



Weekly Briefing

**North Macedonia social briefing:
The Macedonian pension system:
trends and challenges to sustainability**
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The Macedonian pension system: trends and challenges to sustainability

Summary

In spite of several reforms undertaken in the past years, the Macedonian pension system has been described as unsustainable and in need of urgent reform. Until 2008 some improvements have been noted, however there has been a continuous deterioration in the years since. The main reasons for this assessment have been the growing share of pension expenditures within the broader economy and the increase in the amount of transfers for pensions from the central budget which has contributed to the growth of the public debt. In the absence of major positive shifts in the economy, the pension system will continue draining the public finances in light of anticipated demographic challenges and the continuously rising deficit of the Pension and Disability Insurance Fund.

Reform of the pension system since 1991

In 1991 the Republic of Macedonia began establishing an independent pension and disability insurance system by setting up the Pension and Disability Insurance Fund of Macedonia (PIOM). Since 1994, the pension system in the country has been regulated by the Law on Pensions and Disability Insurance, which has undergone significant modifications and amendments in the years that followed.¹ Following the reforms implemented in 2000, in addition to PIOM (which is state-owned and managed), private pension funds have also been integrated in the pension system. As a result, the current system consists of three pillars:

Pillar 1 is known as the Statutory Pension Scheme. It consists of mandatory insurance, which is paid out to PIOM, and it is generated through the principle of generational solidarity - pay as you go (PAYG), providing earnings-related benefits based on the length of working service. Wages contributions of insurers are used to pay out the pensions of current and future pensioners. The first pillar provides part of the old-age pension, disability and survivors'

¹ Pension and Disability Insurance Fund of N.Macedonia, available at, <http://www.piom.com.mk/en/about-us/> accessed on 30.06.2021

pension benefits, and the minimum pension benefit. It is mandatory for all economically active people, including all employees, self-employed persons and farmers.

Pillar 2 is also known as the Statutory Funded Pension Scheme. It is also mandatory and a fully funded pension insurance scheme, which is run by (one of the two) private pension companies supervised by the state, providing benefits linked to accrued pension capital. The second pillar pays out part of the old-age pension. Since January 2003, all insurers pay part of their contributions (7%) to the private pension funds. All the others can choose whether or not they will join the Statutory Funded Pension Scheme. In 2019, the second pension pillar consisted of three pension fund management companies: Sava Pension Company, KB First Pension Company and Triglav Pension Company. As of November 30, 2019, the total number of members in the private pension companies was 507,439. Thereby, the value of the net assets in the mandatory pension funds (second pillar) amounted to Denar 74,889 billion (about EUR 1.22 billion).²

Pillar 3, which is also known as the Supplementary Pension Scheme, was introduced in 2007.³ It is a voluntary and a fully funded pension insurance which includes both personal schemes (for people between 15 and 70 years of age) and occupational-based schemes. The benefits paid from the supplementary pension scheme are similar to those from the second pillar, with the only difference that voluntary pension scheme members can decide to withdraw accumulated assets from third-pillar individual accounts as a lump sum, which is not allowed in the mandatory system.⁴ In 2019 there were two voluntary pension funds in the country: Sava pension plus and KB First Open Voluntary Pension Fund – Skopje. As of November 30, 2019, a total of 24,998 persons were members of the third pillar (voluntary pension funds) whose net assets amounted to Denar 1.91 billion (EUR 31.07 million).

² In 2019 the net assets of the private pension funds represented 10.8% of the total assets of the financial institutions in Macedonia.

³ Radio Mof (2019). Analysis- Hundreds of millions of euros in the private pension funds - how are the insurers' money protected, published on 06.02.2019, available at <https://www.radiomof.mk/analiza-stotici-milioni-evra-vo-privatnate-penziski-fondovi-kako-se-chuvaat-parite-na-osigurenicite/> accessed on 30.06.2021

⁴ Gerovska, M., M., *ESPN Thematic Report: Assessment of Pension Adequacy in the former Yugoslav Republic of Macedonia*, 2017, document prepared for the European Commission

The main rationale behind the establishment of the second and third pillar and the introduction of private funds within the pension system was the need to increase the pension funds by allowing private pension funds to invest the money of the insurers in various instruments such as stocks, mutual funds and securities.

The status quo of the pension system

There are three pension types available: old-age pension; disability pension and survivor pension. The main requirement of old-age pension is age (62 for women and 64 for men) and years of service (minimum of 15 years). The survivor pension is available to members of the family of a deceased contributor. The disability pension is available to people who have experienced an injury at work or occupational disease/disability.⁵ In 2009, there were a total of 278,463 pension beneficiaries in Macedonia, and in July 2020 that number increased to 324,893. Most of the pensioners (215,450 or 66.3%) were beneficiaries of old-age pensions and the average pension was 15 412 denars.⁶ Between 2010-2018, the pension contribution from gross wages was 18% (reduced from 21,2% until 2008). Announcements that contribution will drop to 17,6% failed to materialise due to the deficits in the PIOM. In 2018, the contribution rate for pension and disability insurance increased from 18% to 18.4%, and in 2019 to 18.8%.

Challenges and reform orientation of the pension system

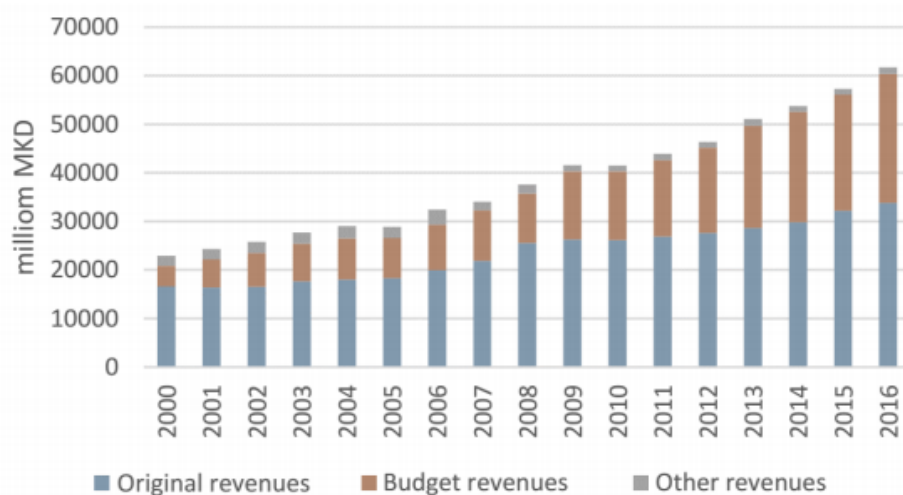
The dominant share of the revenue in the PIOM comes from wages contributions. However, a large share also comes from the budget transfers from the central fiscal budget of the country, which puts an additional strain on the budget deficit and has a negative implication on the financing of other fiscal expenditures. In 2016, 56,4% of revenues of the PIOM came from wages contributions. 43,6% came as a transfer from the central government budget. Transfers from the central budget to the Fund have grown steadily over time: in 1994, they

⁵ Petreski, B, Gacov, P. (2018). Sustainability of the pension system in Macedonia Comprehensive analysis and reform proposal with MK-PENS – Dynamic Microsimulation Model, Finance Think, available at <https://www.financethink.mk/wp-content/uploads/2018/06/Pension-analysis-EN.pdf> accessed on 30.06.2021

⁶ Economy and Business (2020). Вториот пензиски столб чува над една милијарда евра пензиски заштеди“, Економија и бизнис, година 21, број 257/257, јануари 2020, стр. 59.

amounted to 2% of GDP, in 2004 they reached 3% of GDP and are likely to increase to 5% by 2040.⁷

Graph 2: PDIF's revenue structure, 2000 - 2016



Source: PDIF

There are several reasons that have been responsible for the rise. The period of neoliberal transformation (in the 1990s and 2000s) was characterised by a severe socio-economic crisis, which resulted in the constant rise in the number of retirees-pension beneficiaries. This was one of the mechanisms used to deal with the surplus labour force in the country. At the same time, the number of unemployed people in the country was on a constant rise, reducing the wages contributions to PIOM. Furthermore, the overall reduction in the trust in the institutions decreased insurers' confidence in the security of pensions and stimulated the spread of evasion of pension contributions or the declaration of lower wages in order to pay lower pension contributions. Additionally, the multiple ad-hoc pension increases in Macedonia have been noted as one of the factors undermining its fiscal consolidation (European Commission,

⁷ Stojkov, A. (2017). „Пензионерски главоболки“, Економија и бизнис, година 19, број 233, ноември 2017, стр. 24-27.

2016).⁸⁹¹⁰ Finally, another challenge comes from the demographic changes which by 2030 will lead to people over 60 representing 41% of the population, which will practically block the pay-as-you-go system.

According to the World Bank “the reforms enacted since 2018 will stabilize the system over the near term.”¹¹ In the list of positive steps taken they include the Law on Pension and Disability Insurance, which plans to address pension system fiscal sustainability, adequacy of multi-pillar pensions, and overpaid and underpaid contributions to the funded pillar.¹²

Conclusion

The key factors that affect the sustainability of the Macedonian pension system include: demographic changes, labour market movements as part of the broader economy, and pension adjustment to the potential of the economy. Imbalance between the amount of pensions and the potential of the economy to finance those pensions is the major factor for the unsustainability of the pension system. The deficit in the pension system in Macedonia - the difference between the original revenues and total expenditure of the Pension and Disability Insurance Fund - has a tendency to grow over time. In spite of a small slowdown in 2019 and 2020, the trend remains. This has fiscal implications in view of the large contributions to the Fund which come from the

⁸ Similarly, the International Monetary Fund, in its annual report for 2017, argues that the increased budget deficit in recent years is also partly due to the great increase in pensions, creating the need for pension reform aimed at fiscal and pension consolidation (IMF, 2017)

⁹ Petreski, B, Gacov, P. (2018). Sustainability of the pension system in Macedonia Comprehensive analysis and reform proposal with MK-PENS – Dynamic Microsimulation Model, Finance Think, available at <https://www.financethink.mk/wp-content/uploads/2018/06/Pension-analysis-EN.pdf> accessed on 30.06.2021

¹⁰ The pressure for higher pensions is mainly driven by the power of retirees to impact policies, due to their increasing numbers and their importance as an electorate (Kruse, 2010)

¹¹ World Bank (2019). FYR Macedonia Special Focus Note: Pension Reform, available at <https://documents1.worldbank.org/curated/en/895551549468307274/pdf/134426-WorldBankSpecialFocusNotePensionsNovemberFINAL.pdf> accessed on 30.06.2021

¹² Moreover, they mention the pension policy measures aimed to secure fiscal sustainability and strengthen equity, which includes: (i) the price (CPI) indexation of pensions with a supplementary 25-percent wage indexation in case a real GDP grows above 4 percent per year; (ii) harmonization of accrual rates by lowering the PAYG-only accruals for post-2018 service and raising all service year accruals for the second-pillar participants; and (iii) a contribution rate increase by 0.4 percentage points in 2019 as well as 2020, World Bank (2019). FYR Macedonia Special Focus Note: Pension Reform, available at <https://documents1.worldbank.org/curated/en/895551549468307274/pdf/134426-WorldBankSpecialFocusNotePensionsNovemberFINAL.pdf> accessed on 30.06.2021

national budget. In the absence of systemic changes in the economy, any future pension reform will result in the increase of costs and the reduction of benefits for the insurers, such as the increase in the contribution rate from 18% to 22% or an increase of the retirement age-limit for old-age pension by 2 years from 62 years for women and 64 years for men to 65 and 67 years, respectively). In such a context, the long term sustainability of the pension system will depend on developments in the broader economy. Namely, the larger the labour force the larger will be the wage contributions to the pension funds. Therefore, the long-term sustainability of the pension system in the country will be largely dependent on the overall condition of the economy, which includes the condition of the workforce, the rate of employment and the emigration trends.