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Brief
Pension provision in Botswana

Background

Botswana is a relatively well-off country by Southern African standards. The country is not, however, free of deprivation. Policymakers are giving careful attention to a number of social issues. One of these is the financial provision for old age.

FinMark Trust recently commissioned a study on old-age protection that asks whether existing employment arrangements could be altered to improve the level of saving for the retirement years. The results suggest cause for optimism.

The research was carried out by an international team from Genesis Analytics, and included assessing statistics from a range of sources, interviews with influential people in the public and private sectors, and surveys of employers, workers and the elderly.

Circumstances of the elderly

Botswana is one of a small group of countries that provides all citizens with an old-age pension without a needs test based on personal income or assets. The system provides about 90 000 recipients with a monthly benefit of P220. This is an extremely valuable benefit but does not provide for much more than the basic means to survive.

Some of Botswana's elderly also benefit from other state payments such as food grants, war veterans pensions or destitute benefits. Less than 20 percent of senior citizens also benefit from a private pension arrangement, through an employer's pension fund or a personal pension product.

In general, supplementary provision for retirement is poor. Six out of every seven elderly people surveyed express regret that they did not made more effort to prepare for their retirement.

Poor provision for old age

The suggestion of insufficient saving for retirement appears to be confirmed by analysis of the levels of provision by today's workers. Saving for old age is poor. Many workers describe themselves as completely dependent on the state for their well-being in retirement. There is evidence that the elderly are particularly vulnerable to poverty.

Of Botswana's 640 000 economically active people, around one-quarter is unemployed. Another one-quarter is engaged in informal employment or traditional agriculture, which brings with it very poor prospects for secure old-age provision. This leaves around 300 000 people, or nearly half of the labour force, employed in the formal sector.

Just over 100 000 of these workers are members of employer-provided retirement arrangements, leaving many without any retirement fund cover. This means, overall, that more than 85 percent of the economically active population has no access to employer-provided retirement vehicles.

There is little evidence of supplementary saving in individual products to close this gap. FinScope™ surveys* show a low take-up of long-term contractual saving products like retirement annuities and endowments. A proportion of these products can in any case be assumed to be owned by workers who already have company-based pension cover.

The gratuity/severance scheme

The Employment Act requires workers not covered by retirement pension arrangements to receive protection under its gratuity/severance scheme. This started out as an unemployment protection plan that required employers to pay a cash benefit to dismissed workers with more than five years of service. The arrangement was expanded to provide benefits at specified intervals also to workers with continuing service to their employer.

Its provisions require a cash payment on the fifth anniversary of an employee's term of employment, and similar payments – but at double the rate – at the end of every five-year period thereafter.

On termination of employment, for any reason, a worker is eligible for a pro-rata cash benefit, but still only if the service period exceeds five years.

The gratuity/severance scheme suffers from a number of difficulties.

- There is no requirement on employers to fund in advance their obligation to the employees. As a result, companies suffer cash-flow difficulties as their workers attain the thresholds for eligibility. This can be particularly acute for small companies, which may have employed key workers at roughly the same time, and for companies in financial difficulty, which have a financial obligation to workers they may be compelled to dismiss.
- There is an inconsistency in the level of the financial obligation for employers. Those firms focusing on long-term employment relationships rather than short-term contracts effectively bear a form of structural penalty for this loyalty.
- There is evidence that some employers are not complying with the legal requirements of the scheme. Many employment-related trade disputes are attributable to non-payment of the severance benefit, or to unfair termination, issues that may be related to one another.
- The scheme at present does not meet any clear social need. It has compromised the original intention of meeting emergency needs on termination of employment, and benefits those in long-term stable employment more than those with a short working relationship with their employer.

FinMark Trust is a Johannesburg-based, independent think-tank promoting financial inclusion in Africa. In practice this means supporting institutional and organisational development to increase access to financial services by the unbanked and underbanked of Africa.

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* FinScope™ is a nationally representative study that benchmarks the use of, and access to, financial services. www.finscopeafrica.com

Building a more secure provision

The problems of the gratuity/severance scheme are worsened by the fact that participation in such an arrangement is mandatory only for workers with no formal pension cover through their employer, in practice, usually the lower-paid employees.

This suggests that it ought to be used not so much to meet emergency needs on termination of employment, but to provide some preparation for retirement. The surveys provide compelling evidence that gratuity/severance benefits are seldom used for this purpose.

These issues beg the question of whether the imperfect statutory requirement that is in place to assist mostly low-earning workers could not be modified to provide the foundation for a more secure and stable retirement provision.

Encouraging survey results

The study explores prevailing attitudes about the possibility of redirecting gratuity/severance benefits to some form of mandatory retirement provision. Support for such an approach is strong.

- Employers agree that workers on this system are worse off in retirement and would benefit from some form of provision. They express their willingness to contribute to workers' pensions in lieu of their existing commitment to the gratuity/severance arrangement and indicate broad support for some form of national pension system.
- Workers surveyed for the study show a willingness to redirect gratuity benefits to retirement saving and appear positively inclined to the suggestion that they should contribute towards their pension provision. They also express support for a national arrangement, even if it means compulsory contributions.
- Pensioners express regret at not having saved for retirement and state their support for some mandatory arrangement.

Food for thought

The number of Botswana citizens who are 65 years and older is expected to grow steadily, both in absolute terms and as a percentage of the total population. The old-age pension provides the means to stave off poverty but is not regarded as sufficient to meet reasonable consumption needs in retirement.

The gratuity/severance system appears to need an overhaul. It does not meet a well-defined social need and is not operating as it was intended.

The potential for it to be used as a foundation for a comprehensive old-age system is attractive, and support for such an arrangement is widespread.

Simple financial modeling conducted as part of the study indicates that it may be feasible for the existing gratuity/severance scheme to be used as the basis for such a pension arrangement for low-paid workers.

Most importantly, financial projections show that if the amounts being devoted to the gratuity/severance scheme were supplemented by modest additional contributions from employers and employees, and invested during working lifetimes, it would be possible for employees to build up a financial package that could generate a pension equal to around half of their pre-retirement earnings, as long as administration and fund-management costs could be kept low.

Thus retirement provision for a considerable portion of the workforce – the nearly one-third who are in formal employment but not covered by an existing private pension arrangement – could in principle be substantially improved.

Recommendations

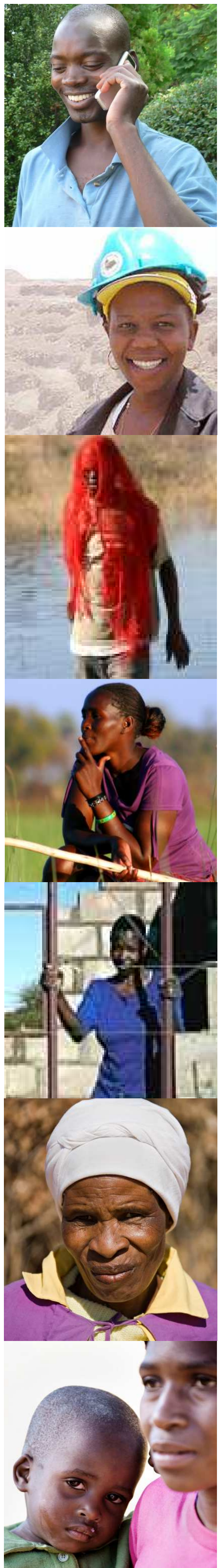
Further consideration of the potential for such an arrangement is strongly encouraged. The possibilities are exciting, but a number of questions need careful thought:

- How could such a system be cost-effectively established and run?
- Should it be run by the public sector, private companies or a combination of both?
- How should benefits be defined and at what rate should contributions be paid?

Many more questions would need serious attention if the proposals in the report are to be taken further.

But probably the most important issue is whether it is appropriate to require working people across different walks of life and socio-economic circumstances to save for their retirement. While in principle additional long-term saving is a good thing, it should be acknowledged that this would reduce consumption spending, which could cause hardships for low-income households. Studies elsewhere show that obligatory pensions and savings schemes might not always be appropriate.

While this report suggests that a broad-based pension scheme replacing the gratuity/severance scheme would be feasible, we nevertheless recommend great care in consideration of the issue in Botswana.



The information in this brief is extracted from the report *Developing a broad-based employee pension scheme for Botswana,* compiled for FinMark Trust by Genesis Analytics, and available at www.finmarktrust.org.za. Comments on the findings are welcome and should be directed to Keith Jefferis at keith@econsult.co.bw or Rob Rusconi at rob@tresconsulting.co.za.