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Abstract

This article examines the past and the present aspects of retirement income provision in Armenia, with an outlook for the future. It particularly looks at the main drivers behind the systemic reform and the structure and operation of the old and new systems. The public attitude towards and the discourse about reform are also analysed. An assessment is made whether the reformed system can better ensure retirement income provision.

Introduction

The reform of the pension system in Armenia has arguably been one of the most contested policies adopted since its independence. Legislatively enacted in 2010, the reform entails a transition from an exclusively publicly financed and managed system (Bismarckian or pay-as-you-go (PAYG)) to one that combines tax-financed tiers with privately managed funded tiers (a multipillar system). The introduction of a mandatory funded scheme for those born after January 1, 1974, met significant opposition from the society, resulting in the formation of a movement called *'Dem Em'* ('I am against'). On April 2, 2014, the Constitutional Court of Armenia declared several provisions of the Law on Funded Pensions as unconstitutional, and the law went into effect covering only public sector employees. Since July 2018, both public and private sector employees have been involved in the scheme, with a contribution rate of 2.5% of their gross wages.

This paper looks at the operation of both the old and the new systems, with the purpose of discussing the causes that made the former system ineffective in providing retirement income and the features that are meant to enable the latter to fulfil its purpose. The first two sections look at the structure of the pension system and its operation. The problems faced by the old system and the extent to which the reformed system copes with those are also discussed. The third section contains a discussion of the public discourse about reform and the attitude towards its implementation.

Structure of the System

Prior to reform, the pension system in Armenia consisted of a single tier that employed a pay-as-you-go (PAYG) defined benefit (DB) scheme to provide pensions, i.e., benefits to the retired population were financed through the contributions of the working-age population. The system followed the Bismarckian logic of social insurance, implying that apart from being used by the government to finance the pensions of the retired population, the social security contributions made by employees and their employers earned for these individuals *a right to pension.* Social assistance was provided to the members of the retired population who did not have the required length of service (five years in 2010) to qualify for an earnings-related pension (National Assembly of the Republic of Armenia, 2002).

By the reform, a transition has been made to a multi-tier system, which is modelled on the World Bank's proposed framework (Holzmann and Hinz, 2005; World Bank, 1994) and includes the following components:

1. *A zero pillar,* which provides old-age, disability, and survivor pensions to individuals with no insurance coverage. Benefits are financed from the state budget and are equal to the minimum food basket allowance.
2. *A first pillar*, which provides old-age, disability, and survivor pensions to those with insurance coverage who were aged above 40 in 2014, thus replacing their lost income. Benefits are financed from the state budget and depend on personal earnings.
3. *A second pillar,* which will provide pensions to those who were aged below 40 in 2014 and who make contributions to their mandatory individual accounts. Benefits are self- and state-financed with contribution rates of 2.5% by the individual and 7.5% by the government. Pension benefits will depend on the amount of accumulated funds at retirement and the investment return, net of management fees.
4. *A third pillar,* which will provide pensions to those who make contributions to the voluntarily funded scheme.

The third and fourth tiers of the system employ *defined contribution (DC)* schemes and operate as a complement to the second tier, which retains the DB scheme of the old system. Benefits from all tiers may be received upon reaching the statutory pensionable age (currently 63 years old for both men and women), except for cases specified by law. The required period for qualifying for an earnings-related pension has been increased from five to ten years (National Assembly of the Republic of Armenia, 2010a, 2010b).

Operation of the System

Pension systems carry out two main functions: insurance against the incapacity to work because of advanced age or disability and alleviation of old-age poverty through redistribution from the lifetime rich to the lifetime poor

(Barr and Diamond, 2010; Holzmann and Hinz, 2005; Schwarz, 2006). These functions, which are also objectives of social policy, can be fulfilled only if certain conditions are met. For one, the population has to be covered by the operating scheme, which involves workers as contributors and the retired as beneficiaries. For another, the size of the pension must be enough to ensure an adequate standard of living for the elderly population. Other conditions include the affordability and sustainability of the retirement income provision given the population and economic growth rates, equity, economic and administrative efficiency, as well as the robustness of the system or its ability to withstand adverse social, political, and economic developments (Holzmann and Hinz, 2005; Holzmann, Hinz, and Dorfman, 2008; Whitehouse, 2012). In the following paragraphs, the situation in Armenia pre- and post-reform is discussed, followed by an assessment of whether the reformed system can better ensure the provision of retirement income.

Coverage: In 2010, the pension system covered less than ¼ of the working-age population, as only 529,100 of the 2.2 million contributed to it (State Social Security Service of the Republic of Armenia, 2020; Statistical Committee of the Republic of Armenia, 2019a). Being close to those observed in Georgia, Azerbaijan, and Albania, that rate of coverage was substantially below the near-universal coverage seen in the countries of Central and Eastern Europe (International Labour Organization, 2019; Pallares-Miralles, Romero, and Whitehouse, 2012, pp. 166–169). In terms of beneficiaries, coverage was high, as the number of those who were above the statutory pensionable age was 376,000 in 2010, while old-age pensions were provided to 465,084 individuals or 14% of the population (National Statistical Service of the Republic of Armenia, 2013, p. 17). As of October 31, 2019, the number of contributors to the funded scheme was 537,627 (Central Bank of the Republic of Armenia, 2019), which is equal to 89% of the registered workers and 47% of the labour force (Statistical Committee of the Republic of Armenia, 2019a, 2019c, p. 70). Approximately one thousand individuals contribute to the voluntarily funded scheme (Capital Asset Management CJSC, 2020). The number of recipients of old-age pensions has decreased to 322,692 (Statistical Committee of the Republic of Armenia, 2019b, p. 459).

Adequacy: Poverty rates among the elderly population were high in 2010. Approximately 33% lived below the upper general poverty line of 33,500 AMD (at that time equal to approximately 90 USD), thus being qualified as *'poor,'* and 2.5% lived below the food or extreme poverty line of 19,000 AMD (50 USD) *('extremely poor')*. Elderly individuals accounted for the largest share (11%) of the poor population (National Statistical Service of the Republic of Armenia, 2011, p. 39). In 2018, the respective rates were lower standing at 21% for poor and 0.5% for the extremely poor, but the elderly population continued to account for the largest—and larger compared with the percentage in 2010—share of the poor population at 14% (Statistical Committee of the Republic of Armenia, 2019d, p. 52). The replacement rate of pensions (defined as the average pension relative to the average wage) was 26% in 2010 and 23% in 2018 (Statistical Committee of the Republic of Armenia, 2019a).

Affordability and Sustainability: In 2010, pensions made up the largest share of government expenditures at 18.5%. That total equalled 5% of GDP and was substantially more than the spending of other social sectors, including education and healthcare (National Statistical Service of the Republic of Armenia, 2011, p. 26). Pension spending accounted for 7% of the GDP and 19% of the government expenditure in 2018 (Statistical Committee of the Republic of Armenia, 2019e, p. 408–410). The system dependency ratio (the number of contributors divided by the number of beneficiaries) was 0.98 in 2010 (State Social Security Service of the Republic of Armenia, 2020), i.e., there was roughly one contributor per retiree, which is well below the ratio of 3:1 necessary for maintaining systemic stability (Government of the Republic of Armenia, 2008). The old-age dependency ratio (the share of population aged 65+ within the population aged 15–64) was 16% in 2010 and is projected to reach 34% by 2050 (United Nations Population Division, 2019).

Equity: Data from the World Bank's ASPIRE database (World Bank, 2020) reveal that in pre-reform years, greater social security benefits were provided to those in the lower quantiles of income distribution. Thus, the PAYG system was intra-generationally equitable. However, in terms of intergenerational equity, the system would be inequitable if left unreformed, as benefits would be provided to current workers that were lower than their contributions (24% of wage in 2010). This is because of the high emigration and low birth rates (25% and 1.5 on average, respectively, for the period 2010–2017) (Statistical Committee of the Republic of Armenia, 2019a).

Economic Efficiency: Conceptual documents on the reform reflected the argument presented in the literature that social security contributions in a PAYG-DB system create disincentives for formal employment and private saving, thus hindering economic growth (Government of the Republic of Armenia, 2005, 2006, 2008). Statistical data are supportive of that claim in that the rate of non-agricultural informal employment decreased notably from 22% to 18% in 2014, the year when social security contributions were unified with income tax (Statistical Committee of the Republic of Armenia, 2018, p. 112).

Administrative Efficiency: The administrative costs of the Social Insurance Fund accounted for approximately

2% of its total expenditures and 7% of the non-pension expenditures (National Statistical Service of the Republic of Armenia, 2008, p. 365). To reduce the administrative costs associated with running the individual accounts, two features are incorporated into the reformed system. First, recordkeeping is centralized and carried out by the Central Depository of Armenia; second, a cap has been placed on the fees that asset managers can charge (1.5% of the net asset value (NAV)) (National Assembly of the Republic of Armenia, 2010a). As of January 8, 2020, the fees charged by the two asset managers are below the legislatively set 1.5%, while the rates of return on pension fund assets have been positive since its inception in March 2014. The average return has been 10% for balanced and fixed-income funds and 9.6% for conservative funds (Amundi ACBA Asset Management Armenia, 2020; C-QUADRAT Ampega Asset Management Armenia, 2020).

Robustness (Security of Benefits): The two determinants of the robustness of a pension system are the extent to which its financing and management are diversified (Holzmann, Hinz, and Dorfman, 2008) and (specifically for DC schemes) the share of the assets that are invested in secure financial instruments, such as government bonds and deposits (Pension System Awareness Center, 2018). As opposed to the old system, which relied exclusively on a publicly financed and managed scheme, the reformed system is diversified; pillars 0 and 1 are tax-financed and managed by the state, while pillars 2 and 3 are funded and managed privately. Data published by the Central Bank of Armenia and the Central Depository of Armenia show that approximately two-thirds of the pension fund assets are currently invested in government bonds and deposits (Central Bank of the Republic of Armenia, 2019; Central Depository of Armenia, 2019).

A general assessment of the reform that can be made at this point is that although replacement rates remain low and poverty among the elderly population persists, the reformed system can ensure a better retirement income for future retirees, as coverage, sustainability, and robustness of the system have been improved, and economic inefficiencies are being overcome. Given the challenges of ageing and the emigration of the working-age population, those are the gains from the reform.

Public Discourse and Attitude towards the Reform

The reform was advocated by the government as a means to ensure a higher standard of living for the elderly population. Increased individual responsibility in the provision of retirement income, captured by the motto *"Not only the state but also the citizen,"* was seen as the key to that objective (Government of the Republic of Armenia, n.d., p. 1). It was emphasized that the tax burden on the employees and their employers would not increase, as social security contributions and the income tax would be integrated in a single tax on income (Ibid.). To promote public awareness, a number of initiatives were started, among which was the establishment of the Pension System Awareness Center (PSAC).

The opposition to reform, represented by the four non-governing factions in the parliament (Prosperous Armenia, the Armenian National Congress, the Armenian Revolutionary Federation, and the Heritage parties), discredited the reform as an attempt by the ruling party (the Republican Party of Armenia) to renege on its responsibility of ensuring the sustainability of the pension system. A social movement called *"Dem Em"* ("I am against"), initially comprised of IT sector employees, organized rallies and demonstrations against the reform. Leaders of the movement declared that by making the funded component mandatory, the government was impinging on the constitutionally enshrined rights and freedoms of the citizens, particularly that of property, and was violating the constitutional provision that Armenia is a social state (Dem Em Initiative, 2020).

In December 2013, opposition MPs filed a case with the Constitutional Court of Armenia to determine the constitutionality of a number of articles in the Law on Funded Pensions. In its decision published on April 2, 2014, the Court declared those provisions unconstitutional, urging the Government and the National Assembly to take steps towards revising the law (Constitutional Court of Armenia, 2014). Public opinion survey data from a representative sample (Caucasus Research Resource Centers, 2015) revealed that the majority of the population across all age groups and income levels disapproved of the reform (for details see Figures 1a and 1b at the end of this contribution).

The revised law went into effect in June 2014, with only public sector employees being required to contribute to the funded scheme. The mandatory operation of the funded scheme for private sector employees, conditioned by the changes in the tax code, was scheduled to take effect on July 1, 2018 (Azatutyun, 2016). The disapproval ratings of the reform remained high in 2017 (Caucasus Research Resource Centers, 2017), though a decreasing trend comparable with that in 2015 did take place (see Figures 2a and 2b at the end of this contribution).

In June 2018, confronted with the decision of either halting the taking effect of the law or not undertaking any action at all, the post-revolutionary government of Nikol Pashinyan chose a middle approach. The funded scheme, which by then already covered some 200,000 employees, was not abolished, but the contribution rates were altered, with individual rates decreasing from 5% to 2.5% of wages and the government contributions increasing from 5% to 7.5%. Referring to the negative consequences that the abolishment of the funded scheme would have for the society and the economy, the prime minister noted that the reform "was in the national interest of the Republic of Armenia and in the long-term interest of its citizens" (CivilNet, 2018). The bill was passed in the parliament with 78 votes in favour, two against, and seven abstaining (Asbarez, 2018). The MPs who initially disapproved of the reform expressed conditional support for the new government with the expectation of further deliberations and reform (Panorama, 2018). Members of the *"Dem Em"* movement planned to renew their protests (Azatutyun, 2018), but as of this writing, no large-scale protests have taken place. Tax law changes introduced by the new government (adopted in June 2019, effective as of January 1, 2020) envisage that in the period 2020–2023, personal income tax rates will gradually decrease from the current 23% to 20% for all citizens (flat taxation), while social security contribution rates will be restored to the pre-2018 rates (5% by the individual and 5% from the government) (National Assembly of the Republic of Armenia, 2019a, 2019b).

Conclusion

In an attempt to solve the fiscal sustainability problem of the PAYG system, the government of the Republic of Armenia chose to transition to a multipillar system that combines tax-financed tiers with fully funded tiers. The opposition to this reform from parliamentary factions and society at large led to the questioning of several provisions of the Law on Funded Pensions and its ultimate revision. Although the reformed system has the potential to address the problems that the old system faced, thus providing adequate retirement income, public disapproval of the mandatory funded scheme remains high.

About the Author

Gayane Shakhmuradyan is an alumna of the American University of Armenia, with an MA in Political Science and International Affairs (2019). Her research interests are in the field of comparative politics, and she wrote her master's thesis on the pension system reform in Armenia. Currently, she is doing research at the American University of Armenia and plans to apply for PhD studies.

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