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# Transition of the Pension System In the Republic of Macedonia

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During period of transition of the entire socioeconomic system in 1990s, pension system was also transformed. This article is following and analyzing the trajectory of transformation of Pension System in Republic of Macedonia. And its consequences for rights of pensioners from one hand and for stability of the pension system form other hand.

**Index Terms**— Pension System, Transition, Republic of Macedonia, Reform

## 1 Introduction

Generally, pension insurance systems are part of the welfare state and they enable to their insured continuous and reliable revenues in old age. This means that the pension system should enable its insured to avoid the risk of poverty and have a decent life in old age. The purpose of pension systems is to provide a decent retirement to the insured on one side and financial sustainability of the pension system on the other side [1]. Pension systems are important because they include many people that use their benefits. In developing countries about 20% of the population is insured through pension systems. Expenditures for pensions tend to amount up to 10% of the GDP of individual countries [2]. When pension systems will prove nonfunctional, either because of inability to provide a decent retirement for the insured or due to financial unsustainability of the pension system, reforms usually follow. In the 1990s pension systems in countries in Central and Eastern Europe, passed through a process of transition from socialistic in a capitalist socio-political structure. The reason for the transition was that pension systems created losses that countries did not want to cover.One of the countries that passed as through socio-political transition and the transformation of the pension system is the Republic of Macedonia, which is the focus of our article.

## 2 The General Framework of Pension Systems

In contemporary societal conditions there are two dominant systems of pension insurance: PAYG pension systems and capitation pension systems.

Pay as you go (PAYG) pension systems are set to intergenerational solidarity. Under this model, the pensions of the current generation insured pay contributions to current pension insurers, and their pensions would be paid from the contributions of the next generation pension insurers [3], [4]. The pension insurance that operate under the PAYG system, commonly are in state ownership. The state could, but usually does not appear as an investor in the financial markets. Accordingly, these funds do not have income from investments in financial markets, but to guarantee regular payment of pensions, always have the possibility of the state budget being used as a reservoir funds will be drawn to pay for pensions.

Pension capitation system (fully funded pension system) is based on the investment of contributions to the pension insured on the financial markets and the accumulation of benefits of such investments, which are reflected in the amount of pensions to insurers [3]. Funds operating on the basis of capitation system of pension insurance usually are private and are a significant factor in financial markets. Because the funds that are used fot pensions accrue interest, dividends, the investment of pension funds in government securities, shares in companies etc. it is possible for insured persons to receive higher pensions than originally invested contributions to the fund.

In the 1990s PAYG pension systems in transition countries have shown some weaknesses. They are reflected in the increasing dependence of pension funds from the budgets of countries, low retirement age of people that went into retirement and evasion of pension contributions [5]. Overcoming these weaknesses is possible through a reform of pension systems and the introduction of capitation insurance system or a combination of both PAYG and capitalistics insurance system.

The Macedonian pension system until the transition was PAYG system. After the reforms in parallel with the PAYG system, the system of pension insurance in the Republic of Macedonia, introduced mandatory and optional capitation system of pension insurance. One could say that after the reforms Macedonia has a mixed pension system [6].

## 3 The Pension System in the Republic of Macedonia before the Transition

After the Second World War, Macedonia was a Republic of the Socialist Federal Republic of Yugoslavia, and as such it had developed its pension system. The pension system in the former Yugoslavia was based on the PAYG system with a significant impact on the amount of contributions paid, and the duration of payment of contributions to the pension which is realized after retirement [7]. Pensions accounted for 85% of the average wage in the 10 best consecutive years in which pension insurance contributions was paid and also adapted to changes in the salary and living expenses. Retirement age was 60 years for men and 55 for women with 40 years of service with contributions to the fund for pension insurance for men and 35 for women. There were also a possibility for early retirement five years before reaching the age limit of 35 years of service for men and 30 years of service for women with a corresponding reduction in pensions of 0.5% per missing year [7].

The system of pension insurance in the former Yugoslavia, allowed citizens to take disability pension (in case of injury at work causing disability and inability to work) and old-age pension for people that could not to gain the right to retirement in any other way. Rising life expectancy significantly increased the number of people who used the right to receive the old-age pension. The system worked successfully in times of high employment rate. The increase in the number of citizens who exercise their right to retirement, with a significant reduction in the number of employed persons in the political and economic turbulence in the second half of the 1980s and 1990s, caused serious problems in the financial stability of the pension insurance in the states that emerged from the former Yugoslavia.

## 4 The Reform of Pension System in Countries in Transition

Benchmark of the reform of the pension insurance for countries in transition was notional defined redistribution (NDR) plans, designed in Sweden and later applied in the transition countries of Central and Eastern Europe [8]. The basis of the reform was coming from universal - towards diversified redistribution of assets tied to the amount of contributions from an insured during a specified period.

The reforms of pension systems initially took place in Hungary, Latvia, Poland and Kazakhstan. These countries have already transformed the existing PAYG system, and have included mechanisms that provide mandatory contributions of contributors to pension systems capitation partial or complete [5].

A feature of the reforms in all these countries was to increase the retirement age, calculation of pensions based on salaries from the entire work experience, indexing of pensions, abolishing the privileges of certain social groups enjoyed in retirement, introducing additional conditions for the acquisition of retirement and early retirement, separation of pension from other types of social insurance state budget and a possibility for additional voluntary insurance of citizens (Muller 2003: 6).

## 5 Reform of the Pension and Desability System in Macedonia

The macedonian economy in the 1990s had serious negative rates of economic growth. So in 1993 the decline in gross domestic period was -9.3 in 1994 was -2.7 in 1995 was -1.6. In 1996 the economy grows by 0.9 and the following year 1997 it grow 1.5. The costs of pension insurance in terms of gross domestic product in 1992 accounted for 11.1 of gross domestic product in 1993 they were 14.6 in 1994 amounted to 12.0 in 1995 and 1996 were 10.4. A feature of the Macedonian economy in this period is the high rate of unemployment, in 1992 it was 18.6, in 1997 it reached 26,5 [5].

The economic difficulties of the early 1990s resulted in serious loss of a significant part of the companies in Macedonia. It reduced the number of employees i.e. pension insurers, which caused a significant reduction of financial inflows to the fund. To address these issues in 1993 was adopted Law on pension and disability insurance. Already in 1997 there were positive changes due to the laws change [9]. However, due to demographic changes that included a reduction of the population in general and especially of youngsters that should be contributors to the fund for pension and disability insurance and the increase in life expectancy and thus the elderly who are mostly retirees and beneficiaries of services of Fund pension and disability insurance, the analysis showed that it would require a new reform of the pension system to ensure its financial sustainability [10]. The recommendations that came from the World Bank for the transition countries since the mid-1990s were the establishment of a pension system with more columns insurance [11]. Pension reform in the Republic Macedonia was provided for in legislation adopted in 2000. Significant elements of the new structure of the pension system in RM, was its organization around three pillars. Implementation of new structure of pension system in Republic of Macedonia began in January 2006 [2]. The first pillar is the mandatory pension and disability insurance in the public pension fund in Macedonia. The second pillar is the mandatory pension and disability insurance to private pension funds. Third pillar consists of voluntary insurance in the private insurance funds. The first pillar pension insurance was to ensure social security of insurance, the second and especially the third pillar introduced market elements in the system of pension insurance in the Republic of Macedonia [6]. The reformed system of pension and disability insurance was intended to provide long-term financial sustainability of the system that faces an aging population.

The first pillar of insurance is mandatory for all employees. It operates on the principle of intergenerational solidarity, respectively Pay As You Go. This pillar provides security of the pension system. This pillar among other things, provides pension insurance against disability and old age. In this pillar, an insured person doesn't have the right to choose the insurance company, but is insured in the public company: Fund Pension and Disability Insurance.

The second pillar of the pension insurance is also mandatory for citizens who are hired after 01.01.2003 and optional for those who were employed before the specified period [8],[10]. Employees are required part of contributions to invest in private pension funds. Private pension funds invest their assets in financial markets, at its discretion and in accordance with the law. In choosing a private pension fund, the employer has no right to compel employees to be assured of a certain fund, but it is the right of the employee.

The third pension pillar started with implementation in April 2009 [2]. It is voluntary. Every citizen older than 15 years has a right to pay their contributions to private pension funds. The third pillar of the pension and disability insurance is provided to those paid in the first two pillars, and want raised pensions, achieved through the payment of contributions to the third pillar. Also, the third pillar of the pension insurance allows persons who for various reasons are not insured in the first two (persons working abroad, housewives, unemployed persons) through the payment of contributions to the third pillar to have pension insurance [10].

Contributions to the fund is 18% of gross salary, where 67% of the funds paid go to the first pillar, while 33% go to the second pillar, and the third is placed on a voluntary basis. Pension insurance allocated 18% of their gross salary. Expectations for reform of the pension system were to provide long-term stability and sustainability of the pension fund, which will be a basis of social security for senior citizens [12]. Since 2009 there is a downward trend in contributions for pension and disability insurance. Thus, in 2009, contributions for pension and disability insurance were reduced from 21.5% to 19% of gross salary. In 2010 the rate of contributions for pension insurance was reduced to 18% [2].

## 6 The Rights of Pension in Macedonia

Pension reforms in the Republic of Macedonia were made on the basis of the Constitution which provides that citizens are entitled to social security based on principles of social justice. However, the reform predicted pension, depends on the duration of the payment of the contributions to the fund for pension and disability insurance [10]. The right to a pension in R. Macedonia is gained after turning 64 years of age for men and 62 for women, with a minimum of 15 years of payment of contributions to the fund for pension and disability insurance. The limit at which individuals acquire the right to retirement is 65 years. If there is interest from the employee and the employer, the law allows a person to work to age 67 [12]. Law on Pension and Disability Insurance provides the following types of benefits: retirement, invalidity pension, family pension, professional rehabilitation, compensation for physical injury and minimal pensions.

The amount of pension received depends on the period in which funds are paid into the fund for pension and disability insurance. Full pension is granted if the contributions paid into the fund for pension insurance 40 years for men and 35 for women. If the fund is paid a smaller period of time, the amount of pension is proportionally reduced. In 2015, the average pension in the Republic of Macedonia stood at around 200 euro's. The maximum pension is 2.4 times the average pension and amounts to the average monthly salary. The minimum pension for people who have at least 35 years of service for men and 30 years of service for women with neat paid contributions to the fund for pension insurance may not be lower than 42% of the average salary in the Republic of Macedonia, while for those with at least 25 years of service for men and 20 years of service for women with duly paid contributions for a given period, the lowest pension can not be lower than 38% of the average salary in Republic of Macedonia. Spouses are entitled to a survivor's pension when the insured dies [12]. At the end of 2010 the number of pensioners receiving the minimum pension was 115 094, which is 42% of the total number of pensioners. The ratio of the average amount of pensions and average wages accounted for 47.9%, the proportion of family pension to average wages is 38.3%, the proportion of disability pensions with average wages is 42.9%, while the proportion of old-age pension to average wages is 54,1% (Mrsic 2012: 12).

The ratio between the number of employees and the number of pensioners in 2015 was 1.8 meaning that 1.8 employees with their contributions covered the pension of one retiree [12]. The number of pensioners in the Republic of Macedonia in 2005 was 297,324, which is 15.66% of the number of persons insured on any basis in Macedonian social security system. In 2006, the number of pensioners was 313,396, which is 16.16% of the total number of persons insured in some of the basics that provides Macedonian social security system. In 2009, Republic of Macedonia had 272,221 retired, of which 54.7% receive age pension, while the rest receive family and disability pensions. In 2010 the number of insured persons amounted to 466,280, the number of people who took pension was 273 751, plus 1817 agricultural pensions and 2161 military pensions. The share of expenditure on pensions in GDP was 10% [2].

## 7 The Modern Trends in Pension Systems

In 2008-2010 global financial crisis had an impact on creation of regulations in the area of pensions. While before the crisis there was a trend of introducing compulsory third pillar mandatory individual insurance after the crisis no country has introduced such a possibility, although some states have considered that option [1].

After the start of the crisis some countries, such as Romania, have increased the rate of pension insurance, in order to reduce the fiscal deficit that caused the crisis, while other countries such as Macedonia and Bulgaria, in order to increase employment and incomes of the population have reduced rates contributions for pension insurance. In some countries such as Estonia, Lithuania, Latvia, Romania and Estonia, rates of contributions to the fund for pension and disability insurance remained unaltered compared to the period before the crisis. Certain countries like Hungary are allowing their citizens all contributions to be paid only in the first pillar, while other countries such as Slovakia the second insurance pillar is projected to be voluntary. Also some countries such as Hungary, Poland and Latvia have taken measures to prevent premature retirement, and increasing age for retirement [1]. Milos and Milos believe that the latest reforms caused by the global financial crisis are short-term solutions and reforms of pension systems have to continue [13].

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