2. Executive Summary

This section summarizes the conclusions of the project team on proposals for setting up a National Retirement Benefits Fund in Tonga. The joint project between the Government of Tonga, the UNDP and the ILO investigated and assessed the expected impacts of schemes set up on a contributory basis. The key findings are listed below.

Key findings

- A National Retirement Benefits Fund would have a major impact in raising savings levels and increasing the availability of investment capital in Tonga. The actual amount accumulated would depend on who was included in the coverage of the scheme and the contribution rates set. Calculations have been done for schemes which covered all full-time wage and salary earners who are not members of existing government or private sector funds, with some options also including other types of contributors. Net earnings rates of 4 per cent a year on Fund assets have been assumed. Alternative contribution rates between 10 and 18 per cent of income have been used in the calculations. Depending on the option chosen, the National Retirement Benefits Fund could build up assets in the range T$56 to T$81 million by the year 2020, and T$202 to T$353 million by the year 2050.

- A choice of scheme design needs to be made between an individual account Provident Fund (where benefits received are largely proportional to personal contributions plus earnings without any collective insurance elements), or a Social Insurance Fund based on solidarity and social insurance principles with an assured and defined pension benefit to be paid. Therefore, Social insurance funds provide a more assured income level in retirement to individual members, and a wider range of benefits. In particular, Social insurance funds normally build in provision to protect members and their dependants against the consequences of invalidity, premature death, or enforced long gaps in membership, while Provident funds tend not to provide this cover unless special arrangements are made.

- Retirement Benefits Funds based on the levels of contributions examined in this report could provide moderately adequate retirement benefits to full-time wage and salary earners who are contributing fund members for all of their working lives. However, retirement benefits would not be adequate for low-income members unless there was a degree of redistribution towards such members. Those, who were not contributing members, would not receive retirement benefits.

- The issue of who is to be covered by Fund membership is critical. All of the proposals in this report assume that membership will be compulsory for full-time wage and salary earners. Extending voluntary membership to other groups, particularly farmers and fishermen in the semi-subsistence sector, is feasible in the Provident Fund model, but would pose great difficulties for a Social Insurance Fund model, because their claims on the guaranteed minimum pension would tend to drain the Fund and require higher contribution rates from other members.

Setting a high minimum contribution requirement for these groups would tend to exclude many from the possibility of Fund membership. Minimum contributions from farmers and fishermen can be fitted into a Provident Fund through an annual contribution system:

- Neither of the options provides for the retirement income of non-members, though provision can be made for the spouses and dependants of members. A long run possibility is social assistance financed from taxes for the poorest old people who are not members and lack support from families.

- Choice of scheme design will also affect the way retirement benefits are paid out. A Social Insurance Fund normally pays out pensions only to retirees. A Provident Fund may provide
either pensions or lump sums. The Social Insurance Fund model developed in this paper is a "pensions only" model for people who have the required minimum number of years of contributions. The Provident Fund model pays a minimum of two-thirds in pensions, and up to one-third in cash lump sums. The project team consider that retirement benefits should be paid mainly or solely as pensions. The research evidence is that retirement cash lump sums in Tonga are quickly used up.

- Tongans living abroad could be fitted fairly easily into a Provident Fund type scheme through a minimum annual contribution system, but not effectively into a Social Insurance Fund. Because of the higher costs of keeping track of overseas members, a higher minimum contribution would be needed for overseas members. It might be possible to run a dual system, though this would be more complex.

- A future merger with the recently set up new Retirement Benefits Fund for government employees would be feasible only if both were on the same basis, i.e. both Social insurance funds or both Provident funds. Other problems to be solved before a merger is a practical possibility include the funding of transfer obligations owed by the Government to its employee fund, shifting from a cash lump sum basis, administrative cost allocation, and the governance system for a combined Fund.

**Scheme design assumptions**

Recommendations, which are common to all the options, are:

- Contribution rates would start at 10 per cent of wages, with workers and employers each paying 5 per cent. Beyond this level, future contribution rates would depend on the scheme type chosen, the level of benefits desired, and the financial development of the scheme.

- The scheme options assume a normal minimum retirement age of 60 years. A flexible option of 60 to 65 years may be desirable.

- The Fund would be run by a tripartite Board of Trustees with elected representatives of members and employers, and some government representation. The Board would hire professional managers to operate the Fund.

- Existing pension funds (government and private) would be permitted to continue as alternatives to the National Fund, provided that they collected total contribution rates at least as high as the National Fund, provided for Employer contributions at least as high as in the National Fund, and provided benefits which were at least equivalent. The Government would need to decide if new schemes would be permitted to be set up. Further new schemes could divert members from the National Fund, and reduce economies of scale in operation.

- Investment of assets would be done on a professional commercial basis. Overseas investment would be permitted subject to Board guidelines once the Fund passed 10 million pa'anga in assets. No "small withdrawals" would be permitted.

- The Fund should move to a full-funding basis, with contribution rates matching the build up of liabilities. With a Provident Fund this is essentially automatic. For the Social Insurance Fund, it is suggested that contribution rates be raised to the longer-term level needed by the year 2009.

- People who emigrate from Tonga pose an issue. Some might be dealt with through bilateral social security agreements with countries to which Tongans migrate. Otherwise, it is proposed that emigrants should be permitted to withdraw contributions if they have emigrated for at least two years, and have citizenship or permanent residence in the country of emigration.
Periodic actuarial reviews will be required to assess the impact of factors such as changes in life expectancy and actual net earnings rates on Fund investments. In the Social Insurance model these reviews would need to be more frequent.