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Public Sector Pension Scheme: From Crisis Management to Comprehensive Reform Strategy

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ABBREVIATIONS AND ACRONYMS

ANA	Afghan National Army
DC	Defined Contributions Pension Scheme
DB	Defined Benefits Pension Scheme
IARCSC	Independent Administrative Reform and Civil Service Commission
MOD	Ministry of Defense
MOF	Ministry of Finance
MOI	Ministry of Interior
MOLSAMD	Ministry of Labor, Social Affairs, Martyrs and Disabled
SOEs	Socially Owned Enterprises

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This note has been prepared as part of the technical assistance provided by the World Bank to the Government of Afghanistan (GoA) in reforming its system of retirement benefits for the public sector employees. It summarizes analysis and policy recommendations provided to the GoA over the period of over three years, by developing analytical framework for analysis of the reform options, discussing reform objectives and important constraints, drawing on international experience, and introducing the reform strategy considered by the Government.

After years of dealing with pension policy in crisis management mode, the Government has begun the process of formulating a national pension policy based on a long-term vision. Not surprisingly, until very recently the Government had been focused on short-term policy actions to alleviate growing pressure on the budget. While these measures were necessary, pension policy by its nature must take a long term view. Recently, Government has developed a comprehensive reform package and initiated the process of legal drafting. In this paper, we put this work in a context of the policy development process and various reform options. A reformed system must have clear objectives, be fiscally sustainable, and address needs of various population groups. The final choices will need to be made as to mandate and design and administrative arrangements of the reformed system. The challenge is to ensure that the measures taken in the next few years do not make it more difficult to pursue certain preferred policies later.

Any attempt at formulating a public sector pension policy must address a number of key questions and issues related to the mandate and design of the scheme. These include: What income replacement rate[1] should the system target and how should pensions be indexed? How to organize financing of the scheme? What parameters will ensure system sustainability? What role should the state budget assume? How to ensure equitable treatment of the old and the new contributors and retirees?

Even an ideal pension scheme design will only succeed if it can be implemented. Design of implementation arrangements will require decisions on the following: How to handle registration, collection, record-keeping, benefit-payments? Who will participate in the reformed system? Should the reform first cover only public sector? Should the system be open to voluntary participation of the private sector workers? How will scalability of the administrative arrangements be ensured? How should information technology and recordkeeping systems be organized and implemented? How should the records of the old system be secured and records of new contributions be tracked? How should disability and survivor provisions be reformed? How can fraud be eliminated and effective financial controls be introduced? How to make accounting transparent?

There are several reasons for starting the process of constructing a new pension policy for Afghanistan. First, the system is becoming an increasingly heavy burden on the budget. Second, even when reform packages gets formulated the implementation process takes several years of internal capacity building. Finally, the pay and grading reform itself provides an opportunity to have a comprehensive approach to design of the new comprehensive compensation package in the public sector. With lack of reforms, inequities will deepen, system imbalances will grow, sustainability will remain threatened, and lack of sound record keeping will perpetuate the problem of efficient monitoring and planning. At the same time, political support to the pension reform today could be gained by introducing it as part of the overall package of the reformed pay. In that context, reinforcing the contributory provisions of the scheme with the reformed parameters may help both to address the immediate financing needs of the program and ensure sustainability.

This paper shows that, according to the financial projections, there is now a window of opportunity for implementing a reform of the system. Outstanding pension debt is still low by international norms, standing at around 6 percent of GDP (as of 2005). The situation will change dramatically as the pay reform progresses. In fact, recent increases in pay to Military and Policy have not been reflected in this

[1] Ratio of pension to earned income while in employment.

estimate. The effect would be a corresponding multi-fold increase in pension liabilities – to likely around one third of GDP. The pay reform effect could in part be counterbalanced by measures of parametrical changes that would have to be carefully calibrated.

A review of the available policy options reveals a wide range of reform possibilities. However, fiscal, administrative and political constraints limit this universe, at least during the transition period that would apply to all of those currently covered by the existing scheme. Reforms in other countries have distinguished between those already receiving pensions, those that are active members of the scheme and those workers yet to have entered the scheme. This report follows this practice and discusses the available options with regard to these three groups. For pensioners, the main question is how already assigned pension values should be adjusted in the future. At the other end of the age distribution, new workers entering the pension scheme should be availed new mechanisms that are adequate, equitable and transparent. Reform would introduce contribution rates and benefit targets that were internally consistent and aim for long-term financial sustainability. The final group would be those that have earned rights to a pension under the existing scheme but who have not yet retired. Here, a transition mechanism must be developed.

With regard to this transition – which will affect the largest number of workers today – policymakers need to narrow the range of options. To the extent possible, these choices should be based on informed and quantitative assessments of the costs – current and future – of different approaches. In the extreme case, the old pension system could be closed immediately. Our assessment of the outstanding pension liabilities should be indicative of the cost of paying out the accumulated liabilities, if such option was to be considered. At the other extreme, simply reforming the current defined benefit formula would help contain the potential new liabilities and eliminate some of the micro-level distortions.

Current infrastructure and administrative capacity will be binding on introducing significant systemic alterations. *Immediate reform steps will likely be limited to changes in the current scheme. At the same time, an immediate measure of re-instituting the contributory concept of the current scheme should become a fundamental step leading towards availing a broader set of reform options in future*. While the note discusses the options of the systemic reform, such as with introduction of the Defined Contributions or the Notional Defined Contributions schemes, it is unlikely that any of such more advanced solutions would be applicable anytime soon in Afghanistan. Both DC and NDC schemes at the minimum would require a robust infrastructure of exchange and consolidation mechanisms for the data on individual earnings. Implementation of such mechanisms in the context of Afghanistan today would be a significant operational stretch. Some important changes, however, could and should apply immediately. The current scheme is contributory in principle but not in practice. Contributory requirements of both the employers and employees must be reassessed as part of the reform program to re-enforce self-sufficiency principle in the program financing. Considerable investments in infrastructure and capacity building will still be required to bring the system up in line with the contributory concept and mandate. When such capacity is in place, perhaps some more comprehensive first-best solutions could be considered in future.

A key long-term policy decision is when to extend the contributory scheme beyond the public sector. In our view, reform measures should first focus on the public sector. This task is complex enough to pose serious implementation challenges. Expansion of the scheme to the private sector in the short to medium terms is not advisable. However, it is important that the proposed framework and administrative setup do not preempt eventual expansion of the scheme to the private sector employees.

Since short run changes will only affect public sector workers, they must be carefully coordinated with the ongoing reform of the civil service. Policy in these two areas should be determined in conjunction, not in isolation. Consolidation of various allowances with the basic pay, with no other changes in the scheme parameters, will lead to immediate increase of pension liabilities. Parametric changes in the pension scheme will help to contain the effect of pay consolidation on both the pension liabilities and current spending. The measures considered should include: (i) adjust the accrual factors, (ii) initiate gradual expansion of period of pensionable earning, (iii) introduce minimum retirement age, and (iv) reform survivor pension provisions.

The Government's reform plan, while preserving systemic fundamentals of the existing system, reflects different approaches to different categories. The parametric changes are proposed for the new scheme that would cover existing and new employees, including (a) reduced accrual factor (down to 2%) and limit on maximum pension (80%, down from 100%) that correspond to the revised new contribution rate (16% employer and employee); (b) pensionable wage that includes all the allowances and spans the period of three years when used in pension calculations; (c) explicit provisions for indexation of the pension benefits; (d) minimum retirement age of 55 with minimum service requirements (25 years) and actuarial adjustment for early retirement (3% reduction in benefit for each year of service); (e) explicit provisions for disability pensions (covering only permanent disability); and (f) rationalizing the survivors benefit provision limiting its fiscal impact and administrative burden. While some more radical steps could be taken on account of the parametric reform (for example, the early retirement age remains quite low, pensionable wage assessment is still relatively short, etc.) the current reform proposal reflects a major progress in conceptualizing and addressing key issues in operation of the existing pension scheme in the very difficult political and operational context of Afghanistan.

As far as the current retirees are concerned, serious considerations are being given to liquidating liabilities of the existing scheme. Lump sum payments to the current retirees and their survivors are being seriously considered. While we do provide indication of the fiscal needs of this policy, we also, however, provide a word of caution on potential social and fiscal implications of such a measure if implemented. First, fiscally, it is unaffordable in the short term, unless some prioritization is done (e.g., payments made first/only to the survivors and/or to the very senior cohorts of the retirees). Second, if money spent too quickly, retirees may face a risk of poverty and turn back to the Government for assistance.

Administrative capacity of the Pension Department will need to be upgraded. Initial investments can go into automation of the benefit processing operation. Automated work-stations should be installed at all the application processing points. A software application should be developed to facilitate benefit amount calculation. The application should be able to incorporate all the rules introduced as part of the reform, including new accrual rates and lump sum conversions. This effort will likely not be a major expense but will considerably improve the quality of operation of the pension agency in the short term.

Implementation of the concept of the contributory pension will require more significant investments and efficient coordination of various government agencies. In future, the pension benefit should be calculated on the basis of record of contributions on behalf of employee. Various agencies will have a role to play in design and implementation of the related systems, including civil service Human Resource Management database and the collection and accounting systems. Overall implementation activities will need to be directed by a special task team or implementation unit and will have to be carefully coordinated with other activities directed to modernization of the public sector operation. As we note above, when such system is in place and covers most of the civil service in all parts of the country, serious considerations could be given to more radical reforms with introduction of some systemic changes to the existing scheme.

Some important external implementation risks remain, however. Success with implementation of this reform depends significantly on the progress with the roll out of the Pay and Grading reform. The new pension parameters apply only to employees who get transferred to the new grades and new pay scales. The only change that applies to the old scheme is indexation of the benefits and option for paying out existing liabilities in form of the lump sum. While no other interim or contingency solutions offered for the current scheme, if the main reform does not progress as expected, perhaps, the proposed pension reform measures by the Government would have to be critically reassessed in future in light of that progress.

2. INTRODUCTION

This policy note has been prepared as part of the technical assistance provided by the World Bank to the Government of Afghanistan (GoA) in reforming its system of retirement benefits for the public sector employees. It summarizes analysis and policy recommendations provided to the GoA over the period of over three years, by developing analytical framework for analysis of the reform options, discussing reform objectives and important constraints, drawing on international experience, and introducing the reform strategy considered by the Government.

After decades of war and economic collapse, today the pension system in Afghanistan faces serious financial and operational challenges. Coverage remains limited to the public sector, despite a broader mandate stipulated by the Pension Rules. Administrative systems are weak and financial management lacks transparency. The funding is largely coming in form of subsidies from the central budget. The lack of adequate protection mechanisms in the Rules and regulations of the scheme lead to deterioration of the benefit value and the ad hoc payments stipulated in the Government decrees (most notably to those who retired prior to year 1382/2003). Various recent decisions lacked proper policy context and sound financial analysis, and resulted in arbitrary disparities across cohorts of retirees.

There is growing concern about the impact of various public sector reform initiatives on liabilities of the pension system. Pay and grading reform with changes in the scale and composition of pay as well as structural adjustments in the civil service will have serious implication for the pension liabilities. Analysis of the short- and long-term implications for the pension system has been lacking. In 1385/2006, for the first time assessment of the outstanding pension liabilities of the public sector pension scheme was provided. This note builds upon those results and presents a more detailed analysis estimating impact of pubic sector reform initiatives leading to change in pay scales, and discussing reform options.

Comprehensive reform of the pension system remains a priority. The challenge is to differentiate crisis management from the process of formulating a new national pension policy for the long run. Most immediately, the government faces the challenge of addressing existing obligations to those that have been covered by the old system. Viable solutions will have to be designed in a difficult environment that includes many competing demands on the budget, poor information and weak administrative capacity. Complicated reform packages should probably be avoided in the short run. Most importantly, a carefully considered new pension policy should not be pre-empted by measures that will be implemented in the next year or two. Because short run changes will only affect public sector workers, they must be carefully coordinated with the ongoing reforms in the civil service. Policy in these two areas should be determined in conjunction, not in isolation.

Most recently, the government has developed a comprehensive reform strategy and initiated the process of drafting the new Pension Regulation. In mid-1386/2007, the reform process entered another active phase. The Government has formed a senior Steering Committee on Pension Reform[2] tasked to oversee the process of the reform policy formulation. An interministerial Technical Working Group was also formed to analyze and propose reform options. By end 2007, the draft comprehensive strategy note was produced and a legal drafting process was initiated.

This note has been prepared as part of the technical assistance provided by the World Bank to the Government of Afghanistan (GoA) and is intended to facilitate the policy dialogue at its final phase of narrowing the set of reform options. The World Bank has been involved with providing support to design and implementation of the government reform program. To this end, the effort focused on collecting data for financial analysis of the scheme, producing estimates of the outstanding pension

[2] The group included representatives of the Ministry of Finance (MOF), the Ministry of Labor, Social Affairs, Martyrs and Disabled (MOLSAMD), the Independent Administrative Reform and Civil Service Commission (IARCSC), and the Ministry of Defense (MOD).

debt, and preparing basic operational analysis of the system, etc. This note summarizes analysis and policy recommendations provided to the GoA over the period of over three years, by developing analytical framework for analysis of the reform options, discussing reform objectives and important constraints, drawing on international experience, and introducing the reform strategy considered by the Government.

The note is organized in sections. Section 3 provides operational review of the current scheme. Section 4 provides overview of the program finances and is followed by Section 5 that presents estimates of both the short-term budget needs and total outstanding pension liabilities. Sections 6 and 7 then discuss general reform options and particular elements of the reform strategy. Section 8 presents recently proposed Government strategy of the reform and Section 8 concludes with an outline of the key steps to be taken to operationalize the reform.

3. ORGANIZATION AND KEY PARAMETERS OF THE CURRENT SCHEME

3.1. SCHEME DESIGN, FINANCING, AND BENEFIT DETERMINATION

The public sector pension scheme is part of the greater set of social protection arrangements operated by the Government. There are three principal cash benefit schemes operated by the government agencies. The main scheme covers employees of the civil service, SOEs, teachers, as well as officers of military, police, and security forces. This scheme is in the focus of this note. It is administered by the Pension Department operated under jurisdiction of the MOLSAMD. Another contributory scheme covers employees of the public banking system. It is administered by the Pensions Unit of "Da Afghanistan Bank" (DAB), the country's Central Bank. Analysis of that scheme is outside the scope of this note[3]. In parallel to the two retirement schemes, another publicly funded program pays benefits to the families of martyrs and disabled (we discuss this program in greater details in Section 3.4).

The Pension Rules and various decrees establish legal framework for operation of the scheme. *It is a PAYG scheme funded by the contributions and transfers from the state budget.* According to the Rules, employers and employees contributions are correspondingly 8 and 3 percent of the basic pay[4]. (The latter is only a component of the total take-home pay that includes various allowances). In practice, employee contributions constitute only a small share of all the receipts, while employers largely provide no matching amount at all. The direct budget allocations provide major source of funding. Historically, the scheme used to have reserves, invested both in physical assets (shops, buildings, cinemas, etc.) and bank deposits. In early 1980s, these assets were taken away from the pension system by the communist government. Discussions have been ongoing over the return of the control over the assets to the Pensions Department but ability to implement such a decision would be questionable given challenges of identifying legitimacy of ownership claims.

The scheme provides insurance against the old age, disability, work-related injury or illness, and death. Annex 1 presents parameters of the scheme and discusses how they get implemented in practice. The following provides summary of rules for various benefit categories. Normally, benefits get paid only once a year for the corresponding periods of 12 months.

- To qualify for a <u>regular old age benefit</u>, the civil servants must have accumulated at least 10 years of service by the time of retirement (normal retirement age is 65). Those claiming benefit with work histories of less than 10 years collect lump sums. Individuals must present certified service record from employer.
- In case of <u>survivor benefit</u>, family normally designates one individual to collect the benefit equivalent to up to 100 percent of the deceased member's benefit amount. Categories of survivors include widow, children, unmarried daughter aged over 18, son in the national military, parents, dependant brother. Although there is no absolutely confirming evidence, family members seem to be able to claim benefit on the roll-over basis: when a surviving beneficiary previously in receipt looses eligibility based on some ground (death, age, or marriage) another eligible next of keen of the deceased member may apply.
- <u>Disability pensions</u> are granted under the same rules. Normally, 60 percent disability is required to qualify for benefit, although no detailed information available on the operational setup and enforcement practices. Still, the overall number of such cases is small. Out of a sample of over

[3] As of 2004, the DAB scheme covered around 3,000 insured employees of the DAB (majority working in Kabul) and around 2,000 employees of other public banks. Data for 2003 showed the DAB scheme paying pensions to 1,511 pensioners, about 80% of whom lived in Kabul.

[4] Additional contribution required at the time of joining the service and each time salary is increased.

32,000 records of regular retirees, only 6 percent were identified with the status of health related reason for retirement[5].

- Provisions for work related injury or work related death guarantee a benefit equivalent to 100 percent of the last pay to the employee or his surviving family. While capacity to differentiate between the work and non-work related cases of health problems is supposedly weak, the Pension Department indicates that the number of work injury claims has remained very low. Indeed, the available sample records do not indicate significant abuses of the provisions. The records of health-related retirement benefits with replacement rates recorded as 100 percent and the work history of less than 40 years constitute less than 2 percent of all health related cases[6].

According to the Pension Rules, benefit calculation takes into account the last pay and the total service period. At the time of retirement, employees must present a record of service certified by employer. Consolidated database of earnings/contributions records however does not exist. All records, even in the central office are paper-based. Administration and monitoring of the program therefore remain very weak and prone to systemic abuses and human error.

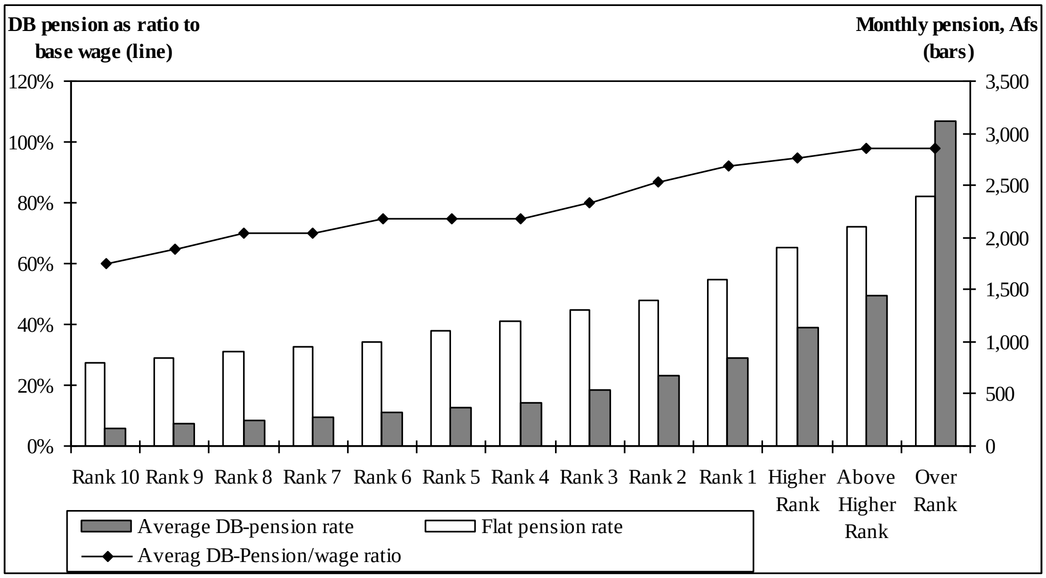
By 1382 (2003) benefit value deteriorated significantly, so that only few seemed to be willing to claim eligibility and collected benefit. As an interim measure, Government announced a benefit increase. The new provisions stipulated flat but grade-specific benefit payments to all those who retired in the past (both civil servants and military), without connection to their length of service. Civil servants who retired in or after 1383 (2004) continued to be subject to the normal rules of benefit calculation based, however, on the new salary scale (a 7-fold increase from 1382).

The interim measure introduced by the Government created some visible disparities. Two principal sources of differences in the pay for the old and the new retirees are lack of length of service consideration for those retired prior to 1382 (2003), and narrow definition of the pensionable base for the new retirees. Basically, two individuals retired before and after 1382 in the same rank and with the same length of service receive different pensions, with the difference primarily being the function of length of service. Tables A2-1 and A2-2 in Annex 2 provide details of rank/grade specific amounts of wage and flat pension. For those who retire today, the ratio of pension to the last wage would vary between 40 and 100 percent of the last pay. We used sample data to obtain rank-specific pattern of the actual ratios of pension to last wage for the civil servant. We then used 1384 (2005) wage rates (prior to the mid-year wage increase of Afs 350) to calculate average DB pensions. Results are presented in Figure 1 where we contrast them to the flat benefits for the same ranks. We note that disparities are significant, especially for the employees in the lower ranks, as those on average accumulate smaller number of years by the time of retirement. For the new retirees, however, the gap between the flat benefits and the DB benefits supposedly is shrinking as the public sector wages are subject to constant increases. Furthermore, this gap will be completely reversed as the pay and grading reform progresses and new retirees will be retiring with pensions calculated on the wages significantly higher than those that were paid in the past.

[5] Although, for a significant number of records, clear identification of the status was not possible.

[6] Around 6.5 percent of non-health-related claims with recorded service of less than 40 years were awarded full replacement rate too, although a dominant majority of those records come with work history of close to 40 years. In general, in the sample dataset of individual records, we could observe a close association between the service record and the granted replacement rate.

Figure 1: Disparities in pensions for the civil servants



Sources: Authors' calculations based on data from the MOLSAMD Pension Department and the IARCSC.

To some extent, present disparities can possibly be justified by the low historic benefits. Furthermore, existing rules that provide for the past due payments seem not to offer adequate compensation for the delayed benefit receipt. Eligible individuals may request a compensation for past periods when they were eligible but did not collect benefits. Our analysis of the sample pension records indicates that there are three different types of overdue payments that correspond to different categories of retirees:

- Type I. Periods of pension eligibility since 1383 for those retired *in or after 1382* provide for benefit calculated based on the DB formula and new salary scale.
- Type II. Periods of pension eligibility since 1383 for those retired *prior to 1382* result in flat benefits according to the temporary norms.
- Type III. Periods of pension eligibility prior to 1383 result in benefits calculated based on the regular DB formula rules and old pre-increase pensionable salaries.

Effectively, some retirees who were eligible for benefit prior to 1383 but (re-)applied only in 1385 will receive past-due payment comprising of two components: two years of flat payments (Type II) and a number of years in no receipt of benefits for the period they were eligible prior to 1382 calculated based on the past (very low) salary (Type III). There is no indexation or any other compensation made for the delayed benefits of the pre-1383 period. As result, those benefits seem to be not only inversely related to the periods in no receipt but also often (especially for the lower ranks of servicemen) when aggregated for several years appear smaller than even 2-3 monthly payments under the new flat benefit provisions. Table 1 provides results of analysis of a sample dataset records and indicates that over a quarter of the total paid amount in 1384(2005) could have constituted various overdue payments.

Table 1: Overdue pension payments by type, % of total payments

Overdues	1383/2004	1384/2005
Type 1	-	3%
Type 2	-	20%
Type 3	3%	5%
Total	**3%**	**27%**

Source: Authors' calculations based on sample data provided by the MOF Monitoring Agent..

Finally, disparities in the military and police component of the pension scheme seem to be of an opposite nature. Those who retired prior to 1382 (2003) receive flat pension amounts according to the same schedule adopted for the civil service. Their fellow servicemen who retired afterwards, however, benefited from a very significant increase in the base pay few years back. So, the new benefit calculated under the normal DB rules of the scheme appears to be significantly higher than the flat amounts. At the same time, in anticipation of even higher benefit based on the most recent pay scales revision for the Afghan National Army and pending the new retirement provisions for the military, at present there is practically a freeze on retirement of the military officers.

In summary, the ad hoc system of adjustments in benefits and methods of paying arrears have resulted in an arbitrary relation between pensions and wages across workers and in very different pension levels for individuals retiring within relatively short time frame. Questions remain as to the total outstanding past due payments and their expected dynamics over time.

3.2. RECORD KEEPING

The collection process and operation of the entitlement assessment mechanism are disconnected. The Pension Department does not retain direct control over the process of contribution collection. Instead, the Ministry of Finance, operating through the Treasury and the Tax Administration (for the government entities and for the state owned enterprises, correspondingly), administers the collection system. The Pension Department seems to receive only some aggregate information from the Tax Administration. It is not clear what use of this information is made. Likely, no systematic monitoring, enforcement, and data consolidation is performed. Importantly, the Pension Department does not keep track of records of the insured employees until the time of benefit claim, at which point individuals apply with documents certified by their employers.

The collection and monitoring systems of the Ministry of Finance still remain weak. The continuous support of the donor community is aiming at modernizing the Treasury operation. Compliance enforcement of pension contributions remains weak. Taxes rather than pension contributions remain priority for the collection agency. As part of the continuous process aiming to improvements in the accounting systems, the Treasury chart of accounts is subject to changes from year to year, which seems to complicate monitoring and reconciliation of the pension scheme. Managerial focus on the pension contribution accounting and enforcement is clearly needed. Ideally, a dedicated pension collection manager should be appointed to supervise the contribution collection process.

Application processing is a long and cumbersome process and is highly centralized. When an official retires from service, his/her service record (last pay drawn, date of joining service, etc.) is forwarded to the Pension Department in Kabul, which is the sole organization authorized to calculate pension benefits. Employees who retire in the provinces have to forward their documents to the office of their respective ministry in Kabul for processing and verification before they can be submitted to the

Pension Department in Kabul. The Pension Department in Kabul then processes the case and forwards payment authorization to the provincial office. Processing of the applications takes on average one month for those retiring in Kabul and around three months for those retiring in the provinces.

The legacy record-keeping systems require modernization. In its current state, expansion of system coverage to the private sector is not advisable. In the environment when most of the companies are de facto part of the public sector, it would not be uncommon for the public pension scheme to operate as an annex to the government payroll system with limited record-keeping capabilities. Where private sector participates in the pension program, the lack of records of service poses major operational and financial risks. Therefore, current operational weaknesses would pose significant challenges were the system to be opened to the privet sector participants.

3.3. PROGRAM COVERAGE

3.3.1. INSURED EMPLOYEES

In principle, the scheme should provide coverage to employees in all sectors of economic activity. The coverage, however, remains limited to employees of the public sector as well as police, military, and security officers. While there is lack of clarity on compliance of the State Owned enterprises (SOEs) with respect to their contributory obligations, eligibility of their employees seems secured simply by the virtue of their civil servant status. With no consistent evidence, there have been reports of other non-government entities contributing on a voluntary basis; however, as noted above, with limited record-keeping capacity, it would be difficult to substantiate such evidence of contributions at the point of benefit claim by individual employee.

In the public sector, all employees, except those on term contracts and regular soldiers of military and police, are covered by the system. Depending on employee status there are three principal categories of retirees: regular civil servants (which includes teachers), ajirs[7], and military (which includes uniform staff of police and security forces). As Annex 1 indicates, ranked officers and generals of the Ministry of Defense, the Ministry of Interior, and Security forces have somewhat different retirement provisions. Reports compiled by the Pension Department differentiate retirement cases by origin (Kabul vs. Provinces) with no detailed breakdown of employee category available for the Provinces.

Exact labor coverage numbers do not exist largely due to the difficulties with assessing overall size of the public sector. Estimates of the civil service and the military staff vary. Annex 3 presents analysis prepared by the World Bank as part of the PFMR report[8]. The same Annex also provides detailed data on structure of the ranks and grades of the civil service employees (without differentiation between the Center and Provinces); Table A2-3 in Annex 2 provides the same data for police officers and sergeants.

Assessment of coverage from the perspective of categorical definition of the participants by the Pension Department would be even more demanding. Ideally, for the purpose of financial analysis, given varying rules and profiles, we would need to have coverage data presented in categories similar to those operated by the Pension Department, i.e., the data would need to be presented in three dimensions simultaneously: (i) covered vs. non-covered employees, (ii) regular employees vs. ajirs,

[7] Also called contractors or workers. Distinction from regular employees is basically "blue collar" versus "white collar" occupations.

[8] Another source of headcount data is payroll reports prepared regularly by the MOF Monitoring Agent. Although, e.g., no separation is made for regular employees and ajirs. It is also often not clear if and where overlap in definitions of various published statistical categories may occur. For instance, it is not clear whether some or all SOE employees in the PFMR report are counted under the general government category (we assume they are included in the detailed report provided by the IARCSC and therefore adjust our estimates correspondingly).

(iii) employee in the center vs. the provinces. At best, such information can be obtained for one category at a time. Therefore, analysis reported in Table 2 provides only very rough estimates based on the findings and assumptions detailed in Annex 3, Table A3-3. This is an attempt to replicate structural elements of the operational setup of the pension system to be used for extrapolation of sample data in our financial projections.

Table 2: Estimates of the public sector employees covered by the pension scheme, mid-1384 (2005)

Sector	Category	Headcount
Civilian employees	**Center**	
	Regular employees	30,000
	Teachers[1]	20,000
	Ajirs	27,500
	SOEs, incl.:	22,000
	Regular employees	*8,500*
	Ajirs	*13,500*
	Provinces	
	Regular employees and ajirs	79,500
	Teachers	90,000
	Total:	**269,000**
Uniformed staff	**Sergeants, officers and generals**	
	MOD/ANA[2]	15,500
	Police[3]	21,000
	Other security forces[4]	2,000
	Total:	**38,500**

Notes: [1] The total teacher count in center and provinces by end-1384 stood already at over 140,000.
[2] Includes reserve officers. Data for early 1385 (MOD).
[3] Payroll data for early 1385 (MOI).
[4] Includes all uniform staff other than the Ministry of Defense and the Ministry of Interior. Not clear if these numbers are included in MOD/ANA data.

Sources: Authors' estimates based on data provided by the MOF Monitoring Agent, the MOF Privatization Department, MOLSAMD Pension Department, IACSC, MOI, MOD.

Comparison of employment coverage with retirement statistics is puzzling. While in our financial analysis below we do not distinguish between the Center and Provinces, we note, however, a puzzling phenomenon that with well over 50 percent of the current non-military employment coverage concentrated in provinces, pension cases registered in Kabul constitute close to 90 percent of all historic cases (see table A4-1 in Annex 4). One potential explanation would be that most retirees prefer to claim benefits in Kabul. Alternatively, one can speculate that due to various limitations (e.g., lack of infrastructure, access and/or information) some number of eligible individuals in the provinces have not yet taken opportunity to apply, – such interpretation would imply a downward bias in the financial estimates provided below.

3.3.2. RETIREES

Individual files maintained by the Pension Department keep record of circumstances of the applicants, including type of retirement (old age, early retirement, etc.), reason for early retirement (e.g, imprisonment or downsizing), and health-related conditions (i.e., permanent or temporary, partial or full, work-related or not work related disability). Information also exists on the affiliated ministry of the applicant.

At the same time, capacity of the Pension Department to monitor the actual stock of eligible retirees is very limited. The monitoring and budgeting processes have largely evolved around the cumulative number of all retirees who ever applied and retired under provisions of the scheme since its inception. The most often referenced official number of pensioners includes all dead and alive, active and passive, retirees and their survivors who have ever applied since inception of the system (see Annex 4, Table A4-1). Most recently, that number stood at around 90,000 registered cases (see Annex 4, Table A4-3). For all the practical purposes, however, our interest is with those alive today who are or could be eligible for the benefit. The Pension Department also has data on actual payments made (see Table 5) but significant differences in number of application cases and payments made indicate possible arrears, inactive cases, as well as double-counting on total application cases (i.e., passive employee file and active survivors file for the same employee). Based on the records captured electronically by the IARCSC in collaboration with the Pension Department, as well as data provided directly by the Pension Department, we provide an assessment of the number of all *registered* retirees who would be alive to claim their benefits (see Annex 4, Table A4-2).

Our knowledge of the overall structure of the retired population, however, remains limited. There are likely individuals who got separated form the civil service in the past but have not yet applied for benefit. There also seem to be individuals who applied but have not collected their past due and/or current payments. Finally, assessment of the recent dynamics of the claim and payment cases indicates that the Pension Department may be paying out arrears to some categories while accumulating arrears to the others.

3.4. NOTES ON PENSIONS FOR DISABLED AND SURVIVORS OF MARTYRS

Pensions for disabled and survivors of martyrs consume budget resources equivalent to the main pension program[9]. While formal review of that program is outside the scope of this paper, we provide a summary with insight to the overall budget envelope available for pensions, the overall operational capacity of the public benefit administration, and potential synergies of the reform initiatives.

The program is currently under management of the MOLSAMD. Operationally, it shares same deficiencies with the civil service pension scheme: it is a heavy paper based operation that lacks monitoring mechanisms. Since 1371, around 300,000 individuals applied, including around 210,000 survivors of martyrs and 90,000 disabled. Actual figures for payment cases, however, are not available. It appears that some cases may not be eligible anymore, e.g., due to death, while others may remain pending. In contrast to the civil service pension scheme, most applications are registered in the provinces. The eligibility process for disability involves verification by local community, government office, and special health commission. Payments used to be made quarterly but annual payments are becoming a norm.

There are concerns with both the restricted definition of disability and potential increase in the required funding if those restrictions are to be lifted. At present, eligible disability and survivorship must be war-related[10], which defines highly sensitive political context of the program. Furthermore, there are likely no robust mechanisms to substantiate evidence of war-related casualty, and discretion of community or authorities would have to direct the eligibility assessment process. Considerations have been given to introducing a more general disability definition (most recent estimates put the

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[9] The 1385 allocation is Afs 965,000,000 (according to the sources of Martyrs and Disability program).

[10] It is possible that only selected conflicts and/or selected categories of the fighters and their families are eligible for benefits.

number of individuals with general disability at around 800,000[11]) but such measure will likely be prohibitive at the moment. At the same time, it is feared that even under the current conditions, there are a considerable number of individuals in the remote communities who have not yet been given a fair opportunity to apply.

There seems to be no viable strategic planning, no robust mechanisms ensuring adequacy of benefits, and no clear budgeting procedures. The program management has rather evolved around the ad-hoc approach. With lack of knowledge on actual eligibility cases, the planned number of recipients seems to have become an endogenous parameter. For instance, with the 1385 budget allocation and the new adopted benefit rate of Afs 400, it is expected that around 201,000 payments will be made in the current year.

Following the recent merger of the Ministry of Labor with the Ministry of Martyrs and Disabled, proposals have been discussed to annex operation of the martyrs scheme program with the administration of the civil service pension scheme. Such initiative may cause serious disturbances in operation of the pension program, given lack of resources and capacity on the side of the pension agency, and more importantly contribute to further deterioration of the monitoring mechanisms of the pension program given poor record keeping. Therefore, no merger should be recommended at this point, at least not prior to modernization of infrastructure of the pension agency. At the same time, as a component of the overall modernization effort of the public sector, and in particular of the pension operation, consideration should be given to devising mechanisms of upgrading the administrative and record keeping capacity of the disabled and martyrs schemes. Some basic monitoring mechanisms should be put in place to facilitate effective policy analysis and reform.

[11] The estimate comes from the National Disability Survey in Afghanistan (NDSA) implemented in 2005 by Handicap-International in cooperation with government agencies and co-funded by a group of donors. In particular, it indicates that only 17% of all disabilities are war related (or between 126,000 and 146,000 cases), including up to 60,000 cases of landmine and UXO survivors. It is not clear if the latter category qualifies under the eligibility definitions of the cash program of the Ministry.

4. OVERVIEW OF THE PROGRAM FINANCES

The budgeting process for the program is not fully transparent. Lack of accrual accounting and past due payments considerably complicate monitoring and planning of the scheme finances. Direct budget subsidies remain a principal source of the program revenues. It is unclear how financing needs of the scheme get assessed as part of the budget cycle. The concerns are with: (i) lack of proper detailed information on the current beneficiaries, (ii) lack of accrual accounting to differentiate between the current and the past due payments, (iii) consequently, limited capacity to monitor appropriation of funds[12], (iv) unclear government plans as to downsizing of the public sector, and (v) lack of information on the current age structure of the covered workforce. Table 3 indicates that a considerable part of the program funding comes from the direct budget allocations.

Table 3: Funding sources of the pension scheme (million Afs),

Revenues,	1383/2004	1384/2005
MOF net allocation[1]	382.3	870.1
Other sources[2]	127.3	190.9
Total	**509.6**	**1,061**

Notes: [1] After netting out of funds returned to the MOF
[2] Includes employee contributions from government and SOEs
Source: MOF Monitoring Agent.

Pension benefit payments are facilitated by at least six principal accounts. In additional to the main (buffer) account for budget allocations, five other accounts are maintained by the Pension Department to separate cash flows for payments to: (i) civil servants in Kabul, (ii) contractors (ajirs) in Kabul, (iii) survivors in Kabul, (iv) pensioners of the military and police, and (v) pensioners in provinces. Table 4 provides details of pension expenditures. While in 2005, the budget originally provided for Afs 724 mil in expenditures on pensions, at the mid-year review additional allocation of around Afs 200 mil was required.

Table 4: Pension expenditures (million Afs)

Type of Expenditures	**1383/2004**	**1384/2005**	**1385/2006**	**1386/2007**
Benefit Payments in Kabul, incl	455.1	820.0	1,005.2	1,324.4
Civil Servants		*132.0*	*298.4*	*364.3*
Ajirs		*149.7*		
Survivors (CS & Ajirs)		*113.6*	*140.8*	*177.7*
Military & Police		*384.2*	*490.0*	*713.9*
Survivors of Military & Police		*40.5*	*76.0*	*68.6*
Benefit Payments in Provinces	54.4	94.5	103.7	175.0
Total pension expenditure	**509.5**	**914.5**	**1,109.0**	**1,499.4**

[12] For instance, rapid increases in expenditures in the recent years could be associated with the fact that some retirees came to collect their benefits for both the current and past year(s), reflecting the process of clearing the backlog of outstanding liabilities and not necessarily the permanent increase in the financing needs.

Source: MOF Monitoring Agent.

Overdue payments seem to have represented a considerable part of the pension expenditures lately. We use reported numbers of actual payment cases in both 1383 and 1384 to assess program budget requirements (see Table 5). A significant part of the gap between assessed needs and the actual expenditures (from Table 4 above) can likely be explained by the overdue payments as evidenced in Table 1[13]. (Reported lump-sum payments by the scheme have been very insignificant). While we would expect for such overdue payments to gradually become insignificant, the most recent statistics provided by the Pension Fund seem to indicate that in parallel to clearing arrears for some categories of the beneficiaries, it keeps accumulating arrears in some other payments; more importantly, as we noted above there is no reliable estimate of the number of individuals who resigned in the past but have not yet applied.

A significant increase in the number of payment cases between 1384 and 1385 remains largely unexplained. For instance, we do not know for sure what share of the new retirees separated from the public service in the same year, or how many of them simply did not apply until recently, and if the Pension Department is experiencing serious delays in processing applications and/or authorizing payments. A significant recent increase in the number of new survivor applications is likely in part reflective of the fact that some individuals indeed delayed their claims.

Table 5: Assessment of the program financing needs

	Pensioners		**Average Benefit, Afs**	**Projected Annul Budget, Afs**	
	1383/2004	**1384/2005**		**1383/2004**	**1384/2005**
Beneficiaries in **Center**, incl.:				**409,000,000**	**666,000,000**
Civil Service, including					
Retirees	10,500	16,900	1,260	159,000,000	256,000,000
Survivors	3,800	6,350	1,180	54,000,000	90,000,000
Military and Police, including:					
Retirees	7,900	11,800	1,890/2,070	179,000,000	293,000,000
Survivors	1,450	2,150	980/1,030	17,000,000	27,000,000
Beneficiaries in **Provinces**:	2,100	4,000	1,200	**30,000,000**	**58,000,000**
Total	**25,750**	**41,200**		**439,000,000**	**724,000,000**

[13] Methodology of calculation of average benefit implies possible upward bias in assessment of the program financing needs. For the category of civil service beneficiaries, we assessed averages based on the available distribution of ranks/grades of retirees and the would-be flat benefits, – while in reality some beneficiaries (perhaps a smaller share) would retire under provisions of the normal DB formula providing for a smaller benefit in comparison. For military beneficiaries, we calculated averages based on actual recorded amounts paid (controlling for outliers in data), with no clear indication of whether or not some of the records reflecting overdue payments.

Notes: The Civil Service category includes ajirs, teachers, and SOEs(?).
The average pensions in the center were calculated based on the sample of individual records; for military, two different estimates were used for 1383 and 1384; for provinces, somewhat smaller average rate was assumed.
The estimates do not include the overdue payments.

Sources: Authors' estimates based on data from MOLSAMD Pension Department and IARCSC.

5. FINANCIAL PROJECTIONS

The following section provides results of the financial analysis of the current pension scheme. Two types of calculations were made. We first assessed outstanding pension debt of the government based on the 2005 sample data of individual records and then preceded with a short-to-medium term analysis of financing needs for the pension program under various scenarios. We discuss our results and assumptions below.

5.1. DATA SOURCES

In our projections of both the outstanding pension debt and the short-term financing needs of the program, we used sources of the Pension Department, the IARCSC, the MOI, the MOF Privatization Department, and the MOF Monitoring Agent, as detailed in Table A5-1 of Annex 5.

5.2. ASSESSMENT OF TOTAL OUTSTANDING PENSION DEBT

Total stock of pension liabilities is a key indicator in assessment of the long-term fiscal viability of the program and government's capacity to undertake comprehensive reform initiatives. In principle, pension law defines certain contractual obligations of the government towards members of the scheme. Therefore, in course of its operation, pension program accumulates implicit liabilities. Growing implicit debt is becoming increasingly a concern in countries with aging population and generous retirement provisions. Changes in compensation packages in the schemes that are based on final salary for calculation of the benefit have also direct impact on the total stock of outstanding pension debt. Therefore, in the context of anticipated changes in the civil service pay scale it is important to evaluate the current accumulated debt and the impact of these changes.

Results indicate relatively low pension liabilities at present, by international comparison. Table 6 provides details of components of the pension liabilities accrued on the system up to year 1385 (2006), with total estimate standing at around 6.2% of GDP (using a conservative 3% discount factor). Annex 5 details assumptions used in the analysis. We applied a normal Pension Rule DB formula to estimate liabilities for the current employees. International comparison with other civil service schemes (Table 7) indicates that Afghanistan still has quite low pension debt-to-GDP ratio. The most recent changes both in structure of the civil service and the military/policy as well in the compensation package (which we used in the latest short term assessment of the fiscal balance of the system) have not been reflected here. Our initial assessment of the change that happen over the past few years on the retirement side of the scheme indicates that due to the number of the newly registered claims, total liabilities towards the pensioners may have already increased by 50%.

The situation may change dramatically as the pay reform progresses.

Table 6.A also presents impact of the proposed pay reform with a multiple increase in the pay scale. As expected, the effect would be a corresponding multi-fold increase in pension liabilities to around one third of GDP. The pay reform effect could in part be counterbalanced by measures of parametrical reform in the pension scheme, which we discuss in Section 7. While we do not model any impact of pay reform on the current retirees (

Table 6.B) since there is no direct relation at the moment between the public sector pay and existing pensions, but it is likely there will be political pressure to at least in part adjust the benefit rate, which will cause additional increase in the pension liabilities vis-à-vis the current retirees.

Table 6: Afghanistan: outstanding pension debt, by categories, US$

A. Active Employees

Category	Headcount	Present value of pension debt			
		3% discount rate		5% discount rate	
		Current	Pay reform	Current	Pay reform
CS – Regular	69,500	46,000,000	823,000,000	32,000,000	598,000,000
CS – Ajirs	67,500	30,000,000	238,000,000	22,000,000	173,000,000
SOEs – Regular	8,500	5,000,000	80,000,000	3,000,000	55,000,000
SOEs – Ajirs	13,500	6,000,000	50,000,000	4,000,000	37,000,000
Teachers	110,000	28,000,000	617,000,000	20,000,000	501,000,000
Police officers	21,000	57,000,000	166,000,000	36,000,000	104,000,000
Military&Security officers	17,500	101,000,000	161,000,000	63,000,000	101,000,000
Total	307,500	$ 273,000,000	$ 2,135,000,000	$ 180,000,000	$1,569,000,000
Share of GDP		**3.8%**	**30.1%**	**2.5%**	**22.1%**
Share of domestic revenues		**59%**	**463%**	**39%**	**340%**

Notes: Teachers headcount was taken prior to recent significant new hires. Assuming most new hires are new employees of the public sector, impact on pension liabilities must be negligible.
We do not account for 1384 mid-year salary review, which added Afs350, supposedly to base pay.
For military and police, we did not apply any change in the pay scale post pay reform.
Pay reform assumes new scales as provided by MOF (see Table A2-4 in Annex 2)
Calculations assumed:
The rules of current DB formula
Eligibility to benefit based on rights accumulated thus far but at future times when current employee reached the normal retirement age (65/55).
Mortality table to assess age-specific duration of periods in receipt of benefit
No change in benefit in real terms over time.
Source: Authors' estimates.

B. Retirees

	Headcount	Present value of pension debt	
		3% discount rate	5% discount rate
Civil Service and Ajirs			
Retirees	18,700	49,000,000	43,000,000
Survivors	7,050	33,000,000	27,000,000
Military and Police			
Retirees	13,100	79,000,000	68,000,000
Survivors	2,350	10,000,000	8,000,000
Total	41,200	$ 171,000,000	$ 146,000,000
Share of GDP		**2.4%**	**2.1%**
Share of domestic revenues		**37%**	**32%**

Notes: Liabilities vis-à-vis individuals who separated from the civil service or military at anytime in the past but have not yet applied remain unaccounted.
For civil service and adjirs, flat pension amounts were imputed based on rank/grade at retirement.
For military and police, actual awarded pension amounts were used.
For retirees, mortality table was used to assess age-specific duration of periods in receipt of benefit.
For survivors, assumed on average 25 years of payments in each case.
Assumed no change in benefit in real terms over time.
We did not account for possible pension increase for *current* retirees following the pay reform.
Source: Authors' estimates.

Table 7: International comparison of outstanding pension debt of civil service schemes

	Year	Outstanding pension debt, % of GDP	Current spending, % of GDP
Afghanistan [1]	2005	6	0.3
Bhutan [2]	2004	22	NA
Brazil	1998	92	1.7
Iran	2001	38	0.5
Korea	1995	7	0.2
Nepal [3]	2002	14	0.5
Philippines	1997	17	0.2
Sri Lanka [4]	2002	60	1.8
Turkey	1997	75	1.7

Notes: 1- All civil servants, teachers, police & military
2 - All civil servants and military
3 – Pension debt: CS only. Pension spending: includes military & police
4 - All civil servants and military
Sources: For Afghanistan: authors' estimates (using 3% discount rate).
Other sources include:
Robert Palacios and Edward Whitehouse, "Civil-service pension schemes around the world", The World Bank, 2006.
Robert Palacios, "Civil service pensions in South Asia: A rising tide of reform", The World Bank, 2004

5.3. PROJECTIONS OF THE SHORT TERM FISCAL BALANCE

Analysis of the short-to-medium term fiscal needs indicates growing burden for the budget. Results and assumptions are presented in Annex 5. Our calculations of the short-term needs to cover pension payments are based on data on age distribution of various categories of civil servants, reformed and less generous DB pension formula (as proposed under the Government reform program – see Section 8), and assumptions on certain age specific retirement and mortality rates. With pay and grading reform measures, even the less generous benefit formula would provide for a growing fiscal gap.

We look at various reform options. Specifically, we adopt new reformed parameters as discussed further in Section 8 and play with assumptions on the wage indexation rules, pensionable allowances, contribution rates, phase-in schedule for the new parameters, etc.

Various scenarios presented here indicate that important choices will have to be made. The preferred option is with the pensionable allowances, higher contribution rates, and gradually phased-in parameters of the new scheme. This is also the option that Government has developed as part of the proposed reform strategy.

Table 8: Results of the short-to-medium term fiscal analysis

Scenario	Definitions/Assumptions	Findings
1 (Baseline)	All new wages, excluding allowances, are pensionable; less generous benefit formula with full effect phased-in *gradually*; lump sum payments to survivors; but same old contribution rates.	Significant and growing deficit requires permanent subsidies
2 (Higher contributions)	Same as Baseline but new contribution rates (16%)	Deficit disappears in the medium term
3 (Pensionable allowances)	Same as Baseline but new contribution rates and allowances are pensionable	Improved fiscal situation in the short-to-medium term (revenues grow faster than expenditures). **The most preferable option**
4 (New benefit parameters introduced overnight)	Same as Scenario 3 but new benefit parameters introduced overnight.	Still improving fiscal situation in the medium term but a more expensive transition.

Source: Author's design.

6. GENERAL REFORM OPTIONS

The dire state of the inherited pension system provides an opportunity to lay out a completely new policy in this area. Doing so would begin with a clear statement of objectives. The first objective typically involves consumption smoothing and is based on contributions to retirement savings. The second is redistribution with the intention of reducing poverty among the elderly. There are several alternatives to dealing with each of these objectives in terms of financing, target benefit levels and administration. The model that is eventually selected will have to take into account the special constraints that prevail in Afghanistan.

The most effective strategy in this environment is to clearly distinguish between short and long term measures. Pension policy by its nature requires a long time horizon. It is important to recognize that what is not feasible now, may become so later when the situation has stabilized. Complicated reform packages should probably be avoided in the short run. At the same time, new long term pension policies should not be pre-empted by measures that will be implemented in the next year or two.

6.1. SHORT TERM MEASURES

In the short run, a number of constraints will continue to limit viable reform options. The most important of these involve coverage and fiscal resources. The short term measures to be considered should recognize these constraints from the outset.

To begin with, coverage is likely to apply only to public sector workers during this period. As noted already, even for the public sector, administrative capacity is very limited. Expanding the mandate to the private sector would not be realistic under the present institutional conditions. Moreover, should policymakers determine that a completely new approach to pension policy is necessary for the country, including new institutions, this process will take several years to implement properly.

The second major consideration is short term financing through the budget. Noting that the salaries of all members of the scheme are paid by the government as employer, whether the financing of pensions in the next few years comes from the budget or through earmarked contributions, the impact on the budget will be the same. However, given the planned pay and grading reform, it will be important to define overall pay envelop in the way that both reflect budget feasibility of the new pension obligations and re-enforces contributory mandate of the scheme. For example, if contributions from the government agencies are to be enforced, the budget should not only provide for the new higher wages but also for corresponding allocation to the employer contributions. Similarly, if additional contributions were to be levied on the employee, the pay reform provides a great opportunity for doing so as new wages will be significantly higher and even if higher contribution rates apply the net effect would still be higher wage (*and* higher new absolute pension amount).

Finally, both the coverage and the financing of the scheme make it necessary to look at short term pension adjustments as part of an integrated civil service compensation package. Wage adjustments, including folding allowances into the basic wage package, have a direct impact on pension liabilities. At the same time, any increase in pension levels will have to be financed from the same budget that pays the current wage bill of civil servants. And, from the civil servants' perspective, the attractiveness of the package is determined by both elements.

The concrete options available can be usefully distinguished according to three types of individuals – pensioners, employees with pension rights, and new entrants.

6.1.1. RETIREES

Pensioners will not be affected by most of the changes that could be contemplated with one major exception, the method by which pensions are adjusted in the future. Assuming that the pension level will not be lowered, these levels can either be maintained or increased over time. If they are maintained, their purchasing power will decline as inflation erodes their real value. They will also fall relative to the new earnings of public sector workers after the pay and grading reform.

The decision as to how pensions should be adjusted for those already receiving them should reflect considerations of adequacy and affordability. If the current level of pensions is considered inadequate in some absolute sense, then a specific target level could be determined and a series of adjustments could be made until this level was attained. The 1382(2003) pension increase appears quite significant to provide for meaningful benefit rate. Adjustment mechanisms however still need to be adopted in order to maintain adequate pension value and cap the liability.

The two options for periodic adjustments in pension value would be to impose an automatic adjustment mechanism, like annual indexation for inflation, or to keep the practice of the ad hoc adjustments by decree. Automatic price adjustments would maintain living standards at this level and limit the growth of the liability in the future. In contrast, ad hoc increases would introduce a high degree of uncertainty for both the budget and for the individual pensioner.

A more radical approach toward compensating those already eligible for pensions would be to offer a lump sum payment in lieu of the regular pension. Government seems to strongly favor this approach. The situation in Afghanistan today is characterized by very high degree of uncertainty and therefore high discount rates. Assuming that incomes will recover from the economic devastation of recent decades, borrowing against the future for individuals is both rational and welfare enhancing. In present value terms, pensioners therefore may be willing to voluntarily exchange the promise of future payments for the cash in hands today at a rate favorable to the government. Lump sum payments could also help to free up administrative resource to focus on the needs of modernization.

Most recently, assessment of the cost of the alternative lump sum payment options has been prepared. The cost of the mandatory conversion is prohibitively high. The total Payouts, depending on the choice of the parameters could range from around $250,000,000 to $350,000,000. **Assessment was based on the following assumptions: (i) all current retirees get their regular pension converted to the lump sum; (ii) commutation factors were used to define amount for each given cohort of old age retirees; (iii) alternative 5% and 10% discount rates used; (iv) on top of the regular payments, additional 3 years of survivor payments were proposed at the point of death, discounted to the present value with the same rates.**

Table 9 presents the results. Additionally, with the current average survivor annual pension of around $450 and the total current of approximately 15,000 active survivor cases, the lump sum payouts to the survivors could be between $20,000,000 and $34,000,000 depending on the decision on whether the lump sum compensation is to be equal 3 or 5 years of equivalent payments (with no further obligations).

Table 9: Estimates of the Lump Sum payment costs (1387/2008)

	Discount rate: 10%		**Discount rate: 5%**	
Age groups	Lump sum years of pension (*)	Total payouts, $	Lump sum years of pension (*)	Total payouts, $
41-45	9.5	2,349,000	14.6	3,602,000
46-50	9.2	4,365,000	13.7	6,468,000
51-55	8.9	14,807,000	12.7	21,179,000
56-60	8.4	79,129,000	11.6	109,142,000
61-65	7.9	54,287,000	10.4	72,076,000
66-70	7.3	35,037,000	9.3	44,749,000

71-75	6.7	27,322,000	8.2	33,577,000
76-80	6.1	14,286,000	7.3	16,918,000
81-85	5.6	3,340,000	6.5	3,816,000
86+	4.8	217,000	5.1	233,000
Total, all cohorts, $		**235,139,000**		**311,760,000**
61+ cohorts only, $		**134,489,000**		**171,369,000**

Notes: (*) Indicates number of years of pension at the current monthly amount
to be paid as lump sum to individuals;
Includes survivors supplement;
Covers both military and civil service.

There are several problems with this approach, however. Even if phased-in over a certain period of years, it is very likely that mandatory conversion for all will be fiscally unaffordable[14]*. Therefore some partial measures should be considered and recipient categories prioritized.* Paying lump sums instead of regular payments allows for the distinct possibility that some pensioners will find themselves without income after a few years if they spend money too quickly or use for non-productive investments. They may find themselves in the need of Government assistance. We do not recommend mandatory conversion for all, both on the fiscal grounds and since it could lead to serious adverse effects both for individuals and for the Government. We favor a voluntary conversion. Different individuals will have different preferences for conversion (some will value today's cash vs. tomorrow's cash more than others). Voluntary conversion, would allow individuals to exercise their choice given information on the conversion method. If, however, lump sum payments are to be made mandatory, we strongly suggest that they are made only for some categories (e.g., for survivors or for very old) or covering only a limited period of time so that regular payments resume after a period (3-5 years) required for implementing all the modernization measures.

6.1.2. INSURED EMPLOYEES

With regard to previous years of service, one option is for the government to buy out the value of pensions accrued to date. This can be done in several ways. First, a lump sum could be paid immediately. This method has the disadvantages of the pensioner buy out in terms of up front cost as well as concern about living standards of future pensioners with no other source of income. The buy out may also be phased in over time allowing the government to continue to develop a long-term strategy to replace the old system with a new model. A variant on this approach would be to offer a larger wage increase in exchange for the accrued pensions to date. The government could alternatively pay out a lump sum amount only upon retirement. Finally, accumulated liabilities could be converted to special government recognition bonds to be deposited in individual accounts. In all cases, the open-ended liability would be made explicit and limited. The question of pension credit accrued going forward could then be handled separately.

Alternatively, past years of service can continue to be counted towards a future pension. This is an option favored by the Government and has been reflected in the recently drafted reform strategy. Pension value would then be potentially affected only by method of accruing pension in future through various parametric changes. For example, the current accrual rates could be changed and applied to the entire career, not just future years of service and the minimum age limit for retirement could be applied in conjunction with the length of service requirement already in place (25 years).

[14] Additional savings will be realized from not paying regular payments to the individual who get transferred their rights to the lump um payments. However, those at the maximum can range to around $30,000,000 – and will be (much) lower if only some receive compensation in the form of a lump sum.

For the same reason of unavailability or poor quality of service records, implementation of the buy-out options may take several years. That constraint will not necessarily be binding on the option of continuous participation in the (reformed) current system. Efficient implementation of either of reform options would require quality data on individual periods of service in public service. Time will be required to collect and validate necessary information and also explain the options to workers. To our knowledge, there have been three separate efforts to capture information on the years of service. A project managed by the IARCSC covered civil servants (but not ajirs) and teachers in Kabul; Ministry of Education has been maintaining data on education sector, including service information on the teachers; SOE Department of Privatization of MOF maintains a database with detailed information, including the service, of the employees of the SOEs. Financial analysis presented in this paper has greatly benefited from the available data. However, there are questions with quality of existing records, efficiency of the background verification mechanisms, and keeping them up to date, -- these factors may limit usability of the available datasets for a serious country-wide operational undertaking.

Special regime could be developed for calculation of benefits for those who will retire in the interim, prior to full implementation of the pay and grading reform, although it would be more operationally complex and perhaps should be avoided. Employees who will retire in the interim will continue to earn pensions that will remain low relative to the pensions to be earned after the pay and grading reform implementation. While a special formula could be devised to deal with this problem, there would be a few arguments against such an approach. First, implementation of such interim provisions will also require some time and by the time they are fully in place, considerable number of the current employees will already be taken through the pay and grading reform process. Second, it will produce another source of disparities and create yet another category of the pensioners with their pensions calculated differently from those who retired prior to 1383 and those who retired after 1383. Rather, some common solution could be apply to all retirees of the old scheme by introducing a one-off adjustment in their benefits as explained above.

6.1.3. NEW ENTRANTS

New employees should be availed a new reformed system. If the long-term reform solution is completely different operational setup, new entrants could be still allowed to participate in a modified version of the existing scheme (after implementing certain parametric reforms). This would buy some time for the decision on what type of pension scheme would apply to them and have advantage of leaving all options for a new system open.

Table 10 summarizes the range of options discussed above. Note that different options for different groups could be combined. The options that apply to pensioner and current employees will have a major fiscal impact. Obviously, the buy-out options generate the highest short term fiscal costs (except conversion to recognition bonds) while continuing with the current system (Option 1, with modifying benefit formula and eligibility requirements) involves the least up front costs. In similar fashion, the administrative burden of implementing a buy out is higher than continuing the current scheme in the short run (this would equally apply to the recognition bond option). We should note, however, that whether or not the buy out is considered, the record-keeping improvements would be necessary to facilitate implementation of even moderate reform options as well as options for the long term. A centralized, electronic database that contains wages, contributions and service history for each individual employee is a must of a modern pension scheme of any structural type.

Table 10: Short term reform options by group

Groups	Option 1 (Moderate changes)	Option 2 (More radical approach)	Comments
Pensioners	Continue with current payments and adopt adjustment mechanisms in benefit value	Buy out – immediate lump sum payment for all or for some	*Options 1 and 2 could be applied in different combinations to different groups (e.g., lump sum payments could be made to survivors, while benefits of the regular retirees adjusted)*
Current employees	Continued accrual in present system with parametric reforms	Buy out – immediate or deferred lump sum payment; or forfeiture of pension credits in exchange for wage increase; or recognition bonds	*Option 1 is preferred*
New entrants	Accrual in the present scheme with parametric reforms		

Source: Authors' design.

6.2. LONG TERM OBJECTIVES AND OPTIONS

Government intervention in the area of pensions falls into two categories – saving and redistribution. Both of these objectives require policymakers to choose target benefit levels. These targets will vary across countries and over time, depending for example, on society's measure of relative poverty. On the other hand, higher benefits imply higher costs, regardless of what country is involved. This has not always been appreciated at the time a new pension system was introduced. More often than not, promises are made that either cannot be kept, require significant transfers from future taxpayers or crowd out other important programs. Ignoring sustainability will lead to poor pension system design. Unfunded pension liabilities create a hidden debt in the fiscal accounts and when the debt comes due, the adjustment can be painful.

Degree of redistribution between various groups of population will be important. Around the world, five types of program have been used to address poverty among the elderly:

- Social assistance. The approach is to make transfers to the poor and elderly based on some criteria of need. These programs can play the role of ultimate safety net for the most destitute or, alternatively, the criteria can be defined in such a way as to result in broad coverage. An example of this case is Australia or South Africa.
- Universal flat benefits. This approach is also referred to as a 'demogrant' because eligibility for the benefit depends only on having reached a particular age and citizenship. This approach has been adopted for example in New Zealand, Namibia, Mauritius, and Kosovo.
- Minimum pensions within contributory defined benefit schemes. Most mandatory defined benefit schemes break the link between the contributions made and the benefits paid out in a way that favors lower income workers. The most common way of doing this is to impose a minimum pension within a contributory scheme. Examples include Sweden and France. Those who do not participate in the contributory system, however, are clearly excluded from these provisions.
- Minimum pension guarantees of defined contribution schemes. Defined contribution schemes (see below) link benefits to contributions directly and the ultimate pension depends on investment returns. In some cases, the defined benefit element is reintroduced through a guaranteed minimum pension. This may be financed through the government or from a tax on members of the scheme. Chile finances its minimum pension from general revenues.
- Matching contributions to defined contribution schemes. While the minimum pension guarantee is an ex post mechanism for redistributing to those with low lifetime incomes, it would also be

possible to prefund this transfer by supplementing the contributions of low income workers before they retired. This is essentially what is done in the Mexican scheme.

Many countries use more than one of these programs for redistribution. For example, Chile has a social assistance scheme for that part of the labor force not covered by the defined contribution pension scheme since these individuals cannot qualify for the minimum pension guarantee. The United States redistributes to low income workers within its contributory, defined benefit scheme, but has a social assistance program that supplements those elderly who still fall below the poverty line.

At the same time, savings or insurance component of the pension program seeks to smooth consumption over the life cycle. By and large, these schemes are designed to be financed through deductions from current income, (regardless of whether the money is actually set aside in a fund or not). The benefit targets of these schemes are sometimes referred to as 'replacement rates' because they replace income earned while working. Some countries choose modest targets that prevent individuals from falling into poverty after retirement while others are more ambitious and therefore, require higher levels of contribution.

The most common type of pension plan is ***defined benefit plan (DB)****, in which a formula is applied to an individual's salary and contribution history*. These DB plans contain an implicit rate of return that depends on wage growth and accrual factors embedded in the formula, as well as other parameters such as the way that past wages are revalued and how pensions are indexed after retirement. In Afghanistan for example, the defined benefit formula specifies that a worker will receive a pension equal to their final pay multiplied by 40 per cent after 10 years of service plus 2 per cent for each year thereafter (See Annex 1). For a worker with 40 years of service, therefore the average accrual rate would be 2.5 percent and the replacement rate would be 100 percent. Over the worker's lifetime, a stream of contributions are deducted from salary and after retirement a stream of payments is made. Since these schemes are rarely prefunded, the risk inherent in the DB approach is a function of the financial strength of the sponsor, be it the central government or an extra-budgetary institution. Mandatory schemes that use DB type formulae are almost always run by the government. Some were designed to be fully funded but failed to maintain assets sufficient to match growing liabilities. There are no known cases of publicly-run and fully-funded DB pension schemes at the national level, although some countries like Holland and Namibia do have fully funded DB schemes for their civil servants. Most began as partially funded schemes, accumulating significant reserves, only to see them dissipated over time as the scheme matured[15].

The alternative to this type of formula is to set the level of contributions rather than defining the benefit. In a ***'defined contribution' (DC) scheme****, the amount deducted is set in such a way so as to produce a certain target benefit under reasonable assumptions about investment returns.* These DC schemes expose participants to investment risk as opposed to the sponsor (government) risk of the DB schemes. These schemes are, by definition, fully funded and therefore preclude the accrual of new liabilities to the sponsor (government). In contrast to the traditional, public DB scheme, they clearly separate the accumulation and the payout phases. When the individual retires, the balance is either withdrawn or paid out in the form of an annuity or other stream of income. Mandated DC schemes are a relatively recent development, but have become more popular in the last two decades. Most DC schemes are managed by private pension firms. However, there are important exceptions in the form of centrally-managed 'provident funds' including those in India, Singapore, and Sri Lanka. Provident funds prescribed rates of return rather than tying them directly to investment performance. This practice moves these schemes closer to the defined benefit model in that the risk involved is tied to the sponsor's decisions rather than market returns.

[15] A rough estimate is that half of the main public pension schemes around the world are pay-as-you-go, public, defined benefit schemes while another quarter are partially funded. Most of these are on their way to becoming pay-as-you-go.

Finally, a relatively new variant on the DB model attempts to mimic DC schemes in various aspects. ***Notional accounts schemes (or Notional Defined Contributions (NDC) schemes)****, as their name implies, attribute contributions to individual accounts but do not set aside and invest the funds*. Rather, a bookkeeping entry is kept and the balances accumulate according to a notional interest rate that is typically tied to the growth of the wage base that finances the scheme. The balance is then annuitized using current mortality tables, as would be the case in a funded, DC scheme. Variations on this approach are found today in a handful of countries including Sweden and Poland.

Many countries operate hybrid schemes, with mandatory both DC and DB programs, and both aimed at consumption smoothing. (DB would typically be unfunded or partially funded). These hybrid systems may involve a large, funded component with a small unfunded component or vice versa. Meanwhile, the redistributive element is generally financed from general revenues (although there are a few exceptions).

The method of financing of a pension program chosen will affect sustainability. A pension scheme can be fully funded, partially funded, or run on a pay-as-you-go basis (See Annex 6, Table A6-2 for operational review of various provisions). Earmarked payroll taxes or general revenues or some combination of these can be used and each has consequences for the efficiency of the economy and for the distribution of income. For example, a scheme that pays civil servants generous pensions and is financed by general tax revenues may be sustainable, but only at the expense of other programs that will have to be cut as the scheme matures.

Savings and redistribution can be financed through either same or separate financing mechanisms. The Australian system, for example, uses a broad, means-tested public scheme for redistribution and a mandated, defined contribution scheme for savings. Chile uses general revenues to finance a minimum pension guarantee for those who are unable to purchase annuities above a certain level with their accumulated pension savings while providing social assistance to the destitute elderly. Alternatively, many public schemes combine the two functions – redistribution and savings – within the same program. The most common case is a public, defined benefit scheme that uses a formula that discriminates in favor of lower income workers. This can be done by providing higher ‘replacement rates’ for lower levels of income, as in the German and US cases, by setting minimum pensions or flat components as in Japan, France and many other countries, or by capping benefits but not earnings subject to contributions, as in Switzerland.

Whether separate or incorporated into the same scheme, it is important to consider the incentives created by the redistributive elements of the scheme as related to the savings element. If an individual that saves more will lose benefits from the redistribution element in the scheme, the incentives will be to minimize the forced savings element. On the other hand, poor design of the forced savings component could lead to rapid depletion after retirement triggering eligibility in the redistributive program. In countries where coverage of the savings scheme is limited to a small proportion of the labor force, these incentive effects are less important. At the same time, the rationale for redistributing within the contributory scheme is less compelling.

7. ANALYSIS OF VARIOUS REFORM OPTIONS

7.1. REFORMS OF THE MAIN SCHEME

The reform will need to address both policy and administrative deficiencies. Prime policy objectives of the reform will be to ensure adequacy and equity in the benefit, contain growth of pension liabilities, retain control over the growth in current expenditures. Moreover, the approach has to comprehensively assess pension benefit as part of the overall compensation package, linking pension reform measures to the initiatives of public sector pay reform. In parallel, administrative capacity of the overall pension operation will need to be upgraded.

Immediate reform steps will likely be limited to changes in the current scheme. Current institutional capacity will be binding on introducing significant systemic alterations. We do not consider proposal of a Defined Contribution (DC) system to be viable in the current context until some minimal conditions are met. DC schemes generally require sophisticated record keeping facilities, efficient payment and information systems that would support money and information flow from the points of contribution collection to the record-keeping agency, and efficient governance and investment mechanisms. At present, pension administration is completely paper-based and has no experience with computerized systems. Collection agency (MOF Tax Administration) is still weak in enforcement and accounting for pension contributions. (Capacity of the banking and payment system must be studied too, should proposal of the reform include expansion of coverage to the private sector.) Finally, new governance structures (normally, a Board of Trustees, with representation of professional experience and constituencies of members) would have to be established and adequate investment mechanisms envisaged.

Still, an immediate measure of re-instituting the contributory concept of the current scheme will become a fundamental step leading towards availing a boarder set of reform options in future. Current scheme is contributory in principle but not in practice. As noted above, government, as employer, does not seem to comply with its own contributory mandate (rather providing subsidy to the scheme); contributions from employees constitute less than 20 percent of total revenues; and efficient capacity to track these contributions down to the level of individual employee is inexistent. Considerable investments in infrastructure and capacity building will be required to bring the system up in line with the contributory mandate.

Finally, as already noted, we do not recommend expansion of the scheme to the private sector in the short term. Reform measures should first focus on the public sector. This task is complex enough to pose serious implementation challenges. It is important however, that the proposed framework and administrative setup are not preemptive of eventual expansion of the scheme to the private sector employees.

We continue with discussion of important policy and administrative changes recommended as part of the reform package, again looking at various categories of the covered individuals.

7.1.1. CURRENT RETIREES

Adequacy of the pension benefit will have to be critically assessed within the available fiscal space. Post 1382 wage increase enabled straightforward application of the pension benefit formula to provide for some meaningful benefit rate. Individuals retiring today receive between 40 and 100 percent of their last basic pay. If allowances are considered, however, the average replacement rate probably drops down to only around 30 percent of the today's total pay. Reforms of the civil service pay will lead to automatic, immediate and significant increases in the benefits for new retirees. Impact of such measure could be prohibitively expensive for the budget, unless consistent reform measures are undertaken. Furthermore, it would deepen disparities among the pensioners who retired before and after the pay reform.

In addition to decision on general benefit level for the current and new retirees, clear pension indexation mechanisms will need to be devised both to preserve purchasing power of the benefit and to contain growth of the pension liabilities. In line with the best international practices, automatic indexation mechanism would be the most desirable. Adjustments could be implemented annually following some formula. If robust mechanisms of measuring inflation exist, they most certainly should be considered for use in devising automatic adjustment procedures. At the same time, it is important to note that in the longer run, pure inflation indexation will on one hand help contain growth of pension liabilities but on the other hand lead to gradual deterioration of pension value relative to the earned income. Recommendation would be perhaps to use some simple composite index of inflation and wage growth.

Disparities in benefit rates caused by the 1382 decree on benefit increase need to be critically assessed. Individuals who retired prior to that measure continue receiving flat benefit linked only to grade/rank but not to the length of service. Those retiring today accrue benefit according to the program rules, which links benefit to the length of service. As noted in Section 3.1, those disparities are quite significant. Some justifications may exist for maintaining those differences, as those may simply be viewed as compensation for the past years when benefit was negligibly low. (Note that even today overdue payments for the period prior to 1382 are not indexed at all.) Those receiving flat payments are more likely to be in older cohorts; therefore, those payments will gradually phase out. If inherited by the surviving beneficiaries, however, they will continue for a number of decades. One recommendation would be to explore alternative mechanisms of indexation for this legacy benefits so that, if desired, their real growth could be contained relative to the other benefits.

***An alternative could be to offer to those who retired in the past a lump sum payment*. Such payment would reflect a discounted present value of future cash payments, and will also factor in future payments to the surviving family. Rough calculations of the required costs are presented in**

Table 9 above. We recommend this conversion to be instituted on the optional basis. The government will have no further obligations towards individuals who chose to receive such one-off transfer. This option however has to be considered with great care given various important aspects discussed above. Given poor state of record-keeping, administering such conversion – e.g., ensuring that the same individual who receives lump sum does not find a way to get back on the system – may become a challenge too, especially in provinces.

Finally, if change in compensation package in public sector is not properly synchronized with pension reform initiatives, the former could lead to yet another source of disparities and inequities. Under an extreme scenario, if accrual factors do not change and pension gets calculated based on the total wage, then benefit rates of the new retirees will be significantly greater than those who retired in the past. Therefore, decision on adjustment in the current benefit rates should be taken in coordination with measures of public pay reform and parametric adjustment in the current scheme, which we discuss next.

7.1.2. CURRENT EMPLOYEES AND PUBLIC SECTOR REFORM INITIATIVES

We address in turn two separate components of the public sector reform proposal with their implications to the pension scheme: pay reform and retrenchment program.

> *The proposed pay reform will lead to immediate increase in pension liabilities of the government. To contain that effect, parametric changes in the pension scheme will be required.*

Table 6 above provides assessment of the corresponding effect on the pension liabilities. Parametric changes in the pension scheme will help to contain the effect of the pay reform on both the pension liabilities and current spending. A more radical solution would include introduction of a scheme financed on the NDC principle, although such approach would be more demanding towards the record-keeping capacity with fully centralized systems of earnings records. Conditions for such a reform unfortunately would be difficult to meet within the next several years given very poor public and private infrastructure that would support such an information exchange. Therefore, recommendation would be to continue with the reformed Defined Benefit formula as further detailed below.

The measures of reform in DB formula should include: (i) adjust accrual factors, (ii) initiate gradual expansion of period of pensionable earning, (ii) introduce minimum retirement age, and (iii) reform survivor pension provisions.

(i) New accrual factors. Current scheme offers 4 percent accrual factor for the first 10 years of service and 2 percent for the service on top of 10 years, up to 40 years. First, 4 percent may be quite generous judging by international standards. Second, maintaining such non-linear accrual factor may be not necessary. Proposal rather would be to have one universal factor applied to all years of service. Detailed calculations will be required to calibrate the accrual rate. The revised factor could be worked out in a way that with the proposed significant increase in the overall pay the revised percentage provides only for a moderate pension increase. It is also possible to phase in a new accrual factor gradually.

Alternatively, different accrual factors could apply to components of the service pre- and post-implementation of the pay reform.

Objectives are to ensure adequate benefit, cross-generational equity, and fiscal affordability of the program.

Table 11 provides comparison of the accrual factors of the civil service schemes in the region. Recent reforms internationally have often incorporated reduction in the accrual factor.

Table 11: Regional comparison of the accrual rate (per cent per annum)

Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
2.8[1]	3.2	2.0[2]	1.52	2.5	2.0	2.33	3.0

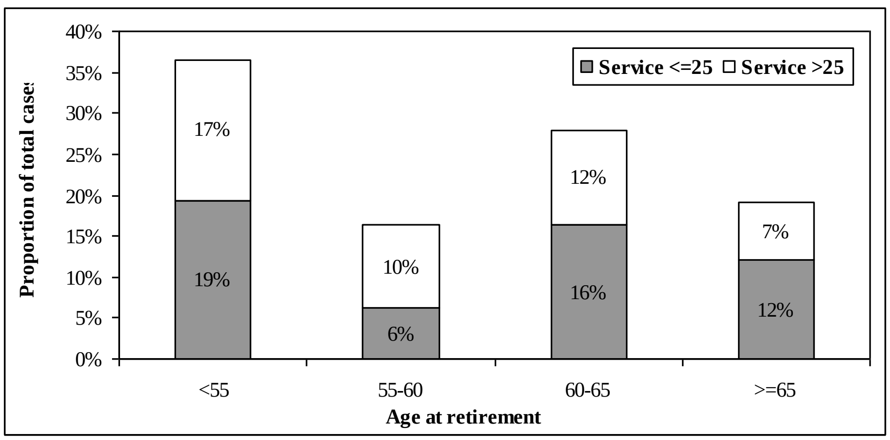
Notes: [1] For an employee with an average career history of 25 years.
[2] In Bhutan, falling to 1.76 per cent by 2026.

Source: Robert Palacios. Civil service pensions in South Asia: A rising tide of reform, 2004, Draft.

(ii) Pensionable wage base. Defining *level* of the pensionable wage will be important since it will provide the base for both the contribution deduction and calculation of pensions. When pay and grading reform measures will take full effect, presumably new wage will become the basis for both contribution assessment and pension calculation. Furthermore, the suggested changes in accrual factor could be combined with expansion of the *period* of pensionable wage. At present, it is only the last wage that constitutes a basis for calculation of pension benefit. A typical component of the DB scheme reforms internationally has been the expansion of period of pensionable wage to eventually cover the whole service history. (Typical obstacle to effective implementation of such measure would be poor state of record-keeping). Such measure could be operationalized even without a centralized database of records. Pension Department could start requiring certification of both the service period and past grades/ranks for some limited number of years. A meaningful starting point could be a point of introduction of pay and grading reform. Fixing that point would imply gradual expansion of the covered period for calculations. Some basic infrastructure requirements are detailed in the sub-section on administration below.

(iii) Minimum pension age. Current provisions allow for retirement at any age with minimum of 25 years of service. Figure 2 below illustrates that historically quite a considerable number of individuals retired prior to reaching the normative pension age. Furthermore, it appears that around a half did not fulfill 25 years of service. Proposal would be to re-enforce the 25 years minimum requirement, with exceptions granted only to the cases of severe disability and work-related injuries. Furthermore, a new provision could explicitly define a minimum pension age, e.g. 55 or 60, so that no normal retirement below that age is allowed even if the 25 year condition met. Finally, actuarial adjustment for early retirement should be introduced. With the same service period and base wage, total paid pension amount will depend on the age of retirement: the sooner is retirement, the longer is period in receipt, and the greater is life-time total payment amount. Hence, incentives to retire earlier. In a properly calibrated scheme, early retirement should be discouraged by reducing the accrual factor. Similarly, delayed retirement could be compensated by increasing the accrual factor and hence monthly benefit.

Figure 2: Distribution of old age pension cases by age at retirement (Sample of historic data for Male Civil servants and Ajirs)



Sources: Author's estimates based on data from MOLSAMD Pension Department and IARCSC.
Notes: Cases clearly labeled as health related were excluded.

(iv) Survivorship provisions. Pension Rules provide for benefit to be paid to the family of the deceased employee/retiree. Furthermore, it is specified that distribution to be arranged for according to Islamic Shariah. One option could be that along with the reformed pay package and new procedures for benefit calculations, overall value of survivor benefit gets reduced, e.g., from today's up to 100 percent of the retiree's benefit down to 60 percent. A more radical reform approach to the survivor benefit provision would be to mandate a conversion to the lump sum at retirement. Such approach would be well advised, as it would alleviate significant administrative burden on the Pension Department to enforce various eligibility rules in respect to various categories of the family members. The requirement could be applied both to the current and future survivor beneficiaries.

A sustainable self-financed Defined Benefit program requires careful calibration of several system parameters. In particular, three key parameters – retirement age, contribution rate, and pension benefit – are closely linked in such analysis. Life expectancy at retirement and length of service are some of the key inputs to the calculations. Based on the life expectancy data for Afghanistan, and a set of assumptions about the wage growth and implicit return of the system[16], we have estimated

[16] Assumed annual wage growth of 2% and implicit annual return of the scheme of 4%

combinations of parameters that would make the reformed public pension scheme sustainable, as presented in Table 12[17].

Table 12: Benefit rate (relative to the pensionable wage) for various combinations of parameters

Retirement Age		60			65		
Contribution rate		***5%***	***10%***	***15%***	***5%***	***10%***	***15%***
Length of Service	***10 y***	5%	11%	16%	6%	13%	19%
	15 y	8%	17%	25%	10%	20%	30%
	20 y	12%	24%	36%	14%	28%	42%
	25 y	16%	31%	47%	18%	37%	55%
	30 y	20%	40%	59%	23%	47%	70%

Source: Authors' calculations.

For example, with the retirement age of 65 and contribution rate of 15%, someone who worked for 25 years prior to reaching retirement, should expect to receive a fair pension of 55% of the last wage on which contributions were paid. The matrix above provides for numerous possibilities for Afghanistan. The task is to select one combination that would be fiscally, economically, and socially sound and would approximate a situation for a representative average employee. (Our analysis of the historic records of the Pension Department indicates that the average length of service of the retiring civil servants has been around 24 years).

Strategy of the pension policy reform has also to be coordinated with the public sector retrenchment programs. Our opinion is that a categorical approach should be adopted. Those individuals who have not completed a required minimum service for retirement and/or have not reached a minimum pension age should not be granted an immediate pension. At the same time, those who would meet both criteria of the minimum service period (25 at present) *and* minimum pension age (e.g., 55 or 60) could qualify for immediate retirement with no (or reduced) additional severance package. Importantly, as suggested above, actuarial adjustment should apply to all cases of early retirement. We note that at present, Pension Rules have provisions that may be interpreted as allowing individuals to retire upon termination, resignation, and in case of "waiting without salary" prior to reaching pension age and without having accumulated sufficient service (which may explain findings of Figure 2). Such provisions if maintained may be costly and would defeat the purpose of providing pension as a mechanism of saving for the old age. Other policy tools should be envisioned to address needs of employees separating prior to reaching minimum pension eligibility criteria.

The proposal to cover past services to the retrenched or even some categories of the retained employees with a lump sum conversion seems not that appealing, given likely no immediate reform measures with systemic changes. Two prime arguments in favor of the broad lump sum conversion policy would be (i) a systemic reform, whereby the calculated cash balances would be deposited into individual accounts of the employees where they would continue earn future pension, and/or (ii) to contain growth of the pension liabilities and ease transition to a new system at some future point. Given no immediate recommendation on the systemic reform, we suggest that the second objective be secured by careful parametric adjustments in the present scheme rather than by cashing out existing liabilities.

[17] Conceptually, analysis involved assessment of equivalent individual account balances at retirement and actuarially fair pension calculation, under different combinations of the system parameters.

7.1.3. MEASURES FOR MILITARY AND POLICE

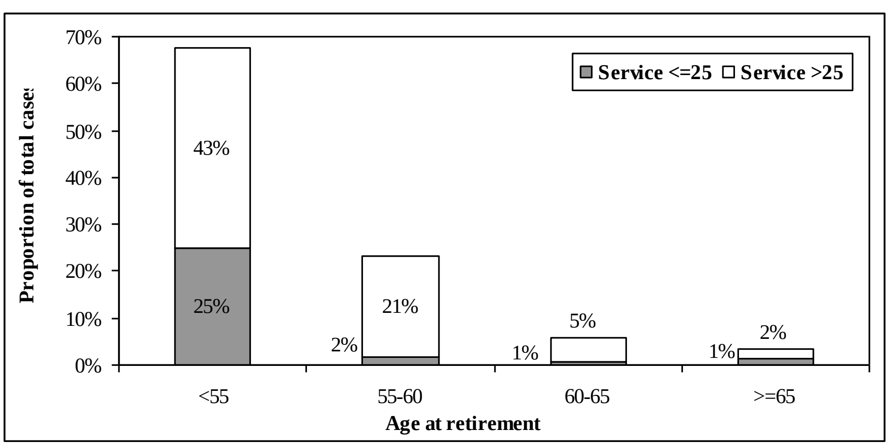
Given old scheme has provided coverage to members of both the civil service and the military, it is important to use the opportunity of the reforms introduced for the civil service and assess the situation with pensions for the military. As indicated in the Annex 1, the servicemen of the military have been retiring under somewhat different conditions. While reforms in the sector could be implemented on separate tracks it is important to coordinate the activities and parametric changes in both systems. At the very least, the core principle of explicit funding provisions for any additional benefit that military and police personnel may be enjoying must be reflected in the new legal framework. Below we discuss measures that could be considered in formulating strategy for military pension reform whether or not as part of the same effort with the civil service.

The same considerations should apply to the retirees of the military, police and security forces in respect to benefit adequacy, equity, and sustainability. The uniform personnel are compensated at much higher basic rates than the civil service. Therefore, upon retirement, they also receive higher pensions. The instrument to adjust pension value over time and contain growth of pension liabilities should also be an automatic indexation. Survivorship benefits could be converted to lump sum payments, in line with the recommendation for the non-uniform sector.

Adjustments in the accrual factor will be required for the current military. Accrual factor, which is currently the same as for the civil service, will need to be adjusted too. A question will be whether or not the new factor should be the same or different for the proposal for the civil service. In any case, any obligation of pension payments in future should not be open ended and should either be supported by proper contributions or explicit provisions in the budget to cover current and future financial needs.

The retirement age policy for military may need to remain different from the civil service provisions. The normal retirement age for junior ranks of the military is lower than 65 (see Annex 1). Figure 3 further illustrates that close to 70% of the military in the past have retired at below the minimum retirement age of 55. (This data does not capture a recent hike in retirement numbers of the military caused by efforts of reform and downsizing the military service). In interesting contrast to the civil service and ajir retirees, over 70 percent of the retired military and police seem to have completed the required 25 years of service. The policy question is what incentives do the system with different retirement ages for different ranks of military create? Does it encourage early retirement over seeking promotion in the military ranks? Should the normal retirement age be a function of seniority (as it is today)? Can a uniform retirement age for military and police be introduced irrespective of rank but with provisions for early retirement? Should there be the same actuarially fair penalty for early retirement?

Figure 3: Distribution of old age pension cases by age at retirement (Sample of historic data for Male military)



Sources: Author's estimates based on data from MOLSAMD Pension Department and IARCSC.

We take the same position on compensation policy for the retrenched military. Over the past years, several stages of downsizing the military service have produced a sizable group of individuals who claim public benefit as compensation for past services. In 2005, 25,000 servicemen who were laid off by 1382 were ordered to be paid a pension by the Government Decree. In general, we would with no exception recommend the same strategy of categorical differentiation in the laid off military. It is only when service and age meet the minimum requirements, individuals should have right to pension. Otherwise a conventional severance package should be devised.

Most importantly, explicit funding provision requirements should equally apply to both the civil servants and the military. While it is common for the military benefits to be more generous relative to the benefits offered to the civilians, it is critical that Government explicitly address the funding needs of the military program. The new contributory mandate could be imposed on the all wages of the military in the same way as it is being proposed under the reform of the civil service sector. Any subsidies should be explicitly costed out. If these provisions are not adequately made, there is a significant risk that the high benefits will not be sustainable.

7.1.4. ADMINISTRATIVE REFORMS

Administrative capacity of the Pension Department will need to be upscaled. Current operation is completely paper based. No automated system of records exists. This makes the job of enforcing the rules and monitoring performance of the system extremely difficult. Clearly, investments in the new systems and capacity to operate the reform scheme will be required. Initial investments can go into automation of the benefit processing operation with computerized work-stations installed in application processing points. Some software should be developed to facilitate benefit amount calculation. No manual calculation should be allowed anymore to avoid mistakes reported so far. The software should be able to incorporate all the rules introduced as part of the reform, including new accrual rates and lump sum conversions. This effort will considerably improve the quality of operation of the pension agency already in the short term.

Full implementation of the concept of the contributory pension will require more significant capital expenses. A new centralized database of personal records of employees and employers will have to be developed. Although, perhaps it is an agenda for the medium term. In future, pension benefit should ideally be calculated subject only to record of contribution in the centralized database. This effort will also require efficient coordination with various agencies in design and implementation of such a systems:

- HRMIS system. The Human Resource Management Information System (HRMIS) will facilitate information flows within the government sector. Implementation of the concept of contributory pension scheme will critically depend on the efforts of modernizing, synchronizing, and centralizing the HR operation and payroll processing in the government sector. Effective interface with the pension system will have to be established.
- MOF collection system. Capacity to enforce and monitor collection of pension contributions within the MOF Tax Administration remains weak. There seems to be lack of managerial focus on the issues of pension contributions. A very passive role of accounting and monitoring is assumed. Our recommendation is to appoint a manager to coordinate activities in pension contribution collection with clear line of reporting from the local MOF offices. Unless weaknesses of the collection system are substantively addressed, no program expansion to the private sector should be considered.

Contributory mandate of the scheme needs to be simplified. At present, in addition to employee and employer contributions, the Rules require additional contribution of 25 percent of pensionable salary in the first month of employee's employment and 50 percent of any wage increment. Such archaic requirement is difficult to enforce and monitor. Rather the payroll should be subject to a simple proportional deduction. If needed, contribution rate will have to be adjusted to ensure sustainability of the scheme. A somewhat more radical solution aimed at simplification of administration will be transferring the total legal contributory mandate on the shoulders of employer. Accounting procedure then would not require two parallel tracks of records of contributions. On the payment side too, no deduction will be required and contributions could simply be processed based on the approved list of active employees with the government organizations in completely centralized fashion (e.g., based on consolidated records of the HRMIS system-to-be). This proposal, however, may be more costly for the budget unless it is implicitly incorporated into the overall pay reform package by adjusting the proposed gross pay schedule.

Depending on the set of reformed parameters, the system may start generating (temporary) surpluses. Operational preparations therefore will be important. If contributions are enforced and properly aligned with other parameters of the scheme, and after the system gets over the crisis period, given demographics, it is very likely that surplus will emerge. Policies and new governance structures will need to be put in place to ensure funds are properly managed. The same surplus could be used to pay out some of the current liabilities in lump sums as discussed above; but proper budgeting, accounting, and monitoring systems would be required.

Finally, the mechanisms of disability assessment will need to be critically looked at. Little is known about practices and procedures of the disability registration. Although evidence of the health related pension cases seem to be insignificant, poorly designed system will always be prone to abuses and exposed to considerable financial contingencies.

7.2. LONG TERM STRATEGY

7.2.1. MAIN SCHEME

At this point we stress the approach rather than particular long-term reform package. While both the economy and operations of the pension scheme are still recovering from the devastating impact of decades of was and desperation, it would be difficult to propose a particular reform package that would be appropriate and feasible to implement in the period of decade or so. For example, it is hard to say whether or rather when conditions would be in place to support implementation of a DC-type of scheme. It is important therefore to adopt a short-term approach that would keep most of the long-term options open.

The proposed immediate parametric changes should help stabilize the system. If various components of the current DB formula are properly calibrated and implemented, the relative growth of the outstanding debt would be contained.

Finally, if properly calibrated, there might be no particular preference for the system to move away from the current DB-type mechanisms, at least in the medium term. Various mechanisms may converge in delivering on income replacement objective of the reform. Therefore, a good reform package for Afghanistan does not require a sophisticated and ambitious agenda but rather focus and commitment.

When the scheme is calibrated and stabilized, planning could be initiated for gradual expansion of the scheme to the private sector. It may take a long period before private sector could be admitted to the system but any parametric or administrative changes today should allow for this possibility in future. Most likely, the first participants of the system could be privatized SOEs, some NGOs, and major private sector employees. Considerations may be given in future to merging the reformed civil service pension scheme with the scheme for employees of the banking sector.

7.2.2. BASIC UNIVERSAL PENSION (DEMOGRANT)

In a longer term, considerations might be given to introducing a universal basic pension program as a main redistributive component of the reformed national system. Table 13 provides assessment of the long-term fiscal impact of the universal program that would pay a benefit equivalent to correspondingly 25 or 15 percent of GDP per capita. Such relative value of benefit would be in line with the international norms (see Table A6-3 in Annex 6 for international comparison). However, if introduced today, it would require resources equivalent to the current spending on the public pension program, or around Afs 1.5 billion if paid at the lower rate to all residents over 65. Savings from narrow means testing (whereby individuals who receive regular pensions would not be eligible for basic pension) would likely be insignificant.

Table 13: Cost of universal basic pension, % of GDP

Benefit as % GDP per capita	Eligibility Age	2010	2025	2040
25%	60	1.3%	1.4%	1.8%
	65	0.8%	0.8%	1.1%
15%	60	0.8%	0.8%	1.1%
	65	0.5%	0.5%	0.7%

Sources: Authors' calculations.

Decision on introducing basic pension should be taken within the context of other competing budget priorities and broader social preferences. At the background of broader social preferences it might be viewed fair and justified to use general funding to directly support elderly who survived harsh conditions of wars and destitution of last decades. At the same time, alternative uses of budget resources have to be considered too. For instance, a general assistance scheme might be another urging priority.

Administering demogrant may pose a challenge too. Effective implementation of the universal scheme will depend on efficiency of means of identification of individuals and their age. Registration with some system that provides evidence of age should be a prerequisite for eligibility. Taskra ID, however, remains a major national mechanism of identification. Its administration seems weak and outdated. Little is known about its coverage for individuals above the retirement age. Similarly, international experience indicates that with lack of proper post-eligibility verification mechanisms, where individuals who die can be identified and taken out of the pay scrolls of the program, financial conditions of the program can quickly deteriorate. Normally, effective implementation of such a program would require well organized civil and death register so that the pension program could rely on information on age, residence, death etc. provided by such external organizations.

To summarize, while a basic pension program could be an effective mechanism of redistribution within the overall framework of retirement income provisions, it is not advisable to have this program in the current social, fiscal, and operational context. Needs of various vulnerable groups, including the elderly, would have to be assessed first. Various tradeoffs would have to be studied in the context of the limited fiscal resources. Current infrastructure, however, will not be accommodating to effective implementation of any universal program of this sort within the medium term.

8. GOVERNMENT REFORM PROGRAM

Since August 2007, Government has been actively working on developing a comprehensive strategy of the reform. A senior Steering Committee on Pension Reform[18] was tasked to oversee the process of the reform policy formulation. An interministerial Technical Working Group was also formed to analyze and propose reform options. By end 2007, the draft comprehensive strategy note was produced and a legal drafting process was initiated. Table 14 summarizes recommendations of the Working Group and Government's proposal in its current shape and contrasts with the old provisions.

The proposed Government reform program is a major step towards establishing a sustainable and modern pension program. The parameters reflected in the Government proposal take into account key policy recommendations as to bringing the scheme back to balance. The reformed program will reinforce the contributory principle of the new scheme, whereby employees with their new higher wages will have to make (higher) contributions towards ensuring better pension in future. Incentives are also in place to defer early retirement and a longer span of the pensionable wage measure helps prevent wage manipulations to gain the retirement system.

The choice of the combination of the benefit rate and contribution rate (as well as adjustment for early retirement) was made based on the fair actuarial calculations. Table 12 offers choices of the core parameters. The objective was to have a 50% replacement rate with the 25 years of service. This resulted in the accrual rate of 2% and the contribution rate of around 14%. This contribution would fund the old age and pre-retirement survivorship pension. Additional 2% contribution was calculated as required to fund the post-retirement survivorship (assuming three years of pension payment at retirement in a lump sum). The total contribution of 16% is proposed to be split equally between the employer and employee. It is important to note that the pensionable base has been expanded, although the wage measure remains limited to the three years. Ideally, as reform progresses and the record-keeping capacity improves, the time span for the pensionable base calculations should be expanded. Attention will have to be paid to practical implementation of the contributory mandate.

Concerns have been expressed on the account of the slow and fragmented implementation of the Pay and Grading reform and the related administrative complexity of phased implementation of the new contributory mandate. In effect, there will be two groups of contributors: those who remain covered under the old provisions in the interim will be subject to the old contributory requirements, while wages of those on the new pay scales will be subject to a higher contribution rate. This will certainly introduce some administrative complexity. The transition therefore will need to be carefully designed and its success will indeed be a function of the pace with implementation of the Pay and Grading reform.

Simplified survivors provisions will ease administration of the program and allow for some additional savings. Given the lax definitions of entitlement to the survivorship benefit of various individual categories, it has been proposed to time-limit the eligibility. Instead of payments to the survivors of the employees and retirees for unspecified periods, the proposal envisions lump sum payouts equivalent to the three years of corresponding wage or pension payments.

It is proposed to phase-in parameters of the new program over time. If the new (lower) accrual rate was applied to the new (much higher) wages at retirement, resulting pensions of the new retires would still be much higher than payments to the current retirees. In addition, some would retire only after one year of paying new higher contributions, others would spend considerable amount of time on the new scales paying higher contributions before they retire. Therefore, considering the fact the past service would be treated equally with the new service accumulated after the reform, it was proposed that the

[18] The group included representatives of the Ministry of Finance (MOF), the Ministry of Labor, Social Affairs, Martyrs and Disabled (MOLSAMD), the Independent Administrative Reform and Civil Service Commission (IARCSC), and the Ministry of Defense (MOD).

new higher pensions would phase in gradually, over the period of 5 years. Basically, the idea was the longer one pays contributions to the new system the higher benefit (accrual rate) such employee is entitled to.

Overall, judging by international standards and principle objectives of such type reforms, the proposed approach for Afghanistan remains in the domain of the second-best solutions; although it does represent an important step towards addressing key issues in operation of the existing pension scheme in the very difficult political and operational context of Afghanistan. Infrastructure and administrative capacity remain binding on introducing more significant systemic alterations. Both DC and NDC schemes at the minimum would require a robust infrastructure of exchange and consolidation mechanisms for the data on individual earnings. Implementation of such mechanisms in the context of Afghanistan today would be a significant operational stretch. Although, reinforcing of the contributory mandate as part of the reform will keep the options open allowing for future reassessment of feasibility of more radical reforms when all major preconditions are in place.

Finally, considerations were given to unifying the new retirement provisions with the Military and Police service. Although as this stage, it seems those will be developed and promulgated separately. The Ministry of Defense (MOD) commissioned a separate working group to develop new retirement provisions for the staff of the Afghan National Army. The work is on-going and a draft set of rules has been produced. Unfortunately, it proposes only marginal changes to the existing provisions offering quite generous benefit and relaxed early retirement provisions. Most critically, the new draft does not provide for any funding requirements of the proposed benefit packaged as the contributions as concept only vaguely mentioned. This is rather alarming as given considerable new wages of the military and the police and lack of any explicit provisions for future retirees in the budget.

Table 14: Comparative analysis of the Government's reform proposal

	Old Scheme	Reformed Scheme	Comments
Normal retirement age	65	65	
Annual pension accrual rate	2.5%	2.0%	*Provides for an adequate benefit of 50% of pensionable wage with average service*
Pensionable wage	Last wage at retirement. Allowances excluded.	Adjusted average of last three years, including allowances	*Inclusion of allowances is an important step but the three year measure for pensionable wage remains short; perhaps it could be extended as the record-keeping capacity develops*
Maximum pension	100% of the last wage	80% of the Pensionable Wage	
Pension indexation	Ad hoc	Based on average index of public wage increases and inflation	*Successful implementation will require careful elaboration of the index design*
Pension while (re-) employed	No provisions	Discontinued while in receipt of earnings from a public sector job	
Early retirement age	Not specified	55 in all cases	*This is a good measure allowing for the separated employees to get re-employed without claiming pension in the interim*
Voluntary early retirement	25 years of service	25 years of service *and* 55 years old	
Actuarial adjustment for early retirement	None	3% decrease in pension for each year below the age 63	*A very positive measure that removes distorting incentives and subsidies to those who retire early. Although full implementation is scheduled to take effect only six years after endorsement of this regulation*
Employee survivors benefit	Benefit for unspecified/unlimited period of time to eligible family members	36 months of Pensionable wage in a lump sum or installments	*This measure will help considerably to curb the cost of the survivors pension and simplify administration*
Retiree survivors benefit	Benefit for unspecified/unlimited period of time to eligible family members	36 months of pension in a lump sum or installments	
Disability benefit	Not clear	Differentiation on full (60%-100%) vs. partial (40%-60%) and work-related (more generous benefit) vs. normal disability	*While provisions are made more explicit and require some minimum vesting, the benefit remains somewhat generous*
Financing	Contributions 3% (Employee); budget covers deficit	Contributions of 8% (Employer) + 8% (Employee); budget will cover deficit	*This is a very important measure that reinforces the contributory mandate of the scheme and ensures fiscal sustainability of the scheme*
Transition		The new accrual is to be phased-in gradually from 1.4% to 2%	*This measure will help avoid both significant disparities between the current and new pensions and significant up front fiscal pressure*

Source: Authors' design based on the draft Regulation on Pensions.

9. CONCLUSIONS

Reform of the pension system should differentiate between the short term options and long term objectives. The guiding principles recommended here include adequacy, sustainability, and efficiency. Adequacy is a largely subjective question, while sustainability can and should be measured to the extent possible.

The reform package proposed by the government, if implemented, will respond to the criteria laid out in this analysis. While some more radical steps could be taken on account of the parametric reform (for example, the early retirement age remains quite low, pensionable wage assessment is still relatively short, etc.) the current reform proposal reflects a major progress in conceptualizing and addressing key issues in operation of the existing pension scheme in the very difficult political and operational context of Afghanistan. The reform proposal is aiming at establishing an equitable, sustainable, and efficient system offering adequate income replacement to the civil servants of the reformed public sector in Afghanistan. The key parametric changes proposed for the new scheme that would cover existing and new employees include: (a) reduced accrual factor (down to 2%) and limit on maximum pension (80%, down from 100%) that correspond to the revised new contribution rate (16% employer and employee); (b) pensionable wage that includes all the allowances and spans the period of three years when used in pension calculations; (c) explicit provisions for indexation of the pension benefits; (d) minimum retirement age of 55 with minimum service requirements (25 years) and actuarial adjustment for early retirement (3% reduction in benefit for each year of service); (e) explicit provisions for disability pensions (covering only permanent disability); and (f) rationalizing the survivors benefit provision limiting its fiscal impact and administrative burden.

The new program will establish a good precedent for reforming or introducing new sustainable provisions for employees in other sectors. There are good reform benchmarks now being established and could be incorporated into the strategy formulating process for reform of the military and police servicemen pension provisions. Similarly, the scheme for employees of the banking sector could follow the suite. Eventually, when conditions allow the program could be open to participation of the private sector employees. All on the solid grounds of the fiscally balanced and well formulated policy of retirement income provisions.

The needs of modernization of the pension administration will have to be urgently addressed. As outlined above, some specific immediate investments are needed to enhance efficiency and transparency of operation of the pension agency. Longer term needs will require careful studies as part of a project that would define specifications of the new business process and interaction with various external systems. The MOLSAMD has developed a work program for implementation of the reform and is seeking assistance of the donor community in this important task. Overall implementation activities will need to be directed by a special task team and an implementation unit and will have to be coordinated with other projects directed to modernization and reform of the public sector.

The progress and success with actual implementation of the proposed reform, however, will heavily depend on the pace with endorsing and implementing proposal for the pay and grading reform. It is anticipated that the pay and grading reform proposal will be endorsed in the nearest future and implementation take up to four years. The new pension parameters apply only to employees who get transferred to the new grades and new pay scales. The only change that applies to the old scheme is indexation of the benefits and option for paying out existing liabilities in form of the lump sum. While no other interim or contingency solutions offered for the current scheme, if the main reform does not progress as expected, perhaps, the proposed pension reform measures by the Government would have to be critically reassessed in future in light of that progress. Still, some time will be required to set up capacity to process new applications according to the new rules and formulas but it is only with the flow of time, when a considerable number of new claims get processed on the system, various advances or shortfall of the new system could be exposed and progress against the initially set benchmarks assessed.

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ANNEX 1: KEY RULES FOR THE NATIONAL PENSION SCHEME

Characteristic	***Civil Service***	***Military***
Age	65 Men and women (although women in general retire earlier)	50 for ranks between sergeant and major; 55 for ranks up to colonel; 65 for ranks above colonel
Min vesting period	10 years	Unknown
Rules for early retirement	At any age with 25 years of service; termination of employment, resignation, "waiting without salary", imprisonment for at least 6 months, 60% disability. No penalty applies for early retirement. Considerable number seem to have retired in the past with below the normal age and with less than 25 years of service.	Unknown
Rules for delayed retirement	No special conditions. Organization can retain employee beyond normal retirement service for the period not exceeding 10 years.	Unknown
Contribution rates	Employee, 3% of the pensionable wage, 25% of the pensionable wage in the first month of his employment, and 50% of the incremental portion on every wage increase. Employer, 8% of the pensionable wage. In theory, pensionable wage includes pay and any other allowances (in particular, education allowances). In practice, allowances can be excluded. Furthermore, Government appears not to pay its part of contributions but instead covers any deficit.	Same as Civil Service
Benefit formula	With service of 10 years: 40% of last pensionable wage; plus 2% for each additional year in excess of 10 years. Service in excess of 40 years is not accounted. Work accident (or work related illness) leading to >60% disability or death qualifies for benefit of 100% of pensionable salary.	Same as Civil Service
Short service benefit	For service less than 5 years, a lump sum of 2 months of last pensionable wage for each completed year of service; for service of more than 5 years but less than 10 years, a lump sum of 3 months of last pensionable wage for each completed year of service	Unknown
Special conditions	Additional year of service for every 4 years of service if in "heavy duty task".	Covered service period gets doubled if involved in "heavy duty" tasks.
Income measure	Last wage	Same as Civil Service
Maximum replacement rate	100% of the last wage	Same as Civil Service
Pension indexation	Ad hoc	Ad hoc
Minimum pension	—	—

Sources: "Rules of the Afghanistan Pension Scheme" and MOLSAMD Pensions Department.
— Not available or not offered.

ANNEX 2: PAY SCALE AND TEMPORARY (FLAT) PENSIONS IN THE PUBLIC SECTOR

Table A2-1. Civil Servants

Civil Service Rank	Base Wage	Average Allowance	Flat Pension rate
Over Rank	3,185	1,640	2,400
Above Higher Rank	1,470	1,640	2,100
Higher Rank	1,190	1,640	1,900
Rank 1	910	1,640	1,600
Rank 2	770	1,640	1,400
Rank 3	665	1,640	1,300
Rank 4	546	1,640	1,200
Rank 5	490	1,640	1,100
Rank 6	434	1,640	1,000
Rank 7	399	1,640	950
Rank 8	357	1,640	900
Rank 9	322	1,640	850
Rank 10	280	1,640	800
Rank 11	NA	1,640	750
Rank 12	NA	1,640	700

Table A2-2. Ajirs

Ajir's Grade	Base Wage	Average Allowance	Flat Pension rate
Higher Grade	896	1,640	1,750
Grade 1	791	1,640	1,300
Grade 2	714	1,640	1,150
Grade 3	651	1,640	1,000
Grade 4	532	1,640	900
Grade 5	476	1,640	800
Grade 6	420	1,640	750
Grade 7	385	1,640	700
Grade 8	343	1,640	650
Grade 9	301	1,640	600
Grade 10	NA	1,640	550

Notes: Base wage does not include the Afs 350 mid year increase of 1384 (2005).
Sources: The MOLSAMD Pension Department and the IARCSC.

Table A2-3. Police

Rank	Headcount	Base Wage	Flat Pension rate
4 Star General	1	5,600	NA
3 Star (Lt) General	19	5,250	2400
2 Star (Major) General	57	4,950	2000
1 Star (Brig) General	253	4,650	1700
Colonel	2,583	4,425	1500
Lieutenant Colonel (Brig)	1,991	4,200	1450
Major	2,258	3,975	1300
Senior Captain	1,927	3,750	1200
Captain	2,126	3,525	1100
1st Lieutenant	1,897	3,300	1000
2nd Lieutenant	1,850	3,150	950
3rd Lieutenant	1,082	3,000	900
Head Sergeant	174	3,500	800
1st Sergeant	319	3,100	800
2nd Sergeant	584	2,800	800
3rd Sergeant	3,639	2,500	800

Sources: MOI (1385) and the MOLSAMD Pension Department.

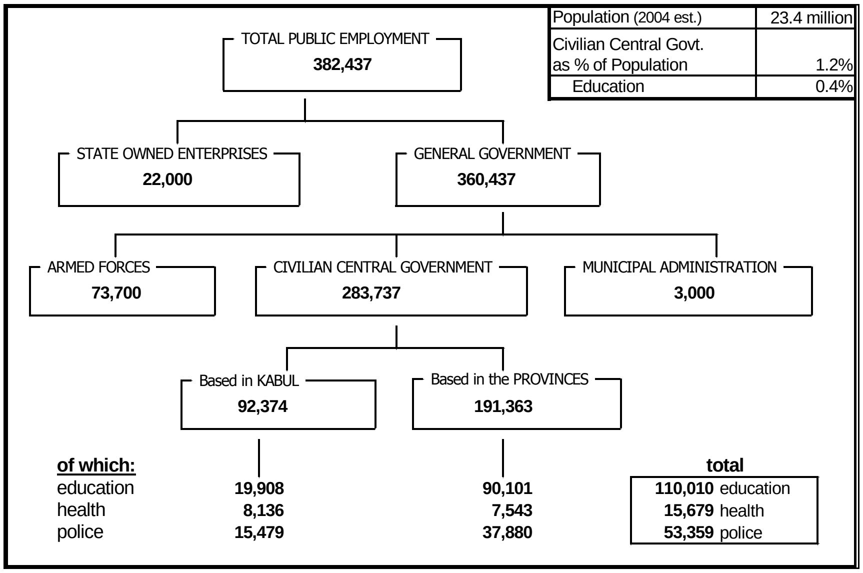
Table A2-4. Post Pay reform wage scales

Status	Rank/Grade	Post Pay reform amount	
		Afs	USD equivalent
Civil Servants	Over Rank	30,400	608
	Above Higher Rank	30,400	608
	Higher Rank	30,400	608
	Rank 1	17,250	345
	Rank 2	17,250	345
	Rank 3	10,800	216
	Rank 4	10,800	216
	Rank 5	8,250	165
	Rank 6	8,250	165
	Rank 7	7,200	144
	Rank 8	7,200	144
	Rank 9	5,650	113
	Rank 10	5,650	113
Ajirs	Higher Grade	4,800	96
	Grade 1	4,800	96
	Grade 2	4,800	96
	Grade 3	4,800	96
	Grade 4	4,800	96
	Grade 5	4,800	96
	Grade 6	4,000	80
	Grade 7	4,000	80
	Grade 8	4,000	80
	Grade 9	4,000	80
	Grade 10	4,000	80

Sources: MOF (2006). The actual rates are still under consideration with the Government.

ANNEX 3: PUBLIC SECTOR EMPLOYMENT

Figure A3-1: Structure of the Civil Service



Source: The World Bank. 2005. Afghanistan: Managing Public Finances for Development. Improving Public Finance Management: Key Cross-cutting Issues (Volume III). December 22, 2005.

Table A3-1: Civil servants in Kabul and provinces

Civil Service Rank	Employees	Teachers
Highest Rank	483	3,505
Higher Rank	608	4,996
Rank 1	1,588	3,756
Rank 2	3,463	3,428
Rank 3	8,902	7,375
Rank 4	17,201	5,800
Rank 5	14,936	6,273
Rank 6	14,802	8,472
Rank 7	7,720	12,213
Rank 8	4,160	12,259
Rank 9	2,908	30,456
Rank 10	1,196	30,965
Total	77,967	129,498

Table A3-2: Ajirs in Kabul and provinces

Grade	Ajirs
Higher Grade	1,505
Grade 1	1,750
Grade 2	3,912
Grade 3	7,094
Grade 4	5,808
Grade 5	6,704
Grade 6	11,459
Grade 7	12,249
Grade 8	9,391
Grade 9	21,196
Grade 10	15
Total	81,083

Notes: Does not include servicemen of the Afghan National Army, Police, and the Ministry of Counter Narcotics. Includes only administrative staff of the judicial system.
Source: the IARCSC.

Table A3-3: Assumptions on estimate of the numbers of covered employment in Table 2.

- Excluding teachers and police, civilian government has just around half of employees in the center.
- At the national level, proportions of the regular employee and ajirs are also equal. However, for the SOEs, based on the available sample data, that proportion was 40 percent to 60 percent for the regular employees versus ajirs correspondingly.
- According to IARCSC, police was not included in the headcount (see Tables A3-1 and A3-2).
- We assumed employees of the SOEs were included into the total IARCSC count, and therefore excluded them all from the count of regular employees *in the center*. This makes totals more consistent with the PFMR report.
- For the uniformed staff, information on division on officers and soldiers was available for the Ministry of Interior only. We simply assume the same proportions for the other agencies. Furthermore, we do not differentiate between central and provincial divisions of military personnel assuming that when retired they get paid through central pension account.
- We assume all reported headcount figures do not include short-term contractors who fall outside of the pension scheme.
- According to the IARCSC, the total teacher count by the end of the year stood already at around 130,000 with another 30,000 to be hired (not reflected in Table 2).

ANNEX 4: ESTIMATES OF THE NUMBER OF ACTIVE BENEFICIARIES

Table A4-1: Cumulative stock of pension files

	1382/2003	1383/2004	1384/2005	Records captured by the IARCSC (*)
Total Individual Files	**50,930**	**53,031**	**71,423**	-
1. Beneficiaries in **Center**, incl:	**44,869**	**46,970**	**58,872**	**48,308**
1.1 **Civil Service,** including	**28,429**	**30,480**	**37,982**	**31,654**
Retirees	20,782	22,780	24,799	20,692
Regular, incl teachers	*14,086*	NA	NA	*12,853*
Ajirs	*6,696*	NA	NA	*7,839*
Survivors (cases)	7,647	7,700	13,183	10,962
1.2 **Military**, including:	**16,440**	**16,490**	**20,890**	**16,654**
Retirees	11,890	11,890	15,576	11,826
Sergeant to Majors	*4,430*	*4,430*	NA	NA
Majors to Colonels	*7,239*	*7,239*	NA	NA
Above Colonels	*221*	*221*	NA	NA
Survivors (cases)	4,550	4,600	5,314	4,819
2. Beneficiaries in **Provinces**:	**6,061**	**6,061**	**12,551**	NA

Notes: Data on Military retirees includes Ministry of Defense, Afghan National Army, Ministry of Interior (Police), and the Security Directorate. Information on Military is presented in sub-categories according to different provisions concerning the retirement age (see Annex 1).

The evidence from analysis of the individual records seems to suggest that the 2004 Pension Department total counts for the survivors in 2004, for both the civil servants and the military, under-represent the actual figures and that some or most of the reported 2004-2005 rapid increase in cases had already occurred between 2003 and 2004.

(*) In 2004-2005, as a one-off effort, the IARCSC contracted a team of technicians and data-entry operators to work on converting records of the Pension Department to an electronic media.

Sources: MOLSAMD Pension Department and the IACSC.

Table A4-2: Alternative estimates of the stock of pensioners

	1382/2003	1383/2004	1384/2005
Beneficiaries in **Center**			
Civil Service, including			
Retirees, B1	9,100	10,600	14,800
Retirees, B2	11,200	10,700	NA
Regular, incl teachers	*6,500*	*6,200*	*NA*
Ajirs	*4,700*	*4,500*	*NA*
Retirees, C	4,100	10,500	*16,899*
Retirees, D	NA	10,600	NA
Regular, incl teachers	*NA*	*5,700*	*NA*
Ajirs	*NA*	*4,900*	*NA*
Survivors, C	2,051	3,800	*6,331*
Survivors, D	NA	3,100	NA

Military, including:			
Retirees, B1	5,800	5,600	9,900
Retirees, B2	7,500	8,000	NA
Retirees, C	2,100	7,900	*11,826*
Retirees, D		8,600	
Survivors, C	288	1,440	*2,131*
Survivors, D	NA	1,700	NA
Beneficiaries in **Provinces**			
All beneficiaries, C	1,173	2,094	*4,000*

Sources: Author's estimates based on data from MOLSAMD Pension Department and IARCSC.

Notations:

B1	
Definition:	Stock of all alive and registered retirees
Methodology:	For 2005, difference between cumulative sets of retirees and survivors from **Table A4-1**. For 2003 and 2004, additionally subtracted 80 and 90 percent, correspondingly, of the 2004-2005 increase in the survivors count, reasoning that such rapid reported increase was due to application/registration delays and not due to the rapid changes in the mortality factor.
Data source:	Pension Department statistics
Strong sides	Provides estimate of registered retirees net of cases of deceased members.
Weak sides	Numbers may still include dead retirees whose beneficiaries have not applied. 2003 and 2004 estimates are sensitive to assumptions.

B2	
Definition:	Stock of all who ever applied and who would have survived
Methodology:	Step 1: Age/sex specific mortality rates[19] were applied to year/age/sex/category[20] specific profiles of new retirees since first year of operation until 2005. Step 2: Obtained total annual stock estimates were extrapolated with category specific adjustment coefficients (average 16 percent upward adjustment) to allow for errors due to excluded invalid records. Step 3: Another upward adjustment of 5% was introduced for the numbers of the civil service regular employees to compensate for differences[21] in the total count for the sample and the total number provided by the Pension Department for 2004 (see **Table A4-1**).
Data source:	IARCSC individual records
Strong sides	Allows checking for internal biases of the system and assessing argument about lack of payments to those who are eligible and registered.
Weak sides	Step 2 (extrapolation procedure) is a rough shortcut

C	
Definition:	Observed payments.
Methodology:	-
Data source:	Pension Department statistics.
Strong sides	Actual authorized payments.
Weak sides	May exclude some registered and eligible; may exhibit processing delays; data

[19] World Bank rates used in the institutional population projections for Afghanistan.
[20] Projections were made separate for regular civil service employees, ajirs, and military.
[21] The actual difference is of the magnitude of 10%. Given lack of knowledge on how the excluded records might have affected the estimated total headcount for the past three years, we assumed an average impact.

	anomalies observed (see CS survivors in 2004).

D	
Definition:	Recorded individual payments.
Methodology:	Step 1: Sum of the number of individual observations of payments made in 2004 and 2005 net of new retirement cases in 2004. Step 2: Obtained total annual stock estimates were extrapolated with category specific adjustment coefficients (average 13 percent upward adjustment) to allow for errors due to excluded invalid records. Step 3: See Methodology for B2.
Data source:	IARCSC individual records
Strong sides	Provides robust estimates of active retirees. Allows for alternative assessment of survivors in receipt of benefit.
Weak sides	Step 2 (extrapolation procedure) is a rough shortcut, although the error margin is acceptable. For survivors, the estimates based on the year of death of the member not the actual application date.

General observations:

- Differences from various estimates for 1383 (2004) are small for the civil servants but significant for the military.
- B2 and D estimates are relatively close both for the civil servants and military. Basically, B2 procedure is an internal consistency check on the sample. This indicates robustness of the estimates.
- For the last 15 years, assessment of the stock data indicates decreasing number of the regular retirees of the civil service and increasing number of the ajir pensioners (not presented in the table).
- Based on individual records, for the past 15 years there has been no significant variation in the ratio of the new retirees to the estimated active stock, for the civil servants (not presented in the table above). For ajirs and the military, rates of retirement significantly and rapidly dropped 7 years ago, which may indicate more sizable overdue payments to those who delayed retirement in those categories. For the past two years, however, rates of retirement in those two groups have been very high.

Table A4-3: Updated pensioner cases, 1386 (2007)

Categories	Total number of registered pensioners	Including newly registered pensioners (1386)	Pensioners collecting their benefits	Total number of active pensioners
Civil Service pensioners	32,405	1,833	17,572	19,405
Survivors	16,232	1,908	7,250	9,158
Military pensioners	22,002	3,021	13,285	16,306
Survivors	6,281	583	2,404	2,987
Total in Kabul	76,920	7,345	40,511	47,856
Total in Provinces	13,146	0	12,146	12,146
Grand Total	**90,066**	**7,345**	**52,657**	**60,002**

Sources: MOLSAMD.

ANNEX 5: FINANCIAL PROJECTIONS

Tables A5-1: Medium Term Fiscal Projections for the Reformed Civil Service Pension Scheme

(all values below are in US$)

Scenario 1: Baseline – All new wages, excluding allowances, are pensionable; less generous benefit formula; lump sum payments to survivors; but same old contribution rates

New wages indexed?	Allowances pensionable after P&G?	New pension formula phased-in?	Civil Service New Contribution: EE / Gov	Military&Pol New Contribution: EE / Gov
3%	No	Yes	**3 / 0**	**3 / 0**

Observations: Significant and growing deficit requires permanent subsidies

	1386	1387	1388	1389	1390	1391
Contributions (at 95% comlpliance)						
Pre-PG Civil Service Employees	3,952,000	4,674,950	4,659,750	3,479,850	2,164,100	45,600
Post-PG Employees						
Civil Service			1,328,100	5,004,600	8,078,800	11,661,250
Police&Military	3,949,150	3,952,950	4,104,950	4,300,650	4,501,100	4,764,250
Post-PG Government						
Civil Service			-	-	-	-
Police&Military		-	-	-	-	-
Total	**7,901,150**	**8,627,900**	**10,092,800**	**12,785,100**	**14,744,000**	**16,471,100**
Expenditures						
Old scheme						
Old age benefits (not indexed)	28,000,000	30,200,000	32,000,000	33,300,000	34,200,000	34,400,000
Survivors benefits (not indexed)	7,000,000	8,900,000	10,100,000	10,900,000	11,200,000	11,200,000
New Scheme						
Old age benefits		2,200,000	4,200,000	6,900,000	9,800,000	12,700,000
Survivors benefits (lump sums)		4,000,000	5,500,000	12,200,000	16,500,000	24,500,000
Total	**35,000,000**	**45,300,000**	**51,800,000**	**63,300,000**	**71,700,000**	**82,800,000**
Balance	**-27,098,850**	**-36,672,100**	**-41,707,200**	**-50,514,900**	**-56,956,000**	**-66,328,900**

Scenario 2: Same as baseline but new contribution rates

New wages indexed?	Allowances pensionable after P&G?	New pension formula phased-in?	Civil Service New Contribution: EE / Gov	Military&Pol New Contribution: EE / Gov
3%	No	Yes	**8 / 8**	**8 / 8**

Observations: Deficit disappears in the medium term

	1386	1387	1388	1389	1390	1391
Contributions (at 95% comlpliance)						
Pre-PG Civil Service Employees	3,952,000	4,674,950	4,659,750	3,479,850	2,164,100	45,600
Post-PG Employees						
Civil Service			3,542,550	13,344,650	21,544,100	31,096,350
Police&Military	3,949,150	10,540,250	10,945,900	11,468,400	12,003,250	12,704,350
Post-PG Government						
Civil Service			3,729,000	14,047,000	22,678,000	32,733,000
Police&Military		11,095,000	11,522,000	12,072,000	12,635,000	13,373,000
Total	**7,901,150**	**26,310,200**	**34,399,200**	**54,411,900**	**71,024,450**	**89,952,300**
Expenditures						
Old scheme						
Old age benefits (not indexed)	28,000,000	30,200,000	32,000,000	33,300,000	34,200,000	34,400,000
Survivors benefits (not indexed)	7,000,000	8,900,000	10,100,000	10,900,000	11,200,000	11,200,000
New Scheme						
Old age benefits		2,200,000	4,200,000	6,900,000	9,800,000	12,700,000
Survivors benefits (lump sums)		4,000,000	5,500,000	12,200,000	16,500,000	24,500,000
Total	**35,000,000**	**45,300,000**	**51,800,000**	**63,300,000**	**71,700,000**	**82,800,000**
Balance	**-27,098,850**	**-18,989,800**	**-17,400,800**	**-8,888,100**	**-675,550**	**7,152,300**

Scenario 3: New contribution rates *and* allowances are pensionable

New wages indexed?	Allowances pensionable after P&G?	New pension formula phased-in?	Civil Service New Contribution: EE / Gov	Military&Pol New Contribution: EE / Gov
3%	Yes	Yes	**8 / 8**	**8 / 8**

<u>Observations</u>: Improved fiscal situation in the short-to-medium term (revenues grow faster than expenditures). **The most preferred option**

	1386	1387	1388	1389	1390	1391
Contributions (at 95% comlpliance)						
Pre-PG Civil Service Employees	3,952,000	4,674,950	4,659,750	3,479,850	2,164,100	45,600
Post-PG <u>Employees</u>						
Civil Service			5,145,200	19,479,750	31,528,600	45,466,050
Police&Military	3,949,150	10,540,250	10,945,900	11,468,400	12,003,250	12,704,350
Post-PG <u>Government</u>						
Civil Service			5,416,000	20,505,000	33,188,000	47,859,000
Police&Military		11,095,000	11,522,000	12,072,000	12,635,000	13,373,000
Total	**7,901,150**	**26,310,200**	**37,688,850**	**67,005,000**	**91,518,950**	**119,448,000**
Expenditures						
Old scheme						
Old age benefits (not indexed)	28,000,000	30,200,000	32,000,000	33,300,000	34,200,000	34,400,000
Survivors benefits (not indexed)	7,000,000	8,900,000	10,100,000	10,900,000	11,200,000	11,200,000
New Scheme						
Old age benefits		2,200,000	4,300,000	7,200,000	10,300,000	13,600,000
Survivors benefits (lump sums)		4,000,000	6,000,000	14,800,000	20,700,000	31,200,000
Total	**35,000,000**	**45,300,000**	**52,400,000**	**66,200,000**	**76,400,000**	**90,400,000**
Balance	**-27,098,850**	**-18,989,800**	**-14,711,150**	**805,000**	**15,118,950**	**29,048,000**

Scenario 4: Same as Scenario 3 but new benefit parameters introduced overnight

New wages indexed?	Allowances pensionable after P&G?	New pension formula phased-in?	Civil Service New Contribution: EE / Gov	Military&Pol New Contribution: EE / Gov
3%	Yes	No	**8 / 8**	**8 / 8**

Observations: Still improving fiscal situation in the medium term but a more expensive transition.

	1386	1387	1388	1389	1390	1391
Contributions **(at 95% comlpliance)**						
Pre-PG Civil Service Employees	3,952,000	4,674,950	4,659,750	3,479,850	2,164,100	45,600
Post-PG Employees						
Civil Service			5,145,200	19,479,750	31,528,600	45,466,050
Police&Military	3,949,150	10,540,250	10,945,900	11,468,400	12,003,250	12,704,350
Post-PG Government						
Civil Service			5,416,000	20,505,000	33,188,000	47,859,000
Police&Military		11,095,000	11,522,000	12,072,000	12,635,000	13,373,000
Total	**7,901,150**	**26,310,200**	**37,688,850**	**67,005,000**	**91,518,950**	**119,448,000**
Expenditures						
Old scheme						
Old age benefits (not indexed)	28,000,000	30,200,000	32,000,000	33,300,000	34,200,000	34,400,000
Survivors benefits (not indexed)	7,000,000	8,900,000	10,100,000	10,900,000	11,200,000	11,200,000
New Scheme						
Old age benefits		3,200,000	6,200,000	9,700,000	13,400,000	16,700,000
Survivors benefits (lump sums)		5,900,000	9,100,000	17,700,000	24,800,000	31,200,000
Total	**35,000,000**	**48,200,000**	**57,400,000**	**71,600,000**	**83,600,000**	**93,500,000**
Balance	**-27,098,850**	**-21,889,800**	**-19,711,150**	**-4,595,000**	**7,918,950**	**25,948,000**

Table A5-3: Assumptions

(MOY)	1386 2007	1387 2008	1388 2009	1389 2010	1390 2011	1391 2012
Actual Pensionable Headcount						
Total pensionable non-uniform	302,000	302,000	301,300	320,600	330,000	329,400
Civil Service (CS)	130,000	130,000	130,000	130,000	130,000	130,000
Teachers (TE)	150,000	150,000	150,000	170,000	180,000	180,000
SOEs	22,000	22,000	21,300	20,600	20,000	19,400
flow of retrenched as result of P&G reform (CS+TE)		2,500	2,500	2,500	2,500	0
flow of normally retired (CS+TE+SOEs) - includes dead		8,106	6,490	4,016	2,128	539
new hires (CS+TE)		0	9,847	29,067	18,502	8,010
CS+TE after P&G reform and (re-)appointed with new salary		30,000	80,000	70,000	70,000	20,000
Police officers (including gen, officers, sergeants)	25,000	26,000	28,000	30,000	32,000	34,000
Military officers (including officers, sergeants, an	27,000	26,500	26,000	25,500	25,000	25,000
Actual Pensionable Wagebill, $						
Avg CS+TE+SOEs base wage	$38	$45	$52	$59	$66	$74
Avg post-PG CS+TE total wage		$147	$142	$144	$148	$151
Avg Police Wage	$200	$205	$210	$215	$220	$225
Avg Military Wage	$230	$235	$240	$245	$250	$255
Pre-PG non-uniform wage bill	$138,655,849	$164,025,193	$163,488,405	$122,109,840	$75,926,997	$1,600,328
Post-PG non-uniform wage bill	$0	$0	$67,694,970	$256,318,087	$414,847,391	$598,242,750
Police and Military Officers Payroll	$138,575,641	$138,690,000	$144,027,101	$150,905,215	$157,942,316	$167,159,751

Table A5-3: Sources of data used in financial projections

Data category	Source	Notes/Assumptions
Age/gender distribution of retirees and their pensions	IARCSC/Pension Department	The IARCSC project was completed by October 2005. (Only a negligible number of individual records in the dataset indicated the year of retirement or last payment as 2005).
Age/gender/length of service distribution of active employees and their wages	Civil Servants (CS): IARCSC, survey of employees in Kabul (22,000 records) Ajirs: assumed same distributions as for Ajirs working with SOEs SOEs: SOE Privatization department, MOF (18,600 records) Teachers: MOE comprehensive database of education sector (113,600 records) Police: MOI payroll department Military: Assumed same distributions as for Police	Civil Servants (CS): Applied Kabul distribution to all. Ajirs: Alternative source, IARCSC sample, indicated on average smaller wages and shorter service periods for Kabul. Teachers: for Kabul, a sub-sample of the MOE data produced very close patterns of distributions as the data collected by the IARCSC for teachers. Police: Wage distribution was obtained by applying the same from the civil servants and extrapolating to the average MOI reported wages for males and females. Length of service assumed to be the same as for civil servants. Military: Wage distribution obtained as above for Police and applying multiplier for average wage specific to military.
Total of retirees, by category	See Table 5	–
Total of active employees by category	See Table 2	–

Notes: SOE – Socially Owned Enterprises
MOE – Ministry of Education
MOI – Ministry of Interior

ANNEX 6: TYPOLOGY OF PENSION PROVISIONS

Table A6-1: Alternative pension program types by objective

Redistribution

Program type	Country examples
Means-tested	Australia/South Africa
Universal flat	Mauritius/Namibia New Zealand
Minimum pension guarantees	Chile
Matching contribution for low income worker	Mexico
Redistribution within defined benefit formula	Germany, US, Mali, many other countries

Savings

Program type	Country examples
Fully funded DB	Namibia (civil servants scheme)
Partially funded DB	Roughly ¼ of public plans around the world including many African countries; examples: Sweden, Canada, Korea, Mali
Pay-as-you-go DB	roughly half of main public schemes around world
Defined contribution	Chile, Hong Kong, Mexico
Hybrid	Croatia, Hungary, Poland, Sweden

Table A6-2: Operational definition of selected public pension provisions

	Defined Benefit Scheme	Defined Contribution Scheme	Basic Non-Contributory Scheme
Financing mechanisms	Contributions and/or general budget	Contributions	General budget
Liabilities	Funded or un-funded. Often not accounted.	Fully funded and accounted	Un-funded
Risks	Largely with Government	With member	With Government
Invested Assets	Yes or No (No individual entitlement to assets)	Yes (Individual entitlement to assets)	No
Basis for benefit calculation	Formula incorporating covered wage and length of service	Amount of savings in individual account and longevity factor	Flat or means-tested benefit
Benefit payments	Regular cash payments	Requires purchase of annuity[22]; scheduled withdrawals, or lump sum payments	Regular cash payments

[22] A financial instrument that facilitates conversion of a lump sum amount into a stream of regular cash payments for life and incorporates longevity risk.

Table A6-3: Characteristics of basic pensions in selected developing countries

	Year of data	Recipients as % of 65+ pop	Benefit as % of income per capita	Eligibility age, M/F
	(1)	(2)	(3)	(4)
Algeria	1998	6%	3%	NA
Argentina	2000	1%	22%	70
Bangladesh	2003/04	22%	7%	57
Bolivia *	2004	110%	23%	65
Botswana *	1999/00	86%	9%	65
Brazil	2003	40% and 7%	33%	60/55 and 67
Chile	2001	15%	12%	65
Colombia	1998	5%	40%	65
Costa Rica	2000	22%	10%	65
Dominican Republic	2000	2%	8%	NA
Egypt, Arab Rep.	2004	18%	13%	65
Estonia	2003	2%	12%	63
India	1999	14%	10%	65
Kosovo *	2004	100%	45%	65
Mauritius *	1999/00	153%	18%	60
Namibia *	1999/00	115%	17%	60
Nepal *	2001/02	21% and 25%	10%	75 and 60
Russian Federation	2004	9%	7%	65/60
South Africa	2003	86%	32%	65/60
Turkey	2005	21%	10%	65
Uruguay	2001	4%	24%	70

Notes: * Countries that operate universal flat schemes.
For Brazil and Nepal data for two separate programs provided separately.
For column (3), where means tests apply (e.g., South Africa) or different amounts are payable to the couples (e.g., Turkey), the value of maximum allotment to an individual is indicated; Other than old age beneficiaries excluded; Income per capita in current prices used.

Source: Robert Palacios and Oleksiy Sluchynsky. "Social pensions. Part I: Their role in the overall pension system". The World Bank. 2006.