Original Article

Central civil servant pension payments in India: Issues and concerns

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ABSTRACT The rapid growth in the size of civil servant pension payments has become a subject of serious deliberation all over the world. As a result, several countries of the world have attempted to reform their existing pension practices. India also is experiencing the increasing burden of pension expenditure. This increasing burden is attributed to large employment provided by the government during its planning process and increasing life expectancy at 60 years. The debates relating to the need for the continuation and reforms of the pension system have been strong. The resulting reforms that have been initiated in India pertain to civil servants joining government service after January 2004. The pre-2004 recruits belonging to the civil departments and all defence employees continue with the Old Pension Scheme (OPS). Important issues that have evoked policy interest for the OPS group include the extent of their pension liability in the past, present and future; factors responsible for such growth; and alternative methods of financing the same. This paper presents an analysis of the growth in civil servant pension expenditure of the OPS group over last three decades sector wise. The paper also highlights important issues and concerns regarding civil servant pension payments in India.

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INTRODUCTION

The rapid growth in the size of civil servant pension payments has become a subject of serious deliberation all over the world. As a result of these debates, several countries of the world have conducted experiments to reform their existing pension practices. Indian efforts in this direction are vivid from the introduction of the New Pension Scheme (NPS) from 1 January 2004.

Central government employees recruited from the referred cutoff date are brought under the Defined Contribution (DC) System. This reform measure of India has received rich acclaim, as it represents a paradigmatic shift in pension practice.

The reform, however, does not extend to the entire central government staff. The employees recruited before January 2004 belonging to the civil departments and defence continue with the Old Pension Scheme (OPS), that is, the Defined Benefit (DB) Scheme. Hence, the NPS does not provide a complete solution to the civil servant pension payment problem as the above two important groups are left out of the reforms. This is popularly referred to as pay-as-you-go (PAYG)

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system. Important issues in the context of this group that have evoked policy interest include the extent of pension liability of this group in the past, present and future; factors responsible for such growth; and alternative methods of financing the same. The scope of this paper is limited to these issues; hence, it does not intend to address the NPS features and the issues revolving around it.

Pension reforms in the Indian context for the group belonging to OPS are best attempted when a more holistic reform is considered by including the subject of government employment and wage fixation policy. Government of India assumed the role of a model employer for long, and generation of employment has served as an important plan objective. This policy has served well to generate a large-scale public sector employment even while the private sector was shy of creating jobs. Wage fixation was, however, based on the concept of 'deferred wage', which would be paid once the employees retire. This practice would help spread the cost of employment over a longer time period. Hence, a step in the right direction would be to attempt a holistic reform by taking into consideration the employment, wage fixation and pension policies together, rather than viewing them independently.

In this backdrop, this paper attempts to analyse the trends in pension payments, its implications and areas of concerns in the Indian context. The remainder of this paper is presented in three sections. Section 2 examines the concept and existing pension benefit system in India and abroad. Reasons for growth in pension payments and analysis of past trends in pension expenditure are presented in Section 3. Pension reform debates and alternatives to PAYG system are presented in Section 4.

PENSION BENEFITS

The concept of pension benefits

Pension payments refer to the periodical payments made to the individuals, beginning with retirement that continue until death.¹ Pension provides lifetime income security for as long as

the retiree lives.² There are largely two forms of financing these benefits. The first is the PAYG system, which is an unfunded scheme in which the current workers meet the bill of the retiree's payments (by way of tax resources raised by the government). The second method involves the workers saving a part of their current income to earn their future retirement income, making it a funded scheme. Thus, pension is a form of transfer of income from the working phase to the retirement phase. 'Pension, therefore, serves two essential purposes. The first is consumption smoothing over an individual's lifecycle, that is, a person provides an income in retirement when some one is no longer working in exchange for contributions into a pension scheme when they are. The second is insurance, especially in respect of longevity risk – the uncertainty attached to an individual's life' (Blake, 2002, p. 1).

The involvement of the government in the pension provisions takes two forms. The first form represents the civil servant pension payments. Retirement benefits provided to the civil servants represent a kind of entitlement for their services rendered during their tenure as government servants. The second is a kind of old age social security payment made out to the aged and infirm in the society. The factors guiding these two categories are different.

Civil servant pension payments system

The first part of this section examines the civil servant pension payments in select countries of the world.

Civil servant pension payments across the world

Civil servant pension payments in the OECD countries on average constitute 1.8 per cent of the gross domestic product (GDP). Austria, Belgium, France, and the United Kingdom, on the other hand, allot a much larger share of the GDP. The share of the United States is just above average of 1.8 per cent. Among the low- and middle-income countries where the average is 1.2 per cent of the GDP, the majority of them, including India,³ have levels higher than the average.

The average pension–GDP ratio in non-OECD countries was of the order of 1.33 per cent, ranging from 0.5 (Nepal) to almost 5 per cent (Brazil). The Indian central government pension expenditure–GDP ratio was of the order of 0.93 per cent in 2004–2005. Although there has been a significant increase over the years, the Indian situation is not very much off the mark, as compared to the OECD and non-OECD average.

This is presented in Figures 1, 2
Intercountry comparisons are useful for assessing the country's situation with other nations implementing similar schemes. However, such comparisons may not be very meaningful when attempted for only one or two time points. It is mainly for this reason that the civil servant pension payments entirely depend on the number of employee intake from time to time. India has not shown a uniform rate of growth in

Figure 1: Pension spending as share of the GDP (OECD countries).
Source: Palacios.⁴

Figure 2: Pension spending as share of the GDP (low- and middle-income countries).
Source: Palacios.⁴

employment in the past. Hence, the future retirements directly correspond to the past recruitment pattern.

Civil servant pension practices in India

Pre-independence Era

Evidence of the old-age support systems for people serving the state in India dates back to the third century bc.⁵ According to Sukraniti, a king had to pay half of the wages for people who had completed 40 years of service. During the British rule, practices of civil servant pension have been evident since 1881, when the Royal Commission on civil establishments gave the retirement benefits. However, these were in the nature of contributory pension with the employees contributing 4 per cent of their salary. While these rules were applicable to all European members, they were applicable to some Indian members of the civil service. Civil servants were given a choice by the passing of the Government of India Act (1919), for people employed before 1 January 1920 to retire on a pension proportionate to their service. Based on the recommendations of the Royal Commission, the practice of contributions by the beneficiaries was cancelled, and an Indian Civil Services Provident Fund for non-Europeans was introduced.

The Royal Commission later recommended an increase in the rate of pension in the year 1924. Commutation of pension up to 50 per cent of the pension drawn was also statutorily granted. Further, the provisions of pension benefits were strengthened in the Government of India Act, 1935. Thus, the civil servant pension system originated in India on the lines of the British system. Today, however, the Indian system differs from the UK system in the sense that a statute governs the UK system, whereas the Indian system is governed by rules.⁶

Retirement benefits to the civil servant employees in modern India

An Indian government servant today is entitled to a monthly pension after retiring from government service on superannuation or invalidation after

completing a qualifying continuous service of not less than 10 years or more until their death. It is also available to those retiring voluntarily after rendering not less than 20 years of continuous service. The pension amount is fixed based on the number of years of qualifying service and average emoluments drawn during the last 10 months of service before retirement.⁶ The retirement benefits to the government servant comprise a monthly recurring payment termed 'pension' and a lump sum payment called 'retirement gratuity'. The former system has long-term financial implications for the government as opposed to a one-time financial outgo on the part of the government for the latter.

Pension benefits⁷

A government servant would be entitled for full pension up on completion of 33 years of qualifying service. Such pension would be reduced pro rata in cases in which the qualifying service is less than 33 years. The minimum amount of pension is fixed at INR 1275 per month (raised from INR 375 per month after 1 January 1996) and is subject to a maximum of INR 15000 per month (raised from INR 4500 per month after 1 January 1996) with a qualifying service of 33 years or more. The maximum and minimum limits were raised by 50 per cent on account of a merger of Dearness Relief equal to 50 per cent of pension as Dearness Pension in 2004. This benefit in the form of a family pension is extended to the spouse after the death of the government servant after completing 1 year of the government service or even before 1 year, if the government servant was declared medically fit at the time of entry into the government service. The family pension scheme was introduced with effect from 1 January 1964. It is provided at a uniform rate of 30 per cent of the basic pay subject to a minimum of INR 1275 per month (raised from INR 375 per month after 1 January 1996) to a maximum of INR 9000 per month (raised from INR 1250 per month after 1 January 1996). In addition, the family pension calculation from 1 January 1996 is made

at a uniform rate of 30 per cent of basic pay instead of the slab system prevailing until then.

Commutation of pension

Government servants have a facility to commute a portion of their pension into a lump sum payment. Although this proportion has undergone some changes in the past, with effect from the Fifth Pay Commission, that is, 1 January 1996, this facility is extended to 40 per cent of pension.^{8,9} The maximum amount of pension admissible for commutation before 1 January 1996 was one-third of the basic pension. The monthly pension drawn for 15 years after the availment of commutation would be reduced by the portion commuted to be restored after 15 years. The restoration of the commuted amount of pension introduced on 1 April 1986 was based on a judgment passed by the Supreme Court until which period commutation was never restored. Dearness Relief, however, is provided for the entire pension amount.

Gratuity

Death-cum-retirement gratuity is admissible to a permanent government servant on his retirement, or is paid to his family in the event of his death while in service. This has been treated under two separate titles since 1 January 1986, 'retirement gratuity' payable to the employee on his retirement and 'death gratuity' payable to the family on his death while in service. Retirement gratuity is admissible if the qualifying service is not less than 5 years. The amount is equal to one-fourth of his emoluments for each completed 6-month period of qualifying service, subject to a maximum of INR 3.5 lakhs; this is an enhanced amount from INR 2.5 lakhs (for retirements on or after 1 January 1996).⁶ The following section of this paper presents the trends in pension payments in India and their analysis.

TRENDS IN PENSION PAYMENTS IN INDIA: AN ANALYSIS

'There are separate pension schemes for civil servants, and often for other public sector workers, in about half of the world's countries, including some of the largest developing

countries, such as Brazil, China and India. Yet, compared with the voluminous literature on national pension programs, very little analysis has been produced on this aspect of pension policy'.⁴

Studies carried out in the Indian context^{4,10,11,12} have analysed pension payments during the 1990s. Studies observe rightly that civil servant pension payments have risen sharply. Its share of the GDP has also indicated an increase. The trends in the 1990s have served as the basis for future pension projections and thus created considerable amount of apprehension about its future growth and fiscal sustainability. The 1990s were odd in many respects. The country was going through a severe fiscal crisis, with intermittent reduction in deficit levels. Revenue buoyancy was low and the rate of growth in the GDP was also low. In addition, the Fifth Central Pay Commission's recommendations were also implemented in the mid-1990s. Coincidentally, the mid-1990s were also a period when the retiree stock was at its peak – a result of the huge employee intake that had taken place in the initial plan period.¹³ This factor was completely missed out in most of the studies.

Hence, to have an understanding of the growth in pension payments in India until the introduction of the NPS, this paper has attempted to analyse the temporal growth in civil servant pension payments in India in the last three decades. Some of the reasons for the increased expenditure on civil pensions are explained below.

Reasons

Increased employment base

In the context of civil servant pension payments, as mentioned earlier, the pension expenditure is directly an outcome of the size and pattern of the corresponding past employment. This is broadly guided by the kind of role assumed by the government in the promotion of social and economic development. Immediately after Independence and at the launch of the planning era, the government embarked on a massive expansionary role for which a huge manpower

Figure 3: The central government employee intake under the Five Year Plans.
Source: Government of India, *Economic Survey* (various issues).

resource base was created to serve in various departments. The initial huge recruitments would continue to churn out a large number of retirees for few more years.

However, it is seen that employee intake under the various 5-year plan periods (from the Third Plan onwards, the period for which annual employment data are available) shows that there has been a considerable decline in the numbers of employees recruited from one plan period to another (Figure 3).¹⁴ The decadal growth shows that employment increased by 33 per cent in the 1960s, 15 per cent in the 1970s, 7 per cent in the 1980s and there was a negative growth of 4 per cent in the 1990s. This suggests that a huge pension outgo at any particular point of time is not tantamount to a secular indefinite increase in pension payments unless and until it is associated with the same kind of civil servant intake all along. Hence, any temporal analysis pertaining to civil servant pension payments has to take into consideration public sector employment and the changes that have taken place in it over a period of time.

The number of central government employees as a percentage of the organised sector employment in the country has declined from 17.3 per cent in 1960–1961 to 11.45 per cent in 2003–2004. Table 1 provides an overview of the

Table 1: The central government employee numbers in India

Year	Civil departments	Railways	Grand total
1960–1961	927 214	1 162 786	2 090 000
1970–1971	1 392 452	1 378 848	2 771 300
1980–1981	1 620 729	1 574 371	3 195 100
1990–1991	1 754 815	1 654 985	3 409 800
2000–2001	1 711 415	1 549 385	3 260 800
2003–2004	1 581 572	1 445 428	3 027 000

Source: Government of India, *Economic Survey* (various issues).

number of central government employees during the period from 1960–1961 to 2003–04.

Table 2 shows the decadal growth in employment in two important government departments, namely, the civil department and railways. The 1960s had a close to 4 per cent rate of growth in the civil departments. The rates of growth have been much smaller in 1970s and 1980s. A negative rate of growth was observed in the 1990s and later.

Life expectancy at 60 years

The life expectancy at the age of 60 years has been on the rise, thus extending the period of pension payments that are committed in nature. Life expectancy for men in India has increased from 11.8 years in 1951–1961 to 15.7 years in 1995–1999, and that of women from 13 to

Table 2: Decadal annual average employee growth rate

Decades	Civil departments	Railways	Grand total
1961–1970	3.94	1.68	2.76
1971–1980	1.49	1.32	1.41
1981–1990	0.79	0.50	0.65
1991–2000	–0.28	–0.66	–0.45
2001–2004	–2.68	–2.34	–2.51

Computed by the author using data published by the Government of India, *Economic Survey* (various issues).

Table 3: Expectation of life at 60 years

Period	Male	Female	Persons
1951–1961	11.8	13.0	NA
1961–1971	13.6	13.8	NA
1970–1975	13.4	14.3	13.8
1976–1980	14.1	15.9	15.0
1981–1985	14.6	16.4	15.4
1986–1990	14.7	16.1	15.4
1991–1995	15.3	17.1	16.2
1995–1999	15.7	17.7	16.7
2005–2010	16.9	18.9	16.7

Source: Bose¹⁵ and ‘World population ageing’ (2007), New York: United Nations.

17.7 years during the same period. This is further expected to increase by 16.9 years for men and 18.9 years for women during 2005–2010, as shown in Table 3. This increased life expectancy means prolonging the pension payment period and eventually the public pension liability.

Pension revisions

The practice adopted in the country until now is to provide for both price and wage indexation. While price indexation occurs every six months, wage revision takes place only once in 10 years. Indexation procedures vary across nations; some follow only price indexation for pension payment (Table 4), the United Kingdom, for instance, which has largely shaped the civil servant pension system in India, is one among them. Other procedures, such as only wage indexation or a combination of both, are pursued in some other countries. India is one among those where both price and wage indexation is practiced, and as a result the pension provisioning appears to be more liberal in the country. However, the ‘replacement rate’ in India appears to be lesser than many other nations.

Table 4: Civil servant pension indexation procedure

Prices	Civil service earnings	Economy-wide earnings	Combination
Australia	Austria	Norway	Belgium
Canada	France		Denmark
Iceland	Germany		Finland
Italy	Brazil		Greece
Spain	Mexico		Luxembourg
Sweden	Turkey		Netherlands
Switzerland			Portugal
The United Kingdom			

Source: Palacios.⁴

The government of India has until now implemented recommendations made by the Fifth Central Pay Commission. The Sixth Pay Commission made its recommendations in April 2008.¹⁶ The hike in expenditure on account of price indexation has been contributing to the gradual increase in pension payments. Pay revision, on the other hand, has generally resulted in a sort of peak for a few years following the implementation of the Pay Commission recommendations. After which although there is a decline, the expenditure has been at a higher level. In particular, the increase that has occurred after the introduction of the Fifth Pay Commission was of a much higher order than the earlier ones. This is shown in Figure 4.

The impact of the Fifth Pay Commission

The impact of the Fifth Pay Commission recommendations as summarised in the Expert Committee report is presented in Table 5.

Having explained the reasons for growth in pension expenditure in India, some important trends in the pay and allowances and pension expenditure are explained below.

Increase in pay and allowances of the central government: Some trends

Data pertaining to the pay and allowances of the central government are presented in Table 6. Expenditure on pay and allowances increased from INR 417 crores in 1960–1961 to Rs 36,704 crores in 2004–2005, resulting in a compound rate of growth of 19.61 per cent per annum. However, the pay and allowance

Figure 4: Pay commission-wise annual average pension expenditure.

Table 5: Impact of the Fifth Central Pay Commission on pension benefits

Sl no.	Pre-1996 pensioner	Post-1996 pensioners
1	Ceiling on pension: INR 4500 p.m.	Ceiling raised to INR 15000 p.m. (50% of the highest pay)
2	No parity in respect of old pensioners	Full parity of pension for pre-1986 pensioners as on 1 January 1986 and modified parity w.e.f. 1 January 1996
		Pension raised to 50% of the minimum of the revised scale as on 1 January 1996 for all pensioners
3	Gratuity ceiling: INR 2.5 lakhs	Gratuity ceiling raised to INR 3.5 lakhs
4	Dearness allowance not included for calculation of gratuity	Dearness allowance included for calculation of gratuity
5	Commutation: one-third of the pension	Commutation increased to 40% of pension
6	Dearness relief neutralization pension 100% – up to INR 1750 75% – INR 1751–3000 65% – above INR 3000	100% neutralization against inflation. Complete relief to pensioners/ family pensioners on par with serving employees
7	Family pension rates were in slabs of 30, 20 and 15%	Uniform rate of 30% of pay for all categories subject to a minimum of INR 1275
8	Family pension ceiling: INR 1250	Ceiling raised to 30% of pay for all categories subject to a maximum of INR 9000
9	Dependent parents, widows/divorced daughters not considered for family pension	Dependent parents, widowed/divorced daughters included in the definition of family for the purpose of family pension
10	Dearness relief for re-employed pensioners and employed family pensioners was not allowed earlier	Dearness relief allowed for re-employed pensioners whose pay was fixed at the minimum of scale and to all employed family pensioners
11	Medical allowance to pensioners did not exist	Medical allowance of INR 100 p.m. was allowed for eligible pensioners who are not covered by the Central Government Health Scheme (CGHS)

Source: Report of High Level Expert Group on New Pension System (volume 1: main report), Government of India, Ministry of Personnel, Public Grievances and Pensions (Department of Pension and Pensioners' Welfare), February 2002.

Table 6: Pay and allowance expenditure of the central government

Year	Expenditure on pay and allowances (INR in crores)	Revenue receipts (%)	Revenue expenditure (%)	GDP at market price (%)
1960–1961	417	32.20	33.50	2.70
1965–1966	754	25.00	27.90	3.10
1970–1971	1186	36.02	37.89	2.60
1975–1976	1886	23.98	27.03	2.26
1980–1981	2751	22.23	19.09	1.91
1985–1986	5422	19.34	15.98	1.95
1990–1991	10027	18.25	13.64	1.76
1995–1996	18785	17.06	13.43	1.58
2000–2001	28688	14.89	10.33	1.37
2004–2005	36704	11.99	9.55	1.18

Source: 'Fifth Central Pay Commission reports,' *Indian Public Finance Statistics*.

expenditure as a proportion of the GDP has experienced a significant decline during the period under reference from 2.7 per cent in 1960–1961 to 1.18 per cent in 2004–2005. The peak level of 3.1 per cent was reached in 1965–1966. Pay and allowance expenditure as a percentage of revenue receipts (36.02 per cent) and revenue expenditure (37.89 per cent) reached its peak in 1970–1971. These declining trends, despite upward revisions effected to the pay by the various pay commissions appointed once in every 10 years, account for the fact that the size of the government staff has reduced during the period under reference.

Pension expenditure: Past trends

Just as wage payments, pension payments too are largely guided by the numbers and the increases effected to pension payments from time to time. The Fifth Pay Commission had hinted at 'a higher rate of retirement in the next ten years, because of 57 per cent increase in employment over the period 1957–71'.¹⁷ Subsequent trends in fresh recruitments to government employment up to 2003–2004, presented earlier, show a sharp decline. In view of this, both the number and the stock of retirees would follow a similar declining pattern after some years. However, this may not be the case with the absolute size of the pension-related expenditure, as it is guided by not only the number of pensioners but also by the price and wage indexation practices.

In order to understand the past trends and pattern of the pension-related expenditure, data were collected from 1964–1965 until 2003–2004, that is, the period covered by the OPS.¹⁸ The total pension expenditure in terms of its absolute size has had a considerable increase during the period of reference, from INR 31.24 crores in 1964–1965 to INR 26,205.06 crores in 2004–2005. Table 5 shows an exponential growth in pension expenditure of 18.45 per cent during the period from 1964–1965 to 2004–2005. The table also presents sectoral breakups of the four sectors that were available namely, civil, railways, posts and telecommunications and defence.

Table 7 shows that the increase has been very sharp for the Railways (21.2 per cent) followed by the civil departments (19.17 per cent) and defence (19.06 per cent). Posts and Telecommunication revealed the lowest increase (17.39 per cent). However, an important aspect to be noted here is that both railways and the civil departments had started with a much smaller base than that of defence; hence, while the rate of growth in railways and the civil departments is higher than that in the defence sector, the volume of pension payments for the defence sector is much higher than that of the other departments.

Sector-wise distribution of pension expenditure

The defence sector has accounted for the largest share all along; however, that share has been on the decline – reduced from 66 per cent to

Table 7: Temporal pension payments by departments (INR in crores)

Year	Post and Telecommunication	Railways	Defence	Civil	Total
1964–1965	3.36	2.2	20.56	5.12	31.24
1969–1970	4.47	7.63	34.36	8.11	54.56
1974–1975	9.12	18.99	87.61	19.53	135.25
1979–1980	26.57	75.35	192	54.89	348.81
1984–1985	73.27	278.15	479.88	148.72	980.01
1989–1990	216.02	782.01	1878.6	448.02	3324.65
1994–1995	409.68	1706.21	2730.84	922.9	5769.63
1999–2000	1118.58	4021.61	11024.03	3261.89	19426.12
2004–2005	1208.04	6696.89	11920.95	6379.19	26205.07
Growth rate	17.39	21.2	19.06	19.7	18.45

Source: Government of India.¹⁹

Table 8: Sector-wise distribution of pension expenditure (percentage to total)

Year	Post and Telecommunications	Railways	Defence	Civil
1964–1965	10.77	7.03	65.8	16.4
1969–1970	8.19	13.98	62.97	14.86
1974–1975	6.74	14.04	64.78	14.44
1979–1980	7.62	21.6	55.05	15.74
1984–1985	7.48	28.38	48.97	15.18
1989–1990	6.5	23.52	56.51	13.48
1994–1995	7.1	29.57	47.33	16
1999–2000	5.76	20.7	56.75	16.79
2004–2005	4.61	25.56	45.49	24.34
Average	7.15	21.94	54.73	16.18

45 per cent during the period of reference. This is shown in Table 8.

On average, the defence sector (currently not included in NPS) accounts for about 54.73 per cent followed by railways with 21.94 per cent, and thus the two sectors together account for more than 75 per cent of the total pension outgo. Posts and telecommunication, on the contrary, had a small share, which was also on the decline. Railways started with the smallest share, but have experienced a sharp increase. (Figure 5)

Railways are a commercial undertaking, which had created a pension fund to meet its future pension liability. The huge increase in pension payments would not have been burdensome had it effectively operated the pension fund created for the purpose. It is observed that ‘As a commercial undertaking, the railways are required to contribute to the actuarially estimated amounts

to this fund so that the balance in the fund accurately reflects the amount paid in a particular year, as well as the potential cumulative liability for the pension benefits earned for each year of service. The railways have failed to do so. In addition, they did not operate the fund in the manner it was originally contemplated and simply dressed up their balance sheets to reflect this contribution’.²⁰

Pension payments and GDP

Pension expenditure as a percentage of the GDP was 0.13 per cent in 1964–1965, which increased to 0.93 per cent in 2004–2005. It reached its peak of 1.1 per cent of the GDP in 1999–2000, after which there has been a decline. On average, pension payments have constituted 0.51 per cent share of the GDP during the period of reference. Incidentally, the rate of growth in the GDP during 1991–1995 was 6.43 per cent per annum

Figure 5: Percentage distribution of pension outgo by sector.
Source: Government of India.¹⁹

Figure 6: Pensionary expenditure as a percentage of the GDP.
Source: Computed by the author using the data from Government of India¹⁹ and the GDP data from the various issues of *Economic Survey*.

and 5.87 per cent during 1996–2000. This was lower than the rate of growth in 1985–1990, when it was 7.01 per cent.²¹

A close look at the chart highlights two interesting aspects. First, the overall trend and its increase are largely guided by the pension payments of the defence sector. Second, the increase was not very significant until the mid-1980s, followed by a marginal increase until the mid-1990s, and a sharp increase thereafter.

These trends synchronise well with the recommendations of the Pay Commissions, especially the Fourth and the Fifth Pay Commissions, and their full implementation. Implementation of the Fifth Pay Commission's recommendations in the case of the defence sector took a longer time than the other sectors, and thus its complete effect was realised only in 2000–2001. This is presented in Figure 6.

Figure 7: Pensionary expenditure as a percentage of revenue receipts.
Source: Computed by the author using the data from Government of India.¹⁹

Pension expenditure in relation to revenue receipts

Although it is meaningful to study the trends in the share of pension payments to the GDP, it is more important to analyse what portion of the governmental receipts are used up in pension payments. These payments are committed payments, and the resource availability for other developmental activities directly depends on the size of such committed payments.

The 1990s had experienced a considerable increase in the share of pension expenditure to the revenue receipts, which, however, showed a declining trend after 1999–2000 (Figure 7). During this decade it was observed that pension payments increased sharply. The decade was also marked by a deceleration in revenue growth. Gross tax revenue as a percentage of GDP declined from 10.12 to 8.78 per cent between 1990–1991 and 1999–2000. Net tax revenue, that is, share of central government after netting out the share of the states during the same period declined from 7.56 to 6.55 per cent.²²

PENSION REFORM DEBATES

This prevailing situation in civil servant pension payments has resulted in serious debate about initiating reforms in an important item of expenditure of the government.

One school of thought urges the government to initiate immediate steps to introduce reforms to reduce the financial outgo and restore fiscal balance. The other school of thought, largely comprising of the pension associations and government employee associations, has been imploring the government to impart more liberal terminal benefits to the retirees. The judgements of the Supreme Court of India also strongly recommend continuance of the practice of pension payment. Various arguments favouring reforms and those opposing reforms are presented in this part of the paper.

Arguments in favour of pension reforms

Fiscal pressure

An important factor generally cited for introduction of pension reforms is on account of the rapid growth observed in civil servant pension payments, which is likely to pose a serious threat to fiscal sustainability. It is feared that the sharp growth in such expenditure could crowd out public investments in education, health and infrastructure.²³ This is especially the case with low-income countries with a limited tax base.⁴ It is also felt that the structure of pension programmes serves to weaken the

functioning of labour market and to distort resource allocation. The PAYG system practised over a period for the government servants has resulted in an increased cost on account of pension payments. It has also been observed that civil servant pension benefits were generous compared to those available to the private sector.⁴

Wider coverage

Only 11 per cent of the labour force is presently covered under this security scheme.²⁴ It is argued that when such a large section of the society falls outside the purview of the social security provided by the government, it may not be possible to sustain a subsidy-based pension programme to a few people for long. It is further argued that there is a need to scale it up to many others in the uncovered sector to combat poverty among the elders. A number of countries provide social security to the old.

Family system

India is a country that has been practicing a joint family system for long. Parents, grown-up adult children and their families live together in one house. Children in such households get parental and elderly care until they become financially independent. They also have the right to inherit the property. Children in turn assume responsibility to fend for the old, including elders other than their own parents. This joint family system has, to some extent, an inbuilt care mechanism for the old and the infirm. However, with modernisation, this joint family system is rapidly disintegrating. The current preference is for nuclear families. The disappearance of the joint family system is considered to be yet another cause for the destitution of the elderly and the enhancement of their poverty. Hence, it is argued that there is every need for the government to step in and provide support to such destitutes. Creation of pension wealth by appropriate pension reforms would provide the required resource support to scale up the social security coverage.^{25,26)}

Demographic transition and pension wealth

Creation of a funded pension system whereby the labour force can start investing in pension

accounts early in their working life is expected to fetch good returns for such long-term investments. This in turn will boost their pension wealth and reduce their financial dependency on others.

The demographic transition in India, in which India's working age population will constitute an increased share from the current level of 60 to 63.5 per cent in 2040, provides a good opportunity to tap the demographic dividend that India is going to experience, and to use this advantage to enhance the national saving rate.²⁵

There is yet another dimension to the demographic transition in the nature of a sharp increase in the proportion of the population above 60 years of age that is expected to occur in the early part of the next century. It is feared that this bulging of population in the older age group is going to cause a huge increase in social security payments world over. In India, this proportion of the population above 60 years of age, would increase from 8.62 per cent in 2010 to 13.75 by 2030 and to 20.14 per cent in 2050; however, this is much lower in comparison to many other nations.

It is from these perspectives that pension reforms are suggested.

Arguments against pension reforms

On the other side, there are strong reasons for why pension reforms are not needed. Some of them are as follows:

Deferred wage

In the context of civil servant pension payments, it is argued that the principle guiding the fixation of the pay package is one of intentionally spreading out the compensation over a long period of time. Wages paid out during the course of the work tenure are kept low by design, and the pension payments made during the retirement phase are expected to compensate for the low working wages. The Supreme Court of India held that pension is neither a bounty nor a matter of grace depending upon the sweet will of the employer. It is not an *ex gratia* payment, but a payment for past services rendered. It is a social welfare measure, rendering socioeconomic justice

to those who in the heyday of their life ceaselessly toiled for the employer on an assurance that in their old age they would not be left in the lurch.

Willmore observes²⁶ that ‘Actually, civil service pensions, because they are not based on contributions, are best described as deferred wages. Civil servants accept a lower current wage in exchange for the promise of a pension in their old age. If this pension were contributory, they would insist on a higher wage and government would have to either increase taxes or borrow (issue debt) to pay it. The real cost of civil servants is thus much higher than recorded under the current system of cash accounting. A good reform would be to move to a system of accrual accounting setting up at least a notional fund to pay these deferred wages’.

Public and private sector pay differentials

The Indian government has assumed the role of a model employer and has played a major role in the provision of secure jobs. Studies that have compared the public and private sector wages show mixed evidence. A study by Glinskaya and Lokshin²⁷ shows that public sector employees get better paid than private sector workers. On the other hand, Duraiswamy and Doraiswamy, and Madheswaran^{28,29} show that public sector wages are lower than those of private sector workers, and wage differentials increase with experience. It is also feared that if this trend continues, public sector will not be able to attract talented workers, and inefficiency will creep in. Currently, the job security and the pensionary benefits that government sector workers enjoy have been to some extent acting as an incentive to retain workers in the government sector.

Future pension payments: Is there an alternative to the PAYG system?

The government of India will have a future pension liability for employees under OPS continuing into the decade of 2070, although on a declining scale after 2036–2037. This liability, in the normal course, is expected to be met from the current revenue of the government, unless reformed. Actuarial estimations to calculate the

Table 9: Fund requirement scenarios (INR in crores)

Period	Interest 6.50%	Interest 7.00%	Interest 7.50%	Interest 8%
10 years	59745	56097	52874	50018
15 year	45678	43259	41115	39211
20 years	38980	37191	35600	34184
25 years	35211	33809	32559	31441

Source: Gayithri¹³

net present value and examine whether the government can fund these pension payments show that it would be fiscally prudent to continue with the PAYG system. This is in view of the fact that investments warranted for any switch over to funded system are huge, and government finances would augur well without making such investments. The funding requirement is shown in Table 9.

In the Indian context, the pension reform issue is best addressed with the employment and wage fixation policy of the government. In the event that deferred wage is not a guiding principle, there is a need to fix wages that are competitive with those of the private sector, failing which the government sector will fail to attract a talented workforce.

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