Chapter 14

India's Social Security Systems : an Assessment

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CHAPTER 14

India's Social Security System: an Assessment

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1. Introduction

India is a federal country comprising 28 States and seven Union Territories. It gained independence in 1947. After following relatively inward-looking economic policies for several decades since gaining independence, India adopted an open-economy- open-society strategy of economic growth in 1991, with the aim of integrating with the world economy in a market-consistent manner (Kelkar, 2004).

As India addresses the challenges of the twenty-first century and manages its rise globally, constructing and implementing a modern social security system represents one of its 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.

This paper analyzes India's social security system, with primary focus on pensions or retirement income arrangements. It also discusses reform themes which the policymakers and provident and pension fund organizations may consider in improving the sustainability, coverage and resilience to economic and other shocks of the current system. The paper is organized as follows. In section II, a broad overview of macroeconomic, demographic and labor market trends is provided. This is followed by a discussion of India's current social security system and its various components in section III. As social security related services must be provided by organizations, this section also provides suggestions for improving their effectiveness. Section IV provides a brief overview of India's healthcare financing system. The final section suggests five broad reform themes designed to transform the current system into a system more appropriate for meeting India's social security challenges in the 21st century.

2. Macroeconomic, Demographic and Labor Market Trends

Since initiating the open-economy, open-society paradigm in 1991-1992, India has exhibited fairly satisfactory macroeconomic performance (Table 1). India's real GDP growth rate has accelerated, while inflation has been moderate. The per capita GDP increased 3.2 times between 1991-92 and 2008-09. The savings and investment rates, which stood respectively at 37.7 and 39.1 percent of GDP in 2008-09, have increased substantially. India's total trade in goods and services increased from USD 48.1 billion in 1991-92 to USD 632.4 billion in 2008-09, while the current account balance remained manageable. India's foreign exchange reserves and foreign direct investment have also increased many times since 1991-92.

Table 1. India: Selected Indicators of Macroeconomic Performance

Indicator	1991-92	2001-02	2008-09
Nominal GDP (Rs. Billion)	7018	12675	53218
Growth in Real GDP (%) (base 1999-2000)	1.1	5.2	6.1
Per capita Nominal GDP (USD)	312	459	1000
Inflation			
Wholesale Price Index – All commodities (Inflation in %)	13.7	3.6	8.3
Consumer Price Index- Industrial Worker (Inflation in %)	13.5	4.3	9.1
Domestic Investment (2007-08)			
Gross Domestic Capital Formation (% to GDP)	22.1	22.8	39.1
Gross Domestic Savings (% to GDP)	21.5	23.5	37.7
Foreign Investment			
Foreign Exchange Reserves (USD billion)	5.6	51.0	252.0
Foreign Direct Investment (USD billion*)*	0.1	6.1	35.2
Total Foreign Investment Inflows (USD billion)	0.1	8.2	21.3
Trade			
Exports of Goods and Services (USD billion)	23.3	61.8	286.4
Imports of Goods and Services (USD billion)	24.8	70.0	346.0
Net Invisibles/ GDP (%)	0.7	3.1	7.7
Current Account Balance/GDP (%)	-0.3	0.7	-2.6

Sources: Calculated from RBI (2009).

The past satisfactory performance however was achieved from a relatively low base and the reforms needed to achieve them were relatively un-contentious. Sustaining this economic performance will be more challenging however. The external environment is not likely to be as favorable for medium-term economic growth, and prospects for world trade have diminished as a result of the global crisis. Internally, further reforms are likely to be difficult particularly those involving agriculture, labor markets, and administrative and governance reforms.

India is currently in a favorable demographic phase, with the share of working age population in the total population expected to increase from 56.2 percent in 2000 to 64.4 percent in 2025, and to 65.0 percent in 2050 (Table 2). This trend is favorable for higher savings and for growth, but it creates two major challenges.

The first is to generate livelihoods for the larger numbers of young people joining the labor force. This suggests that creating livelihoods that are sustainable and match rising expectations, rather than attempting to merely preserve existing jobs, should be the focus of labor market and education policies. As India's total workforce as a percentage of the total population in 2009 was only 38.3 percent and is expected to increase over time, this challenge is expected to be even more acute.

The second challenge arises due to the pattern of employment. In 2009, about 85 percent of the 460 million work forces were either self-employed or engaged in casual employment (Table 2). Traditionally, social security programs have been predicated on the basis of a relatively stable employer-employee relationship. As the share of such employment is low, and is not expected to increase, extending social security coverage would be a major challenge.

Table 2. India: Select Labor Force and Demographic Indicators

Indicator	Time Period		
Life Expectancy at Birth (Years)			
Male *Female*	2005-2010		63.2 66.7
Life Expectancy at age 60 (Years)			
Male *Female*	2005-2010		16 18
Total Fertility Rate *(No. of Children)	2005-2010		2.76
	2005	2025	2050
Population (million) *Females (million)* *Males (million)*	1103.0 537.5 565.7	1431.3 696.3 735.0	1613.8 793.1 820.7
Sex Ratio *(males per 100 females)*	2005		105.2
Population above age 60 (million)	2005 2010 2050		87.5 100.8 329.6
Old Age Dependency Ratio *(%)* **	2005		15.6
Working Age Population (million)	2000 2025 2050		619.7 921.5 1048.2
Employment by Sector			
	2009		As % of population
Total Work Force (million)	460		38.3
Self Employed	261		21.8
Casual Workers	133		11.1
Regular Workers	66		5.5

Sources: UNDESA (2009); Handique (2009).
Notes: * Total Fertility Rate is defined as the average number of live childbirths over a woman's lifetime.

**Old Age Dependency Ratio is defined as $\frac{(population\ \ above\ \ 60\ \ years)}{(population\ \ 15-59\ \ years)} \times 100$

India's favorable demographic phase notwithstanding, it will experience a sharp increase in its elderly population from 100 million in 2010 to 330 million in 2050. The sheer number of elderly will pose formidable challenges in designing, administering, and sustaining social security schemes and programs. Even if India sustains the high growth rates experienced in recent years, its per capita income will still be relatively low by 2050. This implies not only that India must pursue policies which sustain high growth, but that the distribution of income between the young and the old, and among the elderly will need to be given due weight. The social and political management of ageing will therefore acquire considerable significance.

The sheer number of ageing people suggests that flexibility to meet differing needs of such a large number of elderly, and reversibility to ensure that the design or other errors are not too costly, acquire greater importance in the Indian context.

India's rapid ageing is due to declining fertility, and longer life expectancy. The Total Fertility Rate (TFR), which was 2.76 during 2005-10, is projected to reach the replacement level by 2020. Indeed, variations in the TFR among different regions and groups in the country are high, with some states, such as Kerala and Tamil Nadu already experiencing TFR below the replacement level (Government of India, 2001).

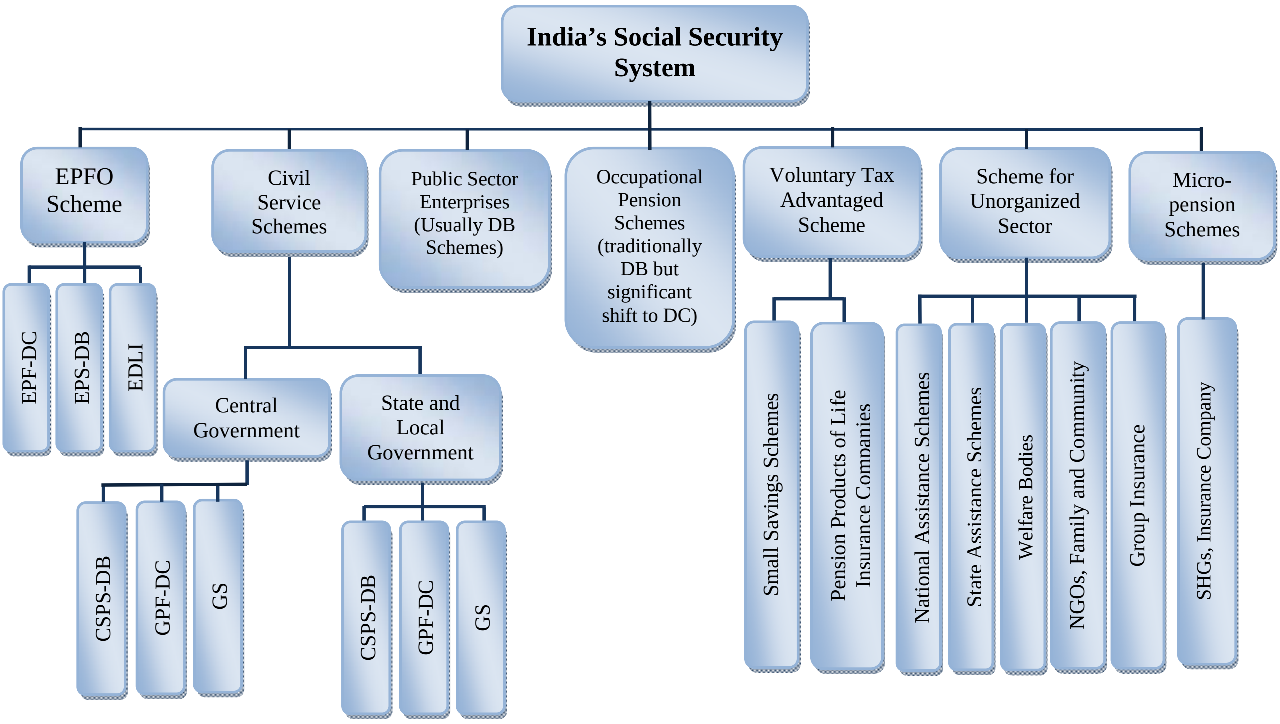
The life expectancy of people at age 60 between 2005-2010 was 16 years for males and 18 years for females respectively. This is expected to increase substantially. As women, as a group, have a longer life expectancy, feminization of the elderly, particularly those above 80 years of age, is anticipated. In conjunction with relatively low labor force participation, such feminization strongly suggests that the survivors' risks would need to be addressed.

The need for fiscal consolidation and flexibility constitutes another important reason for social security reform. Fiscal consolidation is essential to ensure that fiscal policies are consistent with macroeconomic and financial stability. India's combined public sector deficit exceeds 10 per cent of GDP, while total public debt, mostly internal rather than external, is around 85 per cent of GDP (RBI, 2009). This leaves very limited room for an expansionary fiscal policy to address social security needs. Fiscal flexibility requires that government expenditure and revenue raising methods and priorities be aligned to the prevailing economic strategies and goals. If a very large proportion of the expenditure is spent on items such as wages, pensions, and other current expenditure, there will less flexibility in reallocating expenditure towards growth and social cohesion-enhancing activities.

3. The Social Security System in India: An Overview

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

Figure 1A. 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

Table 3. Multi-Pillar Pension Taxonomy of the World Bank

Pillar	Target Groups			Main criteria		
	Lifetime poor	**Informal sector**	**Formal sector**	**Characteristics**	**Participation**	**Funding/ Collateral**
0	X	X	X	"Basic or "Social pension," at least social assistance, universal or means-tested. Example: **Old Age Pension Scheme**	Universal or Residual	Budget/general revenues
1			X	Public pension plan, publicly managed, defined-benefit or notional defined-contribution Example: **Non-Contributory Scheme for Civil Servants**	Mandated	Contributions, perhaps with financial reserves
2			X	Occupational or personal pension plans, funded defined-benefit or funded, defined-contribution. Example: **EPFO**	Mandated	Financial assets
3	X	X	X	Occupational or personal pension plans, funded defined-benefit or funded, defined contribution. Example: **Occupational Plans, Public Sector Enterprises' Pension Plans, Beedi Fund**	Voluntary	Financial assets
4	X	X	X	Personal savings, homeownership, and other individual financial and non-financial assets. Example: **PPF, Micro pensions, Saving-Insurance products from LIC.**	Voluntary	Financial assets

Source: Holzmann and Hinz (2005).
Note: The size of x or X characterizes the importance of each pillar for each target group.

The current system is able to cover at best around 20 per cent of the labor force under at least one of the social security schemes. The challenges arising from the 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.

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 reflect India's current economic needs and priorities to a very limited extent. The paper will argue that 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.

3.1. Select Components of India's Social Security System

3.1.1. Employees' Provident Fund Organization (EPFO)

The Employees' Provident Fund Organization (EPFO) was set up under the 1952 EPFO Act. It is an unusual national provident fund in three respects. First, it administers two separate schemes: *(i)* a defined contribution scheme (EPF) and *(ii)* 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.

The combined contribution rate for all EPFO schemes is 25.7 per cent of members' wages (EPFO, 2007), which is rather on the high side. The density of contributions (i.e. the ratio of actual to full working life contributions) of the EPFO members is not known. 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 half (4.4 per cent of the labor-force) were active contributors.

There appears to be a large actuarial deficit in the EPS. The recent actuarial reports of the EPS, which have not been made public (but should be), suggest that the deficit is in the region of INR. 250 billion. As a result, ad- hoc changes are being introduced in the DB scheme, such as the recent decision to end the commutation of pensions (which permits lump sum withdrawal of future pension benefits, subject to a limit). These however have inconvenienced the members.

Second, the organization combines the role of provident and pension fund administrator with that of a regulator of funds that are exempted from the EPFO Act.

This however applies only to the EPF Scheme. Those corporations seeking exemption from the EPFO are usually large with above average wage rates. The EPFO has a conflict of interest in granting liberal exemptions as the exempted funds could provide competition in investment allocation and management, and in quality of services provided to members.

The EPFO, for example, requires that the exempted funds allocate balances in exactly the same manner as the EPFO; and that they provide at least the same rate of return to members as the EPF. Such requirements mitigate against innovations in asset allocation strategies which could benefit the members.

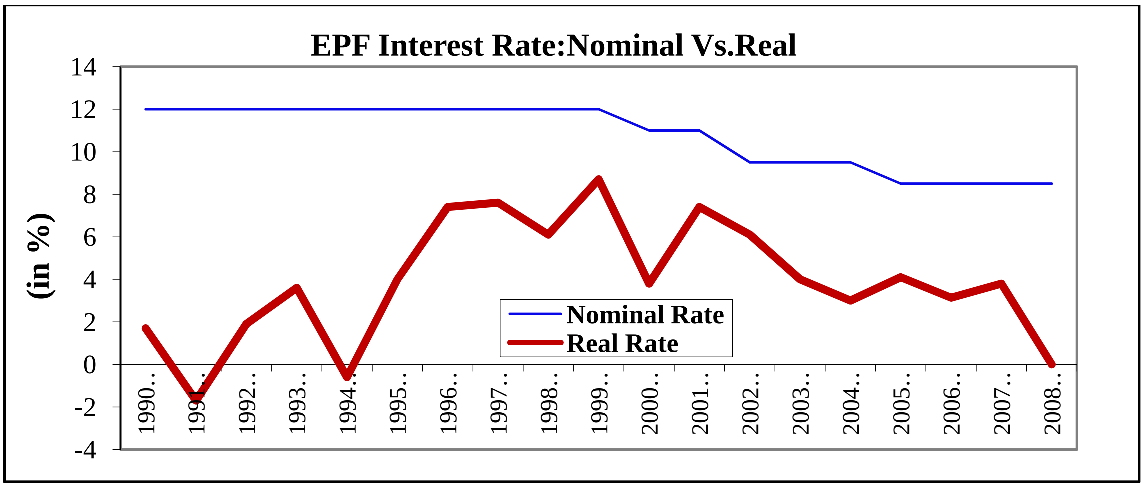
Combining the role of a major service provider and a regulator in one organization such as the EPFO is contrary to good governance practices. These roles need to be separated.

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). While its absolute size is large, relative to pension assets as a percentage of GDP the size of EPFO is quite small.

EPFO has made limited progress in modernizing its investment policies and performance. Its assets are primarily in public sector debt instruments. It has begun trading in debt instruments, and is considering investing in passive index-linked equity products. It has no development investment management expertise in-house, and therefore continues to out-source investment activities. Recently, some contestability has been introduced as investment managers are now chosen through a bidding process. This has the potential to reduce investment management costs.

The nominal interest rate on EPFO balances has been relatively stable, and has generally exceeded the returns from bank deposits, and government securities (Asher, 2010). The real rate of return, as measured by the nominal rate minus wholesale price inflation, has shown less stability (Figure 2). Estimates based on Figure 2 suggest that for the 1989-2009 period, the simple average of the real interest rate paid by the EPFO was 3.7 percent per annum; the corresponding rate being 3.9 percent for the 2000-2009 period.

Figure 2. EPF Interest Rate: Nominal versus Real



Source: Calculated from EPFO (2007) and RBI (2009).

While no official or other projections are available, it appears that 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, even when both the EPF and EPS schemes are combined.

The main challenges facing the EPFO are summarized in Box 1. There is recognition among the policymakers of the above challenges faced by the EPFO. But the progress in addressing them has been slow.

Box 1: The main challenges facing EPFO are:

- An unwieldy governance structure (a 45-member board, with the Minister of Labor 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 an 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.

3.1.2. *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 being 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 the ages of 18 and 55. It became operational on 1 May 2009. Voluntary NPS has limited pre-retirement withdrawal provisions and flexible contributions. The 2010 budget has introduced an initiative called 'Swavalamban' under which the Central Government INR 1000 per year to each Voluntary NPS Account opened in financial year 2010-11. This applies to only those accounts where the minimum annual contribution is INR 1000, and maximum is INR 12000. This scheme will be available for three additional years, and will be managed by the interim Pension Fund Regulatory and Development Authority (PFRDA).

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).

3.1.3. 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 PFRDA should be entrusted with supervision responsibilities.

3.1.4. 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.

3.1.5. Other Retirement Income Schemes

These include such schemes as: voluntary tax-advantaged schemes, schemes for the unorganized sectors (which are essentially social assistance and social pension schemes), and micro-pensions. As there are a large number of such schemes, the discussion, which follows, is brief and selective.

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. As 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 favorable tax treatment.

Social assistance and social pension schemes such as the Old Age Pension (OAP) scheme, financed jointly by the Center and the states, but administered at the state level are usually means-tested. However, their coverage is fairly low (10 to 15 percent of the target population), and the benefit levels are also fairly low (Vaidyanathan, 2005). These schemes need to be strengthened, in terms of the delivery mechanisms, better targeting and larger level of benefits.

An encouraging recent development has been the introduction of co-contribution schemes such as the Abhayahastham for women members of Self Help Groups (SHGs) in Andhra Pradesh; and the Vishwakarma Unorganised Sector Pension Scheme for low-income unorganized sector workers in twenty occupations in Rajasthan. Under these schemes, a member's contribution is matched, within limits, by the state. It is projected that under the Vishwakarma pension scheme a co-contribution INR 1,000 per annum for a member contributing an equal sum over a period of 25 years could result in a monthly pension of INR 1,275 per month which is significantly higher than the present Rs.400 paid under the tax-financed national old age pension scheme.

These schemes are utilizing more modern pension management practices, such as not permitting pre-retirement withdrawals; and electronic-based service delivery systems. As these are largely targeted at women members, they also help address the survivors' benefit and gender issues.

The efficacy of the social assistance and pensions as well and co-contribution schemes depends on the fiscal capacity of the Center 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.

3.2. Schemes for the Unorganized Sector

In 2006, the National Commission for Enterprises in the Unorganized Sector (NCEUS) published a Report which advocated a comprehensive social insurance-based, government run program covering health benefits (hospitalization, sickness allowance, maternity benefits, life insurance, and provident fund, with provision for non-contributory pensions for poor elderly workers).The Report set an ambitious task of covering 300 million workers over 5 years, that is, 60 million individuals per year. The NCEUS Report has been criticized for its limited appreciation of the administrative tasks involved in covering such a large number of individuals in a short period; a lack of detailed actuarial projections of various insurance schemes; and the vague nature of financing sources, and their sustainability (Asher, 2010).

Parliament passed the Unorganized Sector Workers Social Security (USWSS) Bill in 2008. The Bill provided only a broad framework and substantially limited the coverage. It also did not provide funding sources. The progress in effective implementation of the Bill is expected to be gradual and limited. To supplement social protection to the unorganized sector plans to establish a National Social Security Fund (NSSF) with an initial allocation of INR 10 billion was announced in the 2010-11 Budget.

India has also experimented with various welfare funds, which provide social security benefits, organized by occupations. The Beedi[1] Workers' Welfare Fund Act passed by the Parliament in 1976 covering around 4 million workers is among the most prominent of such welfare funds.

3.2.1. Micro-pensions

There has also been progress in developing micro-pension schemes (Shankar and Asher, 2010). A typical micro-pension scheme is based on voluntary savings, accumulated over a long period and intermediated through financial and capital markets by a professional fund manager. The total amount accumulated depends on contributions (less permitted pre-retirement withdrawals), and investment returns net of administrative, investment management and other expenses. At an agreed-upon withdrawal age (usually 58 or 60 years), the accumulated balances can be withdrawn in a lump sum, a phased withdrawal, annuity or a combination of these methods

Their combined membership of these schemes is around two hundred thousand. In contrast, it is estimated that about 35 million individuals have benefited from micro-finance schemes, primarily through self-help groups (SHGs). While the short-term

[1] Beedis are indigenously hand rolled cigarettes.

nature of SHG activities, and relatively short life span of most SHGs are not directly comparable to the long-term nature of the micro-pension schemes based on individuals, the members of the SHGs are potential customers for micro-pension schemes. The pension scheme involves contributions ranging from Rs. 50 to Rs.100 per month per member.

The contributions must be made until age 55 and the pension payments begin after age 58. The savings are pooled by the Bank and transferred to UTI Mutual Fund for investment management. Each member has a pension account with the SEWA Bank, which regularly provides information about the pension accounts. It appears that the accumulated amounts will be insufficient for substantial annuity purchases. Therefore other options such as phased withdrawals may need to be considered.

Micro-pensions have the potential to play a limited role as one of the methods for financing old-age. The extent of their potential will depend on the following factors.

First, in the accumulation phase, minimizing the transaction costs associated with record-keeping, payment of benefits, communication to members, and investment policies and management should be given due emphasis. Second, in savings-based micro-pension schemes, investment, macroeconomic and other risks are borne by the individual. Risk-sharing arrangements have therefore been often advocated, although longevity and inflation risks will have to be addressed. Third, arrangements during the pay-out phase need to be carefully considered while 40% lump-sum withdrawal of the accumulated funds appears realistic. Fourth, micro-pensions represent a long-term financial contract, with potential for significant agency problems, and systemic risk to the financial system.

To make micro-pensions more attractive, considerable innovation which enables provision of goods and services to the poor at a fraction of the cost to the middle and high-income groups should be applied to micro-pensions. This will require that organizations involved in the micro-pension industry are able to benefit from economies of scale and scope.

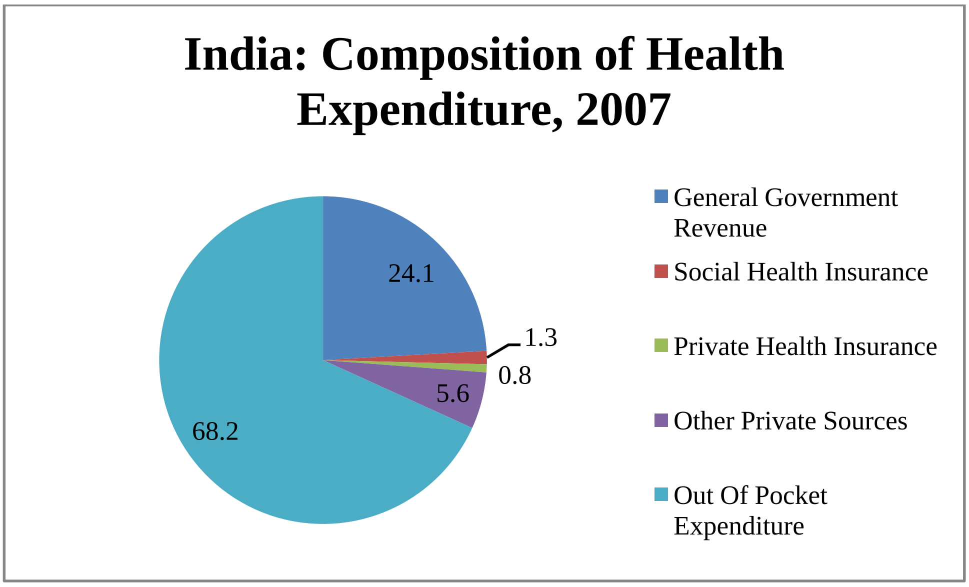
3.2.2. Reverse Mortgage

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 to this scheme has been relatively limited.

4. Health Schemes: A Brief Overview

Healthcare in India is largely financed by private out of pocket expenditure. In 2007, more than 70 percent of health expenditure was financed out of pocket, while private and social health insurance accounted for only two percent of total health expenditure (Figure 3). Gupta and Trivedi (2005) estimate that in 2005 health insurance covered roughly 85 million individuals, or approximately 20 percent of India's labor force. Even this limited coverage does not adequately reflect the limitations of India's health schemes. This is because the range of illnesses covered is limited, and the quality of healthcare for many individuals is relatively low.

Figure 3. Composition of Health Expenditures in India, 2007



Source: Calculation by authors based on data from WHO (2009).

The Employees State Insurance Scheme (ESIS) is a health insurance scheme for workers employed in the formal sector. The ESIS was set up in 1952. Members contribute 1.75 percent of their basic wage, and employers 4.75 percent. As of March

2006, ESIS provided healthcare protection to approximately 35 million beneficiaries, or roughly three percent of India's population. The quality of healthcare facilities managed by the ESIS is perceived to be in need of substantial improvement. This limits its ability to extend coverage and provide competition to private sector healthcare providers.

There have been several initiatives to extend the coverage of community-based health insurance in rural India. These include the National Rural Health Mission (NRHM) implemented in 2005, and the Rashtriya Swasthya Bima Yojna (RSBY) implemented in 2008. RSBY covers expenditure associated with secondary care, whereas the NRHM covers basic illnesses and primary care.

The NRHM, launched in 2005, aims to improve (i) Infant Mortality Rates, (ii) Maternal Mortality Rates, and reduce the (iii) Total Fertility Rate. The NHRM has focused on increasing rural public health spending to improve infrastructure, train and skill requisite professionals, and decentralize the delivery of primary healthcare in rural India (Desai, 2009). These measures may bring about greater choice and contestability in the health sector.

The RSBY is a government financed health insurance scheme for families identified as being below the poverty line (BPL). Households enrolled in RSBY are eligible for healthcare benefits at accredited public and private healthcare providers of up to INR 30,000 each year. As of March 2010, 13 million BPL households have enrolled in the scheme.

Relatively low reach and quality of services in the public sector remains a major constraint on accessibility, and in managing costs through effective competition for the private sector providers. Limited health insurance coverage by the insurance companies has contributed to a continuing large proportion of national health expenditure being financed out of pocket by households.

5. Reform Themes

Many of the specific reform measures concerning EPFO, civil service pensions and other components are implicit in the preceding discussion. It is suggested that social security reforms in India be organized into the following five reform themes. Such reforms will enable India to gradually transform its current social security system, which is characterized by low coverage and inadequate replacement rates, into a more broad-based system with improved and more secure replacement rates.

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 the Labour and other Ministries from a welfare orientation to a professional-technocratic service provider 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 unpredicted 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 amongst 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 Telphone Nigam Limited (MTNL), a public sector telecom firm, has requested that the government 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 the private sectors, reflects insufficient expertise, autonomy, transparency and accountability in their operations. This needs to be urgently addressed by NSSC and a 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 labor 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 favor of more robust social pensions 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, 2009).

The fourth theme concerns the health sector. The key goals should be accessibility, affordability, managing costs, and reforming public sector health institutions to enable them to provide effective competition to the private and not-for-profit sectors. As with pensions, health insurance schemes need to be sustainable for a prolonged period, and avoid falling prey to the tyranny of small numbers where by a seemingly minor change in parameters can significantly affect the financial viability of the scheme. The need for greater professionalism in designing health policies and managing health institutions is an imperative for India.

The fifth 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 programs relating to pensions, health policy and management, and actuarial sciences.

Each of the above five 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 will be limited. 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 favorable 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.

For substantive sustainable social security reform in India, a change in mindset from provider-producer interest dominance to consumer/customer/citizen-centric procedures and attitudes is essential. Different components of India’s social security system are likely to move in this direction at an uneven speed and with varying levels of effectiveness.

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