# Pension tension

## Rajasthan government's decision to return to old pension scheme places unfair burden on future generations

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DEFINED PENSION BENEFIT Schemes (DPBS), which guarantee a pension on retirement, are facing a crisis of funding across the world. This is an ever-increasing challenge, as the old live longer (arguably retirees live even longer, due to better diets and first-world level medical care), and demographic transitions reduce the number of young to pay for the old. Making pension promises today through DBPS schemes such as the old pension scheme, which is paid to government employees recruited up to 2003 as well as that for armed forces personnel, payable 35 years later, is effectively borrowing from our very young and yet unborn children. The New Pension Scheme (NPS), launched in 2004, and adopted across the country (except West Bengal), ensures that governments pay for the concomitant pension liabilities as they incur them.

What, then, has prompted the Government of Rajasthan to take the fiscally unwise, indeed irresponsible, decision to withdraw from the NPS, and revert to DPBS? At first blush, it may seem that the decision is prompted by the elections due in the state next year. That may have been a consideration, but, surely, it is not the only one. There are other reasons, too.

Perhaps the most important of these is the considerable fiscal pressure the state governments currently feel, as they are bearing the burden of both expenditure on defined pension, and their contribution to NPS, and both are rising. In Rajasthan, for example, the current number of pensioners/family pensioners is about 5.6 lakh — a number that will increase by about 30,000 each year up to the late 2030s. On the other hand, under the NPS Scheme, Rajasthan currently has approximately another 5.5 lakh "NPS employees", towards whom the government makes pension contributions each month. This number, too, will increase by at least 30,000 each year, assuming that there is no net increase in the number of government employees, and just the retirees are replaced. The government spent about Rs 23,000 crore on pensions in the current year and has made contributions of about Rs 29,000 crore to the NPS. This expenditure will rise each year by at least 7.5 per cent, up to the late 2030s.

Therefore, in taking the retrograde decision that it did, the Government of Rajasthan is likely seeking to reduce its current fiscal pressure and postpone, to the next and coming generations, the liability of pension to employees being recruited now at an average induction of 30,000 per year. The better way to reduce the current fiscal pressure, however, would have been to plead with the Finance Commission for extra accommodation, of say 0.5 per cent, on the state's fiscal deficit limit. It is, in fact, surprising that the Fifteenth Finance Commission seems not to have explicitly visited this current difficulty of the state governments.

There are also genuine concerns amongst "NPS employees", which ought not to be ignored. The first of these is the uncertainty about the pension amount on retirement. In fact, the law provides for a "market-based guarantee mechanism" to be purchased by the subscriber. The PFRDA has erred in delaying this product, but recent newspaper reports suggest that it would now be available by August this year.

Second, employees have also expressed concerns that their pensions may be affected by market fluctuations. The NPS has given returns of about 9 per cent since inception — this is better than either the EPFO, the PPF or fixed deposits. It is useful to point out that since pension contributions were largely invested in government bonds, the risk is not that they would face downside risk when markets fell, but they would not benefit from the upside when markets rose. At first sight, this may seem not to be a genuine complaint, as risk and reward go hand in hand. However, the NPS employees are contrasting their possibly stable returns to the inflation-linked pension of the DPBS.

Third, there were legitimate concerns about employee and government contributions (either or both) not being transferred for investment in time. The CAG has repeatedly pointed out this failure, sometimes due to inefficiencies, but mostly as acts of commission by state finance departments to contain their fiscal deficit on paper. The CAG has repeatedly stated in its reports that such delays are patently unfair to the employees, and could very well spell the end of NPS. The law needs to be amended to penalise such delays, just as private companies are prosecuted for delays in the transfer of their employees' GPF contributions.

"NPS employees" were also unhappy about the benefits payable in case of the death of an employee while in service. This is easily solvable by several alternative means, such as buying a generous group life insurance product, or governments paying family pension to families of such employees, as in the DPBS.

These problems with the NPS are, as demonstrated above, solvable. Withdrawing from the NPS is the worst of all outcomes, ethically and fiscally. In the case of Rajasthan, it already has a primary deficit of Rs 29,400 crore (2022-23 BE), which means that it has to borrow money to even pay the interest on its earlier borrowings. Because of the political imperative of populism, this situation is likely to be much worse by 2035, when it is hit by the ever-increasing pension storm, with the retirements of those originally employed under the NPS, and reduced non-tax revenues as the Barmer oilfields reach the end of their productive life. Whether there would be a commensurate increase in tax revenues to meet this increase in the requirement of resources is anybody's guess.

In any case, are we not converting our democracy to be "of the government employees, by the government employees, for the government employees"? Rajasthan, for example, currently spends Rs 23,000 crore on pensions and Rs 60,293 crore on salaries and wages. This is 56 per cent of its own tax and non-tax revenues. Thus 10 lakh families — about 6 per cent of the 1.6 crore families in Rajasthan — pre-empt 56 per cent of the state's revenues.

Governments across the world are (in)famous for their next-election oriented short-termism. The really dangerous outcome of the Rajasthan government's decision will be setting in motion a domino effect — state governments will inevitably be attracted to the immediate relief of not having to provide for pension contributions under the NPS. Even in the medium term, this is likely to be fiscally disastrous for the country.

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