The Georgian Dream of Pension Reforms

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Abstract

Although old-age benefits help to alleviate poverty in Georgia, the system does not satisfy its main stakeholders. Retirees believe that pensions are unfair and inadequate, while experts and governmental officials realize the growing burden of benefits for the country's public finances. The past experience of pension (non) reforms suggest that changes are sensitive to the government's capacity to reform, the fiscal health of the economy, political stability and the ideological preferences of the ruling elites. The transfer of power through parliamentary and presidential elections in 2012–2013 opened an opportunity for reforming the pension system based on broad public consensus and economic sustainability.

Why Do Pensions Matter?

The recent parliamentary and presidential elections marked the democratic transfer of power in Georgia—something unique for countries in the South Caucasus. Nonetheless, being a regional leader in democratic development by no means is associated with advances in the social welfare system. If Armenia and Azerbaijan have already worked out and started to implement reforms of their inherited pension provisions, Georgia is once again initiating a reform of its welfare state. As retirees in Georgia represent the largest and most politically active demographic group, the pension system is often used to attract votes during elections. The outgoing government was explicitly criticized for developing the existing pension system in close connection with the country's electoral calendar and the goodwill of certain political leaders.

Pensions arguably have been the most salient aspect of Georgian public and social policies since independence. Most present-day beneficiaries are individuals who experienced transitional turmoil in their 40s and 50s. The dramatic economic decline limited their opportunities to secure streams of income through public or private means. The Soviet savings of thousands evaporated, while employment opportunities were scarce. It is quite rational that pensioners, most of whom have worked and contributed to the socialist pay-as-you-go system, are frustrated not to get back adequate benefits. In turn, accelerated demographic ageing makes even current flat-rate pensions unsustainable in the long run. Except for a small share of libertarians, who think that individuals themselves are in the best position to secure their retirement income, the majority of stakeholders agree on the inevitability of systemic pension reforms.

Despite being unfair and unsustainable, the existing system is still the major instrument of poverty reduction in the country. All Georgian citizens are granted the right to receive pension benefits any time after the age of sixty for women and sixty-five for men. Pensions constitute the largest social spending item in the state budget, accounting for about 15% of public expenditure and four per cent of GDP in 2012. According to the World Bank's 2009 calculations, under the scenario of no pension benefits, the poverty rate (based on the subsistence minimum) would increase from 24% to 33%. It was also projected that the increase in pensions up to 150 GEL in November 2013 would decrease the national poverty rate by about 6 percentage points.

Previous Attempts at Systemic Reform[1]

There have been several consecutive attempts at systemic pension reforms in Georgia. In the second half of the 1990s, implementation of the bottom-up reform initiative devised by the Ministry of Labor and Social Security was problematic mainly because the government was still engaged in broader political and economic reforms and the pension system itself was corrupt and poorly administrated, while social taxes were high and tax administration extremely inefficient. When the fiscal problems intensified in the beginning of the 2000s, the government became interested in gaining political dividends through the top-down reform initiative mediated by the World Bank. However, these reform plans were abandoned due to the fundamental political changes related to the "Rose Revolution."

After 2004, the new government did not exploit the post-election "honeymoon" of high political legitimacy and a sound fiscal standing to conduct systemic pension reform. State priority shifted from a universal pension system to the development of a universal means-tested social assistance program and presented the general tax reduction trend as a component of broader pension reforms, successfully blocking parliamentary attempts to introduce mandatory pension savings. After the dual 2008 crisis, the government still preferred to regularly increase the flat-rate pension as a way to win the votes of pensioners, thereby contributing to the transformation of pension expectations into pension liabilities, which

1 For a more detailed review of pension reforms in Georgia please consult Gugushvili (2012).

not only assumed the sustainable provision of benefits but also their ever-increasing nature.

As a result of increased foreign financial aid in 2008–09, some international agencies became stronger drivers behind pension reform as the donors obliged the Georgian government to engage more proactively in paradigmatic pension reforms. Nevertheless, the libertarian group was arguably responsible for preventing the further evolution of this initiative. On the revenue side, the pension system was also affected by changes to the tax code when the personified social insurance contributions were abolished and a common social tax was introduced. The main credit attributed to the National Movement is that the minimum, flat-rate pension increased eightfold in nominal terms in 2004–2012, from 14 GEL to 110 GEL, but in real teams this growth was much more modest.

Towards a European Social Space?

By the time of the scheduled parliamentary elections in October 2012, the main political rival of the ruling National Movement—the Georgian Dream Coalition put forward systemic pension reform plans. In its election manifesto, along with introducing universal health insurance, improving the targeted social assistance scheme and developing social services, pension reform was one of the main components of the reshuffling in the broader social security system. Although the declared ideological basis of the welfare reforms was in line with the outgoing government—establishing a social security system based on individual responsibilities—the main difference in the outlined plans was much stronger governmental involvement, particularly in the first years of reform.

Unlike the previous attempts, the Georgian Dream more vividly presented the reformed pension system as a facilitator of economic growth though accumulating the working population's retirement savings which would be further used as much needed investment in different areas of the economy. One of the main listed problems was that pension spending had come directly from the state budget with the potential of undermining the stability of the state finances in the long-run. Indeed, the clear message in the proposal was the introduction of a mandatory saving component of workers contributions into their individualized accounts. At the same time, those people who would not have sufficient contributions would qualify for social pensions.

Nonetheless, the most basic proposal was the equalization of pension benefits to the official subsistence minimum in the country. The declared goal of introducing the unified public and private pension schemes would mirror the European pension systems, which, according to the Georgian Dream Coalition, would allow the country to become a part of the European social space. The new system would be based on three universally acclaimed principles such as fairness, solidarity, and security. The proposed pension system implied a strong role for the private pension funds where the amount of pension benefits would depend on the length and amount of contribution. In turn, the state was projected to play an important regulatory function in order to maintain the stability of the system.

Recent Steps and Criticism

Shortly after the new government took office in late 2012, work on the pension reform started in cooperation with the World Bank. The government announced that it had created a Working Group to facilitate the reform process and collaboration between various public agencies. In addition, the Pension Office was established at the Ministry of Finance—the key institution for handling the fiscal implications of reforms. The government also promised to present a concrete action plan and road map in the near future. However, the first step taken by the government was to increase pensions up to 125 GEL in April 2013 and up to 150 GEL from September 2013. The latter affected about 681,000 retirees, while social benefit outlays reached 146 million GEL only for September 2013. For the first time in independent Georgia, the lowest pensions became higher than the official subsistence minimum (145 GEL). Furthermore, pension benefits are expected to be indexed in line with the growing cost of living.

A more important announcement related to pensions was made in November 2013, when the ruling coalition declared the introduction of a mandatory funded pensions system over the next several years, starting from 2014. The pension reform would include the introduction of a mandatory funded component, based on contributions, and social pensions targeted at individuals with no personal savings. The funding system claims to provide a decent retirement for the elderly. As was outlined in the election manifesto, the government program put pension reform in the context of stimulating savings. The supporters argued that macroeconomic outcomes of reforms are at the center of the proposal. The fiscal effect was described as a key beneficial aspect of the reform because the government would only cover the socially vulnerable retirees. Three required pillars were mentioned as being important for the reform's success: the institutions reducing the risks associated with pension funds, developed financial markets, and strong regulatory institutions.

The proposals have met with criticism mostly from the members of the previous government and a small group of experts. They described the proposed pension reform as a potential financial pyramid where people would contribute to mandatory pension funds but in the end the government would determine the size of retirement benefits. Parallels were drawn with the collapse of the Soviet pension scheme when pensioners lost their contributions. The reforms would be targeted to the people under 45 who would have time to accumulate contributions in the system, but the critics questioned the uncertainty related to the behavior of future governments in Georgia that would take decisions related to pension benefits. Furthermore, the government failed to communicate many decisive aspects of the pension reforms, such as if pension schemes will be defined-benefit or defined-contribution, how mandatory contributions will be collected, what will be the role of voluntary contributions, will there be one state or several private pension funds to choose from, and how government will guarantee the security of pension savings.

Lessons Learnt

There are some lessons which can be drawn from the past pension reform initiatives in Georgia and apply them to the ongoing reform process. First of all, the available evidence suggests that many key agencies, experts and the broader public did not possess information on up-to-date pension developments in the country. In addition to having a comprehensive debate on pension policy through sound research practices and consultation, it is more important to have direct and open communication with the broader public on the objective requirements of the pension system. The reform process itself should be developed by a genuine cross-section of public officials, business leaders, trade union representatives and other interested parties—a practice which never happened in the period 1991–2013.

It is also important to see pensions in a positive light, as an opportunity rather than a cost, or a problem. It appears that most of the parties—pubic officials, international agencies, private sector—agree that changes are required. The major thing which has been missing in past years is a willingness to invest political capital into comprehensive pension reform. The parliamentary and presidential elections in 2012–2013 marked a formal transfer of power to a new government and weakened the positions of those who have resisted comprehensive changes in the pension system, mainly based on their ideological convictions rather than on hard evidence. A more balanced distribution of political power opens new opportunities for sustainable, paradigmatic pension reforms.

The review of earlier initiatives also suggests that the successful implementation of pension reforms was hindered by the government's incapacity to reform, fiscal problems, political instability and the ideological preferences of the public officials. However, all these factors could play in favor of successful reforms over the next few years. The Georgian public administration has made remarkable improvements since 2004, the country gradually moves towards a stable democratic political regime, the economy shows signs of recovery after the post-election uncertainty, while the government's public policy priorities come closer to the European model of social-democracy. In short, there are greater chances than ever that systemic pension reforms will finally take place in Georgia.

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