Comparative Analysis of Pension Plans in Western European Countries, Russia and the U.S. with Emphasis on Trends for Future Development of Russian Pension System

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Abstract

The objective of this paper is to consider the superannuation schemes presently being used in Great Britain, Switzerland, Germany, France, Italy, Scandinavian countries, Russia and the U.S. and to develop recommendations on theoretical and practical application of Western experience when creating a new superannuation scheme in the Russian Federation.

All of the countries included in this study have one or more benefits plans available for retirees going by names such as pension systems, pension plans, or social security. The purpose of this research is to study the wide variety of retirement benefits available in those countries with the intent of drawing recommendation to improve the Russian Federation's pension system.

Retirement benefits include wide variety of items, all of which are considered as part of the social security package. The paper is divided into three sections. The first one considers principles of social protection in Western countries and provides a retrospective look on development of this system from ancient times until modern days. Retirement insurance, in particular, is examined to provide the reader with knowledge of various European pension systems. The second section analyzes the U.S. pension plans. The American system has been studied because, first, the U.S. pension plans have succeeded in creating a high level of benefits for an ordinary American pensioner. Second, Russian's proposed reform of the private retirement insurance, is largely based on the decentralized model adopted in the U.S. The third section provides detailed information about the superannuation scheme of the Russian Federation, as well as the ways and methods to reform it at its present stage.

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INTRODUCTION

The present paper considers the superannuation schemes presently being used in Great Britain, Switzerland, Germany, France, Italy, Scandinavian countries, Russia and the U.S. and proposes recommendations on theoretical and practical application of Western experience when creating a new superannuation scheme in the Russian Federation.

All of the countries included in this study have one or more benefits plans available for retirees going by names such as pension systems, pension plans, or social security. The purpose of this research is to study the wide variety of retirement benefits available in those countries with the intent of drawing recommendation to improve the Russian Federation's pension system.

The paper is divided into three sections. The first one considers principles of social protection in Western European countries and provides a retrospective look on development of this system from ancient times until modern days. Retirement insurance, in particular, is examined to provide the reader with knowledge of European pension systems. The second section analyzes the U.S. pension plans. The American experience has been studied because, first, the U.S. pension plans have succeeded in the creation of high level of benefits for an ordinary American pensioner. Second, Russian's proposed reform of the private retirement insurance, is largely based on the decentralized model adopted in the U.S.

The third section provides detailed information about the superannuation scheme of the Russian Federation, as well as the ways and methods to reform it at its present stage. Particular attention has been paid to private retirement insurance, as this kind of retirement insurance has recently become of topical importance. The Russian pension scheme needs reforming. Transition from administrative command to market economy has opened up new vistas in providing of retired citizens with old-age pensions, in particular, through the system of private pension funds (hereinafter referred to as PPF) studied in this section. The PPF system has had a social call both from individuals and organizations, which allows its further development and wider spread in the future, in spite of its present difficulties.

This paper is the first to collect and analyze a variety of information both on various European and American pension plans and on the present status and methods to reform the superannuation scheme in the Russian Federation. The paper has been worked upon for four years and involved both U.S. and foreign publications. In addition, the research has made use of the author's two-year experience in the Principal Financial Group, which provided an opportunity to look at the American pension plans from inside.

In addition to the American experience, the paper has included the materials received while working in Telecom-Soyuz, a Russian PPF. Communication with the administration of the fund, access to unpublished materials, and participation in the conclusion of contracts added essential materials to the research and contributed to its practical nature.

The author is especially grateful to the administration of Telecom-Soyuz, a private pension fund, and Russian North-West PPF Association for their assistance in preparation of the present paper.

SECTION I. THEORY AND PRACTICE OF SOCIAL SECURITY IN WESTERN EUROPEAN COUNTRIES

1. Social Security and Social Insurance

Maintenance in old age, disability or survivor's pensions as well as other arrangements of the same kind make up the most important part of the course of human events. A civilized society solves this problem not only at an individual level, but also at the national scale. The latter is realized through a number of ways, including reduced rates of pay for goods and services, tax privileges, etc. The complex of various forms of maintenance in old age or in the event of disability is called *social security*. (1)

The principal form of organization and law for social security in countries with a developed market economy is *social insurance*, characterized by a thoroughly developed and mature mechanism of evaluation of actual need in social protection, clear dissociation of its specific kinds and sources of funds. (2)

As a socioeconomic category, social insurance is a “system of relations on distribution and re-distribution of national income through special insurance funds formed of premiums paid by working citizens and employers and of governmental subsidies” *(Fedorova, 1997, p. 8).*

Social security is an element of social policy and provides protection of reproduction of human and social capital assets against the most serious of socioeconomic risks. The human capital assets are investments into the person or his physical, educational, or material potential. Social capital assets are social assets of a person, such as social interconnections (ex. friendship), labor relations, and social standards.

2. Background

Social protection of a population has always been one of the most important functions of the *state*. Since ancient times, the powers-that-be have been helping destitutes and disabled in the event of emergency. In the Middle Ages, churches and monasteries hosting free hospitals and asylums supported this activity. Craft unions and merchant guilds, as well as municipalities of big cities, aided members of their communities.

Social protection of populations was not always systematic and permanent. Assistance was rendered through various channels and included such forms as free medical treatment and material support of widows and orphans, and allocation of money, clothes and food to people who were homeless. The goal of this assistance was determined not only by the Christian goodwill traditions, but also by the pure economic necessity. The situation when European countries were depleted by epidemics and wars made each governor take care of his population, as its preservation and accrual was the source of tax and revenues.

When capitalist industrialization began, the former craft union forms of social security lost their importance. The first forms of social insurance as fundamental forms of organization and law of social security appeared in the second half of the 19th century in Europe, their nature being that of collective insurance. Appearance of trade unions maintained the rights of employees in the face of the government and employers made social security transform into collective self-help and self-insurance by establishment of mutual benefit societies, sick-leave funds, and redundance funds.

At first, social insurance was developed to provide protection only to working citizens and to cover the risk of reproduction of the labor-power. Later, as the role of the human factor in production increased, the sphere of the influence of social security was essentially expanded and spread over the whole cycle of human life.

The initial practice of social security showed three possible ways to organize this system:

1. Introduction of social security from below, in the framework of settlement of disputes between employees and employers. That practice was typical in England, where social security of workers was provided by trade unions. Responsibility for collection and distribution of funds rested with employees, employers, and trade unions. Trade union committees managed the funds.

2. Introduction of the institution of social security from above in the framework of state legislation. Adoption of special state laws was the way to introduce social security in Germany. The social reforms of 1883 carried out by Bismarck included the first law in the history of social security -- health insurance law. In 1889 insurance of substandard lives and old age became into existence. Those kinds of insurance used to be provided by sick-leave funds, companies' benefit plans, and credit unions.

Contributions for social insurance were fixed by law and paid by the employer and the employee in the ratio of 1/3 and 2/3 respectively.

3. The third way to arrange social insurance can be called mixed, because its organization involved both state authorities and trade unions. In 1893, the city council of Bern, Switzerland, established a redundance fund. A committee consisting of employers, trade-union members, and city-council members managed the fund. Membership in the society was voluntary. (3)

3. Social Insurance

3.1. Kinds and Models

At present, social insurance in most industrialized countries is represented by

- old-age, disability, and survivor's insurance;
- health insurance and maternity care;
- accident and occupational disease insurance;
- unemployment insurance, and
- family allowances.

The mechanism, through which specific functions are implemented within each of these spheres, as well as the structure and the equity ratio, depends directly on the model of the regulation of social relations adopted in each specific country. By now, countries with market economies have developed several models of social protection for their citizens differing in the ratio of public and private capital in their activity:

- *centralized model*, also known as social-democratic, where the predominant role in the social protection of a population is played by national insurance, which is compulsory and universal. Examples of this model are Scandinavian countries, Great Britain, and Italy.

- *decentralized model*, also known as neo-liberal. Here the problems of social security are solved mainly at the level of direct relations between employers and employees fixed as a rule in collective contracts, while the state functions as an arbiter, that it observes and guarantees that the parties maintain their obligations. Countries using this model are the U.S., Japan, and Germany.

- *intermediate model*, also known as neo-conservative. Here public and collective social insurance are of nearly equal importance in the coverage of socially significant risks. As an illustration, one can refer to the experience of France and Switzerland.

3.2. Basic Principles of Organization and Contents

Social practice has developed four institutions to protect the welfare and life of a person. In developed countries today, they exist in parallel and supplement each other. They are

- public social security,
- national social insurance,
- collective social insurance, and
- personal insurance.

Public social security is a typical form of solidary social support of population implemented by the state at the expense of tax revenues into the budget. The state determines independently by the decisions of its authorities who, in what amount, and on what conditions is to draw social assistance and support.

Systems of national and collective social insurance are mixed forms of material protection of a population combining social solidarity in distribution of assistance and financial independence in organization of insurance funds at the expense of employees' and employers' contributions. National insurance is provided by special state financial intermediaries created by legislative or executive authorities and accountable to them. Any insurance company having an appropriate license obtained from the state may provide collective social insurance. National insurance covers the whole population or particular social groups selected by state authorities on the basis of social risks they are subjected to. Collective social insurance is much narrower than national one and limited by personnel, trade union, or place of residence.

Personal insurance is contrary in principle to the first three. It serves as a protection of the welfare of an individual at the expense of his personal contributions for social insurance arranged by insurance companies and receipt of insurance indemnity or the amount at risk equivalent to the contributions paid.

3.3. Functions

The main function of social insurance is *sponsorial* -- provision of insurance protection on attachment of socially significant risks.

1. Economic functions of social security are those of *saving* and *investing*. The function of saving lies in funding social assistance with the incoming insurance funds. The function of investing provides the drawing of income from the investment of temporarily idle funds.

2. As a social risk management system, social insurance has important regulating and restricting functions in the social sphere (such as development and coordination of special public welfare programs aimed at the improvement of protecting a population).

3. Social insurance not only functions as indemnification of the attached risks to the population, but also finances measures on obviation and preventive maintenance of potential damage.

4. Retirement Insurance

4.1. Kinds

Retirement insurance as a kind of social security can be *compulsory* (national) and *supplementary* (private). Compulsory retirement insurance in different countries equals 25-80% of average earnings (thus, an average American gets “a national federal pension of $900 and at the same time $800-$1,500 from private funds” per month *(Yakyshev, 1994, p.3)*, while in Sweden, almost the whole amount of the pension is paid by the state).

According to classification by L. Rzanizina, *national pension schemes* in developed countries can be divided into three types:

1. "*universal*, i.e. covering the whole population and funded mainly from the federal budget,
2. *connected* with employment, gearing retirement insurance and its amount to the length of the previous working career and funded through social insurance,

3. *social*, their provision being closely geared to the amount of family or private income and aimed at maintaining the level of survival" *(Rzanizina, 1992, p. 14).*

At present, most industrialized countries have universal or combined pension plans that include the first two or even all three types of pension schemes. Some countries – U.S., Switzerland, France -- combine the national pension scheme with private ones. (4)
The schemes connected to employment include mostly the persons referred to as aggregate manpower. It covers almost all hired adults, although several groups of employees -- teachers, police officers, military personnel, people engaged in public organizations -- in some countries have independent superannuation schemes.

Social pension schemes are mainly for the poorest layers of populations and are intended to provide them with minimum guaranteed income. Such schemes are provided in Belgium, France, Great Britain, and New Zealand. (5) Austria, Finland, and several other countries have put the principle of social pensions into the basis of their universal pension plan for the whole population of the country.

An appropriate administrative authority on an individual basis determines amounts and kinds of benefits within the social pension plan after thorough investigation of the livelihood in possession and the daily wants.

The factor, which determines a person's eligibility for an old-age pension, is a certain age and a certain length of paying contributions to the pension fund. In many cases there is also an additional requirement of refusal from employment as a source of livelihood, i.e. retirement.

4.2. Sources of Funds

The most widely spread sources of funds for pension schemes are deductions from earnings paid by employees themselves, social insurance benefits made by employers at the amount of certain percentage of the payroll, and grants from the government. Practically all pension schemes acting on the principle of social insurance are funded from two sources, and about half of the existing schemes uses all three of them.

Grants from the government are most often funded by the general budget, but sometimes they can be financed by special taxes -- excises. Public funds can be used in different ways: for maintenance of administrative authorities of pension schemes, to cover deficit, etc.

4.3. Management of Schemes

In most industrialized countries, responsibility for direct management of pension schemes rests with different kinds of semi-independent agencies headed by boards formed of three parties: representatives of insured citizens, employers, and government. Ministers or special governmental departments carry out general supervision over the appropriate bodies. In some countries, such as Austria, New Zealand, Canada, Great Britain, Switzerland, Portugal, Norway, and Denmark, federal authorities (ministries or departments) directly manage pension schemes. (6)

5. Summary

1. Various forms of social protection were provided since ancient times. Recent forms of social security appeared in Europe in the middle of the 19th century and became standard in the 1950-60s.

2. Social security in industrialized countries is a state priority and is provided both at the national and at the individual level.

3. Four systems of protection of human welfare and life exist in modern countries, all of them existing in parallel and supplementing each other:

- public social security,
- national insurance,
- collective social insurance, and
- personal insurance.

4. Social protection is implemented by mechanisms differing from country to country and depends on the extent of participation of public and private capital in their functioning. The majority of countries fit the following three models of social protection of their citizens:

- centralized model (Scandinavian countries, Great Britain, Italy),

- decentralized model (U.S., Japan, Germany), and
- intermediate model (France and Switzerland).

5. Retirement insurance as a component of social security can be compulsory (public) and supplementary (private). Public retirement insurance can be in its turn subdivided into social, universal, and connected to employment.

SECTION 2. PENSION PLANS IN THE U.S.

This section analyzes development of the pension plans in the U.S. The American experience has been examined, first, because the American pension plans have succeeded in creating a high level of benefits for an ordinary American pensioner. The reasons include high percentage allocations for superannuation, investment of the funds raised, and minimization of expenses on pension scheme management. Those aspects should be studied and introduced in Russia in due time.

Second, the author worked in the pension department of the Principal Financial Group for two years, to get both practical experience in this field and to have a first-hand look at the U.S. pension plan.

Third, Russian's proposed reform of the private retirement insurance, is largely based on the decentralized model adopted in the U.S. American private retirement insurance already has more than a century of history. To disregard the experience and knowledge accumulated would be a waste of time and effort, while avoiding American errors would mean learning from their mistakes.

The main feature of the American pension plan is an elaborate legal system going into the smallest details of the whole plan from the moment of raising funds up to their payment to pensioners. This rigid structure provides social guarantees to pensioners, because in practice it deprives insurance companies of any possibility to perform risky transactions, left alone the transactions pursuing criminal purposes.

Though the American system is not an absolute reference standard, some of its components, such as employer-financed pension plans, are worth consideration and application on the Russian ground.

At present, the U.S. practices three major pension plans: compulsory federal (public), employer-financed pension plans, and individual retirement accounts. Let us consider them in more detail.

<u>1. Federal Plan</u>

The national federal social insurance covers "95% working people" (*Social Security Administration, 2000).* The scheme was founded during the Great Depression to provide some financial support to pensioners. During the last 60 years the scheme has grown in rank providing higher pensions and other kinds of benefits such as Medicare. To draw a social insurance benefit, the employee must pay contributions to the scheme for at least ten years.

Contributions for social insurance amount to a total of "12.4% of gross wages (up to $76,200 for 2000) divided into two halves to be paid by the employer and the employee. (Supplementary 2.9% of earnings are allotted to provide medical benefits for pensioners)" (*Social Security Administration*, 2000). An average pension provided by federal social insurance is $930 per month (*Social Security Administration, 1999)*. The federal public social insurance is managed by the Social Security Administration. There are also several categories of pensioners, such as former federal employees and army pensioners enjoying other governmental programs.

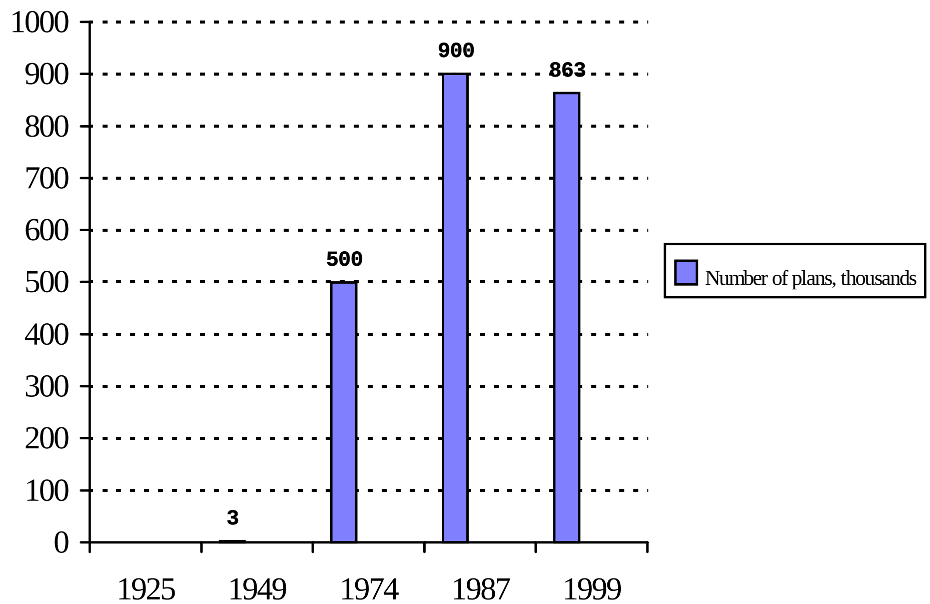
2. Employer-Financed Pension Plans

At the time of this writing, nearly half of the working people in America are covered with various types of employer-financed pension plans. This scheme includes private companies as well as the federal government, governments of state and local (municipal) authorities providing pensions to their employees. These pension plans are voluntary.

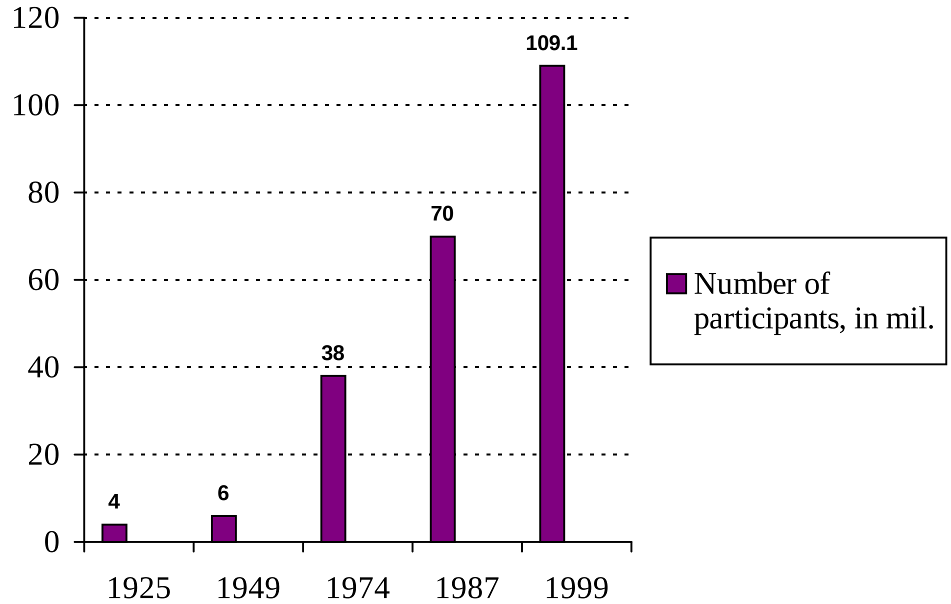
The first pension plan in the U.S. was founded by American Express in 1878. At first, employers looked at the pension plans as a gift to their employees for their services to the company (*Long Service and Good Conduct*), so the employees had no legal rights. In those years, the plans were extremely informal and often consisted of simple statements that the employer was expected to pay certain amounts to those of his employees who had met certain service requirements. As a rule, the employer did not create a special fund to secure his pension liabilities, and the text of the plan was carefully formulated to release him from responsibility.

Essential growth of pension plans in the United States began about 1915, and by 1925, about 4 million employees were covered with 400 plans. Pension plans grew slowly until the end of 1940s, when they began to increase in kinds, number, amounts, and coverage of employees. By "1949, 6.2 million employees were covered with pension plans" *(Harbrecht, 1959, p. 6)*. By that time, many pension funds had based their work on thorough actuarial calculations and founded trust funds to support pension liabilities. The majority of earlier funds had been founded simply as “reserves of balance sheet accounts” in the companies' books. When the trusts were created for employees, the majority of the reserves were invested into the company's own securities; practically in all cases representatives of the trusts had plenary powers in investment policy, which resulted in many imprudent investments. “In 1928, only 41 of 108 companies had trust funds, while 67 of the rest had them only on paper, i.e. in their books” *(Harbrecht, 1959, p. 7).*

By the end of 1958, about 16.5 million employees were covered with all kinds of private pension plans, two-thirds of which were agreements reached by negotiations between employers and trade unions. According to the data of the Statistical Reporting Service of the U.S. and Spectrem Group, there were more than 863,000 private pension plans in 1999, in comparison to 900,000 private pension plans in 1987 and 500,000 plans in 1974. Today, more than 109 million people in the U.S. are covered with various kinds of pension plans. See graph 1 and 2.



Graph 1. Growth of plans 1925-1999.



Graph 2. Growth of plan participants 1925-1999.

2.1. Creation and Development of Legal Base for Pension Funds

After introduction of the income tax in 1913 and up to 1921, enterprises could look at their pension liabilities accumulated during the current year as usual business costs. The amounts invested into pension funds could be deducted from the gross income. However, the income from contributions for retirement insurance was subjected to the same taxation as any other income. At the same time, the pensions drawn were also subjected to taxation. Employees' income, at the rate of their employer's contribution into their pension, was also subject to taxation during their work.

The plan could be interrupted at any time. The law stipulated that if the worker left, he was no longer qualified for a pension. Under those circumstances, employers were not interested in prospective funding of future pension liabilities.

The first provision favorable to pension trusts was included in the *Income Act* of 1921. The Act granted pension trusts a remission of income tax and granted workers a remission of the tax on current contributions made by employers into the trust for the benefit of the employees. The progress gained in 1938 was fixed in the *Income Act* of 1942 that changed the conditions of the pension tax completely. It contained more definite terms of settlement of employees' benefits and methods of allocation of pension amounts.

Those gradual measures on the liberalization of tax laws were a great incentive to create pension plans. As corporate excess profits tax amounted to “82% during and after the war, many companies concluded that they could provide pension plans at the cost of about 18 cents per dollar to their employees” *(Guide Book to Pension Planing, 1996, p. 1324).*

2.2. Employee Retirement Income Security Act (ERISA)

In 1974 when ERISA was developed, it was intended to protect the federal tax authority and interests of the members of private pension plans and their beneficiaries. It improved the equal nature of these plans by introducing new compulsory requirements, such as correlation of future payments to employees with their service terms, the minimum standards of funding the plans by employers, and compulsory insurance of payments of the saved-up amounts to the members of the pension plan in case of its interruption. ERISA was major legislative effort to regulate the pension sphere in the U.S. (7)

2.3. Composition of the ERISA

The ERISA comes in four sections. The first one protects the employees' rights and lays down the conditions of:

- participation and plan-funding rules,
- the fiduciary's responsibility for management of the money and the plan,
- furnishing the member of the plan with information by the employer,
- management of the pension plan.

The second section contains amendments to the Tax Code of 1954.

The third section lays down various conditions connected to jurisdiction, management and implementation of the ERISA.

The fourth section establishes Pension Benefit Guaranty Corporation (PBGC) and creates the scheme of mandatory insurance payments of the saved amounts to the members of the pension plan in case of its interruption.

2.4. The Pension Benefit Guaranty Corporation

The Pension Benefit Guaranty Corporation (PBGC) was established as a federal government corporation to encourage the growth of defined benefit plans1, provide timely and uninterrupted payment of benefits, and maintain pension insurance premiums at the lowest level necessary to carry out the Corporation's obligations.

PBGC takes responsibility for paying benefits to current and future retirees when a pension plan runs out of money, when a company liquidates and has an underfunded plan, or when PBGC must end a plan to protect its participants. It guarantees basic benefits including normal and certain early retirement, disability, and survivor benefits.

PBGC is not funded by general tax revenues. PBGC collects insurance premiums from employers that sponsor insured pension plans, earns money from investments and receives funds from pension plans it takes over.

PBGC protects the retirement incomes of about 43 million American workers in more than 40,000 defined benefit pension plans. Since 1974, according to the PBGC's web site, some "472,000 workers and retirees in 2,665 terminated pension plans" have come to rely on PBGC for their retirement income. The Corporation pays monthly benefits according to the provisions of each individual pension plan up to the limits set by law and which are adjusted yearly. For plans ended in 1999, workers who retire at age 65 or older can receive up to $3,051.14 a month. PBGC paid $848 million in benefits to retirees of terminated pension plans in fiscal 1998. (8)

2.5. Governmental Bodies Regulating Private Pension Plans

In the U.S., there are three governmental bodies implementing the rules of private pension plans. A fourth one takes an active part in the issues of pension policy.

The *Department of Labor* regulates the articles of the plans, rights of members and member's access to information.

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1 A defined benefit plan provides a specified monthly benefit at retirement, often based on a combination of salary and years of service.

The *Internal Revenue Service* supervises execution of the plans, percentage of the employees covered by plan, maximum and minimum contributions and benefits, entitlement of the employees to participate in the plan, etc.

The *Pension Benefit Guaranty Corporation* is a governmental insurance company paying pension benefits to the members of pension plans, when the latter are closed and have no funds.

The *Securities and Exchange Commission* is involved in the process by supervising the investments and minimizing their risk.

2.6. Kinds of Pension Schemes (Plans)

To determine the type of the plan and the level of benefits and features provided by the plan, it is necessary to answer the following questions:

- Can the company afford expenses to establish and maintain the plan?
- Will the establishment of this pension plan help the sponsor to attract and keep employees?
- Does a competitor have a similar pension plan?
- Considering governmental restrictions, is this undertaking worthwhile?

Pension plan establishment can result from negotiations between trade unions and an employer, or from the good will of the employer. The features of the plan are different in each case.

In *defined contribution pension plans*, the sponsor introduces exact amounts to be distributed afterwards between the members according to the rules. Actual payments to the member are based on the contributions made during his/her employment, as well as on the income from the investment of those contributions.

There are three kinds of defined contribution pension plans: (9)

- *profit-sharing pension plan*. The sponsor's contribution is limited to a certain ratio of current yield or net profit. This contribution is distributed between the members by the specified formula.
- *deferred-pay pension plan*. The members are allowed to reduce their salaries and use the saved amounts as a contribution to the plan. The part of the member's wages used as a contribution to the pension fund is excluded from taxable yearly income. Many sponsors encourage members to take care of their own pensions by

also making contributions.

- *accrual pension plan*. The sponsor makes a contribution to the plan at the amount necessary to provide the member with a benefit after his retirement. The amount of the benefit is based on the data of insurance statistics. However, the member draws the pension equal to the amount of annual contributions and the accrued income. It can be larger or smaller than the sponsor's initial contribution, as the whole of the investment risk in this case falls on the pension plan member.

In *Defined-Benefit pension plans*, the sponsor undertakes to provide exact amounts of pension benefits on behalf of the participating employees. To provide the payments promised, the sponsor makes contributions calculated on a statistical basis. Unlike the defined-contribution pension plans, the member knows that after his retirement he will draw a pension and that the investment risk falls on the sponsor.

A *Multi-Employer pension plan* is arranged for employees of several employers. This plan is established by negotiations between a trade union and an employer and is managed by an independent fiduciary council equally representing the sponsors and the trade union. The benefit of the member of a multi-employer pension plan is based on service as a whole, not on the length of service for one sponsor.

General and reference pension plans are developed by banks, insurance companies, brokerage houses, and law firms. These plans fit all the above-mentioned schemes and are easily adapted by the sponsor, whose only job is to select a particular plan among those submitted by the developer. If the sponsor wishes to create a pension plan with non-standard features, the pension lawyer or adviser will prepare an individually developed plan. When establishing the plan, the sponsor is obliged to follow certain legal rules.

An individual or an organization becomes a plan trustee to carry out service functions. Requirements to pension payments are established by the plan trustee. It is he/she who determines the amount of the pension. The trustee's duties also include:

- investment of the pension plan assets,
- selection of the insurance company, and
- determination of investment funds for the members to place in their account.

However, the trustee has no right to distribute the funds among the members.

Employer-financed pension plans enable the increase of pensions in a wide range (from $50 up to $5,000 per month depending on the sum entered in the individual account). The pensioner has a right to draw any amount from his account. However, if the annual amount exceeds $20,000, he has to pay a higher tax and, as a rule, a fine to the federal government and insurance company. Under force-majeure circumstances, that is, if the money is necessary for an expensive medical treatment, for example, a pensioner has the right to draw the required amount without being fined.

3. Individual Retirement Account

If the person is self-employed or works for an organization having no pension plan, there are some other opportunities to save for old age. Any employee can open an *individual retirement account* (hereinafter referred to as IRA) at a bank, brokerage office, or insurance company. Contributions to this account will accrue on a tax-free basis (up to $ 2,000 per annum) until the employee retires. If the employee is not covered with an employer-financed plan, the contribution (or part of the contribution) to the IRA will be considered as the amount reducing the annual tax.

Opening an IRA (about 20% of working people have one) provides the depositor with the following choices:

- to open the account at a financial institution,
- to determine the amount of the contribution (up to $ 2,000 per annum),
- to determine the investment risk of the contribution (as a rule, the finance company offers three kinds of contributions to the investor: high risk, risk, and low risk. If the person has less than 5 years before retirement, the company offers him/her a low risk contribution; from 5 to 10 years, a combination of risk and low risk; from 10 to 15 years, a combination of all three risks).

Having decided on a choice of investment risk, the depositor in most cases has no authority over where his/her contribution will be invested (in what securities, bonds, etc.). The amounts and rules of pension payments to IRA holders are similar to the amounts and rules of payments to the members of employer-financed pension plans. Pension plans have a system of tax privileges, thus, under certain conditions, the sponsor's contribution to the pension plan reduces the sponsor's income tax by the amount of the contribution. The income drawn from this contribution is tax exempt, which enables its net capitalization. The pension benefit is only taxable at the moment of payment.

4. Summary

1. The U.S. provides a well-balanced, three component pension plan: compulsory federal

(public), employer-financed pension schemes, and individual retirement accounts. In addition to comprehensive performance of its own role, each component also supplements the other two.

2. The federal pension plan covers 95% of working people. An average pension is $930 per month. In addition to the federal plan, half of the working population in America is covered with employer-financed pension plans. They enable a wide range of pensions, amounts from $50 to $5,000 per month (depending on the amounts entered in the individual account). IRAs covering about 20% of working people also enable a wide range increase of pensions depending on the amounts entered in the individual account.

3. The importance of supervision and regulation of pension plans has been declared by the federal government since 1974. That year, ERISA was adopted, unifying and compiling various enactments and statutes into a consolidated legislation on retirement insurance, thereby contributing to the strengthening of the federal tax authority, free circulation of the pension capital over the territory of the country, increase of its yield, and therefore increase of social guarantees for the members of private pension plans.

4. Wide spread of private pension schemes. More than two thirds (about 109 million) working people in the U.S. are covered with various kinds of private retirement plans, which shows that not only employees, but also employers are interested in the development of this component of retirement insurance.

5. Variety of kinds and forms of private pension plans. This variety enables the maximization of employees' desires with minimization of employers' expenses, which, for example, are regulated by tax privileges for contributions to the retirement account.

6. Payments of the pension amounts to employees in the event of bankruptcy of the pension trust are fixed by legislation, thereby strengthening social guarantees for members of private pension plans.

SECTION III. SUPERANNUATION SCHEME OF RUSSIA. WAYS AND METHODS TO REFORM IT.

1. Operation of the Superannuation Scheme in Russia and the Necessity of Reform It.

Retirement insurance has become a top socioeconomic priority in Russia during the period of transition to a market economy. Its social importance is determined by the vital interests of almost 39 million elderly persons, disabled and survivors. Table 1 represents the quantitative structure of various groups of people drawing pension *("Pensionnuje fondu", N1, 1998, p. 7):*

	1970	1975	1980	1985	1990	1991
Total number of pensioners (in thousands)	22,513	24,684	27,417	30,291	32,848	34,044
Old-age pensioners	14,155	16,813	19,540	22,522	25,659	27,131
Disabled pensioners	3,865	3,487	3,469	3,462	3,514	3,385
Pensioners due to the loss of head of the family	4,033	3,926	3,864	3,694	2,792	2,574
Pensioners, who qualify by the number of years worked	124	90	95	81	82	84
Special pensioners	N/A	N/A	N/A	N/A	470	870

	1992	1993	1994	1995	1996	1997
Total number of pensioners (in thousands)	35,273	36,100	36,623	37,083	37,827	38,286
Old-age pensioners	28,390	29,021	29,095	29,011	29,081	29,076
Disabled pensioners	3,363	3,562	3,910	4,270	4,542	4,734
Pensioners due to the loss of head of the family	2,473	2,420	2,423	2,482	2,464	2,461
Pensioners, who qualify by the number of years worked	91	107	135	197	544	578
Special pensioners	956	990	1,060	1,123	1,196	1,437

Table 1. Quantitative structure of groups of people drawing pension.

In 1992 prices skyrocketed, and the increase in pensioners' income fell behind the general price increase. It happened despite a decrease in the ratio between average wage and average pension and some stabilization of this socioeconomic index during the previous two years. The ratio of an average old-age pension and average wage is unstable. After reduction of this ratio to “23%[2] at the end of 1992, it was equal to 38%[3] at the end of 1997” *("Pensionnuje fondu", N1, 1998, p. 4)*. Detailed information is provided in Table 2 *("Pensionnuje fondu", N1, 1998, p.7):*

	1970	1975	1980	1985	1990	1991
Average salary per month (in thousands Rubles)	0.121	0.149	0.174	0.199	0.303	0.548
Average pension per month (in thousands Rubles)			0.058	0.073	0.102	0.185
Percentage of average pension to average salary			33	37	34	34
Poverty level (in thousands Rubles per month per person)						
Percentage of average Pension to poverty level						

	1992	1993	1994	1995	1996	1997
Average salary per month (in thousands Rubles)	6.0	58.7	220.4	472.4	790.2	964.5
Average pension per month (in thousands Rubles)	1.6	19.3	78.5	188.1	302.2	365.9
Percentage of average pension to average salary	26	33	36	40	38	38
Poverty level (in thousands Rubles per month per person)	1.9 (first introduced in 1992)	20.6	86.6	264.1	369.4	412.6
Percentage of average Pension to poverty level	84%	94%	91%	71%	82%	89%

[2] $\frac{\text{average pension}}{\text{average wage}} = \frac{\text{1.60 thousand Ru}}{\text{6.00 thousand Ru}} = 23\%$

[3] $\frac{\text{average pension}}{\text{average wage}} = \frac{\text{365.9 thousand Ru}}{\text{964.5 thousand Ru}} = 38\%$

Table 2. Quantitative structure of income.

What is the reason for the frequently changing percentage of an average pension to an average salary? Let us make a short excursion into the historical domain. For more than seventy years, hundreds of millions of Soviet citizens had been drawing a small, but guaranteed, retirement income having no opportunity to enlarge it with other pension payments. The USSR had only one level of compulsory retirement insurance based on the principle of the redistribution of funds between generations, “the working generation of today provides for the senior citizens of today.”

Since January 1, 1991, financial support of pensions given under the law On National Federal Pensions in the Russian Soviet Federative Socialist Republic was radically changed. The highest legislative authorities decided to withdraw these funds from the federal budget and to charge the Pension Fund of Russia with the work on their collection, record-keeping, and target distribution. The budget of the Pension Fund is basically built up of contributions paid by retirement insurance subjects:

- companies, establishments, organizations, collective and state farms;
- individual farms and
- individuals.

The listed categories of organizations and individuals are bound to pay insurance contributions to the Pension Fund of the Russian Federation. Insurance contributions are rated for:

- “companies and organizations at 28% of charged remuneration of labor;
- farm production enterprises at 20.6% of charged remuneration of labor;
- self-employed at 5% of their income *("O porjadke yplatu strahovuh vznosov v bydzet Pensioonogo Fonda Rossii", 1994, p.3).*
- Though this law makes almost all employers and individuals pay insurance contributions, the Pension Fund of the Russian Federation is in great distress for money, and pensioners can hardly make ends meet.

There are several reasons for this situation:

1. Since the end of 1993, *financing retirement insurance has aggravated.* Collection of insurance contributions took a turn for the worse due to economic recession, decrease of financial discipline, and insolvency of enterprises.
2. *Evasion from paying taxes to the Pension Fund of Russia* (PFR). “Insurance contributions are levied from the earnings...and as this contribution often equals

28%...everyone hides his/her earnings. As a result, there is neither money for pensions, nor income tax collected." *(Fedorov, 1995, p. 2).*

3. *Demographic aggravation*. Today, the labor pension scheme works at the ratio of "one retired per only 1.9 worker." *("Pensionnuje fondu", N1, 1998, p. 9)* In 1985 this ratio was equal to "one retired per 2.4 worker." *("Pensionnuje fondu", N1, 1998, p. 9)*
4. *Inefficiency in the management of the current pension system.* Decentralization in tax collection and pension payments results in serious financial losses due to the effect of economy of scale.
5. *Infringement of the principle "to each according to his labor and deserts."* The basic principle of retirement insurance -- dependence on labor contribution -- was deformed. "The ratio of the maximum and minimum superannuation allowance is 1.4:1 instead of 3:1, as the legislation stipulates. The maximum superannuation allowance is only 14% higher than an average one" *(Arjanina, 1998, p. 40).* Therefore, earnings do not practically play any role in calculation of the superannuation allowance, thereby the population does not have much incentive to earn pensions varying in amount.

Thus, the working superannuation scheme needs basic changes in legal, organizational, economic, and social aspects, which would make it adequate for the conditions characterizing the transition to a socially guided market economy. It is clear that the reformed pension scheme should contribute to stabilization and progress of economy, promote structural reorganization, and reduce the load of the superannuation scheme on economy, thus meaning that the general improvement of endowment of all pension groups can result from national economic stabilization, to which the pension reform should also contribute.

Selection of pension reforms and means of their implementation should be based on socioeconomic and demographic projections, on prospects of the labor market, and the effects of the reformed superannuation scheme on the economy.

2. Versions of the Reforms

From the standpoint of preventing collapse in the long-term the pension reform can follow three paths:

- Gradual increase of the pension age within the current distributive superannuation scheme[4] (age 70 being the goal);

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4 Distributive superannuation scheme – scheme, under which today's employees pay

- Encouragement of the immigration of working-age people from high birthrate regions, e.g., from Central Asia, which will create favorable conditions for stable functioning of the distributive superannuation scheme in the future;
- Transition to the superannuation scheme based on the principles of saving5. (10), (11)

In the long view, all three versions allow avoiding the danger of a financial crisis. However, they are far from equivalent in their ability to create pre-conditions for fast and stable economic growth. The first two scenarios fix the problem short-term, without making major structural changes to the retirement system. The third scenario can solve the problem in the long run because it will be addressing economy on the macroeconomic level by stimulating economic growth necessary to bring Russia to the level of more advanced countries.

Introduction of the reform based on the principles of saving would mean that the majority of pensions would be financed, not at the expense of the current wage tax, but with the compulsory target savings of employees. In contrast to the present payments to the PFR, contributions into the savings superannuation scheme accumulate in individual employees' accounts, thus losing the nature of taxes. A considerable part of expenditure on paying pensions in such a scheme is covered by the interest income from savings, therefore rates of compulsory pension contributions become much lower than allocations to the PFR.

2.1. Saving Superannuation Scheme

The transition to the saving superannuation scheme will take about 20 years. The employees, whose age at the moment the transition begins will be 20 years younger than the retirement age, will lose an opportunity to apply for payments through the distributive scheme and will have to finance the pensions in full. The older-generation people will reserve the right on partial payments within the distributive scheme, their amount decreasing inversely to the number of years until the pension age. The other part of the pension is financed at the expense of compulsory savings.

The government proposes to fix the PFR insurance contributions at the total rate of 29% paid by the employer and the employee from the year 2000. At the start, the insurance contributions at the rate of 1% of wages will enter the PFR individual

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taxes which finance today's pensions of retirees.

5 Savings superannuation scheme – scheme, under which today's employees defer parts of their salaries to pay their own pensions in the future.

retirement accounts, and by the year of 2010, the rate will increase up to 8%. Then, at the stated time, these funds are put on the settlement accounts of the pension trusts meeting the requirements of the government of Russia. Investment of pension savings will be carried out in the order prescribed by the government of Russia.

The increase specified (from 1 to 8%) will be achieved by redistribution in favor of the part of the contributions formed by savings within the established underwriting rate. Taking into account the general character of inclusion of employees into the saving scheme and small amount of the saved resources for the employees retiring within the first 5 years from the introduction of the saving scheme, they are stipulated to be used on partial financing of pensions only after the year 2005. During the first 10 years of the transition, the PFR contribution rates will remain at the same level of 29%. Added to the annually growing saving scheme contribution, they will reach their maximum of 32.6% by 2005. Table 3 represents this model:

	2000	2001	2002	2003	2004
% of wages going to the savings scheme	1	1.6	2.3	3	3.6
% of wages going to distributive scheme	29	29	29	29	29
Real total % of salaries going to savings and distributive schemes	29	29	29	29	29
Nominal total % of salaries going to savings and distributive schemes	30	30.6	31.3	32	32.6
Difference between nominal and real rates of money going to pension schemes	1	1.6	2.3	3	3.6

	2005	2006	2007	2008	2009	2010
% of wages going to the savings scheme	4.3	5	5.6	6.3	7	8
% of wages going to distributive scheme	28	27	26	25	24	23
Real total % of salaries going to savings and distributive schemes	29	29	29	29	29	29
Nominal total % of salaries going to savings and distributive schemes	32.3	32	31.6	31.3	31	31
Difference between nominal and real rates of money going to pension schemes	3.3	3	2.6	2.3	2	2

Table 3. Proposed model of savings superannuation scheme.

From 2005, the retirement pensions for the majority of people going on old-age pensions will consist of two parts quoted on distributive and savings bases.

As the insured persons' pension savings grow, the part of the retirement pension financed from the saved resources will grow too, and in the long run, it can reach the amount equal to the retirement pension financed on a distributive basis. Thus, the relative value of the part of pensions quoted on the distributive basis should gradually decrease as the part of pensions under the saving scheme increases.

The table shows that in the financial aspect, the main problem with transition to the saving scheme is search of pension payment sources equal to the difference between the nominal rates of contributions for retirement insurance (equal to 32.6% at the most) and the actual rates (29%) without their real increase. The most obvious sources to finance this gap are the following:

1. Taking advantage of a favorable demographic float if the transition begins in 2000. (According to the projections, in the period from 1997 to 2007, the number of pension-aged people is expected to come down.)

2. Rationalization of payments within the framework of the distributive scheme, e.g., restriction of early retirement practice and of working pensioners' opportunities to get the full pension.

3. Transfer of public welfare payments, "which may amount to 1% per annum" to the budget *(Dmitriev, 1996, p. 11).*

4. Partial capitalization of the pension funds working under the saving insurance scheme by transfer of a certain percentage of shares and other assets owned by the state to these funds.

Assuming that if the beginning of transition to the saving scheme is not put by for a long time, financing of expenses of this period can be carried out without increasing the PFR contribution rates.

Having faced the necessity to reform the superannuation scheme, the governmental committee analyzed a variety of opinions and selected the most conservative one. Only time (or change of the government) will show whether it was the optimal solution of the problem. Let us consider the governmental version in more detail.

3. Superannuation Scheme Model

The basic features of the future scheme are predetermined by its present composition. Introduction of the so-called social service benefits into the national federal pension scheme and declaration of the right to create private superannuation schemes created preconditions for development of a three-level system, which has practically become a world standard.

A governmental committee given remarks and suggestions of ministries, departments, and the European Community experts developed the draft of the retirement insurance reform. (12), (13), (14), (15), (16)

On January 31, 1995, the draft was considered and approved by the Social Sphere Development Council of the Russian government, and at the end of 1996 the realization of the project began. The project develops a three-level superannuation scheme.

3.1. First Level: Basic Pension

The first level of the superannuation scheme is the basic (social service) pension. The basic pensions must be granted to all citizens of Russia and to provide the cost of living guaranteed by the state on attachment of physical disability or arrival at the retiring age irrespective of the length of service. These pensions should not be granted and paid to the working citizens.

Their amount will be fixed and determined according to the pensioner's cost of living (calculated on a monthly basis) and depending on the extent of disablement.

3.2. Second Level: Retirement Pension

The second level is the retirement pension (insurance). It is the main part of the superannuation scheme. The critical requirement to this kind of pension is conformity of conditions and amounts of pension to the volume of each individual's participation in social insurance. The volume of participation is expressed in duration of insurance and amounts of contributions. With this end in view, an essentially new pension-calculation method is introduced providing periodic indexation of the pensions to the cost of living. It will allow supporting pensioners' real income at the level of the present-day living conditions.

In the practical aspect, the transfer of governmental superannuation scheme to the social insurance principles means:

1) The new law stipulates direct dependence of the pension right on payment of insurance contributions, i.e. the superannuation allowance is calculated only on the earnings from which the PFR insurance contributions were held back.

2) Introduction of individual accounting of insurance contributions. All governmental authorities engaged in retirement insurance these days are part of the Federal Pension Service of Russia. The Service collects a databank on all working citizens. The databank includes information about the period when an individual is subject to social insurance, about his/her earnings from which the insurance contributions were held back, and some other data required for future pensioning.

There are two benefits of such accounting procedures:

- it will allow measuring each person's labor contribution exactly and pensioning him/her properly and
- it will simplify the pensioning procedure the most, as it will obviate the necessity to submit documents about the length of service and earnings.

3) It is most likely that the ratio of employers' and employees' insurance contributions in the total amount held back to the pension fund will be redistributed. Today, the general underwriting rate to the pension fund is 29% of the company’s wages, 28% of this rate falling on the employer and 1% on the employee.

This division is sure to be actually conventional, because the employer pays contributions not from his/her pocket, but underpays this amount to the employee in his/her earnings. But from the psychological point of view, it would be better to distribute the rate between the employer and the employee fifty-fifty, i.e. 50% of the rate to be entered by the employer, and the other 50% by the employee. Of course, the employee should be paid higher wages. That way he will feel he is being a direct member of the pension fund.

4) It is possible to change the rule when the insurance contributions are charged on the whole amount of the employee's earnings, but his/her pensioning must fit certain limits.

With this object in mind, it is proposed to introduce a concept of 'basic earnings' into the new pension law. That means determination of the marginal wages as a basis for holding insurance contributions back to the pension fund. Everything that the employee earns up to this amount is taken into account when pensioning, and everything that is

higher is not taken into account any more, but this part of earnings is not levied with insurance contributions. Then there will be no necessity to introduce artificial pension limits such as maximum pension amounts, which causes pensioners' complaints. In addition, the employee will have an opportunity to allocate the saved part of his/her earnings to private pension funds (hereinafter referred to PPF).
5) If the state makes a decision that some periods of the person's life should be included into the length of service on parity with a working career entitling a pension, *it should pay an appropriate reimbursement to the pension fund* (that is the case when maternity leave is included into the length of service). In some European countries with a similar practice, there is a strict rule: the insurance contributions lacking in this case are paid by the state.

3.3. Third Level: Private Pension

The third level of retirement insurance is private pensions. They are provided either at the expense of the citizen's self-financing of the future pension from the current income, or at the expense of the employer's contributions into PPF to employees' individual accounts, or a combination of both methods. Gradually developing and expanding coverage by inclusion of new professional groups, they can essentially improve the social security of the population. Unlike the nation-wide superannuation scheme, granting of these pensions is distinguished by flexibility of conditions and of determination of amounts and adaptation to specific economic conditions.

But one should bear in mind that vitality of private pension establishments can not be separated from economic stability of the society. Development of private superannuation schemes can be stimulated by tax privileges and accompanied by measures on strengthening public supervision over their financial reliability.

The present program, especially its third level, gives a general outline of transition to the new pension scheme. This general approach is explained both by the extraordinary complexity of the reform and by unwillingness of the governmental committee to limit itself with rigid frameworks in the future.

3.3.1. Fundamentals of a Private Pension Scheme

"A private pension fund (PPF) is formed as a non-profit organization accumulating pension contributions and making pension payments according to the terms and conditions of the contract. To build up the purse, the fund trusts it to a special company managing the assets of the pension fund (i.e. pension trust). Except for the share stipulated beforehand as a commission, all the income drawn by the pension trust is spent only on certain objectives appropriate to the fund's Articles of Association, i.e. mainly on pension payments *("Negosydarstvennuje pensionnuje fondu", 1994, p. 11).* That is how the non-profit nature of a private pension fund shows itself. The pension trust acts as an ordinary investment institution.

Under Russian legislation, activity of PPF and pension trusts is subject to licensing carried out by the Private Pension-Fund Inspection at the Ministry of Social Protection of Russia. The Inspection not only analyzes conformity of the submitted documents to the current legislation and standard requirements, but also verifies compliance with the funds' and trusts' liabilities, projected yield and inflationary expectations, and liquidity of invested funds.

3.3.2. Ancestry of PPF

Though the first PPF, *Rossiysky Strakhovoy Pensionny Fond* (Russian Insurance Pension Fund) was registered in November 1991, their number peaked in the first half of 1994, which is presented in Table 4:

Date	Number of PPFs
November 1991	1
January 1993	20
July 1993	45
December 1993	85
July 1994	500
March 1995	800
January 1996	700
January 1997	520
January 1998	350

Table 4. Number of PPFs in 1991-1998.

According to Pension & Actuarial Consulting, at present, there are about 350 PPF in 82 of 90 regions of Russia. The largest number of PPFs are operating in

Moscow, St. Petersburg, Tyumen, Nizhny Novgorod, Rostov, Sverdlovsk, Kemerovo, Samara, and some other provinces (Table 5):

City	Number of PPFs	Percentage
Moscow	150	25
St. Petersburg	74	8
Tyumen	45	5.8
Nizhny Novgorod	25	4.1
Rostov	21	3.8
Ekaterinburg	12	2.3
Kemerovo	12	2.3
Krasnojarsk	8	1.9

Table 5. Distribution of PPFs throughout Russia.

As for the assets, a certain tendency can be clearly traced. “If in January 1993, they equaled 216 million rubles (US$84,700 - author), in October 1994, they were already 150 billion rubles” (US$42.3 million - author) *("Aktivu pensionnuh fondov sostavljayt 400-500 mlrd. ryblej", 1994, p. 14)*, and at the end of 1997 this amount was 6.8 billion denominated rubles (US$1.2 billion - author). Though PPFs’ total assets are still much smaller than total assets of commercial banks, they will take a large sector in the financial market of Russia, if the tendency to increase the number and size of PPF will proceed in the next 5 years. Table 6 presents some data on the development of the PPF system from 1993 to 1997:

	Month/ Year							
	01.93	10.94	07.95	01.96	07.96	01.97	07.97	10.97
Total NPF's assets (in Rubles)	216 mil.	150 bil.	--	--	600 bil.	3.7 trl.	6.2 trl.	6.8 trl.
Number of NPF's members (in thousands)	--	--	--	--	1,387	1,694	1,957	1,997
Amount of pensions paid (in mil. Rubles)	--	--	--	--	76.0	--	80.8	128.4

Table 6. Assets, number of participants, & pensions paid by PPFs in 1993-1997.

In less than six years, industry sectors with supplementary retirement insurance (hereinafter referred to SRI) have essentially extended. Now it includes the energy sector, metallurgy, mechanical engineering, defense industry, agriculture, transport, communications, construction, financial systems, municipal utilities, education, and public health services.

PPFs are already important today from socioeconomic and financial points of view. Despite objective difficulties, the available data shows dynamic development PPF system in Russia.

3.3.3. Primary Trends in Development

In general, PPFs come in three groups:

- the funds where pension contributions are formed by employers,
- the funds formed with contributions made by individuals, and
- the funds with contributions from both individuals and employers.

The first group can be qualified as corporate funds, the second as open-end funds, and the third as mixed funds.

The number of pension recipients and the amounts spent by the funds on pensions for the members is increasing and will increase from month to month. More than half of PPFs are paying out the pensions. In 1996, "156.6 thousand people received private pension". *(Panfilov, 1997, p. 16).*

Chart 1 shows that 23% of the total number of funds account for 91% of the total number of members. (17)

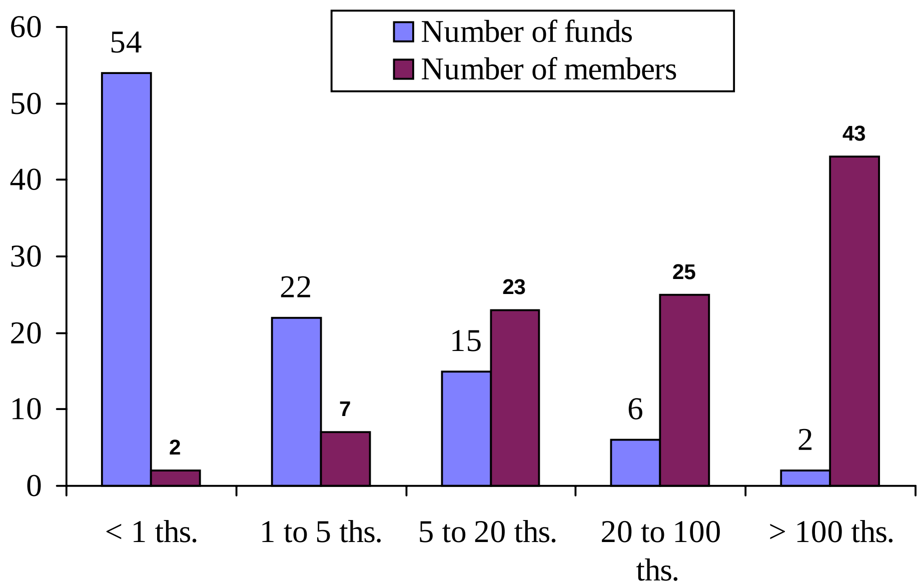

Chart 1. NPFs by the number of members (% of total)

The primary trends in development of PPFs are determined by the 17 largest funds, providing 67% of the total reserves of pension payments, 78% of the pension reserves, and more than 40% of the members. (18)

An important indicator of efficiency and reliability of PPF is the structure of their total means. By the end of 1997, this indicator of 7.2 billion rubles included 3.6 billion rubles of pension reserves (customer funds) and 3.4 billion rubles of own capital (initial owner's start-up capital, property owned, percentage of profit earned on customer funds and etc.) of the funds.

3.3.4. Summary of private pension scheme

The objective necessity to develop a supplementary pension scheme in Russia is obvious to many people. The process, which began in 1991, is most likely to get further development. Along with considerable successes and achievements, there were and are unsolved problems both on macro and micro-levels. It is obvious that formation of normal structure of this market will take a long period of time. In the summary to this chapter, the author has tried to answer the questions about how, in what direction, and with what speed the private pension scheme (hereinafter referred to as PPS) will develop:

1. The crisis of the national federal pension system stimulates *transition from a single-level pension scheme to a three-level one*, where an important role is to be played by PPFs. There is a gap between very limited financial resources of the federal budget and it's ability to provide adequate pensions to the retirees. The federal government relieves itself from part of the retirement insurance problems and shifts it to workers and employers by introducing the system of retirement insurance and private pension funds.

2. *Initially, creation of PPFs was to the interests of four different parties, viz. banking structures, enterprises, government machinery, and private persons.* On one hand, such a variety of persons interested caused intensive development of supplementary retirement insurance in these 8 years, while on the other hand, it also introduced complexity and contradiction in its processes because their interests clash. It was evident in lobbying the government about the definite ways to develop private pension system, in particular, when PPF investment standards were created.

3. Though all theoretically possible kinds and forms of private retirement insurance are represented in Russia, the most widely spread are corporate pension funds, i.e. the funds where contributions for retirement insurance are formed mainly by employers represented by enterprises and organizations. The largest funds (the volume of assets and the number of members) have been created at export-oriented enterprises and monopolists due to their relative financial well-being. The tendency involved is likely to be unchanged hereafter, as they remain rare islands of relative financial stability.

4. *The total number of people covered with private retirement insurance has exceeded 2 million. The number of people drawing pensions from PPFs is about 200 thousand.* These figures demonstrate a rather wide coverage of the population with PPFSs, though it is basically limited to such rich regions as Moscow, Tyumen, Nizhny

Novgorod, and St. Petersburg.

5. *In addition to its main objective of providing a supplementary pension for working people on their retirement, PPFs were also created as a source of the so-called long-term money.* While the idea about the necessity of a long-term investment policy was indisputable, there was a problem with possible sources for its financing. The first one is the budget with its limited resources. Then come western investment credits accessible only to a few enterprises. The third source is a capital base of banks, enterprises and finance companies. Today, the volumes of these assets limit the opportunities to realize amplitude long-term investments. And the fourth source of long-term money, and probably the most essential of all the listed ones in the future, comes in assets of private pension funds formed by the idle cash of the population and enterprises.

PPFs of today can only be considered limited sources of long-term money, which is caused by rather small financial assets of theirs and by the absence of historical experience of such an institution in Russia.

6. While the fundamental concept and tendencies of PPF development remain unchanged, *the primary method of development will be merging small and large PPFs and increasing the volume of business to the latter.* That will happen because of the necessity to increase assets and stability, to attract greater number of depositors, and due to the effect of economy of scale.

7. *The character of PPF development was and will be dependent on the position of the federal government and appropriate policies of executive authorities on this issue.* It was already mentioned above that without a holistic, precisely developed, scientifically established and, which is most important, strictly followed state policy on the issue of private retirement insurance, it is difficult to discuss long-term prospects of development of the private pension scheme.

4. Summary

1. The difficult financial position of the superannuation scheme of the Russian Federation is stipulated both by objective (economic recession, demographic aggravation, infringement of the principle “to each according to his labor and deserts”) and subjective (inefficiency of the present retirement-insurance management, evasion from paying taxes to the PFR) reasons.

2. Pensioners have to exist on the brink of physiological survival, with no hope for improvement in the future (the ratio of average wages to an average pension during the last five years was steadily declining and by the beginning of 1999, it became 3:1, which is about twice as low as the official cost of living).

3. There is a necessity to create a holistic, scientifically established concept of retirement insurance calculated for the prospective economic development of the country. From the legal point of view, the Russian pension law is a set of rules sometimes mutually exclusive and contradicting one another. During the short term of its existence, it managed to acquire a great number of amendments, both populist ones and those correcting miscalculations made during its preparation. (One third of the articles have undergone fundamental changes). For such an important act, the instability of norms is unprecedented.

4. Therefore, there is a vital necessity to create a new three-level pension system for Russia. It can solve the problem of worthy retirement insurance both in the short and in the long view.

5. Creation of the new three-level scheme of retirement insurance is stipulated both by economic and demographic reasons and its present composition. Introduction of the so-called social service benefits into the national federal pension scheme and declaration of the right on the creation of private superannuation schemes preconditioned development of the scheme where the three levels supplement each other, which has practically become a world standard.

The first level is a social service benefit financed by the state budget.

The second level is a retirement pension financed by insurance contributions accumulated in the national federal pension fund.

The third supplementary level is a private pension financed by contributions and the investment income drawn by investment of funds into a PPF.

6. The objective of the forthcoming pension reform is to integrate all three levels and to make them work by creating an endowment for a pensioner which would allow his/her life to remain normal during the transition to a market economy and the change of the retirement policy.

7. The biggest difficulty in reforming the superannuation scheme is practical creation of its third level, i.e. private retirement insurance.

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