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Pension reforms for an ageing society

A CHANGING demographic profile, increased longevity are leading us towards an ageing society. According to the UN, India is going to be the most populous country of the world by 2050 with a population of 1,755.2 million. The number of elderly population will grow accordingly and the population of those aged 60 and above will be 21%, while persons aged 80 and above will be 15% of the total population. The existing pension system in India covers only about 11% of our labour force, mostly in the organised sector. Further, pensions for civil services and public sector are unfunded defined benefit pension, which cause severe strain to the exchequer. Pension liability of the central government as a percentage of revenue expenditure has increased from 2.91% in 1990-91 to 3.81% in 2008-09, while that of state governments increased from 4.49% to 9.09% in the same period.

To tackle the potential socio-economic problems originating from increased longevity, the government of India has initiated social security and pension reforms and launched NPS from January 1, 2004.

The Indian pension reform model can be termed as Semi-Systemic Model (SSM), which retains the defined benefit system for existing employees and adopts a defined contribution system for new recruits.

There are two major pension reform models being followed world over. One, Parametric Reforms Model (PRM) which retains the basic structure of defined benefit system but introduces parametric changes to enhance pension entitlement by increasing retirement age, rate of contribution, revaluation of past earnings, etc. The OECD countries follow PRM.

The other model is Systemic Reform Model (SRM) which usually replaces defined benefit by funded defined contributions. Beginning with Chile, countries such as Mexico, Argentina, Peru, Bolivia, etc. in Latin America, and Hungary, Poland and Sweden in Europe have switched over to defined contribution pension from defined benefit system.

One common instrument, irrespective of the reform model, is to increase the retirement age for pension entitlement. Though pushing the retirement age upward is essentially an ingredient of Parametric Reforms Model, it is being gradually incorporated in the Systemic Reform Model because of the long-term positive impact. Since longevity throughout the world, irrespective of the level of development, has increased significantly, increasing the age of retirement has become a necessity rather than a mere deferment of pension burden as often seen. When a person is living for 80 years and above, early retirement, say at 60, suddenly stops his/ her contribution to organisational growth, and results in a loss of experienced and skilled manpower. The lower pension entitlement can be reversed to some extent by increasing the working age by extending the age of retirement. Higher retirement age is also a boost to domestic savings since the propensity to save is higher than to consume at higher age. This also provides relief to exchequer, though temporarily, allows the government to channelise funds for development work to boost growth. Higher retirement and pensionable age thus have found favour not only in developed countries but also in emerging economies such as Chile, Argentina, Brazil, Poland, Greece which are not that burdened with aged population and face shortage of labour.

Retirement age in OECD countries such as Austria, Australia, Germany, Denmark, Japan, Britain, etc. is 65 years, while in Norway and the US, it is 67-70 years. In emerging countries such as Chile, Argentina, retirement age for male is 65 years and for female 60 years, in Hungary it is 62 years. In Hungary, the government is planning to pass a legislation to increase the retirement age to 64 for women and 65 for men by 2020, and then to 68 for women and to 69 for men by 2050. In Colombia, retirement age will increase from 60 to 62 for men and from 55 to 60 for women by 2014. This indicates that retirement age is a concern and needs to be planned well in advance keeping in view the changing dynamics of population profile and increasing pension burden on exchequer.

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Views expressed are personal