



Azerbaijan: Transformation Stories

BUILDING AN EFFECTIVE PENSION SYSTEM

Capacity development of Azerbaijan's State Social Protection Fund as a core-stone for improving old age security

Introduction

By 1 September 2010, Azerbaijan had the second highest basic pension among the countries of the Commonwealth of Independent States (CIS). The basic pension is currently equivalent to AZN 85, or US\$106, State So-

cial Protection Fund (SSPF) Chairman Salim Muslumov told media in Azerbaijan's capital, Baku. In comparison, the basic pension was US\$ 124.20 in Kazakhstan, US\$ 90.20 in Russia and US\$ 82.10 in Belarus. "As of 1 July, there were roughly 1.29 million pensioners in Azerbaijan," Muslumov said. "The figure will reach 1.38 million by late 2010." from, this success is remarkable. It results from the combination of the strong political will of decision-makers, availability of financial resources as an output of strong economic growth, the commitment and hard work of individuals within the SSPF, and timely and appropriate international assistance – spearheaded by UNDP, the first international organization to extend support to the SSPF as early as 2003.

Economically Azerbaijan suffered a severe post independence crisis

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Context

Post-independence Azerbaijan and old-age poverty

Economically, Azerbaijan suffered a severe post-independence crisis, caused partly by the still-unresolved Nagorno-Karabakh conflict that led to nearly 20 percent of Azerbaijan's territory being occupied and up to 1 million people being displaced.

The initial strong economic growth after the crisis did not immediately translate into improved standards of living for the population broadly. As real public expenditures on the social sectors fell to small fractions of

Considering the multitude of challenges that the country faced after independence in 1991 and the very low baseline it started

¹ Azerbaijan's total population is 8,997,400 (January 2010, <http://www.azstat.org/publications/azfigures/2010/en/004.shtml>)
² <http://www.today.az/news/business/72873.html>

their pre-transition levels, the social safety net maintained under the Soviet regime collapsed, leaving the displaced, the disabled, single mothers, and the elderly particularly vulnerable. A World Bank poverty assessment, conducted in 1995-96, found 60 percent of Azerbaijani households to be living in poverty, with poverty rates particularly high among the displaced population.³ Among the elderly, elderly people living on their own were more than averagely vulnerable to chronic poverty. With the decline in the real value of pensions, they suffered a reduction in their main and often sole source of income.⁴

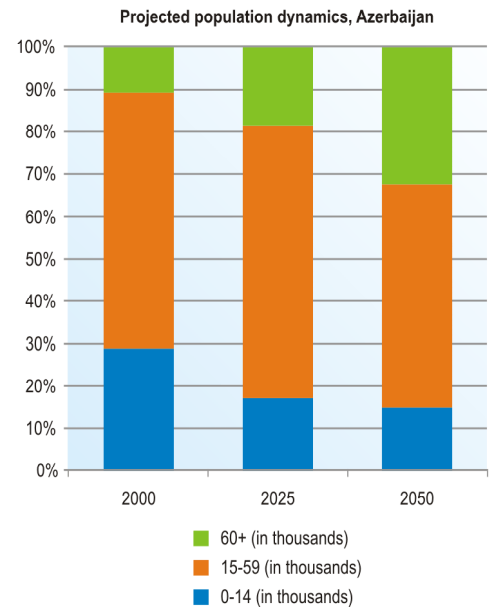
Demographic trends in Azerbaijan has shifted to the state associated with lower birth and death rates

Demographic imperatives and the need to avert an “Old Age Crisis” in Azerbaijan

While the Azeri population is currently still relatively young in comparative terms with only 6.8 percent aged over 65 (8.8 percent over 60)⁵, Azerbaijan has already launched on the path of demographic transition, which involves a country’s shift from the demographic situation characterized by high birth and death rates into that demographic state associated with lower birth and death rates. “As a result, a huge generation of pensioners may impose a considerable financial burden on the social protection system of Azerbaijan Republic during the coming decades.”⁶ (See Chart 1)

Taking into account these realities, the Government of Azerbaijan saw the urgent need for implementing relevant policy measures, including the strengthening of policies for eradicating poverty in the country with policies for the social protection of the elderly and other vulnerable groups of people.

Chart 1: Demographic projections 2000-2050



Data source: Population Division, DESA, United Nations

Azerbaijan’s pension system: the status quo 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. Identification of employment periods and income levels for workers who used to live in other Soviet republics, or 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 (US\$10-15 per month), and procedures for claiming them were very bureaucratic. Despite these small amounts, payment delays could reach three to four months. Pension administration responsibilities were split between district offices of the SSPF and the pension departments of numerous state enterprises and other public institutions. Data processing was done manually, without cen-

³ United Nations Common Country Assessment, Azerbaijan 2001
⁴ Dirk J. Bezemer: “Poverty in Transition Countries”, East-West Journal of Economics and Business Vol. IX – 2006, No 1 (11-35), <http://www.u-picardie.fr/eastwest/fichiers/art47.pdf>
⁵ State Statistical Committee of the Republic of Azerbaijan
⁶ Masuma Mamedova, “Population Ageing Trends in Azerbaijan”, BOLD Vol.14, No. 2 (23-26), 2004

tralized record keeping. All this made possibilities for fraud and error uncomfortably high.”⁷

The Government concluded that the existing pension system was not fitting the needs of current-day Azerbaijan insofar as the system of pension administration was completely out-dated and operating in inappropriate conditions in practice.⁸

Tackling Pension Reform in Azerbaijan

The “Pension Reform Concept”

In 2001, the Government of Azerbaijan adopted a new “Pension Reform Concept” that relies on the principles of (i) separation of the social insurance and pension provision systems from the state social assistance system; (ii) use of individual social insurance accounts; and (iii) calculation of pensions on the basis of contributions made to the state social insurance system and reflected in the individual accounts. The new system was designed to ensure financial sustainability; establish links between social insurance contributions and pensions; put in place the legal foundations for the new three-layered pension scheme; maintain transparency and accessibility of information for the population; increase incentives for more active participa-

tion by the public; and diminish the level of informal employment.

security were inadequate for the objectives of the pension reforms. The conditions in the pension offices also could not inspire the trust needed in the general population to support the implementation of a new system. Hence, a range of inter-related measures was needed to implement the Pension Reform Concept, including drafting new legislation; upgrading offices to modern standards; developing and installing a modern ICT system; and developing the capacity of the SSPF’s human resource base.

UNDP support in implementing the new system through the project “Capacity building for the SSPF”

UNDP was the first international organi-

Box 1: Project facts & figures

Title: Capacity Building for the State Social Protection Fund of the Republic of Azerbaijan

Duration: 2003-2011

Implementing partner: State Social Protection Fund

Total budget: US\$12,882,040 million

zation that came in to support the SSPF in advancing its agenda of reforms in the pension system. On the basis of its experience in the country with public administration reform through introduction of ICT⁹, UNDP agreed to finance a project to implement appropriate ICT systems in the operations of the SSPF, with a view to bring about greater efficiency, transparency and accountability. The project “Capacity building for the State Social Protection Fund of the Republic of Azerbaijan” was signed in September 2003.

The main objectives of the project included: (i) Significant increase of the managerial and technological capacity of the SSPF; (ii) Provision of technological instruments allowing governance of social insurance and pension provision systems in a transparent and fair way; (iii) Design of efficient data flow

The new system was designed to establish links between social insurance contributions and pensions, maintain transparency and accountability

⁷ Salim Muslumov and Oktay Ibrahimov: “Pension reform in Azerbaijan: challenges and achievements”, *Development and Transition*, 12/2009

⁸ Mel Cousins & Associates, *Case study of the Capacity Building for the State Social Protection Fund Project – Final report, UNDP/SSPF, 2008*

mechanisms and automation of daily routine procedures; (iv) Development of efficient data exchange mechanisms between head of office and local branches of the SSPF; (v) Establishment of a firm technological base for introduction of a fully-funded pension scheme; (vi) Improvement of computer literacy and managerial proficiency of SSPF personnel; and (vii) Development of efficient public relations mechanisms.

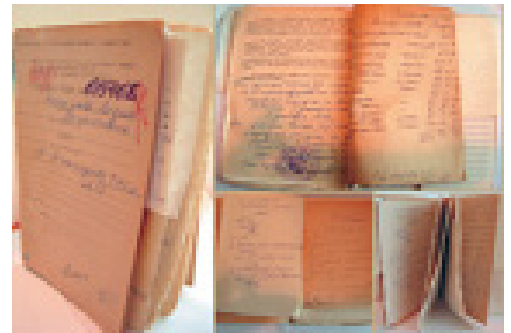
Development of ICT system led not only to the higher efficiency, but also to improved quality of services to clients

As was found in a case study of the project that was carried out by an independent consultant on behalf of the SSPF and UNDP in 2008, the main achievements of the project include:¹⁰

- Design and development of ICT system – this has led to a dramatic reduction in the level of paper used in the system, to higher productivity (in the words of one office manager ‘what used to take weeks now takes hours’) and at the same time to a major improvement in quality of the work carried out. In turn this has led to an improved quality of service to clients (e.g. shorter processing times for contributors, payment of pensions on time, greater transparency as on-line records can be used to explain situation to customers), and to improved conditions and satisfaction for employees of the SSPF.
- Renovation and restructuring of offices has been carried out to a modern professional and user-friendly standard. New offices have been designed to be comparable to those of commercial organizations such as banks with spacious facilities for dealing with customers.
- The ICT system is now installed in 81 out of 88 offices, or almost 93 percent of the

total. It is planned to complete the renovation and installation process by the end of 2010.

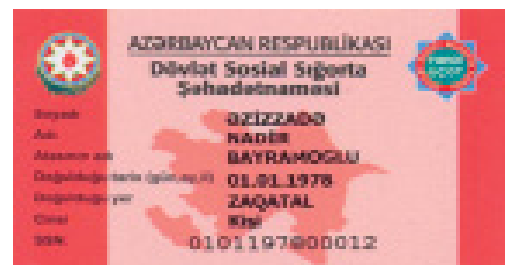
- Design of a wide range of forms aimed at various categories of employers and employees, which are filled out by employee and/or employer and then scanned and entered into the database systems of the SSPF.
- Transfer of data from the old pension workbooks to new centralized record



keeping system.

This has eliminated difficulties arising from the addition of fake certificates to the original workbooks and allows for better planning as to future pension liabilities.

- A computerized system for the generation of unique individual identification numbers and printing social insurance cards has been developed and installed in the central office of the SSPF. By the end of



2009, over 1.6 million workers, representing almost 90 percent of the target, had received their social insurance cards.

- Sophisticated software designed on principles of “knowledge-based software design

⁹ UNDP'S focus on use of ICT as a tool for introducing change in the public administration practices is part of its strategy of supporting the Government of Azerbaijan's effort toward public administration reform through a process of "change from within" by the bias of the introduction of new systems and procedures that appealed to the political leadership as well as the civil servants for cultural and historical reasons. Azerbaijan had been one of the Soviet centres for developing Automated Management Systems, which had enjoyed a measure of success within other key sectors of the Soviet economy, and UNDP has successfully built on this legacy as well as the Soviet faith in technology as the path to modernization in many instances. (See Project AZE/03/007 Capacity Building for the State Social Protection Fund, Evaluation report – Final version for UNDP and SSPF, Alain Théry, 2005)

¹⁰ Mel Cousins & Associates, Case study of the Capacity Building for the State Social Protection Fund Project – Final report, UNDP/SSPF, 2008

technologies” for processing of individual declarations and financial reports was developed and put in place.

- The pension calculation process has been designed in such a manner as to maximize automation, minimize personal contact and to separate processes, thereby reducing the risk of fraud and abuse to a mini-

Payments are now made on-line to over 97 % of pensioners

mum. In addition, it has been made easily understandable and transparent for the population.

- Payments are now made on-line to 97.4 percent of pensioners and payment cards have been issued to 1.09 million pensioners. In many areas, 100 percent of pensioners are already paid on-line and it is planned to extend this nation-wide through the use of mobile ATM machines in remote areas. This is a very high level of on-line payment by international standards. The payment card provided allows withdrawals at any time and in any place and currency (even outside Azerbaijan).
- Pensions are now paid on time rather than 3-4 months in arrears as occurred under the previous system leading to a major reduction in complaints.
- Regular training courses are being provided for SSPF staff to keep them up-to-date on requirements of the installed hardware, software as well as new procedures of registration and data processing. As a

result, the overall level of ICT awareness and the quality of the social insurance services provided has been raised dramatically.

- Efficient human resources and management systems have been established. There is now a database of all staff which can be used, for example, to identify training need and to offer courses to staff members. In addition, the use of an ICT system allows managers to monitor the workload and output of staff and to have caseload allocated automatically to inspectors.
- SSPF staff interviewees believe that public satisfaction with the system is high on the basis of feedback in a dedicated SSPF internet forum, increased demand for registration as an insured person, and major reduction in complaints regarding, for example, late payment of pensions, etc.
- Pension contributions collected have increased very significantly by over 460 percent in the period from 2003 to 2009.

The 2008 case study concludes that there are many advantages to the new system, especially the fact that it is much more productive, allowing more work to be carried out, with better quality and in a shorter period of time. It provides a better service to employers, insured persons and pensioners. The new system is more transparent and significantly reduces the opportunities for fraud and error. The new Management Information System (MIS) is based on a minimal use of paper other than at the contact stage with the customers. Effectively, with the help of the SSPF-UNDP project, Azerbaijan has moved from a system which was perhaps 30 years out-of-date in principle to a system which reflects modern

Manual filing system, solid fuel heating and cramped working conditions in Devechi district office, January 2004

Renovated SSPF branch office in Aghjabadi, 2009

New SSPF branch office in Sheki, 2007



international practice and is similar to that (and in some areas ahead of that) to be found in much more developed European countries (in terms of GDP per capita). It is noteworthy that over 97.4 percent of pension payments are now paid on-line via the banking system. This is a level of on-line payment achieved in relatively few countries world-wide.

Also, there has been a significant increase in the level and quality of social insurance services provided to the population. In interviews with the managers of district offices it was stated that work which used to take weeks to do now takes hours. A recurrent theme in interviews was also the fact that the quality of work was now much higher (because it was automated). In terms of the improvement in service from the customers' point of view, there was a strong sense amongst managers that customers also appreciated the improvement in the delivery of services and this is also reflected in the comments on the SSPF internet forum.

The total investments (effective and planned expenditures) in the project from 2003-2011 amount to slightly over US\$ 12.8 million. To date, in terms of the distribution

There has been a significant improvement in the delivery of social insurance services

of funds by activities, the largest share of the investment (43 percent) related to equipment and software, followed by construction (34 percent) and other back-up costs. The training component (including development and delivery) accounted for 9 percent of investment while other activities each constituted between 3-7 percent of the total project expenditure. The scale of investment rose significantly over the lifetime of the project. In terms of the sources of the funding, the Government of Azerbaijan to date has contributed around 75 percent of the project costs, and UNDP has contributed 25 percent. The

financial contribution of the Government has been rising significantly throughout the consecutive phases of the project, with the SSPF contributing 98 percent of the funding for the final fifth phase of the project (2008-2011), thus creating confidence in the financial sustainability of project initiatives

Transformational change achieved

Impact of pension reform on poverty reduction

Following the economic post-independence crisis, Azerbaijan has been enjoying consistent high growth between since the early 2000's,¹¹ with up to 34.5 percent GDP growth in 2006, the highest in the world that year. Largely propelled by exploitation of the country's oil and natural gas reserves, this strong growth allowed major investments in infrastructure and a steep decline in poverty rates from 46.7 percent in 2002 to 10.9 in 2009, according to official statistics.¹² Per-capita income in current dollars soared by a factor of 17 between 1995 and 2008, now standing at US\$ 5,404 p.a. (2009), and Azerbaijan is ranked as a lower middle-income country.¹³

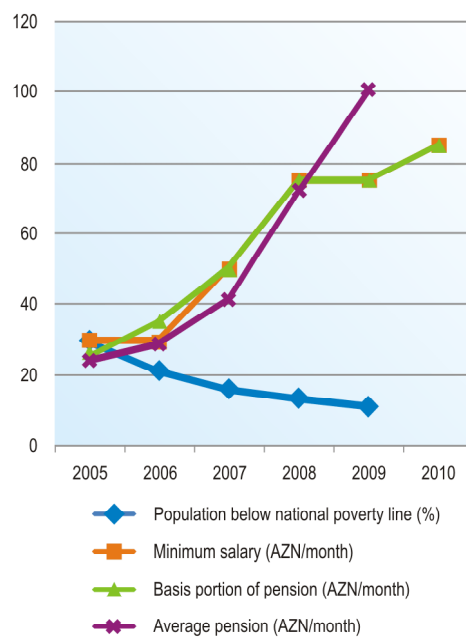
Azerbaijan's oil and gas boom presents a tremendous opportunity not only to put the country's economy on a solid growth path and reduce the aggregate poverty rate, but also to provide targeted care and support for the elderly, disabled, poor, and vulnerable among its population. The investment in the successful reform of the pension system is an illustration of this (see Chart 2).

Recent research by the World Bank reveals that Azerbaijan's contributory and non-contributory social protection programmes, to which the Government allocated an estimated 4.8 percent of GDP in 2008, reached 63.2 percent of the population that year. As illustrated in Chart 3, relative to the fiscal effort (expressed as a percent of GDP), Azerbaijan's social assistance programmes perform well in terms of coverage of the poor compared to other similar programmes in the Europe and

Central Asia Region.

“In terms of programmes, administrative capacity, and poverty reduction performance, social transfers in Azerbaijan are well placed to play a significant role in mitigating the impact of the current global economic crisis. The basic pension plays a role of a minimum income guarantee for the recipients of social insurance benefits. It constitutes almost 80 percent of the average pension, thus contributing critically to the observed moderately pro-poor (progressive) distribution of pensions and to their very important role in poverty reduction in Azerbaijan. Here, a key policy to mitigate the impact of the crisis would be not to allow the basic pension to slide down in real terms, thus protecting the incomes of the old, disabled, and those receiving a survivors’ pension. Pensions are the largest social transfer in Azerbaijan. Seventy-five percent of public spending on social transfers is allocated to pensions, which are received by close to 1.3 million individuals. Of all individuals in Azerbaijan, 45.3 percent reported living in

Chart 2: As the poverty rate declines, minimum salary, the basis portion of pensions and average pensions increase



Data sources: State Statistical Committee of Azerbaijan, Ministry of Labour and Social Protection of the Population, SSPF

¹¹ Azerbaijan at a glance, World Bank, 24 September 2008, http://devdata.worldbank.org/AAG/aze_aag.pdf

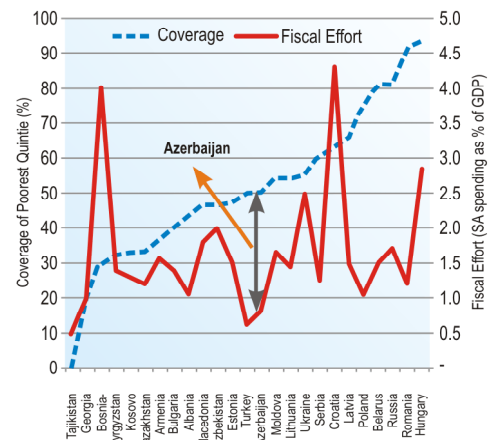
¹² Statistical Yearbook of Azerbaijan 2009, State Statistical Committee of the Republic of Azerbaijan

¹³ State Statistical Committee of the Republic of Azerbaijan

households where at least one member received a pension. Although not targeted at poor population, the coverage of the poor was significantly higher than the coverage of the non-poor: 63.4 and 37.8 percent, respectively.”¹⁴ The World Bank study concludes that without social transfers, the extent of poverty in Azerbaijan would be much higher. Namely, among the different types of social transfers, pensions account for the lion’s share of poverty reduction: the payments of pensions reduce poverty by about 6.8 percentage points, whereas social assistance programmes account for about a 4.6–percentage-point reduction.

The next years will be critical for the Gov-

Chart 3: Despite relatively low fiscal effort, Azerbaijan manages to cover a large share of its poor (Source: World Bank, Azerbaijan Living Conditions Assessment Report, 2010)



Source: MLSPP data for Azerbaijan; various World Bank Public Expenditure Reviews

ernment of Azerbaijan and its international partners to develop a strategy to ensure the fiscal sustainability of the new pension system in the future.

Impact of project on ICT development in Azerbaijan

The 2008 case study of the project finds that in addition to the tangible benefits provided in the areas of the delivery of social

insurance services, the project also has had important wider benefits in the context of ICT development in Azerbaijan. Specifically, it has increased the awareness amongst the citizens of Azerbaijan of the benefits of information technology and helped workers and pensioners to get hands-on practice in utilizing ICT. It has also served as an example for the Azerbaijan public service as to the benefits of ICT

Payment of pensions reduce poverty by about 6.8 per cent

to the public service organization and its customers, and what can be achieved in the area in a relatively short period of time.

By virtue of this, and because of the synergies of the SSPF capacity building project with other UNDP-supported projects in the area of e-Governance (especially the UNDP-Ministry of Justice project for establishment of the State Register of Population), it clearly plays an important role in the realization of

the National ICT Strategy – itself a reflection of the sustained Government/UNDP-driven ICT development efforts in the country.

Azerbaijan received international recognition for the use of ICT in its pension system in 2010, when the SSPF was announced a winner of the European Competition of the International Social Security Association (ISSA) for Efficient Governance through application of ICT.

Experience of Azerbaijan in this area is recommended by the World Bank and ISSA to a number of developing countries, including Afghanistan, Iraq, other countries from Latin America and Africa.

Critical success factors, lessons learned and UNDP contribution ¹⁵

Unsurprisingly, the factor that was most critical to the success of the project was the strong national ownership of the project. Sustained political commitment and support by the Government translated into increasing public funding allocations to the SSPF and hence the SSPF-UNDP project over its lifespan. Quick tangible successes, namely in the area of modernization of offices, introduction

VOICES OF PEOPLE

Bayram Babayev, accessing services in the Pensions Assistance Department at the Narimanov branch, says: 'My father died and now I want to change my mother's pension because before his death, she had pension for her age, but now I want her to have pension for missing a family head. And then she'll have more pension than before. I've found the services here much better. There are not any problems here, they serve on time. Card system is much better for us, when you want you can take out your money. Also, you can phone Azericard (194) and know if there is money on your card. Before, when calculating pensions, there were negative issues. But after January 2010, they calculate the pension for how many years of working practice you have. I hope it will be much better in the nearest future if the basic part of pensions will increase. If minimum pension is 85AZN, it will become more in the future.'

Sevda Jafarli, who was waiting in the reception area of the Head Office of the Pension Fund, during hours set aside for public inquiry: 'I came for my mother to get her pension. Now she is in a meeting with the administrator. I can give my opinion (of the new Pension Fund services) after their meeting. But I can say that reception is at a very high level. Fuad welcomed us very well and has answered my questions while my mother is in the meeting.'

Arzu Ibadzade, resident of Baku: 'It was very difficult (to live before targeted social assistance) with 5 children and one of them is disabled. I couldn't work, that is why living was very hard. After I had social allowance, it helped us a lot. My children are going to school, so it helped me to buy them clothes and food.' When asked about the ease of the process of application, she replied 'yes, it states clearly what documentation we need for that' and, in replying about how easy it was to prepare the documentation, she replied 'it was very easy'.

¹⁴ Azerbaijan Living Conditions Assessment Report, Report No. 52801-AZ, World Bank, March 2010

of ICT and capacity development of SSPF staff, also fostered buy-in to and ownership of the new pension system by the latter.

The support provided to the Government by UNDP and other international organizations is considered to have been vitally important – particularly at the early stages of the SSPF-UNDP project – not only in providing financial support and expertise but also in giving legitimacy and credibility to the reform process and helping to convince SSPF staff of its importance.

The case study concludes that the basic approach of this project could be replicated in other countries, which are similarly situated in terms of socio-economic development and which have not to date modernized the administration of their social protection systems. Clearly Azerbaijan started from a situation of considerable disadvantage but has managed to turn many apparent disadvantages to positive effect. For example, the fact that Azerbaijan did not have any existing ICT system in the SSPF meant that it was able to jump to the newest solutions and to install a modern, state-of-the-art system without being constrained by management and staff expectation (based on an existing system) and without having to replace such a system. Of

note, ICT systems were designed in a way so as to take account of strengths and weaknesses of the existing SSPF set-up – an example of this is the use of ‘thin clients’ primarily for reasons of economy and limited power supply but which also contributed to greater efficiencies and productivity in the use of the ICT system. A further example is the use of the regional offices and the central office as support centres to overcome the shortage of trained ICT staff in Azerbaijan.

The support of UNDP has been critically important to the development of the system, and the approach adopted in Azerbaijan – including lessons learned as to what could have been done better¹⁶ – might be used as a model for a similar capacity development exercise in other countries. In this case as in many others, UNDP has not provided funding so much as it helped Azerbaijan identify expertise that was relevant to its needs from other countries, which had undergone the same reforms earlier. While, a few years ago, Azerbaijan looked up to the experience of the Baltic states in pension reform, today it has itself become an example for countries including Afghanistan, Iraq, and States in Africa and Latin America.

¹⁵ This section draws on the section on success factors and recommendations from the 2008 case study.

¹⁶ Among the points raised in the 2005 project evaluation were that the project objectives were somewhat ambiguous and outcomes and outputs not all sufficiently clear; and that the introduction of the new pension scheme ought to have been supported by appropriate adjustments in the management structure, human resources and modalities within the SSPF instead of merely relying on the introduction of a modern ICT system to increase effectiveness, efficiency and transparency of the pension system. It was argued that, from a strict system management rationale, ICT can only bring efficiency to a system as a tool to adequate management structures and human resources capacities and in no way can compensate for any possible deficiency at those levels.