Pension reforms

2.39 International experience has amply demonstrated the sustainability problems of unfunded pension systems. Pensions is one of the fastest growing items of expenditure. Expenditure on pensions of the Central Government, after increasing from Rs.2,138 crore in 1990-91 to Rs. 14,496 crore in 2002-03, was budgeted to increase to Rs.15,466 crore in 2003-04. Expenditure on pensions as a proportion of GDP increased from 0.38 per cent in 1990-91 to 0.59 per cent in 2002-03. Expenditure on pensions is now almost 50 per cent of the expenditure on pay and allowances. With increasing longevity, the situation is bound to worsen. Concerned over the rising and unsustainable expenditure on pensions, in the Budget for 2003-04, the Government announced a new system of pension. On August 23, 2003, Government approved a new defined contribution pension system for new entrants to Central Government service (Defence personnel excluded). This system provides for a defined contribution, shared equally by Government employees and the Government. The new pension scheme has portability, allowing transfer of benefits in case of change of employment. The existing scheme of pension, GPF and gratuity would continue for existing employees of the Central Government. The main features of the new pension system notified on December 22, 2003 and effective from January 1, 2004 are as follows.

- It is based on defined contribution. New entrants to the Central Government to make a monthly contribution of 10 per cent of the salary and dearness allowance (DA), which will be matched by the Central Government.
- Employees to have the option of a voluntary tier-II withdrawable account in the absence of the facility of General Provident Fund (GPF). Government to make no contribution to this account.
- Employees to normally exit the system at or after the age of 60 years. At the time of exit, it is mandatory for the employee to invest 40 per cent of pension wealth to purchase an annuity to provide for life time pension of the employee and his dependent parents and spouse. Remaining 60 per cent of pension wealth to be paid in lump sum at the time of exit.
- The new system to have a central record keeping and accounting infrastructure and several fund managers to offer three options. Under option 'A', investment will be predominantly in fixed income instruments and some investment in equity. Under option 'B', there will be greater investment in equity. Option 'C' implies equal investment in fixed income and equity instruments.

2.40 The new system will also be available, on a voluntary basis, to all persons including self employed professionals and others in the unorganised sector. However, mandatory programmes under the Employees Provident Fund Organisation (EPFO) and other special provident funds would continue to operate as per the existing system under the Employees Provident Fund and Miscellaneous Provisions Act, 1952 and other special Acts governing these funds.

2.41 The Pension Fund Regulatory and Development Authority (PFRDA) will regulate and develop the pension market. An interim PFRDA appointed by the executive has been proposed till a statutory PFRDA is established. An interim Pension Fund Regulatory and Development Authority (PFRDA) has already been constituted.

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