A DESCRIPTION OF THE PENSION SYSTEM IN UGANDA: NEED FOR REFORM

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Background

The Republic of Uganda became a signatory of the International Covenant on Economic, Social and Cultural Rights (ICESCR) on the 21st January, 1987. Article 9 of ICESCR requires State Parties to recognize the right of everyone to social security and social insurance. Pensions form part of social insurance programs because they pool risks with a view to pay a benefit to qualifying members as may be stated in some law or instrument creating the program. States which are signatories to ICESCR are required to recognize the right to social insurance by creating an enabling economic and legal environment which will enable the realization of the positive right.

Pensions play a fundamental role in the realization of socio-economic right by providing a replacement of income to citizens who lose their regular income owing to old age, disability or death of a wage earner in the family. The system may create a program where the sate makes direct transfers to targeted individuals, or, as in most countries in sub-Saharan Africa provide a legal mechanism which will enable individuals to insure themselves against loss of future earnings by establishing funded pension schemes. Pensions aim at achieving the following objectives[2], i.e. (i) consumption smoothing during the lifetime of a person (ii) insurance against longevity risks (iii) reduction of old age poverty (iv) and redistribution either between generations or from those who have to the less privileged in the society through taxes. Other secondary objectives of the pension system include enabling economic growth specifically in a given country.

A pension system should be inclusive and provide adequate, affordable, sustainable, and robust benefits.[3] In designing a pension system specific objectives intended to be achieved by the system should be clearly analyzed and understood. This will enable development of a pension system which will address specific objectives in a given country. Some of the issues to consider include coverage and financing of the system. This paper makes a brief description of Uganda's pension system and broadly proposes a justification for the system reform.

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[2] Barr N and Diamond P: Reforming Pensions; Principles and Policy Issues; oxford University Press, 2008

[3] Holzmann, R and Hinz, R (2005): Old Age Income Support in the 21st Century: The World Bank's Perspective on Pension Systems and Reform.

A Brief of Uganda's Pension System

The current pension system in Uganda is similar to those in most Anglo-speaking countries in Sub-Saharan Africa. The life expectancy at birth in Uganda is 45 although the retirement age is 60 for public officers. The system is fragmented lacking a policy framework for its efficient operation. Consequently, coverage is low, the public service schemes are unfunded and expensive and the governance of the mandatory pension scheme is unsatisfactory. Private pension schemes operate voluntarily without a law save for the common law principles of trusts and are not supervised. These schemes are poorly governed owing to the lack of regulation. The current pension system can be summarized in a table as follows:

Uganda Pension System

	Public Service Scheme	**Local Govt. workers pension schemes**[4]	**Armed Forces Pension Scheme**	**National Social Security Fund**	**Occupational Schemes**[5]
Legal Structure	Pensions Act (cap 281)	Pensions Act(cap 281)	Armed Forces Pensions Act(cap 298)	National Social Security Act	Trust Deed/private voluntary Plans
Membership	Traditional civil servants, police, teachers **300,000**	All Local Govt. workers **100,000**	Military officers **50,000**	formal sector workers in companies with 5+ 300,000	formal sector workers in companies that have voluntary schemes **50,000**
Funding status	Non-funded	Non-funded.	Non- funded	funded	funded[6]
Benefit financing	Non-contributory (Govt.	Non-contributory (Local Govt.	Non-contributory (Govt.	Contributory (10% employers,	Contributions by employers and employees as per

[4] Urban authorities until 1994 had their own provident funds established under the provisions of the Municipalities and Public Authorities Provident Fund (cap 291). After 1994 amendment of the Pensions Act, all urban authorities were required to provide pensions to their workers under the Pensions Act.
[5] These schemes are currently not regulated and supervised.
[6] The funding status of voluntary occupational schemes is not clearly ascertained there are no records.

	revenues)	Revenues)	Revenues)	5% employees)	different scheme designs
Scheme Design	Defined Benefit	Defined Benefit	Defined Benefit	Defined Contribution (provident fund)	defined contribution / defined benefit/provident funds
Benefit Types	Annuities and lump sums	Annuities and lump sums	Annuities lump sums	Lump sums	Annuities and lump sums

Below is a brief description of each of these pension schemes identifying broadly their limitations which may inform reform considerations by policymakers.

Public Service and Local Government Workers Pension Scheme

The Pensions Act (cap 281, Laws of Uganda), regulates the arrangements of pensions for traditional civil servants , primary and secondary school teachers, police officers, prison officers, doctors and public employees in the judiciary. The Pensions Act also covers civil servants in local authorities. It is worth noting that Urban Authorities until 1994 had their own provident funds established under the provisions of the Municipalities and Public Authorities Provident Fund (cap 291). After 1994 amendment of the Pensions Act, all urban authorities were required to provide pensions to their workers under the Pensions Act[7]. The scheme commonly called public service pension scheme covers therefore civil servants in both central government and local authorities.

The scheme provides for normal retirement age at 60 years with a benefits vesting period of ten years save for the disciplined forces whose vesting period is 12 years. The covered population in this scheme is 300,000 and currently paying pensions to 52,000 excluding those in local authorities. The scheme has a generous full pension based on gross salary with an accrual factor of 2.4% multiplied by the number of years in service capped at 89% of final gross salary.[8] The scheme also promises a commuted pension[9] equivalent to 1/3 of the full pension to new retirees. The pensions are indexed to wages unlike price indexation in a number of countries.

[7] Tatyana B et al: An Assessment of Reform Options for the Public Service Pension Fund in Uganda; The World Bank, 2006.
[8] Kunsa S.K. (2009): Pensions Reform: Its Implications for The Public Service Pension Scheme of Uganda (A paper presented during a Conference on Regulation and Liberalization of the Pension Sector in Uganda, June, 2009)
[9] A Commuted pension gratuity is an advance payment of old age pension to new retirees.

Under the provisions of the Pensions Act, a member will be entitled to pensions or benefits payable under the Act on termination of service on the following circumstances: (a) abolition of office (b) compulsory retirement (c) medical grounds (d) retirement from public service with consent of the president (e) removal from office on public interest subject to 10 years service (f) women retiring or resigning with a view to marry or required to retire on account of marriage subject to 5 years service.

With regard to survivors' pension, the payable pension is 100% of the pension entitlement of the deceased public officer. The guaranteed period for the survivors' pension is 15 years. The scheme also provides an array of other gratuities such as contract gratuities, death gratuities, short term gratuities, and marriage gratuities.

Reform considerations

The said promised benefits are managed by the Ministry of Public Service under the Pensions Department. The defined benefits scheme is non-contributory and is funded by annual government tax revenues. Certainly with the generous benefits, the scheme is faced with challenges such as sustainability, affordability and fragmentation within itself. The need for reform of the scheme is mainly based on the inability of the scheme to balance its liabilities with the financing obligations. In order to address the problem of benefit financing, policymakers may consider systemic reform of the scheme from the current non-contributory defined benefit scheme to a pre-funded scheme on either defined benefit basis or defined contributory scheme. Pre-funding will require the employer and employees to make regular contributions to the scheme targeting to finance the promised benefit. If it remains a defined benefit pre-funded scheme, the government will assume the investment risk.

Pre-funding the scheme will trigger other necessary reforms such as scheme asset management supervision, governance and pension regulation generally to promote confidence in the system because of the heightened interest created by member contributions. Other areas which may need reforms include the capital markets because of the large savings which will require investment opportunities in the local market.

National Social Security Fund

The National Social Security Fund is a mandatory pure defined contribution provident fund which pays lump sums at retirement. The contribution rate to NSSF is 15% shared at 5% and 10% between the employee and employer respectively. The scheme a creation of the National Social Security Fund Act (Cap 222) Laws of Uganda and its core objective is to protect formal employees against uncertainties of social and economic life. In order to realize its core objective the Fund provides the following benefits to its members:

i. Old age benefits in form lump sum payments at age 55 or early withdrawal at age 50
ii. Invalidity benefits
iii. Death benefits (survivors benefits)
iv. Benefits paid on the basis of permanent emigration from Uganda

The core mandate of the Board of Trustees of NSSF may be summarized as to collection of contributions efficiently, invest contributions prudently and pay benefits promptly. To achieve this objective, the governance of Fund must be oh high quality. Lack of quality governance results high costs of collection of contributions, imprudent asset management and delayed benefit payments hence occasioning lack of confidence in the scheme by participants. The ability of a funded pension to honor its legal obligations of paying promised benefits to its members depends not only on adequate funding, but also the investment performance of the collected contributions. Trustees of schemes have an obligation to not only pay benefits but also to prudently manage investment risks.

The scheme assets are centrally managed without the help of external professional fund managers. The fundamental problem of the Fund is the question of low governance. The effect of low governance level has resulted in illiquid social investment in housing and hence making negative returns on members' contributions.

Reform Considerations

The Fund plays an important role in the provision of old age income security. As a mandatory scheme it also widens coverage to formal workers. However, its members have low confidence in the scheme because of low governance standard by the fiduciaries resulting in imprudent investments, high cost of administration and delayed benefit payments. Owing to its mandatory nature and high statutory contributions, the scheme has inhibited voluntary establishment of private occupational pension schemes. In order to improve the status of NSSF in the pension system, policy makers may consider a number of issues ranging from the governance of the Fund, liberalization of the pensions sector or reduction of contribution rates to NSSF.

In order to improve governance the Board composition and selection with a view to enhance independence and accountability ought to be considered. The law would provide for the professional and academic qualification of the board members and the system of appointment which should be subject to parliamentary vetting. A clear and unambiguous statutory mandate on portfolio management would be stated in the law upon which an investment policy will be anchored. Asset management should be guided by clearly stated commercial investment mandates, benchmarking and diversification. An introduction of a supervisory body to introduce private sector professionalism and arms' length standards in regulation and supervision will enhance the performance of the scheme.

Voluntary Private Pension Schemes

These are retirement benefits scheme, unlike NSSF, established on a voluntary basis by employers for the benefit of employees. These schemes vary in design from one employer to the other unlike NSSF which the law requires that it operates as a provident fund. The employer in a private occupational pension scheme becomes the sponsor of that pension scheme. The number of voluntary private pension schemes in Uganda is unknown because they are not regulated or registered by any public body. Owing to high statutory contributions to NSSF, most employers will not have any incentive to establish voluntary in-house scheme for employees. Coupled with lack of tax incentives for employers and employees who wish to participate in a voluntary pension scheme, the number of private pension schemes in Uganda must be low.

Reform Considerations

The development of the voluntary private pension schemes will be enhanced by introducing a regulator to supervise the development and management of the sector. This will enhance confidence among participants by protecting the interests of employers and members of these schemes. Tax policy is equally an important tool in the development of voluntary private pensions and therefore favorable tax incentives may have to be considered to the employers and employees who participate in private pension schemes. But most important consideration towards the promotion of the private pension schemes sector is to liberalize the sector by enabling members of well managed private pension schemes to opt out of the NSSF by contributing statutory contributions to their in-house private pension schemes. Some of the minimum requirements which qualify a private scheme to opt out of NSSF will include providing similar basic benefits as NSSF Act specifies and high quality governance structure as the regulator may determine.

Conclusion

The pension system in Uganda is ripe for reform. The ever rising implicit pension debt in the public service pension schemes, the unresolved governance deficits in NSSF and the underdeveloped private pension schemes mean that Uganda will not be able to guarantee a decent standard of living for its older citizens especially the poor among this category of the population. While pension reform is a major policy which the government should carefully consider, yet it is possible for the same to be developed in phases. In the meantime, those participating in the existing schemes require confidence and a regulator could be established to help in building that much needed confidence and recommend policy on further work for pension reform strategies.