OPS, NPS, GPS: The real pension reform is missing

Pensions must be rationalised to ensure inter-generational, intra-generational equity. But that means subjecting largesse of OPS to scrutiny

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Almost two decades after its adoption for only new civilian workers, there is a growing realisation that not only did the strategy on pension system reform push rectification to a distant future date but worse, by placing the cart before the horse, it ratcheted up the drain on public expenditure. Some observers believe that the assurance of **reversion** to the **old pension scheme (OPS)** in **Himachal Pradesh swayed the election verdict** in favour of the winning party. More recently, there is renewed interest in an April 2022 proposal on a guaranteed pension scheme (GPS) of the **Andhra Pradesh government.**

In India, the evolution of policy, its evaluation or reform have rarely been subjected to analytical rigour prior to making a political public announcement. Introduction or remission of programmes is a fait accompli. One may argue that a promise on reversion to OPS may likely play a significant role in election outcomes only for hill states or special category states where public sector employment is more predominant.

Yet, that would hardly prevent contesting parties in all states from including it in their manifestos. But that would be another missed opportunity to introduce rigour in the debate on pension reforms.

This article describes the OPS and the retirement benefits accruing to its members. It then highlights the differences in administration and benefits for government workers in the new pension system (NPS) and GPS to suggest reprioritisation of the reform agenda.

OPS is administered as a defined benefit (DB) system and expenditure on pensions is an intergenerational transfer from the relatively young (workers) to the relatively elderly (retirees). While it is often a political claim, juridical interpretation underlines such transfer as deferred compensation for service rendered. Pension benefits are formulaic, based on the consideration for eligible pay (the sum of basic pay and dearness allowance averaged for the last 10 months immediately preceding superannuation) and qualifying/eligible service rendered. The formula was configured to replace up to 50 per cent of eligible pay upon superannuation for a period of qualifying service not less than 33 years. For qualifying service of less than 33 years, the formula yielded a proportionately lower (than 50 per cent) replacement rate. Moreover, there are rules on (a) minimum service contribution, (b) minimum benefit, (c) eligible survivors, and (d) proportion permissible for each eligible survivor, among others. Unless faced with compelling reasons, deferred compensation was to be paid periodically (monthly) until death (of member and/or survivor). Further, its value is fully (100 per cent) indexed to revisions in the general price level and wages. Upon reaching the age of 80, the recurring benefit for a member pensioner is ratcheted-up (from 50 per cent) to 60 per cent replacement, and thereafter raised by 10 per cent every five years.

In addition to the monthly component, at the time of superannuation, a fresh retiree is entitled to one-time (terminal) benefits that include gratuity, encashment of (maximum 300) unavailed earned leaves and the option for a proportionately reduced pension from lump sum withdrawal by commuting up to 40 per cent of the monthly pension, with its full restoration after 15 years. Note that all the components of retirement benefits are assured and risk-free for an OPS member.

Civilian recruits (joining service on or after January 1, 2004) both at the federal and sub-national levels, were directed to the new pension scheme (NPS) based on a defined contribution (DC) design. Two distinguishing attributes of NPS are: One, pensions during retirement were to be essentially pre-funded, involving investments of mandatory or voluntary and incentivised savings from income during working years. Two, dissolving attributes of indexation (inflation or wage) and risk-free assurance of recurring benefits. It is easy to see then that as compared to an OPS member, for an NPS member the value of the lump-sum withdrawal component of terminal benefit also becomes uncertain. Only the gratuity and leave encashment components are assured.

Only sketchy information is making the rounds in popular media on contribution, employer co-contribution, and replacement rate in the GPS proposal of the Andhra Pradesh government. But, essentially it is an attempt to restore assurance in the recurring benefit (and thereby the lump-sum withdrawal component). Apparently, the GPS is in the class of hybrid DC-DB plans, and notably in 2002, prior to the government's draft culminating in NPS, a high-level expert group on pension reforms (chaired by B K Bhattacharya) had also proposed a hybrid DC-DB plan for government servants. Moreover, the pension component of the Employees Provident Fund Organisation, Coal Mines Provident Fund, and Assam Tea Plantations Provident Fund are hybrid plans.

The drumming-up of virtues of a DC-based pension system for new workers in government, drowned out the call to urgently cap spiralling public expenditure on OPS retirement benefits of ex-workers. The simultaneous operation of both OPS and NPS constricted the resource space for the latter. Unsurprisingly, the reform failed to widen pension coverage for the vast majority that remains excluded. Further, it introduced segmentation of workers that contributed to lower employment in the public sector.

The expectations of government workers from a pension system (whether NPS or GPS) are essentially anchored to retirement benefits assured for an OPS member. A correction in such expectations and the rapid rise in the expenses on OPS members' retirement benefit, both call for a detailed investigation. A careful assessment reveals elements that clearly constitute a largesse and an overreach on the objective of creating an old-age income support system. These are either absent or declining in much of the world. They include: Lump sum commutation of unfunded pension, restoration of such commutation, the ratcheting-up of replacement rate for the very old, 100 per cent wage indexation, benchmarking of replacement to only peak earnings, and encashment of unavailed leaves. Individually and collectively, these elements distort the incentive for government jobs and subsequent effort at work. For example, the encashment of leaves negates work-life balance. Further, these result in a significant difference in compensation for equivalent roles and adversely impact both inter- and intra-generational equity. Reforms must begin from a rationalisation of largesse in the design of retirement benefits and harmonise these deftly along a glide path for all, to avoid workforce segmentation.