Tensions in the Pension System: Analysing Retirement Financing in Malaysia

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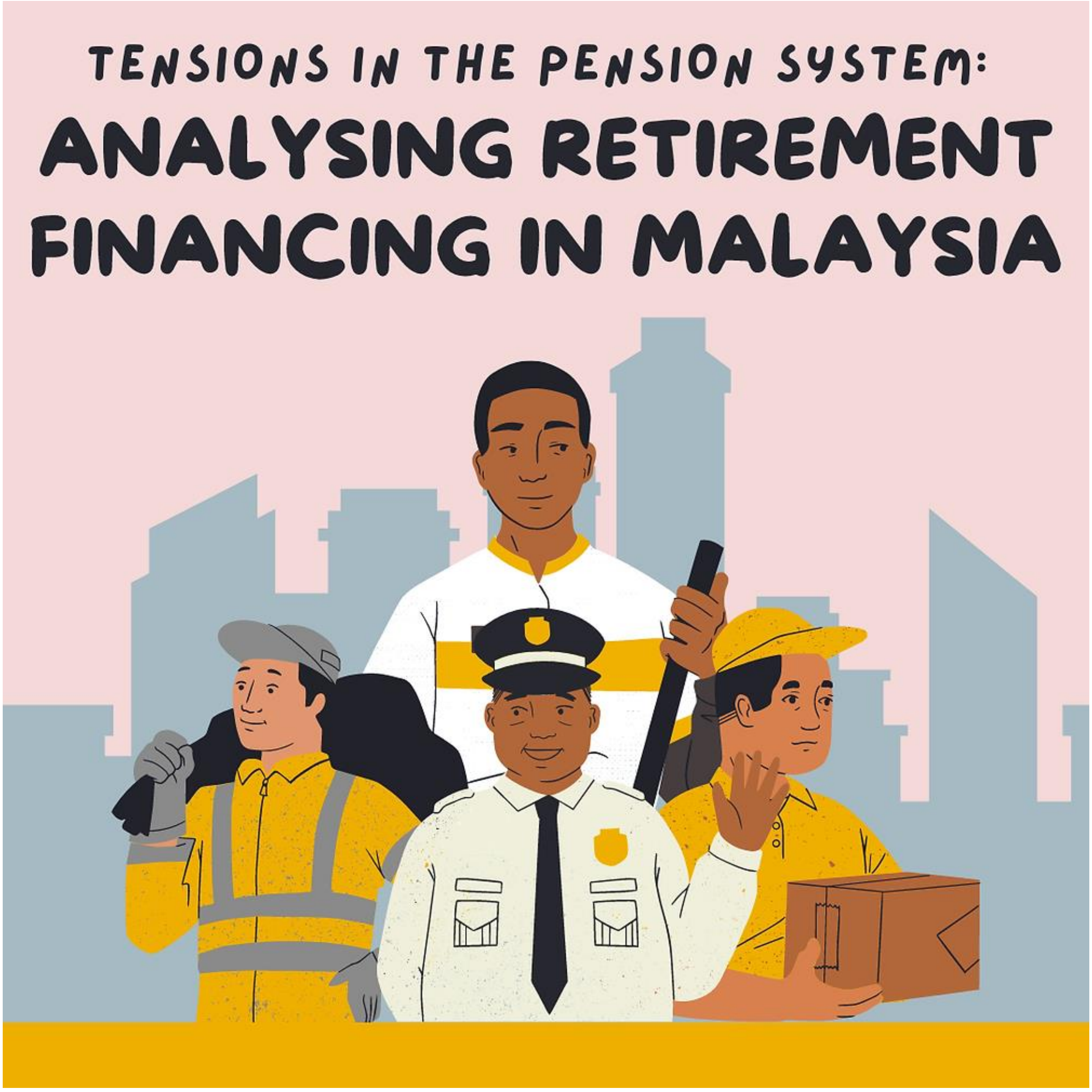

In January 2023, labour strikes raged across France in response to President Emmanuel Macron's plans to reform the country's pension system, through measures like increasing the minimum retirement age from 62 to 64 and requiring people to work 43 years (from 42 years) to be eligible to receive a full pension. This was done in an effort to preserve France's pension system, which is heavily burdened as the ageing population of the nation grows. This is not the first time France has seen widespread protests in response to a rise in the minimum retirement age, as more than a million protesters took to the streets when Nicolas Sarkozy, the then-President of France, raised the minimum retirement age from 60 to 62 for the same reasons. While many disputes over the necessity of such reforms, it certainly calls into question the severity of these issues, with affluent countries like France seriously reconsidering their pension plans in light of demographic shifts.

Similar to France, Malaysia is home to a rapidly ageing population. This places a high burden on the government when it comes to dealing with future pension liabilities as the number of new pensioners outpaces the government's ability to maintain them. Hence, this article seeks to discuss the current problems faced by Malaysia's pension system as well as possible reforms.

We first ought to take a look at the pension system from a legal perspective. Pensions are defined in the case of **Shaukat Husain Beg Mirza v State of Uttar Pradesh AIR 1959 Al 769, 770** as periodical payments of money to a pensioner – Two essentials are necessary in order to constitute a pension: (1) it must be a periodical payment, and (2) it must be a grant not in respect of any right, privilege, perquisite or office but on political considerations or on account of past services or present infirmities or as a compassionate allowance. In the case of Malaysia, they are exclusively associated with the government sector, with the private sector tending to opt for alternative means of retirement financing.

Malaysia's pension system can be boiled down to three different schemes which cater to people from different employment statuses. The first and most widely-used scheme is the Employee Provident Fund (EPF) which is the retirement financing scheme for private sector employees as well as non-pensionable public sector employees. Governed by the **Employees Provident Fund Act 1991**, the EPF is a Defined Contribution plan. This Act holds employers responsible for ensuring that their employees have enough retirement savings, requiring them to make monthly contributions under **S.43(1)**, which will eventually be withdrawn for purposes of purchasing a house, pursuing healthcare treatment, financing Hajj pilgrimage etc. Under **S.55A** of the Act, it states that employees who attained the age of fifty-five years are allowed to withdraw the fund.

The second is the Civil Service Pension Scheme (CSPS), which is the retirement financing scheme for designated government employees. Unlike the EPF, the CSPS is not funded via worker's contributions, but instead gets its funds from federal government allocations, contributions from lower-level government, as well as investment returns from the remaining funds. The contributions from lower level governments come as a "pay as you go scheme' (PAYG) , where employees may choose to make a lump sum contribution to the fund or have percentages or their salary docked for a designated period.

Besides that, the Armed Forces Fund Board (LTAT) is the retirement financing scheme for serving members of the Malaysian Armed Forces, established by the

Tabung Angkatan Tentera Act 1973. This scheme is also a Defined Contribution scheme, taking deductions from employees' monthly salaries as well as monthly contributions from the government. Contributors are entitled to death and disablements benefits while being on active service, and can also withdraw the funds to purchase housing prior to retirement. After retirement, beneficiaries may choose to receive a lump sum at the age of 50, wherein the government's contribution is instead transferred to them and can be withdrawn whenever they choose to.

There also exists other retirement financing schemes, such as the Private Retirement Schemes (PRS), which exists to provide security for workers who wish to fund their retirement through alternative avenues. Also being a Defined Contribution scheme, employees can contribute to a PRS fund of their choice, each with different investment strategies and different returns. Contributors also receive tax reliefs as incentives for those who have the means to invest for their own retirement, rather than relying on alternative schemes that carry inherent risks. From time to time, PRS funds have outperformed the EPF, providing more dividends albeit with more stringent rules when it comes to withdrawal. Nevertheless, PRS does not provide for a minimum dividend per year, making it less stable than the EPF.

However, there are a few general problems that Malaysia's pension systems face. The first is the aforementioned demographic shift as we are transiting into an ageing nation, as life expectancies rise and birth rates decline, causing a significant burden on the pension systems as retirees will withdraw more but there will be less employees to contribute to those retirement funds. This also causes problems as high pension costs place a financial strain on the government, given that the government has to plug the deficits left behind due to the lack of contributors. In cases where the government fails to do so, the livelihood of pensioners will be affected severely, which often leads to political discontent.

Secondly, the fiscal impact of pensions also has other impacts on government policies. For instance, in past years, the fiscal strain that the pension system has placed on government expenditure has ballooned as pension payments rose to keep up with inflation. This is exacerbated by the fact that Malaysia has an outsized public sector (4.1% of population), a fact made apparent when compared to the civil services of similar countries like Indonesia (0.97% of population) and Philippines (1.108% of population). The size of the civil service is both a current and a future problem, adding a political dimension to any attempts to reform the pension system, as we will discuss later.

Lastly, there also exists a disparity in pension benefits between the private sector and the public sector. As the public sector provides for a defined benefit scheme, compared to the private sector in which the workers' retirement benefits are largely self-funded. This creates a high demand for public sector jobs as the retirement benefits are far more secure and hefty compared to private sector jobs. However, the nature of its funding also places an outsized cost on the government, and as such, causes the government to spend outsized amounts of its budget on the civil service and not for other purposes such as investment in national industries or the development of infrastructure. It is also important to note that as more people take up public sector jobs, they are also unlikely to quit their jobs given that the benefits of public sector employment outweigh the benefits of private sector employment, meaning that the labour market has less flexibility to deal with economic shocks, and that the government's problems of a growing weight on its paycheck will not solve itself in case of a recession.

In terms of solutions, there are multiple dimensions that need to be addressed in lowering the government's burden in maintaining the pension system as it is. The first is the legal problem. This is mainly because gratuities and pensions for civil servants fall under the protection of **Article 147 of the Federal Constitution**. **Article 147 of the Federal Constitution** states that the laws applicable to any pension, gratuity or any allowance (namely the **Pensions Act 1980**, the **Pensions Re-Computation Act 1980**, and the **Statutory and Local Authorities Pensions Act 1980**) granted to any member of the public services, or to their widow, child, dependents or local representative, shall be in force for the relevant day or any later law not less favourable to the person to whom the award was given. What this means is that any amendment to the law of pensions which makes it less favourable to public servants is essentially forbidden by this article, and any attempts to reform must not present less favourable terms to public servants as it is constitutionally mandated. Accounting for the aforementioned flaws of the pension system, this significantly restrains the possible actions the government can take to resolve the underlying problems in it. Therefore, in order for the government to reform the pension system in a way which discharges or shifts the financial burden of providing retirement funds, this article would have to be amended. However, this leads us to the political dimension of the problem.

As mentioned prior, Malaysia has an outsized civil service when compared to other similar economies in Southeast Asia. One of the other issues is that civil servants have become a powerful demographic which holds a huge sway over political discussions in Malaysia. For instance, the Congress of Unions of Employees in the Public and Civil Services (CUEPACS) is one of the biggest Trade Unions in Malaysia, having a history of lobbying against any changes to the pension system which would reduce benefits for civil servants. Political parties are extremely hesitant to attract the ire of civil servants as a voting block, and therefore are usually unwilling to pursue options of pension reform which could be viewed as taking away benefits from public sector employees. This is also more pertinent in Malaysia's current political context, where different political parties have taken the helm to run the government for the past 5 years. Therefore, the government will have a diminished motivation to tackle the problem of mounting pension costs once they assume power. The government's ability to function effectively will be severely hindered if it encounters resistance from civil servants. In order to work around this, any government with pension reform on their agenda must first convince the powerful civil service that reforming the pension system is also in their best interests, as it could prevent a future collapse of the fund for certain workers.

Finally, specific reforms to the pension system ought to be pursued in order to prevent the aforementioned harms from proliferating. These reforms can be achieved by amending the relevant legislations, such as the **Pensions Act 1980**, once **Article 147** has been amended. For instance, the CSPS may be changed from a Defined Benefit scheme to a Defined Contribution scheme to lighten the government's burden in having to pay high costs to maintain the pension system. Besides that, pension schemes should implement stringent limitations on withdrawal. Schemes like i-Lestari, i-Citra and i-Sinar which allow short term withdrawals have gotten many people to withdraw their retirement funds to the extent that the Malaysian Central Bank has warned that the average Malaysian would run out of money in their retirement funds 19 years before their death. This could be prevented if the money saved from reforming Malaysia's pension system could be used as fiscal injections or aid for the needy.

In conclusion, Malaysia's pension system has been long due for reform. In comparison to the response by the French populace towards the raising of the retirement age, Malaysia is unlikely to face militant protests due to its strict laws on protesting. However, it is important to note that reforms are unlikely to be passed in parliament without any resistance as well. Hence, parties ought to take note of the past failures of other governments in carrying out crucial reforms as such, in order to minimise the backlash, or risk a rocky road ahead for reform.

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