

Financial Market Implications of India's Pension Reforms

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Summary of the paper

- Drawing on international experiences this paper highlights the preconditions for the pension reforms to kick-start financial development
- It focuses on three factors
 - Critical mass
 - Sufficient flexibility in investment options
 - Simultaneous reforms in capital markets

Critical Mass

- Demand for new pension schemes
 - Relative attractiveness vis-à-vis other saving products
 - Allow existing workers covered under the old system to switch via amendments in the law or tax incentives
 - Low cost to ensure attractive net returns, this can be achieved by achieving economies of scale and industry competition
- Important factors not considered in the paper
 - Behavioral factors, paper by (Madrian and Shea, QJE 2001)
 - Contract design, for example the default option in the contract
 - Investor education (Bernheim 1998)
 - Political economy of pension reforms

Sufficient flexibility in investment options

- There is no minimum guarantee of pension so it might lead to a “safety bias”:
 - Individuals will opt for the conservative asset allocation
 - Regulators might restrict the investment option
- On the other hand having a minimum guarantee might lead to individuals choosing riskier asset allocation (moral hazard)

Pension funds and capital market development

- Based on international experience in Latin America (in particular Chile) and G-7 countries the authors conclude that there will a positive impact of pension reforms and capital market development (provided there are supportive capital market regulations and infrastructure)
- It might be worthwhile to look at the impact of partial privatization of the insurance sector in India on capital market development, diversification of investor base