The pension system is undergoing tremendous changes worldwide. Hence we felt that it was timely to have a round table discussion on the issues and challenges facing the pension business, to explore the developments in the pension business in India, and to consider the international experience and see what lessons India can learn from it. The Round Table package consists of presentations made originally in the discussions on 'Pension Business in India: Development and Regulation', organised by the Centre for Insurance Research and Education, IIM B and the Actuarial Society of India. The presentations cover the existing pension systems in India, particularly the government pensions and the mandated pensions for the organised sector or the EPF, and pension regulation and reform, among other issues. The challenges facing pension systems in other countries and what India could learn from their experiences are considered. Indian insurance companies provide their perspective. The Round Table also features papers dealing with significant facets of the pension scene. They pertain to developments in China, issues of retirement benefits for the self-employed in the US and indexing pensions for inflation in India.

Pensions are expected to achieve the goals of minimising poverty in old age, smoothening inter temporal life consumption which fluctuates significantly and ensuring that retirees do not outlive their pension benefits/incomes. This has been achieved in different countries and among different sectors by following specific retirement benefit schemes. For instance the pay-as-you-go (PAYGO) system helps in minimising problems in old age since it comprises defined benefit schemes, which are publicly funded and often means tested.

The Three Pillar system advocated by the World Bank – the First Pillar made up of publicly funded schemes providing modest benefits or Social Security schemes; the Second Pillar consisting of occupational schemes sponsored by employers or private mandatory pension programmes; and the Third consisting of additional voluntary contributions — accommodates these concerns except that it does not take into account the role of families.

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Developed countries are facing a crisis in their generalised social security system on account of the increased life expectancy due to advances in medicine, decline in population growth due to fall in reproductive rates and increased expectations and lifestyle requirements at old age. It is feared that as the so called ‘Baby Boomer’ generation comes into the retirement market in this decade, the social security scheme in the US will face an unprecedented crisis and the government has to undertake drastic steps to tackle the issue. Even the corporates are feeling the pinch with burgeoning pension outlays threatening to affect their bottom lines. Many corporates would like to move from DB to Defined Contribution (DC) schemes but are being met with substantial opposition from employees due to fall in the benefits. The voluntary market is facing issues in terms of investment incomes particularly in countries like the UK wherein substantial sums were invested in equities and with the market slump from the late 90s onwards, the funds are earning meagre returns.

The issues faced in countries like India and China, two of the fastest growing economies in the last decade, are qualitatively different. Here the issues pertain to the coverage of the population and the ability of the state to sustain its current schemes for government employees. The declining role of joint families, particularly in urban areas, is of concern in both the societies since it creates major issues pertaining to old age protection. Caring for the aged is part of our social tradition and ethos with an explicit recognition of Vanaprastha or the ‘retirement stage’ and action was taken by family and community to facilitate the same. Hence, caring for the aged is by and large taken care of by the joint family and the community. Around one-eighth of the world’s elderly population lives in India. Most of them are not covered by a pension system, and have to rely on family based arrangements or their own earnings. But with globalisation and migration, the joint family system is on the decline — at least in the urban areas — and to that extent the challenge of caring for the aged has become greater for society and the government. The traditional and informal methods of old age income security are not able to cope with the trends of increased life span and enhanced medical expenses during old age. Hence there is a very pressing need to re-examine the existing formal and informal systems available to tackle the challenge of the ‘Age Quake’.

In India, the pension issues pertain to:

- Coverage of large portion of population
- Sustainability of the current government system
- The challenges faced by the mandatory (EPF) system
- Evolving methods to cover the huge self employed groups
- Linking health care issues to retirement benefits.

Government employees (centre, state and local bodies) in India are covered by an un-funded, defined benefit, non-contributory, index linked, Pay Commission revision linked, commutable system. They are also covered by a General Provident Fund Scheme (GPF) and a Gratuity scheme. The dependency ratio is increasing and the replacement ratio according to experts is more than one. The central government has introduced a DC scheme for all those entering service after 01-01-2004 and is also taking steps to reform the current system. The state governments are finding it difficult to sustain these schemes and recently Tamil Nadu introduced some changes but reverted to the old system on account of pressure from employees. By and large it has been realised that these are not sustainable and need reform.

The mandatory Employees Provident Fund (EPF) Scheme covers all establishments employing more than twenty labourers. The Employees Pension Scheme (EPS) is DB, and the EPF Scheme is DC. The contribution by employer substantially goes to EPS and that of employees to EPF. The coverage is nearly 40 million, but a much larger portion of the work force (nearly 350 million) is still not covered. The average balance in the EPF, at the time of retirement is usually not more than six months’ earnings since substantial portions are withdrawn during the working life due to liberal facilities for withdrawal.
The returns on the EPF are not linked to market returns, but fixed by the Board which is under the Ministry of Labour. Currently there is a controversy regarding the EPF Board recommendation for an 8.5% interest rate (compared to last year’s 9.5% and the present fixed deposit rate of 5.5%) with the Ministry of Finance saying that it is not sustainable in the prevailing interest rate scenario.

The investment regulations of the mandated schemes are prescriptive in nature and are significantly skewed to central and state government securities and hence the more than Rs.1.4 trillion cumulative assets are held in government paper. There is a need to enlarge the investment basket to capture the developments in the Bond and Securities markets.

The voluntary schemes are mostly perceived as tax schemes and hence the premium paid is restricted to Rs 10,000 which is the current threshold for tax deduction for pension premium from income. The voluntary schemes have not substantially covered the self employed segments in the semi-urban and rural areas.

The Old Age Social and Income Security (OASIS) Report has pointed out that nearly 90% of the workforce is not covered by any of the mandatory schemes and these groups depend on other financial savings, investment in gold or on family support. In a sense there is an Age Bomb ticking in India since the current elderly population of nearly 75 million is expected to increase to 160 million by 2020, and the aged need to be cared for in the context of declining joint family support. This requires innovative policies to encourage the large mass of the self employed to opt for voluntary pension schemes through appropriate instrumentalities of taxation.

We need to learn from global experiences and also look for local solutions, taking into account our civilizational ethos and our innate ability to solve complex social issues by calibrating the inter generational equity with current consumption aspirations. In this, a minimalist state is preferred since families and individuals can be encouraged to make appropriate choices by education and policy instrumentalities.

The Round Table discussion presentations as well as the other three papers presented here will provide clues to policy planners in shaping the retirement benefit scenario in India based on the experiences of other societies and our own ethos pertaining to caring for the old.