

Latent Aspects of the Funded Pension System



International
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Employer

It is a widespread practice in Armenia to speak of one's earnings in terms of 'net salary': "My net salary is AMD X". Agreements on the salary are reached taking into account the income available presently. Even when a gross salary is mentioned, people tend to recalculate and determine their income based only on the income available for immediate use. However, as the practice shows, following the tax and pension reforms, not all employers routinely applied new rates.

We often hear the following statement: "A lot of people volunteered to join the new pension system upon its introduction". However, the decision of the majority of volunteers having joined the new system has been influenced first by the decisions of their employers. The latter are rather different, much like the employer-employee relations are, which vary greatly. There were many employers who opted for defining salary rates which would allow their employees to continue being paid net salaries. Moreover, some employers defined salaries in light of the changes in income tax as well. Still, there were others who did nothing in anticipation of yet another extension of the deadline for complete introduction of the system.

Salary negotiations

Negotiating over a salary is common. But how does it happen in Armenia? Trade unions are practically dysfunctional, and when unemployment rates are quite high, employers are able to insist on paying the salaries they want. People negotiate differently: women, for instance, tend to agree to a lower salary more easily, much the same as young people, because both prioritise making a career. However, in some cases it will suffice to let your employer know that you are changing jobs because of a higher salary offered and they will offer you an increase the very next day. Let's state it once again: upon introducing the funded pension system, many employers had their employees join the system by defining their salaries so that the net salary remained unchanged. Some employers did the same when income tax was increased.

What resources for employers have for thus defining the salaries? First, it seems that the redefinition of salaries should increase the expenses. Therefore, employers need to reduce their profit, or even operate at a loss. However, the reality is more complex, and the complexity can be understood in comparison with other countries, especially those countries, where the level of taxes and social savings is much higher. Were it a linear decision, an enterprise would not have been called an 'enterprise'.

What is the alternative? There's one answer only: increasing competitiveness and production, and reducing redundant expenses; seeking new work settings at a lower rent; and managing work more efficiently. The list may continue, but it is better to discuss signing of new contracts, accessing new markets, and effectively negotiating with the customers. Certainly, there is another alternative as well: to lower taxes by lobbying, resist social security systems like funded pensions and operate in shadow markets. The latter especially is in the interests of the employer: they are mainly interested in cheap labour and depriving an employee of their social security is not even an issue. Those in shadow job market cannot even save for their pensions or even register their work experience. Such businesses hinder competitiveness, and instead of enhancing productivity and becoming competitive, they damage healthy businesses.

Inclusive economy

There is a lot of discussion about inclusive economy. The structure of Armenia's economy is rather telling: marginalization of capital and income; shadow economy, the wealthy and the poor; unemployment; overconsumption rather disproportional to income... The need for change is obvious. To reduce poverty income should be increased. Introducing a funded pension system compels employers to redistribute income in the interest of employees, and savings, i.e. the condition that the employee should not spend their additional income, tend to contain inflation. The defective



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structure of Armenia's economy will considerably reform with the introduction of the funded pension system. It opens up wider opportunities for implementing new economy policies. Inclusive economy does not mean simply distribution of income available at the moment, because were it so, it would have sufficed to redistribute collected tax money to socially vulnerable groups and 'improve' the economic indicators. Whereas inclusive economy implies that the elderly also contribute to common good. Considering the demographic profile of the country, this is possible only by introducing a funded pension system. With such a reform we address the risk of having 'poor pensioners' in the future. Unfortunately, we cannot address it today, unless we drastically increase the taxes.

The issue of volunteering

"Let us volunteer to save!" Such a claim seems quite rational at first glance. However, it is a myth which we hear quite often. Were Armenia's population saving, we would have had quite a different economic structure. Yes, there are saving societies, but we are not one of them. Consume, consume, consume... incidentally, at times we consume products and services the utility of which is not even clear. Once an income increases a little, the number of attractive offers increases as well. Banks, for instance, start offering loans with greater pleasure. It is a fact that if all the employed stopped taking a loan for only one month, the interest rates would significantly drop. However, this is impossible; this is not about us. It has been four years since the introduction of the funded pension system, and all advocates of the voluntary principle of involving in the system should retrospectively estimate their savings. Economic policies are not developed based on abstract concepts, but rather based on actual social behaviour. And the actual social behaviour in Armenia tends to demonstrate tendency towards overconsumption.

Afterwards

After the introduction of the funded pension system the first issue on the agenda is the legalization of employer-employee relations. The employer should not have an opportunity to work in the shadow job market, and the employee should not be deprived of social guarantees for their future only because they are not able to negotiate good conditions in the present. Many employees opt for shadow jobs, because they prefer the immediate income. Unfair business thrives through exploitation of such short-term needs. People are compelled to sacrifice their future in order to meet their needs today. Therefore, there is a need for new social and economic policies.

However, even reduced consumption encouraged by introduction of the new pension system is not enough for building a more competitive economy. In countries with high poverty rates it is ensured not simply through high income, but through ensuring the population's welfare. It is not about everybody getting rich, which is impossible, but about sensible spending. If someone in the family gets seriously ill, the family budget undergoes serious changes, and the prosperity of the family transforms into poverty. We tend to save in many things: healthcare, safe construction, ecology, sanitation and hygiene, and we turn this seemingly short-term benefit into a long-term expense, which essentially is a sort of a delay-action tax that fact of which we do not fully acknowledge. And the tax rate is much higher, than the one paid from individual income. Still, we should not relax with the introduction of the new pension system but should initiate and implement others. It is only the beginning.

This paper has been elaborated based on the opinions passed by the participants of the round table "Enforcement of the mandatory principle within the funded pension system: actions, risks and opportunities", which took place on 19 February, 2018. The round table was attended by members of the National Assembly, representatives of the Central Bank and independent analysts. It was organized within the project "Improving Communication Strategy of the Monetary and Financial Sector".