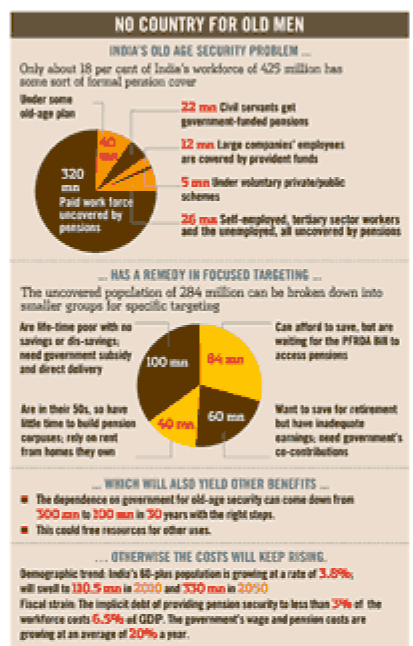
Old Age : Time Bomb Ahead

Ipods, cellphones, branded apparel, fairness creams, hair colour, deodorants, coffee outings, pubs, vacations, dates, films, music … the list is endless. Gadgets, personality enhancing items and entertainment — young India is splurging with gay abandon. And why not, 25-year-olds, especially the cosmopolitan variety, are earning more than what their fathers took home at retirement. The only cloud on the sunny sky of India's youth is the absence of concern or a savings head marked 'retirement'. "Right now, I want to be the first to own the latest cellphone in my gang," beams a chirpy Monica Sharma, 28, who has just quit a private airline to head the marketing department of an export house. "I will have all the time in the world to plan pensions later."

While conspicuous consumption has caught on, the concepts of deferring consumption to post-retirement years and saving today to enable dis-savings when the income streams dry up have not. "That the time bomb is ticking away and every year of savings lost can add up to huge downgrades in living standards after retirement is yet to be fully grasped," says Surya Bhatia, a principal consultant at investment advisor Asset Managers.

Not that youngsters aren't saving — monthly installments in mutual funds and insurance are a hit. How focused these non-systematic savings are, however, is the question. "The need for retirement savings sets in only after they grow grey hair," says Bhatia. "By then, they're committed to expenses, which can't be cut back."



India's old-age problem is not well-understood. Perhaps because India — with an average age of 26 years — is amongst the world's youngest countries. The presence of 15 youngsters for every old Indian, a low dependency ratio, too is a smoked mirror. However, India will not remain young for very long — the above-60-years population would double to 160 million in the next two decades. And then, it would be too late to begin saving. "The need for pension reforms in India arises from low coverage of the existing old-age security programmes, demographical trends and the government's fiscal constraints," says Pension Fund Regulatory and Development Authority's (PFRDA) Chairperson D. Swarup. Pension saving is a tedious, time-consuming process. It needs a well-regulated pensions industry. Returns depend on compounding, giving an edge to the early birds. An additional contribution of Rs 2,500 towards pensions at the age of 20 can enhance the lumpsum retirement benefit at 60 by Rs 25,000.

The problem, as Swarup hints at, is grimmer. Those who want to save for retirement can't do so because a pensions industry doesn't exist. Those who do have access to the existing rudimentary pension system cannot rely on it for worry-free retirements. The coverage of the existing old-age income support systems is grossly inadequate. Only 18 per cent of the total workforce of 425 million is covered by formal pensions. The 22 million who work in the public sector are lucky to get state-funded pensions, with the bureaucrats taking home inflation-indexed benefits that replace up to half their last-drawn salaries. Some 5 million private sector employees also get some, albeit less-lavish benefits. However, the 348 million unorganised sector workers, comprising 82 per cent of the workforce, have little or no access to formal schemes for savings to sustain them after retirement. "Any delay in pension reforms will nullify the advantages we have," says Swarup.

A three-pronged strategy is required. First, the formal pension system has to be opened to all. Second, it needs to be reformed so that it can generate adequate returns. And third, co-contributions must be extended to those who do not earn enough to save.

Of the 284 million that have zero access to formal pensions, 90 million can afford them, according to a survey by Delhi-based pension policy think tank Invest India Economic Foundation (IIEF) spanning 1 million respondents, and the PFRDA's assessment. This is the sizeable chunk — comprising the self-employed, tertiary sector workers and traders — the PFRDA is trying to gain coverage for through the New Pension Scheme (NPS) it is running for employees joining the public sector after 1 January 2004. The NPS is a defined contribution (as opposed to defined benefits) programme that lets savers choose the investment instruments, ranging from equity to debt, and a default option they would like their kitty to be parked with. It will pay out market returns. The PFRDA has recently appointed fund managers to manage the Rs 1,200 crore transferred by the Central government. So far, the money comprising matching contributions by the employees and their employers was being deployed in government securities.

Though the PFRDA appointed fund managers to manage the NPS for government employees last year, private and unorganised workers can't join it, unless Parliament passes the PFRDA Bill. A parliamentary standing committee has recommended that the Bill be passed with minor changes. The government has redrafted the Bill incorporating these changes, yet the resistance from the Left parties, who are opposed to the deployment of pension savings in stockmarkets, has prevented finance Minister P. Chidambaram from introducing the redrafted Bill.

IIEF also estimates that 60 million of the currently uncovered want to save for retirement but do not earn enough. This category, comprising labourers, dabblers in odd jobs, even beggars, need assistance from the exchequer. “For instance, a vegetable vendor could contribute Rs 100 to an old-age scheme, which the government could beef up,” suggests Gautam Bhardwaj, director of IIEF.

Then, about 40 million in their 50s are 10 years away from retirement. Contribution plans have little utility for them as they hardly have time to build corpuses. The survey has shown that a number of them have achieved a useful asset — they own property, which could provide rent or reverse mortgages.

OF THE 1.1 BILLION INDIANS
FEW ARE ATTEMPTING RETIREMENT PLANNING ... • **4.5 mn participate in equity markets** • **33%of earners own life insurance policies** • **20 mn will buy life insurance in 2008** • **11 mn plan to buy residential property soon** • **5.7 mn is the retail mutual fund base** • **18 mn individuals have some form of investments**
... WITH SOME OPTING FOR NON-MAINSTREAM INVESTMENT OPTIONS ... • **6% of 321 mn working-age Indians buy gold purely as an investment optio** • **82% of all consumer loans are from money lenders and friends** • **$6.4 bn of retail savings in gold in 2006-07**
... BUT A SIZEABLE CHUNK IS WAITING TO BE TAPPED ... • **Rs 57,000 cr is the latent demand for voluntary retirement savings** • **79 mn are willing to join NPS on a voluntary minimum SIP basis** • **144 mn have incomes, but no bank accounts** • **$35 bn is the annual savings potential of low-income investors** • **Rs 2,268 cr is the informal savings kitty** • **Rs 2.3 bn is held as savings in self help groups** • **18% of those aware of mutual funds are already investing in them** • **25% is the increase in aggregate earnings in the last 3**

years

... FOR WHICH SOME STEPS ARE NEEDED.

- **87%of the latent demand can be served through post offices and banks' networks**
- **By 2020, the private pension market is expected to grow to $300 bn**

Source: Invest India Incomes and Savings Survey

Another 100 million, however, are life time poor. They need direct delivery such as the national social assistance schemes. Prime Minister Manmohan Singh launched the Indira Gandhi National Old Age Pension Scheme last year, to provide assistance of Rs 200 to every person above 65 years below the poverty line. "The national assistance schemes are not good enough," admits Swarup. "With a large population, how much can tax money provide?"

To address the needs of this group, public-private partnerships are an option, too. UTI Asset Management Company, for instance, has invested in a pension venture with Sewa, an NGO, and IIEF, Invest India Micro Pension Services (IIMPS), which in 18 months has provided micro pensions to over 145,000 low-income workers in Gujarat, Madhya Pradesh and Andhra Pradesh. Rajasthan too has appointed IIMPS to deliver pensions to 500,000 people. The state plans to co-contribute up to Rs 1,000 per annum per member. Rag pickers, marginal farmers and petty artisans are benefiting from the initiatives, according to IIMPS.

Those covered by the existing formal pension system suffer from inadequate pensions. The Left's mantle of the spoilsport isn't limited to restricting the ambit of the NPS. The stiff opponent of stockmarkets and private fund managers is holding up the efficient running of the largest public provident fund, Employees Provident Fund Organisation (EPFO) too. The EPFO paid 8.5 per cent last year, which barely covers the erosion of savings by inflation, now at over 8 per cent. It cannot deliver more because the Left insist its corpus be invested only in government bonds. Between 1979 and 2005, the returns on these have been 7 per cent below equities. "I am a well-informed pension funds participant, yet I am not sure what happened to my pension savings with the EPFO when I switched jobs," says Ajay Shah, a consultant at the National Institute of Public Finance and Policy.

The EPFO does not offer seamless transfers to job hoppers, is not audited, and is extremely opaque. "As the managing director of HDFC AMC, I get the annual statement of funds from the EPFO for the amount we park with it on behalf of employees, but no statement on asset allocation," says Milind Barve, highlighting the gross inadequacies in the regulations for the EPFO. The EPFO is hardly regulated compared with the mutual fund industry, though its corpus is more than four times larger. The Central Provident Fund Commissioner A. Viswanathan defends the EPFO saying the private fund managers are being invited to manage it. Barve joins Bhardwaj, Shah and other financial industries experts in wanting the NPS to be the vehicle for retirement savings.

India's savings rate is very high — 34 per cent — next only to China's, which can be diverted to pensions. For this, tax treatment need to be an incentive, and education on deferring consumption, a driver. Otherwise, it would be too late to diffuse India's old-age time bomb.

By Puja Mehra

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