

A Review - Comparative Study of Old and New Pension Scheme

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Abstract

Now the days the people are striking showing aggression on new pension scheme and revolting against the decision of government to take back the new pension scheme. The daily newspapers are filled with news of pension. These newspapers ignited me to understand and compare the new and old pension policy and whether it is possible for the government to adopt the old pension scheme and at what cost. In this paper I will try to analyse and compare the pension policies and their impact on both pensioners and the government too.

Keywords: Pension, Scheme, Retirement

INTRODUCTION

The Britishers were the first to introduce and implement the pension system in India in 1857. The Britishers use to provide the pension to Indian kings and compel them to collect the fund of pension from the public. The Indian pension act was passed in the year 1871 to overcome the problems and complexities of pension system in India [1]. The government typically classifies pension schemes into hybrid, defined contribution, and defined benefit plans [2]. In a defined benefit plan, the benefits are predetermined based on the employee's final or average salary, and these benefits are guaranteed by the government. On the other hand, in direct contribution plan have no component of guarantee. The benefit of pension is totally based on the performance of the pension fund generated by employee himself and with the contribution of government at a pre specified rate [3]. Hybrid pension plans provide either a guaranteed benefit or a minimum return, with the possibility of offering a variable benefit beyond the guaranteed minimum [4].

In blended pension plans, employees may accumulate two types of benefits simultaneously: a portion of their salary may be covered by a defined benefit component, while the income exceeding that amount is subject to a defined contribution component [5]. Self-annuitizing direct contribution arrangements function like defined contribution schemes until retirement. At that point, the accumulated funds are converted into a pension income according to a pre-defined process outlined in the plan's rules, rather than at market rates [6]. The pension payments are then made from the plan. Underpin schemes combine elements of both defined benefit and defined contribution plans. Upon retirement, employees receive the greater of the benefits calculated by both methods. In a cash balance plan, employees receive a lump sum at retirement, similar to a traditional defined contribution plan, which is then converted into annuity payments. However, the funds in the employee's account are linked to returns on the original investments, which may be guaranteed, smoothed to avoid significant fluctuations, or subject to policy changes. This can make employee benefits somewhat more predictable. Fixed benefit or benefit unit schemes are defined benefit plans where the pension amount is fixed annually and does not vary with earnings [7].

From a sponsor's perspective, defined contribution plans offer several advantages over defined benefit plans. First, in defined contribution plans, the pension responsibility is shared between the sponsor and the employee, whereas in defined benefit plans, the sponsor typically bears the entire pension burden [8]. Second, investment risk—stemming from poor asset performance—is assumed by the plan member in defined contribution plans, while in defined benefit plans, the sponsor takes on this risk. Third, longevity risk—associated with outliving one's assets—is carried by members in defined contribution plans, whereas the sponsor manages this risk in defined benefit plans. Lastly, calculating financial obligations is simpler in defined contribution plans, as the sponsor's liability is limited to the defined contributions. In contrast, defined benefit plans involve more uncertainty for employers, especially if capital market conditions are worse than expected or if retirees live longer than anticipated [9].

An alternative to defined benefit and defined contribution plans is the Collective Defined Contribution (CDC) plan. These plans aim to provide defined benefit-like outcomes while offering flexibility without a full guarantee. In a CDC plan, assets are pooled rather than allocated to individual accounts, and both investment and longevity risks are managed collectively. A key advantage of this approach is the smoothing of mortality and longevity risks, where individuals who die earlier in retirement help subsidize those who live longer [10].

There has been a global shift from defined benefit to defined contribution schemes, with many employers adopting this change when feasible. According to the IMF (2019), employers are progressively transitioning from defined benefit plans to defined contribution plans, though the pace and extent of this shift may differ among advanced economies [11].

States' Pension Outgo

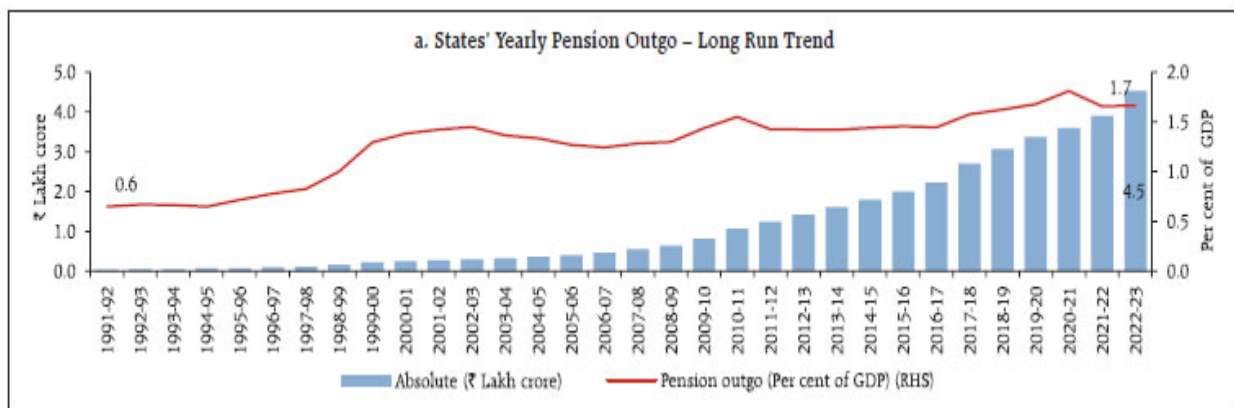


Fig.1 Source: RBI publications [12]

The above figure 1 clearly shows that in the year 1991-92 the proportion to pension to GDP was only 0.6 percent which is increased to 1.7 percent of the GDP.

Old Pension Scheme

In India, government pensions are categorized into the Old Pension Scheme and the New Pension Scheme. The Old Pension Scheme is a defined benefit plan where employees receive a fixed pension amounting to 50% of their last drawn salary, along with an allowance to offset inflation. The pension payout is fixed with no deductions from the salary, meaning the entire pension burden falls on the government.

New Pension Scheme

A person who served the central government is required to serve for a minimum period of 10 years to be eligible for pension. As far as family pension is concerned the widow was entitled to receive the pension on completion of one year service of her spouse.

Pension is calculated on the basis of emoluments drawn during the last 10 months of the service. Emoluments may last basic pay or average basic pay whichever is more. The amount of pension is 50% of the emolument or average emoluments whichever is higher. Presently minimum pension is rs. 9000 per month and maximum limit is 50 % of the highest pay. It is payable up to the date of death.

OLD AND NEW PENSION A COMPARISON

1. Financial Burden

- **Old:** The burden of pensions falls entirely on the government. This can be financially challenging, especially with increasing life expectancies and inflation.

- **New:** The financial responsibility is shared between the employee and the government. Employees have more control over their contributions and investment choices, potentially reducing the government's long-term pension liabilities.

2. Pension Security

- **Old:** Provides a guaranteed pension based on the employee's last drawn salary, offering greater security but posing a higher risk to the government's finances.
- **New:** The pension amount is not fixed and depends on the contributions and investment returns. This means greater variability but allows for potentially higher returns.

3. Risk Allocation

- **Old:** The government assumes all risks, including investment and longevity risks. This can lead to increased financial pressure on public finances.
- **New:** Risks are primarily borne by the employees. They face the uncertainty of investment returns and longevity, which can affect their retirement income.

4. Administrative Efficiency

- **Old:** Typically involves less administrative complexity as pensions are fixed and centrally managed.
- **New:** Requires more administrative oversight due to varying contributions, investments, and the need to manage multiple accounts.

5. Impact on Employees

- **Old:** Employees benefit from predictable pension payments and inflation protection but may lack flexibility in managing their retirement savings.
- **New:** Offers flexibility and control over investment choices, with the potential for higher returns. However, the lack of a guaranteed pension can be a drawback for some employees.

Table 1. Comparative Analysis

BASIS	OLD PENSION SCHEME	NEW PENSION SCHEME
Employee Contribution	ZERO	10% of basic+ DA
Employer Contribution	100%	10/14% of basic+ DA
Pension	50% of basic+ DA or average earnings in last 10 months.	Based on accumulated.
Burden on exchequer	Entire pension corpus	10/14% contribution to NPS.

Cause for emergence of new pension scheme

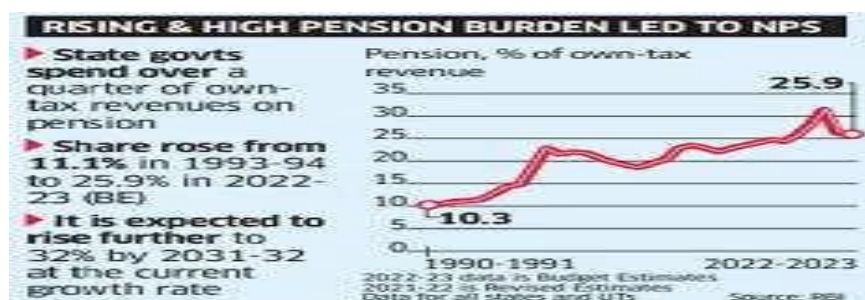


Fig.2 Source: RBI publications [12]

The state government spend approx. one fourth of their incomes on the pensions which was this share was 11.1% in the year 1993-94 and increased to 25.9 percent in 2022-23 (BE) and it is expected to rise to 32% by 2031-32 at the current growth rate. So, it is clear that if government decides to go back to old pension scheme the expenses will increase and finally the deficit will also increase which is shown in Figure 2.

Benefits of New Pension scheme in long run



Fig.3 Source: RBI publications [13]

The figure 3 represents that the liability of the government is limited that is their contributions to new pension scheme. How much pension is required to live a happy and healthy life is to be decided by the

employee himself so he can deposit the amount which he thinks fit by adjusting his working life. In this scheme the employees have to pay the 1 percent of the basic plus dearness allowance and Centre government can raise their share as and when required to support the pension fund as it raised its share to 14% in the year 2019.

Projected Pension outgo (discounted) under NPS versus OPS for a single cohort of Employees

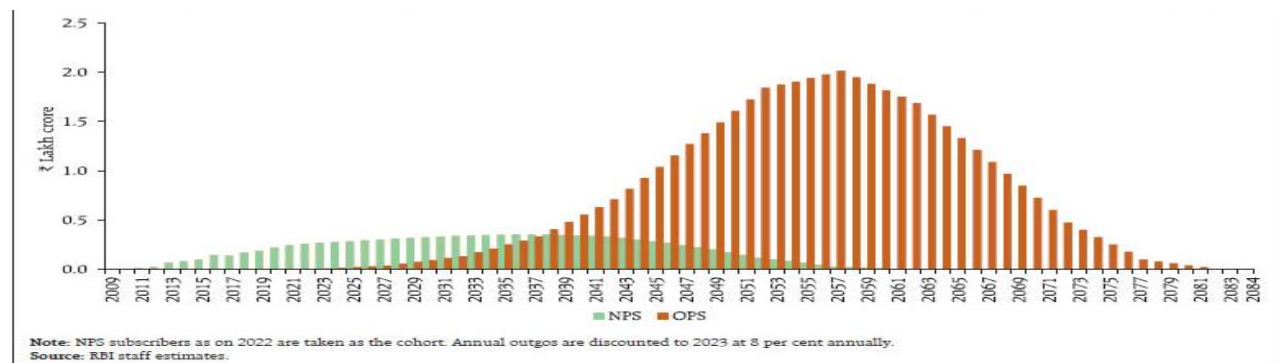


Fig.4 Source: RBI publications [13]

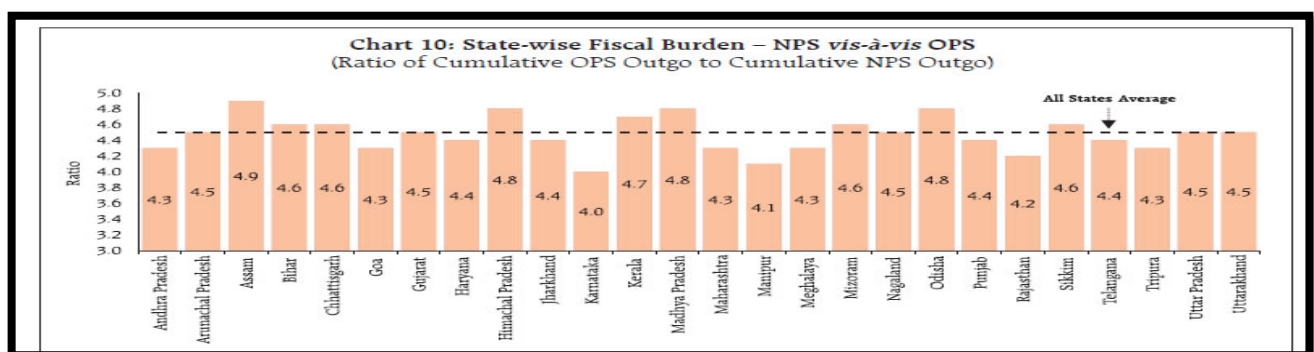


Fig.4.1 Source: RBI publications [13]

Figure 4 and 4.1 shows the burden on the government in the old and new pension scheme. The data indicates that the ratio of the present value of the total burden under the Old Pension Scheme to the present value under the New Pension Scheme will, on average, increase by approximately 4.5 times if states opt to switch from the New Pension Scheme to the Old Pension Scheme over the period from end-March 2023 to end-March 2084.

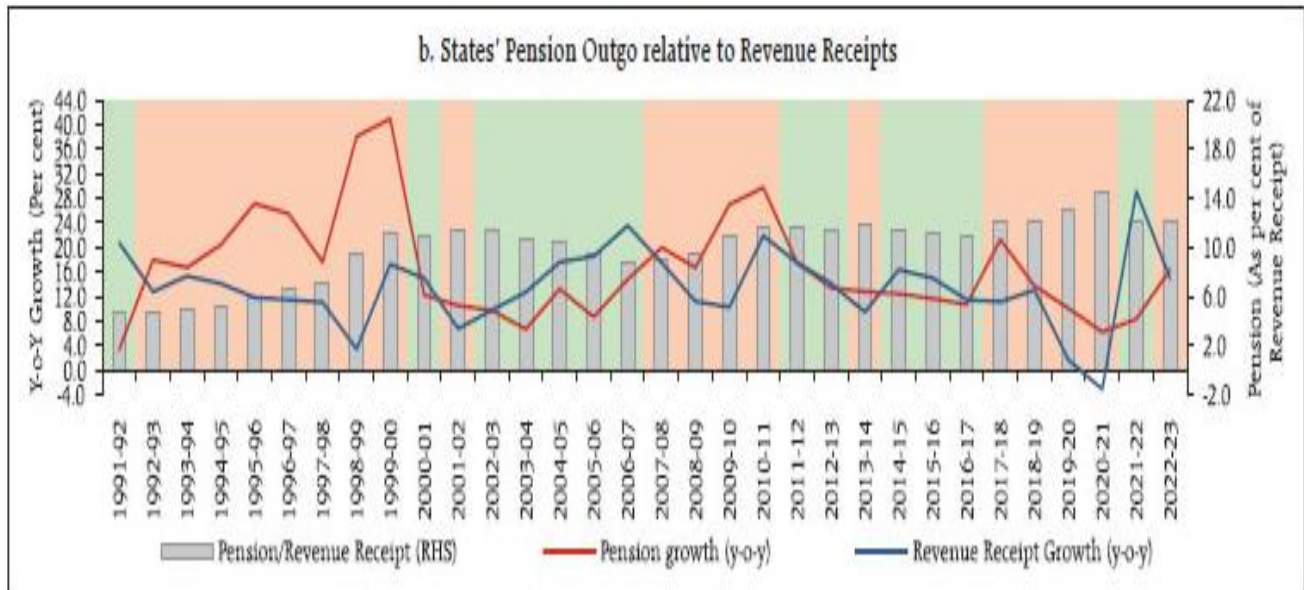


Fig.5 Source: RBI publications [13]

It is clearly depicted in the figure 5 that the revenue receipt from 1991-92 to 2002-03 is comparatively lower than the pension expense and while moving forward in this graph the difference of pension expense and revenue is reduced to the significant level from 2002-03 and this trend led to the increase in the revenue and decrease in the expense of pension.

Conclusion

It is concluded from the article that before introduction of new pension scheme the central and state governments were overburdened with the expenses of unilateral payments that means the payments without work. Government tried to reduce the burden of unilateral payments by introduction new pension scheme but some of the state governments are promising to move back on the old pension scheme which will again increase the expense of the governments. The governance has to understand the what additional sources of revenue can be explored to bear the increased burden of pensions.

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