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Finance Ministry may raise wage cap for provident fund to Rs 15,000 per month

Vikas Dhoot, ET Bureau Oct 7, 2013

NEW DELHI: The finance ministry is considering a proposal that can sharply reduce the government's borrowing costs, bring long term savings into the cash strapped infrastructure sectors, deepen the corporate bond market and, possibly, even make Indian stocks less vulnerable to the whims of foreign institutional investors.

The proposal, moved by the labour ministry, seeks a conditional pact with the finance ministry, under which the finance ministry will raise the statutory wage ceiling for provident fund contributions to Rs 15,000 per month from Rs 6,500. The labour ministry will in turn commit to route a bulk of the incremental annual inflows of Rs 90,000 crore into government bonds and infra projects, where it does not invest.

(The proposal, moved by the labour ministry, seeks a conditional pact with the finance ministry, under which the finance ministry will raise the statutory wage ceiling for provident fund contributions to Rs 15,000 per month from Rs 6,500.)

The proposal, if accepted, will also moderate the cost of corporate debt and deepen the bond market, with officials not ruling out the possibility that the country's largest retirement fund may have to consider equity investments in future as its fast-growing corpus will need more avenues to invest in.

The Centre's borrowing costs rose about 2% between May and August this year, as the depreciating rupee forced foreign investors to pull out thousands of crores from the debt market. The Employees' Provident Fund Organisation's (EPFO) kitty is around Rs 6.5 lakh crore, which makes it India's second largest nonbanking financial institution after Life Insurance Corporation of India.

The infrastructure sector, in particular, is seriously cash strapped and desperately needs investors like pension funds with a long-term horizon, the finance ministry had said last month. "The government intends to raise Rs 4.84 lakh crore of debt this year, with states expected to borrow another Rs 1.6 lakh crore. The domestic demand for such securities by banks, insurance and pension funds, combined with RBI's open market operations, is just around Rs 6.2 lakh crore, leaving a Rs 24,000 crore gap," said a senior labour ministry official.

"If our proposal is accepted, the government can raise debt much cheaper as the EPFO alone would be able to deploy an additional Rs 50,000 crore in such bonds," he said. "Moreover, unlike other investors, the EPFO holds its investments till maturity with no active trading, so debt markets would be less volatile."

Twenty four per cent of an employee's salary is deducted and contributed to his EPF account. A little over a third of that (8.33% of salary) is diverted to an employee's pension scheme, to which the government adds a 1.16% subsidy. Set in 2001, the present statutory cap of Rs 6,500 is lower than the minimum wages prevailing across India, which is depriving the weakest employees in the workforce of any retirement benefits.

The government has now raised a similar salary ceiling from Rs 15,000 a month to Rs 25,000 at the Employees' State Insurance Corporation, EPFO's sister organisation that offers healthcare and unemployment benefits. "The Rs 6,500 cap has turned the EPFO into a voluntary scheme by default, as no one can be legally paid below the minimum wages," said a senior official in the PF office, questioning the different yardsticks adopted for similar social security benefits.

The finance ministry has resisted a hike in the PF ceiling to Rs 15,000, mooted by parliamentary committees as well as the EPFO board since 2009, as it will raise its subsidy bill on the pension scheme that is currently around Rs 1,100 crore a year by around Rs 3,000 crore.

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