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International Scientific Conference

“EU AND MEMBER STATES – LEGAL AND ECONOMIC ISSUES“

Editors:
Dunja Duić
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CHALLENGES AND OPPORTUNITIES OF THE MACEDONIAN PENSION SISTEM ACCORDING THE EU RECOMMENDATIONS (SOCIAL, LEGAL AND FINANCIAL ASPECTS)

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ABSTRACT

The reformed pension system in the Republic of North Macedonia has created an interest based on three poles: legal, financial and social. Therefore, the paper aims to provide not only overview of the North Macedonian pension legislative, the model of financing of the reformed pension system but also to take into account the social character of the pension system. Following the basic European values and the interception of the EC recommendations that were underline in the last 10 years for North Macedonia, the country remains moderately prepared in this area. The rapidly increased expenditure on pensions and the efforts to improve the legal, institutional and social framework on the North Macedonian pension system became new burden for the Public Pension Fund. Therefore, the sustainability and the efficiency of the contemporary pension system is under question mark.

This paper will explore the major challenges and opportunities that were foster by the new pension reforms from the reconstructed pension system. The one-pillared based system (Pay As You Go system– based on principle of generation solidarity,) has become system based on three *pillars (fully funded mandatory pension insurance and fully funded voluntary pension insurance). Regarding the legal and financial aspects of the reformed pension system, there will be three areas of research emphasis: delayed transfer of funds from the state pension insurance fund to private funds, the procedures for supervising voluntary pension insurance schemes and the limits on investing in non-domestic securities. These three aspects resulted in a breach of the legislation on the management of deposits in Republic of North Macedonia, and they were not in line with the acquis under Financial Services Chapter that consists mostly of legal arrangements concerning with capital markets, insurance (including individual pension systems) and banking sectors. This is why they found their place in the annual reports (for 2015, 2016 and 2018) of the European Commission on the Republic of North Macedonia in negative connotation. Analysis of the legislation, as well as comparing the legislation with EU recommendation, is expected to answer the question if our country is complying with the recommendations.*

The paper will be based on a legal, comparative, analytical and synthetic method that will provide a multidisciplinary approach in acquiring knowledge and in delivering results that will be of relevance to all involved stakeholders (future pensioners, pension funds, central and decentralized government).

Keywords: *Reforms, pension system, EU recommendations, pensions, Public fund, fully funded mandatory, fully funded voluntary*

1. INTRODUCTION

The European Commission in its Green Paper on pensions has pointed out the importance of pension systems being both adequate and sustainable. "A sustainable pension system is a system which is not a Ponzi-scheme i.e. which does not rely on perpetual increases in public debt. An adequate pension system is a system which allows for retirement pensions that provide reasonable income in relation to wages of working people."[1] The sustainability is jeopardized by inadequate pensions and increases, and unaffordable pension systems that are not reformed may ultimately collapse under the weight of ageing populations, and so prove inadequate.[2] Following this major consultation, the Commission set out its definitive vision on Pensions in its 2012 White Paper an Agenda for Adequate, Safe and Sustainable Pensions.[3]

1 Šonje, V., *Pension systems and pension reforms: Case of Croatia (with a review of reforms in 13 emerging European countries)*, October 2011, p.11, available at [http://arhivanalitika.hr/wp/wp-content/uploads/2017/02/PENSION-SYSTEMS-AND-PENSION-REFORM_final.pdf] Accessed 10.04.2019

2 European Commission - Green Paper towards adequate, sustainable and safe European pension systems SEC(210)830, Brussels [2010]

3 European Commission – White Paper An agenda for Adequate, Safe and Sustainable Pensions , Brussels [2012], available at [https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0055:FIN:EN:PDF] Accessed 02.03.2019

The two main themes to ensure pensions were adequate and sustainable were: better balancing the time spent in work and retirement and developing complementary private retirement savings.[4]

One of the main Europe's structural weaknesses concerning the pension system is the fact that the demographic ageing is accelerating. "As the baby-boom generation retires, the EU's active population will start to shrink as from 2013/2014. The number of people aged over 60 is now increasing twice as fast as it did before 2007 – by about two million every year compared to one million previously. The combination of a smaller working population and a higher share of retired people will place additional strains on our welfare systems."[5]

Facing the problems about the sustainability of the pension systems was not challenge only in the EU member-states, but in North Macedonia, also. The multi-pillar pension system reform was suggested by the World Bank, and three-pillar model that was conducted in the most of the Middle- East countries (Latvia, Lithuania, Estonia, Poland, Slovakia, Hungary, Romania and Bulgaria).[6] The aim for the governments was to build long –term pension strategy where the public pension funds will bear the unexpected economical situations in future on one hand, but also to provide adequate income in retirement for the pension insurances, on the other hand. Although, there are significant differences in the national pension systems in the EU member states, still they are following similar polices common to the rights of retirement, social security and the model of financing the pension systems. So most of the European countries have implemented the following three-pillar pension system:

- The Public pension system based on pay as you go system (First pillar). It`s a – solidarity system based on contributions. The Public pension and disability Fund is financed from the contributions of the gross income of the employee. The pension depends of the employee's years of service and income/ salary at the end of the working career and the Government, usually, defines the pensions.
- Mandatory Fully Funded Pension Insurance (The Second pillar). The system of defined benefits/defined contributions (individual approach and approach based on pension schemes) and has many different modalities. But, the base

[4] Eatock, D., European Union pension systems Adequate and Sustainable?, Briefing November 2015, European Parliamentary Research System, available at [http://www.europarl.europa.eu/RegData/etudes/BRIE/2015/571327/EPRS_BRI(2015)571327_EN.pdf] Accessed 02.03.2019

[5] European Commission: Europe 2020, A European strategy for smart, sustainable and inclusive growth, Brussels, 3.3.2010 Available at [http://ec.europa.eu/eu2020/pdf/COMPLET%20EN%20BARROSO%20%20%20007%20-%20Europe%202020%20-%20EN%20version.pdf] Accessed 12.04.2019

[6] Talevski, P., *The Financing of the pension systems*, Selektor, Skopje, 2009, pp. 49

is that the contributions are defined, but the pensions will be defined after accumulation of the asset of the private fund which is consisted of units. The members of the mandatory pension fund have individual private account and the pension benefit will depend on the capitalization value of the fund.

- Voluntary Fully Funded Pension Insurance (the third pillar). This pension insurance system may cover pension beneficiaries that are not covered with the mandatory pension insurance and pension beneficiaries covered with the mandatory pension insurance for purposes of gaining additional income after retirement. This pension system works in similar way as the second pillar, by capitalization of the fund assets. The amount of the pension benefit is not defined before hand and it depends on the paid contributions and the investment policy of the pension management companies.

In the traditional pension system, all eligible employees are automatically enrolled in the pension plan defined by the state. In most of the counties, it is compulsory to pay monthly pension contributions, so the so-called "state pension" could be provide to the retired.[7]

The second pillar (the mandatory private fully funded system) is financed by the percentage of the pension contribution from the members of the public pension fund and the capitalization of the asset.

The model of three-pillar pension system was adopted also in the most of Ex-Yugoslavian countries, for example Slovenia, Croatia and Serbia. Three countries (Croatia, Macedonia, Kosovo) introduced the second pillar based on managed mandatory individual retirement accounts. Only Croatia and Macedonia have fully developed systems comprising all three pillars: the defined benefit PAYG system, second-pillar managed individual retirement accounts and third-pillar voluntary pension funds.[8]

2. SOCIAL ASPECTS OF THE PENSION SYSTEM REFORMS IN REPUBLIC OF NORTH MACEDONIA

A pension aims to protect retired people from poverty and allow them to enjoy decent living standard. They are the main source of income for a significant number of populations in every country. According to the public opinion in EU[9] the

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7 [https://dictionary.cambridge.org/dictionary/english/state-pension] Accessed 09.02.2019

8 Šonje, *op. cit.* note 1, p. 11

9 Public opinion survey on *The future of pension systems* that was carried out at the request of the Directorate-General Employment and Social Affairs and organised by the Public Opinion Analysis Sector of the Directorate-General Press and Communication in all the Member at States of the European

States, [55] in Macedonia benefits from funded schemes still play marginal role. According the Law on Mandatory Fully Funded Pension Insurance, Article 3 Paragraph 1, point 5: "*Member of a mandatory pension fund" means an individual who has entered into a contract to be a member of a mandatory pension fund, or in whose name an account has been opened in a mandatory pension fund in cases specified in the Law, and his/her membership lasts until he/she acquires the right to a retiremen.* That is why the withdrawals (transfers) from the Public to the Private funds was made partially and successively. Unfortunately, there process seems is not completed until nowadays. In 2018 the Ministry of Labor and Social Policy announced that 12.000 insurances are damaged by not being informed to make transfer to one of the Mandatory Pension Fund.[56] According to the progress reports on Macedonia that are prepared by the European Commission, another problem with the transfers was the delay in transferring funds but this problem has been overcome and: "There are no longer delays in transferring funds from the state pension insurance fund to private funds, which had previously led to a breach of the legislation on management of deposits." [57]

4. CONCLUSION

Despite the different level of socio-economy development of the countries in EU and in the region, they have faced with similar significant problems comprised from the pension reforms.

The Macedonian pension system was based on the principle of generation solidarity, i.e. pay-as-you-go (PAYG), where the current contribution payments are used to finance the current pensions. This system of solidarity became inadequate and burred with lack of funding. Pension reform was conducted and as a result, today, the pension system structure in North Macedonia consists of three pillars, where: the first pillar (mandatory) is still based on the principle of inter-generational solidarity, while the second (mandatory1) and third pillars (voluntary) operate on a fully-funded basis.[58] The financial objective is the pension beneficiary to earn

55 European Commission - Green Paper towards adequate, sustainable and safe European pension systems SEC(210)830, Brussels [2010], p. 6. Just a few Member States with very acute public budget problems or well anchored automatic adjustment mechanisms were completed to reduce public pensions in payment

56 [https://meta.mk/mapas-ke-gi-vraka-parite-na-penzionerite-koi-se-oshteteni-so-neraspredelbata-na-parite/] Accessed 02.03.2019.

57 Commission Staff working document - The Former Yugoslav Republic of Macedonia Report 2018, European Commission, Brussels, SWD [2018]

58 Petreski, B., *Sustainability of the pension system in Macedonia Comprehensive analysis and reform proposal with MK-PENS –Dynamic Microsimulation Model*, FinanceThink – Economic Research and Policy In-

pension consisted of two parts: the contribution from the gross salary of the pension member and the benefit earned by capitalization (accumulation) of the asset / units.

Key problem is the accumulation of financial assets, through the mechanism of appropriation funds, from the gross salary of employed persons and bring in those assets into the pension and disability insurance fund as well as from the current budget of the state, in order to provide a regular payment of pensions to the beneficiaries and to distribute evenly the burden of provision funds (trying to provide as much as possible participation of the fund's assets instead of assets from the central budget).

Reform processes were expected to stabilize the Macedonian pension system, without raising the age limit for exercising the right to pension and provide equality between the present and future pensioners. At the same time, deficit of assets in the Pension and disability insurance funds would be on the decrease, budget funds transferred to the pensions would be reduced and eventual problems and difficulties in the payment of future pensions would be eliminated.

The expected benefits from the second pillar were: transferring part of the financial burden to the insurers; reducing the older people care expenses for the next generations; stabilized income of pensioners that will not be dependent on the demographic factors; increase in the individuals' work initiatives and social insurance to provide for their future; income will not be depended only on paid contributions in the previous years, but also on the income from interest rates, dividends and other investments. [59]

Instead, the pension reform caused additional budget expenditure for the Government and a financial challenge for the Public Fund.

The analyze of the reformed pension system through the prism of EU recommendations showed that our country has implemented the pension reforms as the most of the Middle East countries in Europe did. But, according to the last annual report of the European Commission on Republic of North Macedonia for 2018 the provision setting a 50 % limit on investing in non-domestic securities by pension funds remains contrary to the *acquis*,[60] despite the fact that the same remark is present in all the European Commission reports, starting from 2011 till

stitute, Skopje, available at [http://www.financethink.mk/wp-content/uploads/2018/06/Pension-analysis-EN.pdf] Accessed 02.03.2019

59 Bornarova, *et al., op. cit.* note 49, p. 396

60 Commission Staff working document - The Former Yugoslav Republic of Macedonia Report 2018, European Commission, Brussels, SWD [2018]

now. These reports contained another remark regarding the withdrawals (transfers) from the Public to the Private funds, which were made with delay. Delayed transfer of funds from the state pension insurance fund to private funds resulted in a breach of the legislation on the management of deposits till 2017.[61]

Today, according to the latest EU progress report on North Macedonia, this problem has been overcome.

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