

Pension Reforms: the Choice of All Choices

If not today, when?

The Armenian Government notes in its pension reforms policy document that preserving the status quo in the pension system will not only result in a crisis, but also hamper the social-economic development of the country.

It must be noted that up to now there has been no sustained effort to analyze our pension system comprehensively. As a result, it keeps stumping in the same place, based as it is on the generally outdated principles, including the notion of pension equity.

As a rule, even the slightest change in the tax system provokes extensive feedback, heated debates, complaints or suggestions. Nevertheless, even though the pension reform is slated as top priority by high government officials who point out that it drags far behind reforms in all other aspects, for some reason it still does not appear on the present political agenda and the list of hot topics for public discussion.

In order to avoid unrest tomorrow

During the Soviet times there were no major difference among salaries, and the number of unemployed was very low. Thus, the system based on the pension solidarity was totally sufficient for the common perception of equity. Even years after the collapse of the Soviet Union pensioners do not complain of the identical approach to diverse pensioners: the major complaint is about the low level of pensions.

In a free market the income differences are substantial and so are pension premiums assessed on the income earned. There are already future pensioners who in the last five years alone have made payments into social security fund that far exceed the stream of benefits that, under the currently existing system, they will have been paid before death. The inequity gap grows wider and wider. In the future when the members of the current labor force retire and the changed pension system continues involving inequitable practices, or when people see that the income they have earned has been for nothing, a huge wave of dissent will rise, which can be prevented today. There is only one way to do this – to choose the right scenario for the reforms.

The price and scope of reforms

Changing systems requires certain costs. The point is that the current generation of employees will have to carry a double load on its shoulders, when on the one hand they have to pay for their future pensions, and on the other hand, they have to provide for the pensions of today's pensioners. The costs of reforms may be born differently, including through reductions of public expenditures, tax increase, ensuring other sources of income¹, etc. This issue is serious, particularly in the context of pension reforms. Thus, it requires initiation of a large-scale public debate and acquisition of agreement between generations. Current pensions are low in Armenia.

¹ Incidentally, pension reforms are not less significant; one may claim they are even a more significant social investment than construction or other fields, where today investments are made through various assistance projects. Directing similar resources towards facilitation of the reform process will allow keeping the tax load as it is and not add to it more.

.....

This is sad. However, this means that the reform load will be much lighter as well. This allows experts to claim that in Armenia, unlike in many other countries, the pension reforms will not have to be too “painful,” and the only issue that remains to be resolved is the scope and development scenario of these reforms.

The scenarios on the table

.....

Numerous factors and indicators should be taken into account in order to decide what kind of pension reform should be undertaken. This diversity of factors necessitates the need for developing a pool of scenarios, from which the model and scope of future reforms can be selected. It is inspiring that nowadays there are already such projections. The Armenian team of the Armenian International Policy Research Group (www.armpolicyresearch.org) is going to present two development scenarios to the Armenian public in December, from which a final one can be chosen. These scenarios will allow assessing future developments of the pension insurance fund quantitatively, as well as will serve as an abundant source of information for the consolidation of the future macro-economic policy of the country.

The internal demand for walking out of the shadow

.....

Actually, the pension reforms will open up the door for those who work in the shadow economy, whose salaries on the paper exactly match the sum they actually get. The first advocates of these reforms will be the firms which are legitimately registered. In fact, fast and targeted pension reforms will result in more positive outcomes than one can envision in advance. This will make up for the transition expenses associated with the reform process. Eventually it may become yet another significant leverage to eliminate shadow economy and create the desirable reality in a more efficient way – an outcome that no tax administration will ever be able to accomplish.

The paper is elaborated based on the opinions passed by the participants of the discussion “Reforms of the Pension System in Armenia”, which took place on November 11, 2005. The roundtable discussion was attended by independent analysts, government officials, and representatives of the international organizations.

The round table was organized with the support of the Friedrich Ebert Foundation.