

Papua New Guinea (PNG)*

Overview of Formal Old-Age Support

The main pension fund in the country is the National Provident Fund (NPF), which began operation in 1980. Under the NPF Act, participation is obligatory for companies with 20 or more employees and voluntary for others. The contribution rates are 5% of salary for employees and 7% for employers. Eligibility for benefits is at age 55 (lump-sum) or at a reduced level after six months of unemployment. The NPF has a death/survivors benefit, a disability benefit, a housing advance scheme, and a voluntary school fee benefit savings scheme. Some companies have obtained exemptions from the NPF and set up their own small funds.

There are separate schemes for public sector workers and defense force personnel. The Public Officers Superannuation Fund (POSF), a mandatory accumulation fund scheme for public employees (police, civil servants and teachers), replaced a previous defined-benefit scheme in 1991. Member contributions occur at a rate of 6% of salary, while the government pays its share plus accrued accumulations (8.4%) only when benefits become available to the retiree. This means that the fund is only partially-financed and the government bears significant deferred liabilities. The fund for the military is known as the Defense Force Retirement Benefit Fund (DFRBF).

I. Background

Papua New Guinea is a middle income country with a GNP per capita of US\$890. However, most of the population – especially the 85% whose livelihood depends on agriculture, the highest percentage in the East Asia and Pacific region – experience living standards equivalent to those in low-income countries. In fact, poverty is widespread, with 37% of the population living in households where the consumption level is below that needed to achieve minimum nutritional intake and to purchase a set of minimum required nonfood items.

From 1991 to late 1994, the government pursued an expansionary fiscal policy and an inappropriate mix of financial and economic policies, which contributed to a steady decline in the quality and coverage of basic public services. A structural adjustment program through the World Bank's Economic Recovery Program Loan helped to reestablish macroeconomic stability. In 1997, the East Asian financial crisis and an *El Niño*-induced drought caused a rapid drop in PNG's terms of trade. The drought reduced agricultural output, hindered production in some mines and decimated the food crop. GDP declined by 4.7% during the year but rebounded to 2.5% in 1998.

The country's population of 4.8 million is still quite young, with only an estimated 7.6% over the retirement age of 55 in 2000. The total fertility rate remains very high (at around 4.8 births in 1995), and life expectancy at birth is one of the lowest in the region, at 58 years in 1998. Annual population growth is around 2.3%, and the size of the population is expected to double in 30 years.

* Ian W. Mac Arthur, The World Bank (imacarthur@worldbank.org) prepared this profile, with input from Mark C. Dorfman.

The urban population, which accounts for about 17% of total population, is growing at a rate of 4.6% per year.

II. Analysis of the Pension System

Financial Status and Coverage

Assets of the contractual savings sector in PNG were an estimated K 850 million (US\$ 405 million) at end-1998, or 11% of GDP. The total value of NPF's assets at end-1999 was K124 million¹ (US\$ 47 million). Because many of NPF's assets are not income earning and such income goes to pay NPF's debt obligations, contributions received during 1999 roughly equaled the amount of benefits and withdrawals.

At end-1998 the POSF had total assets of K 528 million (US\$ 252 million). The total of contributors' accounts was K 415 million (US\$ 198 million). Since the legislation requires the government to pay its portion of contributions only when an employee retires, these amounts represent only employee accumulations plus the amount of benefits that POSF has paid out and is awaiting reimbursement from government. The government has not undertaken a recent actuarial study to project the extent of its future liability. However, the amount of government current arrears to POSF for past retirees was K 65 million at end-1999. Finally, assets of the DFRBF were K 60 million at end-1998.

At end-1998 total membership in the NPF and POSF was about 160,000; in the DFRBF, 5,000. Using the 1997 labor force estimate of 2,203,123, the total member to labor force ratio, or coverage, equals 7.3%. However, actual contributing membership is lower. For example, of 100,000 accounts with the NPF, only an estimated 60,000 were active in 1998.

Governance, Administration and Investments

The governance structure of the NPF and POSF places them under government influence. The NPF Board is government-appointed and composed of three representatives each from employers, trade unions and government. The NPF Board is currently not constituted. The government chooses the POSF Board, consisting of three representatives each from the state and contributors (police, civil servants and teachers). In the case of the POSF, the responsible government minister may terminate the appointment of any board member at short notice.

Investment management decisions in both NPF and POSF have been subject to political influence. Operating in a small economy with large investment concentrations, it is difficult to fully divorce such investment decisions from government objectives other than maximizing returns for members. For

¹ This figure is from the 1999 audited financial statement from the Auditor General and includes K 125 million in losses (primarily due to revaluation) that have not been written to members' accounts at the time of preparation of this profile.

example, the NPF took on a large volume of debt obligations that compromised its liquidity position. The POSF suffered as a result of the Cairns property purchase, which lacked commercial scrutiny according to the Auditor General's report, and the acquisition of long-term inscribed stock from the Bank of PNG through the offering of repurchase options that were not invoked due to a fall in interest rates.

Partly as a result of the influences above, return on investment has generally been poor in both institutions.² Between 1992-96, annual earnings of the NPF averaged less than 9%, compared to 10% inflation. One noted deficiency has been the lack of application of benchmarks to judge performance against risk and market alternatives. The Board uses general reserves to smooth earnings rates by only apportioning a part of accumulations and revaluation increases to members' accounts. At end-1999, the composition of the portfolio was as follows: equities (mainly PNG-based mining companies), 26%; government securities, 49%; and properties, 24%. Although asset allocation guidelines were put into place in 1999,³ asset allocation has shifted markedly from year to year, particularly given the concentration in individual securities. For example, in comparison to 1999, the June 1995 portfolio consisted of government securities (34%); interest-bearing deposits (52%); and funds at call, equities, loans and properties (14%). Volatility has resulted due to high exposure to speculative mining equities and large individual properties.

The portfolio composition of the POSF at end-1998 was 19% properties, 22% government securities, 18% domestic interest bearing deposits, 28% quoted PNG-related shares and 13% government development loans. Despite the portfolio's differences in comparison to that of the NPF (including the fact that POSF has no debt obligations), its performance has been about the same, at around 9% average return during the 1990-1998. The total return was 17% in 1998 and approximately 14% in 1999. The distributions to member accounts have in some years been higher than investment returns, resulting in a draw down of general reserves, while at other times (1999) they have been less than the investment returns, resulting in an increase in the general reserves.

III. Reform Issues and Options

The current government has recognized the importance of reforming the pension and superannuation industry and has (i) publicly announced its intent to undertake reforms, including opening up of the NPF to competitive management and drafting and passing legislation regulating mandatory and voluntary pensions and the life insurance industry by August, 2000; (ii) instructed the Central Bank to begin preparations to establish a pensions and insurance oversight unit charged with carrying out the mandate in the legislation; (iii) established a pension reform working group with broad representation to provide input to public policymakers as the reform process goes forward (iv)

² Administration costs do not appear to be a factor in reducing return to member accounts. The NPF expenses amount to around 1.5% of assets under management, which is quite acceptable by international standards. The investment firm that manages DFRBF resources charges a fee at the same rate (i.e., 1.5%).

³ These were as follows: (i) equities – 20-35%; (ii) government securities – 30-40%; (iii) interest bearing deposits – 10-20%; (iv) loans – 10-25%; (v) properties – 20-30%; and (vi) international (0%).

commissioned financial reviews of the NSF and POSF; and (v) constituted a Commission of Enquiry to investigate potential legal misconduct in the management of NPF. The government also intends to establish an account in the Central Bank to deposit new contributions to the NPF during an interim period in which the institution's portfolio is restructured.

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