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Pension reform in Azerbaijan: challenges and achievements

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Status quo ex ante

Azerbaijan's pension fund as a standalone unit was established in 1991 (at the end of the Soviet period) without defined physical premises, effective national legislation, corporate policies, skilled personnel, a centralized record keeping system, and other necessary characteristics of a modern pension system. The collapse of the Soviet system along with the socio-political and economical cataclysms of the early 1990s ruined the archives in which employment records were kept. Identification of employment periods and income levels for workers who used to live in other Soviet republics, who moved from areas of conflict or worked in enterprises that went bankrupt became a real challenge. Many people were unaware of the pension fund's existence and refused to pay social contributions. Despite the presence of a variety of different beneficiary categories, average pension benefits were of symbolic amounts (\$10-15 per month), and procedures for claiming them very bureaucratic. Despite these small amounts, payment delays could reach 3-4 months. Pension administration responsibilities were split between district offices of the State Social Protection Fund (SSPF) and the pension departments of numerous state enterprises and other public institutions. Data processing was done manually, without centralized record keeping.¹ All this made possibilities for fraud and error uncomfortably high.

Since 2001, the government (with support from UNDP and the World Bank) has significantly reformed and improved the governance of Azerbaijan's pension system. In addition to strengthening its first 'pay-as-you-go' pillar, the government has introduced a second funded pillar based on notionally defined contributions, to increase the pension system's long-term sustainability. While Azerbaijan's social security system continues to face important challenges, there can be no doubt that these governance reforms have significantly improved the quality of services received by Azerbaijani pensioners.



Before the reforms...



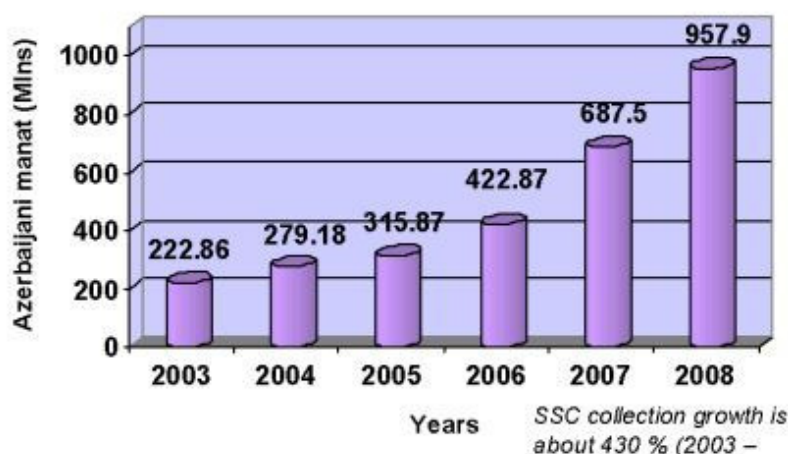
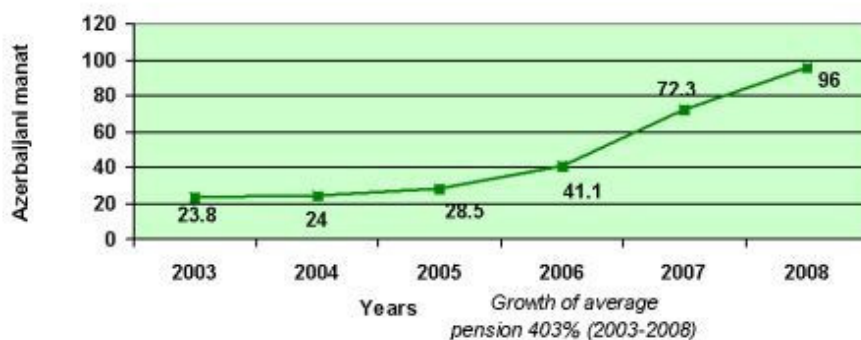
...and after © UNDP Azerbaijan

Pension reform and e-governance

In 2001 the government adopted a reform concept² that sought to ensure the pension system's financial sustainability, strengthen links between social insurance contributions and pension benefits, improve transparency and access to information for taxpayers and beneficiaries, and reduce incentives for avoiding the social security taxes that fund the pension system. In 2003-2004 agreements were concluded with UNDP on the joint 'Capacity Building for the State Social Protection Fund'³ project,⁴ and then with the World Bank for the 'Pension and Social Assistance' project.⁵ These projects worked to significantly increase the SSPF's managerial capacity by introducing e-governance instruments, in order to automate payments and data processing, improve transparency and access to information (for beneficiaries and the general public), improve the flow of information between the SSPF's head office and local branches, and create the technological and financial preconditions for the subsequent introduction of the pension system's funded pillar.

The results of these reforms are apparent in the pension system's performance in recent years. In January 2006 the second pillar of Azerbaijan's pension system was introduced, based on the principle of notionally defined contributions to individual accounts.⁶ More than 70 of the SSPF's branch offices have been reorganized, and all offices have been equipped with modern computer systems and local area networks. Most business processes in the head and branch offices have been fully automated,⁷ producing significant improvements in data accuracy and systemic transparency and eliminating many bureaucratic procedures. Automation has also facilitated the application of the 'one-stop shop' principle in registering company and individual social security tax payers,⁸ and has helped the SSPF and the Ministry of Taxation to catch mistakes and reduce fraud.

Since January 2006, the SSPF's data base has extended coverage to over 1.8 million employed workers,⁹ 300,000 employers, and 1.3 million pensioners. Pension fund revenues and payments for beneficiaries likewise skyrocketed during this time (see charts 1 and 2), growing at rates well above Azerbaijan's very high reported GDP growth.¹⁰ This sharp increase in pension benefits paid out played an important role in reducing poverty in Azerbaijan, particularly among the elderly. Over 80 percent of pension transactions are now made online via ATMs and VISA payment cards; some 500 additional ATMs have been installed across the country. As people frequently visit big villages and district centres for trading, shopping and other purposes, even inhabitants of remote settlements and small villages are able to withdraw their pension benefits from ATMs, without having to pay 'tips'.

Chart 1: Social security taxes collected (2003-2008)**Chart 2:** Growth in average monthly pensions (2003-2008)

Source: www.sspf.gov.az/statistika_2008.aspx

Conclusions

Azerbaijan's pension reform successes were made possible by three key factors: high levels of government commitment, appropriate and timely technical and financial assistance from the international community (UNDP and World Bank), and appropriate use of e-governance tools. These factors allowed Azerbaijan to 'leapfrog' over governance problems found in many other countries in the region, and adopt cutting-edge technological solutions to social policy reform challenges. This experience also underscores the importance of investments in basic IT awareness, as well as of structural reforms in the banking and telecommunications sectors.

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References:

1. Mel Cousins. *Case Study of the Capacity Building for the State Social Protection Fund Project*, (Azerbaijan: UNDP, 2008).
2. http://www.sspf.gov.az/prezident_fer_seren.aspx.
3. In Azerbaijan social security is split into two components: (a) social allowances, targeted social assistance, unemployment, rehabilitation of invalids, etc.; and (b) social insurance for the labour force and labour pension provision. Component (a) is managed by the Ministry of Labour and Social Protection, while (b) is the responsibility of the SSPF. As the SSPF is the only organization in Azerbaijan dealing with social insurance and pension provision, it is frequently referred to as the 'Pension Fund'.

4. <http://www.un-az.org/undp/doc/projdocssp.pdf>.
5. <http://web.worldbank.org/external/projects/main?pagePK=64283627&piPK=73230&theSitePK=40941&menuPK=228424&Projectid=P049892>.
6. Salim Muslumov. *Modernization of Pension Administration: From No Computers to a Sophisticated Record Keeping and MIS System in Three Years. The Case of Azerbaijan*. World Bank, Washington D.C., 13 June 2007. <http://www.ssp.gov.az/konfranslar.aspx>.
7. *Azerbaijan Republic Modernizes its Social Security System with HP Technology*. Hewlett-Packard Development Company, July 2006, <http://h20271.www2.hp.com/SMB-AP/downloads/Pensions%20System%20Azerbaijan.pdf>.
8. Oktay Ibrahimov, *Towards e-Governance in the Social Insurance System*. Presentation delivered at the International Social Security Association, Moscow, 2005. <http://www.issa.int/pdf/moscou05/2ibrahimov.pdf>.
9. *SSPF employment data differ from those reported by the Central Statistical Committee. The difference is explained by Azerbaijan's large informal sector, which is now the focus of special governmental measures*.
10. http://www.ssp.gov.az/statistika_2008.aspx.

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