

## **Republic of Azerbaijan**

### **Preliminary assessment of the Social Protection System**



**Social Security Department  
International Labour Office      Geneva**

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## Introduction

Under the terms of the Country Objectives Agreement between the Government of the Republic of Azerbaijan (the Government) and the International Labour Organization (ILO), it was identified that assistance with the development of social protection was a priority. During his attendance at the International Labour Conference in June 1997, the Minister of Labour and Social Protection, Professor Ali Nagiyev, requested an ILO mission to assess the present needs in the area of social protection and to identify technical assistance activities in collaboration with key officials of the Government.

The terms of reference for the mission were determined as

- ▶ to review all existing social protection provisions from a socio-economic, management and legislation viewpoint and identify national and local institutional arrangements and capacity
- ▶ to undertake a preliminary assessment of social expenditure within the context of total public expenditure and revenue profiles
- ▶ to gather available information and data and identify weaknesses
- ▶ to identify institutional training needs
- ▶ to undertake field visits to discuss needs and reforms of the social protection schemes with representatives of local government, private institutions and non-government and community based organisations
- ▶ to meet with the ILO tripartite constituents as well as representatives of international agencies and the donor community

The objective was to produce a report which would provide a preliminary assessment of the social protection needs and technical assistance requirements to provide the basis for the formulation of a technical cooperation project

The mission was undertaken between 11 and 22 October 1997 by Mr. Clive Bailey, and Ms. Loredana Magni from the Social Security Department, ILO Geneva, and Mr. Irji Kral, ILO Consultant from the Ministry of Labour in the Czech Republic.

The programme for the mission was arranged by Ms. S. Sattarzade of the International Affairs Department of the Ministry of Labour and Social Protection (MLSP). Meetings were held with the Minister, the Deputy Minister, Mr. Namig Gasanov, and other senior officials of the Ministry, the Social Protection Fund (SPF), the Social Protection Fund for the Disabled (SPFD), the Institute for Labour and Social Welfare, the Ministry of Finance, the Ministry of Health, and representatives of the trade unions. Discussions were also held with officials of the World Bank and TACIS, who were on mission in Baku at the same time, and with Mr. Ercan Murat, the Resident Representative of the UNDP.

The Director General of the ILO would like to acknowledge with thanks the cooperation and support provided by the Minister of Labour and Social Protection to what was the first ILO social security mission to the Republic of Azerbaijan.



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# Chapter 1

## The socio-economic environment of Azerbaijan

The population of Azerbaijan in 1996 was 7.6 million, having risen from 6.1 million in 1979. Ninety per cent of the population are Azeris, 3.2 per cent Dagestani, 2.5 per cent Russians, 2.3 per cent Armenians and 2 per cent others. The proportion of Russians and Armenians fell significantly as a consequence of conflict with Armenia over Nagorno-Karabakh and the country is now one of the ethnically most homogenous of the former Soviet Union. In 1996, 52.5 per cent of the population lived in urban areas and 47.5 per cent in rural. The capital Baku is by far the biggest city with a population of 1.8 million.

In 1996 the birth rate was 17 per 1000 having fallen from 26 in 1990, the death rate was 6.4/1000 and the infant mortality rate 20/1000. The average life expectancy of 69.3 years (64.7 for men and 74.0 for women) has dropped by 1.3 years since 1990 (for men by 2 years). The decrease of the average life expectancy for men was mainly influenced by the Armenian conflict.

The population is young with 35 per cent (2.6 million) under 16 years (more than 40 per cent under 18). 54 per cent (4.06 million) are within the productive age group and 11 per cent (841,000) are over retirement ages 60-55. It is projected that the percentage of the population over the present retirement ages will increase by 15 per cent during the next 20 years.

The family plays an important role in Azerbaijan. There are just over one million families with children under 18 years. Twenty-six per cent of them have one child, 31 per cent 2 children, 22 per cent 3 children and 21 per cent four and more children.

The size of the labour force was 2.89 million in 1996, 38.4 per cent of the whole population. 55.6 per cent were employed in state enterprises, 9.1 per cent in agriculture, and the rest (35.5 per cent) in private sector and small enterprises. The ratio of employees in the private sector has been increasing rapidly in recent years.

Azerbaijan has rich mineral resources, and was formerly one of the most industrialized parts of the former Soviet Union. It was therefore hoped that, after achieving independence in 1991, the transition to democracy and a market economy would be relatively easy. But major political and economic problems arose after 1991, caused mainly by the Nagorno-Karabakh conflict and also by the conflict between Chechnya and Russia. These made the political, economic and social transition very difficult, and Azerbaijan underwent one of the most serious depressions among the former Soviet Union countries.

GDP during recent years has fallen dramatically. According to official estimates, GDP in 1995 was only 34 per cent of its level in 1989. The decline was, however, halted in 1996 when GDP increased by 1.3 per cent. The real situation may be rather better since the transition to a market economy has been characterized by low wages in the formal sector but with substantial activity in the informal sector which is difficult to quantify. GDP per capita reached approximately \$450 in 1996.

Public expenditure also fell considerably. Expenditure of the state budget decreased from 41 per cent of GDP in 1993 to 18 per cent in 1996. The elimination of subsidies on bread and other basic commodities and real wage cuts in the public sector together with removal of the linkage between the level of social security benefits and the minimum wage played a major role in the reduction of public expenditure. But the situation was aggravated by the fact that income from revenue also fell. In 1996 public revenue dropped to only 15 per cent of the GDP and the resultant deficit in the state budget was equivalent to 2.9 per cent of GDP. This illustrates the significance of the problem of collecting public revenues which is equally applicable to the social

security contributions and which remains a central problem in relation to the effectiveness of the social protection system.

**Table 1: State budget - Income and expenditure (manat bn)**

	1993	1994	1995
<b>Total revenue</b>	<b>53.6</b>	<b>277.3</b>	<b>1,816.7</b>
Value added tax	12.5	64.4	153.1
Excises	6.3	32.8	89.0
Profit tax	13.0	88.7	427.7
Profit tax collected from population	3.8	35.2	114.0
Tax on foreign economic activities	1.2	8.0	188.0
Duties and non-tax payments	1.7	2.6	78.0
Other income	15.0	45.5	766.9
<b>Total expenditure</b>	<b>64.8</b>	<b>520.9</b>	<b>2,560.5</b>
National economy	18.8	94.0	183.7
Sociocultural events, of which:	24.0	187.5	751.6
education	11.9	91.8	373.3
culture and mass media	1.3	10.1	45.6
public health	5.2	34.9	146.6
Social maintenance and social protection, of which	5.5	50.3	182.9
social protection	5.3	48.3	174.0
Law enforcement bodies	13.4	48.0	90.0
State power and administration bodies	1.8	13.1	202.2
Science, sport and others	1.3	128.0	1,150.1
<b>Overall balance</b>	<b>-11.2</b>	<b>-193.3</b>	<b>-560.9</b>

High levels of inflation were experienced. The price index reached the level 1330 in 1996 in comparison with 1992. The worst situation was at the end of 1994, when the monthly inflation rate reached nearly 50 per cent per month. Since 1995, there has been a considerable improvement - inflation fell to 20 per cent in 1996 and was down to only 1 per cent in September 1997).

Although the social protection system provides a comprehensive range of benefits it proved incapable of responding to the economic crisis and poverty levels increased. It is estimated that over 60 per cent of the households are poor: defined as having an income insufficient to purchase food to the level of a minimum consumption basket and 20 per cent of the households are very poor i.e their expenditure on food is less than one half of what is needed for the basket. The minimum wage, but also the average wage and the social benefits, dropped so far that the minimum consumption basket became meaningless: the income whether from wages or social benefits for the majority



of the population was below subsistence level.<sup>1</sup> Thus the minimum wage has not been adjusted since 1995 when it was equivalent to only 5 per cent of the minimum consumption basket. It is clear that poverty on this scale cannot be solved by any special social protection programme, but only through economic development.

The average monthly wage reached in 1996 85,000 Manats (1US\$ = 3900 Manats currently). This represented a nominal increase of 36 per cent compared with 1995 and a real increase of almost 14 per cent. But if compared to the 1992 level, the real wage dropped to only 23.7 per cent (the lowest level 20.9 per cent being reached in 1995). The earning differentials among the various sectors have also been increasing although there is reason to believe that this has been distorted by significant under-reporting of wages especially in smaller enterprises.

The social protection system is financed partly from the SPF which collects earnings related contributions from employers with a 1 per cent contribution from workers in order to finance pensions, cash sickness and maternity benefits. The Fund also channels resources from the state budget to social assistance payments. The share of GDP taken by total SPF expenditure was only 5.7 per cent in 1996, of which the expenditure on pensions accounted for only 2.6 per cent (which is low in relation to most other countries). In 1995 the equivalent ratios were even lower - 4.3 per cent, and 1.6 per cent. Thus, an effective social protection system should be within the capacity of the economy but is inhibited by low levels of tax and contributions compliance.

The process of transition in the labour market could be characterized not only by decreasing real wages, but also by low open unemployment and increasing hidden unemployment. The number of registered unemployed person increased slowly between 1992 and 1996 (from 15,000 to 31,000) which is about 1.1 per cent of labour force), but the unofficial estimate of hidden unemployment is 400,000. Neither the active labour market policies nor the level of the unemployment benefit scheme offers much incentive for the unemployed to register.

The social economic situation in Azerbaijan displays a growing number of people with large incomes derived mostly from trading but also a very large number of poor and vulnerable of whom the most needy are the internally displaced persons (IDPs) from Karabakh who number about 1 million. Family support is an important factor particularly in rural areas and should be taken into account in determining the social protection structure.

**Table 2: Structure of money incomes, in per cent**

	1991	1992	1993	1994	1995
Total incomes	100	100	100	100	100
Wages	58.6	64.4	57.8	40.6	35.4
Social transfers	20.4	11.7	12.1	5.8	6.1
Incomes from property, self-employment and odd incomes	21.0	23.7	30.1	53.6	58.6

<sup>1</sup> Based on figures provided by the State Statistics Committee, the average monthly income per capita was 64,000 Manats, whereas the minimum consumption basket was 360,000 Manats (approximately \$90)



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## Chapter 2

### The social protection system in Azerbaijan

#### 2.1. The context

The social protection system of the Azerbaijan is still characterized by structures inherited from the system of the former Soviet Union. As such, the system reflected:

- a presumed uniformity of social protection needs
- limited reliance on individual responsibility
- stable employment
- a wide range of social protection benefits extending to health care and housing
- subsidies for many household and consumer goods

The newly independent Republic of Azerbaijan enacted legislation to establish its own social security scheme in 1992. Furthermore, Article 38 of the Constitution states that

*'Every person shall have the right to social security in old age, sickness as stipulated by law, disability, loss of a breadwinner, unemployment and when otherwise specified by law.'*

Although based on the Soviet scheme, the new social security legislation reflected Azeri circumstances and soon needed modification to take account of the difficult economic pressures of the transition.

The development of the market economy has not yet had a significant effect on the social protection system and apart from the important elements of family support and individual asset building the system remains heavily dependent on state provision with employer based and private sector arrangements as yet undeveloped. The public provision displays three classical components of social security systems:

##### *Social insurance*

- employment related benefits to provide income maintenance in respect of the contingencies of old age, disability, death of a breadwinner, sickness, maternity and unemployment

##### *Universal (tax based)*

- the national public health care system

##### *Social assistance*

- cash benefits for the poor and services for the disabled and other vulnerable groups based on an assessment of need

Each of these subsystems has experienced difficulty in coping with the range and depth of social protection needs which have emerged during the process of transition. These needs are attributable not just to the severe economic crises and the political and humanitarian crises associated with the Nagorno-Karabakh conflict, but also to the need to relate to the restructuring of the economy - the development of the market economy, the growth of the private sector and the emergence of an informal economy. Azerbaijan is thus faced, on the one hand, with

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providing adequate social protection for an increased range of needs and, on the other hand, with combatting revenue evasion to ensure that sufficient resources are available to finance this programme.

The constitutional principles on social security have been incorporated in the legislation. In general, the laws authorise the Government to issue regulations which set out the details of implementation. The social insurance system covers practically the complete working population and their dependants. But although universality is sought, uniformity is not and the provisions permit special arrangements for certain groups such as through lower retirement ages.

The following sections describe key characteristics of the different subsystems of the social protection system, and analyse briefly their benefit experience on the basis of information available to the mission.

## 2.2. Administration of the social security system

The social security system is administered by the following institutions:

The **MLSP**, which is responsible for the implementation of social policy, analyses the current social situation, prepares new concepts and drafts laws. In addition, the Ministry carries out the administration of state care homes for the elderly, disabled and children.

**The local social protection branches** are responsible for the administration of social security benefits. They establish entitlements, calculate the entitlement and arrange the payments. They also keep the records of all beneficiaries. They also provide the social assistance services for the needy. The calculation of pensions is based on evidence of the period of employment in the worker's labour book and on the employers' certificates for details of reference earnings. The payment of benefit is made through local post offices and for working pensioners by their employers.

**The Social Protection Fund (SPF)** is responsible for financing of pensions and other social security benefits. It has 86 local offices with almost 1000 employees. The fund collects social insurance contributions and arranges transfers of income from the state budget and of expenditure to post offices and employers.

**The State Employment Service (SES)** with its local branch offices and, recently, together with 17 **labour inspection offices** (with 400 employees) is responsible for the administration of an unemployment benefit scheme, the payment of unemployment benefits and for providing a set of services for unemployed persons, including the provision of training.

**The Employment Promotion Fund (EPF)** is an independent financial institution to finance the implementation of the state employment policy. It is financed by resources from the national and local budgets, by voluntary payments and by compulsory contributions from employers at the rate of 2 per cent of the payroll.

**The Social Protection Fund for Disablement (SPFD)** has 51 local branches, which provide services and activities for 250,000 disabled person (e.g. health services, rehabilitation and vocational training, looking for new jobs, leisure activities, reconstruction of housing, etc.)

**The employers** provide payments of pensions to working pensioners, of cash sickness benefits and some other benefits.

It is evident that responsibility for the administration of social security is fragmented and requires a large number of staff. Weaknesses in the system are being exposed by the growth of private sector employment and increased labour mobility. This has implications for maintaining records of insurable employment and contributions and for identifying and enforcing liability. Computerized data bases for insured persons, beneficiaries (pensioners) and employers should be established to replace the reliance on employers' records and the labour book. This needs,



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however, to be preceded by a revision of administrative procedures and more fundamentally of the institutional division of responsibility.

## 2.3. Financing social security

The social security system is financed partly through social insurance contribution, partly through the state budget transfers, and from some other sources. The 1996 income of the SPF was 756 billion Manats. The social insurance contributions provided 48 per cent of SPF income and the state budget transfer 44 per cent. The other sources were the balance from 1995 (3 per cent) and exceptional assistance from the European Union (5 per cent).

The social insurance contributions are paid by employers, employees and self-employed. The rates of contributions collected by SPF are as follows :

- 35 per cent of the payroll from employers except in the agricultural sector,
- 25 per cent of payroll from employers in agriculture sector,
- 20 per cent of the declared wage for contracted employees,
- 1 per cent of wage for employees,
- 20 per cent of income of self-employed persons.

Besides the social insurance contributions collected by SPF local branches, employers are obliged to pay 2 per cent of the payroll to the EF, and 1 per cent of profit to the SPFD. (In order to finance health care and cash sickness benefit, the Government is discussing the possibility of introducing another special contribution based on the payroll)

There are relatively high penalties for late payment of contribution (0.1 per cent of the debt per day), or for undeclared contribution (50 per cent of the sum + 0.1 per cent per day). In spite of these penalties the compliance rate in 1996 was only 75 per cent of reported earnings. This is attributable to the difficult economic situation of state enterprises. Improvements in detecting and enforcing liability might provide an opportunity to decrease the contribution rate, which is seen as representing a disincentive to investment and for further development of the economy. Under-declaration of earnings, to avoid both tax and social security liability, is said to be widespread particularly in the private sector. In principle, workers are prepared to pay a higher rate of contribution but not to compensate for the loss of revenue attributable to evasion by employers.

The SPF is responsible for compliance but there are indications of a tendency to accept employers' payroll statements at face value and there is a need to ensure that inspection visits are both undertaken more regularly (every employer should be inspected at least annually) and more rigorously possibly with greater collaboration with the tax authority. There is a risk that a "culture of evasion" will develop as a by-product of the free market economy which will inhibit the development of the social protection programme which seeks to help those unable to take advantage of the new economic opportunities.

Full details of the income and expenditure of the SPF for 1996 are provided in Appendix 2.

## 2.4. Pension provisions

The social security system provides contingency related pensions in respect of old-age, invalidity and survivors as income maintenance. It also provides pensions based on years of service and social pensions according to the law of 23 September 1992 with some further amendment. (There is separate legislation relating to pensions for members of the armed forces)



The conceptual basis for the pension scheme is derived, in general, from that of the former Soviet Union legislation and the scheme needs to be restructured to correspond with the characteristics of a market economy. In addition, the transition economic crisis described above imposed an intolerable burden on the social protection system and, in particular, exposed weaknesses in the pensions system in that, on the one hand, pension levels were too low to be meaningful but, on the other hand, they were paid to persons who were still in full time employment or who could reasonably be expected to continue to work.

Reform of the system was inevitable and the MLSP has been developing the framework for a new pension scheme with the elements of a three tier structure in which there would probably be a mix of a basic pay-as-you-go tier, a mandatory probably defined contribution earnings related tier and voluntarily supplementary insurance.

Legislation to enable the establishment of supplementary savings in licensed private pension funds has already been enacted and it is expected that the first pension funds can commence operations during 1998 (although on a voluntary basis).

The legislation for the basic pension scheme will need careful consideration to ensure that it provides an effective anti-poverty guarantee and attention is drawn to the requirements of the international standards notably ILO Minimum Standards of Social Security (Convention No. 102 of 1952) which provide minimum guarantees as to replacement rates and which have been substantially incorporated in the standards of the European Union and the Council of Europe.

But while consideration is being given to the future structure of the pensions system, the Government has already taken steps to address some of the weaknesses in the present system in order to make the most effective use of available resources. Some important changes were introduced from 1 August 1997 (and others will follow from 1 August 1998) according to the law of 13 June 1997. The changes are summarized below:

1. The amount of pension depends on the number of years of covered employment and on average earnings. The changes in the formula relating to the calculation of the benefit has however, increased the linkage with individual earnings.
2. The process of increasing retirement ages has started with a phased increase of 2 years (to 62 for men/57 for women) over the next four years period.
3. The connection to the minimum wage was abolished and the overall level of the scheme will be based on the average wage in the economy (but instead of the statistical average the so called declared average will be taken, and thus for 1996 the Government declared 60 000 Manats as the average wage for the pension scheme instead of the official statistical value 85 000 Manats).
4. The amount of the pension paid to a working pensioner has been cut by 50 per cent.
5. The rules for pension adjustment have been changed (increase of average wage instead of increase of cost of living).
6. Some of the supplements have been reduced and some entitlements have been made more strict.

A more detailed description of the pension scheme is set out in Appendix 1.

## 2.5. Review of the pension system

*Although necessary, a comprehensive statistical and financial evaluation of the present system was not possible during the short mission, but the following summary highlights the principal features as understood from the information available.*



### *The ratio of pensioners to the active population*

The benefit experience of a pension system can be summarized by reference to its demographic and financial characteristics. Sixty per cent of all pensions are in respect of old-age, 13 per cent invalidity, 15 per cent for survivors and 12 per cent social pensions.

In 1993, the number of pensioners was 1.25 million : seventeen per cent of the population of 7.36 million. In January 1996, there were 1.24 million pensioners in a population of 7.5 million (16.6 per cent). This percentage is much less than in some central European countries in transition.

Given an active population of 2.8 million in 1996, the demographic burden of the scheme is about 43 pensioners per 100 contributors, which is much less than in Lithuania where it is 60 per cent, or in Ukraine 58 per cent, but on the other hand much higher than in some other countries such as Turkmenistan, where the ratio is only 24 per cent. It is projected that the ratio will increase in the near future, due to the ageing of the population and to a probable reduction in the formal sector labour force. This implies the need to introduce stricter entitlement conditions for the award of pensions<sup>2</sup>.

### *Pensionable age and early retirement*

Average life expectancy at birth is 69.3 years (74 for women and 65 for men). The difference in life expectancy between sexes is unusually large and emphasises the need to phase in equal retirement ages for men and women. The present situation with 5 years lower basic retirement ages for women is typical for eastern European countries, but should be eliminated in the future in accordance with developments throughout Europe.

But, it must be stressed that the inequality in pensionable ages is not an immediate problem compared with the need to reduce the number of early retirement cases. There are a number of preferential provisions which allow earlier retirement: the most numerous being the 4 - 10 years earlier retirement (in the age of 51 to 45) for mothers of 3 and more children. While the average number of children in the family is high, the frequency of very early retirement for women is also very high. These provisions increase the number of pensioners.

It is recommended that, as a medium term objective, provision for retirement under this public scheme should be on a uniform basis. Any special arrangements for particular groups which are considered desirable having regard to their occupation should be provided through supplementary occupational schemes or conditions of service negotiated between employers and workers and not included as part of a scheme which is based on principles of uniformity.

Until August 1997, there was no retirement condition in the scheme and pensions were payable in persons who were still able to work beyond pensionable age. 17 per cent of all old-age pensioners, some invalidity pensioners and years of service pensioners continue working. The ratio is of course even higher among those with preferential early retirement rights. In all these cases the pensions are paid by the enterprises together with wages. This advantage has been limited since August 1997, and now these pensioners can get only 50 per cent of their pension. This change will lead to important savings in the SPF budget particularly since the number of working pensioners is expected to decrease.

*Thus, in 1996 there were 178,000 working pensioners, who received their pension from employers (15 per cent of all pensioners), it is expected that in 1998 there will be only 119,000*

<sup>2</sup> If account is taken of the level of non-compliance, the active contributors fall to 1.69 million and the ratio increases to 72 per cent.



(11 per cent). The financial savings are expected to be even higher. While in 1996 the expenditure on pensions for working pensioners reached 74 billion Manats (21 per cent of pensions expenditure), for 1998 estimated expenditure for 1998 is only 56 billion Manats (only 9 per cent of planned pension expenditure).

*The impact of this measure was raised during the mission by representatives of trade unions who pointed out that in the context of low earnings a 50 per cent reduction in the pensions which supplemented these earnings was harsh.*

### *The level of pensions*

The generally very low level of pensions is an aspect of critical concern in the present social protection system. The generous pensions formula designed to produce high replacement rates has effectively been reduced by the consequences of inflation to almost a flat rate scheme where the level benefit is far below the minimum amount required to prevent absolute poverty. Average pension in 1996 was 25,540 Manats: only 7 per cent of the minimum consumption basket and 24 per cent of the average wage. It is clear that the income situation of pensioners is very difficult, especially for the oldest. In practice, there was no regular adjustment of pensions and this led to large differences between pensions depending on the date of award. In the legislation of 1992, it was provided that the pensions were to be increased quarterly after at least a 5 per cent cost of living increase, but in practice this has not been applied. The rule was then changed with regard to its linkage to the minimum wage, the indexation of which was far behind the inflation and the minimum wage was increased for the last time in February 1995 (to 5,500 Manats). The new legislation has introduced a new adjustment rule since August 1997 - according to the increase of average wage declared by the Government at least once a year. The last three adjustments took place in May 1995, in November 1996 and in August 1997 and led to an important increase in the real pensions level and a reduction of the great disparity between the level of new pensions awarded and the adjusted level of existing pensions.

It is not quite clear how the decisions on adjustment have been taken, but usually the pensions increase was coordinated with wage increases in state enterprises and the cost of the increase was probably decided having regard to the available resources.

### *Compliance*

This is another critical area. Officially, the compliance rate is put at 75 per cent, but this relates only to non-payment and not to the more difficult problem of evasion. According to figures provided by the State Statistics Committee and the SPF, contributions are being paid regularly in respect of only 60 per cent of employed persons (1.69 million). Economic difficulties have resulted in major public sector organisations delaying the payment of social insurance contributions. A similar problem exists in the private sector, but the impact is compounded by the following two additional features which provide the basis for significant evasion.

1. Many workers are employed on a temporary, casual or contract basis or are merely excluded from the scope of the social insurance scheme.
2. It is common practice to under-declare earnings in order to reduce liability for social insurance.

Non-compliance is attributable to the many factors listed below:

- not enough staff capacity
- insufficient priority accorded to inspection and enforcement
- poor financial situation of enterprises



- no direct connection between contributions and benefits
- lack of co-operation between revenue collection agencies
- possibilities for employers to deduct from the contributions the expenditures paid on social security benefits paid to their employees.

but the high payroll contributions associated with supporting the social protection system is a major factor which has encouraged the informalization of the labour market and the economy.

### *The contribution rate*

The cost of a defined benefit pension scheme is related to:

1. the demographic ratio (i.e., the ratio of the number of pensioners to the number of insurable contributors) - 43 per cent in 1996 -, and
2. the financial ratio (i.e., the ratio of the average pension to the average insurable earnings of the contributors) - 30 per cent in 1996

and, on this basis, the pay-as-you-go contribution rate could be 13 per cent in 1996. But, if the ratio is based on the number of active contributors, the demographic ratio increases to 72 per cent and the PAYG rate to 21.6 per cent. A contribution rate of 36 per cent, therefore implies that the level of earnings used for paying contributions are significantly lower than those used for determining the pension rate.

## 2.6. The short-term cash benefit provisions

The principal short-term cash benefits are paid in respect of loss of earnings due to absence from work because of sickness or maternity.

Sickness benefits are paid at a rate varying with the length of past employment, ranging from 65 per cent of last 2 months average earnings for workers with less than 3 years of service to 100 per cent for workers after 8 years. There is no waiting period.

The maternity leave is paid at a rate of 100 per cent of earnings for the period of 140 calendar days (70 days before and 70 days after the birth). After the expiry of the maternity benefit period, one parent can opt for parental leave during which they can receive a flat rate benefit until the child reaches the age of three years.

The expenditure on all cash sickness benefits reached in 1996 37 billion Manats, which represented only 0.3 per cent of GDP.

Type	Amount (bn. Manat)	No. of claimants
Sickness	15	123,000
Maternity grant	03	104,000
Maternity allowance	10	117,000

While the provision for maternity and parental leave are reasonable, the sickness benefit provisions for longer serving workers can perhaps be seen as too generous. The following proposals are therefore recommended:

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- a. the first two weeks of sickness should be covered not from the social insurance system, but by employers being required to pay wages directly to the employee.
  - b. for longer duration sickness, the rate of sickness benefit should be set at the uniform level of approximately 80 per cent without differentiation according to years of service,

This should enable a reduction in the contribution rate to be determined and the arrangement would provide for more effective control of short term incapacity claims.

## 2.7. The employment injury scheme

Under the governmental Order of September 1996, employers are obliged to pay to a worker who suffered an employment injury full compensation for loss of earnings for the period of unfitness for work until he recovers or is declared as disabled and also the compensation for partial loss of earning if his income from the job he is able to do is less than his income before the accident.

Employed persons are covered in the event of employment injury or occupational disease. Entitlement includes compensation for loss of earnings during temporary incapacity, medical treatment including general and specialist care, hospitalisation, laboratory services, transportation plus cost of appliances and medicines. Under the basic pension scheme the requirements for the minimum qualifying period is deemed automatically satisfied if a person is permanently disabled due to employment injury. Temporary incapacity benefit is paid at the higher rate of sickness benefit.

The necessity to take on a different type of work must be determined by a special medical commission, which should also recommend the type of a new job.

Besides the compensation for loss of earning, employers are obliged to provide any lump-sum determined together with any periodic benefit payments related to disability. The amount of the benefit depends on the percentage loss of working capacity and the average wage of the worker before the accident. The lump-sum payment cannot be less than the worker's annual earnings. The regular monthly payment is paid as well as other social benefits for which the person may be entitled (disability pension, etc.).

In the case of death due to employment injury, the benefits are paid to the surviving dependents as follows:

- dependant children until age 16 (18 if they are students),
- persons who receive old-age pension until death,
- disabled persons as long as they until they are disabled,
- non-working parents who care for a child under age 16.

The employer is also obliged to cover the additional expenditure for treatment and rehabilitation cost plus full cost of working rehabilitation.

It seems that the scheme works satisfactorily as long as the employer is able to cover his financial duties. But where the employer has financial problems or closes his activity the rights of workers would not be secured. This is more likely to occur with the development of private sector employment.

It is recommended that consideration should be given to either:

- a. establishing a separate social insurance based employment injury scheme financed by a small payroll based contribution to provide temporary incapacity benefit in respect of loss of earnings after the first two weeks, health care, disability pension (or lump sum in the case of partial disability) and survivor pension in the event of death, or



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- b. supplementing the existing sickness, disability and death provisions to provide for benefit to be paid without any qualifying conditions where the benefit entitlement related to an employment injury or occupational disease

It is important to design the scheme so as to encourage employers to take steps to prevent accidents and to provide for rehabilitation services to those disabled.

## 2.8. The unemployment benefit scheme

Unemployment benefit is financed from the Employment Fund to which employers pay a contribution of 2 per cent of their payroll. The basic condition for entitlement for the unemployment benefit is a requirement to register at the EF local branch office as able and available for work. Benefit may be reduced or suspended if the unemployed refuses 2 offers of work job or does not take advantage of training provided.

The benefit is paid for a total of 26 weeks plus an additional 2 weeks for every year of employment over 25 years (20 for women) subject to an overall maximum of 52 weeks. The amount of benefit depends on the average monthly earning (AME) in the last 3 months and on the length of unemployment. For the unemployed with 10 and more years of employment the benefit is, during the first 13 weeks, 75 per cent of AME and 60 per cent for an additional 13 weeks. For the unemployed with less than 10 years of employment the rates are 70 per cent and 55 per cent. For each dependant member of the family the benefit is increased by 10 per cent of AME, with the maximum being 100 per cent of AME.

The minimum benefit and the benefit for the first-time job seeker is 100 per cent of minimum wage which, since February 1995, has been 5500 Manats. There is effectively a maximum level of benefits since the level of pre-unemployment earnings taken into account must not exceed the average wages of the enterprise.

The unemployed older persons within two years of reaching retirement age (i.e., 58/53) are entitled to benefits equal to 100 per cent of old-age pension until retirement age.

The official number of registered unemployed has been increasing slowly and in 1996 it reached 31,000 which is only slightly more than 1 per cent of labour force. And only 6800 are receiving the benefit. On the other hand, the unofficial estimates of fully or partly unemployed is somewhere between 300,000 and 400,000. The reason for such a low officially registered unemployment is probably the level of benefits which does not motivate people to cooperate with the administrative requirements. Because of the difficult economic situation for many enterprises, the collection of employment insurance contribution is at a low level and limits the effectiveness of the scheme.

## 2.9. The family benefit scheme

The family benefit system displays features associated both with a universal benefits system and also with targeting as under a social assistance scheme. Thus there is a general entitlement to a birth grant and a maternity grant and also to a parental care allowance for a child up to 3 years. On the other hand, child allowances are now dependent on means and are related to the level of the minimum wage. The failure to increase the minimum wage has obvious implications for the effectiveness of this benefit.

The child allowances are only payable to families where the income per head is less than 16,500 manats (19 per cent of the average wage). The amount of benefit is 9,000 manat per month and the benefit is paid in respect of children until they reach age 16. The strict targeting of the benefit meant that the number of families receiving the benefit diminished. While in 1996



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the benefit was paid to 1,756,000 families, it is expected that in 1998 only 1,450,000 will be entitled and the expenditure on child allowances in 1998 are expected to be practically the same in nominal value as in 1996 (143 billion Manats, i.e. 1 per cent of GDP).

## 2.10. Public health care

*Although brief discussions were held with the Deputy Minister of Health, there was insufficient time within the mission to study at any depth the health care system.* Anecdotal evidence indicated severe shortages of equipment and drugs, low take-up rates and a well established recognition that medical care necessitated an unofficial but obligatory payment for services provided. A legal framework for the establishment of a health insurance scheme has been prepared by the Ministry of Health and pilot projects are planned.

The health care system is basically the classical public system still prevailing in most former planned economy countries. As in most other countries of the former Soviet Union, the health care infrastructure appears extensive compared to, for example, European standards. The country had in 1996 763 hospitals with 73500 beds which gives 9.8 beds per 1,000 persons (compared to 11.0 in Germany, 8.0 in the Czech republic, 6.8 in the UK, or 5.3 in the USA), more than 1722 poli-clinics and ambulatory centres and also the number of physicians 2.9 per 1,000 persons was relatively high (4.4 in the Ukraine, 4.0 in the Czech republic, but only 2.8 in the former West Germany and 1.4 in the UK).

The material and technical base of health service institutions remains poor. All health care services used to be essentially free. There are no earmarked taxes or contributions for health, very little cost recovery and no voluntary medical insurance. Over the last years, there seems to be interest in having a health system financed by a mixture of general resources, a payroll tax or contribution, and some direct fees. The new legislation should enable further fee for "non-essential" services.

The system displays the symptoms that can be observed also in other countries, i.e., the lack of efficiency indicated by poor quality of care provided by unmotivated staff in badly maintained facilities. There is chronic and huge under-funding of the delivery system. Salaries of health care professionals are low. There is critical shortage of non-staff inputs, such as drugs and medical technologies. It results in deteriorating of access to appropriate health care.

On the other hand, it is becoming quite common that the services are provided for direct payment. While the majority of the population seems to accept the principle of co-payment it should be made part of the official scheme and this may be more appropriate as a first step.

Certainly, reflection is urged with regard to the establishment of another social insurance fund not merely because of the increase in payroll contributions but because of the implicit requirement for another institutional infrastructure which would be obliged to cover the tasks of collecting and recording contributions etc.

## 2.11. The social assistance scheme

Social assistance benefits consist of income support benefits in cash and in kind and social care. Under former economic and political system social assistance benefits played only a minor role. The formal full employment policy, comprehensive social security system and price subsidies had the effect of minimising the number of persons becoming dependent on social care. But the situation has changed substantially not only because of political and economic reform but because of adverse economic experience such huge inflation and the deterioration of real income of the majority of the population below the poverty line.



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Social assistance has become for some groups of population the only or very important source of income. A number of special benefits were introduced, e.g. for non-working pensioners as a compensation for the removal of price subsidies, or other benefits which are normally part of universal schemes were made part of social assistance scheme (child allowance). On the other hand social pensions which are unrelated to the payment of contributions are an important part of current pension scheme instead of being part of social assistance.

The social assistance system is based on a social security law of 1 January 1993 which was subsequently amended on 1 May 1996 by the abolition of the linkage between social assistance benefits and the minimum wage. According to statistical sources, expenditure on social assistance in 1996 accounted for 2.7 billion Manats. Social assistance benefits are provided to the needy by local welfare offices from state budget transferred through the SPF and also by enterprises. The right for and value of social assistance under the present scheme is determined much more by the social group of the person than according to his or her real needs. Targeting mechanisms are weak and inconsistent. Social security branch offices are obliged to identify needy families and applicant's requests are screened by an inspector but without a home visit. Some assistance in the process is provided through social organisations such as the 'Aksakals' which are a traditional community-based organisation.

Disabled persons, refugees and persons who have lost a family member in the Karabakh conflict receive a monthly benefit of 25,000 Manats while those over age 70 receive 20,000 manat per month and those over 75 receive an additional supplement. Social assistance is determined by reference to wage income and other income or assets is disregarded. A family with at least one child under age 16 is considered poor if its household income is not more than 16,500 Manats.

The MLSP operates 10 state-care homes, which are not very developed, for more than 1260 persons. In addition, the SPFD has started providing a number of services for disabled people to improve their living conditions, their health care, their access to rehabilitation and to suitable employment.

The existing arrangements for the provision of social assistance lack consistency and there are strong indications that not only are the resources allocated insufficient to adequately meet social protection needs they are not allocated in the most effective way. Targeting needs to be improved and focussed on the most vulnerable groups. This implies a more careful selective screening process with perhaps some reference to proxy indicators of poverty which indicate a lifestyle inconsistent with poverty. Family support is traditional in Azerbaijan it is envisaged within the Constitution and it should perhaps be accorded greater weight in the social assistance programme.

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## Chapter 3

### Future perspectives and recommendations

#### 3.1. Providing a framework for reform and development

Although some changes have been made, the social protection system in place in Azerbaijan is essentially the same as that which operated during the Soviet era and reflects the characteristics of a centrally planned economy in which the state plays a dominant role in providing comprehensive social protection.

The process of transition has proved particularly difficult but Azerbaijan has clearly embarked on the path of a market economy and has the resources and outlook to do this successfully. Consideration should therefore be given, as a medium-term objective, to develop a social security system which complements this change and which therefore recognizes :

- increasing development of the private sector
- increasing labour mobility
- increasing competitiveness
- increasing individual responsibility

and, above all, the need to balance social protection provision with both needs and resources

The present system has proved unable to provide adequate social protection in recent years in the face of high inflation and the dramatic fall in GDP and in real incomes. As a consequence, pensions have also fallen below subsistence levels with adjustment both irregular and inadequate.

Existing obligations will have to be honoured but significant changes will need to be made to the structure of the social security system over a period of time and within the limits set by economic development. Some steps have already been taken to ensure that resources are more effectively targeted by increasing retirement age and by limiting pension entitlement for those still employed but these should be seen as paving the way for deeper structural reforms.

A strategic approach is needed so that individual reforms can be seen as part of a long term goal. And this implies the need to take into account all the elements of social protection system. For example, the development and financing of health care should be seen as a major component of the social protection system.

Azerbaijan is one of the countries that has recognized in its Constitution the right of its citizens to social security, a factor recognized as a human right in the United Nations Universal Declaration of Human Rights (1948). Subsequently, social security principles were embodied in major Conventions and recommendations of the ILO adopted between 1944 and 1988 and, in particular, the Minimum Standards of Social Security Convention (No.102),1952. These same principles have been incorporated in the European Code of Social Security adopted by the Council of Europe in 1964 and revised in 1990.

These international instruments are flexible but they also contain some guiding principles which need to be taken into account in the process of reform and which are pertinent to the situation in Azerbaijan. These guiding principles are:

- equality of treatment between nationals and non-nationals as well as between men and women
- solidarity including collective financing to ensure that the most vulnerable are protected
- compulsory insurability



- the overall responsibility of the State
- democratic management - participation by workers and employers representatives in the management of social security schemes.

### 3.2 Re-defining responsibility for social protection in Azerbaijan

It should be noted that although the State has the overall responsibility for ensuring adequate social protection for its citizens this should not necessarily imply direct provision from public resources. The Government, employers, individuals and families should all play a part both in financing and providing social protection and the basis of the new social protection strategy should be a new division of responsibility on the lines of the following.

1. **A safety net** - a basic level of social protection which should be **provided by Government and financed from taxation** and which should ensure the provision of a basic income consistent with a minimum consumption basket and access to basic health care. This should be provided free to those who are unable to work and whose income and resources are below a prescribed level.
2. **An anti-poverty component** - those who work and their employers should contribute in accordance with social insurance principles to a fund which would provide a **modest anti-poverty** income consistent with minimum international standards during periods including retirement when they are unable to work. (It is considered that workers should contribute for their own social protection and should therefore have the right to participate in the process of developing and managing the social protection system). The same approach would provide the basis for financing access to adequate medical care through an approved provider.
3. **An earnings related component** providing a higher level of income replacement (and health care) and **financed by and directly based on the contributions of the individual worker and his employer.**

Within this outline a large number of policy issues would need to be addressed including those relating to the transition from the present system. But it is considered that the overall system should contain a mixture of the basic elements of:

- direct Government support to the most vulnerable
- collective responsibility and support between workers and employers for a modest level of social protection
- individual responsibility for a higher level of protection

A key issue relates to the scope of the anti-poverty component based on social insurance principles. At present, this is the dominant element in the social protection system and it is recommended that it should remain the core of the new system, but

1. it should be more distinguishable than now from social assistance which should be more focused on the poor and vulnerable.
2. it should provide, in relation to average earnings, a lower replacement rate than at present
3. it should be supplemented by new arrangements under which benefit would be based on individual financing rather than on the pooling of contributions.

It is envisaged that, in order to conform with international standards, the replacement rate should not be below 40 percent of average earnings for a person who had been insured for 30 years. Given the low level of average earnings at present, immediate implementation would result in the safety net level available under the first tier being applied. But, it is considered essential for entitlement to be based on collective contributions and social insurance principles and thus as average earnings increase the anti-poverty tier will come into effect.



## Changing the balance of social protection

Present situation	Manats per mon.
Minimum consumption basket (MCB) (Subsistence level)	360,000.-
Average wage (AW)	85,000.-
Average pension	25,000.-
Minimum pension (30 per cent of AW)	25,500.-
Social pension (100 per cent of minimum wage)	5,500.-
<b>Objective</b>	
Average monthly earnings (individual) AME	AME
Basic anti-poverty component	40 per cent AME+
Supplementary earnings-related component	40 per cent AME +/-
Minimum pension	30 per cent AW
Social pension/Social assistance (Safety net)	MCB

It is understood that some consideration has already been given in Azerbaijan to the establishment of a system based on individual contributions: usually referred to as the defined contribution system. This system may take many forms but typically involves each insured worker accumulating pension contributions in an individual account with the contributions invested to provide interest. At the time of retirement, the balance in the account is converted into an annuity. Clearly under such an arrangement the social protection is open to certain risks related to the investment return on these contributions in relation to inflation and on the price of the annuity at the point of retirement. At present, the capital market in Azerbaijan is undeveloped and although general economic performance has improved, it is of course difficult to predict over a working life time how such a scheme will fare in producing an adequate income on retirement. The structure of any defined contribution system therefore needs careful study to ensure that these risks are minimized and to examine the extent to which they can be underwritten by Government guarantees. But it is considered essential to devise a pension system which balances risks and under which a defined contribution system is underpinned to an extent by a scheme based on social insurance principles of collective responsibility.

The public pension scheme can ensure only modest replacement rates for middle and high income people. With increasing differentiation in incomes the demand for supplementary schemes will grow. A number of preconditions have to be fulfilled before funded private pension schemes can be established. These include a legislative framework providing clear and enforceable rights and obligations, the introduction of modern accounting and auditing standards, a set of prudential regulations for financial institutions and markets and training in modern financial skills. The development of such funds is also dependent on price and trade liberalisation, macroeconomic stability, tradeable financial market instruments, etc. The legislation adopted already in 1997, so that the voluntary pension scheme may start to operate in 1998, is only the first step and it will be necessary to proceed carefully in order to minimise the risks for participants. The successful development of the new voluntary private pension fund scheme will provide an indication as to the feasibility and timing of the introduction of a mandatory system.

Thus, the final structure of the future social protection system requires more comprehensive analysis but this need not inhibit consideration of other reforms which aim to:



- rationalize the institutional arrangements for the policy and administration
- increase administrative efficiency
- contribute to the establishment of the division of responsibility described above
- improve the level of social protection
- increase income from contributions

### 3.3 Institutional reform

There is a need to rationalize the institutional arrangements for the administration of social security for the following reasons:

- to clarify responsibility for policy
- to promote greater accountability
- to provide more efficient use of resources
- to simplify administrative obligations for employers and insured persons

There are three separate funds responsible for the collection of social security contributions, and proposals within the Ministry of Health to establish a fourth. The SPF collects contributions but has no responsibility for and no control over benefit payments. There seems to be overlaps between the Social Protection Fund for the Disable and the MLSP. The labour inspectors are responsible for the collection of the unemployment contribution but the Unemployment Fund is responsible for the administration of the scheme. Non-compliance either in the form of non-payment of declared contribution liability or more significantly in the form of undeclared earnings is a major problem which would seem to be attributable to a lack of support for the scheme and not merely a reaction to economic difficulties.

The existing arrangements were designed to fit a system where people were working only in the public sector, where they did not change employment very often and where there was a form of social control; they do not fit the circumstances of a market economy. It does not fit a market economy where significant growth is anticipated. It is essential for all those who are liable to contribute to the scheme and who are insured by the scheme to be identified and registered and kept track of. This requires the establishment of a computerized data base for both employers, insured persons and beneficiaries and for the allocation of a unique identification (Social Security) number to each person. It also requires breaking away from the reliance on employers to paying benefits and on individuals to maintain their employment record. This will have to be done, to a great extent, by a modernized social security administration.

Having regard to the above, consideration should be given to the following:

- the MLSP to be responsible for all policy and legislation aspects relating to social protection other than health care
- the SPF to collect contributions from employers and insured persons in respect of pensions, employment injury and unemployment benefit (the contribution in respect of the latter should be collected on behalf of the Unemployment Fund and transferred immediately to that fund)
- the SPF to also assume responsibility for the determination of entitlement and the payment of the benefits currently administered by the social security branch offices of the Ministry (thus the SPF should be responsible for both payment and collection but policy and legislation would remain the responsibility of the MLSP)
- the SPF to be accorded a greater degree of autonomy to enable it to undertake the tasks of administering a modern computerized social security system



- the SPF to be responsible for the administration of both the safety net and anti-poverty components of the restructured social security system and in view of the closer linkage between the payment of contributions and entitlement to benefit and to increase the application of democratic principles a supervisory board should be constituted responsible to the Minister of Labour and Social Protection which would contain representatives of government, employers and workers. Day to day administration would remain the responsibility of the Chairman of the Fund and he should also attend the Board meetings.
- Rehabilitation services to be provided by the SPF and state-care homes to be administered directly by the MLSP
- there is a need to ensure both public consensus and understanding with regard to the reform of social security: the existing provisions are complex and lack transparency and it is essential that both employers and individuals understand and accept the principles of reform particularly if an important element of that reform is to transfer some responsibility to individuals for their own social protection. Consideration should be given to establishing a national tripartite committee to participate in the reform process.

### 3.4 Administrative reforms

The issues raised in the previous section as regards the institutional arrangements for social protection would clearly need to be carefully considered in the light of a wide range of factors. Priority should be given to reforms on the administration of social security. There are a number of weaknesses which could and should be addressed regardless of structural reforms although, to an extent, the effectiveness of these will depend on the institutional reforms discussed above. Thus,

- a. compliance and the process of identification and enforcement is a major problem, although the extent of this is difficult to quantify. Clearly, the economic difficulties are a major factor as are perceptions as to the general weakness of the scheme. But it seems that the problem is common to tax collection and efforts must be made to increase collection through a more aggressive policy and more thorough inspection procedures which look behind the basic information provided by employers. Audits could be conducted in collaboration with the tax collection system to verify the number of employed persons and the flow of funds through the business and linkages could be established between the award of licences and compliance performance. The extension of coverage to the self-employed and to all categories of workers will only intensify the problem and further undermine the credibility of the scheme unless this issues is addressed.
- b. individual records must be established for all insured workers, a social security number allocated and procedures established for the transfer and recording of information on earnings, employment and contributions to these accounts on a monthly (or perhaps three monthly basis).
- c. beneficiaries who are dissatisfied with the decision of the social security system should have the right to appeal to an independent authority.
- d. procedures for the determination of entitlement to social assistance (the basis for the safety net) should be reviewed to establish the most effective and practical mechanism for determining poverty and for identifying whether individuals fall within this definition.



### 3.5 Benefits reform

A number of modifications to the existing scheme with regard to benefit entitlement would seem desirable, in accordance with the objective of providing entitlement in return for and based on contributory membership, and to distinguish provision linked to the payment of contributions from benefit based on need. Thus, consideration should be given to the following aspects:

1. The demographic structure of the population does not call for an immediate further increase in basic retirement age. The 2 years increase of retirement ages between 1997 and 2000 is a good solution. After the year 2000, there will be a need for a further increase, but this should be preceded by an actuarial study taking into account the development of demographic indicators and the labour market. But it is strongly recommended to phase out the provisions for preferential early retirement especially for professions in the List n. 2, but also some in the List n. 1, - for mothers of many children and for years of service pensions.
2. As living conditions improve, it will be necessary to consider reducing differences in retirement ages and qualifying periods between the sexes: the present disparity seems unjustified in view of women's higher life expectancy.
3. Pensions should be adjusted regularly based on increases in average earnings. This figure should be determined annually.
4. The earnings-related pension formula should be modified to provide for a closer linkage with contributions and for incentives to delay retirement, on the following basis:
  - decreasing the basic percentage rate (60 per cent at present)
  - removing the percentage maximum for additional years of employment ;
  - provide for an actuarial deduction of 6 per cent for each year of optional early retirement and for increases for each year of delayed retirement ;
  - extending progressively the reference period for the calculation of average earnings and eventually for the full period of insurable employment (this implies the need, however, to index earnings with regard to changes in the level of average earnings);
5. The invalidity pension should be based on years of employment, but also on the potential years of employment until normal retirement age, in order to make the amounts of old-age and invalidity pensions (and also survivor pensions derived from invalidity pensions) comparable. The pension for an invalid person of Group III should be paid only if the earnings of such a person are substantially lower than before.
6. The widows/widower pension should be payable without any other conditions for a period of one year after the death of the spouse (or the funeral benefit should be substantially increased) and the limit on the total percentage amount of survivor pensions should be revised so that the total amount paid should not exceed the pension entitlement of the deceased). Consideration should also be given to progressively:
  - removing entitlement to pensions and other benefits to those who have not paid contributions in accordance with the qualifying conditions
  - requiring employers to be responsible for the payment of sickness benefit for the first 14 days of incapacity and standardising the level of benefit regardless of length of service
  - withdrawing entitlement to resort and recreation facilities



7. The system under which liability is imposed directly on employers to provide compensation in respect of the consequences of employment injury or occupational is not an effective form of social protection particularly where many workers are employed in the private sector and are likely to change employment. Temporary incapacity for the first 14 days could be left as the responsibility of employers but longer periods of temporary incapacity and in particular permanent disablement and death cases should be brought within the scope of a separate branch of the social insurance scheme which would ensure that entitlement was correctly determined and that benefits were made on a periodic payment basis throughout the contingency. (Alternatively, the existing arrangements which provide entitlement to invalidity benefit or survivor benefit could be extended to cover employment injury related disablement and death with special modification of the qualifying conditions to remove requirements in such cases for a minimum period of insurable employment).

### 3.6 Technical assistance and training recommendations

The following recommendations reflect the need for the general upgrading of the social security system both as regards the benefit structure and its administration having regard to the conclusions and recommendations set out above. While it is envisaged that this technical assistance will require the services of international consultants, particularly in the actuarial, administration and legislation fields, it is considered that the technical assistance should take the form of capacity building in which specialist consultants work with national officials to carry out the studies so that there is both a transfer of expertise and a specific output related to the needs outlined above. It is considered that the recently established Institute of Labour and Social Policy Research where special studies are already being undertaken should, in particular, be involved in this process together with staff of the MLSP and the SPF.

In the context of the above, the following technical assistance inputs are proposed:

1. A comprehensive evaluation of the present structure of the social security system including an analysis of present and projected social income and expenditure linked to training in social security planning, standards and legislation and in the preparation of a social budget and leading to the formulation of proposals for structural reform the design of new schemes, their scope and their costing and a schedule for implementation.  
*Estimated duration* - 6 months with training (external/internal) on social security planning, social budgeting and actuarial techniques
2. Special study on compliance and enforcement and training for officials, to include a review of the legislation and penalties and an assessment of the scope for collaboration with other revenue collection agencies.  
*Estimated duration* - 3 months with training (external/internal) in compliance and enforcement techniques
3. Study to assess the implications and methodology for the establishment of a national data base for social security contributors and beneficiaries in which each insured person would be identified by a unique social security number under which an individual record of employment, insurable earnings and contributions would be maintained. Such records to be maintained by a restructured social security administration to replace the existing reliance on employers. The assessment to include the computerisation, staffing and costing implications and the development of a timetable for implementation and of the necessary revision of the legislation.  
*Estimated duration* - 4 months.



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4. Special study to rationalize the system of allocation of assistance to the poor to include an identification of poverty, determination of the minimum consumption basket (MCB), the relationship between the MCB and the level of a new social assistance scheme. The design of a social assistance scheme including the mechanics for assessment of entitlement, the administrative system and projections as to costs.  
*Estimated duration* - 6 months. Training (external/training) on techniques for measuring poverty and the administration of social assistance schemes.
  5. Design and feasibility study including costing of an employment injury benefit scheme  
*Estimated duration* - 2 months including training on employment injury concepts and rehabilitation services.
  6. Assistance in the drafting of social security legislation to include a review of the legislation and an identification of weaknesses with a view to revision and consolidation.  
*Estimated duration* - 2 months including training on social security drafting, legal principles and international standards.
  7. Some language training to facilitate participation in international social security studies.

The International Labour Office would be pleased to work with the Government of the Republic of Azerbaijan and any other agencies in the implementing of any of these technical assistance projects, subject to donor support being found. Detailed terms of reference including inputs can be prepared as required.

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# Appendix 1

## Summary of provisions of social security pension scheme

### 1. Coverage

(no change by 1997' amendment) :

Employees in employer/employee relationship and self-employed persons

Persons who are studying in a secondary school or an university or post-graduate studies;

Persons performing military service;

Persons disabled in connection with performance of state duties;

Persons caring for an disabled of group I or disabled child under 16 years of age or person of age 75 and more;

Persons receiving cash sickness or unemployment benefits;

Woman caring for a child under three years (maximum 6 years);  
and some others.

### 2. Average monthly earnings - AME- (for the calculation of pension entitlement) :

The average monthly earning (AME) is defined as a monthly average of the last 24 months or of any continuous 5 year period during the whole career, whichever is the most favourable. The earnings are indexed according to the increase of average wages in the past. From the result the average of up to 10 times minimum wage (MW) is taken fully into account .

After 1 August 1998 the average will be taken only up to 3 times the average wage (AW) in the country as declared by the Government.

When the pension is awarded, every two years the average earnings (and the pension itself) can be recalculated, if it is advantageous for the beneficiary.

### 3. Old-age pension

#### a) *Qualifying conditions*

The 1997' amendment has introduced a 4 years transitional period for increasing the retirement ages by 2 years (from August 1997 to August 2000) during which the retirement ages will increase by 6 months a year), with exception for retirement ages of women with many children.

Man: at the age of 60 +2 after 25 years of employment.

Woman : at the age of 55 +2 after 20 years of employment.

*Exceptions for professions in prescribed occupations (hazardous and unhealthy jobs) :*

List n.1 Hazardous occupations: Retirement age 50/45 +2 after 20/15 years of employment, out of which 10/7.5 in listed profession.

(The provision that persons not having completed the prescribed 10/7.5 years can retire earlier by 1 month for each completed month of such work has been abolished by the 1997' amendment)

List n. 2 Unhealthy occupations : Retirement age 55/50 +2 after 25/20 years of employment, out of which 12.5/10 in listed profession (20/15 or 25/20 in some professions).



(The provision that persons not having completed the prescribed 12.5/10 years can retire earlier by 1 month for each 2.5/2 completed months of such work has been abolished by the 1997' amendment)

Exceptions for other professions : Retirement ages 55/50 + 2 for air traffic personnel, women in textile industry, women working as tractor drivers and similar heavy equipment and some others.

**Woman with many children :**

Retirement age 51 for 3 children and 16 years of employment.

Retirement age 50 for 4 children and 15 years of employment.

Retirement age 45 for 9 children and 10 years of employment.

Retirement age 50 for 10 children with no qualifying period of employment or at any age with 10 years of employment.

**b) Benefit formula**

Until July 1998 : pension consists of two parts, the flat rate part and earnings related part

flat rate part = 100 per cent of MW

earnings related part = 50 per cent AME plus 1 per cent AME for each year of employment in excess of required minimum (25/20 years or less for preferred professions).

Minimum pension = 100 per cent MW

Maximum pension is not defined

Partial pension for persons with less than required number of years (but with at least 5 years) in proportion to number of years below required; minimum = 85 per cent MW.

After July 1998 :

60 per cent AME (70 per cent AME for professions according to List n.1, 65 per cent AME for List n.2)

plus 2 per cent AME for each year above minimum required number of years.

Minimum pension = 30 per cent AW

Maximum pension = 85 per cent AME (100 per cent for list n.1, 90 per cent for list n.2)

**Supplements:**

- for non working pensioner who supports disabled family member 50 per cent of the minimum old-age pension for each such person,
- for single pensioners older than 76 years 50 per cent of minimum old-age pension (20 per cent AW after July 1997),
- for disabled of I.(II., III.) group 250 per cent (200 per cent, 150 per cent) of minimum old-age pension (100 per cent [70 per cent, 50 per cent] AW after July 1997),
- for war veterans and rehabilitated persons 100 per cent of minimum old-age pension (50 per cent AW after July 1997),
- and some others.

All above mentioned supplements can be provided simultaneously.

Limit for working pensioners : Until 1997 none, after July 1997 the working pensioner can receive only 50 per cent of the pension.

Adjustment : ad hoc by a Presidential Decree according to development of cost of living, after July 1998 according to the development of AW.

## 4. Invalidity pension

### a) Type of invalidity

Group I : fully disabled, permanent care necessary

Group II : total loss of working capacity

Group III : partial loss of working capacity

(The precise description is defined in the decree "On basic criteria for entitlement to invalidity".)

The medical-labour evaluation commissions determine the group of invalidity and the duration.

### b) Cause of invalidity

Employment injury or occupational disease or any other reason or invalidity in youth

### c) Qualifying conditions

No in the case of employment injury or occupational disease or under the age of 21,

1 year of employment between 21 and 23 years,

1 year of employment plus 3 months of employment for each year above 23 years of age.

### d) Benefit formula

The rate of benefit does not depend on employment record.

#### *Till July 1998 :*

Group I - 100 per cent of MW and 60 per cent of AME

Group II - 100 per cent of MW and 40 per cent of AME

Group III - 50 per cent of MW and 25 per cent of AME

If the person (only Group I or II) has number of years of employment required for old-age pension, then the formula is the same as for old-age.

Minimum pension = 100 per cent (65 per cent for group III) of minimum old-age pension, higher rates to some special groups (injured in 1990' events , or in Chernobyl and Karabakh conflicts).

#### *After July 1998 :*

Group I ( II, III) - 70 per cent (50 per cent, 30 per cent) of AME

Minimum pension = 150 per cent (100 per cent, 70 per cent) of minimum old-age pension

Partial pension in proportion to number of years of employment, minimum = 85 per cent MW(= social pension after July 1998).

No limitation for working pensioners.

Higher pensions to the invalids of war (150 per cent MW + 70 per cent /50 per cent, 30 per cent/ of AME, after July 1998 80 per cent /60 per cent, 40 per cent/ of AME .

Supplements similar to supplements to old-age pensions.

## 5. Survivor pensions

### a) Qualifying conditions

Deceased breadwinner' dependants :

- children, brothers, sisters, grandchildren under the age of 18 (students till 23 years),
- parents, widow or widower above the retirement age (60/55+2) or invalid or caring for the child of deceased under the age of 8 and non working,
- grandparents in some cases.

Deceased person had at least required years of employment necessary for invalid pension.



## *b) Benefit formula*

### *Until July 1998 :*

50 per cent of MW and 25 per cent of AME of deceased breadwinner for each dependent, but not less than the social pension (no total limit for all dependants).

For full orphan 50 per cent of MW + 50 per cent of sum of AME of both parents.

### *After July 1998 :*

30 per cent of AME of deceased breadwinner for each dependent, 60 per cent of AME for full orphan.

Minimum pension for disabled and single mother

- 80 per cent of minimum old-age pension for each disabled,
- 100 per cent of minimum old-age pension for single mother.

No limitation for working pensioners.

## 6. Years of service pension

### *a) Qualifying conditions*

Required number of years served in specific profession :

- aircraft personnel after 25/20 years of service (in some cases in the age of 50/45, or 55/50 after 10/7.5 or 20/15 years of service),
- seamen and harbour's personnel after 25/20 years of service,
- teachers after 25 years and physicians after 30/25 years of service.
- artists after 30, 25 or 20 years

Retirement from profession is necessary, but it is allowed to work in any other profession (after July 1998 the possibility to work and to receive the pension will be less advantageous).

The possibility to retire after 35/30 years of employment with condition of termination of any labour activity will be abolished after July 1998.

## *b) Benefit formula*

### *Until July 1998 :*

The same as for old-age pension.

### *After July 1998 :*

60 per cent of AME + 1 per cent of AME for each year of service above required minimum number.

Minimum pension = 100 per cent of minimum old-age pension.

Maximum pension = 80 per cent of AME.

## 7. Social pension

### *a) Qualifying conditions*

Person who is not working and not covered by any other pension, and is invalid, or older than 65/60 years, or orphan under the age of 18 years, and some others .

### *b) Benefit formula*

100 per cent of MW for invalid of group I ,

80 per cent of MW for invalid of group II, man older 65, woman older 60 and for orphan,

65 per cent of MW for invalid of group III (50 per cent after July 1998).

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(After July 1998 the minimum old-age pension instead of MW will be used)

## 8. Military pension

### *a) Qualifying conditions*

25 years of military service, or the age of 50 years and 25 years of employment out of which minimum 17.5 years of military service.

### *b) Benefit formula*

60 per cent AME plus 2 per cent AME for each additional year in excess of required minimum; maximum for this being 75 per cent.

Special increase for invalidity caused during the military service and in war.

## 9. General provisions

A person, who fulfilled the qualifying conditions for more than one pension, has to choose only one pension. Pensions are not awarded to persons living permanently abroad. If the pension was awarded before permanent departure, a lump-sum of six months benefit is payable, unless a bilateral agreement has been signed. The full amount of pension can be repaid upon return.



## Appendix 2

### 1. Social Protection Fund : Income and expenditure 1996

Income	'000 Manat
1. Surplus as at 1 January	21,870.0
2. Social insurance contributions	374,863.5
3. Support from E.E.C.	37,721.8
4. Budget support	340,000.0
5. Other income	1,100.0
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Total	775,555.3
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### 2. Social Protection Fund : Expenditure 1996

Item	No. of beneficiaries	Amount '000 Manats
1. Pensions: retired pensioners	1,031,400	295,413.2
2. Pensions: working pensioners	178,400	74,322.7
3. Family allowances (children up to age 16 or 18)	1,756,100	143,026.7
4. Parental leave benefit	117,000	9,885.7
5. Child benefit for armed forces	3,600	382.4
6. Allowance for non-working mothers with 3 children under age 16	235,000	1,550.3
7. Funeral benefit	32,300	465.6
8. Maternity grant	103,700	3,301.5
9. Maternity allowance	123,500	8,737.8
10. Medical		15,462.0
11. Sickness benefit	4,355.3	14,740.8
12. Support for single parent families	1,600	17.9
13. Social assistance for families with children under age 16	1,792,800	42,909
14. Social assistance for pensioners	1,031,400	125,782
15. Persons disabled in Karabakh conflict	5,800	2,665,900
16. Assistance to veterans of Second World War	59,800	8,153,800
17. Agency charges to Post Office		1,924.5
18. Operational expenditure		36,813.5
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Total:		775,555.3
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