

A Comprehensive Analysis of Pension Schemes in India

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Abstract

Pension schemes serve as a primary means of social security, providing financial support to individuals for many years following their retirement from employment. The traditional pension scheme is particularly beneficial for public sector employees, ensuring they have a reliable source of financial assistance even after they retire. To address the shortcomings of the old pension scheme and to reduce the government's financial burden, a national pension system was initiated in 2004. The aim of this system is to offer financial security and stability to employees who have retired from the central government, especially during their old age when they lack a consistent source of income. Under the national pension system, the funds for post-retirement pensions are contributed jointly by both the employee and the employer. The transition from the old pension scheme to the national pension system sparked significant public unrest, which continues to this day. In response to the implementation of the national pension system, several states across the country have adopted it; however, the central government has now introduced a new pension scheme known as the unified pension scheme. This scheme is designed to provide pensions to public employees upon their retirement. The unified pension scheme will take effect on April 1, 2025, at which point central government employees will be transitioned from the current national pension system to the unified pension scheme. Additionally, state governments will have the option to independently adopt and implement the newly introduced unified pension scheme.

Keywords: Old Pension Plan; National Retirement System; Consolidated Pension Scheme; Authority for the Regulation and Development of Pension Funds.

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Objectives of the Study

1. To examine the pension systems of India, specifically the old pension scheme, the national pension system, and the unified pension scheme.
2. To perform an analytical study on the functioning of the old pension scheme, the national pension system, and the unified pension scheme.
3. To carry out a comparative analysis of the old pension scheme, the national pension system, and the unified pension scheme.
4. To identify shortcomings and provide recommendations and solutions for improved implementation and operation.

I. INTRODUCTION

Pension schemes and systems represent a crucial component of social security, designed to benefit individuals following their retirement from extended periods of active employment. These schemes reflect a progression towards the welfare state ideology, taking into account the continuously evolving social and economic dynamics of society, which is transitioning from traditional pension schemes and national pension systems to a more unified pension scheme.

At the beginning of the 20th century, the government implemented an old pension scheme that granted retired government employees defined pension benefits based on their final pay scale, which served as a reliable income source for these retirees. However, this old pension scheme, while advantageous for a limited segment of society, faced scrutiny due to the rising number of retired employees and the increasing life expectancy of retirees, prompting government reviews concerning its stability and financial sustainability.

To promote the pension sector in our nation and to foster its development and regulation, the government proposed the establishment of a Pension Fund Regulatory and Development Authority in 2003. This authority initiated a contributory pension system in 2004, known as the national pension system. Furthermore, on February 1, 2014, the Pension Fund Regulatory and Development Authority expanded the national pension system's scope to include the Central government, interested State governments, Central and State self-financed institutions, private organizations, and all Indian citizens. Presently, the national pension system is overseen and regulated by

the Pension Fund Regulatory and Development Authority, which also guarantees its significant and systematic growth and advancement.

The establishment of the national pension system aligns with a self-financed pension scheme framework that adheres to global pension regulations emphasizing the importance of financial planning by individuals and encouraging greater awareness of personal financial responsibility. Nevertheless, this new pension system has introduced specific challenges related to its implementation, which necessitates extensive public awareness, comprehension of the schemes, and knowledge of the financial market, including its fluctuations. As the nation advances, the effectiveness of the pension scheme in providing financial security to the general populace has sparked considerable debate. There has been a growing public outcry to abolish the recently implemented national pension system and revert to the previous pension scheme. To address this issue and meet the needs of retired public servants, the central government has proposed a unified pension scheme and has sought to persuade the public that this new scheme is superior to the traditional pension plan. The unified pension scheme is set to take effect on April 1, 2025, ensuring pension benefits for retired government employees. Employees of the central government will transition from the national pension system to the unified pension scheme, and state governments will also be encouraged to adopt this unified pension option.

OLD PENSION PLAN

The inception of the old pension scheme can be officially traced back to the 20th century in our nation, which was primarily designed for civil servants and government employees. Under this scheme, the pension was determined based on the final pay scale of a government employee, ensuring that the retiring employee would receive specific defined pension benefits. A distinctive characteristic of the old pension scheme is that it was non-contributory in nature, as the financial burden of the pension expenses was borne entirely by the government, enabling retired government employees to receive pension benefits for their lifetime.

CURRENT CONTEXT AND FUTURE OUTLOOK

At present, the national pension system has significantly increased in public trust and acceptance, with millions of individuals, including both public and private sector employees, participating in this pension framework. The shift from the previous pension scheme to the new pension system reflects a global trend towards self-financed retirement plans, emphasizing the significance of personal accountability in retirement policies and strategies. Nevertheless, challenges persist, particularly in terms of widespread public awareness about the national pension system and the misconceptions held by stereotypical investors concerning their apprehensions about the volatility of the financial market. The historical evolution of the pension scheme and system in our nation illustrates the changing social and economic conditions, highlighting the necessity for ongoing adjustments in this area. Given the increasing population of our country, along with the growth of the working class, pension schemes and systems aimed at ensuring financial security for all citizens will be crucial.

OLD PENSION PLAN, NATIONAL PENSION SYSTEM, AND INTEGRATED PENSION PLAN

In our nation, following retirement, pension schemes and systems such as the old pension scheme, the national pension system, and the unified pension scheme address various ideologies from diverse segments of society. Each pension scheme or system possesses distinct characteristics, advantages, and drawbacks, which are elaborated upon below:

Old Pension Scheme:

The various aspects of this pension scheme have been elaborated upon in the following points:

1. **Defined Benefit Structure** - The old pension scheme operates on a defined benefit structure, indicating that the retiree will receive a fixed pension amount that has been established based on their last drawn salary.
2. **Non-Contributory Nature** - Under the old pension scheme, employees are not required to make contributions towards the pension.
The amount of pension is solely borne by the government, which finances the pensions of retiring government employees from its budget. This pension scheme model offers immediate financial advantages to retired government employees; however, it imposes a long-term financial burden on the State.⁵
3. **Lifetime Pension** - Under the previous pension scheme, a retiring individual is assured a lifetime pension, meaning that once a government employee retires, they will receive their monthly pension until their death, ensuring that retired government employees receive financial support throughout their old age.⁶
4. **Periodic Adjustment** - When the pension amount is established under this scheme, the government may adjust the pension amount periodically, considering the current inflation rate. However, there is no assurance of such adjustments, as they depend on the government's budgetary condition and policies.⁷
5. **Limited Scope** - The old pension scheme overlooks the unorganised service sector, which is significant in our country, and primarily focuses on government employees.⁸

6. **Lack of Portability** - The old pension scheme exhibits a considerable lack of portability, rendering pension benefits non-transferable across services and sectors. Employees who transition from government positions to the private sector forfeit their pension benefits, potentially leading to financial insecurity and instability.⁹

National Pension System: This system is elaborated upon in the following points:

1. **Contributory Structure** - Unlike the old pension scheme, the national pension system operates on a defined contribution basis, where both the employer and employee contribute 1% of the employee's total salary to the pension fund. This aspect of the pension system motivates employees to actively engage in post-retirement benefit schemes.
2. **Broad Inclusion** - The national pension system has been designed as a comprehensive inclusive policy, allowing every employee from both the private and unorganised sectors to participate in this national pension scheme. This extensive reach guarantees social security for every employee across all sectors.
3. **Investment Flexibility** - Individuals who have opted for a pension policy under the national pension system have various options available to them regarding how to invest their pension funds. Each employee can select from choices such as equity, government bonds, or corporate loans, along with other investment methods, enabling them to tailor their investment strategy according to their risk tolerance and financial objectives.
4. **Portability** - The national pension system offers portability, allowing customers to transfer their accumulated pension funds to other services or sectors. This particular feature is especially advantageous for individuals seeking flexibility in managing their retirement savings. In a context where employees frequently transition between various service sectors.
5. **Market-Related Returns** - The national pension system stipulates that the returns on investments in the pension fund are contingent upon market performance, indicating that potential returns may exceed those of other established income schemes. Nevertheless, this also introduces a risk factor, as market volatility or underperformance can adversely impact the savings and investments within the pension fund.¹⁴
6. **Withdrawal and Annual Options** - Upon an employee's retirement, participants in the national pension system have the option to withdraw a portion of their total accumulated funds while reinvesting the remaining amount into other annual schemes. This provision allows individuals to manage their post-retirement savings in accordance with their financial requirements.¹⁵
7. **Regulatory Framework** - The national pension system is overseen by the Pension Fund Regulatory and Development Authority, which has instituted specific guidelines and regulations to promote transparency and accountability within the pension system. This regulatory structure enhances the formal management and credibility of the national pension system in comparison to the previous pension scheme.¹⁶

Unified Pension Scheme: The unified pension scheme represents a hybrid model that incorporates elements from both the old pension scheme and the new pension system, offering investment-based growth alongside a guarantee of a minimum pension amount, thereby fostering stability and flexibility in post-retirement benefits. Additional features are outlined below:

1. **Government and Employee Contributions** - The government's contribution to the pension fund will be 18.5%, an increase from the previous 14% of basic pay and dearness allowance.
2. **Eligibility and Pension Benefits** - A pension amounting to 50% of the average basic pay over the last 12 months will be granted to employees who have completed 25 years of service, with the pension calculated based on the ratio of the service period of employees.
3. **Family Pension** - In the event of an employee's death, the pension amount equivalent to 60% of the employee's income will be disbursed to the spouse of the deceased employee.
4. **Minimum Pension** - Employees who have served for a minimum of 10 years under the unified pension scheme are entitled to receive a monthly minimum pension of 10,000 rupees.
5. **Index of Pension** - To guarantee the pension, one-third of the pension beneficiaries among industrial workers will receive payments based on the Indian Consumer Price Index, ensuring they obtain a fair and equal benefit.
6. **One Time Withdrawal** - Upon the final retirement of any employee, there is a provision for a complete one-time withdrawal of the total pension amount.

ANALYSIS COMPARATIVE OF THE OLD PENSION SCHEME, NATIONAL PENSION SYSTEM, AND UNIFIED PENSION SCHEME.

To comprehend the effectiveness and stability of the previous pension scheme, the new pension system, and the unified pension scheme, it is essential to recognize and examine the fundamental distinctions among them. The various aspects of these schemes are discussed below under the following headings:

Structure of Benefits

1. The previous pension scheme operates as a defined benefit plan, wherein retired employees receive a specific, predetermined monthly pension based on their duration of service and their final salary.

2. In contrast, the national pension system functions differently from the old pension scheme, as the benefits are determined by defined contributions. In this system, both the employer and employee contribute a portion of the salary to the pension fund. The total pension amount accumulated at retirement is based on the overall contributions and the invested amount, resulting in a system that is less predictable yet more financially stable.

3. A unified pension scheme is established, which considers a minimum of 25 years of service. Prior to retirement, the average salary drawn by the employee over the last 12 months is calculated. A minimum of 10 years of service is necessary, and for those retiring after 10 years under the unified pension scheme, a minimum monthly pension of 10,000 rupees is provided to the employee.

Financial Accountability

1. The responsibility for the old pension scheme lies entirely with the government, which bears the full burden of pension payments, resulting in a significant fiscal strain.

2. The national pension system shares the pension burden between employers and employees, wherein the defined contribution includes 10% of the basic pay and dearness allowance from employees, along with a 14% contribution from the government, thereby reducing the fiscal burden on the government. This model motivates government employees to engage in and take an interest in their financial future post-retirement.

3. Under the unified pension scheme, employees will contribute 10% of their basic pay, while the government will contribute 18.5%.

Coverage and Inclusiveness

1. The old pension scheme mainly benefits government employees, leaving a significant portion of the working class, particularly those in the unorganised sector, without access to this scheme, which creates disparities in social security among workers.

2. The national pension scheme has been structured to be more inclusive, allowing participation and contributions from private and unorganised sectors, as well as all other citizens, ultimately enhancing the overall social security framework in society.

3. The unified pension scheme is set to be implemented on 1st April 2025, at which point central government employees will transition from the national pension system to the unified pension scheme, and state governments will also have the option to adopt this scheme within their jurisdictions.

Investment and Return

1. Under the previous pension scheme, the pension amount remains unaffected by market performance, providing a fixed pension to the employee; however, it experiences a lower rate of increase. While periodic adjustments may occur, there is no statutory guarantee, and it ultimately relies on the government's discretion.

2. The national pension system allows customers the flexibility to select their investment approach, whether in equity, government bonds, or corporate loans, which enhances the potential for returns. However, this increased rate of return is accompanied by market fluctuations, introducing a certain level of inherent risk.

3. In the unified pension scheme, the pension amount will be determined based on the inflation rate, and for industrial laborers, the rate of return will be calculated according to the all-India consumer price index.

Portability

1. The previous pension scheme lacks portability, meaning that if an employee, particularly a government worker, changes their profession, they will forfeit their pension benefits. This absence of portability contributes to a feeling of financial insecurity, especially as employees frequently switch professions.

2. A key feature of the national pension system is its portability, allowing subscribers to transfer their accumulated pension funds in accordance with changes in their service and sectors. This ensures that employees can retain their pension benefits despite changes in their employment.

3. The government has yet to determine whether the unified pension scheme will provide any benefits based on contributions from both employees and the government.

Regulatory Supervision

1. The old pension scheme is subject to limited oversight by regulatory authorities, leading to discrepancies in the distribution and determination of employee pensions.

2. The national pension system is effectively overseen by the Pension Fund Regulatory and Development Authority, which enhances transparency and accountability in its operations, thereby fostering confidence and integrity among subscribers.

3. The unified pension scheme will also fall under the supervision of the Pension Fund Regulatory and Development Authority.

II. CONCLUSION AND SUGGESTIONS

After conducting an analytical examination of the previous pension scheme, the national pension system, and the unified pension scheme, it is evident that the post-retirement benefit scheme in India reflects diverse perspectives within society.

Nevertheless, despite the fact that our country's economy has surpassed all previous records and has emerged as the fifth largest economy globally, it appears that the government has significantly struggled to implement pension schemes and systems effectively. Instead, there has been a notable increase in the pensions of members of parliament and various legislative assemblies. The government asserts that the unified pension scheme, which is set to be implemented in the near future, is considerably superior to both the old pension scheme and the national pension system.

A consolidated pension scheme, in contrast to the previous pension scheme, will alleviate the financial strain on the government while offering a more equitable pension system. Simultaneously, it will reduce the government's liabilities, thereby enhancing and fortifying fiscal stability and confidence. The unified pension scheme, being partially privatized, has fostered improved management of government budgets along with better financial strategies and policies. Within the framework of the unified pension scheme, the advantages of defined contributions will surpass those of defined benefits.

Under the forthcoming unified pension scheme, there will be a consolidation of the benefits from both the old pension scheme and the new pension system, effectively eliminating the deficits associated with these two pension schemes. The primary objective of this scheme is to meet the aspirations of employees while simultaneously addressing the physical burdens they face. With a confirmed return and protection against market inflation rates, there is a likelihood and optimism that the implementation of the unified pension scheme will lead to an increase in the overall pension fund, thereby reducing the risks associated with loans and other market uncertainties.

The government is required to establish and execute the pension scheme in a manner that guarantees ordinary citizens a dignified life. As they age, these individuals should not be forced to make any undesirable compromises that undermine their interests and dignity.

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