Developing an Effective Pension System in Mozambique

A Review of the Pension Program in Mozambique, 19-29 May 2009

[DRAFT]

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Contents

Executive Summary

During a two-week period in May, a USAID review team collected data and information from interviews and discussions with stakeholders about the Mozambique pension program. The group of stakeholders is comprised of representatives from the broad community interested in a strong social security system including representatives of businesses, unions, and Government (see Appendix A for the List of Meetings). The team also was very fortunate to have an opportunity to work with the Center for Mozambiquan and International Studies (CEMO) in conducting interviews and holding a debate of the issues.

This report analyzes various problems that the pension system is experiencing and makes recommendations to improve the program. We review international experience and best practice in pension program operations and reform and present findings of how Mozambique compares with the international situation. This study focuses only on the old-age, invalidity and survivors (OAIS) pension program of the social security system.

The review team has found that the retirement income system in Mozambique is experiencing ongoing problems in several areas and we address those areas in this report. Both the benefit and financing systems are falling short of meeting the criteria that a social security system should attain: providing adequate and equitable benefits to retiring workers and their families and being financially stable and sustainable over a long-term period. Our recommendations are designed to address these problems.

The report is divided into two principle sections with analysis and discussion of short-term and medium term solutions. The recommendations from these sections have been extracted and presented below. A full discussion of the background and findings for these recommendations can be found in the body of the report.

The first section (Chapter 2) discusses short-term reform that will help build confidence in the system and increase sustainability through administrative cost effectiveness and modernization, good governance, and improved transparency. Short-term means over the next year to two years and is used to convey urgency in addressing the problems. Under this section, the report discusses the following:

Improving Program Administration and Management - Efficient and effective administration and management of a social security program is the cornerstone in providing a secure retirement income system. The review team looked closely at three areas in evaluating how well the program is being administered and managed:

- *Increasing Administrative Cost Effectiveness* – Administrative costs as a percentage of program expenditures are one performance indicator of cost effectiveness. Administrative costs of the social security program are very high and outside the norm of comparable costs in many countries around the world. The review team found that some of the costs are hard to explain or justify, but a full accounting of the costs and budget was not available. In light of the high administrative costs, it was equally surprising that about 31 percent of contribution income was not being collected. This shortfall appears to be the result of non-compliance by firms that were registered in the system but not contributing. Also, firms that should have been registered with the INSS are not being registered. Consideration should be given to unifying the tax collection under an organization that is fully automated and can achieve higher compliance rates;
- *Implementing Modern ICT Systems and Business Process Reform* – With implementing and utilizing ICT systems, it is important also to review and improve work processes. Effective work processes will then utilize modern ICT systems to their fullest potential and greatly improve program administration and modernization. Currently, the INSS is trying to implement ICT systems throughout the country, but the progress is quite slow and only a few offices in Maputo have advance systems, though not completely implemented as yet. The Government of Brazil has indicated a desire to help with the implementation and the INSS is discussing this with them. It would help the modernization effort if the Mozambique Government began a thorough review and revision of their administrative processes before the ICT implementation is fully underway;
- *Effectively Developing and Managing Human Resources* – In the area of managing human resources, successful change management and modernization of policies and procedures can greatly improve program operations. Modern techniques that utilize Human Capital Management principles would benefit many managers and employees of the INSS. As part of a strategic plan for human resource development, good education and training opportunities could be organized at the INSS.

Good Governance and Improving Program Performance – Corporate governance of a pension program refers to how administrators manage a program, effectively deal with program provisions, ensure the safety of the investment of reserve funds and look after the interests of the participants and other stakeholders of the program. Good governance of a pension program very often is one of the key elements to good program development and sustainability. In fact, one research study found, “The worst returns are produced by publicly managed pension funds in countries with poor governance records.”[1]

Examples of good governance should come from the top down to each employee in the organization. Stakeholders interviewed by the review team expressed concerns that the INSS Administrative Council is not truly independent and questioned whether the members have the management skills or expertise to oversee the operations of the program and the investment of the reserve funds. The Institute of Directors (IOD), with members from both private sector and state-owned enterprises, has played a leading role in Mozambique in advocating for a code of good corporate governance and ethics. We believe that the IOD can help build good governance and trust in the pension program. A number of changes can be made in improving good governance in the Administrative Council while consideration should be given to appointing a special body specifically to oversee the reserve funds.

***Improving Transparency* –** Another critical issue that in many respects is complementary to good governance is transparency of program operations and provisions. Stakeholders should have a complete understanding of how well the program is functioning, managed and what they can expect in performance. Up-to-date information in all of these areas is lacking from the INSS and should be provided in regular reports, studies and through different outlets in the media. This is important in building trust in the integrity of the program, and in building support for important adjustments that must take place in pension programs from time to time.

The second section (Chapter 3) reviews medium-term reform options that will help with financial stability and program sustainability and help meet retirement income and poverty alleviation goals in the years ahead. Medium-term is used to mean over the next five years, but also should convey a sense of urgency and should indicate that the issues must be addressed starting now. Medium-term goals include:

***Achieving Sustainability* –** One of the chief concerns expressed by stakeholders was whether the pension program, in its current form, was sustainable over the coming years. The costs of benefits now are rising at a much faster pace than contribution income to the pension program. Several problems exist with the structure of the program including the current benefit formula that calculates a pension for minimum wage workers on the highest minimum wage as well as providing high levels of benefits for high earners that are not sustainable.

***Shifting the Paradigm* –** Many countries have been considering whether to make minor adjustments to their programs, called parametric changes, or to make major changes in the

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[1] Iglesias, Augusto, and Robert J. Palacios, “Managing Public Pension Reserves: Part I - Evidence from the International Experience,” Social Protection Discussion Paper 3, World Bank. 2000, quoted on p. 3, Gregorio Impavido, “On the Governance of Public Pensions Fund Management,” World Bank, August 2002

direction of retirement income provision, referred to as paradigm shift. Parametric changes may include changing the contribution rate or contributory period, the benefit formula, and eligibility requirements. In contrast, a paradigm shift involves fundamental changes such as moving from a "solidarity" or PAYG financing based system to a funded system with individual public or private pension accounts or a mix of systems.

Over the years, pension systems have evolved from providing a basic level of pension income. Program reforms have introduced a second level providing earnings-related benefits, as well as four or five levels or pillars of retirement income protection (depending on what is being counted). A "0" Pillar may provide a flat-rate, universal benefit. The first pillar may be the mandatory, PAYG, solidarity scheme, which is what Mozambique currently uses. In addition, a second pillar may be enacted to provide mandatory, fully-funded, individual accounts with private pension funds. A third pillar provides voluntary, private pension plans. Finally, a fourth pillar can provide private savings and investments to supplement pension income.

Stakeholders have raised a number of concerns about the administration, coverage, governance, and sustainability of the program. Other options should be considered, such as how to provide well-targeted, broader coverage for those truly in need that will help to alleviate poverty among the elderly and is cost-effective while providing average and upper income workers with options to save for their retirement in equitable pension plans. This would be something of a paradigm shift in Mozambique that should be considered by a high-level group of stakeholders and leaders in the country.

Next Steps – Several stakeholder organizations were quite interested in a program review. They believe that there are many problems in the current system that must be addressed very quickly, and that a larger review of the goals and objectives of the retirement income system should be completed. This report can provide the basis for formulating a common approach that stakeholders may agree on in pushing for change by the Government. The actions that should be taken as recommended in this report can be summarized as:

- Fix the Financing Short-fall in the Program;
- Undertake a Comprehensive Review of Administration and Management;
- Implement Individual Recommendations On Administrative Reform;
- Consider Changing Program Direction.

The recommendations that follow can help to formulate this common strategy to encourage reform and further development of the system.

RECOMMENDATIONS

The team makes the recommendations listed below based on discussions with stakeholders and findings of the review. They are presented according to the topic sections in the main report.

Improving Program Administration and Management

Efficient and effective administration and management is one of the keys to sustainable social security program development. The following recommendations focus on developing efficient and effective administration of the social security program through comprehensive technical reviews of budgeting and accounting, options for increasing contribution compliance, information technology implementation, human resource development and training.

***1. Conduct Detailed Review of INSS Administration and Management* –** An overarching recommendation that is made at the outset of this paper is that an independent, expert organization conducts a comprehensive technical review of the administration and management of the program with detailed recommendations and a time-bound action plan for modernization. This review would include the recommendations for improving program administration and management discussed below which would help in coordination and prevent any redundant analysis or the recommendations below could be carried out separately as independent activities.

***2. Review Accounting and Budgeting Procedures* –** An independent auditing and accounting organization should review accounting and budgeting procedures to evaluate how international accounting standards could help improve long-term procurement, acquisition and spending procedures in the social security program. This would follow-on from the Commission of Enquiry report of June 2008 by the Minister of Labor investigating fraud and corruption.

***3. Increase Company Registration and Contribution Levels* –** The INSS should allocate additional resources (time and staff) to both registering firms and contributors and ensuring that proper levels of contribution income are paid into the system. The loss of one third of the contributions from the formal sector while carrying large administrative costs of the program is indicative of widespread inefficiencies.

***4. Consider Alternative Approaches to Collecting Contributions* –** As an alternative approach to putting more resources into improving the INSS collection processes, the Government should consider whether the Tax Authority may be better able than the INSS to collect social security contributions and transfer funds to various accounts for paying benefits and keeping the reserve funds. The Tax Authority may have more efficient and established automated systems and access to more registered firms and would be able to more readily and efficiently record contributions in their database. The international trend has been to unify all tax collection authorities.

5. Conduct an Information and Communication Technology Audit – An independent information management and technology organization should conduct an Information and Communication Technology (ICT) audit or review to determine what hardware and software systems are currently in use and planned for implementation, how compatible are these systems with other Government organizations and private sector firms participating in the social security program and whether off-the-shelf software should be used in the modernization effort. This is part of the overall effort to increase contribution compliance and revenue levels.

6. Conduct an Analytical Review of Administrative Processes – A business process analyst should conduct a comprehensive analytical review of the administrative processes being currently used at the INSS and make recommendations for modernization of these processes in advance of the implementation of automated systems throughout the organization. This review could be implemented over a three month period and should take place either before or at the time of the procurement of the Information and Communication Technology systems by the INSS.

7. Develop Strategic Plan to Upgrade Human Resources Management – The INSS should develop a comprehensive, time-bound strategic plan for upgrading their human resources approach to reflect Human Capital Management (HCM) principles and techniques, coordinating with other recommendations made in this study for ICT implementation (recommendation 5) and business process review (recommendation 6).

8. Survey Agency Staff Skills & Design Training Plans – Within the framework of the strategic plan for HCM, the INSS should begin surveying staff in headquarters and delegation offices to ascertain education and skill levels in undertaking their tasks, management and planning, accounting and auditing, and technology. Using survey results, the INSS should develop course curriculum in conjunction with local universities and on the job training techniques, and formulate a schedule for upgrading all staff levels.

Good Governance and Improving Program Performance

Good corporate governance supports good administration and management of social security programs. To achieve good governance several recommendations are made below on the oversight and management of reserve fund investments, accounting and financial standards, implementing policies on conflict of interest, financial disclosure and providing technical support to the oversight of the reserve funds.

9. Review Reserve Fund Investment, Accounting and Financial Standards – As part of the accounting and auditing review under recommendation 2, an analysis of reserve fund investment procedures should be undertaken by an independent auditing organization to review operating and investment guidelines. The review also should evaluate how International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) could be used more effectively in accounting for and investing assets.

10. Consider Appointment of Independent Reserve Fund Board – Consideration should be given to the appointment of a non-partisan, independent reserve fund board or board of trustees to oversee the investment and operations of the reserve funds for the sole benefit of social security participants. One of the factors that should be investigated is the development of Trust Law in Mozambique and how this board would operate within a trustee framework. Each board member should have broad business management, financial or investment experience. Board members would have to divulge all financial interests and develop strict policies and procedures.

11. Appoint Independent Reserve Fund Management & Investment Advisor – The newly formed reserve fund board should appoint and supervise a certified, independent investment advisor to manage and invest the reserve funds and report to the board on a regular basis (no less than on a quarterly basis) on income and fund performance.

12. Formulate & Implement Policies on Conflict of Interest, Code of Conduct, Full Disclosure of Financial Interests and Evaluation of Performance – The Administrative Council should work with the Institute of Directors to formulate policies and procedures to be adopted by the Council on conflict of interest, a code of conduct and ethics, full disclosure of financial interests, and a regular evaluation of competency and performance. If the above-recommended investment board (recommendation 11) is appointed, the Administrative Council will be charged with overseeing the administration and management of the INSS only and would have no involvement in reserve fund management and investment.

13. Provide Technical Support on Reserve Fund Financing by the Office of the Actuary – The newly established Office of the Actuary, should work closely with the Council to develop studies and provide projections of reserve fund financing on a quarterly and annual basis. The Office also should be staffed with well-trained researchers who could help gather and analyze data for regular research studies.

Improving Transparency and Public Education

Transparency of INSS operations can be greatly improved with a strategic, well-designed public education approach that provides up to date information, publications and research reports through various media outlets and is communicated in various venues as recommended below.

14. Modernizing Public Education to Keep the Public Well Informed of Program Operations – Well-trained public affairs staff in an office of public education with high-level visibility reporting directly to the Director General should actively handle communications between the INSS and the public and provide up-to-date information and research studies in coordination with the proposed actuarial and research staff working with the Council and the proposed investment board. Because of the importance that international donor organizations place on complete transparency and good public education on pension program operations, these organizations may assist in training staff, modernizing the office, and funding the proposed public education strategy (recommendation 15).

15. Prepare a Public Education Strategy Drawing on Various Media and Education Approaches – The office of public relations should prepare an up-to-date public education strategy that will draw on sophisticated, modern techniques of public relations to inform the public about program provisions, operations and developments. This should include a highly visible public campaign of town-hall style meetings and debate about current program issues, question and answer sessions on television, radio and in newspapers, and the development of clear, up-to-date and informative brochures for the general public for display and pick-up at delegation offices.

Achieving Sustainability

As part of the effort to achieve a sustainable social security program, the INSS should review several options for achieving program savings. Recommendations below address the current problem with rapidly increasing benefit levels and the need for indexed ceilings on both benefits and contributions.

16. Analyze the Cost/Benefits of an Alternative Benefit Calculation and Supplementary Benefits – The INSS should conduct a full review of benefit levels and consider an alternative formula to calculating pension benefits based on the highest minimum wage. Since the majority of workers in other sectors are reporting lower minimum wages (a significant number of retirees would receive pensions higher than their last wages), it seems highly likely that contribution income will continue to fall short of the growth of benefits, which are based on a higher earnings basis. One alternative option that the INSS should consider is calculating the benefit based on the lowest minimum wage with well-targeted, social pensions for the elderly in need (discussed in recommendation 19).

17. Consider Imposing an Indexed Ceiling on Both Benefit Payments and Income for Contributions – The INSS should also consider whether an indexed ceiling (a maximum) on both individual contribution income and benefit amounts should be imposed. A ceiling on contributions may encourage more workers to report actual income and a benefit ceiling should help to slow down benefit growth.

Pension Program Reform – Shifting the Paradigm

As the social security program reaches the 20-year mark in program development, it may be useful to re-evaluate program goals and objectives for sustainability, adequacy and equity. Recommendations below include the appointment of a high-level working group to review the direction of social security and how adequacy and equity may be improved with a new direction.

18. Appoint a High-Level Working Group to Review a New Direction in Pension Provision - A working group of high-level policy makers representing a diverse group of stakeholders should be convened to analyze, debate, refine and make final recommendations to the Prime Minister on a new direction in pension provision, such as individual accounts, whether funded or notional, or private pensions, whether voluntary or mandatory. The review team has been told that a Social Protection Advisory Committee, composed of stakeholders, is required under the 2007 law to advise the Government on social protection, but this does not seem to have much power to influence change in program direction. Greater consideration should be given to improving adequacy of retirement income for larger numbers of low-income workers and retirees through a universal pension. At the same time the provision of either mandatory individual private pension accounts or voluntary private pension options will improve equity.

19. Evaluate Whether Social Pensions are a Good Solution – High-level policy discussion and analysis should be undertaken with regard to the feasibility (considering costs of the reform, level of income from benefits and good coverage) and appropriateness of designing and implementing a system of either universal/social pensions or well-targeted pensions for the neediest elderly in Mozambique. These discussions and analysis can be done separately or if the proposed working group (recommendation 18) is convened, this should be a consideration in planning an overall paradigm shift in the direction of retirement income provision.

Chapter 1 – Introduction

This report reviews information and data on the Mozambique pension program that a USAID team compiled in field work in Mozambique over a two-week period, 18 – 29 May 2009. The study also draws on international experience and best practices from around the world in analyzing how well the pension program is operating in Mozambique. The review team worked closely with the Center for Mozambiquan and International Studies (CEMO) in conducting interviews and organizing a debate of these issues Wednesday, 27 May, on the topic, "The Social Security System of Mozambique."

The review team found that the retirement income system in Mozambique is experiencing ongoing problems in several areas and we address those areas in this report. Both the benefit and financing systems are falling short of meeting the criteria that a social security system should attain: providing adequate and equitable benefits to retiring workers and their families and being financially stable and sustainable over a long-term period. Our recommendations are designed to address these problems.

Background - This study focuses on the old-age, invalidity and survivors (OAIS) pension program of the social security system (See Appendix A). The social security system also includes cash sickness and maternity, hospitalization, cash death grants and funeral allowances for burial expenses. The social security system is administered by the National Social Security Institute (INSS). A separate pension insurance scheme exists for civil servants and is administered by the Ministry of Finance. Together these social insurance programs play a vital role in providing social protection and income security to workers and their families.

The team held meetings with a large number of stakeholders from various sectors of the economy including businesses, unions and Government (see Appendix B for the List of Meetings). It was important to understand the views that these representatives of the larger community held concerning the strengths and weaknesses of the program that most will depend on for their retirement income. The discussions and information provided in these meetings have contributed greatly to understanding problems developing in the pension system and finding solutions.

The current structure of the OAIS program was established in 1989 after the passage of the Social Protection Law (Law No. 5/89). The program now has been operating for 20 years and needs adjustment as it matures. Ongoing adjustment of pension programs is necessary in most countries and in particular with Pay-As-You-Go (PAYG) financing and defined benefit systems.[2] Amendments to the law were made in 2007 (Law No. 4/2007) extending coverage to the informal sector and changing the formula for calculating the length of service used to determine pension benefit eligibility and amount. These changes eventually will help the financing of the program, but will take time for full effect.

During the team's discussions with stakeholders, some raised the fear that the pension program may not be sustainable over the next several years. In demographic terms, the country is not aging rapidly with an aged dependency ratio of .054.[3] Many other countries with pension financing difficulties, such as Bulgaria, Latvia, Italy, and Japan, have a higher level of older populations (see discussion on p. 28). However, the pension program in Mozambique is growing rapidly and will need changes over the coming years as explained in Chapter 3. This rapid program growth is not the result of population aging, but rather imbalances in financing and benefit growth.

The OAIS program provides very generous replacement rates—the proportion of wages that are replaced by retirement benefits—to retiring workers, but some stakeholders question whether the level of replacement rates is affordable or sustainable in the system.[4] Raising contribution rates may temporarily solve a financing problem, but would increase labor costs for businesses and could lead to dislocations in labor markets. This could also harm a struggling economy trying to be competitive in global markets.

A broader question that is touched on in this study, but should be further examined by Government policymakers and program stakeholders, is whether this system is serving the social protection needs of the population in general. Program coverage is very small compared to the number of economically active. In 2008, 234,311 workers contributed to the system out of 730,934 registered in the system out of an estimated total of 9.7 million economically active.[5] Registered workers are 7.5 percent of the economically active work

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[2] Pay-As-You-Go (PAYG) financing or, as sometimes called, a "Solidarity System" refers to how income from contributions of workers is accounted for in paying benefits of retirees. Contributions from current workers are used to pay benefits to current retirees and to cover other expenditures with a Government-provided guarantee that future generations of workers will pay future generations of retirees, hence the name of solidarity system. Any surplus in income is put into a reserve fund to cover future costs should there be a short-fall in income or rapid increase in benefits during periods of wage loss or high inflation.

Defined benefit systems refer to the method of calculating benefits according to a pre-determined formula rather than paying benefits from the total contributions and investment income held in a fully-funded account.

Other forms of financing may include partial or full funding of projected costs of either defined benefits or defined contribution pensions in the future.

[3] The aged dependency ratio is a comparison between the numbers of population 65 years and older and the population between age 15 to 64. While not always a useful number, particularly in aging populations with high numbers of pre-retirement age population, it does provide a metric for comparative purposes of how much the population is aging.

[4] Generally, 40 to 50 percent replacement rates are considered the norm for average income workers.

[5] Data provided by the INSS in tables showing contributors and beneficiaries, 1990 – 2008.

force and contributing workers are just 2.4 percent of the economically active—less than one-third of registered workers. Only 26,437 retirees received pension benefits (INSS, 2008). The 2007 law extends coverage to all sectors of the economically active population, but in reality the international experience with mandating coverage is that it has very little effect unless structural problems in the program are identified and corrected and confidence is built up over time.

This study examines issues that arose in our discussions with stakeholders and makes recommendations on how the program can develop and become sustainable. These recommendations fall into two categories: 1) short-term reform that will help build confidence in the system and increase sustainability through administrative cost effectiveness and modernization, good governance, and improved transparency and, 2) medium-term reform that will help with financial stability and help meet retirement income and poverty alleviation objectives in the years ahead.

Chapter 2 – Short-Term Reform

OVERVIEW

In this Chapter, we examine critical areas of program development that should be addressed over the coming months in what is referred to as "Short-Term Reform." The usage of short-term is meant to convey a sense of urgency in taking up the issues with actions taken within the next year or two at most. The results of these actions, however, should be long-lasting and provide greater stability and sustainability to the social security program.

During discussions, stakeholders raised a number of issues with the review team. The issues cover many areas of OAIS program operation and development: modernization of administration and management; the level of administrative costs and cost effectiveness of INSS operations; timely implementation of Information and Communication Technology (ICT) systems; better educated and trained staff; improved program governance and secure investments; increased transparency of program operations; and financial sustainability.

Several of these issues, including increasing administrative cost effectiveness, implementing ICT systems, and training and education are covered in this chapter under "Program Administration and Management." Such other topics as transparency and oversight, safe investments and financial sustainability, though all part of good program administration and management, are discussed separately because of the importance that stakeholders gave them in our discussions. All of these issues, though, touch on the central concern that the program must be effective in providing broad retirement income protection over the lifetime of workers and their families in Mozambique.

IMPROVING PROGRAM ADMINISTRATION AND MANAGEMENT

Efficient and effective administration and management of a social security program is the cornerstone in providing a secure retirement income system. In this section of the report, the review team looks closely at three areas in evaluating how well the program is being administered and managed. We make an overarching recommendation for a comprehensive technical review of all areas of program administration and management, but other recommendations also can be implemented separately. The three areas reviewed are:

- *Increasing Administrative Cost Effectiveness* – Administrative costs as a percentage of program expenditures are one performance indicator of cost effectiveness. In addition, good coverage of the working population is another indicator and efficiency and accuracy of contribution collection and benefit payment also is a measure of good coverage as well as another indicator.

- *Implementing Modern ICT Systems and Business Process Reform* – With implementing and utilizing ICT systems, it is important also to review and improve work processes. Effective work processes will then utilize, to their fullest potential, modern ICT systems and greatly improve program administration and modernization.
- *Effectively Developing and Managing Human Resources* – In the area of managing human resources, successful change management and modernization of policies and procedures can greatly improve program operations.

Recommendation

1. Conduct Detailed Review of INSS Administration and Management – An overarching recommendation that is made at the outset of this paper is that an independent, expert organization conducts a comprehensive technical review of the administration and management of the program with detailed recommendations and a time-bound action plan for modernization. This review would include the recommendations for improving program administration and management discussed below which would help in coordination and prevent any redundant analysis or the recommendations below could be carried out separately as independent activities.

INCREASING ADMINISTRATIVE COST EFFECTIVENESS

The level of administrative costs of the social security program is designated in the Law of 2007. The costs must come down to 15 percent of expenditures within three (3) years after adoption of the law. The review team has been told that this was an attempt by the Legislators to reign-in administrative costs.

The INSS informed the review team that current administrative costs, which include administrative and financial services and emergency expenses, are approximately 25 percent of total social security program expenditures. These administrative costs have been higher over past years at 35 percent of total expenditures. As a portion of the total contribution rate for the program, administrative costs are 1.75 percentage points of the 7 percentage point contribution. This is an especially large percentage when considering that the amount of the total contribution allocated for the pension program is 3.25 percentage points—the amount going into administrative costs is equal to more than half the amount going into the pension program.

International Administrative Cost Comparisons – Attempting to make international comparisons of administrative costs can be very challenging at best and difficult to assess properly. Expenses that fall under the umbrella of "administrative costs" for social security programs can be somewhat different from country to country, depending on the maturity of a system, the efficiency of administrative processes and the number and type of programs that are managed. The measurement used to determine the proportion of administrative costs allocated within a social security program also may differ depending on whether the costs are a percentage of expenditures, income or assets, or measured as cost per participant. It is always challenging to find comparable data.[6]

Several studies have attempted to measure administrative costs of national social security systems on a comparative, international basis. It is clear from these studies that countries with developed economies spend far less on administrative costs for their social security programs than countries with transitional economies. Countries of the Organization for Economic Cooperation and Development (OECD), for example, spend an average of 3 percent of their expenditures, the United States spent just over 2 percent of annual expenditures for old-age, disability and survivors, Argentina spent 2.3 percent of expenditures for a range of social security programs including old-age, invalidity and survivors, sickness, maternity, medical care, work injury, unemployment and family allowances, while Chile spent 8 percent of expenditures on the same programs, Brazil spent 7 percent, and Costa Rica spent 4.8 percent on old-age and disability program expenditures.[7] However, a number of high administrative cost programs can be found including Bolivia at 21.39 percent, El Salvador at 33.4 percent, and Honduras at 18.25 percent, among others.[8]

Table 1 - Administrative Costs as a Percentage of Program Expenditures

Country/Organization	Pension Programs	All Social Security Programs
OECD	3.00	-
Argentina	-	2.30
Bolivia	-	21.39
Brazil	-	7.00
Chile	-	8.00

[6] In international administrative cost comparisons tasks can be categorized according to registering participants, collecting contributions, paying benefits, keeping data and information on contributors and beneficiaries, and securing and investing reserve funds. In addition, there are the costs of the organization in providing salaries and benefits, training and educating staff, and maintaining and upgrading infrastructure.

[7] p. 6, Olivia S. Mitchell, “Administrative Costs in Public and Private Retirement Systems,” National Bureau of Economic Research Working Paper #5734, August 1996. For other studies measuring administrative costs of both public and private pension systems, please refer to the bibliography.

[8] Table 1, Olivia S. Mitchell, “Administrative Costs in Public and Private Retirement Systems,” National Bureau of Economic Research Working Paper #5734, August 1996.

Costa Rica	4.80	-
El Salvador	-	33.40
Honduras	-	18.25
Mozambique	-	25.00
United States	2.00	-

Source: p. 6, Mitchell

The review team was told that administrative costs for the Mozambique program include such expenditures as automation of records, constructing and opening new offices, constructing housing for Delegation Directors, car purchasing, and emergency expenses, among others. Without a detailed audit of the accounting procedures and annual budgets it is difficult to know how these expenses could be constrained or deferred.

We were told, however, that a large part of the administrative costs have been up-front expenditures on such infrastructure as offices and staff housing. In long-range programs such as social security, especially programs financed on a PAYG basis, large capital expenditures on infrastructure, office expansion, and automated systems acquisition, very often are financed through loans amortized over a long-term period so contributors at the beginning of the program do not bear the high, up-front costs.

The INSS also is having considerable problems collecting contributions from the formal employment sector. In Appendix A we provide a description of contribution collection procedures that the INSS undertakes with private businesses. This is a time-consuming and rather cumbersome approach for both the INSS and businesses. Some countries have moved toward a consolidated tax collector to gain greater efficiency and accuracy in contribution collection and decrease the burden on the private sector. Several countries in recent years have moved in this direction including, Bulgaria, Croatia, Hungary, and Romania. Greater efficiency and less paperwork would alleviate the burden on businesses and enhance Mozambique's standing in the World Bank's ranking of countries in their annual "Doing Business" report.

The review team has estimated that the INSS is unable to collect approximately 31 percent of contribution income from firms that are registered in the system but not complying with the law. Aside from non-compliance of registered firms, the INSS also has difficulty in identifying other firms that should be registered in the system. Using INSS 2006 statistical data on contributions paid and average wages, we found that the shortfall to the social security program was approximately Mt. 273 million or 31 percent of total contribution income owed to the system. (See Appendix C for the data and analysis of the shortfall.)

Recommendations

***2. Review Accounting and Budgeting Procedures* –** An independent auditing and accounting organization should review accounting and budgeting procedures to evaluate how international accounting standards could help improve long-term procurement, acquisition and spending procedures in the social security program. This would follow-on from the Commission of Enquiry report of June 2008 by the Minister of Labor investigating fraud and corruption.

***3. Increase Company Registration and Contribution Levels* –** The INSS should allocate additional resources (time and staff) to both registering firms and contributors and ensuring that proper levels of contribution income are paid into the system. The loss of one third of the contributions from the formal sector while carrying large administrative costs of the program is indicative of widespread inefficiencies.

***4. Consider Alternative Approaches to Collecting Contributions* –** As an alternative approach to putting more resources into improving the INSS collection processes, the Government should consider whether the Tax Authority may be better able than the INSS to collect social security contributions and transfer funds to various accounts for paying benefits and keeping the reserve funds. The Tax Authority may have more efficient and established automated systems and access to more registered firms and would be able to more readily and efficiently record contributions in their database. The international trend has been to unify all tax collection authorities.

IMPLEMENTING MODERN ICT SYSTEMS AND BUSINESS PROCESS REFORM

An integral part of successful administration and management of social security programs is the modernization of administrative processes and management information systems. These systems are critical to the efficient and accurate operations that must be performed daily in recording data, taking in contributions and paying benefits. Management must have access to automated systems that can analyze large quantities of data and information to set performance standards and measure employee and program performance. In the end, without these automated systems it is nearly impossible to provide a high level of service to pension program participants, to control administrative costs and manage growth of a pension system.

Very often pension program administrators experience difficulties and set backs in implementing ICT technology. Obsolescence, non-compatibility of systems and the lack of technical expertise of staff are all factors that hinder efforts to automate administrative processes and record keeping. Technical assistance and funding for complex and often very costly ICT implementation are very important to achieving good results. Time-bound and well-coordinated plans within the organization and coordination with Government ministries and agencies as well as with private sector businesses using automated systems are crucial factors in accomplishing goals and having compatible systems for data sharing.

It is equally important in international best practice that administrative processes, rules and regulations of program operations be as efficient and effective as possible. Paper-based processes should change dramatically when automated systems are implemented. Redundant tasks should be identified, earnings-records should be more easily transmitted to the pension agency rather than labor-intensive interviews and paper recording, and costly administrative processes should be eliminated.

ICT automation efforts, however, have limited impact at best or at worst are wasted, if administrative reform with business process analysis is not part of the implementation of automated systems. A business process review will help to identify the inefficiencies in the way the program is administered and provide recommendations for process reform.

The review team was given some background on the attempts of the INSS to acquire and implement Information and Communication Technology (ICT) systems. We understand that 11 offices, including the Maputo main offices, have begun automation efforts and beneficiary data is being recorded in the new systems. Five offices have been linked into the central system, but none of the offices have finalized their efforts. We understand it is still not possible to share data nationwide on workers and beneficiaries. At this point, the INSS hopes that the Brazilian Government will provide funding and technical assistance in their efforts to automate their processes.

Recommendations

5. Conduct an Information and Communication Technology Audit – An independent information management and technology organization should conduct an Information and Communication Technology (ICT) audit or review to determine what hardware and software systems are currently in use and planned for implementation, how compatible are these systems with other Government organizations and private sector firms participating in the social security program and whether off-the-shelf software should be used in the modernization effort. This is part of the overall effort to increase contribution compliance and revenue levels.

6. Conduct an Analytical Review of Administrative Processes – A business process analyst should conduct a comprehensive analytical review of the administrative processes being currently used at the INSS and make recommendations for modernization of these processes in advance of the implementation of automated systems throughout the organization. This review could be implemented over a three month period and should take place either before or at the time of the procurement of the Information and Communication Technology systems by the INSS.

EFFECTIVELY DEVELOPING AND MANAGING HUMAN RESOURCES

Organizations today need to attract, retain and develop the skills of good, professional staff in order to meet the demands of administering complex programs. This is no less true for government programs as it is for private corporations that need to be competitive in global markets. Techniques and approaches to developing human resource capital in organizations have been evolving and best practices are readily available from the experiences of high performance organizations (HPO).[9]

International Experience with Human Resource Management – One framework for accomplishing the goals of developing well-trained staff and managing human resources is called Human Capital Management (HCM). HCM in many respects today goes beyond training and education, but builds a strategy or framework for developing the potential of the most important asset that organizations possess: their employees. Comprehensive HCM develops a planning strategy for acquiring, training, deploying, developing staff, for streamlining policies to more effectively manage human resources, and for providing the tools and competencies that employees need to work more efficiently and effectively.

The strategic planning that goes into developing human resources will help ensure that the workforce operates at a high level of efficiency and build confidence among stakeholders. Pension programs are highly reliant on technically well-trained and competent staff because of the nature of the complex program processes and the demands for accuracy and efficiency in serving the participants. Confidence in the functioning of the program is easily undermined if records don't reflect accurately contributions being made, if benefits are not accurately calculated according to laws and regulations, and if processing times for benefits are unreasonably long.

The human resource capabilities of the pension program in Mozambique are developing and show potential for meeting the demands of good program operations. The review team interviewed stakeholders with knowledge of how the program interacts with the public as well as staff working at both headquarters offices in Maputo and in the Delegation office of Matola. The interviews were used to gather anecdotal information and not designed to reflect program operations throughout the country.

The persons interviewed believe for the most part that the pension program can operate much better than it currently works. Some of these stakeholders indicated that the program provides good benefits on a timely basis, but they did not feel that this was sustainable and wanted more strategic planning to go into the management of the program. A few stories emerged that benefits took far too long to be processed while the claimant needed to continue working six months beyond their retirement date or survivors did not have the resources in time to cover funeral expenses of deceased workers and beneficiaries.

Recommendations

7. Develop Strategic Plan to Upgrade Human Resources Management – The INSS should develop a comprehensive, time-bound strategic plan for upgrading their human resources approach to reflect Human Capital Management (HCM) principles and techniques,

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[9] This term is now used extensively in management and administration literature to describe organizations that excel in the businesses and programs that they manage and develop. See, for example, the American Management Association website, "The Essentials of High Performance Organizations," Mark Vickers, the Institute for Corporate Productivity, http://www.amanet.org/

coordinating with other recommendations made in this study for ICT implementation (recommendation 5) and business process review (recommendation 6).

8. Survey Agency Staff Skills & Design Training Plans – Within the framework of the strategic plan for HCM, the INSS should begin surveying staff in headquarters and delegation offices to ascertain education and skill levels in undertaking their tasks, management and planning, accounting and auditing, and technology. Using survey results, the INSS should develop course curriculum in conjunction with local universities and on the job training techniques, and formulate a schedule for upgrading all staff levels.

GOOD GOVERNANCE AND IMPROVING PENSION PROGRAM PERFORMANCE

Governance, or corporate governance as it is sometimes called, of a pension program refers to how administrators manage the pension scheme, oversee the prudent investment of reserves, and whether the interests of the participants and other stakeholders are properly entrusted for their security. Those in a position of authority to perform this governance have an obligation, a fiduciary responsibility, to the participants and stakeholders to ensure that the pension program is performing to its utmost potential.

Good corporate governance is critical to the performance of pension programs. This point is made quite clearly in one study on corporate governance: “The worst returns are produced by publicly managed pension funds in countries with poor governance records.”[10]

In public social security programs, it is important to note that ultimate authority for program governance is not concentrated in one body. Administration of the program is the responsibility of the executive branch of government, but authority to supervise the programs very often is dispersed among legislative and executive branches of government. Accountability for program performance and upholding fiduciary responsibilities, therefore, may be hard to allocate.

International Experience with Governance – Program participants entrust governance of pension programs to the administrators and supervisors of the program. In the international context, a Board of Directors or Administrative Council and Executive Administrators are the supervisors of the program. The composition of the Board most often has tripartite representation from employees (unions), employers (business and professional associations) and government.

The Board also may have additional members who are program specialists, investment professionals or represent provincial as well as national interests. In South Korea,

[10] Iglesias, Augusto, and Robert J. Palacios, “Managing Public Pension Reserves: Part I - Evidence from the International Experience,” Social Protection Discussion Paper 3, World Bank. 2000, quoted on p. 3, Gregorio Impavido, “On the Governance of Public Pensions Fund Management,” World Bank, August 2002

representation on the Korea National Pension Fund consists of twelve members from contributors, seven from the government and 2 specialists from the Korean Development Institute and the Korean Institute for Health and Social Affairs. The Singapore Central Provident Fund board has twelve members representing the government, employers, employees and investment professionals. In Namibia the governing body consists of 3 representatives appointed by the Prime Minister, 3 appointed by the unions, and 3 appointed by the Public Service Commission. The Indian Employee Provident Fund has thirty-seven members consisting of representatives from the federal and state governments as well as employers and employees.[11]

Table 2 – Membership Distribution on Boards of Directors

Country	Representation					
	Total Number of Members	Government	Employee	Employer	Specialists	Other
India	37	22	10	10		5
Mozambique	7	3	2	2		1
Namibia	9	3	3	3		
Singapore	12	3	3	3	3	
South Korea	21	7	12			

Source: p. 13, Impavido

Unfortunately, very often Boards of Directors, especially with regard to public pension funds with tripartite representation, are highly political and the investment and performance of these funds suffers. The Chair and a large number of members are controlled by the Government. This results in poor performance and a failure in exercising the Boards' fiduciary responsibilities. As Impavido notes in his 2002 study:

> "In many developing countries, the politicization of representatives on the board often means that funds are invested imprudently and not necessarily in the interest of beneficiaries but rather in the interest of the sponsor's other public policies. Even in more developed countries, it is possible to link the difference in performance between private sector pension funds and public pension funds to the composition of their respective boards of governors."[12]

[11] p. 13, Impavido.

[12] p. 14, Impavido.

In Mozambique, the Administrative Council is vested with oversight of the social security program managed by the INSS as stipulated in the 1989 legislation (Law No. 5/89). The Council consists of seven members: The Council Chairman appointed by the Prime Minister; two representatives from the workers union; two representatives from the employers association (the Confederation of Business Associations (CTA); and two representatives from Government (one of which is appointed by the Minister of Labor).

The INSS is under the direct supervision as well of the Minister of Labor. The Minister of Labor also may designate a representative to the Council who may speak before any vote is taken by the Council, propose the Council Chairman to the Prime Minister, set the amount of bonus paid to the Council Chairman, propose the dissolution of the Council because of irregularities or decisions deemed contrary to the laws and regulations of the social security system, among other powers.

The duties and responsibilities of the Council also are prescribed in the 1989 legislation. In broad terms, the Council should oversee the general management and administration of the social security program, provide policy guidance and direction, oversee the investment strategy and ensure good reporting to the public. There is no indication in the law or in any information that the review team received, however, that policies are established on conflict of interest, a code of conduct and ethics, on full disclosure of financial interests of Council members, on either evaluating competency and performance of or self-evaluation by Council members.

Stakeholders raised concerns with the review team about whether current governance of the pension program demonstrates good corporate governance, and whether the Council operates as an independent body and truly represents the interests of the participants. They raised additional concerns about whether Council members have the expertise to properly supervise the program and oversee the investment of reserve funds. These are important issues that must be addressed because the concerns can undermine trust in the program and in the supervision of the operations and management. When public programs loose the confidence of the participants, the people they serve, financing of the program becomes increasingly more difficult and may eventually collapse.

The review team had an opportunity to meet with the Executive Director for the Institute of Directors, an organization whose members are high-level officials from both the private and public sectors. The Institute advocates for good corporate governance in all organizations and is promoting a code of corporate governance and ethics as well as fighting against conflict of interest and corruption. We believe this is an Institute that can help build good governance and trust in the pension program.

The review team has been told that allocation and investment of the reserve funds is set down in the law, but the review team did not find any indication that the Council is setting broad guidelines on investment strategy. The law permits investment in a broad range of asset classes and financial instruments including sovereign debt, real estate, low-income housing, social investment, stocks and bonds, bank notes. This does not, however, constitute an investment strategy and guidance from the Council is critical in ensuring stable and sustainable real rates of return. A major concern expressed by stakeholders is that the reserve funds have been mismanaged and the Council is negligent in their fiduciary responsibility to ensure the security of the reserves for the participants.

Many countries invest their PAYG reserve funds, typically anywhere from one to three years of benefit payments, in a wide variety of financial instruments. It is not uncommon for these funds to be fully invested in the country's most stable and secure investments, e.g., sovereign debt instruments, in order to preserve the initial capital to be used in case of economic downturns or sudden price inflation. Some countries may use social investment as a criteria while others may allocate investments in a mix of sovereign and commercial debt, bank deposits as well as private equities.

Prudent and secure investments of a social security program's reserve funds serve the interests of both the participants and the country as a whole. Participants can count on secure retirement income streams and well diversified asset allocations can benefit economic development. Fiduciary responsibility, however, is first and foremost to the participants. Risk in investment must be kept to a minimum and the goals should be to secure a rate of return that maintains the real value of retirement benefits.

The fact that the social security program suffered large losses as a result of fraud and embezzlement that came to light in 2008, calls into question whether enough has been done to achieve good governance in the program.[13] This concern then leads to other questions:

- With extensive investments in real estate, it would be useful to know what accounting procedures are being used and whether it would be more cost effective to rent offices than to buy or build.
- Also given the number of investments in real estate for income, it would be important to know what criteria was used to determine these investments as well as how are these investments performing in terms of income (IRR) and present value.
- What accounting standards are in place and whether International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) are being used?
- Since the extensive portfolio of investments is being handled by internal staff, it would be useful to know what operating procedures have been established in investment guidelines.

The review team did not have the resources and the time to conduct an intensive review of cost accounting and investment procedures. Many stakeholders believe, however, that an intensive review by an independent, outside organization should be a priority reform consideration.

[13] p. 2, "Inquiry Finds US$8 Million Stolen from Social Security," Issue #96, Mozambique The Investor, June 2008.

Recommendations

9. Review Reserve Fund Investment, Accounting and Financial Standards – As part of the accounting and auditing review under recommendation 2, an analysis of reserve fund investment procedures should be undertaken by an independent auditing organization to review operating and investment guidelines. The review also should evaluate how International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) could be used more effectively in accounting for and investing assets.

10. Consider Appointment of Independent Reserve Fund Board – Consideration should be given to the appointment of a non-partisan, independent reserve fund board or board of trustees to oversee the investment and operations of the reserve funds for the sole benefit of social security participants. One of the factors that should be investigated is the development of Trust Law in Mozambique and how this board would operate within a trustee framework. Each board member should have broad business management, financial or investment experience. Board members would have to divulge all financial interests and develop strict policies and procedures.

11. Appoint Independent Reserve Fund Management & Investment Advisor – The newly formed reserve fund board should appoint and supervise a certified, independent investment advisor to manage and invest the reserve funds and report to the board on a regular basis (no less than on a quarterly basis) on income and fund performance.

12. Formulate & Implement Policies on Conflict of Interest, Code of Conduct, Full Disclosure of Financial Interests and Evaluation of Performance – The Administrative Council should work with the Institute of Directors to formulate policies and procedures to be adopted by the Council on conflict of interest, a code of conduct and ethics, full disclosure of financial interests, and a regular evaluation of competency and performance. If the above-recommended investment board (recommendation 11) is appointed, the Administrative Council will be charged with overseeing the administration and management of the INSS only and would have no involvement in reserve fund management and investment.

13. Provide Technical Support on Reserve Fund Financing by the Office of the Actuary – The newly established Office of the Actuary, should work closely with the Council to develop studies and provide projections of reserve fund financing on a quarterly and annual basis. The Office also should be staffed with well-trained researchers who could help gather and analyze data for regular research studies.

IMPROVING TRANSPARENCY AND PUBLIC EDUCATION

Another critical issue that, in many respects, goes hand in hand with good governance is complete transparency in how pension programs operate. Stakeholders must understand how well management is overseeing the program, how sustainable is the financing and benefit structure, what adjustments may be needed well in advance of officially proposed changes to the program. Regular and up-to-date reporting of program data, clear and concise research studies and projections of program operations and regular communications with the public that answer common questions and provide comprehensive information are vitally important to providing transparency.

As mentioned under the section above on governance, accountability in public pension programs may be hard to determine. Administrators, managers and supervisors of the program have laws and guidelines under which they must operate while legislators are responsible to their constituencies. The goals of these various stakeholders are not always the same and program development very often becomes highly politicized. The more that program operations are transparent, though, the more secure and confident participants will feel that their retirement income is secure and not in danger of political pressures.

International Best Practice in Transparency – Pension programs around the world attempt to operate with varying degrees of transparency. The Social Security Administration (SSA) of the United States has made transparent operations of its Old-Age, Survivors and Disability Insurance (OASDI) program a hallmark of its management. Offices for public affairs and research and statistics have been established which provide monthly and annual statistical and research reports not only on the operations of the national program, but also on program operations and policy developments of social security programs throughout the world. A long-time established Office of the Actuary does actuarial computer simulations and financial projection modeling, provides regular research reports and produces the Annual Report of the Trust Funds in support to the Board of Trustees overseeing the OASDI, Supplemental Security Income and Medicare Trust Funds. Meetings of supervisory commissions and boards are open to the public and regularly reported in the media. All of these statistical data and information as well as clear guides on various program provisions are available to the general public upon request and directly from SSA on their website: www.ssa.gov

In a more limited way, though, providing public information and education through other means can be equally effective in instilling confidence in the openness of a pension system. Eastern European countries including Bulgaria, Romania and Ukraine and Central Asian countries Uzbekistan and Kazakhstan have taken this approach. They provide pamphlets and brochures on program provisions at state/provincial/district offices, hold regular briefing sessions with the national and local media, and allow opportunities for questions and answers through television, radio and in regular newspaper columns. Bulgaria has a long-established Office of the Actuary which publishes annual reports on actuarial projections and operations of the PAYG and Individual Account funds.

The INSS has started to provide information and data on the operations of the social security system. In interviews, though, the review team learned that written information on program provisions with clear explanations of benefit eligibility and payment was not available to the general public at a delegation office. We were told that the INSS has a public relations office under the Department of Regimes and Services. The INSS has allocated staff to providing information and some of this information is issued through the delegation offices, but the information we found was outdated and not being issued. The review also was told that the INSS has a public education strategy that is several years old and has not been implemented as yet, but they would like to update and implement it. The

INSS is significantly behind in issuing up-to-date data on program operations and no research or actuarial studies are available to understand the current financial condition of the program.

The INSS is taking several positive steps and must continue to make more progress in the area of transparency. We understand that the INSS has set up an office of the actuary and is working with the World Bank to develop an actuarial degree program at the University of Eduardo Mondlane in Maputo. The program will have an initial class of 15 to 20 students when the curriculum is established. Two actuarial studies have been undertaken to date and the INSS is awaiting the results from the second actuarial study. In addition, the INSS has started issuing annual reports with data on program operations but the latest is the Annual Report of 2004. They hope to be able to catch up rapidly with increased automated records, but that may still be a long time away.

Recommendations

14. Modernizing Public Education to Keep the Public Well Informed of Program Operations – Well-trained public affairs staff in an office of public education with high-level visibility reporting directly to the Director General should actively handle communications between the INSS and the public, provide up-to-date information and research studies in coordination with the proposed actuarial and research staff working with the Council and the proposed investment board. Because of the importance that international donor organizations place on complete transparency and good public education on pension program operations, these organizations may assist in training staff, modernizing the office, and funding the proposed public education strategy (recommendation 15).

15. Prepare a Public Education Strategy Drawing on Various Media and Education Approaches – The office of public relations should prepare an up-to-date public education strategy that will draw on sophisticated, modern techniques of public relations to inform the public about program provisions, operations and developments. This should include a highly visible public campaign of town-hall style meetings and debate about current program issues, question and answer sessions on television, radio and in newspapers, and the development of clear, up-to-date and informative brochures for the general public for display and pick-up at delegation offices.

Chapter 3 – Medium-Term Reform

OVERVIEW

This Chapter discusses several fundamental issues that involve changes over a longer period referred to as "Medium-Term" reform. Medium term may imply a longer period to accomplish change than, for example, making immediate changes to such policy parameters as contribution rates, level of wages replaced by benefits, or length of service for calculating benefits. In reality, medium term means starting the process now and accomplishing the goals of reform within the next five years.

The medium-term reform discussed in this chapter involves something of a paradigm shift in how social protection programs, and in particular, retirement income security is thought of by stakeholders. This type of reform generally needs wider consensus of stakeholders, is politically more sensitive and can be difficult to accomplish if it is not strategically well-planned and driven by influential leaders in the country.

One of the most significant issues that has arisen and would be driving this reform is the issue of sustainability of the current pension program. The growth rate of pension benefits is increasing at a fast pace and the growth in contribution income is not keeping up with it. It is not simply a matter of increasing coverage or increasing contribution rates in order to solve this problem.

A more fundamental change is needed and should be considered by stakeholders as they discuss options for reform. The program must consider to whom benefits are paid, how much should benefit levels be and what fundamental adjustments can be made to deal with the financing burden on the program.

Coverage of the current pension program also is quite limited as discussed in early chapters of this study. Though retirement benefits are generous, an overwhelming segment of the economically active labor force do not participate and consequently receive very little security in their old age or as invalids or as survivors. The Law of 2007 mandates that the informal sector be covered by the pension program, but international experience in transition economies attempting to cover the informal sector through mandates is not promising.

Most workers in the informal sector have low confidence in receiving income security from a formal program and many have incidental attachment to the workforce and may not meet qualifying conditions to receive benefits. Efforts at public education have limited success in bringing informal sector workers into the pension system. Ultimately, implementation of

ICT systems and linking of data bases within the program and to other systems within the Government such as tax authorities, marriage and birth registries and passport control agencies will have positive results. But, in a country with very high levels of poverty and low levels of formal sector employment, other strategies should be considered to achieve social protection goals for the elderly.

This chapter discusses the sustainability of the pension program and then reviews alternative options for expanding coverage and providing retirement income security to a much wider segment of the population. Because of the problems in collecting contributions as discussed in the previous chapter and the basis used to calculate contributions and pension benefits discussed below, the financing and sustainability of the program is called into question.

ACHIEVING SUSTAINABILITY

The current pension program, established in 1989, is a relatively new system at 20 years, as of this year. Since 20 years of contributions is considered a full career of earnings for benefit calculation purposes (up to 36 years), then this year workers can retire with full career earnings for the first time at the age of 55 (women) and the age of 60 (men).

Mozambique is not experiencing the same problems that the developed countries and some other transitional countries face with aging populations (see Table 3). In fact, close to half of the population is below the age of 15 and the median age is 17.4 years. The current aged dependency ratio is quite low at .054 or 5.4 percent.[14] To put this in perspective, compared to Mozambique, aged dependency ratios are quite high in some rapidly aging countries like Latvia (24.6%), Bulgaria (25.8%), Italy (30.5%), and Japan (34.5%).

Table 3 – Cross-National Comparison of Populations & Ages (2009 est.)

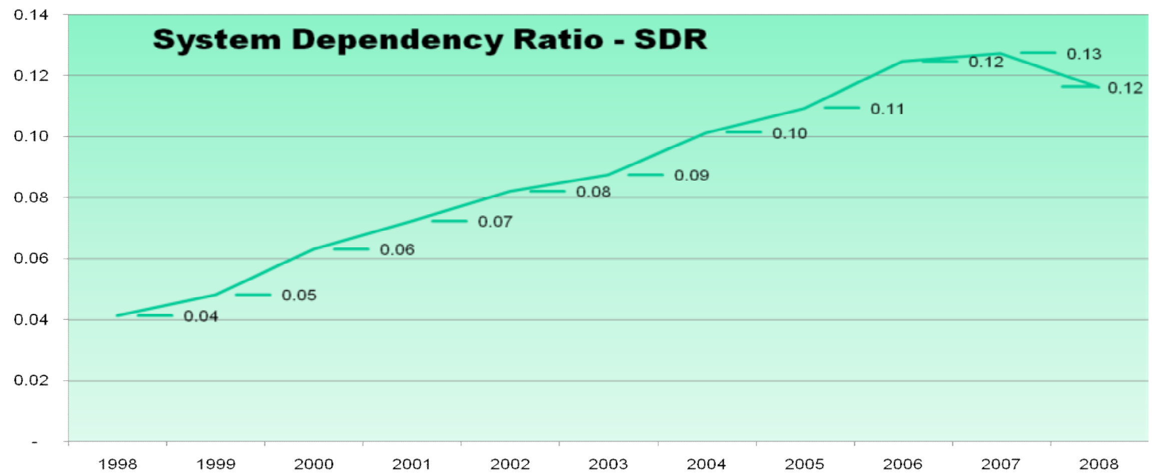
Country	Total Population	Age -14	Age 15-64	Age 65+	Aged Dependency Ratio (%)
Bulgaria	7,204,687	994,460	4,934,832	1,275,495	25.8
Italy	58,126,212	787,0226	38,511,780	11,744,206	30.5
Japan	127,078,679	17,149,265	81,721,301	28,208,113	34.5
Latvia	2,231,503	297,633	1,553,974	379,896	24.6
Mozambique	21,669278	9.602,481	11,447,906	618,891	5.4

Source:The World Factbook Online, 2009

[14] The aged dependency ratio is a comparison of the number of persons age 65 and over to the number of persons of working age, 15 – 64.

Because the population in Mozambique is relatively young, the burden on the pension system should be relatively light for now and into the foreseeable future. Indeed, the ratio of the number of pensioners compared to the number of contributors, called the system dependency ratio is relatively low at .12. As illustrated in Figure 1, this rate has tripled over the past 10 years and will continue to deteriorate if more pensioners enter into the system and the growth in the number of contributors falls off.

Figure 1 - System Dependency Ratios for Pension Program, 1998 – 2008

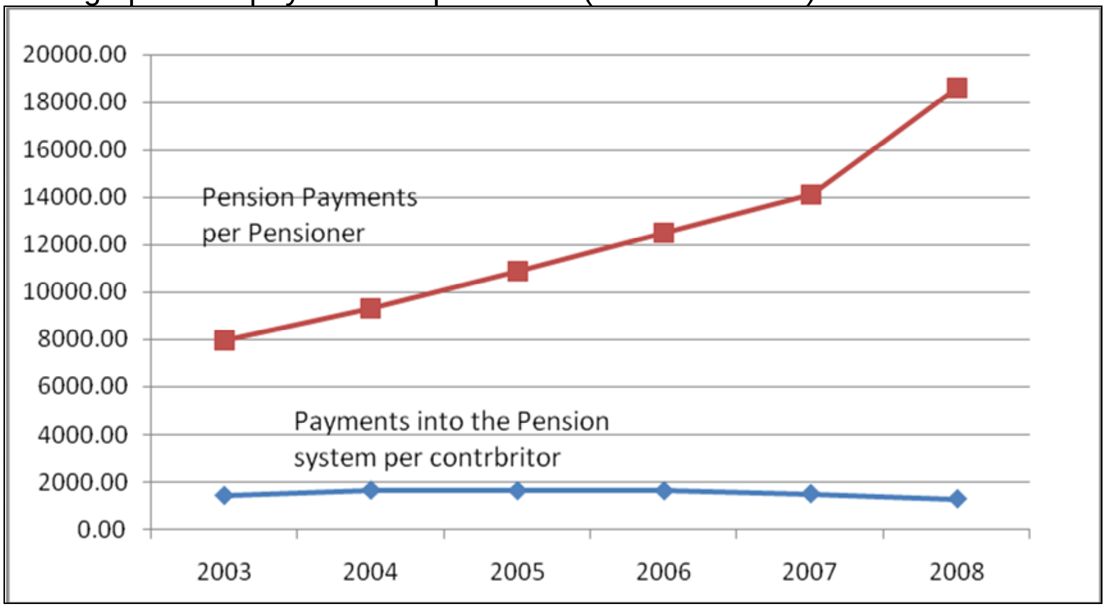


Source: INSS Data on Contributors and Beneficiaries

More contributors could come into the system, but there are two trends that are working against the sustainability of the system. First, the rate of growth of new contributors is slower than the rate of growth of new pensioners (though the increase in the number of new contributors is greater than the increase in the number of new pensioners). At present the growth in the number of contributors paying into the system is 7.99% a year from 159,555 in 2003 to 234,311 in 2008. This compares with the yearly growth of 14.57% of pensioners over the same period from 13,394 to 26,437. Although the number of new contributors coming into the system increased by 74,756 over the five-year period and the number of new pensioners retiring during that period was only 13,043, the growth rate of new contributors is slower than the growth rate of new beneficiaries.

Second, and more importantly, average annual benefit payments to beneficiaries have increased more rapidly than the average annual contribution payments causing system costs to escalate rapidly. As illustrated in Figure 2, the average pension payment has gone up a yearly average of 18.51% from Mt 7,957.32 ($334.59) to Mt 18,598.67 ($746.93). At the same time, the average annual payment per contributor into the pension fund (3.25% of the 7% contribution) has gone down from Mt 1,426.07 ($59.56) to Mt 1,283.35 ($51.54) over this period giving an average annual change of -2.09% per year. (Data is derived from benefit and contribution tables provided by the INSS).

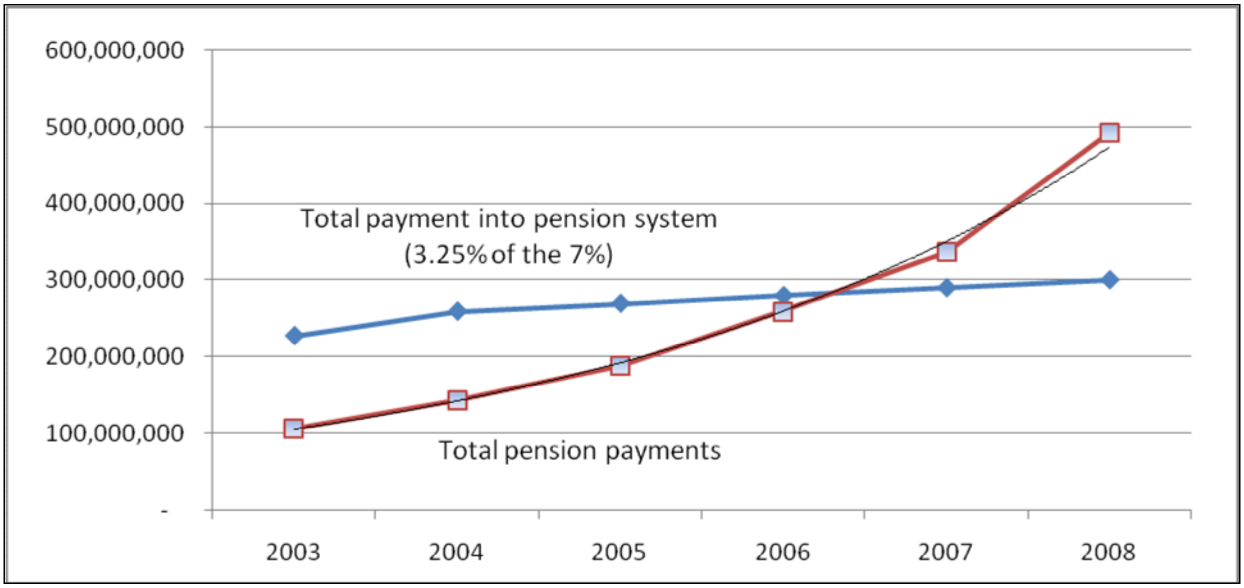
Figure 2: INSS average payments into the pension fund per contributor & average pension payments to pensioner (in Metical MZN)



Source: INSS Statistical Tables

This has resulted in an increase in average annual growth of total pension payouts of 35.8% from Mt 106.6 million to Mt 491.7 million. This growth rate is 5.94 times larger than the growth rate of contributions into the INSS system of 5.74%. (Figure 3)

Figure 3: INSS total contributions into the pension fund & total pension payments (in Metical MZN)



Source: INSS Statistical Tables

A large part of workers have their contribution of 7% based on the minimum wage. The minimum pension is 60% of the highest minimum wage. The highest minimum wage is for the financial sector and is Mt 2,758 and 60% of it is equal to Mt 1,654.80. This is 14% higher than the lowest minimum wage for the agricultural sector which is Mt 1,546. (Table 1) The majority of workers that earn the minimum wage are not in the Financial sector, but in the Commercial or Agricultural sectors earning substantially less (see Table 4 below).

Table 4: Minimum Wages 2008 & Percent Increase from 2007 in Metical (MZN) per month

SECTOR	VALOR	VALOR PERCENTUAL
1-Agricultura, Pecuária e Silvicultura	1.486,00 Mt	13%
Açúcar	1.500,00 Mt	14%
2-Pesca marítima industrial e semi industrial	2.050,00 Mt	8,32 %
Pesca de kapenta	1.900,00 Mt	5 %
3Indústria de Extracção Mineira	2.119,06 Mt	12 %
4-Indústria Transformadora	2.300Mt	16.45%
5-Produção Distribuição de Electricidade, Gás e Água	2.403,00 Mt	12,5%
6-Construção	2.215,00 Mt	16%
7-Actividades dos Serviços não Financeiros	2.250,00 Mt	16,88 %
8-Actividades Financeiras	2.758,00Mt	42%
9-Administração Pública, Defesa e Segurança	Público	

There are several problems with tying a minimum benefit to the minimum wage. The most obvious, given the data presented in this section, is that not only do benefits increase rapidly, but they increase more rapidly than the contribution income paid by lower wage workers, many of whom are in the Commercial and Agricultural sectors. This situation also discourages workers, who have wages that fall between the minimum wage level in their sector and the highest minimum wage level, from reporting any wage higher than the minimum wage for their sector because their retirement benefits will be much higher regardless if they pay contributions on a higher wage level.

Another problem exists with high benefits for upper income workers. Many pension programs, for equity reasons, place a ceiling on the level of contributions paid by higher earning workers while at the same time imposing a maximum on the level of benefit payment that can be awarded. Workers over the last 20 years have not been paying contributions for a full career of earnings until this year. In fact, eligibility for a retirement benefit is based on being registered with the system for 20 years, but having paid contributions only for 10 of those years. The reality is that retirees over the past 20 years have been receiving and will continue to receive far more from the system than they paid into it. The highest benefit levels that continue to be awarded just are not sustainable over the much longer retirement period.

Recommendations

16. Analyze the Cost/Benefits of an Alternative Benefit Calculation and Supplementary Benefits – The INSS should conduct a full review of benefit levels and consider an alternative formula to calculating pension benefits based on the highest minimum wage. Since the majority of workers in other sectors are reporting lower minimum wages (a significant number of retirees would receive pensions higher than their last wages), it seems highly likely that contribution income will continue to fall short of the growth of benefits, which are based on a higher earnings basis. One alternative option that the INSS should consider is calculating the benefit based on the lowest minimum wage with well-targeted, social pensions for the elderly in need (discussed in recommendation 19).

17. Consider Imposing an Indexed Ceiling on Both Benefit Payments and Income for Contributions – In the proposed review above, the INSS should also consider whether an indexed ceiling (a maximum) on both individual contribution income and benefit amounts should be imposed. A ceiling on contributions may encourage more workers to report actual income and a benefit ceiling should help to slow down benefit growth.

PENSION PROGRAM REFORM – SHIFTING THE PARADIGM

Over the past 20 years, countries have been reviewing their social protection policies and examining whether their retirement income programs are providing income security to retirees that is needed for adequate living standards, for equitable return on contributions and for poverty prevention. This reform very often is done in the context of making pension programs sustainable as populations age and pressures grow for fiscal constraints on program growth.

International Experience in Pension Reform – Countries consider whether to make minor adjustments to their programs, called parametric change, or to make major changes in the direction of retirement income provision, referred to as paradigm shift or paradigmatic change. Parametric changes may include changing the contribution rate or contributory period, the benefit formula, and eligibility requirements including the age of early and normal retirement, among others, in order to meet a short to medium term financing short-fall.

A paradigm shift, however, involves a fundamental change in approach to providing retirement income programs. “Solidarity systems,” or those pension programs on a PAYG financing basis that spread the burden of retirement financing over generations and among different income cohorts, may move toward a more individual approach. This can be accomplished with funded or notional[15], individual account pensions, with less redistributive effect, and broader coverage through universal pensions or means-tested basic benefits for lower-income workers to prevent poverty, usually funded from general revenues. Transitional costs from one type of pension system to another, however, can be quite substantial and must be planned very carefully.[16]

In pension reform, tradeoffs between adequate levels of retirement income and equitable return on contributions are inevitable, but reformers try to ensure as much of a balance between the two objectives as is politically and economically possible. To achieve these objectives, reformers consider how much of a “multi-pillar” pension program approach is desirable given the country-specific conditions of financial and economic development.

This approach has evolved over the years from providing a basic level of pension income and a second level providing earnings-related benefits, to four or five levels or pillars of retirement income protection (depending on what is being counted). A “0” Pillar may provide a flat-rate, universal benefit. The first pillar may be the mandatory, PAYG, solidarity scheme, which is what Mozambique currently uses. In addition, a second pillar may be enacted to provide mandatory, fully-funded, individual accounts with private pension funds. A third pillar provides voluntary, private pension plans. Finally, a fourth pillar can provide private savings and investments to supplement pension income.

Reformers of contributory retirement income systems with PAYG financing recognize the need to prevent poverty as a principle objective in designing basic retirement programs. International best practice in defined benefit schemes now is to provide basic benefits calculated on full career earnings while providing a minimum level benefit that is either a demogrant (sometimes called a social or universal pension) which all citizens are entitled to regardless of any contributions paid or, alternatively, a means-tested benefit to supplement the retirement benefit and help to prevent poverty. [17] For higher earners in the upper

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[15] Notional defined contribution systems are a form of PAYG financing, but the funds do not go into the individual contributor’s account though a record is kept of how much of a contribution is made. Rather the funds are used to pay current benefits. When the contributor is ready to retire, the “notional account” is converted to a benefit amount with a real rate of interest calculated on the total contributions made to provide a real return on the contributions.

[16] See the experience of Bolivia with estimating transition costs in “Keeping the Promise of Old-Age Income Security in Latin America,” Indermit Gill, Juan Yermo, and Truman Packard, World Bank, 2004.

[17] Several very good studies have been done on providing universal or social pensions versus means-tested pensions. These include studies by HelpAge International and the World Bank. Please refer to the Bibliography for references to these studies.

income brackets who desire more "consumption smoothing" over their working and retirement lifetimes, a ceiling is placed on both contribution and benefit payment and other pension provision is made either in mandatory second or voluntary third pillar schemes.[18]

The issue of what pension reform approach is best for Mozambique is perhaps the most difficult and critical issue to take up in reform discussions. Balancing adequacy and equity, providing a basic and decent level of support to the elderly, providing equitable pensions to workers bearing the burden of financing are objectives of reform that must be considered by all stakeholders. It is beyond the scope of this study to recommend a particular reform approach.

Studies continue to look very closely at the impact of various pension approaches in developing countries and particularly in Africa and with particular regard to social pensions. One such study finds that many African countries should carefully consider how to provide cost-effective, well-targeted pensions to the needy elderly age 65 and over.[19] Other studies find that social or universal pensions available to all elderly are the right approach to take in many African countries. However the literature evolves over the coming months and years, a thorough analysis and vetting of the options available in the context of Mozambique's political, economic and demographic development done by stakeholders in open and honest national discussions is imperative.

Recommendations

18. Appoint a High-Level Working Group to Review a New Direction in Pension Provision **-** A working group of high-level policy makers representing a diverse group of stakeholders should be convened to analyze, debate, refine and make final recommendations to the Prime Minister on a new direction in pension provision, such as individual accounts, whether funded or notional, or private pensions, whether voluntary or mandatory. The review team has been told that a Social Protection Advisory Committee, composed of stakeholders, is required under the 2007 law to advise the Government on social protection, but this does not seem to have much power to influence change in program direction. Greater consideration should be given to improving adequacy of retirement income for larger numbers of low-income workers and retirees through a universal pension. At the same time the provision of either mandatory individual private pension accounts or voluntary private pension options will improve equity.

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[18] Consumption smoothing describes resources that are available when needed over an entire life cycle or lifetime. Higher income earners in contributory schemes may not receive an equitable return on their contributions if a limit is placed on benefits without a comparable limit on contributions. They also will desire to have supplementary pension opportunities available to achieve adequate income replacement rates for their retirement benefits. Pension options such as second and third pillar programs therefore can provide more of the desired consumption smoothing for higher earners.

[19] Nanak Kakwani and Kalanidhi Sabbarao,"Aging and Poverty in Africa and the Role of Social Pensions," Social Protection Discussion Paper Series No. 0521, World Bank, May 2005.

***19. Evaluate Whether Social Pensions are a Good Solution* –** High-level policy discussion and analysis should be undertaken with regard to the feasibility (considering costs of the reform, level of income from benefits and good coverage) and appropriateness of designing and implementing a system of either universal/social pensions or well-targeted pensions for the neediest elderly in Mozambique. These discussions and analysis can be done separately or if the proposed working group (recommendation 18) is convened, this should be a consideration in planning an overall paradigm shift in the direction of retirement income provision.

Chapter 4 – Conclusions

Based on the discussions held with stakeholders and data and information collected during the review period, the review team can draw a number of conclusions about the current state of the pension program:

— First, the program is paying benefits that provide generous replacement rates to participants and that are paid every month on time after initial delays in processing applications. It is unknown, however, whether benefit amounts are calculated correctly or based on accurately reported earnings and contributions;

— Second, benefit levels are growing at a faster pace than contributions coming into the pension program and are providing many retirees, who had earnings at minimum wage levels, with income higher than what they had been earning as workers. Other high income earners are receiving high benefits that are not sustainable under a PAYG system. Both situations are contributing to a problem with program financial sustainability;

— Third, a number of deficiencies exist in the administration and management of the program that have created some fear among stakeholders that the program is being mismanaged. Some of these problems can be traced to the management culture, lack of modernization, poor governance standards and lack of transparency. Other problems reflect technical, programmatic issues such as an inability to enforce contribution compliance, defects in benefit formulas and lack of broad coverage;

— Fourth, program coverage is very narrow and, although the expansion of coverage is now mandated for the informal sector, it is unlikely that many workers will be brought into the pension program in the near future. This means that many of the poorest workers will have very little to rely on in retirement even though there is a program of social assistance for the elderly. Many countries are now implementing some form of social pension, either as a universal basic benefit or as a basic pension using means testing and targeting for those elderly most in need.

Next Steps

This report recommends several measures that can be taken either in a comprehensive approach as part of an overall pension reform effort or as individual recommendations that can be implemented over the short and medium term periods. The review team believes that a comprehensive and coordinated approach is more desirable and should be undertaken as soon as possible. This would involve both a comprehensive modernization of pension program management and administration and a full and open discussion of the goals and objectives of the retirement income system by a high-level working group representing all stakeholders.

Several stakeholder organizations were quite interested in this program review. They believe that there are many problems in the current system that must be addressed very quickly and that a larger review of the goals and objectives of the retirement income system should be completed. This report can provide the basis for formulating a common approach that stakeholders may agree on in pushing for change by the Government. As part of this common strategy, a number of follow-up actions, based on the recommendations in this report, should now be pursued to encourage reform and further development of the system:

- **Fixing the Financing Short-fall in the Program** – A near-term financing problem is looming in the program that must be highlighted and is of great concern. This is the shortfall in contribution income and the increasingly greater expenditures on benefits. This problem may be sufficient to encourage greater action in the other areas listed below;

- **Undertaking a Comprehensive Review of Administration and Management –** Call for a comprehensive, technical evaluation of the administration and management of the program that will formulate changes in a time-bound action plan as recommended in this report. This review should evaluate the ICT plans, what business processes are in place, corporate governance and transparency of the program and investments, and providing good informative data and research on the program to the public;

- **Implementing Individual Recommendations On Administrative Reform** – If a comprehensive evaluation is not undertaken, then stakeholders must push to implement individual recommendations of this report concerning program management, tax and contribution collection, investment oversight board and advisor, conflict of interest, ethics and performance evaluation policies, and changes in benefit calculations.

- **Changing Program Direction** – Stakeholders have an opportunity to use this report to call for a re-evaluation of the direction of the retirement income system. The current system provides very limited coverage of the economically-active population, yet is facing severe financing shortfalls. It may be time to engage in a national debate that will bring to the forefront important issues of social protection, adequacy of program protection, and equity to program contributors.

APPENDIX A

Pension Program Provisions in Mozambique

Overview
The current Social Security program has been in existence since 1989 (Law No. 5/89). The program provides social insurance protection to workers in the private sector.[20] Program benefits include cash sickness and maternity, hospitalization, old-age, survivors, and invalidity pensions, cash death grants and funeral allowances for burial expenses. This brief overview of the social security program will discuss the provisions of the Old-Age, Invalidity and Survivors' (OAIS) program.

Social security recently was changed by the Law of 2007 (Law No. 4/2007). Among other things, the law extended coverage to the informal sector and changed the formula for calculating the length of service used to determine pension benefit eligibility and amount.

Coverage
The social security system now covers all private-sector employees and self-employed engaged in economic activity. This now includes self-employed, seasonal, domestic and part-time workers in addition to professional and trade workers, artists and agricultural workers. Foreign workers who are not covered by a social security system in their own country also are covered.

Eligibility and Retirement Ages
Pension benefits are paid to workers who retire as a result of old-age or invalidity and to survivors of an eligible beneficiary. The normal retirement age for a worker who qualifies for an old-age benefit is 55 (women) and 60 (men). The worker must have been registered in the system for the previous 20 years and paid contributions in 10 (120 months) of those 20 years. Alternatively, the worker may qualify for a pension if registered with the system for the previous 30 years with paid contributions for 300 months during those 30 years.

A worker may qualify for an invalidity pension if registered in the system for no less than 5 years before the onset of disability and has contributed for at least 2 ½ years (30 months) during those previous 5 years. A worker on sickness benefit may also qualify for the invalidity benefit after reaching the 365-day maximum limit of sickness benefit.

[20] A separate social insurance program covers workers in the Civil Service and is administered by the Ministry of Finance.

The system provides pensions to survivors, lump sum cash benefits for the death of a pensioner or worker with insufficient contribution history, and allowances for funeral expenses. Survivors' pensions are paid to the surviving spouse and to the children of a deceased beneficiary up to the age of 18 or to the ages of 21 or 25, depending on their circumstances. A death grant is provided to survivors of a pensioner or worker with at least 3 years registration and 6 months paid contributions in the 12 months prior to death. For a family to qualify for a funeral allowance the deceased must have been registered and paid contributions in three months prior to death.

Benefits

Old-age pension benefits are now based (as of Law No. 4/2007) on an average monthly qualifying salary over a 20 year period. Monthly qualifying salary is determined by whether contributions have been paid on that salary amount. The pension is equal to 50 percent of the average monthly salary over 20 years and up to 36 years. The pension benefit cannot be less than 60 percent of the highest minimum wage in force at the time of retirement.

The invalidity pension is calculated as 60 percent of an old-age pension benefit had the worker reached retirement age. The invalidity pension cannot be less than 60 percent of the highest minimum wage.

Survivors receive benefits depending on the eligibility of the deceased worker or deceased pensioner. The survivor of a pensioner receives a pension equal to the amount of either the old-age or invalidity pension divided 50 percent to the surviving spouse and 50 percent to the surviving, qualifying children. The death grant to the surviving spouse is a lump-sum payment equal to six times the average monthly salary of the deceased worker in the six months prior to death or six times the pension of the deceased pensioner in the month of death. Surviving minor-aged children receive the amount of one month's average monthly salary. A funeral allowance is given to the deceased's family paying the cost of the funeral and providing receipts for the expenses.

Benefits are to be reviewed periodically by the Ministries of Labor and Finance to decide if they are keeping pace with changes in the cost-of-living.

Financing

The old-age, invalidity and survivors program is supported by 3.25 percent of the total 7 percent contribution rate. The contribution rate is split between employees and employers at the rate of 3:4 and is paid on the base salary or wage, plus bonuses, commissions and management fees. There is no limit on contributory income so the entire wage or salary is taxed at the 7 percent rate.

Contributions must be paid by the employer by the 10th day of every month. The employer or self-employed should deposit the contribution in a bank account and provide the local delegation office with the deposit slip showing that contributions have been paid. Failure to pay contributions or pay contributions on time can result in a fine of 1 to 3 minimum wages. Current law stipulates that contributions that have not been paid over 5 years may be regarded as doubtful debts.

APPENDIX B

Meeting Agenda

Draft Agenda - Pension System Consultancy

Day	Date	Time	Activity
Tuesday	**19.05.2009**		
		10:45	Arrival of Mr. Dan Wartonick
		16:00	Mr. Celso Gusse, Mr. Nelson Magalhaes, CEMO
Wednesday	**20.05.2009**		
		7:45	Mr. Nelson Guilaze
		9:00	Luis Magaco, Executive Director of Austral Cowi
		11:00	Hipolito Hamela, Executive Director
			Institute of Directors of Mozambique
		15:00	Mr. Jamu Assan, CTA Pelouro (Committee) on Trade and Industry
		16:30	Mr. Adelino Buque, CTA Pelouro (Committee) on Labor Policies
			and Social Action
Thursday	**21.05.2009**		
		10:30	Dra. Amelia Bibiana, Mr. Vasco Mudae
			Sindicate for Food and Drink Workers

		12:30	Luis Macuacua, General Secretary of the Hotel Industry Sindicate
Friday	**22.05.2009**		
		9:00	Dra. Domingas Muchine, National Director
			Private Sector Support Office
		12:00	Jose Chidango
			Maputo Province INSS Office
Saturday	**23.05.2009**		
Sunday	**24.05.2009**		
Monday	**25.05.2009**		
		9:30	Regina Muyanga, Director General of the INSS
		16:00	Emidio Mavila, INSS Tecnico
Tuesday	**26.05.2009**		
		10:30	Celso Gusse, CEMO
			Meeting to finalize debate agenda and powerpoint presentation
Wednesday	**27.05.2009**		
		8:30-12:00	Public Debate
		15:00	Arnovo Vilanculos, Director of Social Security, INSS
Thursday	**28.05.2009**		
		11:00	Kekobad Patel, Advisor to the Board, CTA
			Eduardo Macuacua, Policy Analysis Unit, CTA
		15:00	Karina Arouca, PricewaterhouseCoopers

Friday	**29.05.2009**		
		14:00	Wrap-up meeting to discuss preliminary recommendations
Saturday	**30.05.2009**		
		11:45	Departure of Mr. Dan Wartonick

APPENDIX C

Increasing contributory income to the Social Security Program

The National Social Security Institute (INSS) currently may be losing approximately 31% of its income due to non compliance of contribution payment of the 7% tax. Full compliance could result in an annual increase of Mt 291.0 million or US$ 11.7 million. The potential to increase the income to INSS is based on an estimate of the number of enterprises and employees that are registered but are not now paying into the system—non-compliance with the law.

The number of active registered formal sector enterprises in Mozambique was 24,387 for the year 2006 (INE, Inquerito Annual as Empresas 2006, Janeiro de 2009). For the same year INSS registered 19,863 firms, but only 9,310 were paying into the system. By 2008 the number of firms registered by INSS increased to 25,589 but only 13,138 were paying. Based on the INE data the 24,387 firms employed 222,090 in 2006.

The average monthly wage paid in 2006 was Mt 4,697 (INE 2009) or US$ 184.92. Using these numbers the total income to employees would have been Mt 12,517.9 million or $492.8 million in 2006. Based on this the annual INSS income per employee from the 7% tax in 2006 would have been Mt 3945.48 or $155.33. Therefore the potential INSS total annual income from the 7% tax would be equal to Mt 876.3 million. The actual 2006 INSS income is estimated at Mt 603.1 (an average of the data from 2004 and 2008) or 69% of the estimated potential.

These data indicate then that INSS needs to increase its income from firms and employees that are not now paying into the system. The potential gain from a program to have full compliance is estimated at an increase of approximately 31% in total income to INSS. In 2008 that would mean an increase from Mt 647.7 million to Mt 938.5 million or from $26.0 to $37.7.

The estimate of INSS loses and potential increases in income are based on the assumption that:

1. The INE numbers of enterprises for 2006 being the total for the formal sector for Mozambique. If the real number is higher, then the gains to INSS with full compliance could be higher.
2. The total INSS income for the year 2006 was an average between the income of 2008 and 2006.
3. That the 69% complacence rate calculation for 2006 of paying the 7% tax into the INSS system was constant through 2008.
4. That the average workers wage was constant from 2006 to 2008. If the real wage has increased, than the gains to INSS with full compliance could be higher.

Table 2 – Social Security Contributory Income and Pension Benefit Outgo, 2003 – 2008

		Contribuicoes do regime (7%)			*	*	*
	Ano	2003	2004	2005	2006	2007	2008
Contribuitors (Benficaiarios Activos)	#	159,555	157,131	165,324	172,395	193,426	234,311
Total Mt	Mt	490,079,731	558,593,145	580,861,860	603,130,574	625,399,289	647,668,003
Mt/Benf Activo	Mt/#	3,071.54	3,554.95	3,513.48	3,498.54	3,233.27	2,764.14
Cambio	Mt/$	23.78	22.58	24.80	25.40	24.00	24.90
US$ Ano/Benf Activo	$/#	129.15	157.43	141.67	137.74	134.72	111.01
		Pensao - 3.25% de 7%					
Total Mt	Mt	227,537,018	259,346,817	269,685,863	280,024,909	290,363,955	300,703,001
Mt/#	Mt	1,426.07	1,650.51	1,631.26	1,624.32	1,501.16	1,283.35
US$ Ano/#	$/#	59.96	73.09	65.78	63.95	62.55	51.54
US$ mes/#	$/#	5.00	6.09	5.48	5.33	5.21	4.30
		Despesas com Pensoes					
	Ano	2003	2004	2005	2006	2007	2008
Prestacoes (Casos)	#	13,394	15,302	17,366	20,737	23,865	26,437
Total Mt	Mt	106,580,377	142,781,427	188,768,690	259,262,329	337,074,646	491,693,169
Mt/#	Mt	7,957.32	9,330.90	10,870.02	12,502.40	14,124.23	18,598.67
Mt/$		23.78	22.58	24.80	25.40	24.00	24.90
US$ Ano/#	$/#	334.59	413.22	438.31	492.22	588.51	746.93
US$ mes/#	$/#	27.88	34.43	36.53	41.02	49.04	62.24

Source: Data derived from INSS Statistical Tables for Benefits and Contributions. Contribution income estimates based on yearly averages

77% of formal sector employees were paying into INSS based on 2006 data from INSS of workers paying into the system against the total number of employees for that year (INE).

Based on the INE number for 2006 and assuming that the number of firms increased in line with the economic growth of the country for 2007 and 2008, the numbers the number of firms in 2009 would be approximately 28 thousand. The employment of figures again using the 2006 INE data would have grown from 222,090 in 2006 to just over 255 thousand for 2009. INSS has the number workers paying into the system at 234.311.

APPENDIX D

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