, if the pensioner lives longer than 72 years, they would qualify for an additional income of 11,140 rupees if retiring at age 60. This increased pension amount is also subject to the retroactive pension increase.

In Punjab, over 99 percent of employees choose to commute, and the cost of this one-time payment increases as more individuals retire early. When none of these pensions are funded, the entire situation worsens. Employees are being hired at a rapid pace, and the rate of retirement is rising even faster. No government can back out of these commitments. Even in a financial emergency, the government can reduce pay for current employees, but it cannot change the obligations of retirees.

Figure 16: Number of Pensioners (as % age of Employees) in Punjab



Source:

5.1 Steps Taken for Pension Reforms

Since the start of the century, pension reforms have become a significant issue in global policymaking. While most developed economies are increasing pension spending due to aging populations, low fertility rates, and high dependency ratios, structural problems, and limited fiscal capacity make such expenditures unsustainable in some emerging economies. In 2001, the government enacted several parametric adjustments to civil service pension arrangements for current workers to ensure the system's sustainability. These short-term adjustments included lowering commutation factors (the commutable part of the gross pension was reduced to 40% and then to 35% in 2005), eliminating pension benefit restoration, and cutting the maximum pension from 77 percent to 70 percent. However, these short-term measures did not prove very effective. As a result, the government decided to explore a proposal to enroll new government employees in a contributing pension plan. To facilitate this, the Cabinet established an actuarial office in October 2002. It also formed an inter-ministerial Pension Reform Working Group (PRWG) in 2004, which, in collaboration with the Actuarial Office, guided the civil sector

Pension reform in 2005. The National Commission for Government Reforms (NCGR), in its report (Vol-I, 2008), recommended pension reforms, presenting this recommendation as a guiding principle. It stated, "The pension system should be revised from defined benefits to defined contribution and should be funded."

NCGR further recommended indexing pensions to sustain the purchasing power of pensioners, which has recently been excessive. The Commission proposed a comprehensive roadmap that necessitated a thorough analysis of pension options and made recommendations based on consultations from the Pay and Pension Committee, the Finance Division, the Establishment Division, and an actuarial firm or consultant. This recommendation has not yet been fully developed.

The Commission further proposed establishing a Staff Welfare Department similar to that of the Defense Services, which should have a comprehensive mechanism to ensure reemployment prospects for retirees. It was recommended that the government increase reemployment opportunities for civil servants and reduce the burden of unilateral pension payments.

6. Projections for Sustainable Pensions

6.1 Moving from an unfunded Defined Benefit (DB) to a fully funded Defined Contribution (DC) system

With its various payout structures for pensioners, The unfunded defined benefit (DB) system is deemed actuarially unfair, biased upward, and increasingly costly as it relies on taxpayer funds. This system creates both entry and exit barriers in civil service, hindering turnover due to unrealized pension benefits. The DB system necessitates flexibility in contributions, vesting periods, and other parameters to accommodate reforms or challenges like rising life expectancy and inflation. However, Pakistan's Pay-As-You-Go structure hinders such adjustments, rendering the system unsustainable and less favorable globally.

Replacing the unfunded defined benefit system with a hybrid contributory defined contribution scheme for new entrants offers a partial solution to sustainability while diversifying financing risks for individuals and the government over time. Transitioning to a defined contribution system would allow employees to move between governmental entities, autonomous

bodies, various recruitment types, and the private sector, thereby attracting qualified and talented individuals at different stages of their careers.

Under the Defined Contribution (DC) arrangement, both the employer and, at times, the employee regularly contribute to the employee's retirement account. These contributions, typically a fixed percentage of salary, may vary over time. They are tax-deductible, and investment income within the account accumulates tax-free. While employees frequently have investment options, most plans offer limited choices such as bonds, stocks, and money-market funds. Upon retirement, the employee can choose between a lump sum or an annuity payment, depending on the total value of the retirement account. The employee bears all investment risks, as the retirement account is fully funded, and the employer's obligations are limited to periodic contributions. Valuing a DC plan is straightforward: assess the market value of the assets in the account. For personal financial planning, sponsors often provide estimates of the size of a life annuity that could be purchased with the accumulated funds. However, the actual annuity size depends on investment performance, interest rates at retirement, and the employee's wage growth.

Globally, approximately 10-15% of payroll finances pension schemes. In Pakistan, this percentage is estimated to be 33.3% of pension-recognizable emoluments. To transition to a fully funded defined contribution (DC) system—whether inflation-indexed or not—an actuarial analysis is required to determine payroll contributions. For a fully funded DC system, expected payouts can be calculated. Below, we present projections based on the following assumptions:

- i. Current pensioners will continue to receive the same pensions they have now. The total amount is frozen; only exits from the system will allow for inflation indexing. According to budget estimates for Civil Federal Pensions for 2019-20, these amounts are expected to remain steady for the next five years before beginning to decline at a rate of 5% per year due to pensioners exiting the system.
- ii. For those in government service, assuming that emoluments countable for pension are included in the current pay bill 1, along with 30% of current allowances, three scenarios of defined contribution funded by the government at rates of 25%, 20%, and 15% have been developed. A final outlay of defined contributions and ongoing older pension expenditures, as a percentage of current expenditures, is reported in the tables below.

iii. Current Expenditures are assumed to increase by 5% per annum.

Table 1: Scenario I: Defined contribution funded by government at the rate of 15%

Years	Civil Pension Million RS	Pay +30% of allowances increasing @5% per annum Million RS	DC(15%) Million RS	Current Exp increasing @5% Million RS	DC-15%
2019	82221.00			5589431.00	1.47
2020	93912.00	182027.40	27304.11	7288179.00	1.66
2021	93912.00	191128.77	28669.32	7652587.95	1.60
2022	93912.00	200685.21	30102.78	8035217.35	1.54
2023	93912.00	210719.47	31607.92	8436978.21	1.49
2024	93912.00	221255.44	33188.32	8858827.13	1.43
2025	93912.00	232318.21	34847.73	9301768.48	1.38
2026	89216.40	243934.13	36590.12	9766856.91	1.29
2027	84755.58	256130.83	38419.62	10255199.75	1.20
2028	80517.80	268937.37	40340.61	10767959.74	1.12
2029	76491.91	282384.24	42357.64	11306357.73	1.05
2030	72667.32	296503.45	44475.52	11871675.61	0.99
2031	69033.95	311328.63	46699.29	12465259.39	0.93
2032	65582.25	326895.06	49034.26	13088522.36	0.88
2033	62303.14	343239.81	51485.97	13742948.48	0.83
2034	59187.98	360401.80	54060.27	14430095.90	0.78
2035	56228.58	378421.89	56763.28	15151600.70	0.75
2036	53417.15	397342.99	59601.45	15909180.73	0.71
2037	50746.30	417210.14	62581.52	16704639.77	0.68
2038	48208.98	438070.64	65710.60	17539871.76	0.65
2039	45798.53	459974.17	68996.13	18416865.35	0.62
2040	43508.61	482972.88	72445.93	19337708.62	0.60
2041	41333.18	507121.53	76068.23	20304594.05	0.58
2042	39266.52	532477.60	79871.64	21319823.75	0.56
2043	37303.19	559101.48	83865.22	22385814.94	0.54
2044	35438.03	587056.56	88058.48	23505105.68	0.53
2045	33666.13	616409.39	92461.41	24680360.97	0.51
2046	31982.82	647229.85	97084.48	25914379.02	0.50
2047	30383.68	679591.35	101938.70	27210097.97	0.49
2048	28864.50	713570.91	107035.64	28570602.86	0.48
2049	27421.27	749249.46	112387.42	29999133.01	0.47
2050	26050.21	786711.93	118006.79	31499089.66	0.46

Source: Authors' estimates.

Table 2: Scenario II: Defined contribution funded by government at the rate of 20%

Years	Civil Pension Million RS	Pay +30% of allowances increasing @5% per annum Million RS	DC (20%) Million RS	Current Exp increasing @5% Million RS	DC-20%
2019	82221.00			5589431.00	1.47
2020	93912.00	182027.40	36405.48	7288179.00	1.79
2021	93912.00	191128.77	38225.75	7652587.95	1.73
2022	93912.00	200685.21	40137.04	8035217.35	1.67
2023	93912.00	210719.47	42143.89	8436978.21	1.61
2024	93912.00	221255.44	44251.09	8858827.13	1.56
2025	93912.00	232318.21	46463.64	9301768.48	1.51
2026	89216.40	243934.13	48786.83	9766856.91	1.41
2027	84755.58	256130.83	51226.17	10255199.75	1.33
2028	80517.80	268937.37	53787.47	10767959.74	1.25
2029	76491.91	282384.24	56476.85	11306357.73	1.18
2030	72667.32	296503.45	59300.69	11871675.61	1.11
2031	69033.95	311328.63	62265.73	12465259.39	1.05
2032	65582.25	326895.06	65379.01	13088522.36	1.00
2033	62303.14	343239.81	68647.96	13742948.48	0.95
2034	59187.98	360401.80	72080.36	14430095.90	0.91
2035	56228.58	378421.89	75684.38	15151600.70	0.87
2036	53417.15	397342.99	79468.60	15909180.73	0.84
2037	50746.30	417210.14	83442.03	16704639.77	0.80
2038	48208.98	438070.64	87614.13	17539871.76	0.77
2039	45798.53	459974.17	91994.83	18416865.35	0.75
2040	43508.61	482972.88	96594.58	19337708.62	0.72
2041	41333.18	507121.53	101424.31	20304594.05	0.70
2042	39266.52	532477.60	106495.52	21319823.75	0.68
2043	37303.19	559101.48	111820.30	22385814.94	0.67
2044	35438.03	587056.56	117411.31	23505105.68	0.65
2045	33666.13	616409.39	123281.88	24680360.97	0.64
2046	31982.82	647229.85	129445.97	25914379.02	0.62
2047	30383.68	679591.35	135918.27	27210097.97	0.61
2048	28864.50	713570.91	142714.18	28570602.86	0.60
2049	27421.27	749249.46	149849.89	29999133.01	0.59
2050	26050.21	786711.93	157342.39	31499089.66	0.58

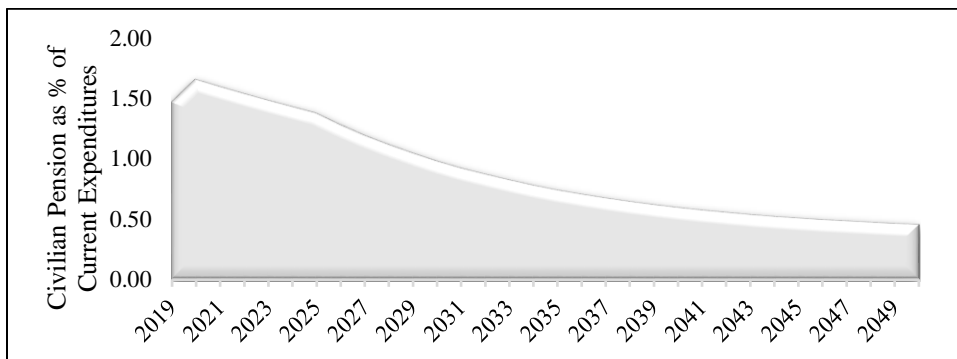
Source: Authors' estimates.

Table 3: Scenario III: Defined contribution funded by government at the rate of 25%

Years	Civil Pension Million RS	Pay +30% of allowances increasing @5% per annum Million RS	DC (25%) Million RS	Current Exp increasing @5% Million RS	DC-25%
2019	82221.00			5589431.00	1.47
2020	93912.00	182027.40	45506.85	7288179.00	1.91
2021	93912.00	191128.77	47782.19	7652587.95	1.85
2022	93912.00	200685.21	50171.30	8035217.35	1.79
2023	93912.00	210719.47	52679.87	8436978.21	1.74
2024	93912.00	221255.44	55313.86	8858827.13	1.68
2025	93912.00	232318.21	58079.55	9301768.48	1.63
2026	89216.40	243934.13	60983.53	9766856.91	1.54
2027	84755.58	256130.83	64032.71	10255199.75	1.45
2028	80517.80	268937.37	67234.34	10767959.74	1.37
2029	76491.91	282384.24	70596.06	11306357.73	1.30
2030	72667.32	296503.45	74125.86	11871675.61	1.24
2031	69033.95	311328.63	77832.16	12465259.39	1.18
2032	65582.25	326895.06	81723.76	13088522.36	1.13
2033	62303.14	343239.81	85809.95	13742948.48	1.08
2034	59187.98	360401.80	90100.45	14430095.90	1.03
2035	56228.58	378421.89	94605.47	15151600.70	1.00
2036	53417.15	397342.99	99335.75	15909180.73	0.96
2037	50746.30	417210.14	104302.53	16704639.77	0.93
2038	48208.98	438070.64	109517.66	17539871.76	0.90
2039	45798.53	459974.17	114993.54	18416865.35	0.87
2040	43508.61	482972.88	120743.22	19337708.62	0.85
2041	41333.18	507121.53	126780.38	20304594.05	0.83
2042	39266.52	532477.60	133119.40	21319823.75	0.81
2043	37303.19	559101.48	139775.37	22385814.94	0.79
2044	35438.03	587056.56	146764.14	23505105.68	0.78
2045	33666.13	616409.39	154102.35	24680360.97	0.76
2046	31982.82	647229.85	161807.46	25914379.02	0.75
2047	30383.68	679591.35	169897.84	27210097.97	0.74
2048	28864.50	713570.91	178392.73	28570602.86	0.73
2049	27421.27	749249.46	187312.37	29999133.01	0.72
2050	26050.21	786711.93	196677.98	31499089.66	0.71

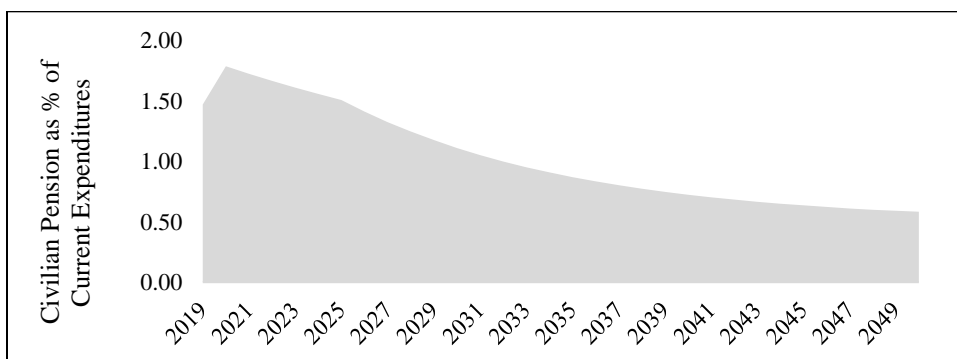
Source: Authors' estimates.

Figure 17: Scenario I-Defined contribution funded by government at the rate of 15%



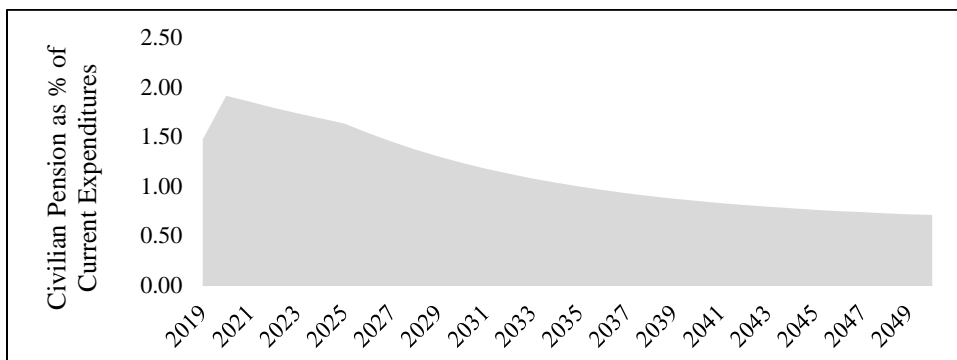
Source: Authors' estimates.

Figure 18: Scenario II-Defined contribution funded by government at the rate of 20%



Source: Authors' estimates.

Figure 19: Scenario III-Defined contribution funded by government at the rate of 25%



Source: Authors' estimates.

This exercise demonstrates that initial pension outlays rise from 1.5% of total current expenditures to approximately 1.83%, 1.72%, and 1.61% for the three scenarios in the first year of reform (2020-21). This initial increase then tapers down to 1.5% in the 6th, fifth, and third years, respectively, for each scenario, and subsequently continues to decline, converging towards 0.50% over thirty years. This trend ensures that pension payouts remain sustainable in the long run.

6.2 Following Pillars based Approach of the World Bank

The federal pension scheme currently offers a pension floor of Rs. 10000 for pensioners and family pensioners, and Rs. 15000 per month for individuals aged 75 and older. However, a pillar-based system can be developed based on the World Bank's recommendations. We have a social safety net program, such as BISP, a means-tested initiative that provides universal support. This could act as the zero pillar of pension payments, available to everyone. The first pillar involves the government increasing the wages of current employees and establishing a mandatory pension contribution scheme, which could function like the GP and Benevolent fund system or through approved private sector pension funds. If wages are not raised, the government can provide the contributory amount and invest as previously outlined.

Ultimately, the younger generation—whether they are government employees or private sector workers—should be encouraged to save so that they and their families can sustain a living standard that fulfills their needs.

7. Conclusion

Pakistan operates a Pay-As-You-Go pension system funded by taxpayers' money, accumulating unfunded liabilities for the government. Spending on superannuation is increasingly discussed and voted on in terms of fiscal sustainability and public financial management. This situation necessitates higher future taxes for solvency. This study uses scenario-based projections to illustrate the fiscal unsustainability of the current pension system. Our projections show that initial pension outlays will rise from 1.5% of total current expenditures to about 1.61% to 1.83% across the three scenarios during the first year of reform. This initial increase tapers down to 1.5% in the 6th, fifth, and third years, respectively, for the three scenarios, and then continues to decline, converging around 0.50% over thirty years. These measures ensure the long-term sustainability of pension payouts.

Globally, approximately 10-15% of payroll finances pension schemes. In Pakistan, this figure is estimated to be 33.3% of pensionable emoluments. An actuarial analysis is necessary to determine payroll contributions to transition to a fully funded Defined Contribution (DC) system, whether inflation-indexed or not. In a fully funded DC system, expected payouts can be calculated.

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