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THE STATE AND PERSPECTIVES OF THE PENSION AND DISABILITY INSURANCE SYSTEM IN THE REPUBLIC OF SERBIA*[1]

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Abstract**:** The paper deals with the current state of the system of pension and disability insurance in the Republic of Serbia and the possible directions of change. The author analyses the causes of an extremely poor status of the pension and disability insurance system, based on current financing and intergenerational solidarity. The disadvantages of this system, in addition to its indisputable advantages, are also pronounced in other countries that apply it. However, in countries such as Serbia, there are factors that further complicate its sustainability, such as poor demographic situation, high unemployment rate, and the like. In this context, the text provides a brief overview of the measures taken to date, with the analysis of their short-term and long-term effects. Finally, the author gives a personal view of the direction of development of the pension and disability insurance system in the Republic of Serbia.

Keywords: pension and disability insurance, ageing, unemployment.

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Introduction

Social insurance is considered the most important pillar of a welfare state as it provides protection of a dominant portion of society against the most adverse social risks. It originated in capitalism with the occurrence of social insecurity of employees and their families at a larger scale.

Since the establishment of the first public pension and disability insurance system in Germany in 1884, there have been problems in its functioning constantly. The wish (and need) to ensure security at an age when one cannot earn for living (due to old age, disability or loss of provider), imposes a constant need for sustainability of such a system (to the largest extent possible). However, it is not always possible. Numerous factors have a negative impact upon a pension and disability insurance system, therefore there is a constant need to change and adapt it to any newly-occurred circumstances.

The reasons for a reform of a pension and disability insurance system are found in non-harmonisations and imbalances within pension systems themselves, which also brings about the imbalance of fiscal and entire financial system. The basic non-harmonisation lies within the number of insured persons and the number of pension beneficiaries ratio (Golubović, 2009; 13). In addition to internal factors, there are also external factors leading to problems related to the functioning of a pension system (e.g. economic factors that, e.g., they cause a high unemployment rate).

The necessity of having changes within a pension and disability insurance system is not characteristic for the Republic of Serbia only. The factors causing it, to a greater or lesser extent, also operate in many other countries, especially in Europe. In priority, there is population ageing that is one of the primary characteristics of the majority of European countries. However, the Central and East European countries, i.e. former socialist countries, had a greater need for a reform of their pension and disability insurance systems due to the transition changes that left a deep mark in this area. The greatest impact of these changes in the area of a pension and disability insurance system reflected in a significant reduction of rights and tightening of the eligibility requirements for their realisation, all with an aim to make the system more stable. A study of the International Labour Organisation (ILO, 2012; 3-4)[2] states the following characteristics as the basic characteristic of national pension systems of the Central and East European countries: low and almost fixed pensions, as well as a small difference between minimum and maximum pensions; generous calculation of non-contributing periods when calculating pensions; privileged position of a few groups of workers in regard to the age limit and the calculation of pensions; impaired harmonisation with social welfare systems due to economic challenges that publicly owned companies were faced with in the course of transition; non-existence of a clear limit between public budgets and social welfare system budgets; high contribution rates comparing to the West European states; reduction of contribution levels in the course of time due to a lack of indexation mechanism (ILO, 2012; 3). As a core characteristic, it is also stated that despite adverse difficulties and significant delays and non-payment of salaries, these pension systems managed to meet their obligations related to payment of reimbursements (ILO, 2012; 3). Due to "economic restructuring", a great number of workers lost their jobs, thus early retirement was used to absorb them, which caused a high reduction of contribution payers and, simultaneously, an increase in the number of pensioners in the beginning of the 1990s. Consequently, the dependency rate rapidly increased. On the other hand, population ageing contributed to an increase of dependency rate (the ratio of the beneficiaries of the right [to pension] and the insured persons) in the system through the increase of the old age dependency rates (the ratio of population aged 65+ to population aged 20-64) (ILO, 2012; 4).

[2] The study is incomplete as it only includes Hungary, Bulgaria, Croatia, Check Republic, Poland, Romania, Slovenia and Slovakia. The following countries are not included in the study: Serbia, Macedonia, Bosnia and Herzegovina, Montenegro, and Albania.

1. The (Basic) Causes of the Pension and Disability Insurance System Crisis in the Republic of Serbia*

Population ageing occurs as a consequence of fertility decline[3] **and a ri**se in life expectancy. One of the big paradoxes of contemporary Europe is that birthrate is in a positive correlation with employment rate of women, primarily because mothers find it difficult to harmonise motherhood and career (Esping-Andersen, 2006; 39).

Population ageing is also one of the basic issues in the pension and disability insurance system functioning. Population ageing is caused by prolongation of life span and low natural population growth. Ever increasing human lifespan, *per se*, represents something that is good and speaking about it in a negative context is inappropriate. However, longer lifespan does not keep up with working capability. In other words, the longer the lifespan of pension beneficiaries, the longer the period in which they use pensions; and for which funds must be found. If it is connected (as it usually happens) to an ever decreasing share of a working age population within the entire population, resultantly, there are less and less breadwinners and more and more spenders. Such a situation represents one of the biggest problems in designing a pension and disability insurance system.

In this regard, population ageing had almost been an unknown phenomenon all the way until the 20th century, while it is widely spread all over the world nowadays. Depending on the share of persons aged 65+ in the total population, demographers classify countries into "young", "mature" and "old; whereby the "old" ones are those countries where the share of these persons is 10+ percent (Schulz, 2001; 284).

[3] Fertility is the number of live births that a woman has had in her reproductive age. In order to have zero natural population growth, i.e. to realise simple population reproduction, fertility rate must be 2. 1 (according to some 2.14). On the contrary, there is a negative decline of natural population growth.

2. Change Dynamics - Dynamics of the Reduction of Rights

Some more significant changes in the pension and disability insurance system in the Republic of Serbia began at the end of 2001 with the changes of the then federal Law on the Bases of Pension and Disability Insurance[4]. The most significant changes referred to a one-off three-year increase of retirement age (up to 63 and 58, for men and women, respectively) and to the change in the manner of harmonisation of pensions by adopting the so-called "Swiss formula", i.e. with the harmonisation with the middle rate of wage and cost-of-living growth (Golubović, 2009; 41). The one-off three-year increase of retirement age, without any transition period, created problems for all potential pensioners. In literature, it is justifiably pointed out that it should have been born in mind that this was happening in the commencement of the transition period, at the time of first mass lay offs and when it was impossible to find a new job (Savićević, 2011; 92).

Significantly greater changes were made in 2003 with the passing of the Law on Pension and Disability Insurance of the Republic of Serbia[5]. With its entry into force, the Law on Pension and Disability Insurance of the Republic of Serbia 1996 became invalid.[6] Among numerous novelties, we shall point out only the most significant ones herein. Certainly the first one is the change in the manner of calculating pensions by introducing a point system and extending the calculation period to entire working lifetime. In this manner, a tighter connection between the height of a pension and the contributions paid was enabled; however, it proved simultaneously that the majority of insured persons were paid poorer during a greater portion of their working lifetime. Thereupon, pensions calculated according to the new system were averagely lower by 20-25% than the ones calculated according to the old system (Savićević, 2001; 93). The next more significant novelty is related to the introduction of a new definition of disability. Namely, because of a noticeably high share of

[4]The Law on Alterations and Amendments to the Law on the Bases of Pension and Disability Insurance, "Official Gazette of the Federal Republic of Yugoslavia", no 70/01.

[5] The basic text of the Law was published in the "Official Gazette of the Republic of Serbia", no. 34/2003, and the alterations and amendments in nos.: 64/2004; 85/2005; 63/2006; 107/2009; 30/2010;101/2010; 93/2012; 62/ 2013; 108/2013, and 74/2014.

[6] Official Gazette of RS, no. 52/96;46/98; 29/2001, and 80/2002.

disability pensions in the total number of pensions even by 30% at the end of 1997[7], the definition of disability was changed, in terms of making it stricter. According to the new definition, disability exists when a total loss of working capabilities of insured persons occurs, i.e. when a total loss of capabilities for military service occurs in professional military staff, due to changes in the health state caused by an injury at work, occupational disease, or diseases, which cannot be cured with a treatment or medical rehabilitation. In other words, now disability exclusively implies total and permanent loss of working capabilities. The aim of this change was to cut down, by making the definition stricter, the number of persons who can realise the right to disability pension, considering their high share in the total number of pensions, which was not caused by an actual loss or decline of working capabilities, but a consequence of milder eligibility requirements for the realisation of the right and numerous abuses. The best indicator that something is not right with the realisation of the right to disability pension is its average usage in relation to the average usage of old-age pension. The right to disability pension, by its nature, is exercised by persons whose health state or functionality of their organism has been ruined due to illness or injury. Thereafter, normally, one would expect that these persons enjoy their pension for a shorter time period than persons who have realised the right to old-age pension However, it is totally different in reality. Thus, in 2008, the average usage of old-age pension was 15 years, whereas the average usage of disability pension was 18 years This relation was also, mainly, retained in 2012 when the average usage of old-age pension was 17 years and the disability pension amounted even to 19.

In addition to these positive effects of the changed concept of disability, the negative ones should also be pointed out. In priority, such a

[7] At the end of the same 1977, the share of old-age pensions was 48.2%, family 21.8%, whereas the disability pensions accounted for even 30% of all pensions. By the end of 2003, the old-age pensions accounted for 50.3% of the total number of pensions, family 22.6%, whereas the share of disability pensions was slightly reduced to 26.4%. A more significant improvement of the results in favour of old-age pensions happened at the end of 2013 when the shares of disability, old-age and family pensions were 19.4%, 59.3%, and 21.3%, respectively. Although there was a significant decline in the share of disability pensions in the total number of pensions, it is still very high. (Pension and Disability Insurance (PDI), 2012).

restrictive definition of disability is uncommon in Serbian law; and for the first time, since the Law on Pension Insurance of Workers of 1922, only one form of disability is recognised, i.e. total loss of working capabilities. In literature, it is justifiably pointed out that disability insurance in the pension and disability insurance system was disavowed to a certain extent in this manner, and the state, actually, admitted its impotence to cope with the corruption of disability commissions. This change was the only way to cut down the share of disability pensioners, not considering that it would lead to another extreme (Savićević, 2011; 94). This another extreme is reflected in the fact that now the insured persons with seriously and permanently ruined health state and working capabilities also cannot exercise their right to disability pension frequently as they do not fit in such a strict disability definition.

With the Law of 2003, an extension was also made and it included compulsory insured persons, i.e. persons who perform jobs on the basis of author copyright agreements, service agreements, jobs through youth and students cooperatives, including also jobs through other types of contracts, for which compensation is realised. Also, certain alterations were also made in relation to insured agriculturers. Those members who are pension beneficiaries or students are excluded from agricultural households.

In 2005, old-age pension limit was raised again [8]. The old-age pension limit was raised for men and women, from 63 to 65 and from 58 to 60, respectively. However, this was not a one-off change, but a gradual one (from 2008 to 2011), which certainly is a better solution. In addition to old-age, family pension limit was also raised, as well gradually within the same time span, from 53 to 55 (widower) and from 48 to 50 (widow). A very important, perhaps the most important, alteration in 2005 referred to the change in the manner of harmonising pensions. The so-called, "Swiss formula", i.e. harmonisation of pensions with costs of living and salary growth, was abandoned. In the course of the next four years, a gradual transition was only made onto harmonisation with costs of living; and this in the foregoing six months. The aim of this alteration is obvious.

[8] The Law on Alterations and Amendments to the Law on Pension and Disability Insurance, "Official Gazette of the RS", no. 85/2005.

By harmonising only with costs of living and not with salaries, smaller funds are needed for their payment.

Voluminous alterations were also made in 2010[9] and they entered into force on 01 January 2011. In priority, the eligibility requirements for old-age pension limit were increased again, both in regard to age and number of years of pension insurance needed. The minimum age for old-age pension (of insured persons with extended duration of pensionable service), is raised from 53 to 58 years of age, from 2011 to 2022 gradually. Pensionable service for women was raised from 35 to 38, as well gradually, up to 2022. The eligibility requirements for family pension were tightened again, so a widow can acquire it at 53 years of age and a widower with 58 years of age. Old age limit is gradually raised four months per a year, from 2012 to 2016.

In regard to insured agriculturers, it is envisaged that all agriculturers are compulsory insured, not only the head of household or one member, which was appraised as the most brilliant example of the wanderings in the PDI system reforms. Namely, an attempt to eliminate the problems in paying contributions, i.e. in financing compulsory insurance of agriculturers was made in the Law of 2003, and this by having only the head of agricultural household, i.e. minimum one member, compulsory insured . Even with such a solution, the funds collected from contributions of agriculturers barely covered 9% of the funds needed for paying pensions; therefore it remains unclear what effects the legislator bore in mind when introducing compulsory insurance of all agriculturers (Savićević, 2011; 100).

Apart from the abovementioned, in 2010, some alterations were made in the manner of harmonising pensions and some stricter eligibility requirements were introduced for insured persons who perform jobs with extended duration of pensionable service.

[9]The Law on Alterations and Amendments to the Law on Pension and Disability Insurance, "Official Gazette of the RS", no. 101/2010.

3. The Latest Changes

The last changes in the pension and disability insurance system of the Republic of Serbia were made in July 2014[10]. In priority, there were alterations made in relation to insured agriculturers, so that, repeatedly, only the head of agricultural household and the head of family agricultural economy are compulsory insured, i.e. minimum one member, which additionally speaks of the "wanderings" in agruculturers' insurance.

A particularly important novelty is the introduction of yet another right in the event of old-age right to early old-age pension. Namely, before the latest changes, the right to old-age pension could also have been exercised before reaching the general old-age limit, with no pension reduction, provided the insured person realises the specified pensionable service. It was 40 and 38, for men and women, respectively, and the lower age limit was 58. Now, the insured person acquires the right to early old-age pension when they have 40 years of service and minimum 40 years of age (with a specified transitional period form 2015 to 2023, but it is permanently reduced by 0.34% for each month before turning 65. The reduction can be maximum 20.4% (maximum for a 60 month period, i.e. five years).

Early old-age pension is not a novelty in Serbian pension system as it was introduced in 1964 with the Basic Law on Pension and Disability Insurance that also provided for certain reductions.[11] The introduction of early pensions with reductions was accounted for with the endeavour to comply with the economic principle of equivalence of paid contributions and realised pensions (Golubović, 2014; 213). Regardless of all the advantages that early pension brings along from the standpoint of justice, those who belong to the generation closest to acquiring pension under former eligibility requirements are affected most since they are brought into a more adverse position. Indisputably, earlier retirement enables longer usage of pension including also insured persons who reached full

[10] The Law on Alterations and Amendments to the Law on Pension and Disability Insurance, "Official Gazette of the RS", no. 75/2014.
[11] "Official Gazette of the Federal Peoples Republic of Yugoslavia (FPRY)", no. 51/64.

pensionable service; therefore it is necessary to either increase the volume of paid contributions or to reduce the pension amount, or both, in order to bring the rights and obligations of every insured person into balance (Golubović, 2014; 223). On the other hand, a permanent reduction of pensions is debatable in our opinion. Notwithstanding that early retirement creates conditions for longer usage of pension, a question related to pensionable service that is sufficient for (unpunished) usage of old-age pension is also being posed. In other words: Is it justifiable that payment of contributions in the course of, e.g., a 40 year period is deemed insufficient for using old-age pension in full amount of, averagely, 15 years?

Regarding the eligibility requirements for the realisation of the right to old-age pension, the requirements were tightened, as well as the equalisation of years for men and women. The equalisation of eligibility requirements was determined gradually, more precisely in two phases. In the first phase, lasting until 2020, the eligible years of age for women will be increased by 6 months per year, starting from 60 years of age. In the second phase, lasting until and including 2031, the increase will be two months per year.

A qualitative change was made in regard to extended duration of pensionable service that, thanks to the inherited state as well as to certain traditions, became one of the basic issues in the functioning of the pension and disability insurance system in the Republic of Serbia. A very mild criteria for acknowledging this pensionable service in the past resulted in a great number of persons who had exercised the right to this service. Although many of them did not meet the core eligibility requirements for acknowledging this service, the legal possibilities resulted in a situation where the right to old-age pension was also realised by persons who had performed neither particularly heavy nor dangerous jobs, thus the share of such beneficiaries equals 13.8 % out of the total number of pension beneficiaries (PDI, 2012). Thereafter, the eligibility requirements required for the realisation of the right to old-age pension on the basis of the service retirement benefit are now tightened. In priority, it is necessary to accumulate at least 2/3 of the total years of pensionable service at those working posts. Additionally, this possibility cannot be exercised by persons who work at administrative and technical working posts, but only those who work at posts where work is especially strenuous, dangerous and health hazardous, i.e. at posts where performing professional activities is limited with reaching specified age or physiological functions decline to such an extent, due to the nature and complexity of the job, that any further successful performance is made impossible. An exception is made in regard to professional military staff pursuant to the regulations on the Serbian Army. In other words, they will not be affected by the tightening of eligibility requirements.

Among the remaining changes, we will only present the one referring to the so-called "special insurance span". Until the last alterations to the Law, it used to be acknowledged to a woman who gives birth to the third child only (in the duration of two years). Now, it is also acknowledged to a woman who gives birth to the first child (six months) and to the second child (one year). We believe these alterations represent, although they seem insignificant at first sight, one of the most positive alterations to the Law on Pension and Disability Insurance.

4. Perspectives of Pension and Disability Insurance in the Republic of Serbia

4.1. The State of the Pension and Disability Insurance System in the Republic of Serbia

The pension and disability insurance system in the Republic of Serbia is based on the compulsory state pension insurance and the current financing through contributions, the so-called PAYG system (Pay-As-You-Go). Essentially, in this system, the insured persons are paying contributions out of which pensions for current beneficiaries are being financed, and the insured persons expect that their pensions will be financed from the contributions of future insured persons, once they have finished their working lifetime.

However, due to population ageing (due to the increase in life expectancy and the birth rate fall), average population age is constantly being increased all over the world, especially with the increase in the number of old people (65+), as well as the increase in the number of very old people (85+) in relation to working age population (from 15 to 65). Thereafter, it is also pointed out that developed economies will be richer before they become old, whereas developing countries will become old before they get rich (Holzmann, Hinz, 2005; 25).

The demographic state in the Republic of Serbia is exceptionally adverse. On the basis of the data of the Statistical Office of the Republic of Serbia[12], Serbia's population number was 7,199,077 with an average age of 42.2 in 2012. The low total fertility rate (for women between 15 and 49) of only 1.405 gave a natural growth of 34.907 in 2012. Simultaneously, the reproduction rate was 0.70. Although, the average lifespan has been increased comparing to, e.g. 2000 (67.8), 73.9 in 2012, the ratio of up to 14 and over 65 years of age represents an issue of concern. Thus, in 2012, in the entire population of the Republic of Serbia, population of up to 14 years comprised 36%, whereas those of 65+ had a share of 17.45% (RS Statistical Office, 2012). On the other hand, the total number of beneficiaries increased to 1,730,222 and the ratio of the number of beneficiaries and the number of insured persons was practically equalised. Average pension approximately amounts to € 200 (RS Statistical Office, 2012).

The high unemployment rate of 748.549 represents a particularly aggravating circumstance for the pension and disability insurance system in the Republic of Serbia in October 2014 (National Service for Employment, 2014).

4.2. The Challenges of the World Bank Model in Serbia

The crisis that caught pension and disability insurance systems, particularly in Europe, yet also in other countries, resulted in the occurrence of different models to "reform" the existing systems and to exit

[12] Data excluding the Autonomous Province of Kosovo and Metohija.

the crisis. The most significant of them, with regard to the number of states that (more or less) accepted it, is the model developed by the World Bank. The model was publicised in 1994 in a study called *Averting the old age crisis,* (WB, 1994). Basically, the proposed pension and disability insurance system is based on three "pillars". The first one is comprised of mandatory pension insurance on the basis of intergeneration solidarity; the second one, mandatory pension insurance for old age on the basis of individual capitalised savings; and the third one would be comprised of voluntary pension insurance, also on the basis of individual capitalised savings (WB, 1994; 239-247).

Obviously, there are two mandatory pillars and a voluntary one; whereby one of the mandatory pillars (the second) is fully financed and privately managed. The third pillar is comprised of voluntary private insurance and should provide supplementary income sources in the old age to persons who believe their income from the first two pillars will not be sufficient (Obradović, Sekulić, 2010; 363-365). As claimed by the World Bank, this one is ideal for dealing with personal savings. However, as it is not recommendable to rely only upon a privately managed pillar in the provision of a network of social security, a publicly managed and tax funded first pillar is much needed (Škember, 2002; 722).. The model was, at first, accepted by many countries of South and Central Americas, with various modalities. Pension reforms in these countries served as a model to former socialist countries, although the model in these countries was applied with more consistency and uniqueness. The Czech Republic was an exception as it refused to apply this model (Golubović, 2009; 73).

Recognising numerous disadvantages of the three pillar model offered, the World Bank offered a new one in 2005. It is presented in the *Old Age Income Support in the 21st* Century study (Holzmann, Hinz, 2005). The most significant novelties refer to the introduction to the so-called “zero" pillar that should provide social pensions, with an aim to achieve a minimum level of social protection, and, conditionally, the “fourth” pillar (informal intra-family or intergenerational source of financial and non-financial support to the elderly, including the access to healthcare and housing) (Holzman, Hinz, 2005; 36).

The offered "reform" model of pension and disability insurance system became a subject of serious criticism even after the first results and analyses. One of the most severe critics was the International Labour Organisation emphasising, *inter alia*, that the world economic crisis implied the sensitivity of the level of pensions in fully capital financed systems with defined contributions according to volatility of financial markets, as well as the manner in which all workers had to bear consequences (ILO, 2012, 6). The negative experience with this model caused different reactions starting from cutting down contributions for the second pillar (Poland, with 7.3 % to 2.3% from the total contributions for pension and disability insurance), to a repeated nationalisation of the second pillar (Hungary) (ILO, 2012; 9-10).[13] So far, the experiences in the application show that the proposed World Bank pension model is "faulty", not only from the standpoint of social policy, but it does not provide certainty in strengthening economic growth in general (Škember, 2002; 735). Thus, the question arises: Who shall profit from the privatization of the pension systems? Perhaps the best answer was given by a renowned economist and the World Bank former-expert, J. Stiglitz. According to him, privatization of pension system would only be immensely beneficial to those companies that administer pension funds and ensure payments of pension allowances. On the other hand, it would also impose greater risks for workers, as the majority of markets in the majority of countries does not offer bonds that are fully indexed against inflation (Stiglitz; 100).

Concluding Considerations

The state of the pension and disability insurance system in the Republic of Serbia is a consequence of population ageing to a great extent as in many other countries. In addition, the adverse economic situation, which created a high unemployment level, had a great impact; but also there were consequences of wrong solutions from the past. The improvement of the existing state has lasted for many years and, basically, it comes down to the so-called parameter reforms, i.e. a correction of elements of the already existing system. In that sense, the changes made in 2014 were particularly significant. Due to the economic sanctions that

[13] More about the disadvantages of this model in: Obradović, Sekulić (2012).

Serbia (within Federal Republic of Yugoslavia) endured for many years, the application of the World Bank model did not happen at the time when it was done in many former socialist countries. This (by all means, happy) circumstance made it possible to observe all the shortcomings of the system on experiences of others and not to commence its application without consideration. The parameter reforms undertaken so far have given certain results, but it is difficult to estimate their efficiency more accurately due to still a very bad economic situation and a constant increase of the number of unemployed persons.

In the coming years, new challenges are certainly awaiting the pension and disability insurance system in Serbia. In priority, short-term and mid-term consideration of the effects of the undertaken measures will be necessary, particularly in regard to the increase of age limit for retirement. The state in the economy and the increase (or decrease) of gross domestic product (GDP), as well as the state of the employment market will certainly affect the further steps to be taken. Depending on the results, we believe that the determination will go from new parameter changes to (eventual) risk taking inherent to the application of any of the World Bank models.

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