



# Pension System – at the End of the Career Ladder

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**Abstract:** The paper represents author's research on efficiency on pension systems and effectiveness of state social care policies from the perspective of stability of life at the end of career ladder. It refers to the topic Work – Labor/Value, where former employees' rights and the impact on countries' economies are discussed. The following topics are presented: social state of the former employees in the end of their career, the structure of the pension systems, comparative analysis of different pension system models, the motivators for the state and companies, efficient model/s of pension funds, responsible authorities and beneficiaries of the system, economic and social impact, ethical standard, life-long learning. The idea of research is connected to the ongoing reform of pension system in Georgia. The author finds the topic very popular not only in Georgia, but in Europe as well. The workforce is the main pillar the country's economy and stability is based on. What does the future look like for us? Management of pension funds are tightly connected to the capital market. As the capital market strategy is being developed in parallel of pension fund scheme, it contains some uncertainty and risk of failure. Though the current system does not meet the requirements of liberal economy and it ought to be changed.

**Keywords:** Pension System, Career Ladder, Accumulative Pension Fund, Social Pension, Socially Oriented Budget, The Aggregate Replacement Ratio

**JEL codes:** G28, G23, H55.

## 1. Introduction

At the end of career ladder when we can't get enough resources by ourselves, there come the demand for additional social aid. In many countries the state has a function for either fully or partially help the people who are not able to earn income by themselves anymore. Some states do this via socially oriented budget or mutually managed accumulative pension funds. The functioning and efficiency of pension systems has been a very popular issue worldwide. Various countries made some reforms – some of them

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implemented successfully, some of them not. Nowadays Georgian pension system is under reform. We are going to instill a new system which will ease burden of tax payers to finance pensions directly from the state budget only. The new system comprises trilateral contributions from the employee, employer and the state. Based on pre-contribution system the person will be accumulating his/her own pension fund while working and earning income. The fund will be serving person at the end of his/her career ladder. The new systems contains some elements of uncertainty, inseparable fear of piloting period – the time show whether it will be successful.

## 2. Historical Preview

There are different types of pension systems in the world. I would like to outline the following ones:

- Pension System based on a Solidarity Principle – in this case the workforce (taxpayers) in the country ensures financing pensions by paying taxes. Consequently the pensions are directly financed from the state budget (EPRC, 2013: 1-33).
- Pension System based on an Accumulation Principle – this model comprises individual character of pension, the amount of pension is in correlation with contributions to pension funds and pension funds' investment strategies (EPRC, 2013: 1-33).
- Mixed Model of the Pension System – this model means collaboration with the both above mentioned models (EPRC, 2013: 1-33).

As an example of Pension System, the Georgian system will be discussed. First of all, a brief historical overview of the system in Georgia hereby. Georgia established Social Pension System in 1995. The amount of pension was depended on the annual income of the pension fund, it was divided by the quantity of pensioners. The income source for the pension fund was contributions from the companies and employees. The next reform started in 2004. Government decided to finance Social Programs from the common budget income. The state fund lost it's the only function – collecting and administering individual social tax. As a result of reorganization two new agencies were formed: Employment and Social Care Agency; and Healthcare and Social Programs Agency. By the end of 2010 the both above mentioned agencies were merged and we got new Social Service Agency, which is functioning nowadays. From 2008 the only source for the pension system is the annual state budget, declared as a law by the Parliament of Georgia. In 2010 there was a huge reform of Taxation System in Georgia, a New Tax Code was established. In the new edition Income Tax united Social Tax and other taxes in itself (MOESD, 2016: 1-38).

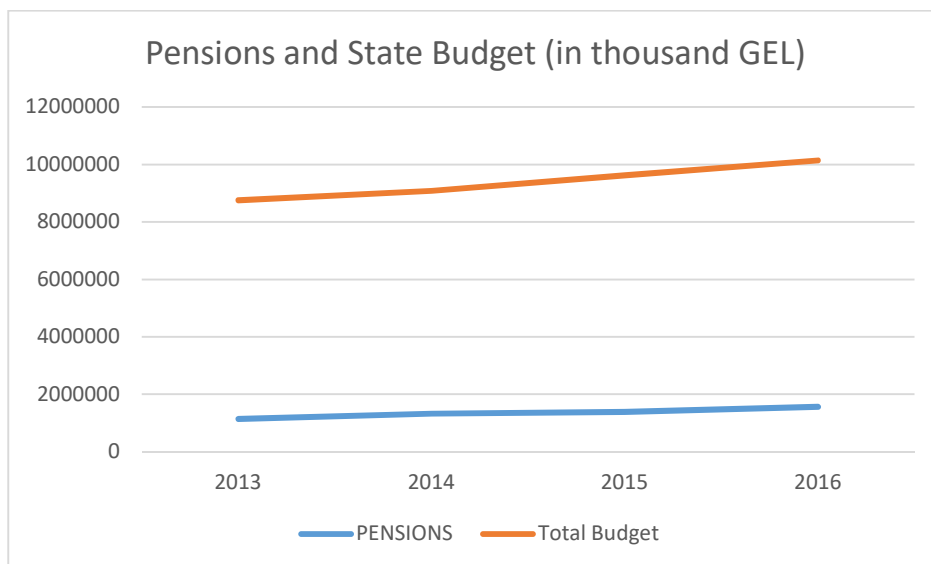
### 3. How the system works nowadays

The sole source for pensions is the state budget. Annually the Parliament passes the budget law for the next year, where all income and expenses are represented. First of all draft budget is prepared by the Ministry of Finance and submitted to the Government no later than 15<sup>th</sup> of September. The Government submits the draft budget to the Parliament no later than 1<sup>st</sup> of October. The relevant committees discuss the draft budget and in case of approval finally the Parliament passes the budget law. According to the annual budget nowadays state expenses on pensions can be divided into four main categories:

- Pension due to the age - 1303 million GEL (2015).
- Compesation to Disabled People – 167 million GEL (2015).
- State Compensation – 95 million GEL (2015).
- Compensation to families who has lost family members who had income and can't take care of themselves – 31 million GEL (2015) (MOESD, 2016: 1-38).

The following figure 1 shows the increasing trend of social expenses – pensions in the annual state budget (PG, LSB 2012-2015). As we can see in 2013 the total share of pensions in the state budget was 13.1%, in 2014 – 14.6%, in 2015 14.5% and in 2016 15.5%.

**Figure 1. The share of pensions in the state budget of Georgia**



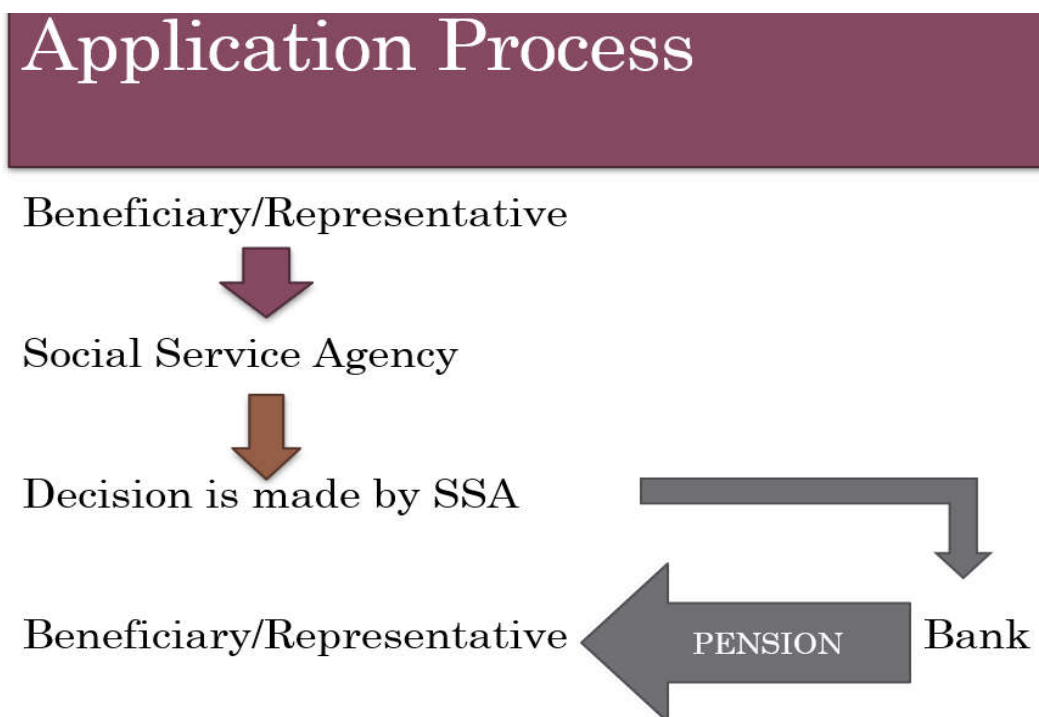
Source: Author's own elaboration based on (PG, LSB 2012-2015).

The most popular type of pension is Pension due to age. In Georgia males can get a state pension as soon as they are 65 years old. As for females this figure is less – 60. You need to be either a citizen of Georgia,

or you should have a status in Georgia, or you should have been legally on the territory of Georgia for the last 10 years by the application date (MLHSA, 2006:1-10).

The pension is administered by the LEPL Social Service Agency, which is a governmental agency under the Ministry of Labor, Health and Social Affairs of Georgia. In order to get pension one needs to apply to the agency with ID card and application form. The decision of appointment pension is made by the agency. The following figure 2 shows the structure of the whole process from applying to getting pension:

**Figure 2. The administrative procedure to get a pension**



Source: Author's own elaboration based on (MLHSA, 2006:1-10).

#### 4. Call for the reform

The need for reform has been arisen due to several reasons. The leading factor is a demographic situation in Georgia – The number for increase of old age people and decrease in fertility rate has been dramatic<sup>1</sup>. This caused decrease the number of workforce. Also migration and reducing in number of jobs influenced on a decrease of labor force. As a result a small number of employees has to finance directly

<sup>1</sup> Georgia has 164<sup>th</sup> position out of 194 countries in terms of Total Fertility Rate, 3. Economic Policy Research Centre (2013) Report on Pension Reform from Global and Georgian Perspectives p.19.

increased number of pensioners. Besides, government's obligations in terms of social pension increases annually step by step. From a long term perspective, it will be very difficult to save the current replacement ratio, not to speak about increasing it. According to the demographic analysis, by 2030 we will have 950 000 pensioners, while we had 708 000 in 2015. Also it should be mentioned that the overall census in Georgia conducted by the end of 2014 revealed that instead of 4.4 million Georgian population 3 730 thousands. The high percentage of the change bases on middle aged workforce. Nowadays the ratio Pensioners to the Workforce is 30%, by 2060 year this figure will hit up 50% which is really significant increase. That means for the next 30-40 years an average employee should bear social pension expenses for two times more pensioners than now. It will probably have a negative impact on fiscal expenses (MOESD, 2016: 1-38).

Among some national characteristics, it should be mentioned that majority of the workforce are self-employed – workers (builders), babysitters, taxi drivers, self-employed people in the farms etc. They do not actually pay income tax. According to the data 2014, out of 2.47 million people who can work (who is not pension aged) 1.73 million represented actual workforce. Out of them 1.1 million people payed an income tax but only 695 thousand people were employed more than 6 months during the year. While the quantity of beneficiaries who got social aid, disabled people's pension and compensation to families who has lost family members who had income were over 878 thousand. These figures make clear that there is a disbalance between income tax payers and pension beneficiaries (MOESD, 2016: 1-38).

The Pension due to the Age has the biggest share in the state budget social expenses. According to the last census data, 19% of Georgian population gets pension. From 2006 to 2015 the pension expenses have been increased five times from 266 million GEL to 1 303 million GEL. If the amount of pension increase in line correlation with the increase of average salary, by 2060 it will count 10% of GDP, almost 33% of the state budget. In this case the tax burden will be heavier and increased, that will probably cause some negative fiscal effects. Fiscal burden will have some negative impact on some governmental projects and obligations. One of the most spread adequacy indicator – The Aggregate Replacement Ratio<sup>2</sup> is quite low in Georgia by 2014 – 18%, while other countries having much higher figures for example Croatia – 34%, Tajikistan 39%, Luxemburg 78% etc (MOESD, 2016: 1-38).

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<sup>2</sup> The aggregate replacement ratio is gross median individual pension income of the population aged 65–74 relative to gross median individual earnings from work of the population aged 50–59, excluding other social benefits.

## 5. New Model

The necessity of new model has been a question for recent years. What will new system bring us or is it possible to move to new system quickly? The analysis of current system shows that the increase of the Aggregate Replacement Ratio is not possible while having the state budget as the sole source of financing. We ought to instill new model of pension system which will be based on contributions by the participating people and financial motivation scheme. This will become an additional source for income for the future generation pensioners (MOESD, 2016: 1-38).

New model will be based on defined contribution plan (EPRC, 2013: 1-33). According to this scheme, the amount of the savings in pension fund is depended on individual contributions, the duration of the employment and the profit of the pension fund. Moreover, the private pension system suggests more fair approach – the amount of the money which citizens will get in the future, is directly proportional to the amount of money earned during being employed and the number of years of employment. Besides, the participants of private pension system will still get social pension. Thus more adequate replacement ratio will be ensured. Taking into account Georgian social-economic environment, the monthly amount of contribution to the pension fund will be defined as 6% of the monthly salary. This 6% will be divided into three parts: employ, employer and the government – each will pay 2%. There will be no taxation for those contributions to the pension fund. Governmental agencies as well as companies will be treated equally in terms of paying 2% of salary for each employee to the pension fund (MOESD, 2016: 1-38).

The contributions from employees, companies and the government will be accumulated in non-commercial fund established by the Parliament of Georgia. (The same models is functioning in the UK – National Employment Savings Trust). The board of the fund will be completed by the professionals and will be in charge of defining investment strategy. The board will also be monitoring the asset management which will be implemented by private Asset Management Companies selected based on a fair competition. The fund will be accountable for the Parliament of Georgia (MOESD, 2016: 1-38).

The overall goals of the reform are the following:

- Better protection to the current pensioners from the poverty, keeping the purchasing level of pension.
- Providing future pensioners with the higher income, which will be is directly proportional to the amount of money earned during being employed and the profit of the pension fund.

There are some advantages and disadvantages of the new model. First of all it prompts the cooperation between private and public sector – Public Private Partnership. The state will have new opportunity to

diversify risks with help from private sector and ease the burden of social expenses on the public finance (EPRC, 2013: 1-33).

Besides creating new investing opportunities through the pension funds is a positive signal for the country. According to the international experience this is the way to encourage economic activities and ensure higher pension savings. As a rule savings create new financial resource for the economic development and decrease the dependence on external financial resources from the overseas (EPRC, 2013: 1-33).

One of the most apparent disadvantage is that the Capital Market development plan is being developed in parallel to pension reform (WB, 2016: 1-10). Capital Market in Georgia is not developed well. This reform means to accumulate quite big amount of money and submit of managing assets to the assets management companies. If the market is not developed, it includes high risks for the whole system. Red flags are outlined in terms of making profit by investing money by the fund.

Additionally there are a few tax payers in Georgia (600 000) and it is unlikely that the amount money accumulated by the pension fund will make significant changes in economic development. Moreover PMCG research director Tamar Jugheli reckons that current social-economic environment does not guarantee that the pension reform will be successful (Devdariani, 2016: 1-10).

It is important to develop several types of pension schemes. For example cops, members of parliament, disabled people without employment history etc. should belong to separate group, which will have social pension and contribution to the pension fund will be voluntary for them (Murghulia, 2013: 5-13).

## **6. Conclusion**

The necessity for the pension system reform in Georgia is obvious. Reform process is quite challenging as our economy is in still developing phase. Management of pension funds are tightly connected to the capital market. As the capital market strategy is being developed in parallel of pension fund scheme, it contains some uncertainty and risk of failure. Though the current system does not meet the requirements of liberal economy and it ought to be changed. Moving to a new system will take a long time but the shift from the old one to new one should be smooth. In this scheme there still are some holes for example the scheme is optional for employee and compulsory for the employer – some businesses may consider it like a pressure from the state. The positive signal is that the reform is being implemented with engagement of international institutions like a World Bank. We should consider the model and adapt it

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to Georgian reality so that reform be a success. Additionally, increasing awareness of Georgian population on new system is very important as it will be a determinant of their choice join or not to join the new scheme. There is a lot of to do in this direction.

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### *System emerytalny - ostatni szczebel kariery*

#### *Streszczenie*

Artykuł przedstawia badania autora na temat skuteczności systemów emerytalnych i skuteczności polityki opieki społecznej państwa w perspektywie stabilności życia po zakończeniu kariery zawodowej. Praca odnosi się do tematu wpływu systemów emerytalnych na gospodarkę krajów. W pracy przedstawiono następujące tematy: sytuację byłych pracowników pod koniec kariery zawodowej, strukturę systemów emerytalnych, analizę porównawczą różnych modeli systemów emerytalnych, efektywny model funduszy emerytalnych, uczenie się przez całe życie. Asumpt do badań stanowi trwająca reforma systemu emerytalnego w Gruzji. Według Autor wybrany temat jest bardzo popularny nie tylko w Gruzji, ale także w Europie. Według badań siła robocza jest głównym filarem gospodarki kraju oraz jego stabilności. Zarządzanie funduszami emerytalnymi jest ściśle związane z rynkiem kapitałowym. W Gruzji obecny system emerytalny nie spełnia wymogów gospodarki liberalnej i powinien zostać zmieniony. Niemniej jednak, ponieważ strategia rynku kapitałowego opracowywana jest równoległe do programu emerytalnego, to występuje pewna niepewność i ryzyko niepowodzenia.

**Słowa kluczowe:** system emerytalny, fundusz emerytalny, emerytura socjalna, budżet zorientowany na społeczeństwo, współczynnik zastąpienia.