

PENSION REFORM IN GEORGIA

Shota VESHAPIDZE*Ivane Javakhishvili Tbilisi State University, Georgia
shota46@yahoo.com***Shota KARALASHVILI***Ivane Javakhishvili Tbilisi State University, Georgia
shotakaralashvili@yahoo.com***Abstract**

The existing financial, demographic and economic challenges have determined the establishment of a new pension system in Georgia. We must mention the fact that receiving a decent pension from the budget of the country is neither effective nor fair. The system of accumulative pensions has been introduced successfully in Europe and other developed countries. As the system of accumulative pension is being adopted in Georgia, it is desirable to consider advanced experiences.

According the above mentioned process, the most important is to be focused on the following issues: strengthening consent principle, keeping the appropriate growth and development of the economy, protection of currency exchange rate from sharp fluctuations, avoiding high inflation process, introduction of compulsory indexing of accumulated pensions, in order to avoid corrupt manifestation, keep forming effective guaranteed mechanisms for its protection and also in order to increase level of public confidence, strengthen public awareness campaigns.

Keywords: *Pension system, reform, prediction, risk, consentaneity, pension age, pension fund.*

JEL Classification: *H50, H53, H55*

I. INTRODUCTION

A long time ago developed countries of the modern world realized the need for reform of the pension system, which would be adequate for the existing financial, demographic and economic challenges of the civilized world. From the middle of the 90s of the last century, the agenda of urgent reform of pension systems took place in Georgia. The background of the process was increasing number of population and aging, life expectancy, the increasing financial crisis and the reduction of working labor force.

In 1994, the first publication under the auspices of the World Bank, responded to the mentioned issue. With this document, the World Bank confirmed that the problem was quite difficult, risk factors related to pension provision were complex, and replacement process of existing system with new ones was urgently necessary. Today's pension system consists of two, uneven part:

1. State pension system – in this case, fixed pensions are issued from the state budget;
2. Non-state (private) pension system - it has a small part of the whole market and does not possess necessary legislative basis for operation. We must also underline the fact that the most of the Georgian population has no income to start thinking about the private pension system. That is why the mentioned issue is at the initial stage of development.

II. GENERAL ANALYSIS

Macroeconomic indicators of the country, priorities of budgetary policy and dynamics of demographic picture indicate that social commitments are the most serious problems for economy and budgetary resources of Georgia. According to the statistical data of 2008-2015 years, the share of current social expenditures of budget is quite high. However, this indicator has increased especially in recent years. In 2013-2015 years the social spending was almost equal to the third of total expenses.

In addition, in 2015, the largest portion of budget social expenditures - 1 390 billion GEL was spent on pensions. Neither 2016 year was an exception and the third -3.150 billion GEL of the total budget expenditures - 8.741 billion GEL was spent on social security.

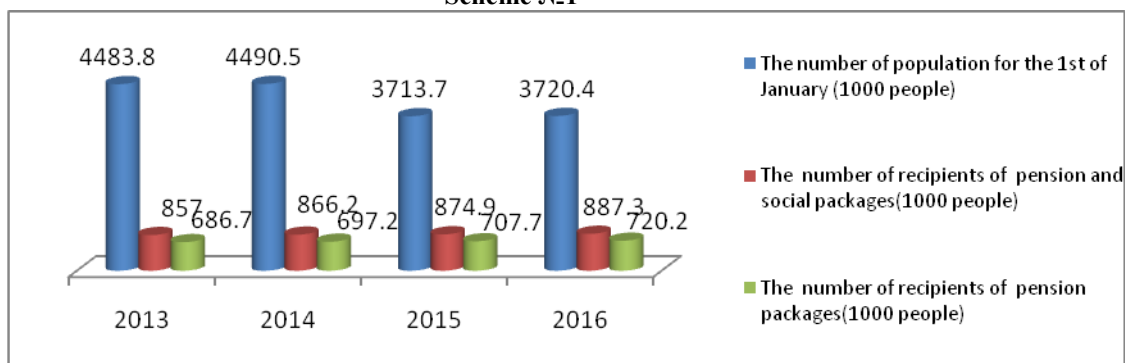
The scheme №1 shows us clearly existing demographic image of the country. In 2013-2016, we can see a decreasing tendency of population. In addition, the number of recipients of the pension and social packages is increasing. That number is an absolute majority of pension package recipients.

This fact indicates that the nation is characterized by an aging tendency and budgetary expenditures which are directed to finance the pension package In the nearest future will be significantly increased. Our discussion is

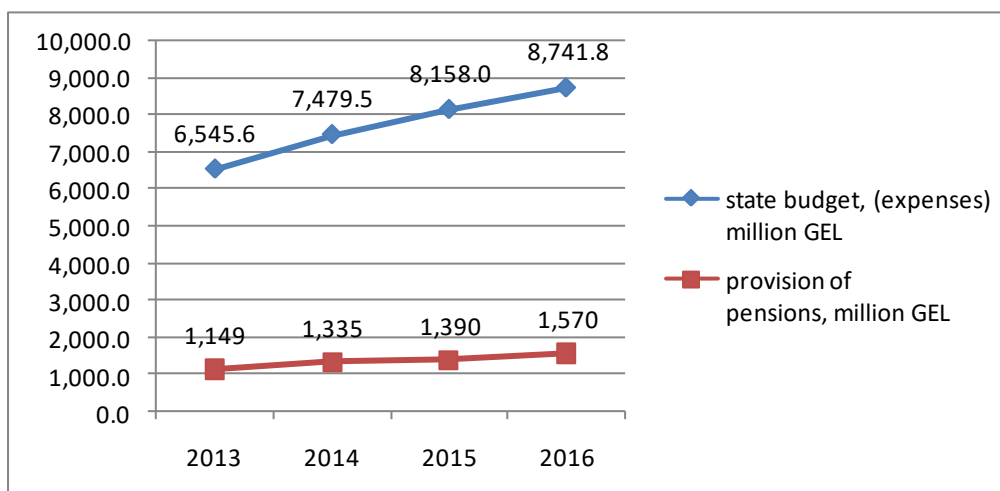
also based on the current experience, which is reflected on scheme №2. Here we can see that more than 17% of annual budget expenditures are spent only on pensions.

The analysis of European experience clearly shows us that the pension system is quite complex. It is maximally focused on the individual's interests. Regardless of the status it does not leave any of its own citizens, without decent pension provision. The system allows every individual dispose of his/her own savings according to his/her will and engages in the subdivision of the foundation which is more convenient for him/her.

Scheme №1⁴



Scheme №2⁵



As for voluntary additional pension schemes, in this case, the state maximally promotes individuals to have motivation and apply to the pension private financing system. According to the above mentioned, for Georgia it is quite difficult to move to the European model of pension provision. Though we must say Georgian government has taken a bold step and announced introduction of a new pension system. The fact is undoubtedly timely and necessary for the further development of the country.

Statistical evidence also confirms the mentioned facts. Nevertheless, the issue requires a lot of caution. As in 2016, the population of the country was 3.720 million and more than 720,000 pensioners were receiving pensions, under these circumstances, the pension reform process can become a trap for any government. Therefore, it is necessary to be focused on the factors, which we will talk below. We consider that their exclusion will contribute to the successful implementation of the reform process.

The reform, which is planned to be implemented, is as follows: every month, employees will pay 2 percent of their existing salary to the Pension Fund. At the same time to the employee's benefit, the employer will pay the same amount to the Pension Fund. According this system, the state will also make a 2 percent contribution to the employee's benefit. The state provides with the accumulation process of the funds. And finally the state will pay pensions from the mentioned fund. On the one hand it is perfect that we use the European experience, but as we know, the medal always has the other side. Here we have a question: due to the

⁴ National Statistics Office of Georgia - http://www.geostat.ge/?action=page&p_id=199&lang=geo , http://www.geostat.ge/?action=page&p_id=151&lang=geo

⁵ Ministry of finance of Georgia - http://mof.ge/saxelmwifo_finansebis_statistika

existing economic situation in Georgia, is it appropriate time to carry out this pension reform process and is it correctly adjusted to the existing reality?

Initiated by the government, the new pension reform has resulted quite skeptical assessments. Maybe this is not baseless. Here are some risk factors, which may determine radically different results for the "triumvirate" idea. The first factor is: will the employer really pay 2% from his/her own pocket to employee's benefit, or he will pay the mentioned 2% from employee's salary or simply from our own money. This approach is based on vicious attitude existing between employee and employer, which is characteristic of Georgian reality. On the one hand, in order not to lose his job an employee prefers to agree with the employer to deduct 2% the contribution from his own salary. On the other hand, if the first model is not acceptable for the employee, in order not to decrease his own revenue, the mentioned employer will increase prices adequately for goods or services created by a particular business.

The second important issue is consentaneity. This considers the following: the employee must have ability to join or choose a new pension system or remain on the existing one. He must make a choice under his own will. But in this case the reform loses its goal. The reason of above mentioned fact is the bitter experience of the population in the 90s, when they have lost huge amounts of money in similar funds. The new project also discusses and emphasizes the results of consentaneity. Even developed countries consider consentaneity as one of the most problematic issues of voluntary principles.

The mentioned provision underlines the importance of consentaneity and at the same time makes it doubtful. According to the regulations of the new pension system, individuals under the age of 40 must be involved in the new pension system. As for people over the age of 40 years, they will join the system in accordance with their wishes.

The issue of volunteerism is more effective, as the target group of the reform does not represent individuals who will be able to make contributions less than 20 years. In Estonia we can see an analogue of the mandatory funded pension scheme (Georgian government has chosen Estonian model for the economic development of the country). There is a mandatory requirement for persons born after 1983. They must be registered in the pension scheme and as for people born before 1983 the same registration process depends on their will.

This discussion is based on the record of the reform project, on the basis of which, at the retirement moment of employed women (pension age 60 years) is predicted relatively low replacement coefficient. The duration and contribution of women's employment period is less than men's (pension age 65). Motivated on value rising of the assets in the investment portfolio, it also underlines the significance of pension age women stay in work force. Of course, this fact creates some awkwardness and makes individual to face dilemma: get deserved pension and dispose of savings at discretion, or continue to work and get a better benefit offered by system and get retired after age of 70 years. Considering that the average life expectancy in Georgia is 72 years, the individual should make a choice himself; he must decide which "Proposed Perspective" is profitable for him. Not only are these aspects of voluntary reliability ambiguous. If we put the question: what will be if the certain old member decides to leave the system?! In this case, we have a very clear answer. The person should be maximally restricted to receiving early payment and only in case of special necessity; it will be possible to withdraw a portion of the assets, without penalty sanction. And this part also arises the following question: whether the fear of penalty sanctions makes or not individual's free choice be dependant on this system?! Only future can show us the results.

According to above mentioned reasons it will be hard to convince people to trust the new pension system. Considering the economic indicators in the existing project, the predictions are quite optimistic. At that time when individuals have a retirement age and as it is designed it will be at least 20 years later, it is hard to predict what kind of purchasing power you will have the mentioned accumulated money.

This approach based on current economical situation of Georgia, where the course of national currency GEL is not stable and is sensitive to any external or internal effects. The main reason for this is that the country does not have a strong economical situation. And the main problem is the following: though the mentioned project somehow considers the protection of savings against investment risks, it does not give any guarantee that the deposits of individuals will be protected and the adequate benefit will be made at the required and previously predicted time.

One more important issue is whether the country is ready to implement mentioned changes according the new reform?! Is not it unadvised action? In response to this, by our opinion, we can say that it is very unadvised and prompt action to implement such kind of reforms. We have already discussed the reasons for that. In addition the business of sector Georgia is not developed enough, not to find ways to avoid taxes. The country is not ready yet to do business and at the same time take into account the interests of the employee and therefore the state. Even if it is not so and if these contributions are equally binding for all, then it will determine the need of a new tax establishment. According to the constitution of Georgia (article 94-4): "Introduction of a new type of state tax, except for excise or common tax, may increase the upper threshold of the existing rate through the referendum, except for the cases envisaged by the Organic Law." The mentioned fact will make implementation

of reform process more complicated. The reform process needs to hold some kinds of events to ensure people, that they can trust their state.

But it can not happen if the economy is not developed enough, and in reality people must feel the consequences of this development when we copy and act according to European experiences and when we use European approaches, we must release that these issues must be in accordance to Georgian reality. We can discuss one simple example: The existing payroll system in Europe, gives opportunity to employee to take care of tomorrow even today. In our country the payroll system has not defined the minimum wage, though the officially declared minimum wage is quite far from reality. In these conditions it is unreal to invite employee to take care of tomorrow.

III. CONCLUSION

Therefore, the most important is to create an appropriate environment for this reform. And then the existing barriers to its introduction will only be technical issues. In addition, we will be able to use and copy the Estonian experience and introduce a voluntary additional pension scheme along with the new pension system, which will significantly lessen the budget.

It is also necessary to encourage people be motivated and have a will to buy a private pension policy. Here also the Estonian model will help us impose tax benefits for the people who decide to purchase private pension policies:

1. The contributions paid to the Private Pension Fund will be deducted from taxable income (maximum 15% of average annual income)
2. Income from private pension fund will be paid only once and only 10% of preferential income rate will be taxed instead of 21% of income rate.

If at pension age, revenues received from private pension fund, will be paid monthly or quarterly, then they are free of income tax. All the above issues show that, in order to minimize probability of possible negative effects, we need to make more profound analysis of the possibilities and risks. Here are the main threats, which can hinder not only the Estonian experience, but they may prevent a new reform process. Any reform is associated with certain fears and skepticism from the population. In regard to this, it is desirable to take into consideration the recommendations. After solving these issues, individuals will have more reckoning with new reforms and will have the feeling that they are appreciated and protected by the state; however, the government will reduce the risks that may lead to the collapse of reforms initiated by him; the latter is not in the interest of either party.

IV. REFERENCES

1. Silagadze, A. (2002). Issues of sustainable pension systems: international trends and Georgian reality. TSU Works, Series "Economics", №1-2, p.28-39. Tb.
2. Silagadze, A., Basilia, T., Chikvaidze, T. (2001). Post-socialist transformation: the Georgian economy on the eve of the XXI century. "Ardana", Tbilisi. 544 p.
3. Silagadze, A., Tvalchrelidze, A., Keshelashvili, G., Gegia, D. (2011). Social-Economic Development Program of Georgia. "Nekeri", page 312.
4. Silagadze, A.(2017). Post-Soviet „Paradoxes” of Unemployment Rate. Bull. Georg. Natl. Acad.Sci, Vol. 11. Issue 1, pp. 136-140.
5. Silagadze, A.(2016). Georgia’s Economy against the Background of the Associate Agreement with the European Union).International Journal of Business and Management Studies. Vol. 5. №2, pp.533-540. (C./A.: 1). (USA).
6. Silagadze, A., Gelashvili, S. (2008). Die Entviklung der Finanzpolitik in Georgien”– Nachhatige Finanz-und Sozialpolitik in Georgien. UniversitätPostdam (Deutschland).S.69-78.
7. Silagadze A., Zubiashvili, T. (2015). Parameters of the European Union and the Post-Soviet Georgia’s Economy. Refereed International Journal of Multidisciplinary Thought (IJMT), Vol. 5, No 3. USA. pp. 441-447. <http://www.universitypublications.net/ijmt/0503/pdf/V5G39.pdf>
8. Veshapidze, Sh., Sichinava, A. (2015). Modern Economic Models: Values, Achievements, Peculiarities. Tbilisi.
9. Sh. Veshapidze, Sh. (2013). European Values for Georgia. Tbilisi. http://www.eprc.ge/admin/editor/uploads/files/sapensio%20reporma_WEB_2.pdf
10. Zubiashvili, T. Aspects of Post-Soviet Economy Against the Background of the Associate Agreement with the European Union. Refereed International Journal Ecoforum. Vol. 6. №1, 2017. <http://www.ecoforumjournal.ro/index.php/eco/article/view/560>
11. Laar, M. The Estonian Economic Miracle. <http://www.heritage.org/research/reports/2007/08/the-estonian-economic-miracle>
12. The draft law of Georgia - accumulative pension. <https://matsne.gov.ge/ka/document/view/3839800>
13. Ministry of Finance of Georgia- http://mof.ge/saxelmwifo_finansebis_statistika
14. National Statistics Office of Georgia.http://www.geostat.ge/index.php?action=page&p_id=314&lang=eng
15. National Statistics Office of Georgia.http://www.geostat.ge/index.php?action=page&p_id=200&lang=eng
16. National Statistics Office of Georgia. http://www.geostat.ge/index.php?action=page&p_id=152&lang=eng