

# EARLY LESSONS FROM ATTEMPTS TO EXTEND PENSION COVERAGE IN INDIA THROUGH AN MDC

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# Background

- India is aging but there are big regional variations
- Data shows that India's elderly are highly dependent on children, especially old women
- There are high rates of co-residence and studies show that India's elderly are not poorer than other age groups...but this may be due to survivorship bias (Palacios/Pal 2010)
- Social pension benefit levels are low and are received by roughly one in five elderly
- Less than 10% of current labor force covered by formal pension system, mostly in public sector

# Policy environment

- India's economic growth is strong – around 8% last five years
- Current government expanding large social programs including workfare, health and life insurance and social pensions for the poor
- Also passed Social Security for Unorganized Sector law in December 2008

# Evolution of India's pension policy

- Origin of current policies in late 1990s with special commission that favored DC, private management and diversified investments
- Led to reform of old British DC scheme for civil services in 2004 – new entrants in DC scheme with 20% contribution rate, private asset managers
- A robust admin and fund management model was put into place with a view to use it for the informal sector
- Opened to the informal sector in May 2009 but with no fiscal incentives
- In April 2010, incentive through matching contribution was included in the new budget

# NPS

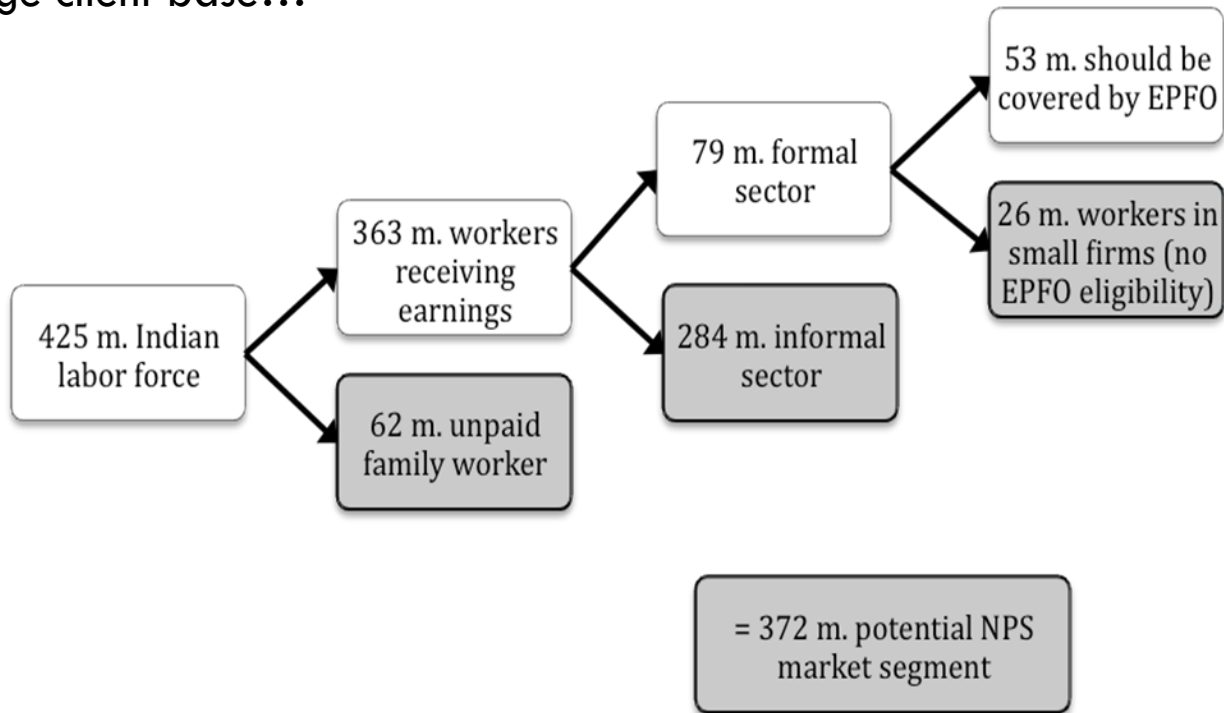
- The New Pension Scheme (NPS) isn't that new any more. There are about 1.3 million contributors and it is automatically growing as new civil servants replace the old
- Assets now total US\$1.4 billion and projected to rise to around 15% of GDP by 2050; charges as AUM are very low and returns have been reasonably good at around 4% real
- But, there are legacy data issues and some state governments participating only on paper and
- The design of scheme is still not fully implemented, eg., annuitization process not established
- But with some effort, the public sector NPS model can work well and possibly an example for other countries

# Moving beyond civil servants

- From the beginning of the NPS, there was always the intention of using the model to cover the rest of the population
- From a political economy perspective, the approach was to avoid direct confrontation with the union-dominated Employee's Provident Fund which covered larger private firms but had failed to significantly expand coverage for decades
- The strategy was to demonstrate a better way of providing pensions and gradually expand it to the 90% not covered by any formal pension scheme

# Expanding the NPS

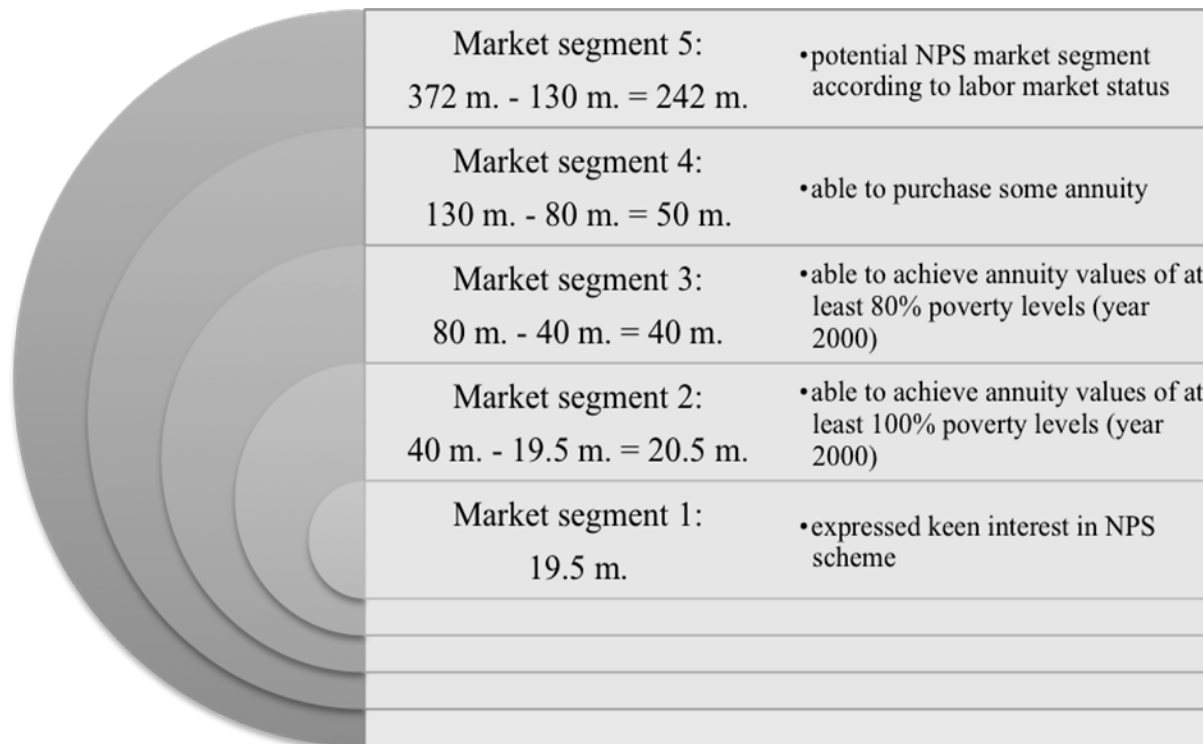
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Source: Stelten (2011) based on Butel (2007)

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# Bringing in the informal sector

- But NPS has failed to attract voluntary take-up
- Reasons include
  - ▣ Lack of fiscal incentives
  - ▣ Competing subsidized products with fewer restrictions
  - ▣ Relatively high account-opening charges
  - ▣ Poor outreach or provider incentives, passive approach
- The first issue was addressed with a government matching contribution in mid-2010 and a no-frills product with lower account charges was introduced around the same time (NPS-lite)
- The provider incentives were addressed with the concept of *aggregators* – entities licensed to recruit NPS members and compensated per enrollee – started in October 2010

# Bringing in the informal sector

- Numbers have started to grow since the introduction of the matching contribution, NPS-lite and the aggregator model but still below 100,000
- Some groups are in the process of enrolling which should raise figures to around a million this year but in India, this is risible with a workforce of 400 million
- What is preventing growth?
  - ▣ Scheme performance reasonable by most measures
  - ▣ Data show many could afford to take advantage of match
  - ▣ Reasons likely to be awareness, outreach, transaction costs

# Bringing in the informal sector

- Awareness
  - ▣ Public information campaign has been passive and not tailored to the masses (TV, newspaper, mostly english)
  - ▣ Similar problems have plagued other government schemes that are run out of Delhi or state capitals
- Outreach and transaction costs
  - ▣ Large share have no interaction with formal financial sector
  - ▣ Many are illiterate
  - ▣ May cannot meet KYC norms, lack identification
- Aggregators can address some of these problems but mostly only for their members

# Early evidence on demand side

- Data from one aggregator, an NGO focusing on financial inclusion in limited geographic areas provides early evidence on demand side factors
  - ▣ Local staff provide information on NPS-lite, match
  - ▣ Enrolment process made simple and low cost
  - ▣ Trusted entity
- Take-up is around 5-10% of eligible population
  - ▣ Although not representative sample, initial results show that women are far more likely to join; income positively correlated; married more likely; landholders less likely; high correlation with insurance coverage;

# Early evidence on demand side

Logistic regression

Number of obs = 17361  
 LR chi2(16) = 5019.44  
 Prob > chi2 = 0.0000  
 Pseudo R2 = 0.2086

Log likelihood = -9523.7357

nps	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
age	.1725838	.014223	12.13	0.000	.1447073	.2004603
agesq	-.0017957	.0001644	-10.92	0.000	-.0021178	-.0014735
male	-.7695538	.0408525	-18.84	0.000	-.8496232	-.6894845
married	.0949619	.1107273	0.86	0.391	-.1220596	.3119834
edu78	-.3528749	.1117397	-3.16	0.002	-.5718806	-.1338691
scst	-.5437197	.0613995	-8.86	0.000	-.6640604	-.4233789
obc	-.5173402	.0568977	-9.09	0.000	-.6288577	-.4058227
lgavgin	.1340258	.0237112	5.65	0.000	.0875528	.1804988
lgland	-.0128296	.0030872	-4.16	0.000	-.0188805	-.0067787
lgzrest	.1146578	.0281021	4.08	0.000	.0595786	.1697369
accidtns	1.275554	.0428305	29.78	0.000	1.191607	1.3595
lifeins	1.853089	.0444418	41.70	0.000	1.765985	1.940193
bankac	-.0240671	.0706514	-0.34	0.733	-.1625413	.1144072
formjob	-.5050457	.088762	-5.69	0.000	-.6790159	-.3310754
age_young	-.0010282	.0018085	-0.57	0.570	-.0045728	.0025164
hhyoung	.1424978	.0720246	1.98	0.048	.0013322	.2836635
_cons	-7.409579	.4906338	-15.10	0.000	-8.371204	-6.447955

# Looking forward

- True MDC experiment only six months old; addition of aggregators likely to increase pension coverage but will plateau after getting low-hanging fruit
- Alternative is a commercial model similar to what is being done with a parallel health insurance program where private Insurers are paid a market determined premium per household enrolled.
- The process is paperless, happens locally (in villages) and establishes ID on the spot (through biometrics) with a local government officer present
- Mobile phone-based or banking correspondent contribution collection and balance reporting could be incorporated

# Looking forward

- The HI scheme – which has reached 70 million people in three years – is targeted and almost completely subsidized, so not comparable,
- But the incentives for outreach using private providers (in this case PFMs instead of insurers) and minimal transaction costs are an important prerequisite for large scale enrolment
- There are emerging proposals to combine the processes of identification and enrolment of the two programs

# Conclusions

- In a low income country, there are three requirements to achieve significant coverage expansion:
  - ▣ A contribution match that is significant enough for the target population in the bottom half of the population to encourage good take up
  - ▣ Entities that are trusted and that have the incentive to enroll people
  - ▣ Technological applications/platforms that are reliable and that reduce the cost of enrolment and transactions for the member enough to make it worthwhile (even for those with relatively small contributions and balances)
- India also shows how cross-subsidizing informal sector with civil service infrastructure costs may have some advantages