

AMERICAN UNIVERSITY OF ARMENIA

A STUDY OF SOCIAL SECURITY SYSTEM IN REPUBLIC OF ARMENIA

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## LIST OF ABBREVIATIONS

AMD – Armenian Drams

CIS – Commonwealth of Independent States

GDP – Gross Domestic Product

IMF – International Monetary Fund

ROA – Republic of Armenia

USSR – Union of Soviet Socialist Republics

ILO – International Labor Organization

H – Hryvnia

STS – State Tax System

SFSI – State Fund of Social Insurance

SP – Social Payments

## ABSTRACT

Social security payments in Armenia are the main source for the pension found. Thus, if there are some inappropriate actions or measures taken by the payer, the whole system will be not at all effective and even destructive for the whole system. On the other hand we can estimate that there are some infringements, which are very common for Armenia. Among them we would like to emphasize such violations as the misreporting of the amount of the salaries and also of the number of the employees, extra-legal inspections and audits, extra-legal prepayment demands, corruption in the system of the administration of social security payments, high number of migration, which made the number of workers less and less; appearance and development of so called shadow economy made almost impossible to use the whole power of the economy and to collect the proper amount of money.

The topic of this Master Essay is **The Study of the Social Security System in Armenia**. So, the purpose of the study is to give the overview of Social Security System in Armenia, how it works, to show main causes of weaknesses of the system and to try to give some recommendations and suggestions for the improvement of the system and its further development. The Essay puts an emphasis on the small businesses in Armenia, recognizing their role for the formation and development of liberal economies, by creating independent and self-sufficient class of entrepreneurs as well as new jobs, enlarging internal market, enhancing the competitiveness among local goods and services in external market and increasing export potential. The essay will find out the activities of small businesses concerning the social security payments, their attitude towards the system as a whole.

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## **INTRODUCTION**

Armenian Social Security System is based on the current year employees and employers social security payments, which determine the amount of money paid to pensioners. Thus, social security payments in Armenia are the main source for the pension fund. Moreover, if there are some inappropriate actions or measures taken by the payer, the whole system will be not at all effective.

Having in mind all these things we can now imagine, how destructive would be for Armenia even the slightest violation, made by payers of the Social Security System. On the other hand we can estimate that there are some infringements, which are very common for Armenia. Among them we would like to emphasize two more important which are: the registration of the wrong amount of the salaries and also the registration of the wrong number of the employees. On the other hand, more global political and economic factors, such as economic decline, high number of migration made the number of workers less and less; appearance and development of so called shadow economy made almost impossible to use the whole power of the economy and to collect the proper amount of money.

So, the purpose of our essay would be to give the overview of Social Security System in Armenia, how it works, to show main causes of weaknesses of the system and to try to give some recommendations and suggestions for the improvement of the system and its further development. The Essay will put an emphasis on the small businesses in Armenia, their activities concerning the social security payments, their attitude towards the system as a whole. For this purpose the survey was conducted among small businesses in Yerevan with original data. Thus, the development of original dataset, which is based on survey conducted among small businesses in Yerevan in 2005, provides needed information to focus on social security system.



Therefore, my objective will be to assess the extent to which the small businesses in Armenia pay proper attention to social security payments, to what extent do they keep proper records of both the salaries and the number of people employed, some governance issues: like how many times per year those businesses get inspected, whether they are compelled or offered to pay bribes.

Research questions for the study of Social Security System in Armenia of this Essay on which I will try to answer are the following:

1. How does the system of social security payments work in Armenia?
2. What is the proportion between the real number of workers and the registered one?
3. What is the average wage in the company and is it in correspondence with the registered one?
4. Have small businesses been visited by an inspector from the Pension Fund in the last 12 months?
5. What do the small businesses think about social payments?
6. Do they use the option of paying a fixed AMD 6000 per employee as social contributions?
7. What are the main obstacles while implementing social security system in Armenia?
8. What are the measures and prospects of the future development of the social security system in Armenia?

## **PART I**

### **LITERATURE REVIEW**

What should one do, when he or she is becoming old and socially vulnerable, by losing his or her ability to work? The answer is that at that case he or she must make savings during the working years in order to have a secure and normal life after retirement. But from this point of view can raise many important questions. First one is that is it possible for people to make some savings during their employment years by having so many problems to solve and questions to think about. The answer is of course it is very difficult and even we can say impossible for people living in developing countries with small salaries and slow economic growth. The second important question is whether the problem of money savings is each individual's personal responsibility? What is going to happen with someone who has worked during whole his life but unfortunately could not make enough savings to have a secure and happy life after retirement? Thus, these were the questions, which bothered many people at the beginning of last century and led to the creation of the social security system.

Social security is defined as a government program that provides economic assistance to persons faced with unemployment, disability, or agedness, financed by assessment of employers and employees; it is designed to provide for the basic economic security and welfare of individuals and their dependents. The programs classified under the term social security differ from one country to another, but all are the result of government legislation and all are designed to provide some kind of monetary payment to defray a loss of or a deficiency in income.

A social security program was adopted first in Germany in the 1880s, when Chancellor Otto von Bismarck advocated social legislation not only in order to benefit the workers but also to forestall the program of the socialists and gain the support of the workers for his own party. Legislation setting up compulsory sickness insurance, for which the worker paid two

thirds of the cost and the employer one third, was passed in Germany in 1883. Compulsory old-age insurance, the cost of which the employee, employer, and government shared, was adopted in 1889; unemployment insurance legislation, however, was not passed until 1927. (Achenbaum, 1988)

As economic insecurity among workers in the highly industrialized countries spread, an increasing number of social security programs were enacted. In Great Britain, the National Insurance Act, devised by David Lloyd George, was passed in 1911, and compulsory unemployment insurance programs as well as old-age insurance and sickness insurance programs were established. The unemployment insurance system excluded many workers, notably government employees, nurses, casual workers, and those who earned over £250 per annum. Survivors insurance program was adopted (1925); in 1942, Parliament was presented with a plan, by Sir William Henry Beveridge, for a more expanded social security program, much of which was enacted after World War II. France adopted in 1905 a program of voluntary unemployment insurance and in 1928 made insurance plans for old age and sickness mandatory. (Achenbaum, 1988)

Meanwhile, diverse social security programs were adopted throughout Europe, differing from country to country as to the kinds of insurance instituted, the categories of workers eligible, the proportions paid by employee, employer, and government, the conditions for receipt of benefits, the amounts of the benefits, and finally in the overall effects of the programs. In 1922, the Soviet Union adopted comprehensive social security plans as part of their socialist economy. In 1924 Chile became the first Latin American country to adopt a social security program. (Lyer, 1993)

The United States did not have social security on a national level until 1935, when the Social Security Act was passed as part of President Franklin Delano Roosevelt's New Deal program. The act established two social insurance programs: a federal-state program of

unemployment compensation and a federal program of old-age retirement insurance. It also provided for federal grants to assist the states with programs for the disabled, the aged, child welfare services, public health services, and vocational rehabilitation. The original Social Security Act of 1935 covered only workers in commercial and industrial occupations, but since then several major amendments increased the categories of persons eligible for benefits. The amendment of 1939 provided for benefits to the dependents and survivors of workers; an amendment in 1950 broadened the coverage to include full-time farm and domestic workers, many self-employed persons, employees of state and local governments, and employees of nonprofit organizations; later amendments extended coverage to members of the armed forces and to self-employed professionals; and a 1957 amendment provided benefits to insured workers 50 years of age and older who became permanently and totally disabled. The age of eligibility for retirement benefits was lowered from 65 to 62, but with lower benefits for persons retiring before 65. (Schieber and Shoven, 1999)

In terms of indicators of human development, Armenia is remaining behind many developing and transitional countries. According to statistics, the average income of every second resident of our country is lower than the poverty level and about one sixth of the population live below the minimum subsistence level. (Jerbashian, Asatryan, 2004) The transitional period has left its negative impact on the population, unable to earn a basic wage. Old age, disability and other social risks result in a desperate situation for pensioners. The overwhelming number of pensioners cannot afford to buy basic food items and non-food consumables.

Social security system in Armenia includes social insurance of vulnerable people, veterans, orphans, invalids and pensions for elders. Armenia has inherited its system of social security from the Soviet Union. During the USSR social protection regulation was gradually expanded to the contingencies mentioned in the ILO conventions. This means that social

protection would provide protection against the consequences of occupational injuries and professional diseases, general disability, death, old age. Later, the protection of sickness and maternity, health care benefits, and a system of children allowances were added (Staarup, 1995).

Social security system is the mechanism, by which the government makes people to make some mandatory savings during the years of their employment in order to use them after the retirement. Thus, the government collects from the employees some part of their income and put it into the special fund, for returning it back to the employee after his or her retirement. Thus, by this action government is creating a system of mandatory social security payments and taking away the burden of the responsibility from each employee.

Social security system is based on two kinds of social security payments. The first system is based on the issue, how much money one had saved during his employment years. In this case money is cumulated on his/her own account during his/her years of employment and is returned to employee after the retirement. In this case of the personal-cumulative system the money accumulated on employees own account are seems to be the savings. The second type of social security system is less complicated and is based on the “agreement of the generations”. In this system the current generation employees make mandatory social security payments, which determine the amount of the money paid to pensioners. In this system the winner is the generation, the next of which will work more and pay more money as social security payment. On the other had the generation, which has worked more than the generation, from which it will get its social security payments, is the loser. In this case, in order to keep some balance, and to secure the people who had worked more, the amount of working years is taken as a base to determine the amount to be paid to the pensioners (Lyer, 1993). Thus, concluding we can estimate that in this case the equality of paid pensions is

more equivalent in the case of the generations' agreement case, as people are more alike by amount of the years they have worked, than the amount of money they earned.

Armenian first laws on social assistance and social insurance were adopted in 1956 and 1964. Current law on social insurance and social assistance systems was adopted in 2002, and implemented in 2003. In April 9, 2003 the new Law on State Pensions came into force. The second article of the law defines the principles of organization and implementation of state pension security and state pension insurance as follows:

- ensuring the right to pension insurance irrespective to nationality, race, gender, language, religious, political or other beliefs, social origin, property existence, etc.
- mandatory character of state pension social insurance,
- ensuring financial stability, balancing the development of the pension system,
- ensuring allocation and payment of pensions based on information on insurance contributions reflected in the personal insurance accounts,
- ensuring social solidarity and justice,
- ensuring a minimal pension guaranteed by the state. (Law on State pensions, Article 2)

The pension system of the RoA covers:

- state mandatory pension insurance (pensions for citizens guaranteed from the budget generated from mandatory social insurance payments for those who have reached pension age, disability, loss of bread winner and other cases defined by the Law),
- state pension security (pensions for citizens not included in the system of mandatory social insurance, provided from the state budget in case of old age, disability, loss of bread winner and other cases defined by the Law) (Law on State pensions, Article 4) .

After enactment of the Law on State Pensions, the pension security system is funded only by the state budget. Pension insurance is financed mainly from social contributions made by employees and employers.

A person has right to a pension when requirements defined by this Law are met and if mandatory pension social insurance payments have been made. Persons eligible for different types of state pensions are granted the one they choose.

Today Armenian pension system is based on the idea of agreement of generations, i.e. mandatory social security payments are done by the current working generation on behalf of the previous retired one. Those payments define the budget of the social security payments, from which the annual social pensions are paid depending on the length of service. This means that to the base of the pension is added additional 160 drams (having in mind minimal service length of employment). Under current law, contributions are a flat 5,000 AMD for everyone earning less than 20,000 AMD. The remainder of the contribution is based on a percentage of wages. Employers pay 15% of wages between 20,000 and 100,000 AMD, and 5% of wages above 100,000 ADM. Consequently, contributions decrease as a percent of pay as wages increase. This is proper, since the benefit does not vary with pay. Benefits are based on a formula that takes into account only years of service. (Law on State pensions, Article 12) Consequently, someone earning 5,000 AMD and someone earning 100,000 AMD, both of whom have 40 years of service, will receive the same benefit. Although the high paid person pays higher contributions, at least the contributions are a smaller percentage of total pay than for the low paid person. The employee contribution rate is 3.0%. There are no maximum earnings for contribution purposes.

**Table 1: Payroll Contributions**

Wages	Contributions	
	Employee	Employer
Less than 20 000 AMD	3%	5 000 AMD
20 000 – 100 000 AMD	3%	5 000 AMD +15% of pay exceeding 20 000 AMD
100 000 and more AMD	3%	17 000 AMD +5% of pay exceeding 20 000 AMD

Self-employed person before the enactment of the amendment of the RoA law on the Mandatory Social Contributions in January 1st 2003 pays 15% of annual income less than 1,200,000 dr. (applies also to some artists and scientists). If annual income is greater than 1,200,000 dr., the contribution is a flat rate of 180,000 dr., plus 5% of the amount greater than 1,200,000 dr. (Collective farmers are exempt from payments.) After the enactment of that law, the self-employed people (including agricultural workers) are exempt from contributions and therefore they accumulate no years of service. However, those self-employed who have already accumulated the required years of service at reaching retirement age will be entitled to a regular old-age pension (Law on State pensions, Article 9).

Thus, contribution revenues are made from: payroll contributions (employer + employee), transfers from the State budget to pay for pensions to career (and non-career) military and others, transfers from the unemployment fund to pay unemployment benefits. All those contributions also finance sickness and maternity, work injury, and unemployment benefits.

Qualifying Conditions for getting old-age pension are the following: age 63 (men) or age 59.5 (women) with at least 25 years of covered employment. Age 58.5 (men) or age 53.5 (women) with at least 20 years of covered employment in arduous or hazardous work; age 53.5 (men) or age 48 (women) with at least 15 years of covered employment in extremely arduous or hazardous work (Law on State pensions, Article 12).

Total or partial disability pension is allocated to persons certified as disabled by Socio-Medical Expertise Commission when the disability is:

- the result of work injuries or occupational diseases irrespective to insured length of service,
- the result of general illness – in case at the moment of disability certification the person has the following insured length of service:



**Table 2: Disability Certification by the Length of Service**

<b>Age group</b>	<b>The length of service</b>
23	2 years
23 – 26	3 years
26 – 30	4 years
30 and over	5 years

The pension is awarded according to three assessed degrees of disability: total incapacity for work and requiring constant attendance (Group I); total incapacity for work but not requiring constant attendance (Group II); or partial incapacity for usual work (Group III). The required length of service is determined based on the person's age when defining his/her disability group at the first time. Disability pension is allocated for the period of disability and is calculated due to the regular formula, where main pension equals:

- I group – 120% of main pension
- II group – 100% of main pension
- III group – 80% of main pension (Law on State pensions, Article 13)

Survivor pension is awarded when the deceased had at least 15 years of covered employment. The pension is payable to a surviving spouse; a person, not employed at the time of deceased's death and not receiving any pension, who cares for the deceased's children, brothers, sisters, or grandchildren younger than age 8; full orphans younger than age 18 who are not receiving any other pension. Daytime students of higher educational institutions are eligible for survivor pension until their graduation or achievement of 23 years of age. The survivor benefit is allocated in the amount of main pension to each of the family members as defined by Law, and adds the insurance part of the deceased breadwinner in the following amounts:

- For one dependant – 50% of main pension
- For two dependants – 90% of main pension

- For three dependants – 120% of main pension
- For four dependants – 150% of main pension (Law on State pensions, Article 26)

The benefit system of the pension system in the RoA is attempted to link the size of a pension to years of service. Regardless the higher contributions made on behalf of the highly paid participants the benefits to which they are eligible for after retirement is the same as for all those with the same years of service. Thus, this means that the higher paid gets a much lower rate of return on their contributions than the lower paid. The real amount of contributions does not play the any role in benefit calculation formula, which consists of the following elements:

**P = Main Pension + SP\*N\*AC, where**

**P** is the total monthly pension,

**N** is the years of service,

**SP** is the supplemental pension for each year of service,

**AC** is the adjustment coefficient.

The sizes of the main and supplemental pensions are defined by the RoA legislation, usually through a special decree. At the moment the main pension is 3000 AMD and supplemental pension is 160 AMD. (Law on State pensions, Article 16)

Some categories of civil aviation are eligible for long service pension. Among them are members of flight-commanding, flight instructive and crew, stewards and stewardesses, whose retirement age is 45, with years of service 25 or 20; members of air-traffic management crew, with retirement age of 50, years of service 25 or; members of engineering-technical crew with retirement age of 55 and 25 years of services or 20 years engaged in activities entitling o the long-service pension (Law on State pensions, Article 14).

## COMPARATIVE ANALYSIS OF PENSION SYSTEMS IN SOME CIS COUNTRIES

Now I would like to make some comparative analysis of social security systems in Armenia and some other post Soviet Union countries. Among them I would like to pay attention to such countries as Russian Federation, Ukraine, Belarus, Kazakhstan and Azerbaijan. First of all it is worth to mention that I decided to compare these countries as they all have similar post-soviet past experience and all had more or less similar ways in overcoming difficulties after collapse of Soviet Union and creation of independent republics with stable and strong social security systems.

**Table 3: Selected CIS and CEEC Countries, Social contributions in percent of GDP**

Selected CIS and CEEC Countries, Social contributions in percent of GDP									
	1995	1996	1997	1998	1999	2000	2001	2002	2003
Armenia	...	...	...	...	...	...	...	...	2,7
Albania	2,9	3,2	2,9	3,0	...	...	...	...	...
Azerbaijan	0,0	3,3	3,5	4,2	3,9	...	...	...	...
Belarus	9,4	9,5	9,7	10,0	9,8	10,2	10,9	10,9	...
Bulgaria	7,6	6,7	6,7	8,3	9,0	9,2	8,4	9,5	10,6
Estonia	10,2	10,1	10,1	10,1	9,5	9,7	10,0	...	...
Georgia	...	...	1,6	2,2	2,0	2,2	2,1	2,1	2,6
Hungary	...	...	...	...	...	13,0	13,0	12,9	12,4
Kazakhstan	...	...	6,9	3,6	0,0	0,0	0,0	0,0	0,0
Latvia	9,1	8,8	9,6	10,0	9,7	9,1	8,5	9,3	8,9
Lithuania	...	...	...	...	...	9,4	9,0	8,7	8,7
Moldova	...	9,3	7,8	8,5	6,3	6,3	6,8	7,3	7,2
Mongolia	...	...	...	...	...	...	...	...	6,6
Romania	8,0	7,5	7,0	8,9	10,7	11,0	11,0	...	...
Russia	...	...	...	...	...	...	...	11,8	8,3
Slovak Republic	...	...	...	...	...	...	...	...	14,1
Slovenia	15,5	13,9	13,0	13,1	13,0	15,9	16,1	16,0	16,0
Tajikistan	...	...	...	1,3	1,8	2,1	2,1	...	...
Ukraine	...	...	...	...	9,0	8,4	9,6	10,7	...

Source: IMF Government Finance Statistics and country desks

First of all it is important to see and compare some selected CIS countries and CEEC countries by their percentage of social security payments in comparison with the GDP.

From this table we can see that the highest number of social security payments as the percentage of GDP is the one of Slovenia, where the social security payments are 16.0% of GDP. The lowest country by the social security payments as the GDP percentage is the Georgia (2.6% of the overall GDP). The second country with the lowest social security payments as the percentage of the GDP is the Armenia with the 2.7 percent of the overall GDP in 2003. Kazakhstan's case is a little different as in 1998; the social insurance system was replaced by a system of mandatory individual accounts. Benefits continue to be paid for rights earned under the old system. Insured person pays 10% of wages as mandatory individual account. Employer pays neither mandatory individual account nor old age pension and social assistance system. Government pays total cost of social allowance benefits, it provides subsidies as needed to finance benefit rights earned under the old system. In other countries, which we would like to discuss further and compare with Armenia Russia has 11.8% of GDP as social security payments in 2002 and 8.3% in 2003. Ukraine's social security payments as percentage of GDP was 10.7 in 2002, and the Azerbaijan's case is the 3.9% of social security payments of GDP.

Current Laws Social security systems was adopted in all those countries in the following sequence: in Armenia as we have already mentioned the current law was adopted in 2002 and implemented in 2003, in Russia current laws on social security was adopted in 2001 (state pension security, labor pensions, and mandatory pension insurance), in Ukraine in 2004 (Compulsory State Pension Insurance), in Belarus in 1999, in Kazakhstan in 2002.

Armenian and Belarus had pure social insurance type of system, while Russia, Ukraine and Kazakhstan have social insurance system combined with the supplementary mandatory individual accounts. In 1998, the social insurance system in Kazakhstan was replaced by a system of mandatory individual accounts. Benefits continue to be paid for rights earned under the old system. Provisions and rates are as of January 1997 unless indicated otherwise.

Armenian law as we have already mentioned covers all employees, self-employed persons, collective farmers, scientists, and artists. (Social Security Programs Throughout the World: Asia and the Pacific 2002, #91)

Russian Social security law covers employed citizens, self-employed persons, and independent farmers. (The individual account covers those born in 1967 or later.) Special schemes are developed for civil servants, military personnel, police officers, war veterans, and other specified groups. Ukrainian law has special provisions for victims of the Chernobyl catastrophe. Law of Byelorussia covers all employed permanent residents, including priests and employees of religious organizations, members of cooperatives, and farmers. Special systems cover aviators, teachers, artists, professional athletes, government employees, and specific categories of medical personnel. (Social Security Programs Throughout the World: Asia and the Pacific 2002, #91)

Funding of the mandatory social payments differs very much in those countries. We will not discuss the Armenian system of funding as we have already discussed it in the previous chapter. It is very important to mention that in Russia insured people do not pay any contributions, while in Ukraine and in Belarus they pay 1% (and in Ukraine 2% if the amount exceeds H150) of their earning, in Azerbaijan 1,5% and in Kazakhstan they pay 10% of their wages for mandatory individual account and pay nothing as old-age pension contribution and social assistance system. In Armenian system self-employed and farmers do not pay contributions; while in Russian law the self-employed and independent farmers contribute a fixed monthly amount of 150 rubles, in Azerbaijan they pay 20% of gross earnings. Employers pay the amount of money, specified by the law, which is not more than 35%. Here the interesting point is that in Belarus employers pay from 10% to 35% of payroll, according to the branch of industry and the type of enterprise. And also it is worth to mention that in Kazakhstan employer does not pay any contribution as Mandatory individual account, old-age

pension and social assistance system. In Armenia as we have mentioned earlier government funds the total cost of the social pension and subsidies as needed. The same can be said about all five countries and it should be mentioned that all of the above contributions also finance sickness and maternity benefits, work injury cash benefits, and family allowances to employees. (Social Security Programs Throughout the World: Asia and the Pacific 2002, #29)

The case with the qualifying conditions for pensions is mostly the same in those countries. Old age pension first of all requires following amount of service and reaching the following age:

**Table 4: Old age pension in Armenia, Russia, Ukraine, Belarus and Azerbaijan**

<b>Old-age pension</b>				
<b>Armenia</b>	<b>Russia</b>	<b>Ukraine</b>	<b>Belarus</b>	<b>Azerbaijan</b>
63.5 (men) 58(women) with at least 25 years of employment.	60 (men) 55 (women) minimum of 5 years of insurance coverage.	60 (men) 55 (women) with at least 5 years of employment.	60 with 25 years of insurance coverage (men) or age 55 with 20 years of insurance coverage (women).	62 with 25 years of covered employment (men) or age 57 with 20 years of work (women).

Conditions can be reduced if men or women are who have worked in the far-north region (Russia) or in hazardous or dangerous work (case in all mentioned countries), to mothers who have five or more children or disabled children (case in all mentioned countries), and to some specified professional categories, such as unhealthy working environment, in geological work, in the railway service, as drivers in mines, dock workers, sailors, or as aircraft ground crew. Russian social security system also has state length-of-service pension: a supplement to the old-age labor pension to state employees, military personnel, and police officers with 15 years of service. Ukraine has special allowances given to carer as social pension. The conditions are following: the monthly allowance is payable to a carer of a person older than

age 80. The carer must not be employed but may receive an unemployment benefit. (Social Security Programs Throughout the World: Asia and the Pacific 2002, #29)

Disability pensions in most countries as also in Armenia (except for Belarus, where disability is divided between total disability or usual work (partial disability); a minimum of 1 year to 15 years of covered employment, depending on age at the onset of disability.) is awarded according to three assessed degrees of disability: total incapacity for work and requiring constant attendance (Group I); total incapacity for work but not requiring constant attendance (Group II); and partial incapacity for usual work (Group III).

Survivor pension case is not so much homogeneous as it was in most cases. First of all it should be mentioned that the years insured's covered employment vary widely among those countries. For example, in Armenia the covered employment is at least 15 years, in the case of Russia, Kazakhstan and Belarus there are no special remarks about it, in Ukraine the number of years is up to 5 and finally in Azerbaijan the number is from 1 to 15 years of covered employment. (Social Security Programs Throughout the World: Asia and the Pacific 2002, #91)

The pension is payable to surviving children whether or not they were the insured's dependents and to nonworking dependents (including the spouse; either parent, if disabled or of pensionable age; and grandparents, if no other support is available). Azerbaijan's law states that the pension is also given to a spouse of someone killed in combat, and to children under age 18 (age 23 if a full-time student; no age limit if disabled). The parents of an insured person killed in combat, regardless of whether they were dependent on the insured; if they have reached retirement age or are disabled and were dependent on the insured; and regardless of age or previous dependency if they do not work and care for one or more of the insured's children under age 8. Brothers and sisters who satisfy the age conditions and whose parents are incapable of work or are not working but are caring for one or more of the

insured's children, brothers, sisters, or grandchildren under age 8 are also eligible for survivor's pension. Grandparents who do not work but care for one or more of the insured's children, brothers, sisters, or grandchildren under age 8 and there is no one else capable of caring for them. (Social Security Programs Throughout the World: Asia and the Pacific 2002, #25)

Social pension is the one payable to a surviving dependent if the insured did not qualify for a social insurance pension. In Armenia this pension is covering Disabled or single pensioners with limited means. In Ukraine this pension is Payable to citizens who are not working and not eligible for an old age, disability, or survivor pension. Belarus' system is similar to this one; it includes nonworking citizens who are not eligible for an old age, disability, or survivor pension and are age 60 (men) or 55 (women), or disabled since childhood, under age 18 and disabled, or orphans under age 18 (older if disabled and the disability began before age 18). The Azerbaijan's law defines this pension to be paid for Group I, Group II, or Group III disabled persons who are not eligible for a disability pension and for disabled children under age 16. (Social Security Programs Throughout the World: Asia and the Pacific 2002, #229)

Benefit system in each country also has its specific features. For example, as we know, in Armenia old-age pension is 100% of the base pension plus a bonus pension of 160 AMD for each insured year, base pension: 3,000 AMD per month. Periodic benefit adjustments are made by government decree. In Russia the old-age pension benefit is calculated as the sum of three components:

- a basic flat rate according to different categories of beneficiaries;
- a benefit based on the notional account; and
- a benefit based on the value of the individual account (contributions plus interest) to be paid beginning in 2013.



There is no officially stated minimum or maximum monthly pension, but the total amount of all three components should not be less than 660 rubles. In Ukraine the Old-Age benefits of old-age pension is 1% of the wage base for every full year of covered employment with at least 5 years of covered employment. The pension is payable monthly. The minimum pension is H92.45 (20% of the national average wage for each employment sector). Partial pension: if the insured has less than 25 years (men) or 20 years (women) of covered employment, the monthly benefit is reduced in proportion to the number of years below the required number of years of coverage. Deferred pension: a supplement of 10% of the pension for each year worked after entitlement to the full pension. The maximum pension is 75% of average monthly earnings. Old-age pension benefit in Belarus is 55% of the wage base, plus 1% of the wage base for each covered year in excess of the required number of years of coverage (25 years for men or 20 years for women), plus 1% of the wage base for each year in excess of 10 years in hazardous work (or 7.5 years for women), up to 20%. The minimum pension is 25% of the national average per capita subsistence income level. The minimum partial pension is 50% of the minimum pension. Benefits are adjusted when the average wage increases by more than 15% a quarter. In Azerbaijan the Old-age pension is 60% of average monthly earnings plus 2% for every year of employment over the minimum requirement. (Social Security Programs Throughout the World: Asia and the Pacific 2002, #91)

While analyzing the case with the social pension benefits we can see that the social pension in Ukraine is paid to a person who has no insurance coverage. The pension rate varies between H23.30 and H59. The case with Belarus it calculates the amount of the social pension as a 50% of the minimum pension per month. Azerbaijan calculates it as 80% of the minimum wage per month.

Disability pensions in Russia are paid as disability labor pension and state disability pension. The benefit of disability labor pension is awarded according to three assessed groups of disability. The benefit is calculated as the sum of three components:

- a basic flat rate according to different categories of beneficiaries (and increased according to the number of dependents);
- a benefit based on the notional account;
- a benefit based on the value of the individual account (contributions plus interest) to be paid beginning in 2013.

State disability pension benefits are set by the government according to categories of beneficiaries (and increased according to the number of dependents). In other countries benefit calculations for those countries is following:

**Table 5: Disability Pension Benefit in Armenia, Ukraine, Belarus, Azerbaijan**

<b>Disability pension benefit calculation</b>			
<b>Armenia</b>	<b>Ukraine</b>	<b>Belarus</b>	<b>Azerbaijan</b>
I group – 120% of main pension	I group - 100% of the old-age pension	I group - 75% of the wage base.	I group - 70% of average monthly earnings* (80% if war-disabled);
II group – 100% of main pension	II group - 90% of the old-age pension	II group - 65% of the wage base.	II group - 50 % (60% if war disabled);
III group – 80% of main pension	III group - 50% of the old age pension.	III group -40% of the wage base.	III group - 30% (40% if war-disabled).

\*Average monthly earnings: The insured’s average monthly earnings (gross) calculated over 5 years chosen out of the entire employment history or over the last 2 years.

Survivor Benefits in Russian federation again consist of two parts: Survivor labor pension and Social survivor pension. The benefit for the first is calculated as the sum of two components:

- a basic flat rate according to different categories of survivor; and

- a benefit based on the notional account and on the number of eligible survivors.

The government according to different categories of beneficiaries sets social survivor pension. In Ukraine survivor monthly pension is 50% of the insured's old-age pension for one dependent; 100% for two dependents. In Belarus Survivor pension consists of a monthly pension of 40% of the wage base for each eligible survivor; 50% for full orphans. Eligible survivors are: surviving dependent spouse; the insured's parents if they are of pensionable age, disabled, or care for a child under age 8 and do not work; grandparents if there is no one legally responsible for their livelihood; children, siblings, and grandchildren under age 18 (age 23 if a student; older if disabled before age 18). Survivor pension in Azerbaijan is for a surviving spouse, 30% of the insured's average monthly earnings, 60% if the insured was in military service. Orphan's pension is 30% of the insured's average monthly earnings; 60% for full orphans. Other dependents: 30% of the insured's average monthly earnings. (Social Security Programs Throughout the World: Asia and the Pacific 2002, #25)

And the last point about which I would like to talk is the one in which we see that in all mentioned above countries benefits are adjusted according to the rate of inflation and increases in the average wage if they are based on the wage or according to changes in average monthly earnings if they are based on average monthly increases. Only in the Law of the RoA on Social Security it is mentioned that the periodic benefit adjustments are made by the government decree.

Thus, this was the short description of social security system of Armenia and now I would like to concentrate more on the main problems facing the administration of the mandatory social security payments and the administration of the system as a whole.

First of all it should be mentioned, that the administration of the healthy social security system is affected by such important factors as migration and as a result of it is the small number of employees, as the population which usually emigrates is the one which is eligible to work, low economic development growth and as result the existence and development of shadow economy.

On the other hand other important factors such as the tax rate, tax accounting, tax forms/filing, payment methods, and frequency of reporting, frequency of payments, inspections, audits, frequency of changes in rules and rates and extra-legal requirements for advance payment of taxes are also very important points, while talking about problems during implementation of social security tax policy.

Other problems that Armenia is facing now are the case of registering the wrong number of employees and the wrong amount of their wages. This is the result of high tax rate of social security payments and unwillingness of employers to pay it. Corruption in the sphere of social security also makes the problem of administering social security payments very difficult and extremely weak.

## **PART II**

The pension insurance system aims at providing adequate subsistence income to the population of Armenia due to social risks such as: old age, long service, disability and the loss of the family breadwinner. As a result of the low average wage, high rates of tax evasion, corruption, migration, the high rate of unemployment, and the small share of salaries in total incomes, contributions are too small to allow payment of adequate pensions. Nonetheless, recent reforms have somehow improved the situation, when after legal changes initiated in 1<sup>st</sup> April 2003 resulted in a 34% increase in social contribution collections (Jerbashian, 2004). While tight legal requirements and strong administrative methods may improve the compliance rate, the pension insurance system works best when the contributions are made consciously and willingly. Compliance on its part can be improved when pension benefits represent a high “rate of return”, and are paid regularly and willingly.

As we had already mentioned small businesses were surveyed in this research as the main source of social security payers. Thus, it is recognized that the role of small and medium business enterprises is very important and is demonstrated by the following statistics. In developed countries they constitute 97 – 99% of the economic units. For example, in the USA the share of small and medium businesses is 99.7% and in GDP- 52%, and in number of employees - 53%; in France and Spain their share is 99.8% in the total number of enterprises and in Japan – 99.7%. The role of small business enterprises is very important and even crucial for the formation and development of liberal economies. Their role and development is vital especially for the economies in transition as they development enables the creation of independent and self-sufficient class of entrepreneurs as well as new jobs, enlargement of internal market, enhancement of the competitiveness among local goods and services in external market and increasing export potential. For example it its important to mention that the role of small business enterprises in the employment ration of economically active

population in Armenia was 31 percent in 2003 and 32.9 percent in 2004. Development of small business enterprise sector facilitates social, economic and political stability in country. (Small and Medium Entrepreneurship Sphere in Armenia, 2005)

Small business enterprises in transitional countries face an obstacles, solution of which depends on such an important factors as economic development tendency and rate, the stage of market economy development, national mentality, existence of correspondent legislative framework and the efficiency of financial, tax and other structures' functioning. (Small and Medium Entrepreneurship Sphere in Armenia, 2005)

As we have already mentioned the role of the small business enterprise is very important for developing countries, and it can be estimated by comparing two years GDP numbers and the share of small businesses in its formulation. For example, the share of small businesses sector in GDP was 38.6% or 730 866.4 million AMD in 2004 and 36.5% or 592 517.7 million AMD in 2003. This means that the share of small business enterprises in generating GDP increased by 2.1 percentage points or 138 348.6 million AMD in comparison with 2003. (Small and Medium Entrepreneurship Sphere in Armenia, 2005)

## **METHODOLOGY**

Thus having in mind all mentioned above and understanding the complexity and importance of this question we decided to conduct a survey and explore this problem among the small businesses in Armenia.

For conducting the following survey were developed and conceptualized mentioned above research questions with appropriate measures for each. Then all measures were combined into one questionnaire. Also the appropriate instructions were developed for interviewers to follow them during the interview.

The survey was conducted during September – October months in 2005 in Yerevan, with the sample size of one hundred twenty. Face-to-face interviews were used for gathering information. The unit of analysis was the average Armenian small business enterprise. The non-probability sampling was used: mainly purposive or judgmental sampling, as well as quota sampling partially and reliance on available subjects, whenever needed. We have included various types of small businesses from almost all suburbs of Yerevan city in our survey. The reason why we did this type of survey is that the cooperation of businesses is extremely low; consequently, the refusal rates are dramatically high, it was very problematic to have a representative sampling. It is noteworthy, that more than 500 small businesses were asked for interviews, from which only 120 gave their agreement. The second reason was that it was almost impossible to find some full list of small business enterprises in Yerevan.

All the necessary methods of voluntary participation and informed consent have been met before beginning the interviews. The refusal rate was very high - 75% percent. All data has been analyzed by running Microsoft Excel.

## **BASIC FINDINGS**

In order to begin presenting the basic findings it should be mentioned, that the survey questionnaire consists of 20 questions with the one composed of 16 sub questions. Questions dealing with the social security issues are 9, with one including eight questions in it. The questions were mostly attitudinal in order to find out the attitude of small business enterprise workers towards the social security policy implementation in Armenia.

First of all we would like to give some general information about the small business enterprises being surveyed by us. Most small enterprises are small shops, small beauty saloons, and small agencies. Most of them operate in the sphere of retailing. The years of

companies' establishment were divided into four categories: established before 1996, from 1997 – 1999, from 2000 – 2002, and after 2003.

**Table 6: Year of the Company's Foundation**

<b>Year the company was founded</b>		
Before 1996	21	17.5
From 1997 – to 1999	29	24.2
From 2000 – to 2002	33	27.5
After 2003	37	30.8
Total	120	100%

The second general type of information describes the numbers of employees. Numbers of employees in the companies were divided again into four categories. The categories were characterized by following ranges: I category – number of employees less or equal to two, II category – from three to five people, III category – from six to eight people and the IV category – nine and more people.

**Table 7: Number of Employees**

<b>Number of employees</b>		
I category	47	39.5
II category	56	47.1
III category	14	11.8
IV category	2	1.7
Total	119	100%

The third question asked people about the average monthly salary in their organization. And again the answers were divided into categories, but at this time into five categories. This time the salary ranges were classified according to following categories: I category – less or equal to 20 000 AMD, the second category includes salaries from 21 000 AMD – to 30 000 AMD, the third category – from 31 000 AMD to 40 000 AMD, the fourth one includes amount from 41 000 AMD – 50 000 AMD, and the last fifth category includes the salary equal to 51 000 AMD and more.



**Table 8: Monthly Average Wage**

Monthly average wage range		
I category	26	21.7
II category	69	57.5
III category	17	14.2
IV category	4	3.3
V category	4	3.3
Total	120	100%

Next two questions ask respondents to answer whether during last twelve months they had been visited from the Pension Fund and Tax Administration. The answers were categorized as “Yes”, “No”, “Don’t know/Can’t say”.

**Table 9: Number of Visits from SFSI and STS**

Visits from STS and SFSI				
	Visits from STS		Visits from SFSI	
Yes	119	99.2	105	87.5
No	1	0.8	15	12.5
Don’t know/Can’t say	0	0.0	0	0.0
Total	120	100%	120	100%

Each of those two questions consists of sub question. For example, both questions about the visits from STS and SFSI consist of the sub question about the purpose of visit. The question about the visit of the STS also consists of the sub question, which asked respondents whether STS administration asked employers about the number of working employees and their monthly wage. The answers about the purpose of visits have different variants, but the most popular one is “inspections”.

**Table 10: Purpose of Visits from STS**

The purpose of visits from STS		
Inspection/audits	79	66.4
Cash registers	15	12.6
Tax collection	19	16.0
Employees	3	2.5
No purposive/extra-legal	3	2.5
Total	119	100.0%

**Table 11: Purpose of Visits from SFSI**

The purpose of visits from SFSI		
Inspection/audits	41	39.0
Number of employees/wages	41	39.0
Payments collection	18	17.1
No purposive/extra-legal	5	4.8
Total	105	100.0%

Next two questions are dedicated to very important problem, i.e. corruption in the system of STS and SFSI tax administration. Both questions ask respondents to answer, whether during last twelve months they had been offered by the STS and SFSI workers to pay a bribe. Answers of both questions were “Yes”, “No”, “Don’t know/Can’t say”.

**Table 12: Offer to Pay Bribe from STS and SFSI**

Offer to pay a bribe from STS and SFSI				
	Offer to pay a bribe from STS		Offer to pay a bribe from SFSI	
Yes	8	80.8	6	5.0
No	97	6.7	102	85.0
Don’t know/Can’t say	15	12.5	12	10.0
Total	120	100%	120	100%

The next question consists of eight sub questions asking people about their attitudes about social payments rate, accounting/reporting, payment methods, frequency of reporting, frequency of payments, frequency of changes regulations, and extra legal prepayment demands. The opinions were represented and classified by a scale, characterizing all answers by four-range scale: no problem, minor problem, moderate problem, and major problem.

**Table 13: Opinion about Social Security Payments**

Opinion about Social Security Payments								
Numbers	SP rate	SP reporting	SP payment methods	SP frequency reporting	SP frequency of payments	SP audits	SP frequency of legislation changes	SP extra-legal prepayment demands
No problem	36	50	53	36	24	16	40	14

Minor problem	42	49	46	55	47	23	39	23
Moderate problem	29	14	17	17	30	35	17	33
Major problem	13	7	4	12	19	46	23	50
<b>Opinion about Social Security Payments</b>								
In percent of total	SP rate	SP reporting	SP payment methods	SP frequency reporting	SP frequency of payments	SP audits	SP frequency of legislation changes	SP extra-legal prepayment demands
No problem	30.0	41.7	44.2	30.0	20.0	13.3	33.6	11.7
Minor problem	35.0	40.8	38.3	45.8	39.2	19.2	32.8	19.2
Moderate problem	24.2	11.7	14.2	14.2	25.0	29.2	14.3	27.5
Major problem	10.8	5.8	3.3	10.0	15.8	38.3	19.3	41.7

As we know, the simplified taxpayers pay minimum monthly amount of 6000 AMD as minimal social contribution. Thus, the next question in the questionnaire asked people to answer whether they pay those monthly minimal contributions or not. The answer categories are: “Yes”, “No”, “Don’t know/Can’t say”.

**Table 14: Payment of Minimal AMD 6 000 as Social Security Payment**

<b>Use of opportunity to pay minimum 6 000 AMD as social payment</b>		
Yes	102	85.0
No	18	15.0
Don’t know/Can’t say	0	0.0
Total	120	100%

And the last issue was the case of the social payments system administration after transmitting it to the STS in January 2005. The answer categories provided for this question were divided into the following ones: worsened, remained the same or improved.

**Table 15: Opinion about Change in SP Administration since 2005**

<b>Opinion about change in SP administration since 2005</b>		
Worsened	18	15.0
Remained the same	76	63.3
Improved	26	21.7
Total	120	100%

## **ANALYSIS**

In this part of the essay I am going to analyze main finding of this survey and try to give the answers to the research questions developed for the following Master Essay.

First of all let us start with the number of employees and the proportion between real one and the registered one. First of all I would like to mention that most of the people, and even almost all (80% of all respondents) reported the real registered number of employees, which does not have any relation to the real number of people working in particular small enterprises. When they were reporting the number of employees, they were asking their accountants or persons responsible for the accountant's job (because many of them did not have accountant at all, or had one who was also unregistered) how many people are registered in their organizations, not how many people are working. So, the issue in most organizations was that almost 80% of them estimated that the number of employees working and registered one differ one from another, where the registered number of employees is of course less than the real employed one.

We can also see this by paying attention to the numbers represented in our basic findings, where 56 enterprises estimated the number of employees from 3 – 5 people, 47 enterprises said that they had 1 or 2 workers, 14 said that the number of their employees is from 6-8 and only 2 employers estimated the number of employees of 9 and more.

What causes this kind of unfair treatment of the registration of the numbers of employees' different people said different things. First and the most popular answer was that the tax rate of the social security is very high. They don't want to carry the burden of paying monthly minimal 6000 AMD and so, in order to avoid it they just do not register the right number of their employees and pay social contributions for only those registered.

The second important factor which should be mentioned as one of the main causes of registering the wrong number of employees is the obligation to pay those minimal 6000 AMD in case if they fire one employee and instead hires a new one. In this situation, as it is prescribed by the Law on Mandatory Social Security Payments, every employer, when he is hiring or firing someone should pay at every time the transaction takes place 6000 AMD. Most of them estimated this issue as the main cause of registering the wrong number of employees. They also said that in the small business enterprises, most of which in our case were little shops and markets, the case of hiring and firing someone is very often happening situation. Thus, this payment is very inconvenient for them and they try to avoid registering someone new at first months of work and do it only after some period of time, when they feel, that they can work with them, when they are sure.

Third cause of registering the wrong number of employees is the agreement of employees themselves to work under this condition, without thinking about the years of covered employment for future pension. This can be explained by the high rate of unemployment and hard economic conditions, which people feel in their daily life. By having no jobs, no source of financing many people in Armenia are going to any work with any conditions and agreeing with all conditions proposed to them by their future employers.

Under current law, as we have already discussed, contributions are a flat 5,000 AMD for everyone earning less than 20,000 AMD. The remainder of the contribution is based on a percentage of wages. Employers pay 15% of wages between 20,000 and 100,000 AMD, and

5% of wages above 100,000 AMD. The employee contribution rate is 3.0%. So, as the employer carries the main burden of the social security payment, it is in his interest to avoid them, by not registering particular employee.

Moreover, we have also mentioned, that the main fund of social pensions in Armenia is the payroll contributions of employees and employers. Thus, can you imagine how destructive would avoidance of payments be from the part of the employers, having in mind all written above?

The next issue that I would like to talk to about is misreporting of wages. And again I would like to mention, that during the survey I had approximately 75% of people who estimated, that the amount of wages they are paying to their employees in reality are really if not very high, but also not as low as they demonstrate in usual statistical documents. Moreover, they again do not know the registered amount of the average monthly wage in the enterprise, when I was asking some of them to present the real amount of wages, they did it quickly, without even a single minute for thinking and for some calculations.

Also if we will watch the results of the survey, concerning with the monthly amount of wage we will notice, that most of the respondents said the amount of money from 21 000 AMD – to 30 000 AMD, 26 people estimated the average monthly wage as less or equal to 20 000 AMD, it should be also mentioned that other 8 organizations (by 4 each of them) estimated that they pay the amount of money more or equal to 40 000 AMD – 50 000 and more.

Again as a cause of this misreporting of the real amount of wages many small business enterprise owners state the high tax rate for the social security tax (even if in their case it is minimal 6000 AMD). Thus, by registering not real amount of their wage and almost always registering the average monthly wage, which is of course lower than the real amount of

money the employee gets, this system of mandatory social security payments will not ever work.

The second cause of this misreporting is so called “oral agreement among employee and employer”. This kind of agreement is based on the idea, that the employer pays the employee more monthly average wage, than it is registered. And in this case, the employer, again as the main person who carries the burden of those payments is not very interested in paying much money to the government in the form of social security payments.

Another important case, which I would like to mention, is that as most of our interviewers – small business enterprises were simplified taxpayers they had an option to pay as a social contribution minimal 6 000 AMD. In this case I would like to give some numbers concerning with the quantity of people paying minimal 6 000 AMD and people paying more than this minimal amount of money.

**Table 16: Payment of Minimal AMD 6 000 as SP among Simplified Taxpayers**

<b>Pay AMD 6000 as social payment for each employee</b>	
	Simplified taxpayers
Yes	81
No	10
No answer	0
Total	91

From this table we can estimate, that the real number of simplified tax payers who paid social security as minimal 6 000 AMD is 89 people out of 91 who pays this amount of money. On the other hand we see, that only 11 people out of 91 pay social security payments more than this minimal 6 000 AMD, i.e. according to their wages.

For this purpose I did some calculations in order to estimate the whether this amount of 6 000 AMD is preferable to the one where all employees and employers make the social security payments in the amount which is usually paid by others. I calculated the average social security payment, which would be done in case of abolition of the law of minimal

social security payments and found out that in this case the average social security payment which should be done on the base of our data of wages, the payment would be 6 647 AMD. This amount is more than the estimated 6 000 AMD by 647 AMD, i.e. is more by 10.8 percent. It should be also mentioned, that the calculation was made on social security payment per employee.

Thus, all mentioned above is pointing out to the idea, that in the case of current estimated minimal 6 000 AMD employers are paying less by 10.8%, than they would pay in the case of abolition of this law. And even after this privileges employers are avoiding to pay even these minimal amount by misreporting the number of employees.

Next point of our analysis would be the case concerning with the visits and audits from SFSI and STS. First of all it is very important to mention, that all the visits and audits from the SFSI and STS are usual events for small business enterprises in Yerevan, because when they were asked to answer, whether during last twelve months they had been visited from the SFSI or STS, most of them immediately answered, that they were of course visited and probably 90% of all respondents said that they are usually visited by SFSI every month and by STS even twice a month. Thus 119 (99.2%) small business enterprises were visited by the STS and only 1 organization said that it was not visited by it. On the other hand, probably 105 (87.5%) organizations were visited by the SFSI and 15 enterprises said the SFSI worker did not visit them during last twelve months.

Most of the respondents have negative feelings towards these visits and most of them said that they would be more responsible in the question of social security and general tax payments, if these tax administration workers were not so aggressive and ruthless toward them.

On the other hand, having already discussed the issue of misrepresenting the numbers of employees and the real amount of wages in order to pay less social contributions, we can say



that this attitude is the only one form of collecting the money and audit in order to find out some fraud if there is any.

Concerning with the purposes of visits of SFSI, I would like to mention that the most popular answer here was “Inspection/audits” and “Inspections concerning with number of employees and amount of wages” – both these purposes mentioned by 105 small business enterprises who were visited got the highest number – 41 and 41 small business enterprises, i.e. 39.0 and 39.0 percent. Generally, the tax inspections are “costly” for the state when they do not ensure an adequate level of tax collections. In the case of STS again the most popular answer was audits and inspections – 79 out of 119 or 66.4 percent.

Tax collection and social security mandatory payments collection respectively for STS and SFSI are the second most popular answer and they got 19 (16.0 percent) answers in STS case and 18 (17.1 percent) in SFSI case. Here some of the respondents said that it is even very good when they are coming to collect taxes or social security payments, as very often all those small business enterprises having the finances available and ready to pay sometimes even do not want to make those payments at all.

The next point that I would like to mention is that in most cases the number of employees and the amount of wages were the main purpose of the visits from the STS and SFSI. Moreover, even when tax inspectors from STS or SFSI came to have some inspections about, for example, cash registers, they almost always try to get some information concerning with the employees and their wages.

On the other had, as we have already mentioned almost all our respondents stipulated that they had inspections from STS and SFSI almost every month, even though they are obliged to make payments once per three months. Most of respondents said that they are afraid of those tax inspectors more than of their own death. Because in most cases those tax collections are extra-legally demanded. They also said that it is such an impression that people there don't

have anything to do except tax collecting every month. Moreover, the case here is that the administration of those taxes and social security payments are very expensive, if for example, we will calculate monthly spending on such kind of “voyages” on tax collections.

Moreover, some of the respondents (approximately 60%) stipulated that they have been offered to pay a bribe to the STS or SFSI administrative tax collector and they did. Although, all of them said that they do not want this answer to be mentioned, instead they insisted that I should write down the negative answer. Thus according to the data I could write down we have the following picture: from STS 97 (80.8%) of respondents estimated that they have never been offered to pay a bribe from the STS, only 8 (6.7%) people said they were offered to pay a bribe and 15 (12.5%) of respondents refused to give any answer. In the case of SFSI the situation is more pleasant and I can estimate that here really less people estimated the situation, when they were offered to pay a bribe: from SFSI 102 (85.0%) of respondents estimated that they have never been offered to pay a bribe from the SFSI, only 6 (5.0%) people said they were offered to pay a bribe and 12 (10.0%) of respondents refused to give any answer.

Thus the issue here is that in many organizations, after the inspections when tax administrators found some fraud, misreporting of number of employees and amount of wages, they offer the employer to solve this problem just right between themselves. This means that they offer the employer to pay some amount of money to them in order for the administrator to forget about the fraud and any other problems. And again I would like to mention, that although the numbers are not presented in the table, by my own notes after the interviews I could estimate that the overall number of bribe offers for both STS and SFSI were approximately 60%.

The next point that I would like talk about is concerning with the social security payments at all. The question of people’s attitude toward social security payments were

measured by asking their opinion about the rate, about the frequency of payments, about the frequency of reports, about extra legal payments and also audits and inspections, frequency of changes and regulations in the Law regulating social security payments.

First of all I would like to mention, that the case of extra legal prepayment demands are the most serious problem, which small business enterprises mentioned during their interview. Thus, 50 (41.7%) people out of 120 mentioned social security extra-legal prepayment demands as the major problem, which they are facing concerning with the social security payments. From my own experience I can estimate, that this problem is really very serious and exists in almost all small and medium business enterprises. The issue here is that, when people are asked to make some extra-legal prepayments, they are not ready to, or even if they are ready, their general attitude is changing and they think about this payments as something not legal and something which will not go directly to the Fund.

The majority of people as really major problem also views inspections and audits. For example, 46 (38.3%) of interviewers said that it is major problem and only 16 (13.3%) people estimated that it is not a problem or a minor problem. We have already talked about the audits and inspections and in this part I would like to present some numbers in order to see that this problem is also very important and serious.

**Table 17: Opinion about Inspections/Audits of SP**

<b>Opinion about inspections/audits concerning with the Social Security Payments</b>				
No problem	Minor problem	Moderate problem	Major problem	Total
16	23	35	46	120
13.3	19.2	29.2	38.3	100%

The third case which I would like to mention and is the third by its problematical character is the question about the frequency of changes in laws and regulations concerning with the social security payments regulations. Here 23 people said that this case is not

working ideally in Armenia, as changes and new regulations are done very often but they do not have enough access to the information and changes at all. On the other hand, 40 people said that this is not a problem at all, but in this case as I could mention during the interviews this 40 people were those (or most of them) who did not even have the general information concerning with this issue. Moreover, when I asked them about the changes in the administration of social security payments after transferring its administration to the STS most of them said that they did not even know about this regulation. Thus, I took as a real number the number of people who said that there are problems with the frequency of changes and regulations, as these were the people who were interested and informed about current issues.

Frequency of payments of social security taxes is the fourth by its problematic character. Although it is worth to mention, that 24 (20.0%) of respondents mark it as minor problem, 47 (39.2%) people mark it as a minor problem, 30 (25.0%) – as a moderate problem and only 19 people (15.8%) mark it as major problem. Moreover, most of the respondents said that this issue will not be so serious and problematic one if there were no extra-legal prepayment demands. Mostly they are all satisfied with the current regulations of paying social security once per month.

Frequency of reporting is also the point which most of the respondents (55 people or 45.8%) see as minor problem while implementing social security payments. And even we can estimate that 36 of respondents (30%) look at this issue as not problematic at all. Only 10.0% of respondents view this as a major problem. Thus, the system of frequency of presenting reports once per three months is working quite well and we can estimate that people are mostly satisfied with this regulation.

Opinion about the rate of social security payments is also can be classified as the positive one as 36 of respondents (30.0%) estimated that they see no problem in the rate of social

security payments, and 42 (35.0%) people see the social security payment rate as a minor problem. 29 of respondents (24.2%) said that the social security payment rate is a moderate problem and only 13 (10.8%) out of 120 said that the rate of the social security payments represent major problem in their implementation. From this analysis we can say that people are mostly satisfied with the social security payments rate and they do not view it as a problem. On the other hand, from this point of view, it is not understandable, why there is such a high rate of misreporting the number of employees and their wages.

Accounting and reporting of social security payments is also represented by the high number of respondents as not problematic by its character. Moreover, 50 respondents (41.7%) said that the accounting of social security tax is not a problem at all. Forty-nine respondents (40.8%) said that accounting represents for them a minor problem, and 14 (11.7%) characterized this issue as a moderate problem. Only 7 (5.8%) people out of those 120 estimated that the reporting and accounting is a major problem while implementing social security payments. Thus, it should be implied from the information above, that the social security payments current accounting system is working good enough, but we should not also forget, that most of the respondents (81 respondents out of total 91 simplified taxpayers) use the opportunity to pay 6 000AMD as a minimal social security payment and do not need some more complicated calculations to be done.

And at last, but not the least, I would like to mention such important issue as payments methods, which are seen by our respondents as the most non-problematic case in all those asking their opinion about social security payments. Thus it is important to mention, that from our 120 respondents 53 (44.2%) estimated no problem in implementing social security methods, 46 (38.3%) people said that this is a minor problem, 17 said – payment methods are moderate problem, and only 4 people (3.35%) estimated the social security payments methods' major problematic character. Thus, from this statistics we can say, that this issue is

not problem in now day's social security payments system. Moreover, during the interviews people said that they were really highly satisfied by this issue.

Thus, concluding all written above we can estimate that small business enterprises are not at all satisfied with the extra-legal prepayment demands and view them as well as very often inspections and audits as the main major problems while implementing the social security payments. On the other hand they were highly satisfied with the social security payment rate, frequency of reporting and payments methods.

The last issue, which I would like to mention in this part of the essay, is connected with the social security payments administration after it was passed to the STS in January 2005. What was the major finding here for me that most of the people even did not know that there had been such a new regulation or even we can say change. Thus, 80 percent of people said that they did not see or feel any difference between the implementation of social security payments when it was under the authority of SFSI or as it is now – under STS. Seventy-six people (63.3%) out of all 120 said that there is no change in the implementation of social security after it has been changed and transferred to the STS administration. Among the respondents (26 respondents or 21.7%) who said, that the social security payments administration became better after transferring it to STS no one could answer what was the improvement. And of course, it should be mentioned that 18 respondents (15.0%) said that the social security payments administration became worse, than it was. And of course no one again could mention what really became worse. Thus, concluding results we can estimate that the social security payments administration did not go through some major changes after being transferred to STS.

## CONCLUSION

International experience demonstrates that pensions have a significant impact on poverty reduction at family and community level. Although the Armenian pension system is financially sustainable, there are major benefit adequacy and plan design issues that must be addressed. In order to correct these problems, Armenia must take serious actions. When we say that the pension system of Armenia is sustainable we mean in short term as we have mentioned that the money gathered from working population is going directly to the current generation payments. Thus, the system of those social payments is sustainable in short period and gives no serious opportunities for the further when we are talking about the long period of time and global changes. It is proposed to replace the benefit supplement -- currently the second component of the “solidarity” benefit – with “insurance pension”. This insurance pension will be made up of two components:

- **The first component** will be paid based on the creation of notional accounts reflecting the accumulation of past contributions paid by or on behalf of an individual to the mandatory state pension system; and
- **The second component** will reflect real balances accumulated in real bank accounts. This part is a fully-funded, mandatory pension program (usually referred to as a “second pillar”).
- **The third component** is the establishment of the Voluntary Private Pension Fund (so called “third pillar”)

On the other hand there are many good predictions for Armenian social security systems and particularly pensions system development. There are very few new retirements in the next 15 years. This is because the birth rate was very low during World War II, and this is the cohort that will be retiring in the next 15 years. As a result, the number of beneficiaries will

decline through 2015. The retirement age has been increased in 2005. This also reduces the number of new retirees, and should increase the size of the labor force, and increase contribution revenue to the SFSI

Although women are giving birth to fewer babies now, the population of Armenia should continue to grow for the next 45 years. This is because the average age of the population is only 33.9 years for women and 30.7 year for men today. This low average age keeps the overall death rate low, and consequently, births will exceed deaths despite a relatively low fertility rate. The favorable demographics in the next 15 years will likely be accompanied by strong economic growth – large increases in real GDP and real wages. (PADCO Armenia Social Transition Program, Report N35, 2001)

As we could see, the social security system in Armenia in practice is not functioning perfectly. There are many different causes of it, which we would like to mention once again in short.

First of all the problem which we could see during the whole process of the research is that employers are trying to avoid Social Security payments by registering the wrong number of employees and also by misreporting the real amount of wages and salaries. As the main cause of this kind of behavior most small business enterprise owners name the high rate of the social security payments and unwillingness to pay this money, as they don't believe to the effectiveness of the system at all. Other cause of this misreporting is also connected with the employees who are also very unwillingness concerning with the question of payments and almost always support this fraud behavior of employers. Employees are also disappointed with very low benefits and are also sometimes obliged to work under the conditions the employers are offering them, by having no choice because of the high unemployment rate in Armenia.



Other important issue that should be mentioned concerning with the social security payments administration is the wrong behavior of the tax administration workers and also the STS and SFSI at all. First of all most of the respondents were highly disappointed with extra-legal prepayment demands which are very usual thing in their daily work. They are very often demanded, not offered, but demanded to pay some extra-legal social security payments. Other problem, they were very complaining about was the issue of inspections and audits. Most of them estimated, that those inspections and audits in most cases are connected with the extra-legal prepayment demands.

Frequency of changes and regulations is also very important issue concerning with the administration of social security payments. Here the major problem that was indicated by most people is that those regulations are changing very often, but this process is not open and general public often do not get informed about those changes on time. This can be also estimated through the point that when most people were asked about the changes in Social Security Payments administration after its transfer to STS, most people said that they did not know anything about those changes and they even did not feel any difference in the administration of the social security payments since 2005.

Today Armenian pension system is based on the idea of solidarity of generations, i.e. mandatory social security payments are done by the current working generation on behalf of the previous retired one. Those payments define the budget of the social security payments, from which the annual social pensions are paid depending on the length of service. Thus, even the slightest violation of the payroll taxes will be terrible for the whole system. It should be also mentioned, that after the calculations for the average wage per employee and his/her social security payment after the abolishment of those minimal 6 000AMD, I found out that in that case we will have more benefit, when it is now.

But the problems with the administration of social security payments are not only those connected with the administration and the tax rate, but also the problems are ingrained in the peoples' attitude toward those payments and the system as a whole. Armenians, both employers and employees do not usually think about the social security payments as a real payment that will for sure go to the Social Security Fund. Most of them think about the Social Security Fund as some kind of bottomless barrel, from, which everyone every time can take money they need. They also do not see the benefits from their payments, as pension payments are always late and are very low.

Although the social security system in Armenia has made real progress in comparison with previous years, but there are still lots of things government and the tax administration system should do. Our key recommendations for the development and bettering the system of social security payments system are the following:

- Benefits must be made reasonable in relation to contributions for all workers – both low and high paid, and for both men and women
- Compliance must be improved. In part, this can be accomplished through improved pension plan design and administration. If the system is perceived as fair, and if workers know their benefits will be based on personified records, compliance will improve. However, many other economic changes must be made, and enforcement must be drastically improved, if compliance is to increase
- Benefits for pensioners should be automatically indexed to 100% of inflation, assuming inflation remains moderate. Consideration should be given to indexing to some portion of real wage growth as well

Armenia needs to seriously reconsider several of the provisions of its proposed pension reform: contribution rates for the higher paid must come down, compliance and enforcement must be improved.

If these changes are not made, the Armenian pension system will continue to suffer from poor contribution compliance, very high contributions in exchange for very low benefits, an inability of the pension system to prevent poverty among the elderly, and a high likelihood that benefit improvements for existing pensioners will prevent introduction of benefits based on pay and service and create serious pension arrears.

Also we would like to mention such issues that also have their impact on social security system administration in general. Among them are such issues as: demographic changes, decrease in the volumes of production, employment reduction, decrease of specific gravity of salaries in the structure of the population incomes, existence of black economy, imperfect mechanisms of collection of the social insurance mandatory payments.

The demographic changes had great impact on the RA pensioner security system. The latest immigrants to Armenia were mostly people of the pensioner age or of about that age immigrated to Armenia, and the emigrants were mainly people of workable age. These occurrences changed the sexual and age homogeneity: the special gravity of people of 60 and more increased considerably which raised social burdensome of the population of workable age and created new difficulties for the pensioner security system

The present average pension in the republic does not satisfy even the minimum of the pensioner's needs.

One of the factors having negative influence on the RA pensioner security system is the presence of black economy. This limits greatly possibility for the RA social insurance state fund to collect the social payments, which causes non-sufficiency of financial resources.

Summarizing this we can conclude that the ROA pensions security system needs serious improvement. It is necessary that this system comply with the changes taking place in our society and that it corresponds to the insurance principles, which is conditioned by presence

of various types of ownership, and by personal responsibility of each citizen in the issue of ensuring the elderly.

In spite of all positive changes taken place, the situation with the pension's security still remains tight, as the changes in the pension security system are much slower than the dynamics of the social and economic life of the republic.

The ideology of pension's reforms undoubtedly belongs to the symbols of building a social state. It is necessary to establish institutions of pension security which will take into account changes in the economic and social conditions of the population, diversity of organizational and legal and working activity forms, the expected average length of life, presence of various social dangers.

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APPENDIX A

Figure 1: Respondents' Opinion about Social Security Payments

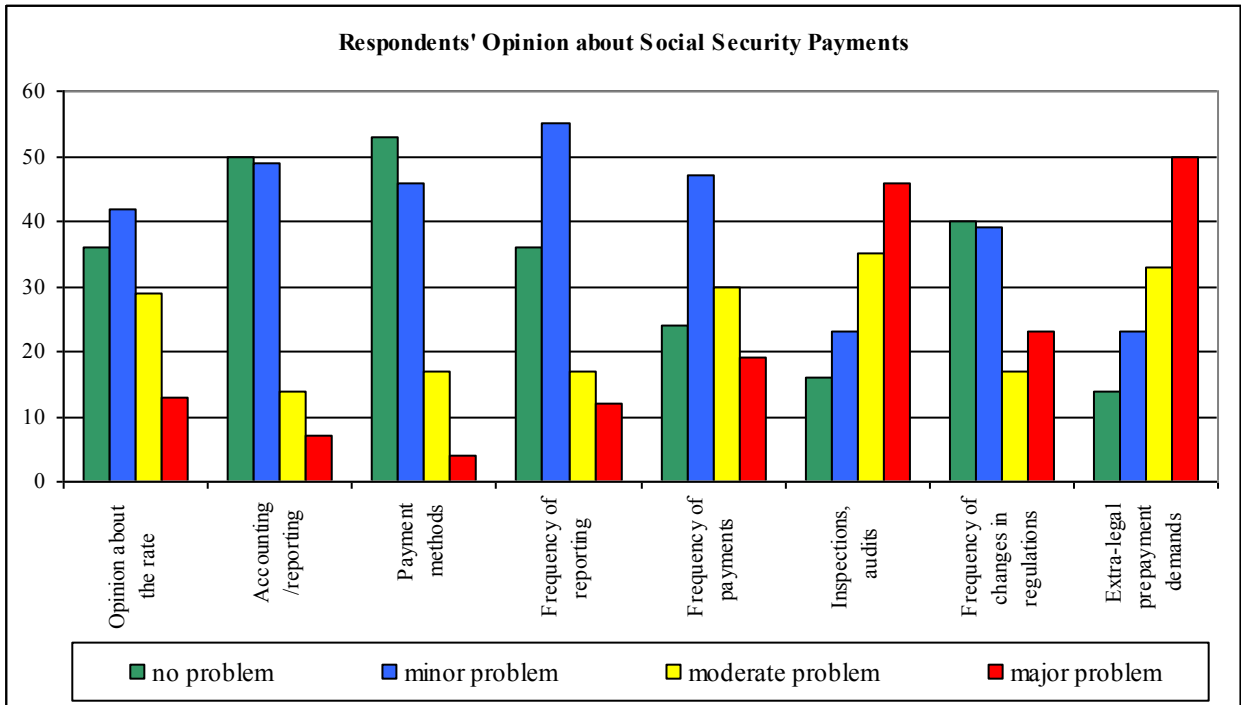


Figure 2: Changes in Administration of SP since 2005

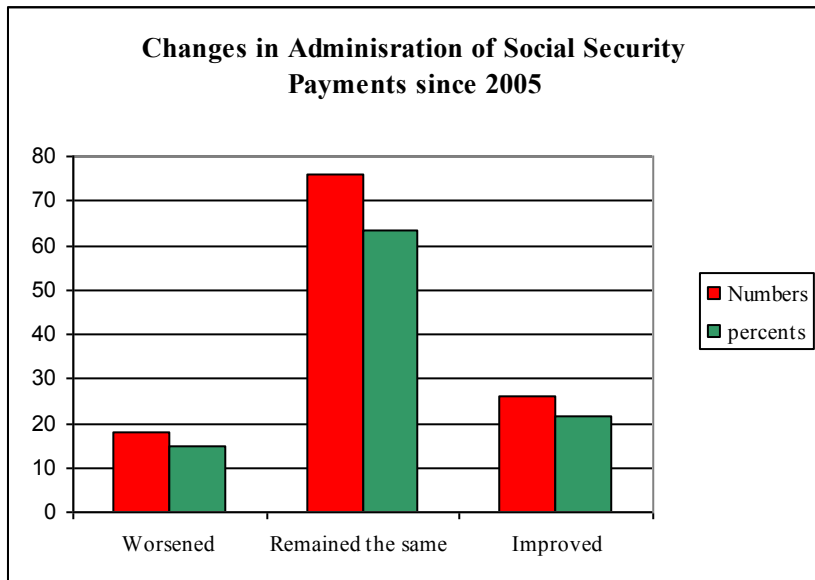




Figure 3: Salary Ranges

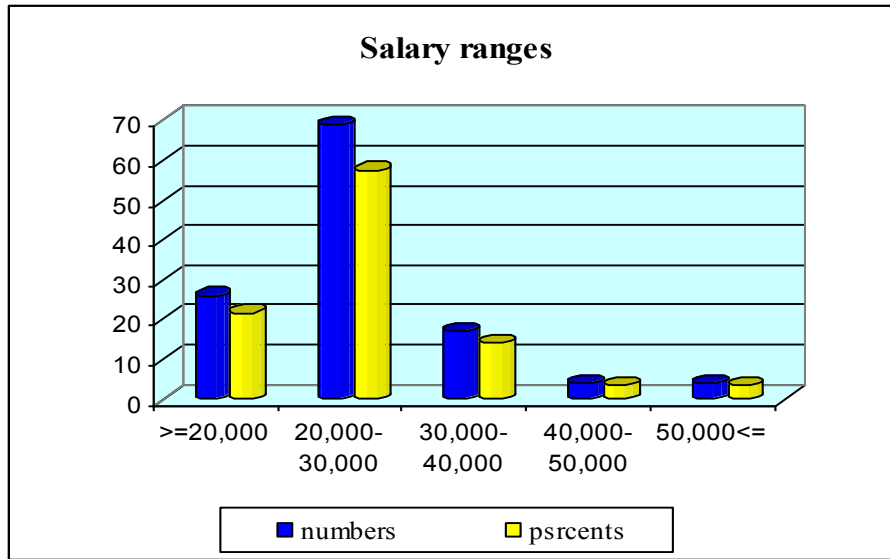


Figure 4: Number of Employees

