Bulgaria: Pension Reform Options

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Outline

- I. Mission's Work and Main Messages
- II. Key Challenges
- III. Options for Reform
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  - Medium term (2013-2050)
- IV. Conclusions

I. Mission's Work

- Assess pension budget implications of the proposed reform measures
- Identify pending challenges in the design of the pension system
- Suggest options for short-run measures
- Identify a package of reforms to ensure pension financial viability in the long run

Messages

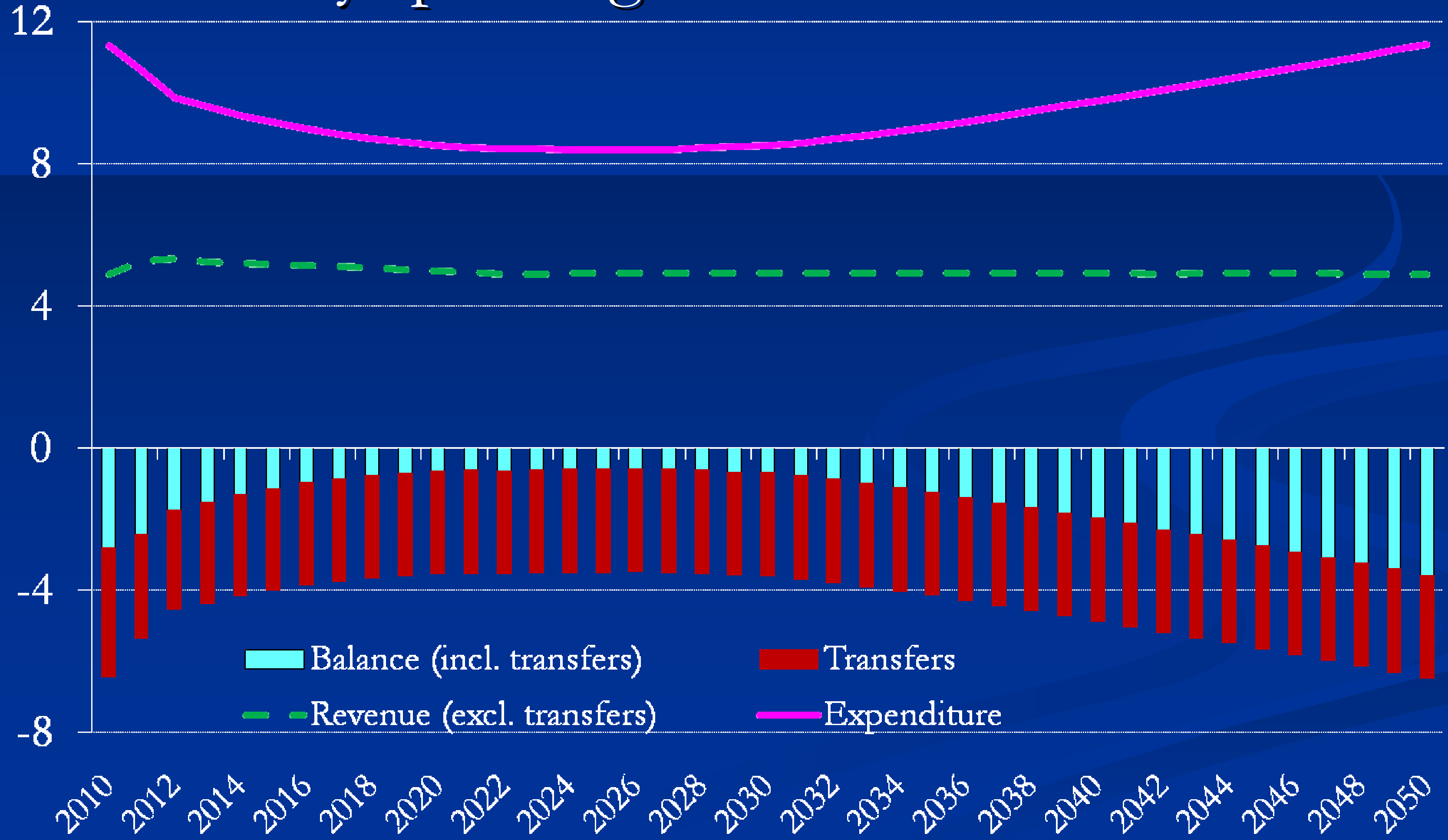
- The three-pillar pension system design is sound
- Proposed measures are not sufficient to eliminate projected imbalances
- A more comprehensive set of parametric reforms would remove the need for budget financing of the pension system
- Over the medium term, measures are needed to strengthen the link between benefits and contributions

II. Key Issues

- Pension fund large imbalances, draining funds from the budget
- Long-term spending pressures caused by demographic trends
- Low retirement age, incentives to early retirement
- Weak link between benefits and contributions, hampering compliance
- Lack of mechanisms to ensure financial viability of pension system

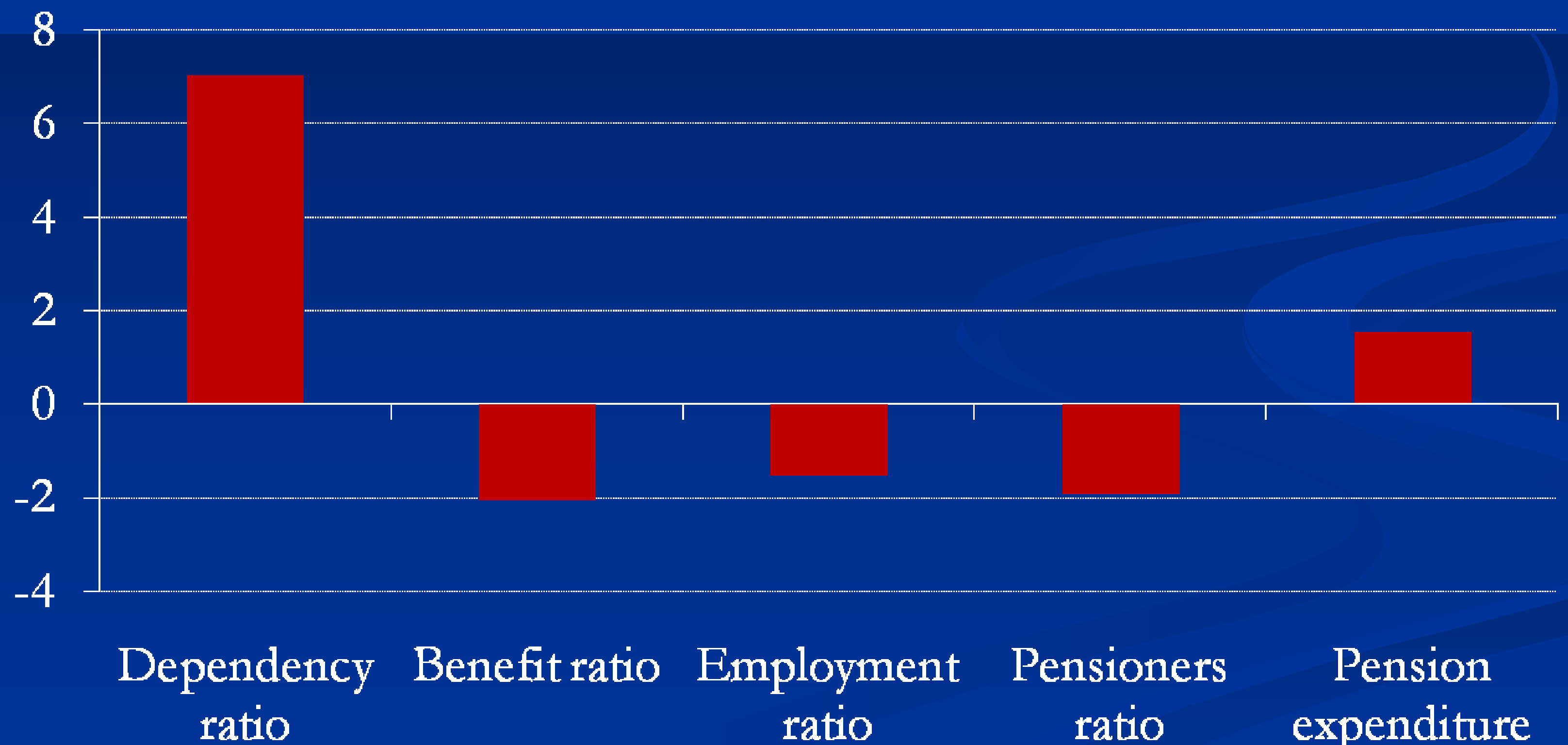
Large Imbalances

- Driven by spending trends



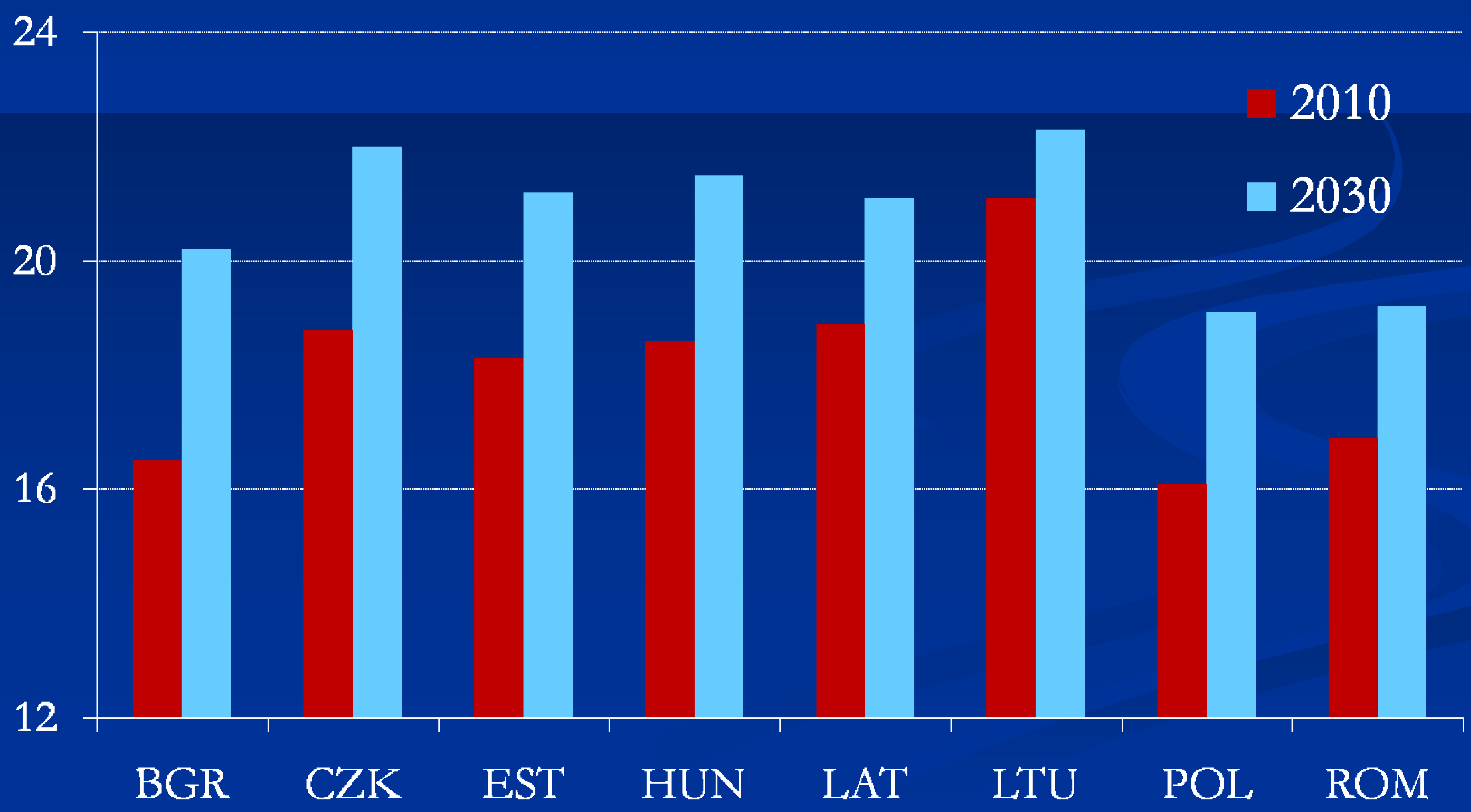
Swimming Against the Tide

- Dependency ratio cost to raise spending by 7 percent of GDP by 2050 reflecting aging



Early Retirement

- Life expectancy at retirement in NMSs

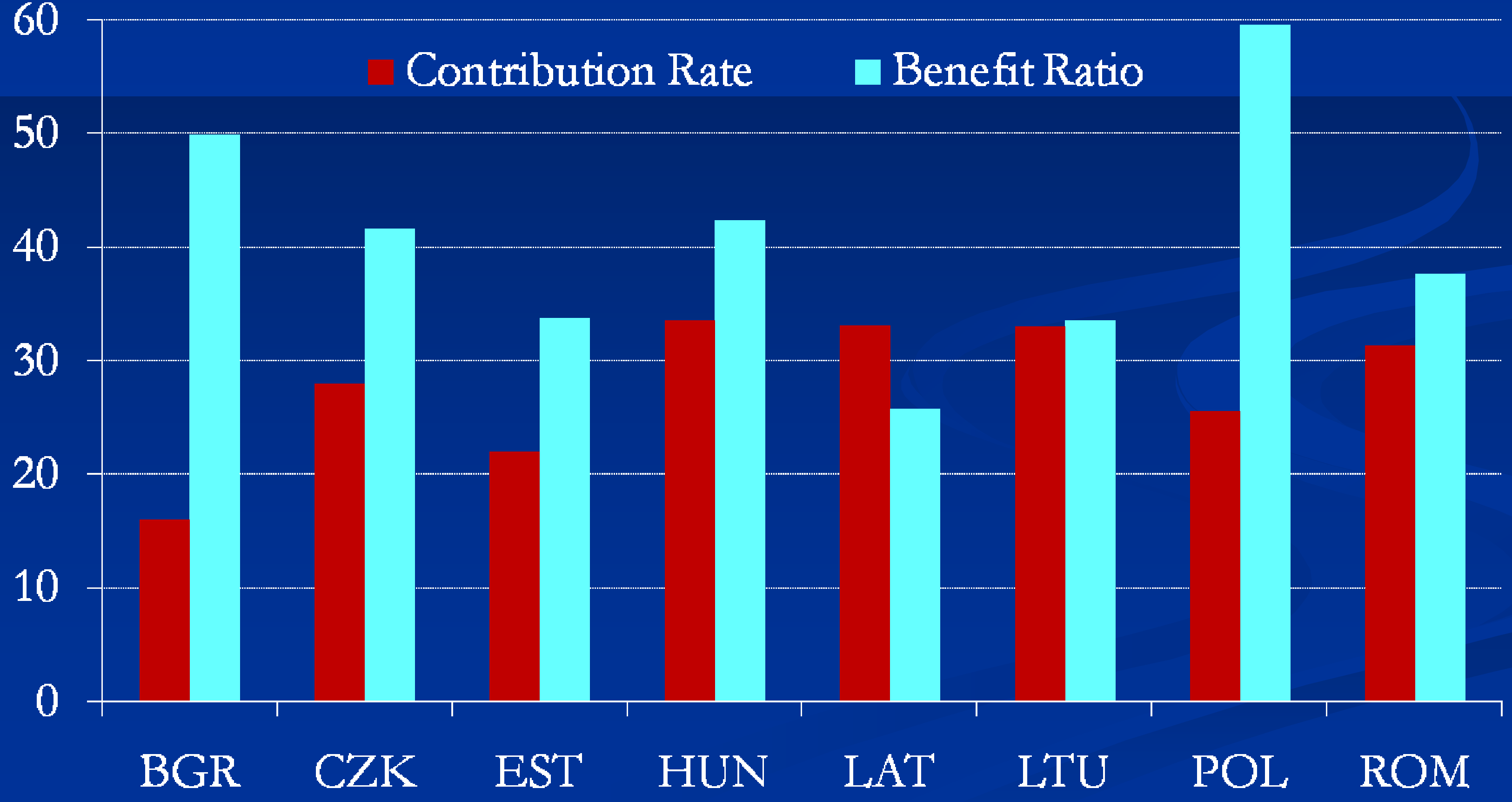


The Weak Link

- Benefit formula depends exclusively on wages and length of service, no link with actual contribution paid
- Length of service includes periods when contributions were not paid
- Retirement age does not reflect life expectancy
- No link between the individual return on contributions and the unfunded pension system's equilibrium rate of return

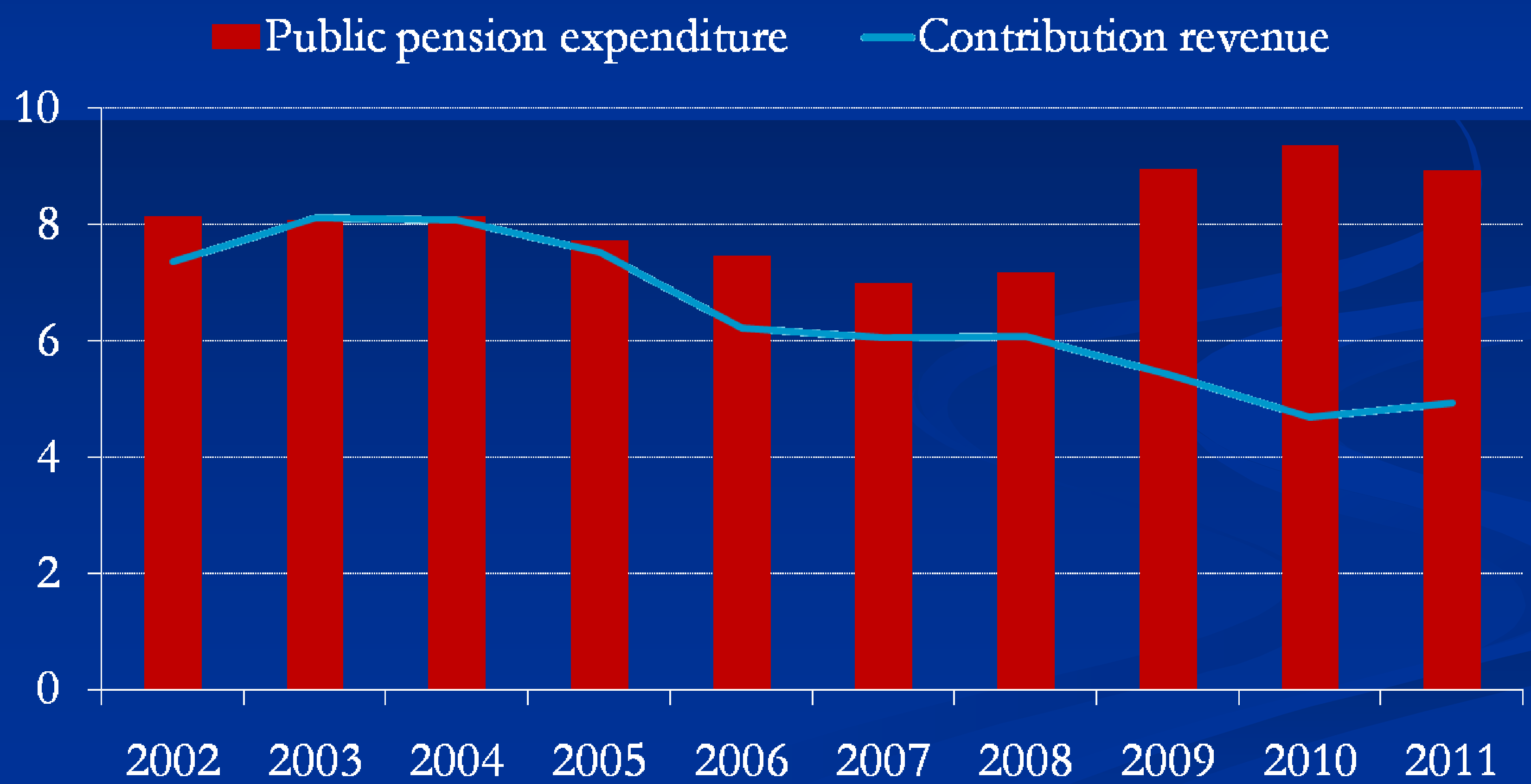
Design Mismatch

- Low contributions, high benefits



No Correction Mechanisms

- Growing gap, no benefit adjustment

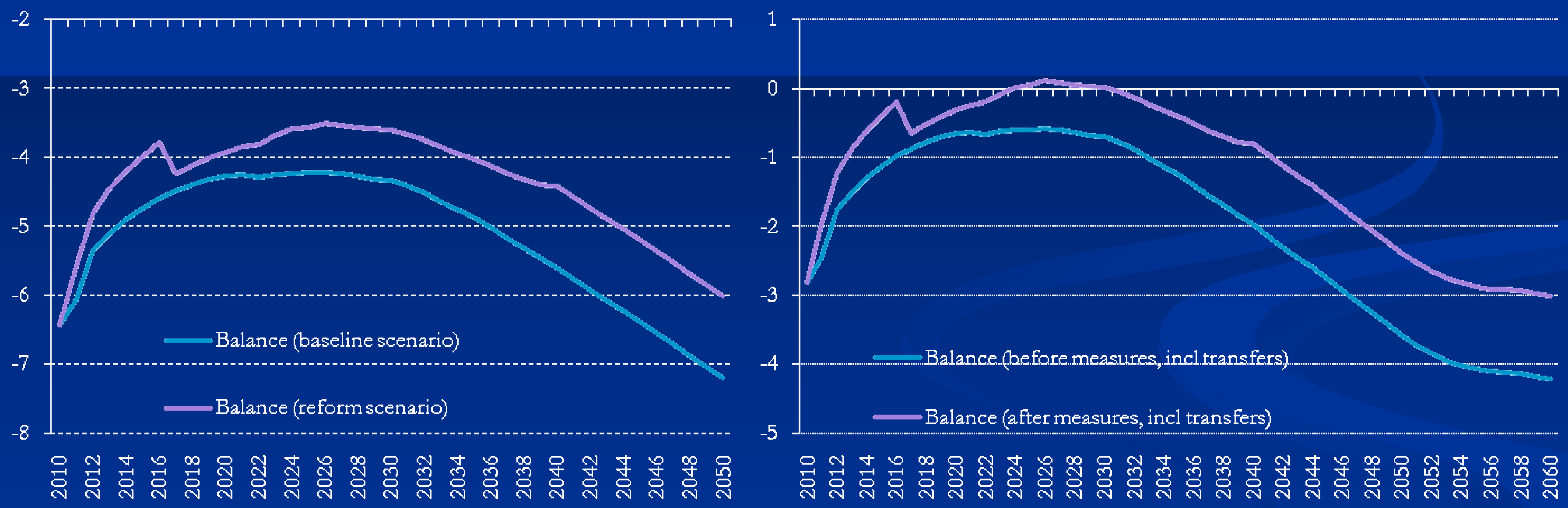


Reform Package Effects

- The proposed package relies on a combination of parametric adjustments
- However, the measures are gradual and address only partially the pension system's problems
- The package would lower the pension deficit by up to 1¼ percent of GDP, but budget financing will continue to be needed.
- Spending pressures will pick up again after 2030

Stubborn Imbalances

- Temporary, partial relief



III. Proposed Reforms

- Short-term measures
  - To be implemented in 2011-12
  - Aim at reducing spending pressures
  - Start to change the system's parameter to ensure long-run stability
- Medium-term reforms
  - To be implemented after 2012
  - Aim to phase out budget support in the long-run

Short-Term Measures

- Yield savings of about 0.8 percent of GDP by 2012 compared to pre-reform baseline
  - Increase length of service by 6 months per year during 2011-12
  - Continue the benefit freeze in 2011-12
  - Raise contribution rate by 2 percentage points from 2011
  - Introduce controls on disability pensioners
  - Start PPF implementation in 2011

Medium-Term Measures

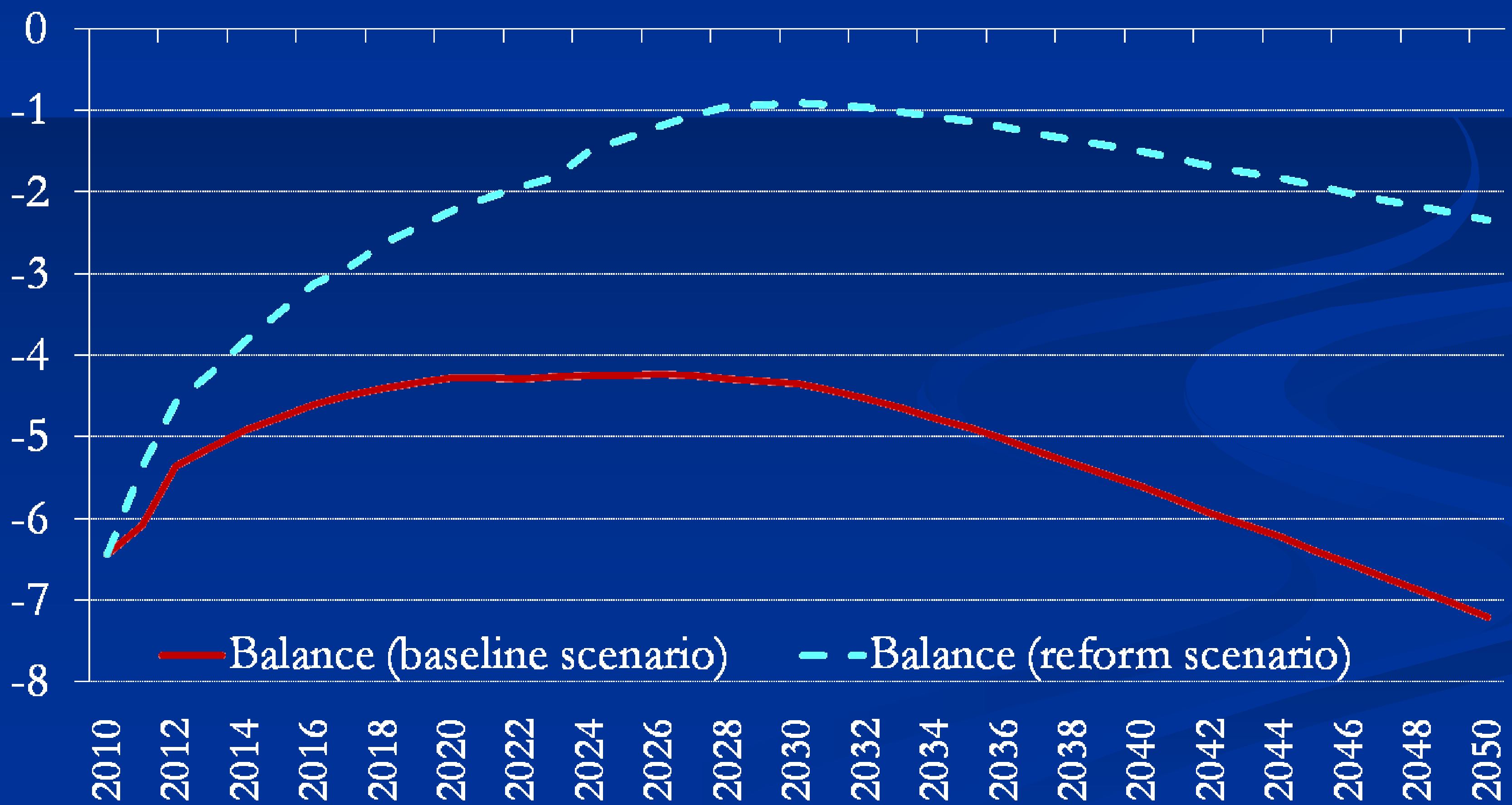
- A package to phase out budget support, while ensuring benefit adequacy could include:
  - Continue increasing length of service until 2016 to 37/40 years for women/men
  - Raise retirement age from 2017 to reach 66 years by 2028 and then link to life expectancy
  - Phase out point system from 2029
  - Index benefits to prices only, starting in 2013
  - Raise UPF contribution rates by 2 percentage points from 2017

Effects

- These reforms would yield additional 4 percent of GDP by 2050 compared to baseline
  - Eliminate (contributory) pension deficit by 2050
  - Mandatory pension <u>net</u> replacement rate would be 50-60 percent
  - One third of the pension from the funded system (UPF)

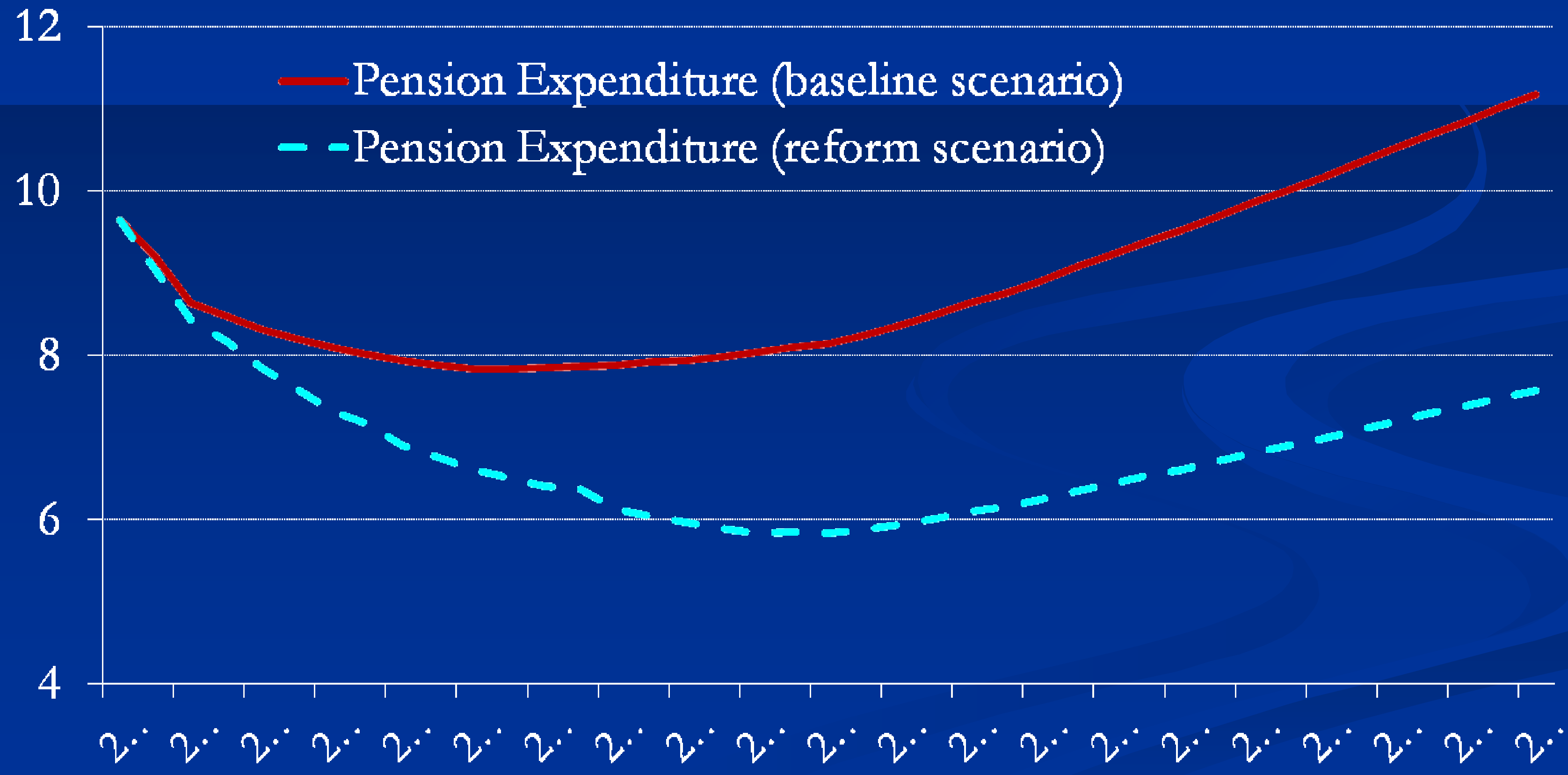
Medium-term Effects

- Eliminating the contributory pension deficit



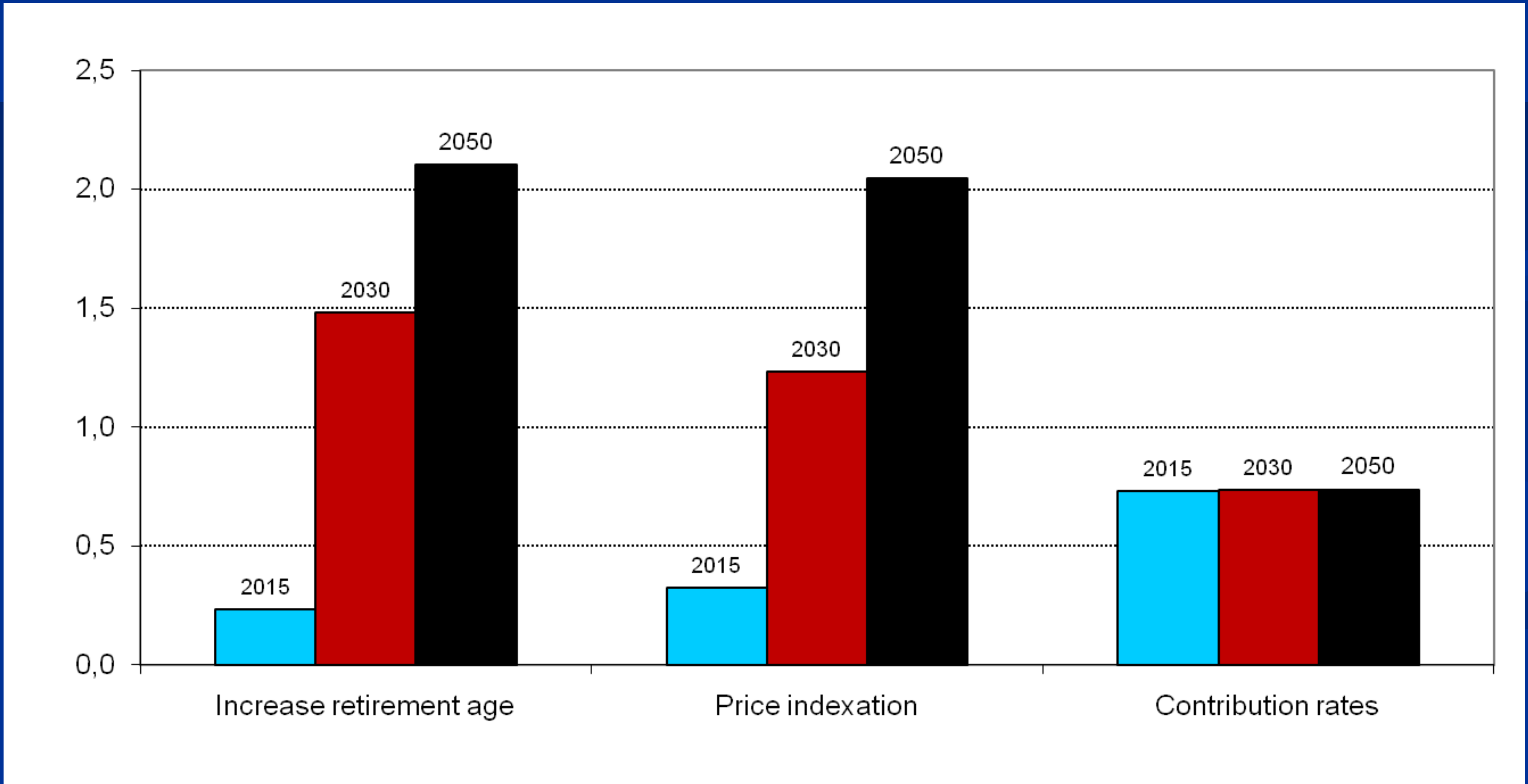
Medium-term Effects

- Reduced pension expenditure



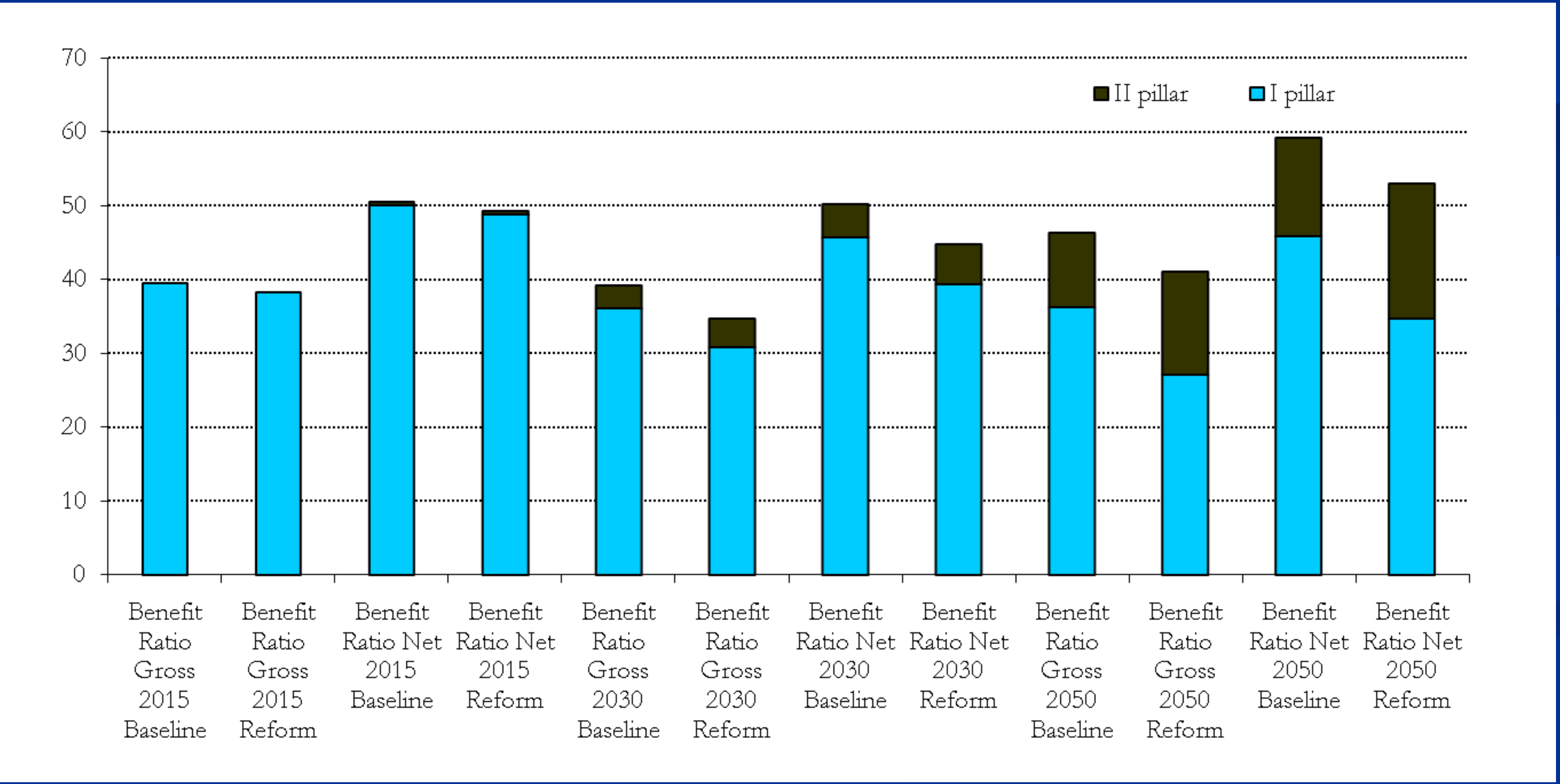
Medium-term Effects

- Decomposition of the expenditure adjustment



Medium-term Effects

- Maintaining pension adequacy through Pillar II



Further Reforms

- Maintain pension sustainability
  - Adopt 3-year reviews of actuarial outlook
  - Make parametric changes automatic in the case of deficits, unless other actions taken
- Strengthen performance of funded pillar
- Address weak link between contributions and pensions
  - Information campaign (e.g., Orange card)
  - Consider moving to a NDC

IV. Conclusions

- While the multi-pillar system is sound, parametric reforms are urgent
- Reforms would help create fiscal space, reduce budget pressure
- Need to build on reform momentum
- The proposed package is a step in the right direction, but more is needed
- Link between benefits and contributions is a challenge

Thank you

Pension Projection Model

$$d\left(\frac{PE}{GDP}\right) = \left(\frac{PE}{GDP} * d\left(\frac{Pensioners}{Pop65+}\right)\right) + \left(\frac{PE}{GDP} * d\left(\frac{AveragePension}{AverageWage}\right)\right) +$$

Eligibility ***Generosity***

$$+\left(\frac{PE}{GDP} * d\left(\frac{Pop65+}{Pop15-64}\right)\right) \qquad +\left(\frac{PE}{GDP} * d\left(\frac{Pop15-64}{Workers}\right)\right)$$

Old - Age Dependency Ratio ***Labor Market Effects***

- The change in pension expenditure as a share of GDP can be broken down into the following components:
  - **Eligibility ratio**: share of pensioners in the elderly population
  - **Generosity ratio**: average pension as a share of the average wage
  - **Dependency ratio**: share of elderly to working age population
  - **Labor market**: workers as a share of working age population

Impact of Measures

	Male			Female		
	minimum retirement age	points	minimum length of service implied	minimum retirement age	points	minimum length of service implied
2010	63	100	37	60	94	34
2011	63	100.5	37.5	60	34.5	34.5
2012	63	101	38	60	95	35
2013	63	101.5	38.5	60	95.5	35.5
2014	63	102	39	60	96	36
2015	63	102.5	39.5	60	96.5	36.5
2016	63	103	40	60	97	37
2017	63.5	103.5	40	60.5	97.5	37
2018	64	104	40	61	98	37
2019	64.5	104.5	40	61.5	98.5	37
2020	65	105	40	62	99	37
2021	65.5	105.5	40	62.5	99.5	37
2022	66	106	40	63	100	37
2023	66	106	40	63.5	100.5	37
2024	66	106	40	64	101	37
2025	66	106	40	64.5	101.5	37
2026	66	106	40	65	102	37
2027	66	106	40	65.5	102.5	37
2028	66	106	40	66	103	37
from 2029	actuarial adjust	none	none	actuarial adjust	none	none