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PENSION SYSTEM REFORM – BETWEEN FISCAL SUSTAINABILITY AND INCLUSIVE GROWTH

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Abstract: *Due to demographic changes and population growth drop, labor force is reduced, which generates the problem of inability to finance pensions and maintain the sustainability of pension systems by means of "pay as you go" principle. The issue of pension system reform becomes highly relevant for the purpose of securing social cohesion and welfare of all categories of the population. Trade-off between the fiscal sustainability, which implies reducing the budget deficit, and inclusive growth, which implies reducing poverty, makes pension system reform problematic. As the financial markets show insufficient maturity and the overall economy is not fully prepared for this system, the introduction of mandatory pension insurance offers the alternative which combines mandatory state insurance and voluntary private insurance. Almost all countries in the world, including Serbia, are facing the challenge of resolving the issue of transitional generation, on the path of transforming "pay as you go" principle into the capital accumulation system. The aim of this paper is to consider the consequences that the current pension system has on fiscal balance, as well as to elucidate the possible ways of reforming the system for the purpose of securing fiscal sustainability without endangering inclusive growth.*

Keywords*: pension and disability insurance, reforms, pay as you go (PAYG), capital accumulation system*

1. Introduction

The strategy "Europe 2020" declares that smart, sustainable and inclusive growth is the top-priority goal of European Union. Inclusive growth implies accomplishing high employment rate through securing economic, social and territorial cohesion (Europe 2020, 8). Accordingly, battle against poverty of all population groups is imposed as the necessary condition for accomplishing social cohesion. The battle includes reducing unemployment

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rate and creating stable social insurance system. Special emphasis is on pension insurance system which is the crucial problem of almost all countries in the world. One of the ways of accomplishing inclusive growth is maximum utilization of labor potential, i.e. human capital, as well as facing the challenges of population ageing. This shows the necessity of reforming the pension system for the purpose of securing welfare of both pensioners and employees who are insured. Implementation of this goal is not an easy task, which is supported by the fact that this issue is a stumbling block for government authorities in almost all countries, and is quite frequently the reason why such governments experience failure and short leadership. The above stated is supported by the fact that pensioners represent a significant part of voting body, and thus exercise significant rights in the field of social policy, unlike other marginalized groups. Therefore, pension system reform represents a very unpopular segment of the government policy.

The paper deals with the issue of sustainability of pension systems which are in accordance with "pay as you go" principle. The initial emphasis is on the importance of pensions, including consideration of the two systems of financing pensions – "pay as you go" system and capital accumulation system. Furthermore, the paper analyses Serbian pension and disability system which is the base for researching the current state of reform system in Serbia. In conclusion, the paper will offer proposals for further reform implementation.

2. The Problem of Financing Pensions and Types of Pension Systems

Pension is periodical income which a pensioner receives based on pension insurance (Kočović, Rakonjac-Antić 2007, 44). Pension is primarily an *economic category* since it represents the amount that labor population saves for the old age. Furthermore, savings is a *social category* as it represents the income of the elderly who are not able to provide funds for their existence. Finally, pension is a *financial category*. The first argument for this statement is that pensions are part of public expenditure and thus part of public finance of a country. The second argument is related to pension system reform and foundation of private pension funds which represent savings for the old age (Ilić 2006, 3).

One of the most articulate problems within social security system and contemporary economics as a whole is the problem of financing pensions. In this respect, there are two different systems of financing pension and disability insurance – "pay as you go" system and capital accumulation system.

"Pay as you go" system, which is dominant worldwide, is based on adjusting social insurance contribution and social insurance expenditure. Namely, insurance beneficiaries pay contribution in order to acquire the right to future social insurance, and thus finance current social security beneficiaries (Petrarković 2007, 31). It is clear that this system can function in a country with young population and long-term trend of net national product growth. Such favorable demographic structure was present in our country during 1960s when pensioner: employee ratio was 1:7 (Raičević 2005, 270). In 1935, when the implementation of social insurance system started in USA, one pensioner covered 45 employees, while today's ratio is 1:3 (Kornblau 2009, 2). As far as Serbia is concerned, one pensioner covers less than two employees.

A respectable indicator of demographic condition of a country is dependency ratio of the elderly population. It represents the ratio between the population, age 65 or older, and population 15-64 years of age, multiplied by 100. This indicator shows the number of individuals who are in pension age group per 100 individuals who are in economically active age group. The increase of elderly dependency rate means that larger number of individuals who are in pension age group will have to be supported by the same number of individuals who are in economically active group (Kupiszewski, Kupiszevska, Nikitović 2012, 16).

Table 1: Dependency ratio of the elderly population according to the census 2002 and 2011, Republic of Serbia

Year	2002	2011
The population aged 65 years and over	1.240.505	1.250.316
The population aged 15-64 years	5.032.805	4.911.268
Dependency ratio of the elderly population	24,64	25,46

Source: Autor's calculations based on data from „Census of Population and Housing in 2002 – Gender and Age", Statistical Office of the Republic of Serbia, Belgrade, 2003, p. 14-15, and „Census of Population and Housing in 2011, Republic of Serbia – Basic Population Groups", Statistical Office of the Republic of Serbia, Belgrade, 2014, p. 24-27., www.stat.gov.rs

The table shows the increase of dependency ratio for the elderly for 0,82 in 2011 as compared to 2001. The increase of this indicator confirms the demographic ageing process in the Republic of Serbia. Coefficient of 25,46 in 2011 shows that there are 25 individuals in pension age group per each 100 individuals in economically active age group.

The following table will show the same indicator for the group of selected countries, all with the aim of defining the alarming situation in Serbia as compared to the chosen countries.

Table 2: Dependency ratio of the elderly population, selected countries, 1990-2010 and projection to 2050

Country	1990	1995	2000	2005	2010	2020	2030	2040	2050
Belgium	22.1	23.8	25.5	26.3	26.0	30.25	36.68	40.95	42.48
Bulgaria	19.5	22.2	23.8	24.8	25.4	32.46	38.69	45.96	56.06
Czech Republic	19.0	19.3	19.8	19.8	21.6	30.37	34.32	40.07	50.14
Denmark	23.2	22.7	22.2	22.7	24.9	31.42	37.00	41.91	41.79
Germany	22.0	22.5	23.9	27.8	31.4	35.78	47.21	56.44	58.11
Ireland	18.6	17.8	16.8	16.3	16.8	22.79	27.59	33.07	39.66
Greece	20.4	22.2	24.2	26.8	28.4	32.57	37.74	47.83	57.45
Spain	20.2	22.2	24.5	24.4	24.7	28.94	35.52	46.70	56.91
France	-	22.7	24.3	25.1	25.6	32.71	39.06	44.37	45.48
Croatia	-	-	-	24.9	25.6	-	-	-	-
Italy	21.5	24.0	26.8	29.3	30.8	34.76	41.14	51.73	56.34
Hungary	20.0	20.9	22.0	22.7	24.2	29.98	33.57	39.52	50.18
Netherlands	18.6	19.3	20.0	20.8	22.8	30.79	40.25	47.29	46.50

Austria	22.1	22.5	22.9	23.5	26.1	29.78	38.83	46.83	48.56
Poland	15.4	16.6	17.8	18.7	19.0	26.94	35.24	39.89	53.00
Portugal	20.0	21.9	23.7	25.2	26.7	31.32	37.85	46.72	55.62
Romania	15.6	17.6	19.3	21.1	21.4	25.68	30.23	40.65	53.81
Slovenia	15.5	17.4	19.8	21.8	23.8	30.41	38.84	46.14	55.05
Slovakia	16.0	16.3	16.6	16.3	16.9	23.59	31.36	37.99	51.38
Finland	19.8	21.1	22.2	23.8	25.6	36.18	42.74	43.46	44.86
Sweden	27.7	27.4	26.9	26.5	27.7	33.47	37.21	40.45	41.7
Unated Kingdom	24.1	24.5	24.3	24.3	24.9	29.63	34.83	38.86	39.41
Island	16.4	17.3	17.8	17.9	17.9	25.07	32.15	34.45	33.54
Norway	25.2	24.8	23.5	22.4	22.5	27.39	33.02	38.49	40.29
Switzerland	21.3	21.7	22.7	23.3	24.7	29.48	38.04	45.71	50.53
Montenegro	-	-	-	18.5	18.8	-	-	-	-
Macedonia	-	12,8	14.6	15.8	16.4	-	-	-	-
Serbia	-	-	23.6	25.5	25.1	-	-	-	-
Turkey	7.1	7.8	8.3	8.9	10.5	-	-	-	-
Albania	-	-	-	12.8	-	-	-	-	-
Russia	-	-	-	-	17.9	-	-	-	-

Source: Eurostat (epp.eurostat.ec)

Hence, the smallest coefficient and most favorable ratio are recorded for Turkey, while Germany is in rather difficult position. The analyzed ratio is constantly increasing, which is the consequence of the growing number of pensioners and reduced number of employees. This situation makes “pay as you go” system unsustainable. However, prognoses indicate that the future ratio between individuals 65 years of age and older and employed individuals will grow much more progressively. According to the prognosis, during 2050 Iceland will have the most favorable ratio, while Germany will be in most difficult position as there will be 60% individuals older than 65 as compared to individuals who are employed.

Therefore, “pay as you go” system faces problems when dependency ratio of the elderly is disturbed. In such case, this system cannot finance pensions in timely manner, and it thus depends on transfers from the budget (Petrarković 2007, 31). There are many causes which disturb dependency ratio, some of them being: population ageing, early retirement and reducing the number of insurance beneficiaries due to evasion and growing unemployment.

On the other hand, capital accumulation system is based on the idea of investing funds from paid contribution, with the aim of acquiring income in the form of interest or dividend. Individuals possess personal account which they use for registering and accumulating the contribution which they have paid. Such funds which have been paid to individual’s account are his private property during the entire period. After obtaining the status of pension insurance beneficiary, the individual receives pension, the amount of which depends on the balance on his pension account. The final balance depends on the paid contribution, number of years that the contribution has been paid for and return on invested accumulated capital (Petrarković 2007, 32). Private pension funds are mainly used in USA where state pensions cover only the administration apparatus. On the other hand, Switzerland and Austria record small presence of private pension funds (Ignjatović 2008, 49).

Small number of countries has decided to use investment based system of social insurance due to high risk related to the use of the system. Chile and Mexico are among rare countries which have done so. However, accepting the mixed or hybrid system may bring about a serious economic progress and is thus used by majority of the countries worldwide (Feldstein 2005, 25).

3. Current State of Affairs and Perspectives of Serbian Pension System

Since 01.10.2010.pension and disability insurance in the Republic of Serbia has functioned along with health insurance and insurance in case of unemployment. The current Law on pension and disability insurance states the following requirements for being approved age pension (Zakon o penzijskom i invalidskom osiguranju 2012, 6):

a) 65 years of age for men and 60 years of age for women, including minimum 15 years of paying insurance,
b) minimum 58 years of age, including 40 years of paying insurance for men and 38 years for women,
c) minimum 45 years of paying insurance.

The Republic of Serbia has both mandatory and voluntary pension and disability insurance. Mandatory pension and disability insurance is defined by the Law on pension and inability insurance which was adopted in 2003. The main principle that home pension and health insurance is based on is the principle of solidarity (Zakon o penzijskom i invalidskom osiguranju, 6). The implementation of this principle implies joint payment of contribution by currently employed for current pensioners.

Contribution rate for pension and disability insurance was increased from 22% to 24% by means of modifications and amendments to Law on contribution for mandatory social insurance which was adopted on May 30th2013. However, new Law on contribution for mandatory social insurace was adopted on May 31th 2014. According to new law, contribution rate for pension and disability insurance was increased from 24% to 26%, so employees pay 14%, while the employers pay 12%. On the other hand, contribution rate for mandatory health insurance was decreased from 12,3% to 10,3%. In this way, sustainability of mandatory pension and disability insurance is encouraged without increasing the overall fiscal burden on wages (Zakon o dopsinosima za obavezno socijalno osiguranje 2014). Monthly disbursement that the employees pay for the above stated is from RSD 5.643,16 to RSD 80.659,80 (www.pio.rs).

Observed in international framework, contribution rate for pension and disability insurance is not high, especially if we have in mind that it covers all three risks (old age, disability and death), specific compensations (custodial care and assistance) and pensioners' health insurance. This rate is even lower as compared to other countries which are in the process of transition (Matković, Bajec, Mijatović, Zivković, Stanić 2008, 42).

Table 3: Contribution rate for pension and disability insurance and total rate of social insurance contribution, selected countries, 2012 (%)

Country	Contribution rate for pen. and disab.insur.			Total contribution rate for social insurance		
	Employee	Employer	Total	Employee	Employer	Total
Albania	8,80	12,8	21,60	11,20	16,70	27,90
Austria	10,25	12,55	22,80	17,20	25,15	42,35
Belarus	1,00	28,00	29,00	1,00	34,30	35,30
Belgium	7,50	8,86	16,36	13,07	24,80	37,87
Bulgaria	7,90	9,90	17,80	12,90	17,80	30,70
Croatia	20,00	0,00	20,00	20,00	17,20	37,20
Czech Republic	6,50	21,50	28,00	11,00	34,00	45,00
Denmark	0,00	0,00	0,00	8,00	8,00	16,00
Finland	5,15	17,65	22,80	7,99	22,39	30,38
France	6,75	9,90	16,65	9,90	32,68	42,58
Germany	9,80	9,80	19,60	20,425	20,845	41,27
Greece	6,67	13,33	20,00	12,05	22,60	34,65
Hungary	10,00	27,00	37,00	17,50	27,00	44,50
Island	4,00	15,79	19,79	4,00	15,79	19,79
Ireland	4,00	4,25	8,25	4,00	4,25	8,25
Italy	9,19	23,81	33,00	9,19	31,78	40,97
Netherlands	19,00	5,70	24,70	23,20	19,12	42,32
Norway	7,80	14,10	21,90	7,80	14,10	21,90
Poland	11,26	14,26	25,52	22,71	17,38	40,09
Portugal	11,00	23,25	34,25	11,00	23,75	34,75
Romania	10,50	31,30	41,80	16,50	38,85	55,35
Russia	0,00	22,00	22,00	0,00	30,20	30,20
Serbia	14,00	12,00	26,00	19,90	17,90	37,80
Slovakia	7,00	20,00	27,00	16,40	33,20	49,60
Slovenia	15,50	8,85	24,35	22,10	16,10	38,20
Spain	4,70	23,60	28,30	6,25	31,08	37,33
Sweden	7,00	10,21	17,21	7,00	20,92	27,92
Switzerland	11,90	11,90	23,80	13,25	13,35	26,60
Turkey	9,00	11,00	20,00	15,00	21,50	36,50
Ukraine	2,00	33,20	35,20	2,85	37,20	40,05
United Kingdom	9,95	11,90	21,85	12,00	13,80	25,80

Source: U.S. Social Security Administration (www.socialsecurity.gov)
*Data for Serbia is related to the year 2014, in accordance with the Law on contribution for mandatory social insurace from May 31th 2014

The table above shows that, among 31 chosen countries, Russia has the lowest pension and disability insurance contribution - the amount of contribution is 0% which means that employees do not pay contribution for pension, health or insurance in case of unemployment. The next country with the lowest contributions paid by employees is Belarus. Employees take part in pension and disability insurance contribution payment with 1% of gross income. At the same time, this is the only contribution paid by the employees in Belarus. Having in mind that the total contribution rate is 1%, employees do not pay contribution for health insurance or insurance in case of unemployment. We can notice that these countries have socialist system which results in the above stated social insurance system which aims at protecting employees and releasing them from the obligation of paying contributions. Contribution rate for pension and disability insurance does not apply to either employees or employers in Denmark. The only contribution paid in this country is 8% contribution in case of unemployment. This maintains high living standard and positive aspects of welfare concept of this Scandinavian country. The highest contribution rate which is paid by the employees is in Croatia - 20%. It is interesting, however, that employers are very privileged in this country, as they do not pay contribution for pension and disability insurance for the employees. However, employers pay contributions for two other types of social insurance and the total amount that they pay is 17,20%, while the employees are freed from paying contribution for health insurance and insurance in case of unemployment. Total contributions for pension and disability insurance are the lowest in Ireland - 8,25% and highest in Romania- 41,80%. Employees in the Netherlands pay 23,20% of gross income for total contributions. As far as the total contribution paid by employers is concerned, most privileged country is Ireland where employers pay 4,25%, while least privileged country is Romania where employers pay 38,85%. Ireland and Romania are the countries which pay the lowest and highest contributions, respectively. Iceland and Ireland are characteristic because the law regulates paying contribution for pension and disability insurance only, while employees and employers are freed from paying the other two types of social insurance contribution.

If we take voluntary pension insurance into consideration, it started developing in Serbia within insurance companies and based on Insurance Law from 2001. However, this component of pension system was formally regulated in 2005. This type of insurance is based on the concept of specialized pension companies which manage pension funds and perform this activity only. This system is regulated by the National Bank of Serbia (Matković, Bajec, Mijatović, Zivković, Stanić 2008, 43).

Finally, the stability of domestic pension and disability insurance system will be assessed best by observing revenue and income, on one hand, and expense and expenditure of Republic Fund for Pension and Disability Insurance, on the other hand.

Table 4: The structure of the financial plan of the Fund for Pension and Disability Insurance, Republic of Serbia, 2013 (thousands of RSD)

Category	Plan 2013	Realization I-XII 2013	Share (%)	Realization (3/2)
I Current revenue	592.004.012	584.303.167	99,91	98,70
1. Contributions for PDI	317.760.000	313.787.727	53,65	98,75
2. Donations and transfers	264.355.900	261.295.101	44,68	98,84
3. Other revenue	890.200	801.378	0,14	90,02
4. Memorandum items for refund of expenses	1.817.504	952.578	0,16	52,41
5. Transfers between budget users at the same level	7.180.408	7.466.383	1,28	103,98
II Income	437.728	539.756	0,1	123,31
1. Income from sales of non-financial assets	34.000	34.187	0,01	100,55
2. Income from borrowing and sales of financial assets	403.728	505.569	0,09	125,23
TOTAL REVENUE AND INCOME	592.441.740	584.842.923	100,00	98,72
I Current expenses	590.784.131	585.926.899	99,92	99,18

1. Expenses for employees	4.349.000	4.357.931	0,74	100,21
2. Using of goods and services	2.896.180	2.541.445	0,43	87,75
3. Repayment of interest and related expanses of borrowing	90.001	126.477	0,02	140,53
4. Donations, grants and transfers	10.800	10.254	0,00	94,94
5. Social insurance and social protection	582.647.150	578.485.110	98,65	99,29
6. Other expenses	791.000	405.682	0,07	0,07
II Expenditure	1.657.609	472.916	0,08	28,53
1. Expenditure for non-financial assets	801.820	260.373	0,04	32,47
2. Repayment of principal and purchase of non-financial assets	855.789	212.543	0,04	24,84
TOTAL EXPENSES AND EXPENDITURE	592.441.740	586.399.815	100,00	98,98

Source: Financial report of the Republic Fund for Pension and Disability Insurance, 2013, www.pio.rs

As the total revenue and income for the year 2013 were RSD 584.842.923, and total expenses and expenditure were RSD 586.399.815, we could state that deficit was RSD 1.556.892 (in thousands). If we observe the structure of income, donations and transfers make 44, 68%, i.e.half of Fund for Pension and Disability Insurance income comes from the budget which cannot be long-term sustainable solution.

The above stated also indicates pension system as the factor of fiscal stability of a country.

4. Pension and Disability Insurance Reform

Having in mind the above mentioned problems related to financing pension and disability insurance, there is a strong need to find a proper solution which will be somewhere between “pay as you go” system and capital accumulation system. This solution is implemented by applying reforms which are very popular in almost all countries. However, the success of such reforms differs from country to country.

Pension system reform implies World Bank pension reform model which implies three basic pillars of insurance. The first pillar represents mandatory and public pension insurance; the second pillar refers to mandatory, but private insurance, while the third pillar includes voluntary savings, i.e. additional insurance.

Positive aspect of three-pillar pension insurance system is consolidating positive characteristics of “pay as you go” system and capital accumulation system. Good sides of “pay as you go” system are part of this concept, as the state still has jurisdiction over one part of the contribution, which increases security and trust of pension beneficiaries. On the other hand, the positive side of capital accumulation system which is implemented in this concept refers to financial sustainability and encouraging growth.

The crucial problem is actually a problem of replacing “pay as you go” system with three-pillar system. The new system implies allocation of contributions which have been paid into the state pension fund earlier to private and state pension fund. However, such action impoverishes state fund for significant amount which is used for paying pensions to current pensioners and those who will soon become pensioners. Thus, the problem of the existing state pension system deficit becomes even larger. Aside from the transaction cost problem, other problems, which represent an obstacle to reform implementation, have a political dimension. Namely, the goal of each government is to keep its position as long as possible. While trying to achieve its goal, the government is facing the problem of reforming pension system, since the process of reform implementation is very serious and not so easy. Therefore, governing parties usually avoid these reforms. Clear evidence of this argument is the fact that French and Italian government had to be dismissed in 1990s which was mainly caused by an attempt to reform pension system (Ilić 2006, 14).

Significant motivating factor of introducing reforms is sustainability of fiscal system. Namely, due to disturbed demographic structure, participation of paid pensions in GDP is increased. Therefore, higher expenditure for pension has influence on the pension system deficit increase. The deficit is further financed by transferring sums from the budget and thus, there is a need for increasing taxes and contributions, which reduces enterprise competitiveness and competitiveness of a country as a whole (Petrović 1991, 17).

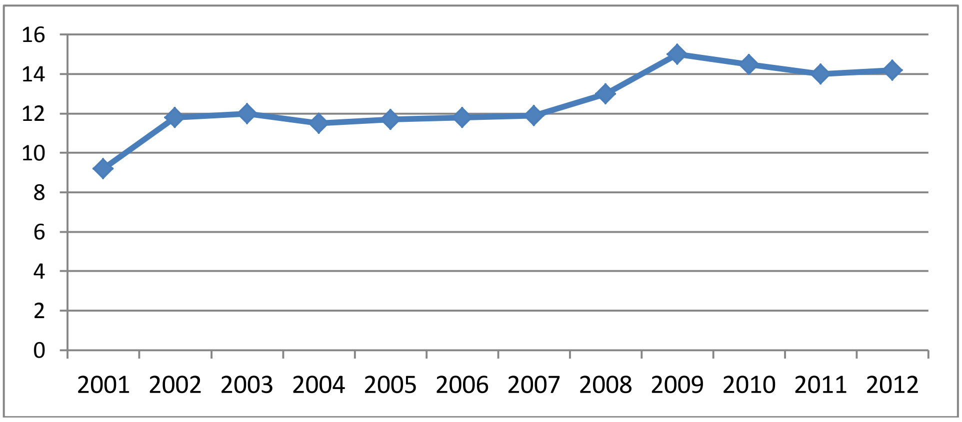
Table 5: Pension expenditure participation in GDP, selected countries (%), 2000-2010

Country	2000	2002	2004	2006	2008	2010
Belgium	10.99	11.24	11.17	11.09	11.37	12.13
Bulgaria	-	-	-	7.25	7.02	9.19
Czech Republic	8.22	8.41	7.95	8.01	8.16	9.21
Denmark	10.49	10.75	11.04	10.68	11.00	12.31
Germany	13.12	13.43	13.48	12.96	12.40	12.83
Ireland	3.57	4.64	4.89	5.02	6.13	7.22
Greece	11.13	11.76	11.70	12.13	12.72	13.92
Spain	9.65	9.30	9.13	8.94	9.26	10.76
France	12.96	13.03	13.16	13.07	13.41	14.40
Croatia	-	-	-	-	9.47	10.63
Italy	14.31	14.51	14.57	14.56	14.85	16.01
Hungary	8.70	8.91	9.32	10.02	11.00	10.96
Netherlands	12.52	12.75	12.79	12.29	12.00	12.88
Austria	14.24	14.50	14.41	13.97	14.02	14.99
Poland	12.60	13.74	13.27	12.54	11.61	11.88
Portugal	10.06	10.90	11.91	12.59	13.20	14.23
Romania	6.11	6.72	6.16	6.02	7.60	9.46
Slovenia	11.01	11.27	10.50	10.26	9.64	11.22
Slovakia	7.46	7.40	7.40	7.35	7.16	8.43
Finland	10.55	10.94	11.17	11.10	10.80	12.72
Sweden	11.27	11.51	12.15	11.79	11.81	12.11
United Kingdom	11.94	10.86	10.59	10.69	11.28	12.23
Island	6.23	6.61	7.10	6.78	7.20	7.88
Norway	7.55	8.33	8.32	7.55	7.49	8.34
Switzerland	11.79	8.33	12.63	12.20	11.62	12.19
Average	10,28	10,43	10,64	10,38	10,49	11,53

Source: Eurostat (epp.eurostat.ec)

The table shows that participation of pension expenditure in GDP varies, but has a general growing tendency. Germany and Poland record reduced expenditure as compared to the initial year. Among all analyzed countries, Italy records the highest expenditure for pensions, while Ireland records the lowest percentage of expenditure.

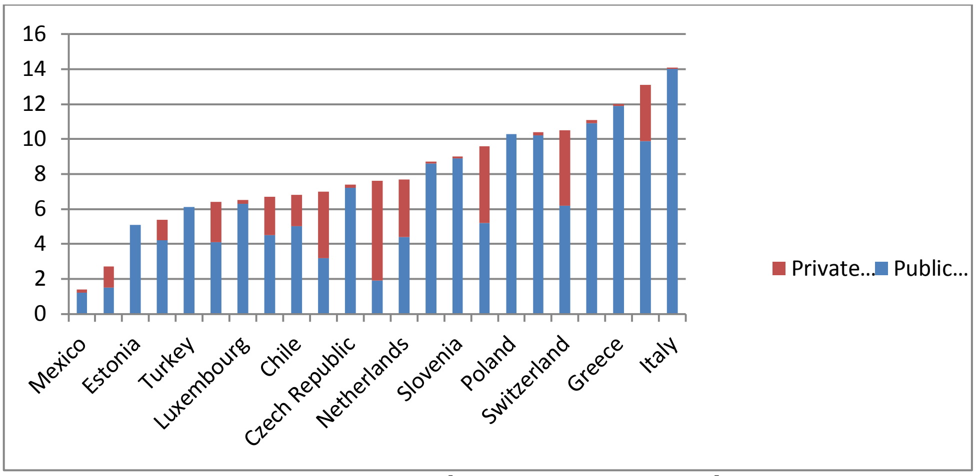
Chart 1: Pension expenditure participation in GDP, Republic of Serbia, 2001-2012



Source: Republic of Serbia, IMF Country Report No. 13/207, International Monetary Fund, July 2013, p. 90 (www.imf.org)

As far as our country is concerned, pension expe„Pension Markets in Focus"nditure participation in GDP was the highest in 2009 and lowest in 2001. At this moment, participation is 14% which is above European average.

Graph 2: Private and public expenditure for pension, OECD countries, 2011



Source: „Pension Markets in Focus",www.oecd.org

Italy, Poland, Turkey and Estonia show one hundred percent public expenditure for pensions. Expenditure structure of other countries includes both private and public expenditure, with public expenditure as dominant, except on Iceland where private expenditure is predominant.

Late transition, decreased performance and increased unemployment are among factors which have been responsible for slow pension system reformation in our country. The beginning of a new century has initiated the reform of domestic pension system. Legal changes, which were adopted in 2001, 2003 and 2005, were base for such changes.

Even though the reforms from 2001 to 2003 considered introducing second and third pillar, as in accordance with World Bank methodology, the idea was soon abandoned. Taking into consideration a large debt to pensioners from the previous period and large deficit in the first pillar, it was estimated that transitional costs of introducing the second pillar would be rather high. The second important reason for abandoning the idea of the second pillar was the fact that Serbian financial market was underdeveloped and thus private pension funds would have absolutely no choice during investment. Furthermore, citizens were still skeptical about saving, even in banks, which was the result of bad experience at the end of 20th century. Thus, it was politically inappropriate to force citizens to accept mandatory savings in private funds. Finally, research and analysis which showed negative sides of second pillar application appeared at that time, which delayed the introduction of the second pillar in Serbia (Matković, Bajeć, Mijatović, Zivković, Stanić 2008, 44). Apart from that, when deficit is high in the first pillar, it is more favorable to develop the third pillar than the second. Development of the second pillar implies decreasing funds for the first pillar due to the obligation of allocating funds to the first and second pillar (Arsić 2005, 66).

Law on voluntary pension funds and pension plans was adopted in 2005. This law regulated private pension insurance, i.e. the third pillar of pension insurance model. Additionally, the law defined foundation of voluntary pension funds which would enable individuals to pay funds at their own account and thus provide higher pension in the future, through the amount that he will be entitled to, based on obligatory pension insurance.

Voluntary pension insurance in Serbia is at its beginnings. The reasons for its limited progress are numerous. Fund investments are limited by legislation, and portfolio structure is very unfavorable- largest part of the funds is invested into securities which provide safe, but low return.

We are witnesses of the new proposal for pension system reform which attempts to solve the issue of unsustainability of “pay as you go” system by increasing age limit for retiring, equalizing the age limit for men and women, increasing the required years of insurance for retiring, as well as other restrictive measures. Adoption of the stated amendments to Law on pension and disability insurance would alleviate the problem of paying pensions to the pensioners and reduce budget deficit caused by financing pensions. On the other hand, it is clear that bad position of employees who are soon to become pensioners (which is mainly caused by the stated amendments) causes discontent. These are the reasons why pension system reform implementation is unpopular and difficult. Acute aspect of the problem, on one hand, and pension insurance beneficiaries’ discontent, on the other hand, open the issue of justification of these measures and reality of comparing Serbia with European Union countries, despite different life and work conditions. Having in mind all specificities and differences, reform problem becomes even more complex burden for economic policy makers.

5. Concluding Remarks – Possible Ways of Further Reform Implementation

The fact is that the work on reforming pension system has been effective so far, especially in terms of reducing deficit in pension system which would otherwise be 3-4 times higher. However, pension system in our country is still in difficult position. Therefore, reform implementation is to be continued.

Reform implementation can be continued in two directions:

1. Continuing improvements in the first and already introduced third pillar,
2. Introducing the second pillar.

Reforms which can be implemented within the firstpillar with the aim of its improvement refer to increasing efficiency in collecting contribution, as well as in collecting and processing information on insurance beneficiaries. The current pension system implies collecting contribution through Tax Administration, after which the contribution is distributed to pension fund. Furthermore, contribution payment is carried out through employers, so Tax administration and pension fund do not have information on individual insurance beneficiaries. Employers are to fill in the form with personal information on insurance beneficiaries, but majority of them does not do that. Many employers register minimum (not real) income, all for the purpose of paying minimum amount of contribution. Creating centralized database of all insurance beneficiaries, which would be used for monitoring employers, would be the best solution for this problem.

As far as the third pillar is concerned, it could be popularized by conducting marketing and education actions which would help include large number of employees in new system. As we have already mentioned, introducing the third pillar is less painful that introducing the second one, which might show the direction of the future reform. Political stability and good background for domestic financial market development should contribute to reform implementation success and introduction of the third pillar (Ilic 2006, 34).

Even though we have concluded earlier that introducing the second pillar into the pension system would not be a good solution at this moment, this action will be inevitable in the future. The reason is very simple and we have mentioned it several times in the paper – the system cannot function as it is forever. Additionally, reform delay is also not the best solution, as late implementation can be rather painful, especially for socially endangered groups. For instance, partial privatization of pension funds might be expected, but specific requirements are to be met for such action. Implementation of such reform is a serious endeavor which cannot be successful without consent, consensus or engagement of influential political factors in the country. Consensus with unions, pensioners and employers is necessary, as they are key players who are to have positive opinion on reforms. This is probably the most difficult requirement for reform implementation.

The second important requirement is macroeconomic stability which is reflected by low inflation and public debt reduction. Low inflation is significant, as the investment in private pension fund is of long-term character and high inflation would devaluate it. Indexation has been offered as a solution. However, possibilities for manipulating pension fund are numerous, as legal framework is still not fully developed. This made Hungary and Poland reform unsuccessful and negative, and therefore low inflation is highly recommendable. Transition costs represent problems for each country which decides to reform its pension system. Namely, covering transition costs is partly done from the public debt, so the economy will easily bear the reform if the public debt is low.

A very important requirement is developing capital market. Appearance of companies and public enterprises (NIS, Telekom, EPS, Serbian Railway, etc.) would be refreshment for the Serbian market. This would make the market more attractive for investors who would gain trust and feel safe, which is necessary for the development of capital market. One of the alternatives would be local authorities' borrowing on the capital market by means of municipal bonds, with strictly defined legal imitations. Adopting the Law on securities, Law on take-over and Law on investment funds is required, but not sufficient condition for successful reform implementation. Along with application of these laws, the entire institutional system is to be strengthened, as well as legal stateand ownership rights. This can attract investors and open the path to pension system reform (Ilic 2006, 35).

To conclude with, efficient way of encouraging capital market development is defining tax incentives which would stimulate employers, employees and pension funds to save and invest at capital market. In this way, the state would show readiness to protect these stakeholders and would increase their confidence in reforms and their successful implementation.

Pension insurance reform is one of the most difficult ventures for many reasons. In order to make compromise related to the conflicted interests of the stakeholders- unions, pensioners, employers and the state, comprehensive reform plan is to be comprised. However, all of this takes time. Assuming a joint attitude on national level represents condition*sine qua non*for providing security of all elderly members of society.

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REFORMA PENZIONOG SISTEMA – IZMEĐU FISKALNE ODRŽIVOSTI I INKLUZIVNOG RASTA

Rezime: Usled demografskih promena i smanjenja prirodnog priraštaja, uočeno je smanjenje radne snage koje generiše problem nemogućnosti finansiranja penzija i neodrživosti penzionih sistema po principu tekućeg finansiranja. U cilju obezbeđenja socijalne kohezije i blagostanja svih kategorija stanovnika, samo po sebi nameće se pitanje reforme penzionog sistema. Trade-off između fiskalne održivosti koju reprezentuje smanjenje budžetskog deficita i inkluzivnog rasta čiji je reprezent smanjenje siromaštva, problematičnim čini reformu penzionog sistema. Uvođenje obaveznog privatnog penzionog osiguranja u uslovima nedovoljne zrelosti fianansijskih tržišta kao i u uslovima nedovoljne pripremljenosti privrede u celini za ovaj sistem, kao alternativu nameće kombinovanje obaveznog državanog i dobrovoljnog privatnog osiguranja. Rešavanje pitanja prelazne generacije na putu transformacije iz sistema tekućeg finansiranja u sistem akumulacije kapitala, izazov je sa kojima se suočavaju gotovo sve države sveta i Srbija među njima. Cilj rada je sagledavanje posledica aktuelnog penzionog sistema na fiskalnu ravnotežu i rasvetljavanje mogućih pravaca reformi istog radi obezbeđenja fiskalne održivosti bez ugrožavanja inkluzivnog rasta.

Kjučne reči: penzijsko i invalidsko osiguranje, reforme, pay as you go, sistem akumulacije kapitala