Old-age Pensions in India and China - Issues and Prospects

Abstract: The study analyses the state of pensions in China and India, the two populous countries in the world accounting for over 37% of the world population. Ageing scenario, old age dependency, pension coverage and pension reforms in the two countries are analyzed

China and India have huge similarities, populous countries with more than half of the population in rural areas and a high proportion of them in the unorganized labor force with little or no access to pension plans. Both countries are among the fastest growing economies with rapid urbanization and increasing personal consumption levels. However due to its one-child policy China is set to see rapid aging and increased old age dependency .With a large unorganized workforce living in rural areas and a decline in traditional families, old age pensions coverage has been limited and/or inadequate. China and India are in the early stages of implementing pension reforms and have devised/introduced old age pension schemes recently. Pension reforms are also underway with the government inviting investment companies to manage part of the public pension fund.

Key words: Pension, Pension structure, provident fund, old-age pensions

OVERVIEW:

Traditionally social security systems in India and China existed in the form of informal arrangements of joint families. In addition, government owned enterprises provided most of the organized sector employment offering defined benefit (DB) pension schemes. The emergence of nuclear families has reduced the traditional social support mechanism, and rising pension deficits have forced governments in the two countries to move towards a contributory pension model.

CHANGING ECONOMIC AND DEMOGRAPHIC LANDSCAPE

Economy and Growth

China and India have both emerged as among the world's fastest growing economies in the world. China's GDP growth has averaged around 10% for well over a decade, while India has broken free from lower growth and has averaged more than 8.5% over the past five years. Rapid economic growth has boosted per capita incomes, driving up savings and has also increased income in-equality in both the countries.

China has a budget deficit of 0.8% of GDP and its export led economy has resulted in huge trade surplus exceeding $2 trillion. In comparison, India runs a budget deficit of 3.1% in 2008 and a current account deficit of 1.4% of the GDP. Hence, while India is constrained by the level of funding it can provide for social security programs, China has already planned a year on year increase in budget allocation to provide for its pension programs.

Demography

Decline in joint families; The traditional joint families as a social setup had risks distributed with households taking care of the social security needs of the elders. The presence of young and the old under the same roof enabled spreading of income risks and had for long negated the need for a centralized system of retirement planning. Now with the decline in joint families, the first or second generation of middle aged now needs to plan for their old age.

Life expectancy on the rise; While the global population especially in developed countries is rapidly aging, India is reaping a demographic dividend with a higher proportion of working age people entering the workforce which is set to keep the economy healthy for the years to come. China on the other hand has implemented a one child policy since the 1970s resulting in lower birth rates while life expectancy continues to rise due to better living standards and healthcare conditions. This has resulted in a marked increase in ageing population and rising old age dependency as compared to India

India's life expectancy has risen dramatically from 49 years in 1970 to 64 years at present and is set to rise to 75.6 years by 2050 and the proportion of old age population is also set to rise from around 5% now to 14.5% by 2050. In comparison China will have 23.7% of population above 65 years by 2050 while Japan will have 37.7% of its population in that age group. To put this ageing data in perspective, by 2030, more than one out of every four persons in China will be over 60 compared to one in every ten persons in India. With rising life expectancy, by 2030 an average worker in China needs to provide for savings for 16 years post retirement. Or a worker entering the workforce at age 25, expecting to retire at the age of 55 needs to provide resources for more than 20 years for his post-retirement life from 30 years in employment.

Increasing job creation in the private sector: Private sector is accounting for a larger proportion of new job creation and has emerged as the major avenue of employment and re-employment. This has, emphasized the need for more options for private pensions and for further developing voluntary pensions. Private sector accounted for more than 75 percent of new jobs created in China over the past ten years (2007, United Front Work Department). In India, growth in IT, hospitality and health sectors have resulted in buoyant job creation in the private sector with no mandated pension options similar to public sector enterprises. According to The Organization for Economic Cooperation and Development (OECD) Employment Outlook 2007 report, India leads the BRIC nations in job creation adding close to 60 million new jobs between 1999/2000 and 2004/2005, while China added 37 million jobs during the same period. Formal salaried jobs though accounting for just 14.4 percent of total workforce (according to OECD); have registered an annual growth of 3.6 percent, higher than the growth in labor force during the period (2.9%). With a large section of the younger population moving into private employment, improving awareness and knowledge of pension planning is critical.

PENSIONS IN INDIA AND CHINA

Comparison of Pension reforms in India and China

China and India have quite a few similarities in the way the social security systems are structured. Both countries had a highly fragmented pension system, confided mainly to state owned enterprises (SOEs) or Public sector enterprises. These traditional government supported pension systems have crowded out private providers in both the countries. (Bob Charles and Phil Collins, 2005)

Among the two countries, China has been early to consider reforming its pension system and introduced the three-tier pension system in 1991. India embarked on its pension reforms a decade later in early 2000 in a move toward defined contribution (DC0 pensions. Both the countries have focused on reforming the mandatory pension for organized labor. However a large section of rural workers and the unorganized sector workers still aren't covered sufficiently by the schemes.

China

China's pension system has been primarily confined to employees of the state owned enterprises SOEs. In addition, its pension system is decentralized and highly fragmented with no major national level social security legislations

The formal system of income security and social insurance was established by the Communist government of the Peoples Republic of China in 1949. The 1951, introduction of the Regulations on Labor, set the focus on workers and covered the employees of SOEs. With state owned enterprises accounting for 87% of all enterprises, such a system, helped in covering a vast majority of the urban workers' social security needs (Felix Salditt, Peter Whiteford and Willem Adema, 2007).

The present phase of reforms was initiated in 1987 with the introduction of individual contributions to pensions. SOE employees were required to contribute up to 3% of their basic wages and employers contributed 15% of the pre-tax wage bill.

Another major step in centralizing and defragmenting pensions was made in 1991 with the State Council Resolution on the Reform of the Pension System for Enterprise Workers. This advocated the integration of pension systems at the provincial level and finally at the national level.

Table 1: China - Roadmap of Pension reforms

Year	Events
1949	Establishment of Peoples Republic of China and introduction of a formal system of income security and social insurance
1951	Introduction of Regulations on Labour Insurance, providing the framework for the provision of various benefits based on the principle of lifetime employment and association with a state owned enterprise
	Cultural revolution - Pension systems ceased to exist
1978	Amendments relaxed the eligibility criteria to permit pensions after 10 instead of 20 years introduced higher pension rates and job in the state sector was promised to one child per retiree. formalized the practice of enterprises bearing full responsibility for all of the labour insurance benefits
1986	Introduction of individual contributions in the pension system
1991	State Council Resolution on the Reform of the Pension System for Enterprise Workers, promoting the integration of local programmes at the provincial level and eventually at the national level
1992	Pension fund was extended to collectively owned enterprises (COEs)
1995	Introduction of Circular on deepening reform of pension insurance system for enterprises employees '
1997	Basic old-age insurance system for enterprise employees in urban areas across the country are unified by the social-pool-plus-personal-accounts scheme
1999	Basic pension coverage expanded to include foreign-invested enterprises, private enterprises and other enterprises in urban areas
2000	Establishment of the National Social Security Fund
2001	Government undertakes experimental reforms in pilot areas to improve
2004	Ministry of Labor and Social Security (MOLSS) issues provisional regulations
2005	MOLSS grants first batch of 37 operating licenses
2007	Second batch of operating licenses issued

In 1995, Circular on deepening reform of pension insurance system for enterprises employees'' was introduced. This marked a major step from a pay as you go system to a partial accumulation of funds and introduced the practice of individual contributions for pension.

To plug its wide pension deficit, China set up The National Social Security Fund (NSSF) in August 2000. The fund comes from the fiscal allocation from the central government, proceeds from divestments in state owned enterprises and from the proceeds from investment in the stocks, bonds and industries (Xiang Huaicheng, 2005). As of end 2007, the NSSF had assets worth more than $70 billion up from less than $10 billion in 2001.

India

In India, the defined contribution National Pension Scheme was introduced for central government employees of India in 2004. New employees starting January 2004 were enrolled in the DC pension scheme and are required to contribute 10% of their annual salary. In addition, employees can also choose to contribute to a tier-2 savings account from which withdrawals is permitted before retirement. Nineteen state governments and other autonomous institutions have also adopted the National Pension scheme

The Pension Fund Regulatory and Development Authority was established on 23rd August 2003. As a major step three public sector companies -- The State Bank of India, UTI Asset Management Company Private Limited and Life Insurance Corporation of India -- were selected as fund managers for the National Pension Scheme. The companies will manage the pension funds of some 300,000 employees initially managing a corpus of $400 million

Table 2: India - Roadmap of Pension reforms

Year	Events
2001	Road-map for a new restructured DC pension scheme for civil servants and the general public announced
2003	New DC pension scheme for civil servants and other workers introduced in the annual budget
2003	Establishment of the interim Pension Fund Regulatory and Development Authority (PFRDA)
2004	NPS introduced for central (civil) government employees
2007	PFRDA selects three public sector companies to sponsor new pension fund management companies for NPS
2007	Launch of the Indira Gandhi National Old Age Pension Scheme (IGNOAPS) to provide Rs.200 per head for all persons below poverty line and aged 65 and above
2008	Employees Provident Fund Organization (EPFO) select four fund managers (including three private sector fund managers) for managing EPF
2009	PFRDA says to extend pension funds (now limited to government employees) to all Indian citizens on April 1 2009

The new pension scheme offers employees two investment options: The low risk option will invest purely in risk free government securities, while the other option will invest a maximum of 15 percent in equities. However, once the PFRDA Bill is passed in the Parliament, PFRDA would allow up to 50 percent investments in equity markets.

PFRDA has also managed to limit the fund management administrative expenses through a competitive bidding to between 3 to 5 basis points. Adding another 5 basis points for brokerage, the total fund management expenses will be around 10 basis points, said to be among the lowest fund management fees in the world. In a similar move by The Coal Mines Provident Fund Organisation (CMPFO) to pick fund managers for assets of Rs 20,000 crore ($4.6 billion), ICICI Securities and SBI quoted as low as 1 basis points. In comparison, typical administrative expenses for mutual funds, life insurance and other services range from 50 bps to 400 bps. By limiting the costs to a much lower base, returns can be over a sustained period of time as higher charges initially can reduce the terminal savings by as much as 20 percent.

Private pension fund mangers will also be accountable for the returns generated by the funds. The PFRDA has made performance as one of the important criteria in assessing performance of the fund managers. Fund Managers are already mandated to generate specified returns. And from the initial signals, the reforms are off to a healthy start – ICICI securities surpassed its mandated 8.5 percent return by a full percentage point.

Comparison of Pensions Structure in India and China

The pension reforms in India and China are modeled broadly on the World Bank model of pension. In 1994, The World Bank advocated the widely popular three pillar structure for pension systems

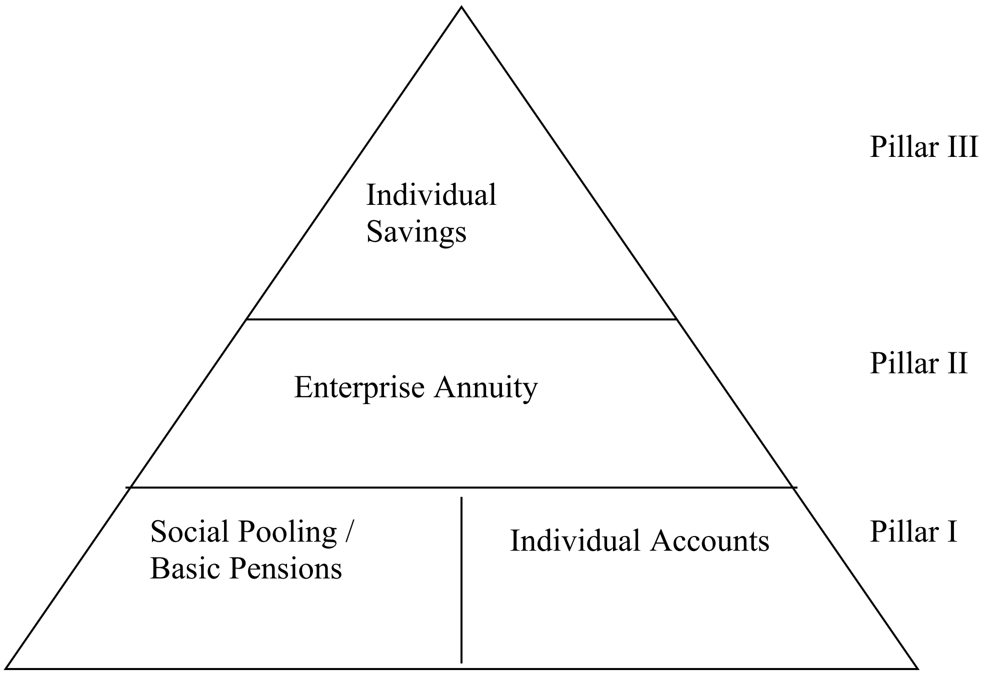
Pillar I: Non-contributory, Publicly managed, tax financed pillar for social insurance (basic pension)

Pillar II: Contributory, privately managed fully funded pillar (Mandatory)

Pillar III: Contributory, individual plans for additional savings and protection (voluntary savings)

China Pensions Structure

Figure 1: China Current Structure of Pensions (Post reforms)



Pillar I: Literature on Chinese Pension structure, normally classify the Pillar I of Chinese pensions under two tiers. The National Social Security fund supports Pillar I

Tier I (Social pooling or basic pensions) is based on a pay as you go approach and is fully funded by employers. The pension payable is calculated as 20 percent of an employee's average monthly wage in the previous year. Payment band is fixed at a minimum of 60% and a maximum of 300% of the provincial average wages. Eligibility is a with a minimum of 15 years of pension contributions and age 60 years for Men, age 60 professional women, age 55 for nonprofessional salaried women , or age 50 for other categories of women.

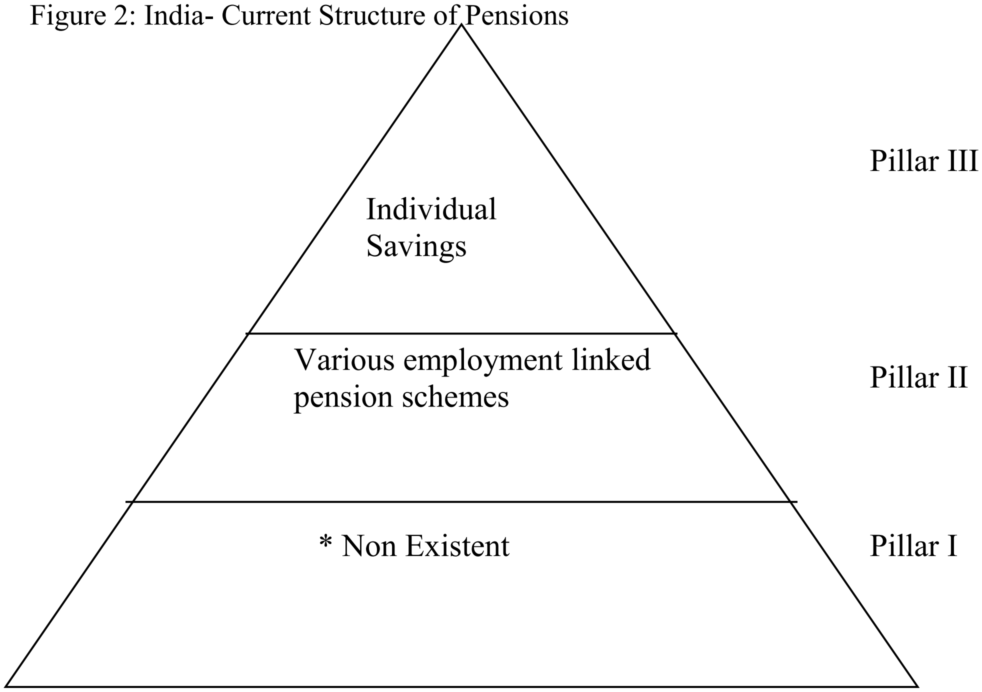
Tier II (Individual Accounts) is a fully funded individual account based mainly on employee contributions. Contribution rates are set at 8% of gross insured earnings of the employee.

Pillar II: (Enterprise annuity) is a voluntary defined contribution pension with individual accounts funded both by the employee and employer. Certain criteria are set for the enterprise including sound financial condition and having a collective bargaining process. Maximum annual contribution limits are set at one months average pay (for employers) or two months average pay (for employees and employers together) for the previous year (Hewitt Quarterly, 2006)

Pillar III: Comprises a voluntary individual savings account managed by individual firms or insurance companies. This pillar is at a nascent stage of development and is not supported by tax incentives at present

India Pensions Structure

Figure 2: India- Current Structure of Pensions



Pillar I: India has no defined benefit basic pillar I scheme as in China. *The government has various old age pension schemes targeting the poor and specific segments of the population but has no guaranteed minimum pension for participants. Hence Pillar I pension is considered non-existent in India (Hélène K. Poirson, 2007, Ramesh Gupta 2002)

Pillar II: Pillar II provides defined benefit and defined contribution schemes for the organized sector under Public and Private Sector Employment

New Pension Scheme: Fully funded individual account based defined contributory pension currently open to Government employees only. Though new employees into Government service have been enrolled into this new pension scheme, its implementation is pending approval of the Pension Fund Regulatory and Development Authority (PFRDA) Bill by the Indian Parliament

Employees' Pension Scheme: A defined benefit scheme which applies to all workers covered under the EPF & MP Act of 1952. Employers contribute 8.33% and the government contributes 1.16% (subject to limits) employers 3.67% of the basic salary

Provident Fund: A defined contribution scheme which pays out a lump sum benefit on maturity. The scheme covers all employees of notified industries and establishments with more than 20 employees. Employees contribute 12% and employers 3.67% of the basic salary

Gratuity: Gratuity is a defined amount paid by the company to the employee upon termination of service. It's applicable to employers with a workforce of 10 or more employees. Employees are required to have served for a minimum of five years and the amount payable is two weeks salary for each year in service subject to a maximum limit.

Pillar III: Comprises purely voluntary individual pension plans provided by insurers and mutual funds. The market is at a very nascent stage with very few participants under this pillar.

COVERAGE OF UNORGANIZED SECTOR

India - Unorganized sector pension coverage remains low

India's retirement coverage remains low due to presence of a huge workforce in the unorganized sector. According to the National Sample Survey Organization, 93% of the workforce in the country works in the unorganized sector with little access to any form of formal social security. Various government programs including National Social Assistance Programme (NSAP), welfare funds and other public institutions such as Self Employed Women's Association SEWA have aimed to address the social security needs of this segment.

While voluntary pension schemes such as the Unorganised Sector Workers Social Security Scheme (2004) have failed to attract subscription, welfare funds have been fairly successful in states such as Kerala where these funds cover 54 percent of the informal sector workers. These welfare funds targeted at specific sectors such as construction, beedi industries, tripartite in nature with contributions from the employer in the form of a cess, employee and the government.

The Unorganized Sector Workers Social Security Bill, 2007 is on the anvil and aims to extend the National Old Age Pension Scheme to all the persons above the age of 65 years below poverty Line with a spend of $800 million per annum. The 2008-09 budget provided for $690 million (2007-08: $480 million) for enlarging the National Old age Pension scheme beneficiary cover. At present the central government pays Rs 200 (~$4) to the old age pension scheme per person requiring an equal contribution from the state governments. In 2007, the government also launched a new pension scheme enlarging the coverage to 16 million old age people below poverty line from the earlier 8.7 million with a total outlay of $960 million annually to the Government

Not withstanding the successes of a few initiatives, rural pension programs by the government and other self help groups have covered not more than 5 to 6 per cent of the informal workforce leaving more than four fifths of the country's workforce without any formal social security cover. New initiatives by the government aim to provide monthly payments to old age people below poverty line. But the successes of initiatives, which aim to encourage individual savings for retirement among the unorganized workforce during their working lifetime, remain limited.

China – Unorganized sector and rural pension coverage

Traditionally social protection in rural areas focused on the needy focused mainly on the labor power (the Five-Guarantee households) and households in poverty. One of the major initiatives in 1978 was the introduction of urban style pension programs in select rich rural areas. By 1984 such programs covered 2.4% of the towns and 0.9% of the villages. In 1987, the Ministry of Civil Affairs (MOCA) initiated pilot schemes for the rural social security system at the grassroots level targeting the rural farmers. By the end of 1987 such programs covered 1.4% of the towns and 0.8% of the villages. (Lutz Leisering, Gong Sen and Athar Hussain, 2002)

In 1991, China established a rural old-age insurance system. The pension was contributory in nature supplemented by collectively pooled subsidy and government assistance. Due to the contributory nature of the rural old age pension system, pension payments were below the minimum living guarantee for living residents. In 1998, the rural pension policy was transferred from MOCA to Ministry of Labor and Social Security (MOLSS), which is responsible for social security in urban areas. The lack of an authority in-charge of rural pensions and MOLSS which is focused on reforming the urban pension system suggests a marginalization of the rural pension system (BBVA, 2008).

Due tot the low coverage and on the earlier rural pension scheme, since 2003, a number of local governments have initiated pilot projects on framers pensions, some of which have achieved moderate success. The Baoji government's initiative on New Rural Social Pension Insurance Programme in 2007, is a Tier 1 scheme aims to alleviate poverty for those aged 60 and above with a qualifying contribution record. Pensioners aged 60 and above receive a monthly pension if their family makes the required premium of about 10% of local average wage to a defined contribution Tier II scheme. People aged 45 and above are required to pay premium regularly till 60 and those younger than 45 years need to contribute for a minimum of 15 years to be eligible for a tier II pension. Current Tier I pension payments are quite low at RMB 60 or 30% of average monthly expenditure. The pilot program launched in five villages and two counties covered 93.6% of the eligible older population as of November 2007.

China plans to introduce a new pension scheme for farmers and aims to provide 80 percent of the farmers with pensions by 2012 and cover 100% of the farmers by 2020. The model is likely to be contributory in nature combining the personal account and the basic pension provided by the government and requires increased funding by the government, (China Daily, 2008)

ISSUES CHALLENGES AND RECOMMENDATIONS

India and China face similar pension problems including a legacy pension deficit, uncovered rural and unorganized workforce and challenge to improve investment returns of pension funds and setting up the necessary regulations. Both the countries can benefit from the experience of pension programs in the other country or from within their countries on the successes and failures of various initiatives.

India and China's pension systems are broadly focuses on reforming the urban organized workforce. A major step in this regard is the establishment of defined contribution schemes. However a key area of concern in both countries is the inadequacy of pensions for the large proportion of unorganized and rural workforce. Measures to accommodate them under a broader social pension or welfare scheme falls much short of what is required for a minimum standard of living.

In both the countries purely contributory old age pension systems haven't achieved much coverage, necessitating the need for larger government role. China is advocating a contributory old age pension scheme with government participation while India has increased its allocation for a non contributory flat rate pension targeted only at the old age population below poverty line. However contributory schemes targeted at specific groups through co-operatives or self help groups have been successful in India, Similarly successful models at the regional level such as by the Baoji government can also be expanded to cover a wider segment of the population.

China has established a National Social Security Fund to partially fund its pension benefit. India's pension payments are paid out of it budget with no separate fund set aside as in China. The Punjab state of India has established a Dedicated Social Security Fund by charging a 3% stamp duty for registration in the urban areas and a 3% extra duty on the electrical bills. The state aims to make pension payments to the most vulnerable and weaker sections of the society on a monthly basis. For India, a national social security fund carved out of revenue from special duties and taxes on lotteries and other means of funding will help in having a dedicated fund for the rural old age population.

A centralized system is a main challenge in China, which has different provincial level pension authorities and regulations. China aims to unify the pooling part of Pillar I of its pension system nationwide by end 2009. In case of India, barring three states, others have joined the National Pension. Due to provincial or state level segregations, having a unified solution poses a major challenge for the two countries.

More solutions for the development of the new pension systems have been suggested including tax incentives for Enterprise annuities in China, and separate tax incentives for pension savings which is at present pooled with other form of savings in India, In addition need for pension literacy for the middle class is suggested (Vaidyanathan, 2007).

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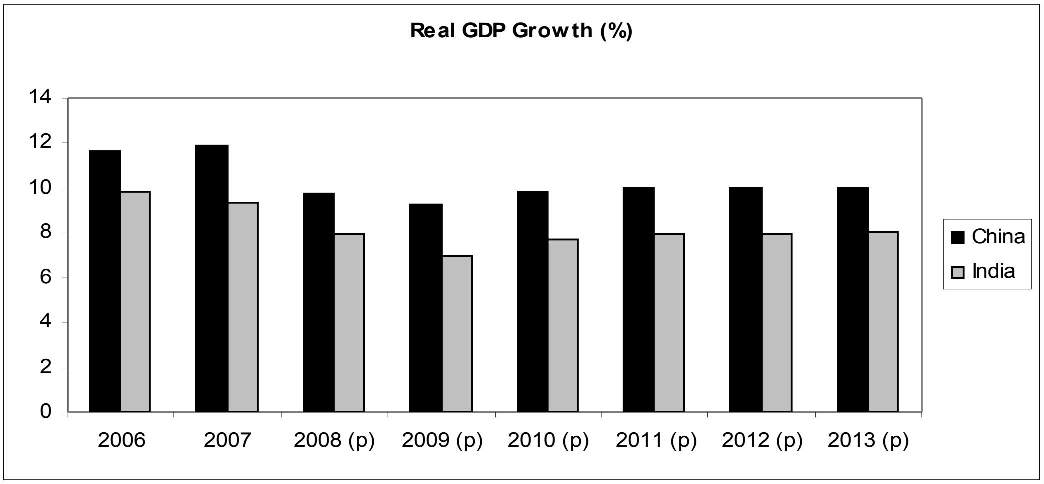
ANNEXURE

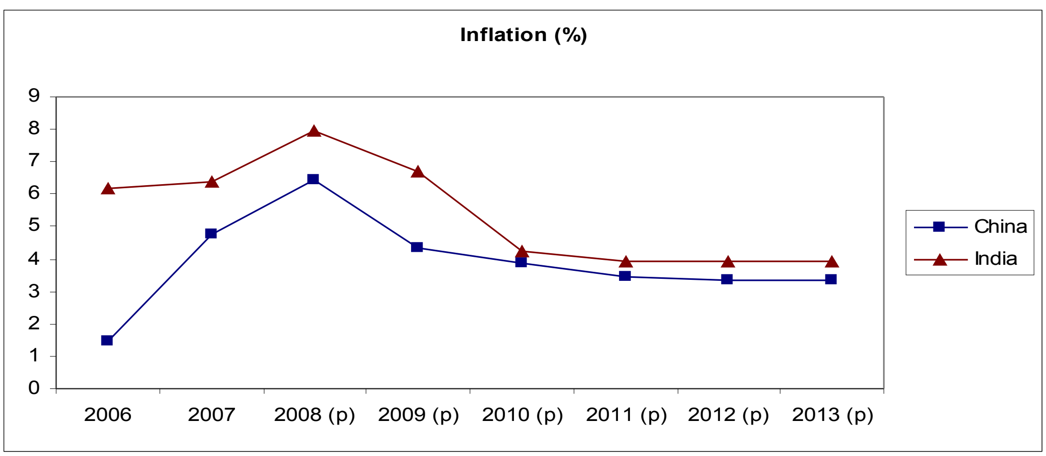
Economic Scenario

Table 1: China, India, Real GDP Growth, 2006-2013



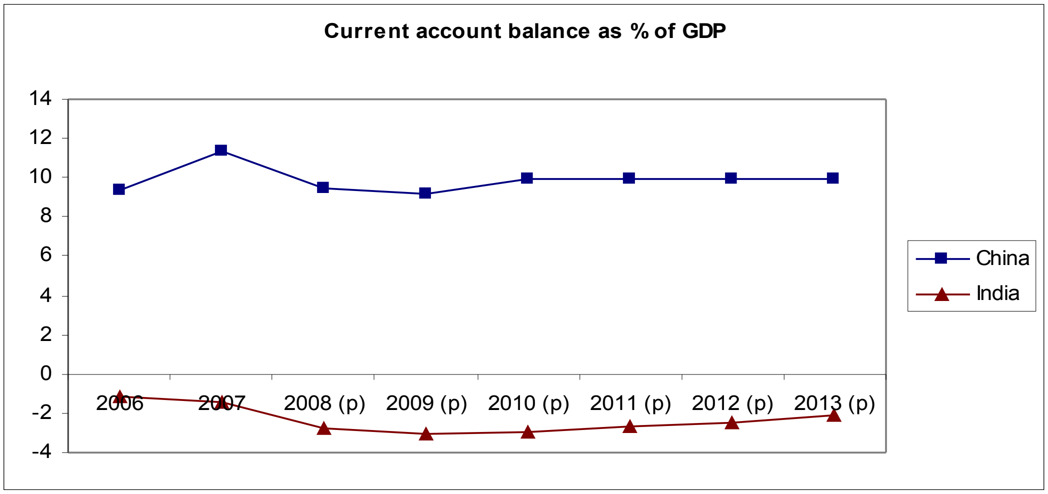
Source: IMF, World Economic Outlook Update, November 2008

Table 2: China, India Inflation, 2006-2013 (%)



Source: IMF, World Economic Outlook Update, November 2008

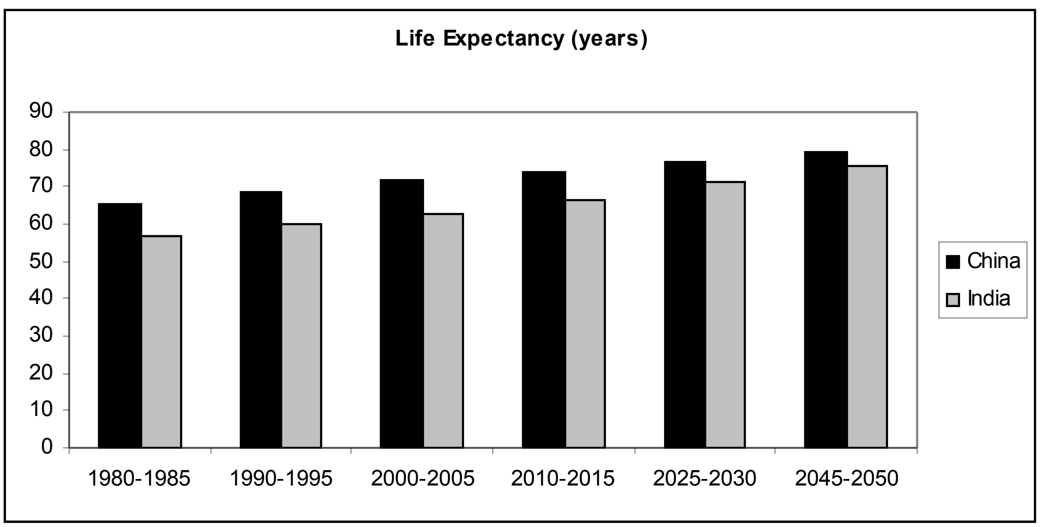
Table 3: China, India, Current Account Balance as a % of GDP, 2006-2013 (%)



Source: IMF, World Economic Outlook Update, November 2008

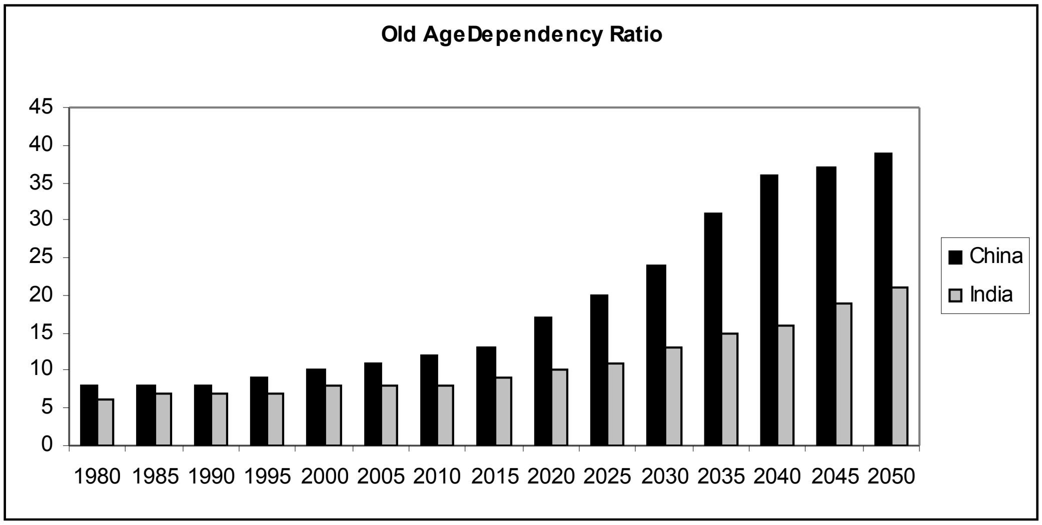
Demographic Scenario

Table 4: China, India Life Expectancy, 1980-2050 (Years)



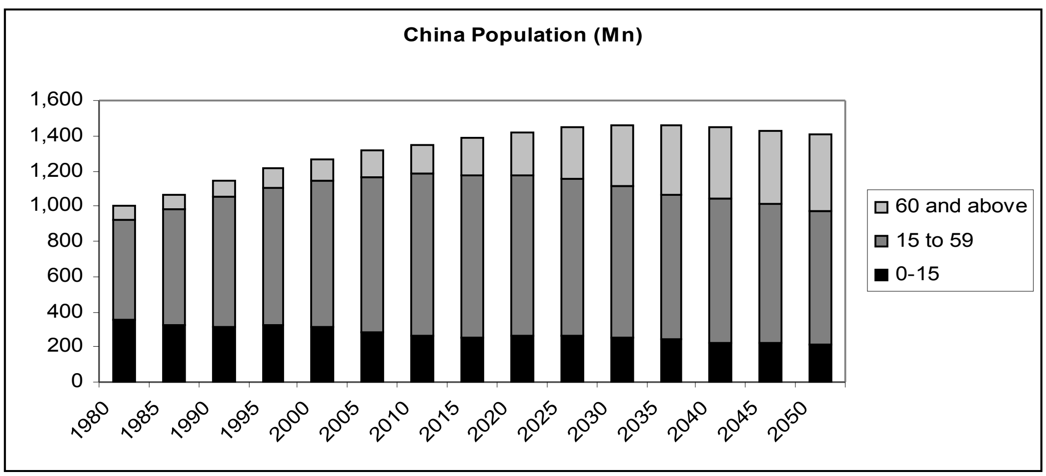
Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects

Table 5: China, India Old Age Dependency Ratio, 1980-2050



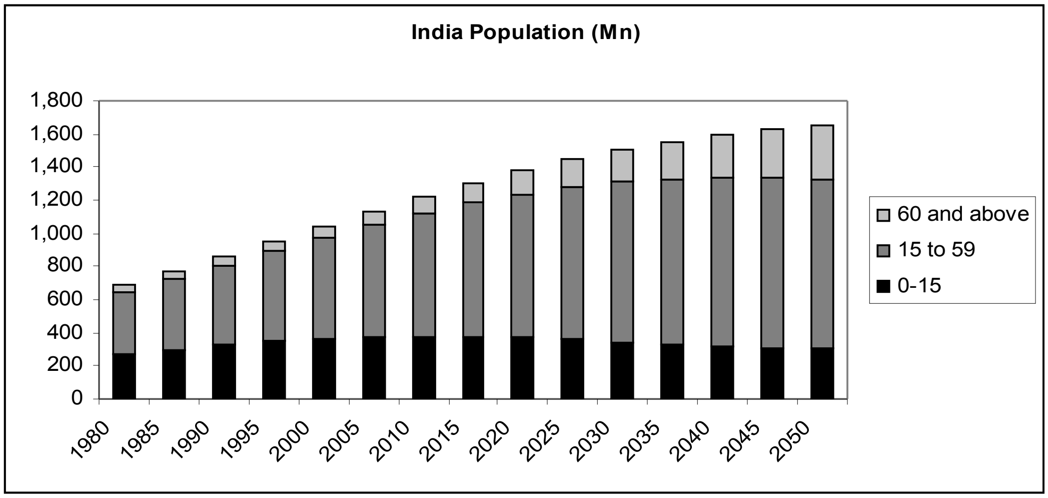
Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects

Table 6: China, Population by Age, 1980-2050 (Million)



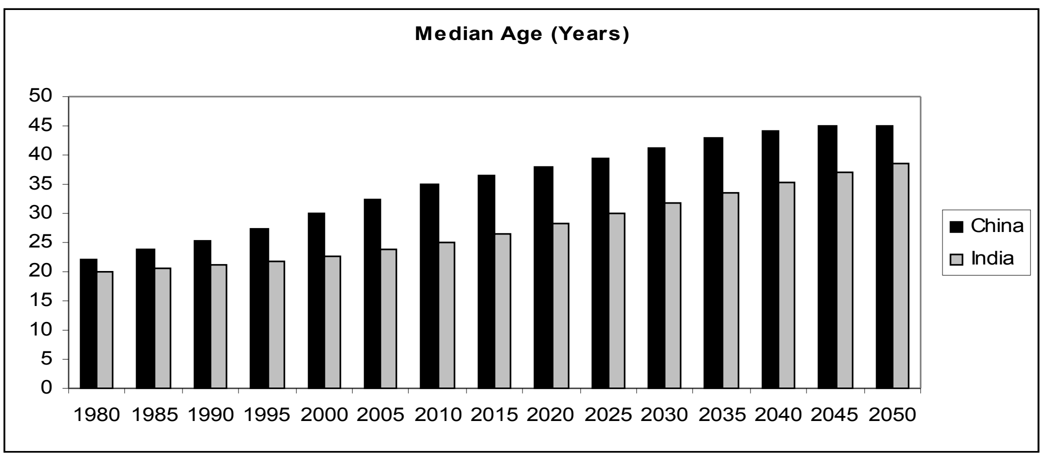
Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects

Table 7: India, Population by Age, 1980-2050 (Million)



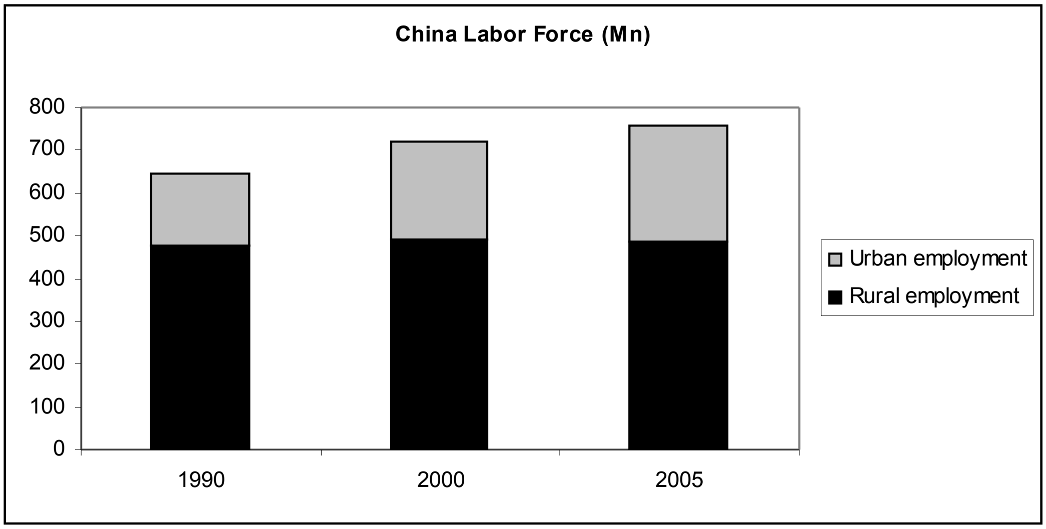
Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects

Table 8: India, China, Median Age, 1980-2050 (Years)



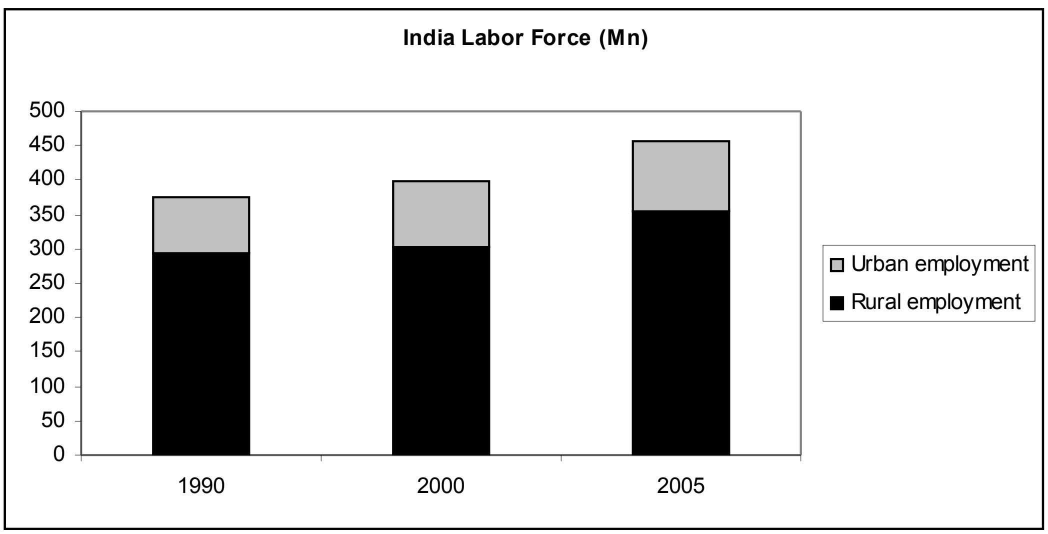
Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects

Table 9: China, Labor Force by type of Employment, 1990-2005 (Million)



Source: OECD Employment Outlook 2007

Table 10: India, Labor Force by type of Employment, 1990-2005 (Million)



Source: OECD Employment Outlook 2007