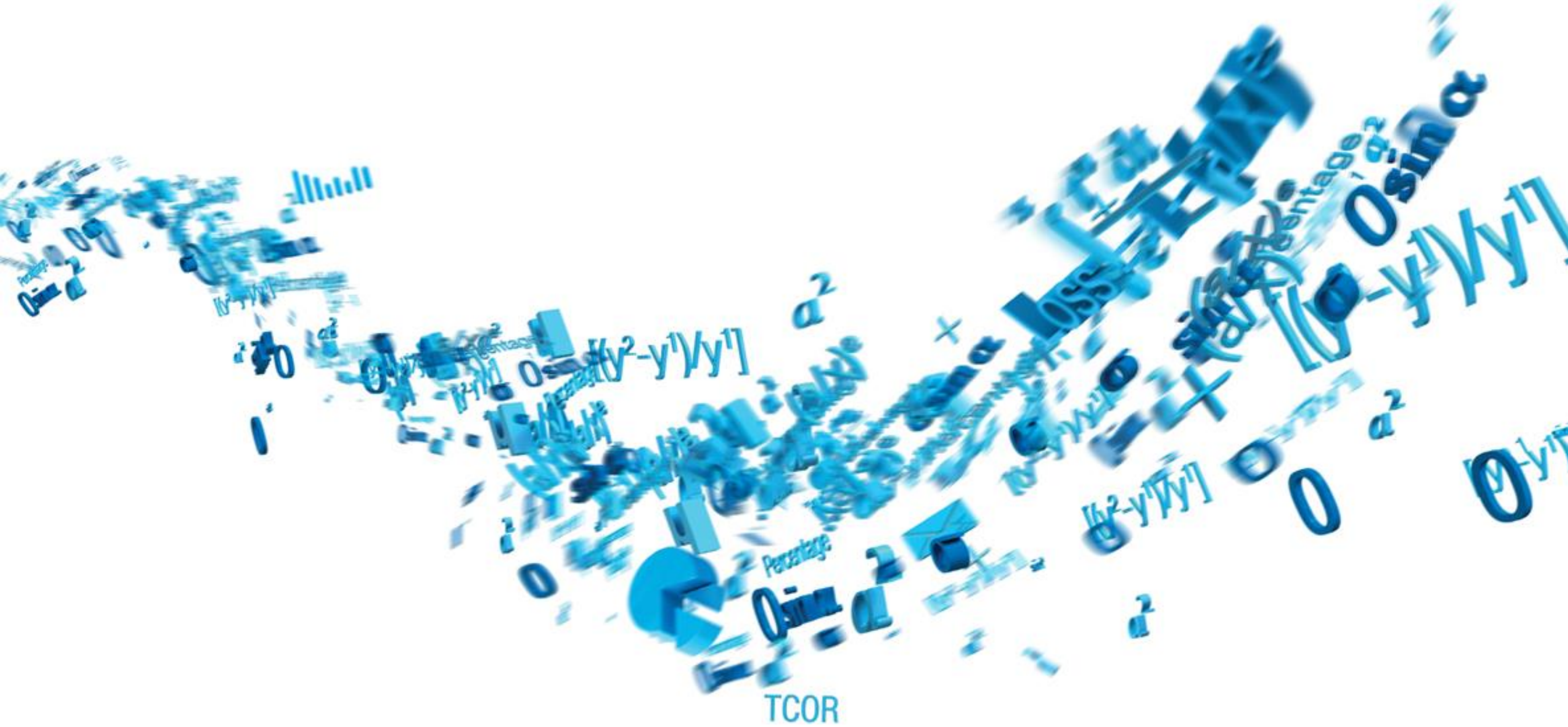

News Alert on Budget 2020/2021

Prepared by Aon Hewitt Ltd

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Empower Results®

The Budget 2020-2021 proposed several changes which will affect labour laws and the pension landscape dramatically.

Workers' Rights Act 2019

The Workers' Rights Act will be amended to –

(a) harmonise the definition of earnings with that specified in the Remuneration Regulations;

(b) facilitate the implementation of the Protocol on Heavy Rainfall for the private sector;

(c) reinforce the protection against discrimination;

(d) avoid double payment in respect of the Portable Retirement Gratuity Fund where severance allowance is paid;

(e) better protect the rights of workers against abusive termination by extending the provision of the Protection Order to the ruling of the Redundancy Board;

(f) provide for employees earning up to Rs 100,000 monthly to be entitled to end of year bonus under the Workers' Rights Act. Employees earning more than Rs 100,000 monthly will be covered under the End of Year Gratuity Act;

(g) provide a better income security to laid off workers by increasing the amount of Transition Unemployment Benefit payable in view of the impact of the COVID-19 pandemic on employment.

Abolition of National Pensions Fund (NPF) contributions and Introduction of Contribution Sociale Généralisée (CSG)

The Minister of Finance, in his Budget Speech, announced the introduction of the CSG with effect from 1 September 2020. Contributions will be as follows:

	% of basic salary	
	Employer Contributions	**Employee Contributions**
Up to Rs50,000	3%	1.5%
Above Rs50,000	6%	3%

An amount of Rs4,500 will start to be paid as from July 2023 to those aged 65 on top of their Basic Retirement Pension (BRP) of Rs9,000 to bring the total to Rs13,500 as from age 65.

As part of this proposed reform, contributions to the NPF will be abolished. However, benefits will continue to be paid to those who have previously contributed. The reasons for abolishing the NPF are that it is considered unsustainable, unfair and regressive.

We understand that the CSG was introduced to finance increases in the BRP promised during the electoral campaign last year. The BRP will be frozen and no increase will be granted until at least 2023 through the CSG.

We consider that this proposal is a step backward and we will consider its impact in this News Alert.

Background of Pension Reforms

Our national pension system consists of a healthy mixture of different pillars which meet different objectives quite effectively, though not perfectly for all of course.

In effect, we have a minimum non-contributory safety net (BRP), a minimum compulsory contributory pension (NPF), a minimum compulsory retirement lump sum (NSF) and space for additional voluntary pension provision/savings (private pension schemes).

Concerns over the long-term sustainability of the BRP have been raised as far back as 20 years ago. There was first an attempt at introducing means-testing and then an attempt at delaying its payment until age 65, both of which had to be withdrawn because of lack of political consensus.

In recent years, there has been no attempt at reforming the BRP, except that the government indicated in 2012 or so that annual increases in the BRP would henceforth be limited to inflation.

However, the following government increased it from around Rs3,600 in 2014 to Rs9,000 only 5 years later, compounding the problem for future generations. To make matters worse in our view, the current government has promised to increase it further to Rs13,500 in 4 years' time! We consider it is high time that our population is educated and informed to understand that such increases can only be paid by themselves and their children in the long run. There is a natural limit to BRP and in our view it should remain well below (e.g. 2/3) the national minimum wage for example.

Background of Pension Reforms (continued)

If the BRP is set too high, it will undermine the efforts made by the various stakeholders in the other retirement pillars. One positive aspect of the CSG proposals is that the BRP will now be frozen for at least 4 years.

However, we consider that the Government should go further in making the CSG a funded arrangement like the NPF and build upon it instead of replacing it. Similarly, the CSG should build upon and encourage employers to continue to fund private pension schemes under the 4th pillar (see fig. 1) instead of crowding them out.

Overview of the Mauritian pension landscape

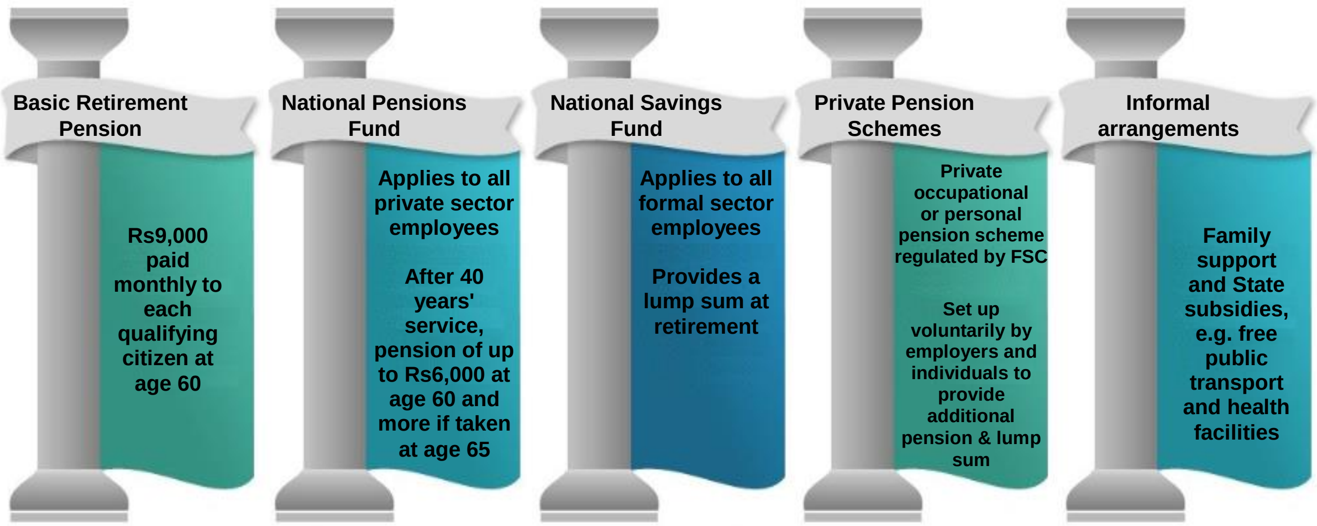
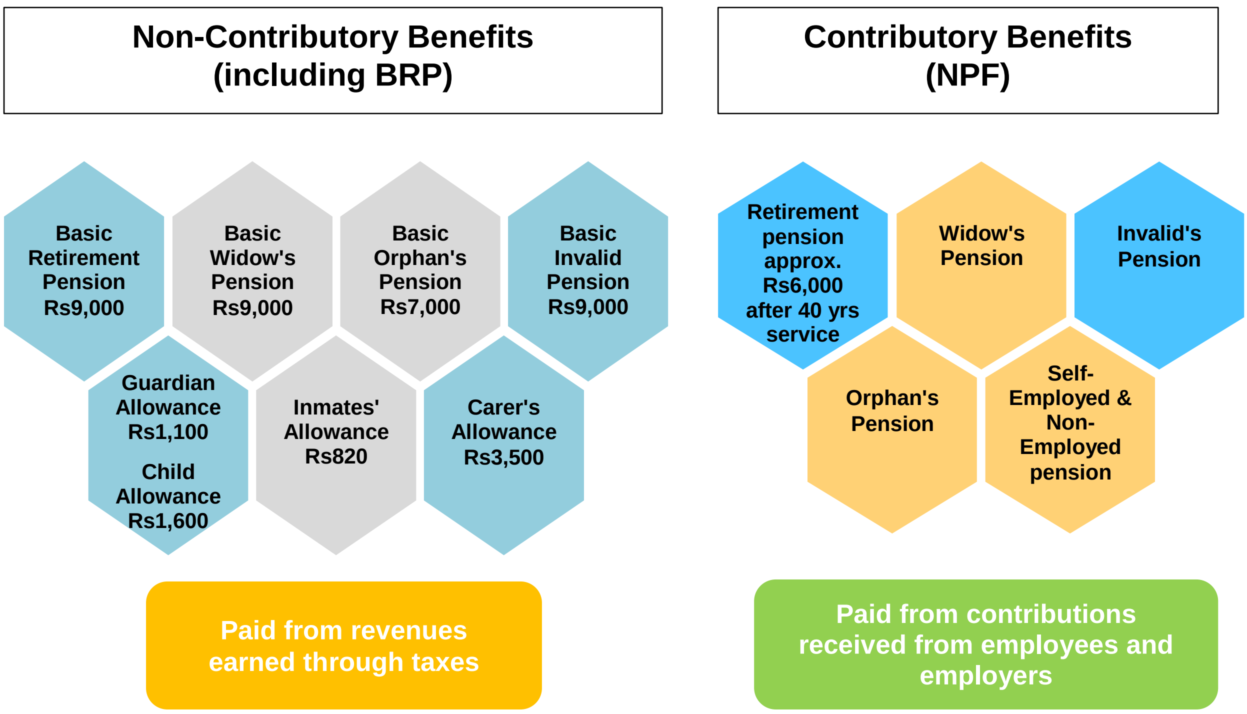


Figure 1

Overview of benefits under the National Pensions Scheme



Comparison of NPF vs CSG in terms of contributions & benefits at different salary levels

Actual *Salary* for CSG (per month)	NPF *Salary* Ceiling (per month)	NPF Employee *Contribution* amount (A)	NPF Employer *Contribution* amount (C)	CSG Employee *Contribution* amount (B)	CSG Employer *Contribution* amount (D)	Expected *Benefit* from NPF at age 65 (E)	Expected *Benefit* from CSG at age 65 (F)	*Increase / (Decrease) in Net Pay for* ***Employee*** *(A Minus B)*	*Increase / (Decrease) in C ost for* ***Employers*** *(D Minus C)*	*Increase / (Decrease) in* ***total contributions*** *per month (A+C) Minus (B+D)*	*Increase / (Decrease) in* ***expected pension benefits*** *per month (F Minus E)*
10,200	10,200	306	612	153	306	3,400	4,500	153	(306)	(459)	1,100
13,000	13,000	390	780	195	390	4,333	4,500	195	(390)	(585)	167
15,000	15,000	450	900	225	450	5,000	4,500	225	(450)	(675)	(500)
20,000	18,740	562	1,124	300	600	6,247	4,500	262	(524)	(787)	(1,747)
25,000	18,740	562	1,124	375	750	6,247	4,500	187	(374)	(562)	(1,747)
30,000	18,740	562	1,124	450	900	6,247	4,500	112	(224)	(337)	(1,747)
35,000	18,740	562	1,124	525	1,050	6,247	4,500	37	(74)	(112)	(1,747)
37,480	18,740	562	1,124	562	1,124	6,247	4,500	-	-	-	(1,747)
40,000	18,740	562	1,124	600	1,200	6,247	4,500	(38)	76	113	(1,747)
45,000	18,740	562	1,124	675	1,350	6,247	4,500	(113)	226	338	(1,747)
50,000	18,740	562	1,124	750	1,500	6,247	4,500	(188)	376	563	(1,747)
55,000	18,740	562	1,124	1,650	3,300	6,247	4,500	(1,088)	2,176	3,263	(1,747)
60,000	18,740	562	1,124	1,800	3,600	6,247	4,500	(1,238)	2,476	3,713	(1,747)
65,000	18,740	562	1,124	1,950	3,900	6,247	4,500	(1,388)	2,776	4,163	(1,747)
70,000	18,740	562	1,124	2,100	4,200	6,247	4,500	(1,538)	3,076	4,613	(1,747)
75,000	18,740	562	1,124	2,250	4,500	6,247	4,500	(1,688)	3,376	5,063	(1,747)
80,000	18,740	562	1,124	2,400	4,800	6,247	4,500	(1,838)	3,676	5,513	(1,747)
85,000	18,740	562	1,124	2,550	5,100	6,247	4,500	(1,988)	3,976	5,963	(1,747)
90,000	18,740	562	1,124	2,700	5,400	6,247	4,500	(2,138)	4,276	6,413	(1,747)
95,000	18,740	562	1,124	2,850	5,700	6,247	4,500	(2,288)	4,576	6,863	(1,747)
100,000	18,740	562	1,124	3,000	6,000	6,247	4,500	(2,438)	4,876	7,313	(1,747)
125,000	18,740	562	1,124	3,750	7,500	6,247	4,500	(3,188)	6,376	9,563	(1,747)
150,000	18,740	562	1,124	4,500	9,000	6,247	4,500	(3,938)	7,876	11,813	(1,747)
175,000	18,740	562	1,124	5,250	10,500	6,247	4,500	(4,688)	9,376	14,063	(1,747)
200,000	18,740	562	1,124	6,000	12,000	6,247	4,500	(5,438)	10,876	16,313	(1,747)
225,000	18,740	562	1,124	6,750	13,500	6,247	4,500	(6,188)	12,376	18,563	(1,747)
250,000	18,740	562	1,124	7,500	15,000	6,247	4,500	(6,938)	13,876	20,813	(1,747)
Informal sector		Voluntary		150			4,500	(150)			4,500?

Table 1

<u>Key Observations from Table 1:</u>

Contributions

- Those earning up to Rs37,480 only will pay lower contributions.

- Net pay will fall between Rs1,000 to Rs7,000 for all private sector employees earning between Rs55,000 and Rs250,000 *(increase in income tax threshold not accounted for).*

- Fall in labour cost for employers with majority of staff earning less than Rs37,480.

- However, there is a significant increase in cost as salary increases. Many private sector companies, in order to manage liquidity constraints, have asked employees to accept temporary pay cuts. The introduction of the CSG will reduce or even nullify any such cost savings.

- The total 6% or 9% contributions which, under NPF, would have been credited into an employee's individual account like an investment will now be used by the Government like a tax. The latter will be free to decide how best to use this additional revenue.

Target Pension

- The target pension for the NPF is roughly around one-third of basic salary or the NPF ceiling (currently Rs18,740), whichever is the lower, after 40 years

- Employees earning Rs18,740 or above per month could expect around Rs6,000 as pension. An employee earning the minimum wage can expect to receive a monthly pension of around Rs3,000 (in today's terms) after 40 years of contributions. The CSG pension will be a flat amount of Rs4,500 per month.

- However, the idea of contributing less to benefit from more strictly applies only to those who earn less than Rs13,500 per month, because the NPF is expected to produce a pension of at least Rs4,500 for the others.

- The Minister effectively said that, under NPF, an employee on minimum wage contributes 3% while an employee earning Rs100,000 per month, say, will only contribute Rs562 per month, i.e. 0.6% of his salary.

- However, what the Minister did not say is that the former will receive a pension of around 33% (3,400/10,200) of salary while the latter will only receive a pension of around 6% (6,247/100,000) of salary. This is fair enough because NPF only pays a benefit based on contributions received.

- Relative to the amount of money being paid in for each individual, it is the CSG which seems an extremely **<u>unfair</u>** arrangement.

- The informal sector appears to be the greatest winner by contributing only Rs150 to earn Rs4,500 (and they may not be paying income taxes as well!). This will discourage salaried-employees.

- Contributory Widow's Pension may also be at risk unless CSG would also pay for a widow's pension increases. However, with a higher pension paid for a longer period, the system may not stand for long.

Regressive or Progressive?

We can illustrate the additional income tax that CSG will represent as follows:

	Before CSG	**After CSG**
Informal sector	0%	Rs150
Below Rs50,000	10%	11.5%
Between Rs50,000 and Rs250,000	15%	18%
Above Rs250,000	15% + 5% solidarity levy in most cases	18% + 25% solidarity levy

- The CSG is effectively a very progressive system of taxation whereby all those with a basic salary of Rs37,480 and above will contribute more (employers will contribute more as well) and earn a lower benefit, i.e. Rs4,500 vs. approx. Rs6,000.

- Employees earning the minimum wage will contribute 50% less under CSG (same impact on employer contributions) but are expected to receive a higher benefit, i.e. Rs4,500 vs. approx. Rs3,000.

- Under CSG, self-employed individuals in the informal sector will be forced to pay an amount of Rs150 whereas contributions were voluntary under the NPF.

- It seems that the 160,000 or so individuals who benefited from the Self-Employed Assistance Scheme will now be tracked and the CSG Contributions effectively represents a tax which has been imposed on them. This could be seen as a way to bring them to the 'formal' sector and be able to collect taxes from that sizable section of the population.

- In the case where the CSG would have been used exclusively for pension benefits, as it was under the NPF, it would have been hard to call it a tax outright. However, we understand the revenues could be used to pay other social benefits, like unemployment benefits.

CSG for All…but Paid by Whom?

- We understand that all citizens will be eligible for the CSG benefit of Rs4,500 at age 65, including public sector employees, existing pensioners, the self-employed as well as the unemployed. However, the Minister of Finance has mentioned that only the private sector will pay contributions. It would be extremely unfair for the financial burden of the promise of a pension of Rs 13,500 pm to be thrust upon the private sector only.

Is CSG more participative than NPF?

- CSG has been described as being participative, i.e. including every category of employees. However, the NPF was already open to the self-employed or unemployed to contribute on a voluntary basis to qualify for a contributory pension.

- There are strong arguments to suggest that CSG, like the NPF, need not apply to the public and para-statal sectors because they are already covered by generous pensions guaranteed by Government. If they are also to benefit from the Rs4,500 additional pension, this will increase the national burden which will eventually fall largely onto the most productive parts of the economy.

The immediate effects on employees

- CSG will reduce the net pay for middle income earners & young professionals. Inflationary pressures will further reduce the value of these employees' income.

- Employers will be reluctant or unable to give salary increases anytime soon due to the associated costs. The possibility of salary cuts as well is real, should the recession last longer than expected.

- Reduction in remuneration package is possible if employers will divert 6% from their private pension schemes or even close them down to absorb the increased cost.

- **<u>This squeezing of the middle income earners will increase inequalities between rich and poor and create an income trap.</u>**

- Will employers allow employees to ever reach that magic mark of ***'Rs50,000'***?

- This begs the question, *"is this really a progressive system or rather an '(un)intended' regressive one?"*

Impact on PRGF

- The PRGF itself will become part of the third pillar alongside the NSF. PRGF contribution will start to be paid as from 1 January 2022. Employers will have to absorb the additional costs.

- For those earning less than Rs50,000 employers' cost under CSG will be 3% (a reduction from the 6% to NPF in most cases). However, when the PRGF contributions of 4.5% will step in, employers will effectively contribute 7.5% (or more if the PRGF rate is based on remuneration) for this category of employees.

- In fact, this additional cost is already here even if PRGF contributions have not yet started. This is because the PRGF is only a funding mechanism for a defined benefit that already exists regardless of any amount accumulated in the PRGF.

Considerations by employers

- Why should a cost-conscious employer in a competitive environment bother to set up a private pension scheme for its employees and contribute anything from 5% to 20% of their salaries into it, when perhaps the BRP/CSG will be increased by subsequent governments again to Rs20,000 or more in the not too distant future?

- Why should anyone bother to save for their retirement when it is easier to consume everything now and leave the problem of looking after their old age to their children and others?

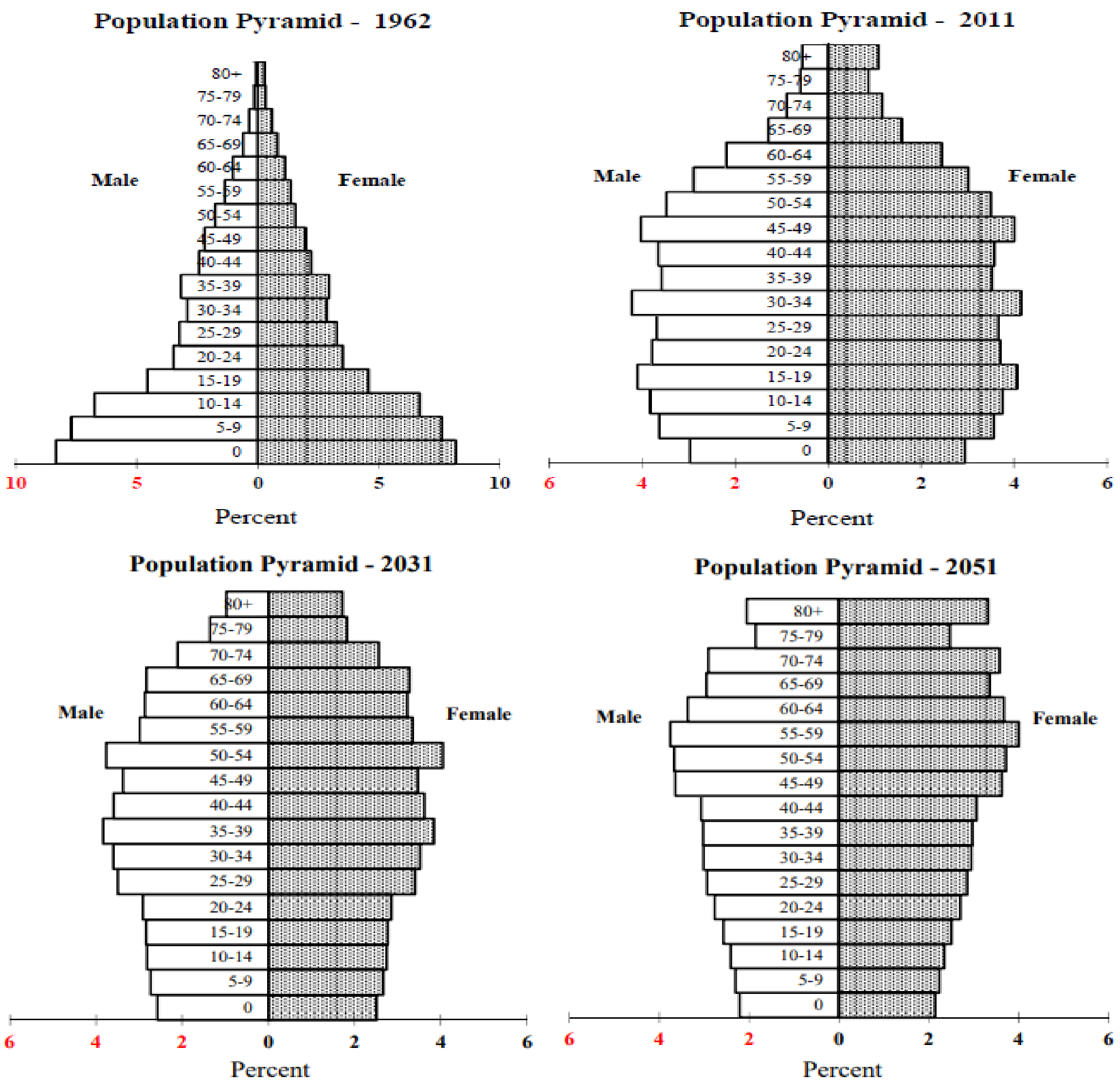
Considerations by employers (continued)

- What does the conscientious and benevolent employer who has already set up a pension plan to provide a pension of 2/3 of final salary including NPF do now that the NPF is being abolished?

- The higher the NPF pension was, the lower and more affordable the top-up pension to reach the target of 2/3 was. The lower the NPF pension will be, the higher and less affordable the top-up pension will now become (further increasing deficits in DB schemes).

- At the same time, it is likely that the new CSG contributions will be higher than the previous NPF contributions. A considerable number of employers will be discouraged by all this and cut costs where they can, starting perhaps by closing down the private pension plans in the third pillar which are voluntary after all.

- If they cannot do that, they will have to reduce salaries and other benefits to remain competitive, or even consider redundancies and more extreme measures.



Source: Statistics Mauritius

- From the above chart, in 1962, the population had a young age structure with a large proportion of the total population under the age of 15 (45%), which explains the large base of the pyramid.

- By 2011, the proportion of the child population aged under 15 years decreased to 21% while that of old persons increased to 13% from 5%.

- By 2051, the population age structure will shift to an inverse pyramidal form with **higher proportions of old persons than children.**

- In 1962, the elderly made up 5% of the total population. This proportion increased to 13% in 2011 and is likely to reach ***30%*** in the next forty years.

Ageing population and sustainability

In May 2020, the number of beneficiaries of Basic Pension reached 282,109, i.e. around 20% of the Mauritian population

- The ageing of Mauritius, or the greying of Mauritius, is a demographic phenomenon characterised by a decrease in fertility, a decrease in mortality rate, and a higher life expectancy, albeit not necessarily in good health, among the Mauritian population.
- Low birth rates and higher life expectancy contribute to the transformation of Mauritius's population pyramid shape.

The Finance Minister in his budget speech said the following:

"Our country is facing a major structural challenge - that of demographic decline.

Alarmingly, last year, our country's population declined for the first time in more than 50 years.

If this trend is maintained, our population will fall by more than 200,000 between now and 2050. "

"Today's generation will contribute towards ensuring higher benefits to our elders. And tomorrow, our children will contribute to ensure that we enjoy a decent retirement."

- In light of the population projections from Statistics Mauritius, and the Minister's claim about the decrease in population, a 30-year old can rightly ask if there will be enough children to support any increase in his/her pension.
- In the short term, the illusion is that some will definitely earn more, simply because one section of the population is subsidizing the other section of the population.
- The proposed CSG will be a Pay as You Go system, i.e. the contributions received from the working population are immediately used to pay current pensioners, so there are no savings for the future. **It is this system that is clearly UNSUSTAINABLE as opposed to the NPF which is based on the concept of advanced funding.**
- Any unfunded system, which is not sustainable in the long run, has Ponzi-like characteristics, i.e. with an ageing population where contributions reduce and benefit payments continue to increase, **the system will collapse at some point.**
- We estimate that annual CSG contributions from the private sector will amount to around Rs4 billion but the annual benefit will be around Rs12-13billion! This amount would have been saved from 2020 to 2023. However, it is important to ask where would the additional Rs8bn come from in 2024 and beyond?

Potential Solutions

In the national interest, wider consultation with all key stakeholders is absolutely vital. Various measures could be considered to manage the problem of our ageing population while making sure that vulnerable groups are not made worse off.

The key principle is to reduce the burden of the Basic Retirement Pension and move to a funded arrangement and not the other way round. The following could be considered, for example:

- A gradual increase in the retirement age to 65 years;
- Reconsider the payment of BRP for employees who continue working;
- Design a long-term, sensible and sustainable pension increase policy so that unaffordable pension increases are no longer promised or given;
- Review the NPF arrangement to make it even more robust and sustainable;
- Increase the NPF salary ceiling in order to provide higher pensions while respecting efforts already made in the fourth pillar of voluntary private pensions;
- Encourage voluntary pension provision by employers and/or individuals as much as possible because this reduces dependence on the State and results in the lowest risk for our future generations;
- Consider a softer approach to means testing for BRP, for example by having a guaranteed amount for all and a means-tested approach for additional tranche(s);
- Introduce measures to reverse the current trend of population ageing and encourage larger families.

Conclusion

- The unfunded, intergenerational arrangement is a quick fix and not a long-term solution. The issue of the current system being unsustainable for future generations has still not been resolved but has instead been exacerbated!
- **There is a real risk that future generations of pensioners, especially in the low to middle income categories, could face financial hardships in retirement as a result of hastily implemented measures.**
- Every employee, except those who are relatively near retirement, can genuinely wonder whether this arrangement will still be in place when their turn arrives, or whether the contributions made over all those years would have been in vain.

We have all heard this saying 'too much money chasing too few goods'; the value of money collapses!

In this case, it will be 'too many pensioners chasing too few workers"; making the pension system collapse!

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