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Kremlin Struggling With Pension Time Bomb

By Howard Amos

October 06, 2012

At some point after 2025, the number of pensioners is predicted to exceed the working population.
Sergei Porter

A broad swathe of expert opinion maintains that the only way for Russia to defuse the ticking time-bomb of its pension system, which runs an annual deficit of 1.3 trillion rubles ($42 billion), is to raise the retirement age.

But such a move would be deeply unpopular among the population as a whole and faces implacable political opposition from the Kremlin.

"I am against raising the retirement age," then-Prime Minister Vladimir Putin wrote last year in an article published amid his campaign to be re-elected for a third presidential term.

Pensions, which average 9,700 rubles a month, grew rapidly during Putin's first two terms as president and he has pledged that they will continue to rise.

Caught between Putin's promises and the urgent need to staunch the money hemorrhaging from the budget to cover the State Pension Fund's spiraling deficit, Prime Minister Dmitry Medvedev's cabinet has been forced into a series of elaborate contortions.

Though publicly opposed by the Finance Ministry, a long-expected outline for the overhaul of the pensions system between 2012 and 2030 was presented by the cabinet to the Kremlin on Oct. 1.

The most controversial part of the document was the proposal to cut the funded part of pension contributions — the so-called "cumulative part" — from 6 percent to 2 percent in order to reduce the State Pension Fund's losses.

Introduced in 2002, the funded part collects 6 percentage points of the 22 percent pension contributions paid by employers on behalf of those born after 1967. This is channeled to individual retirement accounts that are invested in securities.

The remaining 16 percent is comprised of unfunded "pay-as-you-go" contributions that directly finance current pensioners.

The suggestion to reduce funded pensions, championed by the Labor Ministry, prompted howls of criticism from the investment community.

The funded pension pool — valued at about 2 trillion rubles — is one of Russia's few large resources of domestic capital, a key stabilizing force for the country's markets.

"Moving from today's 6 percent to 2 percent is probably a retreat and not a step forward," said UBS Russia head Nicholas Jordan.

"If Russia wants to limit volatility in its local market, it needs local long-term money," he added. "Foreign money is more volatile and more fickle."

As it will mean instantly larger flows into the unfunded section of State Pension Fund, some characterized it as a raid on the inaccessible funded part simply to cover the budget in the short term.

It is "pickpocketing the next generation," Finance Minister Anton Siluanov warned in August.

The adoption of the proposals in their current form would hit equities and bond markets, according to bankers, many of whom believe the Finance Ministry will be successful in its opposition.

Putin's position is not yet clear, but he told a conference of foreign investors last week that he understood the importance of the funded part and its role "in overcoming the problem of long-term financing that everyone worries about."

Russia is not unique in its 2002 adoption of a funded part to the pensions system — 14 other Eastern European countries have enacted similar reforms in the last 15 years. The concept was developed in South American countries in the 1980s.

But while the government maneuvers almost powerlessly between the limits imposed by the president, there are more and more voices calling for firm action.

Pension reform has a "fundamental significance for the economy, people's social well-being and the position of business," former Finance Minister Alexei Kudrin wrote last month. Kudrin, who has compared the pension system to a "classic financial pyramid," supports a rise in the retirement age.

Changing demographics are also injecting urgency to the debate.

Similar to many other countries, Russia's "baby-boomers" will soon become eligible for their pensions, adding to the dependent population. By 2020 there will be 42.5 million pensioners, according to the Ministry of Labor. And at some point after 2025 the number of pensioners will exceed those of working age.

Already rising fast, costs look set to climb further. Putin has said the equivalent of 10 percent of gross domestic product is already spent on pensions — a quarter of the government's annual budget. And the State Pension Fund's deficit has ballooned from 30 billion rubles in 2005 to 1.3 trillion rubles this year.

Largesse over the last decade has also compounded the problem. The current crisis has its "roots in the quite rapid increase in pensions over the last 7 years," said Vladimir Tikhomirov, chief economist at Otkritie Capital.

"Once you increase pensions it's almost impossible politically to cut them back," he added.

About 40 percent of the electorate, pensioners are a significant political force, and they are more likely to vote than young people. In the run-up to Duma elections last year, Putin promised an 8 to 10 percent across-the-board rise in pensions.

And average pensions are far below the average wage. Indeed, the average monthly pension is just 3,331 rubles above the official poverty threshold (a monthly income of 6,369 rubles).

Many academics, experts and businessmen see no viable exit from this demographic, fiscal and political crunch other than lifting the retirement age — whether directly or by the back door.

"The bottom line," wrote Ivan Tchakarov, chief economist at Renaissance Capital in a note to investors last week, "is that all of [the government's proposals] are just tinkering with the system to avoid the only decision that will really solve the problem ... an increase in the pension age for men and, in particular, for women."

While the life expectancy of males in the country is significantly less than that of females, men are currently entitled to a state pension from the age of 60, while women are eligible from 55.

The International Monetary Fund proposed in August that Russia equalize the retirement age for men and women to 63 by 2030, and to 65 by 2050.

But in the face of high oil prices, government infighting and the danger of inciting social instability, radical change appears to be a distant prospect at the moment.

"The discussion about the pension system is only just beginning," Finance Minister Anton Siluanov told reporters last week.

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