

CHALLENGES AND INFLUENCE OF PENSION REFORM: GEORGIAN CASE**Nika CHITISHVILI***Ivane Javakhishvili Tbilisi State University, Georgia
nikachitishvili@yahoo.com***Abstract**

The given article below illustrates changes in Georgian pension system. The article gives information about short historical review of Georgian pension scheme and also economical analyze of the new pension system, possible results and challenges that are related to the successful implementation of the project that could cause economic development and growth of well-being of pension package users.

Key words: *Ageing Pension, Economic Reforms, Georgian Economy, Pension Reform, Pension System*

JEL Classification: *H55, P11, P16*

I. INTRODUCTION

Economic policy of the pension system is one of the most important economic issues for the whole world, because of the various reasons that are related to it, such are: population ageing, significant demographic changes, sharp variations in Economical aggregates and analyzing of budget expenditures and governmental receipts. Economic reformers started thinking about creating pension system that can promote preservation and growth of pensioner's well-being in the future and also putting reform that would not cause any economic damage and make transformation process easier.

Various countries have implemented different pension reforms but most of them have chosen pension system that has several level and type of pension that are oriented on people with different age and different financial condition.

Why do we need having pension system? Pension system is a very sensitive issue for democracy and market economy. There are some important reasons why government and people as well want to have strong pension system: First of all it is social calmness. Social calmness makes possible to meet economic interests of pensioners and nowadays employees and second reason is to transfer economic well-being from generation to generation.

The research object of this article is Georgia's new pension reform, challenges and possible results of it. Talking about pension scheme change in Georgia started recently, before structure of pension system was almost unchangeable with just small increasing of pension package. The draft law about cumulative pension that was created last year means whole changing of pension system, gathering or administration of it. Taking these into consideration the new pension reform of Georgia is one of the most interesting topic to research for Georgian economists and not only for them.

II. PAST EXPERIENCE OF PENSION SYSTEM IN GEORGIA

Georgia's pension system experienced different variations during XX-XXI centuries. One of the most important one was implementing Social Pension System in 1995, which meant defining volume of pension package by contributions in the pension fund and then whole volume was divided by number of pensioners. From 2004 financing of the social programs started by general budgetary income and after that in 2006 Georgia's pension system started to be regulated by "Law of Georgia on the state pension", which illustrated specific regulations that was the main directory of giving and administrating pension.

From 2007 to 2012 pension scheme changed again. To be more obvious I want to mention that there was introduced a bit different system that implied standard pension plus bonus by length of service. Pensioners who had experience less than 5 years would get extra 2 Georgian Gel, from 5 to 15 years would get extra 4 GEL, from 15 to 25 would get 7 GEL and those who had 25 and more years length service they would get 10 Gel.

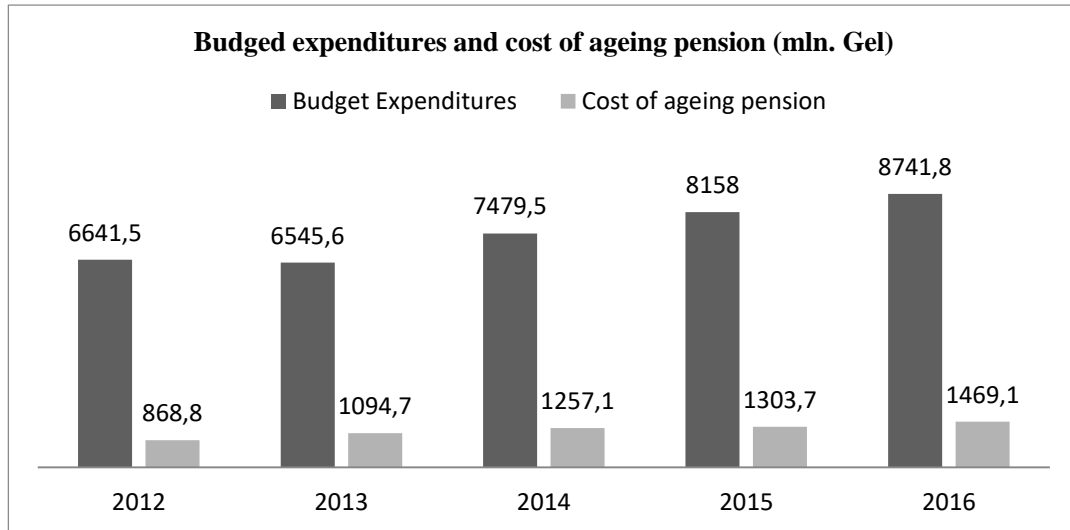
In 2012 bonus system was annulled and was combined with basic pension. Pension for people under 67 years became 110 GEL, and for elders 125. In 2013 Volume of pension became 125 and then 150 Gel, in 2015 – 160 Gel and finally 180 Gel.

To discuss Georgia's different pension packages, for economic analyze the most important one is ageing

pension, because that is a part of biggest social program with average 714 135 beneficiaries in every month. It is very easy to meet the requirements for ageing pension, for women becoming 60 years old and for men – 65 years old.

The importance of pension system is shown by competing budget expenditures and portion of budges costs on pension package.

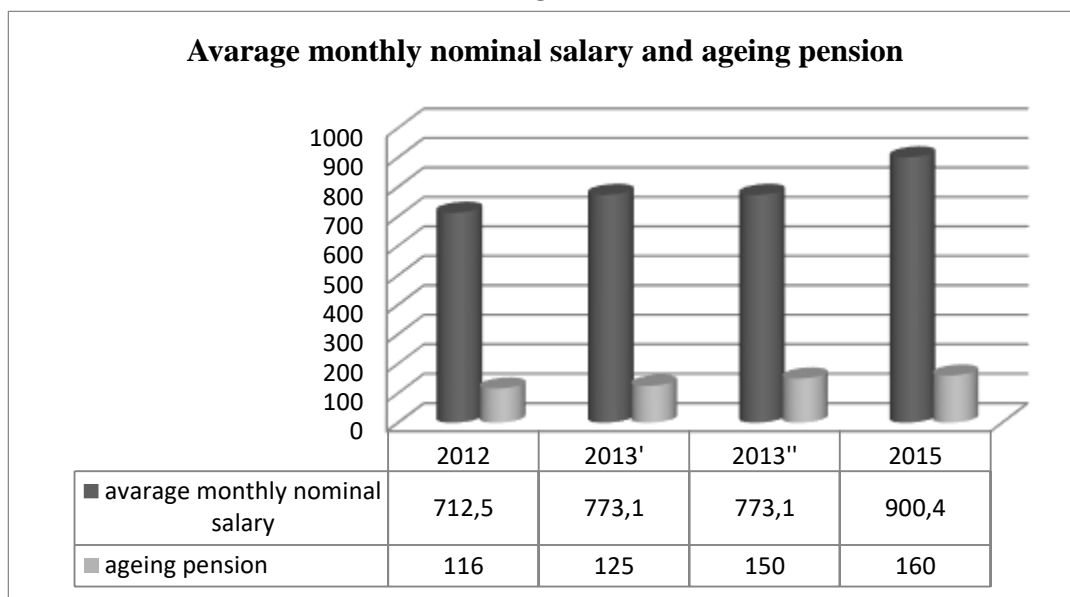
Diagram 1. Budged expenditures and cost of ageing pension (mln GEL) (Source: National Statistics Office of Georgia)



As the diagram shows, portion of ageing pension cost is from 13 per cent to 17 per cent annually, in particular in 2012 – 13.08 per cent, in 2013 16.72 per cent, in 2014 – 16.81 per cent, in 2015 – 15.98 per cent and in 2017 – 16.81 per cent.

People’s income is replaced by volume on pension when they retired, so one of the most important issues is to analyze **rate of substitution** in the other words how pension can replace the salary’s amount. The income is different for every citizens so we should discuss average salary and ageing pension competing.

Diagram 2. Average monthly nominal salary and ageing pension (Source: National Statistics Office of Georgia)



The diagram 2 illustrates that there is a sharp difference between average monthly nominal salary and ageing pension and the rate of substitution by year is:

Table 1. Substitution rate of average monthly nominal salary by ageing pension

Year	2012	2013'	2013''	2015
Substitution rate	16,28%	16,17%	19,4%	17.76%

The given information in table 1 gives opportunity to say that the past changes in pension system could not cause any significant improvements and they just provide to follow growth of average salary. If government want to implement rational economic policy it is obvious that rate of substitution has to be much higher and if it happen like that there will be a real growth of pensioner's well-being. Nowadays we see that after retirement former employee's well-being reduces more than 5 times.

The next topic I want to discuss is the ageing pension competing with the **minimum of subsistence**. As Law of Georgia on Calculation the Minimum of Subsistence teaches the minimum of subsistence means illustrating value of consumer goods on one inhabitant that gives possibility to the person to satisfy minimal physiological and social requirements with taking into consideration state's social-economic development level. Pension is the only income for the most of ageing pensioners, when the minimum of subsistence is 145 GEL in Georgia and that means that pensioners have to live on the edge of the minimum of subsistence.

Gender issues are one more interesting direction to discuss. As I've already mentioned men become pensioners at age of 65 and women at age of 60 when life expectancy for men is much lower that means that most of pension package users are women (almost 1.8 times more). Because of that regulations of existing pension system are leaded to criticism.

I also want to mention **demographic issues**. Nowadays ratio pensioners to worker is 30 per cent. Expectation proves that that would increase to 50 per cent in 2050 and it means that after 30 years 1 pensioner will be depended on 2 workers. Taking these into consideration it becomes clear that rational redistribution of the budgetary expenditures and stabilizing economic aggregates will be impossible.

The last topic I want to analyze about the old pension system is consumer price index. If we take into account inflation substitution rate will be lower and it will become obvious that employees' well-being are going to reduce too much after retirement.

III. NEW PENSION REFORM OF GEORGIA, CHALLENGES AND POSSIBLE RESULTS

In the last recent years Georgian reformers started thinking about need of important changes in the system. There are different reasons that shows need of changes and one of the most important one is Wage Replacement Amount. As the researches above illustrated rate of substitution varies around 16 per cent that means that well-being of employees reduces more than 5 times when they retire. Talking about economic reasons we should also mention poverty level and influence of pension system. Also there should be discussed budget expenditures and budget opportunity to support pension increase taking inflation into account. For instance: if pension amount does not increase proportionally of inflation real cost of pension package will be powerless to satisfy pensioner's needs, but on the other hand if pension amount increases proportionally of inflation there is fair opinion that budget will not be able to cover pension package costs.

Taking these into consideration it's obvious that the country needs the system that can redistribute obligations and the gain as well. Georgian governors introduced the project of the new system that includes fundamental changes in the pension scheme and is illustrated as a completely different side. First of all we should discuss system's structure and possibilities, then challenges and possible results that could give us opportunity to evaluate positive and negative aspects of the reform and also it will be able to discuss how the new scheme can complex arrange of problems or decline to minimum.

The cumulative pension system will be regulated by Georgian Law on Cumulative Pension.

The new law is based on cumulative contributions and is different for employees and self-employees. It is mandatory to enroll in the new pension system for employees, when self-employees have a possibility to choose if they want to enroll. There will be created individual accounts for everybody where employer will contribute 2% of the gross salary up to 60 000 Gel. There will not be transferred any per cent of income after 60 000 Gel. **The pension tax amount will be 6% of gross salary.** 2 per cent will be contributed from employee, 2 per cent from employee and 2 per cent from the government. Self-employees can contribute 4 per cent for their own, but they can even choose private insurance companies for pension insurance and do not use state service.

The government will transfer money to individual's account in this sequence: 2 per cent from gross salary up to 24 000 Gel and 1 per cent for salary between 24 000 – 60 000 Gel.

If we analyze world's different countries' experience it will be obvious that pension systems with different levels are becoming more and more popular. Georgian case means that state pension remains for every

pensioners as a same but plus there will be added benefits from cumulated resources. It will be mandatory to enroll in the pension system for people aged up to 40, and voluntary for people who are 40 or more.

After introduction of pension reform, there will be created the pension agency that will administrate whole system. The pension agency will be eligible to manage cycle of creating individual’s accounts, conclude the contracts with companies who will administrate accountings or actives. One of the important structural branch will be investment Service and of course Investment Officer. That will organize investment of annual pension fee in the different directions.

As it’s announced monthly contribution in individual account will be 6 per cent of salary and it’s divided for 3 subject: employee should pay 2 per cent from salary. For instance, if employee’s salary is 1000 GEL, after paying 20 per cent (200 GEL) of income tax he/she should pay more 2 per cent (20 GEL) for pension contribution. Also we know that another 20 Gel will be paid by government. After these there is needed more 20 GEL contribution from employer. Considering above we analyze that after reform implementation government costs will increase as well as costs of employers (If employee is public servant than also government costs will be increased). If employer paid 1000 GEL after reform there should be paid 1020 Gel, but it does not increase well-being of employee. It may cause optimizing staff and increase of unemployment moreover if we remember that government started staff optimization previous year.

As it already been mentioned The Investment Agency will manage contribution investment. Contributions will be transferred into the individual account and employee will have an opportunity to check information about his/her assets at least once in year. The Investment Agency will choose one depositary who will obliged to save assets. Specialized depositary will be chosen by competition.

As regards investment of pension assets, it should be noted that investments are made by the principles of good investment, which will ensure maximization of real returns. The basic principles that are related to good investment are as follows:

- Maximization of real profits in the long term as a result of investment of pension assets;
- Investing diversification;
- Security of Investment Assets in Long Term Investment;
- Maintaining adequate liquidity;

Pension assets can be invested both in international and local financial instruments, whether it's securities or enterprise shares, but investment portfolios are divided into 3 groups that account for portfolios according to risk. According to the draft law, investing of pension assets in the first 5 years should only be done in the investment portfolio, the limits for the lowest portfolio are as follows:

- Cash and Deposits - up to 75%;
- Debt securities - up to 100%;
- Shares of enterprises up to 20%.

As we see after the implementation of the reform, the most probable pension assets will be invested in debt securities. Investment in debt securities is directly related to the domestic debt. Domestic debt can be as profitable as harmful for the economy. The positive side can be the financial support of economic policymakers and stimulate economic growth, while negative – transferring debt to generations and the economic damage caused by this. The state receives a loan with the issuance of securities and attracts creditors with loan terms indicating both the principal amount and the interest rate.

In the process of analyzing the new Pension Scheme, we should consider the state debt to answer the following questions: Will the increase of domestic debt by the State cause the increase of the taxes needed to secure debt in the future? Of course, it is difficult to answer, though it might be considered as one of the risk factors for the introduction of the reform.

How will pensions be issued in the future? The Agency does not issue pensions jointly. The pension will be paid according to the years of pension acceptance i.e. the life expectancy of pensioners should be taken into consideration. According to the data of the National Statistics Office of Georgia by years, life in Georgia is as follows:

Table N2 Life expectancy duration (Source: National Statistics Office of Georgia)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Both	75,1	74,2	73,6	74,4	74,5	74,7	75,2	72,9	72,9	72,7
Man	70,5	69,3	69,2	70,0	70,2	70,2	70,8	68,6	68,6	68,3
Woman	79,4	79,0	77,7	78,7	78,6	79,0	79,4	77,2	77,2	77,2

As we see the expected life expectancy for women is about 77 years old, and for males 68 years. According to the new pension scheme age pension is unchanged, that is, women are from the age of 60, and men receive pensions from the age of 65. On the basis of the above analysis, it is clear that women uses pension package for average 17 years and men for 3 years. A new pension scheme is a bit difficult to be accepted by population, because for instance for men who have been using the pension package for a period of three years, it may not be acceptable for additional deductions from salaries and a further decrease in the rate of revenue. At the same time, women are expected to have a much lower pension package and may not even make any difference in comparison with state.

The next issue that I consider is crucial to the impact of the savings and inflation. Let's say conditionally, the salary of the employee is 1,000 GEL per month and the salary increase is expected to be 5% per year. Therefore, if we donate 2% of the contribution every month means that 200 GEL for the first year of our salaries, and then 5% more will be transferred to the pension fund. Conventionally, the male is accumulated pension system at the age of 40 and hence retires at age 65. If the continuation of an annual contribution will be made In accordance with the rules, the pension account will be accrued to 11 455 GEL before the pension is paid. If we exceed the expectation of the life expectancy of men, we will recall that it is 3 years old, with a state pension of 3818 lari per year, and 318 lari per month. This will be added to the employer and the state by 2-2 percent of the year and 954 GEL will be added. If the state pension is 180 GEL, the age pensioner will receive a pension of 1134 GEL. If our conditional assumption is taken into consideration by 5% of the wage annually and we will have the appropriate contribution, the pensioner for example during the retirement age will receive a monthly salary of 1134. The salaries will be 3225 GEL before his salary is pensioned. The replacement coefficient is about 35%. As we look at everything, and if the contribution is implemented, when the employee reduces income, the state and employer strives to increase the salaries of the salary pension coefficient by 35%, which is actually only two times more than the current replacement coefficient. Considering the economy of our country and taking into consideration that it is difficult to foresee future inflation and allow it to be 4.5% inflation, as a result, the pension package will be reduced further.

IV. CONCLUSION

The necessity of Georgia's new pension reform is evident, as the existing pension system is characterized by failures in different directions. First of all, the current scheme does not guarantee the level of living and welfare of retirees.

Second and important is budgetary expenditures. In the case of maintaining the existing pension system, there may be two risks: pensions remain unchanged, which, in fact, reduce the real value of pensions in the future so that it will be impossible to satisfy the needs of pensioners with a similar pension package or increase pensions, which is almost impossible, because the share of pension expenditures are increasingly growing.

The fact is that pension reform is necessary for the economic development of the country, but how the new pension system is the issue of a positive effect on the country and society. As noted above, the new pension system implies maintenance of state pensions and involvement in additional compulsory accumulation systems. The monthly contribution to accumulated pensions is 6 percent of the salary, which is equally divided into three parts (State, employer, employee).

The accumulated pension is voluntary for self-employed people, which I think creates unequal situation for people of different professions. In addition, in case of voluntary self-employed may refuse to participate in the state pension system to submit private pension funds.

One of the important thing is public participation, for example, one of Europe's most successful and popular pension model, the Polish pension system's success, first of all, was based on the population's readiness and support, which is also important for our country, but most of Georgian population have little information about the new pension system and its benefits.

One of the challenges is the gender issue. Although a variety of European countries has already have ageing pensions for women over 60 and for men over 65 years of age., I think, for our Georgia it's needed to be double-checked how effective the decision is, because both sexes are in inequal situation: men, who receive higher pensions, but considering the life expectancy only for 3 years and than women who receive less pension, but will use it an average of 17 years.

Also, inflation is also important. Since the main essence of the reform is the pensioners' pension package, which will allow the adequate provision of the needs, however, the analysis showed that in case of conditional assumptions, the pension scheme will not be able to replace the salaries properly and solve all issues.

Overall, it should be noted that it is difficult to calculate the concrete outcome that may lead to reform, but once again we should recall that the pension reform is a necessary precondition for the right economic

policies. The formation of a rational economic policy without the change of the pension system is in fact impossible, therefore, it is important that the conductors of economic policy to properly evaluate all the positive and negative sides that could lead to a new pension reform. It is necessary to inform the population and involve them in the process of implementing reforms in order to make the necessary steps to improve the pension scheme. Based on past experiences, the trust of the population in relation to the use of pensions or other accumulated systems towards the state is very small. In addition, it is noteworthy that statements not to be compromised to understand the essence of the reform. It is impossible to investigate exact calculations of how much the average wage replacement coefficient will be, however, on the basis of various assumptions, economists have the opportunity to reflect a general picture that could be characterized by the introduction of a new pension system in the country.

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