Pension System in Russia

The Political Economy of Putin's Pension Reform

A draft prepared for the International Workshop

"Population, Labor Market, Pension and Quality of Life in Transitional Countries"

On February 23, 2002 in Kunitachi, Tokyo.

The Political Economy of Putin's Pension Reform

Sadayoshi OHTSU

Department of Economics, Osaka Sangyo University

Mail address; ohtsu@eco.osaka-sandai.ac.jp, so0520@aol.com

Contents

Introduction

1.Putin's big push

1- Grev and long term strategy

2- "National Soviet for pension reform"

3- Three Michaels and their enemies

2. Basic Problems facing the pension system reform in Russia

1- Restructuring the pension system.

2- Financing and calculations

3- A new system of non-state pension scheme

3. What has been done

4. What is left

1- Investment of funds, where to invest, how to control

2- Occupational Pension system

3- Wanted ! - Able and honest bureaucracy

List of Laws

References

Introduction

On 30th November 2001, a package of laws regarding pension reform in Russia passed the Duma (Parliament) and they came into effect from the 1st of January 2002. It is true that pension reform has not yet finished but this could be safely called a big landmark for the systemic change of the long ailing Russian pension system. The package includes three laws; “On State Pension Guarantee”, “Labour Pension”, and “Obligatory Pension Insurance” (see the attached list of laws at the end of this paper). In the Government’s original reform plan, three more laws are needed to complete the whole legislation process for the reform. They are still in the form of draft law or on the process of rewriting and then to be put on the agenda for fierce debates in the parliamentary committees and else where. Notwithstanding, the year 2001 was a very successful year at least for the Putin government.

These laws are expected to solve many problems in the old pension system which were accumulated in the long past years coupled with huge amount of problems caused by systemic change, and also by transition shock. In the following, the author will, after a short description of Putin’s “pension reform politics” in the year 2001, try to clarify what was wrong with the old system and then what kind of efforts were made to alleviate these problems. Finally what kind pf problems were still left untouched and the difficulties facing the reformers.

1 Putin’s “big push”

1-1 Grev and his long term strategy

As is well known, the 1998 financial crises destroyed all the process and government plan for pension reform which was prepared and put into practice under the Chernomuildin government. It was only after the Putin’s administration

started working and placed “a big push” onto structural reform.

In the President’s Message (Paslanie in Russian) to the Duma in April 2001, Mr.Putin stressed the need to make haste the process of Structural Reform, particularly the pension system reform. He pointed out that, “Nowadays, in our country, nobody is sure how much pension he gets in the future. I repeat, No-BODY. This situation must be corrected as quickly as possible”. This was a sincere message by the president which could not be lightened by any of the political and social leaders. The official statement of this policy orientation by the Russian political leaders was not new of course but this time the tone was different, because it was preceded and backed up by the so-called “Grev’s long term strategy”.

Mr.Grev was appointed as the chairman of the center for working out long term strategy for Putin’s administration and after a long silence the “perspective Strategy” was announced in the Summer of 2000. The mission of this volumeful document (more than 1000 pages) was to stress the necessity to solve structural problems such as economic infrastrucure and social problems. They included problems of natural monopolies in Gas industry, railway and electricity supply, together with the solution of “social problems” which were also on the top priority among urgent economic policy agenda.

1- 2 “National Soviet for pension reform”

“National Soviet” was a sort of political device by Putin and institutionalized in order to consolidate all the different social forces and press the opposite opinions into the realization of pension reform in Russia. The Soviet is headed by the Prime Minister Michael Kasiyanov and as constituting members were nominated almost every leader of the parliamentary factions together with the head of many social organizations like independent labour unions and so on

The first congress(National Soviet), originally planned on the sixth of March, started its work on 19th of May to consider the draft law on basic

pension insurance. The original draft which was proposed by PFR was not meant as a final one but more or less with transitional character. But Ministry of Economy was not happy with this position and meant to construct a new system with a long life, because the transitional plan, they thought, becomes sooner or later impracticable because of the shortage of budget. This difference of approach was the inherent disagreement between the two parties. But according to the "program" of Autumn of 2000, new pension laws must be put into effect from the first of January of 2002. Therefore, in order to achieve the target set by the program, this large disagreement between them must be narrowed at least by the summer 2001. This means huge amount of works were left to the hands of both parties. Before going into the analysis of politico-economic process, some words should be mentioned here about the background.

On the stage of pension reform drama, three Michaels act the role of major actors among many others. First comes Mr.Michael Dmitriev, Deputy Minister of Economy, who is the protagonist of radical market oriented reform and strongly supported by Mr. German Grev, the Minister of Economy, the chief navigator of structural reform policy of Putin Government. Michael Dmitriev is a Doctor of economics specializing on economic cybernetics, and enjoys a high reputation as a top specialist of labour and pension systems.

Second Michael is Mr. Zurabov who is also a big specialist in the field of pension business and strongly represents the vested interest of Russian Pension Fund, i.e. a huge bureaucratic structure with more than ten thousand personnel working all over Russia. It is quite natural that Mr Zurabov and his colleagues are not happy with the radical reform.

Third Michael is Mr. Kasiyanov, the Prime Minister, who is very keen to finish the reform work as quicker as possible under the pressure from President Putin. His main job is to urge the above two Michaels to find compromise to get the solution. He has a strong subordinate, Evgeni Gontmacher, also a specialist on social and labour policy. He works as a Standing Secretary of the National

Soviet for pension reform, Mr.Gontmacher is widely regarded as belonging to the radical reformers school but because of his official position he plays as a moderator of the first two Michales.

Among these three Michaels, Mr.Zurabov is the key person, first as a man responsible to propose the basic texts of new laws for pension reform, second as militant fighter against radicalism, representing the interests of the Ministry of Labour and Social Develeopment which has been the nest for the old "labour burecrats".

In the course of meetings of the National Soviet, on many occasions, Michael Zurabov's proposals of new draft law or his own version of interpretation of them were met with cool and critical comments by Michael Dmitriev, followed by their harsh debates which often came to a deadlock. This spectacle was repeated quite often before the "innocent" audience because they needed a deep specialist knowledge to understand the real problems at issue. As a result, many works were left to the hands of specialists of both parties to seek a compromise behind the scene.

On 17th April, the second Congress was convened and the Soviet started the discussion on the new reform program and its corresponding legislation (about 6 separate laws as a whole). During the course of discussions of the proposed draft law article by article, it became clear that the criticism by the Ministry of Economy side was still very strong against the Zurabov version and consequently the gap must be filled with every effort before the next meeting.

After the April Congress, the secretary of the Soviet, Evgeny Gontomacher gave interview to the Izvestia newspaper and expressed grieve concern over "unfilled gap". He pointed out that the argument by Mr. Dmitriev who stresses the necessity of income disclosure is not without problem. In his estimate, the Dmitrief version does not ensure to promote the disclosure and does not exclude the financial crisis like the one in 1998. Therefore the population remains strongly worried by Dmitriev's version.

These laws were prepared officially by the Ministry of Labour and Social Development (Headed by the Labour Minister, Mr. Pochinok) but actually put forward by the Pension Fund of Russia (hereafter abbreviated as PFR), and, as the experts point out, they will work more for the interest of PFR and consequently less for the interest of Non-state Pension Fund (hereafter abbreviated as NPF). In the adopted document, PFR is referred to almost everywhere where the operation of pension funds is mentioned. As a result a strong impression has been created that the participation of NPF was not foreseen from the start, only afterwards some additional lists were brought into the law with quotations from the Federal Laws which will control the operations of NPF. But these Federal Laws were not yet adopted. (Nikolisky,www.polit.ru)

In this connection, it is easy to find some inherent contradictions in the law. For instance, in the article No 9 of the Law, mandatory pension insurance, we read, the financing of the insurance payment and funded part of working pension is carried out at the cost of budget of PFR. But at the same time the article No.32 of the same law foresees possibility of transfer of funded part of the pension into NPF. The basic shortcomings of the adopted law are found in the fact that the functioning of PFR and NPF will be regulated by a separate law and that it will give PFR concrete advantages particularly during the period of realizing pension system reforms.

Before going into the assessment of what was done in 2001, we need to look bsck briefly what was the basic problems for reform in the sphere of pension reform. We will summarize them in the next section.

2. Basic Problems facing the pension system reform in Russia

Pensioners in Russia, needless to say, were among the first and hardest

hit victims of Shock Therapy under Elitsin's transition policy with hyperinflation, more than 50% reduction of production and consequently the real income and mass unemployment. In the Soviet period, Socialist pension system, although not without shortcomings, served as a stabilizing structure of the Soviet society as a whole, and particularly for the working masses who now recall it as "good old days".

But the Soviet pension system at the time of Perestroika was already caught by "socialist disease" and in the middle of 90's, Russian pension system was almost dead. In other words, the Russian pension system has been suffering from a fatal disease which has three separate origins, namely; first from socialist state disease, second from transition shock disease, and thirdly from new disease,i.e.the aging of the population.

This disease was accompanied by a series of symptoms such as delay or non-payment of pensions became commonplace, which is equal to the breach of law by the state. The state itself became insolvent in the process of system change, and as a result state pension system ceased to work. Some efforts, however, were made to alleviate the defects. For instance, in 1990, before the collapse of Soviet Union, apart from the Soviet Law, a new Russian state pension law was put into effect and based on this law, a new institution called "Pension Fund of Russia" was set up which was financially supported by the off-budget special fund.

But after the collapse of Soviet Union and the introduction of radical transition policies accompanied by hyperinflation, a change, seemingly small but actually very big change, was brought into the law which allowed to use part of the fund to the payment of pensions for the disabled ex-service men and war bereaved families. Originally the resources in the pension fund were not meant to be used for the payment for this category of pensioners. They must be paid directly from the state budget. But the budget was so poor and as a sort of emergency measure, this change was invented and introduced as one of the many "ordinary amendments and additions" which could evade the attention of

the society. In this way, the part of basic concept was changed which greatly affected policy orientation in the following period. The budget of the pension fund itself, naturally became unhealthy and soon grew into one with deficit.

What is the basic question for pension reform? This was the question asked from the scratch. In the authors view, problems could be summarized into the three areas, namely;

1) Restructuring the pension system. During the Soviet regime, many social gaps were created, in the field of manifold privileges, for people worked in army or in the priority industries or in the priority regions, which were in the socialist regime acquired special meanings. And in the course of social transformation, the many preconditions disappeared which existed earlier and particularly in the course of hyper inflation, they lost their meanings, for instance, for those who are handicapped and/or families needing social assistance. In this area, the renovation of such basic concepts as “fairness” or “equality” are again put into question.

2) Financing and calculations

The so-called pay-as-you-go system” (PAYG) can’t be expected to continue to work in the years to come and instead so-called “fully funded system”(FFS) should be introduced and put into motion. Gradual implementation of this system could be recommended as one of the desirable solutions. This view is, needless to say, widely accepted but when you want to work out a new system, you are obliged to consider various aspects of the problem.

But in order to work out a sort of optimal solution, there are so many variables such as macro economic indicators like growth rates, income growth, and also demographical dynamics, changes in the number of economically active population and so on. It is extremely hard to work out an optimal solution, particularly in the swiftly changing society like Russia.

3) A new system of non-state pension scheme including “coroperate pension funds”, “voluntary pension insurance” are among the strongly-advised items. In the advanced market economies, the private sector is functioning as the main absorber of huge amount of financial resources from pension fund. And in Russia as well, similar organizations are already in existence but they are still very weak.

3 **What was realized? Solutions so far made**

Let us look at the characteristic feature of the new legislation. In the adopted laws, the new pension system is consisted of three parts; basic pension, earning related pension and fully funded pension. The basic pension is fixed (its size is determined by the law), the contribution is paid directly into the Federal Budget (basic part is paid to the pensioners by the pension fund, but PFR receives this money from the Federal Budget). The size of the earning related part depends on the size of contribution of insurer into PFR and with indexation by inflation, income of PFR and so on. The amount of money for the payment of insured part is accumulated in PFR. Fully Funded Part is formed in the specified individual account and indexed according to the returns from the savings in the pension fund. The size of funded part depends only on the payment by the insurer and the rate of returns of the pension fund. Only the funded part could be transferred from PFR to NPF.

All the monetary resources in the PFR are consolidated. Because the exact procedures for raising funded part of the pension are not specified in the law, the possibility emerges that the income from investment might go indexed to the insured part of the pension, but fully funded part might not be protected from high inflation. This kind of contradiction could be removed by the adoption of the law of investment of the insured part of pension.

The size of payment which goes to insured and fully funded part will depend

on various factors. For those people who were born after 1966 and earn less 100,000 roubles a year, following relations are applied, starting from 2006, 8% of wages go to insured pension, 6% to the fully funded pension. The bigger the wage, the smaller part of it goes to insured and funded part of pension. In any case, to the insured part will be transferred not more than 23,780 roubles a year, and to the fully funded part not more than 17,870 roubles. The remaining amount of pension from the common social tax will be included to the budget for the payment of basic pensions.

It is possible to participate in the funded part of pension system for those men who were born in 1953 and for women who were born in 1957 and younger. People born in 1967 and younger are fully eligible to participate in the funded system. The older the worker, the larger the part of the wages goes to the insured part at the sacrifice of the funded part. The possibility of transfers of the fully funded part from PFR to NPF will arise for the citizens later than 2004.

The law of working pension sets forth the foundation and the order for realizing his right to working pension. In the law, the structure of the working pension is specified and the list of people entitled to the pension is found. In the law, the rate of basic pension, procedure and formalities for accounting insured and fully funded part of pension and also procedure of indexation are all prescribed in details. In the document are also described the procedure of trans-account of old pension (until 2002) to new ones (in effect, from the first of January 2002).

The law of obligatory pension insurance specifies a series of concerned persons (subjects), like those insured, insuring person and also insuring security in the framework of pension system. According to this document, obligatory insurance is carried out by the insurance company, i.e. PFR. Apart

from the PFR, other insurance companies could be non-state pension fund within the framework of control spelled out by the Federal Law. The state carries subsidiary responsibility for the activities of pension fund and responsible for the insured persons. The law also specifies the procedure and the rate of payment to pension fund (tariff insurance remittance).

4. **What is left?**

1- Investment of pension funds, where to invest, how to control

On 21st of December 2001, State Duma in its first reading passed the draft law on "Investment of resources for financing the funded part of working pensions in Russian Federation". In the context of the problem of where to invest, liberalize or restrict, this means that State Duma adopted the Government version of the law, worked out by the Pension Fund of Russia, and declined the version, more liberal and more friendly to Non-state Pension Fund, which was proposed by Mr. Boris Nemtsov, ex-prime minister and one of the influential parliamentary members belonging to the right wing faction.

This document is concerned solely with the work of regulating the investment of resources of the Pension Fund of Russia. The draft law obliges the Pension Fund of Russia to report about all the operations listed in the Law. Only in the chapter on "The right of those insured person" nominated the right to choose, or to accumulate the funded part of the pension in the PFR or in the Non-state Pension fund or other finial organizations.

The right to choose Pension Funds starts being effective from the 1st of January 2004. Apart from this, the draft law leaves open the possibilities of the choice of investment portfolio. Regarding all other points including the Non-state pension fund, the draft law refers to the "Federal Law" which is still non-existing.

In this way, the mechanism of investing the resources of PFR and NPF will be regulated by different laws and this means that it gives the PFR other privileges. This draft law itself leaves rooms for some other privileged articles,

for instance, direct influence of PFR over the government Coordinating Committee which has a wide range of authorities in working out the rules in the sphere of formation and investment of the accumulated pension funds.

All in all, the mechanism of investment consists in the following; the funded part of pension is accumulated in the PFR. This resource is put into one of the managing company (by the choice of the owner of the funding account), selected and nominated beforehand at the time of special screening procedure. The managing company puts this money either into the stock market (including foreign stocks) or bank credits (but not in the bill of exchange,wecksels, not in the real property, not in the loan) and receives income from it. If the owner of the account does not choose the managing company, then the government chooses the company.

On the 17th of January, Ministry of economic development sent the agreement to the Government on the corrections of the draft law, substantially liberalizing and for the first time recognizing the almost equal authority for the NPF with those with PFR. This means that now the NPF can enter equally into the pension fund market after receiving the relating license. They are called the "authorized" NPF.

If the law is brought into effect, according to the forecast, already in the year of 2004, private funds receive about 3 milliards of US$. But the new draft law, in an obvious way, contradicts the interest of the PFR, whose position will be taken into account by not only the government but also the State Duma. Therefore the possibility of the law being adopted or not remains as an open question.

2-Occupational Pension system

Another big job left is the removal of old privileged pensions and creating a new system of occupational pension. The principal direction of change is already agreed upon but the problem is How to change without losing the

"Pareto optimum".

Draft law on "Obligatory occupational pension systems" was adopted basically by the Government 22 November of 2001 and the Ministry of Economic Development, making necessary amendments in the draft, 13th December returned it to the Government but the Government on 27th of December, returned the draft once again for further perfection.

This draft law relates to the additional privileged pension for workers employed in the unhealthy production. From the first of January of 2002, the law on "Working pensions" came into effect, in accordance with it, from the first of January 2003, formal procedures for recognizing the earlier (privileged) retirement pension will be transferred to the new "Professional Pension System"(PPS). It is assumed that already from 2003 in the PPS, NPF can operate their business. The volume of resources of PPS is estimated as 70 milliard roubles, which is worth more than three times of the current aggregated amount of active capital of NPF.

Tentative conclusion

The Ministry of Economic Development worked out a temporary measure for the control of investment of funded part of pensions which will function for 6 months from 1st of January 2002. Mr. Michael Dmitriev announced that this normative act is necessary because funded part of pensions has already started flowing into the fund. According to his words, the sum of money flowing into the fund will all be invested into the maximum liquid state bond, "purely with the aim of avoiding the inflationary effects".

In accordance with this decision, the NPF Inspection Office by the Ministry of Labour approved the decree No.1 on "the provisional measure for investing pension resources in 2002". According to this decree, when the NPFs try to invest the pension resources, they have to observe specified limitations concerning the amount of money to be invested, depending on the kind of financial commodities. For instance, in the case of stocks, securities, not more

than 50% of resources should be used, and in the case of putting into the bank credits, the total amount should not be more than 50%, etc.

Another recent news informs that the head of PFR, Michael Zrabov openly said he is for the introduction of “social passport of the citizens” which records the income, fringe benefits and privileges that they really enjoy. Social passport is, by the opinion of Zrabov, what is demanded by the all social safety systems, i.e. health care, medical security, living and community related subsidies, etc. This is an indication that the head of PFR is publicizing his concern for the necessity of raising the efficiency of the administration.

Apart from the legislative effort, there remains, in the author’s view, a vast area of works which are necessary to realize the pension reform. Among many others, the biggest job is the “perestroika” of the administrative structure and creating a bureaucracy that is reliable, honest and able, quickly adapting to the new legal system and environment. This is, in a sense, the core of reform and first concern after the legislation, but the way is obviously very far long.

List of laws;

The package of laws on new pension system in Russia includes the following; (available from network; www. ice.ru/pensionreform/Rus/index-r.htm)

1) Федеральный закон "О трудовых пенсиях в Российской Федерации", （On Working pension in RF）

2) Федеральный закон "Об обязательном пенсионном страховании в Российской Федерации". «Obligatory pension insurance»

3) Федеральный закон "Об основах обязательного социального страхования", (On obligatory social pension)

4) Федеральный закон "Об управлении средствами государственного пенсионного обеспечения (страхования) в Российской Федерации" （Control of state pension resources ）

5) Федеральный закон "Об индивидуальном (персонифицированном) учете в системе государственного пенсионного страхования",

(On individual, personified, account in the system of the state pension insurance).

6) Федеральный закон "Об инвестировании средств для финансирования накопительной части трудовой пенсии в Российской (On the investment of resources of the funded part of working pension)

7) Об обязательном пенсионном страховании в Российской федерации от 15 декабря 2001года №.167-ФЗ (Экономика и жизни, №2 январь 2002 г. принят Гос.думой 30 ноября 2001года) (On the obligatory pension insurance in Russian federation, adopted 15th of December 2001)

8) Федеральный закон "Об обязательных профессиональных пенсионных системах в Российской Федерации"

（On the obligatory professional pension system in RF）

References;

List of works on Russian Pension Reform

1) Georges Heinrich, Pension Reforms in Central and Eastern Europe: Yet Another Transition...? Centre for Economic Reform and Transformation, Department of Economics, Heriot-Watt University, Riccadon, Edinburgh EH 1 4 4AS UK, CERT Discussion Paper No.97/5, February 1997

2) Dmitri Karasyov and Yuri Lublin, Trends in pension reform in the Russian Federation: A brief overview, International Social Security Review, Vol.54, No.2-3,2001. (International Social Sequrity Association, Geneva; and Ministry of Labour and Social Development, Russian Federation.)

3) Vladimir Kosmarsky(Ed.), Meeting the Challenges of Social Policy in the Russian Federation, RECEP,Moscow,Nov.1999, Russian Economic Trends

{Russian literature}

1) А.Вавилов и др. Пенсионная реформа в России: анализ переходного процесса. Вопросы экономики No. 2, 1999,

2) М.Дмитриев, Социальная сфера в условиях финансового кризиса: проблемы адаптация.Вопросы экономики No. 2, 1999,

3) М.Дмитриев, Эволюция пенсионной системы России в условиях

экономического кризиса. С. 20, Вопросы экономики No. 10, 1999,

4) Пенсионный реформ; Человек и труд за 1997 год. №№:

№1,Какие изменения глядут в пенсионной обеспечения, клуглый стол, с.67-74

№2, Какую систему пенсионного обеспечения выбрать:

перераспределительную или накопительную ? р.70-72

№4, Льготное пенсионное обеспечение- на страховую основу,с.86-

№10,Накопительная система все еще под вопросам , Человег и труд, 2001

3) Эмиллия Азарха, перспективная социальная политика в глазах неселения, ВЦИОМ, Мониторинг №1,2001