The Indian pension reform

Ajay Shah

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Initial conditions

- Civil servants pension
- Mandatory for large private firms: EPFO
- Vast unorganised sector.

Part I

The design phase

How it began

- A World Bank conference in Goa, 1995, organised by Jim Hanson and Sanjay Kathuria
- Asked Shankar Acharya "Who in India works on pensions?". Anand Bordia, then JS in Ministry of Welfare.
- At the conference, Dr. Acharya suggested to Mr. Bordia: work with Ajay.
- Gautam Bhardwaj worked with Anand Bordia, raised money, created 'Project OASIS'
- The Ministry appointed the 'OASIS committee' led by Surendra Dave.
- Project OASIS commissioned a dozen research papers, ran a research conference in Goa, etc.

The OASIS proposal (1999): Values

- Thrift and self-help.
- Very conscious about fees, expenses.
- No waste of money on fees, expenses, sales, distribution.
- Difficulties of decision making by workers.
- Use of IT to bring down costs
- This is only about the best interests of workers: No building infrastructure or supporting small enterprise or ...
- This is only about pensions: No objectives like health or housing or ...

The OASIS design

- Individual account, DC system
- 3×3 world of asset classes $\times$ fund managers. Worker would spread 100% of pension wealth between the nine choices.
- Index funds
- Procurement of fund managers using auctions
- Centralised recordkeeping: (a) Economies of scale and (b) Ease of switching
- Extensive use of IT in order to bring down transactions costs
- Proposed a brand-new regulator for this system.

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- Proposed a brand-new regulator for this system.
- Rough calculations showed that pension savings of Rs.10/day would generate significant pension wealth, so this was a feasible path for poor people.
- Proposed that this be built *for the unorganised sector* as a way to get started.

Part II

An unexpected decision

The bureaucratic-political landscape

- The insurance regulator did not want a new regulator to happen
- EPFO did not want to change
- Ministry of Welfare went to MOF and said: "This is too big for us to pull off, you take it over".

There was never a voter-scale problem; there was only bureaucratic-politics.

A key calculation

- ADB funded MOF to run a survey about households, ageing, pension planning.
- Surendra Dave and Gautam Bhardwaj wrote a paper using this survey, that estimated the implicit pension debt (IPD) associated with working or retired civil servants.
- The answer: 68% of GDP.
- This number bubbled up to the FM and the PM.
- They were outraged.
- Consensus between the big 3: PM, FM, HM.

Decisions of Dec 2002

- We will build the NPS
- A new regulator, the PFRDA
- Switch all new civil servants from 1/1/2004 onwards into this.
- 10+10 contribution.
- In the future, we will (a) Bring in the military folk and (b) Give an option to existing civil servants to switch out from the DB system into the NPS.

Part III

A difficult phase

General elections 2004

- The Congress won the elections
- Insurance companies and IRDA did a fresh push in favour of IRDA
- Left unions suggested to the Congress this is a bad reform
- By end-2004, Congress had decided to stay the course.
- Problem: CPI(M) was vital to the coalition and they refused to support the legislation.

Improvisation

- No new legislation was required to change the terms and conditions of recruitment of civil servants
- A non-statutory office, the PFRDA, was established. Dhirendra Swarup – previously Expenditure Secretary – as founding chairman.
- A set of contracts were written with pension fund managers and the central recordkeeping agency through which they agreed to supervision.
- The system was operationalised
- Only in 2013 was the law passed.
- Gradually opened up to the private sector and informal sector, with co-contribution. Life cycle fund.

Part IV

Where we are

Facts

	Civil servants (Mln.)	Total (Mln.)	AUM (Trn. Rs.)	AUM (Bln. USD)
31-3-2016	4.58	12.23	1.19	17
31-3-2017	5.12	15.43	1.75	25
31-3-2018	5.79	21.18	2.34	33

Pension systems do a long slow phase and then the AUM rises dramatically. We have turned that corner.

Part V

Areas for work

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- We are not 3×3
- Numerous different various, numerous little pieces, drives up cost.
- Auction-based procurement, index funds, has not survived. Costs have gone up substantially. The language of mutual funds and insurance companies has crept in.

2. Failure on military employees

- Original plan: Let basic NPS stabilise, then we extend it to armed forces
- The institutional memory was lost
- Demands for "one rank one pension": *wage* indexation for military folk.
- Decisions taken with zero calculations.
- India will have an army with employees and weak equipment.

3. Now that NPS has stabilised, convergence

- Merge the rest of the Indian pension system into it.
- Superannuation funds, gratuity, EPFO, NOAP, etc.

4. Modernise the NPS architecture

- NPS Trust as the owner and operator of the NPS, but not regulator
- FSLRC recommendation: Merge PFRDA and IRDA into SEBI.

5. Modernise the fund management

- International diversification
- The bulk of the money should be in index funds all over the world.

6. Expand into the informal sector

- Occupational groupings: E.g. at the point of purchase of milk by a corporation or cooperative, e.g. taxi drivers that are part of large corporations such as Uber or Meru.
- Fintech
- Innovation

7. Benefits phase

- The annuities market does not yet work well in India
- Phased decumulation.

Some meta lessons from the 24 year journey

1. *Intellectualism* - research, data, papers, think tanks, universities, expert committees.
2. *Leadership from Ministry of Finance, professional economists*.
3. *There are no quick wins*

1995–1999	Design
1999–2002	The first adoption
2002–2013	Implement the Dec/2002 decision
2013–2019	Bulking up, readying for the next phase

4. *A fraternity of pension reformers*, sustained involvement over very long periods of time.
5. *Be prepared to be surprised*. A coherent design philosophy, but today's outcome is vastly different from what was originally envisaged.

Thank you.

Ajay Shah
http://www.mayin.org/ajayshah