Statement to the Panel
Central Bank, Montenegro

Ladies and Gentlemen,

It's an honour and a privilege to have the opportunity to speak at this forum on such important issue as the pension reforms.

The implementation of pension reforms has become an obvious necessity in the last few decades, gaining on importance in highly-developed countries, but maybe even much more in developing countries. Pension system reforms in developing countries are conditioned by underdeveloped financial markets and inflexible labour markets, the very two dimensions that define the priorities of the pension reform implementation.

The existence of competition among pension funds, both public and private, is of great importance for a country's successful pension reform implementation. Competition reduces expenses and leads to the development of new retirement products. However, it is advisable in the initial reform stages, that is, the introduction of voluntary pension funds, to limit the range of retirement products. This is because those who manage voluntary pension funds lack sufficient knowledge and experience and the financial market itself is still underdeveloped. Fewer retirement products are expected to bring about lower risks in managing a pension fund's assets. Reducing these risks is of vital importance because they affect pension revenues and overall social situation in a country. In addition, restricting retirement products is also important as it facilitates regulation and supervision of pension funds.

Pension fund regulation and supervision must be very strong, but it should be taken into account that the authorized institutions also "suffer" from insufficient knowledge and experience, so it is also advisable to make their work easier. The development of specific retirement products should be the result of a continuous work of the newly established institutions offering these products, but also of the institutions in charge of their regulation and supervision. Individuals requiring specific retirement products may acquire them either from domestic or foreign insurance companies offering other retirement products as well. In such cases, the risk lies with the individual, while the policy makers should be concerned with the interest of all citizens, and this is easier to be done in the conditions of a gradual development of retirement products, pension funds and their regulators and supervisors.

In order for pension funds to achieve their primary objectives in the conditions of an underdeveloped domestic financial market, they should be allowed to invest abroad, respecting the investment safety principle. However, these investments provide revenues and the achievement of social objectives of their operations, but they do not contribute to the development of the domestic securities market and the national economy. Nevertheless, pension funds <u>should not and must not</u> be forced to invest in the domestic market, especially if it does not offer a sufficient diversification of quality, liquid and reliable securities. It is needless to stress that it is inappropriate to leave a domestic economy without substantial external financing sources that pension funds can provide by investing the acquired capital.

Therefore, it is necessary to create conditions for the domestic capital market development, not only regulatory and institutional, but also the conditions for new securities issues and trading. It would coincidentaly enable a creation of preconditions for the pension fund development and for the efectuation of their influence on development of domestic economy.

Only in such conditions it is advisable to reduce employers` contributions and coordinate reforms on the labour market in order to create business incentives. However, a business incentive is also the availability of external financing sources, but too early a reduction of contributions and the labour market liberalization may exert the pressure on a still insufficiently reformed pension system. This may be rather dangerous in the conditions of inadequate financial literacy of employees that may be prevalent at the beginning of pension reforms unless employees, as the result of reforms of the labour market and social contribution policy, are left to manage their future pension revenues on their own. Another threat is that in the conditions of low living standards, in accordance with the consumption theory, employees opt for consumption instead of savings and investments.

Therefore, it may be considered that appropriate step-by-step in the follow-on reforms should be determined; the establishment of voluntary pension funds should be accompanied by the creation of conditions for the development of the domestic capital market and financial literacy of the population. Only after these initial steps may the reforms of the labour market commence and a stimulating business-friendly environment could be created. In order to provide an adequate reforms synchronisation it is necessary to constitute appropriate councils or working groups consisting of representatives of the Ministry of Finance, the Ministry of Labour and Social Affairs, regulators of the capital market, and a central bank.