RETIREMENT PLANNING OF NEW MIDDLE CLASS

Dr S. MOHAN
Principal
S.K.S.S Arts College
Thiruppanandal,
India. - 612504

SENTHIL KALYANA SUNDARAM
Degree of Doctor of Philosophy in Commerce
S.K.S.S Arts College, Thiruppanandal
Bharathidasan University
Tiruchirappalli, India. - 612504

I. INTRODUCTION

The end of cold war in late eighties, economic reforms that have begun in India in the early 1990s, entry of China into World Trade Organisation in the early 2000s, helped millions of Asians to come out of their poverty and join the large urban new middle class in the new golden age of Asia. While this new middle class is the primary beneficiaries of the economic reforms and globalisation, many studies raise alarms of coming retirement crisis among this middle class (Mukul, 2010, Devichand, 2011).

These literatures note that the concept of Social Security, retirement planning is generally new to Asia as in the olden days, joint families headed by seniors were common in the Asian society and these families depended on the agricultural based economy which was considered lifelong. Later, only during the British colonial rule, the formal employment structure was introduced in Asia in the form of government jobs or company jobs and those worked for these institutions were covered under the formal pension schemes. These pensions were “defined benefit” schemes which provided a specified monthly benefit based on certain formula or percentage of the employee’s salary history.

While the retirement planning was not common among the previous generation of Indians who had state pensions if they work for central or state government agencies or had ancestral land if they live in the rural areas or had a large number of children to support them in their golden age, fast changing economic and demographic changes in India society demand the need for retirement planning.

Compared to the western world, the retirement planning is relatively new to India, this paper uses the Five Pillars Conceptual Framework proposed by World Bank in the 2005 report titled Old Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform...
(Holzmann and Hinz, 2005) to analyse the existing literature through the Five Pillars:

1. The non-contributory Zero Pillar – The financial assistance from the central or state governments
2. The mandatory First Pillar - Contributions linked to earnings, with the objective of replacing certain percentage of pre-retirement income
3. The mandatory or voluntary second Pillar - Occupational pension schemes with a wide set of investment options
4. The voluntary third pillar – individual retirement savings and investment
5. The non-financial fourth pillar – Support from children or family

The Non-Contributory Zero Pillar - Social Security Schemes

Social Security or Social Assistance Schemes are Programmes run by central or state governments with the objective of mitigating income loss of citizens in their old age. Human development theories advocate providing minimum level of security to prevent workers from economic threats which disrupt their daily lives. In order to maintain social cohesion, stability and ensure citizen’s wellbeing, governments are expected to manage social assistance schemes in which the state bears the responsibility for providing and ensuring a basic level of social security which is an essential ingredient in the protection, development and full utilisation of human resources (1). The governments in the western developed countries advocated and implemented a strong social security scheme for a long time, India is lagging far behind that phase of development (Kundal, 2016). While the introduction of Social Assistance Schemes for employees of formal sector (primarily Government and related services) can be traced back to British colonial days, close to 90% of the labour force (primarily in the agriculture) were not benefited from these schemes (In 1995, India introduced the National Social Assistance Programme (NSAP) and renamed...
as Indira Gandhi Old Age Pension scheme in 2007. In the budget speech then finance minister of India Dr Manmohan Singh noted that the greatest hardships among the poor are often suffered by the old and the weak, most of whom are unemployable. To soften the hardship in their twilight years, a National Social Assistance Scheme has been proposed to cover the poor and needy, the protective type social security scheme, for social assistance benefits to poor families in the case of death of breadwinners or old age. While these programs target to provide a very basic support to the poor households, they do not cover the vast majority of the workers and middles class. Unlike developed economies, there are no universal social security schemes in India. With the large budget deficits and large defence spending, it is very difficult to introduce any comprehensive social security programs in developing countries like India.

**Pillar Two and Three – Mandatory and Voluntary Pension Schemes**

Only less than 14 percent of India’s 321 million paid workforces are covered by the formal retirement programs (Kim et al., 2012) that are traditionally offered to central and state government employees. In 2004, faced by the swelling cost of civil service pension payments and the significant gaps in the pension coverage, the Central Government of India has established the New Pension Scheme (NPS). In contrast to the traditional defined benefit programs, the NPS is a defined contribution, a self-sustaining and individual accounts-based pension program that is mandatory for the central government employees. In 2009, the NPS was made available to the workers of formal and informal sector workers on voluntary basis. The extension of NPS provides a low cost vehicle to non-government employees to accumulate pension savings on volunteer basis. However, the initial participation rate is very low when the NPS is extended on volunteer basis.

Beside the NPS, the corporate sector employees contribute part of their wages towards Employee Pension Funds (EPF) which are managed by the Employees’ Provident Fund Organization (EPFO). The EPF scheme has the following structural deficiencies that make it unfit to meet the retirement income needs of the new middle class.

- The contribution level using Rupees 6500 as the maximum wage base is insufficient to meet the retirement needs.
- The EPF scheme offers excessive opportunities to with-draw the funds during pre-retirement for various reasons including housing, unemployment, marriage, and others
- The EPF scheme allows the employees to withdraw the significant amount as the lump-sum which reduces monthly pension (EPS)

**The Voluntary Third Pillar – Individual Investments and Savings**

Indian households traditionally save higher than their western counterparts. The household savings rate took a sharp upturn in the 1970s and marginally increased thereafter, and then again took an upturn from the 1980s (Athukorala and Sen, 2002). To provide a broad overview, India’s aggregate savings rate is comparable to that of emerging economies such as Indonesia, Thailand, and South Korea, and substantially higher than in most developed countries. While the aggregate gross savings rate in the economy has been growing in the long-historical context (Mohan and Kapur 2015), over the past several decades, this rate has levelled off at about 20 percent of GDP. Decomposing these savings into physical savings (in assets such as gold and real estate), and financial savings (invested in claims such as deposits, debt, and equity), a striking feature of the Indian data is that Indian households have increasingly favoured physical over financial savings. To provide some context, in 2011-12, nearly 70 percent of aggregate annual household savings flow
into physical assets, with comparable ratios in the average household wealth allocation (accumulated savings) being much higher. This pattern is like another major emerging market China.

**The Non-Financial Fourth Pillar**

Indian demographic is changing very rapidly including longevity due to the medical advancements, rapid urbanisation, small families and growing consumerism. These demographic changes put strain in the traditional joint family structure and undermine a comfortable living in the golden age.

The lack universal social security scheme, structural deficiencies of mandatory pension schemes, and the changing demographics such as urbanization, aging population, longevity, and smaller families motivate a comprehensive study to understand the retirement planning of the middle class.

Many studies suggest that individual retirement planning and savings decisions influenced by Financial Literacy and Financial Behaviour of individuals. This research examines these linkages along the following hypotheses.

*Hypothesis 1* – Amount of retirement planning and investment decisions are not depending on financial literacy

*Hypothesis 2:* Amount of retirement planning and investment decisions are not depending on investor Behavioural factors

**II. RESEARCH DESIGN AND METHODS**

The research is using a survey research methodology to study the retirement savings and investment behaviour of individuals and analyse the data along financial literacy and financial behavioural dimensions. A sample survey conducted among fifty participants to perform pre-survey analysis and improve the survey questions. The survey instrument would be carefully designed to inquire the participants on their income, consumption, savings and investment, household risk management, asset allocation, financial education, and literacy. The survey instrument distributed through the internet medium to the participants as the internet medium enables ease of access and data collation. Comprehensive statistical correlation and regression analysis would be performed on the survey data to analyse the relationship among various variables.

**III. FINDINGS AND CONCLUSION**

While the full survey data is being collated and analysed, the analysis of the existing literature and sample survey data suggests that in the absence of universal social security scheme, structural deficiencies of mandatory pension schemes, and the changing demographics such as urbanization, aging population, longevity, and smaller family sizes are real risks that would lead to a retirement crisis among the new middle class.

**IV. REFERENCE**


