REFORMING THE SOCIAL SAFETY NET?
The Crisis of Russia’s Pension System

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Executive summary

Russia inherited from the Soviet Union a pension system characterized by broad coverage of the population and liberal eligibility requirements, combined with relatively low payment levels. In the reform period the tax base of the Pay-As-You-Go system has suffered deep erosion, the payer-recipient ratio has worsened significantly, corporate entities have developed catastrophic debts to the Pension Fund, and the Fund itself has come to be broadly perceived as non-transparent and unaccountable. The results have been structural deficits for the pension system, large-scale arrears in payments to pensioners, pensions paid at subsistence level or below, and a compression of payment levels that discourages contributions.

Since 1995 the Russian government has taken several initiatives to reform pension policy, but these have so far accomplished little. The present paper draws on both published sources and interviews with policy-makers and specialists to examine the obstacles to reform, including: a legacy of broad entitlements, an aging population that forms a large and influential political constituency for the current system, and a high old-age dependency ratio, all characteristic of advanced industrial societies; and the high levels of tax evasion, large informal sector, poorly-regulated markets and weak state capacity more often found in “younger” socio-economies. The paper analyzes the overall failure of reform to the present, focusing on the ways in which policy legacies and the constituencies created by past policy commitments have constrained change, as well as the intrinsic difficulty of designing a reform where neither state nor market can be relied on to provide pension security.
Introduction

Russia's pension system confronts simultaneously two sets of problems that are normally encountered separately: the broad pension entitlement, aging population, and resulting high old-age dependency ratios characteristic of advanced industrial societies; and the high levels of tax evasion, large informal sector, poorly-regulated markets and weak state capacity more often found in "younger" socio-economies (World Bank, 1994). These factors, along with the years of economic decline, have brought the current system into deep crisis and prompted a series of reforming initiatives by the Russian government. The present paper examines those initiatives, including the prominent efforts of the World Bank to influence policy formulation. It then analyzes the overall failure of reform to the present, focusing on the ways in which policy legacies and the constituencies created by past policy commitments have constrained change, as well as the intrinsic difficulty of designing a reform where neither state nor market can be relied on to provide pension security.

The Soviet legacy

Russia inherited from the Soviet Union a pension system that was characterized by broad coverage, liberal eligibility requirements, and relatively low payment levels. The key legislation, the Pension Law of 1956, extended pension coverage to all civilian state employees upon retirement, those disabled by work-related accidents or illnesses, and deceased workers' surviving dependents. Additional legislation in 1964 brought collective farmers into the system on somewhat less favorable terms. Given virtually full employment in the Soviet economy and extremely high labor force participation rates for both men and woman, the system's reach was quite broad. By 1970 an estimated 75-80% of state-sector workers who had reached retirement age received pensions, and by the end of the Soviet period coverage was nearly universal (McAuley, 1979: 269-276).

Soviet legislation provided that men who had reached the age of 60 with 25 years of state employment, and women who had reached 55 with 20 years of employment, were entitled to pensions. These limits, already quite low by the standards of industrial economies, were subject to a great many
privileged exceptions: those who worked in difficult or dangerous occupations could retire early, as could those who worked in the Far North or in severe climatic conditions. A whole series of white-collar workers, including airline pilots, teachers, doctors, and some groups of scientific and cultural workers, could retire on long-service pensions after a designated number of years (commonly 25) regardless of age. Moreover, in calculating the length of service “non-working periods” spent in higher education, military service, and maternity leave to raise a child under three years, were counted. The broad system of early retirement effectively lowered the pension age an additional one and a half to two years on average by the 1990s, while about 10% of Russia’s 38 million pensioners received some kind of special pension privileges (Maleva, 1997). Those eligible for pensions could collect and continue to work without penalty, comprising the large category of “working pensioners” = 20-30% of the total in the later Soviet years (Connor, 1997). In 1992, more than 35 million people, almost one-fourth of the population, received pensions, making the Pension Fund the most important social safety net program (see Table 1). Both the liberal rules for general eligibility and the various privileged exceptions formed a legacy of entitlements that was embedded in Soviet legislation and in the assumptions and expectations of Russia’s population.

Table 1.

| Number and Per Cent of the Russian Population Eligible to Collect Pensions |
|---------------------|-------|-------|-------|
| Number of Pensioners| 35,273| 36,623| 37,827| 38,286|
| % of Total Population| 23.8  | 24.8  | 25.7  | 26.1  |


Soviet-era pensions were the sole responsibility of the state, which paid them from the budget, drawing in part on compulsory contributions from enterprises. Benefit levels were linked to wage and years of service, though pensions were not indexed and their value tended to erode over time. The
comparatively low level of payments is reflected in the overall expenditure levels: in 1991, at the end of the Soviet period, Russia spent about 5% of its GDP on pensions, as against more typical international levels of 8-11% (World Bank, 1997). We must keep in mind, however, that housing, transport, and many goods and services were deeply subsidized in the Soviet system, limiting the value of the comparison especially with non-socialist systems.

In 1990-91 the Soviet pension system, particularly the organization of its funding, underwent significant reform. New legislation provided that pensions would be paid not from the state budget but from a newly-formed, independent, extra-budgetary Pension Fund. Revenues would come mainly from a payroll tax, determined by the legislature on an annual basis and set at a comparatively very high 29% of wages, with 28% to be paid by enterprises and 1% by employees. The state budget would contribute some funds for a new category of “social” pensions paid to those who did not otherwise qualify. Aside from these changes the structure of the inherited pension system remained largely in place (Mikhalev, 1996; Chandler, 1998).

The new legislation created in Russia an essentially Pay-As-You-Go (PAYG) pension system similar to those found in most Western industrial economies: current benefits would be financed from current contributions. This system was solidaristic, i.e. based on an inter-generational exchange of income, and it allowed the state to redistribute that income in favor of poorer groups. The connection between payments into the fund and pensions received remained remote: enterprises paid a lump sum for their employees with no accounting of contributions for individual workers, who in turn paid only a token tax. The amount of pension payments was calculated as 55% of salary during the last 24 months of work or any 60 consecutive months, plus 1% for each year of work beyond pension eligibility (OECD, 1996). The PAYG system meant that the accumulated obligations and entitlements to pensioners would be funded almost entirely from taxes on the wages of current workers. As reform began, this system would encounter both a near-term financial crisis and serious problems of longer-term viability.
The Emerging crisis, 1991-97

Yeltsin’s economic reform policies subjected the pension system to multiple shocks. First and most important, changes in the economic and financial systems undercut the tax base for the Pension Fund. Reform brought a decline of more than 40% in the level of real wages, the main revenue base for pensions. Moreover, as legal order and tax discipline in Russia declined, enterprises engaged in rampant tax evasion, relying on wage arrears, barter transactions, payments-in-kind, and illegal cash payments to their workers to avoid the high social security levies on their payrolls. As Table 2 shows, debt to the Fund, mainly by enterprises, increased steadily from 1993:

Table 2
Debts of Payers to the Pension Fund
(trillions of rubles at end of year for 1993-97; billion new rubles for 1998-99)

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td></td>
<td>1.1</td>
<td>7.0</td>
<td>22.7</td>
<td>59.5</td>
<td>87.8</td>
<td>100.2</td>
<td>130</td>
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</tbody>
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These debts were on a catastrophic scale. In 1997 fewer than 25% of corporate entities were paying into the fund punctually (RG, June 7, 1997), and attempts by the government to pressure the largest debtors (which included the oil and railroad sectors) through the Temporary Extraordinary Commission for Tax and Budget Discipline produced few results (RV, Jan. 30, 1997). An indeterminate but substantial part of the labor force, moreover, had begun to work in the informal sector for part or all of their wages, and these could not be taxed, though many maintained an attachment to the legal economy and could collect. Finally the government itself ran arrears to the Fund for the payment of “social” pensions; by the end of 1996 these arrears equaled R14.1 trillion (Maleva, 1997, p. 15).

At the same time that it undercut the tax base, the reform increased demands on the pension system. Like most mature industrial economies with aging populations, Russia faced an increasingly unfavorable ratio between the number of contributors – those employed and paying into the Pension Fund – and recipients. The percentage of those older than 60 in the general population had doubled in the past
40 years and continued to grow faster than any other group. Demographic factors alone would eventually render the system unviable. And during the first half of the 1990s economic factors caused a sharp worsening in this ratio: labor force cuts pushed older workers out of jobs onto pensions, the numbers claiming invalid pensions increased dramatically, and growing unemployment reduced the size of the labor force. Overall, the number of employed declined by more than 5 million between 1991 and 1996 while the number of pensioners grew by more than 3 million. As a result the official payer-recipient ratio shifted from about 2.1 in 1991 to 1.7 in 1996, significantly increasing the social burden of pension payments on the employed population (Maleva, 1997, p. 17). Experts' estimates that took account of tax evasion and wage arrears put the actual ratio at 1.4 (RG, Aug. 23, 1995).

The results were inadequate payments into the Pension Fund, large-scale arrears in payments to pensioners, and pensions paid at poverty levels and below. Through mid-1995, the Pension Fund managed to cover costs but in the middle of that year revenues began to fall short of expenditures, and by 1996 the Fund had a serious deficit (World Bank, 1996, p. 67). Delays in payments to pensioners, already present in 1992-93, became a serious problem and a constant preoccupation of both government and Duma opposition. The Minister of Social Protection reported that pensions were delayed up to a month in 63 of Russia's 89 regions during 1995 (RG, May 8, 1996). Throughout 1996, payment delays were chronic, with 33% of those eligible to receive pensions reporting to the Russian Longitudinal Monitoring Survey (RLMS) that they had received none in the past month (Denisova et al., 1999, p. 13). In early 1997 the Pension Fund owed R15.7 trillion, and while it settled this debt by mid-year with help from the federal budget, revenues continued to fall below required expenditures and payment arrears piled up again by fall, sparking protests in the spring of 1998 (RG, May 30, 1997). At the beginning of August, 1998, before the financial crisis, the Pension Fund owed pensioners R16 billion (new), equivalent to a month's pension for all recipients (Ekon. i Zh., Aug. 1, No. 31, 1998, p. 6), and by the beginning of September the debt stood at R23 billion. Moreover, though formally the level of pension payments is uniform throughout Russia, in practice the distribution of arrears was highly uneven, meaning delays of up to several months for some (Dmitriev interview).
The pensions that were paid declined precipitously in real rubles, pushing the majority close to the pensioners' subsistence minimum (PSM), and a substantial minority below it. Extremely high inflation during 1992-93 had undercut the real value of pensions as well as older Russians’ lifetime savings. The government and legislature responded with sporadic indexation of both past earnings and pensions, increases in minimum pensions, and compensation payments, but all these measures fell far short of counteracting the devaluation. Average pensions remained for the most part slightly above the PSM—a miserly level that assumed 80% of income would be spent on food—until the 1998 economic crisis. Minimum pensions, at 70% of the PSM in 1993, fell below half PSM level in 1995 (see Table 3).

<table>
<thead>
<tr>
<th>Year</th>
<th>Average*</th>
<th>Minimum*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>116.9</td>
<td>70</td>
</tr>
<tr>
<td>1993</td>
<td>138.1</td>
<td>(est.)</td>
</tr>
<tr>
<td>1994</td>
<td>128.6</td>
<td>75</td>
</tr>
<tr>
<td>1995</td>
<td>101</td>
<td>45</td>
</tr>
<tr>
<td>1996</td>
<td>116.0 (est.)</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>113.2 (est.)</td>
<td></td>
</tr>
<tr>
<td>12/98</td>
<td>80</td>
<td>-</td>
</tr>
</tbody>
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*with compensation payments


The level of poverty among pensioners, low in the early stages of reform, increased markedly in the mid-1990s. The RLMS found that, while in 1993 only 4% of pensioners lived in households below the poverty line, in late 1996, 31% did (RET, 1997, 2, p. 53.). Their situation worsened in 1998, when lower pensions combined with sharper competition in the labor market forced many pensioners out of the low-paid service jobs with which they had supplemented their incomes (Sederlof interview).

Moreover, in order to maintain the average at this level the government had to compress the scale of pension payments. The ratio of average to minimum pensions declined from about 2 at the end of 1993 to 1.2 at the end of 1996, with policy-makers sacrificing differentiation to keep the average above the subsistence level (World Bank, 1997, p. 6). The effect was to push pensioners toward a common
minimum, further divorcing pensions from labor contributions and undercutting incentives, particularly for the better-off, to participate in the system. At the same time, compression demonstrated the capacity of the state to re-distribute and equalize income in a solidaristic pension system, keeping most above the poverty level until the 1998 crisis. As differentiation, and hence the rate of wage replacement for the upper-income, fell, special legislation was passed guaranteeing higher civil servants pensions paid directly from the state budget; both the President and Duma were complicit in this. Through the mid-1990s pensions continued to claim 5-6% of a declining GDP, meaning that the real value of overall benefits fell.

Finally, the pension system itself was (and remains) mired in technical, legal, and institutional problems. Officials have difficulty determining individuals’ pension eligibility in the new economy, where claims of work record and wage are hard to verify and falsification, particularly of wage levels, is reportedly common. Local offices have insufficient administrative capacity to keep up with the frequent re-calculation of pensions, contributing to payment delays and arrears (Mikhalev). More important, legal regulation of the Pension Fund is extremely weak and most informed observers charge that its monies have been badly-managed. Government ministers, academic experts and pensioners’ organizations regularly claim that the Fund’s management has diverted money from pension payments, borrowed from commercial banks at high interest rates, refused audits, and generally operated with a complete lack of transparency or accountability (RV. Apr. 23, 1996; Rfe/Rl, July 29, 1998; Bochkareva. Baskakova interviews).

Proposed solutions: the politics of pension reform

In sum, the Russian pension system faced several major problems: 1) an inherited burden of pension payments that was unsustainable under current financial conditions; 2) large-scale evasion of social security taxes by both employers and those who worked in the illegal economy; 3) pension levels that were too low to keep many out of poverty and too compressed to replace more than a small share of
wages for most; and 4) a pension system that was non-transparent, unaccountable, and unreliable in
delivery of benefits.

Both logic and international experience suggested three basic solutions to these problems: 1)
reduce established benefits and/or restrict eligibility to them; 2) create incentives for legal employment
and pension contributions so that more money would flow into the present, state-run, PAYG system; 3)
transfer more or less of pension provision from the public/state sphere to individual savings and financial
markets. With the aid and advice of the World Bank and other international organizations the
Chernomyrdin and Kirienko governments proposed various combinations of these solutions, producing
conflicts with the Duma, with mobilized groups of pensioners, employers and trade unions, and within the
governments themselves.

Obstacles to short-term reform

First, reform officials sought to change the rules (or parameters) of entitlement to pensions in
Russia, in order to provide immediate fiscal relief to the pension system. They targeted the liberal
eligibility rules and special benefits, bonuses, and privileges inherited from the Soviet period, proposing
changes that, *inter alia*, would: raise the retirement age; restrict rights to early retirement; cut or eliminate
payments to Russia’s 7 million “working pensioners”; eliminate privileged pensions for those who
worked in dangerous jobs, harsh climates, etc., and suspend long-term service payments. In return, they
promised timely payment of pensions and an increase in the minimum sufficient to pull the poorest out of
poverty. From the rationalizing perspective of Russian reformers and their World Bank advisors, these
reforms would bring the system closer to fiscal balance and social justice, providing at least short-term
relief for the Pension Fund while taking benefits from younger and more able-bodied pensioners and
channeling them to the most needy.

Although some have been proposed repeatedly, not one of these measures has passed into law.
Both their design and scope contributed to their failure. As we know from other studies of welfare state
retrenchment (Pierson, 1994), such immediate and visible benefit cuts are the most difficult politically,
and the reformers' broad forays into the entitlements of different sub-groups of pensioners spread the damage and eliminated possibilities for divide-and-conquer policy strategies. In any case the political realities of Russia doomed short-term reform proposals that imposed tangible costs on pensioners. The Communist-led left-wing majority that dominated the Duma depended heavily on older voters for political support and for its party's activist base. It opposed in principle any diminution in their welfare rights, condemned the government's cut-back proposals at every opportunity, and controlled nearly enough votes to reject legislation (Cook, et. al., 1999).

Indeed, the Duma frequently used its right of legislative initiative to press for pension increases as well as additional privileges for specific groups of pensioners. While Yeltsin vetoed much of this legislation and his government condemned it as fiscally irresponsible, the left kept issues of pensioners' rights near the top of the political agenda, and kept the government on the defensive. Most short-term reform proposals were never even submitted to the Duma, where they would have faced inevitable defeat. The lower house also blocked the government's repeated attempts to change the pension contribution formula, refusing to shift even a modest share of the burden from enterprises to employees. Basically government and Duma played a political game of mutual blame over pension arrears while Russia's constitutional arrangements, which during this period gave the Duma little say or representation in government ministries, insulated it from responsibility for the Pension Fund's problems.

The proposed reforms also generated opposition from pensioners' and veterans' organizations, trade unions, and industrial managers. Veterans' organizations, particularly the large Union of Veterans, reportedly lobbied the legislature daily on pension and other issues. Its leadership included many former high-ranking military officers whose links with current leaders contributed to its effectiveness (Avtonomov, Kozmina interviews). Pensioners' organizations generally opposed cuts, distrusted the government's pleas of insufficient funds, and believed that large amounts were mismanaged or stolen. A spokesperson for the Pensioners' Party, for example, claimed: "We are sure that the declarations concerning absence of money are not true; pensions could be doubled without tension in the budget... Stealing occurs at all stages of collecting pension money" (Petrov interview). Pensioners also used the
press, producing an outcry over proposed benefit cuts that frequently led the government to back down. Trade unions, too, spoke against the reforms. Even industrial managers, mainly the “Red Directors” in old heavy industries, opposed changes in the retirement age and early retirement benefits, because existing policies facilitated managers’ shedding of older workers or provided a supplement to low and erratic wage payments.¹

One should not overstate the influence of Russian trade unions or of pensioners’ organizations, which with the exception of the Veterans’ Union were extremely weak, but the cumulative opposition to pension reform mattered. Overall, according to a range of experts, short-term, highly-visible pension benefit cuts were simply “politically unacceptable,” even though leaving the existing system in place actually guaranteed pensioners little in the face of declining real pensions, compression and arrears.

The 1995 reform “Concept”

In August, 1995, the Russian government proposed a new “Concept” for reform of the Russian pension system. Its main thrust was to tie pensions directly to individuals’ contributions, giving employees stronger incentives to participate in the system. In the proposed second, or main, tier, state-mandated contributions would for the first time be registered in personal pension accounts, and the formula for calculating pensions would be changed to one based exclusively on length of employment and size of individuals’ lifetime contributions. The current “social” pensions, for the disabled and others, would be moved to a separate first tier and paid from the state budget. The financing of various special and privileged pensions would be transferred to a third tier of supplementary professional schemes, with money to be saved through insurance companies and non-state pension funds (Maleva, n.d; RG, Aug. 23, 1995). The system was intended to produce more differentiated pension payments and reward those who stayed in the labor force longer.

¹ This point was made by Ilean Cashu, a graduate student at Syracuse University, citing interviews from his research on Russian pension reform; meeting at the Davis Center for Russian Studies, Harvard University, July, 1999.
The "Concept" avoided the politically unpopular approaches of reducing benefits and restricting eligibility. Instead, it sought to change incentives and shift responsibilities in order to increase the inflow of money and lessen the burden on the general fund. It gave workers incentives to retire later without requiring them to do so, and kept privileged benefits but made employers responsible for financing them. With pension accounts personalized and payments clearly and uniformly differentiated according to contributions, workers were expected to participate willingly and monitor employers' payments into the Pension Fund. Overall the 1995 concept qualifies as a modest reform: Russia would keep PAYG financing, with the state retaining major responsibility for pension security and private savings and markets assigned only a supplementary or tertiary role.

The 1995 "Concept" reflected the belief of Russian pension specialists and policy-makers that the "group" nature of the existing pension fund and poor correlation between earnings/contributions and payments were the main disincentives to participation (Bochkareva, Shenkarev interviews). It ignored many other reasons for unwillingness to contribute, including high levels of distrust in the Pension Fund and government, the unreliability of pension payments, and uncertainty about the future rules of the pension system and about the economy generally (Denisova, et. al., 1999, pp. 16-18). Reformers also assumed that employers could take on additional burdens for privileged pensions, ignoring the desperate financial state of much of industry. And they assumed that Russia's poorly-regulated and volatile financial markets could play a role in providing pension security. These flawed assumptions have been retained in current reform proposals.

Two significant pieces of pension legislation based on the 1995 "Concept" were passed by the Duma in 1996-97. The first, the Law on Individual (Personified) Accounting in the System of State Pension Insurance, established procedures (lacking in the inherited system) for registering the individual contributions of current workers to the Pension Fund (S.Z., No. 14, Apr. 1, 1996, St.1401). The Russian government, with technical aid from the World Bank, introduced individual accounts in about one-third of Russian regions by late 1998, creating some of the administrative infrastructure for reform but falling far short of concrete results (World Bank, 1998).
The second, a law on individual coefficients, provided for re-calculation of current pensions on the basis of past contributions and was applied to almost half of all pensioners (some 16 million) in 1998 (Vedomosti, No. 24, Aug. 21, 1997, St. 1151). It quickly became mired in conflict, partly because the method for calculating coefficients excluded periods of higher education, military service, maternity and child care leaves, which had been included in the Soviet-era work стаж. The reform's designers insisted coefficients had to exclude periods when no contributions were made, but the Duma, government and courts were inundated with protests. Newly-appointed Labor Minister Dmitrieva condemned retroactive benefit revisions and promised to re-consider the rules, and, ultimately, pensioners were given a choice of systems for calculating benefits, partially frustrating the intent of the legislation (Denisova, et. al., 1999).

One additional piece of pension legislation, the Federal Law On Non-State Pension Funds, (NSPFs) was passed in May, 1998 (Pensia, No. 6(21), 1998, pp. 23-28). The Law secured the legal base as well as tax privileges for both professional pension systems and voluntary individual pension schemes. The government had been pressing for this legislation for several years, and decrees had already allowed the establishing and licensing of such funds. In late 1997, 279 NSPFs were registered, concentrated in Moscow and St. Petersburg, with about 2 million participants and R7307.4 million in assets. Some 187,000 people, 0.5% of all pensioners, received payments. The largest funds belonged to corporations in raw materials, energy and finance (Pushkina, 1999). The scale of NSPFs at this point was too small to matter much for pension security, but such funds would form a key element in the 3rd tier of the 1995 "Concept" and an even more important part in the proposed 1998 reform, and they provide a cautionary tale.

NSPFs fared poorly in Russia's chaotic financial markets. Even in 1996 there were criminal cases against several (FBIS, Apr. 29, 1996), and while the 1998 Federal Law strengthened rules for licensing and administering them, it provided little protection in the 1998 financial crisis. As a result of the August crisis, all of the funds lost money and the weaker ones collapsed. Many violated their contracts by suspending pension payments, in part because of the government's freezing of payments on GKO's which all the funds held. While the larger NSPFs survived, there was a general loss of confidence
in them as a means for providing pension security (Avtonomov, Baskakova interviews). The experience with NSPFs demonstrates that Russian financial markets have not created the necessary conditions for private pension savings, and that the state is too weak at present to construct an adequate regulatory regime (Barr, 1992; Denisova et. al., 1999).

The World Bank and the debate over systemic reform

In the spring of 1997 pension reform gained new momentum. A group of “young reformers” was brought into the social ministries of Russia’s government, which at the same time negotiated with the World Bank an $800 million Social Policy Adjustment Loan (SPAL) to be disbursed over the following year. Bank documents set out in some detail, as conditions for receipt of the tranches, the parameters of the pension program Russian reformers should propose. The Bank had two central goals: to provide a minimum pension income that would alleviate poverty; and to move Russia’s main system of pension provision away from public financing and solidaristic (i.e., PAYG) principles toward private, funded or accumulative schemes (i.e., shifting responsibility from the public and state to the individual and market).

In funded pension systems, employees save for their own retirement in individual accounts (though these may be mandated and managed by the state); and their pensions depend entirely on the accumulation plus any earnings. It is assumed that pension savings will be invested and earn income, making financial markets a major guarantor of pension security. In the Bank’s view, funding would solve many of Russia’s problems by limiting the responsibility of the state for pension provision and making payments independent of current payrolls, though, as critics note, it would also greatly limit possibilities for redistribution and leave individual pensions vulnerable to inflation and market failures. Proponents and experts stressed that the next 10-12 years would provide a “window of opportunity” for transition to funding – a period of relatively advantageous worker-pensioner ratios caused by the WWII drop in birth rates – before the retirement of the post-War boomers inundated the PAYG system.

SPAL documents recommended gradual introduction of funding, beginning with fictional (or notional) individual accounts and, as obligations to current pensioners lessened, moving to real funding.
In the Bank’s “optimal structure,” the second or main tier would eventually be fully funded, a major departure from the existing system as well as the 1995 “Concept” (World Bank, 1997, p. 44). As conditions for disbursement of the SPAL (as well as a small supplementary implementation loan that provided expert and technical support), the Russian government was to promulgate a pension reform program in broad compliance with Bank recommendations, raise the minimum pension to 80% of the PSM, and audit the Pension Fund (World Bank, 1997; Sederlof interview).

The man placed in charge of pension reform, Minister of Labor and Social Development Mikhail Dmitriev, favored a much more radical version of reform. Dmitriev, impressed by the Chilean success with raising pensions through market investment and convinced that the Russian system must be divorced from politics, proposed that Russia transfer most age cohorts to individual financing of pensions through funded schemes within several months. All those participating in funded schemes would lose their right to draw a state pension, while the state would aid only the destitute.

The nearly complete rejection of Dmitriev’s proposals by the then-reformist Russian government shows the limits of acceptable reform, and the intense debate surrounding it gives evidence of the normative as well as institutional legacies of the old system. The connection between Dmitriev’s ideas (developed while he was an Associate at the Moscow Carnegie Center and already well-known when he joined the Ministry) and the Bank’s agenda are less clear, though in the end the Bank joined the chorus against his proposals. It seems he was a maverick who took the reformist agenda to an extreme and, according to one well-placed Bank official, “alienated a lot of people” (Sederlof interview).

Critics of Dmitriev’s plan, from among both academic specialists and government, argued that under current conditions it would abandon large numbers of future pensioners to poverty and further exacerbate the deep inequalities and growing stratification in Russian society. Many workers, they argued, could not afford to save for retirement at current wage levels, and would be left without pension security. Women, with lower wages and longer life spans, would see their pensions drop from the present near-equality with men’s to less than half. There were also practical objections: the transition period in which current pensioners had to be supported even as workers began saving for their own retirement
would be extremely expensive, and the unavoidable "dual taxation" would drive more from the legal economy. Bureaucratic politics and conservatism also played a part: Dmitriev's commission bypassed both the Labor Ministry and the Pension Fund, antagonizing their leaders even as his proposals threatened their vested interests in running the present pension system (Echenike interview).

But there was at base also a broad normative consensus against abandoning the redistributive and solidaristic elements of Russia's pension system in the face of current realities, voiced by officials from the Labor Ministry, the Pension Fund, the executive branch, specialists and advisors (Trud, Aug. 16, 1997; FBIS, Sept. 3, Dec. 22, 1997). According to one participant: "Everyone criticized Dmitriev – the government, the Ministry of Labor. Everyone said that the accumulative principle must be softened.... The main criticism was that the accumulative system doesn't protect the poorest, and that the mentality of the Russian people is accustomed to security. Dmitriev was almost alone in his support for the pure accumulative system" (Baskakova interview).

In the event the reform commission was broadened and produced a compromise draft that combined distributive and accumulative principles (PAYG and funded components). The Pension Reform Program, finally approved by the government in May 1998, provided that the main tier would begin a gradual transition to funding. It proposed for Russia a "notional defined contribution system" (NDC). In the near term, while pension payments continued to go to current retirees, each employee would be assigned a "notional" pension account, based on fictional contributions and a simulated rate of return, and pensions would be calculated on the basis of the presumed accumulation in these accounts (Fox, 1997). Very gradually real funds would be accumulated, beginning with 1% of deductions in 2000, and progressing to 5% in 2006, 7% in 2009, and eventually 50%, and an increasing proportion of pensions would be paid from these real accumulations (Maleva, n.d.). A first tier would continue to provide a minimal base pension, and a third, supplementary tier would provide special and privileged pensions.

The 1998 reform bore the clear stamp of the World Bank's influence. The Bank succeeded in focusing the policy debate on the shift to a funded or accumulative system, and provided effective
incentives for Russia’s government to conclude a contentious policy debate and approve a reform program. According to the realistic assessment of Hjalte Sederlof, the main World Bank official involved in Russian pension reform efforts, the SPAL succeeded in "bringing about a government decision on pension reform; introducing a second pillar with notional accounts; influencing improved legislation for voluntary pension schemes; and indirectly introducing ideas about industry-wide occupational pension schemes" (Sederlof interview).

The Bank’s influence proved more limited, though, when it came to concrete results. The 3rd tranche of the loan, scheduled for release in the spring of 1998, was withheld because the Russian government failed to meet requirements to raise the minimum pension to 80% of the PSM and complete an audit of the Pension Fund (Sederlof interview). In the aftermath of the August crisis the Bank adapted its position, counseling flat pension payments (advice that was, oddly, resisted by the Primakov government, which insisted on the need for differentiation). It is notable here that Bank officials have consistently pressed for poverty relief, and thus advocated for the interests of Russia’s poorest pensions.

Economic crisis and Primakov government: return to short-term emergency measures

The 1998 financial crisis brought a halt to pension reform efforts and exacerbated the system’s problems. Average pensions fell below the subsistence minimum (see Table 2), payment levels were compressed to a nearly flat rate, and arrears mounted. The government, responding in part to pressures from the IMF to balance the Pension Fund budget, proposed to increase deductions from wages, shift funds from health and other social insurance funds, and suspend some benefit payments. A special temporary tax on non-wage income was introduced by a government decree that had no legal standing (Decree 800; RG, July 25, 1998). The Primakov government, appointed in September, 1998 and much closer in its political leanings to the Duma, managed to pay off arrears and compensate pensioners for part of the year’s inflation by transfers of money from the federal budget and a R10 billion Sberbank credit (RED, 1999, p. 11).
All of these measures were *ad hoc* and did nothing to address the underlying problems. In the face of continuing federal policy failures, regional governments began defecting from the federal pension system, refusing to pay into the fund. Wealthier regions added payment supplements for their own pensioners, and trends toward regionalization have became an additional threat to the system. According to one specialist: “There is a tendency for federation subjects to accumulate and distribute funds on a regional level, leading to a very difficult situation in regions with many old and few young... [I]f reform is stopped, regionalization will become more and more pressing” (Baskakova interview).

**Current state of pension reform: moratorium and lack of consensus**

At present pension reform in Russia has stopped. The many laws and other measures that the government planned to prepare for legislative approval in order to enact the 1998 Pension Reform Program have not been elaborated because of the economic crisis. In any case, according to Dmitriev, “legislative approval is moot. Reform is possible only under conditions of sustained growth, and has been set back years by the August crisis. The best course is to maintain a flat rate and stay close to subsistence. If we permit decompression in order to introduce a defined benefit system, it will mean that the minimum falls below 50% of the PSM” (Dmitriev interview). Other analysts and policy-makers concur, stressing that financial limits won’t permit significant differentiation of pensions and that any accumulation of funds is impossible.

There is also considerable evidence of dissensus and doubt over the 1998 Program. Most significantly, the Ministry of Labor has called for numerous “correctives” to the Program. While the Ministry recognizes that the introduction of an accumulative element is inevitable because of demographic factors, it claims that conceptual aspects of the reform, as well as its consequences for various categories of pensioners, are insufficiently worked out; that the mathematical models on which it is based (developed with the participation of the World Bank) may not be applicable to Russian conditions; that Russian financial markets are not prepared to preserve pension accounts; and that the passing on of special and privileged pensions to enterprises is unrealistic (Mintrud, 1998).
The proposed reform has also generated opposition from women, who would be disadvantaged in the new system because of their comparative longevity, lower wages, and time out of the labor force to raise children. Estimates indicate that women's pensions would fall from their present near-equality to 40-60% of men's (Baskakova interview). Other specialists assert that the introduction of an accumulative element will exacerbate poverty among pensioners and fail to draw increased payments, especially from the better-off and the informal sector, into the system (Roik, 1998). In sum, there is no agreement on either the parameters or likely effectiveness of the 1998 Pension Reform Program, and vested interests both within the government and in Russian society will contest it. In the best case it would be subject to intense debate and bargaining before the new legislature (Mudrakov, 1998).

Conclusion

Pension reform efforts in Russia have achieved little. The government's various proposals for short-term reforms that would cut entitlements or limit eligibility have proven abortive, opposed by both the left-dominated Duma and pensioner constituencies created by past policy commitments. The 1995 “Concept,” designed to increase contributions by linking pensions more closely to wages, did produce some implementing legislation. It also led to real progress in building an administrative structure to track personal pension accounts, a key element in any future reform. But the legislation's intent was undermined by political opposition and economic realities, in the face of which pensions have in fact become further compressed and divorced from wage levels. The 1998 Pension Reform Program, which proposed a much deeper, systemic reform, was adopted just as the economy moved toward crisis and has not been translated into a legislative program. Recent governments have fallen back on ad hoc approaches to address the pension crises. The World Bank, which had considerable success in influencing the policy dialogue and getting the government to approve a reform program, has been much less successful in affecting actual policy and practices.

Even if it could overcome political opposition and institutional resistances, however, Russian pension reform confronts deeper problems. Improving the benefits-contributions correlation will not
increase payments into the pension system as long as many distrust the government to deliver promised benefits. And the collapse of many Non-State Pension Funds in 1998 demonstrated the weakness and vulnerability of market solutions to Russia's pension problems at present. In essence, a better pension system requires a stronger, more reliable state that can collect taxes and regulate financial markets first. In its absence the present PAYG system, in which a somewhat politically-accountable state distributes available pension funds more-or-less equally among those eligible, provides at least minimal income security for Russia's old.
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