

## The Current State of the Pension System in Azerbaijan: Challenges and Prospects

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## The Current State of the Pension System in Azerbaijan: Challenges and Prospects

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### Abstract

This contribution gives an overview of the current state of the pension system in Azerbaijan, examining the regulation of the retirement age and disability pensions as well as the generosity of pension benefits. Major indicators are compared to those of other countries in the post-Soviet region. The contribution continues to assess reform needs and reform plans. The contribution concludes with brief recommendations for pension reform.

### Introduction

According to official data, at the beginning of 2019, 13.2% of the total population of Azerbaijan (equal to 1.3 mn out of nearly 10 mn people) were pensioners. (State Statistical Committee 2019) In comparison to the post-Soviet region, this is a very low number. While in Azerbaijan, as indicated above, there are 130 pensioners

per 1,000 people, the figure is 154 in Armenia, 157 in Kazakhstan, 200 in Moldova, 264 in Ukraine, 273 in Belarus, and 296 in Russia. (Interstate Statistical Committee 2019) Furthermore, Azerbaijan's state finances have benefited from an oil boom. Accordingly, pressure for pension reform has been relatively weak. However, the current system is not sustainable in the long run.

The law “On Labour Pensions”<sup>1</sup> adopted on February 7, 2006, regulates the pension system in the country. The state pension policy of the Republic of Azerbaijan is determined by the “Concept of Pension Reform in the Republic of Azerbaijan for 2014–2020”<sup>2</sup>. There are three categories of labour pensions: old age pension, pension for disabled persons and pension due to loss of the family head. The following sections give an overview of the related regulations as of 2019.

### Retirement Age

Amendments to the law “On Labour Pensions” of March 10, 2017, provide the right to retirement with a pension if the pension capital accumulated in the insurance section of the individual account of a person who has reached the pension age allows for a pension payment that is not less than the minimum amount of the labour pension; alternatively, if that is not the case, an insurance period of 25 years also entitles a person to receive an old age pension.

To reduce pension payments, the retirement age has been gradually increasing since July 1, 2017. According to Article 7 of the law “On Labour Pensions”, each year 6 months are added to the minimum retirement age. According to the adopted schedule, from July 1, 2019, to June 30, 2020, the age limit is 64 years and 6 months for men and 61 years and 6 months for women. After July 1, 2026, when the transition period ends, the retirement age will be equal for men and women, standing at 65 years.

Compared with the region, the retirement age of 65 years is high. Among the post-Soviet countries, only Georgia, Latvia, and Lithuania currently apply this age. Kazakhstan, Kyrgyzstan, Tajikistan, Armenia and Estonia follow with 63 years. In Russia, Ukraine and Belarus, the retirement age is currently 60 years. It is also important to note that the Soviet tradition of gender differences in the retirement age, i.e., women retiring earlier than men, has currently been abandoned only in 6 countries (Latvia, Lithuania, Ukraine, Kazakhstan, Armenia, Estonia).

While the retirement age of 65 is not high when compared to Western countries, the lower life expectancy in the post-Soviet region has to be taken into account. Thus, Estonia and Belarus are among the post-Soviet countries with the highest average life expectancy after retirement and thus with the longest average payment period for old age pensions. The corresponding figure in both countries is 14 years. Armenia follows with 12

years, and Russia and Ukraine with 11 years. In Azerbaijan, the figure is only 7.5 years. (CESD 2017. p.16). According to the latest WHO data published in 2018 the life expectancy in Azerbaijan stands at 73.1 years (70.3 years for men and 75.7 years for women). With this figure Azerbaijan ranks 96<sup>th</sup> in a global comparison. The ongoing increase in the retirement age in Azerbaijan will further reduce the average period of pension payments per person, which will become a factor contributing to a decline in social welfare. Furthermore, the fact that the period of receiving an old age pension is so short creates difficulties in pursuing effective collection policies, because incentives to care for one’s pension are low when the pension payments cover only a few years.

### Disability and Loss of Family Head Pensions

A labour pensioner has the right to move from one type of labour pension to another, except for the transition from the old age pension to disability pension, according to Article 34 of the law “On Labour Pensions”. At the same time, only one pension is granted to adult persons who have different pension rights. This means that a disability pension is only paid as long as a person receives no old age pension.

In Azerbaijan, the disability pension is established in connection with the limitation on an insured person’s ability to work for reasons of mental or physical disability resulting from illness or injury. Disability groups, causes of disability or limited health under the age of 18, as well as the period of disability occurrence are determined by medical and social expert commissions in accordance with the legislation. Disability pension is provided to Group I disabled persons if they have 4 months of insurance period for each full year of the working age, provided that the total insurance period is not less than 5 years. Disability pension is provided to Group II and III disabled persons if they have a determined insurance period, provided that the pension capital recorded in the insurance section of the personal account allows a pension guarantee that is not less than the minimum amount of labour pension.<sup>3</sup>

According to the current legislation, family members (children under the age of 18 with parents who are deceased or killed, as well as children of disabled persons over the age of 18 whose limitations on health were identified up to the age of 18, and students studying full-time at an education department of educational institutions up to the age of 23) who assume the respon-

1 <http://www.e-qanun.az/framework/11566>

2 <https://president.az/articles/13330>

3 <http://sosial.gov.az/elilliyegoreemekpensiyasi>

sibility of the deceased or killed head of the family have the right to a labour pension due to the loss of a family head.<sup>4</sup> Labour pensions due to the loss of a family head consist of only the insurance section.

### Pension Benefits

Old age pensions and pensions for disabled persons consist of two parts, one part based on insurance and one part based on individual savings. Both parts are recorded in an individual pension account, and the respective part of the old age pension is calculated as the ratio of the pension capital in the respective part to the number of months of the expected pension payment term.

Since 2017, each year the old age pensions have been indexed according to the annual growth rate of the average monthly nominal salary for the previous year, as defined by the State Statistical Committee. Until 2017, the labour pensions were based on the consumer price index for the previous year. For orientation purposes, the average nominal monthly wage growth rate in 2017 was 5.7 percent and in 2018 it was 3 percent, while inflation amounted to 12.9 percent and 2.3 percent, respectively.

According to the data from early 2019, the average monthly pension in the country was 222.6 manat<sup>5</sup> (at that time equal to approximately 130 USD), amounting to just 40% of the average monthly nominal salary in the country. In detail, the old age pension stood at 249.3 manat (145 USD), the disability pension at 185 manat (110 USD) and the loss of family head pension at 175.4 manat (110 USD).

As shown in table 1 on p. 18, 2.56 insured people in 2016, 2.7 insured people in 2017 and 2.86 insured people in 2018 corresponded to one pensioner. Although the dynamics of the past three years have been positive, Azerbaijan has not yet reached the minimum level of sustainability for this system—3 insured people per pensioner.

### Reform Objectives

At present, the main objectives of the pension system of the Republic of Azerbaijan are to reduce the dependence of the pension system on budget funds (to minimize non-insurance costs), to increase the functional dependence between the size of the social insurance collection and the size of the amount of the designated pension, to concretize government obligations to finance the pension system, to stimulate the transition to “minimum pension capital”, to create opportunities for the application of a voluntary savings component to the insurance and

to create opportunities for the establishment of non-governmental pension funds (institutions). To achieve these goals, the base part of labour pensions has been abolished so far, the minimum age for the right to receive an old age pension has been increased, the “minimum pension capital” criterion has been introduced, and the requirement of minimum work experience to obtain the right to labour pension has been abolished. The required level of work experience for those who are entitled to a labour pension on preferential terms has been increased by 5 or 10 years in different fields and, as a result, since 2017, Azerbaijan has transitioned from a three-tier system to a two-tier system of labour pensions. However, in the Concept, important issues such as the increase in the insurance premium rates for 2014–2015, as well as the increase in the insurance rates of those people who pay the mandatory state social insurance based on the minimum wage (persons who use agricultural lands on their property, persons engaged in private businesses and labour activity) have not yet been resolved.

Moreover, the pension system in Azerbaijan has not yet been adapted to the needs of the market economy and has not been integrated into international standards. In addition, the pension system has not been financially viable, and this system has not been able to achieve the reliable social protection of retirees in the long term due to the continued serious dependence on state financial resources. Thus, a number of the non-social insurance obligations of the existing pension system in our country have led to an increase in social security spending and transfers from the state budget, significantly increasing the financial burden of this system.

As a result, expenditures in the approved budget of the State Social Protection Fund in 2018 amounted to 3578.7 million manat<sup>6</sup>, which is six times more than in 2006, with 589.5 million manat. During the same period, the amount of transfers from the state budget increased 7.8 times, from 167 million to 1300 million manat, and the share of total expenditures increased from 28.3 percent to 36.3 percent. In the budget of 2019, incomes for mandatory state social insurance are predicted to be 67.1%, and the funds allocated from the state budget are predicted to be 32.8%.<sup>7</sup>

Although recent actions taken at the state level in the direction of formalizing work places, registering labour contracts, and eliminating informal employment expanded the possibilities of using the savings potential of the mandatory state social insurance, in Azerbaijan, the indication of the specific weight of expenses on the

4 <http://sosial.gov.az/ailebashchisitiirmeyegorepensiya>

5 <http://marja.az/news/37393>

6 [http://sai.gov.az/upload/files/DSMF\\_layihe2018\\_27OKTYABR\\_F%C4%B0NAL.pdf](http://sai.gov.az/upload/files/DSMF_layihe2018_27OKTYABR_F%C4%B0NAL.pdf)

7 [http://sai.gov.az/upload/files/DSMF\\_deyishiklik\\_Final.pdf](http://sai.gov.az/upload/files/DSMF_deyishiklik_Final.pdf)

payment of labour pensions by age has had a tendency to decline compared to international indicators, while in contrast, the indication of the specific weight of the expenses on the payment of labour pensions by disability, has had a tendency to increase in comparison with the specific weights of world practices.

The “Concept of economic and social development of the Republic of Azerbaijan for 2018 and the next three years” is aimed at the self-regulation of the insurance-pension system and the achievement of an independent future development. As a priority of the policies on social protection and social security, the Concept also aims at improving the structure of the mandatory state social insurance premium rates, increasing the insurance rates of the people who pay the mandatory state social insurance based on the minimum wage (persons who use agricultural lands on their property and persons engaged in private businesses and labour activity), and optimizing the ratio of the number of people paying the insurance premium to the number of pensioners in 2018–2021.

### **The Impact of Lower Oil Prices**

In 2015 Azerbaijan’s economy started to be effected by lower world oil prices. Since then, various measures have been put in place to reduce the share of transfers from the state budget to the State Social Protection Fund. Thus, as outlined above, the retirement age is currently increased step by step to 65 years. The retirement age of 65 will be introduced in 2021 for men and in 2027 for women.

Another measure has been to change the method of calculating compulsory social insurance contribu-

tions. According to the new methodology, employers pay 15 percent (previously 22 percent), and employees pay 10 percent (previously 3 percent) compulsory social insurance contributions if the monthly wage more than 200 AZN (117.65 USD). Finally, the authorities have tightened controls in order to detect and legalize hidden employment.

### **Recommendations**

In connection with the above, appropriate measures should be taken to further strengthen financial sustainability, regulate the impact of the financial burden of expenditures on government obligations not based on social insurance principles on the system, and strengthen the link between social security contributions and social insurance payments for the long-term development of the pension system. For this purpose, the non-diversification of pension insurance principles for both property and payment sources shows that the use of the reform potential in the country is low.

In conclusion, I would like to emphasize that to strengthen the pension system in Azerbaijan and reduce its financial dependence (ensuring a balance between income and expenditure), the government should first try to legalize the labour market. In this way, it would be possible to increase the ratio of the number of insured persons to the number of pensioners, as well as increase the income of the Social Security Fund. At the same time, it is necessary to regulate the amount of expenditure by automation and transparency of the mechanisms of pension assignment.

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- State Statistical Committee of the Republic of Azerbaijan (2019): Social Security Statistics, <https://www.stat.gov.az/source/healthcare/>

**Table 1: Key Indicators of the Pension System for 2016–2019**

| Indicator   | Unit            | 2016 | 2017  | 2018 | 2019  |
|---|-----------------|------|-------|------|-------|
| Number of insured people registered in the individual accounting system | thousand people | 3372 | 3545* | 3737 | -     |
| Number of labour pensioners (at the end of each year)                   | thousand people | 1315 | 1311  | 1304 | 1300  |
| By age  | thousand people | 782  | 769   | 760  | 756   |
| For disabled persons  | thousand people | 384  | 384   | 380  | 390   |
| By loss of family head  | thousand people | 150  | 158   | 164  | 149   |
| Average monthly amount of pension                                       | manat           | 192  | 209   | 217  | 223   |
|   | USD             | 120  | 122   | 128  | 131   |
| Minimum amount of pension   | manat           | 110  | 110   | 110  | 200** |
|   | USD             | 69   | 65    | 65   | 118   |
| Cost of living for labour pensioners                                    | manat           | 123  | 130   | 144  | 149   |
|   | USD             | 77   | 76    | 85   | 88    |

Notes: \* to November 1, 2017, \*\* from October 1, 2019

Source: State Statistics Committee of the Republic of Azerbaijan