

A glance at the further development of the funded pension system: “Let’s build and defend!”



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Resources of funded pension plan may seem enormous for a small country. For small countries financial and economic crises are regular occurrences. Governments regularly fighting these crises can always be tempted to destroy what has been created over years with an intention of extinguishing a fire. One can understand the intention. It is like cutting the fast growing apple tree in the garden to warm up on a fierce winter day. However, funded pension resources are the allies and supporters of the governments fighting cataclysms. If the natural growth cycle of these resources is supported, these will provide a stronger arm when the next disaster hits. But this may happen only if the craving for getting warm even for ten minutes during the decades necessary for the growth of the tree and its yielding a successful crop, does not take over the government in panic.

The prototype and inspiration for all the future reforms

Introduction of the funded pension system is the most significant reform of the recent decade in Armenia. It continues consistently. It grows and takes roots year after year. Among a number of already known results, this reform has been having a critical impact on increasing transparency in the private sector, as well as on influencing the faster implementation of the goal of formalizing informal jobs in the economy. Moreover, various myths about the new system have been busted due to the transparent activities of the pension funds, specifically due to providing quarterly and annual statements of individual pension accounts.

Since introduction of the system in 2014, a number of challenges have put the system at risk. First, in September-December, 2014 the balance of one of the funded pension plans was negative, which, however, was managed in a very short time. Then, it was necessary to demonstrate a positive delivery of the system during the most complex period of the system-making, i.e. during the first five years since its introduction. It is essentially during this period that the system faces the strongest public resistance, specifically mistrust towards the system’s capacity to deliver. Statements like “Why should I save money in some unknown fund when I could have bought real estate, or open a savings account in a bank and get monthly interest rates?” are the best evidence of dissatisfaction with the new reform, occasionally expressed in the public. It was exactly at the time when the real estate market and currency exchange rates declined in Armenia. However, the value of the funds did not decline.

Another challenge was the annual negative balance in the pension accounts of the people having joined the system in July 2018, which was the result of the decline of the international capital market in the same year. This, however, had no impact on the accounts of the people having joined the system much earlier. The issue was addressed in February-March 2019, which was yet another proof that there is no need to feel threatened by fluctuating markets.

Presently, during the COVID-19 pandemic, such occurrences will happen again. These will happen, but will also be overcome, because the objectives of the system do not target the present, but the long term, and the capacity of professional funds managing the pension resources is a sufficient factor to guarantee such optimism. It will ensure that the pension ship reaches its long-term destination even in a tempestuous sea.



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New airbags for the funded pension system

In parallel to increasing the sustainability of the system and the growth of the volume of the pension funds, special attention is to be paid to ensuring that these funds are secure and 'untouchable'. To meet this goal, there is a need for new legal and procedural assurances for protecting the property rights of the citizens from potential political ambitions in future. In this regard, the following measures can be useful: securing the new guarantees in the Constitution, and creating new 'levees', based on the reputation of supranational companies.

It is paramount to change the perceptions and attitudes of both the people and all the future governments regarding the funded pension. The pension contributions should be regarded not as a tax deducted from personal income, but as a long-term beneficial investment. Therefore, it is crucial to elaborate and promulgate effective targets and simple messages. Towards this end, the resources from pension funds can be effectively directed to funding low risk and long-term initiatives of local importance. The latter will allow governments to lessen the dependence on international loans with seemingly low interest rates, thus contributing to the reduction of the country's external debt.

Simultaneously, such investment can become an effective business deal for the participants of the funded pension scheme, and significantly increase their incomes. Ongoing cooperation with international credit and investment companies will certainly be useful in terms of knowledge and experience exchange as well. Many have misconceptions in this regard, and perceive pension funds as regular banks which should, for some reason, provide easily accessible resources to the business community. However, the resources in the pension funds are actually the most long-term and strategic resources of our country. These are the sprouts of our future woods.

Recently, both the social and political actors have been discussing the possibilities of unlocking pension funds from a pension plan before the age of retirement. Various discussions have been held in this regard, which mostly conclude that such a mechanism will have negative consequences on the whole pension system from a security perspective.

If we continue with the analogy of the sprouts and the woods, it should be noted that even if a few sprouts have grown into trees, cutting these trees will destroy the prospect of ever turning trees into woods. We yet lack a sufficient volume of pension resources; we don't have the woods, which would allow us to enjoy its benefits. The public should consistently be communicated the message that the pension resources are our future, and we cannot afford cutting the trees before the right time. The message needs to be repeated consistently for the coming 20 years, when in parallel to this communication, people will start feeling the benefits of the system and will stop being the heaviest burden on the next generations.

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