

Old-Age Income Security for the Poor

While the new pension system that is being promoted in the country is appropriate for those who can save for their retirement, there is need for an alternative approach for low-income people who cannot fully provide for their retirement, for which reason a significant proportion of workers may not be able to benefit from the new system.

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The new pension system is very much along the lines recommended by the OASIS Committee report: having a defined contribution scheme, creating an individual retirement account, letting pension fund managers manage funds, strict non-withdrawal of savings for getting tax benefits, and certain minimum percentage of accumulated sum to be spent on buying annuity at the time of retirement. This system, we argue, is not suitable for low-income people who either cannot or can only partially contribute towards meeting their old-age needs. The proposed scheme pays undue importance to the efficiency aspect and neglects the redistributory aspect which is the core of providing old-age security to low-income people. Given the fiscal limits of government, a decentralised approach that brings about some redistribution at the local level may well be an appropriate way of providing old-age security to the low-income segment of the population.

I

In India old-age income security is not well developed. About 85 per cent of the total workforce is in the unorganised sector with little or no formal old-age income security.¹ The issue of old-age security is gaining importance, and it is now high on the public policy agenda. What kind of old-age social security system is appropriate for these workers? And how is it different from what is being sought to be promoted? We try to answer these questions.

The ministry of social justice and empowerment that is entrusted with the nodal responsibility for care of elderly recognised the emerging problem resulting from absence of old-age security for the vast majority on one hand, and the growing proportion of the elderly population on the other. The proportion of the elderly (those above 60 years of age) in the total population is expected to increase from 7.1 per cent at present to 13 per cent by 2025, that is, from 72 million to 175 million. Besides the increasing number of the elderly, India is also witnessing longer life expectancy at age 60. The present average life expectancy at the age 60 (which is 17 years) is expected to increase in the coming years. Quite rightly the ministry has realised the need for developing a sound system for old-age income security in the country.

Accordingly, the ministry constituted a committee, known as the Dave Committee, to examine the issue and to recommend a system for unorganised sector workers. Although the committee in its report, popularly known as the OASIS report, examined old-age income security in general, its prime focus was on “the great mass of individuals who are working outside the pension provisions that presently exist in the organised sector”. The committee articulates the seriousness of the emerging problem. It perceives, “a serious threat that a majority of these workers, who may not be below the poverty line in their working lives, might sink below the poverty line in their old age, simply because they have not accumulated enough savings during their years in the workforce.”

This reality coupled with the fact that the number and proportion of the elderly population is going to increase significantly in the coming decades makes the issue of old-age security “much beyond the capacity of the government”. The committee notes, “for instance, providing a Rs 100 per month old-age pension to the projected 175 million population of the elderly in 2025 would translate into an unusual outflow of over Rs 21,000 crore for the government.”

The committee seeks to address this problem through “thrift and self-help.” Accordingly, the committee considers it important to create “necessary institutional infrastructure to enable and encourage each citizen” to prepare for old age by savings accumulating through their decades in the labour force. How is this to be achieved?

Broadly, the OASIS committee recommends: (i) devising a new pension provision for excluded workers who are capable of saving even a modest amount through their working career, (ii) converting these modest contributions into reasonably large sums in an almost risk-free manner, and (iii) buying annuity plans upon retirement from the accumulated amount. This way the report believes that old-age security can be created for the excluded workers spread all over India. The new pension system that is being launched in the country is also based along these lines. It gives importance to efficiency, and totally neglects the redistributory issue that is crucial for development of a pension system for low income people.

The OASIS report recommends that the new pension system be based on individual retirement accounts. “The account will provide the individual with a unique IRA number that will stay with the individual through life. The individual would save and accumulate assets into this account in his working life, subject to a minimum of Rs 100 per contribution and Rs 500 in total accretions per year. Individuals would be free to decide the frequency of accretions into their accounts; there will be no pressure to make a fixed monthly contribution. Individual accounts imply free portability.”

The central assumption in the committee’s prescription, and also in the new pension system, is that the unorganised workers can themselves contribute towards their retirement income provided they are encouraged to do so. While this assumption may be appropriate for the high- and middle-income workers in the unorganised sector, it is questionable for the low-income workers whose share in the total workforce may be anywhere between 30 per cent and 50 per cent. We elaborate on this in the next section.

II

The unorganised sector consists of a heterogeneous mix of workers from well-educated, well-off self-employed professionals to farmers, vegetable vendors, rickshaw-pullers, shoeshine boys, construction workers, casual/contract labourers and so forth. It is hard to imagine how the same system could be appropriate for such a heterogeneous group. Many of these workers not only do not have a regular monthly income, but also face high risk of being without work from time to time.² For the low-income people the basic assumption that they can contribute towards their pension is flawed. The proposed system could be appropriate for the low-income people if it is successful in promoting savings for old age and/or enables better management of funds already being saved. We argue that on both these counts the proposed system is faulty when it comes to dealing with low-income workers. Promoting savings for old-age security is possible if at least one of two things is achieved: (i) higher savings rate (ii) a switch from short-term to long-term savings. Neither of these is expected to be achieved by the proposed system. The rate of private savings is certainly not low in India. But most of these savings occur in the top half by income distribution. According to one recent national survey [NCAER 2000], the poorest 12.4 per cent of households dissave on average and the bottom half of households by income distribution are responsible for only about 2 per cent of all savings in India. Indeed, when income is low, basic needs override all other needs. The scope for saving by reducing basic needs is really very limited. Moreover, whatever little amount they manage to save gets used up within a short period of time when they either suffer income shock or have to incur higher expenditure on some social event or purchase of some asset. Therefore, such savings are mostly of a short-term nature and are stored in instruments/assets having high liquidity. This too is the result of low incomes. To quote the World Bank (2001), “The reluctance to engage in medium- or long-term savings is partly a reflection of the low incomes of majority of Indian households”.

To assume that these workers are saving less than what they can potentially do is erroneous. At younger ages, when workers are struggling to meet their present basic needs and to honour their not-so-distant commitments, asking them to save for their old age is absurd. Therefore, at that level of income it is difficult to either promote thrift or to encourage a switch from short-term to long-term savings. It is a plain and simple question of income or resources.

The incidence of poverty and destitution among the old is, without doubt, significantly higher than in the case of the young. The reason for this may partly be the inability to foresee the decline in earning capability as one gets older, and hence the need for ensuring for old age by setting aside some savings during one's productive life. This behaviour may be described as myopia or short-sightedness.³ But this is true where workers have income to save during their working life. When income is already low it is the inability to save rather than inability to foresee decline in income that kicks in.

If something can still be salvaged from the proposed system, it is through demonstrating that the system is better in management of savings for old age by the low-income people. The single measure that captures better management of funds is the net return on investments. Net return is a function of gross return less transaction costs. For the low income people engaged in their small business what investment can provide better than that in his own business in which they are already labouring. To quote James (1999), "...even when they save, the best rate of return for them may come from investing in land, homes, tools, or the education of their children, who will return the loan by supporting them in future...investing in the human capital of their children or in a family business may be the best old age security programme."

Furthermore, for workers with modest contributions going through the proposed system is likely to have high unit transaction costs. The report admits that "the challenge in building a pension system also lies in obtaining low administrative costs, nationwide collection, and adequate simplicity for participation by millions of people with highly limited financial sophistication."

To address this the report suggests (and the new system is also designed along similar lines) that individual contributions are mobilised by what it calls the "points of presence" that include bank branches and post offices. Currently there are around 64,000 bank branches and 1,53,000 post offices. Funds collected through these points of presence are transferred to the fund managers who invest the money so collected in bonds and equities. Even with this proposed arrangement the unit transaction costs are likely to be higher for small contributions. In the words of James (1999), "...the transaction costs of collecting many small voluntary contributions might be relatively high".

The report makes several suggestions with respect to service delivery, pension fund management, regulatory framework, implementation, etc. All these suggestions make perfect sense for workers with relatively large contributions, but not for low-income workers who have small/modest contributions, if at all. So, on all the above grounds, there are strong reasons to believe that the proposed system is inappropriate for them.

III

How then to build old-age income security for low-income workers? When dealing with people lacking resources the best approach is to help them generate higher income. While this is a long-drawn process from which there can be no escape, some redistribution for low-income group is a must. How can it be achieved in a situation where governments lack the wherewithal? The answer lies in the on-going process of decentralisation that is gaining momentum in the country. The elderly population lacking resources are already to some extent the beneficiaries of the community in which they live. The benefit is not only in terms of cash, but also in kind in terms of food, healthcare and some ready help. In communities and villages, often people at the individual level dole out something to the poor elderly. In most cases, this system is not well-structured and highly uncertain. Many times the help is not timely. This informal system needs to be strengthened and streamlined, and the local government with the cooperation of NGOs and spirited social workers

can bring this about. That the government has a decisive role in the provision of old-age income security to the poor elderly is well recognised in the OASIS report. But the report confines its role to providing security only to the poor elderly and that too through anti-poverty programmes. However, in developing a pension system for the low-income people too, the local tier of government, namely the panchayats, can be assigned a role. How to organise a pension system at the community level is an open issue. We need to experiment with it.

An appropriate pension system for them is one that is flexible and has some redistributive component.⁴ Some amount of redistribution can be effected at the community level itself. This could be supplemented with subsidy from the higher layers of government. For example, the scheme may allow for a matching subsidy. Since these workers do not pay taxes, incentives by way of tax exemption, as envisaged in the new system, do not really encourage savings. Local information can be used to identify the really needy and also the appropriate subsidy amount. Another main advantage of the community level approach is to keep the transaction costs to the minimum.

Moreover, for the elderly people pension is not the only issue. Health care is equally important. The report recognises this link between pension and health: “a rise in the number of older persons often causes a corresponding increase in government expenditure on non-contributory pensions and health services.” The report further notes that “this problem [of lack of income security in old age] is further compounded since they will have to incur heavier expenditure on health during old-age, neglect of which would only worsen their quality of life.” For health care provision, the community level approach is already being tried and tested. Similar initiatives and experiments can be tried for the provision of old-age security as well.

Low-income workers were topmost in the mind of the ministry of social justice and empowerment when it started this whole debate on pension sector reforms in the country. It is a pity that the new system that is being established in the country as a result of this debate is expected to benefit others, but not these people.

Notes

- 1 Almost 90 per cent of India's workforce is not eligible to participate in any scheme that enables them to save for economic security during their old age (OASIS report).
- 2 For the poor elderly the OASIS report favoured that they be covered through anti-poverty programmes.
- 3 If the idea is that government corrects their myopia in planning for their old age, then there are numerous ways in which the government can play a paternalistic role that can make their old age better. For example, promoting healthy living, having lower encumbrances by having a smaller number of children and so forth. Indeed, the government could perform paternalistic role in a much better way by improving their capabilities through education and skill formation. So there are a host of areas through which living in old age can be made comfortable. Why just only through long-term savings?
- 4 Quite distinct from long-term poverty, inadequate savings are one of the main reasons for government involvement in social security.

References

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