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"OLD PENSION SCHEME VS NEW PENSION SCHEME IN INDIA: A COMPARATIVE, FISCAL, SOCIAL & POLICY ANALYSIS"

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Abstract

The transition from the Old Pension Scheme (OPS), a defined-benefit pension system, to the New Pension Scheme (NPS), a defined-contribution model, represents one of the most significant public policy shifts in India's social security architecture. This paper examines the structural differences between OPS and NPS, their fiscal implications, social welfare outcomes, employee perspectives, and institutional challenges. Drawing upon official reports (OASIS Committee, PFRDA annual reports), state-level case studies of reversion, and empirical data, the paper argues that while NPS offers greater fiscal sustainability, it introduces risks and uncertainties for retirees, especially lower-income government employees. The paper proposes hybrid approaches and specific policy reforms—such as inflation-indexed annuities and minimum guaranteed pensions—to reconcile financial sustainability with social protection.

Keywords: Old Pension Scheme (OPS), New Pension Scheme (NPS), Defined Benefit, Defined Contribution, Pension Reform, Fiscal Sustainability, Annuity, India, Social Security.

Introduction

Pensions are vital to the social safety net of any country. They ensure that citizens do not fall into old-age poverty once active income ceases. In India, historically, the Old Pension Scheme (OPS) provided public sector employees with guaranteed lifetime pensions, adjusted for inflation via dearness allowances, and no requirement for employee contribution. However, over time, demographic shifts (longer lifespans), rising government liabilities, and fiscal pressures made OPS increasingly unsustainable.

To address these challenges, the government introduced the New Pension Scheme (NPS) in 2004 (first for central government employees), which is a defined contribution scheme where both employee and employer (government) contribute, but the ultimate pension depends on accumulated corpus and returns. The move aimed to contain fiscal risk, transfer investment risk partially to individuals, and inculcate savings/investment behaviour among employees.

Historical Background: OPS & the Genesis of NPS

1. The Old Pension Scheme (OPS)

Under OPS, government employees (central & state) received a pension equal to 50% of their last drawn salary (basic + dearness allowance). Pension was adjusted periodically via Dearness Relief (DR/DA adjustments) to cushion inflation. No employee contributions; full financial liability lay with the government. Provision of family pension, gratuity, etc., were part of the package.

2. Emergence of Fiscal Strains

Growth in number of pensioners due to longer life expectancy increased the pensioner base. Rising wage bills and expectations of higher

pensions placed state and central governments under pressure. Government reports in early 2000s indicated that pension liabilities would increasingly consume budgetary resources that might otherwise be devoted to developmental expenditure, infrastructure, health or education.

OASIS Committee & Its Recommendations

The OASIS (Old Age Social & Income Security) Committee, constituted around 2002-03, recommended moving to a contributory scheme with Individual Retirement Accounts for employees. It highlighted that in a contributory system, pension liability becomes linked to contributions + investment returns, thereby making liability more predictable.

Proposed features included portability (so that employees could carry benefits across jobs), professional fund management, and greater transparency. These ideas formed the foundation for the later NPS.

Introduction of NPS

NPS was introduced in 2004, initially for central government new recruits, later extended in voluntary mode to others, and adopted by some states. Regulatory oversight by the Pension Fund Regulatory and Development Authority (PFRDA), established in 2003-2004, to oversee NPS operations.

Institutional Framework & Key Features of NPS

1. **Contribution Structure**

Employee contribution: portion of salary + dearness allowance. Government (employer) contribution for government employees. Voluntary contributions by other citizens (private sector, unorganised sector etc.).

2. **Investment & Governance**

Funds are managed by professional pension fund managers, diversified portfolio: equity, government securities, corporate bonds. Regulatory oversight by PFRDA. Norms for disclosures, portfolio limits by asset class etc.

3. **Exit / Retirement Rules**

As per PFRDA, on retirement (or exit), subscribers must use at least 40% of the accumulated corpus to purchase an annuity. Up to 60% may be withdrawn as a lump sum.

If corpus is very small (below a certain threshold), rules may differ.

4. **Portability, Coverage & Flexibility**

NPS accounts are supposed to be portable across employers and states. Available to citizens aged between 18 and 70 years. For private/ voluntary subscribers, there is flexibility in choosing investment options (equity exposure vs conservative debt etc.).

5. Fiscal Implications: Government Liabilities Under OPS vs Costs under NPS

1. **OPS Fiscal Burden**

Under OPS, governments carry all the risk: inflation, demographic change, wage inflation. Pension obligations under OPS have been rising: state governments especially face large liabilities, sometimes consuming significant fraction of revenue budgets. (Exact percentages vary by state.)

2. **NPS Costs & Risk to Government**

Under NPS, government's obligations are limited to its contribution (for government employees) + regulatory/administrative oversight. Investment risk is borne by the subscriber. Government is not obliged to pay more if returns are poor. However, implicit risks may persist: low annuity rates, political pressure for benefits etc.

3. **Projected Liabilities & Budgetary Savings**

Studies suggest that pension liabilities under OPS, if not reformed, would increasingly swallow up fiscal space for other essential services. NPS is expected to moderate growth in pension expenditures over long-term, though in short/medium term governments must invest in building institutions, awareness, and possibly in subsidising annuity or minimum pensions for vulnerable retirees.

Social Welfare & Employee Outcomes

1. Security, Predictability, Adequacy OPS offered predictability: fixed formula ensures retirees can plan.

NPS outcomes depend on contributions + market performance + annuity rates: riskier, possibly lower real pension if markets perform poorly or inflation eats into annuity.

2. **Inflation Protection**

OPS includes dearness relief mechanisms; pensions get adjusted. Under NPS, lump sum withdrawal has no inflation linkage; annuity often not well indexed to inflation. Over time, purchasing power may decline.

3. **Equity & Distributional Impact**

For higher salary employees, even small returns under NPS may yield reasonable corpus; but lower salaried public employees may be more vulnerable to low returns.

Gender, regional disparities may also arise (occupational, tenure differences, life expectancy).

4. **Behavioral Issues & Awareness**

Low awareness among employees about NPS features (investment options, annuity implications). Possible suboptimal investment decisions by subscribers.

Annuity choice complexity, fee structures, withdrawal rules may disadvantage some.

Empirical Case Studies: State Reversions to OPS

Several Indian states have recently moved (or declared intent) to revert to OPS, particularly under opposition rule, citing social welfare and political promises.

Key examples:

State When Reverted / Decided Reasons Cited Financial Implications / Challenges Rajasthan Reintroduced OPS in February 2022. Political promise; concerns among employees about NPS inadequacy. Budgetary impact: increased pension liability; how to fund former employees; possible need to reallocate fiscal resources.

Chhattisgarh Reverted to OPS (date around 2022–2023) under a Congress government. Patient concerns, slogans, electoral promise. Similar fiscal stress; need for actuarial estimates; possible stress on state revenue.

Punjab Also taking steps. See above. As above. Himachal Pradesh Decision announced / implemented. Employee welfare / political commitments. Cost burdens; whether central government will assist; impacts on future state budgets. These reversions illustrate strong political & social pressures. They also highlight that states may undervalue long-term fiscal risk in favour of short-term electoral gains.

Challenges & Critiques of Both Schemes

1. **Challenges with OPS**

Unsustainable fiscal burden, especially for states with many pensioners and few active employees. Difficulty in meeting DA / DR obligations during inflationary periods. Intergenerational inequity: current working generation bears higher tax burden; younger generations benefit less.

2. **Challenges with NPS**

Investment risk: returns may vary; downturns in markets can reduce corpus. Annuity rates: the conversion of corpus into annuity may yield low monthly income; annuity providers may not offer inflation-indexed products or may charge high fees. Inflation erosion: if annuity is not inflation-linked, purchasing power declines.

Behavioural and knowledge gaps: subscribers may not fully understand their investment options or long-term implications. Equity concerns: short employment spells, job instability, or low salary may lead to inadequate corpus.

Policy Proposals & Hybrid Models

To harness the strengths of both systems and mitigate their drawbacks, several reforms or hybrid approaches are proposed:

1. **Minimum Guaranteed Pension / Safety Net**

Introduce a guaranteed minimum pension for retirees, financed in a sustainable way, to protect those whose NPS returns/annuities fall below a threshold.

2. **Inflation-Indexed Annuities**

Encourage or mandate annuity products that adjust for inflation (either via CPI/WA inflation index or periodic revisions), to protect retirees' purchasing power.

3. **Flexible Contribution / Matching**

Employer (government) matching contributions could be tiered or linked to performance; possibility of higher employer contribution for lower income groups.

4. **Transparency, Education & Advisory Services**

Improve awareness of how NPS works: costs, annuity products, investment choices. Provide advisory services to help subscribers plan their retirement corpus.

5. **Hybrid Pension Model**

A model combining a base defined benefit (minimal guaranteed pension) + defined contribution component for returns over and above, or allowing employees to opt between models (with statistical smoothing / risk-pooling).

6. **Better Regulation of Annuity Markets**

Promote competition among annuity providers. Standardize fees. Regulate risks so that annuity providers can offer better products.

Conclusions

1. Trade-offs are central: OPS provides security and predictability; NPS provides sustainability and market discipline—but at the cost of risk to individuals.

2. Fiscal Sustainability Favors NPS: Over long time horizons, NPS helps limit government liabilities and allows more predictable budgeting.

3. Social Security Considerations Remain Strong: Political, social, and moral demands for secure pensions exert pressure, especially among public sector employees.

4. Reversions to OPS are indicative: States reverting to OPS suggest that without addressing welfare concerns (adequacy, inflation protection, annuity rates), NPS may face legitimacy challenges.

5. Policy reforms are essential: Hybrid models, minimum guarantees, inflation indexing, better annuity markets, transparency and education are necessary to make Unacceptable and fair.

6. Future Research Directions: More actuarial modelling at the state level; longitudinal studies of retirees under NPS vs hypothetical OPS; comparisons of real annuity rates vs inflation; behavioral studies of subscriber decision-making.

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