Institute for Social Policy

Discussion paper #1

COVID-19 Pandemic Impact on Social Security Institution

All opinions expressed in this paper are those of the authors and do not necessarily reflect the official position of the HSE National Research University

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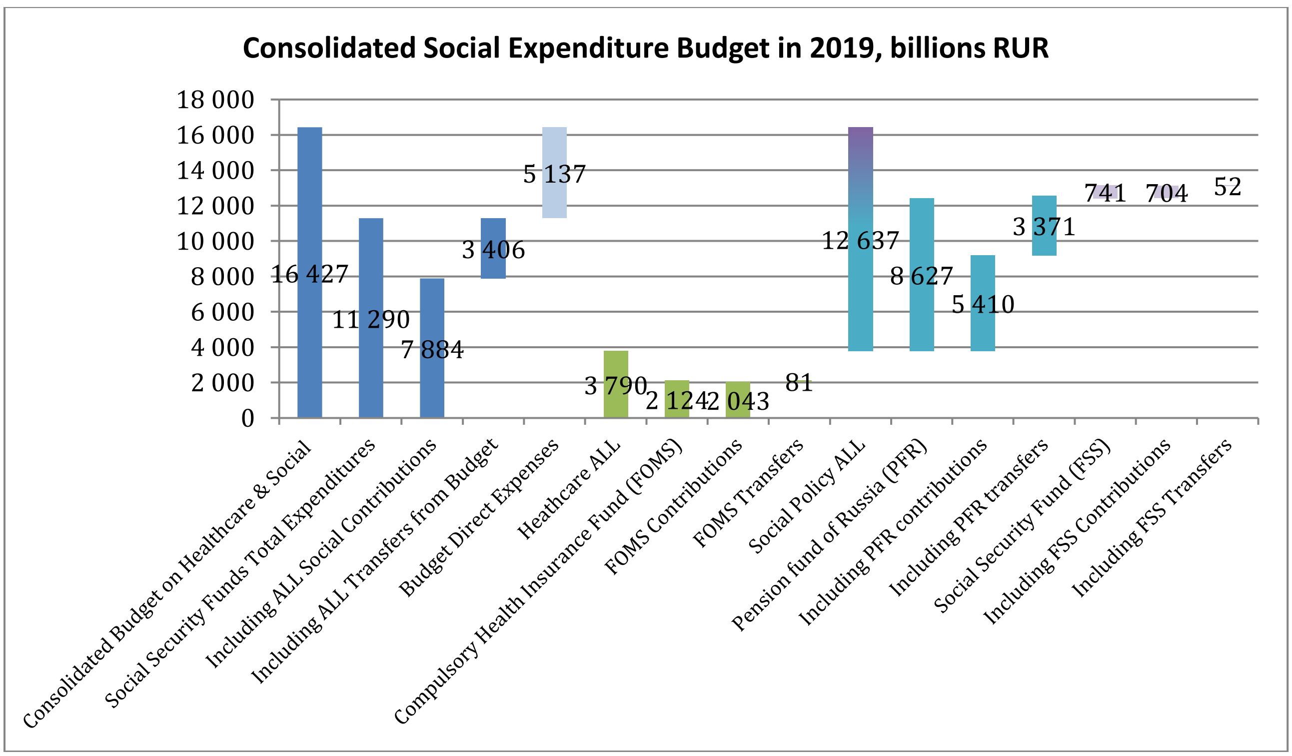
According to our evaluations, the consolidated budget expenditures for "Healthcare" and "Social Policy" in 2019 in Russia exceeded 16.5 trillion rubles.[1]

The income from mandatory contributions to the national social security funds, namely, the Pension Fund of the Russian Federation (PFR), the Social Security Fund of the Russian Federation (FSS), and the Compulsory Health Insurance Fund of the Russian Federation (FOMS) amounted to 7.8 trillion rubles. In contrast, expenditures of budgets of all levels amounted to 8.5 trillion rubles, including direct transfers to the social insurance system of over 3.4 trillion rubles.



[1] We base our calculations on the official data of the Ministry of Finance of the Russian Federation (https://www.minfin.ru/ru/statistics/)

As a result of the economic activity slow-down, we expect the following effects to have an impact on social policy institutions:

- Decrease in the wage fund, also due to partial transfer of workers to part-time employment;
- Reduction of jobs, including those in the form of unpaid leaves;
- Increase in unemployment – both general and officially registered;
- Decrease in population's income.

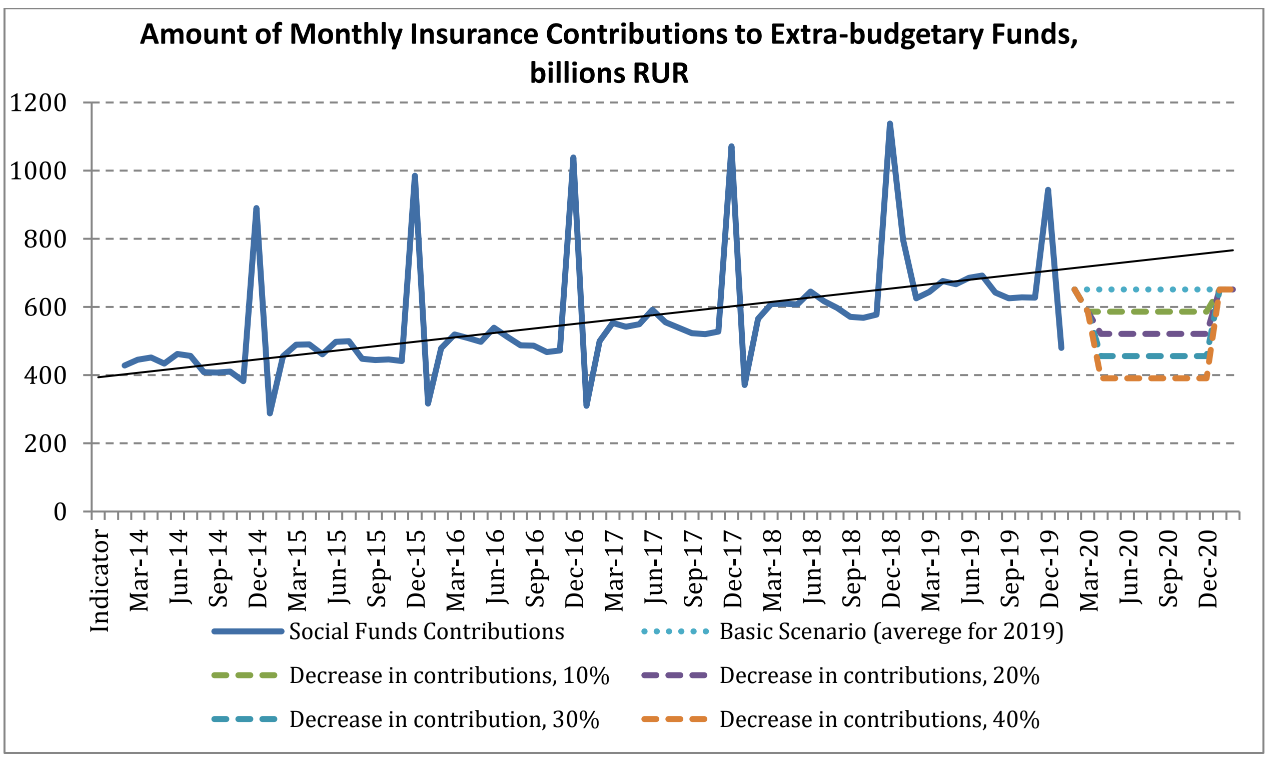
After the introduction of the anti-crisis rescue package proposed by the President of the Russian Federation, the following measures will come in force:

- Reducing the mandatory social insurance and pension contribution rate from 30% to 15% for SMEs workers;
- Decreasing tax revenues to the federal budget (both due to lower economic activity and announced measures of deferred tax payments).

The main expected consequences for social insurance institutions, which receive about 70% of all social benefits, are the following:

- Decreased revenues of extra-budgetary funds from insurance contributions (PFR, FOMS and FSS);
- Increased cost of unemployment benefits (including the revision of these benefits);
- Reduced possibility of deficit compensation within the budget system.

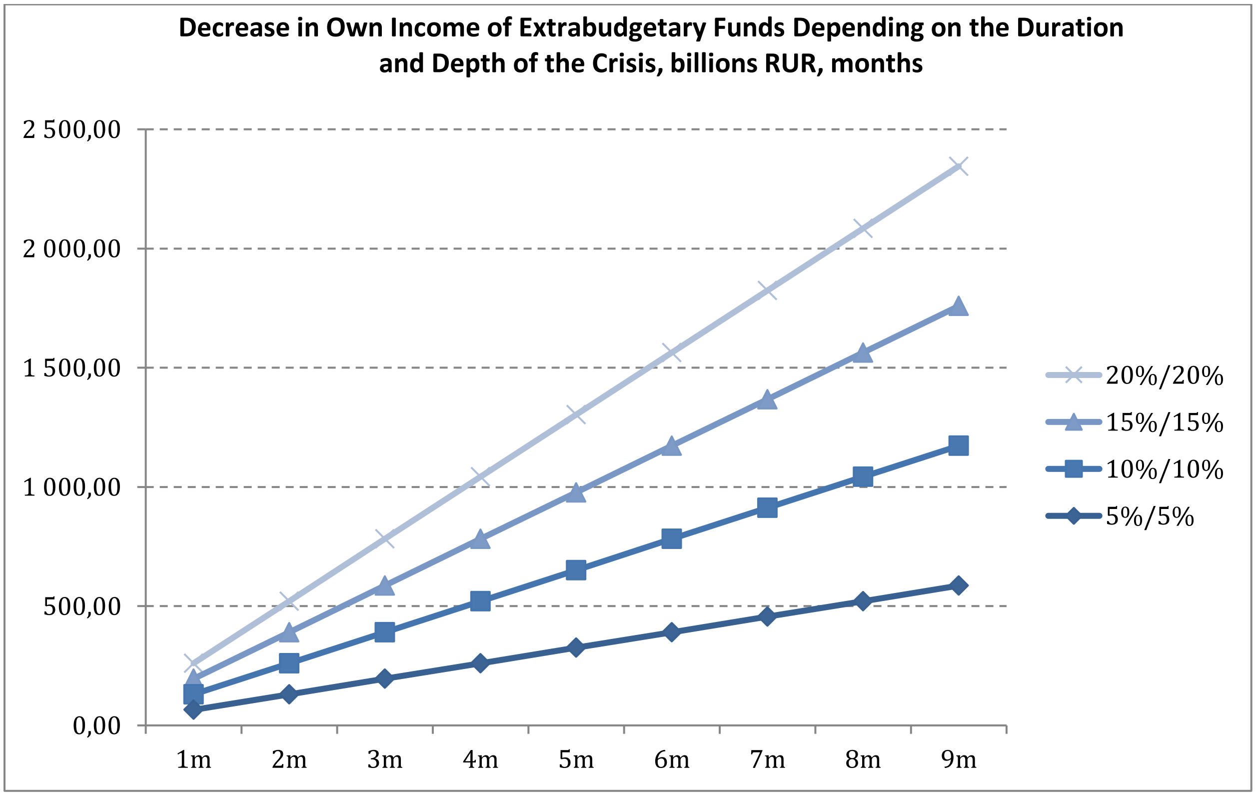
From March 2020, it is expected that the mandatory monthly contributions for extra-budgetary funds will decrease (PFR, FOMS, FSS).



The number of losses will depend both on the reduction of the wage fund number of jobs. The sensitivity analysis of changes in the income of extra-budgetary funds is given in the table below.

Billions RUR		Wage Fund Reduction			
		5%	**10%**	**15%**	**20%**
Jobs Reduction	**5%**	**65,1**	97,7	130,3	162,9
	10%	97,7	**130,3**	162,9	195,4
	15%	130,3	162,9	**195,4**	228,0
	20%	162,9	195,4	228,0	**260,6**

Preliminary simulations show that the total amount of the shortfall in income will depend on the depth and duration of the crisis.



The table below presents the results of simulating the reduction in mandatory social insurance and pension contributions:

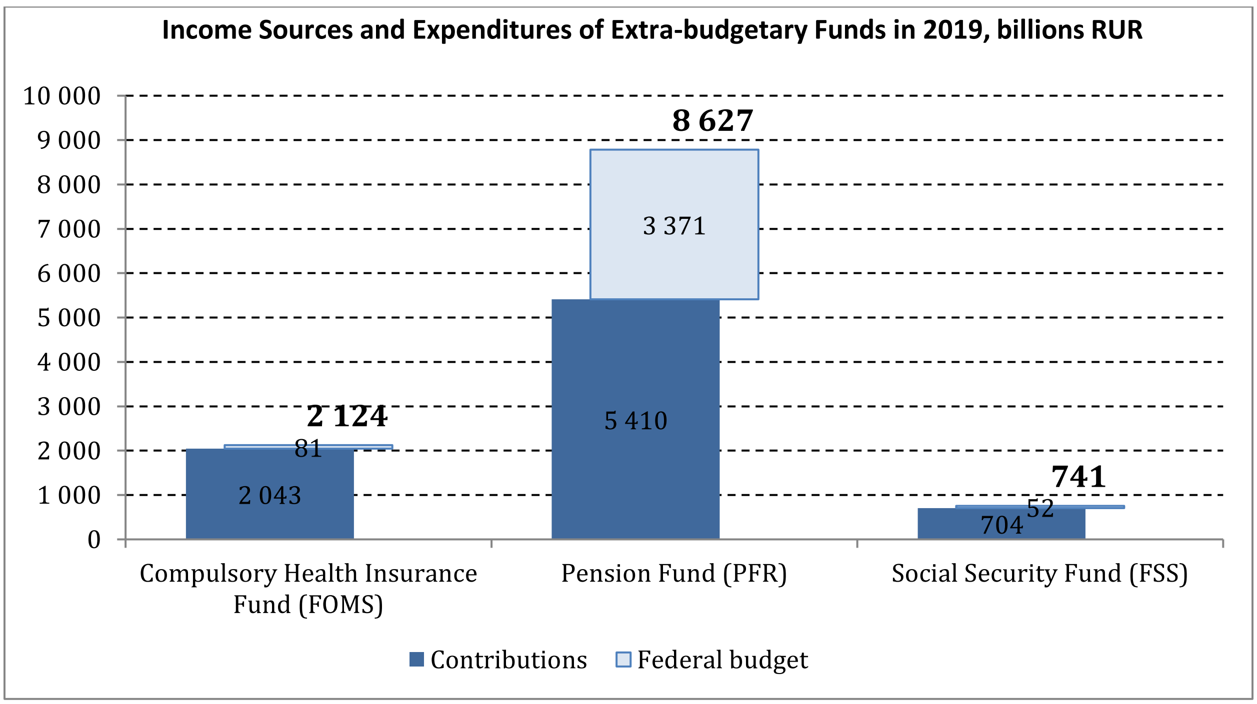
Job Cuts	**5%**	**10%**	**15%**	**20%**
Reducing the number of contributors, millions people	2,6	5,1	7,7	10,2

Decrease in Wage Fund	**5%**	**10%**	**15%**	**20%**
Reducing contributions, billions RUR	32,6	65,1	97,7	130,2

Combined Effects (Jobs/Wage Fund)	**5%/5%**	**10%/10%**	**15%/15%**	**20%/20%**
Reducing monthly contributions, billions RUR	65,1	130,2	195,3	260,4

Decrease in revenues of extra-budgetary funds, billions RUR				
Scenarios (Reduction of Jobs/Wage Fund)	**5%/5%**	**10%/10%**	**15%/15%**	**20%/20%**
Recovering in 3 months	195,4	390,8	586,3	781,7
Recovering in 6 months	390,8	781,7	1 172,5	1 563,4
Recovering in 9 months	586,3	1 172,5	1 758,8	2 345,0

The decrease in own income of extra-budgetary funds due to the reduction of mandatory contributions will require identifying additional sources to cover the shortfall in revenue in order to fulfill social obligations.



To launch an expert discussion, we suggest the following possible scenarios of compensating the income gap:

1. Using the National Welfare Fund (FNB) to cover the revenues gap of extra-budgetary funds (PFR, FOMS, FSS).

2. Issuing the Ministry of Finance bonds (earmarked or within the framework of current borrowing programs) to fund the revenues gap of extra-budgetary funds during the crisis and financing it (or its part) by increasing the transfers from the federal budget.

3. Transferring a part of extra-budgetary funds obligations to the federal budget and changing the structure of social insurance and pension contributions:
    a. Direct financing of health care expenses from the federal budget (refusing from compulsory medical insurance due to the impossibility to implement insurance principles in determining the cost of treatment):
        i. The expenditures will be equivalent up to 2 trillion rubles per year,
        ii. Decrease in the mandatory contribution rate to 5.1% of the wage fund for hired employees;
    b. Direct financing from the federal budget of the fixed part of pensions carried out by the Pension Fund of Russia:
        i. The expenditures will be equivalent up to about 2.5 trillion rubles per year (preliminary evaluations),
        ii. Decrease in the mandatory contribution rate to 7-10% of the wage fund for hired employees;
    c. The announced proposal to lower the contribution rate for small and medium-sized enterprises will require additional compensation for the revenues gap of extra-budgetary funds:
        i. Expenditures are preliminarily estimated to be up to 15 billion rubles per month or up to 90 billion rubles for 6 months.
        ii. The effectiveness of this support measure will increase while maintaining the solvent demand of the population for goods and services by small and medium-sized enterprises.

4. Additional settings of the pension system:
    a. Flexible retirement age for redundant employees. This entails an opportunity to retire earlier before reaching the mandatory retirement age. The pension benefit will be based on actually accumulated pension rights following the minimum requirements for the length of service and number of individual pension points.
        i. Applied as a compensatory mechanism instead of reducing 2 years before the mandatory retirement age under the Employment Act;
        ii. The legislation allows simplifying the procedure and reducing the time for processing of applications.

b. Lifting the "ceiling" on mandatory contributions for highly paid workers and stimulating them by providing an income tax deduction for long-term pension savings:
    i. Applying a flat rate of 22% of the total wage fund will increase mandatory contributions due to highly paid employees;
    ii. To ensure an acceptable retirement replacement rate for the employees with salaries above the average, it is necessary to implement voluntary savings programs within regulated financial institutions such as private pension funds, banks, individual investment funds, mutual funds.

5. Eliminating social insurance institutions and transferring obligations to pay pension benefits on the federal budget level seems inappropriate because these measures will require reviewing the mechanisms and principles of social assistance and change the way it operates.

From a medium-term planning perspective, we should pay attention to demographic changes that will further contribute to the growth of social commitments. Using the social assistance contribution reduction mechanism may stimulate the economic activity in the short-term, but negatively affect the financial stability of social insurance. The "demographic wave" and global trends of aging influence the growth of pension and social insurance obligations, health care and external care costs. Thus, the measures to support the economy should take into account the specifics of the social insurance system functioning and constitutional guarantees of indexation.

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Your feedbacks are welcome!

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