

Statement to the Panel
Ministry of Finance, Serbia

- In accordance with the most recent research studies and evidences (Old Age Income Support in the 21 century (2005), Pension Reform and the Development of Pension Systems (2006), etc) - extensive research is being conducted and efforts made into identifying most appropriate manner in which Serbian Pension System should be reformed.
- Efforts made so far include extensive parametric reforms of mandatory public Pillar 1 pension system and the establishment of voluntary private tax preferred Pillar 3 pension system. Due to extremely high transition costs, Pillar 2 (mandatory private) pension system was not implemented. Also, due to high coverage of the public pension system (and social safety net systems to a certain extent), flat level old-age benefits (Pillar 0) system has not been considered to any tangible extent so far.
- **PILLAR 1 Developments**

Vital statistics data

Year	Average population age (total)	Life expectancy	
		Man	Women
1953	29,4	58,7	60,4
1961	30,5	62,4	64,9
1971	32,4	66,2	70,0
1981	33,7	67,8	72,6
1991	37,5	69,0	74,1
2000	39,8	69,6	74,8
2001	39,9	69,6	74,9
2002	40,2	69,7	75,0
2003	40,3	69,9	75,1
2004	40,4	69,9	75,4
2005	40,6	70,0	75,4

- Total fertility rate dropped from 1.7 in 1995. to 1.5 in 2005.

Year	Number of employees*	Number of pensioners	Employee per pensioner ratio	Dependency ratio
1997	1.988.043	1.243.192	1,60	0,63
1998	1.982.378	1.251.394	1,58	0,63
1999	1.942.001	1.263.315	1,54	0,65
2000	1.883.107	1.264.175	1,49	0,67
2001	1.890.130	1.297.004	1,46	0,69
2002	1.846.937	1.255.814	1,47	0,68
2003	1.789.168	1.248.662	1,43	0,70
2004	1.799.107	1.241.082	1,45	0,69
2005	1.781.888	1.239.573	1,44	0,70
2006	1.792.497	1.267.574	1,41	0,71

* Data for Employees pension fund only. Professionals and farmers not included.

- In the years before 2000, Employees pension fund formally was not in deficit. Reasons for that were: high contributions rates (32%), in the period from 1995 to 2000 only in 1996 all 12 monthly payments were made (that generated debt to pensioners in the amount of 2,4 monthly payments) and finally fund has been financed from other fiscal and non-fiscal sources.
- In 2002, extensive parametric reforms of the mandatory public pension system were conducted. These included the increase in the retirement age by 3 years (effective immediately, without a transition period), linking pension benefits to entire working career contributions (instead of 10 years of best average salary), imposing stricter rules for attaining disability pension, introduction of benefit indexation according to the Swiss formula (50% wage growth, 50% inflation) in order to gradually over time decrease the high replacement rate, which in 2002 equaled over 70% percent. Also contribution rate has been reduced from over 32% before 2001 to 22% in 2004.
- In 2005, further parametric reforms were conducted in order to make the public pension system 'less generous'. These included a further increase to retirement age of 2 years (4 year transition period), and a gradual indexation of pension benefits only with inflation (4 year transition period).
- The conducted parametric reforms improved the fiscal balance¹ of Public Pension Fund and reduced the replacement rate from over 90% before 2000 to below 60% in 2007²

Employees fund – pension expenditures and contributions in mil. of dinars

	Pension expenditures	Contributions (without contributions for old debt repayment)	Contributions/ Pension expenditures coverage
2003	124.478	78.620	63,16%
2004	147.027	99.079	67,39%
2005	181.379	120.393	66,38%
2006	213.701	147.077	68,82%

¹ This improvement might not be immediately obvious due to increased retirement (caused by the increased age required for retirement and poor conditions in the labor market) and the extent of non-pension benefits administratively channeled through the Public Pension Fund.

² It should be noted that disability and survivor pension benefits reduce the average replacement rate. Average replacement rate for old-age pensions alone is above 70%.

Employees fund revenues and expenditures in % of GDP

	2004	2005	2006
Employees fund revenues	12,8	12,6	12,3
Regular contributions	6,9	6,9	6,9
Other contributions	0,6	0,3	0,4
Transfers from budget	4,7	4,7	4,5
Employees fund expenditures	12,8	12,6	12,2
Employees fund social rights	11,9	12,1	11,5
Expenditures for regular pensions	9,6	9,7	9,6
Debt repayment	0,5	0,5	0,2
Other expenditures	2,0	1,7	1,3
Total revenues (all three pension funds)	14,1	13,8	13,8
Total expenditures (all three pension funds)	14,0	13,8	13,4
Total transfers from budget for all three pension funds	5,3	5,3	5,2

• Pillar 2 Developments

- Main fiscal reason why Pillar 2 introduction in Serbia is considered to be implausible are the high transition costs associated with it. If Pillar 2 were to be hypothetically introduced in Serbia in 2008 (according to most common parameters found in other countries: only workers with ages < 40 initially allowed to participate, contributions equal to 7% of gross wage devoted to it), the initial transition costs would equal 0.9% of GDP and would be gradually rising to a maximum of 1.8% of GDP in 2033. Transition costs would then start to decline, and cease in 2048. In total, **transition costs would run for 40 years (2008 to 2048) and would total more than 50% of the average Serbian GDP realized in the referenced period - ie over 50 billion Euros in accounting terms or over 30 billion Euros in 2006 constant price Euros, assuming 2% annual Euro inflation.**
- Other obstacles for a hypothetical Pillar 2 introduction include shallow financial markets and lack of investment opportunities, lack of disability and survivor insurance under Pillar 2 - disability and survivor pensioners account for more than a half of current public pensioners in Serbia.

• Pillar 3 Developments

- Legal requirements required for Pillar 3 introduction were adopted in 2005, and required regulatory framework was established in 2006. At the moment, 6 Private Pension Funds are licensed and operating in Serbia, while another 4 are in the process of being approved.
- Employees' monthly contributions of up to 3000 Dinars (45 Euros, close to 10% of monthly gross salary in Serbia) into voluntary private Pillar 3 pension funds are tax exempt. Although Serbian Pillar 3 tax incentives might look modest compared to tax incentives employed by some countries in the region, it should be noticed that Pillar 3 pensions in Serbia are basically subject to E-E-E tax regime, ie they

are tax exempt at all stages – Exempt at the contribution stage, Exempt at the investment stage and Exempt at the payout stage³. Appropriateness of Pillar 3 tax incentives will be monitored in the future.

- Voluntary private Pillar 3 pension funds are experienced vibrant growth, which is expected to continue into the future years.

- **Anticipated Future Pension Reform Developments in Serbia**

- Further Pillar 1 parametric reforms in order to achieve a fiscally affordable (further reductions in the generosity, incentives for late retirement, automatic stabilization mechanisms) and socially acceptable public pension system.
- Further strengthening of Pillar 3 system, in order to make the fully funded part of the overall Serbian Pension system more tangible.
- Further development of funded retirement mechanisms, including the life insurance industry and/or savings and investments fund industry.

³ Beneficiaries are tax exempt at the payout stage provided that they use the accumulated funds to purchase a life annuity. Beneficiaries that opt for a lump sum withdrawal are subject to capital gains taxation.