Reforming the Pension System of the Russian Federation

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Abstract. The article presents the results of the evaluation of the current stage of the pension system reform in Russia. The achieved level of pension provision in Russia is compared with similar indicators of foreign countries. The prospects of the expected directions of pension system reform are evaluated.

1. Introduction

All national pension systems face the need for reform. The reform of pension systems has become large-scale in the period from 2009 to 2013. In the following years, the pace of pension reforms has slowed. It is associated with improved public finances, a potential pension reform fatigue, as well as political instability. In most countries, pension reforms have been carried out in the following areas: raising the retirement age, encouraging late retirement, tightening the conditions for early retirement, increasing the length of service, restrictions on the payment of pensions to working pensioners. Thus, the reforms mainly concerned the pay-as-you-go pension systems and were aimed at reducing the pension obligations [1].

New socio-economic and demographic challenges necessitate the reform of the pension system in the Russian Federation. In this regard, it is important to give a scientific basis for the directions of pension reform of the country. Many Russian scientists have paid considerable attention to these issues. Thus, the problems and ways of the pension system reform in Russia have been widely covered in the works of such researchers as Mamiy E.A., Novikov A.V. [2], Roik V.D. [3]. The issues of raising the retirement age as a direction of pension reform are discussed in the works of Soloviev A.K. [4, 5], Kudrin A.L., Gurvich E.T. [6]. The works of Degtyar L.S. [7], Shestakova E.E. [8], Pudovkina A.V. [9] are devoted to the study of the world experience of pension reform and its possible application in Russia. The works of foreign researchers like Holzman R., Hinz R. [10], Barr N., Diamond P. [11] are of considerable interest.

In this work, we will give the evaluation of the current stage of the pension system reform in Russia from the standpoint of the level of pension provision for citizens in comparison with similar indicators of OECD countries.

2. Evaluation of the current stage of the pension system reform in Russia

Until 2002, the Russian Federation used a pay-as-you-go pension model. The mixed pension system was established in Russia as a result of the 2002 reform.

There are three levels of mixed pension model in many countries [12]:

Level 1 – mandatory pension provision, the minimum required. It is provided by the state and is aimed at preventing poverty in old age. There are three types: basic pensions, minimum pensions, social assistance.
Level 2 – mandatory pension provision, which includes savings. It can be both public and private. It is aimed at achieving an acceptable standard of living at retirement, proportional to the previous earnings. There are the following types: defined benefit, defined contribution, points and national accounts.

Level 3 – voluntary pension provision, which includes savings. It is private and is aimed at obtaining additional income for pensioners. There are the following types: defined benefit, defined contribution.

We will consider these three levels in relation to the Russian pension system.

The minimum social insurance pension is formed at the first level of the pension system. It is assigned only when the minimum number of pension points is accumulated, as well as if there is a minimum insurance experience. An employee who has reached retirement age cannot expect to receive a minimum social insurance pension with a lack of points. He will have to continue to work until he earns the required number of points or apply for a social pension five years after the generally established retirement period. The minimum social insurance pension does not exceed 14.6% of the employee's average earnings and covers only 2/3 of the pensioner's subsistence level (table 1). The social old-age pension is even lower than the minimum social insurance pension. In this regard, Russian legislation establishes the right for non-working pensioners to receive federal or regional social supplement to the pension up to the minimum subsistence level of the pensioner in the region of his residence.

| Table 1. Minimum pension provision in Russia. |
|---------------------------------------------|
| Average monthly wages, rubles               | 2015 | 2016   | 2017  |
| Minimum social insurance pension:          |      |        |       |
| - in rubles                                 | 4854.91 | 5227.37 | 5700.92 |
| - as a percentage of average wage          | 14.3  | 14.2   | 14.6  |
| Social old-age pension:                    |      |        |       |
| - in rubles                                 | 4769.09 | 4959.85 | 5034.25 |
| - as a percentage of average wage          | 14.0  | 13.5   | 12.9  |
| Pensioner's subsistence minimum:           |      |        |       |
| - in rubles                                 | 7161  | 8803   | 8540  |
| - as a percentage of average wage          | 21.0  | 24.0   | 21.8  |

Source: own calculations based on data [13, 14, 15].

Thus, the minimum pension provision in Russia corresponds to the pensioner's subsistence minimum. Its value ranged from 21.8% to 24% of the employee's average earnings for the period 2015-2017 (table 1). For comparison, in OECD countries the average minimum pension is 25.6% of the average employee's earnings [12].

As of 01.01.2017, 6.7 million people (15.5% of the total number of pensioners) received federal and regional social supplement to the pension [16]. This is the lowest estimate of the share of pensioners with minimum pension provision. After all, it does not take into account those persons who receive a pension at the level of the subsistence minimum without social supplements.

The social insurance pension (above the minimum) and the mandatory funded pension are formed at the second level of the pension system.

The social insurance pension is based on a points system. Its value is defined as the product of the number of pension points accumulated by the employee for the value of one point. The number of points, first of all, depends on the size of the employee's salary. The higher the salary, the more points will be assigned to the employee. At the same time, the legislation has limited the maximum annual score – 10 points (6.25 points for those who will send 6% of contributions to the funded pension) from 2021. This means that workers with wages exceeding the double average wage in the country, all other
things being equal, will earn the same number of points each year. That is, the points system assumes low differentiation of pensions.

The value of one pension point is determined by the ratio of the amount of social insurance contributions and transfers from the federal budget to the total number of pension points of the recipients of social insurance pensions. According to the legislation, the value of the pension point is subject to an annual increase of not less than the consumer price index for the past year. This norm is aimed at protection of pensions from inflationary depreciation. However, in 2016, the value of the pension point was indexed to 1.04 while the consumer price index was 1.129. Accordingly, the real size of pensions has decreased. Thus, the value of the pension point, and accordingly the size of the social insurance pension depend on the financial capabilities of the Pension Fund of the Russian Federation.

The mandatory funded pension has been formed since 2002 in the amount of 2% of the monthly salary for women born in 1957 and later and for men born in 1953 and later. Since 2005, contributions have been increased to 6%. The funded pension began to take shape only for employees born in 1967 and later. Pension savings are formed either in the Pension Fund of the Russian Federation or in non-state pension funds (NPF) at the choice of citizens and are reflected in their individual personal accounts. Since 2014, the funded pension system has been frozen in Russia. The entire amount of pension contributions in the amount of 22% is directed to the formation of the social insurance pension.

Russia is significantly behind the OECD countries in terms of real average annual rate of return of private pension savings. Thus, for the five-year period (December 2011 to December 2016) the real average annual rate of return in Russia was -1.1%, while in most countries it was above 2%. The highest annual returns were observed in Canada (6.9%), Netherlands (6.7%) and Hungary (6.6%) [17, 18].

The real 5-year (2011-2015) average annual return of public pension reserve funds was higher than 1% for the countries surveyed by the OECD. The highest annual returns were observed in New Zealand (11.8%), Canada, CPPIB (10.3%) and Sweden, AP4 (9.2%) [19]. In Russia, the real average annual return of Vnesheconombank's expanded portfolio was at the level of -1.7% over the same period.

Next, we will assess the size of the social insurance pension and the mandatory funded pension. In 2017, the average size of the old-age insurance pension exceeded the subsistence minimum of the pensioner by 1.6 times and amounted to 35% of the average wage (table 2). While in 2015 these figures were, respectively, 1.8 times and 37.7%. A funded pension contributes much less to the replacement of earnings when an employee retires. In 2017, it covered only 2% of the average wage. Together, the insurance old-age pension and the funded pension covered average earnings at 39.9% in 2015, and then fell to 37% in 2017. For comparison, the average replacement rate in 12 OECD countries with state and mandatory personal pension is 56% [12]. At the same time, the average wage in Russia, calculated at purchasing power parity, is 2.5 times less than the same average of these countries.

**Table 2. Average size of mandatory pension.**

|                                  | 2015  | 2016\(^1\) | 2017\(^2\) |
|---------------------------------|-------|-------------|-------------|
| Average insurance old-age pension: |       |             |             |
| - in rubles                      | 12830 | 13172       | 13716       |
| - as a percentage of the pensioner's subsistence minimum | 179.2 | 149.6       | 160.6       |
| - as a percentage of average wage | 37.7  | 35.9        | 35.0        |
| The average size of the mandatory funded pension: |       |             |             |
| - in rubles                      | 758.7 | 802         | 797.8       |
| - as a percentage of the pensioner's subsistence minimum | 10.6  | 9.1         | 9.3         |
| - as a percentage of average wage | 2.2   | 2.2         | 2.0         |

\(^1\)As of 31.12.2016, \(^2\)As of 01.04.2017.

*Source: own calculations based on data [13, 15, 20].
Thus, Russia is significantly behind the OECD countries in terms of mandatory pension provision. The replacement rate of pensions at the level of 37% cannot provide an acceptable standard of living at retirement.

Non-state pension within the framework of voluntary pension provision is formed at the third level of the pension system. Pension savings are accumulated in the NPF through voluntary contributions of citizens or employers, as well as investment income received from their placement. Voluntary pension provision is aimed at obtaining additional income of pensioners – 3222.6 rubles in 2017, which is 8.2% of average earnings (table 3). However, only 3.3% of pensioners are covered by the voluntary pension system. In OECD countries, voluntary pensions increase the replacement rate by 6% on average (for eight countries where voluntary pensions are most common – by 26%) [12].

**Table 3.** The average size of voluntary pension provision.

|                            | 2015  | 2016  | 2017/1 |
|---------------------------|-------|-------|--------|
| Recipients of non-state pensions: |       |       |        |
| - total, thousand people   | 1556.7| 1530.8| 1530   |
| - as a percentage of the total number of pensioners | 3.6    | 3.5    | 3.3    |
| Average size of non-state pension: |       |       |        |
| - rubles per month         | 2640.7| 2908.3| 3222.6 |
| - as a percentage of the pensioner's subsistence minimum | 36.9   | 33.0   | 37.7   |
| - as a percentage of average wage | 7.8    | 7.9    | 8.2    |

As of 01.10.2017.

*Source: own calculations based on data [13, 15, 21, 22].*

Thus, at the present time the distributive component of the pension system plays a major role in the pension provision in Russia. It provides a replacement rate of 35%, while the funded component of the pension system adds only 2% of the replacement rate. However, the funded pension covers up to 10% of the average earnings of pensioners receiving non-state pension.

3. **Prospects for pension reform in Russia**

The further reform of the distributive component of the pension system is related to the decision of the Government of the Russian Federation to increase the retirement age for men to 65 years by 2028, and for women to 63 years by 2034. This decision is justified by the fact that in Russia every year the number of working-age population in relation to pensioners is reduced. This can lead to an imbalance of the pension system, to the point that the state will not be able to fulfill its social obligations. Also one of the arguments is that the retirement age in Russia is one of the lowest in the world. However, it should be taken into account that in Russia the life expectancy after retirement is much lower compared to other countries for both men and women. In Russia the average retirement age is 60.3 years for women and 63.2 years for men. Life expectancy after retirement is 17.6 years for women and 13.1 years for men [12]. At the same time, in OECD countries, women retire at an average of 63.6 years and men 65.1 years. The average number of expected retirement years is 22.5 years for women and 18.1 years for men.

In addition, the increase in the retirement age will exacerbate the problem of employment of both people of pre-retirement age, and young people. This is due to the economic situation in the country, the lack of the necessary number of jobs. Competition in the labor market will increase. This can lead to the deterioration of the terms of labor contracts and the reduction of social protection of employees. In the future, robotics and automation of labor processes can strengthen these negative phenomena.

The expected results of the proposed reform are also questionable. Actuarial calculations show that the effect of increasing the retirement age will be short-term. In the long-term period, pension liabilities will grow due to the additional period of employment [5].
The reform of the funded component of the pension system is related to the plans of the Government of the Russian Federation to abolish the mandatory funded pension and to switch to voluntary pension savings under the "individual pension capital" project. Employers will continue to pay mandatory insurance contributions in the amount of 22% for the formation of the social insurance pension of their employees. Along with this, additional contributions in the amount of 0 to 6% of the employee's salary will be transferred to the formation of his individual pension capital. It is planned to connect citizens to the new system on a voluntary basis on the application of the employee. In the application, the employee indicates what percentage of earnings he will transfer in the form of contributions. Tax deductions on personal income from the amount of contributions paid will be provided to encourage citizens to participate in the system. It is assumed that the pension savings of citizens in the NPF will be automatically transferred to the system of individual pension capital. Pension savings that are in the Pension Fund can be transferred to pension points and sent to the social insurance pension or redirected from the Pension Fund to the NPF for the formation of individual pension capital. The final concept of individual pension capital has not yet been formed. However, its implementation is planned from 2019.

In our opinion, the voluntary savings system will not be able to provide a significant inflow of pension savings in contrast to the previous mandatory savings system. First of all, this is due to low incomes. This does not allow people to make any savings with a lack of funds for current needs. Another factor is the lack of public confidence in the permanently reformed pension system, as well as in financial institutions. It should also take into account the insufficient of financial literacy of the population and the lack of "culture of accumulation" in the country. The influence of these factors is confirmed by the results of public surveys, according to which many people are not ready to save their own pension and expect a pension from the state [23]. Therefore, the abandonment of the mandatory savings system and the transition to a voluntary accumulation system is premature. If the current trends continue, this will not have a noticeable impact on the size of pensions, and will not be able to provide the economy with an investment resource for financing infrastructure projects.

4. Conclusion
Thus, the directions of reforming the pension system of Russia at the present stage generally correspond to the global trends and are associated with the reduction of state obligations to pensioners: the increase of the retirement age, the abolition of the indexation of pensions to working pensioners, the stimulation of a later retirement, the "freeze" of pension savings. However, in the OECD countries, these unpopular measures are implemented in a completely different level of pension provision. In Russia, the wage replacement rate is low. And the wages calculated at purchasing power parity are incomparably low compared to the average of OECD countries. Life expectancy in retirement for both men and women abroad is much higher than in Russia. It is no accident that Russia entered the top 5 of the world's worst countries in terms of life quality of pensioners in accordance with the Global pension index-2017. In our opinion, it is unacceptable to stabilize the pension system by reducing pension obligations in conditions when pensioners are on the verge of survival. It is necessary to look for other reserves. After all, Russia is positioning itself as a social state that is able to take care of the older generation and provide it with a decent standard of living.

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