Burden of the Accumulated Pension Plan for the Population

The mandatory[1] accumulated pension plan was launched in Georgia on 1 January 2019. Participation in the pension plan is mandatory for every employee under the age of 40 years as well as for their employers. Given the mandatory nature of the pension contribution, we can state that it is an additional tax burden both for employees and for employers. In addition, taking into account the low figures of hired labour and the average wage, the accumulated pension plan cannot guarantee the very "decent retirement"[2] as promised by the initiators of the pension reform. Furthermore, in terms of the monetary value, the state makes a higher contribution to the pension savings of the employed and high-income population as compared to low-income individuals or the unemployed which will increase social inequality.

Of note is that the Investment Council of the Pension Fund, which is responsible for determining the investment policy about pension assets, has not yet been staffed. This fact indicates that the Law on Accumulated Pension was adopted hastily.

The proposed pension plan largely stipulates a 6% saving consisting of the joint contribution of an employee, an employer and the state. In particular, an employee transfers 2% of his taxable income each month to his individual pension account, an employer also transfers an additional 2% and the state budget contributes another 2%. A self-employed individual contributes 4% of his income to his pension account and the state contribution is again 2% in this case. If the annual salary of an employee or a self-employed person exceeds GEL 24,000, the state contribution decreases to 1%. Those participants in the pension plan whose annual salary/income exceeds GEL 60,000 will not receive contributions from the state budget. Participation in the accumulated pension plan is voluntary for self-employed individuals and for employees over the age of 40 years. Participants in the pension plan are allowed to access the money in their individual pension accounts after reaching the legal retirement age. A participant is allowed to access the accumulated funds monthly or withdraw all of the funds at once. Of additional note is that a participant in the accumulated pension plan will receive both the accumulated pension and today's social pension as well upon reaching the legal retirement age.

Today's pension is a social expense from the state budget and its financial sustainability will be under question in the long run because Georgia's population is aging and the budget burden increases annually. There are 745,000 old age pensioners in Georgia and their number increases by 12,000 on average every year. Therefore, budget expenses increase annually as well. Nearly 20% of the total budget expenses are spent for pensions. Despite this, old age pension in Georgia amounts to only GEL 200 monthly which is approximately 20% of the average salary. Naturally, pension reform is necessary to ease the budget burden, on the one hand, and have an adequate pension in retirement, on the other

[1] The proposed pension plan is partially mandatory – it is mandatory for a certain group of citizens whilst it is voluntary for the rest of them.

[2] Decent retirement – a large pension saving which is fully sufficient for a pensioner's needs.

hand. However, the success and the sustainability of the proposed accumulated pension plan has been questioned since the very beginning and the reasons are as follows:

- The pension reform does not enjoy the trust or the support of the majority of the public.
- Given the low figures of hired labour, only a small part of the population participates in the accumulated pension plan.
- Given the amount of incomes, people will not be able to have a large saving for retirement with 6% in contributions.

Pension Reform Concerns Only a Small Part of the Population

Presumably, a large majority of the accumulated pension plan participants will be those for whom participation is mandatory. In accordance with the data for 2017, there are 1,706,000 employed people in Georgia. Of this number, nearly 52% (881,600) are self-employed. Only 824,200 people are hired employees. Of those, only 327,700 persons are under the age of 40 years which constitutes only 12% of the total labour force. Most likely, the majority of self-employed individuals will not be involved in the accumulated pension plan because they usually have an unstable and low income. In addition, self-employed individuals participating in the pension plan will have to save more (4%) as compared to hired labourers. Given the amount of the average salary, it is most likely that employees over the age of 40 years will also refuse to be involved in the pension plan because the pension contribution is an additional tax burden.

Citizens will not Make Large Savings with the Proposed Model

If we take into account the average salary of employees and its growth rate, the population will not make any large savings with a 6% contribution. The average monthly salary of hired labourers before taxation is nearly GEL 1,000. Hypothetically, an employee whose salary is GEL 1,000 after making his pension savings for a period of 30 years will receive approximately GEL 618 as a monthly pension for the next 15 years. This calculation also takes into account a 4% annual increase in income and a 7% average annual receivable pension saving (based on the calculator of the Pension Agency). We also need to take into account that the purchasing power of GEL 618 will be much lower in 30 years. If the annual inflation remains within the margins of 3%, the purchasing power of GEL 618 in 30 years will be nearly GEL 225. In addition, it is also assumed that the annual salary will increase by 10% every three years.

Tax Burden of the Accumulated Pension Plan and Social Inequality

The Government of Georgia claims that the pension contribution is not a tax because a pension contribution is accumulated in a personal account and transferred back to an employee once he reaches the age of retirement. In accordance with the official definition of tax, it is a mandatory unconditional payment to the budget. However, as long as a pension contribution is mandatory for both the employee and the employer and, at the same time, it is an unconditional payment for an employee, we can say that it bears the characteristics of a tax. This idea is corroborated by the OECD (Organisation for

Economic Co-Operation and Development) report which considers a mandatory contribution to the welfare fund as a tax.

Of note is that in the case of the private sector, it is mostly the employees who will have to bear the tax burden. Most probably, the 2% payment which the employer is supposed to pay will be made from an employee's salary. In this case, an employee pays 4% instead of 2% of his income. In addition, this reform creates a number of risks on the labour market. Incomes will be taxed by 22% instead of 20% and in some cases even by 24% which will result in a sharp decrease in disposable incomes. This reform will make the labour force more expensive because net income is important and not the amount of the salary before taxation. An increased tax burden will probably also increase the number of informal labour contracts.

Yet another problem associated with the accumulated pension plan is that the 2% and the 1% contribution from the state does increase social inequality. For instance, an individual whose monthly income is GEL 500 (before taxation) will have an additional 2% contribution from the state budget in the amount of GEL 10. If a pension plan participant's monthly income is GEL 3,000, then the 1% state contribution for him will be GEL 30. Therefore, a larger amount of budget funds will be redistributed to higher-income citizens.

In addition, as per the proposed model the state contribution to the pension savings is based on income alone and does not take into consideration a person's well-being or his particular needs.

Public Attitude toward the Pension Reform

An additional fact which also brings the sustainability of the pension reform into question is that the proposed pension plan is unacceptable for many people in society. In accordance with the 2017 research study of the Institute of Social Studies and Analysis, entitled Attitude of the Population in Regard to the Pension System, 88% of surveyed respondents do not oppose the accumulated pension plan although the majority (65%) supports the idea that participation in the accumulated pension plan should be voluntary.

Prior to the adoption of the Law on Accumulated Pension, NGOs addressed the Parliament of Georgia with recommendations to refrain from hastily adopting the law. The recommendations also envisioned the voluntary character of the pension plan and not to make pension contributions into an additional "tax burden."

Of note is that on 8 January 2019, the NGO Georgia's Democratic Initiative (GDI) appealed the Law on Accumulated Pension in the Constitutional Court of Georgia. As clarified by the GDI, mandatory contributions to the pension fund infringe upon property rights whilst transferring budget money to the pension fund for employees infringes upon the principle of equality. At the present moment, the Constitutional Court of Georgia is discussing whether or not to allow the lawsuit for a main hearing.

The opposition is vehemently against the current model of the accumulated pension plan. European Georgia Movement for Freedom demands cancelling the accumulated pension plan and is offering the Parliament of Georgia an alternative voluntary-based model for discussion.

In conclusion, pension reform is necessary for the sustainability of the social system in the long run. However, the Government of Georgia was obliged to take into account the critical attitude of the majority of the public as well as of experts and the political opposition vis-à-vis the planned pension reform. In addition, it seems that whilst working on the Law on Accumulated Pension, the risks associated with this mandatory model were not properly studied. At the present moment, we can say that the accumulated pension plan is a hastily made decision and the new pension contribution is an additional tax burden. In addition, given the existing incomes and level of inflation, this newly "saved money" cannot guarantee our "decent retirement."

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