OPS raises concerns about fiscal sustainability and intergenerational inequities.

Balamuraly B and Lekha Chakraborty || April 5, 2023

In the post-pandemic fiscal strategy of State finances, the fiscal risks emanating from revenue uncertainties, high percentage of committed spending and increasing subsidy burden have a crucial significance for long-term fiscal sustainability. The Reserve Bank of India (RBI) report on State Finances, released in January 2023, has flagged the fiscal crisis in Sri Lanka as a stark reminder of public debt dynamics and how we finance our deficits. To add to these fiscal tensions, States like Rajasthan and Chhattisgarh have opted to switch to the Old Pension Scheme (OPS), and Punjab has followed suit. In addition, certain political parties are including the reinstatement of the OPS in their election promises. How far are these promises sustainable?

What is the fiscal space for the OPS? Should States design the OPS or more broad-based social security measures with identified fiscal space? Only government employees, who form barely 2% of India's population, stand to benefit from the OPS. The OPS guarantees government employees 50% of their final drawn pay plus Dearness Allowance (DA) as a post-retirement income for life, and 50% of that pension to any qualifying dependent family members in the event of death of that employee. The OPS income that the recipient gets is not subject to tax. There continue to be concerns that the OPS would soon become financially unsustainable because there is no means to fund the growing pension liability with the existing tax buoyancy.

Looking ahead

Given the demographic transition, there is high likelihood that governments' pension obligations would increase even more in the future. This would occur as a result of an increase in life expectancy, periodic increases to the DA, and the linkage of pensions to current salary levels. It incentivised early retirement since the pension was based on the final wage earned. This early retirement caused the government to underutilise its personnel resources. The Old Age Social and Income Security (OASIS) initiative was launched in January 2000 with the aim of reforming the pension system to include the unorganised sector. A high-level expert group (HLEG) headed by B.K. Bhattacharya was established after that, and it made a recommendation for a hybrid contribution pension plan for government workers. In 2004, the government implemented the New Pension System for all government workers, as envisioned in the OASIS project.

The New Pension Scheme (NPS) is a scheme in which employees pay to their pension corpus from their salary, with the government matching their contributions. NPS contributions are handled by professional fund managers, such as LIC, ICICI, etc. The NPS enables subscribers to choose their preferred fund manager and investment choice, including a 100% government bond option. When the employees retire, they receive 60% of the corpus tax-free, while the remaining 40% is invested in annuities, which is taxed. There is no General Provident Fund (GPF) benefit, and the pension amount is not fixed. Unlike the OPS which was limited to government employees, the NPS permits all Indian citizens (including NRIs) between the ages of 18 and 70 to participate.

NPS vs OPS

Despite the benefits of the NPS, including the freedom to choose pension funds and investing patterns, the lowering of government retirement obligations, and greater returns than traditional instruments like the Public Provident Fund (PPF), some governments and employees are keen to return to the OPS. This is because employees are concerned that the new NPS would not provide the same advantages as the OPS. Due to market volatility, they feel their money will not be secure in the hands of fund managers, and their pensions may be reduced. It also leaves the employees with less disposable income as they too have to contribute under this scheme. In contrast, under the OPS, the government bears the entire expense, while workers get a higher discretionary income and a pension guarantee. Given the growth in salary and other advantages given by the private sector, in the future the unpredictability of the NPS may dissuade many talented individuals from entering the government sector. Some experts also refer to it as a populist move since employees are a vocal and influential lobbying group. They also execute government policies and programmes, therefore widespread dissatisfaction among them might have a negative effect on the outcomes.

Can the OPS be sustained? In 2004, researchers at Indian Pension Research Foundation calculated the estimated implicit pension debt (IPD) to around 64% of India’s GDP. As per a report published by Asian Development Bank (ADB), the civil service pension programme's annual fiscal cost increased from less than $0.5 billion in the 1980s to about $30 billion in 2012. During the period from 2007-08 to 2013-14, the Seventh Central Pay Commission reports a three-fold increase in pension expenditures. It further claims that the government’s contribution for the OPS (excluding Railways) has steadily increased from ₹924 crore in 2011-12 to ₹1,200 crore in 2012-13 to ₹1,600 crore in 2013-14.

The issue of fiscal sustainability of the OPS is also highlighted by the RBI report on State Finances (January 2023). The States with the largest debt based on the debt-to-GDP ratio in 2020-21 are Punjab, Rajasthan, Kerala, West Bengal, Bihar, Andhra Pradesh, Jharkhand, Madhya Pradesh, Uttar Pradesh and Haryana. These 10 States also account for over half of all State government expenditures in India. Among highly debt-ridden States such as Haryana, Uttar Pradesh, West Bengal, Kerala and Punjab, committed spending, which includes interest payments, pensions and administrative expenditures, accounts for over 35% of total revenue expenditure. This reduces the fiscal resources required to undertake developmental expenditure. In the 10 States, pension spending alone amounts for 12.4% of total revenue expenditures (on average from 2017-18 to 2021-22) and it is predicted that the pension outlay will remain between 0.7% and 3.0% of GSDP through 2030-31. To make matters worse, own tax revenue has declined in states viz., Madhya Pradesh, Punjab and Kerala, and non-tax revenue in most States has declined sharply in the recent years. Therefore, in addition to fiscal sustainability issues, implementing the OPS will also trigger intergenerational inequities.