EPFO, ESI overhaul required to unlock India's formal jobs potential

The EPFO and ESI have resisted radical reinvention since 1991, illustrating how self-interested bureaucracies preserve their own interests by creating improbable scenarios of chaos

Illustration: Binay Sinha

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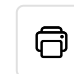

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In 1958, Mao Zedong's Great Leap Forward included a quirky "Four Pests" campaign to eliminate flies, mosquitoes, rats, and sparrows. Research suggests that this culling of 2 billion sparrows, which ate locusts and rice borers that attack crops, resulted in the unintended deaths of 2 million people. This is an

extreme case, but it highlights the second-order effects of noble policy intentions under the licence raj, which have led to the unintended absence of at least 10 million formal employers and 100 million formal employees.

Two licence-raj legacy institutions — they are not government-funded — that have contributed to this sabotage of formalisation are the Employees Provident Fund Organisation (EPFO) and the Employees State Insurance Corporation (ESIC). Indian employers quietly honouring the ₹40,000 crore cost to comply with the labour Codes should earn them radical reforms to the EPFO and ESI, such as creating an Aadhaar-linked, fully portable, lifetime universal social security account that gives employees greater choice.

The ESI and EPFO deserve radical reform for similar reasons: Poor policy outcomes on employer and employee coverage; high dissatisfaction of employers and employees; sabotaging formal employment with a flawed design out of touch with a cost-to-company compensation world; technology systems inadequate for a world where employment has shifted from a lifetime contract to a taxicab relationship; excessive administrative charges relative to benchmarks; weak governance with dozens of people on their unrepresentative boards where "anybody can say no and nobody can say yes" to proposals for improvement. Reforming social security in any country is complex, but the 10-year delay in implementing a Union Budget announcement for radical reform of both organisations makes reform even more urgent. Let's dive into each organisation.

The EPFO has failed to deliver work-based social security; it covers only 2 per cent of our employers (63 million) and 13 per cent of employees (560 million).

Employer surveys cite the EPFO as one of the top three pain points due to corruption, poor employee service, administrative costs collected separately from employers (₹8,000 crore), and high charges that defy benchmarks (4 per cent vs National Pension System, or NPS 0.03 per cent), bloated by an irrational calculation formula based on wages rather than contributions.

Employee dissatisfaction is high; 78 per cent of the 325.6 million subscribers are non-contributing due to the employer-linked design and poor technology adoption, lower returns than NPS, and an involuntary diversion of a substantial portion of the contribution to the sub-account of the Employees' Pension Scheme (EPS), whose birth defect of defined benefits and defined contributions (one must be variable) suggests a deficit of ₹3 trillion that can only be covered by a fiscal contribution or benefit reduction (maybe why 75 per cent withdraw this lifetime benefit within four years).

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The ESI has failed to deliver work-based healthcare financing; less than 1 per cent of employers and 6 per cent of employees are covered. Employees vote with their feet; only 50 per cent of ESI's 32 million contributors use their services. Most painfully, ESI overcharged employees and employers to generate a ₹8,900 crore surplus last year via a low 63 per cent payout ratio (this would be illegal in most countries, where payouts below 85 per cent trigger a refund to contributors by law) and ₹3,000 crore in high administrative charges (calculated at 15 per cent of contributions versus 2 per cent global and local benchmarks) separately collected from employers. ESI's undercoverage and low benefit payout have huge human capital costs.

The pathologies suggest clear reforms for both programmes. The EPFO should offer employees a choice: Pay their 12 per cent employer contribution to either the EPFO or the NPS, and decide among three levels of employee contribution (0/6/12 per cent). It should cut employer administrative charges to NPS levels (4 per cent to 0.03 per cent). The EPFO should explicitly clarify that no coverage applies to employees above the Act's salary threshold (₹15,000 per month) by allowing voluntary discontinuation or withdrawal above that threshold. It should restructure the EPS by filling the funding hole, re-evaluate promised benefits, give employees the option to opt out by directing their monthly contribution to their defined contribution account, and converge with Atal Pension/other schemes. Employees must be given the option to link their accounts to Aadhaar rather than Universal Account Number (UAN). The lowest-hanging reforms are operational: Strengthening investment operations by linking returns to earnings, mandating service-level benchmarks (SLBs), integrating accounts with citizen DigiLocker and Entity DigiLocker, reducing the board size from 42 to

12 members, and moving away from digitisation road maps involving PDFs to application programming interface (APIs by aligning with the paperless and presenceless design of digital public infrastructure.

The ESIC should give employees a choice to divert their monthly health insurance contributions to insurance regulator-licensed insurers. It should reduce administrative costs charged to contributions from 15 per cent to 2 per cent by benchmarking them against regulator-licensed insurers. It should immediately reduce premiums by 30 per cent to reduce excess collection, and mandate future payouts of 85 per cent of the contribution; failing which, the excess should be refunded.

The previously collected ₹1.5 trillion surplus should be used to provide a two-year contribution holiday for micro, small and medium enterprises (MSMEs), women, backward states, and Scheduled Castes/Scheduled Tribes. All employee accounts should be linked to Aadhaar for portability (backpack benefits), and all employer compliance must move from PDFs to APIs to enable straight-through processing. The most difficult but impactful reform would be cutting the board size from 59 to 12 to ensure governance targets stakeholder - employer and employee - welfare rather than self-interest.

The EPFO and ESI have resisted radical reinvention since 1991, illustrating how self-interested bureaucracies preserve their own interests by creating improbable scenarios of chaos. Sir Humphrey Appleby — a civil servant in the BBC Sitcom *Yes Minister* — explained to his deputy that the best way to deter a politician from taking a radical course of action is to tell him that this decision is courageous. He said, "Calling it controversial only means that the policy will lose

you votes. Courageous means that it will lose you the election." The ESI and EPFO have made significant contributions to India's development, but it's time to update their mandates, incentives, and technology. The political upside of courage is the duas (blessings) of 1 million current employers and 100 million employees who are hostages, not clients. But the economic upside is millions of new formal employers and employees.

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