

## **Developing Countries Pension Systems: Some Lessons from Russia**

Alexander Lelchuk (Russia)

Developing countries pension systems have some specific features as compared to those of developed countries. In my paper I would like to analyze two such features:

- High real wage growth.
- Low longevity.

1. Notional defined contribution system is a PAYGO system arranged like defined contribution system with some implicit rate of return based on pension tax base and demography. So for the sake of simplicity I would use comparison funded pension systems with NDC. In Russia the average implicit rate of return of NDC system for the next 40 years will be equal to wage growth minus 1%. Taking into account higher funded system higher expenses it would need a return equal to wage growth to give more or less same results as PAYGO.

2. Advantages of funded pension system versus PAYGO system are based on real, above wages' inflation, return on pension funds. In the US in years 1871-1995 average real wage growth for industrial workers was about 2.5%. Average real rate of return on stocks (based on S&P500 data) was 6.9%. So in the past investments in S&P500 gave comfortable 4% above wage growth.

But in developing countries wages are quite low. For example in Russia average wage is about 500 USD, in Ukraine – twice lower, etc. If the country is really developing, the gap between its wages and those of developed countries would shorten. So we should expect more substantial real wage growth in developing countries. For example, in the last seven years (2000-2006) average annual real wage growth in Russia was about 15% and it is not declining yet. Of course in the future it will become lower, but how much lower? For example, if we assumed that in 20 years real wages level increase 4 times, it would mean more than 7% average annual growth rate. How to achieve high enough rate of return on pension funds to justify State pension system transfer from PAYGO to funded pension in developed countries? Of course there is a possibility of higher return on developing markets. But there are problems of underdeveloped and highly unstable stock markets. Usual recommendation of investments' diversification by investing in developed countries markets would not probably help. As to the bonds, in Russia in the last few years there rate of return was lower than retail price inflation!

3. Developing countries people have much lower longevity. In Russia expected longevity at birth is less than 60 years for male and about 72 years for female. More so the longevity has not been growing from the middle of 1960 years. The absence of longevity growth took place in all European Socialist countries and former Soviet republics. In some of them, e.g. Czech and Slovak republics, longevity started growing, while in the others it is has not yet. Absence of trends makes longevity forecast much more uncertain then for developed countries.

4. Thirteen years past after the issue of the World Bank's research "Averting the Old-Age Crisis: Policies to Protect the Old and Promote Growth". May be it is time to collect the new data and analyze the new experience? This time actuaries should be more involved in this research. I would like to stress, that to develop reasonable recommendations concerning developing

countries pension systems we, first of all, must take special attention to the assumptions used. Experience showed that not all of them turned true.