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USE OIL WINDFALL TO COVER PENSION DEFICIT

By Konstatin Sonin

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Speaking at the "Russia: Going Global?" conference last week, Oleg Vyugin, head of the Federal Service for Financial Markets, advanced a very sound idea. It's well known that high oil prices have allowed the Russian government to increase spending while also squirreling away sizeable sums in the stabilization fund. There's just one problem with the money in the stabilization fund, however. You can't spend it domestically without incurring negative macroeconomic consequences.

Of course, if the government were to seize the opportunity presented by sky-high oil revenues to strengthen crucial economic institutions (the courts, for example) as well as reducing the level of corruption among public servants, it could spend this money on domestic priorities without fear of sparking inflation. But that's another story.

Vyugin proposed using a portion of the stabilization fund to cover future deficits in the state pension fund, which are foreseen as a result of unfavorable demographic trends. A competent immigration policy would go a long way toward solving this problem even without drawing down the stabilization fund, but that's another story, too.

Vyugin is definitely on to something. As New Economic School professor Alexei Goryayev has shown, however, Vyugin's good idea could be developed into something even better.

Here's how. When pension reform was introduced two years ago, part of the working population was given the opportunity to transfer their money from the state pension fund into privately managed accounts. This new "funded" system does not allow workers to choose whether or not to invest their money, but it at least gives them more control over investment choices, which in theory should lead to higher returns down the road.

Such individually managed accounts are considered more progressive than the old "pay-as-you-go" pension system because they create a stronger link between the interests of workers and investors and the public good. The idea behind the reform was sound, but as often happens in this country, the implementation left something to be desired.

Here's what happened. When privately managed accounts were introduced, everyone born before 1967 -- the greater part of the current working population -- was excluded from the new funded scheme. The government's thinking was that if the pension accounts of these workers were transferred from the state pension fund into private accounts, the fund would no longer have enough money to cover current pension payments. Workers born before 1967 were excluded for the same reason that they are crucial to the success of pension reform: They currently earn more than any other sector of the work force. As a result, in 2003 pension reform was implemented only in part because total implementation would have created a temporary deficit in the state pension fund.

The windfall from high oil revenues that Vyugin mentioned would be best used to make up this deficit. This money could be used to pay current pensions instead of the money being paid into the system by workers born before 1967, thereby allowing these workers to shift their pensions into privately managed accounts. This solution would make the macroeconomists happy, and today's pensioners wouldn't notice a thing.

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