PENSION REFORM IN INDIA WITH REFERENCE OF NEW PENSION SCHEME

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ABSTRACT

With the introduction of new pension system, government is now trying to provide adequate retirement income not only to the government employees but also to all citizens of India. The Government employees (except the employees of Armed Forces) who have already joined the service on or after 01.01.2004 covered under the New Pension scheme (NPS). In this Scheme, pension will be determined totally on the return of the pension fund at the time of the retirement. The second phase of NPS is being introduced in India from 01.04.2009 for non-government employees. This paper aims to point out the different aspects of pension benefits available under the traditional old pension system (OPS) and under the new pension system (NPS) and also mechanism, performance of New Pension Scheme. An attempt has been made to provide a brief idea about the pension benefits under the Old Pension Scheme and New Pension Scheme of the government employees of different cadres i.e. Cadre A, B, C and D.

Key Words: New pension Scheme, Old pension scheme, Pension fund, Government and Non-government employees.

1. Introduction

Pension reform is one of the burning issues of debate in India. It has been attracting considerable amount of attention in recent years, especially after the liberalization of Indian economy. Major retirement benefits of the public sector employees are Provident Fund, Gratuity, and Pension. Out of the three schemes, Provident fund and Gratuity provide lump sum amount to the employees at the time of retirement. The other scheme, i.e., Pension, provides monthly financial assistance based on the last salary drawn and the number of completed years of service subject to a maximum of 50% of last salary drawn. Public sector employees are also covered by the General Provident Fund Scheme. This scheme is non-contributory where only the employee contributes to the fund subject to a minimum of 6% of salary and the accumulated fund is returned to the employee along with the interest as prescribed by the Government from time to time. Apart from these two benefits, employees (both public sector and private sector) are also eligible to receive Gratuity on the condition of a minimum 5 completed years of service. Gratuity is calculated @ 15 days' salary last drawn for each completed year of service with maximum limit of Rs. 6, 00,000. Pension and Gratuity are 'defined benefit' (DB) schemes while General Provident Fund is a 'defined contribution' (DC) scheme. Employees of organised private sector are covered by the security of Employees Provident Fund, 1952. It is a contributory programme where both employer and employee contribute 10% -12% of monthly salary to the fund. Only after the introduction of Employees Pension Scheme in 1995, they are eligible to get pension but the pension amount is restricted to the 50% of pensionable salary of Rs. 6500 only subject to fulfillment of certain conditions.

2. Objectives of the Study:

i) To analyze the current pension benefits available to the Government employees in India.

ii) To identify the scope and benefits of the new pension scheme, and

iii) To examine whether the pension benefits under the traditional old pension system (OPS) is equivalent to the pension benefits under the new pension system (NPS).

3. DATA COLLECTION AND METHODOLOGY

3.1 Data Source:

The study is based on secondary data. To calculate the retirement benefits of govt. employees, civil servant employees of the Central Government, West Bengal Service Rules, Death-cum-Retirement Benefit Rules (DCRB Rules, 1971) of West

Bengal will be taken into consideration. For the purpose of our study eligibility criteria, pension formulae, contribution of employee and employer (if any), rate of return, etc. are required to be collected from these sources. Data will also be collected from the reports of the Pension Fund Regulatory and Development Authority (PFRDA) about the new pension scheme introduced by the government with effect from 1.1.2004.

3.2 Study period

The relevant data of the employee retirement benefits are collected for the period of 12 accounting years (2004-05 to 2008-09). New pension is started from 1st January, 2004 for the Central Government employees (except Armed Forces) and also some state governments have started converted their defined benefit pension scheme to the defined contribution new pension scheme.

3.3 Tools and techniques for Data Analysis:

After collection of necessary data, these are suitably rearranged, classified and tabulated as per the requirements of the study.

Salary means the basic salary and dearness allowance. Hence, we consider 'Salary' for the purpose of our study is aggregate of basic pay and dearness allowance.

The trend of growth rate of Dearness Allowance, as declared by the Government from time to time, is calculated by fitting trend equation which is shown below;

$Y_t = a + b.X_t$

Where, Y= Predicted value

a = Intercept

b = Regression Coefficient

t = Time

For determining statistical significance of the retirement benefits under the traditional old pension system (OPS) is equivalent or not to the retirement benefits under the new pension system (NPS)'t' statistic is computed as follows:

$t = x_1 - x_2 / S.E.\ (x_1 - x_2)$

Where, x_1 = mean pension benefit under old pension system (OPS)

x_2 = mean pension benefit under new pension system (NPS)

S.E. (x_1-x_2) = standard error of (x_1-x_2)

4. Discussion

In this article, we would like to have an attempt to focus on the retirement benefits of the Government employees under old, traditional pension system vis-à-vis the benefits under New Pension System (NPS).

However, traditional old age retirement income security covers less than 11% of the current working people in India. Almost 90% of the total workforce is out of any sort of formal income security system. Moreover, most of the beneficiaries belong to salaried class under both of the public sector and the organised private sector.

In post- independence era, Central Government, State government and Union Territories provide 3-tier retirement benefits to their employees in the form of pension, gratuity and provident fund. Government also provides guarantee regarding retirement benefits to the large number of pension schemes administered by the public and private bodies, autonomous institutions. The Central government alone administers separate pension programmes for civil employees, defense personnel and workers in telecommunication, railways and postal departments. Such schemes are non-contributory, defined benefit basis except the scheme of General Provident Fund. In GPF, only worker contributes to the fund minimum @ 6% of the salary.

Retirement benefits form a very important part of the old age income security especially for salaried persons. Major retirement benefits in India are provident fund, gratuity, and pension. The first two provide lump sum amount at retirement while pension provides monthly assistance. Employees of both the public and private sectors receive gratuity the cost of which is entirely borne by the employers. Participation in provident fund is also compulsory for employees in both the sectors. Government employees come under unfunded, defined benefit pension system. The benefit rate is roughly 50% of the last salary drawn.

4.1 TYPES OF RETIREMRNT BENEFITS

Retirement benefits can be classified into two groups:

***a) Defined Benefit System* (DB):**

In Defined benefit system employers are responsible to pay the benefits to the employees i.e. benefit to be received by the employee is assured. Under funded DB system, the employers will have to bear actuarial risk (that the benefit will cost more than that expected) and investment risk (that assets invested will be insufficient). Employees pension scheme (EPS) is an example of defined benefit scheme.

Now-a-days, defined benefit under traditional pension system faces a variety of problems. Main problems of the traditional system are:

i) It creates an increasing financial burden on the Government with the hike of salary, increasing trend of new appointments, etc.

ii) Demographic pressure with the increasing average life expectancy.

iii) Low coverage of the formal pension system.

iv) Fund collected under GPF is not separated and invested. So, the fund operates as a pay-as-you-go basis causing a financial pressure at the time of redemption.

v) Investment restrictions of various funds like EPF and EPS create the increasing gap between benefit and fund wealth.

b) *Defined Contribution System* (DC):

This is a type of plan where the employer's liability is limited to the amount of agreed contribution and risks will be borne by the employee. Employee's provident fund is that kind of plan.

Advantages of DC system:

i) It reduces the burden of paying pension by the employer as they are only liable to pay their own contributions.

ii) In this system participants enjoy the option to choose fund manager. He can invest his money to such fund as he thinks best for him and also can divert his portfolio from time to time.

iii) Individual accounts are maintained in this system. So, the latest position of the account could be known by the participants at any point of time.

4.2 NEW PENSION SCHEME

After a long debate Government of India has launched the New Pension System (NPS) w.e.f. 01.01.2004. Primarily, this system is introduced for the employees who have joined in their service of Govt. of India on and from 01.01.2004. Now several states have adopted the new pension system for the newly appointed employees. From 01.04.2009, this system is opened to every citizen of India of the age falling between 18 to 55 years.

The salient features of the New Pension System are:

i) New Pension Scheme is a defined contribution scheme where the employer's liability is restricted only to the contribution to the fund only.

ii) Unlike traditional pension system, employee has to contribute to the pension fund for future benefit.

iii) No indexation benefit is available to the pension benefit as the subscriber has to purchase annuity at the time of retirement.

iv) Entire investment risk will be borne by the subscriber. Benefits of two employees of same category & service period may be different on the performance of selected option & pension fund managers.

v) Benefit of General Provident Fund will not be available with the introduction of New Pension System.

vi) Two types of schemes are available. Tier I is non-withdrawable fund upto the age of 60 and the subscriber is required to invest at least 40% of accumulated fund in any annuity plan offered by the life insurance companies. Tier II is a withdrawable scheme where the subscriber can draw from the accumulated fund or even quit from the scheme.

Each subscriber has the right to select any one of the pension fund managers and also to change the manager. A subscriber may choose any one the three options available now:

i) Growth option i.e. comparatively risky, equity-oriented fund.

ii) Moderate fund i.e. low risked, corporate debt and security-based fund.

iii) Cautious fund i.e. risk-free Government security-based fund.

Auto choice option is also available in case of failure of selection of any option by the subscriber.

4.3 Case Study

Let us consider an illustration to find out the benefit under New Pension System as compared to the benefit under Old Pension System in respect to the employee belonging to four different groups i.e. Group-A, Group-B, Group-C, and Group D cadre of the government with the minimum Grade Pay of each scale of each group. This illustration is based on the following necessary assumptions:

i) Data regarding Pay in Pay Band, Grade Pay, and Dearness allowance are taken from the West Bengal Service (Revision of Pay and Allowance) Rules, 2009.

ii) The employee will retire at the age of 60 after completion of 33 years of service. Employee is eligible to get full pension after completion of 20 years of service.

iii) The employee will retire after enjoying the 3rd promotion in 8-16-25 year under Career Advancement Scheme.

iv) Only Employer's contribution @ 10% of salary (Basic+D.A.) to NPS is considered to create a fund for pension wealth of the employee.

v) Fund value under the new pension scheme of the employee will be accumulated at the rate of 8% p.a. after deducting all the expenses and charges through out the whole contribution period.

TABLE 1
RETIREMENT BENEFITS UNDER OPS, GROUP-A

Service year			DATE OF JOINING			
	1.4.2004	1.4.2005	1.4.2006	1.4.2007	1.4.2008	AVERAGE
20	25541	26587	27365	28140	28910	27309
21	27110	28194	28992	29785	30574	28931
22	28743	29866	30684	31496	32304	30618
23	30452	31604	32441	33274	34102	32375
24	32230	33421	34279	35133	35982	34209
25	34075	35309	36188	37062	37933	36113
26	37212	38531	39462	40389	41309	39380
27	39291	40655	41610	42558	43502	41523
28	41447	42857	43834	44806	45772	43743
29	43693	45149	46150	47145	48136	46055
30	46030	47534	48560	49580	50593	48460
31	48462	50016	51066	52110	53148	50960
32	51004	52609	53684	54753	55817	53573
33	53646	55300	56402	57498	58588	56287

TABLE 2
RETIREMENT BENEFITS UNDER NPS, GROUP-A

Service Year			DATE OF JOINING			
	1.4.2004	1.4.2005	1.4.2006	1.4.2007	1.4.2008	AVERAGE
20	15973	17167	18261	19394	20581	18275
21	18143	19469	20677	21926	23234	20690
22	20541	22010	23341	24717	26157	23353
23	23187	24812	26277	27790	29373	26288
24	26104	27897	29508	31171	32907	29517
25	29314	31292	33060	34885	36789	33068
26	32876	35055	36995	38996	41083	37001
27	36800	39198	41325	43517	45802	41328
28	41109	43746	46074	48474	50973	46075
29	45836	48732	51280	53904	56636	51278
30	51019	54196	56982	59850	62833	56976
31	56697	60179	63222	66354	69610	63212
32	62912	66725	70048	73465	77017	70033
33	69712	73885	77509	81236	85108	77490

TABLE: 3

RETIREMENT BENEFITS OF GOVERNMENT EMPLOYEE (OPS), GROUP-B

Service Year	DATE OF JOINING					
	1.4.2004	1.4.2005	1.4.2006	1.4.2007	1.4.2008	AVERAGE
20	20204	21067	21683	22297	22908	21632
21	21443	22340	22972	23601	24226	22916
22	22738	23669	24317	24961	25602	24257
23	24045	25056	25720	26380	27036	25647
24	25454	26501	27182	27858	28532	27105
25	26922	28007	28705	29399	30089	28624
26	29551	30717	31459	32198	32931	31371
27	31195	32414	33175	33931	34683	33080
28	32916	34178	34957	35731	36502	34857
29	34705	36009	36807	37601	38391	36703
30	36561	37923	38741	39555	40363	38628
31	38501	39908	40746	41579	42407	40628
32	40512	41980	42838	43691	44540	42713
33	42611	44126	45005	45879	46749	44874

TABLE: 4

RETIREMENT BENEFITS OF GOVERNMENT EMPLOYEE (NPS), GROUP-B

Service Year	DATE OF JOINING					
	1.4.2004	1.4.2005	1.4.2006	1.4.2007	1.4.2008	AVERAGE
20	12459	13403	14247	15115	16021	14249
21	14162	15211	16143	17102	18100	16144
22	16043	17208	18235	19292	20391	18234
23	18119	19409	20541	21704	22913	20537
24	20407	21835	23079	24358	25685	23073
25	22926	24504	25871	27274	28731	25861
26	25726	27468	28969	30509	32106	28956
27	28812	30733	32379	34067	35817	32361
28	32200	34317	36120	37969	39884	36098
29	35919	38248	40222	42245	44339	40195
30	39997	42557	44715	46927	49215	44682
31	44464	47276	49634	52050	54549	49595
32	49356	52440	55016	57653	60379	54969
33	54707	58088	60899	63776	66749	60844

TABLE: 5

RETIREMENT BENEFITS OF GOVERNMENT EMPLOYEE (OPS), GROUP-C

Service Year	DATE OF JOINING					
	1.4.2004	1.4.2005	1.4.2006	1.4.2007	1.4.2008	AVERAGE
20	14044	14825	15259	15691	16121	15188
21	14909	15722	16167	16609	17049	16091
22	15808	16654	17110	17563	18013	17029
23	16742	17633	18099	18564	19026	18013
24	17723	18648	19126	19603	20076	19035
25	18741	19701	20191	20680	21165	20096
26	20766	21798	22325	22850	23370	22222
27	21921	23004	23544	24080	24614	23433
28	23129	24251	24804	25353	25900	24688
29	24393	25553	26120	26683	27244	25999
30	25698	26913	27493	28071	28645	27364
31	27061	28317	28912	29503	30091	28777
32	28482	29782	30390	30996	31598	30249
33	29964	31306	31929	32550	33167	31783

TABLE: 6

RETIREMENT BENEFITS OF GOVERNMENT EMPLOYEE (NPS), GROUP-C

Service Year	DATE OF JOINING					
	1.4.2004	1.4.2005	1.4.2006	1.4.2007	1.4.2008	AVERAGE
20	8762	9514	10098	10696	11316	10077
21	9954	10793	11438	12098	12783	11413
22	11271	12205	12916	13644	14399	12887
23	12724	13762	14545	15347	16177	14511
24	14326	15477	16339	17220	18133	16299
25	16089	17364	18311	19279	20280	18265
26	18055	19466	20506	21569	22667	20453
27	20222	21781	22922	24087	25291	22860
28	22601	24322	25572	26849	28167	25502
29	25212	27109	28478	29876	31317	28398
30	28076	30164	31662	33190	34766	31571
31	31213	33510	35147	36817	38538	35045
32	34648	37171	38959	40783	42662	38845
33	38406	41176	43128	45117	47167	42999

TABLE: 7

RETIREMENT BENEFITS OF GOVERNMENT EMPLOYEE (OPS), GROUP-D

Service Year	DATE OF JOINING					
	1.4.2004	1.4.2005	1.4.2006	1.4.2007	1.4.2008	AVERAGE.
20	12532	13246	13634	14020	14404	13567
21	13309	14043	14440	14836	15229	14371
22	14118	14883	15291	15695	16098	15217
23	14961	15757	16174	16589	17002	16096
24	15836	16664	17092	17517	17941	17010
25	16746	17606	18045	18481	18915	17959
26	18480	19406	19875	20342	20806	19782
27	19517	20479	20959	21437	21912	20861
28	20592	21589	22081	22571	23058	21978
29	21718	22752	23256	23758	24257	23148
30	22884	23955	24472	24986	25497	24359
31	24103	25214	25743	26269	26793	25625
32	25365	26529	27071	27610	28146	26944
33	26683	27886	28442	28994	29544	28310

TABLE: 8

RETIREMENT BENEFITS OF GOVERNMENT EMPLOYEE (NPS), GROUP-D

Service Year	DATE OF JOINING					
	1.4.2004	1.4.2005	1.4.2006	1.4.2007	1.4.2008	AVERAGE
20	7887	8568	9093	9630	10187	9073
21	8956	9716	10296	10889	11503	10272
22	10138	10983	11623	12277	12954	11595
23	11441	12381	13085	13805	14550	13053
24	12878	13920	14695	15487	16305	14657
25	14460	15613	16465	17334	18232	16421
26	16221	17497	18432	19386	20371	18381
27	18161	19571	20597	21643	22722	20539
28	20292	21848	22971	24117	25299	22906
29	22630	24345	25575	26829	28122	25500
30	25194	27081	28427	29798	31211	28342
31	28004	30078	31549	33047	34590	31454
32	31079	33358	34964	36600	38284	34857
33	34444	36945	38698	40483	42320	38578

Pension of the different categories of employees (i.e. Group-A, B, C and D) under the traditional or defined benefit old pension system (OPS) are shown in the Table 1, 3, 5 and 7. From these tables, we can say that amount of pension will be more than doubled if the employee retired after 33 years of service instead of 20 years though they are entitled to receive full pension benefit i.e. 50% of last salary (Basic plus dearness allowance). On the other side, Pension of the different categories of employees (i.e. Group-A, B, C and D) under the traditional or defined benefit old pension system (OPS) are shown in the Table 2, 4, 6 and 8 and the expected return from the pension fund of the concerned employees will be more than four times if they employee retired at the end of 33 completed years service in lieu of 20 years.

To test whether there is statistical difference between the pension benefits under the traditional old pension system (OPS) and the pension benefits under the new pension system (NPS)'t' statistic is applied.

TABLE 9:'t' test results

Group	Mean Pension		Standard error	t value
	OPS	NPS		
A	40681.2	42470.4	2836.74	-0.6307
B	32360	33271.2	2242.22	-0.4064
C	22854.8	23509	1589.21	-0.4116
D	20373.4	21116.2	1420.98	-0.523

Table 10: Decision Criteria (at 5% level of significance)

Group	Observed Value	Tabulated Value (two-tailed)	Decision
A	-0.6307	2.05	Accept Ho
B	-0.4064	2.05	Accept Ho
C	-0.4116	2.05	Accept Ho
D	-0.523	2.05	Accept Ho

5. Findings:

From the above tables (Table 9 and 10), we observe that the average pension (taking pension from 20 years to 33 years) under the New Pension Scheme is more than the pension under the Old Pension Scheme. However, the difference of the pension benefits under the both schemes is not more than 5%.

Applying the ‘t’ test at 5% level of significance, we can say that there is no significant difference between the pension benefits under the traditional old pension system (OPS) and pension benefits under the new pension system (NPS).

6. Conclusion

i) Pension under the old scheme (OPS) is a defined benefit scheme where the Government takes the obligation to pay the benefit available to the employees after retirement. Employees are not required to make any contribution to any fund and they are certain to get benefit from the employer.

ii) Pension under the new scheme (NPS) as introduced by the Central Government w.e.f 01.01.2004 and also most of the state Governments is a defined scheme. Under this scheme both employees and the employers are required to contribute 10% of the monthly salary to pension fund and the accumulated balance at the time of retirement is used to purchase annuity from the annuity providers. According to the nature of the pension fund as chosen by the employee, investment risk will be borne by the employee and the employer is only responsible to pay the contribution of the concerned employee to the fund.

iii) It is observed that pension under old scheme is protected against the inflation as pension amount is increased from time to time through dearness relief by the order of the finance department of the government from time to time. But there is no such provision under the new pension scheme.

iv) Employees retired before 31.12.2003 or before are eligible to receive full pension benefit (i.e. 50% of last salary drawn) after completion of 33 years’ of service. After implementation of recommendation of the Pay Commission, eligible tenure of service is reduced to 20 years’ from 33 years’. This change leads to increase of the benefit to the employees who are retired before the completion of 33 years’ service (between 20-32 years’) by 1.5% to 20%.

v) It is found that pension benefit of the employees retired after 20 years of service under old, defined benefit scheme is less than 50% of the pension benefit of the employees retired after 33 years.

vi) It is observed that pension benefit of the employees retired under old, defined contribution scheme after 20 years of service is almost 23.5% of the pension benefit of the employees retired after 33 years.

NPS is more profitable than the old DB pension system as the number of years of service is increasing. The expected return on pension wealth depends on the performance of the fund, types of fund as well as the overall performance of the market. It is risky in the sense that no one can assure about the amount of return at the retirement.

At the time of introduction of NPS, Government's expenditure towards pension will be increased in order to provide unfunded defined benefit pension to the employees who are not covered by the NPS and at the same time to contribute to the pension fund for the employees covered by NPS. Since New Pension System is a funded defined contribution scheme, liability of Government is limited to the contribution only (i.e. 10% of salary) and with the passage of time, total pension liability will be reduced. It also provides the self-employed personnel, employees of unorganised sector, etc. the scopes to grow a habit of savings for old age income security

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