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**Russia's New Horizons
PENSION REFORM: A CORNERSTONE TO ECONOMIC GROWTH
Panel**

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17:15–18:30, Pavilion 8, Conference Hall 8.3**

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Moderator:

Viatcheslav Pivovarov, Chief Executive Officer, Altera Capital

Panellists:

Zbigniew Derdziuk, President of the Board, Social Insurance Institution of Poland

Anton Drozdov, Chairman of the Board, Pension Fund of the Russian Federation

Steven A. Kandarian, Chairman, President, Chief Executive Officer, MetLife Inc.

Alexey Moiseev, Deputy Minister of Finance of the Russian Federation

Monika Queisser, Head of Social Policy Division, Directorate of Employment, Labour and Social Affairs, OECD

Michal Rutkowski, Country Director for Russia, The World Bank

Jean-Pierre Thomas, Representative of the President of France (2011–2013)

V. Pivovarov:

I think everyone is here. It is hard leading a session that competes with the plenary session, immediately after it. We have been delayed a bit, so I think we will need to cut short our presentations and try not to go over five to seven minutes in order to leave time for questions from the audience, if there are any, and for a short summary by each panellist about what they think was most important or has the most important practical application for today's discussion.

Today we are discussing pension reform as a source of economic growth. Since most of our colleagues here are from abroad, I am going to moderate in English from here on out, so that our panellists will be more comfortable. Let me introduce everyone. On my right is Alexey Moiseev, Deputy Minister of Finance of the Russian Federation, and Anton Drozdov, Chairman of the Board of the Pension Fund of the Russian Federation.

Today we have Steven Kandarian, Chairman and Chief Executive Officer of MetLife; Zbigniew Derdziuk, the President of the Board of the Social Insurance Institution of Poland; Monika Queisser, Head of the Social Policy Division at the Organisation for Economic Co-operation and Development (OECD); Michal Rutkowski, the Country Director for Russia at the World Bank; and Jean-Pierre Thomas, the representative of former French President Nicolas Sarkozy.

The topic that we are discussing today is very important globally because of the macro-economic conditions after the financial crisis and the demographic issues, primarily the ageing population, which are raising substantial challenges for national pension systems around the world. To resolve those challenges, different governments have used various tools and approaches. Some of them raise the pension age. Some invite more people into the pension plan coverage so that they can contribute more to their retirees today. Pension funds are trying to increase the returns on their pension plan assets so that they can deal with the pension fund deficit in that way. Some systems make a choice to shift from fully-funded pensions to pay-as-you-go systems. There are many different solutions. However, we have global experts on pension reforms here today, particularly Monika and Michal, and we will ask them to look into those issues in more detail.

Before that, I will first allow Alexey Moiseev to open this discussion. I will ask Alexey in particular to give us a sense of where we are today in pension reform. We had the budgetary address by President Putin which asked the government to finalize pension reform by the end of this year, so I think Alexey will set the tone for this discussion very well, and then we will go from there. Alexey Moiseev.

A. Moiseev:

Thank you very much. Slava is right that this year is a year that decisions should be made to reform the pension system. The President has mentioned this a number of times, and it is true that the last time he spoke about it was during his budget address. In fact, many of you who listened to his speech today heard that he mentioned this issue again, and talked about the need to reform the pension system, so it is really an important systemic issue for us.

This is so for a number of reasons. First is the current pension reform is basically going along a very dangerous course, becoming more and more imbalanced. External trends such as demographics and the state of the national economy and economic growth are such that the outlook for pension reform has worsened significantly in recent years. We know that the pension system is imbalanced now, and I am sure Anton will give you all of the figures, and it is dependent on transfers from the federal budget on an annual basis. These are major transfers. Second, even with the transfers, if the system is not changed, it will completely lose sense by 2030. It will essentially stop functioning for a number of demographic reasons. And 2030 is, of course, a long-term forecast, but we do not know when it might happen; it might happen in 2040 or 2025, but at this time, it looks like 2030 is really going to be the year it breaks down.

A year ago, the government adopted the pension concept, which contains a number of important ideas, but the most important thing, of course, is that the new pension formula for the pay-as-you-go system has to be developed. And from our point of view in the Ministry of Finance, over time, it must balance the pay-as-you-go part of the Russian pension system. For us, this is a key element that must be realized. There is a lot of discussion about it and essentially a

number of issues that have to be dealt with, including, in particular, early pensions and the number of years people have to contribute. There are a number of things to be determined, but the outcome will only make sense if it shows a clear trend of balancing out the pension accounts.

A second big reason why pension reform is such a major priority – and this is what the President was talking about during his speech today – is that we need the investment resource. I agree completely with the title of this panel; I am fully confident that the current level of development of the Russian economy requires long-term domestic investment resources. Either we create them and economic growth recovers, or we do not create them and economic growth continues to slow down. This is for a number of reasons. One is that the economy has basically exhausted the previous growth model, which was based on rising oil prices and the resulting utilization of existing capacity, more so from a labour force point of view than an industrial capacity point of view.

Number two, we no longer live in a world, which can offer Russia a lot of capital. In a report to the head of the annual summit last year, the IMF wrote that they now expect the world to enter a prolonged stage where there is a deficit of long-term investment capital. We will have a difficult contest to win if we are to attract capital from external sources, and I am not sure we are the most beautiful contestant in this contest. It is going to be tough for us to really expect our investment needs to be financed by the global capital markets, so we will have to have our own long-term investment resources.

Here, we are moving in a number of directions. Basically, we want people to save. We want them to save not only in banks but also in other ways, and here there are three methods of doing that: pension funds, life insurance companies, and individual pension and investment accounts. If people want to save by themselves, if they think they can manage better than a life insurance fund or a life insurance company, then they will be given that option. We are currently building the infrastructure to develop all of this, and it is mainly going to be tax incentives. Essentially, within the requirements, there will be tax incentives that will be largely identical for choosing any of these three main options. The legislation is currently in Parliament and we hope it will get voted on in this

session. We really expect this to happen, and if it does not then we will be a bit disappointed, but generally all of the matters have already been agreed upon.

Speaking of more general institutional change in the pension system, in the process of our negotiations with the OECD, we have learned that the OECD has a lot of recommendations and their experience is very useful. We have drafted a law called the Law on Financial Organizations, basically implementing the OECD guidelines on how to build a pension system. The important thing is that the pension plans will be separately funded and separated. They will be clearly defined and they will present certain tax incentives, but, importantly, they will not be locked into the pension funds. Essentially, this law allows pension funds, life insurance companies, and even banks to compete for pension money. Of course, the principal providers are still going to be the life insurance companies and the pension funds, but from the point of view of marketing the product, it will allow the product to be marketed by banks, by brokers, by everyone. Essentially we will create a system where people really do not care where a person saves. We will create a policy, for example, where people can save in banks and then get their pension directly from their bank savings, or the same with brokers and so on. We want to make it as flexible as possible.

Secondly, of course, we know of experiences in some countries where they have created a good industry for accommodating individual money, but without properly developing the financial markets. The system never quite worked. Of course, you know of these countries as well. Even in those countries where the experience is seen as having been successful overall, without properly developed liquid markets with the presence of not only long-term investments but also speculation, there are serious problems with price determination. There should be high-quality pricing in the markets and there should be good liquidity, and that is not really delivered if a pension fund or the life insurance funds are not participants.

Essentially, we have to have financial markets which, firstly, are appropriately built so that they are convenient to use. We have done a number of technical things in this respect. For instance, the Moscow Exchange has launched T+2 trading. We are doing a number of other things, but as far as pension fund

managers are concerned, we are really freeing up their hands to a large extent by basically planning to allow pension funds to show losses on their accounts for people who are policyholders. We will limit annual transitions from fund to fund to five years, or there is another suggestion of three years, but definitely much more than one year.

The point is we want to develop all parts of the policy, so I spent time talking about individual pension accounts with brokers, for example, because we want to have people who will trade, we have to have speculation on the market. We have to have long-term anchor investors, such as pension funds and life insurance companies, but they do not trade very much. That creates problems with liquidity, so we also want to lure in other parties. Basically, both sides are important.

Finally, I will spend another one or two minutes talking about supervision. This year we launched a major reform of the regulation and supervision of financial markets, creating what we call a mega-regulator. The Central Bank will assume responsibilities for supervising pension funds and insurance companies, among other participants. Essentially, we are doing this not only because we want to optimize the process and give more resources to the regulator, but also because we feel that the current regulations are not built on the right principles. In terms of supervising pension funds and insurance companies, specifically life insurance companies, currently what we have is compliance control, and this compliance control does not work. We have to have prudential supervision. The Central Bank has built prudential supervision in banks, so this will make it easier for us to create prudential supervision in the pension fund industry and of life insurance companies.

The first element of this prudential supervision will be what the President mentioned in his speech, the guaranteeing of a nominal amount of pension contributions. We will guarantee the return on pension contributions. This will be very complex legislation. It is not going easily, I have to say, but we are progressing. It is being principally drafted by the Ministry of Economic Development, but we are working very closely with them. The main idea there is firstly that we will guarantee the mandatory fully-funded tier for people, where we

will guarantee a nominal amount of their overall contributions, but we will not simply write a blank cheque. This will have a number of requirements.

One is that the pension funds will have to create special reserves similar to the reserves for potential losses that the banks have. There will be certain ratios similar to those in banking, kind of like capital adequacy, for pension funds that will measure their actuarial balances against those ratios. The first stage will be that the fund will guarantee from those internal reserves. In addition to the mega-regulator, there will be a mega-liquidator. That mega-liquidator will be the Deposit Insurance Agency (DIA), and essentially pension funds will have to contribute to that. It will be separate, of course, from the banking fund, but within the same DIA. Ultimately, if a fund cannot pay the nominal return, it will fall under the ownership of the DIA, and the DIA will assume its liabilities. Essentially, those are the most important things for me to mention.

V. Pivovarov:

Alexey, thank you very much for giving us that overview of the framework of the pension reform that the government is undertaking right now in Russia. We will look into the details of the Russian pension system with Anton a little bit later in the discussion.

Right now, I want to turn to Monika, since she works at the OECD, which is in charge of analysing and monitoring pension systems in OECD countries, and ask her: what are some examples of successful pension systems today? What makes a pension system successful? What are the criteria? Is it the minimum pension that people receive, or is it the size of the average pension? Is it whether it is balanced or a surplus? Maybe based on those international success stories, are there any particular recommendations that the Russian pension system could use to develop itself further?

M. Queisser:

Thank you very much. First of all, let me say that at the OECD we are delighted to be working with Russia both on the social policy aspects of pension systems and reforms and, as the Deputy Minister just mentioned, on the regulatory and

supervisory aspects. I can only confirm that my colleagues and I in Paris are working very closely with the authorities to make sure that whatever constitutes best practice and experience from other countries that are facing problems gets fed into your reform process with a maximum of interest, so that you can draw lessons from mistakes and good experiences that others have had.

Now let me quickly go through what other countries have been doing and what the main criteria are. Today we see that all countries, with no exceptions, are facing the same big problem with pensions, and that is the trade-off between socially adequate pensions and financially sustainable pension systems. We pay people pensions because we want them to have a proper living standard in old age. We all know the pay-as-you-go system is quite easy when everyone is working and the population is relatively young. Then you can finance this system very easily. The problems start when people work less, contribute less, and get older. That is when the trouble starts, and the trouble has started in most countries. We are seeing very rapid demographic transitions in many OECD countries.

We have 34 member countries, hopefully 35 with Russia soon to join. No matter what your system is, whether it is entirely public, entirely private, or a mix of the two, you can see in any model, in any combination of public, private, or pay-as-you-go in our membership in the OECD, that all of these countries have been carrying out lots of different reforms since the early 1990s. These reforms have basically been going in three different directions. The first important reform in every country has been trying to make people work longer, and not only with respect to the official retirement age. They have been trying to keep older workers in the job market longer, to encourage them to improve their health, to make their employers aware that they are important or that they have important experience. All countries have been working on a combination of increasing retirement ages, making early retirement programmes more difficult to access, and giving people incentives, for example, higher accrual at older ages – basically making it worth their while to work longer.

The next thing countries have been doing is more targeting, and this is something that has been happening more recently in the context of the crisis. As

countries are being faced with having to cut expenditure, they are moving more and more away from the principle where you pay proportional benefits, where you get higher pensions if you earn more and contribute more. Countries, particularly the crisis countries, have been starting to cut, but obviously they have to cut at the top. You mentioned the minimum pension, and that is an important aspect. To what degree can your pension system prevent old age poverty? But obviously that is not good enough, because it has to do more than just prevent poverty.

The third thing that countries have been doing is moving more and more towards funded pensions, like in Russia. They want to have funded pensions, individual capitalized pensions, as part of their pension system because, combined with the reforms I just mentioned, cuts and lowering over time of the public parts, you have to make up for the losses somewhere. This can take many forms. Many countries also have other forms of spending: mandatory pensions, voluntary pensions, long-term savings, life insurance, etc. But countries are trying to place more emphasis on this individual responsibility.

You also asked about what the best model is, and I have to disappoint you. There is no best model. There are some countries with systems that work well, but it is not going to be terribly helpful to Russia if I tell you to look at the Netherlands or at Switzerland. These countries have well-functioning systems, high-coverage basic systems. The whole population is covered by the public pension, and then they have accumulated high levels of privately managed capital. But they started many years ago. Countries that are in a tough situation now obviously cannot afford to put so much money aside because they need the contributions to pay current pensions. That is the fix we are in, and that is why the country I come from, Germany, decided to have only a very small capitalized component because they said they could not afford to put aside more. They only subsidize up to 4% of their contributions through the public system, to encourage people to save in private pension savings vehicles. That is a bit of a problem. It really depends on where your country stands in the continuum of time, and also in the development of your financial sector and labour markets.

Here is another point which I, as an observer of pension reforms around the world, have been noting more recently: some countries are trying to solve all of their labour market problems through the pension system. Countries see that people may have very low earnings, there is high unemployment, and women stay out of the labour market too long or work only part time, and then they say the pension system has to be fair and has to fix these problems. That, of course, is very difficult, and I think this is also an important point for Russia since you have a small contribution base, partly due to early retirement and the fact that many of your older workers have already gone and you are not going to get them back into the system once they have gone. But you also have to look at how your labour market is structured. Atypical contracts, non-compliance with contributions – all of these are framework issues, which, no matter what your system is – public, private, fully-funded, half-funded, zero-funded – you will have to address those problems.

These are some of the issues, and let me make a last point. I think that Russia actually has a very modern system and a lot of the countries we have talked to would be very happy to be where Russia is today in terms of the structural, institutional reform. You have done a lot and have come a long way, and now I think it is urgent to get the framework conditions right.

V. Pivovarov:

Excellent overview, Monika. We will have a question and answer session after everyone has had a chance to address the issues. I think it would make sense to go next to Michal, who is Country Director for Russia at the World Bank, and the World Bank has been advising a large number of CIS and Latin American countries, in particular, on their pension reforms. It would be interesting to learn what you think today about how pension systems have evolved, looking back at the advice that was provided then and the way they were initially set up. How did they pass the test of the global crisis? How well did they adapt themselves to the challenges that Monika explained in terms of demographics? Based on this analysis over time, what conclusions can we draw to help us to get it right?

M. Rutkowski:

Thank you very much. Let me start by saying that I am happy to hear that the OECD has become very much involved in Russian pension work and social policy. One of the reasons is that I have yet to meet a high-calibre OECD person who has not worked in the World Bank before, and that includes Monika.

Let me talk about the key criteria, which we always highlight when we talk to any government to encourage them to improve their pension system. This will be quite consistent with what Monika said; we always have a lot of agreement with our OECD friends. We believe pensions should be adequate, but we would put particular emphasis on the minimum pension, so the replacement rate is particularly important for those who are otherwise at risk of being poor. Systems should have incentives to encourage people to participate in the labour market and to retire late, and we tend to support actuarial increases at older ages, in terms of pension increases corresponding with years worked. We also think that the contributions made by young workers should matter for the level of pension, as this provides the right incentives.

Pension systems should be sustainable and affordable. There should be a reasonable element of individual choice. We also believe in the diversification principle. Different types of pension arrangements; pay-as-you-go, where the social security contribution is paid out immediately as a pension for someone else, or funded pensions face different risks. We believe in 'not putting all your eggs in the same basket'. We believe in better risk diversification.

I was wondering whether Monika would be able to answer the question about which pension system is good, and I like her answer. It reminded me of something our joint colleague Dimitri Vittas said several years ago. He would have responded to your question with the answer 'Swiss Chileanpor', if you remember that phrase. He was saying that by combining the Swiss, Chilean, and Singaporean systems, you could achieve something that is really good. Since then, we have seen the Swedish pension reform, so I would add Sweden to that basket. I think the solutions are somewhere in there.

Let me move to Russia, because I had the privilege to be involved in those discussions in the early 2000s, working where many essential characters are still

involved, so it is very nice to be back. What I first want to say is that it is quite clear that the current debate is about the right things. It is about financial balance, linkages between contributions and benefit incentives for the young to contribute a minimum income and older people to defer retirement. It is clearly a discussion focused on the right things.

What is interesting, however, is that we were discussing all of those things, with almost no exception, in 2000–2001. In the discussions today, there is very little cross reference to those times. There is a sense that people are asking, “Have we not done this already? Have we not reached a conclusion?” I think I understand why. It is because the system, even though it is highly structural, as Monika pointed out, does not work because it has a number of design errors. Those design errors, which are not structural but are within the structure, are making the system go bankrupt; it is not providing incentives and not delivering all of those things I just said. At the same time, I have the strong sense that there are many people who want to let this system go rather than fixing it to see if it will work. This is the interesting part of the discussion, that the discussion questions are also things that are achievements in the system.

A few examples: like I said, the discussion is about the right things, but if we look at the first pillar of the Russian pension system, it is based on the idea that these are notional accounts. The notional accounts are supposed to provide actuarial increases for retirement because it operates like a funded pillar, but with no money to put into it. This system has great incentives for retiring late and participating in the labour market. It does not work in Russia. It does not work because the base pension is far too high, so a large number of participants do not operate according to those principles. It also does not work because it is not actually a defined contribution system, because the factor that should be used to determine pensions, which is life expectancy at the age of retirement, is fixed at 19 years in Russia. So the notional defined contribution (NDC) system is not working.

The question is, what is the best way to go: fix the NDC system or move to something else? I have the sense that the trend in Russia at this point is to move to something else. I hear a lot about a points system, in fact, so I have the sense

that the system is being done away with without giving it the chance to deliver. The same applies to the funded pillar, because the big problem in the funded pillar in Russia's pension system was the fact that the legal structure of funds was not well set up. They were not joint stock companies. They did not have a profit motive, therefore it is not surprising that they have very low returns. Now there is huge disappointment with the returns. There is movement in the right direction, as Mr. Moiseev said, and we wholeheartedly support improving the structure from the bank side. But at the same time, the second pillar is being reduced from six to two.

Again, it is certainly a step forward. I think these are certainly the right things to discuss, but it is like moving forward in circles. That would be my assessment. But that is normal; it is a highly political and difficult topic. The retirement age has to be increased, but it is very hard politically to talk about it. It is no wonder that a lot of the discussion is not about the retirement age explicitly; it is about how to use a different factor or incentive that still ends up with an effective retirement age increase. That makes the discussion extremely convoluted and complicated, but I think with the degree of commitment from people like Mr. Drozdov and Mr. Moiseev, despite everything that I have said, I am actually optimistic that a good solution will be found for a system that has already made significant achievements compared to many others inside and outside the OECD. Thank you.

V. Pivovarov:

Thank you, Michal. We have three representatives of specific national systems, one from the US, one from Poland, and one from France. I was thinking that we could perhaps just have a brief overview of what an employee gets when he retires in France, for example: what the government provides, what the private system provides, and what the average levels of those pension packages that people get are. Jean-Pierre, can you start on this?

J.-P. Thomas:

Thank you for the invitation. I will be speaking in French. Next year I will speak in Russian. With respect to pension systems, Western Europe and the US love to give advice to Russia. I think that Russia should also make note of our mistakes, in order to avoid repeating them. In any case, Russia needs to develop its own system. You can take into account the positive aspects and also the mistakes that we have made.

I will talk about the French pension system and about how we have tried to reform it. When I was a member of Parliament, we adopted a law on pension funds, but amendments adopted by the socialists eviscerated it, and today we have difficulties with our pension system. This is a system that is built on distribution; that is to say that it is a classic example of a solidarity system. By 2020, if we do not carry out root reforms, the pension fund deficit will total over EUR 20 billion. Accordingly, reform in France as of today comes down to extending contributions, raising the pension age from 60 to 65 years. We are trying to extend the period during which contributions into pension funds are made. We think that we have too early a retirement age. This demographic problem is also affecting Russia at present.

The second aspect is increasing the contributions themselves. We are working on this. Of course, politicians are never very brave. Although we address these reforms every two or three years, they behave too timidly. We cannot always be looking at the sum of contributions into the pension fund. Those contributions are just the result of the price of labour; they are objectively limited, and, furthermore, they are subject to regulatory restrictions.

The third aspect is the area in which we will be acting, although we do not talk directly about this. I mean the purchasing power of tomorrow's pensioner. This level is on the decline, although unfortunately, nobody is thinking about that. We have a basic pension, which is around EUR 500 per month, and aside from that, there is a supplementary accruals system that can add another EUR 700, and at present the average pension in France is about EUR 1,250 per month. Of course, this is a higher level than you have in Russia. This equals about half a salary, but the pension is going to decrease, especially for highly paid workers. In 15 years, they will have a replacement rate of under 50%. That is to say that we

predict a decrease in pensions, and the replacement rate will be determined by distribution.

Aside from this, there is the issue of economic growth. Right now there is a problem with this in Europe. In France it is almost sub-zero. We also have demographic problems. Today the post-war generation is retiring, and we can see that due to those baby boomers, the pension distribution system is under threat. It cannot be shut down, of course; it is a solidarity system: today I pay for others, counting on the fact that my children will be paying for me tomorrow. But I am not certain of that. And, of course, there is the capitalization system. This is a defined contribution system that we tried to create, and it is based on responsibility.

This is also an issue of the economy and economic growth. In France, this growth is very negligible: maybe just 3% or so in comparison to what a pension yields overall. In many countries, that figure yields 20–30%, thanks to capitalization. Our defined contribution system so far is in the embryonic stage, but its importance cannot be overstated. It is the application of the principle of capitalizing our own pension contributions that is exactly what will allow us to redirect defined contribution payment collection onto companies, which will make it possible to develop employment and economic growth. Here there is no competition with the solidarity system; the two approaches will complement each other. In Europe, we followed the Anglo-Saxon principle, talking about provincial rules (that is an example that should not be followed), and today Europe is trying to target all its savings to finance debt. Of course, this is politically incorrect, but it is true: we must remove savings from the economy of debt. Our pension system should be serving economic growth, but it is not doing so. So our country, apparently, is not creative enough with respect to growth and the labour market. Our government is trying to save money to pay down debt.

Today we could take up the system that is in use in Sweden, that is being adapted right now for Italy, and that was once under design with respect to French realities. Alas, France did not take this wise advice when it had the chance. We must have a distribution system. Each working citizen should have a personal virtual account in which he would be able to accumulate points

throughout his working years, in accordance with the contributions he made into the pension fund. When he retires (that, of course, is connected with life expectancy), he will have a pension that is scheduled and calculated ahead of time; that will be a more modern system than our 'medieval' one. That scheme is easier to adjust with respect to changes in life expectancy. This most important indicator, as far as I know, is gradually growing in Russia. When I was preparing my report on cooperation with Russia, we often talked about Russian democracy. Sometimes they say that everything is breaking down here, but that is not the case. The mortality rate in Russia, of course, is high, but right now there is definite progress, and the battle to improve the mortality rate and increase life expectancy needs to continue.

I will return to the topic of my presentation: these virtual accounts take an increase in life expectancy as their starting point. And Russia, actually, is beginning to go down the right path. There is no need to wait for the big companies to go in that direction. This is a system of state support connected with capitalization: that is to say, with accruing contributions, not just saving them. This system must be developed, and putting it into use will allow you to follow plans to modernize the Russian economy. I am confident that your government and your president are doing this, and that the process is already underway. This would also allow you to facilitate long-term investment both in your economy and in the economies of the former Soviet republics, to transfer technology and knowledge to them. As a result, you will more quickly facilitate modernization, since you will be able to invest those resources in important sectors, and not just leave them to the discretion of the big sovereign funds. So there is a large area of opportunity for investment and development.

This is what I wanted to say. You must not take what is happening with us as your starting point, because today we ourselves are not succeeding in reforming our pension system. That is the reality. It is not working out for us, and therefore you may take the good parts from our example, but be decisive in tossing out the bad parts.

V. Pivovarov:

We also have Zbigniew from Poland, who can tell us an interesting story. Pension reform in Poland started in 1999 with the idea to provide safe retirement for older people at adequate levels, and at the same time, to invest the capital into economic growth and create a financial centre in Warsaw, which I think has been quite successful.

One interesting thing I noticed is that about a year ago, Poland actually increased the age for retirement, reduced somewhat their fully-funded component, and as Jean-Pierre explained happens in France, the pension plan in Poland also seems to fund a big part of the current government debt, rather than contributing to economic growth or corporate growth in Poland on a larger scale. It would be interesting to hear your comments on this.

Z. Derdziuk:

Thank you, I am very happy to be here in St. Petersburg. I agree with Monika that the system in every country has its own route and its own history. For Poland, unfortunately, we can say that we got our independence too late, because the demographic changes that we had in the 1950s and 1980s had a great impact on the pension system. We had baby booms in the 1950s and 1980s, and when we started to accumulate money in the 1980s, when we had a surplus in the system, it was excellent. When we started to establish the three-pillar system in 1999, it was a very good idea, but it was a little too late, which has now created a problem. We had to adjust the system to the demographic and economic situation.

I agree with the session title that pension reform is a cornerstone to economic growth; of course. In the ISSA, of which my organization is a member, we confirmed that a social security system is a very important element in a country's development. What we did was establish the first and second pillars, and we decided to allocate 7.3% to the second pillar. It was a very good idea, but when you carry out this reform, you have to have very strict discipline. The first reform came too late, but at least we did it. We got rid of the privileges for early retirement. We did this in 2008, fortunately, because the element of the system that we introduced was NDC; it needs people to be active. When we had low

employment activity, due to the previous system and the structure of families, when wives were caring for children at home, we had a lot of privileges for early retirement. The balance of this system became worse and worse.

We first decided to eliminate early retirement and raise the retirement age. We are doing this step by step, starting from this year. The legislation was adopted in 2012. For men and women, the retirement age is 67, but women will not be forced to retire. They can have their pension when they retire at 67 in 2040, but of course they may work longer. The system built incentives for longer activity in the labour market because the NDC system promotes the collection of money in individual accounts, which we also established. Average citizens who are in our system can come to the Social Insurance Institution and log in and look at their individual accounts on the Internet like a bank account.

This reform is very important, but when there is a current deficit in the pension system, the state has to subsidize this. The problem with the second pillar, as I said, is that it was too late to start the system when we had a surplus on the demographic side, so we are creating public debt. We decided to decrease the portion sent to the second pillar from 7.3% to 2.3%. Now it is 2.8%, which will grow to 3.5%, but the key element is that these reforms created a financial market. We observed huge development in the Polish stock exchange because the pension funds are invested in Polish companies. This is the positive side, but on the other side, public debt is growing, and we have to limit it. Fortunately, in our constitution, we have the Maastricht rule which sets a debt-to-GDP ratio of 60%. We are now close to this limit, and we have to manage to ensure we achieve the right levels. But we are thinking about the future, and we are convinced that the next decade will probably raise longevity and we will be forced to raise the retirement age.

We are lucky people, because during the last two decades, the life expectancy for newborn children has increased by five years. This means that it will cost my institution two and half times more to pay their pension. This is a great success, but it is also a great challenge. We have to adjust the system by deciding, first, how to maintain an acceptable pension level; second, how to balance the system; and third, how to be competitive on the global market, because our

people have a choice. Over 2 million Poles went abroad during the last decade, so people really make this choice. This is the challenge for the government, and we strive to maintain both aspects: being attractive for our citizens as a country and being sustainable as well. Thank you.

V. Pivovarov:

Thank you. Jean-Pierre mentioned that the average pension level in France is EUR 1,250.

J. Thomas:

The rate of replacement is not better than what you have here because it is linked to the wage.

V. Pivovarov:

What is it in Poland, just for comparison?

Z. Derdziuk:

In Poland, the average pension is about EUR 400, but you have to compare the replacement rates. The replacement rate is about 50%. This is the replacement rate for the old cohort. For newcomers, the replacement rate is close to 60%.

V. Pivovarov:

I will ask Steven to comment briefly on the US system, and then we will get to Anton Drozdov.

S. Kandarian:

The US has three basic pillars. The first is Social Security, a government system that is a pay-as-you-go system. It began in the Great Depression in the United States in the 1930s. The taxation first began in 1937. It was a 2% tax: 1% from the employer and 1% from the employee. Today that number is 12.4% shared between the two different contributors, employer and employee. The increase from 2% to 12.4% is one way we are addressing the issue of adequacy in

demographics, because back in the 1930s, there were eight people working for every one person retired, and people only lived 5–6 years after retirement. Today there are three people working for every one person retiring, and people are living on average 13 years after they take up Social Security.

We have moved the retirement age up. It is now 66 for people retiring currently. It is moving up even higher over time. But there is a large deficit assumed projecting out the current system. That causes a lot of concern for Social Security and whether it will be there for the future for people; and people worry about that. It is kind of a mathematical exercise; the maths is not terribly hard, but the politics are quite hard. It means pushing up the retirement age, potentially raising taxes, and potentially means testing, which suggests that if you make a lot of money in your life, you probably will not get Social Security. That also becomes a social issue: do I really want to support that system where I am paying in all of the time and getting nothing back? Those are some of the political issues for Social Security.

The second pillar relates to the defined benefits pension system or the employer-provided pension system. A defined benefit means that after you retire, you get a fixed amount of money until you die, so it is an annuity paid for out of a system that is employer and corporate driven. It has been around for a long time in the US, but it really only took off significantly after World War II. What drove it was that there were a lot of older people in the factories during World War II who were not young enough to go to war, and a lot of young men coming back after the war looking for jobs. The idea was to give the older people the pension to enable them to retire because back then, Social Security was in its very early days. It was not paying much money out and was not adequate to retire on. We developed a system meant to get older people out of the workforce so that young people could come into the workforce and get these jobs. Back to something Monika said earlier, the idea today is just the opposite, keeping older people in the system. There is a conflict between this need in the 1940s and 1950s in the United States to where we are today, with the need to keep people in the workforce longer because they are living longer.

That system developed in the 1950s and 1960s in a major way, largely driven by unionized industries, car companies, and steel companies, and in some cases they went on strike to get the benefit, and it is now embedded in those unionized industries. But in the United States, that part of our economy is shrinking dramatically. Newer companies, high-tech companies, service companies, and others largely do not have these kinds of pension systems, which brings me to pillar three: a voluntary system put in the tax code in the late 1970s in the United States. It is referred to as 'defined contribution', which means that the employer and the employee put money in the system on a voluntary basis and the amount of money grows or does not grow based on the returns of that particular person's choice in their retirement plan. This is not a fixed promise; this is what you get based upon the returns.

Today, the average account in the United States for defined contributions is only USD 80,000, which is not really adequate for someone to retire on, even with Social Security, if you want a replacement rate of something like 60% of your average gross earnings, which is what the World Bank and some others suggest you need. That third pillar, which was always meant to become a substitute for the second pillar, is not adequate to replace the second pillar, which companies have moved away from for a variety of reasons. That is one of the big problems in the United States.

Those are some of the challenges faced in the United States. Before I finish, I would like to mention that an insurance company can do something that a defined contribution plan itself cannot do, which is back to Monika's point. It can mean not outliving your savings. A lot of times, people take the defined contribution plan in a lump sum and spend it on something, and often it is a consumable item, as opposed to using it for their retirement years. Insurance companies can take those monies and annuitize them to give people a fixed amount of income for the rest of their lives, because that is what we do for a living; we know about mortality and how to pool risks of that nature. That is a way to address at least a piece of that problem we are facing right now, both in the United States and elsewhere.

V. Pivovarov:

Thank you, Steven. Could you give us a number that could be comparable to the average retirement pension in Poland and France?

S. Kandarian:

In the United States, the average person gets around USD 15,000–20,000 per year in Social Security. That represents maybe 30–40% of replacement, so you are still short maybe 30% or more of what you need for adequate retirement. That is where the second pillar defined benefit plans come into play. Those who have them get to that 60% level in most cases. But again, most people do not have them. Some 44 million people in the United States have a defined benefit pension plan today, and that is a fraction of the workforce. The defined contribution plans, again, are about USD 80,000 if you annuitize them. That is a very small number today, and it does not get you anywhere close to what you need for retirement.

V. Pivovarov:

At the beginning of this session, I mentioned that President Putin, in his budgetary annual address to the government, said that one of the key priorities would be to create a fair and transparent pension where someone who worked longer and earned more should get a higher pension. Another priority outlined by the President was the current pension deficit and how it should be covered, and whether it should have a role, for example, in the Russian National Welfare Fund. I would like to ask Mr. Drozdov, Chairman of the Board of the Russian Pension Fund, to comment on this.

A. Drozdov:

Thank you. The topic of our panel is the pension system and economic growth. First I wanted to say that there are three areas in which the pension system impacts the economy and economic growth. The first is whether it limits the size of contributions and, in that way, the burden on business. This has a positive effect on the economy. The second is whether it guarantees an adequate

pension level, which provides pensioners with purchasing power, and, consequently, has a favourable effect on the economy. The third is whether it creates investment accruals, an investment resource, which can also be effectively invested in the economy. Here in Russia we have a fairly modern pension system that is developing along the usual lines, but, like in many countries (and my colleagues have talked about this), it requires constant adjustment, because economic and labour market conditions are constantly changing. We have already spoken here about the two biggest challenges to the pension system: demographics and macroeconomics. These conditions are constantly changing, and they require certain additional efforts from us.

When we talk about the reform tasks ahead of us right now, they are in line with what I was saying. They are a guarantee of an acceptable level of pensions provided, the provision of long-term balance and stability, and maintenance of the insurance burden on business at an acceptable level. Last December we adopted a programme. The first item in it states that we must develop all three pillars of the pension system: state, corporate, and private. Here we have target indicators: 40 – 15 – 50. This is our methodology, but by OECD methodology, our replacement rate is already at the 60% level, if you count taxes. This is our target indicator, reflecting the correct proportions. In each of these levels – the basic, corporate, and funded – we need to put things in order. As for the funded component, here we are proceeding from the need to present a choice of pension plans. This is what was not provided to citizens previously: the introduction of guarantees and increasing efficiency under managed investment, which Mr. Moiseev was talking about. As for corporate pensions, we need them to develop. In this case we are proceeding from the need to stimulate them. One thing that is specific to Russia – as opposed to Poland, where these privileges were liquidated – is that we still have them in the form of early pensions, and this problem will be and is already being solved by way of introducing additional fees or transferring those exemptions into the corporate system.

The next item is improving the basic system. Here, we are talking about a longer employment time period, about how contributions should be bigger, and about how the minimum requirements should be stricter. Last year, we adopted an

array of measures targeted mainly at balancing our system. This meant increasing rates for people with exemptions, for those jobs where exemptions applied, and increasing minimum payments for the self-employed and providing the right to a choice. This year, we are considering, first and foremost, the following measures for the basic scheme portion: gradually increasing employment period requirements up to 15 years when determining the minimum contribution into the system; and incentive measures connected with incentivizing employment periods longer than 30–35 years. The average employment period for the pensioners who are not working, and who were the first to go on pension, is around 30 years right now, and for those working it is around 35. This means incentivizing putting off going on pension to a later time. And, of course, we will introduce an index to measure income growth in the Pension Fund. The self-employed population will be offered the right to choose a minimal pension plan or an average plan, the same as hired workers, depending on pay. Further on, we will be reforming the institution of early pensions. On one hand, employers will be given the right to conduct an assessment and employ a more flexible rate: not 6.9%, but from 2–10%. As a measure of the output of those jobs, the rate will decrease, and in case of a transfer to a corporate system, it could drop to zero. For corporate systems, we are considering tax incentives, and the plan is for the co-financing programme to be extended first and foremost for these target groups of people.

The results we expect from these measures are an average level of pension coverage up to two and a half to three times the pensioner subsistence level by 2030, and a reduction in the pension system deficit to a minimum of 1% of GDP, or cut in half, to put it more simply. There is another package of measures in addition to that. It is a more active withdrawal of exemptions; here we are talking about doctors, teachers, and people working in the far north. It is bringing salaries out of the shadows, which is done by means of increasing the minimum wage, by means of increasing pay to government employees, and through other methods. It is introducing contributions per worker: right now we are discussing from what pay level and at what time those can be started. It is changes to the parameters of the system past the year 2018, because our peak is going to arrive

in 2035, when the number of employed workers and pensioners may equal out.
Thank you.

V. Pivovarov:

Thank you very much. I see that on your slide, the pensioners look pretty young.

A. Drozdov:

Yes, for now we have the youngest pensioners.

V. Pivovarov:

Tell us, please, does anybody in the audience have any questions? Introduce yourself briefly, if you could, and ask your question.

A. Zaretsky:

My name is Alexander Zaretsky, and I am representing MetLife Russia. My question to the consultants, probably to Monika, is this: today, President Putin mentioned that the government is planning to introduce a guarantee plan for the second pillar and there are a lot of questions as to how to organize this. The first question is what is the guarantee? Does the guarantee take into account inflation? That is one question. The second is how should this be funded? Should this be a pre-funded or post-funded scheme? The third question is what would the OECD's recommendations be? In your countries, do you have examples of successful guarantee schemes, and if there are, could you just explain them?

V. Pivovarov:

I just think that question would be better for Alexey Moiseev, but Monika, if you have comments, then feel free to offer them. Anton, you will probably have comments on this subject as well.

A. Drozdov:

I will quickly answer the first question. The draft law was prepared by the Ministry of Finance. For now, what is provided for is a guarantee of the nominal value,

and the source is contributions from non-governmental pension funds, including from the Russian Pension Fund to the Deposit Insurance Agency. The funds themselves will then be filled again from investment income.

V. Pivovarov:

In which case will the guarantee be triggered? In case of bankruptcy, in case of a collapse of the stock markets, for example?

A. Drozdov:

I think that a market collapse and bankruptcy will be the general situation. First, all the sources of those managing the money will be put in play, including the sum of charter capital, and then, after all the measures are taken, the guarantee mechanisms will be put into play.

V. Pivovarov:

Monika?

M. Queisser:

One country with a system like that is Germany. In Germany, they decided to introduce such a guarantee to reduce resistance from the people, to give more confidence, because Germans did not really have a very sophisticated knowledge of the financial market. To give people the feeling that there was no risk of them losing all of the money they put in, the government instituted this guarantee.

Now, obviously, this will have a strong impact on what you can do as a manager if you have to comply with this guarantee, meaning the amount of risk you can take when you have to comply. The amount of time that you have to comply, whether it is annually or every five years, really determines how you design this in the end, and it has a strong impact on the margin of manoeuvre that you can have. Germans have a very complex array of different back-up insurance funds and institutions, both for pension funds run by employers and also back-up schemes that re-insure the insurers. There are multiple sets of institutions

backing up the guarantee, and so far it has been working fine. I would think Steven would have a lot of ideas on this as well.

V. Pivovarov:

Steven, do you have a comment on this?

S. Kandarian:

I think if you are talking about backing up a private sector plan that invests in the stock market, that is pretty hard to do. We had that in the United States. It is called the Pension Benefit Guaranty Corporation, and it is currently in a large deficit position. In my judgement, it is likely to require federal government bail-outs or support at some point down the road. It is a noble idea, but very difficult to execute. I will leave it at that, given the little time we have.

Z. Derdziuk:

If I may answer the question, one well-known mechanism for avoiding distortion while providing the kind of guarantee that you referred to comes from outside the OECD. It was not so when it started, but it is a minimum relative rate of return guarantee. Basically, you guarantee relatively poor performance of the fund, but if you have a crash of the stock market, that in itself does not trigger a guarantee. In this case, it is an attempt to manage precisely the distortions you referred to. In Chile, I know, it has been working quite well.

V. Pivovarov:

I do not think there is any more time for questions. I will just ask our speakers to give a final remark or comment, potentially a few sentences on how to hone the pension system through pension reform to make it an economic driver rather than a drag on economic development.

Z. Derdziuk:

It is very important that when we reform the pension system, we build our citizens' trust in the system because too many reforms are major changes, like in

Poland when they changed the system from the defined benefit to a national defined contribution. We are now in a time when people are learning, because the majority of pensioners have pensions calculated on the old schemes. The NDC system in the future will depend on the contribution and the age of retirement, but in fact, the replacement rate will be lower. People are still not aware of that, and we have to educate them, and second, we have to develop an economy where people can really save money in the second and third pillars.

V. Pivovarov:

Steven.

S. Kandarian:

There is a potential conflict in the sense that we want pension assets to help stimulate economic growth, which to many people means investing in equities or riskier assets to drive new growth. If you think about what we are trying to accomplish from a social point of view, it is a fixed amount of money for life, ideally with an inflation escalator, to make sure that people live out their lives in dignity. A variable asset equity, trying to offset a fixed amount of money, is a very difficult thing to achieve. Often insurance companies put those monies for lifetime annuities into high-quality fixed incomes that match up, on a cash flow basis, the asset and the liability, with the liability being the fixed amount of payments for life to a person. That is the conflict, and both are noble goals, but they are in conflict.

V. Pivovarov:

Thank you.

Mr. Drozdov?

A. Drozdov:

I think that for our country, people's behaviour is very important. Incentive mechanisms built into the pension system, and multiple possibilities for people with different incomes, with different working conditions, it seems to me, are the

keys to making the pension system healthier and giving everyone the opportunity to shape their own pension plan.

J.-P. Thomas:

I would say that you have to consider the development of your new system of pension funds as the keystone of economic development and growth. Secondly, play the card of responsibility, not so much of assistance, because, at the end of the day, the problem is a big conflict between generations.

M. Queisser:

Coming from the Social Policy Division, my conclusion will not surprise you. I think Russia is working very well now on trying to get all of those financial aspects right. But do not forget the social aspect and think about what type of system you are building and how it relates to the situation in the labour market. Do not forget that any pension system is only as good as the labour market and economic conditions it is built in. Do not forget to put that into the larger context.

V. Pivovarov:

Thank you very much for a very interesting, educational discussion, and thank you very much for your time.