

FRAMEWORK FOR INTRODUCING A SECOND-PILLAR PENSION SYSTEM IN AZERBAIJAN

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ABSTRACT

This paper presents a possible framework for implementing the second-pillar pension system as called for by the Law “On Labor Pensions” of the Republic of Azerbaijan. The proposed option consists of a defined contribution plan, in which both employee and employer contribute on a regular basis, with partial support of government. Simulating the effects for representative workers shows that, even in the most pessimistic scenario, participants in the second-pillar system who reach pension age can maintain a viable standard of living at retirement. This result is even more pronounced for workers in the lowest income group, because of the redistributive effect of the proposed reforms.

Keywords: *Pension law; second pillar; income inequality, Azerbaijan.*

1. INTRODUCTION

The aim of pension system reforms in Azerbaijan in 2017 has been to increase the efficiency, to ensure the adequacy and to consolidate the financial sustainability of the pension system by introducing measures against economic shocks. The Law on Labor Pensions was approved by Azerbaijani Parliament on March 10, 2017, and was amended by Presidential decree on May 1, 2017. According to these amendments, the required length of work experience has been increased, with the exception of police and military personnel. Another change has been the transfer of a larger share of the paid contributions into the individual pension account of workers for compulsory state social insurance.

On July 1, 2017, further amendments came into force indicating the definition of *funded* part of individual pension account, which can be financed voluntarily by the worker in order to get a higher labor pension. This provision paves the way for the introduction of a second pillar in the pension system. However, no method of determining the contribution to this funded part has been defined yet. A proposal in this sense is advanced in this paper.

2. PROPOSED FRAMEWORK

2.1 Benefit

The proposed *funded* pension scheme involves the active participation of employees, employers, and the political-administrative system, as described in the following. Participation is also open (with a specific formula of contribution) to self-employed workers and to farmers.

According to Article 10 of pension law, the amount of an old-age labor pension is calculated as the sum of an *insurance* (first-pillar) part and a *funded* (second-pillar) part. The latter corresponds, in monthly amount, to the pension capital accrued in the *funded* part of the individual pension account, divided by the coefficient set by law (which is currently 144).

Workers unable to fulfil pension requirements, according to Article 7 of pension law, will not receive the first-pillar pension part but only, at the age of 67, the minimum state social-assistance benefit. In our proposal, these individuals shall also receive the second-pillar pension part, calculated as above.