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Pension Reforms in India: The Need for New Approach

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ABSTRACT

In India, the absence of a country-wide social security system, elderly population and social change on account of the interruption of the traditional family support arrangement are significant considerations for presenting pension reform in the unorganized sector. Whereas in the public sector, fiscal stress of the defined benefit pension system, applicable to the employees of the Government sector, was the major driving force for pension reforms. Since 2001-02, several measures have been adopted by the Government for underlining the need for pension reforms for both the Central Government and the unorganized sector for different reasons. This paper focuses on a conceptual analysis of reform of the pension system in India.

Key Words : Investment, Pension, Regulation

INTRODUCTION

The history of the Indian pension system dates back to the British era. The pension system in India, started by the British rulers was the outcome of the Indian struggle for independence in 1857. The proposed pension system reflected the then prevailing pension scheme in Britain. However, despite assuring financial coverage, this scheme emphasized on discouraging the employees for making financial protection for their post-retirement life. Hence, it again met with the opposition from the Indian Government servants and forced the British Government to modify the pension act. Thus, the Indian Pension Act of 1871 was introduced to replace the Pension System of 1857 (Jindal, 2018). Following the 1871 pension act, the temporary increases in pension amount were assured regularly to compensate the price hikes in the market. Moreover, the concept of dearness allowance (DA) was also introduced to satisfy the pensioners. In 1881, the Royal Commission on Civil Establishments awarded the first pension benefits to the Government employees. The pension rules were further changed by the Government of India Acts of 1919 and 1935. Later, these schemes were combined and stretched for providing retirement benefits to the whole public sector working population (Goswamy, 2001). However, the British rulers never agreed to implement a universal social security system to protect the elderly against economic deprivation.

After independence, numerous changes were incorporated to implement various pension schemes to provide coverage to the retired old aged citizens. A description of the currently existing old-age pension schemes in India is described in this section.

Civil Service Pension Schemes:

The government employees (both Central and State) get pension under these schemes. These schemes provide well-defined pension payments to the retired Government employees and pension benefits associated with the final salary. The pension amounts are distributed from the revenues of the respective state and central governments. The pension benefits under these schemes were changed from defined benefit (DB) scheme to defined contribution (DC) scheme. The employees who joined in Government servicers before 2004 were benefited from defined benefit scheme, meanwhile, those who joined after 2004recieves pension under a defined contribution scheme.

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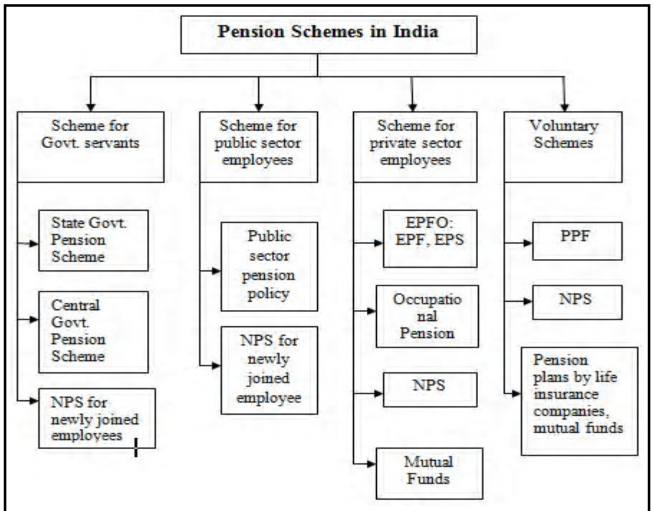

Fig. 1 : Pension schemes in India

Employee's Provident Fund Organization Schemes (EPFO):

The Employees' Provident Fund (EPF) was introduced in 1951 and later in 1952, the scheme was replaced by the Employees' Provident Funds Act. A tripartite board named as the Central Board of Trustees, Employees' Provident Fund, was formed to manage EPF schemes, which include the representatives of Government (both Central and State), employees and employers. The principal function of the board is to manage a contributory pension scheme provident fund and an insurance scheme for the employees of the organized sector in India. EPF board is aided by employees provident fund organization (EPFO), which is considered as one of the largest organizations in the world concerning the clients and the size of financial transactions carried out by it. Three schemes are operated under EPFO to provide pensions and benefits to retired employees of the organized sector. The respective schemes are 1) Employees' Provident Fund Scheme (EPFS), introduced in 1952 to provide mandatory savings/pensions for combating the employees' old age contingencies, 2) Employees' Pension Scheme (EPS), introduced in 1995 to provide pension to members, children, widows, orphans, widower, dependent parents or nominee and physically disabled members and 3) Employees' Deposit Linked Insurance Scheme (EDLIS), introduced in 1976 to provide insurance coverage to the beneficiaries of members who died in harness. The EPFO provide benefits to all organized sector workers with monthly earnings of less than or equal to Rs.6,500 working in an organization with 20 or more members (Sanyal and Jindal, 2013).

Occupational Pension Schemes:

Occupational pension scheme benefits the employees who are working in both public and private sector enterprises. These pension schemes are provided by respective organizations. The nature and mode of payment varies with respect to organizations. Most of the organizations are providing pensions under contributory schemes. At times the organizations themselves manage the fund, whereas in certain other occasions they jointly manage with pension providing companies.

Public Provident Fund (PPF):

The Public Provident Fund (PPF) was introduced in 1968 and stands as a voluntary tax-benefited contributory saving opportunity using the personalized accounts of the workers. This scheme is available to all Indian citizens, however, due to its tax beneficial nature; it is largely used by the organized sector workers, who pay income taxes. In this scheme the minimum and maximum contributions per annum are fixed. The employees can start withdrawing the amounts partially from the sixth year, however, the complete withdrawal of funds are possible only after the expiration of fifteen years. In addition, the scheme also facilitates loan facilities from third to fifth financial year.

National Old Age Pension Scheme:

The Indira Gandhi National Old Age Pension Scheme (NOAPS) was introduced in the year of 1995 for the citizens who are aged 65 or above and have the income under below poverty line (BPL). The beneficiaries will get a pension amount of Rs. 200 per month from the Government of India plus a respective contribution of state, which may vary in accordance with the decisions of the State Governments (Singh, 2014).

National Pension Scheme (NPS):

National Pension Scheme (NPS) was operationalized from 2003 December 22 and had undergone constant renewal over the years, after its launch. National pension scheme was made mandatory for all central government employees (except for the armed forces) after joining the service on 2004 January 1. The NPS was introduced on the basis of the Old Age Social and Income Security project (GOI, 2000), Report of the Working Group (GOI, 2001) and Report of the High Level Expert Group (GOI, 2002) formulated by the Government of India. Based on these reports the Government of India set up a Pension Fund Regulatory and Development Authority (PFRDA) in 2003 October and subsequently introduced a PFRDA bill in Parliament in 2005. The pension scheme was extended on 2009 May 1 to get accessibility to all citizens of India. Another updation in NPS was occurred On 2010 December 1 to introduce the voluntary pillar. Further, 10 other schemes were also included to widen the coverage. All these schemes are contributory schemes. Initially the scheme got dismal responses from the employees and majority of the employees who joined in these schemes belonged to civil servants for them the scheme was mandatory. Hence, in order to encourage the employees of unorganised sector, the Indian government started a new initiative, named as Swavalamban, under which government contributes a certain amount per annum for each NPS account.

Micro-pensions and Other Alternatives:

Micro-pensions, delivered by microfinance institutions, have gained significant relevance in India after the expansion of MFI's and NGO's. Generally, micro-pensions satisfy the requirements of very precise individual groups or local communities with the help of their low contributions and low premium. Self-Employed Women's Association (SEWA) is one of the most successful institutions which provide micro pensions to start self-employment ventures to women. The main advantage of these schemes is that they generally target economically non-privileged groups to provide a mean for their living. In addition, to micro pension schemes there also exist certain long-term saving options offered by banks and pension schemes offered by insurance companies.

Pension Investment pattern:

In accordance with the recommendation of Pension Fund Regulatory and Development Authority (PFRDA), the Pension Funds of India citizens will be managed under 3 separate schemes, such as asset class E, asset class G and asset class C, depends on risk taking capacity of individuals.

Asset class E (equity market instruments):

It is also known equity market instruments. Under this scheme a pensioner can invest in index funds that duplicate the portfolio of either BSE Sensitive or NSE 50 index. The investment under this scheme is capped at 50%. The Index Fund Schemes invest in the securities having the similar weightage of an index. However, it is possible to vary the amount invested in that asset class from the specified cap by less than 5% to balance the portfolios. The risk is high as the returns solely depend on market movements.

Asset class G (Government Securities):

The pension investments under this scheme will be invested in state or central government bonds. The risk is comparatively low as the government holds the responsibility to provide the returns.

Asset class C (credit risk bearing fixed income instruments):

The investment under asset class C will be invested in bonds issued by the entities other than state and central governments. Generally, the assets will be invested in Mutual Funds or in credit rated debt securities.

In addition, an investor can also invest in alternative asset classes including real estate, infrastructure, hedge bonds etc. under the guidelines of PFRDA.

Coverage of pension fund:

The OECD report indicates that INR 150,000 million is invested in the pension funds (both public and private) in the year 2010. It can be observed that in 2011 the amount was increased to INR 151,696 million. It further grew as INR 298,540 million in 2012 and almost doubled to INR 422,047 million in 2013. The trend of growth continued in 2014 with an accumulated pension fund of INR 726,098 million, 2015 with a totally generated fund of INR1,078,020 million and in 2016 with a total amount of INR 1,595,046 million (OECD, 2019). The data of 2017 and 2018 are not available. Hence, from the available data it can be inferred that there is an increase of 9.4% in the investment of pension funds over 7 years (2010-2016).

The rate of returns (nominal) fluctuated highly over the years. The return rate was just 3.7% in 2011, which increased to 11.2% in 2012, only to drop down to 2.8% in 2013. During the year 2014 return rate again rose exponentially to 17.7%, however showed a similar sharp drop (6.4%) in the following year of 2015 (OECD, 2019).

It can be further observed that 11.2% of totally generated pension funds during the year 2016 was invested in various ventures, of which 84.5% was invested in bonds and bills, around 2.5% was invested in cash and deposits and another 1.7% was invested in 'other category', which includes hedge funds, unallocated insurance contracts, private equity funds, land and buildings, loans and other mutual funds (*i.e.*, other than , bills and bonds, equities or cash and deposits) (OECD, 2019).

Pension reforms in India:

In India pension reforms started after the implementation of liberalization policies in early 1990's. The changes occurred in the socio-economic system like the breakdown of traditional family support system and the increasing number of ageing population were the major considerations that fuelled the introduction of pension reform in the unorganized sector. Meanwhile fiscal stress produced by the defined benefit pension system, was the major driving force for pension reforms in the public sector. Hence, a number of measures have been adopted by the Government of India and various state governments to tap the issues in Government, organized and unorganized sectors. A major set of reform initiatives were occurred in 2003 with the introduction of three key changes in the pension system. 1) The complete change in the government' employee's pension scenario 2) introduction of contributory pension scheme for all the government and un organised sectors employees and the 3) introduction of a new NPS-Lite scheme for the poor people. Another extension of pension reform to provide accessibility to all citizens of India was occurred on 2009 May 1 and in 2010, ten new NPS-Lite schemes were added to widen the coverage of schemes.

The present section assesses the reforms in the pension sector in terms of three levels, such as 1) the system level, which reveals to what extent the pension reforms succeeded in bringing overall policy coherence and coordinating with other instruments in the social protection system, 2) to what extent the functional goals of the pension system are being met (Barr and Diamond, 2008) and 3) at an administrative and operational level, *i.e,* to what extent the pension reforms lowered the administrative costs and improved the efficiency in the performance of core functions of provident or pension fund (Ross, 2011).

Policy coherence and coordination:

Indian pension system, in consistent with nation's federal structure, has progressed gradually with the addition of individual programs in an ad hoc manner by the state and central governments (Asher, 2009). The earlier pension system lacked a universal program and had been limited control over its various components. Before the introduction of NPS reforms, the workers of organized private sector had the access to the mandatory EPFO, additionally the bigger organizations had their own contributory pension schemes that were not a part of EPFO. The employees of government, military, and public sector enterprises were covered by non-contributory DB schemes. However, the majority of the workers who were employed in unorganized sector did not have a proper pension scheme other than voluntary community-based micro-insurance scheme. This disparity and scattered structure hinders the appropriate use of pension funds for the benefits of the workers as well as for the nation. Despite the development of skeletal framework of social assistance, the benefit levels were insufficient for giving the retired employees. Additionally, the dismal management of EPFO, which reduced its efficacy among the employees of the private sector and the poor design of public sector pension schemes, limited the coverage of the pension schemes in terms of the number of employees and the range of risks covered. Moreover, most of these pension schemes covered the most 'effectively organized' groups, including bureaucrats, elected public officials, teachers, civil service personnel, employees of public sector organizations, railroad workers, etc. at every repetition of the reform process. However, the majority of India's working population is outside in this privileged group and hence their pension coverage was at a stake.

The reforms like establishment of PFRDA and implementation of NPS changed the scenario by bringing more control over the pension schemes by both state and central governments along and by the competing government agencies like the Ministry of Labour, Ministry of Finance, and Ministry of Rural Development. This gave the pension system more relevance. Moreover, the NPS architecture facilitates a much-needed stage for anchoring its dispersed and fragmented pension system. NPS integrates civil service schemes for state and central government employees as well as the employees belong to organized and unorganized private sectors. This helps to get more acceptances to the pension schemes. However, at the initial phases of the implementation of NPS, it failed to address the concerns of the socially and economically back word employees, despite its coverage on unorganized sector through contribution schemes. This was due to the lack of proper regulatory structure in the pension system. Due to the absence of a proper regulatory mechanism and its awareness, the workers, especially from socially and economically backward class failed in investing their pension funds properly for their social security. A PFRDA act was passed in 2013 to provide statutory structure to interim PFRDA to provide systemic regulation and supervision of all components of the pension system (Asher, 2013).

Functional goals: sustainability :

Sustainability is a significant factor that can be used for evaluating the functional goals of pension reforms. The evaluation is performed with respect to the two issues related to sustainability in pension programs. The first one is financial sustainability or prolonged matching of assets and liabilities and the second is economic sustainability or the ability of the economy to fund the estimated liabilities without suffering economic growth or surrendering other priorities. In the present context, the most significant macroeconomic variable, which measures the economic sustainability of pension programs, is the prolonged trend in economic growth (Barr and Diamond, 2008). In contributory pension system the sustainability is convolutedly associated with adequacy of pension benefits as in a contributory system the benefits relies on the accumulated balances of contributions, income earned, interest, pre-retirement withdrawals, and outcomes of alteration of accrued balances into a retirement income stream. In the contributory system, individual members endure the macroeconomic and investment risks, such as comparatively stagnant wages, unemployment, or inflation beyond the expectation. In brief, the impact of this pension scheme on economic trends is limited because a part of the pension amount will always be present in the economy in the form of various investments. Meanwhile, under the traditional pension scheme, the pension benefits were allocated from the government revenue that in turn result in as a liability to the economy as there is no mandatory provisions to bring back this money to economy. Further, the contributory pension scheme will accumulate the funds that in turn increase national savings and investment rates and eventually catalyse higher economic growth (Barr and Diamond, 2008, 2009).

Administrative level:

The extensive use of information technology and centralized recordkeeping provide a significant advantage for NPS over traditional pension scheme. In traditional scheme multiple files regarding the same individuals, with respect to the individual's changes in the employment, are required to maintain, thereby enhancing the transaction cost. NPS avoids these expenses by adopting the centralized record keeping system. Moreover, centralized recordkeeping permits binding both economies of scale and scope, which in turn further reduce administrative costs.

Conclusion:

India has a complex system of divination and Pension Schemes, targeting different categories of the labor force. The country's social security system has seven components - the future of employees Fund organization projects, civil service projects, public enterprises projects, supervision Corporate sector projects, facilitation of voluntary taxation Schemes, Social Assistance Schemes and Micropayment Projects. However, formal retirement provisions are involved. Less than 12% of the 450 million active workforces in India. Traditionally, access to formal retirement benefits Indian workers is limited to salaried employees Of central and state governments and governments Large private and public sector companies. Most Indian employees are employed in the informal sector, and So most Indian workers are excluded from the admission Formal formal retirement programs. Two major concerns have led to India's pension improvement. The first was the financial imperative to curtail Non-funded defined benefit civil service pension A project involving about 25 million central and state government employees. The second was social. It is imperative to provide a sustainable and scalable pension arrangement for workers in the informal sector of India. To date, the government has enjoyed the benefits of a sponsored retirement income system. The first was the financial imperative to curtail Non-funded defined benefit civil service pension A project involving about 25 million central and state government employees. The second was social It is imperative to provide a sustainable and scalable pension arrangement for workers in the informal sector of India. To date, the government has enjoyed the benefits of a sponsored retirement income system. The first was the financial imperative to curtail Non-funded defined benefit civil service pension A project involving about 25 million central and state government employees. The second was social It is imperative to provide a sustainable and scalable pension arrangement for workers in the informal sector of India. To date, the government has enjoyed the benefits of a sponsored retirement income system.

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