

PENSION SYSTEMS REFORMS IN MACEDONIA: CAUSES, CONDITIONS AND BENEFITS

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Abstract

Pension systems in most countries in the world are in crisis. In Macedonia, the reasons for the crisis in the pension system are generally of socio-economic nature. The pension system reforms in the country are aimed in establishing a new model of pension and disability insurance. Preparations for the reform of the pension system in the country began in 1993 and radical reform was implemented in 2006 with the introduction of the second pillar and another in 2009 with the introduction of the third pillar. The purpose of the paper is making analysis of the main causes, conditions and current and prospective developments in the pension system in Macedonia. The benefits of the reformed pension system in terms of individuals and in terms of the pension system can be very effective for the whole economy.

Key words: *Macedonia, pension system, reform of the pension system*

1. INTRODUCTION

"The most perfect system of government is able to achieve well-being of the highest level, which realizes the greatest possible social security and largely political stability" (Shunderikj 2009, p.83). Social security is the responsibility of every society of individuals to provide for the satisfaction of basic necessities of life, especially in the case of loss of ability to those people that cannot independently support themselves. In other words, society ensures its members through a variety of public measures against the economic, commercial and social disasters that would otherwise hit them for loss or substantial reduction of earnings caused by illness, accident at work, unemployment, disability, old age or death (Faculty of Law-Zagreb 2014).

Social Security is a form of social protection that employees and their family members are guaranteed the right to support itself and that covers health insurance, pension and disability insurance and insurance in case of unemployment. Macedonian Constitution (The Constitution of the Republic of Macedonia, Articles 34 and 35) guarantees the right to social security and social protection of the citizens, and the Republic of Macedonia obligation is to care for the welfare and social security of citizens on the basis of the principle of social justice. Since this law grounded in constitutional provisions, derives the right to pension and disability insurance as one of the fundamental rights of citizens.

Pension insurance is a branch of social security of workers with which the persons employed by them and other categories of workers are provided with the acquisition of the right of retirement, and members of their families are provided with the acquisition of the right to family pension. The pension insurance as part of social insurance is very important for individuals and families who have limited financial means. Therefore, the social insurance is seen as basic financial protection, rather than a source that provides a high standard of living.

Individuals can take the initiative if they want a full financial security. In fact, they may appropriately conclude life insurance which will cover expenses in case of death, health insurance coverage for treatment in case of illness, as well as establish a good pension scheme which will provide the desired level of living standard when it comes to loss of revenue based on unemployment (Boyko et al 1996).

2. REFORMING THE PENSION SYSTEM - CAUSES

Pension insurance rights are exercised by the pension system. The pension system constitutes the legal framework that regulates the insurance risk of old age, disability or death, as well as administrative and institutional arrangement and implementation of the system of pension insurance.

Pension systems in almost all countries in the world are in crisis. There is a marked difference in the problems associated with the operation of pension systems in developed countries compared to countries in transition and countries in Latin America. Besides problems associated with the ageing of population in many European countries there is a crisis in the functioning of the economy that presents the problem of unemployment. Expenditure on social security constantly grew. Therefore, some countries have started to increase the contribution rate and rising the retirement age. Also increases the number of years in working life used as the basis for calculating the pension benefits. Many countries have modified their pension systems in anticipation of worsening the relationship between active contributors and the number of pensioners in future (Rakojnac 2010).

The above detected conditions and problems in the pension systems in developed and developing countries are the main cause of reform in the pension system in the country. The Republic of Macedonia, since its independence in 1991 faces significant socio-economic changes that impact on all spheres of life, including the pension system. By 2006, in the Republic of Macedonia there was solidarity pension system whose principles were the basis of social justice and solidarity. This principle means that current workers pay for current retirees. This pension system functioned successfully for more than 40 years. But the transition has created very bad conditions for the functioning of the pension system. During a transition to a market economy in the country has increased the number of enterprises operating at loss. It began a process of privatization of state enterprises in order to introduce a social rather than private property, a functional market economy rather than planned economy. Such social and economic conditions have led to an increasing number of unemployed people, work surpluses and bankruptcy, which inevitably led to a reduction in the number of active contributors on the one hand and the increasing number of retirees and beneficiaries of other social insurance rights on the other hand. This trend of changing the ratio between contributors and pensioners means that insurers will pay less for a growing number of retirees.

A second reason for the necessity of reforms in the pension system's ageing population is a worldwide problem that affects pension systems globally. The extension of life is better because of living conditions, the progress of medicine improve health and education services and so on. Analyses show that life expectancy is assumed to increase by about 5 years in the next 40 years (Agency for Supervision of Fully Funded Pension Insurance 2006). However, more elderly population means an increasing number of retirees who use longer retirement.

Exception of global flows is not even in Macedonia. The official statistics shows that in 1971, 32.5% of the population in the country was less than 14 years and in 2009 was just 17.9%. Very important for the pension system indicators are changes in the ratio between the working population and 64 years old which in 1971 accounted for 61.5% of the total population and in 2009, 70.5% of the total population. All that compared to the population of over 65 years of age of which 5.8% in 1971 increased to 11.6% in 2009. This means that the ratio between the number of active contributors and the number of retirees on the long run is tightening.

Age	1971	2009
0-14	32,5%	17,9%
15-64	61,5%	70,5%
65 >	5,8%	11,6%

Table 1. Percent of Age categories in 1971 vs. 2009 in the country: A comparison statistics

Source: “Statistical Yearbook of the Republic of Macedonia-2010”, State Statistical Office Web Site, http://www.stat.gov.mk/PublikaciiPoOblasti_en.aspx, accessed November 30, Skopje.

All the above mentioned factors connected with a reduction in the birth rate and the systematic migration trends of the working population abroad and other factors led to the inevitable financial instability and imminent collapse of the pension system in the country. Therefore, the need of a reform emerged as a real priority.

One of the main recommendations of the OECD and the World Bank was strengthening the access to diversified so-called multi-pillar pension system. That provides better risk diversification and better protection of members who may be affected by the crisis. Particularly important was the establishment of multi-funds or pension funds with different investment options or portfolios designed for young workers and workers who are close to retirement in order to allow selection of members depending on their risk tolerance and yields under the pension savings in line with the life cycle of members (Agency for Supervision of Fully Funded Pension Insurance 2009).

3. THE PROCESS OF PENSION SYSTEM REFORM

Pension reforms in the country are aimed for establishing a new model of pension and disability insurance. Radical reform of the pension system was made in 2006 when the existing state-managed solidarity pension system was replaced with a two-pillar system, which later becomes a three-pillar pension system. But preparations for the reform of the pension system started much earlier. The bad financial situation, in which the Pension Fund found itself in 1993 and the constant decline of the ratio between contributors and retirees in Macedonia, has made a situation in which civil servants had to “hurry” in seeking an alternative solution to this problem. In other words, they finally began with the reform of the pension system. Financial institutions (such as World Bank, International Monetary Fund and others) were willing to help Macedonia in reforming the pension system because that problem undermined the overall balance of state financial expenditures. The most realistic assistance came from the World Bank which makes a strong pressure on Macedonia, as well as on the other Central - Eastern and South- Eastern European countries (Centre for Research and Policy Making 2014).

The essence of the proposal to reform the pension system proposed by the World Bank was introducing a three-pillar pension system with mandatory pension and disability insurance, mandatory fully funded pension insurance and voluntary fully funded pension insurance. The design of the reform was influenced by several critical points revealing that Macedonia is a small country with a small number of employees and potential members. In addition, the country is under-developed with liquid capital market, long transition costs, lack of experience and tradition, and finally, there is a lack of financial education to the current workers that deal with finance and insurance issues.

In the period between 1993 and 1998 were enacted several legal acts in order to reduce the fiscal pressure on the Fund. The new Law on Pension and Disability Insurance (Official Law on Pension and Disability Insurance 1993) has increased the contribution rate and increased the retirement age. The contribution rate to 1993 was 18%, and by the end of 1993 increased to 20%. In January 1994, the retirement age increased from 60 to 63 years for men and from 55 to 60 years for women. These and other decisions were derived in order to alleviate the fiscal pressure on the pension fund that was faced with a huge deficit. In 1995 was founded the Actuarial Unit using a statistical model that provides short and long term plans of demographic and economic trends in the country. These actuarial models are one of the instruments of policy for planning pensions that make projections on the state pension system based on assumed economic and demographic parameters. In 2000 legislation was passed in order to reform through amendments the current Law on Pension and Disability Insurance, and finally, in 2002 the Law on Mandatory Fully Funded Pension Insurance was passed (Official Law on Mandatory Fully Funded Pension Insurance 2002). The second pillar started to be implemented from 1st January 2006.

In 2008, the Law on Voluntary Fully Funded Pension Insurance (Official Law on Voluntary Fully Funded Pension Insurance 2008) was adopted as the basis for beginning of the operation of the third pillar. Membership in the voluntary pension funds started since 2009. In these three legal texts (Law on Pension and Disability Insurance, Law on Mandatory Fully Funded Pension Insurance and the Law on Voluntary Fully Funded Pension Insurance) are contained the basics that provide unity of the system and equal position of insurers in respect of the acquisition of basic additional rights from pension and disability insurance and regulation of the state system for exercising those rights. As a result, the structure of the new pension system is based on three types (pillars) of insurance:

1. Compulsory pension and disability insurance based on generational solidarity (namely first pillar). In this pillar, which is mandatory for all employees, the system is actually organized under the basis of the “pay as you go” system, which means that current policy holders pay for current retirees. This pillar provides pensions defined by a predetermined formula and the rest of the pension provided by the fully funded pension insurance. Through this pillar the system exercise the rights of pension and disability insurance in the event of old age, disability and death which means that they pay part of old-age pension, disability pension, family pension and the minimum pension amount. The compulsory pension and disability insurance is carried out by the Pension and Disability Insurance of Macedonia;

2. Mandatory fully funded pension insurance (second pillar) means the establishment of fully funded pension insurance with defined contributions. The second pillar is mandatory for all employees starting from 01.01.2003 and the employees before this date were given the right to choose to voluntarily join the second pillar. This pillar provides the right to pension insurance in case of old age or retirement pension is paid. This pillar provides a close connection and relationship between the volume of invested funds- contributions and future benefits that can exercise each person based on market rules. This type of insurance is based on the principle of collecting funds through the payment of contributions to personal (individual) accounts whose assets remain invested and profits minus the cost of operating the system are added (accumulated) as a means of personal accounts. The second pillar representing the mandatory private pension funds is non state- owned;

3. Voluntary fully funded pension insurance (third pillar). This pillar means establishing a new fully funded pension insurance with defined contributions on a voluntary basis. The status of the insurer depends solely on the desire of the insured. He/her personally decides whether part of his/hers income will pay to the voluntary pension fund or not. And he/her decides solely on voluntary basis whether to leave or not the pension fund at any time. Very significant for this type of insurance is that it can include all individuals who stay in the country on the age between 18 to 70 years, whether in terms of current status of employed or unemployed (except those who have acquired the right to old-age and disability pension).

4. REFORMING THE PENSION SYSTEM- BENEFITS

The main reason for the reform of the pension system was providing a long-term solvency and stability on one hand, and providing financial security for current and future retirees on the other side. With the pension reform and the establishment of a multi-pillar pension system as a combined system of publicly and privately owned financial assets, the pension insurance in the country is expected to provide long-term stability and reliability of the system by providing the rights of pension and disability insurance through achieving long-term benefits for individuals who participate in the pension system and additional effects on the economy (Agency for Supervision of Fully Funded Pension Insurance 2006). The overall reform of the pension system is based on the principles on which it was built the existing pension system: the mandatory pension and disability insurance, depending on the rights of pension and disability insurance based on the length of life, age and contributions, social justice and generational solidarity etc.

The main benefit of the voluntary fully funded pension insurance (third pillar) is providing higher income after retirement of the insured covered in the mandatory pension insurance, and the provision of pension to persons who are not covered by the statutory pension insurance. Also, as a result of the introduction of the third pillar is the establishment of occupational pension schemes as part of the

process of harmonization of the social security system in the country with the social security systems in countries as permanent members of the European Union. Considering the fact that the social security systems in almost all countries in Europe are under severe financial pressure, occupational pensions in the future are expected to have a strong role as additional income for the perspective pensioners. Also, with the introduction of the third pillar is expected to have a significant impact on the whole economy by increasing private savings, increasing investment in power and encouraging the development and deepening of the capital market by investing the assets of the voluntary pension funds etc. (Agency for Supervision of Fully Funded Pension Insurance 2009).

The benefits of the reformed pension system can be evaluated in terms of individuals, in terms of the pension system and the overall economy. In terms of individuals, the introduction of the three-pillar pension system means greater protection of the rights from pension and disability insurance, because the pension will be funded from multiple sources (the first and second pillar on mandatory grounds and the third pillar for voluntarily insured individuals) which will split the risks. Also, the reform provides greater transparency and information to members of the pension funds in the second and third pillar because the pension fund has the obligation for continuously informing the policyholders about the status of their individual account, the dates of payment of contributions, the fees charged etc. Also, the pension fund is obligated at least once a year to inform its members about the value and share of pension fund assets invested in asset classes, principles of investing, investments, net assets of the pension fund, the return etc. Regarding the pension system benefits from its reform can be noted the greater possibility in savings increase and encouraging investment. Population increase as well as the increase in the national savings will lead to growth of the economy, better employment possibilities and solvent national pension system.

5. REFORMING THE PENSION SYSTEM – CONDITIONS

5.1 Condition of fully funded pension insurance in the period 2006-2014

Within the fully funded pension insurance, on April 4, 2005 were granted to pension fund two companies for managing pension funds for a period of 10 years including: NLB New Pension Fund-Skopje and KB- First pension Fund AD-Skopje (Agency for Supervision of Fully Funded Pension Insurance: Annual Statistical Report 2006).

Membership in second pillar for pension insurers is done by making the agreement. The first contracts for membership in the second pension pillar began to conclude in September 2005 and 31st December 2005 was the date to complete the voluntary membership in the second pillar. Compulsory membership of insurers continues under the provisions of the Law on Mandatory Fully Funded Pension Insurance. Mandatory members who did not sign a membership agreement during the period for selecting a pension fund (between 20.09.2005-31.12.2005), after the expiration of that period remained members of the pension fund were allocated by MAPAS (MAPAS - Agency for Supervision of Fully Funded Pension Insurance) according to the method of random selection (Agency for Supervision of Fully funded Pension Insurance 2006).

Membership in a pension fund runs until the insured does not transfer to another pension fund or not in order to exercise the right for a pension. Insurers in the second pillar which is subscribed to a mandatory pension fund can move and join another mandatory pension fund with assets accumulated on their individual account. Insurers can do this only once during the time that has the status of a member of one of the mandatory pension funds. Even if the Mandatory pension fund have a break in work and pay contributions for pension and disability insurance, he remains a member of the pension fund and has the same rights as regular members. Insurers who must become members of the second pillar pension immediately after their employment are temporarily arranged by MAPAS by random selection in order to ensure the fertility of their assets from the beginning of membership in the pension fund. These persons have 3 months to choose membership into a pension fund. If after the expiry of that period decides in which pension fund will become members then they remain members of the pension fund in which they were temporarily allocated (Agency for Supervision of Fully Funded Pension Insurance: Situation Report 2006).

Period	Voluntary	Mandatory				
		With contract	Allocated	Temporary allocated	Total	Total
31.12.2006	60.473	43.497	17.207	6.854	67.558	128.031
31.12.2007	63.714	58.856	30.352	9.731	98.939	162.653
31.12.2008	66.300	79.917	41.952	6.971	128.840	195.940
31.12.2009	67.569	99.668	59.096	10.691	169.455	237.024
31.12.2010	68.609	119.331	69.966	9.064	198.361	266.970
31.12.2011	63.301	140.705	78.051	8.574	227.330	296.631
31.12.2012	69.646	158.845	84.697	10.292	253.834	323.480
31.12.2013	69.572	169.231	95.808	15.429	280.468	350.040
31.12.2014	69.582	169.416	117.507	16.746	303.669	373.251

Table 2. Distribution of the Pension Fund Membership by their Status.

Source: Agency for Supervision of Fully Funded Pension Insurance: Annual Statistical Report for the period (2006-2014), Skopje.

In the analyzed period (2006-2014), it is evident that the number of insured in the second pillar continuously increases, which is expected given the mandatory membership for all new employees. Thus, a total of 128.031 subscribed in the second pillar in 2006, at the end of 2014 their number increased to 373 251 contributors, representing an increase of 332.66%. In terms of total number of employees in the analyzed period, the first year of operation of the second pillar, its insurers were 22.12% of the total number of employed and insured in the last year of the second pillar were 55.90% of the total employees in the Republic of Macedonia. Interesting analysis comes from the data for voluntary membership of insurers in the second pillar. Their numbers continued to grow in the period between (2006-2014), so the increase in the number of these insurers is interesting. This is due to the introduction of a voluntary third pillar pension system in the country, so that employees joining the second pillar as a mandatory in the same time join the voluntary third pillar. Also, the numbers of insurers who must join the second pillar and are not signed to any pension fund or remain in the fund which was randomly allocated by Agency for Supervision of Fully Funded Pension Insurance from year on year decreases or increases. In our opinion, generally it shows the growing interest of the insured persons to decide how the pension fund will entrust their funds in anticipation of greater profits from their investment.

5.2 Condition of voluntary fully funded pension insurance in the period 2009-2014

Under the voluntary third pillar pension operate two companies that manage one mandatory pension fund and one voluntary pension fund as follows: AD management mandatory and voluntary pension fund "NLB new pension fund" -Skopje and "KB First management Company-Skopje" mandatory and voluntary pension funds (Agency for Supervision of Fully Funded Pension Insurance: Annual Statistical Report 2009).

Among the third pillar, employer or association of citizens (insurers) can organize and fund an occupational pension scheme and to contribute to the voluntary fund for their employees and members. More and more employers' organizations can jointly organize and fund occupational

pension schemes. Insurer signs a contract with the company which has chosen to manage voluntary pension fund which will be included in the occupational pension scheme (Agency for Supervision of Fully Funded Pension Insurance: Report on the situation in the fully funded pension insurance 2009).

The status of a member of the third pillar is acquired by signing the contract. Regarding that, there are three alternatives:

-First, concluding the membership agreement between the insurer and the company for management of mandatory and voluntary pension fund, ie the management company of voluntary pension funds by opening an individual account;

-Second, concluding the membership agreement between the insurer or the working organization pays in behalf of the insurer and the company opens an individual account; and

-Third, by participating in an occupational pension scheme organized by an employer or association in which the insurer is a member of a professional pension scheme by opening individual account.

One person can have only one voluntary individual account and a professional account which can be in the same or in different voluntary pension fund. The insured has the right to change the selected voluntary pension fund at any time and to transfer the accumulated fund assets to his newly established individual or professional account.

Period	With contract and individual account	In a pension scheme and with professional account	Total
31.12.2009	1.037	574	1.611
31.12.2010	2.483	4.425	6.908
31.12.2011	3.121	9.074	12.195
31.12.2012	4.306	12.449	16.755
31.12.2013	5.065	13.460	18.525
31.12.2014	6.285	14.148	20.433

Table 3. Distribution of the Voluntary Pension Fund Membership by membership type.

Source: Agency for Supervision of Fully Funded Pension Insurance: Annual Statistical Report for the period (2009-2014), Skopje.

In the analyzed period (2009-2014) it is evident that the number of contributors to the third pillar through the year increased almost at the same pace (around 5,000 new contributors each calendar year). In terms of total number of employees in the Republic of Macedonia in the analyzed period, during the first year of operation of the third pillar, its insurers were only 0.26% of the total number of employed and insured in the last year when the second pension pillar was 254 % of total employees in Republic of Macedonia. It appears interesting data analysis for the type of membership in the third pillar. At the beginning of the analyzed period, almost twice the number of members signed agreement for opening individual account. Already in the second and subsequent years of operation of the third pillar that ratio is different. The number of insured that are in a pension scheme and with professional account doubled and almost tripled compared to insured with contract and individual account.

6. CONCLUSIONS

Pension systems in almost all countries in the world are in a crisis caused primarily by the aging of the population, and consequently in many European countries there is a crisis in the functioning of the economy that presents the problem of unemployment. In Macedonia, the reasons for the crisis in the pension system are generally of socioeconomic nature - reducing the number of employees, increasing the number of retirees as a result of growing aging population, birth rate reduction, working population rapid migrations to developed countries etc. All these factors led to financial instability and the imminent collapse of the pension system in the country at the beginning of 1990s in the last century. Therefore, as a priority emerged the need for pension reform.

Radical reform of the pension system was made in 2006 when the existing state-managed solidarity pension system was replaced with a two-pillar system, which since 2009 has been transformed into a three-pillar system. These reforms provided the system with unity and equal position of insurers in respect of the acquisition of basic and additional rights from pension and disability insurance. The overall reform of the pension system is based on the principles on which it was built the existing pension system and that is: the mandatory pension and disability insurance depending on the rights of pension and disability insurance based on the length of life, age and contributions, social justice and generational solidarity etc.

The benefits of the reformed pension system in terms of individuals and in terms of the pension system are very effective for the overall economy in Macedonia. The most significant benefits of the reform of the pension system are growing protection of the rights from pension and disability insurance, greater transparency and information to the members of the pension funds in the second and third pillar, rising overall savings and investments by encouraging the population to increase the national savings that will lead to growth of the economy, creating a solvent pension system and more.

The analysis of statistical data in the annual statistical reports concerning mandatory fully funded and voluntary fully funded pension insurance since their introduction in the pension system as of 2006 and 2009 respectively until today shows that pension reforms are positively accepted by insurers who are members of the second and third pillar. The final benefits of reforms both from the perspective of the insured and in terms of the pension system are expected to be felt later, when insured members from second and third pillar will begin to realize the rights of pension and disability insurance- the right of age pension, disability or family pension- because insurers will receive pensions from two sources- the first and second pillar, while the members of the third pillar will receive pension from three sources, which will bring financial relief to the Pension and Disability insurance Fund of Macedonia and overall economy.

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