PUBLIC SECTOR PENSION AND EMPLOYEES PROVIDENT FUND (EPF): A COMPARISON OF PENSION SCHEMES IN TERMS OF BENEFITS TOWARDS BLUE- COLLAR EMPLOYEES

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DECLARATION

I hereby declare that this dissertation contains my original research work. Sources of findings reviewed herein have been duly acknowledged.

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ABSTRACT

Adequate savings is essential in order to lead a financially secured retirement life. A wrong decision in choosing the right pension scheme might cause a lot of mishaps and pressure especially among the blue collared employees in Malaysia. With this in mind, a comparison between the Public Sector Pension scheme and Employees Provident Fund (EPF) in terms of benefits is done towards the blue collar employees. Through this a number of outcomes are estimated to achieve. Those are; to compare the financial benefits and to explore the limits of the financial secureness provided by both schemes towards the blue collar employees of Malaysia. The research takes into account a person that is under the job grade of A1 according to the Public Service Department. He is assumed to have a working period of 30 years and a retirement life of 15 years. In order to obtain all the objectives stated, few methods were taken into consideration. A total amount of four case studies were come up where each case study has different real – life circumstances mainly medical expenditures and salary promotions. Mathematical equations and calculations of both Public Sector Pension scheme and Employees Provident Fund (EPF) were applied in all four case studies. Finally, the pension scheme which offers the most retirement income at the end of the day considering all the circumstances is chosen as the best pension scheme. Suggested pension scheme differs according to circumstances that the retiree might face throughout his retirement life. Here a blue collared employee who has no medical illnesses is suggested to opt for EPF. Those with medical expenditures below RM900 is suggested to opt for EPF where else Public Sector Pension scheme is best suggested to those with medical expenditures ranging from RM900 to RM4000. For further research, other circumstances should be considered such as education expenditures and marital status.

PENCEN PERKHIDMATAN AWAM DAN KUMPULAN WANG SIMPANAN PEKERJA (KWSP): PERBANDINGAN SKIM PENCEN DARI ASPEK FAEDAH TERHADAP GOLONGAN BARPENDAPATAN RENDAH

ABSTRAK

Duit simpanan yang mencukupi adalah sangat perlu demi manjalankan kehidupan persaraan yang lebih terjamin. Keputusan yang tidak tepat dalam pemilihan skim pencen yang sesuai boleh membawa kepada kesulitan yang mendalam di kemudian hari. Walhal itu, perbandingan antara Pencen Perkhidmatan Awam dan Kumpulan Simpanan Wang Pekerja (KWSP) dijalankan terhadap golongan berpendapatan rendah di Malaysia. Menerusi ini, beberapa output dijangkakan. Antaranya adalah; untuk membandingkan faedah kewangan serta mengkaji sejauh mana tahap keberkesanan kedua– dua skim pencen tersebut dalam menjaminkan kehidupan yang kukuh secara kewangan selepas pencen. Kajian ini lebih memfokuskan kepada mereka di bawah gred gaji A1 seperti mana yang telah ditetapkan oleh Jabatan Perkhidmatan Awam. Tempoh bekerja dianggarkan selama 30 tahun manakala kehidupan persaraannya dianggarkan selama 15 tahun. Untuk mencapai kesemua objektif, beberapa metod diambil kira. Sebanyak empat kes kajian dipertimbangkan di mana setiap kes mengandungi situasi yang berlainan. Situasi– situasi ini bertumpu kepada perbelanjaan perubatan serta kenaikan gaji. Persamaan matematik yang berkaitan dengan Pencen Perkhidmatan Awam dan KWSP diaplikasikan ke dalam keempat- empat kes kajian tersebut. Akhirnya, keputusan dibuat dengan menilai skim pencen yang mampu menawarkan pendapatan persaraan yang paling tinggi dengan mempertimbangkan kesemua situasi. Daripada keputusan yang diperolehi, bolah dibuat kesimpulan bahawa pemilihan skim pencen adalah bergantung kepada situasi yang dialami oleh pesara. Kepada mereka yang tidak mempunyai masalah kesihatan, KWSP adalah dicadangkan. Kepada mereka yang mempunyai perbelanjaan kesihatan di bawah RM900, KWSP dicadangkan manakala kepada mereka yang mempunyai perbelanjaan kesihatan dari RM900 kapada RM4000, Pencen Perkhidmatan Awam adalah dicadangkan. Untuk kajian lanjutan, situasi lain harus dipertimbangkan seperti perbelanjaan pendididikan dan status perkahwinan.

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LIST OF SYMBOLS

EPF	Employees Provident Fund
PSP	Public Sector Pension
DB	Defined Benefit
DC	Defined Contribution
RBP	Retirement Benefit Plan
DCP	Defined Contribution Pension
%	per cent

CHAPTER 1

INTRODUCTION

1.1 Employment in Malaysia

Malaysia's total population currently stands at approximately 24.9 million (World Bank, 2004). Classified as an upper middle income country (World Bank, 2006), the per capita income currently stands at RM 12,135. The population is projected to increase at an average annual rate of 2.2%, with a growth rate for those aged 65 and above estimated at 4.1% (Mid-term Review of the Seventh Malaysia Plan (MTR7MP), 1999).

With this vast amount of population, Malaysia still manages to show an impressive record of employment rate (Leete, 2006). According to data provided by the World Bank (2002), the labor force in Malaysia currently stands of an approximation total of 11 million people. In other words, there are around 11 million Malaysians employed from the over all total population. Only 3.5% out of the labor force is unemployed. Appendix A shows Malaysia's employment and unemployment rate. Here it is possible to conclude that Malaysia still has full employment rate.

Focusing on the total population of employed Malaysian citizen, professional, technical employees and administrative and managerial employees make up only around 20% of the work-force compared the remaining big bulks which are production related employees, agricultural and service orientated employees who make up the remaining 80% (Doraisamy, 2006). The latter group which also makes up the majority of the total employment rate in Malaysia can be classified as blue-collar employees.

1.2 Blue- Collar Employees

Basically, a blue-collar employee is a working class employee who performs manual or technical labor, such as in a factory or in technical maintenance trades (Wikipedia, 2005). Focusing in Malaysia, blue-collar employees usually consist of those with either low or no education background at all. Training is often learned on the job while working. Blue-collar employees can be separated into several groups according to job sectors (Ayu Trisna *et. al.*, 2004). According to research done by them, the percentage of blue-collar employees in most of these job sectors have been increasing from year to year (Table 1.1).

Table 1.1 Percentage of blue-collar employees according to job sectors in Malaysia

Sector	1990	1995	1999
Agriculture, forestry, livestock and fishing	26.0	20.0	18.4
Mining and quarrying	0.4	0.6	0.4
Manufacturing	19.9	23.3	22.5
Construction	6.3	8.0	8.2
Wholesale, retail, restaurant and hotel	18.2	17.9	18.8
Transport, storage and communication	4.5	4.7	4.8

The main aspect that distinguishes blue-collar employees from other employees the most is of course the wages received. This particular group receives an average household income of less than RM1, 500 per month. This is just enough to lead a simple life considering that the average house hold expenditures for an employee who lives in the city of Malaysia are RM1, 348.44. Appendix B shows a comparison of certain groups of employees and their house hold expenditures. These groups of employees are also separated based on their different housing areas.

1.3 Life Expectancy

Life expectancy among blue collar employees in Malaysia has continued to increase from 65 years for males and 69 years for females in 1980 to 71 years for males and 76 years for females in 2004 (World Bank, 2004). The ageing share of the total population, which stood at 5.7% in 1991, is estimated to reach 14.5% by 2020 (Asher, 1994). This will be reflected in an estimated increase of ageing persons aged 60 and above from 1 million in 1991, to 3 million in 2020 in Peninsular Malaysia. The causes of such change are the advancement of medical service which contributes to the increase of life expectancy and decline of birth rates (Ang and Mckibbin, 2005).

It is clear that the Malaysian blue-collar employees are living longer and are increasing as a percentage of the total population. Taking account of the fact that the normal retirement age is approximately 56 years, there is a real and contemporary need for the establishment of an adequate system of income provision beyond retirement for this group of employees.

1.4 Pension Schemes

There exists in Malaysia a broad spectrum of pension schemes that differ philosophically in their approach. Pension scheme primarily refers to a field of concerned with social protection, or protection against socially recognized conditions, including poverty, old age, disability, unemployment, families with children and others (Wikipedia, 2006).

Malaysia has a diverse set of complementary, as well as in some cases competitive, pension schemes and institutions. They vary not only in their scope and size but also in their underlying philosophies. Thus, the two most important schemes are the Public Sector Pension scheme and the Employees Provident Fund (EPF) scheme (Asher, 1994).

1.5 Public Sector Pension Scheme

The Pension Division, Public Service Department is entrusted with the responsibility of administering retirement benefits efficiently and effectively in accordance with Pensions Re-computation Act 1980 (Public Service Department). This is to ensure that the eligible pensioners enjoy the benefits of retirement promptly. Pensioners mentioned here are government servants which are categorized under certain groups; officers in the Public Service, employees of Statutory and Local Authorities, Members of Parliament and the Administration, Political Secretaries, Judges and the Armed Forces.

1.5.1 Public Sector Pension Scheme Benefits

Public Sector Pension scheme retirement benefits are granted only to pensionable workers who are permanent officers that serve only to the Government of Malaysia.

There are 11 types of retirement approved under the Pensions Act 1980 (Act 227) and Statutory and Local Authorities Pensions Act 1980 (Act 239) which can be classified into four main categories. These four categories are compulsory retirements, retirement of the instance of the Government or Minister with the consent of the officer, optional retirement and retirements on being appointed to serve in organization (Rubayah and Zaidi, 2001). Government servants who fall under any of the retirement categories mentioned above and also retire in accordance with the provisions of the pensions laws (confirmation in his present appointment and has already completed not less than three years reckonable service) are granted retirement benefits.

Retirement benefits under the Public Sector Pension scheme are based on defined benefit (DB) plans (Doling and Roziah Omar, 2002). According to the definition given by Malaysian Accounting Standards Board (2002), DB plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to a formula usually based on employees' earnings and years of service. Taking this to mind, it is obvious to note that Public Sector Pension benefits in Malaysia can be seen as three main parts where every type of pension benefits are based on specific formulas approved by the Public Service Department. These parts are explained below.

a. Old Age Pension

Consist of service pension, service gratuity and cash award in lieu of accumulated leave. Service pension is granted to a pensionable officer who retires in accordance with the provisions in the pension laws which is upon attaining the age of fifty- six years. This is a monthly payment and one should keep in mind that service pension is subject to the maximum pension of half of the last drawn salary if the employee has service the Government for 25 years and above. Last drawn salary is the last drawn substantive monthly salary and includes any pensionable allowance. However, in the case of an officer who retires before being confirmed in his second or subsequent appointment, the last drawn salary applicable is the salary in his former appointment in which he had been confirmed.

Service gratuity is a lump sum payment granted to a pensionable officer upon retirement. The payment rate given is based on the total completed months of reckonable service and also the last drawn salary.

The cash award in lieu of accumulated leave is payment of cash award in lieu of accumulated leave is provided under the Pensions Regulations 1980 and Service Circular No. 4/1993. This cash award is given in exchange for leave not taken on account of exigencies of service whereby the officer is permitted to accumulate up to half of his of his vacation leave eligibility subject to a maximum of 15 days in a year. Cash award in lieu of accumulated leave is paid by the Federal Government (through Pensions Division PSD) in respect of Federal officers, charged on the Federal Consolidated Fund. Cash award payments for State officers are borne by the respective State Governments. Similarly, payments for officers in Statutory and Local Authorities are borne by their respective agencies.

b. Disability Pension

Benefits provided by the Public Sector Pension scheme also covers pensioners who are disabled (disability pension), adjudged a bankrupt, convicted to any terms of imprisonment or sentenced to death (alimentary allowance). Both types of pension benefits are subject to certain conditions such as those under disability pension are eligible to receive payments based on their impairments. Where else, those who are eligible for alimentary allowance are able to restore their pension payment once they are freed from these mishaps.

c. Survivors Pension

One very interesting concept about Public Sector Pension scheme is that it is a familial based scheme. In other words, the family of a pensioner who has deceased is still granted retirement benefits. Among the benefits provided to families under this circumstances are derivative pension and dependent's pension.

Basically, derivative pension is based of not less than $1/5^{th}$ of the deceased officers last drawn salary the or the equivalent amount based on the formula for service pension whichever is more beneficial is granted to his eligible dependents. The derivative pension is payable for a period not exceeding 12 ½ years from the date of the deceased who died in service or date of retirement of the pensioner. Thereafter, the dependent of the deceased officer will receive 70% of the amount granted.

Figure 1.1 gives a general view on the application of derivative pension towards a pensioner who is under the Public Sector Pension scheme. The chart shows the flow from the very beginning of the pensioner's job application until the death of the last ascendant of the pensioner that receives the pensioner's derivative pension.

On the other hand, dependent's pension is an addition to the derivative pension payable either to the widow, widower or child. Both of these particular pension benefits are subject to terms and conditions.

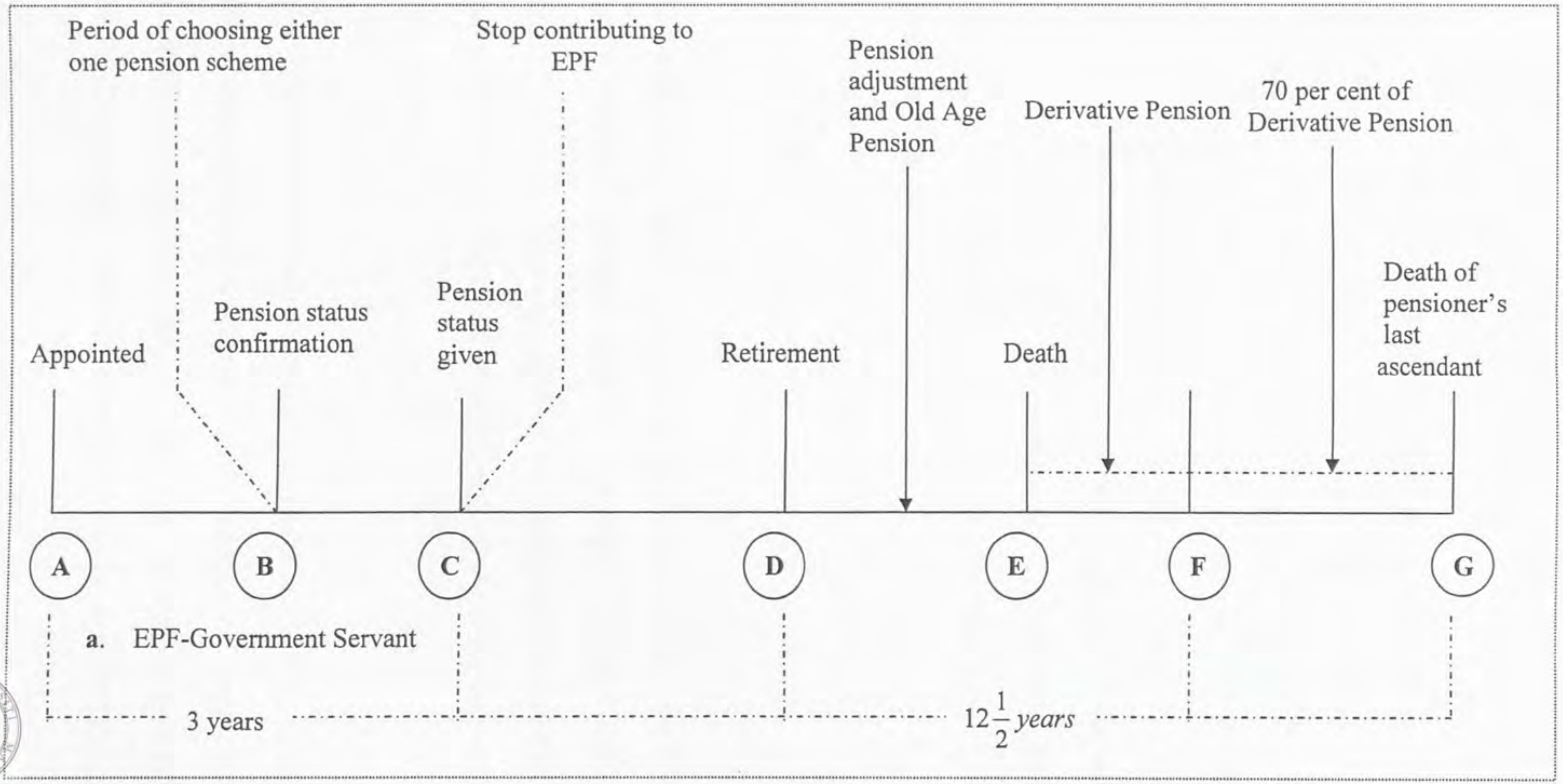

Figure 1.1 Working service, retirement and after death chart of a pensioner under Public Sector Pension scheme

1.6 Employees Provident Fund (EPF) Scheme

The Employees Provident Fund, enacted in 1st October 1951 under the Employees Provident Fund Ordinance 1951 is the major institutional measure available for the preparation of old age and the main stay of Malaysia's system of social security (Orszag and Stiglitz, 1999). These are in terms of coverage, comprehensiveness, and size of fund. The original Act has now been superseded by the EPF Act 1991.

EPF is provided to employees of all job types in Malaysia including Government servants that opt for this scheme instead of the Public Sector Pension scheme. The main objective of the EPF is to provide financial security to its members beyond retirement.

1.6.1 EPF Benefits

Retirement benefits under the EPF scheme is based on defined contribution (DC) plans. According to definition given by Malaysian Accounting Standards Board (2002), DC plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by contributions to a fund together with investment earning theorems.

This can be clearly seen through the overall concept EPF is managed. When an employee opts to join the EPF scheme, both the employer and employee are required to contribute to the Fund, on a monthly basis, which then accumulates to become the worker's retirement fund. This joint contribution rate stands at 23% of an employee's salary, of which the employer's share is 12% (Thillainathan, 2003). The balance is considered as the employee's share of contribution (11%).

In general EPF benefits can be seen in three main categories. All three categories vary in its own way. These categories are explained below. Those are:

a. Accounts

In November 1994, the Fund commenced to segment a member's balance into three accounts; Account I, Account II and Account III. Notably, its main objective was to draw a line between the balances that will at least be available for other purposes (Asher, 1999).

Of the total contribution, 60% of the total balance of the member is allocated under Account I. The funds in the account may be withdrawn only when he attains the age of 55. At age 55, members can withdraw their funds either as a single lump sum, part lump sum with balance paid in periodical payments, periodical withdrawal or withdraw the dividend annually leaving the balance within the account. The second of these accounts, which is Account II is allocated 30% of the total balance of the member. From this account, withdrawals for housing purposes and when a member has reached 50 years of age may be made. From 2000 onwards this account has been drawn to finance higher education expanses and purchase of personal computers. The third account, Account III, is allocated the remaining 10% of a member's total balance with the EPF. Funds in this account may be used for meeting the cost of treatment of critical illness of the member and his spouse, children or parents (Lee, 2001).

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