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Challenges and Perspectives of New Pension Fund Reform in Georgia: Need or Obligation for Population?

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Abstract

As Pension fund system is a cornerstone of countries economy, policymakers across the globe are still discussing about universal effective pension fund systems and struggling to implement and fit it to the country's economy demography and financial system. From this point the main objective of this research topic was to test the effectiveness of new pension system reform in Georgia. It focuses on whether the reform will have positive effects on tackling poverty among elderly and bring to Georgian people real prosperity. The pension fund system represents the essential part of the economic policy. Moreover, it defines the social and political stability and future the development of the state economies. By other words, the simple objective of the pension system is to pay pensions to workers in their old ages and to protect elderly against the risk of poverty. As Pension fund system is a cornerstone of countries economy, policymakers across the globe are still discussing about universal effective pension fund systems and struggling to implement and fit it to the country's economy demography and financial system. From this point the main objective of this research topic was to test the effectiveness of new pension system reform in Georgia. It focuses on whether the reform will have positive effects on tackling poverty among elderly and bring to Georgian people real prosperity. Despite of the central government announcement that the new system of accumulative pension was successfully adopted in the country, there are still hot debates and discussions in Georgian society including its fairness and effectiveness, which indicates the lack their awareness and involvement in this process. Since workers aged over 40 can opt-out from the pension system, hundreds of thousands among population will remain without a decent pension in the future. This will cause massive poverty in old age. The main aim of this paper is to analyze exciting pension fund reform in order to give people a clear understanding of reform. In the presented research, there is discussed the introduction and development reform of the pension system in Georgia. International experience is also analyzed on the example of other countries, specifically Armenia, Azerbaijan Estonia and Latvia. It also discusses the characteristic aspects of the pension model introduced in Georgia. Finally, paper also include Social research specifically opinion of Georgian people about the new pension systems.

Keywords: economy, employment, government, investment, pension fund, poverty, society benefit
JEL: H55, H75, J26, J32

Introduction

It is widely accepted that the pension fund system represents the essential parts of the economic policy. Moreover, it defines the social and political stability and future development of the state economies. But in fact, the simple objective of the pension system is to pay pensions to workers in their old ages and to protect elderly people against the risk of poverty. Under Soviet Union period Georgian people lost their savings and social provisions. This event mainly caused the losing the trust in public mechanisms in Georgian society and took dramatic affect over their memories. After the declaring the independence of Georgia in 1991, the country's pension system has been reformed several times, firstly most significant was the adopting a flat rate pension in 1995, but because of severe economic crisis and conflicts inside of Georgia, it's function to tackle poverty was too low. The inefficiency of social and economic situation to ensure stable and effective social security system was the key motive need for implementing new pension system in Georgia. Starting from 2003, radical transformations were made in social policies by new government to liberate economy. Especially From 2004, the social programs have been financing from the general budget revenues. In 2007-2012 years, long service bonus was added to the pension based on years of employment years, which had a little affect in the reduction of elderly poverty. However soon Another reform took place in 2012, the pensioners stopped getting long service bonus and started receiving combined pension as a flat rate pension benefit. One of the most important reform took place in 2018, when new laws about the accumulative pension system was adopted by Parliament of Georgia in 2018. These

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laws came into force from the first of January 2019. The pension system was created to ensure people with a retirement savings that is more similar to their earnings during the active working years. The pension system based on a 2+2+2 principles. By other words, 2% of pre-tax earnings of workers are transferred to an individual retirement account by employee, employer and the government separately.
According the Hutsebaut, M. (2017) as all workers over 40 years of age would have the possibility to opt-out of the new pensions scheme, hundreds of thousands of Georgian citizens will remain without a decent pension in the future. Thus, the government proposal does nothing to alleviate the threat of massive old-age poverty. Alternatively, the Georgian government should strengthen the basic pension, and develop a second pillar of the pension system that includes two tiers: a mandatory pay as-you-go (PAYG) scheme that would deliver immediate benefits from 2020 onwards, and a funded defined-contribution scheme for workers up to the age of 50, that would increase security in the long run. Following Hutsebaut's proposal, the overwhelming majority of European pension systems have pay-as-you-go-schemes at their core. The counter-argument that PAYG is not possible in Georgia due to the challenging demographics of the country is not valid, as the new system would start from scratch. Hutsebaut stresses his attention to the status of pension system in Georgia and thinks that the current pension system is not fair and constitutes an incentive to informal work. This is due to the fact that the pension is paid out to everyone, independent of his/her employment record, residence in the country during the active life, paid taxes and level of means. It is neither means-tested, as the ILO recommends, nor based on the number of years of residence in the country as it is the case in the Netherlands, Denmark or Sweden. It does not offer the possibility of early retirement either. Instead, a second pillar of the pension system is proposed based exclusively on a hybrid semi-mandatory pension savings ("defined contribution – DC") scheme (and that in a country without an equity market!). The proposed scheme is mandatory for employees under 40 years of age from 1 July 2018. Workers over 40 years of age are auto-enrolled but had the option to opt-out during only 5 months after enrollment. Self-employed could join the scheme on a voluntary basis. The alternative of a "pay-as-you-go - PAYG" component ("defined benefit - DB" scheme), in which the contributions of the workers would fund the pensions of the future retirees, is not even discussed. Neither is there any mentioning of an eventual 3rd pillar pension (occupational or personal DC scheme). In Europe, nearly all countries have developed strong PAYG (DB) schemes, complemented by public or private DC schemes. The Georgian government is, unlike most European countries, establishing a DC savings scheme instead of a PAYG scheme.
I would agree with Hutsebauts and follow his statement that in the draft law on pension reform that was presented by the Government of Georgia on 31 October 2017, nothing is said about the strengthening the reform of the basic pension and since workers aged over 40 can opt-out, hundreds of thousands will remain without a decent pension in the future. This will cause massive poverty in old age.
The pension funds are invested within Georgia. The new law is still being hotly debated and discussed. Georgia has small economy and limited state resources. This means that the government does not have an infinite amount of money to distribute among the population. Considering level of living and employment of Georgian population and if we add ageing process and migration of workforce then we should think about the effectiveness of the accumulative pension system reform in Georgia. Analysis of budgetary spending on social security, economic indicators and demographic trends situation shows that social liability and responsibility represents one of the key challenges for economy of Georgia. The most important fact regarding the new pension scheme is to be focused on the following issues: strengthening consenting 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 the level of public confidence, strengthen public awareness campaigns.
The main purpose of the paper is to ascertain whether current pension is effective and supported by Georgian people or not. Considering into account of economic processes in Georgia, we should figure out whether the period to implement a new, modified pension system changes are proper and properly adjusted to the present reality or not. Was Georgia ready for this new reform? How will the new pension system affect economy of Georgia, employer and employee. Is it fair to all people? The main objective of the paper is also to research the existing best practice pension fund systems across the world and provide recommendation for improvement and strengthen the current pension system of Georgia. Research goals we have focused: • Demonstrate the context and purpose of the pension reform; • Analysis of international experience; • Compare different aspects of the accumulative pension system; • Determining the impact of the new pension model on employed and self-employed persons.
The Georgian government has insisted that the new system will provide pensioners with a "decent retirement", alleviate elderly poverty, and will also boost the domestic capital market, as the pension funds will be invested within Georgia. But there is uncertainty, how government intend to implement this plan when investing within Georgia is associated with high

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risk rather than investing in more developed countries' bonds or other financial instruments. To tell the truth boosting our economy by using such accumulated fund will be profitable for everyone, as for country also for society.
The main purpose of the paper is to ascertain whether current pension system is effective and supported by Georgian people or not. Considering into account economic processes in Georgia, was it proper period to implement a new pension system changes and is it properly adjusted to the present reality? Was Georgia ready for this new reform? How will the new pension system affect economy of Georgia, employers and employees. Is it fair to all people?

The main objective of the paper is to research the existing best practice pension fund systems across the world and provide recommendations for improvement and strengthen the current pension system in Georgia.

The Concept and Importance of Pension Fund Reform

The efficient pension system is the main tool through which governments ensure and maintain people's old age under an acceptable level. More specifically, according to the Andrews (Andrews, 2006), Pensions are defined as a mechanism to reduce the risks of old-age poverty and a means to smooth lifetime income and to maintain living standards in retirement. Retirement is the period of a person's life during which person is no longer working, or the commencement of that period. Retirement systems is part of a larger category, called social security. Social security is a comprehensive social welfare program of benefits, providing workers and their dependents with retirement income, disability income and other payments by utilizing the social security tax (Wang, Zhang, Shand, & Howell, 2014). (Asher, 1998) has identified the main function of a social security system is to provide to a substantial proportion of retirees with socially adequate level of replacement rate which is defined as a proportion of the last drawn salary or other similar benchmark. Analysis of exciting researches show that until the late nineteenth century there wasn't any formalized or defined Pension fund system. Basically, Families were the main source of support for the old in most European countries. People that worked in small agriculture field had ability to work until very late in life at same time they got support from their family members when their capability to work decreased. But the mass migrations to urban centers caused economic change and uncertainty that created barrier to people to plan and save for their old age. In case of losing support or help, churches and neighbors often took responsibility to provide oldster with basic support. Specifically, after the beginning of industrialization processes, people started leaving their local homelands and groups in order to move to the newly developing cities, where they had few family or social connections compared to living in local communities. People increasingly needed a safety of old age, especially protection from the risk of illness and disease. They also needed support in case of losing the family income producer, (Schwarz & Arias, 2014).
According to the Word Bank (1994) existence of pension system has three main objectives. These objectives are: firstly saving - which involves assisting people to transfer portion of salary collected during the active working period to retirement years, for saving purposes, by other words facilitating of income smoothing during the individual's lifetime. The next most important objective is to transfer their lifetime income from one individual to another, called Redistribution – without this objective the system may cause unfair redistribution of income, for example if the individual with low earrings tried to save portion of his income for retire period, they would fall in the extreme poverty during their active working years. And finally, Insurance – safety of saving in case of recession or wrong investments. Generally, it related to safety against the risks to those the old age is especially vulnerable (The World Bank, 1994).
In their research Holzmann and Hinz (2005) defines the key features of successful pension system:

- An adequate system should ensure welfare to the large majority of people in order to decrease and maintain poverty during the old-age under acceptable level;
- Within an affordable system the financing capacity of society shouldn't cause the deterioration of socio-economic environment of country;
- Within a sustainable system, it must be strong and sustainable predictable over the specified time horizon;
- A robust system - ability to avoid the risks caused from different reasons such as political, demographic or economic instability (Holzman & Hinz, 2005).

According to other researchers the most important goal of pension reform should be financial sustainability of the pension system (Figure 1.1.). Two other reform objectives with the highest priority are improved poverty alleviation and improved protection of workers against decreases in income. Development of financial markets and economic growth are lower priorities and often were treated as external to the main reform objectives (Holzmann, Orenstein, & Rutkowski, Pension Reform in Europe: Process and Progress, 2003).

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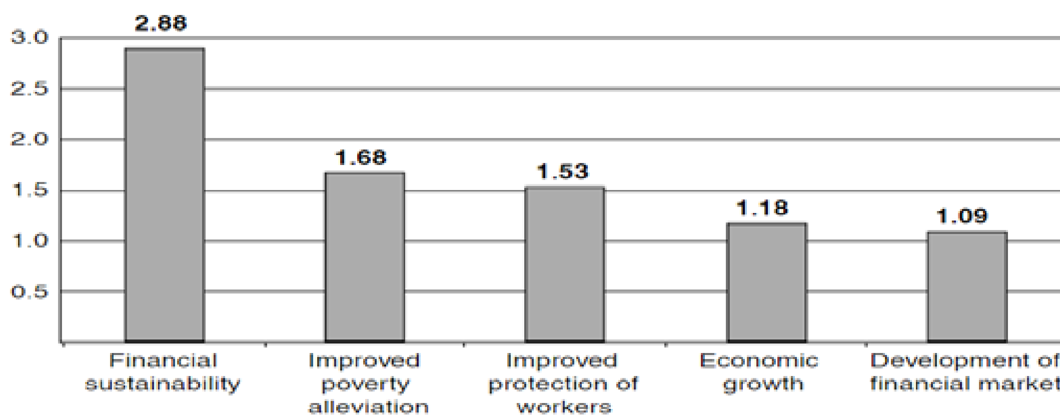

Figure 1.1. What Should Be the Main Goal of Pension Reform

Source: R. Holzmann, M.Orenstein, M.Rutkowski, Pension Reform in Europe: Process and Progress, 2003, p.137

Analysis of different researches and studies showed that current social pension systems mostly stand on systems created by Bismarck or Beveridge. In 1889, the chancellor of Germany Otto von Bismarck, was the first person who created and adopted a contributory pension scheme. According to his pension system benefits were earnings and people's profession related. The system consisted of some additional constraints and allowed to workers with incomes below a specified line, who were considered to need extra safety. On the other hand, workers with high income were supposed to have other resources and ability themselves to protect from poverty in old age. Individual got benefits after reaching the retire age and only if they maintained less than one-third of actual working capacity. Possibility of getting benefits depended on the person contributions during his active working life. At the beginning this system started to spread in central, western and northern European countries, later in southern and eastern European countries. Lord William Beveridge designed model in the first half of previous century in England. it was called Beveridge model and preceded by the setup of the pension for retirement period, due to the significant effects of classical liberalism. In comparison to Bismarck pension system, Beveridgean model, provided basic benefits to each individual, a flat-rate pension without considering of their profession and earnings during active working years. Later this system became popular and spread over in several European countries, especially in northern part of Europe. Nowadays it mostly corresponds a flat rate to Pay-as-you-go system. This system was described as a national solidarity system, managed and financed by government. State collects funds from tax payer and provides benefits to retired people. At the present, the system is developed and implemented in various ways in different country's pension systems (Terziev, 2019). In his research Hachon (2008) states that pension systems can be more Beveridgeian or more Bismarckian. A pension system is purely Beveridgeian if all individuals receive the same pension. On the other hand, a pension system is purely Bismarckian if pensions depend completely on the wages of individuals. if pension system has a Beveridgeian and a Bismarckian component it is called mixed Pension system (HACHON, 2008).

According to the World Bank, generally three main financing and managerial arrangements exists to ensure old age:

- ✓ **Public pay-as-you-go plans** – this is most accepted system, obligatory for individuals in every state. In this kind of plan responsibility is taken by government, which organizes and ensures public pensions for all individuals. it redistributes real income, both across and within generations and generally source of finances represents general state revenues.it is characterized as defined benefit model.
- ✓ **Occupational plans –** type of pension plan that is privately managed by employers. This kind of plan characterized as defined benefit or partially funded and regulated or monitored by government.
- ✓ **Personal saving and annuity plans -** fully funded or defined contribution plans. Individuals save funds during the active working years to ensure their retire age. As the benefits are not predefined, individuals hold the investment risks. Plan can be voluntary or mandatory basis (The World Bank, 1994)

Pension plan or retirement scheme can be divided into categories: ***Defined Contribution or Defined Benefit*** (Bodie, Marcus, & Merton, 1988). The Defined Contribution plan represents the easiest type of retirement plan. The employer and employee make regular contributions into the individuals' saving account. Generally, the contributions are specified and constant, defined in advance as a percentage of individuals earnings. the individuals can define according to their will the type of assets in which funds will be invested and assess the future value of investment at any time (Bodie, Marcus,

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& Merton, 1988). DC plans give employee the freedom to choose the level and allocation of their retirement savings (Gomes, Hoyemz, & Hux, 2020). Generally, contributions can be invested in long- or short-term deposits, securities, but investments have some predetermined limitations regarding to the investment options. At retirement, individuals either receives a lump sum or an annuity, the income of which depends on the collection of the funds. Therefore, the employee holds investment risk (Bodie, Marcus, & Merton, 1988).

On the one hand, in case of a defined benefit plan, formula is used to calculate and define an employee's pension benefit that considers itself individuals active working years and earnings during that period. In DB pension schemes the pension fund bears the investment risk, the longevity risk and the interest rate risk. Investment risk is the risk that the invested pension capital will be worth less than expected because of unfavorable developments in the financial markets. Longevity risk is the risk that pension participants get older than expected. We can distinguish between micro and macro longevity risk. Micro longevity risk results from non-systematic deviations from an individual expected remaining lifetime, i.e. the risk that an individual gets older or dies earlier than expected. Macro-longevity risk results from the fact that survival probabilities change over time, i.e. the risk that the total population gets older than expected. The changes in the interest rate has an unfavorable effect on the value of the pension payments (SCHUTTE, 2018).

Mostly countries have chosen a defined-benefit pension system (Nyce & Schieber, 2005). However, because of the increase in life expectancy, the fiscal burden of this structure has increased strongly. Consequently, some countries, such as Italy, have adopted a defined contribution pension system (HACHON, 2008). DC pension schemes are getting more popular since employers prefer to be exposed to less risk associated with pensions. Moreover, DC pension schemes allow for more customization and freedom of choice for pension participants, which in most cases does not hold for DB pension schemes (SCHUTTE, 2018).

In 1994 the World Bank developed **a three-pillar pension system** report (The World Bank, 1994), based on main principles and concepts. Since then, the World Bank's has mostly payed attention on create pension system designs to adapt these principles to widely varying situation and better direct the needs of various populations in order to manage the risks in old age. Based on this principles and concept created framework, by other words two additional pillars added the original concept which had only included three-pillar structure: a basic (zero) pillar and a nonfinancial (fourth) pillar. The key characteristic of the universal pension is that every single person reaching a certain old age should be ensured with a universal pension. The benefits, in this system, are increased based on specific indexation mechanism over the time period. The zero pillar systems have been implemented in the developing economies with the primary purpose to reduce poverty and provide the social security to low-income part of the population via the execution mechanisms such as conditional cash, universal and means-tested transfers (Holzmann, 2012).

In the First Pillar, the pension benefits are determined according to the person's contributions in the pension fund within the active working time period. The pension funds in this pillar are primarily functioning based on contributions from current active workers and their employers. In this way so called a pay-as-you-go (PAYG) pension system allows to provide benefits for current active pensioners. It can be underlined to the advantage of these systems that reserves can be accumulated if they are immature. However, in case of the deficit the general revenues can be added to the contributions. Generally, there are several types systems of the first system: Conventional Defined Benefit System, Basic Pension, Point System Notional Account System. (Schwarz & Arias, 2014). The First Pillar combines mandated, unfunded and DB systems. Adopting and adjusting those systems have led to various outcomes depending on the countries and economies. In OECD countries, reorganizing has been primarily characterized by the parametric nature by reduction in generosity (a lower annual accrual rate), lengthening of the assessment period at times to all contribution periods, introducing decrements for earlier and increments for later retirement and in a number of countries, an increase in the standard retirement age. Nevertheless, not in all the countries implements has it achieved the sustainability of the pillar. The practice shows that the further parametric reforms are necessary to counter the challenges related to population aging-related fiscal as well as labor market- and social policy-related incentive. The primary focus should be the political discretion that ensures the long-term solvency of pension schemes (Holzmann, 2012).

In the 2nd Pillar pension systems, the contributions normally are accumulated on savings accounts of pension funds management institutions or some financial institutions. The collected funds are invested in various financial instruments and the retirement benefits, combining the principal and the return on investment, are paid out to the beneficiaries(Schwarz & Arias, 2014). In 1981, for the first time the pension system with mandated and funded DC pillar has been successfully designed and implemented in Chile. However, despite the effectiveness of the system, only couple of countries in Europe, such as Poland, has applied the second pillars. The primary adopters, Latin American and Central and Eastern European countries, are confronted with challenges of managing the payout to the beneficiaries, despite the successfully implementing the accumulating phase of the pillar (Holzmann, 2012).

Unlike the 2nd Pillar, in case of the Third Pillar, the contributions are made on a voluntary basis instead of mandatory

one. Accordingly, the individuals can make voluntary contributions to their accounts at financial institutions and manage the accounts personally or by consulting the institution representatives (Schwarz & Arias, 2014). Adoption of this pillar has frequently occurred after the mandated second pillar. Despite the growing attention of policy makers, the concerns have been raised regarding the regulation of the schemes that appears to be the Achilles' heel of the pillar. Nevertheless, it offers a great opportunity to the individuals employed in the informal sector in low- or middle-income countries to compensate the reduced public generosity (Holzmann, 2012).

A **Multi-Pillar** pension system consists of more than one of the pillars above mentioned. While only implicit in Strategy, Averting and Perspective indicate that, when appropriately implemented, multi-pillar systems ought to offer greater retirement income security than PAYG systems by (1) earning higher rates of return from diversified investments and (2) spreading political and systemic risk between the public and private sectors. In order for the pension system to provide retirement income security, the system also has to be fiscally sustainable. Based on existing evidence, multi-pillar reforms in many countries, as implemented, have not improved old-age income security. In many cases, investments in the mandatory funded pillar are not well diversified, and instead are concentrated in government bonds. While in many cases the government bonds offer high rates of return, the high returns often reflect high levels of macroeconomic and investment risk (Holzmann, 2012). Figure 1.2. describes the overall overview of the pillars of old age.

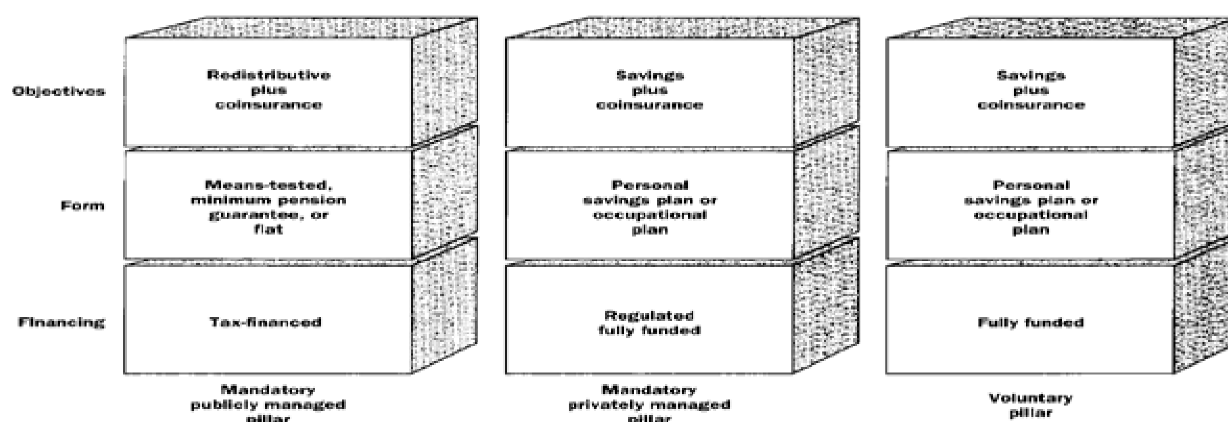

Figure 1.2. Pillars of Old Age

Source: A World Bank Policy Research Report, Averting the Old Age Crisis, 1994, p.15

According to Willmore and Bertucci (1999) the 1st pillar is noncontributory, it ensures a minimum income to all elderly with the aim of alleviating poverty. Pillar third is also contributory, but voluntary, for those who want to supplement the retirement income provided by the 1st and 2nd pillars. Most part of Pillars 1st and 3rd are not controversial. There is an agreed view that first pillar that is redistributive is best left to government, which is in a good position to finance flat, indexed pensions on a pay-as-you-go basis from general income or revenue. There is also consensus that pillar third is best managed by private institutions, with public control and limitations set to financial institutions. On the other hand, Pillar second is very controversial. some extreme liberals argue that there is not any reason at all for such a pillar, that government has no business mandating savings to provide elderly those have incomes that place them well above the poverty level (Willmore & Bertucci, 1999).

The study of the world bank (1994) also suggests that financial security for the old age and economic growth would be better if governments set three pillars to ensure old age security: a publicly managed system with mandatory involvement and the specific goal of reducing poverty among the elderly, second privately managed or mandatory savings system and finally voluntary savings. The 1st pillar is related to redistribution, while the 2nd and 3rd cover savings, and all three pillars decrease the many risks associated to old age. separating of the redistributive function from the savings one, the public pillar - and the size of the payroll tax needed to support it- can be kept relatively small, thus avoiding many of challenges related with a dominant public pillar. Covering the insurance function across all three pillars or systems offers greater income safety to the old age than confidence on any single system (The World Bank, 1994).

In his research on Public versus Private Provision of Pensions Willmore (1999) proves that the 1st pillar or system is best managed through the government, while the 3rd mostly through private markets. On the other hand, he mentions that there is no common opinion regarding the 2nd pillar. He also come to conclusion that individual/private accounts are attractive largely because they provide all savers to receive potentially equal returns. But at same time public

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systems can be changed to reach a similar equitable treatment of contributors while keeping low administrative costs and providing social insurance that is either costly or unavailable privately (Willmore & Bertucci, 1999). The Post-Soviet Union countries have gone through major changes after collapse of the centrally regulated system. Adopting market-based principles lead to row of reforms in all state sectors including economy, financial, socio-cultural, healthcare etc. Pension systems, as part of the state regulated fields, faced significant challenges since the Pay-As-You-Go (PAYG) system inherited from the Soviet Union was no more sustainable due to the demographic changes, high emigration rate and distorted labor market, reduced fertility, weak financial sector and instable economic conditions. Therefore, the necessity of reforming the existing PAYG pension systems was urgent and many countries-initiated transformations from the very beginning of their independence.

Branco et al (1998) analyzed reforms of the pension systems in the Post-Soviet Union countries. According to the study, two main types of policies have been identified to tackle the financial challenges that pension systems faced. The most common practices were reduced benefits, increased contribution rates and accumulation pension arrears. However, those measures were considered as short-term solutions to the problem and could not lead to reformation and transition to a more sustainable system. Nevertheless, there were countries that initiated systematic approach of reforming pension systems. Two major approaches were outlined in those systematic reforms: Latvian and Kazakhstan approaches. Latvian reforms assumed adopting so called *piecemeal* approach, assuming maintaining existing PAYG system and tackling short term challenges by reduced expenditure and increased revenues. However, the ultimate goal of the reform was gradually introducing funding system as well and overall establishing multipillar, balanced funded and PAYG systems in long term. Kazakhstan, on the other hand took rather radical, so called multipillar approach, introducing mandatory private pension funds and replacing existing PAYG one. In this case the fully funded pillar (first pillar) is dominant and the guaranteed minimum pension is provided by government to ensure the conditions of the poor. This approach was also referred as the Australian-Chilean pension system (Branco, 1998).

Schwarz (2014) describes the expected projections of the pension systems challenges in Eastern European and Central Asian countries. The author outlines the demographic structural changes, primarily due to the low fertility and increasing migrations and projects that future pension systems will face difficulties regarding the increasing benefits that will not be possible. Changes in demographic and economic development can be a powerful trigger in destabilizing the pension systems. The pension systems existing in the post-Soviet Union countries have reached its maturity and as described above needed urgent reformation (Schwarz & Arias, 2014).

All researchers note that Pension reforms should be administered and controlled carefully. In his paper Medici (2004) reported that pension reforms may influence the distribution of income among generations and as well as among groups in the same generation. He states that reform is much more successful in countries those have more homogeneous societies and certain groups in this country do not have a history of providing privileges. conversely, reform is slow and hard in countries with political and representative systems, those incapables to produce stable majorities in their parliaments and where traditions related with heterogeneous and segmented pension systems have created political lobbies against changes and impeded a clean political transition (Medici, 2005). In their paper "Retirement, Pension Systems and Models of Pension Systems" authors states that reforming any pension system in any country is not an easy task. Government needs to rebalance the retirement income provision in ensuring the adequacy and the sustainability of the system which also defiantly involves a long-term policy under the situation of uncertainties, But the examples of existing best practices from other countries can benefit policy makers in seeking to reform their own pension systems accordingly (Wang, Zhang, Shand, & Howell, 2014).

Analysis of researches also show that reforming of pension systems may have positive effects. Walker and Lefort (2000) notes that Pension fund reform may have significant positive direct effects on savings, growth, and welfare. In particular, they argued that pension fund reform improves macroeconomic stability by eliminating the political and demographic pressures that threaten the financial stability of the standard (Walker & Lefort, 2000).

Valdés and Cifuentes (1990) developed the concept, which may be particularly important in emerging markets. They argue that the accumulation of relatively large amounts of investable wealth by pension funds induces the authorities to provide and private sector participants to develop financial instruments for pension funds to invest in "pay-as-you-go" systems, and inducing fiscal reform during the transition. conversely, this process improves transparency in terms of fund management and financial market practices. But, the shift from a PAYG system to a funded system carries a transition risks or burden. When the PAYG system was introduced, the first generation of retirees received a pension benefit without ever having paid for it (Corsetti & Hebbel , 1995).

Challenges of Existing Pension System

Until 2019, Georgia had a universal old-age pension system that serves as poverty alleviation function in old age. It was

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a non-contributory pension model, which ensures a flat rate benefit to individuals of eligible age. The state guaranties the pension to all Georgian citizens who reached the official retirement age – 60 years for women and 65 years for men. As mentioned above, typically this public pension scheme is based on the idea, where current working individuals contribute a share of t51heir income to a pension fund which in turn distributes the funds to pensioners. In Georgian case before the reform the pension systems were financed by payroll taxes ***on a pay-as-you-go (PAYG)*** basis which current workers were taxed in order to benefit existing individuals or pensioner. The main goal of system is to reduce poverty and provide people with income in old age.
Research was conducted by the International Labor Office on poverty in Georgia showed that increase in financing of retired people by 100 Georgian Lari can decrease poverty by 18% (Table 1.1.). The effect of this increase is considerable in rural territories. According to World Bank analysis in 2010 growth of pension by twenty Georgian Lari caused decline of poverty rates by 2.8%. as a result, this fact indicates universal pension system has significant role on poverty reduction. The increase in the basic pension over the period 2012-2016 can be explained by the political will to bring it above the level of the subsistence minimum (Figure 1.3.).

Table 1.1. Analysis of Poverty Rate in Georgia

	Increase by 100 GEL	Without increase
Overall poverty	22.9	38.1
Urban	17.7	29.5
Rural	28.2	46.9

Source: M. Abels Universal old-age pensions in Georgia, 2016 p. 3

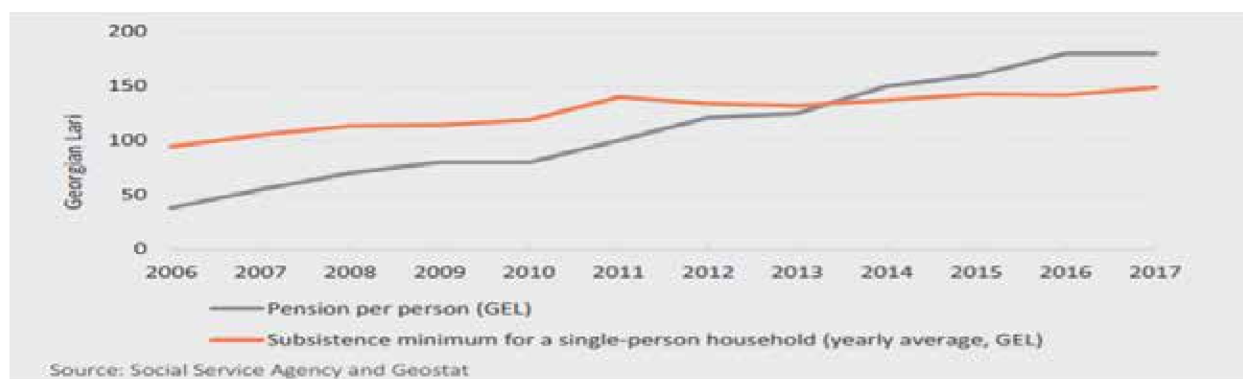

Figure 1.3. Trends in Old-Age Pension and Subsistence Minimum, 2006-2017

Source: Social Service agency and National Statistics Office of Georgia (GEOSTAT).

Macroeconomic Indicators
Despite of recent improvement of dynamics of demographic environment, macroeconomic parameters and budgetary concepts in Georgia, social obligation is still stay key challenge for total economy and state budget. data of 2008-2019 years shows that the portion of expenditure was spent on social liabilities from the state budget had been characterized by increasing tendency. Since 2012, the Georgian government has increased spending on social provisions, including basic pension, state compensation, social assistance programs, healthcare, etc. In 2013, the total spending on social provisions accounted for about 29 percent of the state budget total expenditure (Figure 1.4.). The largest component of the social provision spending is the basic pension, which accounted for 53 percent of the total social provisions budget expenditure in 2013. The primary factor in this increase was the old-age pension, which accounted for over 15 percent of the total state budget expenditures. This economic measure has raised for last years. It’s clear that in 2014-2019, the

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social expenditure increased dramatically and exceeded more than the third of total expenses. Moreover, in 2013-2019 years, share of old-age pensions expense in the state budget equals 15% on average. This might be caused by increased tendency of pension amount and number of pensioners in the country in the same years (Figure 1.5.). Analysis of old-age pensions also shows that in 2008-2013, share of old-age pensions expense in social provision fluctuates between 39% and 53% ranges (Figure 1.6.). Total Expenditure of old-age pensions was increased dramatically from 509.4 million Gel to 1,824.0 million Gel in 2008-2019 (Figure 1.7.). All This fact indicates that the nation was characterized by increasing tendency of budgetary expenditures which are directed to finance the pension package.

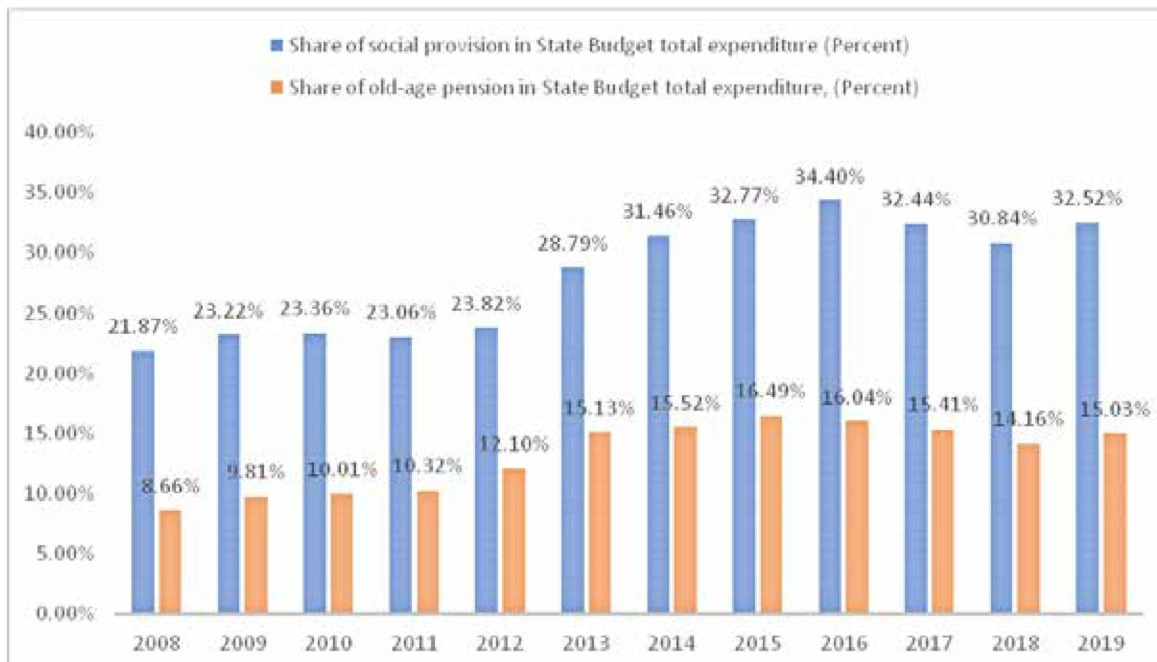

Figure 1.4. Share of Social Provision and Old-Age Pension in State Budget

Source: Personal Research for the Thesis. Data from Social Service agency and National Statistics Office of Georgia (GEOSTAT)

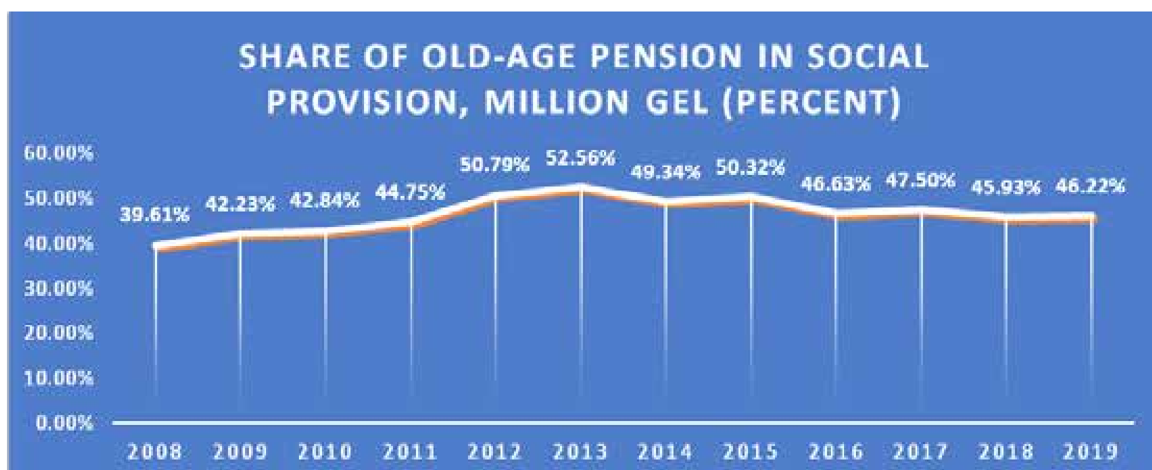

Figure 1.5. Share of Old-age pension in Social Provision

Source: Personal Research for the Thesis. Data from Social Service agency and National Statistics Office of Georgia (GEOSTAT)

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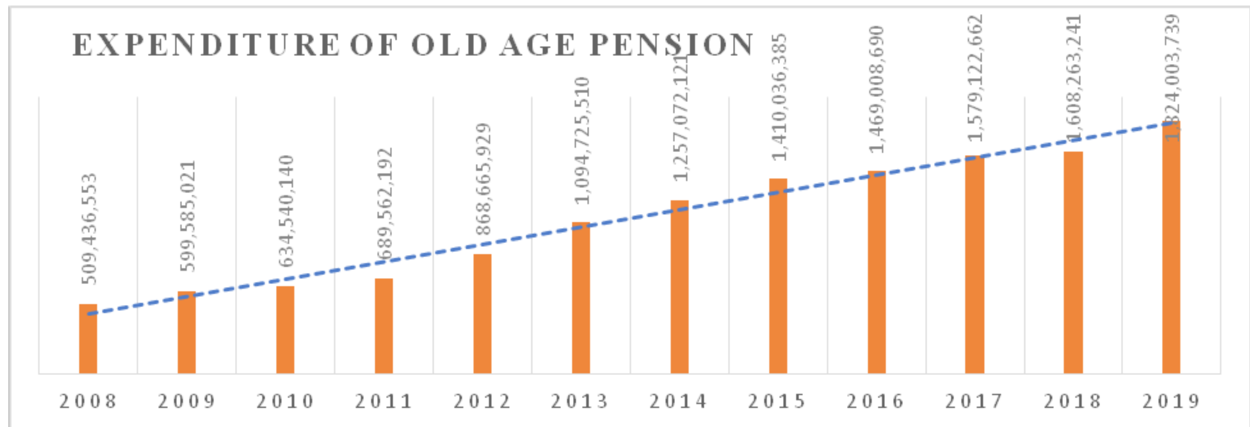

Figure 1.6. Expenditure of Old Age Pension

Source: Personal Research for the Paper. Data from Social Service agency

Social pension recipients represent 20 percent of the total population of Georgia in 2019, which is one of the highest percentages compared to previous years (Figure 1.7.). According to report provided by Georgian official growth dynamic of Social pension recipients will be maintained in the future too (Figure 1.8.). it is estimated to increase in the next 10 years and will reach 950 thousand by 2030, meaning that the elderly make up over a quarter of total population. This constitutes the raising tendency in the number of old-age social pension recipients in short-term period.

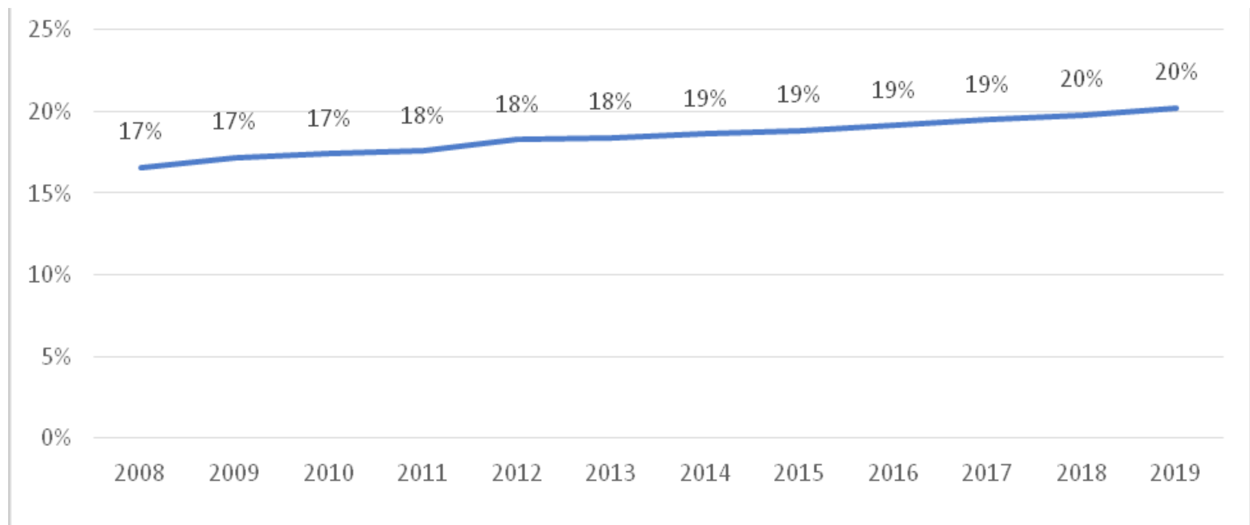

Figure 1.7. Share of Pensioners in Total Population

Source: Personal Research for the Thesis. Data from Social Service agency and National Statistics Office of Georgia (GEOSTAT)

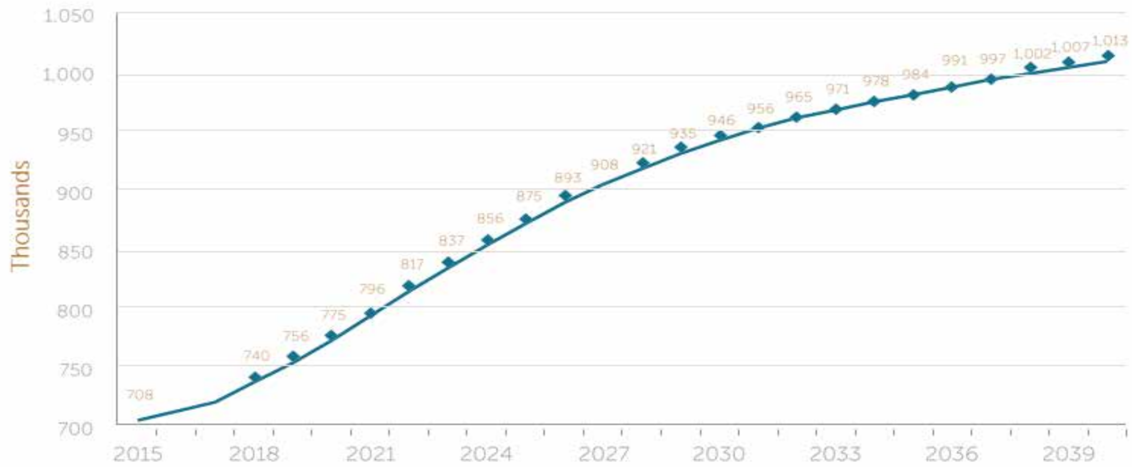

Figure 1.8. Growth Dynamic for Social Pension Recipients (2015-2039)

Source: Ministry of Economy and Sustainable Development of Georgia, 2016, p.13

According to World Bank research (2014, THE INVERTING PYRAMID) Georgia is expected sharp fall in active workforce. According to report decline in active workforce is mainly caused a sharp fall of fertility especially in transition countries for 20 years. Figure 1.4-9 describes the decline in the number of children below the age of five between 1970 and 2010. On the other hand, countries with the high-income has experienced slight volatility, while the other three groups experienced significant and stable fertility decline.

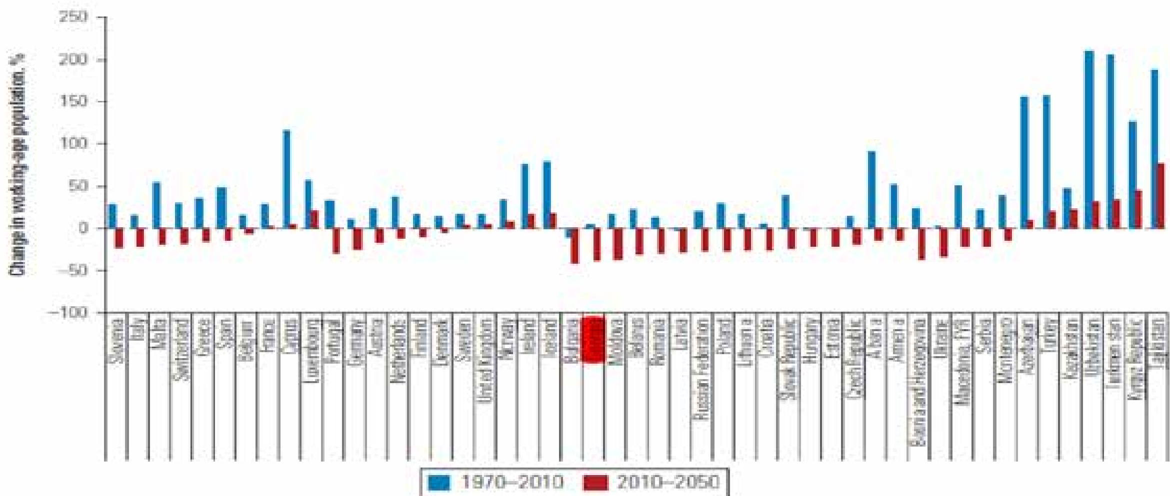

Figure 1.9. Analysis of Active Working Population - 1970-2010 and 2010-2050 Years

Source:Anita M. Schwarz, Omar, The Inverting Pyramid: Pension Systems Facing Demographic Challenges in Europe and Central Asia, 2014 ,p.48.

The Old-Age dependency ratio is an indicator of the relation between the older population (aged 65 and over) and the population in what is generally considered the working-age (ages 15 to 64). The indicator is calculated as the ratio between the population aged 65 and over and the population aged 15 to 64. According to data Figure 1.10. an old-age dependency ratio of 21.3, meaning that for every one older person, there are nearly five persons in the working age. With this ratio, Georgia takes a middle position among the neighboring countries, together with Ukraine and Russia.

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Countries that are more advanced in the ageing process – Romania and especially Bulgaria (30.4) – have considerably higher dependency ratios, whereas countries with large shares of young people – in particular Turkey and Azerbaijan (7.8 only) – have significantly lower old-age dependency ratios.

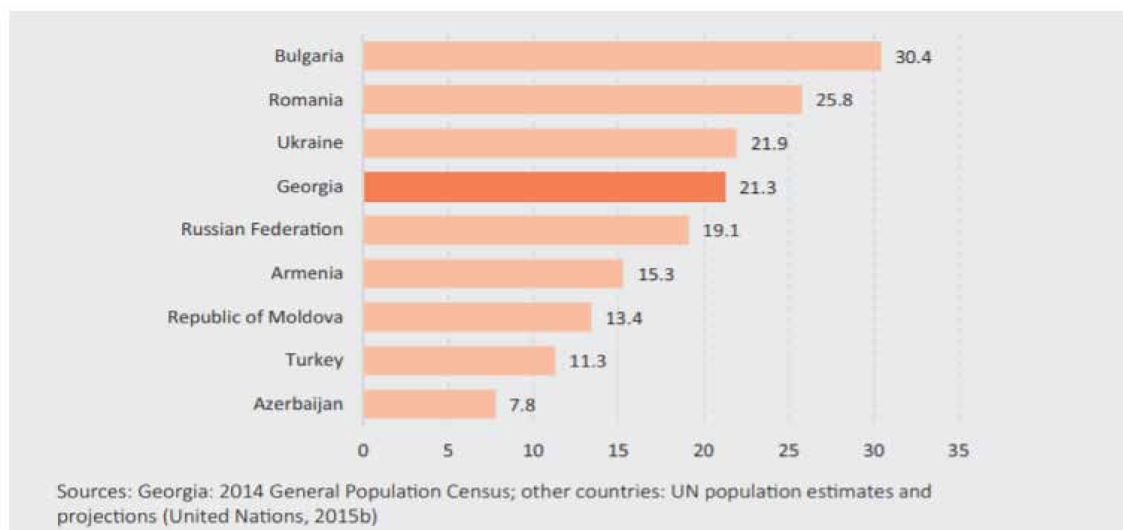

Figure 1.10. Old-Age Dependency Ratio for Selected Countries, 2015

Source: Bart de Bruijn, M. Chitanava, AGEING AND OLDER PERSONSIN GEORGIA, 2014, p.10.

Accumulation Pension Fund

In recent years, the key reason of pension system reforms made in the countries come from budgetary pressures and longer-term challenges related to population aging. Therefore, in many countries with pay-as-you-go systems moved (partially) funded pension model, a shift largely motivated by population aging. Firstly, Georgian government publicly introduced the reform in 2017. Reform that was based on personal savings, didn't consider solidarity. The main idea was *"everyone for him- or herself".* The new Law of Georgia on Funded Pension was issued in 2018. The new law on pension savings does not envisage the annulment of the existing pension system.

From January 1, 2019, the population of Georgia has been involved in the mandatory funded pension scheme. Involvement in this system is obligatory for all employees below to 40 years of age. They must contribute 2% of total income to their retirement savings account and as well as the same amount of contribution must be made by employer. In addition, the state or government also makes contribution but considers employee's earnings: 2% of employee's earnings if annual income is less than GEL 24 000,1% for income between GEL 24 000 and GEL 60 000. Involvement in this system isn't mandatory for self-employed and employees above 40 years old.

The main aim of this reform was offered by Georgian government is to implement the current best practice pension system like in developed countries. Participation of active workforce, their employers and state make pension funds to grow quickly. One of key advantages of fully funded social system are that the pension will be annually indexed and it can change the Replacement rate in positive way. Compared to the existing Pay-as-you-go system, a fully funded social pension system has specific benefits: risk of intergeneration transfer is shifted from the government to individuals, in other words in fully funded pension system individuals save for their own retirement. Generally, collection is invested in various financial assets. The investing principles and strategy of pension funds as well as investing limitations are determined by Law of Georgia on Funded Pensions. At same time investing in financial assets of the funds raised from pension system participants support capital market development and finally promote economic growth for country. It is also clear that raising contribution over the time period means the opportunity of investments which itself generates returns on investment thus higher benefit to pensioners.

Capital market development is key benefit for country created by implementing a funded pension system. The system promotes the development of stronger financial markets and institutions (stock exchanges, investment management

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companies), offers various new financial services. According to the Pension Agency, 278 individuals have completely left the fund through the introduction of the reform until March, 2020, which might be caused by their deaths, retirement or personal disability. 165,713 individuals left the state pension system on their own will in Georgia. This is 4.4% of the country's total population.
According to the social agency data, total pension assets is 780 million GEL in June 2020, of which 84% (GEL 651 million) are deposited in commercial banks with a certificate nominal deposit of 14.7% per annum (effective annual 12.0%) and the remaining 16% (GEL 128 million). , In interest-bearing accounts in commercial banks at 9.8% per annum. The annual current interest rate on total pension assets is up to 14.0%. It should be noted that the amount of cash in commercial banks has already accrued more than 20 million GEL, while the total accrued interest on all pension assets is up to 50 million GEL.

Table 1.2. Analysis of Pensioners in the South Caucasus Region

	Number of pensioners	% of population	Average pension	Pension Age	
				men	women
Georgia	867,000	22%	70 euros	65	60
Armenia	451,900	15%	80 euros	65	63
Azerbaijan	1,299, 946	13	95 euros	63	60

Source: T. Verulava, Pension System in the South Caucasus: Challenges and Reform Options, 2018, p 171.

Comparative Analysis (Georgia, Armenia, Azerbaijan, Estonia and Latvia)
We did comparative analysis of Armenia, Azerbaijan, Estonia and Latvia and concluded: According to official data (Table 1.2.), at the beginning of 2019, 13.2% of the total population of Azerbaijan (equal to 1.3 ml out of nearly 10 ml people) were pensioners. (State Statistical Committee 2019) In comparison to the post-Soviet region, this is a very low number. While in Azerbaijan, as indicated above, there are 130 pensioners per 1,000 people, the figure is 154 in Armenia. According Verulava (2018) average pension in there were the highest number of pensioners in Azerbaijan – 1,299,946, at same time average pension was higher in Azerbaijan than in Georgian and Armenia.
According to World Bank analysis (2014) in Georgia, pension that is spent on per elderly person compared to GDP per capita is almost 20%, which is lower number than in Armenia and Azerbaijan. In Armenia and Azerbaijan pension spent per elderly person are nearly 80 percent of GDP per capita (Figure 1.11.).

Figure 1.11. Pension Spending per Elderly Person Compared to GDP per Capita, Selected European and Central Asian Economies, 2009

Source: Anita M. Schwarz, Omar, The Inverting Pyramid: Pension Systems Facing Demographic Challenges in Europe and Central Asia, 2014, p. 84.

The same research indicates that in the transition countries, the percentage of elderly in total population will be doubled in future years., In the next 30 years on average Georgia are projected to have one elderly for every

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4 people, while Armenia and Azerbaijan should expect to have 5 and 6 people respectively. Figure 1.12 shows the percentage of the population over the age of 65 in 2010 and 2050, based on this data in most countries the percentage of the population over 65 is expected to double in the next 40 years. And Finally, while life expectancies have been increasing too, continued increases can be expected to burden the pension system much more significantly in the future, as they will apply to much larger cohorts of elderly with wide pension coverage. The share of pension spent on old age, disability and survivors are also different in these countries too.

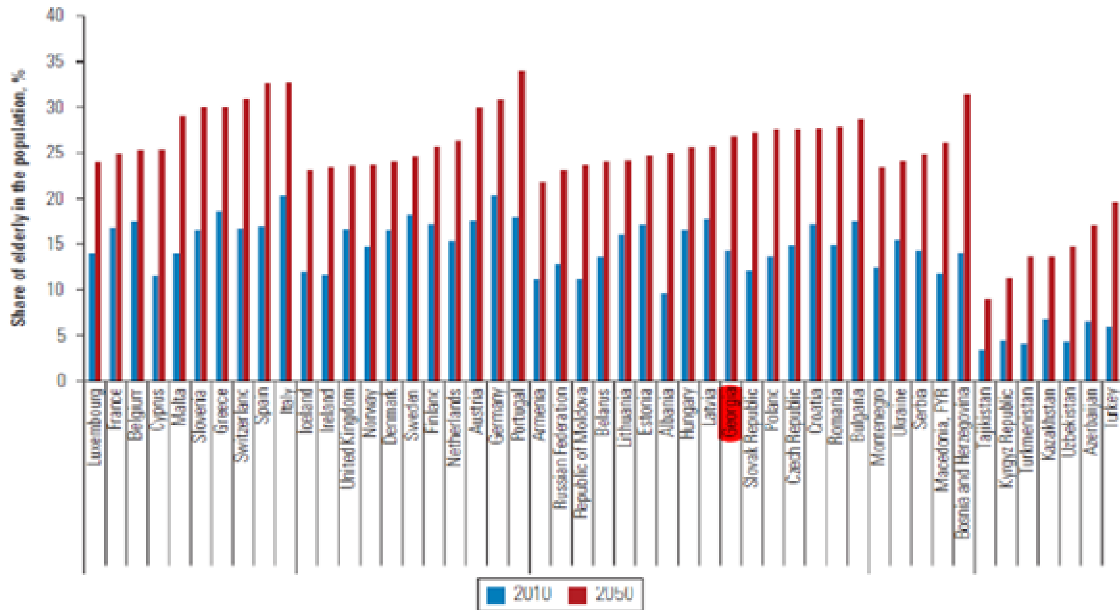

Figure 1.12. Share of Old Age People in the Population - 2010 and 2050 Years

Source: Anita M. Schwarz, Omar, The Inverting Pyramid: Pension Systems Facing Demographic Challenges in Europe and Central Asia, 2014, p.52.

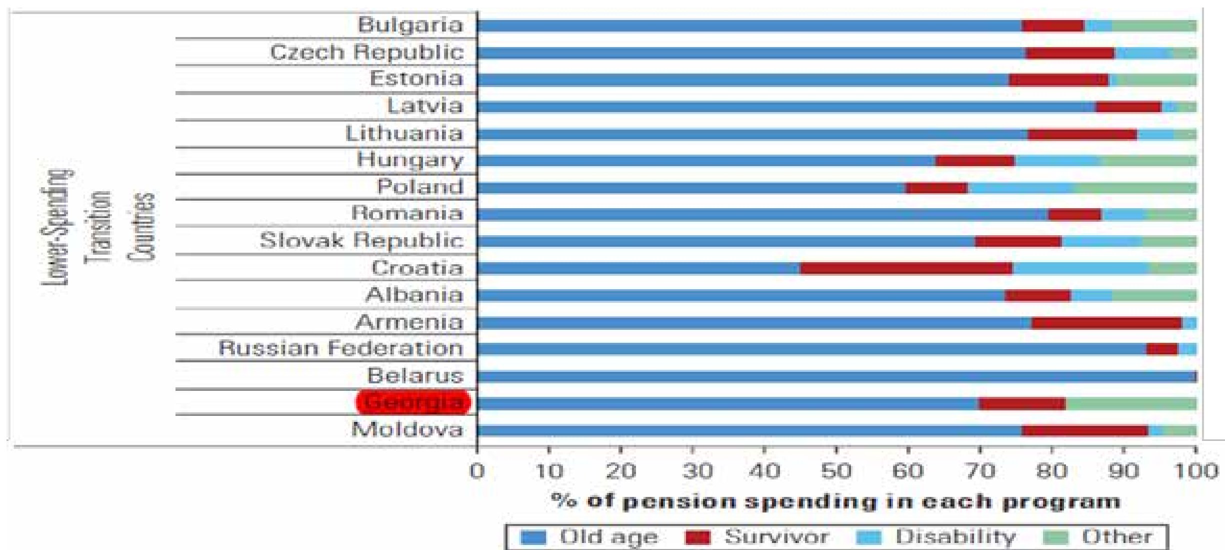

Figure 1.13. Pension Spending on Old Age

Source: Anita M. Schwarz, Omar, The Inverting Pyramid: Pension Systems Facing Demographic Challenges in Europe and Central Asia, 2014, p.52

Figure 1.13. shows that in Armenia spending on old age and survivors are higher than in Georgia

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Research Methodology on Accumulated Pension Reform

A quantitative survey was conducted among Georgian respondents to identify public opinion and expectations on mandatory funded pension reform. A total of 143 citizens took part in survey. The questionnaire included questions on mandatory funded pensions and social security for the elderly in Georgia. 67% of respondents are female and 33% are male. The majority of respondents, 88%, have higher education, 6% have high school education, 6% have students. It should be noted that awareness about the pension system does not depend on gender and age, although the employment rate is an important determinant. The majority of respondents, 79%, are employed, 11% Self-employed, 10% Unemployed. The survey showed that 67% of the respondents considered themselves fully informed about the accumulative pension system, 29% are partially aware, and while 3% of the respondents don't have any information about it. Data shows that 88% of respondents are aged from 18 to 40 and only 10% of respondents would have possibility to leave mandatory accumulated pension scheme from which 3% of respondents left mandatory accumulated pension scheme, result shows this number is quite high. We also investigated the degree of respondents' involvement in voluntary accumulated pension system, 11% of them enrolled in it, 43 – aren't enrolled and 46% didn't answer the question. As indicated below, 42% of total respondents completely agree to employee's 2% contribution, 42% - Partially agree, while 35% of them disagree, which is quite high percentage. The survey also shows that on average 42% of total respondents completely agree to employers' and state contribution in pension scheme, 33% - Partially agree, while 34% of them disagree.

To the question whether compulsory enrollment in the pension scheme for the accumulated population under the age of 40 is acceptable or not, it shows that 64% of respondents consider it unacceptable, while for the rest it is acceptable. According to the survey only 13% of respondents totally trust to the state in terms of managing pension system, this result is quite low and caused from previous bad experience in 1990'ies, when people lost their savings. Since joining the accumulative pension scheme, majority of the respondents (83%) indicate that the economic situation has not changed and but at same time 53% of them have mentioned that their salary decreased after joining the accumulative pension scheme. So, the last fact means that organization decided to reduce the salary of their employees in order to avoid the pressure caused from their mandatory contribution to the accumulative pension system.

Finally, 43% of respondents are not satisfied by involvement in the accumulated pension system and up to 40% of them think that pension system cannot guarantee proper old age. The results of the research show that a majority of the population is still skeptical about the accumulative pension scheme.

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Conclusion and Recommendations

As Pension fund system is a cornerstone of countries economy, there are debates about universal effective pension fund systems. In Georgia existing Pay-as-you-go system is facing challenges due to changing demographics, especially growing demographic risks due to low fertility, life expectancy increase, risks related to migration of working age population. Despite of the fact that the Pay-as-you-go system plays an important role in poverty reduction and based on the solidarity principle accumulative pension system pension system offers many benefits too. The need and the main goals of the reform were to improve financial sustainability of country economy and poverty alleviation growth, protect of workers against drops in their incomes or provide adequate replacement rate of income and finally to promote development of the local capital market. Based on European experience, in order to ensure a strong pension system development in Georgian, it was necessary to move to a three-pillar pension system.

Pension reform can impact significantly on country development; thus, the activities related to pension funds should be transparent, subject to detailed control and people should have access to information on the economic viability of funds. It is also necessary to popularize the accumulation culture in the society. In this regard, it is advisable to carry out large-scale campaigns, which will also increase financial education among citizens. Significant work needs to be done in terms of raising public awareness, in order to avoid the failure of the reform due inexistence of information campaign. The survey found out that the majority of the population distrusts the state and that should not be surprising. Public remember deposits in the bank which disappeared altogether. But we think that this bad practice should be forgotten by the population and the state must do everything possible to speed up the process of restoring trust. The experience, success, mistakes, results of countries with successful practice, everything must be analyzed by the state. The issue of fund management is also largely related to the functions of the state. It must determine in what form and who should manage this accumulated fund. It is clear to everyone that this money should work, it has to be re-invested and it has to bring profit. Also, the most important thing to remember is that these funds should generate more than the deposits can generate, otherwise, people would have saved the money in banks' deposits. Considering all these factors we can conclude that it's needed to create right framework for investment process and must be selected correct institution for managing the fund.

As international practice shows, the management of the fund should be handed over to the asset management company with big experience and high history performance. And as we have already mentioned, the "framework" should be provided by the state. In our opinion, there should be no mediator between the asset management company and the state in order to reduce costs. If we look at international practice, investment companies are obliged to manage this fund and then they are hiring the asset management companies, overall, it costs twice as much. Double expense affects overall performance and if there is poor outcome, high management fee may hard the given situation. We also believe that tenders will be a good way to effectively allocate funds. For example, the fund can be divided into several asset companies to be managed through a tender, in order to reduce the risks and clearly see the right approaches to what will be beneficial in specific cases. We think this recommendation is quite reasonable and it would be good to take into account.

Consequently, we have one option for such a given difficult situation to invest in risk free market to protect Georgian population from uncertainty. For example, we can invest in foreign developed countries' bonds or other low risk foreign securities. The state should eliminate as soon as possible all the obstacles that increase the risks for investing in the Georgian market in order to become possible to implement investment activity in domestic market.

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