The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

Analysis: Pension Reform Spells Disaster for Asset Management Sector

By The Moscow Times

October 22, 2012

A government plan to slash compulsory retirement savings threatens to cripple the nascent asset-management industry without fixing a hole in the state pension budget, industry players and economic experts warn.

Progress on pension reform is being closely watched as Russia grapples with a huge shortfall in its overburdened state pension system. Subsidies to this system already swallow up a quarter of the federal budget, and they will keep rising as the number of pensioners keeps growing.

But the solution the government is now mulling will deal a blow to Russia's financial markets and the pension industry, which had hoped that Vladimir Putin's return to the Kremlin this year would trigger investor-friendly reforms.

"It's close to catastrophic what is going on," said Alexander Lorenz, chairman of the pension fund arm of Austria's Raiffeisen Bank in Moscow, one of the few international players to brave the Russian pensions market.

"In this context, the discussion of Moscow as an international financial center is laughable."

Although Putin has identified pension reform as one of his main economic policy priorities, deep divisions in the government have held up a plan for months.

After a dressing-down from Putin over the delay, Prime Minister Dmitry Medvedev's Cabinet recently presented a new pensions strategy that would slash the contributions that Russians are required to save for their own retirement, freeing up cash that could instead be used to pay pensions today.

Still Not Finalized

Senior officials have emphasized that no final decision on the plan has been made. The final version is expected only at the beginning of next year.

But for Putin, a key advantage of the plan is that it would ease the immediate fiscal burden of pensions without requiring an unpopular increase in the retirement age, now 60 for men and 55 for women, thereby honoring one of the key promises he made before his election in March.

The Labor and Social Services Ministry, which drew up the document, argues that the compulsory savings system is unfair and illogical because the returns on pension fund investments have lagged behind the rate of inflation.

But many analysts warn that the new pension strategy would greatly reduce the funding available for investment in the country's shallow financial markets. That would reinforce their reliance on volatile foreign capital flows and exacerbate a dearth of long-term investment capital, which is widely acknowledged as one of Russia's most fundamental economic problems.

And by reducing the savings available to pay future pensioners, the plan would only increase the fiscal burden of pensions in the long run.

"It is irrational and illogical. It's impermissible to feed the present generations at the expense of future generations," said Pavel Teplukhin, the new country head for Deutsche Bank in Russia, who previously headed leading investment company Troika Dialog.

"It will be a disaster," said Yulia Tsepliayeva, chief Russia economist at BNP Paribas. "There's no way to build an institutional investment industry in this country in the future."

Policy U-Turn

If the government goes ahead with its plan, it would also raise questions about its reliability, as it backtracks on a pension reform adopted by Putin during his first presidential term a decade ago.

The earlier reform introduced the "three-pillar" pension model, which requires citizens to make obligatory savings to cover part of the cost of their future pensions. That money is in addition to the state pension and voluntary savings. The mandatory savings are invested in financial markets.

This once-fashionable system is now facing a backlash from cash-strapped governments pressured by the financial crisis. Both Argentina and Hungary nationalized the obligatory savings, provoking outcries from investors, while Poland slashed the contribution rate on individual retirement savings from 7.3 percent of salaries to 2.3 percent.

The plan now under discussion in Russia would reduce the rate for mandatory contributions, which are paid by employers on behalf of their employees through a payroll tax, from 6 percent to 2 percent, with the excess diverted to the state pension fund.

The change would be a serious setback to Russia's nascent pension fund industry, which remains severely underdeveloped despite the earlier reform but has started to grow quickly.

Total pension fund assets under management represent only 4 percent of gross domestic product, far smaller than the 70 percent share in the United States and the 15 percent share in Poland, an emerging-market pioneer in pension reform.

Nevertheless, as more working Russians have joined the obligatory contributions system, the size of pension fund assets has increased fivefold over the last five years.

"Year-on-year assets under management growth has been 50 percent for us, which is phenomenal. The whole industry has been growing very rapidly," Lorenz said. "And now, to pull the plug on something that is just taking off is just insane."

Analysts at Renaissance Capital calculate that if the present system is left intact, the amount of pension funds under management will more than double, reaching $160 billion by 2022.

"If we grow this funded pillar, we have long term-money and we can use these savings for our domestic investment. And that is very, very important," said Ivan Tchakarov, chief Russia economist at Renaissance.

If the government does reduce the contribution rate to 2 percent, the amount accumulated by 2022 would be slashed in half, to $80 billion, Renaissance estimates. Yet the money freed up over the decade amounts to less than one year's worth of budget subsidies to the State Pension Fund.

Many analysts therefore argue that the only long-term answer is the one step that Putin has vowed to avoid.

"Many of the proposals that are being put out right now are just playing around and trying to avoid the only solution that could radically solve the problem, which is increasing the pension age," Tchakarov said.

A new version of the plan for strategic development of the pension system will be ready by Nov. 15, Deputy Prime Minister Olga Golodets said Tuesday, Interfax reported.

Starting Nov. 1, we will prepare all the changes, and by Nov. 15 the document outlining the new format of the pension strategy will be ready, Golodets told journalists at a Public Chamber hearing on pension reform.

"We already know for sure that there will be changes to the standards for length of service," the deputy prime minister said. "This standard will be reduced to 35 years."

Related articles:

- Kremlin Struggling With Pension Time Bomb
- Tax Dodgers to Fill Pension Fund
- On Pension Plan, Putin Shows He's Not a Leader

Original url:
https://www.themoscowtimes.com/2012/10/22/analysis-pension-reform-spells-disaster-for-asset-management-sector-a18780