ASCI Journal of Management 39(1): 1–18

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Pension Plans, Provident Fund Schemes and Retirement Policies: India's Social Security Reform Imperative**

As India addresses the challenges of the twenty-first century and manages its rise globally, constructing and implementing a modern social security system represents among the major imperatives. A modern social security system can enable India to cushion the burden on workers of restructuring public and private organizations; to increase the legitimacy of further reforms; and to encourage individuals and firms to engage in entrepreneurship and make creative career choices. All three are essential for India to emerge as a resilient knowledge-driven economy and society.

Before enumerating the case for social security reform in India, it may be useful to provide a brief overview of the key concepts and analytical framework involved in designing and implementing social security systems. This will be followed by a discussion on India's current social security system and the specific measures that can be taken to improve the functioning of provident and pension fund organizations. The paper ends with four broad reform themes designed to construct and sustain a modern social security system for rising India.

Key Concepts and Analytical Framework

The main objectives of any social security (or social protection) system[1] are consumption smoothing over an individual's lifetime; insurance (particularly against longevity and inflation risks);[2] income redistribution for society as a

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** An earlier version of this paper was presented as a public lecture at the Administrative Staff College of India, Hyderabad, in January 2010.

[1] 'Social protection' denotes major branches of social security, such as pensions, health care, work injury and social assistance.

[2] Longevity risk concerns the probability that accumulated savings and retirement benefits may be inadequate to last until death. Inflation risk concerns the probability that the value of the retirement benefits may not be protected against inflation during the retirement period.

whole; and poverty relief. However, these have to be traded off against economic growth, labour market efficiency and labour market flexibility.

Since resources devoted to social protection have opportunity costs, the needs of groups other than the elderly in society and other needs, such as health, education and infrastructure, have to be traded off against allocations for retirement. Individual, fiscal and societal affordability should also be considered when constructing and reforming social security systems.

From society's point of view, social security systems should be robust, i.e., withstand macro-economic shocks; and be financially and economically sustainable over a long period of seven to eight decades. Therefore, the design of provident and pension fund schemes must be based on empirical evidence derived from robust, disaggregated databases, which permit appropriate pricing of risks and assessment of long-term assets and liabilities of provident fund and pension schemes. Pension economics is often subtle and exhibits the tyranny of small numbers, i.e., a seemingly small change, such as in life expectancy, can have a disproportionate impact on the financial viability of the scheme.

Such complexity has three important policy implications (Barr and Diamond, 2008). First, an analysis of the effects of the pension system on growth, labour markets and equity should consider the pension system as a whole and not each component separately. Second, a "first-best" approach is not appropriate in designing pension policies or pension reform. Third, pension reform design recommendations must take into account a country's fiscal, institutional and capital market capacities, as also its financial literacy.

The governance and regulation of provident and pension funds involve managing principal-agent (or agency) relationships. These arise when principals (provident and pension fund beneficiaries, and tax payers when government funding is involved) need to rely on agents (provident and pension fund managers and trustees, government bureaucrats) to pursue the interests of the principals. While there has been increasing recognition of the need for institutionalizing good governance practices—involving clarity, accountability, transparency and management of differing interests among stakeholders—progress among Asian countries, including India, has been relatively modest. State domination of provident and pension fund sponsorship and management in Asia has led to less receptivity to the role of an independent pension regulator who can enforce good governance practices.

Long delays in the passage of the PFRDA Bill illustrate the lack of urgency and receptivity in India.

Core Functions of Provident and Pension Fund Organizations

Each provident and pension fund must perform five core functions with a reasonable degree of competence and efficiency (Ross, 2004). These are: *(i)* reliable collection of contributions, taxes and other receipts (including any loan payments in the security systems); *(ii)* payment of benefits for each of the schemes in a timely and correct way; *(iii)* securing financial management and productive investment of provident and pension fund assets; *(iv)* maintaining an effective communication network, including development of accurate data and record-keeping mechanisms to support collection, payment and financial activities; *(v)* and production of financial statements and reports that are tied to providing effective and reliable governance, and to fiduciary responsibility, transparency and accountability.

A provident fund (PF) is essentially a savings scheme. While it is primarily used for retirement financing, it can also enable members to obtain withdrawals for housing, education and other purposes. PF schemes may be mandatory or voluntary. They are defined contribution (DC) schemes, in which the contributions are defined but the benefits are left undefined. As in any DC scheme, individual members bear investment and other risks. Participants usually receive a lump sum at a specified retirement age, though annuity features can be easily incorporated. Contributions are typically by employers and employees, though in some cases the government also contributes. In many provident and pension fund schemes, a member is permitted to borrow for housing, education or other purposes, but the loans need to be repaid. This reduces the power of compound interest.

International experience suggests that there is a strong case for enabling individuals to obtain retirement income from a variety of schemes and sources, with different risk-sharing attributes. In the literature, this is known as multi-tier social security arrangements. In this context, it will become increasingly important in India to consider human skills and capital as similar to a bond proving regular income. By acquiring human capital and skills, income can be drawn throughout an individual's life (physical and mental abilities permitting) and not just during the working years. Of course, during retirement, such income will diminish as compared to the working years, but it can still be a useful supplement to other sources of income. Therefore, learning useful skills, which are in demand, is as essential for retirement security as acquiring formal education.

Demographic and Labour Market Trends

Table 1A: **Demographic Trends in Selected Asian Countries**

Country	*Total Population*		*Average Annual Rate of Change in Population*		*Total Fertility Rate*		*Median Age*		*Life Expectancy at Birth*	
	2007	*2050*	*2005–10*	*2045–50*	*2005–10*	*2045–50*	*2005–10*	*2045–50*	*2005–10*	*2045–50*
World	6671.2	9191.3	1.17	0.36	2.6	2.0	28.0	38.1	67.2	75.4
Asia										
China	1328.6	1408.8	0.58	-0.32	1.7	1.8	32.5	45.0	73.0	79.3
India	1103.4	1592.7	1.55	0.30	3.0	1.8	24.3	38.7	63.1	75.9
Indonesia	231.6	296.9	1.16	0.10	2.2	1.8	26.5	41.1	70.7	78.6
Korea, Rep. of	48.2	42.3	0.33	-0.89	1.2	1.5	35.0	54.9	78.6	83.5
Malaysia	26.6	39.6	1.69	0.41	2.6	1.8	24.7	39.3	74.2	20.1
Philippines	87.9	140.5	1.90	0.50	3.2	1.8	21.8	36.3	71.7	78.7
Singapore	4.4	5.0	1.19	-0.38	1.2	1.6	37.5	53.7	80.0	84.6
Sri Lanka	19.7	18.7	0.47	-0.55	1.9	1.8	29.5	43.4	72.4	77.6
Thailand	63.9	67.4	0.66	-0.27	1.8	1.8	32.6	44.3	70.6	78.1
Vietnam	87.4	120.0	1.32	0.21	2.1	1.8	24.9	41.6	74.2	80.3
Japan	127.9	102.5	-0.02	-0.78	1.3	1.6	42.9	54.9	82.6	87.1

Source: UNDESA (2009).

Table 1B: **Demographic Trends in Selected Asian Countries**

Country	*Life Expectancy at Age 60, 2000–2005*		*Percentage of Total Population Aged 60 and Above*		*Population Aged 60 and Above (in million)*	
	Male	*Female*	*2005*	*2050*	*2005*	*2050*
World	NA	NA	10.3	21.8	672.8	2005.7
Asia						
China	18	21	11.0	31.1	144.0	437.9
India	17	19	8.0	21.0	89.9	329.6
Indonesia	17	19	8.3	24.8	18.9	73.6
Korea, Rep. of	19	24	13.7	42.2	6.6	17.8
Malaysia	18	20	6.7	22.2	1.7	8.8
Philippines	17	19	6.0	18.2	5.1	25.5
Singapore	17	21	12.3	39.8	0.5	2.0
Sri Lanka	17	19	9.7	29.0	1.9	5.4
Thailand	17	22	11.3	29.8	7.1	20.1
Vietnam	19	21	7.6	26.1	6.5	31.3

Source: UNDESA (2009).

Table 1C: **Demographic Ratios in Selected Asian Countries**

Country	*Old-Age Dependency Ratio*	
	2005	*2050*
World	11	25
Asia		
China	11	39
India	8	21
Indonesia	8	29
Korea, Rep. of	13	65
Malaysia	7	25
Philippines	6	19
Singapore	12	59
Sri Lanka	9	36
Thailand	11	38
Vietnam	9	30
Japan	30	74

Source: UNDESA (2009).

Rapid population ageing, signified by rising old-age dependency ratios and increasing life expectancy (with considerable uncertainty) at age 60, suggest a need to devote greater resources for the elderly in India. However, this will have to be reconciled with fiscal consolidation and flexibility.

Demographic trends suggest that little more than three-fifths of the new livelihoods to be created globally between 2005 and 2020 will be in Asia (see Table 2). Of these, India will have to create 200 million jobs or 25 per

Table 2: **Potential Livelihoods Generation* by Region, 2005–2020**

Country/Region		*No. (in million)*	*Share of World Total (Per Cent)*
World		846.6	100.0
Asia-Pacific		526.7	62.2
of which	India	211.7	25.0
	China	71.8	8.5
	Indonesia	32.0	3.8
Africa		232.6	27.5
Europe		-17.8	-2.1
Latin America and Caribbean		79.3	9.4
North America		23.6	2.8

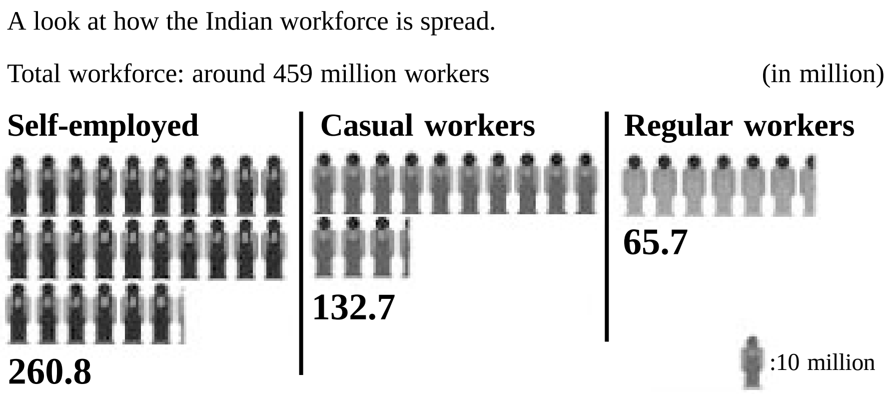
* Defined as the number of economically active persons, defined as those between 15 and 64 years of age in a given region, for whom livelihoods will need to be generated in the formal or informal sectors.

Source: Calculated from UNDESA (2009).

cent of the global total. Livelihoods creation in diverse ways should therefore be given much greater priority in India than merely preserving existing livelihoods.

A shift of the labour force from agricultural to non-agricultural activities needs to occur if the rise in per capital income is to be more evenly attained. Since the share of the formal sector in total employment is relatively low in many Asian countries, much of the anticipated livelihood generation will need to be in the informal sector. This sector constitutes 40 to 80 per cent of the total workforce (Hagemejer, 2009). India's labour force composition, which conforms to the above pattern, is provided in Figure 1 below.

Figure 1: **Where the Jobs Are**



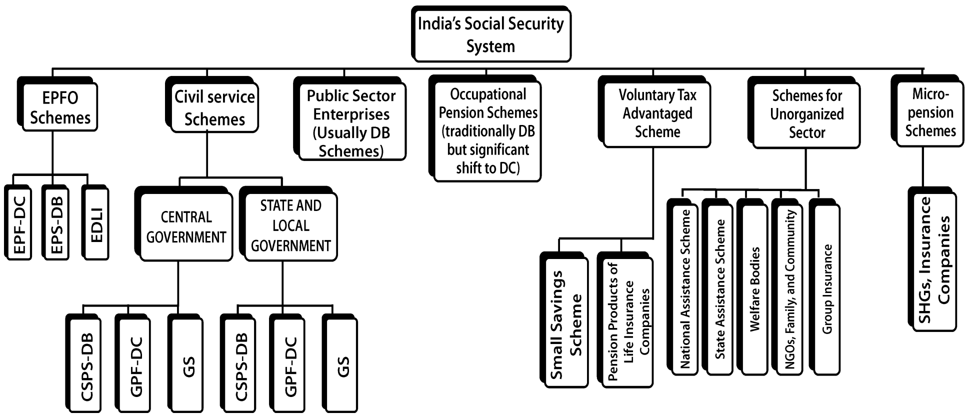
Source: http://www.livemint.com/Articles/PrintArticle.aspx?artid=A6D7FBBA-F48C-11DE-A3C6-000B5DABF613.

Traditionally, social protection systems have been based on employer-employee relationships. Thus, extending their coverage to the informal sector will require innovative approaches. In addition to the reasons cited earlier, the need for fiscal consolidation and flexibility—India's combined public sector deficit exceeds 10 per cent of GDP, while total public debt is around 85 per cent of GDP (RBI, 2009)—constitutes an important reason for social security reform. The current system is able to cover at best around 20 per cent of the labour force under at least one of the social security schemes. The challenges arising from existing low coverage and rapid aging are considerable. Since state-intermediated pension systems cannot cope with this increase in the need for social security, private pension savings will become increasingly important. This will require new organizations and schemes, and product and technological innovations.

The Social Security System in India: A Brief Overview

Since Independence in 1947, India has developed a fairly complex social security system.

Figure 2: **India's Social Security System**



Source: Constructed by the author.

Note: From 1 January 2004, all newly recruited civil servants at the Centre (except for armed forces personnel) are on a DC scheme. Nineteen states have also issued notifications for a shift to the DC scheme, but their starting dates vary.

Abbreviations Used

DB	Defined benefit
DC	Defined contribution
EDLI	Employees' Deposit Linked Insurance Scheme
EPF	Employees' Provident Fund
EPS	Employees' Pension Scheme
GPF	Government Provident Fund
GS	Gratuity Scheme
CSPS	Civil Service Pension Scheme
NGO	Non-government organizations

However, even as the need for inclusive growth has acquired greater urgency due to globalization, the need to maintain social cohesion and reform the social security system has not been accorded high priority by policy-makers, the bureaucracy and other stakeholders. As a result, many elements of the social security system do not reflect India's current economic paradigm. There is a strong case for injecting greater professionalism in performing core functions, and for a thorough systemic overhaul, which integrates the various components of India's social security system.

Select Components of India's Social Security System

Employees' Provident Fund Organization (EPFO)

The Employees' Provident Fund Organization was set up in 1952. It is an unusual national provident fund in three respects. First, it administers two separate schemes: (i) a defined contribution scheme (EPF) and (ii) and a defined benefit scheme (Employees' Pension Scheme). As the DB scheme was carved out of the DC scheme in 1995, the former specifies both the contribution rate and the final benefit. This is mathematically not possible. Perhaps, there is a large actuarial deficit in the EPF. The recent actuarial reports of the EPF, which have not been made public (but should be), suggest that the deficit is to the tune of Rs. 25,000 crore. As a result, ad hoc changes are being introduced in the DB scheme, such as the recent sudden decision to end the commutation of pensions (which permits lump sum withdrawal of future pension benefits, subject to a limit). That such important information is not routinely and publicly available to the stakeholders reflects the distance that must be traversed to reform EPFO.

Second, the organization combines the role of provident and pension fund administrator with that of a regulator of funds that are exempted. This is not consistent with good governance practices. It is therefore not surprising that EPFO does not permit the exempted funds to innovate in investment management or in administration.

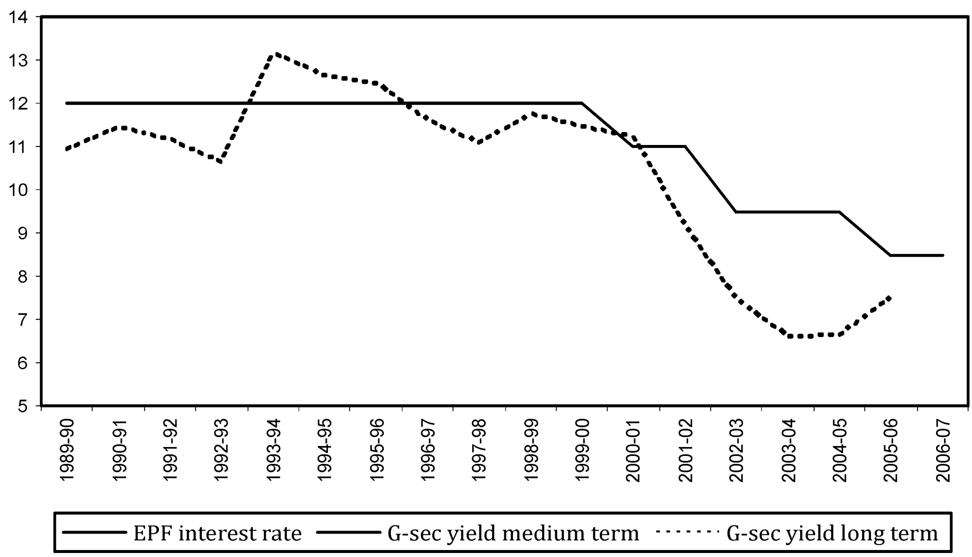
Third, EPFO is among the largest non banking-financial institutions (NBFIs) with assets of over INR 2,562 billion in 2007, equivalent to 5.4 per cent of India's GDP (INR 47.131 billion) (EPFO, 2007). In spite of its size, the organization continues to establish the dividend rate to be paid to the members at the beginning rather than at the end of the financial year. This suggests that in spite of the shift to a new economic paradigm (over two decades ago), EPFO continues to stubbornly adhere to the old economic mindset. While its absolute size is large, in relation to pension assets, the size of EPFO is quite small.

EPFO also continues to adhere to an outmoded pattern of investment allocation. Until recently, it did not permit trading of debt instruments, and refuses to invest even in passive index-linked equity products. Contrary to evidence, it continues to regard investment in state government and public sector entities as risk-free while all private sector investments as unsafe. This reflects the failure of the financial sector reform to touch this important NBFI.

By 2009, after being in operation for 57 years, the EPF scheme covered 0.4 million establishments and had 44 million members, of whom about 22 million (4.4 per cent of the labour force) were active contributors. The contribution rate is 25.7 per cent of the wages (EPFO, 2007), which is rather on the high side. The density of contributions of the EPFO members is not known. But if the distribution of cash balances (provided on a one-time basis in 2004) is any indication, then the expected replacement rates (ratio of pre-retirement to post-retirement income) for most of the members will be substantially lower than the 66 to 75 per cent recommended by the experts.

Figure 3 indicates the relative under-performance of EPFO compared to quite conservative investment return benchmarks.

Figure 3: **Nominal Interest Rates: EPF Payouts Versus Benchmarks**



Source: Calculated by the author based on EPFO (2007).

EPFO should, but does not, provide the distribution of cash balances of members on a regular basis. In 2004, such distribution, covering 34.6 million members, was provided on a one-time basis (see Table 3). The figures suggests that 85 per cent of the members had an average balance of only Rs. 3,133 (equivalent to 0.1 per cent of per capita income). Indeed, only 0.48 per cent of the members had balances exceeding 10 times the per capita income. At the other extreme, for a small proportion of total members (0.023 per cent), the average balances exceeded 100 times the per capita income. This demonstrates that EPFO has failed to provide retirement income security to even the small proportion of the labour force which it has managed to cover.

Table 3: **Members' Balances in EPFO, 2004**

Balance (in Rs.)	*No. of Members (in lakh)*	*Share in Total Members (Per Cent)*	*Share in Total Accumulation (Per Cent)*	*Average Balance (in Rs.)*	*Average Balance/Per Capita Income*
Up to 20,000	293.40	84.59	16.98	3,133	0.1
20,000–49,999	28.77	8.29	21.52	40,468	1.7
50,000–99,000	12.77	3.68	16.67	70,663	2.9
1 lakh–1.99 lakh	7.91	2.28	20.25	1,38,414.00	5.7
2 lakh–2.99 lakh	2.33	0.67	10.37	2,40,616.00	10.0
3 lakh–3.99 lakh	0.83	0.24	5.23	3,41,959.00	14.2
4 lakh–4.99 lakh	0.35	0.10	2.83	3,41,959.00	14.2
5 lakh–9.99 lakh	0.36	0.10	4.29	6,40,229.00	26.6
10 lakh–24.99 lakh	0.06	0.02	1.45	13,16,782.00	54.6
25 lakh–49.99 lakh	0.06	0.02	0.31	25,06,620.00	104.0
Above 50 lakh	0.009	0.003	0.90	54,48,660.00	226.1

Source: Calculated from unpublished data provided by EPFO in 2004.
Note: India's official per capita income in 2004 was Rs. 24,095.

The main challenges facing EPFO are:

- Unwieldy governance structure (a 45-member board, with the Minister of Labour as Chairperson) and limited access to outside expertise.
- Poor design of its schemes (a substantial proportion of the time and energies of the EPFO's 19,000 employees are devoted to non-retirement-related issues).
- Lack of appropriate organizational and individual incentives.
- Outdated budgetary and record-keeping systems due to modest IT systems and absence of appropriate investment in human resources.
- Inability to provide quality of service and retirement income security commensurate with the costs imposed on the economy.

The above discussion suggests that a thoroughgoing reform of the governance structure, management and human resource practices, and design of EPF schemes should be among the highest priorities if India is to develop a modern social security system. The role of the Labour Minister as Chairperson of

EPFO is an anomaly that is significantly contributing to the dysfunctional nature of the organization.

Civil Service Pensions

The current civil service pensions at all levels of government require parametric, administrative and record-keeping, and governance reforms. Civil servants are beneficiaries of pension schemes as well as formulators and implementers of the schemes. This is against good governance principles; and predictably, transparency and accountability of civil service schemes have been low. Many current practices—such as overly generous commutation benefits based on outdated morbidity and mortality data, linking pensions with wage revisions for current government employees, etc—reflect the above arrangements.

The government's cash accounting system does not permit the recording of accrued pension (and health care) liabilities. In the private sector, accounting regulations already require companies to reflect such accrued liabilities in their profit and loss statements and in their balance sheets. Listed government enterprises will need to follow such practices. Moreover, for purposes of proper accounting, all government and quasi-government organizations must recognize such liabilities and clearly specify their plans for meeting them.

Currently, even the government provident fund (GPF) and gratuity contributions are not accumulated in separate funds; instead, they are paid from current revenues. This practice must be changed, and sinking funds arrangements must be instituted to meet future liabilities in an orderly manner. The current arrangements unduly encourage soft budget constraints at all levels of government. The fiscal capacities of different states vary greatly—those with weak fiscal positions and those disinclined to undertake fiscal reforms will find it particularly challenging to meet their pension and other liabilities. If they do meet these liabilities, the opportunity costs, in terms of limited fiscal flexibility and lower growth, will be high.

To reform its civil service pension system, the Government of India introduced in January 2004 the New Pension Scheme (NPS)—a defined contribution scheme with distinct mandatory and voluntary components. The NPS architecture consists of a Central Record-keeping Agency (CRA), auctioning of investment mandates, and points of presence (PoP), which act as distributional and collection agents. The design and architecture of NPS are much more in tune with international pension best practices. However, the mandatory annuitization feature may require some reconsideration.

The mandatory component was made fully operational from 1 April 2008. Mandatory membership covers those central government employees (except armed forces personnel) who first commenced employment on or after 1 January 2004. The total contribution rate for mandatory NPS is 20 per cent of monthly earnings, split equally among the employee and the government (as employer). Members have a limited choice of investments, with life cycle funds as a default choice. Under mandatory NPS, pension is paid at age 60 and pre-retirement withdrawals are not permitted. At present, 22 states/union territories in India have introduced NPS type schemes. Mandatory NPS has the potential to cover 20 million civil servants in India.

The voluntary component of NPS is open to all citizens between ages 18 and 55. It became operational on 1 May 2009. Voluntary NPS has limited pre-retirement withdrawal provisions and flexible contributions.

NPS offers well-considered investment choices, including a default option that automatically reduces the risk levels of asset class exposure with age. The equity exposure in all cases is only through indexed funds. The investment management is auctioned to the lowest bidders. In the latest round, the lowest bid by asset fund managers was only 9 basis points, or Rs. 9 for every Rs. 1,00,000 worth of assets under management. This is much lower than the average cost of a mutual fund of 2 per cent (Rs. 2,000 per year per Rs. 1,00,000) and 1.5 per cent (Rs. 1,500) for a standard unit-linked insurance plan (ULIP) (Halan, 2009).

Pension Plans of Public Sector Enterprises

The pension design for public sector enterprises varies widely. But increasingly, they are also being subjected to NPS. The lack of transparency and accountability of the pension plans of these enterprises does make analysis difficult. However, it is highly probable that professional governance and administration, including the requisite pre-funding and appropriate accounting procedures, need to be improved substantially. Currently, the Income Tax Department, in the union Ministry of Finance, is entrusted with approving such pension funds. But it does not have the required competence to supervise them subsequently. The Pension Fund Regulatory and Development Authority (PFRDA) should be entrusted with supervision responsibilities.

Occupational Pension Plans

These plans currently lack proper supervision and clear guidelines. The proposed changes in India's AS (Accounting Standard) 15 will align it with

FAS 87—Financial Accounting Standard No. 87 issued by the Financial Accounting Standards Board (FASB). FASB is the designated private sector organization in the United States that establishes financial accounting and reporting standards. This will significantly increase the disclosure requirements concerning un-funded pension and other retirement benefits liabilities. These plans also need to be regulated by a pension regulator (i.e., PFRDA). Regulatory gaps that provide arbitrage opportunities must be systematically addressed and plugged.

Other Social Security Schemes

This includes voluntary tax-advantaged schemes, schemes for the unorganized sectors (which are essentially social assistance and social pension schemes), and micro-pensions. Since the number of income tax payers in India is fairly low, tax-advantaged voluntary schemes such as the Public Provident Fund (PPF) have the tendency to become tax shelters for the top third of the income group. There are technical challenges to transitioning from the existing system to a uniform EET system for all pension products and providers. Politically, too, it will not be easy to move towards the EET (exempt contributions, exempt investment income, tax withdrawals at retirement) arrangement from the current EEE (exempt contributions, exempt investment income, exempt withdrawals at retirement) treatment accorded to EPFO, PPF and others. Since NPS is subject to EET rules, its voluntary component, one of the important instruments to reach out to many of the self-employed, is perceived be at a relative disadvantage. In addition, there are many administered interest rate schemes that receive favourable tax treatment.

Social assistance and social pension schemes—such as the Old Age Pension (OAP) scheme, financed jointly by the Centre and the states, but administered at the state level—need to be strengthened. An encouraging development has been the introduction of co-contribution schemes in states such as Andhra Pradesh and Rajasthan. Under these schemes, a member's contribution is matched, with limits, by the state. Their efficacy depends on the fiscal capacity of the Centre and the states and the efficiency with which individual state governments can deliver pension benefits. Thus, fiscal and public sector governance reforms are intricately linked with the broader use of this component.

There has also been progress in developing micro-pension schemes (Shankar and Asher, 2010). A typical micro-pension plan is a DC plan providing for small value contributions collected at a place convenient to the member. In such plans, the accumulation stage has been in focus; however, it is the payout phase that requires greater attention. Annuity markets are unlikely to be sufficiently developed without addressing uncertainty in longevity trends, and without additional instruments, including limited supply of inflation indexed bonds, to match assets and liabilities. These may include annuities which could be re-priced with different risk-sharing mechanisms at periodic intervals; phased or programmed withdrawal plans (which do not pool risks); and reverse mortgage type products, which permit equity in housing to be converted into a consumption stream during retirement. A commercial bank in India has introduced a reverse mortgage loan annuity (RMLA) product, which combines annuity with simple reverse mortgage and thereby addresses longevity risk (Sarang and Bhaskaran, 2009). However, the response has been relatively limited.

Reform Themes

Many of the specific reform measures concerning EPFO, civil service pensions and other components are implicit in the preceding discussion. Four reform themes stand out.

First, there is a strong case for viewing social security systems as an integral part of the overall economic, social, human resources and political management in India. This will require a change in the mindset of provident and pension fund organizations and of labour and other ministries—from welfare orientation to professional-technocratic service orientation. The need for effective management and application of the principles of pension economics and finance in social security policy-making and administration must receive much greater recognition than is the case currently. An unplanned increase in the longevity of members by one or two years, for example, could disproportionately affect the financial viability of the pension and health care schemes. The second theme concerns the need for viewing social security arrangements as a system rather than focusing on individual components. Different components of the social security system in India have evolved, over time, in isolation. As a result, there is limited coordination among different schemes, such as those for civil servants and private sector workers. For a systemic perspective, it is imperative that the PFRDA Bill, which has been languishing for several years in Parliament, be passed in the budget session beginning in February 2010.

There is also a need to understand the systemic risk as the ultimate contingent liability of nearly all social security schemes in India is on the state and, therefore borne, by taxpayers. This is illustrated by the recent press reports that Mahanagar Telephone Nigam Ltd. (MTNL), a public sector telecom firm, has requested the government to bear the pension costs of its employees. Many public sector financial institutions are also likely to be constrained in meeting the pension and health care promises made to their employees. Recent changes in accounting practices will require all companies to reflect their accrued pension and health care liabilities in their profit and loss accounts and balance sheets. As a result of cash accounting, organizations such as the Indian Railways and India Post, who do follow these accounting rules, end up providing an inaccurate picture of their financial position.

There is a strong case for a multi-tiered social security system under which an individual obtains retirement income not from just one scheme but from a variety of sources. This permits risk diversification for the individual and for society as a whole. A multi-tiered approach can help balance the retirement risks borne by individuals and by society; and develop a different mix of financing from taxes, contributions and other methods. Each scheme need no longer be devised to provide full retirement benefits. In India, retirement income transfers, partly or fully financed from the budget, will be needed as one of the tiers. The extent to which this tier can be developed will depend on the fiscal capacity of the government and on the efficacy of government service delivery systems. The existing network of strong micro-finance institutions and community organizations can be utilized to reach relatively low-income and self-employed workers, particularly women, through micro-pension products (Shankar and Asher, 2010).

There are two aspects of a systemic approach to social security arrangements in India that are worth considering. The first is the need for an overall National Social Security Council (NSSC) for strategic policy direction and coherence among different components of the social security system. The second is the need for a pension regulator to ensure that the provident and pension fund organizations undertake their core functions with the requisite professionalism, and that their governance structures meet international best practices. The composition of most of the provident and pension fund boards in India, in both the public and private sectors, reflects insufficient expertise, autonomy, transparency and accountability in their operations. This needs to be urgently addressed by NSSC and the pension regulator.

There is also a need to begin graduate-level courses in social security policy and management. The role of the National Academy of Training and Research in Social Security (NATRSS) ought to be reconsidered. The tendency of almost exclusively relying on current and retired civil servants to be faculty members and resource persons at such institutions must be urgently reviewed.

India has an opportunity to develop the pension sector as a significant component of its overall financial sector, and secure opportunities to turn the expertise to its economic advantage through the export of pension-related services.

The third theme highlights that effective social security reform requires complementary reforms in areas such as labour markets, fiscal policies, civil service, financial and capital markets, and family policies. Thus, any increase in social pensions financed from the budget will require reallocation of expenditure priorities, progress towards fiscal consolidation and better delivery mechanisms. This suggests that to be in favour of more robust social pension systems and to simultaneously be against fiscal reforms is to be inconsistent. A provident fund that invests nearly all of its assets in gilts (a specialized type of investment offered by the government which pays a fixed rate of interest and is considered low-risk) and does not take advantage of trading opportunities will forego opportunities to benefit its members by more professional portfolio management. This may lead to a reduction in national savings to the extent that such a practice may weaken the government's fiscal discipline due to the availability of cheap funds. This defeats the main purpose of mandatory saving, which is to intermediate these savings into productive investments that, in turn, can up the trend rate of economic growth. Only when this is done can pensions be regarded as fully funded (Barr and Diamond, 2008).

The fourth theme concerns the need for more empirical, evidence-based social security policies, particularly in pensions and health care, which require sophisticated price-discovery mechanisms. It calls for developing indigenous analytical capacities and professionals; building robust databases; and establishing professional programmes relating to pensions, health policy and management, and actuarial sciences.

Each of the above four themes is of relevance for constructing more robust, sustainable, professionally managed and regulated social security systems in India. It is often far easier, politically, to increase the demand for pension or health care services. But, if there is no commensurate increase in supply and in the fiscal, institutional, and organizational capacities, the outcomes can be dysfunctional, leading to disillusion and cynicism. Careful planning and homework is required before introducing new social security schemes or reforming existing ones. There is a case for revamping the recruitment policies and the organizational and governance structures of major provident and pension organizations in India, such as the Employees' Provident Fund Organization and the Employees' State Insurance Scheme (which is responsible for the delivery of health care services). The country also needs to put an end to the practice of using the provident fund of government employees to finance current expenditure. India must establish sinking funds to systematically meet the future health care and pension obligations of its public sector organizations.

India has a favourable demographic profile and the capabilities to harness this potential opportunity and make measurable progress towards its professed goal of constructing and implementing a modern social security system—one that is sustainable and covers most of the population. However, progress will not be easy. Sustained focus and efforts will be required. Moreover, pension economics literacy of the stakeholders, particularly of policy-makers and the managers and trustees of provident and pension fund organizations, will have to be substantially improved. As in many other areas in India, a change in mindset—what Bimal Jalan (2005) calls from "ruling" to "governing", and from provider-producer interest dominance to consumer/customer/citizen-centric procedures and attitudes—is the first pre-requisite. We must all resolve to play a role in bringing about such a change.

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