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ECONOMIC POLICY RESEARCH CENTRE

Towards Sustainable Development

POLICY BRIEF

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The Need for Further Reforms in Uganda's Public Sector Pension System

Executive Statement

The need to implement further reforms in Uganda's Public Sector Pension (PSP)scheme, a consolidation of the different schemes is paramount. This arises from the increasing numbers of public servants being employed especially in the ever expanding districts and parliament. This would address the current and future challenge of old age social security risk. The policy brief provides an assessment of the structure, design and the trends in public spending on public pensions; and draws implications for its sustainability and affordability. The study uses public expenditure data on pension payments from the Ministry of Finance, Planning and Economic Development (MFPED), document reviews and some key stakeholder analysis. Results show that the cumulative fiscal burden of public spending on public pensions has been increasing over the years and has reached a higher level to be afforded by government without necessarily crowding out other competing public investments such as infrastructure development. We suggest that the current PSP scheme requires further reforms to gradually convert it from non-contributory to contributory between government and workers, in order to ensure sustainability. This is a good practice recommended by the World Bank for most of the Overseas Economic Cooperation and Development (OECD) countries including those in Africa. Experience from East Africa in Kenya and Tanzania that have implemented second generation pension reforms; show that converting the PSP scheme from non-contributory to contributory scheme eases fiscal burden on national budget and improves efficiency in the management and administration of the scheme.

Introduction

Uganda has operated a non-contributory Public Service Pension Scheme (PSP) scheme since the colonial era. The current scheme is operated under the Amended Pension Act of 1994. Prior to the amendment of the PSPS in 1994, the pensions for the urban authorities were managed under the Local Government Provident Act (CAP 292), while those of municipalities were being administered under Municipalities and Public Authorities Provident Fund Act (CAP 291). Following the amendment of the Pensions Act in 1994, the provision of pensions to both urban authorities and municipality employees was brought under the purview of the Pensions Act, which required that all Local Governments should provide for the pensions of their employees. Subsequently, the responsibility of administering and managing pensions for local government was transferred to the Ministry of Public Service (MPS). Membership to the PSPS currently stands at 429,000 employees covering civil servants at both central and local government levels. Although this constitutes less than 1 percent of the Ugandan population, the PSP scheme, nonetheless accounts for about 0.35 percent of the country's gross domestic product (GDP) as of 2015. The non-contributory nature of PSPS has witnessed sustained increases in pension payments due and in some instances arrears payments, poses a high social security risk to the old aged Ugandans. Indeed, the increasing fiscal burden of the public pension scheme could crowd out other competing public investments on infrastructure and social services. As such,

further reforms are therefore necessary to ensure this scheme is affordable and sustainable in the medium to long term.

Why Further Reforms in the Public Sector Pension System?

This brief is based on an EPRC research report titled "The Need for Further Reforms in Pension Sector in Uganda, Implications and Policy Options". The report was based on analysis of pension payments during 2005/6-2015/16 as well as key stakeholder interviews in the pension sector. This brief focuses on the fiscal burden of Uganda's Public Sector Pension Scheme for the period (2005/06 – 2015/16).

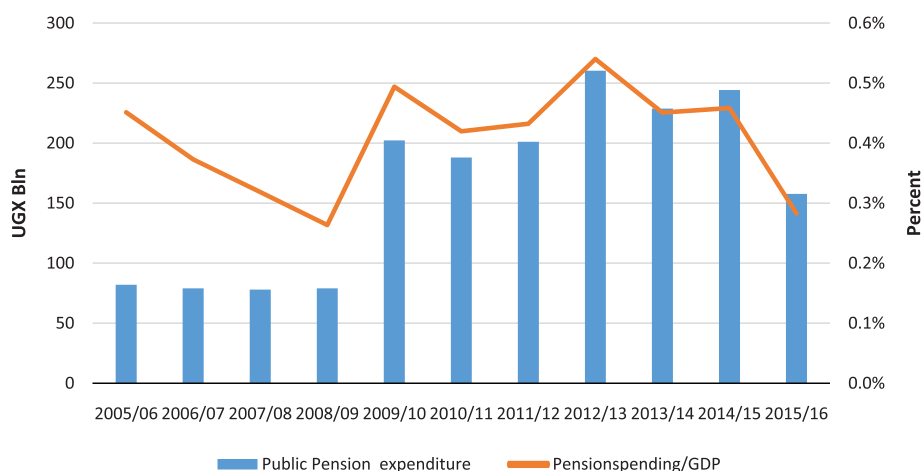
Pension Expenditure as a Share of GDP

There are greater fiscal implications to increasing budget financing of the pension payments in Uganda. For example Figure 1 shows that, during the last decade (2005/06-2015/16), Uganda registered rapid growth in total public pension expenditure from UGX 81 billion in 2008 to UGX 112 billion in 2011. It further increased by an additional UGX 25 billion between 2012 and 2015—aggravated by corruption in the Ministry of Public Service (MoPS).[1] In addition, the cumulative arrears by 2015/16 had reached a higher level of about UGX 516 billion. When the direct pension payment and arrears are consolidated, the fiscal burden amounts to a level of about UGX 716 billion, close to the budget allocated to the Ministry of Agriculture Animal Industry and Fisheries of about UGX 860 billion for the 2017/18 financial year. We further observe that public pension expenditure ratio to GDP has increased and fluctuated between 0.3 to 0.5 percent over the period 2005/06 to 2015/16—indicating an increasing burden of public pension payments to the economy.

Pension Expenditure as a Share of Total Tax Revenue

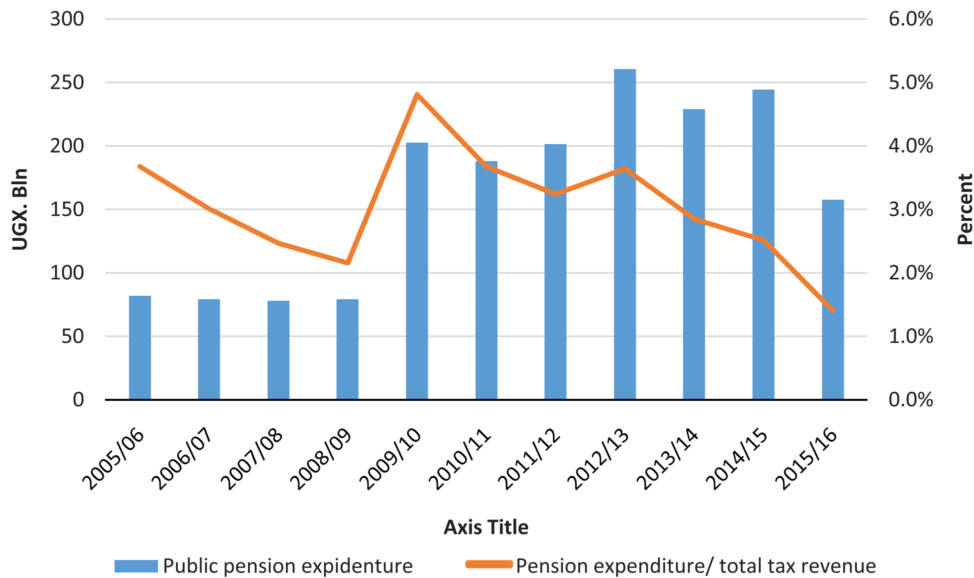
Another measure that captures the fiscal burden of public pensions is the proportion of total public expenditure on public pension scheme to total tax revenue by government. In spite of Uganda's low tax revenue to GDP ratio of 13.35 percent (Uganda Revenue Authority, 2017)[2] , expenditure on public pensions as a share of total tax revenue averaged at 3 percent in the last decade (Figure 2). Nonetheless, there is a noticeable reduction from about 5 percent in 2010/11 to about 2 percent in 2015/16. The decline in share of pension expenditures could be as a result of public finance management reforms that government has implemented since 2012/13 (Munyambonera and Lwanga, 2015).[3] Specifically, the reforms in the decentralized payroll management reduced the incidence of ghost workers and hence reduced government's total wage bill. Even though the share of pension spending in total tax revenue has declined after 2009/10, the cumulative effect of this expenditure remain higher. Given Uganda's low tax base, the increasing level of public spending on public pensions necessitates new reforms in the PSP to make it affordable and sustainable in the medium to long term.

Figure 1: Public Pension Expenditures (values and as share of GDP)



Source: Computation from MFPED Annual Budget Performance Reports.

Figure 2: Public Pension Expenditure (% of Total Tax Revenue)



Source: Computation from MFPED Annual Budget Performance Reports.

Stakeholder Perceptions on Pension Reforms and Implications

Key stakeholders suggest that with the increasing number of public servants—as a result of increasing number of districts—public expenditure on pensions (both arrears and pension payments due), are unsustainable given the low and stagnating tax effort to GDP between 12 to 13 percent in the last ten years. Most policy makers are of the option that the PSP scheme should gradually be converted into a contributory scheme by both the government and civil servants in proportions that may not constrain either party. For example in Kenya, both the government and civil servants contribute 7.5 percent of the gross monthly towards the public scheme. In Tanzania the proportions are 10 percent and 5 percent on the employer's monthly gross salary. To ensure sustainability, Uganda should reform its Public Sector Pension System by borrowing a leaf from these countries.

Implications for Policy

There are fiscal policy implications for reforming the non-contributory public pension scheme to contributory scheme. First, it will ease budget burden to government and release revenues for other competing budget priorities given Uganda's low tax effort; secondly, it will ensure availability of pension to workers at retirement; thirdly, it will ensure medium to long-term sustainability of pension financing from a public reserve fund; finally will improve governance and address administrative challenges that have continued to affect the

"If the current public pension is reformed from non-contributory schemes, government may accumulate about UGX 1.8 trillion in savings from pension in the next five years. This is over above the cumulative arrears estimated at UGX 500 billion by 2016/17.These cumulated funds can be used to clear the fiscal burden on the budget and release resources for other competing development budget priorities of the country. It may be important for government to ensure a fixed amount of pay into the scheme to ensure the adequacy of the system as projected by the formula for the replacement monthly income and gratuity. We also suggest a contribution of 10 percent for government and 5 percent for workers as a minimum. To be effective, it would be important to manage this scheme outside the government account for instance as an independent public pillar of which the most appropriate would be the Central Bank under a trusteeship arrangement. If these funds are invested in the economy they can generate accumulative returns for the savers and ensure higher income at retirement",

public pension management even after the public finance management reforms of introducing the decentralizing pension and payroll management. This backed by sufficient evidence from other East African Countries such as Kenya and Tanzania that there greater benefits from this reform of the PSP.

Endnotes

1 Kayondo (2016), " Pensions Market in Focus", OECD Business Outlook.
2 Uganda Revenue Authority (2017) "Media Press Briefing for 2016/2017 Financial Year".
3 Munyambonera, E and Lwanga, M.M (2015) A review of Uganda's public finance management reforms (2012 to 2014): Are the Reforms Yielding the Expected Outcomes?"EconomicPolicy Research Centre, Research series. No. 121.

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