Public Social Security System Analysis – Current Situation and Reform Options

September 2010

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Context

- Current analysis was undertaken in the August-September 2010 from the FSAF team
- Among the tasks of this analysis were:
  - Overview of the current state of the pension system
  - Identification of the alternatives for improving the financial stability of PSSS budget in short, mid and long run
  - Reform measures, adopting a staged and sustained reform approach combining short-, mid- and long-run
  - Assessment of the effects of the increase of contribution rate for the Pensions Fund on PSSS budget and the State Budget
  - Assessment of the effects of partial bring-to-light part of informal economy on contributions

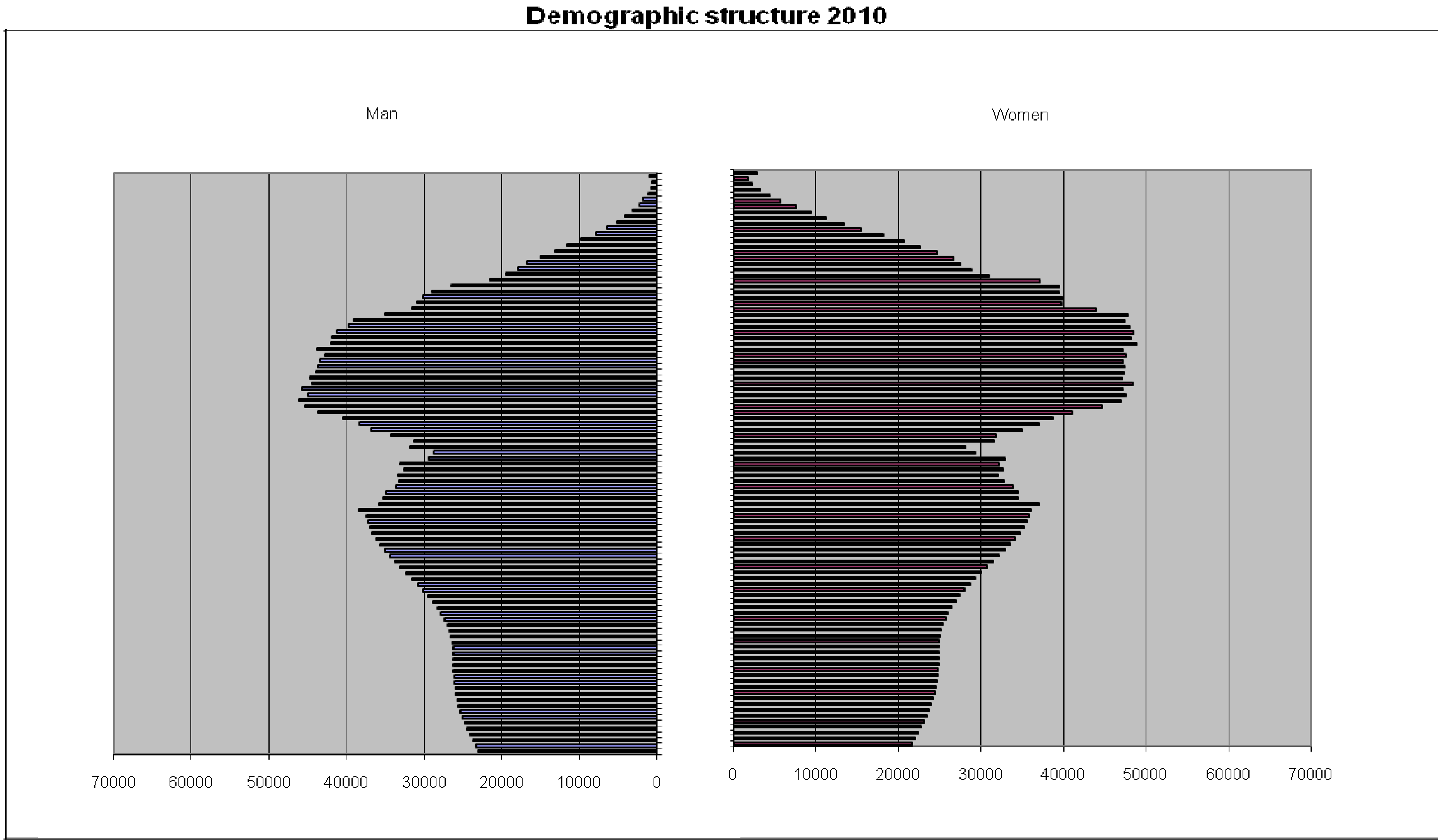
Goals of the analysis

- Overview of the current situation
- Identification of the main problems
- Proposals for financial consolidation in short and long run

Key challenges

- Aging of the population
- Financial instability of the PSS system
- Higher dependency on the State budget
- Violation of the link between contributions and pension benefits
- Liberal regime of receiving pensions

Ageing of the population 2010

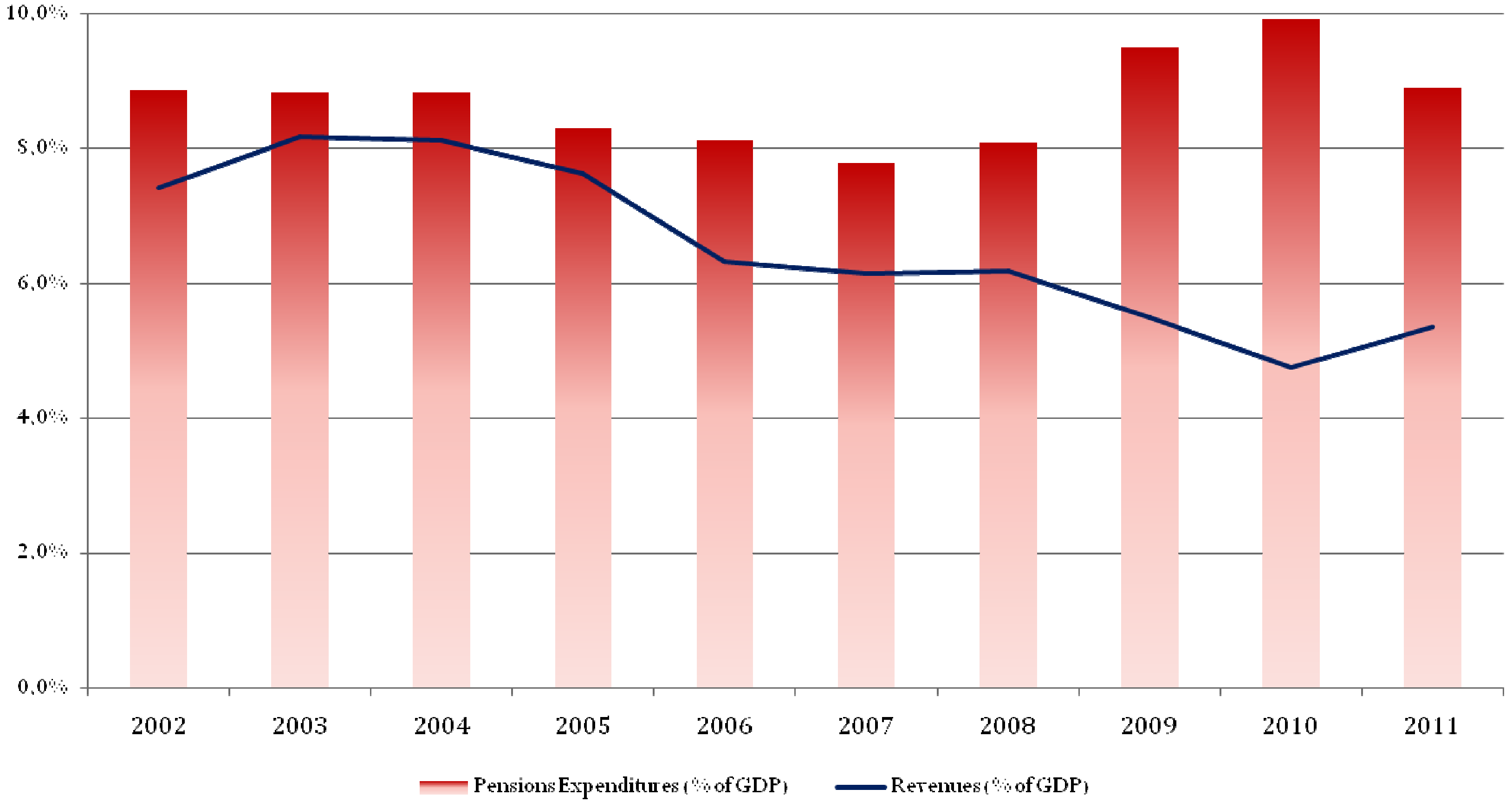


Ageing of the population 2050

Due to decrease of the population, decrease of labor force and increase of the number of the pensioners it is expected that dependency ratio will increase substantially

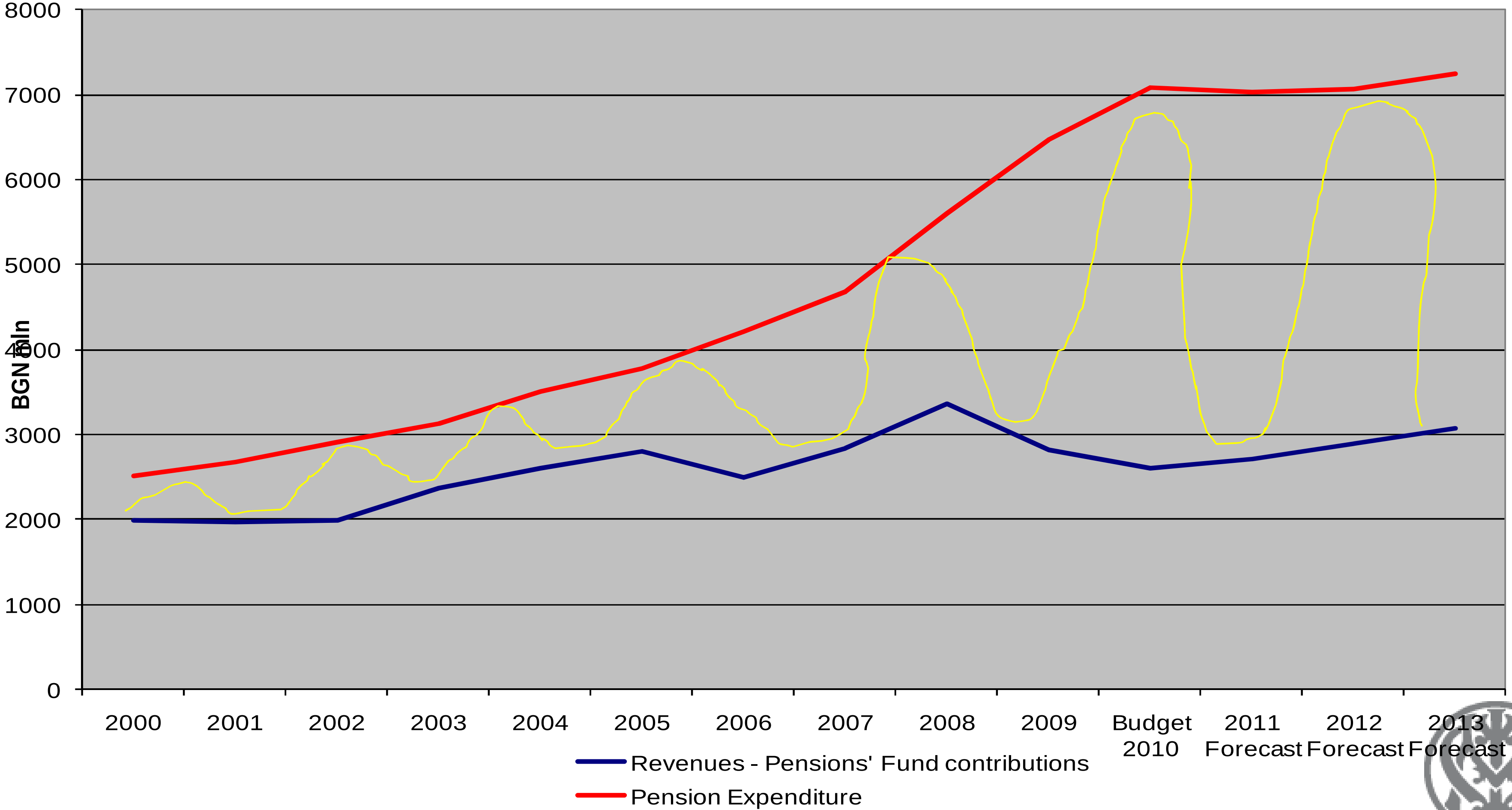
Financial instability of the system

Since 2009 due to low number of insured and lower than planned insurance income the State is a third party insurer with the 12 p.p. contribution on the insurance income of each insured to the Pensions' Fund.



Dependence on the State Budget

PSSS expenditures – around 10% of GDP. It is expected that PSSS budget expenditures will remain at level of 6.5% of GDP in 2010 and to continue to grow afterwards.



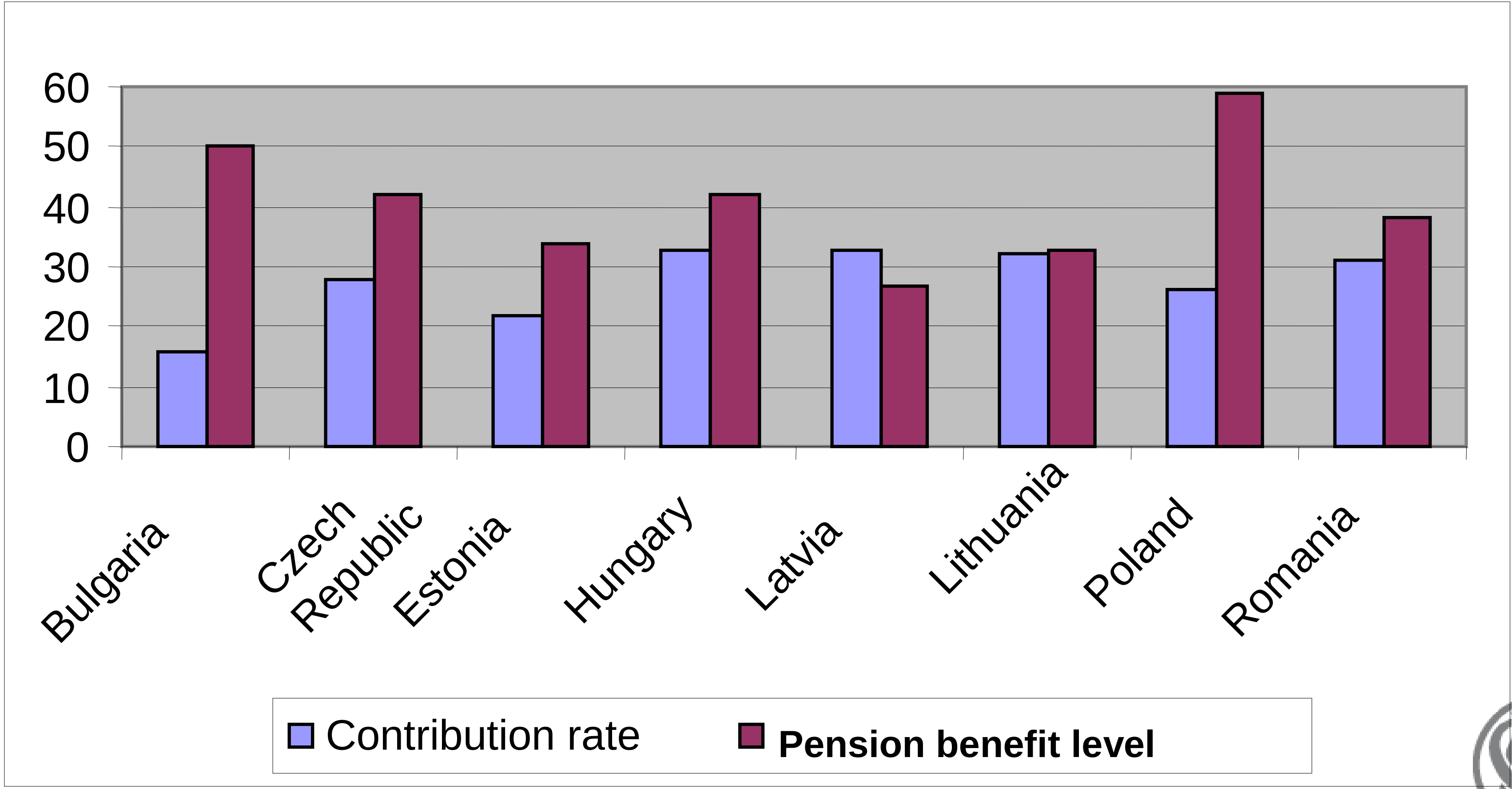
Strong dependence on State Budget

Level of the State Budget transfer for covering the PSSS deficit (in addition to the amount that represents 12 p.p. contributions paid by the State in 2009 and 2010) is following:

- 2000 – BGN 90 mln
- 2001 – BGN 392 mln
- 2002 – BGN 516 mln
- 2003 – BGN 253 mln
- 2004 – BGN 380 mln
- 2005 – BGN 584 mln
- 2006 – BGN 1199 mln
- 2007 – BGN 1178 mln
- 2008 – BGN 1974 mln
- 2009 – BGN 1523 mln
- 2010 – BGN 2062 mln

Violation the link between contribution and pension benefits

The contribution level of 16% is low in comparison to the level of the benefits that are above the average for the new Member States and stands at around 10 p.p. This shows a weak link between contribution and pension benefit.



Alternatives for financial stabilization

Accomplishment of the fiscal stability requires implementation of the measures for restraint the public expenditures pressure and increase the revenues. For achievement of this goal concrete short, mid and long-term amendments in the current parameters of the PSS system are proposed:

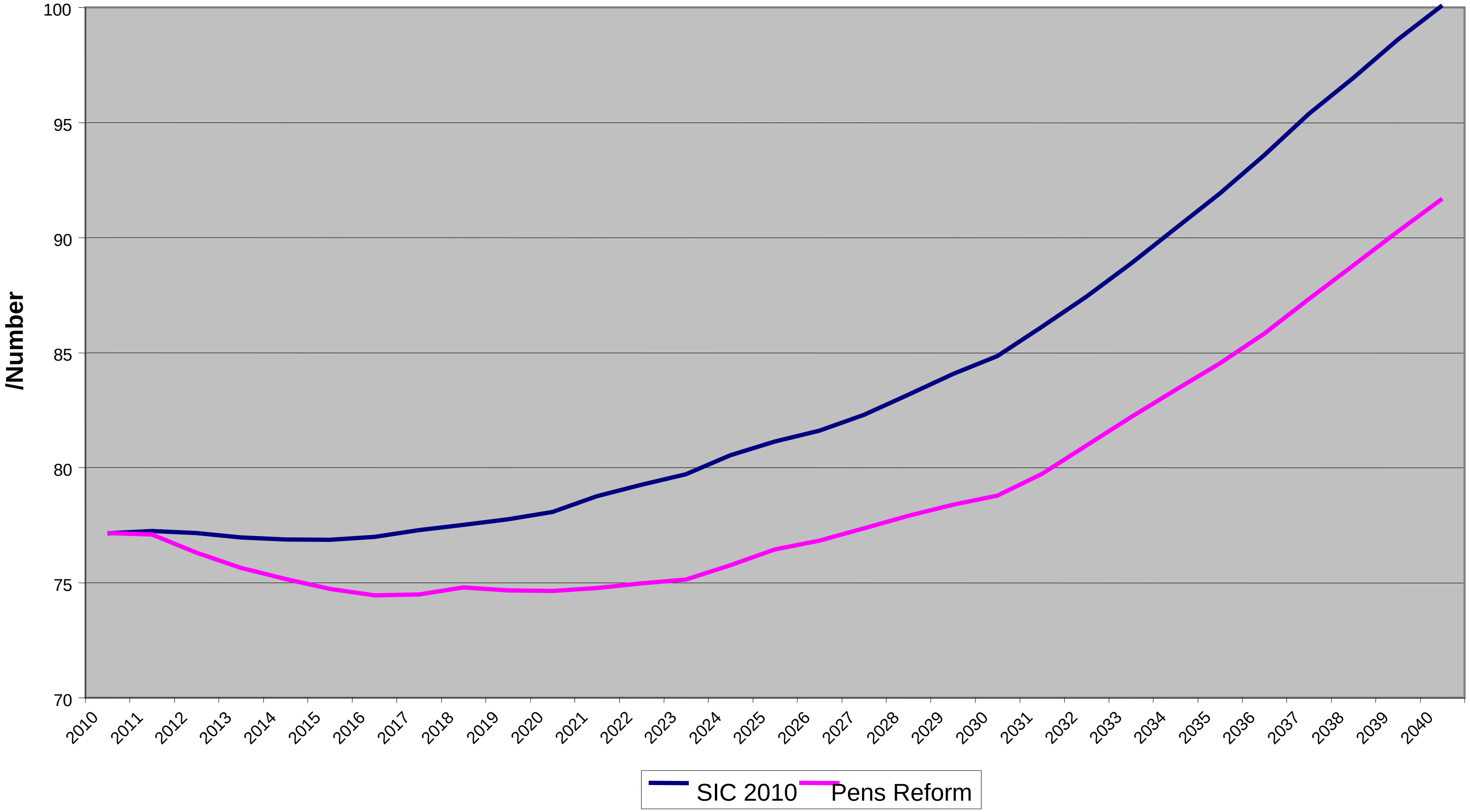
- Gradual raising of the required length of service and statutory retirement age
- Increase of the Pensions’ Fund contribution rate
- Reducing of number of invalidity pensions
- Other (supplementary) measures – widening of the insurance base and increase of the collection rate

Measure A: Length of service and retirement age

- Expected increase in the dependency ratio that is main engine for the increase of the pensions expenditures puts a pressure to implement measures, that would lead to better balance
- Retirement age may be linked to the life expectancy in the mid-term
- Commitment of the statutory retirement age and the pensions to life expectancy would allow of the system to be financially stable
- In order to keep the benefits period to 1/4 of actual length of service for each year increase in life expectancy have to reflect in 9 months increase in retirement age
- These changes are inevitable for guarantying financial stability and sustainability of the pension system in long run

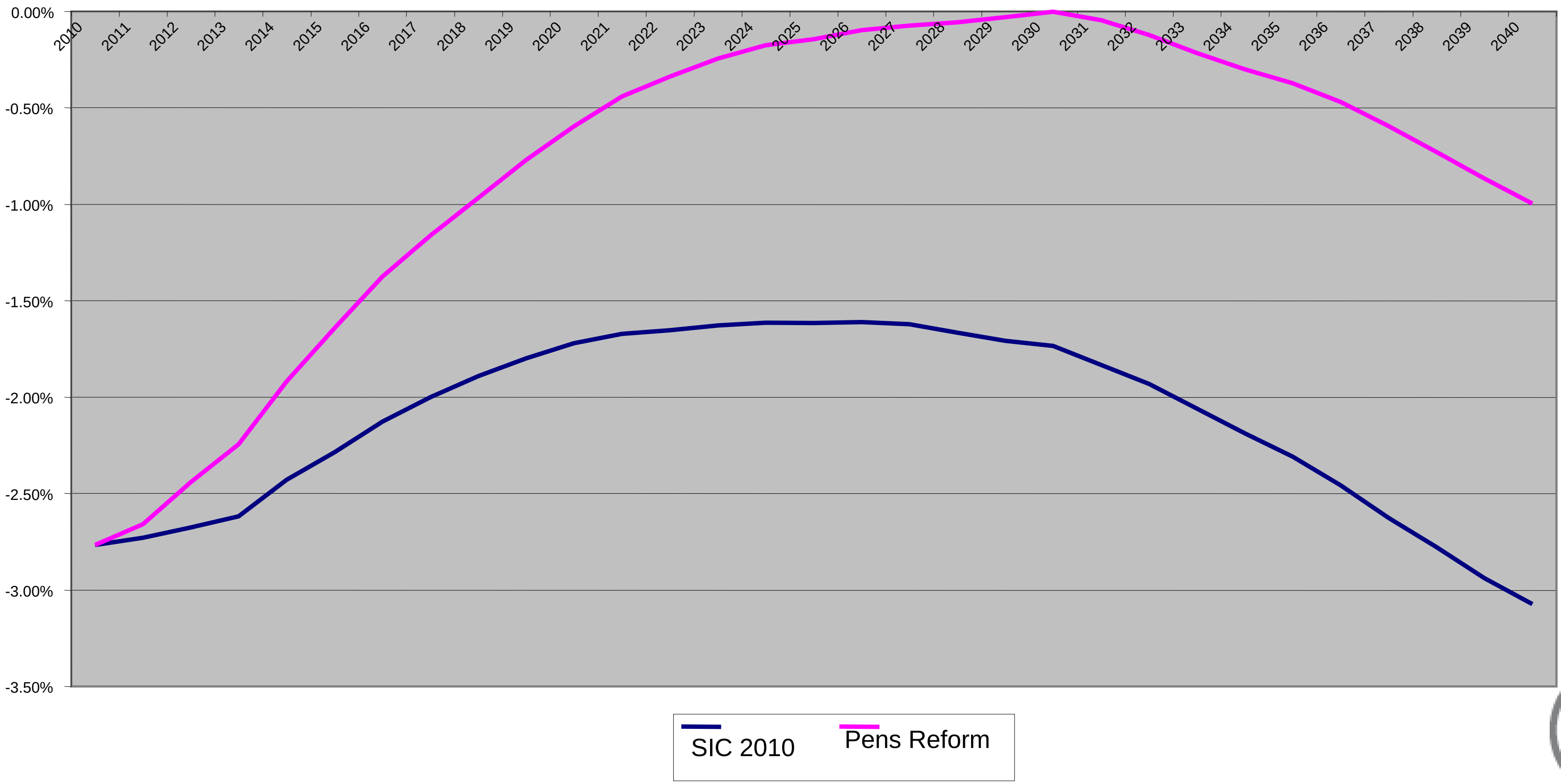
Dependency ratio

Dependency ratio will be doubled quickly and it will be the main driver of the higher pension expenditure for 2023-2050. Even if the length of service is increased by 3 years dependency ratio will stay at the level of 77 pensioners to 100 insured till 2027.



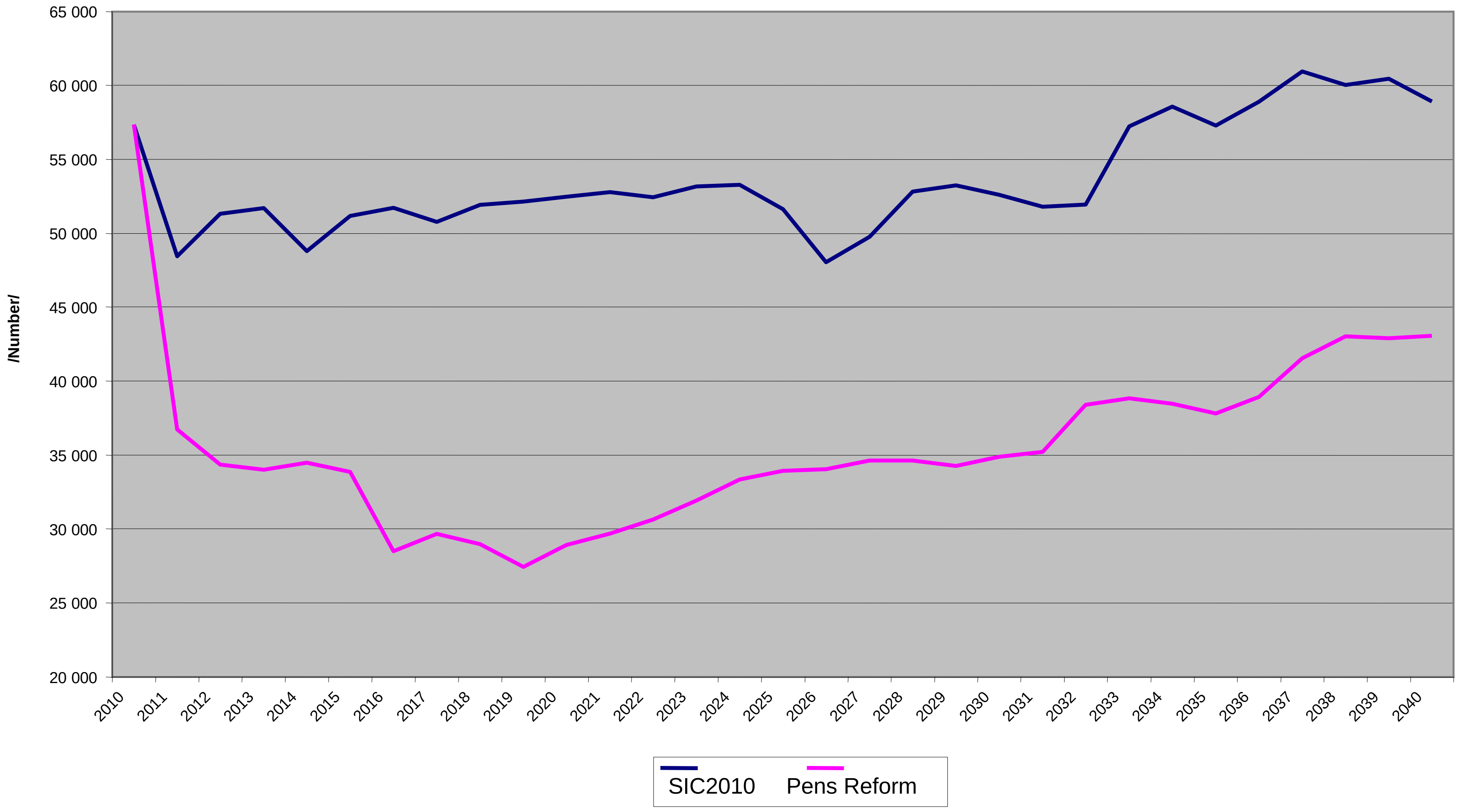
Increase in length of service

Linkage of the length of service and the statutory retirement age to the life expectancy would allow to the system to stay financially stable, while the life expectancy grows. On average increase in the effective retirement age by 1 year would safe 0.2 p.p. of GDP and will increase the revenues by 0.1p.p.



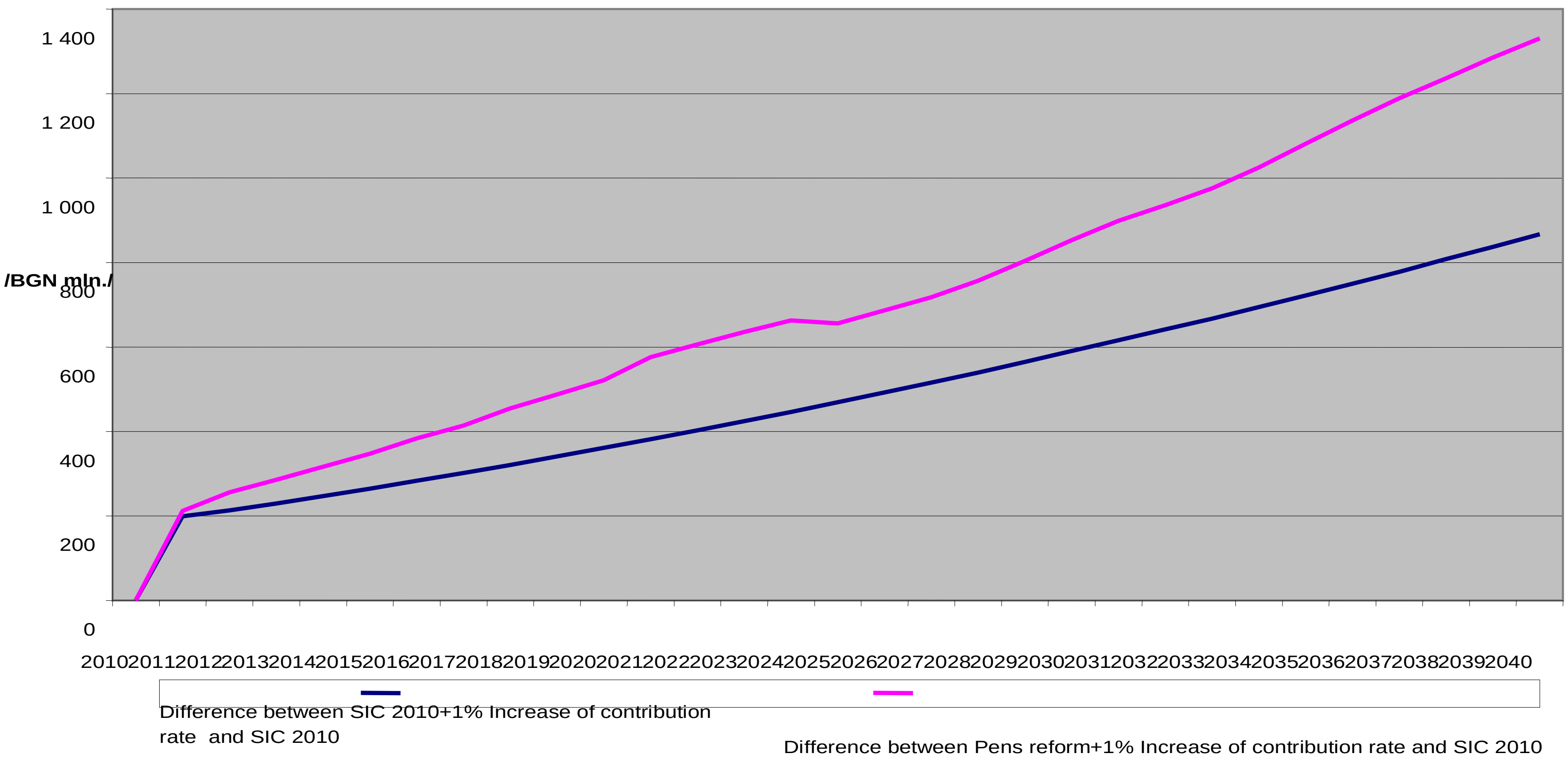
Dynamics of number of pensioners and increase in the length of service

As a result from increased length of service at first the number of new old-age pensioners is expected to decline and then to stay stable.



Measure B: Raising the contribution rate

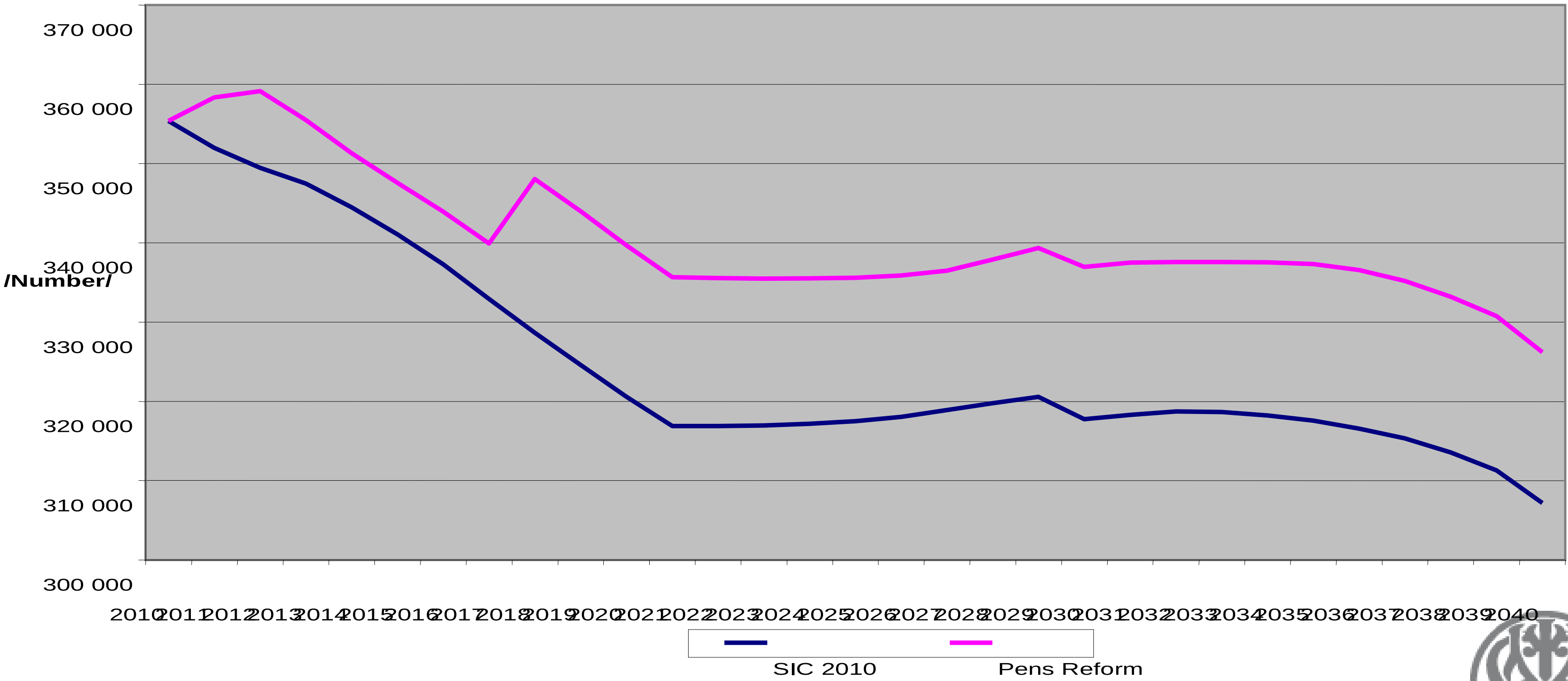
Increase of the contribution rate by 1p.p. could lead to at least 1/4 p.p. of GDP savings and increased revenues of PSSS.



Source:NSSI, MF

Measure C: Reducing the number of invalidity pensions

It is necessary to be implemented administrative measures for improvement of control in the disbursement phrase of the pensions. While the control is strengthened the growth of these pensions and the expenditures could be limited.



Source:NSSI

Additional stabilization measures

- The legislated measures are the first step in the right direction but
- Additional measures for guarantying financial sustainability in long run are needed/necessary
- They should include:
  - Additional actions for improvement the weak link between contributions and pension benefits
  - Widening the insurance base
  - Increase in the collection rate

Some examples of additional measures

- Increase of the insurance base:
  - Deepening of the differentiation of minimal insurance thresholds
  - Registration of the labor agreements/contracts
  - Encouragement of employment participation

- Raising of the collection rate through:
  - Measures for promotion/ increase of the public confidence in the pension system
  - Improvements of the services – alleviation of the administrative procedures, electronic signature, etc.

5.Reform options

- Current analysis recommends carrying out of the package of reforms, that would restrict deficits in the system
- The undertaken measures must preserve adequacy of the benefits in short and mid-term
- Regular actuarial reports on the pension system which may help to support sustainable pension development
- Legislative amendments concerning the payout phase for the second pension pillar is necessary
- There is a room for elaboration of the investment regime in the supplementary pension insurance

6. Conclusions

Analysis shows that the decisions for the problems of system have to start with implementation of the following crucial measures:

- Reestablishing of the link contributions-pension benefits
- Raising of the retirement age for both sexes - including increasing of the retirement age
- Creating stimulus for remaining in the labor market
- Widening the insurance base and reducing of the informal sector
- More active management of the PSSS deficit
- Flexible rules for indexation of the pensions
- More narrowed commitment and improvement of the second and third pension pillars

7.Results

- This analysis was a base for the discussion on pension reform held in September-October 2010. It was taken into account during the preparation of the 2011 State Budget Law
- Analysis serve for government decision in the course of debates on alternatives for strengthening and amending the pension system
- The IMF experts reached to the similar conclusions about the key problems of the pension system during their mission in October 2010
- Results from this analysis are the beginning of the discussion on the further elaboration of the three pillars of Bulgarian pension system