EU Trends on Pension Developments and Challenges for Macedonian Pension System

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Abstract: The European Union (EU) itself is facing many demographic challenges, mobility, migration, and unemployment, all of these important factors in defining pension policies. This issue is today part of academic debates, government policies and discussions in international forums, and the concern of international organizations to find a more appropriate pension system that will face the challenges of today's world. Macedonia, as a candidate country for EU membership, has similar problems with regard to pension policies in general, and recently faces major challenges regarding the stability of the pension system. On the one hand, it is trying to harmonize the national legislations in this area with EU legislation; while on the other hand, it must take care of the stability of the system as the result of demographic changes. The paper tends to analyse the trends of pension policy development in EU member states, then pension system of Macedonia. In the framework of the research there are used descriptive method, method of analysis, comparative method and interview analysis. While results should serve the academic community, students and political stakeholders in finding the most appropriate solution, in accordance with real possibilities, as well as to encourage debate and further studies.

Keywords: Pensions; EU; Macedonia

1. Problem Statement

The paper consists to point out trends for finding the most appropriate solution through the building of policies, laws and institutions that correctly will deal with Macedonian pension system.

The results from the statistical data (2013) that come from the Pension and Disability Fund of Macedonia show an increase in the number of pensioners and the longer use of the pension. The financial situation of the pension system is unstable. Expenditures in 2006 had reached 21 million €, while in 2013 costs increased to 69 million €, and is projected for 2030 to cost 230 million €. This situation is also

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affected by the reduction of contributions, which is a heavy burden for the Fund's financial operations. With the government's decision from 2009, contributions dropped from 21.2% to 19%, while in 2010 contributions dropped to 18% (which means a 15% reduction in the Pension Fund income).

High unemployment rate is another problem that makes the situation more difficult. According to the data of the State Statistical Office (2017), in the first quarter of 2017, the labour force in Macedonia counted 952,664 people out of which 734,043 were employed, while 218,601 were unemployed. The activity rate in this period was 56.7%, the employment rate was 43.7%, while the unemployment rate was 22.9%.

The most important economic parameters affecting the Pension Fund are the GDP, rising real wages, inflation and unemployment. Their mutual relations and impacts ease or hinder the functioning of the Pension Fund, so they appear on the side of the Fund's budget expenditure. The wage movement in the economy affects the Fund's incomes and expenditures, so their growth or reduction affects payroll contributions, along with the cost of living used to regulate pensions.

Demographic negative circumstances such as: reduction in the number of new births; Decrease in the number of active population and high unemployment rate; Increase the life expectancy of the pensioner's population; all of these complicate the functioning of the Pension Fund to cover the cost of pensions.

2. Literature Overview

The financial condition of the pension system is determined by the impact of demographic variables, as well as by the ratio of macroeconomic variables and the employment rate. However, the data presented by the European Commission and Eurostat show that developed countries are facing the aging problem of the population. However, in order to cope with this negative phenomenon, states allow migration of labour force from other countries to labour profiles which are deficient in the labour market. Therefore, some countries with a negative population trend may benefit from migration, a phenomenon occurring in West Germany, eastern Austria, northern Italy and southern Sweden. (Tania et al., 2012, p. 4)

Given the aging of the population, the decline in the number of new births, and institutional weaknesses in existing pension systems, international institutions have published studies on the difficulties and proposals for reforms in pension systems, which consist of changes in retirement practices in all EU member states.[1]

Pensions mainly from the PAYG scheme are the main source of income for older people in Europe. European pension systems are facing the dual challenge: Financial sustainability of pension schemes, and provision of sufficient income for retirees to enjoy good living standards and economic independence.[2]

According to data provided by Eurostat, the population over the age of 60 is currently growing (with about two million people each year), while the number of people of active age is on the decline and will fall each year over the next decades. (Eurostat, 2016) Supporting pension systems requires a good balance between: contributory years and retirement years, then the employment age and job stability.

Sustainability has to do with the fiscal and financial balance between income and liabilities (and the ratio of workers/contributors to pensioners/beneficiaries) in pension schemes. In the future, EU member states will find a deficit in the public pension system. (OECD, 2009a) To be sustainable, long-term public pension schemes should be able to prevent the aging of the population from affecting the destabilization of public finances. Pension expenditures are making up a large part of public spending. The EU-28 average was 11.3% of GDP in 2013, 6.9% in Netherlands to 16.2% in Greece. (European Commission, 2015, p. 7) Public pension expenditures in the 28 EU member states are currently projected to grow by 0.4% of

[1] The World Bank published the report “Avoiding Old-Age Crisis: Elderly Care and Growth Policy” (1994), which sets the key variables that allow the adaptation of pension systems to the new reality of the population. The World Bank proposals are also provided in the 2005 report “Elderly Support and Revenues in the 21st Century: An International Perspective on Pension Systems and Reforms”. The World Bank has consistently recommended the adoption of the five pillars model: “zero pillar”, which includes social pensions, provided for the purpose of providing a minimum age protection, the “pillar”, mandatory, funded by contributions And associated with different income groups, whose main objective is to replace part of the salary received throughout the work when the individual becomes a pensioner; the “second pillar”, mandatory, functions as a typical individual account the savings, which promotes a good relationship between contributions and benefits, the “third pilla” voluntary, can take various forms (individual savings for disability retirement or in case of death) and may adopt a two benefits logic defined contribution and defined, the “fourth pillar” non includes informal support and formal social programs (for example, health care for the elderly) and individual financial assets or non-financial assets (such as real property).

[2] The country’s minimum pension per person in a month calculated in euros: The lowest pension is in Bulgaria (70 euros or 32% of the average salary), Romania (81 euro or 20.2% of the average salary), the Czech Republic (85 euro or 9.5 Hungary (99 euros), etc., while the highest pension is in Denmark (1610 euros or 40.1% of the average salary), Ireland (1076 euros or 31.6% of the average salary), the Netherlands (1065 euros or 29.4% of the average page), etc. Source: MISSOC tables and Pensions at a Glance 2011.

GDP over the period 2013-2040 and 11% of GDP by 2060. Croatia will record the most decline (3.9% of GDP), together with Denmark, Latvia (3.1%) and France (2.8%). In Italy, Greece, Sweden, Estonia, Spain, Portugal and Poland will be reduced by 2% to 0.7% of GDP. Otherwise, Luxembourg will experience strong growth in the ratio of public pension spending (4.1% of GDP) followed by Slovenia (3.5%), Belgium (3.3%) and Malta (3.2%). Germany and Slovakia will have an increase between 2% and 3% of GDP, while the increase will be from 0.7 to 1.1%; The UK, the Czech Republic, the Netherlands and Ireland, while being largely stable (+/- 0.5%) in Austria, Lithuania, Finland, Hungary, Cyprus, Romania and Bulgaria.

The linkage of the statutory retirement age and the life expectancy is inevitable in order to have sustainability and adaptability to pensions. In addition, pension reforms also require the removal of unjustified early pensions, which charge the pension system at extra cost.

Mostly, the EU has limited competence over pension systems, as these are defined by the member states themselves. The EU’s role is to adopt anti-discrimination provisions and people who exercise their right to free movement are not in loss. Fiscal rules and especially the so-called “European Semester” process can bring pensions to EU level. The European Commission in the Green Pension Report has highlighted the importance of pension systems to be adequate and sustainable. It highlights the risk that inadequate pensions, through public pressure, may lead to increased ad hoc pensions, endangering the sustainability of the pension system. The European Commission had defined its final vision on pensions in the 2012 White Paper “An Agenda for Adequate, Safe and Sustainable Pensions”. Two key issues are highlighted to ensure adequate and sustainable pensions: the balance of time at work and retirement, and additional development of private retirement savings. From the first European Semester (2011) to date, there have been developed a total of 5 other extensions, in which the Member States have accepted the specific recommendations for states concerning pensions, where they have agreed to:

- Increasing the retirement age to reflect changes in life expectancy;

- Harmonization of the age of state pensions for men and women;

- Limitation of early retirement and integration of special pension schemes;

- Promotion of active labour markets including older groups and increased employment of older workers (through lifelong learning and active aging);

- Encouraging Private Savings. (Eatock, 2015, p. 4)

National pension reforms have sought to respond to the growth of longevity and demographic pressures at different speeds and on the basis of specific national circumstances. According to forecasts in the Aging Report (2015) pension reform will result in an average growth of about 2.5 years at the effective retirement age for men and about 3 years for women. This will also affect the harmonization of retirement age for both sexes.[1]

3. Interview Analyses

"The current pension system, especially in recent years, is unsettled and if it continues as before, Macedonia in the future will be a country that will only work for retirees and will sacrifice growth and development opportunities" had emphasized in an interview professor *Igor Ivanovski.* (Faktor, 2016) Below is an excerpt from the interview.

1. How do you see the possibility of raising the retirement age as a measure of sustainability of the Pension Fund?

Increasing the retirement age to 67 years without solving the systemic problems is wrong and will have no effect. Through the legal changes in 2014, workers were granted the discretion to decide if they would retire two years later, which according to official data is used by a certain number of employees. This will negatively affect the already dysfunctional labour market and reduce employment opportunities for young people, where unemployment is higher.

2. Where should the reforms in the current pension system begin?

There is a need for clear, accurate, well-thought out and sustainable decisions and policies in the pension system. Actions and steps should be taken in these directions: stabilization and consolidation of the first pillar, through a preliminary objective analysis from which it will be inferred that the policy is wrong and then the package of legal regulation for the pension system should be amended through qualified majority voting, to prevent political interference and improvisation, and to build a new, inclusive and functional system of pension management.

[1] After 2020, England and Ireland are expected to increase their retirement age to 68 years; Germany, Denmark and the Netherlands will increase retirement age over 67 for both sexes; Austria, Romania, Latvia, Hungary, Malta, Czech Republic, and Greece will increase retirement age at 65. *Source:* Eurostat, MISSOC, "The 2009 Ageing Report". (European Commission, 2008a)

3. What does it mean increase the income in the Fund’s portfolio as the results of employment growth?

The level of growth is modest and inadequate, and the reduction of unemployment is slow and inefficient for the pension system. In the meantime, incomes grow less than spending. Moreover, people employed with active measures do not pay contributions, the situation is even worse, because they generate liabilities for future generations, and nobody pays (this practice should be stopped). It is important to build a model of economic development that will generate higher and more stable rates of economic growth with high levels of employment.

4. What was the impact of the increase in the level of pensions on the sustainability of the Pension Fund?

Salaries should also increase, and according to them, pensions. The problem arises when pensions grow more than real economy growth, more than labour productivity, and when pensions are understood as a means to finance unemployed people. It is not economically advantageous to lower pension contributions while pensions grow steadily.

5. What is the future of the Pension Fund?

In such a situation as Macedonia finds itself, economic policies have become part of the daily political propaganda and have no long-lasting approach and concept. This should immediately change, and pension policies should be based on analysis, debates and decisions about the future of the pension system. Consideration should be given to the possibility of changing the system of many pillars, and the change of Pension Fund’s approach from defined pensions to “visible, virtual accounts’ with defined contributions, where transparency will increase, while the first pillar will become more resistant from economic, demographic and political risks.

6. Is there a risk to the payment of pensions?

There is no state that will not pay pensions. It is necessary to stop the intimidation of pensioners with this unrealistic risk. It needs to be started with changes and solving the problems that are systematic. The pension system cannot be considered isolated, and the best solution for it is finding a macroeconomic model with a successful microeconomic implementation that would generate growth and employment, while the pension system should represent a sustainable system that provides enough income to pensioners as a result of just real growth of the economy.

4. Conclusions and Recommendations

To improve the pension fund's state of affairs, or to reduce costs and increase revenue, some measures need to be taken, including: introducing a combined retirement system (raising the retirement age for certain groups), Increase in pension contributions, improvement of financial discipline, reduction of fictitious pensioners, etc.

There should be a comprehensive analysis of on-going reforms of pensions in Macedonia, a redefinition of the complete system and undertaken necessary measures for dealing with the problems in the pension system, and must redefine the priority measures to be faced with factors which worsen system stability (economic, demographic, etc.).

The pension system needs redefinition is operational the first pillar as the dominant pillar in the overall pension system, in which should be introduced mechanism for financial stability and sustainability.

Two fully funded pension pillars need to be strengthened in terms of corporate efficiency, particularly to increase transparency, as well as integration in the country's financial system in ways that directly affects the country's economic growth.

To encourage debate at the level of experts and academics on the possible transformation of PAYG first pillar in the form of defined non-financial contribution or imagined as a form that is under development in several countries of the EU (Sweden, Italy, Poland and Latvia).[1]

Strengthen potential of adequate human resources within the Pension Fund.

[1] Under this system, insurers' contributions are kept in individual accounts under the current financing principle; the assets are used to pay current pensions and are not capitalized as in fully funded classical pension funds. The basic difference with PAYG or defined benefits is to determine future pension benefits for users by means of paid assets and actuarial life expectancy at the time of retirement. Thus, a straightforward actuarial gain is earned, which is paid by the current insurer's inflows, which in itself is associated with the risk of longevity and affects the sustainability of the system. In general, this is similar to the second pillar, but there is no market capitalization of the pooled assets, which are either seemingly or virtual, but not actually accounted for by current transfers of existing pension beneficiaries. Basically, even though it is a system of non-contributed financial contributions, but there is an implicit rate of contribution, which is the result of factors of increase in labor productivity or increase of wages, which affect the increase of the contributions, paid to the individual account of the insured persons.

The introduction of improved data, as well as registration of all outstanding claims, by beginning the process of payments through the Public Revenue Department.

Introduce a system where contributions to social insurance compulsory for all persons who will be employed will be paid in the fund through the budget of RM, which would have been replaced by the current practice according to which employees within the period when they do not pay contributions are not transferred to the Fund, which has generated only liabilities and not income.

The introduction of a system where compulsory social security contributions for all persons employed will be paid to the Fund through the budget of Macedonia.

Given the acquisition of early retirement, the number of employees of the Interior Ministry, ARM, mining and other activities, should be recorded as secured only in the first pillar, because the period of capitalization of assets is lower and the decrease in overall pension.

It is appropriate to enter into the pension system “pillars 0”, and which would incorporate the beneficiaries of the minimum pension, for those who for various reasons have not paid in order contributions and there is a big difference between contributions and benefits paid. This otherwise be known as “state pension” that would be paid by the MLSP from the state budget, with which will reduce the deficit in the first pillar, will be out in front of the needs of the poorest citizens, and can contribute for greater efficiency, transparency and objectivity of the social security system which is subject to severe pressures and abuses by political elites.

Another level of contribution rate for pension insurance should be established, above the current rate of 18%.

To establish the sustainability of the Pension Fund requires full immunity from the governing bodies, from the influence of the political elites of the executive power. Moreover, policy-making should involve representatives of retirees, trade unions, academia, external experts from international organizations (World Bank, International Labour Organization, European Economic Cooperation Organization, United Nations, etc.).

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